



# Fundamentals of Bond Issuance

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Presented to  
**Los Angeles Unified School District  
Committee of the Whole**

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# Role of Bond Counsel, Purpose of the Presentation

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- Hawkins Role as Bond Counsel / Role of Disclosure Counsel
- Purpose of this Presentation is to implement the District's Debt Management Policy
- The District's Debt Management Policy provides that:
  - The District shall engage its counsel to provide a seminar at least every five years, which shall be attended by the District's Tax Compliance Officer, representatives of the Chief Financial Officer, the General Counsel and the Chief Facilities Executive and staff members from each office of the District responsible for the expenditure of proceeds of the District's Tax Advantaged Obligations and the District's Disclosure Coordinator, representatives of the Chief Financial Officer and the General Counsel, and members of the District's Board of Education. Such seminar shall include a review of the use of proceeds of Tax-Advantaged Bonds, arbitrage requirements, and recent developments in federal tax law and District's disclosure obligations under applicable securities laws and recent tax and disclosure compliance initiatives.
- This Presentation satisfies this requirement

# Outline

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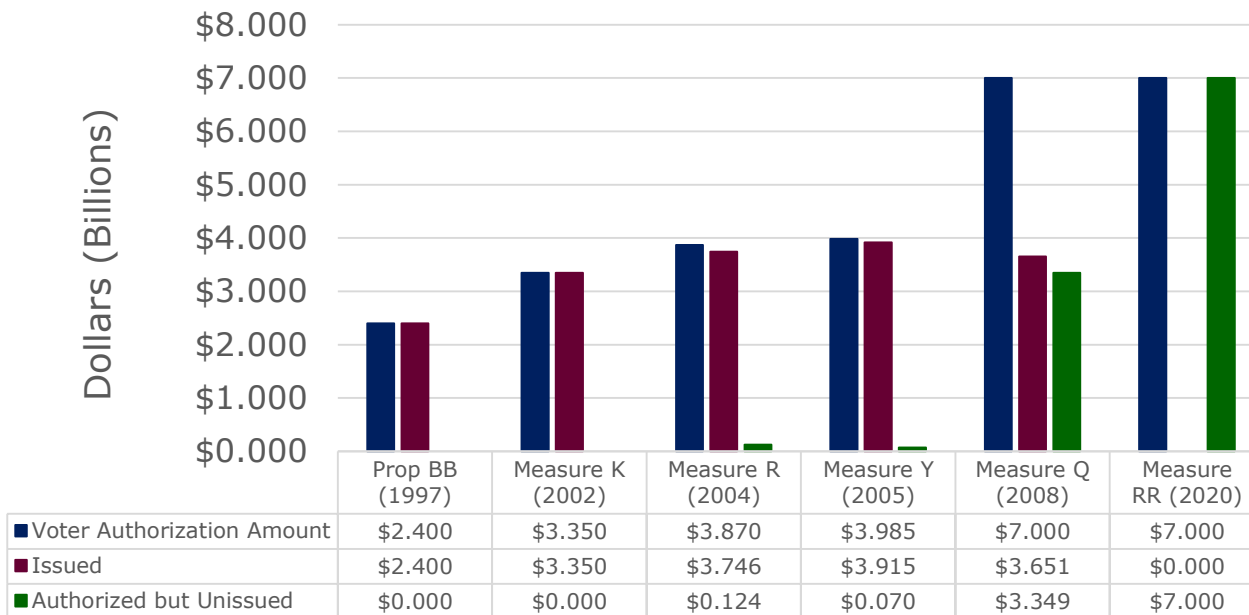
- Types of Debt Issues – See Exhibit A
- General Obligation Bonds
- Capital Projects and Capital Costs
- Required Board Actions
- Federal Securities Law Requirements
- Board Members Responsibilities under Federal Securities Laws
- Federal Tax Law Requirements
- Primary and Secondary Sources – See Exhibit C

# Key Terms

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- Arbitrage
- Rebate
- Private Use
- Official Statement
- Rule 10b-5
- Debt Types:
  - General Obligation Bonds
  - Certificates of Participation
  - Tax and Revenue Anticipation Notes
- Capital Leases
- Use of Bond Premium for New Issue and Refunding Bonds

# LAUSD General Obligation Bond Authorizations



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- Measures K, R, Y, Q, and RR were authorized pursuant to Article XIIIA, Section 1(b)(3) and Article XVI, Section 18(b) and required 55% approval by voters (Constitutional amendments enacted with approval of Proposition 39, the Smaller Classes, Safer Schools and Financial Accountability Act of 2000)

Proceeds may be used “for the construction, reconstruction, rehabilitation, or replacement of school facilities, including the furnishing and equipping of school facilities, or the acquisition or lease of real property for school facilities...”



# Proposition 39: Purpose

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- Prepare our children for the 21st Century
- Make sure children have access to the learning tools of the 21st Century like computers and the internet
- Implement class size reduction
- Ensure that our children learn in a secure and safe environment
- Build and repair dilapidated schools
- Ensure that school districts are accountable for prudent and responsible spending for school facilities

# Capital Projects and Capital Costs

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- Is it a capital project?
  - **Tax law** - does the project have an economic life of one year or more, or is it expected to extend the economic life of the asset by at least one year
  - **Capitalization threshold** - \$5,000 (BUL-1158.2, Accounting for Supplies and Equipment Purchases)
  - **California School Accounting Manual**
    - Estimated Useful Life by Asset Class



# Capital Projects and Capital Costs (cont.)

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- Capital Costs
  - Costs associated with development of capital projects
  - E.g. Software development, training costs
- When is a project “in-service?”
  - IRS: Is the project in use at 90% of capacity?
  - Costs of implementation vs. maintenance
  - Enhancements as separate projects
- Personnel Costs



# Bond Authorizations

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- Bond Proposition Board Resolution
- Voter Approval
- Bond Oversight Committee
- Board Approval for New Money and Refunding Bonds
- Saving Requirements for Current and Advanced Refundings
- County Approval for New Money Bonds
- County Levy of Ad Valorem Property Taxes

# General Obligation Bonds Tax Rate & Bond Amount Limitations

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- Limit on expected tax rate to be collected in a year for each bond measure - **\$60 in taxes per \$100,000 Assessed Value**
- Limit on amount of General Obligation debt the District may have outstanding at time of issuance to 2.5% of assessed value (AV) of taxable property within the District
- Present Assessed Value - \$797,684,010,321

Current Statutory Debt Limit (2.5% of AV)	\$19,692,100,258
Outstanding General Obligation Bonds	\$10,908,345,000
Available Capacity (as of January 1, 2021)	\$8,783,755,258

# Board of Education Members' Responsibilities

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- Following the bankruptcy of Orange County, the SEC issued a report on the financial collapse of Orange County, the investment losses in the County Pool, the Official Statements used in connection with the County's debt and the conduct of the Orange County Board of Supervisors.
- The basic principles regarding Board Members' liability under the federal securities laws are set forth in this 1996 report
- The SEC found that the information disclosed about the County Pool in the Official Statements contained misrepresentations and omissions that were material to the offerings.
- The SEC concluded that the Board of Supervisors adopted the resolutions approving each offering of bonds and other debt "despite their knowledge of facts calling into question the County's ability to repay the securities."

# Board of Education Members' Responsibilities (cont.)

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- The Orange County order stands for the limited principle that if a Board member **knows** of facts that are material to an offering, they have an obligation to **either** read the official statement **or** make sure senior staff and outside professionals are advised of any concerns. The Orange County order does not require that Board members must review and confirm every statement made in the Official Statement. **The scope of responsibility for a Board member, as such, is not coextensive with that of particular public officers (or agents) whose duties are directly related to bond issues.**
- A board member should exercise reasonable diligence to see that any material facts of which the member is aware are either reviewed with top staff officials to determine that such persons are aware of such facts or read the disclosure document to make such determination directly.

# Board of Education Members' Responsibilities (cont.)

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- The SEC's 1996 Orange County Report stated:

In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

# Securities Act of 1933

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## **General**

- The Securities Act requires that investors receive financial and other information about securities being offered for sale to the public
- The Securities Act prohibits deceit, misrepresentations, and fraud in the sale of securities to the public
- Securities Act Amendments of 1975 created the Municipal Securities Rulemaking Board

## **Registration Exemption for “Exempt Securities”**

- Section 5 of the Securities Act imposes a registration requirement for securities – except for exempt securities or exempt transactions
- Section 3(a)(2) of the Securities Act exempts from this registration requirement securities issued by any State or any political subdivision of a State, including the County

## **Antifraud**

- Municipal securities are subject to the antifraud provisions of the Securities Act of 1933

# Securities Act Antifraud

## Provisions:

### Section 17(a) under the 1933 Act

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#### **Section 17(a)**

- It shall be unlawful for any person in the offer or sale of any securities...by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—
  - (1) to employ any device, scheme, or artifice to defraud, or
  - (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
  - (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser
- Legal Standard: Scierter (a mental state embracing intent to deceive, manipulate or defraud) or negligence
  - Recklessness - an extreme departure from the standards of ordinary care - may establish scierter



# Securities Exchange Act of 1934

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## **General**

- Created the SEC
- Established a system of broker-dealer registration and regulation

## **Reporting Requirements for Reporting Companies**

- Section 13(a) requires annual and quarterly reports
- Section 13(b) gives the SEC authority to prescribe accounting standards, recordkeeping rules and rules regarding maintenance of internal controls

## **Municipal Exemption; Antifraud**

- Under Section 12(g)(1) of the 1934 Act, municipal securities are exempt from the (i) registration requirements, (ii) reporting requirements, and (iii) accounting standards, books and records and internal control requirements
- Municipal securities are subject to the antifraud provisions of the 1934 Act

# Exchange Act Antifraud Provisions:

## Section 10(b) & Rule 10b-5 under the 1934 Act

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### **Section 10(b)**

- It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
  - (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered...any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors

# Exchange Act Antifraud Provisions: Section 10(b) & Rule 10b-5 under the 1934 Act (cont.)

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## Rule 10b-5

- It shall be unlawful:
  - To employ any device, scheme, or artifice to defraud,
  - To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
  - To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security

**Rule 10b-5 requires a finding of Scienter (*i.e.*, fraudulent intent or recklessness). Negligence is not a sufficient basis for violating Rule 10b-5.**

# Materiality

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## Materiality

- Case law has established that information is material if there is a “substantial likelihood that, under all the circumstances, the omitted factor would have assumed actual significance in the deliberations of a reasonable [investor]”
- The “reasonable” investor is an objective standard
- For future events, materiality depends upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event
- A misstatement or omission may be material if it affects rating, yield, risk of early redemption, etc., even if it does not present a risk of default
- Confidentiality, business concerns, and political sensitivity are not exceptions to application of disclosure rules

# Disclosure Contexts

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## **Primary disclosure**

- Preliminary and final Official Statements

## **Secondary market disclosure**

- Rule 15c2-12
  - Annual Report
  - Event Disclosure
- Voluntary filings
  - Examples: notices to investors pursuant to bond documents, litigation or enforcement actions, and other event-based disclosures [e.g., COVID related disclosures]

## **Other disclosures “reasonably expected to reach investors”**

- Investor Information Webpage
- Public statements by officials of the Issuer – OMS Bulletin 21
- Certifications relied upon by Bond Counsel for tax exemption analysis

# SEC Action and Private Action: Section 17(a) and Rule 10b-5

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## **SEC Action**

- a materially misleading misstatement or omission
- made or omitted with scienter
- in connection with the purchase or sale of a security

## **Private (Investor) Action**

- In addition to the above requirements, under Rule 10b-5 the plaintiff in a private (investor) action must also prove damages and reliance on misleading disclosure
- No private right of action under Section 17(a)

# SEC Enforcement Powers

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## **Investigations**

- The SEC is authorized to conduct investigations and issue reports under Section 21(a) of the Exchange Act

## **Administrative Proceedings**

- The SEC may initiate administrative proceedings, which usually involve negligence-based charges, and do not require investor loss

## **Criminal Proceedings**

- The securities laws allow for criminal prosecutions for “willful” violations through a referral to the Department of Justice

# SEC Enforcement Powers (cont.)

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- The SEC may seek enforcement actions against:
  - The governmental issuer (*e.g.*, the County, a school district, a city)
  - Individual members of issuer's legislative body (*i.e.*, Board members)
  - Governmental officials and employees
  - Third parties
    - *E.g.*, underwriters, financial advisors, bond counsel, conduit issuers



# Enforcement Lessons:

## No Debt Service Default Necessary for Securities Laws' Violations

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- Misstatements and omissions concerning an issuer's financial condition can be the basis for an enforcement action, regardless of whether such condition would affect negatively the ability of an issuer to pay principal and interest in a timely fashion (*Maricopa County, 1996*)
- Issue is not amount of the dollars but the trend - "the City materially misrepresented its financial condition and results of operations" in that the official statements showed a surplus for FY 1995 of \$0.4 million when there was a deficit of \$9.4 million (*City of Syracuse, 1997*)

# Enforcement Lessons: Documents That May Create Liability

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- Misstatements in Comprehensive Annual Financial Report and transmittal letter that were voluntarily filed (*City of Miami, 2001*)
- Issuer B's offerings that included Issuer A-provided misleading information (*Massachusetts Turnpike Authority, 2003*)
- Documents with materially misleading omissions (Tax Certificate; Loan Agreement) not provided to investors nor reasonably expected to reach investors, but were key to bond counsel's conclusion that conduit issuer's bonds were tax-exempt (*City of South Miami, 2013*)

# Federal Tax Law Requirements

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- Tax-exempt bond rules apply through the maturity date of the bond issue
- Rule: Limited Private Use or Private Loan
- Private use – unrelated trade or business
  - Each issue limited to the lesser of 5% or \$15 million
  - *E.g.*, ownership, leases, management or service contracts
  - Private payment tests - special concern for COPs
- Private Loans
  - Each issue limited to the lesser of 5% or \$5 million

# Federal Tax Law Requirements – Sizing and Maturity Limitations

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- Sizing Limitations
  - Must reasonably expect to spend at least 85% of bond proceeds within 3 years of issuance
  - Program staff provides cash flows to demonstrate
- Must reasonably expect binding contracts for at least 5% of the proceeds within 6 months
- Must spend proceeds only on bond-financeable items (*i.e.*, capital costs; reimbursement of capital costs)
- Must structure the term of the bonds in relation to the useful lives of the assets being funded
  - No more than 120% of the aggregate expected lives of the facilities financed

# Federal Tax Law Requirements – Private Use Limitations

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What is Private Use?

- Use by any person, other than a state or local governmental unit
  - Use by the federal government may be private use
  - Use of property in the same manner that such property may be used by any member of the general public is not private use, *e.g.*, use of highway by trucking company is not private use if such highway is available for use by the general public on the same basis

# Federal Tax Law Requirements – Private Use Limitations (cont.)

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## Application of Private Business Use Limitations

- Limitations apply only when there is both (i) Private Use of bond-financed property, and (ii) such property is either used to secure the payment of debt service, or the District receives, directly or indirectly payments as a result of such Private Use
- When bonds are issued, the District must reasonably expect that the private use rules will be satisfied while the bonds are outstanding
- District must monitor use of bond financed property until the earlier of (i) the end of the useful life of the bond-financed property, and (ii) the latest date that any maturity of the bonds (or any refunding bonds) is retired

# Federal Tax Law Requirements – Private Use Limitations (cont.)

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- Arrangements that may result in Private Use
  - Ownership - Sale of bond-funded property
  - Leases and Permits - Possession of bond financed property
  - Certain Management Contracts
    - Exception for “qualified management contracts”
  - Priority Uses - Right to use property at rates not available to the general public, *e.g.*, discounts for customers of a particular business in a municipal parking garage
  - Control Rights - Right to control use of property; *e.g.*, exclusive right to sell products at bond-financed facility

# Federal Tax Law Requirements –Exceptions to Private Use

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- Exceptions to Private Use
  - Use by state or local government unit
  - Use in the same capacity as members of the general public (e.g., state requirement that District make facilities available to members of the public at generally applicable rates)
  - Temporary use arrangements
    - Term of use (including renewal option not longer than 50 days)
    - Fair market compensation
  - Incidental Uses (limited non-possessory uses, such as vending machines, ATM machines, advertising)
  - Arrangements providing for no rental or other consideration to the District





# EXHIBITS

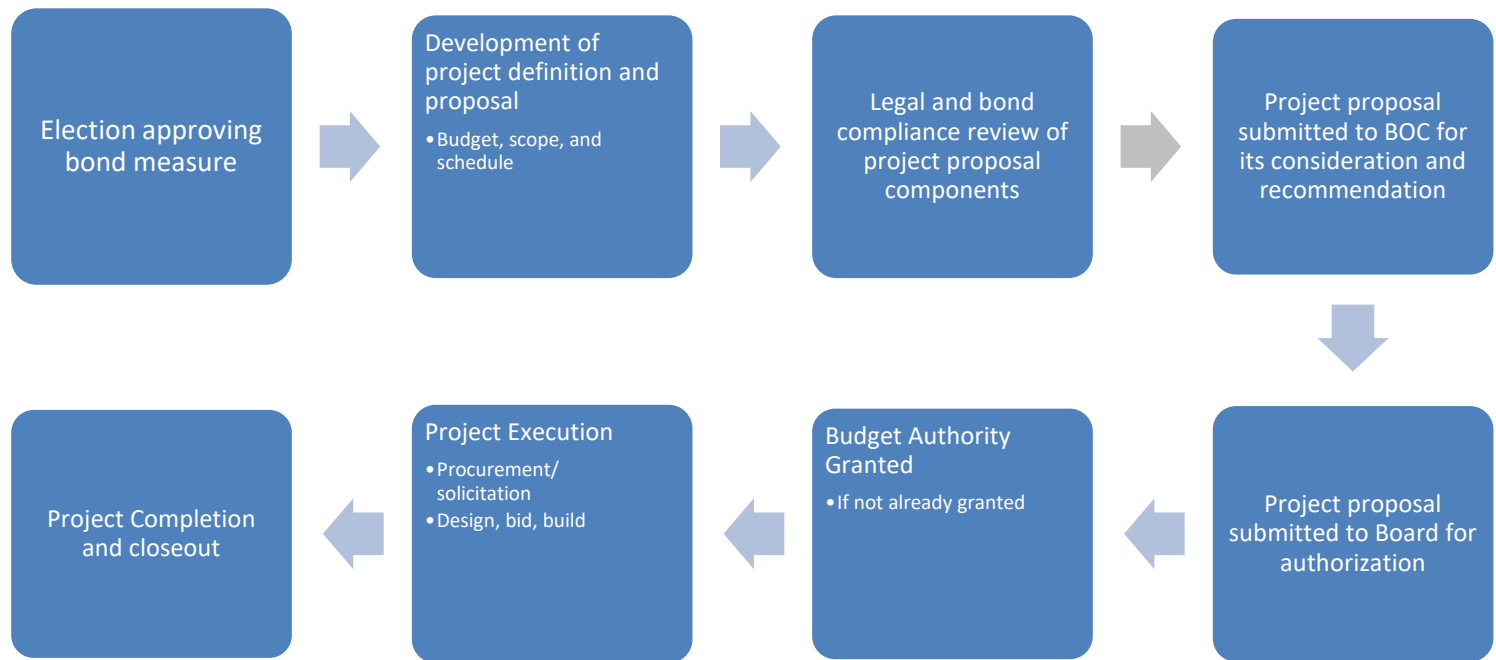
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# Exhibit A - Types of Debt Issues

	General Obligation Bonds ("GO Bonds")	Certificates of Participation ("COPs") / Capital Lease	Tax and Revenue Anticipation Notes ("TRANS")
Voter Approval Required?	Yes	No	No
Source of Repayment	Property taxes levied on district taxpayers	General Fund/ Developer Fees / Cafeteria Fund	General Fund
Statutory Authority	Education Code, Government Code	Education Code	Government Code
What Can Be Financed?	Acquisition and improvement of real property; furnishing and equipping school facilities	Broad array of capital expenditures	Cash flow deficits
Amount Outstanding [as of 6/30/20]	\$10 billion	\$163 million	\$0

# Exhibit B - Process of General Obligation Bond Funding for Capital Projects

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# Exhibit C – Primary and Secondary Resources

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