

**ARKANSAS STATE BANK DEPARTMENT  
EXAMINATION POLICY**

Policy Number	<u>93-2</u>
Effective Date	<u>03-01-93</u>
Supersedes	<u>91-4</u>
Approval	_____

**SUBJECT: State and Local Government Leases**

Act 508 of 1991, the so-called Local Government Lease Act provided a method for structuring a multi-year lease arrangement that local governments could use to obtain capital improvements, equipment, facilities, goods, etc. Certain provisions of the Act provided for payment of interest by the local government. (See Examination Policy 91-4)

An Arkansas Supreme Court decision, *Mason Brown v. City of Stuttgart, Arkansas and First Continental Financial Corporation*, Case No. 92-849 (February 22, 1993) may have invalidated Act 508 of 1991. The case held that a multi-year lease arrangement that provided for the payment of "interest" by the municipality was a violation of the Arkansas State Constitution, Article 16, Section 1, which prohibits a city from entering into an obligation with interest bearing indebtedness. The court cited several other provisions for invalidating the lease in this case, such as a great penalty for default, and the fact that there was no way to terminate the lease except if an appropriation was not made for it each year.

While the court did not reach the question of the constitutionality of Act 508 of 1992, it did invalidate the lease in this case.

**POLICY**

Leases between a lender and state and local governments should be scrutinized for evidence of an interest bearing obligation as well as whether there are major penalties for default from the lease agreement.

Such leases, if discovered, should be accorded a special mention classification and the bank should be requested to confer with bank counsel to determine if a new arrangement should be negotiated due to the above cited Supreme Court decision.