

AN ACT

1 Providing debt limits for local government units, including
 2 municipalities and school districts; providing the methods of
 3 incurring and evidencing debt; defining the powers and duties
 4 of the Department of Community Affairs with respect thereto;
 5 exercising the inherent legislative authority of the General
 6 Assembly by providing additional over-all limitations on the
 7 incurring of lease rental and other obligations for the
 8 acquisition of capital assets to be repaid from the general
 9 tax revenues of such local government units; imposing duties
 10 upon the officers in charge of the recording of deeds,
 11 imposing penalties for filing false or untrue statements or
 12 refusing to give information with respect to proceedings for
 13 the incurring of debt; and conferring jurisdiction on the
 14 Commonwealth Court with respect to certain proceedings
 15 relating to the incurring of debt.

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ARTICLE I

Short Title, Definitions and Preliminary Matters

§001

Section 101. Short Title.--This act shall be known and may be cited as the "Local Government Unit Debt Act."

COMMENT

1. TITLE OF ACT

Since one purpose of the Act is to make a debt limit meaningful by including debt of tax supported lease back authorities, it is necessary to recite that this limitation is imposed in the exercise of inherent legislative jurisdiction over the municipality authority, itself a creature of the legislature and totally subject to legislative control. The Constitution, in defining the "debt" to be included in the debt limit to be established by the General Assembly states that the limit is not to include debt which has heretofore been held to be self-sustaining. All of the cases sustaining the authority financing of school districts and others, using leases payable out of general tax revenues have done so on the ground that the debt is self-sustaining. See, e.g. Kelly v. Earle, 325, 190 Atl. 140 (1937); and Greenhalgh v. Woolworth, 361 Pa. 543, 64 A (2d) 659 (1949). Hence the limit on tax supported lease-back financing is not an implementation of the constitution but an exercise of inherent legislative jurisdiction.

Under prior law, debt documentation was filed in the Court of Quarter Sessions, possibly to make the statements made therein subject to the penalties for false swearing in a court proceeding. Recording in the office of the Recorder of Deeds seems a more appropriate place for the debt records to be kept, and penalties upon false statements relating to debt in the recorded documents are, accordingly imposed.

§002

Section 102. Definitions.--As used in this act:

(1) "Debt" means the amount of all obligations for the payment of money incurred by the local government unit, whether due and payable in all events, or only upon the performance of work, possession of property as lessee or rendering of services by others, except:

- (i) current obligations for the full payment of which current revenues have been appropriated, including tax anticipation notes, and current payments for the funding of pension plans;

26 (ii) obligations under contracts for supplies, services and
27 pensions, allocable to current operating expenses of future
28 years in which the supplies are to be furnished, the services
29 rendered or the pensions paid;

30 (iii) rentals payable in future years under leases not
1 evidencing the acquisition of capital assets; and

2 (iv) interest or assumed taxes payable on debt.

3 (2) "Electoral debt" means all net debt incurred with the
4 assent of the electors, given as herein provided whether issued
5 by a local government unit or through an authority.

6 (3) "Nonelectoral debt" means all net debt determined as
7 herein provided, incurred or authorized to be incurred, except:

8 (i) electoral debt, whether authorized before or after the
9 effective date of this act, and whether before or after the debt
10 is incurred;

11 (ii) self-liquidating debt and subsidized debt to the extent
12 that such debt has been duly certified for exclusion in
13 accordance with this act; and

14 (iii) lease rental debt.

15 (4) "Self-liquidating debt" means debt payable solely from
16 rents, rates or other charges to the ultimate users of the
17 project, to be financed in whole or in part by such debt, or
18 payable solely from special levies or assessments of benefits
19 lawfully earmarked exclusively for the purpose, and includes
20 lease rental debt, whether or not the leases evidence the
21 acquisition of capital assets, where the rentals are payable
22 solely from one or more of such sources. The term also includes
23 debt or any portion thereof at the time qualified as

24 self-liquidating pursuant to this act, whether or not solely
25 payable from such sources. The term "ultimate users" includes
26 the local government unit itself incurring the debt.

27 (5) "Subsidized debt" means that amount of debt which is
28 self-liquidating to the local government unit because the annual
29 debt service on such amount for the fiscal year next following
30 the time of determination will be covered by payments of

1 subsidies on account of cost of the project or on account of
2 operations, but measured by the cost of the project, or which
3 will be covered by capital account reimbursements, which
4 subsidies or reimbursements will be paid by either the
5 Commonwealth of Pennsylvania or the United States of America, or
6 both, where such payments under the legislation in force at the
7 time of determination are stated to be of a recurring nature, if
8 the Commonwealth or the United States shall have qualified the
9 project being financed for such subsidy or reimbursement,
10 preliminarily or finally, all as determined pursuant to section
11 204 of this act.

12 (6) "Lease rental debt" means the principal amount of debt
13 to be repaid from payments made pursuant to leases, subsidy
14 contracts or other forms of guarantee where such payments are
15 made out of the tax and other general revenues of a local
16 government unit under leases or other agreements which evidence
17 the acquisition of capital assets, but the term does not include
18 any such debt at the time qualified as subsidized or
19 self-liquidating debt under sections 204 and 206 of this act, or
20 which has been approved by a vote of the electors. Where lease
21 rentals are payable in part from other than tax or general
22 revenues of the local government unit, the principal amount of
23 bonds or notes to be classified as lease rental debt in any year

24 shall be that portion thereof which bears the same ratio to the
25 total amount of the lease supported bonds or notes that the
26 amount of the annual lease rental payable in such year from tax
27 or general revenues bears to the total annual lease rental for
28 such year as determined by certificates filed pursuant to
29 sections 204 or 206 of this act.

30 (7) "Total revenues" means all moneys received by the local

1 government unit in a fiscal year from whatever source derived,
2 except:

3 (i) subsidies or reimbursements from the United States of
4 America or from the Commonwealth of Pennsylvania measured by the
5 cost of, or given or paid on account of, a particular project
6 financed by debt;

7 (ii) revenues, rates, receipts, user charges, special
8 assessments and special levies which are or will be pledged or
9 budgeted for specific self-liquidating debt, but such portion
10 thereof as may be returned to the local government unit by the
11 pledgee for any general operating purpose shall not be excluded;

12 (iii) interest on moneys in sinking funds, reserves, and
13 other funds pledged or budgeted for the payment or security of
14 outstanding debt; *and interest earned on Bonds or Note proceeds*

15 (iv) grants and gifts in aid of or measured by the
16 construction or acquisition of specified projects; and

17 (v) proceeds from the disposition of capital assets, and
18 other nonrecurring items including bond or note proceeds not
19 considered income under generally accepted municipal accounting
20 principles.

21 (8) "Borrowing base" means the annual arithmetic average of
22 the total revenues for the three full fiscal years ended next
23 preceding the date of the incurring of nonelectoral debt or the

24 annual determination of net debt for filing as herein required, 5
25 as set forth in a certificate stating the total revenues in each
26 of such years and stating such average, executed by the
27 officials of the local government unit regularly auditing its
28 financial affairs or by the independent certified public
29 accountants regularly auditing the books of account of such
30 local government unit.

1 (9) "Local government unit" means a county, city, borough,
2 incorporated town, township, school district or any similar,
3 general or limited purpose unit of local government or any unit
4 operating under a home rule charter or created by joint action
5 of two or more local government units which is now or shall
6 hereafter be created or authorized to be created by the General
7 Assembly; but the term does not include a city of the first
8 class, a county of the first class, or a municipality or other
9 authority or nonprofit corporation existing under any law of the
10 Commonwealth.

11 (10) "Governing body" means the authorities in each local
12 government unit authorized by law to levy taxes or fix the tax
13 rate of the local government unit and the term also includes the
14 school board of a school district and the board or officers
15 authorized to make binding commitments for joint local
16 government units, even though such body has no power to levy
17 taxes.

18 (11) "Bond or note" means any instrument imposing an
19 obligation for the repayment of money borrowed. "Bond" shall
20 mean an instrument in form qualifying as an investment security
21 under Article 8 of the Uniform Commercial Code. "Note" shall
22 mean a negotiable promissory note in form conforming to the
23 requirements of Article 3 of the Uniform Commercial Code

24 applicable to municipal obligations, except in each case as
25 otherwise provided herein.

26 (12) "General obligation" in the title of a bond or note,
27 means a bond or note for the payment of which the full faith and
28 credit of the local government unit is pledged, for the payment
29 of which the local government unit has entered into the required
30 covenant under section 404, and for the payment of which no
1 specific revenues are pledged.

2 (13) "Guaranteed revenue" in the title of a bond or note,
3 means a bond or note payable in whole or in part from pledged
4 revenues, but which becomes wholly or partly a general
5 obligation of the guarantor in the event of deficiency in the
6 pledged revenues.

7 (14) "Revenue" in the title of a bond or note not preceded
8 by the word "guaranteed," means a bond or note payable solely
9 from user charges, rates, revenues, rentals, fees, special
10 assessments and receipts pledged for the purpose.

11 (15) "Issue" means all bonds authorized to be sold in
12 respect of a particular project, whether authorized to be sold
13 at one time or from time to time in one or more series.

14 (16) "Series" means all the bonds or notes to be sold and
15 delivered at one time in respect of one project or of any two or
16 more projects which have been combined for purposes of financing
17 or where such bonds or notes have been combined for sale as
18 provided in this act.

19 (17) "Ordinance" means an ordinance in the case of a local
20 government unit having the power to adopt ordinances and a
21 resolution in the case of all other local government units.

22 (18) "Incur" or "incurred," when used with respect to debt,

23 means the point in time when (i) in the case of debt assented to
24 by the electors, the assent shall have been given, and (ii) in
25 the case of nonelectoral or other debt the first ordinance
26 authorizing the debt, or the project to be financed and its
27 estimated cost shall have been adopted, unless the authority for
28 such debt shall have been cancelled or terminated as provided in
29 this act.

30 (19) "Sinking fund" means a special fund created for the
1 accumulation and holding of moneys for the payment of bonds or
2 notes at a subsequent date and may also include funds or
3 accounts created for the accumulation and holding of moneys
4 required to be held in respect of specific issues of revenue or
5 guaranteed revenue bonds or notes for use in times of falling
6 revenues or for the costs of maintenance or repair.

7 (20) "Project" means (i) any item of construction,
8 acquisition, extraordinary maintenance or repair which has been
9 undertaken by a local government unit, (ii) any preliminary
10 studies, surveying, planning, testing or design work for any
11 such, (iii) any lands or rights in land to be acquired, (iv) any
12 furnishings, machinery, apparatus or equipment normally
13 classified as capital items, but such items must have a useful
14 life of five years or more if financed separately and not as a
15 part of a construction project, (v) the local government unit's
16 share of the cost of a project undertaken jointly with one or
17 more other units or the Commonwealth or one of its agencies; or
18 (vi) any combination of any or all of the foregoing, as any or
19 all of the above may be designated as a project by the governing
20 body for the financing of which it desires to incur debt. The
21 term shall also include any deficit to be funded by bonds or
22 notes as provided herein, or the creation of a revolving fund

23 for specific improvements. Where a local government unit has
24 adopted a capital budget, the term project shall mean any
25 unfunded portion of the capital budget for which debt is being
26 incurred.

27 (21) "Financial advisor" means a person duly authorized and
28 licensed as a bank or bank and trust company and having one or
29 more responsible individuals engaged full time in buying and
30 selling municipal securities, a securities dealer or
1 underwriter, or an investment advisor, who or whose responsible
2 officials have had five years' experience in the municipal
3 securities business or other person having municipal securities
4 experience deemed equivalent by the department, and in all
5 cases, who shall have first registered with the department as a
6 financial advisor to local government units.

7 (22) "Department" means the Department of Community Affairs
8 or any successor department, board or commission to which all or
9 certain of the functions to be performed under this act may
10 hereafter be transferred, either as provided herein or by
11 subsequent legislation.

12 (23) "Authority" or "municipality authority" means an
13 authority or nonprofit corporation organized under any law of
14 the Commonwealth by the Commonwealth, any local government unit
15 or jointly by any one or more of the foregoing.

COMMENT

2. DEFINITIONS

Debt. The concept of debt is broader than that used in the constitutional sense on two grounds, but subsequent sections impose debt limits as provided in the constitution and a separate legislative limit on authorities.

First, it includes debt excluded from debt limits by the constitution, both because voted by the people or because self-sustaining or heretofore ruled to be such by the courts.

Second, because it includes debt incurred through lease rentals where the program involves the acquisition of capital assets. It

also includes, as debt, the face amount of contracts for construction or the like when incurred in advance of bonding so that the power to finance the project is assured at the time the construction contract is made binding. The limits, as heretofore, are placed on net debt, so that when bonds are issued to fund a construction contract, the net proceeds will offset the unpaid face amount of the contract. 3

Excluded from debt are all currently budgeted obligations (also including therein tax anticipation notes and long term contracts for current supplies). For example, contracts for servicing heating apparatus, for supplies, and long term contracts with managerial officials, and the like are excluded from debt, even though they constitute obligations. They would become debt in the year payable if not included in the current budget.

Also excluded are "true leases", as for example leases for several years of office space pending the determination to build a new building.

Since interest is an obligation payable in the future, it is excluded from "debt" because historically, "debt" has referred to the principal to be repaid, and not the interest thereon, although, the rate of interest really affects the annual burden. For example, at 30 years, 3% debt of \$1,000,000 imposes a \$45,000 annual burden, while a 30 year 6% debt imposes a \$72,649 annual burden, a quite different burden.

The study by the Economy League recommended the inclusion in "debt" of all local government units of their respective actuarially determined obligations under pension plans. The study, however, stated that sufficient information as to the extent of the obligation was not available. Hence proper debt limits could not be fixed if these obligations were included. Accordingly they are excluded in the present draft, and subsequent amendment will be necessary to include such obligations if decided to do so.

NONELECTORAL DEBT. A term to cover debt which is to be subject to the debt limits imposed by the General Assembly in this Act. Excluded from this term are the following admitted categories of debt for the reasons indicated.

(1) Debt approved by the voters, for the reason that the Constitution provides that such debt shall not be included within the limit.

(2) Self Liquidating debt, for the same reason (see definition).

(3) Lease Rental Debt, since this too has been held to be self liquidating. A separate limit on such debt is, however, an appropriate exercise of inherent legislative power, and is found in Section 202.

(4) Subsidized Debt is also eliminated. More and more federal funds for various capital programs are taking the form of a subsidy of debt. The portion subsidized is really not a burden on the taxpayers of the local government unit (see comment to that definition, and see also the related comment to the definition of "Total Revenues").

Self Liquidating Debt. The definition includes not only what is normally called an "operating authority", but will include various types of non-debt revenue bonds, heretofore ruled outside of debt limits. The definition will continue this exclusion. Also covered by the definition, but on an annual certification basis, is the so-called "General Obligation Non-Debt Bond" issuable under Act No. 58 of the 1970 session. Equally included on an annual certification basis are the so-called "lease back and guaranteed" municipality authority bonds where the municipal body operates a sewer and water system, agreeing to make up any deficit in the revenues, sometimes with the caveat "when and to the extent lawful." "Ultimate users" is a term used to exclude lease backs to local government units using a project. 10

Subsidized Debt. Debt, the annual burden of which is, in effect, paid through a subsidy or reimbursement by others is not included in the debt of the local government unit to be subject to debt limits. There is here no burden on local taxpayers. Thus excluded, is that portion of a School District's debt which is serviced by its capital account reimbursement on account of the project. Also, excluded would be so much of sewer debt as would be serviced by the subsidy paid by the Commonwealth. Equally excluded would be so much of the principal of incurred indebtedness as is serviced by one or more specific subsidies paid by the federal government. Again, the theory is that, to the extent of the subsidy, there is no burden, and so the debt is self-supporting as to the local government. See the comment to Section 204, and to the definition of total revenues.

Lease Rental Debt. The definition makes it clear that where a tax supported lease rental is involved, only the principal amount of the outstanding debt is to be classified as debt to be subjected to the additional limit imposed in the exercise of inherent legislative power over municipality authorities, non-profit corporations and political subdivisions. A separate and higher combined limit is proposed to avoid the constitutional argument that, by its mandated exclusion from legislative debt limits of debt heretofore ruled to be self liquidating, the Constitution precludes the General Assembly from including this type of debt within the debt limit fixed in implementing the Constitution. An examination of the proceedings of the Constitutional Convention makes it clear that the local government debt limit was not intended to cover authority debt. It was presented to the people on that basis. Hence, it seems safer, constitutionally, to fix a separate, and additional limit for lease-back tax supported authority debt if it is to be controlled.

Total Revenues. The words are taken from the Constitution, Article IX, Section 10. It is significant that these words were used in this Section, whereas in fixing the debt limit for councilmanic debt of the Commonwealth, the words used were "tax revenues." Hence, the definition specifies the total cash intake of the local government unit, but then provides certain exclusions, five in number, in inverse order as follows;

Obvious exclusions are certain non-recurring items which under generally accepted accounting principles are not considered income. These are proceeds from the sale of capital assets, and grants or gifts earmarked for the construction or acquisition of a particular project. These non-recurring items, usually of a substantial nature could unduly inflate the debt limit.

Excluded also is the income on funds accumulated in sinking funds or reserves for the payment of debt. Those moneys are usually earmarked for the payment of the debt and, on a one to one basis would reduce outstanding net debt.

The second exclusion is the exclusion of revenues used to support self liquidating debt. An example would be a municipality which has issued self sustaining sewer or water bonds. User charges have been pledged to service the debt which is excluded from debt limit debt. The debt is excluded because self liquidating, and the pledged revenues servicing that debt are also excluded. However, any surplus revenues returned to the local government unit for general purposes are to be included in total revenues.

Perhaps more difficult to comprehend is the first exclusion that of subsidy payments. An example should, however clarify the situation. Suppose a \$2,000,000 of bond issue, with annual debt service of \$80,000, of which \$40,000 is paid by the state through a capital account subsidy. If the subsidy revenue were to be included in total revenues, and if we assume a 2 times revenues multiplier, the inclusion of the subsidy as revenues would support \$ 80,000 of debt, thus imposing \$920,000 of additional debt within the debt limit, even though such debt is absolutely no burden on the local taxpayer. By excluding the revenues, and excluding the supported debt, only the non-subsidized debt counts as against the debt limit; in the example only \$1,000,000 as against \$1,920,000.

Borrowing Base, a term used to describe the average of the total revenues to which a percentage is to be applied to determine the debt limit. The arithmetic average of the three past years is selected. To be certain that bonds are within the debt limit, the certification of the average by the auditing officials is made the base. This gives bond counsel and the initial purchasers of the bonds a definite and fixed figure to which to apply the percentage multipliers provided by the Act in order to determine the debt limit. Penalties are provided for false certification. It is usually known for some time in advance that debt is to be incurred, and with a little advance planning "total revenues" for a given fiscal year can be determined almost immediately after the year ends. It is the expense side of the ledger, requiring receipt of bills, confirmations, etc. that usually delays the financial report.

Local Government Unit. This is the term used in the Constitution. The itemization includes all known types of units, and the broader language is intended to cover not only new types of political subdivisions that may be created, but also to cover co-operative organizations that may be set up on an area wide basis by joint action pursuant to legislative authorization which may hereafter be enacted. The definition specifically excludes _____ authorities, even when used as vehicles for joint action by one or more local government units.

Bond or Note. The terms cover debt instruments and have the meanings used in the Uniform Commercial Code, thus assuring negotiability in their transfer.

General Obligation is an instrument for which the full faith and credit of the issuing municipality is pledged and if issued without a vote of approval of the electors shall represent Non-electoral Debt. It is known in the trade as a "General Obligation Bond".

Guaranteed Revenue in the title of a bond or note means an instrument payable initially in whole or in part from pledged revenues, but for the cure of any deficiency in such revenues the issuing local government has pledged its full faith and credit. It takes the place of the General Obligation Non-Debt Bonds authorized by Act No. 58 of the 1970 Session of the General Assembly.

Revenue in the title of a bond or note means an instrument payable solely from revenues pledged for the purpose. It takes the place of the former "Non-Debt Revenue Bond".

The three terms, "General Obligation Bond", "Guaranteed Revenue Bond" and "Revenue Bond" are more in keeping with the general municipal market terms and should enable the obligations of Pennsylvania local government units to be more readily identified in municipal bond markets outside of Pennsylvania.

Issues and Series, are used with respect to bonds or notes. An issue will designate all bonds to be issued with respect to a particular project or funding. Series will designate all bonds issued at a particular time. Thus, in a large construction project costing \$10,000,000 the governing body might issue all of the bonds at one time, the usual practice. But it might prove desirable to authorize an issue of \$10,000,000 to be sold in one or more series as construction progresses. If interest rates are extremely high, and the market seems to require a "ten-year" no-call provision, a sale of part of the bonds as one series to finance a year of construction, and the balance a year or so later as a second series to finance the balance may be the desirable method of procedure. Equally, where several projects are being financed at one time, it may be desirable to "combine" one or more issues into one series for purposes of sale. Such combining, of course can only be done where the bonds are of identical type and credit, i.e. all are general obligation bonds, or assessment bonds, or are supported by identical user charges in several areas. Combining may make a more saleable package than several small sales. Electoral debt and non-electoral debt can, of course, be combined for purposes of sale as for example when the vote authorizes a specific dollar amount of debt, but the construction bids for the project exceed the authorized amount. Non-electoral debt can be used to permit the project to proceed, and as provided herein the voters can, at a later election transfer such non-electoral debt to electoral debt.

Ordinance. The definition is taken in part from the definition proposed to be used in the act establishing a uniform procedure for all local government units. Substantive provisions as to publication and effectiveness have been separated and appear in Section 103.

Incur or incurred is a term used in this act to indicate the point in time when a charge must be made against the debt limit. The point selected is when the first ordinance authorizing the debt shall have been adopted, the ordinance heretofore called the "desire"

ordinance. Reference to the definition of debt will indicate that in certain instances the debt will be "incurred" at an earlier point of time, namely when a project is authorized at an estimated cost. Such action will in effect, be a "reservation" of a portion of the debt limit for the particular project. Any "incurred" but unobligated debt can, of course, be cancelled. The time to be sure that action will fit within the debt limitations, or should be put to a vote of the people, should be at the earliest stage practicable.

Sinking Fund, will be used to describe all accumulations of moneys or investments as reserves in connection with financing. The Act contemplates the creation of only one Sinking Fund in connection with each series. Within a given sinking fund there may be one or several "accounts" in which balances will be accumulated or held for various purposes; as for example, (1) for the payment of debt service, (2) for the mandatory annual retirement of principal stated to mature several years in the future, (3) for a reserve to be drawn upon in years of falling revenues; (4) as a reserve for extraordinary and non-recurring items of maintenance, replacement or repair, or as a surplus fund for the optional retirement of bonds. Whether such funds, except for annual debt service funds, shall be created is a matter to be determined by the governing body at the time of issuing the bonds or notes.

Project is defined broadly as including, in effect, any item properly classifiable as an item of capital expense in accordance with sound and generally accepted municipal accounting practices. Included are the expenses of properly pre-planning a project so as to obtain realistic cost estimates at the earliest practicable stage. Except in the larger projects such expenses could be financed by temporary borrowings and refunded when bonds are issued for the project as a whole. If the project does not go forward, the debt must be retired in ordinary course. The capital item must, of course, be one which the particular local government unit is authorized to own, operate, or subsidize. See Section 105(c).

Financial Advisor, the recommendation of the Pennsylvania Economy League is that each local government unit be required, prior to the issue of any bonds to retain the advisory services of an institution qualified in the bond market. The institutions named are those which by virtue of their experience seem qualified to perform the task. Rather than set up a separate licensing scheme, since entrance to each of the stated businesses is already the subject of legal controls, registration with the Department of Community Affairs seems preferable. Other sections of the act are designed to avoid conflict of interest and to require the services of a financial advisor only in the case of substantial issues where the fees to be charged will not be an undue cost in relation to the size of the issue.

Department, means the department of Community Affairs or any successor department, board or commission to which the functions to be performed under this act may hereafter be transferred.

8003

16 Section 103. Effectiveness and Required Notice of
17 Ordinances.--Notwithstanding any other law to the contrary, an
18 ordinance required to be published by this act shall be
19 advertised not less than seven nor more than thirty days prior
20 to its enactment upon final reading by the governing body of the
21 local government unit. The advertisement shall appear once in a
22 newspaper of general circulation, published or circulating in
23 the area of the local government unit, shall set forth a summary
24 of the contents of the ordinance and shall state that a copy of
25 the full proposed text thereof may be examined by any citizen in
26 the office of the secretary of the local government unit at the
27 address and during the reasonable hours stated in such
28 advertisement. Not later than the seventh day after the final
29 enactment of such ordinance, a notice of such enactment shall be
30 advertised once in a newspaper of general circulation published
1 or circulating in the local government unit. This notice shall
2 state:

- 3 (1) Any amendments made during final passage including
4 amendments setting forth the price bid for bonds or notes, the
5 range of interest rates named in the successful bid, and the
6 annual debt service; and
- 7 (2) That a copy of such notice has been conspicuously posted
8 and will remain so posted for the next twenty-three days in a
9 designated position, readily viewable by the public, at the
10 public meeting place of the governing body of such local
11 government unit. The ordinance shall be valid and effective for
12 all purposes on the later of such twenty-third day or the
13 thirtieth day after the final enactment of such ordinance. The
14 second advertisement shall be conclusive, so far as concerns the

15 effectiveness of the ordinance or the validity of any debt
16 incurred, as to the existence of all matters recited therein
17 unless action questioning such validity or effectiveness shall
18 have been filed in timely manner as provided herein, but such
19 conclusiveness shall not affect the liability of any person for
20 failure to post and keep posted the notice or for failure to
21 permit inspection.

COMMENT

3. EFFECTIVENESS AND REQUIRED NOTICE OF ORDINANCES

This section states the substantive requirements for the effectiveness and advertisement of ordinances. For bond ordinances it is important to have clear, objective, fixed criteria governing the effectiveness of ordinances, and yet parallel the normal procedures as closely as possible. The proposed normal procedure will be to advertise before the meeting of the governing body where the ordinance will receive final reading and passage so that the citizens can be heard at the meeting. A requirement of advertising the complete text would preclude amendment at the meeting. Ordinarily there will be no changes, except in the case of an ordinance accepting a bond bid where the details of the bid and the amount of the tax being levied cannot be known until the bid is opened and read. Since a bond bid is for prompt acceptance, such items cannot be advertised in advance. The second advertisement can, therefore, be quite short and inexpensive.

Posting in a conspicuous public place, keeping available for inspection and the like are items requiring too much extrinsic proof to enable bond counsel to give the unconditional opinion expected in the market. Hence the effectiveness of the ordinances and the validity of the bonds is made to turn on the existence and wording of the two advertisements, but without thereby relieving the officials of the local government unit from any liability for failure to carry out the posting and availability requirements.

The seven days and the twenty-three total thirty, the number of days during which an appeal can be taken under the Appellate Court Jurisdiction Act of 1970. Normally the bonds or notes should be delivered to the purchasers as soon as practicable after the final enactment of the ordinance accepting the bid. A period longer than thirty days, in some bond markets, may affect the interest rate bid. Generally between 30 and 45 days will not affect the bid, but a mandatory wait of 37 or more days should be avoided. This is done by using the 23 day period after the advertisement, but a full 30 days is allowed for an appeal in any event.

22 Section ⁸⁰⁰⁴ 104. When Lease or Other Agreement Evidences
 23 Acquisition of Capital Asset.--A lease or other agreement
 24 entered into by a local government unit shall evidence the
 25 acquisition of a capital asset where:

26 (1) The lessee is a local government unit and the lessor is
 27 an authority organized under any law of this Commonwealth, a
 28 nonprofit corporation, the State Public School Building
 29 Authority or other agency or authority of the Commonwealth of
 30 Pennsylvania; and

1 (2) The payments, or any portion thereof, are payable or may
 2 be payable from the tax or general revenues of the local
 3 government unit; and

4 (3) Upon termination of such lease or upon dissolution of
 5 such lessor, whether before or after the termination of the
 6 lease, title to the leased project or premises shall, or at the
 7 option of the local government unit may, vest by agreement or
 8 operation of law in such local government unit, or in the
 9 Commonwealth of Pennsylvania; or

10 (4) In any case where clause (2) of this section 104 applies
 11 and the term of the lease is equal to or exceeds the useful life
 12 of the asset, regardless of the nature of the lessor.

COMMENT

4. WHEN LEASE EVIDENCES ACQUISITION OF CAPITAL ASSET

This section must be read in connection with the definition of Lease Rental Debt of a local government unit. The combination of the two place limitations only upon the incurring of debt which is, or which may be, paid out of the general tax revenues of the local government unit, and in connection with the concept of self-liquidating debt, only during the period when such general tax revenues are in fact being used to defray the lease rental.

Thus, the very common form of financing sewer systems in second class townships by a lease back from a municipal authority in which lease rentals are payable from sewer chargers and from tax revenues "when, as, if, and to the extent lawful" will not be affected until:

- (1) It is lawful to apply tax rentals to the payment of sewer rents; and
- (2) Such rents are, in fact, so applied.

Covered, as leases involving the acquisition of capital assets, are school district leases from the State Public School Building Authority as well as School district leases from local authorities. Of course, the total of such indebtedness will not be charged against non-electoral debt, but only the portion thereof which is not excludable as subsidized debt.

Under the Act it will no longer be necessary in the case of non-electoral lease rental debt to scrupulously avoid a contractual obligation to cancel the lease and convey the asset to the local government unit when all of the authority bonds are paid off, since the debt is within legislatively imposed debt limits. Equally since all debt approved by the electors is excluded from limitations any lease rental debt approved by a vote of the people would likewise be excluded.

Leasing for the full useful life of a project is but a disguised method of acquiring a capital asset, hence it is covered by the section no matter who the lessor may be. The effect of this subsection (4) will, of course, be largely felt in the area of equipment leasing.

8005

13 Section 105. Designation of Bonds and Notes; Authority to
 14 Issue.--(a) Bonds or notes prior to the authorization thereof
 15 shall be classified by the issuing local government unit as one
 16 of the following four types of obligation: general obligation
 17 bonds or notes; guaranteed revenue bonds or notes; revenue bonds
 18 or notes; or tax anticipation notes.

19 (b) Guaranteed revenue bonds or notes may have either a
 20 general or a limited guaranty as the governing body of the local
 21 government unit may determine, but if the guaranty shall be less
 22 than a full unconditional guaranty, the title of the bond or
 23 note shall contain the word "limited" before the word
 24 "guaranteed." The guaranty of the local government may be of its
 25 own revenue bonds or of the revenue bonds of an authority or
 26 nonprofit corporation subject, however, to the provisions of
 27 subsection (c) of this section.

28 (c) Every local government unit shall have full power and
29 authority to issue bonds or notes, and make guaranties as *Complete*
30 provided herein, *and to make the cost of or of the cost of* ~~for~~ any project or combination of projects
1 which such local government unit is authorized to own, acquire,
2 subsidize, operate or lease, or to participate in owning,
3 acquiring, subsidizing, operating or leasing with others and
4 shall also have full power and authority to issue funding bonds
5 or notes as herein provided.

COMMENT

5. DESIGNATION OF BONDS OR NOTES; AUTHORITY TO ISSUE

The Act contemplates Tax Anticipation Notes and 4 classes of securities to be issued by municipalities:

General Obligation Bonds or Notes

Guaranteed Revenue Bonds or Notes

A guaranty of a bond or note of any authority or non-profit corporation

Revenue Bonds, or Notes

Bond Anticipation Notes, when issued, will be in anticipation of the issue of one class of bonds only. The credit risk is clearly different in the case of Revenue Bonds as contrasted with General Obligation Bonds. The Guaranteed Revenue Bond is in a sense a General Obligation Bond which in normal times is excluded from the debt limit. It, of course, takes the place of the so-called Non-Debt General Obligation Bond now issuable under Act No. 58 of the 1970 Session.

It may materially assist the marketing of a Revenue Bond to have the municipality guarantee to make-up any deficiency in revenues, whether the bond or note be its own or that of an authority or non-profit corporation. The municipality may, however, desire to place a limitation on the amount of funds it can be required to contribute in any one year to the make-up of the deficiency. The provisions of subsection (b) permit this to be determined and specified by the governing body.

Subsection (c) clarifies the rights of certain bodies to incur debt. Thus, the power to build roads conferred on second class townships thus clearly includes the power to issue bonds to provide funds for road-building.

Included in the words "own, acquire, operate, or lease" is the word "subsidize" meaning "for the support of which it is authorized to appropriate moneys." This addition will have substantial impact in permitting local government units to provide, through bond issues, capital assets for institutions from which the local government unit may hire services. As an example, a county may contribute to a hospital to enable it to provide hospital care for the poor, or the aged and infirm. Clearly providing additional capacity in existing institutions may well be cheaper and more effective than providing a whole new institution for such purpose. The same rule applied to Port Authorities and mass transit.

8006

6 Section 106. Preliminary Cost Estimates; Financial
 7 Advisor.--Prior to the initial authorization of bonds or notes
 8 to finance any project involving construction or acquisition,
 9 the governing body shall obtain realistic cost estimates through
 10 actual bids, option agreements, or professional estimates from
 11 registered architects or professional engineers, and shall
 12 retain the services of a financial advisor in all cases
 13 involving a proposed issue of one million dollars (\$1,000,000)
 14 or more in aggregate principal amount. In the case of smaller
 15 issues, the governing body may retain the services of a
 16 financial advisor. Costs of preliminary estimates and the fees
 17 of financial advisors may, if initially paid by the local
 18 government unit, be reimbursed out of the net proceeds of the
 19 issue of bonds or notes as a cost of the project.

COMMENT

6. PRELIMINARY COST ESTIMATES; FINANCIAL ADVISOR

The section implements the policy of requiring a professionally prepared preliminary cost estimate before embarking on a project. Such pre-planning, it has been found, enables a local government unit to have a reasonable idea as to costs and avoid the inevitable misunderstandings that arise when construction bids are received. As in the case of state planning, the cost estimates to be meaningful should be projected to a realistic date for the receipt of construction bids.

The Pennsylvania Economy League report recommends the use of financial advisors. The Act adopts this recommendation for the larger issues. Smaller issues are often taken by local banks, where the protection of the local citizens through the use of paid financial experts may not warrant the extra cost. The larger the issue, the lesser, proportionately, the fee of the financial advisor and its impact on local finances. While admittedly arbitrary, the line between large and small issues has been set at \$1,000,000, but if a local government unit desires the protection of outside expertise, it is not a waste of public moneys to hire one. In certain local government units, such as first class school districts, having staff expertise, the staff member having such expertise may qualify as a financial advisor. For the restrictions on the right of a financial advisor to participate in marketing an issue, see Section 711.

8007

20 Section 107. Cost of a Project.--The cost of a project shall 20
21 include the amount of all payments to contractors or for the
22 acquisition of a project or for lands, easements, rights and
23 other appurtenances deemed necessary for the project, fees of
24 architects, engineers, financial advisor and attorneys incurred
25 in connection with the project or its financing costs of
26 preparing bonds or notes, costs of necessary printing and
27 advertising, the costs of preliminary feasibility studies and
28 tests, cost estimates, and interest on money borrowed to finance
29 the project, if capitalized, to the date of completion of
30 construction and, if deemed necessary, for one year thereafter,
1 and a proper allowance for contingencies.

COMMENT

7. COST OF A PROJECT.

The definition covers all elements of the financial cost of a project. Feasibility studies and tests include core borings, soils analysis, revenue projections, traffic counts and any test or study deemed necessary to enable the construction or acquisition of a proper and workable project. Capitalized interest must, of course, be estimated, including an estimate of the date of completion. If the original estimate is too low, additional bonds can be issued, or the local government unit may subsidize the interest during construction, avoiding the doubling of costs inherent in a capitalization.

2

ARTICLE II

COMMENT

ARTICLE 11 - Limitations on Debt of Local Government Units

The Article is designed to cover not only the fixing of the necessary legislative limits, but the procedures to be followed to secure exclusions of debt which, in substance, casts no burden on local tax revenues. At first blush, the reportings for exclusion required may seem onerous. On reflection, it is believed, it will appear that such procedures are required to ensure adequate reporting of incurred debt. Presently, the debt situation of local government units is not known at the Commonwealth level until several years after the fact. As at January 25, 1971, the debt status as at December 31, 1968 was the most recent figure accurately available in the Commonwealth, and it covered only General Obligation Debt. The study of the Pennsylvania Economy League uses 1967 figures, now over four years old. If the General Assembly is to fix and change debt limits by legislative action, it must have up to date information. Criminal penalties, fines, etc. even if provided are, as a practical matter seldom imposed on local officials for failure to file reports. An administrative block on the ability to incur new debt will, in the case of local government units about to incur new debt, or which may wish to be in a position to incur new debt, be an effective means of securing prompt reporting.

3 Limitations on Debt of Local Government Units

4 Section ⁸⁰²¹ 201. No Limitation on Debt Approved by
 5 Electors.--All debt, whenever incurred, which has been or shall
 6 hereafter be approved, either before or after such debt is
 7 incurred, by majority of the votes cast upon the question of
 8 incurring such debt at a general or special election held as
 9 provided in this act, shall be excluded from the nonelectoral
 10 debt of a local government unit and the limitations imposed by
 11 this act upon such debt shall not apply thereto.

COMMENT

1. No Limitation on Debt Approved by the Electors. The section makes clear what is specified in the Constitution, that local government debt approved by the electors is to be excluded from debt limits. This act excludes such debt whether approved before or after the debt was incurred. Of course, debt incurred prior to the approval must be within the limit or be lawfully excluded at the time it is incurred. (See definition of incurred). As the Section relates to debt, generally, there can be excluded, not only general obligation debt, but also lease rental debt, self liquidating debt, and subsidized debt. If approved by a vote, the debt represented by "guaranteed revenue bonds" could be permanently excluded from the limits placed by this Act on non-electoral debt, rather than requiring an annual re-certification of eligibility as Self Liquidating Debt.

12 Section 202. Limitations on the Incurring of Other Debt;
 13 Regular and Additional Debt Limits.--(a) Except as provided in
 14 subsections (b) and (c) of this section, no school district of
 15 the first class shall incur any new debt, if the aggregate
 16 principal amount of such new debt together with all other net
 17 nonelectoral debt then outstanding shall exceed eighty per cent
 18 of its borrowing base or if such aggregate principal amount
 19 together with all other net nonelectoral debt plus all net lease
 20 rental debt then outstanding shall exceed one hundred per cent
 21 of its borrowing base. And except as provided in subsections (b)
 22 and (c) no other local government unit shall incur any new debt
 23 if the aggregate principal amount of such new debt together with
 24 all other nonelectoral debt then outstanding shall exceed two
 25 hundred per cent of its borrowing base or if such aggregate
 26 principal amount together with all other net nonelectoral debt
 27 plus all net lease rental debt then outstanding shall exceed two
 28 hundred twenty-five per cent of its borrowing base.

1 TABLE OF BORROWING BASE PERCENTAGES

2 APPLICABLE TO LOCAL GOVERNMENT UNITS

3	(1)	(2)	(3)
4	Type of Local Government Unit	Nonelectorate	Nonelectorate
5		Debt	Plus Lease
6			Rental Debt
7	County	200%	225%
8	County Institution Districts	200%	225%
9	Second and Third Class Cities	200%	225%
10	Boroughs	200%	225%
11	First and Second Class Townships	200%	225%
12	First Class School Districts	80%	100%
13	First Class A, Second, Third		
14	and Fourth Class School		
15	Districts	200%	225%

16 (b) The limitations of the preceding subsection shall not
17 apply to electoral debt, nor to debt excluded as self-sustaining
18 or as subsidized debt pursuant to sections 204, 205 and 206 of
19 this act.

20 (c) In addition, any county which has assumed county-wide
21 responsibility for hospitals and other public health facilities,
22 air pollution control, ^{sewage and} refuse disposal, public transportation
23 and port facilities, may incur, but only for capital facilities
24 for any or all of the foregoing purposes, additional
25 nonelectoral or lease rental debt up to an additional one
26 hundred per cent of its borrowing base (herein called the
27 "additional debt limit"). Debt at any time incurred for such
28 purposes may be assigned to this additional debt limit if there
29 is insufficient remaining borrowing capacity within the regular
30 debt limit.

1 Also, in case replacement of assets is required as a result
2 of fire, flood, storm, war, riot, civil commotion, or other
3 unforeseeable catastrophe, or such replacement is required for
4 the prevention of dangers to health or safety; or in case funds
5 are required for the payment of tort liability not covered by
6 insurance or for the payment of the costs of mandated
7 installation of anti-pollution environmental protection and fire
8 control and protection devices, or of complying with other
9 mandated Federal or Commonwealth programs, the local government
10 unit, not having sufficient remaining borrowing capacity, upon
11 petition to the Commonwealth Court alleging the catastrophe and
12 the costs of replacement, or construction, or the incurred tort
13 liability, or the costs of the (mandated) installation of health,
14 safety, anti-pollution or fire prevention devices, or of

other non-electoral program

15 complying with ~~such~~ programs, and upon proof thereof to the
16 satisfaction of such court, shall be authorized to incur
17 nonelectoral debt, notwithstanding the provisions of section
18 305, and if there is an insufficiency of borrowing power may be
19 authorized to incur nonelectoral debt up to an additional fifty
20 percent of such borrowing base, (herein called the "additional
21 emergency debt limit") if such increase is found by the court to
22 be made necessary by reason of the cause set forth in the
23 petition and the increase together with all outstanding debt
24 other than funding debt incurred pursuant to previously granted
25 petitions does not exceed the sum of the regular and the
26 additional emergency debt limits. Public notice of the intention
27 to file such a petition and of the purpose for which the debt is
28 to be incurred shall be given by advertisement not less than
29 five nor more than twenty days before the filing thereof. Such
30 emergency nonelectoral debt may be incurred only for the purpose
1 and upon terms approved by the court and any excess over the
2 regular debt limit so authorized shall not thereafter be
3 included in computing net nonelectoral debt. Appeals from the
4 order of the court may be taken by any interested party in
5 accordance with the Appellate Court Jurisdiction Act of 1970.

COMMENT

2. Limitations on the Incurring of other Debt. For enforcement purposes the section, in effect, classes all debt not properly covered by the exception clauses, as non-electoral debt. The exception for electoral debt is made by the results of the referendum. The exception for Self Liquidating Debt and Subsidized Debt depends upon securing the exclusion by the means prescribed in Sections 204, 205 and 206, as the case may be. As heretofore mentioned in these comments, constitutional attack upon this Act is avoided, and operation of the severability clause is made easier should there be constitutional attack. This latter element is important, for, with but a single limit covering both types of debt, it could be argued that the limitation was invalid as it could not be determined whether the limit without the inclusion of lease rental debt would be the same as that selected when lease rental debt was included. Hence the double limitation seems desirable.

The limits are set, in accordance with the Constitution at a percentage of the Borrowing Base, which term means the average of the total revenues received in each of the three preceding fiscal years.

Based upon a 6% 35 year bond issue, a limitation upon debt set at 200% of the borrowing base, means that less than 15% of total revenues are used for debt. Obviously, if a shorter term of years is selected, the annual burden will be higher. The refunding provisions of this Act, however, have intentionally been made flexible so that the initial financing of a project costing, say, 100% of the borrowing base could be financed on a 6 or 10 year basis, and then if additional financing were needed, or if the annual burden, initially undertaken, subsequently was deemed too onerous, the term of the issue could be extended, thus reducing the annual cost. As stated above such refunding would permit the financing of another project, having a cost of 150% of the borrowing base without increasing the annual tax burden.

The former nonelectoral limit of 5% of the assessed value, which had proven itself to be inadequate, is, however, identical in amount with a 100% of total revenues, when total revenues are equivalent to a 50 mill tax on assessed values.

The limits set in this Act were set with a purpose to remove as many of the advantages offered by the authority method of financing as possible. Accordingly, the limits are fixed so as to leave room within the ceilings for foreseeably necessary future financing in all but the most debt ridden of local government units. This seems in accord with the complete exclusion from limits of all authority financing by the final product of the Constitutional Convention as adopted by the people, and as explained to the voters by the proponents during the time preceding the vote.

The proviso clause follows the pattern found in certain other states which will permit a court, on an appropriate showing, to increase the limits in certain emergencies, and for certain mandated purposes. It should not be possible for a local government unit to avoid complying with a Commonwealth Clean Streams Program or Clean Air Program or the installation in schools of fire safety devices, by pleading a lack of debt incurring ability to finance the necessary capital assets required for compliance. The additional percentage of the borrowing base has been fixed with the cost of such assets in mind.

In both the pollution and fire prevention situation and in the emergency reconstruction situation, the safety valve is the requirement that the increased borrowing capacity be demonstrated as necessary to the court in a proceeding filed after public notice and in which interested taxpayers may intervene.

Debt incurred pursuant to such authorization is excluded during the life of such debt from all computations of non-electoral debt so that borrowing capacity made available by reductions in non-electoral debt outstanding when the emergency authorization was obtained, can be utilized. This rule will ensure local cooperation in seeking authorizations for the transfer of such debt to electoral debt thereby freeing the emergency "escape Hatch" for further emergencies which may later occur.

The emergency authorization is also made available for tort liability not covered by insurance. Many local government units now carry tort liability insurance. All should as immunities from tort are whittled away by the court. Policy limits may not be sufficient to cover verdicts arising from catastrophic accidents such as injuries to most of the children on a 40 passenger school bus, the explosion of a municipally operated gas line; or the like. Those recovering a judgement should be paid, even if the local government unit has otherwise exhausted its nonelectoral borrowing power.

8023

6 Section 203. Transfer of Nonelectoral Debt to Debt Approved
7 by Electors.-- The governing body of any local government unit
8 may, by ordinance, signify a desire to have any nonelectoral
9 debt theretofore incurred established as electoral debt. The
10 ordinance shall direct the holding of an election to be held at
11 the proper places within such local government unit for the
12 purpose of obtaining the approval of the electors to such debt
13 in the same manner as provided for securing the approval of the
14 incurring of electoral debt. The question shall be whether the
15 remaining unpaid nonelectoral debt incurred for the project
16 named in the question shall be removed from the category of
17 nonelectoral debt. If such question shall receive a majority of
18 the votes cast at such election, a certified copy of the
19 ordinance, proof of due advertisement of the election and of the
20 ordinance and a certified return of the election shall be filed
21 with the department. If the department finds the proceedings to
22 have been taken in conformity with the law it shall endorse its
23 approval on a duplicate original thereof and return the same to
24 the local government unit. A copy of the proceedings duly
25 certified by the proper officials of the local government unit
26 together with the approval of the department shall be filed in
27 the office for the recording of deeds in and for the county in
28 which such local government unit is located. Such debt shall
29 thereupon be no longer classified as nonelectoral.

3. Transfer of Non-Electoral Debt to Debt Approved by the Elector²⁷
 This section enables a local government unit to restore its non-electoral borrowing power in several circumstances, but is not limited to the circumstances stated in this Comment as illustrative.

a. The voters have authorized the incurring of debt to finance a project, but when construction bids are received, the cost exceeds the debt authorized. Awaiting an election to increase the authorization may result in loss of construction bids, and, on a rebid after the time necessary for an election, a substantial increase in costs may result. Hence non-electoral debt may initially be incurred for the excess, and the extra debt be thereafter transferred to electoral debt.

b. A project initiated by nonelectoral debt may be deemed quite desirable by the voters. The transfer to electoral debt will then release non-electoral borrowing power for the future. If the purpose of holding the election is to release borrowing power for immediate use for an unpopular project, those opposing the unpopular project can easily turn the election into a decision on the unpopular project. To believe otherwise is to indicate a mistrust of the electorate so great as to support the contention that the non-electoral debt limit is the true debt limit, and there is no real escape valve through the electoral position. This Act takes the contrary position, namely that the electoral process can be used effectively on many occasions..

Soundly managed communities will wish to conserve councilmanic borrowing power for future unknown demands wherever possible; the section offers a means of recapturing used non-electoral borrowing power by requesting what is, in effect, a vote of confidence on an already built project.

7024

30 Section 204. Procedure for Exclusion of Subsidized Debt from

1 Nonelectoral Debt and Lease Rental Debt.--(a) Subsidized debt
 2 shall not be excluded from nonelectoral debt or lease rental
 3 debt, as the case may be, until there has been filed with and
 4 approved by the department:

5 (1) A copy, certified by the secretary of the board of the
 6 local government unit, of the permanent or preliminary approval
 7 from the Commonwealth of Pennsylvania or from the United States
 8 of America of the project, the bonds, or the interest thereon,
 9 for subsidization or for reimbursement of debt service;

10 (2) Evidence satisfactory to the department from the
 11 subsidizing agency as to the indicated annual amount of the
 12 subsidy;

13 (3) Appropriate reference to the legislation authorizing such 28
14 reimbursement or subsidy indicating the legislated recurring
15 nature of the subsidy; and

16 (4) A computation, in reasonable detail, certified by the
17 proper officers of the local government unit and approved as
18 mathematically correct by an independent certified public
19 accountant or by the financial advisor of the local government
20 unit, showing the principal amount of the bonds to be serviced
21 by the reimbursement or subsidy, determined in the proportion
22 that the total indicated subsidy or reimbursement to be received
23 over the life of the issue bears to the total debt service to be
24 paid over the remaining life of the issue, computed to stated
25 maturity or earlier mandatory call dates.

26 Such proportion of the bonds or of lease rental debt shall be
27 excluded as subsidized debt. Such filing may be made
28 simultaneously with the filing for the approval of the balance
29 of the bonds then being issued, or may be made or corrected at a
30 later date.

1 (b) If the department shall approve the exclusion of such
2 principal amount of bonds or lease rental debt as being
3 subsidized debt in accordance with this act, it shall return a
4 duplicate original of the filing to the local government unit
5 with its approval endorsed thereon. Upon the filing of such
6 approval and duplicate original in the office for the recording
7 of deeds in the county in which such local government unit is
8 located, such principal amount of bonds shall be excluded from
9 nonelectoral debt or lease rental debt. Each year such debt is
10 outstanding, a new certification shall be made to the department
11 pursuant to section 210 of this act stating either that there
12 has been no material change, or if there has, certifying to all
13 matters so changed.

COMMENT

4. Proceedings for Exclusion of Subsidized Debt from non-electoral Debt. The concept here is that the amount of the subsidy, no matter how it is calculated, is applied to the total debt service, computed over the life of the series of bonds or notes involved, and a ratio determined. The outstanding principal amount is then apportioned in the same ratio, and the portion of the outstanding principal so determined is excluded as Subsidized Debt, because self-supporting as far as impact on the finances of the local government unit is concerned.

For example, in sewer construction, the state subsidy is stated to be an operating expense subsidy but is computed as 2% of the cost of the disposal plant. If we assume for ease of illustration that the effective amount of the subsidy comes to 1% of the principal amount of outstanding bonds, and assume a 35 year 5% issue with a level annual debt service factor of \$61.072 per \$1,000 or 6.1072% a year, then the fraction for exclusion is 1 over 6.1072 or 16.3741% of the bond issue becomes Subsidized Debt, or \$163,741 out of a \$1,000,000 bond issue.

In public school construction, the Department of Education fixes the percentage of annual debt service that will be reimbursed to the School District and that percentage of the outstanding bond issue will be excluded. Customarily the Department of Education will indicate initially, a tentative reimbursement factor, later adjusted (almost invariably upward) as final approved costs are determined. The section covers this procedure by its indication that corrected filings may be made.

The section's prime significance, of course, is that it will permit the use of general obligation bonds by the less affluent School Districts having Capital Account Reimbursement fractions covering 40% or more of Debt service, and correct any imbalance caused by differences in wealth, curing possible federal equal protection defects in debt limit.

A more complicated computation is necessary in the case of federal programs granting an interest equalization subsidy. Here, the amount of the subsidy declines as the interest payable declines. Again assuming a series of \$1,000,000 sold on a 35 year 5% basis, the annual debt service, on the level annual debt service plan would be \$61,072. The total debt service for the 35 years would be \$2,137,520, giving a total amount of interest, at 5%, of \$1,137,520. Assuming that the subsidy was to reduce the interest to 3%, over the life of the issue, the subsidy would amount to 40% of the interest, or \$455,008. Applied to total debt service of \$2,137,520, this yields a factor of 21.2867%, or an exclusion from the \$1,000,000 issue of \$212,867.

Since there can be a delay in obtaining the necessary certifications to support an exclusion from non-electoral Debt, provision is made for the filing to be initially made, either concurrently with the application to the Department of Community Affairs for approval of the issue, or at a later date. If made at a later date, the local government unit must, of course, have sufficient unused non-electoral borrowing capacity to cover the entire series. After certification and approval, there will be a restoration of non-electoral borrowing power, to the extent of the exclusion.

Administrative action can be taken within the Commonwealth to expedite the issue of preliminary certifications as to anticipated subsidies or reimbursements. Hopefully the federal government can be induced to issue a preliminary certification. The section, in item (b) is purposefully vague as to the nature of the acceptable evidence,

since within the Commonwealth, it may take the form of interdepartmental correspondence, a letter, or a more formal certification. The Department of Community Affairs, as a condition of its "satisfaction" may, of course, require the submission of such statutory excerpts references and opinions of counsel as it may deem necessary.

For the necessity for annual recertification, which will either expand or contract the amount to be excluded.

14 Section ⁸⁰²⁵ 205 Procedure for Exclusion from Nonelectoral Debt

15 of Self-liquidating Debt Evidenced by Revenue Bonds or
16 Notes.--(a) Self-liquidating debt evidenced by revenue bonds
17 shall not be excluded from nonelectoral debt until there has
18 been filed with, and approved by, the department:

19 (1) A statement by the proper officials of the local
20 government unit certifying the amount of such debt, the project
21 for which it was incurred, and the nature of the revenues from
22 which such debt is to be repaid;

23 (2) A certificate from a qualified professional engineer or
24 architect, as may be appropriate to the project estimating the
25 revenues and operating expenses of the project, and showing that
26 the net revenues so estimated will be sufficient to pay the
27 annual debt service as it falls due.

28 (3) An opinion of the bond counsel approving the issue, to
29 the effect that the holders of the bonds have no claim upon the
30 taxing power or tax revenues of the local government unit
1 issuing the bonds, but only claims upon the specific revenues
2 pledged and rights to the enforcement of any covenants as to the
3 levying or collection of rates and charges for the use of the
4 project being financed or any covenants as to the assessment of
5 benefits upon properties serviceable by the project as provided
6 in such covenants with the holders of the revenue bonds.

7 (b) If such statement certificate and opinion are found by
8 the department to be in conformity with law, and the revenue

9 estimates to be not unreasonable, it shall endorse its approval
10 on a duplicate original thereof and return the same to the local
11 government unit. A duplicate original of the documents with the
12 approval of the department endorsed thereon shall be filed in
13 the office for the recording of deeds in the county in which
14 such local government unit is located, and upon such filing, the
15 principal amount of such revenue bonds shall be excluded from
16 nonelectoral debt.

COMMENT

5. Procedure for Exclusion from NON-Electoral Debt of Self-Liquidating Debt Evidenced by Revenue Bonds. Since the exclusion here depends upon the legal nature of the instrument issued, an initial exclusion should be a permanent one, and the section so provides. The section also provides for buttressing the exclusion by the report of a qualified engineer as to adequacy of revenues. Revenue bonds facing an imminent default should not be issued.

8006

17 Section 206. Procedure for the Exclusion from Nonelectoral
18 Debt of Lease Rental Debt or Self-liquidating Debt Evidenced by
19 Other Bonds or Notes.--(a) Self-liquidating debt shall not be
20 excluded from nonelectoral debt, and lease rental debt shall not
21 be excluded from the limits imposed thereon by section 202,
22 until there has been filed with, and approved by the department:

23 (1) A report to the local government unit from qualified
24 registered engineers or architects as may be appropriate to the
25 project involved setting forth:

26 (i) the estimated or, if available, the actual cost of
27 construction, acquisition, or improvement of the project
28 financed or to be financed;

29 (ii) the principal amount of the existing bonds or notes,
30 guaranteed revenue bonds or notes or of bonds or notes
1 evidencing lease rental debt, issued or to be issued, the dates,
2 interest rate and amounts of each stated maturity thereof and,
3 set forth separately, the same information with respect to so
4 much of such bonds as may be outstanding;

5 (iii) the amount and the estimated amount of the annual debt
6 service for each year during the life of all bonds issued and
7 intended to be issued to finance the project;

8 (iv) the date or estimated date of the completion of the
project;

10 (v) the estimated net revenues of the project for each year
11 of the life of the bonds with a computation showing, in
12 reasonable detail, that such net revenues will be sufficient in
13 each such year to pay the annual debt service on such guaranteed
14 revenue bonds or a specified aggregate principal amount thereof;

15 (vi) such engineer's or architect's certificate that the
16 estimates of net revenues have been computed from such
17 engineer's best estimate of the gross revenues to be obtained
18 from the rentals, rates, tolls, and charges established by
19 ordinance for the use of the project, or the gross revenues to
20 be received from special assessments levied to finance the
21 project, by deducting from such gross revenues, in each year,
22 the total estimated costs of operation and maintenance of the
23 project chargeable against such revenues or assessments and any
24 State taxes assumed on such guaranteed revenue bonds all based
25 on assumptions deemed reasonable for the purpose by such
26 engineer; and

27 (vii) such engineer's or architect's further certificate
28 that such registered engineer or architect is qualified to act
29 with regard to the type of project then being financed.

(2) A certified copy of an ordinance of the governing body
1 of such local government unit approving the report.

2 (b) If the department shall approve the exclusion of the
3 principal amount of bonds stated in such report and ordinance as
4 being self-liquidating debt as being in accordance with law, and

5 the revenue estimates as not unreasonable, it shall exercise its
6 approval upon a duplicate original of the proceedings and return
7 the same to the local government unit. Upon the filing of such
8 approval and duplicate original in the office for the recording
9 of deeds in the county in which such local government unit is
10 located, such principal amount of bonds shall be excluded from
11 nonelectoral debt or lease rental debt, as the case may be,
12 during the period of construction and for one full year
13 thereafter. Upon the expiration of such year the further
14 exclusion of such principal amount of bonds shall be governed by
15 the provisions of section 210 of this act.

COMMENT

6. Procedure for Exclusion from non-electoral Debt of Self Liquidating Debt Evidenced by Guaranteed Revenue Bonds.

The procedure here suggested is derived from Act No. 58 of the 1970 session "Non-Debt General Obligation Bonds." It enables a local government unit to obtain a better rate for water, sewer and similar projects by guaranteeing to make up any deficit in revenue. Quite generally there will be no deficit and the local government will never be called on to pay on its guaranty. Quite often in authority financing a sewer project is leased to the local government unit under a lease which obligates the general credit of the local government for the payment of the lease rentals. In fact, however, no claim on the tax revenues is made, or if made, it is minimal.

Item (v) of the Engineer's Certificate (and the certificate will usually be made by a registered professional engineer) is the key to the operation of the section. Suppose \$3,000,000 of bonds are issued on a 35 year 5% basis. Annual debt service will be approximately \$185,500 and net revenues from the project are originally estimated at \$195,000. Due to a recession, revenues drop to 175,000. The local government unit will make up only 8,500 from its tax revenues. In such a case the fraction for exclusion is 1750 over 1835 or 95.361% of the debt is self-supporting and to be excluded. The amount that becomes non-electoral debt is only \$139,170.00 for that is the amount of the burden on tax revenues.

As provided in Section 205 (b), the local government unit may set a top limit on its agreed contribution, subject to marketing conditions and issue Limited Guaranty Revenue Bonds.

This concept can also be of great value in growing communities, and will permit projects to be started with reasonable consumer charges, and, as the community grows and the number of users increases more and more of the debt will be excluded by the annual recertifications filed and recorded pursuant to Section 210 of the Act.

It seems appropriate that debt to be so excluded should be indicated as such in the title of the bond as a Guaranteed Revenue Bond.

The same technique of exclusion should be, and is applied to Lease Rental Debt where the project which is leased generates revenues.

It should be remembered that revenue bonds of an authority or non-profit corporation may be guaranteed by a local government unit, subject to the provisions of subsection (c) of Section 105 as to the type of project.

16. Section 207. Effect of Debt Limitations on Outstanding
 17 Debt.--Notwithstanding anything in any other law or elsewhere in
 18 this act, nothing herein contained shall be construed to
 19 invalidate any debt which was lawful when incurred, or which
 20 could have been lawfully incurred if the act had been in effect,
 21 whether incurred before or after the passage of this act, and
 22 the percentage limitations set forth in section 202 shall be
 23 deemed increased to the extent necessary to cover such incurred
 24 debt. Nothing herein contained shall be construed to subject any
 25 debt incurred and voted upon prior to the effective date of this
 2) act as electoral debt to any of the limitations herein imposed
 27 on nonelectoral debt.

COMMENT

7. EFFECT OF DEBT LIMITATIONS ON OUTSTANDING DEBT. a. The section makes two points clear: Debt lawfully incurred prior to the adoption of the Act remains lawful debt notwithstanding that the aggregate amount thereof may exceed the limits of non-electoral debt established by this Act. The effect of presently outstanding debt in excess of the limit will be to prevent any further incurring of non-electoral debt until the outstanding debt chargeable against the non-electoral debt limit is reduced below the limit. This can be accomplished in several ways:

- (1) By paying off outstanding bonds
- (2) By filing the proper documents and obtaining exclusions from non-electoral debt of subsidized debt and self-liquidating debt to the extent possible for such outstanding debt.
- (3) By utilizing Section 203 for the transfer of certain of the outstanding debt to Electoral Debt, thus automatically excluding it from non-electoral debt.

b. Debt lawfully incurred pursuant to this Act, but which subsequently becomes non-electoral debt in excess of the then prevailing limit. This can occur by reason of:

(1) A reduction in total revenues which reduces the Borrowing Base, and consequently the non-electoral debt limit obtained by applying the applicable percentage to the Borrowing Base; or

(2) A reduction in subsidies, state or federal below the amount paid in prior years, thus reducing the amount of subsidized debt, which is excludable; or

(3) A drop in revenues from a project or projects, thus reducing the excludable amount of Self Liquidating Debt.

All of these debts were lawful under the Act when incurred. The subsequently occurring events do not make the debt unlawful in the hands of purchasers. The effect of the excess will preclude the incurring of additional non-electoral debt until there is room for it by reason of either an increase in the Borrowing Base in subsequent years, or by reason of the taking of any of the three types of action discussed under point a above. Exclusion of debt incurred with respect to projects producing revenues can be accomplished by raising user charges, for example, deficiency appropriations at the state level and increased subsidy payments could cause the exclusion of additional subsidized debt. Thus a flexibility of debt limit management is provided under the act.

8028

28 Section 208. Determination of Existing Net Nonelectoral and

29 Net Lease Rental Debt.--(a) Net nonelectoral debt shall be

30 determined by subtracting from the gross principal amount of all

1 incurred debt the sum of:

2 (1) All funds in sinking funds, including reserve accounts
3 therein, except maintenance or replacement reserves, and net
4 bond proceeds held for the payment of the cost of a project;

5 (2) The current annual appropriation for the principal of
6 outstanding nonelectoral debt, except to the extent the same
7 shall have already been deposited in sinking funds;

8 (3) The amount of delinquent taxes from prior years and
9 other undisputed municipal liens actually filed against property
10 less a reserve, reasonable in amount, for so much thereof as may
11 not be collected, and less the amount thereof appropriated for
12 current expenses in the current year's budget;

13 (4) The amount of the preliminary estimates of benefits or
14 costs which may be assessed against owners of property and for

15 which liens may be legally filed in any case where a public
16 improvement has been or is about to be made by any local
17 government unit and bonds have been sold or have been authorized
18 to be sold or lease rental or other debt has been incurred for
19 the costs of such improvement in whole or in part. Such
20 estimates of assessable benefits of cost shall be signed and
21 verified by the engineer or other proper officer of the local
22 government unit. In either case it shall state that the
23 estimates are, in the opinion of the signers, fair and
24 reasonable estimates of the collectible benefits or costs which
25 may be lawfully assessed in the proceedings;

26 (5) The net amount of any debt approved by the electors and
27 of any properly excluded or concurrently excludable subsidized
28 debt and self-liquidating debt;

29 (6) The amount of surplus cash not specifically appropriated
30 to any purpose and available for the payment of debt; and upon

1 such deduction such surplus cash shall not be thereafter
2 appropriated to any purpose except the payment of debt.

3 (7) All other solvent debts due the local government unit
4 directly, payment of which can be enforced as one of the unit's
5 quick assets, and which have not been earmarked for any other
6 purpose; and

7 (8) The amount of any insurance coverage indemnifying the
8 local government unit against any outstanding liability to the
9 extent such liability is debt.

10 To the net debt so determined there shall be added the amount
11 of any overdue interest and State tax assumed on account of the
12 bonds and notes representing outstanding nonelectoral debt plus
13 the amounts of such interest and State taxes due and payable in
14 the current year.

15 In computing value of funds in the sinking fund, all legal
16 investments therein shall be computed at current market values,
17 as determined by the financial advisor.

18 In determining net debt, clauses (1) and (2) above shall be
19 apportioned between nonelectoral debt, electoral debt, tax
20 anticipation notes, lease rental debt, subsidized debt and
21 self-liquidating debt as the same may be applicable to each.
22 Clause (4) shall be applied to the bonds or notes issued to
23 finance such benefits or cost, clause (8) shall be applied to
24 the liability covered by the insurance and clauses (3), (5), (6)
25 and (7) shall be applied to nonelectoral debt, except as
26 provided in subsection (b) of this section.

27 (b) Net lease rental debt shall be determined in like manner
28 but the deductions authorized by clauses (3), (5), (6) and (7)
29 shall not be made from lease rental debt, except for municipal
30 liens applicable to the project financed by such lease rental
1 debt.

COMMENT

8. Determination of Existing Net Non-Electoral Debt. Debt limits are customarily imposed on net debt since the effective burden on the community is reduced by the amount of funds on hand applicable to the payment of such debt. The procedure followed determines gross outstanding debt, as "debt" is defined in this Act. From this is subtracted the credits provided for by items (a) to (h) listed in this section and the remainder, after adding past due and current interest and assumed state taxes, is Net Non-Electoral Debt to which the limitations of section 202 apply.

(a) Sinking Funds. Accumulated funds, even if held, as in a debt service reserve account, are funds on hand applicable to debt repayment in future years, and so reduce the principal over burden, even if there is no effect on the annual burden. Such a deduction is inherent in the concept of limitations which only affect the principal amount of debt and apparently, have no concern with the effect of debt on annual debt service. The final paragraph of the Section requires that these funds be apportioned to the debt to which they apply. Bond proceeds are deducted as an offset to the contract debt for construction, etc.

(b) Current Funds: Appropriations from the current budget, even though not yet set aside, are a proper deduction, for the limitation is on the power to incur new debt. The first repayment of new debt almost always occurs after the close of the current fiscal year.

(c) Delinquent Taxes. To the extent that these are "good and collectible" assets, and are not included in current revenues, they constitute an asset reducing the burden of debt on future taxpayers. Quite often a predictable amount of the taxes due from the immediately preceding year are paid in and budgeted in the year following the year in which due. To the extent that these items are included in the current revenues, they should not be a deduction from debt. Thus the item requires exclusion from the aggregate of a proper uncollectibility reserve, as well as the amount treated as current funds in the current year.

(d) Collectible Assessments. This item is first to be deducted from the debt incurred to finance the improvement, but any surplus, as when assessment bonds are paid off before the total of assessments are collected, is an item of deduction from other non-electoral debt. This surplus can arise, not only by reason of delinquencies in the payment of assessments, but also by reason of permission given to pay in installments. A local government unit having outstanding non-electoral debt may well, in view of rising costs, wish to give its citizens an option for extended payment of an assessment for an improvement, and yet cut down total cost by issuing assessment bonds for the shortest possible term, subject to its own estimate of the impact on annual current revenues. Thus, even though the assessment debt is paid in advance of receipt of payments from assessments, there is no effect on net debt. The assessment moneys receivable after such payment reduce the net debt of other issues, and may only be used for such purposes.

(e) Debt Not Subject to the Limitations. Net debt, not subject to limitations, is also excluded. The last paragraph of the section reduces this debt by the amount of sinking fund and current revenue appropriations applicable thereto.

(f) Surplus Cash. To the extent that this item exists, it will reduce debt.

(g) Quick Assets. Again the limitations are those of collectibility and availability.

(h) Insurance Since the definition of debt includes tort liabilities, the availability of insurance should properly reduce the impact upon debt incurring limits.

Sinking funds to be held for any length of time should be put to work earning money. Article X provides for the custody and investment of those funds. The next to last paragraph of the section requires that investments be valued at the lower of cost or market, and that market values be determined by a qualified financial advisor (See Definition). Thus market appreciation of bonds purchased at a deep discount will go to reduce outstanding debt.

2 8029
Section 209. Determination of Debt Limits.--Whenever it
3 shall be necessary to determine the limitations on the amount of
4 nonelectoral debt, or nonelectoral debt plus lease rental debt
5 that may be incurred by any local government unit, the

6 appropriate percentage limitations of section 202 shall be
 7 applied to the borrowing base of such local government unit. The
 8 certificate as to the borrowing base shall be made a part of all
 9 proceedings for the sale of bonds or notes, and a copy shall be
 10 filed with the department as a part of all proceedings filed for
 11 its approval. The borrowing base set forth in such certificate
 12 and a similar certificate as to net nonelectoral debt or net
 13 lease rental debt outstanding shall be conclusive as to the
 14 respective figures for the purposes of this act, upon the
 15 approval of the proceedings by the department, unless contested
 16 within the specified time limits as herein provided.

no corresponding section → Section 210. Annual Recertification as to Subsidized and
 17 Self-liquidating Debt.--Every local government unit which has
 18 outstanding any nonelectoral debt, any subsidized debt or any
 19 self-liquidating debt excluded from nonelectoral debt pursuant
 20 to section 204 or section 206 shall, within ninety-days after
 21 the close of its fiscal year, file with the department as a part
 22 of the annual report required by section 802 of this act, and
 23 filed in the office for the recording of deeds in the county in
 24 which such local government unit is located, a statement of its
 25 outstanding net debt and, if a material change has occurred,
 26 certificates substantially in the form required by sections 204
 27 and 206 as to the amount of outstanding debt which continues in
 28 each such category, respectively, or, if there has been no
 29 material change, a certificate by its officers, which may be a
 30 part of the annual report, as to such lack of material change
 1 part of the annual report, as to such lack of material change
 2 from the certificates containing such data last filed. If the
 3 department finds the annual recertifications where a material
 4 change is reported to be in conformity to law it shall endorse

5 its approval on a duplicate copy thereof specifying the amount
6 of debt to be excluded from nonelectoral debt and return the
7 same to the local government unit. Upon the filing of such
duplicate original in the office of the recorder of deeds in and
9 for the county in which such local government unit is located,
10 the debt shown to be excluded shall not be included in
11 nonelectoral debt until new certifications of change shall be
12 filed.

COMMENT

10. Annual Recertification as to Subsidized and Self Liquidating Debt. The Section provides for an annual re-examination of the excludability of Subsidized Debt and Self Liquidating Debt or Lease Rental Debt where a claim on tax revenues is involved. Where the re-examination discloses no adverse change from a prior certification of revenues, subsidies and amounts of debt, a short certificate of no adverse change is all that need be filed. Obviously if the amount of debt which can be excluded has increased substantially, the local government unit may wish to file revised figures and obtain a greater exclusion, but it need not do so until it needs an increase in available non-electoral debt for a new financing. "Adverse change" means a change decreasing the percentage of outstanding debt that may be excluded, and, in such case revised figures must be filed to show the increased non-electoral debt outstanding.

In many instances involving the credit of the Commonwealth it is vital to have accurate and up to date figures on outstanding local debt, often considered as "overlapping" Commonwealth debt in credit comparisons with other states. Under this act the Department of Community Affairs should have more up to date figures than are now available. Equally, interested persons can determine accurately the debt picture of any local government unit by searching the "Local Government Unit Debt Records" at the local county seat.

Elsewhere in this Act, the Department is given authority to promulgate forms, rules and regulations. It is anticipated that forms and regulations will be promulgated for use in complying with all filing requirements under this Act.

ARTICLE III

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Procedure for Securing Approval of Electors
8041
Section 301. Desire Ordinance; Expense of Certain

Elections.--(a) Whenever the governing body of any local government unit shall determine that it is advisable to make an increase in the debt of such local government unit with the assent of the electors, or to obtain the assent of the electors to any nonelectoral debt previously incurred, it shall adopt an ordinance signifying such determination, calling an election for the purpose of obtaining such assent, specifying the date (determined as herein provided) on which such election shall be held, specifying the project for which such debt is to be, or was, incurred, stating the then estimated cost thereof, and approving the content and substantial form of notice of election. The date fixed shall be that of a municipal, general, primary, or special election for other purposes, but if the date of the nearest of such elections shall be more than ninety or less than thirty days from the effective date of the desire ordinance the governing body may fix a date for a special election.

(b) In the case of a special election to increase debt not held concurrently with an election for other purposes, the expense of holding such election shall be paid by the local government unit for whose benefit it is held.

ARTICLE 111 - Procedure for Incurring Electoral Debt.

COMMENT

1. Desire Ordinance; Expense of Certain Elections. This section follows the procedure of the prior municipal borrowing law. While the present act places no limitations on the amount of electoral debt, such debt is still limited by the definition of project. Thus, except in the case of "funding debt," which normally will not be electoral debt anyway, debt can be incurred only for capital items as distinguished from current expenses.

New provisions are those requiring the "desire ordinance" to specify the project and its estimated cost. This requirement is assigned to require a measure of "pre-planning" before an election is held so that cost overruns will be reduced. If the electoral debt authorized is not sufficient, nothing in the Act precludes the incurring of non-electoral debt for an overrun or precludes the holding of a further election. Any portion of a capital budget is a project.

The election should coincide with an election being held for other purposes wherever possible, unless the other election comes too soon to have the question included, or will not be held in sufficient time.

Where the election is not held at the same time as an election for other purposes the expense of the election must be borne by the local government unit desiring the election.

New is the provision for electoral approval of guaranteed revenue debt. The effect of such approval will be to eliminate the "no further incurring of debt" sanction imposed in cases where revenues fall causing the guarantee to be in effect. Authority debt approved by referendum is also excludable as electoral debt. See the all inclusive definition (Section 102 a).

8042

7 Section 302. Advertisement of Election.--(a) Notice of the
8 election shall be given in one but not more than two newspapers
9 published or circulating, in such local government unit and in
10 the legal journal, if any, designated by the rules of court of
11 the county in which such local government unit is located, for
12 the publication of legal notices and advertisements. If
13 published in a daily newspaper or newspapers it shall be
14 published three times at intervals of not less than three days,
15 but if published in a weekly newspaper or newspapers and in the
16 legal journal, it shall be published only twice, once a week for
17 two successive weeks. The first publication in at least one
18 paper shall be not less than fourteen nor more than twenty-one
19 days before the day of the election, but all such publications
20 shall be after the effective date of the ordinance, and need not
21 be upon the same dates in different papers.

22 (b) The election notice shall contain and state:

23 (1) The date upon which the election is to be held;

24 (2) The estimated amount of the debt to be incurred, or to
25 be approved by the electors if already incurred;

- 26 (3) The project for which the debt will be, or was incurred; 43
27 (4) The estimated cost of the project;.
28 (5) The form of the question to be submitted to the voters
29 at the election.

COMMENT

2. Advertisement of Election. The advertising required is the same as that found in the prior Act. Subsection (b) states the contents of an election notice concerning the incurring of debt in somewhat greater detail than heretofore.

While The amount of debt to be incurred is stated in the notice as an "estimated amount."

8043

30 Section 303. Conduct of Election.--(a) The governing body,
1 at least forty-five days before any election upon an increase in
2 debt, shall cause to be certified to the county board of
3 elections of each county in which such election is to be held a
4 copy of the desire ordinance and the form of the question to be
5 submitted to the electors.

6 (b) Elections to authorize an increase of debt shall be held
7 at the place, during the hours, and under the same regulations
8 as provided by law for the holding of municipal elections. In
9 receiving, counting, and making returns of the votes cast, the
10 inspectors, judges, and clerks of such election shall be
11 governed by the act of June 3, 1937 (P.L.1333), known as the
12 "Pennsylvania Election Code."

13 (c) At such elections ballots shall only be furnished to, or
14 provision for voting on the question shall only be made for,
15 such voters as are resident in the local government unit the
16 debt of which is to be increased or approved by the electors.

17 (d) The election officers and clerks shall make return on
18 forms provided by the county board of elections of the votes
19 cast on such question to the county board of elections, which

20 shall compute the same and transmit a certified return thereof
21 to the governing body of the local government unit which shall
22 enter the same on its minutes. If it appears that a majority of
23 those voting on such question have voted in favor of the
24 increase of debt, irrespective of any other law requiring a
25 greater percentage, the county board of elections shall also
26 file a certified copy of such return together with the copy of
27 the ordinance certified to the county board of elections by the
28 local government unit, in the office for the recording of deeds
29 in and for such county, where the recorder of deeds or similar
30 officer shall enter the same in the debt records of the local
1 government unit. The local government unit shall also file in
2 the same place proofs of the advertisement of the notice of
3 election.

COMMENT

4. Conduct of Election. Except for the note required to approve the incurring of debt, this section tracks the procedure in the prior act, except that the office for the recording of deeds is made the place of filing consistent with the general concept of this act, that the filings are informational only. The section specifies a majority of those voting to carry the issue irrespective of other laws requiring a higher percentage. While a higher percentage, such as 60%, has been sustained as constitutional, (See Gordon et al v. Lance, U.S., (No. 99 October Term 1970, decided June 7, 1971) the record in that case of some six referenda, each with a majority favoring the bond issue for school construction, and an inability to construct schools since 1946, indicates that, often, the requirement of a 60% vote imposes, as a practical matter, a veto on the incurring of electoral debt. Of course, limiting the vote to taxpayers or property holders would be unconstitutional. Cipriano v. City of Souma, 395 U.S. 701 (1969).

8044

4 Section 304. Finality of Result of Election.--Any interested
5 party or any taxpayer may contest the validity of any election
6 proceedings under this Article III by filing with the
7 Commonwealth Court within thirty days from the date of the
8 election and not thereafter, a petition in the nature of a bill
9 in equity, specifically alleging the error or errors complained
10 of in the proceedings, and the petitioner shall have the burden

11 of proof. If no such petition has been filed within such period
 12 of thirty days from the date of election, or if a petition shall
 13 have been filed and shall have been finally dismissed, the
 14 election shall be conclusively deemed to be valid for all
 15 purposes. If prior to the timely filing of a petition, further
 16 proceedings in connection with the incurring of such debt shall
 17 have been filed with the department, then any contest shall
 18 proceed by way of an appeal to the Commonwealth Court from the
 19 action of the department upon such proceedings. The petition or
 20 appeal provided by this section shall be such party's, or such
 21 taxpayer's, sole and exclusive remedy.

COMMENT

4. Finality of Results of Election. This section gives the election procedure the necessary finality required for bond or note financing. Thus the procedure established by this Section is made the sole and exclusive remedy for any attack upon the validity of election proceedings. Necessary uniformity and expertise is assured by giving the Commonwealth Court exclusive jurisdiction over all suits attacking the validity of election proceedings involving bond issues.

22 Section ⁸⁰⁴⁵ 305. Effect of Defeat of Question.--If at the
 23 election the question is defeated, another election for the same
 24 purpose or purposes may not be held until one hundred fifty-five
 25 days have elapsed since the prior election; nor during the
 26 interim shall any bonds or notes be issued for such purpose or
 27 purposes in any manner, except where required to finance
 28 projects under construction, to finance a portion or portions of
 29 a capital budget, or to evidence debt incurred for purposes and
 30 pursuant to a court approval obtained in accordance with section
 1 202 (b) of this act.

COMMENT

5. Effect of Defeat of Question. Good governmental practice requires that there be some interval after the electors have turned down a request to approve debt before the issue is put forward again. The Act makes a failure to approve, in effect, a veto upon the project for the same interval. Thus it will no longer be possible to finance a project by the authority method if a proposal for electoral debt is defeated at the polls. After 335 days the project can be placed on the ballot again or be financed by non-electoral or lease rental debt. The 335 days is elected to give some flexibility in coordinating a re-submission with elections held for other purposes. The period runs from election date to election date, so that, of necessity the second "desire ordinance" will be proposed and adopted before the expiration of the period.

8046

2 Section 306. Issue of Bonds or Notes to Evidence Electoral
3 Debt.--If at the election the question is approved, the
4 governing body shall issue bonds or notes as electoral debt
5 either as obligations of the local government unit or through an
6 authority at such times and in such amounts, not exceeding in
7 the aggregate the estimated amount approved by the electors,
8 subject to the provisions of Article VI of this act. The bonds
9 shall be for such term as may have been stated in the notice of
10 election, or if none were stated for such term as the governing
11 body shall determine. The initial series may be of bond
12 anticipation notes or of notes to be refunded by a bond issue.
13 If the governing body determines it advisable, the initial
14 series of bonds or notes constituting a part of the issue may be
15 for a shorter term of years, with the maturity or maturities of
16 subsequent series stated to mature later than the last stated
17 maturity of the preceding series for the same project: Provided,
18 That nothing in Article III shall preclude the issue of
19 additional nonelectoral debt or lease rental debt, to complete
20 the project, or the issue of additional electoral debt for the
21 purpose if authorized by a subsequent election.

COMMENT

6. Issue of Bonds or Notes to Evidence Electoral Debt. Once the voters have approved the incurring of debt, the time or times when money will be borrowed on bonds, or notes is left to the sound discretion of the governing body of the local government unit. The authority may be exercised in part from time to time or all at one time as may be desirable. If a term has been stated to the voters, the term of the bond issue shall ultimately be at the stated time but, if financially advisable, one initial series may be by bond anticipation notes, or notes to be refunded, or a series consisting of the earlier maturities, to be complimented by a subsequent series of the later maturities. 47

Section 306 make the stated estimate the top limit for the electoral debt which can be incurred. If costs overrun the estimates, the additional debt to be incurred can be incurred as non-electoral debt, or, if another election is held, as further electoral debt. The "combining" provisions of Sections 401 and 710 will permit the two to be sold as one issue if the additional costs become known prior to a sale, or to a further sale if less than the authorized debt is sold as a first series.

The debt may be evidenced by any form of bond issue, including an authority, and may be for the local government units share of a joint project.

Stating the project in the notice of election makes the validity of the bonds turn on the lawful nature of the project (Cf. Johns-Manville Corporation v/ Village of De Kalb, Mo.,) 439 F (2d) 656 (C.A. 8th 1971), but the defect of an unlawful project will not survive the curative and validating provisions of Section 809. The statement of the project also serves as a limitation on the use of the proceeds by the local government unit, Section 308, until the permitted uses are changed under the procedure specified in Section 309.

As has already been stated, the debt to be incurred as electoral debt is limited to the amount stated in the notice of election and approved by the voters, but cost overruns can be financed by non-electoral debt, or by additional debt authorized in another election. Also, the cost overrun may, if desired, be financed by the authority method. Once a project has been placed under construction, the policy against unnecessary economic wastes dictates that there be always available ways to insure completion and utilization.

- 8047
- 22 Section 307. Cancellation or Termination of Approval of
23 Electors.-- (a) On the fifth anniversary of the date on which an
24 assent of the electors became final, the authority to issue any
25 or any further bonds or notes, other than as nonelectoral debt
26 or lease rental debt subject to the limitations imposed by this
27 act, shall cease and terminate. Any terminations of
28 authorization to issue bonds or notes with the assent of the
29 electors shall be reflected in the annual debt statements filed
30 and recorded pursuant to section 210.

1 (b) The governing body of any local government unit may by
 2 ordinance, without the assent of the electors, rescind or
 3 cancel, in whole or in part, the authorization to incur
 4 electoral debt for any reason stated in such ordinance, and
 5 thereupon such assent of the electors shall be rescinded and of
 6 no further effect. A certified copy of such ordinance with proof
 7 of the due publication thereof shall be filed with the
 8 department and with the office for the recording of deeds of the
 9 county in which such local government unit is located.

COMMENT

7. Cancellation or Termination of Approval of Electors. Con-
 sistent with the concept of the Act that debt is incurred when first
 authorized, an automatic termination of the authority to issue debt
 is provided by this Section. If no bonds are issued the authority
 terminates at the end of five years from the election date at which
 the debt was approved as electoral debt, and, on the fifth anniversary
 an unused debt authorization terminates. This prevents an unused
 overhang from depressing the credit of the local government unit. If
 for credit reasons an earlier termination is desired, subsection (b)
 provides that the authorization may be terminated by ordinance of the
 governing body, the same body that initiated the proceedings by
 calling the election.

8048

10 Section 308. Limitation on Use of Proceeds of Electoral
 11 Debt.--Where bonds or notes have been issued pursuant to an
 12 assent of the electors given under this act, the proceeds
 13 thereof shall be kept in a separate account and shall be
 14 invested and used only for the cost (including the retirement of
 15 notes previously issued for the same project with the proceeds
 16 of bonds) of the project for which such assent was obtained
 17 unless such purpose be changed as provided in this act;
 18 otherwise such proceeds shall be kept invested and used for the
 19 retirement at maturity, or earlier call date, of the fifth or
 20 any subsequent stated maturity of the relevant series of bonds
 21 or notes, unless such proceeds were previously used to purchase
 22 such bonds or notes in the open market or upon tenders at prices

- 23 not exceeding the principal amount thereof plus accrued and
 24 unpaid interest to the date of purchase.

COMMENT

8. Limitations on the Use of the Proceeds of Electoral Debt.
 The Section requires that where the vote of the people has been given in favor of a particular project, the proceeds of the bonds or notes sold to evidence such debt shall be used only to pay the cost of the project, or to retire the very debt incurred, unless a subsequent election results in voter approval of a change of purpose. Section 711 provides that purchasers of bonds or notes are not required to see to the application of the proceeds. The next following section provides the mechanics for effecting a change of electoral purpose. To make certain that the tax impact of a bond issue may not be hidden by selling an inflated bond issue and using surplus proceeds to retire the early maturities.

8049

- 25 Section 309. Manner of Effecting Change of Purpose of
 26 Electoral Debt.--If the governing body shall determine it to be
 27 advisable either before or after the issue of bonds or notes to
 28 use the proceeds, or any part thereof, of bonds or notes
 29 evidencing electoral debt, for any purpose other than the
 30 project approved by the electors or the payment or prior
 1 redemption or purchase of bonds or notes evidencing debt
 2 incurred for such project, the governing body shall by ordinance
 3 express its desire to do so, specifying the project for which
 4 the funds are proposed to be used, and shall provide for an
 5 election to be held in like manner, time, and place as provided
 6 in this article for elections to secure the assent of the
 7 electors to the increase of debt, except that the notice of the
 8 election shall state:
- 9 (1) The date on which such election is to be held;
 10 (2) The date and amount of money theretofore borrowed and
 11 the project for which borrowed;

- 12 (3) The amount of money remaining unused;
- 13 (4) The new purpose for which the local government unit
- 14 desires to make use of the money;
- 15 (5) The reason why the money is not being used for the
- 16 purpose for which it was borrowed; and
- 17 (6) The question to be submitted to the electors, which
- 18 shall be substantially in the following form:
- 19 "Shall the sum of.....dollars Yes
- 20 heretofore borrowed or authorized to be borrowed
- 21 by this local government unit for
- 22 the purpose of..... No
- 23be used for the purpose of.....
- 24?"

25 The election shall be conducted, return made thereon, notices of
) election published and certificates filed and recorded as
 27 provided in section 303 above. If it appears that a majority of
 28 those voting on the question have voted in favor of using the
 29 funds for the changed purpose (irrespective of any other law
 30 requiring a greater percentage) the funds specified may be used
 1 for such changed purpose.

COMMENT

9. Manner of Effecting Change of Purpose of Electoral Debt.
 Today local government units must be able to respond to rapidly
 changing needs and revision of priorities. A recital of impracti-
 cability should not be required for a change of purpose, whether
 the change is desired before or after bonds or notes or any of
 them are sold. This section provides for our election to change
 the purpose. This may be desirable, rather than a new series,
 where interest rates have increased, rendering new debt more expen-
 sive, and it may be possible to terminate, cheaply, liabilities
 incurred with respect to the project being cancelled.

ARTICLE IV

Actions of Governing Body with Respect
to Bonded Debt, Borrowing on Notes, and
Bond Anticipation Notes

COMMENT

Article IV sets up the mechanics for incurring debt. It gives options to combine projects or combine general obligation series for simultaneous sale. It permits the governing body to issue its own bonds or notes or pass the project to a municipality authority for financing. If the determination is that the local government unit will issue its own bonds or notes, the Article contemplates two ordinances, an "Authorizing Ordinance" and an "Award Ordinance", and specifies the topics to be covered in each. It sets forth in detail the "Covenant" required by the Constitution for general obligation bonds. Bonds or notes of any type must have a sinking fund and a sinking fund depository (or trustee or fiscal agent) who is authorized to take certain action on behalf of the holders of bonds, notes or coupons. The article provides for bond anticipation notes and for borrowing on notes. The Article prescribes the Contents of a "Debt Statement" that must be prepared and filed, and the documents that must be submitted to the Department of Community Affairs to secure its required approval of each series to be issued. Provision is made for agreements with holders of bonds or notes all of which must be reasonable. Provision is made for the issue of bonds or notes to replace those lost, stolen, destroyed or mutilated. A permitted method for identifying the holders of bonds or notes is provided. Adopted ordinances are made contracts with the holders of bonds or notes to protect them against change without their assent.

6 8101 Section 401. Combining Projects for Financing.--The
7 governing body of a local government unit may by ordinance
8 combine any two or more projects for financing purposes,
9 including combining all rates, rentals, receipts, tolls and
10 charges, creating common reserve funds, and the like, and it may
11 also, combine by ordinance any one or more series of general
12 obligation bonds or notes for purposes of simultaneous sale;
13 subject, in each case, to the provisions of section 710 of this
14 act.

COMMENT

1. COMBINING PROJECTS AND SERIES FOR FUNANCING.

This Section supplements Section 710 in authorizing the combining of projects for financing and various series of general obligation bonds for simultaneous sale. Limitations and conditions are set forth in section 710.

8102

15 Section 402. Ordinance Authorizing Issuance of Debt.--The
16 governing body of a local government unit, when it is authorized
17 to incur debt, whether as electoral debt, nonelectoral debt, or
18 lease rental debt may determine by ordinance to evidence such
19 debt by an issue of bonds or notes of the local government unit,
20 or by the incurring of lease rental debt. Such an ordinance
21 shall not take effect unless adopted by the affirmative vote of
22 a majority of the members of the governing body then holding
23 office, and the vote of each member thereon shall be recorded
24 upon the minutes of such governing body.

52

COMMENT

2. ORDINANCE AUTHORIZING ISSUANCE OF DEBT.

The section gives a local government unit three options as to the form in which it shall incur debt, as follows:

- (a) by an issue of bonds.
- (b) by an issue of notes.
- (c) by passing the project to a municipality authority and incurring lease rental debt.

In the last named case further proceedings will be taken by the Authority pursuant to the Municipality Authorities Act except that self supporting and subsidized portions of the lease rental debt must be certified and recertified for exclusion from debt limits as required by Article 11 if not electoral debt and before finally becoming bound on a lease, the local government unit must file with the Department under Sections 410 and 411, and obtain a departmental approval.

These three options are available whether the debt is electoral debt subject to no debt limit, or is non-electoral or lease rental debt subject to the limitations imposed by Section 202 of this Act. Bond ordinances, in view of the long term and usually substantial nature of the obligation incurred can be adopted only by the vote of a majority of the governing body then in office, not the majority of a quorum.

Implementing an authorization to incur electoral debt may also be passed by an Authority.

8103

25 Section 403. Contents of Ordinance Authorizing Bonds or
26 Notes.--The ordinance authorizing the issue of bonds or notes of
27 a local government unit shall contain, in substance:

28 (1) In all cases, including lease rental debt:

29 (i) A brief description of the project for which the bonds
30 or notes are to be issued, and, if a capital project, the
1 estimated useful life thereof;

2 (ii) A statement of the aggregate principal amount of bonds
3 or notes proposed to be issued pursuant to the ordinance or, as
4 the case may be, secured by the lease rentals;

5 (iii) A statement whether the bonds or notes evidence
6 electoral or nonelectoral debt;

7 (iv) An authorization and direction to a specified officer
8 or specified officers and their successors to prepare, certify
9 and file the debt statement required by section 410 of this act,
10 and any annual refilings thereof, to execute and deliver the
11 bonds, and to take other necessary action, and such designation
12 may be changed from time to time thereafter; and

13 (v) An authorization, in the case of nonelectoral or lease
14 rental debt, subject to exclusion as subsidized debt or
15 self-liquidating debt to the proper officers of the local
16 government unit to prepare and file originally, and annually
17 thereafter as required, any statements required by Article II of
18 this act which are necessary to qualify all or any portion of
19 the debt for exclusion from the appropriate debt limit as
20 self-liquidating debt or subsidized debt.

21 (2) In every case except that of lease rental debt, the
22 following:

23 (i) A statement whether the bonds or notes when issued will
24 be general obligation bonds or notes, guaranteed revenue bonds
25 or notes or revenue bonds or notes;

26 (ii) The covenant required by section 404 of this act if the
27 bonds or notes when issued will be general obligation bonds or

28 notes or guaranteed revenue bonds or notes and the pledge of
29 specific rents, revenues or receipts, if the bonds or notes when
30 issued will be guaranteed revenue bonds or revenue bonds, and if
1 limited guaranteed revenue bonds or notes, a statement of the
2 limitations on the guaranty;

3 (iii) The substantial form of the bond or note to be issued,
4 including the substantial form of any coupon or authentication
5 certificate;

6 (iv) A schedule of stated principal maturity amounts and
7 dates, and interest payment dates, places of payment, sinking
8 fund provisions, and provisions for prior redemption, including
9 call dates and call prices; all of which shall conform with the
10 provisions of Article VI of this act;

11 (v) A statement of the manner in which the bonds or notes
12 are to be or have been sold and if to be sold at public sale,
13 the matters required or permitted by Article VII of this act;

14 (vi) A covenant creating the sinking fund required by
15 Article X of this act and such accounts in the sinking fund as
16 may be necessary or desirable;

17 (vii) A statement of any tax or taxes the payment of which
18 is assumed by the local government unit in consideration of the
19 purchase of the bonds or notes; and

20 (viii) The authorization to the proper officials of the
21 local government unit to contract with a bank or bank and trust
22 company for its services as trustee, fiscal agent or sinking
23 fund depository, and paying agent, and to contract with such
24 additional co-paying agents as may be desired.

25 (3) In the case of lease rental debt the authorization to
26 the proper officials of the local government unit to execute and
27 deliver a lease, as lessee, of the project, and the annual or
28 semi-annual rental to be paid thereunder, and source or sources
29 of payment.

If change of payment on election debt

If the decision is to evidence the debt by issuing bonds or notes of the local government unit, the authorizing ordinance is to set forth additional matters as specified in this section. Article VI has certain provisions limiting the matters which can be included or otherwise governing them. If the bonds are to be sold at public sale, Article VII requires the adoption of an official notice of sale, and specifies the required advertising. If bonds are sold by private sale (or a negotiated sale) the first ordinance may also include the matters specified in Section 407 for the Award ordinance so that only one ordinance need be adopted. The flow of funds for bonds or notes may now be administered by a trustee for bondholders or a fiscal agent. In any event there will be an independent sinking fund depository with certain powers. (See item 9 of this Section, Section 406 and Article X.)

Special and more limited provisions are required in the case of lease rental debt. The fixed rentals should be set forth in dollar amounts, but contingent matters may be set forth as a summary of the terms. The "sources of payment" means whether tax moneys, revenues from the project or state subsidies. The term includes the plural so that the usual "lease-back and guaranteed" sewer revenue issue may still be used. In such a case if revenues and subsidies are estimated to be enough, a statement of the contingent obligation will comply with the statute.

In the case of electoral or nonelectoral debt any trust indenture must not involve any deduction of essential governmental powers to an unconstitutional degree. Delegation of ministerial duties, such as care and custody of funds and the making of investments would, however, be unobjectionable if done pursuant to continuing instructions.

8104

30 Section 404. Covenant to Pay General Obligation or

1 Guaranteed Revenue Bonds or Notes.--The local government unit
2 shall, in the ordinance authorizing the issue of general
3 obligation bonds or notes or guaranteed revenue bonds or notes,
4 covenant with the holders from time to time of the bonds and
5 coupons outstanding pursuant to the ordinance, that the local
6 government unit shall include the amount of the debt service and
7 the amounts payable in respect of its guaranty or guaranteed
8 revenue bonds for each fiscal year in which such sums are
9 payable in its budget for that year, shall appropriate such
10 amounts to the payment of such debt service, and shall duly and
11 punctually pay or cause to be paid the principal of every bond
12 and the interest thereon at the dates and places and in the

13 manner stated in the bonds and the coupons thereto appertaining,
14 according to the true intent and meaning thereof, and for such
15 budgeting, appropriation and payment, the local government unit
16 shall pledge its full faith, credit and taxing power; but
17 nothing in this covenant contained shall in any way oblige the
18 local government unit to make any payments on limited guaranteed
19 revenue bonds beyond the stated terms of its guaranty, as set
20 forth in the bonds. The covenant shall be specifically
21 enforceable.

56

COMMENT

4. COVENANT TO PAY GENERAL OBLIGATION OR GUARANTEED REVENUE BONDS OR NOTES.

Prior to the 1968 amendments to the Constitution, a local government unit issuing general obligation bonds was required in the final bond ordinance to levy an annual tax in the amount of the annual debt service on all taxable real estate.

The tax was stated in a dollar amount and customarily thereafter forgotten except as a figure to be appropriated each year out of general fund revenues for debt service. Prominent scholars in the law of Municipal government, including former Dean Jefferson B. Fordham of the University of Pennsylvania Law School have recommended that this requirement be eliminated. This Act eliminates the requirement of a tax levy, but includes in the required covenant an obligation to include the amount of the debt service in each annual budget and to appropriate the amount thereof into the sinking fund. The net result, i.e. giving the bondholder or noteholder a non-discretionary obligation to have a fixed annual sum paid into the sinking fund is thus the same, and remedies of mandamus or injunctive enforcement are the same. Thus the elimination of the annual tax does not weaken the bonds or notes. The annual sum to which the remedy is to be addressed will still be stated in the bond transcript as the award ordinance must set forth an annual schedule of debt service or of fixed lease rental payments. (See Section 407). The effect of the covenant, thus, is to state a bit more directly, the same effect achieved by the so-called annual tax. The strength of the bond or note is increased by the covenant to budget and appropriate, since local government budgets are to be adopted before a fiscal year starts. Hence a failure to budget can give rise to an enforceable remedy before the due date of the payment to the bondholders, and Article XII on remedies implements the foregoing explicitly. Compare Act No. 58 of the Session of 1970, Section 8 (10) also.

22 Section ⁸¹⁰⁵ 405. Additional-Provisions in Ordinance Authorizing
23 Issuance of Revenue or Guaranteed Revenue Bonds.--In addition to
24 the provisions required or permitted by section 403, the
25 ordinance authorizing the issuance of revenue bonds or
26 guaranteed revenue bonds shall also contain:

27 (1) Such covenants or provisions with respect to the
28 collection, custody, investment and disbursement of rents,
29 revenues, rates and charges for the use of the project as may be
30 desired;

1 (2) Such covenants as to the fixing and collection of rents,
2 rates and charges for the use of the project, as may be desired,
3 and deemed necessary for the lawful security of the holders of
4 the bonds or notes, except that no such covenant, and no
5 agreement with the holders of bonds or notes shall require an
6 increase in such rents, rates, tolls and charges to a level
7 which, in the opinion of the registered professional engineer
8 advising the local government unit, will result in a decrease in
9 gross revenues over what would have been received at a somewhat
10 lower rate level;

11 (3) Provisions creating a perfected security interest in the
12 rents, revenues, rates, tolls and charges for the security and
13 benefit of the holders of the notes, bonds and coupons;

14 (4) Provisions creating such reserve funds or accounts as
15 may be deemed desirable for the further security of the notes,
16 bonds and coupons and requiring the observance of such covenants
17 on the part of the local government unit as may be deemed
18 necessary or desirable for the protection of the holders of the
19 notes, bonds and coupons or for the maintenance and preservation
20 of the project;

21 (5) The authorization to the proper officers of the local
22 government unit to execute and deliver any trust indenture
23 containing such other, further and lawful provisions as may be
24 desired.

COMMENT

5. ADDITIONAL PROVISIONS IN ORDINANCE AUTHORIZING REVENUE OR GUARANTEED REVENUE BONDS OR NOTES. 53

Where the financing is done on the credit of pledged revenues the basic documents require additional provisions concerning the custody of funds, the fixing of rates, tolls and charges and other matters. This Section authorizes the making of all such arrangements. For the protection of the public users of projects, however, each rate covenant must provide that no mandatory rate increases need be made if the increase will result in a loss of gross revenues over what would have been received at a somewhat lower rate.

25 Section ⁹¹⁰⁶ 406. Sinking Fund Depository; Trustee for
26 Bondholders or Noteholders.-- (a) Every local government unit
27 issuing bonds or notes shall appoint a sinking fund depository
28 which shall also serve as paying agent for the bonds or notes.
29 The sinking fund depository may serve as such for one or more
30 series of bonds or notes. Funds, which may include interest
1 accrued and to accrue on lawful investments, in an amount
2 sufficient for the payment of the principal of and the interest
3 on the bonds or notes shall be deposited with the sinking fund
4 depository not later than ten days prior to the date fixed for
5 the disbursement thereof, unless the ordinance authorizing the
6 issuance of the bonds or notes shall require that such deposit
7 be made on an earlier date or on earlier dates, but no agreement
8 with the holder of bonds or notes shall fix a later date.

9 (b) If the ordinance authorizing the issuance of the bonds
10 or notes provides for a fiscal agent, or authorizes the
11 execution of a trust indenture appointing a trustee, the fiscal
12 agent or trustee shall also be the sinking fund depository.

13 (c) If the local government unit shall fail or refuse to
14 make any required deposit in the sinking fund, the sinking fund
15 depository, the fiscal agent, or the trustee, as the case may
16 be, may, and upon request of the holders of twenty-five per cent
17 in principal amount of the outstanding notes and bonds and upon
18 being indemnified against cost and expense, shall exercise any
19 remedy, provided in this act or at law or in equity, for the

20 equal and ratable benefit of the holders of the outstanding
21 notes, bonds and coupons, and shall disburse all funds so
22 collected equally and ratably to the holders of the notes, bonds
23 and coupons as provided in the ordinance authorizing the bonds,
24 subject to any limitations contained in Article XII of this act.

COMMENT

6. SINKING FUND DEPOSITORY: TRUSTEE FOR BONDHOLDERS OR NOTEHOLDERS.

A new requirement in this Act is the appointment of a Pennsylvania bank or bank and trust company as sinking fund depository and paying agent for bonds or notes. Subject to overriding rules as to conflict of interest one institution may serve for several series of bonds or notes. A fiscal agent or trustee for bondholders, if appointed, automatically become the sinking fund depository.

To give the sinking fund depository time to initiate one or more available remedial proceedings, moneys to be paid to the bondholders or noteholders must be made available to the sinking fund depository ten (10) days before the date for disbursement to the bondholders or noteholders. The agreement with the bondholders or noteholders may specify a longer advance deposit; but may not shorten the 10 day period. Subsection (c) gives the sinking fund depository or other fiduciary standing to take remedial action on behalf of all the bondholders or noteholders as the case may be, subject to the rules of Article XII.

25 Section ⁸¹⁰⁷ 407. Award of Bonds or Notes.--When an acceptable
26 proposal for the purchase of the bonds or notes, or any parcel
27 thereof offered separately, has been received and is in
28 conformity with the terms of the official invitation for
29 proposals or is an acceptable proposal at negotiated sale, and
30 is in compliance with the provisions of this act, it may be
1 accepted by ordinance which shall also fix any details of the
2 series of bonds or notes being sold not fixed by the prior
3 ordinance, and award the bonds or notes, or such of them as have
4 been sold, to specified purchasers at prices specified in such
5 ordinance. Such provisions may be included in the ordinance
6 adopted pursuant to section 403 in the case of a negotiated
7 sale. Notwithstanding any other provision of this act or of any
8 other law, as between the local government unit and the

9 purchasers, an awarding ordinance shall be effective upon its
10 enactment by the governing body. The advertisement thereof prior
11 to enactment shall be sufficient if it describes the items to be
12 completed from the proposal.

7. AWARD OF BONDS.

COMMENT

The Section provides that proposals for the purchase of bonds or notes must be accepted by ordinance. Normally the same ordinance will also specify the interest rates for each maturity. Since investment bankers normally resell bonds or notes promptly after purchase to avoid loss due to market fluctuations, the section provides that the acceptance of a proposal to purchase bonds or notes, if otherwise properly enacted, shall be effective upon final adoption rather than after the required advertising and posting. This effectiveness is only as between the local government unit and the investment bankers. Also the ordinance must be otherwise proper that is, in the case of public bidding, the accepted bid must in fact be the highest and best bid, and pre-adoption advertising must also have been proper. The section makes the pre-adoption advertising proper notwithstanding the absence of interest rates and the schedule of annual debt service, if the advertisement states that these items will be filled in from the accepted bid.

13 Section 408. Bond Anticipation Notes.--(a) If deemed
14 desirable, the governing body may evidence all or part of any
15 electoral or nonelectoral debt by the issue of a series of bond
16 anticipation notes. Such notes shall be payable by exchange for,
17 or out of the proceeds of, the sale of a designated series of
18 bonds referred to in the bond anticipation notes. The reference
19 to the bonds shall specify a maximum rate of interest to be
20 borne by the series of bonds and provide that the series shall
21 be offered for sale but if no proposals shall be received, the
22 sole remedy of the holders of the bond anticipation notes shall
23 be either to accept the bonds at the specified maximum interest
24 rate, or to extend the maturity of the bond anticipation notes
25 for one or more specified additional periods of not less than
26 six months each during which additional offers of the bonds may
27 be made.

28 (b) Bond anticipation notes may be authorized, issued and
29 sold in the same manner as the bonds in anticipation whereof the
30 notes are being issued and principal amounts thereof shall be

1 retired in accordance with the specified stated maturity dates
2 of the said bonds.

COMMENT

8. BOND ANTICIPATION NOTES.

The Section grants specific authority for interim financing by a series of notes issued in anticipation of, and payable out of the proceeds of an identified series of bonds, or by exchange for bonds.

3 8109 Section 409. Borrowing by Notes.--(a) Even though no bond
4 issue has been previously authorized, a local government unit,
5 by ordinance of its governing body, may borrow money on notes
6 for all or any part of the cost of a project other than one
7 involving funding debt. The debt incurred shall be evidenced by
8 general obligation notes, guaranteed revenue notes or revenue
9 notes, as the case may be, and shall be subject to the
10 limitations and restrictions provided in Article II of this act.
11 All general obligation notes or guaranteed revenue notes shall
12 contain the covenant required by section 404 of this act.

13 (b) Such notes shall be stated to mature in five years or
14 less from the date of issue and, unless previously refunded by
15 subsequently authorized bonds, not less than seventeen and
16 one-half per cent in principal amount of the series shall be
17 repaid on or before the end of the first year; an additional
18 nineteen per cent on or before the end of the second year; an
19 additional twenty per cent on or before the end of the third
20 year; an additional twenty-one per cent on or before the end of
21 the fourth year; and the balance on or before the end of the
22 fifth year.

23 (c) Such notes may be issued and sold as provided in Article
24 VII of this act.

25 (d) Prior to any delivery of notes to a lender the local
 26 government shall file a debt statement and a transcript of the
 27 proceedings with the department, in accordance with sections 410
 28 and 411 of this act and no notes shall be delivered to a lender
 29 until the department shall have issued its approval, or its
 30 approval shall be deemed to have been given pursuant to section
 1 806 of this act.

2 (e) Notes may be excluded from nonelectoral debt as
 3 subsidized debt or self-liquidating debt in the manner provided
 4 in Article II.

COMMENT

9. BORROWING BY NOTES.

This Section carries forward the former provisions of the Municipal Borrowing Law permitting temporary borrowing without bonds. Formerly one-fifth of the amount borrowed had to be repaid each year, i.e. the "equal annual maturities plan" was mandated. The section now provides for a quasi-level annual debt service plan by specifying a separate percentage of the principal to be stated to mature each year. Thus a series of \$1,000,000 6% notes could be stated to mature as follows:

<u>Year</u>	<u>Percent</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
1	17 1/2	175,000	60,000	\$ 235,000
2	19%	190,000	49,500	239,500
3	20%	200,000	38,100	238,100
4	21%	210,000	26,100	236,100
5	22 1/2	225,000	13,500	238,500

Where borrowing on notes is made for less than 5 years, the section by using the wording "not less than" permits, a balloon payment in the last year. For example, if the borrowing were for three years, the final maturing amount would be 63 1/2 % of the debt. Except for the purchase of equipment with a 5 year life or less, most borrowing on notes is done in anticipation of a larger issue to come within a year or so. Hence the balloon payment is not dangerous. Another safety valve is in the very flexible refunding provisions of Article XI which would permit a refunding of the balloon.

Section 410. Debt Statement.--(a) Before delivering any
 6 bonds or notes, or executing a lease evidencing the acquisition
 7 of a capital asset, the officer or officers authorized by
 8 ordinance of the local government unit shall prepare and verify
 9 under oath or affirmation a debt statement as of a date not more
 10 than sixty days before the filing with the department showing:

11 (1) The gross indebtedness of the local government unit;

12 (2) By items, the credits and exclusions from such gross
13 indebtedness permitted by this act;

14 (3) The remaining net electoral debt, net nonelectoral debt
15 and net lease rental debt of the local government unit totaled
16 separately;

17 (4) The aggregate principal amount of the bonds or notes
18 being issued or to be supported by a lease;

19 (5) The amount thereof constituting new net nonelectoral
20 debt or new net lease rental debt;

21 (6) The aggregate net nonelectoral debt and the net
22 nonelectoral debt and net lease rental debt combined, stated
23 separately, to be outstanding after settlement for the issue;

24 (7) The borrowing base of the local government unit as shown
25 by an appended borrowing base certificate;

26 (8) The nonelectoral debt limit and the limit for
27 nonelectoral plus lease rental debt computed as provided in
28 section 202 of this act.

29 (b) Within ninety days after the effective date of this act,
30 every local government shall prepare and file with the

1 department and in the proper office for the recording of deeds,

2 an initial debt statement as of January 1, 1972.

10. DEBT STATEMENT

COMMENT

The two instruments which control the amount of non-electoral debt that can be incurred are the Borrowing Base Certificate issued pursuant to Section 209, and the Debt Statement issued pursuant to this section. The Debt Statement here provided for shows whether the series proposed to be issued fits within the limits established by Section 202. A debt Statement must be filed with respect to any series of bonds or notes evidencing electoral debt as well as non-electoral debt for one penalty for the issue of too much non-electoral debt is the inability to issue any debt, except, of course, a fully self-sustaining revenue debt. A Debt Statement must also be filed with respect to lease rental debt prior to becoming bound on the lease. The statement should show any outstanding tax anticipation notes with credit for the pledged taxes.

The Debt Statement with each new issue becomes a part of the proceedings which became of record in the office for the recording of debts.

C4

3 Section ⁸¹¹¹ 411. Submission to Department.--(a) Before
4 delivering any bonds or notes the local government unit shall
5 apply for the approval of the department. The application, in
6 such form as the department shall prescribe shall be accompanied
7 by a transcript of the proceedings consisting of certified
8 copies of any of the following which are applicable:

9 (1) The ordinance calling the election in the case of
10 electoral debt with proofs of all proper advertisements;

11 (2) The return of election;

12 (3) The ordinance authorizing the bonds or notes and
13 prescribing the manner of sale with proofs of proper
14 publication;

15 (4) The written recommendation for private sale of the
16 financial advisor if one was appointed and the bonds or notes
17 were sold at private sale;

18 (5) The accepted proposal for the purchase of the bonds or
19 notes;

20 (6) The ordinance awarding the bonds or notes with proofs of
21 proper publication;

22 (7) The debt statement prepared pursuant to section 410;

23 (8) Such certificates and proofs as may be necessary for the
24 exclusion of any portion of the series proposed to be delivered
25 as self-liquidating debt or subsidized debt.

26 (b) Before becoming bound on any lease evidencing the
27 acquisition of a capital asset, a local government unit shall
28 apply for and receive the approval of the department. The
29 application, in such form as the department shall prescribe,
30 shall be accompanied by certified copies of the following:

1 (1) The ordinance authorizing the execution of the lease;

2 and

3 (2) The debt statement prepared pursuant to section 410.

4 No lease executed and delivered prior to the approval or the
5 presumed approval pursuant to section 806 of the department
6 shall be valid or obligatory. Except for the limitations
7 specifically herein imposed upon local government units with
8 respect to lease rental debt, this act shall have no application
9 to the authorization, issue or sale of its obligations by any
10 authority or nonprofit organization organized or existing under
11 any law of this Commonwealth.

12 (c) The application may be made in as many counterparts as
13 desired. The department, if it approves the application, shall
14 return all such counterparts save one with its certificate of
15 approval appended to each.

COMMENT

11. SUBMISSION TO DEPARTMENT

Central to the finality given to approved bond or note proceedings under Article VIII is the submission to the Department in a convenient number of counterparts of a bond transcript or application for approval of a lease evidencing the acquisition of a capital asset.

Subsection (b) makes it clear that the provisions of this Act do not govern authority financing only such actions as the local government unit may take in connection therewith. It is similar to the present procedure required of school districts by the Department of Education in connection with authority financing.

8112
16 Section 412. Agreements with Bondholders or
17 Noteholders.--Except as otherwise specified in this act, a local
18 government unit has the authority to enter into and perform
19 contracts with the holders of its bonds or notes binding upon
20 the original purchasers and their respective transferees placing
21 greater reasonable and lawful restrictions on the local
22 government unit or on the action of individual holders of bonds
23 or notes than are provided in this act, but no such agreement

24 shall be binding upon a remote holder of a bond or note unless
25 the substance of such agreement is set forth in the text of the
26 bond or note, or set forth in a bond resolution or indenture of
27 trust kept available in one or more designated public offices to
28 which a reference is conspicuously made in the text of the bond
29 or note.

12. AGREEMENTS WITH BONDHOLDERS. ^{COMMENT}

The section authorizes agreements of two types:

- (1) Agreements restricting subsequent action of the local government unit in the interest of greater security for the holders of the bonds or notes; and
- (2) Agreements restricting the action of individual bondholders or noteholders in the interest of providing for group action through a trustee, fiscal agent or sinking fund depository in the interests of all.

Both types of restrictions must be reasonable in the light of the interest to be served. Remote purchasers of bonds or notes must be put on notice of the restrictions applicable to them by having the restrictions set forth in the instrument by take or by a "conspicuous" reference to a trust indenture or other instrument in which such restrictions are set forth. The word "conspicuous" is used in the sense in which it is defined in the Uniform Commercial Code, and "reference" imports a meaningful indication of where in a document as complicated as a trust indenture the restrictions can be found.

30 Section ⁸¹¹³ 413. Lost, Stolen, Destroyed or Mutilated Bonds or
 1 Notes.--If any temporary or definitive bond or note issued under
 2 this act shall become mutilated or be destroyed, stolen or lost,
 3 the local government unit shall execute and any sinking fund
 4 depository, fiscal agent or trustee for bondholders shall, if
 5 required, authenticate and deliver a new bond or note, with
 6 appropriate coupons attached in the case of a bond or note in
 7 coupon form, of like series and principal amount as the bond or
 8 note and attached coupons, if any, so mutilated, destroyed,
 9 stolen or lost, upon surrender and cancellation of such
 10 mutilated bond or note and attached coupons, if any, or in lieu

11 of and in substitution for the bond or note and coupons, if any,
12 destroyed, stolen or lost, upon filing with the local government
13 unit, or if so provided in the bond ordinance, with the sinking
14 fund depository, fiscal agent or trustee, evidence satisfactory
15 to it, that such bond or note and attached coupons, if any, have
16 been destroyed, stolen or lost and proof of ownership thereof
17 and upon furnishing of satisfactory indemnity and complying with
18 such other reasonable regulations as the local government unit
19 shall prescribe, and paying any reasonable expenses, including
20 counsel fees, as the local government unit or the sinking fund
21 depository, fiscal agent or trustee may incur. Mutilated bonds
22 or notes and appurtenant coupons, if any, surrendered shall be
23 cancelled. The new bonds or notes and coupons, if any, so issued
24 shall be independent obligations and all limitations and debt
25 limits shall be deemed increased to the extent necessary to
26 validate such new bonds or notes and any appurtenant coupons.

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COMMENT

13. LOST, STOLEN, DESTROYED, OR MUTILATED BONDS OR NOTES.

The Section contains standard provisions for the replacement of bonds or notes which are lost, stolen, destroyed or mutilated. The issue of the new security will not ordinarily increase the outstanding debt of the local government unit since the indemnity received will become an offsetting asset. In the case of a mutilated bond, its surrender will preclude duplication except in the rare case of two presentations of parts of the same bond. Lost, stolen or allegedly destroyed bonds can show up in the hands of a bonafide purchaser without notice, especially in the case of coupon bonds. Here the person claiming to have lost it or that it was stolen from him must prove the lack of bonafides of the claimant or the indemnity will be called upon to make the local government unit whole. Ordinarily the indemnity will be a surety company bond in an amount equal to the face amount of the bond plus interest to the stated maturity date plus an allowance for counsel fees and costs of suit.

With this section in the statute it will not be necessary to repeat the full text in bond ordinances.

27 8114 Section 414. Evidence of Signatures of Holders of Bonds or
28 Notes and of Ownership of Bonds or Notes.--Any request, consent
29 or other instrument which may be required or permitted to be
30 executed by the holders of bonds or notes may be in one or more

1 instruments of similar tenor, and shall be signed or executed by
 2 such holders in person or by their attorneys appointed in
 3 writing. Proof of (i) the execution of any such instrument, or
 4 of an instrument appointing any such attorney, or (ii) the
 5 holding by any person of bonds or notes or coupons appertaining
 6 thereto, shall be sufficient for the purposes of this act and
 7 any proceeding thereunder if made in the following manner:

8 (1) The certificate shall state that the person or persons
 9 signing such instrument were known to be such persons by the
 10 individual certifying and that such person or persons
 11 acknowledged the execution of the instrument as his or their
 12 act. The authority of an attorney or agent may be proven by like
 13 statement of the principal acknowledged in a like manner, but a
 14 certificate as to authority shall not be necessary if an
 15 instrument is executed on behalf of a corporate holder of bonds,
 16 notes or coupons by a person purporting to be the president or a
 17 vice-president of such corporation with the corporate seal
 18 affixed and attested by a person purporting to be its secretary
 19 or an assistant secretary.

20 The fact and date of the execution by the holder of any
 21 bond, note or coupon, or the attorney thereof, of any instrument
 22 may be proved by the certificate, which, except as hereinafter
 23 provided, need not be acknowledged or verified of:

24 (i) an officer of any bank or bank and trust company which
 25 is in Pennsylvania, or which has a correspondent in Pennsylvania
 26 certifying to the authenticity of its certificate;

27 (ii) an authorized signer for any broker or dealer in
 28 securities doing business in Pennsylvania, or having a
 29 correspondent in Pennsylvania certifying to the authenticity of
 30 its certificate;

1 (iii) any notary public or other officer authorized to take
2 acknowledgments of deeds to be recorded in the state in which he
3 purports to act;

4 (iv) any other witness to such execution, whose certificate,
5 however, must be verified before a notary public or other
6 officer authorized to take acknowledgments of deeds in the state
7 in which he purports to act.

8 (2) The ownership of fully registered bonds or notes or of
9 notes issued payable to the order of a named person, or bonds or
10 notes registered as to principal, and the amount, number and
11 date of holding the same shall be proved by the registry records
12 maintained for the series in question.

13 (3) The amount of bonds or notes transferable by delivery
14 held by any person executing any instrument as the holder of a
15 bond note or coupon, the number thereof and the date of holding
16 such bond, note or coupon may be proved by a like certificate of
17 any person mentioned in subclauses (i) or (ii) of clause (1) of
18 this section 414, stating that such holder exhibited to the
19 person executing the certificate, or had on deposit with him the
20 bonds or notes described in the certificate. For purposes of
21 action to be taken by the holders of bonds, notes or coupons,
22 the holder shall be deemed to continue as such if he acts as
23 such, for a period of nine months after the date of the proof of
24 holding. Continued ownership after such period shall require a
25 new certificate or shall be taken as continuing if the original
26 certificate contains a statement that the bonds, notes or
27 coupons are on deposit with the signer and an undertaking not to
28 release the same, and not to attorn to any new owner, unless the
29 certificate is presented to such depository.

30 (4) Any request, consent or vote of the owner of any bond,

1 note, or coupon shall bind all future holders thereof if a
 2 notation of such action is placed on the bond, note or coupon,
 3 and also even if not so noted, if notice thereof is given once
 4 by publication in a newspaper of general circulation in the
 5 county in which the local government unit is located, and in a
 6 journal of general circulation among dealers in investment
 7 securities.

8 (5) In cases of disputed ownership, and in other cases, in
 9 its discretion, a court, a local government unit, or a trustee
 10 or fiscal or paying agent, may require further or other proof in
 11 cases where it deems the same desirable.

14. EVIDENCE OF SIGNATURES OF HOLDERS AND OF OWNERSHIP OF BONDS OR NOTES. ^{COMMENT}

Both under this Act and under the provisions of many revenue or guaranteed revenue bond ordinances a vote of the holders, or evidence of consent by holders may be required or desired. The Section sets forth an approved form of determining whether such action or such consent has, in fact, been given, in language customary in many trust indentures.

12 Section ⁸¹¹⁵ 415. Ordinances Are Contracts with Holders of Bonds
 13 or Notes.--Except as otherwise provided in any ordinance
 14 authorizing or awarding bonds or notes, the terms thereof and of
 15 this act as in effect when such bonds or notes were authorized
 16 shall constitute a contract between the local government unit
 17 and the holders from time to time of such bonds and notes
 18 subject to modification by the vote of a majority of the
 19 holders.

15. ORDINANCES ARE CONTRACTS WITH HOLDERS OF BONDS OR NOTES. ^{COMMENT}

Making the bond ordinances contracts with the holders of bonds or notes gives the holders the protection of the obligation of contracts clause of the federal constitution, and precludes unilateral governmental action altering the terms of the contract. The contract is, however, a group contract so far as the holders are concerned, and a vote of the group, customarily set at 66 2/3%, is sufficient to effect a modification. Some issuers have experienced difficulty in obtaining the

requisite two-thirds vote. In the interest of flexibility the statute permits a majority vote subject to initial agreement on a higher percentage. Similarly, certain elements of the contract, amount of principal, rate of interest and the percentage vote are excluded from the right to amend by less than a unanimous vote. The act leaves these items to the agreement of the parties. Often these will be terms which the financial advisor will recommend for adoption prior to a public sale, or bond counsel will draft in accordance with the prevailing customs of the market.

ARTICLE V

Tax Anticipation Notes and Funding Debt

COMMENT

In General Article V covers two somewhat diverse special forms of borrowing. Tax anticipation notes are, in effect, only an acceleration of the receipt of taxes. The interest paid is the cost of receiving now taxes due at later dates. The holders of the tax anticipation notes become the equitable owners of the future taxes as collected. The advance is made and repaid in the current year and is subject to a limit of 85% of the taxes certified as still to be collected. No filing with the Department is necessary, but a public record of the proceedings must be made. Funding Debt is the opposite side of the coin, so to speak. This involves borrowing from future years to pay valid obligations which, by reason of unforeseeable circumstances, are not covered by the taxes and other revenues still to be received unless local municipal services are reduced to the point of endangering public health or safety. Departmental approval is all that is required in the case of construction overruns or extraordinary judgments as for tort claims. Court approval is required in other cases.

22 8121 Section 501. Power to Issue Tax Anticipation Notes.--A local
23 government unit shall have power and authority, by ordinance of
24 its governing body, to borrow money from time to time in any
25 fiscal year in anticipation of the receipt of current taxes and
26 current revenues, to evidence the indebtedness by notes,
27 denominated tax anticipation notes, and to authorize, issue and
28 sell such tax anticipation notes in the manner, and subject to
29 the limitations provided therefor in this article. Limitations
30 imposed by this act on the incurring of nonelectoral debt shall
1 not apply to the indebtedness evidenced by tax anticipation
2 notes.

COMMENT

1. POWER TO ISSUE TAX ANTICIPATION NOTES.

Although called tax anticipation notes, the power and authority given includes the borrowing in anticipation of the receipt of other current revenues. Thus a School District can anticipate state reimbursements by the issue of tax anticipation notes, as well as its purely tax revenues. The power to issue is made subject to the limitations and provisions of Article V and it is expressly stated that tax anticipation notes are not subject to the debt limitations imposed on non-electoral debt by Article II of the Act. The theory is that, since the proceeds of the tax anticipation notes are substituted for the tax revenues, there is no real debt created.

3 Section 502. Limitation on Amount of Tax Anticipation
 4 Notes.--No local government unit shall authorize or issue tax
 5 anticipation notes in any one fiscal year in an amount exceeding
 6 eighty-five per cent of the sum of the taxes levied for the
 7 current fiscal year and the revenue for such year, not yet
 8 received, which are certified, pursuant to section 506, as
 9 remaining to be collected or received in such fiscal year from
 10 and after the date of the tax anticipation notes. The
 11 certificate shall be as of a date not more than thirty days
 12 prior to the date of the vote on the ordinance authorizing the
 13 issue and sale of the tax anticipation notes.

COMMENT

2. LIMITATIONS ON AMOUNT OF TAX ANTICIPATION NOTES.

The limitation is 85% of the taxes and current revenues still to be received in the fiscal year or a "coverage" factor of 117 1/2% to allow for errors of estimation of future receipts. The term "remaining to be collected or received in such year" refers to the amount remaining to be collected or received as of the date of the date of the notes, not as of the date of the certificate referred to. The certificate, however, must be of a date not more than thirty days prior to the date of the vote on the ordinance authorizing the issue and sale of the notes. When sold at public sale, the certificate will be further in advance of the date of the notes, than when sold at private sale where the authorizing ordinance can be adopted on the same day that the bid is received. A certificate should estimate future receipts on a monthly basis, and a corresponding monthly dating of the notes will show the compliance with this Act.

Prior law had, in some instances, no specific limits. Some limitation seems necessary to prevent deficit financing. With proper money management, and with allowance for some earnings on the proceeds of the notes held pending expenditure, most borrowing should be less than the limit.

14 Section 503. Limitation on Stated Maturity Date of Tax
 15 Anticipation Notes; Time of Payment of Interest.--No tax
 16 anticipation notes shall be stated to mature beyond the last day
 17 of the fiscal year in which such tax anticipation notes are
 18 issued. Interest on tax anticipation notes from the date thereof
 19 shall be payable at the maturity of such notes or payable in
 20 installments at such earlier dates and at such annual rate or
 21 rates as the governing body of the local government unit may
 22 determine.

COMMENT

3. LIMITATION ON STATED MATURITY DATE OF TAX ANTICIPATION NOTES: TIME OF PAYMENT OF INTEREST.

Since tax anticipation notes are a mere acceleration of current receipts, the stated maturity date must be within the same fiscal year. Going beyond the fiscal year, in effect, permits unbalanced budgets. The subject of borrowing to cure an unbalanced budget is covered in the sections relating to funding debt. The time of payment of interest on tax anticipation notes is made extremely flexible as many borrowings, in the case of smaller units of local government will be from local banks and time of payment of interest can be tailored to the needs and desires of the parties.

23 Section 504. ⁸¹²⁴ Other Terms of Tax Anticipation Notes.--Tax
24 anticipation notes shall be issued in such denominations, shall
25 be subject to such rights of prior redemption, shall have such
26 privileges of interchange and registration, shall be dated,
27 shall be stated to mature (subject to the provisions of section
28 503) on such dates and in such amounts, shall be in registered
29 or bearer form with or without coupons, shall be payable in such
30 coin or currency as at the place and at the time of payment
1 shall be legal tender for the payment of public and private
2 debts, and shall be payable at such place or places, one of
3 which shall be within the Commonwealth of Pennsylvania as the
4 governing body of the issuing local government unit may
5 determine by ordinance.

COMMENT

4. OTHER TERMS OF TAX ANTICIPATION NOTES.

The section gives the greatest flexibility to the structuring of the terms of tax anticipation notes. The only limitation is that the notes must be payable in such coin or currency as may be legal tender at the place and time of the time of payment. This eliminates "gold coin" clauses or repayment of principal in an amount set by some index believed to measure inflation. Due to the short term of the tax anticipation notes (less than twelve months) such provision is not believed to be unduly restrictive.

6 Section 505. ⁸¹²⁵ Security for Tax Anticipation Notes: Sinking
7 Fund.--All tax anticipation notes shall be secured by the pledge
8 of, and a first lien and charge on, the taxes and revenues of
9 the local government unit to be received between the first day

10 of the month next following the date of the delivery of such tax
11 anticipation notes to the purchasers thereof and the last stated
12 maturity date of such notes. Such pledge, lien and charge shall
13 be fully perfected as against the local government unit, all
14 creditors thereof, and all third parties in accordance with the
15 terms of such ordinance from and after the filing thereof in the
16 office for the recording of deeds in and for the county in which
17 such local government unit is located notwithstanding the
18 provisions of any other law. Unless otherwise provided in the
19 tax anticipation notes, eighty-five per cent or such lesser
20 percentage of anticipated revenues as was borrowed of all moneys
21 collected after such first day of the month shall be paid into a
22 separate sinking fund for the tax anticipation notes to be held
23 by a bank or bank and trust company as sinking fund depository,
24 until the amount held in the sinking fund including interest to
25 be earned thereon shall equal the principal of and the interest
26 to be paid upon the outstanding tax anticipation notes. The
27 terms of the tax anticipation notes may provide for the payment
28 of specific sums into the separate sinking fund for the tax
29 anticipation notes on specified dates in amounts sufficient to
30 provide moneys for the payment of the principal of and the
1 interest on such tax anticipation notes as the same shall fall
2 due; but no such specified payment shall be in an amount larger
3 than eighty-five per cent of the taxes estimated to be collected
4 in such fiscal year on and after the date for such payment. Such
5 specified amounts shall on such dates be paid into the separate
6 sinking fund by the treasurer of the local government unit. In
7 default of such payment, all tax moneys and revenue thereafter
8 received by the local government unit shall be paid into such
9 separate sinking fund, until such sum shall have been paid in
10 full. Such obligation shall be specifically enforceable by the

11 sinking fund depository for the benefit of the holders of the
12 tax anticipation notes.

COMMENT

5. SECURITY FOR TAX ANTICIPATION NOTES: SINKING FUND.

The notes, by the terms of the statute are secured by a pledge of and lien on the revenues to be received between the first day of the calendar month next following the date of the delivery of the notes and the last stated maturity date thereof. The statute makes the lien and pledge a perfected security interest (to use Uniform Commercial Code Terminology) and no filing is required. The publicity and public filing of the authorizing and creating ordinance satisfy all requirements of notoriety for perfection. Any filing under the Uniform Commercial Code would be unnecessary duplication.

The section contemplates that the creating ordinance will establish a schedule of sinking fund payments to a skinking fund depository (See Article X) for the benefit of the notes. Payments can be tailored to expected future receipts, so long as the payments do not reduce the 117 1/2 % coverage contemplated by the terms of Section 502. Most local government units will not borrow the full amount permitted by Section 502, so that considerable flexibility in the scheduling of sinking fund payments will be permitted.

Should no fixed schedule of payments into the sinking fund be established, 85% of receipts or whatever percentage was borrowed, if less, shall automatically into the sinking fund until the deposits, and the interest thereon shall equal the amounts to be paid out to satisfy the notes. If a separate sinking fund is established, but default is made in a payment to such fund then 100% of receipts must go into the sinking fund until its requirements are met, and this obligation is made specifically enforceable by the sinking fund depository acting for the holders of the notes. Nothing in this Act precludes the bank making all or any part of a tax anticipation advance to a local government unit from being itself designated as the sinking fund depository.

A usual provision permitting tax anticipation notes not paid in the year the debt was incurred to be paid in the following year is omitted. The escape valve is in funding debt. 8126

13 Section 506. Certification as to Taxes and Revenues to be
14 Collected.--Prior to each issuance of tax anticipation notes,
15 the officers of the local government unit shall make a careful
16 monthly estimate of the moneys to be received in each remaining
17 months of the fiscal year from taxes then levied and assessed
18 and revenues including subsidies or reimbursements to be
19 received. Such estimate shall take due account of the past and
20 anticipated collection experience of the local government unit
21 and of current economic conditions. The estimate shall be
22 certified by such officers and their written certificate dated

23 as of a date not more than thirty days prior to the date of the
24 notes shall be filed of record with the proceedings authorizing
25 the tax anticipation notes in the office for the recording of
26 deeds in and for the county in which such local government is
27 located.

COMMENT

6. CERTIFICATION AS TO TAXES AND REVENUES TO BE COLLECTED.

To provide needed certainty the limitation on the amount of notes that can be issued is tied to an amount established by a certificate. (Penalties are provided in Article XIII for false certificates). The certificate is to estimate receipts by calendar months until the end of the fiscal year, and is to be made in the light of known economic conditions. Thus a rate of collections realized in a prior year of high economic activity must be adjusted downwards in a period of recession. The estimate becomes a public record, available for inspection in the future.

8127
28 Section 507. Sale of Tax Anticipation Notes.--Tax

29 anticipation notes may be sold at public or private sale as the
30 governing body of the local government unit may determine. Any
1 public sale shall be advertised and conducted in the manner and
2 subject to the conditions provided for a public sale of bonds in
3 Article VII of this act, except as modified by Article V. The
4 governing body of the local government unit shall award the
5 notes by ordinance to specified purchasers at a specified price,
6 not less than the principal amount thereof.

COMMENT

7. SALE OF TAX ANTICIPATION NOTES.

A separate provision concerning the sale of tax anticipation notes is included. The short term of such borrowing and the known interest of local banks gives a greater justification for a private sale. Equally since most institutions making a direct purchase from a local government unit purchase for their own account (except perhaps, in the case of large cities) the need for permitting a discount sale disappears. A financial advisor is not required even if the issue exceeds \$1,000,000. See Section 106.

7 Section 508. Condition Precedent to Validity of Tax
 8 Anticipation Notes.--No tax anticipation note shall be valid or
 9 obligatory in the hands of an original purchaser thereof until
 0 certified copies of the authorizing and awarding ordinances, due
 1 proofs of publication, the certificate as to the taxes and
 2 revenues remaining to be collected, and a true copy of the
 3 accepted proposal for the purchase of the tax anticipation notes
 4 shall have been filed for record in the office for the recording
 5 of deeds in and for the county in which the local government
 6 unit is located and with the department. No approval of the
 7 department shall be required in the case of tax anticipation
 8 notes.

COMMENT

8. CONDITION PRECEDENT TO VALIDITY OF TAX ANTICIPATION NOTES.

The Section requires that a public filing of the proceedings be made, consisting of:

- (a) All ordinances adopted in connection therewith;
- (b) The Section 506 certificate as to taxes and revenues to be collected; and
- (c) A true copy of the accepted proposal.

Since the proceeds of the tax anticipation notes take the place pro-tanto of the taxes and revenues to be collected, and in view of the current nature of the liability incurred no requirement of filing with or securing the approval of the Department of Community Affairs is imposed, but, under Section 802, the financing will be reported for statistical purposes in the annual debt statement.

9 8129 Section 509. Unfunded Debt.--Unfunded debt shall mean
 0 obligations of the same or a prior year properly contracted for
 1 current expenses (including tax anticipation notes) due and
 2 owing, which the taxes and other revenues remaining to be
 3 collected in the fiscal year and funds on hand will not be
 4 sufficient to pay without a curtailment of municipal services to
 5 an extent endangering the health or safety of the public or
 6 proper education of school children, and the local government
 7 unit either may not legally levy a sufficient tax for the
 8 balance of the fiscal year, or a sufficient tax, if legally
 9 leviable, would be seriously regressive and not in the public
 10 interest.

COMMENT

9. UNFUNDED DEBT.

At times the best estimates go awry, and a local government unit may find itself with obligations exceeding the revenues it will receive, even though it started the fiscal year with a balanced budget. This section defines such debt, sometimes in the past called "floating debt" and also states certain limitations which must be satisfied before such obligations can be funded by borrowings. These are:

- (1) The obligation must have been properly incurred.
- (2) At the time of borrowing the obligation must be due and owing.
- (3) The local government unit cannot reduce future expenditures within the year without endangering health or safety or, in the case of school districts, the proper education of school children.
- (4) Additional revenues may not legally be obtained through taxation, or any tax leviable for the balance of the fiscal year would have to be so high as to cause more economic harm than an emergency borrowing.

These factors must be established to the satisfaction of the Department in the case of extra costs of capital assets or the payment of unanticipated judgements, and to the satisfaction of the Commonwealth Court in all other cases.

Of course where the ordinance authorizing the incurring of debt has established an estimated cost, including contingencies, and the local government unit has issued only a part of the bonds, the issue and sale of the remainder does not constitute the incurring of "funding debt", since original provision was made for the additional debt.

The debt to be funded may also include obligations of the prior year including tax anticipation notes, as funding may not be determined to be necessary until it is too late in the year to complete the process.

8130

1 Section 510. Procedure to Fund Unfunded Debt.--Whenever the
 2 governing body of a local government unit shall be of opinion
 3 that it has outstanding unfunded debt, it may, with the approval
 4 of the department, in the cases covered by section 511, fund
 5 such unfunded debt by electoral or by nonelectoral debt within
 6 the limits prescribed by Article II of this act, or it may, in
 7 other cases, petition the Commonwealth Court for leave to fund
 8 such unfunded debt pursuant to the provisions of this Article V.

COMMENT

10. PROCEDURE TO FUND UNFUNDED DEBT.

Unfunded debt may be funded as electoral debt outside of debt limits, or as non-electoral debt or authority debt as the local government unit may determine in the case of capital assets or the funding of judgements. In all other cases, the funding must be approved by the Commonwealth Court.

maybe
8130
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9 Section 511. Approval by Department.--(a) The department
10 shall approve an application for approval of the funding of
11 unfunded debt if, on the facts submitted to it, the department
12 shall determine that the debt meets the requirements for
13 unfunded debt and shall also determine either that the debt
14 arises from floating indebtedness incurred in the acquisition,
15 construction, or improvement of capital assets or that the debt
16 is evidenced by a judgment or judgments against the local
17 government unit entered by a court of competent jurisdiction
18 after adversary proceedings upon a claim for other than ordinary
19 current expenses. Bonds or notes authorized pursuant to the
20 provisions of this section shall be stated to mature in twenty
21 years or less as determined by the department in the light of
22 the burden of the annual debt service.

23 (b) Applications to the department shall be upon such notice
24 to the taxpayers of the local government unit as the department
25 shall, by regulation, prescribe. The regulations shall also
26 provide opportunity to any interested taxpayers to submit
27 relevant facts to the department. Appeals from action of the
28 department shall be taken as provided in Article IX of this act.

COMMENT

1. APPROVAL BY THE DEPARTMENT

Where a judgment is rendered for other than an item of current expense or there are cost overruns in the acquisition, construction or improvement of capital assets, and the debt is within the limitations established by Article II, or is, in what probably will be rare cases, approved by the electorate, the funding debt, with a term not to exceed twenty years, can be incurred in the normal way with the approval of the Department. Otherwise the procedures of Section 512 must be followed. A hearing at which local taxpayers may attack any element necessary

to be established under Section 509 must be held. This will serve to prevent use of the procedure in improper cases. The twenty year limit, with consequent increase in annual debt service over that which could be used if appropriate provision had been made in the original funding of the cost of a capital asset serves as a brake on improper use of this Section. For example, a debt of \$100,000 at 6% has an annual cost,

- (a) if incurred as 35 year debt of \$6,898.00
- (b) if incurred as 20 year debt of \$8,719.00

Governing bodies of local government units desiring re-election will not, knowingly, impose the greater annual burden on their taxpayers of about 15%.

Nothing in this section precludes the issue of additional electoral or nonelectoral debt to fund the completion of a capital asset if the bonds or notes are issued before the debt is due and owing.

8130

29 Section 512. Approval by Court.-- (a) In all cases not
 30 covered in section 511, including cases covered thereby in which
 1 the funding debt would exceed applicable debt limitations, the
 2 local government unit shall, by petition to the Commonwealth
 3 Court, setting forth the facts, request approval for the
 4 issuance of notes to fund the unfunded debt. After hearing, on
 5 such notice to the local government unit and its taxpayers as
 6 the court may prescribe, the court shall make an order granting
 7 authority to fund all or a part of such unfunded debt if the
 8 court shall find that such unfunded debt was lawfully incurred,
 9 that there has been an unforeseeable decline in revenues; or
 10 that taxes levied have not produced the revenues anticipated or
 11 that it was not reasonable to foresee such obligation; that
 12 paying such debt by curtailing municipal services will be
 13 dangerous to the public health, safety or education, and that it
 14 is not feasible to levy additional taxes in the current fiscal
 15 year. The funding debt so approved shall be stated to mature in
 16 such amounts and over such number of years, not exceeding ten,
 17 as the court shall find will accomplish the payment of the debt
 18 without endangering the rendering of municipal services or

19 requiring the levying of excessive taxes. The provisions of
 20 section 409 of this act shall not be applicable to such notes.
 21 If the funding of the unfunded debt has not been approved by a
 22 vote of the people, the order of the court shall fix the portion
 23 thereof, if any, which shall not be charged against the
 24 nonelectoral debt limitations of the local government unit under
 25 section 202 of this act, during the time such funding debt is
 26 outstanding, so as to leave some available borrowing capacity
 27 for other situations. The percentages fixed by section 202 of
 28 this act shall be deemed increased to the extent required for
 29 such funding debt.

30 (b) The funding debt so authorized by the court shall be
 1 issued and sold by the governing body as provided by this act,
 2 except that no approval of the department shall be required, but
 3 the local government unit shall file a certified copy of the
 4 proceeding together with a certified copy of the order of the
 5 court with the department, and in the office for the recording
 6 of deeds in and for the county in which such local government
 7 unit is located prior to the delivery of any bonds or notes
 8 evidencing such debt.

COMMENT

12. APPROVAL BY COURT.

In all other cases, of the funding of floating indebtedness, the local govern-
 ment must establish the necessary conditions specified in section 509 to the satis-
 faction of the Commonwealth Court. The Court is given authority to exclude a portion
 of the debt from the normal non-electoral borrowing limitations established by
 Section 202. The exclusion is analogous to that provided in Section 202 for certain
 emergency or mandated programs. The limitation to a ten year term imposed by the
 section will leave a therapeutic effect, preventing undue resort to the section by
 reason of the high annual debt service required. For example, a debt of \$100,000
 at 6% has an annual cost.

- (a) if incurred as 35 year debt of \$6,898.00
- (b) if incurred as 10 year debt of 13,587.00

or more than double that normal in ordinary long term borrowing. The short term is justified in that in the vast majority of cases, the unfunded debt will be a very small portion of the annual budget. Thus, if the unfunded debt to be funded amounted to 10% of the annual budget, spreading the repayment over 10 years would have a budgetary impact of only 1.36% on a level annual debt service plan. The Court is empowered to fix a shorter term if that seems feasible in the light of the debt to be incurred and the size of the budget. Assuming the unfunded debt amounted to, say, 5% of the total budget, a 5 year term would require 23.74% of the debt to be furnished for debt service each year, with a consequent impact of 1.19% on the overall budget.

Since the incurring of the debt will have been approved by the Court, additional approvals by the Department are unnecessary. The section provides that the stated maturities, and term will be fixed by the Court. Bond counsel will not issue an opinion unless these limitations are observed, so that further administrative review seems unnecessary.

ARTICLE VI

Limitations on Provisions of Bonds or Notes

Required Terms and Stated Maturities

COMMENT

IN GENERAL. Article VI is designed to bring to general obligation bond financing, and to preserve for revenue bond financing and guaranteed revenue bond financing under Act No. 58 of the 19th Session, the flexibility of authority financing. To this end few restrictions are placed on stated maturities, call features or provisions for security. Execution is made easier, and the requirement for \$100 term bonds is limited to the areas in which they may prove attractive to the small investor.

12 Section ²¹⁴¹ 601. Form of Bonds or Notes.--Bonds or notes may be
 13 issued in such denominations, in coupon form payable to bearer
 14 or registrable as to principal, or in fully registered form,
 15 with such provisions for exchangeability and interchangeability;
 16 shall bear such identifying designation or title, including
 17 words indicating the type of obligation; shall be dated; shall
 18 bear such rate or rates of interest, including supplemental,
 19 contingent, or variable interest, shall be payable on such
 20 dates; may be subject to such provisions for prior redemption in
 21 whole or in part or both, at such price or prices and at such
 22 times; and shall be stated to mature on such date or dates and
 23 in such amounts; may provide for the payment by the issuer of
 24 such tax or taxes on the bonds or notes, either absolutely or
 25 out of pledged revenues; and may provide for such security,
 26 reserves and other terms as the governing body of the issuing
 27 local government unit may, by ordinance, determine, subject to
 28 the limitations and restrictions specified in this act.

COMMENT

1. FORM OF BONDS OR NOTES.

The section gives broad discretion to the issuing local government unit to select the form of its securities and the terms thereof. Two areas are worth special mention, as follows:

Interest may be at a regular fixed rate, or in addition the bonds or notes may contain provision for supplemental interest rates for a limited period. Interest may also be contingent. For example it may be conditioned upon receipt of revenues generally or from a particular source. Interest may also be variable, as for example a local government unit may agree to pay interest having a relation to the "prime rate" as in corporate financing, or to the "Bond-Buyer's Twenty Bond Index", or other yardstick, as may be deemed advantageous in the particular case. Section 1303 contains a covenant against income taxation of interest.

Provision for the payment by the issuer of taxes on the bonds or notes is continued. Care in the drafting of these provisions will be necessary to avoid a direct payment of state income taxes by the issuing local government unit should the State income tax law be changed. At issue is the amount of protection against higher future rates of state income tax that may be built into the rate of interest bid by the under-writing syndicates. For example, protection against a flat two percent state income tax on a 6% bond of a local government unit would be obtained by bidding a coupon rate of 6-1/8%. Where other states do not tax the income on their municipal bonds, Pennsylvania municipalities would sell at a comparatively higher rate. When dealing with a thirty year bond, the under-writing syndicates may bid a safety factor to compensate for increases in the rate of income tax over the years, so that the bid might be 6-1/4% or 6-1/2%. On a thirty year issue of \$1,000,000 the increased interest cost of the "hedge" for an extra 1/8 or 1% safety factor would be on the order of \$25,000. Until experience is obtained as to the safety factor desired by the market it cannot be determined whether the issuing body should or should not covenant to pay state income taxes, or whether it should merely covenant against the payment of ad valorem personal property taxes on the bonds. Unlike the Municipality Authorities Act of 1945 and similar statutes, the former Municipal Borrowing Law contained no covenant by the Commonwealth in the legislation that bonds issued under the Act should at all times be free from taxation. This Act contains such a tax covenant provision to provide that the "hedge" coverage, need not be included in the bid. Until such a covenant is amended it would seem that no tax covenant should be included in general obligation bonds of local government units.

- 29 ⁸¹⁴² Section 602. Limitations on Stated Maturity Dates.-- (a)
- 30 Except as provided in subsection (b) of section 710 on combining
- 1 for purposes of sale, or in Articles V or XI hereof, no bonds or
- 2 notes shall be issued with a stated maturity date exceeding the
- 3 sooner to occur of:
- 4 (1) Forty years from the date of the first incurring of any
- 5 debt for the purpose of financing the cost of actually
- 6 constructing a project; or

7 (2) The useful life of the project being financed as stated
8 in the ordinance of the local government unit enacted in
9 connection with the first series of notes or bonds, which
10 statement in the first ordinance incurring debt for the project
11 shall be conclusive for all purposes, including any subsequent
12 financing.

13 Where capital budgeting is practiced, and bonds are issued to
14 fund the current portion of a capital budget involving projects
15 of varying useful lives a uniform term of thirty years may be
16 used.

17 (b) The bonds or notes to be issued may be serial bonds, or
18 term bonds or any combination thereof that may be selected by
19 the governing body of the issuing local government unit. If term
20 bonds or notes, other than as required by section 610, are
21 issued, such bonds or notes must be subject to a mandatory
22 sinking fund designed, and, if serial bonds, the amounts of the
23 stated maturities shall be fixed, so as to amortize the series
24 on at least an approximately level annual debt service plan.
25 Maturities for a series may be so fixed that only one-half of
26 the principal amount of the series is fixed on the level annual
27 debt service plan, and the balance is stated to mature in such a
28 manner as to bring debt service on outstanding debt of the same
29 type (and for this purpose lease rental debt not excluded as
30 subsidized or self-sustaining may be considered as the same type
1 as general obligation debt) more nearly into an over-all level
2 annual debt service plan provided that no bond or note in such
3 second half is stated to mature at a date later than two-thirds
4 of the remaining estimated useful life of the project as stated
5 in the first ordinance incurring debt for the project.

6 (c) Stated maturities of principal or the operation of a
7 mandatory call for debt retirement may not be deferred beyond

8 the later of:

- 9 (1) two years from date of issue, or
- 10 (2) one year after estimated completion of construction.

11 In the case of revenue or guaranteed revenue bonds this
 12 provision will be satisfied by the mandatory application to term
 13 bonds of revenues remaining after payment of interest and
 14 operating expenses up to a fixed amount in conformity with
 15 subsection (b) above be specified in the ordinance pursuant to
 16 which the bonds are issued.

COMMENT

2. LIMITATION ON STATED MATURITY DATES.

Currently general obligation bonds may not have a life longer than thirty years from date of issue or the stated useful life whichever is shorter. The Municipality Authority Act, and the resulting reduction in annual cost has been utilized by many school districts and in many water and sewer financings.

This Act adopts the forty year limit, but in view of its greater flexibility in the refunding situation provides that the forty year term runs from the first incurring of any debt for "the cost of actually constructing the project." This phrase excludes debt incurred for planning costs, as sometimes projects are in the planning stage for many years.

The phraseology concerning the stating of the estimated useful life of projects in bond ordinances has changed. A realistic life will have to be stated in the ordinance authorizing the first series of bonds or notes issued in connection with a project. Where temporary financing has been used in the past a useful life of "more than" has often been stated. This will no longer be proper. The term of a "useful life" of course runs from the date of completion of the project, so language excluding planning debt is not necessary in this connection. The ordinance authorizing planning debt should, therefore, state a realistic useful life and the Department should reject any that do not. An arbitrary 30 year period is fixed to avoid complex calculations where bonds or notes are sold to fund the current portion of a capital budget.

Determining the appropriate life of a bond issue is left to the governing body of the local government unit. It always has to blance total cost increases resulting from a longer term issued against the increased annual burden on local tax payers resulting from a shorter issue as illustrated in the following table based on one hypothetical issue of \$1,000,000.

Length of IssueAnnual CostTotal Cost

88

5 years	\$ 226,210	\$ 1,131,050
10 years	126,380	1,263,800
20 years	80,250	1,605,000
25 years	71,860	1,796,500
30 years	66,920	2,007,600
35 years	64,000	2,240,000
40 years	62,330	2,493,200

The above table has been constructed on the assumption that the rate of interest increases approximately by 0.05% a year for the first twenty years and thereafter for every two years of additional term. The initial rate used in the table was 4-1/4%. It thus appears that there is a point of no return beyond which the small reduction in annual cost is overbalanced by the increase in total cost. Forty years seems, thus an appropriate outer limit. It is presently the limit as the Municipality Authorities Act, but some federal programs permit a fifty year issue. Indeed, the annual saving in going from thirty-five to forty years of about \$1,700 seems scarcely worth the additional \$253,200 of total cost. Occasionally the market for long term bonds will be such that the 1/4 of 1% interest increments used in the table will not prevail so that the annual saving could be greater, and the additional cost less than here computed.

The second paragraph of the section is designed to avoid the necessity of having equal annual maturities, as is now the effect of the Municipal Borrowing Law's provision prohibiting the debt service in a subsequent year from exceeding that of a prior year by more than \$1,000. The effect of this is to require a much greater debt service in the earlier years when interest on the full debt is payable thus charging present tax-payers more heavily than later ones. This act permits one "approximate" level annual debt service plan since room must be given for variations due to the necessity that maturities be stated in whole multiples of \$5,000, the bond trading unit; that allowance be made for a possible doubling of the trading unit; and that when maturities are set up for bidding, it is not possible to forecast exactly what rates of interest will be bid for what years.

The section permits "term bonds" so that if the market is hungry for say, thirty year bonds, but selling bonds maturing in years twenty-one to twenty-nine inclusive would be costly, the issue can be tailored to the market, the section, in such a case require a mandatory sinking fund to be established. That is, the issuing body must set aside, each year, a sum of money so that in no one future year will a large change fall on the local taxpayers. Normally this will require that the bonds be made callable for the sinking fund, but the section does not require that this be done. Interest earnings on one accumulative sinking fund could readily reduce the burden of not calling bonds to insignificant proportions.

In setting up one approximately level annual debt service plan, the section allows existing debt to be included as to one half of the principal amount of the series. Thus a local government unit having an outstanding issue

which will be paid off in, say, fifteen years, may combine the debt service on the old issue with debt service on the half of the new issue to achieve an approximate equal annual burden considering the two issues, even though the new issue, if set up to mature in twenty-five years will have a greatly expanded annual debt service in the last ten years. Interest cost on the new issue will be less than it would have been if the governing body, considering primarily the annual burden to be imposed, had selected a forty year issue. Of course the interest cost on a "wrap around" issue will be greater than that incurred in an issue of the same length set up as a level annual debt service issue, but the amount of the annual budget going for debt service, considering the two issues, would be far greater for the remaining fifteen years of the prior issue. The use of only one half of principal for "wrap-around" purposes prevents an "interest only" issue for 15 years.

Permitting "wrap around" issues in the future also will tend to encourage issuers to select shorter terms for their original issues, and hence incur lesser total costs. The governing body will not tend to save as much room for anticipated future issues.

17 Section 603.⁸¹⁴⁴ Number of Interest Rates; Variation.--A series
 18 of bonds or notes may have any number of interest rates, subject
 19 to any limitation on such number fixed by the governing body of
 20 the issuing local government unit, but, unless further limited
 21 by the issuing local government unit in the official notice of
 22 sale, the rate of interest fixed at the time of original issue,
 23 for any stated maturity date in the last two-thirds of the
 24 period of the series may not be at a lower rate than the
 25 interest rate stated for an earlier year in such last
 26 two-thirds.

COMMENT

3. NUMBER OF INTEREST RATES: VARIATION.

No limitation on the number of interest rates should be fixed by statute as it will serve only to preclude the issuer from taking advantage of market situations enabling it to sell at a lower net interest rate. A limitation on the "spread" between the highest and the lowest net interest cost, however, will not completely preclude unbalanced bids, as for example a very high rate on the bonds stated to mature in the early non-callable years and a low rate on the last stated maturity date to balance out at a reasonable net interest cost. The purpose of the limitation is further discussed under Article VII on determining net interest cost. Thus is the case of a thirty year issue, no rate for any stated maturity date in the last 20 years may be lower than a rate used earlier in the last 20 years.

27 ⁸¹⁴⁵ Section 604. Place and Medium of Payment.--Bonds or notes
 28 shall be payable in such coin or currency as at the respective
 29 dates of payment thereof shall be legal tender for the payment
 30 of public and private debts at the place or places of payment.

1 Both principal and interest shall be payable at such place or
 2 places as may be determined by the local government unit by
 3 ordinance. If more than one place of payment is specified, one
 4 or more of the additional places of payment may be outside of
 5 the Commonwealth of Pennsylvania or outside of the United States
 6 of America.

COMMENT
 4. PLACE AND MEDIUM OF PAYMENT.

The Act requires payment in legal tender at the place or places of payment. One such place must be in the Commonwealth of Pennsylvania, others may be outside, possibly in foreign countries if the market for the issues of the larger units of local government indicates a better sale can be made by issuing multi-currency obligations.

7 ⁸¹⁴⁶ Section 605. Execution of Bonds or Notes.--Bonds or notes
 8 shall be signed by such officers as the governing body shall
 9 determine, and coupon bonds shall have attached thereto interest
 10 coupons bearing the facsimile signature of the treasurer of the
 11 local government unit, and bonds or notes may be sealed with the
 12 seal of the local government unit or a facsimile thereof, all as
 13 may be determined by ordinance. Bonds or notes may provide that
 14 they shall not be valid nor enforceable, unless authenticated by
 15 a specified bank, bank and trust company or trust company. If
 16 any one signature on a bond or note (including the signature of
 17 a trustee or fiscal agent) shall be manual, the ordinance may
 18 provide that all other signatures may be by facsimile. If any
 19 officer whose signature, or a facsimile of whose signature,
 20 shall appear on any notes, bonds or coupons shall cease to be
 21 such officer before the delivery of such notes or bonds, such
 22 signature, or such facsimile, shall nevertheless be valid and

23 sufficient for all purposes as if he had remained in office
 24 until such delivery, and, also, any note, bond or coupon may
 25 bear the facsimile signature of, or may be signed by, such
 26 persons as at the actual time of the execution of such note,
 27 bond or coupon shall be the proper officers to sign although at
 28 the date of such instrument such persons may not have been such
 29 officers.

COMMENT

5. EXECUTION OF BONDS OR NOTES.

The section is designed to permit the bonds or notes to be executed with the fewest possible manual signatures. If a bank or trust company is selected as an authenticating trustee or agent, only a bank officer need sign. This is in accord with Stock Exchange Rules for corporate securities. The fewer the manual signatures the greater should be the amount of steel engraved material as a protection against forgery. All other signatures may, if desired, be by facsimile. The section also contains standard provisions validating pre-signed bonds, as for example, if a particular officer dies after printing of the bonds has begun with his facsimile signature thereon but before delivery. Equally, where replacement bonds must be prepared and issued, the person in office may execute even if he or she did not hold office as of the date of the bonds.

30 8147 Section 606. Pledge of Revenues.--The governing body of any
 1 local government unit which has determined to issue any revenue
 2 bonds or notes, or any guaranteed revenue bonds or notes, may
 3 provide, by ordinance, for such pledges of or priorities in such
 4 rentals, revenues, receipts, rates and charges to be received
 5 from projects of the issuing local government unit as may be
 6 desirable. Such pledge or priority shall be perfected as against
 7 the local government unit, all creditors thereof, and all third
 8 parties, in accordance with the terms of such ordinance, from
 9 and after the filing of such ordinance in the office for the
 10 recording of deeds in the county in which such local government
 11 unit is located, notwithstanding the provisions of any other
 12 law.

6. PLEDGE OF REVENUES.

The section perfects a pledge of or a priority in revenues upon the recording of the ordinance creating such pledge, eliminating any requirement of taking possession of the funds in order to perfect the pledge. Unlike the case of tax anticipation notes, where the statute specifies a first lien, this section speaks in terms of priority. This gives one issuing body greater flexibility and enables the creation of subordinate or succeeding liens on revenues where such action will aid the financing of particular projects. The public recording of the ordinances satisfied the requirement of notoriety so that no financing statement under the Uniform Commercial Code is or should be required, even if one would be effective against revenues.

13 Section ⁸¹⁴³607. Deeds of Trust and Other Agreements with
 14 Bondholders and Noteholders.--(a) A local government unit shall
 15 have the power to enter into any deed of trust, trust indenture
 16 or other agreement with any bank, bank and trust company, trust
 17 company or other person or persons in the United States having
 18 power to enter into such agreements or accept such trusts,
 19 including any Federal agency, as security for any notes or bonds
 20 of the local government unit providing for the following:

21 (1) The payment of the interest on and principal of such
 22 notes or bonds; the authentication of the original issue
 23 thereof; the custody of sinking funds or other funds held or to
 24 be held pending presentation of coupons, notes or bonds for
 25 payment; the custody of debt service reserve funds or other
 26 funds to be held as reserves; the disbursement of interest to
 27 holders of fully registered bonds or notes; the cremation or
 28 other destruction of coupons, bonds or notes which have been
 29 paid; the maintenance of records as to registration, exchanges
 30 and transfers and the effecting of the same;

(2) The construction, improvement, operation, maintenance
 2 and repair of any project being financed;

3 (3) Limitations on the purposes to which the proceeds of the
 4 bonds then or thereafter to be issued in connection with the
 5 project, or of any loan or grant by the United States or the
 6 Commonwealth of Pennsylvania, may be applied;

8 and the holder of the bonds or notes (which may include
9 reasonable restrictions upon the individual right of action of
10 such holders); and

11 (5) The terms and provisions, including stated maturities
12 and sinking fund and other reserve fund provisions (not in
13 conflict with the limitations imposed by this act, but which may
14 be more limiting) of, or provided for the bonds or notes being
15 issued or which may hereafter be issued in connection with the
16 project being financed.

17 (b) In connection with any revenue bonds or guaranteed
18 revenue bonds, such deeds of trust, trust indentures or other
19 agreements may contain provisions as to the following:

20 (1) The rate of rents, charges, rates, or tolls to be
21 imposed for the use of the project being financed or the
22 rendering of services through the use of the project or both, to
23 ensure a sufficiency of revenues to cover operating expenses,
24 debt service and an appropriate surplus;

25 (2) The setting aside of reserves or other earmarked funds,
26 and limitation upon the use, investment and disposition thereof
27 for the better security of the bonds or notes;

28 (3) Limitations on the issue of additional bonds or notes
29 ranking equally or having priority in claim on revenues with the
30 bonds being issued; and

1 (4) Any other or additional agreements with the holders of
2 the bonds or notes as may be customary in such agreements,
3 provided no delegation of essential governmental powers is made.

4 (c) In lieu of a deed of trust, trust indenture or other
5 agreement specified above, the bond ordinance of the local
6 government unit may contain similar provisions which shall be a
7 contract between the local government unit and the holders from
8 time to time of its bonds or notes.

COMMENT

7. DEEDS OF TRUST OR OTHER AGREEMENTS WITH BONDHOLDERS OR NOTEHOLDERS

The section permits the governing body to execute trust indentures or other documents providing for an independent custodian of funds that are earmarked for bondholders. Such party can, by virtue of the agreement, be given the power to enforce covenants requiring the construction of the project, including the custody and disbursement of the proceeds of the bonds during construction against architect's certificates of completion of a requisite percentage of the work. The section also permits reasonable restrictions on individual suits in case of default so as to ensure appropriate group action in the interest of all holders of the outstanding obligations. As in the past, no power to mortgage physical public property (except revenues received in any form including currency) is given. No delegation of essential governmental functions to such trustee may be made. The powers delegated are ministerial.

Where revenue or guaranteed revenue bonds are to be issued, the section permits the making of covenants as to rates and charges, and to this extent permits the binding of successive governing bodies. It also permits restrictions on future issues of pari-passu bonds or prior lien bonds. Except as the creation of debt service and maintenance and repair reserves may restrict the flow of funds, no restrictions on subordinate claims upon revenues is provided. Article X places certain restriction on the disposition of pledged revenues.

The section authorizes the use of a bank or trust company as bond registrar and sinking fund custodian (see Article X for further rules governing sinking funds and sinking fund depositories).

- 8149
- 9 Section 608. Negotiable Qualities of Bonds and Notes.--(a)
- 10 Bonds issued pursuant to this act shall have all the qualities
- 11 and incidents of securities under Article 8 of the Uniform
- 12 Commercial Code and shall be negotiable instruments.
- 13 (b) Notes issued pursuant to this act shall have all the
- 14 qualities and incidents of commercial paper under Article 3 of
- 15 the Uniform Commercial Code and shall be negotiable instruments
- 16 notwithstanding any references therein to the terms of the
- 17 authorizing bond ordinance or any trust indenture, deed of trust
- 18 or other agreement, or any variations in the rate of interest
- 19 provided in such note, or any limitations upon the funds from
- 20 which or limitations as to the bonds with which the notes may be
- 21 paid, or any restriction upon the remedies of the holders.

COMMENT

8. NEGOTIABLE QUALITIES OF BONDS AND NOTES.

The section makes it clear that the bonds issued are to be investment securities under Article 8 the Uniform Commercial Code and are to be considered negotiable instruments under any laws restricting investments to negotiable instruments. Notes are to have all the qualities and incidents of commercial paper under Article 3 of the Uniform Commercial Code even though not meeting all of the formal requisites of the Code. Due to the relatively shorter term of notes it is believed that the rules of Article 3 which curtail the creation of purchasers cutting off issuer's defenses and a former holder's rights at earlier dates are more appropriate.

- 22 ⁸¹⁵⁰ Section 609. Temporary Bonds or Notes or Interim
 23 Receipts.--Pending the preparation of definitive bonds or notes,
 24 temporary bonds or notes or interim receipts may be issued in
 25 such form and containing such terms and such provisions for
 26 exchange for definitive bonds or notes as the local government
 27 unit may determine.

COMMENT

9. TEMPORARY BONDS OR NOTES OR INTERIM RECEIPTS.

Some times it is advisable to settle for an issue of bonds or notes before the definitive instruments can be prepared. The Section authorizes the issue of temporary instruments or interim receipts, but leaves the parties (issuing local government unit and initial purchasers) complete freedom to structure these temporary instruments to fit the needs of the special situations in which they will be used.

- NA 28 ? Section 610. Term-bonds of the Denomination of One Hundred
 29 Dollars Each.--(a) Whenever the net interest rate to the local
 30 government unit shall exceed six per cent, computed as
 1 hereinafter provided in section 709, the governing body shall,
 2 and in other cases may, also concurrently provide for the due
 3 public advertisement and issue and sale over the counter by
 4 local banks, savings and loan associations, and savings banks,
 5 of term-bonds in the denomination of one hundred dollars (\$100)
 6 each, payable in not more than ten years from the date of issue.
 7 The principal amount of the term-bonds shall be a reasonable

8 amount, not less than one-half of one per cent and not more than
9 one and one-half per cent of the principal amount of the bonds
10 with which such term-bonds are being concurrently authorized.
11 The rate of interest on such term-bonds shall be not less than
12 the rate of the net interest rate of the bonds being
13 concurrently authorized computed as provided in section 709 of
14 this act, fixed to the nearest one-tenth of one per cent. A
15 separate sinking fund for the redemption of such term-bonds,
16 upon tender by the holders on a first come, first served basis,
17 shall be provided in an equal amount each year, sufficient to
18 provide for the amortization of the term-bonds by their stated
19 maturity dates. Except as stated in this section the term-bonds
20 shall be subject to all the terms and conditions of the bonds
21 authorized concurrently therewith.

22 (b) No term-notes or term-bonds in the denomination of one
23 hundred dollars (\$100) each need be authorized, issued or sold
24 in connection with any series of notes or bonds having a latest
25 stated maturity date of ten years or less at the time of issue.

COMMENT

10. TERM BONDS OF THE DENOMINATION OF ONE HUNDRED DOLLARS EACH.

The securities dealers are not able to make a market for these instruments, and where lower interest rates are placed thereon they have not sold. The purpose is to make tax-free investments available to those who can not afford the \$5,000 units of the regular municipal bond market. But some protection must be afforded those purchasers who need to realize on their investment before the stated maturity date. Consequently a separate purchase fund must be provided for the purchase, to the extent of the funds available in the purchase fund, of such of the \$100 pieces as may be tendered. The coupon rate of the \$100 bonds is to be that of the net interest rate of the issue as a whole. The "reasonable amount" is to be fixed between 1/2 of 1% and 1-1/2% of the issue being concurrently sold. But unless the net interest rate of the issue as a whole is equal to or exceeds 6% past experience indicates that there will be little sale of the \$100 term bonds. Since it can not always be determined in advance whether the net interest rate of the issue will or will not exceed 6% the issue of \$100 term bonds at bonds at below that rate is authorized but not required..

26

ARTICLE VII

27

Sale of Bonds

COMMENT

IN GENERAL. This Article provides that bonds or notes may be sold at a public sale if advertised one time and at private sale if the amount of the issue is less than \$1,000,000, or if there is a financial advisor who recommends a private sale as being in the issuer's best interest. Discount bids are permitted. A short form of advertisement is permitted. Bonds or notes may be sold in an "all or none" bases or may be offered in separate lots. Bid security of not less than 2% of the bonds or notes being purchased is required. Net interest cost is determined by the "street method" or the "present worth" method. The principal objection to the "street method", the unbalanced bid, is controlled for "street method" calculations by the provisions of Section 603 limiting the spread in interest rates. The Article provides for reoffering all or part of bonds or notes offered for public sale and for the rejection of all bids in the discretion of the local government unit. The combining of revenue producing projects for financing purposes is permitted, as is the combining of general obligation issues for purposes sale.

28 ⁸¹⁶¹ Section 701. Manner of Sale of Bonds or Notes.--(a) Except
 29 as otherwise specifically provided in this act and subject to
 30 the following subsections, bonds or notes may be sold at public
 1 or private sale at such price as shall be approved by the
 2 governing body with the approval of the financial advisor in the
 3 case of series in excess of one million dollars (\$1,000,000), as
 4 the governing body of the issuing local government unit shall
 5 determine by ordinance effective prior to the sale. Bonds or
 6 notes may be conditionally sold before or after the adoption of
 7 the bond ordinance fixing the final details of the series.

8 (b) Bonds shall not be sold at private sale unless the local
 9 government unit shall have retained a financial advisor who
 10 shall have recommended such a method of sale as being in the
 .1 best interests of the local government unit, or unless the
 12 aggregate principal amount of the series being sold shall be
 (13 less than one million dollars (\$1,000,000).

14 (c) Except as stated in subsection (b) of this section 701, 98
15 and except for the sale of term-bonds authorized pursuant to
16 section 610 of this act, bonds or notes shall be sold to the
17 highest responsible bidder or bidders after one public notice by
18 advertisement of either the official notice of sale, or of the
19 availability of the official notice of sale, in at least one and
20 not more than two newspapers of general circulation in the
21 county in which the local government unit is located and in the
22 legal journal, if any, designated by the rules of court for the
23 publication of legal notices and advertisements, and may be
24 combined with the advertisement of the adoption of the ordinance
25 authorizing the sale. The advertisement shall also be published
26 once in a financial journal circulating among the underwriters
27 of securities. Advertisements shall be published not less than
28 ten nor more than thirty days prior to the date fixed for
29 opening proposals, and need not appear on the same date in each
30 newspaper or journal.

COMMENT

1. MANNER OF SALE OF BONDS OR NOTES.

The section permits sales at a discount. It is felt that, in many markets an issue which can be reoffered at par will sell more attractively for the issuer than one which must be priced to be reoffered at a premium. The amount of discount varies from time to time. The act limits discount to that approved by the financial advisor in issues of \$1,000,000 or more, but in any given instance the issuing body can limit the amount of discount it will accept and can require the underwriting group to reoffer to the public at par. Since the bidder usually sets the rates of interest, the bonds or notes will often be sold before the adoption of the ordinance fixing the final details of the issue. In some instances and issue may be offered for sale under terms allowing the bidders to fix the stated maturity amounts, although this is not frequently done, but they must conform to Article VI.

Section 507, however, provides that tax anticipation notes must be sold at par .

Subsection (b) limits private sales to smaller issues (less than \$1,000,000) or, in the case of larger issues to those which the financial advisor recommends be sold at private sale. Such recommendations will normally be made when revenue or guaranteed revenue bonds are being sold. The assurance of handling the sale in such cases will often result in more careful market analyses

by the investment bankers and consequently may result in a more favorable interest cost than a public sale. The same point can be made where the issuing local government unit is not known as an issuer in the general market for securities. The Pennsylvania Economy League study recommended permitting a free choice between public or private sale. This act restricts somewhat the use of the private sale as stated above.

Subsection (c) states the rules governing the advertisement of the public sale of bonds or notes. The advertisement in the local newspaper and in the legal journal rarely produces a bond bid. One insertion in the Daily Bond Buyer or in a similar publication is normally all that is required to alert the underwriting firms to bid on an issue. The act follows modern practice in permitting the publication of a short form of advertisement telling prospective bidders where they may obtain copies of the official notice of sale. Use of the short form will save advertising costs and will be as effective as a longer form of advertisement.

8162
1 Section 702. Contents of Public Advertisement and of

2 Official Notice of Sale.--(a) The advertisement of the
3 availability of the official notice of sale shall contain the
4 following:

5 (1) The title, designation and principal amount of the bonds
6 or notes to be sold;

7 (2) A general statement of the term of the issue and whether
8 it will consist of term bonds or notes, serial bonds or notes,
9 or both;

10 (3) A statement whether proposals must be for all but not
11 less than all of the notes or bonds being sold, or, if separate
12 lots may be bid separately, a statement as to the composition of
13 each lot;

14 (4) The place and time for the receipt of sealed proposals;

15 (5) The amount of the bid security to be furnished by the
16 bidder, and the method selected for determining net interest
17 cost; and

18 (6) A statement of the names and addresses of the officer
19 and any other persons from whom an official notice of sale,
20 other details concerning the issuing local government unit, the

21 project, and the official form of proposal, if any, may be
22 obtained.

23 (b) The local government unit shall adopt an official notice
24 of sale which shall set forth, succinctly:

25 (1) The time and place for the receipt of proposals, the
26 officer designated to receive the same, the extent of his power
27 of delegation, and whether and for how long the hour for receipt
28 may be adjourned by announcement prior to opening of any bids;

29 (2) A description of the bonds or notes being offered,
30 including but not limited to, the title and type of bonds or
1 notes being offered, the date thereof, the stated maturity dates
2 and amounts at each date, the dates of interest payments (which
3 may be left open to selection by the successful bidder), the
4 place or places of payment of interest and principal, the form
5 and denominations of the notes or bonds being offered, the
6 provisions for registrability, exchange and interchange, the
7 terms of any sinking fund or reserve funds to be established,
8 the terms of other provisions made for the security of the bonds
9 or notes, the dates, prices and terms of any provision for the
10 redemption thereof prior to stated maturity dates, and any other
11 relevant provisions of the bonds or notes;

12 (3) A statement of the terms of the bidding, including, but,
13 without limitation: the method for determining net interest
14 cost, whether bids must be for all but not less than all; or, if
15 separate bids for separate lots may be submitted, a description
16 of each lot; the limitation on the number and variation between
17 high and low interest rates to be permitted; the required bid
18 security; the permitted discount from par, if any, the funds in
19 which the balance of the purchase price shall be paid; the place
20 at which the balance may be paid; the effect on the obligation

21 to purchase the notes or bonds of litigation pending or change
 22 in tax or other applicable laws occurring before the settlement
 23 for the bonds or notes; the terms of the opinion of bond counsel
 24 to be delivered at the time of payment for the bonds or notes;
 25 the effect of any failure to deliver such opinion; and other
 26 relevant terms; and

27 (4) Any additional provisions as to the furnishing of copies
 28 of documents, including an official statement of essential
 29 facts, the estimated date for delivery of bonds or notes and
 30 whether such bonds or notes will be delivered in definitive or
 1 temporary form, and if temporary, the time and manner of
 2 exchange for definitive bonds or notes.

COMMENT

2. CONTENTS OF PUBLIC ADVERTISEMENT AND OF OFFICIAL NOTICE OF SALE.

The prior section gave the local government unit the option of publishing either a short form notice of availability of the notice of sale or the full text of the notice of sale. The notice of availability can be quite short consisting of six items stated in summary form. It is not necessary to list the annual maturities separately in the summary, a statement such as "stated to mature in varying amounts in each of the years 1973-2008 inclusive" should be sufficient. No bidder submits a bid on the basis of an official notice of sale alone. The additional facts contained in an "Official Statement" are always obtained by inquiring. The official notice of sale can be obtained at the same time.

Subsection (b) provides for the full official notice of sale. Since many proposals are received at the office of the local government unit in the evening when a quorum of the governing body can be obtained, if desired, in inclement weather bidders may be delayed in arriving, but the governing body or its financial advisor may know that a particular group is bidding. It may be in the best interest of the issuing local government unit (but is not mandatory) to delay the opening and reading of all bids for an hour or so to permit the bidder to arrive and submit his bid. It would, of course, be quite contrary to the spirit of competitive bidding to receive and consider a bid after any bid has been opened and read. Adjournment of the bid opening may also be necessary in order to obtain the presence of a quorum of the governing body if it is desired, and as good practice and the ability to make a final acceptance shortly after the bid opening may require.

8163
 3 Section 703. Proposals for Purchase.--Every bid or proposal
 4 for bonds or notes to be sold at public or private sale shall be
 5 in writing and shall be placed in a sealed envelope sufficiently
 6 labeled to indicate that it is a bid or proposal for the bonds
 7 or notes being sold, before being delivered to the officer
 8 designated to receive the same, or to his or her authorized
 9 delegate.

COMMENT

3. PROPOSALS FOR PURCHASE.

The requirement of a writing is in the nature of a Statute of Frauds, and should be delivered as prescribed even in a private sale.

8164
 10 Section 704. Opening of Bids.--At the time and place fixed
 11 in the notice, or at a subsequent hour on the same date to which
 12 the time may have been adjourned prior to the opening of any
 13 proposals pursuant to any right of adjournment reserved in the
 14 official notice of sale, the bids or proposals received shall be
 15 publicly opened by the designated officer, or his or her
 16 authorized delegate, and publicly read aloud.

COMMENT

4. OPENING OF BIDS.

The section states the usual procedure and is in accordance with the existing law.

8165
 17 Section 705. Determination of Highest and Best Bid; Tie
 18 Bids.--The highest responsible bidder shall be the one who,
 19 having complied with the terms of the official notice of sale,
 20 offers to take all of the bonds or notes, or any separate lot
 21 thereof on which separate bids may be made, at the lowest net
 22 interest cost to the local government unit, or, if required by
 23 the terms of any agreement with the United States of America or
 24 the Commonwealth of Pennsylvania or any agency of either
 25 thereof, the highest responsible bidder shall be the one bidding
 26 in conformity with the requirements for the successful bidder

27 stipulated in any such agreement. The net interest cost shall be 103
28 computed in accordance with section 709 of this act. If two or
29 more proposals are found to be the highest and best bids on
30 identical terms conforming to the offering, the bonds or notes
1 shall, with the consent of the bidders, be awarded to them
2 jointly, or, absent such consent, may be awarded to any one of
3 such bidders selected by lot in any manner deemed fair by the
4 local government unit.

COMMENT

5. DETERMINATION OF HIGHEST AND BEST BID; TIE BIDS.

The section states no criteria for determining the responsibility of the bidder, but the term "responsible" implies a demonstrated ability to pay the purchase price and complete the sale. Furnishing the required bid security is not necessarily proof of responsibility. The section provides, as does Section 702 that bonds or notes may be offered on an "all or none" basis, and in separate lots. Usually the lots will be grouped by maturities, and this was sometimes required by the terms of some federal programs in the past and possibly again.

Normally the award will be to the one (i.e. the bidder adjudged to be responsible) bidding the lowest net interest cost. Again, some federal programs in the past required an award to the bidder proposing to take the greatest principal amount of bonds. This was to reduce the balance which the federal government might have to take. Possibly some federal or state programs might take this tack again.

Where bonds or notes are sold in the customary way, "lowest net interest cost" will be determined pursuant to Section 709. Tie bids will result in a sale to combined bidders, or if the groups do not merge within a reasonable time, say an hour or so, the winner is to be selected by lot in any reasonable manner.

5 Section 706. Required Bid Security.--The bid security to be
6 given by each bidder shall be by certified or official bank
7 check payable to the local government unit, and shall be not
8 less than two per cent of the principal amount of the bonds or
9 notes to be purchased. The bid security of the unsuccessful
10 bidder or bidders shall be returned to each unsuccessful bidder,
11 without interest in accordance with written instructions of the
12 bidder conforming to the official notice of sale, promptly upon

13 an award of the bonds or notes or upon the rejection of all
 14 bids. The bid security of the successful bidder shall be
 15 retained by the treasurer of the local government unit and
 16 applied, without allowance for interest, on the purchase price
 17 when the bonds or notes are actually delivered and paid for,
 18 retained as liquidated damages if the bidder defaults, or
 19 returned to the bidder with interest at the judgment rate if the
 20 bonds or notes are not issued for any reason not constituting a
 21 default by the bidder.

COMMENT

6. REQUIRED BID SECURITY.

The act prescribes a minimum bid security of two percent (2%) of the principal amount of the bonds being purchased. In an "all but not less than all" sale this will be 2% of the total issue, but where bidding is by lots, each bidder's security will be measured by the lots for which he bids. Normally the 2% figure is adequate protection, as it represents the normal expected "spread" between purchase and resale. It is stated as a minimum, however, so that the terms of any offering can specify a higher amount should market fluctuations in interest rates indicate the need for greater protection. The act provides that the bid security also acts as liquidated damages. Bid bonds may not be used.

22 Section ⁸¹⁶⁷ 707. Reserved Right to Reject Bids; Effect of
 23 Rejection.-- Every official notice of sale of bonds or notes
 24 shall provide that the right is reserved to the governing body
 25 of the local government unit to reject all bids or proposals,
 26 but in a case where conforming bids have been received and
 27 rejected any subsequent sale of bonds or notes for the same
 28 project must be a public sale to be held at such later time as
 29 the governing body may determine to be advantageous.

COMMENT

7. RESERVED RIGHT TO REJECT BIDS; EFFECT OF REJECTION.

If the interest cost of an issue seems too high, the governing body should have the right to reconsider the project. Thus it must have the right to refuse all proposals, as in practice issues usually do. The higher interest cost may be due to temporary market conditions, and the section authorizes, but does not require, a reoffering but any reoffering must be at public sale. The reoffering, however, will also be subject to the same right of rejection. This is to prevent having a favored bidder in the wings who comes forward after the the rival bid has been opened and read.

30 Section 708. Public Sale; Failure to Receive Conforming
 1 Bid.--If bonds or notes are advertised for sale and no
 2 conforming bid is received, then the local government unit may
 3 cancel the sale, devise a new series for sale, or may sell such
 4 series bonds or notes, or any part or parts thereof, from time
 5 to time, during the ensuing six months at private sale in
 6 accordance with the terms originally advertised with any changes
 7 in call price or dates of call for prior redemption or both as
 8 may be deemed desirable. After such six-month period the local
 9 government unit may sell any unsold portion of the series in any
 10 manner permitted by this act, with such appropriate changes in
 11 the call prices or dates of call for prior redemption or both or
 12 in other terms as may be deemed advisable, provided that as so
 13 changed, the two portions of the series when combined are in
 14 conformity with the requirements of this act as to term,
 15 interest rate and stated maturities.

COMMENT

8. PUBLIC SALE; FAILURE TO RECEIVE CONFORMING BID.

The Act is drafted on the premise that once the initial decision between public or private sale has been made in favor of public sale, the rules as to public sales should govern until the governing body rejects all bids pursuant to the preceding section, or not having received a conforming bid, starts anew with a new series. It has happened, in the past, that while no conforming bid for the entire series has been received, one or more bidders have indicated a willingness to buy, for example, the non-callable stated maturities. Having received favorable construction bids for the project, the local governing body may be willing to obtain part of the funds now and award construction contracts. The purpose of the section is to enable the local government unit to sell the remainder of the series for what it is, a remainder, changing call dates and prices as needed, or after six months making such other changes as the market requires, but still treating the sold and unsold bonds as one series.

16 Section 709.⁸¹⁶⁹ Determination of Net Interest Cost and Net
 17 Interest Rate.--(a) Net interest cost may be determined by using
 18 either the street method or the present worth method whichever
 19 method shall be specified in the official notice of sale.

20 (b) Under the street method a dollar amount shall be
21 determined by computing the total amount of interest payable
22 over the life of the series to stated maturity dates or earlier
23 mandatory call dates and subtracting therefrom the amount of any
24 premium paid above the aggregate principal amount of the bonds
25 or notes, or adding thereto the amount of any discount lawfully
26 allowed in the sale.

27 (c) Under the present worth method there shall be
28 ascertained the semiannual rate, compounded semiannually,
29 necessary to discount the amounts payable on each interest
30 payment date and on each stated maturity or earlier mandatory
1 redemption date to the date of the bonds or notes and to the
2 purchase price offered therefor exclusive of interest accrued to
3 the date of delivery. The net interest cost per annum shall be
4 that rate of interest which is twice the semiannual rate so
5 ascertained.

6 (d) The net interest rate for a series sold under the
7 present worth method shall be the rate of the net interest cost.
8 For a series sold under the street method the net interest rate
9 shall be determined by dividing the net interest cost by the
10 product of: (i) one thousand dollars (\$1,000) multiplied by (ii)
11 the number of bond years from the date of the bonds or notes to
12 the stated maturity or earlier mandatory call dates. A bond year
13 shall be one full year that one thousand dollars (\$1,000) of
14 principal amount shall be outstanding and less than full years
15 shall be fractionalized on a three hundred and sixty-five-day
16 year basis.

COMMENT

9. DETERMINATION OF NET INTEREST COST AND NET INTEREST RATE.

The section represents an attempted compromise between the Economy League's strong preference for the "present worth method" and the underwriting industry's equally strong preference for the "street method". The preference of the Economy League is aimed at the effect of unbalanced bids having a last, or

are usually sold at a discount which must be "recouped" by the purchase by using high interest rates on the uncallable, and perhaps some of the earlier callable bonds, so that the early bonds will sell at a premium. It is also aimed at other types of "skewed coupon" bids.

This Act attempts two frontal attacks on the problem. The first is to permit issuers, when so advised, to use the present worth method successfully used by the Department of Water and Power of the City of Los Angeles, California. The second is provided in Section 603 which limits the permissible spread between the high and the low interest rates that may be accepted by requiring most of the higher rates to be on the long end of the issue. The matter of the most scientific method of determining net interest cost is discussed at length in Moak, Administration of Local Government Debt (M.F.O.A. 1970), at Chapter II, pp 297-313. The author also discusses other disadvantages of "Skewed coupon bids" beside the low coupon on the last maturities.

NA

- 17 Section 710. Combining for Purposes of Financing or
- 18 Sale.--(a) Any local government unit financing two or more
- 19 projects by revenue or guaranteed revenue bonds or notes may
- 20 combine one or more projects for financing purposes prior to the
- 21 incurring of debt with respect thereto. Such combining shall be
- 22 effective upon the effective date of the ordinance enacted with
- 23 respect thereto; but no project designed and limited to serving
- 24 the citizens of one separate and distinct area of a local
- 25 government unit shall be combined with a project designed and
- 26 limited to serving the citizens of another separate and distinct
- 27 area of such local government unit.
- 28 (b) A local government unit may by ordinance combine any two
- 29 or more series of general obligation bonds for purposes of sale.
- 30 If the projects being financed by such general obligation bonds
- 1 have different useful lives, it shall be sufficient for the
- 2 purposes of section 602 if an aggregate principal amount of
- 3 bonds equal to the separate cost of each project having a
- 4 shorter useful life shall have been stated to mature prior to
- 5 the end of each such useful life, and the balance prior to the
- 6 end of the longest useful life. The combined series may be
- 7 stated to mature, otherwise, in conformity with the provisions
- 8 of section 602.

It frequently happens that greater financial strength, and consequently a lower interest cost can be obtained by financing two or more projects as a unit. Water and sewer projects are often combined for financing purposes. Parking projects may be strengthened by being combined with water or sewer. Greater local flexibility of operation is also obtained by permitting the surplus revenues of one such project be used to repair or extend the other. The section gives legislative authority for such combining, but subject to the limitations that taxpayers or rate payers of one area of local government may not be charged to support projects in another area from which they would receive no benefit, as for example when sewer service is provided only for a small area of a township. Parking and recreation facilities open to the public, however, clearly serve all.

Subsection (b) permits the combining for purposes of sale of the general obligation bonds financing one or more projects. This is often desirable as within limits, the larger a single series is when offered for sale, the lower the interest cost will be. Combining also reduces the number of times an issuer comes to market in a given period of time. Since the credit is the same, general obligations, the total debt to be incurred can be rolled up into one series. The useful life limitation, where projects have varying useful lives is satisfied by arranging stated maturities so that at the expiration of the useful life of each project an amount of bonds equal to its cost has been retired. For example, suppose a local government unit desires to finance \$300,000 of equipment having a useful life of 10 years, \$700,000 having a life of 15 years and a \$1,000,000 building having a useful life of over 40 years, but using a 30 year issue. The total series will be \$2,000,000 of which \$300,000 must be retired before ten (10) years, \$1,000,000 by the end of 15 years and the balance by the end of 30 years. Earlier maturities would be greater than if the entire \$2,000,000 were set up on the level annual debt service plan, but considerably less than if each debt were set up on its own and separate level annual debt service basis, again giving present taxpayers a break.

NA 9 Section 711. Financial Advisor May Not Participate in Public
 10 or Private Sale.--Any person acting as financial advisor to a
 11 local government unit may not directly or indirectly purchase,
 12 sell or deal in the bonds or notes of such local government unit
 13 except as a broker executing orders of a bona fide customer,
 14 until the distribution of the series as to which such person is
 15 acting as financial advisor shall have been completed. If such
 16 person violates this section, he shall forfeit twice the
 17 commission or profit realized to the local government unit.

COMMENT

11. FINANCIAL ADVISOR MAY NOT PARTICIPATE IN PUBLIC OR PRIVATE SALE

Obviously there is a potential conflict between advising an issuer on the set-up and marketing of an issue of bonds or notes and being a dealer in or underwriter of the same bonds for personal profit. During the period of distribution of a series of bonds or notes, the financial advisor not only cannot be a member of the underwriting group, but the financial advisor should refrain from dealing in or making a market for such securities during such period. The prohibition against dealing does not prevent the execution of bona fide brokerage transactions on customers' orders.

ARTICLE VIII

Filing with and Duties of the Department

COMMENT

IN GENERAL. The Department of Community Affairs is given jurisdiction over proceedings for the issue of bonds or notes. Transcripts are filed with the Department prior to actual closing of the sale, and a statement of non-completion of sale is filed afterwards if the sale is not completed.

Annual debt statements are also filed with the Department. Up-to-date data on the totality of state and local debt outstanding is important to the credit of the Commonwealth in its extensive bond financing. Failure to file automatically prevents the issuance of further debt. Fees are increased to make this activity of the Department self-supporting, and a penalty for late filings is provided. The Department examines the proceedings in a quasi-judicial manner and issues a certificate of approval or disapproval. The proceedings submitted are approved unless the Department takes timely action (20 days) to disapprove or obtains an extension of time in which to act. Bonds or notes delivered without the approval, or presumed approval of the Department are made invalid. The approval of the Department and the lapse of time for appeals from its action gives a statutory finality to the proceedings precluding subsequent attack except upon constitutional grounds, which now will be few. Records of the Department are admissible in court and may be kept in summary form, the original submissions being periodically destroyed. The Department is given statutory authority to prescribe forms, define terms and issue rules and regulations to simplify and streamline its operations.

208901 Section 801. Certification of Bond or Note Transcript to
 21 Department.--The governing body of each local government unit
 22 shall, before any bonds or notes (except funding bonds issued
 23 with court approval) are actually delivered to the initial
 24 purchasers, or before becoming bound on any lease evidencing the
 25 acquisition of a capital asset cause to be certified to the
 26 department, under the signature of the clerk or secretary of the
 27 governing body and its corporate seal, a complete and accurate
 28 copy of the proceedings had for the incurring of debt, as
 29 provided in section 411 of this act.

COMMENT

1. CERTIFICATION OF BOND OR NOTE TRANSCRIPT TO DEPARTMENT.

The filing with the Department is made for three reasons:

- (a) For review by the Department as a check on the accuracy of the positions taken as to debt exclusion and the absence of debt exceeding the limitations prescribed by this Act.
- (b) To create a finality to the proceedings including an end to attacks by litigation.
- (c) To enable appropriate records to be kept and reports on over-all debt to be made to the General Assembly to enable it to maintain continuous surveillance over the operation of the legislatively imposed debt limits.

The certificate from the recording office accompanying this submission should cover the required filings for previous issues for the exclusion of "subsidized Debt" and the required filings of "Annual Debt Statements", as well as the filings subsequent to Departmental approval of prior debt incurring proceedings. This will demonstrate the local availability of debt information. The "transcript" of proceedings means copies of the adopted resolutions, proofs of advertisement and the bid or bids received for the bonds or notes, as well as any decrees of court entered in proceedings for the approval of funding debt. It does not include the usual "closing" or "settlement" certificates. 8202

30 Section 802. Filing of Annual Debt Statements and Statements

1 of Completion of Sale with Department; Penalty.--Within ninety
 2 days after the close of each fiscal year, each local government
 3 unit shall file with the department a copy of an annual debt
 4 statement in form conforming to section 410 of this act with all
 5 necessary recertifications with respect to the exclusion of any
 6 outstanding self-sustaining or self-liquidating debt. If a bond
 7 or note settlement shall fail of completion, in whole or in part
 8 the local government unit shall file with the department within
 9 ten days a notification of noncompletion of sale, stating what
 10 any part, if any, of the issue shall have been delivered. From
 11 and after the prescribed filing dates required by this section
 12 no certificate of approval of any debt shall be issued by the
 13 department if any filing required to be made by this section,
 14 with the required fee, shall not have been made prior to the
 15 issuance of such certificate. The provisions of this section are
 16 not subject to waiver by the department.

COMMENT

2. FILING OF ANNUAL DEBT STATEMENTS AND STATEMENTS OF COMPLETION OF SALE WITH DEPARTMENT; PENALTY.

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If Departmental records are to be meaningful, they must accurately reflect a true situation, the non-completion of authorizations must be reported. The term "report" means a mere letter of notification which can be dispatched by bond counsel, the financial advisor or any authorized officer of the local government unit. Completions, being the usual situation, need not be reported.

The penalty for failure to file is that no further Departmental approvals may be obtained. The section should be read in connection with section 803 on filing fees, including the additional fees for late filings, and the provision that any submission as to which the appropriate fee is not paid is not a "filing". The requirements of Section 802 as to filings are not subject to waiver, which rule includes the fee for late filings. The express non-waiver clause is not intended to raise any implication as to the right of the Department to waive other mandatory provisions, but is designed to prevent a construction of the fee provision, including the "late-filing" additional fee, as merely directory.

It should be noted that annual debt statements will be due from all local government units within 90 days after the close of their first fiscal year following the effective date of this Act. If filed thereafter, the late filing fee must be paid.

- 17) Section 803.^{8203?} Fees for Filing; Extra Fees for Late
18 Filings.--Every timely filing with the department shall be
19 accompanied by a filing fee of fifteen dollars (\$15), and every
20 late filing shall be accompanied by an additional late filing
21 fee of one hundred dollars (\$100) a day up to a maximum of eight
22 hundred eighty-five dollars (\$885). In the case of filings for
23 new issues of bonds, including filings with respect to lease
24 rental debt the filing shall be accompanied by an additional fee
25 of one mill on each dollar of aggregate principal amount of
26 bonds or notes to be issued and sold by the local government
27 unit up to one million dollars (\$1,000,000) aggregate principal
28 amount, and three-quarters of a mill on each dollar of aggregate
29 principal amount to be sold at such time in excess of the first
30 one million dollars (\$1,000,000), up to ten million dollars

1 (\$10,000,000) and one-quarter of a mill on the excess over ten
 2 million dollars (\$10,000,000). No submission shall constitute a
 3 filing until the proper fee is paid. All fees received hereunder
 4 shall be paid by the department into the State Treasury through
 5 the Department of Revenue.

COMMENT

3. FEES FOR FILING; EXTRA FEES FOR LATE FILINGS.

The fee scale on new issues is double that of existing law by reason of certain additional duties imposed on the Department. The concept should be to make the bond activities of the Department self-supporting, and, consequently no drain on the Commonwealth's budget.

6 Section 804.⁸²⁰⁴ Examination of Bond or Note Transcript and
 7 Other Filings by Department; Certificate of Approval.--The
 8 department shall, upon receipt of any bond transcripts, or other
 9 filings carefully examine the same to determine whether the
 10 proposed debt is within any applicable limitations imposed by
 11 this act, whether prior debt was lawfully incurred and whether
 12 the proceedings for incurring the debt, for issuing and selling
 13 the bonds or notes and for excluding self-liquidating and
 14 subsidized debt have been taken in conformity with the
 15 Constitution and all then applicable laws. If, upon completion
 16 of its examination, a transcript or filing is found by the
 17 department to be in conformity with the Constitution and
 18 existing laws, and is consistent with the record of prior
 19 filings by the local government unit, the department shall
 20 certify its approval to the local government unit.

COMMENT

4. EXAMINATION OF BOND OR NOTE TRANSCRIPT AND OTHER FILINGS BY DEPARTMENT; CERTIFICATE OF APPROVAL.

The section sets the standards by which the Department shall examine the proceedings filed with it. The frame of reference is for conformity with law and consistency with prior filings, not for wisdom or any policy involved in a particular

proceeding. An engineer's certificate as to projected revenues, or the like is not subject to review by the Department except for such obvious departure from reality as would, in effect, make the document no certificate on its face. The consistency with prior filings does not, of course, mean that projected revenues need be the same as prior projections, but a consistent approach must be taken, or correction made in the prior filings. Prepayments may reduce prior debt. Certification as to prepayments since a prior report would remove the apparent inconsistency. One penalty for unlawfully incurred prior debt, including unlawful exclusion of subsidized and self liquidating debt, is the disapproval by the Department of future debt until cure is effected.

21 Section 805.⁸⁰⁰⁵ Certificate of Disapproval; Correction of
 22 Proceedings.--If the department, upon completion of its
 23 examination finds it cannot issue a certificate of approval, it
 24 shall notify the local government unit of the reasons why it
 25 cannot do so. If the proceedings or any prior filings are
 26 subject to correction for demonstrated typographical or
 27 computational error, or otherwise or for failure to include a
 28 necessary document or certification and such correction is
 29 approved by the department, the error shall be corrected in all
 30 places, or the additional document or certification shall be
 1 furnished to the department, within ten days, and upon such
 2 other terms as the department may specify, and thereupon the
 3 department shall certify its approval. If the deficiency shall
 4 not be subject to correction, the department shall certify its
 5 disapproval to the local government unit.

COMMENT

5. CERTIFICATE OF DISAPPROVAL; CORRECTION OF PRIOR PROCEEDINGS.

The section provides for the "cure" of any filing, if that can be done. This avoids the necessity of starting all proceedings over again if an error not going to the foundation of the proceedings exists. Examples would be errors in the application of interest rates to the computation of one or more stated maturities, or an error in the computation of the annual debt service for one or more years. As a condition of its acceptance of any proffered cure, the department may require such corrective notification to the public as may be reasonable.

Obviously minor computational errors not seriously or materially affecting totals will require no public notification. Nor should public notification be required if a required document is inadvertently omitted from a filing. An error of 10% or more in total debt service, on the other hand should require some public notification where the incorrect debt service has been advertised.

The section requires that the Department give notification and opportunity to cure to the local government unit prior to the issuance of a certificate of disapproval. The notification may be oral or may be in writing accompanied by a request for an extension of the Department's time within which to act. Thus, the Department must review the filings and take action, or request an extension promptly.

6 Section 806.⁸²⁰⁶ Effect of Failure of Timely Action by
7 Department; Extension of Time to Act.--If the local government
8 unit shall have submitted a filing to the department by
9 certified mail, return receipt requested, or shall otherwise
10 have an official receipt therefor from the department, and the
11 local government unit shall not, within twenty days of the date
12 of receipt of the filing by the department have received the
13 certificate of approval or disapproval or notification of
14 correctable error, the filing shall be deemed to have been
15 approved for all purposes, unless the local government unit
16 shall have extended the time within which the department may act
17 by written communication to the department, or by failure to
18 object to a written communication from the department requesting
19 such extension. Extensions shall not exceed one additional

COMMENT

6. EFFECT OF FAILURE OF TIMELY ACTION BY DEPARTMENT; EXTENSION OF TIME TO ACT.

The Department is placed under a 20 day time limit. As a condition precedent to the start of the time limit, the filing must be evidenced by a receipt in one of two forms.

- (a) Return receipt for a filing made by registered or certified mail; or
- (b) Official receipt by the Department.

To constitute a "filing" the local government unit must also be able to demonstrate the payment of the appropriate filing fee.

Since the normal time between receipt of bids and settlement or closing is 30 days, the 20 day limit on Departmental action seems reasonable.

Failure to act after a proper filing made in accordance with the conditions of this Section, when properly documented, operates as an approval, such documentation, including a proper affidavit of non-receipt of action or request for extension.

One additional 20 day period is deemed ample, and is made available either by mutual agreement, or by request of the Department and a failure of the local government unit to make timely objection. The request triggers the extension which will last until a reasonable time after written objection is made.

- 8207
- 21 Section 807. Records of Department.--(a) The department
 22 shall keep all proceedings on file for a period of four months
 23 after issuance of its certificate of approval or disapproval and
 24 thereafter, as long as any appeal respecting such proceedings
 .) shall be pending and not finally determined.
- 26 (b) The department shall keep a public record, with respect
 27 to each local government unit showing:
- 28 (1) The name of the local government unit;
 29 (2) The purpose of each issue;
 30 (3) Whether such issue is nonelectoral or electoral, and the
 1 extent to which such debt is subsidized or self-liquidating, and
 2 if subsidized or self-liquidating in part the principal amount
 3 thereby eliminated from nonelectoral debt;
- 4 (4) The schedule of stated maturity dates, interest rates
 and mandatory sinking fund payments for each outstanding issue
 6 of bonds or notes;
- 7 (5) The dates and designations of each issue of bonds or
 8 notes with the approval number assigned to each issue;
- 9 (6) The aggregate principal amount of each issue remaining
 10 outstanding on each December 31;

11 (7) The aggregate principal amount of debt authorized, the
12 aggregate principal amount issued and delivered, and whether any
13 unissued authorized debt has been cancelled;

14 (8) The aggregate principal amount of electoral debt,
15 nonelectoral debt, subsidized debt, lease rental debt,
16 self-liquidating debt represented by guaranteed revenue
17 obligations, and of self-liquidating debt represented by revenue
18 obligations outstanding on each December 31; and

19 (9) The local government unit's most recently certified
20 borrowing base.

21 (c) Documents no longer required to be kept in file by the
22 provisions of subsection (a) of this section 807 and from which
23 all record entries required by the preceding subsection have
24 been made, may be disposed of as waste paper in the manner
25 prescribed by law.

26 (d) The department shall keep an up-to-date list of
27 registered financial advisors.

28 (e) The records of the department shall be public records,
29 available for examination by any citizen of the Commonwealth or
30 any bondholders or noteholders, and copies thereof, certified as
1 correct by the secretary of the department under the seal of the
2 department, shall be admitted as evidence of the facts therein
3 stated in all courts of this Commonwealth and elsewhere.

COMMENT

7. RECORDS OF THE DEPARTMENT.

The records of the Department will be the key to its biennial reporting to the General Assembly, and to the reporting on local debt necessary in maintaining the credit standing of the Commonwealth and its subdivisions. The records of the Department are public records and admissible in all proceedings as prima facie evidence. Items 6, 7, 8 and 9 of subsection(b) must be reviewed annually to be kept up to date.

Subsection (c) permits disposition of filed originals not required for pending litigation. To save expense, micro-filming is not required, and the "take-off" to the permanent records will constitute the evidence, together with the filings in the local offices for the recording of deeds.

808 8208

5 Approval by the Department.--Bonds or notes sold and delivered
6 to the initial purchasers prior to an approval of the issue by
7 the department under section 804 or section 806 of this act
8 shall be invalid and of no effect in the hands of the initial
9 purchasers except to the extent provided in this section 808. In
10 the hands of a bona fide purchaser (other than an initial
11 purchaser or member of an underwriting or selling group) for
12 value without actual notice of the lack of a prior approval by
13 the department, any bonds or notes containing a recital that the
14 issue had been approved by the department shall be valid and
15 subsisting instruments enforceable in accordance with their
16 terms, and any applicable borrowing base shall be deemed
17 increased to the extent necessary to validate and keep such
18 bonds valid, but not for the purpose of reducing the liability
19 of any person under the next sentences. The local government
20 unit shall be entitled to recover all interest and principal
21 payable thereon from the initial purchasers and the individuals,
22 including the officers of the local government unit, responsible
23 for making the unapproved delivery. Notwithstanding the
24 invalidity of the instruments as to them, the initial purchasers
25 shall be entitled to credit, in any action determining such
26 invalidity or for the recovery provided by the preceding
27 sentence for the amount of:

28 (1) Any proceeds of the sale of the instruments still held
29 unexpended by the local government unit; and

30 (2) The lesser of either: (i) the cost or fair market value,
1 whichever is the lesser, of any capital project or part thereof
2 or interest therein acquired by the local government unit by an
3 expenditure of a portion or all of the proceeds of the bonds or
4 notes; or (ii) the remaining nonelectoral borrowing capacity of
5 the local government unit.

COMMENT

8. INVALIDITY OF BONDS OR NOTES DELIVERED PRIOR TO APPROVAL BY THE DEPARTMENT.

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The real enforcement of the requirement for department approval is this provision making the bonds invalid except in the hands of a bonafide purchaser without actual notice, except an initial purchaser (usually an investment banking firm or a financial institution well able to see to it that approval is obtained). The term initial purchaser extends beyond a technical "first buyer" to include all in the professional chain of initial distribution until an ultimate customer becomes a bonafide purchaser of the security (see Uniform Commercial Code, Article 8).

The creation of a bonafide purchaser does not relieve those participating in an unauthorized delivery from liability to the local government unit. The liability will, ordinarily, be limited to the interest payable, since the off-set permitted will usually cover the principal of the debt. The off-set allows the local government to keep the proceeds, so as to protect it from any contractual commitments made on the faith of the sale of the bonds or notes. The section, as a penalty designed to ensure compliance, does not permit the discount to present worth of recoverable interest.

6 Section 809.⁸²⁰⁹ Finality of Proceedings; Validity of Bonds or
7 Notes.-- (a) Where a certificate of approval has been issued by
8 the department or has been deemed issued under section 806, and
9 no appeal has been taken, or when after appeal, the proceedings
10 have been approved finally by the court, the validity of the
11 proceedings, the right of the local government unit to issue its
12 bonds or notes lawfully pursuant to those proceedings, and the
13 validity and due enforceability of the bonds or notes in
14 accordance with their terms shall not thereafter be inquired
15 into judicially, in equity, at law, or by civil or criminal
16 proceedings, or otherwise, either directly or collaterally
17 except where a constitutional question is involved. The effect
18 of the approval by the department, or by the court on appeal,
19 shall be to ratify, validate and confirm, so far as good faith
20 purchasers of the bonds or notes are concerned, such proceedings
21 absolutely, including the lawful nature of the project,
22 notwithstanding any defect or error in such proceedings, except

23 as specifically provided hereinafter in this section, and any
24 debt limit imposed by this act shall be deemed increased to the
25 extent necessary to validate such debt. Nothing herein contained
26 shall, however, free an initial purchaser of bonds or notes from
27 liability to a local government unit for the payment of the
28 consideration agreed in the contract of sale, or make all such
29 bonds or notes valid and enforceable in the hands of an initial
30 purchaser unless the issuer shall have received a substantial
1 consideration for the issue as a whole.

2 (b) Nothing herein contained shall, however, relieve any
3 person participating in such proceedings from liability for
4 knowingly participating in an ultra vires act of a local
5 government unit, or from any civil or criminal liability for
6 false statements in any certificates filed or delivered in such
7 proceedings.

COMMENT

9. FINALITY OF PROCEEDINGS; VALIDITY OF BONDS OR NOTES.

.....
This section puts an end to litigation concerning the validity of bonds or notes upon the expiration of the time for an appeal, or the entry of a final judgment after an appeal. The finality extends to the lawful nature of the project. The finality covers, revenue bond issues and guaranteed revenue bond issues. The exception for where constitutional issues are involved is a lesser one than formerly where debt limits were constitutional and exceeding the limit in a legislatively approved manner was ineffective. The constitutional issue will now center solely on whether the project was one which could constitutionally be authorized by the legislature. In the case of new projects, of types not heretofore recognized as constitutional projects for local local government units, the "test case" approach still remains available as in the past.

The section makes it clear that the concept of finality does not extend to the liability of the initial purchasers to pay the agreed consideration, or free the holders from an issuer's defense or lack of consideration except to the extent stated. The language used conforms to that used in Article 8 of the Uniform Commercial Code.

Subsection (b) indicates that the statutory finality does not relieve from liability those who have knowingly set out to swindle or otherwise participate in actions beyond their powers of a local government unit.

8 Section 810. Power of Department to Define Terms, Issue
 9 Rules and Regulations and Prescribe Forms.--The department shall
 10 have power to prescribe rules and regulations regarding, and to
 11 prescribe forms for, reports and filings to be submitted to the
 12 department pursuant to this act. Such definitions, rules and
 13 regulations when published and made available to the public
 14 shall have the force of law.

COMMENT

10. POWER OF DEPARTMENT TO DEFINE TERMS, ISSUE RULES AND REGULATIONS AND PRESCRIBE FORMS.

This section gives the Department power to "flesh out" the meaning of the statute by its definitions further refining the meaning of terms used and by prescribing procedures and forms not contrary to the express terms of this Act. For example, a departmental rule or regulation could not provide for a waiver of matters expressly made nonwaivable by the statute (See sections 802 and 803 and the accompanying comment). Giving such definitions, rules and regulations the force law makes action taken in reliance thereon legally protected action, subject to attack only upon a finding of invalidity in the definition, rule or regulation as going beyond the scope of the statute.

NA? 15 Section 811. Biennial Reports to the General Assembly.--The
 16 department shall on or before June 15 in each even-numbered
 17 year, beginning on June 15, 1974, report to the General Assembly
 18 the amount of all net debt of local government units for each
 19 class of unit and by each category of debt, outstanding at the
 20 beginning of the period covered by the report, the amount of
 21 debt issued during the period, the amount repaid during the
 22 period, and the net amount outstanding at the end of the period.
 23 The report shall also set forth for each class of local
 24 government unit the highest, the median and the lowest ratio of
 25 net nonelectoral and net nonelectoral debt plus net lease rental
 26 debt to the applicable borrowing bases, and the highest, the
 27 median, and the lowest ratio of the maximum annual debt service
 28 to the applicable borrowing base of all outstanding net
 29 nonelectoral debt and net nonelectoral debt plus net lease
 30 rental debt. The period for each class of local government unit

1 shall be its two fiscal years ended next preceding the January
2 first of the year in which the department is required to file
3 its report. The report shall also list each local government
4 unit whose outstanding net nonelectoral debt and net
5 nonelectoral debt plus net lease rental debt exceeds or is less
6 than one million one dollars (\$1,000,001) below the applicable
7 borrowing base.

COMMENT

11. BIENNIAL REPORTS TO THE GENERAL ASSEMBLY.

Under the Constitution, responsibility for fixing debt limits rests with the General Assembly. Admittedly, the limits here fixed are to some extent experimental and should periodically be reviewed in the light of accumulated experience. If after, say three such reports are received, further reporting is deemed unnecessary or burdensome by reason of the expense involved the Section can be repealed, or modified to require only the data needed by the General Assembly. Annual reports would well be too fragmentary. Every two years seems to be frequent enough. The report should give the General Assembly information not only as to total debt and debt burden. It should also enable the General Assembly to see whether an appreciable number or class of local government units are close to exhausting their debt limits so that timely legislative action may be taken if deemed necessary. It goes without saying that the Department can transmit its recommendations with the report.

ARTICLE IX

Appeals Concerning Debt

SE COMMENT

IN GENERAL. The procedure heretofore used for appeals has been followed. All appeals (and actions) contesting the validity of proceedings concerning the incurring of debt have been centered in the Commonwealth Court. This would always be the case if the appeal were taken after the Department had approved or disapproved the issue, and the fact that court action is sought before the Department takes action should not confer jurisdiction upon another tribunal. This channeling of actions will enable the Commonwealth Court to develop an expertise in matters relating to the incurring of debt. It will likewise ensure a uniformity of approach throughout the Commonwealth. The proceedings will be by petition and answer, with service by certified mail on designated parties. Notice to taxpayers generally will be given in such manner as the Commonwealth Court may direct. Appeals will lie from a decision of the Commonwealth Court as provided in the Appellate Court Jurisdiction Act of 1970, subject to a 10 day notice of intent to appeal.

ARTICLE IX

Appeals Concerning Debt

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9
10 Section 901. Appeals by Interested Parties and
11 Taxpayers.--Where proceedings for the incurring of debt and sale
12 of bonds or notes or the exclusion of debt as self-liquidating
13 or subsidized have been taken by a local government unit and the
14 department shall have certified or shall have been deemed to
15 have certified its approval or disapproval of the issue, or
16 exclusion and the fact of final adoption of the ordinance
17 approving the sale or the exclusion shall have been advertised
18 one time in a newspaper of general circulation in the area of
19 the local government unit, such local government unit or any
20 other interested party, or any taxpayer of the local government
21 unit may appeal within thirty days from the earlier of:
22 (1) The date of advertisement of the fact of the final
23 passage of the ordinance approving the sale of the bonds; or
24 (2) The date of the department's certificate of approval,
25 the date it is deemed to have been approved, or the date of its

26 disapproval. The appeal shall be by petition to the Commonwealth
27 Court. The petition shall allege the error or errors in the
28 proceedings in the manner required of bills in equity, and the
29 burden of persuading the trier of fact as to all matters of fact
30 shall be upon the appellant.

1 Jurisdiction is hereby conferred upon the Commonwealth Court
2 to hear and determine such appeals, and all other appeals and
3 actions provided for in this act.

COMMENT

1. APPEALS BY INTERESTED PARTIES AND TAXPAYERS

Appeals by either the local government unit or by taxpayers or other interested parties may be taken from the action of the department to the Commonwealth Court. Other interested parties may include underwriters, persons whose lands are being taken for a project claimed by them to be an illegal project, or persons otherwise affected by the project, either favorably or adversely. Appeals should be expedited and so the time for appeal runs from the earlier of the final adoption and advertisement of the ordinance approving the sale of the bonds or the date of the department's approval. The appeal time in the ordinary case will run from the final adoption of an ordinance approving the sale of bonds, but in the case of an exclusion of debt as self liquidating or subsidized debt the approval of the exclusion by the Department may occur before the sale of any bonds, since the governing body may not wish to go ahead with the project unless certain of the exclusion. In any event since the Department will have normally acted in less than 20 days, there will be 15 to 10 days after Departmental Action in which to perfect the appeal. The 30 day period is consistent with the 30 day period in the Appellate Court Jurisdiction act. Expedited action is obtained by having the time run from an earlier date than Departmental Action. The filing of an action is not an automatic stay and the Department may act before answer is due from it, so that the court may be advised of its position.

4 Section 902. Action to Contest Proceedings Before
5 Departmental Approval.--Any local government unit, taxpayer, or
6 other interested party may bring an action in the Commonwealth
7 Court asserting the validity or invalidity of any action
8 concerning the incurring or exclusion of debt from nonelectoral
9 debt or lease rental debt prior to action thereon by the
0 department, in like manner as an appeal from departmental
1 action; except in cases where this act expressly confers
2 jurisdiction upon another tribunal.

2. ACTION TO CONTEST PROCEEDINGS BEFORE DEPARTMENTAL APPROVAL

Consistent with the policy of requiring a fast decision of controversies relating to debt matters, action to contest can be brought before final determination by the department. In the normal case a threat of litigation will prevent the giving of a "no litigation pending or to the knowledge of the undersigned threatened," certificate at a bond closing. Thus where serious threat is made the local government unit should be empowered to bring an action at the earliest possible moment to resolve the matter. The petition will, of course, be in the nature of an action for a declaratory judgment, which by reason of the importance of the matter, and the need to avoid useless expenditure of time and funds should be resolved forthwith.

The section will also apply to proceedings where no prior departmental approval is required, as for example, in the issue of tax anticipation notes and funding debt issued pursuant to court order.

13 Section 903. Notice of Appeal or Commencement of Action;
14 Record; Service of Notice.--Notice of any such appeal or the
15 start of any action shall be given by the petitioner, together
16 with a copy of the petition to the clerk or secretary of the
17 local government unit if it is not the petitioner, and to the
18 department at Harrisburg, Pennsylvania by mailing the same
19 certified mail, return receipt requested, postage and fees
20 prepaid. The return receipt shall be accepted as proof of
21 service. Notice shall be served upon taxpayers by publication in
22 such manner as the court shall direct. Forthwith upon the
23 receipt of such service, or the filing of a petition by it, the
24 local government unit shall transmit to the prothonotary of the
25 Commonwealth Court duly certified copies of all documents
26 required to be filed with the department and the department to
27 the extent the same have been concluded shall certify to the
28 prothonotary any action thereon taken by it. Such proceedings so
29 certified shall become a part of the record and shall be
30 admitted in evidence, together with any other evidence offered
1 by the parties.

COMMENT

3. NOTICE OF APPEAL OR COMMENCEMENT OF ACTION: RECORD: SERVICE OF NOTICE

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The section follows the prior statute with necessary modifications to provide for the commencement of actions under Section 902, of the Act. Other details of the proceedings will, of course, be subject to the appropriate Rules of Court established by the Commonwealth Court.

2 Section 904. Filing of Answer.--The local government unit,
3 the department, any person interested and any taxpayer of the
4 local government unit desiring to answer the petition, must file
5 their answer within ten days after the service of the notice of
6 appeal and the petition, or by such earlier date as the court
7 may fix.

COMMENT

4. FILING OF ANSWER

Ten days will always be sufficient for the filing of and preparation of an answer. If those attacking the proceedings are tax payers, the time is clearly sufficient as the issues will have been fully considered by the local government unit before embarking on a course of action. If the action is brought by the local government unit, it will be in response of threats of action by the local groups. The need for a speedy determination of the issues to forestall loss of money due to market changes in interest rates or the expiration of time in which to settle under a bid for the bonds may justify the Court, by order to show cause, or otherwise, in imposing a shorter time for answer.

8 Section 905. Hearings; Pleadings.--After the expiration of
9 the time for filing answers, the court shall fix a day for
10 hearing, of which notice to all parties to the proceeding shall
11 be given as the court may direct. At the hearing the court may
12 hear evidence, but the proceedings shall be limited to the
13 questions raised by petition and answer. New matter in an answer
14 shall be deemed denied and no demurrer or other pleading shall
be required to bring the matter to issue.

COMMENT

5. HEARINGS: PLEADINGS

The section tracks the prior law, and is designed to provide for a streamlined expeditious procedure.

16 Section 906. Order; Further Proceedings Subject to Approval
 17 of Department.--(a) After a hearing, the court shall have power
 18 to affirm or to order stricken from the proceedings in
 19 possession of the local government unit, or in any filing in any
 20 office for the recording of deeds, the approval of the
 21 department or any proceedings erroneously taken by the local
 22 government unit, or, if in the opinion of the court the
 23 proceedings had by the local government unit are subject to
 24 correction or amendment, it may refer the matter back to the
 25 local government unit for such action.

26 (b) Any further proceedings by the local government unit
 27 shall be again filed with and shall again be subject to approval
 28 by the department if the original proceedings were required to
 29 be so filed and approved.

COMMENT

6. ORDER: FURTHER PROCEEDINGS SUBJECT TO APPROVAL OF DEPARTMENT

The section parallels the prior law.

30 Section 907. Appeals from Commonwealth Court.--From any
 1 final decision or order of the Commonwealth Court, appeals may
 2 be taken as from other final decisions or orders in accordance
 3 with the Appellate Court Jurisdiction Act of 1970, but the party
 4 appealing must give all other parties notice of his intent to
 5 appeal within ten days of the entry of the order of the
 6 Commonwealth Court.

COMMENT

7. APPEALS FROM COMMONWEALTH COURT

In an effort to enable contested bond issue cases to proceed after a decision of the Commonwealth Court, any party intending to appeal should give prompt notice, after which he may perfect the appeal in the usual manner.

ARTICLE X

Sinking Funds; Reserves and Pledged Revenues

COMMENT

IN GENERAL. The Article provides for a sinking fund which may have therein one or more accounts for various purposes, including debt service and in the case of revenue or guaranteed revenue bonds for reserves, maintenance, repairs, bond redemption and the operation of the project as well as a surplus account. The funds in the surplus account must be made available to the local government unit for any lawful purpose. Where assessment bonds are issued the proceeds of assessments go into the sinking fund which may have a revolving fund account for the payment of costs of other such improvements. It is a mandatory duty of the treasurer of a local government unit to make the required payments into the sinking fund, and if not appropriated proportionately out of each receipt of moneys. Accumulated moneys in the sinking funds may be invested in the same investments as Commonwealth moneys awaiting expenditure. Withdrawals from a sinking fund account may only be made by the bank appointed as the sinking fund depositary pursuant to Article IV but the investment and management of the funds is in the local government unit or its sinking fund commissioners. Funds remaining in the sinking fund for two years after they are payable to a bondholder or noteholder are to be returned to the local government unit. The Department of Community Affairs is charged with auditing the various sinking funds and compelling compliance with the Act.

9 Section 1001. Creation of Sinking Fund and Accounts

10 Therein.--(a) Every local government unit having outstanding any
11 bonds or notes shall create forthwith, subject to the terms of
12 any existing contracts with the holders of such bonds or notes,
13 and every local government unit hereafter issuing any bonds or
14 notes shall create simultaneously with or prior to the delivery
15 of the bonds or notes and maintain a sinking fund for the
16 aggregate or for one or more series of its general obligation
17 bonds and notes, and separately for each project or combination
18 of projects financed by revenue or guaranteed revenue bonds or
19 notes. The sinking fund shall be maintained with the
20 Pennsylvania bank or bank and trust company appointed from time
21 to time as sinking fund depositary and all moneys deposited
22 therein and the investments thereof shall be subject to a
23 perfected security interest for the bonds and notes for which
24 such sinking fund is operated until properly disbursed.

25 (b) Moneys for the payment of taxes assumed, and principal
26 and interest on outstanding bonds or notes shall be deposited in
27 a separate debt service account in the sinking fund for each
28 series at the times and in the amounts provided in any contract
29 with the holders of the bonds and notes, but every such contract
30 shall provide for deposits to be made in sufficient amount not
1 less than ten days before the date of disbursement for principal
2 or interest.

3 (c) A local government unit pledging the rates, rentals,
4 receipts, charges and tolls from the use of a capital project,
5 for the security of revenue or guaranteed revenue bonds or
6 notes, shall, by ordinance, provide for the deposit thereof as
7 and when received in the sinking fund for the project.

8 (d) A local government unit may provide, by ordinance, for
9 the creation and maintenance of other accounts in the sinking
10 fund for revenue or guaranteed revenue bonds, including
11 operating accounts for financed projects, reserve accounts for
12 various purposes, a bond redemption account and a surplus
13 account, may prescribe the purposes for which the funds in each
14 such account may be withdrawn and the amounts, times and sources
15 of deposits therein, but every such ordinance shall provide that
16 moneys in the surplus fund may be used by the local government
17 unit for any lawful purpose of such local government unit, and
18 no contract with the holders of bonds or notes shall provide to
19 the contrary.

20 (e) Deposits in the surplus account shall be made in each
21 year of all revenues in excess of the sum of the operating
22 expenses plus one hundred and forty per cent of the annual debt
23 service, including funds for the amortization of term bonds, for
24 such year.

COMMENT

1. CREATION OF SINKING FUND AND ACCOUNTS THEREIN.

130

(a) This Section should be read in connection with Section 406 requiring the appointment of a sinking fund depository and paying agent for each series or for several series of general obligation bonds. A local government unit may wish to create one sinking fund for the aggregate of its general obligation debt, but revenue projects will require a segregation of revenues, and, therefore separate fund. The depository may or may not be the same as the depository for one or more series of general obligation bonds. The words "from time to time" make it clear that, subject to the terms of any contract with the holders of its bonds or notes, the local government unit has the power to change a sinking fund depository once appointed.

Moneys in sinking funds, and the investments thereof are held in pledge for the holders of the bonds in respect of which they were deposited until disbursed. If one sinking fund is created for several series, the interests are proportionate to the principal amount of each outstanding series unless the deposit is made, under subsection (b) in the separate debt service account for each series.

(b) Deposits are required to be made in each separate debt service account not less than ten (10) days prior to the date of disbursement. The time is set to permit a sinking fund depository to take protective action for the benefit of the bondholders or noteholders before principal or interest becomes overdue. A longer time may be specified in the bond ordinance, and nothing prevents the specification of a thirty (30) day grace period for non-payment of interest before a default can be called.

(c) In revenue financing, all revenues pledged go directly to the sinking fund as a further perfection of the pledge thereof, but withdrawals for all proper purposes can be created by setting up a proper flow of funds into various accounts pursuant to subsection (d).

(d) The section makes it mandatory to create a final account in the flow of funds, which is, in effect, a release fund freeing surplus pledged revenues for any lawful purpose of the issuing unit. Counsel representing local government units should see that appropriate limits are set upon the fund flowing into other accounts so that there will, in fact, and in appropriate cases be funds flowing into the surplus account.

(e) By contract provision may be made for the flow of a greater amount of moneys into the surplus fund.

2^c Section ⁸⁰⁰² 1002. Sinking Fund for Assessments.--If a local
26 government unit issues bonds or notes as general obligation
27 bonds or guaranteed revenue bonds to provide funds for and
28 towards the cost of making permanent street, sidewalk, water or
29 sewer improvements and such cost is assessed against the
30 properties benefited thereby, the assessments as collected shall

1 be paid into the sinking fund for such bonds. The ordinance
 2 authorizing such bonds may provide for the payment of such
 3 assessments into a revolving fund account to provide moneys for
 4 and towards the cost of other such improvements, and in such
 5 case, the ordinance shall also provide for the payment into the
 6 sinking fund from other sources of moneys sufficient to pay the
 7 principal of and the interest on such bonds or notes and such
 8 bonds or notes shall not by virtue of such assessment revenues
 9 be excluded from nonelectoral debt. To the extent that such
 10 other moneys are paid into the sinking fund, the revenues from
 11 the assessments may be used to make other assessable
 12 improvements. The fund may be continued as a revolving fund, or
 13 discontinued at any time. Upon discontinuance the proceeds of
 14 the assessments shall be used to pay any bonds or notes
 15 remaining outstanding and to reimburse the general fund of the
 16 local government unit for the moneys theretofore paid on account
 17 of the bonds or notes.

COMMENT

2. SINKING FUND FOR ASSESSMENTS.

The section continues the authorization, found in prior law permitting the creation of a "revolving fund" for street and other assessable improvements, with an initial bond issue payable out of general tax revenues. In such a case, the fact that assessments will be collected will not serve to exclude the assessment debt from nonelectoral debt, as the assessment receipts will not, in fact, be used to repay debt. When the revolving fund has served its purpose, the revenues therein and any subsequently flow into the general fund of the local government unit.

18 Section 1003. ⁸²²³ Duty of Treasurer with Respect to Sinking
 19 Fund.--It shall be the duty of the treasurer of each local
 20 government unit to deposit into the sinking fund the moneys to
 21 be deposited therein pursuant to the covenant entered into by
 22 the local government unit with the holders of its bonds and
 23 notes, at the times and in the amounts provided in the pledges

24 or appropriations made by the governing body. If no
25 appropriation of moneys shall have been made, or if it shall
26 appear that, as a result of other expenditures, the appropriated
27 tax revenues will not be received in sufficient amounts in time
28 to make the deposits required to be made for the payment of the
29 taxes assumed and interest and principal on general obligation
30 bonds and notes, or the amount due on a guaranty of guaranteed
1 revenue bonds, it shall be the duty of the treasurer to pay into
2 the sinking fund that portion of each receipt of tax moneys and
3 other available revenues as will result in the timely
4 accumulation of sufficient moneys in the sinking fund to pay the
5 taxes assumed and the principal of and interest on the bonds or
6 notes, or to meet the guaranty obligation of the local
7 government unit. The governing body of a local government unit
8 may issue its tax anticipation notes under Article V of this act
9 to provide all or any part of any moneys needed for deposit in
10 the sinking funds of the local government unit.

COMMENT

3. DUTY OF TREASURER WITH RESPECT TO SINKING FUND.

A non-discretionary duty to make the deposits required to be made in the sinking fund is imposed upon the Treasurer of the local government unit. Accordingly the performance of the duty will be enforceable by mandamus. If no appropriation of tax moneys shall have been made, or if it appears that the receipts will not be available in sufficient amount to fund an appropriation on the date of transfer, the treasurer comes under a statutory duty to begin, at once, setting aside a portion of each receipt of revenues sufficient to ensure that funds will be available to pay the bonds or notes in timely fashion.

If the local government acts properly this provision need not come into play. The governing body will have these options in proper cases:

- (a) Issue tax anticipation notes so as to realize on taxes payable after the disbursement on the bonds or notes is made; or

(b) Incur "funding debt" in order to provide for the payment, if the conditions permitting such action are present; or

(c) Refund the maturity pursuant to Article XI of this act, if a maturity of principal is causing the difficulty.

8224
11 Section 1004. Deposit of and Investment of Moneys in Sinking
12 Funds.-- (a) Any moneys in sinking funds not required for prompt
13 expenditure may be deposited at interest in time accounts or
14 certificates of deposits of any bank or bank and trust company
15 or in shares of building and loan associations or Federal
16 savings and loan associations. Moneys required for prompt
17 expenditure shall be held in demand deposits. To the extent that
18 such deposits are insured by the Federal Deposit Insurance
19 Corporation or the Federal Savings and Loan Insurance
20 Corporation, they need not be secured; otherwise such deposits
21 shall be secured as public deposits whether or not title shall,
22 by virtue of the deposit with a fiscal agent or trustee for
23 bondholders, be in such fiscal agent or trustee, except that
24 moneys held by the fiscal agent, trustee or sinking fund
25 depository itself may be secured as trust funds.

26 (b) Any moneys in sinking funds not required for prompt
27 expenditure may be invested in any securities in which the
28 Commonwealth may at the time of investment, invest moneys of the
29 Commonwealth not required for the time being for expenditure,
30 subject to any stricter requirements in any contract with the
1 holders of bonds or notes for which the particular sinking fund
2 was created or maintained.

3 (c) All such deposits and investments shall be in the name
4 of the local government unit but shall be subject to withdrawal
5 or collection only by the sinking fund depository for proper
6 purposes in accordance with this act.

7 (d) Income received from any deposit or investment shall be
8 a part of the fund or account invested and may be applied if so
9 desired by the local government unit, in reduction of or to
10 complete any required deposits.

11 (e) For the purposes of investment, all accounts in a
12 sinking fund may be combined and each account shall be entitled
13 to its pro rata share of each deposit or investment.

14 (f) The sinking fund depositary shall return to the local
15 government unit all moneys deposited in a sinking fund for the
16 payment of bonds, notes or coupons which have not been claimed
17 by the holders thereof after two years from the date when
18 payment is due, except where such funds are held for the payment
19 of outstanding checks, drafts or other instruments of the
20 sinking fund depositary. Nothing in this subsection or in any
21 action taken hereunder shall relieve the local government unit
22 of its liability to the holders of unrepresented bonds, notes, or
23 coupons.

24 (g) Any investments of a sinking fund, including bonds of
25 the local government unit held therein, may be sold at any time
26 by the sinking fund depositary if cash is required for
27 expenditure, or as directed by the managers of the sinking fund,
28 through any broker or dealer in securities, any other law
29 concerning dispositions of assets of a local government unit to
30 the contrary notwithstanding.

COMMENT

4. DEPOSIT OF AND INVESTMENT OF MONEYS IN SINKING FUND.

In order to permit full utilization by a local government unit of proper techniques of "money management", balances in sinking funds may be put out at interest in time or savings accounts or invested in funds eligible for the investment of funds of the Commonwealth not required for prompt expenditure. The determination of "early" expenditure will depend upon the availability of a suitable interest bearing deposit or investment for the funds available when they reach the sinking fund and convertible into actually and finally collected bank credit when needed for disbursement from the sinking fund.

Indeed, transfers to the sinking fund can be by the transfer to the sinking fund of suitable deposits or investments already made, and, if necessary earnings can be apportioned, or under subdivision (d) may be considered in determining amounts to be deposited.

Frequently more favorable investments can be obtained by combining smaller deposits in the several sinking fund accounts, so that, for example, even multiples of \$5,000, the standard unit of trading in the bond market, can be invested. Also, on occasions a higher rate of return on a certificate of deposit can be obtained if above a certain amount is deposited. Subsection (e) confers the necessary combining authority. The particular combined investment selected would, however, have to be eligible for each account under any restrictive covenant made with bondholders.

Subsection (f) provides for the return to the local government unit of moneys deposited to pay bonds, notes or coupons and not claimed for two (2) years. This follows the usual procedure under contracts with fiscal agents, as does the exception where the sinking fund depository has outstanding its own negotiable instrument. The local government unit still must pay the bond note or coupon when presented. The withdrawal of the deposit does not cause interest to accrue when the making of the deposit had the effect of stopping the running of interest.

Subsection (a) makes it clear that the funds remain public moneys with respect to the requirement for posting funds as security for deposits even when held in the names of the sinking fund depository or trustee. The act permits such security to be given in the same manner as trust funds are secured when held by the sinking fund depository itself. This clarifies an issue sometimes raised by bank examiners and the Federal Reserve Authorities.

The final subparagraph permits the sinking fund depository to convert investments into cash, when needed, through normal market channels, thus making it clear that general statutes concerning the procedure for dispositions of public property do not apply.

- 8225
- 1 Section 1005. Management of Sinking Fund.--The management
 - 2 and control of sinking funds, and investments thereof, subject
 - 3 to the provisions of this act shall be vested in the governing
 - 4 body of the local government unit except:
 - 5 (1) Where by any other law there has been created any board
 - 6 or commission for the management and control of sinking funds of
 - 7 a particular class of local government units, in which case such
 - 8 board or commission shall have the management and control of the
 - 9 sinking funds of such local government units;

- 10 (2) To the extent otherwise provided by this act; and
 11 (3) To the extent otherwise lawfully provided in any
 12 contract with the holders of bonds or notes.

COMMENT

5. MANAGEMENT OF SINKING FUND.

The section makes it clear that, except for the specific provisions of this Act, and except as a lawful contract with bondholders may provide otherwise [cf Beam v. Borough of Ephrata, 395 Pa. 348, 149 A (2d) 431 (1959)] the control and management of sinking funds, including the responsibility for maximizing the earnings of such moneys rests with the governing body of the local government unit, or with its sinking fund commissioners where other law creates such officials. Nothing in the Act precludes an investment advisory contract with the sinking fund depository or the making of investments and reinvestments by the sinking fund depository pursuant to any continuing instructions given by the local government unit.

- 13 Section 1006. Inspection of Sinking Funds; Orders to
 14 Comply.-- (a) The department shall from time to time, not less
 15 frequently than triennially, audit the sinking funds and all
 16 records pertaining thereto of local government units which have
 17 any outstanding debt except those submitting reports audited by
 18 an independent certified public accountant and except for school
 19 districts of the first class or cities of the second class and
 20 second class A.
 21 (b) If such audit or reports shall disclose that any local
 22 government unit has refused or neglected to establish sinking
 23 funds as required by this act, or has failed to provide
 24 sufficient moneys for any sinking fund to meet the payments of
 25 assumed taxes, principal and interest to be made therefrom, is
 26 not investing sufficient of the sinking fund moneys or is
 27 otherwise in violation of this article, the department shall
 28 make an order requiring the local government unit or any officer
 29 thereof or the governing body to take such steps as, in the
 30 opinion of the department, will cause such sinking funds

1 thereafter to comply with this article or to be sufficient.

2 (c) In addition to the criminal prosecutions provided for in
3 Article XIII of this act, or in lieu thereof, the department
4 may, in its discretion, apply to the Commonwealth Court for a
5 writ of mandamus to issue to such officer or governing body of
6 the local government unit to compel compliance with such order
7 of the department or such order with such modifications thereof
8 as to the court may seem just and proper.

COMMENT

6. INSPECTION OF SINKING FUNDS, ORDERS TO COMPLY.

The section continues the present obligation of the Department of Community Affairs to make periodic audits of the operation of sinking funds, and to enforce compliance with the requirements of law and of contracts with the holders of bonds and notes. New is the provision that the audit should cover the proper "money management" activities of the local government unit with respect to balances in sinking funds.

Article XI
Refunding of Debt

138

COMMENT

IN GENERAL. This Article provides maximum flexibility in financing by placing few limits on the power to refund. It specifies the treatment of that portion of a refunding issue which really represents costs of refunding rather than an increase in principal debt and provides for their exclusion from debt limits and separate amortization. The Article prevents the creation of perpetual debt through refunding. It permits the refunding of electoral debt by action solely of the governing body, and provides that refunding of lawfully incurred nonelectoral debt is not precluded if debt limits have shrunk since the debt was incurred. There are provisions permitting the revocation of a call for refunding, specifying when called bonds are no longer outstanding and when interest thereon ceases. Subject to all applicable limitations, general obligation bonds may be refunded by revenue bonds and vice-versa. "Advance refunding" is, of course, subject to certain federal rules. 8241

11 Section 1101. Power to Refund.--Subject to the provisions of
12 the outstanding bonds or notes and subject to the provisions of
13 this article, a local government unit shall have the right and
14 power to refund any outstanding debt in whole, or in part, at
15 any time by the issue of bonds or notes of the same type as the
16 bonds or notes being refunded, and shall have the right and
17 power to refund any outstanding notes with bonds of the same
18 type. The refunding may be for any one or more of the following
19 purposes:

20 (1) Reducing total interest payable over the life of the
21 series, by issuing bonds or notes of a shorter term or at a
22 lower interest rate or rates;

23 (2) Reducing the annual debt service in any particular year
24 or years, by extending the life of the issue subject to the
25 limitations imposed by section 1107;

26 (3) Eliminating any covenant or restriction in, or
27 applicable to, any outstanding series or issue of bonds or notes
28 determined by the local government unit to be unduly burdensome
29 or restrictive;

30 (4) Refunding any maturity or maturities or any portions

1 thereof to a later date subject to the limitations imposed by
2 section 1107; or

3 (5) Substituting a bond issue for notes or bond anticipation
4 notes.

5 It is immaterial whether or not any such refunding under clauses
6 (2) or (3) or (4) increases the total interest payable over the
7 life of the series.

COMMENT

1. POWER TO REFUND.

Since local government units have limited implied powers, it is desirable to state expressly that a power to refund exists.

To many the concept of refunding is limited to a refunding which results in cost savings. It is this type of refunding which is specified in item (a) of this section, and is permissible not only where interest rates have dropped since the date of the original issue, but also if savings can be effected by shortening the term of the issue. There can be, however, other purposes for a refunding, and the local government unit should have the flexibility of debt management resulting therefrom. Also substituting a bond issue for notes is a permissible refunding.

These additional purposes are three in number:

(a) Reduction of Annual Burden. The shorter the life of an issue, the less the total interest cost, but the higher the annual debt service (annual payment of principal plus interest). Local government units which, in the interest of over-all economy select a relatively short life for an initial issue should be able to lessen the annual burden by refunding, especially where subsequent events prove that the annual debt service is creating budgetary problems. Section 1103 provides the necessary safeguards. Note that, except where capital budgeting is practiced and except in emergency cases the term of the issue may not be extended beyond the useful life first stated when the first debt was incurred. Those arranging refundings should consider whether greater savings may not, on occasion be realized by not calling and paying the redemption premium on the stated maturities falling due in the next two to five years.

(b) Elimination of Burdensome Covenants. Especially in revenue bond financing, and in its companion, the guaranteed revenue bond, the underwriters of an issue may require special covenants limiting the terms on which additional bonds may be issued with a pari-passu claim on the pledged revenues, or providing for rates that "cover" debt service by a margin of safety, or provide for the accumulation of reserves for maintenance or to cover losses in revenues. These covenants may have been advisable at the time of an original issue, but in

9 unforeseen shortage in total revenues proven to the satisfaction
 10 of the Commonwealth Court upon petition filed by the governing
 11 body of the local government unit, alleging the emergency and
 12 the unforeseen loss of revenues. Public notice of the intention
 13 to file such a petition shall be given by advertisement not less
 14 than five nor more than twenty days before the filing thereof.
 15 Such emergency refunding shall be made only in the amount and
 16 with the stated maturity date or dates approved by the court.
 17 Appeals from the order of the court may be taken by any
 18 interested party in accordance with the Appellate Court
 19 Jurisdiction Act of 1970. The first maturity of a refunding
 20 issue need not occur until the year after the last stated
 21 maturity date of the bonds not called in the series being
 22 refunded.

23 (b) Except in the case of refundings which effect savings in
 24 interest cost, and except for emergency refundings approved by
 25 the court, no refunding bonds shall be issued which will
 26 increase the amount of principal payable (after provision for
 27 earlier mandatory calls) in any year or years after the latest
 28 stated maturity date of the bonds being refunded, over the
 29 amount payable in each such year, computed to the nearest whole
 30 multiple of five thousand dollars (\$5,000), as if the bonds or
 31 notes originally issued for the project were payable at six per
 32 cent on the level annual debt service plan with a final maturity
 33 at the last stated maturity date proposed for the refunding
 34 bonds, as such amounts shall be computed by the financial
 35 advisor or by a certified public accountant.

COMMENT

3. LIMITATION ON EXTENDING TERM OF DEBT BY REFUNDING.

Flexibility of local debt management through refunding while desirable must not be so free as to permit either the creation of perpetual debt or to permit an undue shift of the debt burden to generations of taxpayers as yet unborn except under rather rigid controls.

The basic scheme of the Act is that projects acquired with the proceeds of incurred debt shall be paid for at least over the estimated useful life of the project. Thus subsection (a) provides that, if a shorter period was originally selected, a refunding may not extend the term of the debt beyond that which could have been originally selected. Under some statutes a maximum term for bonds is selected, say 40 years from the date of issue, and the wording of the provision on refunding bonds is also stated as 40 years from date of issue. In these circumstances, a new 40 year period can start with each refunding, thus, in effect permitting perpetual debt. This Act selects the useful life of the project or 40 years, whichever is shorter as the maximum life for debt (see Section 602), and the term of refunding bonds may not stretch beyond this date except in Court approved emergencies based upon an unforeseen shortage in revenues. As elsewhere in the Act, the Court selected is the Commonwealth Court. Concentrating debt limit and debt incurring litigation in this one tribunal should provide for uniformity of treatment and develop a body of precedent based on experience and expertise in the matters of debt administration.

The last sentence makes it clear that when a local government unit, for good reason, does not call, for example, the bonds stated to mature in the next four years after the call date, the "set-up" of the series refunding the balance of the new issue will be as if it were a series sold in the fifth year.

Subsection (b) addresses itself to the matter of preventing a passing of debt burden to later years in an undue amount by extending the term of the debt beyond that originally selected. It is a relatively simple mathematical task to determine maturities on a level debt service plan at 6% from the date of the original incurring of debt. This pattern is selected as indicating the maximum deferral of principal to subsequent years. No term of years is stated, and, subject to the term of years permitted under subsection (a) including any court permitted emergency extensions, the Financial Advisor can select a term of years for the refunding bonds and make the necessary computation, rounding his computed maturities to round lots of \$5,000 each. It must be noted that this provision for refunding bonds is somewhat stricter than the provision (Section 602) made for controlling the original issue, in that the provisions there incorporated for a "wrap around" type of issue have not been carried forward for refunding.

The computation of the Financial Advisor is made conclusive for this purpose. With the widespread use of computers, errors of computation should be negligible, and give way to the need for definitiveness and certainty.

6 Section 1104. Effect of Debt Limits on Refunding

7 Nonelectoral Bonds or Notes.--If any debt originally incurred
 8 was lawfully incurred and issued, and, at the time such debt was
 9 incurred, the portion constituting nonelectoral debt was within
 10 every limitation imposed thereon by law, the issue of refunding
 11 bonds or notes in respect of such debt shall be lawful and

2 valid, notwithstanding that the aggregate of outstanding debt
 3 shall thereby exceed the then applicable limitations set by
 4 section 202 of this act, which limitations shall be deemed
 5 increased but only to the extent necessary to effectuate the
 6 refunding lawfully. Any portion of such refunding bonds or notes
 7 may be excluded from nonelectoral debt, either as subsidized
 8 debt or self-liquidating debt, in accordance with the procedure
 9 provided in Article II of this act.

COMMENT

4. EFFECT OF DEBT LIMITS ON REFUNDING NONELECTORAL BONDS OR NOTES.

This section is a companion section to section 1102. The concept follows that of section 207, namely that debt lawfully incurred, and within applicable limits at the time the debt is incurred, remains lawful debt notwithstanding the fact that total revenues may decline for several years, thus reducing the Borrowing Base to the point where outstanding debt exceeds the debt limit. Even where this is so, there is a distinction between "debt" and the particular bond or bonds that, at the time represent the debt. Refunding merely changes the term, interest rate or other details of the evidences of the debt. Hence the advantages of a refunding should not be denied to a local government unit whose revenues are declining. Indeed, it is precisely in periods of decline that the advantages of refunding to save interest cost, or to reduce annual debt service by extending the life of a bond issue may be most needed. In a refunding, if portions of the debt are subsidized, or are self-supporting, they should be excluded, but the refunding may affect the portion to be excluded. This section permits such debt to be refunded even though the refunding may decrease the portion to be excluded as subsidized or self-liquidating debt. This will be done only if the advantages to be gained from the refunding will exceed the losses incurred by reducing the subsidized or self-liquidating portion of the debt.

A case in point involves school subsidies on capital account reimbursement. This act takes the position that present taxpayers are entitled to benefit from savings effected by a refunding. Past regulations of the then Superintendent of Public Instruction as to refundings to effect interest rate savings have required that the annual debt service and subsidy remain the same, and that the refunding effect savings by shortening the term of the bonds. This has the effect of giving the Commonwealth its share of the savings effected by the refunding. The savings are, however, not felt or realized by taxpayers either of the Commonwealth or of the local government unit until fifteen or more years in the future. If annual debt service were reduced, savings could be felt by the present taxpayers. The subsidy could remain at the same percentage of annual debt service as before, with a dollar ceiling in any year based upon the original figures. Thus refundings which either shorten or lengthen the term of the bonds could vary the percentage of debt to be excluded as

subsidized, but both the Commonwealth and the local taxpayers could feel the benefits of savings in interest cost immediately. In any event the debt limitations should not operate to prevent a refunding that otherwise makes sense.

20 Section ⁸²⁴⁵ 1105. Refunding of Electoral Debt.--A local
21 government unit may, by action of its governing body, and in
22 accordance with the limitations of this Article XI, refund any
23 debt originally incurred as electoral debt. The refunding bonds
24 or notes so issued shall not thereby be considered nonelectoral
25 debt for any purpose.

COMMENT

5. REFUNDING OF ELECTORAL DEBT.

The theory that a distinction exists between the debt and the bonds evidencing the debt should permit the governing body to refund electoral debt without a referendum thereon. The vote approved the incurring of debt for the approved purpose. Details of debt management should be left to the governing body. Indeed, due to the rapidity, at times, of market changes, there may not be time to hold a referendum on refunding. The purist can find an implied approval of such refunding in the vote taken to incur the debt under this or any prior act.

26 Section ⁸²⁴⁶ 1106. Procedure for Authorization, Sale, Issue, and
27 Approval of Refunding Bonds or Notes.--Bonds or notes issued for
28 refunding purposes shall be authorized, issued, sold, approved
29 and settled in the manner provided in this act for the
30 authorization, issue, sale and approval of nonelectoral debt,
1 subject to any additional limitations provided in this Article
2 XI. No refunding bonds or notes shall be delivered to the
3 purchasers thereof unless, simultaneously therewith, the notes
4 or bonds being refunded become no longer outstanding in
5 accordance with section 1110.

COMMENT

6. PROCEDURE FOR AUTHORIZATION, SALE, ISSUE AND APPROVAL OF REFUNDING BONDS.

The necessary ordinances, advertisements and approvals of refunding bonds shall follow the procedure set up for the original issue nonelectoral debt, subject to two additional limitations. The first limitation concerns the provisions on length of term and amounts of stated maturities set up in Section 1103. The second limitation is the simultaneous com-

pletion of all steps necessary to retire the bonds being refunded, including the irrevocable deposit of funds for the purpose. This Act permits the deposit of a lesser sum, if the interest to be earned upon such a deposit will produce the moneys needed upon interest payment dates, stated maturity dates or call dates, thus reducing the amount of refunding bonds to be issued.

8047

Section 1107. Special Limitation on Refunding of Funding

7 Debt.--No debt incurred for funding purposes shall be refunded
 8 except pursuant to clause (1) of section 1101 until such
 9 refunding shall have been approved as necessary by the
 10 Commonwealth Court. Such approval shall be obtained by petition
 11 to reopen the proceedings in which the funding debt was
 12 originally incurred, and the court shall grant such petition,
 13 if, after hearing, the court shall be satisfied that such
 14 refunding is necessary and is in the public interest. Due public
 15 notice of the filing of the petition, shall be given by
 16 advertisement not less than five nor more than twenty days
 17 before the filing thereof. All subsequent proceedings in respect
 18 of the refunding of such funding debt shall be taken in
 19 accordance with the provisions of Articles V and VI of this act.
 20 Bonds or notes issued to refund funding debt shall be stated to
 21 mature at the dates and in the amounts on each such date as may
 22 be approved by the court, notwithstanding any limitation on the
 23 term of funding debt imposed elsewhere in this act.

COMMENT

7. SPECIAL LIMITATION ON REFUNDING OF FUNDING DEBT.

Funding debt is itself a safety valve to be used only in emergencies. The refunding of funding debt should be a rare thing, and permitted only when the unforeseen drop in revenues has continued at a rate not foreseeable when the original funding debt was authorized as when, in a period of falling revenues generally, a substantial local ratable is removed from the tax rolls, or a business recession plunges into a full fledged depression. The policy requiring balanced budgets is so strong that any extension of funding debt should require court approval. Ordinarily the term of funding debt will be short and opportunities for refunding to effect savings in interest cost will be extremely limited. The section, however, provides that no court approval is necessary in this extremely unusual situation.

24 8248 Section 1108. Approval of a Refunding by the Electors.--The
25 governing body of any local government unit may also obtain the
26 approval of the electors to any refunding of nonelectoral debt
27 in the manner prescribed for an original issue by Article III of
28 this act, and may issue general obligation bonds or guaranteed
29 revenue bonds in such refunding if approved by the electors
30 regardless of the class of bonds originally issued.

COMMENT

8. APPROVAL OF A REFUNDING BY THE ELECTORS.

This section carries the policy of Section 203 into a refunding context. Nonelectoral debt can be converted into electoral debt in connection with a refunding, perhaps more appropriately than at a special referendum on existing debt. It is anticipated that this section will not frequently be used as market conditions may require speedy action that cannot await a referendum. On the other hand, the governing body in a refunding to reduce annual burden may wish to have the action approved by the electorate.

1 Section 1109. Refunding with Bonds of Another Type.--Subject
2 to the limitations of section 202 of this act, or after a
3 referendum held pursuant to section 1108, the governing body of
4 any local government unit may for any purpose specified in
5 section 1101, refund with its general obligation bonds or its
6 guaranteed revenue bonds, any outstanding callable revenue bonds
7 or bonds of any municipality authority formed by it; or may
8 refund any outstanding callable revenue bonds or guaranteed
9 revenue bonds. It may also refund any general obligation or
10 guaranteed revenue bonds with its revenue bonds or with the
11 bonds of any municipality authority of which it is a member.

COMMENT

9. REFUNDING WITH BONDS OF ANOTHER TYPE.

Circumstances may arise when it will be adviseable to refund bonds of one type with bonds of another type. Thus, in certain water and sewer situations an original issue may have been made with guaranteed revenue bonds, but as experience develops and interest rates change, pure revenue bonds may be issuable at savings or at no extra cost. Equally, to avoid a default in a revenue obligation it may be desireable to refund either a revenue obligation or an authority obligation with general obligation bonds, or guaranteed revenue bonds. The term "guaranteed revenue bonds" as used in this and other sections includes both the limited and the unlimited guaranty.

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12 Section 1110. Use of Proceeds of Refunding Bonds; When
13 Refunded Bonds Are No Longer Deemed Outstanding.--(a) The
14 proceeds of refunding bonds, together with any other moneys made
15 available for the purpose shall be used solely for the purpose
16 of retiring the bonds being refunded and for the purpose paying
17 the costs of the refunding.

18 (b) Any bonds or notes to be redeemed shall no longer be
19 deemed to be outstanding for the purpose of determining the debt
20 of the local government unit or for the purposes of any
21 indenture limitations on repledging revenues when the local
22 government unit shall have irrevocably deposited with a bank or
23 bank and trust company in a sufficient amount:

24 (1) Moneys;

25 (2) Noncallable securities of the United States of America
26 or of the Commonwealth maturing or payable at par at the option
27 of the holders at or prior to the dates needed for disbursement;

28 (3) Time deposits or certificates of deposit, with a firm
29 rate of interest issued by a bank or bank and trust company and
30 insured or adequately secured as public deposits; or

1 (4) Any combination of the foregoing.

2 The deposited amount shall be sufficient when it, together with
3 the interest to be earned thereon will equal the principal,
4 premium, and interest to become due on the bonds or notes being
5 refunded to the earlier of the date at which any such bonds or
6 notes are stated to mature, or have been called for prior
7 redemption: Provided, however, That the local government unit
8 shall simultaneously have given such bank or bank and trust
9 company instructions and authority, stated to be irrevocable, to
10 publish any notices of redemption remaining to be published.

11 When stated to be irrevocable, the instructions and authority
12 to call bonds or notes for redemption shall become irrevocable

13 upon the delivery thereof, or upon the deposit of the moneys or
14 securities in a sufficient amount, whichever shall occur the
15 later. Until such irrevocability shall have occurred, a call for
16 redemption may be revoked by notice given in like manner as the
17 notice of redemption.

COMMENT

10. USE OF PROCEEDS OF REFUNDING BONDS; WHEN REFUNDED BONDS ARE NO LONGER OUTSTANDING.

The net proceeds must be used to retire the bonds being refunded and subsection (a) so states. It may be that the local government unit has other funds available, either from general revenues, or from required accumulations in accordance with the terms of the original issue of the bonds being refunded. Such funds will, of course, reduce the total of the refunding bonds required to be issued.

Subsection (b) is but a specialized extension of the principle of Section 208 on the determination of net debt, namely that, in determining the debt subject to a debt limit, quick assets applicable to the debt are deductions reducing the amount of outstanding debt.

Refundings may be of two types, generally referred to as "immediate", and "advance".

An immediate refunding is one in which the bonds being refunded become due, or are called for redemption so as to become due at about the time the refunding bonds are delivered and paid for. Such a refunding presents few problems. The funds available for refunding pass relatively rapidly through the paying account of the bank or trust company selected to handle the refunding.

An advance refunding is one where some substantial period of time will elapse between the issue of the refunding bonds and the date on which the prior issue can be paid off. This gap occurs because bonds usually are not callable for prior redemption for varying periods of years after issuance. In times of high interest rates and "tight money" the bond purchasers will want a long "no-call" term. Sometimes they insist upon 10 or 15 years protection, or they will not buy. Often a longer "no call" term will result in a lower interest rate. This can be attractive to issuers in times of rising interest rates as a lower present interest rate is a bird-in-hand, whereas the prospects of a refunding are a bird-in-the-bush, a speculative situation.

It often happens that a favorable opportunity to refund a high interest rate issue will occur before the "call date" for the outstanding bonds has arrived. The refunding operation then requires not only that provision be made for the principal of the outstanding bonds, for the costs of the necessary procedures to effect the redemption, and for the premium, if any, payable on such redemption; but also for the interest payable until the call date arrives. This act provides that the provision for such interest may be made by any combination of

assured earnings on the investment of the proceeds of the refunding bonds, or through deposits by the local government unit of the interest from time to time as needed.

150

Federal tax questions will arise under the Internal Revenue Code if a local government unit makes an advance refunding too far before the "call date". This Act places no limitation on the length of time in advance of the call date that a refunding can be made, leaving the matter to the federal tax authorities. The Act does remove one point relied upon by the federal authorities. Under some authority trust indentures, an irrevocable deposit in trust releases the authority and leaves the bondholder with only a claim against a fund, for five years or longer, for example. This Act maintains the responsibility of the issuing local government unit until the call date arrives since the "deemed no longer outstanding" provision is limited to the purpose of computing debt limits, not to liability on the bonds, or permissive repledges of revenues. The second sentence of Section 1111 also makes this clear. Any fluctuation of the value of deposited investments is the responsibility of the issuing local government unit until the call date, but the list of permitted investments makes this a minimal risk.

A U.S. Security which must be paid to the holder at par at the relevant time is the equivalent of one that has matured for the purpose of this section.

Counsel drafting indentures should mold the indenture to comply with this section lest the indenture be treated as a contract otherwise granting stricter rights to the original bondholders, and preventing later flexibility of action.

This act places no limitations on call dates or the amount of call premiums which a local government unit may specify in its original issue, or in a refunding issue, leaving the determination to market forces.

The Act permits a call for refunding purposes to be revoked until the later of the following two actions:

- (a) Deposit of funds for payment of the called bonds; or
- (b) Publication of the last required notice of call, or the giving of instructions stated to be irrevocable to a bank or trust company to effect such publication.

18 Section 1111. Cessation of Interest on Called Bonds or
19 Notes.--Upon the date fixed for redemption, such irrevocable
20 deposit having been made, and due notice of the redemption
21 having been given, no further interest on the bonds or notes so
22 called for redemption shall accrue. Nothing in this article
23 shall, however, relieve the issuing local government unit of its

24 obligation to see to it that the holders of the bonds or notes
25 called for redemption are paid in full on the date fixed for
26 redemption. From and after such date, such irrevocable deposit
27 having been made and being the proper amount on such date, the
28 holders of bonds or notes called for redemption shall have no
29 rights against the local government unit except to receive
30 payment from the deposited funds, or from the local government
1 unit to the extent of the moneys returned to it pursuant to
2 subsection (f) of section 1004 of this act.

COMMENT

11. CESSATION OF INTEREST ON CALLED BONDS OR NOTES.

This section makes explicit what is implied in a call for redemption, that when the date for redemption arrives, funds are on deposit irrevocably and notice has duly been given, it is the obligation of the holder to get his money and he is not entitled to further interest. The section, however, makes it clear that an advance deposit and an advance giving of notice does not limit the bondholder to his pro-rata share of the deposit made to effect redemption. It is only from and after the occurrence of the date fixed for redemption that the holder is so limited.

Article XII

Remedies

COMMENT

IN GENERAL. The purpose of the Article is to provide specific remedies implementing the covenant required by the Constitution and by the terms of Section 404 of this Act, while at the same time preventing the local government unit from being subjected to a multiplicity of proceedings. Thus, upon a failure to budget or appropriate funds for its obligations, any bondholders may, in an appropriate proceeding compel the treasurer to apply the "first moneys" thereafter received to the payment of the principal and interest due. The more complicated remedial proceedings are to be instituted by a trustee appointed by the holders of 25% of the outstanding principal. The trustee may bring necessary actions, collect and disburse funds. The most drastic remedy is the levy of an assessment on all taxable real property to pay the bonds or notes, or in the case of a guaranteed revenue bond, to create the current revenues necessary to implement the guarantee. Special provision is made for a receiver for revenue projects. Standard provisions for the recovery of costs and for the distribution of moneys recovered on behalf of the holders of bonds and notes. 8261

5 Section 1201. Failure to Budget Debt Service.--If a local
6 government unit having outstanding any general obligation bonds
7 or notes or guaranteed revenue bonds or notes, fails or refuses
8 to make adequate provision in its budget for any fiscal year for
9 the sums payable in such year or shall fail to appropriate or
10 pay the moneys necessary in such year for the payment of the
11 amount of the guaranty, or as the case may be, of the maturing
12 principal of and the interest on such bonds or notes or any of
13 them, or any sinking fund obligation for such bonds or notes
14 coming due in the fiscal year of such budget or for which such
5 appropriations or payments should have been made, then at the
6 suit of the holder of any bond, note, or coupon or of any
7 taxpayer of the local government unit, the court of common pleas
8 of the county in which such local government unit is located
9 shall, after a hearing held upon such notice to the local

20 government unit as the court may direct, and upon a finding of
 21 such failure or neglect, by writ of mandamus, require the
 22 treasurer of the local government unit and it shall be the duty
 23 of such treasurer to pay into the sinking fund for each series
 24 of bonds or notes then outstanding, the first tax moneys or
 25 other available revenues or moneys thereafter received in such
 26 fiscal year by such treasurer, equally and ratably for each
 27 series in proportion to the principal amount of each such series
 28 then outstanding, or the amounts due upon guaranties, as the
 29 case may be, until the sum on deposit in each sinking fund shall
 30 equal the moneys that should have been budgeted or appropriated
 1 for each such series.

COMMENT

1. FAILURE TO BUDGET DEBT SERVICE.

The Covenant required by section 404 requires an annual budgeting of the funds for payments of principal and interest on general obligation bonds or the sums due from current revenues on a guaranteed revenue bond. When this is not done when the budget for the year is prepared and adopted, the covenant is breached. This breach is made to give any holder of a bond or note whose covenant has been broken the right to compel the treasurer to set aside the moneys out of the "first moneys" thereafter received in the treasury. The concept is taken from the provisions made in the Constitution and the enabling legislation with respect to obligations of the Commonwealth. For speed of proceedings, the action is to be initiated in the Court of Common Pleas of the appropriate county. The action will be for the performance of a non-discretionary duty.

2 8262 Section 1202. Failure to Pay Principal or Interest.-- (a) If
 3 a local government unit fails or neglects to pay or cause to be
 4 paid the interest or principal on any of its general obligation
 5 bonds or notes as the same becomes due and payable whether at
 6 the stated maturity date or upon an unrevoked call for prior
 7 redemption, or to perform its payment obligations with respect
 8 to any guaranteed revenue bonds or notes, and such failure shall
 9 continue for thirty days, the holder thereof shall, subject to
 10 section 1203 of this act and to any reasonable limitations upon
 11 individual rights of action properly provided in the bond

12 ordinance or any indenture, have the right to recover the amount
13 due in an action in assumpsit in the court of common pleas of
14 the county in which such local government unit is located. The
15 judgment recovered shall have first priority upon the moneys
16 next coming into the treasury of the local government unit and
17 shall be a judgment upon which funding bonds may be issued
18 pursuant to Article V of this act.

19 (b) If a local government unit fails or neglects to pay or
20 cause to be paid the principal of or the interest upon any
21 revenue bond or note as the same shall become due, whether at
22 the stated maturity or upon call for prior redemption, the
23 holder thereof shall, subject to section 1203 of this act and to
24 any reasonable limitations upon individual rights of action
25 properly provided in the bond ordinance or any indenture, have
26 the right to recover the amount due in an action in assumpsit in
27 the court of common pleas of the county in which such local
28 government unit is located, but the judgment shall be limited to
29 payment out of the assessments, revenues, rates, rents, tolls
30 and charges from the project which are pledged for the payment
1 of such bonds or notes.

COMMENT

2. FAILURE TO PAY PRINCIPAL OR INTEREST.

If a local government unit fails to make a payment, the unpaid bondholder has an appropriate action, but his rights are subject to restrictions on individual rights of action imposed by this Act or by the terms of the bond ordinance or the appropriate indenture. A judgment so recovered has a priority on the first moneys coming into the treasury and may be the basis of an issue of funding bonds in the case of a judgment on general obligation bonds or notes. But, in the case of a revenue bond or note, the judgment can only be paid out of pledged revenues. In the case of a gross pledge the judgment will have priority over operating expenses, but will be subordinate to operating expenses in the case of a net pledge.

8263

2 Section 1203. Trustee for Bondholders.--(a) Notwithstanding
3 any provision in the bonds or notes or in any authorizing
4 ordinance, if a local government unit defaults in the payment of
5 the principal of or the interest on any series of bonds or notes
6 after the same shall become due, whether at the stated maturity
7 or upon call for prior redemption, and such default shall
8 continue for thirty days, or if the local government unit fails
9 to comply with any provision of the bonds or notes, or in any
10 authorizing resolution or indenture of trust, the holders of
11 twenty-five per cent in aggregate principal amount of the bonds
12 or notes of such series then outstanding, by an instrument or
13 instruments filed in the office for the recorder of deeds in the
14 county in which such local government unit is located, signed
15 and acknowledged in the same manner as a deed to be recorded,
16 may appoint a trustee, who may be the sinking fund depository,
17 to represent the holders of all such bonds or notes, and such
18 representation shall be exclusive for the purposes herein
19 provided.

20 (b) Such trustee may, and upon written request of the
21 holders of twenty-five per cent in principal amount of such
22 bonds or notes then outstanding and upon being furnished with
23 identity satisfactory to it shall, in his or its own name do one
24 or more of the actions set forth below and the taking of such
25 actions shall preclude similar action whether previously or
26 subsequently initiated by individual holders of bonds or notes.

27 (1) By mandamus or other suit, action or proceeding at law
28 or in equity enforce all rights of the holders of the bonds or
29 notes, including in the case of revenue or guaranteed revenue
30 obligations the right to require the local government unit to

1 impose and collect rents, rates, tolls and charges adequate to
2 carry out any agreement or covenant as to, or pledge of such
3 rents, rates, tolls or charges, for the use of the project or
4 projects financed by such bonds or notes, or to require the
5 local government unit to carry out any other agreements with the
6 holders of such bonds or notes;

7 (2) Bring suit on the bonds or notes without the necessity
8 for producing the bonds or notes, and with same effect as a suit
9 by any holder;

10 (3) In the case of revenue or guaranteed revenue bonds or
11 notes to require the local government unit to account as if it
12 were the trustee of an express trust for the holders of such
13 bonds or notes, for any pledged revenues received;

14 (4) In the case of general obligation bonds or notes,
15 petition the court to levy, and the court is hereby empowered to
16 levy, after a hearing upon such notice to the owners of
17 assessable real estate, as the court may prescribe, the amount
18 due on the bonds or notes plus estimated costs of collection as
19 an assessment upon the properties benefited by the improvement
20 pursuant to the front foot rule if the project is an assessable
21 improvement, otherwise upon all taxable real estate in the local
22 government unit, in proportion to the value thereof as assessed
23 for real estate tax purposes, and the trustee may collect or
24 cause the local government unit to collect, such assessments as
25 by foreclosure of a mortgage on the realty if not paid on
26 demand;

27 (5) In the case of guaranteed revenue bonds or notes, to
28 petition the court to levy, and the court is hereby empowered to
29 levy, after hearing upon such notice to the owners of assessable
30 real estate, as the court may prescribe, the amount due on the

1 guaranty plus estimated costs of collection as an annual
2 assessment for the current and future years upon all taxable
3 real estate in the local government unit in proportion to the
4 value thereof as assessed for real estate tax purposes, and the
5 trustee may collect or cause the local government unit to
6 collect such assessments as by foreclosure of a mortgage on the
7 realty if not paid on demand. The levy shall bear interest,
8 until paid, at a rate sufficient to cover accruing interest on
9 the bonds or notes;

10 (6) By suit in equity, enjoin any acts or things which may
11 be unlawful or in violation of the rights of the holders of such
12 bonds or notes; or

13 (7) After thirty days prior written notice to the local
14 government unit, and subject to any limitations in the bond
15 ordinance or relevant indenture declare the unpaid principal of
16 all such bonds or notes to be, and it shall thereby become
17 forthwith due and payable with interest at the rates stated in
18 the bonds until final payment, and, if all defaults shall be
19 made good then to annul such declaration and its consequences.

20 Any assessment levied pursuant to clauses (4) and (5) above
21 shall have the same priority and preference as to other liens or
22 mortgages on the real estate or security interests in fixtures
23 thereon, as a lien for unpaid taxes.

24 (c) The court of common pleas of the jurisdiction in which
25 such local government unit is located shall have jurisdiction of
26 any suit, action, or proceeding by the trustee on behalf of
27 bondholders under this section, and, in cases of extreme
28 hardship may provide for the payment of sums levied in three or
29 less annual installments with interest at a rate sufficient to
30 cover the interest accruing on the bonds or notes. Appeals shall

1 be to the Commonwealth Court in accordance with the Appellate
2 Court Jurisdiction Act of 1970.

3 (d) If a trustee or fiscal agent for the bondholders or
4 noteholders was appointed in connection with the original issue
5 of the bonds or notes, and is willing to serve and exercise the
6 powers confined upon a trustee appointed by this section, no
7 trustee appointed in the manner provided in this section shall
8 have the powers herein set forth unless the appointment under
9 this section was executed by or pursuant to the authority of the
10 holders of a principal amount of such bonds or notes sufficient
11 to remove such originally appointed trustee or fiscal agent.

COMMENT

3. TRUSTEE FOR BONDHOLDERS.

The condition precedent for the appointment of a trustee is a default in payment of principal or interest. Since the action by any bondholder for a breach of the covenant under Section 1201 is in the nature of a class action for the benefit of all holders, it did not seem advisable to permit the appointment of a trustee until there is an actual default in payment. The powers of the trustee are plenary. The trustee's exercise of any right or remedy on behalf of all holders is exclusive and will supersede any previously instituted proceedings which can, on petition of the trustee be consolidated with his action, or be stayed or dismissed. It should be noted that there are no expressed qualifications for a trustee. The use of the word trustee imports all of the rules against conflict of interest applicable to fiduciaries. The suggestion that the sinking fund depository may be a trustee indicates that no conflict of interest is believed to exist with that function. Any one holder of the defaulted bonds or notes has an inherent conflict of interest when representing all holders. Permitting the duly appointed trustee to exercise the rights of all holders does not involve any delegation of governmental functions to the trustee. The office merely consolidates what, otherwise, could be a multiplicity of suits.

In accordance with standard corporate trust practice, since the appointed trustee, in most instances, will be a bank or trust company, the trustee may require indemnity before proceeding. In determining whether such a requirement is reasonable in amount and kind, the priority given to fees and expenses, including reasonable counsel fees, by Section 1205 must be considered. The specific powers given the trustee are:

(1) Once there is a payment default, and a trustee is appointed, then his enforcement of the covenant is proper and the trustee should be able to pre-empt individual enforcement.

(2) After his appointment, the trustee's suits under Section 1202 should pre-empt all individual suits. Procedurally, and to avoid the expense of "deposit agreements", the trustee's right to sue on all bonds or notes may be maintained even though the trustee does not have possession of the proper "paper" evidencing the claims. When funds are collected the trustee will, of course, require presentation of the bonds or notes for notation of the amount paid thereon.

(3) The suit for an accounting includes all of the remedies for misappropriation of funds available to a court of equity in an action for an accounting. In today's world notice of an outstanding revenue bond issue should be the equivalent of notice that revenues are pledged, making it difficult for anyone other than one having a claim for legitimate operating expenses to claim a bonafide receipt of revenues.

(4) This subsection is the final implementation of the covenant to budget, appropriate and pay. Included in the concept of budgeting is the balancing of the budget by the levy of sufficient taxes. When this is not done, or if the taxes levied are, in fact, misappropriated, the bondholders are entitled to a levy. If the project is one which can be assessed by the front foot rule, that method should be followed, otherwise the levy should be upon all. The particular levy will be for the full unpaid principal amount of the issue plus unpaid interest and estimated costs and expenses. The seriousness of this remedy should accomplish two ends. One will be the prevention of default, wherever possible, since the consequences will be drastic. The second will be the strengthening of the quality of the bonds in the bond market.

(5) This subsection parallels the preceding one but applies only to guaranteed revenue bonds, and the collection of the amounts due on the guaranty. The levy will be of an annual amount sufficient to make good on the guaranty. The order making the levy should provide for the collection and application of the revenues from the project as a credit against the amount to be levied. This can be projected into the future by an engineer's certificate. The court should retain jurisdiction to alter the amount to be levied in future years if revenues should differ from the estimate. The concept is that, in the case of guaranteed revenue bonds, the revenues to be received are a credit in determining net debt, and only the amount not covered by the credit becomes nonelectoral debt.

In both subsections (4) and (5) the amount to be levied must include any overdue interest and must provide that the levy draws interest at a rate sufficient to cover the interest accruing on the bonds until the bonds are paid. The section also provides that the levy will have the same priority over other liens and mortgages as a lien for unpaid taxes. In effect this concept replaces the former special tax levy. The latter was almost always forgotten as a special levy in normal budgeting procedures. Its real significance would, it is suggested, arise only in the case of a default when bondholders would be entitled to enforce the levy in the manner here provided.

Both subsections (4) and (5) must be read in connection with the acceleration provisions of subsection (7), which could make the annual amount due equal to the total outstanding principal of the bond or note series that was in default. In the case of guaranteed revenue bonds this will pose difficulties in the manner of treatment of the credit for future revenues.

The governing body of the municipality should avoid this by arranging to finance the credit by an issue of revenue bonds in an amount which, together with the levy will pay off the accelerated series.

(6) This subsection adds the extraordinary powers of a court of equity to the arsenal of remedies available to the trustee for bondholders. Injunctions will include injunctions against mismanagement, the specific enforcement of the covenant contained in section 404, as well as the rate covenants normally contained in revenue bond issues.

(7) The remedy of acceleration is a drastic one. Ordinarily if the funds to pay off what was scheduled to be paid in the current year are not available, acceleration will not increase the availability of funds. It will, however put all bonds or notes, regardless of the specific maturity dates in a position to receive proper pro-rata distributions thus avoiding a preference of one holder over another. The thirty days notice is to give the governing body of the local government unit time to cure the default before acceleration is effected. The subsection gives the trustee power to annul a declaration even after it is effected if all defaults are cured and the future looks as if there may be no further default in the years to come.

Subsection (c) in conferring jurisdiction on the Court of Common Pleas departs from the usual procedure under the act. The particular situation, however, is quite different. The present proceedings are purely remedial and do not involve problems of incurring debt. The overall surveillance of the Commonwealth Court is made available by providing that appeals lie to that court if any are taken.

The subsection also provides that in administering the drastic remedy of an assessment on all taxable real estate, the court may permit installment payments over a period of three years. This parallels the procedure in cases of assessments under the front foot rule where installment payments are often permitted.

Subsection (d) provides that if the trustee under the indenture under which a particular series of bonds or notes has been issued is able and willing to serve as the "After Default" trustee he should be appointed as such unless a different "After Default" trustee is appointed by the holders of the number and amount of bonds or notes required for the removal of the indenture trustee. The appointment by such a number is treated as including a removal pro hac vice.

12 Section 1204. Receiver for Revenue Projects.--A trustee for
 13 the holders of defaulted bonds or notes, whether or not the
 14 series of bonds presented by the trustee has been declared to be
 15 and has become forthwith due and payable, shall be entitled as
 16 of right to the appointment, by the court of common pleas of the
 17 county in which such local government unit is located, of a
 18 receiver of all or any part or parts of a project or the
 19 projects, the rents, rates, revenues, tolls and charges of which
 20 are pledged for the security of the bonds or notes of such
 21 series. Such receiver shall have no power of sale but may enter
 22 and take possession of the project or projects or part or parts
 23 thereof, and, subject to the equal or prior rights of the
 24 holders of any other series of bonds or notes, shall take
 25 possession of all moneys and other property derived from or
 26 applicable to the construction, operation, maintenance, repair
 27 and reconstruction of such project or projects or parts thereof.
 28 The receiver may thereafter proceed with any construction or
 29 other work thereon which the local government unit is under
 30 obligation to do. The receiver may operate, maintain, repair,
 1 and reconstruct such project or projects, or parts thereof and
 2 collect and receive all rents, rates, receipts, tolls, other
 3 charges and revenues arising therefrom, subject to the equal or
 4 prior rights of the holders of any other series of bonds or
 5 notes therein. The receiver shall perform the public duties and
 6 carry out the lawful agreements and obligations of the local
 7 government unit with respect to the project or projects or parts
 8 thereof, all under the direction of the court.

COMMENT

4. RECEIVER FOR REVENUE PROJECTS.

The section does not delegate any governmental discretion to the receiver since he will, in effect, be doing what the local

government has already promised, pursuant to statutory authority, to do. No power to sell any property of the project is given to the receiver, only the power to run the project, generate revenues and disburse them to those entitled. It should be noted that an operating receiver can be appointed wherever there are pledged revenues, thus the appointment can be made in the case of guaranteed revenue bonds as well as in the case of pure revenue bonds. Since a waterworks is no good to the bondholders unless it squirts, the receiver is given authority to complete any necessary construction as well as to operate, maintain and repair the project. Unless the indenture expressly provides for a gross pledge of revenues, the operating expenses of the receiver, in accordance with normal usage and custom, will take priority over the rights of the bondholders. In cases where a health menace is involved, the court appointing the receiver may utilize the powers of a court of equity to keep the project operating until rates can be changed sufficiently to provide sufficient funds. Among the powers of a receiver will, of course, be the power, pursuant to an order of the court, to issue receiver's certificates to raise necessary funds. These too would have priority over the claims of the holders of bonds or notes, if the order of the court authorizing their issuance so provided. This construction results from a reading of this and the next following section together.

9) Section 1205. ⁸²⁶⁵ Costs of Suits or Proceedings.--In any suit,
 10 action or proceeding by or on behalf of the holders of defaulted
 11 bonds or notes of a local government unit brought under this act
 12 the fees and expenses of a trustee or receiver, including
 13 operating costs of a project and reasonable counsel fees, shall
 14 constitute taxable costs, and all such costs and disbursements
 15 allowed by the court shall be deemed additional principal due on
 16 the bonds or notes, and shall be paid in full from any recovery
 17 prior to any distribution to the holders of the bonds or notes.

COMMENT

5. COSTS OF SUITS OR PROCEEDINGS.

The section should cut down on the amount of indemnity a trustee or receiver would require before proceeding under the remedial provisions. The section eliminates any necessity for a particular covenant to this effect in the bond ordinances or other documents.

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18 Section 1206. Distribution of Moneys Realized for
 19 Bondholders.--Moneys or funds collected for the holders of
 20 defaulted bonds or notes entitled to share equally and ratably
 21 therein shall, after the payment of costs and fees as provided
 22 in section 1205, be applied by the trustee or receiver, unless
 23 the terms of the bonds or notes provide otherwise, as follows:

24 (1) Unless the principal of all of the bonds or notes
 25 represented shall have become or have been declared due and
 26 payable, (i) to the payment to the persons entitled thereto of
 27 all installments of interest then due in the order of the stated
 28 maturity dates of such installments of such interest and, if the
 29 amount available shall not be sufficient to pay any installment
 30 in full, then to the payment ratably, according to the amounts
 1 due on such installment, to the persons entitled thereto,
 2 without any discrimination or preference except as to any
 3 difference in the respective rates of interest expressed in the
 4 bonds or notes or coupons for interest; and (ii) to the payment
 5 to the persons entitled thereto of the unpaid principal of any
 6 bonds or notes which shall have become due, whether at stated
 7 maturity dates or by call for redemption, in the order of their
 8 respective due dates, and if the amount available shall not be
 9 sufficient to pay in full all the bonds or notes due on any
 10 date, then to the payment ratably, according to the amounts of
 11 principal due on such dates, to the persons entitled thereto
 12 without any discrimination or preference.

13 (2) If the principal of all of the bonds or notes entitled
 14 to share equally in such moneys shall have become or shall have
 15 been declared due and payable, to the payment of the principal
 16 and interest then due and unpaid upon the bonds or notes without
 17 preference or priority of principal over interest or interest
 18 over principal, or of any installment of interest over any other

19 installment of interest, or of any bond or note over any other
20 bond or note, ratably according to the accounts due respectively
21 for principal and interest, to the persons entitled thereto
22 without any discrimination or preference except as to any
23 difference in the respective rates of interest specified in the
24 bonds, notes and coupons.

25 (3) If more than one series is involved and the principal of
26 all bonds or notes of one or more series has become or has been
27 declared due and payable, and that if one or more others has
28 not, the funds available shall be apportioned to each series
29 according to the respective amounts of principal of each series
30 then outstanding less, as to each series any amounts held
1 earmarked for such series, and distribution to the holders of
2 the bonds, notes and coupons of each series shall be made
according to whichever of clauses (1) and (2) above may be
4 applicable.

COMMENT

6. DISTRIBUTION OF MONEYS REALIZED FOR BONDHOLDERS.

The section, together with the two preceding sections provide guidelines for the distribution of moneys received after a default. The pattern is that provided in standard trust indenture drafting and will therefore be acceptable in the market. Under certain decisions interest after default accrued at the judgment rate and not at the bond rate. In view of the tax-free nature of the interest, and in view of recent fluctuations in interest rates it is deemed better to continue the coupon rate. Some decisions have refused to allow interest on overdue interest at all. The first coupon not paid is here treated as a separate debt due, and will bear interest at the coupon rate to protect those who may have relied upon receiving this money. The same policy does not apply to coupons becoming due after default.

ARTICLE XIII

Miscellaneous; Repeals; Effective Date

COMMENT

IN GENERAL. This article sets forth the penalties for false statements in filings with the department and for failure to obey the sinking fund directives of the department. It also contains a covenant by the Commonwealth to maintain the tax-exempt status of the interest on the bonds and any gains made on the sale thereof (except for underwriting profits in a distribution). It also makes the provisions of the act the exclusive statute controlling the incurring of debt, and the issue and sale of tax anticipation notes. It finally sets forth an effective date.

NA 7 Section 1301. False Statement in Documents Constitute
 8 Perjury; Fines and Penalties Therefor.--Whoever wilfully and
 9 corruptly makes false oral or written statements or any false
 10 statement in any document required to be filed in the department
 11 or in the office of the recorder of deeds of the appropriate
 12 county is guilty of perjury, a felony, and whoever wilfully and
 13 corruptly procures or suborns any other person to make any such
 14 false statement, is guilty of subornation of perjury, a felony,
 15 and on conviction of either offense, shall be sentenced to pay a
 16 fine not exceeding ten thousand dollars (\$10,000), or undergo
 17 imprisonment by separate or solitary confinement at labor not
 18 exceeding seven years, or both, and shall, except as otherwise
 19 provided by law, be forever disqualified from being a witness in
 20 any matter in controversy.

COMMENT

1. It is thought that one of the reasons that filings were made in the Quarter Sessions Court under prior law was to ensure that the penalties for perjury would apply. It seemed simpler for filings to be in the office for the recording of deeds, and office of records, and to provide the same penalties for perjury to false statements in the proceedings for debt as are applicable to perjury in court proceedings. The section is modeled from the perjury statute.

21 Section 1302. Failure to Obey Sinking Fund Directive of
 22 Department Constitutes a Misdemeanor; Fines and Penalties
 23 Therefor.--Any officer or any member of the governing body of
 24 any local government unit who shall refuse or neglect to obey
 25 any order of the department made under the provisions of Article
 26 X concerning sinking funds or who shall refuse to furnish
 27 requested information required by the department, or refuse
 28 agents of the department access to any books, records or
 29 documents relating to sinking funds shall be guilty of a
 30 misdemeanor, and upon conviction thereof, shall be each
 1 sentenced to pay a fine not exceeding five hundred dollars
 2 (\$500) for each day of violation.

COMMENT

2. The section gives some force to the sinking fund direc-
 tives of the department in this administration of the care and custody
 of sinking funds, and in particular the new duty to see that modern
 money management techniques are used to maximize the earnings. The
 penalty applies whether the directive is issued after an inspection
 conducted by the department, or as a result of its review of a report
 submitted by the certified public accountant of the local government
 unit.

3 NA Section 1303. Exemption of Bonds and Notes from Taxation in
 4 Pennsylvania.--The Commonwealth does hereby pledge to and agree
 5 with any person, firm, or corporation or Federal Agency
 6 subscribing to or acquiring any bonds or notes issued by any
 7 local government unit pursuant to the provisions of this act or
 8 the act approved June 25, 1944, as amended, that such bonds or
 9 notes, their transfer and the income therefrom including any
 10 gains made on the sale thereof (other than the underwriting
 11 spread in a distribution thereof) shall at all times be free
 12 from taxation within and by the Commonwealth of Pennsylvania,
 13 but this exemption shall not extend to underwriting profits or
 14 to gift, succession or inheritance taxes or any other taxes not
 15 levied directly on the bonds or notes, the receipt of the income
 16 therefrom, or the realization of gains on the sale thereof.

COMMENT

3. The section states the law as it has developed under the very similar provision of the Municipality Authorities Act. The lack of a similar provision in the former Municipal Borrowing Law gave rise to the custom of including a covenant in the bonds or notes requiring the municipality to assume and pay such taxes. Rather than burden the local government units with the additional sums, in general, the bonds or notes have been exempted from tax by local and state tax laws. The provision is included to strengthen the sale of bonds or notes in view of current discussions as to the taxation of municipal bonds. Reference is made to the former Municipal Borrowing Law to remove any implication that it was the intent of the General Assembly to imply that bonds issued thereunder were to be taxed. Underwriting profits, whether paid as a commission or arising as a result of a purchase at one price and a resale at a higher price in the course of effecting a distribution, have historically been considered business income and subject to tax. Equally, gift, succession and inheritance taxes have been ruled not to be exempted by the covenant in the Municipality Authorities Act. The exception is stated here but should not give rise to any implication that the same exception does not apply to the bonds or notes of an Authority.

NA

1 Section 1304. Exclusive Method of Borrowing on Bonds or
 2 Notes, Including Tax Anticipation Notes.--Hereafter a local
 3 government unit, as defined in this act, may borrow money on
 4 bonds or notes, including tax anticipation notes, only as
 5 provided in this act, it being the intention that this act shall
 6 provide an exclusive and uniform system on the subjects covered
 7 by this act: Provided, however, That school districts of the
 8 first class may for their first four full fiscal years following
 9 the effective date of this act borrow on tax anticipation notes
 10 and other short term borrowing authority in accordance with
 11 prior law.

COMMENT

4. A school district of the first class may have worked out financing program with its existing banking connections for a period of time in the future which should not be disturbed by any differences in amounts and methods of borrowing on tax anticipation notes between this act and the existing law applicable to this school district. Accordingly the proviso established a four year delay in the application of this act's tax anticipation note provisions to school districts. Otherwise this act provides uniformity for all borrowing, and all other borrowing. The legislative intent to repeal by implication borrowing provisions in city, borough,

eals.--(a) The following acts are repealed

1 "Municipal Borrowing Law."

2 (2) The act of March 6, 1970 (P.L. 145), known as "The
3 General Obligation Non-debt Bond Act."

4 (b) All other acts and parts of acts are repealed in so far
5 as they are inconsistent herewith.

6 Section 1306. Effective Date.--This act shall take effect
7 thirty days after the passage of this act as to all series of
8 bonds or notes sold after that date. All series sold prior to
9 that date may nevertheless be settled and delivered under the
10 former applicable statutes, which for such purposes shall be
11 deemed to remain in effect, with a debt limit consisting of such
12 multiplier of the borrowing base as will equal the debt
13 limitation prevailing under prior law.

COMMENT

5. The cross reference to Section 1304 in subsection (a)
(3) is to the proviso in that section relating to tax anticipation
notes of school districts of the first class.

THE CONSTITUTION REQUIRES THAT IMPLEMENTING LEGISLATION BE
ED BEFORE APRIL, 1972.