

PUBLIC
LAW

CALIFORNIA
LAWYERS
ASSOCIATION

presents

Public Law 101 Conference

Public Finance

Wednesday, November 15, 2023
2:15 p.m. – 3:15 p.m.

Speakers:

Vanessa Legbandt, Shareholder
Stradling Yocca Carlson Rauth

Conference Reference Materials

Points of view or opinions expressed in these pages are those of the speaker(s) and/or author(s). They have not been adopted or endorsed by the California Lawyers Association and do not constitute the official position or policy of the California Lawyers Association. Nothing contained herein is intended to address any specific legal inquiry, nor is it a substitute for independent legal research to original sources or obtaining separate legal advice regarding specific legal situations.

© 2023 California Lawyers Association

All Rights Reserved

The California Lawyers Association is an approved State Bar of California MCLE provider.

Vanessa Legbandt. Vanessa Legbandt is a Shareholder in the Public Finance Department at Stradling Yocca Carlson & Rauth. Vanessa focuses her practice primarily on public financing transactions, including lease revenue bond financings, utility revenue bond financings, land secured financings, and other public financings. Vanessa also represents public agencies in connection with public private partnerships involving economic development, housing, utility, and transportation developments. Ms. Legbandt has advised several of the Firm's clients regarding potential benefits of infrastructure financing districts and enhanced infrastructure financing districts, including the procedures required to establish, operate, and issue debt through such districts. Ms. Legbandt received her J.D. from the University of San Diego School of Law in 2005, *magna cum laude* and Order of the Coif, and her B.A. from U.C. Santa Cruz in 2000.

PUBLIC
LAW

CALIFORNIA
LAWYERS
ASSOCIATION

PUBLIC FINANCE 101

Vanessa S. Legbandt, Shareholder
Stradling Yocca Carlson & Rauth, a Professional Corporation

November 15, 2023

Public Finance 101 Outline

- I. Local Agency Revenues
- II. Public Agency Debt Financing in California
- III. Types of Local Agency Financings
- IV. Financing Process
- V. Financing Team Members and Roles
- VI. Questions

PUBLIC
LAW

CALIFORNIA
LAWYERS
ASSOCIATION

LOCAL AGENCY REVENUES

Overview of Local Agency Revenue Sources

- Ad Valorem Property Taxes
- Sales and Use Taxes
- Transient Occupancy Taxes
- Utility Users Tax
- Enterprise Revenues
- Mello-Roos CFD Special Taxes
- Assessments
- Parcel Taxes
- Charges for Services
- Fines

Proposition 13

- Approved by the voters in 1978 as the “People’s Initiative to Limit Property Taxation”
- Added Article XIII A to the California Constitution
- Limits *ad valorem* property taxes to 1% of full cash value without two-thirds voter approval and provides that the 1% property tax is collected by the counties and apportioned according to law by the state (Article XIII A, Section 1)
- Prohibits cities, counties and special districts from imposing “special taxes” without two-thirds voter approval (Article XIII A, Section 4)
- School districts, community college districts and county offices of education may levy *ad valorem* property taxes by 55% vote (Article XIII A, Section 1)

Proposition 218

- Approved by the voters in 1996 as the “Right to Vote on Taxes Act”
- Added Articles XIIC and XIID to the California Constitution
- All taxes are either “general taxes” or “special taxes” (Article XIIC, Section 2(a))
- Majority voter approval required to impose “general taxes” and such taxes must be approved at a regularly scheduled general election for members of the governing body, except in cases of emergency (Article XIIC, Section 2(b))
- Two-thirds voter approval required to impose “special taxes” (Article XIIC, Section 2(d))
- Applies to any tax “imposed, extended, or increased” by a “local government”

Proposition 218 (continued)

- Added substantive and procedural limitations on special benefit assessments and property-related fees and charges, other than charges for electricity and gas services and fees imposed as a condition of property development (Article XIID)
- Protects the citizen initiative power to reduce or repeal local taxes, assessments, fees and charges (Article XIIC, Section 3)
- Proposition 218 Omnibus Implementation Act (Government Code Sections 53750-53758)
 - Public notices
 - Public hearing
 - Protest proceedings/elections

Proposition 26

- Approved by the voters in 2010 as the “Supermajority Vote to Pass New Taxes and Fees Act”
- Amended Article XIII C to define “tax” as “any levy, charge, or exaction of any kind imposed by a local government” that does not fall within one of the enumerated exceptions
 - A charge for a specific benefit or privilege, which does not exceed the reasonable costs of providing the benefit or privilege
 - A charge for a government service or product, which does not exceed the reasonable costs of providing the service or product

Proposition 26 (“tax” exceptions continued)

- A charge for the reasonable regulatory costs of issuing licenses and permits, performing investigations, inspections, and audits, and the administrative enforcement thereof
- A charge for entrance to or use of local government property, or the purchase, rental, or lease of local government property
- A fine, penalty, or other monetary charge imposed as a result of a violation of law
- A charge imposed as a condition of property development
- Assessments and property-related fees imposed in accordance with the provisions of Article XIII D (Proposition 218 protest proceedings)

Gann Appropriations Limit

- Proposition 4, approved by California voters in 1979, also called the “Gann Initiative”
- Added Article XIII B to the California Constitution to address the perceived problem of increasing levels of government spending
- Established an “appropriations limit” for the State and each local government unit limiting expenditures from “proceeds of taxes.”
 - Adjusted annually to reflect changes in the cost of living, population, and services rendered by the public entity
 - Appropriations limit can be raised with voter approval, but resets after 4 years unless re-approved by voters
- Revenues received in excess of the appropriations limit must be returned by a revision of tax rates or fee schedules within the next two fiscal years

Initiative 1935 – Taxpayer Protection and Government Accountability Act

- Qualified for the November 2024 ballot
- Amends the definition of “tax” in Article XIII C to include “every levy, charge, or exaction of any kind imposed by a local law that is not an exempt charge”
- An “exempt charge” is a “reasonable charge for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the actual costs [as opposed to the reasonable costs] of providing the service or product to the payor”
- Shifts burden of proof from “preponderance of the evidence” to “clear and convincing evidence” when defending a fee or charge

PUBLIC
LAW



PUBLIC AGENCY DEBT FINANCING IN CALIFORNIA

Who can issue debt in California?

- State of California and its related entities
- Counties
- Cities
- School districts
- Special districts
- Joint exercise of powers authorities (JPAs)

Express Authority Needed to Incur Debt

- Legal authority to issue bonds or incur other types of debt
 - Voter approval
 - Specific statutes
 - Refunding Bond Law
 - City/County Charter provisions

Constitutional Debt Limit

- Article 16, Section 18 of the California Constitution provides:
 - “No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public entity voting at an election to be held for that purpose”
- Applies to Cities, Counties, and School Districts
- Prohibits debt payable from revenues received in future fiscal years
- Exception: two-thirds vote

Exceptions to Constitutional Debt Limit

- Current fiscal year
- Annual appropriation
- Lease
- Special fund
- Contingent obligation
- Obligations imposed by law

Need for Certainty – Judicial Validation

- Code of Civil Procedure Section 860, et seq. and Government Code section 53510, et seq.
- Confirm legal authority to issue debt
- Confirm compliance with constitutional debt limit
- Includes all agreements essential to the financing
- Judicial validation vs. “passive” validation

PUBLIC
LAW



TYPES OF DEBT FINANCINGS

Types of Debt

- “Types” of debt can refer to several different things
 - Purpose of the financing
 - Security and source of payment
 - Interest and payment characteristics
 - Tax treatment
 - Method of Sale

Purpose and Use of Proceeds

- “New money” financings for construction projects
 - Public infrastructure (streets, parks)
 - Governmental facilities (fire station, city hall, wastewater treatment plant)
 - Equipment (fire truck, communications equipment, solar facilities, copiers, etc.)
 - Housing (low and moderate income, homelessness prevention)
 - Court Judgments
- Refinancing prior obligations (“Refunding”)
- Combination – new money and refinancing

General Obligation Bonds

- Usually paid from unlimited *ad valorem* property taxes levied to pay the debt
 - In addition to the general 1% property tax levy under Prop 13
- Can also be backed by the “full faith and credit” of the issuer
 - Issuer can use all legally-available sources of revenue to pay debt
- Generally, most secure debt with lowest borrowing cost
- Two-thirds voter approval required

Enterprise Revenue Bonds

- “Special Fund” exception to the Constitutional Debt Limit (no vote required)
 - Issued to finance improvements to an “enterprise” (i.e. water or sewer system; utility; transportation) and
 - Payable from the revenues generated by the enterprise (not necessarily the specific project)
- Can be structured with multiple lien levels (senior and subordinate bonds)
- Reminder: Still need statutory authority to incur debt
 - New money financings typically structured as an installment purchase of the financed capital projects
 - Refunding bonds can be issued under the Refunding Bond Law

Lease Revenue Bonds

- “Lease” exception to Constitutional Debt Limit (no vote required)
- “Lease-leaseback financing”
 - Leased asset typically owned by the borrower - Investors prefer “essential” governmental assets
 - Leased asset can be the financed facility or other unrelated property
 - Borrower must have “beneficial use and occupancy” to support lease payment obligation
- Lease payments are structured in time and amount to pay bond debt service
- Appropriations vs. Abatement lease structure
- Sometimes structured as “Certificates of Participation” or “COPs”

Land-Secured Financings

- Mello-Roos Community Facilities District special tax bonds
 - Two-thirds voter approval; usually by unanimous landowner vote
 - Secured by a special tax levied against the properties within the district
- Assessment district bonds
 - Secured by a special benefit assessment against the properties within the District
 - Requires engineer's report showing "special benefit" to each assessed parcel
 - Subject to protest proceeding under Prop 218
- Remedy for property owner's nonpayment of Special Tax or Assessment - Foreclosure

Tax Increment Financing

- Tax allocation bonds
 - Payable from the “incremental” increase in property tax revenues in a specified area
 - Primary financing tool of former California redevelopment agencies
 - Now: infrastructure financing districts and enhanced infrastructure financing districts
- Issued by special districts not subject to the Constitutional Debt Limit

Federal and State Loans

- State Water Resources Control Board loans
- Water Infrastructure Finance and Innovation Act (WIFIA) loans
- United States Department of Agriculture (USDA) loans
- Transportation Infrastructure Financing and Innovation Act (TIFIA) loans

Short-Term Financing Options

- Tax and revenue anticipation notes (TRANs)
- Bond anticipation notes
- Grant anticipation notes
- Commercial paper programs
- Lines of credit
- Teeter notes

Tax-Exempt vs. Taxable

- Interest on municipal bonds can be exempt from income tax of the bondowner under federal law, subject to certain restrictions:
 - Private use and private payment restrictions
 - Expenditure of proceeds by within 3 years (reasonable expectation)
 - Recordkeeping
 - Life of the bond Issue plus three years
 - Arbitrage rebate
- Public agencies can also issue federally taxable bonds
- Interest on municipal bonds is generally exempt from California state income tax

PUBLIC
LAW



FINANCING PROCESS

Public Offering vs. Private Placement

- In a public offering, the bonds are offered to investors on the public capital markets
 - Requires an offering document to comply with federal securities laws
 - A public offering may be “negotiated” or “competitive”
 - A “limited public offering” is an offering limited to sophisticated investors, usually “accredited investors” or “qualified institutional buyers”
- In a private placement, the bonds are sold directly to a single purchaser (or small group of purchasers), such as a bank
 - Purchaser should be a sophisticated investor
 - No offering document (if not a “security” under federal securities laws)
 - Restrictions on transfer (high minimum denomination to limit number of bondowners)
 - Issuer will receive an investor letter with certain representations by the purchaser

Competitive vs. Negotiated Sale

- In a competitive sale, the issuer will receive bids from underwriters to purchase the bonds
 - Pros: Fully transparent sale as bonds are sold to the firm who bids the lowest interest cost
 - Cons: Marketing process more limited than negotiated sale; lack of underwriting support in volatile markets or with complex credits
- In a negotiated sale, the issuer hires one or more underwriters to market the bonds
 - Pros: Selection of a predetermined, preferred underwriting team; underwriter can provide feedback on structure and disclosure; underwriter can utilize capital to support sale of bonds
 - Cons: pricing is based on negotiation with underwriter at time of sale

Basic Legal Documents

- Authorizing resolution or ordinance
 - Action by the legislative body authorizing the financing
 - Includes “not to exceed” parameters: maximum principal amount, interest rate, term, savings thresholds
- Indenture/Trust Agreement: bond terms, covenants and trustee responsibilities
- Installment Purchase Agreement or Lease Agreement: payment terms and covenants of the obligor, if not the issuer
- Bond Purchase Agreement: issuer and underwriter agree to the purchase price, interest rates and maturity schedule, as well as conditions to closing

Disclosure Under Federal Securities Laws

- Municipal securities are generally exempt from federal securities laws but anti-fraud rules apply (Rule 10b-5)
 - Investors in municipal bonds have rights under federal securities laws
 - All “material” information must be provided
- Rule 15c2-12 requires Underwriters to:
 - obtain a Preliminary Official Statement from the issuer before marketing bonds
 - require the issuer to provide a final Official Statement 7 business days after pricing
 - require the issuer and “obligated persons” to provide continuing disclosure

Disclosure Under Federal Securities Laws

- The **Preliminary Official Statement (“POS”)** is the offering document provided to investors
 - Includes all material information regarding the bonds: payment terms, source of payments and security, financial and operating information of the issuer or borrower, investment risks
 - The POS is provided to investors and is used to market the bonds
 - Investors use this information to evaluate the credit quality of the bonds and potential risks
- The **final Official Statement (“OS”)** is prepared after the bonds are “priced”
 - Includes information in the POS, plus the final pricing numbers of the bonds
- The **Continuing Disclosure Agreement**
 - Annual reports: audit and updates to financial and operating information in the OS
 - Obligation to provide notice within 10 business days of certain enumerated events

Typical Financing Timeline

3 weeks before Pricing:

- Finalize legal documents
- Governing board authorization to issue bonds

2 weeks before Pricing:

- Due diligence call
- Finalize disclosure document (POS)

1 week before Pricing:

- Receive ratings
- Post POS
- Marketing and pre-sale

Typical Financing Timeline

Pricing (or “Sale”) of the Bonds

- Interest rates, maturity schedule, redemption provisions are finalized
- Bond Purchase Agreement is finalized and signed by the issuer and underwriter

1-2 weeks after Pricing:

- “Pre-Closing”
 - Gather executed agreements, certificates, and opinions (hold in “escrow”)
 - Confirm all conditions are satisfied
- “Closing”
 - Issue bonds
 - Receive bond proceeds

PUBLIC
LAW



FINANCING TEAM MEMBERS AND ROLES

Finance Professionals

- Issuer
- Borrower
- Municipal Advisor
- Underwriter
- Trustee
- Bond insurer
- Rating Agency
- Other consultants
- Attorneys

Bond Counsel

- Represents the issuer throughout a transaction
 - Prepares legal documents (agreements, resolutions)
 - Confirms legal authority for the financing
 - Structure the transaction to ensure payment and performance
 - Delivers bond counsel opinion to the issuer, supplemental opinion to the underwriter
- Bond counsel opinion is required by rating agencies, insurers and underwriters (on behalf of investors) and confirms:
 - Bonds are legal, valid, and binding obligations of the issuer
 - Tax status of the debt

Disclosure Counsel

- Prepares the official statement with input from the issuer, borrower and financing team
- Prepares the continuing disclosure agreement
- Renders a “negative assurance letter” on the official statement
- Training and guidance on federal securities law and disclosure requirements
- A single law firm can act as disclosure counsel and as bond counsel
- Disclosure Counsel is not legally required, but is best practice

Other Attorneys

- Underwriter's Counsel
 - Sometimes prepares the offering document
 - Provides a negative assurance letter to the underwriter regarding the offering document and an opinion that the bonds are exempt from federal securities law registration requirements
 - Cannot also represent the issuer on the same transaction
- Bank Counsel (private placements)
- Developer's Counsel (CFD Bonds, Public Private Partnerships)
- General Counsel to the Issuer or Borrower (i.e. City Attorney, District General Counsel)

Materials

- CDIAC Debt Issuance Primer
<https://www.treasurer.ca.gov/cdiac/debtpubs/primer.pdf>
- League of California Cities Proposition 26 and 218 Implementation Guide
https://www.calcities.org/docs/default-source/city-attorneys/propositions-26-and-218-implementation-guide.pdf?sfvrsn=23fe61f2_3



Questions?

Vanessa S. Legbandt, Shareholder

(949) 725-4073

vlegbandt@stradlinglaw.com

