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## Attorney General Takes Hardline Position on Permissible Use of School Bond Premium

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On May 19, 2022, the California Attorney General (AG) published Opinion No. 14-202, stating that premium generated from the sale of school district general obligation bonds cannot be used for any purpose other than to pay debt service on the bonds.

### **Background**

School districts, like most public agencies in California, are required to obtain voter authorization in order to issue general obligation bonds. Such bonds are authorized by the voters up to a specific maximum principal amount and are repaid by taxes levied on property within the issuing district. School districts in California commonly sell general obligation bonds at a “premium.” “Premium” refers to the portion of the bond purchase price that is in excess of the principal amount of the bonds. Since bond premium is not part of the principal, it does not get repaid. In theory, bonds that generate premium are issued at interest rates higher than the bonds would be if they were sold “at par” (i.e., with no premium).

Schools generally have little incentive to increase interest rates for the purpose of generating more premium (and thus more sale proceeds), because the California Legislature has placed limits on the use of premium, requiring that premium received by the school district from the sale of general obligation bonds must be deposited into the debt service fund and used to repay the bonds. One common practice in California, however, has been to use premium to pay underwriter’s discount (“takedown” fees charged by municipal underwriters), bond insurance policy premiums, and sometimes other costs of issuing the bonds, prior to depositing the balance of the premium in the school district’s accounts to be used for debt service.

### **AG Opinion No. 14-202**

In the opinion of the AG, paying underwriter's discount and/or costs of issuance from the bond premium, is not consistent with the law. While practitioners have commonly read the larger statutory framework as permitting this practice, the AG has taken a strict position contrary to the common approach, and has opined that all premium generated from the sale of school district general obligation bonds must be deposited in the debt service fund, and no portion of the premium can be first diverted to any other use. In other words, premium cannot be used to pay underwriter's discount, bond insurance, or other issuance costs, according to the AG.

AG opinions do not carry the force of law. Nevertheless, in the absence of controlling authority, an AG opinion on a given matter is considered persuasive to a court. Moving forward, school districts should consult with bond counsel to assess their practices around the use of premium.

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