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

West Texas CJCA Conference
Friday, April 27
8:30 - 9:20 a.m.

Presented By:
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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

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**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

- **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.)
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

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

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
- 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**

<table>
<thead>
<tr>
<th>Election:</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pledge:</td>
<td>Ad Valorem Tax, Revenue, or Both</td>
</tr>
<tr>
<td>Typical Use:</td>
<td>For Personal Property Only</td>
</tr>
<tr>
<td>Max Term:</td>
<td>25 Years</td>
</tr>
<tr>
<td>Requirements:</td>
<td>None</td>
</tr>
</tbody>
</table>

**PUBLIC IMPROVEMENT DISTRICT BONDS**

(“PID BONDS”)

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

**UNLIMITED TAX ROAD DISTRICT BONDS**

(“Road District Bonds”)

<table>
<thead>
<tr>
<th>Election:</th>
<th>Yes (Within Defined District)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pledge:</td>
<td>Ad Valorem Tax</td>
</tr>
<tr>
<td>Typical Use:</td>
<td>Roads, bridges and similar improvements in a specific defined district</td>
</tr>
<tr>
<td>Max Term:</td>
<td>40 Years (But Typically Shorter)</td>
</tr>
<tr>
<td>Requirements:</td>
<td>District Creation, Posting/Publication, etc.</td>
</tr>
</tbody>
</table>
## REVENUE BONDS

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

## TIME WARRANTS

<table>
<thead>
<tr>
<th>Election:</th>
<th>Subject to Voter Petition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pledge:</td>
<td>Ad Valorem Tax</td>
</tr>
<tr>
<td>Typical Use:</td>
<td>Older Method of Finance Authorized under Chapter 262 of the Texas Local Government Code</td>
</tr>
<tr>
<td>Max Term:</td>
<td>40 years</td>
</tr>
<tr>
<td>Requirements:</td>
<td>Time Warrants are Subject to Publication Requirements &amp; Non-Negotiable</td>
</tr>
</tbody>
</table>

### 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

- 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.
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