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Federal Emergency Administration of Public Works

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INDIANA MUNICIPAL REVENUE BOND FINANCING

By ADOLPH H. ZWERNER

HISTORICAL BACKGROUND

The issuance of revenue bonds¹ in the United States as a method of municipal financing of public projects is comparatively new, and considerably more recent in Indiana.

Reliable authority² has suggested the probability that many centuries ago increasing thought was given to the fact that certain types of public improvements are, by reason of the character of their services, not only desirable but economically sound on the strength of their ability to self-liquidate. The essential characteristics and purposes of modern revenue bond financing may be considered as a natural outgrowth of the realization of this factor. An equally important factor, however, which gave rise to municipal revenue bond financing in the United States is the constitutional restrictions and limitations on municipal indebtedness. The continual and growing demand for the lessening of the property tax burden and the resultant enactment of legislation limiting property tax levies have added to the desirability of the revenue bond as a medium of financing various income-producing types of municipal enterprises.

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¹The present use of the term revenue bond refers exclusively to special obligations of political subdivisions, municipal and public corporations which are payable solely from the revenues of an income-producing public project or system and issued for the purpose of financing the acquisition, construction, extension or improvement of such project or system. The term expressly excludes any reference to revenue bonds in the sense of general obligations, special taxing district obligations, short-term bonds, notes, special assessments or warrants issued in anticipation of general or other ordinary public revenues.

England and Scotland used the revenue bond theory for public financing much earlier than did the United States; municipal ownership of gas plants, street tramways, electric lighting systems, etc., was accomplished by means of revenue bond financing. Likewise, port and harbor authorities (Leith Dock Commission, Clyde Navigation Trust, Dundee Harbour Commission, and the Glasgow Harbour Commission) issued revenue bonds of a type similar to the modern American issues. The first municipal gas works in England was established at Salford in 1817, Salford being at that time a part of Manchester. The original cost of the gas works was paid by taxation but subsequent authority was granted to incur indebtedness secured by the gas works and its rates and profits. The receipts from the enterprise were used “to meet all costs, charges, and expenses of keeping up and carrying on the works and of making good all damages and injury due to laying of mains and pipes; interest on borrowed money and mortgages; sinking fund payments as required by law; such other charges as the Council may fix for the improvement of the City.”

The Constitutional Debt Question

The extravagant spending of the Reconstruction Era, following the Civil War, caused the appearance of many of the constitutional provisions limiting debts of municipalities. Indiana fell in line and by constitutional amendment political

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3 For a comprehensive discussion of present day Authority legislation and this subject generally, see Article, Revenue Financing of Public Enterprises, 35 Mich. L. Rev. 1-43 (November, 1936), by Mr. E. H. Foley, Jr., General Counsel, Federal Emergency Administration of Public Works.

4 Note 2, supra.

5 Article 13, Indiana Constitution. "No political or municipal corporation in this State shall ever become indebted in any manner or for any purpose to an amount in the aggregate exceeding two per centum on the value of the taxable property within such corporation, to be ascertained by the last assessment for State and county taxes, previous to the incurring of such indebtedness; and all bonds or obligations, in excess of such amount, given by such corporations, shall be void: Provided, That in time of war, foreign invasion, or other great public calamity, on petition of a majority of the property owners, in number and value, within the limits of such corporation,
cal and municipal corporations are prohibited from incurring indebtedness in the aggregate exceeding two per centum on the value of the taxable property within such corporation. On January 16, 1877, one estimate placed the aggregate indebtedness of Indiana cities, counties and townships at $20,000,000, bearing an average interest of nine per cent., per annum. The demand for restrictions on the spending of the taxpayers' money was, without question, justified. An editorial appearing in the Indianapolis Journal, January 24, 1877, a few days following the introduction by Senator Harris of a Joint Resolution proposing a constitutional amendment designed to prohibit forever the use of public funds in aid of the public authorities, in their discretion, may incur obligations necessary for the public protection and defense, to such an amount as may be requested in such petition. This amendment, among others, was proposed by Joint Resolution of the General Assembly of 1877, and by an Act of the General Assembly of 1879 (Chap. 11, Acts, 1879), and first submitted to the voters on April 5, 1880, and again on March 14, 1881. See In Re Todd, 208 Ind. 168, 193 N. E. 865.

The Indianapolis Journal, January 16, 1877, editorial entitled "Laws for Municipal Indebtedness". From this article it clearly appears that much of the municipal indebtedness so estimated was the result of public financial aid to improvements such as railroads, etc. Concerning legislation authorizing public financial aid to railroads, the editorial stated: "Then there is neither justice nor equity in this legislation. By one law it is provided that counties or townships may make donations to railroads to the amount of two per cent of their taxable property on a vote of a majority of the legal voters of such township or county. This leaves it in the hands of men not owning one dollar's worth of property, and paying no taxes, to vote a tax upon the resident property-holders that may be the means of absolutely robbing them of their property. There is no justice in this. Then another law provides that cities may make donations to railroads without limit upon the petition of a majority of the resident freeholders of such city. * * * These laws were loosely drawn and hastily passed. They were, in fact, lobbied through by men who wanted to set themselves up in the railroad business at somebody else's expense. They have involved the people of the state in an indebtedness which is fearful to contemplate, and which, if it was a state debt, would be more fully understood and dreaded. * * * We are borne down with the fruits of these laws in the way of debt and taxation, and we appeal to the intelligent Legislature to make a clean sweep of the whole business by repealing these laws and placing before the people a constitutional amendment prohibiting their re-enactment. Give the people a chance to speak upon this subject; it is but fair and just that such opportunity be given."
of any person, association or corporation, appears to have expressed the opinion of the day:

"No measure likely to come before the present Legislature is of more importance than the constitutional amendment proposed by Senator Harris for preventing counties, townships, and cities from incurring debt by becoming interested as stockholders in or donors to any railroad or other corporation. Municipal indebtedness is the great curse of this country. The aggregate amount owed by the principal corporations of the United States is simply fearful. The mountainous load is crushing the life out of industry and commerce. The burden of interest is doing more than any and all other causes combined to retard the prosperity of the country. The power to further increase this indebtedness must be curtailed. The amendment proposed to the organic law should be promptly passed, and when it comes before the people in due course it will be adopted by an overwhelming majority."

While there were political differences concerning the wisdom and necessity of the other constitutional amendments submitted at the time, it is quite evident that both major parties definitely favored restrictions and limitations on municipal debts. The article quoted above was the view of a Republican newspaper. The Democratic organ of Indianapolis, The Indianapolis Daily Sentinel, on January 4, 1877, made the following editorial comment:

"The Legislature of Indiana convenes to-day in regular session. It meets at a time when business is prostrated, when the political outlook is dark, and the future uncertain. But it convenes when the health of the people is good, when the barns are filled with the products of the rich soil of the state, and when those products command a good price in the markets of the world. * * * The Legislature will have to consider several matters of much public interest. * * * The rate of taxation should be limited in towns and cities as well as in counties, for experience has proven that the tendency is to the creation of debts and the taxation of the people to pay them. Debts should not be allowed in excess of two per cent of the taxable property of any county, town or city. * * *"

It is quite obvious, therefore, that one of the principal questions usually presented to the courts in cases involving the validity of revenue bonds is whether or not such obliga-
tions constitute debts within the meaning of the constitutional provisions relating to municipal indebtedness.

The First Revenue Obligations in the United States and the Origin of the Special Fund Doctrine

The first court of last resort in this country which was called upon to determine the validity of municipal revenue obligations was the Supreme Court of the State of Washington, when in 1895, it held valid certain obligations of the City of Spokane, *Winston v. City of Spokane.* In that case, the City of Spokane had adopted an ordinance authorizing the city to borrow money for the purpose of completing a waterworks system and to issue obligations payable out of a special fund to be created by sixty per cent of the receipts of the waterworks system. The city had already reached its constitutional limit of indebtedness. The court held that the obligations were not debts of the municipality within the meaning of the constitutional limitation, citing *Baker v. City of Seattle,* which held that warrants issued to a contractor for street improvements and payable out of a special fund to be created by an assessment against benefited property were not an indebtedness of the City of Seattle within the constitutional limitation. The court also relied on the reasoning of *City of Valparaiso v. Gardner.* The Spokane case did not involve a pledge of revenues which the city had previously been using to defray ordinary municipal expenses, neither was the general credit of the city in any manner pledged. The obligations in question were issued for the purpose of completing the construction of a new waterworks. The obligations so issued by the City of Spokane, so far as can be determined, were the first revenue obligations issued in this country and the decision of the Supreme Court of Washington sustaining the validity thereof originated the Special Fund Doctrine.

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712 Wash. 524, 41 P. 888 (1895).
97 Ind. 1.
The City of Joliet, Illinois, in 1901, indebted in excess of its constitutional limit, passed an ordinance (pursuant to statutory authority) providing for the extension and enlargement of its existing waterworks system and authorized the issuance of water fund certificates in an amount not to exceed $240,000. The ordinance provided that the entire proceeds of the waterworks system were to be paid into the water fund and that no expenditures were to be made from such fund except for necessary operating expenses of the system and principal and interest payments on the certificates. The certificates were secured by a mortgage or deed of trust on the waterworks system, including the proposed extensions, the mortgage providing that on foreclosure the purchaser had the right to operate the system for a period of fifty years. The city had realized a net annual income of $10,000 from the operation of the waterworks system. The Supreme Court of Illinois in *Joliet v. Alexander* held that the water fund certificates created an indebtedness of the city within the purview of the constitutional limitation and were void. While the fact that the obligations were additionally secured by mortgage was sufficient in the opinion of the court to make them debts of the city as contemplated by the constitutional provision, the court strongly indicated that the pledge of the revenues of the previously existing waterworks system would have been sufficient to constitute a debt. The court said: "In addition to mortgaging the existing system, the ordinance proposes to take the income now derived from it, amounting to about $10,000 a year and devote it to the payment of the certificates. This is existing property and income of the city derived annually from the present system of waterworks, independent of the extension, and in no manner resulting from or depending upon it. The city is to lose the property in the form of established income for the purpose of paying the certificates. If the city being indebted beyond the constitutional debt limit, can issue certificates payable out of that

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10City of Joliet v. Alexander, 194 Ill. 457, 62 N. E. 86. (But see Ward v. City of Chicago, 342 Ill. 167, 173 N. E. 810 (1930) as having overruled this case.)
fund without creating a debt, it would be equally within its power to issue obligations by pledging the fund derived from dramshop licenses or licenses from hackmen, peddlers, theaters or amusements, or any other funds of the city. * * * *"
The court considered the case of *Winston v. City of Spokane*, supra, and distinguished it on the ground that there the City of Spokane was not pledging revenues previously available for defraying general municipal expenses. The Supreme Court of Illinois in announcing this rule, which in effect was a *restriction* on the Special Fund Doctrine, expressly exempted its application to a mortgage purely in the nature of a purchase-money mortgage, payable wholly out of the income of property purchased or by resort to such property.11

In some states, the rule announced in the *Joliet v. Alexander* case, supra, has been adopted and the courts have held, or by dicta have indicated the view that obligations issued by a municipality to finance the construction of improvements or extensions to an existing revenue-producing system, where such obligations are made payable from the revenues of the system as improved or extended, constitute debts of such municipality within the meaning of constitutional provisions limiting municipal indebtedness or requiring that such indebtedness be approved at an election.12 The reasoning of such decisions is that if the revenues from the system as improved or extended are subject to the payment of the obligations, the municipality is being deprived of an existing source of revenue applicable to its general expenses which, because of such deprivation, must be met at least in part from some new source of income resulting in a resort to taxation. Hence, the new financial burden so necessarily imposed is held to

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11See, State ex rel. City of Excelsior Springs v. Smith, 336 Mo. 1104, 82 S. W. (2d) 37 (1935), which sustained the validity of municipal revenue bonds secured by a pledge of the revenues of a mineral springs project and a foreclosable mortgage on the real and personal property thereof.
make the obligations debts within the meaning of the particular constitutional provision involved.

The Special Fund Doctrine as originated by the Supreme Court of Washington has been more widely accepted as the sounder principle and is sustained by the greater weight of authority.¹³

The Supreme Court of Idaho appears to be the only court which has rejected the Special Fund Doctrine in relation to the financing of new revenue-producing enterprises.¹⁴

**Indiana and the Special Fund Doctrine**

Indiana has adopted the Special Fund Doctrine, although until the decision of the Supreme Court in 1923 in the case of *Fox v. Bicknell*,¹⁵ the inclination of the Supreme Court was toward the restricted theory as announced in the *Joliet v. Alexander* case, supra. The leading Indiana case, prior to the *Fox v. Bicknell* case, supra, was *Voss v. Waterloo Water Company* (1904).¹⁶ In that case much was said by the court on the subject of municipal indebtedness which seems to have been unnecessary since the decision of the court was made on the proposition that at the time the ordinances in question were adopted there was no existing statutory authority empowering the town to buy stock in the waterworks company or to finance such purchase by the issuance of its general obligation bonds. That Indiana has now adopted the Special

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¹⁵193 Ind. 537, 141 N. E. 222.

¹⁶163 Ind. 69, 71 N. E. 208.
Fund Doctrine there can be no question,¹⁷ Fox v. Bicknell, supra; Underwood v. Fairbanks, Morse & Company (1933); Indiana Service Corporation v. Town of Warren (1934); and Lentz Manufacturing Company v. Public Service Commission (1936).

Indiana Revenue Bond Legislation

While the Supreme Court has recognized/implied and inherent and necessarily broad power in cities and towns to furnish light and water and finance the cost thereof in a fairly discretionary manner (pledge orders payable only from the net revenues of the system), as far as can be determined, no revenue bonds have been issued in Indiana without statutory authority.

The first revenue bond act of Indiana was Chapter 96, Acts of 1921, which granted authority to cities and towns to purchase and acquire waterworks and finance the cost thereof by the issuance of revenue bonds. Since then the General Assembly has enacted a medley of revenue bond acts granting municipalities, political sub-divisions, and public corporate bodies authority to finance, by the issuance of revenue bonds, the construction of varied public improvements ranging from new waterworks systems and other utilities to university dormitories, recreation works, and even cemetery improvements. The labor of the recently adjourned Eightieth Regular Session of the General Assembly, likewise, has been productive of revenue bond legislation, the merits of which, of course, are yet to be determined. Synopses and references to the revenue bond legislation, including the first act of 1921 (but omitting the 1937 enactments), are:

(1) 1921 Chap. 96, Acts 1921, supplemented by Chap.


¹⁸Underwood v. Fairbanks, Morse & Company, supra.
56, Acts 1925, amended by Chap. 190, Acts 1927, which was again supplemented by Chap. 88, Acts 1929.\textsuperscript{19}

Authorizes any city, town or other municipal corporation, subject to the approval of the Public Service Commission, to issue revenue bonds to purchase and acquire, construct extensions, additions and improvements to waterworks to supply such city, town or municipal corporation and the inhabitants thereof with water for public and domestic use.

(2) 1925 Chap. 89, Acts 1925.\textsuperscript{20}

Authorizes the Board of Trustees of the Indiana State Normal School (now State Teachers College Board, Indiana State Teachers College and Ball State Teachers College) to construct dormitories and issue bonds payable from a primary fixed charge of the net income of such dormitories.

(3) 1927 Chap. 137, Acts 1927.\textsuperscript{21}

Authorizes the Trustees of Indiana and Purdue Universities and the Trustees of the Indiana State Normal School (now State Teachers College Board, Indiana State Teachers College and Ball State Teachers College) to erect, construct, equip, furnish, operate, control and manage dormitories and to finance the same by the issuance of bonds payable from the net income of the property and secured by mortgage of such property.

(4) 1929 Chap. 49, Acts 1929.\textsuperscript{22}

Authorizes the Trustees of Indiana and Purdue Universities and the Trustees of the Indiana State Normal School (now State Teachers College Board, Indiana State Teachers College and Ball State Teachers College) to erect, construct, complete, equip, furnish, operate, control and manage athletic field houses, gymnasiums, student unions and halls of music and to issue bonds secured by mortgages and the net income of such projects.

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{19}] 1048-5345 et seq., Burns, 1933.
\item[\textsuperscript{20}] 2028-5223 et seq., Burns, 1933.
\item[\textsuperscript{21}] 2128-5722 et seq., Burns, 1933.
\item[\textsuperscript{22}] 2228-5716 et seq., Burns, 1933.
\end{enumerate}
\end{footnotesize}
(5) 1929 Chap. 114, Acts 1929.23

Authorizes any county in the State of Indiana which borders on a river forming a boundary line between this state and any adjoining state to construct a highway bridge over and across such river and to finance the cost by the issuance of toll bridge revenue bonds, and provides for the establishment, as a corporate body, of a county bridge commission in such county.


Authorizes any city or town owning and operating unencumbered waterworks, supplying such city or town and the inhabitants thereof with water for public and domestic purposes, to construct extensions and improvements to such waterworks and to finance the cost thereof by the issuance of revenue bonds, subject to the approval of the Public Service Commission.

(7) 1932 Chap. 8, Acts 1932 (Special Session), which amends the Cities and Towns Act of 1905, Chap. 129, Acts 1905, as amended by Chap. 104, Acts 1911.25

Authorizes any city or town which shall determine to lease or purchase any defined utility to issue bonds payable solely from the income and revenue of such utility.


Authorizes every city and town to own, acquire, construct, equip, operate and maintain a sewage treatment plant or plants, intercepting sewers, outfall sewers, force mains, pumping stations, ejector stations and necessary appurtenances for the treatment, purification and disposal, in a sanitary manner, of the liquid and solid waste, sewage, night soil and industrial waste of such city or town, and to issue revenue bonds to pay the costs thereof. (See Chap. 152, Acts 1935, Secs. 68-501 et seq., Burns' Indiana Statutes 1933, which relates to stream pollution and makes the construction of sewage works, etc., mandatory in
certain cases and provides for the issuance of revenue bonds under Chap. 61, supra.)

(9) 1933 Chap. 85, Acts 1933.27

Authorizes cities, towns and counties, jointly and severally, to accept, construct, maintain, operate and improve or to cooperate with private corporations, associations or individuals in constructing, maintaining, operating and improving auditoriums, recreation buildings and works, and to issue revenue bonds to finance the cost thereof as a self-liquidating project.


Authorizes cities of the first class (Indianapolis) to issue utility revenue bonds payable solely and exclusively from the income and revenues of such utility, as defined, with which to provide funds to pay for the acquisition of any utility property (Indianapolis Gas Works), to redeem or extinguish the capital stock of any utility, etc., and to make necessary betterments, improvements, extensions or additions to such utility property.


Authorizes any municipality (city or town), without the consent or control of any department, bureau or commission other than the municipal council of the municipality, to own, lease, erect, establish, purchase, condemn, construct, acquire, hold and operate any utility, and to finance the cost thereof by the issuance of revenue bonds.

(12) 1933 Chap. 235, Acts 1933.30

Authorizes any city or town owning and operating a waterworks to create a department of waterworks and issue revenue bonds, subject

2748-2601 et seq., Burns, 1933.
2848-7119, Burns, 1933.
2954-105 et seq., Burns, 1933.
3048-5301 et seq., Burns, 1933.
to the approval of the Public Service Commission, to finance the construction of extensions, additions, betterments and improvements thereto.

(13) 1933 Chap. 259, Acts 1933.\textsuperscript{81}

Authorizes any city of the fifth class owning and operating unincumbered waterworks, supplying such city and the inhabitants thereof with water for public and domestic use, to issue revenue bonds, subject to the approval of the Public Service Commission, to finance the construction of extensions, additions and improvements to such system.

(14) 1935 Chap. 53, Acts 1935.\textsuperscript{82}

Authorizes the Trustees of Indiana University to borrow money for the construction, equipment, furnishing or repair of any building to be used for University purposes and to issue bonds secured by mortgages and a pledge of the income from the use of such buildings.

(15) 1935 Chap. 242, Acts 1935, amended Chap. 84, Acts 1933.\textsuperscript{83}

Authorizes any city which owns or has the management or control of any cemetery or cemeteries to transfer the management, control and maintenance thereof to a board which is declared to be a body corporate and politic and authorizes the issuance by such board of revenue bonds as provided by Chapter 61, Acts 1932 (Special Session), supra.

All of the above mentioned act, with the exception of 2 and 14, expressly provide that, in case of cities, towns and counties, the issuance of revenue bonds so authorized shall not create or constitute debts within the meaning of the constitutional provision and limitation relating to municipal indebtedness. In the case of state educational institutions, 3 and 4, the statutes stipulate that the indebtedness, bond or obligation authorized shall not be an indebtedness or liability against the state, nor a lien or charge against the property or funds of the respective corporations, except to the extent

\textsuperscript{81} 148-5441 et seq., Burns, 1933.
\textsuperscript{82} 228-5336 et seq., Burns, 1933, Pocket Supp.
\textsuperscript{83} 848-6023, Burns, 1933, Pocket Supp.
of the property or income pledged or mortgaged.\textsuperscript{34}

Some of the acts make no provision for the negotiability of the securities authorized. However, the more carefully drawn acts\textsuperscript{35} provide that the bonds shall have all the qualities and incidents of negotiable instruments under the Law Merchant,\textsuperscript{36} or under the Negotiable Instruments Law.\textsuperscript{37}

Notwithstanding the general statute\textsuperscript{38} exempting from taxation all bonds, notes and other evidence of indebtedness of municipalities upon which interest is paid, many of the revenue bond statutes expressly provide that such bonds shall be exempt from taxation\textsuperscript{39} and two provide for the exemption of both bonds and property.\textsuperscript{40}

The acts under consideration differ considerably as to the type of security and remedies of the bondholders. For example, under \textsuperscript{1} the statute grants and creates a \textit{statutory mortgage lien} upon the waterworks purchased or acquired in favor of the bondholders, and any holder of the bonds may, either at law or in equity, by suit, action, mandamus or other proceeding enforce such mortgage lien and enforce the rights conferred by the statute. A similar mortgage lien and rights are granted under \textsuperscript{7} with an additional provision for the appointment of an administrator or receiver with power to sell the utility. Upon default a receiver may be appointed under \textsuperscript{8}.

Much remains to be done by the Legislature and the courts to more satisfactorily establish the law and procedure for this type of municipal bond. Considering only a few questions which are suggested as requiring further legislation and clarification, the following observations are presented.

\hspace{1cm}\textsuperscript{34}This stipulation with reference to state institutions appears in view of the constitutional provision prohibiting a state debt except in certain cases. See Sec. 5, Article 10, Constitution.
\textsuperscript{35}See, e. g., \textsuperscript{1}, 6, 8, and 12 of the enumerated Acts.
\textsuperscript{36}See, e. g., \textsuperscript{1}, 6, 12, and 13 of the enumerated Acts.
\textsuperscript{37}See, e. g., 8 and 9 of the enumerated Acts.
\textsuperscript{38}64-201 (20), Burns, 1933.
\textsuperscript{39}See, e. g., \textsuperscript{1}, 3, 4, 5, 6, 8, 9, 10, 12 and 15 of the enumerated Acts.
\textsuperscript{40}See, e. g., 3 and 4 of the enumerated Acts.
(a) The already existing labyrinthian group of revenue bonds act will be further complexed by future legislation, thus contributing to the decidedly confused existing statutory law of municipal corporations. This could be obviated by a simplified and uniform revenue bond act applicable to all municipal and public corporations and political subdivisions. Provision should also be made for the refinancing of revenue producing public projects and the refunding of revenue bonds.

(b) What difference, if any, are the rights and remedies of the holders of revenue bonds which are declared to be negotiable instruments under the Law Merchant comparable with the rights and remedies of the holders of revenue bonds declared to be negotiable instruments under the Negotiable Instruments Law?

(c) The State should declare a definite and uniform policy for either the taxation or exemption therefrom of public revenue-producing enterprises. The wisdom of either policy is left to the economists and the Legislature.

(d) Uniform legislation would appear more desirable in the matter of the jurisdiction of the Public Service Commission. For example, under 1, 6, 7, 12 and 13 (water and other utilities) Public Service Commission approval is required; whereas under 8 and 11 no jurisdiction is conferred in the Public Service Commission. Likewise, the wisdom and philosophy of either policy is a matter for the Legislature, but it should be uniform.

The issuance of revenue obligations as a method of municipal financing of certain public enterprises in Indiana has become fixed, and for the most part very desirable. Social problems and complexities have increased. The American way is for a better, more convenient, healthful and sanitary living. These demands require public participation and furnishing of certain utilities, and sanitary facilities such as water, sewers, sewage treatment, low cost housing and slum clearance. The extremely low constitutional debt limit permitted the municipalities, and the everlasting command for tax reduction, makes very probable the continuation of the financing of various self-liquidating public enterprises by the issuance of revenue bonds.