

Deborah A. Dyson, Legislative Analyst
Deborah.Dyson@house.mn

Revised: January 2015

Capital Investment and State Bonding

One of the ways the state pays for capital improvement projects is to borrow money by issuing bonds, which are promises to repay the money borrowed at a specified time and interest rate. General obligation (G.O.) bonds are the primary type of bonds issued and they are backed by the full faith, credit, and taxing powers of the state. The state constitution limits the purposes for which G.O. bonds may be issued and requires certain procedures. The state also uses other types of debt financing for capital projects as well as direct spending from the general fund. This information brief describes the law governing state bonding and also compares local bonding authority to state bonding authority.

General Obligation (G.O.) Bonds.....	2
All State G.O. Bonds.....	2
Bonds to Acquire and Better Public Land and Buildings.....	2
Other Constitutionally Authorized Uses of G.O. Bonds.....	3
Other Capital Project Funding Sources.....	4
Capital Investment Guidelines.....	6
State Debt Capacity Forecast.....	6
State Bond Ratings.....	6
Capital Appropriation Cancellations.....	7
Role of Bond Counsel.....	7
Origination Clause.....	7
Use of State Bond-Financed Property.....	8
Nonstate Match Requirements.....	8
Other Topics Relating to State Bond-Financed Projects.....	9
Comparison of State Bonding and Local Bonding.....	10

Copies of this publication may be obtained by calling 651-296-6753. This document can be made available in alternative formats for people with disabilities by calling 651-296-6753 or the Minnesota State Relay Service at 711 or 1-800-627-3529 (TTY). Many House Research Department publications are also available on the Internet at: www.house.mn/hrd/.

specific capital project is. An option to buy real property is an intangible asset and not eligible for bonding.

Publicly owned. Bonds issued under the capital improvements provision may only be for publicly owned projects, whether state or local. "Publicly owned" includes projects of the Minnesota Historical Society, but not projects owned by public radio, public TV, Indian tribes, the federal government, or private sewage systems even if they will serve the public.

Three-fifths vote. A law to authorize the issuance of state G.O. bonds for capital improvements must be enacted with at least a three-fifths vote of the House and the Senate. Minn. Const. art. XI, § 5, para. (a). Absent any court decision to the contrary, a law to amend an authorization or appropriation of bond proceeds requires the same super-majority vote. A law to *repeal* an authorization requires only a simple majority vote.

Other Constitutionally Authorized Uses of G.O. Bonds

Under other provisions of the state constitution (included since the dates indicated), state G.O. bond proceeds may also be used:

- ▶ to repel invasion or suppress insurrection (1857);
- ▶ to borrow temporarily through certificates of indebtedness (1962);
- ▶ to refund outstanding bonds of the state or its agencies (1962);
- ▶ to establish and maintain highways subject to constitutional limitations on highway bonds (1924) (see "Trunk highway bonds" below);
- ▶ to promote forestation and prevent and abate forest fires (1924);
- ▶ to construct, improve, and operate airports and other air navigation facilities (1944);
- ▶ to develop the state's agricultural resources by extending credit on real estate (1922);
- ▶ to improve and rehabilitate public or private railroad rights-of-way and other rail facilities up to \$200 million par value (1982); and
- ▶ as otherwise authorized in the constitution.

Minn. Const. art. XI, § 5, paras. (b) to (j).

Not all of these purposes are capital in nature, and the constitution does not require a three-fifths vote to authorize issuance of bonds for these purposes.

Trunk highway bonds. Bonds issued for trunk highways are G.O. bonds, but payable from the trunk highway fund (with a statewide property tax as backup). Trunk highway bond proceeds pay for state-owned capital projects that are part of, or functionally related to, the construction, improvement, or maintenance of the state trunk highway system. Trunk highway projects may not be paid for with G.O. bond proceeds that are payable in the first instance from the general fund. Minn. Const. art. XIV, § 11; art. XI, § 5, para. (e).¹

¹ See also "Minnesota Management and Budget Guidance Relating to Permitted Uses of State Trunk Highway Bond Proceeds," Minnesota Management and Budget, memo, December 8, 2008.

State appropriation bonds. Similar to agency appropriation bonds, the legislature has authorized state appropriation bonds issued through MMB and payable from a standing appropriation. In 2011, the legislature authorized issuing state appropriation bonds to refund tobacco revenue bonds issued to pay the debt service on G.O. debt due during the biennium.⁴ The attorney general had questioned the constitutionality of state appropriation bonds and so the law required the state to bring a lawsuit to test their validity. The state supreme court held that appropriation bonds are not “public debt” within the meaning of the constitution and the state’s full faith, credit, and taxing powers are not committed to their repayment. Therefore, the state may issue appropriation bonds, and those bonds are not subject to the limitations in the state constitution that apply to general obligation bonds. *Schowalter v. State*, 822 N.W.2d 292 (Minn. 2012). The 2012 Legislature authorized state appropriation bonds to help pay for a new Vikings stadium. Minn. Stat. § 16A.965. As with the agency appropriation bonds, the appropriations to pay debt service may be reduced or repealed entirely and are subject to unallotment.

Real estate lease-purchase. The legislature has authorized the state in a few instances to use lease revenue bonds or certificates of participation—lease revenue bonds to acquire and improve real estate. The glossary for the Municipal Securities Rulemaking Board defines a certificate of participation as follows: “An instrument evidencing a pro rata share in a specific pledged revenue stream, usually lease payments by the issuer that are typically subject to annual appropriation. The certificate generally entitles the holder to receive a share, or participation, in the payments from a particular project. The payments are passed through the lessor to the certificate holders. The lessor typically assigns the lease and the payments to a trustee, which then distributes the payments to the certificate holders.”⁵ In 1999, the legislature authorized a lease-purchase agreement with the city of Bemidji to build a Bureau of Criminal Apprehension satellite office.⁶ In 2002, the legislature authorized the Commissioner of Administration to enter into a long-term lease purchase agreement with the Saint Paul Port Authority to develop office facilities for the departments of health, agriculture, and human services.⁷ In 2013, the legislature authorized the state to issue certificates of participation-lease revenue bonds to pay for the new Senate office building.⁸

Master lease program. State statute authorized MMB to issue certificates of participation relative to a master lease in order to acquire capital equipment for state agencies. Minn. Stat. § 16A.85. The statute states that the leases are not debt and payment is subject to appropriations for payment on the leases. It is a way for the state to borrow for capital equipment.

⁴ Laws 2011, 1st spec. sess., ch. 7, art. 11.

⁵ <http://www.msrb.org/glossary.aspx>

⁶ Laws 1999, ch. 216, art. 2, § 26.

⁷ Laws 2002, ch. 393, § 13, subds. 7, 8.

⁸ Laws 2013, ch. 143, art. 12, § 21.

state's rating slightly to Aa1. According to Moody's, issues rated Aa demonstrate very strong creditworthiness and the "1" indicates that the bonds rank at the higher end of the Aa category. In July and September 2011, the other two rating agencies downgraded the state's rating from AAA to AA+. Both rating agencies pointed to what they viewed as the state's failure to address the structural imbalance and an ongoing reliance on nonrecurring measures to balance its budget. The ratings remained at Aa1, AA+, and AA+ for the August 12, 2014, bond sale.

As each bond sale statement says, these ratings are subject to change or withdrawal by the rating agencies at any time.

Capital Appropriation Cancellations

By January 1 of each odd-numbered year, MMB must report to the chairs of the Senate Finance Committee, the House Ways and Means Committee, and the House Capital Investment Committee on the cancellation of capital projects authorized more than four years before January 1 and financed with general fund money, appropriation bond proceeds, or general obligation bond proceeds. The unobligated, unencumbered, or unspent project balances included in the report are canceled effective July 1 unless specifically reauthorized by law. Minn. Stat. § 16A.642.

Role of Bond Counsel

While there is some guidance from the courts on the constitutional requirements for and limitations on state bonding, bond questions rarely reach the courts. In order for bonds to be sold, attorneys for the state—called bond counsel—are asked to provide an unqualified legal opinion approving the issuance of the bonds. Without a good opinion, no one will buy the bonds. Thus, the primary guidance the legislature has on what is "bondable" and how the law must be written comes from bond counsel. The state attorney general is bond counsel and also retains private legal counsel to serve as bond counsel.

Under state statute, bond counsel is paid based on time, knowledge, and experience but cannot be paid a fee based primarily on a percentage of the amount of the bonds sold. Minn. Stat. § 481.21.

Origination Clause

Among issues bond counsel considers is whether the law authorizing the issuance of the bonds was properly enacted. Although there is no Minnesota court decision on point, because the state constitution requires imposition of a statewide property tax in the amount needed to repay any state general obligation bonds, bond counsel has advised that it would not be unreasonable for a court to determine that a bill containing a bond sale authorization is a bill to raise revenue, which must originate in the House of Representatives. Minn. Const. art. XI, § 7; Minn. Stat. § 16A.641, subs. 1, 10, 11, and 12. Because appropriations of bond proceeds, and any changes to bond proceed appropriations, could be viewed as directly related to the bond sale authorization, bond

the cost of each project and the remaining costs must be paid from university sources. For MnSCU, the legislature typically appropriates the full cost of a project and then the MnSCU board of trustees pays the debt service on one-third the principal amount of state bonds issued to finance the projects.

Other Topics Relating to State Bond-Financed Projects

Predesign review and building requirements. The State Architect's Office (within the Department of Administration) must review the predesign documents of most capital projects before design work can begin. Minn. Stat. § 16B.335. In addition, capital funding recipients must not go on to prepare final plans and specifications for any construction, major remodeling, or land acquisition until the agency that will use the project has submitted project information to the legislature for comment.¹² Also, to ensure that all new state buildings and major renovations of state buildings initially exceed the state energy code by at least 30 percent, all state building capital projects paid for with G.O. bond proceeds must comply with sustainable building design guidelines developed by the Departments of Administration and Commerce.¹³ Minn. Stat. § 16B.325.

Percent for art. Up to 1 percent of the total appropriation for a state building project of \$500,000 or more may be used to acquire works of art for the building. The art must be accessible to the public. The program is administered by the Minnesota State Arts Board in cooperation with the Department of Administration. If the amount available for art is not used for the state building project, it is available to the board to acquire art for state buildings existing before 1983. The percent for art is not available for landscaping or state correctional facilities. Minn. Stat. § 16B.35.

Use of bond funds for state agency staff costs. MMB adopted a formal policy, developed in consultation with bond counsel, governing use of state bond funds to pay the capital costs of staff directly attributable to the capital project or projects funded with bond funds.¹⁴ MMB adopted the formal, written policy in response to the December 2008 internal control and compliance audit of G.O. bond expenditures by the legislative auditor. The policy requires specific authority in law before bond proceeds may be used to pay agency staff costs and, even with authority granted, it still strongly encourages state agencies to charge the time of state employees working on capital projects to nonbond funding sources because of the undesirable practice of amortizing salary costs over the 20-year life of state G.O. bonds. MMB "must report by January 15 of each year to the chairs and ranking minority members of the house of representatives and senate committees with jurisdiction over capital investment, finance, and ways and means on the amount and percentage of each agency's capital appropriation that is used to pay for the costs of staff directly attributable to capital programs or projects funded with state general obligation bond proceeds.

¹² There are exceptions to this requirement. Minn. Stat. § 16B.335, subd. 1(b).

¹³ The Minnesota Sustainable Building Guidelines (MSBG) are available online at <http://www.b3mn.org/guidelines/index.html>.

¹⁴ "Policy Regarding Use of General Obligation Bond Proceeds to Fund Staff Costs," Minnesota Management and Budget, policy statement, October 20, 2009.

governments are “creatures of the state” and only have the authority granted to them or necessarily implied by an express grant of authority. The legislature specifies whether local governments may issue bonds and for what purposes, and the legislature has authorized local governments to issue G.O. bonds for some things that would not be eligible for state G.O. bonding, including vehicles and information technology infrastructure. *See* Minn. Stat. § 412.301.

For more information about debt and bonding, visit the government finance area of our website, www.house.mn/hrd/.

corporation. The amount of taxable property shall be determined by the last assessment previous to the incurring of the indebtedness.” Minn. Const. art. XI, § 12.