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Financing Options for School Districts

Alabama Association of School Business Officials (AASBO)
Training Session for Purchasing Agents
Birmingham, Alabama

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Presented by: *R. Kane Burnette*

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Kane Burnette
Partner

Kane Burnette's primary practice involves serving as bond counsel to municipalities, counties, boards of education and public corporations throughout Alabama on both publicly underwritten and privately placed tax-exempt financings.

Kane is particularly active in the public education sector, where he has represented both public universities and boards of education on tax and finance matters, and he currently serves on the faculty of the University of Alabama's academy for finance training for new school superintendents and chief school financial officers.

In addition to bond counsel engagements, he has served as company counsel and bank counsel in letter-of-credit backed transactions, as lender's counsel in direct placement transactions and as trustee's counsel. He also advises municipal clients on economic development and incentive matters. Kane has experience in representing governmental bodies in compliance matters before the Internal Revenue Service and the U.S. Securities and Exchange Commission.

As an Alabama-licensed Certified Public Accountant (currently inactive), Kane worked in the Birmingham office of Ernst & Young LLP before attending law school.

Accolades

- *Listed in Mid-South Super Lawyers, "Rising Stars,"* Government Finance, 2016–2017

Professional & Community Activities

- National Association of Bond Lawyers
- American Institute of Certified Public Accountants
- Alabama Society of Certified Public Accountants
- Alabama Council of School Board Attorneys

You May Not Know

Kane is from Tuscaloosa, attended Tuscaloosa City Schools and has three degrees from the University of Alabama. He and his wife Lyda, who is from Scottsboro, have three children – Martha Helen, James, and Walt. They attend Cathedral Church of the Advent, where Kane serves on the vestry.

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Public Finance
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Alan Zeigler's primary practice area is public finance. He has served as bond counsel and as underwriter's counsel on tax-exempt financings involving public facilities and utilities for municipalities, counties and boards of education through the state. He has participated in numerous legislative drafting projects and has advised cities, counties and boards of education on finance and election matters, particularly those pertaining to ad valorem taxation for public schools. He served as pro bono counsel for the ad valorem school tax project undertaken by the Public Affairs Research Council of Alabama (PARCA) in 2006 and as pro bono counsel for PARCA's school sales tax project in 2008.

Alan has spoken on public finance-related topics in connection with continuing education projects for education, municipal and county officials throughout the state. He has been listed annually in *The Best Lawyers in America*® in the Public Finance Law category since 2003 and has been listed in *Chambers USA* as a "Leading Individual" in Banking & Finance: Public Finance Law since 2005. He is a member of the National Association of Bond Lawyers and the Alabama Association of School Board Attorneys and is a fellow in the American College of Bond Counsel.

Accolades

- American College of Bond Counsel, Fellow
- Listed in *Chambers USA*
  - Banking & Finance: Public Finance, 2006-2017
- Listed in *The Best Lawyers in America*®
  - Public Finance Law, 2003-2016
  - "Lawyer of the Year," Birmingham, Public Finance Law, 2017
- Alabama Association of School Boards, Meritorious Service Award, 2004

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- Leadership Birmingham, Board of Directors
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Clerkships
Judge Walter P. Gewin, United States Court of Appeals, 5th Circuit

Admitted In
United States Court of Appeals, 11th Circuit
United States District Court, Northern District of Alabama
Supreme Court of the United States

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Agenda

- Discuss the two primary options for capital financing
  - Issuance of Warrants (Article 14)
  - Alternative Financing Contracts (Leases or Installment Sales)
- Hypothetical Situations
- Q & A

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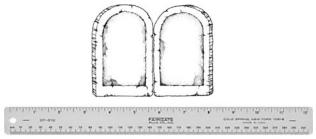
The Legal Framework – Dillon's Rule

- "a municipal corporation possesses and can exercise the following powers and no others: (1) **those granted in express words**; (2) those necessarily or fairly implied in or incident to the powers expressly granted; and (3) those essential to the declared objects and purposes of the corporation – not simply convenient, but indispensable."



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Borrowing Powers Expressly Given to Boards of Education Under Alabama Law

- The Legislature of Alabama has expressly granted Boards of Education the power to borrow, primarily under the following two code sections:
  - Article 14 of the School Finance portion of the Code (§ 16-13-300 *et seq.*) (issuance of Warrants)
  - Alabama Governmental Leasing Act (§ 41-16A-1 *et seq.*)(alternative financing contracts)

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Article 14 – Warrants for Educational Purposes

- Article 14 grants Boards of Education the power to issue and sell warrants for a wide array of capital projects:
  - Real Property
    - Land
    - School buildings
    - Classrooms
  - Personal Property
    - Equipment (computers/IT, copiers, HVAC)
    - Furniture
    - School buses

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Article 14 – Warrants for Educational Purposes

- Article 14 also authorizes the issuance of warrants for the following:
  - Refunding (usually for interest rate savings) prior warrant issues ("refinancing")
  - Funding operating expenses
  - Funding extraordinary expenses (casualty losses, legal judgments, etc.)

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Article 14 – Warrants for Educational Purposes

- May be sold at either public or private sale
  - Public sale: Board engages a financial advisor to issue an invitation for bids and awards sale to lowest bidder
  - Private sale: Board selects a bank or an underwriting firm to work with
- Board must identify a source of repayment; Warrants may NOT be general obligations of the Board

Word of Caution: be wary of "form documents," "standard bank notes" or any document purporting to obligate "any or all lawful revenues of the Board."

Best practice: before selecting a bank lender, consider sending out RFP and comparing rates.

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Article 14 – Warrants for Educational Purposes

- What are permissible sources of repayment?
  - Ad valorem tax or taxes
  - Sales and use taxes
  - Other revenues allocated or apportioned to the Board (such as, sales and use taxes levied by a city and allocated to the Board through an irrevocable funding agreement)

Important Consideration: a Board should be careful to set the maturity of the Warrant(s) to be issued so that the debt does not exceed the duration of levy of the tax or taxes pledged for repayment.

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Article 14 – Warrants for Educational Purposes

- Board may NOT pledge Foundation Program funds or any other state revenues (including fleet renewal funds).
- Warrants issued under Article 14 must have prior written approval by the State Superintendent of Education.
  - Failure to obtain this approval means the Warrant is void and unenforceable.
  - The State Superintendent of Education must also give prior, specific approval for issuance of any variable rate warrants.

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Article 14 – Warrants for Educational Purposes

- Other requirements
  - Maximum Term: 30 years
  - Must be signed by Board President, sealed and attested by the Board Secretary (Superintendent)

Caution: the Board President and the Board Secretary should – if for no other reason other than to protect themselves – make certain that there is clear written authorization (in the form of a resolution) from the Board before proceeding with a financing.

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Article 14 – Warrants for Educational Purposes

- Summary
  - A Board MAY issue its warrants to finance virtually any permissible capital project.
  - A Board MUST identify one or more available local revenue sources for repayment of its warrants.
  - A Board MAY NOT issue warrants payable out of "all available funds."
  - A Board MUST obtain the written approval of the State Superintendent of Education prior to issuance of any warrants.

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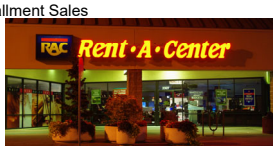
Alternative Financing Contracts

- Boards of Education are also authorized to enter into "alternative financing contracts" to finance certain equipment.
- Examples include
  - Leases
  - Lease-Purchases
  - Installment Sales



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Alternative Financing Contracts

- Focus for Warrants under Article 14
  - Revenue source pledged for repayment
    - Investor/lender will want to know all about that particular revenue stream
- Focus for Alternative Financing Contracts
  - General creditworthiness of borrower
  - Asset that can be protected and re-leased/sold in the event the borrower terminates the contract

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Alternative Financing Contracts

- Alternative financing contracts are available only for **tangible personal property**.
  - Examples of tangible personal property include: office equipment (copiers, telecommunication equipment, computers, etc.), HVAC equipment (maybe) and school buses.
  - Does NOT include: classrooms, land, field turf or other items constituting real property.

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Alternative Financing Contracts

- Security
  - Boards of Education may pledge for payment under an alternative financing either (1) its general faith and credit (general obligation) or (2) one or more specified revenue sources (taxes)
  - Assets themselves are also security

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Alternative Financing Contracts

- Perceived Advantages over Warrant issuance
  - Streamlined documents
  - Expedited timeframe
  - Lower costs/fees
  - Board does not have to "tie down" one of its revenue sources, thus preserving more room for traditional financings

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Alternative Financing Contracts

- However….
  - There is no one perfect set of "lease documents." Every Board is well-advised to have Board counsel and/or Bond counsel review the documents.
  - Alternative financing contracts still require Board approval, so they are not inherently faster or more efficient than warrant financings.
  - The most important cost for any financing is usually the interest cost. An installment sale/lease does not inherently have a lower interest rate than a warrant financing. ALWAYS check the APR.
  - Even if a Board does not have to pledge a particular revenue source for payment of an alternative financing contract, it does have to budget for the payments.

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Comparison – Warrant Financing vs. Alternative Financing Contract

	Warrant Financing	Alternative Financing Contract
Permissible assets	Any lawful	Tangible personal property ONLY
Security	Specified source(s)	General obligation or specified source(s)
Term	30 years maximum	No specified maximum (but not beyond useful life)
Conditions	ALSDE approval; Board approval	Board approval

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Hypothetical Situations

- Hypothetical #1 – New School Construction
  - BOE votes to proceed with construction of a new high school, as outlined in its five-year capital plan. The Board estimates the school will cost $60 million and wants to finance the building (and the related equipment and furnishings) over 30 years. How should the Board proceed?

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Hypothetical Situations – Hypothetical #1 (cont'd)

- Warrant issuance or alternative financing contract?
  - Warrant issuance – not tangible personal property.
- Publicly underwritten or private placement?
  - Either is permissible under Article 14, but > 10 (or 15 in some instances) years usually calls for a publicly underwritten transaction.
- Remember
  - Must have prior written approval of State Superintendent
  - Must identify a source of repayment; taxes in place for 30 years?
- Consider future borrowings
  - May be a good time to "throw in" funds for anticipated future borrowings (new buses, equipment needs, etc.)

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Hypothetical Situations

- Hypothetical #2 – Bus Financing
  - BOE is scheduled to take delivery of 20 new school buses in the next 3 weeks. The Board plans to use fleet renewal funds to pay for a large percentage of debt service on the buses and plans to finance the buses over 10 years. BOE has a brand new CSFO and she just learned about the bus delivery. What are the next steps?

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Hypothetical Situations – Hypothetical #2 (cont'd)

- Relatively short timeframe for payment
  - Publicly underwritten Warrant issue may not be an option
- Either a "direct placement" Warrant issue or an installment sale/lease transaction may be attractive
- Advantage of lease/installment sale: debt service is not a charge on a local revenue source, and Board does not plan to use local revenues to pay debt service
- Possible disadvantage: leases and installment sale agreements might contain onerous or undesirable provisions or conditions; also – always compare APR

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Hypothetical Situations

- Hypothetical #3 – HVAC and Window Project
  - In January, BOE decides to replace HVAC equipment and windows at several schools over the summer break. The Board wants to consider all available financing options and asks the CSFO to "get the best deal possible for the Board." What are the next steps?

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Hypothetical Situations – Hypothetical #3 (cont'd)

- Should the Board consider a lease or an installment sale? A national sales representative for an out-of-state leasing company has visited the Board several times and says leases are easy, efficient and don't have big fees for bankers and bond lawyers.
  - Not in this situation. It is doubtful that windows would qualify as "tangible personal property" under the alternative financing contract statutes.

Make sure the leased property is "ELIGIBLE" for leasing under Alabama law.

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Hypothetical Situations – Hypothetical #3 (cont'd)

- A loan officer at Main Street Local Bank told one of CSFO's Board members to "just walk on over" to the Bank and fill out a couple of forms, sign the standard Bank note and close the same day. Thoughts?
  - While it is clearly permissible and lawful to borrow from your local bank, the easy "just walk on over" method will run afoul of Alabama law. Article 14 requires:
    - Prior written approval of ALSDE
    - Issuance of Warrant (and not a standard bank-provided promissory note), which must be signed by Board President and Secretary and sealed
    - Identification of repayment source

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Hypothetical Situations – Hypothetical #3 (cont'd)

- Consider:
  - Talking to underwriting firm or financial advisor
  - Working with financial advisor or bond counsel on a Request for Proposals (RFP) for private placement transaction

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Key Takeaways

- Two primary options for financings
- The lease/installment sale might make sense in certain situations (school buses, IT equipment, non-affixed equipment)
- No one-size-fits-all approach – always look at the APR
- Beware of "standard forms," which may contain costly or burdensome provisions
- For Warrant financings, identify an available revenue source and obtain written approval from ALSDE
- Lean on your finance professional and legal/bond counsel!

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Questions and Answers

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