



Bonds 101: *The Basics*

**An Overview of the Financing Techniques
Available to California Local Governments**

Basic Legal Issues

- **Each type of jurisdiction has different powers**
 - ◆ Power to lease or purchase property
 - ◆ Power to issue bonds, with or without vote

- **Some jurisdictions have limits**
 - ◆ Require voter approval for the action
 - ◆ Amount of debt limited to some amount

Competitive Sales

- Financial advisor/bond counsel structure
- Issuer, bond counsel, financial advisor write official statement
- Underwriter submits binding bid
- Usually “commodity” bonds

Negotiated Sales

- Underwriter hired in front
- Financial advisor may also be involved
- All parties structure
- Underwriter's counsel writes official statement

The Players

— Issuer

- ◆ Hires the team
- ◆ Approves financing

— Bond Counsel

- ◆ Issues opinion as to validity and exemption

— Underwriter

- ◆ Buys at wholesale, sells at retail

— Financial Advisor

- ◆ Advises on pricing, terms and structure suitability

General Obligation Bonds

- Most secure
- Requires 2/3rds vote
- To acquire real property or improve it
- Secured by unlimited *ad valorem* tax

Advantages of Using GOs

- **Lowest cost**
- **No reserves required**
- **Doesn't cannibalize other revenues**

Disadvantages of Using GOs

- Long lead time, usually 9-12 months
- Vote hurdle is high
- Limited flexibility on use of proceeds
- Limitation on application of levy introduces fairness questions

Revenue Bonds

- **New money: Revenue Bond Law of 1941**
 - ◆ Requires majority vote
- **Refundings done under omnibus refunding authorizations**
 - ◆ Generally no vote required
- **Secured by specific revenue**
 - ◆ Water, sewer, golf, etc.

Advantages of Revenue Bonds

- **Self liquidating**
 - ◆ No lien on other revenues
 - ◆ No general fund impact
- **Usually secure credit**
- **Common investment vehicle**

Disadvantages of Revenue Bonds

- Requires majority vote
- Obligation to raise rates if required
- Requires excess “coverage”
- Additional indebtedness constrained

Land Secured Issues

— Assessment districts

- ◆ 1911 Act
- ◆ 1913 Act
- ◆ 1915 Act

— Mello-Roos districts

- ◆ Special taxes

Assessment District

- **Bonds secured by special assessments**
 - ◆ Property must benefit from improvements
 - ◆ Assessment must be proportional
 - ◆ Not a “tax”
- **Usually, funds basic infrastructure**
 - ◆ Roads sewer, water, drainage, streets
- **Public hearing and “protest” process required**

Assessment District Advantages

- **Doesn't divert other resources for capital improvements**
- **Not a direct obligation of issuer**
- **Property which benefits, pays**
- **Common method of funding the basics**

Assessment District Disadvantages

- Often politically unpopular
- Benefit nexus inflexible
- Lien attaches to property
- Often confused as “tax”
- Requires constant supervision

Mello-Roos Districts

- **Bonds are secured by “special tax”**
 - ◆ No benefit nexus
 - ◆ No principal lien on property
 - ◆ Allows for both capital and service component
- **Finance capital goods in excess of 5 years**
- **Special tax requires 2/3rds vote**
 - ◆ Or, 2/3rds of property if fewer than 12 voters

Mello-Roos Advantages

- **Very flexible**
- **Allows for phasing**
- **Not a direct obligation of issuer**
- **No benefit nexus**

Mello-Roos Disadvantages

- Requires vote
- Often very complex
- Requires minimum value levels
- Requires constant supervision

Certificates of Participation

- **Based on power to lease or purchase property**
 - ◆ No voter approval required
 - ◆ Watch enabling legislation carefully
- **Finances capital facilities**
- **May be “lease based” or “revenue based”**

Lease Based COPs

- **Subject of lease**
 - ◆ To be built: acquisition/construction
 - ◆ Existing facility: asset transfer
- **Subject is leased to another entity which “leases back” to agency**
- **Payments assigned to trustee**
- **Rents must reflect “fair market”**
- **Subject to abatement**

Advantages of Lease Based COPs

- **No voter approval**
- **Quick implementation**
- **Very flexible**
- **Widely available**

Disadvantages of Lease Based COPs

- **General fund obligation**
- **Encumbrance of facility**
- **Abatement risk requires RI insurance**

Revenue Based COPs

- Facilities relation to enterprises
- Payments derived from enterprise
- Installment sale contracts

Advantages of Revenue Based COPs

- **No voter approval**
 - ◆ Compare to revenue bonds
- **Repayments from the enterprise**
- **Very flexible**
- **Widely available**

Disadvantages of Revenue Based COPs

- Requires rate covenant
- No abatement
- Coverage requirement
- Additional indebtedness constrained

Joint Powers Authority Bonds

- JPA is separate entity
- Can purchase obligations of other, enter into lease arrangements, or installment purchases
- Can issue revenue bonds secured by the above

Advantages of JPA Bonds

- Allows for pooling of borrowing, reducing costs
- Very flexible structuring alternatives

Disadvantages of JPA Bonds

- Takes “two to tango”
- More difficult to administer
- More complex
- Subject to “weak link” analysis