

7-1-1984

The Referendum Requirement: A Constitutional Limitation on Local Government Debt in Florida

Tracy Nichols Eddy

Follow this and additional works at: <https://repository.law.miami.edu/umlr>



Part of the [State and Local Government Law Commons](#)

Recommended Citation

Tracy Nichols Eddy, *The Referendum Requirement: A Constitutional Limitation on Local Government Debt in Florida*, 38 U. Miami L. Rev. 677 (1984)

Available at: <https://repository.law.miami.edu/umlr/vol38/iss4/3>

This Article is brought to you for free and open access by the Journals at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in University of Miami Law Review by an authorized editor of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.

The Referendum Requirement: A Constitutional Limitation on Local Government Debt in Florida

TRACY NICHOLS EDDY*

I. INTRODUCTION	677
II. DISTINCTIONS BETWEEN GENERAL OBLIGATION AND REVENUE BONDS	681
A. Overview of Municipal Bonds	681
B. Revenue Bonds—Judicial Exception to the Referendum Requirement ..	684
III. PROBLEMS ARISING FROM ARTICLE VII, SECTION 12	693
IV. RECOMMENDATIONS	703
V. CONCLUSION	709

I. INTRODUCTION

Municipal¹ debt financing has received considerable attention at the federal,² state,³ and local levels since Cleveland's bond default and New York City's financial crisis.⁴ The tax revolt of the 1970's,⁵ characterized by Proposition 13,⁶ exacerbated the fiscal problems of local governments by restricting the use of debt financing devices supported by property taxes. The turbulence of that decade extended into the 1980's with an unprecedented downturn in the bond market,⁷ a primary source of debt financing.⁸ At-

* J.D., 1984, University of Florida.

1. For purposes of discussion, counties, cities, towns, school districts, and special districts are included under the heading of "municipal."

2. See, e.g., JOINT ECONOMIC COMM., 94TH CONG., 2D SESS., CHANGING CONDITIONS IN THE MARKET FOR STATE AND LOCAL GOVERNMENT DEBT 1 (Joint Comm. Print 1976) (prepared by John Peterson) [hereinafter cited as CHANGING CONDITIONS].

3. See, e.g., FLORIDA ADVISORY COUNCIL ON INTERGOVERNMENTAL RELATIONS, LOCAL GOVERNMENT DEBT IN FLORIDA (Mar. 1979) [hereinafter cited as ACIR, FLA. LOCAL DEBT].

4. For a discussion of the 1975 fiscal crisis of New York City, see Gelfand, *Seeking Local Government Financial Integrity Through Debt Ceilings, Tax Limitations, and Expenditure Limits: The New York City Fiscal Crisis, The Taxpayer's Revolt, and Beyond*, 63 MINN. L. REV. 545, 555-75 (1979); Shalala & Bellamy, *A State Saves a City: The New York Case*, 1976 DUKE L.J. 1119; *New York City—What Lies Ahead?*, 12 COLUM. J.L. & Soc. PROBS. 587 (1976) (symposium).

5. See *Sound and Fury over Taxes*, TIME, June 29, 1978, at 12.

6. CAL. CONST. art. XIII A. For an analysis of the changes resulting from the amendment, see *Amador Valley Joint Union High School Dist. v. State Bd. of Equalization*, 22 Cal. 3d 208, 583 P.2d 1281, 149 Cal. Rptr. 239 (1978).

7. See Wall St. J., Feb. 28, 1980, at 1, col. 6.

8. It has been estimated that local governments use municipal bonds to finance 50 to 60% of their capital projects. Bagwell, Evans & Nielsen, *The Municipal Bond Market: An*

tempts to quell this turbulence in municipal finance have often focused upon a single fiscal control, while neglecting needed reform of the overall municipal financing system.

Local governments incur debt by two methods: short-term or long-term borrowing.⁹ Short-term borrowing alleviates temporary cash flow gaps between annual revenues and daily expenditures.¹⁰ Municipalities issue short-term notes,¹¹ under one year in maturity, primarily to cover operating and maintenance expenses.¹² Long-term borrowing, over one year in maturity, provides the financing for capital projects.¹³ Local governments levy taxes to obtain the funds for repayment of the long-term loans over the life of the project.¹⁴

Several rationales support the use of long-term debt financing. Capital expenditures arise irregularly and are not easily financed from current revenues.¹⁵ Capital projects, such as school buildings and utility systems, have a useful life of many years. If a school district accumulates tax revenues for a period of years before purchasing a capital item, many persons who contributed the reve-

Analysis and Suggested Reform, 16 HARV. J. ON LEGIS. 211, 211, 212 n.2 (1979).

9. Greenberg, *Municipal Securities: Some Basic Principles and Practices*, 9 URB. LAW. 338, 340-50 (1977).

10. *Id.* at 346-47.

11. The following are various types of short-term notes issued by local governments. Tax anticipation notes (TANs) are issued in anticipation of receiving specific taxes and are paid out of those receipts. TANs enable local governments to borrow against expected taxes to fund current operating expenses. *Id.* at 347. Revenue anticipation notes (RANs) are issued in anticipation of other sources of future revenue. Typically, the revenues are utility revenues, or federal and state aid. *Id.* at 348. Bond anticipation notes (BANs) are a means of interim financing until a long-term bond issue can be floated. BANs may only be issued after the long-term bonds have been authorized. *Id.* General obligation notes, used for the same purposes as TANs and RANs, are the equivalent in credit quality of general obligation bonds. PUBLIC SECURITIES ASS'N, FUNDAMENTALS OF MUNICIPAL BONDS 19 (rev. ed. 1982).

12. Greenberg, *supra* note 9, at 347. Short-term borrowing is occasionally used for interim financing of capital projects when long-term interest rates are prohibitively high. The issuer hopes that lower long-term rates will be available when the short-term notes mature. *Id.*

13. U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, STATE CONSTITUTIONAL AND STATUTORY RESTRICTIONS ON LOCAL GOVERNMENT DEBT 6 (Sept. 1961) [hereinafter cited as ACIR, LOCAL DEBT]. Long-term borrowing supplied \$39 billion of the \$62 billion spent by local governments on capital outlays from 1952 to 1960. The remaining one-third of the financing for capital outlays, or expenditures for construction and purchase of land and equipment, apparently came from current revenues. *Id.*

14. 15 E. MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 43.02 (3d ed. 1970). Bonds, the primary form of long-term borrowing, generally have a 10 to 30-year maturity. This distributes the cost of local government expenditures over the life of the bonds, rather than requiring local governments to levy taxes for a lump sum payment of the debt when it is created. *Id.*

15. ACIR, LOCAL DEBT, *supra* note 13, at 9.

nues will have moved and will not benefit from the purchase.¹⁶ Those who move into the community after the item is purchased will have the benefit of the facilities without the burden of sharing the acquisition costs.¹⁷ By borrowing to finance construction and then imposing a tax to repay the loan, those who benefit from the new facilities will pay the tax. Furthermore, a capital project is often instrumental in attracting new residents who will increase the community's tax base.¹⁸ Moreover, a community with an expanding tax base can better afford debt payments over time.¹⁹

The state must expressly grant local governments the power to incur debt.²⁰ That power is generally subject to statutory and constitutional restrictions.²¹ The primary objectives of debt restrictions are preventing corruption, discouraging extravagance, and promoting sound fiscal policy for local governments.²² The most common constitutional debt restriction is the debt-to-property ratio, which limits the amount of outstanding debt to a percentage of the property tax base.²³ Local governments in Florida, however, are

16. *Id.* at 10. According to Census Bureau statistics, approximately 20% of all Americans change their residences each year, with one in sixteen moving across county lines. Such population movements could have significant cumulative effects when measured over the life of a local bond issue. *Id.*

17. The principle of "intergenerational equity" requires each generation of taxpayers to pay for its "stream of use" of governmental facilities. Under this concept, one generation of taxpayers should not utilize long-term borrowing to finance capital projects that will not benefit the next generation, which must share the burden of financing. On the other hand, the present generation should not bear the full burden of financing projects that will also benefit the next generation. Thus, present and future generations should share debt service and depreciation costs in proportion to the benefit received. Gelfand, *supra* note 4, at 550-51.

18. PUBLIC SECURITIES ASS'N, *supra* note 11, at 48.

19. *Id.* The "pay-as-you-use" approach represents a concept similar to that of "intergenerational equity," namely, that taxpayers who benefit from new facilities should pay for them over time. *Id.* In contrast to the "pay-as-you-use" approach is the "pay-as-you-acquire" philosophy, which advocates immediate payment for new projects. *Id.* at 49. The "pay-as-you-acquire" approach, often used in poor economic times, increases the taxpayers' burden of both paying off past debt and financing facilities to be used in the future. ACIR, LOCAL DEBT, *supra* note 13, at 11. For a discussion of the contrasts between the two approaches, see L. MOAK, ADMINISTRATION OF LOCAL GOVERNMENT DEBT 192-95 (1970).

20. 15 E. MCQUILLIN, *supra* note 14, at § 39.07.

21. See, e.g., ACIR, LOCAL DEBT, *supra* note 13, at 27-33; Bowers, *Limitations on Municipal Indebtedness*, 5 VAND. L. REV. 37, 37-42 (1951); Morris, *Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions*, 68 YALE L.J. 234 (1958).

22. Bowmar, *The Anachronism Called Debt Limitation*, 52 IOWA L. REV. 863, 867 (1967).

23. Bowers, *supra* note 21, at 37. Until recently, Virginia's constitution had the highest percentage limit, at 18%, of any state employing a debt-to-property ratio. See VA. CONST. art. VII, § 10 (1950, amended 1980); Bowmar, *supra* note 22, at 866 n.21. In 1980, the voters

not subject to such a ceiling on their indebtedness.²⁴

A second method of regulating debt is the restriction of property tax rates that can service the debt, or a limitation on property tax rates as a whole.²⁵ Section 9 of article VII of the Florida Constitution²⁶ limits property tax rates by restricting the millage rate at which counties, school districts, municipalities, and special districts may levy ad valorem taxes. Ad valorem taxes²⁷ are levied at a set millage rate on the assessed value of real estate and tangible personal property.²⁸ A "mill" is equal to one-tenth of one cent.²⁹

The third method of regulating local debt is the requirement of referendum approval of proposed municipal bond issues.³⁰ Arti-

of Virginia amended their constitution and restricted the debt-incurring power of towns and cities by substituting 10% for the 18% limit. See Act of Apr. 4, 1980, ch. 655, 1980 Va. Acts 991; S.J. Res. 29, ch. 764, 1980 Va. Acts 1465. New York's constitution has one of the most detailed percentage limitations on local indebtedness. See N.Y. CONST. art. VIII, § 4. For example, counties, cities with a population of less than 125,000, towns, and villages may not contract indebtedness exceeding seven percent of the average full valuation of taxable real estate. New York City and Nassau County are limited to 10%, and cities with over 125,000 inhabitants may not exceed nine percent. *Id.* Nationwide, the five-percent limitation seems to be the most common percentage device. See, e.g., IOWA CONST. art. XI, § 3; WIS. CONST. art. XI, § 3. See generally ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, UNDERSTANDING THE MARKET FOR STATE AND LOCAL DEBT 46-53 (May 1976) (summary of all state constitutional and statutory percentage limitations on local government power to issue general obligation long-term debt).

24. In 1929, the Florida Legislature considered a constitutional amendment forbidding any county, district, or municipality to issue bonds if their indebtedness would then exceed 20% of the assessed value of taxable property within the locale. This 20% debt-to-property ratio limitation was subsequently stricken from the proposed amendment. S.J. Res. 26, FLA. S. JOUR., 1929 Reg. Sess. at 272.

25. ACIR, LOCAL DEBT, *supra* note 13, at 30; see, e.g., ARIZ. REV. STAT. ANN. § 42-301 (1980); IND. CODE ANN. §§ 6-1.1-19-1 to .1-19-2 (Burns 1984); KAN. STAT. ANN. §§ 79-5001 to -5015 (1978); WIS. STAT. ANN. § 70.62(4) (West Supp. 1982-1983).

26. FLA. CONST. art. VII, § 9 provides in part:

(b) Ad valorem taxes, exclusive of taxes levied for the payment of bonds and taxes levied for periods not longer than two years when authorized by vote of the electors who are the owners of freeholds therein not wholly exempt from taxation, shall not be levied in excess of the following millages upon the assessed value of real estate and tangible personal property: for all county purposes, ten mills; for all school purposes, ten mills

27. The phrase "ad valorem tax" may be used interchangeably with "property tax." FLA. STAT. § 192.001(1) (1983).

28. See FLA. CONST. art. VII, § 9(b).

29. FLA. STAT. § 192.001(10) (1983).

30. See, e.g., ARK. CONST. art. XVI, § 1 (cities may use debt financing only with approval of a majority of the voters in those cities); IDAHO CONST. art. VIII, § 3 (any indebtedness exceeding the annual income and revenue received by the county or municipality requires two-thirds majority approval); LA. CONST. art. VI, § 33(A) (general obligation bonds require approval of both a majority of voters and the State Bond Commission); N.C. CONST. art. V, § 4.

cle VII, section 12 of the Florida Constitution³¹ imposes this referendum requirement to control local government borrowing. There are, however, reasons to doubt the continuing efficacy of the referendum as a method of restricting local governments' incurrence of debt. The history of the referendum requirement exposes the problems that have emerged in defining and implementing constitutional restrictions on local government financing. This article focuses on the referendum requirement and the judicially-developed revenue bond exception to that requirement. Analysis of the problems arising from this constitutional restriction and its exception is followed by suggestions for alternative means of regulating local government debt.

II. DISTINCTIONS BETWEEN GENERAL OBLIGATION AND REVENUE BONDS

A. Overview of Municipal Bonds

Local government debt has increased rapidly over the last century,³² with primary reliance today on the municipal bond market to finance that debt.³³ Currently, local governments finance fifty to sixty percent of capital projects through the sale of municipal bonds.³⁴ The development and sale of a municipal bond issue requires the expertise of financial advisors, underwriters, dealers, and bond counsel.³⁵ The attractiveness of municipal bonds as a financing device stems primarily from the fact that interest on the bonds, unlike other securities, is exempt from federal income tax.³⁶

31. FLA. CONST. art. VII, § 12. Section 12 provides:

Counties, school districts, municipalities, special districts and local governmental bodies with taxing power may issue bonds, certificates of indebtedness or any form of tax anticipation certificates, payable from ad valorem taxation and maturing more than twelve months after issuance only:

(a) to finance or refinance capital projects authorized by law and only when approved by vote of the electors who are owners of freeholds therein not wholly exempt from taxation; or

(b) to refund outstanding bonds and interest and redemption premium thereon at a lower net average interest cost rate.

32. MUNICIPAL FINANCE OFFICERS ASS'N, STATE AND LOCAL GOVERNMENT FISCAL ALMANAC 126 (July 1982). The volume of state and municipal borrowing increased from \$174 million in 1900 to \$80 billion in 1981. The number of municipal bond issues increased from 2,312 to 6,652 during the same time period. *Id.*

33. Bagwell, Evans & Nielsen, *supra* note 8, at 211.

34. *Id.* at 211-12.

35. See *infra* notes 212-13 and accompanying text. See generally PUBLIC SECURITIES ASS'N, *supra* note 11, at 29-40; L. MOAK, *supra* note 19, at 209-24 (discussion of securing specialized services to assist in the planning and sale of bond issues).

36. See I.R.C. § 103(a)(1) (1982). Section 103 excludes from gross income the interest

This tax exemption³⁷ for municipal bonds stems from the constitutional doctrine of "reciprocal immunity."³⁸ As a result, municipal bond interest rates are generally thirty-five percent lower than rates on comparable corporate securities.³⁹ These lower interest rates consequently reduce the municipalities' cost of borrowing money.⁴⁰ Investors are willing to receive the lower municipal yields because of the tax exemption, which is especially advantageous to investors in higher tax brackets.⁴¹

Once a local government decides to finance a project with bonds, a bond validation proceeding is held in circuit court to determine whether the bond resolution complies with Florida law.⁴²

on "the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia." Arbitrage bonds and various industrial development bonds, however, do not qualify for the exemption. Article, *Reform of the Municipal Bond Market: Alternatives to Tax-Exempt Financing*, 15 COLUM. J.L. & SOC. PROBS. 233 (1980). See generally Schilling, Griggs & Ebert, *Wisconsin Municipal Debt Finance: An Outlook for the Eighties*, 63 MARQ. L. REV. 539, 576-80 (1980) (discussing the federal tax exemption).

37. I.R.C. § 103(a)(1) (1982). This federal statutory exemption from taxation of interest payments to municipal bondholders has limited judicial consideration of the reciprocal immunity debate. But see Martori & Bliss, *Taxation of Municipal Bond Interest—"Interesting Speculation" and One Step Forward*, 44 NOTRE DAME LAW. 191 (1968) (discussing municipal securities that may be subject to taxation in the future). Municipal bond interest is also exempt from state tax in Florida. FLA. STAT. § 159.15 (1983).

38. Under the reciprocal immunity doctrine, states are immune from federal interference in state affairs, as the federal government is immune from state interference. PUBLIC SECURITIES ASS'N, *supra* note 11, at 155. Beginning with *McCullough v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), the Supreme Court has held that federal and state governments have reciprocal immunity from taxing each other. Proponents of the constitutional theory cite *Pollack v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), which held that income tax on interest from municipal bonds was unconstitutional. Opponents of the federal tax exemption argue that the subsequent enactment of the 16th amendment in 1913 rendered the reciprocal immunity doctrine inapplicable, and that the federal government could tax municipal interest. See U.S. CONST. amend. XVI; PUBLIC SECURITIES ASS'N, *supra* note 11, at 155-56.

39. PUBLIC SECURITIES ASS'N, *supra* note 11, at 34.

40. *Id.*

41. *Id.* For example, in 1980, a long-term municipal bond paid an interest rate of 8.45% annually. To an unmarried investor in the 49% tax bracket, that tax-free municipal yield is equivalent to a 16.57% return on a corporate bond. The single investor in a 30% tax bracket would have to earn 12.07% on a comparable corporate bond to earn the same return as the 8.45% municipal bond. *Id.* There are three major categories of investors in municipal bonds: commercial banks, fire and casualty insurance companies, and individuals. Generally, individual investors in the 35% or higher tax brackets find municipal bonds attractive. *Id.* at 34. For more information on the patterns of investment by the three major categories, see CHANGING CONDITIONS, *supra* note 2, at 33-40.

42. FLA. STAT. § 75.01 (1983). The validation process begins when the issuer files a complaint in the appropriate circuit court. *Id.* § 75.02 (1983). The complaint must allege the issuer's authority to incur bonded debt, the results of any required election, the ordinance and resolution authorizing the issue, the amount of the bonds, and the bonds' interest rate.

The court makes findings on the questions of whether the issuing body had the power to incur bonded debt and whether it exercised that power in accordance with the law.⁴³ The court may not weigh the fiscal feasibility of the proposed bonds in the validation determination.⁴⁴ The circuit court judgment is final on all matters raised or that could have been raised at the validation hearing, after time for appeal to the Supreme Court of Florida has elapsed.⁴⁵ Constitutional violations that were not raised during the validation proceeding, however, are not subject to this estoppel rule.⁴⁶

There are two basic types of municipal bonds: general obligation bonds and revenue bonds.⁴⁷ General obligation bonds are backed by the issuer's full faith and credit and taxing power. The ad valorem tax is the most common source of revenue pledged for repayment of general obligations bonds.⁴⁸ Revenue bonds are not backed by the issuer's taxing power; they are secured by revenue derived from rents, tolls, or charges paid from the facility constructed with the bond proceeds.⁴⁹

Id. § 75.04 (1984). Notice of the complaint must be published once a week for three consecutive weeks. By this publication, property owners, taxpayers, and citizens of the issuing county, municipality, or district are made defendants to the action. *Id.* § 75.06 (1983).

43. *Town of Medley v. State*, 162 So. 2d 257, 259 (Fla. 1964).

44. *State v. Manatee County Port Auth.*, 171 So. 2d 169, 171 (Fla. 1965).

45. FLA. STAT. § 75.09 (1983). An appeal of the circuit court order for bond validations is taken directly to the Florida Supreme Court. *Id.* § 75.08.

46. *State v. Miami Beach Redev. Agency*, 392 So. 2d 875, 895 (Fla. 1980); *State ex rel. Nuveen v. Greer*, 88 Fla. 249, 259-60, 102 So. 739, 743 (1924); see Patterson, *Legal Aspects of Florida Municipal Bond Financing*, 6 U. FLA. L. REV. 287, 289 (1953).

47. PUBLIC SECURITIES ASS'N, *supra* note 11, at 16. A third category, which will not be discussed in this Article, is the hybrid bond. Hybrids, or double-barreled bonds, are revenue bonds secured by an additional source of revenue or the issuer's full faith and credit. *Id.*

48. Greenberg, *supra* note 9, at 340.

49. *Id.* at 341-42. A growing area of revenue bond financing is the use of "industrial development bonds" (IDBs). IDBs are issued by a governmental unit to aid private corporations in financing projects such as plant construction or pollution control facilities. *Id.* at 344. Several types of financing formats for IDBs are used in Florida. Pitcher, *Use of Tax-Exempt Municipal Bonds to Finance Private Projects in Florida*, 56 FLA. B.J. 253, 253 (1982). Under one format, the bond proceeds are loaned by the municipality to the private company. The company executes a promissory note with payments matching the bond terms. The note is secured by a mortgage and security agreement between the issuer and the company, and the lien is released when the bonds have been paid in full. *Id.* at 253-54. Under the second arrangement, the municipality issues the bonds to construct the project, which is then leased back to the company. Rental payments match the debt service, and the company has an option to purchase the project for nominal consideration after the bonds are paid. *Id.* at 254. The most common arrangement in Florida is the installment sales agreement, under which title is retained by the governmental unit and transferred to the company after the bonds are paid in full. *Id.* The Florida Legislature, by enacting the Florida Industrial Development Financing Act in 1980, significantly increased the types of projects that can be financed in this manner. See FLA. STAT. §§ 159.25-431 (1983). The

Municipal bond investors generally rely on a bond's rating as an indicator of its creditworthiness.⁵⁰ The current reliance on detailed credit analysis of bond issues stems from the weakened state of municipal finance in the 1970's. General obligation bond analysis concentrates on the issuer's financial health and potential taxing power. This analysis includes such factors as outstanding debt, property values, population, income, and unemployment statistics.⁵¹ Revenue bond analysis focuses less on the issuer and more on the project to be financed, considering demand for services, cost, operating efficiency, and competition.⁵² Revenue bonds are generally scrutinized more carefully than general obligation bonds to verify that the funds generated by the project will be sufficient to cover operations, debt service, and reserve funds.⁵³

B. *Revenue Bonds—Judicial Exception to the Referendum Requirement*

Prior to 1930, the Florida Constitution contained no limitation on the power of local governments to incur debt.⁵⁴ Absent a statute

types of projects now eligible include industrial or manufacturing plants, tourism facilities, trade centers, certain health care facilities, pollution control facilities, airports, commercial projects in slum or blighted areas, and certain public lodging or restaurant facilities. *Id.* § 159.27(8)-(17), (19); see also Citrin & Schwartz, *Industrial Revenue Bond Financing in Florida*, 55 FLA. B.J. 779, 779 (1981); Roberts, *Industrial Development Bond Financing: Section 103(b) Examined*, 32 U. FLA. L. REV. 1 (1979).

50. Two major commercial services give nationally recognized ratings—Moody's Investors Service and Standard & Poor's Corporation. The services update an issuer's credit file or compile new information after learning of an impending bond issue. A staff of regional analysts recommend a rating after evaluating the issuer's budgets, financial reports, prospectus materials, and completed questionnaires. A committee of senior analysts must approve this recommendation before release of the final rating, which occurs about a week before the bond is to be sold. The final rating places the bonds in one of seven categories, ranging from Aaa (prime quality) to Ca,C (default). Bagwell, Evans & Nielsen, *supra* note 8, at 232-33. For more information on the process of rating, see TWENTIETH CENTURY FUND TASK FORCE ON MUNICIPAL BOND CREDIT RATINGS, *THE RATING GAME* (1974).

51. PUBLIC SECURITIES ASS'N, *supra* note 11, at 114-15.

52. *Id.* at 125.

53. *Id.* at 126-27.

54. Earlier Florida constitutions did, however, regulate the power of the State to incur debt. Article XII, section 7 of the 1868 constitution provided, "The Legislature shall have power to provide for issuing State bonds bearing interest, for securing the debt [of the State], and for the erection of State buildings, support of State institutions, and perfecting public works." FLA. CONST. of 1868, art. XII, § 7. This provision was substantially narrowed by the 1885 constitution, which limited the purposes for which state bonds could be issued to repelling invasion, suppressing insurrection, and refunding existing indebtedness. FLA. CONST. of 1885, art. IX, § 6. Today state general obligation bonds may be issued to finance state capital projects upon approval of the electors. FLA. CONST. art. VII, § 11(a). In addition, the state may finance capital projects through revenue bonds, which do not require

to the contrary, courts upheld the legislature's power to authorize a city to issue bonds without voter approval.⁵⁵ During the 1920's, Florida experienced rapid growth⁵⁶ and local indebtedness increased to finance needed public facilities.⁵⁷ Ad valorem taxes secured the bonds, and real estate speculation inflated property valuations.⁵⁸ The bust of the land boom,⁵⁹ followed by the Great Depression, led to widespread bond defaults among local governments in Florida during the late 1920's and early 1930's.⁶⁰

To prevent future financial debacles, article IX, section 6 of the 1885 Florida Constitution was amended in 1930.⁶¹ The amendment provided that local governmental units could issue bonds only if approved by a majority vote in an election in which a ma-

voter approval, provided state taxes are not pledged as security. *Id.* § 11(c). See generally Herring & Miller, *Florida Public Bond Financing—Comments on the Constitutional Aspects*, 21 U. MIAMI L. REV. 1, 4-6 (1966) (sketch of Florida bond history); Patterson, *supra* note 46, at 291-305 (discussing history of state bonds).

55. ACIR, FLA. LOCAL DEBT, *supra* note 3, at 91; see, e.g., *Camp v. State*, 71 Fla. 381, 386, 72 So. 483, 485 (1916); *Middleton v. City of St. Augustine*, 42 Fla. 287, 322, 29 So. 421, 431 (1900).

56. ACIR, FLA. LOCAL DEBT, *supra* note 3, at 91. Florida's population expanded from less than one million in 1920 to 1,468,211 in 1930, a 51% increase.

57. *Id.* at 6. Between 1925 and 1926, Florida's local governmental debt increased over 50% in one year. Between 1922 and 1926, per capita debt increased by 257%. *Id.* The amount of local bonds outstanding in Florida increased from \$86 million to \$532 million from 1922 to 1931. *Id.* at 7.

58. *Id.* at 92.

59. The Florida real estate market began to fail in 1925. Several hurricanes and the Mediterranean fruit fly infestation worsened the effect of the real estate collapse. *Id.*

60. A. HILLHOUSE, *MUNICIPAL BONDS* 24-27, 83-87 (1936). By 1936, Florida led the nation with a total of 621 bond defaults. Defaults occurred in 47 out of 67 Florida counties and in 204 out of 514 municipalities. *Id.* at 25-26.

61. See FLA. CONST. of 1885, art. IX, § 6 (1930). That provision provided in part: [T]he Counties, Districts, or Municipalities of the State of Florida shall have power to issue bonds only after the same shall have been approved by a majority of the votes cast in an election in which a majority of the freeholders who are qualified electors residing in such Counties, Districts or Municipalities shall participate, to be held in the manner to be prescribed by law

Due to Florida's boom and bust prior to the Depression, local government's fiscal ills were diagnosed early and the legislature started amendment proceedings in 1929. See S.J. Res. 26, FLA. S. JOUR., 1929 Reg. Sess. at 272. The economic distress of local governments was reflected in the 1929 Governor's Message to the 22d Legislative Assembly of Florida. Governor Doyle E. Carlton identified finance and taxation as the uppermost problem, stating:

Abnormal conditions resulting from the boom left their mark on public as well as private life to such an extent as to endanger our financial security In spite of high taxes, so high that many have ceased to pay, bond defaults are imminent in towns, districts and counties throughout the State. "Unwise," someone says, to release this information. But it is folly to dodge facts which will ultimately force their attention.

FLA. S. JOUR., 1929 Reg. Sess. at 3.

jority of freeholders participated.⁶² The rationale for the amendment was that freeholders, whose property would be taxed in order to repay the debt, should have the right to decide whether the debt should be incurred.⁶³

The 1930 amendment referred only to the issuance of "bonds," and made no distinction between general obligation and revenue bonds.⁶⁴ Early in the amendment's history, however, the Supreme Court of Florida began to distinguish between types of local government financing, and held that revenue bonds were not "bonds" within the meaning of the referendum requirement.⁶⁵ The court introduced this "revenue bond exception" to the referendum requirement in the 1933 case of *State v. City of Miami*.⁶⁶

In *State v. City of Miami*, the city proposed to finance additions to its water supply system by issuing water revenue certificates payable from future net revenues of the water system.⁶⁷ The Supreme Court of Florida acknowledged the long-established municipal practice of owning public utilities and reasoned that because the legislature and the voters knew of this practice when they adopted the amendment, the referendum requirement was inapplicable to the municipal financing required to keep such utilities in operation.⁶⁸ The court concluded that such revenue certificates were not "bonds" within the meaning of the constitutional

62. FLA. CONST. of 1885, art. IX, § 6 (1930). Initially, bond elections had to be held at the same time as other political elections; therefore, a majority of the registered freeholders generally participated. See 1931 Fla. Laws, ch. 14715, § 9 (repealed 1951). Soon, freeholders discovered that they could defeat a bond proposal by remaining away from the polls and preventing participation by a majority of freeholders. To prevent this, the Florida Legislature authorized county commissioners "at any time" to require re-registration of freeholders to secure an up-to-date list before the bond election. 1951 Fla. Laws, ch. 26870, § 9 (repealed 1969).

63. *E.g.*, *State v. Halifax Hospital Dist.*, 159 So. 2d 231, 235 (Fla. 1963); *State v. Florida State Improvement Comm'n*, 60 So. 2d 747, 751 (Fla. 1952); *State v. Hillsborough County*, 148 Fla. 163, 169, 3 So. 2d 882, 885 (1941); *Williams v. Town of Dunnellon*, 125 Fla. 114, 122, 169 So. 631, 635 (1936); *Sullivan v. City of Tampa*, 101 Fla. 298, 314, 134 So. 211, 217 (1931).

64. See *supra* note 61 and accompanying text.

65. See, *e.g.*, *Brooks v. City of Jacksonville*, 127 Fla. 564, 173 So. 365 (1937); *Williams v. Town of Dunnellon*, 125 Fla. 114, 169 So. 631 (1936); *Hopkins v. Baldwin*, 123 Fla. 649, 167 So. 677 (1936); *State v. City of Miami*, 113 Fla. 280, 152 So. 6 (1933).

66. 113 Fla. 280, 152 So. 6 (1933).

67. *Id.* at 282, 152 So. at 7. The water revenue certificates were to be financed from net revenues of the combined present water supply system and the proposed improvements. *Id.*

68. *Id.* at 295-96, 152 So. at 12. The supreme court cited numerous cases from other states that represented three approaches to determining what constitutes a municipal bond within the meaning of article IX, section 6. The court did not, however, attempt to reconcile the different approaches, and declined to define the precise scope of the constitutional referendum provision. See *id.* at 293, 152 So. at 9-11.

amendment so long as the financing was based on utility revenues rather than on ad valorem taxes.⁶⁹

At first, the revenue bond exception applied only to bonds that financed improvements to or expansions of existing public utilities.⁷⁰ Subsequent judicial decisions approved the use of revenue bonds to finance new projects as well, provided the revenue generated from user fees would be sufficient to repay the bondholders.⁷¹ Eventually, the exception expanded to encompass any capital project financed by revenue bonds payable not only from user fees, but from other non-ad valorem sources as well.⁷² Non-ad valorem sources that have been held properly pledged for the retirement of revenue bonds include cigarette taxes,⁷³ utility service taxes,⁷⁴ bridge tolls,⁷⁵ license and franchise fees,⁷⁶ and race track and jai alai funds.⁷⁷ The supreme court has repeatedly held that when revenue bonds were "payable solely from revenues derived from utilities service, excise taxes, licenses or some other source

69. See *id.* at 300, 152 So. at 13.

70. See *Williams v. Town of Dunnellon*, 125 Fla. 114, 169 So. 631 (1936). The court stated in *Williams* that any instruments to finance new projects with revenues from an existing facility would be "bonds" and would require voter approval. *Id.* at 127, 169 So. at 635.

71. See, e.g., *State v. City of Miami*, 72 So. 2d 655 (Fla. 1954) (construction of warehouse with bonds secured by lease payments); *State v. City of Key West*, 153 Fla. 226, 14 So. 2d 707 (1943) (purchase of new electric system with bonds payable from net revenue of the system); *State v. Dade County*, 146 Fla. 331, 200 So. 848 (1941) (construction of causeway with causeway revenue bonds); *State v. City of Hollywood*, 131 Fla. 584, 179 So. 721 (1938) (erection of new waterworks with water revenue bonds); *Flint v. Duval County*, 126 Fla. 18, 170 So. 587 (1936) (construction of additional bridge with tolls from existing bridge).

72. See *State v. Alachua County*, 335 So. 2d 554 (Fla. 1976) (state revenue-sharing and race track funds used for public improvement bonds); *State v. Orange County*, 281 So. 2d 310 (Fla. 1973) (race track and jai alai funds pledged for capital improvement bonds); *State v. City of Boca Raton*, 172 So. 2d 230 (Fla. 1965) (recreation facilities, city waste dump, and street improvements to be financed by revenue bonds backed by cigarette, franchise, and utility service taxes); *State v. City of Coral Gables*, 72 So. 2d 48 (Fla. 1954) (storm sewer bonds secured by cigarette taxes).

73. See, e.g., *Panama City v. State*, 93 So. 2d 608 (Fla. 1957); *Welker v. State*, 93 So. 2d 591 (Fla. 1957); *State v. City of Coral Gables*, 72 So. 2d 48 (Fla. 1954).

74. See, e.g., *Town of Medley v. State*, 162 So. 2d 257 (Fla. 1964); *State v. City of Tampa*, 95 So. 2d 409 (Fla. 1957); *State v. Monroe County*, 81 So. 2d 522 (Fla. 1955); *Schmeller v. City of Ft. Lauderdale*, 38 So. 2d 36 (Fla. 1948).

75. See, e.g., *Lee County v. State*, 370 So. 2d 7 (Fla. 1979); *Sanibel-Captiva Taxpayer's Ass'n v. County of Lee*, 132 So. 2d 334 (Fla. 1961); *Flint v. Duval County*, 126 Fla. 18, 170 So. 587 (1936).

76. See, e.g., *Panama City v. State*, 93 So. 2d 608 (Fla. 1957); *State v. Monroe County*, 81 So. 2d 552 (Fla. 1955); *State v. City of Miami*, 76 So. 2d 294 (Fla. 1954).

77. See, e.g., *State v. Orange County*, 281 So. 2d 310 (Fla. 1973); *State v. Manatee County Port Auth.*, 171 So. 2d 169 (Fla. 1965).

than ad valorem taxes," they could be issued without referendum approval.⁷⁸

The court's expansion of the revenue bond exception to allow pledging a wider variety of non-ad valorem funds resulted at the same time as an increase in local governments' non-ad valorem revenues. When the referendum requirement was first enacted, ad valorem taxes were almost the exclusive source of municipal revenue.⁷⁹ Today, however, ad valorem taxes account for only twenty-five percent of the total revenue of local governments.⁸⁰ Accompanying this decrease in the proportion of ad valorem taxes was an increase in the proportion of non-ad valorem taxes and revenues.⁸¹ The expanding sources of non-ad valorem revenue made revenue bond financing even more attractive to local governments seeking to avoid the referendum required for general obligation bonds.

As local governments increasingly pledge non-ad valorem revenues to repay revenue bonds, arguments were raised that the ad valorem taxing power was being pledged indirectly.⁸² In *Town of*

78. *State v. City of Jacksonville*, 53 So. 2d 306, 308 (Fla. 1951); see, e.g., *State v. Tampa Sports Auth.*, 188 So. 2d 795, 797 (Fla. 1966); *State v. Monroe County*, 81 So. 2d 522, 523 (Fla. 1955); *State v. City of Jacksonville*, 53 So. 2d 306, 308 (Fla. 1951).

79. ACIR, LOCAL DEBT, *supra* note 13, at 42-43. In 1902, property taxes accounted for 75% of all general revenue of local governments in the United States. By 1952, the property tax proportion shifted to less than 50% of general revenue. *Id.*

80. *Advisory Council on Intergovernmental Relations*, FISCAL CAPACITY OF LOCAL GOVERNMENT IN FLORIDA AN INFORMATIONAL REPORT 14 (Oct. 1978) [hereinafter cited as ACIR, FISCAL CAPACITY]. In the fiscal year 1976-1977, the percentage distribution of local government revenue for all local governments was as follows: property tax, 24.8%; utility tax, 2.4%; other taxes, 2.2%; utility revenue, 13.9%; federal intergovernmental revenue, 12.6%; state intergovernmental revenue, 25.1%; and other revenue, 19.0%. *Id.* Property taxes provided 34% of total revenue in counties and 15.3% in municipalities. *Id.*

81. *Id.* The largest percentage increases in local government revenue are from federal and state shared revenues. *Id.* These non-ad valorem funds come from various tax and revenue sources. For example, counties may levy the following non-ad valorem taxes: the occupational license tax, FLA. STAT. § 205.032 (1983); the optional one-cent motor fuel tax (if approved by referendum), *id.* § 336.021; and the optional tourist development tax (requires referendum approval), *id.* § 125.0104. Municipalities may levy the following non-ad valorem taxes: municipal public service (utilities) tax, *id.* §§ 166.231-.232; the occupational license tax, *id.* § 205.042; and the insurance premium tax, *id.* §§ 175.101, 185.08. Sources of non-ad valorem revenue for local governments not derived from taxes include franchise, utility, and intergovernmental revenues. ACIR, FISCAL CAPACITY, *supra* note 80, at 42-46. Miscellaneous non-ad valorem revenue sources include hospital and transportation charges, fines and forfeitures, school lunch sales, interest earnings, and special assessments. *Id.* at 46.

82. See *Welker v. State*, 93 So. 2d 591, 593 (Fla. 1957). In *Welker*, taxpayers argued that by pledging excise taxes to secure revenue bonds, the municipality was indirectly placing an additional burden on ad valorem taxpayers. The taxpayers argued that because excise taxes were being put to such a use, ad valorem taxes had to be used for general operations which otherwise would have been financed by excise taxes. The supreme court called the argument "strong and persuasive," but nevertheless held that the pledge of excise taxes did

Medley v. State,⁸³ the state raised such an objection to the validation of revenue bonds supported by water system revenues, cigarette taxes, franchise taxes on electric power, utility taxes, and occupational license taxes. The state argued that real property was being taxed to operate the water system and to replace those non-ad valorem revenues that would be available for town expenses.⁸⁴ The supreme court noted that when non-ad valorem funds were diverted from operating costs to revenue bond payments, ad valorem taxes would probably have to be increased to cover the deficiency in operating expenses.⁸⁵ Nevertheless, the majority held this "incidental effect on the use of the ad valorem taxing power" did not necessitate a referendum.⁸⁶ The court reasoned that the constitutional provision was never intended to require voter approval for pledging non-ad valorem revenue previously used for operating expenses.⁸⁷ The court ruled that only bonds that "directly obligate the ad valorem taxing power" require approval by referendum.⁸⁸

The state also argued in *Medley* that the bonds were not economically feasible.⁸⁹ The court reiterated its consistent rulings⁹⁰ that business judgments were the responsibility of the issuer and thus beyond judicial interference.⁹¹ The issues in a bond validation proceeding were limited to determining whether the issuer had the power to act and whether it exercised that power lawfully.⁹² Concluding that the town had met this bifurcated validation test, the *Medley* majority approved the validation of the bonds.

not require voter approval. *Id.*; accord *Panama City v. State*, 93 So. 2d 608, 614 (Fla. 1957).

83. 162 So. 2d 257 (Fla. 1964).

84. *Id.* at 258. The state was the only party to file an answer objecting to the town's bond proposal. *Id.* The state attorney is required to examine the issuer's complaint in the bond validation proceeding and make objections to any procedural, informational, or other errors in the complaint. FLA. STAT. § 75.05 (1983).

85. 162 So. 2d at 258.

86. *Id.*

87. *See id.*

88. *Id.*; accord *State v. Alachua County*, 335 So. 2d 554, 558 (Fla. 1976); *State v. Tampa Sports Auth.*, 188 So. 2d 795, 797-98 (Fla. 1966); *Rianhard v. Port of Palm Beach Dist.*, 186 So. 2d 503, 506 (Fla. 1966).

89. 162 So. 2d at 258.

90. *E.g.*, *State v. Dade County*, 142 So. 2d 79, 89 (Fla. 1962); *State v. Florida State Turnpike Auth.*, 134 So. 2d 12, 22 (Fla. 1961); *State v. City of Daytona Beach*, 118 Fla. 29, 41-42, 158 So. 300, 305 (1934).

91. 162 So. 2d at 259. The court recognized that the town had issued the bonds without advice of a fiscal agent. The majority recognized that, although "good business practice dictates that a city obtain such advice before contracting to sell its bonds," there was no legal requirement that it do so. *Id.*

92. *Id.*

Subsequent supreme court decisions have followed the *Medley* test for validating revenue bonds. If the bonds do not directly obligate the ad valorem taxing power, though they could have an incidental effect on its use, the court has not required a referendum.⁹³ In contrast, the supreme court has refused to validate revenue bonds backed by gross revenues from the project to be financed coupled with a supporting pledge of ad valorem taxes.⁹⁴ For example, in *State v. Halifax Hospital District*,⁹⁵ hospital gross revenues were pledged for the repayment of principal and interest on revenue bonds issued to finance hospital improvements. In addition, the authorizing resolution pledged to maintain during the life of the bonds the assessed ad valorem tax at the time of issuance for operation and maintenance of the hospital.⁹⁶ The supreme court reasoned that the ad valorem tax would have to be levied in order to operate the hospital that was generating the gross revenues for bond payments.⁹⁷ The court found that, despite the terms of the resolution, the bondholders could effectively compel the exercise of the ad valorem taxing power.⁹⁸ Granting this power to bondholders was in effect an indirect pledge of ad valorem taxes, and thus voter approval was necessary.⁹⁹

The *Halifax* and *Medley* cases represent the supreme court's attempt to distinguish the referendum requirement for general obligation bonds and the revenue bond exception. There is a clear

93. See *State v. Miami Beach Redev. Agency*, 392 So. 2d 875, 898 (Fla. 1980); *State v. Alachua County*, 335 So. 2d 554, 558 (Fla. 1976); *State v. Tampa Sports Auth.*, 188 So. 2d 795, 797 (Fla. 1966); *Rianhard v. Port of Palm Beach Dist.*, 186 So. 2d 503, 506 (Fla. 1966).

94. See *State v. City of West Palm Beach*, 125 So. 2d 568 (Fla. 1960) (city may issue parking facility revenue bonds, provided that ad valorem taxes are not used to compensate for any deficits in revenues from the facility); *State v. County of Manatee*, 93 So. 2d 381 (Fla. 1957) (invalidating a limited pledge of ad valorem taxes supplementing hospital improvement bonds).

95. 159 So. 2d 231 (Fla. 1963).

96. *Id.* at 231-32. The ad valorem levy for operation and maintenance of the hospital was four mills. The authorizing resolution provided for the deposit of the ad valorem levy in an operating fund. *Id.* Usually, a revenue bond resolution establishes the order in which funds generated by the project will be allocated. PUBLIC SECURITIES ASS'N, *supra* note 11, at 126. The funds are typically used in this order: operations and maintenance, debt service, debt service reserve fund, reserve maintenance fund, renewal and replacement fund, and surplus fund. *Id.* at 126-27.

97. See 159 So. 2d at 233.

98. *Id.* at 232. The court stated that "any device whereby the exercise of the ad valorem taxing power is pledged and can directly or indirectly be compelled to meet the obligation of the securities is a 'bond' which requires freeholder approval." *Id.* (emphasis added). The court noted that bondholders could enforce any covenants in the bond resolution, including the obligatory commitment to levy the ad valorem tax. *Id.*

99. *Id.* at 232.

line between "pure" general obligation bonds, pledging ad valorem taxes, and "pure" revenue bonds, pledging user fees from the project to be financed. The line is less clear, however, between general obligation bonds and those revenue bonds that pledge not only user fees but non-ad valorem sources as well. If the bonds have only an incidental effect on the ad valorem taxing power, they fall within the revenue bond exception. If the bonds indirectly pledge ad valorem taxes, they are not within the revenue bond exception. This line continues to be blurred because the supreme court has never defined the difference between an incidental effect on and an indirect pledge of the ad valorem taxing power.¹⁰⁰

The supreme court has been more explicit in distinguishing between general obligation and revenue bonds when mortgages are given to secure a bond.¹⁰¹ For example, where a city proposed to finance utility improvements with revenue bonds secured by both utility revenues and a mortgage on the utility plant, the supreme court held the bonds invalid.¹⁰² The court, reasoning that the city might be forced to use its taxing power to prevent foreclosure on the plant, ordered a referendum.¹⁰³ Whether real or personal property is involved, the court has consistently held that pledges of mortgages require referendum approval.¹⁰⁴ In effect, ad valorem taxes are indirectly pledged, because a community might feel "morally compelled"¹⁰⁵ to levy taxes to prevent the loss of assets

100. See *State v. Miami Beach Redev. Agency*, 392 So. 2d 875, 898 (Fla. 1980). Distinguishing between incidental effect and indirect pledge is even more difficult for the circuit judge, who may not examine the fiscal feasibility of the proposed bonds. See *supra* note 44 and accompanying text.

101. See, e.g., *Nohrr v. Brevard County Educ. Facilities Auth.*, 247 So. 2d 304, 311 (Fla. 1971); *Hollywood v. Broward County*, 90 So. 2d 47, 51 (Fla. 1956); *State v. Florida State Improvement Comm'n*, 47 So. 2d 627, 631-32 (Fla. 1950).

102. *Boykin v. Town of River Junction*, 121 Fla. 902, 164 So. 558 (1935). The scheme presented in *Boykin* was similar to that approved in *State v. City of Miami*—financing expansions to an existing utility with future utility revenues. 113 Fla. 280, 152 So. 6 (1933); see *supra* notes 66-69 and accompanying text. The fatal difference in *Boykin* was the additional pledge of a mortgage on the physical properties. 121 Fla. at 908-09, 164 So. at 560.

103. See 121 Fla. at 908-09, 164 So. at 561-62.

104. The courts usually have invalidated revenue bonds secured by mortgages on real property. See *supra* note 101. The same principle is also applicable to personal property. *Betz v. Jacksonville Transp. Auth.*, 277 So. 2d 769 (Fla. 1973). In *Betz*, the court held that a referendum was not required where management and bus system contracts created no lien or mortgage on bus system properties to be purchased. *Id.* at 772. The issue is not whether real or personal property is involved, but whether a government may be compelled to levy taxes to prevent the loss of an asset through foreclosure proceedings.

105. *Nohrr v. Brevard County Educ. Facilities Auth.*, 247 So. 2d 304, 311 (Fla. 1971). For further discussion of the prohibition of pledging mortgages without voter approval, see *Op. ATT'Y GEN. FLA. 76-121* (1976); *Op. ATT'Y GEN. FLA. 73-164* (1973).

through a mortgage foreclosure.

Against this background of the revenue bond exception and its restrictions, the Florida Constitution was revised in 1968. Section 12 of article VII now specifies that bonds "payable from ad valorem taxation" are subject to freeholder approval.¹⁰⁶ This limitation on the scope of the referendum requirement is a ratification of prior judicial interpretation of the revenue bond exception.¹⁰⁷ Section 12 applies to long-term bonds and limits the use of bonds to financing only capital projects.¹⁰⁸

The former requirement of majority approval in an election in which a majority of qualified freeholders voted was changed to simple majority approval.¹⁰⁹ The freeholder requirement was declared unconstitutional in 1979, when the United States Supreme Court held that excluding nonfreeholders from general obligation bond elections violates the equal protection clause of the United States Constitution.¹¹⁰ Although the freeholder language remains intact in section 12, the Florida Supreme Court has held that all electors have the right to vote in a general obligation bond referendum.¹¹¹

106. See *supra* note 31.

107. In *State v. Miami Beach Redev. Agency*, 392 So. 2d 875, 898 (Fla. 1901), the Florida Supreme Court recognized that the 1968 revision was a ratification of the revenue bond exception.

108. One of the contributing causes of New York City's 1975 fiscal crisis was the misuse of long-term bonds. Bonds were used to finance non-capital projects such as manpower training and vocational education, which consequently shifted many current expenses to the capital budget. Shalala & Bellamy, *supra* note 4, at 1124-25. Section 12 of the Florida Constitution protects against such abuses by allowing long-term borrowing for capital projects only and not for current operating expenses. See FLA. CONST. art. VII, § 12.

109. After the 1930 amendment was enacted requiring approval by a majority of qualified freeholders, many bond issues failed because of voter apathy. To overcome this problem the legislature provided for re-registration of freeholders to determine the number qualified to vote in a bond election. See *supra* note 62. In *State v. City of St. Augustine*, 235 So. 2d 1, 5 (Fla. 1970), the supreme court found that such "cumbersome and costly procedures" caused by freeholder participation requirements of the 1885 constitution were intentionally eliminated in the 1968 constitution. The Florida Supreme Court interpreted the voter requirement as applicable to any freeholder elector whose property is subject to taxation for any purpose. See *id.* at 7.

110. See *City of Phoenix v. Kolodziejski*, 399 U.S. 204 (1970).

111. See *State v. City of Miami*, 260 So. 2d 497, 499 (Fla. 1972) (involving a bond election in which freeholder and nonfreeholder votes were separately tallied). *Phoenix* was held applicable to Florida local bond elections, and all votes were therefore valid. The two bond proposals, totalling \$27 million, were approved. Ironically, if the prior freeholder requirement had been controlling, both bond issues would have been defeated. *Id.* at 499.

III. PROBLEMS ARISING FROM ARTICLE VII, SECTION 12

Courts and local governments have continued to carve out exceptions to the referendum requirement for municipal bonds.¹¹² Today, section 12 of article VII is an anachronism offering only illusory protection against irresponsible long-term borrowing. The original purpose of the referendum was to permit those whose property would be encumbered to decide whether to incur the debt.¹¹³ This purpose is no longer valid because bond elections are open to all voters, regardless of freehold status.¹¹⁴ Additionally, the referendum's focus continues to be solely on the ad valorem tax, which provides a much lower percentage of total local government revenues than it did when the referendum requirement was enacted.¹¹⁵ Meanwhile, non-ad valorem sources, which account for a proportionally larger part of total revenues, are not subject to the constitutional referendum restriction.¹¹⁶ The illusory nature of the protection provided by section 12 is apparent in light of the widening scope of the revenue bond exception and its increased use in financing both revenue generating and non-revenue generating fa-

112. In addition to the revenue bond exception, there was another category of local borrowing classified as outside the meaning of "bonds" under the 1930 referendum requirement. Under this exception, counties were authorized to levy a 5 mill ad valorem "building tax" to finance essential government buildings such as courthouses and jails. 1949 Fla. Laws, ch. 25469, § 1; *see, e.g.*, *State v. County of Palm Beach*, 89 So. 2d 607 (Fla. 1956) (permitting revenue bond financing of county office building, delinquent children's home, and courthouse improvements without voter approval); *Posey v. Wakulla County*, 148 Fla. 115, 3 So. 2d 799 (1941) (construction of county courthouse with bonds secured by building tax); *Tapers v. Pichard*, 124 Fla. 549, 169 So. 39 (1936) (revenue bonds secured by building tax to finance jail were valid). *But cf.* *Leon County v. State*, 122 Fla. 505, 165 So. 666 (1936) (tax anticipation certificates for future building taxes to construct a jail required voter approval). *See generally* Patterson, *supra* note 46, at 306-08 (discussing the essential government needs exception).

The essential government needs exception was rendered obsolete with the enactment of section 12, article VII in 1968. In *State v. County of Dade*, 234 So. 2d 651 (Fla. 1970), the Florida Supreme Court stated, "The present Constitution is clearly more restrictive and expresses the will of the people that financial arrangements of the type formerly upheld in the *Tapers v. Pichard* line of cases be no longer permitted." *Id.* at 653. The Florida Legislature subsequently repealed the statute authorizing the building tax. 1971 Fla. Laws 14, § 3.

113. *See supra* note 63 and accompanying text.

114. *See supra* note 110 and accompanying text.

115. *See supra* notes 79-81 and accompanying text.

116. Florida's Constitutional Revision Commission proposed a revision of section 12 of article VII that would have included a revenue bond provision. Essentially, the provision would have allowed revenue bonds to be issued without a vote of the electors to finance fixed capital outlay projects authorized by law. This proposed constitutional revision was defeated in a statewide election. *See Greenfield, Flexibility and Fiscal Conservatism: Provisions of the 1978 Constitutional Revision Relating to Bond Financing*, 6 FLA. ST. U.L. REV. 822, 826 (1978).

cilities.¹¹⁷ While voters have a constitutional right to approve general obligation bonds, they have no such right to vote on revenue bonds, which account for seventy percent of municipal borrowing.¹¹⁸ Not only does the referendum requirement fail to provide effective protection against fiscal irresponsibility, but it also restricts the ability of local governments to develop responsible debt management policies that efficiently utilize both revenue and general obligation bonds. *County of Volusia v. State*¹¹⁹ illustrates the restrictive effect of section 12.

In *Volusia County*, federal court orders, mandates, and guidelines had been imposed on the county to alleviate overcrowding in the county jail.¹²⁰ The federal court intervention, however, offered no solutions, and Volusia County struggled with the problem for several years.¹²¹ Because a jail is a non-revenue generating facility that benefits the community as a whole, it is an appropriate project for general obligation bond financing. On referendum, however, Volusia County voters defeated the general obligation bond proposal by an overwhelming majority.¹²² Next, pursuant to its home rule charter power,¹²³ the county enacted an ordinance¹²⁴ and resolution¹²⁵ authorizing the issuance of revenue bonds secured by "all legally available non-ad valorem funds" to finance a new jail.¹²⁶ In-

117. See *supra* notes 72-77 and accompanying text.

118. ACIR, LOCAL DEBT, *supra* note 13, at 26.

119. 417 So. 2d 968 (Fla. 1982).

120. *County of Volusia v. State*, No. 82-2889-CA-01-8 (Fla. 7th Cir. Ct. Sept. 10, 1981). A federal court order imposed on the county jail a temporary limitation of 192 occupants. The jail was originally designed to hold 219 persons, but had an average prisoner population of 368 and, under federal constitutional standards, should have held no more than 62. *Id.* at 2. To meet its remaining presentencing incarceration needs, Volusia County leased space in the Daytona Beach and New Smyrna Beach city jails. *Id.* at 3.

121. In the language of the circuit court, the county has been confronted with "a series of 'Hobson's Choices' as the problem has gotten progressively worse and the alternatives fewer and exceedingly more expensive." *Id.* at 1. The court further recognized that the county "has addressed this most perplexing and politically unpopular problem with courage, imagination and practical application." *Id.* at 1-2. In 1979, Volusia County commissioned a study that resulted in a recommendation to construct a new jail. *Id.* at 3.

122. *Amicus Curiae Brief of Sarasota County* at 2, *County of Volusia v. State*, 417 So. 2d 968 (Fla. 1982); see *Orlando Sentinel*, June 11, 1982, at A5, col. 1 (voters rejected a \$35 million general obligation bond proposal in 1980).

123. See *County of Volusia Home Rule Charter* (1970), reprinted in 1970 Fla. Laws, ch. 70-966.

124. Volusia County, Fla., Ordinance No. 81-6 (Mar. 5, 1981).

125. Volusia County, Fla., Resolution No. 81-84 (July 9, 1981).

126. *Id.* § 12. Section 12 provided that a pledge of non-ad valorem funds would secure the principal and interest of the revenue bonds. Non-ad valorem funds were defined to include "all legally available funds and revenues of the County collected by or accruing to the County other than by the exercise of the ad valorem taxing power." *Id.* § 2F. The resolution

cluded in the non-ad valorem revenues pledged were utility user fees, building permits, other licenses and permits, county officer fees, vehicle inspection fees, and other charges for services.¹²⁷ In addition, the resolution stated that the county was obligated to take all action necessary to continue receiving the non-ad valorem funds for repayment of the bonds.¹²⁸

At the validation proceeding, the circuit court rejected the proposed bond issue.¹²⁹ The court concluded that pledging regulatory and user fees to repay the revenue bonds was unlawful.¹³⁰ Analogizing to earlier "impact fee" cases,¹³¹ the court found that fees collected to offset the costs of government regulation could not be pledged for an unrelated use.¹³² With the exception of fees col-

authorized an issuance of \$40 million in revenue bonds. *Id.* § 5.

127. *County of Volusia v. State*, No. 81-2889-CA-01-B, at 5-6 (Fla. 7th Cir. Ct. Sept. 10, 1981).

128. *Volusia County, Fla.*, Resolution No. 81-64 at § 14H (July 9, 1981). Section 14H provided in part:

The County will not take any action which will impair or adversely affect in any manner the pledge of the non-ad valorem funds made herein or the rights of the holders of the obligations issued pursuant to this resolution. The County shall be unconditionally and irrevocably obligated, so long as any of the obligations or the interest thereon are outstanding and unpaid, to take all lawful action necessary or required to continue to entitle the County to receive the non-ad valorem funds in the maximum amounts as now provided by law to pay any obligations referred to in section 2F hereof and the principal of and interest on the obligations and to make the other payments provided for herein.

Id.

129. *County of Volusia v. State*, No. 81-2889-CA-01-B, at 30 (Fla. 7th Cir. Ct. Sept. 10, 1981).

130. *See id.* at 13-14.

131. *Contractors & Builders Ass'n v. City of Dunedin*, 329 So. 2d 314 (Fla. 1976); *Broward County v. Janis Dev. Corp.*, 311 So. 2d 371 (Fla. 4th DCA 1975). Local governments may impose an impact fee to offset the necessary expense of regulation. This regulatory power is derived from the police power of local government. *Tamaimi Trail Tours, Inc. v. City of Orlando*, 120 So. 2d 170, 172 (Fla. 1960). The Florida Supreme Court distinguished a fee from a tax in *Bateman v. City of Winter Park*, 160 Fla. 906, 37 So. 2d 362 (1948). A fee imposed for regulatory purposes, which also requires compliance with statutory conditions, is a valid fee. If the fee is exacted for revenue purposes, and payment gives the right to carry on business without performance of any further conditions, it is a tax. *Id.* at 907, 37 So. 2d at 363. In *Janis*, land developers challenged the validity of a land use fee that had to be paid before they could build. The fee, ostensibly imposed for the purpose of building roads, was held to be an invalid tax. 311 So. 2d at 375. The district court of appeal explained that the fees exceeded any cost of regulation and were, therefore, invalid. *Id.* In *Dunedin*, building contractors and land owners challenged a municipal ordinance that authorized impact fees for the privilege of connecting to the municipality's water and sewer system. The supreme court found that, while such fees were not taxes, the ordinance was defective for failing to specify restrictions on the use of the collected fees. 329 So. 2d at 321.

132. *County of Volusia v. State*, No. 81-2889-CA-01-B, at 13 (Fla. 7th Cir. Ct. Sept. 10, 1981). In addition to the impact fee cases, the circuit court relied on *McGovern v. Lee County*, 346 So. 2d 58 (Fla. 1977), for the principle that fees must bear a relationship to the

lected by the sheriff's office and county court, the non-ad valorem fees had no relation to financing a jail and were an "unlawful diversion of funds."¹³³ Having ruled that a majority of the pledged revenues were unlawful, the court then found that there would be insufficient coverage of the proposed bonds.¹³⁴ Emphasizing the substance rather than the form of the bonds, the court held that the bond issue violated section 12 of article VII.¹³⁵ According to the circuit court, pledging all gross non-ad valorem sources did not have a merely incidental effect on ad valorem taxes, but directly obligated the county to use its taxing power for repayment of the bonds.¹³⁶

By a four to three vote, the Florida Supreme Court affirmed the circuit court order denying validation of the proposed bonds.¹³⁷ The majority noted that the *Town of Medley* had approved non-ad valorem pledges without referendum even though such pledges would have an incidental effect on the ad valorem taxing power.¹³⁸ Nonetheless, the court distinguished the Volusia County bonds from those involved in *Medley* on two grounds: first, Volusia County had pledged all legally available non-ad valorem revenues, instead of several specific sources; and second, the resolution pledged to maintain fully the programs and services that generated

cost of the regulation involved. If there is no such relationship, the fees are revenue producing taxes. Because there is no statutory authority to levy such taxes, they are invalid under article VII, section 1(a) of the Florida Constitution. Unlike the impact fee cases, *McGovern* involved the validation of bonds. There, proposed road improvements and construction of recreation facilities were to be financed by revenue bonds secured by bridge tolls. The bridge had already paid for itself, and the tolls were being used for maintenance and operation costs. 346 So. 2d at 60. The supreme court examined the statutory authority for funding self-liquidating projects with revenue bonds, and held the proposed scheme invalid. *Id.* at 65-66 (discussing Revenue Bond Act of 1953, FLA. STAT. §§ 159.01-.19 (1983)). The court found that the legislative intent underlying the Revenue Bond Act was that those who directly benefit from the project should bear a substantial portion of the cost. Conversely, those who bear the substantial cost should benefit from the project. *Id.* at 64. The county failed to show that recreation facilities and road improvements would make any significant contribution to traffic over the bridge. Therefore, the use of the bridge toll to pay for the proposed bonds placed an undue burden on island residents and visitors and was invalid. *Id.*

133. *County of Volusia v. State*, No. 81-2889-CA-01-B, at 13 (Fla. 7th Cir. Ct. Sept. 10, 1981).

134. *See id.* at 14.

135. *See id.* at 22.

136. *See id.* at 21. The circuit court concluded that the case was governed by *State v. Halifax Hospital Dist.*, 159 So. 2d 231 (Fla. 1963), because bondholders could compel the county to use its ad valorem taxing power for repayment of the bonds. *See County of Volusia v. State*, No. 81-2889-CA-01-B, at 21 (Fla. 7th Cir. Ct. Sept. 10, 1981).

137. *See County of Volusia v. State*, 417 So. 2d 968 (Fla. 1982).

138. *See id.* at 971; *supra* notes 83-88 and accompanying text.

the non-ad valorem revenues.¹³⁹ The majority opined that to maintain programs and services that devoted their gross revenues to bond payments would inevitably result in an increase in ad valorem taxes to cover the operating costs for continuance of such programs and services.¹⁴⁰ On the authority of *State v. Halifax Hospital District*,¹⁴¹ the majority concluded that the proposed bonds indirectly pledged ad valorem taxes and therefore required voter approval.¹⁴² Having decided the case on the constitutional issue, the majority refused to review the validity of the county's using non-ad valorem regulatory and user fees to finance the jail.¹⁴³

The dissent, favoring validation, stated that the court had repeatedly upheld similar pledges of non-ad valorem revenues without requiring voter approval.¹⁴⁴ The dissent distinguished *State v. Halifax Hospital District* on the ground that pledging gross revenues and promising not to reduce ad valorem taxes levied for hospital maintenance and operations during the life of the bonds required referendum approval.¹⁴⁵ Volusia County, by comparison, had not expressly pledged ad valorem taxes to continue the operation of the programs and services needed to generate non-ad valorem funds.¹⁴⁶ Moreover, the Volusia County resolution specifically stated that the bondholders could not compel repayment through the ad valorem taxing power.¹⁴⁷ The dissent recognized that the diversion of non-ad valorem funds from general revenue would probably require an increase in ad valorem taxes to make up the deficiency.¹⁴⁸ Citing *Medley*,¹⁴⁹ the dissent concluded that this

139. 417 So. 2d at 971.

140. *Id.* The majority reached this conclusion notwithstanding the fact that the bond resolution covenants specifically stated that the bondholders could not compel the levy of ad valorem taxes. Volusia County, Fla., Resolution No. 81-64 § 13 (July 9, 1981).

141. 159 So. 2d 231 (Fla. 1963); see *supra* notes 95-99 and accompanying text.

142. 417 So. 2d at 972. The court posited that "[t]hat which may not be done directly may not be done indirectly," but failed explicitly to define the term "indirectly." *Id.* Instead, the majority found that pledging all available non-ad valorem revenues and promising to do everything necessary to continue to receive those revenues would lead to higher ad valorem taxes. The court concluded that such a result "amounts to the same thing [as directly pledging ad valorem taxes]." *Id.*

143. See *id.*

144. *Id.* at 972-75 (Alderman, J., dissenting) (citing *State v. Alachua County*, 335 So. 2d 554 (Fla. 1976); *State v. Tampa Sports Auth.*, 188 So. 2d 795 (Fla. 1966); *Panama City v. State*, 93 So. 2d 608 (Fla. 1957); *State v. Monroe County*, 81 So. 2d 522 (Fla. 1955); *State v. City of Coral Gables*, 72 So. 2d 48 (Fla. 1954); *State v. City of Jacksonville*, 53 So. 2d 306 (Fla. 1951)).

145. 417 So. 2d at 973.

146. *Id.*

147. *Id.*; see *supra* note 140.

148. 417 So. 2d at 973 (Alderman, J., dissenting).

incidental effect on ad valorem taxation did not require referendum approval.¹⁵⁰

After deciding that a referendum was unnecessary, the dissent next considered the validity of pledging regulatory and user fees.¹⁵¹ In the dissent's opinion, the circuit court mistakenly relied on impact fee cases, which were "inapposite" to bond validation cases.¹⁵² The dissent suggested that the issue was not whether the fees had a reasonable relationship to constructing a jail, but whether the fees exceeded the reasonable cost of regulation.¹⁵³ Furthermore, if a fee were successfully challenged as being unlawful, it would no longer qualify as a "legally available" non-ad valorem source.¹⁵⁴ Finding nothing in general or specific law that precluded Volusia County from pledging all legally available non-ad valorem funds, the dissent concluded that the circuit court erred in finding the pledge of regulatory and user fees invalid.¹⁵⁵

The *Volusia County* decision thus added another twist to the convoluted history of the revenue bond exception to the referendum requirement. The court's opinion raised concern among public officials¹⁵⁶ and bond counsel over the constitutional validity of outstanding revenue bonds containing pledges and covenants similar to those proposed by Volusia County.¹⁵⁷ As a rule, validation

149. See *supra* notes 83-88 and accompanying text.

150. 417 So. 2d at 973 (Alderman, J., dissenting).

151. *Id.*

152. *Id.* at 974. The dissent agreed with the county's argument that the circuit court had mistakenly extended the impact fee principles to a bond validation case. See Appellant's Initial Brief at 7-20, *County of Volusia v. State*, 417 So. 2d 968 (Fla. 1982).

153. 417 So. 2d at 973 (Alderman, J., dissenting). The dissent distinguished *Volusia* from the impact fee cases by noting that in *Volusia* there was no challenge that the regulatory and user fees exceeded the reasonable cost of regulation or services to be performed. *Id.* at 975. The instant case was distinguished from *McGovern v. Lee County*, 346 So. 2d 58 (Fla. 1977), because, unlike the project in *McGovern*, the proposed Volusia County jail was not self-liquidating and, therefore, was not governed by the Revenue Bond Act of 1953, FLA. STAT. §§ 159.01-19 (1983). 417 So. 2d at 974 (Alderman, J., dissenting); see *supra* note 132.

154. 417 So. 2d at 975 (Alderman, J., dissenting). The dissent stated that such individual challenges to the validity of non-ad valorem revenues were "issues collateral to this bond validation proceeding." *Id.* This ambiguous statement leaves doubt about whether such issues are collateral to the supreme court's review of a bond validation, or whether they are collateral to the circuit court proceeding. See *supra* notes 42-45 and accompanying text.

155. 417 So. 2d at 975 (Alderman, J., dissenting).

156. See, e.g., *Orlando Sentinel*, June 11, 1982, at A5, col. 3. Orange County Attorney Tom Wilkes expressed concern that the supreme court's opinion could lead to further interpretations requiring voter approval for revenue bonds backed by non-ad valorem funds. Orange County Comptroller Tom Locker stated that if all revenue bonds required a referendum, "it would bring government's ability to deal with problems to a grinding, screeching halt."

157. See, e.g., *Alachua County, Fla., Ordinance No. 78* (Jan. 20, 1976). This resolution

proceedings estop future challenges of law or fact; questions about the constitutional validity of the bonds, however, are not estopped.¹⁵⁸ In addition to the concern over the continuing validity of past bond issues, there was concern about future revenue bond proposals. The majority's failure to clarify the line between an incidental effect on ad valorem taxes and an indirect pledge of such taxes cast doubt on the future scope of revenue bond financing.¹⁵⁹

Because ad valorem taxes go into a general fund¹⁶⁰ for local government operating expenses, local governments lack guidance in determining how far they may go in diverting non-ad valorem revenue from the general fund to revenue bond repayments. In *Medley*, the pledge of non-ad valorem funds and the incidental effect on ad valorem taxes was insufficient to invoke the referendum requirement. In *Halifax Hospital District*, the pledge of ad valorem taxes to operate and maintain the facility, which contributed its own gross revenues to bond repayment, did require a referendum. In *Volusia County*, the pledging of all non-ad valorem revenue and the covenant to maintain services made voter approval necessary, even though the taxing power was not pledged for bond repayment or for maintaining services.

A broad reading of *Volusia County*, which suggests a retreat from *Medley*, would severely restrict the ability of local governments to finance non-revenue generating projects with revenue bonds. Such a broad reading could also restrict local governments' use of their shares of the penny increase in the state sales tax¹⁶¹ for revenue bond payments. Because the sales tax will add significant contributions to general funds,¹⁶² diversion of the tax could result

concerning \$1.9 million in public improvement bonds pledged race track funds and non-ad valorem funds for repayment. *Id.* § 12. The non-ad valorem funds were defined as "all funds of the County derived from sources other than ad valorem taxation, except that portion thereof constituting Race Track Funds as herein defined." *Id.* § 2.1 Compare *id.* with *Volusia County, Fla., Resolution No. 81-64* § 2F. Section 2F of the *Volusia County Resolution* is quoted *supra* note 126. The non-ad valorem funds pledged for repayment by both counties are very similar, yet the *Alachua County* bonds were validated by the circuit court, and validation was affirmed by the supreme court. See *State v. Alachua County*, 335 So. 2d 554 (Fla. 1976).

158. See *supra* note 46 and accompanying text.

159. See *supra* notes 38-42 and accompanying text.

160. Municipal funds are either general or special. 15 E. McQUILLIN, *supra* note 14, § 39.45.

161. Since October 1982, local governments in Florida have received funds equal to one-half of the one cent increase in sales tax collected in each county. FLA. STAT. § 212.82 (1983) (enacted as 1982 Fla. Laws 154, § 10).

162. See generally JOINT LEGISLATIVE MANAGEMENT COMM. & ADVISORY COUNCIL ON INTERGOVERNMENTAL RELATIONS, LOCAL GOVERNMENT FINANCIAL INFORMATION HANDBOOK, 8-14

in an increase of ad valorem taxes to cover the deficiency. This resulting increase could be considered an indirect pledge of ad valorem taxes, requiring referendum approval. The supreme court's denial of a rehearing in *Volusia County*¹⁶³ rendered the scope of the revenue bond exception doubtful; future bond validation cases will have to define the scope of the exception.

Volusia County illustrates not only the uncertain scope of the revenue bond exception but also the consequences of the inflexible restraints imposed on local government debt management. One consequence of these restraints is an increased cost of borrowing. Revenue bonds generally carry higher interest costs than general obligation bonds with comparable covenants.¹⁶⁴ Because revenue bonds are less secure than general obligation bonds backed by the issuer's taxing power,¹⁶⁵ higher interest rates are necessary to compensate investors for the added risks.¹⁶⁶ Studies have calculated the interest rate differential between general obligation and revenue bonds to range from 0.25 to 1.25 percent.¹⁶⁷ For example, with an interest rate differential of 0.8 percent on a \$100 million, forty-year maturity issue, the annual additional cost would be \$800,000.¹⁶⁸ The total additional cost of using revenue bonds rather than general obligation bonds would be \$3,200,000.¹⁶⁹

The issuer of revenue bonds also incurs other additional costs. The fees of financial advisors and bond counsel increase because they must analyze the legality and sufficiency of each revenue source pledged.¹⁷⁰ Furthermore, additional time is required to negotiate the revenue bond covenants that make the bonds more marketable by providing adequate security to bondholders.¹⁷¹ At the same time, the covenants must give the issuer adequate flex-

(July 1982) (official projections for local government shares of half-cent sales tax in 1982-1983).

163. 417 So. 2d 968, *reh'g denied*, 417 So. 2d 968 (Fla. 1982).

164. A. HEINS, CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT, 36 (1963); Quirk & Wein, *A Short Constitutional History of Entities Commonly Known as Authorities*, 56 CORNELL L. REV. 521, 569 n.286 (1971).

165. See generally Note, *Creditors' Remedies in Municipal Default*, 1976 DUKE L.J. 1363 (discussing limitations on general obligation bondholders' remedies in case of default).

166. In 1957, the average interest cost for state general obligation bonds was 3.22%, while that for state revenue bonds was 3.78%. A. HEINS, *supra* note 164, at 39.

167. Gelfand, *supra* note 4, at 560.

168. A. HEINS, *supra* note 164, at 48-49.

169. *Id.*

170. Rankin, Osburn & Rogers, *Municipal Bonds and Property Tax Limitations*, 9 ENVTL L., 453, 467 (1979).

171. *Id.*

ibility to operate the facility and to anticipate future needs.¹⁷²

The referendum requirement also constrains local government officials in assessing the current capital needs of the community and developing rational debt policies to meet those needs on a priority basis. A community could more readily finance low priority bridge construction that would be secured by tolls than it could finance a pressing community need for a non-revenue generating facility such as a jail. A putative purpose of the referendum requirement is to prevent public managers from over-issuing general obligation bonds to finance projects that create attractive short-term results, but unmanageable long-term debt. Studies indicate, however, that managers with unrestricted borrowing power have been no less responsible than managers with restricted borrowing powers.¹⁷³

As *Volusia County* demonstrates, voters often are unaware of the financial consequences of their decisions. In that case, general obligation bonds, with their lower interest costs, would have been the preferable debt instrument for financing the jail.¹⁷⁴ Revenue bonds, though carrying increased interest costs, would still spread the debt burden among taxpayers for the life of the bonds.¹⁷⁵ Once these options were eliminated, the county considered pay-as-you-go financing of the jail, using revenue from the penny increase in the state sales tax.¹⁷⁶ Ironically, voters unwilling to incur part of the cost of general obligation financing would ultimately bear the entire cost with pay-as-you-go financing.

In addition to revenue bond and pay-as-you-go financing, another method of financing capital improvements without voter approval is by special assessments.¹⁷⁷ The supreme court consistently has maintained that assessments for special benefits are similar to,

172. *Id.*

173. A. HEINS, *supra* note 164, at 59.

174. Ironically, ten years ago Volusia County could have financed a new jail without voter approval under the essential government needs exception. *See* *Tapers v. Pichard*, 124 Fla. 549, 169 So. 39 (1936); *see also supra* note 112.

175. *See supra* notes 16-17 and accompanying text.

176. *Daytona Beach Morning Journal*, June 11, 1982, at B1, col. 1. The county expected to receive \$3 million in additional revenue from its annual share of the state sales tax increase. *Id.*

177. FLA. CONST. art. VII, § 6 provides in part:

(a) Every person who has the legal or equitable title to real estate and maintains thereon the permanent residence of the owner, or another legally or naturally dependent upon the owner, shall be exempt from taxation thereon, *except assessments for special benefits*, up to the assessed valuation of five thousand dollars

but not the same as, ad valorem taxes.¹⁷⁸ An ad valorem tax is an annual levy for the general operation of local government and is measured by the assessed valuation of property and current millage rates.¹⁷⁹ Assessments for special benefits are fixed amounts assessed against benefited property for specific improvements; these assessments are apportioned on a front footage or acreage basis without regard to ad valorem valuation.¹⁸⁰

Because special assessments levied for repayment of bonds are distinguishable from ad valorem taxes, voter approval is not required.¹⁸¹ For example, in *Lake Howell Water and Reclamation District v. State*,¹⁸² assessments were pledged for revenue bonds to finance drainage and reclamation improvements within the district. The supreme court stated that the special assessments represented a fixed lien upon property in the drainage district.¹⁸³ Once the special assessment was paid, the property owner was not responsible for any future payments on the drainage bonds.¹⁸⁴ If the bonds were supported by ad valorem taxes, however, the property owner would be subject to recurring ad valorem levies until the bonds were fully paid.¹⁸⁵ The court held that, because assessments for special benefits are not ad valorem taxes, the drainage bonds did not require voter approval.¹⁸⁶

The supreme court has also upheld the validity of street improvement bonds that were issued without voter approval and were secured by special assessments against the private property to be benefited.¹⁸⁷ With one-fourth of Florida's roads in need of resurfacing or repair,¹⁸⁸ this device for circumventing the referendum requirement may be increasingly used. In effect, capital improvements directly benefiting property may be financed with bonds paid by "assessments" based on property acreage or frontage, and no referendum is necessary. If, however, such bonds are financed

178. See *Fisher v. Board of County Comm'rs*, 84 So. 2d 572, 579 (Fla. 1956); *City of Fort Lauderdale v. Carter*, 71 So. 2d 260, 261 (Fla. 1954); *City of Orlando v. State*, 67 So. 2d 673, 674-75 (Fla. 1953). See generally Note, *Special District Taxation*, 13 U. FLA. L. REV. 531, 548-51 (1960) (discussing homestead exemption and special assessments).

179. *Fisher v. Board of County Comm'rs*, 84 So. 2d 572, 579 (Fla. 1956).

180. *Id.*; *Klemm v. Davenport*, 100 Fla. 627, 631, 129 So. 904, 907 (1930).

181. See cases cited *supra* note 178.

182. 268 So. 2d 897 (Fla. 1972).

183. *Id.* at 899.

184. *Id.*

185. *Id.*

186. *Id.*

187. See, e.g., *City of Orlando v. State*, 67 So. 2d 673 (Fla. 1953).

188. Gainesville Sun, Oct. 8, 1982, at A4, col. 1.

by "taxes" based on property valuation, then voter approval is required.

IV. RECOMMENDATIONS

The 1968 Florida Constitution expanded the home rule powers of both counties and municipalities by giving local governments more control over local affairs.¹⁸⁹ Since then, implementation of home rule powers has resulted in a functional and structural strengthening of local government.¹⁹⁰ Noticeably missing, however, has been a concomitant delegation of "fiscal home rule" powers.¹⁹¹ Fiscal home rule would allow elected local officials to make the financial decisions for the municipality.¹⁹² Although several constitutional provisions currently inhibit the fiscal home rule powers of local government, the referendum requirement of article VII, section 12 remains the major restraint.¹⁹³

One way to increase the fiscal home rule powers of local governments would be to amend section 12 to allow a permissive, rather than a mandatory, referendum for general obligation bonds.¹⁹⁴ Under a permissive referendum system, after the gov-

189. See FLA. CONST. art. VIII, § 1(f)-(g) comment. See generally Sparkman, *The History and Status of Local Government Powers in Florida*, 25 U. FLA. L. REV. 271 (1973) (concluding that continuing resistance to home rule has hindered the success of attempts to reorder legislative power relationships); Note, *Charter County Government in Florida: Past Litigation and Future Proposals*, 33 U. FLA. L. REV. 505 (1981) (recommending further delineation of the legislative intent behind expansion of home rule powers and harmonization of the overlapping philosophies of county and municipal home rule). The concept of "home rule" involves the transfer of certain state governmental powers to local governments in matters of local concern. *Id.* at 508.

190. Morell, *supra* note 178, at 1-2.

191. *Id.*

192. Gelfand, *supra* note 4, at 586.

193. See *supra* note 31.

194. A 1961 study conducted by the U.S. Advisory Commission on Intergovernmental Relations arrived at a similar conclusion in one of their five recommendations:

The Commission recommends that authority to issue bonds should be legally vested in the governing bodies of local governments, subject to a permissive referendum only, on petition, and with participation in any such referendum available to all eligible local voters and the results determined—except under unusual circumstances—by a simple majority vote on the question.

ACIR, LOCAL DEBT, *supra* note 13, at 72; see Bowmar, *supra* note 22, at 899; Schilling, Griggs & Ebert, *supra* note 36, at 556-57 (additional recommendations for permissive referendums).

The permissive referendum concept is consistent with the Model County and Municipal Bond Law. The introduction to the Model Law states that a permissive referendum "tends to stimulate more critical alertness on the part of the electorate than does the provision for mandatory referenda—which frequently receive only perfunctory attention." NATIONAL MUNICIPAL LEAGUE, A MODEL COUNTY AND MUNICIPAL BOND LAW ix (1953).

erning body adopted a bond resolution, electors would have a set time period within which to file a petition requesting a referendum on the bond issue.¹⁹⁵ The bond resolution would then become effective only when approved by a majority vote at a special election or at the next general election. Detailed notice of proposed bond issues¹⁹⁶ and open meeting requirements¹⁹⁷ could restrain potential borrowing abuses. The political process would serve as a further restraint, as the local media subjects local government action to intense scrutiny, and elected officials seeking reelection must answer regularly to their constituents.¹⁹⁸

In addition to procedural and political restraints, the municipal bond market¹⁹⁹ could provide a further check on potential fiscal irresponsibility under a permissive referendum system. Under current market procedure, financial advisors²⁰⁰ carefully

195. Referendum petitions would require signatures numbering at least 20% of the votes cast in the last gubernatorial election.

196. *E.g.*, Wis. STAT. § 67.05(3) (1981) (providing for notice of bond resolution to be published at least twice a week for sixty days in the local newspaper).

197. *E.g.*, *id.* §§ 19.81-98 (open meeting requirements for state and local governmental bodies).

198. See Schilling, Griggs & Ebert, *supra* note 36, at 556.

199. Some analysts suggest that the structure of the municipal bond market is in need of reform. A narrow base of investors who need tax-exempt income, combined with increasing demand for long-term borrowing, could lead to tighter credit and higher municipal bond interest rates. Bagwell, Evans & Nielsen, *supra* note 8, at 216. One proposal suggests the creation of a taxable bond option (TBO). *Id.* at 236-38. With TBOs, local governments could issue bonds that are not exempt from federal taxation and could receive a subsidy from the federal government to offset the higher interest costs. *Id.* at 236. Proponents claim the TBO concept would broaden the range of municipal bond investors. *Id.* For further discussion of reform proposals and their effect on the bond market, see Article, *Reform of the Municipal Bond Market: Alternatives to Tax-Exempt Financing*, 15 COLUM. J.L. & SOC. PROBS. 233 (1980).

200. The local government issuer employs financial advisors to analyze the credit needs of the community, develop a bond issue, assist in selecting an underwriter, and work with the rating agencies. PUBLIC SECURITIES ASS'N, *supra* note 11, at 34. In Florida, local governments use various methods for choosing financial advisors. Some municipalities use one financial advisor for all issues in the belief that an advisor who knows the status and details of that community's debt offers better services. Other local governments accept financial advisors chosen by the finance officer or a committee of local officials. Large governments develop a long-term relationship with advisors specializing in the type of bond issued. ACIR, FLA. LOCAL DEBT, *supra* note 3, at 52.

The duties of the financial advisors overlap with those of the dealer, who engages in the underwriting, trading, and sale of municipal bonds. PUBLIC SECURITIES ASS'N, *supra* note 11, at 35. In 1980, there were approximately 1800 dealers and dealer banks registered with the Securities and Exchange Commission, with about one-third of those being active. *Id.* at 65. Federal law prohibits commercial banks from underwriting municipal revenue bonds. 12 U.S.C. § 378 (1976).

Underwriting—the purchase of municipal bonds for resale to the public—is done on a competitive or negotiated basis, depending on the type of the bonds. Greenberg, *supra* note

scrutinize the economic and administrative health of a community, while bond counsel²⁰¹ assures the legal sufficiency of the proposed issue. The rating agencies further analyze the municipality's past and present debt service capacity.²⁰² Dealers and underwriters use rating agency data,²⁰³ along with opinions from their own research staffs, in submitting bids for the proposed general obligation bonds, with the issuer choosing the bid with the lowest interest cost. Because underwriters must pay their bid price regardless of later success in reselling the bonds to investors,²⁰⁴ they must carefully evaluate both the bonds' marketability and the issuer's fiscal capacity.

If the interest cost of the proposed bond issue reflected dimin-

9, at 357-61. Bonds issued by competitive bids are awarded to the dealer who submits the lowest net interest cost bid to the issuer. Underwriters form a group or syndicate to determine interest rates, time structure, and yields of the bonds to investors. *Id.* at 357. If a dealer believes the interest rate is inappropriately priced, making resale of the bonds difficult, that dealer may withdraw from the syndicate. *Id.* at 357-58. Most general obligation bonds are underwritten by a competitive bidding process, with both dealers and dealer banks participating. PUBLIC SECURITIES ASS'N, *supra* note 11, at 36. For a discussion of general obligation bonds, see *supra* note 48 and accompanying text. With negotiated offerings, there is no competitive bidding, and the issuer chooses one syndicate to sell the bonds. Local governments use negotiated offerings when issuing revenue bonds. PUBLIC SECURITIES ASS'N, *supra* note 11, at 36. For a discussion of revenue bonds, see *supra* note 49 and accompanying text.

201. Municipal bonds are accompanied by a legal opinion of the bond counsel that addresses two main issues: (1) whether the bond resolution authorizing the sale of the bond satisfies the requirements of the state constitution, statutes, case law, local charters, and enabling legislation; and (2) whether the interest income from the bonds is exempt from federal taxation. PUBLIC SECURITIES ASS'N, *supra* note 11, at 32. The bond counsel compiles all documents that verify the legality of an issue into a "transcript of proceedings." This transcript contains the documents required by bondholders to enforce their rights under the bond. *Id.* While the bond counsel normally drafts the bond ordinance and transcript, the local attorney is still considered the representative of the interests of the local government. ACIR, FLA. LOCAL DEBT, *supra* note 3, at 54.

202. See *supra* note 50 and accompanying text.

203. For a discussion of problems that arise when financial advisors who assist in developing the bond issue also act as underwriters by purchasing the bonds, see Magnusson, *Municipal Bond Buying by Fiscal Advisors*, 15 BUS. LAW. 393 (1960).

204. Greenberg, *supra* note 9, at 356. Two types of syndicate accounts prevail in different parts of the country. In an "Eastern syndicate," which is commonly used in major trade centers of the east and west coasts, the dealer members of the syndicate are undivided as to sales and liability. PUBLIC SECURITIES ASS'N, *supra* note 11, at 69. Because an Eastern account is undivided as to sales and liability, syndicate members can trade any of the bonds in the account as long as the bonds are available, but they will be liable for a proportionate share of any bonds remaining unsold. *Id.* at 69-70. In a "Western syndicate," which is predominantly used throughout the midwestern states, participating underwriters are assigned a portion of the bonds. A Western syndicate is divided only as to liability, not as to sales; therefore, a syndicate member's liability terminates upon selling the assigned portion of bonds. *Id.* at 70.

ished financial capacity of the issuer, then the bond issue could be reconsidered by mandatory referendum. The standard reference might be an average of net interest costs of the issuer's immediately preceding general obligation bonds.²⁰⁵ Interest costs that exceed a specified percentage above this average would require a mandatory referendum. In keeping with fiscal home rule principles, these standards should be determined by the local governing body, not by a uniform state statute.

Since the New York City crisis, when the mixing of different accounting bases concealed mounting deficits,²⁰⁶ there has been a recognized need for standardized municipal accounting procedures.²⁰⁷ The Florida Legislature recently responded to this need by enacting mandatory guidelines for annual financial reports by local governments.²⁰⁸ The guidelines require that reports be prepared according to generally accepted government accounting principles and that they follow United States Bureau of Census standards for providing information necessary to assess the financial condition of local governments.²⁰⁹ This upgrading in financial information procedures could both assist bond analysts in calculating accurate interest rates and aid voters in deciding whether to petition for a bond referendum.²¹⁰

Several studies have suggested the creation of a state administrative agency to oversee local government financing, particularly the issuance of bonds.²¹¹ Such an agency could, however, result in a backdoor intrusion on fiscal home rule. In Louisiana, for example, approval by a state agency is required before a local government

205. The U.S. Advisory Commission on Intergovernmental Relations recommends that states regulate local government long-term borrowing by setting statewide interest cost standards indexed to current interest rates for high quality municipal securities. ACIR, *LOCAL DEBT*, *supra* note 13, at 77-82. Such an approach, however, would not accurately reflect individual community debt capacity.

206. Gelfand, *supra* note 4, at 584.

207. See generally Lodal, *Improving Local Government Financial Information Systems*, 1976 DUKE L.J. 1133 (arguing for broadbased reform in local governments' financial management information systems); Petersen, Doty, Forbes & Bourque, *Searching for Standards: Disclosure in the Municipal Securities Market*, 1976 DUKE L.J. 1177 (discussing disclosure by municipal issuers and the possible applicability of federal securities laws to municipal securities transactions).

208. See FLA. STAT. § 218.32 (1983).

209. *Id.* § 218.32(1)(b).

210. Upgrading financial information systems would also assist municipal managers in planning, control, management, and external reporting. Lodal, *supra* note 210, at 1138.

211. See, e.g., ACIR, *FLA. LOCAL DEBT*, *supra* note 3, at 36; ACIR, *LOCAL DEBT*, *supra* note 13, at 82; Gelfand, *supra* note 4, at 601-06.

can issue bonds.²¹² Other states have created state boards with limited advisory powers with respect to local borrowing practices.²¹³ Fortunately, Florida followed the latter approach, by establishing in 1979 the Division of Bond Finance, which serves as a clearing house for information on all local bond issues.²¹⁴ Because a default on bonds in one city could adversely affect bond interest rates paid by other local governments, complete descriptions of all outstanding bonds and recent issues must be reported to the Division of Bond Finance.²¹⁵ Failure to comply with this statutory requirement could result in the state's withholding funds from the negligent local government.²¹⁶

A final restraint on possible abuses under a permissive referendum system is the limitation on local governments' taxing powers found in article VII, section 9 of the Florida Constitution.²¹⁷ Under section 9, counties, municipalities, and school districts are limited to maximum ad valorem levies of ten mills each.²¹⁸ Although this millage cap is contrary to fiscal home rule principles, the current climate of property tax revolt makes its repeal unlikely.²¹⁹ Furthermore, retention of section 9 could facilitate the fu-

212. LA. CONST. art. VI, § 33(A). If the bonds are issued to refinance outstanding indebtedness at the same or at a lower rate of interest, they need not be authorized at an election if the indebtedness is paid or cancelled on delivery of the funds or if authorized funds are set aside explicitly for that purpose. *Id.*

213. The Virginia Legislature created a state commission on local debt composed of the Auditor of Public Accounts, State Treasurer, State Tax Commissioner, Comptroller, Assistant Secretary for Financial Policy, and two other members appointed by the Governor. The commission, only upon request, advises local officials in planning, preparing, and marketing municipal bonds. VA. CODE § 15.1-173 (1981).

214. *See* FLA. STAT. § 218.37 (1983) (originally enacted as 1979 Fla. Laws 79-183, § 6). The duties of the Division include providing information on planning bond issues, commissioning studies on reducing the costs of bond issues, recommending changes in the law to improve the sale and servicing of local bonds, and providing the Department of Banking and Finance with current information on outstanding bonds and new issues. *Id.* § 218.37(1)(a), (d), (e), (h). The statute also provides for creation of an advisory council consisting of representatives from municipal banking, local government units, and the general public. *Id.* § 218.37(3)(a)-(c).

215. FLA. STAT. § 218.38(1)(a) (1983).

216. *Id.* § 218.38(3)(a).

217. *See* FLA. CONST. art. VII, § 9.

218. *See supra* note 26.

219. *See supra* notes 5-6 and accompanying text. Recent bond elections, however, indicate that voters may be retreating somewhat from the tax revolt stance of the 1970's. Wall St. J., Nov. 4, 1982, at 44, col. 1. More than three billion dollars in municipal bonds were approved in elections in November 1982. While New Jersey voters approved a \$170 million jail bond proposal, Rhode Island voters rejected an \$8.5 million prison bond issue. One market analyst felt voters recognized the need for capital improvements and realized that "you get what you pay for." *Id.* Another attributed the New Jersey bond's success to the high

ture amendment of section 12 by giving voters constitutional assurance that property taxes would not escalate as a result of the permissive referendum for general obligation bonds.

Despite the advantages of a permissive referendum system restrained by procedural requirements, the political process, the bond market, and the constitution, the tax revolt climate may nevertheless inhibit the legislature and the electorate in approving amendment of section 12. In that event, the courts should assume responsibility for implementing fiscal home rule powers by continuing to recognize the revenue bond exception to the referendum requirement. Although section 12 offers illusory protection²²⁰ by requiring voter approval for only general obligation bonds, this inconsistency should not be remedied by bringing revenue bonds within the scope of the referendum requirement. Such a proposal would contradict fifty years of precedent through which the revenue bond exception evolved and would severely restrict local government financing of capital improvements.²²¹ Instead, the courts should liberally interpret the revenue bond exception and should allow the political process and the municipal bond market to function as restraints.

Expansion of the revenue bond exception should effectively halt the encroachment on local governments' discretionary power to pledge non-ad valorem sources for non-revenue generating facilities. Accordingly, to prevent such encroachment, *Volusia County* should be narrowly interpreted as merely requiring local governments to specify which non-ad valorem sources have been pledged.²²² Local officials should have the discretion to allocate general fund revenues on a priority basis. For example, public managers should be able to eliminate nonessential programs from the operating budget in order to fund bond payments for critical projects, such as federally mandated jail improvements. This dis-

unemployment rate, with voters believing government spending would create new jobs. *Id.*

220. See *supra* notes 113-18 and accompanying text.

221. Assuming that the capital improvements are necessary to provide adequate community services, they will have to be made at some future point. When construction finally occurs, the cost is likely to be higher than it would have been under the original schedule. Furthermore, inadequate maintenance on existing capital plants will increase the overall cost of maintaining and replacing such plants.

222. If *Volusia County* remains law, the issuers should refrain from promising to maintain programs and services that generate revenue, as this was one aspect of the case that troubled the supreme court. The courts should not interpret *Volusia County* as requiring voter approval when large amounts of non-ad valorem sources are diverted from municipal operating expenses to revenue bond payments. Instead, the courts should consider the principles of *Medley* as unaffected by *Volusia County*.

cretion should include allowing local governments to use the penny increase in the state sales tax for revenue bond pledges.²²³

If the supreme court rejects this more liberal interpretation of the use of non-ad valorem funds, then it should at least define the boundary between an incidental effect on and an indirect pledge of ad valorem taxes.²²⁴ In defining that boundary, the court should refrain from creating a test that makes the fiscal feasibility of proposed bonds and the economic sufficiency of each pledge conditions for validation of a bond issue. As the supreme court has consistently ruled, questions of business policy and judgment related to proposed bond issues should be resolved by the issuer, not the judiciary.²²⁵

Any future questions about the validity of pledging regulatory and user fees for revenue bonds should follow the approach of the dissent in *Volusia County*.²²⁶ If the fees do not exceed the reasonable cost of regulation, local governments should be able to pledge such fees even if the project is unrelated to the source of the fees.²²⁷ Thus, for example, a scheme that pledges tolls from a bridge that has paid for itself to finance a recreation center would be invalid. The invalidity would not result because bridge tolls are unrelated to recreation centers; rather, continuing to charge bridge users a toll that exceeds bridge operating costs would be an unreasonable fee for using the bridge.

V. CONCLUSION

An examination of the restrictions on local government debt financing imposed by the referendum requirement of article VII, section 12 of the Florida Constitution reveals that the revenue bond exception to the referendum requirement has, over time, increased in scope and use by local governments. As a result, section 12 has become an anachronism offering only illusory protection against irresponsible debt financing. The supreme court's recent attempt to narrow the revenue bond exception has only resulted in confusion. The uncertain future of use of revenue bond financing, combined with the continuing referendum restrictions on general obligation bonds, has curtailed local governments' ability to develop flexible, efficient debt policies.

223. See *supra* notes 161-62 and accompanying text.

224. See *supra* note 100 and accompanying text.

225. See *supra* note 44 and accompanying text.

226. See *supra* notes 144-55 and accompanying text.

227. See *supra* note 153 and accompanying text.

To promote fiscal home rule principles, the Florida Legislature and voters should amend section 12 to allow permissive referenda for general obligation bonds. Local governments' fiscal integrity would be maintained through the political process and the municipal bond market. In the alternative, the courts must allow greater flexibility to local governments in pledging non-ad valorem sources for financing both revenue and non-revenue generating facilities. Such an implementation of fiscal home rule powers would promote the efficient use of both general obligation and revenue bond financing to meet the present and future capital needs of communities in Florida.