# BONDS & CERTIFICATES OF OBLIGATION

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# PRESENTED BY:


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# OBJECTIVES

- Gain understanding of parties involved in financing
- Know what a Reimbursement Resolution is
- Gain familiarity with major financing tools
- Gain understanding of potential legal issues, i.e., When should I talk with Bond Counsel?

# BEGINNING THE PROCESS

- **Factors to Consider:**
  - Project to be Financed
  - Size of Issue Needed
  - Overall Debt Management Plan
  - County’s Ability to Repay
  - Future Debt Plans

# WHO'S WHO IN PUBLIC FINANCE?

- **Professionals involved in the debt issuance process:**
  - Financial Advisor
  - Bond Counsel
  - Underwriter/Purchaser
  - Paying Agent
  - Rating Agencies
  - Bond Insurer/Credit Enhancement Companies
  - Attorney General
  - Architect/Engineer

# COUNTY'S FINANCIAL ADVISOR

- **The professional who will:**
  - Guide the county through the economic side of the issuance process
  - Structure the form of the financing and recommend the type of issue to be used – G.O. Bonds, CO's, Anticipation Notes, etc.
  - Conduct the competitive sale or negotiated sale or arrange for a private placement for funding
  - Assist with County's CIP process

# COUNTY'S BOND COUNSEL

- The county's lawyer in the transaction who will prepare the financing documents
- Provides the "Bond Opinion" which opines that the obligations were properly issued and if issued on a tax-exempt basis, that the obligations are not subject to federal insurance taxation
- Must know local government law, federal tax law, and securities law
- An attorney-client relationship must exist between the county and the county's bond counsel
- The county has the right to select its own bond counsel
- Investors/purchasers require a legal and a tax opinion

# BOND OPINIONS

- **Bond Counsel will give a market opinion and a tax opinion that:**
  - County has complied with the law
  - If issued as a tax-exempt obligation, interest on the bonds is excludable from gross income of purchaser for purposes of federal income taxation
  - Bonds are not private activity bonds

# HOW ARE THE PROFESSIONALS PAID?

- **Financial Advisor and Bond Counsel work on a contingent basis**
  - They are only paid if the bonds are issued and proceeds are delivered to the county
- **Architects and other professionals generally do not work on a contingent basis**
  - They expect to be paid even if the bond issue does not pass

# WHEN DO YOU NEED MONEY?

## PROTECT YOURSELF

- Should you use a reimbursement resolution?
- Limit the amount owed to Architect and others if bond issue fails
- Build limits into contract
- Use a government friendly contract
- Do not simply sign all preprinted contracts

# WHO WILL BUY?

- **Underwriters**
  - Then sells to customers/investors
- **Local Banks**
- **United States Department of Agriculture's Rural Development/Rural Utilities Service**
- **Texas Water Development Board**

# FINANCING METHODS

- **General Obligation Bonds**
- **Revenue Bonds**
- **Certificates of Obligation**
- **Anticipation Notes (Tax Notes)**
- **Lease-Purchase Contracts**

# GENERAL OBLIGATION BONDS

- Are often referred to as “G.O. Bonds”
- Require an election
- Are backed by a pledge of ad valorem taxes
- Are best suited for major capital projects where the Commissioners Court believes that it is important to have the voters pass upon the project
- May be amortized over a 40-year period, but usually a shorter period of 15 to 20 years is used

# REVENUE BONDS

- **Are secured by a pledge of revenues from a project**
- **They are not subject to a demand for payment from taxes**
- **Usually involve revenues from a public utility**
- **Primarily used by cities and special districts**
- **Few counties have projects that have sufficient revenues to pledge for payment of bonds**

# CERTIFICATES OF OBLIGATION

- Are often referred to as “Certificates” or “C.O.’s”
- Streamlined method of financing
- Require publication
- Do not require an election unless 5% of the registered voters petition
- Secured by ad valorem taxes, a revenue pledge, or combination thereof
- May be amortized over a 40-year period, but usually a shorter period is used

# LEASE PURCHASE AGREEMENT/ INSTALLMENT SALES CONTRACT

- **Permits the county to purchase goods over period of time**
- **Is not a pledge of taxes (unless for equipment and properly structured)**
- **Is a maintenance and operations expense, not a debt service expense unless properly structured**
- **Attorney General approval is not required**

# LEASE PURCHASE AGREEMENT/ INSTALLMENT SALES CONTRACT

- **Must be subject to annual appropriations (unless structured under the Public Property Finance Act)**
- **No requirement to continue**
- **Practical limits on the ability to discontinue**
- **Interest rates are often higher than a tax pledge obligation**

# REFUNDING BONDS

- Used to refinance the county's outstanding bonds and other obligations
- Allows county to take advantage of lower interest rates
- Used to restructure debt payments

# LEGAL ISSUES TO BE AWARE OF

- **State Law**
- **Federal Securities Law**
- **Federal Tax Law**

# OFFICIAL STATEMENT

- **A document or documents prepared by or on behalf of the issuer of municipal securities in connection with a primary offering that discloses material information on the offering of such securities**
- **Investors may use this information to evaluate the credit quality of the securities**
- **Although functionally equivalent to the prospectus used in connection with registered securities, an official statement for municipal securities is exempt from the prospectus requirements of the Securities Act of 1933**

# CONTINUING DISCLOSURE

- **Requirement to provide financial information at least annually**
- **Requirement to report certain events within 10 days**
- **Some obligations are at least partially exempt**

# THE COUNTY'S DUTIES DO NOT END WHEN THE BONDS ARE ISSUED

- **You MUST comply with requirements you promised in the bond documents that you would not let the bonds become taxable**
- **What may cause the problem – TURNOVER**
- **The personnel that were there when the bonds were issued have departed before the bonds are paid off**
- **You need to familiarize yourself with the requirements so that you can brief your successors**

# GENERAL TAX COVENANTS

- No private activity use
- Will not permit the bonds to become private activity bonds
- No federal guaranty
- Will restrict the use of the proceeds to comply with the arbitrage requirements
- In the event of arbitrage will rebate the excess earning to the United States
- Will maintain the necessary records to permit compliance with the tax-exempt requirements for at least six years after the final principal and interest payment on the bonds

# ARBITRAGE

- The practice of using bond proceeds to acquire higher yielding investments than the rate the government is paying on the bonds
- NO ARBITRAGE OF FEDERAL TAX CERTIFICATE
- REBATE
- SMALL ISSUER EXCEPTION – Under $5,000,000

# IRS AUDITS

- Enforcement officials have targeted what they view as an abusive use of the municipal bond exemptions
- The focus is on arbitrage driven transactions where the bond proceeds are invested in higher-yielding instruments
- The agency has generally sought to settle such tax disputes with agreements in which the feds recoup any profits from the unauthorized investment, but they have threatened to go after bondholders if they cannot resolve the case otherwise

# QUESTIONS?

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