



MEMORANDUM

TO: Lee Leffingwell, City Council Member
Mayor and Council
Marc Ott, Austin City Manager

FROM: David Smith, City Attorney

DATE: August 24, 2008

SUBJECT: Legal Requirements for the Sale of City-Owned Utility Real Property

In anticipation of the City's sale of the Green Water Treatment Plant ("GWTP") and the Austin Energy Control Center ("ECC") properties, you have asked me to address several questions about the requirements applicable to the sale of utility property and the use or disposition of the proceeds of the sale. In analyzing these issues, my office has researched the applicable provisions of the City Charter, city ordinances, and state law. You also asked me to provide this information in a way that could be released publicly, which I have done in this memo.

For the reasons set forth in Parts I and II, below, I conclude that the requirements adopted by the City Council in Resolution No. 20080214-054 ("Resolution"), for both the sale of the GWTP-ECC properties and the use of the sale proceeds, are consistent with the applicable requirements of the City Charter, city ordinances, and state law. I also conclude in Part III that, based on the results of the City's ongoing review, that the sale of GWTP and ECC properties would not jeopardize the tax exempt status of the pertinent bonds issuances.

I. The Sale of GWTP & ECC Properties

I will first address the threshold question of whether the City has authority to sell the GWTP and ECC properties.

A. *City Charter Requirements*

The City has the authority to sell municipal property under Article 1, Sec. 3 of the City Charter. Note that the GWTP and ECC properties are not owned by the utilities; they are owned by the City, and merely used by the utilities. The City's authority to sell those properties is limited, however, by a prohibition against selling "all or any

substantial part of the facilities of any municipally owned public utility....” See Charter, Article II, Sec. 5. Thus, with respect to municipal property that is part of the facilities of the City’s water and electric utilities, the City is allowed to sell that property, if the property being sold is not a *substantial* part of the facilities of the utility.

Council’s resolution authorizing the sale of GWTP and ECC specifically prohibits the sale of GWTP or the redevelopment of ECC until the Council determines, among other things, that the properties are not a “substantial part” of the utilities’ facilities and are surplus to their operations. See Resolution, at 4-5. Such a determination is appropriate if, at or before the date the conveyance occurs, the City has finished decommissioning GWTP and has relocated ECC’s functions to the new facility at 2500 Montopolis Drive. Thus, the Resolution is consistent with, and does not authorize a sale in violation of, the Charter.

Note that this memo does not address the Public Utility Regulatory Act because the Act contains no requirements related to the sale or transfer of water utility property and expressly excludes municipally owned electric utilities from its requirements for electric utilities. See Sec. 31.002(6)(A).

Also, it should be noted that the sale of the GWTP and ECC properties would be consistent with standard practice of the City’s utility departments, which periodically sell surplus properties that are no longer useful to utility operations. These surplus properties are not considered a substantial part of a utility’s facilities.

B. Local Bond Ordinances

The sale of GWTP and ECC properties are subject to general covenants set forth in the City’s bond ordinances for the Austin Water Utility and Austin Energy Utility, passed in 2000 and 2001 respectively. Those ordinances both provide that:

To the extent and in the manner provided by law, the City can sell, exchange or otherwise dispose of property and facilities constituting part of the [Water/Wastewater System or Electric Utility System] at any time and from time to time, **provided such sale or exchange of property or facilities does not impede the operations of the [Water/Wastewater or Electric Utility System].**

See Ordinance No. 006008-56A (“Water Utility Bond Ord.”), Sec. 5(h), at 6; Ordinance No. 010118-53A (“Electric Utility Bond Ord.”), Sec. 5(h), at 6 (emphasis added).

The Council’s Resolution for the sale of the GWTP-ECC properties includes a provision concerning the sales that ensures compliance with the ordinance requirement quoted above. The Resolution specifically requires that, before the sale of GWTP or redevelopment of ECC may occur, the Council must determine that the sale of the facilities “will not impede or disrupt the operations” of the utilities. See Resolution, at 4-5.

II. Use of Proceeds from the Sale of the GWTP & ECC Properties

The next issue relates to the legal requirements applicable to the use of proceeds from the sale of utility property. Texas Government Code § 1502.58(a) generally prohibits a municipality from using the revenue of a utility system for non-utility related purposes until the debt secured by the utility revenue is paid. Under § 1502.59(a), however, a municipality may:

transfer to the municipality's general fund and may use for general or special purposes revenue of any municipally owned utility system in the amount and to the extent authorized in the indenture, deed of trust, or ordinance providing for and securing payment of public securities issued under this chapter or similar law.

Transfers of revenue from the City's water and electric utilities, therefore, is authorized by Government Code § 1502.59(a) provided that any such transfers satisfy the requirements of local bond ordinances.

Section 5 of both the City's water and electric utility bond ordinances sets forth several "General Covenants" applicable to various aspects of the use, operation, and control of the water and electric utilities. These covenants include requirements for the "Sale, Lease or Disposal of System Property," which require that proceeds from the sale of utility property or facilities:

shall be deposited to the credit of a special Fund or Account, and funds deposited to the credit of such Fund or Account shall be used to acquire other property necessary or desirable for the safe or efficient operation of the [Water/Wastewater or Electric Utility System], to redeem or purchase Prior First Lien Obligations, Prior Subordinate Lien Obligations, Parity [Water/Wastewater or Electric Utility System] Obligations, Previously Issued Separate Lien Obligations or for any other [Water/Wastewater or Electric Utility System] purpose.

See Water Utility Bond Ord., Sec. 5(h), at 6; Electric Utility Bond Ord., Sec. 5(h), at 6.

This provision raises two important questions with regard to proceeds resulting from the planned sale of GWTP and ECC:

- (1) What is the "special Fund or Account" into which the proceeds from the sale of utility property must be deposited?
- (2) Under what circumstances, if any, are transfers of sale proceeds from the "special Fund or Account" permissible?

In answering these questions I have relied upon the advice of the City's bond counsel, the law firm of Fulbright & Jaworski.

First, the "System Fund" established under Section 6 of the bond ordinances qualifies as a "special Fund or Account" within the meaning of the above-quoted language. *See* Water Utility Bond Ord., Sec. 6, at 8-9; Electric Utility Bond Ord., Sec. 6, at 8-9. The City may therefore deposit proceeds from the sale of electric and water utility property into the utility's System Fund.

Second, transfers from the System Fund to the general fund are permissible, but only to the extent that surplus Net Revenues exist after required payments are made towards the following obligations: operating expenses, Priority First Lien Obligations, Prior Subordinate Lien Obligations, and Subordinated Debt. As stated in Section 6 of the bond ordinances:

Any Net Revenues remaining in the System Fund after satisfying the foregoing payments or making adequate and sufficient provisions for the payment thereof, may be appropriated and used for any other City purpose now or hereafter permitted by law.

See Water Utility Bond Ord., Sec. 6, at 9; Electric Utility Bond Ord., Sec. 6, at 9.

With regard to sale of ECC property, no transfer from the electric utility System Fund would be required because the Resolution provides that proceeds from the sale must be used for relocating the ECC's functions to another site. *See* Resolution at 5. This purpose clearly constitutes an "operating expense" under Section 6 or an "other Electric Utility System purpose" under Section 5 of the Utility Bond Ordinance.

Proceeds from the sale of GWTP, on the other hand, are required to be used for several non-water utility purposes that would require transfers from the water utility System Fund. Under the Resolution, proceeds from the sale of GWTP must be:

used by the City to offset the City's costs of the following and in the following order of preference:

1. The [GWTP] decommissioning and deconstruction;
2. The Austin Energy South Substation reconfiguration;
3. Street and bridge design construction costs associated with the [GWTP] property, the extension of 2nd Street over Shoal Creek, and the Austin Energy South Substation property (collectively referred to as the Seaholm East Redevelopment District);
4. Assist with the financing of a Public Parking Enterprise supporting the Seaholm East Redevelopment District;

5. The establishment of additional public amenities, including affordable housing, to be identified by the City Council, within the Seaholm East Redevelopment District.

See Resolution, at 7-8.

Except for item No. 1 (decommissioning/deconstruction), which would constitute an “operating expense” or “other Water/Wastewater System Purpose,” the expenditures listed above could not be made out of the water utility System Fund because they do not fall into the expenditure categories listed in Section 6.

However, if surplus Net Revenue exists after payments required under Section 6 are made, that revenue could be transferred from the System Fund and used for item Nos. 2-5. This is consistent with the Resolution’s requirement that Council determine, at the time of sale, that “there are adequate replacement Austin Water Utility System properties in place to create sufficient revenues and *to pay debt of the Austin Water Utility[.]*” *See* Resolution, at 5 (emphasis added).

III. Tax Exempt Debt

The sale of utility property may impact the tax-exempt status of a bond issuance used to finance the utility, depending on how the outstanding bond proceeds have been used at the time of sale. Accordingly, it is important to determine the status of all outstanding bond proceeds prior to the sale of utility property.

The City of Austin electric and water utility departments have periodically issued revenue obligations (tax-exempt bonds) payable from and secured by the net revenues of the respective utility. Utility facilities that are financed by tax-exempt bond financing (“Financed Facilities”) are used for a public purpose, so that the tax-exempt status of the debt that financed the Financed Facility maintains its tax exempt status. The proceeds from a single tax-exempt bond are generally used to purchase and improve multiple Financed Facilities.

If five percent or more of the outstanding indebtedness of a single bond issuance associated with a Financed Facility is converted from a public to a private use, then the issuance could become a “private activity bond” and the tax-exempt status of that bond issuance could be undermined. The tax code provisions associated with private activity bonds are set forth in Section 141 of the Internal Revenue Code and referenced in the associated regulations set forth in Sections 1.141-1 through 1.141-16.

To ensure that the sale of a Financed Facility for a public use would not undermine the tax-exempt status of a bond issuance, the City makes an examination, on a case by case basis, of the uses of the outstanding bond proceeds of such bond issuance prior to the time the Financed Facility is sold. Such examination is for the purpose of determining whether or not the change in use of a Financed Facility, aggregated with

other private uses, would represent five percent or more of the outstanding bond proceeds. In the event that such private use exceeds five percent, the tax code provides certain parameters that must be met to address the tax-exempt status of the outstanding debt. Generally, there is a minimal amount of outstanding indebtedness (less than five percent) associated with utility facilities that were purchased many decades in the past and that have not received major capital improvements in recent decades.

The City, with the assistance of the public financing consultant the PFM Group, is examining all outstanding bond issuances associated with the Green Water Treatment Plant and the Austin Energy Control Center. To date, the examination has revealed nothing which would jeopardize the tax exempt status of the pertinent bonds issuances.