



# **Affordable Housing Bond**

*Stakeholder Advisory Group*

## ***Legal Limits on the Use of General Obligation Bond Proceeds***

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# City General Obligation Bonds are Great!

General obligation bonds are the most desirable kind of borrowing an Oregon city can do.

- General obligation bonds are very secure, and have the lowest available interest rates.
- Because general obligation bonds are very secure, purchasers of those bonds do not “tie the city’s hands” very much.
- *The city is permitted to levy an additional property tax that is sufficient to pay the bonds.*

## But...

- ❖ The city can only issue general obligation bonds if the city's voters approve.
  - The election needs to be held in May or November.
- ❖ The average life of the bonds cannot exceed the average life of the assets that are financed with the bonds.
- ❖ The bond proceeds can only be spent for purposes described in the ballot that the voters approve.
- ❖ The bond proceeds can only be spent for "capital costs."

# Bully Laws and Wimpy Laws

There are three types of Oregon laws that might affect an Oregon general obligation bond issue:

- Provisions of the Oregon Constitution;
- Provisions of the City Charter; and,
- State statutes.

Provisions of the Oregon Constitution are big bully laws; they triumph over the other Oregon laws, and they **cannot be changed without a state-wide vote.**

# Two Big Bully Laws Apply to GO Bonds

- ❖ One was written in the 1850's and the other came from a 1990 citizen initiative.
  - Neither is very clear
- ❖ “Separation of powers” means the legislature cannot tell the Oregon courts what the constitution means.
- ❖ We can't be sure what a provision of the Oregon Constitution really means unless the Oregon Supreme Court tells us.
- ❖ The Oregon Supreme Court hasn't said much about the big bully laws that apply to GO bonds.

# The First Big Bully Law

Article XI, Section 9 was part of the constitution that voters approved in 1857.

- ❖ It says: “No county, city, town or other municipal corporation, by vote of its citizens, or otherwise, shall become a stockholder in any joint company, corporation or association, whatever, or raise money for, or loan its credit to, or in aid of, any such company, corporation or association.”
- ❖ It clearly prohibits stock ownership. What else does it do?
- ❖ In the late 1800’s the Oregon Supreme Court used Article XI, Section 9 to invalidate a City general obligation bond issue that would have financed railroad improvements.

# The Second Big Bully Law

Oregonians approved “Measure 5” in 1990 (Article XI, Section 11b of the Oregon Constitution).

- ❖ Measure 5 required that proceeds of general obligation bonds be spent only on “capital construction or improvements.”
  - ❖ Unfortunately, Measure 5 didn’t define those terms.
- ❖ In 1997, Measure 47 and its replacement, Measure 50, attempted to define those terms and clearly prohibited use of general obligation bond proceeds to finance operating costs, maintenance, supplies and most freestanding equipment.
- ❖ In 2010 the Oregon Constitution was amended to allow GO bonds to be used to finance “capital costs.”
  - ❖ “Capital costs” means costs of assets having a useful life of more than one year, and does not include operating costs, including costs of routine maintenance or supplies.

## To make matters worse, there are more laws!

Federal laws determine whether bonds can bear low, tax-exempt interest rates, or higher taxable rates.

- ❖ Those federal laws are very complex.
- ❖ Managing the use of bond proceeds so that interest on the bonds is tax-exempt reduces the property taxes that the city must levy to pay the bonds.
- ❖ Getting a significant change in the tax-exempt bond rules requires an Act of Congress.

# Housing is really important. Who cares what the law says?

- Governments do not need to repay their borrowings unless they do them “just right.”
  - “Just right” includes spending the proceeds on the right stuff.
  - Bond purchasers want to know whether interest on the bonds is tax-exempt.
  - Bond purchasers require the city to get an opinion of bond counsel that the city borrowed “just right,” and whether interest is tax-exempt.
- So the bond counsel cares and won’t give the required opinion unless almost everything is just right.
- If the bonds are sold in the public securities market and there is an undisclosed problem,
  - there could be **criminal penalties, personal liability and treble damages.**
- So the city folk participating in the bond sale care.
- As a result, bond financing decisions need to be made very carefully.

## What to do:

- Laws that are not easily changed severely limit the city's GO bonds.
  - Terrible penalties could be imposed if the city violates those laws.
- Until those laws change the city must:
  - Only fund projects for which the city will own and control the bond-financed property.
  - Not combine GO bonds with lots of other, conventional housing finance tools.
  - Maximize the opportunity for tax-exempt financing.
    - Tax-exempt financing adds more restrictions.
  - “Leverage” the limited bond proceeds to finance as many projects as is reasonable.



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