89TH ANNUAL WEST TEXAS COUNTY JUDGES AND COMMISSIONERS ASSOCIATION CONFERENCE

Friday, April 27, 2018
8:30 – 9:20 a.m.

"4.001 Bonds and Certificates of Obligation"

Mr. David Mendez
Attorney
Bickerstaff Heath Delgado Acosta LLP

Bonds and Certificates of Obligation: Funding Options for Roads

4.001 Bonds and Certificates of Obligation

West Texas CJCA Conference

Friday, April 27

8:30 – 9:20 a.m.

Presented By:

David Méndez, Partner
Bickerstaff Heath Delgado Acosta LLP
3711 South Mopac Expressway
Building One, Suite 300
Austin, Texas 78746
P: 512-472-8021 F: 512-320-5638

OBJECTIVES

- Provide a brief overview of the finance vehicles available to Texas counties with a focus on funding road projects
- Identify key issues on which the commissioners court should focus when issuing bonds
- Review special aspects of funding road projects

FIRST: A LITTLE BACKGROUND

- Things to line out before you start:
  - Clarify the court's needs and objectives
    - Why is this project needed?
    - Can we afford it (how will we pay for it)?
    - Will the community support it?
  - Discuss your needs and objectives with your financial team
    - Financial Advisor
    - Bond Counsel

Team Members

- **County's Financial Advisor**
  - The professional who will guide the county through the economic side of the issuance process
  - The professional who will evaluate the economics of different financing structures and recommend the type of issue to be used – G.O. Bonds, CO's, Anticipation Notes, etc.
  - The professional who will conduct the competitive sale or negotiated sale or arrange for a private placement

Team Members

- **County's Bond Counsel**
  - The county's lawyer in the transaction who will advise you on and prepare the financing documents
  - Provides the "Bond Opinion" which opines that the obligations were properly issued and if issued on a tax exempt basis, that the obligations are not subject to federal income taxation
  - Must know local government law, federal tax law and securities law
  - An Attorney-Client relationship must exist between the county and the county's bond counsel
  - The county has the right to select its own bond counsel

BEGINNING THE PROCESS

Topics to discuss with your team:

- What is the size, scope, and timing of your project?
- How does this project and the financing fit in with the County's existing debt service?
- How does this project fit in with the County's Capital Improvement Plan?

County Should Have a Good Capital Improvement Plan

- Address capital expenditures for next 5 years – update annually
- Provide a road map for expenditures – anticipate expenditures in advance
- Proactive rather than reactive

Examples Where Capital Improvement Plan Can Help Planning

- Address infrastructure requirements
  - How long will a road last before maintenance is required?
  - How much will deferred maintenance cost?
  - Can preventive maintenance save money?
- Need for new equipment
  - Provide a uniform plan to replace existing equipment during its useful life

ADDITIONAL TOPICS TO DISCUSS WITH TEAM

- **When will we need the bond funds?** (Issuing bonds takes time and you have to factor this into the court's timing and expectations.)
- **When do we need to be in the market?** (You want to borrow when you need the money – not before.)
- **What does the market look like now and how is it likely to change by the time we need to access it?** (The market changes daily and this can affect the costs of borrowing – your financial advisor will need to keep you posted on how this is changing and affecting your project.)

Bonds for Transportation Projects

FINANCING METHODS

- **General Obligation Bonds**
- **Certificates of Obligation**
- **Lease-Purchase Contracts**
- Contractual Obligations
- Anticipation Notes
- Time Warrants
- Public Improvement District Bonds
- Revenue Bonds

What About a Financing Lease or Installment Purchase Contract?

- Viable option for some road building equipment needs, but may or may not constitute an obligation that can be classified as a debt for ad valorem tax purposes.
- If characterized as an M&O obligation, no relief from roll back.

GENERAL OBLIGATION BONDS
("Unlimited Tax G.O. Bonds")Chap 1471

Election:	Yes
Pledge:	Ad Valorem Tax
Typical Use:	Major capital projects where the commissioners court believes that it is important to have the voters approve the project
Max Term:	40 Years (Typically 15-20)
Requirements:	Posting/Publication, etc.

Specific Road Bond Authority

- Tex. Govt. Code Chapter 1471
- Tex. Govt. Code Chapter 1479
- Tex. Govt. Code Chapter 1301
- Tex. Transp. Code Chapter 256

Unlimited Tax Road Bonds (Other Bonds under Chapter 1471)

- Road District Bonds
- Precinct Bonds
- Bond Anticipation Bonds

PASS-THROUGH TOLL BONDS Chapter 1479 Bonds

- Not currently funded.
- Initially created in 2005, -- counties have been authorized to issue "pass-through toll revenue and tax bonds" to fund highway projects that are part of the state highway system, which includes farm-to-market roads. In 2003, the legislature enacted Section 224.104 of the Texas Transportation Code which authorized the Texas Department of Transportation (the "Department") to use a new method of paying for highway projects, known as the "pass-through toll".

CERTIFICATES OF OBLIGATION ("C.O.s")

Election:	5% of Voters May Petition
Pledge:	Ad Valorem Tax, Revenue, or Combination
Typical Use:	Capital projects where an election not viewed as necessary
Max Term:	40 Years (Typically 15-20)
Requirements:	Posting/Publication, etc.

ANTICIPATION NOTES ("Tax Notes")

Election:	No
Pledge:	Ad Valorem Tax, Revenue, or Combination
Typical Use:	Construction of a public work; purchase of materials, supplies, equipment, machinery, buildings, lands, and rights-of-way; professional services such as engineers, architects, attorneys and financial advisors; operating expenses; or to fund issuer's cumulative cash flow deficit
Max Term:	7 Years (1 Year for Cash Flow Deficit)
Requirements:	Auditor's recommendation (or Chief Budget Officer)

Two Approaches to Using Tax Notes

- Determine projected needs and Tax Note to fund needs
  - Sell Note and fund projects
- Pass a Reimbursement Resolution
  - Include all items the County may need in the coming year
  - Use reserves to make purchase, then sell Tax Note at the end of the year to reimburse the General Fund and/or Road and Bridge Fund before the end of the fiscal year

Process for Using Tax Notes

Issue Notes

Cut off Date

Before End of Fiscal Year Reimburse Yourself

Reimbursement Resolution

Adopt Budget for Potential Items

Special Budget Adopted for Debt Issue

- Section 111.015, Texas Local Government Code requires that the county adopt a budget for expenditures from debt issues
- This is in addition to the adoption of a regular county budget

Examples of What Items to Include in a Reimbursement Resolution

- Construction & improvements of roads and bridges in the county
- Acquisition of road right-of-way
- Acquisition of real property
- Construction of improvements to county buildings
- Construction of a county building

Examples of What Items to Include in a Reimbursement Resolution

- Acquisition of road maintenance equipment
- Acquisition of public safety equipment
- Acquisition of vehicles
- Acquisition of office furnishings and equipment
- Acquisition of computer equipment and software

Items to be Covered in Reimbursement Resolution

- Need to designate source of funds to be used
  - Most often use the General Fund as the source
  - May use Road & Bridge Fund or a combination of General Fund and Road & Bridge Fund

- Unless you know exactly what will be needed, keep the list general.
- For instance, “**vehicles**” can include sheriff patrol cars, pickup trucks, and general purpose vehicles.

Issue the Notes No Reimbursement

- Sell Notes before end of the Fiscal Year

Issue the Notes With Reimbursement Resolution

- Sell and close before end of Fiscal Year
- Must reimburse so funds are replenished for audit process
- Otherwise a deficit in fund balance will result

CONTRACTUAL OBLIGATIONS

Election:	No
Pledge:	Ad Valorem Tax, Revenue, or Both
Typical Use:	For Personal Property Only
Max Term:	25 Years
Requirements:	None

PUBLIC IMPROVEMENT DISTRICT BONDS ("PID BONDS")

Election:	No (Landowner Petitions In)
Pledge:	Special Assessment
Typical Use:	Roads, utilities and related subdivision infrastructure in a specific subdivision
Max Term:	40 Years (But Typically Shorter)
Requirements:	District Creation, Posting/Publication, etc.

UNLIMITED TAX ROAD DISTRICT BONDS ("Road District Bonds")

Election:	Yes (Within Defined District)
Pledge:	Ad Valorem Tax
Typical Use:	Roads, bridges and similar improvements in a specific defined district
Max Term:	40 Years (But Typically Shorter)
Requirements:	District Creation, Posting/Publication, etc.

REVENUE BONDS

Election:	No
Pledge:	County Revenues from Public Utility (solid waste, library, etc.)
Typical Use:	Rarely available to counties; used more by cities and utility districts
Max Term:	40 Years (Typically 15-20)
Requirements:	Coverage

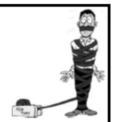
TIME WARRANTS

Election:	Subject to Voter Petition
Pledge:	Ad Valorem Tax
Typical Use:	Older Method of Finance Authorized under Chapter 262 of the Texas Local Government Code
Max Term:	40 years
Requirements:	Time Warrants are Subject to Publication Requirements & Non-Negotiable

TIME WARRANTS

- Disadvantages:
  - Time Warrants are non-negotiable instruments
  - Time Warrants may not be sold for cash
  - Consequently, arrangements must be made with a vendor to accept the time warrant and a bank to buy the time warrant from the vendor

TIME WARRANTS



- Disadvantages:
  - Time warrants often are prepared locally. As a consequence, there may not be all the formalities taken to ensure that the time warrant is a tax-exempt obligation.
    - The rates charged may be higher than market for a tax-exempt security
    - The time warrant may be for beyond one fiscal year, and the formality of an interest and sinking fund may not be established. This will render the time warrant invalid.

LEASE PURCHASE AGREEMENT/ INSTALLMENT SALES CONTRACT

- Permits the county to purchase goods over period of time
- Is not a pledge of taxes
  - Unless for equipment and properly structured
- Is a maintenance and operations expense, not a debt service expense
- Attorney General approval is not required

LEASE PURCHASE AGREEMENT/ INSTALLMENT SALES CONTRACT

- Must be subject to annual appropriations
- No requirement to continue
- Practical limits on the ability to discontinue
- Interest rates are often higher than a tax obligation

REFUNDING BONDS

- Used to refinance the county's outstanding bonds and other obligations
- Allows county to take advantage of lower interest
- Used to restructure debt payments
- No newspaper publication requirement
- No election requirement

TEXAS LAW CHANGES

- Bond Election Dates
- Limitation on holding bond elections
- Additional notice requirements for bond elections

Bond Election Dates

- Uniform Election dates are now limited to:
  - First Saturday in May of odd-numbered years
  - First Tuesday after first Monday in November
- Counties cannot hold bond elections in May of even-numbered years because of primaries.

Limitation on Holding Bond Elections

Effective January 1, 2016

County may not authorize COs if a bond proposition to authorize the issuance of bonds for the same purpose was submitted to the voters during the preceding three years and failed to be approved.

Exceptions

- Public calamity
- To comply with court order/regulation

The County's Duties Do Not End When the Bonds are Issued

- You **MUST** comply with requirements you promised in the bond documents that you would not let the bonds become taxable
- What may cause the problem – **TURNOVER**
- The personnel that were there when the bonds were issued have departed before the bonds are paid off
- You need to familiarize yourself with the requirements so that you can brief your successors

GENERAL TAX COVENANTS

- No private activity use
- Will not permit the bonds to become private activity bonds
- No federal guaranty
- Will restrict the use of the proceeds to comply with the arbitrage requirements
- In the event of arbitrage will rebate the excess earning to the United States
- Will maintain the necessary records to permit compliance with the tax exempt requirements for at least six years after the final principal and interest payment on the bonds

WHAT CAN CAUSE A PRIVATE BUSINESS USE?

- **LEASES** of bond financed property to non-governmental entity generally will create a private business use of the property.
  - Example: Lease of a county jail to a private operator
- Management, operation and services contracts are entered into using the private sector model – the service provider's compensation is based on the net profits from the operation of the property
  - Example: Food service operated by a private entity on governmental property even when the operator is not paid by the governmental entity, but derives compensation from the net revenues of the food service operation

USE BY ANOTHER GOVERNMENTAL UNIT IS OK

- THE UNITED STATES IS NOT CONSIDERED A GOVERNMENTAL UNIT FOR FEDERAL INCOME TAX LAW PURPOSES
- Most likely problem – long term contract to hold federal prisoners

IRS AUDITS

- Enforcement officials have targeted what they view as an abusive use of the municipal bond exemptions
- The focus is on arbitrage driven transactions where the bond proceeds are invested in higher-yielding instruments
- The agency has generally sought to settle such tax disputes with agreements in which the feds recoup any profits from the unauthorized investment, but they have threatened to go after bondholders if they cannot resolve the case otherwise

Resources:

2017
PUBLIC FINANCE HANDBOOK
FOR TEXAS COUNTIES

TEXAS ASSOCIATION OF COUNTIES

PREPARED BY THOMAS M. POLLAN & DAVID MÉNDEZ
BICKERSTAFF HEATH DELGADO ACOSTA, LLP
3711 SOUTH MOPAC EXPRESSWAY
BUILDING ONE, SUITE 300
AUSTIN, TEXAS 78746

LEGAL RESEARCH

- http://www.bickerstaff.com/wp-content/uploads/2017-Public-Finance-Final.pdf
- http://www.bickerstaff.com/publications/

Resources:

- http://www.mazdigital.com/webreader/51105?page=14
- Article in *County Progress*

Financing Routine Capital Expenditures

Each year as counties prepare their budgets, along with the routine maintenance and operational costs, counties inevitably face the need to budget for some routine capital items. Law enforcement vehicles or road grading equipment may need replacement; radios, computers or office equipment may have worn out; gravel and road base material may be needed to repair county roads; or the courthouse roof may need patching. All of these are, technically, capital expenditures – that is, they can benefit the county over a period of time. While financing these items over a period that matches the useful life is possible, many times the county acquires these items by simply paying cash for the items as part of the annual budget or by leasing.

Two problems arise from such treatment. First, to the extent the entire cost of the item is paid for in one budget year, taxpayers incur a disproportionate cost in the current year for the item which ultimately benefits potentially different taxpayers in later years. Second, to the extent the county leases the item or acquires it through a lease purchase arrangement, there are built-in transaction costs in each lease or lease purchase agreement, and the cumulative cost of those individual purchases will be much more expensive than if the county financed all of the capital items it needs for the year with one transaction.

Some counties have used tax notes to consolidate the acquisition of all of these capital items during a year with one loan. This has allowed the county to reduce its M&O costs and realize the benefit of more efficient (cheaper) transaction costs for buying these items. Counties typically implement the program in the following manner: At the time the county sets the budget, it identifies all of the eligible capital items. Then it can issue one tax note at the beginning of the year to pay for these items as needed

review, and the risk
passing.
"We proceeded
able to raise the fu
project at a very attra
without any change
Burrows reported. "
any members of the
Generally spea
to public finance
whether the county
without a change
Burrows related.
"We also co
project is a priority
countywide benefit
a timing issue that
response such as
safety or jail overcro
In addition, there a

Bonds and Certificates of Obligation: Funding Options for Roads

4.001 Bonds and Certificates of Obligation

West Texas CJCA Conference

Friday, April 27

8:30 – 9:20 a.m.

Presented By:

David Méndez, Partner
Bickerstaff Heath Delgado Acosta LLP
3711 South Mopac Expressway
Building One, Suite 300
Austin, Texas 78746
P: 512-472-8021 F: 512-320-5638