Office of the Attorney General
State of Texas

DAN MORALES
ATTORNEY GENERAL

December 9, 1997

To All Bond Counsel:

Re: School District Obligations, Variable Rate Bonds for Governmental Entities Not Qualifying as Issuers under Article 717q, Tex. Rev. Civ. Stat. Ann., Other Matters

1. Approval of School District Obligations - Chapter 46, Tex. Educ. Code. Attached are revised formulas to be used by this office in determining whether a school district has passed the "50 cent test" under section 45.003(e), Tex. Educ. Code. The revisions reflect the addition of chapter 46 by House Bill 4, 75th Legislature, Regular Session, and other changes which simplify application of the formulas. Please note that we require the district to covenant in its bond order to deposit all instructional facilities allotment ("Tier 3") funds in the interest and sinking fund, as provided in chapter 46. For lease-purchases, there must be a covenant to the effect that Tier 3 funds will be deposited into a special restricted account of the general fund of the district and be used solely to make payments under the lease-purchase agreement.

2. Additional Requirement for Deposit in Interest and Sinking Fund by School Districts - Amendment of Section 45.003, Tex. Educ. Code. As you know, subsection (e) of section 45.003 was amended by Senate Bill 1873, 75th Legislature, Regular Session, to require a deposit into the interest and sinking ("I&S") fund of a school district, prior to the adoption of a tax rate for the year, of certain amounts of state aid ("Tier 2") which were used to demonstrate to the Attorney General the ability to comply with subsection (e). It is our position that compliance can be achieved by the deposit into the I&S fund of such Tier 2 money (up to the amount needed to pass the $.50 test for the year of maximum debt service) as will enable the district to make debt service payments without levying a bond tax in excess of $.50. Therefore, each school district using Tier 2 money to pass the $.50 test must, in order to achieve compliance by this method, covenant in its bond order to deposit into the I&S fund, prior to the adoption of its tax rate, the amount of Tier 2 money (up to the amount needed to pass the $.50 test for the year of maximum debt service) which will allow its bond tax rate to be $.50 or less. Note that the amount of Tier 2 money required to pass the test for the year of maximum debt service must be determined and set out in the general certificate.

Alternatively, compliance can also be achieved by determining, at the time the bond order is adopted, the amount of Tier 2 money required each year over the life of the bonds, assuming no change in appraised value of taxable property in the district, and depositing into the I&S fund each year such amount. A covenant to such effect along with a schedule of annual Tier 2 requirements will be required to be in the bond order if this method of achieving compliance is used. A district wishing to show compliance another way must preclear the proposed method with the Public Finance Division.

3. School District Lease Purchase Financings - Senate Bill 826. (a) Improvements. We have received numerous inquiries with respect to our position on the ability of a school district to lease-purchase "improvements" to real property. While the amendments to the Public Property Finance Act (the "Act") by Senate Bill 826, 73rd Legislature, Regular Session, clearly indicate that the legislature intended improvements to be subject to the contract provisions of section 271.004(a), Tex. Local Gov't Code, the definition of improvements added by SB 826 is more limited than the common law definition of the term:

> "Improvement" means a permanent building, structure, fixture, or fence that is erected on or affixed to land but does not include a transportable building or structure whether or not it is affixed to land. §271.003(10), Tex. Local Gov't Code.

There appears to be no ambiguity in the definition with respect to permanent buildings and fences. Under the definition of permanent buildings, we include additions to buildings and will continue to approve lease-purchase agreements relating to additions (e.g. a new classroom wing, a new gymnasium, a new library, etc.) to existing buildings. Note that when the land on which the addition is to be constructed is to be sold to the lessor, it must contain no improvements. (See All Bond Counsel letter of August 30, 1996.) "Fixtures" and "structures" are not without ambiguity, however.

To determine what constitutes a fixture, we will look to common law (see, for example, 41 Tex. Jur 3rd, Fixtures §1 (1985)) and the Uniform Commercial Code, Title 1, Tex. Bus. & Com. Code, ("UCC") for guidance. The UCC provides that "goods are 'fixtures' when they become so related to particular real estate that an interest in them arises under the real estate law...." UCC §9.313(a)(1). This seems to encompass most common law definitions and is the language we will look to in determining if specific items are fixtures and thereby improvements under the Act. Similar language can be found in chapter 2A of the UCC on leases. Both chapters go on to provide, however, that they do not apply to "ordinary building materials incorporated into an improvement on land." UCC §2A.309(b) and §9.313(b). Ordinary building materials used to remodel, renovate or repair school buildings will not, therefore, be considered improvements that can be lease-purchased. Additionally, in determining whether an item is a fixture, and thus an improvement, or an item of personal property, we will consider the treatment that has been afforded such items

in financings under section 271.005, Tex. Local Gov't Code. For example, replacement air conditioning units have traditionally been represented to be personal property and will not be treated as fixtures. Note also that the legislature has made it clear that "transportable" buildings of the type that have been historically financed as personal property items with contractual obligations are not to be considered improvements.

The remaining category in the definition of improvement is "structures." Under a broad interpretation, a structure is "any construction, or any production or piece of work artificially built up or composed of parts joined together in some definite manner." *Black's Law Dictionary, Fifth Ed, p. 1276.* What this term adds to the definition of improvements is not clear. It is possible that a parking lot or sidewalk might qualify, though we have found no law on point. Please note that state aid under chapter 46, Tex. Educ. Code, can only be used for "instructional facilities" which are used predominantly for teaching. A parking lot (at least by itself) would not appear to qualify under section 46.001, Tex. Educ. Code.

In the future, we will require a legal analysis to be submitted with transcripts for improvement leases unless the "improvements" are permanent buildings, additions, fences, above-ground structures, or clearly fit within the above interpretation of a fixture.

(b) Notice. Except for the clarification/addition set out in the next paragraph, notice requirements remain as specified in the All Bond Counsel Letter of August 30, 1996. However, because of the timing requirements for qualifying for Tier 3 funds, we will consider, for those districts attempting to qualify for those funds, on a case by case basis those notices which are partially deficient and will not necessarily require republication. Please note that such notices must contain enough information to give the public a fair idea of the circumstances of the financing. SB 826 financings for those districts not constrained by the December 15, 1997, time requirement for Tier 3 funding will be required to meet the requirements of the All Bond Counsel Letter of August 30, 1996, and to republish for an additional 60 days if the notices are deficient in a material way.

(c) Notice - Cash Contribution. The notice must state the amount and source of a district's cash contribution, including an estimate of the fair market value of the land if the district plans to contribute the cash from the sale of the land to the lessor.

4. Selecting Bonds to be Refunded - No Delegation Authority under Art. 717q, Tex. Rev. Civ. Stat. Ann. Since article 717q does not authorize the governing body to delegate the selection of bonds to be refunded to an officer or employee, a number of issuers have attempted to provide an objective set of criteria for selecting bonds from a pool of outstanding bonds when authorizing the issuance of refunding bonds. This is a workable approach. However, care must be taken so that there is no discretion involved in the selection of the bonds to be refunded and so that undesirable results are not the outcome. As an example, a provision providing for the refunding of the maximum amount of bonds to achieve a minimum 2.5% savings, without any additional criteria, could require the refunding

of a very small amount of bonds. Or, it could require the refunding of maturities which would lower the savings, e.g., refunding $10,000,000 might result in a 2.5% saving where refunding $9,000,000 result in a 3.5% saving, but, under the above language, the issuer would be required to refund the $10,000,000. There are modifications to the criteria which can address concerns such as these, but in the final analysis the criteria must be objective and provide for no exercise of discretion, such that no matter who was making the determination of which bonds to refund the result would be the same.

5. Variable Rate Bonds - Entities Not Qualifying as Issuers under Art. 717q. The following are our requirements relating to standby bond purchase agreements for supporting variable rate bonds of such entities:

a. If the interest rate for bank held bonds is also set out in the standby bond purchase agreement, such provision must be limited to "as and to the extent provided in the Order."

b. The standby bond purchase agreement must provide that in case of a conflict between the agreement and the bond order that the bond order controls.

c. Payment of fees must be subject to annual appropriation. For school districts, payment of fees must be from maintenance tax or surplus funds.

d. There must be term-out provisions for bank held bonds at the termination of the standby bond purchase agreement, whether termination is due to some "event of termination" or because the termination date of the agreement is reached.

e. Term-out provisions must be over a sufficient time period so that hospital districts and other non-717q issuers (other than school districts) can show an ability to pay debt service on the bonds and all other outstanding bonds within the bond allowable rate set out in 1TAC §53.5, or in the case of revenue bonds, with historical or projected available revenues. The term-out period for a school district must be a minimum of three years.

f. Provisions requiring additional payments to the standby bank because of increased costs to the bank or increased taxes which reduce the banks return must be prospective and, as a part of the fees, subject to annual appropriation.

Very truly yours,

Jim Thomassen
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Chief, Public Finance Division

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Attachment

ATTACHMENT 1
December 1997

ABBREVIATIONS

MTR = authorized maximum voted maintenance tax rate of the district, as adjusted according to terms of statute pursuant to which such tax was voted. (see note a, below.)

OMR = district's most recent maintenance tax rate (excluding the portion of the rate attributable to indebtedness secured by the district's maintenance tax authority).

BT1 = tax revenue generated by district levying 50¢ tax rate. Equal to (0.50/100) x TAV x CF.

KO1 = tax revenue generated by district levying tax at rate equal to district's maximum maintenance tax rate minus district's most recent OMR. Equal to (MTR-OMR) x TAV x CF.

T2A = amount of Tier 2 aid that district will receive in the current fiscal year, as demonstrated using the most recent version of the TEA's template for calculating state aid (Tiers 1 and 2), not including state aid to compensate for tax revenue lost due to the increase in the homestead exemption pursuant to section 42.2511, Tex. Educ. Code and less amounts previously "encumbered." See note d. A copy of the completed template will be required as part of the district's general certificate.

FYA = amount of district's Instructional Facilities Allotment (i.e. Tier 3 aid to be received pursuant to chapter 46, Educ. Code), as determined by TEA. Evidence of the amount of the allotment must be received in the form of a copy of notification received by the district from TEA.

T2Δ = amount of district's anticipated increase in Tier 2 aid over amount received in the immediately preceding fiscal year. An explanation of the reason for the anticipated increase, indicating that the increase is expected to continue in future years, will be required. See note b.

TEA = Texas Education Agency

TAV = district's taxable assessed valuation.

CF = collection factor. (Presumed to be 90%, unless demonstrated to be higher).

MDS = maximum debt service on all outstanding bonded indebtedness that is not exempt from the test described in §45.003(e), Educ. Code.

KMDS = maximum debt service on all outstanding indebtedness secured by the district's maintenance tax authority.

MLP = combined maximum lease payment for all lease purchase obligations incurred by the district pursuant to §271.004, Tex. Local Gov't Code.

Notes: a) MTR must be adjusted to account for any limitations imposed by the statute in effect when the tax was approved by voters. (See, e.g., former article 2784e-1, Tex.Rev.Civ.Stat.Ann., which provides for a reduction in the maximum tax rate for maintenance in the event that the district's bonded indebtedness exceeds certain stated limitations.)

b) As a general rule, Tier 2 aid will not be available for use by school districts to demonstrate their ability to pass the contractual obligation test. (Districts are presumed to have used all of their Tier 2 aid for operations and maintenance in prior years. Such funds would not, therefore, be available for contractual obligations.) An exception to this rule will be made where a district is able to demonstrate that it expects to receive an increased amount of Tier 2 aid in the next succeeding fiscal year (and thereafter).

c) All calculations for the contractual obligation test must (i) include a statutory citation to the law pursuant to which the district's maintenance tax was voted along with a copy of the voted proposition and (ii) use the tax rate authorized at such election.

d) Whenever Tier 2 aid is used to pass the lease-purchase test or the bond test, the district must provide certification to the effect that the district has (i) for the bond test, not previously used its Tier 2 aid to pass the lease-purchase test or the contractual obligation test, or (ii) for the lease-purchase test, not previously used its Tier 2 aid to pass the bond test or the contractual obligation test. To the extent the district has previously used its Tier 2 aid for such purpose, it must certify as to the amount of Tier 2 aid "encumbered" by such prior use and deduct the encumbered amount from Tier 2 aid available to meet the requirements of the affected test.

TESTS

1. BOND TEST #1 (§ 45.003(e) without state aid):

$$(0.50/100) \times TAV \times CF \geq MDS$$

2. BOND TEST #2 (§45.003(e) using Tier 2 aid):

$$BT1 + T2A \geq MDS$$

3. BOND TEST #3 (§45.003(e) using Instructional Facilities Allotment):

$$BT1 + FYA \geq MDS$$

4. BOND TEST #4 (§45.003(e) using a combination of Tier 2 aid and Instructional Facilities Allotment):

$$BT1 + T2A + FYA \geq MDS$$

5. CONTRACTUAL OBLIGATION TEST #1 (without state aid):

$$(MTR - OMR) \times TAV \times CF \geq KMDS$$

6. CONTRACTUAL OBLIGATION TEST #2 (using Tier 2 aid):

$$KO1 + T2\Delta \geq KMDS$$

7. § 271.004 LEASE-PURCHASE TEST #1 (relying on Tier 2 aid):

$$T2A \geq MLP$$

8. § 271.004 LEASE-PURCHASE TEST #2 (relying on combination of Tier 2 aid and Instructional Facilities Allotment):

$$T2A + FYA \geq MLP$$