Office of the Attorney General • State of Texas
John Cornyn

March 17, 2000

Via Facsimile

To All Bond Counsel:

Re: Negligence Standard; School Lease Purchase Requirements; Certificates of Obligation; Application of Section 1207.008, Tex. Gov't Code; Health Facility Development Corporation Obligations; Acquisition of School Property Previously Financed; Underwriters Discount; Section 45.108 Notes; All Bond Counsel Letters; Time Requirements

1. Negligence Standard - Reimbursement Agreements. Please note that paragraph 7 of the All Bond Counsel Letter of December 13, 1988, applies to reimbursement agreements between banks and traditional issuers. While agreements submitted have, for the most part, complied with the requirements of the letter, questions have arisen regarding its application to the issuer's obligation to reimburse the bank for payment of the issuer's notes or bonds. We agree that the issuer's obligation should be absolute, except to the extent that payment by the bank caused a loss to the issuer because of the bank's negligence or wilful misconduct. In some instances, the standard of care provisions have dealt with this issue, though modifications to other parts of the agreement may still be necessary. If an issuer you represent is negotiating a reimbursement agreement, we are willing to pre-review the proposed agreement for purposes of determining compliance with this position.

2. School Lease Purchase Requirements. For lease-purchase agreements under section 271.004 of the Local Government Code financed through the issuance of bonds by a public facilities corporation pursuant to chapter 303 of the Local Government Code: Prior to the issuance of bonds by the public facilities corporation, (1) design-build contracts must be entered into, and (2) the purchase of land[1] on which financed school buildings will be located must be completed.

3. Certificates of Obligation and Sales Tax Payments. As you know, sales taxes levied pursuant to section 4A or 4B of article 5190.6, Tex. Rev. Civ. Stat. Ann., may not be pledged to certificates of obligation. However, in appropriate circumstances, a development corporation may contract to pay such sales tax revenues to the city, which in turn would use such funds to pay certificates of obligation, though the purpose of the certificates must fall within an authorized use for sales tax proceeds under section 4A or 4B of article 5190.6, as applicable. When such a contract exists or is anticipated by the issuer, or if the official statement indicates that this sales tax will be used to pay the certificates, a contract must be submitted with the transcript.

[1]If the district is purchasing the land to sell it to the corporation.

4. Application of Section 1207.008 of the Government Code. This new provision requires the governing body of the issuer to make certain findings in the authorizing proceedings when the aggregate amount of payments to be made under the refunding bonds exceeds the aggregate amount of payments that would have been made under the terms of the obligations being refunded. This provision raises certain questions if either the bonds being refunded or the refunding bonds are variable rate (or commercial paper). To give effect to this provision in these circumstances, please make the following assumptions: (1) If variable rate bonds are being refunded by fixed rate bonds, assume that the bonds being refunded would continue to bear interest at the current rate; (2) If fixed rate bonds are being refunded by variable rate bonds, assume that the refunding bonds would bear interest at the maximum rate, 15%, or such other maximum rate permitted for the refunding bonds; (3) If variable rate bonds are being refunded by variable rate bonds, assume that the interest rate for both is the maximum rate.

5. Refinancing of Health Facility Development Corporation Obligations and Sponsoring Entity Consents. As practitioners in the area of health finance law know, chapter 221 of the Health & Safety Code authorizes refunding bonds only with respect to a development corporation's own bonds (section 221.065(a)). Consent of the sponsoring entity (as defined in chapter 221) is not required under section 221.030(a)(1)(B) in connection with refunding bonds, because any consents required by the act would have been obtained at the time of issuance of the bonds being refunded.

A health facilities development corporation, pursuant to section 221.030(a)(5), may also issue new money bonds (for state law purposes) to refinance a prior obligation of the user or other person incurred in the acquisition of a health facility. New money "refinancing" bonds cannot be issued without a consent from each sponsoring entity in which the health facility is located if the facility is located wholly outside the boundaries of the issuer's sponsoring entity, subject to the following exception: If the new bonds will be used to refinance a user obligation incurred in conjunction with bonds issued under chapter 221 by a different development corporation, no new consents will be required, because any consents required by the act in connection with the user's original acquisition of the facility would have been obtained. This type of refinancing does not involve a transfer of ownership of, or improvements to, the health facility and closely resembles a refunding. Note, however, that sponsoring entity consents are required for a health facilities development corporation bond issue that finances a transfer of ownership of a health facility through payment of a prior obligation of the party conveying title to the facility.

6. Acquisition of School Property Financed under a Contract Entered under Subchapter A of Chapter 271 of the Local Government Code. Property which may be acquired (with clear title) under section 45.001(a)(1)(B) of the Education Code is property of the district which has been "acquired" (with title remaining in the seller) under a financing contract under the Public Property Finance Act provision cited above. The property must be in the possession of the school district under a lease purchase, installment sale or similar financing contract *at the time of the bond election* that includes as a purpose the acquisition of such property. Property which is otherwise eligible to be acquired under section 45.001(a)(1)(B), but for which title has passed to the district, may be refinanced. Such property, whether financed with contractual obligations under subchapter A of chapter 271 or pursuant to a financing agreement under that same subchapter, may be refinanced at the time the contractual obligations are callable or the financing agreement is subject to prepayment. Section 45.001(a)(1)(B) does not provide for the advance refunding of contractual obligations or financing agreements.

7. Underwriter's Discount in a Negotiated Sale. We do not see authority for an issuer to set interest rates higher than market in order that the underwriter may resell the bonds at a premium. (We do not view the language in section 45.001(c) of the Education Code (or 1204.006(b) of the Government Code) as permitting the setting of an interest rate at an above-market level to avoid a debt limitation.) A competitive sale is different in that the district is selling its bonds for the best price it can obtain and has no connection with the "production," including how much may, or may not, be generated by a resale, which may not even occur. (We understand that, with the advent of internet sales, some bonds are being sold directly to institutions, so that there is no resale or production for those particular bonds.) With a negotiated sale in which the underwriter does not receive its compensation from the purchase price paid to the district, the district would be intentionally setting interest rates above market in order to generate a premium. We do not view the fact that the premium is paid directly to the underwriter rather than going through the issuer as constituting a meaningful distinction. Additionally, if the principal amount of bonds being issued equaled the amount of voted authority, the district would be in violation of article VII, section 3 of the Texas Constitution. To state it another way, there is really no separation for this purpose between the issuer and the underwriter in a negotiated sale, as the two have negotiated what the amount of the premium will be, and the issuer cooperates with the underwriter to generate the premium. On the other hand, with respect to a competitive bid, the issuer is not a party to determining whether there is a re-offering premium. It merely sells the bonds for the best price it can get. It does know that most purchasers intend to resell the bonds and have tried to bid a price that will enable them to make a profit in reselling the bonds, but all market risk is on the underwriter.

This has been our position for some time, but it is our understanding that paying the underwriter's discount from bond proceeds has for a very long time been the standard practice for negotiated sales without regard to any position of the Attorney General. As set out above, we do not see any inconsistency in our treatment of the underwriter's compensation in negotiated and competitive sales. In fact, as indicated above, in competitive sales the issuer is not compensating the underwriter at all.

8. School District Section 45.108 Notes. Authorizing documents for school district notes issued pursuant to section 45.108 of the Education Code must contain a description of all purposes for which the notes are being issued. (*See* paragraph 1 of the February 11, 1999 All Bond Counsel Letter.) Maintenance expenditures financed must be those that would be incurred in the current or next succeeding fiscal year. There also must be an explanation, which can be in a certificate, of the need for issuing the notes if the maintenance items being financed are intangibles or consumables. Notes issued for intangibles or consumables should be short-term, three years or less.

9. All Bond Counsel Letters on Attorney General Website. All substantive All Bond Counsel Letters from November, 1987, plus selected letters from before that date, are now on the Attorney General website (www.oag.state.tx.us). The Letters may be accessed from the site index.

10. Time Requirement for Transcript Review. For transcripts submitted on or after March 27, the time requirement for review is being changed back to 10 working days for traditional transcripts, 12 for conduit transcripts. However, we still encourage you to set closing dates to allow additional time where practical, especially during the next month as we make the transition to the shorter period. Additionally, please note that, under these time limitations, transcripts should be submitted substantially complete, with "pro forma" transcripts rarely being necessary. Finally, please see paragraph 1 of the January 26, 1994 All Bond Counsel Letter for details of timing requirements.

Very truly yours,

James A. Thomassen
Assistant Attorney General
Chief, Public Finance Division