OPINION NO. 77-049

Syllabus:

Ohio Const. Art. VIII, §6 does not prohibit a municipal corporation from operating a home owner rehabilitation loan and grant program that offers long term loans and outright grants to individual home owners for the purpose of eliminating and preventing urban blight, if the funds advanced to such individuals are at all times exclusively federal funds given to the city for the express purpose of operating such a program under the Housing and Community Development Act of 1974, 42 U.S.C. §5301 et seq.

To: Richard E. Bridwell, Muskingum County Pros. Atty., Zanesville, Ohio
By: William J. Brown, Attorney General, September 26, 1977

I have before me your request for an opinion which provides in part as follows:

> "The City of Zanesville has applied to the U.S. Department of Housing and Urban Development for a Community Development Block Grant of $1,225,000. The City's Community Development Block Grant Program as approved by the Secretary of Housing and Urban Development provides for $91,000.00 to be used in a Home Owner Rehabilitation Loan and Grant Program. The Program as contemplated by the City of Zanesville would make low interest loans and grants to individual home owners for the rehabilitation of homes in certain low and middle income neighborhoods. The goal of the Program would be the elimination and prevention of urban blight, a public purpose under State, ex rel., Bruestle v. Rich, 159 Ohio St. 13 (1953).
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> I therefore request your opinion on the query of whether or not the operation of homeowner rehabilitation loan and grant program by the City of Zanesville . . . constitutes a lending of credit in violation of Article VIII, Section 6, of the Ohio Constitution."

The Home Owner Rehabilitation Loan and Grant Program about which you inquire is one of several new community funding programs authorized by the

Housing and Community Development Act of 1974. 42 U.S.C., §5301 et seq. The Act, which became effective on January 1, 1975, gives local government grant recipients substantially greater latitute in administering federal programs than they previously possessed under the categorical programs for urban development. This increased latitude, however, has not altered the basic contractual relationship between the parties. The Department of Housing and Urban Development is still free to withhold funds from the grantee if it does not submit an adequate plan which shows a demonstrable relationship to the objectives of Congress for the use of the funds. Once the grantee prepares an acceptable plan, the federal government retains an extensive and ongoing power to review the propriety and efficiency of the program.

As I understand it, the administration of the program in question involves the establishment by the city of a letter of credit with the United States Treasury Regional Disbursing Office. Thereafter, from time to time, the city will request withdrawals against this letter of credit for home owner rehabilitation loans and grants. The Disbursing Office will then forward the funds to the city for deposit in a home owner rehabilitation loan and grant program fund. This is a separate account into which only Housing and Community Development Act money will be deposited. No general fund or other tax revenue monies of any type will be deposited in this fund. Moreover, the Department of Housing and Urban Development has established as a condition of payment that the recipient certify its willingness and ability to establish procedures that will minimize the time elapsing between the transfer of the funds and their disbursement to property owners. The City of Zanesville, therefore, will be unable to invest any of the funds in interest bearing obligations prior to utilization. Through the use of a separate account and the immediate utilization of the funds, the federal nature of the money will be preserved throughout the operation of the program.

In the case of the grant program, the funds will then be distributed in the form of an outright grant to qualified home owners. These grants will be processed by city personnel.

The operation of the proposed loan program is more complicated. The loans, which will be initially processed by city employees, will be made to qualified borrowers for varying lengths of time. The repayment of the rehabilitation loans by individual home owners will be made to a separate revolving fund which will be established at the financial institution ultimately selected by bid procedure to service the loans once they are made. The financial institution will receive some portion of the interest that is charged on the loan as compensation for its services. Money paid into this revolving fund will be loaned out to other qualified home owners. These funds will not be mixed with city moneys or used for any other municipal purpose. In the event that a borrower defaults on the loan, the ensuing loss, if any will be borne by prospective borrowers who may be unable to obtain a loan because of any consequent depletion in the revolving fund.

As you have indicated in your request, the permissibility of both aspects of this program turns in part upon the operation of Ohio Const., Art. VIII, §6 which provides as follows:

> No laws shall be passed authorizing any county, city, town or township, by vote of its citizens, or otherwise, to become a stockholder in any joint stock company, corporation, or association: provided, that nothing in this section shall prevent the insuring of public buildings or property in mutual insurance associations or companies. Laws may be passed providing for the regulation of all rates charged or to be charged by any insurance company, corporation or association organized under the laws of this state, or doing any insurance business in this state for profit.

It should be noted that the Franklin County Court of Appeals, in the case of State, ex rel. Eichenberger v. Neff, 42 Ohio App. 2d 69 (1974), has held that Art.

VIII, §6, supra, and Ohio Const. Art. VIII, §4 are to be construed in a like manner. See, 1971 Op. Att'y Gen. No. 71-045. The latter section imposes upon the state a limitation similar to that imposed upon municipalities by the former section. In resolving the question at hand, therefore, cases construing either section of the Constitution are applicable. Moreover, it was decided in the case of Markley v. Village of Mineral City, 58 Ohio St. 430 (1898) that, in addition to any company, association or corporation, a municipal corporation is prohibited from lending its credit to an individual. The fact that the participants in the proposed loan and grant program are individuals is not, in and of itself, sufficient to place it outside of the Constitutional prohibition.

The courts have given a rather expansive interpretation to the term "credit" as it appears in these provisions. The prohibition has been read to extend beyond the types of surety and indemnity contracts that courts in other jurisdictions have found impermissible under similar provisions. See, Mayor v. Shattuck, 19 Colo. 104, 34 P. 947 (1893); Edge v. Brice, 253 Iowa 710, 113 N.W. 2d 755 (1962); State v. Giessel, 271 Wis. 15, 72 N.W. 2d 577 (1955).

The most recent pronouncement by the Supreme Court concerning the meaning and scope of Art. VIII, §4, supra, is State, ex rel. Saxbe v. Brand, 176 Ohio St. 44 (1964). This case involved the constitutionality of statutes creating the Ohio Development Financing Commisison. Under the statutes in question the Commission was authorized to "issue revenue bonds of the state", to "receive and accept grants, gifts and contributions" and to lend its funds to community and state improvement corporations and to other corporations, partnerships and persons for the purpose of procuring or improving real and personal property for the establishment, location and expansion of industrial, distribution, commercial, or research facilities in the state. Pursuant to this statutory power, the Commission had proposed to make loans in excess of $3,600,000 to three corporations for profit.

In concluding that the challenged statutes were invalid by reason of the limitations set forth in Art. VIII, §4, supra, the Court held in the first, second and sixth paragraphs of the syllabus as follows:

> 1. The word "credit" as used in Section 4 of Article VIII of the Ohio Constitution includes within its meaning (1) a loan of money and (2) the ability to borrow, i.e. the ability to acquire something tangible in exchange for promise to pay for it.
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> 2. A creditor is one who gives credit to another or one to whom a debt is due.
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> . . .
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> 6. There can be a giving or loaning of credit of the state within the meaning of Section 4 of Article VIII of the Constitution of Ohio even where no debts of the state, either direct or contingent, are incurred.

In so holding the Court noted at 47 and 48 as follows:

> In order to make two of the loans involved in the instant case, Section 122.17, Revised Code, required the commission to find that "the proposed borrower * * * * is unable to finance the proposed project through ordinary financial channels upon reasonable terms and at reasonable interest rates.
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> It is apparent, therefore, that, as to each proposed borrower, its "ability to borrow" or borrowing power (i.e. credit) is not sufficient to enable it to borrow the money which the commission proposes to provide. In effect, therefore, each such borrower will be receiving more credit

> (or borrowing power) because of the commission's loan to it than it could otherwise get from any financial institution. At least to that extent, the commission is giving or loaning "credit * * * * to or in aid of" that borrower.

Inasmuch as the loan and grant program that you describe would permit certain individuals to receive outright grants and others to receive loans at terms more advantageous than they could otherwise receive, the program clearly involves a giving or lending of credit.

Although the range of activity prohibited by Art. VIII, §§4, 6, supra, is quite broad, it is by no means uncompromising. Both provisions were adopted to address a particular set of circumstances. In discussing the events that led to the passage of these sections, the court,in Walker v. City of Cincinnati, 21 Ohio St. 14, 53 (1871), stated as follows:

> Under the constitution of 1802 numerous special acts of legislation had authorized counties, cities, towns and townships to become stockholders in private corporations, organized for the construction of railroads, to be owned and operated by such corporations. The stock thus subscribed by the local authorities was generally authorized to be paid for by the issue of bonds, which were to be paid by taxes assessed upon the property of their constituent bodies. Many of these enterprises proved unprofitable, and the stock became valueless. Some of them wholly failed. Heavy taxation followed to meet and discharge the principal of the bonds thus issued.

The Court then discussed the nature of the limitation these provisions impose in the following terms:

> The mischief which this section interdicts is a business partnership between a municipality of subdivision of the state, and individuals or private corporations or associations. It forbids the union of public and private capital or enterprise in any enterprise whatever. In no project originated by individuals, whether associated or otherwise, with a view to gain, are the municipal bodies named permitted to participate in such manner as to incur pecuniary expense or liability. They may neither become stockholders nor furnish money or credit for the benefit of the parties interested therein. Id. at 54

Thus, there are rather basic and carefully defined policies underlying these constitutional limitations. It is not surprising, therefore, that the courts, in articulating the real and intended import of these provisions, have developed exceptions to the prohibition.

The Supreme Court has repeatedly held, for instance, that there can be no giving or loaning of credit as long as the state does not incur any indebtedness and that a debt is not incurred by the state or a political subdivision when it merely incurs an obligation to apply revenue to be received from property being acquired by it in payment of the cost of such property. State, ex rel. Allen v. Ferguson, 155 Ohio St. 26 (1951) (the issuance and sale of bonds, which were payable solely from revenues derived from a turnpike project and which specifically state on their face that they do not constitute a debt of the state, held constitutional); State, ex rel. Bridge Commission v. Griffith, 136 Ohio St. 334 (1940) (statute providing that bridge revenues for the payment of bonds issued by the State Bridge Commission for the purpose of purchasing bridges held constitutional); Kasch v. Miller, 104 Ohio St., 281 (1922) (statute authorizing certain improvements to be paid for by the issue and sale of bonds in the name of the state held constitutional).

The loan and grant program about which you inquire, however, would fail to qualify as an exception under this line of cases. In the situation at hand funds are

being given or loaned to individuals who are giving nothing tangible in return therefor. The grant progrm involves an outright transfer of funds. The loans are advanced to borrowers in exchange for nothing more than the promise of repayment.

A second exception to these constitutional prohibitions has focused upon the nature of the recipient and the purpose for which the funds are being spent. The Supreme Court has held that, while the provision forbids the giving or loaning of credit to or in aid of a private business enterprise, it does not prohibit such a gift or loan to a public organization created for a public purpose. Bazell v. Cincinnati, 13 Ohio St. 2d 63 (1968) (lending of a city's credit to a county for construction of a sports stadium held constitutional); State, ex rel. Speeth v. Carney, 163 Ohio St. 159 (1959) (statute authorizing a subway to be built by the county and used by municipally owned transit system held constitutional); State, ex rel. Kaur v. Defenbacher, 153 Ohio St. 550 (1950) (expenditure of public funds for the Ohio Turnpike Commission to complete a feasibility study of a proposed turnpike project held constitutional).

On two occasions, the Court has upheld, as a valid act of the legislative body, an appropriation of public funds to private non-profit organizations to be expended for a public prupose. State, ex rel. Dickman v. Defenbacher, 164 Ohio St. 142 (1955) (appropriation bill which included grants to designated veterans' organizations for the express purpose of rehabilitating war veterans held constitutional); State, ex rel. Leaverton v. Kerns, 104 Ohio St. 550 (1922) (statute providing county financial support for non-profit agricultural society designed for public instruction held constitutional). A public purpose may, therefore, render an otherwise unconstitutional transaction permissible.

"Public purpose" is an amorphous concept that often assumes various dimensions in different contexts. As a limitation on the expenditure of public funds, it is commonly recognized to be a doctrine based on due process of law. It has been held that the Fourteenth amendment to the United States Constitution requires that the taking of one's money by taxation is lawful only when the expenditure of those monies fulfills a public purpose. Loan Association v. Topeka, 20 Wall. 655, 22 L. Ed. 455 (1874). Thus the public purpose limitation is one that for the most part exists independently of that concerning the giving or lending of credit. In both Dickman v. Defenbacher, supra, and Leaverton v. Kerns, supra, however, the court found that the existence of a valid public purpose was sufficient, in the case of a non-profit corporation, to overcome constitutional prohibitions regarding the giving or lending of credit.

Legislative bodies possess great latitude in determining what constitutes a public purpose. In Bazell v. Cincinnati, 13 Ohio St. 2d 63 (1968), the court, recognizing the variable nature of a public purpose, held in the second paragraph of the syllabus as follows:

> The determination of what constitutes a public municipal purpose is primarily a function of the legislative body of the municipality, subject to review by the courts, and such determination by the legislative body will not be overruled by the courts except in the instances where the determination is manifestly arbitrary or unreasonable. (Paragraph two of the syllabus of State, ex rel. Gordon v. Rhodes, 156 Ohio St. 81, approved and followed).

Thus, a public purpose is, in effect, anything reasonably designated as such by the legislative authority of the state or its political subdivisions.

The purpose of the proposed loan and grant program reflects the general purpose of the law under which it is established. That purpose is "the elimination of slums and blight and the prevention of blighting influences and the deterioration of property and neighborhood and community facilities of importance to the welfare of the community, principally persons of low and moderate income." 42 U.S.C. §5301 (C) (1).

Some indication of the attitude of the courts towards the purpose of the program may be gleaned from holdings regarding the validity of similarly designated public purposes in other contexts. In State, ex rel. Bruestle v. Rich, 159 Ohio St. 13 (1953), the court considered the constitutionality of an urban redevelopment program which had as its primary purpose "the elimination of slum conditions and provisions against their recurrence." In upholding the constitutionality of the project, the court held that it may involve a public purpose for which public funds can be expended and the power of eminent domain exercised. Accord, St. Stephen's Club v. Youngstown Metropolitan Authority, 160 Ohio St. 194 (1953). It is reasonably clear, therefore, that the purpose of the proposed loan and grant program is a suitable public purpose.

The existence of a valid public purpose, however, is not sufficient to render any transaction permissible. The status of the recipient must also be considered. As noted by the Court in State, ex rel. Saxbe v. Brand, supra, the fact that in each instance there may be a public purpose for making the loan, does not affect the fact that in each instance credit is being given either to or in aid of a private corporation for profit.

The proposed loan and grant program is problemmatic inasmuch as the recipients of the funds are individual home owners acting in their individual capacities. Although I am unaware of any case upholding the constitutionality of a grant of public funds to an individual, the courts have never indicated that a grant to an individual is per se for a private purpose and, therefore, impermissible. See generally, Auditor of Lucas Co. v. State, ex rel. Boyles, 75 Ohio St. 114 (1906). Thus, a public purpose is sufficient to validate the giving or loaning of credit to a non-profit corporation and insufficient to permit the extension of such credit to a private business enterprise. Whether the state or a political subdivision can, under any circumstances, extend credit to an individual is an issue that has never been addressed by the courts of this state.

It is, of course, possible to argue that grants and loans to individual home owners of low and moderate incomes for the purpose of eliminating and preventing urban blight do not involve the sort of private speculation at the expense of the general tax revenue that Art. VIII, §§4, 6 were designed to prevent. I am, however, disinclined to do so. It is, first of all, an issue that is more properly decided by the courts. Secondly, the resolution of this issue is not necessary to the disposition of your question.

Although, as I have previously indicated, the loan and grant program will clearly involve the giving or loaning of credit to individuals, I am of the opinion that the credit being extended is not that of the city. The funds involved in this loan and grant program are exclusively federal in nature. Moreover, they maintain, throughout the operation of the program, an identity separate from the funds of the state or any political subdivision thereof. In addition to the requirement of prior approval from the Department of Housing and Urban Development, the conclusion that the funds are federal in nature is strongly supported by the control in terms of fiscal management exercised by the federal funding agency. By accepting a community block grant, the local grantee agrees to be bound by the provisions of Federal Management Circular 74-7, "Standards for Granter Financial Systems." 24 C.F.R. §70, 505. The purpose of the circular is to insure that all federal grant-in-aid funds are properly accounted for as federal funds. Under the provisions of the circular, the grantee agrees to render regular reports covering the status and application of the funds and any liabilities and obligations on hand. The grantee must also give the United States or its duly authorized representatives access, for purpose of examination and audit, to any books, documents, papers and records pertinent to the grant.

The obvious conclusion to be drawn from the review powers and extensive fiscal controls by the federal government over this program is that the local grantee, in this case the city, is the instrument of the federal government for the purpose of designing and administering a program which utilizes federal funds to meet national housing and community development objectives as enumerated in the act. The mere fact that the local government exercises brief custody of the funds is not, in my opinion, sufficient to alter the basic fact that they are federal funds.

Although the Supreme Court has never had occasion to pass upon the constitutionality of a city's involvement with any of the federal programs that have been created in recent years, the Court recognized some time ago that the source or origin of the funds involved was an important consideration in determining whether the credit of a municipality was being lent in violation of Art. VIII, §6, supra.

In upholding the constitutionality of statutes that permitted fines and penalties assessed and collected by the Police Court to be devoted for the purpose of aiding and maintaining law libraries, the Court held in State, ex rel. Pugh, Trustees v. Sayre, 90 Ohio St. 215 (1915) as follows:

> Section 6 of Article VIII of the Constitution is applicable to the taxing power of the state and designed for the protection of moneys resulting from its exercise, and it does not prohibit the devotion of "fines and penalties assessed and collected by the police court for offenses and misdemeanors prosecuted in the name of the state" to the aid of a law library association, whose library is subject to use by all officers exercising judicial functions in the county in which such police court sets such library being a corporation not for profit.

Although the Pugh case, supra, has been cited in more recent cases, no Ohio court has ruled further on the proposition advanced by the Court that the source or origin of the funds is an important factor in determining the constitutionality of their use.

Even in their most far-reaching decisions, however, the courts have considered the origin and nature of the funds involved in determining whether the credit of the state was being lent. In State, ex rel. Saxbe v. Brand, supra, for instance, the proposed loans were to be financed through the issuance and sale of bonds which could impose no direct liability upon either the state or its political subdivisions. Nevertheless, the Court, recognizing the practical relationship between the power to issue bonds and the need to tax, noted at 52 as follows:

> Where the state raises money by the sale of revenue bonds which do not involve the debt of the state, could anyone contend with reason that the money so raised is not money of the state? If such money were stolen the state would certainly regard it as state money.
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> Also, the sale of revenue bonds of the state to raise money necessarily involves a borrowing of money even though no indebtedness of the state results. If the bonds are not paid, the borrowing power of the state will as a result be adversely affected, even though the bonds do not represent a debt of the state. The borrowing power of the state is related to the taxing power because, to the extent that the states borrowing power is lessened a greater burden will be placed upon its taxing power.

The foregoing rationale is wholly inapposite to the situation at hand. Because the city merely acts as a trustee for the program funds, the funds cannot be considered the money of the municipal corporation. Because the funds are given to the city for the operation of a specific program and because the operation of this program is exclusively funded by federal monies, the taxing power of the state or its political subdivisions is not even indirectly affected. Consequently, the credit of the city is not involved.

Furthermore, it will be noted that the permissibility of the loan and grant program in question is strongly supported by 1973 Op. Att'y Gen. No. 73-006, the

syllabus of which provides as follows:

> 1) Under R.C. 901.31 and 901.32, funds which formerly belonged to the Ohio Rural Rehabilitation Corporation may be used for the purpose of guaranteeing loans made by commercial banks to Ohio farmers.
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> 2) Article VIII, Section 4, of the Ohio Constitution does not prohibit the use of funds returned to the state pursuant to the "Rural Rehabilitation Corporation Trust Liquidation Act", 40 U.S.C. 440 et seq. (1950), for the purpose of guaranteeing loans made by commercial banks to Ohio farmers.

In reaching this conclusion, I strongly stressed that it was the federal nature of the funds involved that rendered the loan guarantees constitutional. I noted that even though the guarantee of loans made to private individuals constituted a lending of credit, the fact that the money originated with the federal government indicated that it was not the credit of the state that was being lent.

It is unnecessary, for purposes of this opinion, to consider separately the constitutionality of the loans and grants. The basis for my conclusion concerning the permissibility of the program turns upon a characterization of the funds as being the funds of neither the state nor its political subdivisions. It is inconsequential, therefore, whether the funds are advanced in the form of a loan or an outright grant. In both such instances the municipality acts as an intermediary between the Department of Housing and Urban Development and individual home owners.

In conclusion, it will be noted that this opinion should not be interpreted as permitting every conceivable form of program involving loans or grants to home owners. The conclusions set forth herein are formed on the basis of the particular program described. The Housing and Community Development Act of 1974 confers so much latitude upon local government entities that the particular form that a program may ultimately assume is often limited only by the imagination of the individual who plans it. It is impossible to conclude, therefore, that a home owner rehabilitation loan and grant program authorized by the Housing and Community Development Act of 1974 is, in all cases, permissible under Art. VIII, §6, supra.

In specific answer to your question, it is my opinion and you are so advised that Ohio Const. Art. VIII, §6 does not prohibit a municipal corporation from operating a home owner rehabilitation loan and grant program that offers long term loans and outright grants to individual home owners for the purpose of eliminating and preventing urban blight, if the funds advanced to such individuals are at all times exclusively federal funds given to the city for the express purpose of operating such a program under the Housing and Community Development Act of 1974, 42 U.S.C. §5301, et seq.