2017
PUBLIC FINANCE HANDBOOK
FOR TEXAS COUNTIES

TEXAS ASSOCIATION OF COUNTIES

1210 San Antonio Street Austin, Texas 78701

Honorable Joyce Hudman
Brazoria County Clerk & Association President

Gene Terry
Executive Director

Rex Hall
Assistant Executive Director

PREPARED BY THOMAS M. POLLAN & DAVID MÉNDEZ
BICKERSTAFF HEATH DELGADO ACOSTA, LLP
3711 SOUTH MOPAC EXPRESSWAY
BUILDING ONE, SUITE 300
AUSTIN, TEXAS 78746
(512) 472-8021

LEGAL RESEARCH
Legal Helpline: (888) 275-8224 • Toll Free: (800) 456-5974
or visit our website at www.county.org

THIS PUBLICATION IS A RESEARCH TOOL AND NOT THE COUNSEL OF AN ATTORNEY. THIS PUBLICATION IS NOT A SUBSTITUTE FOR THE ADVICE OF AN ATTORNEY. It is provided without warranty of any kind and, as with any research tool, should be double checked against relevant statutes, case law, attorney general opinions and advice of legal counsel e.g., your county attorney. Each public officer is responsible for determining duties of the office or position held. Any question regarding such duties should be directed to competent legal counsel for a written opinion.

The materials contained herein represent the opinions and views of the author and should not be construed to be the views or opinions of the Texas Association of Counties.

Nothing contained in this book is to be considered as the rendering of legal advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel. This book is intended for educational and informational purposes only.

Copyright © 2017 by Thomas M. Pollan & David Méndez

About the Authors

Tom Pollan was a partner in the Austin law firm Bickerstaff Heath Delgado Acosta LLP. Prior to joining the firm, he was Chief of the Insurance, Banking and Securities Division of the Office of the Attorney General of Texas. He retired in 2017.

David Méndez is a partner in the Austin law firm Bickerstaff Heath Delgado Acosta LLP.

He has represented numerous counties, cities and special districts throughout the State of Texas in the issuance of general obligation bonds, revenue bonds, certificates of obligation and tax notes. He is a frequent speaker at public finance seminars and training programs, including those sponsored by the Texas Association of Counties.

He is a member of the National Association of Bond Lawyers and is listed in the *Bond Buyer's Municipal Marketplace* (the "Red Book"). He serves as bond counsel, underwriter's counsel and special counsel in connection with local government financings.

David is always willing to consult with county officials concerning public finance issues. He can be reached at the following address:

David Méndez
Bickerstaff Heath Delgado Acosta LLP
3711 S. MoPac Expressway
Building One, Suite 300
Austin, Texas 78746

Telephone: 512-472-8021
Fax: 512-320-5638
Email: dmendez@bickerstaff.com

TABLE OF CONTENTS

Page

Chapter 1 A County Must Have Express Authority to Create Debt 2

Chapter 2 Consultants and Persons Involved 5

Chapter 3 The Entire Project Should be Considered in Issuing Bonds 9

Reimbursement Resolution 9

Chapter 4 The Issuance Process for Ad Valorem Tax-Backed Obligations 11

Reimbursement Resolution 12
Determination of Financing Vehicle 12
Pre-Sale Issues 13
Post Sale – What to Do with the Money 14

Chapter 5 Documents Used in a County Bond Issue 16

Chapter 6 Types of Financing Commonly Used in County Debt Financing 19

General Obligation Bonds 19
Bid Requirements 19
Revenue Bonds 20
Certificates of Obligation 20
No Election Required Unless Valid Petition Presented 21
CO's Sold for Cash 21
Limitation on the Use of Certificates of Obligation After a Failed Bond Election 22
Competitive Bidding 23
Purposes Combined 23
Tax Notes 24
Contractual Obligations 26
Time Warrants 27
Refunding Bonds 29
Lease Purchase Obligations 30
Equipment Financing 30
Real Property 30

Lease Purchase Transaction Must be Properly Structured 31
Lease Documents Need to be Reviewed and Negotiated 31
The County Must Be Prepared to Terminate 32
Summary Table 33

Chapter 7 Bond Elections 34

Timeline 35
Federal Voting Rights Act 40
Canvass 40
Elected Officials Need to Affirmatively Support the Bond Election 40
No Political Advertising 41
Follow the Law and Avoid Sanctions 42
Establishing Citizen Support 42

Chapter 8 Federal Income Tax Exemption 44

Chapter 9 Securities Issues 49

Continuing Disclosure Requirements 49
The Securities and Exchange Commission is Serious About Continuing Disclosure 51

Chapter 10 Annual Reporting Requirement 52

Chapter 11 Financing a County Jail 54

Chapter 12 Energy Savings Performance Contracts 57

Chapter 13 Pass-Through Toll Bonds 61

Chapter 14 Public Finance for Economic Development 63

Economic Development Corporations 63
Public Improvement Districts 64
County Development Districts 66

Chapter 15 Interlocal Contracts 67

Conclusion 68

TEXAS ASSOCIATION OF COUNTIES

PUBLIC FINANCE HANDBOOK FOR TEXAS COUNTIES

By: THOMAS M. POLLAN & DAVID MÉNDEZ

This handbook is designed to explain the bond issuance process, especially for counties that do not issue bonds on a frequent basis. A county that is not familiar with the process may feel the process appears complex, but it is in fact one that can be readily explained and understood. This handbook is intended to allow you to get a quick grasp of the process and to identify the critical points in that process for the commissioners court.

A Texas county can finance projects in several ways. The most common are the issuance of General Obligation Bonds, Certificates of Obligation, Tax Notes, and Contractual Obligations. Generically, all of these methods can be called "bonds." Other financing methods used by counties are Time Warrants and Lease Purchase Obligations.

A county issues bonds to finance something over a period of time. As a political subdivision of the State, a county cannot simply go to a bank and take out a loan, unless the loan is to be repaid within the current fiscal year. To borrow money beyond the current fiscal year, the county must issue a debt obligation—a security known as a bond which will be sold for cash in return for the county's promise to repay the debt obligation with interest, generally at a favorable tax-exempt interest rate.

In order to sell bonds a county must generally retain consultants to assist in the process. A financial advisor will structure the transaction and arrange the sale of the bonds to an underwriter or a bank. Bond counsel will prepare the bond order and other documents, shepherd the county's bonds through the Attorney General's review process, provide an opinion as to the bond's validity, and if applicable, an opinion that the bond is a tax-exempt obligation for federal income tax purposes. Bond counsel and the county's financial advisor will also guide the county through the various tax and securities issues that are part of bond issuance process. They also assist the commissioners court and other county staff in obtaining ratings, insurance, and securing necessary banking arrangements to complete the transaction.

The process can seem complex, but it is one that can be readily explained and understood. Hopefully, this handbook will assist you in understanding the process.

Chapter 1

A COUNTY MUST HAVE EXPRESS AUTHORITY TO CREATE DEBT

For all local governmental entities in this State, the authority to issue debt must be expressly granted by the Texas Constitution or statute, and without a grant of authority, a county cannot issue debt. The county's power to borrow money may not be implied from other powers, such as the power to acquire or operate a facility. Unless specifically granted by statute, the county does not have the authority to take out a loan from a bank that extends beyond the current fiscal year. However, short term borrowing that is to be paid back within the year is generally not considered the creation of a debt for constitutional purposes. If the loan obligation extends beyond the county's fiscal year, it is a debt which requires statutory authorization. A detailed explanation of the ability of a county to borrow money is found in Texas Attorney General Opinion No. JC-0139 (1999). There, the Attorney General reviewed a county's authority to borrow money from a bank in determining that a county did not have the authority to borrow money from the State Infrastructure Bank ("SIB") as the legislation creating the SIB did not expressly authorize a county to borrow money from the SIB. As a result of the opinion, the legislature at the next session expressly authorized a county to borrow from the SIB.

Using the authority provided by the Texas Constitution, the legislature has provided counties with a variety to mechanisms to issue debt (bonds) to allow the commissioners court to address community needs. Each approach provides the county with a solution to target a particular situation. With this authority, the commissioners court and its financial advisor and bond counsel can select a particular type of debt that is tailored to take care of the county's needs in the best way.

Texas counties have the authority to issue bonds or other obligations that are secured by a pledge of ad valorem taxes. Texas counties can also issue revenue bonds, but few counties have revenue generating projects that will support the issuance of bonds. In order to issue a bond or other obligation, there must be statutory authorization. For general obligation bonds, the specific statute must be identified and reviewed to see if it applies to the project that the county wants. For instance, bonds for jails and buildings are authorized under Section 1473.101 of the Texas Government Code. Road bonds are authorized under Chapter 1471 of the Texas Government Code. County hospital bonds are authorized under Sections 263.021 and 263.022 of the Texas Health & Safety Code. The bond election provisions are found in Chapter 1251 of the Texas Government Code. The county may have various alternatives for its authority. The county in consultation with bond counsel will decide which method is most appropriate to use for the bond issue.

In addition to voted bonds, other laws permit counties to issue ad valorem tax-backed obligations which do not require an election. Subchapter C of Chapter 271, Texas Local Government Code provides the authority to issue certificates of obligation. Chapter 1431, Texas Government Code authorizes the issuance of tax notes. Subchapter A of Chapter 271, Texas Local Government Code, authorizes the issuance of contractual obligations.

Today, most county tax-backed bonds and other obligations have a limited tax pledge that use the 80¢ per $100 authorized by Article VIII, section 9 of the Texas Constitution. Previously, special statutes authorized the amount that could be pledged by project. These statutes are still in the Government Code, but the 80¢ per $100 authorization has replaced the use of these other methods.[1] A county may also issue unlimited tax road bonds under Article III, Section 52 of the Texas Constitution, provided that the total amount of indebtedness does not exceed 25% of the county's total appraised taxable valuation. For obligations backed by the 80¢ per $100 valuation limit, the Attorney General of Texas has administratively by rule limited the amount of bonds he will approve to an amount which produces debt service requirements not to exceed 40¢ of the foregoing 80¢ maximum tax rate, calculated at 90% collections.[2]

A county in borrowing money is required to establish an interest and sinking fund. Article XI, Section 7 of the Texas Constitution provides:

> But no debt for any purpose shall ever be incurred in any manner by any city or county unless provision is made, at the time of creating the same, for levying and collecting a sufficient tax to pay the interest thereon and provide at least two per cent (2%) as a sinking fund...

---

[1] Examples are found in Section 1301.003, Texas Government Code:

> (a) The amounts of bonds issued under this chapter may not exceed:
>
> (1) for courthouse bonds, two percent of the county's taxable values;
> (2) for jail bonds, 1 ½ percent of the county's taxable values;
> (3) for joint courthouse and jail bonds, 3 ½ percent of the county's taxable values; and
> (4) for bridge bonds, 1 ½ percent of the county's taxable values.

[2] Counties that have adopted the 30¢ per $100 Farm-to-Market/Flood Control tax under Article VIII, Section 1a of the Texas Constitution and Chapter 256 of the Texas Transportation Code may also pledge this tax for debt service for related projects.

Bond counsel will provide for the creation of an interest and sinking fund in the bond order in order to comply with this requirement.

Under Texas law, bond issues of counties and other political subdivisions must be approved by the Texas Attorney General's Office and registered by the Comptroller of Public Accounts. The Public Securities Act, Chapter 1202, TEX. GOV'T CODE, provides the procedure for submitting "bonds" to the Attorney General. Section 1202.004 of the Public Securities Act requires the governmental issuer, such as a county, to pay a nonrefundable examination fee for its issues of 1/10 of 1% of the par amount of the bonds, with a minimum of $750 and a maximum of $9,500. Once the Attorney General has approved the bonds, he issues an opinion and sends the bonds to the Comptroller to be registered.[3]

A county that has adopted the tax for farm-to-market and lateral roads or flood control, pursuant to Article 8, Section 1-a of the Texas Constitution and Section 256.054 of the Texas Transportation Code, may pledge such tax for debt obligations for the construction or improvement of farm-to-market and lateral roads or the construction of permanent improvements for flood control purposes.

Texas law provides a great benefit to counties who are issuing and purchasers who are purchasing the bonds. Under Section 1202.006, once the bonds have been approved by the Attorney General and registered by the Comptroller, they become valid and incontestable in a court or other forum and are binding obligations for all purposes according to their terms, except for a constitutional challenge. This provides additional comfort to the prospective purchaser.

---

[3] Section 1202.007, TEX. GOV'T CODE, provides a list of exemptions to the approval and registration requirements. This list includes a time warrant issued under Chapter 262, TEX. LOCAL GOV'T CODE, a lease-purchase agreement or installment sale obligation, and a certificate of obligation that is delivered to a vendor.

Chapter 2

CONSULTANTS AND PERSONS INVOLVED

Bond Counsel—Bond counsel is an attorney retained by the county to assist in the issuance of the bonds. Bond counsel will prepare the documents needed to issue the bonds or other security (including resolutions and the bond order), submit the transcript of bond proceedings to the Attorney General of Texas for approval, assist in the closing, and deliver an opinion that the county is authorized to issue the bonds, that the county has met all legal requirements for the issuance and that the interest on the obligations will be exempt from federal income taxation. If there is a bond election, bond counsel will prepare the bond election materials. While there are a lot of lawyers in Texas, only a few serve as bond counsel. Bond counsel must know the Texas laws that establish the authority for the county to issue its bonds, federal tax law to structure the transaction so that the interest on the bonds is not subject to federal income taxation and securities law so that the transaction does not run afoul of federal and state securities laws. An attorney client relationship exists between bond counsel and the county. A county has the right to choose its own bond counsel; however, bond counsel must be recognized by the marketplace. Purchasers will want bond counsel to be in the "Red Book", a publication called the *BOND BUYERS' MUNICIPAL MARKETPLACE*, which lists law firms which are recognized as having served as bond counsel or underwriters counsel. The county needs to have a relationship where it feels that the bond counsel is looking after its interest and will be available to explain the process. It is important that the county know what is happening and that it has a legal representative to respond to the legal questions that may arise in the issuance of the bonds. Bond counsel is usually compensated only if bonds are sold and from bond proceeds.

Financial Advisor—The financial advisor is the professional who will guide the county through the economic side of the issuance process. The financial advisor will advise the county on the type of security to issue (such as general obligation bonds, certificates of obligation or tax notes) and how to structure the issue. The financial advisor is required to have a securities license, and his or her activities are regulated by state, federal and industry securities regulatory authorities. He or she must know the market conditions. The financial advisor will determine how best to position the county for the market, including whether to sell the bonds with bond insurance and whether to have the bonds rated by one or more of the rating agencies. The financial advisor will usually prepare the securities offering document, known as the Official Statement. The financial advisor will determine whether the bonds will be sold at: a competitive sale – through bids which will determine the price and the interest rates at which the bonds are sold; a negotiated sale – where the interest rates and purchase price are negotiated with

an underwriter; or a private placement – where the bonds are sold directly to a local bank. The size of the bond issue will influence which methods will be used to provide the best results for the county. Financial advisors are required to have a signed financial advisory contract with the county before it can arrange for the sale of the county's bonds. Financial advisors are usually paid only when bonds are sold based on a fee schedule in the financial advisory contract. The financial advisor represents the county, owes a fiduciary duty to the county, and looks out for the county's interest. Some financial advisors work for firms that also underwrite bonds. Others work for firms that only provide financial advisory services. Both methods provide good results. In a negotiated sale, a financial advisory firm is prohibited from serving as the financial advisor to the county and also serving as the underwriter. In a competitive sale, a financial advisory firm may submit a bid for the county's bonds only with the consent of the county.

Underwriter or Purchaser—For most transactions the underwriter will be a brokerage firm or bond dealer or a syndicate of two or more firms that will purchase the bonds for sale to the public and institutional investors. Sometimes the securities will be sold to a financial institution (such as a local bank) as a private placement to hold as an investment and not for resale. The underwriter is compensated based on the difference between the price it agrees to purchase the bonds from the county and the price it sells the bonds to the public. The underwriter does not represent the county.

Paying Agent—A commercial bank that handles the closing of the bonds, registers the owners of the bonds and coordinates the receipt of debt service payments from the county and the payment to the owners of the bonds. Paying agents generally charge an initial set up fee and then an annual fee for as long as they service the bonds.

Credit Rating Agencies—These are companies, such as Standard and Poor's Ratings Services, Moody's Investors Services or Fitch Ratings, that rate the financial condition of the county and its ability to repay the bonds. If the bonds are to be rated, the county will apply for a contract rating. The rating agency will evaluate the county's financial condition and its ability to pay principal and interest on the bonds. The financial advisor will coordinate the request for the rating and assist the county in dealing with the rating agency. The rating agency will bill the county for the rating. Rating fees will be paid from bond proceeds. Not all bonds will require ratings. However, when a county sells bonds through a competitive or negotiated sale, a bond rating will most often be used. Investors use the ratings in determining the risk of their investment. Investors will look to see if the bonds are rated as being investment grade, a credit designation given municipal securities that have a high rate of probability of being paid. Bonds rated "BBB" or higher by Standard & Poor's or Fitch Ratings or "Baa" or higher by Moody's Investors Service, Inc. are generally deemed to be investment grade. The following is a chart of the

ratings used by these companies for long term debt:

	Fitch Ratings	Moody's Investors Service	Standard & Poor's
INVESTMENT GRADE	AAA	Aaa	AAA
	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
	A+, A, A-	A1, A2, A3	A+, A, A-
	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
BELOW INVESTMENT GRADE	BB+, BB, BB-	Ba1, Ba2, Ba3	BB+, BB, BB-
	B+, B, B-	B1, B2, B3	B+, B, B-
	CCC+, CCC, CCC-	Caa1, Caa2, Caa3	CCC+, CCC, CCC-
	CC	Ca	CC
	C	C	C
	DDD	–	C
	DD	–	–
	D	–	–

Bond Insurers—Specialized insurance companies that provide a policy to ensure payment of principal and interest on the securities in the event the county becomes unable to do so. By insuring the bonds, the county's bonds will carry the credit rating of the insurance company. Prior to 2008, bond insurance was the norm for many bond issues to bring a county's rating up to "AA" or "AAA." However, economic difficulties arising from the subprime housing market have impacted many of the companies that were writing such insurance so that, as of November 2011, there are only two companies writing municipal bond insurance policies, and those policies have a "AA" or "AA-" rating. Consequently, counties now are issuing without insurance relying solely on their own credit ratings. Bond insurance may only be used if the county will receive a benefit of a lower overall debt service on the bonds after the cost of the bond insurance premium is factored in. The financial advisor will calculate whether it is economically feasible to use bond insurance. The cost of the bond insurance premium will be paid from bond proceeds.

Attorney General of Texas—Under Texas law, the Attorney General is required to approve and review most securities that are issued by counties and other Texas political subdivisions. The Attorney General will review the transcript, and if he determines that it is legally sufficient will provide his approving opinion. State law prescribes that the county (and other issuers) pay a fee equal to 1/10th of 1% of the par value of the bonds, subject to a $750 minimum and a $9,500 maximum fee.

Comptroller of Public Accounts of Texas—Under Texas law, once the Attorney General has approved the county's bonds, the bonds are then submitted to the Comptroller for registration.

Escrow Agent—A commercial bank that holds, in trust, a deposit to redeem bonds that are being called.

Internal Revenue Service—Since most county bonds are sold on a tax-exempt basis, that is, the interest is not taxed as income to the bondholder, the Internal Revenue Service imposes a significant overlay on what is required to maintain the tax-exempt status. The county will covenant in the bond documents that it will not take any action which will cause the bonds to become taxable and that it will maintain the tax-exempt status of the bonds. Bonds issued on a tax-exempt basis are subject to audit by the Internal Revenue Service.

Chapter 3

THE ENTIRE PROJECT SHOULD BE CONSIDERED IN ISSUING BONDS

A county should not simply focus on the issuance of bonds as a separate process from the project to be financed. It is important to keep the entire project in perspective. First, it is important to get a good estimate for the cost of the project. The estimates for the project need to be reviewed and challenged to ensure that the amount projected will actually be sufficient to complete the project. For equipment and materials, the persons in charge of county purchasing will need to obtain cost estimates of the items to be purchased in order to determine the amount of bonds to be issued. For construction projects, the county will need to engage design professionals, such as architects and engineers, to provide the initial cost estimate on which the amount of bonds will be based. For instance, when a county is planning a new jail project, it will need an architect experienced in jail design to provide an estimate of the construction costs in order to properly size a bond issue. A major concern is that the estimate may be low. This can result in either reducing the size of the project or issuing additional debt to complete the project. When a county has represented to the public the cost of a project, it certainly does not want to have to issue additional bonds to finish the project.

It is important to keep preliminary costs in perspective. While the bond counsel and the financial advisor work on a contingent basis, architects, engineers and others do not. A county should provide protection in its contracts with design professionals in the event the financing does not go forward. Why would a project not go forward? If a bond election is used, it is possible that the bonds may not pass. Circumstances may change where the project is no longer needed. For contracts with architects, the county should consider establishing preliminary dollar limits, beyond which it will have no responsibility if the project does not go forward. The contract should provide for a preliminary phase where the architect will provide a good cost estimate for a fixed amount so that this will be the limit of compensation if the financing does not go forward. Unless a county is willing to pay for work that may not be needed, the architect should not be permitted to complete the design phase until the financing has been completed.

Also, the county should consider **NOT** using the traditional AIA contracts for architect or construction. If an AIA contract is used, you should negotiate the terms so that the county is on a more equal basis. The county is about to spend a lot of money on a bond project; make sure the county is protected. Finally, if the bonds are for a construction project, make certain that the performance and payment bonds are properly written and in place before funds are released to a contractor.

Reimbursement Resolution

If the county has funds on hand which it will need for expenditures in the future but can be freed up for a particular purchase now in connection with a bond financing, the county may want to consider passing a reimbursement resolution so that it can use those funds now and then reimburse itself from bond proceeds once the bonds are issued. This can result in savings by deferring the actual bond issuance until later. Texas law, in Section 1201.042(c), Texas Government Code, and federal law, in 26 C.F.R. § 1.150-2, authorize the use of reimbursement resolutions. Failure to pass a reimbursement resolution may prevent the county from recovering funds spent on a project prior to the issuance of bonds. You should consult with bond counsel who will prepare the resolution so that it meets the state and federal requirements.

The reimbursement resolution must be passed within sixty days of the day you first spend funds on a project, with the exception of certain preliminary expenses, such as architectural and engineering expenses. For a construction project, breaking ground will start the time running.

Chapter 4

THE ISSUANCE PROCESS FOR AD VALOREM TAX-BACKED OBLIGATIONS

The county must first determine what it needs to finance. Does it need to finance the construction of a jail or courthouse improvements? Does it need road machinery or materials or right-of-way? Does it need a combination of various items? Once the county has determined what it needs to finance, it should contact its financial advisor and/or bond counsel to have them assist in the evaluation of how best to finance depending on the county's particular needs.

A financing may be fine using tax notes if the time for repayment can be accomplished within seven years. If more time is needed, then certificates of obligation or general obligation bonds may be needed.

Is the project one where the county believes that a bond election is appropriate? If so, the time to complete the financing will be extended. Since the county can only call a bond election on the May[4] and November Uniform Election Days, that time must be factored in. Remember, the county must call the election at least 78 days and no earlier than 90 days prior to the proposed election day or it will have to wait until the next cycle. Plus, once the bond election has been approved, the county still will not be able to sell bonds until 30 days from the canvass so that the time has passed for an election contest.

In making a time line, it is important to remember that a county will need to approve the order to issue the bonds or other tax-backed obligations at a regularly scheduled meeting of the commissioners court. The order authorizing the bonds is also the order authorizing the sale and the levy of the tax to support debt service on the bonds. Since a tax is being levied, Section 81.006 of the Local Government Code must be followed:

§ 81.006. Quorum; Vote Required for Tax Levy

(a) Three members of the commissioners court constitute a quorum for conducting county business except the levying of a county tax.

(b) A county tax may be levied at any regularly scheduled meeting

[4] An amendment to Section 41.001 of the Election Code prohibits a county from holding a May election in even-numbered years.

of the court when at least four members of the court are present.

(c) A county may not levy a tax unless at least three members of the court vote in favor of the levy.

Reimbursement Resolution

If the county needs to proceed with the project before the financing can be complete, it may want to pass a reimbursement resolution to permit the county to use available funds which it will reimburse from the sale of the bonds later. If the funds needed are only for preliminary work, such as professional expenses for architectural and engineering expenses, those expenses can be reimbursed without a formal reimbursement resolution. If a construction project is involved, the breaking of ground will be considered a construction cost rather than a preliminary expenditure.

Determination of Financing Vehicle

The county needs to have a good estimate of when it will actually need funds from the sale of the bonds. As previously noted, a bond election takes considerable time. Other obligations can be issued on a much faster basis. The following table may be of assistance:

Timing Comparison

	General Obligation Bonds	Certificates of Obligation	Tax Notes
Time Involved Before Funding	5 to 12 months[5]	45 - 60 days	30 - 45 days
Election/ Publication	Election requires calling election on May or November Uniform Election Date at least 78 to 90 days before the election Canvass election	Must authorize publication of notice of intent with first publication date at least 30 days before authorization	None

[5] The passage of S.B. 100 amended section 4.001 of the Texas Election Code to permit a county to hold an election on the May uniform election date only in odd-numbered years. This can result in this time being extended to over one year.

If election passes, place on regular meeting agenda 30 days after canvass	If no petition, place on agenda and authorize sale at regular meeting	Place item and authorize sale at regular meeting
Funding within 30 days from sale date	Funding within 30 days from sale date	Funding within 30 days from sale date

Pre-Sale Issues

The financial advisor will consider which method is most efficient for the county, based on its needs. The financial advisor will determine whether a private placement to a bank or a public offering through either a competitive sale or a negotiated sale should be made.

For a competitive or negotiated sale, a determination must be made whether to obtain a bond rating from one or more rating agencies. The rating will enable a prospective purchaser to know the credit quality of the county. Ratings are not used for a private placement as the purchaser is familiar with the purchase of municipal securities and makes its own determination. In a private placement, the purchaser purchases the bonds through a letter agreement in which the purchaser certifies that it is experienced in the purchase of such securities and has reviewed such financial information concerning the county as it deems necessary to make a decision on purchasing the bonds.

If a private placement is involved, the financial advisor will gather financial data on the county so that the bank can make an informed decision about what it is purchasing. If a competitive or negotiated sale is involved an offering document, the Official Statement, must be prepared. The financial advisor will gather financial information concerning the county and prepare a booklet so that prospective purchasers can review to determine their interest in purchasing the obligations. Bond counsel will also be reviewing and commenting on the document. The initial version is called the Preliminary Official Statement. Certain information will not be available until the bonds are sold. After the bonds are sold the sales information, including the actual amount of bonds sold and interest rates, are inserted into the Final Official Statement.

If a competitive sale is involved, a Notice of Sale is also prepared which sets forth the terms and conditions of accepting bids. The sale date will be scheduled for a regularly

scheduled meeting of the commissioners court.

If a negotiated sale is involved, the underwriter will engage its own lawyer, the underwriter's counsel, to prepare the contract to purchase the bonds. It will contain numerous certifications by the county regarding the bonds. The contract will be reviewed by bond counsel for the county. If the contract is acceptable, a sale date is established which as previously noted must be on a regularly scheduled meeting of the commissioners court.

The commissioners court will meet and pass its order authorizing the issuance of the bonds. Bond counsel will take the order, along with all other documents related to the transaction and put them in a transcript of proceedings and submit the transcript to the Attorney General for approval. Should there be any question concerning the documents, the Attorney General will contact bond counsel for additional information. Once the Attorney General has approved the bonds, they will be submitted to the Comptroller of Public Accounts for registration. The Comptroller will then send the approved bonds to bond counsel to hold for the closing.

Once approval has been obtained, a date for closing on the bonds will be established. The financial advisor or bond counsel will prepare closing instructions to inform the underwriter or purchaser of when to send the money for purchasing the bonds to the paying agent. Bond counsel will send the bonds to the paying agent to release when funds from the underwriter or purchaser are received. For private placement, hard copy bonds are usually delivered to the purchaser. For negotiated or competitive sales, the bonds will be prepared for book-entry through a depository clearing house so that no hard copy of the bonds will be given to the underwriter.

For the closing, the county will execute a Form 8038-g and a certificate confirming the county's expectations on the use of funds to ensure that the tax-exempt status of the bonds will be maintained.

Under any form of sale, the county should reasonably be able to receive funds within 30 days from the date it approves the order authorizing the bonds.

Post Sale – What to Do with the Money

The proceeds the county receives from the sale of the bonds will be deposited as provided in the bond order. Proceeds must be spent for the purposes the bonds were issued for. The proceeds from the sale will be specified in the bond order. The most common item is accrued interest. Although transactions can be structured so that interest accrues from the date of closing, most bonds will be sold to an underwriter where the underwriter will pay the county accrued interest from the date of sale to the date of the closing on the bonds. This accrued interest must be placed in the debt service or interest and sinking fund. The Certificate of Obligation Act expressly requires this. *See*, Section 271.050, Texas Local Government Code. When the first interest payment is due, the underwriter will be entitled to receive interest from the date of the sale. The terms of the sale may provide that the bonds are sold at a premium, that is, in excess of the face amount of the bonds. Recent amendments to Section 1201.042 of the Texas Government Code have expanded what the county may do with a premium. If a county sells its bonds with a premium, the bond order will provide the manner in which the premium will be used. Most common is the payment of costs of issuance. The bond order may provide that the premium is to be placed in the construction fund for the project or the interest and sinking fund.

Most of the sale proceeds will be used for the purposes for which the bonds were issued. If a county issued bonds to build a jail, the funds the county receives for the project must be spent on a jail and cannot be used for unrelated purposes, such as a courthouse or roads. The county will need to establish accounts at its depository for the bond issue. An account for the bond fund or construction fund will be established for funding the purpose of the issue. As previously noted, an account for the interest and sinking fund will be established for debt service. The money in these funds is not to be commingled with other county funds. The bond order will provide for the investment of the money in these funds. Section 1201.043, Texas Government Code, specifically permits the county to invest the proceeds from the sale and use the investment income for the purpose that the bonds were issued. Investments will be made in accordance with the Public Funds Investment Act and the county's investment policy.

Chapter 5

DOCUMENTS USED IN A COUNTY BOND ISSUE

There are numerous documents involved in a bond issue. The following documents are used in most county bond issues.

Order Authorizing Issuance–This document is the document by which the bonds are authorized. Generally, the document is 20 to 40 pages long. It recites the statutory basis for the bonds and the form of the bonds and levies a tax to pay for the bonds. It explains what is being financed with the bonds. The debt service payments and interest rates are included. It will provide whether the bonds are subject to being called before maturity and the requirements for making the call. It contains covenants that the county will make the debt service payments when due and will not cause the bonds to become taxable.

Official Statement–A document or documents prepared by or on behalf of the county in connection with a public offering of the bonds for sale. An initial document called a Preliminary Official Statement is prepared with pro forma information, and a Final Official Statement is prepared once the bonds are sold which incorporates the actual terms of the sale. The Official Statement describes the terms of the bonds, how the proceeds of the bonds will be used, financial information or operating data concerning the county and other entities, and enterprises, funds, accounts or other information material to an evaluation of the offering of the bonds, including the continuing disclosure undertaking. This document is usually prepared by the financial advisor from information provided by the county. It is the county's document and should be read carefully to ensure that the information contained therein is accurate and not misleading. A representative of the county will be asked to execute a certificate that the Official Statement is accurate and not misleading.

Paying Agent Agreement–This is the contract between the county and a bank wherein the county agrees to send the bank funds to make debt service payments and the bank agrees to make the payment to the bondholders. There is often an acceptance fee and an annual fee which will continue as long as the bonds are outstanding.

General Certificate–This document is executed usually by the county judge and county clerk. It confirms the following information: that the county is a political subdivision of the State; the total principal amount of outstanding indebtedness, including the new issue; the debt service requirements for the new issue and all outstanding issues; that the order authorizing the new bond issue is still in force; a list of

county officials; the current valuation of all taxable property in the county; and other related matters.

Signature Identification and No Litigation Certificate–This document is a certificate confirming that the bonds have been executed by the county judge and county clerk and registered by the county treasurer. It also represents that the signatures are genuine.

Purchase Agreement/Bid Form/Investment Letter–Depending on how the bonds are sold, there will be a document evidencing that a purchaser has agreed to buy the county's bonds. In a negotiated sale, it is a bond purchase agreement. In a competitive sale, it is an executed bid form. In a private placement, it is in the form of a placement or investment letter. The purchaser signs the letter and the county accepts it. In a negotiated sale, the bond purchase agreement is very detailed about the terms of the sale and representations of the county. In the competitive sale, much of the same information is contained in accompanying bid documents. In a private placement, the letter is usually a short one- or two-page explanation of the transaction.

Federal Tax Certificate–This document is used with tax-exempt bonds and is executed by a representative of the county, usually the county judge or county auditor. It is dated the date of closing. It sets forth the county's understanding of the transaction, the county's expectations on how the proceeds will be spent and a certification to various matters relating to the arbitrage rules and other matters under the federal tax laws.

Initial Bond and Definitive Bonds–These are the actual securities evidencing the County's obligation to repay a specified principal amount on date certain together with interest. They are based on the form of bond set forth in the Order Authorizing Issuance. The Initial Bond is the bond or bonds submitted to the Attorney General. The Initial Bond is delivered to the paying agent, who will authenticate and deliver the Definitive Bonds to the purchaser. If the bonds are book-entry-only form, they are immobilized and handled only as electronic files.

IRS Form 8038g–This document is executed by a representative of the county, usually the county judge or county auditor, when tax-exempt bonds are issued. It is required by the federal tax laws to be filed in order for the bonds to remain tax-exempt.

Depending on the type of bonds being issued, the following documents may be used:

Escrow Agreement–This document is used for refundings and is the agreement of

a bank to hold the escrowed securities until the bonds being refunded are called for redemption.

Reimbursement Resolution–This document is used if the county needs to expend funds before the bonds are issued on the project and then have the funds reimbursed from the bond proceeds after the bonds are issued.

Resolution Authorizing Publication of Notice of Intent to Issue Certificates of Obligation–The county is required to give notice by publication of a notice of intent to issue certificates of obligation. The commissioners court must authorize the publication of the notice. The notice must be published in a newspaper of general circulation in the county once a week for two weeks, with the first publication being at least 30 days before the proposed date of issuance. This notice alerts the public that the county intends to issue certificates of obligation. If 5% of the registered voters in the county file a petition with the county before the commissioners court authorizes the issuance of the certificates, the certificates must be approved by an election before they can be issued.

Certificate of Approval of Tax Notes–A county can issue tax notes only if the county auditor recommends that they be issued. If a county does not have an auditor, the recommendation must come from the chief budget officer of the county.

Chapter 6

TYPES OF FINANCING COMMONLY USED IN COUNTY DEBT FINANCING

There are various financial instruments available to a county, and different requirements exist for each type of instrument. Some require or may require an election while others do not. The length of time for the financing differs with the type of instrument. Also, the time varies by instrument on the length of time that may be financed. The primary instruments counties use in ad valorem tax-backed financing are General Obligation Bonds, Certificates of Obligation, Contractual Obligations, Tax Notes, Time Warrants and Refunding Bonds. Lease purchase agreements and Revenue Bonds may also be used. The following is a discussion of each of these methods.

General Obligation Bonds

General Obligation Bonds, sometimes referred to as "G.O. Bonds," are bonds secured by the county's ad valorem taxing power. These bonds are issued after approval at a bond election. G.O. Bonds are best suited for major capital projects where the commissioners court believes that it is important to allow the voters to have the opportunity to pass upon the project. The commissioners court calls a bond election, and sets forth the proposition or propositions to be voted on. An amount is specified for each proposition. Costs of issuance of the bonds are included as a part of the issue. G.O. Bonds are sold for cash.

If the election passes, the county must use the proceeds from the sale of the bonds for the purpose stated in the proposition. The amount approved for one proposition cannot be assigned to any other proposition, even if there are excess funds available. Expenditures must be strictly in accordance of what the voters approved. Surplus funds must be placed in the interest and sinking fund and used to pay debt service.

Once the bond election has passed and the time for any election contest has passed, the commissioners court will place the matter on the agenda, and pass an order authorizing the sale of the G.O. Bonds.

The maturity of bonds should be such that they mirror the useful life of the bonds. G.O. Bonds may be amortized over a 40 year period, although market conditions usually dictate a shorter period of 15 to 20 years.

Bid Requirements

In addition to the requirement that the proceeds of the bonds be spent in accordance with the particular proposition approved by the voters, the county is required to spend the proceeds in accordance with the County Purchasing Act. Section 262.023, Texas Local Government Code provides that the county will spend proceeds of a G.O. Bond by (1) complying with the competitive bidding or competitive proposal procedures of the County Purchasing Act; (2) using the reverse auction procedure, as defined by Section 2155.062(d), Texas Government Code, for purchasing; or (3) complying with the alternative procurement methods authorized by Chapter 2267, Texas Government Code,[6] for construction projects.

Because of the complexity of calling a bond election, a separate chapter is included on Bond Elections.

Revenue Bonds

Revenue Bonds, unlike general obligation bonds, do not involve an ad valorem tax pledge. Revenue bonds are secured by the pledge of revenues of a project of the issuer. These bonds are not subject to a demand for payment from taxes. No election is required under state law to issue revenue bonds. Most counties generally do not have projects which will support revenue bonds, although some do. If a sufficient revenue stream exists, revenue bonds could be issued, secured by water systems, toll roads or parks.

The county will be required to set rates that will cover debt service for the bonds being issued and any outstanding bonds, as well as the costs of maintenance and operation of the system producing the revenues. There usually will be a requirement that the county will maintain a debt service coverage ratio, usually 1.10 to 1.25 times the required debt service. Most revenue bonds involve a pledge of net revenues, that is, revenues that are available after the operational expenses of operating the revenue have been deducted. The county will also establish a reserve fund. Often, the county will be required to enter into a trust indenture with a bank so that the revenues are placed in a trust account to pay debt service.

Certificates of Obligation

Certificates of obligation ("CO's") are a streamlined method of financing. They are authorized by the Certificate of Obligation Act of 1971, Subchapter C of Chapter 271 of

[6] For counties, this was formerly found in Subchapter H of Chapter 271, Texas Local Government Code.

the Texas Local Government Code. CO's are limited to certain statutory purposes, which cover most any financing that the county might need to do: (a) pay for construction of a public work; (b) pay for purchase of materials, supplies, equipment, machinery, buildings, lands, and rights-of-way for the issuer's authorized needs and purposes; and (c) pay for professional services such as engineers, architects, attorneys, and financial advisors.

CO’s may be payable from ad valorem taxes, revenues or a combination thereof. Although a CO may be backed solely by a revenue pledge, traditionally if there is a revenue pledge involved, it is a limited pledge of surplus revenues to permit the CO’s to be sold for cash, as explained below.

CO’s may be amortized up to 40 years, just as G.O. Bonds, but a shorter time frame is usually involved. The length of time that CO’s will be outstanding should correspond to the useful life of the project being financed.

No Election Required Unless Valid Petition Presented

Unlike G.O. Bonds that always require an election, the CO’s do not require an election unless at least 5% of the registered voters in the county submit a valid petition protesting the issuance. This should not be viewed as taking away the right to vote on a bond issue, but rather as a method to avoid the time and expense of an election unless the public determines that an election should be held before the CO’s are issued. An election can only be held if a valid petition is received prior to the time the commissioners court votes to approve the issuance of the CO’s. If a valid petition is received, the commissioners court cannot issue CO’s until an election is held. The election is conducted in the same manner as a G.O. Bond election.

To ensure that the public is informed of the possibility of the issuance of the certificates, the legislature has required that notice of intent to issue the CO’s be published once a week for two consecutive weeks in a newspaper of general circulation within the county, with the first publication being not less than thirty days before the date tentatively set for passage of the order authorizing the issuance of the CO’s. The notice and publication must be authorized by the commissioners court. The notice must specify:

(1) the time and place tentatively set for the passage of the order authorizing the issuance of the CO’s;

(2) the maximum amount and purpose of the CO’s to be authorized; and

(3) the source from which the CO’s will be paid, from ad valorem taxes, revenues or a combination of taxes and revenues.

The date chosen for passage must be a regularly scheduled meeting date of the commissioners court, as the date of passage will also be the date for the sale of the CO’s.

CO’s Sold for Cash

CO’s can either be delivered to a vendor for the project or sold for cash. Very few, if any, CO’s are directly placed with a vendor. The county will need to sell the CO’s for cash in order to have funds to pay contractors, equipment suppliers, and costs of issuance. In order to sell CO's for cash, there must be express statutory authority to enable the CO’s. The list for which CO’s may be sold for cash with only a tax pledge is limited. The Certificate of Obligation Act lists the following situations where CO’s may be sold for cash without an additional pledge include: (1) in the case of public calamity, it is necessary to act promptly to relieve the necessity of the residents or to preserve the property of the county; (2) it is necessary to preserve or protect the public health of the residents of the county; (3) in the case of unforeseen damage to public machinery, equipment, or other property; (4) it is for a contract for personal or professional services; (5) work is done by employees of the county and paid for as the work progresses; (6) it is for the purchase of any land, building, existing utility system, or right-of-way for authorized needs and purposes; (7) in the case in which the entire project is to be paid from bond funds or current funds or in which an advertisement for bids has previously been published in accordance with the Certificate of Obligation Act, but the current funds or bond funds are not adequate to permit the awarding of the contract and CO’s are to be awarded to provide for the deficiency; or (8) in the case of a county contract that is not required to be bid under the County Purchasing Act.

The Certificate of Obligation Act also gives a county express authority to sell CO’s for cash without an additional pledge for (1) constructing or equipping a jail; (2) constructing, renovating, or otherwise improving a county-owned building; or (3) constructing a bridge that is part of or connected to a county road or an approach to such a bridge.

Although the listed authority to sell for cash covers many things a county might do, it does not address several items that a county most likely would need, including road construction and equipment acquisitions. To cover these situations, the Certificate of Obligation Act also authorizes CO’s to be sold for cash if there is a revenue pledge

included with the tax pledge. Generally, a limited pledge of revenues is made, such as an amount not to exceed $1,000 or $10,000. There is no requirement or expectation that the pledged revenues will ever be used for debt service. The pledge meets the statutory requirement. Traditionally, landfill revenues have been used for this purpose. As fewer counties have retained landfills, other revenue sources may be used, such as library revenues, park revenues, or revenues for housing out-of-county prisoners, among others. In order to pledge a revenue source, there must be statutory authority to pledge the revenues to support a bond issue. This would eliminate some revenue sources that at first glance might seem to provide a source for the pledge. Also, sales tax revenues are expressly excluded from being used as a pledge under a Tax Code provision.

Limitation on the Use of Certificates of Obligation After a Failed Bond Election

In 2015, Section 271,047, Texas Local Government Code was amended to prohibit the use of CO's for the same purpose that had been presented to the voters in a bond election which failed within the three preceding years. The legislature provided that the three year prohibition on the use of CO's after a failed bond election does not apply to the following situations:

(1) a case of public calamity if it is necessary to act promptly to relieve the necessity of the residents or to preserve the property of the issuer;

(2) a case in which it is necessary to preserve or protect the public health of the residents of the issuer;

(3) a case of unforeseen damage to public machinery, equipment, or other property; and

(4) to comply with a state or federal law, rule, or regulation.

Competitive Bidding

Unless there is an exception, projects to be funded with proceeds from CO's must be competitively bid. The Certificate of Obligation Act contains its own competitive bid requirements which are similar to, but not exactly the same as the County Purchasing Act. In 2011, the competitive bidding requirement for the Certificate of Obligation Act was amended to permit using the alternate construction delivery methods. Prior to this amendment, counties were prohibited from using these methods if a project was to be financed through the use of certificates of obligation. With the amendment, Section

271.054 now reads:

§ 271.054. Competitive Procurement Requirement

Before the governing body of an issuer may enter into a contract requiring an expenditure by or imposing an obligation or liability on the issuer, or on a subdivision of the issuer if the issuer is a county, of more than $50,000, the governing body must:

(1) submit the proposed contract to competitive procurement; or

(2) use an alternate method of project delivery authorized by Chapter 2267, Government Code.[7]

Purposes Combined

Unlike G.O. Bonds which must have the items to be voted on separated, the purposes for CO's are combined. For instance, in a $7,000,000 bond issue, a county would need to have separate propositions on the ballot for the construction of a new jail, road improvements, courthouse improvements and a new communications system. The propositions would be in the following format:

Proposition 1. The issuance of $3,000,000 general obligation bonds to pay for the construction and equipping of a new county jail and the acquisition of a site

Proposition 2. The issuance of $2,000,000 general obligation bonds to pay for the construction and improvement of county roads and bridges

Proposition 3. The issuance of $1,500,000 general obligation bonds to pay for courthouse improvements

Proposition 4. The issuance of $500,000 general obligation bonds to acquire a new communications system

[7] The alternative delivery methods that were formerly found in Subchapter H of Chapter 271 of the Local Government Code were transferred to a new Chapter 2267 of the Government Code.

With CO's, the county would have provided in its notice of intent the following language:

> Authorize the issuance of the certificates of obligation in an aggregate principal amount not to exceed $7,000,000 for the purpose of paying contractual obligations to be incurred for (1) the construction and equipping of a new county jail and the acquisition of a site, (2) the construction and improvement of roads and bridges in the County; (3) construction of courthouse improvements; (4) acquisition of a new communications system; and (5) the payment of professional services and costs of issuance related thereto.

For example, if all the propositions for the G.O. Bond issue were approved and bonds were issued, the county would be required to maintain the allocations. If the jail project cost $3,025,000 and the courthouse improvements only cost $1,475,000, the county could not transfer funds between the two items. With CO's, the county would not be precluded from making transfers from one item where there were surplus funds to an item where additional funds were needed.

Tax Notes

Tax Notes are the most recent addition to the financing options available to counties. They were authorized by the legislature in 1993. The provisions governing Tax Notes are found in Chapter 1431, TEX. GOV'T CODE. Technically, these notes are called "Anticipation Notes" and can be secured by either a pledge of ad valorem taxes or revenues, or both. In order to pledge revenues, there must be specific authority to permit the particular revenue source to be pledged for bonds or similar obligations.

The issuance process is very streamlined. There is no election or publication requirement. Since few counties have enterprise funds that generate sufficient revenues to finance a project, ad valorem taxes are the primary method of financing using anticipation notes. Consequently, the term "Tax Note" is commonly used to describe this method of financing.

Tax Notes may be issued to:

a. Pay for construction of a public work.

b. Pay for purchase of materials, supplies, equipment, machinery,

buildings, lands, and rights-of-way for the issuer's authorized needs and purposes.

c. Pay for professional services such as engineers, architects, attorneys, and financial advisors.

d. Pay for operating expenses or current expenses.

e. Fund the issuer's cumulative cash flow deficit.

Tax Notes have a short maturity which may not exceed seven years from the date of the Attorney General's approval for Notes issued for capital improvements. Tax Notes can also be issued to pay operating expenses or to fund a cash flow deficit and Tax Notes issued for these purposes may not exceed one year from the date of the Attorney General's approval. Additional restrictions are imposed on the percent of revenues or taxes pledged for Notes issued to pay operating or current expenses.[8]

In order to issue Tax Notes, the County Auditor must recommend issuance. No similar restriction is imposed on cities or other governmental entities that are authorized to issue such notes. For counties that do not have a county auditor, the county judge, as the county budget officer, is required to make the recommendation. Section 1431.002(a), TEX. GOV'T CODE.

There are procurement restrictions on using anticipation notes for construction projects. First, in order to use proceeds from anticipation notes for construction projects, the county must comply with the competitive procurement requirements of the Certificate of Obligation Act. Section 1431.012 provides:

§ 1431.012. Restriction on Certain Contracts Payable From Proceeds of Notes

(a) Except as provided by Subsection (b), a county must comply with the competitive bidding requirements of Subchapter C, Chapter 271, Local Government Code, in connection with a contract to be paid from the proceeds of anticipation notes issued for a purpose described by Section

[8] A note issued by an issuer participating in the economic development program established by the Texas Agricultural Finance Authority may have a maturity of up to thirty years. Such notes are limited to a principal amount not to exceed $500,000.

1431.004(a)(1)(A).[9]

(b) Competitive bidding requirements do not apply to an anticipation note or other obligation issued under Section 1431.015[10] for any authorized purpose.

Originally, a county could refund a Tax Note which would mature within seven years of its dated date. The legislature amended Section 1431.009, TEX. GOV'T CODE, to permit refunding up to forty years from its dated date.

Contractual Obligations

Contractual Obligations are a financing tool that is available to counties to finance personal property. They are authorized under Subchapter A of Chapter 271 of the Texas Local Government Code, the Public Property Financing Act, and are payable from a pledge of revenues, funds or taxes, and may not be used to acquire real property. The definition of "personal property" is defined in Section 271.003(9), Texas Local Government Code:

> "Personal property" includes appliances, equipment, facilities, and furnishings, or an interest in personal property, whether movable or fixed, considered by the governing body of the governmental agency to be necessary, useful, or appropriate to one or more purposes of the governmental agency. The term includes all materials and labor incident to the installation of that personal property. The term does not include real property.

The Public Property Financing Act permits a county to enter into a contract to purchase personal property which may be in the form of a lease, a lease with an option or options to purchase, an installment purchase, or any other form considered

[9] Section 1431.004(a)(1)(A) addresses the "construction of a public work."

[10] In response to Hurricane Rita, Section 1431.015, TEX. GOV'T CODE, was added to exempt certain emergency financings from the competitive bid requirement where (1) the governor has issued an emergency proclamation declaring a state of disaster and designating a disaster area under Chapter 418, TEX. GOV'T CODE; (2) the governing body of the issuer (commissioners court) has declared a local state of disaster designating the area affected by the emergency under Chapter 418, TEX GOV'T CODE; or (3) the governor has proclaimed a state of disaster and designated an affected area under Chapter 433, TEX. GOV'T CODE. In such instances, the Attorney General's review process is expedited. Tax Notes issued pursuant to Section 1431.015 must mature within 10 years of the approval by the Attorney General.

appropriate by the commissioners court, including an obligation that is required to be approved by the Attorney General under Chapter 1202, Government Code. If the obligation is in a form that must be approved by the Attorney General, the obligation must be submitted to the Attorney General for approval.

The maximum term of a Contractual Obligation is 25 years, but the term is tied to the actual expected life of the equipment being financed. No election or publication is required, but the county must comply with applicable bidding requirements to make a purchase using Contractual Obligations.

Time Warrants

Time Warrants are one of the oldest and most misunderstood obligations that a county can issue. They are backed by the county's ad valorem tax. Unlike G.O. Bonds, CO's, Tax Notes and Contractual Obligations, Time Warrants are not negotiable instruments. Time Warrants are authorized for counties under Chapter 262 of the Texas Local Government Code.[11] They are expressly exempt from the requirement of Attorney General approval and Comptroller registration by Section 1207.007, Texas Government Code.

A Time Warrant is defined as "... any warrant issued by a county that is not payable out of current funds." Section 262.0022(9), Texas Local Government Code. Time Warrants are subject to the same publication requirements and voter petition/election requirements as CO's, but may not be sold for cash. The vendor can then attempt to sell the warrant to a bank or other purchaser. These requirements are seen in Section 262.025, Texas Local Government Code:

> (a) A notice of a proposed purchase must be published at least once a week in a newspaper of general circulation in the county, with the first day of publication occurring before the 14th day before the date of the bid opening. If there is no newspaper of general circulation in the county, the notice must be posted in a prominent place in the courthouse for 14 days before the date of the bid opening.
>
> (b) The notice must include:

[11] A word of caution. Other statutory procedures exist for issuing time warrants for specific situations, such as Section 1477.152, Texas Government Code, for the purchase of fire fighting equipment. If used, those provisions must be reviewed carefully to ensure that all special requirements are complied with.

> (1) the specifications describing the item to be purchased or a statement of where the specifications may be obtained;
>
> (2) the time and place for receiving and opening bids and the name and position of the county official or employee to whom the bids are to be sent;
>
> (3) whether the bidder should use lump-sum or unit pricing;
>
> (4) the method of payment by the county; and
>
> (5) the type of bond required by the bidder.
>
> (c) ***If any part of the payment for a proposed purchase will be made through time warrants, the notice also must include a statement of the maximum amount of time warrant indebtedness, the rate of interest on the time warrants, and the maximum maturity date of the time warrants.***

(Emphasis added). The election requirement will arise if a valid petition is presented. Section 262.029, Texas Local Government Code provides:

> If before the date tentatively set for the authorization of the issuance of time warrants applying to a contract covered by this subchapter or if before that authorization a petition signed by at least five percent of the registered voters of the county is filed with the county clerk protesting the issuance of the time warrants, the county may not issue the time warrants unless the issuance is approved at an election ordered and conducted in the manner provided for county bond elections under Chapter 1251, Government Code.

These requirements may come as a surprise in that many counties have traditionally sold Time Warrants to a local bank to finance a purchase. Time Warrants must be delivered to the vendor in exchange for the purchase. In some instances, where a county delivered a time warrant to a bank, the bank has treated the Time Warrant as being a tax-exempt obligation. Under federal tax law, only obligations that are properly issued under state law are entitled to have interest treated as tax-exempt. If Time Warrants are used, the county should attempt to make arrangements with a local bank to agree to purchase the

Time Warrant from the vendor. In that instance, the county could issue the Time Warrant to the vendor, and the vendor would be able to assign the Time Warrant to the bank.

Historically, counties used to fund many purchases through Time Warrants issued to vendors. The county would then accumulate a number of warrants and refund them through the issuance of a Refunding Bond, which is a negotiable instrument. Time Warrants are not required to be submitted and approved by the Attorney General. However, if the county wants to refund Time Warrants into a Refunding Bond, the Refunding Bond must be submitted and approved by the Attorney General. In order to refund a Time Warrant, it must have been validly issued. So if the county did not comply with the notice and publication requirements, the Time Warrant cannot be refunded unless it has been validated through a bond validation lawsuit.

Time Warrants are treated the same as G.O. Bonds in regard to the bidding requirements of the County Purchasing Act, including the use of the alternative procurement provisions of Chapter 2267, Texas Government Code.

Refunding Bonds

Refunding Bonds are authorized under Chapter 1207, Texas Government Code. Refunding Bonds are issued by a county to refinance its outstanding bonds by issuing new bonds. Refunding Bonds are generally issued to reduce the county's interest cost by issuing the new bonds at a lower interest rate. Refunding Bonds may also be issued to restructure a county's debt service requirements.

Refunding Bonds are either issued as a current refunding or an advance refunding. A current refunding is where the outstanding bonds being refunded are taken out of the market within 90 days of the closing on the new Refunding Bonds or as an advance refunding where an escrow fund is established to take out the outstanding bonds at a date in excess of 90 days. In either case, the outstanding bonds will be taken out at their call date which is set forth in the order which authorized the outstanding bonds. Refunding Bonds do not require an election or newspaper publication.

The county's financial advisor will determine how best to sell the refunding bonds. This may be done at a regular meeting where all details have been worked out, including the purchaser, the amount of bonds to be refunded, and the par amount of the bonds to be sold. The commissioners court would approve the order resulting in the sale of the bonds and the refunding of the prior bonds or other obligations. Chapter 1207 also provides for the commissioners court to approve the refunding bond order by specifying certain parameters: the bonds that can be considered for refunding, the maximum

principal amount that can be issued, the maximum interest rates for the refunding bonds and the minimum savings that must be produced by the refunding. The commissioners court approves the order authorizing the bonds with certain information not completed, and delegates the authority to complete the sale to one or more county officials who will serve as a pricing officer. The financial advisor will then attempt to arrange for the sale of the refunding bonds in a way that will meet the parameters established by the commissioners court. If the parameters are met, the pricing officer will approve the sale by issuing a pricing certificate which completes the missing information.

Refunding Bonds are submitted to the Attorney General for approval. The obligations being refunded must have been validly issued. If not, the county will have to have the obligation validated as a valid debt under Chapter 1205, Texas Government Code.

In addition to refunding the county's outstanding debt instruments like G.O. Bonds, CO's, and Tax Notes, Refunding Bonds may also be used for any general or special obligation. An example of this type of obligation would be a judgment. If a court approved a million dollar judgment against a county and the county did not have available funds to pay the judgment, the county could issue Refunding Bonds to pay the judgment.

Lease Purchase Obligations

Lease purchase financing can be an efficient, convenient and effective financing tool for counties. Lease purchase financing can be used for both equipment acquisition and real property transactions. It is important to analyze the reason for the lease purchase. The consequences of the acquisition of a new computer and the acquisition of a new jail may be quite different.

Lease purchase agreements that are not participated are not required to be submitted to the Attorney General for approval, but they may be submitted at the option of the county. If the lease purchase agreement is divided into separate securities known as certificates of participation, the certificates of participation must be submitted to the Attorney General for review and approval.

It is important to determine whether the lease is simply a salesman's proposal or a well thought out financing in which the county considered all the alternatives. Generally, your bond counsel or financial advisor will be glad to review the proposal and provide advice on the transaction. Most will do this without additional cost to the county, as a part of their ongoing relationship.

Equipment Financing

Lease purchase financing has become a very efficient and economical method of acquiring equipment and other personal property. Some of the interest rates offered by vendors with their financing programs are very competitive, sometimes on a comparable basis to the rate a county could obtain through the issuance of Tax Notes or Contractual Obligations. Unfortunately, some lease agreements will have rates in excess of what the county could obtain if it did a conventional financing. For the acquisition of a single piece of office equipment, the lease purchase method may be the best method to use. However, it is important to determine what the interest rate actually is. If it is out of line with the rate for a conventional financing, the county should question the rate and if an appropriate rate is not offered, contact other vendors.

A county considering a lease purchase arrangement should make an apples-to-apples comparison to determine the cost of the lease purchase arrangement to that of other forms of financing. First, get the vendor to provide the cost for the item with lease purchase financing and the cost if the county paid cash. While a small equipment lease purchase transaction can be very efficient, it may be less expensive to do a conventional financing transaction for a larger purchase. If in doubt, contact your bond counsel and financial advisor for assistance.

Real Property

With the exception of certain equipment lease purchase arrangements that are structured in compliance with the Public Property Financing Act, Subchapter A of Chapter 271 of the Texas Local Government Code, lease purchase transactions are paid from an annual appropriation from the county's maintenance and operations tax, and are not treated as ad valorem tax debt. Therefore, they go on the maintenance and operations side of the truth in taxation calculation, not the interest and sinking fund debt side. Consequently, these transactions will be subject to roll back, whereas a valid debt obligation is not.

When a county uses a lease purchase transaction for a real estate transaction, it will generally pay a substantially higher amount in costs of issuance. In addition, a developer usually puts together the lease purchase transaction. The developer will arrange for and supervise the construction of the facility. Consequently, there will be a substantial developer's fee included in the financing.

The attractiveness of using lease purchase financing for a real estate project will

require the county to examine whether it would be more appropriate to use traditional financing. An area where the lease purchase method is often promoted is for a county jail or correctional facility. Generally in these transactions, a public facility corporation is created under Chapter 303, Texas Local Government Code, to insulate the county from potential financial exposure. In a jail financing, the concept is that the facility will be paid for primarily through housing out-of-county prisoners for a fee. While this is possible, the county must explore how firm the supply of prisoners will be. To the extent the county does not have sufficient income from housing out-of-county prisoners, the county will be responsible for making up the difference. Should the county choose to exercise its right to not appropriate funds, there are several consequences. First, the county may have to contract with another county to house its own prisoners. Second, while the county may not be obligated for payments once it exercises its right not to appropriate, rating agencies may downgrade the county's bond rating. It is important to fully understand what is involved in the transaction.

Lease Purchase Transaction Must be Properly Structured

Care must be taken to ensure that the lease purchase arrangement is a valid obligation. Unless structured as a debt under the Public Property Financing Act, the lease must provide that the obligation is to be paid from available revenues and that the county may cease to appropriate funds and discontinue the obligation at any time. Some lease purchase agreements contain provisions that violate the Constitution, such as in *City-County Solid Waste Control Board v. Capital City Leasing, Inc.*, 813 S.W.2d 705 (Tex. App.--Austin 1991, writ denied), where the court found a lease purchase agreement for certain machinery constituted an illegal attempt to create a debt and voided the agreement.

Lease Documents Need to be Reviewed and Negotiated

Today, many equipment vendors, both high-tech and heavy equipment, utilize very well written leases that comply with Texas law. They contain subject to appropriation provisions. Unfortunately, there are still some lease document forms that are not properly written. Most lease purchase agreements are presented by vendors. The documents are preprinted, so that the county only has to pass an order to authorize the issue. Very often the county attorney is asked to give an opinion, including the federal tax-exempt status of the transaction. It is important to remember that the lease provisions can be negotiated. Very often lease purchase transactions will provide for a very competitive interest rate; sometimes they do not. A county should consider having the documents and interest rate structure reviewed by its bond counsel to see if the transaction is properly structured and by its financial advisor to see if the interest rate is appropriate. It may be that the financing can be done as a traditional financing in a more

cost effective manner. Sometimes it may not, but it is worth checking.

The County Must Be Prepared to Terminate

A word of caution about using lease purchase agreements. Will the county have adequate revenues to make the payments? Will a maintenance and operations tax increase be required, and if so, will it trigger a rollback election? The answer to these questions, for jail financing in particular, is important. If the jail is to hold the county's own prisoners, it is important to understand how the lease payments will be funded. Unless there is a revenue stream from housing prisoners from other jurisdictions, payments will come from the county's maintenance and operations tax, not its debt service tax. Will the county be able to keep up the payments if the county's economic situation takes a down turn? What will the county have to cut in order to maintain the payments if there is a successful rollback election?

Summary Table

The following table summarizes the most commonly used financing methods:

CAPITAL FINANCING METHODS FOR TEXAS COUNTIES

Instrument	General Obligation Bonds	Certificates of Obligation	Revenue Bonds [2]	Public Property Finance Contractual Obligations	Tax Notes	Lease Purchase
Purpose	General Purpose	General Purpose	Enterprise Systems	Personal Property	General Purpose	Real and Personal Property
Voter Authorization	Yes	No [1]	No	No	No	No
Source of Payment	Taxes	Taxes and/or Revenues	Revenues	Taxes	Taxes	Project Revenues [3] or M&O Fund
Interest Rates	Strongest Credit Best Rates	Same as General Obligation Bonds	Approximately 10-15 Basis Points Higher than General Obligation Bonds and Certificates of Obligation	Comparable to General Obligation Bonds and Certificates of Obligation	Comparable to General Obligation Bonds and Certificates of Obligation	Approximately 50 to 60 Basis Points Higher than General Obligation Bonds or Certificates of Obligation

(1) Publication of notice required; petition during notice period could require election
(2) Not typically available for counties
(3) Certain personal property lease purchase obligations can be structured as ad valorem tax-backed

Chapter 7

BOND ELECTIONS

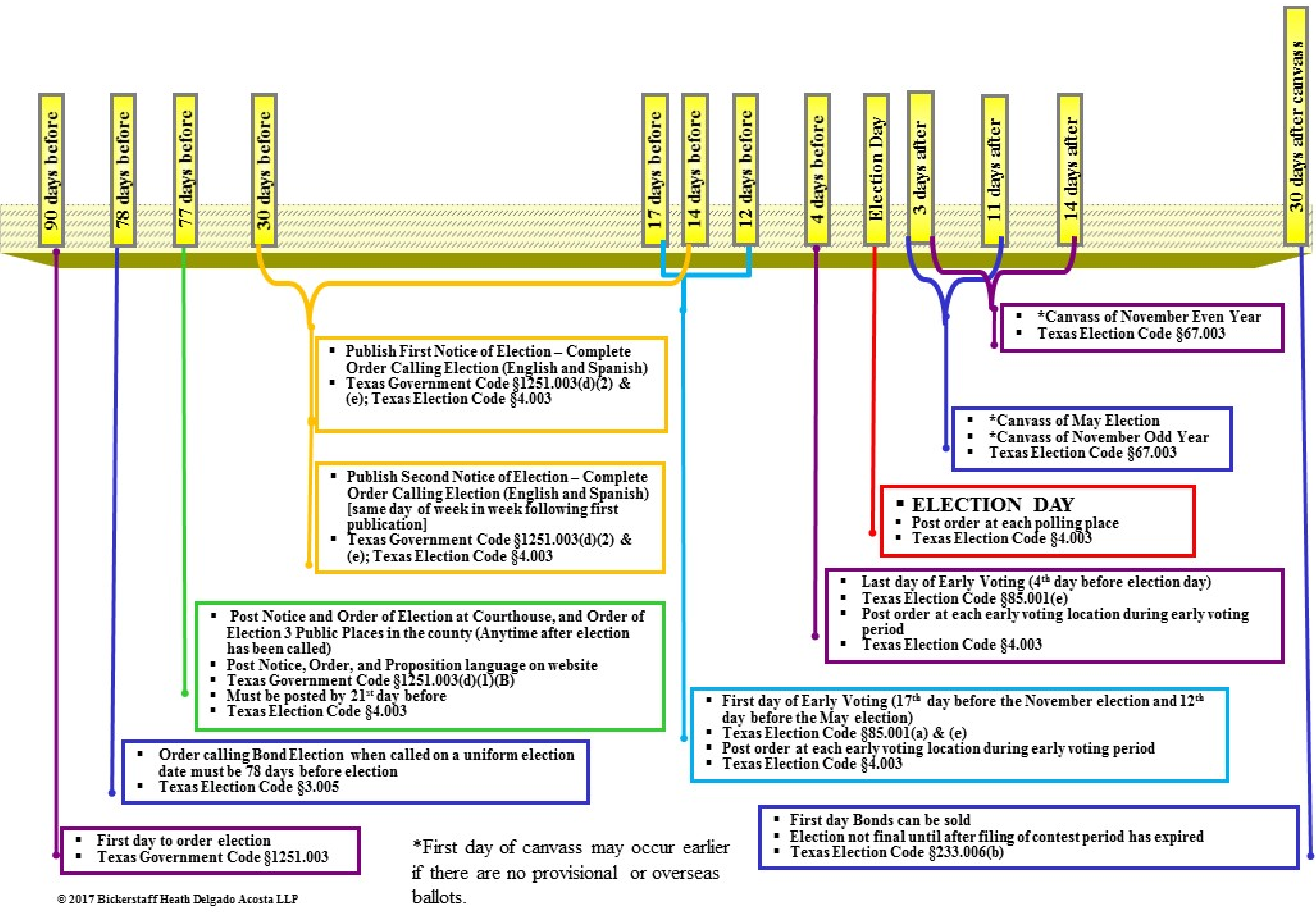
The decision to call a bond election or to use another type of obligation which does not require voter approval rests with the commissioners court. There is no hard and fast rule about when a bond election must be used. Some counties have established a dollar limit as a rule of thumb (for example over $5 million or over $10 million will require an election), depending on the size of the county. Other counties base it on the purpose for which the bonds will be used. If the project is one for which there is an unquestioned need, such as a jail that is about to be closed by the Jail Standards Commission, many counties have used certificates of obligation which only require a vote if the citizens request it. If the project is one where there is a need but may be more discretionary, such as a new exhibition center, a bond election has been viewed as more appropriate.

Several different laws are involved in calling a bond election: Texas Election Code, Texas Local Government Code, Texas Government Code and the Federal Voting Rights Act. These will all come into play once the commissioners court has decided to call a bond election.

Timeline

It is important for the county to have a detailed schedule of events that must occur in calling and conducting a bond election. The following timeline describes the major tasks the county will be required to complete to properly conduct a bond election:

Proposed Timeline for County Bond Election Process



© 2017 Bickerstaff Heath Delgado Acosta LLP

Initially, the county must determine whether it can call a bond election for the particular purpose desired. For example, Chapter 1473, Texas Government Code, contains numerous provisions for issuing bonds for different types of buildings.

Once the county confirms that the election may be called for the particular purpose, the county must determine when it can call the bond election. Bond elections have historically been called on a uniform election date, which now means either the first Saturday in May or the first Tuesday after the first Monday in November, as provided in Section 41.001 of the Election Code[12]. A significant change was made to Section 41.001 in 2011. This change prevents a county from holding a bond election on the May Uniform Election Date in even-numbered years. As amended, Section 41.001 now reads:

§ 41.001. Uniform Election Dates

(a) Except as otherwise provided by this subchapter, each general or special election in this state shall be held on one of the following dates:

(1) the first Saturday in May in an odd-numbered year;
(2) the first Saturday in May in an even-numbered year, for an election held by a political subdivision ***other than a county***; or
(3) the first Tuesday after the first Monday in November.

(b) Subsection (a) does not apply to:

(1) a runoff election;
(2) an election to resolve a tie vote;
(3) an election held under an order of a court or other tribunal;
(4) an emergency election ordered under Section 41.0011;
(5) an expedited election to fill a vacancy in the legislature held under Section 203.013;
(6) an election held under a statute that expressly provides that the

[12] Historically, a county could call a bond election on any day that it thought would be best for the county and its residents. In 2003, the legislature required that bond elections would only be held on one of four Uniform Election Dates. In 2005, the legislature also reduced the number of Uniform Election Dates from four to two, the second Saturday in May and the first Tuesday after the first Monday in November. In 2011, the legislature eliminated the May Uniform Election Date for Texas counties only in even-numbered years. The change to only two Uniform Election Dates will require the commissioners court to consider what other political subdivisions may have on the ballot. There will be more joint elections. This means that some controversial issue from another political subdivision may also be on the ballot which could adversely affect the result of the election.

requirement of Subsection (a) does not apply to the election; or

(7) the initial election of the members of the governing body of a newly incorporated city.

(c) Except for an election under Subsection (a) or Section 41.0011 or a runoff election following an election held under Subsection 9(a)(2), an election may not be held within 30 days before or after the date of the general election for state and county officers, general primary election, or runoff primary election.

(d) Notwithstanding Section 31.093, a county elections administrator is not required to enter into a contract to furnish election services for an election held on the date described by Subsection (a)(2).

(emphasis added).

The effect of this change is that the May uniform election date will not be available to counties for a bond election in even-numbered years.[13]

The order calling the election will set the date of the election. In 2015, the legislature again changed the time for calling an election. Counties are required to call their bond elections no earlier than 90 days before the election. See Section 1251.003(c), Texas Government Code. Section 3.005 of the Election Code requires an election must be called at least 78 days prior to the election date. This will only leave 12 days to call the election in order to comply with the 90 day maximum requirement and the 78 day minimum requirement. The election order will also specify the times that the polls will be open for early voting and election day and will set forth the polling places and the election judges.

Under any circumstance, the court must approve an order calling the bond election. The order will prescribe the measure to be voted, setting out the full proposition(s) and the actual ballot language. The requirements for the content of the order calling the bond election are prescribed in three provisions:

I. Section 1251.002 of the Texas Government Code requires that the County include in the election order the proposition to be voted on and that the proposition to be voted on must distinctly state:

---

[13] This will present a problem for a county which, in the process of issuing certificates of obligation, receives a valid petition. It may cause a year's wait to hold the election.

(1) the purpose for which the bonds are to be issued;
(2) the amount of the bonds;
(3) the rate of interest;
(4) the imposition of taxes sufficient to pay the annual interest on the bonds and to provide a sinking fund to redeem the bonds at maturity; and
(5) the maturity date of the bonds or that the bonds may be issued to mature serially over a specified number of years not to exceed 40.

II. In 2011, the legislature amended Section 52.072 of the Election Code to add a subsection (e) which provides:

> (e) In addition to any other requirement imposed by law for a proposition, including a provision prescribing the proposition language, a proposition submitted to the voters for approval of the issuance of bonds or the imposition, increase, or reduction of a tax shall specifically state, as applicable:
>
> (1) with respect to a proposition seeking voter approval of the issuance of bonds:
>
> (A) the total principal amount of the bonds to be authorized, if approved; and
>
> (B) a general description of the purposes for which the bonds are to be authorized, if approved.

III. In 2013, the legislature added Section 3.009, Texas Election Code, which also contains requirements that must be in the order calling the bond election. Section 3.009(b) provides the following list of requirements that must be in the order calling an election for bond or other voted obligations to be secured by ad valorem taxes:

(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;

(5) a statement of the estimated tax rate if the debt obligations are authorized or of the maximum interest rate of the debt obligations or any series of the debt obligations, based on the market conditions at the time of the election order;

(6) the maximum maturity date of the debt obligations to be authorized or that the debt obligations may be issued to mature over a specified number of years not to exceed 40;

(7) the aggregate amount of the outstanding principal of the political subdivision's debt obligations as of the beginning of the political subdivision's fiscal year in which the election is ordered;

(8) the aggregate amount of the outstanding interest on debt obligations of the political subdivision as of the beginning of the political subdivision's fiscal year in which the election is ordered; and

(9) the ad valorem debt service tax rate for the political subdivision at the time the election is ordered, expressed as an amount per $100 valuation of taxable property.

With the exception of item (5), counties were already required to comply with items (1) – (4) and (6) by Section 1251.002, Texas Government Code, and items (2) and (3) by Section 52.072(e) (1) of the Election Code. The financial advisor should be able to provide this information.

After calling the bond election, Section 1251.003(e) of the Government Code requires that the county must publish notice of the election in the newspaper on the same day of the week for two consecutive weeks. The first notice must be published no earlier than thirty days or later than fourteen days before the date of the election. This notice is the full election order, not the short form that the Secretary of State has promulgated for other elections. It is in addition to the notice required by Section 4.003(c) of the Election Code. In addition to publication, Section 1251.003(d) requires that the notice must be posted on the bulletin board where the commissioners courts' open meetings notices are usually posted and three other public places in the county.

In 2013, the legislature amended Section 4.003 of the Election Code to add a new subsection (f) which requires three additional posting requirements for bond elections, two of which have not been previously required. Section 4.003(f) provides:

> (f) A debt obligation election order required under Section 3.009 shall be posted:
>
> > (1) on election day and during early voting by personal appearance, in a prominent location at each polling place;
> >
> > (2) not later than the 21st day before the election, in three public places in the boundaries of the political subdivision holding the election; and
> >
> > (3) during the 21 days before the election, on the political subdivision's Internet website, prominently and together with the notice of the election and the contents of the proposition, if the political subdivision maintains an Internet website.

Item (2) is already required by Section 1251.003(d). However, items (1) and (3) will require posting that was not previously required. Item (1) will require posting of the order at each polling place. If the county has a website, the order must also be posted on the website.

Other statutes may have more specific requirements which also must be complied with. For instance, in order to call a bond election for a county hospital, Section 286.021, Texas Health and Safety Code, requires that the commissioners court receive a petition from voters requesting the election before it can be called and then the Court prescribes the measures to be voted on.

Federal Voting Rights Act

A bond election is a special election, even if it is held in conjunction with the General Election. Previously, the county was required to submit the election to the United States Department of Justice for review pursuant to the Voting Rights Act. This changed with the decision by the United States Supreme Court on June 25, 2013 in *Shelby County, Alabama v. Holder*, 133 S.Ct. 2612 (2013), in which the Court held that it is unconstitutional to require states to obtain advance approval from the federal government before election laws can take effect. This applies to calling of an election. Recently the Beaumont Court of Appeals in *Rodriguez v. Beaumont Independent School District*, 413 S.W.3d 524,

(Tex.App.–Beaumont 2013, no pet.) held: "as federal law no longer requires BISD to obtain preclearance to conduct its elections and it must now comply with State law."

Canvass

The commissioners court will set a date to canvass the vote. Under Section 67.003 of the Election Code, the canvass must take place not less than the 8th day after the election or more than the 11th day after the election in a November odd year election, not less than the 8th day after the election or more than the 14th day after the election in a November even year election, and for a May election date[14] the canvass must take place not less than the 3rd day or more than the 11th day after the election. The county must post an Open Meetings agenda for the meeting. It is important to set this date before election day. The order canvassing the election establishes the beginning of the 30-day period in which an election contest may be filed.

Elected Officials Need to Affirmatively Support the Bond Election

If a commissioners court decides to call a bond election, it should only do so if the members of the court are ready to support the election. If the court is not willing to mount a campaign to provide information on the measure, it is better not to call the election. Either use another type of financing or do not do the project. Unless the need for the bonds is explained and understood by the voters, the bonds probably will not pass.

---

[14] The 2011 amendment to Section 41.001 of the Texas Election Code only permits a county to have an election on the May uniform election date in odd-numbered years.

No Political Advertising

The most important thing to remember is to deal honestly and fairly with the public and present them with enough factual information so that they can make an informed decision. This task becomes more complicated in that the county cannot engage in advertising to promote the passage of the bonds.

Counties, like other political subdivisions in Texas, are prohibited from engaging in political advertising. Section 255.003(a) of the Texas Election Code prohibits an officer or employee of a political subdivision such as a county from spending public funds for political advertising. This prohibition against the use of public funds to finance political advertising is a broad one. Public funds are all funds that are collected by the county and used for public purposes. Included in the prohibition are county property and services, such as computers, copiers and other office equipment, county internal mail systems and the use of county employees to support the election.

When we refer to "political advertising," we mean communications that either support or oppose the bond election. For this purpose, advertising encompasses communications that, in return for consideration, appear on or in the radio, television, newspapers, magazines, and other publications as well as pamphlets, circulars, fliers, billboards or other signs, bumper stickers, or similar forms of communication.

Section 255.003(b) of the Texas Election Code does allow counties and other political subdivisions to expend funds to publish information about the purpose of a bond issue as long as the "communication does not advocate passage or defeat of the measure." That means that factual communication about the bond election and its purpose can be made by the county and county officials. However, care must be taken so that the communication neither advocates for the passage or the defeat of the bond proposition. For example, the following county funds may be used to provide information concerning:

- The date of the election
- The amount of the bond issue
- How the proceeds from the bond sale will be used
- What facilities will be affected by the bond measure

A word of caution. There is no list of *"magic words"* that constitute support or opposition for a measure or candidate. The Texas Ethics Commission, in enforcing these laws, has not focused on particular phrases such as "vote for" or "vote against" a particular measure. It has taken a broader approach. It is impermissible to combine a campaign

slogan with the facts of a measure. For example, in 1999, the Texas Ethics Commission fined the Superintendent of Northeast Independent School District for using school funds to "promote" the school district's bond issue. The school district bought a six page insert in the newspaper that described the bond projects. The Ethics Commission found that the Superintendent violated the law by writing one sentence in one article in the insert that merely stated, "Our citizens now have the opportunity to position the NEISD for the 21st Century."

Follow the Law and Avoid Sanctions

While the county can make factual information available without violating the election laws, it must use extreme care to make certain that what it communicates does not cross the line of being prohibited political advertising. Violations of these statutes can result in complaints being filed with the Texas Ethics Commission or criminal prosecution. Violating Section 255.003 of the Texas Election Code, which prohibits the use of county funds for political advertising, is a Class A misdemeanor. The Ethics Commission has strictly interpreted the prohibition on the use of public funds for political advertising. Obviously, since the line between advocacy and dissemination of factual information may not always be clear, care should be taken to be sure that any material from the county that might fall within the definition of advertising does not advocate a particular vote.

Legal counsel should assist the county in its review of any informational material. Most bond counsel will review proposed information to see if it might pose a problem as a part of the standard services provided to the county in a bond election. The Ethics Commission also can assist. While the Ethics Commission does not pre-approve factual communication, Ethics Commission staff will advise political subdivisions based on their experience whether proposed language in the factual communication is likely to violate the law. Contact the Texas Ethics Commission at 1-512-463-2989 or through its website: www.ethics.state.tx.us.

When involved in a bond election, communications regarding a measure on the ballot (*i.e.,* calls from the press or public) must avoid the appearance of partiality. The problem for county staff is much more of a problem than for an elected official in giving oral presentations and interviews. While on county time, staff should be made to limit statements to purely factual or objective information and avoid any subjective opinions or personal views on the issue. If appropriate, it may be useful for the speaker to mention that, as a public officer or employee, he or she is prohibited from advocating for the passage or defeat of the election.

For elected officials, care should be taken to avoid advocating for the passage of the bonds while in county offices or using county equipment. A county judge or commissioner can certainly advocate the need for the bonds at public meetings and civic groups.

Establishing Citizen Support

Because of the limits on political advertising to support a bond issue, it is important to get residents of the county involved in supporting the bonds. The citizens can do what the county cannot—advocate for passage. One way to demonstrate support is to establish a citizens committee to support the bonds. This would be done by either establishing a Specific Purpose Campaign Committee if for a single bond issue or if for multiple issues, a General Purpose Political Committee. The committees will have to file the appropriate campaign finance reports.

Citizen support does not spring up overnight. The county may want to have an advisory committee established a sufficient time before calling the election and let the committee make recommendations on what projects are needed. Once the advisory committee has made its recommendations, the group that made up the advisory committee can be reconstituted as a Specific Purpose Political Committee or a General Purpose Political Committee.

Chapter 8

FEDERAL INCOME TAX EXEMPTION

Most bonds issued by counties are issued on a tax-exempt basis; that is, interest income to the owner of the bond is excluded from federal income taxation. Section 103 of the Internal Revenue Code provides that for purposes of federal income taxation, gross income does not include interest on any state or local bond, that is, an obligation of a state or political subdivision thereof. Exceptions to this are private activity bonds, arbitrage bonds and bonds that are not in registered form.

The federal income tax exemption is in essence a subsidy for counties. Because the interest received by the bondholder is not subject to federal income tax, the bondholder is willing to receive a lower interest rate than that paid on bonds offered by the federal government and the private sector. The interest rate savings depends on the federal income tax rate. If the bondholder pays a federal tax rate of 28%, then $100 of taxable interest is only worth $72. If a taxable bond pays $100 of interest, historically, the tax-exempt bond would only have to pay between $72 and $90. This means that a county would save between $28 and $10 in interest each year compared to a private sector bond issuer. For example, if the taxable interest rate for an equivalent private sector bond would be 5%, the tax-exempt rate would be between 3.6% and 4.5%.

Investing in tax-exempt bonds is only advantageous to taxpayers that pay a high rate of federal income tax. Because only certain investors are interested in purchasing tax-exempt bonds, this has resulted in the creation of a separate market where counties can borrow at interest rates lower than the interest rates in the private sector.

Effect of Federal Income Tax on Investment
Taxable vs. Tax-Exempt

	5.0% Interest Rate Taxable	4.00% Interest Rate Tax-Exempt
Pre Tax Income	$ 5,000	$ 4,000
Federal Tax 28%	$ 1,400	0
After Tax Income	$ 3,600	$ 4,000

Consequently, the county is able to have a savings by borrowing money at a lower

rate than the private sector and still attract investors who can retain more of their investment income after taxes than they could at a higher taxable interest rate.

Under Section 265(d) of the Internal Revenue Code, a county that expects to issue no more than $10 million (certain bonds do not count against this limit) in a calendar year can designate its bonds as "Bank Qualified" or "qualified tax-exempt obligations." This permits a financial institution which purchases the bonds to receive an 80% tax deduction for the interest cost on deposits used to purchase the bond issue. This makes the bonds more attractive to a financial institution. The interest rate on a Bank Qualified bond is generally 0.12% to 0.30% lower than a bond which is not Bank Qualified.

Because the federal government regards this as a federal subsidy, it has imposed very strict requirements relating to the issuance, investment of money prior to expenditure, uses of funds and other provisions that must be adhered to at the time the bonds are delivered and while the bonds are outstanding. Only bonds that are legally authorized and validly issued pursuant to the borrowing authority of the county can be tax-exempt. This may require approval by the Attorney General of the State of Texas prior to the issuance of the bond. Because of the complex rules applicable to tax-exempt status, it is customary for the purchaser or underwriter of the bond to demand the formal opinion of bond counsel that the bonds are tax-exempt. In providing its opinion, bond counsel will ascertain whether the county is in compliance with the federal tax requirements and that the county is able to take the actions required to maintain the tax-exempt status of the bonds. These requirements are usually set forth in detail in a nonarbitrage certificate or federal tax certificate of the county. Bond counsel prepares the certificate, but the county official signing the certificate is responsible for its factual accuracy.

In the bond order, the county will obligate itself by covenanting and representing to take or refrain from taking certain actions with respect to the bonds. Among the certifications and requirements for the issuance of tax-exempt obligations that are contained in the bond order and/or the tax certificate, are the following:

- The county will not take any action to permit the interest on the bonds to become taxable.
- File the appropriate Form 8038.
- The county will not permit the bonds to become private activity bonds.
- There is no federal guaranty for the bonds.
- The county will comply with the investment requirements that are designed to prevent impermissible arbitrage.
- The county will, if required, calculate and pay arbitrage rebate amounts,

when due to the United States.

- It will maintain all investment records to permit compliance with the tax-exempt requirements for at least six years after the final principal and interest payment on the bonds.

While it would appear that the rules prohibiting investment of bond proceeds at a yield that is substantially in excess of the yield on the bonds are similar to the arbitrage rebate rules, there are important differences. The arbitrage investment rules are much older and were designed to limit arbitrage, not eliminate it. In the case of financing capital improvements, the county will usually be permitted to invest the proceeds from the sale of the bonds and investment income for three years (investment income may be invested at an unrestricted yield for the longer of three years from the date the bonds are issued or one year from the date of receipt) from the date the bonds are issued without any yield restriction. Money placed in a debt service fund may be invested at an unrestricted yield for up to 13 months (investment income can be invested without restriction for one year). Since the bond proceeds are invested in taxable obligations, the yield on the bond proceeds may exceed the yield on the bonds. In the case of an advance refunding (the refunded bonds will not be redeemed in 90 days or less), the escrow may be invested at an unrestricted yield for a maximum of 30 days.

The arbitrage rebate rules require that all investment income on nonpurpose investments in excess of the yield on the bonds be paid to the U.S. government every fifth year that the bonds are outstanding. A final payment is due when the last bond matures or is redeemed. In lieu of calculating rebatable arbitrage, the county may make an irreversible election to pay a rebate penalty of 1.5% on the amount of unexpended bond proceeds. This penalty is calculated and paid every six months. This penalty should not be elected without discussion with a financial advisor. The calculation of arbitrage rebate permits a reduction of the rebate payment by $1,000 a year to partially cover the costs of calculating the rebate deposit. If there will be no rebate payment due, then nothing needs to be sent to the Internal Revenue Service ("IRS"). There are two types of exemptions from the payment of arbitrage rebate—the small issuer exemption and the spending exemptions. The small issuer exemption from filing arbitrage reports applies to counties who will not issue more than $5 million in the current calendar year. The spending exemptions are six months, eighteen months and two years. The spending exemption applicable to a specific bond issue should be discussed with the financial advisor or bond counsel. If a spending exemption is satisfied, then the county will be permitted to keep its excess investment earnings.

The usual county bond issue is a governmental bond where there is no private use component, such as road improvements, county jail construction or other infrastructure

improvements. However, as time passes, things might change that could result in a problem with the tax-exempt status. The county might lease its jail to a private jail operator. It might enter into a long term contract to house federal prisoners in over 10% of its beds in the jail. If the county has outstanding tax-exempt bonds on the jail, it has created a problem with the tax-exempt status. The project financed by the tax-exempt bonds is now being used for a private purpose (the federal government and charitable organizations are treated as private businesses for this purpose). In determining whether a bond is a private activity bond, there are two tests:

(a) **The Private Loan Test.** If more than the lesser of 5% of the proceeds of the bonds or $5,000,000 are loaned to a nongovernmental entity, the private loan test is satisfied and the bonds are private activity bonds.

(b) **The Private Business Tests.** If the private business use test and the private security or payment test are both satisfied, the bonds are private activity bonds.

(1) Private Business Use Test which prohibits the use of more than 10% of the bond proceeds, including property financed with the bond proceeds, in the trade or business of any person other than a governmental unit, and

(2) Private Security or Payment Test which provides that no more than 10% of the payment of principal or interest on the bonds may be secured, directly or indirectly, by property used in the trade or business or derived from payments related to property used in the private trade or business.

10% is reduced to 5% each place it appears if the private use is unrelated or disproportionate to the county's use financed by the bonds.

A private business use may arise if a nongovernmental entity or person has actual ownership of the property, actual or beneficial use of the property pursuant to a lease, or a management or incentive payment contract, or certain other arrangements such as a take or pay contract. Certain management contracts described in Revenue Procedure 97-13 are not treated as private use. Certain short term agreements for use of property may also be disregarded in determining whether the 5%/10% thresholds are satisfied. Use by a private business on the same basis as the general public's use of the bond financed facility is also disregarded.

If a tax-exempt bond financed project is sold or the use of the project is changed

before the bonds are retired, remedial action may be necessary to ensure this change in the use of the project does not cause the bonds to become taxable. It is important to work with bond counsel before an action is taken that would cause bonds to become taxable so that remedial action can take place. It may be that bonds will have to be redeemed (and if not subject to current redemption, defeased) or that the proceeds are used for another governmental purpose.

The bond issue is subject to audit by the IRS. Should the county be the subject of an audit, the manner in which the county has used the proceeds of the bonds will be reviewed for compliance with the tax-exempt requirements. It is important for the county to keep good records of how the bond proceeds were spent to establish that the county has taken appropriate steps to maintain the tax-exempt status of the bonds. When the county sells its bonds, the bond proceeds are not commingled with the county's general fund. Separate accounts are established as required by the bond order. Generally, in a new money issue, there will be a construction or bond fund established at the county's depository which will be used for the project being financed and an interest and sinking fund. These funds will include not only money being placed in them, but also any investment earnings the county receives. It is the county's records of how and when the money in these funds is used that will need to be accounted for.

In 2008, the IRS announced that it would begin a plan to send out post-issuance compliance surveys to governmental issuers in an attempt to encourage compliance with the tax laws, especially in the area of document and record retention to show compliance with the arbitrage rules. The IRS has amended its reporting requirements in Form 8038g to inquire about whether the issuer has written procedures to ensure compliance with IRS requirements. The IRS will want to see whether the county has complied with its covenants in the order authorizing the bonds or its no-arbitrage certificate. The IRS will want to know what procedure the county has in place to ensure compliance and whether such procedures are written.

Should the IRS determine that there is a problem in the way the county has treated its bond proceeds, the IRS could declare the interest on the bonds is taxable retroactive to the date of issuance. Generally, the IRS will pursue a policy of taxing bondholders only as a last resort and has expressed a preference to resolve tax-exempt bond infractions with other parties to the bond transactions, including the issuer. Consequently, the county will have the opportunity to remedy the problem and protect those who purchased its bonds. There are formal and informal settlement procedures available. The cost of bringing bonds back into compliance can be expensive and may involve redeeming outstanding bonds and payments to the IRS. This can prove to be a better solution than to allow the IRS to go after the bondholders, since this may subject the

county to litigation from those that purchased the bonds because those purchasers have (1) lost the benefit of their tax-exempt income from their investment in the bonds, and (2) they have also incurred income tax liability for amounts that should have been paid but were not paid because the purchaser had relied on the county's representation that it would take no action that would cause the bonds to become taxable.

Chapter 9

SECURITIES ISSUES

Bonds are securities. The bonds are exempt from the registration requirements, but are subject to the anti-fraud provisions of both state and federal law.

When bonds are sold by competitive sale or negotiated sale, an offering document is prepared called an "Official Statement." It is prepared by or on behalf of the county in connection with a primary offering of the bonds that discloses material information about the county and the bonds. Investors may use this information to evaluate the credit quality of the securities. Although functionally equivalent to the prospectus used in connection with registered securities, an Official Statement for municipal securities is exempt from the prospectus requirements of the Securities Act of 1933.

The Official Statement provides prospective buyers of the county's bonds with information on the county and its financial condition. It reflects why the bonds are being issued and under what authority. It sets out the maturity schedules, interest rates and whether the bonds may be called prior to maturity. It will reflect whether the bonds are backed by bond insurance and whether they are rated. It will address any specific risks associated with the county. It will also address tax covenants and a promise by the county to make certain disclosures over the life of the bonds so that the market is aware of the county's financial condition and any particular information concerning the bonds.

What would be a special risk? If a county had an industrial plant located in the county that was responsible for a large part of the county's tax base, a prospective purchaser would want to know that fact in order to assess the risk in purchasing the bonds and that they would be paid if the industry ceased to exist as a result of a plant closing or bankruptcy. Should the county be aware of a potential change at the plant that would impact tax collections, it would be incumbent to disclose that information, especially if the draft of the Official Statement was touting the significant contribution that the company was making to the economic condition of the county. It is important for the county to read the Official Statement to ensure that the statements made about the county are true. While this document is generally prepared by the financial advisor, it is the county's document and the county is responsible for the representations made.

Continuing Disclosure Requirements

The Securities and Exchange Commission continues to strengthen its regulatory authority over municipal securities. Rule 15c2-12 imposes continuing requirements on

counties and other municipal issuers to make annual filings of financial information, such as audited financials, and to notify the public of changes that are material to the issuer's financial condition. If a county issues more than $1,000,000 in bonds, it must make a continuing disclosure undertaking unless it qualifies for an exemption. The bond order will provide that the county agrees to comply with the federal disclosure requirements. In addition to the annual filing of financial information, there are now fourteen events that must be disclosed in a timely manner with respect to the bonds being offered:

- Principal and interest payment delinquencies;
- Non-payment related defaults, if material;
- Unscheduled draws on debt service reserves reflecting financial difficulties;
- Unscheduled draws on credit enhancements reflecting financial difficulties;
- Substitution of credit or liquidity providers, or their failure to perform;
- Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax status of the bonds or other material events affecting the tax-exempt status of the bonds;
- Modification to rights of security holder, if material;
- Bond calls, if material and tender offers;
- Defeasances;
- Release, substitution or sale of property securing repayment of the bonds, if material;
- Rating changes;
- Bankruptcy, insolvency, receivership or similar event;
- The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- Appointment of a successor or additional trustee or the change of name of a trustee, if material.

In addition, the county must disclose in connection with future bond issues whether it has complied with its prior undertakings. The federal regulations are enforced, not directly against the county, but instead upon the underwriter who wants to purchase the bonds. If a county is not in compliance, the underwriter is not permitted to purchase the

bonds.

The greatest problem is getting timely audits from the county's outside auditor. Several counties have had to delay the sale of bonds and other obligations because of delayed audits. Counties should consider building completion deadlines in contracts for outside audit services.

Disclosure is now made to the Municipal Securities Rulemaking Board ("MSRB") through the Electronic Municipal Market Access System ("EMMA"). Documents are filed electronically at http://emma.msrb.org/.[15]

If a county bond issue is less than $1,000,000, it is exempt from the continuing disclosure requirements unless the county agrees that it is subject to the continuing disclosure requirements. Also, transactions that are structured so that the minimum denomination is at least $100,000 are entitled to an exemption. Certain private placement transactions, primarily made directly with a bank, may also be exempt.

The Securities and Exchange Commission is Serious About Continuing Disclosure

The Securities and Exchange Commission ("SEC") has been very vocal about the need for timely disclosure in the municipal market. In 2014, the SEC initiated its Municipalities Continuing Disclosure Cooperation Initiative ("MCDC"). The MCDC is a self-reporting initiative for underwriters and state and local governments to report misstatements in Official Statements regarding prior compliance with Continuing Disclosure Undertakings. The MCDC initiative was to promote municipal issuers and underwriters to self-report inaccurate statements made in offering documents in return for a more favorable settlement than if the SEC discovered the violations.

For an issuer, compliance with its continuing disclosure undertaking is important because failure to comply can result in underwriters being prohibited from purchasing that issuer's bonds. To date, the SEC has not announced settlements with issuers who self-reported. For underwriters, the SEC in July 2015 announced settlements with 36 underwriting firms wherein the underwriters paid $9.3 million to settle with the SEC. The individual settlements were as low as $40,000, but most were between $100,000 and $500,000. This got the underwriters' attention. Issuers will need to be very careful how

[15] Filing through EMMA has replaced the filings with the Nationally Recognized Municipal Securities Information Repositories and the Texas State Information Depository.

they represent information in offering documents. A major point made by the SEC is a representation by an issuer in an offering document that it is in compliance with its prior continuing disclosure undertakings when it is not. An issuer can fail to timely report the information it promised to make when it sold its bonds.

The market needs current and accurate financial information. Filing such information late or failing to file altogether is something the SEC takes seriously. Counties should be proactive to ensure timely filings. A county can sign up with EMMA to provide reminders when disclosure deadlines are approaching. Counties need to impress upon their outside auditors to provide their audits in a timely manner.

Chapter 10

ANNUAL REPORTING REQUIREMENT

A new reporting requirement was imposed on all political subdivisions, including counties, by the legislature in 2015 and will apply only to a fiscal year ending on or after January 1, 2016. It is codified as Section 140.008, Texas Local Government Code, which requires the political subdivision to annually compile and report certain financial information in a specific manner as prescribed by that section.

The county must report:

(A) the amount of all authorized debt obligations;
(B) the principal of all outstanding debt obligations;
(C) the principal amount of each outstanding debt obligation;
(D) the combined principal and interest required to pay all outstanding debt obligations on time and in full; and
(E) the combined principal and interest required to pay each outstanding debt obligation on time and in full.

The amounts required in items (A) – (E) are limited to authorized and outstanding debt obligations secured by ad valorem taxation, expressed as a total amount and as a per capita amount, as well as projected per capita amount as of the last maturity date of the most recent debt obligation. The report is to include an explanation of the payment source for the different types of debt.

The county is also required to report the following information for each debt obligation:

(i) the issued and unissued amount[16];
(ii) the spent and unspent amount;
(iii) the maturity date; and
(iv) the stated purpose for which the debt obligation was authorized.

The report is to include the current credit rating given by any nationally recognized credit rating organization to the county's debt obligations.

---

[16] This is the language in Section 140.008. For a debt obligation there is no unissued amount. Presumably this means the authorized, but unissued amount remaining from a voted bond proposition.

The commissioners court is required to ensure that the county's annual report is made available for inspection by any person and is posted continuously on the county's Internet website until the county posts the next annual report, and that the contact information for the county's main office, including the physical address, the mailing address, the main telephone number, and the e-mail address is continuously posted on its Internet website.

As an alternative to actually providing an annual report, a county may provide to the Comptroller of Public Accounts the information required for the annual report, along with any other information the Comptroller may require in the manner prescribed by the Comptroller. The Comptroller will then post such information on the Comptroller's Internet website, where the information will be easily located by searching for the name of the county. If the county maintains an Internet website, it is required to provide a link from its website to the location on the Comptroller's Internet website where the county's financial information may be viewed. The Comptroller is charged with promulgating rules necessary to implement this function.

A similar alternative is also available for a county with a population of less than 35,000. Rather than providing an annual report, it may provide to the Comptroller of Public Accounts a document which contains the required information, and the Comptroller will post the information from the document on the Comptroller's Internet website. If the county maintains an Internet website, the county shall include a link on its Internet website to the Comptroller's Internet website and the web page where the information may be viewed.

While these requirements may seem daunting at first, much of the required information is assembled by the county's financial advisor each time there is a new debt issue. The county may need to request assistance from its financial advisor and bond counsel to update the information.

Chapter 11

FINANCING A COUNTY JAIL

Planning and coordination is important in planning a construction project. Probably the most common construction project that most counties will have is the financing and construction of a new jail or an expansion of an existing jail. The professionals most often used in a jail project are the financial advisor, bond counsel and architect, although other professionals are often involved. It is important that the county involve its financial advisor and bond counsel as early in the planning process as possible, even before an architect is retained. The bond counsel and the financial advisor can discuss which method of financing will be most efficient for the county based on the county's time frame and needs. They can provide practical insight on other jail projects and identify where problems have arisen. They can assist the county in its preparing for initial expenditures and have a reimbursement resolution ready when and if the county needs it. Unlike the architect, engineers and other professionals involved in the project, the county should have no out-of-pocket expense with bond counsel and financial advisor since they will be paid only if the bonds are issued.

After getting its financial advisor and bond counsel on board, the county should next hire an architect. It is important to have one who is experienced in designing a jail according to the requirements of the Texas Jail Standards Commission. Jail design is very different from designing a courthouse, an office building or a school. Remember, the plans must be approved by the Jail Standards Commission.

Architects tend to use an "AIA" contract, a preprinted contract designed by the American Institute of Architects. While the AIA contract forms are generally good, they tend to favor the Architect over the Owner (the county). As an example, the AIA Standard Form of Agreement between Owner and Architect (both the B-141 and the B-151 forms) permit the Owner to use the Architect's plans and specifications only for the particular construction project described in the contract and expressly prohibit the plans to be used "for future additions or alterations" to the project without the prior written consent of the Architect. The Standard AIA Form Agreement also waives consequential damages, which limits the Owner's ability to recover damages in the event of design errors and does not require the Architect to maintain professional liability insurance, which is the main coverage that insures against loss resulting from design errors. Consequently, if the county wants an architect agreement that has provisions different from these, the county should either use an AIA form that has been modified by the county's attorney to represent the interests of the county or it should use a different, more favorable, architect agreement form. In addition, the county should revise the document

to provide that the architect will provide new drawings without additional cost to the county if the amounts bid on the contract exceed the architect's estimated construction cost. The modification to the AIA documents is done by either lining out certain provisions and adding replacement provisions in an attachment at the end of the AIA contract document or making the changes using the electronic version of the AIA document. The author prefers using a more county friendly manuscript contract, because the extensive number of changes to the AIA contract form needed to protect the county makes using the AIA document cumbersome. In any event, the resulting contract should be more "county friendly" so that the county and the architect are placed on a more equal relationship under the contract.

Because the architect will be billing the county from the moment he or she is hired, it is important to limit initial expenses and wait until after the financing has been approved before approving and authorizing additional expenses. The county should provide limitations in the contract for the amount that the architect will charge for this preliminary work in the event the county does not close on the financing. There are many reasons why the financing might not close. The most common would be that a bond election failed. Other reasons could be the inability to sell the bonds or a diminished need for the jail project, such as a reduction in the number of prisoners or finding another facility to house the prisoners in a less expensive manner than financing new jail bed construction.

To prepare for a jail financing, the county should first have the Jail Standards Commission provide the county with a needs analysis. Often architectural firms will offer to provide a needs study to suggest the proper size of the facility. However, the Attorney General will not approve bonds or other financial obligations unless the Jail Standards Commission has approved the size as appropriate.

Once the Jail Standards Commission has provided a recommended size of the facility, the county should have the architect prepare initial plans that will be sufficient to provide a good estimate of the projected cost of the jail. As previously noted, there should be limits on how much the initial cost estimate will cost. It is also recommended that the contract documents provide that the architect is not authorized to proceed to the next phase and charge the county until financing has been approved.

Once the estimated cost of the jail facility is determined, the county will need to meet with its bond counsel and financial advisor to determine which method of finance will be most appropriate. Generally, jail projects are financed with a debt instrument that is backed by an ad valorem tax pledge. In some instances a revenue backed instrument might be appropriate.

A determination will be made by bond counsel on whether the county can use tax-exempt financing for the jail project. The type of prisoner that will be housed can adversely impact whether tax-exempt financing will be available. For facilities that house county prisoners or state prisoners, tax-exempt financing should be no problem. If the county is going to house federal prisoners, financing may have to be on a taxable basis unless the county contracts with the federal government using a short term contract that is for no longer than 100 days, although such a contract can be automatically renewable unless cancelled by one of the parties. Also, should the county decide to use a private operator to run the facility, it will have to use a management agreement that meets IRS requirements in order to use tax-exempt financing. The county will need to carefully review these issues with bond counsel before proceeding. The IRS has been auditing county facilities that were financed on a tax-exempt basis that primarily house federal prisoners.

Most county jail projects will use ad valorem tax backed debt instruments, such as general obligation bonds, certificates of obligation and in some instances tax notes. Tax-backed financing is the most efficient and least expensive method of finance for these projects. However, in some instances, a revenue backed obligation may be used, usually in the form of a lease purchase agreement. Although lease purchase arrangements may provide a convenient, efficient form of financing, promoters of this method are often developers who come to the county with the financing already arranged. Because the developer has arranged the financing, it may not be the best deal for the county.

The county must analyze the reason for using the lease purchase financing. It is often represented that the revenues from the jail will pay for the project and that no tax levy will be required. While no debt tax levy is involved with a lease purchase financing, the county must first determine whether there will be adequate prisoners from other jurisdictions to cover the debt service. Most important is what will happen if the prisoners from other jurisdictions are removed. Will the county be able to afford the debt service? Will the county have a place to house its own prisoners? If a substantial number of prisoners from other jurisdictions are not available, the county will be paying for the jail through its maintenance and operations tax revenues, not a debt tax levy, so that a roll back situation may arise. A county considering a lease purchase arrangement should make an apples-to-apples comparison to determine the cost of the lease purchase arrangement to that of other forms of financing. The county's regular bond counsel and financial advisor should be asked to review the proposal because the county may not have adequate resources in-house to fairly evaluate the proposal and the risks involved.

Chapter 12

ENERGY SAVINGS PERFORMANCE CONTRACTS

One form of contract may not be recognized as a financing contract. Those contracts are Energy Performance Contracts under Chapter 302 of the Texas Local Government Code. Energy Savings Performance Contracts are defined in Section 302.001(4) as:

> "Energy savings performance contract" means a contract with a provider for energy or water conservation or usage measures in which the estimated energy savings, increase in billable revenues, or increase in meter accuracy resulting from the measures is subject to guarantee to offset the cost of the energy or water conservation or usage measures over a specified period. The term includes a contract for the installation or implementation of the following in new or existing facilities, including all causally connected work:
>
> (A) insulation of a building structure and systems within the building;
>
> (B) storm windows or doors, caulking or weather stripping, multiglazed windows or doors, heat-absorbing or heat-reflective glazed and coated window or door systems, or other window or door system modifications that reduce energy consumption;
>
> (C) automatic energy control systems, including computer software and technical data licenses;
>
> (D) heating, ventilating, or air-conditioning system modifications or replacements that reduce energy or water consumption;
>
> (E) lighting fixtures that increase energy efficiency;
>
> (F) energy recovery systems;
>
> (G) electric systems improvements;
>
> (H) water-conserving fixtures, appliances, and equipment or the substitution of non-water-using fixtures, appliances, and equipment;

(I) water-conserving landscape irrigation equipment;

(J) landscaping measures that reduce watering demands and capture and hold applied water and rainfall, including:

(i) landscape contouring, including the use of berms, swales, and terraces; and

(ii) the use of soil amendments that increase the water-holding capacity of the soil, including compost;

(K) rainwater harvesting equipment and equipment to make use of water collected as part of a storm-water system installed for water quality control;

(L) equipment for recycling or reuse of water originating on the premises or from other sources, including treated municipal effluent;

(M) equipment needed to capture water from nonconventional, alternate sources, including air-conditioning condensate or graywater, for nonpotable uses;

(N) metering or related equipment or systems that improve the accuracy of billable-revenue-generation systems; or

(O) other energy or water conservation-related improvements or equipment, including improvements or equipment relating to renewable energy or nonconventional water sources or water reuse.

These contracts should provide energy savings based on historical costs or avoided anticipated costs.

While energy savings is the focus, Chapter 302 is a method of financing new air conditioning, heating, lighting and water equipment. Section 302.004(a) addresses financing:

Section 302.004. Method of Financing; Terms of Contract

(a) An energy savings performance contract may be financed:

(1) under a lease-purchase contract that has a term not to exceed 20 years from the final date of installation and that meets federal tax requirements for tax-free municipal leasing or long-term financing;

(2) with the proceeds of bonds; or

(3) under a contract with the provider of the energy or water conservation or usage measures that has a term not to exceed the lesser of 20 years from the final date of installation or the average useful life of the energy or water conservation or usage measures.

(a-1) Notwithstanding other law, the governing body of a local government may use any available money to pay the provider of the energy or water conservation measures under this section, and the governing body is not required to pay for such costs solely out of the savings realized by the local government under an energy savings performance contract. The governing body may contract with the provider to perform work that is related to, connected with, or otherwise ancillary to the measures identified in the scope of an energy savings performance contract.

(b) An energy savings performance contract shall contain provisions requiring the provider of the energy or water conservation or usage measures to provide a guarantee. If the term of the contract exceeds one year, the local government's contractual obligations in any one year during the term of the contract beginning after the final date of installation may not exceed the total energy and water savings, the net operating cost savings, and the stipulated or agreed upon increase in billable revenues resulting from the estimated increase in meter accuracy, divided by the number of years in the contract term.

Before approving a contract for energy performance savings, the county should have the prospective vendor provide the cost with and without financing. The reference to bonds in the statute is not limited to general obligation bonds. The Attorney General has permitted the use of certificates of obligation for this purpose. Tax notes would also be permitted, but the county would be limited to a seven year financing rather than a 20 year financing.

The county should also require that the vendor provide a payment and performance bond. Section 302.003, Texas Local Government Code provides:

302.003. Payment and Performance Bond

> Notwithstanding any other law, before entering into an energy savings performance contract, the governing body of the local government shall require the provider of the energy or water conservation or usage measures to file with the governing body a payment and performance bond relating to the installation of the measures in accordance with Chapter 2253, Government Code. The governing body may also require a separate bond to cover the value of the guarantee.

The terms of an energy performance savings contract should be reviewed by an attorney who is familiar with such contracts. If the county is going to use the lease purchase financing offered by the vendor, it should have the lease purchase portion reviewed by its bond counsel. Very often there are terms that are not in a county's best interest and usually can be negotiated to put the county in a more favorable position, as well as ensuring that the agreement complies with Texas law. It is also recommended that the county consult with its financial advisor to see if another financing option would be better for the county.

Chapter 13

PASS-THROUGH TOLL BONDS

Since 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". The Department was authorized to enter into contracts with public or private entities to provide for the payment of pass-through tolls to reimburse the public or private entities for the design, development and construction of the highway project. The pass-through toll is not a true toll method, but an accounting method wherein the State reimburses the county based on a per vehicle or per vehicle mile that is determined by the number of vehicles passing over a certain segment of roadway pursuant to a contract with the Department. In 2005, Section 222.104 was amended to also include financing and other related costs. In 2005, the legislature also enacted Chapter 1479 of the Transportation Code to permit a county to "issue bonds to provide funds for the design, development, financing, construction, maintenance, operation, extension, expansion, or improvement of a toll or nontoll project or facility on the state highway system located in the county or, as a continuation of the project or facility, in an adjacent county." Section 1479.002, TEX. TRANS. CODE.

Under Chapter 1479, a county is authorized to provide for payment of the bonds through a pledge of revenue from any available source, including a contract with the Texas Department of Transportation under Section 222.104, the source of the pass-through toll payments. The payments from the Department will not be sufficient to finance the entire project, so the county must combine those payments with other funds sufficient to pay the debt service on the project. The usual method is to pledge county ad valorem taxes. The county would then issue either unlimited tax bonds or limited tax bonds combined with the pass-through toll revenues to fund the project. Most significantly, a county is authorized to issue its limited tax bonds without an election under this Chapter. If the county issues unlimited tax bonds, it must first hold a bond election.

The pass-through toll method of financing road construction differs from the traditional method where a county would provide a percentage of the cost of a project to the Department and the Department would fund the remainder and construct the project. The pass-through toll method requires the county to finance and construct the project with the Department paying for a percentage of the cost over time through pass-through

toll reimbursement payments to the county. The county receives the pass-through toll payments only after the project is completed and accepted by the Department. While the Department is authorized to use any available funds for making its pass-through toll payments, its obligation to make the payments is subject to appropriation by the legislature of sufficient funds to make the payments.

The county is responsible for the bond payments. The Department's obligation requires it to make payments, but does not require the Department to make payments that are sufficient to pay the debt service on the bonds. While the pass-through toll revenue would be used to cover a portion of the debt service on the bonds, construction delays could result in a delay in the county being able to receive the pass-through toll payments so that the county would have to pay the entire amount from taxes or other available funds until such time as the pass-through toll payments are received. In the event the pass-through toll payments are not received, the county is still liable for making payments on the bonds.

When a county enters into this type of arrangement, it needs to understand the full ramification of this contracting method. The county is responsible for all of the contracting, construction and financing. Generally, it will contract with a large construction engineering firm to design and arrange for the construction of the project. The contracts with the State and the engineering and construction firms must be carefully negotiated to put the county in as good of a position as possible.

Chapter 14

PUBLIC FINANCE FOR ECONOMIC DEVELOPMENT

Economic development remains a very important consideration for Texas counties. The Texas Legislature provides new economic development tools in most legislative sessions. Counties have not been given the economic development tools that have been given to cities,[17] but some are available. While many of these tools do not involve the issuance of bonds, some do. For those that do, it may be a specially created entity rather than the county itself that issues the bonds. Counties can establish Economic Development Corporations under Chapter 501, Texas Local Government Code, and County Development Districts under Chapter 383 of the Local Government Code, and those districts can issue bonds. A Public Improvement District can be created under Chapter 372 of the Local Government Code to issue bonds.

Economic Development Corporations

Several counties have established Economic Development Corporations pursuant to the Development Corporation Act of 1979, Article 5190.6, Texas Civil Statutes. The county establishes an economic development corporation for economic development purposes. The economic development corporation is a non-profit corporation whose board is appointed by the commissioners court. The county must approve the articles of incorporation and bylaws, as well as any amendments.

When a company decides to locate a facility in the county, it may be able to qualify for tax-exempt financing by going through the economic development corporation and the county. The economic development corporation serves as the conduit issuer for the company, and any bonds must be approved by the county.

For some companies, this financing is attractive. For others it is not. As a condition of getting the financing, the company must agree to comply with certain requirements in the Internal Revenue Code. In addition, the maximum amount that can be issued is only $10,000,000.

In order to issue the bonds on a tax-exempt basis, an application must be filed with the State to obtain a portion of the private activity bond allocation. Once an allocation is

---

[17] The legislature placed Proposition 4 on the November 8, 2011 ballot. This measure did not pass, but it would have given counties the authority to issue bonds to finance the development of unproductive, underdeveloped or blighted areas.

obtained, the bonds must be issued and closed within a very short period of time.

The business entity must arrange its own financing. The county's bond counsel is usually involved in the financing, either as bond counsel for the economic development corporation or as counsel to the county and the development corporation, to protect the interests of the county and the development corporation. No county tax is pledged. The bonds are paid solely through the revenues of the facility being financed.

When a business entity approaches the county or economic development corporation to issue bonds on its behalf, it is important to analyze the economic basis of the proposal. The county's financial advisor can usually provide this service. The cost of the county's financial advisor and bond counsel can be included in the cost of the financing which is paid by the company requesting the financing.

The county and economic development corporation should develop a questionnaire which the company must complete that contains all of the information required to be filed with the state. In addition, the industrial development corporation may establish a reasonable application fee to cover the cost of processing the matter through the state, as well as providing a nominal fee that is due upon closing. As a part of the application, an indemnification from the company requesting the financing can be required to protect the county, the economic development corporation and their officers and employees.

Public Improvement Districts

A county can create a Public Improvement District ("PID") under Chapter 372, Texas Local Government Code. A PID is an economic development tool that is available to both cities and counties. It provides a vehicle for a developer to obtain a source of funds for infrastructure in a project from assessments made upon property located within the project, so that the developer does not have to encumber his own funds for these purposes. PID revenues may only be used for infrastructure improvements that will benefit the public, such as streets, water and sewer lines.

In an unincorporated area, a developer would petition the county to create the PID. If the county agrees to create the PID, the county will then be asked to impose assessments on the property within the PID. Since all of the property is owned or controlled by the developer, there should be no controversy when the assessments are established. As the developer sells lots within the project, the purchasers will become responsible for the payment of the assessments.

Often developers will want a county to enter into a development agreement in which the county would agree to create the PID and to execute a promissory note, payable only from PID revenues; and approve bonds for the project based solely on PID revenues.

Counties should review these proposals carefully. If a county decides to pursue a project, it should consider eliminating any promissory note obligation for the county and require that the developer or ultimately the PID would pay for any expense incurred by the county. A county should also consider creating a Public Facility Corporation to administer the PID and require that the name of the PID not contain a reference to the county.

In order to create a PID, a petition is submitted to the county signed by the owners of more than 50% of the taxable real property of the area to encompass the proposed PID, and record owners of real property liable for assessment under the proposal who (A) constitute more than 50% of all record owners with property that will be liable for assessment, or (B) own taxable real property that constitutes more than 50% of the area of all taxable real property that will be liable for assessment. Here, the developer will own all of the property that will be proposed to encompass the PID. Ideally, the county should be involved before a petition is presented so that the petition that is presented is one where the concerns of the county have been resolved in advance.

Once the petition is received, the county is required to hold a public hearing. Before holding the hearing, the county can require preliminary estimates and evaluations of the proposal, and a feasibility study. If the county goes with the PID, the county will want the developer to provide sufficient information to permit an informed decision, including that the PID will generate sufficient revenues to cover debt service. Once the county is satisfied with the information, it convenes a hearing. There are specific notice requirements that must be met in order to hold the hearing. Once these are satisfied, the county would conduct a hearing. Within six months from the date of the hearing, the commissioners court may create the PID.

After the PID has been created, the developer will work up the proposed assessment and service plan. Once this is in final form, the plan is presented to the commissioners court for adoption. A public hearing is then set on the plan. At or upon adjournment of the hearing, the county will hear any objections to the proposed assessments. The commissioners court will then determine the assessments to impose and pass an order to that effect. The developer would have the county issue bonds based on the revenues the assessments will generate.

The problem is that once the plan has been accepted, the county's role is not over.

It will need to provide for the calculation of the assessments. It will have ongoing responsibility to approve a new service plan annually. It will be the focal point for complaints about the assessments which can generate political problems for the incumbent officeholders. The county will also be required to pursue property owners who fail to pay their assessments. This can also create political problems, especially if the county is required to foreclose on the property. The county will probably want to negotiate with the law firm that collects the county's delinquent taxes to also pursue property owners who are not timely in paying their assessments.

The general concept of creating a PID is fairly straightforward. However, the details must be carefully considered. The commissioners court will want to make certain that the county is adequately protected in any document presented for the county to approve.

County Development Districts

Chapter 383, Texas Local Government Code, authorizes a county with a population of 400,000 or less to create a county development district. To do so, it must first receive a petition which is accompanied by a consent from all holders of fee simple title in the proposed district. A hearing is held on the petition, and if the county approves, it will call an election on the creation of the district and the adoption of a sales and use tax for the development of tourism. If passed, the district, rather than the county, issues bonds secured by the pledge of the sales and use tax or other revenues.

Chapter 15

INTERLOCAL CONTRACTS

In 2011, the voters approved a constitutional amendment which authorized the legislature to allow cities and counties to enter into interlocal contracts with other cities and counties without having to assess an ad valorem tax and set aside a specified amount of funds for the payment of costs under the interlocal contract. The amendment amended Article XI, Sections 5 and 7.

The legislature had approved S.B. 760, which became effective upon the passage of Proposition 5 amending Section 791.011, Texas Government Code, to eliminate the requirement that interlocal agreements had to be renewed annually and proving that "an interlocal contract may have a specified term of years."

This change is very helpful. Many times a city and county decide to develop a project jointly. For instance, several counties have established a jail with administrative offices for the sheriff's department. Prior to the amendment, the county would issue bonds for the entire project and enter into an interlocal contract with a city wherein the city would provide debt service to help pay for the financing.

CONCLUSION

Texas counties have a variety of financing tools available. Counties utilize debt less than cities and school districts. Judiciously used, a county can finance essential capital projects when needed and provide for an economically sound repayment schedule to cover debt service with a minimal impact on the county's ad valorem tax rate.