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Introduction: Overview of Municipal Finance

Over the past several decades, municipal debt financing in the United States has expanded dramatically. By the end of 2017, the nation's outstanding short- and long-term municipal debt totaled \$3 trillion, \$662 billion, and \$229.6 million.¹ That same year, municipalities issued \$410 billion of new bonds, the third-highest annual volume on record.² And, over the long term, municipal bond issuance seems likely to increase yet again.

This growth in municipal bond use stems from a number of causes. The state and local government sector of the U.S. economy has expanded significantly since World War II. Subnational governmental entities have been called upon to provide an increasing number of services to their residents, whose numbers (in many instances) have burgeoned. At the same time, however, beginning in the mid-1970s, state and local tax revenues, and intergovernmental aid to localities, have diminished. Local governments have thus been under increased pressure to borrow to meet their capital needs. Moreover, in addition to financing traditional capital infrastructure projects—such as roads, bridges, libraries, and fire stations—state and local governments have also had to borrow



funds to finance such nontraditional endeavors as low- and moderate-income housing projects, pollution control plants and equipment, student loans, improving the resilience of infrastructure to symptoms of climate change, and economic development programs. These financial demands on subnational entities have not diminished.

This book is intended as an introduction, for nonspecialist attorneys, to the often intricate process of financing local capital projects through the sale of municipal bonds. It considers the major institutional and individual “players” in the bond issuance process, as well as those sometimes complex facets of the law that establish the “ground rules” for—and some limitations on—municipal debt financing.

The book is divided into eight chapters, each focused on a discrete aspect of state and local borrowing. Chapter 2 provides an introductory overview of the most commonly utilized types of municipal borrowing instruments. It describes the distinctive features of traditional types of bonds, such as general obligation bonds, revenue bonds, tax increment bonds, zero coupon bonds, and the like. Chapter 2 also treats certain more “creative” approaches to municipal financing, including tender option bonds, letters of credit, variable rate securities, and other relatively recent, innovative local borrowing techniques.

Chapter 3 describes the process by which municipal bond issues are developed, structured, and sold. It focuses on the respective roles and duties of the key “actors” in the bond process, from local elected officials and city attorneys to outside financial advisors, underwriters, bond counsel, underwriters’ attorneys, and others. The chapter also contains practical suggestions for local officials and other municipal employees as to how their tasks in the bond process may be most prudently, and fruitfully, approached.

Chapter 4 builds on the foundation of Chapter 3 by spotlighting the critical role in the municipal bond industry of bond rating agencies, institutions that are charged with assessing—for the benefit of potential bond purchasers and others—the ability of bond issuers to avoid default and meet their legal obligations to repay bond principal and interest in a timely way. The chapter examines some of the strengths and shortcomings of rating agencies; and it describes how they function, the procedures they use in evaluating bond proposals, and their systems for categorizing

bond issues. It also provides some suggestions for municipal officials for deciding whether and when to use bond rating agency services, for relating to agency staffs and boards, and (if necessary) for appealing agency bond rating determinations.

The three chapters that follow consider discrete aspects of the law that bear directly on the issuance of municipal securities. Chapter 5 examines the limitations imposed on municipal borrowing by state law, as a means of limiting an overreliance on borrowed funds by local officials. It considers state constitutional and statutory limits on the amount of local governmental debt that may be outstanding, as well as requirements that mandate the approval of proposed bond issues by local voters. Chapter 5 also describes several techniques commonly employed by governmental entities so that they may lawfully borrow funds in ways that avoid the strictures of debt ceilings and referenda requirements.

Chapter 6 contains a discussion of regulations imposed on the sale of municipal securities by federal and state laws. After summarizing the background and purposes of federal securities laws, the chapter traces the recent evolution of those laws and describes their critical features. It also takes note of the key aspects of state blue sky laws and other state legislative attempts to eliminate fraud and deception in the marketing of municipal bonds.

Chapter 7 concerns the ways in which federal taxation of municipal debt influences the marketing of local bonds. It considers the extent and impact of the federal subsidy that stems from the exemption of interest on municipal securities from federal income taxation, reviews the constitutional basis for the federal tax exemptions, and analyzes in some detail the complicated provisions of the Internal Revenue Code and regulations of the Internal Revenue Service that create and condition that tax exemption. Chapter 7 also treats the limitations currently imposed on private activity bonds, and it explores the ways in which the federal tax laws have been structured to discourage the practice of arbitrage.

Finally, in Chapter 8, we examine those features of federal and state law that have an impact on municipal bond litigation. The chapter describes the types of lawsuits that are most frequently initiated regarding municipal financial instruments. It then proceeds to survey the procedural issues that arise in municipal bond litigation, with particular

emphasis on questions of jurisdiction, venue, and justiciability, and issues that involve pleadings, motions, class action requirements, discovery, trial, and remedies.

As noted, the co-authors of this book hope that it will provide a concise introductory overview of those aspects of municipal bond law and practice that nonspecialist lawyers most need to be familiar with. In representing their clients, however, attorneys may well wish to acquire a more detailed understanding of various facets of the topic. We can recommend several other books that may be helpful in that regard.

M. David Gelfand's multivolume treatise, *State and Local Government Debt Financing*,³ offers in-depth analyses of numerous aspects of municipal finance. It consists of chapters written by leading academics and expert practitioners, and edited by the late Professor Gelfand, that cover most aspects of municipal bond law in a detailed, accurate, and authoritative manner. Another excellent compilation of chapters by distinguished specialists, on a wide range of municipal bond topics, may be found in Sylvan Feldstein and Frank Fabozzi's book, *The Handbook of Municipal Bonds*.⁴ This single-volume work contains 73 separate essays, 21 case studies of "innovative and other" security structures, and several other features. The book's essays are logically divided into seven "parts" that pertain, respectively, to the originators of bond deals, bond distribution and market-making, compliance issues, fixed income analysis of municipal products, institutional investors, credit analysis, and special security structures.

Robert Amdursky and Clayton Gillette's fine volume, *Municipal Debt Finance Law*,⁵ provides a more scholarly analysis of the law of municipal bonds. It is clearly written and comprehensive in its coverage. Finally, M. David Gelfand, Joel A. Mintz, and Peter W. Salsich's short work, *State and Local Taxation and Finance in a Nutshell*,⁶ presents a useful overview of law and policy in the municipal bond area. Although some aspects of that book overlap this work, this "nutshell" also covers some components of state and local government expenditure patterns, the historical development of municipal debt financing, and state and local government revenue sources, which are not treated herein.

■ NOTES ■

1. SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, 2018 U.S. MUNICIPAL REPORT (2018).
2. *Id.* at 2.
3. STATE AND LOCAL GOVERNMENT DEBT FINANCING (M. David Gelfand ed., Thomson West 1984, with Supps.).
4. SYLVAN G. FELDMAN & FRANK J. FABOZZI, THE HANDBOOK OF MUNICIPAL BONDS (1983).
5. ROBERT AMDURSKY & CLAYTON GILLETTE, MUNICIPAL DEBT FINANCE LAW (1992).
6. M. DAVID GELFAND ET AL., STATE AND LOCAL TAXATION AND FINANCE IN A NUTSHELL (3d ed. 2007).