

December 8, 2008

## Minnesota Management and Budget Guidance Relating to Permitted Uses of State Trunk Highway Bond Proceeds

The uses of State trunk highway bond proceeds are governed by legal authority found in the Minnesota Constitution (Articles XI and XIV) and specific legislative authorizations (in bonding bill “riders”).

The Minnesota Constitution allows for the issuance of State trunk highway bonds for expenditures on capital projects that are part of, or functionally related to, the construction, improvement or maintenance of the State trunk highway system. The authority to issue State trunk highway bonds for such purpose may be further limited by bonding bill riders.

Below is guidance provided by Minnesota Management and Budget:

- (1) further outlining the legal authority and restrictions on the use of State trunk highway bond proceeds;
- (2) further explaining what types of projects
  - (a) are capital,
  - (b) constitute construction, improvement or maintenance, and
  - (c) constitute part of the “State trunk highway system” or are functionally related thereto;
- (3) answering other common questions related to the use of State trunk highway bond proceeds; and
- (4) providing additional resources for assistance in determining permitted uses of State trunk highway bond proceeds.

---

### (1) Legal authority

#### *General Authority -- Article XI of the Minnesota Constitution*

State general obligation bonds constitute “public debt” within the meaning of Article XI, Section 4, of the Minnesota Constitution and, therefore, are subject to the limitations of Section 5 of Article XI, which provides that public debt may be contracted and works of internal improvements carried out only for certain enumerated purposes. One such purpose is “to establish and maintain highways subject to the limitations of [A]rticle XIV.” (Article XI, Section 5(e).)

### *Specific Authority to Borrow for State Trunk Highway System -- Article XIV of the Minnesota Constitution*

- Section 1 authorizes the State to “construct, improve and maintain public highways, ... assist political subdivisions in this work[,] and by law ... authorize any political subdivision to aid in highway work within its boundaries.”
- Section 2 creates a trunk highway system constructed, improved and maintained as public highways by the State.
- Section 6 creates a trunk highway fund to be used solely for the purposes of constructing, improving and maintaining the trunk highway system and for the payment of principal of and interest on trunk highway bonds.
- Section 11 authorizes the Minnesota Legislature to provide by law for the sale of trunk highway bonds to carry out the construction, improvement and maintenance of the trunk highway system.

### *Relationship Between Article XI and Article XIV*

Read together, and factoring in relevant Minnesota court decisions, Articles XI and XIV authorize the State to issue its State trunk highway bonds under Article XIV, Section 11, to finance capital projects that are part of, or functionally related to, the construction, improvement or maintenance of the State trunk highway system.

Article XIV, Section 11, is the exclusive authority for issuing bonds for the State trunk highway system. (See letter from Dorsey & Whitney, LLP, Bond Counsel, dated April 11, 2001).

The State can borrow under Article XI, Section 5(a), for transportation projects that are not part of, or functionally related to, the State trunk highway system. The most common example is bonding for local bridges. (See Minnesota Statutes, Sections 174.50 & 174.51.)

### *Specific Legislative Limitations (“Riders”)*

The Minnesota Constitution requires that “each law authorizing the issuance of bonds shall distinctly specify the purposes thereof” (Article XI, Section 7). Therefore, a rider in a bonding bill must (a) designate a specific, sited project or (b) cite a specific statutory or existing administrative program providing for selection of projects to be financed. These statutory authorizations may limit the constitutional authority in some way (e.g., authorizing only pre-design and design, or only construction to the exclusion of pre-design and design). Bonding bill riders cannot override the requirements of the Minnesota Constitution and must clearly state the intent of the legislature to override any other statutory requirements relating to bond-financed projects.

---

## **(2) Permitted Uses of State Trunk Highway Bond Proceeds**

### *What is “capital”?*

One of the best, although perhaps not the exclusive, method of determining what constitutes a capital expenditure is to determine what constitutes an expenditure that must be or may be

“capitalized” under generally accepted accounting principles applicable to governmental entities. This generally includes expenditures made with respect to fixed assets -- identifiable land, buildings and other improvements,<sup>1</sup> including capital equipment – with a useful life that is substantial.

In addition, capital expenditures may include allocable consultants’ fees, salaries and other labor costs (such as benefits and payroll taxes) attributable to capital projects. However, capital expenditures are not the same as operating expenditures. Operating expenditures include (a) expenditures for staff or consultants for general overhead or administration, including preparation of (i) general preliminary studies to determine whether some type or group of capital projects may be needed in the future or (ii) general studies to determine whether a type of modification or improvement to State buildings are needed or desirable; and (b) expenditures for minor repairs and replacements or upkeep.

To ensure compliance with both State law and federal laws applicable to the issuance of tax-exempt bonds, Minnesota Management and Budget is developing administrative guidelines with respect to payment from State bond proceeds of “program delivery” or project management costs attributable to State staff. If you anticipate financing staff salaries or related labor costs from the proceeds of State bonds, contact Minnesota Management and Budget for further guidance.

For additional guidance with respect to accounting principles, see Minnesota Departments of Finance and Administration Operating Policy and Procedure, Number 0106-02 issued June 3, 2003, and Number 0106-03 issued May 19, 2003.

#### *What is “construction, maintenance or improvement”?*

“Construction” is, quite simply, the process or act of combining materials, supplies and labor to build a permanent structure. “Maintenance,” on the other hand, is the upkeep of such structure, to preserve it from failure or decline. The term “improvement” describes a permanent addition to real property that increases the value of real property, involves expenditure of time and money, and makes the real property more useful or valuable, as distinguished from mere replacement or repairs.

#### *Relationship to the “State trunk highway system”*

In determining whether a project is part of, or functionally related to, the construction, maintenance or improvement of the trunk highway system, it is necessary to consider the (a) purpose, (b) location, and (c) ownership of the project.

- *Purpose*

It is important that the dominant and overriding purpose of a project be for the construction, improvement and maintenance of the trunk highway system in order for it to be part of, or

---

<sup>1</sup> See “What is ‘construction, maintenance or improvement’?” subheading for a further discussion of improvements.

functionally related to, the State trunk highway system. An example of a dominant and overriding purpose would be the acquisition of trunk highway right-of-way or the paving of a State trunk highway.

However, the trunk highway system is broader than just the traveled portion of a State trunk highway that directly transports vehicles. Accordingly, trunk highway bonds may be issued for capital projects when the dominant or overriding purpose provides a necessary function related to the trunk highway system (e.g., reconstructing a local street going over a State trunk highway to accommodate construction of the trunk highway) or promoting safe travel or eliminating traffic hazards or dangerous obstructions on the trunk highways (e.g., acquiring land outside of the trunk highway right-of-way to provide for sight lines or drainage easements). (See also “*Location*,” below.)

The purpose of a project to be financed with State trunk highway bonds may not be merely incidental or related to the trunk highway system. Examples of such projects would include: construction of a park-and-ride lot that serves a light rail transit facility and only incidentally serves to alleviate congestion on State trunk highways, or the expansion of a local street going over a State trunk highway that is not necessary to accommodate construction of the trunk highway below. In determining whether a project or a portion of a project is merely incidental or related to the trunk highway system, it may be helpful to consider whether the project would exist “but for” the existence of a trunk highway (e.g., the reconstruction of a local street going over the State trunk highway to accommodate construction of the trunk highway below would not be necessary but for the trunk highway construction; however, expanding the street from two lanes to four lanes is not necessary to accommodate construction of the trunk highway below).

Where a project has multiple purposes – e.g., one which is the construction, improvement and maintenance of the trunk highway system and one which is merely incidental or related to the trunk highway system – it may be possible to issue trunk highway bonds pursuant to Article XIV, Section 11, for the trunk highway portion of the project and to issue general obligation bonds pursuant to Article XI, Section 5(a), to finance the remainder of the project.

- *Location*

The physical location of an improvement is also a factor. Trunk highway bonds can be issued for capital projects located within the trunk highway right-of-way or a trunk highway easement, or located outside of the trunk highway right-of-way or a trunk highway easement. However, the farther a project is located from the trunk highway right-of-way or trunk highway easement, the more difficult it will be to establish that it is part of, or functionally related to, the State trunk highway system. Again, it is helpful to consider whether the project would exist “but for” the existence of a trunk highway (e.g., a trunk highway district headquarters facility will not necessarily be located near a State trunk highway right-of-way, but the facility’s dominant and overriding purpose is for the construction, improvement and maintenance of the trunk highway system, and such facility would not exist but for the trunk highway system).

- *Ownership*

Absent a determination by Bond Counsel to the contrary, property financed with the proceeds of State trunk highway bonds must be publicly owned. In most if not all cases, this will mean ownership by the Minnesota Department of Transportation on behalf of the State.

---

### (3) Common Questions

*Is it possible that a project could be financed under both Article XI, Section 5(a), and Article XIV, Section 11?*

No. The determination of what kinds of projects can be eligible for trunk highway bonding should be consistent over time. For example, if one District headquarters is found to be trunk highway bond eligible, then subsequent similar projects should also be eligible.

*What if a project has multiple purposes (for the State trunk highway system and for local transportation improvements)?*

Where a project has multiple purposes – e.g., one which is the construction, improvement and maintenance of the trunk highway system and one which is merely incidental or related to the trunk highway system, such as a local bridge – it may be possible to issue trunk highway bonds pursuant to Article XIV, Section 11, for a portion of the project and to issue general obligation bonds pursuant to Article XI, Section 5(a), to finance the remainder of the project. However, if an improvement becomes a part of the State trunk highway system (i.e., it is constructed within the trunk highway right-of-way), then it must be financed with trunk highway bonds.

*Can the proceeds of trunk highway bonds issued pursuant to Article XIV, Section 11, or general obligation bonds issued pursuant to Article XI, Section 5(a), be used to finance transit-oriented development?*

It is possible that a portion of a transit-oriented development project may be financed with the proceeds of trunk highway bonds issued pursuant to Article XIV, Section 11, or general obligation bonds pursuant to Article XI, Section 5(a), depending upon the purpose, location and ownership of each of the various components of the project. (See also the immediately preceding question.) However, State bonds generally may not finance land or improvements that do not serve a primarily public purpose or that are not publicly owned (e.g., land or improvements for privately-owned commercial/retail development, even if part of an overall transit-oriented development).

*Is it specific enough to refer to a “statewide” or “systemwide” project in a bonding bill rider?*

No. This is not sufficiently specific. A rider must designate a site for the project or cite a statutory or existing administrative program providing for selection of projects to be financed.

*Can equipment be financed with State trunk highway bond proceeds?*

Only if the cost of such equipment is properly capitalized under generally accepted accounting principles (i.e., capital equipment), and will be used for the construction, maintenance and improvement of trunk highways.

*Can a project that is adjacent to a State trunk highway be financed with State trunk highway bond proceeds?*

Yes, depending on the other facts (related to purpose and ownership). Land acquired or an improvement constructed adjacent to a State trunk highway may nevertheless be a part of the State trunk highway system (e.g. a State-owned trunk highway district headquarters facility, regardless of location; or a State-owned park-and-ride ramp for bus rapid transit traveling on a State trunk highway that is in close proximity to the State trunk highway and that serves to alleviate congestion on State trunk highways).

*Can trunk highway bonds finance the expansion of an existing park-and-ride ramp for the State trunk highway system if the ramp is not State-owned?*

It is possible that such an expansion could be financed with the proceeds of State trunk highway bonds, so long as the “expanded” portion of the facility financed with trunk highway bonds is owned by the State and the State has appropriate access (licenses, easements, etc.) over the remainder of the ramp for the operation and maintenance of the State-owned portion.

*Can trunk highway bonds finance construction of a park-and-ride ramp for the State trunk highway system on privately-owned land?*

It is possible that construction of such a ramp could be financed with State trunk highway bond proceeds if the State has a leasehold interest in the underlying land at least equal to the useful life of the State-owned ramp constructed thereon.

---

#### **(4) Additional Assistance**

It should be noted that the facts and circumstances surrounding a particular project will need to be analyzed to determine the appropriate source of bond proceeds for such project. The determination as to whether a project will be financed with State trunk highway bonds will be made by the Minnesota Management and Budget, Bond Counsel to the State, and the Office of the Attorney General. Questions and concerns will be minimized if the Department of Finance can review, in consultation with Bond Counsel and the Office of the Attorney General, all proposed trunk highway bond riders prior to passage by the Minnesota Legislature.

For further guidance, please contact the officials listed below.

*Minnesota Management and Budget Contacts:*

Keith Bogut, Executive Budget Officer  
651. 201.8034, [Keith.Bogut@state.mn.us](mailto:Keith.Bogut@state.mn.us)

Kathy Kardell, Assistant Commissioner  
651.201.8030, [Kathy.Kardell@state.mn.us](mailto:Kathy.Kardell@state.mn.us)

Sue Gurrola, Financial Analyst -  
651.201.8046, [Sue.Gurrola@state.mn.us](mailto:Sue.Gurrola@state.mn.us) -