



A SELECTED READING

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Municipal Debt Financing

Every municipality, from time to time, must borrow money for various municipal uses. This article will give officials a general knowledge of the legal authority for municipal financing, but it should not be construed as specific instructions in this field. Municipalities should always seek the advice of municipal financing professionals, such as bond counsel, when looking for specific guidance and assistance with financing.

The threshold question municipalities must answer is who will borrow the money and issue the securities? Will the municipality do it directly or will it work through a separate public agency, authority or corporation? Once it is determined who will borrow the money, it is then necessary to determine what legal authority there is to borrow the money and what, if any, limitations exist.

Authority to Finance: Municipalities

Section 11-81-51, Code of Alabama 1975, begins with the following language: “All municipalities shall have full and continuing power and authority within the limits of the Constitution now in effect or that may be hereafter provided to issue and sell bonds ... for the following named purposes ...” The purposes enumerated (herein greatly condensed) are for work on public buildings, sanitary and storm sewers, streets, alleys, bridges, schools; or for building or purchasing utility systems; purchasing needed real estate; equipping and furnishing buildings; building garbage and disposal plants; building hospitals, prisons and police stations; providing for marketplaces, auditoriums, water works, lighting plants, cemeteries, libraries, public baths, wharves and levees, parks, fire houses and equipment, water storage facilities, and abattoirs.

Under this statute, the Legislature gave municipalities a broad and almost all-inclusive range of public projects, which could be financed through the issuance of bonds. This statute should be examined carefully to ensure that the contemplated use is included. Section 11-81-51, Code of Alabama 1975.

Sections 11-81-3 and 11-81-4, Code of Alabama 1975, authorize municipalities to issue, without an election, securities to fund or refund outstanding certificates of indebtedness, warrants or notes of such municipality issued under the provisions of Article 5 of Chapter 81 of Title 11, as amended, or a predecessor statute or combination thereof, whether the same are due at the time of such funding or refunding or at a later date. Such securities may also be issued to refund or discharge any judgment or judgments based upon such obligation. Such securities shall mature at the time or times as the governing body may determine, not exceeding 30 years from the respective dates of issuance. Taxes, licenses or certain other revenues may be pledged to payment of same.

Under the provisions of Section 11-47-1, municipalities have the right to borrow money and may issue notes or non-negotiable warrants. These debts must be payable within 12 months of issue and may be renewed. Section 11-47-1, Code of Alabama 1975. License taxes, ad valorem taxes or other revenues due or to become due within 12 months from the date of the note or warrant, may be pledged to secure their payment. Section 11-47-1, Code of Alabama 1975.

Alabama law provides that money may be borrowed for temporary or any other lawful purpose or use. Sections 11-47-1 and 11-47-2, Code of Alabama 1975. Warrants and notes may be issued as evidence of such indebtedness under the provisions of Sections 11-47-2 and 11-47-3, Code of Alabama 1975. These loans must not be for a period of time exceeding 30 years. Section 11-47-2, Code of Alabama 1975. A municipality may agree to levy annually any special tax or license authorized to be levied and to apply the proceeds of same to the payment of the notes or warrants. Section 11-47-2, Code of Alabama 1975.

The city council may also contract for the construction, extension or repair of municipal buildings, water and electric plants or systems, execute notes and warrants secured by mortgages or deeds of trust on the buildings or systems. No election is required. Section 11-47-3, Code of Alabama 1975. Warrants issued under Sections 11-47-2 and 11-47-3 may be general obligations or they may be payable solely from the rents or revenues of the project financed or improved. *State v. Mobile*, 229 Ala. 93, 155 So. 872 (Ala. 1934).

Constitutional Debt Limit

Amendment 268 (Section 225) of the Alabama Constitution of 1901, states that no municipality shall become indebted in an amount, including present indebtedness, exceeding 20 percent of the assessed value of the property therein. The amendment exempts from the debt limit those obligations issued for certain specified purposes. This amendment does not apply to the cities of Sheffield and Tuscumbia. Additional exemptions from the debt limit are found in Amendments 107 (Section 222.01 - revenue bonds), 108 (Section 222.02 - bonds issued by incorporated municipal boards), 126 (Section 225.01 - utilities in municipalities with less than 6,000 people), and 228 (Section 224.04 - industrial development). Amendment 268 (Section 225) Alabama Constitution, 1901. If the securities to be issued are chargeable to the debt limit, an investigation is required to determine if the new debt will fall within allowable constitutional limits.

Education warrants issued by the county to fund a grant program for local school districts to fund capital improvements or retire debt were not chargeable against the county's constitutional debt limit, where the county secured the warrants with a pledge of education taxes, which was a new source of funding that was not available to the general fund. School buildings that were to be acquired with proceeds of the education warrants were "public facilities" within the meaning of the statute authorizing counties to issue warrants for acquisition of public facilities, even if the county did not ultimately own the buildings. The Legislature included school buildings in the definition of public facilities, the legislature knew that school buildings were operated by local school boards, and the statute permitted the county to acquire public facilities not only for itself, but also for general benefit of the public. *Chism v. Jefferson County*, 954 So.2d 1058 (Ala. 2006).

Although this opinion was issued to a county, the ruling would apply to municipalities as well. Bonds issued by a municipality of 6,000 or more for the construction of a school building do not count against the municipality's debt limit. AGO 1998-181.

Under Amendment 126, municipalities with a population under 6,000 can issue warrants to finance school improvements without it counting against their Section 225 debt limit, so long as they pledge a tax as security for the payment of the bonds.

Necessity for Election

In certain cases, an election must be held to authorize the issuance of securities. Section 222 and Amendment 107 (Section 222.01) and various special and local amendments to the Alabama Constitution of 1901, control. Generally, all general obligation bonds, other than assessment and refunding bonds must be voted upon, whereas most revenue bonds do not require prior approval by the electorate. Warrants, as distinguished from bonds, do not require approval by election. *See, Littlejohn v. Littlejohn*, 195 Ala. 614, 71 So. 448 (Ala. 1916) and *O'Grady v. Hoover*, 519 So.2d 1292 (Ala. 1987), for distinctions and definitions of warrants and bonds.

Election Procedures

All elections, other than those held in Class I municipalities, whether regular or special, are conducted pursuant to the general municipal election laws codified at Sections 11-46-20 through 11-46-74, Code of Alabama 1975, as amended. Section 11-46-22, states that special elections shall be held on the second or fourth Tuesday of any month. The mayor is required to publish notice of any such special election at least two months prior to the date of the election in any municipality organized under the mayor-council form of government. In *Bouldin v. Homewood*, 174 So.2d 306 (1965), the Alabama Supreme Court held that the notice provisions of Sections 11-46-22 and 11-46-93, must be given primacy and full effect in considering whether proper notice was given of any municipal election, notwithstanding other Code provision. In *Ex parte Scrushy*, 262 So.3d 638 (Ala., 2018), the Alabama Supreme Court has also held that a circuit court could void a special election for failure to be held in strict compliance with state's election laws.

Municipal bond elections should, as much as possible, conform to municipal election laws found in Chapter 46 of Title 11, Code of Alabama 1975, and to the election provisions relating to the issuance of bonds found at Sections 11-81-50 through 11-81-68, Code of Alabama 1975. The Attorney General reached a similar conclusion in AGO to Hon. W. M. Bouldin, dated May 3, 1968.

Revenues

The city council must also consider the availability of funds needed to pay and retire the bonded debt as installments become due. Always an individual local problem, this decision requires planning by responsible officials. Naturally, the availability of funds, the certainty of collecting such funds and the amount which can be devoted to debt retirement are among the factors considered when deciding upon the amount of money to be borrowed.

Bonds or Warrants?

Bonds are negotiable promises to pay which may be sued upon directly. Warrants are nonnegotiable orders upon the city treasury. Generally, a general obligation bond issue must be approved by municipal voters. Warrants and revenue bonds are not subject to voter approval as a general rule. Both general obligation bonds and warrants are chargeable against the municipal debt limit.

If bonds are issued they may be sold at public or private sale as the governing body determines. If the bonds are sold at public sale, the public sale shall be either by sealed bids or at auction. The notice of the public sale must recite the proposed method of sale, the amounts to be sold, maturities, data on interest, etc. *See*, Section 11-81-11, Code of Alabama 1975, for details on the contents of notice and the manner of publication. Other exceptions may be found in specific enabling statutes authorizing the issuance of bonds for specified purposes.

Specific statutory requirements as to maturities are found in Section 11-81-6, Code of Alabama 1975. Generally, bonds, with the exception of those dealing with revenue, must be payable in 30 years. Revenue bonds must be payable in 50 years. If bonds are issued to acquire property or to make improvements, then the last installment shall be payable within the period of usefulness of the improvement.

Warrants may be issued under the authority of Sections 11-47-1 through 11-47-4 and Section 11-81-4, Code of Alabama 1975. Warrants may be sold at a negotiated price without meeting the statutory requirements of a public sale. The maturity of warrants sold under provisions of Sections 11-47-2 and 11-47-3 is 30 years. The maturity of refunding warrants authorized by Section 11-81-4 is limited to 30 years.

Temporary Financing

Municipalities are authorized under Section 11-47-1 through 11-47-4, Code of Alabama 1975, to borrow money for temporary use. The purpose of the loan and the size of the municipality determines whether the debt is chargeable to the debt limit. *See*, Amendments 268 (Section 225) and 126 (Section 225.01), Alabama Constitution, 1901. Typically, the City's financials for the preceding fiscal year and the total revenues from all sources are reviewed, and if the loan amount is less than 1/4th of the city's annual revenues, it will not count against the debt limit. If the loan is for 12 months or less and on a promissory note, no election is required. If the evidence of the loan is in the form of a warrant, no election is required. Bond attorneys recommend that all temporary loans be evidenced by warrants instead of a note if due dates exceed 12 months.

Frequently, municipalities will borrow money on a temporary basis and, before repaying all of it, will issue refunding warrants maturing over a period of time. No election is required for this type of financing. The chargeability of such debts against the debt limit is determined by the constitutional provisions mentioned before.

Bond Anticipation Notes

After bonds have been favorably approved, the governing body may issue negotiable notes for the purpose for which the bonds were authorized but not exceeding the maximum authorized amounts of the bonds. Such notes shall be general obligations and shall be payable in 12 months. The notes may be refunded by the issue of new negotiable notes as long as the final date of payment shall not be longer than three years from the date of the original borrowing. The notes may be sold at public or private sale and such notes may be repaid out of the proceeds of the sale of the bonds. Authority for such notes is found in Section 11-81-28, Code of Alabama 1975.

Authority to Finance: Public Agencies, Authorities or Corporations

The governing body may decide to finance through one of the local public agencies which has statutory power to issue securities. Many municipalities have already organized such agencies, but if none exists, then the initial step is to organize the agency. Statutory provisions exist for the organization of municipal utility boards, municipal public housing authorities, municipal industrial development boards, municipal public building authorities, hospitals, libraries, medical clinic boards, recreation boards and other similar incorporated entities. *See* the article titled "Municipal Boards in Alabama" in this publication for information on procedures for forming boards and authorities in Alabama.

Effect on Constitutional Debt Limit

Amendment 108 (Section 222.02) of the Alabama Constitution states that each public authority organized by any municipality shall, for the purposes of Sections 225, 222 and 224 of the Alabama Constitution, be deemed a separate entity and bonds issued shall not be deemed to constitute an indebtedness of the municipality. Thus, bonds issued by incorporated municipal boards generally do not have to be voted upon and are not chargeable to the debt limit of the parent municipality.

Advantages and Disadvantages

Clearly, avoiding the depletion of a city's borrowing capacity is a major advantage of using a public agency to finance needed projects. Management may be selected for special talents and on a nonpolitical basis. The governing body can be insulated, to an extent, from the responsibility of making unpopular decisions. That being said, a governing body cannot exercise complete control and surplus reserves are not unconditionally available for general municipal use. Also interest rates may be higher under this system of financing.

Plan of Financing

The authority, not the town or city, issues the securities and builds the project. If the project is a utility such as a water, gas, sewer or electric system, the authority will own and operate the system. If the project is a public building, the authority may lease the project to the "parent" city or lease it to authorized lessees other than the parent city. Leases to the parent city are on an annual basis but may be renewed. Lease rentals are fixed in an amount sufficient to retire the bonds. The bonds do not have to be voted on and may be sold at negotiated sale without offering the bonds for public sale.

Tax-Exempt Status

Whether financing is done by the municipality or by another public agency, it is important to remember that after the Tax Reform Act of 1986, private activity bonds are no longer exempt from the federal income tax, except when the proceeds are utilized to finance an industrial activity. Congress created two classes of bonds in the Tax Reform Act. 26 USCA §§ 141-150:

- public purpose bonds, which are still tax-exempt; and
- activity bonds, which are tax-exempt provided that no more than 10 percent of the bond issue is used for a private activity.
- In addition, bonds for certain activities are declared to be tax-exempt in the act.
- The constitutionality of congressional authority to tax the interest on publicly-offered long term bonds was upheld in *South Carolina v. Baker*, 485 U.S. 505 (1988).

Securities in Registered Form

Congress has adopted legislation to require that all tax exempt or municipal securities be issued in registered form. Section 41-1-7, Code of Alabama 1975, states that public entities which are authorized by law to issue bonds, warrants, notes, certificates of indebtedness or other securities are fully authorized to issue any such securities in fully registered form without coupons.

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