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A review of Certificates of Obligation and Montgomery County's current uses of Certificates of Obligation and proposal(s) for limitation of uses of Certificates of Obligation ("CO")

This memorandum gives (1) a brief overview of the current law relating to Certificates of Obligation; (2) summarizes and reviews Montgomery County's current uses of Certificates of Obligation; (3) generally addresses the potential for the County to voluntarily limit its use of Certificates of Obligation more restrictively than required by state law; and (4) analyses a specific proposal for the County's voluntary limitation upon its use of Certificates of Obligation.

Conclusion

All of the Certificates of Obligation currently issued and outstanding by Montgomery County were validly issued. The projects and purposes for which each CO was issued were valid under the laws of the State of Texas. The County has used CO primarily for smaller capital improvements and related projects which is the traditional use of CO. The total amount outstanding on CO is approximately \$114.5 million. This amount does not appear to represent a significant debt burden upon the County's current financial condition per the County Auditor and the two (2) most recent CAFR.

Proposals to restrict the use of CO are most properly brought at the state legislative level in order to be tested against and reflect the public policy of the State of Texas. Local proposals adopted by a Commissioners Court are not binding upon it or any subsequent Commissioners Court. An examination and conclusion of the County's current uses (and amounts) of CO should be undertaken before any proposal to locally limit the County's use of CO more restrictively than state law is adopted.

Synopsis of current legal uses of CO

Certificates of Obligation ("CO") are means of borrowing by a county. The need comes from the constitutional and statutory provisions that prohibit a county from incurring an



obligation that is required to be paid from tax collections in future fiscal years. In other words, County obligations are limited to one (1) year unless some statute allows otherwise. CO are authorized by the Certificate of Obligation Act of 1971. SUBCHAPTER C OF CHAP. 271, LOCAL GOVERNMENT CODE. CO are a method of County financing which is more streamlined than issuing general obligation bonds. *See, Public Finance Handbook for Texas Counties, pg. 20, Pollan, Thomas M., (2012).* CO may only be used to pay for authorized statutory purposes. Two (2) statutes delineate the types of obligations for which CO are authorized by law.

Section 271.045 TEX. LOCAL GOV. CODE authorizes CO to be issued for payment for:

- (1) public works;
- (2) purchase of materials, supplies, equipment, machinery, buildings, lands and rights-of-way for issuer's (*i.e.* County's) authorized needs and purposes; and
- (3) professional services such as engineers, architects, attorneys and financial advisers.

TEX.LOC.GOV. CODE §271.045 (V.A.T.S. 1987).

Section 271.046 TEX. LOCAL GOV. CODE authorizes counties to issues CO for payments incurred in:

- (1) constructing or equipping a jail;
- (2) construction, renovating, or otherwise improving a county-owned building; or
- (3) constructing a bridge that is part of or connected to a county road or an approach to such a bridge.

TEX.LOC.GOV. CODE §271.046 (V.A.T.S. 1989).

These authorized purposes are broad and generally will cover most types of financing which the County may require.

Technically, a CO may be given to a vendor as payment instead of cash. Of course, receiving a CO instead of a cash payment is not enthusiastically accepted by a vendor. Some CO may be sold for cash which thus makes it possible to pay the vendor in cash. TEX.LOC.GOV. CODE §271.050(a) (V.A.T.S. 2005). *See also*, TEX.LOC.GOV. CODE §271.056 (V.A.T.S. 2001) (listing of instances when CO can be sold for cash and exemptions from advertising requirements). However, there are methods by which any CO may be sold for cash such that the limits imposed by statute have no great practical effect. Funds of a particular CO may only be used for the purposes stated in the issued CO.



Generally, Certificates of Obligation do not require an election prior to issuance by a county. An election will be required if five (5%) percent of registered voters in the county present a petition to Commissioners Court protesting the issuance of the CO prior to the time the Commissioners Court votes to issue the CO. The statute provides for prior notice to the public of the intent to issue CO. If a valid petition is presented, the Commissioners Court cannot vote to issue the CO unless and until an election is held approving the issuance of the CO. One commentator has remarked regarding this procedure for protesting the issuance of CO that “[t]his should not be viewed as taking away the right to vote on a bond issue, but rather as a method to avoid the time and expense of an election unless the public determines that an election should be held before the CO’s (Certificates of Obligation) are issued.” See, *Public Finance Handbook for Texas Counties*, pg. 21, Pollan, Thomas M., (2012). Procedural safeguards are therefore in place regarding the issuance of CO.

Montgomery County’s current uses of CO

Montgomery County currently has outstanding nine (9) CO dating from 2003 through 2013. The current outstanding indebtedness represented by the outstanding certificates of obligation is \$114,470,000. This amount does not appear to represent a significant debt burden upon the County’s current financial condition per the County Auditor and the two (2) most recent Comprehensive Annual Financial Reports (“CAFR”). The chart below summarizes the currently outstanding CO as of September 30, 2012.¹

<i>Description</i>	<i>Interest Rate (%)</i>	<i>Issue Date(Yr)</i>	<i>Maturity Date(Yr)</i>	<i>Original Issue Amount</i>	<i>Amount Outstanding</i>
Series 2003	4.0 - 5.0 ²	2003	2026	\$ 12,000,000	\$ 640,000
Series 2004	3.75 - 4.6	2004	2020	\$ 2,600,000	\$ 345,000
Series 2006	4.0 - 5.0	2006	2027	\$ 26,320,000	\$ 23,320,000
Series 2007	4.0 - 4.63	2008	2027	\$ 9,250,788	\$ 8,340,000
Series 2008	3.5 – 5.25	2008	2027	\$ 23,790,000	\$ 21,785,000
Series 2010	3.0 -5.0	2010	2039	\$ 23,395,005	\$ 23,395,000
Series 2010A	3.0 – 5.0	2010	2022	\$ 9,055,000	\$ 8,370,000
Series 2012	2.0 – 5.0	2012	2032	\$ 14,925,000	\$ 14,925,000
Series 2012A	2.0 – 5.0	2013	2023	\$ 13,350,000	\$ 13,350,000
			TOTAL		\$114,470,000

¹ Information from Fiscal year 2012 CAFR Save & Except for “Original Issue Amount” which information is taken from the respective CO. Series 2012A issued in FY 2013 is not shown on 2012 CAFR.

² The interest rate shown is the range of interest rates during the life of the certificate of obligation. The stated interest rate(s) increase during the term of the CO.



Certificates of Obligation may only be used for the purposes described in the CO at the time of issuance. The respective CO may be used for the following purposes:

Series 2003	<ol style="list-style-type: none"> 1. Construction of park improvements; 2. Constructing a new county office building; 3. Purchasing two buildings for county facilities at 21134 U.S. Hwy 59, New Caney, Tx (east county courthouse annex) and 8535 Hwy 242, Conroe, Tx (animal shelter); 4. Purchasing parking garage at 301 N. Thompson, Conroe
Series 2004	Airport improvements and renovations and improvements to County buildings
Series 2006	<ol style="list-style-type: none"> 1. Acquisition, construction and equipping airport, county information system, park, library, and election system improvements and renovations, improvements to a juvenile detention center, an animal shelter, a jail and other county buildings including but not limited to office and court buildings; 2. purchase of land and the acquisition, construction and equipping of a county office building complex in Magnolia, Tx, 3. the acquisition, renovation, construction and equipping of a building located in The Woodlands, Tx; 4. the acquisition of land, and construction and equipping of parks located in and around the cities of Montgomery, Willis, Magnolia, Splendora and New Caney and along the Spring Creek Greenway
Series 2007	Purchase of land and the acquisition, construction and equipping of a parking garage
Series 2008	<ol style="list-style-type: none"> 1. purchase of land and improvements thereon located at 1500 N. Frazier, Conroe; 2. construction of an office building and improvement to various existing county buildings; 3. purchase of furniture, fixtures & equipment ("FF&E") for various county buildings
Series 2010	construction of 100-bed forensic psychiatric hospital located at 700 Hilbig Rd, Conroe (MCMHTF)
Series 2010A	construction of 100-bed forensic psychiatric hospital located at 700 Hilbig Rd, Conroe (MCMHTF)



Series 2012	<ol style="list-style-type: none"> 1. renovation and remodeling of the County Courthouse 2. renovation, remodeling and improvements and the purchase of FF&E for various county buildings, facilities and parks, including Pct 2 and Pct 4 concession stand, the County Animal Shelter, the County Jury Assembly Room and a County library; 3. construction and renovation of runway, taxiway and water and sewer improvements at Lone Star Executive Airport; 4. purchase of land and buildings for a forensic services facility to be located at 201 Hilbig Road, Conroe Tx and renovations, remodeling and improvements and the purchase of FF&E related thereto; 5. energy-related renovations, remodeling and improvements and the purchase of land and buildings for County offices to be located at 115 Business Park Dr., Willis, Tx; 6. purchase of land and buildings for County offices to be located at 115 Business Park Dr., Willis, Tx; 7. renovation, remodeling and improvements and the purchase of FF&E for the County Jail.
Series 2012A	<ol style="list-style-type: none"> 1. road improvements, including ROW acquisition, design construction and inspection , to county owned roads in Pct 1 & Pct 4; 2. construction and renovation of runway and taxiway improvements at Lone Star Executive Airport;

A review of the purposes stated in the CO at the time of issuance show that most of the outstanding Montgomery County Certificates of Obligation were issued for capital improvements and related expenditures. All of the CO were for lawful purposes. It is unlikely that these capital projects would have been budgeted to be paid in a single fiscal year. As such, these projects would not have been done unless a means of financing was utilized. The financing alternatives for a County are (1) General Obligation Bonds; (2) Certificates of Obligation; (3) Tax Notes; (4) Time Warrants; (4) Refunding Bonds; and (5) contractual obligations. Each type of financing has different restrictions, including authorized uses and length of financing. In limited instances, lease purchase agreements and/or revenue bonds may be used. In preparing this memo, Montgomery County's currently outstanding certificates of obligation were not reviewed to determine if any of the other means of financing were available at the time of issuance.



Proposals to further limit the use of CO

The County Attorney has been asked to render an opinion regarding potential County action to limit the use of CO more restrictively than the current statute, including whether such potential action is “in the best interest of the County.” This office is not part of the policy making body of Montgomery County and is therefore hesitant to render an opinion of such type. In responding to such request, however, the author of this memo feels that it is pertinent and important to address the following four (4) points.

First, action by Commissioners Court adopting a policy restricting uses of CO that is more limited than state law would be symbolic only. Such action would be a statement of current policy and could be changed at any subsequent Commissioners Court session.

Second, the public policy of the State of Texas is generally expressed and enacted in its general and special laws resulting from the legislative process. Certificates of Obligation, the restrictions on the uses of such and the procedural safeguards connected therewith were authorized in 1971. The enabling statutes have been amended at least five (5) times to reflect the public policy in expanding or limiting the uses of CO. The legislature is best suited and equipped to gather information regarding the statewide uses (and/or abuses), amounts and effects of counties’ issuances of CO. If it were determined the use of CO was expanding to a degree or used in ways that do not reflect the current public policy, the legislature and the legislative process would be the most appropriate venue to address further limitations regarding CO.

Thirdly, a threshold question should be asked: Whether Montgomery County has issued Certificates of Obligation for purposes or in such amounts (individually and aggregately) as the public does not support? Exhibit “A” of this memorandum provides a summary of the issued and outstanding CO showing the interest rates, year of issuance, maturity date, original issue amount, outstanding balance and the projects funded by the CO. One of the major differences between General Obligation Bonds (requiring an election) and CO (not requiring an election) is in the “traditional” uses of the CO. CO are generally issued for a shorter time frame than General Obligation Bonds and are tied to the useful life of the financed project. *Public Finance Handbook for Texas Counties, pg. 21, Pollan, Thomas M.*

Finally, an additional factor to be considered in adopting a policy limiting the uses of CO in ways more restrictive than the statutory limitations is that the cost of issuance of CO is substantially less than the cost of General Obligation Bonds. One of the factors in such cost is the cost of bond elections. The largest of the currently outstanding CO is \$26.32 million. The smallest amount of the original issue is \$2.6 million. Most county bond elections involve proposals to issue substantially more than any currently outstanding CO. The author has not



researched the average or typical cost of a countywide bond election; however, such costs are probably significant or at least not insignificant.

This office has not reviewed any specific proposal other than the O'Sullivan Proposal described below. The O'Sullivan Proposal does mirror significantly one or more bills introduced in the 2013 Texas Legislature. The proposed bills, however, did not move further through the legislative process than referral to committee(s).

The O'Sullivan Proposal

Mr. Bill O'Sullivan has provided a proposal regarding the County's use of Certificates of Obligation. A copy of Mr. O'Sullivan's proposal is attached to this memo as Exhibit "B". Mr. O'Sullivan's proposal (the "O'Sullivan Proposal") asks the Commissioners Court to adopt a policy regarding the use of certificates of obligation that is more restrictive than the uses allowed by law. The following highlights the provisions of the O'Sullivan Proposal which differ or are more restrictive than current law.

The expressed purpose of the O'Sullivan Proposal is to limit the County's uses of CO. To accomplish this, the O'Sullivan Proposal limits the uses of CO to most of the instances when CO are currently exempt from competitive bidding. *See*, TEX.LOC.GOV. CODE §271.056. The O'Sullivan Proposal incorporates all but one of the provisions under §271.056. The O'Sullivan Proposal eliminates the §271.056 provision allowing for a county contract that is not required to be made in accordance with competitive bidding procedures under additional statutory provisions. *See*, TEX.LOC.GOV. CODE §271.056(11). The O'Sullivan Proposal adds an additional allowable situation:

- (9) Other work on projects approved by the County where matching funds from any source on at least a dollar for dollar basis would be otherwise forfeited due to no opportunity for holding a Bond Election. Said opportunity is considered to be a regularly scheduled Countywide Election where the time for placing a Bond Question has not elapsed;

The O'Sullivan Proposal also modifies and limits one of the provisions otherwise listed in §271.056 by restricting the use of CO under §271.056 (6) to the situation "where holding an election would provably [sic] cause enough delay to forfeit the opportunity." The O'Sullivan Proposal further qualifies this provision by stating, "[h]owever, the uncertainty of an election outcome is not a sufficient reason to proceed."

It is unclear from the O'Sullivan Proposal whether the currently available uses of CO allowed under §271.046 would still be permissible under the O'Sullivan Proposal, if adopted. Section 271.046 allows for the use of CO for (1) constructing or equipping a jail; (2)



construction, renovating, or otherwise improving a county-owned building; or (3) constructing a bridge that is part of or connected to a county road or an approach to such a bridge. TEX.LOC.GOV. CODE §271.046. Eliminating the ability to use CO for such construction projects is a significant limitation on the County's ability to borrow for construction projects.

A comparison of the purposes for which the outstanding CO have been issued with the terms of the O'Sullivan Proposal show that few, if any, of the current uses of the CO would be authorized under the O'Sullivan Proposal. The first five (5) uses allowed under the O'Sullivan Proposal require an emergency. The description of the authorized uses in the currently issued certificates of obligation does not include any information regarding exigencies or the circumstances surrounding the issuance of the CO. In the absence of information creating an "emergency" in connection with the currently outstanding CO, none of the O'Sullivan Proposal's initial five (5) authorized uses would apply to the current outstanding CO. Information is not available to determine if any CO would have qualified for item 6 of the O'Sullivan Proposal (ability to purchase of land, building, ROW, etc.. would be lost due to delay in holding an election). Some of the CO may be for a project for which there was some form of contribution by another entity (e.g. the \$23.395 million bond for the MCMHTF has a federal interest subsidy), however, it has not been researched whether any "matching" funds are 1:1 as provided in item 9 of the O'Sullivan Proposal. Generally, the County does not have the power to levy special assessments as item 7 of the O'Sullivan Proposal would require. The information is not readily available to determine if the limitations contained in item 8 of the O'Sullivan Proposal would apply regarding insufficient funds from bond funds. In short, it appears that the O'Sullivan Proposal's limitations and conditions would essentially preclude the issuance of any of the currently issued and outstanding CO if the O'Sullivan Proposal provisions were in effect at the time the CO were issued.

Exhibit(s)

Attached to this memo are the following exhibits:

1. Exhibit "A" is a chart showing the current outstanding Certificates of Obligation and the authorized projects for each CO;
2. Exhibit "B" is the O'Sullivan Proposal.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "B. D. Griffin", is written over a horizontal line.

B. D. Griffin,
Assistant County Attorney

Montgomery County, Texas Current Outstanding Certificates of Obligation

Description	Interest Rate (%)	Issue Date(Yr)	Maturity Date(Yr)	Original Issue Amount	Amount Outstanding	Authorized projects
Series 2003	4.0 - 5.0	2003	2026	\$ 12,000,000	\$ 640,000	<ol style="list-style-type: none"> 1. Construction of park improvements; 2. Constructing a new county office building; 3. Purchasing two buildings for county facilities at 21134 U.S. Hwy 59, New Caney, Tx (east county courthouse annex) and 8535 Hwy 242, Conroe, Tx (animal shelter); 4. Purchasing parking garage at 301 N. Thompson, Conroe
Series 2004	3.75 - 4.6	2004	2020	\$ 2,600,000	\$ 345,000	<p>Airport improvements and renovations and improvements to County buildings</p>
Series 2006	4.0 - 5.0	2006	2027	\$ 26,320,000	\$ 23,320,000	<ol style="list-style-type: none"> 1. Acquisition, construction and equipping airport, county information system, park, library, and election system improvements and renovations, improvements to a juvenile detention center, an animal shelter, a jail and other county buildings including but not limited to office and court buildings; 2. purchase of land and the acquisition, construction and equipping of a county office building complex in Magnolia, Tx, 3. the acquisition, renovation, construction and equipping of a building located in The Woodlands, Tx; 4. the acquisition of land, and construction and equipping of parks located in and around the

Montgomery County, Texas Current Outstanding Certificates of Obligation

Series 2007	4.0 - 4.63	2008	2027	\$ 9,250,788	\$ 8,340,000	cities of Montgomery, Willis, Magnolia, Splendora and New Caney and along the Spring Creek Greenway Purchase of land and the acquisition, construction and equipping of a parking garage
Series 2008	3.5 - 5.25	2008	2027	\$ 23,790,000	\$ 21,785,000	1. purchase of land and improvements thereon located at 1500 N. Frazier, Conroe; 2. construction of an office building and improvement to various existing county buildings; 3. purchase of furniture, fixtures & equipment ("FF&E") for various county buildings
Series 2010	3.0 - 5.0	2010	2039	\$ 23,395,005	\$ 23,395,000	construction of 100-bed forensic psychiatric hospital located at 700 Hilbig Rd, Conroe (MCMHTF)
Series 2010A	3.0 - 5.0	2010	2022	\$ 9,055,000	\$ 8,370,000	construction of 100-bed forensic psychiatric hospital located at 700 Hilbig Rd, Conroe (MCMHTF)
Series 2012	2.0 - 5.0	2012	2032	\$ 14,925,000	\$ 14,925,000	1. renovation and remodeling of the County Courthouse 2. renovation, remodeling and improvements and the purchase of FF&E for various county buildings, facilities and parks, including Pct 2 and Pct 4 concession stand, the County Animal Shelter, the County Jury Assembly Room and a County library;

Montgomery County, Texas Current Outstanding Certificates of Obligation

						<p>3. construction and renovation of runway, taxiway and water and sewer improvements at Lone Star Executive Airport;</p> <p>4. purchase of land and buildings for a forensic services facility to be located at 201 Hilbig Road, Conroe Tx and renovations, remodeling and improvements and the purchase of FF&E related thereto; energy-related renovations, remodeling and improvements and the purchase of land and buildings for County offices to be located at 115 Business Park Dr., Willis, Tx;</p> <p>6. purchase of land and buildings for County offices to be located at 115 Business Park Dr., Willis, Tx;</p> <p>7. renovation, remodeling and improvements and the purchase of FF&E for the County Jail.</p>
Series 2012A	2.0 – 5.0	2013	2023	\$ 13,350,000	\$ 13,350,000	<p>1. road improvements, including ROW acquisition, design construction and inspection , to county owned roads in Pcts 1 & 4;</p> <p>2. construction and renovation of runway and taxiway improvements at Lone Star Executive Airport;</p>
				TOTAL	\$114,470,000	

Note: All Certificates of Obligation (“CO”) also provide that the CO proceeds may be used to pay the costs of issuance of the CO.

EXHIBIT "B" – O'Sullivan Proposal

It is the intent of the law that debt obligations which are the responsibility of the people be approved by them in advance through an election process. Therefore, in addition to the requirements of the applicable law as respects the issuance of Certificates of Obligation (Certificates), the following additional provisions need to apply for the Commissioner's Court of Montgomery County to issue said Certificates:

Commissioners may approve Certificates only for the following:

- (1) a case of public calamity in which it is necessary to act promptly to relieve the necessity of the residents or to preserve the property of the issuer;
- (2) a case in which it is necessary to preserve or protect the public health of the residents of the issuer;
- (3) a case of unforeseen damage to public machinery, equipment, or other property;
- (4) a contract for personal or professional services related to items 1, 2 or 3.
- (5) work done by employees of the issuer and paid for as the work progresses as a result of items 1,2,or 3.;
- (6) the purchase of any land, building, existing utility system, or right-of-way for authorized needs and purposes where holding an election would provably cause enough delay to forfeit the opportunity. However, the uncertainty of an election outcome is not a sufficient reason to proceed;
- (7) expenditures for or relating to improvements in municipal water systems, sewer systems, streets, or drainage, if at least one-third of the cost of the improvements is to be paid by special assessments levied against properties to be benefitted by the improvements;
- (8) a case in which the entire contractual obligation is to be paid from bond funds or current funds or in which an advertisement for bids has previously been published in accordance with applicable law but the current funds or bond funds are not adequate to permit the awarding of the contract, and the increased costs are caused by modifications requested by the issuer, certificates are to be awarded to provide for the deficiency;
- (9) Other work on projects approved by the County where matching funds from any source on at least a dollar for dollar basis would be otherwise forfeited due to no opportunity for holding a Bond Election. Said opportunity is considered to be a regularly scheduled Countywide Election where the time for placing a Bond Question has not elapsed;
- (10) the sale of a public security, as that term is defined by Section 1204.001, Government Code;