S T A T E O F T E N N E S S E E
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Opinion No. 00-186

Legality of Reallocation of Funds Raised Pursuant to Tenn. Code Ann. §9-21-201, *et al.* - General Obligation Bonds

QUESTION

If the Proposed Criminal Justice Center for Knox County is not built or is scaled back significantly, can the tax funds pledged to that project be spent on other capital projects?

OPINION

Yes, with restrictions. The funds dedicated to the proposed Criminal Justice Center for Knox County were raised by a bond issue and such bond proceeds can only be reallocated to public works projects that were approved in that bond issue.

ANALYSIS

This Office has been informed that the planning and building of the proposed Knox County Criminal Justice Center ("the Center") was completely funded from a bond issue, namely by Knox County Commission ("the Commission") Resolutions R-00-1-803 and R-00-1-804, which were adopted by the Commission on January 24, 2000 and May 23, 2000 respectively. Sections twelve and thirteen of the bond resolution, R-00-1-804, contain terms that limit any reallocation of bond proceeds to other public works projects approved in that particular bond issue. A further analysis of this conclusion is as follows:

The bond proceeds raised for the Center were raised pursuant to Title Nine, Chapter Twenty-one of Tennessee Code Annotated. That Chapter details Tennessee law on the issuance of general obligation bonds and the procedures which allow voters to object to such issuance. An Initial Resolution of the Commission, R-00-1-803, was published in accordance with Tenn. Code Ann.
§9-21-206 to notify the voters of Knox County of the proposed amount of the bonds to be issued, the purposes for which the bonds were to be issued and the maximum rate of interest which the bonds would bear. After this notice was published, the law allowed the public to seek a referendum on the issuance of the bonds if voters complied with certain requirements. *See* Tenn. Code Ann.

§9-21-207. Thus, the voters of Knox County had proper notification and a chance to object to the bond issuance and its terms under Tennessee law. Any reallocation of bond proceeds to uses that deviate from the purposes listed in the Initial Resolution would effectively deprive Knox County voters of their right to object to the issuance of the bonds.

The bond resolution involving the Center, R-00-1-804, contains several statements that indicate that the proceeds can only be used for those public works projects approved within that bond issue. Section Twelve, Use of Bonds Proceeds, states in subsection (c) that after interest and expenses are paid as prescribed by subsections (a) and (b), the remainder of the bond proceeds "shall be used solely for the purposes for which the Bonds were authorized." Subsection (c) does allow an exception for proceeds to be used to retire debt obligations incurred in anticipation of and for the same purposes as the bond proceeds.

Section Thirteen of the bond resolution also addresses the use of the bond proceeds as that use relates to the exempt status of the bonds under federal tax law. The first paragraph of that section states the following:

> (Knox) County agrees that it shall take no action and shall not fail to take any action, in either case where the result thereof may render the interest on any of the Bonds includible in federal gross income of the owners thereof (the bondholders) for purposes of federal income taxation and that the principal proceeds of the sale of the Bonds shall be devoted to and used with due diligence for the purposes for which the Bonds are hereby authorized to be issued.

Section Thirteen further states that a tax Certificate will be executed to:

> [A]ssure the purchasers and owners of the Bonds that the proceeds of the Bonds will not be used in a manner *which would or might* result in the Bonds being "private activity bonds" under [Internal Revenue Code] Section 141, "arbitrage bonds" under Section 148 of the [Internal Revenue] Code, or the regulations of the United States Treasury Department currently in effect or proposed or *which would or might* result in the inclusion of the interest paid on the Bonds in gross income of the recipients thereof for purposes of regular federal income taxation. Such Tax Certificate shall constitute a representation, certification and agreement of [Knox] County and *no investment or use* of Bond proceeds *or of monies accumulated to pay the Bonds herein authorized* shall be made in violation of the expectations and covenants prescribed by said Tax Certificate.

The Commission is limited by the terms quoted above when spending the bond proceeds since those are the only terms that have been properly approved by the voters of Knox County. Thus, the bond proceeds can only be reallocated to public works projects that were described in the initial resolution.

There is a question remaining regarding whether the tax funds raised by a recent property tax increase can be reallocated to other public works projects. Section Thirteen of the bond resolution does restrict the investment or use of "monies accumulated to pay the Bonds herein authorized" because of federal tax concerns. However, neither the property tax resolutions, R-00-6-SS-103 and R-00-8-802, nor any of the other resolutions passed by the Commission that address the Center, specifically allocate or reserve any funds from the property tax increase to or for the Center. The bond resolution itself does not address any allocation or reservation of funds from the property tax increase to or for the Center. Since the Commission has not formally dedicated a particular amount of the property tax funds to the Center either through the terms of the bond resolution or a separate resolution, those tax funds are not restricted by the terms of the bond resolution and are not treated in this opinion as funds that were dedicated to the Center. Although the property tax funds are not specifically restricted by the terms of the bond resolution, it is worth noting that a sufficient amount of tax revenue must be reserved to service the portion of the bonds the Commission authorized that have been issued and are outstanding.

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