



February 11, 1999

To All Bond Counsel:

Re: Update of Public Finance Division Positions and Procedures

1. Description of Purpose. It is our longstanding position that the authorizing document for bonds, notes and other obligations must contain a reasonably complete description of the intended use of the proceeds. For obligations issued pursuant to an election, the purpose clause may generally track the language of the voted proposition. (See All Bond Counsel Letter of December 13, 1988, paragraph 4 on page 6.) For certificates of obligation, the language should track the published notice. (See All Bond Counsel Letter of January 26, 1994, paragraph 2.) (Note, however, that if all of the facilities noticed are not being constructed, the purpose clause must be more narrowly tailored to reflect the actual intended use of the certificate of obligation proceeds. Additionally, if not all of the noticed facilities will be constructed or purchased the amount of certificates issued may need to be reduced as well, depending on the factual circumstances.)

In particular, the purpose clause for notes issued pursuant to article 717w, Tex. Rev. Civ. Stat. Ann., must also reflect the actual use of the proceeds even though there is no bond proposition or published notice for such notes. The legal basis for this is twofold. First, we must be able to determine from the authorizing document whether the use of the proceeds comports with state law; secondly, we must be able to determine whether the proceeds can reasonably be expected to be expended for the stated purposes rather than held for a "rainy day fund" or for "working capital." (The purposes for notes issued pursuant to subdivisions (4) and (5) of section 3 may constitute the provision of "working capital," in some instances, but such purposes are specifically authorized). The degree of specificity required depends on a number of factors, including the population of the issuer, the size of the issue and the type of equipment, facilities or construction. For equipment, the general use or type of equipment is sufficient. For example, we consider a purpose of purchasing fire fighting equipment and road maintenance equipment to be an adequate description under most circumstances.

For purpose clauses in general, please note that clauses containing the phrase "including, but not limited to" or "including" are not acceptable when not confined within an acceptable broader category. For example, a purpose of "purchase of equipment, including fire trucks" is insufficient and unacceptable. "Purchase of fire fighting equipment, including fire trucks" is acceptable, though the "including fire trucks" would not be required. Also unacceptable is the use of the phrase "and any other purpose authorized by law" or the like.

2. Issuer Contribution to Refundings. Please ensure that refunding transcripts include debt service schedules showing the amount of debt service savings or loss. These schedules must reflect in the calculations any issuer contribution and show the methodology used. (See All Bond Counsel Letter of July 16, 1997, paragraph 2.) These schedules and calculations must be submitted with the transcript or soon thereafter, preferably as an exhibit to the general certificate. Since verification reports often do not arrive until shortly before closing, we are frequently not able to rely on them in a timely manner. For refundings with a present value debt service loss, we still require that the dollar amount of the present value loss and of any gross¹ or absolute loss be set out in the bond resolution, order or ordinance. (See All Bond Counsel Letter of July 25, 1990, paragraph 2.)

3. Use of Monies Released from Reserve Fund upon Substitution of Surety Bond. When issuing refunding bonds, bond proceeds in a reserve fund "freed up" by the refunding may generally only be placed in the escrow for the refunded bonds, in the debt service fund for the refunding bonds or in the reserve fund for the refunding bonds. (See All Bond Counsel Letter of July 11, 1995, paragraph 7.) The use of funds released because a surety bond is substituted for all or part of a reserve fund requirement is also limited, although a different analysis applies. Our position is that bond proceeds in a reserve fund that are released or become "surplus" on the substitution of a surety bond can only be used for the following limited purposes: (1) for completion of the project for which bonds were authorized; (2) for "system" improvements, where the bonds are system revenue bonds issued for general system improvements and the underlying documents so allow; and (3) for other costs for which the issuer could issue the bonds, but only if such costs are within the scope of any published notice or voted proposition and are allowed by the authorizing documents. Bond proceeds from the reserve fund cannot be used as general revenues of the system. It should be emphasized that document provisions, the published notice or the election proposition may limit the use of reserve fund monies for anything other than paying debt service, or, in the case of refundings, the transfer to a new reserve fund.

The above restrictions regarding the use of reserve fund bond proceeds apply not only to authorizing documents submitted as part of a refunding transcript, but also to surety bonds submitted for approval as credit agreements pursuant to article 717q, Tex. Rev. Civ. Stat. Ann. The credit agreement authorization must provide for the use of funds released

¹We are accustomed to referring to the amount of saving or loss without regard to the time value of money as the gross savings or gross loss. We note, however, that the term "gross present value savings" has been used in some transcript documents, referring, apparently to the present value savings without deducting the issuer contribution. This is not problematic as long as the amounts reflected in the documents take into account issuer contribution.

from the reserve fund and such provisions must be in accord with the preceding paragraph. With respect to reserve fund provisions in new money bond transcripts, the additional purposes described in the preceding paragraph may be incorporated in these documents, but any other proposed uses must be precleared with this office. The use of "surplus" reserve fund monies for "other purposes authorized by law" or the like will not be approved.

Any provisions allowing for future substitution of a surety bond must likewise include these requirements. Note that, for issuers not qualifying as issuers under article 717q, the provisions must include appropriate limits on the type of surety bond policy which can be substituted. (See All Bond Counsel Letter of July 11, 1996.)

Finally, we do not consider interest earnings on bond proceeds in a reserve fund to be surplus that can be removed to a revenue fund or used for operations. Rather, we consider such earnings to be bond proceeds that may be used only for the same purposes for which the bond proceeds may be used.

4. Capitalized Interest and Reserve Funds under Articles 717k-6 and 717q, Tex. Rev. Civ. Stat. Ann. Section 7(a) of article 717k-6 allows the funding of reserve funds and, in certain circumstances, capitalized interest, with bond proceeds. In order to use capitalized interest for the period described, section 7(a) requires the bonds to be payable in whole or part from revenues of the project being financed. We have for some time interpreted this provision to mean that, for combination tax and revenue obligations, the amount of capitalized interest that can be funded from bond proceeds is to be proportional to the amount of revenues from the project that will be pledged to and used to pay the obligations. For example, if the facility to be financed with certificates of obligation is expected to generate half of the debt service from revenues associated with the facility's operation, with ad valorem taxes paying the remainder, then a reserve fund for the purposes set out in section 7(a) should be approximately one-half the size of such fund for a totally revenue-financed facility. If a facility is expected to be financed primarily from revenues with the tax pledge for the purpose of enhancing the marketability of the bonds, then a capitalized interest fund for all interest due during construction and for one year thereafter would come within article 717k-6. Similarly, reserve fund size generally must relate to the proportion of revenue funding. However, we do agree that there is issuer discretion involved in sizing of these funds, and will consider circumstances where public purpose considerations would dictate more bond proceeds being deposited in these funds.

Article 717q defines project costs to include capitalized interest, but does not contain the article 717k-6 requirement for a revenue pledge, probably because it authorized only revenue obligations until relatively recently. However, city and county issuers of article 717q tax obligations are limited constitutionally to capitalizing interest only for the period prior to the earliest time taxes can be levied and collected for the obligation. (See article

XI, sections 5 and 7, Tex. Const.) This time period would ordinarily correspond to the time for which an appropriation certificate is required (See All Bond Counsel Letter of December 13, 1988, paragraph 3 on page 5). Additionally, note that article 717q does not authorize a reserve fund as part of project costs; issuers of article 717q obligations must rely on article 717k-6 for authority for a reserve fund.

5. Tax Obligations under Article 717q, Tex. Rev. Civ. Stat. Ann. The only tax obligations authorized by article 717q are those which are issued pursuant to voted authorization.

6. Use of Premium to Pay Costs of Issuance. For negotiated sales, it is our position that reoffering premium (premium received on the initial offering to the public, even if not actually "received" by the issuer) cannot be used to pay underwriter's discount or other issuance costs. Exceptions are where the reoffering premium amount is counted against the voted authorization for voted bonds, or, for certificates of obligation and other obligations with notice publication requirements, the par amount of the bonds plus reoffering premium does not exceed the noticed amount. This position also does not apply to obligations for which there is no notice or election requirement. As set out in paragraph 2 of the All Bond Counsel Letter of August 30, 1996, the premium, including reoffering premium, may be netted against original issue discount. The documents authorizing the obligation or the bond purchase agreement must be sufficiently detailed to correctly reflect any reoffering premium.

7. Forward Refunding Approval. For forward refundings, this office strongly prefers not to provide an approving opinion for the bonds until shortly prior to the delivery date. We will provide a preliminary approval letter, and will subsequently, if requested, confirm that all outstanding requirements have been satisfied, to the extent that this has occurred. A certificate as to no-litigation and no material changes to the transcript documents will be required before the opinion is given. Please advise the participants in your financings that we will provide an opinion at closing only in exceptional circumstances. If we do determine to deliver the opinion at closing, it will reflect that it is based on the law as of its date and that material changes in law prior to the delivery of the bonds may affect the application of the opinion to the bonds. In such case we will also require, in order to ensure accomplishment of the public purpose of a debt service saving, that the bond purchaser agree to liquidated damages of at least the present value of the debt service saving, should the purchaser fail to take the bonds as agreed.

8. Forward Delivery of New Money Bonds. There appears to be no clear public purpose which would justify our delivering our approving opinion at the closing of forward delivery new money bonds. For forward refundings an amount of savings has been locked in, but for new money bonds there may not be any savings, depending on the movement of interest

rates. Additionally, for new money bonds there are a number of changes - to the need for or desirability of the project, or to the tax base of the issuer, for examples - which could occur prior to the delivery of the bonds and affect the public purpose of the bonds or this office's willingness to approve the bonds. Therefore, we will not deliver an opinion until shortly before the delivery date for new money bonds, but will provide the preliminary approval letter as described in paragraph seven above, though we will require a more extensive "settlement certificate" generally setting forth information of the nature required to be in general and no-litigation certificates and confirming that there have been no material changes made to the transcript which was previously reviewed by this office.

9. Refunding of Notes Issued pursuant to Article 717w, Tex. Rev. Civ. Stat. Ann. While not specifically addressed in article 717w, we think it doubtful that the legislature intended to authorize long-term extensions of these limited-term notes through refunding. Thus, please discuss it with us before submitting a transcript for refunding article 717w notes issued under section 3, subdivisions (1), (2) and (3) for a term of longer than seven years. Notes issued under section 3, subdivisions (4) and (5) are not refundable for more than the current fiscal year.

10. School District Time Warrants - Reminder. School district time warrants (and certificates of indebtedness) must be structured so that principal payments occur at or near (within three months of) the end of the school fiscal year, unless the proceeds are used to pay expenses eligible for payment from maintenance taxes. It is only at that time, after payment of current fiscal year maintenance expenditures, that maintenance tax funds become "surplus" that can be used to pay obligations issued for non-maintenance items. We are willing to permit semiannual interest payments, so that one interest payment occurs during the middle of the fiscal year, based on the assumption that the interest payments will not be sizable, given the statutory constraint upon the principal amount of time warrants that can be outstanding.

11. Dual Propositions - Fire, Police, Emergency Medical Services and other "Public Safety" functions. We have been concerned in the past that the construction and equipping of fire department facilities, police department facilities, emergency medical service facilities and similar public safety facilities were not sufficiently related so as to be combined into one public safety proposition. However, if these facilities are grouped into one proposition, which is passed by the voters, and no election contest is filed within the contest period, we will not refuse to approve the voted bonds, assuming compliance with other legal requirements for the bonds.

12. School District Bonds - Maintenance Tax Information. For all school district bonds submitted subsequent to this letter, please provide in the general certificate the statutory provision pursuant to which the district's maintenance tax was voted. Districts which voted their maintenance tax pursuant to articles 2784e, 2784e-1 and 2784g have limitations which

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must be complied with even if unlimited tax bonds have been subsequently voted. Evidence of the voted proposition need not be submitted with bond transcripts. However, it remains a requirement that sufficient evidence of the maintenance tax proposition be submitted with contractual obligation and other maintenance tax obligation transcripts.

13. Division Personnel Changes. Many of you have already had transcripts reviewed by Leslie Lawler, who joined us in April, replacing Jerry Kyle, who left in January of 1998, and by Carey Troell (pronounced "trell") who came on in October, replacing Greg Shields, who departed in June. Susan Netardus, our office manager for more than three years, departed in November. Lisa Love, with whom many of you have previously dealt, was named as the new office manager. Finally, Lisa Adelman has recently departed, leaving us with a position to fill.

Very truly yours,



Jim Thomassen
Assistant Attorney General
Chief, Public Finance Division