Opinion No. 52-5546

June 4, 1952

BY: JOE L. MARTINEZ, Attorney General

TO: Mr. Edward W. Hartman State Comptroller Santa Fe, New Mexico

*{*255}* On May 29, 1952, you requested an opinion from this office as to the interpretation to be placed upon sub-section (A) of Sec. 1, Ch. 164, Laws of 1947 (Sec. a, 14-3703a NMSA, 1941, as amended).

Section A of Chapter 164, Laws 1947, reads as follows:

"Said cities, towns and villages shall act as the agency for collection of such special assessments liens and, in so doing, shall act as trustee for the benefit of such holders of assignable certificates or bonds. In case any governing body of any city, town or village shall have created more than one improvement district, the funds of each district shall be kept separate from the funds of every other district. Assessments collected for interest and principal, shall be kept in separate funds and shall be used for the purpose for which collection is made. Collections shall be made semiannually."

In your letter of inquiry you state that you interpret sub-section A to require that principal and interest funds of special improvement districts within municipalities should be segregated into two funds and requested an opinion from this office as to the correctness of this interpretation.

For the sake of clarity in considering the problem raised, it may be well to allude briefly to the creation of special improvement districts within municipalities and the means provided to obtain funds to pay off the principal and interest of bonds issued to finance such improvement.

Chapter 14, NMSA, grants the authority to municipalities to create special improvement districts for improvement projects and authorizes such municipalities to levy special assessments against abutting property owners, payable as to principal in sundry installments, with interest on the several deferred installments, at a rate to be fixed by the municipality.

The municipality also has authority to issue bonds to pay for the improvement work, carrying interest, payable semi-annually, at a rate at least 1% below the interest charged on the special assessment installments, which bonds must be paid no later than one year after *{*256}* the last installment of principal and interest on the special assessment is due.

It is thus evident that the plan of the statute contemplated that the municipality will obtain the necessary funds to pay both the principal and interest due upon the

improvement bonds from the funds obtained by payment of principal and interest due upon the special assessments levied in connection with such improvements.

The question reduces itself to the meaning of the sentence "Assessments collected for interest and principal, shall be kept in separate funds and shall be used for the purpose for which collection is made."

Does this require the municipality to segregate the amount received as principal upon the special assessment levied in connection with the improvement in a fund separate and apart from the amount received as interest upon the deferred special assessment installment? In other words, must the municipality maintain a separate principal and separate interest account to be applied toward the payment of principal and interest respectively due upon the special assessment bonds, or is the municipality permitted to keep the amount received from both sources in one fund, which fund is used for the payment of interest on the bonds and for the redemption of the bonds as well?

Admittedly in prior years the practice of municipalities of comingling funds, received from interest and principal upon special assessment installments, worked to the serious disadvantage of bondholders in some cases. In these cases the municipality paid interest upon all of the bonds out of this common fund with the result that when the eventual maturity of all the bonds was reached a shortage was found and the bondholders, due to the provisions of the then existing law, could not enforce the payment of the bonds against the property owners who had benefitted by the improvements but who had defaulted in the payment of the installments of principal and interest due under the special assessments levied.

The plight of those bondholders in these circumstances is depicted in two New Mexico Supreme Court cases.

In Altman v. Kilburn, 45 N.M. 453, the Supreme Court ruled that when paving installments were payable in ten annual installments, with the entire amount falling due upon default in any installment, an action to foreclose must be brought within four years of any such default. In Munro v. City of Albuquerque, 48 N.M. 306, the Supreme Court ruled that even though the municipality might not have foreclosed such lien within the period of limitation, it could not be held liable to pay bondholders who were prevented from enforcing their obligations against the property owners benefited. That ruling turned in part upon the question that the bondholders had the right to institute forecloseure action against property owners, jointly with the city.

The history of that litigation, as well as other cases, indicates that these bondholders were placed at a disadvantage in not being put upon guard to take proper action, if the default occurred in the payment of installments by property owners, in that they had no opportunity to learn of such defaults until too late.

In 1939, prior to the decision in both of the cases referred to above, the Legislature extended the period of limitation for the foreclosure of the special assessment liens, in

case of default in payment of the installments of principal and interest assessed against the property benefitted, to assure bondholders of a period of at least three years beyond the time when their bonds would become due, in which to bring foreclosure action to secure the payment of principal and interest upon their bonds.

Thus whatever mischief might have been possible under the earlier laws was eliminated by the enactment *{*257}* of the 1939 laws with respect to such bonds.

In 1947, when the Legislature enacted the law which we are considering, it would appear that Sec. 14-3703a, concerned itself more with the problems that arose through the creation of different improvement districts by the municipalities, with special assessment bonds, issued as to the respective districts.

It seems reasonable to believe that the Legislature, in enacting this law, had in mind the prevention of the co-mingling of funds of the respective districts which could lead to mischief somewhat akin to that which occurred in connection with the issuance of special assessment bonds by municipalities under earlier laws.

Section A of 37-1403a requires the municipality to keep funds of each district separate and apart from the funds of the other districts. Section B requires the city to prepare annual statements of the several districts, showing delinquencies, and Section C requires the municipality to institute foreclosure action within three years of any default.

It is my opinion that in the enactment of 14-3703 A, the Legislature did not intend that the municipality should segregate the funds collected for principal in any one district into a separate principal fund, and the interest into a separate interest fund, with the use of the principal fund restricted to the redemption of the bonds, and the use of the interest fund restricted to the payment of interest, even though it might appear that this is the meaning of the sentence under consideration when it is read independently of the balance of this paragraph.

I believe that there are impelling reasons for saying that the Legislature did not intend that the municipality should be thus restricted in the payment of principal or interest upon these bonds to respective principal and interest funds.

First of all, it is my thought that if the Legislature had so intended this law to accomplish this purpose, it would have stated so in categorical terms for the reason that I am not able to find any other instance in which the payment of principal or interest upon other bonds issued by political subdivisions is thus restricted.

My attention has been called to a specific statutory provision enacted by the Legislature of the State of Idaho requiring municipalities to segregate principal payments into a separate fund and interest payments into a separate fund, which are received in connection with special assessments, but in that statute the creation of two separate funds is specifically provided for in categorical language such as is not found in our statute under consideration in the present discussion.

It has been suggested that the Legislature intended that the principal and interest payments on special assessments should be kept in separate funds and restricted to the payment of principal and interest upon the bonds from each such separate fund for the protection of the bondholders.

Inasmuch as it is always possible to have a default in the payment of special assessments, I am wondering how the bondholders would be protected under this two-fund theory any more than they are at present under the one-fund theory.

Presumably if there wasn't enough in the interest fund to pay the interest on all of the bonds for the first year, the bondholders would be put upon notice that they must start foreclosure action, or take some steps, to assure themselves of the payment of interest and principal due upon their bonds. But their bonds are not payable until maturity. The bondholders are restricted to the enforcement of their bonds against the properties benefitted by the special assessment and they face no danger of being prevented from enforcing their rights through a short period of limitations.

Since the sum total of principal and interest that is to be received *{*258}* and will eventually be received from the special assessment will go to the payment of principal and intercest upon the bonds, can it be said that the bondholders must have this protection? The statute requires the municipality to start foreclosure proceedings, in case of default in the payment of special assessments, long before the bonds will mature. The door is open to action immediately after default and the financial statement the city must prepare gives the bondholders information they need as to the security of their investments.

This so-called "protection to bondholders" appears to me to be the sole reason why it could be stated that this law requires the creation of two funds to be used for interest and principal payments respectively rather than one fund to be used for the payment of principal and interest both.

I have stated in this opinion that it is my opinion that if the Legislature had intended the two-fund creation with restricted use, it would have made that statement in categorical language.

I believe, however, that the legislation itself shows that the Legislature did not intend this for the reason that such an intendment would lead to at least one ridiculous result.

It is to be noted that the municipalities are permitted to charge interest rates on the special assessments of not less than 1% higher than the interest rate to be paid upon the special assessment bonds. In the case of one municipality it is charging an interest rate on the special assessments 2% higher than the bond interest rate.

By the collection of this interest differential, it would be possible for a city which charges 2% differential to pay all the interest due upon the special assessment bonds if default occurred in the case of 28% of the special assessments levied against property. If the

city charges a 1% differential it would be possible for the city to pay all of the interest due upon the bonds if default occurred in the payment of about 16% of the special assessments due.

These figures will vary with the interest differential charged. Can it be said that the Legislature intended the creation of a two-fund theory to protect bondholders so that they would be put upon notice if interest could not be paid upon the bonds only if less than 72% or 83% of the special assessments were paid?

If the Legislature intended two funds to be created, 28% or 16% of the bondholders would probably feel no reason for alarm when they received their interest, in blissful ignorance of the fact that the holders of bonds with high serial numbers were in danger of not being paid off either as to principal or interest, without some kind of legal action.

It is difficult to perceive how the Legislature at one and the same time would enact legislation intended to protect bondholders without protecting all of them equally.

Another incongruous result follows if one concludes that the Legislature intended the creation of two funds. The interest differential permits municipalities to accumulate a fund in excess of what is required for the payment of interest upon the bonds. If all special assessments were paid each year, on a 2% differential, 40% more would be realized in the interest fund than what is required. If a 1% differential is charged 20% more would be thus realized.

If the two-fund theory is followed, the municipality could use this interest differential only for the payment of interest, even though it might go on building up this accumulation so that eventually there might be enough in the interest fund to redeem the balance of the bonds outstanding.

*{*259}* Under the two-fund theory the city's hands would be tied and the excess in the so-called "interest fund," could not be used for any other purpose than the payment of interest, even though all interest had been paid and there was more than enough in this fund to pay all interest due under the bonds.

There are other comments which could be made to indicate that the two-fund theory, sought to be found in this legislation, would be productive of complexities and difficulties. It is difficult for me to say that the Legislature intended this legislation to have this result.

It is my opinion, therefore, that Sec. A14-3703a, NMSA, was intended by the Legislature to provide that in those cases in which municipalities created more than one improvement district, the funds realized from the special assessment for each district, should be kept separate and apart from the funds realized from the other districts; that the Legislature did not intend that within the individual districts, and with respect to the individual district funds, a separate principal and separate interest fund was to be created, with the use of such separate fund restricted to the payment, respectively, of

interest and principal upon the bonds. It is further my opinion that the Legislature intended that the municipalities, within the confines of this law, could maintain a common fund for the payment of principal and interest upon the bonds, issued as to each improvement district, which common fund could be created out of both principal and interest received upon the special assessments levied in the particular district.

I trust that this fully answers your inquiry.