

State Bonding Authority

One of the ways the state pays for projects is to borrow money by issuing bonds, which are promises to repay the money borrowed at a specified time and interest rate. There are two main types of bonds: general obligation (G.O.), backed by the full faith, credit, and taxing powers of the state, and revenue bonds, backed by revenues other than from a statewide tax. The state constitution limits the purposes for which G.O. bonds may be issued and requires certain procedures. This information brief describes the law governing state bonding and also compares local bonding authority to state bonding authority.

All State General Obligation (G.O.) Bonds

All state G.O. bonds have certain common requirements. They must be for a public purpose, specified in law, and mature in not more than 20 years.

Public purpose. Under the state constitution, all expenditures of state funds, including bond proceeds, must be for a public purpose. There is a public purpose if the expenditure can reasonably be expected to achieve a legitimate public goal or benefit, even if private interests also benefit. In determining whether the purpose is “public,” one must look at both historical and contemporary standards. The legislature is given great deference in determining a purpose to be “public.” *Visina v. Freeman*, 252 Minn. 177, 184, 89 N.W.2d 635, 643 (1958).

Authorized in the constitution. The state constitution lists the purposes for which G.O. bond proceeds may be used, and G.O. bond proceeds cannot be used for purposes not included in the constitution. Minn. Const. art. XI, § 4 (“The state may contract public debts for which its full faith, credit and taxing powers may be pledged at the times and in the manner authorized by law,

but only for the purposes and subject to the conditions stated in section 5. Public debt includes any obligation payable directly in whole or in part from a tax of state wide application on any class of property, income, transaction, or privilege, but does not include any obligation which is payable from revenues other than taxes.”) This means, for example, that G.O. bond proceeds cannot be used to pay judgments or finance information technology as a stand-alone project.

Specified in law. “Each law authorizing the issuance of bonds shall distinctly specify the purposes thereof and the maximum amount of the proceeds authorized to be expended for each purpose.” Minn. Const. art. XI, § 7. This may be done by describing the project in some detail or by referring to a governmental program established in statute.

Mature in no more than 20 years. Minn. Const. art. XI, § 7.

Bonds to Acquire and Better Public Land and Buildings

The principal purpose for which state G.O. bonds are issued is to acquire and to better public land and buildings and to make other public capital improvements. [Minn. Const. art. XI, § 5, para. \(a\)](#). The authority to issue public debt to acquire and better public land and buildings and other public improvements of a capital nature was added to the state constitution in 1962.

Capital project. A capital project, in general, is to acquire or improve fixed assets, such as land or buildings. The fixed asset must be long-lived; bond counsel has suggested that the useful life be at least ten years. The improvements must be substantial, extend the useful life or substantially increase the value of the fixed asset, and not be predictable or recurring (as repairs would be). For example, a study or planning is not capital in nature, but design work for a capital project is. An option to buy real property is an intangible asset and not eligible for bonding. Reimbursement for capital expenditures already made is not a capital project, but payment of principal on the debt is.

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 public radio, TV, or Indian tribe projects, 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. \(a\)](#). 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);
- ▶ 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 projects may not be paid for with G.O. bonds that are payable in the first instance from the general fund. [Minn. Const. art. XIV](#), § 11; [art. XI](#), § 5, para. (e).

Revenue Bonds

The constitution neither specifically authorizes nor prohibits issuance of revenue bonds. As with any expenditure of public funds, revenue bond proceeds must be used for a public purpose. A significant limitation on the issuance of revenue bonds is whether the revenue to repay the bonds is sufficient to make the bonds marketable.

Various state agencies have authority to issue revenue bonds. For example, the Minnesota Housing Finance Agency may issue mortgage revenue bonds and the Minnesota Public Facilities Authority may issue revenue bonds to finance municipal wastewater treatment and other public infrastructure projects.

Other Capital Funding

General fund. Capital projects may be financed with a general fund appropriation and if they are, they are not subject to the same limitations as projects funded with general obligation bond proceeds. However, the general fund capital appropriations are typically still subject to the capital appropriation cancellation law, described below.

In addition to appropriating general fund money to pay the full cost of a capital project, the legislature has on occasion made a commitment to another public entity to appropriate each year an amount sufficient to pay the amount due for the year on bonds issued by that public entity. For example, the legislature has committed to annually appropriate to the University of Minnesota general fund money to pay off a portion of the bonds issued by the university for the new Gopher football stadium and biomedical science research facilities. Another example is the

standing appropriation to the Minnesota Housing Finance Agency from the general fund of up to \$2.4 million a year to pay off bonds the agency issued for nonprofit housing.¹

Master Lease Program. State statute authorizes the Commissioner of Minnesota Management and Budget (MMB)² to issue certificates of participation relative to a master lease in order to acquire capital equipment for state agencies. [Minn. Stat. § 16A.85](#). While 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, in effect, for capital equipment.

Debt Management Guidelines

There is no constitutional or statutory limitation on how much debt the state may incur (with the exception of debt for railroads), but since 1979 MMB has had guidelines intended to maintain the state's good credit rating, "minimize state borrowing costs, and provide a reasonable financing capacity within a prudent debt limit."³ The guidelines specify the following:

- ▶ The general fund appropriation for debt service should not exceed 3 percent of nondedicated revenues
- ▶ G.O. debt of the state should not exceed 2.5 percent of total personal income
- ▶ Total amount of all G.O. debt, moral obligation debt, state bond guarantees, equipment capital leases, and real estate leases should not exceed 5 percent of total personal income
- ▶ Total revenue and G.O. debt of state agencies, public corporations, and the University of Minnesota should not exceed 3.5 percent of total personal income⁴

In addition, MMB guidelines provide that 40 percent of G.O. debt must be due within five years and 70 percent within ten years, a relatively aggressive repayment schedule.

¹ [Minn. Stat. §§ 137.50 to 137.60](#) (stadium); [Minn. Stat. §§ 137.61 to 137.65](#) (biomedical science research facilities); [Minn. Stat. § 462A.36](#) (nonprofit housing bonds).

² In statute, these powers and duties are assigned to the Commissioner of Finance. As a result of legislation that took effect in 2008, most of the duties of the former Department of Employee Relations were merged into the Department of Finance. Although identified in statute as the Department of Finance, the merged department changed its name to Minnesota Management and Budget in October 2008. The department will seek legislative approval for the name change in 2009.

³ MMB, Debt Management Policy, www.mmb.state.mn.us/component/content/article/120.

⁴ State agency bond issuers are: Commissioner of MMB (for various purpose G.O. bonds, G.O. trunk highway bonds, and 911 revenue bonds); Public Facilities Authority (revenue bonds); Minnesota Housing Finance Agency (revenue bonds); Minnesota Office of Higher Education; Minnesota State Colleges and University (revenue bonds); Minnesota Higher Education Facilities Authority (revenue bonds); Minnesota State Armory Building Commission; Minnesota Agricultural and Economic Development Authority; and the Iron Range Resources Agency.

State Bond Ratings

State bond ratings are a measure of the risk to investors who buy the bonds, reflecting the state's capacity to pay interest and repay principal. A good rating reflects lower risk and therefore reduces the interest rate the state has to pay. The rating agencies look at the overall economy and financial health of the state and the state's financial management.

Through the 1980s and early 1990s, the state's bond ratings from the national rating agencies, Standard & Poors Ratings Group, Fitch Ratings, and Moodys Investors Services, Inc., were high but not the highest from all three. The state achieved the highest rating from all three national rating agencies in August 1997 and maintained it until June 2003, when the state was dealing with a massive deficit. In June 2003, Moody's Investors Services, Inc., downgraded the 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.

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

State Debt Capacity Forecast

MMB prepares a debt capacity forecast each February and November. The governor and the legislature use the forecasts in the capital budget process. Forecasts of the cost of debt service are also made at the same time. [Minn. Stat. § 16A.105](#).

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 general fund and bond-financed projects authorized more than four years before January 1. The 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—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.

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 the bonding bill is a bill to raise revenue, which must originate in the House of Representatives. [Minn. Const. art. XI, § 7](#); [Minn. Stat. § 16A.641](#), subds. 1, 10, 11, and 12.

Use of State Bond-Financed Property

As explained above, state bond-financed property must be publicly owned and be for a public purpose. At times, the best way to provide the public purpose or program is through a nonpublic entity. When that is so, the public owner of a state bond-financed project may enter into an agreement to have a private or nonprofit entity manage the facility and operate its public program with oversight by the public owner. That agreement is subject to approval by MMB. [Minn. Stat. § 16A.695](#).

A public entity that enters into a use agreement with a nonprofit organization for operation of a state bond-financed facility is ultimately responsible for the operation of that facility. Even if the nonprofit operator cancels or walks away from the use agreement, the public entity remains responsible for operating the public program. Unlike general fund appropriations, a public entity is not a “fiscal agent” or pass-through agency for state bond funding. The public entity must have the authority to provide the public program for which the state bond-financed property is acquired or built.

Nonstate Match Requirements

In many cases, additional financing is needed to complete a project above and beyond the amount of the state appropriation plus matching requirements named in the appropriation bill. In these cases, the grantee must demonstrate that all financing is in place to complete the project. [Minn. Stat. § 16A.502](#).

A nonstate contribution may be cash, a federal funding commitment, a local commitment to issue bonds or levy, or pledged payments that have been deposited into a segregated account or multiyear pledges that are converted into cash or cash equivalent through a loan or irrevocable letter of credit from a financial institution. [Minn. Stat. § 16A.695](#), subd. 6.

Since 1992, state capital appropriations for the University of Minnesota and the Minnesota State Colleges and Universities (MnSCU) have required a nonstate contribution. This does not include appropriations for Higher Education Asset Preservation and Replacement (HEAPR). For the University of Minnesota, the appropriations are intended to cover approximately two-thirds of 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.

Comparison of State Bonding and Local Bonding

There are four significant differences between state and local government with regard to issuing G.O. bonds: whether voter approval is required, whether there is any limit on the amount of debt, whether nongovernmental entities may own property acquired with the bond proceeds, and the purposes for which the bonds may be issued.

Referendum requirement. One of the main differences between state G.O. bonding and local G.O. bonding is the referendum requirement. In general, local G.O. bonding requires approval of the voters. See [Minn. Stat. § 475.58](#). There are numerous exceptions to that rule both in statute and in special laws. One is the exception for specific types of county, city, or urban town capital improvements that are in the local government's adopted capital improvement plan. The capital improvement plan elements are specified in statute. Issuance of these bonds is still subject to a reverse referendum. [Minn. Stat. §§ 373.40, 475.521](#). Another exception is that a home rule charter may specify that bonds are not subject to referendum. [Minn. Stat. § 475.58](#).

Limit on net debt. The state has debt management guidelines but not a limit on how much G.O. debt it may have outstanding. In contrast, state statute limits metropolitan government and local debt. See generally [Minn. Stat. § 475.53](#). For metropolitan government, see various provisions of chapter 473. In addition, the state constitution prohibits the legislature from authorizing a city, county, or town from issuing debt to aid railroads if the debt is more than 5 percent of the value of the taxable property within that jurisdiction. [Minn. Const. art. XI, § 12](#).

Public ownership. With a limited exception for railroads, state G.O. bond proceeds only may be used for projects that are and remain publicly owned. Local G.O. bonds are not similarly restricted. For example, G.O. tax increment financing (TIF) bonds may be used for privately owned projects.

Purposes. All public spending, state and local, must be for a public purpose. After that condition is met, however, there are some differences between state and local bonding purposes. As described above, the state constitution specifies the purposes for which state G.O. bonds may be issued. In contrast, the constitution does not address local government bonding.⁵ Local 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 general obligation bonds for some things that would not be eligible for

⁵ Railroads are an exception. As a result of the fiascos of railroad loans soon after statehood, a local government's aid for railroads is limited by the state constitution. "The legislature shall not authorize any county, township or municipal corporation to become indebted to aid in the construction or equipment of railroads to any amount that exceeds five percent of the value of the taxable property within that county, township or municipal 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](#).

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 web site, www.house.mn/hrd/hrd.htm.