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California Attorney General Clarifies Use of Premium From Sale of School District General Obligation Bonds.

Premium Must Be Used for Debt Service Repayment

Until recently, there has been uncertainty surrounding premium generated from new money school district general obligation bonds – can the premium be used to pay certain costs of issuing such bonds? The answer is “no” according to the California attorney general’s newly issued Opinion No. 14-202, which comes in response to a request for clarity on the matter. Instead, premium generated on new money school district general obligation bonds must be deposited into an interest and sinking fund.

Background

When general obligation municipal bonds are offered for sale, it is possible they may generate original issue premium, which means they are sold at a price above the par value. When premium is generated on the sale of new money California school district general obligation bonds, the California Education Code requires that such premium be deposited into an interest and sinking fund to be used for debt service repayment. (Ed. Code §15146(g).)

Education Code Section 15146

As evidenced by the need for the request for clarity itself, the practice in California of using premium generated on school district general obligation bonds for costs of issuing those bonds has become more common. According to the statute in question, Education Code Section 15146, “any premium received” for new money school district general obligation bonds must be deposited into an interest and sinking fund. Some bond counsel and other financing professionals have interpreted that language to also allow for the use of premium to pay for certain costs of issuance of school district general obligation bonds. The theory has been that, in the case of certain costs of issuance, the school district issuer never technically “received” the premium, therefore the need to deposit it into an interest and sinking fund is alleviated. Such practice, however, has now been rejected by the California attorney general.

Bond Issuers, Take Note

Accordingly, California school district issuers of municipal bonds should take note of this opinion when issuing new money general obligation bonds. Although courts are not bound by opinions of the California attorney general, they are given great weight. Thus, California school districts should work closely with their bond counsel, municipal advisor and other financing professionals during the issuance of general obligation bonds to ensure they understand the risks involved with the use of premium and to ensure the proceeds received from the sale of such bonds, including any premium generated, are properly utilized.

It should also be noted that the issuance of general obligation refunding bonds falls under a separate authority. And although the attorney general opinion was not entirely clear on this matter, the limitation has not been applied to refunding bonds and this opinion does not seem to imply otherwise.

Key Takeaways

- There are risks involved with using premium generated on new money California school district general obligation bonds for any reason other than deposit into an interest and sinking fund for debt service repayment.
- Per the California attorney general, premium generated on new money California school district general obligation bonds cannot be used to pay for costs of issuing those bonds.
- It is important for California school districts to work closely with bond counsel, municipal advisors and other financing professionals to ensure they understand the type of bond proceeds received and the proper uses thereof.

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