

OFFICIAL OPINION NO. 69-83, Investment of permanent school funds in Small Business Administration loans, constitutional limitations

STATE OF SOUTH DAKOTA  
OFFICE OF  
THE ATTORNEY GENERAL

October 3, 1969

Bernard Linn, Commissioner  
Department of School and Public Lands  
Pierre, South Dakota 57501

OFFICIAL OPINION NO. 69-83

**Investment of permanent school funds in Small Business Administration loans,  
constitutional limitations**

Dear Mr. Linn:

We have your request for an official opinion as to investing a portion of the permanent school funds of the State of South Dakota in Small Business Administration loans. An examination of the file reveals that heretofore the Regional Director of the Small Business Administration, Sioux Falls, South Dakota, submitted a proposal that the Commissioner of School and Public Lands, as custodian of the common school permanent fund and other education funds, make disbursements from such fund in exchange for an assignment from banks of the guaranteed portions of SBA guaranteed loans. Among other things, the Regional Director stated:

"We propose that the Commissioner of School and Public Lands, with the approval of Board of School and Public Lands and of the

Governor, give written authorization to the State Treasurer, as custodian of the Common School Permanent Fund and other education funds (hereinafter referred to as "fund"), to make disbursements from Fund in exchange for assignments from banks of the guaranteed portions of SBA guaranteed loans.

"SBA loans to small businesses and industries can be authorized up to \$350,000 (SBA share), for terms up to fifteen years for construction, ten years for other than working

capital and construction, and six years for working capital. Such loans may be guaranteed by SBA up to 90% and bear interest at the rate set by the bank, but not to exceed 8% per annum. Out of the interest set by bank, it pays SBA 1/2 of 1% as the guaranty fee on the guaranteed portion and the bank services the loan. Only the guaranteed portion, or a part thereof, would be assigned to the Fund, which would make its investment 100.% guaranteed by the Small Business Administration, an agency of the United States Government."

We have examined the guarantee agreement and the form of the proposed assignment of the securities to the permanent school fund that will be used by SBA and the bank that makes the loan to the borrower. The guarantee is 90% of the outstanding balance of the loan. The proposed instrument whereby the bank would assign the guaranteed portion of the loan sets out therein that the bank will collect the installments on the loan, as paid, and 9/10 of the payments received and collected on the principal of said loan will be remitted monthly to the assignee of the certificate of guaranty. In other words, you would be purchasing 90% of the security. The Regional Director of SBA also states that the program, as outlined in his letter, has been placed in effect in North Dakota, Utah and Wyoming with state employee pension funds and investments by the Bank of North Dakota. The types of funds in North Dakota and Wyoming are similar to South Dakota's Teacher's Retirement Fund, which is not affected by the constitutional limitation that we are concerned with in this opinion.

It is interesting to note, however, that in North Dakota the statute which pertains to investments by the Bank of North Dakota provides that:

"It may make such loans and advances of credit and purchases of obligation representing loans and advances of credit as are insured by, or guaranteed, in any manner, in part or in full, by the United States or any instrumentality thereof."

While it is not the function of this office to determine the advisability of such an investment, it would seem there is merit to the Regional Director's proposal wherein he states in his letter of June 12, 1968 as follows:

". . . it will make it possible for banks in this state to make loans to small business concerns which otherwise could not be made on account of unavailability of funds. It would permit banks to cultivate profitable business and industry accounts, well secured, and at the same time enable the firm to obtain a very favorable interest rate at no risk."

We are aware of the desire of your office to aid the development of industry in the State of South Dakota if this can be legally accomplished and a higher income from the investment be realized.

By assignment of the Certificate of Guaranty to the permanent school fund of the bank involved and an agreement with the bank and the Small Business Administration, it would seem that the fund could be protected 100%. The Regional Director states that the permanent school fund share will be fully guaranteed. On the basis of the proposal submitted, it can be seen that in the final analysis the investment could be fully protected.

You have submitted four questions which will be answered in the order in which they are asked. Questions one and two are answered together.

"1. Does the Constitution, Article VIII, Section 11 permit the investment of permanent school funds in SBA loans?"

"2. Does SDCL 5-10-18, as amended, permit investment in any portion of funds not fully guaranteed by the United States?"

Article VIII, Section 11 provides as to pertinent parts as follows:

"The moneys of the permanent school fund and educational fund shall be invested by the Commissioner of School and Public Lands only in hands of the United States, securities guaranteed by the United States . . ."

"The Legislature shall provide by law, such rules, regulations and safeguards as it may deem necessary to secure safe and continuous investment of such funds so far as possible, and to provide the highest income compatible with safety investments."

SDCL 1967 5-10-18 provides as to pertinent parts as follows:

"The moneys of the common school permanent fund and other education fund shall be invested only in: (1) bonds of the United States; (2) securities fully guaranteed by the United States, including Farmers Home Administration and Federal Housing Administration mortgages; . . ."

The answer to Questions 1 and 2 is by no means free from doubt and one that can only be authoritatively answered by the Supreme Court of South Dakota. By giving the phrase in the Constitution, that states:

".. securities guaranteed by the United States"

a liberal interpretation, we could conceivably interpret such statement meaning any investment in which the permanent school fund is protected 100% as is the case here, despite the fact that the security is actually only guaranteed by the United States to the extent of 90%.

The State Constitution gives the Legislature broad rule making powers with respect to the investment of the permanent school fund. However, that body has not seen fit to liberalize or broaden the right of such investments. On the other hand, SDCL 1967 5-10-18 narrows and restricts the right to securities guaranteed 100% and no authorization is given to the purchase of a portion of a security, even though that portion be guaranteed. Also, SDCL 5-10-18 implies very strongly, and may be read to mean that the Legislature intended to limit such investments to loans secured by real estate. To get a different result we would have to read SDCL 5-10-18 as follows:

"Securities, secured or unsecured, or a portion thereof guaranteed in whole or in part, by the United States."

Therefore, the answer to Questions 1 and 2 is in the NEGATIVE.

"3. SBA loans are guaranteed by the Small Business Administration, an **agency** of the United States Government. The statute provides that to be eligible, securities must be guaranteed 'by the United States.' Are the terms 'by the United States' and 'by an agency of the United States' of identical legal force and effect?"

The answer to this question is in the AFFIRMATIVE. The Small Business Administration was created by an Act of Congress and is found in 15 USCA Section 631 through 647. In the case of **U. S. v. Stuart**, 271 F. Supp. 939, the court held that the Small Business Administration is a non-incorporated Federal Agency and an integral part of the United States Government. The phrase, "by the United States" and the term "by an agency of the United States" are of identical legal force and effect.

"4. In the event that the Constitution does provide for the investment of SBA loans, would SDCL 5-10-18 preclude such action until such time as this law was amended?"

We are unable to definitely say that the phrase "securities guaranteed by the United States" in Article VIII, Section 11 could by legislative rules and regulations be defined to provide for investment in SBA loans. Such an enactment by the Legislature would raise the question of such law's constitutionality. I make no comment nor express any opinion as to the constitutionality of such an act by the Legislature.

It is my opinion that it would be preferable to amend the Constitution to authorize you to invest permanent school funds in SBA loans.

Respectfully submitted,

Gordon Mydland  
Attorney General