FLORIDA'S SCHOOL-DISTRICT LEASE FINANCING: CROSS COLLATERALIZATION, PATH DEPENDENCY, AND THEIR IMPLICATIONS

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I. INTRODUCTION

The Great Recession[1] has had a devastating effect on the fiscal health of state and local governments[2] from Pennsylvania to California.[3] The run-up in economic activity from the nationwide housing bubble that had initially padded state and local government budgets with tax revenues has long since reversed course, leaving a nationwide unemployment rate once as high as ten per-

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1. *See* Courtney Schlisserman, *'Great Recession' Gets Recognition as Entry in AP Stylebook*, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ayojB2KWQG4k (Feb. 23, 2010) (stating that the *AP Stylebook Online* added the term "Great Recession" as a reference for the "downturn that began in December 2007").

2. *See generally* Elizabeth McNichol et al., *States Continue to Feel Recession's Impact* 1 (June 17, 2011) (available at http://www.cbpp.org/files/9-8-08sfp.pdf) (noting that "[t]he recession brought about the largest collapse in state [tax receipts] on record . . ."). This report shows that for fiscal years ending July 1, 2009 and 2010, the fifty states had a combined total of over three hundred billion dollars in budget shortfalls; it also provides tables that demonstrate budget shortfalls for 2009 and 2010. *Id.* at 10–11.

3. In May 2008, the City of Vallejo, California, filed for bankruptcy protection under Chapter 9 of the Bankruptcy Code. *In re City of Vallejo*, 2008 Bankr. E.D. Cal., 2008 WL 4146015 at *1 (Aug. 29, 2008); *see also* City of Vallejo, Cal., *Key Pleadings*, http://www.ci.vallejo.ca.us/GovSite/default.asp?serviceID1=744&Frame=L1 (accessed July 5, 2011) (containing key pleadings from *In re City of Vallejo*). On December 15, 2010, the Pennsylvania Department of Community and Economic Development declared the City of Harrisburg, the State's capital, to be in a state of municipal fiscal distress under the State's Municipal Financial Recovery Act. Or. Granting Req. for Determ. of Distress under Act 47, *In re: City of Harrisburg*, http://debtwatchharrisburg.files.wordpress.com/2010/10/harrisburg-order.pdf (Pa. Cmmw. Dep't Community & Econ. Dev. Dec. 15, 2010). The city came under financial distress after defaulting on a $288 million debt-service payment for a municipal incinerator. Patriot-News Editorial Bd., *Harrisburg Incinerator Fiasco Deserves an Investigation to Understand How it Happened*, http://www.pennlive.com/editorials/index.ssf/2010/04/how_did_it_happen_incinerator.html (Apr. 12, 2010).

cent and significant deficits in state and local budgets across the country.[4] In light of these significant budgetary pressures, several commentators and investment professionals have expressed concern over the ability of state and local governments to continue to meet their outstanding obligations.[5] These concerns have even led the U.S. Congress to consider legislation permitting states to file for protection under Federal Bankruptcy Code,[6] an option that has historically been available to municipalities and political subdivisions but not to states.[7]

Florida has been among the states most adversely affected by the Great Recession.[8] The economic downturn, combined with the steep drop-off in population growth (which has long been the economic engine of the State) has put tremendous strain on budgets at all levels of government.[9] Among the local governments affected by the current fiscal pressures are Florida school districts, which receive the bulk of their funding from property and sales taxes[10]—two revenue sources that have seen sharp declines due to

4. *See McNichol*, *supra* n. 2, at 3–4, 6 (explaining the fiscal challenges that confront the states); U.S. Dep't of Lab., Bureau of Lab. Statistics, *Labor Force Statistics from the Current Population Survey*, http://data.bls.gov/timeseries/LNS14000000 (accessed Sept. 7, 2011) (providing tables that show an unemployment rate reaching ten percent).

5. CBS News, *State Budgets: The Day of Reckoning*, http://www.cbsnews.com/stories/2010/12/19/60minutes/main7166220.shtml (Dec. 19, 2010).

6. Oversight & Gov't Reform Comm., Subcomm. on TARP, Fin. Servs. and Bailouts of Pub. & Priv. Programs, *State and Municipal Debt: The Coming Crisis?* Video Recording (posted Feb. 9, 2011) (available at http://oversight.house.gov/index.php?option=com_content&view=article&id=1101%3A2-9-11-qstate-and-municipal-debt-the-coming-crisisq&catid=34&Itemid=39).

7. 11 U.S.C. § 109 (2006).

8. The Pew Ctr. on the States, *Beyond California: States in Fiscal Peril* 1, 41 (Nov. 2009) (available at http://downloads.pewcenteronthestates.org/BeyondCalifornia.pdf) (stating that "[t]he Great Recession has not just stalled Florida's growth—it has reversed it. In 2005, Florida ranked second among the states in economic growth. In 2008, it ranked 48th. . . . As of [November 2009], there were at least 275,000 homes for sale or rent in Florida that nobody wanted, and the state has the second-highest foreclosure rate in the country.").

9. *Id*.

10. Fla. Dep't of Educ., *2010–11 Funding for Florida School Districts* 1–2 (2010) (available at http://www.fldoe.org/fefp/pdf/fefpdist.pdf). This report indicates that Florida school districts receive funding primarily from state appropriations, levy of ad valorem taxes, and federal funding. *Id*. at 1–2, 6. For the 2008–2009 fiscal year, these sources represented 35.68%, 54.15%, and 10.17%, respectively, of the funding for Florida school districts. *Id*. at 1. The portion funded from state appropriations is primarily funded from the State's General Revenue Fund, which is predominantly comprised of sales taxes. *Id*. at 1–2.

the recession.[11] As these revenue sources shrink, Florida's school districts may find difficulty in meeting their long-term obligations, such as the payments required under numerous and sizable lease-financing obligations.

In Florida, school districts finance the construction and improvement of school facilities through lease-financing arrangements.[12] Similar to long-term bonds, these lease-financing obligations require a school district to make continuing payments under long-term leases, with rental payments stretching out twenty years or more.[13] Although Florida's school districts have used lease financing since the 1980s,[14] its use surged after the Florida Supreme Court's holding in *State v. School Board of Sarasota County*,[15] becoming the near-exclusive means by which the State's school districts finance long-term capital projects.[16] As of 2008, school districts throughout the State had issued over $14

11. *See* Fla. Bureau of Econ. & Demographic Research, *Executive Summary, Revenue Estimating Conference Ad Valorem Assessments* (Dec. 3, 2010) (available at http://edr.state.fl.us/Content/conferences/advalorem/adval_summary.pdf) (estimating the property tax-roll taxable values that are used in determining the amount of ad valorem taxes school districts must levy to receive state appropriations under the Florida Education Finance Program (the FEFP)). This summary indicates that "[t]he estimate of 2011 taxable value has been lowered from the previous forecast to account for Florida's weak economic situation." *Id.*; *see also* Legis. Off. of Econ. & Demographic Research, *Executive Summary, Revenue Estimating Conference for the General Revenue Fund* (Dec.14, 2010) (available at http://flaglerlive.com/wp-content/uploads/revenue-estimating-dec14.pdf) (indicating that the forecasts contained therein reflect "an economy that is still in the early stages of an abnormally slow recovery"). This summary further notes that the estimates were particularly impacted by downward adjustments in sales taxes, corporate income taxes, and medical and hospital fees. *Id.*

12. In discussing Florida's school districts and their financings as of 2000, Standard & Poor's notes that "leasing tends to be the primary way for the districts to meet their capital needs . . . ." *Standard & Poor's Public Finance Criteria 2000*, at 101 (2000 ed., Standard & Poor's 2000). Standard & Poor's revised its Public Finance Criteria in 2005 and again in 2007, and in both cases, many of the provisions cited herein, including the foregoing reference, were removed. The ratings reports subsequent to Standard & Poor's revisions, however, offer a rationale that remains consistent with the criteria discussed in the 2000 report.

13. *See infra* pt. II (describing the structure and mechanics of the lease-financing process for Florida school districts).

14. Shelly Sigo, *Florida's TIF Case Raises Questions for Bond Insurers*, The Bond Buyer (Sept. 19, 2007) (available at http://www.bondbuyer.com/news/-278473-1.html?zkPrintable=true).

15. 561 So. 2d 549 (Fla. 1990).

16. *See infra* pt. IV (chronicling the increase in the use of lease financing after *School Board of Sarasota County*).

billion of long-term, lease-financing obligations to finance the cost of school buildings.[17]

Lease-financing obligations are by far the largest source of long-term debt on the books of Florida's school districts.[18] And the annual payment obligations under these lease-financing obligations can be significant, running as high as nearly $64 million for a single school district.[19] Given the size and volume of these obligations statewide, the current adverse economic conditions could hamper the ability of some school districts to continue to make payments under their lease-financing obligations.[20]

If a disruption in the rental payments on leased facilities materializes, some interesting, if not disturbing, aspects of Florida's school districts' lease financing could be revealed. One such aspect involves the cross collateralization of leased school facilities. Cross collateralization in school-district lease financings occurs when a school district conditions its right to occupy any single leased facility on the payment of rent on all leased facilities; failure to pay rent on even one facility results in an obligation to vacate all leased facilities.[21] Cross collateralization is a common characteristic of Florida's school-district lease financings.[22] Lease financings that carry this cross-collateralization remedy tend to garner relatively high credit ratings, which add to their appeal among investors.[23] But this appeal could be fleeting. In this Article, I chronicle the use of lease financing—which has become

17. St. of Fla. Auditor Gen., Rpt. No. 2010-022, *Report on Financial Trends and Significant Findings in Audits of District School Boards* 7 (Oct. 2009) (available at http://www.myflorida.com/audgen/pages/pdf_files/2010-022.pdf).

18. *Id*.

19. *See Final Offering Statement for $109,830,000 Certificates of Participation: School Board of Hillsborough County, Florida Master Lease Program* 56 (Series 2008A, Wachovia Bank, National Association 2008) (charting the combined annual certificate as $63,760,445 for the Series 2008A Project).

20. *See* St. of Fla. Auditor Gen., *supra* n. 17, at 8 (noting that "given the impact of the economic downturn on revenue sources, such as sales tax and property assessments, school districts will need to closely monitor the impact on required debt service payments").

21. *See* Moody's Investors Serv., *Moody's Rating Methodology: The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations* 13 (2004) (stating that repossession of the entire group of leased assets takes place when a default in payment occurs).

22. *See* Standard & Poor's, *supra* n. 12, at 100–101 (mentioning that leasing is usually the main way districts meet their capital needs); *see also infra* pt. IV (discussing the burgeoning of lease financing and cross collateralization in Florida in the early 1990s).

23. *See* Standard & Poor's, *supra* n. 12, at 100–101 (discussing how the bundling of multiple assets into a single appropriation, or cross collateralization, leads to the enhancement of lease ratings).

phenomenally popular among school districts and investors alike—by Florida's school districts. I submit that this popularity is due to what many perceive to be the credibility of cross collateralization. As a consequence of this popularity, school-district lease financings in Florida have become path dependent[24] on cross collateralization. I argue that risks are inherent in this path dependency because certain questions regarding the enforceability of cross collateralization have been overlooked in the past. Should these questions be resolved against the enforceability of cross collateralization, the impact will be far reaching, affecting not only lease-financing investors but all school districts throughout Florida.

In Part II, I briefly explain the concept and mechanics of lease financing and how it is similar to other methods of long-term capital financing, such as bond financing. In Parts III and IV, I discuss the legal basis for school-district lease financing in Florida, chronicling its use and popularity since the Florida Supreme Court's opinion in *School Board of Sarasota County.*[25] In these Parts, I also discuss the concept of path dependency and how the popularity of school-district lease financing among investors is tied to, and path dependent on, the cross collateralization of school facilities. Next, in Part V, I point out that this path dependency has risks: namely, that continued reliance on cross collateralization without reexamining its validity masks legitimate legal questions regarding its enforceability against school districts. In this Part, I explore two potential challenges to the enforceability of cross collateralization of school facilities. Finally, in Part VI, I submit that a number of Florida school districts could be exposed to the adverse effects of the unenforceability of cross collateralization upon the lease-financing default of a single school district. Specifically, I posit that financially weaker school districts have an incentive to exploit the credibility of cross collateralization to obtain financing they might not otherwise get. In such a case, a default by any such school district that leads to a successful challenge to cross collateralization could benefit the defaulting school district—but to the detriment of other more credit-worthy school districts that also relied on the credibility of

24. *See infra* pts. III and IV (discussing path dependency).
25. 561 So. 2d 549.

cross collateralization. Perhaps the best course of action for credit-worthy school districts going forward, then, is to forego cross collateralizing their leased facilities.

II. SCHOOL-DISTRICT LEASE FINANCING: A BRIEF EXPLANATION

School districts in Florida obtain funding for the construction and renovation of school facilities primarily through the use of lease financing instead of other modes of financing such as the issuance of General Obligation bonds (GO bonds) or revenue bonds.[26] In this Part, I describe the typical structure and mechanics of the lease-financing process and how that process compares to forms of capital projects, such as the issuance of long-term bonds.

In a typical school-district, lease-financing transaction, the school district first leases land to a related not-for-profit financing corporation through one or more ground leases.[27] The land-owning

26. *See* St. of Fla. Auditor Gen., *supra* n. 17, at 7 (indicating that Florida's school districts' long-term debt as of June 30, 2008, included $14 billion in certificates of participation in lease financings versus $171 million in qualified zone academy bonds, $1.4 billion in district revenue bonds, $463 million in GO bonds, and $696 million in state board-of-education bonds); *see also* Standard & Poor's, *supra* n. 12, at 101 (discussing Florida's school districts and noting that "leasing tends to be the primary way for the districts to meet their capital needs . . . ."). GO bonds are bonds that are "secured by the full faith, credit and taxing power of an issuer. GO bonds issued by local units of government[,]" such as a school district, "are typically secured by a pledge of the issuer's ad valorem taxing power . . . ." Mun. Sec. Rulemaking Bd., *Glossary of Municipal Terms* GO bond (2d. ed., 2004) [hereinafter Mun. Sec. Rulemaking Bd.] (available at http://www.msrb.org/msrb1/glossary/view_def.asp?vID=3648); *see also* M. David Gelfand, *State & Local Government Debt Financing* vol. 1, § 2.13, 2–15 (Thompson West 2008) (defining revenue bonds as a mechanism for state and local governments "to finance public projects on a self-liquidating basis with the proceeds of the obligations secured solely by the revenues derived from the project financed"). Florida's school districts have the authority to issue GO bonds under Article VII, Section 12 of the Florida Constitution. Revenue bonds are bonds that are secured by a specific source of revenue, such as revenues from a project, grant revenues, or other non ad valorem revenues, and with respect to which the full faith, credit, and taxing power of the issuer is not pledged. *See* Mun. Sec. Rulemaking Bd., *Glossary of Municipal Terms* Revenue Bond (2d ed., 2004) (providing a definition of revenue bonds). Florida's school districts have the authority to issue revenue bonds under section 1013.15(2)(b)1 of the Florida Statutes by pledging lease revenues. (2010); *see generally Sch. Bd. of Sarasota Co.*, 561 So. 2d at 550. One of the consolidated cases on appeal was *State v. Florida School Boards Association, Inc.*, in which the Florida School Boards Association acted on behalf of the School District of Orange County to validate $230,000,000 of lease-revenue bonds. No. 75154 (Fla. Apr. 26, 1990)).

27. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 550 (noting the agreements that supported the bonds and certificates of participation "provide[d] for the lease of public land

school district generally creates or controls the financing corporation for the purpose of facilitating the overall lease-financing transaction.[28] Once the financing corporation has acquired an interest in the land through the ground lease, it arranges the construction of the desired school facilities on the land and borrows funds for this purpose, often in the public-finance market.[29] The financing corporation leases the newly-constructed school's facilities back to the school district and uses the lease revenues to repay the money borrowed for the school facilities' construction.[30] To help secure the repayment of the borrowed funds, the financing corporation assigns its interest in the ground lease and the facilities lease to a corporate trustee; the corporation's interest includes, importantly, its rights to receive the rental revenues as well as its rights to exercise eviction remedies.[31] The trustee collects the rent revenues from the school district and uses them to repay the lenders who provided financing for the construction of the school facilities.[32] The trustee acts on behalf of the lender, the

owned by the boards to not-for-profit entities (by way of ground leases) . . . .").

28. *See* Moody's Investors Serv., *supra* n. 21, at 10 (stating that "[t]he lessor for a rated transaction is typically another governmental agency or a non-profit corporation created by the state or municipal lessee specifically for the purpose of facilitating such financings. . . . Usually, the [controlled financing corporation's] role in lease-backed [financings] is limited to consummating the transaction, assigning its interests to a trustee, and appointing the lessee as its agent in undertaking the construction or acquisition for the project"); *see also* Standard & Poor's, *supra* n. 12, at 98 (noting that "[m]ost of lease transactions rated by Standard & Poor's [at the time of the 2000 report] are between a governmental lessee and a non-profit public benefit corporation, as lessor, which has been established specifically for the purposes of the lease transaction").

29. *See infra* pt. III (discussing the issuance of certificates of participation and lease-revenue bonds as a borrowing method used to provide construction funds).

30. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551; *see* Moody's Investors Serv., *supra* n. 21, at 11 (defining lease-revenue bonds as those with limited obligations to the lessor and as "payable from and solely secured by the lessor's right to receive lease revenues from the rental payments of the public lessee"); *see also* Standard & Poor's, *supra* n. 12, at 97 (noting lease payments are installments that go towards an equity buildup in the leased property, and when the lease is up the lessee should automatically take ownership of the asset).

31. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 550–551 (stating that "[t]hese [lease financing] agreements provide for the lease of public land owned by the boards to not-for-profit entities (by way of ground leases), the construction or improvement of public educational facilities upon the leased lands and the annual leaseback of the facilities to the respective school boards (by way of facilities leases), and the conveyance of the lease rights of the not-for-profit entities to trustees (by way of trust agreements")); *see also* Moody's Investors Serv., *supra* n. 21, at 10 (noting that "[t]o secure the interests of the investor, the lessor typically assigns its interests in the leased property, the title, and the lease payments to a trustee. . . . Lease rental payments are typically made directly to the trustee").

32. Moody's Investors Serv., *supra* n. 21, at 10 (stating that "[l]ease rental payments

creditors, or both, in collecting rental payments and transmitting them to the creditors in case the school district defaults in paying rent.[33]

In order to reach a deeper and more liquid pool of financial resources, lease financings can be securitized and packaged to reach the public-financing market through the use of lease-revenue bonds or certificates of participation (COPs).[34] In California, where lease financing originated,[35] issuers favored COPs over lease-revenue bonds as a way to avoid public-sale requirements and interest-rate limitations that did not apply to COPs.[36] In Florida, school-district lease financings are carried out primarily through the issuance of COPs.[37] Because Florida's school districts

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are typically made directly to the trustee").

33. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 550–551 (noting that "[t]he trustee may relet the facilities for the remainder of the leases' term or sell its interest in the leases to generate revenue to pay bondholders").

34. *See* Moody's Investors Serv., *supra* n. 21, at 11 (listing COPs as one of two types of instruments sold to investors in lease financing transactions, the other being lease-revenue bonds); *see also* Kathleen Brown, *California Debt Advisory Commission: Guidelines for Leases and Certificates of Participation* 4–5 (Cal. Debt Advisory Comm'n 1993) (available at http://www.treasurer.ca.gov/cdiac/reports/Guidelines93-8.pdf) (stating, in terms of COPs, "[w]hen financing larger capital projects, agencies generally can lower their borrowing costs by marketing lease obligations through the retail securities market and attracting multiple investors . . . . To reach this broad investor base, agencies issue [COPs] in tax-exempt lease obligations."). As for lease-revenue bonds, they "are issued by a public agency, or on behalf of a public agency, to finance capital improvements which are then leased to a public agency." Brown, *California Debt Advisory Commission: Guidelines for Leases and Certificates of Participation*, at 5; Gelfand, *supra* n. 26, at § 3:26, 3–15 (noting that "in large [lease-purchase] transactions[,] the financing source may need to be a pool of investors. In these circumstances, the lessor will assign its interests in the lease to a trustee who will execute and deliver certificates of participation evidencing proportionate ownership interests in the lease on the part of the holders of the certificates. These certificates of participation may be sold on a limited basis to several institutional investors or on a wider basis, through an underwriter or underwriters, in a public distribution"); Kevin A. Kordana, *Tax Increases in Municipal Bankruptcies*, 83 Va. L. Rev. 1035, 1051 (1997) (stating that "[m]ore technically, COPs are instruments issued to investors in tax-exempt lease obligations").

35. Brown, *supra* n. 34, at 7 (stating that "the tax-exempt leasing phenomenon started in California"); Nancy J. Gladwell et al., *Certificates of Participation as an Alternative Funding Source for Capital Projects: A Case Study*, 15 J. Park & Recreation Admin. 23, 27 (1997) (noting that "COPs originated in California after the passage of Proposition 13 significantly handicapped governmental jurisdictions' ability to finance needed capital projects through traditional means (e.g., general obligation bonds)").

36. Moody's Investors Serv., *supra* n. 21, at 11; *see* Brown, *supra* n. 34, at 5 (noting that "[l]ease revenue bonds are used less extensively than COPs because they generally must be sold at competitive sale and are subject to other restrictions which do not apply to COPs").

37. *See* St. of Fla. Auditor Gen., *supra* n. 17, at 7 (indicating that Florida school districts' long-term debt as of June 30, 2008 included $14 billion in certificates of

almost exclusively use COPs over lease-revenue bonds,[38] all references in this Article to school-district lease financing are to such lease financings undertaken through the use of COPs.

In many respects, little difference exists between lease financing and more traditional forms of school-district debt financing such as the use of GO bonds.[39] Each allows access to public capital markets to finance capital projects, typically on a tax-exempt basis.[40] But one important aspect of lease financing does set it apart from GO bonds, at least in the context of Florida's school districts. Although Florida's school districts typically pay lease-financing obligations from ad valorem tax revenues,[41] lease financing is not subject to the Florida Constitution's voter-referendum requirement that would otherwise apply to GO bonds and other debt that ad valorem taxation supports.[42] This is an important fact for school districts that receive the majority of their funding from ad valorem taxes.[43]

Indeed, the special legal treatment accorded to lease financing is one reason the technique is so much more popular among school districts than other, more traditional forms of local-

participation, qualified zone academy bonds of more than $171 million, district revenue of $1.4 billion, general obligation bonds of $463 million, and state board of education bonds totaling $696 million).

38. *See id.* (suggesting that the bulk of Florida's school districts' debt arises mostly from certificates of participation, not lease-revenue bonds).

39. *See* Brown, *supra* n. 34, at 4 (stating that COPs work much like municipal bonds do); Gladwell, *supra* n. 35, at 28 (noting that certificates of participation are like GO bonds because they are used to finance capital development projects, are securities underwritten by banks, are purchased by private investors, pay fixed interest rates, have fixed maturities, and are tax-exempt).

40. In this regard, tax exemption refers to the fact that interest paid to investors who own COPs issued by school districts and other governmental issuers is excluded from the U.S. Federal taxable income of investors. *See* 26 U.S.C. § 103(a) (2006) (stating that "gross income does not include interest on state or local bonds"); *see also* Gelfand, *supra* n. 26, at § 3:6, 3–23 (explaining interest on obligations that have been issued "on behalf of" a state or political subdivision is federally tax exempt).

41. Fla. Stat. § 1011.71(2)(e) (2010) (permitting school districts to levy up to $1.5 mills in ad valorem taxes to make payments under lease-purchase arrangements used to finance school facilities).

42. *See* Fla. Const. art. VII, § 12 (allowing school districts to issue debt instruments payable from ad valorem taxation that mature more than twelve months after issuance, provided either a referendum has been held or the bonds are intended to refund existing bonds for savings).

43. Fla. Dep't of Educ., *supra* n. 10, at 1 (reporting that during the 2008–2009 fiscal year, state appropriations, local ad valorem taxes, and federal funding represented 35.68%, 54.27%, and 10.17%, respectively, of Florida school districts' funding sources).

government financing.[44] Significant restrictions surrounding more traditional forms of financing, particularly GO bonds, make the use of lesser restrictive modes of financing more appealing to issuers.[45] In Florida, the special legal treatment accorded to lease financing transactions is set out in a series of three Florida Supreme Court cases that exempt lease-financing obligations from the voter-referendum requirements set out in the Florida Constitution. Those cases are *State v. Miami Beach Redevelopment Agency*,[46] *State v. Brevard County*,[47] and *School Board of Sarasota County*.[48] The final case in this series, *School Board of Sarasota County*, addresses directly the validity of Florida's school districts' use of lease financing to finance the construction of school facilities.[49]

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44. Richard J. Miller & James A. Coniglio, *The Process and Mechanisms of Funding Public Projects*, in *State and Local Government Debt Financing* vol. 1, § 2:28 (M. David Gelfand ed., West 2010) (noting that lease financing appeals to a number of jurisdictions, including Florida, because of its usefulness in avoiding voter-referendum requirements under Florida Statutes section 230.23 (2000), renumbered as section 1001.42(11)(b)5 (2010)).

45. *See e.g.* R. William Ide, III & Donald P. Ubell, *Financing Florida's Future: Revenue Bond Law in Florida*, 12 Fla. St. U. L. Rev. 701, 711 (1985) (noting that financing capital projects with revenue bonds, rather than with GO bonds, makes a more "logical" choice for municipalities because municipal leaders, who are politicians, might be less willing to issue debt to voters, who might not favor raising taxes). A nationwide trend has developed toward the use of revenue-bond financing, while the favorability of GO bonds, which are payable from ad valorem taxation, has declined. U.S. Census Bureau, *Statistical Abstract of the United States* § 9, 313 (120th ed., 2000) (available at http://www.census.gov/prod/2001pubs/statab/sec09.pdf). The amount in revenue bonds more than doubled that of GO bonds, with seventy billion dollars in GO debt versus one one-hundred fifty billion dollars in revenue-bond debt. *Id.* Although half of all outstanding securities are GO bonds, sixty-seven percent of the principal amounts of all outstanding municipal securities are revenue bonds, keeping the two-to-one ratio of revenue bonds to general obligation bonds. U.S. Sec. & Exch. Comm'n, *Report on Transactions in Municipal Securities* 28 (July 1, 2004) (available at http://www.sec.gov/news/studies/munireport2004.pdf).

46. 392 So. 2d 875 (Fla. 1980). The 1968 revision of the Florida Constitution rejected prior judicial exceptions to the voter-referendum requirement. *Id.* at 898. The Florida Supreme Court had previously made exceptions to what constituted a "bond" under Article VII, Section 12 of the Florida Constitution. *Id.* at 896 (quoting *Leon Co. v. State*, 165 So. 666, 667 (Fla. 1936)).

47. 539 So. 2d 461 (Fla. 1989) (distinguishing a lease-financing agreement containing an unconditional right to terminate the agreement from one that might compel the government to raise ad valorem taxes).

48. 561 So. 2d at 552 (directly validating Florida's school districts' lease financing for the construction of facilities).

49. *Id.* at 550–553.

III. FLORIDA LAW RELATING TO SCHOOL-DISTRICT LEASE FINANCING: HOW DID FLORIDA ARRIVE AT THE CURRENT SCHOOL-DISTRICT LEASE-FINANCING LAW?

Since the 1930s, Florida has constitutionally restricted local governments, including school districts, from issuing debt supported by ad valorem taxes.[50] Prior to 1930, the Florida Constitution did not curb the power of local governments to borrow money, and as a result, local governments had issued "hundreds of millions of dollars in bonds,"[51] supported by ad valorem tax revenues.[52] During the ensuing Great Depression, the value of these bonds collapsed along with property values and tax revenues.[53] Numerous local governments went bankrupt, and as a result, in 1930, the legislature added Article IX, Section 6 to the Florida Constitution to prohibit counties and municipalities from issuing bonds, unless the voters in the county or municipality approved them.[54] This referendum requirement was intended to prevent ad valorem-fueled debt issuances in the future.[55] As time passed and memories faded, however, support for the prohibition of non-voter-approved debt began to diminish.[56] In 1968, the legis-

50. Fla. Const. art. VII, § 12 (requiring referendum approval for any form of "tax anticipation certificates" maturing more than twelve months after issuance); *see Strand v. Escambia Co.*, 32 Fla. L. Wkly. S550, S554 (Fla. 2007), *rev'd*, 992 So. 2d 150 (Fla. 2008) (noting that the people of Florida rejected on two distinct occasions a proposed change to the plain language of Article VII, Section 12 of the Florida Constitution).

51. *State v. Fla. St. Improvement Comm'n*, 60 So. 2d 747, 751 (Fla. 1952) (describing the economic "'Boom Days'" in which the legislature passed hundreds of special acts that allowed counties and municipalities to issue hundreds of millions of dollars of public debt).

52. *Id.* (reporting that during "the 'Boom' burst [. . .] a depression was on, and the people and the freeholders found themselves saddled with debts impossible for them to pay").

53. *Id.* (noting that many of these bonds were resold during the Great Depression for less than twenty or even ten percent of par).

54. *Id.* (reporting that the U.S. Congress recognized Florida's financial condition and included Florida's municipalities within the Federal Bankruptcy Act's purview). Amended Article IX, Section 6 permits counties, districts, and municipalities to issue bonds only after majority-voter approval through an election held in such county, district, or municipality. Fla. Const. art. IX, § 6.

55. *Strand*, 32 Fla. L. Wkly. at S553–S554 (noting that, despite the purpose of the 1930 amendment, courts interpreted the amendment to allow certain forms of local obligations); Ide, *supra* n. 45, at 709 (stating that the purpose of the 1930 amendment was to restrain government spending where the government could not repay without public credit the money that it used).

56. *See e.g.* Ide, *supra* n. 45, at 710 (referring to ever-broadening court decisions relaxing the original 1930 referendum requirement); Tracy Nichols Eddy, *The Referendum Requirement: A Constitutional Limitation on Local Government Debt in Florida*, 38 U.

lature revised this constitutional-referendum requirement to its current form, which requires a referendum only in the case in which bonds or other indebtedness is "payable from ad valorem taxation" and "matur[es] more than twelve months after issuance."[57] Debt secured by non-ad valorem revenues is not subject to the voter-referendum requirement of Article VII, Section 12.[58] As a result, since the 1968 amendment, and starting even before its adoption,[59] the pledges of non-ad valorem revenues, as opposed to ad valorem taxes, have supported most local-government financing.[60] Despite the move toward non-ad valorem-based financing, Florida's Constitution since the 1930s has contained an express requirement of voter approval in case local governments pledge ad valorem taxes to the payment of debt.[61] At least presumably, this requirement apprises voters of the possibility that taxes on their property could increase to service bond debt.[62]

Miami L. Rev. 677, 687–688 (1984) (chronicling the progressive judicial expansion of the exceptions to the referendum requirement). Starting with the Florida Supreme Court's decision in *State v. City of Miami*, Florida courts have fashioned and continued to uphold a revenue-bond exception to applicable voter-approval requirements for debt supported by ad valorem taxes. 152 So. 6, 9–10 (Fla. 1933) (holding, on the basis of ample extra-jurisdictional authority, that municipal obligations that are payable solely from the revenues of an "independent revenue producing asset or utility" do not constitute a debt that is subject to constitutional or statutory limitations). A less restrictive view of the voter-referendum requirement, the revenue-bond exception stemmed from a judicial recognition that legitimate restrictions on municipal debt issuance must be balanced against the legitimate need for additional capital funding. Ide, *supra* n. 45, at 712.

57. Fla. Const. art. VII, § 12 (restricting such bonds' purpose to financing or refinancing capital projects and to refinancing debt for a lower interest rate). The 1968 constitution "liberalized bonding authority for projects not tied to ad valorem taxes and for projects supporting economic development." Ide, *supra* n. 45, at 710.

58. *See* Fla. Const. art. VII, § 12 (failing to circumscribe debt secured by non-ad valorem revenues).

59. Although "[l]ocal government indebtedness in Florida [had] increased sharply from 539 million dollars in 1950 to . . . an estimated 2.5 billion dollars in 1968," sources other than ad valorem taxation financed approximately one third of the outstanding indebtedness in 1968. Manning J. Dauer et al., *Should Florida Adopt the Proposed 1968 Constitution? An Analysis* 32 (U. Fla. Pub. Admin. Clearing Serv. 1968).

60. Based on an inquiry of the Division of Bond Finance of the State Board of Administration of Florida, since 2005, local governments in Florida have issued almost $85 billion in bonds and lease-financing obligations. (Survey on file with author). The bond issuers characterized approximately 66% of the bonds as revenue bonds. *Id.* The Division of Bond Finance collects such information on local government bond issuances under section 218.37 of the Florida Statutes (2010) (describing the powers and duties of the Division of Bond Finance).

61. *See generally Strand*, 32 Fla. L. Wkly. at S589–590 (discussing the 1930 amendment to the Florida Constitution requiring a referendum prior to the issuance of bonds).

62. *See* Tracy Nichols Eddy, *supra* n. 56, at 686 (discussing the purpose of the 1930 amendment to Article IX, Section 6 of the Florida Constitution); *see also State v. Fla. St.*

Ad valorem taxes are of particular significance to Florida's school districts, which receive a large portion, if not the majority, of their funding from them.[63] In fact, Florida's school districts rely on ad valorem tax revenues to pay lease-payment obligations under lease-financing arrangements.[64] Lease financings in the form of COPs function "[f]or all intents and purposes . . . like municipal bonds."[65] Therefore, one would expect that school-district lease financings carried out through the issuance of COPs would be subject to the voter-referendum requirement. But this is not the case. Under Florida law, lease financings exploit an important distinction that the Florida Supreme Court drew between using ad valorem-tax revenues to pay debt service and pledging ad valorem-tax power to support debt obligations.[66]

In *Miami Beach Redevelopment Agency*,[67] the Florida Supreme Court established a bright-line test to determine whether pledging a local government's taxing power triggered the constitutional-referendum requirement.[68] The city established a

Improvement Comm'n, 47 So. 2d 627, 631 (Fla. 1952) (holding that "section 6 of Article IX [now Section 12 of Article VII] limits the county's right to pledge . . . taxes to be levied and collected in the future by requiring that before the county may pledge such future revenues for a present county need the county shall first obtain an approving vote of the freeholders of the county who, after all, will be called upon to discharge the burden through means of ad valorem taxes levied against their property); *Leon Co.*, 165 So. at 669 (referring to the 1930 amendment and stating "[i]ts outstanding purpose was to lay a restraint only on the spendthrift tendencies of political subdivisions to load the future with obligations to pay for things the present desires . . . thereby necessitating the involvement of the public credit in some form").

63. *See* Florida Dep't of Educ., *supra* n. 10, at 1–2 (2010–2011) (showing that in 2008–2009, school districts received 54.15% of their financial support from local sources and that local sources derive revenue "almost entirely from property taxes levied by Florida's 67 counties"). The Florida Education Finance Plan (FEFP) sets out the uniform method of funding education in Florida. Fla. Stat. §§ 1011.60–1011.77 (2010). Participation is voluntary by school districts, but participating school districts are entitled to receive state funds. *Id.* School districts desiring to participate in the FEFP are required to levy a school district ad valorem tax. *Id.* at § 1011.71(1).

64. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 554 (McDonald, J., dissenting, Overton, J., concurring in dissent) ("These financing schemes are secured by a pledge of ad valorem taxes, at least on a year-by-year basis. This contrasts with the financing plan approved in *State v. Brevard County* . . . [in which] ad valorem taxes were not a part of the financing agreement."); *see also* Fla. Stat. § 1011.71(2)(e) (permitting school districts to levy up to 1.5 mills in ad valorem taxes to make payments under lease-purchase arrangements used to finance school facilities).

65. Brown, *supra* n. 34, at 4.

66. *Miami Beach Redevelopment Agency*, 392 So. 2d 875.

67. *Id.* at 894.

68. *Id.* at 898–899. This case was recently re-examined and reaffirmed in *Strand*, 992 So. 2d at 157–160. *See generally* Robert C. Reid & Jason M. Breth, *Miami Beach: Receded,*

redevelopment district under Florida Statutes, Chapter 163 to finance redevelopment construction projects with its jurisdiction.[69] To finance this redevelopment, the district proposed that it would issue bonds, in accordance with its authority.[70] The city planned to secure the bonds in part by a trust fund, into which certain taxing districts within the redevelopment district would appropriate money, an amount corresponding to the ad valorem tax revenues from anticipated increases in property values within the redevelopment district.[71] The city referred to this amount of money as the "tax increment revenue."[72]

The State challenged the bonds[73] on the grounds that public referendum had to approve them first because they were "payable from ad valorem taxation within the meaning of [A]rticle VII, [S]ection 12" of the Florida Constitution.[74] In fact some of the revenues to be deposited into the trust fund would indeed come from ad valorem taxation.[75] The Court held that, despite this fact, the issuance of the bonds without a referendum was valid under the Constitution.[76] The Court, importantly, construed the "payable

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Revised and Reaffirmed, 83 Fla. B.J. 18, 18, 22 (2009) (discussing the Court's treatment of *Miami Beach Redevelopment Agency* in *Strand*).

69. *Miami Beach Redevelopment Agency*, 392 So. 2d at 882, 884–893 (discussing whether Florida's Redevelopment Act complies with the constitutional requirement that use of eminent domain and public financing of redevelopment be for public purposes).

70. *Id.* at 884.

71. The actual appropriation requirement provides that

> (a) [t]he amount of ad valorem taxes levied each year by all taxing authorities except school districts on taxable real property contained within the geographic boundaries of a community redevelopment project; and (b) [t]he amount of ad valorem taxes which would have been produced by the rate upon which the tax is levied each year by or for all taxing authorities except school districts upon the total of the assessed value of the taxable property in the community redevelopment project . . . [prior] to the effective date of . . . [the] redevelopment plan.

Id. at 881 (quoting Fla. Stat. § 163.387(1) (1977)).

72. *Id.* at 893–894.

73. When matters come before the court under Chapter 75 of the Florida Statutes, the public is put on notice and they have an opportunity to challenge the issuance of bonds. Fla. Stat. § 75.06–07 (2010). In general, bonds will be validated when (1) the authority exists for the issuer to issue the bonds; (2) the proceeds of the bonds will serve a public purpose; and (3) the bonds will be issued in accordance with the process established under law. *Boschen v. City of Clearwater*, 777 So. 2d 958, 962 (Fla. 2001).

74. *Miami Beach Redevelopment Agency*, 392 So. 2d at 893. The challengers argued that the amounts to be set aside for debt service "will be derived from . . . tax levies on the real property in the area," and therefore "payable from ad valorem taxation" in a manner proscribed by the Florida Constitution in absence of a voter referendum. *Id.* at 894.

75. *Id.* at 894.

76. *Id.* at 898, 899.

from ad valorem taxation" language in Article VII, Section 12 to mean that bonds are subject to the referendum requirement only if *judicial action* could compel the issuer to levy ad valorem-tax assessments in order to pay for the bonds.[77] Despite the fact that the amount of revenues that local governments pledged to bond holders were determined with reference to ad valorem taxes, the Constitution did not require a voter referendum because the city had not granted to any bond holder the right to require, through judicial action, the issuer to levy or increase ad valorem taxes to pay the debt.[78]

By holding that the referendum requirement of Article VII, Section 12 of the Florida Constitution is triggered only in cases in which judicial action could compel an issuer to raise taxes to pay the debt, the Court established a bright-line test to determine when debt is "payable from ad valorem taxation"[79] and therefore subject to the Florida Constitution's referendum requirement.[80] The mere use of ad valorem revenues to pay the debt is not enough to trigger the referendum requirement; rather, under the terms of the financing, the creditor must have the ability to seek judicial redress to compel the debtor, the local government, to raise ad valorem taxes to pay the debt.[81]

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77. The Court held that:

> [w]hat is critical to the constitutionality of the bonds is that, after the sale of bonds, a bondholder would have no right, if the redevelopment trust fund were insufficient to meet the bond obligations and the available resources of the county or city were insufficient to allow for the promised contributions, to compel by judicial action the levy of ad valorem taxation. Under the statute authorizing this bond financing the governing bodies are not obliged nor can they be compelled to levy any ad valorem taxes in any year. The only obligation is to appropriate a sum *equal* to any tax increment generated in a particular year . . . . [Thus,] [i]ssuance of these bonds without approval of the voters of Dade County and the City of Miami Beach . . . does not transgress [A]rticle VII, [S]ection 12.

Id. at 898–899 (emphasis added). This view—that is, the view that whether bonds are payable from ad valorem taxation should be based on whether bondholders, through the courts, can avail themselves of the ad valorem taxing power of the issuer—was recently affirmed by the Florida Supreme Court in *Strand*, 92 So. 2d at 159–160.

78. *Miami Beach Redevelopment Agency*, 392 So. 2d at 898–899.

79. *Id.* at 893.

80. *Id.* at 893–899.

81. *Id.* at 898. Despite the clarity of the Court's bright-line test established in *Miami Beach Redevelopment Agency*, the Court has held that, in some cases, even though the local-government debtor is not contractually subject to judicial redress to raise taxes to pay the debt, the local government could be so bound by other contractual features of the debt that raising taxes would be a foregone conclusion. *Frankenmuth Mut. Ins. Co. v. Magaha*, 769 So. 2d 1012, 1026 (Fla. 2000); *Co. of Volusia v. State*, 417 So. 2d 968, 969, 971–972

Subsequent to the holding in *Miami Beach Redevelopment Agency*, issuers began using the bright line set out in that case to justify the ability to use ad valorem revenues to pay lease-financing obligations. In *Brevard County*,[82] the Court applied the *Miami Beach Redevelopment Agency* bright-line test in the context of a lease financing of personal property.[83] It is the first case in which the Court applies the bright-line test to lease financings.[84] In *Brevard County*, the county proposed to lease-finance certain equipment.[85] The lease was annually renewable and would terminate upon the earlier of (1) payment of all scheduled lease payments or (2) the first fiscal year in which the county failed to "appropriate[e] sufficient funds to make the scheduled lease payments."[86]

The State, opposing the lease-purchase agreement, argued the substance of the lease terms represented an effective pledge of the county's ad valorem taxing power that required approval by voter referendum under Article VII, Section 12 of the Florida Constitution.[87] The State specifically argued that the terms of the lease constituted an indirect pledge of ad valorem taxation much like granting a mortgage on property, which the Court had previously ruled in *Nohrr v. Brevard County Educational Facilities Authority*[88] required voter approval under Article VII, Section 12.[89] But the Court in *Brevard County* disagreed,[90] holding that if the county did not renew the lease, the only remedy available to

(Fla. 1982); *Nohrr v. Brevard Co. Educ. Facilities Auth.*, 247 So. 2d 304, 310–311 (Fla. 1971). But so far, the Court's inclination to look to this logic to conclude that in substance ad valorem taxing power has been pledged (and therefore the debt is subject to the constitutional voter referendum requirement) has been very limited.

82. 539 So. 2d 461.

83. *Id.* at 463–464.

84. *Id.*

85. *Id.*at 462. The lease, including the rights to receive the annual rents, was to be assigned from the not-for-profit corporation to a trustee who would sell COPs in the lease payments. *Id.* at 462. The county's obligation to pay rent under the lease secured COPs that were to be sold to the public. *Id.* The money provided by purchasers of the COPs would be used to purchase the equipment to be leased to the County. *Id*.

86. *Id.*

87. *Id.* at 463.

88. 247 So. 2d 304.

89. *Id.* at 311. The Court in *Nohrr* considered the granting of a mortgage to be a prohibited indirect pledge of ad valorem taxation because the county might be tempted to levy ad valorem taxes to avoid foreclosure of the mortgage, in which case it would lose its equity in the property. *Id. a*t 309.

90. *Brevard Co.*, 539 So. 2d at 464.

lease-financing investors was to have the trustee exercise the typical rights of a lessor: take possession of the property, sell or re-let it, and return any excess proceeds to the county.[91] In this way, according to the Court, the county could maintain its "full budgetary flexibility" either to pay rent or refrain from paying rent without the threat of being forced to abandon built-up equity in the equipment, which would have been prohibited under *Nohrr*.[92]

The premise of the Court's holding in *Brevard County* is that by contracting only to return the leased property—in this case, equipment—to the lessor upon default, the county retained the flexibility to terminate its payment obligations without recourse. If the county no longer wanted the equipment or no longer wanted to pay for it, the solution was simple: return it to the lessor and be relieved of any additional obligation.[93] In the Court's view this constituted neither a direct nor indirect pledge of ad valorem taxing power.[94]

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91. *Id.*

92. *Id.* According to the Court,

> [t]he county is simply renting equipment under the lease. As in the case of any other lease, if the lease is terminated, the county would have a contractual commitment to return to the lessor any leased equipment still owned by the lessor. The state's contention that the county would be under compulsion to keep the lease current in order to protect the 'equity' built up in the equipment is unfounded. If the county permits the lease to terminate, the lessor may sell or relet the equipment. In either event, any monies received by the lessor which exceed the county's remaining obligations under the lease will be returned to the county. *With its 'annual renewal option' under the lease, the county maintains its full budgetary flexibility.* We see no illegality in the county's proposal.

Id. (emphasis added). The Court's distinction seems inapposite, however. If Brevard County exercised its full budgetary flexibility by not renewing the lease, then it seems the county had already decided to vacate or abandon the leased property. The concern of an indirect pledge of ad valorem taxes indeed would be diminished because it seems unlikely that the county would seek to levy ad valorem taxes to prevent the transfer of property it had already decided to abandon. After all, under *Nohrr*, avoiding foreclosure would have likely been possible in a similar fashion by conveying to the mortgage a "deed in lieu" of foreclosure. But, arguably, this scenario was not the concern in *Nohrr*. 274 So. 2d at 310–311. Rather, the concern in *Nohrr* centered on the potential for the County to levy taxes to avoid losing property (property it presumably had decided *not* to abandon) through foreclosure of a mortgage. *Id.* The same situation would be present in *Brevard County* if the lessee sought repossession of the property through exercise of its rights under the lease when the county defaulted but still wanted to keep the leased equipment. The Court in *Brevard County* did not acknowledge this prospect, however, and instead *assumed* the County would abandon the leased property rather than raise taxes to keep it. 539 So. 2d at 463–464.

93. *Brevard Co.*, 539 So. 2d at 464.

94. *Id.*

In *School Board of Sarasota County*, the final case in the series,[95] the Court again affirmed the use of the *Miami Beach Redevelopment Agency* bright-line test in which ad valorem taxes were to be used to pay lease-financing obligations.[96] The Court also applied the principle of annually-renewable budgetary flexibility that anchored the holding in *Brevard County*.[97] The school districts of Sarasota, Collier, and Orange Counties entered into separate lease-financing arrangements to finance the construction and improvements of schools' buildings and other facilities.[98] In each instance, the lease financings were structured essentially as described in Part II of this Article.[99] The school districts were to lease their land through ground leases to special-purpose nonprofit entities.[100] The schools' new facilities were to be constructed on the ground-leased land, and the existing schools' facilities were to be improved.[101] Proceeds from COPs and lease-revenue bonds issued on behalf of the school district were to finance the facilities' construction and improvements.[102] Rental revenues derived from leasing the facilities back to the school districts were to repay the COPs and lease-revenue bonds.[103] To further secure the COPs and lease-revenue bonds' repayment, trustees received assignment of the rights under the ground and facilities leases, and the lease-financing lenders granted the trustees the right to take possession of the leased premises and re-let the facilities if the school boards defaulted on the rent.[104]

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95. *See supra* pt. III (listing the cases in which special legal treatment is accorded to lease-financing transactions).

96. 561 So. 2d at 552, 554.

97. *Id.* at 553.

98. *Id.* at 550–551.

99. *Id.*; *see supra* pt. II (explaining lease-financing practices in Florida's school districts).

100. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 550.

101. *Id.* at 550–551; Initial Br. of Appellant, *State v. Fla. Sch. Bds. Ass'n, Inc.*, http://www.law.fsu.edu/library/flsupct/74979/75154ini.pdf at 3 (No. 75, 154) (Fla. Dec. 21, 1989) (explaining that "[t]he proceeds from these [Lease-revenue bonds to be issued on behalf of Orange County School Board] will be used by the Association to finance educational facilities. The educational facilities will include new schools to be built on land already owned by the Board, new schools to be built on land which will be purchased, and improvements and additions to existing educational facilities.").

102. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 550–551.

103. *Id.*

104. *See id.* at 551 (describing that the not-for-profit entities' lease rights were to be conveyed to trustees and that if a school board should ever fail to make its payment for the facilities lease, the trustees may elect either to sell their interest in the project or re-let

In each of the lease-financing arrangements, school districts paid rent from moneys derived from sources that included ad valorem taxes.[105] School districts structured the leases as a series of twelve-month leases that the school-board lessees could renew on an annual basis.[106] If the school districts defaulted under one or more of the leases, or simply chose not to renew any of the leases for a subsequent lease term, the trustees who had been assigned the rights of the lessors under the facilities leases could (and in all likelihood were required to) exercise certain remedies.[107]

Although ad valorem revenues were one source of revenues to be used to pay rent under the leases, none of the school boards could be compelled to levy ad valorem revenues to pay the lease obligations.[108] Rather, in the event of a default or a failure to renew the lease for any of the leased facilities, each of the school boards had the option either to purchase all the facilities it leased-financed or surrender possession of all such facilities to the trustee.[109] If the school boards elected not to purchase the facili-

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those facilities for the duration of the lease term in order to generate sufficient funds to pay the bondholders); *see also* Initial Br. of Appellant, *State v. Sch. Bd. of Collier Co.*, http://www.law.fsu.edu/library/flsupct/74979/75009ini.pdf at 2–3 (No. 75,009) (Fla. Nov. 29, 1989) (noting that the Foundation had assigned all of its interest in both the ground lease and the lease-purchase agreement to a trustee and that, if the school board were to ever fail to make its lease payment, it would lose its possessory rights in the property for the duration of the lease term, and the trustee would have the option to sell or rent the projects to generate revenue).

105. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551. Specifically, those sources were: (1) the Florida Education Finance Program, (2) the local government infrastructure sales surtax, (3) the Public Education Capital Outlay and Debt Service Trust Fund, and (4) up to one half of receipts from the levy of capital outlay millage (i.e. ad valorem taxes). *Id.* at n. 3.

106. *Id.* at 551; *see* Ans. Br. of Appellee, *State v. Fla. Sch. Bds. Ass'n, Inc.*, http://www.law.fsu.edu/library/flsupct/74979/75154ans.pdf at 2 (No. 75,154) (Fla. Jan. 11, 1990) (explaining that "[t]he [Florida School Boards] Association, in turn, . . . leases the completed facilities back to the School Board on a year-to-year basis under a 'Lease-Purchase Agreement.' . . . If the School Board chooses to renew its yearly lease options for a period of fifteen years or until the bonds are repaid, whichever is sooner, title to the leased facilities vests free and clear in the School Board and the ground lease terminates[.]").

107. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551 (indicating that, should the board ever fail to pay its annual lease, the trustee then has the option to sell its interest in the leases or re-let the lease facilities in order to generate revenue to be able to pay the bondholders).

108. *Id.* at 552.

109. *Id.* at 551. If the school boards did not exercise their option to purchase the leased facilities (presumably through a refinancing under which new bonds or COPs would be issued to pay off the old bonds or COPs) then the trustee had a right, if not the obligation, to enter and re-let the facilities for the benefit of the holders of the COPs and bonds. *See* Amend. Br. of Appellant, *State v. Sch. Bd. of Sarasota Co.*, http://law.fsu.edu/library/flsupct/74979/74979brief1.pdf at 4 (Nos. 74,979, 75,009, 75154, 561 So. 2d 550) (Fla. 1989)

ties, the financing lenders required the school boards to surrender possession of the leased facilities to the trustees to whom the financing lenders had assigned the lease interests.[110] Upon surrender of the facilities, the trustees could sell their interest in the lease agreements or re-let the facilities to third parties for the remainder of the lease terms—and in either case the financing lenders required the trustees to use the proceeds generated from the sale or re-letting to pay off the COPs and bonds issued to finance the school facilities.[111] If a trustee received any excess rent, it had to pay it to the school boards.[112] Title to the school facilities (as well as possession of the land subject to the ground leases) was to be vested in the school boards upon the retirement of the COPs and bonds, regardless of whether the school boards themselves paid the bonds or third parties paid the bonds via the trustee.[113]

As in *Brevard County*, the sole question, in the Court's view, was whether school boards had pledged their taxing power to pay debt service on the lease-finance obligations.[114] Although the lease-purchase agreement in *School Board of Sarasota County* involved real property rather than equipment as in *Brevard County*, making the facts in *School Board of Sarasota County* more similar to *Nohrr*'s, this similarity made little difference to the Court.[115] Because no judicially enforceable covenant existed to levy ad valorem taxes to pay debt service, and because no interrelated promise or mortgage on the property could have led to a

("The [lessor] Corporation [or its assignee] may re-enter the educational facility in the event of default or non-appropriation and the [lessor] Corporation or its assignee will then have exclusive use of the property and the improvements until the bonds are retired and debts paid. . . . In the event of default or non-appropriation, the School Board will have the right to purchase the facilities by paying off the bonds. If it does not exercise this right, the [lessor] Corporation [or its assignee] may reenter and relet or sell its interest in the ground lease and the facilities in order to generate sufficient revenues to pay off the bonds.").

110. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551.

111. *Id.* at 551; Amend. Br. of Appellant, *supra* n. 109, at 4.

112. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551.

113. *Id.*

114. *See id.* (noting that the issue as to the bonds' validity was whether they required referendum approval under Article VII, Section 12 of the Florida Constitution and concluding that a referendum was not required because the school boards had not pledged to pay their debt from ad valorem taxation).

115. *See id.* at 552–553. In rendering its decision, the Court did not mention the difference in the type of property between *Brevard County* (equipment) and *Sarasota County* (buildings). *Id.*

conclusion that the school boards' taxing powers were practically pledged, the Court held that a referendum was not required.[116]

The Court also affirmed that an annually renewable lease does not violate the "maturing more than twelve months after issuance" portion of Article VII, Section 12 of the Florida Constitution.[117] The Court reasoned that such annually renewable leases maintained the same "budgetary flexibility"[118] exhibited in the *Brevard County* leases, in that these leases gave the school boards the "freedom to decide anew each year, burdened only by lease penalties, whether to appropriate funds for the lease payments."[119]

Based on the holding in *School Board of Sarasota County*, school districts should be able to use lease-purchase financing to acquire school facilities, including classrooms and other student-use facilities, without obtaining voter approval for the debt that accompanies the lease-purchase agreement. This is the case even though the school districts may intend to use ad valorem taxes to make the required lease payments.[120] The only requirement imposed on school districts under such an agreement is that there be no judicially enforceable covenant to levy ad valorem taxes to pay rent; instead, the district must retain the annual budgetary flexibility to determine whether to stop making lease payments without risking any consequences other than contractual lease remedies.[121]

In sum, despite the intentional restrictions on pledging ad valorem tax revenues that the legislature included in the Florida Constitution after the enormous fiscal turbulence left in the wake of the Great Depression, the Florida Supreme Court, in the eighty years following the addition of Article VII, Section 12 to the Flori-

116. *Id.*
117. *Id.*
118. *Id.* at 553.
119. *Id.* at 552.
120. *See id.* (holding that the use of certificates of participation to finance the lease of land and the construction of educational facilities without first acquiring referendum approval is constitutional because the certificates of participation were not a pledge of ad valorem taxing power).
121. *See id.* at 552–553 (holding that the bonds did not require referendum approval because the boards reserved the right to decide annually whether to renew the lease or terminate it and be subjected only to lease remedies); *see also Brevard Co.*, 539 So. 2d at 464 (holding that the bonds were valid because the county retains budgetary flexibility as long as it has the option to decide annually whether to renew the lease).

da Constitution, has authorized the lease-financing method, which permits school districts to use ad valorem tax-revenues to service financing obligations on long-lived assets.[122] According to the Court, the primary determinant of an impermissible pledge under Article VII, Section 12 is not whether a school board uses ad valorem taxes to repay a long-term obligation but whether a creditor has the ability judicially to compel the school board to use or levy ad valorem taxes.[123] These cases, importantly, also draw a distinction between the application of traditional lease remedies, such as eviction and abandonment of leased property and mortgages, which have been viewed as an indirect pledge of ad valorem taxing power.[124]

IV. SINCE SARASOTA*: EXPLOSION OF LEASE FINANCING, CROSS COLLATERALIZATION, AND PATH DEPENDENCY*

After *School Board of Sarasota County*, the complexion of school-district debt began to undergo a major change. At the time of *School Board of Sarasota County*, lease financing comprised a relatively low proportion of all long-term debt obligations that Florida's school districts issued. Based on Florida's school districts' financial reports, as compiled by the Florida Auditor General, school-district lease financings totaled approximately $213 million in aggregate, outstanding principal amount at June 30, 1990 (the date of the *School Board of Sarasota County* decision is April 26, 1990), representing approximately eight percent of all long-term obligations of Florida's school districts.[125] Conversely, on June 30, 2008, school-district lease financings totaled approximately $14 billion in aggregate, outstanding principal amount and represented approximately eighty-four percent of all long-term obligations of Florida's school districts.[126] A closer ex-

122. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552; *Brevard Co.*, 539 So. 2d at 464; *Miami Beach Redevelopment Agency*, 392 So. 2d at 898–899.

123. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552 (quoting *Miami Beach Redevelopment Agency*, 392 So. 2d at 898–899).

124. *See e.g. Brevard Co.*, 539 So. 2d at 464 (rejecting the idea that, like granting a mortgage on property, a lease-purchase agreement constitutes an indirect pledge of ad valorem taxation, much like granting a mortgage on property).

125. St. of Fla. Auditor Gen., *Report on Audit of the General Purpose Financial Statements of the State of Florida for the Fiscal Year Ended June 30, 1990* 40 (Jan. 1991) (copy on file with *Stetson Law Review*).

126. *See* St. of Fla. Auditor Gen., *supra* n. 17, at 7 (providing school-district lease fi-

amination of the six largest school districts confirms that this change in complexion is not due just to the issuance of new debt by school districts over this period of time but a *shift* from other types of debt, mainly revenue and GO bonds, to school-district lease financing.[127] In 1990, the year of the *School Board of Sarasota County* decision, lease financing at these six school districts (as measured by principal amount of COPs outstanding),[128] comprised approximately five percent of the principal amount of all long-term obligations that the school districts reported.[129] In 2001, the ratio of outstanding lease-financing principal to the principal amount of all long-term obligations at these school districts had risen to over sixty percent.[130] By 2008, this ratio was approximately ninety percent.[131] Based on the significant increase of lease financing as a proportion of all long-term obligations, the Court's validation of school-district lease financing appears to have served as the impetus for a significant shift toward the use of lease financing and away from other forms of financing-capital improvements.

This shift to lease financings can be attributed to two factors. First, lease financing can be supported by a major source of funding for Florida's school districts (ad valorem taxes) without triggering the referendum requirement under Article VII, Section 12.[132] This makes lease financing a faster and easier method of financing than the more traditional ad valorem-financing method, namely the issuance of GO bonds.[133] To issue GO bonds, for ex-

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nancing totals from June 30, 2008).

127. See Appendix and citations therein.

128. *See* Moody's Investors Serv., *supra* n. 21, at 11 (listing COPs as one of two types of instruments sold to investors in lease financing transactions).

129. See Appendix and citations therein.

130. *Id.*

131. *Id.*

132. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552 (explaining that no voter referendum is required when ad valorem taxing power is not directly pledged to pay the obligations); *see also* Fla. Dep't of Educ., *supra* n. 10, at 1 (noting that ad valorem taxing constitutes a major source of Florida's school-district funding). The report indicates that Florida school districts receive funding primarily from state appropriations, levy of ad valorem taxes, and federal funding. *Id.* at 1. For the 2008–2009 fiscal year, these sources represented 35.68%, 54.15%, and 10.17%, respectively, of Florida's school districts' funding. *Id.* The portion funded from state appropriations is derived from the state's General Revenue Fund, which is predominantly comprised of sales taxes. *Id.* at 1–2.

133. *See* Gladwell, *supra* n. 35, at 27 (noting that, traditionally, the most frequent mode of municipal borrowing was GO-bond financing, which required voter approval). Because several projects failed to obtain voter approval, local governments began increasing their

ample, a school district must hold a referendum election, at which the purpose of the proposed issuance is described to the voters in the district.[134] The electorate within the district must, by majority vote, approve the project and the pledge of the district's ad valorem taxing power to support the debt service on the bonds.[135] Lease financing avoids these expensive and time consuming requirements.[136] As such, all else being equal, school districts are able to construct, acquire, and improve school facilities faster and more easily than they would through financing with GO bonds, which is the more traditional method of ad valorem financing.[137]

But avoiding Article VII, Section 12's referendum requirement alone cannot explain the near-total transition to lease financing as the mode of financing capital projects for school districts. Since the 1930s and *State v. City of Miami*,[138] school districts, like other local governments in Florida, have the ability to issue revenue-supported debt, also known as revenue bonds, which, like lease financing, are also exempt from the referendum requirement under Article VII, Section 12. In fact, school districts do issue revenue bonds supported by certain identifiable revenue streams such as sales-tax receipts.[139] But the volume of lease fi-

use of lease-financing agreements to fund capital projects, which do not require voter approval. *Id.* During a ten-year period, municipal lease financings increased from $350 million in 1983 to $15 billion in 1993. *Id.*

134. Fla. Const. art. VII, § 12(a); Fla. Stat. §§ 1010.40–1010.45 (2010).

135. Fla. Const. art. VII, § 12(a); Fla. Stat. § 1010.45.

136. Gladwell, *supra* n. 35, at 27, 28; *see Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552 (finding the lease financing agreement did not require a voter referendum because it did not pledge ad valorem taxes to service the debt).

137. *See* Gelfand, *supra* n. 26, at § 2:14 (indicating that "[l]ocal government [general obligation] bonds generally are secured by ad valorem property taxes . . ."); *see also* Gladwell, *supra* n. 35, at 27 (describing GO bonds as previously being the most frequent mode of municipal borrowing, which require voter approval).

138. 152 So. 6.

139. These revenue-bond financings are different from the lease-revenue bonds litigated in *School Board of Sarasota County*. *See* 561 So. 2d at 550–551 (litigating COPs issuances delivered to trustees). Lease-revenue bonds are another form of publicly issued lease financing, but unlike COPs, lease-revenue bonds are limited obligations that are not transferred to trustees. Moody's Investors Serv., *supra* n. 21, at 11. Non-lease revenue bonds are not considered lease financing and are therefore not the subject of this article; rather, such non-lease revenue bonds are financed by other types of revenues, such as water and sewer user fees, tolls, landing fees, and other non-ad valorem revenues. Gelfand, *supra* n. 26, at § 2:25. One such type of non-lease revenue bond issued by Florida's school districts is the sales-tax revenue bond. *E.g. School Board of Volusia County, Florida, Sales Tax Revenue Bonds Series 2006*, at 2 (No. 2006, 2006) (available at http://emma.msrb.org/MS246828-MS222136-MD432436.pdf). Rather than lease revenues derived from leased school facilities, these bonds pledge the half-cent local sales surtax

nancings far surpasses the volume of non-lease revenue bonds[140] because lease-financing obligations carry a lower-perceived risk of default than other forms of school-district non-ad valorem financing—a lower-perceived risk because of the school districts' cross collateralization of leased facilities.[141]

To understand how cross collateralization has played such a large role in the popularity of lease financing by Florida's school districts, one must understand (1) the reliance investors place on credit rating agencies' opinions, and (2) the reliance that rating agencies place on the cross collateralization of leased facilities in providing their ratings opinions. Investors in lease financings and other municipal-debt obligations can be assumed to be risk averse.[142] In an effort to mitigate risk, bondholders and investors often turn to the views of rating agencies as credible agents and purveyors of financial analysis of debt obligations.[143] One reason for doing so is that credit agencies can centralize the process of information gathering, processing, and analysis relating to numerous debt offerings by employing skilled professionals and developing sophisticated analytic processes.[144] To the extent these agencies remain credible, investors rely on their opinions as a basis on which to allocate risk and capital.[145] Having the ability to rely on rating agencies' opinions, investors are able to avoid the time, cost, and risk associated with conducting their own analy-

available under Section 212.055(6) of the Florida Statutes. *Id.*

140. St. of Fla. Auditor Gen., *supra* n. 17, at 4, 5, 7.

141. *See infra* nn. 155–168 and accompanying text (discussing Florida school districts' cross collateralization of leased facilities).

142. *See* Stephen J. Choi & A. C. Pritchard, *Behavioral Economics and the SEC*, 56 Stan. L. Rev. 1, 1, 8 n. 27, 9 n. 29 (Oct. 2003) (noting that people tend to value avoiding loss more than they value significant returns).

143. *See* Eddy, *supra* n. 56, at 684 (noting that "[m]unicipal bond investors generally rely on a bond's rating as an indicator of its creditworthiness"); Steven L. Schwarcz, *Private Ordering of Public Markets: The Rating Agency Paradox*, 2002 U. Ill. L. Rev. 1, 3 (explaining that "[i]nvestors in domestic and cross-border financial transactions increasingly rely on rating agencies for substantial comfort regarding the risks associated with the full and timely payment of debt securities"). Indeed, U.S. securities law relaxes certain regulatory registration requirements for securities determined to be "investment grade" by rating agencies that have attained a nationally recognized statistical rating organization designation. *Id.* at 4–5 (citing 15 U.S.C. § 80a-6(a)(5)(A)(iv)(I) (2006)).

144. Frank Partnoy, *The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies*, 77 Wash. U. L.Q. 619, 630–631 (1999).

145. *See generally id.* at 627–631 (explaining that good reputation is essential to a credit agency's success); Schwarcz, *supra* n. 143, at 6 (recognizing the importance of credit rating agencies' reputations).

sis.[146] And investors and creditors do rely on the reports of rating agencies to make decisions about investing and capital allocations.[147]

Lease financings in Florida have garnered ratings closer to an issuer's GO-bond rating than other forms of non-ad valorem financings by school districts.[148] A GO rating for an issuer is the

146. Partnoy, *supra* n. 144, at 629–631. Relying on credit agency ratings is efficient at least in terms of the amount of the perceived benefit obtained compared to the level of output expended. On the other hand, information asymmetry and agency cost could make the process less efficient to the investor if reliance on rating agencies is misplaced due to the rating agencies' negligence or low effort spent on its due diligence. Such possibilities were cited as a potential factor in the severe market disruption resulting from the collapse of sub-prime housing securitizations. *See* The Fin. Crisis Inquiry Comm'n, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the U.S.*, at I, XXV (Jan. 2011) (available at http://www.gpoaccess.gov/fcic/fcic.pdf) (concluding that "the failures of credit rating agencies were essential cogs in the wheel of financial destruction"). The drafters of the report noted that investors relied heavily, "often blindly" on credit agencies' reports in allocating investment capital to "the mortgage-related securities at the heart of the crisis." *Id.*

147. *See* U.S. Sec. & Exch. Comm'n, *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets* 27 (Jan. 2003) (available at http://www.sec.gov/news/studies/credratingreport0103.pdf) ("Credit ratings can play a significant role in [investors' decisions], and the value investors place on such ratings is evident from, among other things, the impact ratings have on an issuer's ability to access capital.").

148. *See e.g.* Standard & Poor's, *supra* n. 12, at 101 (stating that "Florida school districts are another example of [how lease financing fits within an issuer's overall capital plan]"). Florida's school districts have the "ability to levy up to two [million dollars] of property taxes for capital expenditures and lease payments." *Id.* "The levy [is] broad enough [in] its use that Standard and Poor's will not automatically narrow the rating spread [to the issuer's GO bonds]." *Id.* But because "leasing tends to be the primary way for the districts to meet their capital needs, and most financings are done through a master lease structure, many of the lease ratings are closer to the GO rating." *Id. See also* FitchRatings, *Tax Supported Sector Specific Criteria: U.S. Local Government Tax-Supported Rating Criteria* 4 (2010) (available at http://www.fitchratings.com/creditdesk/reports/report_fame.cfm?rpt_id=564566) (noting that, at the time, "[l]egal and statutory provisions that strengthen the entity's incentive to appropriate can enhance the rating of appropriation-backed debt. These include a master-lease structure, in which a number of assets are secured under a single indenture, and failure to appropriate lease payments for one asset causes the entity to lose the use of all assets under the master lease"). *Compare* Moody's Investors Serv., *Moody's Assigns Aa3 Rating to Hillsborough County School Board's (FL) Refunding Certificates of Participation* (Moody's Investors Serv. Series No. 2010A, 2010) [hereinafter *Aa3 Rating to Hillsborough County*] (available at http://www.moodys.com/research/moodys-assigns-aa3-rating-to-hillsborough-county-school-boards-fl?lang=en&cy=global&docid=nir_16355946) (giving a $96,535,000 lease-financing transaction a rating of Aa3) *with* Moody's Investors Serv., *Moody's Downgrades Hillsborough County School District's (FL) Sales Tax Bonds to Baa1 from A2 and Maintains Negative Outlook* (2010) (on file with author) (revising $238.1 million of the district's outstanding sales-tax revenue bonds ratings downward to a Baa1 rating). Those bonds' ratings were revised downward from A2 to Baa1 at almost the same time that the higher Aa3 rating was issued to the lease-financing transaction. *Id.* As of

highest rating available to an issuer;[149] therefore, a rating close to the issuer's GO-bond rating indicates higher credit than a rating that is further away from the GO-bond rating.

In reaching their conclusions regarding the credit quality of school districts' lease financings, rating agencies generally strive to determine the issuer's ability and willingness to repay their lease obligations.[150] Because as set out in *School Board of Sarasota County*, school districts' lease financings can be terminated on an annual basis,[151] one of the main aspects driving the credit rating of lease-financing obligations is proof of the issuer's willingness to continue to pay the rent.[152] Therefore, to garner the best ratings possible, school districts have an incentive to prove to the rating agencies that they intend to continue to pay rent.

In the classic work *An Essay on Bargaining*,[153] Thomas C. Schelling points out that the easiest way to establish the credibility of an assertion is to commit irrevocably and conspicuously to a course of action that a counterparty can inspect.[154] School districts make just such self-limiting and conspicuous commitments in their lease-financing obligations by cross collateralizing leased

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March 11, 2010, Hillsborough County's general-obligation credit rating was Aa2. *Aa3 Rating to Hillsborough County*. Moody's ratings categories run, from highest to lowest, as follows: Aaa, Aa1, Aa2, Aa3, Baa1, Baa2, and Baa3. Moody's Investors Serv., *Rating Symbols and Definitions* 4 (Moody's Investors Serv. 2011) (available at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004). Ratings in and of themselves do not tell the whole story behind a particular debt obligation. *Id.* (stating that ratings are merely an "opinion").

149. *See* Moody's Investors Serv., *supra* n. 21, at 12 (indicating that Moody's looks at a list of factors to determine the quality of government-entity lease-financing obligations, and "[t]aken together these broad factors indicate the governmental entity's general ability to meet its debt repayment obligations. This ability, at its highest expression, is indicated by a municipal government's general obligation rating."). "GO bonds generally are regarded as the broadest and soundest security among tax-secured debt instruments." Standard & Poor's, *supra* n. 12, at 19.

150. *See e.g. See* Moody's Investors Serv., *supra* n. 21, at 12 (stating that "ratings reflect our evaluation of a governmental entity's willingness to meet specific repayment obligations"); Standard & Poor's, *supra* n. 12, at 96 (evaluating essentiality of a leased project to ascertain an issuer's willingness to continue to appropriate rent supporting the lease obligation).

151. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551, 553.

152. *See* Moody's Investors Services, *supra* n. 21, at 12 (stating that "ratings reflect our evaluation of a government entity's willingness to meet specific repayment obligations"); Standard & Poor's, *supra* n. 12, at 96 (evaluating a leased project to ascertain an issuer's willingness to continue to appropriate rent supporting the lease obligation).

153. Thomas C. Schelling, *An Essay on Bargaining*, in *The Strategy of Conflict* 21 (Harv. U. Press 1960).

154. *Id.* at 24.

facilities.[155] School districts generally lease-finance facilities under a master lease or the pooling together and financing of numerous facilities under a single commitment to pay rent on all facilities.[156] Under this structure, a default in the payment of rent on any single leased facility results in a default on *all* facilities leased under the master lease, which then obligates the school district to vacate all leased facilities.[157] The fact that rent has been or could be paid for one of the leased facilities is irrelevant; the obligation to pay rent is for all of the leased facilities or none of them.[158] In this way, each and every leased facility serves as collateral for, or cross collateralizes, each and every other leased facility under the master lease.[159] The idea, of course, is that the hardship of having to vacate all the leased facilities will outweigh any temptation not to pay rent on one or a handful of facilities.[160] By offering up cross collateralization as a feature of lease financings, school districts are making a strong, self-limiting commitment to "prove" their willingness to pay rent under the

155. Cross collateralization occurs through the use of master-lease financing arrangement, under which several facilities are financed under a "master" lease agreement and failure to pay rent on one leased facility results in a default on all leased facilities under the lease. *See* Moody's Investors Services, *supra* n. 21, at 31 (noting that "[b]ecause of its pooled nature, a master lease structure may enhance the remedies available to investors," particularly by cross collateralization of leased facilities, where failure to pay rent on one facility results in forfeiture of all assets under the master lease).

156. *See* Standard & Poor's, *supra* n. 12, at 100–101 (stating that, at the time of the report, "[a]nother common structuring strategy is a master lease arrangement where a municipality bundles multiple assets together into a single appropriation, committing the government to pay for all assets or risk losing all if the government chooses to exercise[ ] its non-appropriation right[.] By tying several assets together, the incentive to appropriate can be strengthened and the lease rating can be enhanced. . . . [S]ince leasing tends to be the primary way for [Florida school] districts to meet their capital needs, and most financings are done through a master lease structure, many of the lease ratings are closer to the GO rating").

157. *Id.*

158. *See e.g. id.* (discussing the appeal of cross collateralization).

159. *See* Moody's Investors Serv., *supra* n. 21, at 31 ("The lease agreement should not provide for any partial payment for selected lease items. Partial appropriation should result in the forfeiture of all assets in the pool.").

160. As an indication of how compelling cross collateralization is for school districts, consider the following statement from Lee County, Florida's school district: "The School District of Lee County has entered into a series of COPs issues that are covered under one 'master lease[.'] A default on one COPs issue is deemed a default on all. Since a substantial number of District facilities are covered under the master lease, default is not a realistic option." The Sch. Dist. of Lee Co., *Lee County School District's Capital Planning Process* 8 (2006–2007) (available at http://budget.leeschools.net/pdf/Capital/capitaloutlayresource.pdf).

obligation.[161] From all indications, cross collateralization has successfully convinced investors that lease financing is relatively secure compared to other forms of non-ad valorem financing.[162]

Credit agencies have routinely cited the cross collateralization of leased facilities under a master lease as a feature that supports the credit rating of lease financings.[163] As indicated earlier in this Part, credit-rating agencies have rated Florida's school-district lease financings closer to the issuing district's GO rating, mentioning that the cross collateralization of leased facilities under a master lease is an important aspect of the credit ratings of lease financings.[164] The willingness of school districts to cross collateralize their leased facilities is understandable—school districts, like all debt issuers, are presumably aware that high-rated debt obligations, including lease financing obligations, are easier to sell and garner lower interest cost, all else being equal, than lower rated obligations.[165] To the extent cross collateralization presents a path to higher-rated lease financings, school districts have an incentive to cross collateralize their leased facilities. In addition, school districts are in effect in competition for a limited resource: investors willing to invest in lease-financing obligations. Cross collateralization of leased facilities, therefore, also serves the purpose of avoiding a competitive disadvantage in the market for limited-investment dollars.

All of the facilities financed by each of the school districts in *School Board of Sarasota County* were financed under a master-

161. The gravity of a school district's undertaking to pay rent is not manifested in the act of cross collateralization alone but in the act of cross collateralizing *school facilities*, which are clearly essential to the governmental function of the school district. *See id.* (discussing the importance of cross collateralization for school districts). Because this Article is about *school-district* lease financings of school facilities, the discussion herein is centered on cross collateralization rather than cross collateralization of essential facilities.

162. *See e.g. supra* n. 160 (discussing the appeal of cross collateralization to the School District of Lee County); *see also* Standard & Poor's, *supra* n. 12, at 100–101 (discussing the appeal of cross collateralization).

163. *See e.g.* Moody's Investors Serv., *supra* n. 21, at 12–13, 31 (discussing Moody's fundamental-rating approach and cross collateralization under master leases). Moody's points out that "[w]hile . . . cross-collateralization may enhance security or offset other risks, it is typically not sufficient by itself to warrant a higher rating." *Id.* at 13. To be clear, cross collateralization alone is not driving the higher ratings for school-district lease financings; rather, it is the cross collateralization of *school facilities*, which represent unique, essential capital projects that together result in the higher ratings.

164. *Supra* n. 148 (comparing lease ratings to GO ratings).

165. *See generally* Moody's Investors Serv., *supra* n. 21, at 14 (explaining the advantages of highly-rated debt obligations).

lease structure, under which each facility leased by a school district cross collateralized every other facility leased by that school district.[166] Since *School Board of Sarasota County*, the majority of school-district lease financings in Florida have been carried out under a cross-collateralized, master-lease structure.[167] Given the tie between cross collateralization and relatively higher ratings, the incentive for school districts to cross collateralize in a competitive market, and the actual practice of lease-financing school districts, school-district lease financing in Florida likely has become path dependent on cross collateralization of leased facilities.[168]

V. PATH DEPENDENCY AND ITS RISKS

Path dependence generally refers to an overreliance on past practices or solutions to particular problems without regard for whether those past practices or solutions still apply to current situations.[169] Path dependence can be efficient, at least in terms of level of effort per unit of output.[170] Sticking to tried and true methods of doing things avoids reinventing the wheel or spending an unnecessary amount of time reexamining every aspect of a situation to determine whether the proposed process will work.[171]

166. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 553.

167. *See* Standard & Poor's, *supra* n. 12, at 100–101 (discussing Florida's school districts and noting that "leasing tends to be the primary way for the districts to meet their capital needs, and most financings are done through a master lease structure").

168. Path dependence is an idea that springs from many disciplines, including math, physics, and economics. Stephen E. Margolis & S.J. Liebowitz, *Path Dependence*, https://www.utdallas.edu/~liebowit/palgrave/palpd.html (accessed April 20, 2011). Essentially path dependence is a way of saying, "Where we are today is a result of what has happened in the past." *Id.* In the context of cross collateralization and lease financing, the idea is this: rating agencies have relied on cross collateralization in assigning relatively high ratings. *See* Standard & Poor's, *supra* n. 12, at 19, 101 (stating that most financing done through a master-lease structure have ratings near the GO rating, which is the "broadest and soundest security"). Lease-financing school districts and investors in lease-financing obligations prefer higher-rated obligations over lower-rated obligations. *Supra* n. 165. So school districts should cross collateralize facilities in their lease-financing transactions. The question is, however, whether cross collateralization is an effective or even efficient answer to the question of whether a particular district has the *ability* to pay. The answer to that question is, no, it is not an effective.

169. *See* Margolis & Liebowitz, *supra* n. 168 (describing the term "path dependence").

170. *Id.*

171. *Id.* Lawyers as a group should be especially familiar with efficiencies and inefficiencies of path dependency. *See e.g.* S. J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-in, and History*, 11 J.L. Econ. & Org. 205, 205–226 (1995) [hereinafter

Path dependency can be especially efficient in financial-market transactions in which a certain level of comfort accompanies familiar deals.[172] Simply put, underwriters have an easier time selling a transaction they are more familiar with; rating agencies are more comfortable rating transactions they are more familiar with; and buyers are more comfortable buying investments they are more familiar with. So from this perspective it pays to find an accepted way of doing things and sticking to it.

Regarding school-district lease financing, path dependence on cross collateralization can provide certain efficiencies to rating agencies and investors because it provides evidence of a school district's commitment to continue to pay rent on the leased facilities.[173] In a financing based on securitizing a rent-revenue stream that the lessee otherwise has a legal right to stop paying, evidence of such a commitment to continue to pay rent arguably takes a significant amount of credit risk off the table.[174] Rational debtors would not make such an onerous commitment inherent in cross collateralizing school facilities if the district had no real intention to continue to pay the rent. As such, cross collateralization serves as a kind of litmus test that substitutes for more detailed credit-due diligence on the part of rating agencies and investors. This in turn should result in less effort on the part of rating agencies and investors to assume lower risk, relative to evaluating a lease financing under which cross collateralization is not a part of the credit terms.[175]

But path dependency carries risks as well. If the circumstances that are present in the early stages of a path-dependent process change, or if certain facts are overlooked early in the pro-

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Lock-in and History] (discussing in detail the potential efficiencies and inefficiencies of path dependence). "For the law itself, path dependence may seem self-evident, given the role of precedent." Stephen E. Margolis & S.J. Liebowitz, *Path Dependence* (J. of Econ. Literature, Working Paper No. 0770, 1999) (available at http://encyclo.findlaw.com/0770book.pdf).

172. *See e.g. generally Lock-in and History*, *supra* n. 171, at 205 (stating that the claim for path dependence is that it creates advantages in technology and influences market allocation when voluntary decisions are made).

173. *See generally id.* (discussing the positive effects of path dependence in market allocation).

174. *See e.g. generally* Standard & Poor's, *supra* n. 12, at 96 (discussing and evaluating the willingness to pay a financing).

175. *See e.g.* Moody's Investors Serv., *supra* n. 21, at 13, 31 (discussing the security that cross collateralization provides to investors but also noting cross collateralization is not "sufficient by itself to warrant a higher rating").

cess, the effect could go unappreciated for a significant duration because reliance on past practice tends to decrease the re-examination of these factors.[176] If these circumstances, had they been known, would have changed the behavior or expectations of those who participated in transactions, then they could cause greater losses or other hardship than would have resulted had they been considered earlier in the process.[177]

Cross collateralization of leased facilities in Florida's school-district lease financings presents just such a risk. A change in circumstances, namely a significant increase in the number of cross-collateralized facilities per school district since *School Board of Sarasota County*, as well as certain state-law limitations on the use and encumbrance of essential facilities that the *School Board of Sarasota County* Court did not address, raise questions about the extent to which cross collateralization of school facilities would be enforced today. These risks are discussed in more detail in Part VI.

A. Questions Regarding Enforceability of Cross Collateralization

The ability of school districts to cross collateralize school facilities is not without some legal support. Although the *School Board of Sarasota County* Court did not address the issue of cross collateralization in its opinion, attorneys did raise the issue in their briefs. Appellant, the State of Florida, on behalf of the citizens of Sarasota County, in its amended brief to the Court, noted that ten school facilities would be cross collateralized in that lease financing, and they specifically pointed out that a failure to pay rent for any school facility would result in a default on all leased facilities.[178] Similarly, the State on behalf of the citizens of Collier County noted that the schools (plural) that were the subject of that financing were cross collateralized under an "all or none" rental payment obligation.[179] Likewise, appellant State of Florida

176. *See generally Lock-in and History*, *supra* n. 171, at 207 (stating that "efficient decisions may not always appear to be efficient in retrospect" and that outcomes may be regrettable and costly).

177. *See generally id.* (explaining that the "inferiority of a chosen path is unknowable at the time a choice was made, but it is later recognized that some alternative path would have yielded greater wealth").

178. Amend. Br. of Appellant, *supra* n. 109, at 11.

179. Initial Br. of Appellant, *supra* n. 104, at 3, 11.

on behalf of the citizens of Orange County noted that fourteen new schools would be cross collateralized under that financing arrangement.[180] In each case, the appellants argued that the terms of each of the financings, including the cross collateralization of the essential facilities, rendered the annually renewable feature of the lease financings illusory and constituted an indirect pledge of ad valorem taxing power by the school districts.[181]

The Court, however, rejected these arguments,[182] holding that the school district's annual renewal option in conjunction with bondholder's "limited" rights to "lease remedies" preserved the school districts' "full budgetary flexibility" to continue to pay the lease obligations in question.[183] The preservation of the school districts' budgetary flexibility in turn obviated the need for a voter referendum relating to the lease financing.[184] In reaching this conclusion, the Court specifically distinguished the facts at hand from the cases that the appellants cited in their arguments addressing cross collateralization, namely *Volusia County v. State*[185] and *Nohrr*.[186] The Court also based its ruling on its prior precedent set in *Brevard County*.[187] The Court's rejection of appellants analogy to *Volusi*a *County* and *Nohrr*, and particularly its reliance on *Brevard County*—in which the Court apparently had no issue in concluding that Brevard County would be dispossessed of leased property if it defaulted[188]—implies that cross collateraliza-

180. Initial Br. of Appellant, *supra* n. 101, at 3–4.

181. Amend. Br. of Appellant, *supra* n. 109, at 6–7; Initial Br. of Appellant, *supra* n. 101, at 14–15; Initial Br. of Appellant, *supra* n. 104, at 4, 11.

182. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552–553.

183. *Id.* at 553.

184. *Id.*

185. 417 So. 2d 968 (Fla. 1982).

186. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 553.

187. *Id.*

188. *Brevard*, 539 So. 2d at 464 ("The county is simply renting equipment under the lease. As in the case of any other lease, if the lease is terminated, the county *would have a contractual commitment to return to the lessor any leased equipment still owned by the lessor*.") (emphasis added). Further, the point that the court did address the question of cross collateralization, even though it did not speak to the issue directly in its opinion, does have some merit. The issue of cross collateralization was raised by the appellant in *School Board of Sarasota County* in arguing that the lease financings in that case constitute an indirect pledge of ad valorem taxation similar to the indirect pledges found in *Volusia* and *Nohrr*. Amend. Br. of Appellant, *supra* n.109, at 6–7; Initial Br. of Appellant, *supra* n. 101, at 6–7; Initial Br. of Appellant, *supra* n. 104, at 4, 11. Because the Court concluded otherwise, one could presumably cite *School Board of Sarasota County* for the proposition that cross collateralization alone does not constitute an indirect pledge of ad valorem taxation.

tion is enforceable to some degree.[189] Nevertheless, in the two Parts that follow, I argue that reliance on *School Board of Sarasota County* as precedent for the enforceability of cross collateralization in all cases is problematic.

B. Key Facts Have Changed since the Holding of *School Board of Sarasota County*

First, the existence of cases such as *Volusia County, Nohrr and Frankenmuth Mutual Insurance Co. v. Magaha*[190] indicate that at some level, facts can determine whether a financing scheme is subject to the voter-referendum requirements of Article VII, Section 12. In *Volusia* County, for example, the Court concluded that an indirect pledge of ad valorem taxation existed because the issuer in that bond-financing case not only pledged all non-ad valorem revenues to the particular debt at issue but also covenanted to maintain the same level of municipal services supported by such pledged non-ad valorem revenues.[191] The Court reasoned that those promises would likely be mutually exclusive in the event non-ad valorem revenues dropped and would ultimately require the county to raise ad valorem taxes to meet its obligations.[192] Similarly, in *Nohrr*, the Court determined that conveying a mortgage on property in connection with debt financing was tantamount to a pledge of ad valorem taxing power because the municipal-property owner would be too tempted to levy ad valorem taxes in an effort to preserve its equity in the property rather than default on the debt and lose the property to foreclosure.[193]

More recently, in *Frankenmuth Mutual Insurance Co.*, the Court concluded that a non-substitution clause[194] in a computer-

189. *Sch. Bd. of Sarasota Co.*, 561 So. 2d at 553.
190. 769 So. 2d 1012 (Fla. 2000).
191. 417 So. 2d at 971.
192. *Id.* at 972.
193. 247 So. 2d at 311.
194. The lease financing in *Frankenmuth Mutual Insurance Co.* involved a lease purchase by Escambia County of a mainframe computer. 769 So. 2d at 1015. The lease terminated upon the county's failure to pay rent. *Id.* But the lease agreement also contained a non-substitution clause that prohibited the county from obtaining substitute or replacement computer equipment for a certain period of time after the termination of the lease. *Id.* The computer equipment involved was essential to the operation of the county, serving as the primary means for processing its payroll, among other critical functions. *Id.*

equipment lease-financing arrangement not only constituted an indirect pledge of ad valorem taxes of the type proscribed by *Volusia County* and *Nohrr* but also eliminated full budgetary flexibility, required by *Brevard County*, to terminate the lease annually.[195] As such, the lease-financing arrangement in that case was found to implicate the voter-referendum requirement of Article VII, Section 12 of the Florida Constitution.[196]

The holdings of *Volusia County*, *Nohrr*, and *Frankenmuth Mutual Insurance Co.* indicate that facts can be determinative in analyzing whether a particular financing arrangement will invoke the voter-referendum requirements of Florida's Constitution. *Frankenmuth Mutual Insurance Co.*, in particular, underscores that at some point, the terms of a lease financing can render the presumed budgetary flexibility implied in lessee's right to terminate a lease illusory.[197] In this regard, things have changed since *School Board of Sarasota County*. The number of facilities involved in *School Board of Sarasota County* was considerably fewer than the number of facilities cross collateralized by school districts in more recent financings. From the briefs of the two appellants that raised the issue, the lease financing cross collateralized fourteen school buildings in the Orange County school district[198] and ten school buildings in the Sarasota County school district.[199] In more recent lease financings for the Orange County school district, for example, the district indicated that at least fifty-eight of the district's 175 operational schools cross collateralize the obligations under its master lease.[200] Several other school districts throughout Florida report similar numbers.[201]

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at 1025–1026.

195. *Id.* at 1026.

196. *Id.* at 1027.

197. *Id.* at 1024.

198. Initial Br. of Appellant, *supra* n. 101, at 3–4 (stating that the Orange County School Board cannot choose to fund only one or several schools but instead must fund the entire lease package).

199. Amend. Br. of Appellant, *supra* n. 109, at 11 (explaining that the school board intends to build approximately ten new schools using revenue from bonds).

200. *See Certificates of Participation, Series 2008C Evidencing Undivided Proportionate Interests of the Owners Thereof in Basic Lease Payments to be Made by the School Board Of Orange County, Florida, as Lessee, Pursuant to a Master Lease Purchase Agreement With the Orange School Board Leasing Corp., as Lessor* 38 (No. 2008C, 2008) (on file with the author) (stating the number of schools leased under a master lease program in Orange County, Florida).

201. *See supra* pt. IV (discussing the significant increase in the use of cross collateral-

For example, the five largest school districts in Florida, representing approximately 1.1 million students, or roughly forty-three percent of all the students in Florida as of 2008, utilize lease financing as their primary method of financing capital facilities.[202] Those five school districts are Miami-Dade, Broward, Palm Beach, Hillsborough, and Orange.[203] All five school districts issue their lease financings through master leases, under which each leased facility cross collateralizes the rental payment for every other leased facility.[204] In total for these five districts, close to four-hundred thousand student stations[205] are financed under a cross-collateralized financing structure.[206] On a district-by-district basis, the percentage of cross-collateralized student stations to total breaks down as follows: Miami-Dade, 25.9% (approximately ninety thousand student stations); Hillsborough 28% (approximately sixty-six thousand student stations); Orange 37% (approximately sixty-four thousand student stations); Palm Beach 43% (approximately ninety-three thousand student stations); and Broward 33% (approximately eighty-five thousand student stations).[207] Some less-populated school districts, however, have an even greater percentage of their facilities under a cross-collateralized lease-financing structure. Collier County, for example, has 61%, or approximately twenty-six thousand, of its student stations cross collateralized.[208] Consider the tremendous personal disruption that would ensue if these school districts were required to vacate the financed facilities in the event of a lease default. In

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zation by the six largest school districts in Florida).

202. See Appendix and citations therein. Appendix reports on the six largest school districts in Florida in terms of number of students. But Duval, the sixth largest district, does not utilize lease financing as a significant source of financing for school facilities. *Id.*

203. *Id.*

204. *See e.g. Aa3 Rating to Hillsborough County*, *supra* n. 148 (stating that the superintendent must fund either all or none of the projects under the master lease).

205. The term "student station" refers to the capital facilities needed to serve one student. Amici Curiae Br. & Appendix of Fla. Sch. Bds. Ass'n, Inc. & Fla. Ass'n of Dist. Sch. Superintendents, *Miccosukee Tribe of Indians of Fla. v. South Fla. Water Mgt. Dist.*, http://www.floridasupremecourt.org/clerk/briefs/2009/1801-2000/09-1817_11-05-2009_Amicus_FSBA[1]_ada.pdf (Nos. SC09-1817, SCO9-1818, 48 So. 3d 811 (Fla. 2010)) [hereinafter Amici Curiae Br. of Superintendents]. Calculating the total amount of student stations requires adding the products of the number of students in each school district and the percentage of student stations in each district.

206. *Id.* at A-1–A-2.

207. *Id.*

208. *Id.*

the Miami-Dade school district alone, 25.9%, or over ninety thousand student stations, would have to be vacated.[209]

Under *Brevard County* and *School Board of Sarasota County*, if avoiding an impermissible indirect pledge of ad valorem taxation depends on maintaining full-budgetary flexibility on an annual basis for the payment of rent or the forfeiture of leased facilities, then at some point the proportion of facilities subject to cross collateralization compared to all school facilities of the financing district could become relevant. The credit-enhancing aspect of cross collateralization (i.e., that a school district will strive mightily to pay its lease obligations to avoid being evicted from numerous leased facilities) runs directly counter to the concept of full budgetary flexibility espoused in *Brevard* and *School Board of Sarasota County*.[210] At some point the number of facilities and school children subject to the cross-collateralized obligation to vacate could become so large that if the school district were evicted from those facilities, it would essentially shut down because there might be few, if any, viable options to transfer and house the school children displaced by the district's abandonment of such facilities. At that point, cross collateralization could be transformed from a mode to express the district's intention to repay the lease financing into a moral compulsion to repay the financing to avoid relocating, in some cases, tens of thousands of school children. What would distinguish that moral compulsion from the perceived (and proscribed) moral compulsion described in *Nohrr* and *Frankenmuth Mutual Insurance Co.*? The incentive to pay rent fostered by cross collateralization could be so great as to usurp completely the full-budgetary flexibility of a leasing school district. At that point, under the holding of *School Board of Sarasota County*, there would be an indirect pledge of ad valorem taxation, raising a stronger question about whether such lease-financing obligations were valid to the extent no voter referendum was held.[211] In other words, despite *School Board of*

209. *Id.*

210. 561 So. 2d at 553.

211. Even if a pledge of ad valorem taxation is found in the school-district lease-financing context, the leases would still not require voter approval because of the apparent "annual renewability" requirement of such leases. *See Strand*, 992 So. 2d at 153 (holding that the bonds at issue did not require voter approval because they were payable, in part, by funds contributed each year based on the tax increment). But, if an indirect pledge of ad valorem taxes were found because the full budgetary flexibility to vacate the leased prem-

Sarasota County's tacit support of the enforceability of cross collateralization, if cross collateralization could be employed at a level that would vitiate the requisite full-budgetary flexibility that the *School Board of Sarasota County* and *Brevard County* Courts considered so important to the validity of lease-financing arrangements, how reliable is *School Board of Sarasota County* as precedent for the enforceability of cross collateralization in the school-district lease-financing context? The Court, interestingly, has not had occasion to reconsider the impact of the increase in the number of facilities subject to cross collateralization since its holding in *School Board of Sarasota County*; no school-district lease financing case has been validated since the Court's holding in *School Board of Sarasota County* over twenty years ago.[212]

C. Possible Overlooked Aspect of *School Board of Sarasota County* Could Call into Question Enforceability of Cross Collateralization

Even if *School Board of Sarasota County* does stand for the proposition that cross collateralization to *any* degree does not constitute an indirect pledge of ad valorem taxation, the question of the enforceability of cross collateralization of school facilities is not necessarily settled. *School Board of Sarasota County* was a bond validation case.[213] The question before the Court was whether the lease financings were a direct or indirect pledge of ad valorem taxation that required voter approval under Article VII,

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ises in lieu of paying rent is determined to be illusory, wouldn't the annual renewability provision of such leases be just as illusory? In other words, how likely is it that a school district would *not* annually renew a lease if the failure to do so would require the district to vacate numerous school facilities?

212. *See* Jt. Mot. for Clarification or, in Alt., for a Rehearing of Amici Curiae, Fla. Sch. Bds. Ass'n, Inc. Fla. Ass'n of Dist. Sch. Superintendents, & the Sch. Dists. of Duval, Hillsborough & Orange Cos., *Strand v. Escambia Co.*, 992 So. 2d 150, 9–10, (Fla. Sept. 17, 2007)) (available at http://www.floridasupremecourt.org/pub_info/summaries/briefs/06/06-1894/Filed_09-17-2007_Joint_Motion_Clarification.pdf) (declaring that "[a]s stated in paragraph 8 of the Joint Motion to Appear as Amici Curiae, . . . [the] school districts of this State have $13,021,234,367 in outstanding certificates of participation or lease purchase obligations [as of September 1, 2007]. . . . The only certificates of participation or lease purchase obligations that were validated were the three original issues consolidated in the *School Board of Sarasota County* decision").

213. *See Sch. Bd. of Sarasota Co.*, 561 So. 2d at 551. ("We are presented with two basic issues: whether the agreements at issue here may be validated pursuant to chapter 75, Florida Statutes . . . and, if so, whether Article VII, Section 12, Florida Constitution . . . requires referendum approval for the bonds' validation.").

Section 12 of the Florida Constitution.[214] The fact that cross collateralization may or may not constitute an indirect pledge of ad valorem taxation would not weigh on whether cross collateralization by a school district is unenforceable on other grounds.[215]

School districts and their boards fulfill an important constitutional and statutory role in educating children and maintaining and operating school facilities.[216] In Florida, each county constitutes a separate school district, which is governed by an elected school board.[217] District school boards have the responsibility of operating, controlling, and supervising all public schools within their districts.[218] In carrying out this charge, district school boards may exercise "any power except as expressly prohibited by the State Constitution or general law."[219] This type of grant has been characterized as a grant of "home rule" powers,[220] which are some of the broadest powers that can be granted to a government in Florida.[221]

214. *Id.* at 552.

215. *See Speedway Superamerica, LLC v. Tropic Enterprises, Inc.*, 966 So. 2d 1, 3 (Fla. 2d Dist. App. 2007) (noting that even though a previous case decided by the Florida Supreme Court was factually similar, it was not binding precedent because the Court had not addressed the same issues as the case at bar); *see also State ex rel. Helseth v. Du Bose*, 128 So. 4, 6 (Fla. 1930) ("[N]o decision is authority on any question not raised and considered, although it may be involved in the facts of the case."). Similarly, "[t]o be of value as a precedent, the questions raised by the pleadings and adjudicated in the case cited as a precedent must be [o]n point with those presented in the case at bar." *Twyman v. Roell*, 166 So. 215, 217 (Fla. 1936).

216. *See* Fla. Const. art. IX, §§ 1–4 (setting forth the constitutional provisions governing the state's public-education system, such as the mandatory class sizes, the state board of education, the school districts, and the school boards); Fla. Stat. § 1001.32 (2010) (pertaining to the management, control, operation, administration, and supervision of the school system).

217. Fla. Const. art. IX, § 4.

218. *Id.* at art. IX, § 4(b); Fla. Stat. § 1001.32(2).

219. Fla. Stat. § 1001.32(2).

220. *See McCalister v. School Bd. of Bay Co.*, 971 So. 2d 1020, 1023 n. 1 (Fla. 1st Dist. App. 2008) (mentioning the "home rule powers [of the] school district[s] [include the power to] operate, supervise, and control free public schools").

221. *See City of Boca Raton v. State*, 595 So. 2d 25, 27–28 (Fla. 1992) (noting that the Florida Supreme Court "acknowledged the vast breadth of municipal home rule power" and, had the 1968 constitutional amendment not granted the home rule powers, local governmental entities would have had only those powers expressly conferred on them by the legislature and such implied powers as were strictly necessary); *contra McCalister*, 971 So. 2d at 1023 n. 1 (stating that school districts' home rule powers "are limited by general law").

As the exclusive contracting agent for their school district,[222] school boards enter into the lease-financing arrangements for their respective districts[223] and presumably purport to cross collateralize those facilities under their home rule" powers. But in Florida, a governmental agency cannot contract away or materially limit the performance of an essential governmental function.[224] This fact raises the question of whether cross collateralization of school facilities violates any provisions of general law so as to invalidate a school board's power grant such a remedy.[225] One could argue that it does.

The education of school-aged children "is a fundamental value" under Florida's Constitution.[226] And the state has a "paramount duty . . . to make adequate provision . . . by law for a uniform, efficient, safe, secure, and high quality system of free public schools . . . and for the establishment, maintenance, and operation of institutions of higher learning."[227] The Florida Supreme Court has held that this "paramount duty" imposes the "maximum duty on the state" to provide a uniform and high quality education to Florida's children.[228]

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222. *McCalister*, 971 So. 2d at 1024 (referencing Fla. Stat. § 1001.41(4) (2006)).

223. *See e.g. Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552–554 (noting that multiple school boards have entered into financing arrangements that have been approved and upheld in court).

224. *City of Belleview v. Belleview Fire Fighters, Inc.*, 367 So. 2d 1086, 1088 (Fla. 1st Dist. App. 1979) (declining to enforce an agreement between a city and a non-governmental corporation under which the city provided equipment and funding but the non-governmental corporation "had the exclusive right to operate the equipment and to determine the manner and method of providing fire protection" because a city "cannot contract away the exercise of its police powers"); *accord City of Safety Harbor v. City of Clearwater*, 330 So. 2d 840, 841–842 (Fla. 2d Dist. App. 1976) (holding unenforceable an agreement among three cities to not annex unincorporated areas in which municipal services were designated to be provided by another city because "the power to annex is governmental and such a power cannot be contracted away"); *Harnett v. Austin*, 93 So. 2d 86, 89 (Fla. 1956) (stating that "a municipality cannot contract away . . . its police powers"); *see also* Fla. Att'y Gen. Op. AGO 84-100 (Nov. 2, 1984) (available at http://www.myfloridalegal.com/ago.nsf/printview/FBB13F021010F286852565770054B0B8) ("It must be cautioned, however, that the city may not improperly delegate or contract away its authority, discretion, and policy control which are obligations inherent in the nature of the city's police power.").

225. *See McCalister*, 971 So. 2d at 1023 n. 1 (noting that a school district's home rule powers are still limited by general law).

226. Fla. Const. art. IX, § 1(a).

227. *Id.*

228. *Bush v. Holmes*, 919 So. 2d 392, 405 (Fla. 2006).

School districts and their boards have been constitutionally and statutorily delegated the responsibility to establish, maintain, and operate school facilities.[229] More directly, school boards have been permitted to lease-finance educational facilities.[230] While some concessions and pledges to obtain those facilities may be reasonable, if those concessions become so burdensome as to interfere materially with the duties of school districts to provide a uniform, efficient, and high quality education to children or with the responsibility to operate and supervise free public schools, then such concessions should not be enforceable. As discussed above, in some districts, if a school district is unable to pay rent on even a single lease, tens of thousands of students could be evicted from numerous cross collateralized facilities.[231] In that event, a significant disruption would befall a district to the point that its operations would undoubtedly be affected. An assumption that the displacement of such a large number and proportion of students within a district would not materially interfere with a district's constitutionally and statutorily imposed educational function simply strains logic. And this is to say nothing of the possibility that vacating leased facilities, even if absorbing children into other facilities is feasible, would violate now constitutionally-mandated class-size limitations.[232]

229. Fla. Const. art. IX, § 4; Fla. Stat. § 1001.30 (2010). "The responsibility for the actual operation and administration of all schools needed within the districts . . . [is] delegated by law to the school officials of the respective districts." Fla. Stat. § 1001.30. "As provided in part II of chapter 1001, district school boards are constitutionally and statutorily charged with the operation and control of public K-12 education within their school district. The district school boards must establish, organize, and operate their public K-12 schools and educational programs, employees, *and facilities*." Fla. Stat. § 1003.02 (emphasis added).

230. *See e.g. Sch. Bd. of Sarasota Co.*, 561 So. 2d at 552 (holding that the use of certificates of participation to finance the lease of land and the construction of educational facilities without first acquiring referendum approval is constitutional).

231. *See supra* nn. 198–205 and accompanying text (discussing the large number of students and schools affected by cross-collateralized facilities).

232. Fla. Const. art. IX, § 1(a). Indeed, an even more direct argument may invalidate cross collateralization. While Florida Statutes § 1003.02(1)(f)(8) clearly permits school districts to enter into lease purchase arrangements to finance school facilities, those lease arrangements must comply with section 1013.15(2). Fla. Stat. § 1003.02(1)(f)(8). That section prohibits the payment of a penalty upon the failure of a school district to renew a lease under a lease-financing arrangement. Fla. Stat. § 1013.15(2)(c)(2). One could conceive of the requirement to vacate one facility, totally without regard for whether the district *could* pay rent on that facility, because rent has not been paid on a different facility as the payment of a penalty.

In sum, in evaluating the strength of the cross-collateralization feature of school-district lease financings, certain legal principles limiting the ability of a governmental unit to abdicate its important governmental functions appears to have been overlooked. Perhaps this is due to placing too much of an emphasis on *School Board of Sarasota County* as precedent not only for the validity of the obligations without a referendum but also in the form of the transaction itself, as if the Court took up all the issues involved in lease financing when, arguably, the Court took up only a limited set of facts.

VI. POTENTIAL IMPLICATIONS OF CROSS-COLLATERAL PATH DEPENDENCY ON FLORIDA'S SCHOOL DISTRICTS

Although legitimate hurdles, which might not have been present in or addressed by the Court in *School Board of Sarasota County*, hamper the enforceability of cross collateralization, these hurdles are, for the moment, conjecture.[233] They have not yet been raised to the courts for consideration.[234] And they might never be. If the primary concern to be addressed by cross collateralization is the *willingness* of a school district to continue to pay rent in light of its ability to stop paying at any time, then a credible threat of enforcing the remedy of cross collateralization could be enough to prevent a default under the financing, which in turn would prevent the need to consider the actual enforceability of cross

233. The uncertainty of the enforceability of cross collateralization has been raised in disclosure documents provided to investors in school-district lease financings. *See e.g. Certificates of Participation, Series 2009A Evidencing Undivided Proportionate Interests of the Owners Thereof in Basic Lease Payments to be Made by The School Board of Broward County, Florida, as Lessee, Pursuant to a Master Lease Purchase Agreement With the Broward School Board Leasing Corp., as Lessor* 76 (No. 2009A, 2009) (available at http://www.broward.k12.fl.us/investors/docs/Broward%20Schools, %20FL% 20Series%202009A%20OS.pdf) (discussing the uncertainty of enforceability of cross collateralization).

234. While the concept of whether eviction from leased space would interfere with the ability of a school district to comply with its essential governmental function was raised in the amici brief for the Florida School Boards Association, the issue was framed in terms of whether the potential for such eviction would constitute an indirect pledge of ad valorem taxation. Amicus Curiae Br. of the Fla. Sch. Boards Ass'n, Inc., *State v. Sch. Bd. of Sarasota Co.*, http://www.law.fsu.edu/library/flsupct/74979/74979amicus.pdf at 39–40 (Nos. 74979, 75009, 75154, 561 So. 2d 549 (Fla. 1990)). The discussion of the issue did not center on whether the eviction would so impair the essential governmental function of a school district so as not to be enforceable under general principals expressed in *City of Belleview*, and *City of Clearwater*. *Id.* at 39–40 (citing *City of Belleview*, 367 So. 2d 1086, and *City of Clearwater*, 330 So. 2d 840).

collateralization.[235] But what if the impetus for default under a lease financing is not willingness to pay but *ability* to pay? In that case, the likelihood that the enforceability of the remedy will be called into question increases with the fiscal pressures of school district lessees—a school district that is unable to pay is unable to pay, no matter how much its school board members might want to pay.

Consider a hypothetical in which a fiscally-constrained school district is beset with such dire financial conditions that it cannot continue to pay all of its current financial obligations. Under such circumstances, it could be forced to consider paying rent on *some* but not all leased facilities, perhaps with the choice of abandoning underutilized or lesser important facilities in the hope that it can continue to operate on a smaller scale in fewer facilities. Such a plan would violate the cross collateralization provisions of its lease-financing obligations.[236] This violation could conceivably force the hand of the lease-financing trustee to press the rights of the investors[237] in the lease-financing obligations that financed the facilities that the school district hopes to abandon. These events could set the stage for judicial consideration of the enforceability of the cross collateralization provisions.[238]

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235. *See e.g.* Schelling, *supra* n. 153, at 35–36 (regarding the deterrence value of credible threats). And at least one rating agency has publicly acknowledged that it is realistic about the limited nature of the repossession remedy, stating that, "overriding analytic reason for having recourse to the facility is [not the ability to actually repossess the facility, but] the ability to *threaten* interference with a government's use of an essential [governmental] facility." Moody's Investors Service, *supra* n. 21, at 22 (emphasis added). Note that here the question is not so much about enforceability. Indeed it is fair to read into the statement that the rating agency assumes the eviction remedy is enforceable because the *threat* of interference with the use of a facility would be pretty empty if no one truly believed it was enforceable. On the other hand, enforceability does not need to be a settled issue for the threat to have value, as the risk of establishing precedence of the enforceability of the remedy will likely have some deterrence value. Moreover, much of the discussion regarding the importance of establishing the willingness to pay is in the context of a school district *choosing* not to appropriate rent for a facility because the facility is in some way no longer wanted. *See* Standard & Poor's, *supra* n. 12, at 96 (discussing a municipality's willingness to appropriate for a facility). This discussion centers on those credit factors that can narrow the ratings spread between an issuer's GO rating and the lease financing rating, which is affected by the ability of the lessee *choosing* not to appropriate for rent. *Id.* at 99–101. One such credit factor is the use of a master lease, where facilities are cross collateralized. *Id.* at 100.

236. *See infra* pt. IV (discussing cross collateralization and lease-financing obligations).

237. *See supra* nn. 27–34, 109 and accompanying text (discussing lease financing in general and the role of the trustee under a COPs or lease-revenue bond).

238. Unlike private businesses that can quickly resort to federal bankruptcy protection,

Under such a scenario, should a court determine that cross collateralization is not enforceable, its decision would likely affect the investors that financed the school facilities no longer covered by a cross collateralization remedy.[239] But it would also affect others beyond those investors. All investors in Florida's school-district lease financings would likely be affected if the enforceability of cross collateralization is successfully challenged because credit rating agencies will likely adjust their ratings on the obligations to account for the elimination of a major determinate of their ratings opinion.[240] This would likely devalue their lease financing investments as well.

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namely the automatic stay of litigation and creditors' rights, school districts, although capable of opting into bankruptcy protection under federal law, first have to obtain permission from the State's Commissioner of Education. Fla. Stat. § 218.503(5) (2010). Ironically, Part V, Chapter 218, of the Florida Statutes could provide an alternative means of avoiding a show down over the issue of cross collateralization. That part of the Florida Statutes establishes financial-emergency procedures for local governments and school districts. *Id.* at § 218.503(3). One possible outcome from applying the procedures of state assistance includes a state loan. *Id.* At 218.503(3)(b). But if the state chooses not to provide assistance and instead permits the district to file for bankruptcy under Chapter 9 of the Bankruptcy Code, this enforceability of cross collateralization would not necessarily go away. The rights of a creditor under federal bankruptcy laws depend on the rights of that creditor under state law. *E.g. Nobleman v. Am. Sav. Bank*, 508 U.S. 324, 329 (1993) (citing *Butner v. United States*, 440 U.S. 48, 54–55 (1979)) (noting that "[in] the absence of a controlling federal rule, we generally assume that Congress has 'left the determination of property rights in the assets of a bankrupt's estate to state law,' since such '[p]roperty interests are created and defined by state law.' Moreover, we have specifically recognized that '[t]he justifications for application of state law are not limited to ownership interests,' but 'apply with equal force to security interests, including the interest of a mortgagee'"). Therefore, the interest of the investors in school-district lease financings in the underlying leases of the school's facilities, including the cross collateralization right, would depend on their enforceability under state law. *See Barnhill v. Johnson*, 503 U.S. 393, 398 (1992) (reinforcing the notion that property is subject to state law in the absence of controlling federal law).

239. A finding that cross collateralization is unenforceable will presumably enable a school district to abandon some facilities while retaining the possession of others that it can or chooses to pay rent on. Investors that financed the abandoned facilities would then be left to re-let the school facilities or otherwise make use of the facilities to realize a return on their investment. This would be a less-than-ideal situation for investors who would generally derive little use or benefit from the ability to possess or re-let such specialized facilities. *See* Moody's Investors Serv., *supra* n. 12, at 22 (mentioning that limitations on an investor's security interest in a leased asset compromises the remedy of re-letting or selling the property). Further the marketability of their investment in the lease financing would also likely be adversely affected few would be willing to trade places with such an investor at the price he or she initially paid.

240. *See infra* n. 242 and accompanying text (discussing an example of the Florida Supreme Court's treatment of *Miami Beach Redevelopment Agency* in the *Strand* case).

Further, any negative action by rating agencies would also adversely affect school districts hoping to lease-finance capital improvements through access to the public finance markets. Even school districts that are not under financial stress, and that have every intention to pay their lease-financing obligations in full, could be adversely affected by the fiscal distress of an unrelated school district that defaulted on its lease financing obligations. The prospects of an en masse downgrade because of a court's holding in a case involving a single school district is not hypothetical; a similar scenario actually played out in Florida as recently as the fall of 2007 in *Strand v. Escambia County*.[241]

In that case, the Florida Supreme Court initially reversed but ultimately reaffirmed its previous ruling in *Miami Beach Redevelopment Agency*. In its initial opinion,[242] the *Strand* Court held that pledging ad valorem tax revenues is synonymous with a pledge of ad valorem taxing power, regardless of the ability of a creditor to force an obligor to levy ad valorem taxes through the courts.[243] By reaching this conclusion, the Court reversed the bright-line test established in *Miami Beach Redevelopment Agency* that predicated the pledge of ad valorem taxation on the ability to compel the levy and collection of ad valorem taxes.[244] In addition to reversing its holding in *Miami Beach Redevelopment Agency*, the *Strand* Court also expressly receded from all its decisions that relied on *Miami Beach Redevelopment Agency*, including *School Board of Sarasota County*.[245]

241. 992 So. 2d 150.

242. 32 Fla. L. Wkly. S587, *withdrawn and superseded on rehearing*, 992 So. 2d 150. The citation to the Court's initial opinion is 32 Fla. L. Wkly S550, but the Court issued a revised opinion twenty-two days later to clear up some confusion that resulted from its first opinion. 992 So. 2d 150. Although the opinions themselves are substantively equivalent, the revised opinion includes a statement clarifying that certain bonds—those issued or validated prior to the Court's opinion, as well as any bonds issued in reliance upon *State v. School Board of Sarasota County*—will not be affected by the *Strand* holding. *Id.*

243. 32 Fla. L. Wkly. at S587.

244. *See generally* Robert C. Reid & Jason M. Breth, *supra* n. 68, at 18, 22 (discussing the Court's treatment of *Miami Beach Redevelopment Agency* in *Strand*).

245. 32 Fla. L. Wkly. at S587. The Court in *School Board of Sarasota County* relied on *Miami Beach Redevelopment Agency* in analyzing one prong of the two-prong test for determining whether a voter referendum is required under Article VII, Section 12, of the Florida Constitution when ad valorem tax revenues are used to pay debt service on obligations. 561 So. 2d at 552. But in its initial decision in *Strand*, the Court also noted that its departure from *Miami Beach Redevelopment Agency* would not affect the ultimate holding in *School Board of Sarasota County* because the second prong of the two-pronged referendum requirement under Article VII, Section 12 of the Florida Constitution was still not

Rating agencies' reactions to the Court's decision was swift. Five days after the Court's holding,[246] Standard & Poor's issued a press release and placed all ratings on Florida's school districts certificates of participation on "CreditWatch" with "negative implications."[247] This had the potential to bring lease-financed school construction to a complete stop.[248] The market's impending disruption prompted issuers and investors alike to urge the Court's to rehear the case: Escambia County, supported by an analysis from the Securities Industry and Financial Markets Association, asserted in its motion for rehearing that the Court's initial opinion "destabilized [lease financing] securities in the capital markets" and harmed the holders of billions of dollars of such securities.[249] The Court ultimately reaffirmed its holding in *Miami Beach Redevelopment Agency*,[250] noting in its final opinion that its shrinking away from the prior precedent of *Miami Beach Redevelopment Agency* would "cause serious disruption to the governmental authorities that have relied upon that precedent for planning public works that are in various stages of development and approval."[251]

The market disruption that coincided with the *Strand* decision is instructive for Florida's school districts because it provides a clear record of what can happen to all issuers of lease-financing obligations upon the adverse ruling in a single case. It should also highlight the risk that all lease-financing school districts face in the event the fiscal distress of just one district pushes it to de-

met in *School Board of Sarasota County.* 32 Fla. L. Wkly. at S587. As discussed in the text in this Part, this distinction did little to placate concerns in the credit market about the validity of *School Board of Sarasota County*.

246. The Court handed down its initial decision on September 6, 2007. *Strand*, 32 Fla. L. Wkly. S550. Standard & Poor's issued its RatingsDirect© circular on September 11, 2007. Appendix to Mot. for Rehearing & Clarification of Appellee, Escambia Co., Fla., *Strand v. Escambia*, 32 Fla. L. Wkly. S550, at A-31 to A-41, (Fla. Sept. 17, 2007) [hereinafter Appendix to Mot., Escambia, Co.] (available at http://www.sifma.org/issues/item.aspx?id=23165).

247. Appendix to Mot., Escambia, Co., *supra* n. 246, at A-31–A-41.

248. Sigo, *supra* n. 14.

249. Appellee's Mot. for Rehearing and Clarification, *Strand v. Escambia Co.*, 992 So. 2d 150, at 4 (Fla. 2007) (No. SC06-1894) (available at http://www.sifma.org/workarea/downloadasset.aspx?id=23165).

250. *Strand*, 992 So. 2d at 151.

251. *Id.* at 160.

fault, potentially bringing to the surface questions surrounding the enforceability of cross collateralization.[252]

The idea that the fate of many can be placed in the hands of a few has some interesting parallels in economics. Among them is the concept of the "tragedy of the commons," described by Garrett Hardin in his 1968 article in the journal *Science*.[253] As an example of his point that the need for an individual to maximize his or her benefit from a free resource results in the detriment of all else who share that resource, the author uses the example of a cattle herdsman and a common pasture.[254] According to Hardin, the cattle herdsman, given his rational incentive to maximize his welfare from grazing cattle, will continue to add cattle to the common pasture.[255] While this action benefits the farmer, it harms the other herdsmen who share the pasture because it will result in the pasture being over-gazed.[256] In sum, Hardin concludes that the incentive for an individual to maximize his or her own benefit through the use of a free resource shared by others who have the same incentive will cause the depletion of the shared resource.[257]

School districts should recognize that similar incentives inhere in the dependency on cross collateralization in the lease-financing context. As discussed above, the cross collateralization covenant is credible because of its presumed enforceability.[258] If one assumes that school districts benefit from the credibility of cross collateralization of school facilities by receiving a higher credit rating on lease-financing obligations, then the credibility of cross collateralization can be viewed as a shared common resource, similar to Hardin's cow pasture. But what if, as I assert above, the enforceability of cross collateralization is open to question, such that a school district could benefit by not only utilizing

252. *See supra* pt. IV (noting that the questions surrounding the enforceability of the cross collateralization remedy are most likely to be raised in the context of a default by a school district, when creditors, including the lease financing investors, have no other choice but to seek legal redress through an attempt to exercise the remedies purported to be accorded them in their financing documents.)

253. Garrett Hardin, *The Tragedy of the Commons*, 162 Science 1243, 1244–1248 (1968).

254. *Id.* at 1244.

255. *Id.*

256. *Id.*

257. *Id.*

258. *See supra* pt. V(A) (stating that cross collateralization is enforceable to some degree).

it to access the public lease-financing market but also, in the event of a subsequent default, challenge its enforceability and avoid having to vacate some or all of the premises under the lease? Such a scenario seemingly would erode, if not eliminate, the credibility of the remedy shared by lease-financing school districts in Florida. Presumably the primary check on the opportunism of a school district in this instance would be the extent to which it perceives itself as a repeat player in the lease-financing market—the poisoning of a well from which it plans to drink in the future would surely do no good.

But in the event of severe fiscal distress, when a school district can presume that its access to the lease-financing market might be constrained in any event, then the incentive to act opportunistically might be overwhelming. Given the significant shift of school districts toward lease financing as the near-exclusive form of financing for capital projects, are we witnessing the proverbial overgrazing suggested in Hardin's 1968 article? Is the credibility of cross collateralization being overused? And do all school districts in Florida want to submit to this potential exploitation by one or a handful of school districts?

Perhaps the takeaway for school districts in this scenario is that they might actually maximize their self-interest by choosing not to. In other words, to the extent a latent unenforceability is present in the cross-collateralization remedy, perhaps school districts might be better off not choosing the path of cross collateralization. In Hardin's example, the solution is not to opt into common use but rely on the use of private property rights at least to some degree.[259] Perhaps that is the answer for Florida school's districts as well—instead of relying on the credibility of cross collateralization, maybe Florida's school districts should consider some aspect of private credit, under which the lease-financing school district is able to prove its willingness to pay rent on leased facilities on grounds other than cross collateralization. Perhaps school districts can seek out premium payments on a financial-guaranty insurance policy,[260] or perhaps they could

259. *Id.* at 1248.

260. This was a common way for issuers to access the municipal finance market with higher credit ratings than otherwise supported by their uninsured credit, but such financial guaranty insurance policies have become less cost-effective to issuers and less appealing to investors since 2007's credit crisis. See Daniel Bergstresser et al., *Financial*

simply no longer cross-collateralize leased facilities. Regardless, a school district that does not want to be exposed to the tragedy of the commons should contemplate how to effectuate a private credible commitment. Although the cost of lease financing might increase, the question is whether the cost outweighs the benefit of no longer being tied to a systemic downgrade resulting from the financial distress of an unrelated school district.

VII. CONCLUSION

As I set out in this Article, Florida's school districts rely heavily on lease financing to construct and improve capital facilities. The use of lease financing greatly accelerated after the Florida Supreme Court case *School Board of Sarasota County*. The popularity of lease financing is largely tied to the presumed enforceability of the remedy of cross collaterization. In fact, school-district lease financing in Florida has become path dependent on cross collateralization. Path dependency carries risk because choices regarding them are often based on stale or incomplete information. When reality fails to match up with expectations, severe adjustments can result. Such is potentially the case with the path dependency of cross collateralization. Further, because the presumed enforceability of cross collateralization in Florida's lease financings are a common, shared resource, opportunism exists for school districts to deplete the shared resource to the detriment of all that rely on it—a concept referred to as a tragedy of the commons.[261] As such, perhaps school districts should consider alternative, individualized ways to provide assurance to the market of their willingness and ability to pay their lease financing obligations.

As a parting point, exploring possible outcomes of the enforceability and unenforceability of cross collateralization might not be just an interesting academic exercise. For the fiscal year ending June 30, 2009, five school districts' unreserved-fund balance fell below three percent of projected general fund revenues—a statistic that is considered to be evidence of a financial emer-

Guarantors and the 2007–2009 Credit Crisis (Harvard Bus. Sch., Working Paper No. 11-501) (discussing the credit crisis and its effect on investors) (available at http://www.hbs.edu/research/pdf/11-051.pdf).

261. *See* Hardin, *supra* n. 253 (describing the tragedy of the commons).

gency.[262] Those five school districts were: Highlands, Jefferson, Manatee, Miami-Dade, and Taylor school districts.[263] Of those five school districts, two had School-District COPs outstanding at that time: Highlands and Miami–Dade.[264] Highlands had just over $66.5 million in School-District COPs outstanding with seventeen schools (including 39% of its total student stations) covered under a cross-collateralized covenant to vacate.[265] Miami-Dade, on the other hand, had over $2.7 *billion* in School-District COPs outstanding (more than any other school districts at that time), with over one hundred schools (including 25.9%, or approximately ninety thousand, of its total student stations) covered under a cross-collateralized covenant to vacate.[266] And the financial situation for these districts may be worsening, as declining property-tax revenues and decreasing enrollment continue to put pressure on school districts that experience budgetary constraints because of significant fixed costs.[267] These current events make an examination of the path dependency of cross collateralization of school facilities and the potential adverse impact on all school districts in Florida all the more timely.

262. St. of Fla. Auditor Gen., *supra* n. 17, at 4–5.

263. St. of Fla. Auditor Gen., *Report on Financial Trends and Significant Findings in 2008–2009 Fiscal Year Audits of District School Boards* 4 (Oct. 2010).

264. *Id.*

265. Amici Curiae Br. of Superintendents, *supra* n. 205, at A-1.

266. *Id.*

267. St. of Fla. Auditor Gen., *supra* n. 17, at 5–7.