KEN PAXTON
ATTORNEY GENERAL OF TEXAS

March 21, 2024

To All Bond Counsel:

RE: Required Safeguards for District Bonds Issued to Fund Amounts Owed to Developers under Reimbursement Agreements and Other Matters

This letter provides guidance as to the safeguards needed to ensure that proceeds of conservation and reclamation district[1] bonds issued to reimburse developers are expended in accordance with Texas law.

1. Reimbursement agreements must comport with Texas law.

When a district authorizes bonds to fund amounts owed to a developer under a reimbursement agreement[2], we must ensure that the reimbursement agreement comports with state law. In such case, when a material portion of the bond proceeds will be used to reimburse the developer, the district must include the reimbursement agreement and the district's resolution authorizing its execution in the bond transcript. If the issuer executed or amended the reimbursement agreement on or after the effective date of the applicable state law verification statute[3], those state law verifications for covered contracts must be included in the agreement. Under the reimbursement agreement, Texas law must govern, and any agreement by the district to reimburse amounts owed to the developer from bond proceeds must be limited to qualified project costs and contingent upon attorney general approval of the bonds, and, when applicable, TCEQ approval of the bonds. When the reimbursement is funded from ad valorem tax bonds of the district, the agreement must also be contingent on voter approval, as required by the state constitution. Any developer interest[4] funded with bond proceeds must stay within the limits authorized by Texas law.

If the issuer executed the reimbursement agreement on or after September 22, 2021, when we began requiring standing letters for covered contracts, developer companies subject to the state

[1] Conservation and reclamation districts include districts, whether created by general law or special act, with article 16, section 59 powers, including municipal utility districts; the district must possess the statutory power to enter into reimbursement agreements and issue bonds to pay amounts owed thereunder; this also includes districts with road tax powers, and includes reimbursements for utility, road, and park bonds. All subsequent references herein will be to "district".

[2] Section 49.213(a) of the Water Code authorizes a district to contract with a person or any public or private entity for the joint construction, financing, ownership, and operation of any works, improvements, facilities, plants, equipment and appliances necessary to accomplish any purpose or function permitted by a district.

[3] The effective date of the Israel anti-boycott law and for the law prohibiting contracts with companies listed under section 2252.153 is September 1, 2017; the effective date of the energy company anti-boycott law and the firearm anti-boycott law is September 1, 2021. Please note that state law verifications are required to be included in covered contracts executed, amended, renewed, or extended on or after the applicable effective date. *See* *Attorney General Advisory on Texas Law Prohibiting Contracts and Investments with Entities that Discriminate Against Firearm Entities or Boycott Energy Companies or Israel*, issued October 18, 2023, at page 4.

[4] Section 49.155(a)(4) of the Water Code permits the district to pay out of bond proceeds interest on funds advanced to the district. *See also* 30 Tex. Admin. Code § 293.50 of TCEQ's Rules regarding developer interest.

law verification statutes must also provide an accompanying standing letter. Should it be more convenient for bond counsel, the company may execute the standing letter at the same time that it executes the reimbursement agreement so long as we can continue to rely on the letter at the time the district submits its bond transcript.[5]

2. Safeguards are required when the developer assigns its rights under the reimbursement agreement to an out-of-state issuer.

We have learned that in lieu of securing private bank financing for the developer's construction of public infrastructure to be conveyed to the district, some developers have assigned their rights to reimbursement under the agreement to an out-of-state issuer that issues debt under the state law in which the out-of-state issuer is located, not Texas law. Then, once the construction of the public infrastructure has been conveyed to the district, the district issues public securities under Texas law which are submitted to our office for approval. Because of the developer's assignment, all or part of those bond proceeds may be used to pay the indebtedness of the out-of-state issuer.[6] Although this may be legal in some circumstances, there are concerns that these arrangements could be used to avoid complying with Texas law.

As we know of no authority for a district to have an out-of-state issuer issue debt on behalf of the district, sufficient safeguards must be in place to ensure that in no event would the out-of-state issuer's bonds constitute a debt of the district under Texas law. Neither may the out-of-state issuer's indebtedness be a means to bypass attorney general approval of bonds issued by the district. We have discussed with counsel for a particular program seeking to provide financing for developers of Texas public infrastructure to determine what safeguards must be in place. For example, we have received a standing letter from the program to ensure that it complies with Texas state law verifications for its underwriters, that any district bond proceeds paid under the reimbursement agreement will only be for qualifying project costs under Texas law, and other safeguards. In no event will a developer program financing necessitate, authorize, or obligate a district to issue bonds or other securities for expenditures unauthorized by Texas law. For example, if a developer obtained out-of-state issuer financing to construct the improvements under the reimbursement agreement, and our review of the district's subsequent issuance of bonds to fund the project costs reveals that the district bonds were not issued in conformity with state law, we must refuse to approve those bonds.

Moreover, when district bonds are submitted for our review, we will also ask whether the developer has assigned its rights under a reimbursement agreement to an out-of-state issuer. If the developer has assigned its rights to an out-of-state issuer, we will require evidence of sufficient safeguards to ensure that the district bond proceeds are being expended for lawful purposes authorized under Texas law. We will accept the attached form of standing letter establishing such safeguards provided we have had an opportunity to review the applicable safeguards.

[5] *See* last paragraph of form of standing letter in Exhibit A of the November 1, 2023 All Bond Counsel Letter, in which the company agrees to notify the Public Finance Division immediately should a change occur that renders the letter ineffective.

[6] Even though the developer has assigned its rights to reimbursement to an out-of-state issuer, district bond proceeds may only be expended on qualified project costs under Texas law; there is no authority for district bonds to be issued for cost of issuance or other financing costs of any out-of-state issuer.

3. Applicability to Public Improvement District Bonds

We recognize that Texas law also authorizes public improvement districts to enter into reimbursement agreements with developers when the improvements are dedicated to the municipality or county or other specified public entities.[7] Moreover, we require standing letters from developers and state law verifications to be included for reimbursement agreements executed or amended on or after the effective date of the applicable state law verification. Therefore, we will consider legal analysis as to whether programs similar to those described above would be permissible for public improvement districts provided that the required safeguards are implemented.

4. Use of Surplus Funds from Interest and Sinking Fund

As it relates to use of surplus funds from the issuer's interest and sinking fund after the bonds have been paid, we direct your attention to the recently issued Attorney General Opinion No. KP-0459. In particular, note 4 of that opinion questions the reasoning of prior Opinion JM-142, which did not rely upon Texas law but upon another state's law to allow surplus funds to be used for any non-statutory purposes. In other words, it is unlikely under Texas law that such surplus levy may be transferred to the general maintenance fund to the extent it is not specifically authorized by law.

We have provided this letter pursuant to our authority under section 402.044 of the Government Code, which requires that we advise the proper legal authorities regarding the issuance of bonds that by law require the Attorney General's approval. However, please note that this letter does not dictate how a court may rule in a legal proceeding.

Sincerely,

Leslie Brock

Leslie Brock
Assistant Attorney General Chief,
Public Finance Division

[7] *See* Loc. Gov't Code § 372.023(a), (d), (e).

Form of Standing Letter for Program

[Date]

Via email: PFDSupport@oag.texas.gov

Office of the Texas Attorney General:

[Name of Company] ("the Company") oversees the [Name of Developer Financing Program] (the "Program"), a program to provide capital to private developers for eligible public infrastructure costs for development projects in Texas. This letter, issued by the Company, pertains to financings through the Program by the [Name of Out-of-State Issuer] ("the Out-of-State Issuer"):

The Company asserts the following with respect to the Program:

1. The Company will disqualify any underwriters or lenders, including affiliates thereof, from participation in all Program financings through the Out-of-State Issuer if any such underwriters or lenders, and affiliates, boycott energy companies (as defined in Section 809.001, Texas Government Code), discriminate against firearm entities or firearm trade associations (as defined in Section 2274.001, Texas Government Code), boycott Israel (as defined in Section 808.001, Texas Government Code), are identified on a list prepared and maintained by the Texas Comptroller of Public Accounts under Section 2252.153 or Section 2270.0201 of the Texas Government Code, or do not otherwise meet the criteria set forth by your office in the All Bond Counsel Letter dated November 1, 2023, and subsequent All Bond Counsel Letters.

2. All Program financings will exclusively rely on the private developer's assignment of specific contractual rights, derived solely from a reimbursement agreement or other similar agreement between a Texas municipal utility district or another conservation and reclamation district created under Article XVI Section 59 of the Texas Constitution ("District") operating under the continuous jurisdiction of the Texas Commission on Environmental Quality ("TCEQ"), including TCEQ review and approval of the issuance of bonds (excluding road bonds for which the TCEQ has not exercised jurisdiction).

3. Program financings will not be secured by any payments from a District to the developer, or developer's assignee, in a way intended to bypass Attorney General review and approval of bonds or other public securities issued by a District.

5. Program financings will not necessitate, authorize, or obligate a District to issue bonds or other securities: a) for expenditures unauthorized by Texas Law, notably Texas Water Code Section 49.155, nor b) that do not meet TCEQ's financial feasibility criteria (where applicable) or the Texas Attorney General's review and approval requirements, including stipulations regarding road bonds.

6. Other than issuing a consent to a private developer's assignment of reimbursement rights to the Out-of-State Issuer or its assignee, a District will never be a party to a Program loan or financing agreement with the Out-of-State Issuer.

7. All Program financings will: a) be structured by a registered Municipal Advisor; b) require verification by a professional engineer, licensed in the State of Texas and engaged by the Company, that all project expenditures are for public purposes and, subject to all applicable state and local regulations, appear to be eligible for reimbursement under a District's enabling authority; and c) be structured in a manner that ensures that the District will not have any responsibility or liability of any kind, direct or indirect, with respect to the term, sale, marketing, issuance, security of payment of bonds issued by the Out-of-State Issuer, all of which shall be the sole responsibility and liability of the Out-of-State Issuer and a private developer.

8. A private developer will not be eligible for consideration in a Program financing if the District in which the private developer's property will be developed has not yet conducted a confirmation (if required by law) and bond authorization election.

Should a change occur that renders this letter ineffective or otherwise inaccurate with respect to financings through the Program, the Company shall notify the Public Finance Division immediately by email to PFDSupport@oag.texas.gov, with the phrase "Inaccurate Company Standing Letter" in the subject heading.

By:[State Name of Company]

By:____/s/_____
Name:
Title: