

## RESEARCH MEMO

To: Interested Parties

From: Stephen Raher, CCJRC Senior Policy Analyst

Date: February 24, 2003

Re: Certificates of Participation/HB 03-1256

### Introduction/Background

In recent weeks, many members of the General Assembly have been educating themselves on certificates of participation (COPs), in light of the passage of House Bill 03-1256 through the House of Representatives. HB 1256 would provide for capital construction projects in the Department of Higher Education and Department of Corrections (DOC) through lease purchase financing. The lease purchase agreements would be securitized and sold to investors by means of COPs. For excellent discussions of COPs, see Colorado Legislative Council Staff's "Issue Brief 03-03" and Prof. Barry Poulson's thoughts on COPs (both attached).

The Colorado Criminal Justice Reform Coalition (CCJRC) objects to HB 1256 for two reasons: COP financing is poor fiscal policy, and the prison project encompassed by HB 1256 is unnecessary. This memo addresses the former topic. For more information on our concerns pertaining to the proposed prison expansion, see our recently published report *Incarceration and Correctional Spending in Colorado*.<sup>1</sup>

### Multi-Year Debt

Article XI of the Colorado Constitution provides two essential guidelines for our state's fiscal policy: it prohibits general obligation (GO) debt (Section 1) and it requires voter approval of allowable forms of multi-year debt (Sections 3, 4 and 5).

Colorado courts have upheld the legality of COPs in a number of cases, most notably *In re Colorado State Senate* (566 P.2d 350). The body of case law which supports the legality of COPs relies on the presence of an annual appropriation clause (such as that contained in Sections 2(d) and 3(b) of HB 1256), which theoretically places annual renewal of the lease purchase agreement at the discretion of the legislature. In the case of the CSP project, it is true that holders of COPs would not have legal recourse against the state if the General Assembly stopped making payments. In this sense, COPs are not long term debt. *However*, the Colorado Supreme Court has also noted that "the purpose of section 3 of article XI is to prevent the pledging of revenues of future years."<sup>2</sup> In this light, COPs can reasonably be seen as a multi-year obligation. As State Treasurer Mike Coffman explained to the Joint Budget Committee in 2002,

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<sup>1</sup> Available online at [http://www.ccjrc.org/pdf/Legislators\\_Handbook.pdf](http://www.ccjrc.org/pdf/Legislators_Handbook.pdf)

<sup>2</sup> *In re Senate Resolution 2*, 31 P.2d 325, 330.

a future legislature does not really have the latitude to not make the annual [COP payment] appropriation. The practical consequences of a decision not to make the annual appropriation, which include credit rating downgrades and quite probably being shut out of the capital markets indefinitely, are so severe that no Legislature will seriously contemplate facing them.<sup>3</sup>

In practical terms, future legislatures *will* be obligated to make annual payments on the COPs. As the Supreme Court noted in 1933, a “general rule of constitutional construction is that the language of Constitutions must, so far as possible, be given its ordinary meaning, and the words thereof their common interpretation.”<sup>4</sup> In the 1933 case, the court found that a legislative proposal to issue highway bonds was, in fact, long term debt, despite theoretical arguments to the contrary. The technical arguments which framed the 1933 case are, in some ways, echoed in the current debate over HB 1256. COPs are *de facto* debt and should be treated as such.

Additionally, legislatures in recent decades have tended to only use COPs that were backed by specific revenue streams (e.g., cash funds, federal funds). Since HB 1256 proposes to use General Fund revenues for repayment, the COPs become more akin to general obligation debt, which is prohibited by the Colorado Constitution.

### Economics

The foundation of the capitalist marketplace is the concept of two parties entering into a mutually beneficial transaction. Thus, the philosophy behind COP-backed financing is that COP-holders use their investment dollars to provide an asset (in this case, a prison) to the state, in return for money (in the form of principal and interest payments). Theoretically, if the state cannot make payments, the investors will be able to fall back on the value of the asset. In the case of CSP, however, the investors would be left with a valueless asset—a prison located within a secure correctional complex, serviced only by state utilities, and situated on state land. Furthermore, since the CSP expansion facility would be a Level V facility, the owners could not legally operate the prison, due to the provisions of CRS §17-1-104.9, which prohibits private entities from operating prisons above medium security. In essence, the COP holders could not operate the facility as a prison, could not physically access the building in order to use it for other purposes, and would most likely not be able to find a willing buyer (except, perhaps, the state).

The economic realities of COPs help to explain the near certainty of a downgraded credit rating should Colorado fail to renew the lease purchase agreement—since the investors have no legal recourse and would have title to a virtually worthless asset, their only leverage over the state is the prospect of a slashed credit rating.

### Voter Approval

Given the above evidence supporting the argument that COPs are, in fact, multi-year debt, we feel that the proposal contained in HB 1256 should be referred to a vote of the people. The people of Colorado could then weigh the potential risks and benefits of such a proposal.

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<sup>3</sup> Quoted in Joint Budget Committee, “FY 2003-04 Staff Budget Briefing: Department of Corrections,” by Karl Spiecker (December 20, 2002), 72-73.

<sup>4</sup> *In re Senate Resolution 2*, at 330.