

How, When and Why Water Revenue Bonds Were Born

By Harold M. Martin published in Investors Dealers' Digest

In the Digest of March 23, 1953 appeared an article by George I. McKelvey, Manager of the Municipal Dep't of Tucker, Anthony in New York, presenting historical data on Water Revenue bonds. The following is an extract from a letter, in response, written to Mr. McKelvey by Harold M. Martin, V.P. Murphey Favre, Inc. of Spokane. It will be obvious to all municipal dealers that Mr. Martin has done a splendid and mighty useful job of research . . . while incidentally setting the record straight about the Northwest's role.

"No doubt your statement is correct that your predecessor firm, in 1925, brought on to the New York market the 'first issue of size payable solely from water sales.' However, we in the investment banking business out here in Spokane are quite proud of the fact that the water revenue bond idea originated in Spokane, and the first issue payable solely from water receipts was the \$350,000 of coupon bonds, entitled '6% Water Works Warrants.' I think I am safe in saying that the first water revenue bond was therefore born on December 8, 1885, when the City Sinking Fund Commission passed an ordinance authorizing these bonds, although they were not actually executed and dated until January 1, 1897. They matured serially to 1917. Incidentally, we have two of the cancelled bonds of this issue on display in our office.

"I delayed writing you with this bit of information until I could explore the City's records and perhaps ascertain the reasons for issuing this type of obligation. In so doing, I discovered a number of interesting developments, and perhaps these will answer your question as to whether the buyers' preference for water bonds germinated the idea or whether 'it was sired by dishonesty in the womb of evasion.'

"In 1891 the City was in the process of rebuilding after the disastrous fire of 1889, and in that year it purchased the existing private water company, issuing \$1,200,000 of general obligation water bonds in payment therefore.

"Two years later the growth of the City required extensions to the system, and a contract for \$300,000 was let for the construction work. The general funds of the City were in local banks, and the Panic of 1893 closed all of the banks, thus freezing the City's cash accounts.

In order pay the contractor, the representatives of a Chicago firm advanced money to the City and accepted 8% warrants. The purchaser required that 60% of the annual revenues of the water system be set aside in a special fund to retire these warrants.

Origin of the "Winston Case"

"There naturally was some question as to the legality of the City's action, and a test case was carried through to the State Supreme Court, which ruled that the City had the right to incur a debt of this nature, as it did not involve a municipal indebtedness within the meaning of the Constitutional provisions. The existing general obligation debt of the City, which was then right at the limit prescribed by the Constitution, precluded the issuance of general obligation bonds. This 'Winston Case' is generally known to be the first to test the right of a city of incur a debt payable from sources other than ad valorem taxes.

"In December 1895, the City Fathers had come to the decision that the rate of interest on these warrants was much too high, and the City Sinking Fund Commission passed an ordinance

authorizing the issuance of 5% bonds, using the Supreme Court decision on the warrants then outstanding for authority to do so. A Notice of Sale, calling for bids on \$350,000 of 'City of Spokane Water Works 5 ¼% Bonds,' appears in the City records.

"The minutes of the Sinking Fund Commission do not state what happened at the public sale which was scheduled for March 6, 1896, for there apparently was no action until June 1896, when an option was given to an individual from New York to purchase the bonds with an interest rate at 5 ¼%. In the contract, this person agreed to 'bend his best efforts in the East, and to go to Liverpool, England, to endeavor to sell the bonds.' Apparently, this option was not exercised.

"Several months later, the Sinking Fund Commission entered in to a contract with A. C. Frost and Company of Chicago to sell the \$350,000 of 'Spokane Water Works 5 ½%' Bonds.' Finally, in February of 1897 this old contract was cancelled, and a new one with a 6% rate was signed. The contract required that a test case be carried to the Supreme Court of the State of Washington ruling on the validity of the issue, and apparently it was felt that by using the description 'warrants' instead of 'bonds' it might expedite obtaining a satisfactory Supreme Court decision.

"According to the records of the Sinking Fund Commission, by February 21, 1898, all of the issue was sold, the proceeds remitted to the City, and the outstanding 8% warrants were retired.

Despite Fires and Panics

"Under the circumstances, with fires and national panic working against the City officials, I feel that they worked out their problems very well. While in those days the interest rates were seemingly high, I was interested to note your reference to the San Antonio Water Revenue 5 ½% bonds which your firm underwrote, in 1925, and the fact that this rate was apparently necessary because of the new idea and perhaps because of the uncertainty as to the security behind the bonds. Just about that same year, the City of Spokane sold a reasonably large issue of water works improvement revenue bonds with a coupon rate of 4 ¼% and 4 ½%. By that time the water revenue idea was quite firmly entrenched in the State of Washington, and at least buyers in this part of the country were quiet satisfied with the security offered them.

"I hope this story, white quiet detailed, may be of some interest to you, and not too boring. At least, you must have the credit for giving me the incentive to uncover the facts concerning the date of birth and the birthplace of a very stalwart financial 'child'."