To All Bond Counsel:

Re: School District Financings under SB 826; Other Matters

1. School District Financings - SB 826. Following are some additional requirements and areas of concern for SB 826 financings submitted to this office. These requirements are in addition to the usual substantive and procedural items and the items outlined in the "To All Bond Counsel" letters of July 11, 1995 and September 5, 1995. Again, this should not be viewed as an exhaustive list of all issues or requirements pertaining to such transactions.

   a. Under proper circumstances school districts may make a cash contribution to the project. The contribution may be used for construction or acquisition of real property, to equip the facility being financed, or to establish a reserve fund under the bond indenture. In order to support such contributions, the district must make a general finding in the order authorizing the school district to enter into the lease-purchase agreement and to make the contribution to the effect that (i) the project sought to be financed is necessary in order to carry out the purposes of the school district and (ii) the contribution is an initial or contract payment that the school district must make in order to acquire or obtain use of the project. The general finding should be supported by specific statements as to why the project is necessary.

   In addition to the general finding, the authorizing documents should provide that upon re-leasing or sale of the project by the lessor due to default or non-appropriation under the lease-purchase agreement, funds (to the extent of the contribution) in excess of amounts necessary to pay the bonds will go to the school district.

   The same findings and provisions would be required for a payment by the school district characterized as an "initial rent payment" when it is disproportionately large in comparison to the remainder of the lease term.
b. The notice required by section 271.004(a), Tex. Local Gov’t Code, must identify the total cost of the project that is the subject of the contract. The cost of the project would include the cost of any land acquired (and any improvements on the land, but see subparagraph c below with respect to improvements) from the district, as well as the cost of any portion of the project financed with a district contribution, which amount of contribution must be specified. The notice must specifically indicate (i) if land (and any improvements thereon) of the district is being sold to the lessor and whether the land and improvements will be subject to a mortgage and to foreclosure if the lease-purchase payments are not made, and (ii) the use to which the sale proceeds will be applied. Even if there is no contribution or land sale involved, the notice must indicate whether the facility will be mortgaged and subject to foreclosure if lease payments are not made. We will allow supplemental notices for those financings for which notices have already been published as of the receipt of this letter.

c. Land owned by the school district which is sold to the lessor so that the land and the financed improvements may be leased back must generally not contain substantial improvements. We do not interpret the provisions of section 271.004, Tex. Local Gov’t Code, article 717s, Tex. Rev. Civ. Stat. Ann., and provisions of the Texas Education Code providing for the sale of school property to constitute together an authorization for sale lease-back financing. The purpose of allowing land to be sold was to address the common occurrence of school districts already owning land for school purposes. We do not think that selling a school building in use by a district, using sale proceeds to renovate the building, and then leasing back the building is contemplated by the statutory authorization.

d. If the lessor under the contract is a non-profit corporation created under Tex. Rev. Civ. Stat. Ann. art. 717s ("Public Facility Corporation") and is responsible for acquiring and constructing the project (which would seem to be required of a lessor under a lease purchase agreement, particularly if lease revenue bonds are a part of the financing) we will continue to require a representation that it will comply with all procurement statutes applicable to a school district. If the acquisition and construction of the project is going to be competitively bid, the representation should so state. If a design/build contract is to be used, we will require satisfactory evidence that a competitive methodology was used in the selection of the vendor to provide the facility and/or the financing. While we have found certain methods acceptable, we have not prescribed a required form of competitive methodology. The following have been found acceptable:
(i) The school district publishes a "Request for Qualifications" in a newspaper of general circulation in the district as the method for seeking companies to act as the developer and "at risk" construction manager; and

(ii) Solicitation of interest in writing, or by phone followed up in writing so that it may be determined that each potential contractor received the same information, with an affidavit as to the parties solicited and the results obtained.

Please note, however, an agreement in a design/build contract between a Public Facility Corporation and the design/builder that the design/builder will bid out all subcontracts is not sufficient in that such method does not, by itself, provide for a competitive selection of the design/builder or of the as-built price of the facility.

e. We are not prepared to approve a lease purchase agreement with a non-substitution clause or an annual termination fee.

f. Please note that a continuing order of a federal district court requires that the Texas Commissioner of Education approve all sales of real property by Texas public school districts. (United States of America v. State of Texas, et al., in the U.S. District Court for the Eastern District of Texas (Tyler) in Civil Action #5281.) We will require evidence of complying with this requirement when the sale of real property is a component of the financing. Please contact Mr. David Anderson, Chief Counsel, Office of Legal Services, Texas Education Agency if you need additional information regarding this matter.

2. Original Issue Discount. As a reminder, please note that we do not consider original issue discount to be an issuance cost. Nor does original issue discount reduce the principal amount of the bonds, notwithstanding that the full principal amount may not actually be paid to the issuer. While in combination new money/refunding transactions the entire amount of issuance costs may be allocated to the refunding portion (see All Bond Counsel Letter of December 14, 1989, paragraph 7), if there is original issue discount the amount deposited to the construction fund must be reduced by the net original discount (i.e., the net of premium and original issue discount) related to the new money portion of the bonds. As you know, for voted bonds, any excess of premium over original issue discount for the new money portion of the bonds would have to be placed in the interest and sinking fund or counted against the voted authorization. This principle would also apply to certificates of obligation and municipal utility system revenue bonds to the extent that an excess of premium over original issue discount caused the principal amount of the indebtedness to exceed the principal amount disclosed in the notice of intent.
3. **Pledge of Delinquent Taxes as Security for Loan.** Please note that section 45.104, Tex. Educ. Code, does not authorize the issuance of notes or other securities. Loans pursuant to that provision are not subject to Attorney General approval.

4. **School District Contractual Obligations.** Please include with contractual obligation transcripts a copy of the election proposition pursuant to which the district’s maintenance tax was voted. The district must demonstrate, as was set out in the July 13, 1993 All Bond Counsel Letter (paragraph 4), that the amount required to pay (i) the maximum debt service on the obligations being issued and all other obligations payable from the maintenance tax plus (ii) the amount of the maintenance tax currently being collected for all other maintenance purposes does not exceed the amount of maintenance tax calculated at the maximum rate authorized for and adopted by the district at its maintenance tax election (the "Contractual Obligation Test"). Please note that for districts which voted their maintenance tax pursuant to Tex. Rev. Civ. Stat. arts. 2784e and 2784g, the available maintenance tax authorization depends on the amount of the bond tax being levied. For maintenance taxes levied pursuant to Tex. Rev. Civ. Stat. Ann. art. 2784e-1, the district must show compliance with the maintenance tax authorization as reduced for bonded indebtedness in excess of 7% of assessed value of taxable property in the district.

Additionally, please note that guaranteed yield amounts are not generally considered to be available for demonstrating compliance with the Contractual Obligation Test. Known increases in Tier Two funds to be received by the district may be so considered.

5. **New Attorneys.** Julia Houston and Greg Shields will be joining us on September 3, 1996.

Very truly yours,

[Signature]

Jim Thomassen
Assistant Attorney General
Chief, Public Finance Division