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RESTRAINTS ON MUNICIPAL INDEBTEDNESS
IN OHIO

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To determine the restraints on municipal indebtedness in Ohio reference must be made to three different sources, namely, the state constitution, the statutes enacted by the General Assembly, and the charter of the particular municipality, if it has adopted one.

In order to understand the application of these restraints and their interrelation it is important to recall that Ohio municipal corporations, that is cities and villages, were placed in a unique position in American jurisprudence by the extensive grant of home rule powers made by article XVIII of the state constitution, adopted in 1912. The change was abrupt and radical; no longer were municipalities to be dependent upon grants of power from the state legislature. Powers of local self-government immediately and directly became vested in each municipality, without the necessity of either action by the legislature or the adoption of a home rule charter by the electors.¹

The general grant of home rule power is contained in section 3 of article XVIII:

Municipalities shall have authority to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws.

The first part of this section is of interest to us here, namely, "Municipalities shall have authority to exercise all powers of local self-government."

Under this section the supreme court has held that municipalities have power to incur debt,² to levy taxes,³ to borrow money,⁴ to issue negotiable bonds⁵ and to issue bonds secured by mortgaging the property acquired with the money borrowed and by pledging revenues of existing facilities.⁶

An express constitutional grant of power to issue mortgage revenue bonds to acquire, construct or extend any public utility is made

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2 State ex rel. Toledo v. Weiler, 101 Ohio St. 123, 128 N.E. 88 (1920).
4 State ex rel. Bruestle v. Rich, 159 Ohio St. 13, 110 N.E.2d 778 (1953); State ex rel. Gordon v. Rhodes, 156 Ohio St. 81, 100 N.E.2d 225 (1951).
5 Ibid.
by section 12 of article XVIII. Such bonds may be issued beyond the general limit of bonded indebtedness prescribed by law, provided that they shall not impose any liability upon the municipal corporation, but shall be secured only upon the property and revenues of such public utility, including a franchise in favor of a purchaser upon foreclosures of the mortgage.

The grants of power above referred to are subject to limitations imposed by, or under authority of, the constitution itself.

The constitution does not impose any direct restraint on municipal power to incur indebtedness, nor any direct limit on the amount of debt. However, it does indirectly impose a debt limitation on unvoted bonds because of the conjunction of a limit on the tax rate without a vote of the electors and a mandatory duty to provide for the levy of taxes for the payment of bonded debt. Article XII, section 2 of the constitution forbids the levy of taxes on property according to value at a rate greater than ten mills on the dollar of valuation, except by vote of the electors or when provided for by a municipal charter, pursuant to laws which may be passed by the legislature. Article XII, section 11 forbids the incurring or renewing of bonded indebtedness unless in the legislation under which it is incurred or renewed, provision is made for the levy and collection annually by taxation an amount sufficient to pay the interest on the bonds and to provide a sinking fund for their final redemption at maturity. These two provisions operate as a debt limit on unvoted bonds.

The constitution authorizes the legislature to impose restraints upon the power of municipalities to incur debts. Article XIII, section 6 imposes a duty on the General Assembly to restrict the power of cities and incorporated villages to levy taxes and assessments, to borrow money, to contract debts and to lend their credit, so as to prevent the abuse of such power; article XVIII, section 13 authorizes the passage of laws to limit the power of municipalities to levy taxes and incur debts for local purposes.

In addition to limitations imposed by the constitution and by statutes authorized by it to be passed, it is competent for the electors of a municipality to provide, in the home rule charter adopted for its government pursuant to article XVIII, section 7, limitations upon the issue of bonds, the incurring of debt and the borrowing of money. Although charter provisions cannot exempt the municipality from debt limits imposed by statute, they can impose limitations more restrictive than those made by the legislature by statute.

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7 State ex rel. Dayton v. Bish, 104 Ohio St. 206, 135 N.E. 816 (1922).
8 Some charters have a direct debt limit less than the statutory limit. It is considered that such restrictions are valid under article XVIII, section 9 of the
Pursuant to the power granted to the General Assembly to restrict the power of municipalities to levy taxes and to incur debt, laws have been passed dealing with the issuance of notes and bonds and imposing restraints on such an issue. The principal legal limitations are found in the Uniform Bond Law, which is Chapter 133 of the Revised Code of Ohio. It was originally enacted as the Uniform Bond Act in 1927 and covers not only municipalities but also counties, boards of education, townships and joint township hospital districts. This law establishes debt limitations applicable to these various subdivisions, and in addition prescribes the procedure to be followed in the authorization and issuance of notes and bonds. Section 133.24 authorizes such subdivisions to issue bonds for permanent improvements as that term is defined in section 133.01 of the Revised Code. Bonds or notes for purposes other than such permanent improvements are specifically authorized for certain limited purposes. See particularly sections 133.27 to 133.30 as to municipal corporations.

**Direct Statutory Debt Limitations, and Exemptions Therefrom**

In any consideration of the borrowing power of an Ohio municipality, it is essential to make a thorough and detailed study of the types of bonds which are subject to, and those which are exempt from, direct debt limitations. Frequently, by reason of such a study, it is found possible to finance a needed improvement by the issue of bonds, although at first glance it may appear that a given project is beyond the means of the municipality to handle in this way.

The reason for this is that the $1\frac{1}{2}\%$ and the $7\%$ debt limitations do not relate to the gross outstanding indebtedness, but only to that part of it defined by law to constitute "net debt." The net debt of municipalities, excluding certain charter municipalities discussed under the next heading, cannot, for all purposes, exceed seven per cent of the total value of all property in the municipality as listed and assessed for taxation.\(^9\)

The *net* debt incurred without a vote of the electors, cannot exceed one and one-half per cent of such total assessed valuation. This percentage is a part of, and not in addition to the seven per cent, referred to above.\(^10\)

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\(^9\) Ohio Rev. Code § 133.03 (1953).

\(^10\) Ibid.
In applying these limitations, it is essential to calculate the amount of debt against the actual assessed valuation at the very time the debt is incurred.\textsuperscript{11}

It is also essential to determine the amount of the net debt in order to know whether proposed bonds would cause the limitations to be exceeded. To ascertain net debt, there are to be deducted from the gross debt the kinds of bonds or notes enumerated in Revised Code sections 133.02 and 133.03. Many of those listed as exempt from debt limitations are infrequently met with in practice, or are probably no longer outstanding, or are outstanding in such small amounts, as not to be of general interest. For a complete listing reference is made to those sections of the Code. The more important and commonly encountered types are the following:

1. Bonds or notes issued in anticipation of the levy or collection of special assessments (either in original or refunded form).
2. Notes issued in anticipation of the collection of current revenues.
3. Notes issued for emergency purposes under Revised Code section 133.29.
4. Bonds issued to pay final judgments.
5. Bonds issued for the purpose of purchasing, constructing, improving or extending water works, sewage disposal plants or sewerage systems, or municipally owned airports, landing fields, steam railroads and rapid transit systems, off-street parking lots and buildings, or either, to the extent that the income from such utility or railroad is sufficient to cover the cost of all operating expenses, and interest charges on such bonds, and to provide a sufficient amount for retirement or sinking fund to retire such bonds as they become due.
6. Excess condemnation or mortgage bonds, issued under sections 10 or 12 of article XVIII, Ohio Constitution, and other bonds or notes not secured by the general credit of the municipal corporation.
7. Voted bonds issued for the purposes of urban redevelopment to the extent that such bonds do not exceed two per cent of the total value of all property in the municipal corporation as listed and assessed for taxation.

There is also to be deducted the amount held in the sinking fund and other indebtedness retirement funds for the payment of the principal of the bonds and notes not excluded in determining net debt.

The foregoing are statutory limitations on the amount of net debt, measured by a direct ratio of net debt to tax valuation. They

\textsuperscript{11} Ohio Rev. Code § 133.02 (1953).
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must not be construed as a grant of power to issue unvoted bonds beyond the limit imposed by the constitution. In other words, the constitutional limit may be reached before the net unvoted debt reaches the statutory limit.

A careful consideration of these limitations and exemptions should be made in any planning of municipal improvements and the financing thereof. By careful selection of the types of bonds to be issued, and the timing of their issue, the greatest advantage can be taken of a municipality's legal and economic resources, and the net interest cost kept at the minimum.

Thus a new sewer or water project may involve costs as much as 10% of the tax duplicate, obviously beyond the 7% limit. Sufficient funds sometimes can be obtained by a combination of several types of financing, such as voted bonds for part of the cost, special assessment bonds for sewage disposal plant, main sewers and lateral sewers, or for water lines, and mortgage revenue bonds. The voted bonds would be subject to the 7% limitation (except as they may be exempted because of earnings, which is discussed below). The special assessment bonds are exempt from the direct debt limitation (although, if unvoted, subject to the indirect debt limitation referred to in subdivision 4 hereafter). The mortgage revenue bonds are exempt from all debt limitations whatever. In addition, bonds without a vote can be issued to an amount, which with other net debt will not cause the unvoted net debt of the municipality to exceed 1½% of the total tax value nor the total net debt to exceed 7% of the total tax value. Again, such unvoted debt is also subject to the indirect debt limitations of the constitution.

In considering these limitations, and in making plans for future improvements of the municipality, it is of great importance to keep in mind that bonds for sewer systems and water works improvements, certain other utilities, and possibly off-street parking lots and buildings, are exempt from the direct debt limitation to the extent that

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12 By reason of the 1959 amendment, 123 Ohio Laws H 917, § 1, effective September 10, 1959, Ohio Rev. Code § 133.03 exempts in part, "Bonds issued for the purpose of purchasing, constructing, improving or extending... off-street parking lots and buildings, or either to the extent that the income from such utility or railroad is sufficient to cover" operating expenses and debt service. The intent and effect of the amendment is obscured by the reference to "the income from such utility or railroad," a phrase scarcely descriptive of off-street parking facilities; and it is by no means clear from the reference to "off-street parking lots and buildings" whether all of the off-street parking facilities of a municipality can and are to be treated as a single entity for exemption purposes, as would be the case with respect to a municipal utility operation such as a sewer or water system. The apparent attempt to exempt from debt limitations off-street parking bonds to the extent that income is sufficient to cover the cost of operation and debt service may have been
the income of the utility is sufficient to cover the operating expenses, interest charges and bond retirement. In the improvement of an existing and going utility, where there is a showing of adequate net revenue, such bonds, when issued, are exempt in their entirety from the direct debt limitation if the earnings meet the test above mentioned. In the construction of a new utility, or in the improvement of one where there have been no earnings or earnings in an insufficient amount, the bonds will, when issued, be subject to the net debt limitation; but it is within the power of the municipality so to operate its utility system that earnings will be produced in the future in an amount sufficient to take care of the operating expenses and debt service. In that way bonds for such purposes, subject to net debt limits when issued, can become exempt from the direct debt limitation, and the municipality's borrowing power for future improvements or other projects can be increased by the exact amount of such bonds which become exempt because of the adequacy of the earnings.

It should be noted that under the statutory test the indebtedness for such purposes is exempt only to the extent that the income is sufficient at the time of the incurring of the indebtedness. Prospective earnings, no matter how rosy the future, do not entitle the bonds to be excluded in the calculation of net debt. By the same token, bonds that are issued as exempt because the earnings are sufficient will cease to be exempt from debt limitations if the net earnings are not sufficiently maintained.

In developing a financial plan consideration should also be given to a recent development permitting the postponement of the issuance of bonds for a period of five years after the initial issue of notes in anticipation of the bonds.¹³ This allows a greater length of time for the completion of the construction of necessary works, and, in the utility field, the time when earnings will be received in a sufficient amount to make the indebtedness self-supporting in whole or in part. Indeed, in some situations the earnings may be sufficient so that the anticipatory notes can be retired by the end of the five years, thus avoiding the funding of the debt with long term bonds.

A word of caution is in order because of the very large borrowing power available for special assessment and utility improvements. Two considerations should be kept in mind. If there is in later years a substantial delinquency in the collection of special assessments (a substantially impaired or even defeated; and it may also be noted that the statute does not presently give consideration to the fact that in financing off-street parking projects municipalities may, and sometimes do, devote a portion of their receipts from on-street meters to the service of off-street parking debt, treating the provision of parking facilities, both off street and on street, as involving a single governmental purpose.

¹³ Ohio Rev. Code §§ 133.31 and 133.32 (1953).
situation encountered during the last major depression) or should the utility earnings fall off or the rates be voluntarily reduced, it will be necessary for the municipality to provide for debt service from its share of the limited taxes, normally used for operating expenses, unless the voters are willing to approve the payment of debt charges by taxes outside of the ten mill limitation under Revised Code Section 5705.19. The other consideration that should be kept in mind is that the indirect debt limitation operates on all overlapping subdivisions, and if a municipality issues bonds to such an extent that this limitation becomes exhausted, the overlapping county, school and township will be unable to issue any bonds without a vote of the electors.

**Limitations Applicable to Certain Charter Municipalities**

By statute, the direct limitation on unvoted net debt for some charter cities is $2\frac{1}{2}\%$ of the total value of property as listed and assessed for taxation, instead of the $1\frac{1}{2}\%$ rule above referred to. This exception is applicable only in the case of charter cities (not villages) whose charters provide for "the levying of taxes outside the 10 mill limitation without a vote of the electors."15

Such a charter provision is authorized by article XII, section 2, Ohio Constitution; the 10 mill limitation upon taxes without a vote of the electors imposed by that section may be exceeded under favor of laws authorizing additional taxes outside of such limitation, either when approved by at least a majority of the electors of the taxing district voting on the question, or when provided for by the charter of a municipal corporation (article XII, section 2, Ohio Constitution). Pursuant thereto Revised Code section 5705.18 provides that the 10 mill limitation does not apply to tax levies of any municipality which by its charter provides for a limitation of the total tax rate which may be levied without a vote for all purposes or for current operating expenses.

It should be noted, however, that this $2\frac{1}{2}\%$ net debt limitation on unvoted bonds, contained in section 133.03, does not have any relationship to the amount of unvoted taxes which may be levied by a city under its charter. All that is necessary in order to have this additional borrowing power is that the city have in its charter a provision for the levying of taxes outside of the 10 mill limitation without a vote of the electors.

Actually, this increased borrowing power may not be of real benefit to a city unless its charter also provides for additional taxes

14 State *ex rel.* Brual v. Brooklyn, 126 Ohio St. 459, 185 N.E. 841 (1933), 130 Ohio St. 223, 198 N.E. 634 (1935).

15 Ohio Rev. Code § 133.03 (1953).
beyond the ten mill limitation without a vote of the electors, for otherwise the city's share of the ten mill taxes for operating expenses would remain as before and the debt service on the bonds up to the 1½% and the additional 1% as well would have to be taken care of from that source. It does provide, however, a temporary means of financing the initial stages of a program, such as a water system, which ultimately can be permanently financed by bonds with the debt service provided from utility earnings rather than from the city's limited taxes.

Some charter municipalities provide for the levy of taxes beyond the ten mill limitation without a vote of the electors under language which permits the issuance of unvoted bonds in a greater amount than are otherwise limited by the constitutional ten mill tax rate limitation. Consideration of the individual charter is necessary to determine such a municipality's indirect debt limitation. In such charter cities, the charter tax rate limitation may operate in the same way as the constitutional tax rate limitation and thus impose an indirect debt limitation.

THE INDIRECT DEBT LIMITATION WHICH RESULTS FROM THE CONSTITUTIONAL DUTY TO PROVIDE FOR THE LEVY OF TAXES FOR THE PAYMENT OF BONDED DEBT AND THE CONSTITUTIONAL LIMITATION ON THE TAX RATE

All unvoted general obligation bonds, whatever their status as to statutory debt limitations, whether exempt or not in calculating net debt, and whether or not debt service is expected to come from special assessments, utility earnings or other sources, are subject to an underlying constitutional indirect debt limitation. No statute can exempt such bonds from this limitation.

Article XII, section 11 of the Ohio Constitution enjoins that no bonded indebtedness of the state or any political subdivision thereof shall be incurred or renewed, unless, in the legislation under which such indebtedness is incurred or renewed, provision is made for levying and collecting annually by taxation an amount sufficient to pay the interest on said bonds, and to provide a sinking fund for their final redemption at maturity.

This provision did not by itself create any debt limitation, but when article XII, section 2 was amended in 1929 to impose a limitation upon the rate of tax without a vote of the electors, the two sections in combination effectively created a debt limitation upon unvoted bonds. Section 11 requires provision for the levy of taxes and section 2 limits the total rate that can be levied without a vote. Therefore, in order to comply with both sections, no bonds may be issued except to an amount that can be paid as to both principal and interest
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within the amount of taxes that can lawfully be levied without a vote of the electors.\textsuperscript{16}

This is an indirect debt limitation. Under it unvoted bonds cannot be issued if the tax required therefor and for all other limited tax bonds of the issuer and of all overlapping political subdivisions, in any one year, will exceed 10 mills on the dollar of tax valuation.

The test in determining the application of this limitation is not the minimum levy apportioned to the municipality from the total ten mills available to all overlapping political subdivisions under Revised Code section 5705.31, but is the full ten mills less only the number of mills theoretically required for unvoted bonds already outstanding whether issued by the same issuer or by all other political subdivisions overlapping it.

Thus, if five mills are theoretically required for bonds already outstanding, a municipality may under this rule authorize and issue such amount of bonds as will not require more than five mills on its tax duplicate to provide tax monies to pay principal and interest in the highest year. It will be seen from this that the amount of bonds is not determined by any direct percentage of the duplicate valuation, but by whether the combined amount for principal and interest in a particular year is greater than the number of dollars that will be produced by a levy of five mills per dollar of tax valuation. The borrowing power therefore becomes greater as the interest rate is smaller and as the annual installments are spread over a greater number of years.

In the application of this rule it is necessary to take into account and to calculate the requirements for all unvoted bonds payable from taxes whether or not such bonds are exempt from the statutory 1\(\frac{1}{2}\)% debt limitation, and also whether or not they are primarily payable from special assessments or other sources of revenue.\textsuperscript{17}

**Bonds Not Creating Debt**

Municipalities, under the present rulings of the Ohio Supreme Court, are authorized under their home rule power, granted by article XVIII, section 3 of the constitution, to borrow money and issue negotiable bonds which do not constitute indebtedness, and in so doing, are not subject to any valid legislative limitations.

The Ohio General Assembly is not authorized by the constitution to interfere with the exercise of the home rule powers granted by

\textsuperscript{16} State \textit{ex rel.} City of Portsmouth v. Kountz, 129 Ohio St. 272, 194 N.E. 869 (1935). The 1929 amendment limited unvoted taxes to 15 mills; the 1933 amendment reduced the amount to 10 mills.

\textsuperscript{17} State \textit{ex rel.} City of Portsmouth v. Kountz, \textit{supra} note 16.
article XVIII, section 3 of the constitution, except in those areas where the constitution directly authorizes the legislature to act. Article XIII, section 6 authorizes the General Assembly to restrict the power of municipalities to levy taxes and assessments, borrow money, contract debts and lend credit, so as to prevent the abuse of such power. Article XVIII, section 13, adopted at the time of the home rule amendments in 1912, provides that laws may be passed to limit the power of municipalities to levy taxes and incur debts for local purposes. When this last section was adopted, section 6 of article XIII was not in any way referred to. The supreme court held in the Columbus and Cincinnati cases\(^8\) that the General Assembly cannot restrict or regulate municipalities in respect to the issuance of notes and bonds which do not create what is technically known as a debt. Under this principle, notes or bonds issued for money borrowed to construct or improve a self-sustaining project, which do not pledge the faith or credit of the municipality and which are payable exclusively from the net revenues of the project, are not debts of the municipality and therefore can be issued in such manner as may be determined by the council of the municipality subject to any charter limitation, but free of statutory limitations. The supreme court has not passed on the question of whether the revenues of a project can be pledged to secure bonds issued to provide funds to construct some other and unrelated project.

It would seem that bonds which are not full faith and credit bonds, but payable only from revenues are not within the category of non-debt bonds if they are secured by a mortgage on property already owned by the municipality.\(^9\) On the other hand, such bonds can be secured by a mortgage upon the property purchased with the proceeds of the bond issue, without creation of debt.\(^{20}\)

It would also seem that revenue bonds not otherwise constituting a debt, would not be entitled to such treatment if the gross revenues rather than the net revenues of the project were to be pledged. There is no decision of the supreme court dealing with such bonds of a municipal corporation, but its decisions holding invalid proposed bonds of the State Institutional Building Authority\(^{21}\) establish a principle that would apparently be applicable to municipalities.


\(^{19}\) 15 McQuillin, Municipal Corporations § 41.33 (3d ed. 1949).

\(^{20}\) State \textit{ex rel.} Gordon v. Rhodes, \textit{supra} note 18.

\(^{21}\) State \textit{ex rel.} Public Institutional Bldg. Auth. v. Griffith, 135 Ohio St. 604, 22 N.E.2d 200 (1939), and State \textit{ex rel.} Public Institutional Bldg. Auth. v. Neffner, 137
Mortgage Revenue Utility Bonds

Municipal corporations are directly authorized by article XVIII, section 12 of the Ohio Constitution to issue mortgage bonds beyond the general limit of bonded indebtedness prescribed by law for the purpose of acquiring, constructing and extending any public utility. The limitations upon such bonds are contained in the section authorizing them, namely that such bonds shall not impose any liability on the municipality, but shall be secured only upon the property and revenues of such public utility, including a franchise stating the terms upon which, in case of foreclosure, the purchaser may operate the same, which franchise shall in no case extend for a longer period than 20 years from the date of the sale of such utility and franchise on foreclosure.

The Supreme Court of Ohio, in City of Middletown v. City Commission, 22 had before it for decision two fundamental questions: (1) whether a mortgage granted under this section of the constitution could mortgage only the property actually acquired with the proceeds of the bonds or whether, on the other hand, it could embrace all of the property of the utility including that previously owned; and (2) whether article XVIII, section 13, authorizing the General Assembly to pass laws limiting the power of municipalities to incur debts, and laws passed pursuant thereto, govern the issuance of utility mortgage bonds under section 12. Both questions were answered favorably to the power of the municipality to mortgage its entire utility property and without any restraint imposed by statute. The court announced in the fourth syllabus that section 12, article XVIII of the constitution is self-executing and self-sufficient, and utility mortgage bonds issued strictly within its terms are not affected by other parts of the constitution or by the Uniform Bond Act.

It follows from this decision that the terms of the bonds, the price and the method of sale are governed by ordinance of council rather than by the Uniform Bond Law, subject to any applicable provision of a home rule charter. Thus, the interest rate, the bond maturities and provision for payment of a call premium are to be determined by council rather than by statute. The method of sale and the price are also not governed by any statute. In addition, the amount of such bonds that may be issued is not subject to statutory limitation and is excluded in determining the net debt of a municipality.


22 138 Ohio St. 596, 37 N.E.2d 609 (1941).
CONCLUSION

It is beyond the scope of this article to discuss the procedures which must be followed for the authorization of bonds, including elections for voted bonds, and for the private or public sale of notes and bonds. Some of these procedures are required by statutes enacted by the legislature, pursuant to its power to limit the incurrence of municipal debt, and others arise from charter provisions. Basically, limitations of this character relate to the method of exercising the power to issue bonds and only in that sense do they constitute restraints on municipalities.

Years of experience in dealing with problems of municipal finance indicate clearly that, in Ohio, improvements determined to be necessary by the electors and by the legislative authority can be carried out by the municipal officials within applicable limitations on indebtedness, although it not infrequently requires ingenuity in determining the types of notes or bonds that will do the job and in scheduling the progress, both with respect to the time when construction contracts must be made and when the proceeds of notes or bonds will become available. The problem is more difficult and sometimes not feasible if the electors are unwilling to give their full support and to vote bonds for a portion of the cost.

Usually the greatest problems, both of municipal policy and of finding the proper financial means, within limitations, of financing projects, arise in the smaller communities faced with the demands of the people or with orders from the state for extensive water or sewer improvements. However, it is generally true that municipalities are able to meet these unusual demands and also the normal requirements of municipal improvements within the presently existing limitations on indebtedness.

By careful planning and selection a combination of types of financing can and should be worked out so that unnecessary costs of financing and excessive costs of interest will be eliminated.