



AUSTIN

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“Bonds 101” – Financing Options

Association for Governmental Leasing and Finance
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Overview

- Different Types of “Bonds”
- Important Features of “Bonds”
- Major Bond Market Players
- Top 10 Takeaways
- Questions?



The background of the slide features a stack of papers and folders, with a pen resting on top. The entire scene is overlaid with a semi-transparent orange gradient. The text "Types of 'Bonds'" is written in white, sans-serif font on the left side of the image.

Types of "Bonds"

Types of "Bonds"

Types of "Bonds"*		Projects*										
		Administration	Public Safety	Parks	Housing	Streets	Drainage	Land	Utility System	Legal Judgement	Econ. Dev.	Convention Center
Ad Valorem Tax-Backed	General Obligation Bonds											
	Certificates of Obligation											
	Tax Notes											
	Contractual Obligations											
	Refunding Bonds											
Revenue-Backed	Revenue Bonds											
	Lease Purchase Obligations											
	Judgment Bonds											
	Special Assessment Revenues											
	Tax Increment Revenues											
Refunding Bonds												

*This is not intended to present an exhaustive list of types of Bonds available under Texas law or the types of projects that may be eligible for financing under Texas law.

Remind me again, what are “Bonds”?

- Caveat: State law will govern the type, form, and terminology associated with “Bonds”.
- “Bonds” are basically promissory notes or evidences of indebtedness that may be referred to as “Bonds”, “Notes”, “Obligations”, or “Warrants”, depending on the statute authorizing their issuance (note: all of these are “Public Securities” under Texas law).
- Issued by the State (and its agencies), counties, cities, school districts, and other public entities created under State law.
- These public entities can’t sell stock, so they sell debt in the form of bonds and other types of public securities to finance their capital projects.
- They are used to finance public-purpose projects—schools, roads, bridges, utilities, hospitals, housing, economic development projects and more.
- Why can’t a city just take out a loan? Incurrence of debt must be statutorily authorized, constitutional “debt” (2% interest and sinking fund), OAG opinion is incontestable, etc.

General Obligation Bonds: Voter Authorized

- Secured by the issuer's ad valorem taxing power.
 - Supported by the full faith and credit of the issuer.
 - Viewed as one of an issuer's most secure obligations → low interest rates.
- Generally, requires a bond election for authorization.
 - The Governing Body calls this election and introduces proposition.
 - Voters will have to approve the proposition and the tax rate.
 - The tax rate to pay debt service is not subject to rollback.
- Once authorized by voters, Governing Body places matter on agenda and passes an order/ordinance authorizing sale of the GOBs.
- Must use the proceeds in accordance with the approved proposition.

General Obligation Bonds: Voter Authorized (*cont.*)

- Can be issued for public projects as provided by Texas statutes, including (but not limited to):
 - Cities
 - Public buildings, waterworks, sewers, streets, bridges, purposes identified in the City's home rule charter: Chapter 1331 of the Texas Government Code.
 - Counties
 - Road Bonds Projects: Chapter 1471 of Texas Government Code (election required to issue unlimited tax road bonds; limited tax road bonds do not require an election).
 - County Hospital Projects: Chapter 263 of Texas Health and Safety Code.
 - Jail and Building Projects: Chapter 1473.101 of Texas Government Code.
 - School Districts
 - School building bonds, sites for school facilities, school buses: Chapter 45 of the Texas Education Code.
- Can be amortized over no more than 40-year period.
 - Typically, this period is less than 40 years.

Certificates of Obligation: Streamlined Financing

- Secured by ad valorem taxes, revenues, or both.
- No election required to authorize (unless a petition is received).
 - Any petition must be signed by 5% of qualified voters.
- Cannot be issued if a bond proposition for the same purpose that was rejected by voters in a bond election during preceding 3 years.
- May be issued to pay for:
 - Public improvements the issuer will own (“public work” is now statutorily defined);
 - Purchase of materials, supplies, or other authorized needs;
 - Professional services;
 - Demolition of substandard structures; and
 - Restoration of historic structures.

Certificates of Obligation: Streamlined Financing (cont.)

- “Notice of Intent to Issue” is required prior to issuance.
 - Published in a local paper on the same day of the week for two consecutive weeks at least 45 days prior to sale date.
 - Notice must specify:
 1. Time when authorizing order will be passed,
 2. The maximum amount and purpose(s) of the CO’s,
 3. The source from which the COs will be paid, and
 4. Certain financial information pertaining to outstanding debt and the COs.
- Purposes can be combined (unlike GOBs).
- Tax rate to pay debt service is not subject to rollback (but, see HB 1869).
- Typically, projects funded by COs must be competitively bid.



COs: 2023 Legislation

(7-a) "Public work" for an issuer that is a municipality or county:

- (A) means any of the following public improvements as authorized by law:
 - (i) a street, road, highway, bridge, sidewalk, or parking structure;
 - (ii) a landfill;
 - (iii) an airport;
 - (iv) a utility system, water supply project, water treatment plant, wastewater treatment plant, or water or wastewater conveyance facility;
 - (v) a wharf or dock;
 - (vi) a flood control and drainage project;
 - (vii) a public safety facility, including a police station, fire station, emergency shelter, jail, or juvenile detention facility;
 - (viii) a judicial facility;
 - (ix) an administrative office building housing the governmental functions of the municipality or county;
 - (x) an animal shelter;
 - (xi) a library; or
 - (xii) a park or recreation facility that is generally accessible to the public and is part of the municipal or county park system;
- (B) means the rehabilitation, expansion, reconstruction, or maintenance of an existing stadium, arena, civic center, convention center, or coliseum that is owned and operated by the municipality or county or by an entity created to act on behalf of the municipality or county; and
- (C) does not include:
 - (i) a facility for which more than 50 percent of the average annual usage is or is intended to be for professional or semi-professional sports;
 - (ii) a new stadium, arena, civic center, convention center, or coliseum that is or is intended to be leased by a single for-profit tenant for more than 180 days in a single calendar year; or
 - (iii) a hotel.

Tax Notes

- Secured by ad valorem taxes, revenues, or both.
 - No election required to authorize.
 - Must mature within 7 years.
 - Note: does not contain the same prohibition on issuance after failed bond election (see COs).
- May be issued to pay for:
 - Public improvements the issuer will own (same “public work” definition as COs);
 - Purchase of materials, supplies, or other authorized needs;
 - Professional services;
 - Operating or current expenses; and
 - Cumulative cash flow deficit.

Contractual Obligations (PPFCOs)

Used to finance *personal* property.

Secured by ad valorem taxes or revenues.

No election required to authorize.

Must mature within 25 years.

Revenue Bonds

- Secured by revenues of one of an issuer's enterprise funds.
- No election required to authorize.
- Debt service coverage ratio (1.10 to 2.00) and/or reserve fund requirements. Also, "springing covenants".
- Parity debt (existing bondholder considerations; Co-Bank, USDA, TWDB considerations).
- Engineer's certificate (OAG).
- Transfer of utility system revenues to the general fund – see S.B. 1110.
- May be issued to pay for:
 - Utility systems
 - Park
 - Swimming pool

Other Types of Obligations

- Type of obligation and type of collateral depends on type of issuer and use of proceeds/project
 - is it a valid obligation?
 - can you get a tax pledge without an election?
 - can you get a deed of trust/mortgage?
 - can you do a loan instead of a bond?
 - is Texas Attorney General approval required?
- Loan/Note structures
 - some governmental issuers can do loans rather than bonds (e.g. emergency services districts, mental health mental retardation authorities, hospital districts, municipal utility districts)
 - covers real and personal property; can get a tax pledge
- Public Property Finance Contracts; Equipment Lease Purchase Agreements
 - applies to any political subdivision
 - covers only personal property/equipment; can get a tax pledge

Case Study

- Hospital District is building a new hospital
- Has obtained a commitment from USDA for a rural development loan (very favorable terms 38 years; 2.50% indicative rate); District must obtain separate construction financing and complete construction first
- What debt options are permitted under Texas law for the construction financing?
- Loan or Bonds?
- What collateral is permitted?
- Is Attorney General approval required?
- Can the debt be tax-exempt?

State Laws Impacting Purchase Contracts

H.B. 1295 Disclosure of Interested Parties form.

H.B. 89 No Boycott of Israel.

S.B. 252 Not on Comptroller List (Sudan, Iran, FTO).

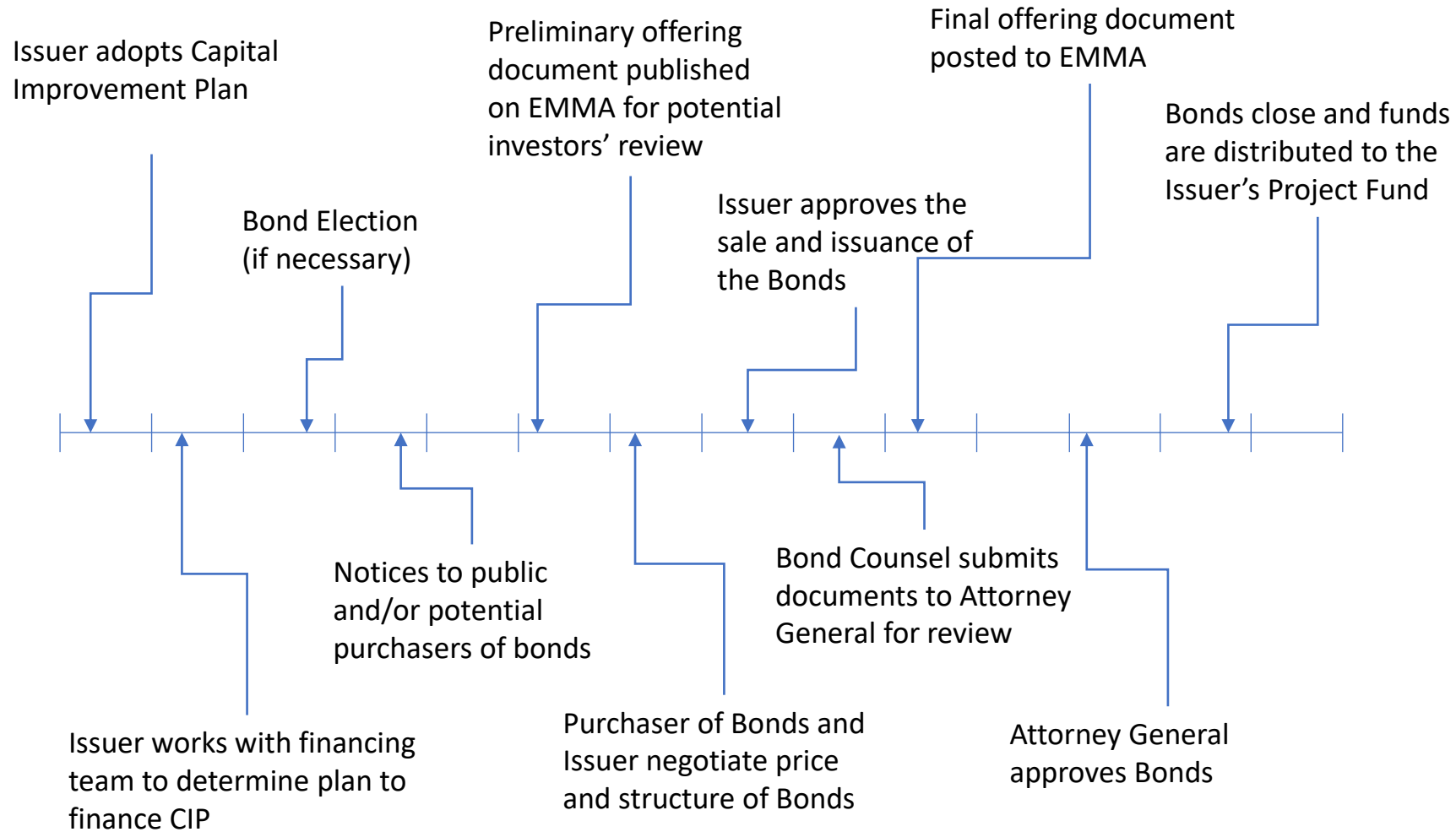
S.B.13 No Boycott of Energy Companies.

S.B. 19 No Discrimination Against Firearm Industry.

S.B. 1060 Anti-ESG (proposed legislation).

Important Things to Remember when Issuing “Bonds”

General “Bond” Issuance Timeline*



* The timeline will change based on type of “Bond” to be issued, type of sale (private bank placement, competitive/negotiated sale, and State law approval requirements. And, this, of course, would be different if the purchaser of the Bonds is the TWDB.

Important “Bond” Concepts: Starting Points

- What is the Issuer’s authority to issue “Bonds” under State law?
- Does this answer differ between Cities, Counties, School Districts, etc.?
- Other limitations on an Issuer’s ability to issue “Bonds”?
 - Constitutional limitations?
 - Limitations on tax rate (Cities, Counties, School Districts)?
 - Attorney General limitations?
 - If someone says you don’t have to get AG approval, check with Bond Counsel.
 - Approval requires a detailed review of the bond transcript, but once approved securities will be uncontestable for state law purposes (absent constitutional defect or fraud on the AG).
 - Limitations on tax rate: the “Bond Allowable” test (see next slide).
 - Recent OAG efforts (CO delegation, overlapping PID, source of revenue pledge, etc.).

Tax Rate Limitations - Cities

Type		# of Inhabitants	Rate and Authority	OAG Limitation*
General Law	A	< 5,000	\$1.50	\$1.00
		> 5,000	\$2.50	\$1.50
	B	201 to 9,999	\$0.25**	None?
	C	201 to 500	\$0.25**	None?
		501 to 4,999	\$1.50	\$1.00
		> 5,000	\$2.50	\$1.00
Home Rule Charter (not limited by charter)			\$2.50	\$1.50
Home Rule Charter (limited by charter)			[\$X]	[\$X] * 2/3

*Title 1, Texas Administrative Code, Rule §53.5 provides the general rule that all political subdivisions have a bond allowable rate equal to 2/3 of the maximum tax rate authorized by law.

**A municipality incorporated under a general or special law and does not have the authority to levy an ad valorem tax of \$1.50 or more is not eligible to issue Certificates of Obligation. See Section 271.044, Texas Local Government Code ([link](#)).

Important “Bond” Concepts: Sources of Capital

- Open Market Financing (e.g., sell bonds): the most common method of funding for the majority of projects.
- Direct Loans and Private Placements
- Texas Water Development Board
- Grants: generally only available to lower income areas to provide basic service.
- Federal Agencies: generally targeted for rural or “inner city” programs.



Important “Bond” Concepts: How are bonds sold?

Competitive Sales

- A sale that is conducted using sealed bids.
- Basic terms and conditions are set by the issuer.
- Bids are submitted in accordance with those terms.
- Bid resulting in lowest effective cost for the issuer is chosen.
- Modern technology and communications have allowed the ability to adjust the provisions of sale in order to respond to market needs, structuring needs, or other factors otherwise limited by the nature of the bidding parameters.

Negotiated Sales

- Issuer selects the underwriter(s) prior to the bond sale.
- Interest rates, underwriter compensation, and expenses are determined through negotiation with the underwriter.

Private Placements

- Interest rates are determined through negotiation with one or more investors.
- These are usually banks or other institutional market participants.
- “Committed lending period” is often limited.

Important “Bond” Concepts: Federal Income Tax

- Most “Bonds” are issued on a tax-exempt basis.
- Therefore, the bondholder does not pay tax on interest income.
 - This is the main reason purchasers buy them, and why issuers receive a low interest rate.
 - A federal tax subsidy intended to benefit local government and **NOT** private industry.
- **However**, can lose exempt status → Private Activity Bond.
 - Private Loan Test: If either 5% or \$5M is loaned to a nongovernmental entity.
 - Private Business Test: If more than 10% of proceeds are used for private business and if more than 10% of the payment of the bonds may be secured by private trade or business.
- Therefore, make sure you ask questions and understand the entire project and the intended use of bond proceeds before agreeing to issue bonds.

Important “Bond” Concepts: Federal Income Tax (cont.)



Increased random
IRS audit activity.



Arbitrage in a
rising interest rate
environment.



Reimbursement
Resolutions.



Compliance with
spend-down
requirements.

Important “Bond” Concepts: Securities Laws

- “Public Securities” are just that, securities.
 - Every bond offering includes facets of federal income tax, security (state and federal), and state law.
- These securities must follow securities law.
 - Often *exempt* from registration requirements.
 - Subject to anti-fraud provisions of both federal and state law.
- Financial Obligations
 - Continuing disclosure requirements may require a local government to file a material event notice if it undertakes a financing in a form other than a publicly offered transaction.

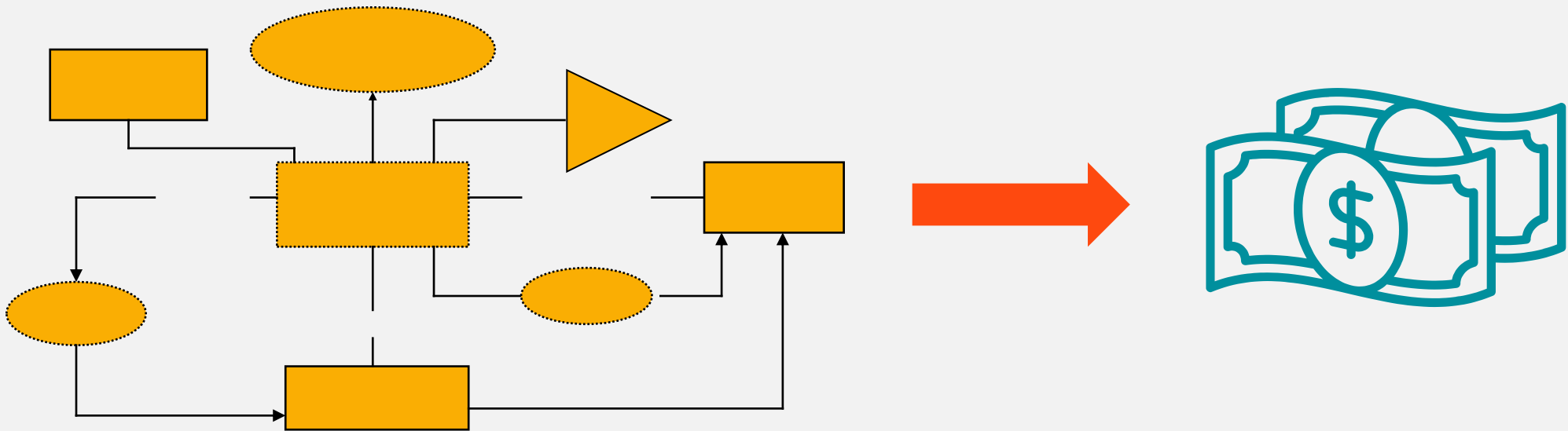


Important “Bond” Concepts: Rules for “Excess”

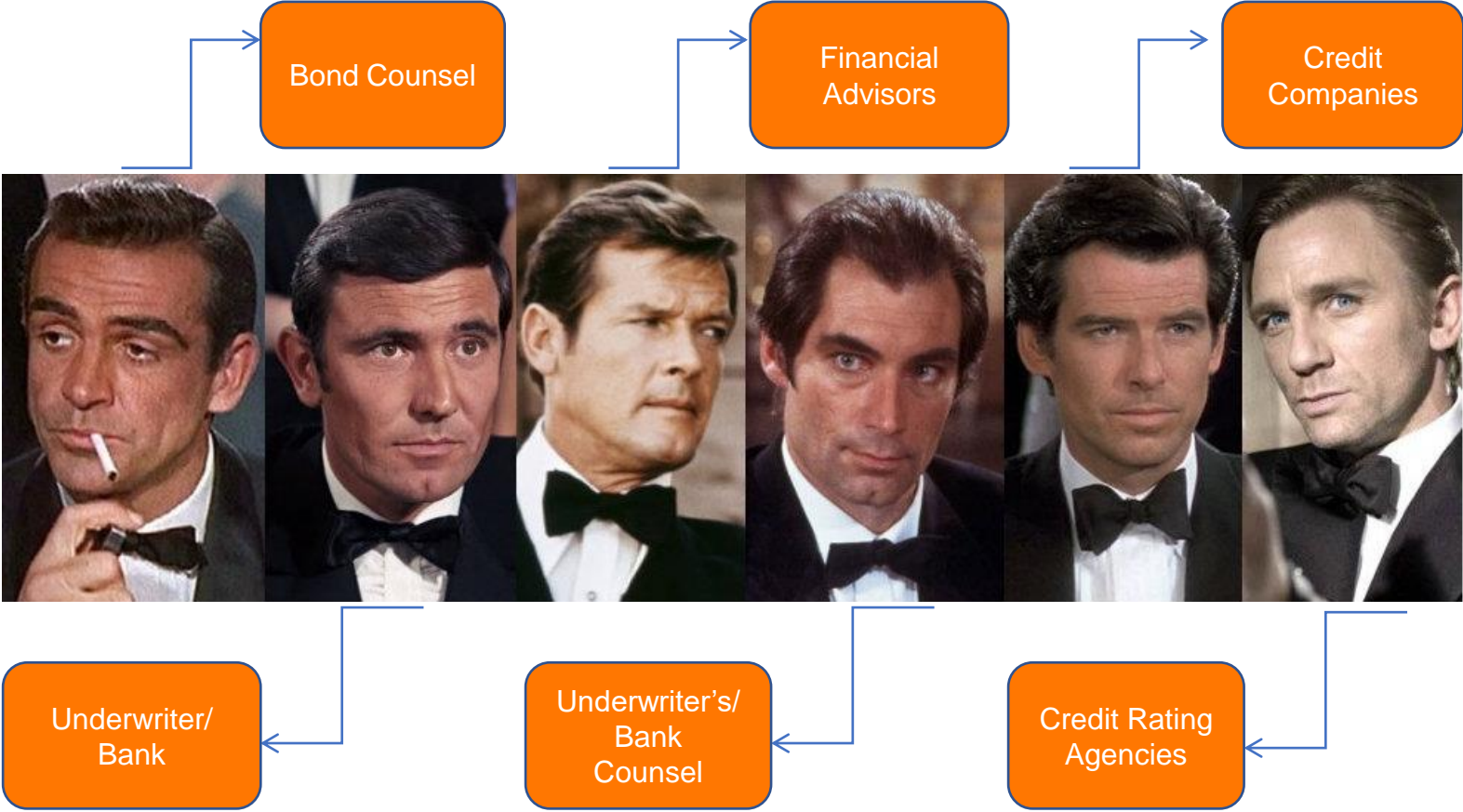
- State law perspective on excess proceeds
 - If a project comes in under budget and there are leftover proceeds, another project of the same type can be undertaken if the authorizing documents provide sufficient authority (bond order, election proposition, etc.).
 - i.e. if the bond proposition authorized general “street” work excess bond proceeds could be used to fix additional streets.
- Excess proceeds can be used to defease outstanding bonds (usually not planned for and, therefore, expensive).
- Ask Bond Counsel.

It May Look Complicated...

But issuing public securities is like poetry—sometimes it's difficult to understand but it is beautiful when done right.



The Bond (Market) Actors



Bond Counsel

- A highly specialized attorney retained by the issuer to give a legal opinion that the issuer is authorized to issue the proposed public securities, the issuer has met all legal requirements necessary for issuance, and the interest on the proposed securities will be exempt from federal income taxation. They will prepare many of the documents used to issue the bonds, including materials for a bond election (if needed).
- Bond Counsel works **with** the issuer and an attorney client privilege exists between the issuer and Bond Counsel. The issuer is Bond Counsel's client.

Financial Advisor

- A consultant who advises the issuer on matters pertinent to the bond issue, such as structure, timing, marketing, fairness of pricing, terms, and bond ratings. The financial advisor may also help prepare securities documents, including the Official Statement. They serve as the issuers access to the market.
- The financial advisor **represents** the issuer and its interests and owes a fiduciary duty to the issuer.

Credit Enhancement Companies

- Organizations such as banks and insurance companies that lend their higher credit quality to the issuer, for a fee, and ensure service payments are made to the bond holders. Credit enhancement companies can (1) allow an issuer to debt at lower interest rates or (2) provide liquidity for variable rate obligations.
- The most common example is a municipal bond insurance company. The issuer will pay an insurance premium in exchange for the insurance company guaranteeing the payment of principal and interest on the issuer's indebtedness as it becomes due. Not prevalent post-2008 financial crisis, particularly for general obligation credits.

Underwriter/Lender

- A dealer, or group of dealers, or a lender that purchase a new series of public securities. An underwriter can either hold the securities for their own benefit or resell the securities in the secondary market.
- An underwriter may initially acquire the securities either through a competitive or negotiated sale.
- Direct Bank Loans - a lender will extend credit to a government entity evidenced by a bond, CO, lease or loan. The lender will hold the instrument for their own benefit with transfer restrictions.
- While an issuer can work with an underwriter or a lender, they are ultimately **across the table** from each other. Either the underwriter or the bank works to benefit its own interests and expects to make a profit from the transaction.

Underwriter's/Lender's Counsel

- A lawyer hired by the underwriters to represent them in purchasing and offering the bonds. They will typically draft bond purchase agreements and may draft the offering document.
- A lawyer hired by the lender to represent it in a direct bank transaction. For credits evidenced by a bond or CO, bond counsel typically drafts the documents. For credits evidenced by a loan or lease, bank counsel typically drafts the loan documents.
- A cooperative environment between the issuer, bond counsel and underwriter's counsel generally exists. Underwriter's/Lender's counsel sits **across the table** from the issuer and represent only the underwriter(s)/Lender.

Credit Rating Agencies

- These companies rate the financial condition of the issuer and its ability to repay its obligations. The three main credit rating companies are: S&P, Moody's, and Fitch. The issuer can contract with one or more rating agencies to assign a rating to a public security. These credit ratings may affect a public security's interest rate.
- These credit rating agencies ultimately work for investors and **not** the issuer.

MOODY'S

FitchRatings

S&P Global
Ratings

A photograph of a desk with a stack of papers, a pen, and a folder, overlaid with a semi-transparent orange gradient. The text is positioned on the left side of the image.

Top Ten Things to Remember about “Bonds”

The Top 10

10
There are many types of “Bonds”, with separate rules and requirements for each;

09
GOs almost always require an election before they can be issued;

08
COs do not require an election (absent a petition), but a notice of intent to issue must be published before they can be issued;

07
There are many parties to an issuance, only some of which sit on the same side of the table as (and therefore share an interest with) the issuer;

06
There may be constitutional, statutory, administrative, local, etc., limitations to an issuer’s ability to issue debt and levy a tax;

05
Federal and State legislative and administrative changes (especially recently) impact an issuer’s ability to issue “Bonds”;

04
“Bonds” are typically tax-exempt, but can lose this status (private use);

03
“Bonds” must comply with certain securities laws;

02
There are rules governing how “excess” bond proceeds are spent; and

01
Bond work can be like poetry— sometimes difficult to understand, but beautiful when done right

Questions

