

Municipal Debentures and Sinking Fund

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Debenture or Bond.

The terms "Debenture and Bond" are now used so interchangeably that in financial practice the difference in meaning may be said to be almost technical. Theoretically a Bond differs from a debenture in that the former is secured by a mortgage deed of trust containing a charge upon specific property, while the latter is merely an acknowledgement of a debt. Both forms of contract covenant to repay the principal amount of debt at a specified time, with interest thereon in the meantime at a fixed rate.

In Canada we speak of municipal debentures, government bonds and corporation bonds. In the United States the term "debenture" is seldom employed. Municipal government and corporation securities (debentures or bonds) are invariably referred to as bonds. There is very little significance to be attached to the mere name of the security, the chief thing which we should be concerned about is the manner in which the obligation can be entered into; secured and what is behind it, etc.

We will briefly refer to some of the bonds and debentures which are common to this country.

Government Bonds.

These are the securities issued by the Dominion and Provincial governments. They, of course, constitute the highest grade of security obtainable, but the rate of interest yielded to the investor is as might be expected, comparatively low. The bonds of the Dominion, rank ahead of those of the Provinces, while those of the older settled Provinces are held in higher esteem than those of the newer ones. London, theretofore, has been the principal place where our governments have marketed their Bonds, although recently Ontario and Alberta bonds have been successfully offered in Canada and in the United States. They carry interest, payable half-yearly, from 4 to 5 per cent, mature in from 5 to 50 years, and are issued usually in amounts of \$1,000. In the recent large issues by England of New Year Loans, subscribers have the option of receiving bearer bonds in respect thereof—or of being inscribed in the Books of the Bank of England as registered holder. In the former way they will have to collect the interest by cashing the Coupons attached to the Bonds; in the latter a dividend warrant for the interest is forwarded quarterly, as in the case of the Consols. In summarizing the advantages and disadvantages of the two forms of investment they point out that Inscribed Stock is registered in the Books of the Bank of England in the name of the holder or holders, and can only be sold or transferred by the holder or his duly appointed attorney—(this involves a 10s stamp duty)—if for any reason it should be inconvenient for the holder personally to attend at the Bank of England. It is accordingly a somewhat serious draw-back in the case of small holders. Bonds to Bearer on the other hand are negotiable instruments and accordingly pass from hand to hand—for this reason it is of the utmost importance that they should be carefully kept. Should they fall into the wrong hands, the rightful owner would experience great difficulty in establishing a claim to their property—even should they succeed in doing so, and should the bonds be destroyed by fire they would likely lose their property altogether. Bonds are accordingly not an ideal form of security unless the holder is in a position to place them in safe custody; under the Trustees Act of 1893, trustees are prohibited from holding Bonds to bearer unless the Deed of Trust so expressly states.

Municipal Debentures.

This class of investment is mostly highly regarded by an important and increasing body of investors—large and small—we will consider somewhat greater details in respect to it.

DEFINITION.—It is an absolute promise of a county, city, town or township to pay a definite amount on a specified date, and also to pay periodically throughout the term, interest at a stated rate.

FORM.—In form, it is self-contained. It states the exact amount that the municipality will pay the holder, and the exact date when it will be paid. When it matures, usually from 5 to 50 years from date of issue, it is only necessary to deposit it in the Bank for collection, or present it to the issuing municipality for payment.

INTEREST.—Attached to each debenture are Coupons representing the exact amount of the interest due at the time. Each year or half-year, when an instalment of interest falls due, a coupon is cut off and either presented for payment to the municipality or it may be deposited in the Bank. Coupons are practically post-dated cheques. The

rate of interest which the debentures of the various municipalities bear differs materially. The large and wealthy cities can, of course, borrow at a lower rate than that which would have to be paid by relatively small and new places. The rates are also affected by the monetary conditions at the time the loan is sought. Lately the debentures of the important municipalities have carried interest at 4½, 5½ and 6 per cent.

VALIDITY.—The Contract is very simple. It resembles somewhat a promissory note. It is, however, much more formal and binding, in that, in addition to bearing the signatures of the Mayor and the Treasurer of the municipality and the Seal of the Corporation, certain formal procedures are required to be taken which absolutely insure its validity. The investor's rights, therefore, are thoroughly safeguarded.

PURPOSE.—Debentures are issued by cities, towns, etc., to raise money for such and essential purposes as schools, sewers, parks, water systems, roads, fire departments, etc. They are, therefore issued for the betterment of the municipality.

SECURITY.—They are secured by the credit of the issuing city or town, etc., and its right and power to levy taxes on all its taxable property, such taxes being a first charge on all the property in the municipality.

Payment of Debentures.

There are several ways in which debentures are payable:

(1) Payable at the end of a specified time (term) commonly called "straight term" debentures. With this form an annual sinking fund is usually provided, so calculated as to be sufficient to pay off the debt at maturity. This form I have just exhibited is a "straight Term" debenture.

(2) Payable in equal annual instalments of principal commonly called "instalment" or "serial" debenture.

(3) Payable in equal annual instalments of principal and interest, commonly called an "annuity" debenture.

In the case of Classes 2 and 3 no sinking fund is necessary, as the debt is being paid off yearly, as the instalments fall due. This method is usually employed by the smaller towns. Class (1) is usually employed by the larger cities and municipalities which have adequate machinery to look after a sinking Fund. Debentures and Bonds are recognized as among the highest forms of investment, but it does not follow that all debentures and bonds are good investments. As in everything else discrimination must be shown, and the investor should seek the advice of some recognized investment house of high standing. The Financial Agents or Bond Houses before actually selling them debentures secure the opinion of some eminent lawyer concerning the legality and validity of the issue. The Municipal Debentures are seldom sold direct to the people, who finally purchase them for investment, they are almost universally sold to brokers who dispose of them to their customers. In the United States some municipalities have made efforts to sell over the counter to the investing public and apparently have been successful, but I would imagine such a procedure would entail a large staff and would only be applicable to very large cities, a second difficulty arises from the fact that a large proportion of buyers deposit a small percentage of the money at the time.

The principal points that a Bond House satisfies itself about are:—

- (1) Legality of the debenture.
- (2) Financial condition of the City (net indebtedness and Sinking Fund).
- (3) Standing of the City (rateable assessment; revenue producing property).
- (4) The yield on the debentures.

Such questions as "Is the City permitted by its charter to issue the debentures," "Have the legal steps been properly taken up by the City," "Have the debentures been properly authorized by the electors." The limit in the amount of debentures which the City can issue.

Investors in Municipal Bonds need not worry about the income of a city, unlike those who put their money into private corporations, and in consequence does not need such careful scrutiny.

The debentures of a municipality are really a first mortgage upon all the realty within its limits—or that the real estate is directly responsible for the Bonded debt of the city because it is looked to for a sufficient sum in the way of taxes to meet the city's obligations.

The expansion of the Dominion during the past few years

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