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of **ALASKA**
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Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
State Capitol
Juneau AK, 99801

Re: HB 331, Alaska Tax Credit Certificate Bond Corporation Legislation

Dear Co-Chairs and Committee Members:

The question of whether subject-to-appropriation debt such as the tax credit bonds proposed in this legislation can be issued consistent with the requirements of Article IX of the Alaska Constitution was raised before the Committee. As set forth at the Committee's April 21 hearing, the Department of Law and the State's bond counsel believe that subject-to-appropriation financing tools such as proposed in this bill do not constitute a form of "constitutional debt" that is prohibited under the Alaska Constitution. We set forth below a summation of our reasoning on this issue.¹

- A. By its express language, HB 331 proposes only to issue bonds that are subject to annual appropriation and does not propose to issue state debt pledging the full faith and credit of the State of Alaska.**

HB 331 expressly provides that the tax credit bonds "do not constitute a general obligation of the state and are not state debt within the meaning of art. IX, sec. 8, Constitution of the State of Alaska."² The bill further provides that "the legislature *may appropriate*" annually for the debt service on the bonds but that the issuance of the bonds does not create "a debt or liability of the state."³

¹ This communication should not be construed as a formal opinion by the Attorney General. We note that if the bill passes and the process toward issuing these bonds is initiated, no bonds will be issued without the certification by both the Department of Law and State bond counsel that it is the respective belief of each organization that the bonds are permitted under Alaska law.

² HB 331, Page 2, lines 20-21.

³ HB 331, Page 4, lines 15-23.

As is customary with bonds whose debt service is subject to legislative appropriation, the bonds and other disclosure documents such as the Preliminary Official Statement will state clearly to potential purchasers that the bonds are NOT STATE DEBT, DO NOT CONSTITUTE A GENERAL OBLIGATION OF THE STATE, AND THAT PAYMENT IS “SUBJECT TO APPROPRIATION.”

B. The fact that repayment on these bonds would be subject to legislative appropriation makes clear that no constitutional State debt has been incurred—and this important principle has been recognized by the Alaska Supreme Court.

General obligation bonds issued pursuant to Article IX, section 8 of the Alaska Constitution pledge the state’s full faith and credit and payments on such bonds cannot be avoided because a court can order payment from the state treasury. But the proposed tax credit bonds would be “subject to appropriation” bonds, which means that payment on these bonds will be contingent on annual legislative appropriation decisions. Thus, by the express terms of the proposed statute, a purchaser of the bonds could not obtain a court order directing payment unless the legislature decides to make an annual debt service appropriation.

The Alaska Supreme Court in *Carr-Gottstein Properties v. State*⁴ addressed the subject of what is constitutional debt that is restricted to certain purposes and what is not constitutional debt:

When taken together, this court finds that the foregoing Alaska cases and the cases cited by the Alaska Supreme Court define constitutional debt as a term of art used to describe an obligation involving borrowed money where there is a promise to pay sums such as rents accruing in the future *whether funds are available or not*.⁵

In concluding that a lease-purchase agreement did not create constitutional debt under Article IX, the Court in *Carr-Gottstein Properties* relied on the fact that a future legislature was not required to appropriate funds.⁶ Further, the Court noted that although “the independent nature of the state corporation or authority is some evidence that the State is not contracting debt” in a particular agreement, “the nature or relationship of the contracting parties alone is not the dispositive issue in determining whether an agreement violates the debt restriction in article IX, section 8.” Instead, the Court found that the “non-appropriation clause,” restrictions on recourse of the debt holder, and the lack of a

⁴ 899 P.2d 136 (Alaska 1995).

⁵ *Id.* at 142 (internal citations and quotations omitted and emphasis supplied).

⁶ *Id.* at 143.

binding obligation on future legislatures served as the basis for concluding that the agreement did not create impermissible constitutional debt.⁷

Similarly here, the purchasers of tax credit bonds will be entering into an agreement in which the repayment of the bonds is expressly subject to appropriation and there will be no recourse to the state. In fact, HB 331 is explicit in providing that the bonds are not state debt and do not constitute a general obligation of the state. Although an effort has been made to distinguish *Carr-Gottstein Properties* from the instant matter based on a contention that bonds would be issued rather than entering into a lease purchase agreement, this is not a significant distinction for purposes of considering whether constitutional debt has been issued. Both a lease purchase agreement and a bond agreement involve contracting with parties. The central question in *Carr-Gottstein Properties* was whether the state had entered into “an obligation involving borrowed money where there is a promise to pay sums ...*whether funds are available or not.*” The bonds proposed in HB 331 are only payable if the legislature decides to make debt service payments in any particular year. There is *no commitment* to make payments “*whether funds are available or not.*”

C. The plain language of Article IX of the Alaska Constitution does not prohibit the issuance of bonds that are only payable subject to legislative appropriation because they do not constitute a general obligation of the state.

The Alaska Supreme Court makes clear that interpretation of the Alaska Constitution begins with the words themselves. The Court recently stated that “[o]ur analysis of a constitutional provision begins with, and remains grounded in, the words of the provision itself. We are not vested with the authority to add missing terms or hypothesize differently worded provisions...to reach a particular result.”⁸ According to the Court: “What matters is what the Alaska Constitution says.”⁹

Article IX, section 8 states that “No state debt shall be contracted” except for specific purposes such as capital improvements, and according to specific rules such as voter approval. The Alaska Supreme Court has described this “constitutional debt”¹⁰ as debt that pledges the full faith and credit of the State of Alaska. HB 331 expressly provides that the tax credit bonds “are not state debt,” do not constitute a general obligation of the state, and the payment on the bonds is subject to annual appropriation.

⁷ *Id.* at 143.

⁸ *Wielechowski v. State, Alaska Perm. Fund. Corp.*, 403 P.3d 1141, 1146 (Alaska, 2017) (internal quotations and citations omitted).

⁹ *Id.* at 1152.

¹⁰ *Carr-Gottstein Properties* 899 P.2d at 143.

Thus, HB 331 clearly does not propose any debt that is prohibited by the plain words of the Alaska Constitution.

Article IX, section 11 identifies an exception to the contracting of state debt; “[t]he restrictions on contracting debt do not apply to debt incurred through the issuance of revenue bonds by a public enterprise or public corporation of the State or a political subdivision, when the only security is the revenues of the enterprise or corporation.” This is an exception to Article IX, section 8, which as set forth above, does not prohibit the proposed tax credit bonds because HB 331 is explicit in providing that the bonds would not be state debt and that debt service on the bonds would be subject to appropriation.

Nonetheless, it appears that Legislative Legal Services may interpret section 11 to imply a possible prohibition on subject-to-appropriation bonds of the proposed Tax Credit Bond Corporation because the revenues of the corporation would come from legislative appropriations. But the constitutional text does not identify what form the revenues of a corporation must take.¹¹ And, as set forth above, missing terms cannot be read into the Constitution. Moreover, HB 331 expressly provides that the bonds would not be state debt and do not constitute a general obligation of the state. Thus, even if the tax credit bonds were considered to be revenue bonds under section 11, they would not be prohibited state debt because the only security for such bonds would be from the corporation and not from a general obligation of the state.

A consideration of the constitutional history supports the conclusion that the framers did not intend to prohibit a form of borrowing that does not actually create a legally enforceable debt for the State. The convention delegates in drafting Article IX were in possession of a report by the Public Administration Services, known as the Alaska Statehood Commission studies, which included a report on the subject of state

¹¹ Legislative Legal Services acknowledges that there is no Alaska court decision providing that a public corporation relying on appropriations for revenues would be forbidden from issuing bonds even if the bonds explicitly provide that they do not constitute a general obligation of the state and are subject to annual appropriation decision by the Legislature. Legislative Legal Services does discuss *Myers v. Alaska Housing Finance Corp.*, 68 P.3d 386 (Alaska 2003). But as Legislative Legal Services notes, the Court in *Myers* addressed a dedicated funds issue and did not engage in a significant analysis of the constitutional debt question because it found that the plaintiff had waived the argument. In contrast, the Court in *Carr-Gottstein Properties* focused specifically on the meaning of constitutional debt and held that it was a term of art and concluded that a subject to appropriation obligation was not a form of constitutional debt.

finance.¹² That report identified debt that pledges “the full faith and credit of the state” as debt subject to constitutional debt limitations and thus revenue debt that does not pledge the state’s full faith and credit was outside of constitutional debt limitations.¹³

A general review of the historical record reveals that the framers were aware that some state constitutions contained extensive provisions restricting debt but ultimately they adopted only the limitations expressed in Article IX, section 8.¹⁴ For example, a proposal was made to require a two-thirds vote of the legislature in addition to voter approval in order to issue general obligation bonds but this proposal was rejected and instead only a majority vote of the legislature in addition to voter approval was adopted as the requirement for general obligation bond issuance.¹⁵ Article IX, section 11 providing for the issuance of revenue bonds by public corporations was adopted but the intent to adopt that provisions appears to have been to avoid litigation as the framers understood most states utilized public corporations to issue such bonds in which the only security pledged was that of the corporation.¹⁶ There is little basis to interpret the adoption of section 11 as establishing an intention to prohibit issuance of bonds that explicitly do not contract state debt and are subject to annual legislative appropriation of debt service. Instead, the constitutional record reveals that the framers did not adopt debt restrictions other than in section 8 for the issuance of general obligation bonds that pledged the full faith and credit of the State even though they were aware of other more restrictive debt measures in other state constitutions.

Accordingly, given that an analysis of the Constitution must be based on “the words of the provision itself” and that “[w]hat matters is what the Alaska Constitution says,”¹⁷ it is clear that the Constitution does not prohibit the issuance of subject-to-appropriation bonds such as proposed in HB 331. Moreover, the history of the constitutional convention also does not support the conclusion that a form of bonds that

¹² The Alaska Supreme Court has noted that the constitutional convention delegates were in possession of the Alaska Statehood Commission studies. *See eg. State v. Alex*, 646 P.2d 203, 209 (Alaska 1982).

¹³ 3 Alaska Statehood Commission, Constitutional Studies pt. IX, at 22 (1955).

¹⁴ The Alaska Statehood Commission, Constitutional Studies report in the possession of the framers discussed the history of state constitutional debt provisions and the report concluded that “the strange thing about the entire matter is that many of the states with highly restricted authority to incur debt are no better off financially than those states which may incur debt without constitutional restriction.” 3 Alaska Statehood Commission, Constitutional Studies pt. IX, at 22 (1955).

¹⁵ Constitutional Convention Minutes, 2435-38.

¹⁶ Constitutional Convention Minutes, 1111.

¹⁷ *Id.* at 1152.

are subject to annual appropriation and do not pledge the state's full faith and credit were intended to be prohibited.

D. The majority of states that have considered whether various forms of subject-to-appropriation financing mechanisms are permissible have concluded that they are—because the appropriating body retains its power to decide whether or not to make payments on the debt.

Subject-to-appropriation bonds and other forms of financing in which legislative bodies are not bound to make debt service payments are common in the United States and have been upheld by the majority of state courts. For example, the Minnesota Supreme Court¹⁸ recently ruled that bonds subject to annual appropriation decisions by the state legislature that were issued pursuant to a statute providing that the bonds were not state debt were permissible, rejecting the argument that the bonds should be considered state debt.¹⁹ Similarly, the New Jersey Supreme Court rejected a challenge to the constitutionality of various forms of debt including “liability of the State, or any independent authority created by the State, which is unsupported by an adequate and independent revenue source, and which is to be amortized exclusively or primarily by funds derived from annual appropriations.”²⁰ Instead, the New Jersey court adopted a clear rule that bond payments that were subject to appropriation did not violate the state's debt limitation provision.²¹ Likewise, the Iowa Supreme Court rejected the argument that bonds for which repayment was subject to annual appropriations were constitutional debt because of the basic fact that the appropriating body retained the authority to decide whether to make debt payments: “If there is no legally enforceable obligation to continue repayments in the future, such debt is not considered constitutional debt.”²²

Other state courts have supported their conclusion that subject-to-appropriation debt is not impermissible constitutional debt by pointing out that the significant majority of other states have reached the same conclusion—and identified the Alaska Supreme Court's decision in *Carr-Gottstein Properties* as precedent supporting the conclusion that subject-to-appropriation debt is permitted in Alaska.²³

¹⁸ *Schowalter v. State*, 822 N.W.2d 292 (2012).

¹⁹ *Id.*

²⁰ *Lonegan v. State*, 819 A.2d 395, 401 (N.J. 2003).

²¹ *Id.* at 401-407.

²² *Fults v. City of Coralville*, 666 N.W.2d 548, 556 (Iowa 2003).

²³ See e.g., *Lonegan*, 819 A.2d 395 at n. 2 (N.J. 2003); *Fults*, 666 N.W.2d 548 at n.3.

- E. There is a long history in Alaska of issuing various forms of debt that is supported by a subject-to-appropriation pledge in reliance on decisions of the Alaska Supreme Court such as *Carr-Gottstein* and the fact that subject-to-appropriation debt is a well-established, public financing vehicle in the United States.**

The State and other public entities have issued subject-to-appropriation debt in various forms including Certificates of Participation to fund buildings, utilized public corporations to issue lease revenue bonds to fund buildings, and the legislature has authorized public corporations to issue revenue bonds and authorized the issuance of pension obligation bonds. These financing mechanisms do not bind appropriation power, but instead are subject-to-appropriation financing arrangements. Some of these arrangements do not involve any revenue pledge other than the State's subject-to-appropriation commitment. The long-held understanding of the Department of Revenue that such debt is authorized and that it is different from State constitutional debt is reflected in the Department's annual Alaska Public Debt report, which identifies "State debt" as an obligation in which the full faith and credit of the state has been pledged and distinguishes that debt from other forms of debt that are based on revenue pledges or subject-to-appropriation pledges.

The Department of Revenue has informed us of many examples of subject-to-appropriation debt being issued or authorized in Alaska directly by the State, through public corporations of the State, through municipalities, and even by the Territorial government. Some examples include:

- The Alaska State Housing Authority (ASHA) created in 1949 and through its absorption into the Alaska Housing Finance Corporation (AHFC) in 1986 was authorized to construct and acquire public buildings for the lease to the state.
 - ASHA would issue lease revenue bonds secured by the subject-to-appropriation leases with the state for the acquisition of the buildings.
 - It is our understanding that ASHA was not required to obtain Legislative approval to issue bonds, although resolutions were approved for state leases securing ASHA lease revenue bonds.
- Since 1984, the State has directly issued Certificates of Participation (a financial instrument where a lease is fractionalized into 5,000 principal blocks and sold to investors) wherein a subject-to-appropriation lease pledge of the state is the only security.

- AS 36.30.085 defines how and when the Department of Administration, the University, or the legislative council may enter into a lease-purchase agreement for real property. In (d) notice to the Legislature (interpreted as stand-alone legislation) is required.
 - An example is the Alaska Native Tribal Health Consortium's Residential Housing Facility.
- Examples of lease revenue bonds where subject-to-appropriation legislative funding is source of the revenues:
 - Goose Creek Correctional Facility – state subject-to-appropriation funding is source for MatSu revenue bonds.
 - Anchorage Jail – state subject-to-appropriation funding was source for Anchorage revenue bonds.
 - AHFC issued bonds to fund the Atwood Building (originally just state subject-to-appropriation pledge although later refinanced as AHFC general obligation bonds) and the Linney Pacillo parking garage.
- Examples of revenue bonds where state subject-to-appropriation funds are the primary or important subset of revenues even if there are some other third-party revenues that might be included:
 - University bonds – University relies on annual state appropriations for substantial portion of its revenues that are considered in rating analysis and included in investor information, creating a form of reliance on the state support for its bonds.
 - Knik Arm Crossing – The state authorized toll revenue bonds with a subject-to-appropriation state pledge. Based on projected traffic flow and bridge construction timeframes, the bonds would be paid only if the state appropriated funds. This makes the bonds subject-to-appropriation debt of the state.
- Pension Obligation Bond Corporation – In both 2008 and 2016 the state and bond counsel were prepared to issue and certify these bonds as lawful subject-to-appropriation bonds. The bonds were to be secured by a funding

agreement commitment from the Department of Administration that was subject to annual appropriation.

F. Courts have considered substantial reliance by a State on the understanding that subject-to-appropriation debt is permissible as an important factor, supporting the conclusion that such obligations do not constitute impermissible State debt.

The lengthy history in Alaska of issuing subject-to-appropriation debt reflects a common understanding that such financial arrangements are lawful. This understanding and reliance is not unique to Alaska and it has been relied upon by courts in other states as an important factor supporting the conclusion that an implied restriction against subject-to-appropriation debt should not be readily adopted so as to block a form of public financing that has been utilized in a state. For example, the New Jersey Supreme Court in *Lonegan v. State of New Jersey* rejected a broad challenge to state statutes authorizing various contract or appropriations backed debt, based on the language of that state's debt limitation clause and "*the State's reliance on the Court's precedents when crafting complex financing mechanisms responsive to changing market conditions.*"²⁴

CONCLUSION

As set forth above and in accordance with our presentation to the Committee on April 21, as well as our letter analysis submitted to the Senate Resources Committee, it is the Department of Law's view that because the legislature retains the authority to decide whether or not to appropriate funds to pay the debt service on the bonds proposed in this legislation the bill does not present a constitutional problem. The fact that the bond payments will be subject to appropriation and the legislation expressly provides that the bonds do not constitute a general obligation of the state and are not state debt under the Alaska Constitution make this clear.²⁵


²⁴ *Lonegan v. State of New Jersey*, 819 A.2d 395, 401 (N.J. 2003) (emphasis supplied). The Court in *Lonegan* concluded its decision as follows: "We are unwilling to disrupt the State's financing mechanisms in the circumstances presented to us, and agree with the majority of state courts interpreting their own constitutions that the restrictions of the Debt Limitation Clause do not apply to appropriations-based debt." *Id.* at 407.

²⁵ We note that Legislative Legal Services in its memorandum addressing this bill notes that it is unlikely that the legislation violates art. IX, sections 7 and 13 of the Alaska Constitution. We agree with that assessment and thus do not address it in this memorandum.

Sincerely,

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