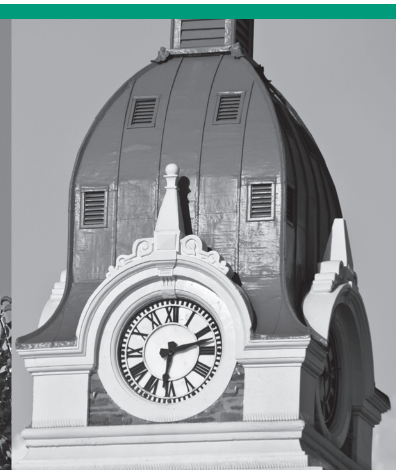
Bond Basics for Towns, Villages and Cities in New York State



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DISCLAIMER: Nothing contained in this booklet should be construed or relied upon as legal advice. Instead, this booklet is intended to serve as an introduction to the general subject of the use of tax-exempt bonds by towns, villages and cities in New York State, from which better informed requests for advice, both legal and financial, can be formulated.

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First Edition

Dedicated to the memory
of
A.T. “Tom” Galloway II

Bond Counsel to Towns, Villages and Cities
Across New York State

1942–2004

Coach, Mentor, Scholar, Friend
and One Funny Guy
We Miss You

Bond Basics for Towns, Villages and Cities in New York State

CHAPTER ONE

Introduction

The borrowing of money for various governmental purposes of a town or village or city in New York State (the "State") is governed predominately by the state constitution and the Local Finance Law, Chapter 33-a of the Consolidated Laws of the State (hereinafter sometimes referred to as the "LFL"). The power to spend the borrowed money to accomplish a valid purpose of the town or village or city, however, generally derives from other laws, in particular, the Town Law, Village Law or the General City Law and particular City Charters. The focus of this booklet is on the restrictions, rules and procedures governing the issuance of debt by towns, villages and cities (other than New York City) in the State. The role of Bond Counsel relates to determination of the validity of debt: valid authorization, valid sale, valid tax and disclosure status, and valid issuance.

The role of Bond Counsel in the issuance of debt by a town or village or city in a nutshell is thus, as follows:

- Determine that the project (an "object or purpose" in LFL terms) is a valid town or village or city purpose under New York State law.
- Determine the useful life of the project as provided by the State Legislature (regardless of what Bond Counsel and/or the town, village or city may know to be different in actual use).
- Determine that any conditions necessary to be completed prior to adoption of a bond resolution have been properly completed (i.e., compliance with the State Environmental Quality Review Act; compliance with town improvement district proceedings if applicable; (note: other than such improvement district matters, town, village or city bond resolutions do not themselves usually require a public hearing; bond counsel frequently drafts the district proceedings, if applicable).
- Draft the text of the bond resolution in accordance with Local Finance Law requirements and confirm valid adoption.
- Draft the text of the Legal Notices of Adoption, if necessary, and of estoppel of the bond resolution to be published after valid adoption and confirm proper publication.

- Draft the documentation necessary to ensure that the sale of bond anticipation notes or bonds is in conformity with requirements of Local Finance Law and the regulations of the Office of the State Comptroller.
- Participate in the production of a disclosure document about the town or village or city and its finances (the official statement) and work with municipality and financial advisor to be sure it is not less than 100% accurate.
- Determine that the sale and award of debt is in conformity with Local Finance Law and the regulations of the Office of the State Comptroller thereunder, and is within the debt limit applicable.
- Draft the actual debt instruments and the requisite closing documentation, including federal tax law and disclosure law covenants and compliance certifications.
- Provide an opinion of Bond Counsel that, in effect, each of the steps described above was completed in conformity with the laws of the State.

To this end, bond counsel are involved early on in planning either a capital project or a cashflow borrowing for operational expenses. From the beginning, the activities of a municipality prior to borrowing may have implications under federal tax laws, federal securities laws, and the local finance law.

Without a "bond counsel opinion" from a reputable, knowledgeable firm, a town or village or city is generally not able to sell its debt because it is that opinion that provides comfort to the purchasers of such debt that it is a valid and binding obligation of the town, village or city to repay the purchaser both the principal loaned and interest thereon.

This booklet should serve as a primer for town, village and city officials and other interested parties on the basic bond rules governing towns and villages and cities (other than New York City) in New York State and the proper functions of bond counsel.

CHAPTER TWO

Constitutional Requirements

Limitations on municipal indebtedness are set forth in Article VIII of the New York State Constitution and are implemented by the Local Finance Law. The provisions of Article VIII are generally applicable to all towns and villages and cities in the State and the obligations authorized by their legislative bodies in their capacity as the finance board. Most local governments, including certain school districts, have a constitutionally established debt limit (and those which do not, have a statutory limit). In addition, there are constitutionally based rules on the loan of town, village or city credit, uses of borrowed monies and the pledge of faith and credit.

Loan of Credit Prohibition

Article VIII, Section 1 of the Constitution provides that no county, city, town, village or school district shall give or loan any money or property to or in aid of any individual or private corporation, association or private undertaking, nor shall any such local governmental unit give or loan its credit to or in aid of any of the foregoing or any public corporation. There are limited exceptions to the general rule that local governmental units cannot give or loan money, property or credit for other than governmental purposes, generally relating to health and welfare facilities. Incidental private benefit is permissible and there is an abundance of case law on its limitations.

Valid Purpose Requirement

Article VIII, Section 2 of the Constitution provides that no county, city, town, village or school district shall contract indebtedness except for a county, city, town, village or school district purpose, respectively. A town, village or city can only borrow money to do things that a town or village or city respectively is permitted to do. No such indebtedness is to be contracted for longer than the period of probable usefulness of the particular purpose which is legislatively determined by the State in every case (or, in the alternative, the weighted average period of probable usefulness of several purposes if financed in the same obligation) for which it is contracted and in no event may this period exceed 40 years.

Pledge of Faith and Credit

Article VIII, Section 2 of the Constitution also provides that each such local governmental unit must pledge its faith and credit and make annual provision for the payment of the principal of and the interest on any of its indebtedness. This is the heart of a "general obligation" bond or note—the ability and promise to tax as necessary to repay the debt. All of the taxable real property within the town, village or city is subject to the levy of ad valorem taxes to pay principal and interest without limitation as to rate or amount. Towns, villages and cities in the State are only authorized to issue general obligation type debt. They cannot issue revenue bonds solely backed by a specific stream of revenue or bonds secured by a mortgage on property or any other type debt instrument, including a simple bank loan. (The sole exceptions to the rule are certain lease-purchase obligations subject to appropriation, including energy performance contracts, which cannot involve the pledge of the faith and credit and, therefore, are not technically debt yet are subject to the same authorization requirements as debt. *See* Chapter 16 herein.)

Except for certain short-term indebtedness contracted in anticipation of the collection of taxes and indebtedness to be paid within one of the two fiscal years immediately succeeding the fiscal year in which such indebtedness was contracted, all indebtedness must be paid in annual installments of principal. Indebtedness must be paid in annual installments commencing not more than two years after the debt was contracted, and no installment may be more than fifty percent (50%) in excess of the smallest prior installment unless the Board provides for and utilizes substantially level or declining annual debt service payments. It is never possible to skip a year in the paydown of borrowed amounts after the first anniversary of the first borrowings.

Annual Appropriation

Provision must be made annually by appropriation by the town, village or city for the payment of interest on all indebtedness and for the amounts required for the amortization and redemption of serial bonds. If at any time the respective appropriating authorities fail to make such appropriations, a sufficient sum must be set apart from the first revenues thereafter received to be applied for debt service and may be so required at the suit of any holder of a debt obligation; however, this latter Constitutional provision does not apply to revenue anticipation notes, tax anticipation notes, or bond anticipation notes, discussed later in the chapter.

Debt Limits

Article VIII, Section 4 of the Constitution provides that no county, city, town or village shall contract indebtedness which, including existing indebtedness, shall exceed seven percent (7%) of the five-year average full valuation of taxable real estate therein. (There are some exceptions to this, most notably cities having 125,000 inhabitants or more (except New York City), nine percent (9%), and any small city school district, five percent (5%). Central and union free school districts are statutorily limited to ten percent (10%).) The average full valuation of taxable real estate of the respective governmental unit is determined pursuant to Article VIII, Section 10 of the State Constitution by taking the assessed valuations of taxable real estate on the last completed assessment roll and the four preceding rolls and applying to such rolls the ratio (as determined by the State Office of Real Property Services) which such assessed valuation bears to the full valuation. Article VIII, Section 5 and Article VIII, Section 2-a of the State Constitution enumerate exclusions and deductions from the Constitutional debt limit. Such exclusions include, for example, self-liquidating debt, indebtedness incurred for water and certain sewer facilities, as well as typical cashflow borrowings hereinafter described.

There are also numerous exclusions and deductions in the debt limit calculations particular to each type of governmental unit. Inasmuch as very, very few, if any, towns, villages or cities ever approach their debt limit, these exclusions and deductions will not be discussed in detail here. Debt issued outside the legal debt limit, absent some specific State authorization, is invalid debt. Invalid debt cannot be repaid because the municipality is without authority to do so. It is an essential part of the specialized role of bond counsel to ensure a borrowing is within a debt limit.

Tax Limits

It is significant that there is no constitutional limitation on the amount that may be raised by a town, village or city by tax upon real property in any fiscal year to pay principal of and interest on its indebtedness. Indeed, the State is specifically precluded from restricting the power of any local government to levy taxes on real property for this purpose in Article VIII, Section 12 of the Constitution. This is the firm basis upon which town, village or city general obligation debt rests that, together with sound fiscal practices and the resultant bond rating, permits a town, village or city to borrow at advantageous tax-exempt interest rates.

CHAPTER THREE

General Implementing Statutory Provisions

Sections 100.00 and 101.00 of the Local Finance Law contain the statutory counterparts of the Article VIII Sections 1 and 2 Constitutional provisions described above. They read simply and clearly:

"§100.00 **Requirement of pledge of faith and credit**

Every municipality, school district and district corporation shall pledge its faith and credit for the payment of all indebtedness contracted by it."

"§101.00 **Giving or loaning of municipal credit and contracting indebtedness other than for municipal purposes prohibited**

a. No municipality, school district or district corporation shall:

1. Give or loan its credit to or in aid of any individual, or public or private corporation or association, or private undertaking, or

2. Contract indebtedness except for the purposes of such municipality, school district or district corporation.

Notwithstanding the foregoing provisions of this paragraph:

1. If any municipality or any county or town on behalf of an improvement district is authorized by a general law or by a special law (a) to provide a supply of water, in excess of its own needs, for sale to any other public corporation or improvement district, (b) to provide facilities, in excess of its own needs, for the conveyance, treatment and disposal of sewage, from any other public corporation or improvement district, or (c) to provide facilities, in excess of its own needs, for drainage purposes from any other public corporation or improvement district, the indebtedness contracted by the municipality for such an object or purpose shall be deemed to be for a county, city, town or village purpose, as the case may be.

2. If any two or more municipalities and county and town improvement districts are authorized by a general law or by a special law (a) to provide for a common supply of water, (b) to provide for the common conveyance, treatment and disposal of sewage or (c) to provide for a common drainage system, the joint indebtedness, or the several indebtedness for a specific proportion of the cost, contracted by the municipality for such an object or purpose shall be deemed to be for a county, city, town or village purpose, as the case may be.

3. If any two or more municipalities and school districts and county and town improvement districts are authorized by a general law or by a special law to join together to provide any municipal facility, service, activity or undertaking which each of such units has the power to provide separately, the joint indebtedness, or the several indebtedness for a specific proportion of the cost, contracted by the municipality or school district for such an object or purpose shall be deemed to be for county, city, town, village or school district purpose, as the case may be."

However, for a town the following are permitted:

a. Advancing to a county or school district, pursuant to law, the amount of unpaid taxes.
b. Giving or loaning its credit when authorized to do so by the State Legislature pursuant to the provisions of Article 18 of the state constitution relating to housing.
c. Paying to a county, such town's share of the state tax levied against such county if such town is required by law to levy and collect such tax.
d. Making such provision for aid, care and support of the needy, including the aid, care and support of neglected and dependent children and of the needy sick, as may be authorized by law.
e. Providing, pursuant to law, for the care, support, maintenance and secular education of inmates of orphan asylums, homes for dependent children or correction institutions and of children placed in family homes by authorized agencies, whether under public or private control.
f. Using town credit when so authorized for:
   1. The examination or inspection of any school or institution of learning wholly or in part under the control or direction of any religious denomination, or in which any denominational tenet or doctrine is taught, or
   2. The transportation of children to and from any school or institution of learning.
g. Increasing, pursuant to law, pension benefits payable to retired members of a police department or fire department or to widows, dependent children or dependent parents of members or retired members of a police department or fire department.
h. Increasing, pursuant to law, the amount of pension of any member of a retirement system of the State, or of a subdivision of the State.
i. Providing, pursuant to law, for the protection by insurance or otherwise against the hazards of unemployment, sickness and old age.
j. Providing, pursuant to law, for the education and support of the blind, the deaf, the mute, the physically handicapped and juvenile delinquents or for health and welfare services for all children.
k. Making loans of money or credit to or in and of any eligible corporation or association for the purpose of providing hospital or other facilities for the prevention, diagnosis or treatment of human disease, pain, injury, disability, deformity or physical condition,

and for facilities incidental or appurtenant thereto, as may be authorized by law pursuant to Section 7 of Article XVII of the State Constitution.

l. Expending or loaning its money, property or credit as consideration for the effectuation of all or part of the public purpose provided for in section eleven-a and thirty-six-a of the private housing finance law.

For a village the following are permitted:

1. Giving or loaning its credit when authorized to do so by the State Legislature pursuant to the provisions of article eighteen of the state constitution relating to housing.
2. Making such provision for aid, care and support of the needy, including the aid, care and support of neglected and dependent children and of the needy sick, as may be authorized by law.
3. Using village credit when so authorized for:

   a. The examination or inspection of any school or institution of learning wholly or in part under the control or direction of any religious denomination, or in which any denominational tenet or doctrine is taught, or

   b. The transportation of children to and from any school or institution of learning.
4. Increasing, pursuant to law, the amount of pension of any member of a retirement system of the state, or of a subdivision of the state.
5. Providing, pursuant to law, for the protection by insurance or otherwise against the hazards of unemployment, sickness and old age.
6. Providing, pursuant to law, for the education and support of the blind, the deaf, the mute, the physically handicapped and juvenile delinquents or for health and welfare services for all children.
7. Making loans of money or credit to or in and of any eligible corporation or association for the purpose of providing hospital or other facilities for the prevention, diagnosis or treatment of human disease, pain, injury, disability, deformity or physical condition, and for facilities incidental or appurtenant thereto, as may be authorized by law pursuant to section seven of article seventeen of the state constitution.
8. Expending or loaning its money, property or credit as consideration for the effectuation of all or part of the public purpose provided for in section eleven-a and thirty-six of the private housing finance law.

For a city, the following are permitted:

a. Advancing to a county or school district, pursuant to law, the amount of unpaid taxes.

b. Paying to a county such county's share of the state tax levied against such county if such city is required by law to levy and collect such tax.

c. Making such provision for aid, care and support of the needy, including the aid, care and support of neglected and dependent children and of the needy sick, as may be authorized by law.
d. Providing, pursuant to law, for the care, support, maintenance and secular education of inmates of orphan asylums, homes for dependent children or correction institutions and of children placed in family homes by authorized agencies, whether under public or private control.
e. Using city credit for
   1. The examination or inspection of any school or institution of learning wholly or in part under the control or direction of any religious denomination, or in which any denominational tenet or doctrine is taught, or
   2. The transportation of children to and from any school or institution of learning.
f. Increasing, pursuant to law, pension benefits payable to retired members of a police department or fire department or to widows, dependent children or dependent parents of members or retired members of a police department or fire department.
g. Increasing, pursuant to law, the amount of pension of any member of a retirement system of the state, or of a subdivision of the state.
h. Providing, pursuant to law, for the protection by insurance or otherwise against the hazards of unemployment, sickness and old age.
i. Providing, pursuant to law, for the education and support of the blind, the deaf, the mute, the physically handicapped and juvenile delinquents or for health and welfare services for all children.
j. Making loans of money or credit to or in and of any eligible corporation or association for the purpose of providing hospital or other facilities for the prevention, diagnosis or treatment of human disease, pain, injury, disability, deformity or physical condition, and for facilities incidental or appurtenant thereto, as may be authorized by law pursuant to section seven of article seventeen of the state constitution.
k. Giving or loaning its credit when authorized to do so by the State Legislature pursuant to the provisions of article eighteen of the State Constitution relating to housing.
l. Expending or loaning its money, property or credit as consideration for the effectuation of all or part of the public purpose provided for in section eleven-a and thirty-six-a of the private housing finance law.

Additionally, Title 8 of the Local Finance Law contains the statutory limitations on the power to contract indebtedness. Section 104.00 limits, in accordance with Article VIII, Section 4 of the Constitution, the ability of local governmental units to contract indebtedness to the respective Constitutional percent of the five-year average full valuation of taxable real estate. The statutory provisions implementing Constitutional provisions authorizing deductions and excluding indebtedness from the debt limits are found in Title 9 and Title 10 of the Local Finance

Law. In addition to the Constitutionally enumerated exclusions and deductions, deductions are also allowed for cash or appropriations for debt service pursuant to the authority of a decision of the New York Court of Appeals, the State's highest court.

Protection of Holders of Local Government Debt in the State

Holders of the debt instruments of local governmental units in the State are the beneficiaries of both Constitutional and statutory protections. The pledge of the faith and credit of the issuer is taken very seriously in the State. There is no known occurrence of an absolute default in the payment of general obligation debt in the State in the past 100 years or more. Rating agencies, insurance companies, bond mutual funds, and banks all know this, which helps to keep the interest rates towns, villages and cities pay on their debt in New York relatively low in comparison to non-general obligation debt.

Contract Remedies

In addition to the Constitutional provisions discussed in Chapter 2, debt holders have additional statutory protections. The General Municipal Law of the State provides that it shall be the duty of the governing board to assess, levy and cause to be collected a sum of money sufficient to pay a final judgment for a sum of money or judgment directing the payment of money which has been recovered against the governmental unit and remains unpaid. The General Municipal Law further provides that the rate of interest to be paid by a municipal corporation upon any judgment against a municipal corporation shall not exceed the rate of nine per centum per annum. This provision might be construed to have application to the holders of local governmental debt, such as town, village and city debt in the event of a default in the payment of principal of and interest. Execution or attachment of town or village or city property cannot be obtained to satisfy a judgment by holders of general obligation indebtedness of any municipality. No one is going to walk off with the municipal office building (even if you wish they would).

The Federal Bankruptcy Code allows public bodies recourse to the protection of a Federal Court for the purpose of adjusting outstanding indebtedness. Section 85.80 of the Local Finance Law contains specific authorization for any municipality in the State to file a petition under any provision of federal bankruptcy law for the composition or adjustment of municipal indebtedness.

At the Extraordinary Session of the State Legislature held in November 1975, legislation was enacted which purported to suspend the right to commence or continue an action in any court to collect or enforce certain short-term obligations of The City of New York. The effect of such act was to create a three-year moratorium on actions to enforce the payment of such obligations. On November 19, 1976, the Court of Appeals, the State's highest court, declared such act to be invalid on the ground that it violates the provisions of the State Constitution requiring a pledge by such City of its faith and credit for the payment of such obligations.

As a result of the Court of Appeals decision, the constitutionality of that portion of

Title 6-A of Article 2 of the Local Finance Law enacted at the 1975 Extraordinary Session of the State Legislature authorizing any city, county, town or village with respect to which the State has declared a financial emergency to petition the State Supreme Court to stay the enforcement against such municipality of any claim for payment relating to any contract, debt or obligation of the municipality during the emergency period, is subject to doubt.

(In the event of a default in the payment of the principal of and/or interest on school district obligations only, the State Comptroller is required to withhold, under certain conditions prescribed by Section 99-b of the State Finance Law, state aid and assistance to the school district and to apply the amount thereof so withheld to the payment of such defaulted principal and/or interest. This requirement constitutes a covenant by the State with the holders from time to time of school district obligations. The provision has always been a comfort to investors and to the credit agencies in rating school district debt in the State. What State Comptroller Arthur Levitt said in 1957—"No bondholder has ever lost a penny through default of any bond issued by a New York State school district"—is as true today as it was over 50 years ago, and it is equally applicable to towns, villages and cities even without this aid intercept mechanism.)

CHAPTER FOUR

Anatomy of a Bond Resolution and Its Adoption

In general, the State Legislature has, by the enactment of the Local Finance Law, authorized the power and procedure for each type of municipality and school district in the State to borrow and incur indebtedness, subject, of course, to the constraining constitutional and statutory provisions set forth previously.

Bond Resolutions

Pursuant to the provisions of the Local Finance Law, towns, villages and cities authorize the issuance of bonds to finance a capital project, a judgment or other valid purpose, known as an "object or purpose" therein, by the adoption of a bond resolution. Bond resolutions are usually drafted by specialized counsel known as bond counsel who will ultimately opine as to the validity of any debt issued thereunder as well as the tax-exempt status of its interest. A bond resolution is approved by a supermajority vote of two-thirds of the voting strength of the members of the Town Board or Village Board of Trustees or City Council or Common Council (each, the respective "Board"), acting as the finance board. Voting strength means the total membership of the board, not simply those board members present at the meeting. Customarily, a finance board delegates to the chief fiscal officer, the Town Supervisor or the Village or City Treasurer (occasionally City Comptroller or Controller), the power to authorize and sell bond anticipation notes in anticipation of authorized bonds, as well as the bonds themselves pursuant to Section 56.00 of the Local Finance Law.

The delegation of the power and duties to sell and issue debt to the chief fiscal officer ("CFO") does not remove the Board from the transaction completely: Sections 20.00 and 163.00 of the Local Finance Law provide that the CFO must file a certificate with the Board upon sale and issuance providing all of the terms and conditions thereof. In addition, a Board holds the power to either limit the delegation of authority or elect to reassume the same pursuant to Section 56.00 of the Local Finance Law. This is rarely, if ever, utilized, as the sale of debt is customarily subject to market conditions requiring very prompt action.

Once delegated to the CFO, Section 160.10 of the Local Finance Law permits the chief fiscal officer to make a further delegation to a deputy of any delegated powers.

Each bond resolution authorizes the construction, reconstruction, acquisition, installation and/or undertaking of an "object or purpose" to be financed, sets forth the plan of financing, and specifies the maximum maturity of the bonds subject to the legal (Constitution, Local Finance Law and case law) restrictions relating to the period of probable usefulness with respect thereto. Historically, towns, villages and cities have authorized bonds for a variety of objects or purposes within the Constitutional constraints noted above, typically including building construction and reconstruction, park facilities, roads, bridges, storm drainage works, acquisition of land, equipment, machinery and vehicles. It is also possible to authorize bonds to pay certain so-called "working capital expenditures," such as judgments, settled claims and tax certiorari expenditures. Debt issuance for these particular items requires special attention by bond counsel's tax department.

A town, a village or a city may adopt one or more bond resolutions authorizing the issuance of bonds for a specific object or purpose, for which object or purpose serial bonds may be issued. In addition thereto, a town, village or city may adopt one or more bond resolutions authorizing the issuance of bonds for any class of objects or purposes, for which objects or purposes serial bonds are to be issued.

The issuance of bonds for two or more specific objects or purposes or two or more classes of objects or purposes may be authorized by the same bond resolution, notwithstanding the fact that such specific objects or purposes or classes of objects or purposes are described in separate subdivisions of paragraph a of Section 11.00 of the Local Finance Law, provided:

1. The maximum period of probable usefulness is five years or less, or
2. The bond resolution is not subject to either mandatory or permissive referendum, which it is generally in the case for towns and villages (but rarely are there bond referendum provisions in cities).

Proceeds of a borrowing pursuant to a bond resolution may never be legally used for any other purpose than that described in the bond resolution. Once borrowed, no reallocation to some other purpose is permissible; the only permissible use of such borrowed proceeds, if not used for the project as described, is to pay down debt service on the debt obligation under which the money was borrowed.

The requisite elements to every bond resolution, discussed below, are based on the few basic Constitutional principles and limitations described previously.

Elements of a Bond Resolution

What does a bond resolution do? The function of any bond resolution is, in essence, to authorize the financing of a valid object or purpose. A bond resolution has several essential components: (The example is of a town but a village or city bond resolution would usually be no different as to the essential components).

a. **accurate description of the item(s) or improvement(s) to be financed. Here is a typical example:**

   Section 1. The reconstruction of roads in and for the Town of Duke, New York, including incidental improvements and expenses in connection therewith, is hereby authorized at a maximum estimated cost of $___________.

b. **statement as to whether the item or improvement is a specific object or purpose or a class of objects or purposes. Here is a typical example:**

Section 2. It is hereby determined that the plan for the financing of said class of objects or purposes is as follows:

c. **statement of maximum estimated cost of the project; the "hard costs" of a capital project may have added to them such "soft costs" as those for planning, public hearings, environmental impact review, title fees, interest during construction, and, yes, attorneys fees. Here is a typical example:**

Section 1. The reconstruction of roads in and for the Town of Duke, New York, including incidental improvements and expenses in connection therewith, is hereby authorized at a maximum estimated cost of $___________.

d. **plan of financing of the cost, i.e., how much to be financed, how much cash is to be used, if any, sources of cash contribution to estimated cost. Here is a typical example:**

Section 2. It is hereby determined that the plan for the financing of said class of objects or purposes is as follows:

(a) by the issuance of the $_________ serial bonds hereby authorized to be issued pursuant to the provisions of the Local Finance Law; and

(b) by the expenditure of $_________ grant-in-aid monies to be received from the State of New York, which monies are hereby appropriated therefor.

e. **statement of the period of probable usefulness of the capital project and the maximum maturity of the bonds authorized. Here is a typical example:**

Section 3. It is hereby determined that the period of probable usefulness of the aforesaid class of objects or purposes is 15 years, pursuant to subdivision 20(c) of paragraph a of Section 11.00 of the Local Finance Law. It is hereby further determined that the maximum maturity of the serial bonds herein authorized will exceed five years.

f. **delegation of authority to the chief fiscal officer, to arrange for the financing by bonds and/or bond anticipation notes as well as renewals of said notes (this is not mandatory but is customary to permit prompt activity when needed). Here is a typical example:**

Section 4. Subject to the provisions of the Local Finance Law, the power to authorize the issuance of and to sell bond anticipation notes in anticipation of the issuance and sale of the serial bonds herein authorized, including renewals of such notes, is hereby delegated to the

Supervisor, the chief fiscal officer. Such notes shall be of such terms, form and contents, and shall be sold in such manner, as may be prescribed by said Supervisor, consistent with the provisions of the Local Finance Law.

Section 5. All other matters, except as provided herein relating to such bonds including determining whether to issue such bonds having substantially level or declining annual debt service and all matters related thereto, prescribing whether manual or facsimile signatures shall appear on said bonds, prescribing the method for the recording of ownership of said bonds, appointing the fiscal agent or agents for said bonds, providing for the printing and delivery of said bonds (and if said bonds are to be executed in the name of the Town by the facsimile signature of the Supervisor, providing for the manual countersignature of a fiscal agent or of a designated official of the Town), the date, denominations, maturities and interest payment dates, place or places of payment, and also including the consolidation with other issues, shall be determined by the Supervisor. It is hereby determined that it is to the financial advantage of the Town not to impose and collect from registered owners of such serial bonds any charges for mailing, shipping and insuring bonds transferred or exchanged by the fiscal agent, and, accordingly, pursuant to paragraph c of Section 70.00 of the Local Finance Law, no such charges shall be so collected by the fiscal agent. Such bonds shall contain substantially the recital of validity clause provided for in Section 52.00 of the Local Finance Law and shall otherwise be in such form and contain such recitals in addition to those required by Section 52.00 of the Local Finance Law, as the Supervisor shall determine.

Section 6. Such bonds shall be in fully registered form and shall be signed in the name of the Town of Duke, New York, by the manual or facsimile signature of the Supervisor, and a facsimile of its corporate seal shall be imprinted or impressed thereon and may be attested by the manual or facsimile signature of the Town Clerk.

Some Additional Provisions For State Revolving Fund/EFC /Rural Development (USDA) eligible transactions:
1). All other matters except as provided herein relating to the serial bonds herein authorized including the date, denominations, maturities and interest payment dates, within the limitations prescribed herein and the manner of execution of the same, including the consolidation with other issues, ability to sell to the United States Department of Agriculture and/or the New York State Environmental Facilities Corporation, and also the ability to issue serial bonds with substantially level or declining annual debt service, shall be determined by the Supervisor, the chief fiscal officer of such Town. Such bonds shall contain substantially the recital of validity clause provided for in Section 52.00 of the Local Finance Law, and shall otherwise be in such form and contain such recitals, in addition to those required by Section 51.00 of the Local Finance Law, as the Supervisor shall determine consistent with the provisions of the Local Finance Law.

2). The Supervisor is hereby further authorized, at his or her sole discretion, to execute a project finance agreement, and any other agreements with the New York State Department of Environmental Conservation and/or the New York State Environmental Facilities Corporation, including amendments thereto, and including any instruments (or amendments thereto) in the effectuation thereof, in order to effect the financing or refinancing of the specific object or purpose described in Section 1 hereof, or a portion thereof, by a bond, and/or note issue of said Town in the event of the sale of same to the New York State Environmental Facilities Corporation.

3). The power to issue and sell notes to the New York State Environmental Facilities corporation pursuant to Section 169.00 of the Local Finance Law is hereby delegated to the Supervisor. Such notes shall be of such terms, form and contents as may be prescribed by said Supervisor consistent with the provisions of the Local Finance Law.

g. pledge of the full faith and credit of the town or village or city to pay any such obligations by using its unlimited taxing power (the "general obligation" pledge). Here is a typical example:

Section 7. The faith and credit of said Town of Duke, New York, are hereby irrevocably pledged for the payment of the principal of and interest on such bonds as the same respectively become due and payable. An annual appropriation shall be made in each year sufficient to pay the principal of and interest on such bonds becoming due and payable in such year. There shall annually be levied on all the taxable real property of said Town a tax sufficient to pay the principal of and interest on such bonds as the same become due and payable.

h. a reimbursement authorization. Here is a typical example:

Section 8. This resolution shall constitute a statement of official intent for purposes of Treasury Regulations Section 1.150 - 2. Other than as specified in this resolution, no monies are, or are reasonably expected to be, reserved, allocated on a long-term basis, or otherwise set aside with respect to the permanent funding of the object or purpose described herein.

i. an estoppel clause. Here is a typical example:

Section 9. The validity of such bonds and bond anticipation notes may be contested only if:

1) Such obligations are authorized for an object or purpose for which said Town is not authorized to expend money, or

2) The provisions of law which should be complied with at the date of publication of this resolution are not substantially complied with, and

an action, suit or proceeding contesting such validity is commenced within 20 days after the date of such publication, or

3) Such obligations are authorized in violation of the provisions of the Constitution.

and

j. a directive to the clerk to publish the estoppel notice described in Chapter 7. Here is a typical example:

Section 10. This resolution, which takes effect immediately, shall be published in full in *The Early Earl Gazette* and the *Southern Duke News,* the official newspapers of said Town, together with a notice of the Town Clerk in substantially the form provided in Section 81.00 of the Local Finance Law.

Temporary Advances of Non-Borrowed Monies/Bond Resolutions for Planning

Temporary advances of other available monies for a project prior to authorization of financing can be a problem.

Bond resolutions to authorize the financing of the cost of planning for a future capital improvement deserve special comment. While preliminary costs, such as the fees of architects, surveys, planners, and environmental analysis, may be rolled into and included in the authorization for borrowing of the capital improvement, there are times when the latter cost cannot be determined until some of the initial costs are incurred. Section 165.10 of the Local Finance Law does not permit reimbursement of those, or any costs, paid temporarily with other available funds, unless a valid bond resolution is in place at the time of expenditure. (There is a similar rule under federal tax law governing tax-exempt obligations—this is the reason for item "(h)" above). This dilemma can be resolved in one of two ways: (a) adoption of a bond resolution with a somewhat high estimate of the ultimate total cost, including initial planning, or (b) adoption of a bond resolution just for the initial planning costs. There is, however, a trap for the unwary in adoption of a bond resolution only for planning costs. Section 99-d of the General Municipal Law provides that where a board has authorized debt issuance for planning costs, authorization for the undertaking of the actual improvement itself cannot occur during the one-year period after such debt is issued. (Section 99-d also places a limit on the aggregate amount of stand-alone advance planning financings a municipality can authorize in any fiscal year. That ceiling is generally 5% of the "amount of the annual budget.")

The continued purpose for this rule in the planning context is unclear in an era when construction projects typically move more quickly than that. Legislation could be introduced to eliminate this unnecessary restriction, which is observed more in the breach in any event.

If a bond resolution for planning costs is adopted, however, the period of probable usefulness for same is five years; however, upon adoption of the later bond resolution for the hard costs, and assuming five years have not elapsed, the period of probable usefulness of the planning can be extended to the full period of probable usefulness for the capital improvement in the later bond resolution. One consequence of this to note: the maximum maturity for debt issued for any aspect of the project, hard or soft, now is determined to have begun running from the first borrowing for planning, if borrowing occurred rather than a temporary advance of available monies. This can be significant in large projects with extended planning periods for this reason—if the period of probable usefulness, for example, of reconstruction of a building is 20 years, but planning financing was separately authorized, and utilized over a two-year period prior to construction, the cost of the building itself must now be paid off over 18 years, rather than 20, increasing the annual debt service burden on the taxpayers.

A possible, but not altogether satisfactory, solution to the problem may be as follows: a municipality could temporarily advance (pursuant to Section 165.10 of the Local Finance Law, after the adoption of a bond resolution for the total cost) moneys from the general fund for the advance planning without issuing obligations under the bond resolution at that time; when obligations were issued pursuant to the bond resolution, the municipality could then use the proceeds of the obligations issued pursuant to that bond resolution to repay the general fund.

In addition to planning costs, in any case in which the municipality intends to reimburse itself from borrowed proceeds for monies temporarily advanced for any aspect of any capital project, the adoption of a bond resolution is necessary *prior to the advance*.

Additional Money Bond Resolutions / Phased Projects

There are times when the bid cost of a capital project comes in higher than that authorized in the bond resolution. What to do? A special form of bond resolution known as an "additional money" bond resolution may be adopted if it is desired by the town or village Board to finance the increased cost. Such a resolution does not amend the existing bond resolution (if monies have already been borrowed under it); rather, it supplements the existing bond resolution and the new plan of financing refers the prior bond resolution. It is subject to all the same rules as other bond resolutions and the period of probable usefulness ("PPU") for the additional costs runs from the first borrowing under the existing bond resolution. Compare this with providing funding for phases of a single large capital project: some projects, generally large ones, have separate construction phases and it is possible to authorize the financing one phase at a time especially as the cost of later phases may be dependent on how the earlier phase(s) work out. Note that this method of authorization can put larger projects at risk mid-construction if later bond authorizations fail to get the requisite legislative approval.

Bond Resolutions and Contingencies to Utilization

Bond resolutions generally cannot include contingencies to their utilization. (However, adoption of a bond resolution does not require that it ever be utilized in whole or in part.) Why? Because the lenders to a municipality, and bond counsel, need surety that the bond resolution is valid. A built-in contingency would impinge on the certainty of valid adoption. In short, bond counsel could not opine in the required "unqualified opinion" that the debt was valid without following up on a contingency and obtaining certified satisfaction that the contingency was met. Reasonable people could differ as to whether the contingency had, in fact, been met. Hence, contingencies are not found in bond resolutions. The only exception to this rule is that pertaining to grants and loans and the determination not to borrow long term to the extent such funds are received.

Repeal of a Bond Resolution

Section 41.00 of the Local Finance Law governs the repeal of all or a portion of a bond resolution. In relevant part, this reads:

"§41.00 Repeal of unexpended authorizations

a. The finance board of:

1. Any municipality may at any time, by resolution, repeal or revoke in whole or in part (a) any resolution heretofore or hereafter adopted authorizing the issuance of obligations, and (b) any certificate of a chief fiscal officer authorizing the issuance of obligations, dated on or after the effective date of this chapter . . . except to the extent that any indebtedness shall already have been contracted or encumbrances made thereunder for the object or purpose for which such resolution or certificate authorizes the issuance of obligations . . . .

b. Any resolution heretofore or hereafter adopted authorizing the issuance of obligations, or any certificate of a chief fiscal officer authorizing the issuance of obligations, dated on or after the effective date of this chapter, unless repealed or revoked at a prior date in the manner provided in paragraph a of this section, shall be deemed to be repealed ten years after the date it becomes effective, except to the extent that any indebtedness shall already have been contracted or encumbrances made thereunder for the object or purpose for which such resolution or certificate authorizes the issuance of obligations."

This latter provision is to ensure that such unexpended authorizations will not unnecessarily swell the authorized but unissued indebtedness disclosure in an official statement and other reports.

CHAPTER FIVE

Certain Legal Elements of a Financed Capital Project

Periods of Probable Usefulness

Every capital project to be financeable must have a legally set PPU which establishes a maximum maturity date for any debt issued for that project. Paragraph a of Section 11.00 of the Local Finance Law assigns periods of probable usefulness to those improvements and other objects or purposes that the State Legislature has determined can have a PPU; without a PPU set forth in this section (or otherwise, in for example, special legislation), a project is not considered capital and therefore no capital debt can be issued for such projects. As Section 10.00 of the LFL states:

> "**§ 10.00 Power of municipalities, school districts and district corporations to contract indebtedness.**
>
> . . . a municipality, school district or district corporation shall have the power to contract indebtedness respectively for any municipal, school district or district corporation object or purpose set forth in paragraph a of section 11.00 of this title, or for a class of such objects or purposes when authorized under the provisions of section 31.00 of this article, if it is authorized by law to expend money for or to accomplish such object or purpose; provided, however, that it shall not be able to contract indebtedness to a greater extent than it is authorized by law to spend money for such object or purpose or class of such objects or purposes and provided also that this section shall not relieve any such unit of government of any duty imposed by law to include in its annual budget or tax levy or otherwise to pay from current funds all or part of any expenditure that it may make for such object or purpose or class of such objects or purposes."

Typical periods of probable usefulness are, for example, 5 years for buses; 5, 10 or 15 years for various items of public works or maintenance type equipment (depending on cost); 20 to 30 years for building construction, expansion or reconstruction, depending on the materials utilized; 30 years for land acquisition; and 40 years for water and sewer projects. The Board may prescribe a serial bond maturity period for any number of years equal to or less than the PPU (but never greater than the legally prescribed PPU). The PPU establishes the maximum maturity for any borrowing or series of borrowings for a project; it does not mandate that the maximum be utilized (but it does provide the greatest flexibility over time). A Board is always able to limit the maximum maturity in the bond resolution or a borrower is always able to voluntarily effect the payoff of its debt over a shorter period, if preferable. It is also true that there is not generally a public market for local governmental debt that has a final maturity beyond the 25–30 year range.

The maximum maturity date of any borrowing or series of borrowings for a single capital project is thus set with the initial borrowing for that project because it is from that date that the period of probable usefulness is calculated. If, for example, a town or a village or a city borrows to construct a new building with a PPU of 25 years by issuance of a one-year bond anticipation note ("BAN") to obtain funds during construction, and then, the following year, refinances that BAN with a serial bond issue, the final maturity of that bond issue cannot exceed 24 years, taking into account that there has already been debt (the BAN) outstanding for one year. Likewise, on a larger, multiyear project, multiple new-money borrowings during construction (commonly known as "series") all have the running of their maximum maturity tied to the date of the very first borrowing. Each series is not entitled to the full PPU as if it were the first borrowing—rather the first borrowing has already established the longest maturity date for any debt issued for that particular capital project. (Needless to say, however, a related but different capital project, which is not additional, increased costs of the same project, would have its own full PPU.)

Specific Object or Purpose or Classes of Objects or Purposes

A bond resolution can authorize a specific object(s) or purpose(s) or a class (or classes) of objects or purposes. If the Board, for example, specifies an exact number of vehicles it plans to acquire, that is "specific" and the cost of each particular vehicle is specific and must be specified; if it authorizes the acquisition of "vehicles," that is a "class" with a single aggregate cost. What is the difference? If a specific number of vehicles is authorized, that is what must be acquired each at no more than the specified cost; if it turns out the amount of dollars authorized is insufficient for any particular vehicle, this is a problem. Even if the aggregate authorization would cover the insufficiency for that vehicle, there is no authority to move authorization from a vehicle that turned out to be less costly to one that turned out to be more costly. If, however, a class is authorized, i.e., "acquisition of vehicles," then greater flexibility ensues. Some flexibility is generally preferable for just this reason. While such problems are rare, they can be quite embarrassing. Issues can arise particularly in bond resolutions for multi-facility building projects when the cost of work at one building comes in high while another comes in lower than expected. There is thus an art to the drafting of bond resolutions.

The LFL provides this guidance of definitions of "specific" and "class":

> "The term "specific" as applied to the terms "object or purpose", "capital improvement" or "equipment" shall mean a single item, or a specified number of items, the description of which is contained in a single subdivision of paragraph a of section 11.00 of this chapter."
>
> "The term "class," as applied to the terms "objects or purposes", "capital improvements" or "equipment", shall mean an unspecified number of items, the description of which is contained in a single subdivision, other than subdivision thirty-five of paragraph a of section 11.00 of this chapter, notwithstanding the fact that such subdivision may be drafted in the singular number."

and then permits either to be used in drafting a bond resolution:

> "Any municipality, school district or district corporation may adopt one or more bond resolutions. . . authorizing the issuance of bonds . . . for a special object or purpose, for which object or purpose serial bonds may be issued. In addition thereto any municipality or school district may adopt one or more bond resolutions . . . authorizing the issuance of bonds . . . for any class of objects or purposes, for which objects or purposes serial bonds may be issued."

Policing a Class of Objects or Purposes

One may well ask, if a capital project is described generally, as a class of objects or purposes, i.e., reconstruction of municipal buildings, how can one know which particular facilities under consideration before the Board at the time of adoption are those intended to receive the funding (and therefore required to receive the funding)? The answer is actually quite simple: the record of adoption by the Board includes the written departmental requests for financing as well as the record of debate at adoption. These form the "legislative history" of the bond resolution adoption and provide the road map to legislative intent as to the use of the borrowed proceeds.

In the case of grant-aided projects within a class, by the terms of the grant they are usually the only legal recipients of the aid portion of the cost of that project.

A chief fiscal officer, in any event, has no power to increase or decrease appropriation or enter into contract beyond the scope of authority. That power is vested only in the legislative body. No delegation of this power is permissible.

Further Aggregation of Items

In addition to the determination of whether a capital project is a specific object or purpose or a class of objects or purposes, it may also be possible for a Board to aggregate multiple *related* elements of a single capital project under one of the "super-PPUs" established by the State Legislature for projects with a common PPU of 5, 10, 15, 20, 25, 30, 35, or 40 years. This would be most useful in circumstances in which the exact costs of certain related components of a capital program are not known at the time of adoption of the bond resolution. If the dollar cost of each component is not yet known, these components of a program can share a common PPU as long as it does not exceed the maximum permitted PPU of any one of the components, one element of a single project has a 15-year PPU and a second element has a 10-year PPU, a combined 10-year PPU (the lowest common denominator) could possibly be used for the aggregated costs of both. The concept of relatedness is important: if one element of the project cannot function for its intended use without the other element(s), such that a permissive referendum on each separately could both be problematical and not properly present the project in question to the taxpayer, then it would seem safe to consider the element related.

A typical context for use of a super-PPU is the acquisition of a parcel of land and the building thereon. Land has a 30-year PPU, and a building acquisition can have a 30-year PPU if it is a fireproof building. Neither the seller nor the municipality may know a reasonable allocation of the cost of the purchase price to the land and to the building—since they both have a 30-year PPU, it may be possible to combine them in one aggregate cost.

While there is some uncertainty about the proper use of super-PPUs, they are in use throughout the State, at least in the case of related improvements for bond resolutions not subject to permissive or mandatory referendum. Arguably, this modality could not be used in a town or village, as most bond resolutions are for projects whose useful life exceeds five (5) years and these are generally subject to permissive referendum (except assessable improvements). However, for "related" project elements, it generally is.

> Section 32.00 (4) provides that a bond resolution includes:
>
> "4. A determination of the period or periods of probable usefulness of the specific object or purpose or class of objects or purposes for which such bonds . . . are to be issued, if such determination is made by the finance board. However, if bonds are to be used for a class of objects or purposes for which more than one period of probable usefulness is prescribed pursuant to section 11.00 of this chapter and if the determination of the period of probable usefulness therefore is to be made by the finance board, the bond resolution authorizing the issuance of such bonds shall
>
> "(a) Specify the kind of specific object or purpose within such class to which the proceeds of such bonds are to be applied and the appropriate period of probable usefulness therefore, or
>
> "(b) Specify as the period of probable usefulness of such class the lowest period of probable usefulness assigned thereto."

This is the basis for the super-PPUs.

Maximum Estimated Cost

The maximum estimated cost of a capital project stated in a bond resolution is intended to be just that and nothing more or less. It is self-evident that how the scope of a project is described will expand or limit its maximum estimated cost. For example, a capital project with multiple sources of funds, only one of which is the local share, could be described in one of two ways:

a. To pay the municipality's share of the cost of construction of a new highway barn (the "Local Share Model" or "net funding")
b. To pay the cost of construction of a new municipal highway barn (the "Full Cost Model" or "gross funding").

The Local Share Model focuses on the local share only. Thus it does not allow for a town or village or city to "gross fund" a capital project with federal and/or state grants-in-aid, i.e., temporarily borrow on short-term bond anticipation notes (but not bonds) until the grant monies arrive. Since many grants require a temporary local advance of the grant portion, as well as a truly local share, this Local Share Model of the bond resolution would not work in those cases. A Full Cost Model of bond resolution will state the total maximum estimated cost and then provide in the plan of financing (described below) for the various sources of funding. As such, it can include (or not) borrowing authority for the grant portion, and that borrowing authority can be limited to bond anticipation notes. This proviso looks like this in a bond resolution:

> *Section 2.* It is hereby determined that the plan for the financing of the aforesaid specific object or purpose is by the issuance of $4,459,150 serial bonds of said Town hereby authorized to be issued therefor pursuant to the provisions of the Local Finance Law; **PROVIDED, HOWEVER,** that to the extent that any Federal or State grants-in-aid are received for such specific object or purpose, the amount of bonds to be issued pursuant to this resolution shall be reduced dollar for dollar.

Regardless of which model is used, keep in mind that a maximum estimated cost for a plan of financing is a maximum ESTIMATED cost. As provided in Section 32.00 (2) of the LFL:

> ". . . Such financial plan, by virtue of its inclusion in such resolution, shall not be deemed binding upon such municipality, school district or district corporation."

In other words, the maximum estimated cost may change at some point after adoption of the bond resolution. That will require amendment of some capital plan and project authorization proceedings, but it will *not* require amendments or supplementation of the bond resolution *unless* the additional costs are to be financed. Furthermore, reduced costs which will result in reduced borrowings do not require amendment of a bond resolution, but repeal of unused authorizations is recommended periodically.

Plan of Financing

As discussed above, the scope of a capital project can be described in a bond resolution as the local share or the entire cost. In either event, a bond resolution must contain a plan of financing paragraph that sets forth the source(s) of funding for the capital project as described. Again, Section 32.00 (2) of the LFL clarifies that changes to the plan do not require amendment or supplementation of a bond resolution unless there are additional costs to be financed. In such circumstances, a bond resolution specifically to cover the additional costs is the recommended course. Such an additional money bond resolution references the prior bond resolution in the plan of finance and with regard to the beginning date for calculating the maximum maturity under the shared PPU.

Some Peculiar PPU Rules

Some peculiar rules in the Local Finance Law about certain financeable and non-financeable items:

1. There is a PPU for replacement vehicles but not for fleet expansion of automobiles (but new "equipment" that is not a replacement is okay).
2. There is no PPU for helicopters or airplanes.
3. The useful life of new buildings depends on what they are made of.

4. The useful life for building reconstruction/additions depends on what it is made of.
5. Road resurfacing has a different useful life than parking lot resurfacing.
6. An SUV-type vehicle could have the useful life of a passenger vehicle or of equipment for maintenance, depending on its projected use.
7. Repairs are not financeable, but reconstruction is.
8. The cost of a piece of public works-type equipment will determine its useful life.
9. Replacing a general telephone system, including Web-based telephone, has no specific PPU, but a "911" system or a police or fire telephone system does. (A general five-year equipment subdivision may be used).
10. HVAC and electrical, plumbing and lighting work has one useful life if done as a stand-alone project and a longer useful life if it is part of, or involves, "reconstruction."
11. Judgments, settled claims, tax certiorari payments and, in some years, snow removal, and certain retirement incentive programs, all have PPUs, but funding other post-employment benefits like health insurance, does not.
12. Land has useful life of 30 years. (What happens to it after that?)
13. There is a PPU for cleaning hazardous waste sites, in Utica, Buffalo and Rochester, but not for anywhere else.
14. There is a PPU for underground fuel tanks but not for aboveground fuel tanks. Not very green.
15. If you can get an "expert" to certify as to the useful life of something not listed in Section 11.00 of the LFL, it is financeable for that period of time (or less).
16. A capital project with a PPU can include incidental expenses. What is "incidental" may be in the eye of the beholder, but it should be reasonable. (Really!)
17. Computer equipment for financial management and accounting has its own PPUs for hardware and software, but no other computer equipment has a specified useful life (must use generic equipment category for it).
18. Garbage trucks technically do not have a specified useful life (but if used for snow removal or are considered equipment used for "maintenance" purposes, they can qualify).
19. Demolition of privately owned structures (public health safety welfare problem) and demolition of municipally owned structures (public health safety welfare problem or without value) have different PPUs.
20. Books (and e-books) do not have a useful life. (There are Bibles in the British Library that are over 500 years old.)

Some of this seem illogical? It is. On the other hand, not having a PPU for acquisition of a pilot-less drone missile system is probably for the best in some municipalities. Bottom Line: PPUs are an art not a science, but it is not worth it to push the limits.

CHAPTER SIX

Certain Procedural Rules Regarding Adoption of Bond Resolutions

Towns and Villages

The steps to be taken prior to and subsequent to adoption of a bond resolution depend on the type of capital project for which the town or village is authorizing the debt. In all cases, however, the first step is compliance with the State Environmental Quality Review Act ("SEQRA") and the regulations promulgated thereunder. One of the easiest ways for an opponent of a project to challenge it is for failure to comply properly with SEQRA. The bond resolution itself should specify the previously determined status under SEQRA of the capital project whose financing is authorized by it. Each pre- or post-bond resolution step should likewise state SEQRA status.

The next step in the case of financing of assessable improvements to be authorized for an existing or to-be-established town improvement district is to complete the series of proceedings required pursuant to Articles 12, 12-A or 12-C of the Town Law. While these are beyond the scope of this primer, it is a function of bond counsel to work closely with the town attorney in the drafting of these proceedings when financing is anticipated. Good bond counsel must be proficient in all varieties of district formation and improvement authorization. Proficiency is good.

If your project engineers offer to provide improvement district legal proceedings or a bond resolution to you, please keep this in mind: bond lawyers do not design sewer systems and the world is undoubtedly a better place for it. Engineers may well be great engineers but most do not have a license to practice law. Yet some, knowing how to move water and . . . well, earth in an anticipatory state, may think bond proceedings are all simple boilerplate. Problems in the proceedings precedent to adoption of the bond resolution can easily ensue. The legal proceedings are not all boilerplate and there are detailed requirements—not surprising when you think about the fact an improvement is going to cost your property owners something, maybe a lot. Among other requirements, constitutional issues of due notice can be an integral part of drafting district improvement and bond resolutions proceedings. Call your lawyers, please. True, we are a secret conclave with arcane magical incantations but only we know the right incantations!

The next general step is adoption of a town or village bond resolution implementing the capital financing authorization, which must be adopted by two-thirds of the voting strength of the Board. Voting strength means total membership, not just those present. Bond resolutions must be adopted at legislative meetings which are in compliance with the Open Meetings Law of the State.

As described earlier, paragraph a of Section 11.00 of the Local Finance Law assigns periods of probable usefulness to those things which can be financed. For a particular item having a five-year period of probable usefulness, this means that the bond resolution must limit the maximum maturity of the serial bonds to five years.

Where an item has a period of probable usefulness in excess of five years, the Board may prescribe a serial bond maturity period for any number of years equal to or less than the period of probable usefulness. It may also limit the maximum maturity of the serial bonds to five years. Where the period of probable usefulness is five years, or where the maximum maturity of the serial bonds is limited to five years, *THE BOND RESOLUTION WILL TAKE EFFECT IMMEDIATELY.*

A bond resolution authorizing a purpose having a period of probable usefulness of more than five years which is to be financed over a period greater than five years will have to be adopted *SUBJECT TO PERMISSIVE REFERENDUM*, because, generally speaking, all bond resolutions for general municipal purposes are subject to permissive referendum (there are some exceptions as set forth in Section 35.00 of the Local Finance Law), *unless* the maximum maturity of the serial bonds is *limited to five years*. Bond resolutions adopted for assessable improvements, chargeable primarily to benefited real property like in a town improvement district, are not themselves subject to permissive referendum.

Where a bond resolution is adopted subject to permissive referendum, the bond resolution must set forth a statement to such effect.

What is a permissive referendum?

It is a special election called by a municipality to approve or disapprove a bond resolution that has been adopted by the legislative body. It is permissive in that it is called only if the voters in the municipality petition the board to have the election (unless the board upon its own motion voluntarily submits the bond resolution to a then mandatory referendum).

If a resident did not attend the board meeting at which a bond resolution was adopted how would they even know that they could petition to have a referendum on it? The law requires that due notice be given of bond resolutions adopted subject to permissive referendum. A notice of adoption with the text of the bond resolution must be published and posted within ten days of adoption or the adoption is invalid.

Thereafter, within 30 days of the date of adoption (not within 30 days of the date of publication), a petition may legally be filed and then a referendum must be scheduled. If not filed within that time frame the bond resolution becomes valid and cannot thereafter be made subject to referendum.

A petition form must be made available at the Clerk's office should anyone ask for one. Upon receipt of a signed petition, it should be provided to local counsel to check it for validity.

So, to summarize, within 10 days of the date of adoption of the bond resolution, the Clerk must cause to be published in the Official Newspaper and to be posted, in the case of a town or village, upon the official signboard and in the case of a village, six conspicuous public places throughout the village, a Notice of Adoption (together with a copy of said resolution) giving notice to the public that such resolution was adopted subject to permissive referendum and specifying the date of such adoption.

Failure to strictly adhere to these requirements will invalidate the adoption of the bond resolution, requiring that the entire procedure be started anew.

The permissive referendum period is a 30-day period measured from the date of adoption of the resolution. If, within this 30-day period, no petition is submitted requesting a referendum upon the question of the adoption of the resolution, the resolution shall take effect upon the expiration of such 30-day period.

As soon as possible after the resolution takes effect (after the expiration of the permissive referendum period), the municipality should then implement the estoppel procedure, hereinafter described by publication of a Legal Notice of estoppel.

NOTE: Where a purpose has a period of probable usefulness in excess of five years, the bond resolution can take effect immediately by setting forth therein that the maximum maturity of the serial bonds will not exceed five years.

In this way the permissive referendum process is avoided but the impact on the taxpayer will be greater.

The opposite result is also permissible under Local Finance Law and other applicable statutory provisions: any bond resolution that is subject to permissive referendum can be made subject to mandatory referendum on the Board's own motion. This is most often utilized for capital projects for which elected officials want a definitive approval of the residents prior to proceeding with a financing, e.g. a new municipal office building, or a new landfill.

The final step in the authorization process is publication of an estoppel notice as described in Chapter Seven.

Cities

The steps to be taken prior to and subsequent to adoption of a bond resolution depend on the type of capital project for which the City is authorizing the debt. In all cases, however, the first step is compliance with the State Environmental Quality Review Act ("SEQRA") and the regulations promulgated thereunder. One of the easiest ways for an opponent of a project to challenge it is for failure to properly comply with SEQRA. The bond resolution itself should specify the previously determined status under SEQRA of the capital project whose financing is authorized by it. Each pre- or post-bond resolution step should likewise state SEQRA status.

The next general step is adoption of a bond resolution implementing the capital financing authorization, which must be adopted by two-thirds of the voting strength of the city council. Voting strength means total membership, not just those present. Bond resolutions must be adopted at legislative meetings which are in compliance with the Open Meetings Law of the State.

Section 34.00 of the Local Finance Law prohibits a city from requiring a permissive or mandatory public referendum on a bond resolution, unless that city has adopted a local law that allows such a referendum.

Whether or not a city charter requires a referendum for bond resolutions, or otherwise sets limits on the amount of bonds that may be issued and/or outstanding at any given time, there is always the limit, known as the "constitutional debt limit," imposed by New York State as noted earlier. Section 104.00 of the Local Finance Law limits the total amount of outstanding debt a city may have at any given time to 7% of the 5-year average full valuation. (Cities having a population of 125,000 or more have a 9% limit.)

Most bond resolutions of most cities are effective immediately upon adoption by two-thirds of the voting strength of the city council. The exceptions are those cases with a city charter provision (or a special act of the state legislature) when a bond resolution is subject to permissive referendum before it becomes effective or where a bond resolution provides that it shall be submitted to a mandatory referendum in a manner authorized by or pursuant to the LFL. In such a case, a three-fifths vote is sufficient for adoption.

In cities, the charter provisions on financing must always be consulted. In addition, more general resolution adoption provisions need to be reviewed, e.g., some cities do require a public hearing on every resolution or ordinance adopted.

There are some unusual special charter provisions in the State relating to city bond financing.

Of the 57 small city charters with which we are familiar out of the 57 small cities in the State, here are some nearly fictitious examples:

- 42 have no charter bond issuance restrictions (last time we looked).
- The City of Salinger in Catcher County requires that bond resolutions:
    a. In excess of 10% of the average gross annual budget for the preceding three years be subject to mandatory referendum;
    b. More than 5% but less than 10% of the average gross annual budget for the preceding three years be subject to a permissive referendum, provided that the aggregate amount of the bond issued and all outstanding bonds issued subject to permissive referendum do not exceed this 10% limit;
    c. Less than 5% of the average gross annual budget for the preceding three years are subject only to council vote, provided that the aggregate amount of the proposed issue and all outstanding bonds issued subject to council vote do not exceed this 5% limit; and,
    d. Are exempt if the bond proceedings will be used for the payment of judgment or claims, or compromised or settled claims against the city, or, for the payment of awards or sums payable by the city pursuant to a determination by a court, or an officer, body or agency in an administrative or quasi-judicial capacity, or, for

obligations sold to the New York State Environmental Facilities Corporation or any successor thereto.

Got that? Good, tell the rest of us what it means.

- The City of Mt. Vegan requires a mandatory referendum for any bond in excess of $750,000, except that no referendum is required for bonds to pay legal judgments, claims, settlements, or where the bonds are matching federal or state funding in a project.
- The City of Amstel, Light County—Bond resolutions are subject to permissive referendum by public petition, or mandatory referendum on motion of the City Council, except:
  a. Bonds with a proposed maturity of less than five years;
  b. Bonds used to pay legal judgments, claims, awards, settlements;
  c. Bonds used to provide for the construction or reconstruction of sewage treatment or disposal as required by the Department of Environmental Conservation.
- The City of Lighthouse—Bond resolutions are subject to permissive referendum for amounts exceeding $250,000, except:
  a. Those used to fund capital improvements where more than 50% of the cost of the improvements will be levied by assessments upon properties benefited;
  b. Those used to pay legal judgments, claims, awards, settlements;
  c. Those used to provide for the construction or maintenance of sewer facilities or water pollution control facilities.
- City of Beefalo – Bond resolutions are subject to permissive referendum except for those issued to pay legal judgments, claims, awards, settlements.
- City of Silver City, Flatware County – Bond resolutions are subject to mandatory referendum for amounts exceeding $575,000, except:
  a. Those used to pay legal judgments, claims, awards, settlements.
  b. Those used to provide for the construction or maintenance of water or sewer facilities required to comply with environmental or health law.
  c. Those used to provide for the construction of sanitary sewer facilities where special assessments will be levied against the benefited properties.
- The City of Equestrian Streams, Thoroughbred County – Bond resolutions are subject to mandatory referendum when "long term debt bonding exceeds 1% of the average full valuation of taxable real estate of the City."
- The City of Hoops, Adams County, and Garageville City, Full Moon County each require that all proposed bond ordinances have their titles and/or summaries published 10 days prior to adoption, but no dollar limits.
- The City of Connectivity, Conductivity County—provides the form for its bonds in the charter and some special rules on borrowing for local improvements but no

dollar limits.

- The City of Skinflints-on-Hudson, Bogota County which has these actual provisions:

  a. "Contracting debt not payable within year restriction.

  The Common Council shall contract no debt and authorize no expenditure on the part of the City which shall not be payable in the fiscal year in which it is contracted or within one month thereafter and from the revenues of the fiscal year in which it was contracted, except as herein otherwise provided."

  b. "City not liable for debts not payable within year.

  In case the Common Council shall contract any debt on or after the first day of May in any year, and before the first day of May next thereafter, which shall not be payable within said fiscal year, or within one month thereafter, and cannot be paid from the revenue of that year, or in case the Common Counsel shall authorized any expenditure for any purpose in such year exceeding the amount of which is Common Council is authorized by this Charter to raise for such purposes, the City shall not be liable to pay the same, nor shall the Common Council audit or pay any debt so contracted or expenditure so authorized."

  c. "Extraordinary expenditures; notice of special election.

  Whenever the Common Council shall be of opinion that the interest of the City require the expenditure of money for any extraordinary or special purpose which cannot be made from the moneys it is authorized to raise under other provisions of this Charter, it shall cause a report to be published in the official newspaper stating the objects for which such expenditure ought to be made, the amount which it would require to be raised and the reasons which the Common Council believes render it necessary or expedient, together with a notice that upon a day fixed therein, and which shall be at least three weeks after the first publication of such report and notice, a special election shall be held at some central and convenient place therein designated at which the question whether the amount required for such expenditure shall be raised by a special tax will be submitted to the qualified electors for their determination. The publication of the notices shall be continued daily except Sundays and legal holidays until the day appointed for the special election."

  d. "Issuance of bonds; raising of tax.

  If it shall appear that the majority of the votes cast at such special election were "for special tax," the Common Council may borrow upon the credit of the City the amount specified and shall issue bonds or certificates of indebtedness therefore and shall cause the amount specified to be raised by tax for the purpose therein set forth, in addition to the moneys otherwise authorized to be raised by the provisions of this Charter. It may direct the whole sum required to be raised in addition to and with the next annual tax for ordinary expenses, or in two or more equal annual installments, with the next two or more annual tax levies. Such special tax, whether raised in one, two or more annual installments, shall be added to the sums otherwise to be raised and imposed and collected therewith, and by the same power and authority. All moneys raised pursuant to the provisions of this article shall be kept by the City Treasurer as a separate fund, and shall be subject only to drafts to be drawn by the Common Council, specifying that the same were drawn to meet the expenditures for which they were raised."

- In the City of Fort Nervous, Encroaching-Pennsylvania County, the following charter provisions are in effect:
  a. "Any bond resolution of the Common Council creating a city debt to be evidenced by the issuance of bonds, other than the bonds hereinafter expressly excepted, shall be adopted subject to a mandatory referendum for the express purpose of approval or disapproval of the bond resolution by a majority of the qualified voters voting thereon at a special election held not less than twenty (20) nor more than thirty (30) days after such bond resolution shall have been adopted by the Common Council."
  b. "The provisions of this section shall not apply to bond resolutions authorizing the issuance of refunding bonds, or bonds for payment of judgments or compromised or settled claims against such city, or awards or sums payable by each city pursuant to a determination by a court or an officer, body or agency acting in an administrative or quasi-judicial capacity or bonds to be issued to finance public improvements which the Common Council has determined by resolution are necessary for the public health or safety and/or which are mandated or otherwise required by the County, State of New York or the United States of America or any agencies, public corporation or departments of the foregoing which possess the power to mandate or require such work and/or improvements at city expense."

Suffice to say, the variations on charter restrictions for bonding are as limitless as the human imagination. Therefore, rather than imagining too late what life will be like in the SHU at Dannemora, best to look up the local law rules before borrowing money. (Don't know what the SHU is? Ask your office mate and if he or she seems quite familiar with it, well, maybe its time for a background check).

The final step in the bond authorization process in any city is publication after adoption of the bond resolution of an estoppel notice as described in Chapter Seven. This notice should include the status of the capital project under SEQRA.

CHAPTER SEVEN

Estoppel

The LFL provides that where a bond resolution is published with a statutory form of estoppel notice, and the bond resolution itself contains an estoppel provision, the validity of the bonds authorized thereby, including bond anticipation notes issued in anticipation of the sale thereof, may be contested only if:

a. such obligations are authorized for a purpose for which the local governmental unit is not authorized to expend money; or

b. there has not been substantial compliance with the provisions of law which should have been complied with in the authorization of such obligations; and

   an action, suit, or proceeding contesting such validity, is commenced within 20 days after the date of such publication; or

c. such obligations are authorized in violation of the provisions of the State Constitution.

Except on rare occasions, most local governmental units comply with this estoppel procedure. It is a procedure that is recommended by bond counsel, but it is not an absolute legal requirement.

In any case, after adoption of a bond resolution (and after the permissive referendum period has elapsed in the case of bond resolutions subject to permissive referendum), a legal notice of estoppel should be published.

What is estoppel and why publish the notice?

If a bond resolution of a Board authorizing the issuance of bonds and BANs contains the estoppel statement referred to in Section 80.00 of the LFL, such resolution after adoption, or a summary of such resolution, should be published in full by the Clerk, together with a notice in substantially the following form:

> "The resolution (or the resolution a summary of which is) published herewith has been adopted on the ________ day of ____________________, 20___, and the validity of the obligations authorized by such resolution may be hereafter contested only if such obligations were authorized for an object or purpose for which the (Here insert name of town, village or city) is not authorized to expend money or if the provisions of law

which should have been complied with as of the date of publication of this notice were not substantially complied with, and an action, suit or proceeding contesting such validity is commenced within 20 days after the date of publication of this notice, or such obligations were authorized in violation of the provisions of the Constitution.
[name]
(_____________ Clerk)"

In the past a legal notice of estoppel always contained both the estoppel statement noted above plus the full text of the bond resolution. Due to rising publication costs, it is now customary to publish a summary legal notice of estoppel which includes the estoppel statement, the bond resolution title, a very brief description of the specific object or purpose or class of objects or purposes (i.e., the capital project), the maximum estimated cost of same, the plan of financing of same (including how much cash and how many bonds), and the period of probable usefulness, as well as an indication as to where the full text may be examined. The use of a summary form of this notice is authorized in Section 81.00 of the LFL.

If a summary of such resolution is published, such summary must list the specific or class or classes of objects or purposes for which the obligations to be authorized by such resolution are to be issued together with the period or periods of probable usefulness and the amount of obligations to be issued for each such specific or class of objects or purposes, SEQRA status and in addition, such summary must state an office of the municipality where the resolution summarized thereby is to be available for public inspection. Such resolution must be kept available for public inspection at such office during normal business hours for 20 days following the publication of such summary.

Such publication is to be in the official newspaper or newspapers of the municipality or if there be no such newspaper or newspapers, then in such newspaper or newspapers having a general circulation in the municipality as the Board shall designate (usually within the text of the bond resolution).

Timing. There is no timing requirement as to how quickly an estoppel notice must be published after adoption of a bond resolution effective immediately. While it is legal to contract for a project during the estoppel period, it is generally not recommended until the 20-day estoppel period has elapsed. Why? Because estoppel protects the municipality and its debt obligations from any validity challenge, other than on constitutional grounds once the 20-day period after publication has elapsed. Thus, any procedural error inadvertently occurring in the process of authorization may not be used to challenge the borrowing after estoppel has passed. The 20-day estoppel period begins to run on the date of publication. Thus, the sooner it is published, the better. The estoppel notice is usually drafted by bond counsel.

If the obligations issued pursuant to a resolution published in the manner described above contain a recital in substantially the form prescribed in Section 52.00 of the LFL, such recital binds the municipality issuing such obligations, and 20 days after such resolution has been published and after such obligations have been purchased in good faith and for fair value by any person, the validity of such obligations cannot be questioned by such municipality or any taxpayer thereof in any court (unless the municipality has violated a provision of the state Constitution). Thus, both the municipality and the purchasers of its debt are protected by estoppel.

CHAPTER EIGHT

Types of Debt

The LFL authorizes a variety of types of debt instruments for municipalities, all of which must be general obligations. Debt instruments which are not specifically authorized, include for example, a revolving line of credit at a local bank, a revenue bond backed not by the pledge of the faith and credit, but rather solely backed by some particular stream of revenue, or a bond with a security interest in a municipal building, land or asset. The basic types of debt instruments most frequently utilized in the State by towns and villages and cities are as follows:

a. bond anticipation notes ("BANs") and bond anticipation renewal notes ("BARNs");
b. serial bonds;
c. statutory installment bonds;
d. tax anticipation notes ("TANs");
e. revenue anticipation notes ("RANs"); and
f. budget notes.

Less common are:

g. specialized bond types, including capital appreciation bonds, original issue discount bonds, variable rate bonds, term bonds, and joint indebtedness;
h. capital notes; and
i. refunding bonds.

Each of these is described later in this chapter. Even less common are:

j. urban renewal notes;
k. deferred payment notes;
l. land installment purchase obligations; and
m. certain agreements with the Dormitory Authority of the State of New York ("DASNY").

These latter four categories are not discussed herein.

The basic elements of any type of bond or note are to be found in Sections 51.00 and 52.00 of the LFL, which read as follows:

§51.00 Terms, form and contents of obligations

Every bond and note shall contain a statement of at least the following:

1. The type of obligation.
2. The amount of the obligation and the total amount of the issue of which the obligation is a part.
3. The date and maturity of the obligation.
4. If the obligation is a tax anticipation note or a revenue anticipation note, the fiscal year for which the taxes were levied or are to be levied or in which the revenues are to become due and payable, as the case may be; if the obligation is a tax anticipation note to be issued in anticipation of the levy or collection of assessments for a fiscal year or in anticipation of the collection of an installment of an assessment for a capital improvement, the fiscal year for which such assessments were levied or are to be levied or in which such installment becomes due, as the case may be.
5. The rate of interest or, in the case of obligations bearing a variable rate of interest, the procedure for calculating such variable rate of interest and the maximum rate of interest which such variable rate notes may bear, together with the date or dates of payment thereof. [Eff. Until July 15, 2012]
6. The rate of interest and the date or dates of payment thereof. [Eff. July 15, 2012]
7. The place or places of payment of principal and interest.
8. The medium of payment.
9. An irrevocable pledge of the faith and credit of the municipality, school district or district corporation issuing the obligation for payment thereof.
10. If the obligation is payable to bearer, whether it may be converted into a registered obligation; if the obligation is in registered form, whether it may be converted into a bearer obligation.
11. If the obligation may be called for redemption prior to its date of maturity, the terms and conditions under which such obligation may be redeemed.

and:

§52.00 Recital of validity in obligations

Any obligation issued by a municipality, school district or district corporation may contain on its face a recital in substantially the following form:

"It is hereby certified and recited that all conditions, acts and things required by the Constitution and statutes of the State of New York to exist, to have happened and to have been performed precedent to and in the issuance of this (*Here insert type of obligation*), exist, have happened and have been performed, and that the issue of (*Here insert type of obligations*) of which this is one, together with all other indebtedness of such (*Here insert name of municipality, school district or district corporation*) is within every debt and other limit prescribed by the Constitution and laws of such State.

The method of execution of any note is found in Section 61.00 of the LFL which reads:

§61.00 Execution of obligations

a. All obligations, including interim bonds, shall be executed in the name of the municipality, school district or district corporation by the chief fiscal officer unless the finance board shall by resolution, designate a different officer or officers to execute such obligations. Such execution may be by facsimile signature, in which event the finance board shall provide for authentication of such obligation by the manual countersignature of a fiscal agent or of a designated official of the municipality, school district or district corporation. Such obligations shall have the seal or a facsimile seal of the municipality, school district or district corporation impressed or imprinted thereon. Such obligations may be attested by the school district or district corporation or such other official thereof as may be designated by the finance board. Coupons attached to a bond shall be authenticated by the facsimile or manual signature of the chief fiscal officer unless the finance board shall, by resolution, provide that such coupons shall be authenticated by the facsimile or manual signature of a different officer.

b. Obligations executed in the manner set forth above by the officials designated and referred to above shall be valid and binding obligations when duly delivered, notwithstanding the fact that before the delivery thereof the persons executing the same shall have ceased to be officials or other officials may have been designated to perform such functions.

BANs and BARNs

BANs and BARNs are typically one year or less, single fixed-rate debt obligations, renewable annually at maturity at then-current interest rates. Principal and interest are due at maturity. A new-money borrowing is known as a BAN; its annual renewal is known as a BARN. BANs and BARNs are issued only for capital projects (or judgments or settled claims), never for cashflow purposes and never for a greater amount than the amount of bonds authorized for the capital project or judgment or settled claim. However, a BAN may be issued for capital costs which include a portion of a project for which a grant is later anticipated. Once the grant is received, it usually must be used to pay down an equal portion of BAN principal at the next renewal date. It is often wise to authorize borrowing for both the local share and the non-local share of a project by BANs in case grant-in-aid monies are delayed in receipt. Financing for all municipal projects must convert from BARNs to bonds no later than the fifth anniversary date after the first BAN. (Therefore, if new money for a project was borrowed in series, each series must comply with the five-year rule independently and is not tied, for this purpose, to the very first new-money borrowing.) (Also, there is an exception to this general rule for assessable improvements in town or other special improvement districts.)

While BANs and their renewals may be authorized by one, or annual, BAN/BARN resolutions, it is far more common that the original bond resolution authorizing the issuance of serial bonds for the capital project, includes a delegation of authority to the chief fiscal officer to issue BANs and BARNs as well as the eventual bonds. Which method is used is a political, rather than legal, decision. Flexibility and quick action ensue from full delegation, so it is common nowadays when markets can change quite rapidly.

One final feature of BANs and BARNs is worthy of note: either may be issued for less than one year or with an early redemption feature which would permit the optional right (of the issuer) to call in and pay off such a note prior to its maturity date. This option may be useful when a town, village or city plans to convert its notes to bonds sometime during the forthcoming fiscal year but is for any number of factors unsure precisely when. Similarly, either BANs or BARNs can be issued for over one year, up to five years, as long as provision is made for specific annual principal paydowns in the documents.

Serial Bonds

Serial bonds are the most common long-term debt obligations issued by municipalities in the State. They are often referred to as "plain vanilla general obligation bonds"; "plain vanilla" meaning they are a simple form of debt instrument with multiple succeeding annual maturities of principal, each maturity of which has a single fixed-rate of interest. The "general obligation" aspect refers to the constitutionally required pledge of the faith and credit of the municipality to use its taxing power to pay the debt, no matter what.

Serial bonds may be issued either (a) to redeem outstanding BANs and/or BARNs, or (b) to acquire new money to pay the cost of all or a portion of one or more capital projects. A combination of these purposes is also permitted. Bonds issued to finance all or a portion of the cost of multiple capital projects, and/or to refinance same, are known as consolidated bond issues. There is no restriction on how many projects may be consolidated for purposes of sale into a single bond issue. (The same is true of BANs and BARNs). However, each project in such a consolidation must maintain separate accounting for purposes of its annual requisite principal paydown schedule, its PPU and its maximum maturity. Only in the case of debt sold with a substantially level or declining annual debt service structure may these elements be merged, aggregated and averaged across all the individual capital projects financed in a consolidated serial bond issue.

Serial bonds mature serially; that is, one after the other in their stated principal amounts, annually on the same day each year until final maturity. That annual maturity day can be any date but the first or the fifteenth of any calendar month are most common. Principal must be paid annually and by custom interest is paid semiannually in most serial bond issues. Serial bonds may carry an early redemption feature—the industry custom is 10-year call protection; that is, the first 10 years of a serial bond issue are not "callable," i.e., redeemable prior to maturity. Early redemption historically involved payment of a small premium to the bondholder at the time of the call (almost always in the 2% of principal redeemed early or less range, depending on how soon prior to stated maturity the call occurs). In the current low interest rate environment, a par call (without premium) is common. This feature is set at the time of sale of serial bonds in consultation with a financial advisor and bond counsel.

One exception to the requirement that annual principal be paid is the basic two-year rule applicable at the beginning of a borrowing cycle for a project, which comes into play here: The first payment of principal on a new-money borrowing (by series) need not be paid until the second anniversary of the first borrowing. This initial one-year optional moratorium period on payment of principal may occur during the period of time that the financing for a project is still in its BAN/BARN cycle or, it may occur within the structuring of the serial bond issue. The two years runs from the first borrowing (by series) for a capital project regardless of the form that borrowing has taken. Each new-money borrowing starts operation of its own two-year rule; therefore, in multiple new-money borrowings over time for a single project, each such series has its own timetable in this regard.

In plain English, this means that a municipality must make a principal payment within two years of the date of issuance of a borrowing of new money (i.e., not renewals).

By omission, then, the statute permits a municipality to make no payment at the end of the first year and, for example, roll over a bond anticipation note in full (or skip that first principal payment in a new-money bond issue).

As an example, take a $100,000 financing with a 10-year maturity. The municipality issues $100,000 bond anticipation note in year one. At the end of year one, the municipality makes a $10,000 principal payment and issues a $90,000 renewal note. At the end of year two (the year in which a principal payment is mandated by the statute) the municipality makes a $5,000 principal payment. This is an automatic violation of the fifty percent rule, because the fifty percent rule says that no principal payment may exceed by more than 50% the smallest previous principal payment mandated by law. By making the principal payment in the amount of $5,000, no subsequent payment may legally exceed $7,500, and one can see that over the next eight years, it is impossible to amortize the remaining $85,000 without violating the fifty percent rule.

Consider a different scenario, however: at the end of the first year, the municipality makes a $5,000 principal payment. The uninitiated would conclude, using the reasoning above, that there is an automatic violation of the fifty percent rule. This is not correct. After all, the LFL provides that no principal payment need be made at the end of year one. If that is the case, then why should a municipality be punished for making a "voluntary" payment at the end of year one. Thus, for the purpose of the fifty percent rule, one can disregard the first payment in this case, since it was voluntary, not mandated by law.

Serial bonds for multiple capital projects each contain pro-rata allocations of principal relating to the different projects financed by the bond issue. In each maturity, there will be multiple projects represented to the extent that each such project has not exceeded its maximum maturity. Thus in the first five years after issuance, all consolidated projects may be amortizing but in the sixth year, any project with a five-year PPU will have already been paid off in full in the prior annual maturity (except in the case of substantially level or declining annual debt service which merges all project PPUs to a shared average, as described earlier). It is part of the function of a financial advisor and bond counsel to ensure compliance of the whole and its parts to these rules.

In a consolidated serial bond issue, each component must be in compliance with the fifty percent rule described earlier, or be part of a substantially level or declining annual debt service amortization structure which has aggregated all components.

At each maturity of a serial bond issue, a portion of the principal due on each consolidated project is and must be annually paid down (no skipping of principal paydowns is permitted after the initial year), together with semiannual interest due on all outstanding maturities. On the other semiannual interest payment date, just interest due on all outstanding serial bonds is due. Therefore, note, the interest due on any interest payment date always relates to multiple outstanding maturities, not just the particular maturity amount of principal due in that particular year. There is only one rate of interest per maturity — these aggregate for the overall debt service payment due at such semiannual date.

How is principal and interest paid when due on outstanding bonds or notes? A municipality can pay a bank or trust company located and authorized to do business in the State to act as fiscal agent for the debt. Those duties and responsibilities are set forth in Section 70.00 of the LFL. In brief, they are payment of debt service when due, conversion, reconversion and transfer of bonds and notes, preparation of substitute bonds and notes for lost or destroyed ones, and related services.

Alternatively, an officer of the municipality may serve as the fiscal agent. This is common in this era of book-entry-only issued debt (described below). Unless otherwise named, the particular officer for a town and a village, the clerk, and for cities, the chief fiscal officer, is specified in Section 70.00 of the LFL. It is the job of the fiscal agent to wire the principal and interest when due to the holders of the debt obligations. Nowadays, with the prevalence of book-entry-only debt, it is usually only necessary to wire payment to one party, a national repository holding the debt on behalf of all owners. It is then their responsibility to forward the funds to the beneficial owners. See "DTC" in the "Transaction Players and Their Roles" appendix herein.

Finally, serial bonds may only be issued for valid capital projects, each specified in Section 11.00 of the LFL and identified as a specific object or purpose or a class of objects or purposes. They may not be issued for cashflow purposes, including the redemption of outstanding RANs, TANs or budget notes (further described below). Through special legislation, however, bonds to finance the payoff of a cumulative budgetary deficit can be given a period of probable usefulness, declared as a valid object or purpose and be issued.

To summarize, consistent with rules discussed earlier, the first payment of principal in a serial bond issue must also conform to the following rules:

a. it must occur within two years of the date of issuance of all new money or for any such portion;
b. it must occur annually thereafter;
c. it must occur no later than the fifth anniversary date of any first borrowing for a non-assessable project included in the bond issue that was previously financed with BANs and BARNs; and
d. it must be paid, like each succeeding principal payment, by an annual appropriation.

To further summarize, consistent with the above rules, the last payment of principal in a serial bond issue must conform to the following rules:

1. it must occur on a date no later than the maximum maturity date calculated based upon the PPU of each of the projects or average PPUs of the projects, and the first borrowing date(s) for each project or each series of new-money borrowings for a project;
2. it must occur no later than the expiration of the period of probable usefulness of the object or purpose (or average objects or purposes in the case of level annual debt service) for which the serial bonds were issued as computed from the date of such bonds, or if BANs and BARNs were issued in anticipation of the bonds, as computed from the date of the earlier note so issued;
3. it must not exceed by more than 50% any prior principal payment on a project-by-project basis internal to the maturity or, if the bonds were issued with substantially level or declining annual debt service, it must not exceed by more than 5% or $10,000, whichever is greater, any prior annual debt service for the bond issue as a whole.

When serial bonds are issued, traditionally there were multiple printed bonds issued for each maturity adding up to the total per maturity in paper form, each with the owner's name (or, in prehistory "bearer"), the amount, the maturity date, the interest rate, and the interest payment date schedule (or actual interest "coupon") on it. Nowadays, most bonds are issued in book-entry-only form such that only one printed bond is issued for each annual maturity and held at a national repository on behalf of all owners, whose ownership record is maintained electronically. See "DTC" in the "Transactional Players and Their Roles" appendix hereto. The basic elements of a serial bond are provided in Sections 51.00 and 52.00 of the LFL as noted earlier, and the rules of their execution are found in Section 61.00 thereof, as provided above. It is a function of bond counsel to prepare the actual physical, printed bonds (and notes) for issuance.

Statutory Installment Bonds

Statutory Installment Bonds ("SIBs") are a somewhat simplified type of serial bond. All of the rules of amortization described above apply; however, instead of printed bonds for each maturity, an SIB is a single "typewritten" style bond representing all maturities which, in addition to regular serial bond information described above, also includes a full principal amortization schedule and separate interest payment schedule (SIBs are the form of serial bonds in which one occasionally sees annual rather than semi-annual interest payments). If the principal amount for an object or purpose, or objects or purposes, or class or classes thereof, to be financed by the issuance of bonds does not exceed $1 million in the aggregate, a single SIB may be issued for the full principal amount. A town, village or city may not issue more than $1 million in SIBs in any fiscal year. Any such bond shall provide for the payment of both the principal and interest upon physical presentation of the bond for notation of such payments thereon (except SIBs issued and sold to the United States of America or any agency thereof in any amount may have principal and interest payable without such presentation). The notations of principal and interest payments are to be made on the face of the bond, on the reverse side, or on a sheet attached thereto.

SIBs can be issued for new-money purposes or to refinance a BAN or BARN or both. Since SIBs may not exceed $1 million in principal and require physical notation, they are typically placed with local banks in the community where the issuer is located (and deposits its fund balances). While capital projects of any period of probable usefulness and maximum maturity may be financed with an SIB, local banks typically do not like to invest in SIBs with maturities greater than ten (10) years. This forms a market-based maximum maturity limitation on projects with longer than 10 year PPUs.

SIBs are usually sold at private sale rather than public sale. This distinction is discussed below in Chapter 10.

There is a standard form to an SIB, which is provided in detail in Section 62.10 of the LFL.

§62.10 Statutory installment bonds

a. Notwithstanding any other provisions of this chapter, if the principal amount for an object or purpose, or objects or purposes, or class or classes thereof, to be financed by the issuance of bonds does not exceed $1 million in the aggregate, a single bond, to be known as a statutory installment bond, may be issued for the full principal amount, if the issue is to be sold at private sale. Any such bond shall provide for the payment of both the principal and interest upon presentation of the bond for notation of such payments thereon, except that such a statutory installment bond may be issued and sold to the United States of America or any agency thereof in any amount and that such principal and interest shall be payable without such presentation.

b. A statutory installment bond, in bearer, if authorized by federal law, or registered form, shall be in terms, form and contents, substantially as follows:

Statutory	United State of America	$	*(Here insert full*
Installment	State of New York		*amount of bond*
Bond	Name of Municipality		*issue)*

(Here insert name of the issuer)

(Here insert type of bond and year, such as "Highway Machinery Serial Bond - 2009")

The (*Here insert name of the issuer*), in the County of ___________________, a (*Here insert whether a municipality, school district, fire district or other district corporation*) of the State of New York, hereby acknowledges itself indebted and for value received promises to pay to (*Here insert "bearer" or the name of registered owner if the bond is issued in registered form*) the principal sum of ________ Dollars ($_______) (in (______) equal annual installments of _______ Dollars ($_____) on the _______ day of ________ in the years, 20__, to 20__, inclusive)

Or

(in _________ (_________) annual installments (*Here state the amounts, the annual principal payment date, and the year in which the principal payments will be made. No annual installment shall be more than fifty percentum in excess of the smallest prior installment unless the finance board has determined to provide for substantially level or declining annual debt service, in which case the aggregate amount of debt service payable in any year shall not exceed the lowest aggregate amount of debt service payable in any prior year by more than five percent*))
and to pay interest on the unpaid balance of such principal sum at the rate of _____________ per centum (_____%) per annum, semi-annually on the _________ days of __________ and ___________ in each year from the date of this bond until it matures. Interest will not be paid on any installment or principal, or of interest, after the due date thereof. Both the installments of principal of and the interest on this bond will be paid to the (*Here insert "bearer" or "registered owner" if the bond is issued in registered form*) of this bond in lawful money of the United States* only upon presentation of this bond for notation of any such payment thereon* (*omit language enclosed within asterisks when the bond is sold to the United States of America or any agency thereof*) at the office of ______________

(*Here insert place or places of payment*)

This bond is a statutory installment bond, the principal sum of which cannot exceed One Million Dollars ($1,000,000) unless it is issued and sold to the United States of America or any agency thereof, and is issued pursuant to section 62.10 of the Local Finance Law and pursuant to a bond resolution entitled "(*Here insert title*)", duly adopted by (*Here insert name of the finance board*) of such (*Here insert name of issuer*) on the _______ day of ___________, 20__. This bond may not be converted into a coupon bond.

The faith and credit of such (*Here insert name of the issuer*) are hereby irrevocably pledged for the punctual payment of the installments of principal of and the interest on this bond according to its terms.

It is hereby certified and recited that all conditions, acts and things required by the Constitution and statutes of the State of New York to exist, to have happened and to have been performed precedent to and in the issuance of this bond, exist, have happened and have been performed, and that this bond, together with all other indebtedness of such (*Here insert name of the issuer*) is within every debt and other limit prescribed by the Constitution and laws of such State.

In Witness Whereof, the (*Here insert name of the issuer*) has caused this bond to be signed by its (*Here insert title of officer*) and its (*Here insert title of officer*), and its corporate seal to be hereunto affixed and attested by its (*Here insert title of attesting officer*) and to be dated as of the _______ day of _______________, 20__.

(Name of municipality, school district,

(Corporate Seal) *fire district or other district corporation)*

By: (Signature and title of officer)

and (Signature and title of officer)

Attest:

(Signature and title of attesting officer)

PRINCIPAL PAYMENT

Amount	Date Received	Received by
$____________	_______________, 20__	__________________
		(Signature of person receiving payment)
$____________	_______________, 20__	__________________

(*Continue as necessary*)

INTEREST PAYMENT

Amount	Date Received	Received by
$____________	_______________, 20__	__________________
		(Signature of person receiving payment)
$____________	_______________, 20__	__________________

(*Continue as necessary*)

The notations of principal and interest payments may be made on the face of the bond, on the reverse side, or on a sheet attached thereto (omit language enclosed within asterisks when the bond is sold to the United States of America or an agency thereof).

Note that until September 30, 2011, statutory installment bonds, in substantially the form noted above, may be issued and sold to the New York state environmental facilities corporation in a principal amount not to exceed $20 million, and such bonds can provide for either a fixed rate or, if such bonds provide for serial maturities, at a set rate for each maturity, which rate is fixed on the date of issuance of such bonds.

BANs or Bonds for a Capital Project

A municipality has the option to issue bonds or bond anticipation notes initially for a capital project. BANs generally mature within one year, at which time they may be renewed, after the paydown of a portion of the principal due (principal paydowns to begin no later than the second anniversary of the first borrowing). Similar to a variable rate home mortgage in respect to interest rate risk, each year at renewal, the issuer is subject to the then-current interest rate environment and the issuer's then-current rating by companies like Moody's who rate issuers. Nevertheless, as typically one-year obligations, the interest rate is always, or almost always, historically lower than longer term debt. Thus, a municipality might choose to issue one-year BANs at the then-current one-year rate each year for five years. This option would also permit a municipality to use unexpected excess cash to pay down extra principal on any annual maturity date, prior to renewal.

The issuance of serial bonds to obtain funds for a capital project involves establishing at sale a single interest rate or rates per maturity on a single date of sale, which then locks that rate or rates in for the life of the bonds. Likewise, the annual principal paydowns must be pre-determined prior to sale in order to establish what the purchasers are going to be buying. There is usually no ability to pre-pay all or any portion of a serial bond issue within the first 10 years after issuance. On the other hand, in a period of rising interest rates, it is a very reasonable decision to set and lock rates before they increase.

A typical borrowing pattern for construction or reconstruction projects involves issuing BANs and BARNs during construction and converting to serial bond financing after the project is complete. While this pattern is often followed to be sure all of the proceeds are in fact needed for the project, no County project has ever used less than the maximum amount authorized!

In addition to debt issued for a capital project, towns, villages or cities often issue short-term debt to keep their general fund solvent.

Tax Anticipation Notes

Tax Anticipation Notes ("TANs") are a debt instrument issued for cashflow purposes. They are typically issued because the receipt of property taxes by a municipality is not congruent with its cashflow expenditure requirements within its fiscal year cycle. TANs are not subject to the same amortization rules as debt issued for capital purposes.

TANs may be issued by any town, village or city,

a. During a fiscal year in anticipation of the collection of taxes or assessments levied, or to be levied, for such fiscal year,
b. Within 10 days prior to the commencement of a fiscal year or, where the fiscal year of the issuer is a calendar year, within 30 days prior to the commencement of a fiscal year, in anticipation of the collection of taxes or assessments levied, or to be levied, for such fiscal year,
c. During any fiscal year in anticipation of the collection of taxes or assessments levied for any of the four preceding fiscal years.

In the case of such notes issued in anticipation of the collection of taxes already levied, such notes may not be issued in an amount in excess of the amount of taxes levied for a fiscal year which is uncollected at the time of such borrowing (i.e., at closing, not at the date of sale of the TAN) less:

a. The amount of the outstanding tax anticipation notes issued in anticipation of the collection of such taxes, and
b. The amount, if any, included in the annual budget for such fiscal year or in the levy of taxes for such fiscal year to offset, in whole or in part, an anticipated deficiency in the collection before the end of such fiscal year of the taxes levied for such fiscal year.

In addition, there are federal tax regulations establishing limitations on the size of cashflow borrowings based upon a reasonably expected cashflow deficit during the term of the TAN and allowing for a small margin of comfort. See Chapter 11 for a further discussion of these tax considerations.

TANs must mature within one year from the date of their issuance and may be renewed from time to time, but each renewal may be for a period not to exceed one year. Such notes or the renewals thereof must be retired within five years after their date of original issue and in any event not later than five years after the close of the fiscal year for which were levied the taxes in anticipation of the collection of which such notes were issued; (however, such notes issued in anticipation of taxes to be levied (i.e., not yet levied at the time of borrowing), or the renewals thereof, may not extend beyond the close of the fourth fiscal year succeeding that in which the original notes were issued). TAN principal and interest is payable in a single payment (not semi-annually) at maturity.

There are five other significant aspects to the issuance of TANs:

a. The authority to issue TANs is by resolution by the affirmative vote of the majority of the voting strength of the Board; the TAN resolution typically delegates to the chief fiscal officer the authority to sell and issue TANs, often up to a capped amount and often only for a single fiscal year (but multiyear authorizations and delegations are permitted). There is no public referendum requirement. There is no estoppel or other public notice publication requirement after adoption. The essential elements of a TAN note are provided in Section 51.00 of the LFL as discussed earlier. The essential elements of a TAN resolution are described in Section 39.00 of the LFL hereinafter set forth.
b. The proceeds of such notes are only to be used for the purposes for which the taxes or assessments in anticipation of which they are issued were or are to be levied or for the redemption of notes in renewal of which they were issued.
c. Whenever the amount of TANs issued in anticipation of the collection of the taxes or assessments levied or to be levied for a fiscal year equals the amount of such taxes or assessments remaining uncollected (less the amount, if any, included in the annual budget for such fiscal year or in the levy of taxes or assessments for such fiscal year

to offset, in whole or in part, an anticipated deficiency in said collection before the end of such fiscal year), such monies as thereafter collected, must be set aside in a special bank account to be used only for the payment of such notes as they become due, unless other provision is made pursuant to law for the redemption of such notes. This is the Local Finance Law Section 24.00 (a) debt service fund, also discussed later in this primer under tax considerations. Any town, village or city may make budgetary appropriations for the redemption of such notes whether or not required or otherwise authorized by law to do so. In the event such an appropriation is made, such municipality shall not be required to pay into the special account the proceeds of the taxes or assessments against which such notes were issued but such proceeds may be used in the manner provided by law, or if there is no provision of law pertaining to the use of such proceeds, such proceeds shall be treated as surplus moneys for the fiscal year in which they are collected.

d. Where a tax anticipation note is to be renewed by the issuance of a renewal note, and the taxes or assessments in anticipation of which it was issued have been levied for a fiscal year, but remain uncollected, such renewal note shall not be issued for an amount in excess of the amount of such taxes or assessments remaining uncollected at the time of such renewal, less:

    (a) The amount of any other outstanding tax anticipation notes issued in anticipation of the collection of such taxes or assessments, and

    (b) The amount, if any, included in the annual budget for such fiscal year or in the levy of taxes or assessments for such fiscal year to offset, in whole or in part, an anticipated deficiency in the collection before the end of such fiscal year of the taxes or assessments levied for such fiscal year.

    Renewal notes cannot be issued for an amount in excess of the amount of the note in renewal of which it is to be issued, including TANs issued in anticipation of taxes or assessments which remain unlevied as of the renewal date.

e. There are other specialized rules in Section 24.00 of the LFL for issuing TANs in special circumstances, such as prior to the adoption of an annual budget and for fire districts.

Revenue Anticipation Notes

Revenue anticipation notes ("RANs") are a second common debt instrument issued for cashflow purposes by municipalities. Again, RANs are typically issued because the receipt of some particular form of revenue, e.g., state aid, is not congruent with cashflow expenditure requirements within the fiscal year cycle. Like TANs, RANs are not subject to the same amortization rules as debt for capital projects.

RANs may only be issued in anticipation of receipt of certain types of revenues and then, only such revenues due and payable within the fiscal year of issuance. The common types of revenue against which RANs may be issued are taxes other than real estate taxes (i.e., sales tax), rents, rates or charges (such as special fee revenues, grant-in-aid monies from the State or Federal government). Because of the payback limitations described below, it is usually preferable to borrow in anticipation of grants-in-aid for capital projects through BANs, which can be renewed up to 5 years while awaiting such grant receipt.

RANs may be issued by any town, village or city in anticipation of the collection or receipt of revenue, provided that each such note shall be issued only against a specific type of revenue, or for the purpose of renewing a previously issued RAN. A RAN may be issued in anticipation of multiple types of revenues, but in such case each such type must be separately accounted for in authorizing documentation and for purposes of all applicable rules.

RANs may be issued during any fiscal year in which such taxes, rents, rates or charges or other income in anticipation of which such notes are issued become due and payable or such moneys become due.

The total amount of RANs which a municipality may issue in anticipation of the collection or receipt of a specific type of revenue is to be determined in the following manner:

> In a typical town, village or city in which an annual budget is prepared and adopted for a fiscal year prior to the commencement thereof, such amounts must be:
>
> a. The amount of such specific type of revenue as estimated in the annual budget of such municipality for such fiscal year, or the amount of such specific type of revenue recognized for the fiscal year preceding that for which such budget is to be or has been adopted, whichever amount is the smaller, less
>
> b. The amount of such specific type of revenue so estimated in each budget which has actually been received or collected at the time of the issuance (not sale) of such RANs, and the amount of any outstanding RANs issued against such specific type or revenue for the fiscal year for which such notes are to be issued.
>
> These provisions are not applicable (1) where a specific type of revenue has not been estimated in such budget and in that case such amount may be the amount of such revenue as is estimated by the chief fiscal officer to be recognized for the fiscal year for which such budget has been adopted, or (2) where a specific type of revenue has not been recognized for the entire fiscal year preceding that for which such budget has been adopted, and in that case such amount may be the amount, if any, of the specific type of revenue as estimated in the annual budget, less, in either case, the amount of such specific type of revenue which has actually been received or collected at the time of the issuance of such notes, and the amount of any outstanding RANs issued against such specific type of revenue for the fiscal year for which such notes are to be issued.

In addition to this limitation under the LFL, there are applicable federal tax regulations limiting sizing as noted in the discussion of TANs. *See* Chapter 11.

There are three other significant aspects to the issuance of RANs:

a. The authority to issue RANs is typically by resolution by the affirmative vote of the majority of the voting strength of the Board, the RAN resolution typically delegates to the chief fiscal officer the authority to sell and issue RANs, often up to a capped amount and often only for a single fiscal year (but multi-year authorizations and delegations are permitted). There is no public referendum requirement. There is no estoppel or other public notice publication requirement after adoption. The essential elements of a RAN resolution, like a TAN resolution, are described in Section 39.00 of the LFL hereinafter discussed. The essential elements of a RAN note, like a TAN note, are provided in Section 51.00 of the LFL.

b. Whenever the amount of RANs issued for a fiscal year against a specific type of revenue shall be the estimated amount of such specific type of revenue in anticipation of the collection or receipt of which such notes shall have been issued, less the amount of such revenue actually received or collected, all of such revenue, as thereafter received or collected, is to be set aside in a special bank account to be used only for the payment of such revenue anticipation notes as they become due. This is the Local Finance Law Section 25.00(g) debt service fund also discussed later in this primer under tax considerations. Any town, village or city may make budgetary appropriations for the redemption of revenue anticipation notes whether or not required or otherwise authorized by law to do so. In the event such an appropriation is made, such town, village or city is not required to pay into the special account of proceeds of the specific type of revenue against which such notes were issued, but such proceeds may be used in the manner provided by law or if there is no provision of law pertaining to the use of such proceeds, such proceeds shall be treated as surplus moneys for the fiscal year in which they are collected.

c. RANs must mature within one year and may be renewed from time to time, but each renewal must be for a period not exceeding one year and in no event may such notes, or the renewals thereof, extend beyond the close of the second fiscal year succeeding the fiscal year in which such notes were issued. Such notes may not be renewed in an amount in excess of the difference between the amount of the uncollected or unreceived revenue in anticipation of which they were issued and the amount of any other outstanding revenue anticipation notes issued in anticipation of the collection or receipt of such revenue. RAN principal and interest is payable solely at maturity.

TAN and RAN Resolutions Format

The following provision of law governs the text of both TAN and RAN resolutions.

§39.00 Tax anticipation note resolution, revenue anticipation note resolution and urban renewal note resolution, form and contents.

a. Whenever the finance board shall authorize the issuance of tax anticipation notes, revenue anticipation notes or urban renewal notes, or the renewal of such notes, it shall do so by a “tax anticipation note resolution," a "revenue anticipation note resolution" or an "urban renewal note resolution," as the case may be. Each such resolution shall be properly dated and shall bear a title which will indicate the type of note to which it relates. Whenever any such note has been duly authorized by a chief fiscal officer the certificate required to be filed by such officer pursuant to section 30.00 of this chapter shall bear a title which will indicate the type of note to which it relates.

b. A tax anticipation note resolution, revenue anticipation note resolution or an urban renewal note resolution shall contain, in substance, the following provisions:

1. A statement that such notes are issued in anticipation of:

(a) The tax collection of real estate taxes or assessments, in the case of tax anticipation notes;

(b) The collection of revenues other than real estate taxes or assessments, in the case of revenue anticipation notes; or

(c) The receipt of moneys from (1) the sale of real property, or any interest therein, acquired for or incidental to an urban renewal project; or (2) from the United States government pursuant to title one of the federal housing act of nineteen hundred forty-nine, as amended; or (3) from the state of New York pursuant to the general municipal law; or from any or all such sources, in the case of urban renewal notes.

2. (a) In the case of tax anticipation notes:

(1) If such taxes or assessments were levied or are to be levied for a fiscal year, a statement of the fiscal year for which such taxes or assessments were levied or are to be levied, or

(2) If such notes are to be issued in anticipation of the collection of assessments levied for a capital improvement and to be collected in a single installment, and, if such assessments have been levied, a statement of the date of the levy of such assessments, or

(3) If such notes are to be issued in anticipation of the collection of an installment of assessment which are levied for a capital improvement and which are to be collected in several installments, and, if such installment of assessments has been levied, a statement of the date on which such installment is due and payable.

3. (a) In the case of revenue anticipation notes, a statement of the assessments have been levied, a statement of the amount of such taxes or assessments remaining uncollected against which such notes are authorized to be issued.

(b) In the case of revenue anticipation notes, a statement of the amount of uncollected revenues against which such notes are authorized to be issued.

(c) In the case of urban renewal notes, a statement of (1) the total estimated cost of the urban renewal project as stated in the certificate of the chief fiscal officer of the municipality filed and approved in the manner prescribed in paragraph d of section 25.10 of this chapter; (2) the total amount of any and all advances, loans and grants made by the United States government or by the state of New York in aid of such project to the municipality prior to and including the date of the issuance of any such note or notes; (3) the amount of any and all local grants-in-aid made or to be made for such project; and (4) the total amount of such notes outstanding for such project.

4. In the case of urban renewal notes, a statement identifying the particular urban renewal project with respect to which such notes are to be issued.

5. A statement of the amount of such notes to be issued.

6. A statement of the period of maturity on such notes.

7. (a) In the case of tax anticipation notes issued in anticipation of the collection of taxes or assessments which have been levied, or the renewals thereof, a statement that the date of maturity of such notes shall not extend beyond the close of the applicable period provided in section 24.00 of this chapter for the maturity of such notes.

(b) In the case of revenue anticipation notes, if such notes are to be issued in renewal of similar notes, a statement that the date of maturity of such notes shall not extend beyond the expiration of the second fiscal year succeeding the fiscal year in which such original notes were issued.

Budget Notes

A town, village or city may issue budget notes during any fiscal year for expenditures for which an insufficient or no provision is made in the annual budget for such fiscal year. The amount generally may not exceed five percent of such annual budget (limitation not applicable in cases of unforeseeable public emergency).

Budget notes must be redeemed out of the taxes or assessments levied or to be levied for the fiscal year in which they mature or out of other revenues of that fiscal year legally available for that purpose. Principal and interest is payable solely at maturity.

Any municipality which has the power to issue budget notes is also granted the power to appropriate and expend money received from the proceeds of the sale of budget notes for the purposes for which such notes are issued.

There are also special rules for budget notes for certain insurance purposes, snow and ice removal, judgments and settled claims, improvement districts; and other specific problematic budgetary situations.

It is important to note that, while budget notes may be issued due to increased expenses or to cover costs of unforeseen public emergencies, there is no authority to issue budget notes for revenue shortfalls of any kind. That is considered a problem to be solved by cost-cutting, cashflow borrowings, midyear tax or fee increases and/or deficit financing.

Budget notes are authorized by a budget note resolution of the Board by the affirmative vote of a majority of the voting strength. A public referendum is not required. Delegation to the chief fiscal officer of sale and issuance duties is common. There is no publication requirement. The essential elements of a budget note resolution may be found in Section 40.00 of the LFL, as follows:

§40.00 Budget note resolution; form and contents; authorization thereof

a. The issuance of budget notes or renewals thereof shall be authorized by a "budget note resolution." Each such resolution shall be properly dated and shall bear a title which will indicate that it relates to a budget note.

b. Any municipality, school district or district corporation may adopt one or more budget note resolutions authorizing the issuance of budget notes for a specific object or purpose, for which object or purpose budget notes may be issued. In addition, any municipality may adopt one or more budget note resolutions authorizing the issuance of budget notes for a class of objects or purposes set forth in paragraph b, c, d or e of section 29.00 of this chapter.

c. A budget note resolution shall contain, in substance, at least the following provisions:

1. A statement setting forth the facts and circumstances necessitating the issuance of such budget notes and the specific object or purpose or the class of objects or purposes for which the budget notes to be authorized by such resolution are to be issued and stating that there are no other funds available with which to pay or provide for such object or purpose or class of objects or purposes. Such circumstances necessitating the issuance of budget notes and such specific object or purpose shall be described in brief and general terms sufficient for a reasonable identification.

2. A statement of the amount of budget notes to be issued for such specific object or purpose or class of objects or purposes.

3. A statement of the period of maturity of such notes.

4. If such notes are to be issued in renewal of other notes a statement that the date of maturity of such notes shall not extend beyond the applicable period provided in section 29.00 of this chapter for the maturity of such notes.

d. Every budget note resolution shall be adopted by at least a majority vote of the voting strength of the finance board. A majority vote shall be sufficient for the adoption of a resolution authorizing the renewal of any budget note.

The essential elements of a budget note are also provided in Section 51.00 of the LFL, as described earlier.

The issuance of a budget note is a red flag to the rating agencies that there are fiscal problems at the municipality, and it should be avoided if at all possible.

Specialized Bond Types

In addition to the plain vanilla fixed-rate general obligation serial bonds, towns, villages and cities in the State have authority to issue certain specialized type long-term debt obligations, including capital appreciation bonds ("CABs"), original issue discount ("OID") bonds, including zero coupon bonds, variable rate bonds, and term bonds (otherwise known as sinking fund bonds). While each of these bond types must be issued as general obligation bonds, they each include features as to the nature or timing of interest or as to partial mandatory redemption of principal by lot that appeal to certain types of investors in certain markets. These instruments are very rarely issued in the State. It is only important to note their available authority and the need to put separate provisions in a bond resolution, or, if necessary, amending resolutions to permit the use of them. Investment banking firms will make towns, villages and cities, their local counsel, their bond counsel and their financial advisors aware when such instruments might be an advantageous form of issuance, because such debt can be sold on a negotiated basis to them.

Capital Notes

In the hoary days of antiquity when dinosaurs still roamed the State, the authorization for the financing of most capital projects by municipalities, required a five percent so called "down payment" to be appropriated in cash as part of the financing plan. This was considered to be "earnest money"—the local governmental unit really had to want the capital project enough to use some currently raised taxpayer dollars. For many years, prior to 1991, when this requirement was eliminated, a municipality could also satisfy this requirement, however, through the issuance of capital notes. (This effectively negated the "earnest money" aspect of the down payment.)

While it is still permissible to authorize the financing of a capital project in whole or in part with capital notes instead of BANs and bonds, the particular requirements for principal payoff are not appealing: such capital notes may be renewed from time to time, but such notes, including the renewals thereof, must mature not later than the first day of the second fiscal year succeeding the fiscal year in which such notes are issued. In addition, an installment of not less than 50 percent of the principal amount of such notes must mature in the first fiscal year succeeding the fiscal year in which such notes are issued, unless such notes are authorized and issued during a fiscal year at a time subsequent to the date of the adoption of the annual budget for the next succeeding fiscal year. (In such case, one more year is permissible.) As a result, BANs and BARNs are much more common due to their flexibility and longer term renewability.

Capital notes must be redeemed out of taxes or assessments levied or to be levied for the fiscal year in which they mature or other legally available revenues of that fiscal year. They cannot be automatically converted to BARNs, but can be refinanced with bonds. Principal and interest are payable at maturity.

Capital notes and capital renewal notes are each authorized by adoption of a capital note resolution adopted by the Board by an affirmative vote of two-thirds of the voting strength. Unlike bond anticipation notes and bond anticipation renewal notes, the renewal of a capital note cannot be authorized and delegated in the original capital note resolution. The essential elements of a capital note or capital renewal note resolution may be found in Section 32.00 of the LFL, and are the same as for a bond resolution, discussed elsewhere herein. The essential elements of a capital note are provided in Section 51.00 of the LFL, as described earlier.

Capital notes are rarely, if ever, utilized nowadays.

Refunding Bonds

What is an advance refunding? An advance refunding is a refinancing of outstanding bonds by the issuance of new bonds. It is thus not unlike refinancing a home mortgage note. It is a transaction in which a municipality issues new bonds ("refunding bonds"), the proceeds of which are placed in an escrow account (in a bank or trust company located and licensed to do business in New York State). The proceeds, after payment of costs of issuance, are used to purchase special United States Treasury securities (generally directly from the Bureau of the Public Debt Division of the U.S. Treasury Department), the principal and interest payments of which are then used to pay the outstanding, now "refunded bonds." Debt service on the refunded bonds is paid from those investment proceeds in the escrow account. The refunded bonds are subsequently (on their "call date") "called" for early redemption prior to their stated maturity date, if such bonds have such a call feature. Many plain vanilla general obligation bonds have such a call feature available as of and after the date 10 years from the original dated date of the bonds.

Certain outstanding bonds without a call feature rarely may also be advance refunded, but in such a case, the escrow account is established to pay debt service on the refunded bonds to each bond maturity date rather than an earlier "call date."

It is generally necessary to issue a greater amount of refunding bonds than the amount of bonds to be refunded due to two factors:

a. The costs of issuance of the refunding bonds (which may be included in the refunding bond size rather than paid in cash). These costs include: bond counsel, financial advisor, escrow agent bank, independent verification agent (to confirm that the escrow is sufficient to pay off the outstanding bonds), local counsel, and underwriter's fees.
b. The amount of money necessary to invest in U.S. Treasury securities to pay off the outstanding bonds (which are generally at a higher interest rate(s)) is necessarily more than the outstanding, refunded bond amounts because the escrow will pay principal *and* interest on the refunded debt and will be invested usually at a lower interest rate than the rate(s) on the refunded bonds (due, in part, to federal arbitrage rules governing advance refundings).

If it is necessary to issue more new bonds than the old bonds to be refinanced, how can one know if it makes any financial sense to do such a transaction?

Present Value Savings. "Present value savings" is the historical benchmark requirement for advance refunding transactions in New York State: it is a time-value analysis of the stream of debt service payments due on the outstanding bonds in comparison to the proposed advance refunding bonds. The main governing provision of law, LFL Section 90.10, requires that there be present value savings for an advance refunding transaction to receive the legally requisite approval of the Office of the State Comptroller. Such transactions are generally not done unless the present value savings in dollars equal or exceed 3% of the outstanding principal amount of bonds to be refunded (although this 3% threshold is not a legal requirement). Thus, although a refunding bond may be larger in size than the remaining outstanding, refunded debt, the transaction *must*, nevertheless, make financial sense to proceed.

In addition, in order to receive the requisite approval of the State Comptroller, there are certain additional requirements.

Costs of Issuance of Refunding Bonds. The State Comptroller also must approve the full terms and conditions of the refunding transaction. What does this mean? It means that all of the fees and expenses of the transaction are subject to State Comptroller review prior to closing an advance refunding transaction. Section 90.10 of the Local Finance Law provides for the inclusion of costs of issuance in the sizing of the refunding bond issue (then automatically takes such bond-paid costs into account in any calculation of the present value savings of the transaction). A municipality may also pay such costs with available cash if it prefers.

Section 90.10 of the LFL provides for the inclusion of such costs of issuance in the sizing of the refunding bond issue (thus automatically taking such bond-paid costs into account in any calculation of the present value savings of the transaction). Advance refunding transactions are the most complicated general obligation bond issues which a local governmental unit could undertake. There are more parties to the transaction, more documentation and more governmental oversight and approval than a "plain vanilla" capital project borrowing. As a result, advance refundings are more costly to complete. These costs should be taken into account in determining whether to proceed with such transactions. Consultation with a financial advisor is recommended on this point.

Board Action. Advance refunding transactions require adoption of a refunding bond resolution which includes a "preliminary refunding financial plan" (obtained from a financial advisor or willing underwriter/investment banking firm who will usually bring the refunding opportunity to the Board's attention in the first place). This is a specialized form of bond resolution with "magic" language known only to bond counsel. Some of it truly is essential to validity.

Refinancing Debt Structure Rules. In the course of structuring a refunding transaction, the first payment of principal on the new, refunding bonds must occur no later than the next occurring principal payment date on the outstanding bonds to be refunded. Why? If this rule were not in place, it would be effectively possible to skip the current fiscal year cycle in the payment of principal. The Constitution and Local Finance Law of New York State require regular annual principal paydowns of debt on each project which is bond-financed. Nevertheless, note: a refunding *can* generate savings in the current or next fiscal year to the benefit of the municipality.

Similarly, there is a separate provision of law which states that the *maximum* period of probable usefulness cannot be extended simply by completing a refunding transaction. In short, if your capital project financed by bonds has a 40-year *maximum* period of probable usefulness (typical of water and sewer projects, but not much else) and the first borrowing was, for example, in 2000, then the anniversary date of that first borrowing in 2040 is *still* the final date by which the refunding bonds must be paid off, even though two years have elapsed since the initial borrowing. The clock continues, rather than beginning to run anew. *That is not to say that outstanding debt cannot be extended.* If the outstanding debt was issued for 20 years when the project for which it was issued is entitled to a maximum 40-year useful life, then an extension of the debt to a longer period would be permissible in the course of the refunding (as long as it would not exceed a maximum of 40 years total). This would lower the annual costs of debt service by spreading it out over time despite the incremental increase in interest expense over time. The refunding must still offer present value savings to work.

Finally, the internal structure of your new refunding bond issue must conform to the so-called “fifty percent rule” or substantially level or declining level annual debt service. The determination of compliance with these rules is generally made solely with reference to the new refunding bonds. How the prior, now to be refunded, bonds were amortized in this regard becomes irrelevant.

Steps in an Advance Refunding Transaction

a. Adoption of a Refunding Bond Resolution by affirmative vote of two-thirds of the voting strength of the Board including an appendix with “Preliminary Refunding Financial Plan,” after consideration of proposals received from underwriters and consultation with financial advisors and bond counsel.
b. Publication of Legal Notice of Estoppel of Refunding Bond Resolution, or summary thereof.
c. After passage of a minimum of 20 days, sale of Refunding Bonds can commence including, in the interim, preparation of Preliminary Official Statement and solicitation of bids and award for escrow bank and verification agent by financial advisor.
d. Sale of Refunding Bonds including initial advance purchase of special U.S. Treasury Securities of the State and Local Government Series (“SLGs”) to fund escrow on closing date.
e. Application of Office of the State Comptroller for approval of transaction in accordance with requirements of Section 90.10 of the LFL. (Minimum 10 day approval period)
f. Closing of Refunding Bond Issue and purchase of SLGs to fund escrow.
g. The Escrow Account pays all refunded bond debt service when due until called and then the cost of redemption on the date all the bonds are called. The municipality is responsible for debt service on the Refunding Bonds.

Joint Projects and Municipal Cooperation Debt

There are various ways to accomplish this depending on the particular facts and circumstances. A municipality should explore these kind of obligations with bond counsel if financing a joint project is contemplated. Article VIII Section 1 and Section 2-a of the constitution, Title 1-A of the Local Finance Law and Article 5-G of the General Municipal Law are the main governing provisions.

CHAPTER NINE

Amortization Structures

In New York State, there are rules regarding when principal must first be paid, when principal may last be paid, and how often and how much may and must be paid between the two dates.

The New York State Constitution has long provided that no installment for the payment of principal of outstanding indebtedness of any municipal issuer may exceed any prior installment by more than fifty percent. This provision has generally meant that the debt service requirements for any particular general obligation municipal debt in New York declined with time, as the decline in annual interest due overtook any limited permitted annual increase in principal repayment. The point was to ensure that debt was not backloaded to future generations of property taxpayers.

In 1993, that provision of the Constitution was amended, effective January 1, 1994. All municipalities, school districts and district corporations in New York State may now, consistent with the Constitution, alternatively contract to repay indebtedness in substantially equal or declining annual debt service payments.

Paydown of Principal Options

There are a few basic legal rules in this regard that must be considered:

a. **The 2-Year Rule:** the municipality must begin to pay down principal within two years of the original date of issuance, but may voluntarily pay down its first principal earlier. (If a local government delays in the case of five-year items like vehicles, it does substantially increase what the last four payments will look like.)

b. **Annual Principal:** Thereafter, principal *must* be paid down annually. (That means not so little as one day beyond the anniversary date.)

c. **Method of Amortization of Annual Principal:** As noted above, there are two methods for determining the overall structure of debt service over the payoff period: (1) what is known as "fifty percent debt" in which principal is structured according to the Constitutionally based rule that no principal payment over time may exceed any prior smaller principal payment by more than 50%. This rule was designed to prevent excessive backloading of principal payoffs onto later generations of taxpayers, or (2) substantially level annual debt service in which principal and interest payments are substantially equal in each year (not usually perfectly equal) similar to home mortgage payments, except that BANs usually pay interest and principal annually and bonds usually pay interest semiannually and principal annually.

d. **Length of Amortization:** The period of probable usefulness of a capital project establishes the outside date by which all debt for the project must be paid off, set by the date of the first borrowing therefore, be that a bond anticipation note or a serial bond.

The "Two-Year Rule" for Bond Anticipation Notes

A principal payment must be made with respect to bond anticipation notes within two years of the date of issuance of the first bond anticipation note. That principal payment should be sized with the "fifty percent rule" in mind, or after determining to implement level annual debt service.

The "Two-Year Rule" for Bond Issues

If a town, village or city does not issue bond anticipation notes, but instead goes directly to a bond issue, the first principal payment of a bond issue must fall within two years of the date of the bonds.

Put another way, the rule is that the first principal payment with respect to any financing must be made within two years of the date of the first bond anticipation note or within two years of the date of the bonds.

The Fifty Percent Rule

The general rule is that no principal payment during the course of bond anticipation note financing or serial bond financing may exceed by more than fifty percent, the smallest previous principal payment.

Thus, when a town, village or city plans on making a principal payment during the course of bond anticipation note financing, the municipality wants to make sure that principal payment is sufficient to allow the municipality to amortize the future bond issue over the remaining years allowed without any of the future principal payments exceeding by more than fifty percent the next principal payment that the municipality is planning to make.

In the case where the period of probable usefulness is in excess of five years, and the bond resolution does not restrict the maximum maturity thereof to five years, and it is planned to finance that purpose over a period in excess of five years (i.e., common municipal building projects), the general rule is that serial bonds must be sold, issued and delivered within five years of the date of issuance of the first bond anticipation note, with the first maturity of such serial bonds falling on or before the date that marks the five-year period computed from the date of issuance of the first bond anticipation note.

A principal payment from a source other than the proceeds of bonds or bond anticipation notes must be made within two years of the date of issuance of the first bond anticipation note and the amount of that principal payment and the amount of each subsequent principal payment should be sufficient to allow the municipality to pay off the balance of the financing over the remaining period of years allowed to it without violating the so-called "fifty percent rule."

The fifty percent rule, simply stated, says that no principal payment of indebtedness, whether made in the course of bond anticipation note financing or in a serial bond maturity schedule, may exceed by more than 50% the smallest of any of the previous principal payments.

A simple illustration: a town, village or city has a $100,000 purpose that can be financed, according to the term specified in the bond resolution, over 10 years. It makes a first principal payment of $8,000. Because the fifty percent rule permits the municipality now to go as high as $12,000 on any subsequent payment, it is obvious that, whether or not a principal payment is made at the end of the first year of bond anticipation note financing, the municipality will be able to pay off the indebtedness over the period remaining to it (eight years in the first case, nine years in the second) without violating the fifty percent rule.

Compare another town, village or city, with the same $100,000 purpose, which makes a first principal payment of $6,000 instead of $8,000. Under the fifty percent rule, the $6,000 payment limits the municipality to a maximum payment of $9,000 in any subsequent year. Assuming that the $6,000 payment was made at the end of the second year (no payment having been made at the end of the first year), the municipality now has eight years of payment left. Taking these eight years and multiplying 8 x $9,000, you arrive at $72,000; and one can see, this $72,000 plus the original $6,000 payment ($78,000) makes it impossible for the municipality to pay off the financing by the end of the 10-year period without violating the fifty percent rule.

The Fifty Percent Rule and Seeming Violations

Under certain circumstances bond counsel can approve the legality of bond anticipation notes which, on their face, seem to violate the so-called fifty percent rule described above.

Assume that a town, village or city issued a bond anticipation note in the principal amount of $330,000 for a building reconstruction project in "Fiscal Year 1." This was the first note issued for the project. The bond resolution limited the maximum maturity of the serial bonds to five years. (It would never happen, but imagine it for purposes of a simplified illustration.)

In the following fiscal year ("Fiscal Year 2"), against the outstanding $330,000 bond anticipation note then maturing, the town, village or city made a principal payment in the amount of $66,000, such amount constituting the first installment of such indebtedness, and issued a renewal note in the principal amount of $264,000.

Similarly, in the next succeeding fiscal year ("Fiscal Year 3"), the town, village or city made a principal payment in the amount of $66,000 and issued a renewal note in the principal amount of $198,000.

The municipality then advises bond counsel that they would now like to pay off entirely the outstanding $198,000 bond anticipation note at the time of its maturity and asks whether this would be legal in view of the so-called "fifty percent rule."

The answer to that question is unequivocally in the affirmative: the municipality legally may make such a payment. The rationale lies in the distinction between "voluntary" payments and "involuntary" or "mandated" payments.

Pursuant to Section 53.00 of the LFL, a municipality may issue obligations which are redeemable prior to maturity. Thus, for example, a municipality could issue a $2,000,000 bond issue payable $100,000 per year over a period of 20 years, with the bonds callable at the end of the tenth year. Assume that that serial bond issue was issued by a current administration in office at a town or village in Fiscal Year 1 with a 10-year call feature. The provisions for early redemption do not mandate upon the administration which is in office in year 10 the decision to call in the bonds at that time; the decision to call in the bonds in Fiscal Year 10 by the administration in office in that year is an entirely voluntary decision not mandated by law or any other circumstances.

If one accepts the constitutionality of the provisions of the LFL which permit the issuance of callable bonds, and which allows an administration 10 years after issuance to voluntarily pay off the balance of the bonds, thus seeming to violate the so-called "fifty percent rule," then one must accept the constitutionality and legality of an issuer voluntarily deciding to pay off a bond anticipation note in the circumstances described above.

It is important to note: voluntary payments can only be said to be constitutional and legal where the previous payments have been of such sufficient magnitude so as not to have mandated the issuer into having to make a payment which violates the fifty percent rule in order to amortize the issue over the remaining allowable maturity.

Thus, for example, in the instant situation, if the town, village or city had paid $66,000 in Fiscal Year 2 and then in Fiscal Year 3 lowered that payment to $30,000, one can see that under the fifty percent rule no subsequent payment could exceed $45,000 and to enable the municipality to pay off the financing within the allowable five-year maturity period (computed from the date of issuance of the first bond anticipation note), the town, village or city would be forced (mandated) to make a principal payment within such five-year period of such a magnitude so as to result in a violation of the fifty percent rule.

Accordingly, it follows that whether a payment may be regarded as being "voluntarily" made or "involuntarily" made depends upon the size of the principal payments that have been made during the course of the financing up to the date that the municipality is considering the payment which, on the face of it, would seem to violate the fifty percent rule.

Now consider a different set of circumstances when a principal payment has been made after the first year of bond anticipation note financing which seemingly violates the so-called fifty percent rule set forth in paragraph d of Section 21.00 of the Local Finance Law.

Paragraph b of Section 23.00 of the Local Finance Law provides that bond anticipation notes shall mature within one year from the date of their issue and may be renewed from time to time, but each renewal shall be for a period not exceeding one year and in no event shall such notes or the renewals thereof extend more than two years beyond such original date of issue unless a portion of such notes or the renewals thereof shall be redeemed from a source other than the proceeds of bonds within two years from such original date of issue.

In plain English, as discussed earlier, this means that you must make a principal payment within two years of the date of issuance of the first bond anticipation note.

By omission, then, the statute permits a municipality to make no payment at the end of the first year and roll over the bond anticipation note in full.

Let us take a $100,000 financing with a 10-year maturity as an example. The municipality issues $100,000 bond anticipation note in year one. At the end of year one, the municipality makes a $10,000 principal payment and issues a $90,000 renewal note. At the end of year two (the year in which a principal payment is mandated by the statute) the municipality makes a $5,000 principal payment.

Bingo!—you have an automatic violation of the fifty percent rule, because the fifty percent rule says that no principal payment may exceed by more than 50% the smallest previous principal payment mandated by law. By making the principal payment in the amount of $5,000, no subsequent payment may legally exceed $7,500, and you can see that over the next eight years, it is impossible to amortize the remaining $85,000 without violating the fifty percent rule.

Take a different scenario, however: At the end of the first year, the municipality makes a $5,000 principal payment. The uninitiated would conclude, using the reasoning above, that there is an automatic violation of the fifty percent rule. This is not the case. After all, the Local Finance Law provides that no principal payment need be made at the end of year one. If that is the case, then why should a municipality be punished for making a "voluntary" payment at the end of year one. Thus, for the purpose of the fifty percent rule, one can disregard the first payment in this case, since it was a voluntary payment not mandated by law.

Level Debt Service

Since January 1, 1994, the LFL provides for the issuance of bonds with substantially level or declining annual debt service, as an alternative to compliance with the "fifty percent rule" described above. This provision also allows use of the weighted average period of probable usefulness of various capital projects in the case of a consolidated bond issue in which a single bond issue is sold for multiple projects. If bond anticipation notes are issued for a project or projects for which it is anticipated that serial bonds will be issued with substantially level or declining annual debt service, such notes must be redeemed in part in each year in an amount at least equal that which an annual installment of hypothetical substantially level or declining serial bonds would be if issued at a five percent rate of interest. Compliance with the "fifty percent" rule during bond anticipation note financing prior to the issuance of serial bonds should generally comply with this requirement but should always be verified.

Bond Counsel should always be consulted as to exactly how "substantially level or declining annual debt service" should be implemented. If it is not done properly, the debt is not validly issued. And that is not good.

Note the relationship of PPU calculation discussed earlier to a level debt service amortization: in the level debt service context, each object or purpose with its own PPU, in effect, "pulls its own weight" to be part of a resultant average aggregate maximum PPU. In this context, while a project with a 5-year useful life may be paid for, in effect, over 10 years, so too is a building with a 25-year useful life.

Relationship of Bond Anticipation Notes to Bonds: The "Five-Year Rule"

Generally, serial bonds must be sold, issued and delivered within five years of the date of issuance of the first bond anticipation note. A municipality must arrange to sell the bonds sufficiently in advance of the five-year anniversary date so that the first maturity of the serial bonds will fall within five years of the date of the first bond anticipation note. This is a trap for the unwary.

Series Financings

It is possible to divide a financing into series of notes and series of bonds.

Assume that a town, village or city has authorized an issue of $10,000,000 and in the first year they only wish to issue $5,000,000 and follow that up in the second year by another $5,000,000 note issue. In the third year, they plan to consolidate the two borrowings into one serial bond issue.

In each case, each of the series (let us call them Series A and Series B) would stand on their own as separate issues; each series would have its own two-year rule; each series would have its own five-year rule; each series would have its own fifty percent rule; however, it is important to remember that the maximum maturity of the Series B financing would have to be pegged from the date of issuance of the first bond anticipation note (or serial bonds, if no such notes were ever issued) issued for the Series A financing. Within the single consolidating bond issue in year three, these rules must be observed.

CHAPTER TEN

Public or Private Sale of Debt Instruments

The sale of BANs and serial bonds can involve private local placement or public competitive sale, but if over $1 million, competitive sale of bonds (not notes) is legally required at this time with few exceptions. Unlike bonds, BANs may be sold at public competitive sale or privately placed with local banks or regional investment banking houses, regardless of the size of the issue. One of the roles of a financial advisor is to assist in the determination of how to sell the debt, between the legally available options. (This chapter is rather dry and boring but you probably should read it just once.) In case you don't, here is the executive summary:

- A town, village or city can sell bond anticipation notes in any amount either by competitive public sale with the help of a financial advisor or by placing them with a local bank, often a bank with which you have a depository relationship. Get three bids if possible.
- A town, village or city can sell up to one million dollars of serial bonds annually locally to a bank, often a bank with which you have a depository relationship. Get three bids if possible.
- Any bond issue of over $1,000,000 must be sold publicly competitively following detailed statutory law and State Comptroller's regulations. You will need a financial advisor to help you with access to this market.

Note Sales

Notes (BANs, BARNs, TANs, RANs, capital notes and budget notes) may be sold at public competitive sale or be placed privately regardless of the size of the issue. If sold publicly, the notice of sale must conform to the requirements of Section 60.00 of the LFL and the State Comptroller's rules found in Part 26 of Chapter II of the Title 2 of the N.Y. Comp. Codes Rules and Regulations (hereinafter, "N.Y.C.R.R."). If privately placed, it is recommended that bids be solicited from at least three institutions, e.g., local banks, assuming three banks still do business in the area. This is not a legal requirement.

The basic note sale rules are as follows:

a. Notes may be sold either at public or private sale, but they cannot generally be sold on option or on a deferred payment plan.

b. Notes may be sold without limitation as to rate of interest, and generally for a sum not less than the par value of, and the accrued interest on, such obligations, and bond anticipation notes may be sold to the state of New York municipal bond bank agency, at such rate or rates of interest as may be agreed upon by and between the issuer and such agency.
c. Capital notes for one or more specific objects or purposes or classes of objects or purposes, or a combination thereof, may be sold as a single capital note issue. Bond anticipation notes for one or more specific objects or purposes or classes of objects or purposes, or a combination thereof, may be sold as a single bond anticipation note issue. This is known as a consolidated issue.
d. If notes are sold at public sale the legislative body may specify the procedure therefor or they may adopt as much of the procedure prescribed for the sale of bonds in Sections 57.00 to 59.00 inclusive, of the LFL, as they may desire. In all such sales, however, the provisions of paragraph e below must be complied with. Nothing in the rules prevents the sale of notes at public auction.
e. The State Comptroller has adopted rules prescribing a procedure for the circularization of notices for the public sale of notes and which also prescribe such data and information as his office deems advisable to be contained in such notices. It is one of the functions of bond counsel to ensure compliance with these rules.

Smaller note issues are often privately placed after an informal solicitation process with local banks, particularly depository banks of the issuer. What constitutes small is basically a matter of the appetite of your local banks for local governmental debt. When notes are publicly competitively sold or are to be sold privately in the larger financial markets, the services of a financial advisory firm are usually engaged.

Public Bond Sales

Bonds of over $1 million in principal amount may be sold only at public sale and in accordance with the procedures set forth in Sections 57.00, 58.00 and 59.00 of the LFL with few exceptions as noted below. A debt statement must be filed with the Office of the State Comptroller before the public sale of most bonds (but not notes) in accordance with the requirements and procedures specified in Title 10 of the LFL.

The basic bond sale rules are as follows:

a. Bonds issues of over $1 million shall be sold only at public sale and in accordance with the procedures set forth in the LFL, except as described below.
b. Bonds may be sold at private sale to the United States government or any agency or instrumentality thereof (such as the Department of Agriculture, Rural Development Division), the State of New York Municipal Bond Bank Agency, to any sinking fund or pension fund of the municipality, school district or district corporation selling such bonds, or, in the case of bonds or other obligations of a municipality issued for the

construction of any sewage treatment works, sewage collecting system, storm water collecting system, water management facility, air pollution control facility or solid waste disposal facility, also to the New York State Environmental Facilities Corporation ("EFC").

c. Bonds may also be sold at private sale as provided in Section 63.00 of the LFL for $1 million and under, hereinafter described.

d. No bonds shall be sold on option or on a deferred payment plan, except that options to purchase, effective for a period not exceeding one year, may be given in certain very limited cases, including to EFC with respect to bonds or other obligations issued for the construction of any sewage treatment work, sewage collecting system, storm water collecting system, water management facility, air pollution control facility or solid waste disposal facility. A loan commitment may also be entered into by and between a municipality and the State of New York municipal bond bank agency and by and between such a municipality and EFC, such commitment to be fulfilled by the purchase of the bonds or other obligations by such State agency or such State corporation.

e. Bonds shall be sold without limitation as to rate of interest and for a sum not less than the par value of, and the accrued interest on, such obligations except as authorized by the LFL, and may also be sold at private sale to the State of New York municipal bond bank agency and to EFC and to the Dormitory Authority of the State of New York in certain cases. When sold at public sale, the rate of interest shall be determined in the manner provided in Section 59.00 of the LFL. A maximum rate of interest at which such bonds shall be sold may be fixed.

f. Bonds for one or more specific objects or purposes or classes of objects or purposes, or a combination thereof, may be sold as a single bond issue. This is known as a "consolidated bond issue."

g. The State Comptroller has adopted rules with which bond counsel ensures compliance:
   1. Designating a financial newspaper or newspaper published and circulated in the city of New York in which notices for the sale of bonds may be published;
   2. Prescribing the procedure for the circularization of notices for the sale of bonds;
   3. Prescribing certain other requirements as necessary relating to the publication or circularization of notices for the sale of bonds;
   4. Prescribing certain data and information with which both bond counsel and the financial advisor are familiar; and
   5. Prescribing the requirements for the alternative and permissive publication or circularization of notices particular to the sale of bonds of an issue not exceeding $1 million.

   It is part of the duties of bond counsel and the financial advisor to the issuer to ensure compliance and to assist with the filing of a debt statement with the Office of the State Comptroller prior to the bond sale.

h. Notwithstanding the limitations set forth above, a municipality or school district may provide for the public sale of its bonds at a price of less than the face value of such bonds at maturity, i.e., at an original issue discount such that the issuer does not receive full face amount of principal; provided that no issue of bonds shall be sold at a price such that the difference between the sale price of such bonds, not including accrued interest, and the face value of such bonds at maturity, shall exceed five percent of the face value of such issue of bonds at maturity unless the municipality, school district or district corporation issuing such bonds has determined to issue them pursuant to a substantially level or declining annual debt service schedule or unless interest is contributed at least annually to a sinking fund in accordance with Section two of article VIII of the constitution and the procedures of Section 22.10 of the LFL. The cost of such original issue discount, together with other costs of the issuance of obligations, is deemed a part of the cost of the object or purpose for which such obligations are issued.

Public Bond Sale Notice

The rules for the notice of sale of bonds are as follows:

a. There must be published, at least once, not less than five nor more than 30 days before the date fixed for public sale of bonds, a notice of such public sale or a summary thereof in accordance with one of the following methods:
(1) the notice of sale shall be published in any financial newspaper published and circulated in the city of New York, which the State Comptroller has designated for such publication as *The Daily Bond Buyer*;
(2) the notice of sale shall be circularized in such manner as the State Comptroller has prescribed and shall be published in any newspaper or newspapers that the Board may designate for such purpose; or
(3) (i) a summary of the notice of sale shall be published in both the financial newspaper published and circulated in the city of New York, which the state comptroller has designated as *The Daily Bond Buyer*, and (ii) any newspaper or newspapers which the legislative body may designate for such purpose. A summary of the notice of sale at a minimum must contain the name of the issuer; the amount, date, and maturities of the bonds; the frequency of interest payments; the place where bids will be received, including the designation of the receiving device if the legislative body has authorized the receipt of bids in an electronic format; the time and date for the opening of the bids, including circumstances under which such time and date may be changed in accordance with law; the method of award and a procedure for promptly obtaining the complete notice of sale and any preliminary official statement prepared in connection with the sale; and certain other information that the State Comptroller requires.

b. Such notice shall call for sealed bids for the purchase of such bonds, and shall state:
(1) The place where bids will be received and considered, and the designation of the receiving device for electronic bids if the legislative body has authorized same.

(2) (a) The time and date for the opening of bids, which shall be only on weekdays, Saturdays and holidays excluded, between the hours of ten o'clock A.M. and four o'clock P.M.

(b) In lieu of the statement of the time and date for the opening of bids required by subparagraph (a) of this subdivision, a statement (i) that the time and date for the opening of bids will be provided on not less than 24-hours prior notice by means of a supplemental notice of sale and indicating the manner in which such supplemental notice will be provided, or (ii) setting a time and date for the opening of bids, stating that notice of a change in time or date for the opening of bids may be provided not less than 24 hours prior to the time originally scheduled for the opening of bids by means of a supplemental notice of sale and indicating the manner in which such supplemental notice will be provided. Where notice is given that the time or date of a sale will be changed without specifying the new time or date, notice of the new time or date of sale must be provided by means of a second supplemental notice of sale at least 24 hours prior to the new time for the opening of bids.

(c) A supplemental notice of sale must refer to and be deemed a part of the notice of sale required by this section and must not establish or change the terms of the sale other than the time or date for the opening of bids, the amount of principal scheduled to be repaid in each year, the right or redemption prior to maturity, and the face value at maturity of the issue or any installment thereof. The time set for the opening of bids in the supplemental notice of sale must not be less than five nor more than 30 days after publication of the notice of sale required pursuant to paragraph a of this section.

(d) The supplemental notice of sale must be provided by transmittal over a definitive trade wire service of the municipal bond industry which, in general, makes available information regarding activity and sales of municipal bonds and is generally available to participants in the municipal bond industry, or by publication in the financial newspaper published and circulated in the city of New York, which the State Comptroller designates for such publication in regulations. In addition, public notice of the time and date set for the opening of bids in the supplemental notice of sale must be given to the news media and must be posted in one or more designated public locations within the issuing municipality or school district at least 24 hours prior to the time and date set for the opening of bids; provided, however, that such public notice is not to be construed to require publication as a legal notice.

(3) The maximum rate of interest, if any, that may be bid.

c. Such notice must also include:

(1) A statement that the rate or rates of interest to be bid shall be a multiple of one-hundredth of one per centum per annum or a multiple of one-eighth of one per centum per annum, as the agency in charge of the sale may determine and may require or permit in such notice.

(2) A statement of the conditions of sale and the methods of bidding, which must include the following:

(a) A statement that one or more than one rate of interest may be bid; provided, however, that only one rate of interest may be bid for bonds of the same maturity. Where more than one rate of interest may be bid, such notice shall specify the maximum number of rates which may be bid. Where the net interest cost method of calculating interest cost is used, or where the notice so provides, the interest rate for each maturity shall not be less than the interest rate for any prior maturity. Such notice shall also state that such rate or any of such rates may not be higher than the maximum rate prescribed in such notice, if a maximum rate has been prescribed. Notwithstanding the above, in inviting proposals for the sale of bonds in an amount of $20 million or more, a municipality may advertise in such notice to sell, in series, at a single bid price per bond.

(b) Where two or more issues are offered in the same notice of sale, a statement specifying whether each of the issues so offered shall be sold separately as a single bond issue, whether some of the issues shall be combined and sold separately as one or more single bond issues, or whether the aggregate amount of bonds of all of the issues shall be combined and sold as a single bond issue.

(c) Where the legislative body legislature has determined to provide for substantially level or declining annual debt service, a statement specifying the dates of maturity for such bonds and the dates for payment of interest on such bonds, and setting forth the annual principal installments expected to provide for, together with the interest thereon, substantially level or declining annual debt service on such bonds. Such notice shall state that the municipality or school district may, after selecting the low bidder, adjust such installments to the extent necessary to meet the requirement of substantially level or declining debt service.

(3) A requirement that as a condition precedent to the consideration of his bid, each bidder shall deposit with the official of the municipality or school district in charge of the sale, a certified or cashier's check drawn upon an incorporated bank or trust company to the order of the municipality or such official, for not less than one per centum of the amount of bonds to be bid for. Such notice may also provide that, in lieu of a certified or cashier's check, bidders may furnish as security an eligible surety bond or an eligible letter of credit, approved by such official as to form, sufficiency, and manner of execution. "Eligible surety bond" means a bond executed by a insurance company authorized to do business in this State, the claims-paying ability of which is rated in the highest rating category by at least two nationally recognized statistical rating organizations; and "eligible letter of credit" means an irrevocable letter of credit issued in favor of the municipality or school district, for a term not to exceed 90 days by a bank, as that term is defined in Section two of the banking law, whose commercial paper and other unsecured short-term debt obligations (or, in the case of a bank that is

the principal subsidiary of a holding company, whose holding company's commercial paper and other unsecured short-term debt obligations) are rated in one of the three highest rating categories (based on the credit of such bank or holding company) by at least one nationally recognized statistical rating organization or by a bank that is in compliance with applicable federal minimum risk-based capital requirements.

(4) A statement that there is reserved to the municipality or school district the right to reject all bids, and that any bid not complying with the terms of the notice will be rejected.

(5) A statement that the municipality or school district has reserved to itself the power to call in and redeem a portion of such bonds prior to their date of maturity pursuant to Section 53.00 of the LFL, if it has reserved to itself such power (a so-called "early redemption" provision). Such statement shall identify the portion of the bonds which may be so redeemed and shall describe the terms and conditions under which such bonds may be redeemed.

(6) A statement indicating which of the methods set forth in paragraph a of Section 59.00 of the LFL (described below) will be used in awarding such bonds.

(7) Certain further data and information required by the State Comptroller.

d. It may be a condition of the sale of bonds that every bidder may be required to accept a portion of the whole amount of the bonds for which he has bid, at the same rate for such portion as may be specified in his bid for the full amount. If such condition is imposed, the notice of sale shall so state and such notice also shall state that, in addition, any bidder may offer to purchase all or none of such bonds on different terms.

e. The notice of sale may provide that the bidder to whom the bonds are to be awarded, at his option, may refuse to accept the bonds if prior to the delivery of the bonds any income tax law of the United States of America shall provide that the interest on such bonds is taxable, or shall be taxable at a future date, for federal income tax purposes, assuming the bonds were sold as federally tax-exempt.

f. Until June 1, 2013, sealed bids can include bids submitted in electronic format but not as a sole method and this method must be in compliance with certain statutory rules.

Bid Opening and Award Rules

The bid opening and award process is also governed by statute, being Section 59.00 of the LFL, with the following rules:

a. All bids must be opened publicly at the time and place stated in the notice of sale, and not before, and shall be publicly announced. Prior to the time fixed for such public opening of bids, a sealed bid may be amended by a bidder by delivery to the official to whom the sealed bid was delivered of a sealed amendment to such bid. No bid can be amended by a telegraphic or telephonic communication (except electronic bids may be amended by same method). The bonds are to be awarded to the bidder offering the lowest interest cost to the municipality, school district or district corporation, as computed in accordance with the net interest cost method or the actuarial or true interest cost method as duly noticed in the notice of sale.

b. If it is a condition of the sale of bonds that every bidder may be required to accept a portion of the whole amount of such bonds for which he has bid, at the same rate for such portion as may be specified in his bid for the full amount, then any bidder may, in addition, offer to purchase all or none of such bonds on different terms.

c. When the bidder to whom the bonds are to be awarded has been ascertained, the municipality, village or district corporation shall promptly return all security to the persons furnishing the same, except the security furnished by such bidder. Such bidder shall be promptly notified of the award to him, and if he refuses or neglects to pay either the agreed price for the bonds less the amount of any certified or cashier's check furnished as security, or the agreed price in full for the bonds if an eligible surety bond or eligible letter of credit was furnished as security, the security furnished by him, in whatever form, shall be forfeited to and retained by or claimed against or drawn upon by, the municipality, school district or district corporation as liquidated damages for such neglect or refusal. However, if the notice of sale shall contain notice and if prior to the delivery of the bonds any income tax law of the United States of America shall be revised to provide that the interest on such bonds is federally taxable, or shall be so taxable at a future date, for federal income tax purposes, and the debt had been sold as federally tax-exempt then, at the request of such bidder the security accompanying his bid shall be returned to him and he shall be relieved of his contractual obligations arising from the acceptance of his bid.

Bond Interest Rates

While the LFL provides that bonds must be sold without limitation as to rate of interest and for a sum not less than the par value of, and the accrued interest on such obligations except as authorized by the LFL, this does not preclude establishing certain bidding parameters in a public competitive bond sale. Here is an example from a typical notice of sale:

> Each bid must be for all of said bonds and may state a single rate of interest or different rates of interest for different maturities, provided, however, that (i) only one rate of interest may be bid for bonds of the same maturity, (ii) the maximum difference between the highest and lowest interest rate bid may not exceed one-and-one-half per centum per annum, (iii) variations in rates of interest so bid shall be in ascending progression in order of maturity so that the rate of interest on any single maturity of said bonds shall not be less than the rate of interest applicable prior to maturity, and (iv) all rates of interest bid must be stated in a multiple of one-eighth or one-hundredth of one per centum per annum. Unless all bids are rejected, the award will be made to the bidder complying with the terms of sale and offering to purchase said bonds at such rate or

rates of interest as will produce the lowest net interest cost computed in accordance with the net interest cost method of calculation, that being the rate or rates of interest that will produce the least interest cost over the life of the bonds, after accounting for the premium offered, if any.

The purpose of such limitations is to prevent surprises like a 25% interest rate in one maturity counterbalanced by low rates later.

Bonds may also be sold by municipalities at private sale to the State of New York municipal bond bank agency or to the EFC, or to the Dormitory Authority of the State of New York, each in accordance with particular programs such rate or rates of interest as may be agreed upon by and between the issuing municipality and any such agency or corporation, as the case may be.

When sold at public sale, the aggregate rate of interest shall be determined in the manner provided in Section 59.00 of the LFL computed as net interest cost or true interest cost as provided in the notice of sale. A maximum rate of interest at which such bonds shall be sold may be fixed by the issuer.

Sale of Bond Issues of One Million Dollars or Less

When sold at public sale, bonds of an issue not exceeding $1 million, whether of a single issue or sold as a single issue pursuant to paragraph c of Section 57.00 of the LFL, having a maximum maturity of not more than five years measured from the date of the bonds, need not be sold in accordance with the requirements of Section 58.00 of the LFL, described above, for publication of the notice of sale but may be sold upon such publication or circularization of the notice as shall be prescribed by the State Comptroller in a rule or order.

Bonds of an issue not exceeding $1 million, whether of a single issue or sold as a single issue pursuant to paragraph c of Section 57.00 of the LFL, may also be sold at private sale without limitation as to rate of interest, provided, however, that the total amount of bonds which may be sold at private sale in any fiscal year of the issuer cannot exceed $1 million. The five-year limit does not apply to private sales.

Private Sales of Bonds in General

As described above, bonds of an issue not exceeding $1 million may be sold at private (negotiated) sale as provided in Section 63.00 of the LFL, without limitation as to rate of interest, provided, however, that the total amount of bonds which may be sold at private sale in any fiscal year of a municipality may not exceed $1 million. This permits any municipality to place such bonds privately, or informally solicit bids locally without any of the formal notice requirements described above for competitive sales of bonds.

Bonds may also be sold at private negotiated sale with original issue discount, as described earlier, or as variable rate debt. As both are exceedingly rare in New York State, they shall not be further discussed here.

Bonds may also be sold at private sale to the United States government or any agency or instrumentality thereof such as the U.S. Department of Agriculture (formerly known as the Farmers Home Administration bond program, now referred to as "Rural Development"), the State of New York Municipal Bond Bank Agency, to any sinking fund or pension fund of the municipality selling such bonds, or, in the case of bonds or other obligations of a municipality issued for the construction of any sewage treatment or collecting system, storm water collecting system, water management facility, air pollution control facility or solid waste disposal facility, to the New York State Environmental Facilities Corporation (which has an interest subsidy program for qualifying issuers and projects) and in certain cases to the Dormitory Authority of the State of New York.

The State Comptroller has also promulgated rules in conformance with the State administrative procedure act governing the sale of bonds and notes on a negotiated basis. No bond or note sale on a negotiated basis can be conducted by a municipality or school district, without prior approval of the State Comptroller except as provided in such rules, which set forth the circumstances under which such approval shall not be required, which includes bonds sold pursuant to the authority specified in Section 63.00 of the LFL.

Private Competitive Sale of Bonds

Serial bond issues of under $1 million may also be sold at private competitive sale. This is a hybrid category. What distinguishes it from sales pursuant to Section 57.00 of the LFL as described above is (1) no filing of a debt statement with the State Comptroller is required, (2) no notice of sale need be published, and (3) an official statement will not generally be necessary. It is thus an inexpensive way to sell certain debt by mailed or other transmitted-only notice.

Sales and Closings

Except in the cases of the local placement of notes, small serial bond issues or SIBs, most significant local government debt is sold nowadays in the State and national capital markets with the assistance of a financial advisory firm and bond counsel. Competitive bidding procedures are typically conducted by the financial advisors with legal guidance by bond counsel who drafts the notice of sale and the award documentation. After the award, bond counsel drafts the closing documents, the obligations themselves, and a detailed letter of instruction which is typically forwarded to local counsel, or on advice of counsel, directly to the mutual client. In negotiated note or bond offering, an opinion of local counsel as to any material litigation is often required in addition to the validity opinion of bond counsel. Nowadays, these competitive sales of notes and bonds typically "close" without a formal physical closing (or lunch at a nearby bistro) at a law office. Instead, the issuer forwards the debt obligations themselves to bond counsel or to a national repository on their instruction, and the closing papers are forwarded to bond counsel. At closing, the purchaser wires the purchase price to the issuer's bank, and upon telephonic or facsimile confirmation of receipt, bond counsel, the financial advisor and the purchaser call the repository and "release" the debt obligations to the purchaser. The closing is now complete and all parties may eat lunch at their desks.

CHAPTER ELEVEN

Federal Tax Law Issues—Arbitrage and Arbitrage Rebate

The Federal Tax Exemption

Bonds and notes of state and local governmental units generally bear interest that is excludable from gross income for federal income tax purposes for their holders. This federal provision has provided several generations of low-interest borrowings for several generations of local governmental capital improvements. Prior to 1986, the federal government did not ask for much in return. Municipalities and school districts issued this debt and invested the proceeds until they needed the money for the project. The Internal Revenue Code of the time had some basic rules, but they were such that municipalities and schools hardly needed to concern themselves with any federal tax implications of their borrowings; so they didn't.

The Tax Reform Act of 1986

On October 22, 1986, the Tax Reform Act of 1986 ("1986 Act") was signed into law ushering in a new era for tax-exempt finance, and instituting the new Internal Revenue Code of 1986 ("1986 Code"). The 1986 Act could be said to have been a congressional attempt to micromanage the issuance of tax exempt debt; the 1986 Code imposed many new restrictions on the ability of state and local governmental units to finance their facilities and operating expenses on a federally tax-exempt basis. For the first time, municipalities like towns, villages and cities might need to employ taxable financing for some operations that had traditionally been thought of as governmental in nature. In addition to raising the interest cost of borrowing, the 1986 Code increased the administrative burdens placed on state and local political subdivisions in maintaining compliance with the rules relating to tax-exempt financing, thereby further increasing the overall costs of transactions.

The 1986 Code changed the rules relating to tax-exempt financing in two major ways. First, it sought to eliminate the "arbitrage" profits that, at least in the past, were frequently generated in tax-exempt financings as a result of a municipality's ability to borrow at low tax-exempt interest rates and invest the proceeds of the borrowing at higher taxable rates until use. Second, it was designed to drastically reduce the ability of state and local governments to undertake tax-exempt financings which benefit nongovernmental entities, regardless of whether the conferring of such benefits is a primary goal or is merely incidental to a true municipal purpose (as would be necessary of a municipality capital project under state law).

Under the 1986 Code, a distinction is made between "governmental bonds" and "private activity bonds." A brief discussion of the treatment of private activity bonds under the 1986 Code is included in the next chapter, and it should be reviewed with some care, as the terms "governmental bonds" and "private activity bonds" are something of misnomers. For example, obligations issued for a number of legitimate governmental purposes in accordance with state statutory and constitutional requirements may, in some instances, be private activity bonds under the 1986 Code. Unless specifically noted, the restrictions imposed by the 1986 Code apply equally to bond and notes (and to other evidences of municipal indebtedness, as well). Accordingly, as used herein, the term "bond" includes notes (and other evidences of municipal indebtedness).

This chapter will outline those substantive provisions of the 1986 Code that have the greatest impact on town, village and city issuers of general obligation bonds and notes. Since the vast majority of general obligations issued by municipalities within New York State would be considered "governmental bonds" under the new law, the discussion of "private activity bonds" has been relegated to a later chapter. Except as discussed in such chapter, and as may be specifically noted elsewhere, all general obligation bonds and notes issued by a town, a village or a city pursuant to the LFL and Article 8 of the State Constitution will be considered to be "governmental bonds" under the 1986 Code.

Arbitrage Restrictions with Respect to "New-Money" Issues

Perhaps the most important impact of the 1986 Code on issuers of general obligations like towns, villages and cities is the limitation that it imposes upon the amount of "arbitrage" that a municipality can realize as a result of issuing its obligations at a low tax-exempt interest rate and investing the proceeds of such borrowings in taxable obligations bearing higher interest rates. By taking advantage of this spread between tax-exempt and taxable interest rates, municipalities in the past could realize arbitrage profits within the fairly liberal constraints imposed by Section 103 of the Internal Revenue Code of 1954 (the "1954 Code") and the Treasury Regulations promulgated thereunder. In addition to being used to pay the costs of issuance of obligations, arbitrage profits often played a key part in the financing of municipal projects.

The 1986 Code accomplishes the goal of limiting the amount of arbitrage profits that a municipality can earn in one major new way. While it generally does not shorten the currently available "temporary periods" during which proceeds of an issue of municipal obligations can be invested in taxable securities with a yield higher than the yield on the bonds, it does require the issuer to rebate to the federal government *all* of the arbitrage profits earned with respect to the financing unless all (or in some cases, almost all) of the original and investment proceeds of the bonds (and, in certain cases, other amounts) are spent within certain time frames after the date of issuance. It should be emphasized that failure to satisfy this requirement may result in the bonds being retroactively taxable as of their date of issuance.

In addition, the 1986 Code generally prohibits tax-exempt bonds from being issued too far in advance of the time proceeds are expected to be used to construct or acquire the assets to be financed (the so-called "hedge bonds rule"). The temporary period rules and the arbitrage rebate exceptions described in this chapter often provide good reason to issue bonds close to the time when the bond proceeds will be spent; similarly, economics dictates this result whenever the short-term interest rates at which bond proceeds may be invested are lower than the long-term rates at which the bonds accrue interest. However, under certain circumstances, towns and villages may be interested in issuing bonds at the earlier opportunity. In general, interest on the bonds will not be tax-exempt unless the town or village reasonably expect either (i) to spend at least 85% of the net sale proceeds within three years of the date the bonds are issued, as well as invest no more than 50% of the bond proceeds in investments or guaranteed yields of four or more years, or (ii) to spend at least 10% of the net sale proceeds within one year, 30% within two years, 60% within three years, and 85% within five years, as of the date the bonds are issued. These expenditure requirements do not apply to refundings or to new-money bonds in which virtually all of the proceeds of the bonds are invested in other tax-exempt bonds until such proceeds are expended. These rules are separate from the arbitrage rebate rule and its exceptions.

Temporary Periods and the "Minor Portion"

The 1954 Code, as amended up to 1986, provided "temporary periods" during which the proceeds of an issue of municipal obligations could be invested in taxable obligations having a yield which exceeded the yield on the bonds. In the case of obligations issued for construction or acquisition, a three-year temporary period was generally available. In the case of cashflow borrowings, such as revenue anticipation notes, tax anticipation notes, and grant anticipation notes (e.g., bond anticipation notes issued to refund the portion of the costs of a project anticipated to be paid with federal or State grants-in-aid), a temporary period of at least 13 months has been generally available if the proceeds of the issue did not exceed the "maximum anticipated cumulative cashflow deficit" that was expected to occur during the term of the borrowing.

The 1986 Code does not reduce these temporary periods. However, for all bonds and notes, the former "minor portion" rule, under which up to 15% of the bond proceeds could be invested at an unrestricted yield even after the expiration of the applicable temporary period, was replaced with a new "minor portion" rule. The "minor portion" is now limited to the lesser of 5% of bond or note proceeds or $100,000.

The new "minor portion" is in addition to any proceeds deposited in a reasonably required reserve fund. However, while a reasonably required reserve fund can also generally be invested without restriction as to yield, the amount of original bond proceeds which can be deposited in such a fund is limited to 10% of bond proceeds. Moreover, even if cash on hand is used to fund a larger reserve, the amount held in the reserve that may be invested at an unrestricted yield is still limited to 10% of the original bond proceeds. Thus, any amounts held in a reserve fund that are in excess of 10% of the original bond proceeds must be yield-restricted. There are, however, exceptions to these 10% limitations for issues which the Treasury Department determines require a larger reserve fund. (In New York, it is generally not permissible to fund the type of reserve fund addressed here with the proceeds of general obligations, so this is not discussed further.)

Definition of "Yield"

The 1986 Code substantially revises the definition of "yield" by legislatively overruling then-current case law. Under the new law, yield must now be calculated based on the price at which the obligations were sold to the public, rather than the funds received by the issuer after the payment of underwriter's compensation and other issuance costs. This has the effect of reducing the yield on the bonds, thus decreasing the permissible arbitrage profit which may be earned (although subject to rebate) after expiration of the applicable temporary period. In many cases, "negative arbitrage" will result. In effect, unlike prior law, issuance costs can no longer be partially "recovered" from arbitrage earnings.

The 1986 Code does, however, provide that certain credit enhancement fees, such as municipal bond insurance premiums and letter of credit fees, may be treated as interest payments on the bonds if such fees result in a net present value interest savings to the issuer. By treating these payments as interest on the bonds, the "yield" on an issue is increased, thereby allowing bond proceeds to be invested at a correspondingly higher yield, with the result that the issuer can recoup a portion of such credit enhancement fees from permissible arbitrage.

In all circumstances where yield restrictions are imposed, the issuer is obligated to abide by the "market price rules." Thus, an issuer cannot artificially limit its apparent yield by investing in obligations which bear a below-the-market interest rate or by acquiring an investment at a price in excess of its fair market value or selling it at a price below its fair market value. When yield must be restricted and there is no suitable investment available in an arm's-length transaction, an issuer can subscribe for United States Treasury Securities–State and Local Government Series (commonly referred to as "SLGS"), which are United States Treasury Bonds, Notes or Certificates of Indebtedness with yields and terms tailored to the municipality's needs sold by the United States Government to municipalities and states. In the alternative, the municipality can invest in tax-exempt obligations (subject, of course, to the limitations set forth in Section 165.00 of the LFL). The Treasury Department was mandated by the Tax Reform Act to develop a "money market"-type, flexible SLGS program to accommodate issuers.

Rebate Requirement and Exceptions

The General Rule. Even if arbitrage profits are permissibly earned, in the first instance, pursuant to the exceptions for temporary periods, the minor portion and reasonably required reserve funds, the issuer must nevertheless rebate to the federal government *all* the arbitrage profits that are earned from the date of issuance of the bonds. (See below for *de minimus* exceptions to the rebate requirement that apply when *all* original and investment proceeds of the obligations are spent within six months of their date of issuance.) The amount which must be rebated to the federal government is equal to the arbitrage "profit" that results from the investments. For example, if a municipality issued tax-exempt 30-year bonds having a yield of 8% and earned 10% on its investments, only those earnings attributable to the difference between 10% and 8% would have to be rebated. The rebated amounts must be paid to the Internal Revenue Service at least every five years and within 60 days of the date that the last of the bonds is retired. In effect, this renders useless temporary periods and minor portions, since issuers will have to rebate most of the profits they have earned in any event.

Rebate cannot be avoided by investments that violate the previously discussed "market price rules." However, where feasible, investment in tax-exempt obligations is an alternative to avoid rebate. (However, an issue may permissibly utilize demand deposit accounts (such as N.O.W. Accounts) rather than investing proceeds in certificates of deposit, Treasury Bonds, Bills or Notes, or other high yielding types of investments, so long as the investment is made in accordance with the "market price rules" and complies with other limitations applicable to investments of proceeds by the issuer (e.g., those found in the Local Finance Law, or General Municipal Law).) Note that the restrictions of LFL Section 165.00 apply to proceeds of all types of obligations except tax anticipation notes and revenue anticipation notes.

The provisions of Section 11 of the General Municipal Law apply to investments of proceeds of TANs and RANs. Simply placing proceeds in a non-interest-bearing account (such as a typical checking account) will not obviate the necessity to make a rebate. Since the bank is gaining the use of those funds at no cost, an interest rate will be imputed for the deposit.

Arbitrage Rebate and Its Exceptions

Since the effective date of the 1986 Code, all towns, villages and cities (and other local governmental units such as school districts and counties, and fire districts) have been potentially subject to the arbitrage rebate rules whenever they issue federally tax-exempt bond anticipation notes, capital notes, statutory installment bonds or other serial bonds for capital projects. These rules, in the form of detailed U.S. Treasury Regulations, can require a municipality to pay to the federal government much of the interest earnings on proceeds received by the municipality from the issuance of such tax-exempt obligations and invested prior to use for their intended purposes.

However, the Code and regulations do provide several exceptions to these generally applicable rules:

1. an exception for governmental issuers, such as towns, villages or cities, who do not reasonably expect to issue more than $5,000,000 in tax-exempt obligations in the current calendar year (This is the so-called "small issuer" exception.);
2. an exception solely applicable to school districts who, in addition to the issuance of not to exceed $5,000,000 in tax-exempt obligations for any school district purpose (i.e., cashflow or capital) in the current calendar year (as noted in (1) above), do not reasonably

expect to issue more than an *additional* $10,000,000 in tax-exempt obligations in the current calendar year, *provided*, such additional $10,000,000 (or such lesser amount as is applicable if the school district is not issuing that much) is attributable *solely* to financing the "construction" of "public school facilities" (The "school small issuer" exception is not generally applicable to towns, villages or cities but is included here in the interests of completeness.);

3. an exception for governmental issuers of RANs or TANs, regardless of whether they reasonably expect to issue more than $5,000,000 in the current calendar year, if the issuer can meet certain rapid spend-down requirements once the obligation is issued; and
4. several exceptions for governmental issuers of notes or bonds for capital projects regardless of whether they reasonably expect to issue more than $5,000,000 in the current calendar year, if the issuer can meet certain rapid spend-down requirements once the obligation is issued.

Small Issuer Exception to Rebate Rule. *This exemption from the rebate requirement is for governmental bonds or notes issued by small governmental units with general taxing powers which will not issue in excess of $5 million of governmental obligations in any given calendar year. This exemption does* not *apply to the first $5 million of issues of governmental units which will issue more than $5 million per year. The issues of any "subordinate" governmental issuers must be aggregated with the issues of an issuer for purposes of the $5 million limit.*

For purposes of this requirement, an entity will be deemed "subordinate" to the issuing governmental unit if the entity derives its power to issue obligations from the governmental unit or is subject to substantial control by the governmental unit. However, the mere fact that the entity is located within the boundaries of the issuing governmental unit will not, in and of itself, be viewed as making the entity "subordinate" to the governmental unit. (This aggregation requirement is generally unimportant for New York issuers, since it requires aggregation only of issues by subordinate entities which derive their power to issue indebtedness from the entity in question. Geographic location within the territory of an issuer does not mean that one municipality is subordinate. However, issuance by an urban renewal agency, for example, would probably have to be aggregated with the issuances of the municipality to which it relates.)

If your town, village or city may be a "small issuer" in any current calendar year in which general obligation notes or bonds are proposed to be issued, there is a three-step analysis which must be completed to confirm that status:

Step No. 1: Determine whether the municipality reasonably expects to issue an aggregate of $5,000,000 or less in tax-exempt notes or bonds in the calendar year.

WHAT COUNTS:

1. All new-money governmental issues (BANs, Serial Bonds, RANs, TANs, Capital Notes).
2. Advance refundings (renewal of a note or bond more than 90 days in advance of its maturity or redemption date).
3. All governmental new-money or advance refunding bonds or notes issued by a governmental entity subordinate to the municipality or an entity issuing "on behalf of" same (i.e., certain I.D.A. debt may count).
4. All tax-exempt lease purchase or installment sales agreements.

WHAT DOES NOT COUNT:

1. Current renewals (to the extent that the amount of the renewal does not exceed outstanding principal amount of maturing debt, i.e., typical bond anticipation renewal notes).
2. Private activity bonds or notes (i.e., obligations, the proceeds of which are used for a capital project with a private business user receiving some substantive benefit from the project).
3. Most federally taxable debt obligations.

Step No. 2: Determine whether, in addition to the obligations considered in Step No. 1, the municipality reasonably expects to issue an additional amount, not to exceed $10,000,000, for public school facilities construction costs. This is unlikely for a town, village or city in this state; this provision tends to benefit school districts in New York State.

Note that for Steps No. 1 and No. 2, this is a "reasonable expectations" standard which the town or village must apply to itself at the time of each borrowing. The expectation of being and remaining a "small issuer" is not made one time for each calendar year. It is made each time the town or village proposes to borrow. Likewise, an unanticipated borrowing later in a calendar year which unexpectedly brings an issuer over the $5,000,000 mark does not "taint" debt previously issued in that calendar year and, thus, does not make such prior debt retroactively subject to the arbitrage rebate rules.

Step No. 3: Determine whether the particular note or bond issue itself is eligible for the "small issuer" exceptions to the general arbitrage rebate requirement. The fact that the municipality has determined in Step No. 1 (and Step No. 2, if applicable) that it is, indeed, a "small issuer" does not automatically exempt its note or bond issue from the rebate requirement. The note or bond issue itself must also meet certain requirements:

A. NEW MONEY ISSUES

1. Ninety-five percent or more of net proceeds of the issue are to be used for local governmental activities of the issuer.
2. Not a "private activity" bond or note (i.e., proceeds not used for a capital project with a significant private business user of the project).

B. RENEWAL/REFUNDING ISSUES (current or advance)

1. Aggregate face amount does not exceed $5,000,000.
2. Each refunded bond or renewed note was part of an issue which itself qualified at the time for the "small issuer" exception in its year of issuance.
3. The average maturity date of the refunding/renewal obligation is not later than the average maturity date of the obligations being refunded/renewed.

NOTE: This rule in itself would eliminate renewal notes or bonds from qualifying when refunding/renewing typical one-year notes, so there is an exception:

If the average maturity of the refunded debt is three years or less, the requirement is waived. (Town and village and city debt most frequently renewed is in the form of one year or less bond anticipation notes; these qualify for this waiver.)

4. No refunding bond can have a maturity date which is later than the date which is 30 years after the date that the original note or bond was issued.

NOTE: it is possible to be a $5,000,000 or under "small issuer" (or a $15,000,000 or under "school small issuer") and still be required to rebate if the issue itself does not meet the requirements of Step No. 3.

C. COMBINATION NEW MONEY/RENEWAL-REFUNDING ISSUES

1. All of the above-stated rules apply.
2. The aggregate face amount rule may require that a consolidated issue be split into two issues.

6-Month/12-Month Exception to Rebate Requirement: Under a special exception to the rebate rule, no rebate will be required if all of the original and investment proceeds of the issue, except for a "minor portion" equal to the lesser of 5% of the bond proceeds or $100,000, are expended within 6 months of the date of issuance of the obligations, and all of the proceeds, including that "minor portion," are spent within 12 months of the date of issuance. However, this rule does not apply to revenue anticipation note and tax anticipation note issues, which have a separate exception noted below.

This 6-month/12-month exception to rebate requirement must be considered in conjunction with Section 165.00 of the LFL, which limits the use by New York issuers of investment proceeds to the payment of debt service on the municipal obligations with respect to which such amounts constitute proceeds. In the case of notes, unless all proceeds are expended *immediately*, there will be at least some investment earnings which cannot be expended to pay debt service until the maturity of notes. Thus, unless the maturity of notes is limited to 6 months or less, an issuer will not be able to avoid the rebate requirement under the 6-month/12-month exception unless all original and investment proceeds in excess of the "minor portion" (i.e., all such proceeds in excess of the lesser of 5% of the proceeds or $100,000) are expended within the first 6 months and the minor portion is spent within the second 6 months; thus, if the "major portion" proceeds (i.e., all proceeds except that amount which is the lesser of 5% or $100,000) cannot be expended within the first 6 months, or if only a "minor portion" remains unexpended as of such date, but such "minor portion" cannot be expended within the second 6 months then all the arbitrage must be rebated. Where an issuer expends a "major portion" of the proceeds of its issue within 6 months and uses the entire remaining "minor portion" to pay debt service within the next 6 months, the necessity to make any rebate will be avoided.

6-Month Exception for RANs and TANs: A separate exception to the rebate requirement is available for RANs and TANs. First, in order to be exempt from the rebate requirement, *all* of the original and investment proceeds of the RANs or TANs must be spent within the first 6 months. Second, there is a special rule for determining whether all of the proceeds of RANs and TANs will be deemed to have been expended within the first 6 months. The rule states that the original and investment proceeds of such issues will be treated as expended on the first day after the date of issuance that the *actual* cumulative cashflow deficit exceeds 90% of the issue's face amount. In this calculation, all other proceeds available for the governmental purpose of the borrowing must be treated as spent first, with the result that the original and investment proceeds of the RANs or TANs are viewed as having been expended last. For this purpose (unlike the method for determining the maximum permissible size of the issue, which remains the same as under prior law), no allowance is permitted for a working cash balance equal to the issuer's estimate of an additional month's gross expenditures, and the deficit is calculated on the basis of actual experience. Thus, the allowance for a working cash balance remains available for sizing issues, but its inclusion in the face amount of a financing could make it difficult to meet the safe harbor test. This means that some issuers should probably reduce the size of their RAN and TAN issues so as to ensure that all of the proceeds will be viewed as expended within six months in order to avoid rebate. This may necessitate a schedule of semiannual RAN and TAN borrowings with maximum cashflow deficits projected to occur within six months. RANs and TANs should benefit from the rebate exception for bona fide debt service funds (discussed below) as regards their LFL Sections 25.00(g) and 24.00(e) funds. See Chapter 8.

The 6-Month Capital Spend-Down Exception: an exception for all local governmental issues, including Counties, which actually spend all of the borrowed process (and investment earnings thereon) for a capital project on or before the date 6 months after the closing date for the new-money notes or bonds (exception for an amount not to exceed 5% of the proceeds of such issue, as long as such amount is spent no later than an additional 6 months thereafter.) This exception is not limited to construction and reconstruction projects and is likely to be most useful in acquisition financings, reimbursement financings and current refundings.

The 18-Month Capital Spend-Down Exception: an exception for all local governmental issuers, including Counties, which actually spend all of the borrowed proceeds (and investment earnings thereon) for a capital project in accordance with the following schedule: at least 15% within 6 months, at least 60% within 12 months, and 100% within 18 months (in each case, measured from the date of issuance), except that an amount held for reasonable retainage after 18 months is permitted as long as it is expended for the capital project within 30 months of the issue date. This exception is not limited to construction and reconstruction projects.

The 2-Year Construction Spend-Down Election/Exception: an exception for all local governmental issuers of notes or bonds, including Counties, for capital construction and reconstruction projects only, regardless of whether they reasonably expect to issue more than $5,000,000 in the current calendar year, if the issuer can meet certain rapid spend-down requirements once the obligation is issued. The rules for this much-utilized exception are as follows:

How to Calculate the Construction Spend-Down Election/Exception

Step No. 1: The first step is that the municipality designate the issue as a "*construction issue*" (this can be done where 75% of the proceeds are allocable to construction vs. acquisition; bond or note issues may be bifurcated for this purpose). "Construction issue" is defined in the Internal Revenue Code of 1986, as amended to include reconstruction and rehabilitation expenses. A "construction issue" is entitled to avoid arbitrage rebate if the municipality can meet certain spending rules which are much more favorable than the "95% in the first six months—5% in the next six months" schedule which is available for acquisitions. The spending rules for a designated construction issue give the municipality the following schedule: The municipality would have to expend 10% of the proceeds, including earnings on investments, within six months of the date of issuance of the obligations; 45% of the proceeds, including earnings on investments, within 12 months of the date of issuance of the obligations; 75% of the proceeds, including earnings on investments, within 18 months of the date of issuance of the obligations; and 100% of the proceeds*, including all remaining earnings on investments, within two years of the date of issuance of the obligations unless a retainage is required by law, in which event, the 100% becomes 95% and the final 5%, including all remaining earnings on investments, must be expended within three years of the date of issuance of the obligation. (Money is expended only when the check is not only written and delivered.)

Step No. 2: The second step of the "*construction issue*" designation process is that the town or village must elect whether the bond or note issue should operate under the so-called "Penalty Option" or decline to operate under such "Penalty Option." If the municipality elects to operate under the "Penalty Option," then failure to meet any of the spending tests at the six-month expiration, the 12-month expiration, the 18-month expiration, the two-year expiration or the three-year expiration, will subject the municipality to a penalty instead of arbitrage rebate for that particular period. The penalty is calculated by multiplying the difference between what the municipality did spend and what the municipality should have spent by 1.5%, and this will give the town or village the amount that the municipality has to pay as a penalty to the federal government for that period.

For instance, if a town, village or city had to expend $100,000 within the first six months, and the town, village or city only expended $90,000 as of that date, the difference,

$10,000, would be multiplied by 1.5%, which produces $150.00, and the town, village or city would have to pay $150.00 to the federal government.

The advantage of the "Penalty Option" is that the penalties are a lot easier to calculate than the arbitrage rebate. However, for the reason described below, it is rarely chosen.

On many occasions (for instance, during a period of "negative arbitrage") a municipality may not wish to elect the Penalty Option. In this case, the municipality would designate the issue as a "*construction issue,*" but the municipality would specifically decline to elect the penalty option. In such case, the municipality would still be subject to the same 10% within six months, 45% within 12 months, 75% within 18 months, 100% within 2 years (or 95% within 2 years with remaining 5% within 3 years) spending tests, but if the municipality should fail to meet such spending test, then the municipality would not owe the aforesaid 1.5% penalty; rather, the municipality would be subject to rebate on the investment (arbitrage) earnings, *BUT ONLY* to the extent the municipality had such earnings, *and* such earnings exceeded the overall arbitrage yield on the bond or note issue. This makes the most sense at those common times when the municipality expects to spend the proceeds quickly and reinvestment rates are relatively low compared to the rate the municipality is paying on an issue. In such event, the municipality may not even be able to earn any arbitrage earnings to rebate in the first place, or may well earn less than the amount which the penalty would be. In such "negative arbitrage" or similar situations, it may not make sense to elect to pay a penalty when investment earnings would not be rebatable because they do not exist (or they would be less than the penalty amount(s)).

Bona Fide Debt Service Fund Exception to Rebate Rule. There is one other special rule regarding exemptions from the rebate requirement for any issue with a maturity of less than five years, such as BANs, BARNs, RANs and TANs. Any amount earned on a "bona fide debt service fund" will not be taken into account in determining the aggregate amount to be rebated for a given year if the gross earnings on such fund for any bond year are less than $100,000. In the current interest environment, this means that fairly substantial debt service funds can still earn arbitrage without rebate. This includes such funds established for RANs or TANs under LFL Sections 25.00(g) and 24.00(e). In addition, such arbitrage earnings in this type of fund are exempt from any rebate requirement for most issues of bonds that have a fixed rate of interest or for issues with an average annual debt service of $2,500,000 or less.

Administrative Burdens. In addition to eliminating most, if not all of the arbitrage profits that may presently be realized by municipal issuers of tax-exempt obligations, the rebate requirement necessitates burdensome new accounting procedures and may require complex mathematical computations that are beyond the capability of all except the most sophisticated financial managers. Since failure to satisfy the rebate requirement may result in the bonds becoming taxable as of their date of issuance if the failure is due to "willful neglect" (or in the imposition of an additional penalty of up to 50% of the amount the issuer failed to rebate, even if the failure is due to "reasonable cause"), it seems obvious that many municipalities will be forced to retain accountants or others to perform this task, thus further increasing the municipality's total costs for the bond issue.

Reasonable Expectations. Under the 1954 Code, if an issuer did not reasonably expect to invest the proceeds of the tax-exempt obligations in taxable obligations with a yield materially higher than the yield on the bonds (except for permitted temporary periods, minor portions and reserve funds), then a certification to that effect served to protect the tax-exempt status of the bonds. The 1986 Code clarifies this "reasonable expectations" test by providing that any subsequent "intentional" act which produces arbitrage after the bonds are issued will render the bonds taxable retroactively to their date of issuance.

Summary. The net result of the rules relating to the reduced minor portion and the redefinition of "yield" is that issuers will be able to *earn* lesser amounts of arbitrage in the first instance than has previously been the case. Moreover, if the obligations do not qualify under the "small issuer" exception, and all proceeds of the issue are not spent within six months (except, in the case of obligations other than RANs or TANs, for the lesser of 5% or $100,000, which is allowed to remain invested for a year if the rest of the proceeds are spent within six months), any arbitrage profits that issuers do earn will have to be rebated to the federal government. More frequent issuance at greater cost seems the most likely practical solution. Issuers will also have to be more vigilant to ensure that they do not violate the arbitrage rules so that the tax-exempt status of their obligations is not put at risk.

Restrictions on Refundings. The 1986 Code also applies severe new restrictions on the current ability of municipalities to advance refund their existing tax-exempt indebtedness. The new law defines an "advance refunding" to be a refunding transaction where the refunding obligations are issued more than 90 days prior to the repayment of the refunded obligations.

It is extremely rare for bond anticipation renewal notes to be issued other than simultaneously with the maturity of the outstanding notes of which they are renewals. When renewal notes are issued before the maturity of the refunded notes, it typically is only done one or two days prior to the maturity of the outstanding notes—and then only for the convenience of the issuer. Thus, most renewal note issues are "current" refundings, not subject to the advance refundings rules. On the other hand, serial bonds are often issued for the purpose of refunding several series of notes, with the result that some of the refunded notes are redeemed more than 90 days after the issuance of the serial bonds.

If the refunded notes were issued after August 15, 1986, any portion of the temporary period remaining for the unexpended proceeds of the refunded notes terminates upon the date of issuance of advance refunding obligations, and such remaining proceeds must then be invested at a yield no higher than the yield on the refunded obligations plus one-eighth of one percent until the refunded notes are paid. After such date, such proceeds can be invested at a yield no higher than the yield on the refunding obligations. For other refundings (i.e., so-called "current" refundings), the balance of any remaining temporary period for proceeds of the refunded obligations remains available. In all cases, the proceeds of the refunding issue may be invested only in accordance with the rules described in the text.

In connection with refundings, note that, to the extent that unexpended proceeds of an original borrowing (and the interest earnings thereon) remain when an issue of obligations is refunded, such proceeds are considered to be "transferred proceeds" of the refunding issue as of the date on which the proceeds of the refunding issue are used to pay off the refunded issue. Where the outstanding obligations being refunded were issued prior to August 16, 1986, any remaining proceeds of such obligations will be unaffected by the 1986 Code until, and unless, refunding obligations are issued. At the time such proceeds become transferred proceeds of the refunding issue, they are subject to the arbitrage rebate rules outlined above in the text, and (assuming the refunding issue (or an issue which it refunded) was originally issued more than six months prior to the date on which such proceeds become transferred proceeds) the issuer will be obligated under the 1986 Code to rebate to the federal government all arbitrage profits realized after they become transferred proceeds, which will require valuation of all assets in which such proceeds are invested as of such date.

Governmental bonds may be advance refunded only if *all* of the following conditions are satisfied:

a. Bonds or notes originally issued before January 1, 1986, may not be advance refunded more than twice (or, if already advance refunded twice before March 15, 1986, not more than once after such date). Thus, for example, if a municipality issued "new-money" BANs in 1983, issued refunding BANs in 1984 more than 180 days prior to the maturity of the 1983 BANs, and issued refunding bonds in February of 1985 to refund the 1984 BANs more than 180 days prior to their maturity date, the bonds could only be advance refunded one more time.
b. Bonds or notes originally issued after December 31, 1985, can only be advance refunded once.

In the case of refunded bonds or notes issued after 1985, the refunded obligations must be called on the first call date if there are (or may be) present value debt service savings (determined without regard to administrative expenses) as a result of the refunding.

In the case of refunded bonds or notes issued before 1986 (most of these will have already matured in full), the refunded obligations must be redeemed at the earliest date on which they can be redeemed at par or at a premium of 3% or less if present value debt service savings will (or may) result from the refunding.

The original and investment proceeds of the advance refunding bonds are granted a temporary period of only 30 days. At the end of such temporary period, the proceeds of the refunding bonds can be invested at a yield no higher than the yield on the bonds (plus a truly *de minimus* amount known in the business as "the peanut"). It is important to note that the temporary period rules and the arbitrage rebate rules are independent. Thus, even if a temporary period is available, if all proceeds of an issue, including a refunding issue, are not expended within six months (subject to the "minor portion" exception discussed above), arbitrage profits, including profits earned during a temporary period, must be rebated. In the case of refundings, issuers must exercise particular care to ensure that not only the refunding bond proceeds are promptly expended, but also that the refunded bond proceeds were spent within six months. Moreover, any remaining temporary period with respect to unexpended proceeds of the refunded obligations terminates as of the date of issuance of the refunding obligations if the refunded obligations were issued after August 15, 1986. Thus, as of the date of issuance of the refunding bonds, all unexpended proceeds of such refunded obligations must be invested at a yield no higher than the yield on the refunded obligations (plus one-eighth of 1%). This, of course, would be very detrimental to the issuer where bond anticipation notes, or other short-term municipal obligations bearing a very low interest rate, are refunded more than 90 days prior to their maturity. Moreover, as of the date the refunded obligations are actually paid off, any remaining proceeds of the refunded obligations must be invested at a yield no higher than the yield on the refunding obligations (plus one-eighth of 1%).

The minor portion for the refunded obligations must be reduced on the date of issuance of the refunding bonds to an amount no greater than the lesser of 5% of the refunded bonds' original amount or $100,000.

Information Reporting Requirement

In order for its obligations to qualify for tax exemption, the issuer must file with the Internal Revenue Service an information return with respect to *all* obligations. The return, similar to the Form 8038 required only for certain nongovernmental bonds under earlier law, requires information relative to, among other things, the issuer, the bonds (including the date of issuance, amount of net proceeds, interest rate, costs of issuance and the amount of any reserves) and, where applicable, any private users of the bond proceeds. Failure to file this return will cause interest on the bonds or notes to be taxable as of the date of issuance unless relief is sought from, and granted by, the Internal Revenue Service.

CHAPTER TWELVE

Federal Tax Law Issues—Private Business Use of Municipal-Financed Facilities

Introduction

Federal tax law governing local governmental issuance of tax-exempt debt includes a concern with private business beneficiaries of such tax-exempt financing. At the outset, it is necessary to remind ourselves: so does the Constitution and applicable statutes of the State. Indeed, assuming a town, village or city is in compliance with State laws governing private use of government facilities and resources, such as the loan of credit and valid town, village or city purposes provisions of the Constitution described in an earlier chapter, and the implementing statutes, caselaw, and opinions of the office of the State Comptroller, compliance with the federal tax law rules in this area is very likely. Nevertheless, a review of the tax rules is appropriate.

Federal Restrictions on Tax-Exempt Financing for the Benefit of Nongovernmental Entities Before 1986

Before the 1986 Code, up to 25% of the proceeds of tax-exempt municipal obligations could be "used" for the benefit of taxable business entities. However, the indirect, as well as the direct, use of bond proceeds had to be taken into account for purposes of determining whether the 25% limitation was exceeded. Thus, for example, the lease of all or a portion of a bond-financed facility to a taxable business entity was treated as an indirect use of the bond proceeds by such entity. Therefore, prior to the 1986 Code and if permissible under State Law, a municipality could issue tax-exempt obligations to finance an office building and lease up to 25% of the office space to one or more taxable business entities without impairing the tax-exempt status of the bonds. (This would not be permissible in New York State.) However, if more than 25% of the building were leased to such entities, more than 25% of the bond proceeds would be viewed as being indirectly "used" by such entities and, thus, the bonds would generally be taxable. A similar rule applied in certain instances where a taxable business entity agreed to operate a bond-financed facility on behalf of a municipality, as well as to other arrangements whereby one or more taxable business entities agreed to purchase the output of a bond-financed facility, such as, for example, a municipally owned electric generating plant. (These type arrangements can be permissible in New York State subject to many restrictions.)

In addition, tax law prior to 1986 provided that, with certain enumerated exceptions, no more than 5% of the proceeds of an issue of municipal obligations could be "loaned" to persons other than state or local governmental units or certain charitable organizations. However, the 5% threshold for "loans" has usually not presented a problem to issuers of traditional general obligation bonds because the proceeds of such issues typically cannot be loaned to nongovernmental entities under the provisions of our State Constitution noted earlier. Moreover, the 25% limit also has not been a serious problem because the indirect "use" of general obligation bond proceeds by taxable entities is usually *de minimus*, as towns, villages and cities are all without authority to do so, in most cases.

Finally, earlier tax law did not require that any nongovernmental use of bond proceeds be related to governmental uses of such proceeds of any particular issue.

Private Activity Bonds Under the 1986 Code

Under the 1986 Code, an issue of municipal obligations is deemed to constitute "private activity bonds," and, therefore, generally subject to federal income taxation, if 10% or more of the proceeds of the bonds is "used," directly or indirectly, in the trade or business of persons other than state or local governmental units or members of the general public on an equal basis and if 10% or more of the debt service on the bonds is secured by funds from private users (e.g., rental payments for the use of bond-financed facilities). "Use" includes leasing a bond-financed facility, purchasing output from a bond-financed facility, or certain management contracts (including such contracts as are permissible in New York State). Debt service will be considered to be "secured" by funds of private users even if there exists no direct link between debt service and monies paid or available from a private user. Thus, the fact that debt service is paid from monies in an issuer's general fund is not significant if monies are paid by the private user to the issuer and applied by the issuer for a purpose other than direct payment of the obligations. Continuing the rule of prior tax law, bonds will also be private activity bonds if 5% or more of the bond proceeds or $5 million, whichever is less, is "loaned" to persons other than state or local governmental units. (For purposes of these tests, the portion of the bond or note proceeds used by all nongovernmental beneficiaries of the obligations is aggregated. Note that Section 501(c)(3) charitable organizations are not exempt users of bond proceeds for purposes of the "use" and "loan" provisions.) The term "loan" is to be broadly construed. The only exception to this 5% or $5 million rule is provided for loans which enable the borrower to finance any governmental tax or assessment of general application for an essential governmental function. Thus, the present ability of state and local governmental units to issue tax-exempt obligations to finance tax assessments or certain types of public improvements, such as water and sewer lines, is not impaired so long as the financing is made available to all members of the general public on an equal basis.

Although the legislative history of the 1986 Code stated that its provisions were not intended to interfere with traditional municipal financings, lowering the threshold from 25% nongovernmental use to 10% can call many more projects into question than was previously the case. The following examples illustrate the severity of these restrictions:

Example 1

A town, or a village or a city wishes to issue general obligation bonds to finance a municipal office building. The building will have four stories and cost $5 million. Because the office building will be located in the middle of a business district, the municipality desires to lower its overall occupancy costs by leasing out the first floor for use as shops and stores temporarily until needed for town use. Because of these leases, more than 10% of the bond proceeds will be viewed as being "used" by the store owners and, since the rental payments for the shops and stores will be viewed as "securing" the bonds even if they are not formally pledged to the payment of debt service, the bonds will be private activity bonds. The same result would apply if the first floor consisted of a cafeteria and parking spaces for use by municipal employees if the municipality, rather than operating such facilities itself, hired private management companies to perform such functions pursuant to certain types of long-term contractual arrangements.

Example 2

A city desires to issue general obligation bonds to finance certain improvements to the city airport. Because commercial airlines constitute a large portion of the traffic at the airport and the landing fees paid by the airlines equal more than 10% of the debt service on the bonds, the bonds may be viewed as private activity bonds because more than 10% of the bond proceeds may be considered as being "used" by the commercial airlines. What is being financed may make a difference here.

Example 3

A city proposes to issue general obligation bonds to finance a bus terminal. Some of the buses using the terminal are owned and operated by the city transit authority. However, the terminal is predominantly or significantly used by privately owned bus companies. Because over 10% of the bond proceeds would be viewed as being "used" by the private bus lines, the bonds may be private activity bonds.

Example 4

A town or village or city will issue general obligation bonds to finance a municipal auditorium. In general, the auditorium will be available to anyone desiring to use it on a first-come, first-served basis, paying by a rate-scale method. However, the auditorium will be made available on a long-term basis to a local philharmonic orchestra that will use the auditorium more than 10% of the time. Because the auditorium will be used more than 10% of the time by the philharmonic orchestra, the bonds will be private activity bonds. If the orchestra is a Section 501(c)(3) organization, the use may, nevertheless, be permissible. If such a user is a private business, it would be problematic.

Example 5

A town or village or city proposes to finance a "resource recovery" facility that will burn garbage collected by the town or village or city. The heat resulting from the burning process will be used to generate steam, which, in turn, will be used to drive turbine generators that will produce electricity. Having been informed by bond counsel that private ownership or management of the facility will cause the bonds to be private activity bonds, the municipality decides to own and operate the facility itself. However, the only available customer for the electricity generated by the facility is an investor-owned utility. Because the investor-owned utility will purchase all of the electricity generated by the resource recovery facility, the bond proceeds are deemed "used" by the utility and the bonds may be private activity bonds even though the municipality owns and operates the facility.

Related Use Rule Under the 1986 Code

The 1986 Code imposed additional requirements even if the new 10% rule is not violated. Under the 1986 Code, if over 5% of the proceeds of a bond issue is used by private entities in a way that is not related to the governmental purpose of the rest of the issue, the bonds become taxable. This provision ended the era of consolidated issues in which private uses were "flooded" as part of large issues for which 75% or more of the proceeds would be used for assorted traditional governmental purposes with the "private" financing being limited to 25%. Now, only 5% of the bond proceeds can be used for the benefit of private entities without any further restrictions. The remainder of the permissible 10% that is used for the benefit of private entities must satisfy two additional restrictions—first, any such additional private financing must be "related" to a governmental facility that is also being financed with the bond issue; second, the amount of bond financing provided to the private entity with respect to such facility cannot exceed the amount of financing being provided to the governmental entity with respect to the same facility.

For example, if a $1 million bond issue were to be used to finance a courthouse costing $900,000 that was to be used solely by a governmental entity and a $100,000 improvement at the issuer's airport, which is used mainly by commercial airlines, the bonds would be taxable even though the 10% limit was not violated, because over 5% of the proceeds would be used for an "unrelated" facility. However, if the $100,000 were instead used to finance a privately operated cafeteria located in the courthouse that would be used predominantly by municipal employees, the bonds would be tax-exempt because the additional financing being provided with respect to the cafeteria (i.e., the amount in excess of the 5% unrestricted amount) would be "related" to the governmental use of the facility and the bond-financed cost of the cafeteria does not exceed the amount of financing being provided to the governmental entity with respect to the same facility.

In the case of an issue in which more than 5% of the proceeds, but less than 10%, is to be used for an unrelated purpose, the entire issue would be treated as a private activity bond, requiring a public hearing and becoming subject to the alternative minimum tax. Furthermore, if the private use is not one treated as an exempt purpose under the 1986 Code, there is a risk that the whole issue would be retroactively characterized as taxable (even if 90% of the bonds was used for a traditional governmental purpose).

Because of these stringent requirements and the severe penalty, municipalities must regularly examine their financing plans very carefully in order to determine whether or not tax-exempt financing is effectively being "made available" to entities other than state or local governmental units or members of the general public on an equal basis, and they should consult with bond counsel early in the planning process if any questions are raised in this regard. Obligations that are private activity bonds may still be entitled to tax exemption, but only if they meet all of the applicable requirements of the 1986 Code, including the holding of a public hearing and, in some cases, obtaining an allocation of "volume cap" from the State.

Private Activity Bonds That Qualify for Tax-Exemption as "501(c)(3) Bonds," "Exempt Facility Bonds," "Qualified Redevelopment Bonds" or Small Issue "Industrial Development Bonds"

Although private activity bonds are generally taxable under the 1986 Code, there are several exceptions to this rule that provide at least some relief. Thus, some private activity bonds nevertheless qualify for tax-exempt status if they constitute "501(c)(3) Bonds," "qualified redevelopment bonds" or are issued to finance the various types of "exempt facilities," or some types of "industrial development," each under its own qualifying set of conditions. These permutations are beyond the scope of this primer, as the primer is directed at general obligation governmental bond issues that would not finance such facilities or projects.

State Law Aspects of Private Activity

A full review of the basic rules governing nongovernmental use of municipal facilities is beyond the scope of this bond primer. In brief, and subject to the specific facts and circumstances in any case, and certain statutory caselaw, and State Comptroller opinion exceptions, these are the rules in "nutshell" form:

- No gifts or loans of public funds or properties to any private individual, private undertaking, private corporation or association;
- No gifts or loan of credit to same or to any other municipality;
- No contracting indebtedness except for a valid municipality purpose;
- Truly incidental private benefit is permissible;
- Private management contracts negotiated at arm's length to operate certain municipal facility on behalf of a municipality are permissible under certain limited conditions;
- Property leased by a municipality may be improved for municipal use provided that such improvement is completely amortized during the life of the lease;
- A town, village or city cannot be in the landlord business as an investment, but it can acquire a property needed for a valid municipality purpose that is larger than current need as long as the entirety is reasonably expected to be needed by the town or village in the "foreseeable future." Such temporary use by others if at fair market value is permissible, but if the property is bond-financed, "private activity" considerations are paramount and should be considered prior to leasing to the private user.

Please note that this is a very "broad stroke" description of State law limitations on what federal tax laws refer to as "private activity." There are numerous permitted exceptions. Always talk first with your local counsel when such matters come up!

CHAPTER THIRTEEN

Federal Tax Law Issues—Special Tax Provisions for Certain Buyers of Municipal Debt

Bank Qualified Debt—Basic Rules

The law before the 1986 tax reform disallowed a deduction for interest on indebtedness incurred or continued by a taxpayer to purchase or carry obligations the interest on which is exempt from federal income tax. This rule applied both to individual and corporate taxpayers. Banks, however, had been largely exempted from this general rule. The 1986 Code changed this by denying banks a deduction for that portion of the bank's interest expense which is allocable to tax-exempt obligations (regardless of date of issuance) acquired by them after August 7, 1986, for taxable years which began after December 31, 1986. The prior law rule allowing an 80% deduction for banks was continued for bonds acquired on or before August 7, 1986.

The 1986 Code did, however, provide an exception to this rule which continues presently. Under the exception, a bank can purchase up to $10 million ($30 million in 2009 and 2010) of the obligations of any governmental issuer who does not expect to issue in excess of $10 million ($30 million in 2009 and 2010) of obligations in the calendar year in which the "bank qualified" debt is to be issued. This exception does not apply to the first $10 million ($30 million in 2009 and 2010) in obligations of municipalities that plan to issue more than $10 million ($30 million in 2009 and 2010) in the calendar year. This exception is limited to "qualified obligations" acquired by a bank. A bank can acquire as many of such obligations as it wishes of different issuers without limitation. For this purpose, "qualified obligations" include any obligation which (1) is not a private activity bond (i.e., town or village or city general obligations), and (2) is designated by the issuer.

Obviously, not more than $10 million of such obligations ($30 million in 2009 and 2010) may be designated for these purposes by any issuer during any calendar year. Moreover, it must be reasonably anticipated that the issuer will not issue more than $10 million (30 million in 2009 and 2010) of tax-exempt obligations (other than private activity bonds) in any calendar year, including any issues of "subordinate" governmental entities which are controlled by or derive their authority from the issuer in question. For issuers meeting these criteria, this is a cost-free way to make their obligations more attractive to bank purchasers.

In order for issuers to maximize their benefits from this exception, appropriate language must be inserted in notices of sale for applicable notes or bonds so that bidders will be aware that the obligations qualify for this treatment. When informal bids for notes are solicited orally, prospective purchasers should be similarly informed. Additionally, for qualifying issues which are sold without a printed notice of sale, Bond Counsel must be so informed so that the necessary insertions can be made in the certificate authorizing the issuance of such obligations, and a copy of such certificate must be provided to the purchaser.

How can a town or village or city determine if it will be a municipality that can issue bank-qualified debt in a particular calendar year? Here are the steps:

Step No. 1: Does the municipality reasonably expect to issue $10,000,000 ($30,000,00 for calendar years 2009 and 2010) or less in tax-exempt bonds and notes in the calendar year? (small issuer question)

WHAT COUNTS:

1. All new-money governmental general obligation issues.
2. Advance Refundings (renewal more than 90 days in advance).
3. All governmental general obligation new-money or advance refunding bonds or notes issued by a governmental entity subordinate to the municipality or issuing debt "on behalf of" same (i.e., some I.D.A. debt may count).
4. All tax-exempt installment sales/ lease purchase agreements.

WHAT DOES NOT COUNT:

1. Private activity bonds or notes.
2. Current renewals (to the extent that the amount of the renewal does not exceed outstanding principal amount of maturing debt).
3. Most federally taxable debt obligations.

Step No.2: Is the issue itself eligible for designated and qualified status? (issue qualification question)

A. New-Money Issues—
   1. Not a private activity bond or note (other than a 501(c)(3) obligation).
   2. Not a taxable bond or note.

B. Renewal/Refunding Issues (Current or Advance)
   1. Aggregate face amount does not exceed $10,000,000 / $30,000,000 (09-10).
   2. Each refunded bond or renewed note was part of an issue which itself did *not* qualify at the time for the $10,000,000 / $30,000,000 (09-10) exception in its year of issuance and was *not* designated. (An issue renewing or refunding a designated bond or note will be deemed designated—see below.)

3. Not a private activity bond or note (other than a 501(c)(3) obligation).
4. Not a taxable bond or note.

C. Certain Refundings/Renewals or Designated Obligations May Be "Deemed Designated"
1. If a qualified and designated obligation is refunded/renewed, the refunding bonds or renewal notes are "deemed designated" if:
a. The refunded/renewed obligation was both eligible to be designated and was actually designated.
b. The par amount of refunding obligations does not exceed the outstanding amount of the refunded or renewal obligation. (Any excess can be designated.)
c. The average maturity date of the refunding/renewal obligation is *not* later than the average maturity date of the obligations being refunded/renewed. NOTE: This rule by itself would eliminate renewal notes or bonds from qualifying when refunding/renewing typical one-year notes so there is an exception:
If the average maturity of the refunded debt is three years or less, the requirement is waived.
d. No refunding bond has a maturity date which is later than the date which is 30 years after the date that the original note or bond was issued.
2. Deemed designated obligations provide financial institutions with same benefit as designated obligations.
3. Deemed designated obligations do not count toward the $10,000,000/$30,000,000 limit of obligations which may be designated in a calendar year.
Therefor, over $10,000,000 ($30,000,000 in 2009 and 2010) may ultimately be issued, of which $10,000,000 / $30,000,000 is designated and the rest is renewals/refundings, which are deemed designated.

D. Certain Obligations May Not Be Designated or Deemed Designated:
1. Any refunding/renewal obligation when the aggregate face amount of the issue exceeds $10,000,000 / $30,000,000.
2. Private activity notes or bonds (other than 501(c)(3) obligations).
3. Taxable obligations.

Alternative Minimum Tax

The 1986 Code imposed an alternative minimum tax on individuals and a similar tax on corporations. Although the alternative minimum tax on individuals existed before the new tax law, it included from 1986 until 2009 the computation of income interest on newly issued private activity bonds (other than qualified 501(c)(3) bonds). In addition, corporations have had to treat 50 percent of the interest on *all* types of municipal obligations as a preference item, regardless of when such bonds were issued. (That is, 50 percent of interest received on any tax-exempt obligations, including governmental activity general obligations, became subject to the corporate minimum tax.) In addition, interest income received by corporations was for some time includable in a corporation's tax base for purposes of computation of such corporation's liability for an additional 0.12% environmental corporate tax imposed by the "Superfund Amendments and Reauthorization Act of 1986" and later phased out.

Under a provision of the American Recovery and Reinvestment Act of 2009 ("Recovery Act"), interest earned on any new-money bonds or notes issued in 2009 and 2010, and any bonds or notes issued in 2009 and 2010 to refund/refinance bonds or notes issued in calendar years 2004 through and including 2008, is not subject to the alternative minimum tax in any form.

New "Cost to Carry" Deduction for Banks in 2009 and 2010

The Recovery Act has also provided an additional incentive for bankers to buy the type of debt issued by a town or village or city in 2009 and 2010 as it permits banks to avoid limits on interest expense deductions for new-money, nonbank qualified bonds issued in 2009 and 2010, provided such bonds do not exceed 2% of its total assets.

Under prior law, individuals and corporations are generally prohibited from deducting interest expense that they incur in order to acquire or carry tax-exempt bonds. However, as a matter of administrative policy, the IRS does not apply this rule to individuals and corporations (other than banks) whose holdings include only an insubstantial amount of tax-exempt bonds. Corporations generally meet this "insubstantiality" test if tax-exempt bonds comprise no more than 2% of their investment in active business assets; for individuals, tax-exempt bonds must comprise no more than 2% of their total investment portfolio and business assets.

Banks that hold tax-exempt bonds have not benefited from the IRS policy described above, and are generally prohibited from deducting a portion of their total interest expense. The nondeductible portion is calculated based on the ratio of the bank's investment in tax-exempt bonds to its total investment in all assets. Bank Qualified Bonds are generally not counted as tax-exempt bonds for purposes of the investment ratio calculation.

To stimulate the purchase of tax-exempt bonds by banks, the Recovery Act allows banks to avoid any limitations on interest expense deductions for a limited amount of new-money, nonbank qualified bonds issued in 2009 and 2010. Thus, any new-money bonds issued in those years (whether or not they are private activity bonds) can qualify for exclusion from the investment ratio calculation. Each bank may only exclude 2009 and 2010 bonds up to 2% of its total investment in all assets; amounts beyond that limitation will be counted as invested in tax-exempt bonds in the investment ratio calculation and reduce the bank's deductible portion. Refunding bonds issued in 2009 and 2010 to refund bonds issued prior to 2009 will continue to be subject to the full interest expense deduction disallowance unless they are bank-qualified bonds. However, refunding bonds issued to directly or indirectly refund 2009 and 2010 bonds that qualified for the exclusion will themselves qualify for the exclusion, regardless of when the refunding bonds are themselves issued.

CHAPTER FOURTEEN

Disclosure Issues

The Official Statement ("OS")

Except in the case of direct lease financings with a vendor, leasing company or bank and financings where the securities are sold to a bank or very limited number of sophisticated investors for investment rather than resale, the documentation in a debt financing includes a disclosure document, which is usually called an "official statement." The official statement is used to provide information to investors and prospective investors about the town, village or city and the bonds or notes. Bonds and notes constitute securities for purposes of state and federal securities laws and, therefore, the offering and sale of them through the official statement is subject to certain provisions of such laws, including, importantly, the antifraud laws. The official statement sets forth information about the terms of the securities, the security features, the sources and uses of the proceeds, the issuer, any material risk factors in an investment in the securities, the documents under which the bonds or notes are issued and the tax-exempt status of interest on the securities.

Prior to 1989, debt issuance by towns, villages and cities was not directly or indirectly subject to oversight by the U.S. Securities and Exchange Commission ("SEC"), except for general securities law rules governing the perpetration of "fraud on the market" by an issuer of debt. These general antifraud provisions are found in the Securities Act of 1933 and the Securities and Exchange Act of 1934, and have always covered municipal securities.

Background of the Rule

In 1989, Rule 15c2-12 under the Securities Exchange Act of 1934 (the "Rule") was adopted to further protect investors in the municipal securities market from fraud and manipulation. Historically, the municipal securities market has been largely unregulated, but over the past 20 years, the SEC has progressively introduced regulation designed to protect and inform investors.

The Rule requires an "underwriter," that is, one buying municipal bonds, notes, or other securities for purposes of resale in a primary offering, to obtain disclosure material or an "official statement," describing the issue and the issuer that is "deemed final" by the issuer. "Deemed final" means that the official statement is as complete and as accurate as possible, without (among other items, specifically referred to in the Rule) the principal amount(s), interest rate(s), offering price(s) and name of underwriter(s). Financial advisors work with issuers on their official statement for borrowing and bond counsel reviews it prior to distribution.

Before a competitive sale, "deemed final" official statements are provided to underwriters interested in bidding. After a competitive sale, the "deemed final" official statements which have been circulated to potential underwriters may then become final official statements by reprinting them, or attaching to them new covers or wraparounds with the final principal amount(s), interest rate(s), offering price(s), name(s) of underwriter(s) and other information which is reflective of the winning bid(s) (for example, if the issue is insured, the name of insurer and information concerning the insurance). Final official statements must be printed in an adequate supply and provided to underwriters within seven days following the bond or note sale (or less, to permit underwriters to comply with applicable Municipal Securities Rulemaking Board ("MSRB") requirements, if delivery is scheduled for less than seven days after the sale).

In a negotiated sale, the underwriter must secure a contractual commitment, usually in the bond purchase agreement ("BPA"), to be furnished with an appropriate quantity of final official statements within seven business days of the date of the BPA. MSRB Rule G-32 requires that one official statement and at least one official statement for each $100,000 of principal amount of the issue be furnished by the underwriter to each purchaser not later than the settlement date of their purchases. The official statement must be available to bond or note purchasers promptly after the date of sale, but no later than two business days before the date the securities are delivered to the underwriters.

Under the Rule, Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") were proposed as a means to improve availability of official statements. Final official statements have been sent by underwriters to current NRMSIRs and kept on file. As of July 1, 2009, only one NRMSIR is now recognized by the SEC, and it is operated by the MSRB and known as the Electronic Municipal Market Access system ("EMMA"). The role of the NRMSIRs (and hence, now, EMMA) was increased under certain amendments to the rules further discussed below.

1994 Amendments

On November 10, 1994, the SEC adopted amendments (the "Amendments") to Rule 15c2-12 under the Securities Exchange Act of 1934, establishing disclosure requirements for municipal securities offerings in the secondary market. The Amendments, which are a modified version of those proposed by the SEC in a release dated March 9, 1994 (the "March Release"), were part of an ongoing process to improve the quality of information about municipal securities available to potential purchasers.

The SEC, among other things, regulates the underwriters that purchase municipal securities for resale. While, under current law, the SEC has limited power to regulate municipal issuers directly, the Rule, including the Amendments, has an impact on such issuers because underwriters can purchase most municipal securities only after reviewing disclosure materials provided by the issuer. Furthermore, underwriters cannot recommend most municipal securities to their customers unless they have enough information to judge that the securities are an appropriate investment for their customers.

The Amendments require underwriters to determine that municipal issuers have agreed to provide ongoing disclosure to state and national repositories, including annual financial statements, operating data, and notices of "material" events that could affect such issuers' obligations, and that underwriters have systems in place to monitor such information concerning municipal bonds, notes and other securities being sold in the secondary market. Some municipal securities are exempt or partially exempt from the Amendments.

The Amendments have been effective since July 3, 1995.

The Amendments in Detail

The Rule was originally adopted to protect investors in the "primary" market (the market in which underwriters directly offer municipal bonds, notes or other securities purchased by them from issuers in either competitive or negotiated sales). The Amendments are intended to offer protection to investors in the "secondary" market (the market in which the securities are traded or resold). Although many of the general obligation notes offered by issuers in New York State are purchased directly by banks or other institutions and held in their portfolios and not reoffered (and those that are reoffered are often purchased for mutual funds by dealers), it is important to become familiar with the Amendments.

Secondary market disclosure is viewed by the SEC and others as necessary because purchasers of municipal securities in the secondary market should have access to current financial information and operating data in order to evaluate the securities they are interested in selling or purchasing in the secondary market. The current financial information and operating data presented in the final official statement that is prepared for the initial offering certainly will change over time, possibly affecting the value of the securities. The purpose of the Amendments is to make available, to purchasers in the secondary market, the most current financial and operating information regarding issuers. The SEC believes that accessible, periodic updates from issuers are a way to ensure orderly markets and fairness to all participants.

Under the Amendments, underwriters will require as a condition of purchase that, among other things, issuers provide in the future reviewable information in a timely fashion. The Amendments required underwriters to have systems in place, by January 1, 1996, for reviewing such information. Generally, underwriters are prohibited from purchasing or selling municipal bonds, notes and other securities (unless such securities fit within an exemption to the Rule as amended) unless they determine that the issuer (or obligor on the securities for conduit-type issues) has undertaken a written agreement or contract for the benefit of the holders of bonds, notes or other securities, to provide annual financial information and notices of material events (notices of material events are explained further below).

Under the Amendments, underwriters cannot agree to purchase bonds or notes in competitive or negotiated sales unless they have reasonably determined that the issuer has agreed in writing to provide ongoing disclosure of annual financial information and notices of material events (unless the issue is exempt under the Amendments, or partially exempt; see "Exemptions" herein).

The effective dates of the Amendments were designed to allow issuers, underwriters and other market participants enough time to develop and implement the procedures necessary to comply therewith. The first step is a covenant by the issuer, for the benefit of holders of bonds, notes or other securities, to provide ongoing secondary market disclosure of annual financial information and notices of material events to the NRMSIRs and state information depositories ("SIDs") or the MSRB.

The official statement for the primary offering sets the standard for ongoing disclosure. Future financial information and operating data must be provided for those persons, entities, enterprises, funds and accounts that are necessary for an evaluation of the offering. The SEC suggested in an interpretive release dated November 10, 1994 ("November Release"), that in the case of a general obligation offering, demographic statistics should be considered as operating data.

The official statement must contain a description of the agreement to provide ongoing financial information and operating data and notice of material events, as well as the scope of that ongoing disclosure.

At the time of the primary offering, the participants in an offering (for example, the issuer, the purchaser and the insurer, if any) will decide what type of information is material to the offering and who is responsible for providing ongoing information to repositories. As stated above, the final official statement will set the standard for what type of information this will be. The final official statement would either contain financial information and operating data, or refer to documents prepared and previously made publicly available containing such information.

The participants in the primary offering will also commit to provide annual financial information for subsequent years by a particular date. The SEC originally proposed that issuers be required to produce annual audited financial statements, which was considered quite burdensome by many of those who commented on the proposed Amendments. As adopted, the Amendments do not require that all issuers produce audited financial statements. However, if an issuer or obligor does produce audited financial statements, they must be delivered to the NRMSIRs. The accounting principles used in preparing such statements must be stated, and financial information should be reasonably consistent to enable year-to-year comparisons. Annual financial information may reference other information already on file with the NRMSIRs and SIDs or the MSRB.

In addition to annual financial disclosure, the Amendments list 11 "material" events requiring notice to the secondary market, in a timely manner ("timely" has not been defined by the SEC, and could be interpreted to mean as soon as reasonably possible), by delivery to NRMSIRs or the MSRB and the appropriate SIDs until July 1, 2009 and as of this writing only to the MSRB:

- principal and interest payment delinquencies
- nonpayment-related defaults
- unscheduled draws on debt service reserves reflecting financial difficulties

- unscheduled draws on credit enhancements reflecting financial difficulties
- substitution of credit or liquidity providers, or their failure to perform
- adverse tax opinions or events affecting tax-exempt status of the security
- modifications to rights of security holders
- bond calls
- refundings
- release, substitution, or sale of property securing repayment of securities
- rating changes

In addition, notice of any failure of the issuer to provide annual financial information by the date specified in the written agreement generally must also be disclosed to repositories, which is discussed below. Any failure to comply with the written agreement to provide secondary market disclosure within the previous five years must be disclosed for bond issues. The SEC recommends, but does not require, that issuers file notice of favorable events, including cure of an adverse event listed above.

Underwriters must now have in place systems designed to monitor material event disclosure and must have "reasonable assurance" that they will receive prompt notice of material events before they can recommend purchase of a municipal security to their customers. Although this appears to be a limitation placed only on underwriters, this is also a concern for issuers as well, because if a dealer is unable to recommend or sell a security, they are unlikely to purchase it in either the primary or secondary market.

Annual financial information and notice of material events (the ones listed above) must be sent by issuers (or the obligors in conduit issues) to all NRMSIRs or the MSRB and the appropriate SID (in the state of issuance, if such depository exists) until July 1, 2009 and as of this writing only to the MSRB.

The SEC required that NRMSIRs be national in scope, maintain current accurate information, and have effective retrieval and dissemination systems. They cannot place limits on the persons from which they will accept information, and must provide access to documents to anyone willing to pay the fees. They must charge "reasonable" fees and may not charge issuers for filing information.

In the November Release, the SEC encouraged and offered guidance to states developing SIDs. As mentioned above, if an appropriate SID exists, notices of material events and annual financial information were to be submitted to such SID as well as the NRMSIRs or the MSRB. With the preemptive takeover of the NRMSIR function solely by the MSRB in July 2009, SIDs, if any, will likely cease to operate.

The New York State Comptroller's Office (the "OSC") already collects most debt statements, official statement filings and reports of financial condition, as required under Section 30 of the New York State General Municipal Law. In 1994, the Comptroller held a public hearing to discuss, among other things, the feasibility of the OSC acting as an SID. New York State never did establish an official SID.

Exemptions

The Rule fully exempts some issues. The Rule does not apply to issues with principal amounts under $1,000,000. The Rule also only applies to issues purchased from the issuer by an underwriter with a view to offer or sell. If the issue is being purchased privately for the portfolio of an institution, for example, a bank buying a bond anticipation note that such bank will hold in its own portfolio, the Rule does not apply (regardless of the principal amount).

An issue of bonds, notes or other municipal securities, which is otherwise subject to the Rule, that is sold in denominations of $100,000 or more is not subject to the Rule, if such issue: i) is sold to no more than 35 "sophisticated" investors (investors who are believed to have the knowledge and experience in financial matters to evaluate the merits and risks of such issue) who are not purchasing for distribution; or ii) has a maturity of nine months or less, or has a put option exercisable at least every nine months (a put option is the opportunity for the owner to request that the issuer, directly or through an agent, redeem or purchase such security at par value or more).

The Amendments provide limited exemption for securities with maturities of 18 months or less. Annual financial and operating information is not required for these securities, but issuers are still required to agree to provide notices of material events to the NRMSIRs or the MSRB and appropriate SIDs until July 2009, and, thereafter, to the MSRB.

Issuers with less than an aggregate of $10 million in outstanding debt (including the obligations offered and excluding securities that were offered in transactions exempt under the Amendments), were exempt from the annual financial information requirement of the Amendments if such issuers made a "limited undertaking" (the term used in the Amendments) to provide financial information and operating data on request, or provide such information annually to an SID. (An agreement to provide the financial and operating data that is generally prepared and available to the public satisfied such limited undertaking. Issuers using this exemption had to describe in the final official statement where the financial information and operating data can be obtained and from whom.) Recent revisions to this provision have effectively eliminated this special limited undertaking.

Compliance

Frequent issuers, and those with full-time finance staff, have been able to meet the new requirements with the least difficulty. However, disclosure in official statements needs constant updating and revision. Issuers must covenant to provide ongoing information (unless, of course, the issue is exempt). Nowadays, appropriate modifications to customary bond and note proceedings accommodates the inclusion of such covenants.

It is important for issuers to understand the implications of Rule 15c2-12, because failure to comply may have several potential repercussions. At the very least, failure to provide ongoing information will cause the market to react unfavorably the next time such an issuer tries to sell its bonds or notes. A refusal to make a covenant would severely limit the market of an issue.

While your bond counsel will certainly want to review your compliance with the Rule and its Amendments, including any Official Statement prepared by a financial advisor with the help of a school district in connection with a public offering of debt, it is ultimately the responsibility (and liability) of the town or village to ensure that the Official Statement or other disclosure compliance document is 100% accurate. The standard to which the town, village or city will be held is as follows:

> The statements contained in the Final Official Statement dated _______________, 200_, do not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

There is a limited exception for data from other sources.

That is, the general antifraud requirement of the securities laws applicable to any municipal securities offering in the public markets of any municipality in the State.

Responsibilities and Liabilities

As noted above, the antifraud provision of the 1933 Securities Act and the 1934 Securities Exchange Act require that the information provided in connection with the offer or sale of securities must not contain any untrue statement of a material fact and must not omit to state a material fact necessary to make such information not misleading. This is of critical importance to the town, village or city. The town, village or city itself is primarily liable for any material misstatements or omissions regarding the town, village or city made in the documents used to offer and sell the securities. The municipality may not transfer this primary liability to its underwriter, its financial advisor, local counsel, bond counsel or any of the other parties involved in the financing. Such parties might be liable in their own right, but their liability will not absolve the town or village of its primary liability. Consequently, the municipality and its staff must make every effort to ensure that the offering documents are accurate and complete. The SEC has stated that:

> "Because they are ultimately responsible for the content of their disclosure, issuers [of municipal securities] should insist that any professionals retained to assist in the preparation of their disclosure documents have a professional understanding of the disclosure requirements under the federal securities laws."

In connection with its Orange County, California bankruptcy investigations, the SEC reiterated that issuers "bear the most significant responsibility to ensure" disclosure is adequate, and commented that:

> "[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."

In short, always read your draft official statement.

CHAPTER FIFTEEN

Post-Issuance Responsibilities, Issues and Problems

After issuance of any cashflow or capital debt obligation, there are several areas of continuing responsibility for the issuer (besides paying back the bond or note holders for the loan of their money—highly recommended) as well as certain typical problem scenarios.

The areas of responsibility include proper investment of borrowed proceeds within LFL, General Municipal Law and federal tax law guidelines; compliance with the federal reporting, arbitrage and arbitrage rebate rules; compliance with ongoing federal disclosure requirements; and proper reporting to State oversight authorities.

There are also some fairly typical problem scenarios that may arise, such as: (a) not enough money to finish a project; (b) too much money authorized, or authorized and borrowed for a project; and (c) issues surrounding reimbursement of monies temporarily borrowed on an inter-fund basis to be repaid with debt proceeds upon issuance.

Responsibility: Investment of Borrowed Proceeds

The proceeds received upon the sale and issuance of debt obligations must, in most cases, be treated differently from other monies raised by the tax levy or from other sources. While TAN, RAN or budget note proceeds may be treated like general fund monies, monies received from the sale of BANs or bonds to finance the cost of capital projects must be kept and accounted for separately.

The proceeds, inclusive of premiums, from the sale of bonds, bond anticipation notes, capital notes, urban renewal notes (a form of note similar to a specialized RAN) or budget notes must be deposited and secured in a special account in the manner provided by Section 10 of the General Municipal Law. Such capital proceeds cannot be commingled with other funds of the issuer and must be expended only for the object or purpose for which such obligations were issued. Capital fund monies cannot be utilized for inter-fund loans. In the event that any portion of the proceeds, inclusive of premiums, from the sale of bonds, bond anticipation notes, capital notes, urban renewal notes or budget notes is not expended for the object or purpose for which such obligations were issued, such portion must be applied only to the payment of the principal of and interest on such obligations, respectively. Notwithstanding the foregoing provisions of the LFL, the Board may adopt any or all of the following resolutions to provide that:

a. The proceeds, inclusive of premiums, of capital notes issued in amounts of $100,000 or less, and of budget notes, need not be deposited in a special account but may be deposited and commingled with other funds of the issuer in any account of the issuer in a bank or trust company located and authorized to do business in the State, but such power should not be construed as authorizing the use of such proceeds for an object or purpose other than that for which the obligations were issued.
b. The proceeds, inclusive of premiums, from the sale of any two or more issues of bonds, bond anticipation notes, capital notes, urban renewal notes or budget notes need not be deposited in separate special accounts but may be deposited in a single special account of the issuer in a bank or trust company located and authorized to do business in the State, but should not be commingled with other funds of the issuer. The chief fiscal officer should then maintain a separate accounting record of each issue to ensure that the proceeds shall be used only for the object or purpose for which the obligation was issued.
c. Moneys appropriated for a purpose for which bonds, bond anticipation notes, capital notes or urban renewal notes have been authorized may be deposited in the same bank account with the proceeds from the sale of such obligations. Such power should not be construed as authorizing the use of the proceeds of such obligations for an object or purpose other than that for which they were issued. Any moneys remaining in such bank account after the object or purpose has been completed or abandoned must be applied to the payment of the principal of and interest on such obligations. Any excess remaining thereafter may be used for any lawful purpose.

The proceeds, inclusive of premiums, from the sale of bonds, bond anticipation notes, capital notes and urban renewal notes are to be invested in the manner provided by Section 11 of the General Municipal Law, which provides a list of permitted investments for towns, villages and cities. Such investment is to be made by the Board, or, more typically, the chief fiscal officer, if the Board, as is customary, shall delegate such duty to that person. The separate identity of the proceeds from the sale of bonds, bond anticipation notes, capital notes, urban renewal notes and budget notes is to be maintained at all times, whether such proceeds consist of cash or investments or both. Any interest earned or capital gain realized on any investment is to be applied to either the payment of the principal of and interest on the bonds, bond anticipation notes, capital notes, urban renewal notes or budget notes, as the case may be, the proceeds from the sale of which were used in making such investment or for any other purpose or purposes for which such issue of bonds, capital notes or urban renewal notes has been authorized. However, any interest earned or capital gain realized on any investment, to the extent necessary to maintain the exemption from federal income taxation of interest on the obligations the proceeds from the sale of which were used in making such investment, is to be paid to the United State Treasury Department.

Where the proceeds from the sale of bond anticipation notes have been invested and such notes have been retired from the proceeds from the sale of the bonds in anticipation of which they were issued, any interest earned or capital gain realized on any investment is to be applied only to the payment of the principal of and interest on the bonds.

Investment of such monies is regulated by the provisions of Sections 10 and 11 of the General Municipal Law, and the possible application of the yield restriction rules of the U.S. Treasury Regulations promulgated under Section 148 of the Internal Revenue Code of 1986, as amended (the "Code"), previously discussed.

Responsibility: Compliance With Federal Reporting, Arbitrage and Arbitrage Rebate Regulations

Because the interest on general obligation bonds and notes issued by municipalities in the State generally is tax-exempt to the holders thereof for federal income tax purposes under Section 103 of the Code, each issuance of such debt is subject to the federal requirement that a Form 8038-G or Form 8038-GC be filed within regulatory deadlines. Bond counsel assists in completion of these forms. These are "information returns" by which the Internal Revenue Service is able to track all tax-exempt municipal debt issuances in the United States. Random audits of governmental debt have become more commonplace in the new millennium.

It is also part of the job of bond counsel to inform any municipal issuer and their local counsel of the applicability of the federal arbitrage rules governing the period of time, if any, during which borrowed proceeds may be invested without restriction as to yield and the arbitrage rebate rules (and exceptions) governing the provision to the U.S. Treasury of certain investment earnings on borrowed proceeds, accrued prior to expenditure on the purpose for which the debt was borrowed. See Chapter 11 herein. The municipality may need a rebate compliance provider to help with annual calculations.

Responsibility: Compliance With Federal Disclosure Rules

Any governmental debt issuance in the public markets, national, state or local, is potentially subject to the effect of Rule 15c2-12 of the U.S. Securities and Exchange Commission (SEC) promulgated under the Securities Exchange Act of 1934, as amended. While the SEC does not directly regulate municipal issuers, it does regulate the bond markets, and it does have authority to take legal action against municipal issuers in connection with fraud or misrepresentations in the sale of their debt. It is again part of the role of bond counsel to advise town issuers and their local counsel as to any Rule 15c2-12 disclosure requirements upon the sale of debt and ongoing thereafter to maturity. The Rule does fully exempt some issues and certain small issuers are subject to less onerous reporting requirements.

However, any debt issuance of over $1 million nowadays will usually involve production of an "official statement." The production of an official statement is a joint work product of the issuer and its financial advisor, local counsel and bond counsel. This is the municipal equivalent of a corporate prospectus plus annual report. The official statement is a general overview of the current financial and related circumstances of the issuer and its tax base. The standard for the inclusion of information in an official statement is straightforward: it must be the case that the statements contained in the Official Statement do not contain any untrue statements of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.

In order to sell such debt, an issuer will need to contract to update certain of the information in the official statement for the life of an issue (which information needs updating and when is a function of the type of debt and the size of the issuer). Bond counsel must be familiar with these rules and advise local counsel and the issuer accordingly. See Chapter 14 herein.

Responsibility: State Oversight Reporting

The issuance of serial bonds must be reported to the Office of the State Comptroller, both in the annual report thereto as well as the filing of a debt statement, prior to the public sale of any issue of serial bonds.

Not more than 15 nor less than three days before any town, village or city having an aggregate assessed valuation of taxable real property of $100,000 or more sells any bonds which are required to be sold at public sale, it must file with the State Comptroller a verified statement of its debt-contracting power prepared as of the date not more than 30 days previous of the date of the sale of such bonds. The statement is to show the amount of obligations proposed to be sold at such sale. A duplicate copy of every such debt statement is to be filed in the same respective period of time with the clerk of such town, village or city.

Such statements are to be prepared in the manner prescribed in title 10 of article 2 of the LFL. Any error, defect, omission or inaccuracy in any such statement, or in the manner of its execution or filing, will not affect the validity of any obligations of any town, village or city.

Thereafter, the annual report must include the latest debt information.

Post-Issuance Issues: Insufficient Funds

Turning now to some typical post-issuance problem areas, insufficient borrowed proceeds to finish a project is not an uncommon scenario.

Investment earnings which have been made on the borrowed proceeds prior to their expenditure must be used to pay arbitrage rebate to the federal government, if applicable, or debt service on the debt obligations and is generally (but not exclusively) not available for project costs in the general obligation context. In any event, even if available for the capital purpose, it would be necessary to authorize the capital project first at the increased cost.

Assuming insufficient available funds from any other source, the only option is for the Board to adopt a supplemental bond resolution authorizing the issuance of additional debt for the capital project. Such a supplemental bond resolution would be subject to precisely the same pre-adoption proceedings or post-adoption referendum requirements as the initial bond resolution.

Post-Issuance Issues: Too Much Money Authorized

Everyone should have this problem: the Board has authorized a higher maximum estimated cost and debt issuance than the project as originally envisioned requires. What to do? It is first useful to note what cannot be done:

a. The excess authorized amount cannot be used on some other capital project.
b. The excess authorized amount cannot be used for any general fund or other fund operating purposes.
c. If the excess has already been borrowed at the time it is determined to be excess, it must be used to pay debt service on the obligation from whence it is proceeds at the next available debt service payment date(s). It is only when no such debt service remains that such excess proceeds may be used for any lawful purpose, subject to federal yield restriction, arbitrage and arbitrage rebate rules.

Excess authorization which is not utilized or otherwise encumbered may be repealed, or, pursuant to Section 41.00 of the LFL, will automatically self-repeal 10 years after the date of adoption.

Post-Issuance Issues: Reimbursement Issues

Often, prior to authorizing the financing of a capital project, a town, a village or a city may expend available funds in connection with some initial or preliminary costs relating to the project. It is generally understood by all concerned that, if and when the project moves ahead, those available funds will be reimbursed from the proceeds of a borrowing, hopefully within the same fiscal year.

Both the LFL and the U.S. Treasury Regulations promulgated under Section 148 of the Code have specific rules regarding the reimbursement of previously expended available funds.

Section 165.10 of the LFL provides that if there are funds of a municipality other than the proceeds of bonds, bond anticipation notes, capital notes and budget notes, and funds which, by law may be used only for stated purposes, which are not immediately required for the purpose or purposes for which the same were borrowed, raised or otherwise created, the Board may authorize the temporary use of such funds for the purpose or purposes for which an issue of bonds or capital notes has been authorized. Suitable records must be kept of the temporary diversion of such funds. Such funds are to be made again available to the municipality from the proceeds of such bonds or capital notes or from the proceeds of the sale of bond anticipation notes issued in anticipation of the sale of such bonds.

Therefore, if a valid bond resolution is not in place (including any applicable referendum having successfully occurred) at the time available monies are advanced, they may not be reimbursed from later borrowing proceeds. Nevertheless, this practice continues to occur with some regularity. It can be the subject of criticism on audit by the Office of the State Comptroller. It is preferable to simply adopt a bond resolution prior to the temporary advance without borrowing the funds in the public markets, and, thus, without starting the PPU clock running.

The adoption of a bond resolution will also cover the municipality with regard to the federal bond reimbursement regulations. These regulations generally require a "statement of official intent" prior to temporary advances of available monies. A properly drafted bond resolution may serve as an official notice of intent to borrow under these Treasury Regulations as well as LFL Section 165.10.

CHAPTER SIXTEEN

Lease Purchase Agreements, Energy Performance Contracts and Certificates of Participation

Background. General Municipal Law Section 109-b authorizes political subdivisions to enter into installment purchase contracts to finance certain capital equipment and to cause or permit certificates of participation to be issued in connection therewith.

An "installment purchase contract" means any lease purchase agreement, installment sales agreement or other similar agreement providing for periodic payments between a corporation, person or other entity and a political subdivision which has as its purpose the financing of equipment, machinery or apparatus under General Municipal Law Section 109-b, which governs town, village or city participation in such instruments.

A political subdivision may enter into an installment purchase contract subject to the following restrictions:

a. The governing board of a political subdivision must adopt a resolution authorizing the installment purchase contract, much like a bond resolution.
   (1) If an authorization for the issuance of the obligations to finance the equipment, machinery or apparatus would have been required by law to be subject to a permissive or mandatory referendum, then the authorization to enter into an installment purchase contract is subject to a permissive or mandatory referendum, as the case may be, in the same manner as provided for such referendum on the issuance of obligations.
   (2) If the authorization for the issuance of obligations to finance the equipment, machinery or apparatus would have been required by law to be subject to: (i) a certain supermajority vote of the governing board, (ii) a mandatory or permissive referendum, or (iii) both, then the authorization to enter into an installment purchase contract for equipment, machinery or apparatus is subject to such vote, referendum or such referendum and vote, as the case may be, in the same manner as provided for such vote and/or referendum on the issuance of obligations.
   (3) If the authorization for the issuance of obligations would have been subject to a referendum only if the obligations had a maturity of more than five years or not less than some other minimum period, then the authorization to enter into the installment

purchase contract is subject to referendum only if the term of the contract is equal to or more than such minimum period of maturity.

b. The term of such installment purchase contract, including all renewals thereof, cannot exceed the period of probable usefulness prescribed by Section 11.00 of the Local Finance Law for equipment, machinery or apparatus being financed under the installment purchase contract.

c. The installment purchase contract must separately state the principal and interest component of the periodic payments to be made thereunder. The total of all periodic payments that include both principal and interest components made by the municipality during each year throughout the term of the installment purchase contract must be substantially level or declining.

d. An installment purchase contract must contain the following statement: This contract shall be deemed executory only to the extent of monies appropriated and available for the purpose of the contract, and no liability on account thereof shall be incurred by the political subdivision beyond the amount of such monies. The installment purchase contract is not a general obligation of (insert name of political subdivision(s)). Neither the full faith and credit nor the taxing power of (insert name of political subdivision(s)) is pledged to the payment of any amount due or to become due under such installment purchase contract. It is understood that neither this contract nor any representation by any public employee or officer creates any legal or moral obligation to appropriate or make monies available for the purpose of the contract.

e. No payment under the installment purchase contract except payment for the total amount outstanding can be financed from the proceeds of obligations issued pursuant to the Local Finance Law other than the proceeds of revenue anticipation notes, tax anticipation notes or budget notes due to cashflow needs. An installment purchase contract may thus be paid off in full with the issuance of duly authorized BANs or serial bonds.

f. There are additional provisions if an installment purchase agreement is to be made a part of a certificate of participation instrument for wider sale of the financing contracts to the general public.

g. Installment purchase contracts for equipment, machinery or apparatus do constitute purchase contracts for public bidding purposes and are subject to public bidding requirements to the extent applicable by law. For purposes of determining whether the cost of the equipment, machinery or apparatus exceeds the monetary threshold fixed in Section 103 of the General Municipal Law relating to competitive bidding, the cost of the equipment, machinery or apparatus, exclusive of the cost of financing is considered. If the equipment, machinery or apparatus is to be financed by a party other than the party submitting the bid, the bid specifications may provide that the political subdivision may assign its right to purchase to a third party without the necessity of approval by the other party to the contract. Nothing precludes a municipality from advertising for bids in the alternative with and without financing.

h. Each political subdivision shall have the power to enter into agreements providing credit enhancement with respect to the installment purchase contract, but any reimbursement obligation of the political subdivision is subject to appropriation by the legislative board.

It is important to note installment purchase contracts made pursuant to this section of law do *not* constitute or create indebtedness of the state or the municipality for purposes of article seven or eight of the state constitution or Section 20.00 of the Local Finance Law, nor do they constitute a contractual obligation in excess of the amounts appropriated therefor. Neither the state nor a town or village has any continuing legal or moral obligation to appropriate money for said payments or other obligations due under the installment purchase contract. No installment purchase contract is permitted to contain any provision which, in the event of non-appropriation, precludes a municipality from acquiring equipment, machinery or apparatus for the same or similar purpose as the equipment, machinery or apparatus included in the installment purchase contract for a period of more than 60 days from the date of expiration, termination or cancellation of such contract, provided, however, that in no case can an installment purchase contract contain any provision which would preclude a municipality from performing any statutorily or constitutionally required duties or functions, or require the political subdivision to pay liquidated damages.

In the case of the failure to appropriate, the sole security, apart from any security provided by a credit enhancement, for any remaining periodic payments is the equipment, machinery or apparatus subject to the installment purchase contract. Any installment purchase contract may provide that the installment purchase contract is secured by the underlying equipment, machinery or apparatus and that, in the event the municipality fails to appropriate funds sufficient for payments required under the contract, the financed equipment, machinery or apparatus may be sold on behalf of the persons entitled to receive payments under the installment purchase contract, provided that any excess proceeds from such a sale, after deduction for and payment of fees, expenses and any taxes levied on sale, plus accrued interest, must be paid to the municipality.

What a rating agency may think about a failure to appropriate is another matter entirely.

The aggregate amount of unpaid periodic payments, excluding interest, to be made under any outstanding installment purchase contract is to be deemed to be existing indebtedness solely for the purpose of determining the power of any municipality to contract indebtedness under the debt limitations of Section 104.00 of the Local Finance Law. No municipality can enter into any installment purchase contract if the amount of unpaid periodic payments, excluding interest, proposed to be made under such installment purchase contract and those outstanding, together with the amount of outstanding indebtedness, would exceed 150 percent of the limit prescribed by such Section 104.00 or if the total amount of such payments, excluding interest, under such proposed contract and those outstanding would exceed 40 percent of such limit.

A town, village or city does not have the power to enter into an installment purchase contract except as authorized in Section 109-b of the general municipal law, and general municipal law Section 109-b does not authorize the conveyance or lease of property owned by a town, village or city except as otherwise authorized by law.

All installment purchase contracts of a town, village or city and the interest thereon are exempt from taxation for municipal and state purposes.

This general municipal law provision authorizing installment purchase contracts will expire July 15, 2012.

The State Comptroller's Rules

Subparagraph (d) of subdivision (3) of General Municipal Law Section 109-b requires the State Comptroller to adopt rules "governing the procedure which shall be adhered to when entering into installment purchase contracts or authorizing the execution and delivery of certificates of participation. . . ." The primary purposes of these rules are to:

a. cause a political subdivision to critically evaluate the financing alternatives available to it under Section 109-b of the General Municipal Law and the LFL;
b. ensure that a political subdivision, when procuring the capital improvements to be financed, complies with the competitive bidding requirements of article 5-a of the General Municipal Law or any other general, special or local law or, if such competitive bidding requirements are not applicable, the policies required to be adopted pursuant to General Municipal Law, Section 104-b; and
c. require a political subdivision to seek competition for financing unless the political subdivision determines that it is in its best interest to conduct a private sale of certificates of participation.

Definitions. For purposes of the State Comptroller's regulations governing installment purchase contracts, the following definitions apply.

a. *Cost of financing* shall mean the total payments of principal and interest estimated to become payable pursuant to an installment purchase contract or due on indebtedness, as the case may be, together with any estimated actual and necessary expenses incurred in connection with the execution of such installment purchase contract or the issuance of such indebtedness to the extent such expenses are not included in the periodic payments to be made under the installment purchase contract or aid from the proceeds of the indebtedness.
b. *Evaluation of financing alternatives* shall mean the evaluation prepared pursuant to the criteria indicated below.
c. *Indebtedness* shall mean bonds or notes issued in accordance with the LFL.
d. *Political subdivision, capital improvement, installment purchase contract* and *certificate of participation* shall have the meanings ascribed to them by paragraphs (a) through (d) inclusive of subdivision (1) of Section 109-b of the General Municipal Law.

e. *Pooled* or *aggregate program* shall mean any program under which certificates of participation are issued and represent a proportionate interest or the right to receive a proportionate share in lease, rental, installment or other periodic payments made or to be made by a political subdivision and one or more parties, other than the political subdivision, pursuant to installment purchase contracts.
f. *Private sale* shall mean any sale of certificates of participation, other than a public sale, conducted by a political subdivision.
g. *Public sale* shall mean any sale of certificates of participation conducted by a political subdivision pursuant to the regulations.

The following rules of the State Comptroller are currently in effect:

Evaluation of financing alternatives. No Board is permitted to adopt a resolution authorizing an installment purchase contract unless an evaluation of financing alternatives has been prepared in connection therewith. Such evaluation shall set forth the financing alternatives considered and the criteria used to evaluate these alternatives. The evaluation must also contain written documentation substantiating the estimates required to be included in the evaluation pursuant to this section. At a minimum, the evaluation of financing alternatives must contain the following:

a. a statement indicating the estimated cost of each capital improvement to be financed, exclusive of the cost of financing;
b. a statement indicating whether the proposed capital improvements may be financed with indebtedness issued under the LFL and, if not, the specific reasons why such financing is not authorized;
c. if the capital improvements may be financed with indebtedness, a statement indicating the estimated total cost of the capital improvements, inclusive of the cost of financing, if financed pursuant to the LFL;
d. a statement indicating the estimated total cost of the proposed capital improvements, inclusive of the cost of financing, if financed pursuant to an installment purchase contract;
e. a comparison of the estimated total costs required by subdivisions c. and d. of this section; and
f. a recommendation as to whether it is in the best interests of the municipality to finance the capital improvements pursuant to the LFL or pursuant to an installment purchase contract and the specific reasons for such recommendation.

Adoption of resolution authorizing an installment purchase contract. Any resolution authorizing a municipality to utilize an installment purchase contract to finance capital improvements must refer to the evaluation of financing alternatives and, after taking into account such evaluation, set forth the specific reasons why the governing board has determined that it is in the best interests of the political subdivision to finance the capital improvements pursuant to an installment purchase contract. The evaluation of financing alternatives must be maintained by the municipality as a public record and be filed with the resolution to which it pertains.

The resolution to be adopted is subject to the same rules of adoption as those governing bond resolutions.

Compliance with competitive bidding statutes or other applicable provisions. No political subdivision can enter into an installment purchase contract unless and until it has complied with the competitive bidding requirements of article 5-A of the General Municipal Law or of any other general, special or local law. If no such competitive bidding requirements are applicable, the political subdivision must comply with its procurement policies and procedures adopted pursuant to General Municipal Law, Section 104-b. For purposes of complying with such requirements or procedures, a political subdivision may determine to solicit bids, quotations or proposals, as the case may be, in the alternative, exclusive and inclusive, of the cost of financing.

Procurement of vendor and non-vendor financing. If the Board determines that it is in the best interest of the municipality to select a bid, offer or proposal, as the case may be, inclusive of the cost of financing, the governing board must adopt a resolution authorizing the municipality to enter into an installment purchase contract with the successful bidder or offeror making a bid or offer inclusive of the cost of financing.

If the Board determines that it is in the best interest of the municipality to select a bid, offer or proposal, as the case may be, exclusive of the cost of financing, it must adopt a resolution requiring the capital improvement to be procured from the successful party making a bid, offer or proposal, exclusive of the cost of financing, and directing that non-vendor financing be obtained pursuant to the State Comptroller's applicable regulations. Such resolution must also authorize the political subdivision to enter into an installment purchase contract with any party selected to provide the financing (or, if certificates of participation are to be issued, with a party acting on behalf of the holders of the certificates of participation, the resolution may also delegate to the chief fiscal officer the power to cause certificates of participation to be sold pursuant to the State Comptroller's applicable regulations.

Any such resolution adopted must include a statement that execution of the installment purchase contract will not cause the political subdivision to exceed the limits prescribed by paragraph c of subdivision 6 of Section 109-b of the General Municipal Law.

Public sale of certificates of participation. A political subdivision is permitted to cause certificates of participation issued in connection with one or more of its installment purchase contracts to be sold at public sale, although this has rarely been done in this State. Such certificates of participation must be sold to the bidder offering the lowest interest cost as computed in accordance with the net interest cost method, taking into consideration any premium or discount, or the actuarial or true interest cost method, whichever is specified in the notice of sale. The notice of such sale must be circularized in accordance with any rule or order prescribed by the State Comptroller pursuant to paragraph (d) of Section 57.00 of the LFL for the circularization of notices for the sale of bonds. Where the notice of sale provides that bids shall be awarded based on net interest cost, the notice shall also require that the interest rate for each maturity shall not be less than the interest rate for any prior maturity. The notice of sale must be circularized not less than four nor more than 15 days, Sundays excluded, before the date fixed for the public sale unless the notice provides for a supplemental notice of sale in accordance with the procedure for the sale of bonds in paragraph (d) of Section 58.00 of the LFL.

Private sale of certificates of participation. The Board or the chief fiscal officer, if the Board has delegated such power to him, may determine that a public sale of certificates of participation is not in the best interests of the political subdivision. The determination of the governing board or chief fiscal officer, as the case may be, must state that a private sale of such certificates of participation is expected to reduce the cost of financing and set forth the specific factors upon which the governing board or chief fiscal officer has relied on making such determination. The factors recited in such determination may include:

a. unstable or volatile market conditions;
b. conditions of fiscal stress or negative credit factors being experienced by the issuer;
c. the large dollar amount of the proposed issue;
d. the complexity of the issue; or
e. any other factor which the governing board or chief fiscal officer, as the case may be, reasonably and in good faith believes will cause the cost of financing to be lower if the certificates of participation are sold at private rather than public sale.

Such determination, if made by the Board, shall be made by resolution and if made by the chief fiscal officer shall be made in a certificate filed with the governing board prior to such sale. Upon making the determination required, such certificates of participation may be sold at private sale, provided that any underwriters, providers of letters of credit or liquidity facilities, bond counsel and financial advisors to be used in connection with such sale have been selected in accordance with the policies and procedures contained in the applicable State Comptroller's regulations. The prior approval of the State Comptroller is not required for private sale of certificates of participation conducted in accordance with these requirements.

Solicitation of alternative financing quotations. The Board may, or if authorized by the governing board, the chief fiscal officer may, solicit alternative quotations for financing from qualified interested parties. The political subdivision or chief fiscal officer, as the case may be, is to prepare and maintain written documentation of compliance with this section, including the names and addresses of all qualified interested parties from which financing quotations were sought, the responses received from such parties and written justification of the ultimate selection made. Any political subdivision which enters into an installment purchase contract by private sale cannot permit certificates of participation to be issued in connection therewith except as part of a pooled or aggregate program.

Application of periodic payments and proceeds of certificates of participation. Periodic payments to be made under an installment purchase contract and the proceeds of certificates of participation shall only be applied toward the following:

a. the cost of the capital improvements being financed;

b. the payment of interest pursuant to paragraph (e) of subdivision 2 of the General Municipal Law, Section 109-b;
c. preliminary costs of surveys, maps, plans, estimates, taking of title and interest during construction;
d. the establishment of reserve funds;
e. the cost or premiums of letters of credit, insurance or other credit enhancements;
f. the costs of bond counsel, financial advisors, underwriters, trustees and paying agents; and
g. other actual and necessary expenses directly related to the issuance of certificates of participation or execution of the installment purchase contract.

The political subdivision shall include in its annual report filed with the State Comptroller in accordance with Section 31 of the General Municipal Law such information as the Comptroller may require for all installment purchase contracts and certificates of participation that are issued in connection with such installment purchase contracts, including the amount and date of all certificates of participation sold at private sale.

Energy Performance Contracts

Installment purchase contracts tied to energy performance contracts are also subject to the rules provided in Section 109-b of the General Municipal Law but as modified by the requirements of Article 9 of the Energy Law. They are a specialized form of installment purchase contract for capital projects designed to reduce energy costs and involving guaranteed savings.

The term "energy performance contract" is defined in Section 9-102(4) of the Energy Law as:

> [A]n agreement for the provision of energy services, including but not limited to electricity, heating, ventilation, cooling, steam or hot water, in which a person agrees to install, maintain or manage energy systems or equipment to improve the energy efficiency of, or produce energy in connection with, a building or facility in exchange for a portion of the energy savings or revenues.

The purpose of this law is to obtain long-term energy and cost savings for agencies and municipalities by facilitating prompt incorporation of energy conservation improvements or energy production equipment, or both, in connection with buildings or facilities owned, operated or under the supervision and control of agencies or municipalities, in cooperation with providers of such services and associated materials from the private sector. Such arrangements are believed by the State to improve and protect the health, safety, security, and welfare of the people of the state by promoting energy conservation and independence, developing alternate sources of energy, and fostering business activity.

The primary operative provision of law is Section 9-103 of the Energy Law:

Section 9-103 Energy Performance Contracts

1. Notwithstanding any other provision of law, any agency, municipality, or public authority, in addition to existing powers, is authorized to enter into Energy performance contracts of up to thirty-five years duration, provided, that the duration of any such contract shall not exceed the reasonably expected useful life of the energy facilities or equipment subject to such contract.
2. Any energy performance contract entered into by any agency or municipality shall contain the following clause: "This contract shall be deemed executory only to the extent of the monies appropriated and available for the purpose of the contract, and no liability on account therefore shall be incurred beyond the amount of such monies. It is understood that neither this contract nor any representation by any public employee or officer creates any legal or moral obligation to request, appropriate or make available monies for the purpose of the contract."
3. In the case of a school district or a board of cooperative educational services, an energy performance contract shall be an ordinary contingent expense and shall in no event be construed as or deemed a lease or lease purchase of a building or facility, for purposes of the education law.
4. Agencies, municipalities, and public authorities are encouraged to consult with and seek advice and assistance from the New York State energy research and development authority concerning energy performance contracts.
5. Notwithstanding any other provision of law, in order to convey an interest in real property necessary for the construction of facilities or the operation of equipment provided for in an energy performance contract, any agency, municipality or public authority may enter into a lease of such real property to which it holds title or which is under its administrative jurisdiction as is necessary for such construction or operation, with any energy performance contractor, for the same length of time as the term of such energy performance contract, and on such terms and conditions as may be agreeable to the parties thereto and are not otherwise inconsistent with law, and notwithstanding that such real property may remain useful to such agency, municipality or public authority for the purpose for which such real property was originally acquired or devoted or for which such real property is being used.
6. In lieu of any other competitive procurement or acquisition process that may apply pursuant to any other provision of law, an agency, municipality, or public authority may procure an energy performance contractor by issuing and advertising a written request for proposals in accordance with procurement or internal control policies, procedures, or guidelines that the agency, municipality, or public authority has adopted pursuant to applicable provisions of the state finance law, the executive law, the general municipal law, or the public authorities law, as the case may be.
7. Sections one hundred three and one hundred nine-b of the general municipal law shall not apply to an energy performance contract for which a written request for proposals is issued pursuant to subdivision six of this section.

This provision establishes the basic features of an installment purchase contract for energy savings equipment: the useful life ("PPU"), the contingent nature of the town, village or city obligation to pay, the method of procurement, and the need for there to be savings guaranteed in the contract for the provisions to apply.

It was further clarified in 1996 by counsel to the New York State Energy Research and Development Authority that the financing portion of an energy performance contracting transaction may benefit from the same rules applicable to the acquisition of equipment through the lease purchase acquisition agreement portion. (This remains ambiguous in the law as written).

As was pointed out at that time, for those who are considering energy performance contracting, the agreement to install, maintain, or manage energy system or equipment must be "in exchange for a portion of the energy savings or revenues." Energy Law, Section 9-102(4). An energy performance contract should not be misused in an attempt simply to purchase equipment without regard to energy savings and without regard to other supporting services, such as maintenance, monitoring, and other activities that are necessary to ensure energy savings."

In summary,

A. Energy Performance Contracts with vendor financing may be validly entered into by municipalities and school districts (and school districts may do so without the usual mandatory voter approval.)

B. Third-party financing for an energy performance contract may be validly entered into by municipalities and school districts (and school districts may do so without voter approval), and certain other relevant elements of General Municipal Law Section 109-b should also be complied with.

C. Energy performance contracts may be entered into only for equipment and incidental reconstruction costs in connection therewith, not for integral structural elements such as roofs and windows, and internal elements such as wall insulation and asbestos removal.

D. The installment purchase agreements entered into in connection with an energy performance contract should comply with the level annual debt service rules of the LFL, in accordance with the requirements of General Municipal Law Section 109-b applied to the financing portion of the transaction (but not to the energy performance contract portion).

E. A town, village or city could adopt a bond resolution for the purchase and installation of energy-saving equipment and in conjunction therewith enter into an energy performance contract as a service contract with a guaranteed savings provision. However, as the serial bonds or bond anticipation notes would be payable regardless of savings, and would not be subject to a non-appropriation clause, the energy performance contract would require drafting to account for such structure (unlike the cases of vendor financing or third-party institutional financing, both of which are subject to a non-appropriation clause). For example, such an energy performance contract would require not only savings and penalties for the lack thereof, but also a termination/liquidated damages provision for payment to the municipality in the event of non-appropriation and/or cancellation, in order for the municipality to pay off its general obligation debt. Also, any "savings" projected (and achieved) in an energy performance contract must be net of any State aid for the project. Such debt would need an early redemption provision.

CHAPTER SEVENTEEN

Bond Insurance and Section 168.00 of the Local Finance Law

A Board is authorized and empowered by Section 168.00 of the LFL to enter into agreements (and delegate to the chief fiscal officer authority to do so) as it deems reasonable and appropriate, with any department or agency of the United States of America, the State, or any other financially responsible party, to facilitate the issuance, sale, resale and payment of bonds, notes, or other evidences of indebtedness of such municipality, including, but not limited to letters of credit, lines of credit, revolving credit, bond insurance or other credit enhancements. Such agreements may provide for (i) the advance or advances of funds on behalf of such public body to pay the interest on and principal and premium of bonds, notes or other evidence of indebtedness of such municipality on their date or dates of maturity or redemption or when interest is otherwise due, and (ii) the reimbursement of such advance or advances by such town.

Before the great credit meltdown of 2008, bond insurance was often utilized in town, village and city bond issues and the major insurance companies providing bond insurance to general obligation bonds issued in New York State were Ambac Indemnity Corporation ("AMBAC"), Financial Guaranty Insurance Company ("FGIC"), MBIA Corporation ("MBIA"), Financial Security Assurance, Inc. ("FSA"), and CIFG Assurance. Losses due to insuring collateral mortgage obligations and subsequent ratings downgrades made most bond issuers unable to sell bond insurance that would save the issuer money on the interest cost. Now, in 2009, the market is just beginning to redevelop, and the players have changed to some extent: Assured Guaranty Corp., Municipal and Infrastructure Assurance Corporation, Everspan Financial Guaranty Corporation (formerly AMBAC), and National Public Finance Guarantee Corporation (owned by MBIA) are the emerging bond insurers for town, village and city debt. Whether a serial bond issue should be insured is a financial question: Will it save money or not on the interest rates the town, village or city will have to pay to the holders of the debt? In competitive bond sales, it is generally the purchasing broker-dealer who decides whether to buy bond insurance (and pays for it out of any expected profits from resale of the debt). In a negotiated bond transaction, it is the municipality which decides (and pays the premiums which Section 168.00 of the LFL permits to be treated as part of the cost of the object(s) or purpose(s) being financed by the bonds), usually with the help of a financial advisor.

It is common for a financial advisor to a municipality to run anticipated debt service schedules at anticipated insured and uninsured rates to assist in making this determination.

Bond anticipation notes are not subject to the bond insurance option, although they can be sold with a letter of credit purchased from a bank which serves as a credit enhancement. As this is very rare in New York State for town, village or city note issuers, it will not be further discussed in this primer.

If it is the town, village or city which is determining to acquire (and pay for) bond insurance, it must take the following considerations into account pursuant to Section 168.00 of the LFL:

> "(1) consider the ability of the credit or liquidity enhancement provider to make required payments as and when due under the terms of the appropriate governing instruments;
>
> (2) consider the business reputation of the credit or liquidity enhancement provider;
>
> (3) consider the maximum term of the credit or liquidity enhancement relative to the maturity of the bonds, notes or other obligations being credit or liquidity enhanced;
>
> (4) provide for the right of substitution for the credit or liquidity enhancement provider in all agreements, including a provision permitting such substitution when the rating of the credit or liquidity enhancement provider falls below the probable credit rating of the issue without considering the credit or liquidity enhancer; and
>
> (5) consider the cost of the credit or liquidity enhancement relative to the savings or other benefit likely to be achieved through the utilization of the credit or liquidity enhancement."

CHAPTER EIGHTEEN

New Types of Bonds Authorized by the American Recovery and Reinvestment Act of 2009

On February 17, 2009, President Barack Obama signed the American Recovery and Reinvestment Act of 2009 (the "Recovery Act") into law. The Recovery Act provides significant new financing methods for state and local governments by expanding the types of projects that can be financed on a tax-exempt basis, creating several new categories of tax-exempt and tax-credit bonds, and giving issuers the temporary ability to issue governmental obligations as either taxable tax-credit bonds or subsidy bonds. In part, the Recovery Act is an attempt to create new classes of investors in state and local government debt, investors who are indifferent to the current federal tax benefits of such debt. The Recovery Act also increases the tax benefits afforded to banks and other holders of tax-exempt bonds. The majority of these provisions are temporary and apply only to obligations issued in 2009 and 2010. For towns and villages in New York State it is important at the outset to note that the creation of new categories of bonds in federal law does not supersede the Local Finance Law requirements and restrictions for the authorization, sale and issuance of town, village and city general obligation bond debt. The eligible projects for each type bond must have a PPU under LFL, authorization must be by bond resolution, and sale and issuance must follow existing constitutional LFL and State Comptroller rules.

Part 1—Build America Bonds (BABs)

Permitted Issuers

All types of state and local government issuers

Eligible Projects

- Governmental purpose projects, so not available for 501(c)(3) nonprofit or private activity projects
- Subsidy BABs available only for new-money capital projects
- Credit BABs may be used for refundings and working capital

Key Elements

A "taxable" bond that at the election of the issuer provides: (i) a direct federal interest subsidy to the issuer, or (ii) a federal tax credit to bondholders

Volume Cap Limitation

None

Basic Rules

The Recovery Act allows state and local government issuers to elect to treat any bonds issued in 2009 and 2010 as "Build America Bonds" ("BABs") provided that such bonds are (1) not private activity bonds, (2) otherwise tax-exempt under existing law, and (3) issued with no more than a *de minimus* amount of original issue premium. The completely novel and most notable feature is that issuers may elect to receive a direct federal cash subsidy with respect to certain BABs ("Subsidy BABs") in lieu of providing bondholders with the tax credit ("Credit BABs"). Unlike traditional tax-exempt bonds or tax-credit bonds, BABs bear taxable interest for the holder. However, the federal government provides a tax benefit to issuers of BABs through a direct cash subsidy (with a Subsidy BAB) or to holders of BABs with a credit against federal income tax (with Credit BABs).

Subsidy BABs

While any tax-exempt, governmental obligation that is not a private activity bond and that does not have excess original issue premium may be issued as a BAB, only certain BABs are eligible to be Subsidy BABs. In order for an issuer to elect to treat a BAB as a Subsidy BAB, 100% of the sale proceeds of a BAB must be used for (1) capital expenditures, (2) costs of issuance not exceeding 2% of the issue price, and (3) a reasonably required debt service reserve fund.

Thus, working capital financings are not eligible to be issued as Subsidy BABs. Without further guidance, it appears that refundings also may not be eligible to be issued as Subsidy BABs. However, both types of financings may be done as Credit BABs.

If a BAB is issued as a Subsidy BAB, on each interest payment date, issuers are to receive a cash subsidy from the federal government equal to 35% of the interest payable on the BAB in lieu of providing the tax credit to bondholders. These cash subsidy payments are not subject to future appropriation risk. Depending on state law authority, it may be possible to monetize all or part of the payment stream on Subsidy BABs.

Credit BABs

Unlike Subsidy BABs, Credit BABs may be issued for refunding purposes or for working capital purposes in addition to or instead of capital expenditures, and are not subject to a 2% limitation for costs of issuance.

If a BAB is issued as a Credit BAB, on each interest payment date bondholders will receive a tax credit equal to 35% of each interest payment payable on such date. The credit is nonrefundable, but the unused portion may be carried forward to successive years. The tax-credit mechanism for Credit BABs is fundamentally different from that which is applicable to Qualified Zone Academy Bonds, School Credit Bonds, and other existing tax-credit obligations, in that the credit on a BAB is not intended to enable the issuer to borrow without interest. Instead, it is designed to allow issuers to borrow at rates approximately equal to 74% of rates on comparable taxable bonds.

With a Credit BAB, the bondholder is required to treat the amount of the credit as taxable income, thus reducing the overall economic advantage of holding a Credit BAB below 35% of the amount of the interest payments. For example, assume that a bondholder receives an interest payment of $741 on a Credit BAB. The amount of the tax credit on that interest payment is $259 (35% of $741). Under the rules applicable to Credit BABs, both the cash interest payment of $741 *and* the tax credit of $259 are included in the bondholder's income. On the other hand, with Subsidy BABs, the amount of the economic benefit is equal to 35% of the amount of the interest payments (or 45 percent in the case of an RZEDB as discussed below) because governmental entities are not required to pay tax on the amount of the subsidy.

As with most tax-credit bonds, other recent tax law changes now permit the credit portion to be "stripped" from the bonds. This mechanism may permit issuers to market Credit BABs to a broader group of investors and achieve the same or better results than tax-exempt bonds by selling the taxable Credit BABs and the tax credit separately to different buyers. The IRS is expected to release guidance in the coming months of 2009 regarding credit stripping.

Traditional Tax-Exempt Bond Rules Apply to BABs

Failure of a BAB to satisfy the underlying tax-exempt bond rules will result in retroactive loss of BAB status. This presumably will expose holders of Credit BABs or holders of stripped tax credits to a retroactive loss of tax credits and will expose issuers to an obligation to return to the United States Treasury the full amount of the cash subsidy previously received. BABs continue to be subject to all arbitrage and private use restrictions applicable to comparable tax-exempt obligations. There are no bond maturity constraints for BABs other than those applicable to governmental tax-exempt debt in general. If issuers are to preserve the right to take "remedial action" to cure excess future private use of bond-financed facilities, BABs generally must be optionally redeemable no later than 10.5 years after the issue date. With respect to refundings, BABs may only be refunded after 2010 with traditional tax-exempt bonds. The Recovery Act lacks specific guidance on advance refundings of BABs, but the economic benefits afforded to issuers of BABs as compared to traditional tax-exempt bonds may generally limit the desire to refund BABs.

Part 2—Recovery Zone Economic Development Bonds

Permitted Issuers

Cities with a population of over 100,000 and Counties

Eligible Projects

New-money governmental purpose projects or programs (including various types of capital expenditures, expenditures for job training and educational programs), but not available for 501(c)(3) nonprofit or private activity purposes

Key Elements

- A "taxable" bond that provides issuers a direct federal subsidy of 45% of interest
- Expenditures must be for property within a recovery zone or otherwise promote economic activity therein
- Issuers in control of "recovery zone" designations
- Federal Davis-Bacon prevailing wage rules apply to projects financed with proceeds of RZEDBs

Volume Cap Limitation

$10 billion

Basic Rules

The Recovery Act allows cities with a population of over 100,000 and all Counties to issue a specific type of subsidy BAB with an enhanced subsidy rate of 45% in 2009 and 2010. See Part 1 for a discussion of BABs. Recovery Zone Economic Development Bonds ("RZEDBs"), and must comply with all requirements generally applicable to BABs as well as the special requirements described below. Thus, they may not be private activity bonds and they may not be issued with more than *de minimus* amounts of original issue premium.

To qualify as an RZEDB, 100% of the sale proceeds of a bond must finance some combination of eligible expenditures, a reasonably required debt service reserve fund, and costs of issuance not exceeding 2% of the issue price of the bond. Eligible expenditures include (a) capital expenditures paid or incurred with respect to property located in a "recovery zone," as defined below, (b) expenditures for public infrastructure and construction of other public facilities, wherever located, that promote development or other economic activity in a recovery zone, and (c) expenditures for job training and educational programs, wherever located.

Definition of a Recovery Zone

A "recovery zone" includes any area designated by an issuer as having significant poverty, unemployment, rate of home foreclosures, or general distress, or any area designated by an issuer as economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990. This broad authority to designate recovery zones should provide issuers with significant flexibility in designating recovery zones in order to facilitate financing of eligible projects or programs. Presumably, the adoption of a resolution identifying one or more of the factors set forth above in a particular area should suffice as a designation of a recovery zone. In addition to these newly designated areas, a recovery zone also includes any area currently designated as an empowerment zone or as a renewal community area.

The Allocation Process

The Recovery Act provides for $10 billion of authority nationwide through December 31, 2010, to issue RZEDBs. This authority will be allocated to states in proportion to the relative declines in employment during 2008, although each state will receive at least 0.9% of the national allocation in 2009 and 2010. The states, in turn, will reallocate the authority among Counties and large municipalities within the state (i.e., cities with a population of over 100,000) in proportion to their relative declines in employment during 2008. In calculating this local employment decline, the portion attributable to large municipalities is not also attributed to the Counties. Any County or large municipality may waive all or part of its allocation to allow further allocation among other Counties and large cities within a state. States, state agencies, and smaller cities are not eligible issuers of RZEDBs. It is unclear at the present time whether County and city public authorities or agencies may issue RZEDBs "on behalf of" the Counties and cities that control them.

Part 3—Recovery Zone Facility Bonds

Permitted Issuers

Cities with a population of over 100,000 and Counties

Permitted Borrowers

Includes for-profit private companies

Eligible Projects

Private use depreciable property (i.e., equipment, buildings) the original use of which in the recovery zone commences with the taxpayer

Key Elements

The bond-financed property may be privately owned and operated for purposes not limited to those of traditional exempt facility or small issue private activity tax-exempt bonds

The property must be constructed, reconstructed, renovated or acquired after the area is designated a recovery zone

Volume Cap

$15 billion

Basic Rules

The Recovery Act creates a new tax-exempt qualified private activity bond, known as Recovery Zone Facility Bonds ("RZFBs"), to support trades or businesses in areas suffering from economic distress, and it provides $15 billion for Counties and large cities (but not states or other governmental units) to issue such bonds. Typically, the bonds would be issued by the city or County and proceeds loaned (or the project leased or sold) to a for-profit company as the true borrower and real party in interest. To qualify as an RZFB, a bond must be designated as such by a governmental issuer and be issued by December 31, 2010, and 95% of the proceeds must be used for recovery zone property.

The proceeds of RZFBs may be used by taxpayers engaged in certain types of businesses in recovery zones to finance depreciable property, the original use of which commences in the recovery zone with the taxpayer. Land may not be financed with such bonds, because it is not depreciable. Substantially all of the use of the property must occur in the recovery zone, and the property must be constructed, reconstructed, renovated or acquired by the taxpayer after the area is designated as a recovery zone. Generally, any capital asset used in any trade or business will qualify for financing except residential rental property, golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other gambling facilities, or stores that principally sell alcoholic beverages for consumption offsite.

The Allocation Process

The $15 billion authority to issue RZFBs will be allocated among the states (and, if appropriate, reallocated) in the same manner as the allocation of authority to issue RZEDBs discussed in Part 2 above.

Part 4—Tax-Credit Bonds—General Introduction

Background

Bonds that offer tax credits feature prominently in the Recovery Act. The Recovery Act creates a new type of traditional tax-credit bond and substantially increases the authority to issue existing types of tax-credit bonds. The tax-credit bonds provisions in the Recovery Act target the following sectors: (1) recovery zones as described above, (2) "green" energy, and (3) public schools. This Part 4 provides a general overview of tax-credit bonds, including an explanation of the relaxed arbitrage rules for such bonds, followed by Subparts A and B, which describe the specifics of particular bonds. As explained in Part 1, Credit BABs function differently than those bonds described in this Part 4 and are not included in the following.

Unlike bonds that bear interest that is exempt from income tax, tax-credit bonds pay the holder a federal tax credit in lieu of interest. With tax-credit bonds, the federal government is directly providing the subsidy to the bondholder rather than the issuer paying the bondholder interest. The amount of the tax credit is determined by multiplying the bond's "credit rate" by the face amount of the holder's bond. The credit rate is determined by the Treasury Secretary on the date the bonds are sold and varies by the specific type of tax-credit bond. Although the rate is generally established to allow the bond to be sold without discount and without interest cost to the issuer, for some bonds a lower rate is set so that the federal government and the issuer share the obligation to pay the bondholder. The credit accrues quarterly and is includible in gross income (as if it were a regular interest payment on a bond), and it can be claimed against regular income tax liability and the alternative minimum tax liability. Tax-credit bonds are generally structured as "bullet" maturity bonds, with the Treasury Department establishing the maximum maturity, which is typically between 14 and 15 years.

With respect to spending requirements, issuers must spend 100% of proceeds of tax-credit bonds on project costs (with an allowance of up to 2% for costs of issuance) within 3 years from the issue date. "Proceeds" for this purpose includes investment earnings. Any proceeds remaining after 3 years must be used to redeem bonds unless an extension is obtained from the IRS.

Arbitrage Relief

Tax-credit bonds are afforded favorable treatment with respect to yield restriction and rebate during the 3-year spend-down period discussed above. Issuers are allowed to invest proceeds of tax-credit bonds for 3 years after issuance at an unrestricted yield and, provided that 100% of project proceeds are spent on qualified costs, none of the earnings are subject to arbitrage rebate.

In addition to the above, issuers of tax-credit bonds are allowed to set aside funds annually to repay the bonds without creating an impermissible sinking fund. A fund created to repay the bonds may be invested at a favorable interest rate established by the Secretary of the Treasury provided that the issuer does not contribute more to the fund than is necessary to repay the bonds and contributes to the fund no more rapidly than in equal annual installments. Under this new provision for tax-credit bonds, an issuer is effectively able to "arbitrage" a sinking fund to have adequate funds on the maturity date to pay off the principal of the bonds.

Credit Stripping

The tax credits with respect to tax-credit bonds may be "stripped" from the bonds, meaning that the holder of the tax credit with respect to the bond may be a different party from the holder of the bond itself. The Treasury Department is directed to prescribe regulations regarding this feature of tax-credit bonds.

Discussed below are the following types of tax-credit bonds created or expanded by the Recovery Act of interest to a town or village:

A. New Clean Renewable Energy Bonds

B. Qualified Energy Conservation Bonds

Part 4A—New Clean Renewable Energy Bonds (New CREBs)

Permitted Issuers

All types of state and local government issuers, municipal utilities, electric cooperatives and certain cooperative lenders

Eligible Projects

A broad range of renewable generation facilities

Key Elements

- The project must be owned by a municipal utility, a state or local government, or a cooperative electric company, but may be leased to or operated by or its output sold to a private company
- A traditional "tax-credit bond" designed to provide the issuer with a 70% interest subsidy. Bondholders are provided federal tax credits equal to 70% of the interest on the bonds. The balance of any interest is paid by the issuer
- Federal Davis-Bacon prevailing wage rules apply to projects financed with proceeds of New CREBs

Volume Cap

$2.4 billion

The Recovery Act provides authority to issue an additional $1.6 billion (for a total of $2.4 billion), of Clean Renewable Energy Bonds ("New CREBs"). New CREBs can be issued by: (1) a public power provider, (2) a state or local government (including an Indian tribal government), (3) a cooperative electric company, (4) a not-for-profit electric utility that has received a loan or guarantee under the Rural Electrification Act, or (5) a lender that is a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and was in existence on February 1, 2002, and shall include any affiliated entity that is controlled by such lender.

The types of projects that can be financed with New CREBs include:

- Wind energy facilities
- Closed-loop biomass facilities
- Open-loop biomass facilities
- Geothermal energy facilities
- Solar energy facilities
- Small irrigation power facilities
- Landfill gas facilities
- Trash combustion facilities
- Marine and hydrokinetic energy facilities
- Qualified hydropower facilities

A facility financed with New CREBs must be owned by either a public power provider, a state or local government or a cooperative electric company. A public power provider means a "State Utility" with a "Service Obligation" (as such terms are defined in Section 217 of the Federal Power Act). Unlike with tax-exempt bonds, the "private business use" tests do not apply to New CREBs. Therefore, a facility financed with New CREBs can be leased to or managed by a private business, or the output of the facility can be purchased by a private business (provided such arrangements do not transfer tax ownership of the facility).

Allocation of Cap

Eligible issuers are required to file an application with the IRS for an allocation when the New CREB "window" is open.

Part 4B—Qualified Energy Conservation Bonds (QECBs)

Permitted Issuers

All types of state and local government issuers

Eligible Projects

A broad array of "green" expenditures including: (1) implementing green community programs, (2) grants to support research in emerging energy technologies, (3) rail and bus facilities, (4) public education programs, (5) renewable energy facilities, and (6) demonstration projects for emerging energy technologies

Key Elements

- At least 70% of each state's volume cap allocation must be used for governmental purpose bonds
- Up to 30% of each state's volume cap allocation may be used for private activity bonds, meaning proceeds may be loaned to private companies and/or for privately owned or operated projects
- A traditional "tax-credit bond" designed to provide the issuer with a 70% interest subsidy through tax credits to bondholders. The balance of any interest is paid by the issuer
- Federal Davis-Bacon prevailing wage rules apply to projects financed with proceeds of QECBs

Volume Cap

$3.2 billion

The Recovery Act provides authority to issue an additional $2.4 billion (for a total of $3.2 billion) of Qualified Energy Conservation Bonds ("QECBs") originally authorized by legislation in 2008. QECBs may be issued by state and local governments to finance a broad array of qualified conservation purposes.

Projects that may be financed with QECBs include the following categories:

Type I—Capital expenditures incurred for purposes of—

- Reducing energy consumption in publicly owned buildings by at least 20%,
- Implementing green community programs,
- Rural development involving the production of electricity from renewable energy resources, or
- Any facility eligible for the production tax credit under Section 45 of the Internal Revenue Code (i.e., New CREBs projects).

Type II—Expenditures with respect to research facilities and research grants to support research in—

- Development of cellulosic ethanol or nonfossil fuels,
- Technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels,
- Increasing the efficiency of existing technologies for producing nonfossil fuels,
- Automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation, or
- Technologies to reduce energy use in buildings.

Type III—Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting.

Type IV—Demonstration projects designed to promote commercialization of—

- Green building technology,
- Conversion of agricultural waste for use in the production of fuel or otherwise,
- Advanced battery manufacturing technologies,
- Technologies to reduce peak use of electricity, or
- Technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity.

Type V—Public education campaigns to promote energy efficiency (other than movies, concerts and other events held primarily for entertainment purposes).

Private Use

QECBs are subject to a specific regime regarding private business use. Under existing rules, at least 70% of each state's cap allocation must be used for bond financings that do not meet either the "private business use test" or the "private loan test." Accordingly, up to 30% of the volume cap may be used for private activity bonds, meaning that proceeds may be loaned to private companies and/or used for privately owned or operated purposes. Importantly, the legislative history of QECBs provides that all of the proceeds applied for private activity bond purposes must be applied to capital expenditures.

Allocation of Cap

States are allocated volume cap according to population.

Part 5—Temporary Suspension of AMT as Applied to Tax-Exempt Bonds

Types of Bond Issues Impacted

Principal impact on airport-qualified private activity bonds, student loan bonds, dock and wharf facility bonds, solid waste disposal facility bonds, affordable housing bonds, and other types of qualified private activity bonds

Secondary impact on governmental and Section 501(c)(3) bonds

Key Elements

- Applies to new-money bonds issued in 2009 and 2010
- Outstanding AMT bonds issued between 2004 and 2008 may be refinanced in 2009 or 2010 on a non-AMT basis

General AMT Rules

Individuals and corporations are subject to the federal alternative minimum tax ("AMT") to the extent that their "tentative minimum tax" exceeds their regular income tax. The tentative minimum tax is based on the taxpayer's alternative minimum taxable income ("AMT income"), which is the taxpayer's regular taxable income with certain adjustments and additions. Historically, interest on governmental bonds and 501(c)(3) bonds has been excluded from both regular taxable income and AMT income, but interest on private activity bonds is a "specific tax preference item" that adjusts AMT income upwards (the "Specific Preference Adjustment"). Upward adjustments in AMT income increase the likelihood that a taxpayer will be subject to AMT and generally increase the taxpayer's total income tax liability.

Corporate taxpayers' AMT income is subject to an additional upward adjustment if their "adjusted current earnings" exceed their calculated AMT income (the "ACE Adjustment"). Adjusted current earnings generally include all tax-exempt interest earned, whether from private activity bonds, 501(c)(3) bonds or governmental use bonds. Thus, corporations can be subject to two separate upward adjustments in their AMT income if they hold private activity bonds and one upward adjustment if they hold governmental use bonds.

Temporary AMT Relief

In 2008, Congress introduced a limited exclusion from AMT for certain housing-related private activity bonds. The Housing Assistance Tax Act of 2008 (the "Housing Act") eliminates both the Specific Preference Adjustment and the ACE Adjustment for new-money multifamily housing bonds, mortgage bonds and veterans mortgage bonds issued after July 30, 2008. The Housing Act did not affect the AMT treatment for other private activity bonds or for governmental bonds, nor did it affect the AMT treatment from multifamily housing bonds, mortgage bonds, and veterans mortgage bonds issued after July 30, 2008, to refund obligations issued prior to July 31, 2008.

Under the Recovery Act, the special treatment the Housing Act afforded to housing bonds will apply to all new-money bonds issued in 2009 and 2010. Thus, the interest on any new-money bond issued in 2009 or 2010 is now entirely excluded from AMT income of both individual and corporate bondholders.

The Recovery Act also includes two provisions that apply to refunding bonds. First, the Recovery Act's AMT exclusions will apply to any refunding bonds issued in 2009 and 2010 to refund obligations issued in calendar years 2004 through 2008. Unfortunately, it appears that the new AMT exclusions will not carry over to refunding bonds issued after 2010 to refund, directly or indirectly, a new-money bond issued prior to 2009. Second, however, the new AMT exclusions will carry over to refunding bonds issued after 2010 to refund, directly or indirectly, new-money bonds issued in 2009 and 2010.

Part 6—Expansion of "Bank Qualified Bond" Category

Issuers Impacted by Change

- State and local government issuers that issue no more than $30 million of debt annually
- Conduit issuers that issue bonds for Section 501(c)(3) organizations that borrow less than $30 annually
- Issuers of pool bonds for Section 501(c)(3) organizations pursuant to which each conduit borrower borrows less than $30 million annually

Benefits of the Change

Banks can deduct up to 80% of the interest expense that is allocable to a "bank qualified bond." As a result of this permitted bank arbitrage, qualified bonds placed with a bank will generally be sold at a lower bond coupon when compared to nonqualified bonds.

Prior Law

Under prior law, only a "qualified small issuer" was eligible to issue bank qualified bonds in an amount not to exceed $10 million. For 2009 and 2010, the Recovery Act dramatically expands issuers' ability to issue "bank qualified bonds" for both new-money and refunding purposes by making three significant changes to the definition of a "qualified small issuer."

Changes Made by the Recovery Act

First, with respect to new-money and refunding obligations issued in 2009 and 2010, a qualified small issuer will include any issuer that expects to issue no more than $30 million of tax-exempt debt during the calendar year (excluding certain current refundings); for this purpose, all bonds issued for Section 501(c)(3) organizations are excluded. Second, Section 501(c)(3) beneficiaries are treated as separate issuers for purposes of the $30 million small issuer definition. Accordingly, a separate bond issue for a Section 501(c)(3) organization of less than $30 million can now be bank-qualified. Third, the treatment of pool conduit issues under the small issuer rules is generally applied at the conduit borrower level, and an issue of pool bonds will be bank-qualified bonds if each of the conduit obligations would so qualify if directly issued by the conduit borrower. Thus, a single issuer, during 2009 or 2010, could issue $30 million of bank-qualified bonds for its own benefit, and an unlimited amount of 501(c)(3) and governmental conduit obligations to benefit eligible 501(c)(3) and other governmental entities provided each conduit borrower's loan is not in excess of $30 million. The combination of these three changes will greatly expand the number of bond issues in 2009 and 2010 that can be issued as bank-qualified bonds.

Part 7—Expansion of the IRS 2% *De Minimus* Rule to Banks

Impact

Permits banks to avoid limits on interest expense deductions for new-money, nonbank qualified bonds issued in 2009 and 2010 provided such bonds do not exceed 2% of its total assets

Background

Under prior law, individuals and corporations are generally prohibited from deducting interest expense that they incur in order to acquire or carry tax-exempt bonds. However, as a matter of administrative policy, the IRS does not apply this rule to individuals and corporations (other than banks) whose holdings include only an insubstantial amount of tax-exempt bonds. Corporations generally meet this "insubstantiality" test if tax-exempt bonds comprise no more than 2% of their investment in active business assets; for individuals, tax-exempt bonds must comprise no more than 2% of their total investment portfolio and business assets.

Banks that hold tax-exempt bonds have not benefited from the IRS policy described above, and are generally prohibited from deducting a portion of their total interest expense. The nondeductible portion is calculated based on the ratio of the bank's investment in tax-exempt bonds to its total investment in all assets. Bank Qualified Bonds are generally not counted as tax-exempt bonds for purposes of the investment ratio calculation.

Expansion of 2% Rule to Banks

To stimulate the purchase of tax-exempt bonds by banks, the Recovery Act allows banks to avoid any limitations on interest expense deductions for a limited amount of new-money, nonbank qualified bonds issued in 2009 and 2010. Thus, any new-money bonds issued in those years (whether or not they are private activity bonds) can qualify for exclusion from the investment ratio calculation. Each bank may only exclude 2009 and 2010 bonds up to 2% of its total investment in all assets; amounts beyond that limitation will be counted as invested in tax-exempt bonds in the investment ratio calculation and reduce the bank's deductible portion. Refunding bonds issued in 2009 and 2010 to refund bonds issued prior to 2009 will continue to be subject to the full interest expense deduction disallowance unless they are bank qualified bonds. However, refunding bonds issued to directly or indirectly refund 2009 and 2010 bonds that qualified for the exclusion will themselves qualify for the exclusion, regardless of when the refunding bonds are themselves issued.

Brief Overview of the Interaction of the Local Finance Law With the New Federal Provisions

The new federal bond provisions may provide alternative methods for marketing certain town, village or city bonds in the future. This may or may not end up being a cheaper way to borrow for some projects. (We won't know until the market develops further for these new instruments—as of August 2009, only larger issues seem financially advantageous for these types of bonds.) However, the authorization of any bonds will remain dependent on adoption of valid bond resolutions for valid purposes and will remain subject to State Constitutional and statutory restrictions (i.e., as to amortization structure and maximum length of time to amortize debt for a capital project). These are state-law determined aspects that are most unlikely to change. One can say, however, that there does not, at least at this early stage, appear to be any provision of State law that will preclude utilization of these new types of bonds. The only potential fly in the ointment is this: as discussed earlier, the sale of bonds by a town, village or city must be by competitive sale with only these exceptions:

1. bonds sold with original issue discount ("OID");
2. bonds sold with variable rates of interest;
3. bond issues of $1 million or less.

These categories may be sold at negotiated sale. If the market for the new types of bonds, which would be each what are typically known as "story bonds" (because it takes explanation to sell them to investors unlike simple general obligation bonds), is slow to develop, it may not be possible to sell these new types of bonds in 2009 and 2010 (the only years authorized for now) competitively. In that case, for issues of over $1 million, which it is anticipated virtually all new bond issues of these new types will be (indeed, there is some speculation/indication that issue sizes of at least $15–20 million may be necessary to sell some of the new types of bonds), if the "OID" or variable rate options do not work for the new categories of buyers, then municipalities will need State legislation to authorize the negotiated sale of such bonds.

Whether towns, villages and cities in New York will have access to this wider array of financing tools remains to be seen, as does whether the costs of raising capital through them compares favorably to traditional general obligation bonds. As well, the market may require different amortization structures than permissible in New York State.

Bond issues which combine traditional general obligation bonds with some maturities of these specialized new bonds may become an option as the market gets more familiar with the latter.

A type of tax credit bond in existence a number of years for school districts, qualified zone academy bonds ("QZABs") has been but rarely used in New York State using the "OID" provision to permit negotiation for such reason. They have been virtually unsalable competitively. Tax-Credit Bonds and the subsidized taxable bond option are significant new alternatives to traditional tax-exempt financings, but it is not clear at this point whether they will find a market, and if so, whether New York State issuers will be able to access it.

As to the expansion of the "bank qualified" category and the "2% rule," there is little doubt that these will increase the appetite of banks, including local depositories, for town, village or city debt (assuming the banks need the deductions ...) and possibly translate into lower interest rates.

APPENDIX A

Transactional Players and Their Roles

Beneficial Bond Holder/Owner: The actual person, pension fund, corporation or mutual fund who owns the note or bond.

Bond Counsel: Provides validity and tax opinion on municipal debt for the benefit of the buyer. Drafts bond-related proceedings and sale and closing documentation.

Bond Insurer: A company that promises to pay debt service on debt it insures if the issuer does not. Sometimes purchased by winning bidders in competitive bond sales or can be part of a negotiated transaction.

Bureau of Public Debt: Division of the U.S. Treasury Department that issues debt to municipalities for advance refunding escrows.

Chief Fiscal Officer: Town Supervisor; Village Treasurer; City Treasurer, Comptroller or Controller per charter.

DTC: The Depository Trust Company, a corporation formed by banks and investment banks to act as a depository and central processing function for debt sold in book-entry only (i.e., electronic form without each holder getting their own physical paper bonds or note certificate; ownership recorded electronically).

Escrow Agent/Holder: Bank located and authorized to do business in the State, and acting as holder of U.S. Treasury securities in escrow for refunded bond debt service.

Financial Advisor: Consultant to municipality on financings, structuring bond and note issues and related matters, including preparation of official statements and disclosure law annual compliance materials.

Finance Board: Town Board; Village Board of Trustees, City Council or Common Council.

Fiscal Agent: Usually same as paying agent. Keeps record of owners of a bond or note issue and conversions if needed. The officer named in LFL Section 70.00 to this role can delegate to an authorized bank with consent of the Board.

General Obligations: The only type of debt a municipality may issue in New York State, pledging the faith and credit and unlimited taxing power of the municipality.

Investment Banker: A person employed by an underwriter to develop negotiated transactions in notes or bonds with municipalities, usually an officer of an investment bank or a regular bank.

Issuer: The local political subdivision; town, village or city.

Letter of Credit Bank: Sometimes used in the note market (like bond insurance).

Local Counsel: Town or Village Attorney, City Attorney or Corporation Counsel.

National Repository: Filing locale for updated material information about a town or village or city. Municipal Securities Rulemaking Board as of July 1, 2009.

Objects or Purposes: Legal term for a capital project or capital items.

Paying Agent: Who pays debt service to the holder (or DTC) as and when due. Usually you or a hired fiscal agent bank.

Rating Agencies:	Independent companies which rate bonds and notes, such as Moody's, Standard & Poor's and Fitch.
Rebate Compliance Provider:	Vendor, often financial advisor who helps calculate arbitrage rebate liability, if any.
State Comptroller:	You know what these people do (oversee all the financial aspects of the local government).
Taxpayer:	You know who these people are (Us—working citizens and residents, including Gus. You know Gus. Every Board has one. Sits in the back of the room and doesn't like anything you do. If he had as much money as time, you'd be in court constantly.)
Trustee Bank:	See Escrow Agent, Paying Agent, Fiscal Agent: A bank or trust company located and licensed to do business in the State.
Underwriter:	A bank or investment bank which is a "broker-dealer" buying municipal debt for resale.
Underwriter's Counsel:	Lawyers for the buyers in a negotiated transaction.
Verification Agent:	An independent specialized accounting firm which verifies that money deposited in the escrow account in an advance refunding is sufficient to pay the intended principal and interest on refunded debt.

APPENDIX B

Sample Bond Counsel Opinion of General Obligation Debt

September 27, 2009
Town of Duke
Earl County
State of New York

Re: Town of Duke, Earl County, New York
$4,155,000 Public Improvement (Serial) Bonds, 2009

Ladies and Gentlemen:

We have been requested to render our opinion as to the validity of an issue of $4,155,000 Public Improvement (Serial) Bonds, 2009 (the "Obligations"), of the Town of Duke, Earl County, State of New York (the "Obligor"), dated September 15, 2009, initially issued in registered form in denominations such that one bond shall be issued for each maturity of bonds in such amounts as hereinafter set forth, bearing interest at the rate of three and eighty-five hundredths per centum (3.85%) per annum, payable on March 15, 2010 and semi-annually thereafter on September 15 and March 15, and maturing in the amount of $225,000 on September 15, 2010, $230,000 on September 15, 2011, $250,000 on September 15, 2012, $275,000 on September 15 in each of the years 2013 to 2018, both inclusive, and $300,000 on September 15 in each of the years 2019 to 2024, both inclusive. [**Description of the debt obligation**]

Bonds maturing on or before September 15, 2018 are not subject to redemption prior to maturity. Bonds maturing on or after September 15, 2019 are subject to redemption prior to maturity as a whole or in part (and by lot if less than all of a maturity is to be redeemed) at the option of the town or village on September 15, 2018 or on any interest payment date thereafter at par, plus accrued interest to the date of redemption. [**Description of the early redemption features, if any**].

We have examined:

(1) the Constitution and statutes of the State of New York;

(2) the Internal Revenue Code of 1986, including particularly Sections 103 and 141

and 150 thereof, and the applicable regulations of the United States Treasury Department promulgated thereunder (collectively, the "Code");

(3) an arbitrage certificate executed on behalf of the Obligor which includes, among other things, covenants, relating to compliance with the Code, with the owners of the Obligations that the Obligor will, among other things, (i) take all actions on its part necessary to cause interest on the Obligations not to be includable in the gross income of the owners thereof for Federal income tax purposes, including, without limitation, restricting, to the extent necessary, the yield on investments made with the proceeds of the Obligations and investment earnings thereon, making required payments to the Federal Government, if any, and maintaining books and records in a specified manner, where appropriate, and (ii) refrain from taking any action which would cause interest on the Obligations to be includable in the gross income of the owners thereof for Federal income tax purposes, including, without limitation, refraining from spending the proceeds of the Obligations and investment earnings thereon on certain specified purposes; and

(4) a certificate executed on behalf of the Obligor which includes, among other things, a statement that compliance with such covenants is not prohibited by, or violative of, any provision of local or special law, regulation or resolution applicable to the Obligor.

We also have examined a certified copy of proceedings of the finance board of the Obligor and other proofs authorizing and relating to the issuance of the Obligations, including the form of the Obligations. In rendering the opinions expressed herein we have assumed the accuracy and truthfulness of all public records, documents and proceedings, including factual information, expectations and statements contained therein, examined by us which have been executed or certified by public officials acting within the scope of their official capacities, and have not verified the accuracy or truthfulness thereof. We also have assumed the genuineness of the signatures appearing upon such public records, documents and proceedings and the certifications thereof. [**Description of the law and documentation reviewed**]

In our opinion:

(a) The Obligations have been authorized and issued in accordance with the Constitution and statutes of the State of New York and constitute valid and legally binding general obligations of the Obligor, all the taxable real property within which is subject to the levy of ad valorem taxes to pay the Obligations and interest thereon, without limitation as to rate or amount; provided, however, that the enforceability (but not the validity) of the Obligations (i) may be limited by any applicable bankruptcy, insolvency or other law now existing or hereafter enacted by said State or the Federal government affecting the enforcement of creditors' rights, and (ii) may be subject to the exercise of judicial discretion in appropriate cases. [**Validity Opinion**]

(b) The Obligor has the power to comply with its covenants with respect to compliance with the Code as such covenants relate to the Obligations; provided, however, that the enforceability (but not the validity) of such covenants may be limited by any applicable bankruptcy, insolvency or other law now existing or hereafter enacted by said State or the

Federal government affecting the enforcement of creditors' rights. [**Covenant authority of the issue**]

(c) Interest on the Obligations is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, and is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York). Interest on the Obligations is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, nor is it included in adjusted current earnings in calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Obligations. [**Federal Tax Status Opinion**]

Certain agreements, requirements and procedures contained or referred to in the Arbitrage Certificate and other relevant documents may be changed and certain actions (including, without limitation, economic defeasance of the Obligations) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. [**Qualifications**]

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. Accordingly, this opinion is not intended to, and may not, be relied upon in connection with any such actions, events or matters. Our engagement with respect to the Obligations has concluded with their issuance, and we disclaim any obligation to update this opinion. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents. Furthermore, we have assumed compliance with all covenants and agreements contained in the Arbitrage Certificate, including without limitation covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Obligations to be included in gross income for federal income tax purposes or no longer exempt for purposes of personal income taxes imposed by the State of New York or any political subdivision thereof (including The City of New York). We call attention to the fact that the rights and obligations under the Obligations and the Arbitrage Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium or other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against municipal corporations such as the Obligor in the State of New York. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, or waiver provisions contained in the foregoing documents. [**Assumptions underlying the opinion**]

The scope of our engagement in relation to the issuance of the Obligations has extended solely to the examination of the facts and law incident to rendering the opinions expressed herein. Such opinions are not intended and should not be construed to express or imply any conclusion that the amount of real property subject to taxation within the boundaries of the Obligor, together with other legally available sources of revenue, if any, will be sufficient to enable the Obligor to pay the principal of or interest on the Obligations as the same respectively become due and payable. Reference should be made to the Official Statement prepared by the Obligor in relation to the Obligations for factual information which, in the judgment of the Obligor, could materially affect the ability of the Obligor to pay such principal and interest. While we have participated in the preparation of such Official Statement, we have not verified the accuracy, completeness or fairness of the factual information contained therein and, accordingly, we express no opinion as to whether the Obligor, in connection with the sale of the Obligations, has made any untrue statement of a material fact or omitted to state a material fact necessary in order to make any statements made, in the light of the circumstances under which they were made, not misleading. [**What the opinion does not cover**]

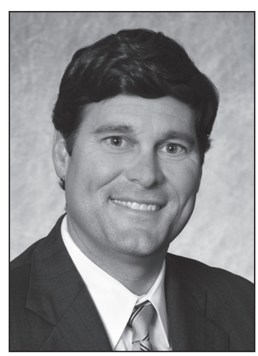
Very truly yours,

About the Authors

Douglas E. Goodfriend, a New York Public Finance partner, has extensive experience in municipal general obligation financings for various New York counties, cities, towns, villages, school districts, and fire districts. He frequently serves as bond counsel to municipal and school district issuers participating in the financing programs of the New York State Environmental Facilities Corporation and the Dormitory Authority of the State of New York, and the grant and loan programs of the Rural Development division of the United States Department of Agriculture.

Mr. Goodfriend's specialized areas of New York municipal law interest include open spaces programs and financings, town and county improvement district formation, consolidation and improvement, innovative lease-purchase financings, school district bond resolution referendum law, library projects, village local improvement programs and the drafting of local laws and propositions, as well as state legislation on behalf of clients.

Mr. Goodfriend is a frequent speaker at professional municipal organizations on local finance law, federal securities law, and federal tax matters affecting municipal debt issuance. You can contact him at 1-212-506-5211 or dgoodfriend@orrick.com.



Thomas E. Myers, a New York Public Finance partner, has extensive experience in financings for various New York municipalities, school districts, and fire districts in connection with over $6 billion in general obligation financings. Mr. Myers' practice also focuses on financings for industrial development bonds, local development corporations, housing bonds, resource recovery and water/sewer authority revenue bonds. Mr. Myers has extensive experience as underwriter's and placement agent's counsel on a wide variety of public finance matters. In addition, Mr. Myers was special counsel in connection with tax lien and tobacco settlement securitizations by various New York counties. Mr. Myers was named Dealmaker of the Year by *The American Lawyer* in 2001 for his innovative work on the first pooled counties tobacco securitization. He is a graduate of Marquette University and the Syracuse College of Law, past chair of the Municipal Law Section of the New York State Bar Association and a frequent speaker at meetings of various municipal organizations. You can contact him at 1-212-506-5212 or tmyers@orrick.com.

Mr. Goodfriend and Mr. Myers are the authors of the Bond Basics series of primers for counties, cities, towns, villages and fire districts, as well as school districts and library districts in New York State, which distill their combined 50 years of public finance legal experience. Mr. Goodfriend and Mr. Myers may also be reached at their toll-free number, 1-800-295-8506.

ABOUT ORRICK

Orrick, Herrington & Sutcliffe LLP has maintained a substantial law practice in the area of public finance for nearly a century. Our lawyers provide bond counsel services to towns, villages and cities throughout New York State and are committed to providing cost-effective and innovative services and solutions for all types of public finance matters.

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