

BUILDING AUTHORITY FINANCING OF PUBLIC BUILDINGS FOR POLITICAL SUBDIVISION USE

A political subdivision in need of additional building space initially must determine whether to lease or build the necessary space. If the decision is to build and the construction cost cannot be covered by existing funds, the question becomes whether to incur indebtedness through issuance of bonds of the political subdivision or find an alternative means of financing the project. One alternative method of financing public building construction which has been used in North Dakota is establishment of a building authority.

Use of a building authority to construct a public building is similar in many respects to traditional financing through a bond issue of the political subdivision. However, building authority financing also differs in several significant respects. To be viable, bonds issued by the building authority must be eligible for the federal income tax exemption for bondholders to make the bonds attractive to purchasers. To qualify for the federal income tax exemption status, a building authority must be established as a nonprofit corporation and under Internal Revenue Service Ruling 63-20:

1. The corporation must engage in activities that are essentially public in nature;
2. The corporation must be one that is not organized for profit;
3. The corporate income must not inure to any private person;
4. The state or a political subdivision must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation for which the indebtedness was incurred, upon retirement of the indebtedness; and
5. The corporation must have been approved by the state or a political subdivision, either of which must also have approved the specific obligations issued by the corporation.

A political subdivision lacks the power to form a nonprofit corporation building authority (see North Dakota Attorney General Letter Opinion 2008-L-05). Individuals, including employees or elected officials of the political subdivision, may form a nonprofit corporation building authority. The building authority issues tax-exempt bonds for construction of a building to be leased to the political subdivision. The political subdivision makes lease payments from the building fund or other sources of the political subdivision. If lease rental payments are budgeted from available funds of the political subdivision, no indebtedness is occurred in the constitutional sense. However, because the revenue and appropriations of the political subdivision are an annual decision (school boards are limited to one-year leases by North Dakota Century Code Section 15.1-09-33(7)) and not an indebtedness backed by the property within the political subdivision, the bondholders run the risk of the political subdivision not appropriating funds to pay the lease rentals. The bondholders have no recourse against the political subdivision in the event of default.

One aspect of building authority financing of public buildings that has drawn criticism from some taxpayers is that use of a building authority does not require voter approval while bonding for construction of a public building generally requires 60 percent voter approval under Section 21-03-07. In addition, in the case of school buildings, construction of a new school building must be approved by the Superintendent of Public Instruction under Section 15.1-36-01, but that does not apply if a school building is to be constructed by a building authority.