

## Opinion No. 76-16

May 26, 1976

**BY:** OPINION OF TONEY ANAYA, Attorney General Robert A Engel, Assistant Attorney General

**TO:** Vincent Montoya, Director, Department of Finance and Administration, State Capitol Building, Santa Fe, New Mexico 87503

### QUESTIONS

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1. May the City of Albuquerque use the interest earned from the temporary investment of general obligation bond proceeds for general operating expenses of the City?
2. May the City of Albuquerque transfer a surplus of \$ 1,263,027 in the improvement district fund to the general fund?

#### CONCLUSION

1. No.
2. Yes.

### OPINION

#### {\*76} ANALYSIS

1. A municipality may sell general obligation bonds for a number of municipal purposes, said bonds to be repaid from ad valorem tax revenues. See Article IX, Section 12 of the New Mexico Constitution; Sections 14-29-1 through 14-29-9, NMSA, 1953 Comp.; Sections 11-6-13 through 11-6-22, NMSA, 1953 Comp.

Article IX, Section 9 of the New Mexico Constitution states:

"Any money borrowed by the {\*77} state or any county, district or municipality thereof, shall be applied to the purpose for which it was obtained, or to repay such loan, and to no other purpose whatever."

By the very words of this section, the money borrowed, i.e., the proceeds of the bond sale, must be **applied** either to the project itself or to repay the loan **and to no other purpose whatever**. The fact that the interest earned is additional to the proceeds is of no consequence. The interest results from the investment of the proceeds. To permit the interest from proceeds to be used in the general fund is to permit the application of

the proceeds for purposes other than those authorized by the Constitution and the practice is therefore prohibited. It is a general rule of law, aside from being constitutionally required in this case, that where there is no statute to the contrary, interest becomes part of the fund by whose investment it was produced. See **Bordy v. Smith**, 150 Neb. 272, 34 NW 2d 331. Thus, the interest must be deposited in either the sinking fund (to repay the loan) or in the capital projects fund (to be used for purposes for which the proceeds were borrowed). Indeed, we believe that the only justification for investment of the bond proceeds at all is that the interest will inure to the benefit of the taxpayer by increasing the sinking fund or benefit the project itself by increasing the capital fund.

A similar result was reached in Opinion of the Attorney General No. 65-27, dated February 11, 1965. In that opinion we considered whether or not ad valorem tax revenues raised to repay school bonds could be used for operating expenses of a newly consolidated school district when the bonded indebtedness of one of the consolidated school districts had been retired. We concluded therein that Article IX, Section 9 of the Constitution prohibited such use. That opinion states in pertinent part:

"The above cited constitutional sections [Article IX, Section II, Article IX, Section 9] have application to the prohibition existing against the expenditure of monies derived from the sale of school bonds and under the facts as herein set forth the situation involves a problem concerning monies which are not derived from the sale of school bonds, but constitute monies obtained from tax levies imposed upon property to repay the principal and interest of such school bonds. **While the sources of the funds are diverse, it is our opinion that the same restrictive features against the use of such monies apply . . . We think that to permit the use of tax raised ad valorem funds for school operational purposes would be the allowance of an expenditure indirectly which could not be done directly . . .**" [Emphasis added.]

In the case herein presented, the interest comes from the investment of **restricted** funds, and to allow use of the interest for general expenses would be to allow an expenditure indirectly which could not be done directly.

In **Scott v. City of Truth or Consequences**, 57 N.M. 688, 262 P.2d 780, the New Mexico Supreme Court held that Article IX, Section 9 prohibited a municipality from using earnings from its electrical and sewer systems for corporate purposes other than maintenance of the utilities, payment of interest on the bonds issued for their improvement or creation of sinking fund for repayment of the bonds.

{\*78} In **Sinclair Prairie Pipe Line Co. v. Excise Board**, 49 P.2d 114, 173 Okl. 375, the Supreme Court of Oklahoma sustained an order of the tax court directing that monies received as interest on daily balances of unexpended bond funds be transferred back from the general fund to the sinking fund to which it belonged.

We also call your attention to **Governmental Accounting, Auditing and Financial Reporting**, 1968, a publication of the Municipal Finance Officers Association of the United States and Canada, which states in pertinent part:

"[S]ome of the proceeds of a bond issue sold to finance a Capital Projects Fund may not be expended for a considerable period of time after their receipt. In cases of this kind, it is customary and appropriate to invest as much of the proceeds as possible in short-term, interest-bearing government securities of a high quality or in short-term deposits in commercial banks. Investments made under these circumstances must be carried as an asset of the Capital Projects Fund, because they were acquired with the fund's cash resources. What is done with the interest earnings on such investments would be governed by legal provisions or established financial policy applicable in the circumstances. One alternative would be to apply such interest earnings against interest costs of the bonds issued to finance the project. This would require transfer of the earnings to the appropriate Debt Service Fund. Another alternative is to credit the interest earnings as revenue of the Capital Projects Fund and use it along with other cash resources to meet authorized project expenditures. **The use of interest earnings on temporary investments by this fund is justified on the ground that the amount of resources allocated to the project is restricted exclusively to that project, and any increase which might result from prudent, short-term investment of such restricted resources should not be diverted to any other use.** Moreover, since as a practical matter the final cost of capital projects may exceed original project authorizations, any interest earnings credited to the fund can help to meet such costs without additional resort to the original source of funds or new appropriations from other sources. [p. 44 Emphasis added.]

The aforementioned publication is a well-recognized authority on proper accounting principles for state and local governments. In the extremely sensitive area of municipal bonds we believe conforming to proper accounting principles is highly advisable.

We are aware that the City of Albuquerque is a "home-rule" municipality and as such has certain constitutionally and statutorily granted prerogatives. See Article X, Section 6 and Sections 14-14-1 through 14-14-14, NMSA, 1953 Comp. We have examined the Albuquerque City Charter and find no specific provisions relating to the issuance of bonds. See **Davis v. Pueblo**, 158 Colo. 319, 406 P.2d 671. Even if the Albuquerque charter granted prerogatives contrary to the conclusions of this opinion, the charter could not prevail. Section 14-14-5, NMSA, 1953 Comp. states in pertinent part:

". . . [t]he charter shall not be inconsistent with the Constitution of New Mexico . . ."

{\*79} See also **Apodaca v. Wilson**, 86 N.M. 516, 525 P.2d 876.

As expressed herein, we believe the Constitution prohibits the use of interest earned on proceeds for general operating expenses.

We are further aware that Article X, Section 6 (D) states in pertinent part:

"A municipality which adopts a charter may exercise all legislative powers and perform all functions not expressly denied by general law or charter."

While general law may not expressly prohibit the practice, we believe that the Constitution does prohibit it and the Constitution must prevail.

We also call your attention to Section 11-2-25.4, NMSA, 1953 Comp., which states:

"The state treasurer upon order of the state board of finance shall invest the proceeds of state revenue and general obligation bonds until the money is needed for the purpose for which the bonds were sold. **Income from these investments shall be credited to the appropriate fund to apply toward payment of principal and interest of the bonds.**" [Emphasis added.]

While we recognize that this section has no direct applicability to the City, we note that the legislature has seen fit to limit the State to depositing interest from investment of bond proceeds into the sinking fund.

Finally, we are advised that the City relies on an advisory letter from this office, dated October 16, 1968, which, the City claims may condone its practice. We have examined that letter, a copy of which is attached hereto, and conclude that the advice contained therein applies only to whether the interest earned from bond proceeds must be applied to repay the loan or to the capital project fund. We fully agree that the interest may be applied to either fund. We do not believe, however, that the interest may be applied to the general fund and there is nothing to the contrary in the advisory letter.

In conclusion, it is the opinion of this office that the Constitution of New Mexico prohibits the use of interest earned on the investment of bond proceeds as general operating revenue of the City. However, it is also our opinion that, due to the practical difficulties in applying this opinion retroactively, the apparent good faith on the part of the City, the confusion with respect to this matter in the past, and the fact that some state agencies have in the past at least quietly acquiesced in this practice, this opinion should apply prospectively.

2. Section 14-32-25, NMSA, 1953 Comp. answers the second inquiry. That section states:

"The governing body may transfer to the general fund of the municipality any money obtained from the levy of an assessment for an improvement district if:

- A. Bonds or assignable certificates were issued to finance the improvement; and
- B. The funds obtained by the bonds or assignable certificates were spent for the improvement; and

C. The assessments were levied and collected for the payment {<sup>\*</sup>80} of the bonds or assignable certificates; and

D. Either the bond holders or assignable certificate holders are barred by the statute of limitations or a court judgment or decree from collecting the indebtedness; or

E. The bonded indebtedness or assignable certificates have been paid."

Thus, Section 14-32-25, **supra**, authorizes the City to transfer surplus improvement district funds to the general fund if the conditions specified therein are satisfied.

\* \* \*

October 16, 1968

Mr. C. R. Sebastian

Legislative Auditor

Executive-Legislative Bldg.

Santa Fe, N.M. 87501

Dear Mr. Sebastian:

The office has received a number of opinion requests concerning interest earned from the investment of moneys derived from the sale of bond issues. Evidently, when bond issues are authorized all of the bonds authorized are immediately issued even though all of the proceeds will not be immediately needed by the governmental body issuing the bonds. Many governmental bodies invest this money and the interest earned by these investments is either spend on the public project for which the bonds were issued or to retire the bonds. The proper disposition of this interest has been the subject of controversy for some time.

A number of the attorneys in this office have researched this problem in order to attempt to resolve the controversy, but have been unable to find any authority one way or the other.

As you are probably aware, there are good arguments for each side of the controversy. Those who argue that the interest earned on investments should be used to retire the bonds seek to limit the amount spent on the proposed project to the amount authorized. Thus it is argued that the governmental body issuing \$ 400,000.00 in bonds was authorized to issue and spend only \$ 400,000.00 on the project for which the bonds were issued and not \$ 400,000.00 plus any interest on the \$ 400,000.00 that may be earned before the \$ 400,000.00 is needed to pay for the public project.

On the other side of the controversy, we have the pragmatists who say we should let the governing authority use the interest on the project as this gives the officials who have custody of the money the incentive to make the best investments possible. The Public School Finance Division of the Department of Finance and Administration can give you figures on how much public money is deposited in banks rather than invested as it should be. Further, it is argued that this approach allows the governmental body to make unanticipated change orders without the necessity of issuing additional bonds.

The more persuasive of the two arguments set forth above may well depend on the governmental body and the type of bond issue involved. Perhaps the second argument has more validity when we are considering bond issues authorized for public buildings than it does for bond issues authorized for construction of a sewer line.

Since there is absolutely no authority {81} which is helpful in deciding this controversy one way or the other, this office would in effect be legislating if we were to issue an opinion attempting to resolve this controversy. We would therefore suggest that this argument be settled, if need be, by the legislature. We do note that the legislature provided that interest from the proceeds of bond issues authorized under the State Capitol Expansion Act is to be deposited in the State Capitol Expansion Fund and is not used to pay off the Severance Tax Bonds that have been issued.

We apologize for not answering your first request sooner, however, as you can see there really is no answer that we can give that will be of any help in settling the controversy that apparently exists. We do hope that the above will be of some help to you in advising those investing proceeds from bond issues until the legislature can study the problem more thoroughly.

GARY O'DOWD

Assistant Attorney General