

**LETTER OPINION
2011-L-12**

December 21, 2011

Mr. Marvin K. Madsen
Mohall City Attorney
PO Box 476
Mohall, ND 58761-0476

Dear Mr. Madsen:

Thank you for your letter requesting my opinion on whether a city creates a debt obligation subject to state constitutional and statutory debt limitations by approving a general obligation pledge under N.D.C.C. § 23-11-24(23)(b) to additionally secure revenue bonds issued by its housing authority. For the reasons indicated below, it is my opinion that a city approving a general obligation pledge under N.D.C.C. § 23-11-24(23)(b) to additionally secure revenue bonds issued by its housing authority only creates a contingent liability which is not subject to any state constitutional or statutory debt limitation. It is my further opinion, however, that upon any payment default by the city housing authority on its bonds, the contingent liability of the city would ripen into a current liability which would be subject to state constitutional and statutory debt limitations.

ANALYSIS

A city housing authority is authorized to issue bonds backed by the income and revenues of the project being financed, other designated housing projects, or from the authority's general revenue.¹ These revenue bonds² are not payable out of any funds or property other than those of a city housing authority.³ However, these revenue bonds may be additionally secured by the general obligation of a city under N.D.C.C. ch. 23-11.⁴

¹ N.D.C.C. § 23-11-20.

² In your letter you refer to the general revenue bond law, N.D.C.C. ch. 40-35. However, that chapter is inapplicable here since it does not relate to revenue bonds issued for housing projects. See N.D.C.C. § 40-35-02.

³ N.D.C.C. § 23-11-20(2).

⁴ See N.D.C.C. §§ 23-11-11(35), 23-11-20(2), 23-11-21, and 23-11-24(23)(b).

State law provides that:

The governing body of . . . [a housing] authority may pledge the general obligation of the city . . . for which the authority was created as additional security for bonds provided that the authority finds that the pledged revenues will equal or exceed one hundred ten percent of the principal and interest due on the bonds for each year, the maturity of the bonds does not exceed thirty-five years, and the principal amount of the issue and the general obligation pledge are approved by the governing body of the city . . . in which the housing project is located and whose general obligation is pledged. A public hearing must be held on issuance of the obligations and the pledge of the general obligation by the city . . . in which the housing project is located. The hearing must be held at least fifteen days, but not more than one hundred twenty days, before the sale of the obligations.⁵

You ask whether the pledging of the city's general obligation under this statute creates a debt obligation which is subject to state constitutional and statutory debt limitations. One noted author has explained the concept of debt limitations:

A majority of the states have constitutional or statutory limitations upon borrowing by local governments. . . .

Debt-limitation provisions are designed to promote the common good and welfare. It is their purpose to serve as a limit to taxation and as a protection to taxpayers; to maintain municipal solvency, both governmental and proprietary; and to keep municipal residents from abusing their credit, and to protect them from oppressive taxation.⁶

The author also states:

There are various classes of debt-limit provisions. First, there are constitutional provisions, second, statutory provisions and, third, charter provisions. Further divisions appear, as; (1) those forbidding indebtedness in excess of a certain percent of the value or assessed value of the taxable property in the municipal area

. . . .

⁵ N.D.C.C. § 23-11-24(23)(b).

⁶ See 15 McQuillin, Mun. Corp. § 41:1 (3d ed. 2005) (footnotes omitted) (citing, inter alia, Lang v. City of Cavalier, 228 N.W. 819 (N.D. 1930)).

Most of the constitutional and statutory provisions make the assessed value of the taxable property of the municipality the basis for ascertaining the amount of indebtedness which may be incurred, by limiting the indebtedness to a certain percent of such assessed value.⁷

In this state, the constitutional debt limitation for cities is contained in N.D. Const. art. X, § 15, which provides, in part, 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 said five per centum limit"⁸

The North Dakota Constitution also authorizes the Legislature to permit a home rule city to establish a debt limitation which is not restricted by other debt limitations contained in the constitution.⁹ The constitution also requires that any city incurring indebtedness "shall, at or before the time of so doing, provide for the collection of an annual tax sufficient to pay the interest and also the principal thereof when due, and all laws or ordinances providing for the payment of the interest or principal of any debt shall be irrevocable until such debt be paid."¹⁰

Municipalities are permitted to issue general obligation bonds under N.D.C.C. ch. 21-03. However, this authority is constrained by a parallel debt limitation contained in that law:

No municipality may incur indebtedness in any manner or for any purpose in an amount which, with all other outstanding indebtedness of the municipality, exceeds five percent of the assessed value of the taxable property therein, except:

⁷ Id. at §§ 41:2 and 41:7 (footnotes omitted).

⁸ N.D. Const. art. X, § 15.

⁹ See N.D. Const. art. VII, § 6. The Legislature has permitted home rule cities to establish debt and mill levy limitations under N.D.C.C. § 40-05.1-06(2). Even though the city of Mohall is a home rule city, its home rule charter does not implement this home rule power to establish a city debt limitation; its primary content relates to the establishment of a city sales tax. See Home Rule Charter, City of Mohall, Article 3 (1992). Consequently, I will primarily focus on the general debt limitations contained in N.D. Const. art. X, § 15 and N.D.C.C. § 21-03-04.

¹⁰ N.D. Const. art. X, § 16. When a municipal obligation is entirely contingent, the provision for levying of a tax to meet the liability may also be contingent. See Marks v. City of Mandan, 296 N.W. 39, 47-49 (N.D. 1941).

1. Any incorporated city, by a two-thirds vote of the qualified voters thereof voting upon said question at a general or special election, may increase such limit of indebtedness three percent on such assessed value beyond said five percent limit¹¹

The question here is whether a city which authorizes its housing authority to pledge the city's general obligation to secure revenue bonds issued under N.D.C.C. ch. 23-11 is subject to these constitutional and statutory debt limitations. Before a city would become liable under its general obligation pledge, however, the revenue bonds issued by the city housing authority would have to be in payment default.¹² Under statute, city housing authority revenue bonds backed by the general obligation of a city may only be issued if, at the outset, there are sufficient revenues projected to pay principal and interest on the bonds; the revenues supporting them must "equal or exceed one hundred ten percent of the principal and interest due on the bonds for each year"¹³ Thus, the housing authority's pledged revenues would have to actually be insufficient to pay debt service on the bonds in order for the city's contingent general obligation pledge to kick in. "Merely incurring a contingent future liability does not create an indebtedness."¹⁴

As explained by this office:

The term "debt" has been judicially defined as "an obligation arising out of contract express or implied which entitled a creditor unconditionally to receive from the debtor a sum of money which a debtor is under legal, equitable, or moral duty to pay without regard to any future contingency." McGee v. Stokes Heirs at law, 76 N.W.2d 145, 156 (N.D. 1956). (Emphasis supplied). On the other hand, a "contingent liability" is a liability which

¹¹ N.D.C.C. § 21-03-04.

¹² Marks v. City of Mandan, 296 N.W. 39, 46-49 (N.D. 1941).

¹³ N.D.C.C. § 23-11-24(23)(b).

¹⁴ 15 McQuillin, Mun. Corp. § 41:22 (3d ed. 2005) (footnote omitted) (citing, inter alia, Bismarck Water Supply Co. v. City of Bismarck, 137 N.W. 34 (N.D. 1912); Davidson v. City of Elmira, 44 N.Y.S.2d 302 (1943), aff'd 46 N.Y.S.2d 655 (1943) "(holding city's guaranty of payment of debt incurred by Housing Authority not a 'pecuniary obligation,' and that city's liability was contingent upon Housing Authority's default)"; and Koppenhaver v. Dep't of Cmty. and Econ. Dev., 898 A.2d 654 (Pa. Commw. Ct. 2006) "(Limited guaranty by city, covering potential shortfalls in redevelopment authority's payment of debt service to the extent authority had to pay real estate taxes on hotel it was to own and lease to developer, did not fail the legality of purpose test under the Debt Act on ground that is was merely a mechanism to indirectly pay real estate taxes for the developer where limited guaranty only would be invoked if authority had to pay real estate taxes and it was unclear if any of the events that would trigger the limited guaranty would happen.)."

“depends upon some future event, which may or may not happen, thereby making it uncertain whether it will ever become a liability.” Hanson v. Hanson, 302 N.W.2d 801, 803 (S.D. 1981) (citations omitted). The distinction, therefore, between a debt or current liability and a contingent liability is that in the case of the former, the obligation does not depend on the happening of a future event. In the latter situation, the obligation of the debtor hinges on the occurrence or non-occurrence of a future event.¹⁵

The North Dakota Supreme Court long ago recognized the distinction between indebtedness and a contingent future obligation.¹⁶ In that early case, a city passed an ordinance granting a 20-year franchise to a private company to construct and maintain water mains and, in case of a change of grade of any street, the city would reimburse the franchisee for any expenses incurred by changing and relaying its mains and pipes.¹⁷ The court determined that the ordinance and contract were valid and enforceable and that the city did not exceed its powers in obligating itself to reimburse the franchisee for such expenses, noting that “the obligations thus assumed by the city do not create an indebtedness in excess of the constitutional debt limit. Such stipulation created no indebtedness, but merely a contingent future liability.”¹⁸

Based on the foregoing, it is my opinion that a city approving a general obligation pledge to additionally secure revenue bonds issued by its housing authority under N.D.C.C. § 23-11-24(23)(b) only creates a contingent liability which is not subject to any state constitutional or statutory debt limitation. The mere fact that a city may authorize its housing authority to pledge the general obligation of the city only means the obligation remains contingent until such time it is actually drawn upon.

However, at such point that the city housing authority actually has insufficient revenues to pay debt service on the revenue bonds it issued, the obligation of the city for the deficiency would then become a current debt obligation. Consequently, it is my further opinion that upon any payment default by the city housing authority on its bonds, the contingent liability of the city would ripen into a current liability for the deficiency which would be subject to state constitutional and statutory debt limitations. How expansive the general obligation liability of the city would be at that point would depend on the amount of the deficiency,

¹⁵ N.D.A.G. Letter to Lundberg (Dec. 20, 1985).

¹⁶ See Bismarck Water Supply Co. v. City of Bismarck, 137 N.W. 34 (N.D. 1912).

¹⁷ Id.

¹⁸ Id. at 34 (Syllabus by the Court). See also Marks v. City of Mandan, 296 N.W. 39, 48 (N.D. 1941) (“Where the obligation of the municipality rests wholly upon a contingent liability, there is no debt created until the contingency occurs.”).

and how close the city was to the constitutional or statutory debt limitation.¹⁹ When a debt liability exists, the debt limitations may not be exceeded.²⁰

Thus, a city considering approval of a general obligation pledge to additionally secure bonds to be issued by its housing authority should be aware of the potential financial liability it may face. Even though the pledge is only a contingent obligation at the outset, it could become a direct obligation years down the road if the housing authority becomes unable to make full debt service payments and draws upon the city's pledge. Such a draw would require the city to measure the amount of available funds it has under the applicable debt limits, and to pay accordingly.

Sincerely,

Wayne Stenehjem
Attorney General

jjf/pab

This opinion is issued pursuant to N.D.C.C. § 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts.²¹

¹⁹ See Marks v. City of Mandan, 296 N.W. 39, 49 (N.D. 1941) (once a deficiency in the bond payment fund exists, it becomes a liability of the city, definite in amount).

²⁰ See Anderson v. Int'l School Dist. No. 5, 156 N.W. 54, 57 (N.D. 1916).

²¹ See State ex rel. Johnson v. Baker, 21 N.W.2d 355 (N.D. 1946).