WHAT OUTSIDE BOND COUNSEL WISHES EVERY CITY ATTORNEY KNEW

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Experience
Public finance
Global infastructure

Industries
Transportation
Education
Government

Paul A. Braden
Partner

AREAS OF CONCENTRATION
Public Finance
Global Infrastructure

EXPERIENCE
Paul Braden joined Fulbright & Jaworski as a partner in 2007 and has been practicing law in Texas for over 20 years. His public finance clients have included key underwriting firms, government agencies and political subdivisions, for whom he has advised on a variety of debt issuance matters, including Build America Bonds and Qualified School Construction Bonds. Serving as bond counsel, underwriters' counsel and issuer counsel, he has represented clients in financings involving billions of dollars of debt securities.

Prior to joining Fulbright, Paul was a founding partner of what became (at one time) the largest Hispanic-owned law firm in Texas.

REPRESENTATIVE EXPERIENCE
In addition to numerous traditional financings, Paul acted as bond counsel:

- in the first issuance of Recovery Zone Economic Development Bonds ("Super BABs") in Texas;
- in the first offering of Qualified School Construction Bonds (0% Tax Credit Bonds) in Texas;
- to a municipality in a private placement of Build America Bonds with the North American Development Bank;
- to a Texas regional mobility authority in issuing $233 million of pass-through toll revenue bonds for financing an urgently needed State highway, which involved multiple public entities and a private developer and was the first such financing in the U.S., and was recognized as 2008 Deal of the Year for the Southwest Region by The Bond Buyer;
- to a municipality in issuing $101 million of general obligation pension bonds to partially fund the city's unfunded actuarial accrued liability;
- to a municipality in issuing approximately $40 million of combination pass-through toll and limited revenue bonds to assist with State highway construction within the municipality's city limits; and
- in issuing education revenue bonds by a State charter school finance corporation to fund its renovation and expansion.

PROFESSIONAL ACTIVITIES AND MEMBERSHIPS
- Texas Bar Foundation, Life Fellow
- State Bar of Texas
- Dallas Bar Association
- American Bar Association
- Mexican American Bar Association
- Hispanic National Bar Association
- National Association of Bond Lawyers

PUBLICATIONS
Co-Author, "Texas Public Finance Legislative Review - 81st Session," The International Law Firm of Fulbright & Jaworski - Public Finance, July 2009.

EDUCATIONAL BACKGROUND
1989 - J.D., with honors, The University of Texas School of Law
1986 - B.A., cum laude, University of Dallas

Paul is admitted to practice law in Texas.

CIVIC INVOLVEMENT
In 2004, Governor Rick Perry appointed Paul to the Texas Pension Review Board and in 2009, he was elected Vice Chair of such board.

Paul is a graduate of the Leadership Dallas Class of 2011, a leadership program sponsored by the Dallas Regional Chamber of Commerce. He is involved with the United Way of Metropolitan Dallas as a Grant Review panelist (Child Care/After School) and volunteers as a youth soccer coach and league commissioner with the Lake Highlands Soccer Association.

While residing in El Paso, Paul served on the Board of Directors for the United Way of El Paso County and as an advisory director of the American SIDS Institute. Paul is the former Executive Vice President and Director of the Texas Society to Prevent Blindness, El Paso Chapter. Paul was also actively involved in various other El Paso civic groups, including the City of El Paso Charter Review Committee and the Paso Del Norte Group.

LANGUAGE CAPABILITIES
Spanish - Limited

Just like in High School:

It Would Be Nice
To Be Understood

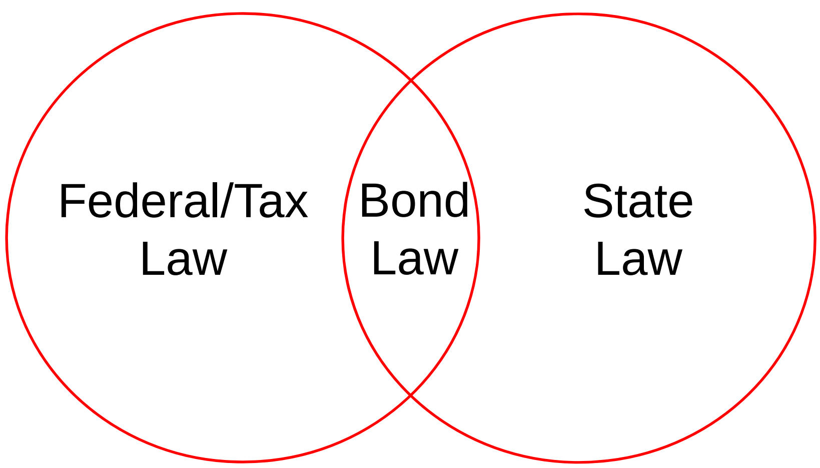
Wish They Knew What We Do

- Other lawyers don’t even know what Bond Counsel does
- Specialized field of the law
- Came about after massive defaults on railroad bonds in the late 19th Century
- Meant to restore confidence in the bond market
- Opinion of bond counsel is a form of assurance, in theory, for issuers and investors that all legal requirements are met

What is a Bond Counsel?

- An attorney or law firm
- Typically retained by the issuer
- To give **<u>a legal opinion</u>** (key function) that
  - *the issuer is **authorized to issue** proposed municipal securities*
  - *the issuer **has met all legal requirements** necessary for issuance and*
  - ***interest on the proposed securities** (if they are intended to be tax-exempt) will be **excluded from** gross income of the bond holders for **federal income tax** purposes and from state and local taxation (if applicable)*

"I live in the middle."



State Law

- Almost every question you ask of bond counsel, no matter how "apparently" simple will involve issues of State law and federal tax law and sometimes securities law
- Texas State law issues typically involve the Texas Constitution, Texas statutes and then home rule charter provisions (as applicable)

Texas Constitution Trumps All Other State Law

State Law

- Seems obvious, but sometimes even the State legislature seems to forget
- There are various instances where the Legislature has passed existing laws that are somewhat in conflict with the Constitution
- Trap for the unwary or unsophisticated
- AG polices

State Law

- For example, “capitalized interest”
- Chapter 1201 of the Texas Government Code authorizes an issuer [which includes a municipal corporation] to pay interest on a public security while the project is being constructed and for the year after it is constructed
- However, capitalized interest on City debt has constitutional limitations.

State Law

- A city is constitutionally required to levy a tax to pay interest (and a 2% sinking fund) at the time of the creation of the debt
- From that constitutional provision, the AG has taken the position that a city may capitalize interest on a tax obligation <u>only</u> for the period prior to the earliest time taxes can be levied and collected for the obligation

State Law

- When debt is both a tax and revenue obligation, the city can use cap I for a longer period of time to the extent the revenue supports the debt obligation
- Key issue is when the City levies its taxes in relation to when the bond deal closes

State Law

- If you close a bond deal 60 days before a city levies its tax, the city has to put the bond debt service in that levy and your cap i would be very limited (if at all)
- If you issue bonds right after a city levies its tax for the following year, you could do cap i through the following year up until the city's next tax rate is established and those taxes collected

State Law

- DEBT--generally, under Texas law, any "pecuniary obligation" imposed by contract is a "debt" under Texas law
  - *That is, something saying you have to pay money*
- Exceptions for obligations which as of the date of the contract could be satisfied out of current annual revenues (as reasonably contemplated by the parties) or out of some fund then within the "immediate control" of the City

State Law

- This is black letter Texas law that dates back over 100 years (McNeal v. City of Waco, 89 Tex. 83, 33 S.W. 322 (Tex. 1895).
- So what…"big deal"… its "debt"…
- If a contract is "debt," then Texas Constitution requires that at the time of creating that debt, the City provides for the levy & collection of a sufficient tax to pay the interest on the obligation and provide for at least a 2% sinking fund. (Article XI, Section 5 and Section 7, Texas Constitution.)

- A "sinking fund" is a fund created to pay down the "debt"
- Any attempted creation or incurrence of a "debt" without also making such provision for payment "is contrary to the express prohibition of the constitution, and void." McNeill; see also Tex. & New Orleans R.R. Co. v. Galveston County, 169 S.W.2d 713, 715 (Tex. 1943)

State Law

- "A contract which violates these constitutional provisions is void, and the governmental unit involved need not pay any related obligation." City-County Solid Waste Control Bd. v. Capital City Leasing, Inc., 813 S.W.2d 705, 707 (Tex. App.--Austin 1991, writ denied).]
- To avoid any contract which extends across fiscal years being construed as "debt," contracts are written to be subject to annual appropriation or payable from a specifically identified non-tax source (usually need statutory authority for the latter).
- *Expenditures past the current budget year "subject to appropriation"*

State Law

- No inherent right for a City to issue bonds
- Must have specific authority for the specific purpose
- Also need express authority to make the pledge
- Usually statutory authority but it may be charter
- There are a whole bunch of statutes which allow cities to issue debt
- In some instances voter approval is required
- Voter approval typically depends on whether pledging taxes or not, but not always (e.g., CO's)

State Law

- Loc. Gov't Chapter 334 (venue projects)
- Loc. Gov't Code 331 (park purposes)
- Tex. Transp. Code 22.052 (airports)
- Gov't Code ch. 1504 (civic centers, auditoriums, museums, libraries, golf courses, tennis courts, and other municipal buildings)
- Gov't Code ch. 1506 (municipal parking and transportation facilities)
- Gov't Code ch. 1508 (municipal parks, airports and recreational facilities such as swimming pools, golf courses, ballparks, and fairgrounds)

General Obligation "GO" Bonds

- Tex. Gov't Code, Sec. 1331.052
- Backed by ad valorem taxes
  - Full faith and credit of the City
- Authorized by municipal bond election
- Used for permanent public improvements and other public purposes as provided by statute or City Charter
- Typically used for long-life assets

Revenue Bonds

- No bond election required (unless city charter requires) (even then state law may allow revenue bonds to be issued w/o election)
- Not secured by a pledge of property taxes
- Revenue stream is pledged to finance a revenue-producing asset
- Authority from various statutes according to type of project
  - Examples are Gov't Code Sections: 1502 – Water and Sewer; 1433.023(a) – Industrial Project; 1504.002 – certain facilities

Revenue Bonds

- Typically more restrictive covenants than tax bonds
- Additional bonds test, rate coverage, operations, etc.
- Bond holders can only be paid from the revenue source so they "care" about that revenue and how the project which generates the revenue is run

Certificates of Obligation (CO)

- Chapter 271, Subchapter C of Local Government Code
- May be issued to pay for:
  - Public improvements the city will own (real, personal, or both)
  - Professional services
  - Demolition of substandard structures
  - Restoration of historic structures
- No election is required (unless a petition is received)
  - Any petition must be signed by 5% of qualified voters
- Supported by ad valorem taxes, revenues or both

Refunding Bonds

- Chapter 1207
- No bond election is required
- May be used to refinance short-term or long-term debt, or other "obligations"
- Consolidate several short-term notes for a more favorable interest rate and term
- A pledge of ad valorem taxes, revenue or both unless limited by applicable statute
- Typical Purposes: present value interest cost savings; restructuring

Conduit Bonds

- Issued by local government, special authority or non-profit for the benefit of a private entity
- Payable exclusively from revenues received from the private entity
- Usually result in private financing through a public body with no tax dollars or other public funds pledged for payment (e.g., hospitals, colleges)
- Special federal tax law considerations for conduit bonds
- Examples: housing, industrial development, 501(c)(3) issuers

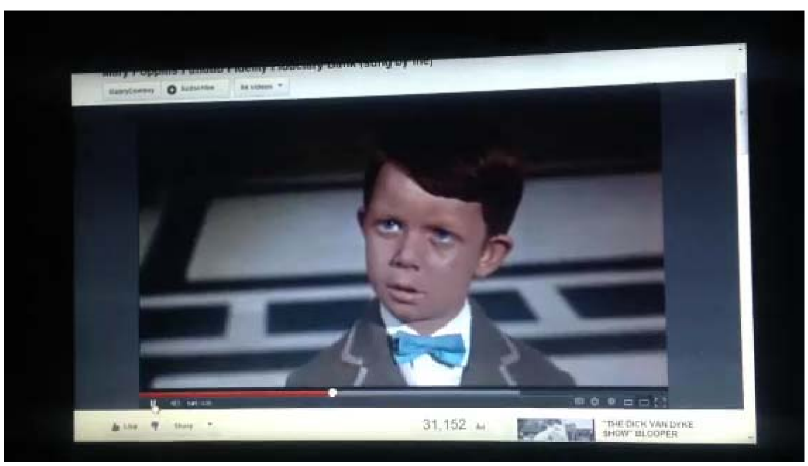
Judgment Bonds

- Bonds issued to pay final judgments against the city if money is not available to pay the judgment
- Election required but may be able to refund an "obligation" to pay pursuant to a court judgment without an election
- Must mature within 40 years
- Texas Gov't Code, Section 157.001

Texas AG Process

- For most part, all bonds in Texas have to be approved by the Attorney General
  - If someone says you don't have to go through the AG, that may be OK but it is a red flag to check with your Bond Counsel
- Very detailed review of the bond transcript (all documents associated with authorizing the debt and associated pledge)
- Once approved, AG issues its opinion and bonds are uncontestable for all state law purposes except fraud or constitutional issues
- Comptroller registers the bonds after release of AG opinion
- AG review does not cover federal tax law issues

What do a 1964 musical and Bond Counsel work have in common?



So remind me again, what are Municipal Bonds?

- Basically promissory notes
- Issued by cities, states, school districts and other public entities
- To finance public-purpose projects –schools, roads, bridges, utilities, affordable housing, airports, hospitals, etc.
- States and local governments can't sell stock, so they "sell" debt to finance capital projects

Issuer Hires Bond Counsel

Public Finance Team

- Bond Counsel
  - *City's lawyer*
- Financial Advisor
  - *Also works for City; very important to transaction and typically coordinates most aspects of transaction*
- Underwriters/Purchasers
  - *Buys your bonds; technically across the table from City but cooperative atmosphere*
- Underwriters Counsel
- Disclosure Counsel
- Others: Rating Agencies, Insurers, Trustees, Paying Agents

What is Underwriters Counsel?

- Underwriter's counsel is employed to represent the underwriter in the offering of bonds
- Cooperative atmosphere but "across the table" from bond counsel
- Drafts bond purchase agreements, may draft official statements, review all documents for underwriter
- Assists the underwriter in meeting its legal responsibilities generally in the issuance and sale of the bonds

Economic Development Issues

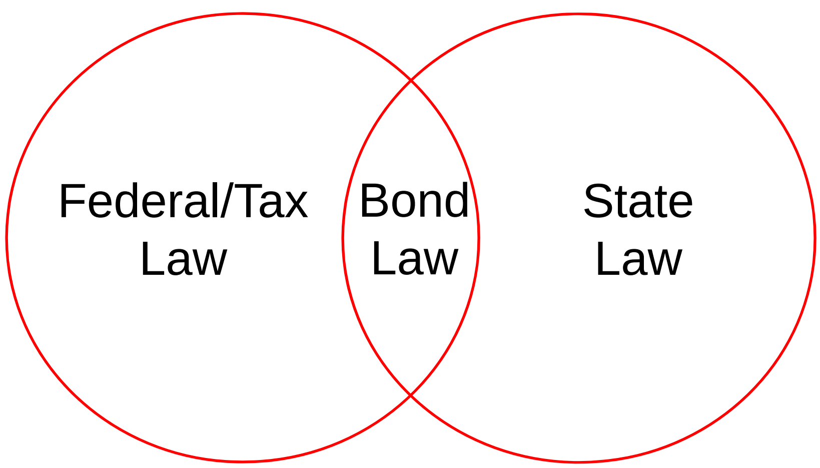
- A City cannot issue general obligation bonds for economic development without an election—Constitutional issue
- Moreover, AG has opined that the general Constitutional economic development provision does not authorize the issuance of bonds for economic development
- Economic development is a "public purpose" but there is no separate statutory authority to issue bonds for that purpose (with the limited exception of Govt Code Chapter 1509)
- A Home Rule City's Charter may permit the issuance of economic development bonds with an election if it permits the issuance of bond for "any public purpose" or "any purpose not prohibited by law" or similar language

- Cannot use bonds proceeds or ad valorem taxes to pay for a 380 grant without a vote
- Any other "lawful" revenue available to the City, including sales tax
- Cannot rebate or refund property taxes but can create a formula to equate the property taxes paid from "lawfully available revenues"
- Cannot refund a 380 obligation with bonds except under very limited circumstances
- Subject to annual appropriation

State Law

- General rule, cannot assess a tax in anticipation of debt
- City only has the authority to assess a debt tax sufficient to pay debt service coming due on its outstanding obligations in the next year
- A City can take into account its collection factor or percentage and assume less than 100% collection, which will naturally create a small “cushion” in the debt service fund that is acceptable for State law purpose and is treated as a “reasonably required reserve” for federal tax purposes
- As the “cushion” builds up over time, then there could be federal tax law implications for an “overfunded” reserve that requires additional tax analysis, including yield restriction and, in the event of a refinancing, that a portion of the “cushion” be contributed to redemption of the bonds

“I live in the middle.”



Federal Law

- How do we pay ourselves back if we have to front money
- Reimbursement Resolution
  - *Go back 60 days*
  - *Rule of Thumb: good for 18 months*
  - *all of the expenditures to be reimbursed (ie, expenditures occurring prior to the delivery date of the bonds) need to be capital expenditures or costs of issuance. [Treas. Reg. 1.150-2(d)(3)]*

  State law for the most part tracks federal law with respect to reimbursement

Federal Law

- Questions regarding reimbursement of payroll expenses
- Cannot reimburse (but possibly may pay on a going forward basis as de minimus working capital expensse, see following)
- As a result, payroll expenses for engineers assigned to the project which were paid prior to the delivery date of the bonds do not qualify for reimbursement since these are treated under the tax code as working capital expenditures
- For most part, think of using bond proceeds only for "bricks & mortar" (and cost of issuance) but there are some exceptions

Federal Law

- Treasury regulations allow a small amount of bond proceeds to be used for working capital expenditures incurred subsequent to the delivery date of the bonds
- Working capital costs must be incurred **subsequent** to the delivery date of the bonds, are **under 5 %** of the sales proceeds of the bonds and are **directly related** to the capital expenditures financed by the issue (ie, the bond projects) [Treas. Reg. 1.148-6(d)(3)]

Working Capital Issues

- In addition, generally speaking, if the employee's time is spent on a capital project funded with bond proceeds and the City's auditor's would classify their salary expense as a "capital expenditure," you may be able to pay with proceeds
- Not for the faint of heart or unsophisticated
- Detailed record keeping
- Check with your bond counsel
- May be State law issues in certain cases (e.g., CO Act))
- Federal tax law requires, with limited exceptions, that bond proceeds be spent on capital costs unless the issue meets the requirement for a working capital financing.

Just because the City issues the bonds, does not make them tax-exempt.

Federal Law

- Private Business Use Concept
- Section 103(a) of the Internal Revenue Code provides that, generally, interest on any State or local government bond is not included in gross income for federal income tax purposes
- Exclusion does not apply to any private activity bond (that is not a "qualified bond" under section 141 of the Code) if it is issued as part of an issue that meets either the private business use test **and** the private security or payment test, or the private loan financing test
  - *You don't want to meet these tests*

Federal Law

- Private business use test is met if more than 10 percent of the proceeds of an issue are to be used for any private business use
- Section 141(b)(6)(A) defines the term private business use as use (directly or indirectly) in a trade or business carried on by any person other than a local governmental unit
- Private business use would include use by the Federal Government or 501(c) organizations

Federal Tax Law

- Private business use can include leases and management agreements
- Special safe harbors for "qualified management contracts"
- Ask questions: Was the project financed with bonds? Are those bond still outstanding, or are any bonds issued to refund the original bonds still outstanding? What are the terms of the agreement (i.e. payments, terms, etc.) Are there any other "private use" or "private payments" from the same issue of bonds that financed the facility, etc.

Federal Tax Law

- The IRS considers the benefit that a private entity (including a non-profit) receives from a naming right to be a private use of the facility that generates private payments. Therefore, a sale of naming rights may cause the related bonds to exceed the private business test limitations
- This would not include a City's naming a building after a natural person unrelated to trade or business
- When "naming rights" or other "private payments" are expected from the beginning of a project, the Bonds can be structured to accommodate the structure from the beginning (i.e., part tax-exempt and part taxable bonds)

"Leftovers" - not just for dinner anymore

State & Federal Law

- Federal Tax Law Perspective
  - As long as the money is spend on a capital project that has a governmental purpose, then a City can spend the leftover bond proceeds on a different capital project
  - Unexpended bond proceeds can be used to redeem or defease outstanding bonds of the same issue
- State Law Perspective
  - If a project came in under budget and there are leftover proceeds and there is another project of the same type, then those leftover proceeds can be spent on that project if authorized under the bond ordinance (i.e., the proposition was a general "street" proposition and the City sized a bond issue to build Main Street and it came in under budget – they can use leftover proceeds to resurface 1st Street)
  - If the bond proposition was specific (i.e., to build Fire State No. 1), then proceeds cannot be spent on a new animal shelter or any other project without going back to the voters
  - For Certificates of Obligation, if the published notice provided for multiple projects, then excess proceeds from one project can be used on another project specified in the notice
  - Excess funds can be used to defease outstanding bonds

- Federal tax law generally allows bond proceeds to be used for different projects so long as they are capital projects that would otherwise be permitted under federal tax law; however, final allocations of proceed to expenditures must be made within certain timeframes
- From a State law perspective, it is a more difficult question
- Chapter 1332, Government Code, authorizes a City to change the use of proceeds from bonds already issued with an election (not realistic)
- It is important to contact Bond Counsel to discuss the facts and circumstances of the change before any action is taken

"Why Can't We Just Sell It?"

State & Federal Law

- Private business use issues if bonds still outstanding
- If the City has fully completed the project for which the bonds were issued and now the land or facility is no longer needed for the project, then it may be possible for the City to sell the land or facility even while bonds are outstanding, depending on the facts and circumstances of the situation.
- If the sale is to a private entity (including the federal government or a non-profit), then the sale proceeds may cause the related bonds to exceed the private business test limitations.
- May have to defease bonds with payments.
- Any sale of land is subject to Local Government Code competitive sale procedures

Disclosure and Post Issuance Compliance

- The IRS has increased its scrutiny of actions taken (or not taken) by an Issuer after bonds have been issued
- IRS in now asking whether an Issuer has written procedures for tax compliance on the IRS Form 8038-G that is submitted for each bond issuance
- A post-issuance tax compliance program is an established set of protocol that allows an issuer to monitor the requirements necessary to maintain the tax status of its bonds (e.g. arbitrage, use of bond proceeds, record retention) and identify potential problems so that it may take preventative or corrective action, if necessary

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- Rule 15c2-12
  - *EMMA filings*
- Tax Covenants

Top Ten List

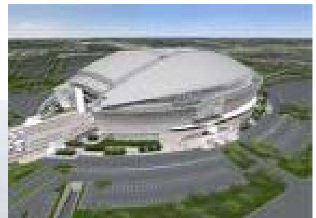
- A list of the Top Ten Things that every bond counsel wishes every city attorney knew….

10. Nice to be understood. (same lament as my teenage daughter)
9. I work for you.
8. I live in the middle.
7. Texas Constitution trumps all other state law - not even AG approval cures that.
6. Almost anything can be "debt" if you're not careful (constitutional issues)
5. Just because the city sells the bonds does not make them tax exempt (tax law)
4. Federal Government is the same as IBM (tax law)
3. Bond Proceeds are not FUNGIBLE (bricks and mortar v. working capital)
2. WHAT YOU DO AFTER CLOSING MATTERS
1. Finally, Bond Counsel work is like poetry – sometimes difficult to understand but beautiful when done right.

FULBRIGHT & Jaworski L.L.P.
Attorneys at Law

Sample Projects

Underwriter's Counsel for the financing for the new Cowboys Stadium in Arlington



Sample Projects

- Bond Counsel to Camino Real Regional Mobility Authority

- State Spur 601 highway project—2008 Deal of the Year, Small Issuer, SW Region

Sample Projects

- Kay Bailey Hutchison Desalination Plant, El Paso, Texas--world's largest inland desalination plant

Sample Projects

- Bond Counsel to Texas Tech University System

TEXAS TECH UNIVERSITY SYSTEM

Sample Projects

Underwriter's Counsel for the new Dallas Center for the Performing Arts

We're Pretty Good at This Stuff….

- The Bond Buyer ranked Fulbright 1st in Texas as bond counsel in 2011, helping to issue $7.53 billion par amount of bonds
- In 2011, we were ranked 6th nationally as bond counsel ($8.8 billion raised in 305 offerings) and 4th nationally as underwriters counsel ($8.7 billion placed in 219 offerings)
- In 2010, the Firm ranked 2nd nationally as disclosure counsel ($9.2 billion in 81 offerings)
- Consistently rank in the Top Ten nationally in bond counsel and underwriters counsel work

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