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FINANCING VIRGINIA'S LOCAL GOVERNMENTS

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12-1 SCOPE

12-1.01 Scope

In recent years, state and local governments have experienced growing demands for capital that have been increasingly difficult to satisfy. The infrastructure of the Commonwealth and many of its communities was constructed years ago and now must be expanded, replaced, or upgraded. Federal and state contributions to capital projects are shrinking or have disappeared. Many Virginia counties, cities, and towns are no longer able to finance necessary capital projects out of current tax revenue as they did in the past and are finding the need to venture into the financial markets more often. This chapter will identify and discuss some of the frequently encountered laws and regulations affecting public finance in Virginia. The chapter is not designed to be a detailed discussion of the intricacies of the many types of financing alternatives and techniques available. Rather, it will survey the basic rules that govern the incurrence of debt by localities and certain special political subdivisions in Virginia.

12-2 POWER TO INCUR DEBT

12-2.01 General

Under the Virginia Constitution, the General Assembly may prescribe by general or special law the powers that may be exercised by localities. Va. Const. art. VII, § 2. Because Virginia follows the Dillon Rule, powers granted to localities must be “granted in express words; . . . necessarily or fairly implied in or incident to the powers expressly granted; . . . [or] essential to the declared objects and purposes of the [locality], not simply convenient, but indispensable.” *City of Winchester v. Redmond*, 93 Va. 711, 25 S.E. 1001 (1896); see also *City of Richmond v. Confrere Club of Richmond, Inc.*, 239 Va. 77, 387 S.E.2d 471 (1990); *Cnty. Bd. of Arlington Cnty. v. Brown*, 229 Va. 341, 329 S.E.2d 468 (1985); *Tabler v. Bd. of Sup’rs of Fairfax Cnty.*, 221 Va. 200, 269 S.E.2d 358 (1980); *Commonwealth v. Cnty. Bd. of Arlington Cnty.*, 217 Va. 558, 232 S.E.2d 30 (1977); *Commonwealth v. Brown*, CR20-745, Letter Opinion¹ (Fredericksburg Cir. Ct. Sept. 14, 2020). The powers that may be conferred by the General Assembly are, however, subject to limitations set forth in the Constitution. In the context of public finance, the Dillon Rule prevents a Virginia locality from borrowing money or issuing bonds unless the power to do so is conferred by, or clearly implied by, an express legislative enactment or constitutional provision or is essential to the declared objects and purposes of the locality. *Lynchburg & Rivermont St. Ry. Co. v. Dameron*, 95 Va. 545, 28 S.E. 951 (1898); *Richmond & W. Point Land, Navigation & Improvement Co. v. Town of W. Point*, 94 Va. 668, 27 S.E. 460 (1897).

¹ This [Letter Opinion](#), comprehensively discussing the Dillon Rule in the context of an emergency curfew order, is available on the LGA website.

Any indebtedness incurred by a Virginia locality that exceeds that locality's powers is void.² *Scofield Eng'g Co. v. City of Danville*, 35 F. Supp. 668 (W.D. Va. 1940), *aff'd*, 126 F.2d 942 (4th Cir. 1942). All persons dealing with a Virginia locality are treated as having knowledge of the limitations on the locality's powers to incur debt, and, if a debt exceeds such powers, there may be no recovery on the debt on the basis of unjust enrichment or implied contract. *American-LaFrance & Foamite Indus., Inc. v. Arlington Cnty.*, 164 Va. 1, 178 S.E. 783 (1935). Indeed, if the debt is enforced, the locality and its taxpayers will, in effect, be paying the prohibited debt, the very result sought to be avoided by the constitutional or statutory limitation or prohibition. On the other hand, when a locality is empowered to incur a debt for a given purpose but fails to follow the required procedure, there is no reason why the locality should be relieved of liability.³ 15 E. McQuillin, *Municipal Corporations* § 43.149 (1985). A court of equity may enjoin a locality from incurring unauthorized debt at the request of taxpayers of the locality.⁴ *Town of Galax v. Appalachian Elec. Power Co.*, 177 Va. 29, 12 S.E.2d 778 (1941); *Lynchburg & Rivermont St. Ry. v. Dameron*, 95 Va. 545, 28 S.E. 951 (1898).

12-2.02 Virginia Constitutional Limitations

12-2.02(a) General

While the specific power of Virginia localities to borrow money is granted by statute or charter, the Virginia Constitution places certain limits on this power. The limitations generally applicable to cities and towns are different from those generally applicable to counties. The most important difference is that cities and towns may incur debt without a referendum, but are subject to a debt limitation based on the assessed value of all real estate in the locality. The debt of counties generally must be approved by the voters in a referendum, but is not subject to any limitation in amount. Both limitations are subject to a number of exceptions.

Note that as a general principle, the Virginia Constitution is not a grant of legislative powers to the General Assembly, but is a restraining instrument only, and except as to matters ceded to the federal government or expressly limited by the Virginia Constitution, the legislative powers of the General Assembly are without limit. Implied constitutional limitations on the legislative power of the General Assembly are particularly disfavored. *FFW Enters. v. Fairfax Cnty.*, 280 Va. 583, 701 S.E.2d 795 (2010).

12-2.02(b) Cities and Towns

Article VII, section 10(a) of the Virginia Constitution, commonly called the Debt Clause, provides that:

No city or town shall issue any bonds or other interest-bearing obligations which, including existing indebtedness, shall at any time exceed ten per centum of the assessed valuation of the real estate in the city or town subject to taxation, as shown by the last preceding assessment for taxes. In determining the limitation for a city or town, there shall not be included the following classes of indebtedness:

² In *Chemical Bank v. Washington Public Power Supply Systems*, 99 Wash. 2d 772, 666 P.2d 329 (1983), the Dillon Rule was cited as one basis for invalidating agreements, which precipitated the largest municipal bond default in history.

³ In a sequel to the 1935 *American-LaFrance* case, the Supreme Court of Virginia applied equitable principles to unwind the inequity inherent in the county's having received use of the assets, despite the fact that the financing was ultra vires. See *American-LaFrance & Foamite Indus., Inc. v. Arlington Cnty.*, 169 Va. 1, 192 S.E. 758 (1937).

⁴ Note, however, that a taxpayer suit must seek to protect the interests of taxpayers and cannot be a proxy for other interests such as protection of business. *Charlottesville Area Fitness Club Operators Ass'n v. Albemarle Cnty. Bd. of Sup'vrs*, 285 Va. 87, 737 S.E.2d 1 (2013).

- (1) Certificates of indebtedness, revenue bonds, or other obligations issued in anticipation of the collection of the revenue of such city or town for the then current year; provided that such certificates, bonds, or other obligations mature within one year from the date of their issue, be not past due, and do not exceed the revenue for such year.
- (2) Bonds pledging the full faith and credit of such city or town authorized by an ordinance enacted in accordance with Section 7 [of Article VII of the Virginia Constitution], and approved by the affirmative vote of the qualified voters of the city or town voting upon the question of their issuance, for a supply of water or other specific undertaking from which the city or town may derive a revenue; but from and after a period to be determined by the governing body not exceeding five years from the date of such election, whenever and for so long as such undertaking fails to produce sufficient revenue to pay for cost of operation and administration (including interest on the bonds issued therefor), the cost of insurance against loss by injury to persons or property, and an annual payment to be placed into a sinking fund sufficient to pay the bonds at or before maturity, all outstanding bonds issued on account of such undertaking shall be included in determining such limitation.
- (3) Bonds of a city or town the principal and interest on which are payable exclusively from the revenue and receipts of a water system or other specific undertaking or undertakings from which the city or town may derive a revenue or secured, solely or together with such revenue, by contributions of other units of government.
- (4) Contract obligations of a city or town to provide payments over a period of more than one year to any publicly owned or controlled regional project, if the project has been authorized by an interstate compact or if the General Assembly by general law or special act has authorized an exclusion for such project purposes.

The power of Virginia cities and towns to incur debt and issue bonds has been subject to limitations based on a percentage of the assessed value of real estate since 1875. 1874–75 Va. Acts ch. 179. The current constitutional provision restricts, with certain exceptions, the power of cities and towns to incur debts or obligations in excess of the stated limitation and is intended to protect taxpayers against extravagance by the governing bodies of cities and towns. *Town of S. Hill v. Allen*, 177 Va. 154, 12 S.E.2d 770 (1941). The provision is self-executing, and no legislative action by the General Assembly is needed. *Robertson v. City of Staunton*, 104 Va. 73, 51 S.E. 178 (1905).

While the framers of article VII, section 10(a), clearly desired to place a limit on the ability of cities and towns to incur debt, they also provided the flexibility to create certain types of debt that do not fall within the limitation. Cities and towns may issue obligations, normally called revenue or tax anticipation notes (RANs or TANs), in anticipation of the collection of revenue or taxes that do not count against their debt limit. These obligations are often used to finance cash flow deficits caused by differences in the timing between collections of revenue or taxes and the cash requirements of the governmental unit. In order to be excluded from the determination of the debt limit of a city or town, the obligations must mature within one year and must not be past due. In

addition, the obligations may not exceed the revenue for such year.⁵ Article VII, section 10(a)(3), of the Constitution permits Virginia cities and towns to issue revenue bonds payable solely from the revenue and receipts of a specific undertaking from which the city or town may derive revenue or from contributions of other units of government. Such revenue bonds are not required to be taken into account in determining the debt limit of the city or town issuing them.

The Virginia Constitution also permits cities and towns to exclude from the determination of their debt limit so-called “double barrel” bonds issued to finance revenue-producing projects. These bonds are secured by both the full faith and credit of the city or town and the revenue of the project being financed. The bonds must be approved by the affirmative vote of a majority of the qualified voters of the city or town and must be issued to finance an undertaking from which the city or town may derive revenue, such as a water or sewage system. If, after a period of time determined by the governing body of the issuer, not to exceed five years from the date of the election approving the bonds, the project does not produce sufficient revenue to pay the costs of operation, administration and insurance, interest on the bonds, and an annual amount to be placed into a sinking fund sufficient to pay the bonds at or before maturity, the bonds must be included in determining the city’s or town’s debt limit. Although the subsection does not address the possibility of the use of serial bonds not requiring a sinking fund, it is probable that courts would interpret it liberally enough to authorize their use.⁶ The failure to satisfy any of the conditions of section 10(a)(3) of the Constitution results in the bonds being included in the debt limit of the city or town. *Town of S. Hill v. Allen*, 177 Va. 154, 12 S.E.2d 770 (1941).

Finally, article VII, section 10(a)(4) permits cities and towns to exclude from the determination of their debt limitation contracts to make payments to certain publicly owned or controlled regional projects. The project must be authorized by interstate compact, or the General Assembly must authorize an exclusion from the debt limit for the project.⁷

12-2.02(c) Counties

Article VII, section 10(b) of the Virginia Constitution provides that:

No debt shall be contracted by or on behalf of any county or district thereof or by or on behalf of any regional government or district thereof except by authority conferred by the General Assembly by general law. The General Assembly shall not authorize any such debt except the classes described in paragraphs (1) and (3) of subsection (a), refunding bonds, and bonds issued, with the consent of the school board and the governing body of the county, by or on behalf of a county or district thereof for capital projects for school purposes and sold to the Literary Fund, the Virginia Supplemental Retirement System, or other State agency prescribed by law, unless in the general law authorizing the same, provision be made for submission to the qualified voters of the county or district thereof or the region or district thereof, as the case may be, for approval or rejection by a majority vote of the qualified

⁵ See section 12-3.03 for a more detailed discussion of RANs and TANs and additional statutory restrictions applicable to their issuance.

⁶ See A.E. Dick Howard, *Commentaries on the Constitution of Virginia*, Vol. II, 869 (1974).

⁷ The General Assembly granted an article VII, section 10(a)(4) exemption to the member jurisdictions of the Southeastern Public Service Authority to permit them to contract obligations to provide payments over a period or periods of more than one year to said Authority, so as to guarantee the payment of all or any part of the principal of and the interest of such revenue bonds issued from time to time by said Authority. Chapter 544 of the Acts of Assembly of 1977; Chapter 872 of the Acts of Assembly of 2003.

voters voting in an election on the question of contracting such debt. Such approval shall be a prerequisite to contracting such debt.

Unlike cities and towns, the Constitution imposes no debt limit on Virginia counties. However, with certain specified exceptions, the issuance of bonds or other obligations by counties must be approved by a majority vote of the qualified voters voting in an election on the question of contracting such debt.⁸

Counties may issue obligations in anticipation of the collection of revenue for the current fiscal year and obligations for revenue-producing projects secured solely by the pledge of revenue of the project without referendum. Bonds issued by a county with the consent of the school board and the board of supervisors to finance “capital projects for school purposes” and sold to the Literary Fund, the Virginia Supplemental Retirement System, or other prescribed agency such as the Virginia Public School Authority, also are not subject to the requirement of voter approval. Va. Const. art. VII, § 10(b); Va. Code § 15.2-2638. Finally, no referendum is required for bonds to refund a previous bond issue.⁹ Va. Const. art. VII, § 10(b); Va. Code §§ 15.2-2638, 15.2-2643.

The Commission on Constitutional Revision that produced the drafts of the 1971 Constitution proposed to make the constitutional debt provisions affecting cities and towns also applicable to counties.¹⁰ This was not acceptable to the General Assembly, but as a compromise, a provision was added to the Constitution that permits a county to elect to be treated as a city for the purposes of issuing bonds. The election must be approved by the affirmative vote of the qualified voters of the county voting in the election on such question. If the election is made and approved by the voters, the county is entitled to all of the benefits and is subject to all of the limitations of the Virginia Constitution relating to the issuance of bonds by cities. The indebtedness of any town or district in an electing county, unless of a type excluded by the Constitution, must be included in determining the debt limitation of the county.

12-2.02(d) The Credit Clause

Article X, section 10 of the Virginia Constitution provides that:

[n]either the credit of the Commonwealth nor of any county, city, town, or regional government shall be directly or indirectly, under any device or pretense whatsoever, granted to or in aid of any person, association or corporation

The purpose of the “Credit Clause” is to protect the Commonwealth and its political subdivisions from losses that they might incur by extending credit and aid to privately owned ventures. The credit clause was incorporated into the Constitution of 1869 in response to a perceived “over-active participation in the promotion of privately owned transportation facilities.” *Button v. Day*, 208 Va. 494, 158 S.E.2d 735 (1968); see also 2017 Op. Va. Att’y Gen. 193 (guarantee of a bank loan to a private airline is an extension of public credit prohibited by the Credit Clause).

Despite the apparent restrictiveness of the Credit Clause, it has repeatedly been held not to restrict or limit the state or localities in the exercise of their governmental

⁸ The procedures for conducting the voter referendum are discussed in detail in section [12-2.03\(e\)](#).

⁹ See 2000 Op. Va. Att’y Gen. 49 (a county may not create a corporation with the sole authorized purpose of contracting debt on behalf of the county).

¹⁰ *The Constitution of Virginia: Report of the Commission on Constitutional Revision to His Excellency, Mills E. Godwin, Jr., Governor of Virginia, the General Assembly of Virginia, and the People of Virginia*, Charlottesville, Va. (1969), 242-44.

functions. See, e.g., *Almond v. Day*, 199 Va. 1, 97 S.E.2d 824 (1957). The general approach adopted by the Virginia Supreme Court in determining whether or not a transaction violates the credit clause is to examine its “animating purpose.” *Bd. of Sup’rs of Fairfax Cnty. v. Massey*, 210 Va. 253, 169 S.E.2d 556 (1969). If the animating purpose of an extension of credit is to benefit a public purpose, there is no violation of the Credit Clause even though private interests may also be incidentally benefited.¹¹ However, an expenditure or extension of credit will be invalid if its dominant purpose is to benefit private ventures. *Button v. Day*, 208 Va. 494, 158 S.E.2d 735 (1968). A payment of money by the state or by a locality to an authority to aid it in exercising its governmental function does not violate the Credit Clause. *City of Charlottesville v. DeHaan*, 228 Va. 578, 323 S.E.2d 131 (1984).

In *Board of Supervisors of Fairfax County v. Massey*, 210 Va. 253, 169 S.E.2d 556 (1969), an agreement between a Virginia city and county to underwrite their proportional shares of any operating deficits incurred by the Washington Metropolitan Area Transit Authority was held not to violate the Credit Clause. The Court found that such payments furthered a governmental purpose when made to an authority created and vested with the power to establish and maintain subway or street railway projects in large metropolitan areas in the interests of health, safety, and public welfare. *Id.*; see also *Harrison v. Day*, 200 Va. 750, 107 S.E.2d 585 (1959). In *Troy v. Walker*, 218 Va. 739, 241 S.E.2d 420 (1978), the Virginia Supreme Court found that the City of Newport News did not violate the Credit Clause by agreeing to make up any deficiency in funds available to the Virginia Port Authority from a new lessee of its facility for payment due on certain bonds and other obligations. The city entered into the agreement in order to replace an existing tenant, under whose operation the business of the port facility had deteriorated, with a more aggressive, innovative, and competitive operator. The Supreme Court held that this was a proper public purpose and the payments under the agreement were not primarily for the benefit of the previous lessee or the new operator of the port. In *City of Charlottesville v. DeHaan*, 228 Va. 578, 323 S.E.2d 131 (1984), the Virginia Supreme Court held in a four-to-three decision that the issuance of general obligation bonds by the City of Charlottesville and the appropriation of the bond proceeds to its redevelopment and housing authority, which then loaned the funds to a private developer of a hotel and convention complex being built as part of a redevelopment project, did not violate the Credit Clause. The Court found that the animating purpose of the transaction was to benefit the public.

In upholding the state’s grant of funding to a railroad for the construction of a rail/highway intermodal facility, the Court stated that a grant was not an extension of the Commonwealth’s credit and thus the credit clause did not apply. *Montgomery Cnty. v. Va. Dep’t of Rail & Pub. Transp.*, 282 Va. 422, 719 S.E.2d 294 (2011).

12-2.02(e) What Constitutes Debt?

The Virginia Supreme Court has found the words “bonds or other interest-bearing obligations” in article VII, section 10 of the Constitution to be “manifestly connected and interwoven with the idea of obligations, indebtedness, or liabilities, which may directly or indirectly require the obligor or insurer to discharge by the payment of money.” *Button v. Day*, 205 Va. 629, 139 S.E.2d 91 (1964). Generally, any unconditional obligation requiring the payment of money must be counted towards the debt limit. *Bd. of Sup’rs of Fairfax Cnty. v. Massey*, 210 Va. 253, 169 S.E.2d 556 (1969). Only “absolute” debts or obligations clearly fall within this definition. To be absolute and not contingent, the debt must be “free

¹¹ *City of Charlottesville v. DeHaan*, 228 Va. 578, 323 S.E.2d 131 (1984); *Troy v. Walker*, 218 Va. 739, 241 S.E.2d 420 (1978); *Bd. of Sup’rs of Fairfax Cnty. v. Massey*, 210 Va. 253, 169 S.E.2d 556 (1969); *Almond v. Day*, 197 Va. 782, 91 S.E.2d 660 (1956); *Taubman Regency Square Assocs. v. Bd. of Sup’rs of Henrico Cnty.*, No. CH00-1304 (Henrico Cnty. Cir. Ct. May 10, 2002) (upholding validity of bond financing scheme associated with a shopping center development).

from conditions, limitations or qualifications, not dependent . . . or affected by circumstances, that is, without any condition or restrictive provisions.” *Button, supra*. The term debt includes obligations “certain as to the liability and uncertain only as to the amount.” *Id.* The status of contingent obligations, defined as those whose enforceability is dependent on a contingency that may never happen, has not been determined. *Id.*

Excepted from the definition of “obligations” is a continuing-services contract, under which the locality agrees to pay in installments for services provided on an ongoing basis; e.g., water, electric, or other public service utilities provided to it, the furnishing of which is a condition of the obligation. *Armstrong v. Cnty. of Henrico*, 212 Va. 66, 182 S.E.2d 35 (1971). However, other types of service contracts for multiple years might also fall into this exception. This type of contract does not create a present debt for the aggregate amount of all the installments throughout the term of the contract. *Bd. of Sup’rs of Fairfax Cnty. v. Massey*, 210 Va. 680, 173 S.E.2d 869 (1970). In contrast to the continuing-services contract, however, is the debt payable by installments in the future. The Virginia Supreme Court views this arrangement as a present debt for the sum of the installments, for it represents an absolute promise to pay the entire amount, with only the time of payment being postponed. *Button v. Day*, 205 Va. 629, 139 S.E.2d 91 (1964). Whether a contract is a debt or not depends on whether the contract imposes an unconditional liability to pay even though payment is postponed or whether the liability arises only after the locality receives the services or the property for which it contracted. *Fairfax-Falls Church Cmty. Servs. Bd. v. Herren*, 230 Va. 390, 337 S.E.2d 741 (1985). The attributes of continuing-services contracts which cause them to fall outside the Debt Clause also preclude the application of the doctrine of anticipatory repudiation. To fall outside the scope of the Debt Clause, such contracts must be severable into annual segments. Within each annual segment, they must be essentially unilateral. There is no cause of action for the anticipatory repudiation of such contracts. *Id.*¹²

The case *Concerned Residents of Gloucester County v. Gloucester County Board of Supervisors*, 248 Va. 488, 449 S.E.2d 787 (1994), concerned a contract between a county and a private waste disposal company. The Virginia Supreme Court held that a termination clause, which provided for damages from the county, was not debt within the meaning of the Virginia Constitution because it was contingent on an event that might never occur, i.e., termination of the contract by the county. The Court also held that the contingent additional costs provided for in the contract—(1) if future county ordinances resulted in increased company operating costs, the costs would be borne by the county through either credits against rents or increased fees, and (2) the sharing of the cost of disposal of hazardous waste when the disposer was unknown—were not debts because the obligation to pay did not arise until the services were rendered, and therefore they fell within the continuing-services contract exception.

The Supreme Court of Virginia has also held that a so-called “moral obligation” to appropriate funds for the payment of an obligation does not create a debt. In *Dykes v. Northern Virginia Transportation District Commission*, 242 Va. 357, 411 S.E.2d 1 (1991), the Supreme Court held in a four-to-three decision that an agreement by Fairfax County to make payments to the Commission of amounts sufficient to pay debt service on the Commission’s bonds, which payments were subject to annual appropriation by the county’s governing body, did not constitute debt of the county. The Court said:

“Subject to appropriation” financing does not create constitutionally cognizable debt because it does not impose any enforceable duty or liability

¹² See also 1985–86 Op. Va. Att’y Gen. 70, in which the Attorney General opined that a lease-purchase agreement for an office building conditioned on annual appropriations by the Board of Supervisors does not create a present debt within the meaning of the Virginia Constitution.

on the County. Expectations of bondholders, County officials, or bond rating agencies do not create County "debt"¹³

Id.

12-2.03 Public Finance Act

12-2.03(a) General

The Public Finance Act of 1991, Va. Code §§ 15.2-2600 to 15.2-2663 (the "Act"), authorizes localities to borrow money and issue bonds for a variety of public purposes. The Act permits the governing body of a locality to elect to issue bonds either under the provisions of the Act or under the provisions of any charter or special or local act applicable to the governing body. Va. Code § 15.2-2601. However, any referendum requirement for the issuance of bonds or debt limitation contained in any charter or local or special act controls over the provisions of the Act. *Id.*

12-2.03(b) Provisions Applicable to All Bonds

The Act authorizes localities to incur debt and issue bonds to pay the "cost" of any "project." Va. Code § 15.2-2602. The word "project" is defined as "any public improvement, property or undertaking for which the locality is authorized by law to appropriate money, except for current expenses, and specific undertakings from which the locality may derive revenues . . . including, without limitation, water, sewer, sewage disposal, and garbage and refuse collection and disposal systems and facilities . . . , recycling facilities, facilities for the production of energy from waste, gasworks, electric light and other lighting systems, airports, off-street parking facilities, and facilities for public transit or transportation systems." *Id.*¹⁴ Localities are also authorized to issue bonds to create a self-insurance reserve fund and to pay the cost of satisfying a final judgment imposed against them or their school boards by a court of competent jurisdiction. Va. Code § 15.2-2604. Localities that are authorized to accept voluntary cash proffers may also issue bonds under the provisions of the Act to finance certain improvements to the extent that the costs of such improvements have been pledged by landowners as voluntary cash proffers. Va. Code § 15.2-975. While all of the facilities on the list are capital in nature, there are no Virginia Supreme Court cases determining whether only capital projects may be financed through the issuance of bonds. At least one Virginia circuit court has held in a bond validation proceeding that a city can issue bonds to finance annexation payments to a county. *City of Fredericksburg v. Taxpayers, Property Owners & Citizens of the City of Fredericksburg*, No. 3955 (City of Fredericksburg Cir. Ct. Sept. 9, 1985).

The term "cost" as defined in the Act includes both "hard" costs, such as the purchase price for property and various costs of construction, and "soft" costs, such as engineering and legal services, expenses for feasibility studies, administrative expenses, and interest expenses during construction and for a period not to exceed one year after completion of construction. Va. Code § 15.2-2602. The term also includes payments made by a locality of its share of the costs of any multi-jurisdictional project.

Except for the limited power to issue notes in anticipation of revenue in certain situations, the Act does not grant Virginia localities the power to issue bonds or notes to pay current expenses. A circuit court ruled that a bond resolution authorizing the issuance of bonds to finance "Future Needs of the Town" did not state a proper purpose under the Act, in part because such authorization could encompass a financing for current expenses.

¹³ A similar result had previously been reached in cases involving undertakings of the Commonwealth that were subject to appropriation. *Baliles v. Mazur*, 224 Va. 462, 297 S.E.2d 695 (1982); *Harrison v. Day*, 202 Va. 967, 121 S.E.2d 615 (1961).

¹⁴ In *Hutton v. Town of Elkton*, 57 Va. Cir. 278 (Rockingham Cnty. 2002), the court held that financing the "future needs of the Town" is not a permissible purpose for issuing bonds under the Public Finance Act.

Hutton v. Town of Elkton, 57 Va. Cir. 278 (Rockingham Cnty. 2002). Other jurisdictions have defined current expenses as “the usual ordinary, running, and incidental expenses of a given municipality.” *Atchison, Topeka & Santa Fe R.R. Co. v. City of Topeka*, 149 P. 697 (Kan. 1915). In *State ex rel. Oster v. Jorgenson*, the South Dakota Supreme Court ruled that “[e]xtraordinary, emergent, and exceptional expenses” cannot be considered current expenses. 136 N.W.2d 870 (S.D. 1965). In *Cherey v. City of Long Beach*, 26 N.E.2d 945 (N.Y. 1940), involving a challenge to a city ordinance authorizing the issuance of bonds for the purpose of funding certain unpaid judgments, the New York Court of Appeals held that the state constitution plainly prohibited municipal bond issues “for objects or purposes of purely transient usefulness.” The *Cherey* ruling, however, is based on a prohibition against issuing bonds to finance objects or purposes with no discernible period of probable future usefulness.

Subject to certain exceptions, before a locality may issue any bonds, its governing body must hold a public hearing on the proposed bond issuance. Va. Code § 15.2-2606.¹⁵ A notice of the public hearing stating the estimated maximum amount of the proposed bonds, the proposed use or uses of the bond proceeds (and if there is more than one use, the proposed uses for which more than 10 percent of the bond proceeds is expected to be used), and the time and place of the hearing, must be published once a week for two successive weeks in a newspaper having general circulation in the locality, with the first notice appearing no more than fourteen days before the hearing. *Id.* The public hearing must be held not less than six, nor more than twenty-one, days after the date the second notice appears in the newspaper. *Id.* Within these limitations, the hearing may be held at any time before the final authorization of the issuance of the bonds. The public hearing requirement does not apply to bonds approved by a majority of the voters actually voting on the issuance of the bonds, i.e., pursuant to a referendum, to notes issued in anticipation of taxes and revenue for the current year, to notes issued in anticipation of grants and reimbursements, and to refunding bonds. *Id.*

The governing body of any locality is authorized by the Act to provide by ordinance or resolution for the issuance of bonds, subject to any required approval of voters. Va. Code § 15.2-2607.¹⁶ The authorizing resolution becomes part of the contract with the bondholders. In the authorizing resolution, the governing body of the locality may pledge the revenue of a project, the full faith and credit of the locality, or both, to the payment of the bonds. *Id.*¹⁷ If the full faith and credit of the locality is not pledged to the payment of the bonds, the locality may grant a security interest on the project or other government property to secure payment of the bonds. *Id.* Provisions for the establishment of sinking or reserve funds, the redemption of the bonds, the limitations on the operation of the project, the securing of payment by a trust agreement with a corporate trustee (which may be a trust company or bank having trust powers located within or outside of Virginia), the incurring of additional debt, and the application of bond proceeds may also be included in the authorizing resolution authorizing the bonds. *Id.*¹⁸ If the bonds are being issued for

¹⁵ Note that if there are multiple uses, only uses expected to exceed 10 percent of the bond proceeds need to be stated. Governing body members are not disqualified from voting on an issue simply because they failed to attend a public hearing on the issue. *Hutton v. Town of Elkton*, 57 Va. Cir. 278 (Rockingham Cnty. 2002).

¹⁶ No particular formalities are required under the Act for the introduction of the resolution or ordinance. *Fordney v. Harrisonburg City Council*, 51 Va. Cir. 383 (Rockingham Cnty. 2000).

¹⁷ Bonds that carry both the pledge of specific revenue and the full faith and credit of the locality are frequently referred to as “double barrel bonds.”

¹⁸ Although the question submitted to voters may be worded specifically or generally, a locality is bound by that language and may not use bond proceeds for any use other than that expressly approved by the voters, as set forth in the bond referendum. Thus, if the resolution or ordinance approved by the voters sets forth a separate authorization amount for each project listed without

a revenue-producing undertaking, the governing body may covenant to fix and maintain the rates of the undertaking at a level that will produce sufficient revenue to pay operating costs and debt service. *Id.*

The governing body of a locality issuing bonds is authorized to determine or provide for the determination of the interest rates on the bonds. Va. Code § 15.2-2612. Interest rates may be determined by reference to indices and formulas or by agents designated by the governing body under guidelines established by it. The Act no longer prescribes a maximum interest rate. See Va. Code § 2.2-5000. The maturities, redemption dates and prices, the price at which the bonds are sold, and most matters affecting the form and execution of the bonds are also subject to the discretion of the governing body of the issuing locality. Va. Code §§ 15.2-2612 and 15.2-2613. However, the maximum maturity of the bonds may not exceed forty years. Va. Code § 15.2-2612. Bonds may bear facsimile signatures of any officials authorized to sign them, but if all signatures on bonds are facsimiles, the bonds must be authenticated by an approved agent of the issuer, usually the bond trustee or the registrar. Va. Code § 15.2-2613.

Unless otherwise specifically provided by the governing body of a locality or in the ordinance, resolution, trust agreement, indenture, or other instrument authorizing the issuance of bonds, all proceeds realized from the sale of bonds must be paid to the treasurer or chief financial officer of the locality, who is required to deposit the proceeds in a bank to the credit of the locality and account for them as a separate fund. Va. Code § 15.2-2618. Pending the application of the proceeds of bonds to the purpose or purposes for which the bonds were authorized, all or any part of the proceeds may be invested. Va. Code § 15.2-2619. Investments must qualify as legal investments under the laws of Virginia. *Id.*¹⁹ If bonds are issued for school purposes, the governing body of the locality may control the investment of bond proceeds pending their application, but has no power to expend the proceeds or to prohibit the school board from expending them for a proper purpose. *Fluvanna Cnty. Sch. Bd. v. Farrar*, 199 Va. 427, 100 S.E.2d 26 (1957); see also Va. Const. art. VIII, § 7.

The governing body of any locality is authorized to provide by resolution or ordinance for the defeasance of any outstanding bonds, to the extent that defeasance is not provided for in the documents governing the issuance of the bonds. Bonds are deemed defeased when an escrow or sinking fund consisting of sufficient cash and noncallable obligations of the U.S. or Virginia has been established to pay all bonds either at maturity or upon redemption. The escrow or sinking fund may also consist of noncallable obligations unconditionally guaranteed by the U.S. or Virginia. Va. Code § 15.2-2623.

The governing body of any locality is authorized and required to levy and collect annually, at the same time as other taxes, a tax on all taxable property within the locality, without limitation as to rate or amount, sufficient to pay when due any general obligation bond of the locality to the extent that funds are not lawfully available and appropriated for such purpose. Va. Code § 15.2-2623.²⁰

A certified copy of any resolution of a locality authorizing the issuance of bonds must be filed with the circuit court having jurisdiction over the locality. Va. Code § 15.2-2607. Within thirty days after the filing with the court, any person in interest may contest

language permitting the use of leftover bond funds authorized for one of the listed projects to be applied to another project listed in the resolution or ordinance, the governing body is bound by the language used and cannot reallocate those proceeds. 2012 Op. Va. Att'y Gen. 76.

¹⁹ See Va. Code § 2.2-4500 et seq. for legal investments.

²⁰ It appears that Virginia political subdivisions are not authorized to declare bankruptcy, so this provision appears mandatory for general obligation debts. *Suntrust Bank v. Alleghany Highlands Econ. Dev. Auth.*, 270 B.R. 647 (Bankr. W.D. Va. 2001).

the validity of the bonds or any of their provisions. Va. Code § 15.2-2627. If the contest is not begun within the thirty-day period, the validity of the bonds and their provisions will be conclusively presumed, and no court will have authority to inquire into their provisions. *Id.*

In *Town of Leesburg v. Giordano*, 276 Va. 318, 667 S.E.2d 552 (2008), the Court analyzed the applicability of Va. Code § 15.2-2627 to water and sewer rates and concluded that such rates could be “immunized from attack” but only if such rates were specifically included in the bond resolution.

12-2.03(c) Bond Issues by Cities and Towns

Unless otherwise provided in their charter or by local or special act, bonds issued by Virginia’s cities and towns are not required to be approved by the voters but are subject to a constitutional debt limit. No city or town may issue any bonds or other indebtedness if the principal amount of the proposed bonds or other indebtedness, together with existing indebtedness, at any time exceeds 10 percent of the assessed valuation of the real estate in the city or town subject to taxation as shown by the last assessment for taxes. Va. Const. art. VII, § 10(a). Under article VII, section 10(a) of the Virginia Constitution, certain obligations of a city or town are not counted against its debt limit.²¹

Whenever the governing body of a city or town determines to issue bonds, the governing body should adopt an authorizing resolution stating the maximum principal amount of bonds to be issued and in general terms the purpose or purposes for which the proceeds of the bonds are to be used. If bonds are to be secured by both the full faith and credit of a city or town and the revenue of the revenue-producing undertaking (“double barrel”) and are not to be included in the debt limit pursuant to § 15.2-2635 of the Act, the governing body of the city or town must adopt an ordinance setting forth such fact and describe the revenue-producing undertaking for which the bond proceeds will be used. Va. Code § 15.2-2636. The ordinance must be passed by the affirmative vote of a majority of all members of the governing body of the city or town. *Id.*; Va. Const. art. VII, § 10. If the bonds are to be “double barrel,” the circuit court will order that a referendum of the qualified voters be held to determine whether the bonds are to be issued. Va. Code §§ 15.2-2610 to 15.2-2636. An advisory referendum on the issuance of bonds by a city is not permitted without express authority from the General Assembly. 1974-75 Op. Va. Att’y Gen. 331.

12-2.03(d) Bond Issues by Counties

Counties have similar powers as cities to issue bonds or incur debt to finance the cost of any project; however, the provisions of the Virginia Constitution and the Act generally require counties to obtain the approval of the bond issue by a majority vote of the county’s qualified voters, i.e., by referendum. Va. Code § 15.2-2638. Voter approval is not required for (i) indebtedness issued in anticipation of the collection of taxes and other revenue for the current year, (ii) bonds payable exclusively from the receipts of revenue producing undertakings, (iii) refunding bonds, and (iv) bonds issued, with the consent of the school board and the governing body of the county, for capital projects for school purposes and sold to the Literary Fund, the Virginia Retirement System, or other state agency prescribed by law, such as the Virginia Public School Authority. Va. Code § 15.2-2638; Va. Const. art. VII, § 10(b). The Constitution and the Act also provide that a county may be treated as a city for the purposes of contracting debt upon the affirmative vote of the qualified voters of the county. Va. Code § 15.2-2639; Va. Const. art. VII, § 10(b). The county will then have all the benefits and limitations of a city when issuing bonds.

Whenever the governing body of a county determines it is advisable to issue general obligation bonds, the governing body should adopt an ordinance or resolution

²¹ See section [12-2.02\(b\)](#).

setting forth in general terms the purpose or purposes for which the bonds are to be issued and the maximum amount of the bonds. Va. Code § 15.2-2640. If voter approval of the bond issue is required, the resolution should request the circuit court to order an election. Before the governing body adopts any resolution requesting an election on the question of the issuance of bonds for school purposes, or, if no referendum is required, a resolution authorizing the issuance of school bonds, the school board of the county must first have adopted a resolution requesting the governing body to take such action. *Id.*; 1974-75 Op. Va. Att'y Gen. 345.

12-2.03(e) Procedures for Referenda and Form of Ballot

If voter approval of any bond issue is required by the Constitution, the Act or any charter provision, a certified copy of the resolution or ordinance adopted by the governing body requesting the referendum on the issuance of the bonds must be filed with the circuit court having jurisdiction. Va. Code § 15.2-2610. The circuit court then will enter an order calling an election on the issuance of bonds in accordance with Va. Code § 24.2-681 et. seq. The election order must be entered at least 81 days before the date of the election. Va. Code § 24.2-682. Notice of the election must be published at least once, not less than ten days before the election, in a newspaper published or having general circulation in the locality. Va. Code § 15.2-2610. In *Board of County Supervisors of Prince William County v. All Taxpayers*, No. 58517 (Prince William Cnty. Cir. Ct. Jan. 7, 2003), the court held that the notice provision was directory and not mandatory in validating a bond referendum for which the newspapers had failed to print the notices sent. The court further held that there had been no due process violation because of the public information was otherwise provided.

All bond referenda are held and conducted in the manner prescribed by law for other elections. Va. Code § 15.2-2610. Special elections on the issuance of bonds are governed by Va. Code §§ 24.2-681 through 24.2-687. These provisions include a prohibition on advisory referenda (§ 24.2-684 which provides that no referendum shall be placed on the ballot unless specifically authorized by law). Virginia Code § 24.2-687 provides procedures for the required distribution of printed information regarding the bond referendum, which must state the estimated maximum amount of the bonds proposed to be issued and the proposed use of the bond proceeds, and, if there is more than one use, the proposed uses for which more than 10 percent of the total bond proceeds is expected to be used. Bond proceeds not needed for a particular project may not be used on another project unless specifically authorized. 2012 Op. Va. Att'y Gen. 76 (highlighting the need to carefully craft referenda questions and information submitted to the voters to provide any desired flexibility). The ballot for a bond referendum is prepared by the appropriate electoral board in the form prescribed by statute. The principal amount of the bond issue on which the vote is to be taken must be stated in the ballot, *Williamson v. Town of Graham*, 113 Va. 449, 74 S.E. 393 (1912), but there is no requirement that the ballot specify the maximum interest rate which the bonds are to bear, *Miller v. Ayres*, 211 Va. 69, 175 S.E.2d 253 (1970). A variation of form and not of substance in the ballot from that prescribed by statute will not invalidate the bond issue. *Fairfax Cnty. Taxpayers All. v. Bd. of Cnty. Sup'rs*, 202 Va. 462, 117 S.E.2d 753 (1961).

In *Williamson v. Town of Graham*, 113 Va. 449, 74 S.E. 393 (1912), a proposed bond issue was challenged on the grounds that the question on the ballot gave voters the opportunity only to vote for or against a bond issue, the proceeds of which were to be spent for a public school building, water works improvements, street sidewalks, and sewers. The Virginia Supreme Court held that the various purposes of the bond issue were not required to be voted on separately. See also *Falls Church Taxpayers League v. City of Falls Church*, 203 Va. 604, 125 S.E.2d 817 (1962); *Ennis v. Town of Herndon*, 168 Va. 539, 191 S.E. 685 (1937). The Act now specifically authorizes the governing body of a

locality to combine two or more purposes and amounts of bonds into a single question for election purposes. Va. Code § 15.2-2610.²²

The ballots on a bond referendum are counted and the returns made and canvassed as in other elections, pursuant to Va. Code § 24.2-681 et seq. Va. Code § 15.2-2611. The results of the election are certified by the secretary of the electoral board to the State Board of Elections, to the court ordering the election, and to the governing body of the locality proposing to issue the bonds. Va. Code § 24.2-684. If a majority of the qualified voters voting on the question approve the issuance of the bonds, the circuit court calling the election enters an order to that effect and the governing body of the issuer is then authorized to proceed with the bond issue. Va. Code § 15.2-2611. Bonds issued pursuant to an election must conform to the terms and conditions of the question submitted to the voters. The terms of the bonds cannot be changed after the vote so as to materially increase the burden on the voters.²³

Bonds authorized by referendum may not be issued by a locality more than eight years after the date of the referendum. Va. Code § 15.2-2611. However, this eight-year period may, at the request of the locality, be extended to up to ten years by order of the circuit court entered before the expiration of the eight-year period. *Id.* The court is required to grant the extension unless it is shown by clear and convincing evidence that the extension is not in the best interests of the locality. *Id.*

Until 2013, the United States Justice Department, applying Section 5 of the Voting Rights Act of 1965, required that any proposed bond referendum be submitted to the Justice Department for preclearance review because the governing body of the locality could exercise discretion in setting the date for the bond election.²⁴ The United States Supreme Court, in *Shelby County v. Holder*, 570 U.S. 529, 133 S. Ct. 2612 (2013), determined that the formula for determining “covered” localities in Section 4(b) of the Voting Rights Act was invalid and overturned Section 5. Accordingly, localities no longer need to seek preclearance for bond referenda under Section 5 of the Voting Rights Act, although certain localities (none of which are in Virginia) are under court order to seek preclearance for voting changes under Section 3(c) of the Voting Rights Act.

12-2.03(f) Refunding Bonds

The governing body of any locality is authorized by the Act to issue bonds to refund any outstanding obligations whether or not such obligations have matured or are subject to redemption. However, bonds may not be issued to refund obligations issued in anticipation of the collection of revenue for the current year. Va. Code § 15.2-2643. Refunding bonds may not be issued in an amount exceeding the amount necessary to amortize the principal, interest, and redemption premium, if any, on the obligations to be redeemed, plus the expenses of issuing the refunding bonds, less any amounts in any sinking, escrow and other funds which are available to pay the obligations to be refunded. Va. Code § 15.2-2645.

Refunding bonds may be issued or exchanged for the indebtedness to be retired, including indebtedness not matured, redeemable, or surrendered for retirement. Unless exchanged for the indebtedness to be retired, refunding bonds may be sold either at public or private sale for such price as the governing body of the locality may determine. Proceeds of refunding bonds may be applied to pay matured or redeemable indebtedness,

²² A county may provide as a single question in a bond referendum whether the bonds shall be issued and paid for from revenue collected from a food and beverage tax. Va. Code §§ 15.2-2607(1) and 58.1-3833(5).

²³ See *Miller v. Ayres*, 211 Va. 69, 175 S.E.2d 253 (1970), where because a maximum interest rate was stated in the question on the ballot, even though not required, bonds could not be issued at a higher rate.

²⁴ Voting Rights Act of 1966, 42 U.S.C. § 1973c (1994); 28 C.F.R. § 51.17 (1996).

including any redemption premium, or to pay unmatured indebtedness held for purposes of payment by banks or trust companies designated by the locality. Alternatively, the proceeds of refunding bonds may be used to establish an escrow or sinking fund in an amount that, together with interest to be earned on the fund, will be sufficient to pay the bonds to be refunded at maturity or upon redemption. Money in such an escrow or sinking fund may be invested only in noncallable obligations of the United States or the Commonwealth of Virginia or noncallable obligations unconditionally guaranteed by the U.S. or Virginia. Any escrow or sinking fund established from the proceeds of refunding bonds will be irrevocably pledged to the payment of the indebtedness to be refunded. Va. Code § 15.2-2644.

The owners of the refunded indebtedness are divested of all rights except the right to payment of the indebtedness as it becomes due. The principal and interest on any refunded indebtedness for which an escrow or sinking fund has been established will be paid solely from such fund. The intent of the Act is that any escrow or sinking fund established from the proceeds of refunding bonds constitutes a special fund for the payment of the refunded indebtedness, and that the refunded indebtedness will not be included in determining any limitations on the amount of indebtedness imposed by law. Va. Code § 15.2-2644.

12-2.03(g) Judicial Validation of Bonds

The governing body of any political subdivision²⁵ proposing to issue bonds may bring a proceeding in the circuit court of the county or city in which the political subdivision is located to establish the validity of the bonds and the legality of the proceedings taken in connection with their issuance. Va. Code § 15.2-2651. The judicial proceeding may also establish the validity of the tax or other means provided for the payment of the bonds, the validity of pledges of revenue, and the validity of covenants and other provisions of the bond issue. *Id.* The legislative purpose of the proceeding is to provide for an expeditious judicial determination of the validity of bond issues to enhance their marketability. *Harper v. City Council of the City of Richmond*, 220 Va. 727, 261 S.E.2d 560 (1980).

Private citizens, businesses, or other interested persons may contest the issuance of bonds by a political subdivision by filing a motion for judgment in the circuit court of the city or county in which the issuer is located. Such a proceeding must be commenced within thirty days after the resolution or ordinance authorizing the issuance of the bonds is filed with the circuit court, or if contesting the validity of a petition for—or the results of—a referendum, within thirty days after the date the result of the election for the issuance of the bonds is certified. Suits contesting refunding bonds not authorized pursuant to a referendum, or for which the authorizing resolution or ordinance is not required to be filed with the circuit court, must be filed within thirty days after the adoption of the authorizing resolution or ordinance. Va. Code § 15.2-2653.²⁶

²⁵ In 2003, community development authorities were designated by statute as political subdivisions of the Commonwealth and thus may bring a bond validation suit. Va. Code § 15.2-5152. In *Short Pump Town Center Community Development Authority v. Hahn*, 262 Va. 733, 554 S.E.2d 441 (2001), the Supreme Court of Virginia held that CDAs were not statutorily authorized to bring suit. The court's decision in *Short Pump* also vacated the determination by the circuit court on the merits that the proposed bond financing scheme was invalid because it would fund infrastructure improvements that were not necessary to meet increased demands on the county caused by the proposed community development, as required by Va. Code § 15.2-5158. *Short Pump Town Center Cmty. Dev. Auth. v. Taxpayers*, 54 Va. Cir. 501 (City of Richmond 2001), vacated by *Short Pump Town Center Cmty. Dev. Auth. v. Hahn*, 262 Va. 733, 554 S.E.2d 441 (2001); see also *Taubman Regency Square Assocs. v. Bd. of Sup'rs of the Cnty. of Henrico*, No. CHOO-1304 (Henrico Cnty. Cir. Ct. May 10, 2002) (less restrictive interpretation of CDA powers).

²⁶ All bonds issued prior to July 1, 1992, have been statutorily validated. Va. Code § 15.2-2662.

The defendants in an issuer-initiated validation proceeding are the taxpayers, property owners, and citizens of the political subdivision proposing to issue bonds. Va. Code § 15.2-2652. Upon the filing of a complaint or petition concerning the validity of a bond issue, the court fixes a time and place for hearing the proceeding and orders the publication of the motion for judgment. *Id.* The publication must be made at least once a week for two consecutive weeks in a newspaper published or having general circulation in the political subdivision. *Id.* The date of the hearing must not be sooner than ten days after the second publication. *Id.* If the proceeding is initiated under § 15.2-2653 of the Act by a party other than the bond issuer, the plaintiff must have the complaint or petition personally served on at least one member of the governing body of the issuer. Va. Code § 15.2-2653. Validation proceedings take precedence over all other business of the court. Va. Code § 15.2-2654.

The court in a validation proceeding may determine all questions of law and fact. Va. Code § 15.2-2654. However, the court should adjudicate only whether the procedure followed in connection with the issuance of the bonds conforms to law; the “necessity and propriety” of the bond issue by a political subdivision is a question of public policy which the court cannot consider. *Ficklen v. City of Danville*, 146 Va. 426, 132 S.E. 705 (1926). The proposed bond issue should be validated by the court, if possible, and should not be invalidated unless the court finds “substantial defects, materials and omissions” in the bond issue. Va. Code § 15.2-2658; *Harper v. City Council of the City of Richmond*, 220 Va. 727, 261 S.E.2d 560 (1980); *Falls Church Taxpayers League v. City of Falls Church*, 203 Va. 604, 125 S.E.2d 817 (1962); *Fairfax Cnty. Taxpayers Alliance v. Bd. of Cnty. Sup’rs*, 202 Va. 462, 117 S.E.2d 753 (1961).

Historically, the final judgment of the circuit court in a bond validation proceeding could be appealed directly to the Virginia Supreme Court. But with the expansion of the jurisdiction of state courts, effective January 1, 2022, an appeal of a bond validation proceeding is taken to the Court of Appeals. Va. Code § 15.2-2656. The notice of appeal must be filed in the circuit court within fifteen days after the circuit court enters its final judgment, and the opening brief must be filed with the Court of Appeals within thirty days of judgment entry, rather than the more customary—and longer—time periods provided by the Rules of Court. *Id.* The Court of Appeals must give the appeal “an expedited review,” though this term is not defined. *Id.* If the circuit court validates the bond issue and no appeal is taken within the prescribed period, or if taken, the decision of the circuit court is affirmed, the decree of the circuit court “shall be forever binding and conclusive” as to the validity of the bonds, any taxes for the payment of the bonds, any pledges of revenue, any covenants and provisions contained in the resolution or ordinance authorizing the issuance of the bonds, and any other matters which were adjudicated. Va. Code § 15.2-2657. All persons are permanently enjoined against the institution of any proceeding contesting the validity of the bonds or any other matters adjudicated. *Id.*

12-2.04 Public-Private Education Facilities and Infrastructure Act

The Public-Private Education Facilities and Infrastructure Act of 2002 (PPEA) was enacted by the 2002 General Assembly. Va. Code §§ 56-575.1 et seq. The PPEA authorizes a responsible public entity to enter into a comprehensive agreement with a private entity to develop or operate a qualifying project. The project may be either solicited by the responsible public entity or the proposal may be unsolicited. There is often a substantial financing component in PPEA proposals and contracts that requires careful consideration in light of the principles discussed in this chapter. See Chapter 25, Public Procurement Law, section [25-6.03](#), for a thorough discussion of the mechanics of the PPEA.

12-3 TYPES OF LOCAL DEBT

12-3.01 General Obligation Bonds

12-3.01(a) General

General obligation bonds or notes are instruments of indebtedness issued by a locality and secured by its full faith and credit and general taxing power. General obligation bonds and notes are used frequently by localities to finance the costs of projects that do not produce revenue, such as schools, courthouses, government office buildings, jails, libraries, parks, and roads. These bonds are a primary obligation of the issuer, and the bondholder may look to all sources of revenue of the issuer for repayment. A locality is required by law to levy taxes on all property of the jurisdiction subject to local taxation sufficient to pay the principal of and interest on general obligation bonds. Va. Code §§ 15.2-2604, 15.2-2605, 15.2-2607, and 25.2-2624.

12-3.01(b) Enforcement of Payment

If an issuing locality defaults in the payment of the principal of or interest on general obligation bonds, a bondholder could compel the locality to levy taxes sufficient to make the required payments. Va. Code §§ 15.2-2602, 15.2-2604, 15.2-2605, 15.2-2607, and 15.2-2624. However, the bondholder has no lien on any property of the locality to secure payment. In addition to the right to compel the levy of tax, the owner of any general obligation bond issued by a locality that is in default may give notice of the default to the Governor of Virginia. If the Governor determines after investigation that a default exists, the Governor is required to notify the Comptroller of the Commonwealth, and the Comptroller is required to withhold State funds from any sources that are payable to the defaulting locality and use those funds to cure the default. Va. Code § 15.2-2659.

12-3.02 Revenue Bonds

12-3.02(a) General

Revenue bonds or notes are debt instruments issued by a locality and secured by the pledge of a specific source of revenue of the issuer. If the pledged revenue is insufficient to pay the bonds, the bondholders have no recourse against other revenue or assets of the locality, unless the bonds are "double-barreled" bonds carrying both a pledge of revenue and a pledge of the locality's full faith and credit. Revenue bonds frequently are used to finance revenue-producing projects, such as water and sewer systems, solid waste disposal facilities, toll roads, hydroelectric facilities, and hospitals on a self-liquidating basis.

Virginia localities are permitted to issue revenue bonds payable exclusively from the receipts of a revenue-producing undertaking without counting the bonds against their debt limit in the case of cities and towns and without obtaining the approval of the qualified voters in the case of counties. Va. Const. art. VII, §§ 10(a)(3), 10(b); Va. Code §§ 15.2-2635 and 15.2-2638. While revenue bonds normally are payable solely from the revenue of the facility that they are used to finance, in some cases the locality may want to pledge, in addition to the revenue of the financed facility, revenue from other facilities or from special taxes or a moral or general obligation. Such an arrangement must be examined carefully to ensure that it does not result in the bonds becoming subject to the debt limit or referendum requirements of the Virginia Constitution.

12-3.02(b) Revenue Bond Covenants

Since the owners of revenue obligations may look only to the specific pledged revenue for payment, they are naturally concerned with the construction and operation of the facility that will produce such revenue. The issuer of revenue bonds will be required to make a series of covenants concerning the facility that will be tailored to the nature of the facility and the creditworthiness of the issuer. These covenants usually make the documentation of revenue bonds much more complex than for general obligation bonds.

In most cases, the locality issuing revenue bonds will be required to agree to complete the construction of the revenue producing facility on a specified schedule and, once complete, to maintain the facility in good repair and insure it against loss or damage. The locality will typically covenant that it will not issue additional bonds secured by a pledge of the revenue of the same facility unless the current or projected revenue of the facility, or both, after the payment of operating expenses, exceeds a specified percentage (e.g., 115 percent) of debt service on the outstanding bonds and the additional bonds.

The issuer also will be required to agree to establish and collect rates, fees, or other charges for the revenue producing facility at a level that will generate funds sufficient to pay operating expenses and the debt service on the bonds. Va. Code § 15.2-2609. Often the rate covenant will impose an obligation on the locality to fix rates, fees, and other charges at a level that will generate revenue after the payment of operating expenses in an amount equal to a specified percentage (e.g., 115 percent) of debt service on the bonds.²⁷ While it is not customarily done, Virginia localities are authorized to grant a mortgage or deed of trust on a revenue-producing facility to secure the payment of bonds issued to finance the facility if the full faith and credit of the locality has not also been pledged to the payment. Va. Code § 15.2-2607.

12-3.03 Short-Term Debt

Instruments evidencing the short-term borrowing needs of localities are referred to as notes. While there is no specific maturity that distinguishes notes from bonds, notes generally have a maturity of seven years or less. Notes are issued to provide temporary financing for capital projects or to provide for short-term cash flow deficits. Notes usually are identified by the anticipated source of funds for their repayment, i.e., tax anticipation notes (TANs), grant anticipation notes (GANs), revenue anticipation notes (RANs), and bond anticipation notes (BANs). Notes are normally secured by a pledge of the funds to be used for their repayment (e.g., the proceeds of the permanent financing or utility revenues) and in some cases by the full faith and credit and the taxing power of the issuer.

TANs and RANs are short-term debt issued to finance cash flow needs when the anticipated timing of the receipt of taxes or revenue does not correspond to the need for the funds. For example, a locality may collect taxes only once or twice a year while its cash needs are spread throughout the year. The locality might finance its cash shortfall through the issuance of TANs or RANs. The Virginia Constitution provides that obligations issued in anticipation of the collection of revenue for the then-current fiscal year do not count against the debt limit of cities and towns and do not have to be submitted for voter approval by counties, provided the obligations mature within one year from the date of their issue, are not past due, and do not exceed the revenue of the locality for the year. Va. Const. art. VII, §§ 10(a)(1) and 10(b). The Act authorizes localities to issue notes in anticipation of the collection of taxes and revenue for the current year, but the principal amount of the notes may not exceed the anticipated revenue for the fiscal year. The notes must mature and be paid within one year from the date they are issued. No extension of the notes will be valid, and no additional notes may be issued, unless all notes issued during the preceding years have been paid. Va. Code § 15.2-2629. RANs and TANs can be a convenient vehicle for short-term financing of capital needs, but their use to meet current costs except in rare circumstances indicates fiscal instability in a local government and an insufficient undesignated fund balance.

²⁷ In *City of Charleston v. Public Service Commission*, 57 F.3d 385 (4th Cir. 1995), the Fourth Circuit held that a West Virginia law that limited the circumstances under which a water and sewer charges lien could be imposed did not constitutionally impair the city's sewer revenue bond contracts, which provided generally that such liens would be applied if rates and charges were not paid.

The receipts from federal and Virginia grants for capital projects usually do not match the need for funds to pay the costs of the projects. Many localities issue GANs to provide the short-term financing necessary for the construction of the project until the grant payments are received. GANs are normally issued as revenue obligations secured by the grant receipts and are not the general obligation of the issuer. Va. Code § 15.2-2630.

BANs are issued to provide interim financing at lower interest rates during the design and construction of a project or to avoid entering the long-term bond market during periods of high interest rates. BANs may be issued as either general or revenue obligations, but if issued as general obligations, they are subject to the same restrictions as general obligation bonds. Virginia localities are authorized to issue BANs in anticipation of the sale of bonds for the purpose for which the bonds have been authorized and within the maximum authorized amount of the bond issue. Va. Code § 15.2-2628. However, neither counties nor their school boards are permitted to issue BANs for school purposes in anticipation of the sale of bonds which have not been approved at referendum, unless the BANs themselves are sold to the Literary Fund, the Virginia Retirement System, the Virginia Public School Authority, or other authorized state agency. 1974-75 Op. Va. Att'y Gen. 346; 1987-88 Op. Va. Att'y Gen. 325.

BANs must mature within five years of the date of their original issuance. BANs may be extended and refunded from time to time provided that no extension or refinancing matures later than five years from the date of their original issuance. BANs may, in the discretion of the locality, be retired by other available funds in lieu of funds from the bond issue, provided the maximum amount of the bonds that have been authorized is reduced by a corresponding amount. Va. Code § 15.2-2628.

12-3.04 Creative Techniques

12-3.04(a) Credit Enhancement

In order to improve the marketability of the debt of an issuer and thereby achieve lower interest rates, a number of techniques have been developed in recent years to enhance creditworthiness. These devices substitute the higher credit rating of a third party for the credit of the borrower, with the third party assuming the credit risk of the borrower. This technique is especially helpful where the credit of the borrower is not well recognized in the public market but is known and acceptable to the third party providing the credit enhancement. Credit enhancement may take many different forms, including bond insurance, letters of credit, and guarantees.

Prior to the financial crisis of 2007, bond insurance was the most common form of credit enhancement for local governments. Bond insurance is now a much less viable credit enhancement option due to the post-2007 downgrades in the credit ratings of the bond insurers. When it is available, the premium for bond insurance is typically paid as a one-time charge when the policy is issued and the insurance coverage extends for the full term of the bond issue. Under the policy of insurance issued to secure the bonds, the insurer agrees to pay the bonds if the issuer defaults.

Letters of credit issued by commercial banks have been used for some time as credit enhancements for private activity bonds. The 2007 financial crisis rendered letters of credit a less viable option, particularly for governmental bonds. The borrower usually pays an annual fee for the letter of credit and most letters of credit are issued for a term of ten years or less. Letters of credit may be of a "direct pay" or "stand-by" type depending on how the financing is structured. Bond rating agencies have established complex requirements that letters of credit must satisfy before they will be recognized by the agency in assigning a rating to the bonds.

Bond insurance policies and letters of credit issued by commercial banks are exempt from the registration requirements of the Securities Act of 1933. 15 U.S.C. § 77c(a)(2), (5), (8). Letters of credit and guarantees issued by other parties may be subject to registration with the Securities and Exchange Commission.

Since 2007, the most viable substitutes for bond insurance and letters of credit have been bond banks with credit support provided by the sponsoring states and commercial bank private placements.²⁸ In Virginia, the Virginia Resources Authority and the Virginia Public School Authority are the state-supported bond banks available to finance qualified capital projects of localities and authorities. See section 12-6.04. In recent years, commercial banks have been far more likely to prefer buying governmental bonds and holding them in their own portfolios than to provide letters of credit to support bonds sold to the public. By holding the bonds in their own portfolios, the banks are still assuming the credit risk without the complexities and uncertainties of the public bond markets.

12-3.04(b) Variable Rate Debt

The use of variable rate bonds and notes is another technique used to make the obligations of local governments more attractive to investors. The interest rate on the variable rate obligation floats with a prescribed index or formula. The obligation shifts the risk of rate fluctuations from the investor to the borrower, permitting the borrower to obtain lower financing costs in the short run. Variable rate features are often coupled with tender options to achieve even lower financing costs.²⁹

A number of different indexes and formulas are used in order to maintain the interest rate on the variable rate obligation at a current market rate. The interest rate may be set at a percentage of the rate of specified government securities or of the prime rate of a recognized commercial bank. Alternatively, the rate could be tied to some published or announced tax-exempt bond index or to the average interest rate of a list of comparable obligations. The rate could be determined periodically based on what a designated agent determines is necessary for the variable rate obligation to sell at par. Another important consideration is how often the interest rate on the obligation will be adjusted. Adjustment periods vary greatly, with the rates on short-term obligations usually being adjusted daily or weekly and the rates on long-term obligations being adjusted monthly or semi-annually.

12-3.04(c) Tender Option Bonds

In order to take advantage of short-term interest rates and at the same time issue long-term bonds, some local governments have found it advantageous to issue so-called “tender option” or “put” bonds. In such financing, a long-term (i.e., thirty-year) bond is issued, but the bondholder is given the option to tender or put the bond for purchase at par plus accrued interest on or after specified dates or after giving a prescribed notice. When bonds are tendered pursuant to such an option, they are generally remarketed to a new investor by a remarketing agent appointed by the issuer to provide the money necessary to pay the purchase price to the tendering bondholder. In this type of financing, the bondholder owns a short-term security and is willing to accept a correspondingly lower interest rate. On the other hand, assuming the bonds can be remarketed when tendered, the borrower has the advantage of long-term financing at lower, short-term interest rates.

In order to maintain the marketability of a tender option bond, the bond will provide that the interest rate will be “reset” periodically at the rates deemed necessary; therefore, it is generally necessary to adjust to remarket the bond at par. There are various ways to

²⁸ See, e.g., this Moody’s [article](#).

²⁹ See section [12-3.04\(c\)](#).

adjust the interest rate, but the most common method is for the remarketing agent to set the rate at what it determines is necessary to result in a sale of the bond at par.

If the remarketing and interest rate adjustment mechanisms work as planned, the borrower should not have to retire the bonds until their stated maturity. However, in order to ensure that tendered bonds will be purchased even if they cannot be remarketed, the borrower will be required to provide a liquidity arrangement, such as a letter of credit or line of credit from a commercial bank or insurance company. The liquidity facility will provide that, if the tendered bonds are not remarketed, they will be purchased by the provider of the liquidity facility. Often bonds held by the provider of the liquidity facility will bear a higher interest rate and must be retired by the borrower if they cannot be remarketed within a specified period of time.

There are many different varieties of tender option bond structures. These financings are complicated and involve additional participants and costs. In addition, there are risks associated with the structure. The budgets of many local governments are not flexible enough to accommodate interest rate spikes due to market dislocations. Moreover, bonds may be tendered at a time when they cannot be remarketed because of the same or similar dislocations. In such cases, the local government might have to retire the bonds or refund them in an unfavorable market. The 2007 economic crisis resulted in many tender option issues that could not be remarketed or could not be remarketed on favorable terms, resulting in a decrease in the use of tender option bonds.

12-3.04(d) Lease Financing

In recent years more and more localities are turning to lease financing as an alternative to traditional bond issues. For some time, leasing has been a popular method of financing the purchase of personal property, such as fire trucks, school buses, computers, and telephone systems. Lease financing has evolved into a mechanism frequently used by Virginia localities to finance the acquisition of land and the construction of improvements. If structured properly, the interest component of the rental payments under a lease purchase agreement will be exempt from federal and Virginia income taxes, but the lease will not be subject to the Virginia Constitutional restrictions on incurring debt. Many governmental lease financings in Virginia are now structured as lease revenue bond financings through an industrial development authority. See the discussion in sections [12-3.04\(e\)](#) and [12-7.01\(c\)](#).

Leases can be divided into two categories depending on whether the intent is to transfer beneficial ownership of the property to the lessee. A "financing lease" contemplates that the lessee will acquire ownership of the property at the end of the term of the lease either automatically or upon the exercise of a purchase option at a nominal purchase price. The rental payments under a financing lease generally approximate the purchase price of the property plus the financing cost of deferring payment. On the other hand, a "true lease" contemplates that the lessor will retain ownership of the property at the end of the lease term. If the lessee has an option to purchase the property under a true lease, the option will be based on the fair market value of the property at the time the option is exercised. The Internal Revenue Service has set forth the factors for distinguishing a true lease from a financing lease in Revenue Ruling 55-540. 1955-2 Cum. Bul. 39; see also Va. Code § 8.1A-203. No single factor is controlling. All of the facts and circumstances surrounding the transaction must be taken into account to determine the intent of the parties and the substance of the transaction. *Meiselman v. Comm'r*, 300 F.2d 666 (4th Cir. 1962); *Oesterreich v. Comm'r*, 226 F.2d 798 (9th Cir. 1955); *In re Dunn Bros.*, 16 B.R. 42 (Bankr. W.D. Va. 1981).

Section 103 of the Internal Revenue Code of 1986 excludes from gross income for federal income tax purposes interest on obligations of a state or any of its political

subdivisions.³⁰ The term “obligation” includes not only traditional bonds but also other forms of financing arrangements of a state or its political subdivisions such as financing leases. I.R.S. Priv. Ltr. Rul. 78-21-068 (Feb. 24, 1978). However, the term does not include a true lease. The financing lease must be in writing and must meet all of the requirements of I.R.C. § 103. The lease must specify the portion of rental payments that constitutes interest. If the interest component of the rental payments is not specifically segregated in the lease, no portion of the rent will be treated as tax-exempt interest. *Marsh Monument Co. v. United States*, 301 F. Supp. 1316 (E.D. Mich. 1969); *Newlin Mach. Corp. v. Comm’r*, 28 T.C. 837 (1957); *Kurtz Bros. v. Comm’r*, 42 B.T.A. 561 (1940).

In order for a financing lease not to constitute debt for the purposes of Virginia constitutional and statutory limitations, the lease cannot obligate the locality as lessee to make rental payments beyond its current fiscal year. Leases that satisfy this requirement contain a so-called “non-appropriation clause” that provides that the locality as lessee is not obligated beyond the current year to make rental payments. Because of this limitation on the locality's liability, the rental payments under the lease are considered current expenses and are not subject to the Virginia Constitution's restrictions on incurring debt. *Dykes v. N. Va. Transp. Dist. Comm’n*, 242 Va. 357, 411 S.E.2d 1 (1991); *Fairfax-Falls Church Cmty. Servs. Bd. v. Herren*, 230 Va. 390, 337 S.E.2d 741 (1985); *Baliles v. Mazur*, 224 Va. 462, 297 S.E.2d 695 (1982); 1985-86 Op. Va. Att’y Gen. 70; 1985-86 Op. Va. Att’y Gen. 86; 1984-85 Op. Va. Att’y Gen. 95; 1974-75 Op. Va. Att’y Gen. 28.

The typical financing lease includes warranties and representations by the parties, rental payment terms, the term of the lease, provisions for termination in the event of non-appropriation of funds to make rental payments, provisions for the use, operation, and maintenance of the property, and such other terms as the parties may agree to. The rental payments under the lease are “net” to the lessor, with the lessee being obligated to pay all operational costs associated with the property such as utilities, taxes, insurance, and repairs. If the financing involves the construction of a building on land already owned by the locality, the land will be ground leased or conveyed by the locality to the lessor, the building constructed, and the land and completed building leased back by the lessor to the locality.³¹ The lessor under the lease may be the manufacturer or vendor of the property, a leasing company, a developer, an investment banker, an industrial development authority, or other entity. Often the lessor will assign its interest in the lease to an investor who will provide the funds necessary to purchase or construct the property. If the size of the transaction requires multiple investors to raise the necessary funds, the lease may be assigned to a trustee who will deliver certificates of participation to the investors evidencing proportionate ownership interests in the lease and the rental payments to be made under it. The certificates of participation are issued in denominations and maturities much like bonds and may be sold in a public distribution to a number of investors.

In addition to the lease agreement, these transactions require most of the documentation usually associated with a bond issue, such as an authorizing resolution of the governing body of the locality, certificates of officials of the locality, an opinion of counsel to the locality, an opinion of tax counsel, a non-arbitrage or tax certificate, a trust agreement if certificates of participation are to be issued, and an official statement or offering circular if a public distribution of certificates of participation is anticipated.

³⁰ See section [12-4.01](#).

³¹ Note that *County Board of Arlington County v. Brown*, 229 Va. 341, 329 S.E.2d 468 (1985), holding that a county did not have the power to lease land being used as a government parking lot because of a lack of enabling legislation, was reversed by subsequent legislation. Va. Code §§ 15.2-1800 and 15.2-734; 1986 Va. Acts c. 47.

12-3.04(e) Annual Appropriation Financing

In order to provide more flexible financing arrangements and, in some cases, to increase the creditworthiness and marketability of certain revenue obligations, Virginia's localities have increasingly turned to financings backed by contractual obligations to make payments subject to annual appropriation. If structured properly, these annual appropriation contracts will not be considered "debt" for purposes of debt limit and referendum restrictions contained in the Virginia Constitution. *Dykes v. N. Va. Transp. Dist. Comm'n*, 242 Va. 357, 411 S.E.2d 1 (1991). These financings have been termed "moral obligation" financings or "subject to appropriation" financing. Historically, moral obligation financings have consisted of revenue bonds with a debt service reserve fund securing the bonds. The locality agrees to replenish any deficit in the reserve fund, subject to the appropriation of the required amount by its governing body. In recent years, annual appropriation financings have been structured using revenue bonds issued by an authority, such as an industrial development authority, water and waste authority, or a multi-jurisdictional authority or district. These revenue bonds are secured by contracts or leases with one or more localities, pursuant to which in the event of a deficiency each locality agrees to pay to the issuer of the bonds amounts sufficient to pay debt service on the bonds, subject to the annual appropriation of the required amounts by the governing body of each participating locality. These financings require careful structuring and scrutiny of the non-appropriation provisions and the legal authority of the locality to enter into the lease or contract in order to assure their validity and creditworthiness.³²

12-4 TAX CONSIDERATIONS**12-4.01 Federal Income Tax Exemption****12-4.01(a) General**

The unique feature—aside from their relatively low risk—that makes obligations of state and local governments attractive to investors is the exemption of interest from federal income taxes. Although the exemption is not based on specific language in the United States Constitution, *South Carolina v. Baker*, 485 U.S. 505, 108 S. Ct. 1355 (1988), its theoretical underpinnings derive from the federal system established under the Constitution. The income tax exemption for interest on obligations of state and local governments has been a part of the federal tax code since 1913. The current exemption is found in Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), which provides, subject to numerous qualifications and exceptions, that gross income does not include interest on the obligations of a state or its political subdivisions. I.R.C. § 103(a).

12-4.01(b) Definition of Obligation

For purposes of I.R.C. § 103, an obligation must be incurred in connection with the exercise of the borrowing power of a state or local government. *Fox v. United States*, 397 F.2d 119 (8th Cir. 1968); *United States Tr. Co. of N.Y. v. Anderson*, 65 F.2d 575 (2d Cir. 1933). Agreements to pay condemnation awards, tax refunds, and state pension benefits do not arise from the exercise of borrowing power and do not constitute obligations under section 103. *Drew v. United States*, 551 F.2d 85 (5th Cir. 1977); *Am. Viscose Corp. v. Comm'r*, 56 F.2d 1033 (3d Cir. 1932); *Newman v. Comm'r*, 68 T.C. 433 (1977); Rev. Rul. 72-77, 1972-1 C.B. 28. While the form of the obligation is not important, the local government must intend to incur a debt and agree to pay interest for the interest to be tax-exempt. *Fox, supra*. Payments under an agreement will be treated as interest only if the agreement

³² In *ACA Financial Guaranty Corp. v. City of Buena Vista*, 917 F.3d 206 (4th Cir. 2019), an authority issued bonds to finance a municipal golf course and entered into an agreement with the city whereby the city would lease and maintain the golf course. The lease agreement stated that the rental payments were subject to appropriation. The rental payments were used by the authority to service the bonds. When the city stopped appropriating money for the rental payments, the bank and guarantor sued the city and authority as third-party beneficiaries of the lease agreement. The Fourth Circuit held that there was no enforceable obligation to make the rental payments; thus, the bank and guarantor had no claim.

specifies that a portion of the payment is interest. *Newlin Mach. Corp. v. Comm'r*, 28 T.C. 837 (1957); Rev. Rul. 72-399, 1972-2 C.B. 73.

12-4.01(c) Types of Issuers

Entities that may issue obligations qualifying under section 103 of the Code include political subdivisions of a state. A political subdivision is any division of a state or local government that is a municipal corporation or that has been delegated the right to exercise part of the sovereign power of the unit. Treas. Reg. § 1.103-1(b). The entity must be delegated a portion of the sovereign power of the state to tax, to exercise the right of eminent domain, or to exercise the police power in order for the entity to constitute a political subdivision. *Comm'r v. Shamburg's Estate*, 144 F.2d 998 (2d Cir. 1944). The delegation of only an insubstantial portion of sovereign powers is not sufficient for this purpose. Rev. Rul. 77-164, 1977-1 C.B. 20; Rev. Rul. 77-165, 1977-1 C.B. 21. Even though an entity does not qualify as a political subdivision, it may still issue tax-exempt bonds under section 103 on behalf of a state or political subdivision if it satisfies certain requirements. Such entities include authorities created expressly for the purpose of issuing bonds for a public purpose and nonprofit corporations that comply with certain requirements. Rev. Rul. 57-187, 1957-1 C.B. 65, Rev. Rul. 63-20, 1963-1 C.B. 24.³³

12-4.01(d) Private Activity Bonds

A state or local bond issue is considered an issue of private activity bonds if it meets either (A) the private business use test and the private security or payment test (collectively, the "private business tests") of section 141 (b) of the Code or (B) the private loan financing test of section 141 (c) of the Code. The interest on a private activity bond is exempt from federal gross income only if it is a "qualified bond," such as an exempt small-issue manufacturing bond, a qualified 501(c)(3) bond, qualified residential rental project bonds, solid waste disposal bonds, or an airport exempt facility bond. The purposes for which qualified bonds may be issued are limited, and the restrictions on qualified bonds are significant. The interest on any state or local bond that is a private activity bond but not a qualified bond is taxable. A discussion of the limitations and restrictions on qualified bonds is beyond the limited scope of this chapter.

The private business tests for private activity bonds are satisfied if (i) more than 10 percent of the proceeds of the bonds will be used in a trade or business of a nongovernmental person, and (ii) more than 10 percent of the debt service of the issue is either secured by property used for private business use or to be derived from payments made in respect of property used for private business use. I.R.C. § 141(b). If the "private use" is unrelated or is disproportionate to governmental purpose of the financed project, the threshold for both tests is reduced to 5 percent. For the purpose of these tests, the use of bond-financed property is considered the use of bond proceeds. A "nongovernmental person" is any person or entity that is not a state or local government or any instrumentality thereof. Treas. Reg. § 1.141-1(b). For purposes of I.R.C. § 141, the federal government and its agencies and instrumentalities are considered to be nongovernmental persons. *Id.*

A full discussion of the ways in which private business use may arise is beyond the scope of this chapter. However, both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership, actual or beneficial use of property pursuant to a lease, a management or

³³ Virginia law has created certain entities, for instance, authorities under the Industrial Development and Revenue Bond Act, Va. Code § 15.2-4900 et seq., which are specifically designed to meet these criteria.

incentive payment contract, or certain other arrangements such as a take or pay or other output-type contract. Treas. Reg. § 1.141-3(b).³⁴

The private loan financing test for private activity bonds is satisfied if more than 5 percent of the bond proceeds or \$5 million, whichever is less, is used to make or finance loans to nongovernmental persons. Treas. Reg. § 1.141-5(a). A loan may arise directly from the lending of loan proceeds or indirectly where an economic benefit that is the equivalent of a loan arises, such as financing leases, installment sale arrangements, and other deferred payment arrangements. Treas. Reg. § 1.141-5(c).

For a bond issue to avoid private activity bond status, the issuer must, in general, reasonably expect, as of the issue date, that no action or event will occur during the entire term of the bonds that would cause the issue to meet either the private business tests or the private loan-financing test. A bond issue may also become a private activity bond issue if the issuer takes a deliberate action, subsequent to the issue date, that causes the bond issue to meet either the private business tests or the private loan financing test. For the purposes of these tests, an issuer's expectations are reasonable only if a prudent person in the same circumstances as the issuer would have those same expectations or take those same actions, based on all the objective facts and circumstances. The final regulations define a "deliberate action as any action within the control of the issuer." A safe harbor rule excludes from the definition (1) an involuntary or compulsory conversion under section 1033 of the Code and (2) a response to a regulatory directive made by the federal government. There are certain remedial actions that an issuer may be able to take to prevent a deliberate action from causing bonds to become private activity bonds. Treas. Reg. §§ 1.141-2 and 1.141-12.

12-4.01(e) Arbitrage

Interest on obligations that are classified as arbitrage bonds does not qualify for federal tax exemption. I.R.C. § 103(b)(2). Generally, the arbitrage provisions of the Code place limitations on the yield at which bond proceeds may be invested, impose restrictions on reserve and replacement funds, and require the rebate of arbitrage profit to the United States. I.R.C. § 148(a), (d), (f).

An obligation is an arbitrage bond if any portion of the proceeds of the obligation is reasonably expected (at the time of the issuance of the obligation) to be invested directly or indirectly in investment property that produces a yield materially higher than the yield on the issue of which the obligation is a part. I.R.C. § 148(a). The term "materially higher yield" generally means a yield one-eighth of 1 percent over the yield on the bond issue. The term "investment property" means any security, obligation, annuity contract, or investment-type property, other than certain tax-exempt bonds. I.R.C. § 148(b). The method for determining "yield" on a bond issue is set forth in detail in the Treasury Regulations. Treas. Reg. § 1.148-4. In general, the yield is the interest rate that when used in computing the present value of all payments of principal and interest on the bonds, produces an amount equal to their aggregate issue price. *Id.* The issue price of each maturity of a publicly offered bond issue is generally the price at which a substantial amount of the bonds were sold or expected to be sold. I.R.C. §§ 148(h), 1273. The issue price is not reduced for underwriter's discount or costs of issuance. Under certain circumstances, bond insurance premiums and letter of credit fees may be treated as

³⁴ Certain types of short-term leases and incidental uses of tax-exempt bond-financed property to or by nongovernmental persons will not create private business use. Treas. Reg. § 1.141-3(d)(3) and (5). In recent years, the Internal Revenue Service has liberalized the "safe harbor" rules for structuring management contracts between issuers and nongovernmental persons for the management of tax-exempt bond-financed facilities. If the safe harbor criteria are satisfied, the management contract will not constitute private business use. [Rev. Proc. 2017-13](#).

interest expense in calculating yield, if the insurance or letter of credit results in a net present value interest rate savings. Treas. Reg. § 1.148-4.

Subject to certain qualifications, the determination of whether a bond is an arbitrage bond is made based on the reasonable expectations of the issuer at the time the bonds are issued. Treas. Reg. § 1.148-2(b)(1). However, despite the expectations of an issuer, subsequent deliberate and intentional actions taken in violation of the arbitrage restrictions can cause the obligations to become arbitrage bonds. The expectations of the issuer normally are set forth in a non-arbitrage certificate executed and delivered at the time of the issuance of the bonds. The non-arbitrage certificate describes the bond issue, the use and investment of proceeds, the facts and estimates that form the basis for the issuer's expectations, and other facts important to the arbitrage analysis. Treas. Reg. § 1.148-2(b)(2)(i). A non-arbitrage certificate provides evidence of the issuer's expectations, but does not establish any conclusions of law or any presumptions regarding either the issuer's actual representations or their reasonableness. Treas. Reg. § 1.148-2(b)(2)(i). An issuer is not required to make a certification if the issue price does not exceed \$1 million. Treas. Reg. § 1.148-2(b)(2)(ii)(B).

An exception is made to the yield limitations to permit the investment of bond proceeds at a materially higher yield during certain temporary periods. I.R.C. § 148(c). There are a number of different temporary periods, but the most important is that which permits the investment of bond proceeds at an unrestricted yield for up to three years until used to pay the acquisition or construction costs of capital projects. Treas. Reg. § 1.148-2(e)(2)(i). To qualify for this three-year temporary period, the issuer must reasonably expect to meet the following three tests:

1. Expenditure Test. The expenditure test is met if at least 85 percent of the net sale proceeds of the issue are allocated to expenditures on the capital projects by the end of the three-year period.
2. Time Test. The time test is met if the issuer incurs, within six months of the issue date, a substantial binding obligation to a third party to expend at least 5 percent of the net sales proceeds of the issue on the capital projects.
3. Due Diligence Test. The due diligence test is met if completion of the capital projects and the allocation of the net sale proceeds of the issue to expenditures proceed with due diligence.

Facts supporting the qualification for the three-year temporary period are normally set forth in the non-arbitrage certificate.

Section 148(d) of the Code permits the investment of bond proceeds deposited in a reasonably required reserve or replacement fund (a "reserve fund") at an unrestricted yield. The fund is pledged to secure the bond issue and used to pay debt service on the bonds during periods when money is not available for such purpose from the revenue of the issuer or other sources. Treas. Reg. § 1.148-2(f)(2). Normally a reserve fund will be treated as "reasonably required" if it does not exceed the least of (i) 10 percent of the proceeds of the bonds, (ii) maximum annual debt service on the bonds, or (iii) 125 percent of average annual debt service on the bonds. Rev. Proc. 84-26, 1984-1 L.R.B. 468. Reserve funds are customary in revenue bond financings and the basis for supporting that the reserve fund is "reasonably required" is usually set forth in the non-arbitrage certificate. Except in rare and unusual circumstances, a reserve fund for a general obligation bond will not be treated as "reasonably required." *Id.*

12-4.01(f) Rebate Requirement

With certain exceptions, the excess of the amount earned on the investment in nonpurpose investments of the gross proceeds of the bonds over the amount that would have been earned if such proceeds had been invested at the yield on the bonds, plus any earnings from the investment of such excess, must be rebated to the United States. I.R.C. § 148(f).³⁵ The rebate requirement applies even to proceeds that may be invested at a higher yield pursuant to an exception to the investment yield restriction. Consequently, proceeds invested at an unrestricted yield for a temporary period or in a reserve fund are subject to rebate. The term "gross proceeds" is broadly defined to include original, investment, sinking fund, pledged, and replacement proceeds. I.R.C. § 148(f)(6)(B). The term "nonpurpose investments" means any investment property other than investments acquired in order to carry out the governmental purpose of the bond issue. I.R.C. § 148(f)(6)(A), (b)(2). Any amount required to be rebated must be paid to the United States in installments, at least once every five years. Each installment must be in an amount which ensures that at least 90 percent of the rebate due will be paid by the date the installment is due. The last installment must be made no later than sixty days after the last payment is made on the bonds in an amount sufficient to pay in full the balance of the rebate that is due. I.R.C. § 148(f)(3).

Governmental bond issuers may take advantage of five major exceptions to the rebate requirement. The first major exception is available if all of the gross proceeds of the bonds (other than gross proceeds held in a bona fide debt service fund or in a reserve fund) are expended within six months of the date the bonds are issued. I.R.C. § 148(f)(4)(B). A reasonable expectation to expend all of the gross proceeds of the issue within the six-month period will not satisfy the requirements of the exception; actual expenditure is required. The issuer must satisfy the rebate requirement from and after the date of issuance on any bona fide debt service fund or a reserve fund established for the bond issue. A special safe harbor rule exists for determining when proceeds of tax and revenue anticipation notes are expended. The proceeds of such note issues are treated as expended on the first day that the cumulative cash flow deficit of the issuer exceeds 90 percent of the aggregate face amount of the note issue. I.R.C. § 148(f)(4)(B)(iii).

The second major exception applies to the proceeds of a "construction issue" if certain spending requirements are met. I.R.C. § 148(f)(4)(C). The general spending requirements are met if at least 10 percent of the proceeds of the construction issue are spent for the governmental purpose of the issue within six months after the date of issuance, 45 percent are spent within one year, 75 percent are spent within eighteen months, and 100 percent are spent within two years. I.R.C. § 148(f)(4)(C)(ii). "Construction issue" means any issue of bonds if at least 75 percent of the proceeds are to be used for construction, reconstruction, or rehabilitation expenditures with respect to property that is to be owned by a governmental unit or a charitable organization. I.R.C. § 148(f)(4)(C)(iv). If only a portion of a bond issue qualifies as a construction issue, the issuer may make an irrevocable election on the date of issuance to treat that portion as a separate issue. I.R.C. § 148(f)(4)(C)(v).

A failure to satisfy one or more of the spending requirements described above will not cause an issuer to have to compute and pay rebate if it has made the penalty election described below on the date of issuance. By making this election, the issuer agrees to pay a penalty, with respect to each six-month period after the date of issuance, equal to 1.5 percent of the proceeds which, as of the close of such six-month period, are not spent in accordance with the spending requirements. I.R.C. § 148(f)(4)(C)(vii). The penalty election is irrevocable and, subject to certain provisions for terminating the penalty, will result in the issuer being liable to pay the penalty every six months for the term of the construction issue if the proceeds are not spent as required. The penalty must be paid to

³⁵ The arbitrage rebate rules can be found at Treas. Reg. § 1.148-3.

the United States not later than ninety days after the period to which the penalty relates. I.R.C. § 148(f)(4)(C)(xvi).

The third major exception to rebate applies to all issues and is met if certain spending requirements are met. The general spending requirements are met if at least 15 percent of the proceeds are spent within six months, at least 60 percent are spent within twelve months, and 100 percent are spent within eighteen months. Treas. Reg. § 1.148-7(d). This exception does not apply to an issue any portion of which is treated as meeting the rebate exception for construction issues. Treas. Reg. § 1.148-7(d)(4).

The fourth major exception to the rebate requirement is available to certain small issues of governmental bonds used to finance local governmental activities. The governmental unit issuing the bonds must have general taxing power and must reasonably expect not to issue more than \$5 million in governmental bonds in the calendar year in which the bonds to which the exception is to apply are issued. I.R.C. § 148(f)(4)(D). However, the governmental unit may issue up to an additional \$10 million in governmental bonds if such amount is attributable to financing the construction of public school facilities. I.R.C. § 148(f)(4)(D)(vii). Governmental bond issues of all subordinate entities to the issuing governmental unit, all entities which issue bonds on behalf of the issuing governmental unit, and certain other entities, must be aggregated in determining compliance with the \$5 million/\$15 million limits. I.R.C. § 148(f)(4)(D)(ii). Subordinate governmental entities include those deriving their issuing authority from another entity and those subject to substantial control by another entity.

The fifth exception is available for the earnings on a bona fide debt service fund. Such earnings are disregarded in determining the aggregate amount earned on nonpurpose investments if the gross earnings on the fund are less than \$100,000 for the bond year. If a governmental bond issue bears interest at a fixed rate and has a weighted average maturity of at least five years, then this exception applies without regard to the dollar limitation on gross earnings. I.R.C. § 148(f)(4)(A)(ii).

If an issuer fails to comply with the rebate requirement with respect to a bond issue, the interest on the bonds becomes taxable retroactive to the date of their issuance. I.R.C. § 148(f)(1). However, in lieu of the loss of tax exemption, the Treasury may treat an issue as not having violated the rebate requirement if (i) the bond in question is not a private activity bond (other than a qualified 501(c)(3) bond); and (ii) the issuer pays (subject to waiver by the Treasury) a penalty equal to 50 percent of the amount that was not rebated plus interest. I.R.C. § 148(f)(7); Treas. Reg. § 1.148-3(h).

12-4.01(g) Registration Requirement

Historically, tax-exempt bonds of state and local governments were issued in bearer form. However, since January 1, 1983, with limited exceptions, bonds have been required to be issued in registered form in order for the interest on them to be exempt under section 103 of the Code. I.R.C. §§ 103(b)(3), 149(a)(1). Excepted from this registration requirement are bonds of a type not offered to the public, bonds that mature within one year, and bonds intended to be sold outside of the United States to non-United States persons. I.R.C. § 149(a)(2); Treas. Reg. § 5f.103-1. If a bond is of a type that is offered in the public bond market, it will not be exempt from the registration requirement even though it is sold to one investor in a private placement. Treas. Reg. § 5f.103-1(b)(1), (f), Example (3). A bond is in registered form if ownership of both principal and interest payments is registered with the issuer and if the bond can only be transferred upon surrender of the bond and the reissuance of the bond or the issuance of a new bond in the new owner's name. In addition, a bond is in registered form if a book-entry system of registration is maintained by the issuer or its agent and the ownership of the bond is recorded in such system and the transfer of ownership is effected through such system. Treas. Reg. § 5f.103-1(c)(2).

12-4.01(h) Federal Guarantee Restrictions

Interest on bonds of state or local governments is not exempt under section 103 of the Code if they are "federally guaranteed." I.R.C. §§ 103(b)(3), 149(b). Bonds are federally guaranteed if (i) the payment of principal or interest on the bonds is directly or indirectly guaranteed, in whole or in part, by the United States or any of its agencies or instrumentalities, (ii) 5 percent or more of bond proceeds are used to make loans guaranteed by the United States or any of its instrumentalities, or (iii) 5 percent or more of the bond proceeds are invested, directly or indirectly, in federally insured deposits or accounts. I.R.C. § 149(b)(2). The term "guarantee" is not defined in the statute or, to date, in regulations. Exceptions to the rule are made for obligations guaranteed by the Federal Housing Administration, the Veterans' Administration, Fannie Mae, Freddie Mac, the Government National Mortgage Association, and certain other federal agencies. I.R.C. § 149(b)(3)(A). The rule also does not apply to the investment of bond proceeds for an initial temporary period until used for the purpose for which the bonds were issued, the investment of funds in a bona fide debt service fund and reasonably required reserve fund, and investments in obligations issued by the United States Treasury. I.R.C. § 149(b)(3)(B). The Internal Revenue Service has stated in a private letter ruling that the federal guaranteed prohibition does not apply to grant anticipation notes secured by the pledge of receipts from certain government grants. Rev. Rul. 85-37-037 (June 18, 1985).

12-4.01(i) Carrying Cost Deduction Restriction ("Bank Qualification")

Banks are generally not allowed to deduct from their federal income taxes interest expense incurred in acquiring and holding tax-exempt municipal bonds. I.R.C. § 265(a)(2). There is an exception for municipal bonds that are "qualified tax-exempt obligations" that allows banks to deduct 80 percent of the interest expense they incur in carrying such bonds. I.R.C. §§ 265(b)(3)(A) and 291(a)(3). Generally, a "qualified tax-exempt obligation" is a governmental bond or qualified 501(c)(3) bond (and a bond issued to refund such bonds) that is issued by a qualified small issuer for a public purpose and which the issuer designates as a "qualified tax-exempt obligation" at the time of issuance. I.R.C. § 265(b)(3)(B)(i). An issuer may be treated as a "qualified small issuer" if it reasonably anticipates that it will not issue more than \$10 million in tax-exempt obligations in the current calendar year. I.R.C. § 265(b)(3)(C)(i). Private activity bonds other than qualified 501(c)(3) bonds, however, do not count against the \$10 million limit. I.R.C. § 265(b)(3)(C)(ii)(I). Obligations of the issuer to currently refund previous obligations of the issuer also do not count against the \$10 million limit to the extent the amount of the refunding obligations do not exceed the outstanding principal amount of the refunded obligations. I.R.C. § 265(b)(3)(C)(ii)(III).

12-4.01(j) Advance Refundings

Advance refunding bonds are defined as bonds issued more than 90 days before the redemption or payment of the bonds being refunded. I.R.C. § 149(d)(2). Until December 31, 2017, bonds issued for governmental purposes and for the benefit of section 501(c)(3) organizations generally could be advance refunded one time. However, federal tax law now prohibits the issuance of tax-exempt bonds for advance refundings of other tax-exempt bonds. Generally, however, federally taxable bonds may be issued to advance refund tax-exempt bonds, and, in certain instances, tax-exempt bonds may be issued to advance refund federally taxable bonds. I.R.C. § 149(d)(1).

12-4.01(k) Information Reporting

For interest on bonds to qualify for an exemption from federal income tax, the issuer must file an information return (Form 8038 or Form 8038-G) with the Internal Revenue Service not later than the fifteenth day of the second calendar month after the close of the calendar quarter in which the bonds are issued. I.R.C. § 149(e). The report is required to contain information regarding the issuer, the bond issue, the property financed, and other matters. *Id.*

12-4.01(I) Post-Issuance Compliance

The Internal Revenue Service has instituted a “compliance check” program to follow up with randomly selected municipal bond issuers on post-issuance matters including use of facilities financed with tax-exempt bonds, arbitrage rebate, and record-keeping (see [IRS Form 14002](#)). The post-issuance compliance check program imposes a requirement that the issuer designate a person responsible for keeping certain information with respect to tax-exempt bonds. The information return ([Form 8038](#) or [Form 8038-G](#)) has been updated to require certification as to whether the issuer has written procedures to ensure that any nonqualifying bonds are remediated pursuant to the IRS Voluntary Closing Agreement Program (VCAP) and that arbitrage rules and rebate requirements are met.

12-4.02 Virginia Income Tax Exemption

Interest on bonds issued by Virginia local governments that are exempt from federal income taxation is also exempt from Virginia income taxation. Virginia taxable income is based on a taxpayer’s federal adjusted gross income subject to certain adjustments. Va. Code §§ 58.1-322 to 58.1-322.04, 58.1-361, 58.1-391, and 58.1-402. In order to determine Virginia taxable income, federal adjusted gross income is reduced by interest on obligations of the Commonwealth or any of its political subdivisions or instrumentalities to the extent such interest has been included therein and increased by interest on obligations of any state other than Virginia or any political subdivision of any such state to the extent excluded from federal adjusted gross income. Va. Code §§ 58.1-322.01(1), 58.1-322.02(2), 58.1-363, 58.1-391, 58.1-402(B)(1), (C)(2). In addition, enabling legislation grants certain issuers a specific Virginia tax exemption for interest on bonds issued by them. See, e.g., Va. Code §§ 15.2-5132 and 15.2-4912.

12-5 SECURITIES LAWS CONSIDERATIONS**12-5.01 Federal Securities Laws****12-5.01(a) Exemption from Registration**

Section 5 of the Securities Act of 1933 (the “1933 Act”) prohibits the offering or sale of securities through any means of interstate commerce or by use of the mail, unless a registration statement is in effect with the Securities and Exchange Commission (SEC) or an exemption from the registration requirement is available. 15 U.S.C. § 77e. However, Section 3(a)(2) of the 1933 Act exempts from registration “any security issued or guaranteed by any State of the United States, or by any political subdivision of a State.” 15 U.S.C. § 77c(a)(2). Consequently, bonds of local governments that are offered to the public by means of interstate commerce are not required to be registered with the SEC, and no prospectus need be used in connection with their sale. However, a disclosure document containing information similar to a prospectus may be required under the antifraud provisions of the securities laws. In the case of industrial development bonds, the exemption from registration under section 3(a)(2) of the 1933 Act is only available if the interest on the bonds qualifies for exemption from taxation under section 103 of the Internal Revenue Code. *Id.*

In recent years, the SEC has focused increasing attention on the adequacy of municipal disclosure, even though under current law it is precluded from directly regulating municipal issuers. The SEC released a “Report on the Municipal Securities Market” on July 31, 2012,³⁶ recommending broader legislative authority to regulate the content and timing of municipal financial disclosure. Under current law, regulation of municipal disclosure is accomplished by regulating the underwriters and financial advisors participating in the sale of municipal bonds. The Municipal Securities Rulemaking Board (MSRB) was created in 1975 when the U.S. Congress enacted the Securities Acts Amendments of 1975. The MSRB is a self-regulatory organization that promulgates rules regulating firms engaging in municipal securities and advisory activities. In 2012, the

³⁶ [SEC Release 2012-147](#) (July 31, 2012).

MSRB published an interpretive notice expanding the scope of MSRB Rule G-17 (governing fair dealing by municipal bond underwriters) and resulting in increased due diligence by underwriters in connection with the sale of municipal securities. This guidance was superseded by new guidance for underwriting deals commencing after March 31, 2021.³⁷

Although bonds issued by local governments are exempt from registration under the 1933 Act, the financing must be analyzed carefully to determine if some part of the transaction involves a separate security that must be registered. Examples of situations where separate securities may exist include third party guaranties, letters of credit, participation certificates, and insurance. While letters of credit issued by banks to secure bonds may be separate securities, they usually qualify for an exemption from registration under section 3(a)(2) of the 1933 Act as securities issued or guaranteed by certain banks. 15 U.S.C. § 77c(a)(2). Similarly, insurance policies issued to secure the payment of municipal bonds may qualify for an exemption under section 3(a)(8) of the 1933 Act as insurance policies issued by companies subject to supervision by the insurance commissioner or similar agency of any state. 15 U.S.C. § 77c(a)(8).

12-5.01(b) Antifraud Provisions

Securities issued by local governments, while exempt from the registration requirements of the 1933 Act, are not exempt from the antifraud provisions of sections 12 and 17 of the 1933 Act or section 10(b) of the Securities and Exchange Act of 1934 (the "1934 Act"). *Thiele v. Shields*, 131 F. Supp. 416 (S.D.N.Y. 1955). Sections 12 and 17 of the 1933 Act prohibit false or misleading statements in connection with the offer or the sale of a security. Section 10(b) of the 1934 Act and Rule 10b-5 adopted by the SEC also prohibit the making of false or misleading statements in connection with the sale of a security.³⁸ The protection of sections 12 and 17 applies only to buyers, while section 10(b) and Rule 10b-5 apply to both buyers and sellers. The antifraud principles developed by the courts in the corporate securities area are generally applicable to securities issued by local governments.

12-5.01(c) Disclosure

The document used by local governments to satisfy the information disclosure requirement of the antifraud provisions is usually called an official statement. A locality's official statement should provide the information an investor would consider important in making an informed decision to purchase the securities being offered. Official statements usually include a description of the securities being offered, a description of the project to be financed with the proceeds of the issue, detailed facts concerning the issuer, a discussion of the tax-exemption of interest, and financial statements of the issuer prepared in accordance with generally accepted accounting principles.

12-5.01(d) Rule 15c2-12

On June 28, 1989, the SEC adopted Rule 15c2-12. 17 C.F.R. § 240.15c2-12 (1989). The Rule has been amended several times since its adoption. The most recent amendments became effective February 27, 2019.³⁹ The Rule requires underwriters participating in primary offerings of municipal securities in an amount greater than \$1 million to obtain, review, and distribute to investors copies of the disclosure documents relating to the issue. The underwriter is required, before it bids for, purchases, offers, or sells any municipal

³⁷ MSRB, [Interpretive Notice concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities \(Mar. 31, 2021\)](#).

³⁸ See *Gasner v. Bd. of Sup'rs of Dinwiddie Cnty.*, 103 F.3d 351 (4th Cir. 1996) (addressing effect of cautionary language on alleged misrepresentations); see also *Caudill v. Cnty. of Dinwiddie*, 259 Va. 785, 529 S.E.2d 313 (2000) (related case) (parties to construction contract may change terms to detriment of bondholders when there is no clear indication contract intended to confer a benefit to the bondholders).

³⁹ See Amendments to Municipal Securities Disclosure, [SEC Release No. 34-83885](#) (Aug. 20, 2018); [83 Fed. Reg. 44700](#) (Aug. 31, 2018).

securities, to obtain and review a "near final" official statement from the issuer. The official statement must be deemed "final" by the issuer, except for the omission of certain pricing information to be supplied in the final official statement. The underwriter is also required to contract with the issuer to receive, within seven business days after entering into an agreement to purchase the bonds, sufficient copies of the final official statement and to provide copies of it to investors and, upon request, to potential investors.

The requirements of the Rule do not apply to bonds in authorized denominations of \$100,000 or more which (i) are sold in limited placements to no more than thirty-five sophisticated investors, (ii) have short-term maturities of less than nine months, or (iii) have short-term tender or put features that allow the investor to sell the bond to the issuer or its agent at least as frequently as every nine months, except that bonds described in clause (iii) which are issued after November 30, 2010, are subject to the continuing disclosure requirements described in section [12-5.01\(e\)](#).

12-5.01(e) Continuing Disclosure

An underwriter may not enter into a contract to provide underwriting services unless there is in place an undertaking by a party to the offering to make continuing disclosure of certain financial and other information. The undertaking must state that one party to the offering will provide (i) "annual financial information" for certain parties to the offering and (ii) notices of certain "events" concerning the offering itself and obligated persons. The required annual financial information and notices of certain events must be submitted to the Municipal Securities Rulemaking Board.

In addition, an underwriter must make a reasonable determination, prior to purchasing or selling securities in connection with a primary offering, that a sufficient undertaking has been made in a written agreement or contract for the benefit of the holders of the securities. The underwriter's reasonable determination must include verification that the undertaking party's representations are true and accurate. The undertaking may appear in a trust indenture, bond resolution, or other legislation, in a separate written agreement, or on the bond itself and must be in place at the time of delivery of the securities. The undertaking must also appear in the final official statement. An underwriter may look to provisions in the bond purchase agreement or notice of sale for assurance that the undertaking will be included, if necessary, in the final documents when prepared.

Securities with maturities of eighteen months or less are exempt from the continuing disclosure requirements of Rule 15c2-12, except the requirement to provide "event" notices. The SEC may exempt certain underwriters from the requirements of the Rule if the SEC determines that such exemption is consistent with the public interest and the protection of investors.

A local government issuer issuing bonds subject to Rule 15c2-12 will be required by the underwriter to enter into a "continuing disclosure agreement" pursuant to which the locality agrees to provide annual financial disclosure and immediate disclosure of any "events" as specified in the Rule. Most annual disclosures are required to be filed by the locality within 270 days after the close of each fiscal year; however, the deadline for submission is a matter of contractual negotiation. The SEC later revised Rule 15c2-12 to require that annual financial disclosure and material event disclosure be made through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("EMMA") system. Failure to file annual financial disclosure requires a material event filing and must be disclosed in offering documents for subsequent bond issues.

For primary offerings on or after February 27, 2019, the SEC has expanded the reportable "events" under Rule 15c2-12 and requires that notice be provided no later than ten days after the occurrence of such an "event."

Current reportable "events" listed in Rule 15c2-12 are:

1. Principal and interest payment delinquencies;
2. Non-payment-related defaults, if material;
3. Unscheduled draws on debt service reserves reflecting financial difficulties;
4. Unscheduled draws on credit enhancements reflecting financial difficulties;
5. Substitution of credit or liquidity providers, or their failure to perform;
6. Adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations regarding the tax status of the security, or other material events affecting the tax status of the security;
7. Material modifications to rights of security holders;
8. Bond calls, if material, and tender offers;
9. Defeasances;
10. Release, substitution, or sale of property securing repayment of the securities, if material;
11. Rating changes;
12. Bankruptcy, insolvency, receivership, or similar event of the obligated person;
13. The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;
14. Appointment of a successor or additional trustee or the change of name of a trustee, if material;
15. Incurrence of a material financial obligation of the obligated person, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation⁴⁰ of the obligated person, any of which affect security holders, if material; and

⁴⁰ "Financial obligation" is defined as (A) a debt obligation; (B) a derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (C) a guarantee of an obligation or instrument described in (A) or (B). The term "financial obligation" does not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with Rule 15c2-12. S.E.C. Rule 15c2-12(f)(11).

16. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties.

12-5.02 Virginia Securities Law

12-5.02(a) Exemption from Registration

Like the 1933 Act, the Virginia Securities Act ("the Act") prohibits the offering or sale of securities in the Commonwealth unless the security is registered under the Act or an exemption from registration is applicable. Va. Code § 13.1-507. The Act exempts from the registration requirement "any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state or any agency or corporate or other instrumentality of one or more of the foregoing." Va. Code § 13.1-514(A)(1). Accordingly, bonds issued by Virginia cities, towns, counties, and political subdivisions are not required to be registered under the Act. The laws of other states relating to the offering or sale of municipal securities vary considerably from state to state. Those laws should be examined by counsel before securities are offered outside of Virginia.

12-5.02(b) Antifraud Provisions

The Virginia Securities Act contains antifraud provisions similar to federal law that apply to the offer or sale of securities whether or not the issuance of the securities is exempt from the Act's registration requirement. Under the Act, it is unlawful to employ any device, scheme, or artifice to defraud or to obtain money or property by means of any untrue statement of a material fact or omission to state a material fact. Va. Code § 13.1-522(a). Any person who violates such provisions, who sells a security by means of an untrue statement of a material fact, or who omits to state a material fact is liable to the person purchasing the security for the amount paid for the security together with interest. *Id.*

12-6 METHODS OF SALE

12-6.01 General

Securities issued by local governments are sold in either competitive or negotiated sales. In a competitive sale, the issue is structured by the issuer and its financial advisors and, after public advertisement, is sold to the bidder whose bid results in the lowest interest cost to the issuer. In a negotiated sale, an investment banker participates with the issuer in structuring the transaction and then purchases the bonds from the issuer at an interest rate that is negotiated between the banker and the issuer. A private placement of bonds with a single or limited number of investors is a type of negotiated sale. The method of sale selected will depend on legal restrictions, the type of securities to be issued, the type of project to be financed, the credit strength of the issuer, market conditions at the time, and other factors.

12-6.02 Competitive Versus Negotiated Sale

While not required by statute, many Virginia localities have traditionally sold their general obligation bonds in competitive sales. In a competitive sale, the bonds being offered are sold at a public auction to the bidder who offers the lowest interest cost. Most competitive bond sales are now conducted electronically through an electronic bidding system. The issuer, usually in consultation with its financial advisor and bond counsel, determines the terms of the bonds to be offered for sale and prepares an official statement or other disclosure document that describes the bond issue and provides information about the issuer. A notice setting forth the time, date, place, and terms of the sale is posted electronically, and the official statement or disclosure document is made available to interested bidders. At the sale, the electronic bids are opened, and the bonds awarded to the bidder offering the lowest interest cost provided the bidder's bid conforms to the terms of the sale. The local government normally reserves the right to reject all bids if no acceptable offer is received.

In contrast, a negotiated sale involves the local government entering into a contract for the sale of bonds by the local government and the purchase of the bonds by a single investment banker or syndicate of investment bankers or some other purchaser such as a commercial bank. The local government preparing for a negotiated sale selects in advance the investment banker or purchaser with whom the local government will negotiate for the sale of the bonds. The investment banker or bankers selected as the initial purchasers of the bonds may also assist the issuer in structuring the terms of the bond issue and then purchase the bonds from the issuer for resale to investors. The interest rate (or rates) to be borne by the bonds is negotiated between the issuer and the investment banker as a part of the contract of sale. The issuer usually has no direct obligation to pay the investment banker for its services. The investment banker normally receives its compensation from the difference between the price it pays for the bonds and the price at which it resells them to investors.

12-6.03 Rating Agencies

Rating agencies perform an independent analysis of an issuer's creditworthiness and publish the results of that analysis for use by investors and others. The rating assigned by rating agencies to a bond provides investors with an easily recognizable scale of the issuer's capacity and willingness to repay the debt in a timely manner. Ratings are not a recommendation to purchase or sell a bond and are not the sole determinant of the interest rate a bond will bear. However, the rating assigned a bond by a recognized rating agency will have a strong influence on the interest rate an issuer will have to pay in order to attract investors to the bond.

The three major rating agencies are Moody's Investors Service, S&P Global Ratings (formerly Standard & Poor's), and Fitch Ratings, Inc. Moody's generally uses a system of nine symbols ranging from the highest investment quality, which is Aaa, to the lowest, which is C, to evaluate the credit of municipal bonds. Bonds in the top four Moody's categories (Aaa, Aa, A, and Baa) are considered to be of investment grade quality. The bond rating system of S&P generally uses ten symbols ranging from the highest quality, which is AAA, to the lowest, which is D. Bonds in the top four S&P categories (AAA, AA, A, and BBB) are considered to be investment grade. Fitch generally uses ratings symbols AAA to DDD, with ratings of AAA, AA, A, and BBB considered to be investment grade.

The rating processes of all three rating agencies are similar, but each has a different approach to the evaluation of creditworthiness. The information that must be submitted to a rating agency in order for it to assign a rating to a debt issue varies from agency to agency and depends on the type of debt instrument involved (e.g., general obligation bond, revenue bond, short-term note, etc.). Generally, however, the rating agency will want to look at information about the finances and debt structure of the issuer, its budgetary procedures, its management, the adequacy of the revenue that will be pledged to pay debt service, the economy and demography of the area in which the issuer is located, and other factors which affect creditworthiness. The agency will also review the legal documents and opinions involved in the financing for sufficiency. A report is prepared by the rating agency's credit analyst and presented to a rating committee that assigns the rating.

12-6.04 Bond Banks

12-6.04(a) General

States have created entities that are empowered to sell bonds and use the proceeds to make loans and purchase bonds of local governments. These entities facilitate the marketing of bonds which may be too small to market individually or which could not have been marketed individually due to the weak credit or lack of market recognition of the issuer. Bond banks often use letters of credit, insurance, or credit enhancements provided by the state to improve the pooled credit of the local borrowers. Some states, including Virginia, have used a "moral obligation" mechanism to provide credit enhancement.

12-6.04(b) Virginia Public School Authority

The Virginia Public School Authority (VPSA) was created by the General Assembly with the power to issue revenue bonds and use the proceeds to purchase or refinance general obligation bonds issued by Virginia localities to finance capital projects for public schools. See Va. Code § 22.1-162 et seq. VPSA is authorized to pledge to the payment of its bonds the school bonds it purchases from localities. Va. Code § 22.1-166. VPSA is also authorized to implement a pass-through of refunding savings to a locality without requiring any further local legislative action on the part of the locality. Va. Code § 22.1-167.1. It may also pledge state aid intercept payments, and any funds in the general fund of the Commonwealth appropriated for such purpose. Va. Code §§ 22.1-167.2 and 22.1-167.3. In addition, in order to enhance the credit of VPSA bonds, all notes evidencing loans made by the Literary Fund to local school boards are transferred semiannually from the Literary Fund to VPSA. These notes may also be pledged to secure the payment of bonds issued by VPSA. Local school bonds issued by counties and sold to VPSA are not subject to the referendum requirement of the Virginia Constitution. Va. Const. art. VII, § 10(b). VPSA is managed by an eight-member Board of Commissioners, and its staff is provided by the Office of the State Treasurer.

12-6.04(c) Virginia Resources Authority

The Virginia Resources Authority (VRA) was created in 1984 as a separate political subdivision of the Commonwealth to provide an additional source to finance the needs of Virginia local governments and political subdivisions for water supply, wastewater treatment, and solid waste disposal facilities. Va. Code § 62.1-197. VRA has the power to issue revenue bonds and use the proceeds to purchase bonds issued by localities and certain other local governments, including water and sewer authorities and sanitary districts, to finance or refinance the cost of water supply and wastewater treatment facilities, solid waste disposal facilities, certain drainage projects, public safety facilities, airport facilities, public transportation projects, remediation of brownfields and contaminated properties, renewable energy projects, oyster restoration, recovered gas energy facilities, the location or retention of federal facilities in the state and the support of the transition of former federal facilities to other uses, land conservation, park facilities, site acquisition for economic development, broadband, and certain other local government infrastructure. Va. Code §§ 62.1-198, 62.1-199, 62.1-203, and 62.1-204. VRA is authorized to pledge to the payment of its bonds the local bonds VRA purchases. Va. Code § 62.1-206. In addition, by the establishment of reserve funds, the credit on VRA's bonds may be enhanced and, thus, the interest cost to local borrowers reduced, by the "moral obligation" of the Commonwealth. It is empowered to use a state aid intercept program when a locality defaults on certain local obligations that are held or credit-enhanced by the Authority. Va. Code § 62.1-216.1. VRA also may enter into several types of agreements with localities that enhance its ability to collect on local obligations. Va. Code § 62.1-216(D). The General Assembly is authorized, but is not obligated, to appropriate money to VRA to make up any deficiency in certain reserve funds created by VRA. Va. Code § 62.1-215. VRA is managed by a nine-member Board of Directors and has its own staff. Va. Code § 62.1-201.

12-6.05 Role of Bond Counsel

The role of bond counsel in public financing developed in the late nineteenth century as a result of the bond issues being declared invalid due to defects peculiar to governmental law. In response to investor concern over such events, underwriters and investors began requiring that an objective opinion on the validity of a bond issue be obtained from an attorney recognized on the subject of public finance before they would purchase the bonds from the issuer. As the practice evolved, bond counsel often was retained by the issuer to supervise the conduct of the proceedings of the issuer with respect to the bond issue to insure that the opinion could be obtained when the bonds were issued. Today, the opinion of bond counsel still involves passing on the validity of the bonds, but also addresses other issues such as the exemption of interest on the bonds from federal and state taxation. Bond counsel normally prepares most of the resolutions, ordinances, and other legal documents

related to the authorization, issuance, and sale of the bonds, prepares the bonds or notes, and supervises the execution and delivery of the bonds or notes and related financing documents. In addition, bond counsel may be called upon to advise the issuer on various legal matters related to the financing and to assist with the preparation of an appropriate official statement.

Bond counsel is usually selected and retained by the issuer. The Bond Buyer's *Directory of Municipal Bond Dealers* (known as the "Red Book") contains a list of law firms that are recognized as providing specialized bond counsel services. The engagement of bond counsel services is exempt from the Virginia Public Procurement Act (Code § 2.2-4344(A)(2)); however, many Virginia localities and authorities elect to undertake some competitive process in making the selection, and in some instances state agencies will require it, for example as a condition of grant funding. Procurement of attorneys by RFP is also sometimes required by federal crosscutting rules.

12-7 SPECIAL PURPOSE ISSUERS

12-7.01 Industrial and Economic Development Authorities

12-7.01(a) Organization

The governing body of any locality in Virginia is authorized to create by ordinance an industrial development authority as a separate political subdivision for the purposes and to exercise the powers set forth in the Industrial Development and Revenue Bond Act. Va. Code § 15.2-4903. The Act has been amended to allow the locality to name its authority an "Economic Development Authority." 1999 Va. Acts ch. 157. An industrial development authority created under the Act is a separate and distinct legal entity established to perform a constitutional public purpose and is not a device to avoid the limitations imposed on the issuance of bonds by localities by the Virginia Constitution. *Indus. Dev. Auth. of the City of Chesapeake v. Suthers*, 208 Va. 51, 155 S.E.2d 326 (1967). Industrial development authorities are governed by a board of directors composed of seven people appointed by the governing body of the locality or localities creating the authority. Va. Code § 15.2-4904. Directors are appointed for terms of four years, except that the initial directors serve staggered terms prescribed by statute. *Id.* Each director must subscribe to the oath provided for in Va. Code § 49-1 before beginning his or her duties, and in general no director may be an officer or employee of the locality creating the authority. *Id.*; 1981-82 Op. Va. Att'y Gen. 301; 1979-80 Op. Va. Att'y Gen. 199; 1976-77 Op. Va. Att'y Gen. 110. Directors must reside within the boundaries of the locality with respect to which the authority is organized or within the boundaries of any adjoining locality. *Id.* Directors may be removed for failure to attend meetings or upon a unanimous vote of the board of supervisors of a county. Va. Code § 15.2-4904(A).

12-7.01(b) Purposes

The legislatively mandated purposes of industrial development authorities include the promotion of industry and the development of trade, the protection and promotion of the health of the inhabitants of the Commonwealth, the conservation, protection, and improvement of natural resources, and the protection and promotion of the safety, health and welfare of the inhabitants of the Commonwealth. Va. Code § 15.2-4901. A county, city, or town may make donations, gifts, and appropriations of money to industrial development authorities, and such authorities may make loans or grants to individuals and business entities for purposes of promoting economic development. Va. Code §§ 15.2-953 and 15.2-4905. To carry out these purposes, authorities are permitted to assist in the financing of:

1. Industrial facilities;
2. Facilities for commercial enterprises, subject to certain limitations;
3. Multi-state regional or national headquarters office or operation centers;

4. Pollution control facilities;
5. Medical facilities, including office and treatment facilities;
6. Facilities for the residence and care of the aged;
7. Facilities for private, accredited and nonprofit institutions of collegiate, elementary, secondary or graduate education in the Commonwealth whose primary purpose is to provide collegiate or graduate education and not to provide religious training;⁴¹
8. Parking facilities;
9. Facilities for use as office space by nonprofit, nonreligious or nonsectarian organizations;
10. Facilities for use by organizations described in section 501(c)(3) of the Internal Revenue Code, except organizations operated exclusively for religious purposes;⁴²
11. Facilities for use by a county, a municipality, the Commonwealth or its agencies, or other governmental organizations⁴³;
12. Enterprise zone facilities in accordance with I.R.C. section 1394. Va. Code § 15.2-4902; *Mayor of Lexington v. Indus. Dev. Auth. of Rockbridge Cnty.*, 221 Va. 865, 275 S.E.2d 888 (1981); and
13. Facilities used primarily for single or multi-family residences (provided no housing authority has been activated in the relevant locality or localities pursuant to Va. Code §§ 36-4 and 36-4.1).⁴⁴

Previously, in the case of facilities for commercial enterprises, no more than 25 percent of the proceeds of any bonds issued by an authority for such facilities could be used to provide any private or commercial golf course, country club, massage parlor, tennis club, skating facility (including roller skating, skateboard and ice skating), racquet

⁴¹ In *Virginia College Building Authority v. Lynn*, 260 Va. 608, 538 S.E.2d 682 (2000), the Virginia Supreme Court held that the Virginia College Building Authority, pursuant to the Education Facilities Authorities Act, Va. Code §§ 23-30.39 to 23-30.58, could issue conduit bonds to a pervasively sectarian institution because its primary purpose was preparing students for secular vocations, albeit from a religious viewpoint. See also *Indus. Dev. Auth. of Albemarle Cnty. v. Mohler*, 51 Va. Cir. 449 (Albemarle Cnty. 2000) (IDA conduit bonds can finance Christian day school). Moreover, no organization may be prohibited from receiving public funds as part of a neutral grant or funding program from a locality on the basis of the organization's religious status, provided the funds are used to provide community services for secular purposes without regard to the religious affiliation of the recipients. Va. Code § 15.2-953(A).

⁴² An IDA is authorized to loan its bond proceeds to a tax-exempt organization affiliated with a religious denomination when the organization's primary purpose is to provide low-income housing. 1995 Op. Va. Att'y Gen. 77.

⁴³ The Attorney General of Virginia has opined that an industrial development authority cannot finance an office building for the health and welfare department of a county. 1976-77 Op. Va. Att'y Gen. 109. Virginia Code § 15.2-4902 supersedes in part this opinion.

⁴⁴ An inconsistency in the language of Va. Code §§ 15.2-4901 (purposes) and 15.2-4902 (definition of "authority facility"), with respect to whether the power to finance residential housing applied only to industrial development authorities of municipalities or to industrial development authorities of all localities, was resolved by the Attorney General as applying to all localities, regardless of whether they are municipalities or counties. 2009 Op. Va. Att'y Gen. 58.

sports facility (including any handball or racquet ball court), hot tub facility, suntan facility, racetrack, or facility used primarily for single or multifamily residences. Va. Code § 15.1-1374(d). In addition, no more than 25 percent of the proceeds of any bonds issued by an authority for a commercial enterprise could be used to provide a facility the primary purpose of which is retail food and beverage service (excluding grocery stores), automobile sales or service, the provision of recreation or entertainment, banks, savings and loan institutions, or mortgage loan companies. *Id.* These restrictions on facilities for commercial enterprises are similar, but not identical, to restrictions on private activity bonds that were imposed by federal tax law. See I.R.C. §§ 144(a)(8), 147(e). The General Assembly subsequently amended the Industrial Development and Revenue Bond Act to remove the restrictions on the use of bond proceeds for those various recreational and entertainment sports facilities; however, commercial enterprise facilities that are taxable authority facilities constitute authority facilities only if the interest on the bonds to finance such facilities is not exempt from federal income taxation. Va. Code § 15.2-4902. The Internal Revenue Code has been amended at various times to restrict tax-exempt financing to certain limited categories of qualified projects, as described below.

If a locality has created an industrial development authority, no other industrial development authority may finance facilities, except pollution control facilities, within the boundaries of the locality unless the governing body of the locality adopts a resolution concurring in the proposed financing. Va. Code § 15.2-4905. Such approval is not required for the refinancing of an existing facility. *Industrial Dev. Auth. of the City of Roanoke v. Board of Sup'rs of Montgomery Cnty.*, 263 Va. 349, 559 S.E.2d 621 (2002).

12-7.01(c) Issuance of Bonds

An industrial development authority is authorized to issue or refinance revenue bonds to carry out its purposes, including the payment of the costs of any facilities that it is permitted to finance. All bonds issued by an authority must be payable solely from the revenue derived from the leasing or sale by the authority of its facilities or from loans made by the authority. Va. Code §§ 15.2-4901 and 15.2-4908. The bonds of an authority are not a debt of the Commonwealth or any of its political subdivisions, including the locality that created the authority, and the bonds are required to contain a statement to such effect. Va. Code § 15.2-4909.⁴⁵ The terms and details of the bonds issued by an authority are to be determined by its board of directors subject to the provisions of law. The maturity of bonds issued by an authority may not exceed forty years. Va. Code §§ 15.2-4908 and 15.2-4911.

Revenue bonds issued by industrial development authorities have become a commonly used tool for financing governmental facilities such as schools, administrative offices, libraries, jails, and courthouses. In these structures, the industrial development authority's bonds are secured by a financing agreement or lease agreement with the locality in which the locality agrees to make payments to the industrial development authority, subject to annual appropriation, in amounts sufficient to pay debt service on the bonds. The locality's obligation is not treated as debt for constitutional purposes because it is subject to annual appropriation. The authority will pledge the locality's payments to its revenue bonds. Although items of cost for most facilities financed by an industrial development authority are exempt from competitive procurement requirements under subsection B of Va. Code § 2.2-4344, facilities for ultimate ownership by a locality, the Commonwealth or its agencies or other public bodies are not exempt. Va. Code § 15.2-4902.

Whenever federal law requires a public hearing and governing body approval in order to obtain a federal tax exemption for interest paid on bonds issued by an authority,

⁴⁵ Since any bonds issued by an industrial development authority are not bonds of the county, no voter referendum is required to fund school construction through bonds issued by an industrial development authority that leases the school facilities to the county. 1995 Op. Va. Att'y Gen. 44.

Virginia law provides that the public hearing is to be conducted by the authority.⁴⁶ Notice of the public hearing containing prescribed information must be published once a week for two successive weeks in a newspaper published or having general circulation in the jurisdiction of the locality where the facility to be financed is located. The Internal Revenue Code of 1986, as amended, and regulations issued under it, also prescribe requirements that the notice of the public hearing must satisfy which are somewhat different from those prescribed by Virginia law. Notices must be carefully drafted in order to comply with the requirements of both laws. If after the hearing the authority approves the bond issue, a reasonably detailed summary of the comments expressed at the hearing, together with the authority's recommendation on the issuance of the bonds, must be submitted to the governing body of the locality creating the authority. The governing body must, within sixty days of the public hearing, either approve or disapprove the bond issue. Va. Code § 15.2-4906.

12-7.01(d) Federal Tax Considerations

In the past, most bonds issued by industrial development authorities were classified as private activity bonds under federal tax law.⁴⁷ However, industrial development authorities are increasingly being used by localities to finance governmental facilities, as discussed above. If structured properly, governmental bonds are not subject to the requirements described below for private activity bonds. Interest on private activity bonds will be excluded from gross income for purposes of federal income taxation only if the bonds and the financed projects satisfy numerous highly complex requirements. Although Virginia industrial development authorities are not empowered to issue certain types of tax-exempt private activity bonds and a detailed discussion of these requirements is beyond the scope of this chapter, a brief summary of some of the more important provisions is provided.

In order for the interest on a private activity bond to be exempt from federal income taxation, it must fit within one of seven categories of qualified bonds and comply with a number of other restrictions applicable to all private activity bonds. I.R.C. §§ 141(d), 146, and 147. The seven categories of private activity bonds qualifying for tax exemption are:

1. Exempt facility bonds;
2. Qualified mortgage bonds;
3. Qualified veterans' mortgage bonds;
4. Qualified small issue bonds (manufacturing facilities);
5. Qualified student loan bonds;
6. Qualified redevelopment bonds; and
7. Qualified 501(c)(3) bonds.

I.R.C. § 141(e).

Exempt facility bonds may be issued to finance the following types of facilities:

1. Airports;

⁴⁶ Locality approval is not required for the refinancing of an existing facility. *Indus. Dev. Auth. of the City of Roanoke v. Bd. of Sup'rs of Montgomery Cnty.*, 263 Va. 349, 559 S.E.2d 621 (2002).

⁴⁷ See section [12-4.01\(d\)](#) for definition of private activity bonds.

2. Docks and wharves;
3. Mass commuting facilities;
4. Facilities for the furnishing of water (including irrigation systems);
5. Sewage facilities;
6. Solid waste disposal facilities;
7. Qualified residential rental projects;
8. Facilities for the local furnishing of electric energy or gas;
9. Local district heating or cooling facilities;
10. Qualified hazardous waste facilities;
11. High speed intercity rail facilities;
12. Environmental enhancements of hydro-electric generating facilities;
13. Qualified public educational facilities;
14. Qualified green building and sustainable design projects;
15. Qualified highway or surface freight transfer facilities;
16. Qualified broadband projects; and
17. Qualified carbon dioxide capture facilities.

I.R.C. § 142(a).

To qualify as having been issued to finance one of the exempt facilities described above, at least 95 percent of the proceeds of the bonds must be used to provide the exempt facility, I.R.C. § 142(a), and the aggregate costs of issuance, including attorney's fees and underwriter's discount, paid from bond proceeds may not exceed 2 percent of the amount of the bonds, I.R.C. § 147(g). The costs of issuance do not count toward the 95 percent requirement.

All exempt facilities must satisfy some type of public ownership, use, or benefit requirement. Airports, docks, wharves, mass commuting facilities, and environmental enhancements of hydroelectric generating facilities must be owned by a governmental unit, although they may be leased to or managed by a private business if the lease or management contract meets certain requirements. I.R.C. § 142(b). Certain exempt facility bonds are subject to the state volume limitation on private activity bonds prescribed by § 146 of the Code.

Qualified small issue bonds may be issued to finance the acquisition, construction, and equipping of manufacturing facilities. I.R.C. § 144. The term "manufacturing facility" means any facility used in the manufacturing or production of tangible personal property, including the processing resulting in a change in the condition of such property. A manufacturing facility may include on-site offices, but the office space may not exceed that directly related to the day-to-day operations of the manufacturing facility. I.R.C. § 144(a)(12)(C). Qualified small issue bonds may be issued in an aggregate principal amount of up to \$10 million, but if the issue exceeds \$1 million, additional restrictions on the total outstanding amount of any other private activity bonds and on the amount of

capital expenditures in the city, county, or town where the facility is located will be imposed on the owner and principal users of the facility. I.R.C. § 144(a). At least 95 percent of the proceeds of the qualified small issue bonds must be used to acquire, construct, reconstruct, or improve land or property subject to an allowance for depreciation. I.R.C. § 144(a)(1). As in the case of bonds issued to finance exempt facilities, costs of issuance do not count toward this requirement, and not more than 2 percent of bond proceeds may be used to pay costs of issuance. I.R.C. § 147(g).

The small issue exemption is not available for a bond issue if the amount of the issue allocated to any beneficiary of the project being financed with the bonds plus the outstanding amount of other tax-exempt bonds (including both qualified small issue and exempt facility bonds) allocated to the beneficiary or any related person exceeds \$40 million. I.R.C. § 144(a)(10).

Qualified 501(c)(3) bonds may be issued for the benefit of organizations described in section 501(c)(3) of the Code if all of the property that is to be provided by the net proceeds of the issue is owned by the section 501(c)(3) organization or by a governmental unit. I.R.C. § 145(a)(1). In addition, the issue would not be an issue of private activity bonds if (i) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying I.R.C. § 513(a), and (ii) the 10 percent thresholds for the regular private activity bond tests are reduced to 5 percent and the tests were applied by substituting "net proceeds" for "proceeds" each place it appears. I.R.C. § 145(a)(2). Bond proceeds spent on costs of issuance are considered used for private business use and not more than 2 percent of bond proceeds may be used to pay such costs. Treas. Reg. § 1.145-2(c)(2) and I.R.C. § 147(g).

With certain limited exceptions, federal tax law prohibits the use of 25 percent or more of the proceeds of any private activity bond to acquire land. I.R.C. § 147(c). In addition, the use of 25 percent or more of the proceeds to acquire existing property is prohibited unless, in the case of an existing building, rehabilitation expenditures that equal or exceed 15 percent of the portion of the acquisition cost of the building financed with bond proceeds are made with respect to the building. For used equipment, rehabilitation expenditures must be made with respect to the equipment in an amount not less than 100 percent of the portion of the acquisition cost of the equipment financed with bond proceeds. I.R.C. § 147(d). The average maturity of any private activity bond may not exceed 120 percent of the average reasonably expected economic life of the facilities being financed with the bonds. I.R.C. § 147(b).

In order for any issue of private activity bonds to qualify for federal tax exemption, a public hearing must be held on the proposed issue after not less than fourteen days' public notice, and the issue must be approved by the governing body of the local government on whose behalf the authority issues bonds. I.R.C. § 147(f); Treas. Reg. § 5f.103-2. Also, a private activity bond will not be tax-exempt unless an information report (Form 8038) setting forth certain prescribed information is filed with the Internal Revenue Service Center on or before the fifteenth day of the second calendar month after the close of the calendar month in which the bond is issued. I.R.C. § 149(e); Treas. Reg. § 5f.103-3.

Most private activity bonds are subject to an annual volume limitation. I.R.C. § 146(a). The total aggregate principal amount of private activity bonds that may be issued in Virginia during any calendar year may not exceed a volume cap subject to an annual cost of living adjustment. I.R.C. § 146(d); Treas. Reg. § 1.103(n)-1T.⁴⁸ For the purpose of the volume limitation, the term private activity bond does not include any

⁴⁸ The amount for 2022 is \$110 per capita. Rev. Proc. 2021-45.

qualified veterans' mortgage bond, any qualified 501(c)(3) bond, any exempt facility bond issued pursuant to paragraphs (1) or (2) of section 142(a) of the Code (relating to airports, docks, and wharves), any exempt facility bond issued for a governmentally owned solid waste disposal facility pursuant to section 142(a)(6) of the Code, any facility bonds relating to environmental enhancement of hydroelectric generating facilities and high-speed intercity rail facilities, and any refunding bonds to the extent they do not exceed the outstanding principal amount of the refunded bonds. I.R.C. § 146(g), (h), (i). All other private activity bonds must receive an allocation of a portion of Virginia's annual volume limitation in order to qualify for exemption from federal income taxation. This allocation breaks down to 57 percent set aside for single family and multifamily housing bonds, 25 percent set aside for industrial development bonds for manufacturing and exempt facilities, and 18 percent set aside for state issuing authorities for allocations to housing and to exempt projects and manufacturing facilities of state and regional interests as determined by the Governor. Va. Code § 15.2-5002. Authorities may enter into contracts with prospective borrowers that require repayment of any unused private activity bond allocations. 2003 Op. Va. Att'y Gen. 40.

With certain exceptions and variations, federal tax law imposes prohibitions similar to Virginia law on the use of the proceeds of private activity bonds to finance certain facilities. I.R.C. §§ 144(a)(8) and 147(e). In addition, the registration, federal guaranty, arbitrage, and rebate restrictions previously discussed generally apply to private activity bonds. I.R.C. §§ 149(a), 149(b), and 148.⁴⁹

12-7.01(e) Virginia Tax Considerations

The income from bonds issued by an industrial development authority, including any profit made on the sale of the bonds, is exempt from all taxation by the Commonwealth or any of its political subdivisions. Va. Code § 15.2-4912.

12-7.02 Water and Waste Authorities⁵⁰

12-7.02(a) Organization

Under the terms of the Virginia Water and Waste Authorities Act, Va. Code § 15.2-5100 et seq., the governing body of any one or more localities may, after a public hearing, by ordinance or resolution, create a water authority, a sewer authority, a sewage disposal authority, a stormwater control authority, a garbage and refuse collection and disposal authority, or any combination thereof. Va. Code § 15.2-5102.⁵¹ The ordinance or resolution creating the authority must include the articles of incorporation under which the authority is to operate. Va. Code § 15.2-5103. The ordinance or resolution, or a descriptive summary of the ordinance or resolution, together with a notice of the public hearing, must be published at least once in a newspaper of general circulation within the jurisdiction of the locality or localities proposing to create the authority not less than seven days before the date of the public hearing. Va. Code § 15.2-5104. The governing body or bodies may in their discretion call a referendum on the creation of the authority if substantial opposition is heard at the public hearing. The provisions of Va. Code § 24.2-684 govern this order for a referendum. Va. Code § 15.2-5105. After the adoption of the ordinance or resolution creating an authority, the governing body or bodies must file the articles of incorporation for the authority with the State Corporation Commission. Va. Code § 52.1-5107. If the Commission finds that the articles conform to law and the estimated rates for service are fair and equitable and have been advertised as required by law, the Commission issues a certificate of incorporation. Va. Code §§ 15.2-5103, 15.2-5104, 15.2-5107, and 15.2-

⁴⁹ See section 12-4.01(d).

⁵⁰ For further discussion of water and waste authorities, see Chapter 17, Public Utilities, section 17-3.

⁵¹ The 1997 recodification substituted the less inclusive term "locality" for the broad phrase "political subdivision" to clarify the kinds of entities that have this power.

5108.⁵² Importantly for the purposes of bonds, the legality of the creation of a water and waste authority is not subject to collateral attack once the articles of incorporation are registered with the Commission. *Morrisette v. McGinniss*, 246 Va. 378, 436 S.E.2d 433 (1993).

Authorities created under the Water and Waste Authorities Act by a single locality are governed by five members, or at the option of the governing body of a county, a number of members equal to the number of members of the governing body of the county. The number of members of an authority created by two or more localities will be as specified in the articles of incorporation of the authority, but may not be less than one member from each locality. The members of an authority serve for the terms provided by the ordinance or resolution creating the authority, but no member may be appointed for a term of more than four years. Members of the governing body of the locality or directors of an industrial or economic development authority may serve as members of the authority. Alternate members, who have all of the rights of a member in the member's absence, may also be selected in the same manner as the members. Va. Code § 15.2-5113.

12-7.02(b) Powers

An authority created under the Virginia Water and Waste Authorities Act has an existence as a corporation for a term of fifty years and for such further period as may be provided by resolution of the localities then members of the authority. Va. Code § 15.2-5114.⁵³ An authority has the power, among other things, to acquire, construct, and operate any sewage disposal system, sewer system, stormwater control system, or water or waste system. Va. Code §§ 15.2-5101, 15.2-5114; *Brooks v. Roanoke Cnty. Sanitation Auth.*, 201 Va. 934, 114 S.E.2d 758 (1960); *Farquhar v. Bd. of Sup'rs*, 196 Va. 54, 82 S.E.2d 577 (1954).

12-7.02(c) Issuance of Bonds

An authority created under the Virginia Water and Waste Authorities Act has the power to issue its revenue bonds for the purpose of paying the cost of any system that it is authorized to undertake. Va. Code §§ 15.2-5114 and 15.2-5125. The bonds of an authority are not a debt of the Commonwealth or any of its political subdivisions, and the bonds are required to contain a statement to such effect on their face. Va. Code § 15.2-5131; *Farquhar v. Bd. of Sup'rs*, 196 Va. 54, 82 S.E.2d 577 (1954). The terms and details of the bonds of an authority are to be determined by its members subject to the provisions of law, but the maturity of any bonds may not exceed forty years. An authority may sell its bonds at public or private sale for such price as it may determine to be in the best interests of the authority and the localities it serves. Va. Code §§ 15.2-5125, 15.2-5130, and 15.2-5133.

12-7.03 Community Development Authorities⁵⁴

12-7.03(a) Organization

Any city may consider the petition for the establishment of a community development authority (CDA) by owners of 51 percent of the land area or assessed value of the land in a proposed authority district. The CDA may include non-contiguous tracts provided 51 percent of the owners of each such tract join in the petition. In counties and towns, the governing body, following a public hearing, may adopt an ordinance electing to consider such petitions. Va. Code §§ 15.2-5152 and 15.2-5153. The CDA may, upon petition and after a public hearing, be created by ordinance or resolution. Provisions are included for land within

⁵² The State Corporation Commission has no jurisdiction to review or revise the rates of water and sewer authorities. *Myers v. Moore*, 204 Va. 409, 131 S.E.2d 414 (1963).

⁵³ An authority does not automatically dissolve at fifty years; it must still be wound up in accordance with Va. Code § 15.2-5109.

⁵⁴ For further discussion of CDAs, see Chapter 11, Economic Development Incentives, section 11-5.02 and Chapter 17, Public Utilities, section 17-3.09.

multiple jurisdictions and the subsequent adjustment of the CDA's boundaries. Va. Code §§ 15.2-5155 and 15.2-5156. The CDA is governed by a board selected in the same manner as those for water and waste authorities; the petition may provide that the board members shall consist of a majority of the petitioning landowners or their designees or nominees. Va. Code §§ 15.2-5154 and 15.2-5113.

12-7.03(b) Powers

In addition to the powers granted in Article 3 of the Virginia Water and Waste Authorities Act, CDAs are authorized with respect to any area included therein, to finance, fund, plan, establish, acquire, construct or reconstruct, enlarge, extend, equip, operate, and maintain the infrastructure improvements enumerated in the ordinance or resolution establishing the district, as necessary or desirable to meet the increased demands placed upon the locality as a result of development within or affecting the district, see *Taubman Regency Square Assocs. v. Bd. of Sup'rs of Henrico Cnty.*, No. CH00-1304 (Henrico Cnty. Cir. Ct. May 10, 2002), including, but not limited to:

1. Roads, bridges, parking facilities, curbs, gutters, sidewalks, traffic signals, storm water management and retention systems,⁵⁵ gas and electric lines and streetlights;
2. Parks and facilities for recreational, cultural and educational uses; entrance areas; security facilities; fencing and landscaping improvements throughout the district;
3. Fire prevention and control systems;
4. School buildings and related structures, which may be leased, sold or donated to the school district, when authorized by the local governing body and the school board; and
5. Infrastructure and recreational facilities for age-restricted active adult communities.

12-7.03(c) Issuance of Bonds

In a challenge to bonds proposed to be issued by a CDA, the Virginia Supreme Court vacated a lower court decision that imposed a restrictive interpretation of the types of infrastructure a CDA is authorized to finance. Nevertheless, the Court vacated the lower court ruling on the grounds that a CDA is not a political subdivision and, therefore, may not bring a validation proceeding under the Public Finance Act of 1991. *Short Pump Town Ctr. Cmty. Dev. Auth. v. Hahn*, 262 Va. 733, 554 S.E.2d 441 (2001). The Virginia Water and Sewer Authorities Act was subsequently amended to clarify that a CDA is a political subdivision, and a 2009 amendment provides that the creation of a CDA and its bond activity "heretofore" is presumed valid. Va. Code § 15.2-5159.

12-7.03(d) Special Tax and Assessment

A CDA may request annually that the locality levy and collect a special tax on taxable real property within the CDA's jurisdiction to finance the services and facilities provided by the authority. Any such special tax shall be levied upon the assessed fair market value of the taxable real property. Va. Code § 15.2-5158; see *Taubman Regency Square Assocs. v. Bd. of Sup'rs of Henrico Cnty.*, No. CH00-1304 (Henrico Cnty. Cir. Ct. May 10, 2002). The CDA may also impose a special assessment for up to forty years on abutting property within the district to finance the services and facilities it provides to such property. Va. Code § 15.2-

⁵⁵ The Attorney General has opined that, in light of the liberal statutory language and the similarity between a retention system and a retaining wall, a CDA's power to "finance, fund, plan, (etc.)" includes retaining walls. 2022 Op. Va. Att'y Gen. 50.

5158. The statute provides that the special assessment would continue even though the land is subdivided such that the resulting lots no longer abut.

Property that abuts a portion of a system of improvements may be taxed or assessed under Article 6 of the Water and Waste Authorities Act to pay its allocable share of the cost of the entire system of improvements. Va. Code § 15.2-5158; see *also* 2006 Op. Va. Att’y Gen. 89. Multiple tax parcels owned by a single landowner may all be considered to abut an improvement when, at the time the assessment is levied, at least one such parcel abuts the improvement, each parcel adjoins another such parcel, and each parcel derives some benefit from the infrastructure improvements. Va. Code § 15.2-5158. The sale of one or more such adjoining parcels to a different owner after the levy of the assessment does affect the validity of the assessment, as such assessment may be apportioned subsequent to sale. A parcel abuts a financed improvement when it is proximate to the improvement, but physically separated by a public right of way, easement, or road. Ownership of an easement connecting property to beneficial services such as roads or water service renders the owner of such easement an abutting owner with respect to improvements to which the easement extends. *Id.*

12-7.03(e) Finance and Fund the Acquisition of Land

A CDA may finance and fund the acquisition of land within the district, subject to any statutory or regulatory jurisdiction and the permitting authority of all applicable governmental bodies and agencies. Va. Code § 15.2-5158(A)(8).

12-7.04 Sanitary Districts⁵⁶

12-7.04(a) Organization

Upon the petition of fifty qualified voters of the proposed district, or if the proposed district has less than 100 qualified voters, upon the petition of 50 percent of the qualified voters, the governing body of any city⁵⁷ or county may, after a hearing, create by ordinance a sanitary district and prescribe its boundaries. Va. Code § 21-113. At the hearing, the board must make findings of fact that the proposed district is necessary, practical, fiscally responsible, and supported by at least 50 percent of persons who own property in the proposed district. All affected residents and landowners have a right to be heard. Notice of the hearing must be published once a week for three consecutive weeks in a newspaper of general circulation within the city or county, with the first publication appearing no more than twenty-one days before the hearing. Va. Code § 21-114.

Sanitary districts are managed and operated by the governing body of the city or county in which they are located. Va. Code § 21-118; *Abbott v. Bd. of Sup’rs of Amherst Cnty.*, 200 Va. 820, 108 S.E.2d 243 (1959).⁵⁸ The governing body has the exclusive power to fix the rates and fees for the use of the system or systems of the authority, and this power cannot be delegated. Va. Code § 21-118(5); *Abbott, supra*; *Cnty. of York v. King’s Villa, Inc.*, 226 Va. 447, 309 S.E.2d 332 (1983); *Armstrong v. Cnty. of Henrico*, 212 Va. 66, 182 S.E.2d 35 (1971).

The procedure for abolishing a sanitary district is set forth in Va. Code § 21-117.1.

⁵⁶ For further discussion of sanitary districts, see Chapter 11, Economic Development Incentives, section 11-5.04 and Chapter 17, Public Utilities, section 17-4.

⁵⁷ Note that although most of the sanitary district statutory provisions refer only to counties, by operation of Va. Code § 21-112.22, “county” also means “city.”

⁵⁸ The statutory scheme generally presupposes that the districts will be encompassed by a single jurisdiction. Upon reaching an agreement with another jurisdiction, however, a sanitary district can operate outside its boundaries. 2010 Op. Va. Att’y Gen. 109.

12-7.04(b) Powers

Sanitary districts have the power to acquire, construct, and operate water supply, sewerage, garbage removal and disposal, heat, light, firefighting equipment, power and gas systems, and sidewalks within their boundaries. Va. Code § 21-118; *Marsh v. Gainesville-Haymarket Sanitary Dist.*, 214 Va. 83, 197 S.E.2d 329 (1973). The governing body of the city or county in which the district is located is authorized to levy and collect an annual tax on all property in the district subject to local taxation to pay in whole or in part the expenses incident to constructing, maintaining, and operating any facilities of the district. Va. Code § 21-118(6). In addition, sanitary districts are authorized to acquire, construct, and operate dams, motor vehicle parking lots, community buildings, community centers and other recreational facilities, and certain utility and firefighting systems, but do not have the power to levy taxes to pay the expenses of such facilities. Va. Code § 21-118.4.

12-7.04(c) Issuance of Bonds

The governing body of any city or county in which a sanitary district has been created has the power to issue bonds of the district, but the aggregate amount of bonds outstanding at any time may not exceed 18 percent of the assessed value of all real estate in the district subject to local taxation. The 18 percent limitation does not apply if the bonds are to be issued for a specific revenue-producing project. However, if after a period determined by the governing body, not to exceed five years from the date of the election authorizing the bonds, the project fails to produce sufficient revenue to pay principal and interest on the bonds, operating and administration costs of the project, and the costs of insurance, the bonds for the project will be included in the limitation. Va. Code § 21-122.

Most bond issues by sanitary districts must be approved by the voters in the district. The circuit court of the city or county in which the sanitary district is located will order an election on the issuance of bonds upon the petition of a majority of the members of the governing body of the city or county or fifty qualified voters of the sanitary district. Va. Code § 21-123. The election is conducted in the manner prescribed by law for regular elections, and, if a majority of the qualified voters of the district voting on the question approves the issuance of the bonds, the court will enter an order directing the governing body to proceed with the bond issue. Va. Code §§ 21-124 and 21-125. Bonds of a sanitary district may be issued by the governing body without voter approval to pay the cost of improvements to water or sewerage systems mandated by the State Water Control Board pursuant to the Federal Water Pollution Control Act. Such bonds may be paid only from revenue of the water or sewerage system to be improved, and no tax may be levied on property in the district to pay the bonds. Va. Code § 21-122.1. Subject to certain limitations, revenue and tax anticipation notes also may be issued by a sanitary district without voter approval. Va. Code § 21-118.4(k).

Virginia Code § 21-121.6 prevents the issuance of bonds of a sanitary district created after January 1, 1993, in counties that have created a water and sewer authority, without the approval of the governing body of the county. A referendum on the issuance of the bonds may not be held in the district unless the county requests the referendum. If the district levies a tax to pay the expenses of a project in the district, all property in the district will be taxed at its full assessed value, regardless of any special land use assessment ordinance. The sanitary district may issue bonds for water, sewer, and other systems whether they are owned by the district or the water and sewer authority. 1993 Va. Acts c. 272.

The terms and details of the bonds of a sanitary district are to be determined by the governing body of the city or county in which the district is located subject to the provisions of law, Va. Code §§ 21-122 to 21-140.3, but the maturity of any bonds may not exceed thirty-four years. Va. Code § 21-130. Bonds may not be sold at less than their par value, and the commission paid to agents to sell bonds may not exceed 3 percent. Va. Code § 21-129.

12-7.05 Other Issuers**12-7.05(a) Redevelopment and Housing Authorities⁵⁹**

The Housing Authorities Law, Va. Code § 36-1 et seq., provides that each Virginia locality has a separate political subdivision called a redevelopment and housing authority. In order to transact business or exercise any of its powers, it must be “activated” through a referendum. Va. Code § 36-4. A redevelopment and housing authority is vested with the power to issue revenue bonds for specified purposes. Va. Code §§ 36-29 to 36-35.

12-7.05(b) Park Authorities

The Park Authorities Act, Va. Code § 15.2-5700 et seq., authorizes the governing body of any one or more localities, after a public hearing, to create a park authority with the power to acquire, construct, and operate parks within or partly within and partly outside the jurisdiction of the localities. A park authority is authorized to issue revenue bonds and notes to pay the cost of acquiring, constructing, and equipping parks. Va. Code §§ 15.2-5704, 15.2-5712, and 15.2-5713.

12-7.05(c) Public Recreation Facilities Authorities

The Public Recreational Facilities Authorities Act, Va. Code § 15.2-5600 et seq., authorizes the governing body of any one or more localities, after a public hearing, to create an authority with the power to acquire, construct, and operate certain public facilities, including auditoriums, theaters, concert or entertainment halls, coliseums, convention centers, arenas, field houses, stadiums, fairgrounds, campgrounds, sports facilities, parks, zoos, and museums. An authority created under the Act is authorized to issue revenue bonds and notes to pay the cost of acquiring, constructing, and equipping any project it has the power to undertake. Va. Code §§ 15.2-5601, 15.2-5604, and 15.2-5607.

12-7.05(d) Transportation Districts

The Transportation District Act of 1964, Va. Code § 33.2-1900 et seq., authorizes any two or more counties or cities to create a transportation district with the power to adopt a transportation plan for the district in accordance with specified procedures and to acquire, construct, and operate transportation facilities in accordance with the plan. A transportation district is authorized to issue revenue bonds to pay the cost of any transportation facility it has the power to undertake. Va. Code § 33.2-1920.

12-7.05(e) Hospital or Health Center Commissions

The governing body of any one or more localities may create a hospital or health center commission as a separate political subdivision with the power to acquire, construct, and operate any hospital, health center, or other facility for the care and treatment of sick persons. Va. Code § 15.2-5200. A hospital or health center commission is authorized to issue revenue bonds or notes to pay the cost of hospital or health centers undertaken by it. Va. Code §§ 15.2-5200 and 15.2-5208 et seq.

12-7.05(f) Hospital Authorities

In each city and county in Virginia there has been created a hospital authority as a separate political subdivision, but such authority may not transact business or exercise any of its powers until the governing body adopts a resolution declaring that there is a need for the authority to function in the locality. Va. Code § 15.2-5300 et seq. Hospital authorities have the power to acquire, construct, and operate hospital facilities and to issue revenue bonds to pay the cost thereof. Va. Code §§ 15.2-5324, 15.2-5330, 15.2-5337, 15.2-5339, and 15.2-5346 et seq.

⁵⁹ For further discussion of redevelopment and housing authorities, see [Chapter 3, Redevelopment & Housing Authorities](#).

12-7.05(g) Electric Authorities

The Electric Authorities Act, Va. Code § 15.2-5400 et seq., authorizes the governing body of any one or more localities to create an electric authority as a separate political subdivision; however, no locality may participate as a member of an electric authority unless its participation has been approved by a majority of the voters of the locality voting in a referendum held on the question. Va. Code § 15.2-5405. Electric authorities have the power to acquire, construct, and operate facilities for the generation, transmission, transformation, or supply of electric power and energy, and to issue their revenue bonds to pay the cost thereof. Va. Code §§ 15.2-5406 and 15.2-5412 et seq.

12-7.05(h) School Districts and Boards⁶⁰

The governing body of any county, acting on behalf of any school district, may authorize the issuance of general obligation bonds of the school district for school purposes. Va. Code § 15.2-2642. If voter approval of the bonds is required by the Virginia Constitution, the bonds shall not be issued unless a majority of the voters of the district voting in the election held pursuant to Va. Code §§ 15.2-2610 and 15.2-2611 on the question in the district, or in each of the districts separately, approve the contracting of the debt and the issuing of the bonds. For this purpose, each magisterial district in the county constitutes a school district. *Id.*

Any school board, with the approval of the governing body of the applicable locality, is authorized to borrow money from the Virginia Retirement System for capital projects for schools. Va. Code §§ 22.1-161.1 to 22.1-161.8. Bonds to evidence the loan are issued by the school board in the name of the locality and the full faith and credit of the locality are pledged to the payment of the bonds. Va. Code § 22.1-161.3. Bonds issued by counties to the Virginia Retirement System are exempt from the referendum requirement of the Virginia Constitution. Va. Const. art. VII, § 10(b).

12-7.05(i) Sanitation Districts

The Sanitation Districts Law of 1938, Va. Code § 21-141 et seq., and the Sanitation Districts Law of 1946, Va. Code § 21-224 et seq., authorize the creation of sanitation districts in tidal and non-tidal waters, respectively, to acquire, construct, and operate sewage disposal systems and facilities. The creation of the district must be approved by a majority of the qualified voters of the district voting in a referendum on the question. Va. Code §§ 21-143, 21-149, 21-150, 21-226, 21-232, and 21-233. Sanitation districts so created have the power to issue bonds, subject to the approval of the voters at a referendum, of up to \$10 million to carry out its purposes. Va. Code §§ 21-168(6), 21-189 et seq., 21-248(6), and 21-269 et seq.

12-7.05(j) Regional Industrial Facilities Authorities

The Virginia Regional Industrial Facilities Authority Act, Va. Code § 15.2-6400 et seq., authorizes the governing bodies of any two or more localities within a region, provided that at least two or more of the localities are cities or counties or a combination thereof, to create a regional industrial facility authority by adopting ordinances proposing to create an authority with the power to develop, own, and operate one or more facilities on a cooperative basis involving its member localities. "Facilities" means any structure or park, including real estate and improvements as applicable, for manufacturing, warehousing, distribution, office, or other industrial, residential, recreational or commercial purposes, and specifically includes a structure or park that is not owned by an authority or its member localities, but is subject to a cooperative arrangement pursuant to subdivision 13 of Va. Code § 15.2-6405. Va. Code § 15.2-6400. A regional industrial facility authority is authorized to issue revenue bonds to provide funds for any valid purpose, including to develop facilities. Va. Code § 15.2-6409. Virginia Code § 15.2-6406 authorizes the governing body of the member locality in which a facility owned by an authority is located

⁶⁰ See also [Chapter 18, School Law](#).

to direct that all tax revenue collected with respect to the facility to be remitted to the authority. Such revenues may be used for the payment of debt service on bonds of the authority and other obligations of the authority incurred with respect to such facility. In addition, the member localities may agree to a revenue and economic growth-sharing arrangement with respect to tax revenues and other income and revenues generated by any facility owned by an authority or owned by a non-authority and used as part of a cooperative arrangement entered into by an authority promoting economic and workforce development. Va. Code § 15.2-6407.

12-7.05(k) Green Banks

Any locality may, by ordinance, establish a “green bank” to promote investment in and provide financing for clean energy technologies. Va. Code § 15.2-958.3:1(B). The statute defines clean energy technologies as “energy resources and emerging technologies that have significant potential for commercialization” and do not involve nuclear fission or the combustion of coal, petroleum, or municipal solid waste. Va. Code § 15.2-958.3:1(A). The green bank may be a public entity, quasi-public entity, depository bank, or nonprofit entity. Va. Code § 15.2-958.3:1(C). Private lending institutions must be allowed to participate in the green bank. Va. Code § 15.2-958.3:1(D). Prior to the adoption of an ordinance establishing a green bank, the locality must conduct a public hearing with notice. Va. Code § 15.2-958.3:1(E).

12-8 SPECIAL PURPOSE FUNDS

12-8.01 Literary Fund

The Literary Fund is a perpetual fund in which money from a number of sources is collected, including fines paid for offenses committed against the Commonwealth, unclaimed property that has escheated to the Commonwealth, and property that has been forfeited to the Commonwealth. Va. Code § 22.1-142 et seq. The Virginia Board of Education is authorized to use money in the Fund to make loans to local school boards for the purpose of constructing, altering, or enlarging school buildings. Va. Code § 22.1-148. The Board of Education is charged by statute with the responsibility of making an equitable distribution of loans from the Literary Fund among the several school divisions of the Commonwealth. Va. Code § 22.1-147. Loans from the Fund are secured by a lien on the school building financed with the loan proceeds, § 22.1-157, and the governing body of the locality whose school board has borrowed money from the Fund is required to levy taxes sufficient to pay the loan, § 22.1-158. Interest on loans from the Fund is fixed by the Board of Education, but may not be less than 2 percent or more than 6 percent per annum. Va. Code § 22.1-150. The school boards of localities are authorized to borrow money from the Fund and the borrowings are not subject to any referendum requirement of the Virginia Constitution. Va. Const., art. VII, § 10(b); Va. Code § 22.1-153; *Bd. of Sup'rs of King & Queen Cnty. v. Cox*, 155 Va. 687, 156 S.E. 755 (1931). A voter referendum is not required to fund school construction through county bonds sold to the Literary Fund to secure a loan from the Fund. 1995 Op. Va. Att’y Gen. 44. It is the policy of the Board of Education that priority on the waiting list for Literary Fund loans be given to those localities with the greatest need. Similarly, the interest rate for a particular loan is determined by the Board of Education within the statutory minimum and maximum based on the relative affluence of the locality. Most Literary Fund loans are issued as subsidized local bond issues through the Virginia Public School Authority rather than direct loans from the Literary Fund.

12-8.02 Virginia Water Facilities Revolving Fund

The Virginia Water Facilities Revolving Fund was created by the General Assembly in 1986 as a perpetual fund similar to the Literary Fund primarily to make low-interest loans or grants to Virginia localities and authorities to finance the cost of wastewater treatment facilities. Va. Code § 62.1-224. Loans also may be made to localities, public authorities, partnerships, or corporations for brownfield remediation. Va. Code §§ 62.1-229.2; 62.1-229.3. Loans are also available for stormwater management best practices. Va. Code

§ 62.1-229.4. There is to be deposited into the Fund amounts appropriated to it by the General Assembly and amounts allocated to the Commonwealth by the EPA under the Clean Water Act, 33 U.S.C. § 1251 et seq., expressly for the purpose of establishing a revolving fund. Va. Code § 62.1-225. The localities and authorities to which loans are to be made, the purposes of each loan, the amount of each loan, and the interest rate and repayment terms, which may vary between borrowers, are designated by the State Water Control Board in consultation with the Virginia Resources Authority (VRA). VRA administers the Fund and the loans made from the Fund. Va. Code §§ 62.1-225 and 62.1-229. In general, loans from the Fund are secured either by the full faith and credit of the borrower or by a pledge of specific revenue. Va. Code § 62.1-229.

12-8.03 Virginia Water Supply Revolving Fund

The Virginia Water Supply Revolving Fund was created by the General Assembly in 1987. Va. Code § 62.1-233 et seq. It is patterned after the Virginia Water Facilities Revolving Fund, except that its primary purpose is to make low-interest loans to Virginia localities and authorities and some privately-organized water suppliers to finance the cost of drinking water facilities. The Fund receives U.S. EPA grants and state matching moneys. Va. Code § 62.1-234. The borrowers to which loans are to be made and the interest rates and repayment terms are designated by the Virginia Board of Health in consultation with the VRA. Va. Code §§ 62.1-234 and 62.1-238. VRA administers the Fund and the loans made from the Fund. Va. Code § 62.1-234. Loans from the Fund may be secured either by a pledge of specific revenue or by the full faith and credit of a locality. Va. Code § 62.1-238.

12-8.04 Resilient Virginia Revolving Fund

In 2022, the General Assembly created and funded the Resilient Virginia Revolving Fund, to be administered by VRA, to make grants and loans to local governments for projects related to flooding prevention and mitigation. Va. Code § 10.1-603.28 et seq. This includes home upgrades, home buyouts for the construction of mitigation or resilience projects, assistance to low- or moderate-income homeowners for flood mitigation and prevention projects, and projects identified in the Virginia Flood Protection Master Plan or the Virginia Coastal Resilience Master Plan.