

If I only had a Brain for Bonding

Municipal Clerks' Association of New Jersey, Inc.

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Municipal Finance

The Three Pillars of *Municipal Finance Law*:

- State and Local Law
- Internal Revenue Code
- State and Federal Securities Law

What is a Bond Counsel?

Bond Counsel's role in a transaction predates both the Internal Revenue Code and Federal Securities Law.

Historically, our role was created following a number of fraudulent or ill-advised transactions that resulted in the Issuer's failure to tender payment to the holders of its bonds.

As Nobel Prize winning economist Paul Krugman famously observed: **Debt is one person's liability, but another person's asset.** The role of Bond Counsel was created to preserve that asset.

The Unqualified Opinion

The initial role of bond counsel was to deliver an unqualified opinion.

“**Unqualified**” goes to the opinion itself and **does not** touch on the expertise of the person rendering the opinion.

The opinion **may not** contain typical exceptions seen in other types of corporate debt.

The opinion has certain customary assumptions which may be allowed.

Counsel must have a “**high degree of confidence**” that under the law in effect at the time of the transaction, the highest court in the jurisdiction, properly briefed and acting reasonably, would reach the legal conclusions contained in the opinion.

The Opinion is **not a guaranty** of a particular outcome or result; it is a professional judgment.

And Our Opinion is ...

Based on the foregoing, we are of the opinion that, under existing law:

1. The Bonds have been duly authorized and executed by the Issuer, and are valid and binding general obligations of the Issuer.
2. All taxable property in the territory of the Issuer is subject to ad valorem taxation without limitation regarding rate or amount to pay the Bonds. The Issuer is required by law to include in its annual tax levy the principal and interest coming due on the Bonds to the extent that necessary funds are not provided from other sources.
3. Interest on the Bonds is excludable from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed on certain corporations. The opinion set forth in the preceding sentence is subject to the condition that the Issuer comply with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Bonds in order that the interest thereon be, and continue to be, excludable from gross income for federal income tax purposes. The Issuer has covenanted to comply with all such requirements. Failure to comply with certain of such requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds.

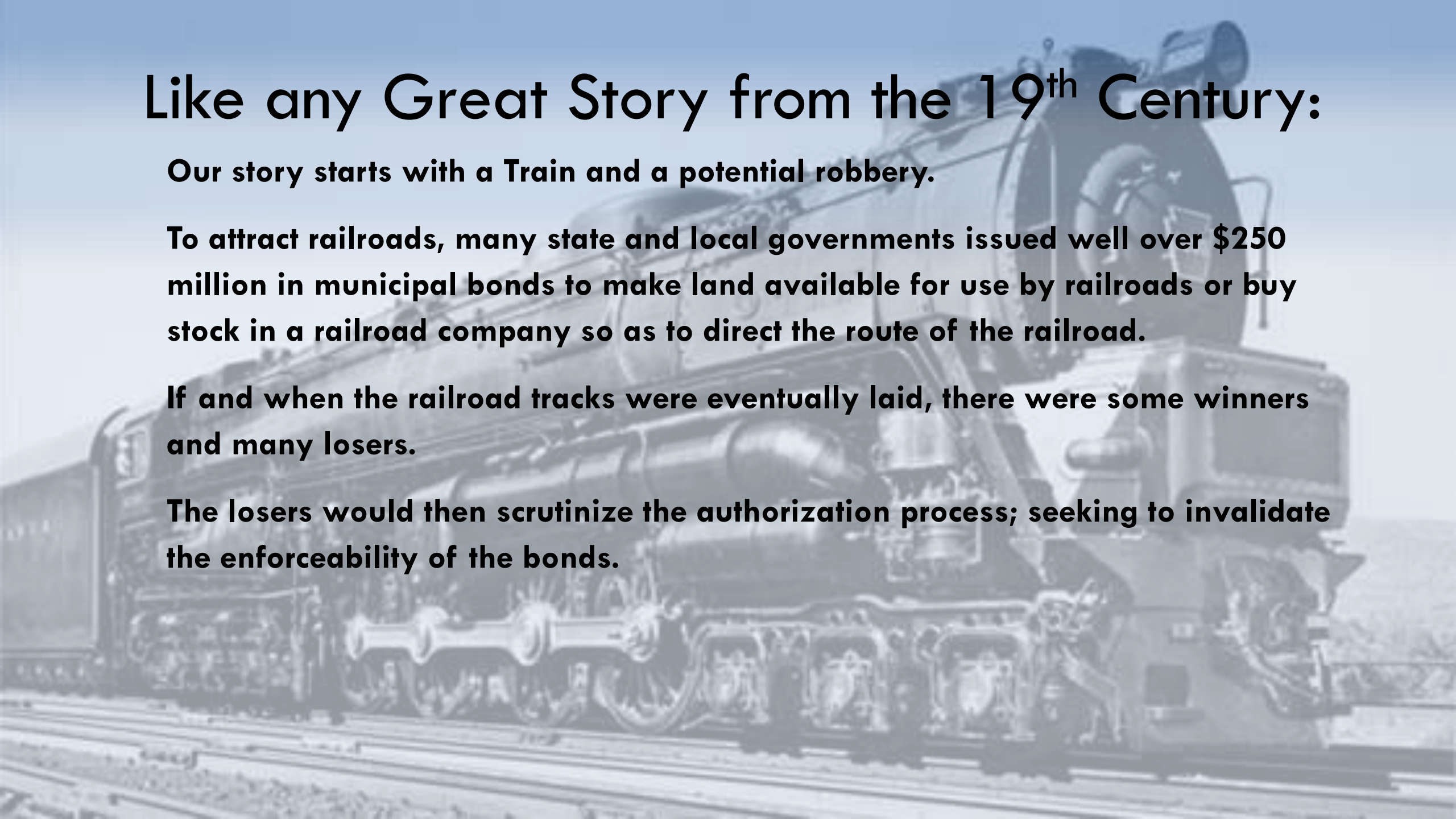
Like any Great Story from the 19th Century:

Our story starts with a Train and a potential robbery.

To attract railroads, many state and local governments issued well over \$250 million in municipal bonds to make land available for use by railroads or buy stock in a railroad company so as to direct the route of the railroad.

If and when the railroad tracks were eventually laid, there were some winners and many losers.

The losers would then scrutinize the authorization process; seeking to invalidate the enforceability of the bonds.



Ties go to the home team

Many investors who bought these bonds sued to enforce their right to payment. State and local governments tried to defend their actions in state courts, where locally elected or appointed judges were thought to favor the home team. The investment banks and institutional investors used diversity of citizenship to remove cases to federal courts.

A 1971 academic study by Charles Fairman notes that over 200 cases involving “railroad aid” bonds were heard by the U.S. Supreme Court between 1864 and 1888. Most were decided in favor of the investors.

These cases made investments in municipal bonds appear speculative or risky.

Lipstick for your porcine?



To assist in selling municipal bonds, Wall Street firms hired procedural lawyers to examine the record of proceedings related to the debt authorizations. These counsel were expected to deliver an unqualified opinion that the bonds being issued were validly authorized and enforceable in accordance with their terms. This was a **marketing tool** used to help sell the bonds.

The initial process worked well for communities that could garner the interest of Wall Street, but eventually the issuing entities themselves began hiring Bond Counsel directly to preserve a community's access to the municipal marketplace.

Counsel to the Transaction

Since bond counsel were independent procedural experts rather than advocates, for decades they were known as “Counsel to the Transaction”.

In 1983, the American Bar Association promulgated the Modern Rules of Professional Conduct. These rules established or clarified standards and obligations such as confidentiality, privilege, and duty to communicate. These were duties that an attorney owed to a client. That is a *client*; not to a *transaction*. Today, most bond counsel are hired directly by the Issuer.

The Municipal Marketplace

The MSRB suggests that at the start of 2020, there were:

“Approximately 50,000 issuers of municipal securities, including states, their political subdivisions (such as cities, towns, counties, and school districts), their agencies and instrumentalities (such as housing, health care, airport, port, and economic development authorities and agencies), as well as a variety of private entities that access the market through “conduit” financings (such as hospitals, senior living and continuing care retirement communities, and museums).”

Further their data supports that “there are approximately one million different municipal securities outstanding compared to approximately 30,000 corporate bonds outstanding.”

And while all these types of debt instruments are “public finance instruments”, offerings of municipal securities range in size from thousands of dollars to billions of dollars, and the payments of principal and interest on these securities come from a variety of sources, including general revenues, specific tax receipts, or revenues from a particular project, among others.

From January 2019 through March 2020, daily trade volume of municipal securities, whether measured in dollars or the number of trades, was significant—approximately \$12.4 billion and 34,467 per day, respectively

Authorization of Debt

Local units authorize debt via a bond ordinance.

An ordinance is adopted over two meetings and requires **public notice**, a **public hearing** prior to final adoption and **public notice** following final adoption.

Both form and substance matter and an investor is entitled to an unqualified opinion of counsel that bonds are validly authorized.

So what goes in a bond ordinance?

40A:2-12. A bond ordinance shall contain in substance the following:

- a. (1) an authorization for the issuance of obligations, stating in brief and general terms sufficient for reasonable identification the purpose or purposes for which the obligations are to be issued, a statement of the estimated maximum amount of bonds or notes to be issued, and the estimated cost of such purpose or purposes, but related improvements or properties may be treated as one improvement or property; or

(2) an authorization for the assumption by the local unit of the obligations of the authority sought to be dissolved pursuant to section 20 of P.L.[1983, c.313](#) (C.40A:5A-20) for which the local unit is not a guarantor;
- b. a determination of the period of usefulness of the purpose within the limitations of this chapter or, if issued for several purposes, a determination of the average period of usefulness, taking into consideration the respective amounts of obligations authorized for the said several purposes;
- c. a determination that (1) the supplemental debt statement has been filed in the office of the clerk, (2) such statement shows that the gross debt as defined in this chapter is increased by authorization of such obligations by \$ or is not increased, and (3) the obligations authorized by the bond ordinance will be within debt limitations prescribed by this chapter, or the issuance thereof is permitted by an exception to said limitations naming the particular section, paragraph or law providing such exception;
- d. a statement of the aggregate amount for items of expense permitted under 40A:2-20.

Anything Else?

Other common sections include:

- Delegation to sell notes to a finance officer.
- Tax related covenants.
- SEC related covenants.

And the Clerk's role in this whole process?

Create the record of proceedings, which typically includes:

- Certified copy of the bond ordinance as adopted;
- Minutes to the meetings where ordinance was introduced and adopted;
- Copies of newspaper publications following publication and final adoption;
- Proof of filing of the supplemental debt statement with DLGS prior to final adoption; and
- Certification of the Clerk that bond ordinance was adopted at least 20 days prior and no litigation has been filed challenging said adoption.
- Under the standards of the National Association of Bond Counsel, Bond Counsel can rely on certified records (as opposed to actual attendance) to deliver unqualified opinion.

Security and Protection

Local Bond Law provides other protections for bondholders, including:

- Borrowing capacity is tied to a local unit's property tax base.
- Statutory provisions prevent a late legal challenge to authorization and issuance of debt by local unit.
- School districts must approve new debt by referendum.
- Required down payments for each bond authorization.
- Statutory asset lives for typical projects.
- Mandatory amortization schedules to avoid payment deferrals.
- Regulatory monitoring by State Division of Local Government Services.

And the Number 1 Question to this Bond Counsel is ...

Can I borrow for this?

Current Expense vs Capital Item.

Operating expenses, salary and health benefits, etc.

Shorter term useful life; usually lower cost unit price.

Under NJ Law, growth of these types of expenses are restrained by the “CAP” laws.

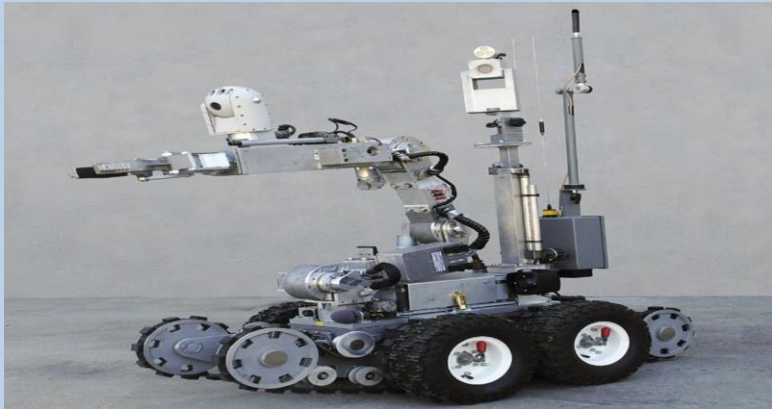
Restraints within NJ’s Local Budget Law create a tension to borrow for current expenses that “feel” like capital.

Current or Capital Expense?

A Bond Ordinance may be adopted to fund:

- A Police Officer?
- A Police Officer's gun?
- A Police Officer's bullets?
- A Police Car?
- A Police SUV?
- A Bullet Proof Vest?
- Body Cameras?

But what about?



Let's go again!

CAN YOU BORROW FOR:

- Building City Hall.
- Renovating City Hall.
- Painting a wall in City Hall.

Ok, we get it.
You can't bond
for painting ...



The Local Budget Law

There are certain items that are not truly capital but may still be financed.

The Local Budget Law allows for borrowings to finance anticipated receipt of taxes and fees as well as codification of ordinances, new tax maps, tax reevaluations, master plan updates, costs related to natural disasters, and payments for extraordinary court ordered judgments.

Depending on the type of expenditure, cost may be spread over three to five years.

That's All Folks!



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