OPINION
59-113

June 4, 1959 (OPINION)

GOVERNMENTAL FINANCE

RE: Bonds - Debt Limit

We have examined transcript showing proceedings of the above municipality in regard to issuance of bonds and in regard to increase of debt limit. From examination of same, it is out opinion that the district has substantially complied with the applicable statutes and it is therefore our conclusion that the municipality has increased its debt limit to ten percent of one hundred percent of assessed valuation of the district and that it may now issue its bonds for the purpose expressed in the initial resolution for bond issue. In so far as there has been considerable discussion in regard to the amount of the constitutional debt limit of the district, we have gone into considerably more detail than usual in determining same as follows in accordance with financial statement of date May 25, 1959.

Section 183 of the constitution of this state provides in so far as here applicable:

> The debt of any county, township, city, town, school district or any other political subdivision, shall never exceed five per centum upon the assessed value of the taxable property therein; provided that . . . . a school district by a majority vote may increase such indebtedness five percent on such assessed value beyond said five per centum limit. . . .

Presumably the total assessed valuation of the districts as last finally equalized as determined from information given on the financial statement presented is: ---------- $10,922,868.00

> (Note: The county auditor of the county is the official local custodian of this information - see chapter 57-13 N.D.R.C. 1943. Final transcripts should therefore contain his certification as to this figure: For your convenience we are enclosing land department form used by the Board of University and School Lands in this type of transaction.)

Proceedings to increase the five percent limit as shown by the transcript are herewith and hereby found to show substantial compliance with the applicable statutes and constitutional provision and it is therefore our conclusion that the debt limit of the district has been validly increased. The debt limit of the district would be --------- 10% of assessed valuation, or in this instance ---------- $1,092,286.80

The first item shown upon the financial statement presented representing the amount apparently unpaid upon a bond issue of date July 1, 1954 is ---------- $375,000.00

The second item is: Interest from January 1, 1959 to June 1, 1959,

on $335,000.00 balance at 3% ---------- $4,187.50"

> (Note: Schlieber v. City of Mohall, 268 N.W. 445 at 450, 66 N.D. 593 states: "6 McQuillan on Municipal Corporations 42. Interest is not a debt within the meaning of debt limit provisions until it is earned and becomes due . . . . On the other hand, interest which has become due and payable is a part of the existing indebtedness in figuring the total of municipal indebtedness."

We therefore conclude that this figure should be included in determining total indebtedness leaving a total figure as of the present date of ---------- $379,187.50. The interest to become due by the same authority would not need to be and is not included in said financial statement.

Credits are included as follows:

> (a). Payments in sum of ---------- $40,000.00
>
> (b). Cash in interest and sinking fund for redemption of said bonds.

With treasurer of district ---------- $43,553.08

> (Note: Cash in sinking funds is properly deductible: See 6 McQuillin on Municipal Corporations 72, Section 2397: ". . . . And a sinking fund is a proper offset as against existing bonds in payment of which it is pledged. . . ."

As to offsetting general current obligations and general revenues due and on hand, see Anderson v. International School District No. 5. 32 N.D. 413, Darling v. Taylor, 7 N.D. 538, Jones v. Brightwood Independent School District No. 1, 247 N.W. 884. As to this specific deduction i. e. cash on hand in the sinking fund see: Williamson v. Aldrich, 21 S.D. 13, 108 N.W. 1063:

> In determining whether a city's limit of indebtedness, prescribed by Constitution Article 13, Section 4 has been reached, money in the sinking fund and applicable under the constitution only to payment of bonded indebtedness not yet matured, is to be deducted from its debt."

And see: Farrar v. Britton Independent School District of Marshall County, 32 N.W. 2d. 627, 72 S.D. 226:

> In determining whether bonds to be issued by a school district without existing indebtedness would create an indebtedness in excess of constitutional debt limit, only amount on hand to credit of sinking fund for proposed bonds and income to be derived from current sinking fund levy were deductible from amount of proposed bond issue, and money in general fund of district or other assets not set apart to meet bonded indebtedness were not deductible. Farrar v. Britton Ind. School District of Marshall County, 32 N.W. 627, 72 S.D. 226."

See also: Anno: 125 A.L.R. 1393. We thus come to and concur with

the concluding statement of the financial statement i.e. Bonded Debt Balance ---------- $295,634.42

The next item upon the financial statement if "Obtained from State School Construction Fund"

"May 1, 1957 ---------- $200,000.00

May 20, 1957 ---------- 140,000.00

December 2, 1957 ---------- 60,000.00

Total ---------- $400,000.00

There is of course some question as to whether or not the agreement entered into by this district pursuant to the project in which State School Construction funds are invested is or is not a debt within the meaning of the constitutional provision hereinbefore quoted.

In the Syllabus by the Court in Schieber v. City of Mohall, 268 N.W. 445, 66 N.D. 593, we find the statement that:

> The terms 'debt' and 'indebtedness' as used in Section 183 of the Constitution which provides that: "The debt of any county, township, city, town, school district or any other political subdivision, shall never exceed five per centum upon the assessed value of the taxable property therein; provided, that any incorporated city may, by a two-thirds vote, increase such indebtedness three per centum on such assessed value beyond indebtedness three per centum on such assessed value beyond said five per centum limit, ...' must be understood in the common and ordinary acceptance of the terms and refer to the pecuniary obligations imposed by contract upon the municipality except the obligations to be satisfied out of the current revenue.'"

(Note: However, the consideration of balancing revenues and obligations in Anderson V. International School District, 156 N.W. 54, and Jones v. Brightwood, 63 N.D. 275, 247 N.W. 884).

In Bartelson v. International School District No. 5, Portal Tp. 43 N.D. 253, we find:

> Constitutional Limitations upon the creation of indebtedness of municipalities are mandatory and are enacted to curb the taxing power and restrain excessive expenditures entailing tax burden."

In the head notes to Farrar v. Britton, 32 N.W. 2nd. 627, 72 S.D. 226, we find the statement that:

> The object of constitutional limitations on indebtedness of counties, municipalities, school districts, etc. is to protect taxpayers from the burdening of their property beyond five percent of assessed valuation thereof and such limitation deals with indebtedness and not with solvency."

We are indebted to the attorneys for the district for the statement from Farbo v. School District No. 1, (Mont.) 28 P. 2d. 455:

> 'Indebtedness' has no fixed meaning, but as used in constitutional provision limiting 'indebtedness' of political subdivision it means what is owed, irrespective of demands held against others, whether tax or otherwise."

We are indebted to counsel for the district for the citation to the annotations in 71 A.L.R. 1318 and 145 A.L.R. 1362, in regard to the question of whether or not this agreement, investment and construction constitutes a debt or does not constitute a debt of the district within the meaning of the above quoted constitutional provision. From the annotation itself and the cases there cited it would appear to generally be held under the more recent decisions that an annual rental of any building payable out of current revenues as a current operating expense does not of itself constitute an indebtedness of the district (assuming of course, that there is sufficient revenue to meet the rental as it becomes due) within the meaning of the constitutional provision. Also, an option to purchase at some future time does not constitute an indebtedness, at least until such time as that option is exercised. However, three factors remain at the present time, in the instant case. One, the supreme court of this state has not as yet passed on this question; two, the decisions from other states are not unanimous (particularly, in view of the older cases) in so holding; and, three, we must consider the practical effect of the total series of transactions herein, i.e. it seems extremely doubtful that it would be practicable from the standpoint of the district to abandon the building, or the lease or agreement by whatever name it is called after the length of time and the amount of investment therein. Thus while it is out opinion that the better view is that this agreement should be considered as a lease purchase agreement, not creating a fixed indebtedness of the district, in so far as there has not been a decision of the supreme court of this state as to this, either creating or not creating a fixed indebtedness of the district, that in computing debt limit for purposes of issuance of further obligations, from the viewpoint of the investor, this should be included as a part of the debt of the district at least until such time as the matter has been finally settled by a decision of our supreme court.

We are indebted to counsel for the district on this point informing us that:

> In this case, the school district owns the property, and whatever the contract may be called by the state, the fact is the State School Construction Fund loaned four hundred thousand dollars to the School District and the District has levied a tax to pay the loan over a period of years."

An alternative would, of course, have been to issue bonds to raise money to either pay off the obligation of the district to the state school construction fund or to purchase the state school construction fund's interest in the building, dependent upon which theory of the nature of this obligation the district is operating under. This alternative, however, was not adopted.

The next item appearing in said statement is listed as:

> Earned interest on $322,925.46 balance from April 22, 1959 to May 23, 1959 ---------- $807.25

If this item be considered as earned interest, it is obviously under the authority of Schieber v. City of Mohall (cited supra) a part of the debt of the district. If it be construed as an accrued current rent, it would appear on the authority of Anderson v. International School District, Darling v. Taylor and Jones v. Brightwood Independent School District No. 1 (cited supra) that there is a possibility of deducting therefrom accrued revenue payable therefor. (If such is to be the case, we should also examine financial statement showing all current revenues, assets liabilities and expenses.) However, in so far as it is listed as an interest item, and in view of the matters considered in the first paragraph of consideration of the nature of this agreement herein, we do not believe we would be justified in so considering it until such time as these matters have been considered by out supreme court, or in the alternative the moneys have been paid to the state school construction fund.

The next items appearing on the financial statement are as follows:

> "Credits as follows:
>
> (a) Paid on Principal April 23, 1958 ---------- $35,440
>
> (b) Paid on Principal April 22, 1959 ---------- 41,634
>
> (c) Cash with County Treasurer to credit of building
>
> fund derived from ten mill levy ---------- 11,312

It is, we believe, too clear to require citation of authorities that the amounts paid to the state school construction fund must be deducted from the initial amount hereunder.

As to the third item, it would appear that same is subject to considerably more doubt. Considering same to constitute a fixed fund held to pay off a fixed obligation, it is, we believe, arguable that same constitutes a close parallel to those sinking funds considered above in regard to bonded debt (See: authorities there cited.) Considering the basic matter herein, however, as a lease purchase agreement not constituting a debt of the district, it would probably be possible on the authority of Anderson v. International School District, Darling v. Taylor and Jones v. Brightwood Independent School District No. 1. (cited supra) to consider same as a current collected revenue available to pay on the current accruing expenses (i.e. rental for the present year), however, the argument has been advanced that the school board under the building fund statutes has discretion to use such fund for building purposes other than payment of such rentals. While we do not subscribe to such theory, the matter can only be finally settled by either supreme court decision or by payment of the moneys therein to the State School Construction Fund. In so far as the district does not choose to do so, we are unable to finally and absolutely state that same is deductible.

(See: Also Birkholz v. Dinnie. (ante)

We therefore arrive at a total net "owing" State School Construction Fund of ---------- $323,732.71

We thus arrive at the third paragraph of the financial statement. We fully agree with the first line thereof:

> Amount owing on outstanding bond issue -------- $295,634.42"

We do not agree with the second line thereof for reasons explained above and it is therefore our conclusion that said third line should read:

> Amount owing on $400,000.00 obtained from State School Construction Fund ---------- $323,732.71"

On the same basis, we do not fully agree with the third line of said financial statement and believe it should read:

> Total present outstanding indebtedness on outstanding bonds and to State School Construction Fund ---------- $619,367.13"

The next item on said financial statement is:

> Credits as follows:
>
> (a) $80,000.00 transferred from General Fund to Old Building Fund
>
> (b) $35,224.31 balance in Old Building Fund before above transfer ---------- $115,224.31

In so far as the State School Construction Fund law and for that matter, the school district building fund law, are relatively new in this state, there is no supreme court decision giving us the exact nature of the fund and obligations if any thereunder created. It is my understanding that the $35,224.31 fund referred to here represents a building fund balance prior to the state school construction fund investment. The propriety of the retention of same etc. to the present date is not, of course, at issue in regard to this bond issue at the present time. We tentatively assume that the $80,000.00 transferred to the building fund is a twenty percent transfer from general fund to building fund. I do not find statutory authority that necessarily leads to the conclusion that there are or can be two building funds, but that question at the present time also is of course not at issue. The question would therefore be whether or not these moneys could be used as an offset to either state school construction contract or as an offset to general indebtedness of the district.

We would like to call attention to the case of Birkholz v. Dinnie, 6 N.D. 511, 72 N.W. 931. The question in that case was the validity of bonds issued for the express purpose of refunding with the proceeds thereof certain municipal bonds of the city. The court recognized the propriety of refunding bonds being issued in excess of the constitutional debt limit where the old debt would thereby

necessarily be extinguished, however, held against the issue there concerned. While the factual situation there concerned is thus different than taht here concerned, it is our opinion that the reasoning is directly applicable. If we may quote from that decision:

> To give to Section 183 so lax a construction that the debt limit may be passed by the sale of refunding bonds is both dangerous and unwarrantable. Everyone must concede that if such bonds are not held to be within the scope of the prohibition the dishonesty of officials causing the loss of the proceeds of such bonds, or the loss of the money after it has been paid to the municipality, or the diversion of it to some other public purpose, may leave the old bonds unpaid and thus the constitutional inhibition will be violated and yet the new bonds will be valid. . . . .
>
> We think that the mere execution of refunding bonds may be authorized even beyond the debt limit and that they may then be put on the market and sold on the condition that they are not to be delivered until an equal amount of the old bonds are surrendered. The resolution might provide that simultaneously with the delivery of the refunding bonds and the payment of the cash therefor, there should be at hand an equal amount of the old bonds to be then and there extinguished by the use of the cash so received and delivered up to the city as part of the same transaction. But the purpose of the city officials is something radically different from an exchange or a sale guarded in the manner specified. Their plan is to sell the bonds of the city thus increasing the indebtedness thereof against the prohibition of the constitution and leaving uncertain the question whether the old debt will be fully extinguished or whether a dollar of it will be paid. The scheme is to pay the old debt with the proceeds of the new; but there is no absolute certainty, although there may be a probability that this will be done. Nothing short of a certainty that the debt will not be increased permanently will suffice; and even that will not suffice if it is temporarily augmented beyond the constitution limit. . . ."

Thus in the present instance, the district does have funds on hand that could be used to pay to the state school construction fund its investment. Dependent, of course, upon the exact source of the building fund moneys concerned, it is possible that the fund concerned might be bound to fulfill that purpose, although as to these two items we do not have sufficient information to definitely settle this question. The argument has been advanced by counsel for the district that this money is primarily obligated to the erection of buildings, etc., and only secondarily to the state school construction fund. This question of course will only finally be settled by supreme court decision. This, of course, is not a question of solvency of the district - it is merely a question of what is a proper offset to an existing fixed obligation of the municipality. As stated in the headnotes to Farrar v. Britton, 32 N.W. 2d. 627, 72 S.D. 226:

> In determining whether bonds to be issued by school district

without existing indebtedness would create an indebtedness in excess of constitutional debt limit, only amount on hand to credit of sinking fund for proposed bonds and income to be derived from current sinking fund levy were deductible from amount of proposed bond issue, and money in general fund of district or other assets, not set apart to meet bonded indebtedness were not deductible."

The question, of course, of the ultimate use of this fund and as to the manner the school board would exercise its discretion as to the disposal of same could, of course, be finally settled by the payment of such funds to the state school construction fund, however, this district has not chosen to do so. We thus come to the final paragraph of said financial statement which on the basis of the previous we believe should read as follows:

IV

Total Constitutional Debt Limit	$1,092,286
Present Net Existing Indebtedness	619,367
Maximum Limit of New Bond Issue	$ 471,919

In other words, it is out opinion on the basis of the financial statement submitted that the present constitutional debt limit of the municipality is $472,919.67 and that to such limit new bonds of the district would be valid. Of course as debt limit is determined as of the date of incurring indebtedness at some future time when the financial condition of the district warranted same, further bonds could be sold up to, of course, the time limit specified in section 21-0314 of the N.D.R.C. of 1943 as to the length of time for keeping unsold bonds.

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