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MEMORANDUM

Constitutional Debt Limitation/State  
and Municipal Leaseback Transactions

This memorandum reviews cases relating to state and municipal leaseback transactions, focusing on the viability of such transactions under constitutional debt limitations. For purposes of clarity, it may help to begin by defining some of the terms used in this paragraph.

Our concept of "leaseback transaction" generally includes the following basic elements:

(1) one party is a state or local government which cannot or will not directly finance a capital project ( with "capital project" here generally limited to those capital projects which do not generate user income other than in the form of rent from the state or local government users);

(2) a second party to the transaction is the financing entity, which may be either a public or private corporation;

(3) the financing mechanism generally involves the issuance of bonds; and

(4) the relationship between the state or local government and the corporation is established by a lease agreement under which the state or local government agrees to lease from the corporation the capital project financed with the corporation's bonds; there may also be a preceding lease or sale of land from the state or local government to the corporation for use as the site of the capital project.

By "consitutional debt limitations" we refer to those provisions in the various state constitutions which inhibit the ability of a state or local government to incur debt. These limitations generally fall into one of two categories: (1) those which prohibit debt absent voter approval except for certain

enumerated purposes; and (2) those which limit permissible debt to a particular amount, usually expressed as a percentage of revenues. Alaska's debt limitation falls into the former category, and, because of their relevance to proposed leaseback transactions in Alaska, we present here in full the four pertinent sections from the Constitution of the State of Alaska, Article IX:

SECTION 8. STATE DEBT. No state debt shall be contracted unless authorized by law for capital improvements or unless authorized by law for housing loans for veterans, and ratified by a majority of the qualified voters of the State who vote on the question. The State may, as provided by law ratification, contract debt for the purpose of repelling invasion, suppressing insurrection, defending the State in war, meeting natural disasters, or redeeming indebtedness outstanding at the time this constitution becomes effective.

SECTION 9. LOCAL DEBTS. No debt shall be contracted by any political subdivision of the State, unless authorized for capital improvement by its governing body and ratified by a majority vote of those qualified to vote and voting on the question.

SECTION 10. INTERIM BORROWING. The State and its political subdivisions may borrow money to meet appropriations for any fiscal year in anticipation of the collection of the revenues for that year, but all debt so contracted shall be paid before the end of the next fiscal year.

SECTION 11. EXCEPTIONS. The 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. The restrictions do not apply to indebtedness to be paid from special assessments on the benefited property, nor do they apply to refunding indebtedness of the State or its political subdivisions.

We note also the presence of Article IX, Section 16, of the Alaska Constitution, which establishes a ceiling on permissible annual appropriations by the State. While this section is not per se a limitation on debt (the section expressly exempts from its provisions appropriations of bond proceeds), it may have some effect on the feasibility of a proposed leaseback transaction to the extent that it limits the state's ability to make appropriations.

Finally, among our list of defined terms is "lease participation certificate." By this, we refer to the financing instrument used in a lease participation transaction. A "lease participation transaction" has the same basic elements described for a "leaseback transaction" with one exception: instead of or in addition to issuing bonds to finance the capital project, the corporation, as lessor of the project, issues lease participation certificates which entitle their holders to a share of the lease revenues generated by the project.

With these preliminary matters established, we proceed now to an overview of the research we have completed with regard to leaseback transactions and constitutional debt limitations.

#### OVERVIEW

In preparing this memorandum, we have reviewed some 47 cases decided in 26 states. The earliest case was decided in 1939, the most recent in 1982. There are earlier cases which we declined to include in this survey, primarily because of the existence of more recent cases in their jurisdictions. For ease of reference, we will refer to those cases which have invalidated leaseback transactions as invalidating cases and to those cases which have upheld leaseback transactions as validating cases.

While legal research can seldom, if ever, be satisfactorily reduced to figures and statistics, some of the numbers revealed by our research may be of interest. Of the 47 cases we reviewed, 21 were invalidating cases and 26 validating. Among the 26 states in which these 47 cases were decided, 16 states can be considered validating states in the sense that the most recent decisions in those states are validating decisions. The remaining 10 states have only invalidating decisions, but only two of those states -- Ohio and New Mexico -- have considered the question more than once. Of the 16 validating states, 10 have considered the question more than once. Six of the validating states had early invalidating decisions followed later by validating decisions. In no state has an invalidating decision followed a validating decision.

On the following pages of this memorandum, we will generally follow a chronological order in presenting the cases reviewed; however, three states -- New Jersey, Wisconsin, and Missouri -- have had such extensive judicial review of leaseback transactions that their cases are most instructive if viewed apart from the others. Therefore, the following pages will begin with cases decided in New Jersey, Wisconsin, and Missouri and will then proceed with a chronological review of the cases from the other states.

#### NEW JERSEY

New Jersey's supreme court has decided four leaseback transaction cases. Its first decision, McCutcheon v. State Building Authority, 97 A.2d 663 (N.J. 1953), became the most cited of the leaseback transaction cases of all the states. McCutcheon has been cited approvingly or for support in the invalidating cases of Arizona, Iowa, Massachusetts, Ohio, Oregon, Washington, West Virginia, and Wisconsin. It has also been cited and then ignored, distinguished, or dismissed by many of the validating cases.

In 1968, the New Jersey court expressed some clear misgivings about its McCutcheon decision, though it did not expressly overrule the decision at that time. In 1973, the court fortified the impression created in the 1968 case that it no longer endorsed McCutcheon. Again, however, the court did not expressly overrule the decision at that time. A New Jersey Appellate Court summed up the status of McCutcheon in 1981 with the following comment: "it is apparent that as precedent the case is dead; it simply has not as yet been interred." Enourato v. New Jersey Building Authority, 440 A.2d 42, 48 (N.J. Appel. 1981). Final interment arrived in 1982 when Enourato was appealed to the New Jersey Supreme Court, which expressly overruled McCutcheon.

The effect of McCutcheon on other state courts which have reached invalidating decisions should be noted. We listed above eight states whose courts have reached such invalidating decisions. Three of these states -- Arizona, West Virginia, and Wisconsin -- have since had validating cases decided in their supreme courts. The remaining five states have not had any other post-McCutcheon cases. It will be interesting to note the effect, if any, which the overruling of McCutcheon has on those states as future cases come before their courts.

McCutcheon involved a statutorily created public corporation known as the State Building Authority. The sole business of the Authority was to provide for the construction and acquisition of buildings through the issuance of its bonds. The source of income to the Authority from which the bonds were to be

repaid was the leasing of the buildings to the state and its various departments and agencies. Under the Authority's enabling statutes, the lease contracts would be "valid and binding upon the department, agency, or instrumentality of the State, notwithstanding that no appropriation was made or provided to cover the cost or estimated cost of the contract." 97 A.2d at 665.

Neither the statutory nor the lease provisions set forth by the court in its opinion indicate whether or under what circumstances title to the property would be transferred to the State; however, the statute did authorize the Authority to convey property it acquired. In any event, the most significant concern to the court, as reflected in the following passage from the opinion, was whether the lease contracts were actually purchase contracts:

While in form a way of providing the State with leasehold interests in building facilities for public use, in reality the design of the act is to enable the State by contracts of purchase to acquire for state use buildings possessed and constructed by the Authority by means of bond issues sustained by the State's promise to supply in the guise of rentals sufficient money to liquidate the bonds, available only through the medium of annual appropriations. And this in disregard of the constitutional debt limitation and the restraints laid by the organic law upon the appropriations process. There is no pretense of conformance with the debt limitation provision; there was no submission of the project to the electorate .... The legislation proceeds upon the hypothesis that the fulfillment of the project will not burden the State with a debt or liability within the constitutional sense. But in this the accent is on the external appearance rather than the substance. The label is unimportant; it is the essence that controls. It is an obvious truism that constitutional limitations may not be set at naught by indirection.

97 A.2d at 668. It was this piercing of the lease contract to unveil an underlying purchase agreement which primarily led the court to conclude that the transaction was governed by, and invalid under, the State's constitutional debt limitations.

Another important factor to the court was the nature of the Authority. Regarding this factor, the court stated:

There is for the reasons stated, a radical difference in the relationship between the State and the Authority and the State and a private corporate lessor....The Authority is not an independent autonomous public corporation. It may lease its building facilities only to the State, its departments, agencies, and instrumentalities....And, quite apart from the other considerations heretofore adverted to, the State's taxing power is the sole source of its revenue.

97.A.2d at 671. The court's apparent perception of the Authority as, in essence, the alter ego of the State involved in a transaction which the court viewed as, in essence, a purchase agreement created the situation necessary for the court to reach its conclusion. From the court's perspective, it was reviewing, in essence, a capital construction contract entered into by the State without the required voter approval. The result was inevitable.

As noted above, the statute made the lease payments valid and binding against the state agencies entering into the lease contracts even if the legislature failed to make appropriations for such payments. While the meaning of the statute is not clear, one might have expected the court to use the statute to conclude that any lease entered into under it would be prohibited debt by virtue of its apparent attempt to avoid the appropriation process. Instead, the court virtually ignored the statute. In fact, the following passage, which should most likely be considered as dicta, reflects the opposite situation -- one in which there is no obligation to make payments except to the extent that appropriations so provide:

The constitutional debt-limitation provision is not limited in quality and scope to debts enforceable by action. It has in view the temptation or inducement and incentive to make appropriations for "debts" beyond the prescribed amount, unless approved by the people in the manner ordained. Moral and ethical compulsions are not to be allowed to override the constitutional safeguard against improvidence and the integrity of the State's economy.

97 A.2d at 671

By the court's own account, McCutcheon stood as a rigid enforcement of the state's debt limitation provisions. Any leaseback transaction plan which reflected any indicia of a purchase -- whether by transfer of title at termination of the lease, or by the holding of title by a public corporation, or by lease payments fashioned to pay for debt service on the bonds -- would likely have failed before that court, at least to the extent that one party to the plan was a public corporation whose only customer was the State.

Fifteen years after McCutcheon, the New Jersey Supreme Court again considered a leaseback transaction case, this time with a markedly different result. The second of the New Jersey cases was Clayton v. Kervick, 244 A.2d 281 (N.J. 1968). The opinion was written by Justice Jacobs, the only remaining member of the McCutcheon court and a dissenter in that case (along with Justice, later to become Mr. Justice, Brennan).

The statute in Clayton established the New Jersey Educational Facilities Authority. The Authority was empowered to borrow money and issue bonds to construct projects to be leased to public and private colleges. The projects were anticipated to be revenue producing projects (such as dormitories), and the revenues they produced were primarily the source from which lease payments were to be derived. To this extent the transaction in Clayton was not a "leaseback transaction" as we have defined the term for purposes of this memorandum, and, indeed, it was the revenue-producing character of the projects upon which the court ultimately distinguished the Clayton situation from the McCutcheon situation.

Nevertheless, before distinguishing McCutcheon, the court referred approvingly for nearly two full pages in its opinion to the dissent in McCutcheon and to cases from other states which had rejected the majority opinion in McCutcheon. As to the McCutcheon dissent and the cases from the other states, the court stated:

these decisions, along with the dissent in McCutcheon, appear to us to be clearly the more persuasive....

244 A.2d at 281. Although the court was able to find a way to distinguish, rather than expressly overrule, McCutcheon its disenchantment with the earlier case was apparent.

Thus, while Clayton, is not, strictly speaking, a leaseback transaction case under our definition, its use by the court as the vehicle to undercut McCutcheon, to warmly embrace

the McCutcheon dissent, and to cite approvingly the leaseback transaction cases from other states rejecting the McCutcheon thesis makes the case important for our purposes. Fifteen years after writing his dissent in McCutcheon, Justice Jacobs was finally able to incorporate into a majority opinion his thoughts about the McCutcheon case. Taking full advantage of the opportunity, he recorded the following pertinent comments, among others:

In their separate opinion, the dissenting justices [in McCutcheon] referred to the fact that the generally accepted accounting practice throughout the country does not encompass future rents as debts or liabilities and that corporate balance sheets would be examined in vain for references to lease rentals payable in future years....

The majority in McCutcheon apparently viewed the rental plan as a purchase rather than a lease and as evasion rather than avoidance of the debt limitation....But, as the dissent pointed out, leases between affiliated governmental bodies are common and unquestioned in our society and there was no plausible basis for dishonoring the carefully formulated leasing arrangement between the independent Building Authority and the non-autonomous agencies of the State.

244 A.2d at 283.

Although the Clayton court chose to distinguish rather than overrule McCutcheon, and though much of what the Clayton opinion had to say about McCutcheon was, therefore, simply dicta, it should have been reasonably clear that Clayton marked the deathknell for the earlier case. Still, five years later, a New Jersey Superior Court apparently had not yet clearly received the message.

Bulman v. McCrane, 302 A.2d 163 (N.J. Super. 1973), involved the following issue as explained by the court:

Put concisely, the problem presented is whether a lease-purchase arrangement whereby a state agency contracts with a builder to erect a facility on state-owned land and lease the same to the State for a term of

years at stipulated annual rentals, with an option to purchase at intervals during the term, title to revert to the State at the expiration thereof, violates the debt limitation clause of the State Constitution.

302 A.2d at 164. After reviewing McCutcheon and Clayton, the Superior Court concluded that neither provided guidance for a situation involving a lease to the State of a non-income producing facility by a private corporation. While it avoided using either case as authority for its decision, the court nevertheless reached the McCutcheonesque conclusion that, while the arrangement was cast in the form of a lease, it was, in essence, a purchase agreement. As such, the court determined that the arrangement created prohibited debt. The reason for the court's perception of the arrangement as a purchase agreement basically rested upon the fact that the lease provided for reversion of the building (which was built on state-owned land) to the State at the expiration of the lease.

Nine months later, the New Jersey Supreme Court reversed. Bulman v. McCrane, 312 A.2d 857 (N.J. 1973). The court stated:

The fact that the State may be advantaged by ultimately acquiring title to a potentially useful building as the residue of a transaction otherwise faithful to the theory of a lease...represents no good reason for judicial assiduity in laying hold of that circumstance to destroy the transaction as an unconstitutional debt. The sole obligation of the State here is for future installments of rent. They will presumably be paid out of current revenues as annually appropriated for the purpose. Under settled principles, there is no present debt in the constitutional sense.

312 A.2d at 863--864 (footnote omitted).

The most recent of the New Jersey leaseback transaction cases is Enourato v. New Jersey Building Authority, 448 A.2d 449 (N.J. 1982). The statute in this case, very much like that in McCutcheon, created a state building authority the sole function of which was to construct buildings for lease to the State. Rental payments, made subject to annual appropriations, were the sole source of repayment of the bonds issued by the Authority to finance the construction of the buildings. The bonds, of course,

expressly stated on their face that they were the obligations of the Authority and not the State. In a relatively brief review of the question, the court rejected the claim that the Authority's bonds would create a state debt. The court noted:

The Authority's creditors have notice that their only remedy lies against the Authority.

Nor does the liability of the State on its lease agreements with the Authority create any debt of the State. Both the statute and the lease make clear that all rent payments from the State are subject to legislative appropriations....

Since the Building Authority Act does not authorize the creation of any debts by the State, the debt limitations clause...does not apply to the Authority's debts or any obligations of the State on its lease agreements with the Authority. We have already disapproved the contrary result reached by a sharply divided Court in McCutcheon...and now expressly overrule that case.

448 A.2d at 456.

These New Jersey cases, from McCutcheon to Enourato, demonstrate an evolution in judicial thinking with regard to leaseback financing. Several of the early cases took the view expressed in McCutcheon of rigid adherence to debt limitation provisions. Under that view, the enforceability of an obligation claimed to exist against a state was not determinative. Any arrangement which appeared to be or could plausibly be said to be a purchase agreement was equated with debt. If there were any moral obligation to make payments or even if the court surmised that, because of practical considerations, the legislature would most likely make the appropriation for the payments regardless of the existence of any moral or legal compulsion, that, too, could be equated with debt. We believe the modern trend and certainly the majority position is more closely attuned to the Enourato view. As long as the obligation of the state under the lease agreement is clearly subject to annual appropriation by the legislature, as long as the bonds issued to finance the project clearly identify the foregoing and clearly indicate that they are not the obligations of the state, as long as state property is not encumbered (a factor extensively discussed in the Wisconsin cases reviewed below), and as long as the enabling statutes

authorizing the transaction reflect all of the foregoing, the likelihood is that the transaction will be upheld.

#### WISCONSIN

Like New Jersey, Wisconsin's supreme court has reviewed four cases concerning leaseback transactions. Unlike New Jersey, however, all of Wisconsin's cases were decided in a two-year period (1953 -- 1954), and, in its four decisions, the Wisconsin court has not experienced the dramatic change in attitude reflected in New Jersey's cases.

The first Wisconsin case was State v. Giessel, 65 N.W.2d 529 (Wisc. 1954) (herein "Giessel I"). The plan in Giessel I called for the incorporation of a non-profit corporation by the State Building Commission. The Commission would lease state land to the corporation. The corporation would construct a building on the land and lease both land and building back to the Commission for the use of state agencies. As security for its loans, the corporation would have the ability to mortgage its lease of the land and of any buildings on the land. One project of the corporation was to construct an addition to an existing state office building. To secure financing for the project, the corporation intended to mortgage the lease to the corporation of the land and existing building.

The court found no fault with the financing plan except with regard to the mortgaging of an interest in state property. As to such mortgaging, the court declared the plan unconstitutional and void, stating:

Logically there would seem to be just as much coercion on the part of the state to pay an indebtedness, for the payment of which existing state property, or an interest therein, had been pledged as security but the state had not otherwise agreed to pay the debt, as

the state had made itself directly liable for the payment thereof.

65 N.W.2d at 540.

Three months later, the court decided State ex rel. Rogers v. Milligan, 66 N.W.2d 326 (Wisc. 1954) (herein "Milligan I"). This case involved virtually the same facts as in Giessel I and was decided in accordance with that case.

Early in 1955, the court had before it State ex rel. Rogers v. Milligan, 69 N.W.2d 485 (Wisc. 1955) (herein Milligan II). Once again, the facts were virtually identical to Giessel I and Milligan I except that here the building company as lessor of the land (which was owned by the city and leased to the building company) and building, instead of mortgaging its leasehold interest in the land, would be able to re-enter and take possession of the land and building if the city failed to pay its rent. The court saw no distinction in this feature of the lease and ruled the plan unconstitutional, noting, however, that if the building company were also the owner of the land "this objection to the lease would be eliminated." 69 N.W.2d at 487.

Finally, toward the end of 1955, the Wisconsin court considered State ex rel. Thomson v. Giessel, 72 N.W.2d 577 (Wisc. 1955) (herein "Giessel II"). Decided only two years after McCutcheon, Giessel II became the second most prominent case on leaseback transactions (after McCutcheon). In a lengthy analysis of the leaseback transaction before it, the court considered McCutcheon and rejected the conclusions of that case, stating:

That case is distinguishable from the present situation in that it rests on legal premises which this court has not adopted....This court....has heretofore held that no debt is created unless the state itself is under a legally enforceable obligation.

72 N.W.2d at 589. The Wisconsin court indicated various distinguishing factors between the two cases and between the constitutions of the two states. Whether it was a result of those distinguishing factors or, more likely, a result of a plain disagreement between the two courts, the Wisconsin court reached conclusions opposite to those of the New Jersey court with respect to two significant legal issues: first, as noted above, the Wisconsin court found no constitutional debt in the absence of a legally enforceable obligation; and second, the Wisconsin court, though it did not find an installment purchase contract to exist in the plan before it, indicated that even if such contract did exist it would not necessarily create state debt (this second conclusion being no more than a corollary to the first in that a purchase contract, to the same extent as a lease, creates no debt in the absence of a legally enforceable obligation).

The plan before the court in Giessel II was a typical leaseback transaction involving a private, nonprofit corporation as the financing entity. The corporation was empowered to either purchase or lease land from the state for the purpose of constructing buildings on the land and either leasing or subleasing,

depending upon the interest initially conveyed to the corporation, the land and building to the state. There were three causes of action presented to the court in *Giessel II*.

The first cause of action related to a lease and sublease. Rent on the sublease was calculated to enable the corporation to retire the indebtedness to be created in the construction of the building. The sublease provided that "it is mutually agreed by the parties hereto that the corporation, its successors or assigns, hereby waive, relinquish and release any and all rights of re-entry, or to re-take possession of the herein demised premises, and hereby agree not to exercise any such rights, in the event of nonpayment of rent or of other defaults hereunder by the University, its successors or assigns." 72 N.W.2d at 580. The second cause of action involved the same type of arrangement with the same re-entry waiver.

The third cause of action related to a sale of land by the state to the corporation. The corporation was to build an office building on the land and lease it to the state building commission. The loan by the corporation to finance the construction was to be secured by a mortgage on the land. The lease provided that if the legislature failed to appropriate money for rental or for any other breach of the lease, the corporation would be entitled to "enter on, and expel, the commission from said premises forthwith, and without notice, and the corporation may from time to time apply all monies held by the corporation as security for faithful performance by the commission of its covenants and undertakings hereunder, to the payment of all damages sustained by the corporation by reason of any such default, which damages shall include, without limiting the generality of the foregoing thereby, the cost of decorating, altering and improving the premises and brokers' commission incurred in reletting the same, and also the difference between the net income actually received by the corporation from said demised premises upon reletting and the rent limited herein." 72 N.W.2d at 581. The lease further provided that it was made subject to a mortgage made by the corporation to its lender. Under the mortgage, rents to be paid by the commission were pledged to the lender.

With regard to these causes of action it should further be noted that (1) the state consented to a pledge or assignment of the state's obligation to pay rent by the corporation to its lender; (2) the state purchased equity in the building projects described in the first two causes of action in amounts greater than fifty percent of the cost of the projects; and (3) the state was authorized to use income derived from existing state buildings to pay the rent on the building described in the first cause of action.

The court first considered whether the state's consent to the assignment of its rental payments to the corporation's lender created debt. The court ruled that it did not and referred to the principle enunciated in Giessel I that the payment of future rent is not a presently existing debt. 72 N.W.2d at 584. The court noted that the assignment of the rents simply changed the party entitled to receive the rents if paid and did not obligate the state to pay the corporation's obligations.

The court next considered whether the state's investment in the projects led to prohibited debt. The court rejected the contention, stating that the investment did not obligate the state to pay all or any portion of the sums borrowed by the corporation to construct the buildings "even though good judgment may dictate that it do so voluntarily". 72 N.W.2d at 586.

The court next encountered the old McCutcheon argument that the leases and subleases were, in effect, contracts of purchase which created impermissible state debt. As noted above, the court chose not to follow McCutcheon and adhered to its general principle that where there is no obligation against the state to make payments, whether under a lease or under a purchase contract, there can be no debt.

Finally, the court considered whether the state's agreement to use income from existing state buildings to pay the rent on the building leased from the corporation created a state debt. The court noted that the nature of the fund from which the rental payments were to come had no bearing on the nonenforceable and contingent nature of the state's obligation and, therefore, did not affect the court's determination that no debt had been created.

To the degree that McCutcheon was rigid, Giessel II can be said to be flexible in considering its constitution's debt limitation provisions. Giessel II represents the position that as long as the state's obligation is nonenforceable and contingent and as long as there can be no loss of state-owned property there is no state debt.

#### MISSOURI

The first of the Missouri cases is Board of Public Buildings v. Crowe, 363 S.W.2d 598 (Mo. 1962). The financing entity in that case was a public corporation which had authority, once it constructed a building in a city, to require any state agency which occupied rental quarters in such city to rent space from the corporation's building and to contribute from funds

appropriated for such agency's support a proportion of the rentals of the building. It was argued in the case that the payment of rentals from funds appropriated to the state agencies and taken from revenue raised by taxation would create a "liability" of the state. The court noted that no rents could be paid by any agency unless the legislature appropriated money to that agency. Once such an appropriation was made, the money lost its character as general state revenue. The court rejected the contention and sustained the transaction.

Crowe was followed in 1971 by New Liberty Medical and Hospital Corporation v. E. F. Hutton and Company, 474 S.W.2d 1 (Mo. 1971). In this case the Missouri court did find constitutionally prohibited indebtedness arising from the provisions of the lease agreement used in the leaseback transaction. Under the agreement, the hospital district (which was subject to the state's constitutional debt limitations) was obligated unconditionally to pay rentals "without abatement, deduction, set-off, counterclaim, recoupment or defense or any right of termination or cancellation arising from any circumstances whatsoever." 474 S.W.2d at 6. The court noted that

This is more than the usual obligation of lessee to pay rent for premises furnished. It is an unconditional undertaking to pay a sum total which will equal the principal and interest on the debentures plus taxes, costs and certain other items over a 30-year period, even if for some reason the premises become unavailable for use of lessee. This is assuming indebtedness which must be paid in all events.

474 S.W.2d at 6. Not surprisingly, the court invalidated this leaseback transaction. A similar lease agreement was used in the third Missouri case, Scroggs v. Kansas City, 499 S.W.2d 500 (Mo. 1973), and it, too, was invalidated by the court.

The last of the Missouri cases was St. Charles City-County Library District v. St. Charles Library Building Corporation, 627 S.W.2d 64 (Mo. 1981). Like the lease agreement in the Colorado Gude decision, discussed later in this memorandum, the district here was able to avail itself of annual options to renew. Because of this feature, the court distinguished Scroggs and held that there were no long-term repayment obligations created on the part of the district and, hence, no violation of the constitutional debt limitations of Missouri.

OTHER STATES

Having reviewed the cases of three of the most active courts in the leaseback transaction area, we proceed in this part to review the remaining cases from the other states. As noted earlier, this review will proceed in chronological order.

The earliest case in our survey is State v. Griffith, 22 N.E.2d 200 (Ohio 1939). The leaseback transaction in this case involved a public corporation which constructed additions to state mental hospitals and subleased the buildings back to the state Department of Public Welfare. Under their contract, the department pledged "all and every part of its available source of income" to pay the rent on and to maintain the buildings. There were a number of elements to the transaction to which the court took exception in invalidating the arrangement.

While the court accepted the concept that pure revenue bonds (that is, those payable solely from the revenues generated from the project financed with the bonds) were acceptable under constitutional debt limitations, the court could not accept a general obligation bond of a public corporation. This was particularly so in a situation, as in this case, where the public corporation was joined in its obligation by the Department of Public Welfare

The court noted that

the obligation of the Department of Public Welfare of the state of Ohio under its contract with the authority to pay as rental for the state property turned over to the authority the sum of \$421,500 per annum for twenty-five years, plus other expenses of the authority is an absolute and outright obligation of the department, an arm of the state, on account of such bonds. In addition the department obligates itself to liquidate the indebtedness to the authority by pledging "all and every part of its available sources of income" and "to fix the amount or amounts to be charged and collected for the support of patients and inmates of the hospitals under [its] control...so as to be sufficient in the aggregate to provide available funds to pay the maintenance costs of said buildings...and to pay the Public Institutional Building Authority the sums" promised....

22 N.E.2d at 205. The court additionally disapproved of the pledging of income derived from existing buildings in addition to the income to be derived from the buildings financed with the bonds. The court reasoned that "to the extent that the income from the use of these buildings is diverted to the payment of rental to the authority for the purpose of servicing these bonds, the general revenues from taxation to support these institutions must necessarily be increased to the same extent. The income from the institutions ought to be increased, by reason of the new structures, but there will also be greater expense in administration and upkeep." 22 N.E.2d at 205.

Plainly, the most serious problem in the Griffith situation was the outright pledge by a department of the state to pay a sum certain annually under contract with the corporation. Because of the number of concerns expressed by the court, it is difficult to surmise how a provision making all payments subject to annual appropriation by the legislature might have changed the court's conclusion, but such provision could only have helped the situation.

In 1941, New Mexico's supreme court rendered the first of its two leaseback transaction cases, State Office Building Commission v. Trujillo, 120 P.2d 434 (N.M. 1941). Trujillo presented a lengthy and considered analysis of leaseback transactions in the light of constitutional debt limitations and became another oft-cited and significant case in the area.

As much as any other case in the field, Trujillo clearly pointed out the dual considerations inherent in any leaseback transaction involving a public corporation. The court carefully considered the relationship of the public corporation in Trujillo to the state and then considered the nature of the obligation entered into by the state itself.

The statute creating the corporation in Trujillo designated it "a public body corporate as an agency of the State." The court immediately seized upon this language and noted that "it is through such agency that the State is to act, and being an agency, its acts are the acts of the State." 120 P.2d at 440. The conclusion that the bonds of the corporation are then debts of the State itself could hardly be avoided from that point. It may not be likely that the same difficulty would be encountered in Alaska considering the Alaska Constitution's express reference to obligations of public corporations as exceptions to this state's debt limitation provisions. (Constitution of the State of Alaska, Article IX, Section 11); however, it is certainly advisable in any event to give the courts a clearer indication that a separate and independent legal entity is intended to be

created as has generally been done in the statutes creating Alaska's present public corporations.

From the perspective of the obligation created by the other state agencies in entering into the lease contracts, it was urged upon the court that the rental payments should not be considered debt for the reason that they amounted to current administrative expenses. This, of course, was the argument accepted by the Wisconsin court in *Giessel II*; however, the facts in this case did not permit such a conclusion. There was no provision in the agreement or in the statute making the payment of rent by the state agencies contingent upon appropriation for the purpose; in fact, once the agencies entered into the lease agreement, both the statute and the agreement prevented them from terminating the lease except under narrowly specified circumstances. As the court noted:

Subject only to the one condition set out in said section, the state would be obligated to continue payment of rentals until the indebtedness of the Commission was satisfied. This would mean, so long as the agencies did not recede from the lease agreements under the one specified condition, that future legislatures would be bound to provide appropriations for payment of rentals.

120 P.2d at 448 (emphasis in original). The lesson from this aspect of the case is the now familiar refrain: the obligation of the state agency to pay rent must be contingent upon the legislature's decision to appropriate for that purpose. Such a provision might not have saved the case before a court such as that in McCutcheon, but it could have made a difference in many of the cases.

The next leaseback transaction case was Opinion of the Justices, 79 A.2d 753 (Maine 1951). In this lone entry into the leaseback transaction arena by the Supreme Court of Maine, the state senate presented to the Justices a proposed leaseback transaction the only significant feature of which was a statutory provision which appeared to make it mandatory upon the state and the public corporation to enter into a lease agreement upon completion of construction of the building by the corporation. The lease agreement was to provide rents sufficient to retire the corporation's bonds. There is no provision indicating that rental payments by the state were subject to appropriations.

The court foreshadowed the McCutcheon analysis by finding the "so-called" lease to be a contract of purchase.

The so-called rental is not true rent, to wit, payment for the use of property. The total amount of so-called rental is the purchase price the State is to pay for the property....Being a contract of purchase, obligating the State to pay the purchase price, unless the entire amount thereof is to be paid pursuant to appropriation presently made from funds or revenues currently available therefor, such contract of purchase would in the consitutional sense be a liability created by the Legislature on behalf of the State.

79 A.2d at 756 (emphasis in original).

In 1955, two leaseback cases from two states emerged. In McArthur v. Smallwood, 281 S.W.2d 428 (Ark. 1955), the rental payments from the state to the public corporation were to come first from legislative appropriations and, if such appropriations were not forthcoming, then from a special levy to be assessed by various county treasurers. Noting particularly that there was no obligation on the legislature to make the appropriations, the court upheld the transaction. The special levy was upheld on the basis of the "special fund doctrine", which was also a significant consideration in the Trujillo case. The "special fund doctrine" provides, in essence, that the repayment of bonds from a special tax or levy does not violate state debt limitations because the general taxing power of the state is not involved. Any reliance upon such a doctrine in Alaska, of course, would require serious consideration of the dedicated fund prohibition in the Alaska Constitution (Article IX, Section 7).

The other 1955 case was State v. Yelle, 289 P.2d 355 (Wash. 1955). Yelle relied extensively on McCutcheon, employed the same analysis, determined that the lease was actually a purchase, and invalidated the arrangement. The opinion does not clearly indicate whether there was any compunction on the legislature to make the appropriations to pay for the rents, nor is it clear that the rental payments were contingent upon such appropriations. In any event, such considerations probably do not make much difference with regard to the McCutcheon progeny. We have discovered no Washington case subsequent to the crumble or demise of McCutcheon.

Illinois' court considered a municipal leaseback transaction in People v. Public Building Commission of Chicago, 142 N.E.2d 67 (Ill. 1957). Of particular importance to that case was a provision in the statute which required municipalities entering into leases with the public corporation to "enact an ordinance or

resolution providing for the levy or a direct annual tax sufficient to pay the annual rental under the lease when it becomes due and payable." 142 N.E.2d at 72. The Illinois court noted that its definition of "indebtedness" was "not as liberal as that indulged in by a majority of jurisdictions." 142 N.E.2d at 75. Nevertheless, even in the more liberal jurisdictions, a provision such as that embodied in the statute quoted above would have been likely to lead to a finding of debt. The Illinois court had no trouble reaching such conclusion.

In 1958, the Indiana Supreme Court was presented with a leaseback transaction involving a public corporation. In Book v. State Office Building Commission, 149 N.E.2d 273 (Ind. 1958), the lease agreement between the public corporation and its state agency lessees contained a provision, much like that in Trujillo, which permitted the lessees to terminate their agreement only under specified conditions. Nevertheless, the court upheld the agreement.

In Book, the court was presented with a series of assertions reflecting a McCutcheon-like analysis of the situation. The court repudiated each assertion as it was presented. Thus, the court, looking to the statute creating the public corporation and to previous Indiana cases, denied that the public corporation was "in reality" the State of Indiana. It followed that since the corporation was a corporate body separate from the state, the holders of its bonds would have to rely upon the corporation's revenues derived from rental income and would not have any recourse against the state. For these reasons, the court concluded that the bonds of the corporation were not debt of the state. In response to the assertion that the lease agreements were "in reality" contracts to pay the corporation's bonds, the court stated the general rule that

a municipal corporation may lawfully contract for necessary services over a period of years and agree to pay therefor in periodic installments as the services are furnished. In such cases the aggregate of the amounts to be paid as the services are rendered under such contracts are not considered as an indebtedness of the corporation, and such contracts are not rendered invalid by the fact that the aggregate of the installments exceeds the debt limitation.

149 N.E.2d at 284 -- 285. In any event, the fact that the state agencies might obtain title to the buildings they rented at the expiration of their lease would not be sufficient to convert the

lease into a purchase agreement. The court further stated, reminiscent of Giessel II, that the Indiana debt limitation provisions applied only to legally enforceable obligations. Since the court found no language binding any future legislature to make appropriations for the rent under the lease agreement and since the rentals could be paid only by appropriations made by the legislature, the court concluded that the lease agreement created no constitutionally prohibited debt.

Giessel II and Book are located on the more liberal end of the leaseback transaction spectrum, with Book perhaps a bit more liberal because of the court's willingness to overlook the lease provision apparently limiting the state agencies' ability to terminate the lease.

It is worthwhile at this point to temporarily abandon our chronological order to briefly review a later Indiana case -- Teperich v. North Judson-San Pierre High School Building Corporation, 275, N.E.2d 814 (Ind. 1971). We note the case only for its reaffirmation of the Book principle that rent payments "cannot be considered debt until the payments become due." 275 N.E.2d at 817.

In 1960, the Massachusetts court issued its solitary opinion relating to leaseback transactions. Ayer v. Commissioner of Administration, 165 N.E.2d 885 (Mass. 1960), involved, as the financing entity, a nonprofit corporation created by statute. The sole purpose of the corporation was to construct a building to be leased, and ultimately transferred, to the state. Citing McCutcheon, Trujillo, and Yelle, among others, the court embarked upon its analysis by "looking through form to substance". 165 N.E.2d at 892. The court first considered the nature of the corporation and then considered the nature of the lease agreement.

Although the court agreed that the corporation was an entity separate from the state, it nevertheless concluded that the corporation was "nothing more than a mere intermediary to carry out only one purpose." The following factors were pertinent to the court's analysis: (1) the corporation's sole purpose was to construct and lease to the state a building to be used only by the state; (2) the corporation was given powers of eminent domain; (3) the building, at the expiration of the lease, would become the absolute property of the state and the corporation would fade from existence; and (4) the corporation had virtually no power to deal with its property except as provided in the lease agreement. Reflecting upon these factors, the court then considered the statutory provision that the bonds of the corporation would not constitute a debt of the state or a pledge

of its faith and credit. The court's opinion as to this was as follows:

This disclaimer is ineffective if, contrary to the disclaimer, such be the natural and reasonable effect of the statute.

165 N.E.2d at 889.

With regard to the lease agreement, the court noted:

Viewing realities, we consider that the so-called "rentals" are not really rentals at all, but in practical effect are installment payments on account of a purchase by the Commonwealth of an office building, with full title to be acquired at an indefinite future date.

165 N.E.2d at 890. One of the important characteristics of the lease agreement leading the court to this conclusion was the requirement in the agreement that the state continue to make rental payments even if the building was not completed on time or was damaged or destroyed.

This 1960 case, which to the best of our knowledge has not been followed by any other Massachusetts leaseback transaction case, employed the McCutcheon-like analysis of piercing through form to arrive at the court's impression of substance. In this regard, the presence of a provision making the state's rental payments contingent upon legislative appropriations may not have changed the result, particularly if the Massachusetts court adopted the McCutcheon view that a mere moral imperative or even a practical likelihood for making the appropriations would suffice to create debt. However, the absence of such a provision allowed the court to reach its conclusion without the necessity of taking that position, and the presence of the affirmative duty of the state to make the rental payments even in the absence of a completed or inhabitable building for the state to occupy doubtless provided a strong incentive to the court to find a prohibited debt.

Another 1960 case, which was also the only decision on the subject we have found for its jurisdiction, was Application of the Oklahoma Capitol Improvement Authority, 355 P.2d 1028 (Ok. 1960). While Ayer emulated McCutcheon and Yelle, the Oklahoma court closely followed the pattern of Giessel II and Book.

There were two significant features of the statute under review in the Oklahoma case. First, a provision of the statute required the state treasurer to purchase the public corporation's bonds issued to provide financing for the building to be leased to the state. Second, the public corporation was authorized to require state agencies and departments to occupy space in the building and pay rent. A third feature also merits consideration, that feature being the intended rental of a portion of the building to federal government agencies.

Despite the first two of the foregoing features of the statute, the court reasoned that housing for state agencies was essential to state government. If the state did not own the housing, a proper method of providing it was through leases.

The court then noted:

We see no real distinction between a state department entering into a lease agreement and paying rent to a private party and having the same transaction with the Authority. In either event the state department receives a service in the form of housing which the state itself does not own. In addition the state will obtain two office buildings paid for in part from rentals from federal agencies.

355 P.2d at 1032. Given the second of the statutory provisions described above, we must allow that other courts might have seen a difference.

Two lower court California cases were decided in 1962 and 1963. In McClain v. County of Alameda, 25 Ca.R. 660 (Dist. Ct. of App., First Dist., Calif. 1962), and City of La Habra v. Pellerin, 30 Ca. R. 752 (Dist. Ct. of App., Fourth Dist., Calif. 1963), the California courts upheld leaseback transactions on two bases:

(1) the leases did not create an immediate indebtedness for the aggregate amount of the installment rent due; and

(2) under previous California cases, an obligation imposed by law on a city (such as, in these cases, to provide facilities for city functions) is not an indebtedness or liability within the meaning of the California debt limitation provisions. At least with respect to the first of the foregoing bases, the California courts, without citing Giessel II or Book, reflected a judicial attitude similar to that expressed in those other cases.

The following year, 1964, brought forth Montana's only entry in the leaseback transaction area, State v. City of Missoula, 395 P.2d 249 (Mont. 1964). The transaction there was somewhat unique to the extent that the financing entity involved was an individual -- Theodore Jacobs. In a succinct opinion, the Montana court expressed its belief that

A debt payable in the future is obviously no less a debt than if payable presently; and a debt payable upon a contingency, as upon the happening of some event, such as the rendering of service or the delivery of property, etc., is some kind of debt, and therefore within the prohibition.

395 P.2d at 251 (quoting from State ex rel. Helena Water Works v. City of Helena, 63 P. 99 (Mont. 1900)). Thus, with virtually no discussion of the elements of the lease from Jacobs to the city, the court reached the opinion that the lease would constitute prohibited debt. It is worth noting another difference in outlook, if not legal analysis, between this case and the California and Oklahoma cases described above: that is, in both California and Oklahoma the need for governmental facilities was viewed as rising to the level of a legal duty, while the Montana court expressed the following opinion as to the need of Missoula for the building in question:

No one, we believe, would seriously contend that the acquisition of a building valued at approximately \$46,000 would be a reasonable and necessary expense requisite to maintain the corporate existence of the City of Missoula.

395 P.2d at 251.

It took the Arizona court five years -- from 1965 through 1969 -- to ultimately conclude its leaseback transaction case. The case began as City of Phoenix v. Phoenix Civic Auditorium & Convention Center Association, Inc., 408 P.2d 818 (Ariz. 1965). Quoting extensively from McCutcheon, Trujillo, and Yelle, the court adopted the principles and reasoning of those cases and invalidated the leaseback transaction because (1) it was, in reality, a purchase agreement; and (2) the source of payment of rents by the city under the lease was to come from the general revenues of the city and not from a special fund derived other than from general taxes.

The next year, the court was asked to clarify its opinion as to whether the debt limitation would be violated if the lease agreement expressly provided that rental payments would come only from excise and ad valorem taxes and not from the city's general taxes and general fund. City of Phoenix v. Phoenix Civic Auditorium & Convention Center Association, Inc., 412 P.2d 43 (Ariz. 1966). Under such circumstances, the court indicated it would find no debt limitation violation.

After fully complying with the clarifications presented in the court's 1966 supplementary opinion, the City of Phoenix found itself once more challenged over the lease agreement. The City sought a peremptory writ of prohibition from the Supreme Court to prevent the City's challengers from proceeding with their case in the superior court. The Supreme Court issued the writ, thus finally concluding the case. City of Phoenix v. Superior Court, 455 P.2d 257 (Ariz. 1969).

In Hall v. Baltimore, 250 A.2d 233 (Md. 1969), the Maryland Supreme Court upheld a leaseback transaction relying on the prevalent common law rule that rent to fall due beyond the current period is not a present debt. The court specifically noted that there was no pledge of municipal assets as the leases involved were subordinate to the city's interest in the property. The court cited with approval Giessel II to the same effect.

Another 1969 case, McFarland v. Barron, 164 N.W.2d 607 (S. Dak. 1969) presented a leaseback transaction which should probably be the model for future endeavors in the area. The court provided the following summary of the plan which reflects a careful and thoughtful preparation for the avoidance of debt limitation problems:

The leases must contain a provision that rents shall be payable solely from appropriations to be made by the legislature and any revenues derived from the operation of the leased premises. In the event of nonpayment of rents by the State, the building or facility may be leased to others for suitable purposes. A lease may be made for a term of one year from the time a building is completed and ready for occupancy, with an option to the lessee to extend the term for one year from the expiration of the original term and for one year from the expiration of each extended term until the original term of the lease has been extended for a total number of years to be agreed upon at a rental which, if

paid for the original term and for each of the full number of years for which the term of the lease may be extended, will amortize the total cost of the erection of the building and appurtenances.

164 N.W.2d at 609. Referring to the common law concept that future rents do not create present indebtedness, the court upheld the arrangement. To the suggestion that the state would have a moral obligation to discharge the bonds, the court repounded:

While the legislature in making appropriations may not be confined to legal obligations, but may recognize moral or equitable obligations...there would exist under the proposed leases no binding legal obligation to authorize expenditures for rent ....In the event of nonpayment of rent or failure of the legislature to appropriate funds the Building Authority is empowered to lease the building or facility to others for suitable purposes to meet accruing payments.

164 N.W.2d at 609 -- 610. And the court finally concluded:

Since the stipulation of the State to pay rents to the Building Authority will be subject to available appropriations and current revenues, the inhibition of the debt limitation provisions of the Constitution will not apply.

164 N.W.2d at 611.

We temporarily abandon our chronological order once more to note here the subsequent South Dakota case, Millar v. Barnett, 221 N.W.2d 8 (S. Dak. 1974). Citing McFarland, the court again upheld a leaseback transaction similar to the transaction under review in the preceding case.

In 1970, three cases from three states were decided. New Mexico produced its second leaseback transaction case (following the 1941 Trujillo decision) in McKinley v. Alamogordo Municipal School District Authority, 465 P.2d 79 (N.W. 1970). The leaseback arrangement in Alamogordo stands in stark contrast to that crafted in the McFarland case. The financing entity in this arrangement was to be a nonprofit corporation whose membership was identical to the membership of the municipal agency which would be the corporation's lessee. As part of the lease

agreement the municipal corporation was to agree to budget and appropriate sufficient funds to pay the rent under the lease and, moreover, the municipal corporation agreed to the placement of a lien on all of its income from all sources, except ad valorem taxes, to cover the rental payments. There was at least one mitigating factor; that is, the lease was for only one year with successive one year extensions and was terminable at the request of either party. This mitigating factor was insufficient to prevent the court from invalidating the agreement.

In the Trujillo tradition, the court recognized the corporation as "nothing more nor less" than the municipal agency. Thus, the bonds of the corporation would necessarily be debts of the municipal agency. Although the court averred that the pledge of the municipal agency's income and the lien on funds to be received by the municipal agency were not critical factors in its decision (465 P.2d at 81), the court nevertheless referred to these factors in its concluding paragraphs:

Here the only source of money to pay rent to accrue is state tax proceeds and amounts received from federal sources. As a matter of fact, these moneys are specifically pledged by the terms of the lease. It is quite apparent that the funds to be used are those realized from "general taxation" held unconstitutional in Trujillo.

465 P.2d at 84.

While McFarland reflects careful consideration in the preparation of a leaseback transaction to avoid the constitutional concerns expressed by the various courts, Alamogordo seems to represent a studied indifference to those concerns. The result is that New Mexico has two invalidating cases and none validating. It would be enlightening to see how the New Mexico court would handle a case involving a leaseback transaction which reflects some concern for judicial precedent.

The Nevada case of State v. Hancock, 468 P.2d 333 (Nev. 1970), approaches, but does not achieve, such an effort. The leaseback transaction in that case, invalidated by the Nevada court, provided on the one hand that rentals from the state would derive from biennial appropriations from the legislature; on the other hand, the drafters of the plan curiously chose to also provide that the legislature could choose to pledge itself to make future appropriations as necessary to pay the rents.

The Nevada court followed the McCutcheon, Trujillo, Yelle, and Ayer approach of looking to "the essence" of the plan to reveal the true nature of the public corporation as the alter ego of the state and, thus, concluded that the corporation's debt was the state's debt. The argument was presented to the court that biennial legislative appropriations for the rent would not present a debt problem, with regard to the lease, because the constitutional concern does not extend to expenses payable out of current revenues. The court conceded that the argument carried "some persuasive force" but, in reviewing the transaction as a whole, was convinced that

successive biennial appropriations for rent until the bonds issued by the Authority are fully retired must be considered in the same light as a legislative pledge to make future appropriations for the same purpose. It is inconceivable that the legislature would default in either instance since the good faith of Nevada would not allow it.

468 P.2d at 338.

The third 1970 case was from West Virginia; it was followed in 1971 by a second West Virginia case. The 1970 case invalidated a leaseback transaction, while the 1971 case upheld such a transaction.

The 1970 case is State ex rel. Hall v. Taylor, 178 S.E.2d 48 (W. Va. 1970). Although the legislation authorizing the transaction in Taylor indicated that the rents to be paid by the state would come from annual appropriations, the court found an obligation, as a practical matter, for the state to make the appropriations. In the court's words:

It is an exercise in fiction, semantics, sophistry or circumlocution, devoid of substance, to assert that the statute in question does not create a state debt. It is a debt which, in the contemplation of the statute, must necessarily be paid in annual installments over a period of years and by successive legislatures from fiscal year to fiscal year. The state is legally obligated to furnish office space and to pay other expenses incidental to the continued existence and functioning of the various state agencies and departments which rented office space in the building in question. The legislature is le-

gally obligated to make appropriations from time to time to defray the costs of such essential governmental operations.

It is no answer to the invalidity of this statute and of the action of the Building Commission in issuing these bonds to say that some future legislature is not required to make an appropriation to one of these agencies or departments in order that the agency or department might make its payment of rent. The failure to make such an appropriation could result in the holders of the bonds taking over the buildings involved, and it is incomprehensible that any legislature would permit any such thing to happen. However, the test is not whether a future legislature is required to make such appropriations. The test is the authority to do so. Clearly the only source of income by which the bonds may be liquidated is the rent to be paid by the occupants of the buildings. Therefore, the reason for the invalidity of the statute lies in the authority of the legislature to make such future appropriations. It is not necessary for this Court to wait until some future legislature refuses to make an appropriation to make a determination of the legality of this procedure.

178 S.E.2d at 57 and 58 -- 59 (emphasis in original). The reasoning employed by this court is singular among all the leaseback transaction cases.

In the following year, the West Virginia court reviewed another leaseback transaction which cured the problem apparently perceived by the court in the Taylor case. In State ex rel. State Building Commission v. Moore, 184 S.E.2d 94 (W. VA. 1971), the rental payments from the state were to be made from a special fund into which flowed proceeds from the state's sale of alcohol. Since the state's general revenues would not be considered for payment of the rents, the court was not offended by the plan. Curiously, however, a provision in the lease agreement which required the state agency occupants of the building to provide for the maintenance and operation of the building from their general revenue funds appropriated by the legislature survived the court's review notwithstanding Taylor. Without any explanation, the court simply ruled that payments under the provision by

the state agencies would conform with the provisions of the Act under review.

Ohio decided its second leaseback transaction case in 1972. The court's opinion in State ex rel. Kitchen v. Christman, 285 N.E.2d 362 (Ohio 1972), began with the court's recitation that

At the outset, it should be emphasized that this court examines this transaction, not for what it purports to be, but for what, in essence, it is. In short, the court looks through the form to the substance of the proposed transaction.

285 N.E.2d at 365. The court's conclusion should come as no surprise. True to the McCutcheon, et al., tradition, the court pierced the lease agreement veil to find the hidden purchase agreement. The court concluded that

the entire contract price is a present indebtedness of the city. The city has presently obligated itself to make future payments, and the Company has a present right to compel each succeeding administration to make those payments. The city's obligation under the contract is a continuing one, and no succeeding city council can refuse to appropriate available funds (generated by its taxing power) for payment.

285 N.E.2d at 367 (footnote omitted).

Of particular interest in the opinion is a footnote in which the court states;

If such an unconditional obligation of payment [by the city] did not exist, but instead, the city were free to periodically choose whether to continue to appropriate monies for the purpose of acquiring eventual complete ownership of the property in question, an entirely different question might have been presented.

285 N.E.2d at 367, n.6.

Another 1972 case, Bachtell v. City of Waterloo, 200 N.W.2d 548 (Iowa 1972), also followed the "piercing" approach to

conclude that a leasing arrangement was merely a subterfuge for an attempted purchase. The court listed many of the cases both pro and con which had preceded it in the leaseback area. The court considered that those which had upheld such transactions were distinguishable from this case, though the court scarcely attempted to explain either the distinguishing features of the other cases or even the particular objectionable features of the plan under review.

In Opinion to the Governor, 308 A.2d 802 (R.I. 1973), the Rhode Island court responded to questions proposed by the governor of that state regarding a contemplated leaseback transaction. The governor asked whether lease payments under the transaction would involve debt of the state. Viewing the position that such payments would not constitute debt as the majority view and as the "sounder and more reasonable" position, the court answered the governor's question in the negative.

The Oregon Supreme Court, in Martin v. Oregon Building Authority, 554 P.2d 126 (Ore. 1976), reviewed a leaseback transaction which, among other things, provided that the state's obligation to make rental payments was unconditional as long as the premises were available for rental and which also provided that the state's full faith and credit supported such obligation. As the court noted regarding the use of a public corporation in such a scheme to attempt to avoid the constitutional debt limitation:

It is a scheme which would fool only a lawyer.

554 P.2d at 131. Although the provisions of the leaseback transaction noted above were relatively outlandish, the court's opinion creates the impression that even a more moderate plan would have reached the same result as long as it involved a public corporation whose only purpose for existence was to issue bonds to provide financing for state projects and whose only source of revenues was rental payments from the state. In this regard, Martin should probably be added to the list of McCutcheon-Trujillo-Ayer-Yelle type cases.

In an unusually flexible approach to debt limitations and leaseback transactions, the court in In re Request for Advisory Opinion Enrolled Senate Bill 558 (Being 1976 PA 240), 254 N.W.2d 554 (Mich. 1977), indicated that a leaseback transaction would be upheld even though it acknowledged that, under the plan, future legislatures would be bound to appropriate the necessary public funds to meet the state's rental obligation. The court took the following pragmatic approach to the question:

However, in that its power to invoke sovereign immunity can particularly or even totally obstruct enforcement, the state differs essentially from non-governmental contractors....Although in granting limited jurisdiction over all contract claims against the state to the Court of Claims...the State of Michigan has waived its sovereign immunity, even that waiver is subject to legislative revocation.

254 N.W.2d at 547. This case probably should not be considered likely precedent for most other states.

In Laramie Citizens for Good Government v. City of Laramie, 617 P.2d 474 (Wyo. 1980), the leaseback transaction was not unusual except to the extent that it involved the purchase of a ranch by a public corporation with the intent that the corporation would lease the ranch to the city so that the city would have the benefit of water rights on the ranch. The public corporation was created solely for that purpose. Nine of the eleven members of the corporation's board of directors were elected city officials. The corporation had no financial base except for the rents it would receive from its lease of the ranch to the city. All of this led the court to the conclusion that the corporation was the alter ego of the city and that the corporation's debt was prohibited.

The court also considered the nature of the lease agreement and concluded that it was a mere subterfuge for a purchase of the ranch. In its opinion, the court listed the following factors which reflect a lease rather than a purchase:

provision for cancellation of the lease by the lessee at its option at yearly intervals, or the converse provision that the term is for one year with yearly renewal options; provision for payment of a fixed and substantial amount at the end of the term, or the converse that there is no provision for transfer of title at the end of the term without payment at that time of a fixed and substantial amount in addition to rental payments; provision that the lessor pay the cost of upkeep, repair, taxes, etc., the amount of the rental payments being equal to the debt service amount.

617 P.2d at 479.

Eberhart v. Mayor & City Council of Baltimore, 433 A.2d 1118 (Md. 1981), was Maryland's second leaseback transaction case and was by far the most ornate of the plans we have reviewed. The subject of the plan was a parcel of land with improvements owned by the City. The City rented the land and building on a rent free at will basis to a culinary arts institute. The City desired to extract its capital out of the property while still enabling the institute to rent the property at no cost. Under the plan, the City would sell the building to a limited partnership and lease the land to the partnership for thirty-five years. The partnership would lease the land and building back to the City under a thirty year lease. The partnership, in order to obtain financing, would seek the issuance of industrial development bonds by the Industrial Development Authority of the Mayor and City Council of Baltimore, a public corporation. The authority would issue its bonds, and the proceeds of the sale of the bonds would be loaned to the partnership to finance the partnership's purchase of the building from the City. As security for the bonds, the partnership would grant a mortgage on the building and its leasehold interest in the land, which would be assigned to the trustee for the bonds. The mortgage would be subordinate to the City's interests as tenant under the ground and building lease and as fee simple owner of the land.

The partnership would also assign to the trustee the right to receive rent payments from the City.

This plan was challenged on the same grounds enunciated in the McCutcheon line of cases; that is, that the authority was simply the alter ego of the City so that the authority's bonds constituted debt of the City and that the use of the general funds of the City to pay rent under the lease amounted to an obligation on the part of the City to repay the authority's bonds. Although the court noted and the City conceded that the obligation to pay rental under the lease was a full faith and credit obligation of the City, the court rejected the challenge and upheld the arrangement.

With regard to the contention that the authority was the alter ego of the City, the court listed an interesting collection of statutory provisions rebutting the position.

The provisions of Art. 41, secs. 266A--I indicate that an industrial development authority is not simply the alter ego or instrumentality of the county or municipality which creates it. An authority is a body politic and corporate and "a political subdivision of the State." Section 266A-3 mandates that none

of the five members of the board of directors that govern an authority and exercise its powers by resolution may be officials or employees of the incorporating county or municipality. A director, although appointed by the incorporating county or municipality, may be removed only for misfeasance, neglect of duty, or other good cause. Sec. 266A-3(b)-(7). Section 266A-3(a) provides that the incorporating county or municipality may exercise its own powers under secs. 266A--I even though it has chosen to incorporate an authority with similar powers. These various statutory provisions suggest that an authority is a distinct entity from its incorporating county or municipality.

433 A.2d at 1127.

With regard to the notion that the City's rental payments will be used to pay the authority's bonds and therefore constitute debt, the court noted that the determinative factor was the payment of bona fide rent by the City. The court stated:

Uncontradicted evidence was presented to the circuit court that the City's estimated annual rental payments under the Ground and Building Lease would represent the fair rental value of the Property. The correlation of the City's rental payments to Culinary Associates' debt service obligation does not, therefore, destroy the essential character of the Ground and Building Lease as a lease. Because the rent reserved under the Ground and Building Lease represents the fair rental value of the Property, and there are no factors that suggest a contrary result, the Ground and Building Lease is a bona fide lease. Thus, the City's obligation to make rental payments will not create debt even though the obligation to pay rent is an enforceable, full faith and credit obligation of the City.

433 A.2d at 1125.

Another 1981 case, Gude v. City of Lakewood, 636 P.2d 691 (Colo. 1981), also upheld a leaseback transaction against

similar contentions. The transaction took the form of a lease-back to the City of land by a nonprofit corporation, which lease provided for 25 consecutive one-year renewals which were automatic unless the City elected against the renewal. The rental payments from the City under the lease would be used to repay the bonds issued by the corporation, and the security for the bonds would include a lien on the corporation's building and on the corporation's lease of the land. Upon payment of the bonds, the corporation would transfer title to the building to the City.

The court first considered the contention that the corporation was the alter ego of the City, noting that, where the alter ego doctrine applies, the court will disregard a corporate entity, or pierce the corporate veil, and consider the actions ostensibly taken by the corporation to be those of its shareholders. The court noted that "the record fails to establish the essential element that the building authority is to be used to promote injustice or protect fraud." 636 P.2d at 697. The court found no fraud upon the taxpayers of the City, though the taxpayers had earlier voted on and rejected a general obligation bond issue to finance the facility now being financed through the issuance of the corporation's bonds, because it is not the construction of a facility that requires voter approval but rather, the creation of general obligation debt. The plan before the court did not create any general obligation debt. As to any potential fraud on purchasers of the bonds, the court noted:

The record reflects that the financing plan has been carefully structured to assure that the city has no obligation on the anticipation notes or the revenue bonds and that purchasers of those instruments will be made fully aware of that fact by the terms of the notes and bonds. The purchasers also will be advised that the city's lease and attendant obligations can be terminated at the end of any year and that, should the city elect to terminate its lease, the security for the building authority's obligations is limited to the municipal office building itself and the building authority's 25-year lease on the building site.

636 P.2d at 698.

The court then considered whether the City's rental obligation for future years under the lease agreement constituted proscribed debt and concluded that it did not.

Of particular importance to our conclusion that the city's rental obligations for future years do not constitute debt in contravention of Colo. Const. Art. XI, Sec. 6 is the lease provision that those obligations are contingent upon exercise of the city's renewal options. We have held that discretionary or

contingent obligations are not constitutional debt. "To constitute a debt in the constitutional sense, one legislature, in effect, must obligate a future legislature to appropriate funds to discharge the debt created by the future legislature."

636 P.2d at 699.

Finally, the plaintiffs in the case urged the court to take the McCutcheon "total picture" approach to determine that the plan as a whole amounted, in essence, to a subterfuge and an evasion of the constitutional debt limitations. Taking such an approach, the court reached the opposite conclusion. Recognizing that the corporation was created solely for the purpose of providing financing for the project after the voter's had disapproved general obligation indebtedness for the project, the court found "no evil in seeking an alternate means of achieving a result so long as the alternate is itself consistent with the law." 636 P.2d at 699 -- 700.

As noted earlier, there is a real difference between the city's proposed plan and the plan which was rejected by the voters. That difference is the absence of any obligation of the city on the anticipation notes or revenue bonds under the new plan. We are aware of the argument that, although the city's lease is terminable in form, practicalities dictate that the likelihood of termination is remote because the city hall will be specially designed to city specifications and because of the prospect, gaining substance with each rental payment, that the city will become the owner of the building when the bonds have been retired....The ability to terminate its lease gives the city flexibility which is real, not illusory. We cannot say that the city will never avail itself of its termination rights.

636 P.2d at 700.

The final case in our review is Baliles v. Mazur, 297 S.E.2d 695 (Va. 1982), involving the financing of state capital projects through the issuance of revenue bonds by a public corporation of the state. To the question of whether the revenue bonds constituted debt of the state, the court answered they did not, noting that the enabling legislation specifically denied such assertion. To the assertion that the issuance of the revenue bonds was a transparent attempt to evade the constitutional debt limitations, the court summarily disagreed.

### CONCLUSION

The foregoing review of cases demonstrates that the majority of jurisdictions which have considered the issue accept leaseback transactions as constitutionally permissible methods for financing public facilities. It is our opinion that the majority view upholding such transactions would be followed in Alaska. Moreover, we are also of the opinion that the categorization of the agreement between the state and a financing entity as either a "lease" or an "installment purchase contract" is insignificant as long as the state's obligation to make payments is contingent upon annual appropriations by the legislature for that purpose. Thus, whether the arrangement is for a lease or for an installment sale, we believe the courts in Alaska will uphold it.

We noted in the "Overview" to this memorandum that 16 of the states whose cases we have reviewed can be considered as "validating states" in the sense that the most recent cases in those states are cases which uphold leaseback transactions. Ten of the states can be considered invalidating states. This does not necessarily mean that leaseback transactions are prohibited in the other ten states.

The only significance to the categorization of the 16 states as validating states is that we can be sure that in a clear majority of the states a constitutionally valid leaseback transaction can be created. It may be equally true that constitutionally valid leaseback transactions could be created in some or all of the invalidating states, with some changes in the features of the transactions presented to the courts in those states as a result of recent cases.

The following list describes features of a leaseback transaction which may be considered significant in analyzing the transaction under constitutional debt limitations. We emphasize that these should not be considered as "musts" (with the exception of item "3" below) but are provided only as suggestions. If all other considerations allow and if the consensus is to take

the most conservative approach, the preparation of a leaseback transaction containing all of the suggestions listed below would come as close as possible to satisfying the most conservative of the invalidating state courts. It should be recognized, however, that other considerations are likely to call for different or even conflicting features. We do not mean to imply that those other considerations cannot or should not be accommodated. Again, the following list is intended only to provide suggestions for contemplation in fashioning a leaseback (or installment purchase) agreement.

1. The financing entity, whether a public corporation or a private corporation, should have some business to perform other than and in addition to the financing of the particular project to be leased to the state. One of the common themes of the invalidating cases is the "alter ego" argument. If the financing entity has some other purpose for existence it will help to refute that argument.

2. For the reason stated in "1", the financing entity should have some source of revenue other than rents to be paid by the state.

3. In any lease agreement with the state, the state's obligation to pay rent must be contingent upon annual appropriations by the legislature.

4. The amount of rent to be paid by the state should bear some resemblance to "fair rental value" for the property rather than simply being based on debt service requirements for the bonds.

5. If possible, title to the property should remain in the financing entity (if a public corporation) at the expiration of the lease; alternatively, the state should be required to pay a significant amount to exercise an option to purchase at the term of the lease.

6. The lease should be terminable by the state at any time without any further obligation.

7. The financing entity should have the ability to lease the facility to users other than or in addition to the state during the period of the lease.

8. Should the state terminate the lease, the financing entity should have control over the use or disposition of the facility.

9. No existing state property should be encumbered except for the leaseholder interest granted to the financing entity.

10. If title to the property on which the facility is to be built remains in the state, provision should be made in the lease agreement for the disposition of the facility at the termination or expiration of the lease if the state does not exercise its purchase option.

11. The statute, the bonds, and any other pertinent documents should clearly indicate that the bonds are not obligations of the state and are payable solely from the revenues derived from the project.

12. Should the legislature fail to appropriate money for rental payments or the state fail for any reason to make rental payments, it should be clear that neither the financing entity nor the bondholders have any recourse against the state, though the financing entity may endeavor to enter into other lease agreements, and, if the financing entity holds title to the land and building, it may re-enter and take possession thereof.

13. If a financing entity is to be specially created for the purpose (which we advise against; see "1" above), membership in the entity should not include officers of the state.

14. There should be no possibility of loss by the state of any of its pre-existing property.

15. There should be a provision reducing or eliminating the state's rent to the extent that the facility is not timely completed or, upon completion, becomes unusable.

16. Any long-term lease should be prepared as a one-year lease with the proper number of annual options to renew.

17. Revenues from other state facilities should not be pledged as security for the bonds. This is particularly so in Alaska given our state's dedicated fund prohibition.

18. The statute creating the financing entity, if any, should carefully describe the financing entity as having a separate and independent legal existence.

19. The financing entity, if a public corporation, should not be given powers of eminent domain.

20. The financing entity, as lessor to the state, should agree to pay the cost of upkeep, repairs, taxes, etc. with regard to the facility.

21. If the financing entity is created by statute, its directors should be removable from office only for malfeasance, neglect of duty, or other good cause.

Finally, with respect to the applicability of this memorandum to lease participation certificates, we perceive no reason why such certificates should be considered differently from revenue bonds or why lease participation transactions should be considered differently from leaseback transactions.

LAW OFFICES

BIRCH, HORTON, BITTNER, PESTINGER AND ANDERSON  
A PROFESSIONAL CORPORATION  
1127 WEST SEVENTH AVENUE  
ANCHORAGE, ALASKA 99501

MAYER, BROWN & PLATT

231 SOUTH LA SALLE STREET  
CHICAGO, ILLINOIS 60604

April 4, 1984

State Bond Committee  
Department of Revenue  
State of Alaska  
Pouch SB  
Juneau, Alaska 99811

Attention: Mr. Milt Barker

Ladies and Gentlemen:

You have requested that we review various issues raised by the proposed lease-purchase financing by the State of Alaska ("State") of various State facilities.

Under the proposed financing structure, the Alaska State Housing Authority ("ASHA") would issue bonds or notes in order to provide funds to pay the costs of construction of the State facilities. Pursuant to a lease agreement ("Lease") between ASHA, as lessor ("Lessor"), and the State, as lessee, the Lessor would lease the State facilities and lease or sublease<sup>1/</sup> the underlying land (collectively, the "Facilities") to the State. The State would be obligated to make rental payments<sup>2/</sup> on a fixed basis throughout the term of the Lease in amounts sufficient to pay when due the principal and interest on the Lessor's outstanding bonds or notes. The State's rental payment obligation would be subject to annual appropriations; failure by the State legislature to appropriate sufficient funds to make rental payments would result in the termination of the Lease. Upon the expiration of the term of the Lease, the State would pay a predetermined purchase price in order to acquire title to the Facilities.

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- <sup>1/</sup> If Lessor does not own, but rather leases from the owner thereof, the underlying land, the Lessor would sublease the land to the State.
- <sup>2/</sup> The interest component of the State's rental payments would be exempt from federal income taxation, assuming compliance with all applicable federal tax law requirements.

The question we have considered is whether this proposed financing of the Facilities would be in violation of the debt limitations set forth in the State Constitution. Analysis of this general issue requires consideration of two component issues: (1) whether debt issued by ASHA would be found to constitute prohibited State debt under the State Constitution and (2) whether the State's rental payment obligation under the Lease would be found to constitute prohibited State debt under the State Constitution.<sup>3/</sup>

Article IX, § 8 ("Section 8") of the State Constitution provides in pertinent part:

No state debt shall be contracted unless authorized by law for capital improvements or unless authorized by law for housing loans for veterans, and ratified by a majority of the qualified voters of the State who vote on the question.

Article IX, § 11 ("Section 11") of the State Constitution, however, excepts from the Section 8 debt limitations revenue bonds of a public corporation of the State, as follows:

The 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.

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<sup>3/</sup> We note that between 1966 and 1974 ASHA issued eleven separate series of bonds in the aggregate principal amount of \$106,150,000 to finance construction of a variety of capital projects for lease to the State. The bonds were secured by lease rentals from the State. Over \$60 million of the bonds remain outstanding. 1984 Moody's Municipal & Government Manual 244-246.

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Thus, Section 8 restrictions on incurring State debt apply only to obligations against the general credit of the State. 1959 Op. Att'y Gen., No. 39.

If the debt to be issued by ASHA to finance the Facilities will fit within the Section 11 exception, the Section 8 debt limitations will not be applicable. In National Bank of Alaska v. State of Alaska, Department of Revenue, Sup. Ct. Op. No. 2480 (File No. 5482), 642 P.2d 811 (1982), the Supreme Court of Alaska ("Court") found that bonds issued by ASHA do not constitute debt of the State subject to the Section 8 debt limitations.<sup>4/</sup> The Court based its conclusion on § 18.55.160 of the Alaska State Housing Authority Act ("Act"), which provides in pertinent part as follows:

The bonds of the authority are not a debt of the state or a political or municipal corporation or other subdivision of the state and each bond shall so state on its face. Neither the state nor a political or municipal corporation or other subdivision of the state other than the authority is liable on the bonds, nor are the bonds payable out of funds or properties other than those of the authority. The authority may not pledge the faith of the people of the state for a loan or obligation. Bonds of the authority are not a debt, indebtedness or the borrowing of money within the meaning of any limitation or restriction on the issuance of bonds contained in the constitution or laws of the state.

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<sup>4/</sup> In National Bank of Alaska, the Court held, inter alia, that ASHA bonds (and bonds of the Alaska Housing Finance Corporation) are not "state obligations" for purposes of the Alaska Business License Act. Bonds at issue in the case appear to have included lease revenue bonds referred to in footnote <sup>3/</sup> above.

Without expressly referencing the Section 11 exception the Court found that § 18.55.160 of the Act placed ASHA bonds outside of the scope of the Section 8 debt limitations: "the ASHA . . . bonds in the instant case are not, by the very terms of AS 18.55.160 . . . state debts backed by general treasury funds." Id. at 817.

The Court cited as controlling two of its earlier decisions on the issue of whether bonds of public corporations are subject to the Section 8 debt limitations: DeArmond v. Alaska State Development Corporation, Sup. Ct. Op. No. 116 (File No. 285), 376 P.2d 717 (1962) (enabling act provisions determined finding that bonds of Alaska State Development Corporation are not debts of the State) and Walker v. Alaska State Mortgage Association, Sup. Ct. Op. No. 353 (File No. 669), 416 P.2d 245 (1966) (enabling act provisions determined finding that bonds of Alaska State Mortgage Association are not debts of the State within the scope of Section 8).

Thus, we conclude that ASHA bonds issued in conformance with the Act in order to finance the Facilities on the terms outlined above would not constitute prohibited debt of the State.

Arguably, the provisions of Section 11 as applied to a revenue bond financing secured by rental payments made by ASHA pursuant to the Lease are dispositive of the entire issue and render irrelevant the question of whether the Lease, in itself, constitutes State debt. Nonetheless, the majority of jurisdictions which have considered this issue have upheld the validity of lease financings of public facilities under state constitutional debt limitations. The generally accepted view is that a lease arrangement between a state and an independent state agency constitutes state debt only if the state presently has an unconditional, legally enforceable obligation binding future legislatures to make future annual rental payments under the terms of a multi-year lease. See, e.g., Gude v. City of Lakewood, 636 P.2d 691 (Colo. 1981); State ex rel. Kitchen v. Christman, 285 N.E.2d 362 (Ohio 1972); Book v. State Office Building Commission, 149 N.E.2d 273 (Ind. 1958); State ex rel. Thomson v. Giessel, 72 N.W.2d 577 (Wisc. 1955). If, however, under the terms of a multi-year lease the state has a present obligation to pay current rental payments out of current revenues and only a contingent, legally

nonenforceable obligation at the discretion of future legislatures to make future annual rental payments, no prohibited debt is created. Thus, the essence of the majority rule is that no constitutionally prohibited debt results from a state's obligation to make future annual rental payments under a multi-year lease if the obligation is conditioned upon legislative appropriations. See e.g., Enourato v. New Jersey Building Authority, 448 A.2d 449 (N.J. 1982); Bulman v. McCrane, 312 A.2d 857 (N.J. 1973); McFarland v. Barron, 164 N.W.2d 607 (S. Dak. 1969).<sup>5/</sup>

We are of the view that a lease-purchase financing of the Facilities on the terms outlined above is valid under Section 8 debt limitations. Support for our view comes from several sources.

In the Walker opinion, supra, at 253 and 254, the Court cited approvingly in footnotes two of the landmark decisions holding that lease-purchase financings do not violate state constitutional debt limitations. Although it cited the Book and Giessel opinions specifically in connection with its resolution of the issue of whether the debt of a public corporation constitutes state debt, it is reasonable to assume that the Court would similarly embrace the holdings in those decisions validating lease-purchase financings.

In the October 14, 1983 Informal Opinion of the Attorney General (File No. 366-101-84),<sup>6/</sup> the Alaska

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<sup>5/</sup> In this connection we have also reviewed the following authorities, inter alia: Ayer v. Commissioner of Administration, 165 N.E.2d 885 (Mass. 1960); State v. Yelle, 289 P.2d 355 (Wash. 1955); McCutcheon v. State Building Authority, 97 A.2d 663 (N.J. 1953).

<sup>6/</sup> Although opinions of the Attorney General are not controlling on a court, his opinions are entitled to great weight. See Allison v. State, 583 P.2d 813, 817 (Alaska, 1978) in which the Court adopted the following statement from a California appellate court decision:

While opinions of the attorney general are not controlling as to the meaning of the statute the fact that his opinions

(Cont'd)

Attorney General opined in accordance with the majority position that a lease financing of a public facility by means of a lease agreement between the State and the developer of a public facility would not violate Section 8 if future legislatures of the State are not bound to appropriate funds for rental payments. As the Attorney General explained in interpreting Section 8:

[It is] imperative that the state's right to possess and use the facility is contingent on annual appropriations from revenue anticipated for the fiscal year in which the lease obligation is incurred. Traditionally, appropriations for lease payments are considered operating appropriations which lapse on June 30 of the fiscal year. A lease agreement which provides for termination of the leasehold if sufficient appropriations to pay rent are not enacted will negate the conclusion that a debt is created. A one-year lease with automatic annual renewal for a maximum number of years upon enactment of an appropriation to finance the annual rent has been approved as a term which negates any possibility that a debt is created. Gude v. City of Lakewood, 636 P.2d 691 (Colo. 1981). See also Glennon Heights, Inc. v. Central Bank and Trust, 658 P.2d 872 (Colo. 1983).

Further support for our conclusion can be found in Proceedings of the Alaska Constitutional Convention, pages

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have not been challenged and that he is the officer charged by law with advising the officers charged with the enforcement of the law as to the meaning of it, entitled his opinions to great weight. (citations omitted)

2435 - 2437.7/ Although the delegates to the Convention do not appear to have addressed directly the precise issue of the constitutional validity of lease financings of public facilities by the State, the following excerpts from an exchange between Delegate V. Fischer and Delegate White regarding the committee proposal form of Section 11 8/ suggest that the delegates viewed lease-purchase financings as being within the scope of the Section 11 exception:

V. FISCHER      The committee proposal in Section 10 authorizes the floating of bonds by public corporation when the only security from such indebtedness is the revenue of the enterprise or public corporation. The Committee, in putting that in, has specifically told us in the commentary<sup>9/</sup> that they're condoning

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7/ Warren v. Boucher, 543 P. 2d 731, 735 (Alaska 1975) (In interpreting a constitutional provision, the Court "must infer the purposes and intentions of the framers from the language of the constitution itself, with careful regard for the apparent aims which the framers had in mind.")

8/ Referred to therein as Section 10.

9/ As noted in a Memorandum to the Constitutional Convention Committee on Finance and Taxation summarizing the comments of various finance specialists on proposal forms of Sections 8 and 11:

The prohibition against incurring debt except by referendum in Section 9 [Section 8] and the exceptions in Section 11 as pertains to revenue bonds of public corporations would appear to be an open invitation to create 'authorities,' in the Pennsylvania pattern, for the financing of public improvements.

(Cont'd)

a practice which is used in every state as a means of getting around this kind of bonding restriction as we currently have in Section 8. In other words, we put the provision in Section 8, it is a cumbersome provision. We are telling the state that that of course is of too much bother. Therefore, go ahead and create a separate corporation; if you want to build highways, set up a toll road, set up a separate corporation. If you want to put up public buildings, set up a separate corporation and many states have done that, float bonds and then the state purchases those buildings from that corporation. What happens in those cases? In those cases the credit of the state is not pledged . . .

. . . .

WHITE:

Mr. President, just in closing, briefly, in answer to Mr. Fischer I think he has brought a side issue in here by mentioning Section 10. If Mr. Fischer can draft language that would eliminate the necessity for Section 10, I'm sure the Committee would go for it. The reason Section 10 is in there is because it has been found that no matter what you do, as far as the Committee can find, that way can be found to get around debt limitations, and, therefore,

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See Kelley v. Earle, 190 A. 140 (Pa. 1937), in which the Supreme Court of Pennsylvania upheld the validity under state constitutional debt limitations of lease financings between the State of Pennsylvania and the General State Authority for the construction of public projects.

April 4, 1984

if in order to avoid suits in court you might just as well make the authority clear. . . . [I]f the legislature wants to take this end way around of getting at it and going to special authorities they are subject to check by the people, the people will know what's being done and they will react accordingly if they are not in favor of it. . . . Id.  
(Emphasis added)

In addition to reflecting the liberal, modern approach of the framers of the State Constitution, these comments suggest that the delegates did not consider as prohibited debt an obligation of the State to make payments to acquire a public facility financed with debt of a public corporation. It appears that the delegates contemplated and condoned reading Section 11 as authorizing an outright purchase by the State of a public building from the financing public corporation, a more extreme debt limitation circumvention device than the proposed lease-purchase financing.

Other statements of delegates to the Convention demonstrate that the fundamental impetus behind the Section 8 debt restrictions was the framers' desire to restrict the State's ability to contract debt prospectively. Since the proposed lease-purchase financing of the Facilities would not entail the creation of a rental payment obligation binding future legislatures of the State, it is not likely that the Court would find that such a financing contravenes the Section 8 debt limitations.

Thus, in view of the apparent aim of the framers of the State Constitution in imposing the Section 8 debt limitations and in granting the Section 11 exception therefrom, and in light of the approach taken by the Court in this general area, we are of the opinion that the Lease would not constitute debt of the State.

After you have had an opportunity to review our views, we would be happy to discuss them, and any related concerns which you may have, with you at your convenience.

Very truly yours,

BIRCH, MORTON, BITTNER,  
PESTINGER AND ANDERSON

MAYER, BROWN & PLATT

James

A M E N D M E N T

<sup>2 spaces</sup>  
Offered in the House Special Committee or State Loans

By Sund

TO: HB 519

Page 2, line 2, after "payment":

Delete "and" and insert ","

Page 2, line 4, following "Authority":

Insert ", and the anticipated total construction or acquisition cost of the project"

Page 2, lines 5 - 7:

Delete "until the state bond committee has approved the proposal for the issuance of debt under AS 37.15.770."

Insert "unless the public building to be provided has been approved by law. An appropriation for the project does not constitute approval by law for purposes of this section"

Page 3, line 24, following "payment":

Delete "and" and insert "1"

Page 3, line 26, following "Authority":

Insert ", and the anticipated total construction or acquisition cost of the project"

Page 3, lines 27 - 28:

Delete "until the state bond committee has approved the proposal for the issuance of debt under AS 37.15.770."

Insert "unless the public building to be provided has been approved by law. An appropriation for the project does not constitute approval by law for purposes of this section."

Page 4, line 19, following "payment":

Delete "and" and insert " , "

Page 4, line 21, following "Authority":

Insert " , and the anticipated total construction or acquisition cost of the project"

Page 4, lines 22 - 23:

Delete "until the state bond committee has approved the proposal for the issuance of debt under AS 37.15.770."

Insert "unless the public building to be provided has been approved by law. An appropriation for the project does not constitute approval by law for purposes of this section."

Page 4, line 25, delete "(a)"

Page 5, lines 8 - 19, delete all material

Page 5, line 8, insert a new bill section to read:

"\* Sec. 9. AS 37.05 is amended by adding a new section to read:

Sec. 37.05.285. LEASE FINANCING. The department may enter into lease-financing agreements only with the Alaska State Housing Authority acting as the Alaska State Building Authority. A lease-financing agreement must provide that lease payments are subject to annual appropriation. If the department intends to enter into an agreement under this subsection, the department shall provide notice to the legislature and to the state bond committee. The notice must include the anticipated annual lease payment, the anticipated principal amount of the debt to be issued by the Alaska State Housing Authority acting as the Alaska State Building Authority, and the anticipated total construction or acquisition cost of the project. The department may not enter into an agreement under this subsection unless the public building to be provided has been approved by law. An appropriation for the project does not constitute approval by law for purposes of this section."

Renumber remaining bill sections accordingly.

Page 7, line 28, through page 8, line 6, delete all material and insert:

"(a) The bonds shall be sold in the manner, price or prices, [SUCH] amounts or series, and at the [SUCH] time or times [AS] determined by the committee, at either public or private sale. [BEFORE SELLING A SERIES OF BONDS, THE COMMITTEE SHALL GIVE NOTICE INVITING SEALED BIDS IN SUCH MANNER AS IT MAY PRESCRIBE. IF SATISFACTORY BIDS ARE RECEIVED, THE BONDS OFFERED FOR SALE SHALL BE AWARDED TO THE HIGHEST RESPONSIBLE BIDDER. IF THE COMMITTEE DETERMINES THAT THE BIDS

RECEIVED ARE NOT SATISFACTORY AS TO PRICE OR RESPONSIBILITY OF THE BIDDERS, IT MAY REJECT ALL BIDS RECEIVED.] The bonds,"

Page 8, following line 12, insert new bill sections to read:

"\* Sec. 16. AS 37.15.460 is amended to read:

Sec. 37.15.460. BOND RESOLUTION. The committee is authorized and directed to adopt the bond resolution and prepare all other documents and proceedings necessary for the issuance, sale and delivery of the bonds or any part or series of them. The bond resolution shall fix the principal amount, denomination, date, maturities, place or places of payment, rights of redemption, if any, terms, form, conditions and covenants of the bonds or each series of them. The committee shall also determine and provide for the date and manner of sale of the bonds, and shall provide where a [WHETHER THE] notice of sale, if any, is to be published [ELSEWHERE IN ADDITION TO THE PUBLICATION REQUIRED BY AS 37.15.450].

\* Sec. 17. AS 37.15.650(a) is amended to read:

(a) The toll facilities bonds are sold in the manner, price or prices, amounts or series, and at the time as determined by the committee, at either public or private sale. [BEFORE SELLING A SERIES OF BONDS, THE COMMITTEE SHALL GIVE NOTICE INVITING SEALED BIDS. IF SATISFACTORY BIDS ARE RECEIVED, THE BONDS OFFERED FOR SALE ARE AWARDED TO THE HIGHEST RESPONSIBLE BIDDER. IF THE COMMITTEE DETERMINES THAT A BID RECEIVED IS NOT SATISFACTORY AS TO PRICE OR RESPONSIBILITY OF THE BIDDER, THE COMMITTEE MAY REJECT THE BID RECEIVED.] Bonds, or a series of bonds, may not be sold if the effective interest rate over

the life of the bonds exceeds 11 percent per year or that rate of interest that is 125 percent of the rate of the Bond Buyer Index of 20 Municipal Bond Average Yields for the week previous to the date of sale of the bonds, whichever is higher. Interest is payable annually or semiannually.

\* Sec. 18. AS 37.15.660 is amended to read:

Sec. 37.15.660. BOND RESOLUTION. The committee is authorized and directed to adopt the bond resolution and prepare all other documents and proceedings necessary for the issuance, sale, and delivery of the bonds or any part or series of them. The bond resolution shall fix the principal amount, denomination, date, maturities, place or places of payment, rights of redemption, if any, terms, form, conditions, and covenants of the bonds or each series of them. The committee shall also determine and provide for the date and manner of sale of the bonds, and shall provide where a [WHETHER THE] notice of sale, if any, is to be published [ELSEWHERE IN ADDITION TO THE PUBLICATION REQUIRED BY AS 37.15.650]."

Renumber remaining bill sections accordingly.

A M E N D M E N T

Offered in the House Special Committee on State Loans

By Sund

TO: HB 519

Page 2, line 2, after "payment":

Delete "and" and insert ",,"

Page 2, line 4, following "Authority":

Insert ", and the anticipated total construction or acquisition cost of the project"

Page 2, lines 5 - 7:

Delete "until the state bond committee has approved the proposal for the issuance of debt under AS 37.15.770."

Insert "unless the public building to be provided has been approved by law. An appropriation for the project does not constitute approval by law for purposes of this section"

Page 3, line 24, following "payment":

Delete "and" and insert ".\_"

Page 3, line 26, following "Authority":

Insert ", and the anticipated total construction or acquisition cost of the project"

Page 3, lines 27 - 28:

STATE OF ALASKA  
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y : STATE CAPITOL  
JUNEAU, ALASKA 99811  
907-465-3800

MEMORANDUM

March 3, 1986

SUBJECT: Notice of Bond Sale - CSHB 519  
(House Special Committee on State Loans)

TO: Representative John Sund  
Attention: John Hartle

FROM: Joyce James *JJ*  
Legislative Counsel

The new text deletes the requirement of notice for international airport revenue bond sales in AS 37.15.450 and toll facility revenue bond sales in AS 37.15.650. Please be advised that AS 37.15.040 still requires notice inviting sealed bids before selling an issue or series of bonds. Because it is not clear that AS 37.15.040 applies only to general obligation bonds, or, if your intent is to allow flexibility in the sale of all bonds, you may want to amend this section also.

If I can be of further assistance please advise.

JJ:csH  
c6/020

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**Briefing Materials**

# **Debt Management Plan**

February, 1986

State of Alaska  
Office of the Governor

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February 1986

DEBT MANAGEMENT PLAN

Governor Bill Sheffield

Through careful management, the State of Alaska has maintained the best credit rating we've ever had. That AA rating, in turn, has allowed local governments across Alaska to keep their investment grade ratings as well. This good credit rating translates into lower property taxes for Alaskans.

With dropping world oil prices, however, Alaska's annual debt payments automatically become a larger part of our expenses.

So, I have asked the 14th Alaska Legislature to approve a package of new laws which, viewed as a whole, will give our young state a plan for comprehensive debt management for the first time. None of these proposed improvements in our laws is flashy or exciting, but as a package they are vital to the continued financial health of Alaska. I encourage you to read the enclosed information.

In short, the debt management plan I have placed before the Alaska Legislature will keep the commitments voters have made to our future, particularly in regards to local school construction. The plan also will guarantee we can continue to incur a reasonable amount of debt for school construction and other improvements in the future, while we preserve our good credit rating.

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## **Debt Management Plan**

*"We've borrowed a considerable amount of money to help build Alaska. We can manage that debt, but it takes planning...lest that debt manage us in the future."*

**Governor Bill Sheffield**

January 14, 1986

## DEBT MANAGEMENT PLAN

### An Overview

Without firm control of public debt the credit rating of all debt issuers in Alaska could be in jeopardy. Right now the State has an AA rating, the highest it's ever had, and all issuers within the State are rated as investment grade. But as oil prices decline, the share of revenues devoted to debt service will become an increasingly heavier burden. The State of Alaska cannot control the price of oil. What we can and must control is the amount of public debt.

Proper stewardship of public debt in Alaska can be accomplished through enactment of legislation covering four distinct needs. Taken separately, each of the four bills brings reasonableness to a different aspect of public debt. But viewed as a whole, this legislation provides a plan for comprehensive debt management for the first time. It assures that all State-supported debt, which is any debt paid from the State general fund, is subject to the control of the State Bond Committee. It is this total of State supported debt which the rating agencies look to in establishing the State's credit rating.

The first bill, House Bill 293, provides for orderly financial management in the event of a default by a municipality of its debt obligations. This legislation protects both issuers of public debt in Alaska and creditors.

House Bill 519 provides for the lease financing of public buildings through the Alaska State Housing Authority, acting as

the Alaska State Building Authority. The bill gives the State Bond Committee control over issuance of this debt as well as debt of the University of Alaska.

House Bill 520 gives the State Bond Committee control over the total amount and maturity of municipal school debt to be reimbursed by the State. The investment community needs to see some control on this fast-growing part of State supported debt.

The fourth bill, House Bill 521 places a limit on the issuance of general obligation debt by municipalities. Even with this limit some municipalities in Alaska will have some of the highest debt ratios in the United States. This legislation does not limit the ability to issue revenue bonds.

As background, Alaska's combined debt (State, municipal and school district) through the issuance of general obligation bonds was \$2.9 billion as of June 30, 1985. That amounts to about \$5,500 per Alaskan. When the amount of G.O. Bond debt for veterans' housing is included in the total, Alaska's per capita debt load is \$7,000.

That debt is manageable, but it takes planning. The State of Alaska has not had a bond authorization since 1980. Yet, the per capita interest on the State's general obligation bond debt is 20 times the national average. State policy limits debt service to five percent of unrestricted revenues, but that ratio is about 10 percent now and could climb to 16 percent by fiscal year 1989.

Again, this is a result of a combination of factors. World oil markets have seriously eroded the revenue Alaska receives from oil and gas production. At the same time, Alaska voters have authorized new debts, including \$325.0 million in school construction bonds so far in fiscal year 1985 alone. That translates into a possible 30 percent increase in State

reimbursement for local school debt--added costs which show up in the State operating budget.

These and other construction commitments are viewed by the nation's financial markets in different ways. On one hand, Alaska's rating agencies know this is a unique state, with enormous potential for generating public revenues and a young, dynamic workforce; on the other hand, the rating agencies look at all of Alaska's debt together, and while they are concerned about how much we borrow, they are more concerned that Alaska have controls on the growth of debt statewide.

To tackle that issue, Governor Sheffield is asking the Legislature to take the following initiatives:

- ° For school construction, honor all existing debt (as of March 31, 1986) under the current 80 percent reimbursement law, and limit the growth of future State reimbursement to \$10 million per year for school construction in the future.
- ° Set standards for school construction to guarantee more schools can be built with the funds available.
- ° Reimburse 100 percent of principal only for bonds authorized after April 1, 1986. This will encourage local districts to shop for the lowest interest rates.
- ° For local governments, limit debt to seven percent of assessed property values.
- ° Designate the Alaska State Housing Authority, acting as the Alaska State Building Authority, as the issuer of lease revenue bonds to finance public buildings. This

change was recommended by a citizens task force appointed by the Governor to study the issue in 1985.

- ° Designate the State Bond Committee as overseer of lease revenue bond issues and the total of State reimbursement for school debt (after March 31, 1986).

## DEBT MANAGEMENT PLAN

### Questions and Answers

QUESTION: Why do we need a debt management package?

ANSWER: The State has achieved a AA rating for its general obligation debt. However, the burden of paying the State's debt becomes heavier as revenues shrink. Now, with oil prices falling, the State must demonstrate to the rating agencies that it has the procedures, checks, and balances necessary to manage its debt obligations, if the State is to retain its high credit rating.

QUESTION: Why does the State have to be concerned about lease-purchase financing, University of Alaska, and municipal school debt? (HE 519, HB 520)

ANSWER: All or a major portion of the payments on this debt come from the State's general fund. These types of debt obligations are referred to as State supported debt. The total of State supported debt and State general obligation debt is the figure that Moody's and Standard and Poor's uses as the measure of the State's debt burden. As of June 30, 1985, this total was \$1,610.3 million, of which less than half, \$752.7 million, was State general obligation debt. Even the State's share of school debt alone, \$753.6 million, exceeded State general obligation debt.

QUESTION: Why should the State seek to limit municipal debt generally? (HB 521)

ANSWER: Because of high levels of State support to municipalities, they may be tempted to issue more debt than they could reasonably expect tax payers to support without the State aid. With State revenues declining, State support for municipalities eventually may suffer budget cuts along with other programs. The State needs to insure that such developments do not create avoidable financial difficulties for municipalities.

QUESTION: Is one reason for the State's concern with municipal debt levels that municipal credit ratings affect the State's ratings? (HB 521)

ANSWER: No. The State's rating is not affected by the rating of any or all municipalities. Even a municipal financial emergency or default would not ordinarily affect the State's rating. However, an emergency or default would be likely to tarnish all Alaska issuers somewhat, much as the New York City default affected all municipal debt issuers and the WPPSS (Whoops) default affected Northwestern U.S. and public power supply issues. This could significantly raise, for some period of time, the interest rates the State and other municipalities have to pay on bonds.

QUESTION: Is the WPPSS (Whoops) syndrome the reason for the introduction of the Municipal Financial Emergency Commission legislation? (HB 293)

ANSWER: It's one reason. However, a more important reason is to establish a mechanism that ensures satisfactory and early resolution of a municipal financial crisis so that provision of public services is impeded. Unlike nuclear power plants, municipalities cannot be mothballed. A mechanism for

satisfactory and early resolution also provides a valuable assurance to bond buyers.

QUESTION: What is the State's debt capacity and how is it determined?

ANSWER: In recent years, the State's debt policy has been that the State had capacity to issue additional general obligation debt if the debt service on the new bonds, combined with the debt service on outstanding bonds, would not exceed 5 percent of the State's unrestricted revenues. 5 percent is a level which few states with a AA credit rating exceed.

QUESTION: What is the current level of debt service relative to unrestricted revenues?

ANSWER: Considering only State general obligation bonds, the level for fiscal year 1987 is 5.7%. However, inclusion of all State supported debt which the rating agencies look at boosts the percentage to 11.5%. Falling State revenues will push the debt service to a level of 16.4% of revenues in fiscal year 1989.

QUESTION: Does this mean the State can't issue any more debt in the near future?

ANSWER: No. In the first place, the State could issue additional debt if it were willing to sacrifice its credit rating and that of State agencies and municipalities, whose ratings generally are tied to the State's. More to the point, additional issuance in modest amounts with a AA rating might be possible if the rating agencies were assured total debt obligations will remain limited. The limits and controls in Governor Sheffield's debt management package are an essential step in providing these assurances.

QUESTION: What happens to the State's reimbursement of municipal school debt that was authorized last fall? (HB 520)

ANSWER: That debt and all municipal school debt authorized before April 1, 1986, will be grandfathered under current law. This means State reimbursement for that debt will be under the current formula of 80% of principal and interest.

QUESTION: Does the Governor's budget contain the funds necessary for the State to reimburse the grandfathered bonds? (HB 520)

ANSWER: The amount required is contained in the Department of Education's fiscal note for HB 520. The estimated amount required for fiscal year 1987 is \$43 million. The Governor plans to support the \$43 million appropriation if the legislation is passed.

QUESTION: How much additional school debt could be reimbursed by the State under HB 520?

ANSWER: HB 520 would permit State reimbursement of \$10 million per year for debt authorized after March 31, 1986. Since the legislation establishes reimbursement at 100% of principal and requires the debt to have a 10 year term and constant principal payments, the \$10 million State reimbursement could support as much as \$100 million initially.

QUESTION: How does 100% of principal compare to 80% of principal and interest? (HB 520)

ANSWER: It depends on how much the interest is in relation to principal, which depends on the interest rates at the time the bonds are sold. At current interest rates, 100% of principal is approximately 89% of the current formula for reimbursement (80% of principal and interest). Thus, the new formula would provide

reimbursement at a level about 11% less than current reimbursement. 100% of principal would represent approximately 71% of total principal and interest.

QUESTION: How will it be decided what municipal school debt receives reimbursement if the \$10 million limit otherwise would be exceeded? (HB 520)

ANSWER: The Department of Education will establish a priority list based on criteria specified by law. Portions of school construction project costs also may be deemed ineligible for reimbursement based on design standards and regional cost differentials determined by the Department of Transportation and Public Facilities. Financing costs will not be eligible for reimbursement. State reimbursement will be reduced further by the interest earned on bond proceeds, except arbitrage which would have to be paid to the federal government under pending congressional legislation. These limitations will spread increasingly scarce State dollars further and enable the State to support more schools under the \$10 million limit.

QUESTION: Why is the limit set at only \$10 million? (HB 520)

ANSWER: There has been an explosion of authorization of municipal school debt. Between October 1, 1985, and March 31, 1986, total municipal school debt receiving voter approval is expected to exceed \$350 million. This would represent an increase of almost 50% in six months over the \$739 million school debt outstanding as of June 30, 1985. It is this explosion which will propel State payments for debt service to over 16% of State revenues by fiscal year 1989.

QUESTION: Can the limit be revised? (HB 520)

ANSWER: Certainly the limit could be amended by law in future legislative sessions. A report to the 1988 session of the legislature by the Department of Education on school construction needs is required in section 17 of HB 520. This would be an appropriate time to consider a revision. As an alternative, the State bond committee may revise the limit at any time in light of State credit conditions, school requirements, or any other reason.

QUESTION: Will the State Bond Committee decide which schools receive funding? (HB 520)

ANSWER: No. This will be determined solely by the Department of Education in establishing the priority list. The State Bond Committee will be concerned only with the credit implications for the State of the total amount of reimbursement to be paid.

QUESTION: What is lease-purchase financing? (HB 519)

ANSWER: Lease-purchase financing consists of debt obligations issued by a private developer or State agency to finance the construction or acquisition of facilities which are leased to the State. The lease payments made by the State are in an amount and duration which is equal to the principal and interest payments on the debt obligation. The debt obligation may take the form of a revenue bond or a certificate of participation in rent (CP or CCF as they are sometimes called). At the conclusion of the lease, title to the facility generally passes to the State.

QUESTION: Why is the Alaska State Housing Authority (ASHA) designated as the issuer of all lease-purchase financing for State facilities? (HE 519)

ANSWER: ASHA has previously issued lease revenue bonds for State facilities and is the current lessor of these facilities to the State. The designation of a single agency which has experience

and technical expertise in this area will improve accountability, efficiency, and control of these types of financing.

QUESTION: Why would ASHA be issuing debt under the name of the Alaska State Building Authority? (HB 519)

ANSWER: This name change, applicable only to the financing of public buildings, will improve the marketability of the debt. The alternate name avoids confusion about the issuer and debt since most state housing authorities issue debt only for the provision of low and moderate income housing. The name change helps recognize the higher credit standing accorded debt which is secured by payments from a state government for leases rather than from private individuals for rent.

QUESTION: What became of the State Office Complex Financing Task Force?

ANSWER: The Task Force, a body of executive branch officials, two legislators, and five members of the public with substantial financing experience, held hearings in the fall of 1985 and produced a report to the Governor which is available from the Treasury Division of the Department of Revenue. HB 519 implements the recommendations contained in that report.

QUESTION: Will ASHA be deciding what public buildings will be built or acquired? (HB 519)

ANSWER: No. Each branch of government and the University of Alaska would decide what facilities would be built or acquired. The facilities would have to meet the requirements and specifications of each branch or the University before the branch or University could be expected to execute the lease. No financing can occur without an executed lease.

QUESTION: Does this mean each branch or the University can enter into lease-purchase financings without legislative approval or approval by law? (HB 519)

ANSWER: Yes. However, the annual lease payments are subject to appropriation by the legislature as a matter of constitutional law. HB 519 requires lease-purchase agreements to state this fact so that it is clear to all parties. Because lease payments are subject to appropriation, lease-purchase financing is not debt from the standpoint of the State Constitution.

QUESTION: Could legislative approval or approval by law be required of lease-purchase financing by statute? (HB 519)

ANSWER: Alaska Supreme Court decisions indicate that this probably would violate the separation of powers doctrine and be unconstitutional. Legal questions of this caliber can easily derail debt financings because bond buyers will not purchase debt with such uncertainties about it. To achieve the same purpose, Governor Sheffield has pledged to seek legislative approval of any executive branch lease-purchase financings. The other branches and University might be expected to do the same.

QUESTION: Why does the State Bond Committee need to approve lease-purchase financings? (HB 519)

ANSWER: Lease-purchase financing is paid from the State general fund and, accordingly, is added into the State's debt burden by the credit rating agencies. Because of this, the State Bond Committee needs to control aspects of such financings which can affect the State's credit standing. This can include such things as the maturities of the debt, need for insurance, or the timing of the sale. The State Bond Committee will not be concerned with project justification or specification. This is the same manner

in which the Committee functions with respect to State general obligation debt.

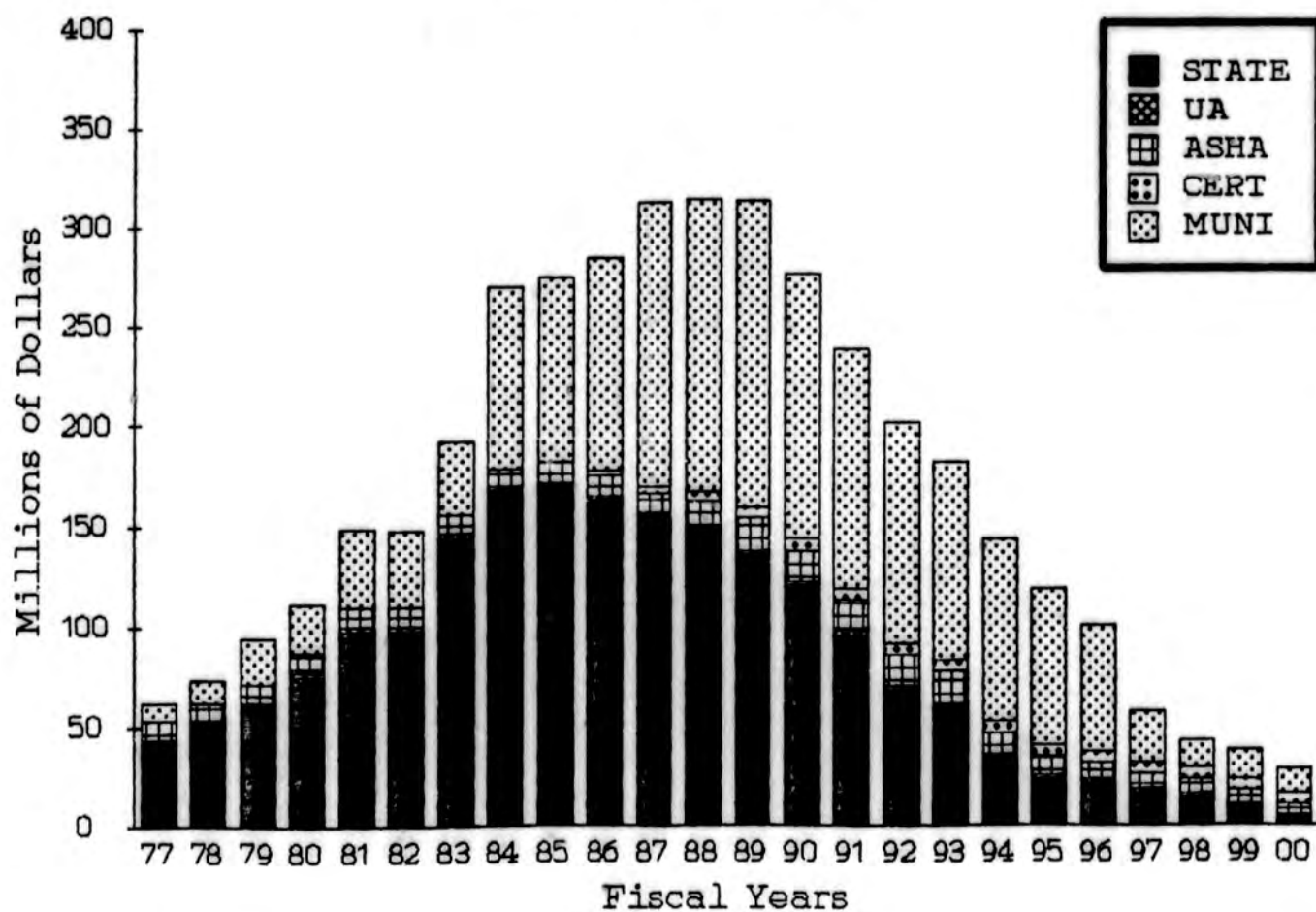
QUESTION: What municipalities would be forestalled from issuing additional debt under HB 521?

ANSWER: The North Slope Borough and the city of Wrangell currently have general obligation debt exceeding 7% of the full value of their property tax base. They would not be able to issue additional debt until their tax base has increased sufficiently or outstanding debt is paid down. The North Slope Borough should be able to issue additional debt again within two years. The city of Nenana would not be limited by the cap due to the exemption in HB 521 for self-supporting debt which is issued as a general obligation bond. Issuance of revenue bonds and refunding bonds are not limited by HB 521.

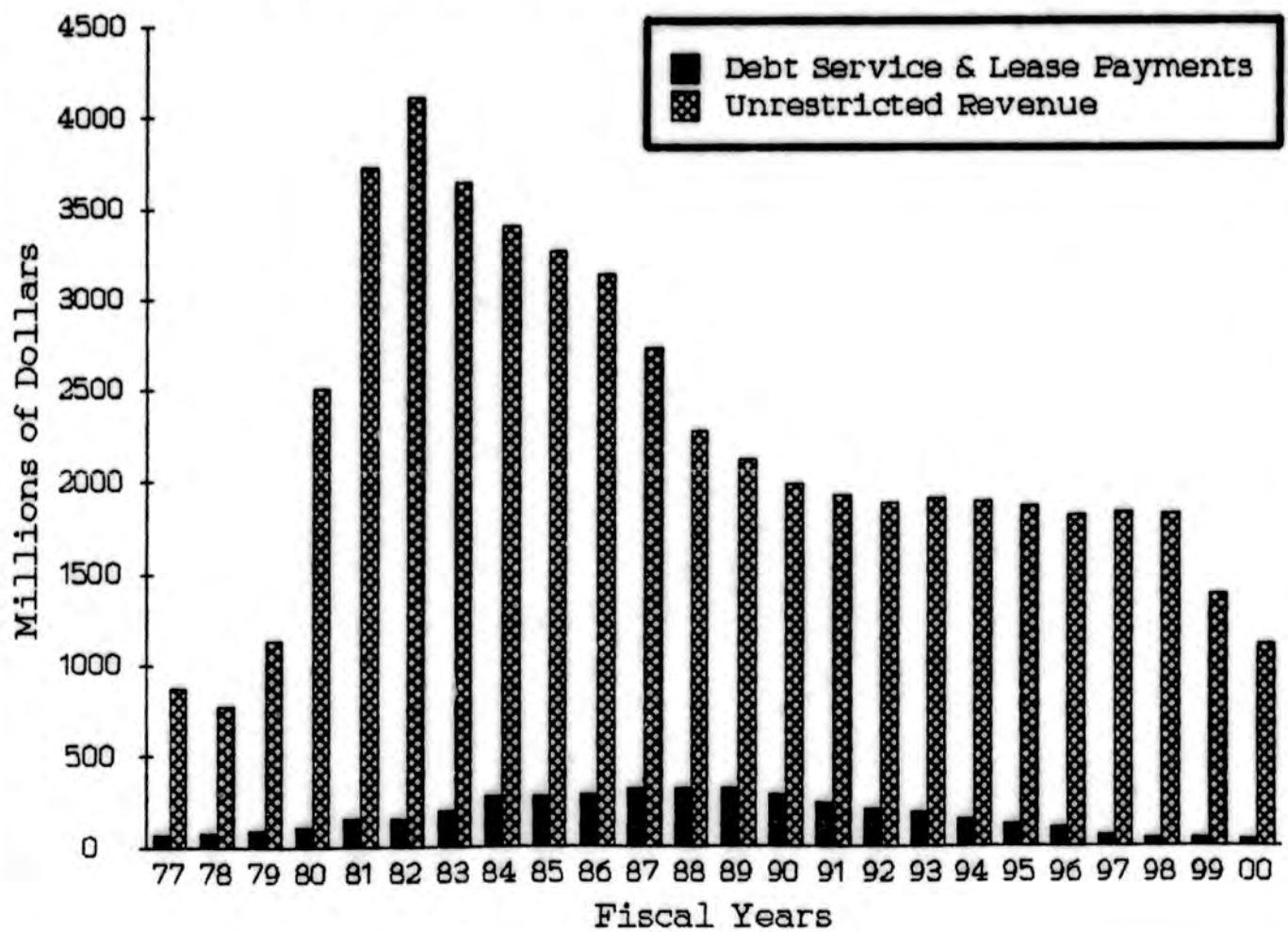
QUESTION: Why is the limit set at 7%? (HB 521)

ANSWER: National medians for municipal general obligation debt are in the range of 3% to 4% of full value. A higher level is appropriate for Alaska because the economy is still developing, with spurts of rapid growth in particular localities, if not statewide. However, a level significantly above 7% would not be an effective limit or provide the credit markets any comfort that Alaska is managing its debt.

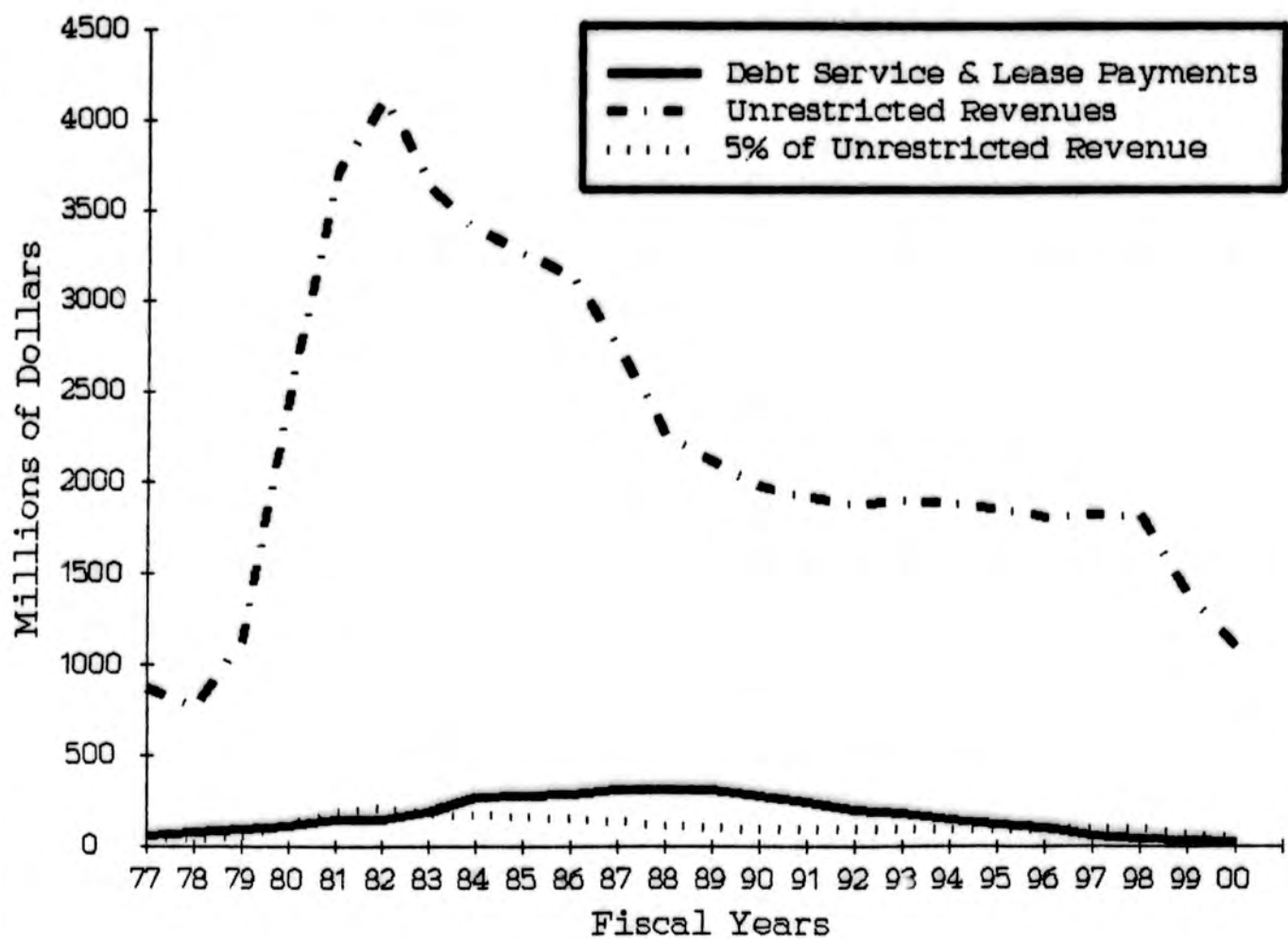
# Total Debt Service & Lease Payments (January 28, 1986)



## Debt Service vs. Unrestricted Revenue



### Debt Service vs. 5% Revenue



**Total Debt Service & Lease Payments**  
(\$ Millions)

| <u>Fiscal<br/>Year</u> | <u>State</u> | <u>UA</u> | <u>ASHA</u> | <u>Certificates<br/>of Participation<br/>(Cert)</u> | <u>School<br/>Debt<br/>(Muni)</u> |
|------------------------|--------------|-----------|-------------|-----------------------------------------------------|-----------------------------------|
| 77                     | 41.9         | 1.5       | 9.9         | 0                                                   | 9.0                               |
| 78                     | 50.0         | 1.7       | 10.1        | 0                                                   | 11.4                              |
| 79                     | 60.0         | 1.7       | 10.1        | 0                                                   | 22.3                              |
| 80                     | 75.1         | 1.8       | 10.1        | 0                                                   | 24.1                              |
| 81                     | 97.6         | 2.2       | 10.0        | 0                                                   | 38.4                              |
| 82                     | 97.5         | 2.3       | 10.0        | 0                                                   | 38.3                              |
| 83                     | 143.6        | 2.3       | 9.9         | 0                                                   | 36.2                              |
| 84                     | 166.3        | 2.0       | 9.9         | 0                                                   | 91.2                              |
| 85                     | 169.5        | 2.0       | 9.9         | .1                                                  | 92.8                              |
| 86                     | 163.2        | 1.8       | 9.9         | 3.0                                                 | 105.3                             |
| 87                     | 154.9        | 1.8       | 9.5         | 3.0                                                 | 143.0                             |
| 88                     | 147.9        | 1.7       | 12.5        | 5.1                                                 | 146.0                             |
| 89                     | 135.5        | 1.8       | 16.5        | 5.1                                                 | 154.0                             |
| 90                     | 120.3        | 1.7       | 15.5        | 6.0                                                 | 132.0                             |
| 91                     | 95.5         | 1.7       | 15.5        | 6.0                                                 | 119.0                             |
| 92                     | 68.2         | 1.7       | 15.5        | 6.0                                                 | 110.0                             |
| 93                     | 59.7         | 1.7       | 15.5        | 5.9                                                 | 99.0                              |
| 94                     | 33.9         | 1.5       | 11.1        | 5.9                                                 | 91.0                              |
| 95                     | 23.1         | 1.5       | 9.5         | 5.9                                                 | 79.0                              |
| 96                     | 21.5         | 1.5       | 8.0         | 5.9                                                 | 63.0                              |
| 97                     | 16.7         | 1.5       | 7.0         | 5.9                                                 | 26.0                              |
| 98                     | 14.4         | 1.5       | 7.0         | 5.9                                                 | 14.0                              |
| 99                     | 9.0          | 1.5       | 7.0         | 5.9                                                 | 14.0                              |
| 00                     | 2.6          | 1.5       | 6.0         | 5.9                                                 | 12.0                              |

Debt Service vs. Unrestricted Revenue  
(\$ Millions)

| <u>Fiscal<br/>Year</u> | <u>Total Debt<br/>Service</u> | <u>Unrestricted<br/>Revenue</u> | <u>Percentage</u> |
|------------------------|-------------------------------|---------------------------------|-------------------|
| 77                     | 62.4                          | 874.3                           | 7.1%              |
| 78                     | 73.3                          | 764.9                           | 9.6               |
| 79                     | 94.1                          | 1133.0                          | 8.3               |
| 80                     | 111.0                         | 2501.2                          | 4.4               |
| 81                     | 148.2                         | 3718.2                          | 4.0               |
| 82                     | 148.1                         | 4108.4                          | 3.6               |
| 83                     | 192.0                         | 3631.0                          | 5.3               |
| 84                     | 269.5                         | 3390.1                          | 7.9               |
| 85                     | 274.3                         | 3260.0                          | 8.4               |
| 86                     | 283.2                         | 3124.6                          | 9.1               |
| 87                     | 312.0                         | 2718.8                          | 11.5              |
| 88                     | 313.0                         | 2257.4                          | 13.9              |
| 89                     | 313.0                         | 2109.1                          | 14.8              |
| 90                     | 276.0                         | 1980.4                          | 13.9              |
| 91                     | 238.0                         | 1915.5                          | 12.4              |
| 92                     | 201.0                         | 1874.6                          | 10.7              |
| 93                     | 182.0                         | 1903.7                          | 9.6               |
| 94                     | 143.0                         | 1881.8                          | 7.6               |
| 95                     | 119.0                         | 1854.9                          | 6.4               |
| 96                     | 100.0                         | 1808.2                          | 5.5               |
| 97                     | 57.0                          | 1820.7                          | 3.1               |
| 98                     | 42.0                          | 1812.5                          | 2.3               |
| 99                     | 37.0                          | 1378.1                          | 2.7               |
| 00                     | 27.0                          | 1106.0                          | 2.4               |

# DEPARTMENT OF COMMUNITY AND REGIONAL AFFAIRS

## SEVEN PERCENT CAP

| Borough           | FULL<br>VALUE       | G. O.<br>DEBT      | 7% OF<br>FULL VALUE | PERCENT<br>OF G.O.<br>DEBT/CAP | CURRENT<br>PERCENT<br>DEBT |
|-------------------|---------------------|--------------------|---------------------|--------------------------------|----------------------------|
| Anchorage         | \$15,755,411,000.00 | \$358,799,900.00   | \$1,102,878,770.00  | 32.53%                         | 2.28%                      |
| Bristol Bay       | \$101,798,800.00    | \$3,535,000.00     | \$7,125,916.00      | 49.61%                         | 3.47%                      |
| Fairbanks         | \$4,210,997,700.00  | \$90,928,500.00    | \$294,769,839.00    | 30.85%                         | 2.16%                      |
| Haines            | \$93,945,500.00     | \$1,300,000.00     | \$6,576,185.00      | 19.77%                         | 1.38%                      |
| Juneau            | \$1,613,388,900.00  | \$47,651,000.00    | \$112,937,223.00    | 42.19%                         | 2.95%                      |
| Kenai Peninsula   | \$3,290,219,200.00  | \$137,929,000.00   | \$230,315,344.00    | 59.89%                         | 4.19%                      |
| Ketchikan Gateway | \$675,985,100.00    | \$31,930,000.00    | \$47,318,957.00     | 67.48%                         | 4.72%                      |
| Kodiak            | \$572,370,700.00    | \$28,270,000.00    | \$40,065,949.00     | 70.56%                         | 4.94%                      |
| Mat-Su            | \$2,367,406,200.00  | \$112,208,000.00   | \$165,718,434.00    | 67.71%                         | 4.74%                      |
| North Slope       | \$12,876,786,900.00 | \$1,155,680,000.00 | \$901,375,083.00    | 128.21%                        | 8.97%                      |
| Sitka             | \$396,227,900.00    | \$12,400,000.00    | \$27,735,953.00     | 44.71%                         | 3.13%                      |
| Total Boroughs    | \$41,954,537,900.00 | \$1,980,631,400.00 | \$2,936,817,653.00  | 67.44%                         | 4.72%                      |

## CITIES

|                |                    |                 |                  |         |        |
|----------------|--------------------|-----------------|------------------|---------|--------|
| Bethel         | \$182,296,900.00   | \$556,500.00    | \$12,760,783.00  | 4.36%   | 0.31%  |
| Cordova        | \$120,673,000.00   | \$0.00          | \$8,447,110.00   | 0.00%   | 0.00%  |
| Craig          | \$34,707,400.00    | \$0.00          | \$2,429,518.00   | 0.00%   | 0.00%  |
| Delta Junction | \$30,870,500       | \$0             | \$2,160,935.00   | 0.00%   | 0.00%  |
| Dillingham     | \$94,669,900.00    | \$0.00          | \$6,626,893.00   | 0.00%   | 0.00%  |
| Eagle          | \$9,104,500.00     | \$0.00          | \$637,315.00     | 0.00%   | 0.00%  |
| Galena         | \$19,149,500.00    | \$900,000.00    | \$1,340,465.00   | 67.14%  | 4.70%  |
| Hoonah         | \$27,845,200.00    | \$0.00          | \$1,949,164.00   | 0.00%   | 0.00%  |
| Hydaburg       | \$12,688,900.00    | \$0.00          | \$888,223.00     | 0.00%   | 0.00%  |
| Kake           | \$11,608,000.00    | \$0.00          | \$812,560.00     | 0.00%   | 0.00%  |
| King Cove      | \$23,230,800.00    | \$0.00          | \$1,626,156.00   | 0.00%   | 0.00%  |
| Klawock        | \$5,563,000.00     | \$0.00          | \$389,410.00     | 0.00%   | 0.00%  |
| Kotzebue       | \$93,245,100.00    | \$0.00          | \$6,527,157.00   | 0.00%   | 0.00%  |
| Nenana         | \$12,881,500.00    | \$2,717,300.00  | \$901,705.00     | 301.35% | 21.09% |
| Nome           | \$116,712,900.00   | \$2,161,200.00  | \$8,169,903.00   | 26.45%  | 1.85%  |
| Pelican        | \$10,155,400.00    | \$0.00          | \$710,878.00     | 0.00%   | 0.00%  |
| Petersburg     | \$161,219,300.00   | \$6,195,000.00  | \$11,285,351.00  | 54.89%  | 3.84%  |
| Sand Point     | \$71,086,800.00    | \$0.00          | \$4,976,076.00   | 0.00%   | 0.00%  |
| Skagway        | \$58,447,100.00    | \$820,000.00    | \$4,091,297.00   | 20.04%  | 1.40%  |
| St. Mary's     | \$4,239,400.00     | \$0.00          | \$296,758.00     | 0.00%   | 0.00%  |
| Tanana         | \$11,195,400.00    | \$0.00          | \$783,678.00     | 0.00%   | 0.00%  |
| Unalakleet     | \$19,714,500       | \$0             | \$1,380,015.00   | 0.00%   | 0.00%  |
| Unalaska       | \$105,309,400.00   | \$3,299,000.00  | \$7,371,658.00   | 44.75%  | 3.13%  |
| Valdez         | \$1,740,431,900.00 | \$75,833,000.00 | \$121,830,233.00 | 62.24%  | 4.36%  |
| Whittier       | \$19,419,200.00    | \$0.00          | \$1,359,344.00   | 0.00%   | 0.00%  |
| Wrangell       | \$111,757,000.00   | \$10,750,000.00 | \$7,822,990.00   | 137.42% | 9.62%  |
| Yakutat        | \$17,679,400.00    | \$235,200.00    | \$1,237,558.00   | 19.01%  | 1.33%  |

TOTAL CITIES \$3,125,901,900.00 \$103,467,200.00 \$218,813,133.00 47.29% 3.31%

STATE \$48,915,237,900.00 \$816,100,000.00 \$3,424,066,653.00 23.83% 1.67%

Total Boroughs \$41,954,537,900.00 \$1,980,631,400.00 \$2,936,817,653.00 67.44% 4.72%

BILL SHEFFIELD  
GOVERNOR



STATE OF ALASKA  
OFFICE OF THE GOVERNOR  
JUNEAU

January 27, 1986

The Honorable Ben Grussendorf  
Speaker of the House  
Alaska State Legislature  
P.O. Box V  
Juneau, AK 99811

Dear Representative Grussendorf:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting two bills that provide for improved state debt management. One relates to control of state-supported school debt, the other to lease-financing transactions by the various branches of government.

These two bills are each cornerstones of a comprehensive proposal designed to monitor and control more effectively the issuance of debt instruments that harbor substantial credit implications for the state. (Some citations in each bill are to provisions in the other bill. The two work together.) Alaska's remarkable wealth has facilitated tremendous economic growth in all areas of the state's economy and at all levels of government. Many of these worthy projects and programs have been funded directly by the state. In other instances, however, funding has been obtained through the issuance of debt instruments, either by the state or by local governments. Where government activities are funded through the issuance of debt, maintenance of a favorable credit rating for the state assumes critical importance. Simply stated, actions detrimental to the state's credit standing are injurious to the Alaska economy.

Unlike past years, we approach an era where the state's vast wealth is not, in and of itself, sufficient to support a favorable credit rating. In my discussions with representatives of the national financial community, the constant theme stated was the need for Alaska to demonstrate its ability to effectively manage its resources. One critical

attribute of responsible state management is an effective debt management program.

Any discussion of maintenance of a favorable credit rating for the state must reflect the broad array of financial obligations encompassed within the term "state-supported debt." It is critical to bear in mind that state general obligation bonds are but one type of debt instrument that affects the state's credit standing. The financial community also looks to other recurring, long-term financial obligations which are paid from the general fund, such as those which arise under a lease-financing agreement. In a similar vein, the state's commitment to support school debt issued by municipalities is a type of long-term financial commitment with substantial credit implications.

Debt management concerns must further reflect the impact of excessive or improvident municipal debt issuance on the state's credit standing. I initially observe that responsible state debt management policies must necessarily include a degree of state supervision of municipal debt issuance. While I am, of course, cognizant and supportive of the prerogatives of local government, problems with municipal debt issuance inevitably burden the state as well. For that reason, I previously introduced a bill that relates directly to the issuance of municipal debt. Last session I proposed the establishment of a Municipal Financial Emergency Commission to assist municipalities that have defaulted in bonded indebtedness (HB 293). I am also proposing legislation that imposes reasonable limitations on a municipality's authority to issue general obligation debt. As noted in the transmittal letters accompanying each of those bills, responsible state management of municipal debt is necessary to assure the continued investment community support of and confidence in municipal and state debt issues.

The two bills attached to this letter today are intended to assure proper state oversight before the state enters into the type of recurring, long-term financial commitments that might have an impact on the state's credit standing. Where the state issues general obligation bonds, the constitutional requirement of voter approval offers an appropriate opportunity for the electorate and for elected officials to gauge any adverse effect that issuance of the debt may have on the state. Under present law, however, neither the statutory reimbursement formula for school debt nor the unrestricted authority to enter lease-financing agreements

offers comparable mechanisms to assure that state credit implications are adequately addressed. As the decline of available revenues further exacerbates the sensitivity of the state's credit standing, it is of critical importance to assure that each project is viewed not only on its own merits but also with consideration of how the issuance of additional state-supported debt will affect broader state interests. I believe that these two bills offer a responsible way of meeting the needs of the state to obtain office facilities and of municipalities to provide necessary educational facilities -- a way that best preserves the state's favorable credit standing.

I.

The shorter bill implements the recommendations of the State Office Complex Financing Task Force, a body whose membership brought together the views of executive-branch officials, two legislators, and several members of the public with substantial financing expertise. The task force conducted extensive hearings to consider the most appropriate method to provide state office facilities in the most cost-efficient manner possible. After review of the available financing alternatives, the task force recommended the enactment of legislation to facilitate the acquisition of state office facilities through lease-financing agreements. The bill designates the Alaska State Housing Authority as the appropriate financing entity, but provides that when the authority issues debt for this purpose, it do so as the Alaska State Building Authority. The name change is intended to prevent confusion in national financing markets.

Sections 1, 6, 7 and 8 provide that the university and each branch of government, respectively, have legal authority to enter into lease-financing agreements with the Alaska State Housing Authority acting as the Alaska State Building Authority. The state has previously executed lease-financing agreements under existing lease authority, and these sections are thus intended to remove any ambiguities regarding the legal authority to enter into lease-financing agreements. The cost of building acquisition or development would be provided by the sale of revenue bonds by the Alaska State Building Authority. In all instances, a lease-financing agreement preserves legislative prerogatives through the requirement that lease payments be subject to annual appropriation.

While the bill recognizes the desirability of the lease-financing technique, the bill also imposes effective debt