



Dave Yost • Auditor of State

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TO: All Public Offices and Independent Public Accountants

**FROM: Dave Yost
Ohio Auditor of State**

SUBJECT: Allocating Premiums from Local Government Bond and Note Sales

A number of Ohio public entities have inquired whether premiums they receive from their bond and note sales may be applied to project funds or must be applied to bond retirement funds. Historically low interest rates have resulted in an increase in the volume and size of premiums as investors seek “coupon protection” against interest rates rising in the future. As explained more fully below, the Ohio Revised Code generally requires premiums received by public entities to be applied solely to bond retirement funds. For bonds and notes issued on and after July 1, 2014, AOS will issue findings for adjustment when public entities apply bond and note premiums they receive to project funds instead of bond retirement funds.¹

I. Factual Background

Local governments and school districts have experienced historically low interest costs on their bond and note issues since 2008. However, investors have been less willing to purchase bonds and notes with low stated interest rates. The solution has been for public entities to offer higher (i.e., above market rate) stated interest rates on the bonds and notes they issue in exchange for payment of a “premium” (i.e., an amount in excess of the principal or “face” amount of the bonds or notes) by the purchasers. This arrangement benefits both parties by giving purchasers the higher stated interest rates they seek and the public entity a premium to offset the higher interest costs resulting from those higher stated rates. However, it also poses an important legal question: must the premium be applied to the bond retirement fund, or may it be applied to the project fund?

II. Relevant Statutes

¹ This bulletin solely addresses the application of premiums to project funds. Auditor of State will not issue findings for adjustment, where premiums are used to cover financing costs, Ohio Rev. Code § 133.01(K).

Two statutes generally govern the allocation of premiums received by public entities from the sale of bonds and notes: Ohio Rev. Code §§133.32(B) and 5705.10(E)². Section 133.32 states, in relevant part:

133.32 Depositing proceeds from sale.

Unless otherwise provided by law or in proceedings authorized by law, proceeds from the sale of Chapter 133. securities shall be deposited and credited as follows:

...

(B) Any amount received as payment of premium and accrued interest, and if determined by the taxing authority or the fiscal officer any amount for capitalized interest, and in the case of securities maturing over five or more years any amount provided for in the proceedings as a reserve for debt charges, not exceeding the highest debt charges on the securities in any fiscal year, shall be paid into the bond retirement fund and credited to accounts as provided in the legislation. (Emphasis added.)

...

Section 5705.10(E) states:

(E) All proceeds from the sale of public obligations or fractionalized interests in public obligations as defined in section [133.01](#) of the Revised Code, except premium and accrued interest, shall be paid into a special fund for the purpose of such issue, and any interest and other income earned on money in such special fund may be used for the purposes for which the indebtedness was authorized or may be credited to the general fund or other fund or account as the taxing authority authorizes and used for the purposes of that fund or account. The premium and accrued interest received from such sale shall be paid into the sinking fund or the bond retirement fund of the subdivision. (Emphasis added.)

The wording of the statutes, underlined above, clearly indicates the General Assembly's intent to require public offices to apply bond and note sale premiums solely to bond retirement funds. The only way around this requirement would be to read §133.32's language "Unless otherwise provided *** in proceedings authorized by law***" as permitting public entities to draft authorizing legislation in such a way as to permit the

² Ohio Rev. Code Section 133.34(D) separately addresses the application of moneys, including premiums, received from the sale of securities issued to refunding outstanding general obligation bonds. Under its provisions, these amounts are to be deposited in the bond retirement fund or a separate escrow fund for the retirement of the refunded bonds.

application of premiums to funds other than bond retirement. The flaw in this approach is that all of §§133.32 and 5705.10(E) would, in practical effect, become merely advisory, and would side-step the legislature's preference for debt repayment. The State Auditor's Office reads the language, "Unless otherwise provided by law or in proceedings authorized by law****" narrowly. Unless there is a specific statutory provision authorizing the bond premium to be used other than for debt retirement, the statutory requirement for payment of any premium into the bond retirement fund may not be overridden merely by a public entity's own proceedings authorizing a sale of its bonds.

Even in an era of historically low interest rates which place unique pressures on public entities raising revenue, the State Auditor's Office may not ignore §§133.32(B) and 5705.10(E). Failure of a public entity to comply with these statutory provisions will result in a finding for adjustment against the project fund in favor of the bond retirement fund.

III. Implementation

Multiple public entities have contacted the State Auditor's Office on this issue requesting guidance. This Bulletin provides that guidance. Because local government and school district debt issues are complex and preparation of financing plans and related documents may occur over lengthy periods of time, this Bulletin will only go into effect for any bonds or notes issued on or after July 1, 2014.

Questions concerning this bulletin should be addressed to the Legal Division of the State Auditor's Office at (800) 282-0370.



Dave Yost
Ohio Auditor of State