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Financing Municipal Improvements*

By Robert B. Tunstall

It may be doubted whether, with all the study so lavishly bestowed upon other aspects of municipal activity, there has not been neglected, comparatively speaking, the vital question of finance. Certainly there is hardly any municipal function less standardized. It is true that as a comparatively recent development there has come to pass in the better managed cities something approaching a recognized accounting system, but there financial standardization stops. Public improvements are paid for diversely from current revenues, by the proceeds of lump-sum assessments, by annual assessments, by the proceeds of long-term bonds, by bonds maturing annually, and in any other way that the casual whim of the governing body from time to time and the hodge-podge of laws under which the particular city is operating may dictate or permit.

It is the purpose of this paper to offer some ideas on the subject of city finance as involved in the subject of public improvements in cities, and especially streets which are the most usual form of such improvements and largely typify others.

It is obvious that any proper method of financing an improvement of this character should combine at least four principles, namely:

First, it must be legal. Considerations both of present necessities and future credit imperatively dictate the avoidance of any system open to serious attack.

Second, it should be fair. The incidence of the burden should be in the right place.

Third, it should be conservative. The value of the improvement from time to time should reasonably represent the indebtedness incurred for it. This is really only another way of saying that the system should be fair, for as we shall see hereafter any other system would put the burden of improvements in part upon a generation which has not enjoyed them.

*An address delivered before the Virginia State Bar Association, 1915.

Fourth, it should be practical. That is to say, any securities issued should be attractive to the class of persons that would naturally invest in them.

Let us consider how far these principles are observed in Virginia and the working of the system now in force.

Except in the instances, comparatively rare, when a street improvement is paid for out of current revenue, the funds for making it are provided by the issuance of general bonds running usually for thirty years—occasionally less, sometimes more. Sinking fund provisions vary, but are by no means uniformly, if they are generally, adequate to discharge the principal at maturity.

The average life of paving may be put at fifteen years. Assuming thirty-year bonds to be issued, it results that at the end of the first fifteen years another bond issue must be made to provide for repaving the street. At the end of thirty years, the city has one bond issue due, another outstanding with fifteen years to run, and a third one immediately pressing for consideration to provide for the new paving necessary; while on the asset side of the ledger there are two worn-out streets—value nil—and such a sinking fund as has grudgingly been created. Such a system in the case of a business corporation would spell bankruptcy.

But this is by no means all the story. The bond issue is carried by the city at large. Whether the street be the most travelled thoroughfare in the city or intersect a suburban district founded on credulity and maintained on optimism; whether it serve the multitude or the few; whether its paving add nothing to the values of abutting property or create those values—in each case the public purse pays the piper.

Such a system is not fair, as the cost is not properly distributed; it is not conservative, as it accumulates liabilities against ever-diminishing assets; it is not practical, as it keeps the bonded indebtedness pressing hard upon the heels of the bond-issuing limit and so impairs the marketability of the bonds. The bond-issuing limit itself is far too liberal. By the constitution of 1902 it is fixed, except as to pre-existing charters, at eighteen per cent. of the assessed value of the real estate in the city. Under the savings bank laws of New York and New England, those banks are forbidden to invest in the securities of cities whose bond issues exceed varying percentages, never more than seven, of

assessed municipal property values; and the result follows that this most important class of customers is forced out of the market for our municipal securities.

It might be expected that the consequences of such a system would be striking; and the expectation will not be disappointed.

Taking our two principal cities of Richmond and Norfolk, the latest state and city section (published November 21, 1914), of the *Financial Chronicle* fails to disclose, with two exceptions —Omaha, Nebraska, and Yonkers, New York, as to each of which somewhat special circumstances exist*—a single city in the entire United States, within a limit of population, as given by the 1910 census, ten thousand in excess of that of those two cities respectively, whose net direct bonded indebtedness is so large. There may possibly be a few instances where bonds issued by school districts containing or contained by cities would bring up the total to that of the Virginia cities referred to; but these are not city bonds proper, and such instances, if they exist at all, are few. Moreover, in the generality of cases the disparity is very great. For various reasons, among the more important of which are inadequate sinking funds and the practice of issuing bonds of too long maturities—of which more hereafter—southern cities are generally bonded far more heavily in proportion to population and assessed values than northern; and, therefore, when we find that Richmond has a larger indebtedness than any other southern city, regardless of size, except New Orleans, and that Norfolk's indebtedness is only exceeded in the south by New Orleans, Richmond, Louisville and Houston, we feel that we should pause and consider.

Not only is this true, but the results of this unscientific system of financing are manifest in another way. It is generally recognized that municipal indebtedness may be created with entire propriety for remunerative public service enterprises, such as water and lighting systems, docks or ferries—to mention a few. From an interesting article by Mr. LeGrand Powers, of the census bureau, in the *National Municipal Review,* we learn that of the total debt in 1911 of American cities of over 30,000 popu-

*Approximately half the debt of Omaha is for a water system reported to be paying over ten per cent. on the investment. In proportion to property values Omaha's debt is not very high. Most of the debt of Yonkers has been arranged to mature serially with an unusually short average life, and these bonds are required by law to be paid off as they mature. The figures given include a large water debt, which represents income-producing property, and likewise include a large amount of revenue bonds and certificates of indebtedness which are not counted against the bond limit.

lation, 33⅓ per cent. was incurred for such public service enterprises. Of the indebtedness of Richmond only 21.7 per cent. of the net debt was incurred for such enterprises, while in Norfolk the proportion is only 13.7 per cent., though in the latter case it is fair to say that it is probable that the accounts have not been kept so as fully to disclose the real situation. In other words, our principal cities not only have too much debt, but the debt represents too large a proportion of non-remunerative investments.

The conclusion should not be hastily formed that there is anything essentially unsound in the financial position of either of these cities. The contrary is true, as amply attested by the ready sale of their bonds on a favorable basis. The ultimate security for a city bond is the taxable property in the city, and the solid values in the two cities named are such as to inspire confidence. But that their position is such as to require conservative and scientific treatment there can be no doubt.

It appearing, then, that the consequences of what we may call the Virginia system are just what might have been expected *a priori* of that system, it remains to inquire what can be done to remedy these conditions. Clearly, if the principles above laid down are sound the remedy is to be found in the application of those principles. It has been said that the system should be legal, fair, conservative and practical. How can these requirements be attained?

It is believed that the remedy lies along two main lines.

In the first place, all securities issued by a city should be for a term of years not exceeding the life of the improvement for which they are issued, and provision should be made whereby the securities so issued will be automatically retired at maturity. This can be accomplished as to each bond issue made, either by creating a sinking fund that will pay off the issue when due, or by issuing what dealers in municipal securities call serial bonds, by which are meant bonds some of which fall due and are paid each year during the life of the issue. It would be wholly impracticable within the limits of this paper to discuss the question which of these two methods is the more advisable, or the further question whether the amortization charges under either system should be equal or graded and, if graded, how. Suffice

it to say that there is no legal or constitutional objection to the immediate adoption of this principle by our Virginia cities as to their future bond issues. As to existing indebtedness, steps should at once be taken so to readjust the sinking fund provisions as to retire the bonds as they severally mature.

It would be difficult, however, for our Virginia cities under existing conditions to provide the very high amortization charges that would be required for street improvements under such a method, unaided as they are by any contributions from the persons principally benefited by the improvements made. And this leads to a consideration of the second of the lines along which relief is to be sought, which involves the placing of the burden of such improvements where it belongs or, in other words, making the financial system fair.

This can be accomplished, it is confidently believed, only by the re-introduction in Virginia of a system of local assessments; and it is with this subject that this paper is principally concerned.

Prejudice against such assessments long existed in Virginia, and it was in great part justified by the unscientific manner in which they were imposed. They were not infrequently made in lump-sum amounts, whereby the entire amount assessed against the abutter was immediately made a lien on his property—a method burdensome in the extreme. Even when payable in instalments, the instalments did not extend over a sufficient length of time properly to distribute the burden. And moreover, so far as available information goes, the cost of improvement was usually divided between the city and the abutting owner in a proportion inflexibly fixed in each city, regardless of the character and location of the street to be improved.

A proper system of local assessment for streets would require first, the ascertainment by some competent authority of the proper division of the cost of the paving as between the property owner and the city. It is clear that this should greatly vary. In suburban sections the street is almost entirely for the benefit of the abutter and the assessment should be high—say from 75 per cent. to 90 per cent. of the cost. Contrariwise, in the case of downtown thoroughfares the street is primarily for the benefit of the city at large, and the city's share should be high, the property owner contributing only, say, from 10 per cent. to 25 per

cent. In either case the assessment should be made in instalments, not necessarily equal, continuing approximately through the life of the improvement, with an option to the abutter to pay, if he desires, the whole amount in cash with a suitable discount.

The portion of the cost not provided for in this way would, of course, be borne by the city at large; and the preferable method of financing the improvement is for the city to issue bonds covering the entire cost, looking to the local assessments for its *pro tanto* reimbursement. The term of the bonds so issued should be regulated by the principle above laid down.

Such a system would not be burdensome to the abutter, and the city at large would be infinitely the gainer. Amortization charges would be in large part provided for; each improvement would be paid for by the time its usefulness ended; and outstanding bond issues would relatively decrease and would approach a proper limit.

But to bring about this result a constitutional amendment is necessary. Section 170 of the constitution, in part, provides that:

> No city or town shall impose any tax or assessment upon abutting land owners for street or other public local improvements, except for making and improving the walkways upon then existing streets, and improving and paving then existing alleys, and for either the construction or for the use of sewers; and the same when imposed shall not be in excess of the peculiar benefits resulting therefrom to such abutting land owners. Except in cities and towns no such taxes or assessments for local public improvements shall be imposed on abutting land owners.

It is apparent at a glance that this clause operates as a practical interdict against local assessments. In the country it is absolute. In the cities such assessments can be made only for sidewalks on existing streets, existing alleys and sewers. No such assessments can be made for opening, grading, curbing, guttering, or paving the roadways of any streets, whether existing or not, nor for any improvements except the very limited classes named.

With the inhibition of the Virginia constitution eliminated, there are few practical difficulties in the way of installing in this state a scientific system of local assessments. An outright appeal is what is required. Opinions may differ as to the proper framing of local assessment laws—whether, for example, assessments should be made for opening streets as well as paving them, and in such case whether the value of the benefits should be allowed

as against the value of the land taken or merely as against that of the land damaged; by what system assessments should be determined, whether by frontage values or how; whether assessments should or should not be preceded by a petition of property owners, and, if so, of what proportion of them; and many other questions that might be enumerated. But these matters should be left to public opinion as reflected by the legislature. The safeguards of the Virginia bill of rights and the fourteenth amendment are adequate. Details should be avoided in constitution-making. It is no rare phenomenon that those most insistent upon creating constitutional restraints are most impatient of them when they make themselves felt. If the people in the rural districts wish to retain the constitutional prohibition against local assessments there let them do so, though such a course is believed to be unwise for reasons that will be stated; but the cities should be set free from this mistaken and unprecedented restriction that was so lightly adopted. Otherwise their position will be hard indeed. The exigent demand for repaving which will soon be felt will result by a species of reaction in partial atrophy of plans for suburban development, except where, as has sometimes been successfully done in Norfolk, the desired result can be accomplished by a large voluntary increase by the owner of the assessment for taxation—a method that works fairly well, but is generally impracticable where there are many owners. Our cities will continue to pile up debt; and the generations to come will curse our improvidence.

Should this provision be repealed a few cautionary words may not be amiss. In framing local assessment laws the experience of other states should be carefully studied. Particularly in providing for the issuance of securities legal counsel specializing in municipal issues should be consulted. It has been said that a system of municipal finance should be practical so as to be attractive to bond buyers. In no respect is the opposite quality more apt to be displayed than when a legislature or city council attempts, unaided, to authorize a bond issue.

One serious blunder sometimes made deserves special mention in any consideration of the local assessment system as applied to municipal finance. It consists in leaving uncertain the question whether a security issued is predicated on the general credit of

the city or on a local assessment or the remedy on the assessment has to be exhausted before the city's credit is looked to. Uncertainty of this kind will greatly injure any bond issue for market purposes. The bond should be either an assessment bond pure and simple with the credit of the city left untouched or it should be based wholly on the city's credit. The former does not affect the bond limit, but the latter is more marketable and is believed to be preferable; and proper constitutional provision could and should be made for not counting against the bond limit such proportion of the bonds as will be paid by the assessment, for of course in such case the city looks to the assessment for reimbursement, in part or total. The bond buyer, however, knows only the city in the transaction.

The primary purpose of this paper will have been subserved if a case has been made out for the repeal of the constitutional inhibition against local assessments, thus opening the way for the installation of that historic system on an enlightened and scientific basis. A proper correspondence between the life of municipal securities and that of the improvements for which they are issued has likewise been urged. Considerations of space and time render impossible a complete treatment of the entire subject of financing public improvements; but mention, at least, should be made of that new but economically sound method known as excess condemnation, whereby the appalling expense of acquiring property, especially in congested districts, can be relieved as to the city while conserving the legitimate rights of the property owner. It is to be hoped that a constitutional amendment embodying this idea may be introduced along with one permitting local assessments, for the two things, while in no way necessarily interdependent, are yet philosophically akin.

It is believed that much of what has been said respecting the financing of public improvements in cities would be applicable in principle to the rural districts, where the need of such improvements is scarcely less acute, and the difficulty of providing them is far greater. But difficulties may exist as to a local assessment system in the country that would not occur in the cities; and it is in the latter that Virginia should first undertake to set her house in order to the end that their financial systems should not lag behind their other notable advances.