

COMMONLY ASKED BOND LAW QUESTIONS

Can a City issue general obligation bonds for economic development?

- Cannot issue general obligation bonds for economic development without an election
- Economic development is a “public purpose” but there is no separate statutory authority to issue bonds for that purpose (with the limited exception of Government Code Chp. 1509)
- The Attorney General has opined that the general Constitutional economic development provision does not authorize the issuance of bonds for economic development
- A Home Rule City’s Charter may permit the issuance of economic development bonds with an election if it permits the issuance of bonds for “any public purpose” or “any purpose not prohibited by law” or similar language

What revenues can we use for a 380 economic development agreement?

- Cannot use ad valorem taxes 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 to property taxes paid from “lawfully available revenues”
- Cannot refund a 380 obligation with bonds except under very limited circumstances

Side Note: The Attorney General has become much more aggressive in their position on economic development and have refused to approve certificates of obligation (which do not require a vote) when they believe the true purpose is economic development (i.e., for a city water park operated by a private operator)

Can a City use bond proceeds to pay for employee salaries?

- Generally speaking, if the employee's time is spent on a capital project funded with bond proceeds and the City's auditors would classify their salary expense as a "capital cost," then yes
- The Certificate of Obligation Act (Chapter 271, Local Gov't Code) specifically provides that a City can pay employee salaries **only** if the employees are hired specifically for the bond-financed project or where the City incurs greater or equivalent costs to replace normal work the employee would have provided
- Federal tax law requires, with limited exceptions, that bond proceeds be spent on capital costs unless the issue meets the requirements for a working capital financing

- Use of a bond-financed facility by a private user in a trade or business (which, for this purpose, includes the federal government and non-profits) through agreements such as leases and management agreements, can raise federal tax law issues for any bond-financed facility. This should trigger a call to the City's Bond Counsel, where the answers to the following questions will help speed the process and the answer from Bond Counsel:
 - First Question: Was the facility or part of the facility being leased financed with bonds?
 - Second Question: Are those bonds still outstanding, or are any bonds issued to refund the original bonds still outstanding?
 - Third Question: What are the terms of the agreement (i.e., payments, term, etc.)
 - Fourth Question: Are there any other "private use" or "private payments" from the same issue of bonds that financed the facility?
 - Fifth Question: What was the total amount of the original bond issue; how much of the original issue was used for the facility being leased; what are the amounts of the subsequent refundings and what maturities were refunded?

(Note: there are ways to structure certain agreements so that they are not considered to give rise to private use for federal tax law purposes)

Can the City sell “naming rights” to some of its bond-financed facilities ?

- The IRS considers the benefit that a private entity (including a non-profit) receives from a naming right to be 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
- The City should contact Bond Counsel to discuss the tax consequences
- 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)

What can we do with leftover bond proceeds from an old issue?

Federal Tax Law Perspective:

- As long as the money is spent on a capital project that has a governmental purpose, then a City can spend the leftover bond proceeds on a different 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 (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 Station 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

Can a City use bond proceeds for a project different from the one the bonds were issued for?

- 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 proceeds to expenditures must be made within certain timeframes
- From a State law perspective, it is a more difficult question
- Chapter 1332, Gov't Code authorizes a City to change the use of proceeds from bonds already issued with an election
- It is important to contact Bond Counsel to discuss the facts and circumstances of the change before any action is taken

- 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 still outstanding, depending on the facts and circumstances of the situation – the City should contact Bond Counsel
- 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 and the City should contact Bond Counsel to discuss any tax consequences and potential remedial actions
- Any sale of land is subject to Local Government Code competitive sale procedures

Can a City assess a higher debt service tax rate than it needs to pay debt service in any year?

- A 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 (i.e., there is no authority to “over-levy”)
- 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 purposes 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 bonds
- Contact Bond Counsel to discuss the specific facts and circumstances

- The IRS has increased its scrutiny of actions taken (or not taken) by an issuer after bonds have been issued
- IRS is 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
- The City’s Bond Counsel can help develop written procedures for tax compliance

What is a “Parameters Ordinance”?

- A bond ordinance that is adopted by the City Council that delegates the authority to sell the bonds to a “pricing officer”
- Allows the ordinance to be adopted and the actual sale of the bonds to take place on any date thereafter, when the market is favorable, eliminating the need to price the bonds on the date of a council meeting
- The delegation of pricing authority is pursuant to certain “parameters” (i.e., maximum interest rate, maximum maturity date, savings threshold, etc.)
- Often used for refunding bonds when market timing is key to the savings achieved by the refunding
- Authorized by Chapter 1207, Gov’t Code for refunding bonds and Chapter 1371, Gov’t Code for new money bonds (Chapter 1431 also has delegation authority for large cities when issuing Tax Notes)
- Chapter 1371 has limitations on who can be an issuer (i.e., many small cities are not authorized under 1371 to adopt a parameters ordinance for new money bonds)

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