



## A REVIEW OF THE STATE'S BONDING PRACTICES

### Introduction

Practically since its creation South Dakota's state government has been all but prohibited from using general fund debt as a way to fund day-to-day operations. Barring any grave circumstances such as war, the South Dakota Constitution essentially mandates a "pay as you go" basis for funding normal state government operation. Yet, debt by bonding is an effective, commonly used tool by state government for accomplishing priorities in South Dakota.

### Expenses Of State Government Versus Revenue

South Dakota state government was designed in its Constitution to be operated on a "pay as you go" basis. For "ordinary expenses of the state for each year," the South Dakota Constitution mandates that the Legislature shall "provide for an annual tax" to raise "sufficient" revenue through a tax on property. (Article XI, §1). The Legislature is effectively prohibited from using debt for a source of general fund revenue by two stoppers, a constitutional provision concerning maximum state indebtedness and statutory direction for the way the state is to figure its books.

For the purpose of defraying extraordinary expenses and making public improvements, or to meet casual deficits or failure in revenue, the state may contract debts never to exceed with previous debts in the aggregate **one hundred thousand dollars** [emphasis added], and no greater indebtedness shall be incurred except for the purpose of repelling invasion, suppressing insurrection, or defending the state or the United States in war and provision shall be made by law for the payment of the interest annually, and the principal when due, by tax levied for the purpose or from other sources of revenue...(S.D. Constitution Article XIII, §2)

When ordinary expenses exceed revenue in a year, taxation is still to be the first source of revenue. The Legislature is to levy a tax in the ensuing year "sufficient, with other sources of income," to cover that year's expenses as well as the previous year's shortfall. If debt is used to make up the difference—the "casual deficits or failure in revenue"—that debt is to be retired within ten years. (Article XI, §1).

However, despite the obvious constitutional authorization—which is arguably a mandate—and related statutes, there is clearly no state property tax in effect. The Legislature has not used the state property tax since 1954, according to the Department of Revenue. Rather, the state relies upon its retail sales and use tax, bank tax, and others to fund ongoing operations of state government. There is no statewide levy and subsequent collection of a property tax because it is up to the state Board of Equalization to implement it **only if the state’s estimated expenses exceed its estimated revenues from all sources of funds.**

According to SDCL 10-12-3, the Board must determine the “amount of dollars necessary to meet the estimated ordinary expenses of the state for each year” and the amounts necessary to meet the previous year’s shortfall (and any interest). The Board is to then subtract from that total the amount of money the Commissioner of the Bureau of Finance and Management says will be available for the year. If expenses exceed revenue, the Board is to determine “the rate of tax to be levied against the taxable property in the state.” This has not been the case for decades. South Dakota’s myriad general fund revenue sources, combined with federal and all other sources of revenue, are more than sufficient to cover ordinary expenses.

### **The Practice Of Bonding**

None of the above is to say, however, that the State of South Dakota never bonds for its priorities. South Dakota state government, *through authorities*, issues millions of dollars of bonds. Be it to raise funding for state buildings, to erect dormitories or classroom facilities at the state universities, to fund water projects, or to spur the housing industry, the Legislature has accomplished many of its priorities through means other than direct taxation and appropriation.

These priorities generally share the characteristic of being long-term projects or goals requiring amounts of capital much larger than those usually seen in either the general or special appropriation processes for single projects. In 1999, the seven active bonding authorities issued some \$355 million in bonds. At the end of 1999, there was more than \$2 billion in bonds outstanding.

Essentially, the Legislature has decided over the years that certain expensive projects should be accomplished for the good of the state, and it created a mechanism to pay for them. The Legislature created, for specific purposes and reasons set forth in statute, entities that issue bonds to bondholders. The money raised accomplishes the projects, and then some source of long-term revenue is usually tapped to service the debt or pay off the bonds. This revenue may derive from dormitory room rent, lease payments from state agencies for their offices in state buildings, homeowners’ mortgage payments, or even state general fund appropriations (though this last example is rare, e.g., the Cultural Heritage Center).

To raise, account for, and expend the huge sums of capital necessary to effect some of the state’s improvement projects and works, the Legislature has, over the years, created a number of authorities—bodies politic and corporate—to act on the state’s behalf in the world of business and capital. The Legislature has authorized ten entities

to issue bonds for projects that benefit the state. These entities are: the South Dakota Building Authority; the South Dakota Housing Development Authority; the South Dakota Health and Educational Facilities Authority; the South Dakota Railroad Authority; the South Dakota Conservancy District; the South Dakota Economic Development Finance Authority; the Value Added Finance Authority; the Petroleum Environmental Compliance Authority; the Bureau of the Public Entity Pool for Liability Fund; and the South Dakota Airline Authority.

### **The Role Of Bonding Authorities**

For each bonding authority it created the Legislature specified its intent or certain purposes of the authority and its funds. For example, the Building Authority's purposes are:

- (1) To build and otherwise provide hospital, housing, penitentiary, administrative, classroom, dining halls, fieldhouses, parking facilities, union buildings, library, recreational, laboratory, office and similar facilities for use by the state of South Dakota;
- (2) To serve the Legislature by making reports concerning the providing of such facilities; and
- (3) To make, and undertake commitments to make, loans to farmers or ranchers who are participants in the United States Department of Agriculture Conservation Reserve Program. (§5-12-7).

When created in 1967, the Building Authority's statutory purposes originally included a duty "to conduct continuous studies into the need" for buildings. These duties were repealed in 1988.

For the Housing Development Authority, along with the statement of purposes, there is a lengthy declaration of legislative findings. These begin with the "serious shortage of sanitary, decent and safe residential housing at prices or rentals which people of the state can afford." (§11-11-1). They also state that "it is to the economic benefit of the state to encourage the availability of adequate housing for all levels of society."

<b>AUTHORITY</b>	<b>SDCL CITE</b>	<b>YEAR CREATED</b>
<b>South Dakota Building Authority</b>	<b>Chapter 5-12</b>	<b>1967</b>
<b>South Dakota Housing Development Authority</b>	<b>Chapter 11-11</b>	<b>1973</b>
<b>South Dakota Health and Educational Facilities Authority</b>	<b>Chapter 1-16A</b>	<b>1972</b>
<b>South Dakota Conservancy District</b>	<b>Chapter 46A-2</b>	<b>1973</b>
<b>Economic Development Finance Authority</b>	<b>Chapter 1-16B</b>	<b>1978</b>
<b>Railroad Authority</b>	<b>Chapter 49-16B</b>	<b>1975</b>
<b>Value Added Finance Authority</b>	<b>Chapter 1-16E</b>	<b>1986</b>
<b>Bureau of the Public Entity Pool for Liability</b>	<b>§3-22-13.1</b>	<b>1987</b>
<b>Airline Authority</b>	<b>§50-14-1</b>	<b>1989</b>
<b>Petroleum Environmental Compliance Authority</b>	<b>§34A-14-1</b>	<b>1988</b>

Generally, all of the authority enactments specify not just the purposes of the authorities and their funds, but also the range of allowable projects, the composition of the governing board of directors, lengths of their terms, etc. Thus, each time it created a bonding authority, the Legislature specifically defined that authority's charge or purpose, established its management via a controlling board, and attached the authority to a mainline state agency.

If the Legislature was acting in its role as problem solver, then the role of the authorities is to implement the mechanics to address whatever issue or problem the Legislature was trying to solve when it created that authority. So long as the authorities adhere to their enabling legislation, they are able to operate relatively unfettered, at least by budget law and process that apply to the rest of state government. That is, the authorities only need to report their operational budgets to the Legislature on an

*informational* basis. They generate their own funding, so clearly missing is the “power of the purse string.”

## **Legislative Review Of Bonding**

Most of the bonding authorities report annually to the Legislature. In fact, six of them are specifically mentioned in statute and required to report to an “interim joint bonding committee, established pursuant to the rules of the Legislature.” (§2-6-14). Those enumerated authorities are: the South Dakota Housing Development Authority; the South Dakota Health and Educational Facilities Authority; the South Dakota Building Authority; the South Dakota Conservancy District; the South Dakota Economic Development Finance Authority; and the South Dakota Railroad Authority.

Of the four other bonding authorities the Legislature created, three are inactive. The South Dakota Airline Authority, the Petroleum Environmental Compliance Authority, and the Bureau of the Public Entity Pool for Liability Fund have never issued bonds. The Petroleum Environmental Compliance Authority is the only one of these that ever organized, but it has since disbanded. The only other authority not specifically listed in §2-6-14, the Value Added Finance Authority, is an active entity that has issued bonds. It was probably just an oversight that it has not yet reported to the Legislature’s Bonding Review committee or even directly to the Legislature.

The Bonding Review Committee of the Legislature is to “review the operations, programs, accomplishments and financial status of” those authorities, as well as “any other agency, board, or commission authorized to conduct statewide programs in the State of South Dakota and to issue bond and note indebtedness.” Statute lists a considerable amount of information the authorities are to report to the committee.

Presumably, the committee is supposed to ask “the hard questions,” and statute, in fact, gives the committee permission to ask for much more than just figures. The “committee may request...detailed accounting of the security underlying outstanding bonds” and “detailed explanations of the public purpose underlying any [of an authority’s] programs.” (§§2-6-17, -18). Thus, the committee has the power to ask for and discuss the authorities’ policies and management. Like all other committees of the Legislature, members of the Bonding Review Committee even have the power to administer oaths to anyone appearing before the committee. (§2-6-1).

For many years the Executive Board of the Legislative Research Council appointed a Bonding Review Committee and charged that group with the duty of reviewing and accepting the reports of bonding entities. That committee heard and accepted the reports, then reported such to the Executive Board. In recent years, however, the Bonding Review Committee has been comprised of the Executive Board itself and meets just once a year specifically for this purpose.

While it is true that the Legislature could revise the reporting statute to include all active authorities, perhaps just introducing a bill would bring attention to the situation. On the other hand, perhaps a letter from the Bonding Review Committee to the appropriate agencies—now just the Value Added Finance Authority—would rectify the issue. If the

amount of ink devoted to the bonding authorities' reports and their subsequent write-ups in minutes of the Bonding Review Committee are any indication, there are no controversies. That is, the past several years the committee meets one day, hears and accepts the reports, then reports to the full Legislature that it heard and accepted the reports. These reports can be found in the Legislative Research Council Library.

There have been no items of substance or exceptions reported during any of the previous interims, at least none that were recorded and then relayed to the full Legislature for it to correct via legislation. For that matter, the annual meeting of the Bonding Review Committee is quite brief, so in-depth discussion would be very constrained. The 1999 meeting lasted approximately an hour and a half, according to the committee's minutes.

As for the bonding entities it creates but which never actually organize or issue bonds, there is a statute (§4-8-21.1) that repeals bonding authority. This statute says that at "the end of four full fiscal years following the effective date of any act authorizing...debt for any project or other purpose" the authorization lapses if the debt is not "necessary to finance the completion of the project or purpose." Those entities never activated could remain in statute and still be activated in the future.

## **Conclusion**

While at first glance it would appear that South Dakota government is not to use debt financing, this is far from the true situation. The Legislature has accomplished a lot of good for the State of South Dakota through the use of debt issued by its bonding authorities. Essentially, the Legislature has created an arm of government that can raise money and effect change without taxation of the people. While the actual oversight of bonding authorities and their practices in South Dakota might not be as strict as it could be, should the Legislature see fit to look harder at its practice, it has the means to do so already in place.

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**This issue memorandum was written by Mark Zickrick, Principal Fiscal Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.**

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