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No. 3609: March 1, 1936

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A DEBT ADMINISTRATION MANUAL FOR TEXAS CITIES

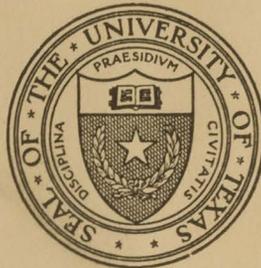
By

J. T. BARTON

Research Assistant in the Bureau of Municipal Research

Bureau of Research in the Social Sciences
Study No. 16

Municipal Studies, No. 5



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The benefits of education and of useful knowledge, generally diffused through a community, are essential to the preservation of a free government.

Sam Houston

Cultivated mind is the guardian genius of Democracy, and while guided and controlled by virtue, the noblest attribute of man. It is the only dictator that freemen acknowledge, and the only security which freemen desire.

Mirabeau B. Lamar

Municipal Studies of The University of Texas

Number 5

BUREAU OF MUNICIPAL RESEARCH

A DEBT ADMINISTRATION MANUAL FOR TEXAS CITIES

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PREFACE

Since December, 1934, the Bureau of Municipal Research has published four monographs in the field of municipal finance. The present study is the fifth and last of the manuals designed to serve as financial handbooks for city officials. It deals with a subject, namely the administration of debt, whose importance at this time will hardly be questioned.

As in the past, representative cities to the number of 10 per cent of the total incorporated municipalities of this state were selected for study. A questionnaire was sent to fifty-eight cities, some fifty-two of which supplied the information requested. In addition, some thirty municipalities were visited personally. The facts collected thus may not be said to present a complete picture, though undoubtedly they do reflect what is common practice among the cities in their treatment of the debt problem.

In the pursuit of the study, many persons contributed generously of their time and assistance. In particular, Mr. Victor W. Bouldin, Assistant Attorney General of the State of Texas, Mr. G. R. Daniels, Auditor of the City of El Paso, Mr. C. F. Gibson, municipal bond attorney of Austin, Mr. T. W. Gregory of the Gregory-Eddleman Company of Houston, Mr. C. D. Simmons, Investment Officer of The University of Texas, and Mr. E. E. McAdams, Executive Secretary of the League of Texas Municipalities, each read all or a large part of the manuscript and made suggestions whose adoption increased materially the value of the study. Again, Mr. George B. Simpson, then State Auditor, and Messrs. Pat Dooley, Chief Clerk, and E. F. Elkin, Bond Clerk, in the Comptroller's Department of the State of Texas, were more than obliging in making the records of their offices available. Finally, the Bureau of Research in the Social Sciences of The University of Texas financed the preparation and the publication of the study.

ROSCOE C. MARTIN,

Director of the Bureau of Municipal Research.

Austin, Texas.

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CHAPTER I

THE DEBT PROBLEM

Close observers of municipal credit have long known that all is not well in the realm of city debt. Although the cities of Texas have been in no worse condition than those of many other states, their position has not been as strong as that occupied by the municipalities of a few commonwealths. Particularly since the advent of the recent period of economic stress have a number of weaknesses appeared in the funded debt structure of many Texas cities and towns. Decreased property values and diminished tax collections, coupled with unplanned debt maturities, have increased the number and complexity of financial problems in both large and small municipalities. The experiences of the past few years have emphasized anew the necessity for enlightened attention to and consideration of the problems which have their origin in municipal indebtedness.

A casual survey of the subject at hand reveals that not less than five groups or agencies are directly concerned with the problems which rise from local debt administration. The interest of each in and its responsibility for the pursuit of a sane debt policy may be examined briefly.

The taxpayers, of course, are first among those interested in local indebtedness. Those who own property in a community are concerned not only because they are consumers of municipal services but also because it is they who must pay for these services. Taxpayers have the definite responsibility to demand that the city's credit be used only for justifiable purposes and that money raised from the sale of bonds and time warrants be handled honestly and wisely. Among the most disheartening features of urban democracy is the fact that property owners customarily evidence an active concern in the field of city finance only during periods of economic uncertainty. A solution to the problems of municipal indebtedness awaits the day when the taxpayers will change their vigorous

in it but also because of the predominant position which it occupies in relation to the indebtedness of other units of government. In this state the total debt of cities and towns is more than twice that of any other single governmental debt-creating group, excluding the counties, whose total debt is 70 per cent of that of cities and towns.¹ The net funded debt of cities and towns, moreover, amounted to approximately 36 per cent of the grand total of the net funded debt of the state and of all the debt-creating units within it in 1932; this figure dropped to 35 per cent in 1933 and remained at that level in 1934.² This discussion of municipal indebtedness then, concerns Texas' largest single class of public debt, the total of which aggregates more than one-third of all the public debt of the state and its subdivisions.

There is, of course, an inescapable relationship between the ability of a city to pay its debt service charges and the portion of its tax dollar which must be set aside to meet such charges. As revealed by Table I, the percentage of total tax collections devoted to debt retirement for the cities of the sample showed a marked increase during three consecutive years of the depression. This increase, far from resulting from a yearly growth of the actual amount set apart for debt maturities, is the consequence of an annual decrease of gross tax collections during a period when the sums required for debt service charges remained practically constant. The table also sets forth in a striking manner the fact that the burden of debt service is no

¹This computation was made from information which appears on page 3 of the *Report on Taxes and Indebtedness of Local Units of Government in Texas for 1934*. This report is available at the office of the State Auditor and Efficiency Expert, Austin, Texas.

²Net debt in this instance is computed by deducting the debt retirement fund assets from gross outstanding debt.

Information for calculating the relation between the debt of cities and towns and the total debt was obtained from three annual reports on local taxes and indebtedness which were compiled and published by the State Auditor's Office (see footnote 1). The data came from tables on p. 13 of the 1932 report, p. 5 of the 1933 report, and p. 3 of the 1934 report.

respector of size but that it makes unrelenting demands upon large and small municipalities alike. City officials in Texas have been forced to face the enigma of having increasingly greater proportions of the current tax receipts of each year consumed by debt requirements while contending with the never-ceasing clamor of the populace for additional municipal services.

TABLE I*

THE PERCENTAGE OF TOTAL TAX COLLECTIONS DEVOTED TO DEBT RETIREMENT IN FIFTY-FIVE TEXAS CITIES, 1931-1934

Population Groups	Number of Municipalities	1931-32	1932-33	1933-34
1,000 to 4,999.....	19	58.3%	62.2%	57.1%
5,000 to 14,999.....	17	50.6%	54.2%	52.0%
15,000 to 39,999.....	7	60.5%	58.5%	61.8%
40,000 to 99,999.....	7	39.2%	48.8%	52.1%
100,000 and Over.....	5	39.9%	46.2%	50.9%
All Cities.....	55	41.2%	47.8%	51.9%

*Data for this table were obtained from the office of the State Auditor for the cities of the sample which made their 1934 report to that office.

As might be expected, this heavy burden of debt requirements has been accompanied by considerable difficulty in making debt payments. Both interest and principal payments have been passed by municipalities of various sizes. Including the cities which postponed payment only under an agreement with their creditors and those which deferred payment only during refunding operations, some 29 per cent of the cities surveyed suspended payment of principal or interest for a minimum of thirty days at some time during the years 1933 and 1934. These defaults took place in cities ranging in size from the smallest in the sample, which had a population of only a few more than 1,000, to one of more than 40,000 population. Payments have been passed on time warrants, revenue bonds, and tax supported bonds. The duration of these defaults has varied from slightly more than one month to four years. This most ominous specter of city debt has little regard for size of municipality or for type of security; it is an ever-present threat which serves as a perpetual challenge to develop and maintain carefully planned debt programs.

The annual amounts of bonds issued by fifty-seven Texas cities (see Table II) indicate that the debt structures of municipalities in this state have undergone a tumultuous experience during the past seven years. Further, the table reveals clearly the influences of prosperity and depression. The greatest amount issued by the cities of the sample in any one year was in 1928; large annual issues followed through 1931, when a precipitate decline set in. The amount issued in 1932 was only 16.7 per cent of that of the preceding year, and the issues of 1934 were no more than 10.6 per cent of those of the peak year of 1928; furthermore, the amount for 1934 was less than that for any year since 1918.

TABLE II*

BOND REGISTRATIONS OF FIFTY-SEVEN TEXAS CITIES, 1928-1934

Year of Registration	Amount of Total Bonds Registered	Per Capita Amount Registered	Amount of Refunding Bonds Registered	Per Cent of Total Registrations in Refunding Bonds
1928	\$25,065,024	\$14.39	\$2,482,024	9.9%
1929	18,038,950	10.36	1,793,950	9.9%
1930	15,562,500	8.94	1,143,000	7.3%
1931	16,700,477	9.59	2,744,477	16.4%
1932	2,794,000	1.60	980,000	35.1%
1933	3,389,000	1.95	3,254,000	96.0%
1934	2,669,000	1.53	95,000	3.6%

*Material for this table was obtained for the cities of the sample from the records which are kept of each municipal bond issue in the office of the State Comptroller. Each per capita amount rests on the population figures of the 1930 Census.

The proportion of funding and refunding bonds to total bonds increased at a phenomenal rate during the three years 1931, 1932, and 1933. This proportion, however, dropped from a peak of 96.0 per cent in 1933 to 3.6 per cent in 1934. Reports from the Comptroller's office indicate that issuance of refunding bonds was very heavy during the early months of 1935. While it is unquestionably true that cities issued bonds in excessive amounts during the boom period of the middle and last part of the decade 1920-1930, it is equally obvious that the amounts issued since 1931 have been ridiculously small. Apparently the administration of municipal debt has been guided by no semblance

of an organized attempt to secure systematically regulated issuance of bonds and warrants.

Administrators of municipal debt are confronted with the dual problem of handling existing exigencies and of evolving improved debt structures. Excessive demands have been made upon the time of city officials during the past few years. Refunding bonds have been issued; information has been distributed to numerous security holders who suddenly have come to realize that all municipal securities are not of equal worth; detailed reports have been made to higher levels of government; the condition of many sinking funds has required additional work; militant organizations of dissatisfied taxpayers have arisen to make demands not always based upon a complete knowledge of the facts; and political upheavals here and there have played havoc with programs of debt administration. Debt requirements have remained unrelentingly constant during a period of rapidly falling tax collections, and city officials have been forced, in some cases, to neglect their creditors while making a valiant effort to enforce retrenchment programs without sacrificing the essential services expected of municipalities. Importunate demands upon local officials have tended to keep their attention glued to matters which have risen from day to day, and thus have made it difficult for them to realize that the problems of the present are the result, in part at least, of unplanned operations in the past, and that future improvement is possible only when the program of the present is tempered by and conducted in accordance with a definite plan for the years to come. This manual has been prepared chiefly to supply the needs of these harassed city administrators, though each group or agency interested in municipal indebtedness may find something of consequence in the principles it lays down.

The chapter which immediately follows is devoted to the issuance and sale of city obligations, which chronologically are worthy of first treatment. A thorough study both of the proposed expenditure and of existing indebtedness would, at this initial point, do much to keep a municipality

from overbonding or from creating a burdensome sequence of maturities.

Chapter III deals with refunding operations. Regardless of their size, cities may find it advisable to refinance at least a portion of their outstanding debt. Each such operation should receive individual consideration, and its administration should be regulated according to the kind of refinancing to be done and the circumstances which make it necessary.

Chapter IV relates to the procedure incident to paying the periodical principal and interest charges on funded indebtedness. Subsequent to the issuance and sale of credit obligations, either of original or of refunding issues, the credit position of a community depends largely on the regularity and the certainty with which debt service charges are paid, which thus become important factors in debt administration.

The first portion of Chapter V treats administrative aids which are essential not only to the development of a sound debt program but also to the efficient operation of a city's government. The chapter also deals with the features which should characterize security issues and with the types of information which a city should keep available for the groups interested in local indebtedness.

The relationship of the state government to local indebtedness is treated in the concluding chapter. Legal restrictions and requirements are given a prominent place, for these constitutional and statutory provisions comprise the fundamental basis for the issuance and repayment of local securities. Finally, the desirability of administrative control by a central state agency is discussed in the last portion of the chapter.

CHAPTER II

DEBT INCURRENCE

Many individuals have placed themselves in positions of financial embarrassment as a consequence of misusing an apparently unlimited store of credit. A number of municipalities, similarly, have fallen into straitened circumstances as a result of borrowing unjustifiably large amounts during the boom years when credit is easy and when opposition to bond issuance is at a minimum. Many cities also have been guilty of the common error of giving insufficient attention to the arrangement of debt maturities, with a result that impossible situations have arisen when heavy maturities have fallen due within relatively short periods of time. Still another result of unplanned issuance of instruments of indebtedness is that city officials have made little attempt to synchronize their issuance with general economic conditions. This lack of foresight has meant that periods of diminishing property values and declining tax collections have not been anticipated and that municipal construction work often has taken place during times of high construction costs.

The incurrence of long-term debt, by the issuance of bonds or time warrants, should be predicated on a thorough understanding of the types of instruments to be issued. Municipal debt, however, often is contracted through the action of officials who are not conversant with the qualities or characteristics of the instruments of funded debt. Considerable confusion, for example, exists in the minds of municipal officials concerning the exact definition of a time warrant. A time warrant is a transferable, non-negotiable instrument which represents existing, lawfully created indebtedness. It is an order of one of the officers of a municipality upon another of its officers to pay some of its funds to a third party.¹ It is payable from future

¹Eugene McQuillin, *The Law of Municipal Corporations*, Second Edition (Callaghan and Co., New York, 1928), Vol. VI, Sec. 2400.

funds and may or may not bear interest. The Texas Bond and Warrant Law of 1931 specifies that any warrant not payable from current funds is a time warrant.² Cities incorporated under the general laws of this state have authority to issue interest-bearing warrants in evidence of indebtedness legally created.³

A warrant, in the absence of a special legislative grant, is non-negotiable⁴ and does not constitute a new debt or evidence of new debt but is only a prescribed means of paying existing debt.⁵ The power to issue municipal warrants is sometimes expressly conferred, but in the absence of an express grant, it is well understood that a municipality has the implied power to issue non-negotiable warrants for debts lawfully incurred.⁶ When payable to bearer, warrants may be transferred directly from one holder to another, and when payable to a specified person, they may be transferred by endorsement and delivery.⁷

A similarity exists in the purpose for which time warrants and bonds may be issued, for a city has power neither

²*General Laws of Texas, Regular Session of the Forty-second Legislature, 1931* (Austin, 1931), Ch. 163, Sec. 1. References to the various session laws are hereafter cited as *General Laws*, and reference to the particular session which passed the laws is made in the following style: *Regular Session, 1931*, or *First Called Session, 1931*.

³*Clark v. Pearson and Co.*, 39 S.W. (2d) 27 (1931).

⁴John F. Dillon, *Commentaries on the Law of Municipal Corporations*, Fifth Edition (Little Brown, and Co., Boston, 1911), Vol. II, Sec. 856. McQuillin, *op. cit.*, Vol. VI, Sec. 2401.

The following Texas cases indicate the non-negotiability of warrants: *Sims v. City of Mt. Pleasant*, 12 S.W. (2d) 833 (1928); *Keel v. Pulte*, 10 S.W. (2d) 694 (1928); *Payne v. First National Bank*, 291 S.W. 209 (1927); *City of Belton v. Harris Trust and Savings Bank*, 283 S.W. 164 (1926); and *Lasater v. Lopez*, 217 S.W. 373 (1919).

The state legislature may, however, by special legislation, make municipal warrants negotiable. See *General Laws, First Called Session, 1935*, Ch. 383, Sec. 1; also see McQuillin, *op. cit.*, Vol. VI, Sec. 2401.

⁵Dillon, *op. cit.*, Vol. II, Sec. 851; McQuillin, *op. cit.*, Vol. VI, Sec. 2400.

⁶*Ibid.*, Vol. VI, Sec. 2401. *Clark v. Pearson and Co.*, *supra*.

⁷Dillon, *op. cit.*, Vol. II, Sec. 858.

to incur indebtedness nor to expend money for other than a public purpose.⁸ A municipal bond is a formal, negotiable instrument of indebtedness, generally under seal, which possesses all the attributes of commercial paper, which is intended for sale on the market, and which contains a promise to pay a certain sum at a fixed future date, with interest to be remitted at specified periods in the interim.⁹ Bonds may be issued by a city only when it is duly empowered since there is no inherent authorization for municipal bond issuance.¹⁰ Legal provisions in connection with municipal bonds are of direct concern to cities, which must observe specified procedures in the use of this source of credit, and to prospective security owners, who desire to be assured of the validity of their purchases.¹¹

The issuance of municipal credit obligations should be founded upon carefully evolved plans which have their basis in a long-term budget. A long-term plan, when properly formed and used, does not consist of an iron-clad set of specifications but, on the contrary, comprises a number of rational policies designed to serve as a guide for municipal activities for several years in advance. Long-term budgets are related to current budgets in that the formation of each of these aids to administration comprehends an estimate of expenditures, a conservative forecast of receipts, and a balance between expected expenditures and anticipated receipts. Although their execution may prove difficult, the basic steps in the preparation of a long-term financial program are evident. The total debt service charges (interest plus principal payments) should be computed for each year included in the plan, and to these yearly totals should be added the annual amounts expected to be necessary to pay the general city operating expenses. Next, it is essential, by studying past receipts in light of conditions likely to

⁸McQuillin, *op. cit.*, Vol. VI, Sec. 2439.

⁹Dillon, *op. cit.*, Vol. II, Secs. 871, 879; McQuillin, *op. cit.*, Vol. VI, Sec. 2421.

¹⁰*Ibid.*, Sec. 2437.

¹¹*Ibid.*, Sec. 2422.

prevail in the future, to ascertain the amounts of the probable yearly receipts; allowance should be made for a reasonable growth in population, for changes in valuation, and for any money expected to be transferred to the general fund or debt payment funds from utility profits. The anticipated receipts and expenditures of each of the years included in the plan should then be compared; the amount by which the receipts exceed the expenditures of each year may be taken as a base in determining the ability of the municipality to pay interest and principal charges on anticipated additions to its funded indebtedness.

A long-term budget, by revealing the amounts likely to be available for payment of charges on new security issues, makes possible the formulation of an intelligent program of capital expenditures. When such a program is in operation, the general welfare of the city is assured of receiving primary consideration, since the pet schemes of individuals and special groups are overridden by the general plan. Moreover, a capital expenditure program tends to stabilize the local economic situation since, through its application, credit instruments may be issued during favorable market periods, and their maturities may be evenly spread; further, construction work may be done at a time of low cost, and the tax burden may be equalized over a period of years. Finally, it should be remembered that a long-time plan is not mandatory as to the issuance of proposed obligations but is optional only, thus permitting a cessation of bond issuance during unfavorable periods.

A few municipalities of this state are placing credit obligations on the market only after a thorough plan has been formulated which presents both the need for capital funds and the ability to bear the extra financial burden. The City of Victoria, for example, has a Street Bond Advisory Committee and a Public Building Bond Advisory Committee. Dallas, in its "Ulrickson Plan," has perhaps the most widely known program for bond issuance of any city in the state. The Ulrickson Plan is unique in that the bonds proposed in it were actually authorized by popular vote and therefore may be issued merely by council action.

This particular plan, while commendable in many respects, is indicative of one error which should be guarded against by other cities. While the assessed property value, the basis of assessment, and the tax rate have not increased as provided in the plan, the bonds have been issued substantially as originally outlined, with the result that the proportion of tax receipts available for general fund expenditures has grown constantly smaller.

Although 53 per cent of the municipalities studied indicated either that bonds were already authorized but unissued, or that definite plans existed for the issuance of bonds, or that the physical equipment of the city was in such condition that issuance of new securities likely would be imperative within five years, only 19 per cent of the group studied possessed definite plans for probable future bond issues. The first and most important problem for the majority of Texas cities in regard to issuance of securities is the formulation and use of a long-term budget and of an accompanying program of capital expenditures.

If time warrants are to be used, they should be issued to supplement a sound bond program rather than to serve as a major source of funds for capital expenditures. There has been much abuse of the privilege of issuing time warrants, due doubtless to the facts that a popular vote is not necessary to their validation and that they require neither approval by the Attorney General nor registration by the State Comptroller. In many cases, for example, bonded debt has been increased without popular vote through the subterfuge of issuing time warrants and later refunding them into bonds, an operation which does not require popular approval. The consensus of enlightened opinion appears to favor legal provision that time warrants may be issued only in a grave emergency, that they should be limited in amount, that they must be paid rather than refunded, and that they must not be used as a substitute for bonds. It would be desirable also to restrict the purpose of issue, preferably to construction and rehabilitation work during periods of disaster.

The Bond and Warrant Law of 1931 specifies the maximum amounts of time warrants which may be issued by

general law or home rule cities during any one calendar year without extending the right to petition for a referendum vote. These amounts are \$7,500 for cities having a population of 5,000 or less, \$10,000 for those having a population ranging from 5,000 to 25,000, \$25,000 for those having a population ranging from 25,000 to 50,000, and \$100,000 for those having a population in excess of 50,000.¹² These limits are entirely too flexible, for they may be exceeded if the taxpayers, who often are characterized by complete indifference, do not demand a referendum vote and defeat proposed warrant issues in excess of these amounts. Moreover, precaution should be taken lest a specific limit on the issuance of time warrants may, in practice, become a minimum as well as a maximum limit.

In any event, the restriction on the annual amount of issue of time warrants was enacted too late to be of much assistance to the taxpayers of one Texas town of less than 7,000 population. This particular municipality in 1934 had a per capita bonded indebtedness of \$64.32, which is a conservative amount of funded debt for a community of that size; over and above that amount, however, it had a per capita indebtedness of time warrants of \$84.31, making a staggering total funded debt of \$148.63 per capita. This city had a per capita assessed property valuation of only \$302.86.

That issuance of time warrants is not imperative to the operation of Texas cities is indicated by the fact that it is the policy of 37 per cent of the municipalities included in this study to make no use whatever of this source of credit. Although issuance of time warrants within the limits imposed by the Bond and Warrant Law of 1931 does not necessitate an election or approval and registration by state officials, the administrative procedure in connection with their printing and ultimate payment should follow the steps hereinafter outlined as applicable to bonds.

A bond election should be preceded by a conscientious effort to enlighten the electorate concerning the proposed issue. Apathy on the part of the voters may result in the

¹²*General Laws, Regular Session, 1931, Ch. 163, Sec. 5.*

approval of an objectionable bond issue or in the defeat of a desirable one. Those eligible to vote on a proposed issue are vitally concerned and should be easy to interest, for the electorate on this question is composed of qualified voters who own property within the city and who have rendered their property for taxation.¹³ An election, however, is not necessary for the issuance of refunding bonds or for the issuance of repair bonds for a sum of less than \$2,000.¹⁴

Newspaper publicity, as well as printed election notices, should be used to inform citizens of the features of a proposed bond issue. Members of the electorate should be given the opportunity of basing their votes on definite information rather than on hearsay. The purpose of issue, generally speaking, has greater news value than any other feature of a proposed block of bonds. Even more important, however, is the ability of the municipality, as measured in its long-term budget, to pay the additional debt charges which would result from approval of the new bonds.

Two factors in regard to additional debt charges which should concern citizens are the total life of the proposed bond issue and the type of maturity for which it calls. Citizens too often appear interested in a proposed issue only to the extent that the project to be constructed enhances the value of their property. Perhaps it is this attitude which, on occasion, has resulted in the authorization of forty-year bonds for the purpose of placing a temporary gravel topping on city streets. Some states have sought a remedy for this inexcusably short-sighted view by placing in the statutes the maximum periods of time which may be covered by bonds issued for various specified purposes. Exhibit A shows the number of years for which cities and towns of Massachusetts may incur debt for specified purposes. The tabulation is not presented as a model for ideal time limits but as an illustration of the manner in which

¹³*The Constitution of the State of Texas*, Art. VI. Sec. 3, as amended on Nov. 8, 1932. See also *City of Richmond v. Allred*, 71 S.W. (2d) 233 (1934).

¹⁴*Revised Civil Statutes of Texas, 1925* (Austin, 1925), Art. 717. These statutes are hereafter cited as *Revised Civil Statutes*.

EXHIBIT A

THE NUMBER OF YEARS FOR WHICH CITIES AND TOWNS OF MASSACHUSETTS MAY INCUR DEBT FOR SPECIFIED PURPOSES*

Purpose of Loan	Duration in Years
Additions to buildings, when such additions increase floor space, including cost of original equipment and furnishings	20
Airport construction	10
Bridges of stone or concrete or of iron superstructure....	20
Buildings	20
Buildings for pumping stations.....	20
County tuberculosis hospital, proportionate share of city..	20
Departmental equipment	5
Electric lighting plant purchase, extension, or enlargement	20
Emergency appropriations, as approved by a board composed of the attorney general, the state treasurer, and the director	1
Filter beds	20
Gas plant purchase, extension, or enlargement.....	20
Judgments rendered after fixing of tax rate.....	1
Land damages incurred in paving work.....	10
Land for airports.....	10
Land for cemetery purposes.....	10
Land for protection of water system.....	30
Land for public parks or playgrounds.....	30
Land for purposes not otherwise specifically provided for	20
Memorials to soldiers, sailors, and marines.....	20
Pavement of macadam, as approved by the department of public works.....	5
Pavement of stone, block, brick or other permanent material approved by the department of public works	10
Relief expenditures	2
Reservoirs	20
Sewage disposal	30
Sewer connections when part or all of the cost is assessed against abutting property owners.....	5
Sewers, sanitary and drainage.....	30
Sidewalks laid at the time of original construction of public ways	10
Sidewalks of brick, stone, or concrete	5
Standpipes	20
Street railway property.....	10
Temporary loans	1
Walls or dikes for protection of highways or property....	10
Water departmental equipment.....	5
Water main extension.....	5
Water mains and aqueducts of sixteen inches or more in diameter	25
Water mains of not less than six inches but less than sixteen inches in diameter.....	15
Water rights	30
Water system purchase or establishment.....	30

*Extracts from the General Laws, *Municipal Bulletin Number 12* (Division of Accounts of the Department of Corporations and Taxation, The Commonwealth of Massachusetts, Boston, Oct., 1932), pp. 62-64.

the statutes of one state have limited the duration of municipal loans. The laws of Texas make no attempt thus to classify the life of bonds issued for various purposes but merely specify that bond issues shall mature within thirty or forty years.¹⁵

Although it is axiomatic that the life of a bond issue should not exceed the life of the improvement to be financed, a reasonable approach to the problem must of necessity comprehend more than the mere life of the improvement. Municipal debt should be retired as rapidly as circumstances will permit. That much remains to be accomplished in obtaining the proper life-periods of proposed bond issues is indicated by the fact that 38 per cent of the cities studied make no attempt to keep the duration of their bond issues equal to or less than the expected period of usefulness of the improvements so financed.

It is accepted by almost all intelligently interested parties that serial bonds unquestionably are more desirable than term bonds.¹⁶ As contrasted with the indifferent attitude concerning the life of bond issues, 98 per cent of the city officials who answered a question on the point consider that serial bonds are preferable to term bonds. When serial bonds are issued, maturities should begin early, preferably the first year after issuance.

Careful consideration should be paid to the legality of each step taken in the issuance of city bonds. Bonds must comply with all legal provisions in order to be valid, negotiable instruments. Although the causes of illegality are legion, they resolve themselves upon analysis into four groups which concern the authority of issue, the purpose of issue, the process of issue, and the restrictions on

¹⁵*Ibid.*, Arts. 706, 828.

¹⁶Municipal Securities Committee of the Investment Bankers' Association of America, "A Guide to Sound Procedure in Municipal Bond Issuance," *Minnesota Municipalities*, Dec. 1931, p. 506; Committee on Municipal Borrowings, *A Model Bond Law* (National Municipal League, New York, 1929), p. 140.

amounts of taxes or debt.¹⁷ The authority, purpose, and process of issue are treated in both the context and the legal citations of this chapter, and legal restrictions are discussed in the last chapter. The state constitution, state statutes, and city charters outline the procedures which must be observed in order to assure the legality of city bond issues.

The procedure presented in this chapter is applicable to the issuance of general obligation bonds which are payable from taxes and which may be issued for the purpose of construction or purchase of public buildings, waterworks, sewers, roads, bridges, streets, school sites, school buildings, and other permanent improvements within the city limits.¹⁸ Separate and distinct provisions obtain, however, for issuance of various special classes of bonds such as revenue bonds, special assessment bonds, and mortgage bonds.¹⁹ When an issue is to be made of any of these special types, the particular legal provisions which are prescribed should be explicitly observed, but the general administrative procedure in regard to their advertisement, sale, and retirement should be consistent with that hereafter outlined.

The question of levying a tax to pay interest and to create a principal-retirement fund must be submitted for vote; in addition, the proposition to the voters must specify the purpose of issue, the amount of issue, the rate of interest, the tax necessary to pay interest and to provide a fund for principal retirement, and the maturity dates (bonds may mature serially within any given number of years not to

¹⁷Lawrence Chamberlain and George W. Edwards, *The Principles of Bond Investment* (Henry Holt and Co., New York, 1927), pp. 247-248.

¹⁸*Revised Civil Statutes*, Art. 823.

¹⁹*Ibid.*, Arts. 1111, 6830. See also *General Laws, Regular Session, 1925*, Ch. 33, as amended by *General Laws, First Called Session, 1933*, Ch. 36, Sec. 1; *General Laws, Fifth Called Session, 1930*, Ch. 10, Sec. 1; *General Laws, Regular Session, 1931*, Ch. 309; *General Laws, Regular Session, 1933*, Ch. 231; *General Laws, Second Called Session, 1934*, Ch. 17; *General Laws, Second Called Session, 1935*, Chs. 417, 425, 453, 470, 473.

exceed forty).²⁰ The ballot must be printed in a form which allows the citizens to vote "For issuance of bonds" or "Against issuance of bonds."²¹ The date of the election should be designated in the election order. The election order must designate the time and place (or places) of holding the election, which must be held not less than fifteen nor more than thirty days from the date of the order. Copies of the election order must be posted in each precinct and at the city hall and must be printed on the same day in each of two successive weeks in a newspaper of general circulation published in the city, the date of first publication not to be less than fourteen days prior to the date set for the election.²² When the bonds have been authorized, the city council must approve the levy and collection of a tax sufficient to pay annual interest charges and to provide a fund for principal retirement; the interest rate must not exceed 6 per cent.²³

Prior to the printing of the bonds, the mayor must forward to the Attorney General a transcript containing a certified copy of the ordinance providing for the tax intended to retire the bonds, a statement of the total indebtedness (including the amount of the proposed issue), the total assessed value of all real and personal property, and any additional information which the Attorney General may require.²⁴ Other items which are included in this transcript, either as parts of the above requirements or as additional features, are: a statement that the city has not changed its boundaries or form of government since the time of the last previous bond issue (if either has been altered, there must be an explicit description of the kind and extent of change), affidavits concerning the notices which preceded the election, a copy of the ordinance calling the election,

²⁰*Revised Civil Statutes*, Art. 703.

²¹*Ibid.*, Art. 705.

²²*General Laws, First Called Session, 1935*, Ch. 382, Sec. 1. Except as provided in the foregoing statute, the manner of holding a bond election is the same as that set forth in the statutes which govern general elections.

²³*Revised Civil Statutes*, Art. 707.

²⁴*Ibid.*, Art. 709.

affidavits concerning the returns of the election, a certified copy of the form in which the bonds are to be printed, a certificate from the district clerk that there is no litigation pending which would endanger the boundaries or the corporate existence of the city, and the latest revised copy of the charter if the city is a home rule city.

Upon approval of the transcript in the Attorney General's department, the bonds may be printed. They are then signed by the mayor and countersigned by the city secretary.²⁵ After being duly printed and signed, they must be delivered to the Attorney General's office where their validity is further investigated by an examination of the printed bonds and by a comparison with the original transcript. The certificate of approval issued by the Attorney General's department is preserved of record, and the bonds are transferred to the Comptroller's office for registration. A waiver then must be secured on the option which the Board of Education holds on new issues. This waiver is necessary in order for the securities legally to be sold to a bond dealer or agency other than the Board of Education. If the Board chooses to exercise its option, it must meet the terms offered by the best bidder.²⁶

If the bonds are to be widely marketable, their validity must be attested in a written opinion of a legal firm which is nationally recognized as an authority on municipal securities. The urgency of painstaking observance of all statutory provisions in the preliminary stages of bond issuance is emphasized by the necessity of obtaining a legal opinion upon which prospective investors may rely with confidence. Comparatively few law firms in this country enjoy the implicit trust of bond dealers and purchasers throughout the country, and it is from one of these firms that the city must receive an approving opinion. Although the final legal opinion is not given until the time of actual delivery, bond houses prefer to have an issue approved in a preliminary opinion prepared before the time of actual sale; thus they

²⁵*Ibid.*, Art. 825.

²⁶*General Laws, Regular Session, 1929, Ch. 278, Sec. 1; General Laws, Second Called Session, 1929, Ch. 10, Sec. 9.*

are not involved in the inconvenience and delay caused by the contrary practice and are in a position to make the city a better bid than otherwise. The legal firm which is employed should pass on the resolutions, ordinances, and form of ballot in order that there will be no legal misstep.²⁷ Two practices are observed in regard to payment for the opinion: in one instance the city pays the fee directly, while in the other the successful bidder agrees to meet the expense. In the former case, payment may be made either from the general fund or from the receipts of the bond sale. It is more desirable for the city to pay for the legal opinion, for the city then can keep in direct contact with the firm furnishing the opinion. Moreover, the city may thus expect a better price for its securities than if the successful bidder were charged with obtaining and paying for the necessary opinion. In any case, however, the city officials should demand that a copy of the opinion be given the city and be preserved of record.

An established and trustworthy firm should be selected to print the bonds. When the Attorney General's department has approved the transcript and when assurance has been received that the proposed issue of bonds is in proper and legal form, the city officials may feel free to have the instruments printed. Forgery of municipal securities has become common enough to warrant study by a special committee of the Investment Bankers' Association, which concluded that: (1) municipal officials must exercise due care, (2) bonds must be printed by a responsible bank note company which handles blank bonds the same as currency, (3) steel engraving should be used for the borders, vignette, and background of all coupons, as well as for the bond numbers and bond text, (4) the engraver's name should be printed on each bond and coupon, and (5) bond dealers should exercise care to ascertain the reliability of firms which print securities upon which they place bids.²⁸

²⁷Committee on Municipal Debt Administration, *Marketing Municipal Bonds* (a pamphlet published by the Municipal Finance Officers' Association, 850 E. Fifty-eighth Street, Chicago, 1935), p. 1.

²⁸Investment Bankers' Association, "Bond Forgeries," *Public Management*, Dec., 1934, p. 416.

As is the case with expense incident to obtaining a legal opinion on a new bond issue, the cost of printing may be paid either by the city or by the successful bidder. It is desirable for the city to pay this cost, thus reducing the number of factors which the dealers must consider in computing their bids. In any instance, however, the responsible city official should assure himself of the reliability of the firm which contracts to do the printing and should deal directly with the firm. It should be remembered that municipal bonds are official, negotiable instruments of public credit and that their appearance should be in keeping with their importance.

The bond text should, of course, specify the time and place of interest and principal payment. If the securities are to be sold on the usual market, these payments should be made on one of the largest and best known financial institutions in New York City. A few municipalities in the southeast-central portion of Texas, however, market all their bonds in the county in which they are issued. In this case, payment should be made locally both because of convenience to the purchasers and because of the saving which the city effects through the elimination of exchange fees.

Advertisement should play an important part in the issuance and sale of municipal securities. Several cities in the State of New York have secured particularly favorable purchase terms by a wise use of publicity for several months preceding a proposed bond sale. These cities have been in good financial circumstances and have taken advantage of their sound condition to disseminate information concerning their status which has served to increase the demand for their bonds. Some of these cities have employed advertising agencies to furnish their publicity. Many Texas cities are in excellent financial condition and might improve their position in the bond market by making available information concerning their ability to meet all obligations.

While advertising the financial condition of a municipality as a method of improving the demand for its securities is optional, it is imperative that a public announcement be made of an approaching bond sale. Printed notices

EXHIBIT B*

NOTICE OF SALE OF CITY OF DALLAS, TEXAS, BONDS

- \$165,000.00 Hospital Improvement, maturing \$8,000 each year except \$9,000 each fourth year from June 1, 1936, to June 1, 1955, inclusive, and being numbered from 1 to 165, inclusive.
- 100,000.00 Street Paving, maturing \$5,000 each year from June 1, 1936, to June 1, 1955, inclusive, and being numbered from 1 to 100, inclusive.
- 150,000.00 Street Opening and Widening, maturing \$5,000 each year from June 1, 1936, to June 1, 1965, inclusive, and being numbered from 1 to 150, inclusive.
- 100,000.00 Sanitary Sewer Improvement, maturing \$3,000 each year except \$4,000 each third year from June 1, 1936, to June 1, 1965, inclusive, and being numbered from 1 to 100, inclusive.

\$515,000.00

Sealed bids marked "PROPOSAL FOR BONDS," on the above bonds, will be received at the office of the undersigned until 2:15 o'clock P.M., Wednesday, December 4, 1935, for the purchase of all or part of the above named bonds. Bonds will be of the denomination of \$1,000.00 and will bear date of December 1, 1935, interest to be payable semiannually on the first days of June and December of each year, both principal and interest payable at the Chase National Bank in the City of New York and State of New York.

Bids may be filed for the purchase of any or all issues of the above named bonds to bear single rate of interest in quarters of 1 per centum not to exceed 4 per centum.

The City of Dallas reserves the right to reject any and/or all bids.

The City will furnish at its expense, lithographed bonds with interest coupons thereto attached.

The approving opinion of the Attorney General of the State of Texas and the approving opinion of Messrs. Chapman and Cutler of Chicago, Illinois, will be furnished by the City of Dallas.

It is believed that bonds will be ready for delivery to the purchaser about January 5, 1936.

Bonds are payable to bearer with the option of registration as to PRINCIPAL ONLY.

Each proposal must be accompanied by a Certified Check or Cashier's Check, made payable to the City of Dallas, in an amount equal to 2% of face value of bonds bid for. Said check to be retained by the City of Dallas, as and for liquidated damages in case successful bidder fails to take up and pay for said bonds in accordance with his or their bid.

For financial data and descriptive circular, address R. V. Tompkins, City Auditor, Dallas, Texas.

EARL GOFORTH, City Secretary,
City of Dallas, Texas.

All the above named bonds were voted December 15, 1927. The Liberty State Bank of Dallas, Texas, will certify as to the genuineness of the signatures of the officials signing said bonds, also as to seal of the City impressed thereon.

*Reproduced through the courtesy of Mr. Hal Moseley, City Manager of Dallas, Texas.

should invariably be mailed directly to all dealers likely to be interested in placing bids. The accompanying illustration (Exhibit B) is a copy of the first page of such a notice used by the City of Dallas. If the proposed issue is to be one of considerable size, notice of the approaching sale should also be published in a periodical of national distribution among investment bankers, in order that dealers of the northern and eastern markets may have the opportunity of placing bids.

Both printed notices and periodical advertisements should state the name and address of the official who is to receive the bid, the manner in which the bid is to be sealed and endorsed, the time (day and hour) and the place the bids are to be opened, the method to be applied in determining the most desirable bid, and whether bids of less than par will be considered. The following data relative to the proposed issue should be presented: the name, amount, purpose, and date of the issue, the denomination of the bonds, whether the bonds carry an option and the terms of the option if carried, the privilege of the holders as to registration, the coupon rate (if the rate is to be set by the bidders, the maximum should be specified; if split-rate bidding is to be permitted, the provisions should be outlined), the dates and place of interest and principal payment, the source of payment, and the legal provision for payment.

In addition to the above, the advertisements should state the name of the firm whose opinion of legality will accompany the bonds, the name of the concern which is to print the bonds, whether the city or the purchaser is to pay the expense of the legal opinion and of the printing, the amount and form of the deposits required to insure good faith on the part of the bidding firms, the conditions of delivery and the probable delivery date, whether the city or the purchaser is to pay for the delivery, and whether there is any pending litigation which endangers the validity of the bonds or the corporate existence or boundaries of the city. Further, both notices and advertisements should contain

general information relative to the city's tax rate, tax limitations, population, and defaults. Finally, it should contain a recent financial statement presenting, for several years, facts concerning funded debt, tax collections, and property valuations. The prospectus which is mailed directly to financial institutions may well include facts concerning the form of government, local economic and social conditions, and overlapping indebtedness. Some cities purchase a greater amount of advertising space in periodicals than is necessary, when less pretentious and less expensive advertising often would serve the desired purpose equally well.

Certain general policies should be observed in the sale of municipal bonds. One of the most important considerations involved in the issuance of bonds arises in determining whether the interest rate should be set by the council in advance of the sale or allowed to remain open as a factor to be adjusted by the dealers in making their bids. The relative desirability of these two modes of procedure depends largely upon the ability of city officials to judge the condition of the security market. Some few city officials are in a position to estimate the market rate with considerable accuracy. Such officials may, by setting the rate in advance of the sale, have the legal opinion prepared and the bonds printed earlier than otherwise would be possible. The mechanics of sale is simplified when this procedure is followed, for all bids are made on the same nominal rate. The practice of setting the interest rate in advance, however, is not here recommended; on the contrary, it is offered as a procedure which under certain conditions may prove advantageous.

In the great majority of cases, however, the coupon rate should be optional with the bidders, who should be given the privilege of bidding in multiples of one-fourth of 1 per cent and within a range fixed by a maximum rate prescribed by the council. When bids may be made in this manner, dealers can adjust the coupon rate to existing market conditions and thus, in most instances, give the city a better price than if the rate had been specified in advance.

In some unusual instances, it may be desirable to permit dealers to make bids in multiples smaller than one-fourth of 1 per cent, but Texas cities are hardly likely to sell issues of sufficient size to permit an appreciable advantage from the extending of this privilege. If the bond issues of a city bear a number of different coupon rates, many of which are of unusual size (for example, $4\frac{1}{8}$, $3\frac{3}{8}$, or $5\frac{1}{16}$), the payment of interest becomes unduly complicated. In some few cases, it may be advantageous to permit split-rate bidding—the setting of one rate for a portion of the bonds and of another rate for the remainder. The use of split bids, however, not only complicates the computations necessary in the designation of the winning bid but also adds to the number of different existing coupon rates and thus increases the number of administrative problems incident to the payment of interest. The meeting of interest payments on an issue which bears two coupon rates amounts, from the viewpoint of work involved, to the handling of two bond issues rather than one.

The sale of bonds always should be conducted strictly in accordance with the terms named in the various advertisements and notices printed prior to the time of sale. Observance of this rule, as a means of retaining the confidence of the bidders, is imperative. All bids, likewise, should be made precisely in accordance with the terms advertised. The bond sale should be conducted in a manner above reproach. Bids customarily are received on a form which is prepared for the purpose and which is attached to the notice of sale that is mailed to the dealers before the time for receiving bids. Not all prospective purchasers may be in a position to send personal representatives; consequently a number of bids may arrive by mail. Offers thus received should be given the same consideration as those which are personally presented. All bids should remain sealed until the appointed time when they should be opened publicly, tabulated, and analyzed impartially.

When calculation is being made of the best bid, the fact should be kept in mind that, with exceptions in certain home rule cities, bids must not be less than par value and

accumulated interest, exclusive of commissions.²⁹ This provision fosters the payment of premiums on bond issues. Premiums serve to complicate the computations necessary in determining the most desirable bid on a new bond issue; consequently some local officials experience difficulty in ascertaining which of several bids may be the most desirable.

The computation of the most desirable bid may be made according to two different procedures, and the choice of procedure should depend upon whether it is desired to borrow at the smallest net interest rate or at the lowest money cost. First, it is possible through the use of a table of bond values to determine the amount of the net interest rate on bids which may be based upon differing premiums and coupon rates. Financial officers of municipalities should thoroughly familiarize themselves with the use of these tables. Second, the total interest cost may be ascertained by deducting the amount of the premium from the total amount necessary to pay interest requirements through to maturity according to the various coupon rates indicated.³⁰ With comparatively few exceptions, calculation of the best bid by these two methods will give the award to the same bidder; however there are exceptions.³¹ Upon determina-

²⁹*Revised Civil Statutes*, Art. 708. Exceptions are pointed out by W. P. Dumas, "Taxation and Limitation of Taxes in Texas," *The Governmental Reporter, Southwestern Division*, Nov., 1933, pp. 5, 8; *Charter of the City of Dallas* (Dallas, 1931), Ch. XXVII, Sec. 289.

³⁰Committee on Municipal Debt Administration, *op. cit.*, p. 3.

³¹If the following bids were made on a forty-year loan of \$1,000, these two methods for computing the better sale price would give different results.

	Nominal Rate	Par Value	Bid Per Bond	Net Interest Rate	Total Interest Cost
I.	4 %	\$1,000	\$1,000	4.000%	\$1,600
II.	4¼ %	\$1,000	\$1,040	3.959%	\$1,660

Calculation of the best bid by use of a table of bond values awards the sale to the bid placed on the nominal rate of 4¼ per cent, for it involves the lower net interest rate. Computation of the best bid on the basis of monetary interest cost, however, awards the sale to the bid placed on the nominal rate of 4 per cent, for although the net interest rate is slightly greater in this case, the amount of money

tion of the most desirable bid, the award should be made immediately, and the bonds delivered as soon as possible. A municipal bond does not become binding, as an obligation, until delivery.³²

Each bona fide bidder should be required to place a certified check on deposit with the city as evidence of his good faith. Checks of unsuccessful bidders should, of course, be returned immediately upon award to the successful bidder. The check of the successful dealer, however, should be retained to insure proper performance of the terms of sale. One of the larger cities of the state requires the deposit by each bidder of a certified check totaling 2 per cent of the face value of the bonds offered for sale.

City officials should seize the opportunity to sell bonds when the market is most favorable. Market information may be obtained by using current financial journals, by observing the results of bond sales in other cities, and by conferring with bond dealers. Generally, bonds should not be sold during summer months or during the Christmas holidays, for large buyers of municipals are not active during these periods. It is more desirable to consolidate borrowings than to advertise and sell small issues frequently.³³ The security market, like the cost of permanent improvements, is subject to considerable fluctuation, and favorable terms of sale are more likely to be obtained if it is a policy to receive bids only during propitious market periods than if bonds are offered for sale without reference to the condition of the market.

Finally, before the bonds are delivered, all information that later is likely to be needed concerning the issue should be entered in the bond records.

The potentialities of a local market for new issues of municipal securities should be thoroughly investigated. The officials of some Texas municipalities have met with marked success in their efforts to sell securities to individuals or

borrowed is sufficiently smaller than interest payments over a forty-year period are less than those required by the other bid.

³²McQuillin, *op. cit.*, Vol. VI, Sec. 2457.

³³Committee on Municipal Debt Administration, *op. cit.*, p. 1.

to institutions in the immediate vicinity. Of the cities from which information was obtained on this point, 31 per cent have at one time or another made attempts thus to dispose of new bond issues, and 14 per cent have met with notable success in these efforts. One city, for example, has sold entire issues to one citizen. In the town of Schulenburg all city bonds are held locally, and in still another town a recent entire issue of refunding bonds was purchased by local banks.

While the local sale of municipal securities greatly facilitates the matter of taking bids and lessens the expense and work necessary in paying maturing interest coupons and principal amounts, city officials should not lose sight of the fact that bona fide bond dealers may be in a position to pay a better price than that offered by local individuals. It should be remembered, moreover, that sale of securities on the open market offers a greater opportunity of building up a broad basis of credit than is afforded by a purely local market. Local citizens and institutions should be encouraged to bid on new issues of securities, but the sale should be open to all interested and responsible parties regardless of their location. Only in an open sale is it probable that the city will receive the best offer. Finally, it is undesirable for local banks to acquire excessive amounts of local securities, for the time may come when the city will need short-time loans which the bank would be unwilling to make if it already held a large amount of city obligations.

From the point of view of citizen interest in local government, however, it is desirable that a portion of the outstanding bonds be held within the municipality which issues them. Citizens who have large capital amounts invested in securities of their own city must be concerned in the efficiency of the city's government and in the collection of a high percentage of the tax levies. In case a city suffers financial embarrassment, the city officials likely would find it much easier to reach a satisfactory compromise with life-long acquaintances than with unknown security holders located in distant parts of the country. There is a strong objection to local ownership of securities, however, in that

an individual has a poor spread of risk if his property and security holdings are of the same municipality. A disaster which would destroy his property also would affect adversely the market value of his securities.

The development and perpetuation of a sound program of security issuance can result only from careful planning and intelligent action. Securities should be issued in accordance with a program of capital expenditures which has its basis in a long-term budget; moreover, the type of securities to be issued should be considered carefully and time warrants should be used only in cases of emergency and then only to supplement a sound bond program. Voters must authorize the issuance of bonds, and they should be educated concerning the various features of the indebtedness which they are asked to authorize. The legal procedure which governs the issuance and sale of local securities should be explicitly observed. The legality of a bond issue should be attested in a written opinion of a nationally known law firm, and the bonds should be printed by an established, trustworthy firm. Every bond sale should be widely advertised and should be impartially conducted. Investigation should be made of the possibility of securing a local market for municipal obligations.

Finally, whether new issues are to be sold locally or to bond dealers, a spirit of openness should characterize all transactions. Municipalities stand to gain much in good will and in improved terms of sale by furnishing complete information concerning their fiscal affairs and their political situations.

CHAPTER III

REFUNDING

Funding procedure involves the conversion of current accounts or bills payable into instruments of long-term indebtedness. Needless to say, the shoddy type of financial management which fosters the recurrence of annually mounting deficits is unjustifiable. A current warrant, which is distinguishable from other obligations in that no specific tax is levied against future years to provide for its payment, is an order by one official upon another to pay a certain sum from a specified current fund to a designated payee for a valuable consideration.¹ If cities were permitted indiscriminately to fund these amounts into long-term obligations which have no permanent improvements to justify their existence, there could result only a growth of debt service charges, with a consequent decrease of the proportion of current receipts available for day-to-day operating expenses. A statute passed by the Forty-second Legislature expressly provides that the city council when authorizing current warrants shall also pass an order setting aside enough current funds to pay the warrants; moreover, this statute specifies that current warrants may not be funded but must be paid from the designated funds.² For the further reason that current warrants are not interpreted to constitute debt as that term is used in Article 11, Section 7 of the Constitution of the State of Texas,³ these instruments of day-to-day operating expenditure (current warrants or scrip) may not legally be funded either into bonds or time warrants. The definition of the word "debt"

¹McQuillin, *The Law of Municipal Corporations*, Vol. VI, Sec. 2400. *Attorney General's Opinion on Proposed Somervell County General Fund Refunding Bonds, Series 1935*, p. 3. This opinion, handed down on September 28, 1935, is available in mimeographed form.

²*General Laws, First Called Session, 1931*, Ch. 24, Sec. 1.

³*McNeill v. City of Waco*, 33 S.W. 322 (1895); *City of Corpus Christi v. Woessner*, 58 Texas Reports, 462 (1883).

as used in the statutes which set forth the refunding procedure is, of necessity, the same as that which the courts have placed on the word as used in the constitution.⁴

Refunding procedure, on the other hand, involves the substitution of new long-term obligations for similar obligations already outstanding. Valid outstanding obligations (bonds and time warrants), for the retirement of which specific taxes have been provided and which are payable from other than current funds, constitute debt within the meaning of the word as it is used in the constitution; hence these long-term obligations are eligible to be refunded.⁵ This substitution of new securities for those already outstanding may be effected either by a direct exchange of the new instruments for the old or by the retirement of the old obligations with money made available through the sale of the new. In either event, the coöperation of the creditors is essential. Since refunding bonds are issued in lieu of existing indebtedness and do not, of themselves, create a new debt, it is reasoned that popular vote should not be a requisite to their validation. The power to issue these bonds must be specifically conferred, for there is no inherent power for their issuance.⁶

The depression has been accompanied by debt readjustment on the part of many municipalities of Texas. Municipalities ranging in size from towns of less than 1,000 to cities of more than 100,000 population have refunded, for a number of different reasons, all or a portion of their debt during the depression. Within the three years 1931-32 to 1933-34, inclusive, 39 per cent of the municipalities included in this study engaged in refunding activities. Of this group, three-fourths had met all interest and principal maturities on the refunded obligations up to the time of adjustment.

Depression conditions, however, have not caused cities to use the Federal Municipal Debt Adjustment Act, for only one city in the nation, Sweetwater, Tennessee, was definitely

⁴Attorney General's Opinion, *op. cit.*, p. 7.

⁵*Ibid.*, pp. 6-7; *McNeill v. City of Waco*, *supra*.

⁶McQuillin, *op. cit.*, Vol. VI, Sec. 2429.

known to have taken advantage of its terms by February, 1935. Moreover, a petition for debt adjustment under this federal procedure by the Cameron County (Texas) Water Improvement District Number One was dismissed on December 1, 1934, for lack of jurisdiction upon two points: (1) the petition did not present sufficient factual allegations, and (2) the State of Texas had not granted specific permission to its political subdivisions to take advantage of the act.⁷ Although the legislature later extended permission to Texas municipalities to take advantage of the debt adjustment act,⁸ no city of the state had effected a debt compromise according to the terms of the act by January 1, 1936.⁹ The life of the debt adjustment act is limited to two years from the date when it went into effect and thus becomes inoperative on May 24, 1936.¹⁰

If a debt adjustment is to be made, the council should place upon some one city official the responsibility of and the authority for performing the necessary administrative work. The mayor, auditor, secretary, manager, or some other responsible official should be charged with putting into effect the debt policies decided upon by the council. This official should keep closely in touch with the Attorney General's department. In addition, he should endeavor to protect impartially the interests of taxpayers, of city officials, and of creditors. If it is necessary to contract for the services of a bond broker to assist in the refinancing operation, several items should be thoroughly investigated by the responsible local official: it should be determined whether the proposed fee covers *all* the necessary expenses and is reasonable, whether an agent of the bond company

⁷A. M. Hillhouse, "Use of the Federal Debt Adjustment Act," *Municipal Finance*, Feb., 1935, p. 7.

⁸*General Laws, Regular Session, 1935*, Ch. 107.

⁹This information was obtained at the central office of the League of Texas Municipalities.

¹⁰Carl H. Chatters and John S. Rae, *The Federal Municipal Debt Adjustment Act* (Publication No. 41, Public Administration Service, Chicago, 1934), p. 2.

expects to stay in the city until the transaction is completed, whether the dealer will give due weight to the interests of the city, and whether the entire field of qualified dealers has been canvassed.¹¹ When small municipalities seek to refund debt through an agreement with a bond broker, the city officials should be particularly cautious when deciding upon the contractual terms, for a few irresponsible dealers who operate in this state on several occasions have charged exorbitant fees for refunding operations completed in an unsatisfactory fashion.¹²

The official who has charge of debt adjustment should study reports which show the requirements of each outstanding bond issue and the cash position of each debt retirement fund. Further, he should lean heavily on the annual budget, the long-term budget, and the capital expenditure program. Finally, a legal adviser, perhaps the city attorney, should prepare a statement of the rights of the city in seeking a debt adjustment. The city should never choose as its lawyer the firm that has been selected to represent the creditors.

The procedure incident to the refinancing of indebtedness should be conducted in strict accordance with legal requirements. Refinancing which is made necessary as a consequence of destruction of property by storms or other natural disasters may be conducted in accordance with special statutory procedures.¹³ Special provisions also exist for the compromise of debts and the setting up of a special liquidation board to manage debt payment.¹⁴

With an exception in the case of home rule cities which have charter provisions to the contrary, an election is not a requisite to the issuance of bonds in connection with the

¹¹Carl H. Chatters, Editor, *Municipal Debt Defaults, Their Prevention and Adjustment* (Publication No. 33, Public Administration Service, Chicago, 1933), p. 7. This publication is an invaluable guide for refinancing procedure, and its text is followed rather closely in a portion of the ensuing discussion.

¹²Pat Daugherty, "Refunding Municipal Obligations," *Texas Municipalities*, April, 1935, pp. 87-89.

¹³*Revised Civil Statutes*, Art. 796-802.

¹⁴*Ibid.*, Arts. 828-834.

refinancing of valid indebtedness.¹⁵ If, however, the debt which is to be refunded was incurred after the passage of the Bond and Warrant Law of 1931, a notice of the proposed action must be published for three successive weeks at least thirty days before the meeting at which the council is to propose the new issue of bonds, and at any time during the intervening period, 10 per cent of the qualified tax-paying voters may file a petition demanding a referendum on the proposed refunding issue.¹⁶

All the necessary ordinances for the issuance of refunding bonds may be passed by the council. As is the case with an issue of original bonds, an approving opinion by a recognized bond attorney is essential; moreover, as before, a transcript must be prepared and delivered to the office of the Attorney General prior to the printing of the bonds. When the transcript has been approved and the bonds printed, the procedure differs from that described for an original bond issue in that the obligations which are to be refunded must be presented at the State Comptroller's office for cancellation before the new bonds may be registered and thus made valid obligations. The old bonds may, however, be canceled in installments.¹⁷ The new refunding bonds are delivered directly from the Comptroller's office to the holders of the old securities, and the expense of delivery is paid either by the creditors or by the municipality, in accordance with the agreement reached in the refinancing arrangement.

The Bond and Warrant Law of 1931 provides that bonds for the refinancing of legal debt shall be payable serially, shall bear not more than 6 per cent interest, shall have a life not exceeding forty years, and shall have the burden of payment evenly distributed over the life of the issue unless the council concludes that the financial condition of

¹⁵*Ibid.*, Art. 717.

¹⁶*General Laws, Regular Session, 1931, Ch. 163, Sec. 7.*

¹⁷*Revised Civil Statutes, Art. 714.* If the refunding is made necessary by a natural disaster, however, it is not required that the old bonds be canceled first (Art. 802).

the municipality will not permit the payment to be so spread.¹⁸

An adjustment of municipal indebtedness should rest upon due consideration of the factors which appear to make it advisable or necessary. Municipalities may be divided into two broad groups on the basis of their ability to meet their debt requirements. Those of one group enjoy good financial circumstances and are in a position to meet all payments. A number of these efficiently managed municipalities have voluntarily refunded outstanding bonds with matured optional provisions in order to substitute for them new bonds bearing a lower interest rate or having more advantageous maturity dates.

One Texas city, for example, succeeded in effecting two distinct types of savings in interest by completing a voluntary refunding operation in which the new interest rate was three-fourths of 1 per cent lower than the old rate, and the new maturity periods were shorter than the old. The ability of a local government thus profitably to refund part or all of its debt, if callable bonds are outstanding, depends upon the condition of the bond market and the credit standing of the city.

The cities of the second group have been less fortunate than those of the first. With these cities, refinancing has not been voluntary, but has been resorted to as a matter of necessity. Cities of this group are faced with varying degrees of financial stress; for example, some are in a position to meet all their debt charges if arrangements can be made to prolong the period of payment, while others are over-bonded and must scale down the amounts due in order to make payment. Such municipalities find themselves of necessity precipitated into a refunding program in an effort to reach an agreement concerning the payment of outstanding indebtedness. Their officials should be alert, while working on the compromise agreement, to the possibilities of securing improved interest rates and maturity dates and of working out a desirable consolidation of outstanding issues. Cities which are financially embarrassed generally

¹⁸*General Laws, Regular Session, 1931, Ch. 163, Sec. 7.*

cannot find a satisfactory market for their securities and must complete the process of refinancing by a direct exchange of new securities for old on the best terms obtainable.

The issuance and sale on the regular market of refunding bonds should be guided by the principles set forth in the preceding chapter. Most cities which find it desirable voluntarily to refund callable bonds have good credit positions and hence can find a ready market for their refinancing securities. These securities should, of course, be sold in accordance with good procedure. The issuance and sale of refunding bonds differs from that of original issues, however, as a consequence of the requirement that the old obligations must be canceled at the Comptroller's office prior to the registration of the refunding bonds. Money from the sale of the refunding issue is needed in order to retire the outstanding optional bonds which are to be called, and a dilemma arises in that the unregistered refunding bonds cannot legally be sold until the optional bonds have been obtained from the holders and canceled by the Comptroller. This impassé has been avoided, upon occasion, through the coöperation of a third party, generally a bond broker, who advances funds for the retirement of the optional bonds and waits for repayment until the optional bonds have been paid and canceled and the refunding bonds have been registered and sold.¹⁹

If optional term bonds are to be refunded, the amounts to the credit of their sinking funds must be used to retire as many of the original bonds as possible. One Texas city has found it advantageous, in this regard, to enter into an agreement with the bond dealer who advances the funds

¹⁹Although this procedure is used as a matter of practical application, there is considerable question concerning its legality. Creditors probably could not legally be forced to surrender their optional bonds when the money to be used in the purchase of these bonds is not raised by taxation (or by some other method specified in the bond contract), is not from the particular funds set aside for the retirement of the outstanding optional issues, and is not the property of the city, but is the property of a third party who advances it temporarily.

for the purchase of the new refunding bonds. According to this agreement the dealer pays the cost of redemption for the first bonds presented, and the city, from these sinking fund balances, pays the cost of redemption for the last bonds presented. When this procedure is observed, any creditors who refuse to surrender their callable securities for payment from money advanced by a third party may, after the money so advanced has been used in the purchase of securities from creditors who are agreeable to the transaction, be forced to surrender their bonds for payment with money from the sinking fund accumulated for the retirement of that particular series. Further, by the terms of this agreement the dealer may advance money for the minimum time, may have the old securities canceled with the greatest expediency, and may have the new refunding bonds registered by the Comptroller and ready for delivery at the earliest possible date. The city, on the other hand, keeps its funds on deposit for the maximum length of time, a valuable consideration if interest is being paid on the deposit. Finally, the notice of redemption should state that interest on called bonds ceases on the called date.

If debt adjustment is unavoidable, a refunding agreement should be made, if possible, before a default takes place. Depleted tax collections, bank failures, and fundamentally unsound debt structures have conspired to make it impossible for some municipalities to pay their annual debt requirements. The acuteness of these circumstances varies widely. While some cities have been able to escape refunding by securing temporary loans to tide them over until the advent of the next tax collection period, others have found it possible to obtain sufficient relief only by reaching an agreement to postpone payment of amounts, due on maturing interest and principal requirements. Still others have had actually to scale down the amounts of their debt payments.

It is only when municipal officials possess the acumen necessary to foresee debt complications that it is possible to initiate a refunding plan prior to actual default. This foreplanning is highly desirable since the city is likely to

find its creditors disposed more favorably toward debt adjustment before default than after. Furthermore, the protection to the credit standing of the city is invaluable if actual default can be averted, for a default may be expected to narrow a city's security market for many years. Unless the securities are held locally or unless the city officials are fortunate enough to possess a list of the names of security holders, the services of a bond dealer most likely will be required in order to contact creditors prior to default.

In case a default is to occur, city officials should investigate the advisability of formulating a refunding program without the assistance of a bond dealer. Needless to say, most creditors will make themselves known in case of default. City officials should not, however, wait until security owners make an inquiry. Before the first default takes place, a printed statement should be drafted setting forth the reasons for default and making requests for the names and addresses of the holders, the amounts of bonds held, and the due dates of the bonds held. These printed notices should be sent to the paying agent for distribution to the security holders. If it appears that considerable time will elapse before an adjustment can be made, the creditors should be supplied with a full explanation of the situation.

When the names of the security owners are known, local officials are no longer dependent upon a bond dealer to contact the creditors, and may open preliminary negotiations with a few of the largest bondholders in order to ascertain the nature of an acceptable plan. If the city officials are competent, considerable savings may be effected by completing an adjustment arrangement without the necessity of paying a brokerage fee. Creditors should be sympathetic with this approach because it saves for them the amount which otherwise would be paid as a fee to a bond dealer. It should be borne in mind by city officials that interest does not stop accruing at the maturity date of a defaulted bond, even though the coupons do not run beyond maturity.²⁰

²⁰McQuillin, *op. cit.*, Vol. VI, Sec. 2431.

Of the cities included in this survey, 25 per cent of those which refunded their debt during the depression did so without the services of a bond dealer. With only one exception, the cities which dispensed with the services of a bond dealer were those which refunded as a result of necessity rather than as a result of voluntary desire; the single exception occurred in a city which was fortunate in that its securities were held locally and in that the new block of refunding bonds was purchased by a local bank.

If it is necessary for municipal debt to be refunded, it is to the advantage of both the municipality and its creditors for the refunding program to be agreed upon without recourse to litigation. Attorneys alone profit from the long-drawn court proceedings which sometimes characterize attempts to adjust city debt. Bondholders' suits are rarely filed against a defaulting municipality which makes a sincere and honest effort to meet its obligations by working out a satisfactory refunding plan. If the capacity to pay is absent, the creditors must eventually accede to a compromise, and it is to their advantage to accept a compromise when its necessity is first apparent and thus avoid the delay and expense incident to court action. If, on the other hand, the wealth of a municipality is sufficient to support the outstanding debt, it is unethical for that municipality to take recourse to court action in an attempt to secure a reduction of the amount owed. If bond owners see fit to resort to a court fight, however, the case ordinarily is taken to a federal rather than a state court, for the reason that federal courts have set forth pronounced views for sustaining the validity of municipal bonds.²¹ In case bonds are not paid on maturity, action is available against a municipality even though the bonds may be payable from a special fund required to be created by the municipality.²² If judgment is obtained by the creditors, it is conclusive as to the validity of the bonds, and the municipality may be compelled, by mandamus, to levy a tax to pay the judgment.²³ In court

²¹*Ibid.*, Sec. 2486.

²²*Ibid.*, Sec. 2508.

²³*Ibid.*

action, the defenses available to a municipality may be stated briefly as: (1) the lack of power to issue the bonds, (2) the issuance of bonds in excess of a debt limit, and (3) the failure to perform conditions precedent to bond issuance.²⁴

Efforts should be made to keep the citizens amicably inclined toward the holders of the city's securities. Undesirable situations have arisen when citizens have become unduly incensed over the size of the municipal debt and have permitted that problem to become a political issue. Militant candidates in one sizeable Texas city recently made debt readjustment one of the controversies in their race for the council and, upon election, plunged their city into what it appears will be a long and expensive fight in the courts. Citizens should not, on the other hand, be left ignorant of refinancing plans but should be brought, through systematic public reporting, to see the advantages which are expected to accrue to the city and to the taxpayers from the adoption of a rational refunding plan.

Both creditors and city officials should insist on the continued performance of essential governmental services. Some creditors may adopt the short-sighted view of desiring to sacrifice municipal services in order to apply the greatest possible proportion of receipts to debt retirement. Similarly, some city officials may adopt the equally short-sighted view of wanting to neglect debt payment in order to insure the unretrenched continuation of municipal services. Neither view, of course, is equitable. Experience has proved that neglect of current functions arouses a dissatisfaction on the part of the taxpayers which generally may be expected to result in smaller tax collections. On the other hand, if debt charges are unduly neglected, the credit rating of the city must suffer more than is necessary. The major objective of refunding should be the installation of a plan whereby municipal services may be continued and an equitable amount paid on funded debt.

If its financial condition is such that debt must be scaled down before a municipality can meet its payments, every

²⁴*Ibid.*, Secs. 2511-2513.

effort should be made to provide for eventual retirement of the principal amount. Certainty of principal payment is desirable from the viewpoint both of security owners and of city officials. Knowledge that the principal will be retired gives the bonds a re-sale value and thus protects the original investment of the creditors; furthermore, definite provision for payment of the principal gives the city the opportunity of honorably retiring the capital amount of its indebtedness. If it is necessary to scale down the amount of the payments, the interest charges should be made the object of this reduction. As a result of their desire to protect capital investment, creditors are, almost without exception, willing to allow financially embarrassed municipalities to effect a greater net saving by decreasing the coupon rate than by lowering the principal amount. If the interest rate must be lowered, it should be decreased by an amount which will leave funds sufficient to retire annually a reasonably large amount of the principal. Moreover, interest should be paid on the amounts of defaulted principal and interest for the duration of the period between the occurrence of the default and the time of agreement upon a new debt program.

A number of refunding plans which have been agreed upon by municipalities in this state provide for a low coupon rate during the first few years immediately following the agreement, and for a rapid increase in the coupon rate during the ensuing years until the interest payments become as large as at the time of default. The theory on which this type of agreement rests is that tax collections eventually may be expected to improve and that higher rates thus may be paid in the future. City officials should, however, accept an agreement of this type only after giving it the closest study. Conservative estimates should be made of the revenues which may be expected to be collected during each of the years in which the coupon rate is to increase; and if the anticipated revenue fails to grow rapidly enough to care for the increasing coupon rate, the officials should demand a more reasonable adjustment, or the city likely will find itself again in default within a few years.

The refunding agreement should be made on the smallest amount of bonds which make it possible to obtain the desired result. One of the smaller cities of this state recently initiated a movement to refund its entire debt when a cursory examination would have revealed that a satisfactory adjustment could have been made by refunding a comparatively small percentage of its total outstanding obligations. Unnecessary damage is done to municipal credit when every security holder is asked to make the concession of accepting a refunding bond in exchange for each bond held if the desired result might be obtained by the exchange of a smaller number of securities. Moreover, the expense of refunding bears a direct relationship to the amount of debt to be refunded. The city official who has charge of the refunding program should, in making a study of the local debt structure, determine the smallest portion of outstanding indebtedness which may be refunded in order to obtain the desired objective.

In deciding upon an agreement concerning the maturities of the refunding bonds, the creditors should be treated impartially. It is but natural that each individual who holds securities of a municipality which has defaulted should wish to receive his principal payment as soon as possible. It is likely therefore that most of those who agree to exchange their holdings will endeavor to obtain refunding bonds which have early maturities. City officials, on their part, should demand that a reasonably small amount of refunding bonds mature in early years in order that the city may have an opportunity to recover from its financial difficulties and thus find it possible promptly to meet all payments. City officials, moreover, should demand that no more bonds fall due within one year than can conservatively be expected to be paid within that year.

In order to circumvent the difficulty of getting the various creditors to agree on the maturities of the refunding bonds which are to be exchanged for their original securities, the suggestion has been made that refunding bonds should be of term maturity. Acceptance of this suggested solution likely would prove undesirable, however, since a municipality which has defaulted on its securities is not likely to

be in a position to manage efficiently the sinking funds which are necessary to the repayment of term bonds.

On the other hand, it is desirable, as provided in the Bond and Warrant Law of 1931, that the refunding bonds be of serial maturity.²⁵ These maturities, if serial bonds are to be refunded, should be arranged in the same sequence as those of the original issue. In this manner each of the security holders is given a date of principal payment which bears the same chronological relationship to the maturities given the other creditors as that borne by the securities originally held. If, on the other hand, a term issue is to be refunded, an effort should be made to have the creditors agree on some acceptable arrangement of maturities of the serial refunding bonds. In case the holders prove contentious and refuse to agree, it would be fair to all concerned for the city officials to determine the maturities of the refunding bonds by lot.

Final negotiations with creditors should be preceded by a painstaking compilation of all available facts concerning the fiscal condition of the city. A schedule should be prepared which shows for each outstanding bond issue the total interest and principal requirements for each year of its life, and a recapitulation of these individual schedules should present the total of the requirements of all issues. A report having its basis in the annual budget should set forth a forecast of the cash position of each sinking fund. A long-term budget should be available which contains an estimate of the receipts and expenditures for five or more ensuing years. Additional data should present historical analyses for several years of assessed valuations, delinquent tax collections, miscellaneous receipts, current operating expenses, and debt service charges.

As a matter of fact, the above information is not likely to be available in the average municipality which has defaulted, for the type of administration which results in defaults likewise results frequently in an inadequate system of records. In any event, however, the city officials may greatly strengthen their request for debt adjustment by

²⁵*General Laws, Regular Session, 1931, Ch. 163, Sec. 7.*

making a special analysis of the local situation. A property reappraisal on the unit basis should be made. A reasonable tax rate should be decided upon and applied to this adjusted valuation, and to the portion of the proposed levy which conservatively may be expected to be collected should be added the aggregate of all other prospective revenues for the ensuing year. A special expense estimate should be made of the total cost of performing the essential municipal services, and this amount should be deducted from the estimate of revenue. The excess of revenue over a reasonable minimum of operating expense constitutes the amount which may be allocated to debt service charges the following year. This information is essential if the city officials are to hold an intelligent conference with the creditors.

If at all possible, a conference should be arranged between the bondholders, the large taxpayers, the local bankers, and the city officials. Some refunding agreements may be completed largely through correspondence; if this procedure is to be attempted, a concise, printed statement containing all the information outlined above should be mailed to the bondholders. An agreement satisfactory to all interested parties is more likely to be obtained, however, through a conference. The creditors then have an opportunity to voice arguments for protection of their original investment. The large taxpayers, who must bear the brunt of debt payment, also have a chance to defend their interests. The local bankers should be in position to give expert and relatively impartial advice concerning local business conditions and the ability of the municipality to pay its obligations. The city officials should bring to such a conference a tentative refunding plan, and should have readily available all information which may be desired concerning the fiscal condition of the city. Not only should they possess complete data concerning the city's ability to pay its debts, but they should manifest at all times a willingness to do all in their power to assist the city in meeting reasonable demands made by its creditors. Information should be freely available to all interested parties, and the conference should be marked by openness and a spirit of cooperation.

When the terms of the refunding arrangement have been agreed upon, the resulting plan should be formally adopted by the city council and by holders of 80 per cent of the face value of outstanding securities. The council should adopt the plan in order that the refunding bonds may be started on their routine of approval by the Attorney General and registration by the Comptroller. The Attorney General's Department, before giving official approval to a proposed refunding issue, observes the practice of requiring the holders of 80 per cent of the face value of the bonds which are to be refinanced to agree to the proposed refunding plan.²⁶ It is desirable that security holders set forth their approval in a formal statement which will give the city officials definite assurance that the refunding bonds will be accepted in exchange for the securities of the original issue.

A debt adjustment program should satisfy the circumstances which dictate its adoption. The tragic aspect of some complicated and expensive refinancing programs is that they fail to accomplish the desired objectives or to relieve the conditions which necessitated the adjustment. When voluntary refunding is used to reduce interest charges, for example, it is possible that fees to the bond dealer, the approving attorney, and the printer may total more than the amount of interest saved. This type of refunding should be preceded by a painstaking comparison of the total interest saving with the aggregate cost of the program. In the event that a natural disaster or a bank failure precipitates a city into a refunding project, arrangement should be made to postpone debt charges until the

²⁶This requirement was made in order to prevent unscrupulous bond dealers from guaranteeing (for a fee) merely to obtain the approval of the Attorney General to a proposed refunding issue. These dealers would refrain from making any other guarantee. In these cases the bonds were printed, signed, and approved; but the bond dealer would then make no attempt to contact the creditors and effect an exchange of the new securities for the outstanding ones. Since the cities were not equipped to contact the creditors, this practice was but a legalized method of stealing public funds through making misrepresentations to officials.

municipality regains its normal state and is able once more to resume its customary debt payments.

In case refunding results from an overbonded condition, the new interest rate should be sufficiently low that reasonable payments may be made toward the eventual retirement of the principal amount. In event the trouble has its origin in unplanned maturities which call for prohibitive payments during a short period of time, the refunding program should provide for spreading out the principal payments. If, on the other hand, the difficulty results from depression conditions, arrangement should be made for easing the burden of payment temporarily, with the object of taking up regular payments again with the return of better times. If the need for debt adjustment arises from poor management and antiquated tax collection procedure, the city officials should support their new debt program with an up-to-date system of organization and practice.

Finally, any refunding program which fails to recognize and to remedy the conditions from which it grew can be satisfactory neither to taxpayers, nor to creditors, nor to city officials, and can serve no purpose except to act as a temporary stop-gap.

CHAPTER IV

DEBT PAYMENT

Since both interest and principal payments must be made in order to retire funded debt, individual consideration should be accorded to each. Interest payments, which are comparatively stable from year to year, should be made directly from the receipts of taxes currently collected for that purpose. Similarly, serial bonds mature in relatively constant annual amounts and, like interest charges, should annually be liquidated from currently collected taxes. Term bonds, on the other hand, fall due at the end of a specified number of years and require for their retirement a special variety of fund which is annually accumulative. The expression "interest and sinking fund" often has been used indiscriminately to refer to any type of financial arrangement designed to meet one or all of the classes of payment described above. This commonly used expression is too indefinite for present purposes. In this discussion, any fund which is designed for the payment of debt service charges is known as a "debt retirement fund," and the expression "sinking fund" is used only to designate the special kind of debt retirement fund necessary for the principal payment of term bonds. The management of sinking funds gives rise to special problems which are treated in the last part of this chapter.

The payment of interest and principal charges is essentially the same on time warrants as on bonds, and the procedure hereinafter outlined is equally applicable to both types of obligations. The analogy between the payments on bonds and those on time warrants is complete in that either type of obligation may be of serial or of term maturity.

Satisfactory administration of debt payment is dependent upon adequate records. A schedule should be kept for each bond issue containing all relevant information concerning the time, place, and amount of each principal and interest payment. The general laws of Texas specify that it is the duty of the city secretary to maintain a record of the bonds

and bills issued by the city.¹ If the city, as a service to its creditors, registers any of its outstanding bonds, an exact account should be kept of the registrations. Dallas, for example, maintains a special record for its bonds, which are registerable as to principal only. Many Texas cities fail to keep adequate records concerning their outstanding funded debt, as is evidenced by the fact that 29 per cent of the cities which participated in this survey do not possess a carefully worked out table containing interest and principal requirements for as many as five years in advance.

Records should be kept which show for the interest payments on each issue the due date, the coupon numbers, the bond numbers, and the amount of payment; the records also should show for the principal payments on each issue the due date, the bond numbers, the amount of payment, and the balance outstanding. The accompanying illustration (Exhibit C) is a bond and interest record which was prepared by the Michigan Municipal League for use by the cities of that state. When a bond issue is sold, a sheet of this record is filled in as shown. When payment of principal or interest is authorized, the date and amount are recorded in the payment column, and a liability account is set up in the general ledger to which this amount is credited. Maturing bonds and coupons are paid from this account, and the ledger balance represents the amount authorized for payment but for which matured bonds or coupons have not yet been received.²

Municipal records, without exception, should contain at all times the amount to the credit of the fund for the retirement of each bond issue. Some cities maintain a separate bank account for each such fund. Of the cities studied, 48 per cent have an individual bank account for each outstanding security issue. This practice has the advantages of certainty and simplicity, but it has the disadvantages attendant upon the use of many relatively small bank accounts, some of which may contain surplus amounts

¹*Revised Civil Statutes*, Art. 1000.

²*Bond and Interest Record* (mimeographed pamphlet published by the Michigan Municipal League, Ann Arbor, Oct., 1933), p. 1.

EXHIBIT C*

BOND & INTEREST RECORD

Municipality	Southfield	Amt. of Issue	\$100,000	Dated	July 1, 1933
Authorization—By Ordinance	June 10, 1933	Purpose—Paving			
Authorization—By Vote of Electors	June 20, 1933	Coupon Rate—5%	Payable	July 1—Jan. 1	
Sold To: A. B. C. Bond House	Price—par plus premium \$440	Net Interest Cost to City—4.90%			
Due: Serially on July 1 in ten equal installments beginning July 1, 1934					
No. of Bonds	100	Denomination	\$1,000		

INTEREST RECORD						BOND RECORD					
Date Due	Coupon No.	Bond No.	Amount	Payments		Date Due	Bond No.	Amount	Payments		Balance Outstanding
				Date	Amount				Date	Amount	
1/1/34	1	1-100	2500.00								100,000.00
7/1/34	2	1-100	2500.00			7/1/34	1-10	10,000.00			
(((((((
)))))))			
(((((((
7/1/44	20	91-100	250.00			7/1/44	91-100	10,000.00			

*Prepared by the Michigan Municipal League for use by the cities of that state. Reproduced through the courtesy of Mr. Harold D. Smith, Director of the Michigan Municipal League.

while others are overdrawn. Banks may be expected to pay a higher rate of interest on one comparatively large deposit than on many small ones. In any event, however, the total money to the credit of the various debt retirement funds on the city records always should tally with the total of actual bank deposits for those funds. Information concerning the assets to the credit of each debt fund is necessary properly to make the required annual report to the state Comptroller;³ furthermore this information is essential because of the constitutional provision that taxes for debt retirement must be separately levied and collected.⁴

Information concerning the condition of debt payment funds should be available in report form. The frequency with which these reports should be prepared depends upon the size of the municipality and upon the volume of its transactions. Even in the smallest towns, however, debt reports should be prepared at least semiannually because it is customary for interest payments to be made twice per year, and information should be readily available concerning the ability of the city to meet each payment. Statutory provision is made for the preparation of a quarterly fiscal report by the treasurer.⁵ Many Texas municipalities prepare reports too infrequently; for example, 43 per cent of the cities studied make up such reports only once a year. Of the remainder, reports of indebtedness are drafted monthly by 41 per cent, quarterly by 6 per cent, and semiannually by 10 per cent. It is significant that a great majority of the municipalities in which statements are prepared only once a year are below 7,000 in population and that most of the cities in which monthly statements are issued are in the higher population brackets.

While the local agency charged with debt management is in a position to make almost constant use of facts relative to the condition of debt payment funds, this informa-

³*Revised Civil Statutes*, Art. 838, as amended by the *General Laws, Regular Session, 1931*, Ch. 230, Sec. 1.

⁴*The Constitution of the State of Texas*, Art. XI, Sec. 6.

⁵*Revised Civil Statutes*, Art. 1001.

tion also will prove of interest to all parties concerned with local indebtedness. Reports concerning the condition of debt payment funds therefore should be published. It is partly through dissemination of this information that the citizenship as a whole may be expected to develop a wholesome attitude toward retirement of public debt. Publication also offers city officials the opportunity of explaining their activities publicly. The general laws of the state provide for semiannual and annual publication of fiscal receipts and disbursements, and this statement of necessity must include the transactions of the debt payment funds.⁶ These statutory provisions are not observed by all Texas cities as is shown by the fact that 26 per cent of the cities surveyed publish no reports. Reports are published annually, however, by 56 per cent, quarterly by 8 per cent, semiannually by 6 per cent, monthly by 2 per cent, and biennially by 2 per cent. Certainly the very least that should be expected of a municipality is semiannual publication of financial reports in compliance with legal provisions.

The administrative duties involved in management of debt payment should be delegated to some one official who is in a position to give the required time and attention to this work. The council, as the policy forming branch of the city's government, should set forth rules to be observed in the management of debt payment. The administrative work involved, however, may well be performed by some responsible official. An exception should be noted in the case of compromise bonds since the statutes provide, with reference thereto, in certain instances, for administration of debt payment by a special board appointed for the purpose.⁷ Municipalities of this state have been slow to fix definitely the responsibility for managing debt payment, as is evidenced by the fact that some 46 per cent of the cities which answered a question on the point include this task among the duties of the council.

⁶*Ibid.*, Arts. 1001, 1023.

⁷*Ibid.*, Arts. 830-831.

In the search for contributions to debt service charges, attention should be directed to the premiums which often are paid for bond issues. The requirement that bonds must be sold at not less than par and accrued interest in this state encourages the payment of premiums. There is no justification for placing this premium amount in the general fund; to do so is, in effect, to fund current operating expenses, since a premium is actually borrowed money. Under certain circumstances it might be advisable to use the premium to assist in financing the construction for which the bonds were issued. This practice, however, is undesirable as a general policy because it constitutes a temptation to extravagance. The premium may properly be used to pay legal and printing expenses incident to the bond issue. Generally speaking, however, it should be placed in the debt retirement fund because a premium is nothing more than an interest adjustment in the form of an addition to the loan. From a theoretical viewpoint, the premium should be amortized over the entire period of payment. Practically such amortization is likely to entail greater accounting complications than its benefits justify. Of the cities which participated in this study, 46 per cent apply the premium to the cost of construction; 42 per cent place it in the debt redemption fund; 9 per cent put it in the general fund; and 3 per cent use it to pay printing and legal costs.

So far as possible, publicly owned utilities should bear their own debt retirement expenses. The common practice of paying current governmental operating expenses from utility receipts and of paying utility bonds from property tax collections is confusing. Money from other than tax sources legally may be appropriated for retirement of debt,⁸ and specific provision is made for the application of utility revenues to retirement of interest and principal of bonded debt incurred on account of the utilities. This appropriation of utility revenue must be made before enactment of the tax rate, and the amount so appropriated, if insufficient,

⁸*Ibid.*, Art. 1015, Sec. 43.

must be supplemented by a tax rate designed to produce collections sufficient to pay the balance of the debt charges.⁹ Of the municipalities studied, approximately 44 per cent appropriate sums from utility receipts to assist in payment of general obligation bonds; moreover, half the cities which follow this practice pay one-fourth or more of their total annual debt charges from utility receipts.

The tax contributions to each debt payment fund should be carefully computed every year. The total interest payments to be made during the coming year should be ascertained from the bond records and added to the total amount of serial bonds to be retired during the year. To the resulting total should be added the amount of tax receipts necessary to maintain the actuarial requirements of the sinking funds for the retirement of term bonds. The resulting grand total is the aggregate amount which must be available for debt purposes during the coming year.

After this total is computed, it should be analyzed into the amounts necessary for payment of interest and principal on each bond issue. Each such individual amount then should be increased or decreased according to the existence of an overdraft or surplus in its fund account; moreover, the probable collections of delinquent taxes and other contributions to debt retirement should form additional bases for adjustment. The final figure for each issue is the amount which must be raised by current property tax collection in order to satisfy debt requirements for the approaching year. The tax rate necessary to produce each such required amount on the existing valuation should be calculated, and the calculation should include ample allowance for uncollectible taxes.

A carefully prepared schedule of the amounts of previous tax rates which were designated for the various bond issues should be used in order that delinquent tax collections may be distributed to the various debt payment funds in proper and legal amount. A constitutional provision requires municipal corporations, upon creation of debt, to assess and collect a sufficient annual sum to pay the interest and to

⁹*Ibid.*, Art. 1106.

create a fund for principal retirement of at least 2 per cent of the amount outstanding.¹⁰

Attempts to exploit the debt funds for purposes other than the payment of the debt for which they were created constitute a breach of the original contract with the creditors. Diversion or misapplication of these funds is illegal; indeed, no disbursement may lawfully be made from them except by a warrant which must be signed by the mayor and attested by the secretary, and which may be issued only for payment of interest, retirement of principal, or purchase of securities as investments.¹¹ The muddled administration of debt service funds in some Texas cities makes it impossible to discover the amount to the credit of each outstanding bond issue, and the task of determining whether payments are legally made thus becomes almost hopeless.

Remittances to creditors should be made promptly. Matured bonds and coupons customarily are presented to the institution which serves as the municipality's paying agency in New York City. Texas municipalities are far removed from this financial center and can best establish their reputation for trustworthiness through speedy compliance with all the conditions of their loans. Some cities start their remittances to their New York fiscal agent fifteen days before the due date; and in any event, the necessary funds invariably should be on deposit at the paying agency several days before that date. The amount necessary to meet interest and principal payments should be carefully calculated and thoroughly checked in order to avoid error. One of the larger Texas cities once had six New York paying agents for its various bond issues. This situation only complicated the making of remittances and reduced the volume of business done with any one paying agent. The individual accounts were so small as to be bothersome to the paying agents. By arranging to make all remittances through one bank, the city not only received better service but simplified the procedure incident to paying debt service

¹⁰*The Constitution of the State of Texas*, Art. XI, Secs. 5, 7.

¹¹*Revised Civil Statutes*, Arts. 839, 2565.

charges. Finally, it is to the advantage of the city to arrange for these payments to fall due after the tax collection period in order that the necessary funds may be certain to be available.

Many cities hold their own securities as sinking fund investments. Payment of maturities on these bonds should be made not through the New York fiscal agent but in the local bank, and should be evidenced by proper entries on the city's books.

Redeemed coupons and bonds should be handled with the greatest of care. Although one city of the state is supposed to have retired a bond issue some fifteen years ago, no record exists of the receipt, cancellation, or destruction of the bonds involved, and the officials of the city are still in a quandary concerning the disposition of the bonds. It is customary for the fiscal agent in New York to cancel the redeemed instruments and deliver them to the city of issue. These voided documents should be checked, and since both bonds and coupons are negotiable instruments, the cancellation of each should be verified. The cancellation should be performed with a perforating machine which punches each document.

The canceled coupons should be arranged according to issue and according to the bond numbers within each issue. Note should be made of any missing coupons. Some of the smaller municipalities use coupon books which are ruled off with a space for each coupon, and the canceled coupons are pasted in their specified spaces. Other cities arrange the coupons in numerical order and indicate missing coupons by paper clips or rubber bands. Canceled bonds also should be filed according to issue and number.

Some cities burn canceled coupons and bonds soon after their receipt; it is preferable, however, to burn the voided instruments only after they have been audited and have been filed for several years. In any event, these instruments should never be destroyed except in the presence of several responsible city officials. An affidavit of the number and issue of each bond and coupon so destroyed should invariably be made and preserved of record.

In connection with the management of funded debt, it is desirable to compile a list of the names of the bondholders. Knowledge of the identity of creditors is invaluable if the city ever should find it necessary to seek a debt adjustment. When a city official occasionally finds the name of some holder, it should be carefully recorded. The identity of a few bond owners may be discovered on the coupon envelopes if the coupons should happen to be presented to the local rather than to the New York bank for payment.

Great care should be exercised in selecting a city depository. Several municipalities of this state have lost debt payment funds as a result of bank failures. Consideration should be given not only to the rate of interest paid on deposits but to the maximum amount which it is prudent to place in one bank, the soundness of the bank, and the type of deposit security offered by the bank. The city secretary is authorized to publish a notice that sealed bids are to be received for selection of a city depository. The council has the right to reject any and all of the resulting bids and to call for new ones. The depository which is selected must qualify by furnishing the bond of five solvent individuals who own real estate valued at or who have a net worth equal to the total amount of revenue collected by the city in the previous year, by furnishing the bond of a solvent surety company, or by pledging an amount of specified securities equal in value to the amount of city funds on deposit.¹² Upon approval of the bond, the bank is designated as the depository, and the treasurer is immediately bound to deposit the city's money therein. If the treasurer complies with these legal requirements, he is not liable for loss of funds by the depository.¹³

The security which banks furnish for city deposits is a paramount factor in guaranteeing the liquidity of debt payment funds. Personal surety should be regarded with extreme disfavor because it likely would mean very little in case of a bank failure, since the signers of a personal

¹²*Ibid.*, Art. 2560, as amended by the *General Laws, First Called Session, 1931*, Ch. 9, Sec. 2.

¹³*Revised Civil Statutes*, Art. 2564.

surety likely would have their personal fortunes tied up with the success of the bank. If the deposit is to be guaranteed by a surety company (an expensive service), city officials should demand conclusive proof of the solvency of the company. It is most desirable, however, to have actual bonds or other approved securities as collateral for municipal bank deposits. The statutes enumerate a wide range of obligations (including those of various special districts) as eligible for use in guaranteeing city deposits.¹⁴ If the city is in a position to do so, however, it should require that deposits be guaranteed only by certain specified obligations from the eligible list, preferably by those of the United States Government, the State of Texas, or the city itself. Furthermore, it would be desirable for the city to require that these securities have a par value of 10 per cent greater than the amount of city funds on deposit. In any event, the council should exercise its prerogative of making a semiannual investigation of the condition of the depository bond.¹⁵ Of the cities studied, 50 per cent had their deposits secured by actual bonds as collateral; 21 per cent used personal surety; 8 per cent used both personal surety and actual bonds; and 4 per cent used surety company guarantee. Seventeen per cent of the group, however, had no depository security. If local banks refuse to meet the legal requirements expected of a city depository, the city should request proposals from banks in other municipalities.¹⁶

City officials should seek to maintain a harmonious relationship with the depository. Municipal deposits often are subject to wide fluctuations during the course of a year, and it is only reasonable that the bank should be kept informed on the financial outlook of the city. The payment

¹⁴*Ibid.*, Art. 2560, as amended by the *General Laws, First Called Session, 1931*, Ch. 9, Sec. 2.

¹⁵*Ibid.*

¹⁶A discussion of the several methods for safeguarding public deposits, together with a number of excellent suggestions concerning the accompanying administrative problems, may be found in Martin L. Faust, *The Security of Public Deposits* (Publication No. 51, Public Administration Service, Chicago, 1936), 45 pp.

of a large issue of term bonds, for instance, could conceivably make such demands on the debt fund accounts that the bank would be caused great inconvenience unless warned beforehand in order that proper arrangements might be made.

The administration of sinking funds for the retirement of term bonds involves problems which are more numerous and complex than those found in the management of funds for retirement of serial bonds. Whereas serial bonds are retired by a number of relatively small principal payments throughout the life of the issue, term bonds are retired in one large payment. Sinking funds provide a method of distributing the burden of this payment evenly over the life of the term bonds without upsetting the flow of municipal finance. A sinking fund is a fund in which certain sums are placed annually and allowed to accumulate until the various contributions, together with their earnings, are sufficient to retire a particular term bond debt upon maturity.¹⁷

Some security issues partake of the nature both of serial and of term bonds, providing for no principal payments during the first part of the life of the issue but calling for serial retirement thereafter. The use of this deferred serial type of payment is seldom justifiable. If, however, the city must pay extraordinarily heavy maturities on other bond issues during the first years of the life of a deferred serial issue, it may be desirable to make no provision for its payment during this period; otherwise a regular sinking fund should be accumulated for the issue in order to spread the cost of principal retirement evenly over its life.

Sinking fund management should be recognized as a long-time proposition and should be based on carefully laid plans. While interest charges and serial maturities are paid currently from year to year and do not necessitate the accumulation of an ever-increasing fund, sinking funds are unique in that their administration may extend over a period as

¹⁷Lent D. Upson, *Practice of Municipal Administration* (The Century Co., New York, 1926), p. 110.

long as forty years.¹⁸ The difficulty of obtaining systematic management of these funds in city governments, many of which experience intermittent political upheavals, is apparent. A number of authorities have recommended that a commission of men not connected politically with the city government should have the responsibility of managing sinking funds in order that the bookkeeping and the actual handling of these funds may be done by different parties and in order that the commission may endure as a special and disinterested group through periods of political change in the city government.¹⁹

An annual analysis should be made of each sinking fund, and each should receive yearly contributions sufficient to maintain actuarial requirements. The necessity for a scientific approach to the problem of payments into sinking funds may be emphasized by the fact that 43 per cent of the municipalities studied will be confronted with the year of their greatest principal payment at some time later than 1937. The term bond maturities coming due may be met only through properly accumulated sinking funds.

The size of the annual contribution to a sinking fund depends upon the amount of bonds to be retired, the date of retirement, and the rate of interest to be earned on sinking fund investments. The first two of these items are known; a very conservative estimate should be made of the expected rate of interest earnings. With this information it is simple, with the use of a sinking fund table, to calculate the annual contribution necessary to produce the required total at maturity. In addition to the actuarial requirements, records should show for each sinking fund the cash assets, the investment assets, a comparison of actuarial requirements and actual holdings, the amount of optional bonds which have been redeemed, the interest earnings, and the market value and types of securities held.

¹⁸*Revised Civil Statutes*, Art. 706.

¹⁹A. Howard Myers, *The Administration of Municipal Sinking Funds in New York State* (New York State Conference of Mayors, Albany, 1933), p. 20.

Table III contains the amounts of money which must be set aside annually to accumulate to \$1 at the end of any specified number of years from one through sixty and at a rate of interest earning from 1 through 7 per cent (the interest being graduated in steps of one-half of 1 per cent). When term bonds are issued, it is simple, by use of this table, to compute the yearly contribution which must be made to the sinking fund in order that sufficient money may be on hand to pay the principal amount at the maturity date. It is necessary, of course, to determine the exact number of annual contributions which may be made toward the retirement of a bond issue, for if the bonds are issued after the appropriations for the year have been made, the total possible number of annual contributions will be one less than the number of years included in the life of the loan. If twenty-four payments may be made toward the retirement of an issue of term bonds and if it is estimated that the sinking fund assets will earn 3 per cent during that period, it may be determined by referring to the column headed "3%" that an annual contribution of \$0.0290474 must be made in order to accumulate \$1 within the required period of time. If the term bond issue totals \$50,000, it is found, by multiplying \$0.0290474 by \$50,000, that an annual sinking fund contribution of \$1,452.37 must be made in order to accumulate sufficient money to retire the principal amount by its due date.

Sinking funds should be productive assets. The cash in sinking funds on deposit may be expected to draw a higher rate of interest than that in the general fund, for the amount of sinking fund cash is relatively stable and thus may be made a time deposit rather than a current checking account. Of the cities which have term bonds outstanding in the sample studied, approximately 59 per cent keep very little of their sinking funds in cash but invest as much of them as they prudently can. This policy, unless the maturity date of the bonds is close at hand, is desirable because the interest rate on good securities customarily may be expected to be higher than that which the bank is in position to offer on time deposits.

TABLE III*

THE ANNUAL SINKING FUND CONTRIBUTION WHICH WILL ACCUMULATE TO 1 AT THE END OF A GIVEN NUMBER OF YEARS

Years.	1½%.	1¾%.	2%.	2¼%.	2½%.	2¾%.	3%.	Years.
1	1.0000000	1.0000000	1.0000000	1.0000000	1.0000000	1.0000000	1.0000000	1
2	0.4962779	0.4956630	0.4950495	0.4944376	0.4938272	0.4932183	0.4926108	2
3	0.3283830	0.3275675	0.3267547	0.3259446	0.3251372	0.3243324	0.3235304	3
4	0.2444448	0.2435324	0.2426238	0.2417189	0.2408179	0.2399206	0.2390271	4
5	0.1910893	0.19031214	0.1912584	0.1912002	0.1902469	0.1892983	0.1883546	5
6	0.1605252	0.1595226	0.1585258	0.1575350	0.1565500	0.1555708	0.1545975	6
7	0.1365562	0.1355306	0.1345120	0.1335003	0.1324954	0.1314975	0.1305064	7
8	0.1185840	0.1175429	0.1165098	0.1154846	0.1144674	0.1134580	0.1124564	8
9	0.1046098	0.1035581	0.1025154	0.1014817	0.1004569	0.0994410	0.0984339	9
10	0.0934342	0.0923753	0.0913265	0.0902877	0.0892588	0.0882397	0.0872305	10
11	0.0842938	0.0832304	0.0821779	0.0811365	0.0801060	0.0790863	0.0780775	11
12	0.0766800	0.0756138	0.0745596	0.0735174	0.0724871	0.0714687	0.0704621	12
13	0.0702104	0.0691728	0.0681184	0.0670769	0.0660483	0.0650325	0.0640295	13
14	0.0647233	0.0636556	0.0626020	0.0615623	0.0605365	0.0595246	0.0585263	14
15	0.0594944	0.0584374	0.0573855	0.0563385	0.0552966	0.0542592	0.0532266	15
16	0.0557651	0.0546996	0.0536501	0.0526166	0.0515990	0.0505971	0.0496109	16
17	0.0520797	0.0510162	0.0499698	0.0489404	0.0479278	0.0469319	0.0459525	17
18	0.0485058	0.0474449	0.0464021	0.0453772	0.0443670	0.0433806	0.0424087	18
19	0.0457875	0.0448206	0.0438718	0.0429382	0.0419766	0.0410780	0.0398139	19
20	0.0432457	0.0423192	0.0414167	0.0405421	0.0396947	0.0388717	0.0372157	20
21	0.0408655	0.0398146	0.0387848	0.0377757	0.0367873	0.0358194	0.0348718	21
22	0.0387033	0.0376564	0.0366314	0.0356282	0.0346466	0.0336864	0.0327474	22
23	0.0367308	0.0356878	0.0346681	0.0336710	0.0326964	0.0317441	0.0308139	23
24	0.0349241	0.0338857	0.0328711	0.0318802	0.0309128	0.0299686	0.0290474	24
25	0.0332635	0.0322295	0.0312204	0.0302360	0.0292759	0.0283400	0.0274279	25
26	0.0317320	0.0307027	0.0296992	0.0287213	0.0277687	0.0268412	0.0259383	26
27	0.0303153	0.0292908	0.0282931	0.0273219	0.0263769	0.0254578	0.0245642	27
28	0.0290011	0.0279815	0.0269897	0.0260253	0.0250879	0.0241774	0.0232932	28
29	0.0277788	0.0267642	0.0257784	0.0248208	0.0238913	0.0229894	0.0221147	29
30	0.0266392	0.0256298	0.0246499	0.0236993	0.0227776	0.0218884	0.0210193	30
31	0.0255743	0.0245701	0.0235964	0.0226528	0.0217390	0.0208545	0.0199989	31
32	0.0245771	0.0235781	0.0226106	0.0216742	0.0207683	0.0198926	0.0190466	32
33	0.0236414	0.0226478	0.0216855	0.0207572	0.0198594	0.0189925	0.0181561	33
34	0.0227619	0.0217736	0.0208187	0.0198966	0.0190068	0.0181488	0.0173220	34
35	0.0219336	0.0209508	0.0200022	0.0190873	0.0182056	0.0173565	0.0165393	35
36	0.0211524	0.0201751	0.0192329	0.0183252	0.0174516	0.0166113	0.0158038	36
37	0.0204144	0.0194426	0.0185068	0.0176064	0.0167409	0.0159095	0.0151116	37
38	0.0197161	0.0187499	0.0178206	0.0169275	0.0160701	0.0152476	0.0144593	38
39	0.0190546	0.0180940	0.0171711	0.0162854	0.0154362	0.0146226	0.0138439	39
40	0.0184271	0.0174721	0.0165558	0.0156774	0.0148362	0.0140315	0.0132624	40
41	0.0178311	0.0168817	0.0159719	0.0151009	0.0142679	0.0134720	0.0127124	41
42	0.0172643	0.0163206	0.0154173	0.0145536	0.0137288	0.0129418	0.0121917	42
43	0.0167247	0.0157867	0.0148899	0.0140336	0.0132169	0.0124387	0.0116981	43
44	0.0162104	0.0152781	0.0143879	0.0135390	0.0127304	0.0119610	0.0112298	44
45	0.0157198	0.0147932	0.0139096	0.0130681	0.0122675	0.0115069	0.0107852	45
46	0.0152512	0.0143304	0.0134534	0.0126192	0.0118268	0.0110749	0.0103625	46
47	0.0148034	0.0138884	0.0130179	0.0121911	0.0114067	0.0106636	0.0099605	47
48	0.0143750	0.0134657	0.0126018	0.0117823	0.0110060	0.0102716	0.0095778	48
49	0.0139648	0.0130612	0.0122040	0.0113918	0.0106235	0.0098977	0.0092131	49
50	0.0135717	0.0126739	0.0118232	0.0110184	0.0102581	0.0095409	0.0088655	50
51	0.0131947	0.0123027	0.0114586	0.0106610	0.0099087	0.0092001	0.0085338	51
52	0.0128329	0.0119467	0.0110991	0.0103188	0.0095745	0.0088744	0.0082172	52
53	0.0124854	0.0116049	0.0107739	0.0099909	0.0092545	0.0085630	0.0079147	53
54	0.0121514	0.0112767	0.0104523	0.0096765	0.0089480	0.0082649	0.0076256	54
55	0.0118302	0.0109613	0.0101434	0.0093749	0.0086542	0.0079795	0.0073491	55
56	0.0115211	0.0106580	0.0098466	0.0090853	0.0083724	0.0077061	0.0070845	56
57	0.0112234	0.0103661	0.0095612	0.0088071	0.0081020	0.0074440	0.0068311	57
58	0.0109366	0.0100850	0.0092867	0.0085398	0.0078324	0.0071927	0.0065885	58
59	0.0106601	0.0098143	0.0090224	0.0082827	0.0075931	0.0069515	0.0063559	59
60	0.0103934	0.0095534	0.0087680	0.0080353	0.0073534	0.0067200	0.0061330	60

TABLE III—(Continued)

Years.	3½%.	4%.	4½%.	5%.	5½%.	6%	7%	Years.
1	1.0000000	1.0000000	1.0000000	1.0000000	1.0000000	1.0000000	1.0000000	1
2	0.4914005	0.4901961	0.4889976	0.4878049	0.4866180	0.4854369	0.4830918	2
3	0.3219342	0.3203485	0.3187734	0.3172086	0.3156541	0.3141098	0.3110517	3
4	0.2372511	0.2354901	0.2337437	0.2320118	0.2302945	0.2285915	0.2252281	4
5	0.1864814	0.1846271	0.1827916	0.1809748	0.1791764	0.1773964	0.1738907	5
6	0.1526682	0.1507619	0.1488784	0.1470175	0.1451790	0.1433626	0.1397958	6
7	0.1285445	0.1266096	0.1247015	0.1228198	0.1209644	0.1191350	0.1155532	7
8	0.1104767	0.1085524	0.1066097	0.1047218	0.1028640	0.1010359	0.0974678	8
9	0.0964460	0.0944930	0.0925745	0.0906901	0.0888395	0.0870222	0.0834865	9
10	0.0852414	0.0832909	0.0813788	0.0795046	0.0776678	0.0758680	0.0723775	10
11	0.0760920	0.0741490	0.0722482	0.0703889	0.0685707	0.0667929	0.0633569	11
12	0.0684840	0.0665522	0.0646662	0.0628254	0.0610292	0.0592770	0.0559200	12
13	0.0620616	0.0601437	0.0582754	0.0564558	0.0546843	0.0529601	0.0496509	13
14	0.0565707	0.0546690	0.0528203	0.0510240	0.0492791	0.0475849	0.0443449	14
15	0.0518251	0.0499411	0.0481138	0.0463423	0.0446256	0.0429628	0.0397946	15
16	0.0476848	0.0458200	0.0440154	0.0422609	0.0405525	0.0388921	0.0358577	16
17	0.0440431	0.0421985	0.0404176	0.0386991	0.0370420	0.0354448	0.0324252	17
18	0.0408168	0.0389933	0.0372369	0.0355402	0.0339199	0.0323565	0.0294126	18
19	0.0379403	0.0361386	0.0344073	0.0327450	0.0311501	0.0296209	0.0267530	19
20	0.0353611	0.0335818	0.0318761	0.0302426	0.0286793	0.0271846	0.0243929	20
21	0.0330366	0.0312801	0.0296006	0.0279961	0.0264648	0.0250046	0.0222890	21
22	0.0309321	0.0291988	0.0275457	0.0259705	0.0244712	0.0230456	0.0204058	22
23	0.0290188	0.0273091	0.0256825	0.0241368	0.0226606	0.0212785	0.0187139	23
24	0.0272728	0.0255868	0.0239870	0.0224709	0.0210358	0.0196790	0.0171890	24
25	0.0256740	0.0240120	0.0224390	0.0209525	0.0195494	0.0182267	0.0158105	25
26	0.0242054	0.0225674	0.0210214	0.0195643	0.0181931	0.0169044	0.0145610	26
27	0.0228524	0.0212385	0.0197195	0.0182919	0.0169523	0.0156972	0.0134257	27
28	0.0216027	0.0200130	0.0185208	0.0171225	0.0158144	0.0145926	0.0123919	28
29	0.0204454	0.0188799	0.0174146	0.0160455	0.0147686	0.0135796	0.0114487	29
30	0.0193713	0.0178301	0.0163915	0.0150514	0.0138054	0.0126489	0.0105864	30
31	0.0183724	0.0168554	0.0154435	0.0141321	0.0129167	0.0117922	0.0097969	31
32	0.0174415	0.0159486	0.0145632	0.0132804	0.0120952	0.0110023	0.0090729	32
33	0.0165724	0.0151036	0.0137445	0.0124900	0.0113347	0.0102729	0.0084081	33
34	0.0157597	0.0143148	0.0129819	0.0117554	0.0106296	0.0095984	0.0077967	34
35	0.0149984	0.0135773	0.0122705	0.0110717	0.0099749	0.0089739	0.0072340	35
36	0.0142842	0.0128869	0.0116058	0.0104345	0.0093664	0.0083948	0.0067153	36
37	0.0136133	0.0122396	0.0109840	0.0098398	0.0087999	0.0078574	0.0062369	37
38	0.0129821	0.0116319	0.0104017	0.0092842	0.0082722	0.0073581	0.0057951	38
39	0.0123878	0.0110608	0.0098557	0.0087646	0.0077799	0.0068938	0.0053868	39
40	0.0118273	0.0105235	0.0093432	0.0082782	0.0073203	0.0064615	0.0050091	40
41	0.0112982	0.0100174	0.0088616	0.0078223	0.0068909	0.0060589	0.0046596	41
42	0.0107983	0.0095402	0.0084087	0.0073947	0.0064893	0.0056834	0.0043359	42
43	0.0103254	0.0090899	0.0079824	0.0069933	0.0061134	0.0053331	0.0040359	43
44	0.0098777	0.0086645	0.0075807	0.0066163	0.0057613	0.0050061	0.0037577	44
45	0.0094534	0.0082625	0.0072020	0.0062617	0.0054313	0.0047005	0.0034996	45
46	0.0090511	0.0078821	0.0068447	0.0059282	0.0051218	0.0044149	0.0032600	46
47	0.0086692	0.0075219	0.0065073	0.0056142	0.0048313	0.0041477	0.0030374	47
48	0.0083065	0.0071807	0.0061886	0.0053184	0.0045555	0.0038977	0.0028207	48
49	0.0079617	0.0068571	0.0058872	0.0050397	0.0043023	0.0036636	0.0026285	49
50	0.0076337	0.0065502	0.0056022	0.0047767	0.0040615	0.0034443	0.0024599	50
51	0.0073216	0.0062589	0.0053323	0.0045287	0.0038350	0.0032388	0.0022937	51
52	0.0070243	0.0059821	0.0050768	0.0042945	0.0036219	0.0030462	0.0021390	52
53	0.0067410	0.0057192	0.0048347	0.0040733	0.0034213	0.0028655	0.0019951	53
54	0.0064709	0.0054691	0.0046052	0.0038644	0.0032325	0.0026960	0.0018611	54
55	0.0062132	0.0052312	0.0043875	0.0036669	0.0030546	0.0025370	0.0017363	55
56	0.0059673	0.0050049	0.0041811	0.0034801	0.0028870	0.0023877	0.0016201	56
57	0.0057325	0.0047893	0.0039851	0.0033034	0.0027290	0.0022474	0.0015118	57
58	0.0055081	0.0045540	0.0037990	0.0031363	0.0025801	0.0021157	0.0014109	58
59	0.0052937	0.0043384	0.0036222	0.0029780	0.0024396	0.0019920	0.0013169	59
60	0.0050886	0.0042019	0.0034543	0.0028282	0.0023071	0.0018757	0.0012292	60

*Taken from Laurence I. Hewes and James W. Glover, *Highway Bonds* (Bulletin No. 136, U. S. Department of Agriculture, 1915), pp. 120-121. Reproduced through the courtesy of Mr. H. S. Fairbank, Chief of the Division of Information, Bureau of Public Roads, U. S. Department of Agriculture.

All sinking fund investments should mature prior to the time for retirement of the bonds for which the sinking fund was created. If the sinking fund contains a block of unmatured securities when the payment date approaches, these securities must be sold on the market in order to transform the assets completely into cash. A strong probability always exists that the market may not be in condition to assimilate these obligations at par value. Despite a statutory provision that cities may purchase for sinking fund purposes only securities which mature before time for payment of the term bonds for the retirement of which the fund exists,²⁰ 22 per cent of the cities surveyed do not make it a policy to purchase securities which mature sufficiently early.

Sinking fund cash should be invested in the city's own outstanding obligations. State statutes provide that sinking funds may be invested in securities of the United States Government, obligations of the State of Texas, and bonds of political subdivisions of the state.²¹ This is ample latitude for investment; as a matter of fact, it has proved to be a greater range of choice than is desirable. One of the larger cities of the state, for example, was forced, through investment in low-grade securities, to take a staggering loss on its sinking funds although the city unquestionably was large enough to have obtained competent advice in making its investments. This loss in turn made it necessary for the city to refund a considerable portion of its debt in order to return its sinking funds to a sound basis. Obligations should be worth face value to the city which issued them. A city, then, has nothing to lose by purchasing its own securities as sinking fund investments. Pursuance of this policy reduces the number of a city's obligations which are held by private investors and thus extends to the obligations which remain in private hands a greater proportionate lien against the taxpaying capacity of the municipality. If a city can find none of its own obligations available for investment, sinking fund money should be

²⁰*Revised Civil Statutes*, Art. 836.

²¹*Ibid.*, Arts. 836-837.

invested only in securities of unquestionable standing, preferably in United States Government bonds. While good earnings are highly desirable, they are less important than safety.

Interest and principal maturities in a city's own securities which are held in its sinking funds should be paid just as though the securities were held by private investors. Such payment does not upset the annual calculations of actuarial requirements, and it leaves the securities free to be marketed if the need should arise. Cancellation is advisable, however, when optional term bonds are purchased by the sinking funds accumulated for their retirement.²²

A periodical survey should be made of the market value of the securities which are held in the sinking funds. This is particularly desirable if sinking funds are invested in securities other than those issued by the city. A city should, as a matter of course, keep informed concerning the market value of its own obligations. This investigation of the current worth of investments should be made at least semi-annually. Unless the sinking funds have been loaded with low grade securities, however, it is well, in making reports of sinking fund assets, to list investments at par value. Only one city in the group studied follows the policy of quoting these investments at market value.

²²A city may invest in its own outstanding bonds by buying for one sinking fund the various securities of issues other than that to be retired by that particular sinking fund; see *Elser v. City of Fort Worth*, 27 S.W. 739 (1894). There is some question, however, concerning the rights of a city to buy into a sinking fund and to hold for investment purposes the securities of the issue which that particular sinking fund was created to retire. It is a common opinion that the meeting of an evidence of indebtedness and the fund created for its retirement constitutes a cancellation of the evidence of indebtedness. If this is the case, securities which are purchased by the fund created specifically for their retirement should not be held but should be canceled. As an illustration of this opinion, the office of the Attorney General requires city officials to make a statement to the effect that none of the bonds of any issue which is to be refunded have ever been the property of the sinking fund created for their retirement; this requirement is made as a result of the opinion that obligations become invalid when purchased by their own particular sinking funds.

The greatest caution should be observed in the handling of securities which are owned by sinking funds. Just as it is important for a city to demand security for its cash deposits, it is important to assure the safety of its investments. Sinking fund securities should at all times be kept in a vault or safety deposit box. Access thereto should be limited, and at least two responsible city officials should be present each time the vault or deposit box is opened.

As an added measure of protection, securities purchased as sinking fund investments have, in some instances, had an inscription stamped on them in order to impair their negotiability. For example, one Texas city stamped the following sentence on bonds held in its sinking funds: "This bond is owned by the Interest and Sinking Fund of the City of _____ and is not negotiable." This city once endeavored to sell a number of stamped bonds from its sinking funds only to find that a special certificate of release was necessary, that dealers and investors regarded with disfavor the purchase of securities which could be made marketable only through an unusual procedure, and that the marketability of the bonds had been seriously impaired. While the stamping of sinking fund securities as a protective measure may be advisable in cases in which there is no doubt that the city will hold these investments until maturity, the securities should not be stamped if there is any possibility that they may be sold from the sinking fund at a later date.

The use of sinking funds as a source from which to obtain short-term loans and as a place for disposing of new bond issues should be very definitely limited. The convenience of securing loans for current expenses from sinking funds is apparent. Cash balances in sinking funds are limited, however, and are easily depleted if used as sources of short-term capital during times of unusual need. The city, furthermore, is placed in the unique position of being its own creditor and may not be meticulous in repaying the loans promptly. It is through ostensible loans of this variety that many unjustifiable and illegal raids have been made on sinking funds.

The use of the sinking fund as a purchaser of new bond issues, however, may be desirable if the usual rules for acquisition of sinking fund investments are applied. The legality of an issue so purchased should be attested just as though the issue were to be sold on the open market, for the time may arrive when it will be desirable to sell the bonds from the sinking funds, and not only their marketability but the credit of the city will be injured if any doubt exists concerning their legality. Moreover, bond dealers who know that the city is prepared to purchase its own new issues are likely to make better bids than if this evidence of confidence is absent.

Retirement of debt by the use of sinking funds entails a number of undesirable features. It is practically impossible to secure uniformly efficient administration of sinking funds, particularly in small cities. In a number of municipalities these funds have been raided to pay current expenses, in some instances maliciously and in others unwittingly. The statutes contain no adequate provision for sinking fund contributions based on a scientific, actuarial formula. The possibilities of bank failure and of loss of sinking fund investments are ever-present contingencies. Even though a sinking fund is properly administered, it requires considerably more time and involves greater overhead expense than is required in the annual retirement of serial bonds.

Every effort should be made to secure efficient administration of debt payment regardless of existing circumstances. That debt payment involves diverse problems in different cities is indicated by the municipalities included in this survey. The annual totals of interest and principal payments of these cities from year to year are expected by 48 per cent to remain approximately the same, by 39 per cent to decrease, and by 13 per cent to increase. Regardless of the trend of total yearly charges, however, the requirements of good procedure should be observed.

Adequate records and reports should be kept available for use by the official who has charge of debt payment. Contributions to debt retirement funds should be based on

accurate computations, and disbursements from the funds should be made only for payment of interest or principal or for purchase of securities as investments. The canceled evidences of indebtedness should be audited and handled with the greatest of care. The city depository should be chosen first with the objective of providing for the safety of deposits and second with that of collecting interest on the amounts deposited. Sinking funds should be given individual consideration, and their annual contributions should be computed on an actuarial basis. Moreover, the sinking funds should be operated as productive assets and should be considered inviolable, being used only for the retirement of the bonds for which they were created. Finally, the administration of debt payment should be marked by an honest handling of funds, an intelligent approach to each problem, and a sincere effort on the part of the city to pay its debts in the manner agreed upon.

CHAPTER V

THE CITY'S PART IN DEBT ADMINISTRATION

The principles discussed in the present chapter are designed to aid a municipality in attaining the credit position to which it is entitled by virtue of its economic condition and the efficiency of its government. The following suggestions, therefore, are not limited to any one field of action, but on the contrary cut across the subjects treated in the preceding chapters, including in addition reference to certain matters not previously discussed. It is the purpose of this chapter to serve as a focal point for information of use to municipal officials as administrators of indebtedness. In the pursuit of this purpose, it duplicates in some measure some of the earlier chapters, though the shift in emphasis minimizes the repetition, as the change in point of view appears to warrant it.

There is no panacea which will act as an instantaneous remedy for all the ills of funded debt administration in Texas municipalities. A solution cannot come overnight but must be evolved by thoughtful action and hard work on the part of city and state officials. City officials, in particular, are in a position to take the first steps in the direction of more efficient management of municipal indebtedness. Any betterment of local debt administration should result in the issuance of more desirable securities, an improvement of the credit position of the city, and an adjustment of the time of sale to the condition of the security market. Improved local procedure, as one factor affecting the bond market, therefore should enable cities to obtain loans at rates of interest relatively lower than they must pay at present, and the interest rate is one criterion by which to judge the effectiveness of the management of local indebtedness.

Municipal administrators too often follow the path of least resistance until the date arrives for the issuance of a new block of bonds. There is no one time to prepare

for the issuance of securities; preparation must be a continuous process if city officials are to avoid a futile, last-minute attempt to obtain a desirable bid. This unceasing preparation should include not only an application of the principles of bond issuance and retirement which have been discussed above, but also a thoughtful and methodical handling of the problems which arise from day to day.

City officials, in the first place, should understand the importance of installing and perpetuating sound methods of fiscal procedure, since it is only through the operation of such methods that a city may be expected to maintain a currently satisfactory financial condition. Second, city officials should study each proposed bond issue separately with a view to incorporating into each the features which best serve the interest of both city and prospective investors. Local administrators, in the third place, should keep in mind the data desired by the agencies or individuals who are interested in municipal indebtedness and should make this information readily available to all such parties. This chapter is devoted to a discussion of the extent to which procedure along these three lines may be employed to improve the administration of municipal debt in Texas.

The formulation and use of an annual budget is an absolute prerequisite to good city government. Careful planning of administration, extensive control of current operations, and conservative estimates of the cash position of each debt retirement fund are all characteristics of a budget system and are indicative of the paramount importance of a budget to any adequate program of debt administration. Many cities which claim to use a budget operate under incomplete and ineffective systems and thus fail to gain the benefits which ordinarily may be expected to result from the use of this most important of administrative aids. A guide to proper budgetary procedure has been prepared expressly for use by Texas city officials.¹ The acuteness of

¹See *A Budget Manual for Texas Cities*. This monograph was published by the Bureau of Municipal Research of The University of Texas in 1934.

the need for the budget in Texas municipalities is emphasized by the fact that while many of the systems which are now in operation are sadly defective, 14 per cent of the cities included in this survey make no use whatever of budget methods.

A long-term financial program is necessary not only to the development of a workable debt structure but also to the actual physical growth of a city. Through use of a program of this type, an even spread may be obtained for debt maturities, and bond issues may be sold when the market is favorable. Moreover, construction work may be initiated when building costs are low, and public improvements may be made at the most desirable time. Equally important, however, is the fact that through use of a long-term program a workable set of city plans may be formulated and used to guide the physical growth of the city. Many cities of this state offer mute testimony to the absence of long-term planning. These cities have crooked, confusing streets and poor sewer and water service as a result of the lack of a rational program to guide construction work. Furthermore, many of them, for the same reason, must labor under unbalanced and expensive debt structures. Of the Texas cities studied, 79 per cent have no long-term plan. The benefits to be expected from the use of this type of plan are obvious. Directions exist for its formulation and administration.²

An efficient tax system should be installed and used. It hardly stands to reason that the full blame for the high percentage of tax delinquency found in many Texas cities during the depression should be placed exclusively on poor business conditions. The apathy of tax officials who labor under antiquated methods must be named as an important contributing factor. The Texas cities which sought constantly to increase the effectiveness of their tax departments during the period of economic stress proved, by

²See C. E. Rightor, *The Preparation of a Long-term Financial Program* (Publication No. 5, Municipal Administration Service, New York, 1927), 28 pp.

maintaining reasonably high collections, that city governments need not be wholly at the mercy of the vagaries of economic conditions. The principles of a sound tax system, with particular reference for present purposes to the matter of collection, should be applied regardless of business conditions and should not be considered merely a bulwark upon which to depend during depressions.³

Texas municipalities, without exception, should install adequate accounting systems. The keeping of books is not a goal within itself, but is a means to an end and should be so regarded. A scientific and orderly system of records should be designed to furnish information to serve as both a check on and a pattern for official activities, and to preserve facts; furthermore, the records should be so kept that they may at any time be analyzed and understood by an accountant who is not connected with the city government. A number of municipalities in this state, particularly some of those in the higher population brackets, have developed excellent accounting systems. Many of the systems now in use, however, are cumbersome, antiquated, and ineffective. Fortunately, officials of small as well as large cities now have available complete directions for the installation and use of an adequate accounting system.⁴

Cities may improve their administrative procedures and credit positions along a number of miscellaneous lines. Considerable financial assistance, for example, may be obtained through recourse to revenues other than those accruing from the property tax.⁵ Most municipalities could synchron-

³See *A Manual of Tax Collection Procedure for Texas Cities*. This monograph was published by the Bureau of Municipal Research of The University of Texas in 1935.

⁴See Carl H. Chatters, *Accounting Manual for Small Cities* (Publication No. 1, Municipal Finance Officers' Association, 850 East Fifty-eighth Street, Chicago, 1933), 79 pp.; Walter O. Harris, *A Municipal General Ledger* (Publication No. 2, Municipal Finance Officers' Association, 1934), 44 pp.; and League of Minnesota Municipalities, *A Uniform Accounting System on a Double Entry Basis* (Minneapolis, May, 1934), 29 pp.

⁵See *A Revenue System for Texas Cities*. This monograph was published by the Bureau of Municipal Research of The University of Texas in 1935.

ize and greatly simplify their activities by effecting a correlation of their tax collection year, their budget year, their accounting year, and their dates for debt payment. It should be the policy of those governing the city to strive for a workable organization structure and to select an efficient corps of city employees. Finally, local officials should cooperate with state departments both in filing annual reports at the capitol and in meticulously observing the legal requirements incident to the issuance and retirement of bonds.

Consideration should be given each provision which may be incorporated into an issue of securities. The routine of security issuance, the management of debt payment, and the use of effective general administrative principles are, individually and collectively, highly important. It should be remembered, however, that the contractual provisions contained in the securities also are of first significance. When a city sells securities, it is selling merchandise, and every effort should be made to have available for sale the kind of merchandise which will bring the best price and which will fit most aptly into a workable program of debt retirement.

Time warrants should be used very sparingly. With the exception provided in the Bond and Warrant Law of 1931, which makes it possible for taxpayers to petition for a referendum vote on time warrants issued in excess of specified amounts, these instruments of indebtedness need not be validated by a vote of the electorate and thus have neither the prestige nor the widespread appeal possessed by bonds; hence they may be expected to bear a higher rate of interest than bonds. Cities should make it a policy to issue time warrants only in case of emergency, for notes and short-term loans should suffice for all ordinary capital needs not satisfied by bond issues.

When a remunerative enterprise is to be financed, investigation should be made of the relative desirability of issuing bonds payable from taxes or from revenues of the enterprise. The market price of a credit instrument reacts sensitively to the source of its payment. Bonds payable from

property taxes generally are considered more desirable by creditors than those payable from utility revenues, though according to some city officials this is not invariably the case. If tax bonds sell at a more advantageous rate, it may be desirable to issue tax bonds and, as the statutes provide, repay these bonds in so far as possible from utility receipts.⁶ When this procedure is followed, no extra burden is thrown on the taxpayers if the operation of the utility results in collection of the expected amount of revenue. The tax feature serves merely as an underwriting arrangement which improves the marketability of the bond. If, on the other hand, revenue bonds may be sold as advantageously as general obligation bonds, it is desirable to issue revenue bonds and thus relieve the taxpayers of the contingency of ever having to repay loans for utility purposes. The issuance of another variety of self-liquidating bond, the special assessment bond, should be marked by observance of drastic restrictions. Too often have these bonds served as subsidies to real estate speculators.⁷

It is greatly to be preferred that bond issues be made to mature serially. If an issue of straight serial bonds and an issue of term bonds, each of which covers an identical period of time, are sold at the same yield, the serial issue is less expensive to retire, for its average life is shorter than that of the term issue.⁸ Serial bonds, furthermore, may generally be expected to bring a better market price than term bonds for the reason that investors are acquainted with the perils which accompany the management of term bond sinking funds in most municipalities and for the further reason that serial bonds offer a wide range of maturities and thus satisfy the needs of a greater number of investors than term bonds. The use of serial bonds also relieves the municipality of the extra overhead costs and

⁶*Revised Civil Statutes*, Art. 1106.

⁷Arthur C. Myers, "Municipal Debt Administration—A Recommended Policy," *Texas Municipalities*, Jan., 1936, p. 15.

⁸Luther Gulick, "Debt Administration," in A. E. Buck, Editor, *Municipal Finance* (The Macmillan Co., New York, 1926), pp. 485-489.

risks of loss which are incident to the retirement of term bonds.

The issuance of straight serial or of serial annuity bonds should depend upon the circumstances expected to prevail during the period of repayment. It is customary for an equal amount of straight serial bonds to be retired each year. In this case, the outstanding principal amount is regularly pared down; consequently the interest payments decrease from year to year, and each total annual debt service charge, principal payments plus interest payments, is smaller than the preceding one. On the other hand, serial annuity bonds (sometimes called level tax bonds) are retired in such a manner that principal payments increase each year in an amount approximately equivalent to the annual decrease of interest payments. In this manner, the total debt service charges remain practically constant from year to year.

The total cost of retirement of a serial annuity issue is greater than that of a straight serial issue of the same size in those instances where the two extend over an identical period of time, for the average life of the serial annuity bond is longer.⁹ A serial annuity issue may not be expected to bring as good a price as a straight serial issue if the demand for short-term securities is great because it has a smaller amount of early maturities than a straight serial issue of the same size. Its greater simplicity, shorter average life, and decreasing gross annual payments make the issuance of a straight serial bond, in most cases, preferable to the issuance of a serial annuity bond. If, however, a situation exists in which a municipality is likely to find it difficult to pay the relatively large initial maturities on a straight serial issue, the use of serial annuity bonds may prove a desirable solution.

Bonds should be made callable only when it is to the advantage of the city to make them so. Inclusion of the callable feature in the bond contract constitutes a concession for which the city must expect to pay in the form of

⁹Committee on Municipal Borrowings, *A Model Bond Law*, pp. 149-150.

a higher net rate of interest than would otherwise obtain. This disadvantage, however, may be worth accepting if the current market rates are extraordinarily high or if the city's credit is temporarily impaired. If it may reasonably be anticipated that an issue can be refunded or replaced during the proposed callable period at a rate of interest substantially lower than that borne by the original securities, the callable feature may well be included if its cost is not prohibitive. The callable feature gives the city better control over its funded debt, making possible a subsequent consolidation of the debt structure or rearrangement of maturities. When the privilege of optional retirement is being considered, all relevant facts should be weighed, and if the privilege is to be written in, the bonds should be made callable neither too early nor too late to serve the desired purposes.

Miscellaneous features of bonds are important and each should receive careful attention. Coupon bonds, which are desirable because of their simplicity and universal usage, have come to be issued in Texas to the exclusion of registered bonds. If an entire issue is to be sold locally to investors who expect to hold the securities permanently and if interest and principal payments are to be made locally, it may be desirable to issue registered bonds, which are less expensive to print than coupon bonds. Populous cities which have a large volume of coupon bonds outstanding may increase the marketability of their securities by making them registerable at the option of the holder. If bonds are registerable, the context should state whether a charge is made for registration and what steps must be observed in order to transfer a registered instrument.¹⁰ The negotiable character of a registered bond is temporarily suspended, thus extending protection to the owner in case of loss or theft. Bonds should not be made registerable by small cities, however, for such municipalities do not have a sufficient volume of indebtedness to make the process

¹⁰Committee on Municipal Debt Administration, *Marketing Municipal Bonds*, p. 4.

profitable and ordinarily they are not equipped to handle the additional work which registration necessitates.

The date of bonds should be fixed as near the time of sale as possible in order that the dealer who purchases the securities will not be forced to speculate on the future market or to pay a large amount of accrued interest. The interest payments on the bonds should be made semi-annually, for investors have become accustomed to expect their interest earnings twice a year. Of the new issues which were sold by the cities studied during the ten-year period 1925-1934, 98 per cent contained provision for semi-annual payment of interest.

The denomination of a bond ordinarily should be one thousand dollars. This size is preferred because it has a wide appeal to purchasers, is simple to administer, and involves smaller printing costs than an issue divided into smaller denominations. Of the total number of bond issues sold during the decade 1925-1934 by the cities studied, 94 per cent were of one-thousand-dollar denomination.

Finally, the bond context should contain provision for payment of principal and interest maturities in one of a few prominent banking institutions in New York City unless the entire issue is to be sold and held locally.

City officials should investigate the types of information which may be desired by those interested in municipal indebtedness. Security owners and bond brokers, in their search for a basis for estimating the worth of local obligations, frequently appeal directly to the municipalities for aid. Knowledge of administrative conditions gives an indication of the probable attitude of city officials toward debt administration and thus is important to creditors. If the debt problem is likely to become a plaything of politicians, the security owners must suffer. Information relative to any peculiar legal provisions under which a municipality operates also is of direct interest to creditors. This legal information, with the exception of charter provisions in home rule cities, is available in the state statutes and constitution. Unusual charter provisions should be explained to all who are interested.

The most important class of facts which city officials are in a position to furnish, however, concerns local fiscal conditions. The manner in which such data may be made available is of sufficient importance that it is desirable to dwell briefly on each of three classes of essential information relative to this subject.

Data on a city's current financial situation should be readily available. Property valuation, which represents the wealth upon which both funded debt and current governmental activities must rely for support, is of direct concern to creditors; moreover, a division of valuation into that assessed on real and that on personal property also is important inasmuch as these two classes of property are of distinctly different natures. The proportion of true value at which property is assessed for tax purposes also is significant, for through its application to assessed value, an estimate may be made of full value. An analysis of the tax rate is particularly important to the creditors of Texas cities since the tax contribution to each debt retirement fund is made from a separately levied portion of the rate.

Data relative to the yearly amounts of tax levies and tax collections are significant both to those interested in debt and to those concerned with day-to-day municipal services. The current collections for each year should be compared with the levies of each corresponding year in order to indicate the effectiveness with which taxes are collected. Outstanding delinquent taxes are of interest inasmuch as they also constitute a potential source of cash receipts. A report of these past-due amounts should be analyzed according to the years in which they became delinquent, for the portion which recently has become delinquent is more readily collectible than that which is past-due a number of years.

Budget information relative to current operating expenses is desirable in order to gain an indication of the efficiency with which the city is performing its usual governmental services. Budget data should, of course, indicate the relationship existing between total receipts and expenses.

Finally, the status of current and floating debt is of direct concern to holders of city securities. Short-term obligations

are more immediately sensitive to economic or administrative conditions than are funded obligations, and any undue increases in the amounts of short-term obligations are properly regarded as an encroachment upon the resources of funded debt.

A report on current finances should be accompanied by an analysis of outstanding funded debt. In order to form an estimate of the ability of a municipality to meet its debt payments, one must have a knowledge of the amount and characteristics of the outstanding funded debt. In the first place, the outstanding obligations should be classified according to their source of payment. Self-sustaining securities should be analyzed separately from tax supported obligations. Time warrants should be analyzed separately from bonds. The desired information concerning each of these types of outstanding funded debt includes, for each individual block of securities, the purpose of issue, the date of issue, the date of maturity, the type of maturity (serial or term), the rate of interest, the terms of option, the dates of interest payment, the denomination of securities, the amount of original issue, the amount outstanding, the total debt payment fund assets, and the name of the New York fiscal agent. A recapitulation should contain the gross funded debt, from which should be deducted both the gross self-sustaining debt and the debt payment fund assets of the tax supported securities. The final figure will be the net debt.

Data on city indebtedness, to be complete, must include information relative to the debt of other governmental jurisdictions which take in part or all of the territory within city limits. The depression has focused attention on the fact that taxpayers may be held responsible for the payment of more debt than that owed by their particular city. Twelve distinct types of local districts, other than counties, which owe funded debt are enumerated in the report of the State Auditor.¹¹ Each of these special jurisdictions incurs indebtedness, levies and collects taxes, and

¹¹*Report on Taxes and Indebtedness of Local Units of Government in Texas for 1934*, p. 7.

makes debt payments. Each is a separate entity and has recourse against taxpayers who own property within its limits. Obviously then, the ability of taxpayers to repay city loans depends not only on the size and arrangement of the debt of the city but also upon the debt of overlapping special districts.

County indebtedness, of course, invariably overlaps that of some cities and towns. Only 11 per cent of the cities studied, however, have no other overlapping debt than that owed by the county. Each of the remaining cities is included, either wholly or partially, within the boundaries of from one to six special districts. Of these cities, 46 per cent are overlapped by one, 25 per cent by two, 15 per cent by three, 8 per cent by four, 3 per cent by five, and 3 per cent by six special districts. Of these special districts, 48 per cent are independent school, 23 per cent are road, 13 per cent are the various types of water, 8 per cent are drainage, 4 per cent are navigation, 2 per cent are levee, and 2 per cent are irrigation districts. The number of these special districts and the regularity with which they overlap cities indicate that any report on municipal indebtedness is incomplete if it contains no information relative to the amount and types of overlapping debt.

A number of Texas cities have found it advantageous voluntarily to furnish bond dealers and city creditors accurate fiscal information. The spirit of openness and coöperation exhibited by these cities acts to improve their credit positions. It is most desirable for city officials to coöperate with private agencies which compile municipal credit reports for bond dealers and security holders, for these reports are relied upon extensively. Even though a city may be experiencing the ill effects of a depression, it has nothing to gain by being secretive in regard to its financial condition. Nine of the cities which were visited had either printed or mimeographed financial statements available for distribution. The length of these statements, of course, varies with the size of the city and the number of security issues outstanding.

On a single printed sheet, the City of Plainview made a rather complete statement as of March 1, 1935 (see Exhibit D). This report contains for a six-year period information concerning the assessed valuation, tax rate, amount of levy, percentage of delinquency, gross water and sewer receipts, water and sewer operating expense, and water and sewer operating profit. The report further contains for each outstanding security issue the purpose of issue, the date of issue, the rate of interest, the original amount of issue, the amount redeemed, the balance outstanding, the maturity date, and the dates of interest payment. Finally, it contains data concerning population, the division of valuation into that assessed on real and that on personal property, the ratio of assessment, the deductions from bonded debt, the net bonded debt, the amount of cash in banks, and the amount of the city's own bonds held in its sinking funds.

The value of this type of report is readily apparent; the city secretary does not have to go to his books each time he receives one of his numerous requests for information, but merely sends a prepared report to the inquirer. Finally, however, there is one bit of information which was not included in any of the reports obtained from cities of this state: none contained information relative to overlapping debt. Although overlapping debt is neither a direct nor a contingent liability of the city government, it is an obligation which must be paid by the same citizens who pay taxes to the city. Information in regard to overlapping debt, therefore, is highly desirable in a city report, for this information gives an indication of the amount of public debt borne by the citizens.

City officials should take advantage of every opportunity to improve financial methods, debt structures, and techniques of reporting information. The inauguration and use of sound administrative procedures have a direct and powerful bearing not only on the issuance and payment of securities but also on the management of current operations. The various provisions which are included in the text of securities as part of the contractual agreement with

EXHIBIT D*

FINANCIAL STATEMENT, CITY OF PLAINVIEW, TEXAS, AS OF MARCH 1, 1935

	1934-35	1933-34	1932-33	1931-32
Estimated Actual Value all Property.....	\$9,000,000.00	\$9,000,000.00	\$10,000,000.00	\$10,000,000.00
Assessed Valuation, 75% Basis.				
Real Estate, \$4,753,650.00.				
Personal Property, \$941,817.61.				
Total.....	5,795,467.61	5,805,865.00	6,547,132.00	8,309,022.00
Population Official (1920, 3,940) (1930, 8,834).				
Population estimated.....	8,800	8,800	8,500	8,500
TOTAL BONDED DEBT OUTSTANDING	\$ 597,000.00	\$ 601,000.00	\$ 610,000.00	\$ 622,500.00
Deduct Sinking Fund Bonds..... \$ 21,000.00		19,000.00	4,000.00	
Deduct Water Fund Bonds..... 10,000.00		10,000.00	10,000.00	
Deduct Water and Sewer Debt on Revenue Property..... 265,000.00		270,000.00	276,500.00	278,000.00
Deduct Cash in Interest and Sinking Funds.. 34,143.35		26,673.22	15,464.70	6,120.98
Total Deductions.....	330,143.35	325,673.22	305,964.70	622,500.00
NET BONDED DEBT.....	266,856.65	275,326.78	304,035.30	338,379.02
NET BONDS OUTSTANDING.....	566,000.00	572,000.00	596,000.00	622,500.00
NET BOND DEBT OUTSTANDING, PER CAPITA.....	64.32	65.00	67.73	70.74
CASH ON HAND IN BANKS				
INTEREST AND SINKING FUND.....	34,143.35	26,673.22	15,464.70	6,120.98
GENERAL FUND.....	44,752.72	35,310.82	25,320.74	36,657.71

TAX COLLECTIONS

WATER AND SEWER DEPARTMENT

Year	Assessed Valuation	Rate	Levy	Per Cent Delinquent	Fiscal Year	Gross Receipts	Operating Expense	Operating Profit
1929	\$8,113,429.00	\$1.75	\$141,935.02	2.7%	1928-29	\$51,924.07	\$38,683.20	\$13,240.66
1930	8,676,189.00	1.64	142,289.41	6.8%	1929-30	59,162.87	44,021.56	13,141.31
1931	8,309,022.00	1.50	124,635.33	14.1%	1930-31	56,490.82	29,616.16	26,874.66
1932	6,547,132.00	1.50	98,206.35	11.7%	1931-32	51,076.00	22,596.17	28,479.83
1933	5,805,865.00	1.50	87,087.97	21.8%	1933-34	44,572.08	18,087.07	26,485.01
1934	5,795,467.61	1.45	84,034.27	28. %	1934-35	48,182.95	20,750.54	27,432.41

DEBT SCHEDULE

Kind Of Bond	Issued	Rate	Amount	Paid	Balance	Due	Interest Date
Sewer Ext.	9- 1-09	5	\$ 20,000	\$	\$ 20,000	40 Yr.	4, 18-10, 18
City Hall	10- 9-10	5	10,000		10,000	"	4, 18-10, 18
Sewer and Water	10-18-12	5	10,000		10,000	"	5, 18-11, 18
St. Imp.	10-18-12	5	12,000		12,000	"	5, 18-11, 18
St. Imp.	3-19-17	5	40,000		40,000	"	3, 19- 9, 19
Sewer	6-10-21	5	75,000	27,000	48,000	Serial	6, 10-12, 10
Water	6-10-21	5	9,000	9,000	16,000	"	3, 1- 9, 1
Auditorium	9-15-21	5	60,000	21,000	39,000	"	3, 1- 9, 1
Refund, 1926	9- 1-26	5½	216,000	10,000	206,000	"	3, 1- 9, 1
St. Imp. 1927	6- 1-27	5	30,000	3,000	27,000	"	3, 1- 9, 1
Water 1927	6- 1-27	5	25,000	3,000	22,000	"	3, 1- 9, 1
Sewer 1927	6- 1-27	5	20,000	4,000	16,000	"	3, 1- 9, 1
Refund. 1929	8- 1-29	5	51,000	5,000	46,000	"	2, 1- 8, 1
Refund. 1930	2- 1-31	5½	80,000	4,000	76,000	"	2, 1- 8, 1
Sew. Rev. 1934	6- 1-34	5	9,000		9,000	"	6, 1-12, 1
Totals			\$683,000	\$86,000	597,000		

Held by City: Auditorium	\$ 6,000
Held by City: St. 1927	11,000
Held by City: Water 1927	6,000
Held by City: Refdg. 1931	8,000
Held by City: TOTAL	31,000
NET BONDS OUTSTANDING	\$566,000

Warrants—None. Script—None. Defaults—None.

I certify the above to be correct, as shown by the Records of the City of Plainview.

(Seal)

Signed: P. H. BRYAN, City Tax Collector.

Signed: J. L. GALLAWAY, City Treasurer.

*Reproduced through the courtesy of Mr. J. L. Gallaway, City Treasurer of Plainview, Texas.

creditors are, individually and collectively, of paramount importance, and each should be given the closest scrutiny. Finally, the spirit of city officials in making information freely available to each of the other groups or agencies interested in municipal debt is coming to be recognized as a factor which exerts a pronounced influence on the credit position of the city.

Municipal officials have the opportunity of demonstrating increasingly greater efficiency in coping with their innumerable problems. The rise of a feeling of professional consciousness on the part of city finance officers, as evidenced by their activities in the Municipal Finance Officers' Association, is a strong indication of their determination to exchange ideas and to familiarize themselves with improved methods of procedure. It is largely through the cultivation of this professional spirit on the part of local finance officers that taxpayers may expect the cause of economically administered municipal services to be carried forward.

CHAPTER VI

THE STATE'S PART IN DEBT ADMINISTRATION

Although municipalities can accomplish much through their independent efforts, they remain dependent upon state assistance for a complete solution of the problems which relate to funded debt. Municipalities must rely upon state action for a sound statutory basis for issuance and payment of securities as well as for protection against default and shoddy administration in other units of local government within the state. State action may consist of more than mere legal directions which govern the issuance, sale, and redemption of local obligations; for example, fiscal reports may be required, central agencies may give counsel to local officials, or administrative bodies may actually control local indebtedness. The desirability of strong administrative control by a state agency is debatable, though the subject unquestionably merits serious study.

Any change in the legal background of local securities should be founded on a thorough analysis of the debt status of the various municipalities. Reform movements often run to a blind enthusiasm which fails to take into account existing circumstances. Legislative reform should be founded on definite information concerning actual conditions as well as on an observable need for improvement.

A debt limitation is preferable to a maximum tax rate. Texas municipalities are restricted in the amount of the total tax rate which may be set.¹ This limitation serves only indirectly to control local indebtedness, however, since it is a restriction on the amount available for debt payment rather than on the amount of debt which must be repaid. Tax limitation in Ohio has furnished vivid examples of the myriad difficulties which have been felt by a few municipalities of this state. The recently imposed drastic limitation on the tax rate of Ohio cities came at a time of increasing indebtedness and falling property valuations. As

¹*Revised Civil Statutes, Arts. 1027-1028.*

a consequence, cities in that state have had practically no opportunity for rapid debt retirement, have found the general property tax much less reliable than formerly, and have had to depend partially on a sales tax which is reported to have increased the total tax burden of many small home owners.²

A tax limit, far from acting to guarantee payment, serves to impair the fundamental resources for retirement of all general obligation securities which have been or which may be issued. Thus a tax limit serves to lower the marketability of municipal obligations and, consequently, to increase the rate of interest which must be paid upon them. Perhaps the most significant example of the effect of a tax limit on the marketability of municipal securities is found in the laws of the State of New York which govern the investment of the funds of savings banks in that state.³ This provision specifies that no municipal instrument of indebtedness issued after the year 1938 shall be an authorized investment for the moneys of savings banks unless the municipality which issues the instrument has the power to levy taxes, without limitation of rate or amount, on its taxable real property for the payment of the obligation. In 1938 a considerable volume of Texas securities will become ineligible as investments for New York savings banks unless a constitutional amendment is enacted which will make it possible for cities to levy unlimited taxes on real property for retirement of valid debt.⁴ Such an amendment should, of course, be accompanied by a limit on the amount of municipal indebtedness. The marketability of Texas municipal securities will be seriously impaired unless they remain eligible as investments for New York savings banks.

²George L. Leffler and G. Burman Curry, "Ohio Cities Battle Depression and Tax Limitation," *National Municipal Review*, July, 1935, pp. 391-397, 418.

³*Laws of New York, The 151st Legislature, 1928* (Albany, 1928), Ch. 446, Subdiv. 5, Par. g.

⁴See the limits on municipal taxes in *The Constitution of the State of Texas*, Art. XI, Secs. 4-5.

Indebtedness should be limited to a definite proportion of taxable valuations. Local governments are likely to over-bond themselves if no restriction is placed on the amount of debt which may be assumed. A number of cities in this state, in the absence of a direct debt limitation, have issued an excessive amount of securities despite the existence of a maximum tax rate. Although several criticisms may be directed at limitation of debt to a given percentage of property valuations, this basis of limitation possesses the merits attaching to simplicity, long usage, and extensive application.

The provisions of a debt limitation should be explicitly stated in the statutes. Limitations contained in the statutes of many states are indefinite and permit countless exceptions. Provision for the limitation of debt in accordance with valuation should indicate the maximum proportion permitted to exist, the deductions allowed from gross funded debt in order to ascertain net debt, whether the proportion is to be founded on the valuation of the preceding year or on the average valuation of a specified number of preceding years, whether calculations are to be based on full or on assessed valuation, and whether they are to rest on total or only on real valuation.

A statutory restriction of indebtedness, moreover, should limit overlapping debt as well as the debt of any one jurisdiction. Limitation is likely to be meaningless if new debt-creating districts may be formed for many different purposes. Statutes governing the investment of funds of savings banks in the State of New York provide that municipal obligations may not legally be purchased which are issued by cities the debt of which, plus a proportionate part of the debt of all overlapping debt-creating jurisdictions, exceeds 12 per cent of the valuation of taxable real property in the municipality.⁵ A statute limiting local indebtedness might well take into consideration the provisions governing the New York savings banks. In arriving at the net debt by which to calculate the indebtedness

⁵*Laws of New York, The 151st Legislature, 1928, Ch. 446, Subdiv. 5, Par. c.*

allowed, it is customary to deduct the debt fund assets of general obligation securities and the gross amounts of bond issues which are self-sustaining. Any limitation of indebtedness should cover both bonds and time warrants.

*It is preferable for debt limitation to be based on the average valuation for several years rather than on the valuation of the preceding year.*⁶ A limit which is based on the most recent valuation tends to expand municipal borrowing power rapidly during periods of rising property values in boom years and to diminish borrowing power rapidly during depression years when property values are falling. This situation encourages the issuance of securities during prosperity when construction costs are great and when interest rates are likely to be high and restricts issuance during depression years when construction costs and interest rates are likely to be comparatively low. The use of an average of the valuations for five or more preceding years affords a figure on which to base a limitation which rises slowly during boom periods and which falls equally slowly during depression years. The use of this reasonably stable base is greatly to be desired.

Legal provisions not only should limit the total amount of funded debt but should include various special restrictions. Texas taxpayers would be benefited greatly if the issuance of time warrants were prohibited except in time of disaster or grave emergency. Further, the refunding of time warrants into bonds should be made illegal in order to stop the increase of bonded debt without official sanction by the taxpayers. Restrictions should also be made on the amount of floating and current debt such as notes, tax anticipation warrants, and accounts payable. All short-term debt of each year should be redeemed from the tax collections made during the succeeding year. The amount of refunding bonds should be limited to the total of interest and principal which is to be refunded.

⁶Karl Scholz, "Municipal Borrowing and Legal Debt Limits," *National Municipal Review*, June, 1935, pp. 323-327.

Cities of Texas should, in the opinion of many bond dealers, be permitted to sell bonds for less than par and accrued interest. Bonds which may be sold at less than par often possess a wider marketability than those which must be sold at par and accrued interest. This is true both because of the psychological pull of par value and because of the desire of purchasers to protect their original capital investment by paying out no more for principal than is to be repaid at maturity. This wider marketability often makes it possible for bonds sold at less than par to be marketed at a lower net interest cost to the city than bonds sold for a minimum of par and accrued interest. If bonds may be sold at less than par and accrued interest, however, a danger exists that unethical dealers may victimize the smaller and less experienced municipalities. This contingency might be circumvented by requiring local governments to obtain bids from a number of brokers before selling an issue of bonds, by restricting the amount of commission which may be paid, and by setting a minimum limit below which bonds may not be sold. The *Model Bond Law*, for example, provides that bonds may not be sold for less than 95 per cent of par and accrued interest.⁷

Perhaps the most complex problems of local indebtedness which confront state legislatures today arise in connection with overlapping debt. The often coterminous existence of water, navigation, drainage, irrigation, school, and other special districts frequently gives rise to excessive indebtedness and to disorganized administration. Too many special districts have been created as promotional schemes rather than as jurisdictions to serve the best interests of the taxpayers. These various independent entities within a particular region should be consolidated under one management in order that their debt might be unified and thus properly administered. Judicious consolidation of overlapping jurisdictions would be an effective barrier against excessive pyramiding of local debt. City officials of this state apparently are willing to sanction consolidation and elimination

⁷Committee on Municipal Borrowings, *A Model Bond Law*, p. 142.

of these districts, as evidenced by the fact that some 79 per cent of those interviewed favor such a policy.

A number of miscellaneous items connected with local indebtedness which often assume great importance should be governed by statutory provisions. The disposition of premiums should be restricted. Perhaps it would suffice to require that each premium be placed in its debt retirement fund unless qualified officials make an affidavit to the effect that the amount of the premium must be used to pay legal, printing, or construction costs.

Provision should be made for effective management of debt retirement funds. It should be required that annual contributions to sinking funds be made on an actuarial basis. Moreover, the types of securities which may be purchased for sinking funds should be further restricted, preferably to obligations of the United States Government, of the State of Texas, and of the city administering the sinking funds. A requirement that all security issues must mature serially would, by doing away with sinking funds, prove of great value in simplifying the problems having their origin in the management of debt payment funds.

Voluntary refunding, involving the calling of optional bonds, might well be facilitated by making it possible to register the refunding bonds at the Comptroller's office prior to cancellation of the bonds which are to be called. This provision would answer the criticism of some large out-of-state bond dealers who, under the present procedure, often are adverse to placing bids on refunding contracts in Texas for the reason that the delivery date of the new refunding bonds is indefinite. If such a provision should be placed in effect, however, it should provide safeguards both for the bonds and for the receipts from their sale. The called bonds should be delivered directly from the holders to the office of the State Comptroller for redemption, and they should be canceled immediately. The proceeds from the sale might well be held in cash in a special fund by the State Treasurer pending presentation of the old called bonds.

Finally, it is to the interest of the state government to require municipalities to maintain sound current financial positions. The State of Kansas has taken an important step

in this regard in its "cash basis law."⁸ This law provides for the funding of outstanding current and floating debt which could not be paid by a given date. Under its terms all cities have been placed on a cash basis. Further, they have been forced to stay on a cash basis, for it is illegal for any debt to be created or paid which is in excess of funds actually on hand in the treasury for that specific purpose. Provisions of the act, however, do not apply to contracts and indebtedness the payment of which has been authorized by vote of the electors, nor do they apply to capital expenditures which have been authorized by the issuance of bonds as provided by law. The administration of a law similar to the Kansas "cash basis law" would be greatly facilitated by the installation of a uniform fiscal year and a uniform accounting and reporting system in the various municipalities of the state.⁹

Administrative control over municipal indebtedness, if adjusted to local needs, has much to commend it. Contrary to a widespread belief, such control by state authorities is not necessarily either distasteful in kind or oppressive in character. An outstanding authority on the subject has listed the following as the chief types of administrative control: (1) furnishing of advice and information to local officials; (2) requirement of reports from such officials; (3) inspection by state authorities of local activities without specific power of control; (4) inspection with a conditional grant of money (the familiar grant-in-aid); (5) audit of local accounts by state officials; (6) requirement of permission from state officers for the performance of certain duties by local officials; (7) authoritative review under which state authorities have the power to reject a proposed local action; (8) issuance of orders with power to

⁸*State of Kansas Session Laws, 1933, Passed at the Forty-fifth Regular Session of the Legislature of Kansas (Topeka, 1933), Ch. 319.*

⁹A digest of the legislation enacted by the various states during 1935 in regard to municipal finance may be found in Irving Tenner, *Municipal Finance Legislation* (Publication No. 50, Public Administration Service, Chicago, 1935), 44 pp.

enforce observance; and (9) partial or complete assumption of a local function.¹⁰ The centralization of local duties in state administrative authorities thus runs the gamut from the first control device, to which there would be little or no objection, to the ninth, upon which very few local officials would look with favor. There doubtless is a point somewhere along this line where municipal finance officers could obtain needed assistance on almost every problem which confronts them.

Recognizing this fact, the General Municipal Law of the State of New York creates a Bureau of Municipal Accounts in the State Department of Audit and Control. The functions of the Bureau are: (1) to formulate and install a uniform system of accounts for each class of municipality in the state; (2) to audit and examine the fiscal affairs of each city as rapidly as a limited staff will permit; (3) to prepare and distribute forms for the use of fiscal officers in transmitting a report annually to the State Comptroller; (4) to compile, from the reports received, a complete report to the Legislature, which will furnish comparative data on the receipts and their sources and the expenditures and their purposes for each municipality.¹¹ In his 1934 report to the Legislature, the State Comptroller says, with reference to the fourth function:¹²

The importance of this report can not be overemphasized. Investment firms, bankers, persons acting in a fiduciary capacity, and private investors are now using the report as a guide in the purchase and sale of municipal securities.

¹⁰See Leonard D. White, *Introduction to the Study of Public Administration* (The Macmillan Co., New York, 1926), pp. 85-87.

¹¹*State of New York, Special Report on Municipal Accounts by the State Comptroller*, Legislative Document (1934), No. 13, p. vii.

Some have suggested that such a bureau should serve as the central selling agency for all bond issues offered by the municipalities of the State. Such a state agency, the argument goes, not only would be more competent than the finance department (or officer) of the typical city, but would be able to conduct sales which would attract more bidders and so increase competition, which in turn would secure better prices for the bonds offered for sale than are now obtained.

¹²*Ibid.*, p. viii.

Last year and during the current year advance excerpts of the municipal indebtedness section of the report have been issued and have been eagerly sought by the classes of investors referred to in the preceding sentence. Purchasers of bonds are constantly becoming more critical, and the credit of a municipality, like the credit of a commercial corporation, is dependent upon the ability to meet its obligations.

Nor is administrative control unknown to other states. The "Indiana Plan," which vests broad authority over local finance in the State Board of Tax Commissioners, is known the country over.¹³ New Jersey has provided for central inspection of local sinking funds and for the enforcement of certain provisions with regard to their management.¹⁴ In North Carolina the Director of Local Government has authority, after a municipality has remained in default for six months, to prepare a refunding plan designed to remove the default and prevent its recurrence. When a plan has been perfected and has been approved by the Local Government Commission, it must be adopted by the governing body of the defaulting unit of local government. The Director of Local Government thereafter has authority to approve or disapprove the annual budget of the municipality, to demand a periodical statement of receipts and disbursements, and to require that disbursements be legally made from the proper funds.¹⁵

Such a system of state supervision over local finance has certain advantages to recommend it. First, it relieves the

¹³See Philip Zoercher, Chairman of the Indiana State Board of Tax Commissioners, *The Indiana Plan of Controlling Expenditures* (a printed pamphlet of an address made before the Thirty-first Annual Conference of State Board and Tax Commissioners and County Assessors of Indiana, Dec. 22, 1931), pp. 18-19.

¹⁴*Acts of the 142nd Legislature of the State of New Jersey, 1918* (Trenton, 1918), Ch. 266.

¹⁵*Public Laws of North Carolina, Session of 1935* (Charlotte, 1935), Ch. 124.

The various forms of state supervision over local financial affairs in Massachusetts are described in detail in a book by Royal S. Van de Woestyne entitled *State Control of Local Finance in Massachusetts* (Harvard University Press, Cambridge, 1935).

burden on the state legislature since with administrative supervision it is no longer necessary for that body to attempt to control by statute the details of local finance. At the same time the volume and cost of legislation are reduced. Second, it provides a more effective means of control over local government since administrative officials are better informed on detailed questions of administration than is the legislative body, and since control by administrative order is much more flexible and may be exercised much more readily than control by statute. The counter argument that such a system is not democratic loses its force if the legislature retains in its hands ultimate power, and merely transfers to the administrative agency certain duties of a supervisory character.

With particular reference to Texas, it may be observed that the units of local government are already familiar with certain forms of state administrative supervision. The most widely known is perhaps the system of "state aid" for the public schools. Again, to illustrate, Texas cities are required to file their budgets and debt statements in the office of the State Comptroller, and to file certain data concerning tax collection and funded debt in the State Auditor's office.¹⁶ Yet again, a municipal bond issue must be approved by the Attorney General's department, and the bonds must be registered in the office of the Comptroller. The instances cited, however, evidence a tenuous and random rather than a closely knit and highly centralized system of control.

It is likely that state administrative control over local finance in Texas will increase as time goes on, though such control need not prove oppressive or objectionable. The rapidity with which it will grow, and indeed to some extent the question whether it will grow, depends in good part upon the willingness and the ability of local authorities to discharge their financial duties in a satisfactory manner.

¹⁶*General Laws, Regular Session, 1931*, Ch. 206, Sec. 14; *Revised Civil Statutes*, Art. 838, as amended by the *General Laws, Regular Session, 1931*, Ch. 230, Sec. 1; *General Laws, Regular Session, 1931*, Ch. 279, Secs. 1-6.

Granted a capable corps of local officials, it is hardly to be questioned nevertheless that the establishment of a Bureau of Municipal Finance by the state would work to the advantage of both the state and its subdivisions, and so of the people of Texas. Ideally, such a bureau would operate as an integral part of a unified department of finance. Under the present set-up, it probably would serve its purpose best as a division of the Comptroller's Department.

Both state and municipal officials should recognize the limits of their respective spheres of activity in regard to the administration of local indebtedness. Three of the preceding chapters have dealt with the routine procedures incident to issuing, refunding, and retiring local securities while the last two chapters have dealt with suggested activities of local and state officials in regard to debt administration. The last-mentioned chapters indicate the distinct natures of the fields in which officials of these two levels of government must operate in order to develop a system of municipal debt administration satisfactory to all the interested groups or agencies. Although a state and its municipalities occupy different positions with respect to local indebtedness, the honesty and efficiency of city debt management should be among the major goals sought by both. State and local control should supplement each other, for the attainment and perpetuation of fundamentally sound and adequately administered city debt structures are dependent upon the effective coördination of the activities of the state and the municipality.

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