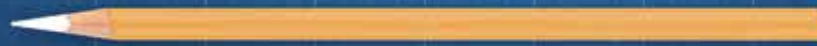


# OREGON **SCHOOL BOND** MANUAL



The Purposes and Procedures  
for Borrowing

14TH EDITION



JANUARY 2018

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for Borrowing

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JANUARY 2018



# Foreword

**T**he *Oregon School Bond Manual* was written to help school district, education service district and community college officials understand their long- and short-term borrowing options.

This newly updated 14th edition was the result of a collaboration between the Oregon School Boards Association (OSBA), Confederation of Oregon School Administrators (COSA), Piper Jaffray and Hawkins Delafield & Wood LLP. It was reviewed by Carol Samuels, managing director, and Lauren MacMillan, senior vice president, Piper Jaffray & Co.; Ann Sherman, bond counsel, and Jennifer Cordova, tax attorney, Hawkins Delafield & Wood LLP; and Morgan Allen, COSA deputy director of policy & advocacy; and produced at OSBA. Individual chapters were contributed by Angie Peterman, executive director, Oregon Association of School Business Officials; and Marcia Latta.

Please keep in mind as you use this manual that although best efforts were made to provide current information, you must rely on advice from your attorney or bond counsel on issuing or administering debt.

If you have questions or suggestions regarding this manual, you may contact one of the following:

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e-mail [info@osba.org](mailto:info@osba.org)

We believe this manual, which is based on state and federal laws, rules, and regulations in effect in January 2018, will be extremely useful for your finance team and will help them successfully issue debt when the need arises. We welcome your feedback.



Jim Green, executive director  
Oregon School Boards Association

Go to the OSBA website to view, download or print this manual, which contains all the details you need to understand the long- and short-term borrowing options for school districts, education service districts and community colleges.

<http://www.osba.org/Members/MbrResources>

MEMBER LOGIN REQUIRED

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## DISCLAIMER

In producing the *Oregon School Bond Manual*, the authors and editors used their best efforts to provide the most accurate information and materials for reference in planning for and issuing debt. Content is based on state and federal laws, rules and regulations in effect in January 2018. Consequently, the authors can make no warranty or representation as to the accuracy and completeness of the information and materials provided in this manual at the time it may be used. Only the advice of an attorney who is legally authorized to advise you offers legal protection against the personal liability of officials who take action on financial matters.

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# Introduction

*“Begin at the beginning  
and go until you come to  
the end; then stop.”*

*Lewis Carroll*

Oregon school districts, education service districts (ESDs) and community colleges (“districts”), like other municipal entities, borrow money for two general purposes:

- ▶ To finance capital improvements and major purchases that are too expensive for payment from current operating budgets
- ▶ To make up for timing mismatches that occur between required expenditures and the receipt of property taxes and state funds

In both cases, school districts, ESDs and community colleges may borrow money directly from financial institutions and equipment vendors or by selling debt in the public market.

This 14th edition of the Oregon School Bond Manual is designed to help the boards and staffs of Oregon school districts, ESDs and community colleges accomplish borrowing as efficiently as possible.

The manual includes information about kinds of borrowing, procedures for borrowing, the professional assistance needed to meet federal and state borrowing requirements, tax treatment of interest on debt obligations, explanations of ratings and bond insurance, securities law concerns and other topics. We’ve included a discussion of Oregon’s Local Budget Law as it relates to debt issuance and a glossary of municipal finance terms.

Note: This manual does not address borrowings designed to reduce a district’s unfunded Public Employees Retirement System (PERS) liability. PERS transactions are not traditional borrowings for capital projects or cash flow

deficits. Districts considering using debt instruments to fund PERS liabilities should consult legal and financial service professionals with specific expertise in PERS financings.

## What’s Inside?

Chapter 1, **The Financing Team and Public Debt Markets**, outlines how bonds and other securities are sold through public debt markets; the professionals required to assist districts with their borrowing needs; and the roles and responsibilities of boards and district staff in the borrowing process.

The next three chapters include the specific authorizations for long- and short-term debt.

Chapter 2, **General Obligation Bonds**, describes general obligation bond requirements including the use of proceeds, debt limitations, classification of taxes and structuring repayment schedules. General obligation bonds typically are used to finance the construction or acquisition of major capital items over an extended period of time. Districts must have voter approval to issue general obligation bonds.

Chapter 3, **Financing and Lease-Purchase Agreements**, lists requirements for entering into lease-purchase agreements or issuing full faith-and-credit obligations (FFCOs). Lease-purchase agreements and FFCOs typically are used to pay the costs of acquiring equipment and buses, for building construction or remodeling, or any real or personal property item. The use of lease-purchase agreements and FFCOs does not require voter approval.

Chapter 4, **Short-Term Borrowings**, includes information

about tax (and revenue) anticipation notes (TANs or TRANs), bond anticipation notes (BANs) and grant anticipation notes (GANs). Districts use these methods of short-term borrowing when they have a temporary mismatch between the receipt of funds and required expenditures. Chapter 5, **The Bond Election Process**, has information on election dates, ballot title requirements, voting by mail, setting the levy amount using community input, conducting successful bond elections, and election do's and don'ts for public officials.

Chapter 6, **Federal and State Tax Treatment**, describes federal and state laws and rules that regulate the investment and use of bond proceeds. Topics include basic information about the complex issues involved with tax-exempt status, including changes in use, arbitrage, investment and yield restrictions; rebate, registration and reimbursement rules; and IRS reporting requirements. Failure to comply with federal and state rules can cause bonds to become taxable retroactively. To avoid any problems, districts should consult with bond counsel when dealing with federal and state tax treatment issues.

Chapter 7, **Federal Securities Law Disclosure Requirements**, outlines the Securities Act of 1933, Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 15c2-12 standards for disclosure and requirements for

continuing disclosure. Again, this area of federal law is complex. It is wise to work with underwriters, municipal advisors and bond counsel in complying with disclosure and continuing disclosure requirements.

Chapter 8, **Credit Analysis, Ratings and Bond Insurance**, explains bond ratings, rating agencies and the services they provide, the factors considered in determining ratings, whether districts should apply for a rating and bond insurance options. A municipal advisor or underwriter can explain rating options that best suit the circumstances.

Chapter 9, **Refundings**, discusses the three reasons to consider refinancing debt obligations: debt service savings; debt restructuring; or change in legal status of debt covenants. It also describes types of refundings. Because of the complexity of state and federal regulations involved in refunding transactions, issuers contemplating refundings should seek the advice of bond counsel and underwriters or municipal advisors early in the process.

Chapter 10, **Local Budget Law**, deals with those sections of the law that apply to debt. Topics covered include establishment of capital projects and debt service funds, bond repayment structuring, appropriation and other debt service issues.

Chapter 11: **The 2015 Matching Grant Legislation**, explains how Senate Bill 447 made it possible for eligible districts to receive state matching grant funds after

passing a local bond measure for capital improvement projects.

Each chapter includes a checklist of important steps districts should follow and answers to frequently asked questions.

**Appendix I** is a glossary of municipal finance terms.

**Appendix II** lists, by chapter, the citations for state and federal laws referred to in this publication.

**Appendix III** contains a brief description of interest rate exchange agreements or swaps. An important typical feature of municipal debt is that, if properly structured, the interest on that debt is not subject to federal or state income taxes. This tax-exempt status enables public education institutions to borrow at lower interest rates than are available to individuals or private businesses.

To protect the tax-exempt status of their debt obligations, school districts, ESDs and community colleges must diligently comply with all pertinent state and federal laws, rules and regulations.

In addition, investors will not purchase tax-exempt bonds without a bond counsel's opinion. Consequently, this manual cannot substitute for the advice of a duly appointed bond attorney on any procedure or transaction that involves the issuance or administration of municipal debt.



# The Financing Team and Public Debt Markets

*“Earn nicely, spend wisely and you will live happily.”*

*Oscar Auliq-Ice*

Nationwide, billions of dollars in municipal bonds are issued every year. The U.S. Securities and Exchange Commission (SEC) estimates a current total of \$3.8 trillion in outstanding municipal bonds. Issuers, in addition to school districts, ESDs and community colleges, include the full range of municipal jurisdictions:

- ▶ States, cities, counties
- ▶ Municipal power authorities
- ▶ Transportation districts
- ▶ Urban renewal agencies
- ▶ Hospital districts
- ▶ Housing agencies
- ▶ Park, fire and water districts
- ▶ Private universities and other types of 501(c)(3) non-profits such as hospitals and museums

Oregon’s share of the national market historically represents less than 1.5 percent. Oregon’s school districts, ESDs and community colleges represent 0.25 percent. Municipal securities generally are tax exempt, meaning the interest payments are not subject to federal income tax, nor typically to state income tax. This tax-exempt status makes municipal bonds a desirable

investment for investors who are willing to accept lower interest rates in exchange for the tax advantages municipal bonds offer. To establish and maintain tax-exempt status for debt obligations, districts must comply with all federal and state laws, rules and regulations that relate to public debt. This chapter introduces the financial and legal experts available to assist districts in borrowing money in compliance with current regulations. It describes their roles and the roles and responsibilities of the board and district staff. In addition, it includes information about the public debt market where municipal bonds are sold.

## The Financing Team

Federal and state laws, rules and regulations governing public debt are complex and constantly changing. Consequently, the district’s first step in any borrowing is to identify its borrowing team, which should include:

- ▶ The issuer (board members, the superintendent/president, business official and other appropriate staff)

## Six Steps for Successful Tax-Exempt Borrowing

- ✓ Develop a long-term capital construction and improvement plan.
- ✓ Identify potential municipal and professional experts, e.g., bond counsel, underwriter or municipal advisor, etc.
- ✓ With the board’s approval, engage financial and professional experts.
- ✓ In consultation with the financing team, determine funding needs and the appropriate type of borrowing, and obtain voter approval if a general obligation bond.
- ✓ In consultation with financing team, structure debt and sell the bonds.
- ✓ Adopt policies and procedures to maintain the borrowing’s tax-exempt status.

- ▶ Underwriter or municipal advisor

- ▶ Bond counsel

In addition to these financing team members, districts will encounter other participants during the process of issuing and administering tax-exempt bonds:

- ▶ Paying agents who serve as a liaison between the district and the investors who own the district's bonds
- ▶ Regulatory groups such as the Oregon State Treasury, the Internal Revenue Service and the Securities and Exchange Commission
- ▶ Rating agencies
- ▶ Firms that calculate and report arbitrage rebate liabilities

Because municipal bonds are sold under different state laws, the municipal market is often more regional than national. While Oregon school district, ESD and community college bonds usually are sold to investors nationwide, districts are likely to find that financial consultants and bond counsel for their issues come from regional or local service providers who understand local laws, regulations and customs. This is true for local issuers in other parts of the country as well.

## The Issuer

The issuer is the school district, ESD or community college that issues or enters into the debt obligation. The issuer, both before and after closing, is responsible for fulfilling all legal requirements for the debt. (For purposes of this manual, the terms district and issuer are used interchangeably.)

The district board authorizes the process through resolutions. District staff (usually the business manager or superintendent/president) are delegated authority by the board to execute transaction details.

The issuer's roles in the financing process are as follows.

**Board of directors** – The district's board of directors must make the major policy decisions related to any financing. For general obligation bonds, the key components of the policy decision are included in two resolutions, one that authorizes the election and one that authorizes the financing and sets the general terms of the transaction. For other types of debt, only the resolution authorizing the financing is required.

Whether the board is involved in a more detailed role or prefers to delegate the authority to authorized district officials varies from district to district. The board has certain responsibilities to fulfill, either actively or through delegation:

- ✓ Directing the preparation of a long-term capital construction and improvement plan.
- ✓ Determining the district's funding needs in consultation with members of the financing team.
- ✓ Adopting a resolution (prepared by bond counsel) authorizing the election, ballot title and reimbursement, if required.
- ✓ Adopting a resolution (prepared by bond counsel) authorizing the issuance and sale of the bonds. For general obligation (GO) bonds, the resolution must establish the tax classification to pay the bonded indebtedness as outside Oregon constitutional limits.
- ✓ Authorizing the method of sale and the execution of all issuance-related documents and contracts.
- ✓ If desired, causing publication of the notice declaring that bond proceeds are authorized by Oregon constitutional limits. The notice

must be published within 15 days after the authorizing resolution is adopted.

**District staff** – Depending on the district's size and administrative structure, the superintendent/president, business manager or other district staff has responsibility for financing process details. District staff, following board direction, selects and oversees financing team members.

After selecting financial experts and bond counsel, district staff works with them through the preliminary debt analysis and structuring, the election process, and, upon voter approval of general obligation debt, the authorization, sale, execution and delivery of the bonds. Specifically, staff responsibilities include:

- ✓ Providing financial consultants with the required disclosure information for the preliminary and final official statements and providing bond counsel with a project description and draft wording for the ballot title and resolution.
- ✓ Providing information required by rating agencies and bond insurers.
- ✓ Budgeting for debt service for the specific type of bonded indebtedness and obtaining budget committee and board approval as required by the Local Budget Law.
- ✓ Filing the appropriate form with the county assessor to levy for debt service.
- ✓ Overseeing and participating in the bond sale process following voter approval of the bond levy. This includes approving bond pricing (either through negotiation or bid) and assisting bond counsel by providing all requested closing documentation.
- ✓ Directing establishment of capital project funds for the deposit and investment of

bond proceeds (including calculating and paying rebates, if any, during the life of the bonds) and debt service funds to account for the payment of principal and interest on the bonded debt.

## Legal and Financial Experts

The two key professional services needed on public debt issues are (1) legal and (2) financial services. A summary of these roles follows.

**Bond counsel** is an attorney or firm of attorneys that specializes in municipal debt law. Investors usually require an opinion of a nationally recognized bond counsel listed in the "Red Book." Bond counsel provides two services in the debt financing:

- ✓ Ensures all state and federal tax and securities law requirements are met.
- ✓ Provides an opinion to investors that the district's debt is valid and binding and that interest paid on the debt is exempt from federal and state income taxes.

Specifically, bond counsel assists a district by:

- ▶ Determining which financing options comply with state statutes, the Oregon Constitution and federal tax laws
- ▶ Drafting election resolutions and authorizing bond resolutions for board consideration, approval and adoption
- ▶ Working with the district to draft the ballot title and explanatory statement for general obligation bonds
- ▶ Reviewing and commenting on portions of the preliminary and final official statements, directing the bid opening for a competitive bid sale, or reviewing the bond purchase agreement for a negotiated sale
- ▶ Preparing closing documents,

including a non-litigation certificate, no-arbitrage certificate and the Internal Revenue Service information filing for execution by the authorized district representative

- ▶ Coordinating the delivery of the bonds and the receipt of the bond proceeds
- ▶ Issuing an approving legal opinion
- ▶ Preparing and distributing transcripts of the proceedings to the financing team

## Financial Services

There are two areas in which districts use financial services when issuing debt:

1. Planning for and structuring the issue to best fulfill the district's goals, generally prior to the election, and
2. Upon a successful election, selling the bonds and obtaining proceeds.

The first service may be provided by either an underwriter or a municipal advisor; the second is provided by either an underwriter (for a public sale) or a bank (for a direct bank placement). In Oregon, as with bond counsel services, these are considered contracts extended in connection with the issuance of obligations and are not subject to state bidding requirements under ORS 279A.25(12)(9).

## Regulatory Differences Between Municipal Advisors and Underwriters

Municipal advisors and underwriters are regulated by the Municipal Securities Rulemaking Board (MSRB), the self-regulatory arm of the Securities and Exchange Commission. MSRB rules distinguish between the role and responsibilities of these two service providers. An underwriter must "deal fairly" with an issuer, but has no explicit fiduciary

responsibility to the issuer. A municipal securities professional serving as a municipal advisor, whether working at a brokerage/underwriting firm, or at a private municipal advisory firm has a fiduciary responsibility to the issuer. That means the advisor must put the issuer's best interests above those of his or her firm. A firm cannot provide municipal advisory services and serve as an underwriter or placement agent on the same transaction. Under Oregon law, there is no requirement to hire a municipal advisor except in the case of advance refundings. By contrast, an underwriter must be retained to sell the bonds in the public market. If a private placement is contemplated, the underwriter may instead serve as the placement agent.

While municipal securities professionals at brokerage firms have long been subject to regulatory registration and qualification rules, municipal advisors have recently become subject to registration requirements as well. The MSRB continues to improve disclosure and standards in this area and districts should visit the MSRB website ([www.msrb.org](http://www.msrb.org)) for the most recent rules and regulations under which underwriters and advisors must conduct business. The website is also an excellent source of information regarding the municipal market in general.

Whether using an underwriter or municipal advisor, a district should expect its chosen municipal securities professional to assist with the following services:

- ▶ Preparing recommendations on bond issue structure and timing of sale
- ▶ Providing the district with a cost of issuance estimate for inclusion in the size of an issue
- ▶ Providing debt service and tax rate information for use in



district information about the bond levy election for general obligation bonds

- ▶ Providing estimates of proposed debt structure tax rate impacts for general obligation bonds
- ▶ Reviewing the authorizing resolution and other legal documents
- ▶ Preparing the preliminary and final official statement
- ▶ Recommending and assisting the district in evaluating the need for a rating
- ▶ Developing a ratings strategy and evaluating use of the Oregon School Bond Guaranty or bond insurance
- ▶ Preparing a rating presentation for discussion with rating analysts
- ▶ Assisting with the application for the Oregon School Bond Guaranty program, if desired
- ▶ Developing bid specifications for use in the official notice of sale if using a competitive bid
- ▶ Assisting in closing the transaction

Underwriters are securities firms that purchase debt from a district and resell it to investors in the bond market. The underwriter may purchase the bonds by bid at a public sale or through direct negotiation with the district. In a negotiated sale, the underwriter typically performs some or all of the structuring duties required by the district prior to the bond sale.

**School attorney** – While bond counsel provides the key financing documents and resolution forms, some districts involve their local attorney to ensure that the district remains in compliance with local laws relating to meetings, filings and other official district actions related to the financing. The local school attorney may:

- ✓ Provide legal counsel to the board, the superintendent/

president and the business manager, clerk or deputy clerk.

- ✓ Help monitor the bond election and monitor board meetings to insure compliance with public meetings laws and with the school district's policies and procedures.

**Pricing advisor** – In a negotiated sale only, a district may wish to engage a municipal advisor in a limited capacity to evaluate the pricing terms offered by the underwriter. The pricing advisor typically:

- ✓ Consults with the district on its financing priorities.
- ✓ Attends the pre-pricing conference meeting with the district and underwriters.
- ✓ Assists in negotiating pricing terms with underwriters.
- ✓ Delivers a letter that recommends acceptance of pricing terms.

**Registrar/paying agent** – The registrar/paying agent is a corporate trust department of a commercial bank. The district designates the paying agent to:

- ✓ Receive debt payments from the district that the agent uses to make interest payments to registered bond owners on the payment dates and to redeem principal on redemption dates.
- ✓ Keep the official records relating to bond ownership.

**Escrow trustee** – For refundings, the escrow trustee (usually the same firm as the paying agent) holds funds deposited in a refunding escrow that are dedicated to paying off the district's outstanding debt. The escrow trustee publishes the redemption notice, as required, and makes the refunded debt payments from the escrow fund. There also is an escrow trustee on lease-purchase financings. For "full faith-and-credit obligations," the escrow trustee is the issuer of the certificated interests in the issuer's financing

agreement and also performs the tasks of the paying agent.

**Rating agencies** – Provide an independent evaluation of the district's credit relative to bond issues and similar credits nationally. Through the rating system, an investor anywhere can quickly judge the credit quality of an Oregon district even though that investor knows nothing specifically about the district or its community. Applying for a rating is an economic decision, not a legal requirement.

**Credit enhancers** – These firms provide irrevocable insurance policies that additionally secure the debt. There are two kinds of credit enhancers:

- ✓ Bond insurers, for a one-time premium, offer irrevocable insurance policies that will pay the district's debt service if the district should ever default on its debt payment obligations. The Oregon School Bond Guaranty Program run by the Oregon Treasury also offers this coverage for school district and community college general obligation bonds.
- ✓ Bank letter of credit (LOC). For both an upfront fee and ongoing annual fees, commercial banks may offer to guarantee the debt of a municipal issuer. Bank LOCs are more common on variable rate debt than long-term debt.

The use of some form of credit enhancement is an economic decision, not a legal requirement.

**Arbitrage rebate services** – There are firms that specialize in providing arbitrage rebate services to tax-exempt bond issuers. Many districts engage these firms to calculate rebate liability. (See Chapter 6, Federal and State Tax Treatment, for an explanation of arbitrage rebate rules.)

**Oregon State Treasury (Debt Management Division)** – The Debt Management Division of the



## Tax Exemption Benefits to Investors

Bond	3.35% tax-exempt from Municipal issuer	5.00% taxable U.S. Treasury
Cash investment	\$10,000	\$10,000
Interest	335	500
Less: Federal income tax (33%)	–	(165)
Net return	335	335
Yield after taxes	3.35%	3.35%

Taxable equivalent yield = tax-exempt rate / (1-marginal tax rate)

Note: This simple example does not account for credit quality and liquidity differences between a municipal security and a U.S. Treasury obligation.

Oregon State Treasury serves as a clearinghouse for information. With the exception of approving advance refundings, the treasury does not approve or disapprove any local debt issuance plans or take positions on local debt issuance. However, for advance refundings, the Debt Management Division must review and approve preliminary and final advance refunding plans submitted by the underwriter or advisor.

The Debt Management Division also oversees the Oregon School Bond Guaranty Program, tracks overlapping debt statistics and maintains a calendar of upcoming Oregon municipal debt issues.

### Market Factors

When a school district sells debt, it is, in essence, creating a “product” that needs a market. A brief understanding of the market side (e.g., investors and underwriters) can be helpful in evaluating a district’s options as it contemplates “making” a bond issue and selling it.

### The Investors

Investors loan districts money by purchasing the district’s debt. Because interest on municipal debt is usually exempt from federal and state taxes, these investors are looking to shelter income from taxation. The demand for tax-exempt debt

is always subject to investors’ evaluation of tax-exempt securities versus higher yielding but taxable investments such as stocks or U.S. Treasury bonds. See table, Tax Exemption Benefits to Investors, above.)

Districts typically have no direct contact with investors who purchase the district’s debt. The underwriters are the district’s agents in contacting investors and selling the debt to them. However, districts should understand what kinds of investors purchase municipal securities.

Most investors who purchase municipal securities are seeking a fixed rate of return on their investment that is exempt from federal (and, where applicable, as in Oregon, state) income tax. These investors range from individuals (retail investors) to large institutional investors such as property and casualty insurance companies, money market funds or mutual funds. The classes of investors who purchase municipal securities are:

- ▶ Retail: Individual investors
- ▶ Retail proxies: Bank trust departments, investment advisors, tax-exempt mutual funds and tax-exempt money market funds (sometimes referred to also as “professional retail”

- ▶ Institutional: Property and casualty insurers, corporations and bank portfolios

Sometimes districts will actually sell their securities directly to investors. This generally occurs when vendors finance equipment or when a district places an issue directly with a bank portfolio department as if it were a bank loan.

Sometimes an issuer may place an issue directly with a commercial bank. The issuer’s authority (e.g., to issue a general obligation bond or a full faith and credit issue) does not dictate who buys the issue. For some issues (particularly those that are smaller and shorter term) the issuer may find that a commercial bank may wish to buy the entire issue. In this circumstance the issuer may forego much of the costs and regulatory burdens of a public securities offering.

When deciding on the relative value of a tax-exempt offering, investors are not only looking at the bond yield (or return), but its relative value as far as maturity structure, future liquidity (how easy will it be to sell or trade in the future) and most importantly, its credit quality. The weighting given to credit quality and liquidity can explain why a tax-exempt bond may often trade at a yield equal to or higher than a comparably termed U.S. Treasury security.

### The Underwriter

Underwriters buy bonds from an issuer and resell them to investors. Underwriters not only find investors for the district’s bonds, they also take the risk out of the transaction for the issuer. Once the underwriter offers to purchase the bonds, the issuer is no longer at risk if the issue does not sell or if the interest rates rise. Because investor interest in tax-exempt debt fluctuates with profitability and the relative supply of tax-exempt bonds in the

market, it is the underwriter's job to find the most aggressive set of buyers for a district's offering on the day it comes to market.

Sometimes, underwriters join together in a syndicate. Having more than one underwriter spreads the financial risk if the bond sale does not go well. When there is more than one underwriter in a deal, one firm leads the transaction while the others take secondary roles. The lead firm is called the lead underwriter or senior manager. Other underwriters are called co-managers. There may be one or several co-managers, or none.

The senior manager is responsible for interacting with the issuer, setting pricing terms for the bonds, managing the sale and allocating bonds to all investors at the sale's conclusion. Co-managers assist in the bond sale but generally have no other role.

Syndicate firms agree on a target percentage of the bonds to sell. For example, the senior manager may get 70 percent while a co-manager may get 30 percent. These percentages are only guidelines; actual orders dictate

the number of bonds each firm receives at the end of the sale. However, if bonds go unsold, these percentages dictate each manager's liability for the unsold bond inventory.

Selling group members are not syndicate members. Selling group firms are securities firms that are granted the opportunity to put in orders for a new bond issue.

Unlike co-managers, selling group members are not "guaranteed" that bonds will be allocated to them. However, selling group firms do not have any liability to take bonds if the sale goes poorly, nor are they required to order any bonds.

### Method of Sale

Municipal offerings are typically sold via one of three methods:

1. A negotiated sale, where the underwriter is selected as part of the finance team up front and participates in the structuring and sale of the issue;
2. A competitive or public bid, where a municipal advisor helps structure the issue and then the issue is put out for the best bid; or

3. A non-public offering to a bank as a loan or to a small group of investors as a private placement.

These options are briefly described below.

**Negotiated sale** – By negotiating the sale of a bond issue, the district maintains control over which underwriting firm structures and markets its bonds. One underwriting firm may be more qualified than another to structure or market an issue with unique aspects.

Negotiated sales make up about 70 percent of all municipal sales by volume.

If a district negotiates the bond sale with an underwriter, the district gains flexibility in adapting to changing market conditions and investor coupon preference. Taking into account the district's need for project money, the underwriter selects the timing of an offering to coincide with a favorable market and receptive investors in an attempt to get the best interest rate for the district.

Once a target sale date is selected, the underwriter continues to monitor the market

## The Negotiated Sale Process

10-14 days before pricing	Seven days before pricing	Two days before pricing	One day before pricing	Pricing/ Sale day	About 2 weeks after pricing
<input type="checkbox"/> Rating received <input type="checkbox"/> Preliminary Official Statement (POS) finalized and distributed	<input type="checkbox"/> Underwriter's sales force begins premarketing calls to investors <input type="checkbox"/> Use of selling group reviewed	<input type="checkbox"/> Underwriter updates the issuer on market conditions <input type="checkbox"/> Financing goals reviewed	<input type="checkbox"/> Preliminary pricing conference with underwriter, issuer (and municipal advisor, if any) <input type="checkbox"/> Market conditions reviewed and comparable pricing analyzed <input type="checkbox"/> Preliminary interest rates determined	<input type="checkbox"/> Official order period begins <input type="checkbox"/> Orders compared against available bonds <input type="checkbox"/> Pricing adjustments determined as necessary <input type="checkbox"/> Underwriter offers to purchase <input type="checkbox"/> Final numbers packet prepared	<input type="checkbox"/> Closing documents signed <input type="checkbox"/> Funds delivered to issuer

and advise the district whether the sale should be accelerated or moved back, depending on market conditions.

When the week of sale arrives, the underwriter provides preliminary interest rate estimates to the district, along with any available information regarding comparable sales. The day before the sale, the underwriter schedules a pricing conference with the district to confirm the interest rates that the underwriter will offer to investors the next day. The actual sale happens quickly, with the formal sale (order period) typically beginning early in the morning and concluding by midmorning. Districts may attend the pricing in person at the underwriter's office or request access to an online order entry system to monitor the sale during the order period. The underwriter reviews the results with the district and recommends whether any adjustments are necessary to conclude the sale process.

Once the district and underwriters agree on terms, the underwriter offers the district a bond purchase agreement that is the legally binding sale document. Issuers may also choose to employ a municipal advisor

in a negotiated sale, along with the underwriter. The municipal advisor's role may be comprehensive (e.g. assists in all aspects of structuring and advises on the pricing terms) or may be more limited (e.g. only advises on the pricing terms).

#### **Competitive bid sale –**

Competitive sales typically comprise about 25 percent of municipal sales each year. In a competitive sale, the terms of the issue – size, structure, maturity dates and amounts, and redemption provisions – are determined prior to the sale and distributed in a notice of sale. Bids are almost always taken via electronic bidding platforms.

The notice of sale contains the bidding rules, constraints, the amount and handling of any good faith deposit submitted by the winning bidder, and the method for evaluating the bids the district receives. The district establishes these terms in consultation with its municipal advisor and bond counsel.

Bidders (underwriters or syndicates of underwriters) base their bids on the salability of the district's debt, the stability of the bond market, and their pool of potential bond purchasers. The successful bidder establishes its

reoffering prices to investors by considering comparable sales, what investors are willing to pay, and the supply of bonds in the market waiting to be sold.

In a competitive bidding, the district hopes to receive numerous bids in response to its notice of bond sale, thereby increasing its chances of paying the lowest possible interest rate on its debt. To increase the odds of this happening, the bond sale should be set at a date and time when the bond market is most receptive to a new issue. Bids typically are calculated by the true interest cost (TIC) method. TIC is defined in the Appendix I.

The financing team should set the bond sale date after consulting the Oregon State Treasury's Debt Management Division's Oregon Bond Calendar.

Ideally, a sale should be held at a time when the market is not saturated with other local or national issues. Sales on Tuesday, Wednesday and Thursday are typically preferable. Sales scheduled for Mondays and Fridays and days bracketing holidays and long weekends are less common.

As noted above, bids are now commonly received electronically over the Internet. Bid constraints now provide greater flexibility for the issuer to resize or restructure the original offering to react to the terms bid by the underwriter.

**Private Placements –** Placing debt directly with a bank comprised about 5 percent of the national municipal bond market, according to The Bond Buyer trade publication. Bank placements have become increasingly attractive to districts as the interest rates banks are able to offer have become more competitive with the public debt market. Districts may wish to pursue a private placement to reduce disclosure requirements, shorten the

### **The Competitive Sale Process**

<b>3-4 weeks before the sale</b>	<b>1-2 weeks before the sale</b>	<b>Sale day</b>	<b>About 2 weeks after sale</b>
<input type="checkbox"/> Issue structure and bid constraints determined	<input type="checkbox"/> Notice of Sale distributed electronically <input type="checkbox"/> Preliminary Official Statement (POS) distributed electronically	<input type="checkbox"/> Bids received from underwriters <input type="checkbox"/> Award of bonds to lowest bidder <input type="checkbox"/> Structure adjusted if as needed <input type="checkbox"/> Final numbers packet	<input type="checkbox"/> Closing documents signed <input type="checkbox"/> Funds delivered to issuer



issuance timeline, eliminate credit rating requirements and lower issuance costs. However, banks have particular structure and term requirements so this may not be an option for everyone. Districts should discuss the option with their underwriter/placement agent or municipal advisor.

While a district could simply call up their local bank and negotiate a deal to purchase the bonds directly, this is not advisable. Having bond counsel and a municipal advisor or placement agent involved can help the district avoid undesirable provisions that banks may try to include. A placement agent can also help the district obtain a competitive interest rate by soliciting bids from a wide audience of banks.

There is no official statement prepared in a private placement. Instead, a brief term sheet which outlines the security, terms and key financial information is prepared and circulated to banks. After bank responses are received, the district reviews with the financing team and selects a bank offering the most favorable terms. The district is not required to simply award to the lowest interest rate; other factors, such as prepayment provisions, may

come into consideration. In addition, as discussed in Chapter 7, disclosure of onerous bank loan terms to the securities market is a best practice and may become required.

## Interest Rate Swaps and Other Derivative Products

As of January 1, 2004, all Oregon municipalities, including school districts, ESDs and community colleges, received broad legal authority to use a new set of financial management tools. While interest-rate-exchange agreements (swaps) and their various permutations are not debt per se, they are related and based on debt that was or will be issued. These financial tools are generally outside the scope of this manual, although this manual describes some basics about these instruments throughout the manual where they may be applicable. Issuers wanting to know more about these financial instruments should contact their financial consultants and bond attorneys.

For the most part, swaps have limited application to Oregon school districts, ESDs and community colleges because of

certain risks and the prevalence of fixed-rate general-obligation borrowing. See "Interest Rate Swaps with General Obligation Bonds" in Chapter 2 and see Appendix 3 for a brief discussion of interest rate swaps.

### The Private Placement Process

3-4 weeks before bids due	2 weeks before bids due	Bids due	2-4 weeks after bids due
<input type="checkbox"/> Issue structure and terms determined	<input type="checkbox"/> Term sheet circulated to banks	<input type="checkbox"/> Bids received from banks <input type="checkbox"/> Select bank offering most favorable terms <input type="checkbox"/> Interest rate locked <input type="checkbox"/> Structure adjusted if needed	<input type="checkbox"/> Closing documents signed <input type="checkbox"/> Funds delivered to issuer



## Frequently Asked Questions about the Financing Team and Public Debt Markets

**Q: How much time does district staff have to spend on a bond issue? Can't we just hire someone to take care of it?**

A: The district relies on a number of financial industry professionals to guide it through the issuance process. However, the district has ultimate legal responsibility for the bond issue. Consequently, district officials must understand the process and all the implications of actions taken.

**Q: What official actions must the district's board take on a bond election and sale?**

A: There are two actions:

- 1) Adopt a resolution authorizing the election and ballot title
- 2) Adopt a resolution authorizing issuance of the bonds after a successful election

How much the board participates in the details of the process outside these actions varies by district. Typically the board is more involved in determining the projects and the size of the bond levy than in the subsequent details of the bond issuance process.

**Q: How does a district engage finance industry professionals?**

A: Districts have authority to engage service professionals, according to board policy, in any manner that best fits the district's particular situation. Bond counsel, underwriter and municipal advisory services are not subject to public contracting rules pursuant to ORS 279A.025(2)(g)(A).

**Q: When should the district engage financial consultants and bond counsel? How are they paid if the district doesn't have the money for fees unless the bond passes?**

A: Districts should engage financial consultants and bond counsel as early as possible. Many finance industry professionals are paid on a contingency basis. This means they do not charge for services until the bond issue passes and sells. Districts should ask potential service providers whether they would work on a contingency fee basis. If not, find out what fees will be charged if the election fails or an issue does not close for some reason.

**Q: What is the difference between a competitive bid sale and a negotiated sale?**

A: In negotiated sales, the district engages the bond underwriter prior to the bond sale. The underwriter usually does the structuring and analytical work for the bond issue, then, during the sale, underwrites and sells the bonds as well.

In a competitive bid sale, the district engages a municipal advisor to structure the bonds and provide other analysis. The bonds are then sold to the highest bidding underwriter at an advertised bid opening.

**Q: Can we sell our bonds to members of our own community? Our local brokers want some of the bonds to sell.**

A: A district can direct its underwriter to give preferential allocations to investors from within the district's boundaries. To do this, the district must use a negotiated sale so that the district retains control over the actions of its underwriter(s).

Local brokerage offices can be good sources of sales to retail customers and can be included in the sale as selling group members. (See the discussion on underwriting syndicates, page 7).

However, local investors typically cannot absorb the entire bond issue.

In addition, local sales campaigns may not be the cheapest way to sell bonds. Consequently, local sales campaigns can conflict with the district's responsibility to get the lowest possible interest rates for its taxpayers. Districts should consult with their financial service providers about including its community in a bond sale without raising issue costs.

**Q: Our board members and staff want to buy some of the bonds to show support for the district. How do we do that?**

A: The district board and staff must exercise caution here. Technically what is "good" for the board and staff as "investors," i.e., higher interest rates, is "bad" for the district's taxpayers. Because the board and staff have responsibility for approving final interest costs, the potential for a conflict of interest is clear.

*“Education costs money, but then so does ignorance.”*

*Sir Moser Claus*

**S**chool districts, education service districts and community colleges are authorized to issue general obligation bonds and notes to finance capital construction and improvements. General obligation bonds must be approved by district voters and are secured by the full faith and credit of the district’s property taxing authority. Voter approval of a bond measure authorizes a district to sell bonds in a par, or face, amount not to exceed the amount specified on the ballot and levy taxes in the amount necessary to pay the principal and interest on the bonds. Under ORS 334.125 ESDs are required to contract general obligation bonded indebtedness through a vote of all those within the ESD’s boundaries or through creation of a county education bond district.<sup>1</sup>

## General Obligation Bond Requirements

**Use of proceeds** – Districts are authorized to issue general obligation bonds upon approval of a majority vote in a May or November election with no voter turnout requirement or a majority vote in a March or September election with a 50 percent voter turnout requirement.

If a general obligation bond is secured by unlimited property taxes, the proceeds can be used only for capital costs as defined by Article XI, Sections 11L of the Oregon Constitution.

Bonds issued before Jan. 1, 2011, are subject to the constitutional definitions of allowed projects in effect at the time of issuance.

Bonds issued on or after Jan. 1, 2011, are subject to Article XI,

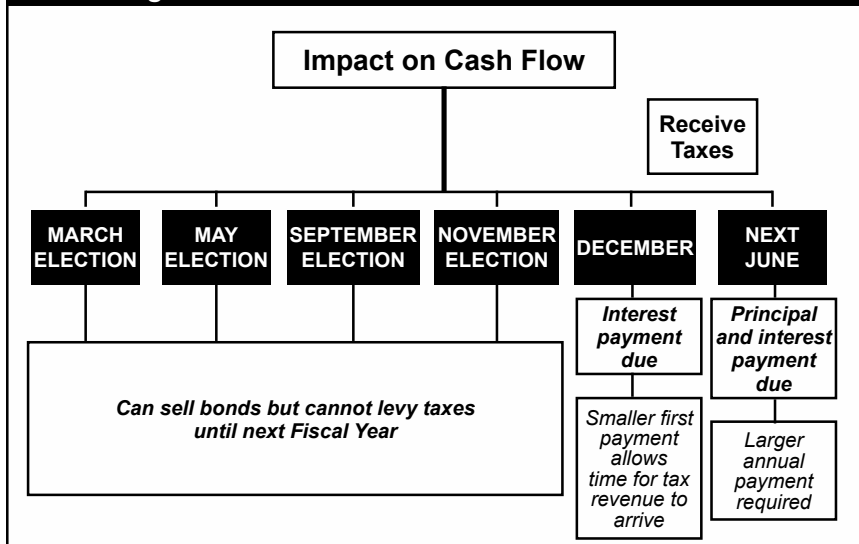
## Nine Steps for Using General Obligation Bonds

Districts considering the use of general obligation bonds for capital costs should:

- ✓ Establish a community advisory committee to assist in the planning process to determine the scope of the projects to be financed by the bonds and the size of the bond issue.
- ✓ Complete a long-range facility plan and facility assessment that meet requirements for the Oregon School Capital Improvement Matching (“OSCIM”) Program.
- ✓ Conduct community research – surveys, focus groups, school community meetings – to determine voters’ understanding of the need and support for the proposed projects.
- ✓ Select and retain underwriter or municipal advisor and bond counsel.
- ✓ Establish a planning calendar with specific targets for progress to the election and for anticipated completion of the project(s).
- ✓ Submit application and related documents for the OSCIM program.
- ✓ Finalize the scope of the project(s) and the size of the bond issue, including all applicable construction and bond issuance costs and fees.
- ✓ Adopt an election resolution and a subsequent authorizing resolution.
- ✓ Develop budgets for both capital projects and debt service funds.

<sup>1</sup> An ESD county education bond district (CEBD) is formed under ORS 328.304 as follows: A CEBD may be formed if two-thirds of the component school districts with at least a majority of the students approve a resolution creating the CEBD. The boundaries of the CEBD must be coterminous with the boundaries of the school districts that have administrative offices within the boundaries of one county within the ESD.

## Selecting the Election Date



Section 11L, which requires that bond proceeds be used for capital costs.

Also, the weighted average life of the bonds may not exceed the weighted average life of the capital costs that they finance.

The constitution defines "capital costs" to mean costs of land and other assets having a useful life of more than one year, including costs associated with acquisition, construction, improvement, remodeling, furnishing, equipping, maintenance or repair.

Capital costs do NOT include costs of routine maintenance or supplies.

In addition to meeting the constitutional and statutory restrictions, school districts, ESDs, and community colleges may only issue bonds for the purposes authorized in the statutes that give those entities the authority to issue bonds. Under ORS 328.205, school districts may issue bonds for the following projects:

- ▶ Acquire, construct, reconstruct, improve, repair, equip or furnish a school building or school buildings or additions thereto

- ▶ Fund or refund the removal or containment of asbestos substances in school buildings and for repairs made necessary by such removal or containment
- ▶ Acquire or improve all property, real or personal, to be used for district purposes, including school buses
- ▶ To fund or refund outstanding debt and provide for payment of debt

Community colleges have a separate statutory authority, ORS 341.675, to fund projects with bond proceeds. Community colleges are authorized to use bond proceeds for the following purposes:

- ▶ To acquire, construct, reconstruct, improve, repair, equip or furnish a college building or buildings or additions thereto
- ▶ To acquire or improve all property, real or personal, appurtenant to or connected therewith, including self-financing facilities
- ▶ To fund or refund outstanding debt and provide for payment of debt

The use of bond proceeds and any interest earned on investment of the proceeds are also limited by the purposes that are identified in the ballot title authorizing the issuance of the bonds. Examples:

- ▶ A school district whose ballot title specifically sought authorization to build and equip a new elementary school may not use some portion of the bond proceeds to remodel the high school
- ▶ A school district or community college that includes the purchase of property in its ballot title but does not include the demolition of the existing structures on that property may find it cannot use bond funds to pay demolition costs

Districts wishing to maintain flexibility in the use of bond proceeds should be careful not to restrict the ballot title language too severely. A discussion of the ballot title requirements for general obligation bonds is included in Chapter 5.

**Debt limitations** – State law limits the amount of outstanding general obligation debt school districts, ESDs and community colleges may have at any time. The limit is based on the district's real market value and the number and kinds of grades the district serves. In general, debt limits are as follows:

- ▶ For K-12 districts, the debt limit is 7.95 percent of the district's real market value
- ▶ For K-8 districts, the debt limit is .55 percent per grade level of the district's real market value
- ▶ For 9-12 districts, the debt limit is .75 percent per grade level of the district's real market value
- ▶ For ESDs, the debt limit is the same as K-12 districts,



7.95 percent of the ESD's real market value. For a CEED only the taxable property within the component school districts in the designated county is used to calculate the debt limit

- For community colleges, the debt limit is 1.50 percent of real market value

Note that although Measure 50 reduced assessed value, it did not affect real market value or a district's debt capacity.

In most cases, large districts are unlikely to approach their debt limits. However, very small districts may find that the cost of constructing new buildings pushes them close to, or over, their debt limits. Consequently, small districts should exercise caution in determining the size of a bond issue.

#### **Notice of classification of uses –**

The district may give notice of its adoption of an ordinance or resolution specifying the authorized uses of proceeds of bonded indebtedness within 15 days after the adoption of the authorizing action in its newspaper of record, in the form described in ORS 305.580(9). This process shortens the time period for challenging the uses of bonded indebtedness proceeds to within 60 days after the adoption of the resolution or ordinance. If such notice regarding the authorized use of proceeds is not published, a petition to challenge the use of bonded indebtedness proceeds may be filed within 180 days after the questioned use of the proceeds is made.

ORS 305.587 provides that when a petitioner challenges the authorized use of proceeds of bonded indebtedness, the tax court will construe the language in the measure authorizing the indebtedness liberally to allow the government unit to provide

the facilities or services approved by the voters. However, if the court finds the challenged use of proceeds was not authorized under applicable law, it may prohibit the expenditure or fashion another remedy that does not impair the security of the bondholders or the value of the bonds in accordance with ORS 305.586.

### **Structuring Long-Term Bond Issues**

School districts have substantial leeway in structuring debt issues for the public debt markets. Given the complexity and constantly changing nature of debt investors' preferences, districts are urged to hold early consultations with their underwriters or municipal advisors about market expectations and the likely repayment implications of the district's debt plans. Such early consultation will assist the district in developing the best possible debt management plan.

In general, a district has four primary considerations in any given debt financing:

- Raise sufficient funds, in a timely manner, to meet the district's project requirements
- Meet tax rate projections communicated to the public during the election campaign
- Provide for future debt capacity
- Raise the funds in the most cost-effective manner

Each of the following issues directly affects the size of the amount a district will refer to voters and the district's ability to repay that debt in the most cost-effective manner possible.

#### **Project fund requirements –**

The most important variable affecting debt issue size is the project's estimated cost. Normally, estimates include the estimated cost of the project(s) and a reasonable contingency

amount to cover unexpected events. If a district is concerned about the affordability of a project, it may also consider using expected project fund earnings to reduce the par amount of the bond issue. The district's underwriter or municipal advisor can estimate project fund earnings and advise the district regarding their use to reduce the amount of the bond issue.

The money in the project fund will earn interest until it is expended. In the case of a construction project, these interest earnings, even if subject to arbitrage rebate (see Chapter 6, Federal and State Tax Treatment), can be substantial. These additional earnings are considered bond proceeds just like the initial sale proceeds received at closing. These proceeds must be used only for the project or to pay debt service on the bonds. The project fund earnings cannot be used for any other purpose.

**Issuance costs –** The sale of debt in the public markets is highly regulated. Bringing a debt issue to market generally requires the use of experts who specialize in municipal bond transactions (see Chapter 1). Consequently, the issuance of debt comes with certain transaction costs that should be included as part of the bond issue. The district's municipal advisor or underwriter can determine the likely issuance and underwriting expenses. The issue then can be properly sized to pay for these expenses and still have sufficient funds remaining to pay all project costs. Issuance costs generally include fees for bond counsel, municipal advisor, registrar/paying agents, escrow agents, rating agencies, the Oregon School Bond Guaranty Program and/or other credit enhancement costs and other state regulatory fees, and underwriting fees. There may



be travel expenses related to the issuance process and other miscellaneous expenses.

Issuance costs vary, depending on the size, credit quality, term, complexity of the debt issue, and market conditions. They may range from as little as \$20,000 for a very small issue to more than \$100,000 for large or complex transactions (exclusive of underwriting fees). Underwriting fees may vary from .25 percent or less of the issue amount for a highly rated, short-term issue to 2.0 percent or more for smaller, longer term, unrated issues. Issuance expenses are almost always paid from bond proceeds and not due until after the bond issue has closed. Some application fees may be paid prior to closing and districts can reimburse themselves from bond proceeds.

#### Market Premium and Discount –

Voters authorize a district to sell a maximum par amount of bonds. However, investors often prefer to buy bonds at prices that may either exceed the par amount (a “premium”) or at a price lower than the par amount (a “discount”). Depending on market conditions, these market premiums or discounts may amount to a significant difference from the par amount of bonds.

In case of market premiums, the district has the option of retaining the amount received in excess of par. This amount is considered additional bond proceeds and may be only used for project costs outlined in the ballot title. It is important to note that premiums received above the par amount are generated by commensurately higher interest payments on the bonds. Consequently, while the district is receiving more in the way of proceeds than the par, it is also paying additional interest cost as well. However, additional premium paid upfront reduces the ultimate yield to the investor so that the premium structure still provides the lowest cost to the district.

The opposite condition – market discounts – can be a more serious problem for general obligation bond issuers. Under such conditions, the district cannot simply offer more par bonds to make up the discount because voters have authorized a maximum par amount. The district should work with its underwriter or municipal advisor to attempt to minimize the loss of proceeds under such a market scenario. Where market discounts are the market “norm” when the district is formulating its election request,

the district should ask its finance professionals how to size up the par amount request to account for possible market discounts at the time of sale.

## Issue Affordability and Tax Rates

Once a district decides on the size of its bond request, it can then determine how to structure bond issue terms to best achieve its affordability goals. The most cost-effective method of financing is the method that best matches the issue size and repayment structure to the district’s (and its taxpayers’) financial ability to meet the debt obligation.

The question of affordability must be translated into estimated debt service and, for general obligation bonds, tax rate projections that can be compared to the resources available for repayment.

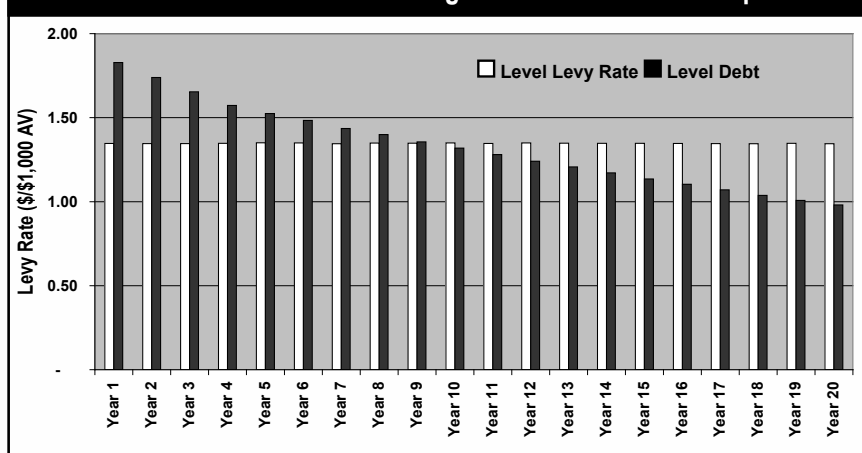
Taxpayers do not pay a set “levy rate.” Taxpayers pay taxes, in dollars. Tax rates for bonds are calculated simply by dividing the annual debt service (plus estimated collection delinquencies) by the total taxable assessed value (not real market value) of the district. Then, for an individual taxpayer, that rate is applied to the taxpayer’s property assessed value with annual dollars amount resulting owed for that fiscal year.

Consequently, the art and science of translating a dollar of par amount needed for projects into a debt service structure and estimated tax rates is a critical part of evaluating the affordability of the district’s bond request.

## Budgeting and Cash-Flow Concerns

Districts must be careful to structure initial bond repayments on a schedule that allows for adequate collection of the initial year’s tax levy. Districts must

**Basic Structure Choice – Oregon School District Example**



submit notice of the tax levy for bonds by July 15 unless the county assessor grants an extension (usually early or mid-September). Initial collections will not be available until November or December. If a district sells debt after the tax levy has been submitted, collections will not be available until the following fiscal year.

Districts must also account for the levy impact created by uncollected taxes in the levy's first few years. Because there are no prior year collections yet to offset uncollected taxes, the tax rate in the early years can spike up higher than anticipated or a district may not collect enough to make the debt service payment and may need to borrow from the general fund.

Consequently, in the first years of a new bond property tax levy, a district will need to account for current year uncollected taxes not offset by prior year tax collections. Districts must also assure they levy the necessary taxes in their initial budgets sufficient to pay the first year's debt service payment. Of particular concern is the authorization to levy taxes during the budget process when a district holds a May election. In some situations district budgets may be finalized before the results of the election are known. If the district does not have proper approval to levy taxes for debt service from their budget committee, they will not be able to collect taxes in the following fiscal year.

## Debt Repayment Schedules

The district's underwriter or municipal advisor can prepare issue structures to achieve the district's desired repayment impact. Simple examples of various structures:

- ▶ A **level debt** structure, in which debt service each year is about equal
- ▶ For general obligation bonds, a **level levy rate** structure, in which the debt repayment is designed to achieve an approximately level tax rate every year, based on projections for future assessed value growth
- ▶ A **structure** that allows for anticipated future debt issuance
- ▶ A **combination** of these approaches, designed to produce a particular debt service and/or tax rate impact

## Specific Debt Repayment Options

Several specific structuring options relating to general obligation bonds are discussed in this section. The structure of a bond issue, i.e., the timing and manner of principal and interest payments, should coincide with the district's repayment plan.

**Maturity schedule** – A general obligation bond issue's final maturity is limited only by the terms of the ballot title. Most school district, ESD and community college bonds are sold to mature over 20 to 30 years. Shorter or longer maturities are less common. The weighted average maturity of the bond may not exceed the weighted average useful life of the projects being financed. The optimal maturity period for individual districts depends on the relative tax rates that a longer or a shorter maturity produces and which rate is most acceptable to taxpayers. Generally, extending the term will increase the total interest cost but reduce the annual payment and levy rate.

**Structuring goals** – The most important consideration in determining bond issue size and

structure is balancing project requirements with affordability. Affordability can be measured several ways. However, with general obligation bonds that are repaid primarily, if not entirely, from property taxes, affordability translates into the tax rates paid by taxpayers. Taxpayers do not pay an interest rate per se; they pay dollars expressed in a tax rate per \$1,000 of assessed value of their property.

One measure of affordability then is the tax rate's impact on the taxpayer over the life of the bond issue. The district should also consider the cost of any outstanding debt and any future debt plans as well.

The optimal repayment plan is one that best matches the debt service to the district's ability to repay. In the case of general obligation bonds, the district does not repay the bonds out of its own resources, its taxpayers do. Consequently, the question a district must answer is, "What repayment plan best fits our taxpayers' abilities and inclinations?"

Here are several repayment plans and their impact on tax rates:

**Level debt service** – In this plan, the new issue is structured to produce a debt service schedule that is relatively level each year. This is akin to the standard fixed rate home mortgage. In the early years, debt service is primarily interest. In the later years, debt service is primarily principal.

Level debt service produces higher tax rate impacts in the early years and declines over the life of the issue as a result of the growth in the district's assessed value.

**Level principal** – In this plan, a level amount of principal is repaid each year. This results in declining total debt service each

year because interest expense is reduced as principal is repaid. A level principal repayment plan is rarely used in Oregon because it produces high tax rate impacts in the early years of the financing.

**Level levy rate** – This repayment plan structures debt service so that the resulting tax levy rates are projected to be more or less the same each year. This structure accounts for estimated growth in assessed value and the corresponding increase in repayment resources. This structure, on average, defers principal repayment slightly to account for increasing assessed values.

A level levy rate plan can significantly reduce taxpayers' early year tax rates. The lower tax rates produced by rising assessed values are captured early in the repayment plan rather than later as occurs in the level debt service approach.

Two of these plans, level debt service and level levy rate, are represented in the graph on page 14.

All of these approaches to repayment may be affected by the amount and repayment terms of a district's outstanding debt. Districts should always take into account the combined effect of new, outstanding and anticipated debt when structuring a new debt issue.

## Types of Long-Term Bonds

There are many kinds of bonds. A bond is simply a formal written promise to repay a specified dollar amount at a certain time with a stated rate of interest. The kinds of bonds that Oregon districts can offer are limited to four:

- ✓ Current coupon bonds
- ✓ Deferred interest bonds
- ✓ Convertible deferred bonds
- ✓ Variable rate bonds

**Current coupon bonds** are the most frequently issued bonds in the municipal debt markets. Current coupon bonds pay interest at a fixed interest rate every six months until they are redeemed or mature. The interest payment date is almost always the first or 15th day of the month.

The first interest payment date may or may not be exactly six months from the date of issue. It is not unusual for the first interest payment date to be as short as three months (a "short first coupon") or as long as 12 months (a "long first coupon"). Varying the first coupon period is often necessary to put a district on its preferred interest payment schedule regardless of the date the bonds are initially sold. Once the first coupon date is set, all following interest payments occur at six-month intervals.

Current coupon bonds are almost always sold with serial maturities. By using serial maturity dates, the bond issue's total principal amount is split into pieces that mature each year, i.e., serially, over the life of the issue as opposed to having the entire principal amount come due in a single year.

Current coupon bonds usually are sold in minimum principal denomination sizes of \$5,000. Because these bonds are the most common instruments in the public debt markets, they usually carry the lowest fixed interest rates for the type of credit quality offered.

A district's underwriter or municipal advisor may recommend combining some of the serial maturities into one or more term bonds. Term bonds are consecutively maturing current coupon bonds aggregated and sold as a single nominal maturity. For example, rather than finding investors to purchase bonds maturing serially in years

18, 19, 20 and 21 years, the combined amount of bonds could be sold as a term bond nominally maturing in 21 years.

To avoid a larger lump sum payment at maturity, term bonds are subject to mandatory redemption according to the serial current coupon bonds aggregated to form them. So, in the above example, portions of the term bond principal would "sink," or be paid, in years 18, 19, and 20, with the final portion of principal paid in year 21. Term bonds carry a single rate of interest, despite the mandatory redemption schedule. Creating a term bond helps attract investors but does increase the interest cost to the district.

**Deferred interest bonds** (also known as zero coupon or capital appreciation bonds) pay no interest until they mature; interest accretes and is paid in a lump sum at maturity. Principal can be scheduled to mature serially, as the desired structure allows. These bonds sell at prices far lower than their maturity value. Issuers may issue deferred interest bonds because they can receive and use bond proceeds now without paying periodic interest for some time. For districts, this can lower tax rates in the early years of debt repayment. The drawback to issuers is that deferred interest bonds typically carry higher interest rates than current coupon bonds. In addition, they are often non-callable or the call provision further increases the interest cost, which impacts future debt capacity and do not offer a premium structure.

Because of these higher costs and the deferral of interest, districts should carefully weigh whether the higher costs are a good tradeoff for the increased flexibility deferreds may offer for the debt service structure, timing



of bond sale and other factors.

**Convertible deferred bonds** – Convertible deferred bonds are bonds that combine the features of deferred interest bonds and current interest bonds. Typically, a convertible deferred bond starts as a deferred interest bond then “converts” to paying current interest at a specified future date. The conversion date is usually not more than two years from the original issuance date. The amount of time between the issuance date and the conversion date will impact the pricing of the bonds.

Convertible deferred bonds are sometimes used to bridge short-term debt service spikes caused when a new issue is layered on top of existing debt. Convertible deferred bonds can be used only under certain market conditions and issue sizes. Convertible deferred bonds typically carry higher interest rates than regular current coupon bonds but may be more cost effective than using deferred interest bonds for the same purpose.

**Variable rate bonds** – Variable rate debt is debt where the interest rate is reset on a very short-term basis, usually weekly. Because the rate is a very short-term rate, variable rate bonds usually carry very low interest rates compared to contemporaneously issued long-term fixed-rate bonds. However, because the rate floats with market conditions, variable rate bonds involve interest rate

risk. Even though variable rate debt can have many advantages, the difficulty of correctly calculating and levying property taxes to support a floating rate debt instrument makes variable rate debt problematic for general obligation bond issuers. Variable rate debt may be simulated by using interest rate swaps. (See “Interest Rate Swaps,” Chapter 1.)

**Early-redemption or call provisions** – Bonds are normally sold with provisions that allow an issuer to prepay the bonds prior to their stated maturity date. In the municipal bond market, prepayment is referred to as redeeming or calling the bonds. For example, early redemption may allow a district to refinance the bonds to take advantage of lower interest rates (see Chapter 9). There are two variables in early-redemption provisions:

- ▶ The date(s) on which the bonds may be redeemed
- ▶ The price(s) at which the bonds may be redeemed

Investors do not like early-redemption provisions because they create uncertainty. However, the market does not penalize issues with early-redemption provisions if the provisions conform to reasonable market standards. While market standards can change over time, a typical long-term municipal bond call provision approximately is 10 years after issuance, at par. Districts should consult with their underwriter or municipal advisor

to determine which redemption provisions are most appropriate for the district’s issue.

**Bond Anticipation Notes** – Districts can accelerate receipt of cash from general obligation bond sales through the use of Bond Anticipation Notes (BANs). The sole security for these short-term note issues is the district’s ability to sell the general obligation bonds at a future date. Unless the takeout financing is assured, investors are unlikely to buy the district’s BAN. See Chapter 4 for more information regarding this short-term borrowing option.

**Interest rate swaps with general obligation bonds** – Issuers of general obligation debt face particular issues in using swaps. The risk of an involuntary termination payment (see “Interest Rate Swaps” in Chapter 1 and a general discussion of swaps in Appendix III) is the biggest concern. Under current law, the issuer may not levy an unlimited property tax to pay the termination payment. Consequently, a termination payment would have to be paid from a district’s general fund. Because a termination payment could be substantial, an issuer of unlimited property tax-based debt would be unlikely to take that risk.



## Frequently Asked Questions about General Obligation Bonds, *continued*

**Q: What is a general obligation (GO) bond?**

A: A bond is simply a type of loan. Investors loan money to a municipality for specific capital projects. A bond normally carries a fixed interest rate payable semiannually until the bond matures. A bond issue usually includes bonds that mature on different dates so that the entire principal does not come due on a single date.

General obligation bonds issued by Oregon municipalities are secured by the issuer's ability to levy unlimited property taxes, not subject to Oregon constitutional tax limits, on all taxable property within its jurisdiction to repay the bond's debt service.

**Q: Do school districts, ESDs and community colleges need voter approval to issue general obligation bonds?**

A: Yes. If a district wishes to borrow money with an unlimited property tax pledge, the district must have voter approval to do so.

**Q: How can general obligation bond proceeds be used?**

A: General obligation bond proceeds may be used only for those projects and costs listed on the ballot. Oregon law also limits the use of bond proceeds to capital costs, as further described on page 13.

**Q: Can districts use general obligation bonds for operating purposes?**

A: No. Bond proceeds may be used only for capital costs. However, if voters approve, a district may be able to pay for certain continuing capital

projects with bond proceeds, thus removing these items from the general fund.

**Q: What other limitations apply to the use of general bond proceeds?**

A: A district should consult bond counsel to discuss the use of proceeds related to any given bond issue. In general, districts should not use general obligation bond proceeds for assets with a useful life of less than a year or routine maintenance or supply items.

**Q: Are there legal restrictions on the size of bond issues?**

A: Yes. State law limits the amount of outstanding general obligation debt a school district, ESD or community college may have at any time. The limit is based on the district's real market value and the number and kinds of grades the district serves. In general, debt limits are as follows:

- ▶ For K-12 districts the debt limit is 7.95 percent of the district's real market value.
- ▶ For ESDs the debt limit is the same as K-12 districts, 7.95 percent of real market value.
- ▶ For community colleges the debt limit is 1.50 percent of real market value.

Note that even though Measure 50 reduced assessed value, it did not affect real market value or a district's debt capacity. Also note that a district's debt capacity includes any outstanding bonded debt.

**Q: How long does it take to receive bond proceeds once the voters approve a bond issue?**

A: It depends. If the district is ready to proceed with the project immediately, a bond issue can be structured, sold and closed in as little as two months. Generally, however, the issuance process takes about three months from start to the receipt of money at closing.

**Q: What is arbitrage?**

A: Arbitrage, technically, is risk-free profit. For example, if you can simultaneously buy an item for \$1 and resell it for \$2, you have made arbitrage profits. In the bond market, arbitrage is sometimes possible because municipalities can borrow at tax-exempt interest rates that are lower than taxable reinvestment rates. Thus, for example, a district might be able to borrow at 4 percent tax-exempt and simultaneously reinvest the proceeds in a taxable security paying 6 percent.

Federal tax law strictly regulates state and local municipalities' ability to earn and keep arbitrage profits. In fact, unless an issuer qualifies for specific exemptions, federal regulations prohibit either earning or keeping the arbitrage profits from tax-exempt bond issues. (See Chapter 6 for a more detailed discussion of these rules.)

**Q: How can the district make arbitrage and avoid rebate?**

A: Federal rules either prohibit the earning of arbitrage in the first place or require the rebate of any arbitrage earnings to the federal government. However, the rules provide some exceptions. A district must qualify for an exemption from these rules before it may

*continued*

## Frequently Asked Questions about General Obligation Bonds, *continued*

earn arbitrage or be allowed to keep any arbitrage earnings. (See Chapter 6 for a more detailed explanation.)

Even though you may not be able to earn arbitrage profits, a district can keep investment earnings at the interest rate it is paying on the debt. Interest earnings on bond proceeds are subject to the same uses as the original bond proceeds and may not be used for operating purposes.

**Q: How much does it cost to issue bonds?**

A: A number of issuance expenses are incurred in issuing bonds. The total expense varies according to issue size, structure and credit quality. Issuance costs may be as little as \$20,000 for small

issues or more than \$100,000 for large issues. In addition, the issuer pays underwriting fees, which may vary from 0.25 percent to 2.0 percent of the bond proceeds. This amount is determined by the size and type of debt issued.

**Q: How does the district pay these issuance costs?**

A: Issuance expenses can be paid from bond proceeds. When determining the size of the bond issue, the district should ask its municipal advisor or underwriter to determine the likely issuance costs. These costs may be added to the bond authorization amount being requested from the district's electorate.

# Financing and Lease-Purchase Agreements

*“Money cannot buy happiness; it can, however, rent it.”*

*Anonymous proverb*

**O**regon school districts, ESDs and community colleges have authority to enter into lease-purchase and similar financing agreements without voter approval. Such agreements can be used to finance a wide variety of capital items including certain supplies, equipment and maintenance projects prohibited from bond levies under Oregon constitutional tax limitations. Under ORS 271.390, the estimated weighted average life of these financing agreements may not exceed the estimated dollar weighted average life of the real or personal property that is financed.

These agreements also can be used to purchase land, modular buildings and pay for construction of new facilities, major maintenance, and renovation of existing facilities that might be financed with voter-approved bonded debt but may be more

easily financed with a lease-purchase agreement.<sup>1</sup>

Master lease-purchase agreements are also authorized under ORS 271.390.

In many respects a financing or lease-purchase agreement is similar to a bond issue. Money is borrowed from an investor and finance payments are made to that investor until the obligation is paid. Finance payments under such agreements contain a principal component and an interest component. When properly structured, the interest is exempt from federal and state income taxes, resulting in relatively low borrowing costs.

There are significant differences, however.

Financing/lease-purchase debt service typically is paid from and secured solely by all available district funds. In practice, this means the district’s general fund

## Seven Steps for Using Lease-Purchase Financing

Districts considering the use of lease-purchase type financing should:

- ✓ Identify projects or assets to finance.
- ✓ Determine whether public sale, bank loan, or vender financing is best.
- ✓ Select and retain bond counsel (called special counsel in lease-purchase deals) and municipal finance professionals.
- ✓ Adopt a resolution authorizing the lease-purchase agreement and the other documents necessary to execute a lease-purchase agreement.
- ✓ Execute either a purchase agreement, bank loan or vender financing.
- ✓ Budget for the payments related to the lease-purchase transaction as a lease payment account in the district’s general fund.
- ✓ Provide for ongoing compliance with any continuing disclosure or federal tax law provisions.

<sup>1</sup> “Lease-purchase agreements” and “financing agreements” are interchangeable terms and used as such throughout this chapter.

is the source of payment. There is no authority to levy additional property taxes to pay debt service on a financing agreement as there is for repayment of general obligation bonds for capital costs. Financing/lease-purchase agreements do not require voter approval. Full faith-and-credit obligations (FFCOs) are essentially a piece of a financing or lease-purchase agreement. Because lower interest rates usually can be obtained by offering a large debt obligation to a number of investors in the public debt market, a financing agreement is divided into smaller pieces and sold to a number of investors.

An FFCO usually bears a higher interest rate than a general obligation bond because there is no ability to levy additional property taxes to pay the debt service. Consequently, investors do not consider FFCOs to be as safe as GO bonds and, therefore, demand a higher interest rate to compensate for the higher risk.

The maximum term or maturity of an FFCO is determined by the district's available resources and by the property being financed. Under Oregon statutes, the maximum term of the financing agreement for school districts and ESDs is 30 years. FFCOs typically have a maximum maturity of 5 to 20 years. The estimated weighted average life of the FFCO cannot exceed the estimated dollar-weighted average life of the property financed.

Note: Financing or lease-purchase based transactions used to be marketed under the term "certificates of participation" or COPs. In Oregon, financing or lease-purchase transactions that carry the unconditional promise to pay from the general fund are now typically marketed under the term of "full faith-and-credit obligations" or FFCOs, representing the issuer's unconditional promise to pay.

## Financing Agreement

## Requirements

Oregon districts may enter into financing agreements and issue FFCOs for which the obligation to repay is binding and can be enforced in court. In effect, this makes a lease-purchase agreement, or a FFCO, an obligation payable from the district's general fund.

Because this obligation is binding, a district typically will not need to provide additional security. In most instances, the district's promise to repay the lease-purchase obligation from its general fund is more valuable to investors than a security interest in the property being financed.

Two basic documents are required for a lease-purchase type financing. A third document is required if the issue is sold to public investors. Bond counsel (referred to as special counsel for a lease-purchase/FFCO financing) should draft the required documents:

### ► Board resolution(s)

authorizing the terms of the lease-purchase agreement must do the following:

1. Include a not-to-exceed principal amount, maturity and use of proceeds
2. Authorize the execution of other documents and the taking of other actions necessary to complete a lease-purchase transaction
3. Approve the selection of the lessor/lender and appointment of the financing team members such as bond counsel (called special counsel in lease transactions) and underwriter

The resolution may deal with these items in detail or it may delegate the responsibility for setting terms, such as the interest rate, to the superintendent/president or business manager. In such cases, parameters such as

## Comparison of General Obligation Bonds and Lease-Purchase Agreements

CHARACTERISTIC	GENERAL OBLIGATION BONDS	LEASE-PURCHASE
<b><i>Project to be financed</i></b>	Restricted by Oregon Constitution and ORS 328.205	Broad authority under ORS 271.390 and 332.155
<b><i>Authorization</i></b>	Board resolution with voter approval of bond levy	Board resolution only
<b><i>Nature of debt service security</i></b>	Unlimited property taxes outside constitutional limits	District's general fund
<b><i>Lessor/Lessee required</i></b>	No	Yes (also called lender and borrower)
<b><i>Refundable</i></b>	Yes	Yes (No, if not certificated)
<b><i>Escrow Agent</i></b>	No	Yes
<b><i>Paying Agent</i></b>	Yes	No (Combined with escrow agent if certificated and not needed if not)



maximum principal amount and interest rate may be set in the resolution with the actual amounts and rates set later by district staff in conjunction with the financing team.

- ▶ A **financing agreement** is between the district as the lessee and the lessor or lender. The lessor may be a third-party financial institution, especially if the financing agreement is divided into FFCOs. The agreement may include language specifying the issuance of FFCOs and the use of an escrow agreement. The financing agreement incorporates terms established in the resolution and provides details of the property to be financed, payment schedules, security provisions and other matters.

The form of a financing agreement should always be

subject to negotiation. A district should not execute any lease-purchase agreement without having it reviewed by special (bond) counsel.

- ▶ An **escrow agreement** is required for a publicly offered FFCO financing. In addition to the basic resolution and the financing agreement, an FFCO issue usually requires the execution of an escrow agreement. The parties to this document are the district and the escrow agent. The escrow agreement usually is a separate document but may be combined with the financing agreement.

The escrow agreement is needed because the district's repayment obligation is being sold to investors as separate units and documentation is needed to provide the terms of this division.

An escrow agreement will define the duties of the escrow agent, how payments are to be made to the investors, the actions that the escrow agent may take if the terms of the financing or lease-purchase agreement or the escrow agreement are violated and other items.

Because of the credit strength of a district's binding obligation to pay debt service from its general fund, debt service reserves are not usually necessary for financing agreements or FFCOs. However, districts should note that equipment vendors may have different requirements for lease-purchase acquisitions of their equipment.

## Frequently Asked Questions about Lease-Purchase Agreements

### **Q: What is the difference between a "lease-purchase agreement" and a "financing agreement"?**

A: Just the name. Both terms are used and are issued under the authority of ORS 271.390.

### **Q: How do lease-purchase issues differ from GO bond issues?**

A: In most respects they are similar. Both offer interest that is exempt from federal and state income taxes. Interest is also paid semi-annually and principal is paid annually. There are two important differences:

- A district cannot levy property taxes outside of the permanent rate to pay debt service on a lease-purchase issue as it can to pay debt service on a general obligation bond.

Principal and interest on a lease-purchase issue must be paid from a district's existing general fund resources.

- A lease-purchase issue usually bears a higher interest rate than a GO bond because there is no ability to levy additional property taxes to pay debt service. Consequently, investors do not consider lease-purchase issues as safe as general obligation bonds and, therefore, demand a higher interest rate to compensate for the higher risk.

### **Q: Is voter approval needed to issue lease-purchase agreements?**

A: No. Voter approval is not required.

### **Q: What can be financed through lease-purchase issues?**

A: In general, the proceeds of a lease-purchase issue may be used for the same purposes as the proceeds of a GO bond issue plus items for which GO bonds may not be issued. A lease-purchase issue may be used to finance real or personal property including routine supplies and maintenance as long as they can be capitalized. Lease-purchase proceeds, like GO bond proceeds, cannot be used to finance working capital.

### **Q: What are full faith-and-credit obligations (FFCOs)?**

A: FFCO is simply a marketing name for lease-purchase agreements that are divided into smaller pieces and sold in the public markets like bond issues. School districts, ESDs

*continued*

## Frequently Asked Questions about Lease-Purchase Agreements, *continued*

and community colleges have authority to enter into lease-purchase agreements and they also have authority to authorize an escrow agent to issue certificated securities based on those agreements.

**Q: Will the districts have to give a mortgage or security interest in the property financed with the lease-purchase issue proceeds?**

A: No. Investors usually do not believe that the property financed by a lease-purchase issue has value to them if a district defaults on debt service. Therefore, investors do not believe a mortgage or security interest on that security has value. Instead, investors rely on the binding nature of the underlying lease-purchase agreement, and the ability to sue and obtain monies from a district's general fund.

**Q: How large can a lease-purchase issue be?**

A: There is no legal limitation. However, the district and investors must be comfortable with the district's ability to pay the debt and satisfy the underwriter that it will have

sufficient resources to pay debt service over the life of the lease-purchase issue. Once issued, debt service on a lease-purchase issue is a binding obligation. (Lease-purchase agreements or FFCOs may be redeemed, or paid off, early, however, depending on the specific terms of the issue.)

The district also must be able to show potential purchasers where it will get the monies to pay debt service. Will it redirect current resources or have additional resources to service the debt?

**Q: How long does the district have to spend the proceeds of a lease-purchase issue?**

A: Based on federal tax rules, proceeds of a lease-purchase for capital generally must be spent within three years of the date of issue.

**Q: How long will it take to get the money from a lease-purchase issue?**

A: Depending on the method of sale, it will take about two to three months to get the money from the lease-purchase issue once the district has made a decision to proceed.

**Q: What is the maximum term for lease-purchase issues?**

A: The maximum term or maturity for the lease-purchase issue is determined by the district's available resources and by the property being financed. Typically, FFCOs have a maximum maturity of five to 15 years, although some issues go as long as 20 years. The estimated weighted average life of the lease-purchase issue cannot exceed the estimated dollar weighted average life of the property financed.

# Short-Term Borrowings

*“Let us . . . live within our means, even if we have to borrow the money to do it with.”*

*Charles Farrar Browne*

**O**regon school districts, ESDs and community colleges use short-term borrowings to fund various cash-flow mismatches. The short-term borrowings authorized for Oregon districts, described in this section:

- ▶ Tax (and revenue) anticipation notes (TANs or TRANs) may be used to fund short-term cash flow deficits
- ▶ Bond (or grant) anticipation notes (BANs or GANs) may be used to accelerate receipt of anticipated proceeds of long-term borrowing or grants
- ▶ Other short-term credit facilities

## TANs or TRANs

School districts, ESDs and community colleges are authorized to issue short-term notes to meet current expenses in anticipation of tax collections or other budgeted revenues. Such notes are referred to as tax anticipation notes (TANs) or tax and revenue anticipation notes (TRANs).

**Issue size** – Under ORS 287A.180, the amount of TRANs issued cannot exceed 80 percent of the district’s budgeted basic state support, tax levies and other budgeted revenues; and they must mature within 13 months after they are issued.

Federal tax law also restricts the size of TRANs. Voter approval is not required to issue TRANs.

Federal tax law limits the maximum size of tax-exempt TRANs issues based on a fairly complicated set of formulas. These formulas take into consideration a variety of factors, including the issuer’s anticipated fiscal year cash-flow deficit, amount of prior year’s expenditures paid from prior year revenues, the average cash balance maintained by the issuer in the past, and the total amount of tax-exempt debt the issuer expects to deliver for all purposes during the calendar year. Tax-exempt debt includes general obligation bonds, full faith-and-credit obligations and leases.

TRANs may also be sold on a taxable basis and market conditions may make that option more attractive than tax-exempt debt.

The maximum permissible TRANs issue is generally larger than the actual anticipated deficit. Issuers should work with their municipal advisors, underwriters and bond (special) counsel to maximize the financial benefits that may be derived from their TRANs issues.

**Interest earnings on TRANs** – Federal law allows school districts

## Seven Steps for Using TRANs

- ✓ Prepare a cash-flow projection.
- ✓ Select and retain a recognized underwriter or municipal advisor and special counsel.
- ✓ Size the TRANs issue in consultation with your underwriter or municipal advisor and bond (special) counsel.
- ✓ Determine the length of borrowing.
- ✓ Adopt a resolution authorizing the TRANs.
- ✓ Budget for the TRANs in a debt service account used solely to pay the principal and interest on the TRANs.
- ✓ Execute the transition via either a market sale or bank loan.

to borrow at tax-exempt interest rates and, as long as they follow federal rules on sizing, to invest the proceeds in higher rate taxable securities. Thus, districts are allowed to “arbitrage” TRANs proceeds. Districts must expend a portion of the proceeds for the cash-flow deficit. But, generally, over the life of the borrowing, the investment earnings help offset the interest costs of borrowing.

**Repayment** – Districts must repay TRANs no later than 13 months after the TRANs are issued. TRANs are payable from not less than 100 percent of the proceeds of state support, tax levies or other budgeted revenues whose collection is anticipated at the time the TRANs are issued, plus earnings.

The district must establish a repayment account for depositing property taxes, revenues and earnings upon receipt. The account must be maintained until there are sufficient funds to retire the TRANs. Monies in the repayment account may be invested, as provided by law, in investments that mature no later than the TRANs’ maturity date.

### **Structuring TRANs**

Like bonds, TRANs do not come in a “one size fits all” format. A district may choose between fixed rate notes or floating rate instruments. The term can be as long as 13 months or as short as the cash flow deficit itself. Two basic models are outlined below.

**Fixed Rate Notes** – The traditional method of issuing TRANs is to borrow for nearly the full term at a fixed rate. Under certain market conditions and the correct sizing for tax law purposes, this TRAN structure may produce an “interest free” borrowing. Here is how this can work:

The district identifies its projected deficit for mid-November, just prior to the receipt of the bulk

of its property tax levy. The district borrows early in July at a fixed tax-exempt rate of, say, 3 percent with the borrowing due the following June 30. The district invests the money in short-term taxable investments at, say, 3.5 percent until it is needed to pay operating expenses in November. In November, the district uses the money (for a couple of weeks) to pay operating expenses, then restocks the TRAN investment account with enough in property taxes to repay the debt at year-end. The money is again reinvested (let’s say at 3.4 percent) from December to end of June. Under the right market conditions, the investment earnings more than offset the interest cost over the life of the issue.

Note: Not all market conditions produce this opportunity. Available reinvestment rates may often be insufficient to cover the interest cost. Under such scenarios, the district might consider a shorter repayment period on a fixed rate note or look at the alternative shorter-term floating rate/line of credit TRAN.

**Floating Rate/Line of Credit TRAN** – Rather than issue a longer term fixed-rate note, a district may wish to establish a line of credit with a local bank to fund the cash flow deficit. Under this approach, a district would draw on the line of credit as needed to cover pending deficits. The line of credit typically would be repaid as soon as the district received its major tax turnover in November or early December. This approach minimizes the interest accrual on the borrowing but forgoes any possible offsetting interest earnings allowed under the federal tax rules. This line of credit type structure can be a good choice when market conditions do not allow for making arbitrage interest earnings.

### **BANs and GANs**

BANs and GANs are methods by which districts can accelerate receipt of cash from either bonds being sold in the future or grants being received in the future. Often, the sole security for these short-term note issues is the district’s ability to sell bonds (BANs) or the assurance the district will receive the grant (GANs). Unless the takeout financing is assured, investors are unlikely to purchase the district’s notes. At times the district may be required to also secure the note with its full faith and credit.

If TRANs or BANs are issued in anticipation of taxes or bond proceeds, they are subject to the limitations described in those sections.

Use of GANs by Oregon school districts, ESDs and community colleges is rare because sizable grants are unusual. The first notable issue of GANs was in response to the state of Oregon lottery bond program initiated in 1998. A number of districts used GANs to accelerate the receipt of the state bond money by one year. GANs must mature not later than 13 months after the GANs are issued.

### **Other Short-Term Financing**

In addition to TRAN, BAN and GAN financing, districts are authorized by ORS 287A.180 to borrow money on an interim basis in a number of other ways. Districts can enter into credit agreements, or issue notes, warrants, short-term promissory notes, commercial paper or other obligations to provide interim financing to acquire capital assets or in anticipation of grants. Capital asset obligations must mature not later than five years after they are issued.



## Frequently Asked Questions about General Obligation Bonds

**Q: What is a TAN or TRAN?**

A: A TAN or TRAN is a short-term borrowing to fund projected fiscal year cash-flow shortfalls due to timing considerations. Most districts do not receive property tax or state revenues on a schedule that matches their expenditure requirements. Consequently, districts may need to borrow to meet their immediate needs. For most districts, TRANs are simply a cost-effective way to accomplish that borrowing.

**Q: Why are TRANs such a low-cost form of borrowing?**

A: Federal law allows school districts, ESDs and community colleges to borrow for short-term financings at tax-exempt interest rates and, as long as they follow federal rules on sizing, to invest the proceeds in higher rate taxable securities. Thus, districts are allowed to arbitrage TRAN proceeds. Districts must expend a portion of the proceeds for the cash-flow deficit, but generally, over the life of the borrowing, the investment earnings offset the interest costs. Districts that comply with certain federal requirements can even legally make money on the borrowing.

**Q: Do TRANs always pay for themselves?**

A: Not always. It depends on whether the issue is exempt from rebate and whether the interest rates available on investments are high enough over the course of the life of the TRAN to offset the TRAN's interest and borrowing costs.

**Q: How much may a district borrow?**

A: Under state law, a district may borrow up to 80 percent of its budgeted resources. However, most districts restrict the borrowing size to fit under federal arbitrage rebate rules.

**Q: What happens if a district borrows more than the federal rules allow for arbitrage?**

A: It is not illegal to borrow more than the federal rules allow for arbitrage. However, if a district does borrow more than federal rules allow, then the district must either borrow on a federally taxable basis or restrict the yield on the investment of TRANs proceeds to the yield on the TRANs. For example, if the arbitrage yield limit on a district's borrowing was 3.5 percent, then the district may

not invest TRANs proceeds at a yield higher than 3.5 percent. The proceeds of the borrowing would be yield restricted.

**Q: When should a district borrow and repay?**

A: State law does not permit TRANs to extend more than 13 months after the date the obligations are issued. The issue's optimal timing and repayment depends on several factors. The most important is the cash flow needs to be available to cover the projected deficit. In certain interest rate environments, the best option is to borrow just before the deficit occurs and repay immediately after tax or revenue resources are available to fund the repayment. In other rate environments, it is better to borrow for as long as possible and earn interest on the proceeds while they are not needed to cover the cash flow deficit. Your municipal finance professional and bond (special) counsel can help identify which option best fits the district's circumstances in any given year.

# The Bond Election Process

*"Somehow we must be able to show people that democracy is not about words, but action."*

*Eleanor Roosevelt*

**O**regon school districts, ESDs and community colleges must seek voter approval authorizing them to issue general obligation bonds. Authorization requires a simple majority vote in any May or November election (with no turnout requirement) or a "double majority" vote in a March or September election (a majority approval with at least 50 percent voter turnout).

## Ballot Title Process

**Election dates** – School measures can be submitted to voters on the following dates (ORS 255.345).

### Simple majority, no turnout requirement for approval:

- ▶ Third Tuesday in May
- ▶ First Tuesday after the first Monday in November

Double majority:

### Simple majority, 50 percent turnout required for approval:

- ▶ Second Tuesday in March
- ▶ Third Tuesday in September

For a current election calendar with filing deadlines, visit the Oregon Secretary of State's elections website, <http://sos.oregon.gov/elections/Documents/current-elections-calendar.pdf>

**Notice of election** – Districts must file two forms prior to an election. SEL 805, the request for ballot title, is a new requirement, effective Jan. 2, 2018. This form includes the ballot title, drafted by bond counsel, and is due 80 days prior to an election. After receiving the SEL 805, the county clerk must publish the notice of receipt of ballot title and measure election in the newspaper of general circulation in the district. Electors then have seven business days to challenge the ballot title. SEL 803, the notice of measure election, must still be filed 61 days prior to the election, but it cannot be filed until the seven-business-day referral period has passed. In counties that are doing a voter pamphlet, the explanatory

## Six Steps for Conducting a Bond Levy Election

- ✓ Organize and use a broad-based community advisory committee to review and prioritize facility needs and recommend a bond levy amount.
- ✓ Conduct community research – surveys, focus groups, community forums – to determine voters' understanding of the need and support for the project(s). Do not include projects that have very low community support.
- ✓ Set an election date and follow Oregon statutes for placing the bond measure on the ballot and conducting the election. Allow a minimum of six months prior to the election for information sharing.
- ✓ Determine district and community representatives' roles and responsibilities in providing information about and advocating for the bond measure. Be sure that staff understand the restrictions on political activity by public employees.
- ✓ Identify the kinds of information the district should provide voters about the bond measure.
- ✓ Identify the kinds of activities an advocacy committee should conduct for turning out a majority "yes" vote.

statement is filed at the same time as the SEL 803. Oregon law requires the ballot title to provide “a reasonably detailed, simple and understandable description of the use of bond proceeds” (ORS 250.037(3)). Districts should write the ballot title using messages from survey data, so that it reflects community priorities and is easy for voters to understand.

The district’s bond counsel should review the district-drafted ballot title to ensure that it meets all legal and statutory requirements. Failure to consult with bond counsel could result in an invalid ballot title and election.

**Measure filing considerations** – School districts and other local governments often wait until close to the filing deadline to officially file their measures for two reasons:

- ▶ They want to make sure bond costs are as accurate as possible and all elements to be paid for with bond proceeds are included in the ballot title.
- ▶ They want to continue the discussion about the need for and benefits of the bond measure with community groups without violating election law. Under ORS 260.432, once the district officially files a measure with the county clerk, discussions of this nature, or district communications that include information of this nature would be considered advocacy and are prohibited by law.

Under ORS 260.432, once a measure is officially filed, “no public employee shall solicit any money, influence, service or other thing of value or otherwise promote or oppose any political committee or promote or oppose the nomination or election of a candidate, the gathering of signatures on an initiative, referendum or recall petition, the adoption of a measure or the recall of a public office holder while on the job during working hours.”

## Voting by Mail

The vote by mail law (ORS 254.470) requires all Oregon elections to be conducted by mail: county clerks must mail ballots to registered voters not more than 18 days before the date of the election and not later than the 14th day before the election. Ballots for out-of-state Oregon voters may be mailed 29 days before the election. ORS 253.065 requires county clerks to mail ballots to voters who are in the military no later than 45 days before each election.

The deadline to register to vote is 21 days prior to an election.

Ballots must be received by county clerks by 8 p.m. on Election Day. Voters may return

## Ballot Title Wording Requirements

The ballot title includes a caption, question and summary. Wording requirements are as follows:

**CAPTION:** No more than 10 words.

Suggested wording: **(Name) district General Bond Authorization for (key purpose)** so that the first words voters see are the district name and the measure’s primary purpose(s).

**QUESTION:** No more than 20 words plus required second sentence (ORS 250.035 .037).

Suggested wording: **Is (name) district authorized to (key purposes) by issuing general obligation bonds in an amount not exceeding (dollar amount)?**

Required second sentence: **If the bonds are approved they will be payable from taxes on property or property ownership that are not subject to the limits of sections 11 and 11b, Article XI of the Oregon Constitution.**

**SUMMARY:** No more than 175 words (ORS 250.035) **plus** required first sentence for March and September elections only (ORS 250.036).

Required first sentence for March and September elections only: **This measure may be passed only at an election with at least a 50 percent voter turnout.**

The 175-word summary described the major effect of the referral. It must be “a reasonably detailed, simple and understandable description of the use of the proceeds.” Districts may list items using bullets and bold type and use survey data to present issues in terms that reflect community priorities and concerns. The summary should be easy for the voter to read and understand.

**EXPLANATORY STATEMENT:** No more than 500 words (ORS 251.345 and OAR 165.022-0040); available only in counties that publish voters’ pamphlets for elections. The 500-word explanatory statement can describe the measure in more detail than the Ballot Title summary. However, the explanatory statement should be impartial and as easy to read and understand as the summary, listing items and points using bullets and bold type. Content should be developed using survey data to present proposal in terms that reflect community priorities and concerns.



ballots by mail or in person to the county elections office or drop them at official ballot drop sites. If your district has a measure on the ballot, check with the county clerk for the schedule for mailing ballots and for the locations of official ballot drop sites.

## **Setting the Levy Amount with Community Input**

Successful bond measures require community ownership. The district should involve key community leaders in a broad-based community advisory committee charged with reviewing and setting priorities for district facility needs as a first step toward generating community ownership of the district's facilities and any potential bond measure.

In addition, the district should hire a professional survey firm to conduct a random-sample telephone survey to assess voter understanding of the need and support for the community advisory committee's recommendations. Boards should use the survey data to make decisions about the final bond levy proposal and include the survey messages in the ballot title and election materials.

Note: Surveys can be paid for with district funds if the survey is part of the board's decision-making process and occurs before the board adopts the resolution to put the measure on the ballot.

### **Effective use of advisory committees:**

- ▶ Identify up to 30 community members who represent key groups in your community to review and prioritize facility needs. Make sure the committee represents a cross-section of community groups: builders, Realtors, the Chamber of Commerce or other key business groups, city and county planners, the fire marshal's office, the ministerial association, parents, school district classified and licensed employees, senior citizens, and any other organization or agency that has recent experience with major building or renovation projects.
- ▶ Send personal invitations to potential representatives asking them to serve on the committee. Describe the task. Provide a timeline that indicates how many meetings or hours will be required.
- ▶ Once the committee is formed, review and discuss the district's facility needs and establish a timeline for addressing those needs based on the desired completion date and election date.
- ▶ Provide appropriate administrative and secretarial support.
- ▶ Follow open meetings law requirements. The facility review committee is an advisory committee to the board. Its meetings are public meetings. Notice requirements are the same as for board meetings.
- ▶ Make sure meeting minutes and the committee's final report are distributed widely so that all staff and other community members become aware of the district's needs.
- ▶ Follow the committee's advice as closely as possible in determining bond levy projects and amounts.

## **Conducting a Community Survey**

Random-sample telephone surveys of district voters continue to be the most reliable way of testing voter understanding of and support for an issue. This kind of survey can be paid for with district funds if the survey is

conducted as part of the board's decision-making process and prior to the board's approval of the resolution to put a measure on the ballot.

For statistically accurate results, the number of voters polled will depend on the number of registered voters in a district. Surveys generally cost about \$1,000 per minute, but costs vary, depending on district size and survey sample size. Districts should conduct a 10- to 15-minute survey (about 40 questions, including three to five open-ended questions) with +/- 5 percent accuracy. Questions about the measure should be specific, including the amount of the levy, the tax rate, project components and their costs as well as other issues that may influence the board's decision.

## **Conducting Successful Bond Elections**

A school board's decision to put a bond levy on the ballot should trigger a number of district information and community-sponsored activities. These activities should involve a cross-section of key community members in the decision-making process, show voters the merits of the district's proposal, and help advocacy committees focus on methods of gaining voter support.

### **Roles and responsibilities**

Following are roles and responsibilities for board members, administrators, staff, parents, students and community members in a bond election campaign.

#### **School board members**

- ▶ Involve a broad cross-section of community members in determining building/bond priorities. Follow community members' advice as closely as possible in determining bond levy projects and amount.
- ▶ Conduct a community survey



to determine community understanding of and support for the bond proposal and its various components.

- ▶ Vote *unanimously* on the final bond proposal. This is important for demonstrating the need for the bond and generating community support.
- ▶ Become advocates. School board members are not restricted by public employee election law. Participate in community-run campaign activities. Volunteer to accompany district personnel giving informational presentations so that you can encourage those present to vote yes for the measure. As long as board members are not using district staff time or resources, they can, and have a responsibility to, advocate for passage of measures they have voted to put on the ballot. (See Election Do's and Don'ts for Public Officials, page 31.)

#### **Superintendent and administrators**

- ▶ Help the board identify staff, parents and other community members who should be involved in planning and/or campaign processes.
- ▶ Provide information about the bond levy to staff, parents and community groups/members and be prepared to answer their questions.
- ▶ Assist in voter registration efforts and in providing opportunities for public discussion of the bond measure.
- ▶ Support advocacy as appropriate. (See Election Do's and Don'ts for Public Officials, page 31.)

#### **Staff**

- ▶ Know about the bond levy measure; be prepared to provide information and answer student, parent and community

questions. Be careful not to advocate for the measure during work hours.

- ▶ Volunteer to work with the community advocacy campaign during non-work time. (See Election Do's and Don'ts for Public Officials, page 31.)

#### **Parents and community leaders**

- ▶ Know about the bond levy measure and be prepared to answer questions about what the measure means for students.
- ▶ Volunteer to take leadership roles in or work with the community advocacy campaign.

#### **Students**

Generally, students should not be involved in campaign activities. Teachers should not suggest that they participate in the advocacy effort. However, high school and community college students in civics classes, student councils or clubs sometimes ask to be involved and there are some appropriate tasks for them:

- ▶ Conducting voter-registration drives to register 18-year-olds and recent high school graduates
- ▶ Contacting alumni to encourage them to vote
- ▶ Writing informational articles for the student newspaper
- ▶ Helping produce video or PowerPoint presentations about the bond measure

#### **Preparing district information**

- ▶ Use survey data to write the 175-word ballot title summary and 500-word voters' pamphlet explanatory statement. Have bond counsel review the ballot title and explanatory statement.
- ▶ Use the 500-word explanatory statement to prepare a brief (one-page) summary of the bond proposal to use at presentations and for staff and others to use for quick reference in talking about the bond

proposal. OSBA recommends the district send this summary to the Secretary of State's Elections Division ([elections.sos@state.or.us](mailto:elections.sos@state.or.us)) for review to be sure it is free of advocacy.

- ▶ Meet with all staff and parent groups to discuss the bond proposal. Tell them it is important for them to be informed and able to answer questions from the public. Respond to and record all staff/ parent questions for reference in producing district newsletters and other bond levy informational pieces.
- ▶ Establish and maintain a section on the district's website with all pertinent and current information about the bond. Make it possible for patrons to ask questions and get immediate answers electronically.
- ▶ Meet with community groups as requested to discuss the bond proposal. If possible, arrange presentations that include a district representative to present the facts and a board member or advocacy committee representative to advocate support.
- ▶ Consider producing two mailings to community members regarding the bond proposal. The first mailing, sent to all households and out-of-state voters, should include a summary of the facilities committee's report, details regarding the bond levy amount, and election and voter-registration information. The second mailing, to all registered voter households, should include the ballot title and explanation, questions and answers, and election information. If all this information is included in the first mailing, consider a second mailing of an oversize postcard

a month to six weeks prior to the election, repeating key information about the measure.

- ▶ The 2016 motor voter law substantially increased the number of registered voter households by automatically registering voters through driver's license renewals. To target mailings to likely voters, review voter data. Voter lists can be targeted to reach voters who have voted in every, or almost every, recent election.

#### **District information guidelines –**

Information provided in all district communications, including websites, PowerPoint and video presentations, must be factual, impartial and free of any words or references that could be considered advocacy. Detailed guidelines for producing impartial information and other issues related to ballot measures are included in the Secretary of State's *2018 Election Law Summary* and *2018 Restrictions on Political Campaigning by Public Employees* publications available online at [www.oregonvotes.gov](http://www.oregonvotes.gov) on the Voting & Elections website under Election Laws, Rules and Publications and then Manuals and Tutorials. See also the *Quick Reference on Political Campaigning for Public Employees*. To ensure that factual information about a measure is advocacy-free, districts can ask the Elections Division to review election-related materials. Submitting explanatory statements for county voters' pamphlets, district fact sheets, newsletters and presentations to the Elections Division for review and then following the division's advice helps keep communications advocacy-free. Send requests for review to [elections.sos@state.or.us](mailto:elections.sos@state.or.us). Districts also must be cautious about the links included on

their websites. A district cannot provide a link to a political action committee (PAC) website on the district's website unless links are provided to opposing committees as well. This also means measure information should not include a PAC's contact information and must not include any encouragement for readers to volunteer for a PAC or other support or opposition efforts related to a measure such as phone banks. In addition, a district should not allow one political group to use its facilities unless all groups have the same opportunity.

#### **Community advocacy campaign activities**

- ▶ An advocacy committee should have at least three months to conduct a campaign.
- ▶ The advocacy committee should have a simple organization focused on identifying and turning out the number of "yes" voters required to pass the bond measure. (See pages 32-34 for a suggested campaign organization.)
- ▶ Activities to reach identified voters should be personalized, such as phone calls, letters, handwritten postcards, and hand-addressed brochures along with door-to-door canvassing in key precincts.
- ▶ An effort should be made to reach those most likely to vote:
  - ▶ Voters requesting early mail ballots for all elections
  - ▶ Newly registered voters
  - ▶ Voters with preschool and school-age children
  - ▶ Targeted groups of older voters who support education issues
- ▶ The advocacy committee should check parent and staff lists against the voter-registration list to see if a voter-registration drive is required to register more

parents and all in-district staff. This activity should take place early in the campaign and can be conducted by parent, high school and community college groups early in the school year.

- ▶ Activities should be prioritized based on available resources – volunteers, dollars and in-kind contributions – and listed on the campaign calendar developed for accomplishing campaign goals.
- ▶ A delegation of district and committee members should attend an OSBA *Bonds, Ballots and Buildings Conference* to find out more about successful campaign strategies and available resources.

#### **Political Action Committee registration rules**

Following are the rules for registering political action committees for community advocacy to support a school district, ESD or community college bond or local option measure:

- ▶ If a district is considering putting a bond or local option measure on the ballot, but has not officially filed that measure with the county clerk, community members can organize an advocacy group (political action committee) to support that measure before the district officially files the measure. The group can give itself a name, appoint a treasurer, open a bank account, collect contributions and make expenditures. A political action committee must file a Statement of Organization within three business days of first receiving a contribution or making an expenditure. Forms may be found on [www.oregonvotes.org](http://www.oregonvotes.org). Election Laws, Rules and Publications and then Manuals and Tutorials. The treasurer must keep careful records of all the group's

financial activities.

- ▶ As soon as the district officially files the measure with the county clerk, the measure is certified and given a number. At that time, the advocacy group must complete and file forms with the Secretary of State Elections Division, not the county clerk. The forms are in the *Secretary of State's 2016 Campaign Finance Manual*, available online at <http://sos.oregon.gov/elections/>

Documents/campaign-finance.pdf. The treasurer, from that point on, must account for and file on the appropriate state forms all of the committee's contributions and expenditures.

The Secretary of State's Elections Division cautions districts to follow the preceding rules and NOT try to file earlier as a miscellaneous committee. School bond/local options advocacy committees do not fit the definition of a miscellaneous committee.

School committees that file as miscellaneous committees and do not support multiple candidates and measures would face penalties if someone questioned their activities. This is more of a concern now that all political action committee campaign contributions and expenditure reports are online on the state's ORESTAR system for anyone to review.

## Election Do's and Don'ts for Public Officials

The following guidelines provide some general legal principles found in case and statutory law (ORS 260.432). School district, ESD and community college board members and administrators are encouraged to consult the Oregon School Boards Association (800-578-6722 or 503-588-2800 or [info@osba.org](mailto:info@osba.org)) or their attorney when specific questions arise.

**Don't use district resources** – School districts, ESDs and community colleges cannot use public resources to advocate a position on a ballot measure. Public resources mean money, staff time during working hours, vehicles or travel allowances, or facilities and equipment.

**examples:** Employees cannot do research or write speeches designed to advocate a position on a ballot measure. Employees cannot charge travel expenses to the school district, ESD or community college for attending a meeting at which they advocate a campaign position. A board secretary cannot draft a board resolution that takes a position on a ballot measure before the board has officially taken action on the resolution. (Following a board action, the

board secretary can format the resolution to comply with a standard format used for resolutions.)

**Do provide information** –

Elected board members may use public resources to develop and distribute objective material on the effects of a ballot measure. Such material must be informational, providing the public with a fair presentation of all relevant facts and may not advocate a position.

**examples:** Employees can be asked to do research and prepare impartial, factual information that fairly assesses the effects of a measure on the district/ESD/community college and the community. Boards and staff can use such information in meetings with individuals, organizations, the news media, legislators, civic leaders, special interest groups and others to explain objectively the measure's impact. Measure proponents or opponents can also use the information gathered.

**Do check content, intent** – Give careful consideration to style, tenor and timing when creating informational documents. The distinction between legitimate

research/information efforts and improper campaign advocacy may be difficult to determine for specific cases. When in doubt, check with the district's attorney or send the information document to the Secretary of State Elections Division ([elections.sos@state.or.us](mailto:elections.sos@state.or.us)) for review.

**Do speak out** – Elected board members may campaign fully for or against any ballot measure as long as they don't use public resources. The courts recognize the right, if not the duty, of elected officials to speak out on major issues, particularly on matters that affect the constituents they serve. Board members can speak without restriction as long as public resources are not involved in any way. The board member can use district-prepared materials for reference because these materials are public records available to anyone.

**Do take positions** – Elected boards of school districts, ESDs and community colleges can take a position on a ballot measure provided public resources are not used to advocate that position.

Board resolutions for or against a ballot measure must be drafted by a board member, not by the

*continued*



## Election Do's and Don'ts for Public Officials *(continued)*

superintendent/president or board secretary. The board secretary can make copies of the proposed resolution and include the drafted resolution in board packets sent out before the board meeting. On resolutions that take a position on a ballot measure, the superintendent/president can prepare information that indicates the impact that ballot measure would have on the district/ ESD/community college, but must make that information balanced and impartial.

Following passage of a resolution, the board secretary can retype the resolution to conform to the district/ ESD/community college format. The superintendent/president may not endorse the board's action, but can sign the resolution strictly "attesting to the action taken" and as the official clerk. Label the signature as such on the signature line.

If the district/ESD/community college normally includes information on board meeting actions in a regular district publication, the action the board took on the ballot measure

resolution can be included as part of the listing of board actions, but should not be specifically highlighted. Board action to support or oppose a ballot measure should be included in the board's official minutes.

**Don't campaign on district time** – School district, ESD and community college employees can campaign outside their hours of employment and without the expenditures of public funds. Employees must not be required or coerced to aid in a campaign. During working hours, employees can say "Here are the facts; please vote." They can say "Vote yes" on their own time.

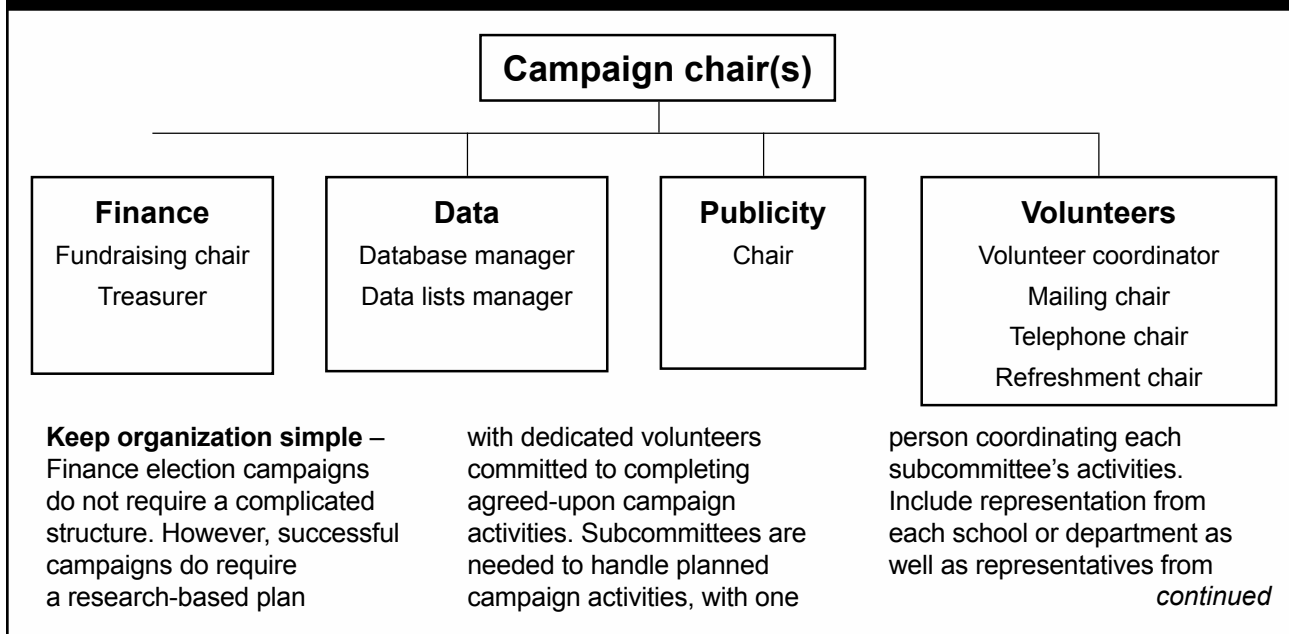
A superintendent/president attending a meeting as the representative of the district/ community college cannot advocate passage of a ballot measure. The superintendent or president can provide information on how a ballot measure would impact the district but should provide information that is balanced and impartial. If an

employee of the district/ESD/ community college wants to advocate a position on a ballot measure, that employee must make it perfectly clear before speaking at a public gathering that such opinions are personal and are not given in the employee's official position. If such opinions are given at a public gathering, the district/ ESD/ community college cannot pay for any part of that employee's appearance, such as the cost of the meal or travel expenses.

**Do provide public forums** – School districts, ESDs or community colleges may provide, at public expense, a forum in which the opponents and proponents for a ballot measure are given equal time to present their views. A forum may not be provided to one side but denied to the other.

For further information, see *Restrictions on Political Campaigning by Public Employees* from the Elections Division at [http://sos.oregon.gov/elections/Documents/260.432\\_quickref.pdf](http://sos.oregon.gov/elections/Documents/260.432_quickref.pdf)

## Sample Campaign Structure





## Sample Campaign Structure (*continued*)

employee unions and key local businesses/community groups as campaign volunteers and as subcommittee members.

**Have one leader** – Assign one person to coordinate the overall campaign. Campaign organizations tend to be democratic. While this is necessary to attract dedicated volunteers, make every effort to ensure that one person is in charge and campaign goals are clear. That person is either the committee chair or the hired campaign consultant, if the campaign is large enough and has enough money to hire a campaign consultant. People move in and out of campaigns with both good and bad ideas. The consultant or chair's job is to keep the campaign on target and on schedule.

If the leader wants to share the responsibility, some campaigns name co-chairs. Others have a chair and a consultant. The chair or one of the co-chairs should be a highly organized person who can keep the whole campaign on track, make sure subcommittee work is coordinated and all research-based activities are completed. Some districts also need a well-known and respected community leader as co-chair to give the advocacy effort credibility.

- **Campaign chair(s)/consultant:**

- ▶ Coordinates all facets of the researched-based campaign and makes sure the committee sticks with and carries out the research-based plan 100 percent.
- ▶ Prepares agendas for meetings.

- ▶ Establishes the following subcommittees and appoints chairs who have overall responsibility for subcommittee tasks.
- ▶ Keeps in contact with all subcommittee chairs to be sure their tasks are being accomplished as scheduled.

- **Finance committee:**

Raises the dollars and finds the in-kind contributions (printing, postage, office space and supplies, phone bank locations, food, etc.) needed for the campaign. The treasurer files all of the required forms and reports with the Secretary of State's Elections Division ORESTAR system ([oregonvotes.org](http://oregonvotes.org)).

- **Data committee:**

Responsible for making sure the campaign has all of the voter information and lists needed for phoning, mailings and door-to-door activities. This requires creating and maintaining the campaign's voter database or working with the county elections office and/or a commercial list service to provide voter lists as needed.

- **Publicity committee:**

Prepares all campaign literature based on survey research-identified themes and messages. This committee designs the materials to meet campaign requirements and has them produced in time to meet campaign deadlines.

- **Volunteers committee:** Key to the campaign's success.

- ▶ *The volunteer coordinator* recruits and assigns volunteers by distributing sign-up sheets to the

schools/departments and groups willing to send volunteers and coordinating the times each school/department/group is assigned to work. The most important task is to follow up to make sure the required number of volunteers is present for each night of phoning, each mailing and door-to-door activity.

- ▶ *The mailing chair* is responsible for all campaign mailings. This person should be familiar with current mailing requirements and procedures. The mailing chair also works with the volunteer coordinator to be sure there are enough volunteers for the scheduled dates for mailings.

- ▶ *The refreshments chair* is responsible for making sure there are beverages and snacks for all activities that involve volunteers.

Other volunteer subcommittees may be required depending on the campaign strategy based on the committee's analysis of survey and other research data.

- ▶ *The telephone chair* must be available each night phoning takes place to be sure volunteers have direction and guidance. This person is responsible for providing training as well as for supervising the phoning.
- ▶ *The door-to-door chair* is responsible for working with the database manager and elections office to produce walking lists; with the volunteer coordinator to recruit volunteers and to prepare lists and information

*continued*

## Sample Campaign Structure *(continued)*

packets for the canvass; and with the refreshments chair to arrange starting and ending locations for canvassing where refreshments can be served. In addition, the door-to-door chair may need to

get appropriate permissions from the city or county for volunteers to go door-to-door.

For step-by-step instructions for information and advocacy campaigns, see *Election Success: Proven strategies*

for public finance campaigns, published by the National School Public Relations Association ([www.nspr.org](http://www.nspr.org)); authors: Gay Campbell and Jeanne Magmer.

## Frequently Asked Questions about Elections

### **Q: When can districts vote on a bond levy?**

A: There are four election dates each year (ORS 255.345): Simple majority, no turnout requirement for approval:

- ▶ Third Tuesday in May
- ▶ First Tuesday after the first Monday in November

Double majority: Simple majority, 50 percent turnout required for approval:

- ▶ Second Tuesday in March
- ▶ Third Tuesday in September

Filing deadlines are on the Oregon Secretary of State's elections website - [oregonvotes.org](http://oregonvotes.org).

### **Q: When does the double majority requirement for elections apply?**

A: There is no turnout requirement for May or November elections. However, there is a 50 percent voter turnout requirement for March and September elections.

### **Q: Is there any limit to the number of times a district can submit a measure to voters?**

A: No. However, the county does charge the district election costs for each election. In addition, multiple elections can erode a district's credibility with voters.

### **Q: Is there a disadvantage to voting by mail?**

A: No. Voting by mail increases voter turnout and may help districts voting in March or September reach the 50 percent turnout requirement.

### **Q: Which election is the best for school bond measures?**

A: Districts need to consider survey data and their community's characteristics in choosing an election date. Statistics indicate that school bond levies do better in March, May and November elections. September elections are difficult because ballots are mailed before school is in session. March and September elections require a 50 percent voter turnout. Property tax bills are mailed at about the same time ballots are mailed for November elections and may impact a measure's success.

### **Q: What can a district tell voters about the election?**

A: Districts can provide factual information about the measure and tell voters what the results would be if the measure passes or doesn't pass. District information must be impartial and avoid advocacy. For example, "The ABC

district is asking voters to consider a bond levy" is information. "The ABC district is asking voters to approve a bond levy" is advocacy.

### **Q: Who decides what's advocacy and what's information? What's the penalty for violating the law?**

A: The district has the responsibility to review all election-related materials and activities paid for with public funds or involving public employees to be sure they are advocacy-free. If a community member believes something the district produces advocates a positive or negative vote, that individual can file a complaint with the Secretary of State.

The Elections Division reviews the complaint. If the district and/or employees are found in violation of the law, they may be fined.

If a public official "expends any public money in excess of the amounts, or for any other or different purposes than authorized by law," that official can be sued by the county district attorney or taxpayer from that district (ORS 294.100 (2)).

*continued*

## Frequently Asked Questions about Elections, *continued*

**Q: Can school board members engage in advocacy activities?**

A: Yes. They can engage in advocacy activities at any time as long as no public funds are involved.

School boards can pass resolutions in support of or in opposition to measures. The action can be reported in board minutes and board reports, but no public funds should be used for any further publication of the action.

**Q: Can district employees engage in advocacy?**

A: Yes, as long as these activities take place outside of work hours and do not involve use of public resources.

**Q: Can the campaign committee hold meetings in district buildings?**

A: Yes, if the campaign committee is treated like other community groups that request use of the same district facility.

Districts should check and follow board policies for facility use.

**Q: Can the advocacy committee use a district copy machine or make phone calls using district phones?**

A: In general, the advocacy committee should find non-district sources for printing and phoning. However, if the district makes these resources available to the public, then a campaign committee can use the district copy machine and phones provided the committee is treated like all other community groups or members of the public that are allowed to use these resources.

**Q: Can the district put a link on its website to the advocacy committee website?**

A: No. A district should not put a link on its website to an advocacy (political action)

committee website. This also means a PAC's contact information and requests to volunteer for PAC activities should not be included on the district's website or in other district information, or communicated using district email addresses. However, if a district wants to provide links related to a measure on its website, the district may do so providing all (pro and con) PAC websites are included.

# Federal and State Tax Treatment

*"A child of 5 could understand this. Fetch me a child of 5."*

*Groucho Marx*

**T**he federal government is more aggressively auditing outstanding tax-exempt debt issues; consequently, districts must carefully monitor the use and investment of all funds related to a tax-exempt borrowing as well as the use of all assets financed with tax-exempt debt. Failure to comply with applicable federal rules can result in the tax-exempt debt becoming taxable, retroactive to its date of issue.

This section is a brief overview of an extremely complex area of law. It is intended to acquaint district officials with current rules and regulations.

Note: Federal tax rules may change frequently whether through amendments to the Internal Revenue Code, federal Treasury regulations, and/or new IRS rulings. Failure to comply with these changes can result in severe financial and legal consequences to the issuer.

Bond counsel advises districts regarding compliance with these requirements prior to debt issuance

but generally does not monitor post-issuance events that may affect a debt's tax-exempt status. As a result, district business officials should track applicable federal tax requirements and consult with bond counsel regarding any investments of bond proceeds and uses of bond-financed assets that may have an adverse effect on the tax-exempt status of the district's outstanding debt.

## Avoiding Private Activity Bond Status

The Internal Revenue Code generally prohibits governmental issuers from using the financed assets in a manner that provides significant benefit to non-exempt persons. The IRS definition of non-exempt persons includes non-profit organizations and the federal government as well as profit-making businesses and individuals acting in a trade or business capacity.

U.S. Treasury regulations finalized in 1997 employ complex rules to determine whether non-exempt

## Six Steps for Complying with Tax Requirements

- ✓ Follow bond counsel's advice in structuring the debt issue prior to issuance so that the issue meets all federal and state tax-exempt status requirements.
- ✓ Adopt post-issuance compliance policies and procedures.
- ✓ Monitor changes in tax law, rules and regulations regarding the status of tax-exempt debt.
- ✓ Consult bond counsel before investing bond proceeds or making any changes in the use of bond-financed assets to avoid any adverse effects on the debt's tax-exempt status.
- ✓ Make sure the district complies with all bond registration and IRS reporting requirements.
- ✓ Make sure the district understands, tracks and complies with all rebate requirements.



persons derive a benefit from financed assets and, if so, whether this benefit exceeds permissible limits over the life of the borrowing. These rules focus on whether a non-exempt person has preferential rights regarding the use of bond-financed property (private use) and whether the bonds are secured by private property or are expected to be repaid from payments derived from the privately used property.

Permissible limits on private benefit range from 5 to 10 percent depending on the type of use. These limits generally are measured over a term beginning on the bond issue date or on the placed-in-service date, whichever is later. They end on the expiration of the financed asset's expected life or on the final borrowing maturity date, whichever is earlier.

The most common type of preferential use occurs when bond-financed assets are leased or managed by non-exempt persons. Except for certain short-term arrangements, leases of bond-financed property are always treated as preferential use.

Management contracts relating to bond-financed assets, such as contracts for providing food service, transportation services or general school administration, are treated as preferential use unless the management contract's terms comply with IRS safe-harbor guidelines. Bond counsel should review any proposed management contract that involves bond-financed property, regardless of whether the bonds are yet to be issued or have been outstanding for years.

Management contract guidelines established by the IRS provide generally that a management contract will not be treated by the IRS as resulting in private use if:

- ▶ Compensation paid to the manager under the agreement is reasonable and in no way based on the net profits derived from the operation of the managed property, and the manager does not, in substance, bear any share of net losses from the operation of the managed property.
- ▶ The district exercises a significant degree of control over the use of the managed property.
- ▶ The term of the management agreement, including renewal options, does not exceed the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property.
- ▶ The manager agrees in writing not to take any tax position that is inconsistent with its role as a service provider with respect to the bond-financed property.
- ▶ The manager does not have any role or relationship with the district that substantially limits the district's ability to exercise its rights under the contract.
- ▶ The district, rather than the manager, bears the risk of loss from damage or destruction of the property.

### Change in Use

In the event an issuer decides to sell a tax-exempt debt-financed asset prior to the debt's retirement, the issuer should consult with bond counsel before the sale. Unless handled properly, the sale may be treated as fostering private use, and federal law may require the district to take remedial action. Similarly, if a district, contrary to its original expectations, decides after completion of a debt-financed project to lease a portion of the asset to a private person or enter into a management contract

with a private person, the district should consult with bond counsel before making the change.

### Arbitrage and Investment Restrictions – General

The Internal Revenue Code regulates the investment of bond proceeds. These regulations are referred to as the arbitrage rules.

Arbitrage is the positive difference between the investment yield on unspent bond proceeds and the yield on the district's bonds (the arbitrage yield).

There are two sets of rules governing these investments, yield restriction rules and rules requiring rebate of arbitrage earnings to the federal government.

Failure to comply can cause the bonds to become taxable retroactively.

### Yield Restriction Rules

Bond proceeds may not be invested at a yield in excess of the arbitrage yield plus 0.125 percent, unless there is an applicable exception. Yield restriction rules apply even to issues that are exempt from rebate. In many cases, tax-exempt debt issue proceeds are governed by one of the following exceptions:

#### ✓ Proceeds expenditures on the financed projects

- Proceeds for construction and acquisition projects may be invested at an unrestricted yield for a three-year period beginning on the issue date of the bonds if, on the bond issue date, the district expects that the following will be true:
- ▶ At least 85 percent of the debt's sale proceeds (less any amount deposited in a reserve fund) will be spent within three years of the issue date
- ▶ Within six months from the issue date, the district will incur substantial binding obligations that will require the expenditure

of at least 5 percent of the debt's sale proceeds

- ▶ The district will pursue completion of the project with due diligence
- ✓ **Reasonably required debt service reserve funds** – In full faith-and-credit obligations (FFCOs), the underwriter sometimes requires the district to establish a debt service reserve fund. The reserve fund may be financed from issue proceeds and invested at an unrestricted yield to the extent its size does not exceed the least of the following:
  - ▶ 10 percent of the issue proceeds (as defined by the federal tax regulations)
  - ▶ The maximum annual debt service of the borrowing
  - ▶ 125 percent of the average annual debt service on the issue

Additional district resources may be deposited in a reserve fund but must generally be yield restricted.

- ✓ **Bona fide debt service fund** – Amounts designated by a district to pay debt service may be invested at an unrestricted yield, provided that the debt service fund is depleted at least once each year except for a carryover amount equal to the investment earnings in that fund in the preceding year or one-twelfth of the preceding year's debt service.
- ✓ **Refunding amounts** – Amounts designated to pay debt service on another debt issue generally may be invested at an unrestricted yield if they are used to pay debt service on another issue within 90 days after receipt of the funds.
- ✓ **Yield Reduction Payments** – In many cases, proceeds that do not fall into any of the exceptions described above

and are therefore subject to yield restriction may still be invested at a yield in excess of the arbitrage yield. In such case, the district will often need to make "yield reduction payments" to the federal government in order to reduce the net earnings to the district on such proceeds to the arbitrage yield plus 0.125 percent. Any such yield reduction payments would be made in the same manner and at the same time as rebate payments as described below.

## Rebate

The second set of investment rules requires rebate to the federal government of any positive arbitrage above the bond yield unless certain exceptions are met. The Internal Revenue Code provides the following exceptions:

- ✓ **Bona fide debt service fund exception** – A bona fide debt service fund (as described above) established by a school district, ESD or community college is exempt from rebate if the bonds or FFCOs are fixed rate and have an average maturity of at least five years and/or the average annual debt service due on the bonds or the FFCOs does not exceed \$2.5 million. In the case of bonds or FFCOs that do not fall into one of those two categories, a bona fide debt service fund is still exempt from rebate for any year in which the gross investment earnings in such fund do not exceed \$100,000.
- ✓ **Small issuer exception** – No rebate is required if, as of the obligation's issue date, the school district, ESD or community college reasonably expects to issue:
  - ▶ Not more than \$5 million of tax-exempt obligations within the calendar year for all purposes

or

- ▶ Up to \$15 million of tax-exempt obligations during the calendar year provided any amount in excess of \$5 million is attributable to construction of primary or secondary public school facilities.

Under this test, any district lease-purchase obligations, TANs, or other borrowings, as well as bonds, count towards the \$5 million and \$15 million limits.

- ✓ **Six-month spending exception** – No rebate is required (except with respect to amounts deposited in a reserve fund) if 100 percent of the proceeds (excluding amounts in reserve funds on which rebate must be paid in any event) and investment earnings are spent within six months of the issue date.
  - ✓ **Eighteen-month spending exception** – No rebate is required (except with respect to amounts in a debt service reserve fund) if no part of the issue is a refunding issue (or a borrowing for working capital expenditures) and sale and investment proceeds are spent quickly enough to hit the following targets:
    - within six months of the delivery date,
    - at least 60 percent within 12 months, and
    - 100 percent within 18 months.
- Certain exceptions apply for amounts held back on the final date as a retainage and for certain de minimis amounts.
- ✓ **Two-year spending exception** – No rebate is required (except with respect to amounts in a debt service reserve fund) if no part of the issue is a refunding issue (or a borrowing for working capital expenditures), at least 75 percent of the sale and

investment proceeds are used for construction expenditures, and sale and investment proceeds are spent quickly enough to hit the following targets:

- at least 10 percent within six months of the delivery date,
- at least 45 percent within 12 months,
- 75 percent within 18 months, and
- 100 percent within 24 months.

Certain exceptions apply for amounts held back on the final date as a retainage and for certain de minimis amounts.

Even if the district believes it has complied with one of the rebate exceptions, it should have bond counsel, an accounting firm or another expert review its determination.

If any borrowing proceeds do not qualify for a rebate exception, the district must compute and, if necessary, pay rebate to the federal government every five years. Each rebate payment, except the final rebate payment, must be paid in an amount that, when added to the future value of any prior rebate payments, assures that at least 90 percent of the rebate amount is paid. Any remaining rebate amount must be paid within 60 days of the bonds' final scheduled maturity or earlier redemption. The district is not required to file any forms with the IRS unless rebate is actually owed. As discussed above, any yield reduction payments owed to the federal government must be paid in the same manner and at the same time as rebate payments.

Even though rebate owed does not have to be paid for about five years after the bond sale date, districts should calculate their

rebate liability annually until all of the bond proceeds are spent. That way if an amount is owed, the district can reserve that amount for later payment to the federal government. If the district does not wish to track the liability itself, it can hire a firm that specializes in arbitrage rebate calculations.

Districts that accrue a rebate liability should check with auditors regarding proper accounting procedures.

### **Bank Qualified Obligations**

A school district, ESD or community college may benefit from substantial interest rate savings by designating its bonds as qualified tax-exempt obligations. This designation is available to districts that reasonably expect to issue \$10 million or less in tax-exempt debt in the calendar year (certain current refundings are not taken into account in making this determination). This special designation is permitted by Section 265(b)(3) of the Internal Revenue Code, which provides an exception to the rule that prohibits banks and other financial institutions handling tax-exempt obligations from deducting their interest expense allocable to owning tax-exempt bonds.

### **Registration**

The Internal Revenue Code requires registration of most new issues of tax-exempt securities with maturities of one year or more. The bonds must be in registered form, i.e., the bond register maintained by the bond registrar records the names and addresses of all registered bond owners and all subsequent bond owners.

Securities may be registered in certificate form or in full book-entry form:

- ▶ When registered in

certificate form, investors hold the physical certificates representing the principal amount of bonds they own (most often in denominations of \$5,000 or multiples of \$5,000)

- ▶ When registered in a full book-entry system, certificates are not issued to investors and all processing is accomplished electronically

In each instance, the bonds are identified according to the number assigned to an issue (CUSIP number), the interest rate and the year of maturity.

The Depository Trust Company, a depository company in New York, is the most frequently used entity for electronically processing the receipt and payment of principal and interest to bond owners. The cost for this service is charged to the bond purchaser, not the district. Electronically processed debt service payments should provide a net saving to the district since the electronic system may reduce paying agent fees.

### **IRS Information Reports – Form 8038-G**

The Internal Revenue Code requires school districts, ESDs and community colleges issuing tax-exempt debt to file information reports with the Internal Revenue Service (IRS Form 8038-G or IRS Form 8038-GC).

The report contains information on the district, the issue, the property financed, and such other information as may be required by the Treasury Department. Bond counsel will prepare this document as part of the bond closing documentation. This requirement applies to all tax-exempt obligations including small equipment leases.

### **Reimbursement Rules**

Federal tax laws permit issuers to reimburse themselves for



certain prior expenditures initially paid for from sources other than proceeds of a borrowing. These reimbursements are subject to significant constraints. Generally, only capital expenditures may be reimbursed. Issuers may not reimburse themselves for prior payments for debt service or operating expenditures.

To preserve the ability to subsequently reimburse itself for most expenditures, a district must put in place a declaration of intent to reimburse no later than 60 days after paying an expenditure for which reimbursement will be subsequently sought. This declaration must describe the general category of expenditures to be reimbursed, e.g., school construction, purchase of school buses, or purchase of equipment. It also must identify the maximum amount of debt expected to be issued to finance the project for which the expenditures to be reimbursed are a part.

The reimbursement declaration may be done by board resolution or by any person to whom the board has delegated the power to make such declarations. The declaration does not commit the district to issue debt, but should not be made unless the district reasonably expects to issue debt (assuming all required approvals are obtained).

Once a reimbursement declaration is in place, federal tax law provides that reimbursement must occur (if it occurs at all) within certain specified periods:

- ✓ For issuers who qualify for the \$5 million or \$15 million rebate exception described on page 39, reimbursement must occur no later than the later of three years after the expenditure is actually paid, or three years after the project of which the expenditure is a part is placed in service.

- ✓ For issuers who do not qualify for this rebate exception, reimbursement must occur no later than 18 months after the later of (a) the date the expenditure is paid or (b) the date on which the project is completed, but in no event more than three years after the expenditure is paid.

No reimbursement declaration is required for preliminary expenditures such as architectural, engineering, survey, soil testing and similar costs as long as they do not exceed 20 percent of the bond issue from which they are paid. In addition, no reimbursement declaration is required to reimburse a de minimis amount of expenditures of not more than the lesser of \$100,000 or 5 percent of the bond issue.

Also, no reimbursement declaration is required for expenditures that are made after the related borrowing is issued. However, these expenditures must be reimbursed with bond proceeds not later than within 18 months after the date of payment or the date the financed project is completed, whichever date is later.

### **ARRA and Other Tax-Advantaged Debt**

Although districts predominantly issue tax-exempt obligations to secure lower financing rates, there have been other varieties of obligations issued by districts that, while not federally tax-exempt, have other tax advantages that have enabled districts to obtain favorably low financing rates.

For example, the 2009 American Recovery and Reinvestment Act ("ARRA") offered districts the ability to issue certain types of "tax-advantaged debt" other than tax-exempt debt to lower the cost of borrowing. Another type of tax-advantaged debt was Qualified

Zone Academy Bonds, a federal program developed in 1997 to provide a low-cost financing option for school districts.

Districts can no longer issue these types of tax-advantaged debt; however, many districts did issue one or more of these tax-advantaged bonds in the past and have continuing post-issuance compliance obligations with respect to such debt. In addition, qualified zone academy bonds are a type of tax-advantaged debt that are currently authorized. Many types of tax-advantaged debt carry restrictions and limitations similar to those that apply to tax-exempt obligations; however, they often have unique requirements as well.

Any district that has issued one of these types of tax-advantaged debts should consult with its bond counsel to determine the specific requirements applicable to its debt. Tax-advantaged bonds that may have been issued by districts include Build America Bonds, Recovery Zone Economic Development Bonds, Qualified School Construction Bonds, Qualified Energy Conservation Bonds, and Qualified Zone Academy Bonds.

### **Written Post-Issuance Compliance Procedures**

The tax requirements that apply to tax-exempt or tax-advantaged debt are numerous and any district that has issued, or is considering issuing, such debt, may want to consider adopting written procedures that will assist it in addressing these compliance obligations in the future. Although adopting written post-issuance compliance procedures is not currently required by federal tax law, the IRS strongly encourages the adoption of such procedures. The 8038 form filled out by districts has a box to check if a



district has or does not have such procedures. Further, participation in the Oregon School Bond Guaranty Program is contingent on a district having such procedures for securities and tax compliance. In addition, the IRS has specified that such written procedures should contain certain key characteristics, including making provision for:

- ▶ Due diligence review at regular intervals;
- ▶ Identifying the official or employee responsible for review;

- ▶ Training of the responsible official/employee;
- ▶ Retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds and the use of bond-financed facilities);
- ▶ Procedures reasonably expected to timely identify noncompliance; and
- ▶ Procedures ensuring that the issuer will take steps to timely correct noncompliance

Any district interested in pursuing the adoption of written

post-issuance compliance procedures should consult with its bond counsel.

## Frequently Asked Questions about Federal and State Tax Treatment

### **Q: Why should school districts care about federal tax law? Aren't school borrowings tax-exempt?**

A: In 1988, the U.S. Supreme Court held that the federal Constitution did not prohibit federal taxation of state and local bonds. Congress has, by statute, made many types of school district, ESD and community college borrowings exempt from taxation, but has imposed numerous conditions these bonds must satisfy to be, and remain, tax-exempt. These conditions restrict permissible uses of borrowed monies and affect investment of borrowed monies prior to their expenditure.

### **Q: How do federal tax laws restrict borrowing expenditures?**

A: School districts, ESDs and community colleges may not borrow on a tax-exempt basis to finance assets that benefit private businesses. These rules are known as the private activity rules. For example, districts generally cannot lease

bond-financed educational or athletic facilities for use during non-school hours, except on a short-term basis. Also, contracts with private parties to manage various aspects of district operations, e.g., food service, are subject to strict rules if the manager uses tax-exempt bond-financed assets in providing services to the district.

### **Q: Does federal tax law affect what a district may do with financed assets after they are placed in service?**

A: Yes, federal tax restrictions apply as long as the related tax-exempt debt is outstanding.

### **Q: Do these restrictions prevent a district from changing the use of bond-financed assets or from selling assets if the district later decides it is prudent to do so?**

A: Federal tax law does not prevent a change in use of bond-financed assets unless that use is by private parties. However, if a change in use does involve private parties

(such as a sale of bond-financed land to a developer), then tax law generally requires the district to take some remedial action to preserve the tax-exempt status of the bonds that financed the asset. For example, a district might be required to dedicate the sale proceeds to redeeming some of the tax-exempt debt. Or, in certain circumstances, the district might be permitted to choose between dedicating the sale proceeds to redeeming debt or using the proceeds to acquire additional district assets within a reasonable period of time.

### **Q: What are arbitrage rules?**

A: Federal tax arbitrage rules impose restrictions on a district's investment of money borrowed on a tax-exempt basis. These rules govern the purchase and selection of permissible investments. They can require districts to restrict the yield on bond proceed investments and to rebate a certain portion of the investment proceeds to the federal government.

## Frequently Asked Questions about Federal and State Tax Treatment, *continued*

**Q: What is yield restriction?**

A: If a district fails to spend borrowed monies within a reasonable period of time, federal tax law can require a district to restrict the yield on the investment of unspent monies to the yield on the related borrowing. This can be accomplished, in certain circumstances, by making yield reduction payments the federal government.

**Q: Rebate sounds like a tax. What is it?**

A: Rebate is like a tax, but it is governed by different rules. Under these rules, if a district is fortunate enough to invest borrowed funds at a yield in excess of its costs, federal tax law will sometimes require the district to pay the excess investment earnings to the federal government.

For example, if a district subject to rebate borrows money on a tax-exempt basis at 4 percent and invests the money prior to its expenditure at an average yield of 5 percent, the value of the 1 percent spread would have to be rebated.

**Q: Do all districts have to pay rebate?**

A: No. There are a variety of rebate exceptions that exempt tax-exempt obligations from rebate. One exception applies to districts that expect to issue less than specified amounts of tax-exempt debt (either \$15 million or \$5 million) during the year.

# Federal Securities Law Disclosure Requirements

*“When someone goes on a board, even if it is the school board, I want them to be as mindful of disclosure and securities laws as directors of a corporate enterprise. I have no patience with municipal officials who say ‘We didn’t understand.’”*

*Arthur Levitt*

**B**ecause school district, ESD and community college bonds and other debt obligations are considered municipal securities, they are subject to federal securities laws. There are two main federal laws regulating the issuance and sale of securities, the Securities Act of 1933 and the Securities Exchange Act of 1934. Section 3(a)(2) of the Securities Act exempts from registration “any security issued or guaranteed by ... any State of the United States, or by any political subdivision of a State, or by any public instrumentality of one or more states ....”

Because school districts, ESDs and community colleges are political subdivisions of the State of Oregon, their debt obligations are exempt from the Securities Act’s cumbersome registration requirements that apply to corporate debt issuers.

Although bonds of political subdivisions are generally exempt from registration, they are not exempt from the antifraud provisions of the federal securities laws. Court-developed federal antifraud principles that apply to corporate securities transactions generally apply to municipal securities as well. (See Section 17

of the Securities Act and Section 10(b) of the Exchange Act and paragraph (b)(5) of Securities and Exchange Commission Rule 15c2-12.) These provisions prohibit any person, including municipal bond issuers, from making false or misleading statements of material fact, or omitting any necessary material facts, in connection with an offer, purchase or sale of any security.

This chapter gives districts basic information about the disclosure requirements under federal securities laws. Bond counsel can answer specific questions about these requirements and can assist districts with compliance.

### New Issue Disclosure

The adequacy of disclosure for municipal securities is tested against the same objective standard that applies to corporate securities. Under this standard, an omitted fact is material if there is a substantial likelihood that, under all circumstances, the omitted fact would be significant to a reasonable investor. In other words, there must be a substantial likelihood that investors would view the omitted fact’s disclosure as significantly altering the information made available.

### Four Steps for Complying with Tax Disclosure Requirements

- ✓ Carefully review all federal securities law disclosure requirements with financial consultants and bond counsel.
- ✓ Follow financial consultants’ and bond counsel’s advice in assembling and presenting required information.
- ✓ Set up a timeline and process for meeting annual continuing disclosure reporting requirements.
- ✓ Follow through with material events requirements.



OFFICIAL STATEMENT DATED AUGUST 1, 2013

**\$31,000,000**  
**Klamath County School District**  
**Klamath County, Oregon**  
**General Obligation Bonds, Series 2013**

**DATED:** August 15, 2013 ("Date of Delivery")

**DUE:** June 15, as shown on the inside cover

**PURPOSE** — The \$31,000,000 General Obligation Bonds, Series 2013 (the "Bonds") are being issued by the Klamath County School District in Klamath County, Oregon (the "District"). The Bonds are being issued to finance the costs of capital projects for the District, and to pay the costs of issuance of the Bonds. See "Purpose and Use of Proceeds" herein.

**STANDARD & POOR'S RATINGS** — "AA+" enhanced; "A" underlying. See "Oregon School Bond Guaranty" and "Ratings" herein.

**NOT BANK QUALIFIED** — The District has NOT designated the Bonds as "qualified tax-exempt obligations" for purposes of Section 265(b)(3)(B) of the Internal Revenue Code of 1986, as amended (the "Code").

**BOOK-ENTRY ONLY SYSTEM** — The Bonds will be issued, executed and delivered in fully registered form under a book-entry only system and registered in the name of Cede & Co., as owner and nominee for The Depository Trust Company ("DTC"). DTC will act as initial securities depository for the Bonds. Individual purchases of the Bonds will be made in book-entry form, in the denomination of \$5,000 or any integral multiple thereof. Purchasers will not receive certificates representing their interest in the Bonds purchased.

**PRINCIPAL AND INTEREST PAYMENTS** — Interest on the Bonds will be paid on December 15, 2013 and semiannually thereafter on June 15 and December 15 of each year to the maturity or earlier redemption of the Bonds. Principal of and interest on the Bonds will be payable by the District's Paying Agent, initially U.S. Bank National Association, to DTC which, in turn, will remit such principal and interest to the DTC participants for subsequent disbursement to the beneficial owners of the Bonds at the address appearing upon the registration books on the last business day (the "Record Date") of the month preceding a payment date.

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**MATURITY SCHEDULE — SEE INSIDE COVER**

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**REDEMPTION** — The Bonds may be subject to redemption prior to their stated maturities as further described herein.

**SECURITY** — The Bonds are general obligations of the District. The full faith and credit and taxing powers of the District are pledged to the successive owners of each of the Bonds (the "Bondowners") for the punctual payment of such obligations, when due. The District covenants with the Bondowners to levy annually a direct ad valorem tax upon all of the taxable property within the District without limitation as to rate or amount, and outside of the limitations of sections 11 and 11b, Article XI of the Oregon Constitution, after taking into consideration discounts taken and delinquencies that may occur in the payment of such taxes, and any other funds available to pay interest accruing and the principal maturing on the Bonds promptly when and as they become due. The Bonds do not constitute a debt or indebtedness of Klamath County, the State of Oregon, or any political subdivision thereof other than the District.

Payment of the principal of and interest on the Bonds when due is guaranteed by the full faith and credit of the  
**State of Oregon**

under the provisions of the Oregon School Bond Guaranty Act. See "Oregon School Bond Guaranty" within.

**TAX MATTERS** — *In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the District ("Bond Counsel"), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In the opinion of Bond Counsel, interest on the Bonds is exempt from State of Oregon personal income tax under existing law. See "Tax Matters" herein.*

**DELIVERY** — The Bonds are offered for sale to the original purchaser subject to the final approving legal opinion of Bond Counsel. It is expected that the Bonds will be available for delivery to the Paying Agent for Fast Automated Securities Transfer on behalf of DTC, on the Date of Delivery.

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*This cover page contains certain information for quick reference only. It is not a summary of the issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.*

**PiperJaffray**



To comply with anti-fraud rules, municipalities intending to sell their bonds in the public markets prepare a disclosure document, commonly called the official statement. The official statement is prepared in a preliminary and final form:

- ▶ The preliminary official statement (POS) contains all material information except for terms related to bond pricing, i.e., maturities, interest rates, premium or discounts, terms of redemption, and other features not known until pricing.
- ▶ The final official statement (OS), prepared after pricing, supplements the POS by inserting the pricing terms. In the official statement, a school district, ESD or community college must disclose all information that is material to an investment in the bonds. Determining exactly what information is material, however, is a fact-specific inquiry.

There is no legally prescribed form that an official statement must take. Organization and presentation of information is determined more by custom and practice. Issuers may follow general disclosure guidelines such as those published by the Government Finance Officers Association. There also are more specific examples that serve as useful reference points, such as official statements prepared by other school districts, ESDs, community colleges or municipal jurisdictions that have issued general obligation debt in Oregon. (See page 45 for sample official statement cover page.) Official statements for recent bond issues can be found on the Municipal Securities Rulemaking Board's EMMA (Electronic Municipal Market Access) system: <https://emma.msrb.org>.

## **SEC Rule 15c2-12 Standards for Disclosure**

In 1982 the Washington Public Power Supply System defaulted on more than \$2 billion of municipal bonded debt issued to finance the construction of two nuclear power plants. In 1983 the Securities and Exchange Commission investigated the default to determine whether federal securities anti-fraud provisions were violated in the bond sale.

As a result of this investigation, and pursuant to its power under Section 15(c) (2) of the Exchange Act to make rules reasonably designed to prevent fraud, the SEC instituted Securities and Exchange Commission Rule 15c2-12.

This was the commission's first exercise of its rulemaking authority directed at disclosure activity in the municipal market. Rule 15c2-12 does not directly regulate municipal security issuers. Instead, it requires an underwriter in a primary public offering of municipal securities with an aggregate principal amount of \$1 million or more to:

- ✓ Obtain and review an official statement that has been deemed final by an issuer, prior to making a purchase, offer, or sale of municipal securities
- ✓ Provide, in negotiated sales, the issuer's most recent preliminary official statement (if one exists) to potential customers
- ✓ Deliver to customers, upon request, copies of the final official statement for a specified period of time
- ✓ Contract to receive, within a specified time, sufficient copies of the issuer's final official statement to comply with the rule's delivery requirement

and the requirements of the Municipal Securities Rulemaking Board rules

Rule 15c2-12 does not directly regulate the content or quality of disclosure, but it does regulate the timing and production of disclosure documents by underwriters in municipal security transactions.

In its March 1994 Interpretive Release, the SEC noted that while progress had been made in first issue market disclosure practices since Rule 15c2-12 was instituted, secondary market disclosure was still deficient. Specifically, the SEC found that: "[A]ccess by market participants to current and reliable information is uneven and inefficient, [and] municipal issuers presently face a risk of misleading investors through public statements that may not be intended to be the basis of investment decisions, but nevertheless may reasonably be expected to reach the securities markets. [T]o minimize the risk of misleading investors, municipal issuers should establish practices and procedures to identify and timely disclose, in a manner designed to inform the trading market, material information reflecting on the creditworthiness of the issuer and obligor and the terms of the security."

On the basis of findings such as these, the SEC began efforts to amend Rule 15c2-12 to require secondary market disclosure for municipal securities.

**Continuing disclosure** – Until 1995, Rule 15c2-12 contained no duty to update the final official statement. This is because Rule 15c2-12, in its original form, was adopted as a delivery rule, not as an update rule. As such, it has functioned not as an anti-fraud rule but simply as a means for disseminating information for a given number of days following

issuance of municipal securities. Effective July 3, 1995, the SEC amended Rule 15c2-12 to require continuing disclosure for municipal securities unless they qualify for an exemption. Continuing disclosure, in general terms, means a process of providing financial and other material information to the marketplace on a regular basis for as long as securities are outstanding. The SEC has recently been carefully scrutinizing the compliance of both issuers and underwriters with continuing disclosure obligations, which in some cases has resulted in fines. Further, non-compliance could lead to future difficulty in marketing bonds. Districts would be well advised to do everything possible to ensure compliance with these rules.

Rule 15c2-12, as amended, does not apply to bonds and other municipal securities issued before July 3, 1995.

Continuing disclosure requirements apply to obligated persons, whom the SEC defines as the following:

"... any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account ... committed by contract or other arrangement to support payment of all, or part of the obligations on municipal securities ..."

For most school district, ESD and community college bond issues, the district is the sole obligated "person" and the district is required to provide either full or limited disclosure, as described here. Rule 15c2-12 specifically excludes most credit enhancement providers, e.g., bond insurance, letters of credit or other liquidity facilities, from the definition of obligated person. Likewise, major taxpayers are not covered by Rule 15c2-12.

The district's undertaking to provide continuing disclosure

may be included in the bond resolution, or in a separate agreement or certificate entered into for the benefit of bondholders. However, an underwriter must receive reasonable assurance regarding the continuing disclosure commitment before agreeing to act as underwriter. This means that in negotiated offerings, assurance is obtained at the time the district signs the underwriting agreement or bond purchase contract.

In competitive offerings, the disclosure commitment should be included in the issuer's notice of sale and must comply with Rule 15c2-12 requirements. If the district's commitment does not fully comply with the rule's requirements, underwriters may not submit bids. In fact, there have been instances of underwriters abstaining from the bid process for this reason.

**Annual financial information –** Annual financial information and certain material events must be disclosed on a continuing basis under Rule 15c2-12.

The SEC defines annual financial information as:

"... financial information or operating data, provided at least annually, of the type included in the final official statement with respect to an obligated person."

The SEC defines operating data as a subset of annual financial information that refers to quantitative information given in the official statement to help investors place the financial information in context. Economic and demographic data normally are not considered annual financial information subject to update.

Rule 15c2-12 does not prescribe form and content criteria for the annual financial information. However, the written information the district provides, as well as

the OS, must be reasonably detailed and include the categories of information that will be updated on an ongoing basis.

Typically, annual financial information includes a district's real market value and assessed value, amount or rate of property taxes levied and collected, outstanding indebtedness, major taxpayers, appropriate measure of enrollment and audited financial statements.

The undertaking must also specify the date by which the annual financial information will be provided, i.e., so many days following the end of the issuer's fiscal year, and it must describe the accounting principles used in preparing the annual financial information, including whether or not audited financial statements will be prepared. Districts must also file notification of any failure to file annual financial information prior to the deadline.

**OS model for annual update –** Since the continuing disclosure amendments were added to Rule 15c2-12, the official statement has assumed greater significance because it serves as the template for future disclosure. The official statement establishes the financing elements that are material and, therefore, subject to ongoing disclosure. Issuers and obligated persons should carefully consider both the content and the context of the financial information presented in the official statement. Rule 15c2-12 requires annual updating of the type of financial information and operating data included in the official statement.

A district may choose to meet Rule 15c2-12's financial information requirements by filing a Comprehensive Annual Financial Report (CAFR). If this approach is taken, districts should pay special attention to make sure the CAFR contains

the required annual disclosure material. The district does not have to include the entire CAFR in the official statement. However, to the extent that information overlaps, e.g., tables, charts, audited financial statements, the overlap should be identical. Investors in the secondary market should not have to deduce from the CAFR information the type of data that was contained in the official statement.

**Certain material events** – In addition to annual disclosure of financial information, Rule 15c2-12 requires timely notice (not in excess of 10 business days after the occurrence of an event) of the following events:

- ▶ Principal and interest payment delinquencies
- ▶ Non-payment related defaults, if material
- ▶ Unscheduled draws on debt service reserves reflecting financial difficulties
- ▶ Unscheduled draws on credit enhancement 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 security, or other material events affecting the tax status of the security
- ▶ Modifications to rights of security holders, if material
- ▶ Bond calls, if material, and tender offers
- ▶ Defeasances
- ▶ Release, substitution or sale of property securing repayment of the securities, if material

- ▶ Rating changes
- ▶ Bankruptcy, insolvency, receivership or similar event of the obligated person; (Note: For the purposes of this event, the event is considered to occur when any of the following occur: The appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.)
- ▶ 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
- ▶ Appointment of a successor or additional trustee or the change of name of a trustee, if material

Typical material events for Oregon school districts, ESDs and community colleges might be a ratings change or notice of

bond calls due to a refunding. For example, a district's undertaking to provide notice of material events extends to a notice regarding a change in the state of Oregon's credit rating, if the district takes part in the Oregon School Bond Guaranty Program. Failure to provide annual financial information by the date specified in the written undertaking also is a disclosure item.

**National Repositories** – On December 8, 2008, the Securities and Exchange Commission (SEC) announced a major change in how both primary and secondary market disclosure will be handled. Effective July 1, 2009, the Municipal Securities Rulemaking Board's EMMA (Electronic Municipal Market Access) system is the sole repository for ongoing disclosures by municipal issuers. The EMMA system will make disclosure more readily available to investors, similar to the SEC's EDGAR system for corporate disclosure. More information about EMMA can be found at [www.emma.msrb.org](http://www.emma.msrb.org).

**Amending Disclosures** – Generally, the undertaking to provide continuing disclosure may not be modified after the fact. However, an undertaking that includes an amendment provision may comply with Rule 15c2-12 if the following conditions are met:

- ✓ The amendment must be made in connection with a change in circumstances that arises from a change in legal requirements; change in law; or change in the identity, nature, or status of the obligated person or type of business conducted
- ✓ This disclosure undertaking, as amended, would have complied with the requirements of Rule 15c2-12 at the time of the primary offering, after taking into



account any amendments or interpretations of Rule 15c2-12, as well as any change in circumstances

- ✓ The amendment does not materially impair the interest of bondholders, as determined either by parties unaffiliated with the issuer, such as a trustee or nationally recognized bond counsel; or the bondholders must approve the amendment

In addition, the next filing of financial information must explain, in narrative form, the reasons for any amendment and the impact of the change in the type of operating data or financial information being provided.

#### **Terminating Continuing Disclosure Obligations –**

A district may terminate its continuing disclosure obligations when it ceases to have any liability for payment on the bonds. According to the SEC, this occurs

when the bonds are redeemed in full or in cases of legal defeasance and release of any lien securing the bonds.

**Exemptions to Rule 15c2-12 –** School districts, ESDs and community colleges should be aware of the following exemptions from Rule 15c2-12:

- ✓ Issues of less than \$1 million in aggregate principal amounts are exempt from both Rule 15c2-12's new issue and continuing disclosure requirement
- ✓ Issues in large minimum denominations of \$100,000 or more are exempt from Rule 15c2-12 if one of the following is true:
  - ▶ They are privately placed with no more than 35 sophisticated investors
  - ▶ They have a maturity of nine months or less
  - ▶ They may be optionally

tendered at par value at least every nine months

Effectively, this means that most private placements and variable rate issues are exempt from Rule 15c2-12. Districts should note, however, that investors and rating agencies have both become more aware of and sensitive to debt that has not been sold in the public market. The MSRB has recently recommended that municipalities voluntarily disclose such private placements on EMMA. Onerous provisions such as acceleration in private placement documents are the focus of increased disclosure. Short-term notes and other municipal securities whose stated maturity is 18 months or less, e.g., tax anticipation notes, are exempt from the financial information continuing disclosure requirements of Rule 15c2-12. However, districts must still provide timely notice of material events.

## **Frequently Asked Questions about Federal Securities Law Disclosure Requirements**

### **Q: Are school district bonds and other debt obligations subject to federal securities laws?**

A: In most cases, yes. School district, ESD and community college bonds, like other municipal securities, are exempt from the Securities Act registration requirements. However, they are subject to the anti-fraud rules that prohibit any person from making false or misleading statements of material fact, or omitting any necessary material facts, in connection with the offer, purchase, or sale of a security.

### **Q: What kinds of facts are material and, therefore, subject to disclosure?**

A: An omitted fact is material if there is a substantial likelihood that, under all circumstances, the omitted fact would be significant to a reasonable investor. There must be a substantial likelihood that the omitted fact's disclosure would have significantly altered the information made available to investors.

### **Q: What does continuing disclosure mean?**

A: Continuing disclosure generally means a process of providing financial and other material information to

the marketplace on a regular basis for as long as the bonds are outstanding. Rule 15c2-12 is the statutory basis for the continuing disclosure requirements that apply to municipal securities' issuers.

### **Q: What kinds of information must be continually disclosed?**

A: Annual financial information and certain listed material events.

### **Q: Are there any exemptions from Rule 15c2-12's continuing disclosure requirements?**

A: Yes. Exemptions may be based on:

*continued*



## Frequently Asked Questions about Federal Securities, *continued*

- The size of the bond issue in question
- The security's length of the maturity
- The terms on which the security is offered

**Q: What happens if a district fails to comply with continuing disclosure requirements?**

A: Bondholders' rights and remedies depend on what the

authorizing documents for the bonds provide.

A breach of continuing disclosure obligations does not trigger a bond default. However, Rule 15c2-12 requires the issuer to disclose any failure to provide continuing disclosure as and when required in subsequent official statements for the next five years. Note that the SEC has recently been carefully

scrutinizing the compliance of both issuers and underwriters with reporting continuing disclosure obligation compliances, which in some cases has resulted in fines. Districts would be well advised to do everything possible to ensure compliance with these rules.

# Credit Analysis, Ratings and Bond Insurance

*“Honest criticism is hard to take, particularly from a relative, a friend, an acquaintance or a stranger.”*

*Franklin P. Jones*

**A** district’s primary goal in issuing any type of debt is to obtain the lowest possible interest rates while accomplishing other financing objectives. The interest rate on any debt issue is directly related to investors’ perceptions of the bond’s value. Consequently, credit quality is a major factor investors use in determining a bond’s value as an investment.

This chapter describes bond ratings and the rating agencies that assign them. After reviewing the information in this chapter, districts may consider applying for a rating, using the Oregon School Bond Guaranty Program, or purchasing bond insurance to enhance their ratings. Districts should seek the advice of their municipal advisors or underwriters about which option may produce the best borrowing results.

## Ratings and Rating Agencies

A district can often enhance its credit quality and obtain lower interest rates by obtaining a debt rating from a national credit rating agency. These agencies are for-profit corporations that analyze the credit quality of debt issues. The

district pays the rating fee, which is based on the size of the bond issue.

While a rating is not legally required, any district wanting to sell debt in the public markets should begin with the assumption that a rating will be necessary to obtain competitive interest rates.

The rating agency assigns one of a number of standardized ratings, e.g., A, AA, AAA, to the issue. In general, the higher the debt rating, the lower the interest rate investors will accept.

There are three major rating agencies that analyze school district, ESD and community college debt:

- ▶ Moody’s Investors Service, Inc.
- ▶ S&P Global
- ▶ Fitch Ratings

All three agencies use a standardized series of rating symbols. For example, Moody’s rates long-term debt issues on a scale of Aaa (the highest category) to D (a security that is in default). The lowest rating that Moody’s considers investment grade is Baa3. The other agencies use similar letter scales.

### Four Steps for Deciding Whether to Apply for a Rating

- ✓ Review rating factors with district’s underwriter or municipal advisor to determine likely bond rating outcome.
- ✓ Ask underwriter or municipal advisor to outline pros and cons of applying for a rating or purchasing bond insurance.
- ✓ Decide whether to apply for a rating or purchase bond insurance.
- ✓ With the underwriter’s or municipal advisor’s assistance:
  - Apply for a rating
  - Apply for the OSBG Program
  - Arrange to qualify the issue for bond insurance

Separate rating symbols are assigned to short-term debt obligations such as tax and revenue anticipation notes (TRANS) or variable rate bonds.

An assigned rating represents the rating for all of a district's outstanding debt of that kind. Different kinds of debt may have different ratings. For example, a district may have one rating for its general obligation bond debt and another for its full faith-and-credit obligation debt.

## Determining a Rating

In general, a particular rating is assigned to a debt issue based on a rating agency's opinion regarding the probability of timely principal and interest payments. Rating agencies consider a number of factors in determining the probability of repayment including:

**Financial analysis** – A rating agency reviews prior budgets and audited financial statements to determine if adequate resources are available to operate the district and pay debt service. For debt being repaid primarily from property tax collections, a rating agency considers general fund balance levels, tax levies, the schedule for state funding payments, concentration of property ownership by large taxpayers, real market and assessed value growth, tax delinquencies and similar data.

**Debt structure** – A rating agency examines how the debt issue is structured to determine the following:

- ▶ Whether repayment is deferred or accelerated
- ▶ The length of the debt related to the financed improvements useful life
- ▶ The district's plans for future debt issuance
- ▶ If the district's plan for future and current capital financing needs is adequate

## Local economic conditions –

A rating agency evaluates the district's local economy and factors that could affect the district's ability to repay debt:

- ▶ Levels of income and growth or decline
- ▶ Diversity and strength of the local employment base
- ▶ Building activity
- ▶ Population growth

A rating agency also may evaluate other economic and demographic criteria to determine a district's long-term ability to repay its debt.

## Administration and

**management** – The expertise and stability of a district's top management is considered an important factor in assigning a rating. This evaluation is based on contact with administrative personnel, examination of financial reports, management policies and procedures, and other documents as well as other more objective criteria.

Please note that there is no completely objective means used to assign a rating. The factors described here and other criteria used by a rating agency are subject to interpretation. Districts are compared to national peer groups, not just to neighboring or similarly sized Oregon districts.

## Assigning Ratings

Rating agencies use similar processes for assigning a debt rating. An analyst evaluates the credit quality of the issue under review according to their rating methodology for the particular credit. This analysis is used to develop a rating recommendation.

The analyst then takes the recommendation to a rating committee. The rating committee usually consists of two or more members, most senior to the analyst. The committee reviews the recommendation and votes

to assign a rating. Generally, the rating assigned is the one recommended. However, it is not unusual for a rating committee to assign a rating other than the recommended rating.

A district may appeal a rating if it feels the assigned rating is inappropriate. Appeals are seldom granted and then only on the basis of relevant new information that changes the committee's view.

Each rating agency publishes their rating methodology which summarizes the key factors considered in assigning the rating. Districts should review the methodology to be conversant in the factors the rating analysts will be concerned about and what might be considered a red flag.

## Deciding to Apply for a Rating

School districts, ESDs and community colleges are not required by law to seek a rating. Some debt can be successfully issued without a rating. Issuing

## Comparison of Rating Agency Categories

Moody's Investors Service	S&P Global	Fitch Ratings
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-

debt without a rating may sometimes produce a better result than issuing debt with a very low rating. Or, if an entire debt issue is being sold to a bank portfolio, the bank may not require a rating. Also, if the issue is small and short-term the benefit of obtaining the rating may not outweigh the cost.

Reasons a district should apply for a bond or other debt issue rating:

- ▶ The rating will save the district money through lower interest costs
- ▶ The district has rated bonds outstanding and wishes to maintain its rating

Determining whether to apply for a rating should be made only after consultation with the district's financing team. In addition, the rating fee and costs for preparing ratings materials should be more than offset by lower interest costs before a rating is obtained. The district's underwriter or municipal advisor can provide the information necessary to make a decision to seek a rating.

## Surveillance

### Ratings Reviews

While a rating is assigned for a specific bond credit issued at a specific time, the rating process continues over the life of the bond issue. Rating agencies routinely review credit material related to a district and may find reason to revise or change a rating. Rating agencies may contact the district directly and ask for updated information regarding the district's financial status. These "surveillance" rating reviews should be taken just as seriously as an original rating application. Districts may wish to seek assistance from their municipal securities professional when faced with a surveillance rating review. Should an ongoing rating review

result in a rating change either up or down, the district will be obligated to report this rating change as a "material event" under its continuing disclosure responsibilities. See Chapter 7 for details of continuing disclosure responsibilities.

## The Oregon School Bond Guaranty Program

The State Treasury offers a credit enhancement program for Oregon school districts, ESDs and community colleges. The Oregon School Bond Guaranty (OSBG) Program (<http://www.oregon.gov/treasury/Divisions/DebtManagement/LocalGov/Pages/Oregon-School-Bond-Guaranty.aspx>) insures the payment of principal and interest on general obligation bond issues that qualify for the program. The OSBG program is designed to replace or enhance the use of underlying ratings or bond insurance. **Lease-purchase or full faith-and-credit issues are not eligible for the program.**

Districts may apply for OSBG enhancement by submitting a simple form to the State Treasurer accompanied by a small application fee. Eligible issues include all voter approved school district, ESD and community college general-obligation debt.

Bond issues that use the OSBG program are given the same overall rating as the state of Oregon's general obligation bond rating at the time of their issue. The enhanced rating may be obtained from any one or more of the three ratings agencies that rate the state's debt. The state charges a one-time fee at closing for the credit enhancement. The application for the OSBG program requires submission of a post-issuance policy and certain other materials.

A decision to use the OSBG

program is an economic one. Districts should seek their underwriter's or municipal advisor's advice about the OSBG program and how its use may interact with underlying ratings and with bond insurance.

## Bond Insurance

The Oregon School Bond Guaranty program has supplanted the use of private bond insurance for general obligation bonds. However, private bond insurance may be of value to issuers of lower rated full faith-and-credit obligations.

Districts may also enhance investors' reception of the bonds by obtaining a municipal bond insurance policy. Certain insurance companies specialize in issuing these policies. For payment of a one-time premium at the time of issuance, these companies will insure the principal and interest payments on bonds or other debt obligations. The premium is a one-time cost and the policy, once issued, is irrevocable.

Districts purchase bond insurance because the rating agencies will then substitute the bond insurer's rating for the issuer's rating.

Where the insured rating is higher than the issuer's own rating, bond insurance may have value. Bond insurance can be used in conjunction with the OSBG program.

To make an informed decision regarding bond insurance, a district should consult with its municipal advisor or underwriter. The cost for bond insurance can be substantial and its market value can fluctuate. Consequently, districts should incur this cost only when the interest rate savings from the higher rating exceed the insurance premium.



## Frequently Asked Questions about Credit Analysis, Ratings and Bond Insurance

**Q: Does a district need credit enhancement? If it does, is something wrong with the district's credit?**

A: Seeking credit enhancement does not mean a district has poor credit. Credit enhancement can be a method of evaluating or improving a district's credit. Investors rely on credit enhancement (via a rating) to provide an independent evaluation of the district's credit or (via the OSBG program or a bond insurance policy) to guarantee debt service payments. Many investors will not buy bonds unless some form of credit enhancement is used.

**Q: How large an issue can be sold without a rating or insurance?**

A: A rating or bond insurance substantially increases the number of buyers willing to consider a district's bonds, if the interest rate is reasonable. The market for non-rated and uninsured issues is limited. Issues of as little as \$1 million can benefit from a rating or insurance.

**Q: How many ratings should the district get?**

A: Whether or not to get a rating and how many to get is a judgment call. The district's underwriter or municipal advisor can help determine the pros and cons of applying for more than one rating. Generally, the larger the issue, the more likely multiple ratings may be advantageous.

**Q: Does the district have to make an in-person presentation to a rating agency?**

A: No. Face-to-face presentations with rating analysts usually are not necessary. Typically, presentations are handled by sending documents and information to the rating agencies and following up with a phone call to answer questions. However, there may be occasions where a personal presentation is best. In such situations, the ratings analyst may want to come to see the issuer rather than vice versa.

**Q: What can the district do to influence its general-obligation bond rating?**

A: Much of the rating for a general obligation bond issue hinges on the district's

economic base, employment levels and other factors that are out of a district's control. Controlled factors include balanced budgets, adequate fund balances and good management. However, because these are analyzed over at least five years, the district must plan ahead if it hopes to influence its rating by improving these factors. Generally, even the best financial performance does not change substantially the rating level on a GO bond because the base level is set by the district's economic conditions.

**Q: Are there other forms of credit enhancement? What about letters of credit?**

A: Other kinds of credit enhancement are unusual on general obligation bonds. Letters of credit are issued by commercial banks to back certain kinds of municipal debt. However, these letters are rarely used for school district, ESD or community college issues because they are more expensive and restrictive than the OSBG program, standalone ratings or bond insurance.

# Refundings

*“Thrift is an attractive idea until you get down to the specifics.”*

*Mason Cooley*

**F**rom time to time, it may be in the best interest of a school district, ESD or community college to refinance bonded debt for general obligation bonds, lease-purchase agreements or full faith-and-credit obligation issues. Refinancing bonded debt is called refunding, and is typically done to:

- ▶ Take advantage of lower interest rates to achieve debt service savings
- ▶ Restructure the debt service repayment schedule
- ▶ Make a change in the legal status of debt covenants or comply with federal tax law

In a refunding, new bonds are sold and the proceeds are used to make the interest and principal payments on some or all existing bonded debt. Once a bond issue is refunded, its debt service is paid by an escrow funded by the new issue. The issuer pays the new debt service on the refunding debt issue and any unrefunded portion of the old issue (some maturities may not be prepayable and will remain outstanding). An issue can even be refinanced before it is callable by using the technique known as advance refunding. (See section on advance refundings, page 57.)

Issuance of general obligation refunding debt does not require voter approval. Property taxes levied to pay principal and interest on such general obligation refunding bonds are not subject to Oregon constitutional limits, same as new money general obligation bonds.

Refundings are subject to specific and technical Internal Revenue Service regulations that materially impact the structure and timing of refunding transactions. Additionally, state law regulates refunding beyond the normal regulations of new money debt issues.

Because of its complexity and regulations involved in a refunding transaction, issuers contemplating refundings should seek the advice of underwriters or municipal advisors early in the process.

## Reasons for Refunding

Following is a more detailed discussion of the three reasons issuers typically refund debt. The math of refundings works the same for refunding general obligation bonds and refunding FFCOs. There are, however, some differences in the legal requirements between refunding

### Five Steps for Refunding Borrowing Issues

- ✓ Consider refunding a bond issue if interest rates drop, the debt service repayment schedule needs adjustment or the legal status of debt covenants requires changes
- ✓ Employ bond counsel, an underwriter and/or municipal advisor to assist in determining whether refunding is feasible and to make sure all state and federal laws and regulations are followed
- ✓ Establish a savings goal if refunding for savings
- ✓ Follow direction from bond counsel, underwriter or municipal advisor for refunding transactions
- ✓ Establish and maintain appropriate debt service accounts as required by Oregon's Local Budget Law

FFCOs and refunding general obligation bonds.

**Debt service savings** – The most common reason for refunding an outstanding issue is to take advantage of lower interest rates. Just as with a home mortgage, if interest rates decline substantially after the issuance of a debt issue, an issuer may be able to refinance the old issue with a new issue and achieve substantial debt service savings, even after paying all costs associated with the new issue.

In the case of a general obligation bonds, the debt service savings are passed on to the district's taxpayers in the form of lower taxes. In the case of an FFCO, the debt service savings become an additional resource to the district's general fund.

Savings usually are measured by their present value, i.e., the total savings over the life of the refunding discounted to their value in today's dollars.

In refunding for debt service savings, an issuer usually refunds only the callable portion of the outstanding bond issue. Savings can only be generated if the refunded bonds can be redeemed before their maturity dates. While an escrow can be designed to pay the interest costs on bonds that are not callable (as must be done in a refunding for defeasance purposes), there are no additional savings attributable to those bonds because the issuer is still paying the original interest cost on the non-callable bonds and usually earning less on the escrow funds.

When only a portion of an outstanding bond issue is refunded for savings purposes, for a period of time, the district actually has two issues outstanding after the refunding: (1) the unrefunded portion of

the old issue and (2) the new refunding issue. However, the combined annual debt service for these two issues will be lower than the old issue's original debt service.

**Debt restructuring** – Refunding an issue allows a district to restructure its outstanding debt. The old debt is paid off by the new issue's proceeds and the district can structure its new debt to better suit current circumstances and future expectations. For example, a district may wish to consolidate several debt issues into a single new issue and restructure the debt in a way to produce a different annual debt service payment, shorten (or lengthen, if allowable) the final maturity or adjust the projected tax rate impact. Or a district may wish to restructure a lease-purchase to better match the district's changing cash resources.

**Changing legal covenants** – Once an issue is refunded it may be possible to have any legal restrictions relating to the issue voided. This is called legal defeasance. Legal defeasance allows the issuer to remove restrictive legal covenants. To legally defease an issue, the old issue must have a defeasance clause and the issuer must refund all of the remaining debt.

While unlikely to be a concern with general obligation bonds, legal restrictions may be a concern with lease-purchases. For example, a district may have pledged a security interest in a property or equipment lease-purchase and may wish to void that pledge of security. A new lease-purchase may be sold (with more favorable legal covenants) to refund and defease the old lease, thus releasing the district from the old issue's more restrictive covenants.

A refunding may be undertaken to accomplish any one or a combination of these three advantages. However, in the case of general obligation bonds, refundings are almost always undertaken to produce debt service savings.

## Types of Refundings

There are three basic types of refundings: current refundings, advance refundings and forward refundings. The type of refunding an issuer must use depends on the transaction's timing compared to the first available date on which the old debt may be called or redeemed. The state of Oregon and the Internal Revenue Service have different definitions for current and advance refundings.

**Current refundings** – Under Oregon law, a current refunding is one in which the new refunding bond transaction is closed within one year of the next available call date of the debt to be refunded. Current refundings are not subject to any regulations other than those that apply to other general obligation bonds, lease-purchases or FFCOs. Under federal law, current refundings are bonds that refund another bond if the new bond is issued within 90 days of the refunded bond's next redemption date. In a current refunding, the new debt proceeds are usually held (sometimes in a very short escrow) to make one payment, i.e., the payment required to call and retire all of the old debt and pay any accrued interest costs on the next available call date.

**Advance refundings** – Under Oregon law, an advance refunding is one in which the new refunding bond transaction is closed more than one year before the first available call date of the debt being refunded. In an



advance refunding, an escrow is required. Under federal law, advance refunding bonds close more than 90 days before the refunded bond's first available call date. The escrow must make all interest and principal payments on the debt being refunded until the first available call date of the old debt. Advance refundings (State of Oregon definition) of debt must be approved by the Office of the State Treasury (OST) and are subject to certain requirements as part of that approval process. Among other requirements, an issuer must employ an independent registered municipal advisor to provide a letter to OST recommending the desirability of the refunding plan. The

treasurer's office charges a fee to review advance refundings. Districts should note that beginning in 2018, bonds can no longer be advance-refunded on a tax-exempt basis. There is no restriction of current refundings.

**Forward refundings** – A forward refunding is used where the bonds to be refunded are not permitted to be advance-refunded under federal tax law. Rather than wait until the bonds' call date (and exposing itself to the risk of rising interest rates), the issuer wishes to lock in interest rates now available. The issuer agrees now to issue bonds on a specified future date when the issuance would become a "current" refunding under federal tax law.

Forward refundings are not as common as advance and current refundings. They are more complicated and carry an interest rate premium.<sup>1</sup>

<sup>1</sup> *The economic benefit of forward refundings also can be achieved through the use of interest rate swaps. For example, the issuer can enter into a swap now that does not start until a future date. In that way, the issuer can lock in future fixed rates and ensure the success of the refunding without waiting to see what happens to interest rates in the future. Interest rate swaps, however, entail certain risks that must be carefully evaluated before an issuer commits to a financing plan. In particular, current Oregon state law prohibits an insurer from levying property taxes to make a termination payment on a swap.*

## Frequently Asked Questions about Refunding Bonds

### **Q: What is a refunding?**

A: A refunding is a refinancing of outstanding debt. A new issue of debt is sold and the proceeds are used (usually in an escrow) to pay off some or all of an old issue. A refunding does not raise new money but simply provides for the refinancing of outstanding debt.

### **Q: Why would a district want to refund an old issue?**

A: The most common reason is to reduce debt service costs when interest rates decline. Refundings also may be used to change legal debt covenants or restructure an outstanding debt issue's payment schedule and terms.

### **Q: Do districts need voter approval to refund general obligation bond issues? How about refunding for a lease-purchase issue?**

A: State law allows issuers to sell

general obligation refunding issues without voter approval. Voter approval is not required for financing or refinancing a lease-purchase obligation.

### **Q: How far do interest rates have to decline before a refunding might produce savings?**

A: Generally, rates must be 1 to 3 percentage points lower before refunding is economically feasible. The ultimate feasibility depends on the size of the issue, call date, call price and other factors.

### **Q: Are refundings subject to different federal and state laws than other kinds of debt issues?**

A: Yes. Both the U.S. Treasury and Oregon have rules that apply specifically to refundings. These rules are often more restrictive than rules applying to new money bond issues.

Issuers should involve bond counsel and an underwriter or municipal advisor early in the process to ensure compliance with all federal and state laws and regulations.

### **Q: Who gets the savings on a refunding?**

A: Whoever is paying the original debt service. For a general obligation bond, the savings are returned to the district's taxpayers in the form of lower tax rates. For a lease-purchase issue, the debt service savings become an additional resource to the district's general fund.

### **Q: What is an advance refunding?**

A: Unlike a home mortgage, most bond issues cannot be prepaid at any time but can be retired (redeemed or called) only after a certain date. In an advance refunding, the issuer sells new

*continued*



## Frequently Asked Questions about Refunding Bonds, *continued*

bonds before the old debt issue can be redeemed or called.

The money is deposited in an escrow that makes all principal and interest payments on the refunded debt until that first call date, then provides the funds to call and retire all the refunded debt on the first available call date. An advance refunding allows an issuer to lock in savings now even though the old debt cannot be called for years. Beginning in 2018, advance refundings can only be issued on a federally taxable basis.

**Q: What is a forward refunding?**

A: A forward refunding allows the issuer to lock in interest rates now available rather than wait until the bonds' call date (and exposing itself to the risk of rising interest rates). A forward refunding is used when the bonds to be refunded are not permitted to be advance refunded under federal tax law. Under a forward refunding the issuer agrees now to issue bonds on a specified future date when the issuance would become a "current" refunding under federal tax law.

**Q: Why refund only a portion of an old issue?**

A: A district can save money only on the portion of the old debt that is callable. Therefore, districts often only refinance the callable portion of the debt. That means that, after the refunding, for a period of time, the district may have two issues outstanding: (1) the unrefunded portion of the old issue and (2) the new refunding issue. Certain maturities may also have very low coupon rates and not be economical to refinance so districts may choose to leave them out of the refunding.

**Q: Does the district need to budget for the old debt once it is refunded?**

A: No budget is required for the portion of the old debt that is being paid by the escrow. However, the district must continue to budget (and collect taxes for) any portion of the old debt that was not refunded.

**Q: What are present value savings?**

A: Present value is an economic term that translates future savings/costs into current

dollars. Present value incorporates the concept that a dollar received today is worth more than a dollar received tomorrow. In a refunding, most debt service savings occur over a multi-year period. The present value of those savings provides an issuer with a means of valuing the savings in today's dollars.

# Local Budget Law

*“Never spend money before you have it.”*

*Thomas Jefferson*

**W**hen school district, ESD or community college voters approve a bond issue, certain requirements must be met to conform to Oregon’s bonding and Local Budget Law. This section outlines the steps districts must take to comply with local budget law requirements.

## Capital Projects Fund

Federal tax law and the Department of Revenue OAR 150.294.388(1) (A) require districts to establish a capital projects fund to account for the resources and expenditures of bond sale proceeds. The estimated resources and expenditures must be shown on the budget detail sheets and publication forms under the column labeled *Budget Next Year*. (See examples later in this chapter.)

When the district receives bond proceeds, they must be deposited in the capital projects fund. This fund will account for all revenue and expenditures associated with the project. Districts must annually forecast capital projects fund revenues and expenditures for budget committee and board approval. Bond proceeds must be spent for the purpose(s) for which the

bonds were issued. Any proceeds in excess of the principal from the bond sale must be placed with the principal in the capital projects fund for bond projects or in a debt service fund to repay the bonds.

## Debt Service Fund

A debt service fund is a fund established to account for principal and interest payments on all outstanding bonded debt. There may be several bond issues accounted for in one debt service fund. However, districts should set up a separate account for each bond issue. Transactions to record the redemption of outstanding bonds with proceeds from refunding bonds also are recorded in a debt service fund. Accounting for FFCOs/lease purchases and general obligation bonds should not be mixed in the same fund.

ORS 328.260 provides for a debt service fund and a tax levy to pay the principal and interest. Resources for this fund must be held in an interest bearing account. Any earnings accruing from such investment must be used to pay the principal and interest.

Resources in a debt service fund cannot be diverted or used for any other purpose. Transfers from a

## Six Steps for Meeting Budget and Accounting Requirements

- ✓ Establish a capital projects fund to account for bond issue proceeds and expenditures.
- ✓ Establish a debt service fund to pay principal and interest on outstanding debt.
- ✓ Work with bond counsel and financial consultants to structure debt and to be sure debt payments are budgeted according to law.
- ✓ Ensure budget resolution includes debt service levy.
- ✓ Annually levy property taxes to pay principal and interest due on general obligation bonds.
- ✓ Audit and report all financial activity to the board and public.

debt service fund are not allowed in most cases. However, if bond documents allow a transfer, districts can make the transfer only if:

- ▶ The transfer is lawfully made from a debt service fund to repay an inter-fund loan.
- ▶ A surplus remains after all interest and principal is paid. The district can then dissolve the fund and transfer the balance to any fund originally designated by the governing body, or included in the bond contract. However, when estimating the amount of tax levy needed for the final year, the tax levy should be adjusted for any available resources within the fund. This will result with no or very minimal amount of remaining fund balance.

Payments for bond principal and interest must be appropriated from a debt service fund. If the first payments come due and were not anticipated, appropriations must be made by a supplemental budget. Only interest and principal repayments may be made from a general obligation debt service fund. Continuing expenses, such as registrar fees, must be paid from an operating fund, such as the general fund, or a capital projects fund.

The final-year tax levy would be adjusted to levy only the amount

sufficient (less current fund resources) to cover the principal and interest payments for that final year.

### Exceptions

Districts do not have to follow Oregon's Local Budget Law in three instances:

1. For bonds or other obligations that were approved by voters during the current fiscal year.
2. For bonds or other obligations issued during the current year to refund previously issued bonds or other obligations.
3. For the issuance of revenue bonds. (However, since school districts, ESDs and community colleges normally do not issue revenue bonds, exceptions one and two are more pertinent.)

In the year following an occurrence of above items, these monies must be budgeted. Remember that to levy taxes to pay debt service, the debt service fund must be included in the regular district budget. No statute allows the district to increase its tax levy after the budget is adopted.

### Specifically ORS 294.338(4) states:

Subsection (1) of this section does not apply to the expenditure during the current year or current budget period of the proceeds of the sale of the following bonds as defined in ORS 287A.001, or to

the expenditure during the current year or current budget period of other funds to pay debt service on those bonds:

- (a) Bonds that are issued under ORS 287A.150 and for which the referral period described in ORS 287A.150 ended after the preparation of the budget of the current year or current budget period;
- (b) Bonds that were approved by the electors during the current year or current budget period; or
- (c) Bonds issued during the current year or current budget period to refund previously issued bonds or obligations.

### Structuring Issues

Forecasting principal payments on bonds is relatively straightforward and easily obtained from the bond amortization schedule. The first payment may be timed with the district's debt service tax levy. Subsequent principal payments occur at 12-month intervals.

Scheduling initial principal and interest payments is a structuring issue. Districts should refer to bond counsel and financial consultants for guidance.

### Budgeting Principal and Interest

Oregon's bonding and local budget law require local governments to forecast debt service obligation requirements. This includes disclosure of principal and interest due dates and amounts. Consideration of these due dates determines when property tax revenues are collected.

For example, if a payment's due date occurs July through November, the debt service budgeting must occur in the prior fiscal year and be carried forward as a net working capital.

### Budget Impact of Election Choice

March Election	May Election	June 30	November Election
▼	▼	▼	▼
In next FY Budget for expenditures and include levy for debt service.	In next FY Budget for expenditures and include levy for debt service. Include estimate of debt	Fiscal Year End: Budget Complete	District is exempt from Local Budget Law but board must pass appropriation resolution authorizing expenditures. Tax levy for debt service MAY NOT be included until next fiscal year.

*continued on page 63*

# Sample Budget Pages

Oregon Department of Education  
255 Capitol St. NE  
Salem, Oregon 97310

## CAPITAL PROJECTS FUND

Budget detailed estimate sheet

School District \_\_\_\_\_

County \_\_\_\_\_

☒ Requirements  
July 1, \_\_\_\_

☒ Resources  
to June 30, \_\_\_\_

Page \_\_\_\_\_

ACCOUNT CODE DESCRIPTION (1)	Actual Data for Prior Two Years		Budget This Year		Budget Next Year				
	Second Year (2)	First Year (3)	Adopted (Amended) (4)	No. of Empl. (5)	Proposed (6)	No. of Empl. (7)	Approved (8)	Adopted (9)	No. of Empl. (10)
<b>RESOURCES</b>									
1510 Interest on Investments					\$175,000		\$175,000	\$175,000	
5100 Long-Term Debt Financing Sources									
5110 Bond Proceeds					7,000,000		7,000,000	7,000,000	
Total RESOURCES					\$7,175,000		\$7,175,000	\$7,175,000	
<b>REQUIREMENTS</b>									
4150 Facilities Acquisition and Construction									
300 Purchased Services									
382 Legal					\$30,000		\$30,000	\$30,000	
383 Architect/Engineer Services					125,000		125,000	125,000	
389 Bond Issue Expenditures					60,000		60,000	60,000	
Total PURCHASED SERVICES					215,000		215,000	215,000	
520 Buildings – Acquisitions and Improvement					6,960,000		6,960,000	6,960,000	
Total EXPENDITURES					\$7,175,000		\$7,175,000	\$7,175,000	
<div style="border: 1px solid black; padding: 5px; margin-bottom: 5px;">Bond issue expenditures include printing costs, bond counsel, financial consultants, costs relating to obtaining a rating and other related issue costs.</div> <div style="border: 1px solid black; padding: 5px; margin-bottom: 5px;">Forecasted interest earnings on investment of bond proceeds.</div> <div style="border: 1px solid black; padding: 5px;">Proceeds from the sale of bonds.</div>									

Note: When the capital projects fund is closed, any remaining money should be transferred to the debt service fund to help retire any remaining debt.



# Sample Budget Pages

Oregon Department of Education  
255 Capitol St. NE  
Salem, Oregon 97310

## DEBT SERVICE FUND

Budget detailed estimate sheet

School District \_\_\_\_\_  
County \_\_\_\_\_

☒ Requirements  
July 1, \_\_\_\_

☒ Resources  
to June 30, \_\_\_\_

Page \_\_\_\_

ACCOUNT CODE DESCRIPTION (1)	Actual Data for Prior Two Years		Budget This Year		Budget Next Year				
	Second Year (2)	First Year (3)	Adopted (Amended) (4)	No. of Empl. (5)	Proposed (6)	No. of Empl. (7)	Approved (8)	Adopted (9)	No. of Empl. (10)
<b>RESOURCES</b>									
1112 Prior Year Taxes	\$3,472	\$3,115	\$2,875		\$3,200		\$3,200	\$3,200	
1510 Interest on Investments	867	811	750		795		795	795	
5400 Beginning Cash Balance	13,220	12,560	12,000		11,150		11,150	11,150	
Total RESOURCES EXCEPT TAXES	17,559	16,486	15,625		15,145		15,145	15,145	
1111 Current Taxes									
Taxes Required to Balance	41,621	42,858	42,640		43,018		43,018	43,018	
Total DEBT SERVICE RESOURCES	\$59,180	\$59,344	\$58,265		\$58,163		\$58,163	\$58,163	
<b>REQUIREMENTS</b>									
5110 Debt Service									
610 Bond Principal									
Issue dated 3/1/____\$20,000									
Issue dated 4/1/____7,000									
620 Bond Interest	\$23,000	\$25,000	\$25,000		\$27,000		\$27,000	\$27,000	
Issue dated 3/1/____\$17,520									
Issue dated 4/1/____3,255									
Total EXPENDITURES	23,620	22,420	22,115		20,775		20,775	20,775	
	46,620	47,420	47,115		47,775		47,775	47,775	
7000 Unappropriated Ending Fund Balance For Interest Due in Second Ensuing Year									
820 Reserve for Next Year									
Issue dated 3/1/____\$8,760									
(due 9/1/____)									
Issue dated 4/1/____\$1,628									
(due 10/1/____)									
Total DEBT SERVICE REQUIREMENTS	12,560	11,924	11,150		10,388		10,388	10,388	
	\$59,180	\$59,344	\$58,265		\$58,163		\$58,163	\$58,163	

Do not combine separate sales. Budget  
different line items for each issue outstanding.

Budgeted requirements always equal  
budgeted resources.

Estimate of all resources except current year  
property taxes.

Use unappropriated ending fund balance for  
any payments that come due between  
July 1 and November 15 for which other  
revenue in debt service is not available.

Obtain exact amounts for principal and inter-  
est due from the bond amortization schedule  
in your audit report.

## Special Rules for May Elections

In those instances where a district's voters approve the issuance of general obligation bonds at a May election, the district may adopt a budget including estimated requirements to pay the debt service on these bonds in the ensuing year or each of the years of the ensuing budget period (where biennial budgets are prepared). Revisions to ORS Chapter 294 also allow for the utilization of a supplemental budget pursuant to ORS 294.471 for the purpose of levying a tax to pay debt service or to adjust the amount of the debt service resulting from a May election. The requirements are very specific to the May election and require the district request an extension of time to certify their tax levy to the County Assessor pursuant to ORS 310.060. If you are dealing with a May election, be certain to carefully review the revised statutes and rules prior to finalizing your budget.

## Appropriation

Appropriation authority must be granted from the district's board prior to the expenditure of funds. Before adopting the appropriation resolution, local budget law must be satisfied in one of the following situations:

- ✓ Estimates must be included in a proposed budget and subsequently approved by the budget committee and a hearing held by the board
- ✓ Supplemental budget must be adopted following the same procedure used above
- ✓ The district must use the authority granted by ORS 294.338(4) (excluding debt service)

## Failure to Budget Debt Service Requirement

If the tax required to pay bond principal and interest payments is not levied by the district, the county treasurer is granted authority to certify a tax levy to the county on behalf of the district. (ORS 328.265)

If a tax is not levied or there is a shortfall in collections, the district is legally required to use other available resources to make debt service payments. The district may increase the tax levy in the following year to reimburse the fund that covered the shortfall. If local budget law is not followed, it may not be possible to levy for debt service. It could be costly to the district to access additional funds if funds on hand are not sufficient to cover payments.

## Resources

The Oregon State Treasury Debt Management Division created the Oregon Bond Education Center which offers more detailed information than this manual on some subjects. The materials are available online: <http://www.oregon.gov/treasury/Divisions/DebtManagement/LocalGov/Pages/Oregon-Bond-Education-Center.aspx>.

## Frequently Asked Questions about Local Budget Law

### Q: What is a capital projects fund?

A: A capital projects fund accounts for revenues from bond proceeds and the expenditures for the projects approved by the voters. A school district, ESD or community college may have other sources of revenue in this fund. For example, a capital projects fund could include interest earnings from investments or proceeds from the sale of district property.

### Q: What is a debt service fund?

A: A debt service fund is a separate set of accounts

in the budget that is used to account for and pay the principal and interest that is due on bonded debt.

### Q: Is budgeting for the revenue and expenditures in these funds required?

A: Yes. Oregon's Local Budget Law requires that all governmental funds be budgeted. There is one exception for bond proceeds that are received in the same year that voters approve the bond issue.

For example, if voters approve a bond issue at the November election, bond proceeds could

be received in January. The board could pass a motion to approve spending bond proceeds during the months of January through June without budget committee approval. However, the district must budget the funds in the new fiscal year.

### Q: Our district has two outstanding bond issues. For budget purposes may we combine payments in one line item in our budget?

A: No. Local Budget Law requires that the issues be itemized separately in the budget document.

*continued*

## Frequently Asked Questions about Local Budget Law *(continued)*

**Q: May our board borrow or transfer debt service funds?**

A: No. By law these funds must be used exclusively for paying the principal and interest on outstanding bond issues. There are two exceptions:

- ▶ If the board initially transferred funds as an inter-fund loan into the debt service fund to fund a payment, repayment of that loan is authorized.
- ▶ If, after all bonded debt is repaid, a surplus remains, the board may transfer the remaining balance to any fund originally designated by the board.

**Q: What happens if the debt service fund does not have enough funds to make a principal and interest payment at the due date?**

A: The county treasurer has the authority to make the required payments from any school district, ESD or community college funds including general fund tax turnovers. The Oregon Legislature granted the county treasurer

this authority to make sure that bond principal and interest payments are made on time so that the state's and local governments' credit ratings remain solid. This "safety value" cannot be used later than Oct. 1 of any year.

**Q: May registrar or trustee fees on a bond issue be paid from the debt service fund?**

A: No, only principal and interest payments may be made from the debt service fund.

**Q: What local or state sources are available if a district has questions about budgeting procedures for bonds or other borrowing issues?**

A: Various sources are available to assist districts in this process. Oregon Department of Revenue, Local Budget Division, can answer questions on the Local Budget Law. (503-945-8293)

Oregon State Treasury, Debt Management Division can assist in questions on bonded debt. (503-378-4930)

# 2017-19

## Matching Grants

*"I have enjoyed great satisfaction from my climb of Everest and my trips to the poles. But there's no doubt that my most worthwhile things have been the building of schools and medical clinics."*

*Sir Edmund Hillary*

**S**enate Bill 447, approved in the 2015 legislative session with support from the Oregon School Boards Association and other school advocates, provides matching grant funds to eligible districts that pass a local bond measure for capital improvement projects. The 2017 Legislature allocated \$101 million to the successful program, with \$100 million of that available to districts. The Legislature has to authorize funding in each regular session for the upcoming biennia.

The primary goal of SB 447 is to encourage communities to pass local school district general obligation bonds to address capital needs. The program has three grant categories: matching grants for districts that pass such bonds; technical assistance grants to districts for facilities assessments, long-range facilities plans and other specialized assessments; and hardship grants, based on funding availability, for districts with immediate critical needs.

In addition to the grant funds, SB 447 also established the Oregon Office of School Facilities, which is responsible for reviewing grant applications, distributing funds, providing technical assistance to support local capital improvement efforts, and establishing a database. The Oregon Department of Education has established a webpage with information about what is now officially known as the Oregon School Capital Improvement Matching Program. The information can be accessed at <http://www.oregon.gov/ode/schools-and-districts/grants/Pages/Office-of-School-Facilities.aspx>

### Grant Awards

Matching funds are divided into two different pots: priority list funds and first-in-time funds. Sixty percent (approximately \$60 million) of grants will be available for districts in rank order according to a priority funding list and 40 percent (approximately \$40 million) will be distributed based on a lottery system that takes into account the timeframe in which applications are received.

To qualify for a general obligation bond matching grant, a district must submit an application and pass a local general obligation bond during elections in May 2018, November 2018 or May 2019. Each election will have its own application cycle, and districts may only apply for matching funds one time per election. The minimum grant is the general obligation amount approved by local voters, or \$4 million, whichever is less. The maximum amount is \$8 million. A district may qualify for up to \$8 million based on a funding formula that is included on the priority list document (the "calculated grant amount"). A district that has a calculated grant amount in excess of \$4 million may receive such amount only if it does not exceed the amount approved in the local bond sale.

The Oregon Department of Education (ODE) will accept applications before the election so that applicants will be able to use the grant award in campaign messaging. Applying districts will be told that they are either guaranteed a grant, or on a waiting list should districts above them fail to achieve voter



approval. Districts that are guaranteed a grant will receive the calculated grant amount. Districts on the waiting list may receive a partial grant award, depending on the amount remaining once guaranteed districts receive their allocation. It is important to work with bond counsel to review the ballot title references to the match program to assure accuracy. In addition, ODE has indicated that it will require districts to adopt and submit their election resolution ahead of the filing deadline for measure elections. Again, it is important that districts consult with their bond counsel to make sure they can meet this new timing requirement. The ODE grant agreement also requires that the district's bond counsel submit a reliance letter and documentation to the state and the district must hire local counsel to provide an opinion on the grant agreement.

### **Priority List Funding and First-in-time Funding**

Funds will be available to districts according to priority ranking, and based on a lottery and the order in which applications are received.

#### **Priority list and funding**

**formula:** Districts have already been ranked. The priority list and calculated grant amount is available at <http://www.oregon.gov/ode/schools-and-districts/grants/Documents/2017-19%20Priority%20List%20and%20Funding%20Formula.pdf>. The list

is also available alphabetically. The priority list ranks districts based on factors that include the district's assessed value, number of students in poverty and extended weighted Average Daily Membership. This list will be updated each biennium.

Given limited resources available, not all districts that receive voter approval may receive a grant. In addition, a district that has qualified to receive a matching grant but does not pass a general obligation bond in a given election cycle must apply for a grant again if it seeks voter approval in a subsequent election.

**First-in-time funding:** Such funding will be based on a lottery process to select districts that have submitted applications within the specified time frame. Applications must be submitted electronically. An application will not be counted until the complete application has been submitted.

If more applications have been submitted than funds are available, a random lottery process will be used to select grant recipients.

### **Applications**

Information on application deadlines will be available at <http://www.oregon.gov/ode/schools-and-districts/grants/Pages/Office-of-School-Facilities.aspx> for subsequent elections. Long-range facility plans and facility assessments are required to be submitted two weeks prior to the application deadline for any election cycle. Plans must

meet certain standards and be submitted electronically. Early submission is encouraged to allow OSF to help districts correct deficiencies.

### **Technical Assistance and Hardship Grants**

Technical assistance grants are expected to be available. Hardship grants, which will use funds from unspent facility grants, are unlikely to be available during the 2019-21 biennium because of the success of schools in passing bonds.

# Glossary of Municipal Finance Terms

*This glossary gives Oregon School Bond Manual readers quick and easy-to-understand definitions of municipal finance terms used in this publication. A more extensive glossary is available on the Municipal Securities Rulemaking Board's website, [www.msrb.org](http://www.msrb.org).*

**Accrued interest** – The amount of interest earned on a security from the date of issue up to, but not including, the date of delivery or closing; or from the last interest date up to, but not including, the date of purchase.

**Accreted value** – The nominal value, at any given point in time, of a security such as a capital appreciation bond, deferred interest bond or some deeply discounted interest-paying original issue discount bond on which all or a portion of the investment return is received in the form of an accretion from an initial principal amount to the maturity or redemption value. See *deferred interest bonds*.

**Ad valorem tax** – An annual tax based on the market value or, in Oregon, the taxable assessed value of property.

**Advance refunding** – The refinancing of an outstanding issue by a new issue, more than 90 days (under federal law) or more than one year (under state law) prior to the date on which the outstanding issue can be redeemed. The proceeds of the new issue are deposited in an escrow account that pays the debt service of the issue being refunded. See also *defeasance*.

**Alternative minimum tax (AMT)** – AMT is applicable to income of certain tax-exempt “private activity” bonds for the purpose of assuring that all individuals with substantial income will pay some amount of federal income tax.

**Annual financial information** – The type of financial information or operating data about the issuer

or any other obligated persons that is included in the final official statement. Rule 15c2-12 obligates underwriters for most municipal securities’ primary offerings to ensure that the issuer or other obligated persons provide such information or data on an annual basis to EMMA. See *continuing disclosure and EMMA*.

**Anti-fraud provisions** – This term usually refers to the provisions of federal law prohibiting fraud (typically in the form of material omissions or misstatements) in the issuance and sale of securities, regardless of whether such securities are subject to registration with the SEC. These provisions include Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and other related rules.

**Arbitrage** – With respect to municipal bonds, arbitrage occurs when interest earned on bond proceeds exceeds interest paid on the bonds. Federal income tax laws generally restrict the ability to earn arbitrage in connection with a tax-exempt issue.

**Arbitrage bonds** – Bonds that violate federal arbitrage regulations. If the Internal Revenue Service finds that bonds are arbitrage bonds, the interest becomes taxable and must be included in each bondholder’s gross income for federal income tax purposes. More often, the issuer may make payments to the IRS in lieu of the bonds being declared taxable.

**Arbitrage certificate** – See *no-arbitrage certificate*.

**Assessed valuation** – The value of real and personal property subject to taxation. See *real market value*.

**Average life or average maturity of bond issue** – The aggregate life of all bonds (in years) divided by the number of bonds. The average maturity reflects how rapidly the issue's principal is scheduled for repayment.

**Ballot title** – The wording that appears on the ballot, which, if approved by voters, authorizes bond issuance for the purpose(s) described in the ballot title. The ballot title includes a 10-word caption, a 20-word question and a 175-word summary, plus additional required wording in the question and summary from ORS 250.035 and ORS 250.037.

**Bank qualified** – This designation is given to a public purpose bond offering by the issuer if, in the calendar year of such offering, it reasonably expects to issue no more than \$10 million of tax-exempt bond proceeds. When purchased by a commercial bank for its portfolio, the bank may receive a tax deduction for the interest cost of carry for the issue. A bond that is bank qualified is also known as a "qualified tax-exempt obligation."

**Basis point** – One one-hundredth of one percent (0.0001). One hundred basis points equal one percent. Used in pricing bonds and discussions of bond yields.

**Bid** – A statement of what a bank or syndicate of banks will pay for an entire bond issue in a competitive sale, implying an offer to purchase the bonds. The highest dollar bid, i.e., the bid with the lowest true interest cost, is the winning bid.

**Bond** – A written evidence of debt representing a promise to pay a

specified sum of money, called the face value or principal amount, at a specified date or dates in the future, called the maturity date(s), together with periodic interest at a specified rate.

**Bond anticipation note (BAN)** – Notes issued by public agencies to obtain temporary financing for projects that eventually will be financed on a long-term basis through the sale of bonds. The BAN is repaid when the bonds are sold. BANs also may be retired from other revenue.

**Bond counsel's opinion** – Opinions that usually address:

- ▶ Whether the issuer's bonds are valid and binding obligations
- ▶ The source of payment or security for the bonds
- ▶ Whether and to what extent interest on the bonds is excluded from an owner's gross income for federal income tax purposes and is exempt from taxes, if any, imposed by the issuer's state

**Bond insurance** – A guarantee by a bond insurer to pay the principal and interest on municipal bonds as they become due should the issuer fail to make required payments. Bond insurance typically is acquired in conjunction with a new issue of municipal securities, although insurance may be available for outstanding bonds trading in the secondary market.

**Bond purchase agreement (BPA)** – An agreement between an issuer and the bond underwriter setting forth the terms of sale, i.e., price of securities, any premium or discount, interest rates, conditions to closing, restrictions on the issuer's liability and any indemnity provisions. In a competitive sale, the notice of sale and the bid form replace

the BPA.

**Bond rating** – Designations assigned to bonds by credit rating agencies that give relative indications of credit quality.

**Bond registrar** – The institution (usually a bank or trust company) identified on the security as the agent designated by the issuer to maintain the bond register and make principal and interest payments. See *paying agent*.

**Bond resolution** – A resolution passed by a governing body authorizing the issuance of securities. The resolution also may contain the covenants and restrictions for the issue. For a competitive sale, the bond resolution also includes or authorizes the notice of sale.

**Bonded debt** – The portion of an issuer's total indebtedness represented by outstanding bonds.

**Bondholder** – The owner of a municipal bond. The owner of a registered bond is the person whose name is noted on the bond register. In the case of a book-entry bond, the beneficial owner may often be treated as the bondholder for purposes of certain rights.

**Book-entry-only bonds** – Securities that are not available to purchase in a physical form. Book-entry-only bonds are accounted for through a centralized system for the holding and accounting for ownership and transferring ownership.

**Broker/Dealer** – A firm that is engaged in effecting securities transactions for the accounts of others.

**Call** – Exercise of the issuer's right to prepay bonded debt prior to the specified maturity date and demand surrender of the bonds for redemption, refunding or sinking fund purposes on a



specific date at a specified price.

**Call date** – The date on which bonds may be called for redemption.

**Call premium** – The amount the issuer promises to pay in excess of par value when bonds are redeemed prior to the maturity date.

**Call price** – The specified price, at or above par value, paid by the issuer upon redemption of bonds prior to maturity.

**Callable bonds** – Bonds that are redeemable by the issuer prior to the specified maturity date at a specified price at or above par value.

**Capital appreciation bonds** – See *deferred interest bonds*.

**Capital lease** – A lease that, for accounting and financial reporting purposes, is characterized by a term that spans all or a major portion of the leased property's useful life.

**Capital projects fund** – A construction fund established by an issuer into which bond issue proceeds are deposited to pay capital construction or capital improvement costs. Establishment of a capital projects fund to account for construction and improvements funded by bonds is required by Oregon's budget law.

**Capitalized interest** – A portion of bond issue proceeds that is used to pay interest on the bonds for a specific period of time (usually the bond project's construction period).

**Cash flow financing** – Financing in which an issue's proceeds are used to pay the issuer's current expenses in anticipation of future taxes or revenue. These issues are sometimes called TRANS, TANS or RANS (tax and/or revenue anticipation notes).

**Certificate of participation (COP)** – See *full faith-and-credit obligations (FFCOs)*.

**Closing date** – The date on which all documents relating to a new securities issue must be finalized and signed. After an issue is declared closed, bond counsel authorizes the exchange of money and securities. See *delivery date*.

**CUSIP (Committee on Uniform Security Identification Procedures)** – CUSIP was established under the auspices of the American Bankers Association to develop a uniform method of identifying municipal, United States government, and corporate securities. CUSIP numbers are assigned to all new debt issues. CUSIP numbers are used to make continuing disclosure filings on EMMA.

**Competitive sale** – The sale of municipal securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities. When bonds are sold at a competitive sale, the issuer typically specifies all of the terms of the issue other than interest rates and purchase price. The bonds are awarded to the underwriter presenting the best bid based on the criterion specified in the notice of sale.

**Constitutional limits** – In Oregon, the maximum amount of tax on property that can be collected from an individual property in each limitation category. (Article XI, section 11b, Oregon Constitution)

**Continuing disclosure** – Disclosure of information relating to municipal securities provided to the marketplace by the issuer of the securities or any other entity obligated with respect to the securities, after the issue has closed. Such disclosures include,

but are not necessarily limited to audited financial statements, annual operating data and event notices provided by the issuer or obligor to various information repositories for the benefit of holders of the issuer's securities under Rule 15c2-12.

**Continuing disclosure agreement or undertaking** – The agreement or undertaking by the issuer of municipal securities or an obligated person with respect to such securities to disseminate annual financial information and event disclosures as provided for under Rule 15c2-12. A continuing disclosure agreement may also provide for more frequent or additional disclosures beyond Rule 15c2-12 requirements. Continuing disclosure filings are currently made on EMMA. See *EMMA and MSRB*.

**Convertible bond** – A bond with a fundamental feature that changes in a prescribed manner at a future date, such as a deferred interest bond that "converts" to paying current interest.

**Costs of issuance** – The expenses associated with the sale of municipal securities issues, including such items as underwriter's spread, legal fees and rating costs.

**Coupon** – The interest rate at which a bond pays interest. The coupon may be different from a bond's yield. See *yield*.

**Covenants** – Agreements made by the issuer regarding repayment, security, pledges and the use of funds.

**Cover bid** – The second-best bid received at a competitive sale.

**Credit enhancement** – A credit support purchased by the issuer



to raise the credit rating on a debt issue. The most common credit enhancement for Oregon school districts, ESDs and community colleges is the Oregon School Bond Guaranty Program. See *OSBG*.

**Current coupon bonds** – Bonds that pay interest, at a fixed interest rate, every six months until they are redeemed or mature.

**Current refunding** – Under federal tax law, a refunding transaction where the municipal securities being refunded mature or are redeemed within 90 days or less from the date of issuance of the refunding issue. Under Oregon statutes, a current refunding is defined as a redemption within one year of the date of issuance of the refunding issue.

**Dated date** – The date of an issue from which the bondholder is entitled to receive interest, even though the bonds actually may be delivered at some later date.

**Debt limit** – The statutory or constitutional limitation on the principal amount of outstanding debt that an issuer may legally incur. In Oregon, the limitation for school districts, ESDs and community colleges is based on a percentage of the district's real market valuation.

**Debt service** – The amount of money necessary to pay the interest and principal required during a given time period. Debt service on bonds may be calculated on a calendar year, fiscal year or bond fiscal year basis.

**Debt service fund** – The fund established to account for payment of interest and principal on debt. Different bond issues may be tracked within the fund through separate accounts.

**Debt service schedule** – A table listing the principal and interest payments necessary to meet debt

service requirements over the period of time that the bonds are outstanding.

**Default** – Breach of some covenant, promise or duty imposed by the bond contract. The most serious default occurs when the issuer fails to pay interest or principal when due. Other "technical" defaults occur when the issue fails to comply with financing document covenants.

**Defeasance** – Termination of the rights and interests of bondholders and their lien on the pledged revenues in accordance with bond contract terms for a prior bond issue. Defeasance usually occurs with the refunding of an outstanding bond issue by final payment, or provision for future payment through escrow, of principal and interest on the prior issue.

**Deferred interest bonds** – Bonds that pay all interest only at maturity. Deferred interest bonds normally have maturity values (including all compounded interest) of \$5,000 and thus sell at substantially discounted values when originally issued. See *accreted value*.

**Delivery date** – The date bonds are delivered to and paid for by the original purchaser. See *closing date*.

**Denomination** – A bond's face amount or par value that the issuer promises to pay on the maturity date. Most municipal bonds are issued in a minimum denomination of \$5,000.

**Depository Trust Company (DTC)** – DTC is a central securities certificate depository through which members make security deliveries among themselves using computerized bookkeeping entries. Most municipal bond issues close through DTC.

**Derivative or derivatized security** – A product, whose value is derived from an underlying security, structured to deliver varying benefits to different market segments and participants. The term encompasses a wide range of products offered in the marketplace including interest rate swaps, caps, floors, collars and other synthetic variable rate products. See *interest rate swap contract*.

**Direct and overlapping debt statement** – A list of all outstanding debt issues covering any portion of an issuer's jurisdiction. Self-supporting debt is subtracted to show net debt.

**Discount** – The difference between the price paid for the bond and its par value.

**Discount bonds** – Those bonds selling at less than par value.

**Double exemption** – A term applied to bonds paying interest that is exempt from both state and federal income taxes.

**Double majority** – In Oregon, a term that refers to an election where at least 50 percent of the registered voters eligible to vote in the election cast ballots and more than 50 percent voting approve the question.

**Downgrade** – The lowering of a bond rating by a rating agency. Downgrading makes the bonds less creditworthy and, typically, less valuable to an investor.

**Due diligence** – The thorough investigation of a bond issue, usually by the underwriter or its counsel. Such inquiry is made to assure that all material facts are fully disclosed to potential investors and that there are no material omissions or misstatements of fact in the official statement.

**Electronic bid** – The process of submitting a competitive bid for

a new municipal securities issue through any of several proprietary services that facilitate the collection of bids by electronic means.

**EMMA** – Electronic Municipal Market Access System. A centralized online system for free access to municipal disclosure. Also the sole location to file all continuing disclosure material. Operated by the MSRB.

**Escrows** – Bond proceeds invested in securities until certain conditions described in the bond documents occur. Proceeds may be used for new projects or for refunding a bond issue.

**Escrow verification report** – In a refunding, a report, prepared by a certified public accountant or other independent third party, demonstrating that the cash flow from investments purchased with the proceeds of the refunding bonds and other moneys are sufficient to pay the principal and interest on the refunded bonds that are being defeased.

**Face value** – The par value, i.e., principal or maturity value, of a security that appears on the face of the bond document. See *denomination*.

**Facsimile signature** – The reproduction of a signature by engraving, imprinting, scanning, stamping, or other means.

**Federal funds** – Immediately available funds representing non-interest bearing deposits at Federal Reserve banks. Federal funds are actively traded among commercial bank members of the Federal Reserve system. Federal funds usually are used in payment for new municipal securities issues at closing.

**Federal funds rate** – The interest rate at which federal funds are traded.

**Financial or municipal advisor** – A municipal advisor who

provides the issuer with advice regarding the structure, timing, marketing, fairness of pricing terms, bond ratings and other similar matters related to a new issue of municipal bonds. Such advisors must be registered with the SEC and the MSRB, and have a fiduciary responsibility to the issuer.

**Fiscal agent** – An agent, usually an incorporated bank or trust company, designated by a government to act for it in any of several capacities in the sale, administration and payment of bonds and coupons. See *paying agent*.

**Floating-to-fixed rate swap** – An agreement whereby an issuer synthetically converts variable rate debt to fixed rate debt through an interest rate swap.

**Forward** – A contract (variously known as a “forward contract,” “forward delivery agreement” or “forward purchase contract”) wherein the buyer and seller agree to settle their respective obligations at some specified future date based upon the current market price at the time the contract is executed.

**Forward refunding** – A refunding mechanism that allows the issuer to lock in interest rates now available rather than wait until the bonds’ call date (and exposing itself to the risk of rising interest rates). A forward refunding is used when the bonds to be refunded are not permitted to be advance refunded under federal tax law. Under a forward refunding the issuer agrees now to issue bonds on a specified future date when the issuance would become a “current” refunding under federal tax law.

**Forward swap agreement** – An agreement whereby two parties enter into an interest rate swap agreement to begin at a future date.

**Full faith-and-credit obligation (FFCO)** – In Oregon, a marketing term used to describe obligations typically issued under authority of ORS 271.390. A certificate showing participation through ownership of a “share” of lease payments or a financing or lease-purchase agreement. In Oregon the district’s general fund normally is pledged to support repayment of principal and interest on an FFCO. The acquired equipment or asset is not typically pledged as security.

**General obligation bonds (GO bonds)** – In Oregon, GO bonds are bonds secured by the pledge of the issuer’s full faith, credit and unlimited property taxing authority. GO Bonds are subject to voter approval (except for refundings).

**Good faith deposit** – A deposit required as part of acceptance of an underwriter’s winning bid in a competitive sale. The good faith deposit helps assure that the underwriter actually will fulfill the terms of its winning bid at closing. Good faith deposits are delivered by wire transfer after the winning bidder is selected.

**Gross bonded debt** – The total of an issuer’s bonds backed by a general obligation pledge, including any bonds that may be self-supporting.

**Gross proceeds** – Under federal tax law, gross proceeds are the total proceeds of a bond issue, including the original proceeds, the investment return on obligations acquired with the bond proceeds (including repayment of principal), and amounts used for or available to pay debt service on the issue.

**Guaranteed investment contract (GIC)** – An investment, secured by a contract with a financial institution, that guarantees a fixed rate of return and a fixed maturity.

**Interest payment date** – Date on which interest is due and payable.

**Interest rate swap contract** – A contract entered into by an issuer or obligor with a swap provider to exchange periodic interest payments. Typically, one party agrees to make payments to the other based upon a fixed rate of interest in exchange for payments based upon a variable rate. Interest rate swap contracts typically are used as hedges against interest rate risk or to provide fixed debt service payments to an issuer dependent on a specified revenue stream for payment of such debt.

**Interim financing** – Financing used between the time capital construction or improvement projects begin and the closing of the long-term bond issue, usually in the form of a short-term note. See *bond anticipation note*.

**Internal Revenue Code** – The Internal Revenue Code of 1986, as amended, governs issues of taxation related to bonds.

**Investment banker** – A person or firm assisting an issuer in developing debt plans and bond issue structures and who typically also arranges and completes the underwriting and sale of the debt.

**Investment grade** – A credit designation given municipal securities that have a high 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 considered investment grade.

**Investment of proceeds** – State law governs the allowable investment of bond proceeds. Permitted or qualified investments are reviewed carefully by rating agencies, credit providers and investors. Interest earnings, with

some exceptions, are subject to rebate.

**Investor** – The ultimate buyer of any number of bonds from an issue, who intends to hold the bonds for investment purposes.

**Issue** – Bonds or notes sold on a contemporaneous (or nearly contemporaneous) basis in one or more series that are authorized under the same bond contract.

**Issuer** – A state, political subdivision, agency or authority that borrows money through the sale of bonds, notes or other types of debt obligations.

**Kicker bond** – A callable high-coupon bond sold at a premium and priced to a specific call date. The actual yield realized by the investor increases or “kicks up” if that call is not exercised.

**Lease-purchase agreement** – A contract that is called a lease but actually is a purchase or sale for which payments are made in installments over time. Lessee acquires ownership as well as use of the leased property for the lease term. The lease typically specifies a date on which title to the property changes hands.

**Lease-purchase financing** – A long-term financing lease that may be sold publicly to finance capital equipment or real property acquisition or construction. The lease may be resold as full faith-and-credit obligations or lease-purchase revenue bonds.

**Legal opinion** – An opinion concerning the validity of a securities issue with respect to statutory authority, constitutionality, procedural conformity, and usually the exemption of interest from federal and state income taxes. A law firm recognized as specializing in public borrowings, often referred to as bond counsel, usually renders the legal opinion.

**Lessee** – The person or agency that agrees to lease specific property from a lessor (vendor ) for a specified number of lease payments. The lease payments include principal and interest components and are made over a specified period of time.

**Lessor** – The entity (usually private in Oregon) that agrees to participate in a lease agreement to facilitate the lessee’s ability to borrow money through issuance of full faith-and-credit obligations or lease revenue bonds. The lessor typically assigns all duties, including collection of lease payments and payments to investors, to a trustee.

**Letter of credit (LOC)** – A commitment, usually made by a commercial bank, to honor demands for debt payment upon compliance with conditions and/ or the occurrence of certain events specified under the terms of the commitment. In municipal financings, bank letters of credit are sometimes used as additional sources of security for issues of municipal notes, commercial paper or bonds, with the bank issuing the letter of credit committing to pay principal of and interest on the securities in the event that the issuer is unable to do so. A letter of credit also may be used to provide liquidity for commercial paper, variable rate demand obligations and other types of securities.

**Level debt service** – An arrangement of serial bond maturities in which the amount of principal maturing increases at approximately the same rate as the amount of interest declines, resulting in substantially equal annual debt service payments over the life of the bonds.

**Level levy rate** – A repayment plan for general obligation bonds that structures debt service so that the resulting tax projected



levy rates are estimated to be approximately the same each year. This structure, on average, defers principal payments slightly to account for increasing assessed values.

**Limited tax bond** – A bond secured by a pledge of a specified tax (usually the property tax) that is limited as to rate or amount.

**Liquidity** – The relative ability to convert a security into cash without substantial transaction costs or reduction of value.

**Local option tax** – In Oregon, a voter-approved taxing authority that is in addition to the taxes generated by the permanent tax rate. The amount available to districts is based on the gap in tax collection between Oregon's tax rate limitation and its tax assessment limitation and varies from district to district. Local option taxes can be used for general operations, a specific purpose or capital projects. They are limited to five years unless they are for a capital project, then they are limited to the useful life of the project or 10 years, whichever is less. Local option levies, however, are subject to compression before any other tax levy, which makes them an uncertain revenue source to leverage.

**Manager or senior manager** – The underwriter that serves as the lead underwriter for a bond issue. The manager may or may not enlist "co-managers" to assist in the underwriting and sale of the bonds. See *syndicate*.

**Mandatory redemption** – Circumstances that require the call or redemption of outstanding securities, usually at par value.

**Material event disclosure** – Disclosure of certain enumerated events affecting a

municipal security as required by Rule 15c2-12 in a continuing disclosure agreement. See *continuing disclosure*.

**Maturity** – The date when a security's principal amount becomes due and payable.

**Maturity schedule** – A schedule, arranged by dates and amounts, that shows when a bond issue's principal matures.

**Minor portion** – Under the federal Tax Reform Act of 1986, the minor portion is the portion of bond proceeds that may be invested at an unrestricted yield (an amount not exceeding the lesser of 5 percent of issue proceeds or \$100,000).

**Municipal Securities Rulemaking Board (MSRB)** – An independent, self-regulating organization established by the Securities Amendments Act of 1975. The MSRB is charged with primary rulemaking authority over dealers, dealer banks and brokers in municipal securities. The MSRB also runs the EMMA disclosure site and provides general information about municipal securities to both issuers and investors.

**Nationally Recognized Municipal Securities Information Repository (NRMSIR)** – An entity designated by the SEC to receive final official statements, material event notices and annual financial information under Rule 15c2-12. The NRMSIR's role has since been replaced by the MSRB EMMA site.

**Negative arbitrage** – Investment of bond proceeds and other related funds at a rate below the bond yield.

**Negotiated sale or underwriting** – A sale of securities that is negotiated with a single underwriter, or underwriting syndicate, selected by the issuer.

**Net direct debt** – All an issuer's bonds that are backed by and paid for by an unlimited property tax levy.

**Net interest cost (NIC)** – An outdated method of calculating bids for new municipal securities issues. The NIC is computed as either:

- ▶ Dollar cost: total scheduled coupon payments plus bid discount (minus bid premium), or
- ▶ Interest rate: total scheduled coupon payments plus bid discount (minus bid premium) divided by bond year dollars.

NIC does not differentiate between the value of interest paid immediately and interest paid in the future and, therefore, can produce misleading comparisons. See *true interest cost*.

**Net lease or triple net lease** – A lease in which operational costs, including maintenance, taxes and insurance, are paid by the lessee and are not part of the lease payments.

**No-arbitrage certificate** – A certificate prepared by bond counsel and signed by the issuer stating that the sale of the security and investment of proceeds will not violate IRS arbitrage regulations.

**No-litigation certificate** – A certificate prepared by bond counsel and signed by the issuer stating that no pending litigation against the issuer will interfere with the pledges and covenants made by the issuer for repayment of debt service.

**Non-appropriation clause** – A clause in a lease-purchase financing agreement stating the lease will terminate if the governing board does not annually appropriate the lease payment. Oregon school districts, ESDs and community colleges



normally do not employ a non-appropriation clause because it leads to higher interest rates.

**Non-callable bond** – A bond that cannot be redeemed by the issuer before its maturity date.

**Notes** – Short-term promises to pay specified amounts of money, secured by specific sources of future revenues, such as taxes, federal and state aid payments or bond proceeds.

**Notice of sale** – An official document prepared by or for the issuer describing the terms of sale for an anticipated new competitive bid offering of municipal securities. The notice of sale (NOS) generally contains the date, time and place of sale, amount of issue, type of security, amount of good faith deposit, basis of award, name of bond counsel, maturity schedule, method of delivery, time and place of delivery and bid form. Issuers use the notice to solicit bids from prospective underwriters for a competitive bond sale. The NOS and the underwriter's bid form constitute the legal sale contract.

**Offering price** – The price or yield at which the underwriter or members of an underwriting syndicate for a new issue offers the securities to investors.

**Official statement** – A comprehensive document prepared by or for the issuer containing detailed information about the security being offered, the issuer and the security pledged for payment of the issue. The official statement is similar to a prospectus. See *preliminary official statement*.

**Oregon School Bond Guaranty (OSBG)** – A program offered by the Oregon State Treasury that guarantees the debt service payments on qualified Oregon

school bond issues. All general obligation bonds offered by Oregon school districts, ESDs and community colleges are eligible for the program. Full faith-and-credit obligations are not eligible. The OSBG program charges a fee, payable at closing, based on the par amount of the bonds guaranteed.

**Original issue discount** – The amount by which a security's par value exceeds its public offering price at the time it is originally offered for sale to an investor.

**Original issue premium** – The amount by which a security's original offering price exceeds its par value at the time it is sold to an investor.

**Original proceeds** – The net amount an issuer receives from an issue's sale after all issuance expenses are paid.

**Original purchaser** – The person or firm, usually an underwriter, who purchases an issue directly from the issuer.

**Over issuance** – A bond issue where the issue's original proceeds exceed by more than 5 percent the amount necessary to fund the purpose(s) of the issue.

**Overlapping debt** – That portion of other jurisdictions' debt for which taxpayers of a particular municipality are responsible, e.g., services or facilities shared by several municipalities.

**Par value** – The principal amount of a bond or note that must be paid at maturity. The par value is also referred to as the face amount of a security.

**Paying agent** – The institution (usually a bank or trust company) identified on the security as the agent designated by the issuer to make interest and principal payments. See *bond registrar*.

**Point** – One percent of par value.

Because municipal dollar prices are quoted relative to \$1,000, a "point" is worth \$10 regardless of the actual denomination of the bond.

**Preliminary official statement or red herring** – A version of an official statement in preliminary form without pricing, yield or maturity information. The preliminary official statement is used by the issuer or underwriter(s) to inform the public of a pending bond sale prior to receipt of bids in a competitive sale or prior to the assignment of an interest rate and offering price in a negotiated sale. Orders for the security may not be taken based on a distribution of these preliminary documents. A statement to this effect is usually printed in red on the cover page and thus the preliminary document is often referred to as the "red herring."

**Premium** – The amount by which the price paid for a security exceeds the security's par value. Premium is generated when a bond's coupon rate is higher than the bond's yield.

**Present value** – The value in "today's dollars" of a payment or stream of payments expected to be received in the future, discounted at a given interest rate.

**Present value savings** – Difference expressed in terms of current dollars between the debt service on a refunded bond issue and the debt service on a refunding bond issue.

**Pricing advisor** – A consultant who provides a fairness letter to an issuer or its agent regarding the pricing of a new issue of municipal securities.

**Pricing date** – In a negotiated sale, the date the interest rates and original issue prices are finalized to determine yield to maturity. In a competitive sale,

the date bids to purchase the issue are due.

**Principal amount** – The face amount of a bond, exclusive of accrued interest, payable at maturity; or the aggregate principal amount of the issue.

**Private placement** – The original placement of an issue with one or a few investors, usually banks, life insurance companies, pension funds or other financial institutions.

**Proceeds** – The amount paid to the issuer by the initial purchaser, usually the underwriter, of a new issue. Bond proceeds equal the principal amount of the bonds issued, plus premium or less discount, plus accrued interest.

**Project** – The bond issue proceeds' stated use.

**Public offering price** – The price at which a new issue of municipal securities is offered to the public at the time of original issuance. This price, sometimes referred to as the "initial offering price," is equal to the par value less original issue discount or the par value plus original issue premium, as appropriate. It usually is expressed as a percentage of par.

**Qualified zone academy bonds (QZAB)** – Municipal securities issued to finance projects for certain eligible public schools in conjunction with private business contributions. In lieu of receiving periodic interest payments from the issuer, an eligible holder of a qualified zone academy bond is allowed annual federal income tax credits while the bond is outstanding.

**Ratings** – Evaluations of notes' and bonds' credit quality usually made by independent rating services.

**Rating agencies** – Organizations that provide publicly available ratings of the credit quality of

securities issuers, such as Moody's Investors Service, Standard & Poor's, and Fitch IBCA.

**Rebate** – Requirement imposed by Tax Reform Act of 1986 whereby issuers of bonds must pay the Internal Revenue Service an amount equal to any arbitrage profit earned from bond investment proceeds. Payments are due at least every five years and are subject to certain exceptions.

**Real market value** – The amount in cash that could reasonably be expected by an informed seller from an informed buyer in an arm's-length property transaction. In Oregon, real market value differs from assessed value. See *assessed value*.

**Redemption** – Also referred to as a call, redemption is the cancellation of an outstanding debt through a cash payment prior to its stated maturity date.

**Refunding** – A procedure whereby an issuer refinances an outstanding bond issue by issuing new bonds. Issuers refund bonds to reduce interest costs, restructure the payment of the debt or remove restrictive covenants in the security documents.

**Registered bond** – A bond whose owner is designated on records maintained for this purpose by a registrar. Transfer of ownership can only be accomplished when the registered owner properly endorses the securities and the transfer is recorded in the registration books.

**Registrar** – The person or entity responsible for maintaining records on behalf of the issuer that identify the owners of a registered bond issue.

**Reoffering price** – For new issues coming to market, the price at which bonds are offered

for sale to investors by the underwriter(s).

**Reoffering scale** – The prices and/or yields, listed by maturity, at which the underwriter offers new issue securities for sale to the public.

**Reprice** – In the case of a new issue of municipal securities, the process by which the interest rates and/or public offering prices are changed from the rates and/or prices established during the initial pricing, generally as a result of substantially higher or lower investor interest in the new issue than initially expected or significant changes in market conditions.

**Reserve fund** – Fund maintained by the issuer or designated trustee for a portion of bond proceeds as required by law and the bond resolution. A reserve fund is often required for revenue bonds to maintain sufficient revenues to pay debt service in the event of a shortfall but is never used for general obligation bonds.

**Restructure** – A repricing of a new municipal securities issue including changing the principal amounts and/ or maturity schedule of the offering. In some cases this involves more significant modifications to the structure of the new issue.

**Rule 15c2-12** – An SEC rule under the Securities Exchange Act of 1934 requiring underwriters to receive, review and disseminate official statements prepared by issuers of most primary offerings of municipal securities and to obtain continuing disclosure agreements from issuers and other obligated persons to provide material event disclosures and annual financial information on a continuing basis. See *Continuing Disclosure and EMMA*.

**Sale date** – See *pricing date*.

**Scale** – See *reoffering scale*.

**Secondary market disclosure** – Disclosure of information relating to outstanding municipal securities made following the end of the underwriting period by or on behalf of the issuer or other obligor. See *continuing disclosure*.

**Selling group** – A group of dealers and brokers that are asked to join in the offering of a new securities issue, but are neither liable for any unsold balance nor share in the underwriting syndicate's profits.

**Serial bonds** – Bonds that mature annually, or semiannually, over a number of years.

**Short-term debt** – Debt with a maturity of one year or less after the date of issuance.

**Sinking fund** – A fund established by bond issuers, generally required in the bond resolution, that is increased through time to retire some of the outstanding bonds before their maturity or to reduce the risk of bond default.

**SLGS** – An acronym (pronounced “slugs”) for State and Local Government Series issued by the U.S. Treasury Department. These securities are backed by the full faith and credit of the U.S. government. They may be ordered only on behalf of state and local issuers to fulfill yield restriction requirements imposed by federal tax law.

**Special tax counsel** – A municipal bond lawyer or legal firm that specializes in Internal Revenue Code compliance.

**Spread** – With respect to new issues of municipal securities, spread is the difference between the price paid to the issuer for the new issue and the prices at which the securities are initially offered to the investing public.

**Swap** – A sale of a security and

the simultaneous purchase of another security for purposes of enhancing the investor's holdings. The swap may be used to achieve desired tax results, to gain income or principal, or to alter various features of a bond portfolio, including call protection, diversification or consolidation, and marketability of holdings.

**Syndicate** – A group of underwriters formed for the purpose of participating jointly in the initial public offering of new securities issues. A senior manager leads the underwriting syndicate and works directly with the issuer in structuring the issue. “Co-managers” usually participate only in the sale of the bonds.

**Synthetic refunding** – An agreement between an issuer and counter-party entered into in connection with outstanding bonds that the issuer is not permitted to advance refund on a tax-exempt basis under the Internal Revenue Code. The agreement is designed to generate debt service savings that the issuer would realize if it were permitted to advance refund the outstanding bonds.

**Tax-exempt municipal lease** – A long-term financing lease, e.g., a lease with an option to purchase, which, for Internal Revenue Service purposes, is a state, local or other governmental agency obligation.

**Tax anticipation note (TAN)** – A short-term note issued in anticipation of the future receipt of proceeds from taxes assessed by the issuer.

**Tax and revenue anticipation note (TRAN)** – A short-term note issued in anticipation of the future receipt of proceeds of taxes assessed by the issuer and of revenues received from other sources.

**Tax Reform Act of 1986** –

Federal tax legislation that substantially changed existing federal income tax laws. The 1986 legislation imposes severe restrictions on local governments for the issuance of debt securities with interest exempt from federal income tax.

**Taxable security** – A bond or other security that does not qualify for an exclusion from gross income under federal tax law. Corporate, U.S. government and agency debt generally is federally taxable. In some cases, municipal securities also are taxable under federal tax law.

**Temporary period** – Under Section 148 of the Internal Revenue Code, the temporary period is the period of time during which bond proceeds can be invested at unlimited yields. However, the investments still may be subject to rebate.

**Term bonds** – Bonds that are issued with a single stated maturity date, but typically include a mandatory redemption schedule of principal prior to final maturity. Term bonds and serial bonds are often combined in one issue.

**Transcript of proceedings** – Collection of all documents relating to an issue. The transcript is prepared and distributed by bond counsel.

**Transferred proceeds** – A federal income tax concept applicable to refunding. Transferred proceeds refer to the proceeds of a prior bond issue that are unexpended on the date the prior issue is discharged. Such proceeds are treated as a transfer to the refunding bond issue for investment yield limitation purposes.

**True interest cost (TIC)** – A method of computing interest cost or rate for new securities that involves the annual discount



rate. TIC is the preferred method for calculating the effective interest cost of an issue structure because it accounts for the time value of money. See *net interest cost (NIC)*. The TIC is sometimes called the internal rate of return, the net effective interest rate or the Canadian interest cost (CIC).

**Underlying rating** – The rating assigned by a rating agency to a security that has a credit enhancement without regard to credit enhancement or the ratings assigned to the issuer's other securities that have the same features and security structure but do not have credit enhancements.

**Underwriter** – A dealer that purchases a new issue of securities for resale. The underwriter may acquire the bonds either by negotiation with the issuer or by award on the basis of a competitive bidding. The underwriter assumes all risk (profits or losses) for selling the new issue.

**Underwriter's counsel** – A firm of municipal bond attorneys hired by the underwriter to prepare the official statement in a negotiated underwriting and review all documents and agreements.

**Underwriting spread** – An amount representing the

difference between the price at which the underwriter buys securities from the issuer and the price at which they are reoffered to the investor.

**Variable rate** – An interest rate, sometimes referred to as a "floating rate," on a security that changes at intervals according to market conditions or a predetermined index or formula.

**Yield** – The rate of return earned on an investment based on the price paid for the investment, the interest earned during the period held and the selling price or redemption value of the investment.

**Yield curve** – A graph that plots market yields on securities of equivalent quality but different maturities at a given point in time.

**Yield to call** – The rate of return an investor earns from payments of principal and interest, with interest compounded semi-annually at the stated yield, presuming that the security is redeemed on a specified call date (if the security is redeemed at a premium call price, the amount of the premium is also reflected in the yield). Yield to call takes into account the amount of the premium or discount at the time of purchase, if any, and the time value of the investment.

**Yield to maturity** – A yield concept based on the assumption that the security is held to maturity and that all interest received over the life of the bond is invested at the same yield.

**Zero coupon bonds** – Bonds that bear no periodic interest but are marketed at substantially below face amount. The maturity value an investor receives is equal to the principal invested plus interest earned compounded semi-annually at the original offering yield to maturity. See *deferred interest bonds and current coupon bonds*.



# Legal References

## Chapter 2: General Obligation Bonds and Notes

ORS 287A.335 describes the legal parameters for interest rate swap agreements.

ORS 305.583 governs notice and publication requirements.

ORS 305.586 and ORS 287A.145 provides guidelines for fashioning remedies for misspent bond proceeds.

ORS 305.587 provides that where a petitioner challenges the authorized use of proceeds of bonded indebtedness, the tax court will construe the language in the measure authorizing the indebtedness liberally to allow the government unit to provide the facilities or services approved by the voters.

ORS 328.205 describes the projects for which school districts may issue bonds.

ORS 328.304 describes formation of an ESD county education bond district (CEBD).

ORS 334.125 requires ESDs to contract general obligation bonded indebtedness through a vote of all those within the ESD's boundaries or through creation of a county education bond district.

Article XI, Section 11L of the Oregon Constitution defines capital costs for general obligation bonds secured by unlimited property taxes.

Article XI, Sections 11 and 11b of the Oregon Constitution also describe additional conditions that must be met to levy unlimited property taxes.

## Chapter 3: Lease-Purchase and Financing Agreements

ORS 271.390 authorizes lease-purchase and other financing agreements.

ORS 332.155 also authorizes lease-purchase agreements for school districts.

## Chapter 4: Short-Term Borrowings

ORS 287A.180 prohibits TRANS from exceeding 80 percent of the district's budgeted basic state support, tax levies and other budgeted revenues and requires that the TRANS mature within 13 months after they are issued. In addition ORS 287A.180 authorizes districts to borrow money in a number of other ways including entering into credit agreements, or issuing notes, warrants, short-term promissory notes, commercial paper, or other obligations to provide interim financing to acquire capital assets or in anticipation of taxes, grants or other revenues.

## Chapter 5: The Bond Election Process

ORS 250.035 lists ballot title requirements.

ORS 250.036 includes required first sentence of ballot titles for all elections except general elections in even-numbered years.

ORS 250.037(3) requires the ballot title for general obligation bonds to provide a reasonably detailed, simple and understandable description of the use of bond proceeds.

ORS 251.345 and OAR 165.022-0040 relate to the 500-word ballot explanation.

ORS 253.065 requires county clerks to mail out ballots to long-term absent electors no later than 45 days prior to each election.

ORS 254.470 requires county clerks to mail ballots to registered voters not sooner than 18 days before the date of the election and not later than the 14th day before the election.

ORS 255.085 specifies filing requirements for the notice of election.

ORS 255.345 specifies election dates. ORS 258.036 sets the procedure for contesting election results.

ORS 260.432 relates to restrictions on activities of public employees during working hours.

ORS 294.100 (2) says that any public official who "expends any public moneys in excess of the amounts or for any other or different purpose than authorized by law," shall be civilly liable for the return of the money if the expenditure constitutes malfeasance in office or willful or wanton neglect of duty.

Oregon Secretary of State's *2018 Election Law Summary* and the *2018 Restrictions on Political Campaigning by Public Employees* publications available online at <http://sos.oregon.gov> include detailed guidelines for producing impartial information and other issues related to ballot measures.

## **Chapter 6: Federal and State Tax Treatment**

The Internal Revenue Code of 1986 (the "Code") regulates the use and investment of all funds related to tax-exempt borrowing as well as the use of all assets financed with tax-exempt debt.

Section 265(b)(3) of the Code provides an exception to the rule that prohibits banks and other financial institutions handling tax-exempt obligations from deducting their interest expense allocable to owning tax-exempt bonds.

IRS Form 8038-G or IRS Form 8038GC are forms districts must use to file information reports with the Internal Revenue Service.

## **Chapter 7: Federal Securities Law Disclosure Requirements**

The Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act) are the two main federal laws regulating the issuance and sale of securities.

Section 3(a)(2) of the Securities Act exempts from registration "any security issued or guaranteed by ... any State of the United States, or by any political subdivision of a State, or by any public instrumentality of one or more states...."

Section 17 of the Securities Act and Section 10(b) of the Exchange Act and paragraph (b) (5) of Securities and Exchange Commission Rule 15c2-12 provide federal antifraud principles that apply to corporate securities transactions and municipal securities.

The Securities and Exchange Commission Rule 15c2-12 ("Rule

15c2-12") is designed to prevent fraud by regulating disclosure activity in the municipal market.

## **Chapter 8: Credit Analysis, Ratings and Bond Insurance**

The Oregon School Bond Guaranty (OSBG) program replaces or enhances the use of underlying ratings or bond insurance by insuring the payment of principal and interest on bond issues that qualify for the program.

## **Chapter 10: Local Budget Law**

ORS Chapter 287A governs the creation of municipal debt.

Federal tax law and the Department of Revenue OAR 150.294.352(1) (A) specify Capital Projects Fund requirements.

ORS 287A.150 is the procedure for municipalities to issue revenue bonds.

ORS 294.326(5) is the exception to the Local Budget Law regulating expenditure of bond proceeds during the current year or current budget period.

ORS 328.260 describes the debt service fund and tax levy to pay principal and interest.

ORS 328.265 grants the county treasurer authority to certify a tax levy to the county on behalf of the district.

## **Chapter 11: The 2015 Matching Grant Legislation**

ORS 327.008 and 329.488 were amended under Senate Bill 447, creating the Office of School Facilities and the Oregon School Facilities Database.

# Interest Rate Swaps and Other Derivative Products

**A**s of January 1, 2004, all Oregon municipalities including school districts, ESDs and community colleges received broad legal authority to use a new set of financial management tools. While interest-rate-exchange agreements (swaps) and their various permutations are not debt per se, they are related and based on debt that was or will be issued. These financial tools are generally outside the scope of this manual, although some basics about these instruments are described throughout the manual where they may be applicable. Issuers wanting to know more about these financial instruments should contact their financial consultants and bond attorneys.

For the most part, swaps have limited application to Oregon school districts, ESDs and community colleges because of certain risks and the prevalence of fixed-rate general-obligation borrowing. See “Interest Rate Swaps with General Obligation Bonds” in Chapter 2.

What is an interest rate swap? An interest rate swap is an agreement between two parties to trade cash flows based on different interest rates. One party is the bond issuer and the other (the “counterparty”) is the swap provider. One party pays a fixed rate and the other party pays a floating (variable) rate based on an industry index. Rates are applied to a “notional amount,” i.e., the amount on which the interest amounts are calculated. No principal is exchanged and the swap is not, by itself, debt. It is simply a way to manage interest rate risk based on debt that was or will be issued.

Why do a swap? There are some potential benefits to swaps:

- ▶ Saving money on new debt service issues
- ▶ Locking in savings on a refunding that can only be done in the future
- ▶ Locking in fixed rates now for a future new money bond issue
- ▶ Offsetting adverse changes in interest earned on investments

Swaps can be executed in the process of a new bond issue or can be executed based on outstanding debt. For example, an issuer may issue variable rate debt and enter into an interest rate swap to fix the rate. Under certain market conditions, this may produce a fixed rate cash flow at a lower rate than if the issuer originally issued fixed rate bonds. In another example, an issuer with a large amount of outstanding fixed rate debt might wish to take on variable rate exposure. Rather than issue its new debt as variable rate, the issuer could enter into a swap that changes some of its fixed rate obligation to variable.

For issuers of general obligation bonds, the most likely use of a swap may be to lock in fixed rates for debt that will be issued in the future. This may be in the form of a district with a bond authorization that it wishes to sell in several pieces over a multi-year period. Or it may be in the form of capturing refunded savings now that could otherwise only be accomplished years in the future if interest rates allowed.

What are the risks? There can be significant risk involved in a swap depending on how the transaction

is structured. Perhaps the most significant risk for a municipal issuer is “termination risk.” If a swap is terminated before its maturity, one side or the other may owe a payment. Swap agreements provide that only the issuer may voluntarily terminate the swap. A swap provider may not terminate early. However, an involuntary termination payment may be triggered by a default, e.g., a bankruptcy by the swap provider. Under such a scenario, an issuer could be liable for a significant termination payment to the bankrupt swap provider.

Additionally, issuers may need to “voluntarily” terminate a swap to refinance outstanding associated debt. In the financial crisis of 2008-09, many municipal issuers were forced into “voluntary” terminations in order to exit the auction rate security market when it collapsed.

Other risks include “basis risk,” which simply means that the variable rate index on which the swap payments are based does not accurately track the actual interest rate payments the issuer makes on its variable rate bonds.

This would expose the issuer to extra costs not covered by the swap.

Swaps are complicated financial tools that entail certain risks including but not limited to the risks described here. Issuers should engage competent financial and legal assistance in evaluating whether an interest rate swap may be an appropriate instrument and to fully review and understand all of the financial risks involved.