RATE COVENANTS IN MUNICIPAL BONDS: SELLING AWAY CIVIL RIGHTS AND FAIR HOUSING GOALS

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ABSTRACT

State and local governments across the United States issue municipal bonds to raise capital to cover infrastructure projects. Jurisdictions issue revenue bonds to fund projects ranging from improvements to public utilities and toll roads to convention centers and retirement communities. These revenue bonds often include a rate covenant, a provision in which the local government issuer assures bondholders that the user fees the project raises will adequately service the debt. These covenants generally do not reserve state and local governments the right to lower rates in the public interest, nor do they impose a restriction on how high the rates can go. Rate covenants have important equity implications because they control access to public services and facilities in ways that may undermine civil rights and fair housing goals. These limitless rate covenants allow local governments to sell out their constituents by accepting bond issue terms that disproportionately harm low-income people and people of color. States should modify their revenue bond statutes to require local governments to cap rate increases to protect the public interest.

The literature has treated rate covenants in normative terms, accepting them as standard features of a revenue bond issuance. Most municipal finance scholars focus on the conflict between municipalities and their creditors, arguing that mechanisms like rate covenants hold cities accountable and prevent debtors from using their political or legal leverage to avoid full repayment. This Article is the first to focus on the intersection of race and municipal finance law and centers the relationship between municipalities and their residents. It argues that when cities are negotiating

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the terms of municipal debts, they should incorporate terms that take into account their obligations under civil rights law.

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INTRODUCTION

On a cold day in February 2010, Vicki Valentine and her teenage son stood by helplessly as authorities snatched her West Baltimore home on behalf of real estate investors.[1] Her family had owned the home for thirty-three years,[2] and her father had paid off the mortgage in 1984.[3] She moved into the house after her father passed away.[4] Ms. Valentine sank into a serious depression following the death of her father and paid the wrong amount on her water bill.[5] Although she tried to make payments to catch up, she still had an unpaid balance of less than $400.[6] The City of Baltimore, however, had sold her debt to investors years earlier at a tax

1. Fred Schulte, Ben Protess, & Lagan Sebert, *The Other Foreclosure Menace*, HUFFPOST, https://www.huffpost.com/entry/the-other-foreclosure-men_n_579936 (Dec. 6, 2017).

2. *Unpaid Water Bills Leading to Foreclosed Homes*, ABC NEWS (Nov. 12, 2012, 9:17 AM), https://abcnews.go.com/Business/unpaid-water-bills-leading-foreclosed-homes/story?id=17698480.

3. Schulte, Protess, & Sebert, *supra* note 1.

4. *Unpaid Water Bills Leading to Foreclosed Homes*, *supra* note 2.

5. *Id.*

6. *A License to Steal*, BALTIMORE SUN, https://www.baltimoresun.com/2010/05/19/a-license-to-steal/ (June 4, 2019, 12:38 AM).

sale.[7] The investors piled fees and interest onto the debt until it ballooned to just over $3,600—far beyond Ms. Valentine's ability to pay.[8] Then, they put a lien on the property and sued to foreclose.[9] After a sheriff's deputy arrived at Ms. Valentine's doorstep to oversee a work crew that punched out the locks on her house, Ms. Valentine and her son had no place to go, and they ended up on the streets.[10]

Ms. Valentine was not alone. The City of Baltimore knew there was a problem looming on the horizon even before her foreclosure. By 2007, according to The Baltimore Sun, "[a]bout 400 Baltimore homeowners ha[d] lost their property to foreclosure in the past three years after falling behind on water bills."[11] The problem, however, started further back than the point at which Ms. Valentine could no longer pay her water bill. It began with municipal bonds that the City of Baltimore Department of Public Works issued to fund improvements to its water service in 1983—around the same time that Ms. Valentine's father finished paying off his rowhouse. The city renewed the bond in 1990.[12]

The official statement for the 1990 bond included a provision known as a rate covenant.[13] Rate covenants take different forms, but all of them use rates to generate profit for bondholders. Generally, a state or local government entity or agency (known as an "issuer") issues a revenue bond to fund the construction or maintenance of a particular facility or type of

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7. *Id.*
8. Schulte, Protess, & Sebert, *supra* note 1.
9. *A License to Steal*, *supra* note 6.
10. Schulte, Protess, & Sebert, *supra* note 1.
11. John Fritze, *Dixon Limits Rise in Water, Sewer Bills*, BALTIMORE SUN, https://www.baltimoresun.com/news/bs-xpm-2007-04-19-0704190084-story.html (Oct. 27, 2018, 5:05 AM).
12. MAYOR AND CITY COUNCIL OF BALT., SERIES 1990-A, PROJECT AND REFUNDING REVENUE BONDS (WATER PROJECTS) (1990) [hereinafter SERIES 1990-A], https://emma.msrb.org/MS40148-MS44677-MD85840.pdf.
13. *Id.* at 6–7. The Securities Act of 1933 exempts issuers of municipal securities from all its provisions, except where it specifically provides otherwise. *See* 15 U.S.C. § 77c(a)(2). While publicly traded companies are required to issue a prospectus that complies with the Act's detailed provisions, municipal bond issuers are indirectly required by regulation to provide "official statements" because underwriters must obtain these statements before they can recommend securities to investors. The official statement must include the terms of the bonds, information about the issuer and other entities, enterprises, funds, and accounts that are materially relevant to evaluating the offering, such as operating data and financial information. *See* 17 C.F.R. § 240.15c2-12(f)(3) (2024). The official statement must also contain a written agreement that the issuer will provide annual updates of the financial information and operating data that is included in the official statement. The issuer must also agree to provide audited financial statements (if available) and notice of specific events, such as payment delinquencies, material defaults, credit rating changes, insolvency, and the incurrence of or default under certain debt obligations. *See id.* § 240.15c2-12(b)(5). The issuer must also disclose any instances of material noncompliance with prior continuing disclosure undertakings in the last five years. *See id.* § 240.15c2-12(f)(3). These disclosure agreements are not required in some cases. *See* Heather G. White, *A Little Help from Our Friends: Moving Beyond Enforcement to Improve State and Local Government Compliance with Federal Securities Laws*, 22 N.Y.U. J. LEGIS. & PUB. POL'Y 129, 149 n.86 (2019) ("In transactions where a state or local government is issuing bonds on behalf of another entity and that other entity is solely responsible for paying debt service on the bonds, the issuer is not required to enter into such an agreement.").

infrastructure.[14] The issuer promises to investors who buy the bond issue (known as "bondholders") that the management will keep rates high enough to meet operation and maintenance expenses, renewal and replacement expenses, and to pay down, or "service," the facility's debt.[15] Another type of rate covenant requires the issuer to set rates to provide a safety margin of revenues above debt service, after the facility meets its operation and maintenance expenses.[16] But all of them use rates to generate profit for bondholders. Rate covenants also vary greatly among different types of bonds. Bonds issued for stable and monopolistic enterprises, such as water systems and power plants, have lower rate covenants in part because the high need for the service ensures that users will pay consistently.[17] By contrast, bonds issued for less stable enterprises that face competition, such as health-care institutions, have higher rate covenants.[18]

In Ms. Valentine's case, the 1990 bond that followed Ms. Valentine twenty years later sought almost $56.4 billion, which was largely to finance capital improvements for its water utility service.[19] The rate covenant stated that the City made a commitment to bondholders to "take or cause to be taken all actions necessary to ensure that [r]ates and [c]harges are assessed, established[,] and collected" in an amount that equals all of the funds necessary to operate the utility services in addition to an amount that relies purely on rate increases.[20] The rate covenant guarantees payments from "increases in [r]ates and [c]harges" that grow the utility company's revenue.[21] These revenues must be at least 120% of the greatest amount required to pay down the city's outstanding bonds and revenue notes in a given fiscal year.[22] Thus, the increases must be enough to service the city's debt, but also generate profit for bondholders. In other words, there is a floor of "at least . . . 120%" but no ceiling.[23] In every year since April 2002, Baltimore has increased its water and wastewater treatment rates, with the highest at 16% for water service in 2002.[24] The lowest increase began in July 2022, which was 3% for water service.[25] These rate

14. *See* NEIL O'HARA, SEC. INDUS. & FIN. MKTS. ASS'N, THE FUNDAMENTALS OF MUNICIPAL BONDS 56 (6th ed. 2012).
15. *See id.* at 201.
16. *See id.*
17. *See id.*
18. *See id.*
19. SERIES 1990-A, *supra* note 12.
20. *Id.* at 6.
21. *Id.*
22. *See id.* A bond is typically a debt instrument with an extended maturity date, from two to thirty years. James Chen, *Municipal Bond: Definition, Types, Risks, and Tax Benefits*, INVESTOPEDIA, https://www.investopedia.com/terms/m/municipalbond.asp (May 23, 2024). A note, however, matures within three months or up to three years. James Chen, *Municipal Note: What It Is, How It Works, Types*, INVESTOPEDIA, https://www.investopedia.com/terms/m/municipal-note.asp (June 20, 2022). In the Baltimore revenue bond at issue here, payment on the principal of the City's notes is subordinate to payment on the bonds. *See* SERIES 1990-A, *supra* note 12, at A-11.
23. SERIES 1990-A, *supra* note 12, at 6.
24. *FY 2023–2025 Water/Sewer/Stormwater Rates*, BALT. CITY DEP'T PUB. WORKS, https://publicworks.baltimorecity.gov/proposed-rates (last visited Aug. 19, 2024).
25. *Id.*

increases, however, are not always necessary. Baltimore public works officials admitted to having a surplus in 2007 and claimed that they asked for a 9% rate increase to assure credit agencies that the city could afford another loan to repair its sewer system.[26] The city admitted that the extra money could not be used for other purposes.[27] Although news articles did not fully explain the logic of this decision, one can assume the terms of the city's revenue bonds had an impact. Ms. Valentine's story is but one example of how a rate covenant—one aspect of the complicated debt instrument known as a revenue bond—affects real people and fuels inequality.

Like publicly traded companies offer stock for sale, state and local governments issue classes of securities (sometimes referred to as "offerings"), series of securities, or bonds for sale. Before the mid-1970s, general obligation bonds with standardized terms made up the bulk of these offerings.[28] Today's state and local governments, however, have shifted toward focusing on revenue bonds.[29] State and local governments across the United States rely on the issuance of municipal bonds to raise capital to cover their expenses and to finance infrastructure projects. Investors purchase the bonds and, in exchange, state and local government issuers incur debt obligations on the bonds. The U.S. municipal securities market is one of the largest sub-sovereign markets in the world. As of 2021, it represented 8% of the U.S. bond market and is valued at nearly $4 trillion.[30]

> Municipal bonds, or municipal securities, represent a promise by state or local governmental units (called the issuers) or other qualified issuers to repay to lenders (investors) an amount of money borrowed, called principal, along with interest according to a fixed schedule. Municipal bonds generally are repaid, or mature, anywhere from 1 to 40 years from the date they are issued.[31]
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> Municipal bonds are authorized and issued pursuant to express state and local laws, which impose restrictions on the size and financial structure of the debt.[32]

As "securities issued by states and their political subdivisions," municipal bonds "pay for public projects like the construction of water, sewer and

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26. Fritze, *supra* note 11.
27. *Id.*
28. *See* Christine Sgarlata Chung, *Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs*, 33 REV. BANKING & FIN. L. 663, 686 (2014).
29. *See id.*
30. CARMEN NUZZO & JASPER COX, PRINCIPLES FOR RESPONSIBLE INV., ESG INTEGRATION IN SUB-SOVEREIGN DEBT: THE U.S. MUNICIPAL BOND MARKET 9 (2021), https://www.unpri.org/download?ac=14049.
31. O'HARA, *supra* note 14, at 1 (emphasis omitted).
32. *Id.* at 5.

power plants, highways, bridges, hospitals and schools, and to meet day-to-day funding needs."[33]

The municipal securities market includes two main types of municipal bonds: general obligation bonds and revenue bonds.[34] State and local governments issue general obligation bonds to raise capital to cover expenses. These bonds rely on the state or local government's taxing powers or the issuer's full faith and credit.[35] They are also usually governed by laws that limit a state or local government's ability to incur debt without approval from voters in that jurisdiction and that constrain their ability to exceed debt limits imposed by state law, including the state constitution.[36] In other words, general obligation bonds are often backed by the issuer's power to levy taxes to repay the debt. Revenue bonds, in contrast, are "securities for which specific revenues, not governments' full faith, credit, and taxing power, are the source of repayment."[37] Jurisdictions issue revenue bonds to fund particular projects or services, which can include facilities and services ranging from public transportation to plants that provide electric power, water, wastewater treatment, resource recovery, convention centers, apartment complexes, sports stadiums, and toll roads.[38] Revenue bonds are supported by the income that the projects they fund ultimately generate, including electric rates and charges, water and sewage usage fees, waste disposal costs, and tolls.[39] They can also rely on lesser-known fees like landing fees, which are charges that airport authorities impose on aircraft for landing at their facility, and tipping fees, which are fees charged to dispose of solid waste at landfills and waste transfer stations (usually by the ton).[40] Although there are various kinds of municipal bonds and financing schemes for funding public services, this Article focuses on revenue bonds that rely on user fees charged for services to repay the bond debt (rather than revenue bonds that are repaid with proceeds from a tax on a particular set of goods or services, such as bonds to finance

33. Chung, *supra* note 28, at 683–84 (internal quotation marks omitted).
34. *See id.* at 684.
35. *See* O'HARA, *supra* note 14, at 5.
36. Chung, *supra* note 28, at 684 & n.94.
37. O'HARA, *supra* note 14, at 5.
38. *Id.*; *see also* Anoop K. Bhasin, *Tax-Exempt Bond Financing of Sports Stadiums: Is the Price Right?*, 7 VILL. SPORTS & ENT. L.J. 181, 182 (2000) (discussing revenue bond financing for sports stadiums); R. William Ide, III & Donald P. Ubell, *Financing Florida's Future: Revenue Bond Law in Florida*, 12 FLA. ST. U. L. REV. 701, 721, 725–26 (1985) (discussing revenue bond financing for convention centers).
39. O'HARA, *supra* note 14, at 5.
40. *See id.*; *What Is a "Landing Fee"?*, GLOBEAIR, https://www.globeair.com/g/landing-fee (last visited Aug. 19, 2024); *see also* Joseph G. Jarret, *Garbage, Garbage Everywhere . . . : The Effects of* United Haulers Association Inc. v. Oneida-Herkimer Solid Waste Management Authority *on Local Government Solid Waste Management*, TENN. BAR J., Jan. 2008, at 24 (defining tipping fees). Tipping fees have slightly decreased across the United States except for the Northeast, where the average tip fee has risen "$8.52, reaching $84.44, the highest among all regions." *Analyzing Municipal Solid Waste Landfill Tipping Fees*, ENV'T RSCH. & EDUC. FOUND. (May 31, 2024), https://erefdn.org/analyzing-municipal-solid-waste-landfill-tipping-fees/.

the construction of a performing arts center at a state university repaid from an increase in a city hotel, motel, or restaurant tax).[41]

Revenue bonds often come with trust indentures, which are legally binding agreements between government entities that issue bonds and trustees that represent the interests of bondholders.[42] The bonds also often carry an underwriter, who delivers the proceeds of the sale of the bonds to a commercial bank.[43] The commercial bank "act[s] as trustee under a trust indenture between the bank and the municipality. The bondholders are the beneficiaries under the trust indenture."[44] Trust indentures often include "protective covenants" that control the income source of the bond.[45] Likewise, state law provides local governments with the authority to incorporate covenants related to rates and fees collected from the underlying facility or project into bond ordinances.[46] Rate covenants are a common provision in which the issuer assures bondholders that the user fees associated with the project can or will be raised to adequately service the debt. The government entity commits to charging user rates high enough to repay the debt on the schedule in the bond offering—generally without any reservation or restriction on how high the rates may be.

These rate covenants control access to public services and facilities in ways that may undermine civil rights and fair housing goals. For example, when discussing Philadelphia's green infrastructure initiative to manage overflows from the city's combined sanitary and stormwater sewer system, public finance attorneys observed that charging residents for untreated stormwater flowing into the combined water and sewer system was critical to generating revenue to finance the program. Although Philadelphia has historically charged both water and stormwater fees in one bill, public finance attorneys have explained the importance of charging residents separately for untreated stormwater to avoid "unfairly imposing charges on those generating only wastewater or using water supplied by a local government, either for activities that generate wastewater or those, such as irrigation, [which] do not."[47] These two classes of users have demographic differences. The majority of residents across income groups "generat[e] only wastewater or us[e] water supplied by a local

41. *See, e.g.*, Drury v. City of Cape Girardeau, 66 S.W.3d 733, 735 (Mo. 2002).

42. *See Indenture*, BLACK'S LAW DICTIONARY (12th ed. 2024) (defining "trust indenture" as "[a] document setting forth the terms that govern a trustee's conduct and the trust beneficiaries' rights"); *see also* O'HARA, *supra* note 14, at 72, 174 (noting that "[t]he legal provisions of the trust indenture protect bondholders from such risks as dilution of security through the issuance of additional bonds").

43. *See* Thad Grundy, Jr., *Practical Aspects of the Deposit Insurance System*, 44 BUS. LAW. 169, 187 (1988).

44. *See id.*

45. *See* Marcel Kahan, *Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights*, 77 N.Y.U. L. REV. 1040, 1044–45 (2002).

46. Robert B. McKinstry, Jr., H. David Prior, Jennifer E. Drust, Ana C. Montalbán, & Kimberly D. Magrini, *Unpave a Parking Lot and Put Up a Paradise: Using Green Infrastructure and Ecosystem Services to Achieve Cost-Effective Compliance*, 42 ENV'T. L. REP. NEWS & ANALYSIS 10824, 10838–39 (2012).

47. *Id.* at 10835–36.

government . . . for activities that generate wastewater."[48] Other jurisdictions, such as Portland, Oregon, assess the fees separately to allow local governments to distribute the cost of services more equitably to those in the best position to bear them.[49]

Residents who also use the water supply for irrigation, which does not generate wastewater, tend to be those individuals who have lawns or own tracts of land that must be watered. Residents with lawns to irrigate tend to be moderate- to high-income homeowners or residents of single-family homes. Indeed, pride in one's lawn has long been a symbol of wealth and status as America has suburbanized and constructed more neighborhoods dominated by single-family homes.[50] Given the racial disparities in access to homeownership, this group is disproportionately white.[51] Yet a rate structure that charges each of these classes of residents the same rate to service debt on water infrastructure forces lower-income individuals who do not make the same use of water as higher income individuals—for reasons rooted in a legacy of racist housing policies[52]—to subsidize their water use and perpetuates existing inequalities.

Municipal bonds are subject to surprisingly little government regulation. They have very little federal oversight because they are exempt from most federal securities laws.[53] Revenue bonds also generally avoid regulation under state constitutional debt limitations. As a matter of state law, some states cap state or local debt service at a specific fraction of state or local taxable wealth or revenues, particularly in the context of limiting local government debt. As Richard Briffault has observed, this regime may be an effort to ensure that "new borrowing does not result in burdensome taxation or cuts in existing services" by keeping states and localities from

48. *Id.* at 10835.

49. *Id.* at 10835–36.

50. *See, e.g.*, VIRGINIA SCOTT JENKINS, THE LAWN: A HISTORY OF AN AMERICAN OBSESSION 2 (Lorraine Atherton ed., 1994); TED STEINBERG, AMERICAN GREEN: THE OBSESSIVE QUEST FOR THE PERFECT LAWN 76–77 (2006); Caleigh Wells, *Los Angeles Should Lose Its Lawns, Some Say*, NPR (June 8, 2022, 5:05 PM ET), https://www.npr.org/2022/06/08/1103785093/los-angeles-should-lose-its-lawns-some-say (including an interview with a California homeowner who pays $175 a month to water his lawn, in which homeowner commits to "rip up the concrete driveway [of his home] and put in more lawn" rather than reduce the amount of water-consuming grass and foliage because "I grew up saying that you can judge a man by his lawn, so the lawn ain't [sic] going.").

51. For example, in 2022, 74.6% of white households owned their homes, compared with 45.3% of Black households—a gap of more than 29 points. The gap today is even wider than it was sixty years ago. In 1960, the white homeownership rate was 65%, and the Black rate was 38%—a 27-point gap. Tim Henderson, *Black Families Fall Further Behind on Homeownership*, STATELINE (Oct. 13, 2022, 12:00 AM), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2022/10/13/black-families-fall-further-behind-on-homeownership; *see also* KENNETH T. JACKSON, CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES 5–8 (1985); Nadiyah J. Humber, *A Home for Digital Equity: Algorithmic Redlining and Property Technology*, 111 CAL. L. REV. 1421, 1435 (2023) (noting that "federally backed policies incentivizing homeownership were primarily for white people during the suburbanization boom of the 1950s").

52. *See* RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA 60–63 (2017) (detailing the federal government's role in subsidizing home ownership exclusively for white Americans through redlining and denying mortgage insurance to communities of color and homes in racially integrated neighborhoods).

53. *See* Chung, *supra* note 28, at 736–44; 15 U.S.C. § 77c(a)(2) (providing for exemption for municipal debt instruments under Securities Act of 1933).

taking on debt beyond their means.[54] These limits, however, largely apply to general obligation bonds rather than revenue bonds. Revenue bonds are "typically not subject to the constitutional limitations that apply to general obligation debt" by virtue of state judicial interpretation or, in some states, constitutional amendments.[55] Many courts have construed revenue bonds as what Briffault describes with the oxymoron "non-debt debts."[56] Indeed, states have exempted these kinds of bonds from debt limitations that otherwise support the regulation of general obligation bond debt. As a result, the terms under which state and local governments issue revenue bonds are subject to very few restrictions that are designed to protect the public interest.

Scholars discussing debt service on revenue bonds often address regulating payments during a disaster on the back end—namely, municipal bankruptcy, fiscal distress, or insolvency.[57] Likewise, courts have addressed situations in which states have passed laws that would impair an obligation under an existing bond covenant.[58] Laws that have attempted to divert revenue in violation of an existing bond covenant attempt to deal with unaffordability on the back end, after the fact.[59] However, the terms under which governments can issue revenue bonds on the front end and the promises they can make to bondholders to support these bonds receive less attention. This Article focuses on the failure to address the affordability issue on the front end as a policy matter.

The literature around municipal debt finance law also tends to center the interests of municipalities' creditors rather than those of actual residents. Scholarship on debt service for cities in fiscal distress often addresses how the law facilitates actual or potential conflict between cities and their creditors.[60] Where there is attention to effects on residents, it is

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54. Richard Briffault, *The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 916 (2003).

55. *Id.* at 918.

56. *Id.*

57. *See, e.g.*, Clayton P. Gillette, *Saving Cities or Exploiting Creditors?: State Redirection of Municipal Assets*, 48 FORDHAM URB. L.J. 753, 764–65 (2021).

58. *See, e.g.*, Hutchinson, Shockey, Erley & Co. v. Evansville-Vanderburgh Cnty. Bldg. Auth., 644 N.E.2d 1228, 1234 (Ind. 1994) (refusing to allow "units of government to override the maturity and redemption provisions of outstanding bonds and indentures in unfavorable interest rate environments, depriving bondholders of their high-rate securities," because "[g]overnment has no power to impair a contract in this way"); Bd. of Comm'rs of Clark Cnty. v. Woodbury, 187 F. 412, 414 (8th Cir. 1911); Brewis v. City of Duluth, 9 F. 747, 748–49 (C.C.D. Minn. 1881).

59. *See, e.g.*, U.S. Tr. Co. v. New Jersey, 431 U.S. 1, 3 (1977) (striking down law retroactively repealing a bond covenant enacted prior to the statute where the statute "limited the ability of the Port Authority of New York and New Jersey to subsidize rail passenger transportation from revenues and reserves" pledged as security for consolidated bonds issued by the Port Authority).

60. *See* Gillette, *supra* note 57, at 799; Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 FORDHAM URB. L.J. 639, 644–45 (2012) [hereinafter Gillette, *Bondholders*]. The control that creditors have over government debt may be a reason why Gillette makes the claim

> that public credit can enhance democracy not simply because the desire to attract credit generates institutions that check the exercise of executive discretion, but also because

in the context of fiscal distress—centering on when insolvency law should limit the imposition of austerity measures, which cause a city's debt to impact its residents' quality of life.[61] This Article interrogates how municipal debt should shape public policy going forward, outside the context of financial crises.

The costs of municipal debt for residents and taxpayers receive little attention compared to the triad of the state, the creditor, and the public.[62] In *Bondholders and Financially Stressed Municipalities*, Clayton P. Gillette examines how the law resolves bondholders and residents' competing claims to tight municipal budgets.[63] He argues that local government law should balance interests of creditors and current residents in situations outside of when a city is in fiscal distress.[64] This Article centers the conflict between municipalities and their residents rather than the conflict between the municipality and its creditors in the context of municipal debt. The issue is how cities prospectively set up their obligations and the limits of the terms under which they will offer revenue bonds, not the effort to impair bondholders' interest in collecting on existing debts. Indeed, the structure of statutes that authorize state and local governments to enter into rate covenants suggests that municipalities focus too heavily on the demands of their potential investors—their sought-after creditors—at the expense of their most vulnerable residents.[65]

In addition to only addressing disaster on the back end and focusing only on municipalities' creditors, scholars discuss rate structures that government bond issuers choose rather normatively. Scholars emphasize the fact that a revenue bond financing structure must "generate[] sufficient rate charges to pay debt service, or principal and interest payments on the bonds as they become due," with little if any discussion of how this requirement may run counter to the public interest.[66] Indeed, many government officials may not appreciate the importance of the rate covenants in bond indentures to which they become signatories. Experienced municipal advisors to government debtors report that "government officials d[o] not

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> creditors have incentives to monitor the exercise of that discretion in ways that overcome limits on the capacity of constituents to deploy those democratic institutions.

Clayton P. Gillette, *Can Public Debt Enhance Democracy?*, 50 WM. & MARY L. REV. 937, 950 (2008) [hereinafter Gillette, *Public Debt*]. Citizens wind up relying on creditors to constrain the choices of government because many constituents have so little power to intervene directly.

61. *See, e.g.*, Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1129 (2014).

62. *See* Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1481–87 (2013) (discussing ways in which residents bear the burden of onerous debt terms despite the low default rates associated with municipal bonds); Briffault, *supra* note 54, at 920 (highlighting the diminishing regulation of state and local government debt under state constitutional law and jurisprudence as courts narrow the types of debt subject to regulation under state constitutions).

63. Gillette, *Bondholders*, *supra* note 60, at 641.

64. *See* Anderson, *supra* note 61, at 1122.

65. *See infra* Section I.A.

66. *See* McKinstry Jr., Prior, Drust, Montalban, & Magrini, *supra* note 46, at 10835–36.

always understand the implications of the financial instruments that they used."[67] While that may be the case for some of the more complex elements of a debt instrument, such as its amortization schedule or liquidity restrictions, the consequences of agreeing to charge rates as high as necessary to service the debt—without a clear right to limit rates—should be much easier to grasp.

The normative approach to rate covenants, which takes for granted the need to charge rates high enough to service debt, is consistent with the growing trend toward privatization of municipal services.[68] Government officials who agree to bond ordinances and trust indentures that require them to charge whatever rates are necessary to pay back the debt—without any contracted-for restriction on how high those rates might go—demonstrate that they view individuals who must eventually pay the rates demanded as persons paying dues for the services they receive. Gerald Frug has referred to residents of exclusive enclaves developing a "consumer-oriented vision" of local government, as they come to see their local government as providing services for taxpayers with wealth levels similar to their own.[69] In the same way, cities respond to their residents' perceptions and come to see the costs of these services like "country club dues."[70] "[T]he 'dues mentality' pervades many aspects of local governments' never-ending quest to raise more money."[71] While it is true that fees have "overtaken general taxation as the preeminent revenue raising device"[72] for many local governments, one must not overlook how these fees are often charged to pay back municipal debt under promises made to largely nonresident bondholders.

This Article is the first in legal literature to examine the intersection of the terms of municipal bond offerings and racial and wealth inequality. It critiques the practice of state legislatures granting state and local governments the power to agree to rate covenants that make no exception to allow the issuer to lower or adjust rates to protect affordability for residents. It also draws on the work of scholars who have highlighted how physical features of a community make it difficult for certain

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67. Lori Raineri & Darien Shanske, *Municipal Finance and Asymmetric Risk*, 4 BELMONT L. REV. 65, 67 (2017); *see also* DESTIN JENKINS, THE BONDS OF INEQUALITY: DEBT AND THE MAKING OF THE AMERICAN CITY 129 (2021).

68. *See* Leonard Gilroy, *Policy Brief 86: Local Government Privatization 101*, REASON FOUND. (Mar. 16, 2010), https://reason.org/policy-brief/local-government-privatization-101/ ("Over the last half century, governments of all political complexions have increasingly embraced privatization—shifting some or all aspects of government service delivery to private sector provision—as a strategy to lower the costs of government and achieve higher performance and better outcomes for tax dollars spent."). There is, however, a tendency for urban jurisdictions and rural communities in the South to avoid privatization. *See id.*; Olurominiyi Ibitayo, *Privatization of Municipal Services In Mississippi: What Have Location, Fiscal Stress and Absence of Public Employees' Unions Got To Do With It?*, 30 HUMBOLDT J. OF SOC. RELS. 53, 55 (2006).

69. Gerald E. Frug, *City Services*, 73 N.Y.U. L. REV. 23, 30–31 (1998).

70. *Id.* at 29–30.

71. Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay for" Model of Local Government*, 56 FLA. L. REV. 373, 376 (2004) (footnote omitted).

72. *Id.* at 376.

individuals—namely people of color and poor people—to access certain spaces.[73] For example, a rate covenant in a revenue bond issued to finance the opening of a convention center or stadium may require the issuing jurisdiction to charge rates to use or enter the facility that become cost-prohibitive for lower-income residents, who are often disproportionately people of color. Likewise, a bridge that must charge a series of tolls to finance debt service can make it unaffordable for certain individuals to access an exclusive neighborhood, beach, or park. These forms of exclusion become particularly salient as Black Americans still face harassment for taking up space in areas where people believe they do not belong.[74]

To some extent, the principle of equitable distribution of costs is built into the concept of municipal securities. The "nexus of the municipal bond market"[75] relies on the theory that state and local governments take out debts to spread out the cost for a public facility over time so multiple generations are responsible for the debt instead of one set of residents.[76] As finance expert Neil O'Hara explains,

> [r]oads, transit systems, schools, water and sewer systems, police and fire stations, parks and numerous other projects are vital components of transportation, education, public safety, and environmental policy. Because these projects often have useful lives measured in decades, it would be unfair and impractical to expect current citizens to bear the entire cost of these often very expensive investments. Instead, most states and communities choose to borrow to finance public capital investment and to retire that borrowing over time.[77]

Distributing costs over time is also a practical necessity:

> [I]f debt payments are not spread out, then big projects like this could hardly ever be built. It is likely that a major capital project is as large as the city's entire operating budget. It would take a long time for a municipality to save that much money. Accordingly, pay-as-you-use (pay-use or debt) financing has dominated pay-as-you-go (pay-go or cash) infrastructure financing for a very long time.[78]

State and local governments structure bonds with a view toward leveling out the burden that financing a facility imposes on residents across time. That same concern should apply when state and local governments exercise their power to raise rates. They should incorporate an analysis of how a rate increase will affect users across the population. Not all residents

73. *See, e.g.*, Sarah Schindler, *Architectural Exclusion: Discrimination and Segregation Through Physical Design of the Built Environment*, 124 YALE L.J. 1934, 1953–88 (2015).

74. *See* Christopher J. Tyson, *The Impact of Municipal Fiscal Crisis on Equitable Development*, 48 FORDHAM URB. L.J. 883, 904 (2021); Taja-Nia Y. Henderson & Jamila Jefferson-Jones, *#LivingWhileBlack: Blackness As Nuisance*, 69 AM. U. L. REV. 863, 863 (2020); Elise C. Boddie, *Racial Territoriality*, 58 UCLA L. REV. 401, 434–46 (2010).

75. O'HARA, *supra* note 14, at ix.

76. *Id.*; *see also* Raineri & Shanske, *supra* note 67, at 69.

77. O'HARA, *supra* note 14, at ix.

78. Raineri & Shanske, *supra* note 67, at 69.

should bear equal costs in terms of rates they pay to service the debt of any given public facility. A jurisdiction may decide to charge different rates depending on residents' incomes.[79] A bond issuer may also decide not to raise rates above certain amounts because of this impact—or if it does have to raise rates, it may charge different classes of individuals different rates or offer discounts based on income.

This Article proceeds in three parts. Part I delves into the role of revenue bonds in the municipal debt market and the structure of state laws that regulate them. It also frames the phenomenon of limitless rate covenants within the context of the declining commitment to enforcing state and local debt limits caused by state constitutions. As revenue bonds evade state constitutional debt limitations, rate covenants become even harder for taxpayers to challenge, and therefore rates become harder to rein in. Part II focuses on the fair housing and civil rights implications of these rate covenants. It focuses on three contexts in which rate covenants most directly affect lower-income people and people of color: public utility services, toll roads, and housing for seniors. These serve as case studies linking revenue bonds with people's everyday lives and futures. Finally, Part III analyzes the standard responses to the harms that rate covenants generate—voter referenda, litigation, and public opposition—and their limited utility. Part IV discusses alternatives to rate caps that may also mitigate the inequities that rate covenants currently create. It ultimately proposes, however, that states modify their revenue bond statutes to provide a right to cap rate increases. While potential investors may balk at any limit on ensuring repayment of their investment, even a marginal one, this Article argues that by imposing limits on the front end, rate caps promote predictability and stability in revenue bond repayment schemes in ways that address creditors' longstanding fear that cities will shirk their obligations by changing the terms of a bond offering on the back end. Likewise, rate caps are consistent with a return to the fiscal responsibility at the heart of protecting the public from excessive amounts of debt—which ultimately falls on residents.

79. Courts have repeatedly upheld a classification of residents' income for water users, for example, and fixing different rates for different classes of users is permissible where the classification has a rational basis and is consistent with equal protection principles. *See* Applegate, LP v. City of Frederick, 179 F. Supp. 3d 522, 531–33 (D. Md. 2016); Brittany Park Apartments v. Harrison Charter Twp., 443 N.W.2d 161, 163 (Mich. 1989) ("[I]t is undisputed that the municipality has a right to charge for the services it provides to the community" and "it has the right to rationally impose classifications upon its users so long as all persons within the class are treated alike."); Eudora Dev. Co. of Kansas v. City of Eudora, 78 P.3d 437, 440 (Kan. 2003) ("Neither the common law nor the statutes forbid reasonable classification of rates or discrimination so long as it is not unjust, but is reasonable in view of substantial differences in services or in conditions of service."). The same is true with tolls for toll roads. *See* Selevan v. N.Y. Thruway Auth., 584 F.3d 82, 96 (2d Cir. 2009) (finding that rate structure for highway tolls was permissible by providing a discount to residents of certain municipalities where it did not discriminate against interstate commerce in violation of the Dormant Commerce Clause).

I. THE MUNICIPAL REVENUE BOND MARKET AND RUNAWAY RATE COVENANTS

A. Rate Covenant Statutes

State statutes generally set the limits on which units of state or local government may issue revenue bonds. The most common types of entities that may serve as issuers include states, acting through individual departments or a cabinet-level board; independent state authorities and commissions; counties; municipalities; special districts with taxing powers, such as school districts and water districts; and independent authorities or commissions. These entities may include agencies that do not have the power to tax, such as housing authorities and industrial development.[80] In the case of counties and municipalities, states have an enabling statute that almost always require them to initiate borrowing through a local ordinance or resolution.[81] The ordinance or resolution must provide for the bond issue's key terms, including the terms of maturity, the amount of the bond, and maximum interest rates. The enabling statute limits the flexibility of local governments with regard to the provisions of the ordinance or resolution by setting limits on the terms.[82] For any municipal bond issue, "[t]he bond resolution, the indenture, and the trust agreement are the heart of the issue's legal structure."[83] These documents form "[t]he key elements of the contract between the issuer and the bondholders."[84] They "cover the mechanics of the issue, including the principal and interest payment dates, [and] method[s] and place of payment."[85] They also establish important funds associated with the bond, such as the construction fund, the debt-service fund, and required reserves.[86] The indenture specifically includes the "flow of funds," which is a pledge that establishes the order of priority for who will receive payment on the bond from the revenue it generates, namely between payments for operating and maintenance expenses and payment of interest or principal to bondholders.[87] The foundational documents for a bond issue also include key financing, operating, and tax

80. 2 GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING § 12:6 (2d ed. 2023).
81. *Id.* § 12:11.
82. *Id.*
83. O'HARA, *supra* note 14, at 72.
84. *Id.*
85. *Id.*
86. *Id.*
87. *See Bond-Basics: Flow of Funds*, NAT'L ASS'N OF BOND LAWYERS, https://www.nabl.org/bond-basics/flow-of-funds/ (last visited Aug. 20, 2024). There are two major forms by which flow of funds provisions are structured in a bond issuance: net revenue pledge and gross revenue pledge. *Analyzing the Credit Quality of Revenue Municipal Bonds*, TAMAR SECURITIES, https://www.tamarsecurities.com/Municipal-bond-presentation-analyzeRev.aspx (last visited Sept. 12, 2024). In a net revenue pledge, the revenue is first applied to cover operating and maintenance expenses and all the bondholders receive interest and principal payments from the amount of revenue remaining. *See id.* In a gross revenue pledge, the issuer pays the bondholders interest and principal first, and then pays operating and maintenance expenses. *See id.* Gross revenue pledge provisions "improve[] the credit quality" for bondholders. *Id.* They raise, however, serious concerns about the impact a shortfall can have if sufficient funds are not left over to cover the service's operating expenses or maintenance costs.

covenants, and the types of investments the issuer can make with the monies held in bond funds.[88] Finally, the indenture describes what triggers a default and a bondholder's remedies in the event of a default.[89]

State law allows a bond issuer to enter into certain types of covenants based on their topic, such as "the marketability and security of debt obligations, including covenants respecting the collection and use of project revenues, creation of security interests in such revenues, establishment of reserve funds, and delegation to a trustee of the right to enforce bond covenants."[90] At the moment the investor purchases the bond, the covenants become effective and form an enforceable contract between the issuing state or local government and the purchaser.[91]

State law also restricts the topics a covenant may cover and the terms a promise may provide. For example, the New York Public Housing Law includes a long list of types of covenants that an issuer can make "[i]n connection with the issuance of bonds or the incurring of an obligation, and to secure the payment of such bonds or obligations, an authority, in addition to its other powers."[92] These include in relevant part the power to "[p]ledge, covenant to pledge, or covenant against pledging, all or any part of [the issuer's] rents, fees, revenues, subsidies, grants or contributions to which its right then exists or may thereafter come into existence."[93] In addition to pledging "all or any part of its rents [and] fees," an issuer can also "[c]ovenant as to the rents and fees to be charged, the amount to be raised each year or other period of time by rents, fees and other revenues, and as to the use and disposition to be made thereof."[94]

State statutes frame a municipal revenue bond issuer's power to enter into rate covenants in a variety of ways. For example, New Jersey law provides that local governments may make promises on multiple subjects in a revenue bond transaction, including "the fixing and collection of such rates, rentals and other charges for connection with or the use of any such municipal public utility, including" the cost of making improvements to the facility, to ensure that the charges "will annually produce revenues sufficient" to cover the expenses of the utility, the reserve funds, and the payments on the obligations provided for in the bond ordinance, such as principal and interest to investors, mortgage payments, and payments of liens on the utility's revenues.[95] New Jersey law defines a "municipal public utility" broadly to encompass water, sewer, or power systems, public parking systems, or "or any other utility, enterprise or purpose authorized to be undertaken by a local unit from which it may receive fees, rents, or

88. O'HARA, *supra* note 14, at 72.
89. *See id.*
90. GELFAND, *supra* note 80, § 12:45.
91. *Id.*
92. N.Y. PUB. HOUS. LAW § 47(1) (McKinney 2024).
93. *Id.* § 47(1)(a).
94. *Id.* § 47(1)(g).
95. N.J. STAT. ANN. § 40A:2-15(d) (West 2024).

other charges . . . ."[96] State law requires the local government issuer to comply with these covenants once the bond is purchased.[97] Thus, a local government entity can agree to impose rates that are high enough to effectively exclude access for certain individuals, which runs counter to the letter or spirit of other federal, state, and local laws that guarantee equal access to public facilities and services.[98]

In contrast to New Jersey, other states provide revenue bond-issuing jurisdictions blanket authority to enter into rate covenants and to set their terms. For example, Arkansas allows water districts to issue negotiable bonds that "contain such terms, covenants, and conditions as the resolution of the board authorizing the bonds may provide."[99] Other states restrict the rates a local government entity may agree to charge—but the restriction does not necessarily include a right to control rates to further interests in access, affordability, or equity. As a case in point, Pennsylvania grants local governments the authority to set rates in the issuance of revenue bonds and notes. The statute, however, places restrictions on rate increases. A local government may include covenants in a bond ordinance that cover

> the fixing and collection of rents, rates and charges for the use of the project as may be desired and deemed necessary for the lawful security of the holders of the bonds or notes, except that no covenant and no agreement with the holders of bonds or notes shall require an increase in the rents, rates, tolls and charges to a level which, in the opinion of the registered professional engineer advising the local government unit, will result in a decrease in gross revenues over what would have been received at a somewhat lower rate level.[100]

This restriction targets rate changes that would lead to a "decrease in gross revenues."[101] One might argue that many individuals from marginalized groups who otherwise would use a public facility, whether it is a utility, a

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96. N.J. STAT. ANN. § 40A:1-1 (West 2024).

97. *See* N.J. STAT. ANN. § 40A:2-15 (West 2024) ("Any bond ordinance to finance any cost or expense of a municipal public utility, or any ordinance amendatory thereof or supplemental thereto adopted prior to the issuance of obligations, may" include specific "covenants with the holders of such obligations which *shall be observed and performed* by the local unit, notwithstanding the provisions of this or any other law.") (emphasis added).

98. *See, e.g.*, N.Y. CIV. RIGHTS §§ 40, 42, 45 (McKinney 2024) (authorizing Industrial Commissioner to enforce Section 42 and prohibiting discrimination by utility companies against protected classes); *see* MASS. GEN. LAWS ANN. ch. 151B, § 4 (West 2024) (prohibiting housing discrimination against protected classes); 34 MASS. PRAC., LANDLORD AND TENANT LAW § 21:29 (3d ed.) (noting that "discrimination in the furnishings of facilities or services" is illegal under Boston's fair housing law); Hawkins v. Town of Shaw, 461 F.2d 1171, 1173 (5th Cir. 1972) (finding equal protection violation resulting from discriminatory provision of municipal services based on race); Kennedy v. City of Zanesville, 505 F. Supp. 2d 456, 494, 497 (S.D. Ohio 2007) (denying summary judgment against Black plaintiffs based on violation of federal Fair Housing Act for discriminatory provision of public water service).

99. ARK. CODE ANN. § 14-116-402(13)(B) (West 2024); J.W. Looney, *Enhancing the Role of Water Districts in Groundwater Management and Surface Water Utilization in Arkansas*, 48 ARK. L. REV. 643, 691 (1995) (describing the "exact nature of the bonds" as "quite flexible" under the statute).

100. 53 PA. STAT. AND CONS. STAT. § 8105(2) (2024).

101. *Id.*

beach, or street parking, may refrain from doing so when the rates charged are too high.[102] In that sense, high rates could cause revenues to be lower than they otherwise would have been. Nonetheless, Pennsylvania's restriction does not address circumstances in which individuals decide to use a public amenity even though the cost is disproportionately burdensome for that individual compared to the average resident.[103]

Credit rating analysts and underwriters who market bonds to investors evaluate revenue bonds tend to specialize in specific industries, such as utilities, housing, or health care, to keep track of trends occurring in the

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102. States like New Jersey allow cities to charge visitors to public beaches by imposing fees for "beach tags." *See* Maggie Mancini, *Ocean City Doubles Price of Daily, Weekly Beach Tags in 2023 as Shore Town Looks to Increase Revenue*, PHILLYVOICE (Oct. 21, 2022), https://www.phillyvoice.com/ocean-city-new-jersey-beach-tag-price-increase-revenue-maintenance-summer/ (citing resident at public comment who opposed measure, arguing that "[d]oubling the daily fees and increasing weekly and seasonal tag prices is excessive and could make beach trips cost prohibitive for the working class family"). Likewise, moving into a neighborhood with greater amenities becomes cost prohibitive in communities that charge parking fees to residents to park on the street. *See, e.g.*, Alyssa Schnugg, *Some Oxford Residents Will Have to Pay to Park in Their Neighborhoods*, THE OXFORD EAGLE (Sept. 7, 2016, 10:21 AM), https://www.oxfordeagle.com/2016/09/07/residents-paying-to-park/ (describing ordinance that requires residents of exclusive neighborhood near historic Square in Oxford, home to the University of Mississippi, to pay for street parking); Patrice Berry, *Stop Punishing Poor Californians Who Can't Pay Parking Tickets*, END POVERTY IN CAL. (May 17, 2023), https://endpovertyinca.org/upset-the-setup/stop-punishing-poor-people-who-cant-pay-parking-tickets/ (discussing "poverty tows" in California where "[u]npaid tickets, expired registration, and parking for more than 72 hours combine to constitute a large percentage of impounds," more than a quarter of the tows are for non-emergency reasons, and these tows "overwhelmingly impact low-income individuals and people of color, often permanently stripping people of the thing that allows them to keep a roof over their heads").

103. *See* Nina Lakhani, *Revealed: Millions of Americans Can't Afford Water as Bills Rise 80% in a Decade*, THE GUARDIAN (June 23, 2020, 5:00 EDT), https://www.theguardian.com/us-news/2020/jun/23/millions-of-americans-cant-afford-water-bills-rise (explaining that the "analysis of 12 US cities shows the combined price of water and sewage increased by an average of 80% between 2010 and 2018, with more than two-fifths of residents in some cities living in neighbourhoods with unaffordable bills"). In 2020, Congress funded the Low-Income Household Water Assistance Program as part of a COVID-19 relief package, but the program ended in 2023. *See Low-Income Household Water Assistance Program*, NAT'L COUNCIL ON AGING (Aug. 8, 2024), https://www.ncoa.org/article/low-income-household-water-assistance-program. By the end of fiscal year 2022, the program kept 228,000 from losing service and helped restore service to about 30,000 households that lost water service. Kery Murakami, *Low-Income Water Assistance Program Set to End*, ROUTE FIFTY (Sept. 19, 2023), https://www.route-fifty.com/finance/2023/09/federal-assistance-program-helped-pay-water-bills-set-expire/390443/. The same challenges exist with respect to energy costs. According to data on the Low-Income Energy Affordability Data (LEAD) tool managed by the U.S. Department of Energy, the national average energy burden for low-income households is 6%, which is three times higher than that for non-low-income households (estimated at 2%). *Low-Income Energy Affordability Data (LEAD) Tool and Community Energy Solutions*, U.S. DEP'T OF ENERGY, https://www.energy.gov/scep/low-income-energy-affordability-data-lead-tool-and-community-energy-solutions (last visited Sept. 12, 2024). Likewise, toll roads also have negative equity impacts for low-income people that use them for work. Researchers in Washington found that the lowest-income drivers receive the greatest benefit from using toll roads, based on the value of time saved minus the cost of the toll "because lower-income drivers most often choose to use toll roads during peak times, when traffic is at its worst, for urgent tasks, such as getting to work and picking up kids from school on time." Jacob Denney, *Reducing the Toll of Tolls on Low-Income Drivers*, SPUR URB. CTR. (May 16, 2023), https://www.spur.org/news/2023-05-16/reducing-toll-tolls-low-income-drivers; *see also* SHIRLEY LEUNG, COREY MCCARTAN, CJ ROBINSON, KIANA ROSHAN ZAMIR, MARK HALLENBECK, & VAUGHN IVERSON, ESCIENCE INST., I-405 EXPRESS TOLL LANES: USAGE, BENEFITS, AND EQUITY 8–11 (2019), https://www.wsdot.wa.gov/publications/fulltext/design/ConsultantSrvs/I-405ExpressTollLanes.pdf. Yet, despite the need to do so, they use them less than any other group. *See id.* at 13–14.

industry on a regional and national level.[104] Analysts and underwriters assess the economic strength of the public utility, agency, or private corporation on whose behalf the local government has issued a revenue bond.[105] They also consider the economic stability and resources of the community the project or entity serves.[106] Most notably, these analysts "carefully scrutinize" the legal provisions and covenants of the trust indenture.[107] "From the beginning, analysts determine what security is available for the bonds. Traditionally, revenue bonds are secured by a first lien on net revenues. This means that debt service is paid out of the net revenues, the funds that remain after the normal operating costs have been paid."[108]

Indeed, user rates for key public services and facilities start from an amount that the local government entity agreed to charge residents, in some cases, thirty or forty years ago under a bond covenant in a trust indenture.[109] The city promised its creditors that it would charge users a minimum rate necessary to satisfy not just the debt, but the potential anxieties of investors considering whether to purchase the bond issue to give the local government entity money to build the system in the first place. This promise came with a commitment to charge rates necessary to service the debt, even if the debt service involves adjustable interest rates that can change over time. The rate is not the result of an arms-length transaction between the city and the resident. Rather, it is the result of a transaction between a government entity—which has some degree of leverage depending on its credit rating—and an investor that extracts guarantees based on the city's relative strength or weakness.

It is important to question the profile of the "user" that a local government has in mind when it sets the fees it expects residents to pay. This practice of governments agreeing to charge users ever-increasing rates for services affects a broad array of users when the service reaches across multiple income levels and a larger geographic area littered with racial segregation and spatial inequality. Not all users are burdened equally by the fees charged. Revenue bonds rely on courts underwriting their use with no traditional debt restrictions while governments do little to compel compliance with civil rights obligations in how their funding streams of revenue bonds affect disadvantaged groups—who are disproportionately racial minorities. For example, tax-based revenue bonds sometimes draw on excise taxes, including fuel taxes and vehicle license fees, as sources of revenue.[110] Higher fuel taxes lead to higher gas prices. Higher vehicle license

104. *See* O'HARA, *supra* note 14, at 174.
105. *See id.*
106. *See id.* at 193–96.
107. *Id.* at 174.
108. *Id.* at 198 (emphasis omitted).
109. *See id.* at 174.
110. *See Tax-Based Revenue Bonds*, NAT'L ASS'N OF BOND LAWS., https://www.nabl.org/bond-basics/revenue-bond/ (last visited Dec. 24, 2024) (explaining that fuel taxes may serve as sources of revenue for tax-based revenue bonds); *In re* Fin. Oversight & Mgmt. Bd. for P.R., 919 F.3d 121, 125

fees increase the cost of owning and using a car, a particular burden for low-income individuals with long car commutes to jobs that have moved into suburbs and for individuals in jurisdictions with inefficient public transit. Indeed, the flight of jobs from the cities to the suburbs has given Black Americans the longest commute times of any racial group in the United States.[111] Higher fees to meet obligations in revenue bonds have a ripple effect across the country's racial and class landscape.

B. Rate Covenants and Limitless Debt

The role of rate covenants in municipal bonds becomes increasingly important as one considers the decline in the use of property taxes to finance local government in the last fifty years.[112] In response to fluctuating periods of high government defaults on debt from the Industrial Revolution in the years prior to the Great Depression, in the 1930s, states began to impose limits under their state constitutions on the amount of debt that state and local government could incur.[113] Post-World War II, "[a] massive expansion of revenue bond debt financing by . . . governmental entities [special districts and special authorities rather than states and municipalities] began," largely as a way to circumvent legal debt limitations.[114] The decline in property taxes has been offset in large part by the increase in user fees and charges for public services.[115] Proponents of this user-charge bond model argue that (1) increased reliance on user fees "can promote efficiency by requiring the user of a municipal service to internalize the costs of her use," (2) it is more equitable for the principal beneficiaries of the service to pay for the service through user fees rather than having the entire community pay for the service through property taxes, and (3) user charges are a "more certain source of revenue" because they cover the cost of providing the service associated with the charge.[116] As a general matter, "state courts have exempted a host of special assessments, fees, and charges from tax limitations."[117] Thus, the courts also provide very little protection for a ratepayer to challenge the amount of the fees charged for services.

(1st Cir. 2019) (referring to motor vehicle license fees among the excise taxes that backed revenue bonds issued by the Puerto Rico Highways and Transportation Authority).

111. *See* JAMES W. LOEWEN, SUNDOWN TOWNS: A HIDDEN DIMENSION OF AMERICAN RACISM 342 (2005); John D. Landis, *Minority Travel Disparities and Residential Segregation: Evidence from the 2017 National Household Travel Survey*, 112 TRANSP. RSCH. PART D 1, 1–2 (finding that, in racially segregated metropolitan areas, Black commuters have longer travel times to opportunities for work and recreation than their white counterparts).

112. Briffault, *supra* note 54, at 932 ("Property tax levels, as well as the role of the property tax in financing local government, have dropped sharply across the United States, particularly in the states that adopted the most stringent property tax limitations.").

113. *See* William E. Mitchell, *The Effectiveness of Debt Limits on State and Local Government Borrowing*, 45 N.Y.U. INST. FIN. BULL., Oct. 1967, at 1, 10–17.

114. *See* 1 GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING § 11:14 (2d ed. 2023).

115. Briffault, *supra* note 54, at 932.

116. *Id.* at 933.

117. *Id.* at 934.

State high courts have interpreted restraints on taxes in their state constitutions in ways that render revenue bonds effectively exempt from state constitutional debt limitations, even when states have amended their constitutions to add language that specifically appears to contemplate revenue bonds.[118] These decisions play a critical role in shielding rate covenants from regulation, making efforts to change the terms under which bond issuers can set rate covenants more immune to challenge.[119] The exemption reaches across various types of revenue bonds, including bonds with methods of repayment that extend beyond rates directly charged to users for the use of the facility or service. State courts often exempt not only project finance bonds but also bonds in which the issuer limited its debt service payment obligation to a "special fund" generated by the project.[120] For example, courts have exempted revenue bonds to finance highway construction if the project was backed by taxes on motor fuels and vehicle license fees.[121] Likewise, a convention center bond issue may be exempt if it is backed by a new tax on hotel occupancy.[122]

The fact that revenue bonds generally remain unregulated by state constitutional debt limits also incentivizes the creation of agencies with the power to issue these bonds. State courts have generally held that debt issued by public authorities, ranging from expressway authorities to public utilities, is not subject to constitutional debt limits because public authorities lack the power to impose taxes or pledge the full faith and credit of the states in which they reside.[123] As a result, public authorities that are run by unelected officials—who are technically separate from state or general purpose local governments (i.e., cities and counties)—play an

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118. For example, voters added what is known as the Hancock Amendment to the Missouri Constitution to provide in relevant part:

> Counties and other political subdivisions are hereby prohibited from levying any tax, license or fees, not authorized by law, charter or self-enforcing provisions of the constitution when this section is adopted . . . without the approval of the required majority of the qualified voters of that county or other political subdivision voting thereon.

MO. CONST. art. X, § 22(a); *see also* Briffault, *supra* note 54, at 936–37 (discussing amendment). Then, the Missouri Supreme Court determined that, despite the amendment's broad language, some fees were not subject to the voter approval requirement. Keller v. Marion Cnty. Ambulance Dist., 820 S.W.2d 301, 304–05 & n.10 (Mo. 1991). The court developed a cumbersome test to determine whether certain fees are "tax-fees" covered by the amendment or exempt from it. *Id.* at 303–04 & n.10. Similarly, California voters amended the state constitution in 1996 to apply the voter approval requirement to all instruments used to raise revenue and narrowed the list of special assessments exempt from tax limitations. *See* CAL. CONST. art. XIII C; *see also id.* art. XIII D. Nonetheless, California's appellate courts have recognized exemptions where the broad language of the amendment would indicate that there would be none. *See, e.g.*, Apartment Ass'n of L.A. Cnty., Inc. v. City of Los Angeles, 14 P.3d 930, 935 (Cal. 2001) (finding that an apartment inspection fee assessed to private landowners fell outside of the amendment); Howard Jarvis Taxpayers Ass'n v. City of Riverside, 86 Cal. Rptr. 2d 592, 601 (Cal. Ct. App. 1999) (finding that fees collected for street lighting were not subject to the amendment); Howard Jarvis Taxpayers Ass'n v. City of San Diego, 84 Cal. Rptr. 2d 804, 807 (Cal. Ct. App. 1999) (ruling that assessment by a business improvement district was not covered by the amendment).

119. *See* cases cited *supra* note 118.

120. Briffault, *supra* note 54, at 918–19.

121. *See id.* at 919 (citing *In re* Okla. Capitol Improvement Auth., 958 P.2d 759, 766 (Okla. 1998)).

122. *See id.* (citing Convention Ctr. Auth. v. Anzai, 890 P.2d 1197, 1208–09 (Haw. 1995)).

123. Briffault, *supra* note 54, at 927.

increasingly outsized role in state and local government given their control over revenue-backed debt.[124] These public authorities ultimately lack accountability to state and local voters, which eliminates an avenue for redress that the public could otherwise use to control the rates they charge to cover the bonds they issue.

II. RATE COVENANTS: COMPROMISING AFFORDABILITY, FAIR HOUSING, AND CIVIL RIGHTS

The rates residents pay to use city services can be understood within the broader frame of local government finance and revenue generation. Laurie Reynolds explains:

> When a local government decides to provide a service, improve or construct infrastructure, or regulate private activity, the question of how to pay will generally be an important consideration. In simple terms, the first, most fundamental decision the government must make is whether to resort to taxation powers or to use a more narrowly targeted revenue device.[125]

Property taxes are the most common taxation tool local governments use, followed by sales taxes, use taxes, and income taxes as distant seconds.[126] These revenues, however, only account for 42% of local general revenues, on average.[127] Thirty-seven percent come from intergovernmental transfers, namely payments from the federal and state governments, such as federal transportation infrastructure grants and state funding for K-12 schools.[128] User fees, such as city revenue from sewerage and parking fees, made up 16% of local general revenues in 2021.[129] Despite this comparatively smaller percentage, these charges are on the rise. Since 1977, charges have increased as a share of both state and local government revenue, while property taxes have declined.[130] The share of revenue coming from property taxes fell from 22% in 1977 to 17% in 1985 and has remained stable ever since.[131] By contrast, revenues from charges steadily increased from 11% of general revenue in 1977 to 16% in 2020.[132]

Reynolds describes these charges as "local government dues" that "crucially depend on the relationship between the payer and the purpose

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124. *Id.*
125. Reynolds, *supra* note 71, at 378.
126. *Id.* at 380. According to 2021 data from the U.S. Census Bureau's Annual Survey of State and Local Government Finances, taxes provided 42% of local government revenues. Of this percentage, 30% were from property taxes; followed by 5% in general sale and gross receipts taxes; 2% from selective sales taxes on purchases such as alcohol, motor fuel, and tobacco products; 2% from individual income taxes; and 3% from other taxes, including local taxes on hotels and restaurant meals. *State and Local Tax Policies*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-state-and-local-governments (Jan. 2024).
127. *State and Local Tax Policies*, *supra* note 126.
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.*
132. *Id.*

for which the revenue raised will be spent."[133] Reynolds argues that "dues treat government activities just like any other market transaction in a consumer economy" because the cost comes from "calculating the charge with a computation of the benefit received by the payer or [offsetting] the cost imposed on the general population by the payer's activity."[134] However, the source of the initial capital required to pay for construction of a facility or system that provides the service turns the idea that these "dues" are "like any other market transaction in a consumer economy" into a problem.[135] Rather than "dues," this Article uses the term "rates" because the literature and language of bond covenants refer to them as such.

A. Equity Challenges

The increasing reliance on user fees to provide government services raises social equity concerns. The description of these fees as purely market transactions (the "you want a service, so you pay for it" logic) frames user fees as matters of contract or private law and conceals the extent to which they should be sources of concern for civil rights law. Rate covenants implicate the public's interest in advancing fair housing rights, residential integration, and social equity in communities. Rate covenants in municipal bonds disproportionately affect communities of color in part because of racial disparities in wealth and income. The average wealth of white families is seven times higher than the average wealth of Black families, and more than one in four Black households have zero or negative net worth, compared with less than one in ten white families.[136] Additionally, a 2014 study indicated that working families of color are twice as likely to be poor or low-income (47%) compared to white working families (23%).[137]

In the context of revenue bonds that finance public spaces, the user rates charged for access to these spaces serve as literal barriers to entry. Historian Destin Jenkins's seminal work, *The Bonds of Inequality: Debt and the Making of the American City*, poses challenging questions about the facilities local government leaders choose to build with debt financing and whose interests they serve.[138] Using mid-twentieth century San Francisco to exemplify a larger national phenomenon, Jenkins argues that the two decades after World War II were "a moment of historically low interest rates."[139] The market of investors interested in buying tax-exempt

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133. Reynolds, *supra* note 71, at 380.
134. *Id.*
135. *Id.*
136. Janelle Jones, *The Racial Wealth Gap: How African-Americans Have Been Shortchanged Out of the Materials to Build Wealth*, ECON. POL'Y INST. (Feb. 13, 2017), http://www.epi.org/blog/the-racial-wealth-gap-how-african-americans-have-been-shortchanged-out-of-the-materials-to-build-wealth/.
137. DEBORAH POVICH, BRANDON ROBERTS, & MARK MATHER, THE WORKING POOR FAMS. PROJECT, LOW-INCOME WORKING FAMILIES: THE RACIAL/ETHNIC DIVIDE 1 (2014–2015), https://www.prb.org/wp-content/uploads/2015/03/WPFP-2015-Report-Racial-Ethnic-Divide.pdf.
138. JENKINS, *supra* note 67.
139. *Id.* at 15.

bonds exploded and the number of bonds for short-term debt issued by local governments skyrocketed, rising from 567 new bond issues totaling $741 million in 1946 to more than 1,900 issues worth over $6.5 billion in 1965.[140] Still, "[B]lack neighborhoods were continuously deemed unworthy of debt."[141] Instead, state and local governments made an "infrastructural investment in whiteness," investing in "public infrastructure, but largely for white elites through a system of privatized development."[142] These kinds of revenue bond issues financed the kinds of amenities—such as art museum renovations,[143] sports arenas,[144] symphony halls,[145] and parking garages[146] necessary to serve patrons who commute by car from the suburbs—that turn cities into urban playgrounds for those who can afford to use them.

Rate covenants also undermine federal civil rights laws and strategies for enforcing compliance with these laws. For example, Title VI of the Civil Rights Act of 1964 prohibits programs receiving federal financial assistance from discriminating on the basis of race, color or national origin.[147] The Federal Transit Administration at the U.S. Department of Transportation has issued guidance to grantees—namely local government entities that operate public transit systems—regarding compliance with their obligations under Title VI.[148] The agency requires transit providers to evaluate the effects of fare changes on low-income populations and groups protected under Title VI "regardless of the amount of increase or decrease."[149] This mandate has been proposed as a basis for challenging fare increases that disproportionately impact people of color who rely on public transit to travel to work.[150] Despite the efforts of civil rights advocates working to make rates affordable, the rate covenant is a binding provision within a trust indenture for a municipal bond offering. A local government borrower risks failing to abide by the terms of the covenant if it alters rates in a way that reduces profits for bondholders, even if it can

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140. *Id.* at 14–15.

141. *Id.* at 15.

142. *Id.*

143. *See id*. at 78–79 (discussing the renovation of the DeYoung Museum of Art in downtown San Francisco).

144. *See id.* at 79 (discussing the construction of Giants Stadium with financing from tax-exempt bonds).

145. *See, e.g.*, Brian Wise, *Bank Set to Foreclose on Nashville Symphony's Concert Hall*, WQXR: BLOG (June 7, 2013), https://www.wqxr.org/story/297612-bank-foreclose-nashville-symphonys-concert-hall/ (describing the default of the Nashville Symphony Orchestra on its bond issue after its revenues fell by more than fifty percent in 2011 and 2012).

146. JENKINS, *supra* note 67, at 71–72 (discussing the financing scheme necessary to issue bonds at reasonable interest rates to build a 1,450-car garage beneath Civic Center Plaza in San Francisco with access to retail shopping).

147. Civil Rights Act of 1964, 42 U.S.C. § 2000d.

148. FED. TRANSIT ADMIN., U.S. DEP'T OF TRANSP., CIRCULAR FTA C 4702.1B, TITLE VI REQUIREMENTS AND GUIDELINES FOR FEDERAL TRANSIT ADMINISTRATION RECIPIENTS (2012), https://www.transit.dot.gov/sites/fta.dot.gov/files/docs/FTA_Title_VI_FINAL.pdf.

149. *Id.* ch. IV-19b.

150. *See* Sara Amri, *Fighting for Fair Fares in New York City Through Civil Society Enforcement of Title VI*, 26 J.L. & POL'Y 165, 168 (2018).

service the debt on the bond.[151] Courts also have not hesitated to invalidate state laws that would change a local government's payment obligation as violating the Contracts Clause of the U.S. Constitution.[152] A rate covenant can be at work in the background, controlling rates such as fares charged to public transit users, with terms that make it impossible to reduce those rates in the public interest.[153]

Why do policymakers raise rates or fees to levels that they know will have an exclusionary impact on lower-income individuals in the community? Why do courts justify these decisions by ruling that they are in the interest of complying with a jurisdiction's debt obligations to investors? Elise Boddie's theory of racial territoriality may help answer these questions.[154] Boddie argues that "[r]acial territoriality involves more than discrimination against individuals and the inability to travel from one place to another; it is an expression of institutional power that is mediated through racial geography."[155] The authority to issue a municipal bond draws on raw institutional power, provided by state and local law. The terms of these bonds have significant implications for racial inequality.

According to Boddie, "racialized spaces represent more than a physical set of boundaries or associations: they correlate with and reinforce cultural norms about spatial belonging and power. These norms have a dynamic and symbiotic relationship with racially territorial conduct."[156] Decisions to use the power of the government to support the construction of certain spaces and not others—for example, a downtown fine art

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151. A bondholder has some legal avenues available to challenge an issuer that fails to abide by the terms of a rate covenant. The state law remedy of mandamus may be sought to compel officials to levy and collect taxes sufficient to comply with the rate covenants in the bonds. *Municipal Adjustments*, 1981 ANN. SURV. OF BANKR. L. 5, at n.77 (1981). But this remedy may be toothless because lack of funds is generally a defense the government may raise against the issuance of the writ. *See* State v. Pomeroy, 131 So. 384, 385 (Fla. 1930). Likewise, a bondholder may sue for the appointment of a receiver based on a failure to comply with the rate covenant, but the federal Johnson Act bars federal courts from issuing orders that would interfere with a state public utility's ratemaking authority. *See* Bank of N.Y. Mellon v. Jefferson Cnty., No. 2:08-CV-01703-RDP, 2009 WL 10704121, at *14 (N.D. Ala. 2009) (citing 28 U.S.C. § 1342). Thus, a federal court may lack the jurisdiction to appoint a receiver with ratemaking authority. *See id.* at *28. The greater threat, however, may be that the issuer has to disclose failures to comply with the terms of existing debt in future bond issues for five years after the failure. *See* 17 C.F.R. § 240.15c2-12(f)(3) (2024). The failure could discourage investors and lead to a downgrade of the issuer's credit rating. *See id.*; White, *supra* note 13, at 149 n.86.

152. U.S. CONST. art. I, § 10; *see also* Port of Mobile v. Watson, 116 U.S. 289, 290 (1886) (invalidating an Alabama law that restructured the city of Mobile into a new entity in order to frustrate access to tax revenue by Mobile's bondholders); Von Hoffman v. City of Quincy, 71 U.S. 535, 555 (1866) (nullifying Illinois law that withdrew taxing powers from municipalities where the power was necessary to pay outstanding bonds).

153. In fact, the Transportation Equity Act for the 21st Century (TEA-21) authorizes the use of fare box revenues as collateral for revenue bonds issued to public transit agencies. *Revenue Bonds*, FED. TRANSIT ADMIN., https://www.transit.dot.gov/funding/funding-finance-resources/revenue-bonds/revenue-bonds (Oct. 11, 2018); *see also* Transportation Equity Act for the 21st Century, Pub. L. No. 105-178, 112 Stat. 107 (1998). The New York City Metropolitan Transit Authority is among the list of revenue bond issuers listed by the Department of Transportation. *See supra Revenue Bonds*.

154. Boddie, *supra* note 74, at 406.

155. *Id.* at 446.

156. *Id.* at 438.

museum over a community center in a low-income majority-Black community, or a soccer complex over a football stadium for a majority-minority urban high school—implicate race and class. These decisions indicate whose interests are priorities in the eyes of the state. The space that is built becomes racialized as it provides services for and access on reasonable terms to certain racial groups and not others. The space "reflect[s] widespread conscious and implicit racial biases that lead racial groups to attempt to control other racial groups within the subject space and/or to exclude them altogether."[157]

Ostensibly, high user fees for public facilities exclude those who cannot afford them. Scholars often accept these user fees as the result of determinations about "what the market will bear."[158] The truth, however, is that state law governs the terms under which state and local government entities can issue bonds and incur debt. It explicitly authorizes governments to charge whatever rates are necessary to service their debt. This requirement provides the basis for a formula that, at a minimum, sets a floor for rates. Law is at work shaping these rates artificially. State law or the various bond covenants it authorizes could provide conditions under which government entities must limit rates in the public interest, but they generally do not. The refusal to use law to protect the government's power to set reasonable rates becomes a form of racially territorial conduct that "physically prevents or otherwise discourages [Black people] from accessing white spaces."[159]

"The second stage of territorial conduct," Boddie explains, "involves the active defense of space by creating, maintaining, or highlighting boundaries[] and then seeking to control access to the area and to things within it . . . ."[160] High rates and fees can function as mechanisms for "[c]reating, maintaining, or highlighting boundaries."[161] Making spaces unaffordable limits who uses them—and works to the benefit of those who can afford them. These rates "signal[] use or ownership through signs, markers, and labels; or communicat[e] warnings of varying levels of

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157. *Id.*

158. *See, e.g.*, Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 419–24 (1956); Frug, *supra* note 69, at 31 (critiquing the reliance on fees to fund local government services by arguing that they "replac[e] the one-person, one-vote principle associated with democracy with the one-dollar, one-vote rule of the marketplace"); Reynolds, *supra* note 71, at 380 (arguing that "dues treat government activities just like any other market transaction in a consumer economy"). The phrase "what the market will bear" is an idiom which refers to a strategy of setting the price of a good or service according to its perceived or estimated value. *See* GARY ARMSTRONG, STEWART ADAM, SARA DENIZE, & PHILIP KOTLER, PRINCIPLES OF MARKETING 273 (6th ed. 2014); Rafi Mohammed, *How to Find Out What Customers Will Pay*, HARV. BUS. REV. (Sept. 7, 2012), https://hbr.org/2012/09/how-to-find-out-what-customers-will-pay (noting that "every business" should ask "What price should I charge? The right answer to that question is a company should charge 'what the market will bear'—in other words, the highest price that customers will pay.").

159. Boddie, *supra* note 74, at 438.

160. *Id.* at 444 (internal quotations and footnote omitted).

161. *Id.* (quoting RALPH B. TAYLOR, HUMAN TERRITORIAL FUNCTIONING: AN EMPIRICAL, EVOLUTIONARY PERSPECTIVE ON INDIVIDUAL AND SMALL GROUP TERRITORIAL COGNITIONS, BEHAVIORS, AND CONSEQUENCES 84 (1988)).

indirectness and subtlety to potential intruders."[162] As fine art museum admission prices become too expensive for lower-income people of color to afford, or downtown parking garage rates become so high that only the financially comfortable can afford to spend significant time near elite retail shops, "those with power . . . co-opt [the] space" and the rates themselves "help[] to reinforce social hierarchies."[163]

"Although racial territoriality is most obvious when it results in the outright exclusion of people of color from white space, territorial behavior might also manifest in more subtle ways, including unwelcoming attitudes and social ostracization."[164] High rates and fees to use spaces funded with public debt are a "subtle way" of demonstrating territorial behavior. If the cost does not function as a sufficient deterrent, the rate can be raised based on the court-sanctioned justification of needing to make payments on bond debt, and then these methods of unwelcoming attitudes and ostracism—which are thoroughly less convenient than the hidden exclusionary effect of a parking garage fee—can be applied. Raising rates is an easier way for high-income, disproportionately white residents to convey unwelcoming attitudes to and ostracize low-income people of color, rather than employing more blatant ways of doing so. The following Sections illustrate contexts in which rate covenants reinforce racial inequality and create barriers to entry: access to water, electricity, and sewer service; toll roads; and senior housing.

B. Public Utility (Water, Electric, and Sewer) Service

The relationship between rate covenants and fair housing becomes apparent when one considers the importance of applying principles of fair housing beyond just the provision of housing. Section 3604(b) of the Fair Housing Act (FHA) prohibits discrimination in the "terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith."[165] Revenue bonds often finance water, sewer, and other municipal services that directly connect to an individual residence. Many courts have applied this provision to cases involving the discriminatory provision of municipal services. In 2007, the district court in *Kennedy v. City of Zanesville*[166] ruled that the FHA, Title VI of the Civil Rights Act of 1964, and 42 U.S.C. §§ 1981, 1982 & 1983 "clearly" cover discrimination in the "procurement of water, a vital resource."[167] In the 2019 decision of *Georgia State Conference of the NAACP v. City of LaGrange*,[168] the Eleventh Circuit determined that the FHA, in § 3604(b),

162. Boddie, *supra* note 74, at 444 (internal quotations omitted).
163. *Id.*
164. *Id.* at 446 n.299.
165. 42 U.S.C. § 3604(b).
166. Kennedy v. City of Zanesville, 505 F. Supp. 2d. 456, 499 (S.D. Ohio 2007).
167. *Id.*
168. Ga. State Conf. of the NAACP v. City of LaGrange, 940 F.3d 627, 634 (11th Cir. 2019).

covers water services, which are closely tied to the "sale or rental of a dwelling" and necessary to render the dwelling habitable.[169]

Rate covenants may also run afoul of multiple policy imperatives. The FHA requires that the Secretary of Housing and Urban Development (HUD) administer the Act to affirmatively further fair housing (a policy also known as "AFFH").[170] The Community Development Block Grant (CDBG) program is the largest HUD program under which jurisdictions are required to comply with the AFFH mandate.[171] Congress created the CDBG program in 1974 to provide grants to localities to develop "viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income."[172] Likewise, Title VI of the Civil Rights Act of 1964 prohibits discrimination on the basis of race, color, and national origin in programs receiving federal financial assistance.[173] The FHA and Title VI are "two of the civil rights laws that most directly apply to challenging governmental and private market decisions that further racial disparities in housing and community development."[174]

Fair housing and civil rights laws come with many compliance requirements that make cities accessible and affordable for lower-income residents.[175] For example, Title VI requires large providers of fixed-route public transportation that receive federal financial assistance to collect demographic information about their riders, including the types of fares they use. They must also analyze their service routes and fares to ensure equity and to avoid disparate impacts on the basis of race, color, or national origin.[176] Additionally, the FHA's protections against discrimination that extend to families with children precludes housing providers from maintaining playgrounds in a unsafe and unsuitable condition for children.[177] In the water systems context, federal law prohibits discrimination in the provision of water services by recipients of federal funds.[178] Similarly, California and New York have recognized a human right to water.[179] Local

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169. *Id.*

170. *See* 42 U.S.C. § 3608(e)(5); Affirmatively Furthering Fair Housing, 80 Fed. Reg. 42272 (July 16, 2015) (to be codified at 24 C.F.R. pts. 5, 91, 92, 570, 574, 576, 903).

171. Affirmatively Furthering Fair Housing, 80 Fed. Reg. at 42272.

172. 42 U.S.C. § 5301(c).

173. 42 U.S.C. § 2000d.

174. *See* Jade A. Craig, *"Pigs in the Parlor": The Legacy of Racial Zoning and the Challenge of Affirmatively Furthering Fair Housing in the South*, 40 MISS. COLL. L. REV. 5, 69 (2022).

175. 42 U.S.C. § 5301(b)–(c).

176. *See* 49 C.F.R. § 21.5(b) (2024); FED. TRANSIT ADMIN., U.S. DEP'T OF TRANSP., CIRCULAR FTA C 4702.1B, TITLE VI REQUIREMENTS AND GUIDELINES FOR FEDERAL TRANSIT ADMINISTRATION RECIPIENTS ch. 4-1, 4-11 (2012), https://www.transit.dot.gov/sites/fta.dot.gov/files/docs/FTA_Title_VI_FINAL.pdf.

177. *See, e.g.*, HUD v. Murphy, 1990 WL 456962, Fair Housing-Fair Lending (P-H) ¶ 25,002 at 25,053 (HUDALJ July 13, 1990).

178. 40 C.F.R. §§ 7.85, 7.120, 7.130 (2024).

179. CAL. WATER CODE § 106.3(a) (West 2024) ("It is hereby declared to be the established policy of the state that every human being has the right to safe, clean, affordable, and accessible water adequate for human consumption, cooking, and sanitary purposes."); N.Y. CONST. art. I, § 19 ("Each person shall have a right to clean air and water, and a healthful environment.").

governments may also be held liable for discriminatory denials of municipal services, such as water and electric utility service, to protected classes under the FHA.[180] Likewise, courts have held that the Equal Protection Clause, Title VI, and the FHA prohibit discrimination in providing street paving services, drainage, parks, street lighting, and fire protection, among other essential local government services.[181]

The nexus between fair housing and the development of affordable housing is apparent and has been thoroughly explored.[182] The development of affordable housing, however, implicitly includes the need to build infrastructure to support new residents. In the context of residential development, municipalities possess the authority to require residential developers to defray all or part of the cost of new residents coming into a community, including development impact fees to cover the construction of roads and schools, "in light of the nexus between the demand for such facilities and the population growth attendant to development."[183] Additionally, consider the fact that "[c]ommercial development attracts new residents to an area, increasing the need for housing, and reducing the land that may be devoted for such residences. As a result, real estate prices[] rise, and lower-income families are deprived of a chance at affordable housing."[184]

In a line of decisions beginning with *South Burlington County NAACP v. Mount Laurel Township*,[185] the Supreme Court of New Jersey held that New Jersey's constitution requires municipalities to provide a fair share of the affordable housing needed in the state.[186] *Mount Laurel* has been one of the most important innovations in fair housing activism in recent years because it allowed an effort to leverage the power of

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180. *See* 24 C.F.R § 100.70(d) (2024); Kennedy v. City of Zanesville, 505 F. Supp. 2d 456, 495 (S.D. Ohio 2007). In July 2008, a jury awarded the plaintiffs $11.6 million for illegally denying water service to African American residents. *See* Kevin Murray & Sara Kominers, *The Human Right to Water in the United States: A Primer for Lawyers & Community Leaders*, NE. UNIV. SCHOOL OF L. 14 (2021), https://law.northeastern.edu/wp-content/uploads/2021/04/phrge-water-primer.pdf (last visited Nov. 8, 2024). The case ultimately settled for $9.6 million. *See id.*

181. *See* Ammons v. Dade City, 783 F.2d 982, 983 (11th Cir. 1986); Baker v. City of Kissimmee, 645 F. Supp. 571, 573, 590 (M.D. Fla. 1986); Bryant v. City of Marianna, 532 F. Supp. 133, 135 (N.D. Fla. 1982); Johnson v. City of Arcadia, 450 F. Supp. 1363, 1376–79 (M.D. Fla. 1978); Selmont Improvement Ass'n v. Dallas Cnty. Comm'n, 339 F. Supp. 477, 481 (S.D. Ala. 1972); Campbell v. Bowlin, 724 F.2d 484, 489–90 (5th Cir. 1984).

182. *See, e.g.*, Shanna L. Smith, *The Legal Guide to Affordable Housing Development: Incorporating Fair Housing into Affordable Housing Policy and Programs*, 20 J. AFFORDABLE HOUS. & CMTY. DEV. L. 215, 235–37 (2011); Patricia E. Salkin & John M. Armentano, *The Fair Housing Act, Zoning, and Affordable Housing*, 25 URB. LAW. 893, 893–94, 902–03 (1993); Tim Iglesias, *Affordable Housing, Fair Housing and Community Development: Joined at the Hip, We Need to Learn to Walk Together*, 25 J. AFFORDABLE HOUS. & CMTY. DEV. L. 195, 199–201 (2017).

183. Ross Lloyd, *Fair Housing: Nonresidential Developers May Have to Contribute to Municipal Affordable-Housing Fund*, 21 REAL EST. L. REP. 6, 7 (1991).

184. *Id.*

185. S. Burlington Cnty. NAACP v. Mount Laurel Twp., 336 A.2d 713, 733–34 (N.J. 1975); S. Burlington Cnty. NAACP v. Mount Laurel Twp., 456 A.2d 390, 413–14 (N.J. 1983); Hills Dev. Co. v. Bernards Twp., 510 A.2d 621, 632 (N.J. 1986); *In re* Adoption of N.J.A.C. 5:96 & 6:97, 110 A.3d 31, 33 (N.J. 2015) (collectively making up the "Mount Laurel doctrine").

186. *S. Burlington Cnty. NAACP*, 336 A.2d at 724–25.

government to further racial and class integration to play out for policy-makers, activists, and scholars to evaluate all of its successes and short-comings. When the court came to the question of whether or not municipalities could compel nonresidential developers to pay development fees into an affordable housing trust fund, the court ruled in the affirmative and recognized the inextricable relationship between fair housing and broader land use policies.[187] Indeed, water, electricity, sewer, and wastewater services are essential features of modern housing.

Water prices have soared across the United States, more than doubling between 1990 and 2006.[188] At least two events drew the national—and to some degree global—attention to the severe inequity in access to water service that millions of Americans face: the uncovering of toxic levels of lead in the water supply in Flint, Michigan, and thousands of water shut-offs in Baltimore and Detroit due to unpaid bills.[189] Across urban areas in the United States, the price of water is rising faster than inflation, in part as a way of recouping the cost of infrastructure investments—likely funded through revenue bond debt.[190] By most standard metrics, "[w]ater is generally considered 'affordable' when families spend no more than . . . 4.5% [of their median household incomes] on water and wastewater services."[191] According to a 2016 U.S. Government Accountability Office (GAO) study, in four out of the ten cities the GAO studied, the low-income households spent more than 8% of their income on water and sewer service—nearly four times the acceptable standard for affordability.[192] In May 2024, the U.S. Department of Health and Human Services (HHS) released a report which, according to HHS, analyzed the largest survey of water rates, arrears, disconnections and fees in one dataset in the country, with information from more than 1,800 water and wastewater providers, representing the District of Columbia and every state except South Dakota.[193] The report concluded that, on average, 20% of U.S.

187. Holmdel Builders Ass'n v. Twp. of Holmdel, 583 A.2d 277, 293–94 (N.J. 1990).

188. Coty Montag, *Lien In: Challenging Municipalities' Discriminatory Water Practices Under the Fair Housing Act*, 55 HARV. C.R.-C.L. L. REV. 199, 200 (2020).

189. *See* Jessica J. Goddard, Isha Ray, & Carolina Balazs, *Water Affordability and Human Right to Water Implications in California*, 16 PLOS ONE, Jan. 2021, at 1, 2; *see also* Marissa Jackson Sow, *Coming to Terms: Using Contract Theory to Understand the Detroit Water Shutoffs*, 96 N.Y.U. L. REV. ONLINE 29, 35 (2021).

190. *See* Goddard, Ray, & Balazs, *supra* note 189, at 2; Ellen Hanak et al., *Paying for Water in California*, PUB. POL'Y INST. OF CAL., Mar. 2014, at 1, 28 ("Monthly water bills have indeed been going up faster than inflation to recoup the costs of new investments.").

191. Montag, *supra* note 188, at 203 (noting, however, that "[t]his affordability metric has been soundly criticized, particularly given that current income does not account for the toll of individual economic hardships, such as varying family size, credit access, standards of living, and demands on resources"). Thus, even these percentages may be too high for some.

192. *Id.* at 204 (citing U.S. GOV'T ACCOUNTABILITY OFF., GAO-08-751, WATER INFRASTRUCTURE 27 (2016), https://www.gao.gov/assets/680/679783.pdf).

193. U.S. DEP'T OF HEALTH & HUM. SERVS. (HHS), UNDERSTANDING WATER AFFORDABILITY ACROSS CONTEXTS: LIHWAP WATER UTILITY AFFORDABILITY SURVEY REPORT 4 (2024) [hereinafter HHS REPORT], https://www.acf.hhs.gov/sites/default/files/documents/ocs/lihwap-survey-report-03-14-24.pdf; Press Release, U.S. Dep't of Health and Hum. Servs., HHS Releases Large Scale Water Utility Affordability Survey Report as Part of the First-Ever Federal Water Assistance Program (Mar. 21, 2024), https://www.hhs.gov/about/news/2024/03/21/lihwap-water-affordability-report.html.

households are in debt to their water utility.[194] The percentage of tribal households in this position is at 32%.[195] A 2023 Duke University study evaluated nearly 800 of the largest drinking water providers across every U.S. state and concluded that basic water services are unaffordable for 17% of households in the study—more than 28 million people.[196]

Consistent with the racial wealth gap, rising water and sewer rates disproportionately affect communities of color.[197] Racial wealth disparities play a significant role in explaining how the effects of rate covenants trickle down to negatively affect low-income residents, including low-income communities of color. Still, studies have shown that "wealth and income gaps do not fully explain the disproportionate impact of rising water bills on communities of color."[198] Researchers have found greater disparities in water prices and access to water and sewer service in areas with greater proportions of racial minorities, even after controlling for income differences.[199]

Coty Montag, senior counsel at the NAACP Legal Defense and Educational Fund (LDF), has emphasized how municipal liens for unpaid water bills can cause families to lose their homes through foreclosure and eviction.[200] Public utilities have generally issued or sold tax-exempt municipal bonds to fund water infrastructure projects. As federal investment in waste and wastewater systems has declined, local government entities have had to rely more heavily on municipal debt to cover costs. The conventional wisdom has been that local governments charge higher rates to customers because municipal utility entities face increased costs.[201] The phenomenon of rate covenants, however, suggests that bond issuers agreed to charge higher rates from the outset when they took on municipal debt to finance infrastructure investments. Thus, local governments are aware of the risk of increased costs far in advance and fail to protect users from excessive rate increases by contracting or regulating around it. Unaffordable water service starts upstream with rate covenants in revenue bonds.

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194. HHS REPORT, *supra* note 193, at 5.

195. *Id.*

196. Lauren A. Patterson, Sophia A. Bryson, & Martin W. Doyle, *Affordability of Household Water Services Across the United States*, 2 PLOS WATER, May 2023, at 1, https://www.nasuca.org/wp-content/uploads/2023/11/Affordability-of-Water-Services-in-the-US-05.10.2023.pdf.

197. Brett Walton, *Water Affordability Is a New Civil Rights Movement in the United States*, CIRCLE OF BLUE (Mar. 22, 2016), http://www.circleofblue.org/2016/water-policy-politics/water-rights-access/water-affordability-new-civil-rWights-movement-united-states/.

198. Montag, *supra* note 188, at 205.

199. *Id.*; *see also* Rachel Butts & Stephen Gasteyer, *More Cost Per Drop: Water Rates, Structural Inequality, and Race in the United States—The Case of Michigan*, 13 ENV'T PRAC. 386, 391 (2011); KIMBERLY FOLTZ-DIAZ, PATRICK KELLEHER-CALNAN, & SUREN MOODLIAR, MASS. GLOB. ACTION, THE COLOR OF WATER: A REPORT ON THE HUMAN RIGHT TO WATER IN THE CITY OF BOSTON 4–5 (2012).

200. *See* Montag, *supra* note 188, at 206; COTY MONTAG, THE THURGOOD MARSHALL INST. AT THE NAACP LEGAL DEF. & EDUC. FUND, INC., WATER/COLOR: A STUDY OF RACE & THE WATER AFFORDABILITY CRISIS IN AMERICA'S CITIES, at A1 (2019), https://tminstituteldf.org/wp-content/uploads/2019/12/Water_Report_FULL_12_20_19.pdf.

201. Montag, *supra* note 188, at 203.

Local governments commit to charge rates necessary to service the outstanding debt, without any exemption to reduce rates to make them affordable. The fact that the FHA covers the discriminatory provision of municipal services, including water service, suggests that a plaintiff may bring a viable claim for a violation of the FHA based on the disparate impact that rate covenants in revenue bonds issued to fund water infrastructure have on the basis of race and national origin for persons who tend to be lower-income.[202] Additionally, the terms of rate covenants and municipal bond offerings should be considered during the discovery phase by plaintiffs challenging the discriminatory provision of municipal services. As Part III explains, however, the relief may be limited to an order enjoining the defendant government entity from incorporating limitless rate covenants in future bond offerings rather than undoing rate covenants in existing bond issuances.

C. Toll Roads and Toll Bridges

While rate covenants in public utilities burden household expenses for cash-strapped residents, toll roads put literal barriers between communities in a spatially segregated society. Indeed, toll roads' popularity grew after World War II, around the same time as spatial segregation along racial lines worsened with the growth of the suburbs.[203] The Pennsylvania Turnpike became the first modern intercity toll road when it opened in 1940.[204] Before the road first opened, bankers were skeptical because the concept of toll roads was untested at the time and they were not sure that travelers would actually pay to use the road.[205] As a result, the state had to rely on financing from the federal government.[206] The popularity of toll roads grew when traffic levels surged after World War II, and New York, Ohio, Massachusetts, and other states built their own superhighways.[207] Indeed, many of the bonds used to finance toll road construction "represented some of the largest [bond] issues of that era."[208] The success of toll roads during the postwar era was closely related to white flight from the cities to the suburbs. Highways, which did not charge tolls, have been a focal point of scholarship about white flight and suburbanization during the postwar period,[209] but the story of transportation and segregation in America is incomplete without considering the impact of toll roads.

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202. *See* Tex. Dep't of Hous. & Cmty. Affs. v. Inclusive Cmtys. Project, Inc., 576 U.S. 519, 538–40 (2015) (holding that disparate impact claims are cognizable under the FHA).

203. Robert H. Muller, *Toll Road Analysis*, *in* THE HANDBOOK OF MUNICIPAL BONDS 981, 982 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008).

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*; *see also* Richard Weingroff, *Why Does The Interstate System Include Toll Facilities?*, U.S DEP'T OF TRANSP., https://www.fhwa.dot.gov/infrastructure/tollroad.cfm (Sept. 8, 2017).

208. Muller, *supra* note 203, at 982.

209. *See* Deborah N. Archer, *"White Men's Roads Through Black Men's Homes": Advancing Racial Equity Through Highway Reconstruction*, 73 VAND. L. REV. 1259, 1263–64 (2020) ("Indeed, highway construction both symbolically and physically encouraged racial segregation and isolation.") (internal quotation marks omitted).

The 1930s through the 1950s saw battles over whether the federal interstate highway system would adopt tolls. University of Virginia historian Peter Norton argues that "people with a stake in the automotive industry" worked to change how roads were funded to avoid having the auto industry go the way of the streetcar, as cities started to dismantle their privately-funded streetcar systems because they no longer generated revenue.[210] Automotive industry stakeholders realized the nation would remain wedded to cars longer if advocates "characterize[d] road-building as a public responsibility."[211] Toll roads posed a threat because they could lead to a view that only the owners of cars should be responsible for paying to build roads designed for large numbers of automobiles and the general public should not have to pay to build roads that people who did not own cars would never use.[212] Instead, automobile advocates argued that the government should pay for roads, a move that benefited the nation's nascent car industry because it made car ownership more convenient, which would in turn incentivize people to buy cars. Automobile advocates suggested that the government should finance highway construction with revenue bonds backed by gasoline taxes.[213] They started calling these roads "free roads"—which evolved into the modern moniker "freeways"—to persuade the federal government to shift its attention away from tolls.[214] "Free roads" implied a sense of public ownership because "taxpayers pay for 'free roads.'" In 1939, the U.S. Bureau of Public Roads embraced the "free road" position when it issued a report to Congress entitled *Toll Roads and Free Roads* in which it rejected using tolls to finance the construction of interstate highways.[215]

Toll roads have remained in constant competition with so-called freeways throughout the interstate highway system's life. During the 1940s, more than a dozen states started building toll roads after the Pennsylvania Turnpike opened—"often in corridors that had been designated as part of the Interstate System."[216] Congress debated how to respond to these turnpikes. It struggled to do so because the problem implicated

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210. Joseph Stromberg, *Highways Gutted American Cities. So Why Did They Build Them?*, VOX, https://www.vox.com/2015/5/14/8605917/highways-interstate-cities-history (May 11, 2016, 9:20 AM); *see also* PETER D. NORTON, FIGHTING TRAFFIC: THE DAWN OF THE MOTOR AGE IN THE AMERICAN CITY 7 (Wiebe E. Bijker, W. Bernard Carlson, & Trevor Pinch eds., 2008).

211. Stromberg, *supra* note 210.

212. *Id.*

213. *Id.*

214. *Id.*

215. Weingroff, *supra* note 207. The Bureau also considered the fact that "the majority of automobile owners had low incomes, and that half of all family cars were owned by families that had an annual income of $1,500 or less," which was significant because the median income of an American family in 1939 was less than $1,217. *See* Carlos Sun, *The Toll Road Not Taken: Could the One Option Less Used Make A Difference?*, 21 KAN. J.L. & PUB. POL'Y 280, 288 (2012). The Bureau assumed that, for these car owners, "a toll of one cent per mile was not feasible because it was a 100% increase in the cost of operation." *Id.* at 289. The cost of gasoline was a little more than one cent per mile. *See id.* at 289. Thus, a gasoline tax that slightly increased the cost of gasoline, which could ultimately finance a toll-free road, would lead to significantly less than a 100% increase in cost for the average driver.

216. Weingroff, *supra* note 207.

obligations to investors in municipal bonds. Congress considered building toll-free interstate highways parallel to the turnpikes, but doing so would threaten bondholders' investments.[217] In 1956, Congress eventually decided to incorporate existing toll facilities into the interstate highway system.[218] By 2018, the 46,730-mile interstate highway system included approximately 2,900 miles of toll-charging turnpikes.[219] While the "free road" position mostly won out, the fact that Congress had to compromise and incorporate toll roads into the interstate highway system illustrates Norton's point: "[o]f course, there's no such thing as a free road."[220]

Toll roads facilitated the movement of middle- and high-income white families to the suburbs throughout the latter part of the twentieth century because the cost of using a toll road could pose a greater barrier to entry for low-income people of color, thereby keeping suburban neighborhoods white and upper class.[221] In Atlanta in the 1980s and 1990s, toll roads were built to connect interstate highways surrounding the city, which fueled one of the nation's most famous examples of segregated sprawl.[222] These second-generation toll roads are "largely urban highways, shorter in length than the older toll roads and designed to provide added mobility within metropolitan areas rather than between cities or regions."[223] Toll roads thrive in an environment of inner cities and outer ring suburbs where people have to travel between a central city and towns or between towns for employment and recreational opportunities. The number of users on toll roads increases with racial sprawl as suburbs become disproportionately white and metro areas' non-white populations remain disproportionately in the inner city.[224]

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217. *Id.* Congress considered repaying the bondholders and removing the tolls on the existing toll roads but decided against it because "it would divert hundreds of millions of dollars from the construction program without adding a single mile of highway to the Interstate System." *See id*.

218. *Id.*

219. *Id.*

220. *Id.*; *see also* NORTON, *supra* note 210, at 197–200.

221. *See* Omari Scott Simmons, *Urban Removal: Reshaping Urban Landscapes Through a Responsive Communitarian Lens*, 29 CORNELL J.L. & PUB. POL'Y 885, 944 (2021); *No Tolls for I-275, FDOT Decides, but Now Its Focus Switches to I-75*, TAMPA BAY TIMES (May 1, 2018), https://www.tampabay.com/news/transportation/No-tolls-for-I-275-FDOT-decides-but-now-its-focus-switches-to-I-75_167841597/ (describing the end of a plan to install express tolls on Interstate 275 in Tampa, Florida, a thoroughfare that runs through several Black and Latinx neighborhoods, and instead shifting focus to tolls on Interstate 75, which leads into Tampa's majority white northern suburbs).

222. *See* Elizabeth E. Henry, Halting White Flight, Atlanta's Second Civil Rights Movement (May 5, 2012) (Ph.D Dissertation, Georgia State University) (https://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1029&context=history_diss) (shining a light on the story of a small group of white mothers mobilizing to support investment in Atlanta public schools and remaining in Atlanta proper in the midst of highway and toll road expansions driving displacement and white flight).

223. Muller, *supra* note 203, at 983.

224. *See, e.g.*, David D. Troutt, *Katrina's Window: Localism, Resegregation, and Equitable Regionalism*, 55 BUFF. L. REV. 1109, 1112–13 (2008); Robert D. Bullard, *Anatomy of Sprawl*, *in* SPRAWL CITY: RACE, POLITICS, AND PLANNING IN ATLANTA 1, 2–7 (Robert D. Bullard, Glenn S. Johnson, & Angel O. Torres eds., 2000); Florence Wagman Roisman, *Opening the Suburbs to Racial Integration: Lessons for the 21st Century*, 23 W. NEW ENG. L. REV. 65, 84 (2001) (arguing that the "separation of white suburbs from inner cities of color" did "lasting damage"); Etienne C. Toussaint, *Of American*

State and local governments have created more than twenty authorities and agencies to finance new urban toll roads and bridges across the country, from southern California to Miami.[225] By 2013, there were forty-four agencies, eight of which were privately operated.[226] The amount of miles covered by toll roads increased rapidly between 1950 and 1960, followed by a gradual increase through 1975.[227] About 450 miles of toll roads were added each year from 1953 to 1958, with about 40 miles added every year thereafter.[228] Since 1975, toll road mileage flattened as the growth in roads was offset by the number of roads where tolls were removed or phased out.[229] One commentator argues that the use of toll roads has grown since the 1970s because the increase in gas prices and the advent of more fuel-efficient cars have reduced revenue from the federal gasoline tax—the main source of funding for non-toll highways.[230] Federal legislation in the 1980s and 1990s also eased restrictions on the construction of toll facilities with federal funds and encouraged the use of tolls as an alternative source of highway transportation funding, particularly in light of declining federal spending on the nation's roads.[231] The relationship between toll roads and racial equity, however, lies in the location of the roads themselves. Many of the newer toll roads are shorter than the older, core system of toll roads.[232] But a "[l]ocational analysis of toll road facilities shows that *nearly all* of these newer, shorter toll roads are located in urban areas while older roads operate in rural or urban areas or a combination of both." Despite the ostensibly neutral reasons for the growth of toll roads in the United States, toll roads have played an integral role in exacerbating racial segregation in urban areas by enabling white flight and suburbanization. The use of revenue bonds to build toll roads and rate covenants to protect bondholders' investment—in turn resulting in high prices unrestrained by the public interest—furthered an "infrastructural investment in whiteness" driven by municipal debt.[233]

The rates that toll road authorities charge often rely on a concept known as the "value of time."[234] This concept identifies that "[e]ssentially the higher an individual's income or the more expensive and perishable a truck cargo, the higher the assumed value of time for that trip and the

Fragility: Public Rituals, Human Rights, and the End of Invisible Man, 52 COLUM. HUM. RTS. L. REV. 826, 838–40 (2021).

225. Muller, *supra* note 203, at 984.

226. Ronald W. Davis III, *U.S. Toll Roads Since 1950: Trends in Toll Rates Per Mile Compared with Inflation*, 2450 TRANSP. RSCH. REC. 144, 146 (2014).

227. *Id.*

228. *Id.*

229. *Id.*

230. Muller, *supra* note 203, at 983.

231. *See* Davis, *supra* note 226, at 147; *see also* Surface Transportation and Uniform Relocation Assistance Act of 1987, Pub. L. No. 100-17, 101 Stat. 132 (1987) (codified at 23 U.S.C. § 101); Intermodal Surface Transportation Efficiency Act of 1991, Pub. L. No. 102-240, § 1012, 105 Stat. 1904, 1936 (1991) (amendment codified at 23 U.S.C. § 129) (authorizing the use of federal funding in the construction and operation of toll roads and facilities).

232. Davis, *supra* note 226, at 146.

233. JENKINS, *supra* note 67, at 15.

234. Muller, *supra* note 203, at 986.

higher the toll rate that can be charged."[235] Thus, toll road authorities analyze how much a driver is willing to pay based on the value of the time associated with the trip that they are taking. Transportation studies have consistently shown that Black Americans have the longest commute times of any racial group in the United States.[236] While the disparities have fallen in small and mid-sized cities, racial disparities in commute times persist in "large, segregated, congested, and—especially—expensive cities, revealing the limits of cars in overcoming entrenched racialization of other factors of commuting."[237] For example, in metropolitan Chicago, a 2017 study showed that

> [*a*]*ll* of the top 20 census tracts with the highest commute times in the region (49–56 minutes) are located in Chicago-proper, and at least 80% of the population is represented by non-white residents, which in this case means either African-American or Latino. Furthermore, 19 out of 20 of these tracts are at least 88% African-American, and over half have a median household income below $30,000.[238]

Toll rates disproportionately affect workers of color who have longer commute times, as segregated "patterns in residential and workplace locations lead to longer commutes for Black workers."[239] Economic models that tollway authorities use to set rates often imagine higher income individuals as the ideal drivers based on the assumption that they will pay a higher toll rate because they have a higher value of time.[240] Yet these calculations do not account for individuals taking "[t]rips with a high degree of time urgency" whose trips therefore have a "higher value of time associated with them."[241] These travelers include low-wage workers who have to move farther from employment centers to find affordable housing, which increases their commute times.[242]

Other metrics take advantage of low-income drivers with few alternative options for commuting to work or traveling around the region. Traffic consultants and analysts who advise on toll road rates often determine

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235. *Id.*

236. *See, e.g.*, devin michelle bunten, Ellen Fu, Lyndsey Rolheiser, & Christopher Severen, *The Problem Has Existed over Endless Years: Racialized Difference in Commuting, 1980–2019*, at 1, 3, 8, 9 (Fed. Rsrv. Bank of Phila., Working Paper No. 22-13, 2022), https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2022/wp22-13.pdf ("Black commuters spent 50.3 more minutes commuting per week in 1980 than White commuters; this difference declined to 22.4 minutes per week in 2019."); *Longer Commutes Disadvantage African-American Workers*, SCIENCEDAILY (Feb. 15, 2014), https://www.sciencedaily.com/releases/2014/02/140215122416.htm (finding that "African-Americans spend more time than any other group getting to work and in some cases spend about 15 minutes more a day than whites commuting").

237. bunten, Fu, Rolheiser, & Severen, *supra* note 236, at 1.

238. Shehara Waas & Emily Rhodes, *Data Points: Black, Brown and Stuck in Traffic*, METRO. PLAN. COUNCIL (Mar. 10, 2017), https://archive.metroplanning.org/news/7406/Data-Points-Black-Brown-and-Stuck-in-Traffic.

239. bunten, Fu, Rolheiser, & Severen, *supra* note 236, at 22.

240. Muller, *supra* note 203, at 986.

241. *Id.*

242. *See The Unequal Commute: Examining Inequities in Four Metro Areas' Transportation Systems*, URB. INST. (Oct. 6, 2020), https://www.urban.org/features/unequal-commute.

a road's profitability by comparing the "actual time traveled on different competing routes."[243] Toll bridges, therefore, are considered more valuable investments than toll roads because "toll bridges are generally less subject to competition than land-based toll roads and in many cases represent near monopolies providing the only travel route across a water crossing."[244]

For example, in July 2013, the Bay Area Toll Authority (BATA) for the San Francisco Bay Area announced it would issue $750 million in subordinate toll bridge revenue bonds.[245] The bonds were subordinate because BATA had already issued bonds that held a claim on revenues and these new bonds were second in line for payment, similar to the way in a which the first mortgage on real estate (known as a "senior mortgage") has priority over any mortgage (known as a "junior mortgage") that comes after it in the event of insolvency. The offering was designed to fund several construction projects, including an eastern span of the San Francisco–Oakland Bay Bridge to make the bridge more resistant to earthquake damage.[246] The bonds were junior to past bonds, which were secured by a prior claim on net toll revenues that BATA collects on its seven bridges in the Bay Area.[247] Moody's gave the 2013 subordinate bonds an A1 rating, noting that "toll revenues provide good coverage of outstanding debt service obligations."[248] Moody's also cited BATA's "flexibility to increase rates to support all debt service associated with the completion of its seismic retrofit program" despite the fact that the toll authority did not have any increases planned until 2027.[249] Moody's enthusiasm over this authority suggests that the power to increase rates matters, even if no rate increases actually take place.

The A1 rating Moody's gave these 2013 subordinate bonds was one level downward from its rating for the senior bonds on the toll roads and

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243. Muller, *supra* note 203, at 987.

244. *Id.*

245. *See* Tonya Chin, *BATA Bringing $750 Million for Bay Area Bridges*, THE BOND BUYER (July 18, 2013, 1:09 PM), https://www.bondbuyer.com/news/bata-bringing-750-million-for-bay-area-bridges. "Subordinated bonds are typically issued when certain contractual elements prohibit or restrict the municipality from issuing more revenue bonds at parity." *Subordinated Revenue Bonds & Certificates of Participation (COP)*, ALL-AM. INV. GRP., https://aaig-finance.com/tax_exempt_financing/subordinated/ (last visited Dec. 12, 2024). An issuer may be required to issue subordinate bonds, also known as junior-lien bonds, because they are subject to a covenant in a previous bond resolution that stipulates that any bond issued after it would be entitled to proceeds after the senior bond is paid unless the junior bond is necessary to complete the enterprise. O'HARA, *supra* note 14, at 198, 201. This "closed-end provision" protects senior bondholders by keeping an issuer from giving a subsequent bond an equal claim to the project's revenues, but they may also make the junior bond harder to market because the rights of the junior bondholders are subordinate to those of the senior bondholders. *See id.* at 201.

246. *Id.*

247. *Id.*

248. *Id.* Moody's rating scale lists investment grade bonds on a scale from highest to lowest as follows: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3. *Moody's Rating Scale and Definitions*, MOODY'S ASIA PAC. DESKTOP REFERENCE, https://www.moodys.com/sites/products/productattachments/ap075378_1_1408_ki.pdf (last visited Sept. 8, 2024).

249. Chin, *supra* note 245.

bridges. To explain this downgrade, Moody's cited the 2013 subordinate bonds' "lower standing in the flow of funds and a weaker rate covenant."[250] A Moody's analyst noted that the subordinate lien on the 2013 bonds' potential toll revenues benefited from the toll authority's "very strong market position," including its "near monopoly over bridge crossings in the San Francisco Bay area, as well as the strong service area demand for its seven bridges."[251] Multiple major credit rating agencies supported their high ratings for BATA's subordinate bonds despite the senior liens on toll revenues by citing the public's dependence on the bridges.[252] Fitch Ratings indicated that its AA rating "reflect[ed] BATA's monopolistic bridge network located within the large and affluent San Francisco Bay Area, strong pricing framework with high pricing power and low demonstrated elasticity of demand."[253] Standard & Poor (S&P)'s rating service assigned an A+ rating to the 2013 bonds, also noting "the demand for and essentiality of the authority's bridge system, as well as management's ability to set and raise tolls to finance its capital program."[254] From 1998 to 2013, drivers on all Bay Area state-owned bridges paid a one dollar seismic surcharge. After the 2013 bond issuance, the rates went up to three dollars to help service the approximately $9 billion in outstanding debt held by BATA's construction program.

These increases have been the subject of intense litigation seeking to control toll fees using state constitutional debt limits. In 2017, the California General Assembly passed Senate Bill 595, which allowed residents to vote on a toll increase of no more than three dollars.[255] Bay Area voters took the opportunity to vote on a regional ballot measure, entitled Regional Measure 3 (RM3), that would increase tolls in all nine counties in the Bay Area.[256] On June 5, 2018, a majority of Bay Area voters approved RM3, including a toll increase of three dollars phased in over time, increasing the toll for vehicles traveling on the bridges by one dollar every three years until 2025.[257] The two leading lawsuits challenging this increase have

250. *Id.*
251. *Id.*
252. *Id.*
253. *Fitch Rates BATA's Sr Toll Revs Series 2021 D, E, F-2 and F-3 'AA'; Outlook Stable*, FITCH RATINGS (Nov. 22, 2021 5:06 PM), [hereinafter *Fitch Rates*] https://www.fitchratings.com/research/us-public-finance/fitch-rates-bata-sr-toll-revs-series-2021-d-e-f-2-f-3-aa-outlook-stable-22-11-2021. "Fitch's credit rating scale for issuers and issues is expressed using the categories 'AAA' to 'BBB' (investment grade) and 'BB' to 'D' (speculative grade) with an additional +/- for AA through CCC levels indicating relative differences of probability of default or recovery for issues." *Rating Definitions*, FITCHRATINGS, https://www.fitchratings.com/products/rating-definitions (last visited Dec. 12, 2024). The ratings move from three to two, down to one letter, before dropping to the next letter (i.e., AAA, AA, A, BBB, BB, etc.). *See id.*
254. Chin, *supra* note 245. Standard and Poor's uses the same ratings scale system as Fitch. *See Bond Ratings*, FIDELITY, https://www.fidelity.com/learning-center/investment-products/fixed-income-bonds/bond-ratings (last visited Dec. 12, 2024).
255. S. 595, 2017–2018 Leg., Reg. Sess. (Cal. 2017).
256. S.F. BAY AREA RAPID TRANSIT DIST., $758,550,000* SAN FRANCISCO BAY AREA RAPID TRANSIT DISTRICT GENERAL OBLIGATION BONDS app. A at A-24 (Apr. 29, 2022), https://www.bart.gov/sites/default/files/docs/CASanFrancisco04a-POS.pdf.
257. *Id.*

alleged that Senate Bill 595 is unconstitutional and RM3 was a special tax that required approval by two-thirds of the voters rather than a majority.[258] The intermediate appellate court placed a decision in the case on hold pending the Supreme Court of California's ruling in another case: *Zolly v. City of Oakland*.[259] In *Zolly*,[260] the California high court considered whether franchise fees that the City of Oakland charges to certain waste hauling companies are exempt from the voter approval requirements that apply to taxes under Proposition 26, Article XIII C of the California Constitution.[261] The relevant provision arguably exempts charges "imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property."[262] On August 11, 2022, the *Zolly* court remanded the case, concluding that it lacked sufficient factual evidence to determine whether the provision applied to franchise fees.[263] The case is currently still in litigation before the trial court.[264]

The relationship between the cases that the courts have identified highlights the importance of voter approval requirements in controlling user fees charged to residents. Setting revenue bonds outside the purview of these state constitutional restrictions forecloses yet another avenue for civil rights advocates to protect the public's interest in affordability and to reduce the racially disparate impact of user fees set by rate covenants in municipal debt instruments.[265] The results in the two cases remain mixed at the moment, but they each leave open potential avenues to challenge high user fees. In *Zolly*, advocates have viewed the high court's decision to remand the case as an indication that franchise fees paid to cities by companies that enter into agreements with cities to provide public services

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258. *Id.* (citing Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth., 265 Cal. Rptr. 3d 235 (Cal. Ct. App. 2020)); *see also* Whitney v. Metro. Transp. Comm'n, 265 Cal. Rptr. 3d 235 (Cal. Ct. App. 2020) (consolidated with *Howard Jarvis*).

259. Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth., 265 Cal. Rptr. 3d 235 (Cal. Ct. App. 2020), *rev. dismissed & remanded*, 522 P.3d 1074 (Cal. 2023).

260. 514 P.3d 799 (Cal. 2022).

261. *Id.* at 801.

262. CAL. CONST. art. XIII(C), § 1(e)(4).

263. *Zolly*, 514 P.3d at 810.

264. The trial court is the Superior Court of Alameda County, Case No. RG16821376.

265. It is notable that, in *Zolly*, the issue turns on the meaning of the phrase "local government property." While the court indicated that it lacked evidence to determine whether a franchise fee charged to a waste hauler for its right to bring heavy equipment through city streets and place waste receptacles should be considered a form of "local government property," *see id.* at 808–09, it seemed clear to the court that "the term 'local government property' in [A]rticle XIII C seems to refer to physical objects under the control of a local government, such as its streets and rights-of-way." *Id.* at 807. As a result, it may be easier for the plaintiffs in the toll increase cases to establish that the Bay Area toll roads and bridges are "local government property" within the meaning of the state constitutional provision and, as a result, the tolls are subject to the two-thirds voter approval requirement. Still, there are various theories that could be raised to contradict the position that tolls are "special taxes" under Article XIII C or that the toll roads and bridges are "local government property" to the extent the toll roads and bridges are still subject to various outstanding bond obligations that could limit the extent to which ownership has truly passed to the local government such that it can fully control the rates, or "special taxes" it must impose in light of the bond covenants. *See, e.g.*, Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth., 265 Cal. Rptr. 3d 235, 239, 241 (Cal. Ct. App. 2020).

may ultimately require voter approval.[266] The court did suggest, however, that the fees may fall under another exemption from the voter approval requirement as "[a] charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged" as long as the record ultimately shows that the fee "does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege."[267]

By contrast, the transportation authorities that oversee the toll roads ultimately succeeded against the challenge brought against them. On January 25, 2023, the California Supreme Court dismissed the challenge to toll increases, effectively approving RM3, and ordered the release of $545.3 million in Bay Area bridge tolls that had been held in escrow during the pendency of the lawsuits.[268] The decision arguably served as an endorsement of ballot initiatives like RM3 as a way for voters to have input on rate increases, although with only a majority vote for passage.

The disputes, however, never significantly damaged the subordinate bonds' ratings. In 2021, credit rating firm Fitch found that BATA's bond offering and the likelihood of repayment remained stable.[269] Investors have greater certainty because the public cannot reasonably drive from one side of the bay to the other without using one of BATA's bridges. Bay Area residents have no choice but to pay the rates BATA requires.

No matter what the rate is, residents subject to toll roads and toll bridges—rich or poor—are at the mercy of the rate covenant. As Ursula the sea witch reminds Ariel in *The Little Mermaid* before Ariel signs away her voice to Ursula in a desperate bid to become human, "If you want to cross the bridge, my sweet/You've got to pay the toll."[270]

D. Senior Housing and Assisted Living

Municipalities sometimes use revenue bonds to finance the construction of retirement communities or assisted living facilities for seniors:

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266. *See, e.g.*, *Zolly v. City of Oakland Requires Reexamination of Local Franchise Fees*, RURAL CNTY. REPRESENTATIVES OF CAL. (Aug. 26, 2022), https://www.rcrcnet.org/zolly-v-city-oakland-requires-reexamination-local-franchise-fees; Michael G. Colantuono, *Update on Public Law: New Threat to Franchise Fees*, COLANTUONO HIGHSMITH & WHATLEY, PC (Fall 2022), https://chwlaw.us/wp-content/uploads/2022-Fall-Newsletter.pdf.

267. *See Zolly*, 514 P.3d at 809–10 (citing CAL. CONST. art. XIII C, § 1(e)(1)). In *Zolly*, the amici who filed briefs suggested that franchise fees may fall under exception (e)(1) and thus would not be considered taxes subject to voter approval, but the City of Oakland, for reasons unexplained in the opinion, "resist[ed] this application of Exemption 1." *See id.* at 809. It is unclear whether the city will ultimately pursue this theory in the trial court.

268. *See* Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth., 522 P.3d 1074 (Cal. 2023) (dismissing and remanding case); Carolyn Yu, *CA Supreme Court Ruling Ends Dispute for $545M in Bay Area Bridge Tolls*, DAILY CAL. (Jan. 30, 2023), https://www.dailycal.org/news/city/ca-supreme-court-ruling-ends-dispute-for-545m-in-bay-area-bridge-tolls/article_1e89717b-2569-5a1f-ac9d-b6f6840c372c.html (referring to decision).

269. *Fitch Rates*, *supra* note 253.

270. PAT CARROLL, POOR UNFORTUNATE SOULS, *on* THE LITTLE MERMAID (Walt Disney Recs. 1989).

> In the municipal bond arena, a continuing care retirement community (CCRC) is a nonprofit corporation providing or arranging for housing and designated health-related services to an elderly person pursuant to a residency agreement or agreements effective for the rest of the person's life or for a specified period exceeding one year. To provide such designated health-related services, the CCRC (1) accepts an advance fee deposit or other type of entry fee and (2) charges a full or discounted periodic monthly fee. . . . *The collection of advance fee deposits sets a CCRC apart from other housing bonds* or, from a consumer's point of view, from other senior living options.[271]

In 2017, there were just under 1,955 total CCRCs operating across the United States.[272] In these transactions, the municipality often serves as a "conduit" for the issuance of the bond. The city lends its tax-exempt status to the project because senior housing facilities are considered beneficial to the public interest.[273]

Rate covenants in bonds for CCRCs are usually worded to make a default finding more difficult to trigger compared to most other rate covenants.[274] While the rate covenants in other revenue bonds usually allow a finding of default if the revenue falls below the amount necessary to service 100% of the debt with additional liquidity (cash on hand) in just one year, for a CCRC bond, the ratio must fall below 100% for multiple years.[275] Bond issuers provide this level of flexibility because, in a stabilized CCRC, the net cash receipts from net advance fee deposits is uncertain.[276] Even when the CCRC does not experience turnover, the debt service coverage will be below 100% because of the lack of net advance fee deposits, but the debt service is still paid on time with cash on hand.[277] This additional hurdle to trigger a violation of the rate covenant, however, does not mean that CCRCs any less of a profitable investment.

According to researchers, "[i]n the last 20 years, the assisted living industry has experienced tremendous growth as an additional residential [long-term care] option primarily for older adults with greater financial resources."[278] The wealth disparities that heighten the significance of rate covenants also play out in the context of senior housing. "In 2013, the median net worth of [Black] older adult households ($56,700) was roughly

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271. Edward C. Merrigan, *How to Analyze Startup Continuing Care Retirement Community Bonds*, *in* THE HANDBOOK OF MUNICIPAL BONDS 941 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008) (emphasis added).

272. Katherine C. Pearson & David Sarcone, *Ongoing Challenges for Pennsylvania Continuing Care and Life Plan Communities*, 90 PA. BAR ASS'N Q. 1, 3 (2019).

273. *See, e.g.*, Marie Puleo, *John Knox Village Transformation to Continue with Revenue Bonds from the City of Pompano Beach*, COASTAL NEWS (Dec. 3, 2021), https://thecoastalnews.com/john-knox-village-expansion-to-continue-with-revenue-bonds-from-pompano-beach/.

274. Merrigan, *supra* note 271, at 954.

275. *Id.*

276. *Id.*

277. *Id.*

278. Meghan Jenkins Morales & Stephanie A. Robert, *Black-White Disparities in Moves to Assisted Living and Nursing Homes Among Older Medicare Beneficiaries*, 75 J. GERONTOLOGY: SOC. SCIS. 1972, 1972 (2020).

one-fifth of the median net worth of white older adult households ($255,000)."[279] CCRCs, also known as "life plan communities," generally charge a one-time, upfront entrance fee of between $100,000 and $1 million, with an average fee of about $300,000.[280] Some facilities charge monthly fees in addition to these upfront costs, while others charge high entrance fees with no monthly fee thereafter.[281] However, "[u]nder a traditional life care plan, the members pay an upfront entry fee, monthly fees, and a portion of their costs of care as copayments."[282] Rate covenants for CCRCs are rather generous because CCRCs rely on advance fee deposits.[283] Thus, it is easier for developers to obtain tax-exempt construction financing in the form of revenue bonds because of these upfront payments. Bondholders can also rely on the remittance of regular payments in addition to the entrance fees, which increases the certainty.

Local and federal tax law also subsidizes various costs related to living in a life plan community. Residents generally are exempt from property taxes on their community apartments.[284] Likewise, CCRCs qualify for tax deductions on portions of the entrance fees and monthly health care fees.[285] This subsidization of retirement communities that are available primarily to white older adults is consistent with the myriad ways in which the federal tax code further entrenches the wealth gap and benefits white and non-white individuals unevenly, as law professor Dorothy A. Brown outlined in her trailblazing work, *The Whiteness of Wealth*.[286] Rate covenants loosen when they finance facilities that will disproportionately benefit higher income white individuals who can afford to pay in advance. Rate covenants tighten when the bond provides financing that benefits lower income Black individuals who cannot afford to pay in advance. Thus, there are fewer affordable assisted living options for Black older adults.

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279. JAMES H. JOHNSON, JR., FRANK HAWKINS KENAN INST. OF PRIVATE ENTER., RACE, OLD AGE VULNERABILITIES, AND LONG-TERM CARE 1 (2019).

280. *A Closer Look at CCRC Entry Fees*, MYLIFESITE (Dec. 21, 2021), https://mylifesite.net/blog/post/a-closer-look-at-ccrc-entry-fees/.

281. Pearson & Sarcone, *supra* note 272, at 1, 9. Indeed, there is so much variation in CCRC models that industry spokespersons are known to reportedly claim, "If you have seen one CCRC, you've seen one CCRC." *See id.* at 6.

282. *Id.* at 1, 9.

283. *See* Merrigan, *supra* note 271, at 942; Heather Gillers, *Retirement Communities Lose Residents, Attract Muni Investors*, THE WALL ST. J. (Jan. 4, 2022, 7:00 AM), https://www.wsj.com/articles/retirement-communities-lose-residents-attract-muni-investors-11641271160.

284. *CCRC Retirement Communities and the Benefits of an Entry Fee*, HUMANGOOD, https://www.humangood.org/resources/senior-living-blog/why-pay-entry-fee-to-senior-living (last visited Nov. 29, 2022); *see* Brad Breeding, *Understanding Tax Deductions for CCRC Residents*, MYLIFESITE (July 6, 2021), https://mylifesite.net/blog/post/understanding-tax-deductions-for-ccrc-residents/.

285. *CCRC Retirement Communities*, *supra* note 284.

286. *See* DOROTHY A. BROWN, THE WHITENESS OF WEALTH: HOW THE TAX SYSTEM IMPOVERISHES BLACK AMERICANS—AND HOW WE CAN FIX IT 20–21 (2021).

Rate covenants for life plan communities increase the cost of entry for assisted living, a cheaper form of elder care in the long run than nursing home care.

> In 2018, the annual median cost for assisted living in the United States was roughly $48,000, compared to $89,000 for a semi-private room in a nursing home. Most assisted living residents privately pay for services as well as room and board, whereas the majority of nursing home residents rely on Medicaid to cover all housing, food, and service costs. High out-of-pocket costs and few public financing options limit the ability of low- and moderate-income older adults to access assisted living as a [long-term care] and housing option.[287]

In the realm of long-term care, just as it is many other facets of American economic life, it is expensive to be poor.

According to health care researchers, "[n]ational estimates suggest that Black older adults are underrepresented in assisted living and overrepresented in nursing homes."[288] Title VI of the Civil Rights Act of 1964 exempted nursing homes from required public disclosures of information about race and ethnicity in medical treatment and referral patterns.[289] The facilities were also originally exempt from compliance reviews,[290] but a mandatory resident assessment system now provides complete information about nursing home care by race, allowing researchers to study racial use patterns.[291] The data shows that Black and white older adults who live in long-term care environments tend to occupy racially segregated facilities.[292] A 2008 study shows that white older adults have increasingly turned to private-pay alternatives to nursing home care, like CCRCs and other assisted living facilities.[293] In 2000, nursing home use among Black older adults was 14% higher than it was among white older adults.[294]

The strength of continuing care retirement communities may rely, to some extent, on the racially segregated nature of the project. For example, developers and government issuers conduct feasibility studies for a CCRC

287. *See* Morales & Robert, *supra* note 278, at 1973 (citation omitted).
288. *Id.* (citation omitted).
289. David Barton Smith, Zhanlian Feng, Mary L. Fennell, Jacqueline Zinn, & Vincent Mor, *Racial Disparities in Access to Long-Term Care: The Illusive Pursuit of Equity*, 33 J. HEALTH POLS., POL'Y & L. 861, 862 (2008).
290. *Id.*
291. *Id.*
292. *See* JAMES H. JOHNSON JR., ALLAN M. PARNELL, & TERRY L. JOHNSON, CEDAR GROVE INST. FOR SUSTAINABLE COMMUNITIES, AFRICAN AMERICAN VOICES REGARDING CONTINUING CARE RETIREMENT COMMUNITIES/LIFE PLAN COMMUNITIES 5 (2018), https://cdn.ymaws.com/www.leadingagenc.org/resource/resmgr/diversity_study_2018/african_american_voices_&_cc.pdf.
293. Smith, Feng, Fennell, Zinn, & Mor, *supra* note 289, at 876–77.
294. *Id.* at 871.

prior to issuance of the bond.[295] Developers and investors rely on these studies in an effort to ensure the facilities are not "overbuilt."[296] Developers also use "up-front pre-marketing, which ordinarily secures at least sixty percent pre-commitments before construction begins."[297] Fair housing investigations of assisted living facilities suggest that they may have a pattern of using racially discriminatory advertising, whether during the pre-marketing phase or otherwise, that discourages non-white residents from applying. A 2009 study from the Metropolitan St. Louis Equal Housing Opportunity Council (EHOC), a federally funded fair housing rights organization, investigated advertisements for senior housing communities in the St. Louis metropolitan area. The EHOC filed fourteen complaints against senior assisted living communities, alleging that they advertised the communities to convey a preference for white residents by, for example, only including photographs of people of color as employees but not as residents.[298] Indeed, in some cases, the organization found advertisements where the only Black individuals featured in the advertisement were opening doors or cooking food for residents.[299]

If the EHOC report's findings reflect national trends, then they suggest that discouraging Black people from applying for housing is part of how developers and bond issuers attract residents who can afford to pay entrance fees of tens or hundreds of thousands of dollars to justify flexible rate covenants. After all, given that senior housing for older adults remains racially segregated and a disproportionate number of higher-income individuals are white, a project geared toward white residents remains more profitable. These projects do not turn into tax-free municipal bonds that reach the hands of potential investors without local government issuers to serve as conduits for bringing them to market. Local governments benefit from the increase in other taxable revenue that these senior housing developments generate, including through their ability to attract or retain higher income residents who stimulate the local economy and pay taxes. Currently, bond investors are hungry for tax-exempt municipal bonds and

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295. Merrigan, *supra* note 271, at 941 ("[P]ractically all startup CCRC bond issues are floated with feasibility studies. These studies provide the core raw information that must be analyzed to discern good projects from potentially bad ones.").

296. VanEck, *CCRCs: A Growing Source of Municipal Bonds*, SEEKING ALPHA (Jun. 30, 2017, 2:05 PM), https://seekingalpha.com/article/4085158-ccrcs-growing-source-of-municipal-bonds.

297. *Id.*

298. *EHOC Finds Widespread Discrimination in Senior Housing Market, Files 14 Complaints*, THE ST. LOUIS AM. (Sept. 25, 2009), https://www.stlamerican.com/news/local-news/ehoc-finds-widespread-discrimination-in-senior-housing-market-files-14-complaints/. The FHA prohibits "mak[ing], print[ing] or publish[ing], or caus[ing] to be made, printed, or published any notice, statement, or advertisement . . . that indicates any preference, limitation, or discrimination . . . or an intention to make any such preference" against a protected class. 42 U.S.C. § 3604(c); *see also* 24 C.F.R. § 100.75(a) (2024) (HUD advertising guidelines).

299. *See* METRO. ST. LOUIS EQUAL HOUS. OPPORTUNITY COUNCIL, SELECTIVE MARKETING: A REPORT ON SENIOR HOUSING PROVIDERS' COMPLIANCE WITH THE FAIR HOUSING ACT ADVERTISING REQUIREMENTS 3 (2009) (explaining that "the FHA takes into account that a picture is worth a thousand words. Housing providers that avoid blatantly discriminatory language may still violate the FHA when they, for instance, depict minorities only as employees, display a cross or Star of David, or exclusively show photographs of able-bodied residents").

continue to purchase senior housing bonds despite their recently high default rates.[300] But local governments are complicit in these violations because they lend their issuing power to senior housing developers engaging in FHA violations.

Courts' interpretations of the rate covenants make these bonds attractive by providing bondholders the right to secure payment from entrance fees, which are critical to the strength and security of the investment. Indeed, disputes over rate covenants in senior housing bonds sometimes pit bondholders directly against residents seeking refunds of their fees as courts decide who has priority entitlement to the funds. In *In re Atrium of Racine, Inc.*,[301] the Wisconsin Court of Appeals reversed a trial court ruling in a receivership proceeding involving a senior housing facility that became insolvent.[302] The appeals court held that the residents of a retirement community had priority over bondholders in obtaining a refund of more than $7.4 million in entrance fees, deposit fees, and trust funds as a matter of state landlord–tenant law.[303] In March 2023, however, the Wisconsin Supreme Court reversed the lower appeals court's decision and ruled in favor of the bondholders—a decision which reinforces the protection that courts provide to bondholders even in the presence of contrary legal theories that would warrant holding for the residents.[304]

Costs that rate covenants may control—including water bills, toll fees, and rents at housing developments financed by revenue bonds—can have a regressive effect as they require low-income people to bear the cost of constructing a facility that everyone, in theory, is entitled to use. The consequences of an unpaid water bill—including eviction or home foreclosure—are more likely to happen to low-income people of color than to high-income white users of the same municipal utility. It is a higher burden for a low-income resident to pay a daily toll to use a road that runs through the heart of their city than it is for a high-income resident. Those

300. The Wall Street Journal reported that 8% of the $41 billion in outstanding senior living bonds were in default as of December 2021—the highest levels of default since tracking began in 2009. Gillers, *supra* note 283. This was likely a result of declining enrollments amid the COVID-19 pandemic. *Id.* "The sector now accounts for almost one-quarter of defaulted debt in the muni market, not including bonds caught up in Puerto Rico's bankruptcy." *Id.* Still, "investors remain bullish. After a fall in debt issuance in 2020, senior-living facilities sold $7.4 billion in new bonds in 2021 through Dec. 13, 21% more than they did in 2019 . . . ." *Id.* Investors reportedly view senior housing bonds as the lesser of several evils as the demand for new municipal bonds is greater than the supply in circulation and potential tax increases make tax-exempt investment options more attractive. *Id.*

301. 964 N.W.2d 544 (Wis. Ct. App. 2021).

302. A receivership proceeding is a court action in which a business enterprise is placed under the control of a receiver, usually because of a lack of assets. *Receivership*, BLACK'S LAW DICTIONARY (12th ed. 2024). A receiver is

> an indifferent person between the parties, appointed by the court to collect and receive the rents, issues, and profits of land, or the produce of real estate, or other things in question, pending the suit, which it does not seem reasonable to the court that either party should do, or where a party is incompetent to do so, as in the case of an infant.

D.H. Chamberlain, *New-Fashioned Receiverships*, 10 HARV. L. REV. 139, 139 (1896) (cited in *Receiver*, BLACK'S LAW DICTIONARY (12th ed. 2024)).

303. *Id.* at 545–46.

304. *In re* Atrium of Racine, Inc., 986 N.W.2d 780 (Wis. 2023).

lower-income residents will feel the impact even more where a rate covenant requires the expressway authority to increase prices. An older Black adult may be shut out of an assisted living facility—which would allow them to manage their long-term health needs while preserving their independence—because of cost-prohibitive entry fees, making it harder to break down racial segregation even in the twilight of a person's life. Rate covenants that do not allow local governments to reduce rates for low- to moderate-income users can increase the financial strain of paying for resources, like electricity or water, that residents cannot live without.

III. STANDARD RESPONSES TO THE HARMS OF RATE COVENANTS

Conflicts around rates often show up in times of uncertainty during the life of the bond—namely voter referenda, litigation, and political opposition during a fiscal crisis. The consequences of these all point to the need for states to statutorily require bond issuers to control price increases in the public interest. The following three Sections analyze three policy alternatives for limiting the impact of rate covenants and concludes that these proposals are inadequate to protect marginalized communities from the harms of rate covenants. Section A discusses the possibility of voter referenda to provide greater accountability over revenue bonds as they do with general obligation bonds, but highlights the drawbacks of its unintended consequences. Section B evaluates the limits of civil rights litigation in controlling the terms of rate covenants, particularly after the government entity has issued the bond, which is the point at which advocates may become aware of the contractual obligation the government has already incurred and that it cannot easily undo. Section C argues that political opposition to rate increases can give the public leverage in the event of a fiscal crisis that makes the expected payments on a bond less predictable for bondholders than a mechanism for controlling rate increases on the front end.

A. Voter Referenda

Unlike general obligation bonds, which are repaid through local taxes on residents, revenue bonds that finance utilities such as water and sewer service often lack public accountability because they do not require voter approval prior to issuance.[305] A voter approval requirement, however, is not a panacea. Even for general obligation bonds where voter approval is required, voter approval generally does not include the power to set the conditions around rate increases, a power that state law gives to the government issuer.[306] When the political process does give voters the power

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305. *See Types of Municipal Debt*, MUN. RSCH. & SERVS. CTR., https://mrsc.org/explore-topics/finance/debt/types-of-municipal-debt (Aug. 29, 2024).

306. *See id.*; *see also* Oswald v. City of Blue Springs, 635 S.W.2d 332, 334–35 (Mo. 1982) (holding that a voter approval of a bond issue necessarily implies approval of rate increases to meet the covenant with the bond holders without further voter approval); City of Oxnard v. Starr, No. 2D Civ. B295252, 2020 WL 6042024, at *1 (Cal. Ct. App. Oct. 13, 2020) (invalidating a voter-approved

to exercise control over user rates, it can have a negative impact that extends beyond the rates voters would like to control. Where voters have the power to lower their rates for utilities, the utility provider risks a credit rating downgrade based on that vote alone. For example, in 2011, voters in the Foresthill Public Utilities District, located sixty miles northeast of Sacramento, approved an initiative to lower rates during a special election.[307] For a utility district already in dire financial straits, the vote prompted S&P to slash its underlying ratings by eight levels from A- to B, taking its investment grade bonds down to junk bond status.[308] To make matters worse, the district was in technical default because of rate covenant violations even before it approved the initiative to roll back rates.[309] According to S&P, the district had not been in compliance with its rate covenant for several years prior to the downgrade in its rating, meaning it had not complied with the obligation to consistently raise its rates.[310] The voters' decision to further reduce rates below the rates in effect at its most recent revenue bond issuance only put it further out of compliance.[311] According to an analyst at Moody's, passing a measure to reduce utility rates would be "a credit negative if it occurred, as it demonstrates unwillingness to raise rates as needed to support operations and maintain anticipated coverage levels."[312]

While voter control appears to be attractive as a democratic solution to the risk of rising rates, relying on elections to control rates can cause unnecessary volatility that affects a government issuer's overall

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measure rejecting a city ordinance which increased wastewater utility rates to service revenue bond debt and finding that the measure violated California Revenue Bond Law of 1941).

307. Randall Jensen, *A California Utility District Fights for Its Life After Voters Lower Rates*, THE BOND BUYER (Dec. 23, 2011), https://www.proquest.com/newspapers/california-utility-district-fights-life-after/docview/912471041/se-2. S&P is a rating agency that ranks the creditworthiness of borrowers, including issuers of municipal bonds. S&P rates issuers' debt or other securities on a standardized ratings scale. *See Standard & Poor's (S&P)*, THOMSON REUTERS: PRAC. L., https://uk.practicallaw.thomsonreuters.com/5-382-3832 (last visited Oct. 22, 2024). The most common types of ratings include ratings of long-term financial obligations and ratings for short-term financial obligations (which is typically an obligation that terminates in three years or less). *Credit Rating Basics for Municipal Bonds on EMMA*, MUN. RULEMAKING SEC. BD. (MSRB) 2 tbl.1, https://www.msrb.org/sites/default/files/Credit-Rating-Basics-for-Municipal-Bond-Investors.pdf (last visited Oct. 22, 2024). They both estimate the relative risk that a borrower will not honor their financial promises to its investors. *See id.* Revenue bonds, which are the focus of this Article, are usually issued as long-term debt instruments. *See* 1 GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING § 2:2 (2d ed. 2024). For S&P, its ratings scale for long-term debt "runs from AAA to D and intermediate ratings of (+) or (-) are offered at each level between AA and CCC (for example, BBB+, BBB and BBB-)." *Standard & Poor's (S&P)*, *supra*. S&P offers guidance (known as a "credit watch") about whether the rating may be upgraded (meaning the borrower's rating increases), downgraded (where the rating falls), or it will be deemed uncertain (neutral) as the borrower's circumstances change. *Id.* The top four ratings are considered investment grade: AAA, AA, A, BBB (from best quality to good quality but somewhat vulnerable to changing economic conditions). *Id.* Non-investment grade bonds are sometimes referred to as "junk." These bonds include those with ratings of BB, B, CCC, CC, C (speculative; from the least degree of speculation to the highest degree); and D (in payment default). *Id.*

308. Jensen, *supra* note 307.

309. *Id.*

310. *Id.*

311. *Id.*

312. *Id.*

creditworthiness. Municipal bonds cover the cost of necessary government services on which low-income people and people of color rely.[313] It is important to regulate the terms under which government entities issue debt instruments to ensure that the agreed-upon terms are in the public interest. And cities should be able to maintain strong credit ratings so that they can continue to borrow on fair terms. Modifying state enabling statutes that authorize local governments to issue debt should reflect an understanding of the importance of revenue bonds to the local government's operations and avoid changing the terms so severely that the change has disastrous unintended consequences. In other words, the cure to the disease should not kill the patient.[314]

B. Litigation

Some scholars have argued that civil rights litigation, particularly under the FHA, is a "both viable and necessary" method for addressing the inequity and harms that stem from unaffordable public services, such as water service.[315] However, dealing with this crisis in litigation against local government entities largely targets the problem too late. Litigation against a municipality for unaffordable water service may affect policy decisions over time and discourage bond covenants that commit the entity to charging rates that are ultimately unaffordable for certain users. This problem, however, demands a policy solution to regulate the rate covenants terms in order to protect the fair housing and civil rights interests at stake. Nonetheless, if state and local governments do not seek a policy solution, advocates can take what might be called a "Malcolm-Martin approach," with litigation as a sword and policy change as a shield.[316]

The use of litigation requires leveraging doctrines that apply outside of civil rights law. Civil rights lawyers tend to first resort to civil rights statutes to develop a legal theory to attack intractable problems of racial inequality. Psychologist Abraham Maslow wrote, "[I]t is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail."[317] The truth, however, is that antidiscrimination law has not yet succeeded in reaching many of the gravest instances of racial inequality and in targeting

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313. *See* Dante Moreno, *#BuiltByBonds: Demonstrating Why Tax-Exempt Municipal Bonds Are Essential for Cities*, NAT'L LEAGUE OF CITIES (Oct. 17, 2024), https://www.nlc.org/article/2024/10/17/builtbybonds-demonstrating-why-tax-exempt-municipal-bonds-are-essential-for-cities (explaining that "[c]ities of all sizes rely on tax-exempt municipal bonds as a critical tool to finance infrastructure projects and essential public services" including schools, hospitals, roads, and utilities).

314. British philosopher Francis Bacon once described the problem of a person calling on a physician that was "thought good for the cure of the disease you complain of, but is unacquainted with your body; and therefore may put you in way for a present cure, but overthroweth your health in some other kind; and so cure the disease and kill the patient." FRANCIS BACON, THE ESSAYS OF FRANCIS BACON 87–88 (Clark Sutherland Northup ed., Houghton Mifflin & Co. 1908) (1625).

315. Montag, *supra* note 188, at 201.

316. For more about this analogy, see PENIEL E. JOSEPH, THE SWORD AND THE SHIELD: THE REVOLUTIONARY LIVES OF MALCOLM X AND MARTIN LUTHER KING JR. 23 (2020).

317. *See generally* ABRAHAM F. MASLOW, THE PSYCHOLOGY OF SCIENCE: A RECONNAISSANCE (1966).

systems that perpetuate white supremacy.[318] Contract law and property law have long been critical of Black Americans asserting their rights to social participation and to building wealth, even before the modern Civil Rights Movement of the 1950s and 1960s.[319] Likewise, administrative law as a field generates issues with implications for racial justice.[320] Contract and administrative law disputes can serve as a site for advancing principles of racial and economic justice, as the debates in several cases involving rate covenant indicate. Advancing these claims in commercial and regulatory disputes do not always lead to a win,[321] which is why policy change is preferred, but they are sites of contestation that should not be ignored.

For example, the City of Hamilton, Missouri, entered into an agreement to sell potable water to Public Water Supply District No. 2 of Caldwell County for resale to its customers.[322] At the time of the litigation, the contract included an agreement to supply up to 2 million gallons per month at a flat rate of $1.07 per thousand gallons.[323] The contract provided that "[a]ny increase or decrease in rates shall be based on a demonstrable increase or decrease in the costs of performance hereunder, but such costs shall not include increased capitalization of the City system," but it did not carve out the right to increase rates to satisfy the terms of a municipal bond.[324] In April 1989, the voters approved a $1 million water works revenue bond issue.[325] In May 1989, the city provided the district a copy of a water rate study it had commissioned prior to issuing the revenue bond.[326] The city sent the study to comply with the requirement to show a

318. *See, e.g.*, Marissa Jackson Sow, *Whiteness As Contract*, 78 WASH. & LEE L. REV. 1803, 1822 (2022) (noting that "[e]ven as antidiscrimination laws sought to reform Western legal systems, they did little, if anything, to transform the underlying ideologies of white supremacy and the desire to dominate material resources that undergird both"). *See generally* DERRICK BELL, AND WE ARE NOT SAVED: THE ELUSIVE QUEST FOR RACIAL JUSTICE (1987).

319. *See also* Seema Kakade, *A Contractual Relationship with Environmental Justice*, 73 AM. U.L. REV. 343, 365 (2023) ("Contract law, a traditionally private law field, is not typically the first legal arena to come to mind when thinking of justice."). *See generally* DYLAN PENNINGROTH, BEFORE THE MOVEMENT: THE HIDDEN HISTORY OF BLACK CIVIL RIGHTS (2023).

320. *See, e.g.*, Sophia Z. Lee, *Racial Justice and Administrative Procedure*, 97 CHI.-KENT L. REV. 161 (2022); Brian N. Williams & Carmen Williams, *The Past and Present of Racism in the Administrative State*, THE REGUL. REV. (Oct. 29, 2020), https://www.theregreview.org/2020/10/29/williams-williams-past-present-racism-administrative-state/; Cristina Isabel Ceballos, David Freeman Engstrom, & Daniel E. Ho, *Disparate Limbo: How Administrative Law Erased Antidiscrimination*, 131 YALE L.J. 370 (2021).

321. Sometimes, the success is in the confrontation of inequity in itself—the standing up in opposition to a practice that is wrong and inconsistent with basic fairness. *See generally* DERRICK BELL, CONFRONTING AUTHORITY: REFLECTIONS OF AN ARDENT PROTESTOR (1994). Derrick Bell recounted a conversation with a Black woman who was a civil rights activist in Mississippi, who explained that she kept challenging white authority in spite of intimidation and the ever-present risk of retaliation because "I lives to harass white folks." DERRICK BELL, FACES AT THE BOTTOM OF THE WELL: THE PERMANENCE OF RACISM, at xii (1992). There is power in gumming up the works; in being the squeaky wheel that may eventually get the grease. *See generally* BELL, CONFRONTING AUTHORITY, *supra*.

322. City of Hamilton v. Pub. Water Supply Dist. No. 2 of Caldwell Cnty., 849 S.W.2d 96, 98 (Mo. Ct. App. 1993).

323. *See id.* at 99.

324. *See id.* at 98.

325. *Id.* at 99.

326. *Id.*

"demonstrable increase" in the costs of performance to justify an increase in rates.[327]

In July 1989, the City enacted an ordinance to authorize the issuance and sale of $870,000 worth of bonds. The ordinance included a classic rate covenant: the City promised bondholders it would "'fix, establish, maintain and collect such rates, fees and charges' for the use of the waterworks as would be sufficient to operate and maintain the system and to protect the bondholders."[328] As the rates escalated from April to July 1989, the district issued a letter to the city rejecting the rate increases and refused to pay.[329] The city filed a petition for declaratory relief and sought a judgment ordering the district to pay for water used since the adoption of the new rates. The City also sought a declaration that affirmed its obligations under the revenue bonds it had issued, namely that the contract authorized the City to increase its water rates and that Missouri law required rate increases to comply with the covenants of the revenue bond.

> [T]he City is authorized under the contract, and is required by Missouri law, to increase its water rates conformably with the covenants of the water revenue bond so that the charges are sufficient to pay for the costs of the operation of the water system as well as the capital improvements . . . .[330]

The trial court issued a directed verdict in the district's favor and the city appealed.[331]

The appeals court focused on the city's claim that Missouri law required the increase in rates. A Missouri statute imposes on local governments that issue revenue bonds "the mandatory duty . . . to fix and maintain rates and make and collect charges for the use and services of the system" served by the revenue bonds, sufficient to cover maintenance and operation costs, principal, interest, and "to provide funds ample to meet all valid and reasonable requirements of the ordinance or resolution by which such revenue bonds have been issued."[332] This statute also does not require the local government to reserve the authority to limit rate increases in the public interest or bar a "requirement[]" that the issuer increase rates even beyond the amount necessary to pay operation costs, principal, and interest to generate a profit for bondholders. The appeals court concluded that the water sale contract was subordinate to this rate covenant statute because the statute was in force at the time the city and the district entered into the

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327. *Id.*

328. *Id.*

329. *Id.* The court illustrated the rate of increase in noting that "in July 1989, the City adopted yet another resolution which increased the rates to $6.10 for the first 1,000 gallons; $4.30 per 1000 for the next 9,000 gallons; $4.00 per 1000 for the next 11,000 gallons; $3.50 per 1000 for the next 29,000 gallons; and $3.00 per 1000 for all gallons over 50,000." *Id.*

330. *See City of Hamilton*, 849 S.W.2d at 99.

331. *See id.*

332. MO. ANN. STAT. § 250.120(1) (West 2024); *see also City of Hamilton*, 849 S.W.2d at 101 (citing MO. REV. STAT. § 250.120(1)).

water sale contract.[333] As a result, it formed part of the contract, was incorporated into it, and the contract was "controlled or affected" by the statute's "necessary legal operation."[334] The appeals court remanded the case for the trial court to determine the amount of the rate increase based on how much of the city system services the district uses—but not to stop the rate increase altogether.[335] The power of Missouri statutory law to control local governments' rights and duties in a bond issuance, regardless of the terms in the local government bond ordinance or the agreement with bondholders, speaks to the importance of adjusting the terms of rate covenants by amending the statutory language authorizing cities to enter into them.[336]

In some cases, voters challenging a rate increase may win on narrow, technical grounds depending on the terms of the bond ordinance or agreement with bondholders.[337] In most cases, however, the persons challenging the rate increases lose.[338] Even where the trust agreement with bondholders requires the local government to charge reasonable rates, a jurisdiction may still increase rates over the amount necessary to finance the cost of maintaining the water system in order to make a profit as long as the charges are "reasonable" and not "arbitrary or discriminatory."[339] For example, in *Campbell v. Water Works & Sanitary Sewer Board of the City of Montgomery*,[340] the water and sewer board issued $10 million in revenue bonds which included a provision, among others, that "the board shall charge and collect 'reasonable rates for the sale of water' and such rates shall be equitable and uniform for all classes of customers."[341] A taxpayer challenged the changes to water rates and the court considered "whether the board may set its rates sufficiently high to operate and expand its combined systems and service its debts or, in other words, may make a profit on the sale of water and use that profit for all of its legal corporate

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333. *Id.* at 103.

334. *Id.* ("It is a fundamental rule that the laws which exist at the time and place of making a contract, and at the place where it is to be performed, affecting its validity, construction, enforcement, termination and discharge, enter into and form a part of the contract as if they were expressly referred to or incorporated therein.") (quoting Sharp v. Interstate Motor Freight Sys., 442 S.W.2d 939, 945 (Mo. 1969); Conn. Mut. Life Ins. Co. v. Cushman, 108 U.S. 51, 65 (1883)).

335. *Id.*

336. *See id.* at 101.

337. *See, e.g.*, Beatty v. Metro. St. Louis Sewer Dist., 731 S.W.2d 318, 320 (Mo. Ct. App. 1987) (holding that the plan for a metropolitan sewer district, which authorized the district to fund improvements from revenues to be derived from the operation of "such" sewage facilities, prohibited the district from issuing revenue bonds payable from revenues associated with its entire sewer and drainage system because the word "such" in the plan limited the scope of facilities from which revenues could be collected under the bond and the users who had to pay rate increases under the bond's terms).

338. *See, e.g.*, *infra* Part III; Rizzo v. Bd. of Trustees, 32 Cal. Rptr. 2d 892, 903 (Cal. Ct. App. 1994), *disapproved of on other grounds by* Yamaha Corp. of Am. v. State Bd. of Equalization, 960 P.2d 1031 (1998) (rejecting university students' challenge to increased student union activity fees, finding that the university that exercises statutory authority to issue revenue bonds to fund construction of new student union may increase fees to service the debt, even if the fees would exceed the statutory limit that would apply to student union fees in the absence of a revenue bond).

339. *See* Campbell v. Water Works & Sanitary Sewer Bd., 115 So. 2d 519, 522 (Ala. 1959) (quoting Benson v. City of Andalusia, 195 So. 443, 445 (Ala. 1940)).

340. 115 So. 2d 519 (Ala. 1959).

341. *Id.* at 521.

purposes."[342] The state supreme court squarely situated the problem as one of the government's authority to commodify water. It determined that increasing rates to make a profit was completely appropriate. Rates could not be "unreasonable, confiscatory or excessive merely because the charges made are in excess of those required to finance the cost of maintaining the water system supplying the water."[343] The court considered testimony that the charge for water was "equal to or less than that of many other cities of comparable size" to find that the rates were "reasonable[.]" Notably, the court did not consider the income levels of those who paid the rates and certainly not whether the rates had a disparate impact on any racial groups in Jim Crow Alabama, even though this case coincided with the entire run of the Montgomery Bus Boycott.[344] According to the court's reasoning, so long as the rate is "reasonable, equitable or uniform," the power to set rates could not be regulated to restrict profit.[345] This authority to generate a profit from the sale of water implicitly includes the power to generate a profit for the bondholders to whom the revenues of the water system have been pledged, consistent with the terms of most bond ordinances and trust agreements.[346]

The contexts of private contract law and tax challenges, the places in which disputes over rate covenants tend to play out in courts, bend toward decisions that favor profit over the public interest. Although *Campbell* arises in Alabama in 1959, it relies on the same logic as the positions of the courts and the City of Detroit during the water shutoff crisis in 2014. Despite the fact that access to water is a human right under international law,[347] "[b]oth local and federal governments have reminded the people of the City of Detroit that they do not enjoy a right to water; rather water is a commodity that must be paid for."[348]

Fights over rate covenant compliance that involve regulators—who are voices for the low-income residents who are otherwise unheard—can be viewed as a conflict between forces attempting to protect the affordability of public services and forces placing the interests of creditors above

342. *Id.* at 522.
343. *Id.*
344. *Id.* at 521. The bond that led to changes in water rates was issued in 1953, and the case was decided in November 1959. *See id.* at 520. The Montgomery Bus Boycott, when thousands of Black residents of Montgomery refused to ride city buses on a segregated basis after Rosa Parks refused to give up her seat to a white passenger, lasted 381 days, starting on December 5, 1955, and ending on December 20, 1956. *See Montgomery Bus Boycott*, STAN. UNIV.: THE MARTIN LUTHER KING, JR. RSCH. & EDUC. INST., https://kinginstitute.stanford.edu/montgomery-bus-boycott (last visited Nov. 13, 2024); Browder v. Gayle, 142 F. Supp. 707, 717 (M.D. Ala. 1956), *aff'd*, 352 U.S. 903 (1956) (ruling segregation in Montgomery city buses unconstitutional). The case contributes to one's understanding of the onerous economic conditions under which Black residents in Montgomery were living—down to ever escalating water rates—that might have contributed to the open revolt that characterized the Montgomery Bus Boycott.
345. *Campbell*, 115 So. 2d at 524.
346. *See* O'HARA, *supra* note 14, at 72 (noting that "key sections of the indenture include the pledge of revenues and the order in which those funds are applied (called the *flow of funds*)" (emphasis in original)).
347. G.A. Res. 70/169, at 1 (Dec. 17, 2015); G.A. Res. 64/292, at 2 (July 28, 2010).
348. Sow, *supra* note 318, at 1809 (footnote omitted).

affordability concerns. For instance, in *Alaska Public Utilities Commission v. Municipality of Anchorage*,[349] the City of Anchorage filed a request with the Alaska Public Utilities Commission (the Commission) for a permanent rate increase of more than 50%, arguing the increase was necessary to sell an $11 million revenue bond issue.[350] The "proposed bonds were to contain a provision that rates will generate at least 1.4 times the principal and interest due each year on all bonded indebtedness after necessary expenses of maintenance and operation of the system have been paid, but before depreciation."[351] Thus, the structure of the bond issue itself is designed to turn a profit, particularly the 40% of revenues collected above the costs, principal and interest. The Commission granted only a partial increase, of about 35% rather than over 50%.[352] The city argued that the increase was necessary to "generat[e] adequate revenues to assure payment of amounts to become due under a proposed bond issue[,]" essentially ignoring the extent to which the rate increase would generate a profit beyond providing "adequate revenues" to repay the bond debt.[353] The city contended that the public utility commission lacked the authority to deny the rate increase because it was necessary to comply with existing bond covenants and to service debt on proposed bond covenants.[354] Essentially, the city argued that the public agency's authority must slavishly follow the mandates of existing rate covenants and allow for higher rates on new bonds—a result that would effectively strip the agency of its power to oversee rates in the public interest.[355]

The dichotomy between the statute and its legislative history illustrates a tug-of-war between the Commission's power to set rates and municipalities' power to agree to charge whatever rates are necessary to secure investments. The Alaska Public Utilities Regulatory Act provides broad powers to regulate and set utility rates:

> When the commission, after an investigation and hearing, finds that a rate demanded, observed, charged, or collected by a public utility for a service subject to the jurisdiction of the commission, or that a classification, rule, regulation, practice, or contract affecting the rate, is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine a just and reasonable rate, classification, rule, regulation, practice, or contract to be observed or allowed and shall establish it by order.[356]

While it does not explicitly negate this section, the next sentence—related to rate covenants—is not fully consistent with the breadth of this power:

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349. 555 P.2d 262 (Alaska 1976).
350. *See id.* at 264.
351. *Id.* at 263.
352. *Id.* at 264.
353. *Id.* at 263.
354. *Id.*
355. *Id.* at 263–64.
356. ALASKA STAT. § 42.05.431(a) (2024).

"A municipality may covenant with bond purchasers regarding rates of a municipally owned utility, and the covenant is valid and enforceable and is considered to be a contract with the holders from time to time of the bonds."[357] The Commission has a power to "determine a just and reasonable rate" when the rate is "unjust, unreasonable, unduly discriminatory or preferential."[358] The municipality has a right to "covenant with bond purchasers regarding rates" through agreements that are "valid and enforceable."[359] The two statutory provisions sit side-by-side. The municipality has no concomitant obligation to covenant only for "just and reasonable rate[s]," and likewise, the text of the statute does not provide an exception to the Commission's mandate to set a just and reasonable rate when it finds that a rate is unjust or unreasonable.[360] The 1976 *Alaska Public Utilities Commission* case was the natural endpoint of the collision course on which the Alaska statute set the two authorities.

The state trial court interpreted the cities' statutory right to covenant regarding rates to mean the Commission had to give way and "set rates to meet the covenants."[361] The trial court found the covenants were important because investors demanded them: "The bonds, in order to sell, must contain a coverage covenant that is meaningful, unequivocal, and absolute, and must be supported by a clean opinion from the Municipality's bond counsel . . . ."[362] If the Commission were allowed to deny the request, according to the trial court, it would imperil access to debt for the entire state. "This action not only affected the proposed bond issue, but also would have a drastic effect on all municipal bonding, and to a certain degree on state bonds . . . ."[363]

The Alaska Supreme Court reversed, holding that

> in advance of issuance of bonds, the Commission is not required to grant a rate which may be necessary to meet future bond requirements, but . . . the Commission must honor covenants contained in revenue bonds actually sold. That is, after there are existing contracts with bondholders, the covenants contained in the bonds must be honored by the Commission.[364]

The court concluded that the statutory language deeming a municipality's covenants "valid and enforceable" and the requirement that the Commission approve rates meant that the Commission must honor the city's covenant—"otherwise there would be no enforceability of the covenants."[365] As for future bonds, the bond marketing process required that the

357. *Id.*
358. *Id.*
359. *Id.*
360. *Id.*
361. Alaska Pub. Utils. Comm'n v. Mun. of Anchorage, 555 P.2d 262, 264 (Alaska 1976).
362. *Id.* at 265 (internal quotation marks omitted).
363. *Id.* (internal quotation marks omitted).
364. *Id.* at 264.
365. *Id.* at 267.

commitment to maintain rates at a multiple of the principal and interest due must be "on record at the time of the delivery of the bonds."[366] The state supreme court agreed with the trial court that "[t]he Commission, by refusing such a requested rate increase, may destroy the marketability of those bonds."[367] The court reasoned, however, that the "valid and enforceable" language in the statute cut both ways: "Until there is an existing covenant with bond purchasers, there is nothing which is valid and enforceable, and therefore nothing to interfere with the Commission's general rate-setting authority."[368] Therefore, the Commission could block a bond issue by refusing to agree in advance to the rates the issuing municipality demanded, but it could not deviate from the rate covenant after the bond was issued.

The Alaska State Legislature's response to this ruling showed a shift in the balance of power away from the public interest and toward providers of capital. Ten years later, in 1986, the legislature amended the Alaska Public Utilities Regulatory Act to include "mortgages and other debt instruments" issued by cooperative electrical and telephone companies.[369] The revised statute made clear that "financial covenants" in those documents "are also valid and enforceable, and rates set by the commission must be adequate to meet those covenants."[370] The legislature apparently removed the ambiguity about who would have the power to set rates when it came to debt financing and sided with bond issuers and potential investors. But it created an exception whereby the Commission could retain its power to control rates by disapproving the debt instrument altogether: "a cooperative utility that is negotiating to enter a mortgage or other debt instrument that provides for a times-interest-earned ratio (TIER)[371] greater than the ratio the commission most recently approved for that cooperative shall submit the mortgage or debt instrument to the commission before the instrument takes effect."[372] This restriction essentially prevents utility cooperatives from promising to maintain unnecessarily high levels of

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366. *Id.* at 268.

367. *Id.*

368. *Id.*

369. Alaska Public Utilities Commission Act, ch. 104, § 4 (1986) (codified at ALASKA STAT. § 42.05.431(a)).

370. *See id.* (emphasis added).

371. "The times interest earned ratio is also known as the interest coverage ratio and it's a metric that shows how much proportionate earnings a company can spend to pay its future interest costs." Brooke Tomasetti, *Times Interest Earned Ratio*, CARBON COLLECTIVE, https://www.carboncollective.co/sustainable-investing/times-interest-earned-ratio (September 2, 2024). It measures the company's solvency and its ability to pay down its debt.

> The times interest earned ratio is expressed in numbers instead of percentages. The ratio shows how many times a business could pay its interest costs using its pre-tax earnings. This indicates that the bigger the ratio, the better the company's financial position is. For example, a ratio of 3 means that a company has enough money to pay its total interest cost, even if this was multiplied by 3. Obviously, creditors would be happy to lend money to a company with a higher times interest earned ratio. This is because it proves that it is capable of paying its interest payments when due. Therefore, the higher a company's ratio, the less risky it is, and vice versa.

Id.

372. ALASKA STAT. § 42.05.431(a) (2024).

solvency such that they would have to raise rates substantially to maintain them. Overall, Alaska's state law advanced toward some requirement for public approval of rate increases, but the threshold of a TIER that exceeds the ratio the Commission has approved as the point at which the Commission must approve the debt instrument before it takes effect only applies to cooperative utilities and not municipalities. It does not directly factor in affordability for low-income users or equity in distributing the cost burden when it comes to the terms of the debt instrument. This pre-approval requirement should be applied to all of the utilities regulated by public utility commissions consistent with their rate-setting authority. This state law provides a model of sorts for the use of a public commission to approve the terms of rate covenants in revenue bonds before the instruments take effect. It is notable, however, that this small step forward did not come as a result of litigation. In fact, the statute was amended to avoid the arguments raised by the Commission about its authority to regulate rates in the case. Each of the cases demonstrate that, while there may be some victories on technical or narrow grounds, litigation generally results in courts siding with capital over communities.[373]

C. Public Opposition

Advocates interested in protecting against the negative impacts of limitless rate covenants are not without leverage in terms of public pressure. After all, access to clean water and sanitation, both of which rely on systems that are often maintained through public debt, are matters of life or death. But this is not a reliable way of managing the negative effects of rate covenants. Public opposition can create political or social conflict over the enforcement of rate covenants that may not affect judicial decision-making when bondholders take their claims for payment to court, leaving residents without relief. The risk, however, that it may affect judicial decision making or lead the government to attempt to change the terms of the repayment on future bonds creates unnecessary uncertainty for bondholders. The efforts of bondholders to collect on revenue bonds issued to the Puerto Rico Electric Power Authority (PREPA) illustrate the operation of this double-edged sword.

The Puerto Rico Electric Power Authority Act, which established PREPA, provides for the appointment of a receiver in the event of a default.[374] The statute limits creditor rights and only allows creditors to sue to compel compliance with the covenants (including rate covenants) in any agreement PREPA makes with bondholders.[375] Despite the fact that Puerto Rico is not a U.S. state, provisions that provide remedies to bondholders that limit their rights to the terms of the bond covenants are not uncommon in U.S. states as well. Louisiana, North Dakota, and Montana, for example,

373. *See generally* KATHARINA PISTOR, THE CODE OF CAPITAL: HOW THE LAW CREATES WEALTH AND INEQUALITY (2019).
374. *See* P.R. LAWS ANN. tit. 22, § 207 (2011).
375. *Id.* § 208.

all have similar restrictions.[376] The statute in Puerto Rico and the underlying trust agreement that provides the contractual terms governing the debt between PREPA and its bondholders allows bondholders to move to place PREPA under a receivership to enforce collection of payments due.[377] In Puerto Rico's context, at least three reasons make clear why reliance on these rights provides limited value for bondholders.

First, the trust agreements into which PREPA entered related to its bonds changed over time. In January 1974, PREPA entered into a trust agreement with bondholders to "fix, charge and collect [other] reasonable rates and charges" to ensure that the system generated enough to pay current expenses and at least 120% of the revenue to pay principal and interest on the bond—20% above the actual amounts owed.[378] In 2015, PREPA's trust agreement with bondholders limited the remedies available for enforcing the bond covenants, including on equitable grounds.[379] Secondly, federal law changed. In 2016, Congress created the Financial Oversight and Management Board (the "Board") and authorized the Board to place Puerto Rico entities into debt restructuring proceedings similar to municipal bankruptcy proceedings under Chapter 9 of the Bankruptcy Code.[380] Consequently, the bondholders' ability to pursue any remedies against PREPA afforded under Puerto Rico law or the trust agreement, including the right to enforce rate covenants in that trust agreement, were automatically stayed.[381] Finally, even Puerto Rico law does not provide much assurance because, under Puerto Rico law and the law of most states, receivers traditionally have a great deal of discretion in the exercise of their powers for the benefit of all persons interested in the estate—in this case, both

376. *See, e.g.*, LA. STAT. ANN. § 48:877 (2024) (authorizing trust indentures for bridge revenue bonds to "restrict the individual rights of action of bondholders as is customary in trust indentures serving bonds and debentures of corporations"); N.D. CENT. CODE ANN. § 61-35-41 (West 2023); MONT. CODE ANN. § 85-1-306 (West 2023) ("Either the resolution providing for the issuance of bonds or the trust indenture may contain provisions for protecting and enforcing the rights and remedies of the bondholders as are reasonable, proper, and not in violation of law, including covenants setting forth the duties of the state and the department in relation to the acquisition, construction, improvement, maintenance, operation, repair, and insurance of the works and the custody, safeguarding, and application of all money.").

377. *In re* Fin. Oversight & Mgmt. Bd. for P.R., 104 F.4th 367, 379 (1st Cir. 2024) (citing 22 L.P.R.A. §§ 207–208). A receivership involves placing a business enterprise under the control of a receiver, who is "[a] disinterested person appointed by a court, or by a corporation or other person, for the protection or collection of property that is the subject of diverse claims," including bankruptcy. *Receiver*, BLACK'S LAW DICTIONARY (12th ed. 2024).

378. P.R. ELEC. POWER AUTH., $673,145,000: POWER REVENUE BONDS, SERIES 2013A, at 1, 13 (2013), https://aldia.microjuris.com/wp-content/uploads/2013/08/prepa-revenue-bonds-series-2013a.pdf.

379. Robert Donahue, Managing Director, Mun. Mkt. Analytics, Testimony at the House Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law Hearing: H.R. 870, the "Puerto Rico Chapter 9 Uniformity Act of 2015" (Feb. 26, 2015) [hereinafter Donahue Testimony], https://www.proquest.com/other-sources/house-judiciary-subcommittee-on-regulatory-reform/docview/1659762565/se-2.

380. 48 U.S.C. § 2121(b)(1).

381. *See In re* Fin. Oversight & Mgmt. Bd. for P.R., 104 F.4th 367, 379 (1st Cir. 2024) (citing 48 U.S.C. § 2161(a) & 11 U.S.C. § 362(a)).

PREPA and the bondholders.[382] The vague nature of a receiver's powers also arguably makes it difficult for creditors to enforce rate increases, particularly given that PREPA's rates are already more than twice the U.S. average.[383] All of these factors would suggest that public pressure could be used to reduce rates, despite the existence of rate covenants. Bondholders have limited rights to enforce rate covenants in some jurisdictions. Legislative interventions, like the establishment of the Board overseeing Puerto Rico's finances, can shift bondholders' rights out of the realm of contract and into an insolvency proceeding where their claims as creditors may be compromised. The discretion afforded to receivers as a matter of law could also make a receiver vulnerable to public pressure, at least in theory, to make decisions that favor residents over bondholders.

Questions of great public importance in America, however, rarely stay outside of the courtroom for long. As Alexis de Tocqueville observed even in early American society, "[s]carcely any political question arises in the United States that is not resolved, sooner or later, into a judicial question."[384] The intervention of courts tend to level the playing field in ways that limit the persuasive powers of public opposition. On September 19, 2022, a federal district court in Puerto Rico ordered the Board to file briefs related to its request to sue PREPA bondholders to resolve issues related to settling the utility's debts.[385] The Board challenged whether the rate covenant covered bondholders at all or amounted to one of several "liabilities of PREPA that cannot be pledged."[386] The district court ruled that the covenants, including the rate covenant, were "merely promises and means of seeking the fulfillment of promises, are not property in which PREPA has and can grant an interest" like an enforceable lien, and the pledge was limited to the net revenues generated by energy already created.[387] Thus, the court weakened the force of the covenant in raising rates.

During the litigation, Puerto Rico Governor Pedro Pierluisi Urrutia leaned into principles of equity, arguing that his administration would

382. *See* 75 C.J.S. Receivers § 126 ("The nature and purposes of a receiver's appointment necessarily clothe with some discretion the exercise of many of its official duties" subject to court oversight.).

383. Donahue Testimony, *supra* note 379.

384. 1 ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 275 (J.P. Mayer ed., George Lawrence trans., 1969) (1835).

385. *Judge Orders Parties in PREPA Bankruptcy to Arguments on a Fiscal Board Request*, THE SAN JUAN DAILY STAR (Sept. 19, 2022) [hereinafter *PREPA Bankruptcy*], https://web.archive.org/web/20230207051410/https://www.sanjuandailystar.com/post/judge-orders-parties-in-prepa-bankruptcy-to-prepare-arguments-on-a-fiscal-board-request.

386. *Id.* Like many trust agreements that accompany revenue bonds, the trust agreement at issue in PREPA's dispute included a provision indicating that the Authority pledged to the trustee that represented its bondholders "the revenues of the System, subject to the pledge of such revenues to the payment of the principal of and the interest" on another set of bonds PREPA issued in 1947 "and other moneys to the extent provided in this Agreement." *In re* Fin. Oversight & Mgmt. Bd. for P.R., 649 B.R. 381, 402 (D.P.R. 2023), *motion to certify appeal denied*, 650 B.R. 756 (D.P.R. 2023), *aff'd in part, rev'd in part*, 104 F.4th 367 (1st Cir. 2024). The pledge of revenues only covered "net revenues" which the agreement defined as "the amount of the excess of the Revenues" over the covered expenses for the time period specified in the agreement. *Id.* at 404.

387. *See Fin. Oversight & Mgmt. Bd. for P.R.*, 649 B.R. at 412–13.

refuse any agreement that would burden working families and saying "PREPA has to reduce its debt to sustainable levels *that its subscribers can pay*."[388] Governor Urrutia's line in the sand is consistent with a normative principle that should apply to any local government debtor: municipalities must be able to weigh competing obligations to provide services and to meet debt obligations. As the National Rural Utilities Cooperative Finance Corporation has advised: "In setting rates for electric utilities, state regulatory commissions have sought to create a balance between the utility's financial interests and the consumer's right to reliable service at reasonable rates."[389] A cap on rate increases in rate covenants is a policy choice consistent with this balancing process. This Article, however, argues for a cap on rate increases to further the public interest in fair housing and civil rights compliance and not necessarily for fiscal solvency.

In June 2024, however, the bondholders won a victory on appeal in support of their demands for full payment, namely principal plus matured interest.[390] The trust agreement allowed the bondholders to sue for "specific performance of any covenant or agreement contained" in the trust agreement, which would include the rate covenant, although the court did not specifically address it.[391] As a result, the bondholders maintained an unsecured deficiency claim on PREPA's net revenues from which they have a "legal right to payment."[392]

Puerto Rico offers a cautionary tale in several respects. The political process can create conflict when it comes to raising rates in the event of insolvency. The decision not to control the process of increasing rates in ways that account for the negative effect that rate increases can have on the public interest on the front end makes this kind of conflict more likely. While the governor had no ostensible authority to control rate increases, the statements express the public's opposition to the move. It is short-sighted to assume that political opposition would have no effect on judicial decision making or at least on the terms of settlement. It may have had an impact on the trial court in Puerto Rico, but less impact on appeal to the First Circuit, which is far away in New England.[393] The most recent result

388. *PREPA Bankruptcy*, *supra* note 385 (emphasis added).
389. NAT'L RURAL UTILS. COOP. FIN. CORP., SETTING RATES: BEST PRACTICES FOR ELECTRIC COOPERATIVES pt. 4, at 1 (2008), https://www.cooperative.com/cfc/documents/rates_setting_part4.pdf.
390. *See In re* Fin. Oversight & Mgmt. Bd. for P.R., 104 F.4th 367, 398 (1st Cir. 2024).
391. *Id.* at 380.
392. *Id.* at 380, 397.
393. *See, e.g.*, Gillette, *supra* note 57, at 779. Considerations of public policy and social welfare play a time-honored role in American jurisprudence. *See* Gregory v. Ashcroft, 501 U.S. 452, 466 (1991) ("The common law, unlike a constitution or statute, provides no definitive text; it is to be derived from the interstices of prior opinions and a well-considered judgment of *what is best for the community*.") (emphasis added). U.S. Supreme Court Justice Oliver Wendell Holmes, Jr., a jurist who perhaps best represents the pragmatist tradition in American law, explained in 1881 in his book *The Common Law*:

> The very considerations which judges most rarely mention, and always with an apology, are the secret root from which the law draws all the juices of life. I mean, of course,

of a decision in the bondholders' favor only amplifies the fact that limiting rate increases out of a concern for low-income people and residents of color is difficult, as the representatives of bondholders have confidence that the courts will side with them in the end. The tenuous nature of legal precedents in state high courts and the Supreme Court surrounding state and local government efforts to modify the terms of municipal debt suggests that courts do not always side with bondholders over residents.[394] As a result, bondholders should not feel too comfortable with leaving fallout over the terms to court intervention. Given the contractual rights provided by rate covenants, public opposition to rate increases is likely to collide with litigation. The uncertainty created by public opposition harms the market for municipal debt. As a result, public opposition alone is unlikely to succeed in controlling rates in the public interest. The limited degree of certainty about the outcome of a court case coupled with the strong likelihood of success for bondholders in a court challenge suggest that advocates concerned about controlling rates in the interest of low-income people, residents, and civil rights law should prioritize policy change over litigation.

In short, voter referenda, litigation, and public pressure all have significant shortcomings in controlling the harms that rate covenants can cause. Voters normally lack the power by statute to change user rates associated with revenue bonds. If they do take action by proposing a local ballot initiative or a statute constitutional amendment, then the credit ratings industry would likely respond by downgrading the local government issuer's credit rating substantially, making it impossible to borrow or increasing the cost of borrowing in ways that reduce access to capital to fund other essential services or to provide access to amenities and opportunity in ways that tend to benefit low-income people and people of color. The extent to which public opposition to rate increases outside of voter referenda, particularly the extent to which it would influence a trial court if the local government is in bankruptcy or a similar insolvency proceeding, is uncertain. Courts, however, ultimately tend to favor the position of bondholders and side with capital over people. The result is similar in litigation outside of the context of insolvency. Courts tend to regard the obligation to bond covenants as ironclad, so anti-discrimination law may be subsumed in a commitment to the enforcement of the bond ordinance or trust agreement rather than changing the terms of the agreement after the bond

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> considerations of what is expedient for the community concerned. Every important principle which is developed by litigation is in fact and at bottom the result of more or less definitely understood views of public policy . . . .

OLIVER WENDELL HOLMES, JR., THE COMMON LAW 35 (1881). Likewise, "Justice Benjamin Cardozo saw law as an instrument for the conscious pursuit of social welfare" and "the good of the collective body." Alan B. Handler, *Judging Public Policy*, 31 RUTGERS L.J. 301, 304 (2000) (citing BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 66, 72 (1921)). Despite the effort to constrain judicial decision-making with tests and boxes, "[t]here is no formula. There is only judgment." JAMAL GREENE, HOW RIGHTS WENT WRONG: WHY OUR OBSESSION WITH RIGHTS IS TEARING AMERICA APART 86 (2021).

394. *See* Gillette, *Bondholders*, *supra* note 60, at 653.

is issued. Disputes over rate increases pursuant to rate covenants tend to arise in the context of contract, state and local taxation, and state administrative regulation. The fights over rate increases in basic services like water and electricity in these areas demonstrate that although these areas of law are often considered devoid of considerations of racial injustice, they can become a forum in which issues of social inequality animate public policy concerns. With rare exceptions, however, bondholders win, even if it requires undermining other statutory mandates that attempt to control prices in the public interest. The problem calls for policy solutions where the authorizing statute requires local governments to consider these questions of social equity and fairness up front.

IV. RATE CAPS: BALANCING GOVERNMENT, CREDITOR, AND RESIDENT INTERESTS

One of the most straightforward ways to address the excessively high user rates that rate covenants cause is to build rate caps into the terms of bond issues from the outset. State law should require (or at least allow) bond issuers to reserve the right to limit rate increases for services backed by revenue bonds, especially when doing so will preserve affordability for low-income residents. A reservation of the right to control rates, however, risks running afoul of foundational principles of municipal debt finance. This Part analyzes the benefits of rate caps and illustrates their disadvantages before proposing alternate approaches.

A. Benefits of Rate Caps

Since the earliest days of public debt regimes, creditors have demanded constraints on government action in exchange for their investment. The concept of public financing goes back at least as far as early Italian republics. In the early fifteenth century, creditors of the Republic of Genoa responded to the Republic's financial crisis by creating a private organization known as San Giorgio.[395] The organization exchanged the Republic's debt for shares in the organization.[396] In return, the creditors acquired the right to collect taxes and operate some of Genoa's most profitable businesses.[397] Comparing this transaction to later municipal securities transactions, a pattern starts to emerge: a wealthy organization of individuals takes advantage of a government in distress. The organization acquires a literal ownership interest in a local government entity and gains a right to collect tax revenue (public funds) and operate government businesses. Genoa's system closely resembles a classic revenue bond structure, such as a toll road run by an expressway authority beholden to creditors or a public utility company charging service rates to pay down debt.

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395. *See* Gillette, *Public Debt*, *supra* note 60, at 939.
396. *See id.*
397. *See id.*

Creditors have also traditionally had a deep-seated distrust of the state's commitment to repay their debts. In postmedieval England and throughout Europe, governments sometimes granted creditors the right to collect debts directly, rather than to receive payments funneled through the debtor's treasury.[398] Echoes of this distrust remain today in the structure of some revenue bond transactions. For example, revenue bonds for toll roads use separate authorities authorized to collect payments that go directly to pay down debt. Unlike the general obligation bond, the revenue bond is based on the idea that there is more security in receiving repayment directly from revenues collected from use of a facility or service rather than from the public treasury. The funding source of a revenue bond is more direct and relies less on the government intermediary. In fact, Clayton Gillette suggests that financial covenants, including rate covenants, grow out of a fear of the government's power to "default[] with relative impunity" and argues that this power justifies the use of clauses to "ensure repayment, such as negative pledge clauses and promises to maintain revenues (taxes) sufficient to service the debt."[399]

The presence of public debt is seen as a catalyst for democracy and robust markets rather than simply a means of financing the self-interested objectives of political officials.[400] In negotiating the terms of revenue bonds, public creditors would condition their loans on the government constraining its own capacity to use loaned funds to pursue objectives that creditors do not anticipate (the so-called moral hazard problem).[401] Creditors would also seek to limit the state's ability to repudiate its debts or unilaterally alter the obligation to repay.[402] Either of these approaches increases the likelihood of payment for creditors. These institutions decidedly represent the interests of creditors and, as the theory goes, serve as "precursors to rapid commercialization, economic growth, and the general enforcement of contract and property rights."[403]

Although this conception makes creditors seem like virtuous drivers of public prosperity, this vision breaks down when considering communities struggling with racial inequality and spatial segregation. Public creditors condition their loans on taking advantage of a distressed city's dependence on debt to finance public works and setting terms and conditions without regard to how these demands will affect regular members of the public. The benefits public creditors allegedly create—"rapid commercialization, economic growth, and the general enforcement of contract and

398. Gillette, *Public Debt*, *supra* note 60, at 945.
399. *Id.* at 948.
400. *Id.*
401. *Id.* at 941–42. A moral hazard is "[a] hazard that has its inception in a faulty mental state or attitude such as dishonesty, greed, carelessness, indifference, or insanity." It is most often associated with insurance and refers to a "tendency to exercise less care to avoid a loss than would be exercised if the loss were uninsured. For example, the insured might leave an unattended vehicle running despite the increased chance of theft." *Hazard*, BLACK'S LAW DICTIONARY (12th ed. 2024).
402. Gillette, *Public Debt*, *supra* note 60, at 942.
403. *Id.*

property rights"—largely accrue to white and wealthier residents.[404] Legislators and local government issuers of revenue bonds must balance the potentially beneficial impact that public creditors have on incentivizing development with the risk of alienating investors by reserving a right to limit rate increases in the public interest.[405]

Courts have long recognized the importance of balancing a distressed state or local government's interest in financing necessary services against the demand that bondholders receive full repayment on municipal debt. Indeed, Clayton Gillette frames nineteenth-century cases in which courts upheld state efforts to help a local government place certain assets out of creditors' reach as evidence of "a desire to balance the interests of both residents and creditors."[406] Likewise, cases from the Great Depression reflect courts' willingness to "exercise[] their discretion over writs of mandamus, or other equitable remedies, to subordinate bondholders to the interests of impoverished municipalities."[407] The distinction between residents and state or local governments is important given the impact that municipal debt liability has on the lives of real people. In evaluating the legality of state laws that are designed to prioritize a city's solvency over creditor security, Gillette argues that the purpose behind them should matter.[408] In the same way, the reason why a municipal bond issuer limits the rates it will charge to provide public services matters. Concerns around racial and socioeconomic equity are valid reasons.

Courts and state legislatures generally reserve the power to alter or restrict the terms of repayment on bond debt for local government entities in financial distress.[409] But the regulation of municipal debt is not merely a question that deserves attention in the context of municipal bankruptcy and fiscal distress. Limits on the conditions under which a local government bond issuer can borrow and the kinds of promises they can make in trust indentures or bond ordinances should also be available to protect the public interest in racial equity and affordability. This power goes to the heart of urban governance and the allocation of opportunities to residents. Treating municipal debt as a matter of public policy by regulating the kinds of debt instruments cities can issue in the first place may also address fears that cities will use their sway over legislatures and the power of the courts as fellow government actors to escape their obligations when they are in financial distress.

404. *See* JENKINS, *supra* note 67, at 216; *see also* Gillette, *Public Debt*, *supra* note 60, at 942.

405. *See* Gillette, *Public Debt*, *supra* note 60, at 949 (arguing that public creditors have contributed to the development of innovations like the administrative bureaucracies that constrain the executive, the "expanded powers of Parliament, the inclusion of the Contracts Clause into the American Constitution, and the evolution of an independent judiciary" that shaped the evolution of English and American government).

406. Gillette, *supra* note 57, at 799.

407. Gillette, *Bondholders*, *supra* note 60, at 644–45.

408. Gillette, *supra* note 57, at 756.

409. *See id.* at 764 (citing Meriwether v. Garrett, 102 U.S. 472, 502–04 (1880)).

Rate caps may initially strike investors as a threat because they ostensibly allow a municipal debtor to "unilaterally alter the repayment obligation"—one of the risks that public creditors work to mitigate in structuring bond transactions.[410] A rate cap provided within a rate covenant and authorized by state law, however, does not involve "unilaterally alter[ing]" the terms of the bond after the bondholder has already purchased it. As the Foresthill Utilities example in Part III illustrates, the problem for credit rating analysts primarily stems from the instability created by the refusal to comply with bond terms after the fact. Reserving a right to set the cap in advance creates transparency on the face of the official statement and offering documents associated with the bond. Credit rating factors also focus on a local government issuer's ability to repay the debt, a factor which a rate cap would not affect. A proposed rate cap ensures that the principal and interest on the bond can be timely repaid, but it limits the extent to which an issuer can agree to raise rates with no limit or set rates beyond the amount necessary to repay the bond for the sake of pure profit.

Limiting the amount of profit the bond may generate is also appropriate in light of the fact that investors often use municipal bonds because of their tax-exempt status.[411] Tax exemptions have economic justifications and often carry a legislative intent that furthers a broader public goal.[412] The Joint Committee on Taxation explained that, under the Tax Reform Act of 1986, municipalities "may issue tax-exempt bonds to finance general government operations and facilities, without regard to most of the restrictions (including volume limitations) that apply to bonds used to finance activities of nongovernmental persons."[413] It defined "traditional governmental purposes" as "general government operations and the construction and operation of such governmental facilities as schools, roads, government buildings, and governmentally owned and operated sewage, solid waste, water, and electric facilities."[414] Tax-exempt status should be reserved for issuers whose bond issuances further a broader, publicly beneficial purpose rather than a purpose that perpetuates racial hierarchy or social inequality.[415] Federal civil rights law mandates equal access to these facilities regardless of race, color, or national origin, and directs local

410. *See* Gillette, *Public Debt*, *supra* note 60, at 942.

411. *See* Likhitha Butchireddygari, Note, *Taxing Police Brutality Bonds*, 123 COLUM. L. REV. 1017, 1019 (2023) ("When investors buy bonds, they typically have to pay federal income taxes on the interest proceeds. Municipal bonds, however, produce tax-exempt interest.").

412. *See* Daniel Knepper, Note, *Eliminating the Federal Subsidy in Kelo: Restricting the Availability of Tax-Exempt Financing for Redevelopment Projects*, 94 GEO. L.J. 1635, 1646 (2006). Historically, Congress afforded tax-exempt status to municipal bonds because they were largely used "to finance traditional public uses such as roads and schools." *Id.* at 1644.

413. STAFF OF JOINT COMM. ON TAX'N, 99TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 1129 (Comm. Print 1987).

414. *Id.* at 1151–52; Treas. Reg. § 1.141-5(d)(4)(ii) (2024) (similarly defining appropriate purposes).

415. *See* Butchireddygari, *supra* note 411, at 1020–21 & n.22 (arguing that the federal government should end the tax-exempt status of bonds used to pay settlement and judgments arising from police brutality cases, particularly because the victims of police misconduct and violence are disproportionately Black and Hispanic and police violence is the sixth-leading cause of death among young Black men).

governments to ensure their policies do not have a disparate impact on these kinds of services. A revenue bond with a limitless rate covenant that can lead to the escalation of rates in ways that make services unaffordable or pose barriers to entry does not deserve tax-exempt status.

Additionally, investors, particularly those in the highest tax brackets, generally use bonds to reduce their tax liability.[416] The wealthiest taxpayers are the primary holders of municipal bonds. In 2013, the top 0.5% of Americans by wealth held 42% of all municipal bonds.[417] The tax exemption provided to interest on municipal bonds means that, when the interest rate on a municipal bond becomes closer to that of a private bond, the gain from investing in municipal bonds increases.[418] Consider the restriction on cooperative utilities entering into debt instruments that set higher TIERs than the Alaska Public Utility Commission has approved and the fact that it triggers a requirement for the Commission to approve the debt instrument prior to it becoming effective.[419] One reason a borrower may increase its ratio is because "creditors would be happy to lend money to a company with a higher times interest earned ratio. . . . [I]t proves that it is capable of paying its interest payments when due. Therefore, the higher a company's ratio, the less risky it is, and vice versa."[420] The ratio, however, involves increasing its earnings in ways that would require significant rate increases to comply with the covenant. In a diversified portfolio, other types of investments (such as stocks in publicly traded companies or in hedge funds) are better designed to generate large returns than tax-exempt bonds.[421] In short, the economic realities surrounding the class of investors who target municipal bonds and the benefits they provide, even with lower returns, indicate that the market will bear an effort on the part of legislators and local government bond issuers that reserves the right to limit rate increases in the public interest once the terms for repayment of the principal and interest on bonds have been met, even if these limits reduce profit margins. Rate caps would protect the public purpose of the facility funded by the tax-exempt bond. They provide a fair exchange: in exchange for the tax-exempt status of the bond, the bondholder accepts the opportunity to make less or limited profit out of respect for the public interest in affordable rates.

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416. *See id.* at 1031 & n.89; Patrick Manchester, *Be Kind to Your Foreign Investor Friends*, 98 GEO. L.J. 1823, 1826 (2010) (explaining that the tax code allows "two taxpayers with identical incomes [to] incur different federal income tax liabilities if one of them invested in taxable bonds while the other invested in tax-exempt municipal bonds").

417. Peter Olson & David Wessel, *A Smaller Share of Americans Owns Municipal Bonds. Does That Matter?*, BROOKINGS INST. (Aug. 18, 2016), https://www.brookings.edu/blog/up-front/2016/08/18/a-smaller-share-of-americans-owns-municipal-bonds-does-that-matter/.

418. *See* GRANT A. DRIESSEN, CONG. RSCH. SERV., RL30638, TAX-EXEMPT BONDS: A DESCRIPTION OF STATE AND LOCAL GOVERNMENT DEBT 2 (2018), https://crsreports.congress.gov/product/pdf/RL/RL30638/17.

419. *See supra* Section III.C. (citing ALASKA STAT. § 42.05.431(a) (2024)).

420. *See* Tomasetti, *supra* note 371.

421. *See Investment Portfolios: Asset Allocation Models*, VANGUARD, https://investor.vanguard.com/investor-resources-education/education/model-portfolio-allocation (last visited Oct. 23, 2024) (noting that bonds generate lower returns while stocks generate higher returns).

The level of risk to creditors admittedly, however, depends on the rate cap's structure. Rate caps should have some degree of predictability. For example, a state law may require that revenue bond transactions to reserve for the government issuer the right to cap rates at a certain metric of affordability, including in the context of water and sewer service. A potential investor can then calculate the floor for a rate cap—a level below which user rates would never fall—based on the relevant jurisdiction's median income, percentage of residents at or below the federal poverty line, or another statistical metric.

Rate caps are also more consistent with constitutional and statutory regimes that limit government debt and require state and local governments to engage in fiscal restraint. For instance, rate caps provide a significant limit on profitability, thus dimming the allure of user fee-backed revenue bonds for investors. Rate caps also align with fiscal federalism, a theory that says "a federal system will only enjoy the benefits of federalism if the component jurisdictions work under hard budget constraints."[422] These budgetary constraints limit the ability of central governments to bail out government entities below them (the federal government with respect to states, and state governments with respect to cities, counties, and local government authorities). In theory, component jurisdictions' restraint discourages them from making the "improvident" choice to "impose low taxes and provide high services, while borrowing to cover the difference," and then "wait[ing] for a bailout from the central government" if they overspend or their gamble that their investments will raise revenue fails.[423] Debt caps are among the various types of "hard budget constraints" built into state and local law.[424] In addition to protecting the public's interest in equitable access to public facilities and services, the proposal to limit rate increases in rate covenants is also a type of hard budget constraint within which subnational governments are already expected to operate.

Moreover, the authority to increase rates on users allows local governments to incur debt they otherwise may not be qualified to pay back under a general obligation bond by externalizing the responsibility to pay for excessive borrowing or spending onto their most vulnerable residents. An unlimited right to raise rates to cover debt creates a moral hazard that encourages issuers to take out bonds they cannot afford to repay. Bond issuers then have the expectation that they can raise rates on the underlying facility to cover the bill at the expense of public access. The public's right of access to public services is as important as, if not more important than, the generalized notions of fiscal responsibility that underpin fiscal federalism.

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422. Raineri & Shanske, *supra* note 67, at 76 (footnote omitted).
423. *See id.*
424. *See id.* at 76–77.

B. Bond Insurance: An Alternative to Rate Caps

It could be politically difficult to build a coalition to support rate cap legislation. One of the challenges to setting rate caps on municipal debt is that residents within that jurisdiction often have competing priorities. For example, in several nineteenth-century cases in which state legislatures dissolved or reconstituted cities in ways that hindered repayment of their debts to bondholders, "small property owners and rural residents were prone to favor default, while those who had tied their fortunes to city growth wanted to preserve municipal credit and favored debt payment when feasible and renegotiation when not."[425] In the modern context, only some residents in the state are harmed by limitless rate increases while others benefit from them, particularly where high rates on services like retirement communities and toll roads create barriers to entry that impose an additional cost that discourages low-income people and people of color from using the services or keeps them out altogether.

As an alternative to rate caps, bond financiers have developed innovative mechanisms for backstopping revenues that secure the debts on revenue bonds and could be used to strengthen their creditworthiness, even in a world of rate caps.[426] For example, the Puerto Rico Highway & Transportation Authority (PRHTA) constructs, maintains, and operates Puerto Rico's highway network.[427] PRHTA has issued revenue bonds that are payable solely from special gas and fuel taxes, highway tolls, and some license fees.[428] In 2010, it issued a bond valued at $297 million in which the official statement provided that an insurance policy guaranteed full payment, in addition to the special gas and fuel taxes, highway tolls, and license fees it puts up as security for the debt.[429] Insurance policies for revenue bonds could be used to ensure payment to creditors despite the use of rate caps. Bond insurance is a legal commitment in which an insurance company agrees to make payment of principal and interest on debt in the event the issuer fails to pay on time.[430] Demand for bond insurance has steadily increased since the 1980s, going from 16.2% of the long-term, new-issue bonds issued in 1986 to more than 57% of the same market in

425. Gillette, *supra* note 57, at 779 (citing ERIC H. MONKKONEN, THE LOCAL STATE: PUBLIC MONEY AND AMERICAN CITIES 89 (Allan Bogue, David W. Brady, Nelson W. Polsby, & Joel H. Silbey eds., 1995)) (internal quotation marks omitted).

426. "Backstopping" refers to shoring up and reinforcing the security of repayment and ensuring recovery on an investment in a municipal bond. For example, the Federal Reserve provided financial support to guarantee payment on municipal bonds in light of the COVID-19 pandemic. *See* Heather Long, *Federal Reserve Backstops Muni Bond Market As Coronavirus Hammers Cash-Strapped States and Cities*, WASH. POST (Mar. 20, 2020, 12:09 PM), https://www.washingtonpost.com/business/2020/03/20/federal-reserve-muni-bond-market-coronavirus/.

427. *Puerto Rico Highways and Transportation Authority (HTA)*, P.R. FISCAL AGENCY & FIN. ADVISORY, https://www.aafaf.pr.gov/puerto-rico-issuers/puerto-rico-highways-and-transportation-authority-hta (last visited Nov. 14, 2024).

428. Ramón A. Parrilla Carbia, *Full Faith Bonds and Revenue Bonds in Puerto Rico*, 82 REVISTA JURÍDICA UPR 121, 128–29 (2013).

429. *See id.*

430. O'HARA, *supra* note 14, at 14.

2005.[431] In 2023, demand for municipal bond insurance grew 10.4% year-over-year, leading to the highest growth rate since 2008.[432] While a bond issuer can charge a higher interest rate to account for a lower bond rating that a credit rating agency may issue as a result of a rate cap, "[t]he only viable alternative to paying higher interest rates is purchasing bond insurance to raise the rating and thereby lower the perceived risk."[433] Both higher interest rates and bond insurance can increase a bond issuer's costs, which would be passed on as increased costs or even cancelled civic projects.[434] The cost of bond insurance, however, is less than the cost of raising the interest rate on a bond.[435] Bond insurance may also elevate costs to some extent, but not as high as the limitless rate covenant would for lower-income residents.

C. Implementing Rate Caps

State and local governments can target the inequities associated with rate covenants a variety of ways. This problem requires a policy approach, and the options available depend on the jurisdiction's political will. The most direct approach involves amending state statutes authorizing local governments to enter into trust agreements with bondholders. The amendment would modify bond ordinances so that issuers are required to reserve the right to limit or reduce rates no more than necessary to pay the principal and interest on the bond. This restriction would limit the extent to which rates could be raised purely to generate profit in an effort to protect access to services at affordable rates for lower-income residents. Likewise, bond issuers and their counsel may negotiate provisions into trust agreements that allow for limiting rates in the public interest. This approach provides transparency to bondholders and their trustees about rate caps as a matter of law. It also avoids litigation and controversy on the back end as the public opposes limitless rate increases to comply with rate covenants. These limits make sense because most investors in municipal bonds purchase bonds for their tax-exempt status rather than for a high return on investment. Limiting investment returns still preserves one of municipal debt's core benefits to an investor.

In the absence of an approach that changes the terms of municipal bonds, policymakers should institute policies that lessen the impact of rate increases mandated by bond covenants on low-income households, which are disproportionately people of color. For example, local government

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431. *Id.*; *see also History of Bond Insurance*, WM FINANCIAL STRATEGIES, https://www.munibondadvisor.com/BondInsurance.htm (last visited Oct. 23, 2024) ("In 1980, only 3% of bond issues were insured compared to approximately 60% in 2007.").

432. Jessica Lerner, *Bond Insurance Rises Despite Drop in 2023 Bond Volume*, BOND BUYER (Jan. 12, 2024, 9:23 AM), https://www.bondbuyer.com/news/muni-bond-insurance-rises-in-2023.

433. Jason Saylor, Note, *Credit Rating Agencies and Municipal Bonds: How A Misunderstood Industry Has Cost Taxpayers*, 4 GEO. MASON J. INT'L COM. L. 259, 265 (2012).

434. *See id.*

435. *See* John Yinger, *Municipal Bond Ratings and Citizens' Rights*, 12 AM. L. & ECON. REV. 1, 8–10 (2010).

entities could charge differential rates based on income. They could also institute flexible billing policies that allow households to change the timing and frequency of their bill, which can help some customers choose to pay their bill based on their regular payday to reduce cash flow difficulties.[436] Levelized billing options allow households to choose to receive a water bill for the same amount every month, based on average monthly usage, which increases predictability and eliminates sticker shock.[437] Utility service providers can also develop more equitable rate setting practices that apply to all ratepayers.[438] Research shows that inclining block rates, which set a per-gallon rate that increases for larger increments of use rather than using uniform rates that charge all users for each gallon of water used, incentivize water conservation and have the least damaging effect on low-income households among the most common volume-based rate-setting methods.[439]

Tax rebates are another way for policymakers to lessen the impact of rate increases on their communities. Tax rebates allow individuals who pay for expensive services can obtain a refund to offset the impact on their budget. For example, with respect to life plan retirement communities, state and federal governments can authorize lower-income seniors to use Medicaid funds to cover the cost of assisted living facilities. Forty-six states and the District of Columbia now provide some level of financial assistance to individuals in assisted living, but the meaning of the term varies from state to state and often does not cover comprehensive facilities like the kind of life plan communities funded by revenue bonds discussed in this Article.[440] State and federal governments may also provide programs that support adults in saving to cover the cost of a retirement community, similar to a 529 tax-exempt college savings account[441] or a long-term care insurance policy.[442]

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436. *See* U.S. ENV'T PROT. AGENCY (EPA), DRINKING WATER AND WASTEWATER UTILITY: CUSTOMER ASSISTANCE PROGRAMS 10 (2016), https://www.epa.gov/sites/default/files/2016-04/documents/dw-ww_utilities_cap_combined_508.pdf.

437. *See id.* at 7, 10.

438. *See Water Affordability Advocacy Toolkit: Equitable Water Rates*, NAT. RES. DEF. COUNCIL 94, https://www.nrdc.org/sites/default/files/water-affordability-toolkit-section-9.pdf (last visited Oct. 23, 2024).

439. *See id.* at 98.

440. *See* Carin A. Marney, Lane Powell, & Mary ZakKowalczyk, *Introduction to Long Term Care: The Continuum of Care*, 2017 AM. HEALTH LAWS. ASS'N, Feb. 2017 ("Often, nursing homes that are part of Continuing Care Retirement Communities ('CCRCs') do not participate in Medicaid.").

441. "Section 529 college savings plans allow families to save money in state-sponsored investment programs. Contributions to these plans benefit from tax-free compounding and, in many states, investors also enjoy a state-level income tax deduction for a portion of their contributions." Quinn Curtis, *Costs, Conflicts, and College Savings: Evaluating Section 529 Savings Plans*, 37 YALE J. REGUL. 116, 118 (2020).

442. "Unlike traditional health insurance, long-term care insurance is designed to cover long-term services and supports, including personal and custodial care in a variety of settings such as your home, a community organization, or other facility." *What is Long-Term Care Insurance*, ADMIN. FOR CMTY. LIVING, U.S. DEP'T OF HEALTH & HUM. SERVS., https://acl.gov/ltc/costs-and-who-pays/what-is-long-term-care-insurance (Feb. 18, 2020). Most facilities include an assisted living unit and an

Additionally, policymakers can limit the instances in which persons are required to pay for certain public services subject to revenue bond rate covenants and provide exceptions for certain populations. Government authorities can implement payment holidays to lessen the burden on low-income families. For example, despite the use of revenue bonds to fund toll roads, Florida law authorizes the governor to suspend tolls during and after emergencies like hurricanes to allow more residents to use all of the state's roads on equal terms for evacuation purposes and to provide services to areas in need.[443] Florida also specifies that "[a] person with a disability who has a valid driver license, who operates a vehicle specially equipped for use by persons with disabilities," and who has a severe impairment that limits their ability to toss coins into a toll basket "shall be allowed to pass free through all tollgates and over all toll bridges and ferries" in Florida, including the toll facilities whose revenue is pledged for the repayment of bonds.[444] The presence of this exception in the statute today in light of the growing use of vehicle transponders like SunPass and E-ZPass that digitally register passage through a toll collection point, without the need to deposit coins into a basket, suggests that other exemptions could be provided based on income, for example, to persons who receive Social Security benefits or public assistance.[445]

Where there is not an appetite for modifying statutes, it is imperative for policymakers to use other tools to mitigate the impact that rate increases have on lower-income people. Utility providers should use more equitable billing practices and rate structures that support lower-income ratepayers. Governments should subsidize the cost of using publicly assisted facilities like retirement communities to promote racial and socioeconomic integration. Changing Medicaid rules and creating tax-advantaged savings plans and insurance programs can help individuals garner the funds to move into retirement communities that now have high fees which pose barriers to entry, but which make revenue bond financing very

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independent living unit. While long term care insurance typically covers CCRCs, "long-term care insurance covers only licensed facilities, although some policies will cover home health services and personal care services only in unlicensed living units." Judith A. Weaver, *CCRCs: Moving the Reluctant Resident*, AM. HEALTH LAWS. ASS'N, AHLA-PAPERS P02190332, Feb. 2003.

443. FLA. STAT. ANN. § 338.155(1)(b) (West 2024) (providing that "[t]he secretary or the secretary's designee may suspend the payment of tolls on a toll facility when necessary to assist in emergency evacuation"); Press Release, Exec. Off. of the Governor, Governor Ron DeSantis Suspends Tolls To Assist Hurricane Milton Evacuations (Oct. 7, 2024), https://www.flgov.com/eog/news/press/2024/governor-ron-desantis-suspends-tolls-assist-hurricane-milton-evacuations. While the statute allows specific classes of persons to travel without paying tolls and makes no exception for the use of "toll facilities managed by the department the revenues of which are not pledged to repayment of bonds," it does specify that the state department of transportation may issue regulations that "allow the use of such facilities by public transit vehicles or by vehicles participating in a funeral procession for an active-duty military servicemember without the payment of tolls." FLA. STAT. ANN. § 338.155(1)(d) (West 2024).

444. *See* FLA. STAT. ANN. § 338.155(1)(d) & (3) (West 2024).

445. SunPass began in 1999. Twenty-seven million customers use SunPass for travel through toll roads in eighteen U.S. states. *Newsletter from Nicola to SunPass Customers*, FLA.'S TPK., https://floridasturnpike.com/sunpassport/newsletter-from-nicola-to-sunpass-customers/ (last visited Oct. 23, 2024).

lucrative. Finally, payment holidays that waive the cost of certain public facilities for certain qualified individuals can do so without running afoul of the bond covenants that govern them.

CONCLUSION

Critiques of the terms of municipal bond issues, ordinances, and trust indentures have largely remained in the securities law realm. These terms, however, have powerful implications for the residents in the jurisdictions that issue these bonds. Rate covenants provide a way for activist bondholders to make bond profitability the highest priority for state and local governments. Indeed, compliance with the bond's terms may take precedence over any other interest, given the risk that defaulting on the bond can ruin a jurisdiction's credit rating. With these stakes, diversity and equity can easily take a backseat. Relegating access and inclusion to the lowest priority, however, compromises the ability of disadvantaged members of a community to grow and thrive—the overarching public purpose at the core of a local government's mission in building a project in the first place. Rate covenants not only prevent community members from growing and thriving but also contradict fair housing and civil rights laws. To protect both bondholders and its residents, states should consider more creative regulation to rein in the power rate covenants have. Antidiscrimination law also plays a role to ensure that rate covenants' terms do not overshadow principles of equity and inclusion. Advocates and government leaders should incorporate an analysis of the terms of municipal bonds into their process of examining barriers to entry and access to opportunity when conducting civil rights compliance reviews of government entities that rely on revenue bond financing. Access to capital must not come at the expense of an inclusive society and achieving the nation's fair housing and civil rights goals.