

Fundamentals of Bond Financing in Georgia

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OVERVIEW

Chapter 1 emphasized the importance of knowing the enabling legislation that created one's authority. This is especially critical when an authority undertakes bond financing. The question of whether an authority may issue bonds, the purposes for which bonds may be issued, and the types of bonds that may be issued depend upon the authority's enabling legislation, the purposes for which the authority was created, and the nature of the project being contemplated. Accordingly, the discussion presented in this chapter is intended to provide a general overview of the Georgia laws governing the issuance of bonds. Every authority should work closely with its own attorney(s) to understand its specific purposes and authorized procedures and the types of projects it can facilitate.

The State of Georgia allows cities, counties, special districts, and special authorities created for specific purposes to issue debt securities in the form of bonds, notes, and certificates to finance many types of specifically authorized projects. Referred to interchangeably as municipal securities, municipal bonds, or governmental bonds, these obligations have enabled local governments and authorities to build and pay for a broad spectrum of projects, including

- Elementary and secondary school buildings and capital improvements
- Government office buildings such as city halls, jails, and courthouses
- Higher education buildings, research laboratories, and dormitories
- Transportation facilities, including bridges, highways, roads, airports, seaports, and surface transit
- Electricity generating facilities
- Water and sewer treatment facilities
- Resource recovery facilities
- Hospitals, healthcare, and assisted living facilities, including nursing homes for the elderly
- Housing for low and moderate income families

Many of the projects listed above can be undertaken only by cities, counties, and special districts. Often, these projects will be financed through the issuance of general obligation bonds that are backed by the full faith and credit of the local governmental entity issuing

the bonds and secured by general tax revenues generated within the local government's jurisdiction. Georgia's constitution, however, contains a number of restrictions on the issuance of general obligation bonds. For example, a referendum is required before a local government can issue general obligation bonds, and general obligation debt may not exceed 10 percent of the total assessed value of property subject to taxation in the jurisdiction.

In the face of the debt limitations, the State of Georgia has allowed the creation of numerous types of local government authorities and has authorized these authorities, along with other traditional local governmental entities, to issue revenue bonds instead of general obligation bonds. Revenue bonds are repaid from the specific revenues derived from the project that is financed with the bonds. The local governmental entity or authority is neither required nor permitted to use its general tax revenue to repay the bonds, unless an intergovernmental contract between the taxing body and the authority is established. Accordingly, since tax revenues are not pledged as security for revenue bonds, they are not considered to be a debt of the local government and are not subject to either the 10 percent of assessed property value limitation or the referendum requirement. Revenue bonds, therefore, have become the primary method of project financing used by Georgia's local authorities.

WHAT IS A BOND?

A bond represents a promise made by the issuer of the bond to the purchasers of the bonds to repay the amount of money borrowed, known as principal, along with interest according to a fixed schedule. The repayment of principal and interest is referred to as the debt service on the bonds. Generally, it may take up to 40 years from the date they are issued for bonds to mature (be repaid).

TYPES OF BONDS THAT MAY BE ISSUED IN GEORGIA

General Obligation Bonds v. Revenue Bonds

As previously discussed, local governmental entities such as counties, municipalities, and school districts are authorized to issue general obligation bonds for a variety of public purposes. General obligation bonds rely on the taxing power of the local governmental entity as security for the payment of the principal and interest due on the bonds. In addition, because general taxing power is backing the repayment of general obligation bonds, Georgia law imposes several strict requirements that must be met before the bonds can be issued. It is important to note that, with few exceptions, public authorities in Georgia have no general taxing power and, therefore, are not authorized to issue general obligation bonds.

In addition to general obligation bonds, Georgia law allows local governmental entities and public authorities to issue revenue bonds. Revenue bonds may also be issued to refund and refinance any outstanding revenue bonds previously issued. The revenues generated by the specific project financed by the revenue bonds are used to repay the principal and interest as it is due over the life of the bonds.

Revenue bonds issued by public authorities are often backed by revenues in the form of rents, fees, tolls, or charges applicable to the services, facilities, or commodities that are furnished or otherwise made available through the specific project. For example, a public utility authority may issue revenue bonds to finance utility infrastructure in a particular community, and through the fees charged for its services, the authority repays the bonds.

In many cases, however, revenue bonds are issued for the benefit of conduit borrowers, who may be either for-profit or not-for-profit entities that propose a project that is consistent with the purposes for which the authority was created. This form of transaction is comparable to other types of revenue bond financing in that the authority pledges the “revenues” paid to the authority by the conduit obligor as security for the repayment of the bonds. There are three primary financing structures involving conduit obligors. In the most common of these, the proceeds of the revenue bonds are loaned to the conduit borrower, who agrees to make loan payments in amounts sufficient to repay the bonds. The second is lease financing, in which the authority builds the project with the bond proceeds and then leases it to the conduit obligor for rental payments sufficient to repay the bonds. Lease financing may provide ad valorem tax benefits to a conduit borrower because the authority, as owner and lessor of the project, generally pays no property tax on the project. The conduit obligor pays taxes on its leasehold interest in the project, which may be assessed at a lower value than the full ownership interest. In any event, when the bonds mature, the conduit obligor acquires the title to the project by purchasing the project for nominal consideration under a purchase option included in the lease. The third structure used by public authorities is an installment sale. Instead of leasing the project to the conduit borrower, the conduit borrower enters into an installment sale contract, whereby it agrees to pay the purchase price of the project in installments equal to the debt service on the bonds. In all three of these structures, repayment of the bonds is secured by the loan, lease, or installment sale payments being made by the conduit obligor.

Taxable v. Tax-Exempt

Revenue bonds can be either taxable or tax-exempt. When a bond is tax-exempt, the interest paid to the purchasers of the bonds is not subject to federal or state and local income taxation. Because the purchasers of tax-exempt bonds do not have to pay income tax on the interest they receive, they are willing to accept a lower rate of interest on the bonds. The lower rate of interest is then extended to the conduit obligor, who receives the direct financial benefit of receiving a loan at below-market interest rates. Note, however, that not all bonds issued by a governmental authority are tax-exempt. Tax-exempt status depends on a variety of factors, the most important of which is the purpose for which the bonds are being issued. For example, public purpose bonds are generally tax-exempt while private activity bonds are tax-exempt only if they meet certain criteria set forth in the Internal Revenue Code (see the next section for a discussion of public purpose v. private activity bonds).

Even if a particular revenue bond fails to qualify for tax-exempt status, public authorities in Georgia can nonetheless issue taxable bonds for specific projects. Although they generally do not have the low interest rates associated with tax-exempt bonds, taxable bonds are often combined with other economic development incentives, such as the ad valorem tax relief previously discussed in connection with lease financing.

Public Purpose v. Private Activity

The public purpose doctrine states that government entities and public authorities may only issue bonds when a public purpose is being served. Like most states, however, Georgia law defines “public purpose” broadly, and increasing employment opportunities, promoting commerce or industry, and otherwise improving public welfare are all public purposes for which revenue bonds may be issued. Public purpose bonds, therefore, refer to those bonds issued by governmental entities and authorities for the purpose of financing a project that benefits the general public. For example, in order to build water and sewer lines, water and sewer authorities have the power to issue revenue bonds to pay for the capital costs of constructing and operating the system. The revenue received from the fees collected from the users of the service are pledged to repay the debt service on the bonds. The Internal Revenue Code provides that the interest on all public purpose bonds is tax-exempt from federal income taxation.

In contrast to a public purpose bond, a private activity bond is one that serves a general public purpose but nonetheless primarily benefits a private entity. The Internal Revenue Code sets forth several categories of qualified private activity bonds that are tax-exempt and, therefore, achieve the low interest rate financing available for governmental projects. Historically, the most well-known qualified private activity bonds were those issued to finance the construction of manufacturing facilities. Those bonds, commonly referred to as industrial development bonds, or IDBs, are subject to size limitations that have severely curtailed their use in recent years. Qualified private activity bonds may also be used to finance the construction of facilities for Section 501(c)(3) nonprofit organizations, such as private schools, social service agencies, healthcare facilities, and charitable institutions. Private activity bonds are also authorized for certain exempt facilities, which include multi-family housing developments, solid waste disposal facilities, hazardous waste facilities, water furnishing facilities, sewage treatment facilities, local electricity production facilities, mass transportation facilities, and certain qualified redevelopment projects. Also included are government-owned airports, docks and wharves, and public transportation systems, which may be leased or managed by a private business.

WHO MAY ISSUE BONDS IN GEORGIA?

Creating Authorities

The power to create local public authorities is vested in the Georgia General Assembly. Under Georgia law, authorities are created in one of three ways: (1) general enabling legislation, (2) local law, or (3) constitutional amendment. The majority of local authorities were created through general enabling legislation. However, some authorities were created through local law even when general enabling legislation was available. Although creation of authorities through amendments to the Georgia constitution has not been permitted since 1983, many of the authorities created in this manner are still in operation and enjoy additional powers that are not held by authorities created through general enabling legislation or local law. For a more in-depth discussion of each of these methods, please refer to Chapter 1.

Revenue Bond Law

Georgia's Revenue Bond Law authorizes local governmental entities, including public authorities, to issue revenue bonds to finance various revenue-producing projects. The list of projects authorized under the Revenue Bond Law includes

- Causeways, tunnels, viaducts, bridges, and other crossings
- Highways, parkways, airports, docks, piers, wharves, terminals, and other facilities
- Systems, plants, works, instrumentalities, properties used in water and sewage supply and treatment systems, and solid waste disposal facilities
- Dormitories, laboratories, libraries, and other related facilities
- Certain parks and sporting facilities
- Combinations of sea wall, groin, and beach erosion protection systems
- Public parking areas and public parking buildings
- Parking meters
- Purchase of certain lands used by the U.S. government
- Purchase of existing public common carriers for transportation of passengers on streets and highways
- Purchase of land and the construction thereon of facilities for lease to industries, so as to relieve abnormal unemployment conditions
- Jails and all other structures and facilities that are necessary and convenient for the operation of jails

The governing body of the local governmental entity or authority must approve all of the terms relating to the costs of the project and the issuance of the bonds through the adoption of a resolution at a regular meeting or a special session. Georgia law contains a number of requirements applicable to meetings of governmental entities (which are covered in Chapter 3), and authority members should consult with counsel to assure compliance with such requirements. The law also sets forth certain restrictions relating to the terms of the bonds, the interest rates allowed, and the covenants and obligations of the authority that may be included in the bond documents.

Specialized Authorities

Under the Georgia Development Authorities Law, each county and municipality in the State of Georgia is authorized to activate a development authority. Each development authority is granted the power to accomplish the public purpose of promoting trade, commerce, industry, and employment by facilitating certain development projects. The list of projects authorized under the Development Authorities Law is expansive and includes

- Buildings and structures used in agricultural, manufacturing, mining, or industrial businesses
- Construction or renovation of industrial facilities
- Water pollution control facilities
- Sewage disposal facilities
- Certain facilities involving natural gas

- Aircraft maintenance facilities
- Certain sports facilities
- Convention and trade show facilities
- Airports, docks, wharves, public transportation systems, parking facilities, or related storage or training facilities
- Facilities for local furnishing of electricity or gas
- Facilities for furnishing water, if available to members of the general public
- Hotel and motel facilities constructed in connection with or adjacent to convention, sports, or trade show facilities
- Acquisition of land as a site for an industrial park
- Financing of an office building for use by any business or charitable entity furthering trade, commerce, industry, or employment opportunities
- Nursing home facilities
- Certain cable television facilities
- Research and development facilities
- Other projects essential for the public purpose of developing trade, commerce, industry, and employment opportunities

It should be noted that although most development authorities in Georgia were created by a general enabling statute, many counties and municipalities have development authorities that were created by local law or constitutional amendment, each of which will have a unique list of purposes and authorized projects that may be facilitated in addition to those specified in the Revenue Bond Law. Authority board members should reference their own authorizing legislation to determine which specific projects they are authorized to undertake.

Bond Resolutions and Validation Procedures

Subject to certain limited exceptions, Georgia law requires that the governing board of local public authorities conduct meetings in a forum that is open to the public. Prior to the issuance of any revenue bonds, a bond resolution setting forth all of the terms and conditions relating to the bond issuance must be adopted at a duly called meeting of the authority board. In order for private activity bonds to be qualified for tax-exempt status, the governing board, or some other designated party, must also hold a public Tax Equity and Fiscal Responsibility Act (TEFRA) hearing after public notice has been published. The TEFRA hearing is a federal law requirement that affords concerned citizens the opportunity to voice concerns regarding projects benefiting a private entity.

Validation is a legal proceeding in which a Superior Court judge reviews the authority's creating legislation and purposes for which it is authorized to issue revenue bonds, the specific project concerned, the type of financing structure proposed, and the feasibility of the project. All revenue bonds are required to be validated in the Superior Court of the county in which the authority is located. Upon review, and after publication of notice and a hearing in open court, the judge will rule on the validity of the revenue bonds. Under Georgia law, a judge's order of validation is final and cannot be challenged in a later proceeding.

TYPICAL BOND FINANCING OF A DEVELOPMENT AUTHORITY

For most authorities in Georgia, the opportunity to participate in bond financing for the benefit of a private party is extended quite informally. A company representative might place a telephone call to the local economic development professional, chamber of commerce staff, or development authority contact to discuss a project that may be on the drawing board, asking general questions such as, “How can we work together to accomplish this vision?” Such conversations are the beginning of a working relationship between the public and private sectors. The following is an example of how the financing aspect of that relationship might evolve.

Step 1—Application for Bond Financing

Most development authorities require a company seeking bond financing to file an application or request for assistance. The application generally includes information regarding the company, the nature and estimated cost of the project, and the number of jobs the project is anticipated to create. Certain historic and/or pro forma financial information relating to the company and the project may also be required.

Step 2—Adoption of the Inducement Resolution

The first official action taken by an authority following receipt of an application is generally the adoption of an inducement resolution. This resolution is evidence of a commitment, in principle, to proceed with the company on financing the project. While preliminary in nature, the inducement resolution allows the company to proceed with project planning and investment while preserving its ability to obtain bond financing to pay for any related costs.

For tax-exempt private activity bonds, the inducement resolution (also referred to as an official intent resolution) should be adopted before the company makes any major expenditure related to the project. Under applicable federal tax regulations, the proceeds of tax-exempt private activity bonds may be used to reimburse project costs paid by the company within 60 days prior to the adoption of the inducement resolution, as well as to reimburse certain preliminary soft costs and other capital expenditures not exceeding the lesser of \$100,000 or 5 percent of the proceeds of the bonds to be issued.

Step 3—Assembling the Financing Team

Upon receiving the “green light” from the authority to proceed with the project, the company will assemble its financing team. In particular, this team will negotiate with prospective bond purchasers as well as other people or institutions as necessary to achieve the financing objectives, including bond counsel, financial advisors, underwriters, credit enhancers, liquidity providers, indenture trustees, and their respective legal advisors. At the conclusion of negotiations, the company should finalize and accept a bond purchase commitment.

Step 4—TEFRA Hearings

For tax-exempt private activity bonds, a public hearing must be conducted, and approval must be obtained from elected officials. Federal TEFRA regulations require that public notice be given not less than fourteen days prior to the hearing. Following the hearing, the bond issue must be approved by the highest elected official or body of officials of the local governing body of the jurisdiction within which the development authority is located.

Step 5—Application for State Bond Cap Allocation

There is a cap on the total value of private activity bonds that may be issued in each state, based on population. In 2005, the total amount available in Georgia to be issued was slightly more than \$700 million. While certain projects do not require allocation of the state volume cap (such as bonds issued for nonprofits), most do. Georgia has its own allocation system, overseen by DCA. DCA initially dedicates approximately 85 percent of its total yearly allotment to be split equally between economic development projects and housing related projects, with the remaining 15 percent being allocated at its discretion to other types of projects. In connection with each transaction, the local development authority will request from the state an amount equal to the proposed bond amount.

Step 6—Drafting of Bond Documents

Working with the development authority, the company, and the financing team participants, the authority's attorney(s) will draft the basic financing documents necessary for completion of the transaction. These documents include a trust indenture, a loan agreement, and disclosure documents for potential investors, as well as other agreements relating to the type of financing structure that is selected.

Step 7—Adoption of the Bond Resolution

Once the parties agree to the specific terms and provisions of the bonds and the basic financing documents, the development authority will adopt a bond resolution specifically authorizing the issuance of the bonds and approving the forms of all bond documents.

Step 8—Validation Proceedings

As previously discussed, Georgia law requires that all revenue bonds be validated in the Superior Court of the county in which the development authority is located. Validation generally takes approximately three weeks to complete.

Step 9—Closing

At the closing, all of the bond documents, as well as a host of closing certificates, legal opinions, and related materials, are executed and delivered. The bond transaction may be closed on the first mutually agreed-upon date after obtaining a favorable validation judgment from the Superior Court and an allocation from the state bond cap, if required. Money received in exchange for the bonds is held by the bond trustee until actual project costs are incurred.

SUMMARY

The bond issuance process can be complex, with numerous federal, state, and local laws, rules, and regulations to be observed. Nonetheless, the availability of bond financing through public authorities remains the most widely used and effective means for attracting and retaining businesses that are vital to Georgia's future. Understanding the purposes and goals of their authority, and then teaming with a competent group of professional advisors to achieve those goals, will allow authority board members to navigate the bond issuance process successfully and serve their communities effectively.