

M E M O R A N D U M

I. Constitutional limitations

- A. No debt shall be contracted by the General Assembly unless such debt shall be authorized by a law providing for the collection of an annual tax or taxes sufficient to pay the interest on such debt as it falls due, and also to discharge the principal within 15 years from the time the debt was contracted. Constitution, Art. III § 34.
- B. The credit of the State shall not be given or loaned to, or in aid of any individual, association or corporation. Constitution, Art. III § 34.
- C. The General Assembly shall not have the power to involve the State in matters of internal improvement

which shall involve the faith and credit of the State. Constitution, Art. III § 34.

II. Application of Constitutional debt limitation provisions

A. Definition of works of internal improvement

1. The historical context of the provision suggests that works of internal improvement are canals, railroads and possibly turnpikes.

Bonsal v. Yellott, 100 Md. 481 (1905)

2. Works of internal improvements does not include improvements done for a public purpose:

- a. public roads

Bonsal v. Yellott, 100 Md. 481 (1905)

- b. private, nonprofit hospitals

Finan v. Cumberland, 154 Md. 563 (1928)

Melvin v. Anne Arundel County, 199 Md. 402 (1952)

- c. drainage and sewer systems

Welch v. Coglan, 126 Md. 1 (1915)

- d. private institutions of higher education

Johns Hopkins University v. Williams, 199 Md. 382 (1952)

- e. site and building for a private manufacturing company when needed to attract industry to the town to relieve unemployment

Frostburg v. Jenkins, 215 Md. 9 (1957)

f. maritime commerce and trade center

Lerch v. Md. Port Authority, 240 Md. 438 (1965)

g. mass rapid transit

Goldsborough v. Dept. of Transportation,
279 Md. 36 (1977)

3. Factors to consider in determining whether the work of internal improvement is for a public purpose

a. The fact that a private corporation may receive incidental benefits does not defeat the public purpose of the proposed improvement.

Frostburg v. Jenkins, 215 Md. 9 (1957)

b. The fact that a certain portion of the space available in a public purpose building will be used for other nonpublic purposes to generate incidental revenue does not defeat the public purpose.

Lerch v. Md. Port Authority, 240 Md. 438 (1965)

c. The fact that the improvement is a railroad is not determinative if the railroad will be owned by a public body and it is being developed not for private profit but to meet a public need.

Goldsborough v. Dept. of Transportation, 279 Md.
36 (1977)

- d. The fact that the improvement may not be financially self-supporting and may become a financial disaster is not of judicial concern in determining public purpose.

Goldsborough v. Dept. of Transportation,
279 Md. 36 (1977).

B. Constitutionality of various financing methods

1. General obligation bonds

- a. It is a loan of a county's credit to give a corporation coupon bonds in payment of a subscription of the corporation's stock.

Baltimore & Drum Point R.R. v. Pumphrey,
74 Md. 86 (1891).

- b. The State or the City of Baltimore or a county may issue general obligation bonds following all required procedures to give the proceeds to a private entity to accomplish a public purpose without this being considered a loan of credit.

Finan v. Cumberland, 154 Md. 563 (1928)

Melvin v. Anne Arundel County, 199 Md. 402 (1952)

Johns Hopkins v. Williams, 199 Md. 382 (1952)

- (i) The prohibition against a loan of credit was designed to prevent State authorities from suretyship situations in which

the State incurred secondary liability.

Johns Hopkins University v. Williams,

199 Md. 382 (1952)

- (ii) It is not a loan of credit for the State to use its credit to obtain funds to use for a public purpose.

Johns Hopkins v. Williams, 199 Md. 382 (1952)

- c. The State may issue general obligation bonds to obtain funds to loan to entities to accomplish a public purpose.

Truitt v. Bd. of Public Works, 243 Md. 375 (1966)

- (i) It is not a loan of the State's credit when the institutions receive the proceeds of the sale of the State's G/O bonds under conditions of a loan.

Truitt v. Bd. Public Works, 243 Md. 375

(1966)

- d. A county may use the proceeds of its G/O bonds to acquire a site and to contribute to the costs of construction of a building to be owned by a private corporation that serves a public purpose and the county may require that the private corporation contract with the county to make annual

payments for the purchase of the building without this being a loan of credit.

Frostburg v. Jenkins, 215 Md. 9 (1957)

- e. The City of Baltimore may sell its assets and use the proceeds to purchase other assets without creating a debt in the constitutional sense.

Eberhart v. City of Baltimore, 291 Md. 92 (1981)

2. Revenue bonds not involving State property.

- a. A State may issue bonds, payable solely from revenues to be derived from the project to be funded without incurring constitutional debt requiring an annual tax and discharge within 15 years.

Wyatt v. State Roads Comm., 175 Md. 258 (1938)

- b. No property or income already existing and owned by the State may be applied to the repayment of revenue bonds.

Wyatt v. State Roads Comm., 175 Md. 258 (1938)

- c. A State may agree to pay for the future maintenance, repair and operation of the facility; a contract for the payment of future services is not debt.

Wyatt v. State Roads Comm., 175 Md. 258 (1938)

- d. Revenue bonds may be paid by a pledge of non-tax revenues from existing projects other than those to be financed by the bonds.

Lacher v. Bd. of Trustees of State Colleges,
243 Md. 500 (1966)

- e. The diversion of the revenues of existing facilities from maintenance to repayment of revenue bonds and the corresponding replacement of these revenues with tax funds does not create debt.

Lacher v. Bd. of Trustees of the State Colleges,
243 Md. 500 (1966)

- f. It is a pledge of the State's faith and credit to state that mortgage loans are insured by the State's faith and credit even if it is further stated that the payment by the State is limited and conditional.

Md. Industrial Development Financing Authority
v. Meadow-Croft, 243 Md. 1515 (1966)

- g. It is a pledge of the State's faith and credit to pledge the faith and credit of the State to secure bonds and other indebtedness issued by a publically created instrumentality

even if the amount to be secured by the pledge of the State's credit is limited to a fixed dollar amount.

Development Credit v. McKean, 248 Md. 572 (1968)

- h. The pledge of payment from a limited fixed rate excise tax even if the State is under no obligation to increase the tax or to provide other funds in the event that the fixed tax revenues are insufficient constitutes constitutional debt.

Secretary of Transportation of Maryland v. Mancuso, 278 Md. 81 (1976)

3. Incurrence of debt through a pledge or other-use of assets

- a. The pledge of valuable, income-producing property creates a debt.

Baltimore v. Gill, 31 Md. 375 (1869)

- b. The sale of a facility operating at a loss for fair consideration to an authority that will issue bonds payable solely from revenues and not secured by a mortgage is not debt.

Castle Farms v. Lexington Market Authority, 193 Md. 472 (1949)

- c. The pledge of revenues from an existing facility is not debt.

Lacher v. Bd. of Trustees of State Colleges,
243 Md. 500 (1966)

- d. The pledge of the revenues and the mortgage of a building to be constructed with the proceeds of a bond issue is not debt.

Lerch v. Md. Port Authority, 240 Md. 438 (1965)

- e. The lease of land to a contractor to build a facility with a leaseback of the land and facility to the City is not debt.

Hall v. Baltimore, 252 Md. 416 (1969)

- f. The lease of land and the sale of an existing building and subsequent leaseback by the City is not debt.

Eberhart v. Baltimore, 291 Md. 92 (1981)

4. Comparison of present issue with previous cases
(see Attachment 1)

- a. Only Gill and Hall involved a transaction with non-public entities -- all other transactions involved State agencies or public authorities.

- b. Only Gill, Castle Farms, Lacher and Eberhart involved existing non-land property.

- (i) In Gill the property was pledged
 - (ii) In Lacher the facilities were not transferred nor mortgaged
 - (iii) In Castle Farms the facility was sold for fair consideration and was not to be mortgaged.
 - (iv) In Eberhart the facility was sold for fair consideration and mortgaged.
- c. Only Gill and Eberhart involved current revenue producing property.
- (i) in Gill, the pledge of the property created debt.
 - (ii) in Eberhart, the facility was sold for fair consideration, mortgaged and leased-back by the City without creating debt.
- d. None of the cases defining the State constitutional debt limitations involve (1) a lease (2) for nominal consideration (3) of existing revenue producing property (4) to a nonprofit corporation (5) with a close nexus with the State.

J. A. A.

Attachment A

<u>Case</u>	<u>Constitutional Provisions</u>	<u>Project</u>	<u>Legislative Authority</u>	<u>Issuer</u>	<u>Deal</u>	<u>Holdings</u>
<u>Mayor of Baltimore v. Gill</u> 31 Md. 375 (1869)	Art. XI § 7	Western Maryland Railroad	City Ordinance authorizing pledge of stock	City of Baltimore	City pledged B&O RR stock (valuable, income producing property), money raised was to be invested in bonds issued by railroad secured by a second priority mortgage. Parties loaning money to the City could look only to the B&O stock pledged, not to the City in the event the B&O stock was insufficient.	A pledge of valuable, income producing property is a debt even if the City's obligation to repay is limited to the value of the amount pledged. Pledge of stock might result in imposing additional burdens upon citizens. Must look to the substance of the transaction.
<u>Castle Farms v. Lexington Market Authority</u> 193 Md. 472 (1949)	Art. XI § 7	Lexington Market	Lexington Market Authority Act (1945)	Lexington Market Authority	City to convey title to real property and improvements to Authority for a reasonable price. Authority to issue revenue bonds payable solely from earnings of the Market Authority. Authority could not convey or mortgage the market. Market was operating at a loss. Land not subject to execution or attachment for debts of the Authority. Land may not be alienated or diverted from use as a market. All property of Authority reverts to City when bonds paid and retired.	This arrangement does not fall within the meaning of debt as the pledge of revenue producing property because the property had not been revenue producing and it was being sold for a fair price.

<u>Case</u>	<u>Constitutional Provisions</u>	<u>Project</u>	<u>Legislative Authority</u>	<u>Issuer</u>	<u>Deal</u>	<u>Holdings</u>
<u>Lerch v. Maryland Port Authority</u> 240 Md. 438 (1965)	Art. III, § 34	International Trade Center	Maryland Port Authority Art. 62 B § 1-25	Port Authority	Port Authority to issue revenue bonds secured by a pledge of revenue and by a pledge of the building. Unclear whether title to the land was given to the Authority or whether it was leased. Unclear whether land interest was pledged.	The pledge of a building, to be build from the proceeds of revenue bonds is not debt because it does not jeopardize any existing property of the State. In the event of default, the State will lose nothing which it currently owns.
<u>Lacher v. Bd. of Trustees of the State Colleges</u> 243 Md. 500 (1966)	Art. III, § 34	State College dormitories	State College Dormitories Act Laws of 1965, Chapter 739	Board of Trustees of State College	Board to issue revenue bonds payable from fees, rents and charges for use of the new facilities and from an increase in fees charged for existing dormitories. None of the buildings (existing or to be build) are to be conveyed or mortgaged.	Pledge of non-tax revenues from existing State-owned facilities is not the creation of debt. Division of fees from operations and maintenance to debt service is not debt. A contractual obligation to maintain buildings is not debt.

City of Baltimore
 v.
City of Baltimore
 291 Md. 92 (1981)

<u>Constitutional Provisions</u>	<u>Project</u>	<u>Legislative Authority</u>	<u>Issuer</u>	<u>Deal</u>	<u>Holdings</u>
Art. XI § 7	Culinary Arts Institute	Various City documents, Resolution of the Industrial Development Authority	Authority	<p>City to sell building and lease land to private entity for fair consideration.</p> <p>Authority to issue bonds, proceeds loaned to the private entity to purchase the building.</p> <p>Payment on bonds to come from repayment of loan.</p> <p>Security on loan is a mortgage on building and leasehold interest.</p> <p>Mortgage subordinate to City's interest as lessor and as subleasee.</p> <p>Private entity to lease back building to the City for rental equal to debt service on the loan, the ground lease payments and return on investment.</p>	<p>An outright sale and subsequent leaseback of an existing building even if on default of rent the private entity can retake the building is not a pledge of existing property. City's lease of property is not debt if the rental payments represent the fair rental value of the property.</p> <p>A properly constituted Authority is not an alter-ego of the City.</p>

<u>Case</u>	<u>Constitutional Provisions</u>	<u>Project</u>	<u>Legislative Authority</u>	<u>Issuer</u>	<u>Deal</u>	<u>Holdings</u>
Hall v. Mayor of Baltimore 252 Md. 416 (1969)	Art. XI, § 7	City of Baltimore	Documents including a request for construction bids and lease and leaseback provisions, various City department reports.	Private Contractor	<p>City leased land to private contractor at a nominal rent.</p> <p>Contractor to mortgage leasehold interest, obtain ordinary financing and construct a warehouse.</p> <p>Land and warehouse to be leased back to the City for rental payment equal debt service and operating expenses with an option to purchase at a fixed price. All mortgages subordinate to the City's interest as lessor and subleasee.</p>	Long term rental obligation is not debt until the time for payment arises. Lease with an option to purchase does not create debt when the rental is fair and no part of the rental is to be credited to the purchase price.