



June 28, 2001

Via facsimile

To All Bond Counsel:

Re: Premiums, Multifamily Housing, Certificates of Obligation Notices, School District Matters

1. Premiums and Capitalized Interest - Tax Obligations and Other Voted Obligations.

As you know, it is our position that small premiums received on bond sales must be placed in the interest and sinking fund or counted against voted authorization or, for certificates of obligation, the noticed amount. (See All Bond Counsel Letters of December 14, 1989, para. 6 and August 30, 1996, para. 2.) However, larger premiums must be treated differently. For tax bonds issued by cities and counties, capitalized interest, even when statutorily authorized, must be limited to the amount needed to pay interest before a tax can be levied and collected. (See All Bond Counsel Letter of February 11, 1999, para. 4.) School districts are not statutorily authorized to capitalize interest.¹ Thus, premium amounts not counted against voted authority which exceed the limited amount that may be used, in certain circumstances, to pay interest, must be used to pay principal. Issuing bonds for the purpose of paying principal is also problematical, however. Thus, the better solution is to not generate excessive premiums in bond sales. Clearly, this can be accomplished in negotiated sales. Evidently it can be accomplished in competitively bid sales as well, by tailoring the bidding instructions. Alternatively, if the issuer believes selling the bonds at a substantial premium is economically desirable, the par amount of the bonds sold may be reduced so that the premium may be placed in the construction fund without exceeding the voted authorization. To implement our position we have formulated the following guidelines: (a) In all circumstances the premium may be counted against available voted authorization or, for certificates of obligation, the noticed amount. (b) When premium is not counted against the voted authorization or noticed amount, then: (1) A small amount of premium (\$5,000 or less) must be placed in the interest and sinking fund and may be applied to pay interest on the bonds. (2) A premium between \$5,000 and ½% of the par amount must be placed in the interest and sinking fund and applied to pay principal. (3) Issues with premiums exceeding ½% of par must be restructured. Note that premium may be offset against original issue discount, but not against underwriter's discount. (See All Bond Counsel Letter of August 30, 1996, para. 2.)

¹It may be arguable that school districts that are issuers under chapter 1371 of the Government Code may capitalize interest, but we have not considered adopting that position. Water districts and other entities, to the extent they are statutorily authorized to capitalize interest, are not required to use the premium to pay principal.

2. Payment of Issuance Costs with Premium on Conversion to Fixed Rate. We believe that the remarketing of voted variable rate bonds, on conversion to a fixed rate, at an interest rate that generates a premium, would require voted authorization in the same way that selling the bonds initially at a premium would. See paragraph 1 above. Thus, in the future, the bond resolution or other appropriate bond document must contain provisions that fees and underwriter's discount be paid from other funds of the issuer, or the premium be subtracted from voted authorization.

3. Multifamily Housing - Restrictions on Disbursement of Proceeds and Public Purpose. Frequently, the purchaser of multifamily bonds or the provider of credit enhancement for the bonds will place certain conditions on the disbursement of bond proceeds. For there to be a public purpose for the issuance of multifamily bonds, particularly when the issuer has received a cap allocation, there may not be substantial unfulfilled conditions to the disbursement of bond proceeds at the time of closing. Issuing bonds prior to fulfilling such conditions for disbursement constitutes a premature issuance for which there is no public purpose. Please discuss with us any conditions in your multifamily financing that could be substantial. These concerns are not, of course, limited to multifamily, but they do seem to arise more often with these bond issues than with any other type of issue.

4. HUD Endorsement Requirement for FHA/HUD Guaranteed Multifamily Housing Bonds. Recently there have been substantial last minute difficulties in obtaining satisfactory confirmation that all conditions of HUD commitments have been satisfied or waived. (Without this confirmation, there is no certainty that the mortgage loan will be made and the public purpose of the bond issue be accomplished. See paragraph 3 above.) To eliminate these problems, beginning with the 2002 private activity bond allocation we will require that the HUD endorsement of the mortgage note be obtained prior to the bond closing. For those financings receiving the remaining 2001 allocation, we encourage the issuers to obtain the HUD endorsement before closing. We will require, at a minimum, that: (a) HUD schedule its closing within 7 days following the bond closing and (b) the lender in the transaction certify (1) the date of the scheduled HUD closing, (2) that it is satisfied that the conditions of the HUD commitment have been met or will be met to the lender's satisfaction prior to the HUD closing and (3) to the extent any conditions are requirements for provisions in the financing documents, that the documents reflect these requirements.

5. Notice Requirements for Limited Revenue Pledge Certificates of Obligation. If the notice for certificates of obligation provides that the certificates will be secured by "revenues," "revenues of the system" or similar language then the revenue pledge may not be limited to a specific amount, such as \$1,000 or \$10,000. With such notice the revenue pledge may be a subordinate lien, because the notice does not indicate or limit the priority of the revenue pledge. We do allow a limited pledge when the notice states that "certain revenues" of the named system would be pledged to the certificates. However, we are

concerned that such language may not be appropriately descriptive when the actual pledge is limited. We encourage you to determine whether a limited pledge is planned and to draft the notice accordingly, instead of relying on the "certain revenues" language. A notice stating that the certificates were secured by a "limited pledge" of net revenues, without specifying the amount, would also suffice.

6. Election Propositions for School Elections to Refinance or Acquire Property Acquired under Subchapter A of Chapter 271 of the Local Government Code and to Acquire New School Buses. All purposes authorized by section 45.001(a)(1) of the Education Code, including the amendment adding new school buses (effective September 1, 2001), may, at the discretion of the school board, be in one election proposition or in separate propositions.

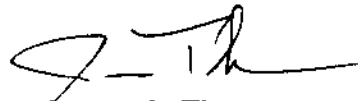
7. Refunding of School District Contractual Obligations. Chapter 1207 of the Government Code provides a methodology for advance refunding school district contractual obligations. However, section 1207.003(b) requires an election before issuance of refunding bonds if "the constitution of this state requires an election to permit a procedure, action, or matter pertaining to refunding bonds[.]" An election is required for tax bonds refunding school district contractual obligations because the bond taxes securing the refunding bonds have not been approved by the voters as required by article VII, section 3 of the Texas Constitution. (We have approved tax bonds refunding school district contractual obligations pursuant to chapter 1207 without an election when the refunding bonds were payable from the maintenance tax, but that tax had been, of course, previously voted.) Tax bonds (payable from the bond tax) refunding school district contractual obligations must be approved by the voters in a separate proposition. The exact wording of such a proposition is within the discretion of the governing board of the school district, but must clearly present the question of whether bonds to refund contractual obligations should be issued. Please note that this paragraph is limited to the refunding of contractual obligation securities and does not apply to subject-to-appropriation finance agreements or similar obligations to which chapter 1207 does not apply.

8. School District Refunding Bonds. Section 45.0011 of the Education Code authorizes the use of credit agreements only for bonds issued pursuant to sections 45.001 and 45.003(b)(1), not for refunding bonds issued under chapter 1207 of the Government Code. Additionally, section 2 of Acts 1999, 76th Leg., ch. 984 (the italicized language following section 1371.051 of the Government Code, which language was put in a new section 1371.0521 by section 11 of SB 1759 enacted this past legislative session and effective September 1, 2001), limits the use of chapter 1371 to bonds "authorized in accordance with Section 45.003." However, given the difference in language used in section 45.0011 and section 1371.0521 - "in the issuance of bonds as provided by" vs. "authorized in accordance with" - the chapter 1371 provision appears to cover refunding bonds because the bonds being refunded, and thus the refunding bonds, were authorized by the election required by section 45.003.

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9. Division Personnel. This past year Carey Troell and Saira Shah departed for private practice. They have been ably replaced by Cecilia Gonzalez and Bill Walker, with whom many of you are already familiar. We welcome back Susan Colvin, recently returned after three months of recovery from a serious injury sustained from a close encounter with an SUV.

Yours truly,



James A. Thomassen
Assistant Attorney General
Chief, Public Finance Division