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BEYOND A "BOND-AID" APPROACH: BUILDING A BETTER BOND LAW

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Local governments play a critical role in American society and construct much of the infrastructure upon which we rely, frequently financing this infrastructure by borrowing. Local government borrowing is likely to play a significant role in the building and improving of infrastructure as we look for ways to revive the economy and move beyond the COVID-19 pandemic. This article discusses some of the typical provisions of state laws governing this borrowing and suggests some ways these laws could be revised to provide appropriate flexibility to local governments while protecting current and future residents. Because states have varying priorities, values, and government structures, it does not propose a single solution, but rather identifies key components of these laws and presents considerations, alternatives and recommendations for each component. It also proposes alternative ways to improve bond laws in an effort to begin a conversation about this important topic.

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INTRODUCTION

The COVID-19 pandemic has highlighted the important role that local governments play in our lives, thrusting county public health officials into the spotlight and causing us to turn to them and to other local officials to keep us safe. But local governments have long played a critical role in American society, providing services and facilities on which we rely, such as roads, bridges, schools, hospitals, fire and police protection, clean water, sewers, solid waste collection, electricity, airports, ports, and public transportation. Some local governments have transformed their regions with public transportation projects, bridges, stadiums, and other infrastructure projects. Local governments built the Golden Gate Bridge, the Los Angeles Aqueduct, and the Brooklyn Bridge.[1]

[1] The Golden Gate Bridge was built by a local authority formed by six counties. *Special District Formed*, GOLDEN GATE BRIDGE HIGHWAY & TRANSP. DIST., https://www.goldengate.org/bridge/history-research/bridge-construction/special-district-formed/ [https://perma.cc/88PJ-ESVG]. Over 40 million vehicles cross the Golden Gate Bridge every year. *Annual Vehicle Crossings and Toll Revenues*, GOLDEN GATE BRIDGE HIGHWAY & TRANSP. DIST., https://www.goldengate.org/bridge/history-research/statistics-data/annual-vehicle-crossings-toll-revenues/ [https://perma.cc/J7P2-EN3S]. The Los

State and local governments build and preserve much of the nation's public infrastructure (considerably more than the federal government does).[2] They borrow hundreds of billions of dollars annually to do so, usually in the form of long-term debt securities referred to as "municipal bonds."[3] Local governments are likely to play a critical role in moving past COVID-19 and the economic crisis it has created, and municipal bonds will be an essential tool for doing so.

Most states have constitutional and/or statutory restrictions on the amount and terms of debt that local governments within their borders may

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Angeles Aqueduct was built by the City of Los Angeles, and some credit it with the dramatic growth of the city (albeit at great cost to the Owens Valley, from which the water for the city was acquired). *See* ALBERTA M. SBRAGIA, DEBT WISH: ENTREPRENEURIAL CITIES, U.S. FEDERALISM, AND ECONOMIC DEVELOPMENT 71 (1996) (noting that areas that wished to receive water had to agree to be annexed to the city and citing an expansion of the city from 43 to 422 square miles between 1906 and 1930); LES STANDIFORD, WATER TO THE ANGELS: WILLIAM MULHOLLAND, HIS MONUMENTAL AQUEDUCT, AND THE RISE OF LOS ANGELES xviii (2015) (suggesting that the man responsible for the construction of the aqueduct had "made such a place as Los Angeles possible"). The cities of Brooklyn (then a separate city) and New York both contributed to the financing and construction of the Brooklyn Bridge. *See* People ex rel. Murphy v. Kelly, 76 N.Y. 475, 480–87 (1879) (describing the cities' involvement during the early stages of construction); *City Pays Off Brooklyn Bridge of 1883; Interest Was Double Cost of Erecting It*, N.Y. TIMES, Nov. 3, 1956, at 25, available at https://www.nytimes.com/1956/11/03/archives/city-pays-off-brooklyn-bridge-of-1883-interest-was-double-cost-of.html (noting that New York City had made its final debt service payment on bonds issued to construct the Brooklyn Bridge). In 2016, an average of over 100,000 vehicles crossed the Brooklyn Bridge each day. N.Y.C. DEP'T OF TRANSP., 2016 NEW YORK CITY BRIDGE TRAFFIC VOLUMES 61 (2018).

[2] State and local governments put in place approximately $313.6 billion of new non-residential construction and improvements in 2021, compared to $23.6 billion of similar projects put in place by the federal government. *Annual Value of Federal Construction Put in Place 2012-2021* and *Annual Value of State and Local Construction Put in Place 2012-2021*, U.S. CENSUS BUREAU, https://www.census.gov/construction/c30/historical_data.html [https://perma.cc/U6AD-HXNC] (providing the cited financial information in spreadsheet files entitled "Annual," "2012-2021," "State and Local" [https://perma.cc/LQV8-JZPA] and "Federal" [https://perma.cc/8USH-BR2U]).

[3] *See* SEC. INDUS. & FIN. MKTS. ASS'N, 2021 CAPITAL MARKETS FACT BOOK 17 (2021) (indicating that state and local governments issued $484.5 billion in long-term bonds in 2020); Andrew J. Ceresney's keynote address to the SEC:

> [I]f your children attend a public school or a university; if you have been treated at a local hospital; if you have visited a library, park or sports facility; if your parents reside in an assisted living facility; if you took the subway, or drove on roads or bridges or through a tunnel today; even if you turned on your tap water this morning, you are likely seeing the tangible results and benefits of the municipal securities marketplace.

Andrew J. Ceresney, Dir., Div. of Enforcement, Sec. & Exch. Comm'n, Keynote Address at the Securities Enforcement Forum: The Impact of SEC Enforcement on Public Finance (Oct. 13, 2016), *available at* https://www.sec.gov/news/speech/speech-ceresney-10132016.html [https://perma.cc/AFU3-RF4T].

issue.[4] These restrictions are intended to serve a variety of purposes, including promoting fiscally sound decision-making, reducing the risk of default, preventing excessive burdens on taxpayers, and promoting interperiod equity (the concept that the burden of paying for a facility should be spread fairly over period during which the facility is used).[5]

Because of the critical role that local government borrowing plays in the development of public infrastructure and likely will play in the recovery from the effects of the COVID-19 pandemic, and because of the volume of this borrowing, it is essential that the laws that govern local government borrowing (referred to herein as "bond laws") are clear and coherent, and that they set reasonable parameters while also providing sufficient flexibility to allow local governments to borrow in the most efficient way possible even as market conditions change. Unfortunately, not all existing bond laws meet these standards. This article discusses a range of existing bond laws and proposes improvements. Because states have varying priorities, values, and government structures, because state constitutions contain a variety of restrictions on local government borrowing that may be difficult to change, and because the types of bonds vary somewhat from state to state, this article does not propose a single solution for all states or all bonds. Rather, it identifies key components of laws governing municipal bonds and presents considerations, alternatives, and recommendations for each component. It is

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[4] *See, e.g.*, U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL REL., M-186, STATE LAWS GOVERNING LOCAL GOVERNMENT STRUCTURE AND ADMINISTRATION 10 (1993) (describing the prevalence of several types of restrictions, including debt limits, voter approval requirements, restrictions on the purposes for which debt can be used, maximum interest rates and maximum terms); James E. Spiotto, *The Role of the State in Supervising and Assisting Municipalities, Especially in Times of Financial Distress*, MUN. FIN. J. 1, 6–8 (2013) (discussing the limits states have placed on debt municipalities may issue and noting that all states except three have a limit on local government debt); Clayton P. Gillette, *Fiscal Home Rule*, 86 DENV. U. L. REV. 1241, 1255 (2009) ("Virtually every state constitution imposes limits on the amount of debt that its political subdivisions can issue in order to fund capital projects . . . .").

[5] *See, e.g.*, James A. Coniglio on the issue of constitutional municipal debt limitations:

> The traditional objective of constitutional debt limitations has been to prevent municipalities from improvidently contracting debts for other than ordinary current expenses of administration, and to restrict their borrowing capacity, and to prevent the creation of excessive debt, the carrying charges of which would fall on current revenues, and the principal on posterity.

James A. Coniglio, *Borrowing Authority of State and Local Governments*, *in* 1 STATE AND LOCAL GOVERNMENT DEBT FINANCING § 1.3, (2d ed.) (database updated Nov. 2020); Gillette, *supra* note 4, at 1256 (discussing the reasons debt limitations were created, including protecting taxpayers and promoting interperiod equity); Spiotto, *supra* note 4, at 10 (identifying prevention of financial crises and defaults as a reason for the imposition of debt limits). The reasons states have laws concerning local government borrowing are discussed in greater detail in Section 3.3.

intended to start a thoughtful conversation about what modifications to bond laws would be desirable and achievable.

Following this introduction (Part 1), Part 2 of this article provides a brief overview of municipal bonds and Part 3 briefly describes the laws governing them and highlights some of the problems with these laws.

Part 4 identifies and discusses the aims to be achieved by improved bond laws. One key objective of these laws should be providing appropriate flexibility for local governments to innovate, make decisions and adapt to changing circumstances while protecting citizens (including future citizens) from poor decisions made by local governments. A second critical objective is ensuring that citizens have the opportunity to be aware of and involved in local government borrowing decisions. These objectives are more likely to be achieved if different types of borrowing and different local governments are treated the same way unless there are clear reasons not to do so; legislation is not unduly complicated; and laws are flexible enough that local governments can adapt to changing market conditions.

Parts 5-7 each address different aspects of bond laws. Part 5 addresses restrictions on the ability to issue debt. Part 6 covers laws regulating bonds, including those relating to the use of proceeds, restrictions on terms of bonds such as maturity, amortization, and interest rate, and on the process of selling bonds. Part 7 focuses on the process for governing boards to approve bonds, information requirements, and opportunities for community involvement. Each section discusses some existing approaches to bond laws and alternatives.

While it might be ideal for a state to adopt one cohesive set of laws for the issuance of municipal bonds, this may not be a realistic political option. Therefore, Part 8 discusses ways to improve state bond laws short of wholesale revision. These improvements can still provide great benefit to local governments that issue bonds and, more important, to their citizens.

2. An Introduction to Municipal Bonds

2.1. Overview

"Municipal bonds" generally refers to debt securities issued by state or local governments.[6] However, this article focuses on securities issued by local governments and uses the term to refer to that debt.[7] There are more

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[6] *Glossary of Municipal Securities Terms: Municipal Bond*, MUN. SEC. RULEMAKING BD., https://www.msrb.org/Glossary/Definition/MUNICIPAL-BOND.aspx [https://perma.cc/9NSE-KP4P].

[7] While the term "bonds" typically refers only to debt securities sold to the public, for simplicity's sake in this article it also refers to borrowing from financial institutions.

than 90,000 local governments in the United States.[8] Many local governments have overlapping territory. For example, a piece of property could be within a county, a city, a school district and one or more other special districts.[9]

Local governments issue bonds primarily to finance capital projects and to refinance existing debt,[10] though they are sometimes issued for other purposes. They typically (though not always) have a maturity of more than

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[8] U.S. CENSUS BUREAU, FROM MUNICIPALITIES TO SPECIAL DISTRICTS, OFFICIAL COUNT OF EVERY TYPE OF LOCAL GOVERNMENT IN 2017 CENSUS OF GOVERNMENTS 2 (2019), https://www.census.gov/content/dam/Census/library/visualizations/2019/econ/from_municipalities_to_special_districts_america_counts_october_2019.pdf [https://perma.cc/E2PM-6TKE]. Counties, municipalities and townships provide general governmental services, such as courts, jails, law enforcement, public health, welfare, hospitals, airports, streets and highways, parks, libraries and environmental protection within a particular area. *Definitions: Local Purpose Governments*, U.S. CENSUS BUREAU, https://www.census.gov/newsroom/cspan/govts/20120301_cspan_govts_def_3.pdf [https://perma.cc/Q9HJ-595U]; U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 4, at 1. These are sometimes referred to as "general governments." Special districts are created for a more limited purpose or purposes, such as fire protection, transportation, water supply or parks. *Id.* at 2-3; U.S. CENSUS BUREAU, *supra* note 5, at 2–5.

[9] *See, e.g.*, CTY. OF MONTEREY, MONTEREY COUNTY TAX RATES FOR FISCAL YEAR 2020-21 (2021), *available at* https://www.co.monterey.ca.us/home/showpublisheddocument?id=98164 [https://perma.cc/4CTN-62X6] (identifying the cities, redevelopment agencies, school districts, community colleges, county services areas, water resources agency and other special districts within the county and showing the overlap between various local governments in the county); SAN JUAN UNIFIED SCH. DIST., $30,000,000 GENERAL OBLIGATION BONDS, ELECTION OF 2012, SERIES 2020, $150,000,000 GENERAL OBLIGATION BONDS, ELECTION OF 2016, SERIES 2020 & $143,090,000 2020 GENERAL OBLIGATION REFUNDING BONDS (FEDERALLY TAXABLE) OFFICIAL STATEMENT 30 (Oct. 15, 2020), *available at* https://emma.msrb.org/P21409591-P11111346-P11521176.pdf [https://perma.cc/46NV-7TMR] (identifying the various debt issued by other local governments that have territory overlapping with all or part of the district, including a community college district, park district, county, cities and other special districts); THE CNTY. OF COOK, ILL. $101,820,000 GENERAL OBLIGATION REFUNDING BONDS, SERIES 2018 OFFICIAL STATEMENT 29 (Jan. 18, 2018), *available at* https://emma.msrb.org/ER1119813-ER875890-ER1276531.pdf [https://perma.cc/3NJZ-X9AC] (identifying debt of other local governments with territory overlapping that of the county, including a city, board of education, park district, community college system, water reclamation district and forest preserve district).

[10] GRANT A. DRIESSEN, CONG. RSCH. SERV., RL 30638, TAX-EXEMPT BONDS: A DESCRIPTION OF STATE AND LOCAL GOVERNMENT DEBT 1, 6 (2018). State and local governments also issue shorter term debt, typically referred to as "notes." *Glossary of Municipal Securities Terms: Note*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/Glossary/Definition/NOTE.aspx [https://perma.cc/PVE2-PFM4]. While short-term debt is not the focus of this article and is not addressed in the proposed framework for laws governing municipal bonds, some of the principles discussed also apply to short-term debt.

three years;[11] many bonds have a significantly longer term, frequently up to thirty years and sometimes even longer.

Municipal bonds are issued in a face amount (also referred to as a "principal amount" or a "par amount") that is payable upon maturity or earlier prepayment.[12] Municipal bonds may bear interest at a rate that does not change (a "fixed rate bond") or at a rate that changes periodically based on market conditions or a predetermined index (a "variable rate bond").[13] Interest is paid by the issuer of the bond to the purchaser of the bond, usually semiannually for fixed rate bonds.[14]

Municipal bonds are sometimes (in my experience, usually) sold at a price lower or higher than their face amount (at a "discount" or "premium," respectively).[15] Thus, the amount received by the issuer from the sale may be lower or higher than the principal amount of the bonds sold, and the rate of return for the investor may be higher or lower than the interest rate on the bonds. Municipal bonds are typically sold to investors based on the "yield" of the bond, the annual rate of return taking into account not only the interest rate on the bond but also any discount or premium.[16] Discounts and premiums can make bonds more attractive to investors.[17] For example, some

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[11] *Glossary of Municipal Securities Terms: Bond*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/Glossary/Definition/BOND.aspx [https://perma.cc/8B9J-DCEU]; *Short Term or Short Term Range*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/Glossary/Definition/SHORT-TERM-OR-SHORT-TERM-RANGE.aspx [https://perma.cc/NF2C-NRGP].

[12] *Glossary of Municipal Securities Terms: Principal*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/Glossary/Definition/PRINCIPAL.aspx [https://perma.cc/VZJ3-SZCW]. For discussion of prepayment (also referred to as redemption) provisions, *see infra* text accompanying notes 33-34.

[13] SEC. & EXCH. COMM'N, REPORT ON THE MUNICIPAL SECURITIES MARKET 8 (2012); *Glossary of Municipal Securities Terms: Fixed Rate*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/glossary/definition/fixed-rate.aspx [https://perma.cc/NMK8-95W3]; *Glossary of Municipal Securities Terms: Variable Rate*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/glossary/definition/variable-rate.aspx [E**rror! Hyperlink reference not valid.**https://perma.cc/AL2Z-49ZH].

[14] *Glossary of Municipal Securities Terms: Interest Payment Date*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/Glossary/Definition/INTEREST-PAYMENT-DATE.aspx [https://perma.cc/9U2Z-3URK]. Sometimes interest is added to principal and itself bears interest until it is paid at or near maturity. Bonds that accrete interest in this matter are referred to as capital appreciation bonds and are discussed in detail in Heather G. White, *Getting Local Governments Where They Need to Go Without Taxing Taxpayers for a Ride: "CABs," Why They Are Used, and What Can Be Done to Prevent Their Misuse*, 49 ST. MARY'S L.J. 363 (2018).

[15] *The Underwriting Process*, MUN. SEC. RULEMAKING BD., http://msrb.org/EducationCenter/Municipal-Market/Lifecycle/Primary/Underwriting-Process.aspx [https://perma.cc/3FDR-XPC5] (last visited Mar. 19, 2022).

[16] *Id.*, NEIL O'HARA, SEC. INDUS. & FIN. MKTS. ASS'N, THE FUNDAMENTALS OF MUNICIPAL BONDS 281 (6th ed. 2012) (definition of "yield").

[17] O'HARA, *supra* note 16, at 82.

institutional investors prefer to buy long-term bonds that are priced at a premium.[18]

Bonds are usually issued in a group (referred to as a series) with different maturities.[19] Sometimes a single issuance consists of more than one series, particularly when the bonds being issued have different characteristics, such as being issued for different purposes or having different tax-exempt status.[20]

Principal of each bond is typically paid at maturity or over a period of years leading up to maturity.[21] However, because bonds are usually issued in a series with multiple maturities, principal payments are typically made over the life of a series of bonds, though the amount of such payments may vary from year to year.

2.2. Payment Sources and Security for Municipal Bonds

Principal and interest on municipal bonds may be payable from a single source or a combination of sources, such as property taxes, sales taxes or other taxes, the local government issuer's general fund, or revenues from a particular project, such as a utility system or an airport.[22] Bonds payable from property taxes and/or from all legally available funds of the issuer are referred to as "general obligation bonds."[23] Bonds payable from a particular revenue stream, such as a sales tax, hotel tax or other tax, revenues generated by a particular project or enterprise, or rent payments made on particular

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[18] *Bond Pricing – The Problem with Premium Pricing*, WM FIN. STRAT., http://www.munibondadvisor.com/PremiumPricing.htm [https://perma.cc/Y8HM-Q5CA] (last visited Mar. 19, 2022).

[19] *See* Andrew Ang & Richard C. Green, *Lowering Borrowing Costs for States and Municipalities through CommonMuni*, HAMILTON PROJ. 10, (Feb. 2011), https://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/THP_ANG-GREEN_DiscusPape_Feb2011.pdf [https://perma.cc/CA3H-WXNS] ("Since 1995, the average municipal bond series has contained thirteen separate bonds, with the top 5 percent of bond series comprising more than twenty-five separate bonds.")

[20] *Glossary of Municipal Securities Terms: Issue*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/glossary/definition/issue.aspx [https://perma.cc/9QBW-Q3Q4] (last visited Mar. 19, 2022).

[21] Payment of principal over a period of years leading up to maturity is referred to as "mandatory sinking fund redemption." Payments are allocated to investors by lot. O'HARA, *supra* note 16, at 273.

[22] This article provides only a general overview of the types of local government debt. For additional detail, *see generally* Robert S. Amdursky, Clayton P. Gillette & G. Allen Bass, MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE §§ 1.3, 4.4–4.12, 4.14 (2nd ed., 2020-2 Cum. Sup.); CAL. DEBT & INV. ADVISORY COMM'N, CDIAC NO. 19.05, CALIFORNIA DEBT FINANCING GUIDE ch. 3 (2019).

[23] NAT'L ASS'N OF BOND LAWYERS, GENERAL OBLIGATION BONDS: STATE LAW, BANKRUPTCY AND DISCLOSURE CONSIDERATIONS i–ii (2014).

property, or from a combination of such sources, are called "revenue bonds."[24] Some revenue bonds, called "lease revenue bonds," are paid from rent under a lease; in some circumstances that lease is from the local government issuer to another local government, and the rent is payable from all legally available funds of the renting local government.[25] Some bonds are hybrid in nature, payable primarily from a stream of revenues or, if that stream is not sufficient, from property taxes.[26]

Payment of principal and interest and on some municipal bonds is guaranteed by a bank or a bond insurer.[27] Sometimes, issuers establish a reserve fund from which funds can be drawn to pay debt service if other funds are not available.[28]

2.3. Federal and State Tax Exemption

The U.S. federal government and state governments subsidize most local government borrowing. The federal government reduces the cost to state and local governments of issuing debt by making interest earnings on most of such debt (referred to as "tax-exempt debt" or "tax-exempt bonds") exempt from federal income tax.[29] Tax-exempt debt typically bears interest at a lower rate than taxable debt of identical credit quality because lenders receive the benefit of tax exemption.[30] Interest on most state and local

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[24] *See* AMDURSKY ET AL., *supra* note 22, at § 1.3.4 (describing a variety of revenue bonds). Some revenue bonds are payable solely from loan payments or lease payments made by a nongovernmental borrower in what is referred to as a "conduit financing." CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 3.3.9. These financings are beyond the scope of this article. These financings allow nongovernmental entities to take advantage of the lower interest rates on tax-exempt bonds (*see infra* Section 0).

[25] *See* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 3.6.1 (describing financing leases and noting that sometimes the leased property is owned by the renting local government, which leases the property to the lessor and then subleases it back). Certificates of participation have a similar structure to lease revenue bonds. *Id.* at § 3.6.3. They are not addressed separately in this article.

[26] AMDURSKY ET AL., *supra* note 22, at § 1.3.4.

[27] SEC. & EXCH. COMM'N, *supra* note 13, at 10-11. For more information regarding bond insurance, letters of credit and other support, *see* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 2.3.2.

[28] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 2.4.4.

[29] In 2011, 90.6% of state and local government securities were issued on a tax-exempt basis. SEC. & EXCH. COMM'N, *supra* note 13, at 11. In 2017, the loss of federal tax revenue resulting from the exemption from income of interest on public purpose tax-exempt bonds was $28.6 billion. DRIESSEN, *supra* note 10, at 3.

[30] *See* DRIESSEN, *supra* note 10, at 1 (explaining that investors are willing to receive a lower interest rate on tax-exempt bonds because their returns after taxes are the same as if they had received interest at a higher rate but had to pay taxes on the interest).

government debt is also exempt from home state taxation.[31] Tax-exempt bonds are subject to extensive requirements under the Internal Revenue Code of 1986 and related regulations.[32]

2.4. Other Provisions

Sometimes, the local government issuing bonds may have the option to prepay them or may be obligated to do so upon the occurrence of specified events or on a predetermined schedule.[33] Such prepayment is referred to as "redemption". While these provisions vary, issuers often have a right to elect to redeem bonds without paying a premium approximately ten years after the date the bonds were issued.[34] Bondholders, particularly those holding variable rate bonds, may have the right to require the issuer to repurchase their bonds at certain times or under specified circumstances.[35]

The terms of municipal bonds are contained in bond resolutions, indentures, trust agreements or other agreements, which generally also contain provisions regarding (among other things) the use of proceeds of the bonds, the security and source of payment for the bonds, terms of a reserve fund (if any), events of default, remedies, and covenants of the issuer.[36]

Local governments sometimes enter into interest rate swaps (agreements to exchange periodic interest payments, for example with one party making payments at a fixed interest rate and the other at a variable rate) and other derivative arrangements in connection with their bonds.[37] Local governments use these for a variety of reasons, including attempting to manage exposure to interest rate risk, better matching assets and liabilities, endeavoring to reduce net interest costs, generating cash and locking in current interest rates.[38] However, swaps entail risks to local governments, including the potential that the local government could have to make a substantial payment if the agreement is terminated (even if the termination is

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[31] Daniela Pylypczak-Wasylyszyn, *Are Municipal Bonds Exempt from State Taxes?*, MUNICIPALBONDS.COM (June 24, 2015), http://www.municipalbonds.com/tax-education/tax-exemption-from-state-income-taxes [https://perma.cc/R66H-4KX7]; Nadav Shoked, *Debt Limits' End*, 102 IOWA L. REV. 1239, 1289–90 (2017).

[32] For a description of some key requirements, *see generally* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at ch. 4. These regulations are not addressed in this article except where relevant to discussion of state bond laws.

[33] *See id.* at § 2.3.1 (describing common redemption provisions).

[34] *Id.* at § 2.3.1.3.

[35] *See id.* at § 3.4.2.2 (describing variable rate bonds with a tender feature).

[36] *See id.* at § 2.4 (describing a variety of provisions included in bond documents).

[37] JUSTIN MARLOWE, WILLIAM C. RIVENBARK & A. JOHN VOGT, CAPITAL BUDGETING AND FINANCE 200 (2009); SEC. & EXCH. COMM'N, *supra* note 13, at 8.

[38] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 2.3.3; SEC. & EXCH. COMM'N, *supra* note 13, at 8.

through no fault of the local government), that the counterparty will not be able to meet its obligations, and that as market conditions change the interest received will not align with the interest rate the issuer pays on the hedged obligation.[39]

2.5. Issuance and Sale of Bonds

Newly issued municipal bonds may be sold publicly or privately. Most municipal bonds are sold publicly, but a growing portion are sold privately to financial institutions.[40] Public sales are made through an investment bank acting as an underwriter in either a competitive or negotiated sale.[41] In a competitive sale, the issuer solicits bids to purchase the bonds and sells them to the underwriter that offers the lowest interest cost on the bonds.[42] In a negotiated sale, the issuer selects an underwriter to purchase the bonds on negotiated terms.[43] Regardless of which method of public sale is used, the underwriter then sells the bonds to investors.[44]

Issuers prepare offering documents that are used by underwriters in selling newly issued municipal bond and provide updates to certain information annually as long as the bonds are outstanding.[45]

Local governments issuing bonds engage lawyers to serve as bond counsel; the primary role of these lawyers is to provide an expert opinion as to the validity and the tax-exempt status of the bonds.[46] Increasingly, issuers also engage lawyers as disclosure counsel to assist them in complying with their disclosure obligations under federal securities laws.[47]

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[39] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 2.3.3.

[40] *See* SEC. & EXCH. COMM'N, *supra* note 13, at 15-16 (noting that in 2011, 54.4% of municipal securities issuances were sold in negotiated sales, 42.2% in competitive sales and 3.2% in private placements, and that private placements had increased from $3 billion in 2010 to $15 billion in 2011); Benji Nguyen et al., *Risky Business: Bank Loans to Local Governments,* STANFORD INST. FOR ECON. POL'Y RSCH. 1 (Aug. 2017) (noting that private bank loans to local governments in California increased from $49 billion to $91 billion over a four-year period).

[41] SEC. & EXCH. COMM'N, *supra* note 13, at 15. For discussion of the reasons to use each method of sale, *see infra* the text accompanying notes 282-284.

[42] SEC. & EXCH. COMM'N, *supra* note 13, at 17; Jun Peng et al., *Method of Sale in the Municipal Bond Market*, *in* THE HANDBOOK OF MUNICIPAL BONDS 51, 52 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008).

[43] SEC. & EXCH. COMM'N, *supra* note 13, at 16; Peng, *supra* note 42, at 52.

[44] *Id.* at 15.

[45] For a brief discussion of the legal requirements imposed on underwriters with respect to offering documents and ongoing disclosure, *see* Heather G. White, *A Little Help from Our Friends: Moving Beyond Enforcement to Improve State and Local Government Compliance with Federal Securities Laws*, 22 N.Y.U. J. LEGIS. & PUB. POL'Y 129, 147–150 (2019).

[46] SEC. & EXCH. COMM'N, *supra* note 13, at 47.

[47] *Id.* at 48.

In addition, local governments often engage an external advisor (referred to as a "municipal advisor" or "financial advisor") to assist in developing a financing plan, advising on the method of sale and assessing alternative financing strategies, among other things.[48] Municipal advisors have a fiduciary duty towards their local government clients.[49]

3. STATE REGULATION OF MUNICIPAL BONDS

3.1. Local Government Borrowing

There are several good reasons that local governments borrow to finance infrastructure. First, major capital projects such as airport terminals or schools will last many years, and debt can be used to spread the cost of such a project over its useful life. Spreading the burden of paying for a facility fairly over time (referred to as "intergenerational equity" or "interperiod equity") is one of the justifications for borrowing to finance capital projects rather than requiring current taxpayers or fee payers to pay the full cost of a facility that will be used for many years.[50]

In addition, because major capital projects arise only intermittently, it would be difficult to finance them from revenue streams that do not vary significantly from year to year.[51] A local government may borrow because it not have sufficient funds to construct an urgently needed facility or because

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[48] *See* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § i.4.1.1 (describing the types of services provided by municipal advisors); Governing Inst., Bond Issuance Guide for Small & Mid-sized Municipalities 13 (2017) (indicating that nationwide 85% of municipal bond transactions had used a municipal advisor so far in 2017); Diana Yang, *Top Municipal Financing Team Participants: Calendar Year 2018*, CAL. DEBT & INV. ADVISORY COMM'N, DEBT LINE, Feb. 2019, at 3, 4-5 (indicating that municipal advisors were used on approximately 53% of reported municipal debt issuances in California in 2018, down from 61% the prior year).

[49] 15 U.S.C.A. § 78o-4(c)(1) (West 2020); MUN. SEC. RULEMAKING BD., RULE G-42(a)(ii), http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-42.aspx [https://perma.cc/9SKB-U3PN] (last accessed Mar. 19, 2022).

[50] ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., STATE CONSTITUTIONAL AND STATUTORY RESTRICTIONS ON LOCAL GOVERNMENT DEBT 9-10 (1961); CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § i.2.2; LEAGUE OF OR. CITIES, GUIDE TO BORROWING AND BOND FOR OREGON MUNICIPALITIES 6 (2018); MARLOWE ET AL., *supra* note 37, at 133; RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 693–94 (4th ed. 1984); M. David Gelfand, *Seeking Local Government Financial Integrity Through Debt Ceilings, Tax Limitations, and Expenditure Limits: The New York City Fiscal Crisis, the Taxpayers' Revolt, and Beyond*, 63 MINN. L. REV. 545, 550–51 (1979).

[51] ADVISORY COMM'N ON INTERGOVERNMENTAL REL'S., *supra* note 50, at 9.

its existing resources are required to meet other immediate needs.[52] Local governments also borrow when the cost of borrowing is less than the expected increase in construction or acquisition costs if the project is delayed until funds are available.[53] New facilities may also attract new residents to the community, increasing local governments' ability to pay debt service.[54]

Furthermore, some local governments borrow because this is the only way that they can generate additional tax revenues to pay for a project.[55] That is, they would not be allowed to impose or raise a tax or fee absent the borrowing. For example, property taxes in California are limited by a cap which can be exceeded for assessments to pay bonded debt approved by the voters.[56]

However, there are also reasons that local governments may borrow too much, or may borrow unwisely. Some of these reasons are discussed *infra,* in Sections 3.3.1 and 3.3.2.

3.2. State Regulation

Local governments are created by state law, and have only the powers given to them by the state.[57] Local governments only have the powers expressly conferred upon them by state constitution, statute, or charter; powers fairly implied by the powers expressly granted; and powers essential to the declared objectives or purposes of the local government.[58] This is referred to as "Dillon's Rule."[59]

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[52] LEAGUE OF OR. CITIES, DEBT ISSUANCE MANUAL 1 (2007); *see also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § i.2.2, i.2.2.2.
[53] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § i.2.2.2; LEAGUE OF OR. CITIES, *supra* note 50, at 6.
[54] Tracy Nichols Eddy, *The Referendum Requirement: A Constitutional Limitation on Local Government Debt in Florida*, 38 U. MIAMI L. REV. 677, 679 (1984).
[55] LEAGUE OF OR. CITIES, *supra* note 52, at 1.
[56] CAL. CONST. art. XIIIA, § 1 (b).
[57] GERALD E. FRUG & DAVID J. BARRON, CITY BOUND: HOW STATES STIFLE URBAN INNOVATION 2 (2008); Coniglio, *supra* note 5, at § 1.3; 2A MCQUILLIN MUN. CORP. §§ 10.10 (3d ed., Aug. 2020 update). Some states allow cities to become subject to "home rule" and have more control over their form of governance and local affairs. However, this power is not unlimited. *See* AMDURSKY ET AL., *supra* note 22, at § 2.2.2 (describing some limitations that remain under home rule); 2 MCQUILLIN, *supra* note 57, at § 4.28 (describing home rule and some of its limitations). Some of the laws discussed in this article do not apply to home rule cities.
[58] 2A MCQUILLIN, *supra* note 57, at § 10.10. *See also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 1.1 (describing the application of this rule in California).
[59] 2A MCQUILLIN, *supra* note 57, at § 10.10.

Borrowing by local governments is regulated by state constitutions and statutes.[60] The extent to which states exercise control over local government borrowing varies. At one end of the spectrum is a requirement that a state agency approve all local government bond issuances, or a prohibition of all local government borrowing. North Carolina takes the former approach for virtually all local government debt.[61] At the other end of the spectrum would be an unfettered ability to borrow on any terms the local government deems appropriate. I am not aware of any state at this end of the spectrum, though some are closer than others.

This article addresses four main categories of State bond laws: restrictions on the ability to issue debt; limitations on the use of proceeds of bonds; constraints on use of proceeds, terms of debt, and mechanics of selling debt; and requirements for information to be made available and opportunities for citizens to provide input. These categories of regulations are discussed in Parts 5-7.

Some state laws include provisions governing how different types of bonds are to be paid and secured, the remedies available to bondholders, and provisions intended to ensure that bonds are not invalidated after they are issued.[62] State laws also address more general topics that are relevant to municipal bonds, such as the treatment of financially distressed municipalities and whether they can apply for bankruptcy,[63] restrictions on the ability to raise taxes or other revenues, laws governing the duties of government officials, laws concerning the procedures for elections, and open meeting laws. While all of these laws are important, they are beyond the scope of this article.

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[60] Peter W. Salsich, Jr., *Chapter 11: State Laws Regarding Issuance of Bonds and Notes* in 2 GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING § 12, § 12.1 (2d. ed.) (database updated Nov. 2020).

[61] Adam C. Parker, *Positive Liberty in Public Finance: State Oversight of Local-Government Debt and the North Carolina Model,* 37 CAMPBELL L. REV. 107, 145 (2015).

[62] *See* AMDURSKY ET AL., *supra* note 22, at §§ 2.7, 5.2.1, 5.4, 5.14 (2d. ed., 2020-2 Cum. Sup.) for a description of some of the methods that states use to ensure the validity of bonds, a discussion of some provisions relating to payment of bonds and securities, and remedies available to bondholders.

[63] While Chapter 9 of the federal Bankruptcy Act governs municipal bankruptcy, it does so only if state law permits the affected municipality to file for bankruptcy protection. *See* AMDURSKY ET AL., *supra* note 22, at § 5.15.2.2 and NAT'L ASSOC. OF BOND LAWYERS, MUNICIPAL BANKRUPTCY: A GUIDE FOR PUBLIC FINANCE ATTORNEYS 40–43 (2011) for discussion of this limitation and some of the relevant state laws.

3.3. Reasons for States to Regulate Local Government Borrowing

The consequences of borrowing too much or borrowing unwisely can be severe. Local governments in financial distress may have to cut important city services, may default on bonds, and may (in some states) file for bankruptcy protection. There were 55 defaults on municipal bonds rated by Moody's Investors Service (one of the three main organizations that provides credit ratings on municipal bonds) between 2007 and 2019, including defaults by 24 general governments (such as counties, municipalities, and townships).[64] Financial distress and defaults harm not only bondholders, but also residents and potentially the state and other communities in the state. When issuers experience financial distress, bondholders may not be paid the full amount they are owed, or payments to them may be delayed. Residents and property owners may experience reduced services or increased taxes and fees.[65] Retired employees may lose their retirement benefits.[66] States may be under pressure to provide fiscal relief to the distressed city, and other cities in the state may have to pay higher interest rates on their bonds.[67]

While local government financial distress has causes other than imprudent borrowing, obligations to pay large amounts of debt service can certainly contribute to financial problems. For example, the use of auction rate securities (on which interest rates were reset periodically at auction, or if the auction failed, were set at predetermined rates, which often ranged

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[64] MOODY'S INVESTORS SERV., US MUNICIPAL BOND DEFAULTS AND RECOVERIES 1970-2019 7 (2020).

[65] For example, during its bankruptcy, the City of Vallejo made significant cuts to police and firefighting services, resulting in more violent crime and longer response times to fires and medical emergencies. THE PEW CHARITABLE TRUSTS, THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS 14 (2013). *See also* Christine Sgarlata Chung, *Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs*, REV. BANKING & FIN. L. 663, 667 (2013) (describing some impacts of the Detroit's fiscal distress on taxpayers and noting that they "face escalating expenses, crumbling infrastructure, and grossly inadequate services, despite their tax burden"). Note, however, that some local governments have strongly resisted doing either of these things. *See* Clayton P. Gillette, *Fiscal Federalism, Political Will and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 283, 285 (2012) (describing "refusals of fiscally distressed municipalities to accept higher taxes or reduced services").

[66] For example, in its bankruptcy proceedings the City of Detroit, Michigan cut pension and health care benefits for retirees. Christine Ferretti, *For Detroit Retirees, Pension Cuts Become Reality*, DETROIT NEWS (Feb. 27, 2015), https://www.detroitnews.com/story/news/local/wayne-county/2015/02/27/detroit-retirees-pension-cuts-become-reality/24156301/ [https://perma.cc/V4LD-KUZA],.

[67] ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 37–38; Gillette, *supra* note 66, at 288, 303–09 (2012); Parker, *supra* note 61, at 112 (quoting Massachusetts Representative Barney Frank).

between 12-15% and as high as 20%)[68] and interest rates swaps appear to have contributed to fiscal challenges that local governments confronted during and in the aftermath of the 2008 economic downturn.[69]

Even absent financial distress, borrowing may result in excessive costs for local governments and may reduce government flexibility to address changing circumstances. Payments on debt can divert funds from other important uses. Furthermore, in addition to the obligation to make the payments, debt can come with burdensome financial and operating covenants, and failure to comply with covenants may result in a default.[70] Debt gives some power over policy decisions to lenders, rating agencies and others.[71] For all of these reasons, state governments are justified in regulating local government borrowing.

Two primary reasons (in addition to the need under Dillon's Rule to provide clear authorization for local governments to be allowed to borrow at all) that states regulate local government borrowing are discussed in the following subsections: incentives of local governments to borrow more than they should, or for longer than they should; and inexperience or lack of knowledge leading local government officials to make unwise decisions about borrowing.

3.3.1. Incentives to Borrow Too Much

Government officials may have incentives to borrow more (and for longer) than would be consistent with interperiod equity,[72] and possibly than the local government can comfortably support, in order to obtain short-term

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[68] *See* Lori Raineri & Darien Shanske, *Municipal Finance and Asymmetric Risk*, 4 BELMONT L. REV. 65, 72–73 (2017) (describing auction rate securities); Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1488 (2013) (noting that interest rates on auction rate securities could be as high as 20% when auctions failed).

[69] Spencer T. Bachus, *Federal Policy Responses to the Predicament of Municipal Finance*, 40 CUMB. L. REV. 759, 765–67 (2010); Chung, *supra* note 68, at 1487–91; Theresa A. Gabaldon, *The Sewers of Jefferson County: Disclosure, Trust and Truth in Modern Finance*, *in* THE PANIC OF 2008: CAUSES, CONSEQUENCES AND IMPLICATIONS FOR REFORM, 255, 256–59 (Lawrence E. Mitchell & Arthur E. Wilmarth, Jr. eds., 2010); Raineri & Shanske, *supra* note 68, at 66; Tom Sgouros, *Predatory Public Finance*, 17 J. L. SOC'Y 91, 91–93 (2015).

[70] *See infra* notes 181–182 & 260 and accompanying text for discussion of some covenants.

[71] *See* Richard C. Schragger, *Democracy and Debt*, 121 YALE L. J. 860, 864–65 (2012) (citing David Hume and noting that debt gives capital markets some power to dictate policy choices). *See also generally* Roger Biles, *Public Policy Made by Private Enterprise: Bond Rating Agencies and Urban America*, 44 J. URB. HIST. 1098 (2018) (describing the influence that credit rating agencies have on public policy).

[72] *See* text accompanying note 50 for discussion of interperiod equity.

benefits the cost of which will not be paid until far into the future.[73] Furthermore, special interest groups that benefit from a particular borrowing may influence officials to undertake the transaction, resulting in more debt than is appropriate or debt the cost of which outweighs the benefits for the population as a whole.[74]

Voters may not prevent officials from borrowing too much. Elected officials may rely on support from interest groups to help them be elected or reelected, and these groups may not have the same interests as the broader community.[75] Even if current constituents are concerned about the burden on future residents, that will be merely one of many factors that contribute to their decision of whether to re-elect the local official.[76] In addition, voters may not monitor local government finances adequately. Even assuming that residents generally prefer that their local government behave in a fiscally responsible manner, each individual resident has the incentive to rely on others to monitor, with the result being an underinvestment in monitoring, and those that do have a greater interest in monitoring may not represent the interests of the residents as a whole.[77]

Furthermore, voters may have similar incentives to government officials to benefit today even if doing so burdens future residents, or they may not fully appreciate the long-term impacts of borrowing.[78]

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[73] *See, e.g.*, AMDURSKY ET AL., *supra* note 22, at § 4.1.1 ("[L]ocal officials, who will want to demonstrate constructive activity to constituents before the next election, have incentives to over-utilize debt, paying scant attention to long-term adverse effects."); Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 917–18 (2003) ("the ability to shift the costs forward may … induce elected officials to incur too much debt" because "they can get the credit for the new project immediately, while the blame for the additional taxes needed to pay off the debt will be borne by their successors"); Gelfand, *supra* note 50, at 549–51 (noting that future taxpayers are the primary beneficiaries of debt ceilings); Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1323–24 (1991) ("Debt limitations were meant to cure a perceived institutional defect of legislatures: the inability to account for the future costs of present decisions to incur debt.")

[74] *See* Sterk & Goldman, *supra* note 73, at 1365–66.

[75] Clayton P. Gillette, *Can Public Debt Enhance Democracy?*, 50 WM. & MARY L. REV. 937, 955 (2008).

[76] AMDURSKY ET AL., *supra* note 22, at § 4.1.1.

[77] Gillette, *supra* note 76, at 955, 961–64. Gillette identifies expected duration of residency and different individual priorities within the range of services provided by local governments as two reasons that even if some residents monitor, they may not represent residents as a whole. *Id.* at 961-964.

[78] AMDURSKY ET AL., *supra* note 22, at §§ 2.1, 4.1.1; Gelfand, *supra* note 50, at 599 (also noting that voters may reject desirable projects); Shoked, *supra* note 31, at 1267. If debt service were fully capitalized into real estate values and rents—that is, if property values fully reflected the cost of future debt service—then the interests of current and future

3.3.2. Lack of Expertise

Local government officials are not always experienced or knowledgeable enough to make good decisions about borrowing. Only 38% of government leaders surveyed considered themselves experts or very knowledgeable about public finance.[79] Local governments often have few resources dedicated to debt management, and frequently borrowing is outside the primary roles of even those officials responsible for issuing debt.[80] Many local governments only issue bonds once every few years; staff and officials at these governments may be particularly likely to be unfamiliar with the bond issuance process. Smaller communities tend to have smaller financial staffs, and the differences in capacity are likely to impact management of the

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residents would be more closely aligned. Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEG. ISSUES 365, 392 (2004). Scholars have reached varying conclusions about the extent to which taxes are capitalized into home values, though it appears that some capitalization occurs. *See id.* at 392 (noting varying conclusions about the extent of capitalization but indicating that some level of capitalization occurs); WILLIAM A. FISCHEL, THE HOMEVOTER HYPOTHESIS: HOW HOMES VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE AND LAND USE POLICIES 47–51 (2005) (discussing various capitalization studies and concluding that anticipated taxes are fully capitalized). However, even if property taxes are fully capitalized in some circumstances, it seems unlikely that the possibility of higher taxes in the future to pay debt service, much less the possibility of higher rates, charges or fees of other kinds, would be.

[79] Justin Marlowe, *Guide to Financial Literacy: Connecting Money, Policy and Priorities*, GOVERNING 5 (2014), https://media.erepublic.com/document/GOV14_FinancialLiteracy_v.pdf [https://perma.cc/7V4A-NQ9G]. *See also* Thomas A. Schweich, Missouri State Auditor, Report No. 2013-116, Statewide General Obligation Bond Sales Practices 12 (2013) ("Based on interviews with local government finance officials, there is a clear lack of understanding of the bond issuance process.").

[80] GOV'T FIN. OFFICERS ASSOC., DEBT 101: ISSUING BONDS AND YOUR CONTINUING OBLIGATIONS 2 (2020); Monique Moyer, *Current Issues Facing Bond Issuers and Their Financial Advisors*, MUN. FIN. J. 17, 18 (2003); *see also* ANG & GREEN, *supra* note 19, at 8 ("Furthermore, when municipalities negotiate with investment banks and other financial intermediaries to issue debt, municipalities often have less expertise and relatively few resources to guide their decision making. This is detrimental not only to investors, but also to municipalities themselves."); Jack Casey, *MCDC's Appropriateness, Effect on Market Disclosure Debated*, BOND BUYER (May 5, 2016), http://www.bondbuyer.com/news/washington-securities-law/mcdcs-appropriateness-effect-on-market-disclosure-debated-1102961-1.html [https://perma.cc/KYZ8-F6R3] (noting that officials at small issuers sometimes have multiple responsibilities and citing the example of a finance director for a small school district who also drives the school bus).

issuer's debt, including the interest rates paid on that debt.[81] Even large issuers don't always understand the agreements they make.[82]

Of course, there are also many local government officials who are extremely capable and knowledgeable about local government finance and borrowing. Some of the most knowledgeable, intelligent, dedicated people with whom I have had the pleasure to work have been local government officials involved in public finance. Some local government officials are recognized leaders in their field, training others at programs for the Government Finance Officers Association, the California Debt and Investment Advisory Commission, and others.[83]

3.4. How Problems Have Developed

Many state laws governing municipal bonds have developed piecemeal over the years, with new laws being added on top of existing legislation, rather than legislation being revised in its entirety.[84] Furthermore, in most states bond laws are scattered throughout numerous statutes and codes.[85] The requirements for different types of bonds and different types of issuers are not always the same (and this is not always intentional).[86] This

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[81] Bill Simonsen et al., *The Influence of Jurisdiction Size and Sale Type on Municipal Bond Interest Rates: An Empirical Analysis*, 61 PUB. ADMIN. REV. 709, 710–11, 715 (2001).

[82] *See* Stephan Whitaker, *Financial Innovations and Issuer Sophistication in Municipal Securities Markets* 4 (Fed. Res. Bank of Clev., Working Paper No. 14-04, 2014) (citing Orange County, California and Detroit, Michigan as examples).

[83] *See, e.g.*, *Debt Management: Overview of a Bond Issuance*, Gov't Fin. Officers Assoc., https://www.gfoa.org/events/overview-of-a-bond-issuance [https://perma.cc/EKG6-3BV4]; *Municipal Debt Issuance Fundamentals*, Cal. Debt & Inv. Advisory Comm'n, https://www.treasurer.ca.gov/cdiac/webinars/2020/20200909/description.asp [https://perma.cc/XZ8P-TLTA]; *Navigating Investor Disclosures during the COVID-19 Crisis*, Cal. Debt & Inv. Advisory Comm'n, https://www.treasurer.ca.gov/cdiac/webinars/2020/20200501/description.asp [https://perma.cc/Y4ZB-HHHC].

[84] Salsich, *supra* note 60, at §§ 12.1, 12.2; *see also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 1.1.2 (noting that rather than amending existing statutes to reflect changes in the bond market, California added a series of statutes that apply to all local governments issuing bonds); Fredric A. Weber, et al., *A Case for Public Finance Reform in Texas*, 23 HOUS. L. REV. 1113, 1113–16 (1986) (describing Texas borrowing law as developing "gradually by bits and pieces in response to immediate needs" and describing the tendency to establish new governments and to add new statutes rather than amending existing ones).

[85] Salsich, *supra* note 60, at § 12.1; *see also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at App. A (a list of bonding statutes that spans several pages).

[86] *Id.* at § 12.2; *see* Harvey W. Rogers, *Government Borrowings Work Group: Revision of State and Local Government Borrowing Laws Found in ORS Chapters 286, 287 and 288 HB 3265*, *in* BIENNIAL REPORT OF THE OR. LAW COMM'N 2005-2007 § 2 (noting that prior to a revision of Oregon bond law in 2007, local governments were "occasionally left out because of drafting inconsistencies").

makes it more difficult (and hence more time consuming and potentially more costly) to determine which requirements apply to a particular transaction.[87]

Additionally, state laws have not always kept up with changing circumstances. For example, debt limits are tied to property values in most states.[88] This dates back to 1800s, when property taxes generated most local government revenues and property owners were regarded as a class deserving special protection.[89] Today, more local government revenues come from sources other than property taxes, and several have suggested that, to the extent debt limits should apply, this is not an appropriate measure.[90] Some laws do not reflect current market practices. For example, Montana law requires that a notice of competitive sale be published in a local newspaper, and Hawaii law requires that a notice of a competitive sale be published in a financial newspaper published in New York, Chicago or San Francisco.[91] As a practical matter, bidders are more likely to learn of a competitive sale through an online service today. As such, complying with or legally avoiding archaic requirements can be costly.

Complicated laws increase the likelihood of errors. For example, one New York bond lawyer has noted that in reviewing bond resolutions and procedures taken by New York local governments, his firm "often find[s] an error or other violation of New York State law that raises an issue of the validity of the bond resolution."[92]

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[87] *See* Salsich, *supra* note 60, at § 12.2 (noting that authorizing statutes must be reviewed carefully); Rogers, *supra* note 87, at § 2 (noting that "ambiguous or inconsistent" borrowing statutes create "significant and unnecessary cost" to local governments and that prior to the revisions in HB 3265, it had become increasingly difficult to determine how different statutory provisions relate to each other and what the statutes mean).

[88] AMDURSKY ET AL., *supra* note 22, at § 4.2; M. David Gelfand, *Debt Ceilings and Other Restrictions on Debt Financing: Compliance, Avoidance, and Evasion, in* 1 GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING §§ 11.1, 11.4 (2d. ed.) (database updated Nov. 2020).

[89] Gelfand, *supra* note 89, at § 11.1.

[90] *See infra* Section 5.1.2.

[91] HAW. REV. STAT. ANN. §47-8 (LexisNexis 2020); MONT. CODE ANN. § 7-7-2252 (2019).

[92] A. Joseph Scott, III, *Ten Common Mistakes in the Preparation and Adoption of Bond Resolutions*, TALK OF THE TOWNS 14, 14 (2009), https://www.hodgsonruss.com/media/publication/47_AJS_ATSNY_10_2008.pdf [https://perma.cc/MUU2-QGFQ]. Correcting these errors can delay a financing. *Id.*

4. MOVING TOWARDS A BETTER BOND LAW

4.1. This is Not a New Idea

Parts 5-7 of this article discuss some existing bond law provisions and recommended improvements. This is not the first time that improved bond laws have been proposed. The National Municipal League proposed a model county and municipal bond law in 1953, a model municipal revenue bond law in 1958 and a revised model municipal bond law in 1962.[93] Individual states have taken actions to improve their bond laws. For example, Texas consolidated (but did not revise) its bond laws in 1999.[94] Oregon reformed its bond law in 2007 with the objectives of clarifying how provisions relate to each other; simplifying and modernizing language and definitions; eliminating inconsistencies and outdated or unnecessary requirements; making financing techniques available to all local governments unless there was a reason not to do so; granting the state Treasurer more authority to adopt rules affecting borrowings; and reforming older statutes to allow local governments to adapt to evolving market conditions.[95] The revisions did not affect debt limits or other requirements that are in the state's constitution.

In addition, others have criticized and proposed alternatives to some aspects of municipal bond law, particularly debt limits and voter approval requirements. Some of these criticisms and alternatives are discussed elsewhere in this article.

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[93] *See generally*, NAT'L MUN. LEAGUE, A MODEL COUNTY AND MUNICIPAL BOND LAW (1953); NAT'L MUN. LEAGUE, MODEL MUNICIPAL REVENUE BOND LAW (1958); NAT'L MUN. LEAGUE, MODEL MUNICIPAL BOND LAW (1962).

[94] *See generally* 1999 Tex. Sess. Law Serv. Ch. 227 (H.B. 3157) (VERNON'S); *see also* Tex. Office of House Bill Analysis, Bill Analysis, H.B. 3157 (July 15, 1999) ("The Public Securities title is a nonsubstantive revision of Texas law. The sole purpose of the title is to compile the relevant law, arrange it in logical fashion, and rewrite it without altering its meaning or legal effect. If a particular source statute is ambiguous and the ambiguity cannot be resolved without a potential substantive effect, the ambiguity is preserved."), https://capitol.texas.gov/tlodocs/76R/analysis/html/HB03157I.htm [https://perma.cc/X4ZG-5ZSA].

[95] Rogers, *supra* note 87, at § 3. This bill "was warmly received by both Oregon House and Senate Revenue Committees, sailed through both chambers and was signed into law by the governor." David R. Kenagy, *The Oregon Law Commission at Ten: Finding Vision for the Future in the Functions of the Past*, 44 WILLAMETTE L. REV. 169, 190 n. 78 (2007). Although some policy changes were made by this bill, making policy changes was not its objective. Rogers, *supra* note 87, at § 4.

4.2 Starting a Conversation

This article is intended to start a conversation about changes that could be made to move towards better bond laws. It does not present a single model bond law for all states, or for a particular state, nor does it describe in detail the complete bond laws of any particular state or the specific types of bonds that may be issued in any particular state. Rather, it is intended to provide decisionmakers with a basis for making informed decisions about the approach to municipal bonds that is most appropriate for local governments in their state. States vary in the types and structures of local governments and the powers given to them.[96] Values and priorities are also likely to vary among states, so different states may prefer different solutions.

Furthermore, it does not address all aspects of bond laws. Instead, it focuses on areas that affect the ability of local governments to make decisions about how much debt to issue, in what form, with what terms, and how to sell that debt and the ability of the public to be aware of and to impact those decisions. Within this scope, the article provides a recommended policy option (or options) and the reasoning for the recommendations, as well as other alternatives and some examples of what states currently do. It addresses both constitutional and statutory provisions (recognizing that constitutional ones may be difficult to change).

4.3. Underlying Goals

Ideally, law governing local borrowing would achieve two principal goals: (1) providing local governments the freedom to innovate and make decisions in the interest of their citizens while protecting current and future citizens from poor decisions made by local governments,[97] and (2) ensuring

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[96] *See, e.g.,* U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, A-127, LOCAL GOVERNMENT AUTONOMY: NEEDS FOR STATE CONSTITUTIONAL, STATUTORY, AND JUDICIAL CLARIFICATION 7 (1993) (noting that local governments take a variety of forms and organizational structures); FRUG & BARRON, *supra* note 57, at Part II (comparing the powers given to seven major cities in the United States).

[97] Or, to put it another way, "striking a careful balance between flexibility in the exercise of authority on the one hand, and appropriate controls and safeguards on the other." Elsie Addo Awadzi, *Designing Legal Frameworks for Public Debt Management* 5 (Int'l Monetary Fund Working Paper no. WP/15/147, 2015). *Also see* ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 2 (the purpose of bond laws is "[t]o empower local governments to make use of borrowing, prudently and in a responsible and locally responsive manner, as one means for financing their requirements.").

that information is available to the public and that the public has a meaningful opportunity to influence proposed local government borrowing.[98]

4.3.1. Freedom and Protection

This article starts with the premise that there is value in allowing local governments to make their own decisions, in large part because local governments are more likely to represent the interests of their citizens than the state or federal government is.[99] This is not to say that there should be no restrictions on local government action. For example, local governments should not be able to impose negative externalities on other communities or on future citizens (such as by violating interperiod equity), nor should they be able to act in ways that are fundamentally inconsistent with important values like protecting civil rights and promoting racial equality.

However, current and future citizens deserve and need protection from poor decisions made by local governments. As was discussed in Sections 0 and 0, local government officials may be predisposed to borrow

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[98] Others have also noted the importance of transparency and responsiveness. *See, e.g.*, Awadzi, *supra* note 98, at 4 (noting the importance of transparency and accountability, along with discipline); Gelfand, *supra* note 50, at 579, 586 (1979) (noting the importance of providing accurate information to stakeholders, including officials and voters, and of government being responsive to citizens).

[99] Various commentators have taken this view. *See, e.g.*, AMDURSKY ET AL., *supra* note 22, at § 1.1.3 (noting that local governments have been viewed as "the focal point of attempts to formulate communities of like-minded individuals" and "the only meaningful places in which political participation can occur and the objectives of democracy be realized" and that these perspectives suggest that local governments should differ from each other in the goods and services they provide); FRUG & BARRON, *supra* note 57, at 49–52 (highlighting the importance of local governments to democracy and innovation); Heather K. Gerken, *A New Progressive Federalism*, 24 DEM. J. 37 (2012), https://democracyjournal.org/magazine/24/a-new-progressive-federalism/ [https://perma.cc/MA4W-MC5K] (noting that racial and political minorities can have more power at the local level than at the federal or state level); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956) (suggesting that people will move to the community that best meets their set of preferences and that more communities and more variation between them will allow more people to more closely meet their preferences). Some have noted increased efforts of states to restrict power of local governments (in areas other than debt issuance) in recent years. *See, e.g.*, Jessica Amoroso & Sarah Winston, *COVID-19 Unmasks Issues Around Public Health Preemption*, HARV. L. SCH. PETRIE-FLOM CTR,: BILL OF HEALTH (Dec. 21, 2020), https://blog.petrieflom.law.harvard.edu/2020/12/21/covid-public-health-preemption/ [https://perma.cc/R2AH-9P9M] (noting that state preemption is increasingly being used to prevent local governments from addressing public health issues, such as paid sick leave or prohibiting stay-at-home measures or mask requirements to prevent the spread of COVID-19); Erin Scharff, *Preemption and Fiscal Authority*, 45 FORDHAM URB. L.J. 1270, 1273–4, 1279–82 (2018) (describing more restrictive state laws constraining local governments and citing examples); Richard C. Schragger, *The Attack on American Cities*, 96 TEX. L. REV. 1163, 1169–83 (2018) (citing examples).

more than they should and some officials may not be sufficiently knowledgeable to make prudent decisions about borrowing. This article suggests that while some restrictions on borrowing are appropriate, for the most part education and support is a better solution to lack of expertise than are detailed rules about the terms of financings. More straightforward bond laws may even help local government officials make better borrowing decisions, as is discussed in Section 4.3.3.

4.3.2. Ensuring Public Opportunity to Participate

The second primary objective of the framework is ensuring that information is available to the public and that the public has a meaningful opportunity to provide input on proposed local government borrowing. It is critical in a democratic society that residents are aware of and have the opportunity to understand the significant actions that are being taken by their government (including their local government) and that they have the opportunity to influence those actions, whether that is through public comment, contacting public officials, or voting on the matter.

4.3.3. Other Key Principles

In addition to the underlying goals identified above, the framework is guided by several principles. In particular, the importance of:

- Treating all local governments the same except where there is a reason not to do so.
- Treating all debt the same except where there is a reason not to do so.
- Focusing on the economics of the transaction rather than the structure.
- Providing flexibility for changing circumstances and market conditions.
- Avoiding overlapping, inconsistent and unduly complicated provisions whenever possible, and keep related provisions together whenever possible.

Each of these principles contributes to the underlying goals described above. Consistent treatment of different types of government and different types of debt encourage local governments to make decisions based on which type of financing structure best meets their needs rather than based on restrictions or approval requirements that apply to some types of debt but not others. Treating types of government and borrowings consistently also will promote transparency.[100] Similarly, laws that focus on the economics of the

[100] *See infra* note 180 and accompanying text.

transaction rather than its structure are less likely to distort borrowing decisions, and flexibility to adapt to changing circumstances and market conditions is more likely to allow local governments to structure their borrowing optimally and to avoid needing to satisfy obsolete requirements. Structuring borrowing law as simply as possible should make the law easier for both the governments and citizens to understand and follow and should help local governments avoid making costly mistakes.

4.4. Limitations of the Framework

Due to constraints of space, the framework doesn't cover all possible types of borrowing or financing, nor does it specifically address interest rate swaps or other derivatives in any detail. Instead, it focuses on general obligation bonds and revenue bonds issued by local governments. Some of the same principles could be applied to other types of financing. The article uses the term "borrowing" to cover all transactions that result in a local government receiving money in exchange for an obligation to repay, but does not cover other obligations local governments may have, such as commitments to pay pension and other benefits to retirees in the future.

Furthermore, the article is focused on general purpose local governments and special districts, not on bonds issued for the benefit of private nonprofit or for-profit entities. Borrowings on behalf of private parties raise some of the same concerns, but many different ones.

Additionally, as noted in Section 4.2 above, this article focuses on topics related to the scope of decision-making authority of local governments and the involvement of community members in the decision-making process, rather than more technical (but also important) aspects of bonds such as how revenues to pay bonds are collected, how bonds are secured, remedies available to bondholders and methods to ensure the validity of bonds issued. Those topics, and perhaps a proposed uniform act that could be adopted by multiple states covering some or all of them, could be the subject of a separate article or a project by an organization such as the National Association of Bond Lawyers.

State laws also address topics that are relevant to municipal bonds but have more general applicability, such as laws concerning treatment of financially distressed municipalities and whether they can apply for bankruptcy, restrictions on the ability to raise taxes or other revenues, laws governing the duties of government officials, laws concerning the procedures for elections, and open meeting laws. While these laws are all important, they are beyond the scope of this article.

5. Restrictions on the Ability to Issue Debt: Debt Limits and Voter Approval Requirements

5.1. Debt Limits

5.1.1. Existing Debt Limits

Most states impose limits on the amount of debt issued by their local governments.[101] Some of these limits appear in state constitutions and others are statutory. The limits take a variety of forms, most commonly a fixed percentage of property values.[102] The limits imposed on governments vary, sometimes even for different local governments within a state or for debt issued for different purposes. For example, the Hawaii Constitution limits outstanding debt of a local government to 15% of the total assessed value of real property within the local government's boundaries.[103] The New York Constitution includes a range of limits based on a percentage of average full valuation, including, among others, 10% for Nassau County and 7% for other counties; 10% for New York City, 9% for other cities with populations of 125,000 or more and 7% for smaller cities; 7% for towns and villages.[104] Oregon limits outstanding general obligation bonds of counties to 2% of the market value of taxable property in the county, and of cities to 3% of the market value of the taxable property in the city (with exceptions for cities for some types of projects).[105] California limits the outstanding general obligation bonds of elementary and high school districts to 1.25% of the assessed value of taxable property in the district, while the limit for non-home-rule cities is 3.75% and for counties is 1.25% or 3.75% depending on the purpose for which the bonds are being issued.[106]

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[101] Spiotto, supra note 4, at 6–8 (discussing the limits states have placed on debt municipalities may issue and noting that all states except three have a limit on local government debt); Gillette, *supra* note 4, at 1255 ("Virtually every state constitution imposes limits on the amount of debt that its political subdivisions can issue in order to fund capital projects . . .").

[102] *See supra* note 88 and accompanying text.

[103] HAW. CONST. art. VII, § 13. The Hawaii Constitution includes exceptions to this limit. Assessed value is the value assigned to property by a taxing authority for purposes of ad valorem taxation. The method of establishing assessed valuation varies from state to state and is sometimes lower than the market value of the property. *Glossary of Municipal Securities Terms: Average Life*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/Glossary/Definition/ASSESSED-VALUATION-OR-ASSESSED-VALUE.aspx [https://perma.cc/6PCS-45EN].

[104] N.Y. CONST. art. VIII, § 4.

[105] OR. REV. STAT. §§ 287A.050, 287A.100 (2019).

[106] CAL. DEBT & INV. ADVISORY COMM'N, CDIAC NO. 06-04, CALIFORNIA DEBT ISSUANCE PRIMER 138 (2006). The limit for unified school districts (which include both elementary

Exceptions to debt limits sometimes make them less meaningful. For example, local governments in New York are rarely constrained by debt limits because of exclusions and deductions.[107] Some state laws, such as the California and Oregon laws described in the preceding paragraph, expressly apply limits only to certain types of debt, and courts also have created exceptions to these limitations in most states.[108] This is discussed in greater detail in Section 5.3.

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and high schools) is 2.5%. *Id.* The California State Board of Education sometimes waives the limits for school districts. KEVIN DAYTON, CAL. POLICY CTR., FOR THE KIDS: CALIFORNIA VOTERS MUST BECOME WARY OF BORROWING BILLIONS MORE FROM WEALTHY INVESTORS FOR EDUCATIONAL CONSTRUCTION 44 (2015).

[107] *See* DOUGLAS E. GOODFRIEND & THOMAS E. MYERS, ORRICK, BOND BASICS FOR SCHOOL DISTRICTS IN NEW YORK STATE 5 (2009), https://media.orrick.com/Media%20Library/public/files/2/2163-pdf.pdf [https://perma.cc/KKK5-2VCS] [hereinafter GOODFRIEND & MYERS, BOND BASICS FOR SCHOOL DISTRICTS] (noting this with respect to school districts other than small city school districts); DOUGLAS E. GOODFRIEND & THOMAS E. MYERS, ORRICK, BOND BASICS FOR TOWNS, VILLAGES AND CITIES IN NEW YORK STATE 5 (2009), https://media.orrick.com/Media%20Library/public/files/2/2161-pdf.pdf [https://perma.cc/BSH2-JWU9] [hereinafter GOODFRIEND & MYERS, BOND BASICS FOR TOWNS, VILLAGES AND CITIES] (noting this with respect to towns, villages and cities); THOMAS E. MYERS & DOUGLAS E. GOODFRIEND, ORRICK, BOND BASICS FOR COUNTIES IN NEW YORK STATE 5 (2009), https://media.orrick.com/Media%20Library/public/files/2/2160-pdf.pdf [https://perma.cc/HM9J-TFNW] [hereinafter MYERS & GOODFRIEND, BOND BASICS FOR COUNTIES] (noting this with respect to counties); THOMAS E. MYERS & DOUGLAS E. GOODFRIEND, ORRICK, BOND BASICS FOR FIRE DISTRICTS IN NEW YORK STATE 5 (2010), https://media.orrick.com/Media%20Library/public/files/4/4257-pdf.pdf [https://perma.cc/B3VA-BQS3] [hereinafter MYERS & GOODFRIEND, BOND BASICS FOR FIRE DISTRICTS] (noting this with respect to fire districts).

[108] *See, e.g.*, AMDURSKY ET AL., *supra* note 22, at § 4.1.1 ("[M]yriad devices have evolved, largely with judicial blessing, to remove borrowing schemes from what might, in common parlance, be considered debt."); Gelfand, *supra* note 89, at § 11.12 (indicating that most courts have held that debt not backed by the government's full faith and credit is exempt from debt ceilings and referenda requirements); Shoked, *supra* note 31, at 1253–54 (noting that financing structures that are equivalent to debt are not always subject to limits and that debt limits typically only apply to debt guaranteed by property taxes).

5.1.2. Debt Limits in Their Current Form Do More Harm Than Good and Should Be Replaced or, Better Yet, Eliminated, Wherever Possible

Effective debt limits would promote interperiod equity and prevent local governments from borrowing more than they can afford.[109] However, it is unlikely that debt limits in their current form achieve these goals, even if they are effective. Furthermore, debt limits may have negative impacts on some communities and prevent needed projects from proceeding, and they may be counter to the objective of providing the public with a meaningful opportunity to influence borrowing (at least if such borrowing exceeds the legal limits, since it would not be permitted regardless of public sentiment). If debt limits are effective, they raise some of the issues discussed below. The possibility that they may not be effective and may simply lead to more expensive debt and less transparency is discussed in Section 5.3. For these reasons, discussed in greater detail below, debt limits should be modified or, better yet, eliminated.

As was noted above, debt limits vary widely. Although some differences in limits may be explained by the different responsibilities or needs of local governments in different states, or of different types of local governments in the same state,[110] the wide variety of limits "… suggests that, far from being linked to some conception of an optimal amount of debt, these provisions have been created in a haphazard manner in order to place some cap on borrowing, regardless of how that level correlates to ability to pay, to need, or to any other standard."[111] Compounding the problem, a single property may be within the boundaries of multiple overlapping local governments (for example, county, city, school district, special districts) with separate debt limitations, meaning that the amount of debt burdening that

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[109] *See, e.g.*, AMDURSKY ET AL., *supra* note 22, at § 2.1 (describing the purposes of restrictions as ensuring that bonds are issued only when the societal benefits outweigh the costs and describing interperiod equity as the purpose of debt limits); Gelfand, *supra* note 88, at § 11.2 (describing effective debt ceilings as protecting future taxpayers from "inordinate debt service on capital projects that may have produced few tangible benefits for them"); *see also supra* Section 3.3.

[110] *See* ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 44 (suggesting that different types of local governments should have different limits because of differences in "scope of responsibilities and financial needs" and noting that municipal governments commonly borrow several times more than counties, school districts or townships).

[111] James A. Coniglio, *Chapter 4: Credit Rating Agencies*, *in* 1 GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING § 4.1 (2d. ed.) (database updated Nov. 2020). *See also* Gillette, *supra* note 4, at 1258 (2009) (noting that "the variety of limitations placed on municipalities belies [the] proposition" that "municipal debt limitations reflect[] some sophisticated analysis of the optimal debt level that a locality should incur" and describing various limits).

property may be far higher than the debt limit for any individual local government within the boundaries of which it is located.[112]

Furthermore, even if an optimal level of borrowing had been determined, it is not likely that level would be tied to real property values, particularly with respect to debt that is not payable exclusively from property taxes. When debt limits were initially enacted over a century ago, local revenues were derived almost entirely from property taxes.[113] Today, though, property taxes comprise a minority of overall local government revenues (45.3% of local own-source revenues and 28.3% of total local government general revenues in 2008).[114]

Property taxes tend to be a relatively stable revenue source because they are based on asset value rather than an annual stream of income or sales.[115] In some states, property tax revenues can be adjusted when property values decline by increasing tax rates.[116] For these reasons, if there are limits on borrowing, they should be a component of the limit. However, it would be sensible to also include other sources that would be available to pay debt service, including revenues from other taxes and fees. A limit based on appropriations or revenues (or revenues available to pay debt service) would be a better gauge of ability to pay.[117] This would not, however, address the

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[112] *See* AMDURSKY ET AL., *supra* note 22, at § 4.13 (discussing this problem); *see also* MONTEREY COUNTY, *supra* note 9 and accompanying text.

[113] Gelfand, *supra* note 89, at § 11.1.

[114] Michael E. Bell, *Real Property Tax*, *in* THE OXFORD HANDBOOK OF STATE AND LOCAL GOVERNMENT FINANCE 271, 271 (Robert D. Ebel & John E. Petersen eds., 2012). Local own-source revenues are revenues generated by the local government itself (such as taxes and fees) rather than received from the federal or state government. General revenues are revenues that can be used for any purpose. A property tax that must be used to pay debt service on bonds or a grant that must be used for a specific purpose would not be general revenues. The extent to which local governments depend on property taxes varies. For example, on average, property taxes are responsible for 14% of California city revenues, 22% of California county revenues, and 65% of non-enterprise special district (such as fire district or library district) revenues. INST. FOR LOCAL GOV'T, Understanding the Basics of Municipal Revenues in California: Cities, Counties and Special District (2016 Update), https://www.ca-ilg.org/sites/main/files/file-attachments/basics_of_municipal_revenue_2016.pdf [https://perma.cc/RV6X-ZXCH], 4–6.

[115] Bell, *supra* note 114, at 274–75.

[116] *See* Catherine Collins and Geoffrey Propheter, *Tax Analysts Special Report: The Property Tax Base and The Great Recession*, TAX ANALYSTS, at 445 (2013) (noting that some locales did this during the 2007–2009 recession). The ability to raise tax rates is limited in some states. For example, the California Constitution imposes a 1% limit on property taxes with some exceptions, most significantly for voter-approved bonds. CAL. CONST. art. XIIIA, § 1.

[117] *See* AMDURSKY ET AL., *supra* note 22, at § 4.2 (suggesting that limits based on revenues or appropriations might be better); Briffault, *supra* note 74, at 948 (noting that debt limitations might be more defensible if they were tied to the revenue-generating capacity of governments); Gelfand, *supra* note 50, at 587 (noting that limiting debt based on only a

issue of what the limit should be and as noted above, there does not seem to be consensus on what an appropriate limit is.

Debt limits tied to property values also may exacerbate existing economic disparities. Jurisdictions with relatively low property values per capita are more likely to be constrained by debt limits, both because the limits restrict them to a smaller amount per capita to meet infrastructure needs and because areas with lower property values may have greater needs than areas with higher property values.[118]

Debt limits of the type discussed in this section do little to promote interperiod equity since they say nothing about how debt is amortized, the period for which debt is outstanding or the amount that can be borrowed for a particular project, all they restrict is the total amount borrowed. If set too low, debt limits could even be counter to interperiod equity because they would not allow for enough borrowing. That said, some studies do suggest that communities that are subject to debt limits borrow less than those not subject to such limits.[119]

In addition, debt limits can block desirable as well as undesirable debt.[120] Because of the important role that debt plays in providing important infrastructure, "[l]ow levels of debt and the resulting low levels of capital

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portion of the government's income base is not effective and proposing including wealth if there is an income tax and sales volume if there is a sales tax).

[118] *See, e.g.*, AMDURSKY ET AL., *supra* note 22, at § 4.15 (noting there may be an inverse relationship between assessed valuation and need and debt limits may prevent the localities most in need of debt financing from borrowing); ORANGE CNTY. GRAND JURY, SCHOOL BONDS—THE UNTOLD STORY OF ASSESSED VALUES 11–12 (2014), https://www.ocgrandjury.org/pdfs/2013_2014_GJreport/BondsReport.pdf [https://perma.cc/G6VH-4KRP] (providing an example of how borrowing capacity in a school district with lower assessed value per student compares to that in a district with higher assessed value per student); Eric J. Brunner & Kim Rueben, *Financing New School Construction and Modernization: Evidence from California*, 54 NAT'L TAX J. 527, 535–36 (2001) (school districts that have low assessed valuation per student are more likely to be constrained by debt limits that are based on property values); Darien Shanske, *Above All Else Stop Digging: Local Government Law as a (Partial) Cause of (and Solution to) the Current Housing Crisis*, 43 U. MICH. J.L. REFORM 663, 703 n. 110 (2010) (noting that a limit on the tax rate required for debt service compared to assessed value has a disproportionate impact on areas with lower property values). The same may also be true of debt limits tied to local government revenues generally, and grants or other mechanisms to redistribute resources may be more effective at reducing disparities than relaxing restrictions on borrowing, though this topic is beyond the scope of this article).

[119] *See infra* note 178. Of course, it may be that regions where residents are less supportive of government borrowing are more likely to have debt limits. Others also have made this point. *See* D. Roderick Kiewiet & Kristin Szakaly, *Constitutional Limitations on Borrowing: An Analysis of State Bonded Indebtedness*, 12 J. L. ECON. & ORG. 62, 69 (1996) (noting that debt limits may "reflect the degree to which citizens of the state are averse to borrowing").

[120] *See* Sterk & Goldman, *supra* note 74, at 1366 ("Mechanical limitations are doomed to failure," in part because they can prevent borrowing even when it is desirable).

investment can be as harmful to a state or locality as excessive debt," but debt limits that do not take need into account do nothing to address this.[121] In addition, debt limits that cannot be modified by approval of voters in the affected area negatively affect the ability to respond to community desires because even if voters within a local government's boundary want to borrow in excess of the limit, they cannot do so unless the state legislature and/or voters statewide act to allow them to do so.[122]

Some of these issues may have contributed to the creation of exceptions to debt limits described in Section 5.3. These exceptions have created significant additional problems. Because similar issues arise regarding exceptions to voter authorization requirements, both are discussed together in Section 5.3.

5.2. Voter Approval Requirements

5.2.1. Existing Voter Approval Requirements

Most states have voter approval requirements for some local government borrowing, most commonly majority approval, but in some states, supermajority approval (the size of the required supermajority varies).[123] Sometimes, approval of debt is also an approval of an increased tax to pay the bonds, or approval occurs concurrently with the approval of the new tax. For example, California local governments must obtain the approval of two-thirds of their voters voting on the matter (with smaller percentages required for certain issuers in some circumstances) to issue general obligation bonds, which also authorizes the increase in property taxes to pay those bonds.[124] Bonds payable from sales taxes also often require voter approval in California.[125] Local governments in Oregon must obtain approval of a majority of their voters voting on the matter before issuing general obligation bonds.[126] In some states, debt limits of the type described in Section 0 above

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[121] Briffault, *supra* note 74, at 949.

[122] *See* Gelfand, *supra* note 50, at 91 (noting that voters in a locality that wanted to borrow in excess of a constitutional debt ceiling would need the support of voters throughout the state to amend the ceiling and allow them to do so).

[123] Salsich, *supra* note 60, at §§ 12.23, 12.30; Gillette, *supra* note 79, at 370.

[124] CAL. CONST. art. XIIIA, § 1(b)(2), (3); art. XVI, § 18(a), (b).

[125] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 3.3.3. The sales taxes themselves also require voter approval (by either a majority or 2/3 of those voting on the matter, depending on the use of the tax proceeds). CAL. CONST. art. XIIIC. *See also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 3.3.3.

[126] OR. CONST. art. XI §§ 11(11)(d)(C)(ii), 11b(3)(b), 11L (these provisions allow property taxes to be set at levels sufficient to cover debt service with voter approval); OR. REV. STATS. §§ 287A.050, 287A.100 (2019).

can be overridden with voter approval.[127] In others, there is only a voter approval requirement, not a debt limit.[128]

Sometimes, voters may be asked to approve debt only at certain elections. For example, in Oregon, general obligation bonds must be approved either at an election held in May or November, or at another election at which a majority of registered voters cast ballots.[129] In California, school districts may obtain approval of general obligation bonds for which approval of only 55% of those voting on the matter (rather than two-thirds) is required only at "a primary or general election, a regularly scheduled local election at which all of the electors of the school district … are entitled to vote, or at a statewide special election."[130] Presumably these requirements are imposed because voter turnout is higher at some elections than others.[131]

Instead of a voter approval requirement, some states provide a period in which voters can petition to have an election concerning particular debt (sometimes referred to as a "permissive referendum" or "backdoor referendum") for some local government bonds. For example, with limited exceptions, bond resolutions adopted by towns and villages in New York are not immediately effective.[132] Rather, the local government must publish a notice that the resolution has been adopted, and during a 30-day period after adoption, a petition may be filed signed by a specified number of voters requesting that the voters of the town or village be given an opportunity to vote on the bonds.[133] If no petition is filed within 30 days, the resolution

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[127] AMDURSKY ET AL., *supra* note 22, at § 4.2; Salsich, *supra* note 60, at § 12.25.
[128] Gelfand, *supra* note 88, at § 11.7.
[129] OR. CONST. art. XI, §§ 11(8), 11k. Since it is rare for a majority of voters to cast ballots, general obligation bond elections are usually held in May and November. LEAGUE OF OR. CITIES, *supra* note 50, at 8.
[130] CAL. EDUC. CODE § 15266(a) (Deering 2021).
[131] For example, one study covering the period from 2004-2006 found that voter turnout for local elections held concurrently with national elections had an average turnout rate of 76% during a presidential election year and 56% during congressional elections, while local elections held in off-years or not at the same time as national elections had an aggregate turnout rate of between 18-35% (the author suggests that the 35% reflects some states having statewide elections at the same time). J. ERIC OLIVER, LOCAL ELECTIONS AND THE POLITICS OF SMALL-SCALE DEMOCRACY 64–65 (2012).
[132] N.Y. LOC. FIN. LAW §§ 35.00, 36.00 (McKinney 2021); GOODFRIEND & MYERS, BOND BASICS FOR TOWNS, VILLAGES AND CITIES, *supra* note 8, at 28. In contrast, cities and counties are often not subject to a permissive or mandatory referendum process (so no voter approval is required) and school districts and fire districts are often subject to a mandatory referendum process (so voter approval is always required). *Id.* at 30; MYERS & GOODFRIEND, BOND BASICS FOR COUNTIES, *supra* note 8, at 25; GOODFRIEND & MYERS, BOND BASICS FOR SCHOOL DISTRICTS, *supra* note 108, at 29; MYERS & GOODFRIEND, BOND BASICS FOR FIRE DISTRICTS *supra* note 108, at 23.
[133] N.Y. TOWN LAW §§ 90, 91 (McKinney 2021); N.Y. VILLAGE LAW § 9-900.2, 9-902 (McKinney 2021).

becomes effective and the bonds may be issued.[134] Illinois, Oregon and Texas have similar procedures for some debt.[135]

5.2.2. Voter Approval Requirements Should Be Carefully Considered and Potentially Limited

Voter approval requirements should ensure that local government officials are acting consistently with the desires of their constituents and that community members are informed (or at least have the opportunity to be informed) about proposed borrowing and major projects being financed. Ideally, they also would promote interperiod equity. While voter approval requirements are more successful in achieving these objectives than debt limits are in achieving theirs, they are imperfect tools.

5.2.2.1. Benefits of Voter Approval Requirements

Voter approval requirements provide greater flexibility than debt limits and improve the ability of the local government to respond to the preferences of the community.[136] They likely also promote transparency. States that require bond elections typically require that information be provided to voters in a notice or the in the ballot measure itself.[137] For example, California law requires that when any local government bond measure is presented to voters, a statement indicating the specific purposes of the bonds must be provided and that when a general obligation bond is proposed to voters, a statement must be sent to voters including an estimate of the average annual tax rate and the highest tax rate that will be required to pay the bonds, the final year in which the tax rate is expected to be collected, the year in which the tax rate is expected to be highest, and the estimated total

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[134] N.Y. TOWN LAW § 91 (McKinney 2021); N.Y. VILLAGE LAW § 9-902 (McKinney 2021).
[135] *See* Kelly K. Kost & Anjali Vij, *General Obligation and Revenue Bonds, in* ILL. INST. FOR CONTINUING LEGAL EDUC., MUNICIPAL LAW FINANCING, TAX, AND MUNICIPAL PROPERTY §§ 2.20, 2.24 (2018) (describing the process that applies to some Illinois local government bonds); LEAGUE OF OR. CITIES, *supra* note 50, at 10, 13 (describing the process that applies to some Oregon full faith and credit bonds and revenue bonds); THOMAS M. POLLAN & DAVID MÉNDEZ, TEX. ASSOC. OF COUNTIES, 2017 PUBLIC FINANCE HANDBOOK FOR TEXAS COUNTIES 20–21 (2017) (describing the process that applies to county certificates of obligation).
[136] *See* Gelfand, *supra* note 89, at § 11.7 (noting that voter approval requirements "emphasize[] the principles of fiscal flexibility and local political responsiveness"); Kirk J. Stark, *The Right to Vote on Taxes*, 96 NW. U. L. REV. 191, 194 (2001) (noting in the context of tax limits that while voter approval is "less reliable as a taxpayer protection device[,] … it is more respectful of majoritarian preferences and local autonomy"). The same would be true for voter approval as opposed to strict debt limits.
[137] Salsich, *supra* note 60, at §§ 12.31, 12.32.

principal and interest on the bonds.[138] Oregon requires that ballot measures for general obligation bonds include the amount of bonds to be authorized and the purposes for which the proceeds are to be spent and a statement that property taxes may increase.[139] This means that community members have at least some information about the proposed bonds and the project they are to finance. In addition, it may be that having bond measures on the ballot encourages more public discussion of the costs and benefits of the financing and the project being financed.

Furthermore, notwithstanding that voters may have incentives to borrow more or for a longer term than would be consistent with interperiod equity as was noted above, some studies suggest that voter approval requirements result in less debt that is subject to those requirements and possibly less debt overall (though there are conflicting conclusions about the impact on overall debt levels).[140] While many bond measures are approved (for example, 73% of school bond measures proposed in California from 2008 through 2020 passed),[141] some are not.

Furthermore, local government officials may be deterred from pursuing financings unless they have a reasonable expectation that they will be approved by voters, because presenting the measure to voters can be costly, both in terms of out-of-pocket costs and politically.[142] The resulting

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[138] CAL. ELEC. CODE § 9401 (Deering 2021); CAL. GOV'T CODE § 53410 (Deering 2021).

[139] LEAGUE OF OR. CITIES, *supra* note 50, at 8. The estimated tax rates to pay debt service are not required to be included, but they often are. *Id.*

[140] *See* AMDURSKY ET AL., *supra* note 22, at § 4.15 (citing several studies suggesting that voter approval requirements reduce debt levels). One study of state borrowing found that referendum requirements appeared to reduce the level of guaranteed debt, but the study also found that the impact on nonguaranteed debt was not clear and that there were strong indications that in these states more debt was simply issued by local governments rather than the state. Kiewiet & Szakaly, *supra* note 120, at 84–86. This is not, of course, an option for local governments, but in some states they may be able to issue through state authorities or other local governments; this might have a similar effect. *See also infra* note 178 for description of other studies.

[141] *School Bond Elections in California*, BALLOTOPEDIA, https://ballotpedia.org/School_bond_elections_in_California [https://perma.cc/ZA7V-VWAV].

[142] *See infra* notes 159–63 and accompanying text. *See also* Kiewiet & Szakaly, *supra* note 120, at 68 ("[P]ublic authorities probably do not put bond issues to voters unless the likelihood of voter approval is reasonably high"). Government officials also may avoid borrowing to finance projects if doing so is politically unpopular even absent a voter approval requirement, because presumably there is a political cost to doing so. However, they may be more inclined to approve a project and related borrowing when voter approval is not required because the borrowing may garner less attention than a ballot measure would and because they may hope that once community members are receiving the benefits of the facility, they will feel more positive about the borrowing to the extent they consider it at all. Occasionally when voters reject a bond measure, local government officials proceed to finance the project using a method of borrowing that does not require voter approval. *See infra* note 177 for further discussion and examples.

lower level of borrowing may serve to counterbalance the incentives to borrow more than is optimal (described above in Section 3.3.1).

5.2.2.2. Drawbacks of Voter Approval Requirements

Notwithstanding that voter approval requirements appear to be more beneficial than debt limits, they do raise some concerns.

5.2.2.2.1. Voter Approval Requirements May Lead to a Lower-than-Optimal Amount of Debt

There are reasons to believe that less than an optimal level of debt may be approved by voters, and some have expressed concerns about whether voter approval is an effective means for voters' wishes to be met.

As was discussed in Section 3.3.1, current community members may have the same interest in deferring payment of debt to the future that elected officials do. But there are also reasons to believe that voters may not approve enough borrowing or may not approve the right borrowing.

Supermajority requirements give a minority the ability to block a financing desired by the majority.[143] The size of the supermajority matters. For example, of the 857 ballot measures approved under a California law permitting the issuance of general obligation bonds for school facilities with approval of 55% of the voters, 488 would not have been approved had the alternative requirement for approval by 2/3 of voters applied (meaning that they were approved by more than 55% but fewer than 2/3 of voters voting on the matter).[144]

In addition, it is not clear that voters are sufficiently informed enough to make good decisions about financing matters.[145] Unless a measure receives significant media attention (and this is rare), voters generally have little information about the measures upon which they are voting,[146] Furthermore,

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[143] Schragger, *supra* note 72, at 870; *see also* Briffault, *supra* note 74, at 954 (noting that supermajority requirements thwart majority wishes); *Editorial: State Must End Supremely Bad Supermajority for School Bonds*, NEWS TRIB. (Apr. 28, 2018), https://www.thenewstribune.com/opinion/editorials/article210003224.html (describing defeat of a school district bond measure in Washington State that received 59% of the vote but not the 60% supermajority required to pass and advocating for the elimination of supermajority requirements as undemocratic).

[144] DAYTON, *supra* note 107, at 16.

[145] *See* Briffault, *supra* note 74, at 953 (noting this concern).

[146] Richard Briffault, *Distrust of Democracy*, 63 TEX. L. REV. 1347, 1355 (1985) (reviewing DAVID B. MAGLEBY, DIRECT LEGISLATION: VOTING ON BALLOT PROPOSITIONS IN THE UNITED STATES (1984)). *See also* Elizabeth Garrett & Mathew D. McCubbins, *When Voters Make Laws: How Direct Democracy is Shaping American Cities*, 13 PUB. WORKS MGMT. &

one study determined that the descriptions and analysis of ballot initiatives included in voters' handbooks prepared by states are written at the reading level of a third year college student.[147] Presumably, many voters do not read at this level. While bond measures may be easier to understand than many ballot measures, voters may not always understand the matter on which they are voting. Certainly, it is unlikely that voters generally have the expertise, knowledge, or, often, incentive, to monitor a local government's overall fiscal health and the impact of borrowing on that health.[148] In addition, voters are not likely to be presented with the details of the financing structure and alternative methods of financing. Voters also are making decisions about bond measures without knowing whether other bond measures on the ballot will pass, or what bond measures may be on future ballots.[149] As a result, an individual voter may approve either more or less debt than even that individual voter would desire.

Questions also have been raised about whether those who actually vote on ballot measures are representative of the electorate as a whole.[150] Only a portion of voters typically participates in elections in the United States. Approximately two-thirds of people eligible to vote participated in the November 2020 presidential election, and this was the highest turnout since at least 1980.[151] Turnout at elections that garner less attention, and in particular at local elections, is typically much lower.[152] Even among those

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POL'Y 39, 40, 47, 55–57 (2008) (describing case studies that showed that the amount of information about bond measures varies significantly and discussing the low levels of voter knowledge about many some ballot measures); Craig M. Burnett, Elizabeth Garrett & Matthew D. McCubbins, *The Dilemma of Direct Democracy*, 9 ELECTION L.J. 305, 317 (2010) (noting that a higher proportion of the information about ballot measures comes from political campaigns than is the case for political candidates and that not every ballot measure has a meaningful supporting and opposing campaign). Some states require certain information be provided to voters. *See supra* notes 137–139 and accompanying text.

[147] Glenn R. Schmitt, *David B. Magleby, Direct Legislation: Voting on Ballot Propositions in the United States* 12 J. LEGISLATION 122, 138 (1984) (Book Review). *See also* Garrett & McCubbins, *supra* note 146, at 55–56 (describing ballot pamphlets as "often dauntingly long and dense" and suggesting that while information may be in the pamphlet, "it is not provided in a format that makes voting cues accessible and salient to voters")

[148] *See* Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 FORDHAM URB. L.J. 639, 658–664 (2012) (giving reasons residents likely are not effective monitors of a local government's fiscal health); Richard C. Schragger, *Citizen v Bondholder*, 39 FORDHAM URB. L.J. 787, 790 (2012) (noting that any one citizen has "little incentive, little expertise, and little time to monitor local fiscal health").

[149] Garrett & McCubbins, *supra* note 146, at 45.

[150] *See* Briffault, *supra* note 73, at 953 (noting this concern).

[151] Drew Desilver, *Turnout Soared in 2020 as Nearly Two-Thirds of Eligible U.S. Voters Cast Ballots for President*, PEW RESEARCH CENTER (Jan. 28, 2021), https://www.pewresearch.org/fact-tank/2021/01/28/turnout-soared-in-2020-as-nearly-two-thirds-of-eligible-u-s-voters-cast-ballots-for-president/ [https://perma.cc/8DGF-XEDV].

[152] *See supra* note 132, 64–65.

who do vote in a particular election, some do not vote on ballot measures.[153] Those who vote on ballot measures may not represent the community as a whole. Studies suggest that more educated and older people are more likely to vote at all and that of those who vote, those with more education are more likely to vote on ballot measures.[154] Another study suggests that educated homeowners who are long-term residents may be more likely to vote in local elections than others are, and that any bias caused by low voter turnout is likely to lead to "policies that protect property values and suppress property taxes."[155] At least for general obligation bonds that are payable from property taxes, the result may be that those who vote are more likely to oppose a bond measure, absent a clear connection between the project financed and higher property values.

Furthermore, local governments that need to obtain voter approval may seek it for a lower amount of bonds than the voters would approve. A study of school boards found that school boards typically propose a lower amount of borrowing than that for which they could obtain voter approval.[156] The authors of the study attribute this to the costs of the election and selling the bonds and because of uncertainty about voter preferences.[157] It is likely that other local governments behave in a similar manner to school boards. Furthermore, local governments may not put a bond measure on the ballot at all if it is not expected to pass, possibly by a substantial margin.[158]

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[153] The amount of "dropoff" (the percentage of people who vote in an election but not on a particular measure or candidate) varies but can be substantial. *See* MAGLEBY, *supra* note 148, at 90–95 (reporting dropoff rates for a variety of measures in several elections, including a 13% dropoff rate for bonds in the 1976 California election and a 15% dropoff rate for bonds in the 1978 California election).

[154] MAGLEBY, *supra* note 148, at 80–82, 104–111. Other factors also correlate to turnout and proposition voting, including occupation, income, education, age, race, perceived social class and gender. *Id.*

[155] OLIVER, *supra* note 132, at 55–56.

[156] Ed Balsdon et al., *Private Demands for Public Capital: Evidence from School Bond Referenda*, 54 J. URB. ECON. 610, 612 (2003). *But see* Elizabeth Garrett & McCubbins, *supra* note 146, at 41 (suggesting that a local government can theoretically receive approval for a higher level of debt than would be the voter's ideal preference because the voter is presented with a "take-it-or-leave-it" offer).

[157] Balsdon et al., *supra* note 156, at 612.

[158] *See* FAIRBANK, MASLIN, MAULLIN, METZ & ASSOCIATES, INC., NOVEMBER 2020 ELECTION OBSERVATIONS FROM FM3 RESEARCH 2 (2020) http://californiacityfinance.com/Votes2011final.pdf [https://perma.cc/UKR7-GDDY] (while sometimes local governments put measures on the ballot when it does not appear certain that they will pass, they appeared to have been less likely to do so in California at the November 2020 after a relatively high proportion of measures failed to pass at the March 2020 election).

5.2.2.2.2. Voter Approval Requirements Increase Costs and May Cause Delays.

Even if local governments do not campaign in favor of a ballot measure (at least some states prohibit such campaigning),[159] they incur financial costs in deciding whether to put a bond measure on the ballot and preparing the measure for the ballot. For example, local governments may hire lawyers and political consultants to assist with the ballot measure and election process and pay for a voter survey to determine whether to propose a ballot measure.[160] They also incur costs of running the election.[161] In addition to these costs, and perhaps more significantly, there is a political cost to proposing a bond measure. Elected officials "desire to remain in the good graces of the community and its voters and fear that frequent requests for property tax increases will jeopardize this."[162]

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[159] *See, e.g.*, CAL. EDUC. CODE § 7054 (Deering 2021) (prohibiting the use of school district or community college district funds to urge support or opposition to any ballot measure, excepting impartial factual information); CAL. GOV'T CODE § 54964 (Deering 2021) (prohibiting local government officials from spending public funds, services, supplies or equipment to support of oppose a ballot measure except to provide impartial information about relevant facts); 10 ILL. COMP. STAT. ANN. 5/9-25.1 (LexisNexis 2021) (prohibiting the expenditure of public funds to campaign for or against a candidate or ballot measure but permitting the use of public funds to provide factual information); TEX. ELEC. CODE § 255.003(a) (LexisNexis 2021) (prohibiting the spending of public funds for political advertising except for communications that merely describe factually the purpose of the measure).

[160] *See, e.g.*, CAL. COAL. FOR ADEQUATE SCH. HOUS., PROPOSITION 39 BEST PRACTICES HANDBOOK 27–30 (2003), https://cashnet.org/resource/resmgr/resourcedocuments/prop_39_handbook_2003_s.pdf [https://perma.cc/T6JK-BTZ3] (describing the role of bond counsel and political consultants and identifying voter surveys as a permitted use of public funds); TEX. ASSOC. OF SCH. BDS., OVERVIEW OF A SCHOOL DISTRICT BOND ISSUANCE (2020), https://www.tasb.org/services/legal-services/tasb-school-law-esource/business/documents/overview-of-school-district-bond-issuance.pdf [https://perma.cc/P9X2-GAUP] (identifying retaining bond counsel and an election attorney as steps to take when determining whether to issue bonds and including publicity and communication as components of ordering the election); LEAGUE OF OR. CITIES, *supra* note 52, at 131 (noting the importance of hiring an outside expert to assess voter understanding of and support for the proposed measure); Balsdon et al., *supra* note 157, at 618 n.14 (stating that school district funds can be used to conduct a survey of the community and provide guidance on how much should be requested and noting that this cost between $30,000-$40,000).

[161] *See* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 107, at 138 (noting that if the election fails, the local government will usually have to pay the costs of the election out of its general fund); Lynda Roberts, *Election Costs and Billing*, COUNTY OF MARIN, https://www.marincounty.org/depts/rv/election-info/election-costs-and-billing [https://perma.cc/2E5J-LE7G] (describing election costs charged by the county to cities, school districts and special districts).

[162] Balsdon et al., *supra* note 157, at 618.

In addition, determining whether to put a measure on the ballot and preparing for the election takes time. One expert indicates that it can take six to nine months, or even longer, from beginning election proceedings to issuing the bonds.[163] This does not include the time to determine whether to pursue a bond election at all. In some states, bond measures may be presented at only certain elections.[164] When projects are urgently needed or when construction costs are rising rapidly, these delays may create problems for local governments.

5.2.3. Voter Approval Requirements Should be Carefully Evaluated

Voter approval requirements, particularly those that require supermajority approval, should be carefully evaluated. However, it does appear that they contribute to providing information to community members and to protecting community members from local government officials who may be inclined to borrow more than community members would prefer. Requirements that specific information be provided to voters in an easily understandable format may make voter approval requirements more valuable.[165]

It is less clear whether they help promote interperiod equity. In all likelihood, any impact they have on interperiod equity is fairly small. As was noted in Section 3.3.1, current community members may have the same interest in deferring payment of debt to the future that elected officials do. It is possible, however, that because of the factors discussed in Section 5.3.2.1., voter approval requirements result in less debt being incurred than the community would prefer. This may counterbalance tendencies to issue more debt than is appropriate. However, although voters generally approve the principal amount and use of debt (and may be given some other information, such as the expected impact on tax rates), this is an incomplete protection of interperiod equity because it does not prevent debt service from being disproportionately pushed to later years.[166]

If voter approval requirements are used, they ideally would be consistent for different types of debt. This is not always the case. For

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[163] GREG HARRINGTON, JOHN HARTENSTEIN, & DONALD FIELD, THE XYZS OF CALIFORNIA SCHOOL DISTRICT DEBT FINANCING 28 (Orrick, 3d ed. 2015), https://www.orrick.com/en/Insights/2007/03/The-XYZs-of-California-School-District-Debt-Financing [https://perma.cc/DXW3-QRCA]; *see also* POLLAN & MÉNDEZ, *supra* note 135, at 12 (indicating that it takes 5-12 months, or even longer, to issue general obligation bonds).

[164] *See generally* notes 129–130 and accompanying text.

[165] For examples of some current requirements, *see supra* note 137–138 and accompanying text.

[166] This is because voters approve the amount of debt, not terms of the debt such as the maturity structure. For discussion of other ways that maturity and amortization schedules of bonds could be regulated, see Section 6.2.3.

example, under California law, different voter approval requirements apply depending on the purpose and payment source of the bonds and other factors.[167] In some states, supermajority requirements are imposed for general obligation bonds, but not revenue bonds.[168] As is discussed in greater detail in the following section, some types of debt are typically not subject to voter approval requirements at all.

One alternative to voter approval requirements short of eliminating them entirely would be to ensure that there is appropriate notice of and ability to participate in board meetings at which bonds are approved, and a waiting period afterwards in which a specified number of voters could require that the measure be voted upon at the next election.[169] This would shift the burden of convincing voters from the elected governing body to the objecting voters.[170] As was described above, some states allow voters to petition to put certain types of debt on the ballot.[171] There could be merit in broadening this approach to cover a wider range of debt. However, it would be important that the hurdles are set at the appropriate level; making it too easy for a handful of voters to compel an election defeats the purpose of using a permissive referendum process rather than a mandatory one, and making it too difficult or too expensive would be little different from having no voter approval requirement.[172]

5.3. Exceptions to Debt Limits and Voter Approval Have Distorted Borrowing Decisions

Courts and legislatures have created numerous exceptions to both debt limits and voter approval requirements, and the avoidance of these limits and requirements has "fundamentally shaped public finance."[173] General obligation bonds are typically subject to these restrictions, but they often do not apply to revenue bonds (though some voter approval requirements do

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[167] *See supra* notes 124–125 and accompanying text.
[168] Salsich, *supra* note 60, at § 12.30.
[169] The Advisory Commission on Intergovernmental Relations recommended permissive referendum requirements in 1961. *See* ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 48, at 72–73.
[170] *Id. at* 73.
[171] *See supra* notes 132–135 and accompanying text.
[172] The challenges of obtaining signatures for initiatives (legislation proposed by voters) are discussed in MAGLEBY, *supra* note 147, at 61–70 (1984). Those gathering signatures for a permissive referendum likely would encounter similar issues.
[173] AMDURSKY ET AL., *supra* note 22, at § 4.1; *see also* Briffault, *supra* note 73, at 925, citing WILLIAM D. VALENTE, ET AL., CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 647 (William D. Valente ed., 5th ed. 2001) (noting that two-thirds of city and county debt is exempt from debt limits).

apply to some revenue bonds).[174] Avoiding debt limits is so common that guides to municipal finance have sections with titles like "Devices Employed to Avoid Debt Ceilings and Procedural Requirements"[175] and "Common Strategies for Avoiding the Debt Limit."[176] Local governments sometimes simply issue a different form of debt than they might otherwise to avoid the limits and restrictions.[177] It is not clear whether the end result is a lower amount of local government debt than there would be without the limits and approval requirements.[178]

What is clear is that the result is more expensive debt and less transparency. Interest rates on revenue bonds are generally higher than on general obligation bonds, and legal and administrative costs for revenue bonds are typically higher.[179] The debt burdens borne by local governments

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[174] Gelfand, *supra* note 89, at § 11.14; Salsich, *supra* note 60, at § 12.23; *see also* Gillette, *supra* note 4, at 1256–57 (describing some of the exceptions from debt limits).
[175] *See generally* Gelfand, *supra* note 89, at pt. IV.
[176] *See generally* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 1.3.
[177] *See, e.g.*, Shama Gamkhar & Jerome Olson, *Factors Affecting School District Choice of Bonds*, 2002 NAT'L TAX ASS'N PROC. OF ANN. CONF. ON TAX'N, 396, 405 (concluding that school districts in Texas that are less likely to win a bond election are more likely to issue lease revenue bonds, which generally do not require voter approval); Gillette, *supra* note 78, at 375–78 (describing instances of local governments financing projects by methods that do not require voter approval after losing a bond election); Richard Williamson, *Certificates of Obligation Fund Austin Courthouse After Voters Rejected Bonds*, BOND BUYER (May 13, 2019), https://www.bondbuyer.com/news/certificates-of-obligation-deal-bypasses-voters-on-austin-courthouse [https://perma.cc/T7XF-N7TA] (describing funding of courthouse with a different form of debt that does not require voter approval three-and-a-half years after voters rejected a general obligation bond measure for the same project).
[178] *See, e.g.*, ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 3 (noting that while debt limits may have restrained local government borrowing, the extent to which they are effective cannot be measured); AMDURSKY ET AL., *supra* note 22, at § 4.15 (citing several studies suggesting that voter approval requirements reduce debt levels); Briffault, *supra* note 74, at 925 (noting that while there may have been some impact on total debt levels, it does not seem significant); Paul G. Farnham, *Re-examining Local Debt Limits: A Disaggregated Analysis*, 51 S. ECON. J. 1186, 1195–96 (2001) (indicating that referenda requirements do not affect overall debt levels, but that debt limits do reduce the amount of both general obligation and overall borrowing); Kiewiet & Szakaly, *supra* note 119, at 78–82, 85–86, 93 (concluding that at the state level, referendum requirements and prohibitions on borrowing appeared to reduce the level of guaranteed debt, though limits based on revenues are somewhat less effective, and that states do not appear to issue nonguaranteed government in lieu of guaranteed debt, but that that there were strong indications that in these states more debt was simply issued by local governments and authorities rather than the state).
[179] *See, e.g.*, LEAGUE OF OR. CITIES, *supra* note 50, at 7 (noting that general obligation bonds "are regarded as very secure and are usually the least expensive way for a city to borrow money"); MARLOWE, RIVENBARK & VOGT, *supra* note **Error! Bookmark not defined.**, at 1 59 ("interest rates on GO bonds are usually lower than rates on other types of long-term debt used to finance capital projects"); Briffault, *supra* note 74, at 926 (noting higher interest rates

are less visible, and government structures are more complicated and public authorities and agencies that are not necessarily run by elected officials play more significant roles.[180]

In addition, local governments may give up future budgeting flexibility and may be subject to more restrictive covenants when they issue revenue bonds rather than general obligation bonds. Revenue bond documents typically include requirements that the revenues from which the bonds are paid are tracked separately and can be used only for specified purposes in a specified order.[181] The documents also typically include covenants that that restrict future flexibility, such as restrictions on the ability to issue new bonds, insurance requirements, and covenants that rates be set at levels to cover debt service and maintain reserves (sometimes with additional cushion).[182]

Furthermore, local government decisions about which projects to finance and construct may be distorted by differing approval requirements for different types of bonds. Projects that would typically be financed with general obligation bonds or other bonds requiring voter approval may be less likely to be undertaken, while those more typically financed with revenue bonds or other types of bonds that are not subject to the same restrictions may be more likely to proceed. Riskier projects that cannot be financed at reasonable interest rates without also including a pledge of taxing authority may be less likely to be undertaken, even when the projects are desired by

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and greater administrative and legal costs); Gelfand, *supra* note 50, at 560–61 (noting that interest rates on revenue bonds are typically higher than on general obligation bonds); Gillette, *supra* note 4, at 1257 (noting higher interest rates and additional costs to develop legal alternatives); Shoked, *supra* note 31 (noting that debt limits force local governments to pay higher interest rates and generate administrative expenses, among other things).

[180] *See, e.g.*, ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 3 ("Debt restrictions have tended to impair the public accountability and responsiveness of local governments in various ways, including the promotion of special districts and various kind of financing authorities, and the complication and obfuscation of financial arrangements."); Briffault, *supra* note 74, at 926 (the avoidance of debt limits has contributed to the "baroque structure of state and local government, and the major role played by un-elected public authorities and similar agencies"); Gamkhar & Olson, *supra* note 177, at 402 (noting that lease revenue bonds "can be concealed from voters since they are not legally required to be included as debt in the district's budget or financial statements" notwithstanding that credit rating agencies and other bond market participants would consider them as debt); Gillette, *supra* note 4, at 1257 ("circumvention of debt limitations obfuscates the locality's true debt position").

[181] *See* O'HARA, *supra* note 16, at 199–200 (describing typical provisions); ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 56–57 (noting that revenue bonds tend to come with earmarking arrangements that can narrow budgetary discretion).

[182] *See* MARLOWE, RIVENBARK & VOGT, *supra* note **Error! Bookmark not defined.**, at 164–6 5 (describing typical provisions); O'HARA, *supra* note 16, at 201–202 (describing typical provisions).

the local community.[183] New housing developments with new schools and other public facilities may be favored over rebuilding or building a new school in an existing community when it is easier to issue municipal bonds to finance facilities in new developments.[184]

None of this is to say that revenue bonds shouldn't be used or that they don't serve important purposes. However, any debt limits or voter authorization requirements should "take cognizance of all forms of local borrowing and debt" and "should be designed to facilitate – rather than hamper – intelligent choice among suitable alternative forms of borrowing."[185] Different types of debt should be treated differently only if there is a sound basis for doing so. For example, there is a reasonable argument that short-term debt might be treated differently since it does not give rise to the same issues of interperiod equity,[186] though other restrictions (such as the term and the amount that can be borrowed) would be appropriate to prevent misuse.[187] Exceptions for emergencies or to meet legal mandates (such as to satisfy a tort judgment) also may be reasonable, at least if appropriately tailored.[188] It also would be reasonable to treat debt for which the bondholders alone bear the risk of project failure differently than debt for which the community bears the risk, and one commentator suggests that this analysis may go a long way (albeit not the whole way) towards explaining exceptions from debt limits.[189]

A fundamental question, then, is whether there is a good reason to subject general obligation bonds payable from property taxes to greater restrictions than other debt. For some types of facilities typically financed with revenue bonds, such as an airport paid for by airline rates and charges, a convention center paid for with hotel taxes from surrounding hotels, or an express lane financed by tolls, the answer likely is "yes" (at least if the local government is not obligated to pay any bonds from other sources should the relevant revenue sources prove inadequate). These are all facilities that a community member can truly elect whether or not to use (and that can be used by people other than members of the community). The answer for

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[183] Gillette, *supra* note 4, at 1258–59 (noting that these projects compete with "more traditional capital expenditures for a limited amount of permissible debt").

[184] *See* Shanske, *supra* note 119, at 668 (2010) (arguing that a particular type of bond that is typically approved by the developer before homes in a new development are sold has contributed to urban sprawl).

[185] ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 4.

[186] Some state courts "readily" reached this conclusion. Sterk & Goldman, *supra* note 74, at 1314.

[187] *See* Gelfand, *supra* note 89, at § 11.9 (noting that overuse and abuse prompted states to impose limits on short-term debt).

[188] *See* AMDURSKY ET AL., *supra* note 20, at § 4.4 for further discussion of these types of exceptions and how courts have created and interpreted them.

[189] AMDURSKY ET AL., *supra* note 20, at § 4.1.1.

utilities such as water and wastewater systems is less clear, since even though residents may be able to cut back on their use of these utilities, it is unlikely that they can avoid using them entirely. For financing structures that use general fund revenues to finance a facility but are not treated as debt, such as some lease revenue bonds, the better answer in my view is that they should be treated the same as (or at least similarly to) general obligation bonds, even if bondholders take the risk that the local government will not appropriate funds to make the payment. General fund moneys that are used to pay the debt service to finance the facility could be used for other purposes (or taxes and fees could be reduced) if they were not used to pay debt service, and the local government likely will feel pressure to appropriate funds to repay the debt even if it is not legally obligated to do so because its ability to borrow in the future likely would be affected by a failure to pay.

Ideally, a broader range of debt would be treated more similarly for purposes of debt ceilings and voter approval rights. Treating debt similarly would lead to greater transparency (and hence public opportunity to participate) and to better financial decisions (because decisions about transaction structure would be based on the economics of the transaction rather than avoiding a debt ceiling or voter approval right). It is likely that fewer exceptions would also simplify the laws governing local government borrowing. That said, for the reasons discussed in Section 0, ideally debt ceilings would be eliminated. Where they remain, exceptions likely will be needed, and allowing a state agency to provide waivers of them in appropriate circumstance may be desirable. In contrast, it may be appropriate for some voter approval requirements to be retained in some form (perhaps providing for permissive referenda) and to apply to a broader range of debt.

6. Regulation of Use of Proceeds, Terms and Sale of Bonds

State laws restrict the purposes for which bonds can be issued, the terms of the bonds, and the mechanics for sale of the bonds. Each of these topics is addressed below. Some states also regulate other details of the bonds such as who can sign them and how they should be printed. These more administrative points are not addressed below. Suffice it to say that any provisions relating to purely administrative matters should be kept as flexible as possible to avoid unnecessary expense or requirements that are not consistent with standard practices in the bond market as it has evolved and continues to evolve. If states do regulate detailed terms of bonds or administrative points, legislatures may want to delegate to a state agency the power to create appropriate regulations since these will be easier to change over time than a statute or constitutional provision would be.

6.1. Restrictions on the Use of Bond Proceeds

Every state has restrictions on the purposes for which local governments can use their funds, including bond proceeds.[190] Some have additional restrictions on the use of bond proceeds, as described below.[191]

6.1.1. Public Purpose Requirements and Prohibitions on the Lending of Public Credit

Local governments generally may expend funds only for public purposes.[192] Because proceeds of local government borrowing are public funds, these provisions apply to the use of bond proceeds. The intent of these provisions is to "restrict public funding to activities that serve the interests of the public at large."[193] Some public purpose restrictions are in state constitutions, and others have been created by courts.[194] What has been considered a public purpose has evolved over time,[195] and in virtually all states public purposes may include economic development programs that provide direct assistance to individual businesses.[196] Courts tend to defer to legislative findings of public purpose,[197] and public purpose requirements are "largely rhetorical" today.[198] Nonetheless, requiring that public funds be used for public purposes (even if such purposes are defined very broadly), and retaining for courts the ability to decide in controversial cases whether a

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[190] AMDURSKY ET AL., *supra* note 22, at § 3.1.

[191] The use of local government bond proceeds is also restricted by the Establishment Clause of the U.S. Constitution; this is particularly relevant when bond proceeds are used to assist schools, hospitals, and other organizations with religious affiliations. For a brief discussion, *see id.* at § 3.4. In addition, the Internal Revenue Code and U.S. Treasury Department regulations also impose restrictions on the use of proceeds of tax-exempt bonds. For a short description of some of the restrictions for tax-exempt bonds, *see* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §§ 4.4, 4.6.

[192] Gelfand, *supra* note 89, at § 11.11; NAT'L ASSOC. OF BOND LAWYERS, SECTION 1: GENERAL LAW, FUNDAMENTALS OF MUNICIPAL BONDS LAW 2012 6 (2012); Briffault, *supra* note 74, at 910.

[193] AMDURSKY ET AL., *supra* note 22, at § 3.1.

[194] *See id.* at § 3.2 for discussion of both.

[195] *See*, *e.g.*, *id.* at § 3.5 (what constitutes a public purpose "changes to meet new developments and conditions of times") (quoting *In re* Limited Tax Gen. Obligation Bonds of the City of Edmonds, 256 P.3d 1242 (Wash. Ct. App. 2011)); Gelfand, *supra* note 89, at § 11.11 ("the concept has evolved through the case law to meet changing conditions").

[196] Gelfand, *supra* note 89, at § 11.11; Briffault, *supra* note 74, at 913.

[197] AMDURSKY ET AL., *supra* note 22, at §§ 3.5.3, 3.5.4; Briffault, *supra* note 74, at 945–46.

[198] Briffault, *supra* note 74, at 914.

purpose is public, serves the objective of protecting citizens from bad decisions by local government officials.[199]

In addition, most states prohibit local governments from making gifts or loans of public credit to private parties and investing in private enterprises, presumably to restrict the ability of individuals or companies to benefit at the expense of the public.[200] These provisions, like public purpose provisions, can limit the use of bond proceeds. Even if a gift of public credit serves a public purpose, it may be prohibited by these provisions, absent an exception.[201]

While there are often exceptions to these provisions,[202] they do sometimes constrain local governments from undertaking activities that the community deems desirable. For example, in 2018, Oregon voters approved a constitutional amendment adding an exception to the state's constitutional prohibition on the lending of public credit and investing in private enterprises that would allow local governments to invest with private developers in affordable housing projects.[203] Supporters indicated that the amendment was needed because the constitutional prohibition constrained the ability of local governments to collaborate on much-needed affordable housing projects.[204] However, like public purpose requirements, restrictions on lending of public credit (at least with appropriate exceptions) generally impose appropriate constraints on local governments and should be retained.

6.1.2. Other Restrictions

Bond proceeds may be used only for valid purposes of the local government.[205] General obligation bond proceeds typically may be used only for "land acquisition, construction and equipping of traditional public projects such as courthouses, hospitals, jails, libraries, schools, sewage

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[199] Additional statutory provisions may be valuable, too. *See id.* at 947 (noting that statutory requirements for better record keeping and public disclosure of the public benefits of economic development might be more effective than judicial enforcement).
[200] AMDURSKY ET AL., *supra* note 22, at § 3.7; Gelfand, *supra* note 89, at § 11.10. *See, e.g.*, CAL. CONST. art. XVI, § 6; N.Y. CONST. art. VIII, § 1.
[201] *Id.*
[202] *Supra* note 200; *see also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 7.3 (describing broad court-created public purpose exceptions to California's prohibition).
[203] *Oregon Measure 102, Removes Restriction that Affordable Housing Projects Funded by Municipal Bonds be Government Owned (2018)*, BALLOTPEDIA, https://ballotpedia.org/Oregon_Measure_102,_Removes_Restriction_that_Affordable_Housing_Projects_Funded_by_Municipal_Bonds_be_Government_Owned (2018) [https://perma.cc/33TZ-W8TC].
[204] *Id.*; Dirk VanderHart, *Oregon's Constitution Has Shackled Portland's $258 Million Housing Bond*, Portland Mercury (Jan. 17, 2018), https://www.portlandmercury.com/news/2018/01/17/19611094/oregons-constitution-has-shackled-portlands-258-million-housing-bond [https://perma.cc/UX4W-RU8Z].
[205] Salsich, *supra* note 60, at § 12.38.

treatment facilities, and streets and roads."[206] Some states allow general obligation bonds to be used for a broader range of purposes.[207] The use of proceeds of other types of bonds also may be restricted by state law.[208]

Where voter approval is required, the use of proceeds may be limited to the purposes approved by the voters or there may be additional steps that need to be taken for them to be applied to other purposes. Some have described the voter approval of a bond measure as creating a contract between the issuer and the voters; this contract would limit the use of bond proceeds to the purposes approved by the voters.[209] The concept that proceeds cannot be used for purposes other than those approved by the voters sometimes also appears in statues. For example, California law provides that proceeds of local government general obligation bonds may be used only for the purposes for which the bond were issued.[210] Should there be any proceeds remaining after the purpose is completed, it sometimes is required to be used to pay debt service on the bonds.[211] Some states provide more flexibility. In Georgia, for example, if proceeds of bonds remain after the project approved by the voters is completed, or circumstances change such that the approved project would be obsolete or wasteful, unexpended bond proceeds must either be used for a substantially similar purpose or to repay the bonds or other bonds, as

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[206] *Id.* at § 12.4.

[207] For example, California cities can use general obligation bonds to finance loans to private landowners for seismic safety improvements, to finance redevelopment projects in blighted areas and to finance "other works, property, or structures necessary or convenient to carry out the objects, purposes, and powers of the city" and home rule cities have broader powers to borrow using general obligation bonds. CAL. GOV'T CODE §§ 43601, 43602 (Deering 2021); CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 106, at 136. In Illinois, general obligation bonds can be used to finance wind generation turbine farms and redevelopment projects in blighted areas. Kelly K. Kost & Vij, *supra* note 135, at § 2.5.

[208] *See, e.g.*, CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 106, at ch. 6 (identifying the types of projects that may be financed with each type of financing described).

[209] *See, e.g.*, *id*. at 13; Salsich, *supra* note 60, at § 12.23. The contract consists of the applicable law, the bond resolution, the ballot measure. *Id.* Related costs such as funding a reserve fund, capitalized interest and costs of issuance are typically also permissible uses as described in the following paragraph.

[210] CAL. GOV'T CODE § 53410 (Deering 2021). *Also see* CAL. EDUC. CODE § 15146(g)–(j) (Deering 2021) (requiring virtually all proceeds of school district bonds to be deposited in the building fund and used for the purposes for which the bonds were issued and allowing a portion to be used for capitalized interest, reserves, and costs of issuance).

[211] *See, e.g.*, CAL. GOV'T CODE § 43628 (Deering 2021) (the proceeds of general obligation bonds issued by general law cities must be used for the purpose for which the bonds were issued or for capitalized interest; once such purpose is achieved, any excess must be used to pay debt service on the bonds until they are paid in full and then can be used for other purposes); N.Y. LOCAL FIN. LAW § 165.00(a) (McKinney 2021) (providing that bond proceeds may be applied only to the purpose for which the bonds were issued or to pay debt service on the bonds).

determined by a two-thirds vote of the governing body of the local government.[212]

In addition to the primary purpose of the issuance, bond proceeds are typically allowed to be used to fund a reserve fund (available to pay debt service for a short period of time if the local government does not pay), to pay costs of issuing the bonds (such as bond counsel and disclosure counsel fees, printer costs, underwriter's fees and municipal advisor fees), and sometimes to pay interest on the bonds until shortly after a project is completed (sometimes referred to as "capitalized interest."[213] These purposes are consistent with the those permitted for tax-exempt bonds under federal tax law.[214] A state may want to have its own requirements rather than relying on federal tax law requirements not only because the state may have different perspectives on the purposes for which local governments should be allowed to borrow than the federal government or even other states do, but also because not all bonds are subject to the federal tax law requirements, federal tax law requirements can change without the approval of any state, and because the focus of the federal tax restrictions is the circumstances under which the federal government should subsidize borrowing, not when local governments should be able to borrow.

Some states have additional restrictions on the use of proceeds, and these can be problematic. For example, some California local governments may use premium received from the sale of certain bonds only to pay interest on the bonds.[215] These provisions likely are intended to discourage issuers from borrowing more than the authorized amount of bonds by selling them at a premium.[216] However, the provisions can lead to undesirable outcomes when market conditions are such that the best price on the bonds can be obtained if they are sold at a premium. The bonds must be priced without premium notwithstanding the market conditions, or a small amount of interest

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[212] JAMES P. MONACELL, GEORGIA PUBLIC FINANCE HANDBOOK § 3.2.5 (2018). *See also* HAW. REV. STAT. ANN. § 47–5 (LexisNexis 2020) (permitting application of county general obligation bonds proceeds to purposes other than those for which the bonds were issued or to the repayment of the bonds, in either case with the approval of 2/3 of the members of the county council).

[213] Salsich, *supra* note 60, at § 12.38.

[214] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §§ 4.4.2–4.4.4 (describing permitted uses and some limitations).

[215] For example, California school districts generally are required to use any premium received from the sale of general obligation bonds to pay debt service. CAL. EDUC. CODE § 15146(g) (Deering 2021). Similar requirements apply to some bonds issued by various transit districts. *E.g.*, CAL. PUB. UTIL. CODE §§ 40246, 50246, 70246, 96471, 98341, 101311 (Deering 2021). *But see* notes 216–17 and accompanying text for discussion of the use of premium to pay costs of issuance.

[216] *See supra* note 16–17 and *infra* 221–23 and accompanying text for further discussion of sale of bonds at a premium.

must be capitalized rather than being used for the project, regardless of whether the issuer wishes to do so. Either option increases the cost of the bonds to the issuer.

Limits on the use of premium received by California school districts, combined with a limit (equal to 2% of the proceeds of the bonds) on the amount of school district general obligation bond proceeds that can be deposited into a costs of issuance account and be used to pay costs of issuance, [217] have contributed to the practice many California school districts have used of issuing bonds at a premium and using the funds generated to pay costs of issuance without ever being "received" by the district, despite criticism of this practice.[218] Any limit on the amount of bond proceeds that can be used to pay costs of issuance is likely to be particularly burdensome for smaller issuances because some costs do not vary proportionately with the size of the issuance.[219]

Counting the premium towards the authorized amount as is discussed in Section 0 below would be a better solution to the problem of issuers generating excessive premium, as would restricting the amount of premium that can be generated as a percentage of the principal amount of the bonds

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[217] CAL. EDUC. CODE §§ 15146(h) (Deering 2021). Depending how one interprets the statute, this could mean that if costs of issuance are over 2% a portion of them must be paid from principal in the building fund, increasing the administrative burden because they are paid from two accounts rather than one, or even they cannot be paid from amounts received by the school district.

[218] *See* Jason Chung, *Selling at Premium: How School Districts Can Pay Costs of Issuance*, FIELDMAN ROLAPP & ASSOCIATES SCH. FIN. NEWS (Oct. 2012) [https://perma.cc/TGK2-GFHC] (describing the practice of paying costs of issuance from premium and noting criticism of it, but indicating that the practice is legal and generally accepted); Letter from Kamala D. Harris, Att'y Gen., State of Cal., to Wendy H. Wiles, Robert E. Anslow & Jeffrey A. Hoskinson, Bowie, Arneson, Wiles & Giannone, Poway Unified Sch. Dist. v. All Persons Interested, Sup. Ct. of Cal., Cty. of San Diego, Case No. 37-2010-00106255–CU–MC–CTI (Mar. 2011) (expressing concern about the legality of using premium to pay costs of issuance); Rich Saskal, *California Schools on Notice*, BOND BUYER (Mar. 10, 2011), https://www.bondbuyer.com/news/california-schools-on-notice [https://perma.cc/9QKD-XEDC] (describing this use of premium as a common practice, providing an example of the underwriter paying costs of issuance from premium, and describing the California attorney general's response).

[219] *See* Marc Joffe, Haas Institute for a Fair and Inclusive Society Research Brief, Doubly Bound: The Costs of Issuing Municipal Bonds 12 (2015), https://belonging.berkeley.edu/sites/default/files/haasinstituterefundamerica_doublybound_cost_of_issuingbonds_publish.pdf [https://perma.cc/EK23-QM7C] (noting that issuance costs are proportionately higher for smaller bond issuances and that there are certain costs associated with any bond issuance regardless of the amount issue); David Brodsly & Charles Turner, *CDIAC Seminar: Session Five: Cost of Issuance* 10 (Mar. 17, 2015), https://www.treasurer.ca.gov/cdiac/seminars/2015/20150317/day1/5.pdf [https://perma.cc/UF8A-REPC](while financial advisor and bond counsel fees were lower for smaller issues, as a percentage of the principal amount issued they were higher).

using an amount that is high enough not to interfere with normal market practices but low enough to prevent issuers issuing bonds at unusually high premiums as a way to generate more bond proceeds while complying with limits on the principal amount that can be borrowed.

Limiting the use of bond proceeds to purposes for which the local government could spend its other funds ensures that the government is acting within its intended scope and is not encouraged to borrow simply because that is the only way it can spend for a particular purpose, thus protecting citizens from poor decisions made by local governments. Limiting the use of bond proceeds to capital projects and related costs (including costs of issuing the bonds and reserve funds securing the bonds) gives future citizens some protection from being disproportionately burdened by debt by limiting the use of debt to projects that are most clearly going to provide benefits over the term of the debt. While other uses likely would provide future benefits (for example, job training programs for the unemployed, supportive programs for the homeless, or higher quality education for children well might provide benefits for many years to come), these benefits are often more amorphous and uncertain. Limiting the use of proceeds of voter-approved bonds to the purposes that were authorized by the voters (or related or similar purposes) is essential to maintain the meaningfulness of a voter approval requirement. Other limits on the use of proceeds should be carefully considered before being imposed. As with the examples above, some have the effect of adding unnecessary complications or distorting the process of determining the terms or pricing of bonds, both of which are inconsistent with transparency and sound decision-making.

6.2. Restrictions on Terms of Bonds

6.2.1. Limits on Principal Amount

When voters or governing boards approve bonds, they usually approve a maximum principal amount to be issued. Sometimes state laws require that this information be included. For example, Texas law requires that the ballot proposition requesting approval of general obligation bonds include, among other things, "the total principal amount of the debt obligations to be authorized."[220] Governing board authorizing resolutions

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[220] TEX. ELEC. CODE § 52.072(f) (LexisNexis 2021); TEX. GOV'T CODE § 1251.052(a)(2) (LexisNexis 2021). Other states have similar requirements. *See, e.g.,* CAL. EDUC. CODE § 15122 (Deering 2021) (stating that the amount of bonds must be included for school district bond measures); 65 ILL. COMP. STAT. ANN. 5/8-4-2 (LexisNexis 2021) (stating that the form of question to the voters includes the amount of the bonds).

typically include the maximum principal amount of bonds to be issued.[221] The debt limits described in Section 0 also are framed in the context of the principal amount of debt outstanding.

However, municipal bonds are typically sold at a discount or a premium, which is reflected in the amount received by the issuer (the "proceeds") from the sale.[222] Limits tied to the amount actually borrowed rather than the principal amount of the bonds would promote transparency, because limits would be based on the economics of the transaction.[223] In addition, limits tied to the amount borrowed rather than the principal amount would remove incentives issuers have to avoid original issue discount, which results in issuers receiving less than the principal amount of the bonds, or to maximize premium, which results in issuers receiving more than the principal amount of the bonds, and instead allow issuers to price the bonds with whatever premium or discount provided the lowest yield on the bonds.[224] This would also eliminate any need for provisions restricting the use of premium such as those discussed above.[225]

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[221] *See, e.g.*, Jacquelynne Jennings, Schiff Hardin LLP, *California Debt & Investment Advisory Commission Municipal Debt Essentials Day 2: Planning a Bond Sale Session Five: Bond Documents* 9 (Feb. 13, 2019), *available at* https://www.treasurer.ca.gov/cdiac/seminars/2019/20190212/day2/5.pdf [https://perma.cc/88TQ-J587] (describing the "maximum principal amount of bonds to be issued" as a key provision of the issuer's resolution authorizing the bonds); GOODFRIEND & MYERS, BOND BASICS FOR TOWNS, VILLAGES AND CITIES, *supra* note 108, at 15 (identifying the principal amount of the bonds as an "essential component" of a bond resolution); GOODFRIEND & MYERS, BOND BASICS FOR SCHOOL DISTRICTS, *supra* note 108, at 13 (including the principal amount of the bonds as an "essential component" of a bond resolution).

[222] *See supra* notes 15–16, and accompanying text for further discussion.

[223] For example, under Texas law, any premium used to pay costs of the project financed is counted against the voter-authorized amount. TEX. GOV'T CODE § 1201.042(e) (LexisNexis 2021). I would go further and count any premium generated in, and exclude any original issue discount from, the calculation, regardless of how the premium is used.

[224] Discounts and premiums can make bonds more attractive to investors. *Supra* notes 17–18 and accompanying text. Other restrictions on selling bonds at a discount or premium would also need to be eliminated. These restrictions are discussed at *infra* note 291 and accompanying text.

[225] *See supra* note 214 and accompanying text.

6.2.2. Limits on Interest Rate or Yield

Some states impose limits on the interest rate or interest cost on municipal bonds.[226] For example, California generally imposes a maximum interest rate and maximum yield on municipal bonds of 12%.[227] Local governments in Texas generally may not issue bonds with a net effective interest rate (taking into account original issue premium and discount and compounding of interest) in excess of 15%.[228] Illinois uses a hybrid approach, allowing local governments to issue tax-exempt bonds bearing interest at a rate up to the greater of 9% or 125% of average municipal bond yields and taxable bonds bearing interest at a rate up to the greater of 13.5% or 200% of a recent benchmark rate for taxable bonds.[229]

Other than perhaps as a negotiating point with lenders, these requirements do not serve any meaningful purpose. Maximum rates or yields do not ensure that local governments are paying a fair or appropriate interest rate on their bonds, but they sometimes may prevent local governments from borrowing when it would be desirable to do so. Average yields on general obligation bonds maturing in 20 years and having an average credit rating of Aa2 (Moody's) and AA (S&P) have not approached 9% since 1987.[230] An interest rate well below the maximum in California, Illinois or Texas would have been excessive during the last three decades, absent extraordinary circumstances.

However, particularly in high interest rate environments, maximum interest rates or yields expressed as a fixed percentage may restrict desirable transactions. For example, the California legislature amended its interest rate and yield caps in 1974, 1980 and 1981 from 7% to 8%, then 10% and 12% as interest rates rose,[231] presumably to keep up with rising interest rates. (The caps were not subsequently reduced as interest rates declined.)

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[226] In 1993, 24 states did. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 4, at 10; *also see* Salsich, *supra* note 60, at § 12.4 (noting that most statutes authorizing county and municipal bonds include maximum interest rates).

[227] CAL. GOVT. CODE §§ 53531, 53532 (Deering 2021). (There are exceptions. For example, the limit is 8% for certain general obligation bonds issued by California school districts. CAL. EDUC. CODE § 15143 (Deering 2021), CAL. GOV'T CODE § 53508.5 (Deering 2021)).

[228] TEX. GOV'T CODE § 1204.006 (LexisNexis 2021). Computations are set forth in TEX. GOV'T CODE §§ 1204.003, 1204.004, 1204.005 (LexisNexis 2021).

[229] 30 ILL. COMP. STAT. 305/2 (LexisNexis 2021).

[230] WM Financial Strategies, Rates Over Time – Interest Rate Trends, www.munibondadvisor.com/market.htm [https://perma.cc/P8DL-ATRY] (table entitled 20-Bond Buyer Index 1970-Present).

[231] CAL. GOVT. CODE §§ 53531, 53532 (Deering 2021) (describing the amendments). Average interest rates climbed from below 6% in 1977 to over 11% in 1981 and 1982 before declining. WM Financial Strategies, *supra* note 229, at table entitled 20-Bond Buyer Index 1970-Present.

While they provide more flexibility, even limits tied to benchmark interest rates (for example published average interest rates on high quality bonds) may unduly restrict issuers with lower credit ratings (ratings of the creditworthiness of the issuer).[232] Bonds with lower credit ratings bear interest at higher rates.[233] Credit ratings are based on a variety of factors, such as the economy, debt, finances and management.[234] A local government bond issuance may be desirable even if the government has a low credit rating or has to pay a higher interest rate on its bonds for other reasons, and restricting the ability of that government to do so without providing an alternative funding source may further exacerbate existing disparities (for example, if an economically disadvantaged area is not able to finance school facilities comparable to those provided in wealthier areas).[235]

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[232] While the Advisory Commission on Intergovernmental Relations recommended that states consider limits tied to the interest rates on high quality bonds in 1961, two council members dissented because "State regulation of this nature might make it impossible for some local governments to borrow for outlays they urgently need." ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 77 n.76.

[233] *See, e.g.*, Biles, *supra* note 72, at 1099 ("the differences in interest based upon the ratings often amount to millions of dollars for municipal treasuries"); John Yinger, *Municipal Bond Ratings and Citizens' Rights*, 12 AM. L. AND ECON. REV. 1, 9-10 (2010) (discussing academic studies that demonstrate that higher credit ratings lead to lower interest costs); WM Financial Strategies, *supra* note 233, at table entitled Municipal Market Data Index 20th Year Maturity by Rating Grade (showing that interest rates on bonds with lower credit ratings have been higher than on bonds with higher credit ratings since 2008). Most municipal bonds are rated by one or more of the three rating agencies that dominate the market: Moody's Investors Service, S&P Global Ratings and Fitch Ratings. O'HARA, *supra* note 16, at 175, 179. *See id.* at 189 (showing percentage of municipal debt not rated by Moody's and S&P ranging from 7.5% in 2000 to 2.4% in 2009). Kroll Bond Rating Agency also rates some municipal bonds. *See* Mun. Sec. Rulemaking Bd., Electronic Municipal Market Access Website, Understanding Credit Ratings, https://emma.msrb.org/EmmaHelp/Understanding CreditRatings [https://perma.cc/33ZR-FDTM]. Other bonds are not rated. O'HARA, *supra* note 16, at 179.

[234] Edward A. Rabson, *The Role of Rating Agencies*, *in* THE HANDBOOK OF MUNICIPAL BONDS 223, 225 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008) (quoting Moody's long-term municipal bonds rating scale).

[235] This may be especially true if particular types of communities are disproportionately affected. For example, one study concluded that smaller communities pay higher interest rates than larger ones. *See* Simonsen et al., *supra* note 81. Another commentator suggests that credit rating formulae disadvantage cities with large Black and Hispanic populations. Yinger, *supra* note 236, at 28-29. Furthermore, to the extent that interest rate limits increase the importance of credit ratings to local governments, they may increase the risk that credit rating agencies have too much influence on local government decisions. *See generally* Biles, *supra* note 71 (arguing that local governments prioritize the requirements of credit rating agencies over the needs of their citizens).

6.2.3. Regulation of Final Maturity and Amortization

Many states have limits on the final maturity of some or all local government bonds, and some also regulate the amortization schedule.[236] Presumably the intent of these provisions is to prevent today's decisionmakers from placing an excessive debt burden on future residents.

6.2.3.1. Forms of Limits on Maturity

Different states have different approaches to establishing final maturity dates, and the dates sometimes vary depending on the type of bonds or the type of project. Some states specify a period of years. For example, general obligation bonds issued by Hawaii counties must mature within 25 years and revenue bonds within 30.[237] General obligation bonds issued by California local governments must mature within 40 years.[238] The maximum term for many public enterprise revenue bonds in California is 40 years and for sales tax revenue bonds ranges from 20-50 years depending on the issuer and the authorizing law (with some instead limited by the term of the tax).[239] New York municipalities and school districts generally may not issue bonds with a term longer than the "period of probable usefulness" of the project or projects being financed, and periods of probable usefulness for over 100 types of projects are included in the Local Finance Law, subject to constitutional caps.[240] Oregon does not specify a maximum term for general obligation bonds and for some other types of local government borrowing, but instead

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[236] Forty-one states had limits on maximum maturities in 1993. ADVISORY COMM'N ON INTERGOVERNMENTAL REL., *supra* note 4, at 10. *See also* Salsich, *supra* note 60, at § 12.4 (noting that many state laws include maximum terms for municipal bonds).

[237] HAW. CONST. art. VII, § 13, HAW. REV. STAT. ANN. § 49-4(b) (LexisNexis 2020).

[238] CAL. CONST. art. XVI, § 18(a). Some general obligation bonds have shorter maximum terms. For example, some California school district bonds must mature within 25 years. CAL. GOV'T CODE § 53508.5 (Deering 2021), CAL. EDUC. CODE § 15144 (Deering 2021).

[239] CAL. GOV'T CODE § 54400 (Deering 2021); CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 106, at D-118-21 (2006).

[240] N.Y. CONST. art. VIII, § 2; N.Y. LOCAL FIN. LAW § 11.00 (McKinney 2021). Projects range from more typical ones like water systems, sewer systems, and roads to unique and specific projects such as payments to certain former employees of the town of Southampton, Lynbrook and Oyster Bay and payments from the city of Elmira for past service costs due to the state. *Id.* Bonds generally cannot be issued for projects that are not included in the statute. GOODFRIEND & MYERS, *supra* note 107, at 21. The periods of probable usefulness and the items that are included are not always intuitive. For example, replacement vehicles are included but vehicles to expand a fleet are not; land has a useful life of 30 years; and cleaning of hazardous waste sites in some locations is included but not in others. *Id.* at 25-26.

requires that the weighted average life of the bonds be less than or equal to the weighted average life of the project financed with the bonds.[241]

6.2.3.2. Provisions Governing Amortization Schedule

Some states also have restrictions on how debt service is spread out over the life of the bonds. For example, general obligation bonds issued by Hawaii counties must mature in substantially equal installments and the first principal payment must be made within 5 years of issuance.[242] In New York, local government bonds generally must be paid in annual installments beginning within two years after the bonds are issued, and no installment may be more than 50% higher than the smallest preceding installment unless the governing body of the local government provides for substantially level or declining debt service payments.[243] Prior to 2010, California had a law that required substantially level debt service on many issuances of general obligation bonds, unless principal was paid faster or if the issuance of bonds resulted in morel level debt service on all of the local government's outstanding general obligation bonds.[244] These restrictions do not always apply to revenue bonds.[245]

6.2.3.3. Properly Drafted Restrictions on Maximum Term and Amortization Can Promote Interperiod Equity

"[I]t is axiomatic that bonds should be retired within the period of usefulness of the facilities which they have financed and that their retirement or amortization should begin at an adequate rate with a minimum of delay."[246] Limits on the period that bonds can be outstanding and provisions restricting the ability to backload debt service may each serve to effectively

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[241] OR. CONST. art. XI, § 11L. *See also* LEAGUE OF OR. CITIES, *supra* note 50, at 10, 13 (noting that some financing agreements and revenue bonds are subject to these limitations). The weighted average life of bonds is the weighted period of time required to repay half of the principal of the bonds. It can be calculated by multiplying each principal payment by the number of years that principal is outstanding, then dividing that result by the total amount of principal of the bonds. For an example, see *Glossary of Municipal Securities Terms: Average Life*, MUN. SEC. RULEMAKING BD., http://www.msrb.org/glossary/definition/average-life.aspx [https://perma.cc/47DW-F5LG] (last updated Jan. 5, 2022).
[242] HAW. CONST. art. VII, § 13.
[243] N.Y. CONST. art. VIII, § 2. Because interest payments decline with the outstanding principal amount, principal payments go up from year to year if debt service (principal and interest) is the same in every year.
[244] Former Cal. Gov't Code § 253508.5 (1993 Cal ALS 841). The largest annual debt service payment could not exceed the smallest by more than ten percent. *Id.*
[245] For example, no such restriction applies to Hawaii revenue bonds.
[246] NAT'L MUN. LEAGUE (1953), *supra* note 93, at xviii.

counterbalance the tendency of current officials to borrow more and for a longer term than would be consistent with interperiod equity. These provisions serve separate yet related functions.

Limits on maturity will best promote interperiod equity if they are tied to the useful life of the facilities financed rather than an arbitrary number of years. Although allowing local governments to determine the useful life of the project being financed, or of components of the project being financed, and tying final maturities to that is daunting, there are ways to make the process more manageable. It is important that the process be one with a result that is clear enough for bond counsel to be able to deliver an opinion as to the validity of the bonds. One alternative would be a statute or regulation detailing useful lives for various types of projects, along the line of New York's periods of probable usefulness.[247] Another option would be to incorporate the economic lives that are used as "safe harbors" for tax-exempt bonds.[248] Since these are commonly used by local governments and bond counsel, they should be comfortable working with these for another purpose, as well. If the state wished to allow local governments some flexibility to extend debt beyond the safe harbor useful life of the project financed, it could do so, either by generally providing for a longer period (for example, 120% of the specified period, like in the federal regulations) and/or by allowing local governments to amortize over a longer period in certain circumstances or with the approval of, or following consultation with, a state agency with relevant expertise.[249] If a state were wary that the safe harbor useful lives could sometimes be too long, it could impose a shorter period (either a percentage of the useful life or an outside limit on maximum term). Laws

[247] *See supra* note 240 and accompanying text.

[248] In order for interest on bonds to be excluded from income for federal income tax purposes, the average maturity) of the bonds cannot exceed 120% of the average reasonably expected economic life of the assets financed with the proceeds of the bonds absent extenuating circumstances. 26 U.S.C.A 147(b)(1) (West 2020); Treas. Reg. 1.148-1(c)(4)(B)(2); CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §§ 4.4.1, 4.7.2.3. The safe harbors for various types of structures and equipment are in two revenue procedures released by the Internal Revenue Service, Rev. Proc. 62-21, 1962-2 C.B. 418 (1962) and Rev. Proc. 83-35, 1983-1 C.B. 745 (1983).

[249] David Gamage and Darien Shanske have suggested that the California Debt and Investment Advisory Commission approve certain types of local debt that they believe are more likely to be problematic. *See* David Gamage & Darien Shanske, *The Case for a State-Level Debt-Financing Authority*, 67 ST. TAX NOTES 188, 193 (2013). While their suggestion was not in the context of final maturity of bonds, state agency approval may be appropriate here because it would provide the opportunity for an agency with more expertise and without a vested interest in the outcome (unlike an underwriter) to provide guidance. While there is risk that a state agency could block financings for political reasons or otherwise unduly restrict the ability of local governments to borrow, in the context of borrowing for a term longer than the useful life of the project, the risks of involving such an agency seem minimal.

governing maximum maturities and useful lives of projects should be the same regardless of the type of bond being issued.

Laws that promote front-loaded or fairly level debt service also play an important role in promoting interperiod equity. They should, however, provide some flexibility, for several reasons. First, future debt service will be paid in future dollars, which likely will be worth less than today's dollars, and some cushion should be included to account for that. Second, while as a general rule it makes sense for bonds payable from an established tax or from rates paid for use of an existing facility to have fairly even payments over the term of the debt, this is not necessarily true for a new facility or a new stream of payments. A new facility that is being constructed will not generate revenues until it is completed, and perhaps will not reach its revenue-generating potential until some time after completion. Even in the absence of a new facility, it may take time for a new revenue stream from an existing facility or from a new tax to reach its full potential. Third, allowing local governments flexibility to structure new debt service around existing to provide a smoother structure can assist in avoiding large changes in fee levels and tax rates, which may create difficulties for taxpayers.[250]

Fourth, and particularly salient in the midst of a global pandemic, local governments need the flexibility to deal with economic shocks and disasters. In a time of economic distress, local governments may need to structure debt service on new borrowing or refinancing so that a larger proportion of the debt service is payable in the future than might be ideal for interperiod equity in order to obtain critically needed funds in a timely manner and to provide economic relief to citizens. Safety valves could be built into amortization requirements to address this issue. For example, the local government might be permitted to deviate from the statutory restrictions in specified circumstances, such as a natural disaster or a recession, or if the governing body might be required to make findings with respect to economic distress. Exceptions of these kinds could be helpful, but risk being abused and also being too narrow to cover unanticipated circumstances.

While the legislature could amend the law to loosen level debt service requirements should the need to do so arise, it may not do so (or may not do so in a timely manner), or the looser requirements may remain in place after they are no longer desirable. For example, the California legislature eliminated a requirement of substantially level debt service on many general obligation bonds in 2009 to give local governments more flexibility during a time of financial crisis.[251] This change affected the way that local

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[250] *See* MUSGRAVE & MUSGRAVE, *supra* note 50, at 693 (noting that "taxpayers find it easier to live with a more or less stable tax rate"). Such flexibility should have reasonable limits.
[251] Assemb. B. 1388 2009-2010 Leg. Reg. Sess. (Cal. 2009); Cal. Governor's Office of Planning and Research, A.B. 1388 Enrolled Bill Report, Reg. Sess., at 3-4 (2009).

governments borrowed even after the crisis had passed. Prior to 2009, California school districts could issue bonds with a maturity of up to 25 years without having to provide for substantially level debt service; after the legislature acted in 2009, they could issue bonds with a maturity of up to 40 years without having to meet that requirement. In the years after the amendment passed, a significantly higher portion of the capital appreciation bonds (on which all or nearly all debt service is paid close to maturity) issued by California school districts had maturities in excess of 25 years, increasing from 24% in 2009 to 80% in 2012 before declining to 58% by 2015 (still significantly higher than prior to the change).[252]

Perhaps a better alternative would be allowing a state agency to waive the statutory restrictions in appropriate circumstances,[253] or allowing a local government to proceed with a financing with significantly higher debt service in later years if the government's governing body makes findings of necessity and is given nonbinding guidance of a state agency or other entity with expertise.[254]

6.2.4. Restrictions on Other Provisions

States sometimes impose other restrictions on the provisions of bonds. For example, some California school district general obligation bonds must be subject to redemption at the option of the issuer beginning not later than 10 years after the date they were issued.[255] Historically, some states required that bonds be issued in coupon form (meaning that whomever held a "coupon" for an interest payment would be paid the interest) rather than registered form (in which payments are made to the registered owner of the bond), but once the U.S. Congress amended the Internal Revenue Code to

[252] *See* White, *supra* note 14, at 409 n. 225.
[253] *See supra* note 249.
[254] The nonprofit organization proposed in Ang & Green, *supra* note 19, to (among other things) establish best practices, provide independent advice to issuers and disseminate information could fulfill this role.
[255] CAL. EDUC. CODE § 15144.2 (Deering 2021). This applies to capital appreciation bonds with maturities in excess of ten years. *Id.* While this right to redeem gives school districts greater flexibility to refinance at better interest rates or a preferable structure, it presumably comes at a cost in the form of higher yields, particularly when interest rates are high, since it creates the risk that investors will have to reinvest not only earning on but also principal of the CABs in lower yielding securities before the scheduled maturity date of the CABs. These requirements may become more costly should the market move away from 10-year par calls in the future.

provide that tax-exempt bonds had to be in registered form, states modified their laws to allow for registered bonds.[256]

Most states "prescribe by statute bond terms that can be said to affect policy . . . but give local governing bodies a good deal of discretion in setting bond terms of an administrative nature."[257] In general, this provides appropriate flexibility to local governments to determine the terms of their bonds and adapt to changing market conditions that are not likely to create substantial risks to current or future citizens. Bond laws could either simply state that local government governing bodies and their delegees can determine terms of the bonds other than any specified by law, or could include a list of the types of terms that local governments <u>may</u> want to include in their bond documents along with flexibility to include other terms.[258] For particular practices that cause concern,[259] states may want to consider whether education of local government officials, requiring local governments to work with an experienced municipal advisor that has a fiduciary duty to the local government, mandating consultation with or approval by a state agency or other entity with expertise, or legislative prohibition are appropriate.[260]

Bond laws typically authorize local government issuers to make agreements with lenders regarding the collection and use of revenues, creation of security interests, establishment of reserve fund and other matters.[261] These covenants are important to bondholders, particularly those of revenue bonds, but they restrict the issuer's flexibility. However, local governments may not always understand the terms to which they are agreeing.[262] As a result, these covenants may prove harmful to current or future citizens. Because covenants vary significantly, legislating the types of covenants that are and are not appropriate is not a reasonable solution. Better

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[256] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at § 1.1.2; Bernard P. Friel, *The Model Registered Public Obligations Act: A Brief History*, 16 Urb. L. 17, 24–25 (1984); Salsich, *supra* note 60, at § 12.44.

[257] Salsich, *supra* note 60, at § 12.35.

[258] *See, e.g.,* CAL. GOV'T CODE 53508 (Deering 2021) (listing several items that "may" be addressed in the resolution, including "other terms and conditions of the bonds and of their execution, issuance, and sale deemed necessary and appropriate ….").

[259] Some candidates would be auction rate securities (described in Section 3.3) or other types of transactions in which a local government bears a disproportionately high risk in exchange for a relatively small reward. Lori Raineri and Darien Shanske make this argument in Raineri & Shanske, *supra* note 68.

[260] Raineri and Shanske urge the use of a state agency that would monitor local government borrowing for asymmetric risk. *Id.* at 83. For additional discussion of municipal advisors, *see supra* notes 48–49 and accompanying text. *Also see supra* notes 248 and 253.

[261] Salsich, *supra* note 60, at § 12.45. *Also see* supra notes 181–182 and accompanying text for description of some other common covenants.

[262] *See, e.g.,* Nguyen et al., *supra* note 40, at 1 (noting that local governments may not fully comprehend loan risks); *see also supra* note 83 and accompanying text.

options would be providing access to guidance from a state agency or other entity with expertise at a reasonable cost or at the very least making trainings and other materials available to local governments so they can better educate themselves. Requiring local governments to use a municipal advisor, which would have a fiduciary duty to the local government and have needed expertise, is another option.

6.3. Refinancing

Most states allow local governments to issue bonds and to repay outstanding debt prior to maturity.[263] This is referred to as "refunding," the bonds being repaid are referred to as "refunded bonds", and the bonds being issued to repay them are referred to as "refunding bonds." The most common reason for refunding is to take advantage of lower interest rates.[264] Sometimes, issuers refund outstanding bonds to eliminate or modify covenants that have become unduly burdensome or to restructure debt service.[265] Due to the severe economic strain caused by the COVID-19 pandemic, some local governments have refinanced outstanding debt to provide short-term relief by deferring debt service.[266]

In some states, refunding bonds must satisfy certain requirements, or refunding bonds that would otherwise require voter approval (such as general obligation bonds) do not need such approval if specific requirements are met. For example, in New York, refundings generally must result in present value savings and refunding bonds generally cannot mature later than the end of the period of probable usefulness of the project financed, computed from the same date as for the refunded bonds.[267] California local governments may issue general obligation bonds to refund other general obligation bonds without obtaining a new voter approval only if the total amount of debt service through maturity is lower for the refunding bonds than for the refunded bonds and the refunding bonds mature no later than the refunded

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[263] Salsich, *supra* note 60, at § 12.50.
[264] William H. Wood, *Municipal Bond Refundings*, in THE HANDBOOK OF MUNICIPAL BONDS 235, 236 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008).
[265] *Id.* at 236–37; O'HARA, *supra* note 16, at 83; LEAGUE OF OR. CITIES, *supra* note 50, at 17.
[266] *See State and Local Governments Relied on Debt for Budgetary Help in 2020*, PEW CHARITABLE TRUST (Jan. 28, 2021), https://www.pewtrusts.org/en/research-and-analysis/articles/2021/01/28/state-and-local-governments-relied-on-debt-for-budgetary-help-in-2020 [https://perma.cc/WC4W-WMP2] (interview with Matt Fabian and Lisa Washburn) (noting that although this practice historically has not been common, some local governments did this in response to the economic fallout of the COVID-19 pandemic).
[267] N.Y. LOCAL FIN. LAW §§ 90.00, 90.10 (McKinney 2021). *See supra* note 240 and accompanying text for discussion of periods of probable usefulness.

bonds.[268] Other states are somewhat less restrictive. Oregon allows refunding bonds to be issued without voter approval as long as the maturity of the refunding bonds does not exceed any maturity limit imposed on the refunded bonds by the voters or by law by more than six months.[269]

States generally limit the amount of refunding bonds to the amount necessary to repay the refunded bonds and pay costs of issuance.[270] In addition, some states have other restrictions on the issuance of refunding bonds. For example, in Oregon, any refunding bonds that are issued more than a year in advance of the repayment of existing bonds must be approved by the State Treasurer's office and are subject to additional requirements.[271] Among other things, the State Treasurer's regulations require that local governments use a municipal advisor for any such advance refundings.[272]

Allowing local governments to refinance outstanding debt allows them to save money when they can refinance at lower interest rates and provides flexibility to adapt to changing circumstances by eliminating restrictive covenants in bond documents or restructuring debt service in challenging times. As long as the transaction does not increase the overall burden on taxpayers and as long as the term of the new bonds not significantly longer than would have been legally allowed for the initial bonds and any level debt service requirements that applied to the refunded bonds also apply to the refunding bonds, present and future citizens are not likely to be harmed by a refinancing. Furthermore, because it takes several months to obtain voter approval,[273] requiring such approval for refunded bonds would make it impossible for a local government to act quickly to take advantage of interest rate fluctuations, preventing some local governments from achieving debt service savings. That said, it may be sensible to require consultation with a state agency or other expert, state agency approval or use of a municipal advisor with a fiduciary duty to the local government issuer, or to require a

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[268] CAL. GOV'T CODE §§ 53552, 53553(e) (Deering 2021). Georgia similarly exempts refunding bonds from voter authorization requirements as long as the term is not extended, the interest rate is not increased, and debt service through maturity does not increase. GA. CONST. art. IX, § 5(III).

[269] OR. REV. STATS. §§ 287A.360, 287A.365 (2019).

[270] Salsich, *supra* note 60, at § 12.50. While California law does not expressly do so, the California Attorney General has interpreted the refunding statute to allow refunding general obligation bonds without voter approval only if proceeds for other purposes are not generated and noted that view is consistent with case law in other jurisdictions. Opinion of Edmund G. Brown Jr., Att'y Gen., No. 06-1102 8-9 (Jan. 9, 2009).

[271] OR. REV. STATS. §§ 287A.001(1); 287A.365-287A.375 (2019). The additional requirements are likely because advance refundings are more costly than current ones because the proceeds of the refunding bonds must cover interest through the date the refunded bonds are to be paid.

[272] OR. ADMIN. R. 170-062-0000(2) (2021).

[273] *See supra* notes 163–164 and accompanying text.

local government governing body to make findings as to the benefits of the transaction in some circumstances, such as refinancings that do not result in debt service savings or that defer a significant portion of debt service.

6.4. Regulation of Sale of Bonds

6.4.1. Method of Sale

Some states restrict the method of sale for at least some bonds. For example, some states require some or all local governments to sell their general obligation bonds (but not revenue bonds) through a competitive process.[274] General obligation bonds may be sold on a negotiated basis in other states.[275] Some states also allow local governments to privately sell bonds to, and to borrow directly from, financial institutions, and this practice is becoming increasingly common.[276] Most local government debt is sold in negotiated sales.[277]

Some states impose additional requirements for bonds to be sold on a negotiated basis. For example, California local governments selling general obligation bonds on a negotiated basis must include a statement of the reasons for selecting a negotiated method of sale and an estimate of the costs of issuance in the governing body resolution that authorizes the bonds.[278] For revenue bonds and refunding bonds, California local governments must disclose in a filing with the California Debt Investment Advisory Commission the reason for using a negotiated sale.[279] In New York, some local governments must obtain the approval of the State Comptroller before

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[274] Peng et al., *supra* note 42, at 52–53 (citing Jun Peng & Peter Brucato Jr., *Do Competitive-Only Laws Have an Impact on the Borrowing Cost of Municipal Bonds?*, MUN. FIN. J. 22 (2001)); *also see* Darío Cestau, Richard C. Green, Burton Hollifield & Norman Schürhoff, *The Cost Burden of Negotiated Sale Restrictions: A Natural Experiment Using Heterogenous State Laws* 1 (Hutchins Center on Fiscal & Monetary Policy at Brookings, Working Paper No. 36, 2017), https://www.brookings.edu/wp-content/uploads/2017/11/wp363.pdf [https://perma.cc/RM49-RNNL] (noting that some states do not allow school districts to use negotiated sales).

[275] *See, e.g.*, OR. REV. STATS. § 287A.300 (2019); CAL. GOV'T CODE § 53508.9 (Deering 2021).

[276] *See supra* note 40.

[277] Peng et al., *supra* note 42, at 62.

[278] CAL. EDUC. CODE § 15146(b)(1) (Deering 2021); CAL. GOV'T CODE § 53508.9 (Deering 2021).

[279] *See* Cal. Debt & Inv. Advisory Comm'n, Reason for Negotiated Refunding / Reason for Negotiated Sale of Revenue Bonds Report, https://www.treasurer.ca.gov/cdiac/reporting/reason-refunding-sale-bonds-instructions.pdf [https://perma.cc/H84C-M8M7](last visited Mar. 31, 2021).

selling some bonds privately or in a negotiated sale.[280] In determining whether to approve the sale, the State Comptroller considers factors including the reasonableness of the underwriter's fee, costs, bond yields, refunding savings, any derivatives (such as interest rate swaps) related to the transaction.[281]

Each method of sale has advantages and disadvantages. Negotiated sales provide greater flexibility to adjust the transaction structure and timing as market conditions change and permit greater underwriter involvement in structuring the transaction and preparing the offering document.[282] Competitive sales eliminate the risk of negotiating unfavorable terms with the underwriters (either because of corruption or lack of experience) because bonds are awarded to the lowest bidder in an open bidding process. Numerous studies suggest that local governments obtain lower yields and pay lower costs when they sell their bonds competitively, though others reach the opposite conclusion.[283] Generally, negotiated sales are recommended for complex transactions, new issuers, or complicated credits, while competitive sales are recommended for higher rated issuers with straight-forward security.[284]

Presumably, restrictions on method of sale are intended to ensure that local governments get the lowest possible yields on their bonds and do not pay excessive compensation to underwriters. Ideally, rather than blanket restrictions on methods of sale, states will allow local governments to select the method of sale that best suits their needs. At the very least, states should

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[280] N.Y. State Comptroller, Office of the State Comptroller Debt Issuance Approval Policy Statement and Guidelines, 1 (amended July 1, 2020), *available at* https://www.osc.state.ny.us/files/debt/pdf/debt-policy-statement-and-guidelines.pdf [https://perma.cc/RR8L-BBYJ].

[281] *Id.* at 4–5.

[282] Peng et al., *supra* note 42, at 56–57; *see also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 107, at 10–12 (describing the roles played by an underwriter in a competitive and a negotiated sale).

[283] *See* Peng et al., *supra* note 42, at 59–62 (describing some studies that indicate that competitive sales are most cost effective and others indicating that in some circumstances negotiated sales may result in better pricing); WM Financial Strategies, Studies Pertaining to Competitive and Negotiated Sales, (Nov. 2013), http://www.munibondadvisor.com/SaleStudies.html [https://perma.cc/8BBU-PQ5K] (describing studies reaching various conclusions); Cestau, *supra* note 274 (concluding that prohibition of negotiated sales increase the yields on bonds maturing within 20 years and decrease the yields on bonds with longer maturities); Simonsen, *supra* note 81, at 714–15 (indicating that competitive sales lead to lower interest rates on bonds).

[284] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §5.3.1; LEAGUE OF OR. CITIES, *supra* note 50, at 26; Gov't Fin. Officers Assoc., *Selecting and Managing the Method of Sale of Bonds*, https://www.gfoa.org/materials/selecting-and-managing-the-method-of-sale-of-bonds [https://perma.cc/KGB7-W7J7]; WM Financial Strategies, *Bond Sale Methods (Competitive v Negotiated Bond Sales)*, http://www.munibondadvisor.com/SaleChoice.htm [https://perma.cc/3H4B-3A9P].

allow local governments to sell revenue bonds and refunding bonds without using competitive bidding since these transactions tend to be more complex or more time-sensitive.[285] Rather than prohibiting negotiated sales of general obligation bonds or borrowing from financial institutions, a state could require a local government's governing body to make findings about the reasons a negotiated sale or private borrowing was being pursued, or could require use of a municipal advisor or consultation with or approval of a state agency or other expert before undertaking the transaction. Other options would include making available guidance from a state agency or other entity with expertise at a reasonable cost or requiring local governments to use a municipal advisor for negotiated sales of general obligation bonds.

States also might want to encourage the use of a competitive process involving obtaining proposals from several underwriters to select underwriters for a negotiated sale, or even make available technical support to assist with such a process.[286] Selecting underwriters for negotiated sales using a competitive process has significantly reduced the underwriting costs paid by issuers.[287]

Some states restrict the method of sale for at least some bonds. For example, some states require some or all local governments to sell their general obligation bonds (but not revenue bonds) through a competitive process.[288] General obligation bonds may be sold on a negotiated basis in other states.[289] Some states also allow local governments to privately sell bonds to, and to borrow directly from, financial institutions, and this practice is becoming increasingly common.[290] Most local government debt is sold in negotiated sales.[291]

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[285] *See* Peng et al., *supra* note 42, at 63–64 (noting that revenue bonds tend to be riskier and investors may need more information about them, and that refunding bond sales are more time-sensitive).

[286] The Government Finance Officials Association recommends using a competitive process to select underwriters for negotiated sales. Gov't Fin. Officers Assoc., *supra* note 284. For descriptions of this process, *see* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §5.3; Peng et al., *supra* note 42, at 55–56.

[287] Peng et al., *supra* note 42, at 55–56.

[288] Peng et al., *supra* note 42, at 52–53 (citing Jun Peng & Peter Brucato Jr., *Do Competitive-Only Laws Have an Impact on the Borrowing Cost of Municipal Bonds?*, MUN. FIN. J. 22 (2001)); *also see* Darío Cestau, Richard C. Green, Burton Hollifield & Norman Schürhoff, *The Cost Burden of Negotiated Sale Restrictions: A Natural Experiment Using Heterogenous State Laws* 1 (Hutchins Center on Fiscal & Monetary Policy at Brookings, Working Paper No. 36, 2017), https://www.brookings.edu/wp-content/uploads/2017/11/wp363.pdf [https://perma.cc/RM49-RNNL] (noting that some states do not allow school districts to use negotiated sales).

[289] *See, e.g.*, OR. REV. STATS. § 287A.300 (2019); CAL. GOV'T CODE § 53508.9 (Deering 2021).

[290] *See supra* note 40.

[291] Peng et al., *supra* note 42, at 62.

Some states impose additional requirements for bonds to be sold on a negotiated basis. For example, California local governments selling general obligation bonds on a negotiated basis must include a statement of the reasons for selecting a negotiated method of sale and an estimate of the costs of issuance in the governing body resolution that authorizes the bonds.[292] For revenue bonds and refunding bonds, California local governments must disclose in a filing with the California Debt Investment Advisory Commission the reason for using a negotiated sale.[293] In New York, some local governments must obtain the approval of the State Comptroller before selling some bonds privately or in a negotiated sale.[294] In determining whether to approve the sale, the State Comptroller considers factors including the reasonableness of the underwriter's fee, costs, bond yields, refunding savings, any derivatives (such as interest rate swaps) related to the transaction.[295]

Each method of sale has advantages and disadvantages. Negotiated sales provide greater flexibility to adjust the transaction structure and timing as market conditions change and permit greater underwriter involvement in structuring the transaction and preparing the offering document.[296] Competitive sales eliminate the risk of negotiating unfavorable terms with the underwriters (either because of corruption or lack of experience) because bonds are awarded to the lowest bidder in an open bidding process. Numerous studies suggest that local governments obtain lower yields and pay lower costs when they sell their bonds competitively, though others reach the opposite conclusion.[297] Generally, negotiated sales are recommended for

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[292] CAL. EDUC. CODE § 15146(b)(1) (Deering 2021); CAL. GOV'T CODE § 53508.9 (Deering 2021).

[293] *See* Cal. Debt & Inv. Advisory Comm'n, Reason for Negotiated Refunding / Reason for Negotiated Sale of Revenue Bonds Report, https://www.treasurer.ca.gov/cdiac/reporting/reason-refunding-sale-bonds-instructions.pdf [https://perma.cc/H84C-M8M7](last visited Mar. 31, 2021).

[294] N.Y. State Comptroller, Office of the State Comptroller Debt Issuance Approval Policy Statement and Guidelines, 1 (amended July 1, 2020), *available at* https://www.osc.state.ny.us/files/debt/pdf/debt-policy-statement-and-guidelines.pdf [https://perma.cc/RR8L-BBYJ].

[295] *Id.* at 4–5.

[296] Peng et al., *supra* note 42, at 56–57; *see also* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 107, at 10–12 (describing the roles played by an underwriter in a competitive and a negotiated sale).

[297] *See* Peng et al., *supra* note 42, at 59–62 (describing some studies that indicate that competitive sales are most cost effective and others indicating that in some circumstances negotiated sales may result in better pricing); WM Financial Strategies, Studies Pertaining to Competitive and Negotiated Sales, (Nov. 2013), http://www.munibondadvisor.com/SaleStudies.html [https://perma.cc/8BBU-PQ5K] (describing studies reaching various conclusions); Cestau, *supra* note 274 (concluding that prohibition of negotiated sales increase the yields on bonds maturing within 20 years and decrease the yields on bonds with

complex transactions, new issuers or complicated credits, while competitive sales are recommended for higher rated issuers with straight-forward security.[298]

Presumably, restrictions on method of sale are intended to ensure that local governments get the lowest possible yields on their bonds and do not pay excessive compensation to underwriters. Ideally, rather than blanket restrictions on methods of sale, states will allow local governments to select the method of sale that best suits their needs. At the very least, states should allow local governments to sell revenue bonds and refunding bonds without using competitive bidding since these transactions tend to be more complex or more time-sensitive.[299] Rather than prohibiting negotiated sales of general obligation bonds or borrowing from financial institutions, a state could require a local government's governing body to make findings about the reasons a negotiated sale or private borrowing was being pursued, or could require use of a municipal advisor or consultation with or approval of a state agency or other expert before undertaking the transaction. Other options would include making available guidance from a state agency or other entity with expertise at a reasonable cost or requiring local governments to use a municipal advisor for negotiated sales of general obligation bonds.

States also might want to encourage the use of a competitive process involving obtaining proposals from several underwriters to select underwriters for a negotiated sale, or even make available technical support to assist with such a process.[300] Selecting underwriters for negotiated sales using a competitive process has significantly reduced the underwriting costs paid by issuers.[301]

Some state laws include detailed provisions about the mechanics of competitive sales, in particular, such as when and where notice of sale must be published and what the notice must contain.[302] Some of these provisions,

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longer maturities); Simonsen, *supra* note 81, at 714–15 (indicating that competitive sales lead to lower interest rates on bonds).

[298] CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §5.3.1; LEAGUE OF OR. CITIES, *supra* note 50, at 26; Gov't Fin. Officers Assoc., *Selecting and Managing the Method of Sale of Bonds*, https://www.gfoa.org/materials/selecting-and-managing-the-method-of-sale-of-bonds [https://perma.cc/KGB7-W7J7]; WM Financial Strategies, *Bond Sale Methods (Competitive v Negotiated Bond Sales)*, http://www.munibondadvisor.com/SaleChoice.htm [https://perma.cc/3H4B-3A9P].

[299] *See* Peng et al., *supra* note 42, at 63–64 (noting that revenue bonds tend to be riskier and investors may need more information about them, and that refunding bond sales are more time-sensitive).

[300] The Government Finance Officials Association recommends using a competitive process to select underwriters for negotiated sales. Gov't Fin. Officers Assoc., *supra* note 284. For descriptions of this process, *see* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at §5.3; Peng et al., *supra* note 42, at 55–56.

[301] Peng et al., *supra* note 42, at 55–56.

[302] Salsich, *supra* note 60, at § 12.40.

such as requirements to publish in newspapers in particular cities,[303] seem almost quaint today when competitive bidding takes place through electronic platforms.[304] In all likelihood, some requirements that seem reasonable today will be obsolete in the future as technology and market practices evolve. Ideally, any specifics about notice, method of submission of bids and the like would be drafted in general terms (for example, requiring notices of sale to be published in a manner (including online) that is reasonably expected to reach prospective bidders) [305] or delegated to a state agency that can more easily revise regulations to adapt to changing technology and market practices. The alternative is unnecessary expense and complication.

Some states prohibit the sale of general obligation bonds at a discount or limit the amount of discount that is allowed.[306] These laws presumably are intended to prevent local governments from selling bonds at a yield that is higher than (or substantially higher than) the authorized maximum interest rate. A better solution would be to authorize a maximum yield (or, better yet, to eliminate any maximum interest rate or yield imposed by state law), and to allow local governments to sell at a discount or premium in order to obtain the best price on their bonds.[307]

7. THE APPROVAL PROCESS, INFORMATION AND OPPORTUNITIES FOR PUBLIC INVOLVEMENT

One of the key functions of bond laws is to ensure that governing bodies and the public have access to information about proposed bond issuances and existing debt, and that the public has a meaningful opportunity to influence proposed local government borrowing. Much of the information provided to the public and the public's opportunity to provide input outside the voter approval process occurs on the context of governing body approval. All states require governing body approval (or that of a delegate of the

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[303] *See, e.g.*, CAL. PUB. UTILITIES CODE § 22784 (Deering 2021) (requiring that the board of supervisors publish notice in a newspaper of general circulation in the county, or if there isn't one, in a different county, before selling bonds); MONT. CODE ANN. § 7-7-2252 (2019) (requiring publication of notice of sale in a local newspaper and providing the option to also publish in a financial newspaper in New York or Chicago).

[304] For example, one bidding platform indicates that it is used by the top 30 underwriters. IPREO, *Competitive Bid Calculation System*, https://www.newissuehome.i-deal.com/Destination/docs/BiDCOMP.pdf [https://perma.cc/D4HN-T52N].

[305] For example, California allows publication of a notice of sale in "a financial publication generally circulated throughout the state or reasonably expected to be disseminated among prospective bidders for the securities." CAL. GOV'T CODE § 53692 (Deering 2021). This could be expanded to include online platforms.

[306] Salsich, *supra* note 60, at § § 12.43. *See also* N.Y. LOCAL FIN. LAW § 57.00(e) (McKinney 2021) (limiting the discount to no more than five percent except in specified circumstances).

[307] *See supra* notes 15–17 and accompanying text.

governing body) of bond issuances,[308] some require supermajority approval. Some states also require that issuers provide information to a central repository or otherwise make information about debt readily available to those interested. Governing body approval and information requirements are discussed in the following sections. As with voter approval requirements, if governing body approval and information requirements are imposed, they should be applied consistently so that decisions about financings are made on the basis of the needs of the community rather than the challenge of meeting the requirements.

7.1. Supermajority Approval

Some state laws require that a supermajority of a local government's governing body approve certain bond issuances, with different definitions of supermajority in different cases.[309] Supermajority requirements may help protect against unwise borrowing by making it more difficult for "small but well-organized groups to put together the legislative coalition necessary to authorize new debt."[310] A supermajority requirement may also signal to the governing body that the decision to borrow is a particularly important one, and that in itself may have value. While at least one study has suggested that legislative supermajority approval requirements do not reduce the level of debt,[311] it is possible that the requirements caused the debt to be more carefully considered.

7.2. Requirements for Information and Findings Before Issuance

Some states require that specific information be provided to governing body members or made publicly available before bonds are approved, or that governing bodies make specific findings in their resolutions authorizing bonds. For example, before authorizing the issuance of bonds, governing bodies of California local governments must obtain and disclose estimates of the expected yield on the bonds, the costs of issuance, the proceeds to be received and the total amount of debt service that will need to

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308 Salsich, *supra* note 60, at § 12.2.

309 For example, New York local governments generally may issue bonds only if the transaction is approved by two-thirds of the membership of the governing body (or three-fifths if a referendum is being held). N.Y. LOCAL FIN. LAW § 33.00 (McKinney 2021). Two-thirds of council members of California non-home rule cities must approve an ordinance to put a general obligation bond measure on the ballot, and some California local transportation authority boards must approve the issuance of sales tax bonds by a two-thirds vote. CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 106, at 139, 195.

310 Sterk & Goldman, *supra* note 73, at 1366.

311 Kiewiet & Szakaly, *supra* note 119, at 76. This study was of state legislatures, not local governments, but it is reasonable to think that the impact would be the same at the local level.

be paid to maturity.[312] The purpose of this requirement, which was added in 2017, is to provide the public with a better understanding of the financial impact of the financing.[313]

At least in states that have laws requiring that meetings of local government governing bodies must be properly noticed and open to the public ("open meeting laws"),[314] requirements to present information to the governing body and for the governing body to make findings can serve dual purposes of informing the governing board and informing the public. While it is safe to assume that few members of the public attend local government board meetings or review meeting agendas on local government web sites, there is value in having the information available to anyone who wants to see it, and interest groups and the press may bring attention to more controversial measures. Mandating wider publication of a notice with key information about the financing in advance of the meeting might garner more public attention, notwithstanding that it is likely that most people do not read the public notices published in their local newspaper. However, requirements should be as straightforward as possible and should be limited to information that is meaningful to members of the governing board and the public. Otherwise, the requirements may simply impose unnecessary costs and create another opportunity for error while providing little benefit.

7.3. Opportunities for Public Discussion and Waiting Periods

In addition to open meeting laws, some states provide specific opportunities for public discussion, or require a waiting period before bonds are issued to ensure that the public has the opportunity to provide input.[315] For example, Illinois law requires that local governments hold at least one public hearing after giving public notice of the hearing before authorizing some types of bonds that do not require voter approval.[316] For some bonds, California requires school districts to provide notice and present the resolution authorizing the bonds at two consecutive governing body meetings and it can be adopted only at the second one,[317] in effect giving a longer period in which members of the public can comment on the proposed

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[312] CAL. GOV'T CODE § 5852.1 (Deering 2021).

[313] Cal. S. Rules Comm., Senate Floor Analysis, SB 450, 5 (Cal. 2017) (quoting the bill's author). Similarly, some local government governing bodies in California must make specific findings and include costs of issuance information in the authorizing governing body resolution in order to sell general obligation bonds at a negotiated sale. *See supra* note 277–278 and accompanying text.

[314] Most states have such laws. MCQUILLIN, *supra* note 57, at § 13.11.

[315] Some examples appear in Salsich, *supra* note 60, at § 12.18.

[316] 30 ILL. COMP. STAT. ANN. 352 (LexisNexis 2021).

[317] CAL. EDUC. CODE § 15146(b)(2) (Deering 2021). This only applies to capital appreciation bonds.

issuance. Requirements to give public notice and to give the public a period of time and the opportunity to provide input (whether that is in the context of a regular governing body meeting or otherwise) could promote public engagement and increase the likelihood that government officials hear varying viewpoints in the community before making a final decision to issue bonds, or at least before the bonds are issued. The Internal Revenue Code takes a similar approach, requiring that a public hearing after notice for some (but not all) tax-exempt bonds.[318]

7.4. Additional Information Requirements and Other Accountability Measures

Some states require reporting of bond issuance data to a state agency or otherwise require that the information be made accessible to the public. For example, every time a California local government issues bonds, it must provide information to the California Debt and Investment Advisory Commission ("CDIAC") about the issuance, including the principal amount of the bonds, premium and discount on the bonds, maturity schedule, purpose of the bonds, type of bonds, method of sale, identity of outside professionals and fees paid to them.[319] Local governments in California also must annually file with CDIAC information about outstanding debt and debt issued and paid during the preceding year.[320] CDIAC provides aggregate information about statewide debt issuances and also makes available information about individual issuances in excel on its web site.[321] Other states also collect and publish information about local government borrowing.[322] While information about publicly sold debt is available on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access website, the information on that site is prepared for investors and does not include all of the information that might be of interest to, or provide information in the format that would be most usable by, citizens or to other local governments.[323] States that do not

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[318] 26 U.S.C.A. § 147(f)(2)(B)(i) (West 2020); Treas. Reg. 1-147(f)-1(a)-(d).

[319] CAL. GOV'T CODE § 8855(i), (j) (Deering 2021); CAL. CODE REGS. Tit. 4, § 6020 (Barclays 2021).

[320] CAL. GOV'T CODE § 8855(k) (Deering 2021).

[321] *See generally California State and Local Government Debt Issuance Data,* CALIFORNIA STATE TREASURER'S OFFICE, https://www.treasurer.ca.gov/cdiac/debt.asp [https://perma.cc/F7CM-XLSR].

[322] Numerous states collect and publish information about local government debt. The California Debt and Investment Advisory Commission found in 2007 that 17 states had some form of state and/or local government debt data on their web sites. Cal. Debt & Inv. Advisory Comm'n, *State and Local Government Debt Data Resources* (CDIAC No. 07-08) 1 (2007).

[323] The site is called "emma.msrb.org". [https://perma.cc/8S2V-VGBG]. It generally includes disclosure information required to be provided for municipal bonds under federal

collect and provide information should consider doing so and states that already collect information should evaluate whether it would be valuable to collect additional data. A state could form a working group that includes representatives of local governments, municipal advisors, and taxpayer organizations to evaluate what information would be useful and could be proved at a reasonable cost. States also could consider collaborating so that information from multiple states was available in a single database. While reporting requirements create additional work and cost for local governments, and compliance may not be perfect, this information is valuable not only to researchers and by the state, but also by citizens and by other local governments who may want to compare their issuance costs and bond yields to those of others.[324]

8. So, What Now?

This article has discussed some of the typical elements of bond laws and different ways that states have addressed them. It also has identified problems with some bond laws and proposed solutions. States have several options for improving bond laws and local government borrowing practices. These options range from a wholesale revision of the bond law to providing additional support and guidance to local governments. Several options are discussed below.

8.1. Changing the Law

8.1.1. Wholesale Revision or Even a New Model Bond Law

Ideally, states would consider revamping their bond laws entirely to ensure consistency and clarity while providing needed flexibility and updates. An organization like the National Association of Bond Lawyers or the National League of Cities could even undertake the drafting of model bond laws similar to what the National Municipal League did in the 1950s and 1960s[325] or similar to the Uniform Commercial Code or other laws that have been adopted in numerous states, though these options may prove unduly challenging, particularly where constitutional provisions need to be amended

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securities laws. For example, official statements posted on the site do not typically include detailed information about fees charged by individual service providers involved in a transaction; this information may be useful to other local governments. In addition, because one has to look at official statements for separate transactions individually, it is not as easy to compare terms of issuances and issuers.

[324] *See* Joffe, *supra* note 219, at 15–16 (noting that making costs of issuance more visible is the first step towards reducing them).

[325] *See generally* note 93.

or where there is a wide range in approaches among different states. Harmonizing a new set of model bond laws with existing laws that are spread throughout numerous statutes and codes, as is the case in many states,[326] also may be challenging.

8.1.2. Incremental Change

As an alternative to a wholesale revision of bond laws, states could evaluate specific aspects of their bond laws and make changes to those provisions. Similarly, national organizations could prepare and promote uniform versions of laws to change particular aspects of municipal bond law. For example, when federal law was changed so that municipal bonds had to be in registered form in order to be tax exempt, representatives of several organizations worked together to develop a model law permitting local governments to issue bonds in registered form, and at least 20 states adopted the model law entirely or in part.[327] It may be simplest to make amendments to laws that relate to specific terms of bonds and mechanics of issuance and sale rather than to voter approval requirements or debt limits. Another alternative would be to delegate requirements regarding issuance and sale mechanics and terms of bonds to a state agency so that provisions can be changed more easily as circumstances warrant, and even to allow local governments to deviate from some or all those requirements either after approval by the state agency or after consultation with the agency or another expert.

8.1.3. Consolidation

In most states, bond laws are scattered throughout numerous statutes and codes.[328] Even if no substantive changes to the laws are made, consolidating them in a single location would be valuable. Consolidation "would expose more fully the widespread existence of overlapping and contradictory provisions which have tended to hamper sound financial administration by local governments and to limit the ability of State legislatures to deal intelligently with this subject."[329] Consolidation would also make it easier for bond counsel and other professionals both within and outside local governments to understand what the laws are that apply to a particular issuance. Having statutes spread throughout multiple codes increases the risk of inadvertent noncompliance. It likely also increases the

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[326] *See generally* note 85.
[327] *See supra* note 256 and accompanying text.
[328] *See generally* note 85.
[329] ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., *supra* note 50, at 85.

cost of compliance because of the time and effort involved in ensuring that all relevant provisions are considered or, where there is ambiguity, complying with provisions that may not be intended to apply to a particular transaction. Consolidation, or at least partial consolidation, is achievable. For example, Texas consolidated its bond laws in 1999.[330]

8.1.4. Proceeding Carefully

Laws governing local government borrowing are complex, and they intersect with state laws regarding matters such as fiscal distress and municipal bankruptcy, the imposition of taxes and fees, open meeting laws and election laws. To avoid unintended consequences or disconnects with other bodies of law, amendments to bond laws should be made carefully. For example, when Texas consolidated its bond law in 1999, it involved public finance attorneys and the head of the public finance division of the office of the attorney general to review and provide comments on the proposed legislation and widely distributed drafts of the proposed law for comment.[331] Oregon also involved numerous public finance professionals (lawyers and finance professionals, both from private practice and governments) in the drafting of its 2007 revised bond law.[332] The Oregon bill also allowed Oregon local governments to use existing law for two years after the act became effective in order to "protect . . . local government borrowers against the possibility that the substantial revisions to existing law in this very large bill have adverse unintended consequences."[333] This gave the legislature time to address any problems of which it became aware during that two year period before any local government could be harmed.

In addition, additional research may be needed to inform discussion of some issues. For example, if permissive referenda are being considered, it would be valuable to know more about how the petition requirements and timing limitations affect the likelihood that citizens can actually require a measure to be on the ballot.

8.2. Other Alternatives: Education and Guidance

Even absent any revisions to the law, there are things states can do to improve the situation. For example, in its 2019 Debt Financing Guide, CDIAC includes a list of all of the general bond statutes.[334] This list, together with the information provided in the guide, is very valuable. States also can

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[330] *See supra* note 94 and accompanying text.
[331] Tex. Office of House Bill Analysis, Bill Analysis, H.B. 3157 (July 15, 1999).
[332] Rogers, *supra* note 86, at § 1.
[333] *Id.* at § 4.M.
[334] *See generally* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22, at App. A.6.

(and do) provide training and educational resources to local governments through entities like CDIAC and the Oregon Municipal Debt Advisory Commission.[335] States that don't provide these resources should consider doing so or should consider supporting academic institutions and other organizations within the state that do.

States also could provide support to local governments in other ways, such as providing support services to local governments that could be accessed for a reasonable fee at the option of the local government or collaborating with a nonprofit organization that would provide this assistance.[336] States could take this a step farther and encourage or require use of these services for particularly complex or problematic transactions.

9. CONCLUSION

As we look for ways to revive the economy and to move beyond (or at least move forward despite) the COVID-19 pandemic, local government borrowing is likely to play a significant role. We need to do what we can now to make sure that borrowing is done in an effective and efficient way, and that local governments receive the guidance they need but are not constrained by outdated or unduly complicated mechanics. The first step to that is a robust dialogue about how state bond laws can be improved. The second step is determining whether in a particular state wholesale revision is realistic, or more circumspect objectives such as consolidation or revision of a particular aspect of bond laws are more achievable. It is time to start that conversation.

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[335] *See, e.g.,* Cal. Debt and Inv. Advisory Comm'n, 2020 Debt Issuance and Public Investment Webinars, Seminars and Conferences, https://www.treasurer.ca.gov/cdiac/seminars/2020/index.asp [https://perma.cc/9LLT-6SGN] (listing its 2020 training events); Or. State Treasury, Oregon Bond Education Center, https://www.oregon.gov/treasury/public-financial-services/pages/oregon-bond-education-center.aspx [https://perma.cc/V3J9-DB7W] (providing educational materials about bond issuance). *See also generally* CAL. DEBT & INV. ADVISORY COMM'N, *supra* note 22.

[336] Such an organization was suggested in Ang & Green, *supra* note 19. *See supra* note 257 for a very brief description of the organization they proposed.