# *Bonds and Certificates of Obligation in 2024*

**4.001 Bonds and Certificates of Obligation**

V.G. Young Institute of County Government

School for County Commissioners Courts

Tuesday, February , 20

4:10 – 5:00 p.m.

Presented By:


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# OBJECTIVES

- Overview of the Key Issues Related to Bonds and Certificates of Obligation
- Describe the Major Structure and Function of Bonds and Certificates of Obligation
- Outline the Major Components of Using These Legal Sources of Money
- Legal Framework and Statutory Guidance for Bonds and Certificates of Obligation

# The Key Issues Related to Bonds and Certificates of Obligation

# Texas has jealously guarded the ability of counties to issue debt supported by an ad valorem tax pledge.

- Bonds are debt instruments of the county
- Issued pursuant to authority under Art. III Section 52 (GO) or Art. III Section 9 (Road Bonds) of the Constitution
- These provisions, and laws enacted pursuant to these provisions, reserve to voters to power to authorize debt.

# Voter Approval of Debt

- Texas Legislature has created mechanisms for this under the Texas Government Code and Local Government Code
- Generally requires election/voter approval or alternative
- Require Attorney General review and approval

# Bond Elections

- Since a major element of bonds is the election requirement, it is important to note that there are strict laws which limit when elections can be held as well as a County's ability to advocate for or against a bond measure once it is on the ballot.

- Later in the presentation, we will review in more detail the various types of debt obligations and election requirements that are authorized under the constitution and how they work.

# Debt Service

- Debt service (principal and interest on the bonds)is paid from a specific interest & sinking fund (I&S) levy

- Each year, the county, along with its M&O levy must establish an I&S tax rate that will fund the debt service reserve

- I&S tax rate is not factored into the rollback rate for M&O

- Most bonds supported by unlimited tax pledge

# Federal Legal Implications

- Federal tax law recognizes the sovereign nature of state and local governments and allows interest on state and local government bonds (municipal bonds) to be eligible for tax exempt treatment
- Federal securities regulations likewise recognize the special nature of municipal bonds and treat them under special rules

# IRS Regulations and Arbitrage

- The interest on a county's bonds may be eligible for tax exempt treatment if the bonds are issued for governmental purposes, the money is utilized for these projects with reasonable diligence, and the county does not merely invest the bond proceeds to try to engage in arbitrage.
- Tax exempt bonds means the county can pay lower interest rates to bond holders.
- Lower interest rates mean lower tax burdens on the County's taxpayers.

# SEC Disclosure Obligations

- The County must be transparent to investors in the use of bond proceeds and in the County's financial condition as it pertains to its pledge(s) to pay the debt service
- These continuing disclosure obligations persist for the life of the bonds
- County officials can face serious sanctions if the County violates these rules

# Compliance with Federal Requirements is a Major Aspect of the County's Bond Program

- These IRS and SEC regulations are complicated, strictly enforced, and have harsh penalties
- Bond Counsel and the Financial Advisor are the County's team to insure compliance
- We will discuss these responsibilities in more detail later in the presentation

# The Major Structure and Function of Bonds and Certificates of Obligation

# Basic Structure of GO Bonds

- GO Bond authority generally provides for a pledge of ad valorem tax revenues to support payment of the debt service

# General Structure of GO Bonds



- Art III Section 52 of the constitution allows counties to levy taxes up to eighty cents per one hundred dollars ($0.80/$100) of which the Attorney General allows for up to forty cents ($0.40) toward debt service
- Requires 2% reserve to be established
- These are generally referred to as **unlimited tax bonds**

# General Structure of GO Bonds



- Government Code Chapter 1251 establishes basic parameters including a maximum maturity of 40 years

# GENERAL OBLIGATION BONDS ("G.O. Bonds")

| | |
|---|---|
| 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. |

# Basic Structure of Certificates of Obligation

- COs for certain county projects, jails, courthouses, bridges can be supported by a pledge of ad valorem taxes.
- COs for other county public works must be supported by a combination pledge of ad valorem taxes and other county revenues.
- Texas Local Government Code Chapter 271

# Basic Structure of COs

- Traditionally, these other county revenue sources have been quite limited
- For example, library, solid waste facilities, fees and charges for various county services. Usually, in combination tax and rev COs, the other revenue pledge is limited to a nominal amount
- COs don't require election but require notice
- Qualified voters may petition (5%) to require the county to call an election on whether to issue the COs. If such an election fails, the county cannot sell COs for that same purpose for 3 years (unless for exceptional catastrophic items)

# 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. |

# Basic Structure of Road Bonds

- Legislative enhancements allow for different types of such bonds for different types of county public works (Government Code)
- Article VIII Section 9 of the Constitution allows for limited tax bonds to be issued by counties for flood and road projects.
- These are typically referred to as **limited tax road bonds**.

# Road Bond Structure

- Road bonds require election, AG approval, and are marketed and issued in other respects like the GO bonds but may command higher interest rates as the bond holders view the limited nature of the pledge as a detractor from their value.
- Require creation of a district

# 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. |

# 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) |

# 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 |

# 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. |

# 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 |

# REFUNDING BONDS

| | |
|---|---|
| Election: | No |
| Pledge: | Ad Valorem Tax |
| Typical Use: | Refinance certain other outstanding County Bonds |
| Max Term: | 40 Years (Typically 15-20) |
| Requirements: | Track the underlying bond |

# The Major Components of Using These Legal Sources of Money

# Overview of Major Components for GO Bonds

- Election generally required to obtain voter approval
- If approved by the voters the authority should be utilized within 10 years
- To exercise the voted authority, the Commissioners Court must authorize issuance of the bonds in one or more series
- To issue a series of bonds the Commissioners must sell the obligations to a purchaser through either a private placement, a negotiated sale, or a competitive sale
- Each approach has distinct complex technical requirements
- Any sale requires submission to and approval by the Attorney General of Texas and registration with the Comptroller of Public Accounts.
- The sale must be in compliance with SEC and IRS regulations

# When and How Ordered

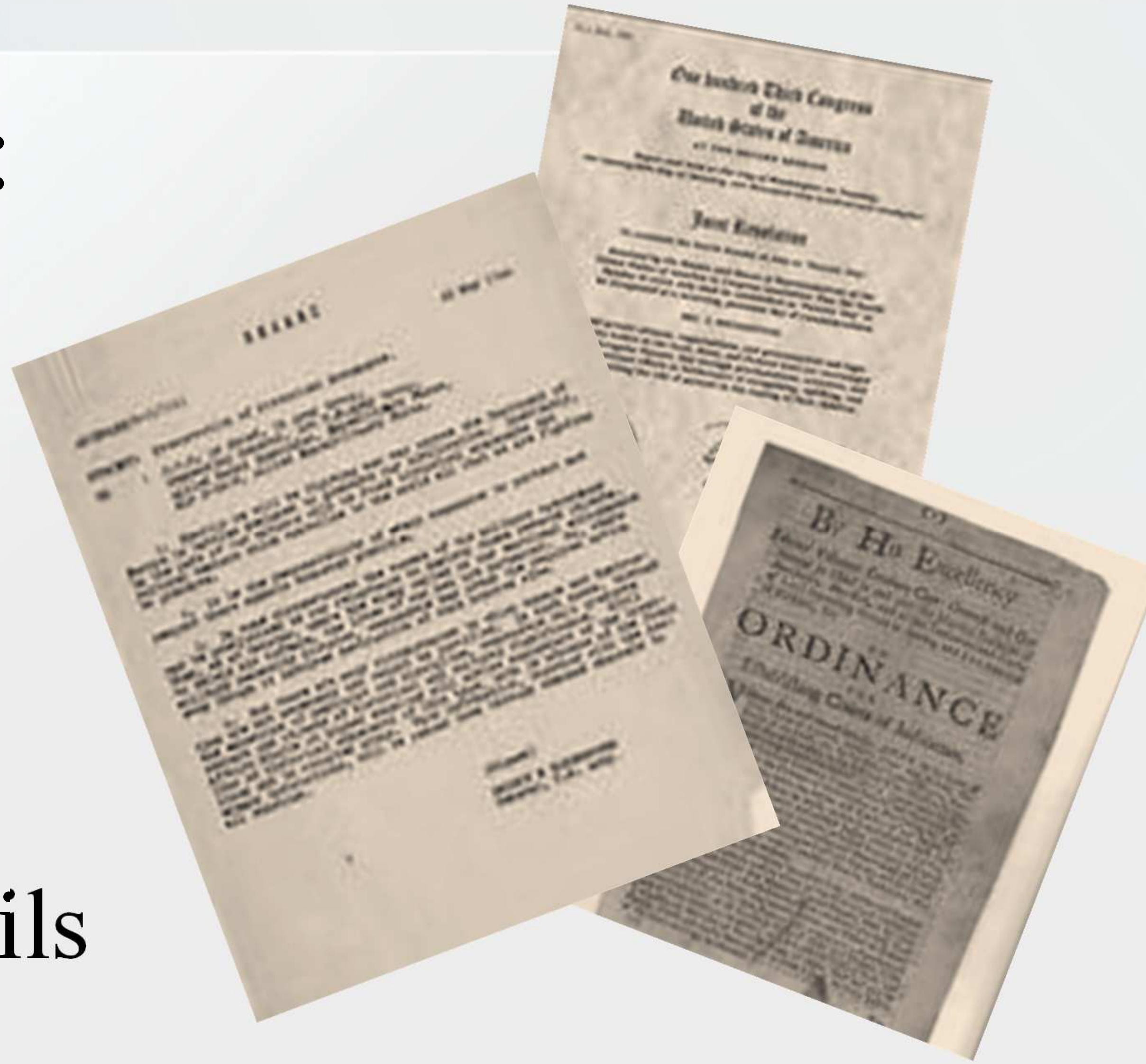
- Order includes:

  Measure

  Size

  Scope

  Election Details



# Counties are Restricted as to When They Can Call a Bond Election

- Uniform election dates first Tuesday after first Monday in **November** each year.
- Uniform election dates in **May** of odd numbered years.

# Special Information Goes into an Order Calling a Bond Election and Where These Notices are Posted and Published

- Texas Government Code Chapter 1251 specifies some notice requirements for County GO bond elections. The rest of these type of requirements tie into the Texas Election Code

- The Public Finance Division of the Attorney General's Office has special rules on how a notice is posted or published and in what kind of newspaper it must be published

# Language of Document Ordering an Election
## Election Code Section 3.009

1) the proposition language that will appear on the ballot;

2) the purpose for which the debt obligations are to be authorized;

3) the principal amount of the debt obligations to be authorized;

4) that taxes sufficient to pay the annual principal of and interest on the debt obligations may be imposed;

# GO Bonds

- If measure is approved, Commissioners may then sell bonds in one or more series
- The bonds can be sold by the county competitively, through a negotiated sale, or privately placed
- To issue obligations through competitive sale and negotiated sale Texas Counties have traditionally utilized a financial advisor

# GO Bonds

- These public sales typically are to an underwriter and require the County to make an offering statement that describes the bonds and the financial condition of the County
- To obtain the best pricing, the County will typically seek ratings from a rating company
- The FA, underwriter and Bond Counsel work with the County to assure that representations made to obtain ratings and pursuant to the offering documents are accurate

# GO Bonds

- SEC Rule 15c2-12 requires certain continuing disclosure obligations of financial and other data
- County bonds are generally for governmental purposes
- Interest on the bonds is eligible for tax exempt treatment
- County gets a lower interest rate on the bonds
- Extensive regulation of the tax exempt bond market
- County must comply

# IRS Requirements

- Most county bonds are issued as tax exempt obligations
- The county is required to provide the purchaser with assurances that the bonds are being utilized and will always be utilized for a purpose and in accordance with procedures that will keep the bonds eligible for tax exempt treatment throughout their life
- The county will provide a tax certificate that lays out these promises

# IRS Requirements

- The <u>basic promises</u> are:
  - To use the bond proceeds for a qualifying governmental project or purpose within the scope of the authority granted by the voters
  - To utilize the proceeds quickly to complete the project without unreasonable delay
  - To insure that the bond proceeds or any funds used for debts service are invested at rates which do not allow the county to make more money from those investments that it is paying bond holders for debt service.  The county must avoid engaging in arbitrage.

# Team Members

- **County's Bond Counsel**
  - The county's lawyer in the transaction will 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 insurance 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

# 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 structure the form of the financing 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

# Legal Framework and Statutory Guidance for Bonds and Certificates of Obligation

# Basic Federal Structure

In Texas, we must look to the state and federal constitutions and statutes as well as our state regulatory system for a full understanding of the county's bond issuance authority

The federal constitution recognizes the states' sovereign power to govern and provide for the state's citizens

# Basic Federal Regulatory Oversight

The federal statutes concerning the **Treasury** and the **Securities and Exchange Commission** provide for tax treatment and the offering documents that the county uses to sell bonds to the public

# Basic Texas Legal Structure for Bonds

The state constitution grants debt issuance power to political subdivisions, including Counties.

The Texas Government Code, Local Government Code, Transportation Code, Tax Code and other statutes provide specific authority for the particular types of bonds issued by these entities including Counties.

# Texas Regulatory Structure

- The Attorney General must approve all debt issued by a county
- The debt obligations must be registered with the Comptroller of Public Accounts
- In some instances, the Comptroller must preclear a special bond election for a County
- The Texas Ethics Commission regulates conduct of officials in bond elections

# Bond Election Resources for County Officials

- These various legal authorities are discussed and explained in the ***Texas Public Finance Handbook*** which we publish through the Texas Association of Counties
- As bond counsel for the county, we work with the commissioners court to guide you through these technical principles along with your financial advisor

2017
PUBLIC FINANCE HANDBOOK
FOR TEXAS COUNTIES

TEXAS ASSOCIATION OF COUNTIES
1210 San Antonio Street Austin, Texas 78701

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