LEAGUE OF OREGON CITIES

GUIDEBOOK

GUIDE TO BORROWING AND BONDS FOR OREGON MUNICIPALITIES

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Prepared by the law firm of Hawkins Delafield & Wood, LLP and the investment bank and asset management firm of Piper Jaffray & Co.

FOREWORD

Oregon cities have the power to borrow money in a variety of ways for a variety of purposes. This guide attempts to explain those differences, and in the process help cities select and use a borrowing method that will help meet their goals.

This guide was written and prepared by the law firm of Hawkins, Delafield & Wood LLP and the investment bank and asset management firm of Piper Jaffray & Co. Several employees of these two firms generously donated their time and expertise to the League, and its member cities, in the production of this guide. The League sincerely thanks both firms, and extends its gratitude to Jennifer Cordova, Sarah Dickey, Gulgun Mersereau and Lauren MacMillan.

Jennifer Cordova is a tax attorney and partner with the law firm of Hawkins Delafield & Wood LLP. Her experience includes acting as tax counsel in connection with the issuance of many types of tax-exempt and tax-advantaged financings, advising clients with respect to post-issuance tax compliance issues, including private use, arbitrage and rebate, and assisting clients undergoing IRS audits of bond transactions. Jennifer has also represented clients in other proceedings before the Internal Revenue Service and is an active member of the National Association of Bond Lawyers. She received her BA from the Millersville University (Pennsylvania) and her law degree from the University of Pennsylvania. Jennifer can be reached at jcordova@hawkins.com or (503) 402-1326.

Sarah Dickey is a bond attorney at the law firm of Hawkins Delafield & Wood LLP. She serves as bond counsel for local governments throughout the State of Oregon, including many cities and urban renewal agencies. Sarah has experience with a wide variety of types of financings, including general obligation bonds, revenue bonds (including tax increment financings), refundings, and full faith and credit borrowings. Sarah is an active member of the Oregon Government Finance Officers Association and serves on its Education Committee. She received her BA from the University of Oregon and her law degree from the University of San Diego. Sarah can be reached at sdickey@hawkins.com or (503) 402-1332.

Gulgun Mersereau is an experienced bond attorney and a partner at the law firm Hawkins Delafield & Wood LLP. Her clients include a great many Oregon cities large and small, located throughout the state, from Prineville to Roseburg, Klamath Falls to Hillsboro, John Day to Eugene and many in between. Gulgun also has a specialty in tax increment financing and represents the urban renewal agencies of many of her city clients. In addition to her legal practice, Gulgun served on the governor-appointed Tax Supervising and Conservation Commission and on the board of directors of the Oregon Government Finance Officers Association and the education committee for that association. Many moons ago she received both her BA and a law degree from UCLA. Gulgun can be reached at gmersereau@hawkins.com or (503) 402-1325.

Lauren MacMillan joined Piper Jaffray in 2009 and currently specializes in working with Oregon cities, counties, school districts and community colleges to determine the short-term and long-term financing strategies which meet their needs. She began working in the public finance industry in 2006. Lauren is genuinely committed to Oregon's public finance community. She

has regularly presented at conferences on a variety of topics, including continuing disclosure, refundings, bond basics, local option, Oregon's property tax system and hot topics in bonds. She currently serves as the Associate Board Member for the Oregon Association of School Business Officials (OASBO), chairs the OASBO Associate Committee and is a member of the Oregon Government Finance Officers Association (OGFOA) Hospitality Committee and the OASBO Professional Development Committee. Prior to joining Piper, Lauren was a public finance associate with Stone & Youngberg in Phoenix, Arizona. She graduated from the University of Arizona with a bachelor's degree in finance and a bachelor's degree in French. She holds her Series 50, Series 52 and Series 63 securities licenses.

DISCLAIMER

Any guide provided by the League is intended to be used as a starting point in an individual city's understanding of municipal responsibilities and opportunities. Each city is unique, and any policy or plan should be individually tailored to meet a city's unique needs. This guide is not intended as a substitute for legal advice. Cities should consult with legal counsel before taking any action related to borrowing and/or bonding.

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Differences Between City Borrowing & Private Borrowing

Most readers will have borrowed money at some time in their lives. For example, individuals commonly borrow money to finance their education, a vehicle or a home. Private businesses often borrow money as well. Individuals and businesses most commonly borrow directly from banks or other financial institutions. Only large, credit-worthy businesses borrow by selling bonds or other obligations in the public securities market, and individuals never do that.

Oregon cities can, and often do, borrow from commercial banks. But even small cities may borrow by selling bonds in the public securities market.

Individuals and businesses usually secure their loans with every asset they have. A city, on the other hand, commonly limits the security for its borrowings to ensure that the city will be able to continue to provide essential public services if the city encounters financial difficulties.

Oregon cities can often issue "tax-exempt" bonds. If a bond is "tax-exempt," the federal government doesn't tax the interest income that investors receive, so investors are willing to accept a lower interest rate than is typically available to individuals and businesses.

Even the terminology is different; individuals and businesses say they will "get a loan" when they need to borrow money, but cities typically say they will "issue a bond."

What is a "Bond?"

Formally a "bond" is simply the written promise of a city to pay a specified principal amount on a specified date, together with interest. Historically, investors received certificates printed on fancy paper with embossed seals. These were called "bearer bonds." Owners of bearer bonds had to clip the interest coupons off and send them in to get paid the interest, and they had to send the bond itself in to get paid the principal. Federal law changed to prohibit bearer bonds, and now bond ownership and payment is handled electronically.

Informally, "bond" can refer to any borrowing of a city.

Bonds typically pay interest every six months, and principal every year. If a city issues $2 million in principal amount of bonds, a portion of the principal would be due each year, so that the annual debt service over the life of the bonds was about the same. The principal and interest payments on a ten-year, $2 million bond might look like this:

Payment Date	Principal	Interest Rate	Interest Payment	Debt Service	Annual Debt Service
12/01/17			$ 40,000.00	$ 40,000.00	
06/01/18	$ 165,000.00	4.0%	40,000.00	205,000.00	$ 245,000.00
12/01/18			36,700.00	36,700.00	
06/01/19	175,000.00	4.0%	36,700.00	211,700.00	248,400.00
12/01/19			33,200.00	33,200.00	
06/01/20	180,000.00	4.0%	33,200.00	213,200.00	246,400.00
12/01/20			29,600.00	29,600.00	
06/01/21	185,000.00	4.0%	29,600.00	214,600.00	244,200.00
12/01/21			25,900.00	25,900.00	
06/01/22	195,000.00	4.0%	25,900.00	220,900.00	246,800.00
12/01/22			22,000.00	22,000.00	
06/01/23	205,000.00	4.0%	22,000.00	227,000.00	249,000.00
12/01/23			17,900.00	17,900.00	
06/01/24	210,000.00	4.0%	17,900.00	227,900.00	245,800.00
12/01/24			13,700.00	13,700.00	
06/01/25	220,000.00	4.0%	13,700.00	233,700.00	247,400.00
12/01/25			9,300.00	9,300.00	
06/01/26	230,000.00	4.0%	9,300.00	239,300.00	248,600.00
12/01/26			4,700.00	4,700.00	
06/01/27	235,000.00	4.0%	4,700.00	239,700.00	244,400.00
	$ 2,000,000.00		$ 466,000.00	$ 2,466,000.00	$ 2,466,000.00

This example shows roughly equal annual debt service payments, but cities have many options in how they structure the repayment schedule. The structure should match the revenues the city intends to use to pay the bonds.

Why Might a City Need a Bond?

A city might need a bond for the same reasons that an individual or business most often needs to borrow money: the city may need to pay for something, and does not have the cash available to pay for it.

Cities may also borrow for other reasons, including:

1. The city may be borrowing for a capital asset that will provide services to its citizens for many years, and the city may feel it is appropriate to spread the cost of acquiring the asset over the useful life of the asset, so that cost is also paid by future citizens who benefit from the asset, rather than just current residents.

2. If the city's borrowing costs are low enough, it may be less expensive to borrow and acquire an asset immediately, rather than waiting and having inflation drive up the cost of the asset.

What Types of Bonds Are There?

The three main categories of bonds that Oregon cities use are:

1. General obligation bonds. General obligation bonds are usually issued as long-term, fixed-rate bonds, but they can be issued as short-term bonds, or variable rate bonds.

2. Full faith and credit bonds. Full faith and credit bonds are used to finance many city projects that do not have their own revenue streams; they are almost always used to finance local improvement projects, and they are often used when a city borrows from a state agency.

3. Revenue bonds. Revenue bonds come in many types, including sewer, water or electric utility revenue bonds, urban renewal or "tax-increment" bonds and conduit revenue bonds for private projects.

I. General Obligation Bonds

A. What They Are

In Oregon, city general obligation bonds are bonds that are secured by the power of the city to levy an additional property tax, outside of constitutional limits, that is sufficient to pay the bonds. This tax is dedicated solely to pay the bonds, and cannot be used by the city for other purposes. The amount and rate of the tax are said to be "unlimited" because a city may levy whatever amount is necessary to collect enough taxes to pay the bonds.

Because the property tax system is considered to be very reliable and stable, and the taxes that can be levied to pay the bonds are not limited, general obligation bonds are regarded as very secure and are usually the least expensive way for a city to borrow money.

Although the property taxes a city imposes to pay general obligation bonds are not limited, a city's ability to issue general obligation bonds is substantially limited by the Oregon Constitution and statutes. General obligation bonds must be approved by the city's voters and can only finance "capital costs." In addition, the "lending of credit" provision of the Oregon Constitution prevents general obligation bonds from being used to finance certain kinds of projects with substantial involvement by private businesses.

B. Typical Uses

Because general obligation bonds come with the authority to levy an additional property tax that is sufficient to pay the bonds, they can be used by cities that cannot afford to repay bonds from existing revenue streams. Oregon cities often use general obligation bonds to finance city assets that do not directly generate revenues, such as libraries and city halls.

General obligation bonds may also be used to finance revenue-generating facilities. A city might ask its voters to approve general obligation bonds for a revenue-generating project because:
(a) the city believes that property taxpayers, rather than users of the facilities, should pay some or

all of the debt service on the bonds, or (b) the city might plan to pay the bonds from revenues, but want the lower borrowing cost that is available from general obligation bonds.

For example, if the city's voters approve general obligation bonds for a water treatment plant, the city may choose to pay all or part of the debt service from property taxes, or choose to pay all or part of the debt service from water revenues. Such a structure would help the city obtain the lowest cost of financing and keep user fees lower than simply borrowing as a revenue bond.

C. Legal Limits

The Oregon Constitution requires:

1. Voter Approval. The issuance of general obligation bonds must be approved by a majority of the city's voters who vote at that election ("simple majority" approval), at an election held in May or November,[1] or at another election at which a majority of registered voters cast ballots ("double majority" approval).[2] As a practical matter, a majority of registered voters infrequently cast ballots at city elections, so general obligation bond elections are usually held in May or November.

2. Capital Costs. General obligation bonds may only be issued to finance "capital costs."[3] Capital costs are defined as costs of land and of other assets having a useful life of more than one year, including costs associated with acquisition, construction, improvement, remodeling, furnishing, equipping, maintenance or repairing real or personal property that has a useful life of more than one year. The Oregon Constitution also specifically states that "capital costs" does not include costs of routine maintenance or supplies.[4]

3. Limit on Term of Bonds. The weighted average maturity of general obligation bonds may not exceed the weighted average life of the capital costs that are financed with those bonds.[5] This means that cities cannot issue long-term bonds to finance short-lived assets (i.e. cannot use all of the proceeds of bonds that mature over 30 years to finance computers that have a useful life of five years). However, because the limit is based on averages, it rarely affects bond issues that finance a variety of projects, including long-life assets such as land or buildings.

Oregon election laws require that the ballot measure approving the bonds state, in clear and simple language, the amount of the bonds that will be authorized, the purposes for which the bond proceeds will be spent, and that property taxes may increase. Oregon election laws do not require the ballot to contain an estimate of the taxes or tax rates that will be imposed to pay the bonds, but estimates are commonly included in the ballot.

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[1] Oregon Constitution, Article XI, Section 11k.

[2] Oregon Constitution, Article XI, Section 11(8).

[3] The ability to spend general obligation bond proceeds on capital costs was approved by Oregon voters in May of 2010. It effectively replaces a more complicated provision in Article XI, Section 11b of the Oregon Constitution that voters approved in 1990, and that required proceeds of general obligation bonds only be spent on "capital construction and improvements."

[4] Oregon Constitution, Article XI, Section 11L(1) and (5).

[5] Oregon Constitution, Article XI, Section 11L(4).

ORS 287A.050 limits the total amount of general obligation bonds that a city has outstanding to three percent of the city's real market value. However, the limit does not apply to general obligation bonds that finance local improvement district improvements, water supply, treatment or distribution; sanitary or storm sewage collection or treatment; hospitals or infirmaries; gas, power or lighting; or off-street motor vehicle parking facilities. The limitation is quite generous and most cities do not issue enough bonds to be close to this limit.

City charters may place additional limits on city bond issues, although it is rare for a city charter to impose limits on general obligation bonds that exceed the limits in the Oregon Constitution and statutes that apply to general obligation bonds.

Article XI, Section 9 of the Oregon Constitution says "No… city…, by vote of its citizens, or otherwise, shall… raise money for, or loan its credit to, or in aid of, any [joint] company, corporation or association." This poorly understood provision of the Oregon Constitution prevents cities from using general obligation bonds to finance certain kinds of projects that involve corporations or other artificial entities such as most private businesses.

II. Full Faith & Credit Bonds

A. What They Are

In Oregon, full faith and credit bonds are secured by a pledge of the city's full faith and credit. Pledging the full faith and credit is specifically authorized by ORS 287A.315. Such a pledge commits the city to pay the bonds from all lawfully available funds of the city, and any taxes that are within the authority of the city to levy.

The Oregon Constitution imposes strict limits on the ability of cities to impose property taxes. Almost all cities have a "permanent rate" which is a rate of property taxes that the city may impose each year within the limits of Article XI, Sections 11 and 11b of the Oregon Constitution, without additional voter approval. Revenues from permanent rate levies must be used to pay full faith and credit bonds if other sources are not available. However, unlike general obligation bonds, full faith and credit bonds are not secured by the power to levy a property tax outside the limits of Article XI, Sections 11 and 11b of the Oregon Constitution.

Cities also may have local option levies. These levies are limited to five or ten years and are compressed first if the city's taxes are compressed (reduced) by Article XI, Section 11b of the Constitution. That provision limits taxes (other than general obligation bond taxes) for non-school purposes to $10/$1,000 of real market value. Because of their short term and compression risk, local option levies may not provide substantial security for full faith and credit bonds.

Cities may also impose gas taxes, income taxes, sales taxes and other taxes that may generate revenues to secure full faith and credit bonds. The full faith and credit pledge allows a city to use a basket of revenues to secure or repay the debt, rather than one revenue stream as with revenue bonds.

Because full faith and credit bonds are secured by the existing taxes and other legally available money of the city, full faith and credit bonds typically bear favorable interest rates, but higher interest rates than general obligation bonds.

The "lending of credit" provision of the Oregon Constitution[6] applies to full faith and credit bonds as well as general obligation bonds, and prevents use of full faith and credit bonds for certain kinds of projects with substantial involvement by private businesses.

B. Typical Uses

Full faith and credit bonds are used by Oregon cities for a wide variety of purposes. They can be used for assets that do not directly generate revenues, like city halls and libraries, and paid from general fund revenues of the city. Full faith and credit bonds can also be used to finance revenue generating assets, and either paid from general fund revenues of the city, revenues generated by the assets that are financed, or by a combination of the two. Pledging the city's full faith and credit to a revenue generating project can help lower the financing cost and make the project affordable.

C. Legal Limits

No single statute places an overall limit on city full faith and credit bonds. However, city charters may impose limits on full faith and credit bonds. The most common charter limits on full faith and credit bonds require that city voters approve those bonds.

ORS 287A.150 permits a city to issue revenue bonds for any lawful purpose, and ORS 287A.315 allows a city to pledge its full faith and credit to secure those bonds. To use ORS 287A.150 a city must either authorize the bonds by non-emergency ordinance and wait at least 30 days, or publish a notice describing the bonds and wait 60 days. While the city is waiting, citizens may file a petition to refer the question of issuing the bonds to an election. The term of bonds issued under ORS 287A.150 is not limited by Oregon law.

ORS 271.390 allows a city to issue bonds in the form of financing agreements, but only to finance costs of real or personal property that is needed by the city. ORS 287A.315 allows a city to pledge its full faith and credit to secure those financing agreements. The weighted average life of the financing agreement cannot exceed the weighted average life of the real and personal property that is financed. Financings under ORS 271.390 can be authorized by resolution.

A financing agreement is a single borrowing, and may be for a large amount. Investors in the bond market are accustomed to buying bonds in increments of $5,000. ORS 271.390 allows cities to convert financing agreements into $5,000 pieces that can easily be sold in the bond market. Those pieces have a variety of names, but are often called "certificates of participation" or "full faith and credit obligations."

[6] Article XI, Section 9 of the Oregon Constitution.

A city's charter may impose special debt limits on a city. The meaning of the debt limit in a city charter depends on exactly what the charter says. However, the most common type of charter debt limit would require voter approval of full faith and credit bonds.

Article XI, Section 9 of the Oregon Constitution says "No… city…, by vote of its citizens, or otherwise, shall… raise money for, or loan its credit to, or in aid of, any [joint] company, corporation or association." This poorly understood provision of the Oregon Constitution prevents cities from using full faith and credit bonds to finance certain kinds of projects that involve corporations and other artificial entities, including most private businesses.

The level of general fund and other revenues will also limit the amount of bonds the city can secure with the full faith and credit pledge.

D. Subject to Appropriation Borrowings

It may be possible for a city to borrow money, but not promise to pay it back. The city decides every year through the budget process if they will appropriate money to pay debt service. These borrowings are called "subject to appropriation" borrowings and are used by entities with particular kinds of debt limits. They were used frequently by the State of Oregon and Oregon counties, but Oregon laws have changed and these entities no longer use them. Oregon cities rarely use subject to appropriation borrowings because they are more expensive than other alternatives.

III. Revenue Bonds

A. What They Are

When people use the term "revenue bond" they usually mean a bond that is payable solely from a specified type of revenue. Because general obligation bonds and full faith and credit bonds are payable from all legally available funds of the issuer, general obligation bonds and full faith and credit bonds are not this kind of "revenue bond."[7]

The types of revenues that can be used to secure revenue bonds vary substantially. As a result, some revenue bonds are very secure and credit-worthy (sometimes even better than an issuer's full faith and credit bonds), and some are so poorly secured they cannot be sold on reasonable terms.

A variety of Oregon statutes authorize cities to issue revenue bonds. Revenue bonds are most commonly issued under ORS 287A.150, which allows a city to issue revenue bonds for any public purpose, and under ORS 271.390, which allows a city to issue revenue bonds in the form of financing agreements and "revenue obligations," and only for costs of real or personal property that is needed by the city.

[7] ORS Chapter 287A defines "revenue bond" differently. For that chapter, "revenue bond" means any bond except a general obligation bond, and "revenue bond" therefore includes a full faith and credit bond. This [guide] will use "revenue bond" the way people usually use that term, to mean a bond that is not a general obligation bond or a full faith and credit bond.

Because revenue bonds are not secured by the general tax revenues or general fund of the city issuing the revenue bonds, the "lending of credit" provision of the Oregon Constitution should not apply and, when compared to general obligation bonds and full faith and credit bonds, private businesses may have more substantial involvement with projects that are financed with revenue bonds.

B. Typical Uses

Utility Revenue Bonds

Revenue bonds are often issued to finance assets that a city uses to provide services to users, for which the city charges fees. For example, many Oregon cities have issued revenue bonds to finance water systems or sewer systems. Those revenue bonds are usually payable solely from the revenues of the system that is financed with the bonds.

Because a city is not legally obligated to pay revenue bonds except from the specific revenues the city commits to pay the bonds, purchasers of revenue bonds usually require the city to make many promises (called "covenants") about how the city will operate the utility system that produces the committed revenues and how the city will impose rates and charges for services from that system. This means revenue bond documents are more complicated than the documents for general obligation bonds and full faith and credit bonds. Since the covenants in revenue bond documents affect the decisions a city makes about operating its utility system, it is very important that a city issuing revenue bonds understand the covenants it agrees to uphold, and to seek alternatives if the covenants will impede the city's ability to operate the system. For instance, investors and rating agencies often want to see pledged revenues exceed the debt service requirement by 10-25 percent (referred to as debt service coverage). This may cause rates to increase substantially and put a strain on rate payers. For general obligation bonds and full faith and credit bonds, no additional cushion is required and rates may be set lower to generate only the amount needed to pay debt service.

Revenue bonds can sell on favorable terms if they are issued for essential services for which the city faces little or no effective competition (such as revenue bonds that finance sewer, water and electric systems), because the city will be able to raise rates to the extent required to pay the bonds. Revenue bonds may not sell on favorable terms (or may not sell at all) if they are issued to finance non-essential services, or services which may be provided by others (such as golf courses, internet services or cable television), because customers may simply quit purchasing services from the city if the rates get too high.

Other Common Revenue Bonds

1. Revenue bonds can also be secured by special tax revenues. For example, a number of Oregon cities have issued revenue bonds that are secured solely by gas tax revenues or by transient lodging taxes.

2. Some Oregon cities have urban renewal agencies that issue revenue bonds secured solely by the tax increment revenues of an urban renewal area.

3. Some Oregon cities have housing departments or housing authorities that issue revenue bonds secured solely by housing revenues.

4. Cities may also combine multiple revenue streams to finance a project in order to enhance the security and lower borrowing costs.

C. Legal Limits

No single statute places an overall limit on city revenue bonds. However, city charters may impose limits on revenue bonds. The most common charter limits on revenue bonds require that voters approve those bonds. Some statutes authorize particular types of revenue bonds for particular purposes, and those statutes may impose limits on those revenue bonds.

ORS 287A.150 allows cities to issue revenue bonds for any public purpose. To use that statute a city must either authorize the bonds by non-emergency ordinance and wait at least 30 days, or publish a notice describing the bonds and wait 60 days. While the city is waiting, citizens may file a petition to refer the question of issuing the bonds to an election.

ORS 271.390 allows cities to issue revenue bonds in the form of financing agreements, but only to finance costs of real or personal property that is needed by the city and only if the estimated weighted average life of the financing does not exceed the estimated dollar weighted average life of the real or personal property that is financed. Financings under ORS 271.390 can be authorized by resolution.

Other statutes may authorize cities to issue revenue bonds for other purposes, and may impose limits on those bonds.

IV. Bonds for a Particular Purpose

The following kinds of bonds are issued by cities so frequently they deserve special mention.

A. Local Improvement District (LID) Bonds

When a city constructs public improvements that benefit nearby property, the city may be able to assess the cost of constructing those improvements against the nearby property that benefits from the improvements, rather than using an existing revenue source. For example, a city may be able to assess the cost of a new street against neighboring property, instead of paying for that street from gas tax revenues. Oregon law requires a city that does this to "form the LID" before construction of the public improvements begins.

A city "forms an LID" by determining what public improvements will be constructed, estimating their cost, and determining how that cost will be apportioned among benefitted property owners. The city then gives the benefitted property owners notice and holds a "remonstrance" hearing on the proposed LID. If a sufficiently large number of property owners remonstrate (object to the

LID) at the hearing, the city cannot continue with the LID or impose assessments for the costs of the public improvements.
The LID is said to be "formed" after the city holds the remonstrance hearing without receiving sufficient remonstrances to stop the LID. Once the LID is formed the city may construct the public improvements and charge property owners in the manner specified when the LID was formed. However, the city cannot charge property owners for the costs of the public improvements until the public improvements are completed.[8]

Because the city cannot charge property owners until the public improvements are complete, the city must either pay for the improvements using existing revenues, or must borrow to pay for costs of the improvements. Usually a city that borrows issues short-term notes that mature when the project is expected to be complete and the city is able to charge property owners for the costs of the improvements.

When the LID projects are complete, the city assesses the cost of the LID projects against the benefitted properties in the manner specified when the LID was formed. Oregon law gives property owners who are assessed for LID projects the right to pay those assessments in installments, with interest, over at least 10 years. The city may allow property owners to pay over a longer time, and may give property owners the option to pay over a shorter time period. If property owners elect to pay their assessments in installments, the city may issue LID bonds under ORS Chapter 223, and use the installment payments of assessments to pay debt service on the LID bonds. The LID bond proceeds are used to pay off any short-term financing the city obtained for the LID, and to reimburse the city for LID costs the city paid before the city could charge property owners for those costs.

LID bonds should be structured to be paid from the LID assessment installment payments the city expects to receive. Since the owners of assessed property have a statutory right to prepay their assessments at any time, it is usually prudent for the city to reserve the right to prepay its LID bonds at any time.

LID assessments are a first lien on the property that is assessed, subject only to state and federal tax liens. The lien of an LID assessment is superior to mortgages, trust deeds and other consensual encumbrances. However, the LID liens are not personal obligations of the property owners. A city can foreclose the property that is subject to the LID lien, but property owners can abandon that property and not be personally liable to pay the city the LID assessments.

Although LID assessments are a first lien on the assessed property, and have to be paid before mortgages and other owner borrowings if the property is foreclosed, the LID assessments are hard for investors to understand. Cities therefore usually pledge their full faith and credit to secure LID bonds, to attract investors and lower the bond interest cost.

If a city issues full faith and credit LID bonds, it will have to use its general fund to pay the bonds if the assessments it collects from benefitted property owners are not enough to pay the bonds. The city's ability to collect the assessments is entirely dependent on the assessed property being worth more than the LID assessments. Cities must, therefore, be very careful

[8] Oregon Constitution, Article XI, Section 11b(2)(d).

when they form LIDs, because once an LID is formed and the city has commenced construction of the public improvements, there is little the city can do to improve its rights.
Oregon cities have been using LIDs and LID bonds to finance public improvements since the early 1900s. Many LIDs have worked well for property owners and cities, but some have not, and some cities have lost large amounts of money on LID projects. The only way to protect the city against these losses is to be very careful when the LID is being formed.

B. Urban Renewal or "Tax Increment" Bonds

Oregon law allows cities to create urban renewal areas that are operated by the city's urban renewal agency. Urban renewal areas can collect "tax increment" revenue, which is described below.

A city can form an urban renewal area by adopting an urban renewal plan. The goal of the plan must be to eliminate "blight" in the urban renewal area. Tax increment revenue may be spent only to pay indebtedness that is incurred to finance urban renewal projects. Urban renewal projects must be located in the urban renewal area and described in the area's urban renewal plan. Tax increment revenues generally cannot be spent on operating costs.

To create an urban renewal area a city must:

1. Prepare an urban renewal plan that describes the urban renewal area and the projects that will be funded with tax increment revenues from the urban renewal area, and establish a "maximum indebtedness" limit for the area (the maximum indebtedness limit is actually a limit on total expenditures of tax increment revenues);

2. Prepare an urban renewal report that estimates the cost of each urban renewal project that is described in the plan, the date by which all of the indebtedness will be paid and the date by which tax increment collections will cease;

3. Give very extensive notice of the plan and report, and hold a public hearing; and,

4. Approve the plan by non-emergency ordinance, which can be referred to the voters.[9]

Adopting an urban renewal area requires a substantial amount of time and effort. However, if the plan authorizes collection of tax increment revenues, once the plan is adopted the urban renewal agency begins to receive a share of most property taxes that are imposed inside the area. The assessed value of the taxable property in the urban renewal area at the time an urban renewal plan is adopted is called the "frozen base." Any increase in the assessed value of that property after the plan is adopted is treated as "excess value" or "incremental value." Tax revenues equal to most of the taxes levied by overlapping jurisdictions (city, county, school district) against the excess value are sent to the urban renewal agency. These tax revenues are called the "tax increment" or "division of tax."

[9] See ORS 457.085 and 457.095.

Tax increment revenues increase when assessed values inside the area increase, and they also increase if the tax rates of overlapping jurisdictions increase. Tax increment revenues of an urban renewal area may increase slowly after the area is formed because newly constructed facilities receive an assessed value that is less than the market value of the facilities, and because existing assessed values normally may only increase by three percent a year. Tax rates inside the area may not increase unless voters in overlapping jurisdictions approve new property taxes. Because tax rates and assessed values inside the urban renewal area may not increase predictably or significantly after an urban renewal area is created, the urban renewal agency may not be able to borrow for the area until the plan has been in effect for a while.

Urban renewal areas that were formed before 1997 may also have the power to impose an additional, special levy up to a maximum amount that was established in 1998. This is the only tax actually levied by an urban renewal district and is not divided amongst overlapping jurisdictions.

Tax increment revenue bonds are less secure than city general obligation or full faith and credit bonds, since revenues are mostly dependent on future assessed value increases in a limited area of the city. Lenders often will not purchase tax increment revenue bonds unless the urban renewal area is already collecting an annual amount of tax increment revenues that exceeds the maximum annual debt service that will be due on the urban renewal bonds.

Because tax increment revenue bonds are less secure than full faith and credit bonds, and are therefore more expensive than full faith and credit bonds, cities may issue full faith and credit bonds and loan the proceeds to their urban renewal agency to finance urban renewal projects. The urban renewal agency typically will agree to pay the debt service on the city's full faith and credit bonds, so the city will not have to use city revenues to pay the full faith and credit bonds as long as the urban renewal area generates enough tax increment revenue to pay the city's bonds.

Tax increment revenue bonds can be used to finance privately owned or operated urban renewal projects in an urban renewal area without violating the "lending of credit" provision of the Oregon Constitution. However, city full faith and credit bonds are subject to lending of credit restrictions, and those bonds may not be used to finance urban renewal projects that are owned or operated by corporations and similar entities, including most private businesses.

C. Conduit Revenue Bonds

A "conduit revenue bond" is a bond that is issued by a city, another local government or the state, but that is payable solely from the revenues and assets of a third party, typically a private business. Oregon cities can issue conduit revenue bonds through city housing authorities for private housing projects, for private medical facilities through city hospital facility authorities, and can issue conduit revenue bonds directly for private higher education facilities.

Conduit revenue bonds are usually issued to lower the borrowing cost of private entities. The United States Internal Revenue Code allows states and local governments to issue lower cost, "tax-exempt" bonds for certain kinds of private business facilities. That code refers to this type

of bond as a "private activity bond." Congress has from time to time considered repealing the provisions of the code that allow states and local governments to issue private activity bonds.

V. Refunding Bonds

"Refunding bonds" are bonds a city issues to refinance and pay off bonds the city previously issued. Oregon law broadly authorizes cities to issue refunding bonds for outstanding general obligation, full faith and credit, and revenue bonds by simply passing a resolution. Refundings are typically undertaken to reduce interest costs if current market rates are less than the rates on the outstanding bonds. However, cities may also issue refunding bonds to restructure debt service, adjust covenants or change the security.

Refunding bonds are typically secured in the same way as the bonds that are being refunded (general obligation bonds are refunded with general obligation bonds, and water revenue bonds are refunded with water revenue bonds). However, a city often can change the security for the refunding bonds. Changing the security may require the city to authorize the refunding bonds by ordinance, and to develop additional bond documents with new covenants. If a city wishes to refund full faith and credit bonds or revenue bonds with general obligation bonds, the city voters would need to approve the refunding general obligation bonds, just as they would for an issue to finance new capital costs.

In order to achieve debt service savings, the refunded bonds must have a call feature (a provision that allows the bonds to be prepaid prior to their original maturity). Most municipal bonds are callable beginning approximately 10 years after they are issued. The date on which the bonds can be prepaid is often referred to as the "call date."

Most city bonds are "tax-exempt" bonds that must comply with provisions of the United States Internal Revenue Code and the regulations and rulings of the United States Internal Revenue Service (the "IRS"). Tax-exempt bonds are described in greater detail in the "Federal Law and City Bonds" section of this manual.

The rules of the IRS classify tax-exempt refunding bonds into two types: current refundings and advance refundings. In a current refunding the refunded bonds are paid off within 90 days after the refunding bonds are issued. Current refunding bonds are lightly regulated by the IRS.

In an advance refunding, the refunded bonds are paid off more than 90 days after the refunding bonds are issued. As of January 1, 2018, advance refunding bonds are no longer permitted to be issued on a tax-exempt basis. Prior to 2018, advance refunding bonds were permitted, but heavily regulated by the IRS, and required greater care and preparation than current refunding bonds.

Cities may still opt to issue advance refunding bonds on a federally taxable basis, however, and in such a case, if the advance refunding bonds will be issued more than one year before the refunded bonds are paid off, the State Treasurer must approve an advance refunding plan before the bonds are sold.

If it would be beneficial to a city to not have to comply with covenants related to a bond issue but the bonds are not yet callable, the city could choose to formally "defease" the bonds. Defeasance is only permitted if the original bond documents provided for it and it is a way to deem a borrowing no longer outstanding, generally by setting aside enough funds to pay off the bonds when due in a formal escrow account.

Sources of Funds

I. The Public Municipal Bond Market

The United States has a large, healthy municipal bond market. Institutions and individuals can buy municipal bonds through their brokers. Oregon cities can sell their bonds in this market, but doing so requires substantial care and effort.

A city may sell its bonds in the public municipal bond market by competitive bid or negotiated sale.

In a competitive bid the city publishes a "notice of bond sale," describing the bonds and the terms under which the city will sell the bonds, and awards the bond sale to the bidder offering the lowest interest cost ["favorable terms" seemed to imply there were other options bidders could offer] to the city. The city usually engages a "municipal advisor" to assist with preparing the official statement and the notice of bond sale.

In a negotiated sale the city hires an investment banking firm to purchase the city's bonds and resell those bonds to investors. The investment banking firm assists with preparing the official statement. The city signs a "bond purchase agreement" with the investment banking firm when interest rates are set.

Any bond sale to the public municipal bond market requires the city to prepare an "official statement" that gives the potential bond purchasers the information they need to determine whether to buy the city's bonds. The official statement is the city's document describing the bonds and the city. The official statement is released into the public securities market, and material misstatements or omissions in the official statement constitute securities fraud under state and federal law, for which civil and criminal penalties may be levied against city staff and elected officials. It is therefore very important that the official statement be prepared carefully and accurately.

The city receives the bond proceeds at "closing." Closing usually occurs two to four weeks after bids are received (in a competitive sale) or the bond purchase agreement is signed (in a negotiated sale).

II. Private Placement

The city may sell its bonds to a commercial bank or other financial institution that does not intend to resell the city's bonds in the public municipal bond market. Banks tend to offer higher

interest rates and shorter amortization periods than a city could obtain by selling bonds in the public municipal bond market, but transaction costs are lower and the bonds often can be sold more quickly to a commercial bank than they can in the public municipal bond market.

No official statement is required for a sale to a commercial bank.

Because transaction costs are higher for sales in the public municipal bond market, smaller bond issues are more often sold to commercial banks, and larger bond issues are more often sold in the public municipal bond market. A financial services provider can help a city determine whether a private placement with a commercial bank is likely to be more beneficial than a sale in the public municipal bond market.

III. Government Loans

Oregon state agencies make loans to cities for a variety of purposes. For example:

1. Business Oregon, the state's economic development agency, operates several loan programs for infrastructure projects;

2. The Oregon Department of Environmental Quality operates the state revolving fund loan program for sewer and water system improvements that reduce pollution;

3. The Oregon Department of Energy makes loans to cities for certain kinds of energy projects; and,

4. The Oregon Department of Transportation make loans to cities for road improvements.

Federal agencies also make loans to Oregon cities. In Oregon, currently the most frequent federal lender is "Rural Development," a branch of the United States Department of Agriculture. Some government agencies that make loans to cities also make grants, and may combine grants and loans.

Government loans often have lower costs than other kinds of bonds, and may have more flexible terms and less restrictive bond covenants. However, government loans may also have special requirements that are unique to the government loan program.

The availability of government loans and the terms under which they may be available will change over time. Cities that need to borrow money should determine early whether a government loan might be beneficial, and should compare the estimated costs and benefits of government loans to the costs and benefits of other kinds of bonds.

Participants in a City Bond Issue

There are two key professional services a city will need on any type of bond: legal services and financial services. In Oregon, these are considered contracts extended in connection with the

issuance of obligations and are not subject to state bidding requirements under ORS 279A.25(12)(9).

I. Legal Services

An attorney or firm of attorneys that specializes in municipal borrowings is often referred to as bond counsel or special counsel (dependent on the security being issued). Investors usually require an opinion of a nationally recognized bond counsel listed in the "Red Book." Bond counsel provides two services in the bond financing:

1. Ensures all state and federal tax law requirements are met.

2. Provides an opinion to investors that the city's bond is valid and binding and, for tax-exempt bonds, that interest paid on the bonds is exempt from federal and state income taxes.

Specifically, bond counsel assists the city by:

1. Determining which financing options comply with state statutes, the Oregon Constitution and federal tax laws.

2. Drafting ordinances and resolutions for council consideration, approval and enactment/adoption.

3. Working with the city to draft the ballot title and explanatory statement for general obligation bonds.

4. For public offerings, reviewing and commenting on portions of the official statements, directing the bid opening for a competitive bid sale, or reviewing the bond purchase agreement for a negotiated sale.

5. For private placements, reviewing and commenting on the term sheet sent to banks and preparing the relevant legal documents.

6. Preparing the relevant legal documents and closing certificates, including, where applicable, a tax certificate and the Internal Revenue Service information filing for execution by the authorized city official.

7. Issuing an approving legal opinion.

8. Preparing and distributing transcripts of the proceedings to the financing team.

II. Financial Services

There are two areas in which issuers use financial services when issuing bonds:

1. Planning for and structuring the issue to best fulfill the issuer's goals.

2. Finding investors to purchase the bonds and obtaining proceeds.

The first service may be provided by either an underwriter or a municipal/financial advisor; the second is provided by either an underwriter (for a public sale) or a placement agent (for a private placement).

An underwriter must "deal fairly" with the city, but has no explicit fiduciary responsibility to the city, as a municipal advisor does. Municipal advisors are legally required to put the city's best interests before their own. Under Oregon law, there is no requirement to hire a municipal advisor. By contrast, an underwriter must be used to sell the bonds in the public market, either through a negotiated or competitive sale process. Financial professionals working at a broker dealer may act in the role of underwriter and municipal advisor to different issuers, as long as they are registered with the U.S. Securities and Exchange Commission (SEC) as both and have passed the necessary licensing exams. The Municipal Securities Rulemaking Board's (MSRB) Rule G-23 prohibits a firm from acting as underwriter on a bond issue once a financial advisory relationship has been established. However, the same firm could serve in different roles on different transactions, provided the appropriate documentation is in place. MSRB rules also dictate that the financial professional's role must be established at the inception of the relationship and an engagement agreement (for underwriting) or contract (for financial advising) must be executed.

Whether using an underwriter or municipal advisor, a city should expect its chosen municipal securities professional to assist with the following services:

1. Preparing analysis on bond issue structure.

2. Providing the city with a cost of issuance estimate for inclusion in the size of a bond issue.

3. Providing debt service and tax rate information for use in city information about the election for general obligation bonds.

4. Reviewing the authorizing resolution and other legal documents.

5. In some cases, preparing the preliminary and final official statement (sometimes this role is filled by underwriter's counsel, bond counsel or a separate disclosure counsel).

6. Recommending and assisting the city in evaluating the need for a rating.

7. Developing a ratings strategy.
8. Preparing a rating presentation for discussion with rating analysts.

9. Analyzing the benefit of credit enhancement and orchestrating hiring a provider, if desired.

10. Developing bid specifications for use in the official notice of sale if using a competitive bid.

11. Assisting in closing the transaction.

Other entities may also be involved, depending on the type of transaction.

III. Paying Agent

The registrar/paying agent is a corporate trust department of a commercial bank. The city designates the paying agent to:

1. Receive bond payments from the city that the agent uses to make interest payments to registered bond owners on the payment dates and to redeem principal on redemption dates.

2. Keep the official records relating to bond ownership.

The use of a paying agent is required for bonds issued in the public market but not for private placements.

IV. Rating Agencies

These companies provide an independent evaluation of the city's credit relative to bond issues and similar credits nationally. Oregon cities most frequently work with Moody's Investors Service or S&P Global Ratings, though Fitch Ratings also provides these services. Through the rating system, an investor anywhere can quickly judge the credit quality of an Oregon city even though that investor knows nothing specifically about the city or its community. Depending on the issue size, credit quality and market conditions, a city may consider applying for a rating from more than one agency. Applying for a rating is an economic decision, not a legal requirement.

V. Bond Insurers or Other Credit Enhancers

These firms provide irrevocable insurance policies that additionally secure the bonds. There are two kinds of credit enhancers:

1. Bond insurers, for a one-time premium, offer irrevocable insurance policies that will pay the city's debt service if the city should ever default on its debt payment obligations.

2. Bank letter of credit (LOC). For both an upfront fee and ongoing annual fees, commercial banks may offer to guarantee a city's bonds. Bank LOCs are more common on variable rate bonds than long-term bonds.

The use of some form of credit enhancement is an economic decision, not a legal requirement.

How Does a City Choose the Right Type of Security?

General obligation bonds: highest security and lowest cost, restricted to financing "capital costs," includes the ability to levy an "unlimited" property tax to pay the bonds, is subject to "lending of credit" restrictions, and must be approved by the city's voters. General obligation bonds are often used to finance governmental facilities like city halls and parks. This type of financing is not available for operating costs.

Full-faith-and-credit borrowings: relatively high security and relatively low cost, payable from all legally available revenues of the city, including the general fund and taxes collected under the city's permanent rate limit, is subject to "lending of credit" restrictions, and does not need to be approved by the city's voters unless the city's charter requires voter approval. Full-faith-and-credit borrowings are often used to finance the same kinds of projects that general obligation bonds finance.

Revenue bonds: security and cost vary widely depending on the revenues that are pledged to pay the bonds, but often have a lower security and a higher cost than full-faith-and-credit borrowings. Revenue bonds are usually not subject to "lending of credit" restrictions and usually do not require voter approval. They often finance systems that have their own revenue source like water and sewer systems and the revenue bond structure is used where a government, like an Urban Renewal Agency, only has one source of revenue.

I. Options

Cities have several options for structuring bonds and accessing funds:

A. Long-term, fixed rate bonds sold in the public securities market

Most cities prefer to borrow on a fixed rate basis so their interest cost is locked in over the term of the bonds, providing stability to budgeting for annual payments. The length of the bonds depends on many factors. Most Oregon long-term financings mature in 20 to 30 years, however some cities may borrow over a shorter or longer time frame. Depending on market conditions, credit factors, borrowing length and security, cities may be able to obtain the lowest cost of funds by selling bonds in the public market. Rather than placing the entire issue with one bank or investor, selling bonds in the public market allows multiple investors to purchase pieces of the bonds that best fit their investing goals, which can help bring down the borrowing cost. Borrowing in the public market is regulated by the SEC and comes with more upfront and ongoing disclosure obligations compared to borrowing directly from a bank.

B. Variable rate bonds sold in the public securities market

Variable rate debt is debt where the interest rate is reset on a very short-term basis, usually weekly. Because the rate is a very short-term rate, variable rate bonds usually carry very low interest rates compared to contemporaneously issued long-term fixed-rate bonds. However, because the rate floats with market conditions, variable rate bonds involve interest rate risk. Even though variable rate debt can have many advantages, the difficulty of correctly budgeting

and levying property taxes or collecting revenues to support a floating rate debt instrument makes variable rate debt challenging for some cities.

C. Bank loans and lines of credit

In recent years, banks have been fairly aggressive in lending to municipalities. A city could place a long-term fixed issue directly with a bank, similar to a public sale. The benefits of borrowing directly from a bank include lower costs of issuance, no credit rating, a shorter issuance timeline and reduced disclosure obligations. however, the tradeoff may be that the interest rate offered is not as competitive as what could be obtained in the public market. Cities can increase competition by preparing a term sheet ad soliciting bids from a variety of banks to ensure they get the best rate and terms. And in certain circumstances, a bank loan may be the best option for a city if the credit quality is weaker, the security is complicated (e.g. urban renewal) or there is a quick deadline to receive funds. In some cases, banks may be able to offer more flexible call provisions than the public market, but are often limited in the term of the bonds they will accept (often 15 to 20 year maximum).

Cities may also set up a multi-year line of credit from a bank whereby interest is only charged as funds are drawn down. This may be advantageous if the city does not know when funds will be needed. However, after the passage of the Dodd-Frank Wall Street reform and Consumer Protection Act, banks are subject to more stringent capital requirements and regulation, so fewer banks are willing to offer lines of credit at competitive rates. Cities are also susceptible to the risk of interest rates going up before long-term financing can be locked in.

D. Short and intermediate term notes

Notes usually mature in one year or less, although notes of longer maturities may be issued. Cities typically sell short-term notes to manage cash flow when the timing of expenditures does not line up with the receipt of funds. Oregon cities most often issue tax and revenue anticipation notes in anticipation of future tax receipts and revenues (TRANs). Cities may also sell notes in anticipation of grant funds (GANs) or in anticipation of selling long-term bonds (BANs).

II. The Process

When a city realizes it wants to borrow money, it usually will go through the following steps:

A. *Choosing the best type of borrowing*

This choice can be easy or difficult, depending on the project and the intended source of repayment.

For example, if the city wants to finance a new city hall, it likely will have to use general obligation bonds, full faith and credit bonds or tax increment bonds, as city halls do not produce revenue. General obligation bonds require voter approval, and tax increment bonds can only be issued for facilities inside an established urban renewal area and projects identified in the urban renewal plan. So if the city is not willing to ask the voters to approve general obligation bonds

and increase their property taxes, and the city does not have an urban renewal area, the city may only be able to use full faith and credit bonds to finance the city hall.
If, on the other hand, the city is financing an improvement to its water system, the city might use general obligation bonds, full faith and credit bonds, water revenue bonds or tax increment bonds. Each type of financing would have different financial impacts on citizens and ratepayers.

The city's bond counsel can help the city understand the legally available options and the future legal obligations associated with each option, and the city's financial services provider (municipal advisor or underwriter) can help the city understand the cost implications of the options.

B. *Determining whether the financing will bear tax-exempt interest*

Tax-exempt financing produces lower interest rates than taxable financing, so cities usually choose tax-exempt financing if it is available. However, tax-exempt financing reduces the city's flexibility and imposes more compliance burdens on the city. Tax-exempt financing is also not permitted for certain purposes, including advance refundings and certain private purpose projects.

C. *Putting the bond team together and deciding how to sell the bonds*

The city will need to hire bond counsel early in the process. Bond purchasers normally will not buy the city's bonds unless the city provides an unqualified opinion of nationally recognized bond counsel, and bond counsel can keep the city from going down blind alleys. Bond counsel represents the city.

If the borrowing is significant in size, early in the process the city should hire a financial services provider who can assist in the structuring of the borrowing. The bond counsel and financial services provider can help the city choose the best way to borrow for a project.

Once the best way to borrow has been determined, the bond counsel and financial services provider can work with the city to start the bond issuance process, and to select the method of sale (competitive bid or negotiated sale) for bonds sold in the public bond market, or privately placing debt with a bank.

D. *Council action*

The city council will need to authorize issuing the bonds at least once, by resolution or ordinance. The precise type of council authorization that is needed will depend on the type of bonds that are being issued.

If the city is issuing general obligation bonds, which must be approved by the city's voters, the city council likely will need to adopt a resolution calling the bond election, to take action to accept the vote, and to adopt a resolution authorizing the bond sale.

If the city is issuing full faith and credit bonds under the authority of ORS 271.390, the city council can authorize the financing with a single resolution.

If the financing method has not been determined, bond counsel can help the city craft the authorizing resolution to allow flexibility for staff to determine the sale method.

E. *Bank and other private placements*

Interest rate information about private placements and bank loans is not widely published or as transparent as the public market, however, cities can ensure they receive a competitive rate by soliciting bids from a variety of banks. The financial services provider can prepare a term sheet outlining the preliminary structure, security and terms desired by the city which can be disseminated to banks. For a bank placement, an underwriter can act as a placement agent and place the debt directly with a bank or other financial entity. A municipal advisor may assist in document review and preparation but may not act as an agent or negotiate on behalf of the city in the placement of a securities issue.

Many banks are comfortable using documents prepared by bond counsel, but it can save time and headaches if a draft of the purchase agreement or financing agreement with key terms is included with the distribution of the term sheet. Banks are asked to provide comments with their bid so a city can determine whether or not their requests are acceptable upfront.

After the bid deadline, the financing team can review all of the responses and select a bank. The winning bid may or may not provide the lowest interest rate if other factors such as call provisions are important or if the bank providing the lowest interest rate also imposes onerous covenants. Once a bank has been selected, the costs and debt service schedule can be finalized and incorporated into the final closing documents.

F. *Sales in the public municipal bond market*

There are many factors which influence whether a competitive bid or negotiated sale may be a better fit for a bond sale. The financial services provider can provide information regarding the methods of sale and assist the city in making a decision which is transaction specific and should consider financial, market, security and city conditions.

Competitive sales are used frequently by highly rated cities offering a straight-forward security of moderate size. In a competitive sale, the underwriter is not selected until the day bonds are sold so all of the terms and structuring decisions have already been made. Because of this, the underwriter needs to be comfortable investors will be interested in purchasing the bonds. The city is also locked into the coupon structure as bid and has a limited ability to adjust the sizing after bids are received.

In a negotiated sale, the underwriter is involved in the process upfront and has input in the credit and structuring decisions. The underwriter can also begin preliminary discussions with investors ahead of the bond sale and determine how receptive the market is to the bond issue which can be important for weaker credits, unknown issuers and more complex security structures. The city

also has the ability to communicate with the underwriter during the pricing to adjust the maturities and coupons so the structure best suits the city's needs. From an issuer perspective, the main steps for preparing an issue to be sold in the public market will be the same, regardless of the method of sale. If the city selects a negotiated sale, the process could include a request for proposals, upfront to select an underwriter, however, this is not legally required. A city could simply select an underwriter and move forward.

The major task involved with a public sale is the preparation of a disclosure document, often referred to as the Official Statement (OS). Prior to the bond sale it is referred to as the preliminary official statement (POS) and is the primary source of information for underwriters, investors, and rating agencies in evaluating the value and creditworthiness of the bonds and the city. The OS includes general sections concerning the city, its economy, fiscal condition, financial structure, revenue sources, revenue data, debt authority, and any outstanding litigation. The document will also include transaction specific information regarding the project to be financed, the security pledge and the terms of the bonds (including the maturity structure and redemption provisions).

The financial services provider or an attorney (underwriter's counsel, bond counsel or a separate disclosure counsel) will be in charge of drafting the OS with review and input from the other members of the financing team. Several drafts are typically prepared with time for participants to review and comment on each draft. When the POS is near final, the city will be instructed to circulate a copy to their council for review as well. While service providers may assist in the preparation of the OS, it is legally the city's document and the city's responsibility to ensure that the OS contains all material information needed to comply with federal and state requirements. See "Federal Law and City Bonds – Disclosure Requirements" for more information.

A credit rating is often obtained for bonds sold in the public market as investors look to rating reports as a key indicator of the credit quality of an issue. Bonds can be sold nonrated, however, the interest rates received are often much higher than rated debt. The rating agency assigns a letter grade along a standardized scale which allows investors to more easily compare bonds of different issuers and securities. The methodology used to assign ratings is available from each rating agency and varies by security type. Key factors may include:

Issuer financial condition	Length of debt and repayment structure
Current debt burden & future debt needs	Management
Pension burden	Local economy
Legal covenants	

The financial services provider will forward the necessary documentation to the rating agency and facilitate the review process with a rating analyst (usually a conference call or, in certain circumstances, an in-person meeting). The rating analyst will bring a recommendation to a committee and then a rating will be assigned. A credit report will be published and the city will have the opportunity to review it prior to publication. The credit rating is maintained as long as

the bonds are outstanding and the rating agency may contact the city periodically to conduct surveillance rating reviews.

A document will be prepared describing the terms under which the bonds will be purchased. For competitive sales, the terms are outlined in the notice of sale (NOS) and for negotiated sales, a purchase agreement is prepared. The NOS contains the date, time and place of sale, amount of issue, type of security, redemption provisions, bidding constraints, amount of any good faith deposit, basis of award, name of bond counsel, maturity schedule, method of delivery, time, place of delivery and form of issue price certificate (for tax-exempt debt). The NOS is usually included as part of the POS and is reviewed by the financing team prior to publication. The purchase agreement is the contract between the underwriter and the city detailing the final terms, prices and conditions upon which the underwriter purchases the bonds. The underwriter or underwriter's counsel will draft the purchase agreement ahead of the bond sale and the financing team will review. The document is finalized and executed on the sale date, after the bonds have been sold.

The interest rates, proceeds and debt service are locked in on the sale date. For a competitive sale, a deadline is set for bids to be received and underwriters submit bids through an electronic platform called Parity. The city, bond counsel and municipal advisor will review the bids received and verify that the winning bid conforms to the NOS requirements. The best bid is determined according to criteria in the NOS, but typically is the lowest true interest cost.

Once the bid is awarded, the municipal advisor will work with the underwriter to resize the issue within the NOS parameters to meet the city's desired structure and the numbers will be finalized. For a negotiated sale, the underwriter holds an order period on the morning of the sale date. The day prior to the sale, the underwriter, city and municipal advisor (if any) will review market conditions, comparable transactions and discuss the preliminary interest rates proposed by the underwriter. The underwriter offers the preliminary rates to investors during the order period and will propose adjustments to interest rates based upon the level of orders received. If the underwriter receives lots of orders for the bonds, they may be able to reduce interest rates. However, if the underwriter does not receive orders for the entire issue, interest rates may be increased in order for the underwriter to commit to buy the bonds.

Once the terms have been finalized, the underwriter purchases the entire issue and the city's costs are locked in. Any unsold bonds are the underwriter's responsibility and they assume the risk if interest rates increase before bonds are sold.

G. *"Closing"*

A bond issue "closes" when the initial bond purchaser pays the city for the bonds.

If the bond issue was sold in the public municipal bond market, the issue likely will close electronically through The Depository Trust Company, or "DTC." The initial purchaser likely will pay for the bonds by wiring funds to an account of the city. The initial purchaser will not receive any bonds; the bonds will be held by the city's paying agent, and DTC will simply credit the initial purchaser with the bonds in DTC's system.

DTC is headquartered on the East Coast, and closing must occur by the DTC closing deadline, which is mid-morning Oregon time. Failure to close by the DTC deadline creates administrative difficulties, increases costs, and potentially jeopardizes the bond sale, so cities and their bond teams go to considerable lengths to make sure that everything is in order and the bonds can close on time.

If the bonds are sold to a bank or otherwise privately placed, bonds can close at any mutually agreeable time.

H. *Assembly of the bond "transcript"*

Once the bonds are sold, the city and the other members of the bond team must provide the documents to bond counsel for the "bond transcript." The bond transcript contains all of the major documents that directly relate to the financing. Bond counsel will send copies of the transcript to all members of the bond team, usually on a compact disc. Because the bond transcript has all the major documents related to a particular bond issue, the bond transcript is an excellent source of information about the bond issue.

Federal Law and City Bonds

I. The IRS and Tax-Exempt Bonds

The internal revenue codes of the United States have long provided that interest on the obligations of state and local governments (such as cities) is not "includable in gross income." Because that interest is not included in investors' gross income, it is often not taxed, and bonds bearing that interest are called "tax-exempt bonds."

However, for a city bond to actually be tax-exempt, the city and the facilities financed with the bonds must comply with a large number of internal revenue code provisions and IRS regulations. This manual will refer to those code provisions and regulations as the "IRS Rules."

Currently, the IRS Rules have two main divisions: the "arbitrage rules" and the "private activity bond rules."

II. The Arbitrage Rules

In the municipal bond world, "arbitrage" refers to investing tax-exempt bond proceeds in securities that pay interest. "Positive arbitrage" occurs when a city can invest bond proceeds at an interest rate that is higher than the "bond yield."

The "bond yield" is a time-weighted average interest rate on the entire bond issue that is calculated according to IRS Rules. The bond yield is a rate that is slightly lower than the effective, average interest rate that the city pays on the bonds.

Temporary Periods

The IRS Rules actually prohibit the city from investing its bond proceeds at a rate that is higher than the bond yield, unless the investment is made during a "temporary period." Happily, there is a temporary period available for most situations in which a city holds bond proceeds.

The IRS Rules provide lots of different temporary periods, but the most well-known temporary period is the "three-year temporary period." A city may invest the proceeds of a tax-exempt bond that is not a refunding bond at any interest rate the city can get, as long as, when the bonds are issued, the city reasonably expects:

1. To enter into a contractual obligation within six months that will require the city to spend at least five percent of the proceeds.

2. To spend at least 85 percent of the spendable proceeds of the bonds within three years.

3. To "proceed with due diligence" to complete the project, and not delay spending money on the project to benefit from the positive arbitrage.

If the city cannot qualify for this three-year temporary period the city may have to invest the bond proceeds in tax-exempt bonds or in special securities issued by the federal government. Both of these options are highly inconvenient and earn the city less than it otherwise could.

If the city is issuing tax-exempt bonds for a project that will take more than three years to complete, the city may have to divide the bonds into several issues, so that the city meets the requirements for the three-year temporary period. The three-year temporary period is the reason people often say that a city "must spend its bond proceeds" within three years.

The Rebate Requirement

"Rebate" is a requirement of the IRS Rules that a city pay any positive arbitrage to the federal government no less often than every five years.

Cities that do not issue more than $5 million of tax-exempt bonds in a calendar year usually do not have to pay arbitrage rebate on those bonds.

Cities that issue more than $5 million of tax-exempt bonds in a calendar year are usually subject to arbitrage rebate, but may qualify for exemptions if the bond proceeds are spent relatively quickly.

If a city has outstanding bonds that are subject to arbitrage rebate, the city should monitor earnings and consider employing an outside consultant to calculate the rebate that may be due to the federal government. It is easy for cities to forget about the rebate requirement, since payments are only due every five years. However, arbitrage rebate payments can be quite large, and the IRS can impose interest and penalties if rebate is not paid when due.

I. The Private Activity Bond Rules

The IRS Rules define a "private activity bond" as a bond in which more than a small percentage of the proceeds are specially used in the trade or business of a taxpayer, or a bond in which more than a small percentage of the proceeds are loaned to a taxpayer.

If a bond is a private activity bond, interest on the bond cannot be tax-exempt unless the bond qualifies for one of the exceptions provided in the IRS Rules. Exceptions are available for a number of purposes, including facilities used by:
501(c)(3) organizations;

- Airports;
- Docks and wharves;
- Homes loans for veterans and first-time home buyers;
- rental housing for low income individuals and families;
- Mass commuting facilities;
- Certain kinds of water, sewer and solid waste facilities;
- Green building and sustainable design projects;
- Hazardous waste facilities;
- High-speed intercity rail facilities;
- Student loans;
- Small manufacturing facilities;
- Agricultural land and facilities for first-time farmers;
- Highway or surface freight transfer facilities;
- Public educational facilities; and
- Certain facilities for the local furnishing of electric energy or gas, heating and cooling, and environmental enhancements of hydro-electric generating facilities.

Each exception has complex limitations. In addition, many exceptions require an allocation of "private activity bond volume cap," or "volume cap." Volume cap is allocated to each state each year based on population. The Oregon Legislature allocates volume cap to some state programs, and authorizes the private activity bond volume cap committee to allocate what is left to local governments and state agencies based on their needs.

In addition, private activity bonds generally cannot be issued until the city holds a "TEFRA hearing." The city usually must give at least 14-day advance notice of the hearing. The notice must describe the facilities that will be financed, their location, and the amount of bonds that will be issued. Anyone may appear and testify in favor, or against, issuing the bonds.

II. Other Rules Related to Tax-Exemption

The IRS Rules have many other requirements that are not described in this manual. The city's bond counsel should help the city understand the requirements of the IRS Rules for each bond issue, and will prepare a "tax certificate" or other document for the city to sign, in which the city agrees to comply with those requirements. The tax certificate is included in the bond transcript.

III. Disclosure Requirements

The SEC is responsible for regulating the securities industry. Their mission is to protect investors and maintain fair, orderly and efficient markets. While municipal securities are exempt from certain registration requirements, the anti-fraud provisions of securities law apply to the primary disclosure documents (POS/OS) that cities prepare. To improve transparency and enhance investor protections, the SEC also requires issuers to provide ongoing disclosure to investors while debt is outstanding, known as continuing disclosure.

Requirement for an official statement. SEC Rule 10b-5 makes it unlawful for an issuer of securities to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. The SEC has stated, in the context of an enforcement action against a securities issuer, that "[i]nformation is material if there is a substantial likelihood that a reasonable investor would consider it important to an investment decision." Prior to finalizing the POS, a due diligence call will be held with bond counsel, the underwriter and/or municipal advisor and underwriter's counsel (if any). The party leading the call will run through a list of questions designed to form a reasonable basis for a belief in the truthfulness, accuracy and completeness of the key representations made in the disclosure documents. The due diligence process helps satisfy the underwriter's requirement to inquire on the key representations in the OS and assist issuers in preparing a correct and complete OS to comply with securities law.

Continuing disclosure. SEC Rule 15c2-12 requires underwriters to ensure issuers enter into a continuing disclosure agreement at the time bonds are. The agreement is included in the OS and establishes the information a city is required to make available to investors throughout the term of the bonds. Audited financial statements and certain operating data are required to be filed on an annual basis. A list of 14 specified events require a notice filing within 10 business days of their occurrence. Filings are currently required to be made on the MSRB's Electronic Municipal Market Access (EMMA) website. The SEC requires underwriters conduct a review of the city's filing history over the most recent five-year period prior to offering securities in the public market. Any missing filings must be remedied and late filings must be noted in the disclosure document. EMMA offers extensive information on continuing disclosure in general and using the website, including tutorials on submitting filings: https://emma.msrb.org/.

IV. Post-Issuance Compliance Policies

It is best practice for an issuer of bonds to have adopted policies to assist the issuer in complying with its continuing disclosure obligations and post-issuance tax requirements. The form of policies will differ based on each city's needs. Consult with your bond counsel for a form of policies.

1201 Court St. NE, Suite 200 | Salem, Oregon 97301
(503) 588-6550 | 1-800-452-0338 | www.orcities.org