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Feb. 10, 2003

Representative Rob Burpo
New Mexico State House of Representatives
State Capitol
Santa Fe, NM 87503

Representative Rick Miera
New Mexico State House of Representatives
State Capitol
Santa Fe, NM 87503

Re: Opinion request--Tax Increment Bonds Payable from Real Property Taxes

Dear Representative Burpo and Representative Miera:

You have requested our opinion regarding the constitutionality of legislation authorizing the issuance of tax increment bonds. To the extent these bonds are payable from allocations of real property taxes, we conclude that although New Mexico courts have not had an opportunity to address the specific question posed here, they would likely find this funding scheme unconstitutional under the debt provisions of our state constitution.

Section 3-60A-23.1 of the Tax Increment Law ("the Law") authorizes a municipality to issue tax increment bonds (and tax increment bond anticipation notes) for purposes of financing metropolitan redevelopment projects. These bonds "are payable from and secured by real property taxes, in whole or in part", as those taxes are allocated to the metropolitan redevelopment fund pursuant to two other sections of the Law. The Law authorizes a municipality, subject to certain approvals, to designate certain parcels of real property within a metropolitan redevelopment project to be included in a tax increment funding. Upon approval, the taxable value of each parcel is then determined as the "base" value. Once improvement or rehabilitation is complete, a new taxable value is determined. The difference between the "base" value and the new taxable value is credited to the municipality and deposited into the metropolitan redevelopment fund. NMSA 1978, §§ 3-60A-21 and 23 (2000). That fund is then pledged to and used to pay off any tax increment bonds that have been issued.

The question arises whether the monies in the metropolitan redevelopment fund constitute a "special fund" and thus are exempt from the dictates of the debt clauses in our constitution, or,

because those monies are real property taxes, the debt which they are to satisfy must first be approved by the voters.

Article IX, section 12 of our state constitution declares, in pertinent part:

> No such debt [contracted by a municipality] shall be created unless the question of incurring the same shall, at a regular election ...or at any special election called for such purpose, have been submitted to a vote of such qualified electors...and a majority of those voting on the question...shall have voted in favor of creating such debt.

(Explanatory note added.)[1] New Mexico courts have long recognized this provision (and other constitutional debt clauses) to apply to debt incurred by a municipality (or other public body) when real property taxes are the source of repayment. See Seward v. Bowers, 37 N.M. 385, 389, 24 P.2d 253 (1933) (municipal bonds payable solely from water system revenues, which are not derived from general taxation, are not debt in constitutional sense); State v. Connelly, 39 N.M. 312, 318, 46 P.2d 1097 (1935) (Article IX, § 12 debt is that contemplating the levy of general property tax as sources of funds to retire same); Bolton v. Bd. of County Comm'rs, 119 N.M. 355, 364, 890 P.2d 808 (Ct. App. 1994) (applying Seward and Connelly analysis to sever non-special fund revenues of county as source of repayment, consistent with severability provision in bonds).[2] It is only when non-real property tax-based revenues are identified and pledged as the sole source(s) of repayment that the "special fund" doctrine applies and the obligation does not constitute debt in the constitutional sense. State Office Building Commission v. Trujillo, 46 N.M. 39, 46, 120 P.2d 434 (1941).

Whether a "special fund" may be created simply by allocating a portion of real property taxes has not been addressed by a court in New Mexico. We are aware that there is "a presumption of the validity and regularity of legislative enactments." State v. Public Employees Retirement Bd., 120 N.M. 786, 788, 907 P.2d 190 (1995). Thus, legislation must be upheld unless a court is "satisfied beyond all reasonable doubt that the Legislature went outside the bounds fixed by the Constitution in enacting the challenged legislation." Id.

We are also aware that there is a split of authority among courts in other jurisdictions as to whether obligations issued in conjunction with tax increment financing are "debts" within constitutional confines. See Oklahoma City Urban Renewal Authority v. Medical Technology

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[1] The New Mexico Constitution contains separate debt limitations for the state, counties and school districts, as well. Each, however, requires voter approval of any debt therein authorized. See N.M. Const. Art. IX, §§ 8, 10, and 11. These provisions, along with that quoted in the body of this letter, are referred to throughout collectively as the "constitutional debt clauses".

[2] In addition, Article IX, Section 13 limits the aggregate amount a county, city, town or village may become indebted to 4 per cent of the value of taxable property within the public body's jurisdiction, subject to certain exceptions not applicable here.

and Research Authority of Ok., 2000 OK 23, 4 P.3d 677, 688 (2000), citing those authorities at footnote 43. There, the Supreme Court of Oklahoma held that the city's tax increment financing plan unconditionally obligated the city to apportion ad valorem taxes in excess of base assessed value for retirement of long-term bonds issued by the research authority, and thus constituted "debt" that was subject to Oklahoma's constitutional provision requiring voter approval. In so holding, that court concluded that a provision in its tax increment legislation declaring bonds issued pursuant to that law did not constitute a debt of the political subdivision—such as that contained in § 3-60A-23.1(B) of our Law—had not been found dispositive in West Virginia, nor was it in Oklahoma. Id. at 689, citing State ex rel. County Comm'n. of Boone County v. Cooke, 197 W. Va. 391, 475 S.E.2d 483, 491 (W. Va. 1996).

Mindful of the presumption of constitutionality that attaches to the Law, and cognizant of the split of authority that exists in other jurisdictions, our prime focus must be on New Mexico decisions addressing the constitutional debt clauses because of the paramount role of our courts in interpreting our constitution. Beginning in 1937, our Supreme Court has repeatedly rejected innovative financing techniques designed to avoid constitutional restraints. In City of Santa Fe v. First Nat. Bank in Raton, 41 N.M. 130, 65 P.2d 857 (1937), the court reviewed the constitutionality of certificates issued to fund sewer improvements which pledged first the revenues from the system to be generated through special assessments. In the event of a deficiency in those monies, the certificates guaranteed payment from the city's general revenues. In the face of collections below the amounts assessed, the city asserted that resort to the city's general revenues was unconstitutional under the applicable constitutional debt clause because the voters had not approved the indebtedness. In declaring the guaranty inoperative by force of the constitutional debt clause, the court reaffirmed the principles enunciated in Seward and Connelly. It also cited the reasoning of a Florida case:

> Only where it can be clearly demonstrated beyond a reasonable doubt that a contemplated scheme of embarkation upon new capital ventures will not immediately or mediately, presently or in futuro, directly or contingently, operate to impose an added burden on the taxing power, or have the effect of impairing the public credit in futuro, will the consummation of such a debt incurring scheme be held authorized, absent the approving voice of the freeholders...

Brash v. State Tuberculosis Board et al., 124 Fla. 652, 169 So.218, 219 (1936), quoted at 41 N.M. at 138. (Emphasis added.) Here, we cannot be sure that the amount of taxes assessed, let alone actually collected, in excess of the "base value" will be sufficient to repay the bonds. If it is not, then property tax rates may have to be raised (subject to the 4% cap set in our Constitution) to make up for that deficiency. This contingency imposes an added burden on property taxes of the type condemned by the First National Bank court.

In the years following First National Bank, our highest court has consistently acted to strike down financings in which public debt is to be retired or repaid out of real property taxes. In 1941, it declared unconstitutional an act that attempted to create a special fund for acquisition of an office building to house state agencies from monies paid by those agencies out of

appropriated funds which were not restricted to excise taxes or other revenue sources separate from general taxation. Trujillo, supra, 46 N.M. at 54. And in Wiggs v. City of Albuquerque, 56 N.M. 214, 224-225, 242 P.2d 865 (1952), it declared bonds that imposed a lien on an auditorium to be constructed with bond proceeds and the city-owned land upon which it was to be built created unconstitutional debt, even though those bonds were to be repaid from the auditorium's net revenues.[3] Again, in McKinley v. Alamogordo Municipal School District Authority, 81 N.M. 196, 201, 465 P.2d 79 (1969), it found illegal a plan by which a non-profit corporation with membership identical to the local school board would issue bonds for the construction of a school, which would then be leased to the school district. In that scenario, the rent paid by the district and used to retire the bonds came from state tax proceeds and federal funds. The Court found this funding scheme violated our Constitution's debt restrictions requiring voter approval and setting a 6% cap on school district debt.

Finally, its most recent case in this area involved a lease with an option to purchase entered into by a county for a new jail facility, which the Court held created unconstitutional debt. Montaño v. Gabaldon, 108 N.M. 94, 95-96, 766 P.2d 1328 (1989). The voters in the county had twice voted down a referendum to finance a new jail. 108 N.M. at 94. Although the lease contained a non-appropriations clause that allowed for termination at the end of any fiscal year should the county commission not appropriate sufficient funds to pay the rent, the Montaño court cautioned:

> In keeping with the intent of the framers, a broad interpretation of the debt limitation has long been favored in New Mexico...An agreement that commits the county to make payments out of general revenues in future fiscal years, without voter approval, violates the New Mexico Constitution even if that obligation is merely an "equitable or moral" duty [citing Connelly and Seward] or "contingent" duty [citing Trujillo].

Id at 95. (Explanatory notes added.)[4]

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[3] This holding also calls into question the language in § 3-60A-23.1(A)(1) which allows a municipality to create a lien for the benefit of the bondholders or noteholders on any public improvements or public works used solely by a metropolitan redevelopment project or any portion of such a project financed by those bonds or notes.

[4] In 1993, our Supreme Court did uphold a contract between a water commission and the federal Bureau of Land Management to fund the initial phases of the Animas-La Plata water project. The agreement was funded by the county from a "special, segregated fund" comprised of real property tax proceeds, which the Court found exempted the debt from the strictures of the Bateman Act. The agreement and the pledge of those revenues had been approved by county voters. San Juan Water Comm. v. Taxpayers, 116 N.M. 106, 110, 8609 P.2d 748 (1993). That approval clearly distinguishes this case from the cases relied on herein, and rendered the existence of a special fund unnecessary for constitutional debt clause purposes.

In keeping with that admonition, we believe that, the presumption of constitutionality notwithstanding, if faced with the question of whether a special fund may be created simply by siphoning off a certain amount of real property taxes that are collected, it is likely our courts would determine the scheme violates Article IX, Section 12 of the New Mexico constitution.

If we may be of further assistance, please let us know. Your request to us was for a formal Attorney General's Opinion on the matters discussed above. Such an opinion would be a public document available to the general public. Although we are providing you our legal advice in the form of a letter instead of an Attorney General's Opinion, we believe this letter is also a public document, not subject to the attorney-client privilege. Therefore, we may provide copies of this letter to the public.

Sincerely,

Martha A. Daly
Assistant Attorney General

cc: Stuart M. Bluestone, Deputy Attorney General