

## Local Government Bond Pools

### PERFORMANCE AUDIT REPORT Issued May 22, 2003



WILLIAM O. MONROE, CPA

**STATE OF FLORIDA  
AUDITOR GENERAL**

*LOCAL GOVERNMENT BOND POOLS*

**PERFORMANCE AUDIT**

**PERFORMANCE AUDIT**

**LOCAL GOVERNMENT BOND POOLS**

**Table of Contents**

	<u>Page No.</u>
LETTER OF TRANSMITTAL.....	i
ABSTRACT.....	1
SCOPE, OBJECTIVES, AND METHODOLOGY.....	1
SUMMARY OF FINDINGS.....	3
FINDINGS AND RECOMMENDATIONS .....	7
<i>Loan Commitments</i> .....	12
<i>Out-of-State Loans</i> .....	18
<i>Bond Validations</i> .....	20
<i>Related Parties</i> .....	22
<i>Determination of Bond Sale Method and Selection of Bond Service Providers</i> .....	23
<i>Accountability and Reporting of Bond Transactions</i> .....	25
<i>Payments to Bond Service Providers</i> .....	28
<i>Oversight Related to Bond Pool Issues</i> .....	31
<i>Potential Need for Additional Bond Pools</i> .....	34
APPENDICES.....	36



WILLIAM O. MONROE, CPA  
AUDITOR GENERAL

# AUDITOR GENERAL STATE OF FLORIDA

G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450



850/488-5534/SC 278-5534  
Fax: 488-6975/SC 278-6975

May 22, 2003

The President of the Senate, the Speaker of the  
House of Representatives, and the  
Legislative Auditing Committee

Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that a  
performance audit be made of

## *LOCAL GOVERNMENT BOND POOLS*

The results of the audit are presented herewith.

Respectfully submitted,

*William O. Monroe*

William O. Monroe

Audit supervised by:  
Ted J. Sauerbeck

Audit made by:  
Charles E. McClellan

## *ABSTRACT*

### *PERFORMANCE AUDIT OF LOCAL GOVERNMENT BOND POOLS*

This abstract highlights the findings of audit report No. 03-187. The entire audit report should be read for a comprehensive understanding of our audit findings and recommendations.

## *SCOPE, OBJECTIVES, AND METHODOLOGY*

### *SCOPE*

The Auditor General is authorized by State law to perform independent audits of governmental entities in Florida. The scope of this audit included local government bond pools administered by local governments, or by other entities on behalf of local governments, and included an examination of transactions related to selected local government-related bonds issued for the purpose of making loans to local governments during the period January 1996 through January 2002.

Through examination of a database maintained by the Florida State Board of Administration, Division of Bond Finance (DBF), and other procedures, we identified 14 governmental entities operating bond pools with 59 bond pool issues totaling approximately \$3,800,000,000. From these, we selected a sample of 8 bond pool issues totaling \$1,683,000,000 for audit. These bond issues were selected based primarily on the type of entity issuing the bonds, the description of the bonds, and the size of the bond issue. The amount of the sampled bond issues represents 44 percent of the total identified bond pool issues. Details of the selected bond issues are shown on Appendix A.

### *OBJECTIVES*

The objectives of our audit were to:

- Determine the extent to which local government bond pools are operating in the State of Florida.
- Determine whether current State law provides for adequate oversight regarding the operation of local government bond pools.

- Determine whether local government bond pools complied with various sections of the Florida Statutes.
- Determine the extent to which controls over local government bond pools promoted compliance with Federal requirements.
- Evaluate the efficiency and effectiveness of existing bond pools in meeting the needs of local governments, including a determination as to whether all local governments, as appropriate, have reasonable opportunities to participate in bond pools.

#### METHODOLOGY

The methodology used to develop the findings in this report included the examination of pertinent records of local governments or other entities that administer bond pools in connection with the application of procedures required by generally accepted auditing standards and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

*In accordance with generally accepted auditing standards, management representation letters are obtained to confirm representations explicitly or implicitly given to the auditor, to document the continuing appropriateness of previous representations, and to reduce the possibility of misunderstanding concerning the matters that are the subject of the representations. Although requested, the Escambia County Health Facilities Authority did not provide us with a management representation letter. The Chairman of the Escambia County Health Facilities Authority, in his response, stated that "we have not received any audit of this Authority's bond issue and therefore decline to provide a letter of representations in the form you have requested. At such time as an audit document is received in this office, an appropriate management representation letter will be provided." The Preliminary and Tentative Findings document provided to the Authority on April 2, 2003, to which the Chairman has responded, describes the findings of our audit pertaining to the Authority's Series 2000A and 2000B bond pool issue and, as such, constitutes an audit of that bond issue. Although the City of Gulf Breeze responded to our request for a management letter, the response did not include several of the requested representations. In the absence of representation letters from the City of Gulf Breeze and the Escambia County Health Facilities Authority that provide all of the necessary representations, our ability to rely on the documentation and representations provided by the City and Authority is impaired.*

## SUMMARY OF FINDINGS

The following summarizes the results of our performance audit of State of Florida local government bond pools existing at January 2002.

*Finding No. 1: Of the eight bond pool issues we reviewed, the proceeds of only one, the City of Gulf Breeze Capital Funding Revenue Bonds, Series 1997A, were substantially loaned out to accomplish the public purposes for which the bonds were issued. Of the remaining seven bond pool issues, through January 2002 approximately \$1.45 billion of bond proceeds (91 percent of the total bonds issued) had not been loaned to accomplish the intended public purposes, while \$42,327,144 of bond issuance and administrative costs had been incurred. The effect of issuing these bonds without loaning a significant portion of the proceeds has been to generate significant investment earnings and significant fees for financial advisors, underwriters, insurers, attorneys, consultants, and other bond professionals, with minimal demonstrated benefit to the local governments and citizenry of Florida. This appears to be inconsistent with the provisions of Article VII, Section 10 of the State Constitution, in that it appears that private, rather than public, purposes were primarily served.*

*Finding No. 2: For the eight bond pool issues we reviewed through January 2002, \$72,320,000 of bond proceeds had been loaned to out-of-state local governments and nonprofit organizations, with no apparent benefit to citizens of the State of Florida. The issuers and their representatives generally maintained that the out-of-state loans benefited Florida citizens. However, for the bond issues we reviewed, the validation orders and other documentation provided did not clearly state the benefit to Florida citizens.*

*Finding No. 3: For some of the bond issues we reviewed, bond validations were made on a blanket basis and had no term limits; did not address what specific projects were intended to be financed with the bond issue; and were used by local government issuers and administrators as justification for issuing bonds with a myriad of purposes, including out-of-state loans for which there was no demonstrated benefit to Florida citizens.*

*Finding No. 4: Organizations used by one of the local government bond issuers to administer its local government loan program paid a total of \$39,445 to an employee of the local government for administrative services during the fiscal years ended September 30, 2000, and 2001. This situation may represent a conflict of interest in violation of Section 112.313(7)(a), Florida Statutes.*

*Finding No. 5: For the eight bond issues we reviewed, there was no documentation, of record, as to how the local governments determined that a negotiated sale was in the best interests of the issuers, borrowers, and citizens of the State of Florida. In addition, the issuers generally incurred certain issue costs, including underwriter fees, financial advisor fees, attorney fees, credit facility fees, insurance, and remarketing services, without benefit of a competitive selection process.*



*Finding No. 6: Our audit disclosed a lack of accountability and reporting for the eight bond issues we reviewed as follows:*

- Records on bond pools to ensure proper accountability for the bond funds were not available for six of the eight bond pool issues. Our review of trustee account statements disclosed several errors made by the trustee for three bond issues, which may have been prevented or detected had accounting records been maintained.*
- Each bond pool earned millions of dollars in interest on investments (at least \$157 million collectively for the eight bond issues we reviewed). The amounts of interest earned were accepted at face value by the local governments without verification.*
- Although requested, we were not provided with a schedule of sources and applications of funds from the date of issuance for each bond pool issue and, as such, we prepared such schedules through January 2002 based on information provided by the issuers and other parties to the bond programs. We requested that the local governments or their designated representatives verify the schedules; however, for three bond issues, the local government issuers were unable to determine, without qualification, the accuracy and reliability of source and application of funds information for each bond issue. For three other bond issues, for which the issuer did verify the schedules, calculated balances (total sources less total applications) exceeded actual balances by a total of \$2,101,936.*
- Three of the local government issuers provided for audits for the fiscal years ended September 30, 2000, and September 30, 2001, pursuant to Section 218.39, Florida Statutes; however, the seven bond issues we reviewed for these entities were not included within the scope of those audits. Nor did these entities otherwise provide for separate audits of their bond pool operations for the fiscal years ended September 30, 2000, and September 30, 2001.*

*Finding No. 7: For the eight bond issues we reviewed, adequate documentation was generally not available to support payments for professional services and related expenses. Our review of approximately \$17,000,000 of issue costs paid disclosed that \$6,698,449 of such costs were not supported by invoices or other documentation, or were supported by documentation that was not adequate to demonstrate the propriety of the payments.*

*Finding No. 8: It appears there is a need for additional oversight over bond pools, given the findings noted in this report. Additional oversight for bond pool issues, other than bonds issued by finance commissions created pursuant to Section 163.01(7)(d), Florida Statutes, could be accomplished by:*

- Requiring that all such bond pool issues be issued by the Division of Bond Finance or by a newly created State or other finance commission, or by*
- Designating the Division of Bond Finance or other existing State agency, or establishing a newly created governmental or nonprofit entity, to be responsible for approving all such bond pool issues prior to issuance.*

*Finding No. 9: There appears to be a need to make additional bond pool financing available to local governments within the State of Florida. There are several means by which this could be accomplished, such as establishing a State Finance Commission or multiple finance commissions, or by authorizing a State agency to operate a bond pool consistent with provisions of the State Constitution.*

Management responses to the audit findings and recommendations are presented as [Appendix C](#).

*FINDINGS AND RECOMMENDATIONS*

Local governments often issue bonds to secure financing for the provision of public services, when the provision of such services from currently available resources is impractical. Bonds are typically issued to finance major capital projects or acquisitions. To facilitate the issuance of bonds, improve their marketability, and minimize the costs of issuance and borrowing, many local governments have elected to participate in pooled bond financing arrangements. Under such arrangements, bonds are issued by local governments, either individually or jointly, for the purpose of making loans to other governments and qualified nonprofit corporations for capital projects or other purposes.

Article VII, Section 12 of the State Constitution, authorizes counties, municipalities, and special districts with taxing authority to issue bonds to finance or refinance capital projects authorized by law when approved by a vote of electors or to refund outstanding bonds. Certain other Florida laws grant local governments the authority to issue bonds under specific circumstances. For example:

Chapters 125 and 166, Florida Statutes, provide general authority for the issuance of bonds by counties and municipalities, respectively.

Chapter 159, Florida Statutes, authorizes counties, municipalities, and certain special districts to issue bonds for various capital projects and conduit debt. Section 159.416, Florida Statutes, provides that such entities may issue bonds to fund a pool financing program.

Section 154.219, Florida Statutes, provides for the issuance of revenue bonds by health facilities authorities.

Section 163.01(7)(d), Florida Statutes, provides the authority for two or more counties or municipalities to enter into an agreement to jointly issue debt. For purposes of this report, such entities formed by such agreements are referred to as finance commissions. In Florida, bonds for the purpose of providing loans to local governmental entities (i.e., counties, municipalities, and special districts) are generally issued either by finance commissions or by individual governmental entities. Our audit was limited to individual local governmental entity bond pool issues and did not include bond pools administered by finance commissions; however, in this report we have referred to finance commissions for comparative purposes.

In addition to the above-noted State laws, United States Internal Revenue Code (IRC) and related U. S. Treasury Regulations govern the issuance of tax exempt bonds for loans to local governments. Specific provisions of law and the IRC are discussed in the various findings in this report.

For purposes of our audit, bond pools were considered to be programs under which bonds are issued by individual local governmental entities for the purpose of making loans to one or more entities to provide financing for capital projects or other purposes.

*Follow-up to Escambia County Health Facilities Authority Response*

*The responses to the findings in this report by the issuers of the bond pools included within the scope of this audit have been appended, in their entirety, to this report (see Appendix - C). While most issues raised by the responses were addressed within the findings themselves, where necessary we have provided additional clarification following specific findings to address certain responses.*

*The Chairman of the Escambia County Health Facilities Authority, in addition to providing responses to the individual findings in the report, provided a general response relating to the nature of the audit and the qualifications of the auditors. The following is provided in response to the general issues raised by the Chairman:*

- *The Chairman indicated that the Authority and its counsel spent numerous hours explaining various aspects of the bond pool program, but the information provided was wholly disregarded by us. To the contrary, the information provided by the Authority and its counsel was considered and, in many instances, was directly addressed within the findings. For example, the circumstances discussed by the Chairman as impacting the ability to loan the bonds proceeds were specifically addressed in Finding No. 1 and the fact of differing opinions on the application of Internal Revenue Service (IRS) regulations was specifically addressed in Finding No. 8. Having divergent views should not be construed as disregarding information provided to us.*
- *The Chairman indicated that the question of whether or not programs serve the public interest is an issue that is committed by law to local officials and the courts, and not to the Auditor General. To the contrary, Section 11.45(2)(k), Florida Statutes, authorizes the Auditor General to conduct audits of local governmental entities, and Section 11.45(1)(a), Florida Statutes, defines "audit" as a financial audit, operational audit, or performance audit. "Performance audit" is defined by Section 11.45(1)(h), Florida Statutes, to include, in addition to legal compliance, issues related to: economy, efficiency, and effectiveness of the program; structure or design of the program to accomplish its goals*

*and objectives; adequacy of the program to meet the needs of the Legislature or governing body; and alternative methods of providing program services. As indicated in the Preliminary and Tentative Findings that were delivered to the Chairman, this was a performance audit.*

- *The Chairman questioned whether auditors have the necessary experience, capability, and understanding to determine whether bond programs are beneficial, as "... evidenced by the fact that the Auditor General's report completely ignores the benefits that accrue from the existence of capital bond programs, whether or not they are, in fact, utilized by the intended beneficiaries." In Finding No. 9, we not only acknowledged the benefits of bond pools, but suggested the creation of additional bond pools to meet the needs of additional borrowers; however, it is difficult to discern the benefits that may be derived from bond issues when very few, if any, loans are actually made to anyone from the proceeds. As to the knowledge, capability, and understanding needed to audit the bond programs, the staff of the Auditor General's Office has many years of experience in auditing bond issues at both the State and local government levels. We believe that the findings in this report demonstrate the application of that experience to the subject.*
- *The Chairman indicated that the audit report implies that taking advantage of existing Federal tax laws and the IRS Code to issue bonds is somehow contrary to the public interest of the people of the State of Florida. Nowhere in this report is such an opinion either expressed or implied. In Finding No. 8, we addressed the need to provide greater assurance that the relevant IRS Code provisions are complied with to assure the tax-exempt status of the bonds. The Chairman also inquired as to why the Auditor General would side with the IRS in criticizing the bond pool programs, but did not indicate in what respect we may have sided with the IRS. Again, in Finding No. 8, we pointed out situations in which IRS Code provisions may be subjected to varying interpretations and pointedly stated that the objectives of our audit did not include a determination of compliance with the Internal Revenue Code.*
- *The Chairman indicated that the representatives of the Auditor General's Office had an existing bias against pool bond issues and went into the review process with the goal of making adverse determinations. While the Chairman*

*provided no basis for this observation, it must be assumed that it was prompted by the inclusion in this report of audit findings that may be construed as criticisms of the administration of the Authority. We believe that the findings stand on their merits. As to a bias against pool bond issues, again, we have recommended in Finding No. 9 an expansion of the bond pool concept to provide the advantages inherent therein to additional local governments.*

#### *Follow-up to City of Gulf Breeze Response*

*The Mayor of the City of Gulf Breeze, in his response to the findings in this report, also included a general response for which additional clarification is required as follows:*

- *The Mayor expressed concern that the Auditor General's Office chose to narrowly focus on programs in various parts of the State that did not meet standards defined by the Auditor General, as opposed to examining the City's entire finance program. The Mayor is correct in that the scope of this audit did not include a review of the City's entire finance program, but rather a review of selected bond pool issues within the State of Florida. The selection of bond pool issues for examination as part of this audit was based, in part, on a risk analysis that, as indicated in the Scope section of this report, included such factors as the type of entity issuing the bonds, the descriptions of the bonds, and the sizes of the bond issues. It was not practical for us to examine all 59 bond pool issues identified for the audit period. We have no reason to believe that examination of additional bond pool issues would have disclosed results significantly different than the results of our examination of the 8 bond issues. However, even if all of the proceeds of the other 51 bond pool issues were loaned out, the existence of significant amounts of unloaned proceeds for the 8 bond pool issues we selected alone demonstrates a problem that needs to be addressed.*
- *The Mayor referred to an attempt by this Office to coerce the Florida legislature to restrict the ability of a local government to operate as it has for many decades and, in responses to specific findings, has characterized the findings as questioning, or being critical of, the legislature. To the contrary, the Florida legislature relies on this Office to suggest ways of improving the effectiveness and efficiency of government operations in Florida by recommending revisions to existing Florida Statutes.*

- *The Mayor has indicated in his response that we have advocated in our findings that the Florida legislature limit the power of local governments, and that any such restriction would be inconsistent with the principles of municipal home rule. We have not recommended in this report that municipalities be prohibited from issuing pool bonds. Rather, we have recommended that the law be changed to establish certain safeguards with respect to such bond issues. The Florida legislature has, in the Florida Statutes, already established numerous requirements with which municipalities and other local governments must comply, including the provisions of Section 218.385, Florida Statutes, regarding local government bond issues.*
- *The Mayor has indicated in several parts of his response that the City's bond pool programs have cost the citizens of Florida nothing and have caused no harm to those citizens. The costs of the bond issues we examined were paid from bond proceeds and interest earnings thereon or, in those instances where loans were made, by borrowers. Regardless of how such costs were paid, the point of our Finding No. 1 is that the effect of issuing these bonds without loaning a significant portion of the proceeds has been to generate significant fees for various private interests with minimal demonstrated benefit to the local governments and citizenry of Florida. As indicated in Finding No. 1, this appears to be inconsistent with the provisions of Article VII, Section 10, State Constitution, the purpose of which is to protect public funds and resources from being exploited in assisting or promoting private ventures. Further, any bonds issued in Florida, including bond issues such as those selected for our examination, that are not issued and administered in a prudent manner, or that lose their tax exempt status because of noncompliance with IRC requirements, could have an adverse effect on the bond market in Florida.*
- *In his responses to Findings Nos. 2 and 3, the Mayor characterizes the findings as questioning the courts. We have not questioned any decisions of the courts in these findings, but rather have recommended changes in the Florida Statutes to improve the court validation process for bond pool issues.*

## ***FINDING No. 1: Loan Commitments***

There are various provisions of law that authorize the issuance of bonded debt by counties, municipalities, and certain special districts, either individually or jointly, for various purposes, including providing loans to other local governments. Such laws include Sections 125.01(1), 154.219, 159.416(1), 163.01, and 166.121(2), Florida Statutes. These laws, with respect to bond pools, generally do not address whether such bond pools should be operated as blind pools (pools that do not require an upfront identification of actual borrowers and projects and that are issued only on the basis of non-binding demand surveys), although Section 159.416(1), Florida Statutes, indicates that bonds may be issued to fund a "pool financing program," under which the bond proceeds may be used to make loans to borrowers that may or may not be identified at the time the bonds are issued.

Our audit included a review of eight bond pool issues by four individual local governmental entities (see additional discussion on page 1). Of the eight bond pool issues we reviewed, the proceeds of only one, the City of Gulf Breeze Capital Funding Revenue Bonds, Series 1997A, was substantially loaned out to accomplish the public purposes for which the bonds were issued. The following tabulation shows for each of the remaining seven bond pool issues, the amount issued, loans made through January 31, 2002, the percentage of the bond issue that was actually loaned, issuance and administrative costs incurred, and percentages of issuance and administrative costs to the amount of bonds issued and loans made:



Description of Bonds	Bond Issue Amount	Loans Made Through 1/31/2002 (a)	Percent Loans/ Bond Issue	Costs Related to Bond Issue	Percent Costs/ Bonds Issue	Percent Costs/ Loans Made
Escambia County Health Facilities Authority - Health Care Facility Revenue Bonds Series 2000A and 2000B (issued 7/1/2000)	\$156,500,000	\$30,000,000	19.2	\$6,067,610	3.9	20.2
City of Gulf Breeze - Variable Rate Demand Revenue Bonds Series 1995A (issued 4/1/1996)	50,000,000	17,236,000	34.5	2,697,195	5.4	15.6
City of Gulf Breeze - Variable Rate Demand Healthcare Revenue Bonds Series 1999 (issued 4/16/1999)	300,000,000	23,217,061	7.7	14,588,996	4.9	62.8
City of Moore Haven Capital Projects Finance Authority - Revenue Bonds Series 1997A (issued 8/26/1997)	165,000,000	40,190,700	24.4	4,860,205	2.9	12.1
City of Moore Haven Capital Projects Finance Authority - Variable Rate Demand Revenue Bonds Series 1998A (Hospital) (issued 6/24/1998)	300,000,000	5,055,000	1.7	8,625,221	2.9	170.6
City of Moore Haven Capital Projects Finance Authority - Variable Rate Demand Revenue Bonds Series 2000H (Airport) (issued 12/14/2000)	300,000,000	34,455,000	11.5	2,902,013	1.0	8.4
Orange County Health Facilities Authority - Variable Rate Demand Revenue Bonds Series 2000A (issued 6/29/2000)	330,000,000	0	--	2,585,904	0.8	--
Totals	\$1,601,500,000	\$150,153,761	9.4	\$42,327,144	2.6	28.2
(a) As of August 31, 2002, a total of \$28,441 of additional loans had been made subsequent to January 2002 from the proceeds of the City of Gulf Breeze Series 1999 Bonds.						

As shown in the above tabulation, through January 2002 only \$150,153,761, or 9 percent, of the \$1,601,500,000 of bond proceeds was used to make loans, while \$42,327,144 of bond issuance and administrative costs had been incurred (see Appendix B for details of issuance and administrative costs). Thus, approximately \$1.45 billion of bond proceeds (91 percent of the total bonds issued) had not been loaned to accomplish the intended public purposes. In addition, although the total issuance and administrative costs as a percentage of bonds issued for these bond issues ranged from .8 to 5.4 percent, these costs were high in comparison to bond proceeds actually loaned. As shown in the above tabulation, the total issuance and administrative costs as a percentage of loans made for six of these bond issues ranged from 8.4 to 170.6 percent. Because no loans were made from the Orange County Health Facilities Authority issue, costs as a percentage of loans made could not be calculated.

We recognize that there may have been other bond pool issues for which the proceeds were substantially loaned out for anticipated projects. However, we believe that the number and size of the bond pool issues stated above, from which loans of the bond pools were minimal, disclosed a condition that needs to be addressed. A common characteristic of these bond issues is that they were

issued based on non-binding demand surveys in which the issuers' representatives sent surveys to potential borrowers to determine their interest in participating in an issue as a borrower. No binding commitments or applications were required, and the efforts, of record, made to determine the level of interest and credit-worthiness of potential borrowers, specific identification of projects considered for funding, and the likelihood of potential borrowers to participate in the issue varied significantly among the issuers. We did find that the Escambia County Health Facilities Authority, for several potential borrowers identified with respect to its \$156,500,000 Series 2000A and 2000B bond pool issue, obtained resolutions from county and municipal governments indicating an interest on the part of the potential borrowers within their jurisdictions to borrow bond proceeds for various projects. The Authority also obtained other information, such as financial statements, utilization statistics, and forecast assumptions, that could be used to assess the credit-worthiness and likelihood of participation of potential borrowers. However, these efforts could have been enhanced by obtaining resolutions from the governing bodies of the potential borrowers. Efforts made, of record, by the other three issuers (City of Gulf Breeze, City of Moore Haven Capital Projects Finance Authority, and Orange County Health Facilities Authority) to assess the credit-worthiness and likelihood of participation of identified potential borrowers were minimal. Although the other issuers have asserted that extensive efforts were made, documentation of such efforts was not retained and presented for audit.

The issuers, administrators, and bond counsel have suggested various reasons for the inability to loan substantial amounts of the bond proceeds. These reasons include public pronouncements by the IRS raising concerns over the viability of bond pools, reluctance on the part of insurers and letter of credit providers to authorize loans due to credit concerns regarding the borrowers, and a general decline in economic conditions, including increased costs of providing health care services (e.g., increased insurance rates for nursing and other health care facilities). While there are many reasons why a prospective borrower might ultimately decide not to, or be unable to, borrow, issuing bonds primarily on the basis of non-binding demand surveys, with minimal effort to evaluate the level of commitment, credit-worthiness, and likelihood of participation for potential borrowers, is likely to result in a lower level of utilization of the bond proceeds for the intended purposes. For example, determinations of credit worthiness as part of an application process prior to issuance would minimize the concerns of insurers and letter of credit providers. Also, requiring potential borrowers to submit resolutions from their governing boards indicating their intent to borrow bond proceeds for specific projects would help provide assurance as to the likelihood of participation by borrowers.

We did find that bond pool issues by finance commissions as authorized by Section 163.01(7)(d), Florida Statutes, were generally more successful in utilizing the proceeds for their intended purposes. A significant distinction between the

bond pool issues we reviewed and those issued by finance commissions is the higher level of commitment by potential borrowers prior to the issuance of the bonds and level of effort to determine the credit-worthiness of potential borrowers.

Article VII, Section 10 of the State Constitution, prohibits local governments from giving, lending, or using their taxing power or credit to aid a corporation, association, partnership, or person. According to Attorney General Opinion No. 96-90, the purpose of this provision is "to protect public funds and resources from being exploited in assisting or promoting private ventures when the public would be at most incidentally benefited." Article VIII, Section 2(b) of the State Constitution, provides home rule powers for municipalities. However, the State Supreme Court of Florida concluded, in the case of *State v. Orlando*, 576 So. 2d 1315 (1991), that borrowing money for the primary purpose of reinvestment is not a valid municipal purpose as contemplated by Article VIII, Section 2(b) of the State Constitution. Special districts do not have home rule powers, and we are unaware of any specific legal authority, for the three special districts that issued the bonds that we reviewed, to borrow money for the primary purpose of reinvestment.

We are not aware of any intent on the part of the issuers to issue bonds for the primary purpose of reinvestment, or of any arbitrage investment earnings that were not subject to rebate in accordance with IRC or U. S. Treasury Regulations. However, the basic premise encompassed by the above-noted constitutional provisions and State Supreme Court ruling is that a governmental entity should not issue bonds for a purpose other than a public purpose. The governmental entities that issued the bonds we reviewed may have intended that such bonds be used to make loans to other entities for capital projects or other public purposes. However, the effect of issuing these bonds without loaning a significant portion of the proceeds has been to generate significant investment earnings and significant fees for financial advisors, underwriters, insurers, attorneys, consultants, and other bond professionals, with minimal demonstrated benefit to the local governments and citizenry of Florida. This appears to be inconsistent with provisions of Article VII, Section 10 of the State Constitution, and the above-noted State Supreme Court ruling, in that it appears that private, rather than public, purposes were primarily served. It is not our intention to suggest that the issuers did not expect to loan the proceeds of the issues, but rather that a lack of due diligence in assessing the likelihood of loans contributed to the lack of use of the proceeds for intended purposes.

### **Recommendation**

**The Legislature should amend Section 159.416(1), Florida Statutes, and other applicable provisions of law, including Sections 125.01(1), 154.219, 163.01, and 166.121(2), Florida Statutes, to minimize the likelihood that bond pools will be established without significant utilization of the proceeds for the intended**

purposes. The Legislature should amend these laws to prescribe procedures that potential bond pool issuers must use to demonstrate that due diligence has been exercised in determining that there is a demonstrated need for such financing. Such procedures could include, for example, requiring prospective borrowers, prior to the issuance of the bonds, to submit applications containing detailed information about projects and demonstrating that the applicant's financial condition is adequate to allow for the completion of such projects and repayment of loans. In addition, borrowers could be required to submit resolutions from their governing boards indicating their intent to borrow bond proceeds to finance specific projects. As discussed in Finding No. 8, there would also be a need for additional oversight to ensure that such due diligence is exercised.

Follow-up to Escambia County Health Facilities Authority Response

*The Chairman of the Escambia County Health Facilities Authority, in his response to this finding, expressed concerns that we limited our review to only those bond pool programs that have not yet loaned out significant amounts. The selection of the 8 bond pool issues we examined was based, in part, on a risk analysis that included various factors as indicated in the Scope section of this report. The selection was made without previous knowledge as to whether or not significant amounts of loans had been made from the selected bond pool issues.*

*The Chairman further indicated in his response to this finding that we had made judgments about the success of the loan program in the middle of the origination period. IRC 149(f)(2)(A) provides that beginning on the date of the issue, the issuer must reasonably expect that 95 percent of the net proceeds of the issue will have been used directly or indirectly as of the close of a 3-year period to make or finance loans to ultimate borrowers. In the case of the Authority's Series 2000A and 2000B bonds, issued July 1, 2000, the 3-year period expires July 1, 2003. However, based on documentation provided to us by the Authority, only \$30,000,000 of the net bond proceeds have been loaned as of January 10, 2003, for qualified public purposes leaving the Authority less than six months to loan an additional \$98,250,000 from the net bond proceeds to comply with the 3-year requirement. Additionally, the Chairman did not identify any additional loans in his response dated May 2, 2003, less than two months from the close of the 3-year period.*

Follow-up to Capital Projects Finance Authority and City of Gulf Breeze Responses

*The Program Administrator for the Capital Projects Finance Authority further indicated in his response to this finding that the comparison of costs to loans made, as shown in the tabulation on page 13, was meaningless as none of the bond issuance costs were paid by the borrowers. A similar response was provided by the Mayor of the City of Gulf Breeze with respect to the pool bonds issued by the City. The costs shown on the tabulation include both issuance and recurring administrative costs; however, the point of the finding was not that the borrowers paid excessive costs, but rather that there was minimal benefit from the bond pool issues in relation to the amount of funds paid to the various bond professionals involved in the issues.*

*The Mayor of the City of Gulf Breeze further indicated in his response that the lack of inclusion of the City of Gulf Breeze Capital Funding Revenue Bonds, Series 1997A, in the tabulation shown on page 13 results in a skewed analysis. The tabulation was presented for the purpose of demonstrating the lack of significant borrowing from these specific issues despite the incurrence of significant issuance and administrative costs. We did not contend or imply that these results could be extrapolated to all bond pool issues, but rather were establishing that there were 7 bond pool issues for which the amount of moneys used for the intended purposes did not justify the amount of such costs.*

Follow-up to Orange County Health Facilities Authority and Capital Projects Finance Authority Responses

*The Chairman of the Orange County Health Facilities Authority and the Program Administrator for the Capital Projects Finance Authority indicated in their responses to this finding that due diligence was performed with respect to their bond pool issues and described various procedures that were applied in an effort to assure the success of the issues. While we agree that the described procedures would be helpful in assuring that the bond proceeds would be loaned, the procedures evidently were not effective, in the absence of some type of stronger commitments from the potential borrowers, in assuring that the bond proceeds were substantially loaned. Further, although requested, documentation of the application of the described procedures was generally not made available for our examination.*

**FINDING No. 2: Out-of-State Loans**

Loans from bond pools to local governments and other entities within the State of Florida generally provide benefits to Florida citizens, businesses, and organizations by providing for the delivery of needed services by, for example, funding the construction of housing and hospital facilities within Florida. However, as shown below, \$72,320,000 of loans were made to out-of-state local governments and nonprofit organizations with no apparent benefit to Florida citizens:

Bond Issue	Loaned To	Purpose	Amount
City of Moore Haven Capital Projects Finance Authority Variable Rate Demand Revenue Bonds, Series 2000H	Springfield, Missouri	Airport improvements	\$34,455,000
City of Moore Haven Capital Projects Finance Authority Revenue Bonds, Series 1997A	Utilities Board of Trussville, Alabama	Waterworks and gas distribution system	7,865,000
Escambia County Health Facilities Authority Health Care Facility Revenue Bonds, Series 2000A and 2000B	Hutchinson Hospital Corporation in Hutchinson, Kansas	Nonprofit hospital	30,000,000
Total Loaned Out-of-State			\$72,320,000

In addition to the above loans, there appears to have been an intention on the part of certain bond pool issuers to loan money out-of-state on a much broader scale. For example, we noted the following:

- In November 1999, the Capital Trust Agency, a nonprofit corporation created to act as a finance commission (see additional discussion in Finding No. 4) pursuant to Section 163.01, Florida Statutes, obtained validation for \$900,000,000 of bonds to be issued to create a Health Facilities Loan Program. Subsequently, in April 2000, the Capital Trust Agency entered into an interlocal agreement with the Escambia County Health Facilities Authority, which provided for the Authority to issue \$156,500,000 in bonds (Escambia County Health Facilities Authority Health Care Facility Revenue Bonds, Series 2000A and 2000B) for loans to nonprofit healthcare facilities as part of the Health Facilities Loan Program (as shown in the above tabulation, \$30,000,000 of the \$156,500,000 bond issue was loaned to a nonprofit healthcare corporation located in Hutchinson, Kansas). The interlocal agreement indicated that substantial amounts of the proceeds of the \$900,000,000 of validated bonds would be used to finance projects located outside the State of Florida, and that the Authority was willing to permit portions of the proceeds of the \$156,500,000 bond issue to be used for projects located outside the State of Florida. The interlocal agreement further provided that the Capital Trust Agency would pay to the Authority two basis

points for each loan made within the State of Florida, and the Authority would pay the Capital Trust Agency two basis points for each loan made outside the State of Florida. Based on the provisions of the interlocal agreement, as much as an additional \$870,000,000 of bonds could potentially be issued and used for out-of-state loans.

- The City of Moore Haven Capital Projects Finance Authority established a loan program in coordination with the American Association of Airport Executives to loan money mostly to construct and renovate airports throughout the United States. Pursuant to the program, the City of Moore Haven Capital Projects Finance Authority Variable Rate Demand Revenue Bonds, Series 2000H, in the amount of \$300,000,000, were issued in December 2000. The Series 2000H Bonds Official Statement, dated December 13, 2000, indicated that borrowers under the program included entities from any state in the United States and its territories. Although only one loan was made from this program (to the City of Springfield, Missouri, for \$34,455,000), the program's intention was to make mostly out-of-state loans as evidenced by the fact that 34 of 36 demand surveys were obtained from out-of-state entities. As such, there is the potential for the remaining un-loaned Series 2000H bond proceeds to be used for out-of-state loans.
- Effective March 13, 2001, the City of Moore Haven Capital Projects Finance Authority obtained validation for an additional \$3,000,000,000 in bonds. The validation order provides that the proceeds will be used within the State of Florida, within the states of the United States, and within the area of operation of other public agencies for the acquisition, construction, rehabilitation, improvement, and equipping qualifying projects, including infrastructure, administrative facilities, educational facilities, community redevelopment, industrial development, and health care facilities. Section 15 of the \$3,000,000,000 bond validation order provides that the use of the proceeds of the validated bonds to finance qualifying projects outside the State of Florida serves a public purpose within the State of Florida in that such financing has a sufficient nexus to issuers and the State of Florida by creating credit-worthy means of financing qualifying projects within the State of Florida, and by establishing and promoting capital markets for the issuers' bonds and notes for qualifying projects within the State of Florida.

These loans were generally made, or intended to be made, pursuant to interlocal agreements under Section 163.01, Florida Statutes. We recognize that there may be instances where out-of-state loans benefit the citizens of the State of Florida, such as described in Section 154.247, Florida Statutes, or where there is a mutual benefit to an in-state and out-of-state entity as provided for in Section 163.01, Florida Statutes. However, neither these sections of law, nor other sections of law authorizing local government bond issues (e.g., Chapters 125, 154, 159, and 166, Florida Statutes), provide authority for proceeds of bonds to be used to

make loans to entities located outside the State of Florida, when there is no apparent benefit to Florida citizens.

The issuers and their representatives generally maintain that the courts, in validating the above-noted bond issues, determined that the out-of-state loans benefited Florida citizens. However, for the bond issues we reviewed, the validation orders and other documentation provided did not clearly state the benefit to Florida citizens for out-of-state loans. Further, it is not apparent how the State of Florida could have been the primary beneficiary of out-of-state loans made from the proceeds of the Escambia County Health Facilities Authority Series 2000A and 2000B bonds, and the City of Moore Haven Capital Projects Finance Authority Series 2000H bonds, since no loans were made from the proceeds of those bonds to entities within the State of Florida.

### **Recommendation**

**Issuers of bonds used to make out-of-state loans should clearly document how such loans benefit citizens of the State of Florida. In the absence of a demonstrated benefit to Florida citizens, such loans should not be made.**

#### **Follow-up to Escambia County Health Facilities Authority Response**

*The Chairman of the Escambia County Health Facilities Authority, in his response to this finding, indicated that the courts recognize the economic benefits to be obtained by lending bond pool proceeds to out-of-state borrowers, and that the Florida legislature expressly amended Chapter 154, Florida Statutes, to make clear that benefits do accrue to Florida hospitals by the financing of out-of-state facilities. As stated in the finding, we recognize that there may be instances where out-of-state loans may benefit Florida citizens, such as those described in Section 154.247, Florida Statutes. That Section permits the Authority to issue bonds for an out-of-state nonprofit organization that is under the control of a health facility located within the Authority's jurisdiction. However, we were not provided documentation demonstrating that the nonprofit healthcare corporation located in Hutchinson, Kansas, to whom \$30,000,000 was loaned from the Series 2000A and 2000B bonds, was under the control of a health facility located within the Authority's jurisdiction.*

### **FINDING No. 3: Bond Validations**

Pursuant to Chapter 75, Florida Statutes, any county, municipality, taxing district or other political district or subdivision of this state, may determine its authority to incur bonded debt, and the legality of all proceedings in connection therewith.



To accomplish this, a complaint must be filed in the circuit court in the county where the local government is located against the state and the taxpayers, property owners, and citizens of the county, municipality or district. Pursuant to Section 75.04, Florida Statutes, the complaint must set out, among other things, the ordinance, resolution, or other proceeding authorizing the issue and its adoption; all other essential proceedings; the amount of the bonds to be issued and the interest they are to bear; and all other pertinent matters. If the court validates the bonds, the court's judgment is conclusive as to all matters adjudicated and the validity of the bonds can never be called in question in any court.

All of the bond issues discussed in this report, except for the Orange County Health Facilities Bonds, Series 2000A, were validated. However, as evidenced by the findings in this report, the bond validation requirements existing in current law do not appear to be effective in ensuring that local government bond pool issues are primarily serving a public purpose.

Validations of local government bonds included in our audit were made on a blanket basis and had no term limits. These bond validations addressed a myriad of purposes and were used by local governments to issue bonds several years after the date of the validation. For example, a \$750,000,000 bond validation dated in October 1993 was used as the basis by the City of Moore Haven Capital Projects Finance Authority to issue bonds in August 1997 to loan funds to other local governments for local government projects and to issue bonds in June 1998 to loan to nonprofit organizations to construct or renovate health facilities. The validation noted that the plaintiff, after due and proper proceedings, had determined that "within the territory of the Plaintiff, within this state and within the states of the United States there is a demand for Anticipation Financings and for the acquisition, construction, rehabilitation, improvement and equipping of Qualifying Projects, including infrastructure, administrative facilities, community redevelopment, industrial development and health care facilities and there is a shortage of readily available capital for investment in Qualifying Projects." However, neither the validation complaint or validation order addressed what specific projects were intended to be financed with the bond issue. A subsequent validation made in September 1998 for an additional \$750,000,000 also did not address specific projects intended to be financed. In all, the two bond validations were used for eleven bond issues totaling \$1,075,520,000 between August 1997 and June 2001 for various purposes, ranging from solid waste disposal to student housing to airport renovation and construction. As discussed in Finding No. 2, the bond validation provisions were also used to justify out-of-state loans that provided no apparent benefits to citizens of the State of Florida.

Chapter 75, Florida Statutes, does not require that the bond validation complaint filed by the plaintiff, or the bond validation order issued by the court, address

the specific purposes of bond issues, including specific projects to be financed, or the specific time period in which the bonds are to be issued. Without a specified time period, it is possible that the original circumstances, or laws in existence at the time of validation, may change significantly prior to the validated bonds being issued.

### **Recommendation**

**The Legislature should amend Chapter 75, Florida Statutes, to require that the public purposes, and benefits to the citizens of the State of Florida, provided by the bond issues, and the specific time period in which the bonds are to be issued, be included in bond validation complaints and addressed in bond validation orders.**

#### ***Follow-up to Capital Projects Finance Authority Response***

*The Program Administrator for the Capital Projects Finance Authority indicated in his response to this finding that our conclusion that the bond validation complaint did not adequately explain the benefit to Florida citizens is contradicted by the final judgment issued by the Court. We concur that the Court's final judgment did not address any inadequacies in the explanation of benefits to the citizens. The point of our finding was that Chapter 75, Florida Statutes, currently does not require that the specific purposes of the bond issues, including specific projects to be financed, be included in the validation complaint and that Florida law should be amended to require that information to enhance the benefits that may be derived from the validation process.*

#### **FINDING No. 4: Related Parties**

Gulf Breeze Financial Services and Capital Trust Agency are nonprofit corporations created to administer bond programs for the City of Gulf Breeze. Gulf Breeze Financial Services administers the City of Gulf Breeze Local Government Loan Program under which all City of Gulf Breeze bonds that we reviewed were issued. Capital Trust Agency, which was created pursuant to an interlocal agreement between the City of Gulf Breeze and the Town of Century, administers the City of Gulf Breeze Health Facilities Loan Program (see additional discussion in Finding No. 2).

Pursuant to Section 112.313(7)(a), Florida Statutes, no local government officer or employee may have or hold any employment or contractual relationship with any entity that is subject to the regulation of, or is doing business with, the local government. The audit reports for the City of Gulf Breeze for the fiscal years ended September 30, 2000, and 2001, disclosed that payments by Gulf Breeze Financial Services and Capital Trust Agency had been made to the City Manager

of the City of Gulf Breeze for administrative services. According to the City Manager's contracts with these entities, he was to provide administrative oversight, management, and marketing services related to the City's Loan Programs. According to the audit reports, the City Manager was paid a total of \$28,970 by Gulf Breeze Financial Services and \$10,475 by Capital Trust Agency for such services during the fiscal years ended September 30, 2000, and 2001.

Given that the City Manager is in a position to influence the City's decisions regarding the bond issues and its dealings with Gulf Breeze Financial Services and Capital Trust Agency, and is being compensated both by these entities and the City, it appears that this situation may represent a conflict of interest in violation of Section 112.313(7)(a), Florida Statutes.

In response to our inquiry, the attorney for the City of Gulf Breeze, in a memorandum dated December 2, 2002, indicated that no conflict of interest exists because Gulf Breeze Financial Services is essentially an arm of the City, is not subject to regulation by the City, and does not do business with the City as contemplated by Section 112.313(7)(a), Florida Statutes. However, the premise for our contention that a conflict may exist under Section 112.313(7)(a), Florida Statutes, is that Gulf Breeze Financial Services is a separate legal entity and the City Manager was paid as an employee of the City and as an independent contractor doing business with Gulf Breeze Financial Services. If, as the attorney for the City maintains, Gulf Breeze Financial Services should not be treated as a separate legal entity, then the City Manager's relationship with the City as both an employee and independent contractor would appear to be a conflict of interest in violation of Section 112.313(3), Florida Statutes, which prohibits an employee of a municipality from providing services to the same municipality.

### **Recommendation**

**The City of Gulf Breeze should consult with the Florida Commission on Ethics to determine whether the above-noted situation constitutes a conflict of interest in violation of Section 112.313(7)(a), Florida Statutes.**

### ***FINDING No. 5: Determination of Bond Sale Method and Selection of Bond Service Providers***

In audit report No. 01-075, Finding No. 10, we noted that Section 218.385, Florida Statutes, which sets forth procedures for local governmental entity bond issues, does not require the governmental entity to document the conditions favoring the selected method of sale. Failure to use the most appropriate method could result in unfavorable issue terms and excessive financing costs. Although resolutions were adopted authorizing negotiated sale (private placement) rather than competitive bid for each of the bond pool issues we reviewed, there was no documentation, of record, as to how the local governments determined that a

negotiated sale was in the best interests of the issuers, borrowers, and citizens of the State of Florida.

We also noted, in audit report No. 01-075, Finding No. 11, that Florida law does not include provisions for competitive selection of financial and professional services for local governmental entity bond issues. Competitive practices provide objective assurance that the best services and interest rates are obtained at the lowest cost possible and demonstrate that marketing and procurement decisions are free of self-interest, personal, or political influences. The local government issuers of the eight bond issues we reviewed generally incurred certain issue costs, including underwriter fees, financial advisor fees, attorney fees, credit facility fees, insurance, and remarketing services, without benefit of a competitive selection process. Detailed information regarding the costs incurred is shown on Appendix B. Some representatives of the local governments indicated that service providers were selected based on their reputations in their areas of expertise or on underwriter recommendations. However, absent competitive procurement of these services, neither the local governments nor the citizens of the State of Florida have any assurance that the services were obtained at the lowest cost consistent with the size, nature, and complexity of the bond issues.

### **Recommendation**

**As also recommended in audit report No. 01-075, Finding No. 10, the Legislature should amend Section 218.385, Florida Statutes, to require local governments to maintain documentation evidencing the conditions favoring the selected method of bond sale, including a financial or market analysis prepared by a qualified financial advisor that is independent from the underwriter with respect to the bond issue. In addition, as similarly recommended in audit report No. 01-075, Finding No. 11, the Legislature should amend Section 218.385, Florida Statutes, to require local governments to select bond service providers using a competitive selection process that includes a detailed analysis supporting agreed-upon fees. Local governments should also be required, for negotiated bond issues (i.e., issues for which the local government is going to negotiate with an underwriter as to the interest rate and purchase price), to use a competitive selection process to solicit qualified firms to serve as the underwriter.**

### **Follow-up to Escambia County Health Facilities Authority Response**

*The Chairman of the Escambia County Health Facilities Authority, in his response to this finding stated that the suggestion that the financing team for a pooled loan program be chosen on the basis of the lowest bid, rather than expertise, as if an issuer were acquiring office furniture, demonstrates the inexperience of the Auditor General's staff. This report does not suggest selection of bond*

*professionals on the basis of the lowest bid, but rather recommends a competitive selection process. Such a process would include numerous factors, such as demonstrated experience, in addition to price.*

**FINDING No. 6: Accountability and Reporting of Bond Transactions**

Local government public officials have a responsibility to ensure that records are maintained demonstrating the use of public resources for public purposes. Section 11.47(1), Florida Statutes, provides that all officers whose respective offices the Auditor General is authorized to audit or examine must enter into their public records sufficient information for proper audit or examination, and must make the same available to the Auditor General on demand. The extent of such records is dependent on the nature, complexity, and volume of transactions.

Of the four local governments (eight bond pool issues) we reviewed, only the City of Moore Haven Capital Project Finance Authority kept records on bond pools to ensure proper accountability for the bond funds, and that entity kept records on only two of the three bond issues we reviewed. Therefore, records were not available for six of the eight bond pool issues we reviewed. The only records available to account for these bonds issues were the records kept by the trustees. Notwithstanding the responsibilities of the trustee, the issuers have a fiduciary responsibility to assure that proper accountability is maintained over the bond proceeds, and income derived thereon. Relying on the trustee is similar to a local government relying on a bank to properly account for transactions. Statements provided by banks are routinely compared with, and reconciled to, records maintained by the local government. For the six bond issues we referred to above, records that would permit such reconciliations were not maintained.

Our review of trustee account statements for the three City of Gulf Breeze bond issues disclosed several errors made by the trustee, some of which were subsequently corrected and others that were not. For example, the following errors, which may have been prevented or detected had accounting records been maintained, were noted during our review:

- A participant loan in the amount of \$1,131,000 was paid on August 20, 1997, from the 1995A Series bonds, but should have been paid from the 1997A Series bond issue. A correction was subsequently made on September 24, 1997, to repay the 1995A Series bonds. However, there was no evidence of repayment of \$1,972 in deferred issuance fees that were paid from the 1995A Series bonds on August 20, 1997.
- A participant loan in the amount of \$20,500,000 was made from the 1999 Series bonds on November 8, 2000. The loan amount included \$385,263 that was to be retained in the bond acquisition fund to cover an allocable portion

of the costs of issuing the 1999 Series bonds. A wire transfer was made on November 10, 2000, to redeposit the \$385,263 to the guaranteed investment account; however, the Trustee did not record the redeposit to the acquisition fund until May 21, 2001.

- On June 11, 1996, a \$1,000 duplicate payment was made to the trustee. Repayment was not received until June 22, 1998, approximately 2 years later.
- On March 24, 1999, an origination fee of \$3,600 was paid to the underwriter in error from the 1997A Series bonds. The repayment was not made until December 20, 1999, approximately 9 months later.
- On September 24, 1997, the trustee was paid a \$3,200 disclosure fee from the 1997A Series bonds cost of issuance account. On November 18, 1999, approximately 2 years later, an entry was made by the trustee to reclassify the expenditure from the cost of issuance account to the administrative discretionary account. However, the entry was made incorrectly and resulted in an additional \$3,200 being deducted from the cost of issuance account.

Without adequate records for each bond issue, and without any verification of such records to the bond trustees' statements, it was not practical for City of Gulf Breeze personnel to verify that amounts received and paid by the trustee were correct, and timely and properly accounted for.

In addition, each bond pool earned millions of dollars in interest on investments (at least \$157 million collectively for the eight bond issues we reviewed). The amounts of interest earned were accepted at face value by the local governments without verification.

We requested from the issuing local governments a schedule of sources and applications of funds from the date of issuance for each bond pool issue. However, none of the four issuing local governments furnished us the requested source and application of funds. We, therefore, prepared a schedule of sources and applications of funds through January 31, 2002, for each bond issue from information provided by the issuers and other parties to the bond programs. Because of the lack of records for most of the bond pool issues, and the lack of an audit of those records that were maintained (see further discussion below), we cannot be assured as to the accuracy and completeness of the schedules of sources and applications of funds derived from available information and included in this report as Appendix B. We requested that the local governments or their designated representatives verify the schedules. However, the local governments were unable to determine, without qualification, the accuracy and reliability of source and application of funds information for each bond issue as follows:

- The City of Moore Haven Capital Projects Finance Authority verified only two of the three schedules without qualification. For the other schedule, the Authority's Administrator verified the information on the schedule but with a qualification regarding amounts reported for post-closing earnings and interest accruals.
- The Orange County Health Facilities Authority's Administrator verified the information on the schedule but with a qualification regarding amounts reported for post-closing earnings and interest accruals.
- The Escambia County Health Facilities Authority's representative would verify only the balance in the trustee account as of January 31, 2002, but would not take any responsibility for the transactions that resulted in that balance.
- Although the City of Gulf Breeze verified the three schedules for its bond issues, as shown on Appendix B, the calculated balances as of January 31, 2002, based on identified sources and applications of funds, exceeded the actual balances by \$583,223 for the Series 1995A Bonds, \$455,471 for the Series 1997A Bonds, and \$1,063,242 for the Series 1999 Bonds. Given the lack of adequate records showing the use of bond proceeds and interest earned thereon, and these unidentified differences, there is an increased risk that bond funds could be misappropriated or otherwise used for unauthorized purposes.

Local governmental entities are subject to the audit requirements prescribed in Section 218.39, Florida Statutes; however, there is no provision for separate audits of local government bond pool operations except as prescribed in Section 163.01(5)(q), Florida Statutes, for finance commissions. The City of Moore Haven, City of Gulf Breeze, and Escambia Health Facilities Authority provided for audits for the fiscal years ended September 30, 2000, and September 30, 2001, pursuant to Section 218.39, Florida Statutes; however, the seven bond issues we reviewed for these entities were not included within the scope of those audits. Nor did these entities otherwise provide for separate audits of their bond pool operations for the fiscal years ended September 30, 2000, and September 30, 2001. Only one of the bond issues we reviewed, the Orange County Health Facilities Variable Rate Demand Revenue Bonds, Series 2000A, was subjected to an audit for those fiscal years. By way of comparison, we noted that all of the finance commissions (except for the Capital Trust Agency), of which we are aware, that were created pursuant to Section 163.01, Florida Statutes, were audited for those fiscal years and have filed copies of the audit reports with the Department of Financial Services (formerly the Department of Banking and Finance). Although not statutorily required, such audits were conducted in accordance with generally accepted government auditing standards and Chapter 10.550, Rules of the Auditor General. Had all eight of the bond issues we reviewed been

subjected to such audits, the deficiencies disclosed by our audit may have been detected or prevented.

### **Recommendation**

The Legislature should amend Section 163.01(5)(q) and other appropriate Florida Statutes to require, for local government operated bond pools, that records be maintained providing a full accounting for all related transactions. In addition, such legislation should require that audits of all bond pool operations be made annually in accordance with generally accepted government auditing standards and Chapter 10.550, Rules of the Auditor General.

#### **Follow-up to Escambia County Health Facilities Authority Response**

*The Chairman of the Escambia County Health Facilities Authority, in his response to this finding, indicated that the Authority did not decline to take responsibility for the transactions stated in the Trustee's report. In a response dated September 7, 2002, to our request for confirmation of the compilation of transactions from the Trustee's records, the Authority confirmed only the trust account balances as of January 31, 2002, and referenced a memorandum from the Trustee that the Authority should confirm only the account balances as of that date.*

### **FINDING No. 7: Payments to Bond Service Providers**

The Attorney General, addressing the degree of support necessary to substantiate claims for payment from public funds, stated in Opinion No. 68-12, dated January 25, 1968, that vouchers for payment of public funds, whether State, district, or county, submitted to the paying agency should contain sufficient information for the paying agency, or its preauditors or officials and the postauditor, to determine the requested payment is authorized by law.

As discussed in Finding No. 6, accounting records were not maintained for six of the eight bond issues we reviewed as the issuers relied primarily on the trustees to keep records of bond transactions. Likewise, local government issuers relied on trustees to maintain documentation supporting payments to service providers. However, our audit disclosed, for the eight bond issues we reviewed, that adequate documentation was generally not available to support payments for professional services and related expenses. Our review of approximately \$17,000,000 of issue costs paid disclosed that \$6,698,449 of such costs were not supported by invoices or other documentation, or were supported by documentation that was not adequate to demonstrate the propriety of the payments, as summarized below:



Bond Issue	No Invoices or Other Documentation	Invoices or Other Documentation Not Adequate	Total
Escambia County Health Facilities Authority Health Care Facility Revenue Bonds, Series 2000A and 2000B	\$265,241	\$633,883	\$899,124
City of Gulf Breeze Variable Rate Demand Revenue Bonds, Series 1995A	416,250	105,750	522,000
City of Gulf Breeze Capital Funding Revenue Bonds, Series 1997A	51,654	374,773	426,427
City of Gulf Breeze Variable Rate Demand Revenue Bonds, Series 1999	0	1,758,821	1,758,821
City of Moore Haven Capital Projects Finance Authority Revenue Bonds, Series 1997A	0	586,250	586,250
City of Moore Haven Capital Projects Finance Authority Variable Rate Demand Revenue Bonds, Series 1998A	0	925,875	925,875
City of Moore Haven Capital Projects Finance Authority Variable Rate Demand Revenue Bonds, Series 2000H	0	731,662	731,662
Orange County Health Facilities Authority Variable Rate Demand Revenue Bonds, Series 2000A	0	848,290	848,290
<b>Totals</b>	<b>\$733,145</b>	<b>\$5,965,304</b>	<b>\$6,698,449</b>

As shown above, although we requested, we were not provided with invoices or other documentation supporting \$733,145 of issue costs. For the remaining \$5,965,304, documentation presented for audit was not sufficient to show how the fees and related expenses were determined. In these instances, written agreements setting forth the basis for the amounts to be paid were not available and invoices submitted for services provided were not in sufficient detail to demonstrate the specific nature of the services provided, the hourly rates, the number of hours, or details of out-of-pocket expenses for which the service provider was seeking reimbursement. As such, it is not apparent how the issuing local governments, for the above-noted inadequately supported costs, determined the reasonableness and propriety of charges for services and related expenses. The issuers and their representatives generally indicated that many bond service provider fees are fixed fees determined at some point just prior to the bond sale and are verbally agreed to but not reduced to writing. However, absent written agreements, we could not verify the agreed upon fees.

### **Recommendation**

**Local governments issuing bonds, prior to authorizing payments to service providers by the trustee, should obtain from service providers documentation**

sufficient for the local governments to determine the exact nature of services provided and whether the services were billed in accordance with agreed upon terms. Such documentation should be retained for audit and public inspection. In addition, written agreements specifying the basis for compensation and reimbursable expenses should be maintained for all service providers.

*Follow-up to City of Gulf Breeze Response*

*The Mayor of the City of Gulf Breeze, in his response to this finding, stated that he disagreed with the finding that large amounts of invoicing documentation was inadequate, but did not provide any additional documentation. Instead, the Mayor expressed the opinion that "a certain level of trust must be maintained and a high level of flexibility provided in order for the professionals to concentrate on the proper structure of the financing rather than the burden of adhering to exact and defined contractual agreements under a defined and inflexible compensation arrangement engaged long in advance of the program coming to the market having many changes along the way." We believe that the needed flexibility could be incorporated into the contractual arrangements and that the provision of adequate invoices would in no way adversely affect the bringing of a changing program to the market. Nor do we believe that requiring professionals to document the basis for their compensation would preclude their innovation and creativity.*

*Follow-up to Capital Projects Finance Authority Response*

*The Program Administrator for the Capital Projects Finance Authority indicated in his response to this finding that an independent trustee was retained to disburse funds and verify the legitimacy of each expenditure. He further stated that, in all cases, invoices that clearly detailed the services provided were submitted to the trustee and that legal fees were paid in accordance with mutual understandings (without formal agreement) pursuant to submission of properly detailed invoices that were reviewed and approved by various parties. While utilizing the services of a trustee is customary, the Authority should not delegate its ultimate discretionary authority and responsibility with regard to the propriety of the payments. It is not apparent how the Authority has exercised such responsibility and could be assured as to the adequacy of the invoices in the absence of signed contracts setting forth the basis of payment and payment documentation.*

## ***FINDING No. 8: Oversight Related to Bond Pool Issues***

Currently, there appears to be a lack of adequate oversight over local government bond pool issues. Although the Division of Bond Finance (Division), pursuant to Section 218.38, Florida Statutes, acts as a repository of bond information, there is no requirement for the Division, or any other State agency, to assess the reasonableness and feasibility of bond pool issues prior to their issuance and compliance with State reporting requirements. Pursuant to Section 218.38, Florida Statutes, finance commissions created under Section 163.01, Florida Statutes, and other local government entities that operate bond pools, are required, for each bond pool issue, to file a copy of the official statement and certain disclosure forms with the Division. However, we noted that bond disclosure forms filed with the Division for the City of Moore Haven Capital Projects Finance Authority's Series 1997A bonds, and the City of Gulf Breeze's Series 1995A and 1997A bonds, were not complete as to issuance costs.

The objectives of our audit did not include a determination of compliance with the IRC. However, serious consequences, such as loss of tax exempt status, can result if a determination of noncompliance is made by the IRS, which could have an adverse effect on the bond market in Florida. Accordingly, our audit included a determination of the extent to which controls over local government bond pools promoted compliance with IRC requirements. We found that the provisions of various IRC requirements are numerous, very complicated, and can be subject to many varied interpretations, including the following requirements relating to private activity bonds that must be complied with for bonds to qualify for tax-exempt status:

- IRC Section 149(e)(2)(D), which requires that each initial principal user (i.e., borrower) of any facility provided with proceeds from qualified private activity bond pools be identified, including their names, addresses, and employer identification numbers, to the Secretary of the Treasury by the 15<sup>th</sup> day of the second month after the close of the calendar quarter in which the bonds were issued. We noted differing interpretations as to whether the requirements of IRC Section 149(e)(2)(D) apply to potential or actual borrowers.
- IRC Section 147(f) and IRS Regulation 5f.103-2(f)(2), which require that descriptions of the properties or projects to be financed, the maximum aggregate face amount of the obligations with respect to each facility, the initial owner, operator, or manager of the facility (i.e., borrower) and prospective location of the facility by its street address, or if none, by a general description designed to inform readers of its specific location, be included in the Technical and Equity Fiscal Responsibility Act hearing notice. We noted differing interpretations as to whether the requirements of IRC

Section 147(f) and IRS Regulation 5F.103-2(f)(2) apply to potential or actual projects and borrowers.

- IRC Section 147(f)(2), which requires approval of bonds by an elected official. We noted differing interpretations as to whether or not an elected official could delegate the actual signing of bond approval notices to individuals that were not elected officials.
- IRC Section 147(f)(2)(A), which provides that the issuer must reasonably expect that 95 percent of the net proceeds of the issue will have been used directly or indirectly to make or finance loans to ultimate borrowers within three years of the bond issuance date. We noted differing interpretations as to what constitutes a reasonable expectation that 95 percent of the net proceeds will be used for loans within the 3-year period, and as to what constitutes an ultimate borrower.

Many efficiencies and increased assurances of compliance with IRC requirements could be achieved by designating an oversight agency to communicate with the IRS on certain issues of compliance and to review the proposed bonds prior to issuance. In the absence of an oversight agency, it is incumbent that each entity that issues bonds individually communicate with the IRS on areas of the IRC that may be subject to varied interpretations.

The need for additional oversight over bond pool issues is also evident by the various deficiencies disclosed by our audit (see Findings Nos. 1, 2, 6, and 7). We have recommended several statutory changes to address these deficiencies, including revising the bond validation process; however, without sufficient oversight, there is little assurance that the revised statutory provisions will be complied with. Additional oversight for bond pool issues, other than bonds issued by finance commissions created pursuant to Section 163.01(7)(d), Florida Statutes, could be accomplished by:

- Requiring that all such bond pool issues be issued by the Division of Bond Finance or by a newly created State or other finance commission (see Finding No. 9); or
- Designating the Division of Bond Finance or other existing State agency, or establishing a newly created governmental or nonprofit entity, to be responsible for approving all such bond pool issues prior to issuance. The oversight entity would be responsible for ensuring that there is a demonstrated need for bond issues, and that bonds are issued in accordance with applicable Federal and State laws and good business practices. Our survey of other states disclosed various ways to provide for such oversight. For example, several states require prior approval of local government bond issues by a State agency, including the State of North Carolina, which requires approval by the State Local Government Commission. Another

state, the State of Nevada, has created debt management commissions for each county, approval of which is required for municipal bond issues.

We also believe there is a need, with respect to bond pool issues, for additional oversight to ensure compliance with established accountability and audit requirements. Such oversight could be provided through an annual audit requirement (see recommendation for Finding No. 6) and a review of such audit reports by the oversight agency responsible for approving bond pool issues.

### **Recommendation**

The Legislature should enact legislation assigning the Division of Bond Finance, or some other appropriate existing or newly created agency, responsibility for issuing bond pool issues or oversight responsibility over bond pool issues. Oversight responsibilities should include verifying that there is a demonstrated need for bond pool issues, that the bonds are issued in accordance with applicable Federal and State laws and good business practices, and compliance with established accountability and audit requirements.

#### **Follow-up to Orange County Health Facilities Authority and Capital Projects Finance Authority Responses**

*The Chairman of the Orange County Health Facilities Authority and the Program Administrator for the Capital Projects Finance Authority, in their responses to this finding, indicated that the differing interpretations cited in the report are a product of the failure of the IRS to promulgate regulations under certain provisions of the Internal Revenue Code providing guidance for pooled financing arrangements and that the Authorities relied on guidance from nationally recognized professionals. Additional guidance from the IRS in the form of new regulations may be necessary and illustrates the need, under existing conditions, for strong oversight to assure that viability of the bond issues. Further, where an issuer feels that regulations are not sufficiently definitive, it may be prudent to contact the IRS for guidance.*

*The Program Administrator for the Capital Projects Finance Authority, in his response to this finding, indicated that proper disclosure was made for all issuance costs. Our examination of the Bond Issuance Form (BF2003) filed with the Division of Bond Finance for the Local Government Bond Pool Revenue Bonds, Series 1997A, disclosed that certain costs paid at closing had not been shown thereon. These costs included remarketing fees (\$1,700,450), an issuer acceptance fee (\$82,500), and trustee fees (\$24,750).*

## ***FINDING No. 9: Potential Need for Additional Bond Pools***

As part of our audit, we identified six finance commissions created pursuant to Section 163.01(7)(d), Florida Statutes, that provided loans to local governments (these do not include utility finance commissions created by Section 163.01(7)(c), Florida Statutes). On a Statewide basis, the availability of the six finance commissions to local governments with smaller economies or lower credit grade ratings may be somewhat limited because of the finance commissions' use of criteria to determine which loan applicants qualify for loans. For example, some finance commissions require at least an "A" credit rating and approval by the finance commission's members or board of directors. In addition, one finance commission has established a financial indicator for which the borrower must achieve a minimum rating. The purpose of using the criteria to select borrowers is to enhance the credit rating of the bond pool issue and to reduce related issuance and administrative costs.

Another reason for the limited participation in bond pools may be that many local governments are not aware of the availability of the finance commissions as a financing alternative. Our audit included a survey of local governments to determine the extent to which they participated in, or sponsored, bond pools. Of 689 survey respondents, only 78 had participated in a bond pool. Many of those that did not participate in a bond pool did not do so because they had no need for financing or because they were restricted by law from participating in a bond pool. However, many did not participate because they were not aware that bond pools existed or because no bond pools existed for which the entity was eligible to participate. While the results of our survey may not be conclusive as to need for additional bond pool financing, it does indicate an interest on the part of numerous local governments.

Bond pools potentially can provide local governments improved marketability and lower issuance and borrowing costs than could be achieved through individual bond or other long-term debt issues. It appears that there may be a need to make additional bond pool financing available to local governments. There are several means by which this could be accomplished, including:

- Creation of a State finance commission to operate a bond pool for all types of local governments. Our survey of other states disclosed several states that have established State bond banks to provide financing for local governments.
- Creation of multiple finance commissions to operate bond pools specifically tailored to meet the needs of particular types of local governments. For example, the Florida Ports Financing Commission, created pursuant to Section 320.20(3), Florida Statutes, provides a means of financing various

capital projects for special districts that operate Florida's ports by issuing bonds and transferring the proceeds thereof to the individual ports.

- Authorization of a State agency to operate a bond pool consistent with provisions of the State Constitution. The Division of Bond Finance does this to some extent in that it administers a State revolving fund used to make loans to local governments for construction, renovation, or remodeling of water, wastewater, and storm water operations. Also, the Department of Transportation, pursuant to Section 339.55, Florida Statutes, is authorized to administer a State Infrastructure Bank (SIB) for the purposes of making loans to local governments and other entities for constructing and improving transportation facilities. Potentially, the SIB could be funded through a bond pool issue.

### **Recommendation**

**The Legislature should consider expanding the availability of bond pool financing within the State of Florida using one or more of the above-noted alternatives, or by other appropriate means.**

## *APPENDICES*

The following Appendices are attached to and form an integral part of this report:

*Appendix - A*      *Information on Bond Pool Issues Selected for Review.*

*Appendix - B*      *Source and Application of Funds.*

*Appendix - C*      *Statements from Audited Officials.*



**APPENDIX - A**

**LOCAL GOVERNMENT BOND POOLS**

**INFORMATION ON BOND POOL ISSUES SELECTED FOR REVIEW**

<b>Name of Governmental Unit</b>	<b>Escambia County Health Facilities Authority</b>	<b>City of Gulf Breeze, Florida</b>
<b>Type of Issuer</b>	Special District	Municipality
<b>Name of Bond Issue</b>	Health Care Facility Revenue Bonds, Series 2000A and 2000B	Variable Rate Demand Revenue Bonds, Series 1995A
<b>Amount Authorized</b>	\$300,000,000	\$100,000,000
<b>Amount Issued</b>	\$156,500,000	\$50,000,000
<b>Issue Date</b>	July 1, 2000	April 1, 1996
<b>Legal Authority</b>	The Constitution and the laws of the State of Florida, particularly Chapter 154, Part III, Florida Statutes, Chapter 159, Part II, Florida Statutes, Section 163.01 et seq., Florida Statutes, as amended and supplemented from time to time, and other applicable provisions of law, an Indenture of Trust dated as of July 1, 2000, between the Authority and SouthTrust Bank, Birmingham, Alabama, and resolutions duly adopted by the Issuer on April 25, 1996, October 13, 1999, and April 18, 2000.	Sections 163.01, Et Seq., Florida Statutes, and Chapter 61-2207, Laws of Florida, special Acts of 1961, as from time to time amended and supplemented, resolutions adopted by the Issuer on March 18, 1996, and under an Indenture of Trust dated as of April 1, 1996.
<b>Type of Issue</b>	Revenue	Revenue
<b>Private Activity Bond</b>	Yes, Qualified 501(c)(3) issue.	No
<b>Specific Revenues Pledged</b>	The bonds are payable solely from, and are secured by, an assignment and a pledge of the Trust Estate consisting primarily of: (i) payments and other revenues to be received by the Issuer under the Loan Agreements among the Issuer and certain Health Care Participants, and (ii) certain funds on deposit under an Indenture of Trust dated as of July 1, 2000, between the Issuer and SouthTrust Bank, pursuant to which the Bonds are issued and secured.	The Revenues received by the Issuer under the Loan Agreements or any security provided therefore, moneys received under the Letter of Credit, and certain funds held under Indenture, subject to the application thereof by the provisions of the Indenture, which revenues and the security therefore have been pledged and assigned to the Trustee to secure payment of the bonds.
<b>Purpose(s) of the Issue</b>	To fund a program consisting of the financing or refinancing of costs of construction, acquisition and installation of capital improvements, including equipment for certain governmental and nonprofit healthcare institutions (each a "Health Care Participant," and collectively the "Health Care Participants"); to establish certain reserves, including a debt service reserve and to pay certain expenses of the Program.	Financing facilities (as defined in the Act) by lending funds to, or entering into leases with, certain counties, cities, towns and other governmental organizations in the State of Florida.

**APPENDIX - A (CONTINUED)**

**LOCAL GOVERNMENT BOND POOLS**

**INFORMATION ON BOND POOL ISSUES SELECTED FOR REVIEW**

<b>Name of Governmental Unit</b>	<b>City of Gulf Breeze, Florida</b>	<b>City of Gulf Breeze, Florida</b>
<b>Type of Issuer</b>	Municipality	Municipality
<b>Name of Bond Issue</b>	Capital Funding Revenue Bonds, Series 1997A	Variable Rate Demand Healthcare Revenue Bonds, Series 1999
<b>Amount Authorized</b>	\$81,500,000	\$500,000,000
<b>Amount Issued</b>	\$81,500,000	\$300,000,000
<b>Issue Date</b>	May 20, 1997	April 16, 1999
<b>Legal Authority</b>	The Laws of the State of Florida, particularly Sections 163.01 et seq. and 166.01 et seq., Florida Statutes, and Chapter 61-2207, Laws of Florida, Special Acts of 1961, as from time to time amended and supplemented and an Indenture of Trust dated as of January 15, 1997, between the Issuer and SunTrust Bank, Central Florida, National Association.	The Constitution and laws of the State of Florida, particularly Sections 163.01, et seq., and 159.01 et. Seq., Florida Statutes, Chapter 166, Part II, Florida Statutes, as amended and supplemented from time to time, and other applicable provisions of law, Resolution No. 28-98, duly adopted by the Issuer on November 16, 1998, and Resolution No. 06-99, duly adopted by the Issuer on Mach 15, 1999, and a Trust Indenture dated as of April 1, 1999, between the Issuer and SunTrust Bank, Central Florida, National Association, Orlando, Florida.
<b>Type of Issue</b>	Revenue	Revenue
<b>Private Activity Bond</b>	No	Yes, Qualified 501(c)(3) issue.
<b>Specific Revenues Pledged</b>	Revenues received by the Issuer under the Loan Agreements, or any security provided therefore, and certain funds held under the Trust Indenture, subject to application thereof by the terms and provisions of the Indenture including amounts paid pursuant to the Swap Agreement, which revenues and the security therefore have been pledged and assigned to the Trustee to secure payment of the Bonds.	(i) all of the right, title and interest of the Issuer in and to the Revenues, the Notes, and the Loan Agreements; (ii) all moneys received by the Trustee pursuant to the Payment Agreement; (iii) all right, title and interest of the Issuer in the Interlocal Agreements; (iv) all right, title and interest of the Issuer in and under a Swap Agreement, if any, and the Revenues there from; (v) all revenues, moneys and securities and funds and accounts created under the Indenture (except the Rebate Fund, the Project Fund and the Taxes and Insurance Escrow Account); (vi) all right, title and interest of the Issuer in the Project Fund of the Borrower, subject to the lien in favor of the Provided; and (vii) all right, title and interest granted to the Trustee under the Collateral Assignment (collectively, the "Trust Estate").
<b>Purpose(s) of the Issue</b>	To provide a source of funds from which to provide financing for a county, municipal corporations, state or local agency or other public body or agency created or established under State or local law.	The proceeds of the Bonds will be used to fund the Program in order to (i) provide funds to loan to the Borrower that will in turn apply such proceeds to make Participant Loans, approved by the Provider, to the Participants for purposes of financing or refinancing the costs of acquiring and, in some cases, rehabilitating Projects; (ii) fund certain working capital and funded interest costs with respect to the Projects, and (iii) pay certain costs of issuance of the Bonds.

**APPENDIX - A (CONTINUED)**

**LOCAL GOVERNMENT BOND POOLS**

**INFORMATION ON BOND POOL ISSUES SELECTED FOR REVIEW**

<b>Name of Governmental Unit</b>	<b>City of Moore Haven, Capital Projects Finance Authority</b>	<b>City of Moore Haven, Capital Projects Finance Authority</b>
<b>Type of Issuer</b>	Special District	Special District
<b>Name of Bond Issue</b>	Revenue Bonds, Series 1997A	Variable Rate Demand Revenue Bonds, Series 1998A
<b>Amount Authorized</b>	\$750,000,000	\$750,000,000
<b>Amount Issued</b>	\$165,000,000	\$300,000,000
<b>Issue Date</b>	August 26, 1997	June 24, 1998
<b>Legal Authority</b>	Chapter 166 and Section 163.01, Florida Statutes; Ordinance No. 214 of Moore Haven.	Chapter 154, Part III, Florida Statutes; Ordinance No. 214 of Moore Haven.
<b>Type of Issue</b>	Revenue	Revenue
<b>Private Activity Bond</b>	No	Yes, Qualified 501(c)(3) issue.
<b>Specific Revenues Pledged</b>	Pledge of the Trust Estate including Revenues from Borrower Loans and Notes and Interest from Authorized Investments generated by Bond Insurance Policy and Liquidity Facility.	Pledge of the Trust Estate including Revenues from Borrowers, investments, and Notes and Loan Agreements, and Loan Collateral generated by Bond Insurance and Liquidity.
<b>Purpose(s) of the Issue</b>	Making Loans to Borrowers for Qualifying Projects; Funding the Debt service Reserve Fund.	Making Loans to Borrower Institutions for healthcare Projects; Funding the Debt Service Reserve Fund.

**APPENDIX - A (CONTINUED)**

**LOCAL GOVERNMENT BOND POOLS**

**INFORMATION ON BOND POOL ISSUES SELECTED FOR REVIEW**

<b>Name of Governmental Unit</b>	<b>City of Moore Haven, Capital Projects Finance Authority</b>	<b>Orange County Health Facilities Authority</b>
<b>Type of Issuer</b>	Special District	Special District
<b>Name of Bond Issue</b>	Variable Rate Demand Revenue Bonds, Series 2000H	Variable Rate Demand Revenue Bonds, Series 2000A
<b>Amount Authorized</b>	\$400,000,000	\$330,000,000
<b>Amount Issued</b>	\$300,000,000	\$330,000,000
<b>Issue Date</b>	December 14, 2000	June 29, 2000
<b>Legal Authority</b>	Chapter 163, Florida Statutes; City of Moore Haven Ordinance No. 214 and the Resolution adopted by the City of Moore Haven on August 11, 1998, as supplemented by the Resolution of the Authority adopted on November 8, 2000, and December 5, 2000.	Chapter 154, Part III, Chapter 159, Part II and Chapter 163; other applicable provisions of law.
<b>Type of Issue</b>	Revenue	Revenue
<b>Private Activity Bond</b>	No	Yes, Qualified 501(c)(3) issue.
<b>Specific Revenues Pledged</b>	Money and Investments, including the guaranteed investment contract for the Bonds held under the Trust Indenture (as defined in the Official Statement); Amounts payable under loans funded by the Program (as defined in the Official Statement).	The Series A Bonds and any Series of Bonds (as defined in the Trust Indenture) are payable solely from the Related Trust Estate under the Trust Indenture, including Investment Agreement and amounts paid by the Institutions pursuant to the Loan Agreements and other moneys available under the terms of the Trust Indenture.
<b>Purpose(s) of the Issue</b>	Provide proceeds for financing or refinancing the costs of airports and related facilities.	The Series A Bonds are issued under a Trust Indenture dated as of June 1, 2000 (the "Trust Indenture") between the Issuer and the Bank of New York, as Trustee. The Series A Bonds are issued for the purpose of paying costs of projects within the meaning of Chapter 125, Chapter 154, Chapter 159 and Chapter 166, Florida Statutes, as amended, for certain eligible not for profit corporations or eligible governmental units of the State. The Issuer will lend proceeds of the Series A Bonds to Institutions to finance Projects pursuant to Loan Agreements.

**APPENDIX - B**  
**LOCAL GOVERNMENT BOND POOLS**  
**SOURCE AND APPLICATION OF FUNDS**  
**JANUARY 31, 2002**

	Escambia County Health Facilities Authority Health Care Facility Revenue Bonds Series 2000A and 2000B	City of Gulf Breeze Variable Rate Demand Revenue Bonds Series 1995A	City of Gulf Breeze Capital Funding Revenue Bonds Series 1997A	City of Gulf Breeze Variable Rate Demand Healthcare Revenue Bonds Series 1999	City of Moore Haven Capital Projects Finance Authority Revenue Bonds Series 1997A	City of Moore Haven Capital Projects Finance Authority Variable Rate Demand Revenue Bonds Series 1998A (Hospital)	City of Moore Haven Capital Projects Finance Authority Variable Rate Demand Revenue Bonds Series 2000H (Airport)	Orange County Health Facilities Authority Variable Rate Demand Revenue Bonds Series 2000A	Total
Date of Issuance	July 1, 2000	April 1, 1996	May 20, 1997	April 16, 1999	August 26, 1997	June 24, 1998	December 14, 2000	June 29, 2000	
<b>Source of Funds:</b>									
Interest from Investments	14,925,996	7,020,459	20,717,964	35,030,990	16,312,630	35,857,391	9,632,276	17,883,290	157,380,997
Accrued Bond Interest	615,755								615,755
Bond Proceeds	156,500,000	50,000,000	81,500,000	300,000,000	165,000,000	300,000,000	300,000,000	330,000,000	1,683,000,000
Principal Payment on Loans	50,000	3,773,264	7,623,052		15,658,500	5,024,728			32,129,543
Option Contract Proceeds					2,825,000		2,240,912	1,595,000	6,660,912
Interest on Loans	352,287	3,348,281	8,395,262	1,267,664	3,872,364				17,235,858
Other				142,304			8,583	5,624	156,511
Payments to Rebate Account by Borrowers		43,785			382,399				428,184
Line of Credit Draw				767,653					767,653
Administrator Contribution							5,600,000		5,600,000
Funds from SWAP Agreement			3,970,493						3,970,493
<b>Total Sources</b>	<b>172,444,039</b>	<b>64,185,789</b>	<b>122,206,771</b>	<b>337,208,611</b>	<b>204,050,893</b>	<b>346,482,119</b>	<b>311,881,771</b>	<b>349,483,914</b>	<b>1,907,943,907</b>
<b>Application of Funds:</b>									
<b>Issuance and Administrative Costs</b>									
Administrator Fees			13,688	907,000	289,720	304,908		34,509	1,549,825
Bond Counsel Fees & Expenses	399,260	56,250	204,607	185,917	492,658	350,000	623,038	504,100	2,815,831
Other Counsel	84,777	92,250	301,107	893,722	40,197	402,216	236,661	324,930	2,375,861
Other	240,203	125,607	174,686	89,173	93,497	36,722	60,750	33,731	854,368
Insurance	4,060,654				1,008,339	1,846,819			6,915,812
Financial Advisor Fees & Expenses	80,000	138,509	208,017	614,000	165,000	400,000	120,000	20,000	1,745,526
Issuer Fees	78,010	123,991	258,644	551,942	105,748	42,224	150,000	38,000	1,348,558
Liquidity Fees						1,374,066	745,564	1,314,358	3,433,987
Letter of Credit Provider		1,830,327		7,738,728	810,607				10,379,662
Printing	15,634	2,757	14,162		9,348	3,351		3,776	49,029
Foreign Counsel for Liquidity Bank							17,500		17,500
Rating Agency Fees	37,084	39,500	31,200	61,000	69,000	52,000	78,500	78,500	446,784
Rebate Analyst Fees	15,439	67,534	24,000		24,270	26,840		3,000	161,083
Reimbursement of Interest									0
Remarketing Fees		130,471		1,037,514	1,737,617	602,142		231,000	3,738,744
Sponsor Fees	137,049		44,750		14,203	952,569	90,000		1,238,572
Underwriter Fees	919,500	90,000	340,603	2,510,000		2,231,363	780,000		6,871,466
<b>Total Issuance and Administrative Costs</b>	<b>6,067,610</b>	<b>2,697,195</b>	<b>1,615,464</b>	<b>14,588,996</b>	<b>4,860,205</b>	<b>8,625,221</b>	<b>2,902,013</b>	<b>2,585,904</b>	<b>43,942,608</b>
<b>Debt Disbursements</b>									
Bond Principal		3,520,000		50,000,000		300,000,000	34,455,000 (2)		387,975,000
Bonds Retired		32,540,000			140,435,000				172,975,000
Bond Interest & Fees Paid	13,790,464	7,610,139	15,618,173	26,894,486	18,004,210	32,877,716	8,738,788	16,662,174	140,196,151
Loans	30,000,000	17,236,000	80,962,397	23,217,061	36,537,000 (1)	4,557,905 (1)			187,952,458
Rebate Payments to IRS	922,247	203,247				377,647			1,503,141
Principal Payments for Default Loan				28,902					28,902
<b>Total Debt Disbursements</b>	<b>44,712,711</b>	<b>61,109,386</b>	<b>96,580,570</b>	<b>100,140,450</b>	<b>194,976,210</b>	<b>337,813,268</b>	<b>43,193,788</b>	<b>16,662,174</b>	<b>890,630,652</b>
<b>Total Application of Funds</b>	<b>50,780,321</b>	<b>63,806,581</b>	<b>98,196,034</b>	<b>114,729,447</b>	<b>199,836,415</b>	<b>346,438,489</b>	<b>46,095,801</b>	<b>19,248,078</b>	<b>934,573,260</b>
<b>Calculated Balance at January 31, 2002</b>	<b>121,664,422</b>	<b>1,545,654</b>	<b>24,010,737</b>	<b>222,479,164</b>	<b>4,214,479</b>	<b>43,630</b>	<b>265,785,970</b>	<b>330,235,836</b>	<b>977,575,225</b>
<b>Actual Balance at January 31, 2002</b>	<b>121,664,070</b>	<b>962,431</b>	<b>23,555,266</b>	<b>221,415,922</b>	<b>4,214,479</b>	<b>43,630</b>	<b>265,785,970</b>	<b>330,235,836</b>	<b>975,472,936</b>
<b>Difference</b>	<b>(352)</b>	<b>(583,223)</b>	<b>(455,471)</b>	<b>(1,063,242)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>(2,102,289)</b>

(1) Net of debt service reserve and costs.

(2) Initially, this amount was loaned to the City of Springfield, Missouri. Subsequently, the loan was restructured to be a bond issue.

Source: Information provided by the issuers and other parties to the bond programs (see Finding No. 6).

*APPENDIX - C*

*LOCAL GOVERNMENT BOND POOLS  
STATEMENTS FROM AUDITED OFFICIAL*

**ESCAMBIA COUNTY HEALTH FACILITIES AUTHORITY**

**1001 N. 12<sup>th</sup> Avenue ■ Pensacola, Florida 32501**

**Mailing address:**

**P.O. Box 2762**

**Pensacola, FL 32513-2762**

**(850) 432-7555**

**(850) 433-8845 fax**

May 2, 2003

Mr. William O. Moore  
Office of the Auditor General  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, FL 32399-1450

Re: Auditor General Report on Pooled Loan Program Bonds

Dear Mr. Moore:

Enclosed is the response of the Authority to the preliminary and tentative findings report of the Auditor General regarding pooled loan program bonds.

Please also be advised that we have not received any audit of this Authority's bond issue and therefore decline to provide a letter of representations in the form you have requested. At such time as an audit document is received in this office, an appropriate management representation letter will be provided.

It is requested you provide a copy of all future correspondence regarding the Auditor General's report to our legal counsel, Paula G. Drummond, at the above address. Your office failed to forward a copy of the preliminary report to her attention. Thank you for your cooperation.

Sincerely yours,



H. Christopher Brooks, Sr.  
Chairman

HCb:dl

cc: Members of the Authority  
Paula G. Drummond, Esq.  
Richard I. Lott, Esq.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**ESCAMBIA COUNTY HEALTH FACILITIES AUTHORITY**

**1001 N. 12<sup>th</sup> Avenue ■ Pensacola, Florida 32501**

**Mailing address:**

**P.O. Box 2762**

**Pensacola, FL 32513-2762**

**(850) 432-7555**

**(850) 433-8845 fax**

May 1, 2003

Response of the Escambia County Health Facilities Authority to the Report of the Auditor General.

1. The Escambia County Health Facilities Authority takes issue with and disagrees with the findings of the Auditor General which criticize its pooled loan program. This Authority and its counsel spent numerous hours explaining the history and mechanics of its loan program, the efforts made to loan the proceeds, factors affecting the number of loans made; the duties of the administrator, trustee and other parties responsible for administration and oversight, providing records, responding to questions, and addressing all aspects of the bonds and their issuance. This information appears to have been wholly disregarded by the Auditor General's office.

2. The Authority notes that the Auditor General's report is NOT an audit of the Authority, but is the Auditor General's report upon a subject matter: pool bond issues. Moreover, such report is not an "audit" but is, rather, a statement of the Auditor General's opinion regarding the advisability of issuing these types of bonds. The Auditor General's report does not identify any illegality or errors in the issuance of the bonds, or the administration of the loan programs, but instead questions the wisdom of certain bond programs. We note that the question of whether or not the programs serve the public interest is an issue that is committed by law to local officials and the courts, and not to the Auditor General.

3. The importance of this distinction is that auditors do not have the necessary experience, capability or understanding of the capital markets that is required to determine whether bond programs are beneficial. This is evidenced by the fact that the Auditor General's report completely ignores the benefits that accrue from the existence of capital bond programs, whether or not they are, in fact, utilized by the intended beneficiaries. The law requires that the Authority be composed of members that have the experience and expertise on the public policy issues of financing health care. No similar requirement applies to the Auditor General, and its report belies its inexperience in the competitive nature of capital financing. To suggest that the financing team for a complex financial transaction such as a pooled loan program should be chosen on the basis of the lowest bid rather than expertise, as if an issuer were acquiring office furniture, is case in point.

4. The Authority's experience in connection with this review revealed that the representatives of the Auditor General's office who conducted the review were not familiar with tax exempt bond issues and had little understanding of

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

the federal tax regulations and applicable Florida statutes governing pool bond issues. It was further plain from the attitude of the auditors throughout the review that they had an existing bias against pool bond issues, and went into the review process with the goal of making adverse determinations.

5. The Authority understands that there are many methods by which local health care facilities can be financed. The Authority's program offers hospitals an alternative to issuing their own bonds. This enables the hospitals to negotiate with other sources of funding, utilizing the pool program rate as a tool to obtain even better financing. By thus improving the hospitals' negotiating positions, the hospitals clearly benefit from lower financing costs, and this serves the purposes for which the Authority was created. This is true, whether or nor the hospital ultimately finds the Authority's financing the most attractive. This Authority made every effort to insure that its loan program offered a very competitive interest rate and favorable financing terms to the health care facilities who indicated their interest in participating in the program. There are many factors which could not have been predicted at the time these bonds were issued that impacted the ability of the Authority to close more loans to date. These factors included the profound negative effect on the nation's economy following the terrorist attacks of September 11, 2001, which in turn affected the credit standing of many of its authorized health care participants who intended to secure capital financing from the Authority's loan program. The targeting of pooled loan programs by the IRS, and now, Florida's Auditor General, are additional factors that cause otherwise qualified and interested health care participants to seek capital financing from other sources.

6. Regarding the Auditor General's negative statements on the loan program's lending of pool bond proceeds to out of state borrowers, it is clear from the bond validation judgments authorizing this process that the courts of the State of Florida recognize the economic benefits to be obtained by Florida hospitals from allowing out of state participation. The Florida legislature expressly amended Chapter 154, Florida Statutes, to make clear that benefits do accrue to Florida hospitals by the financing out of state facilities.

7. We question the motivation of the Auditor General in limiting its review to only those pool bond programs that have not yet loaned out significant amounts. If the Auditor General were truly trying to give an unbiased view of the benefits of pool programs, it would have included a more representative sample of pool transactions. Any such sampling would have shown that the vast majority of pool bond proceeds are successfully loaned out. We point out that the origination period for the Authority's loan program is still ongoing. The Authority continues to market its loan program to authorized health care participants. It is one thing to look back at a pooled loan program and analyze its performance AFTER the loan origination period has ended. It is quite another to make judgments about the success of a loan program in the middle of the loan origination period. The unjustified negative findings in this report, when released to the public, will further impair the ability of ongoing programs to loan out their proceeds.



*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

8. The Auditor General report implies that taking advantage of existing federal tax laws and the IRS Code to issue bonds is somehow contrary to the public interest of the people of the state of Florida. This is the longstanding view of the IRS (which generally opposes the tax-exemption of state and local bonds because it reduces the amounts available to federal government agencies to spend on their own programs). However, the Auditor General's job is to advance the interests of Florida, not the federal treasury. If permitted programs benefit Florida at the expense of the federal government, why should the Auditor General side with the IRS in criticizing such programs? Instead, the Auditor General should applaud the use of these programs to derive more benefits to Florida.

9. In response to Finding No. 6 it is noted that the difference between the Auditor General's analysis of the sources and applications of funds in the Authority's bond issue, and the detailed monthly reports of our Trustee, is \$352. This Authority did not decline to take responsibility for the transactions stated in the Trustee's report. The Authority's Trustee reviewed its records after being notified of this difference in the totals and did not find any error in its accounting of funds. The Authority was asked to certify to the Auditor General's calculations which failed to account for \$352, and declined as we believe your calculations are incorrect.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*



# *City of Gulf Breeze*

LANE GILCHRIST, MAYOR

May 13, 2003

William O. Monroe  
Auditor General  
State of Florida  
111 West Madison Street  
Tallahassee, FL 32399-1450

Dear Mr. Monroe:

The City of Gulf Breeze has the statutory authority to develop and implement financing programs that relieve the burdens of government. Gulf Breeze has developed a sophisticated and successful enterprise consisting of loan programs that comply with federal tax laws. These programs cost the tax payers of Florida nothing and often result in considerable savings to the borrowers and their tax payers. The process of implementing a successful financing program may result in some issuances that achieve less success than was originally envisioned, yet the successful issuances result in such savings to the borrowers that the overall financing program is a tremendous public service to the citizens of the State of Florida. Programs not performing successfully have resulted in no cost to the citizens of Gulf Breeze or the State of Florida. Any enterprise will surely fail if it cannot try new ideas. Unfortunately, as opposed to examining the City's entire finance program, the Auditor General's (AG) office chose to narrowly focus on programs in various parts of the State which did not meet standards as defined by the AG. Little notice or recognition was given to the far more numerous successful programs which provide much benefit to governmental agencies serving millions of citizens around the State.

As it pertains to the City of Gulf Breeze, we are encouraged that no finding or suggestion of the Auditor General concluded that the City violated any provision of Florida law. The City has strictly and faithfully complied with all Federal and State law requirements. The AG is advocating in its findings that the legislature limit the power of local governments in Florida so as to prohibit them from doing what other States permit under Federal tax law. At the same time, more services traditionally funded and administered by the State are being shifted to the local level. Any attempt by the AG to coerce the State legislature to restrict the ability of local government to operate as it has for many decades needs better justification than is cited in this report. We also observe that such restriction would be inconsistent with the principals of municipal home rule as espoused in the Florida Constitution and the Statutory Municipal Home Rule Powers Act.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

Letter-Monroe  
May 6, 2003  
Page Two

Finding No. 1 Loan Commitments Summary

Although the AG office did acknowledge the high rate of success of the Gulf Breeze 1997A Program in originating loans benefitting the citizens of the state, the auditors chose to delete this program from its schedule on page 7 of the report. The result is a more skewed analysis in showing issuance costs related to loans made. Another fallacy in the matrix presented on page 7 is a calculation of costs relative to loans made as if the citizens of the state bear the burden of such costs. Although Gulf Breeze cannot speak to other programs audited, we can assure anyone wanting to objectively analyze loan programs sponsored by Gulf Breeze that borrowers pay only a pro-rata of costs associated with issuing the bonds. Remaining costs, which are not amortized, are paid by parties taking the risk in the transaction such as credit providers or insurance companies. In the 1995 program, as an example, bonds were called for early redemption due to a portion of the bond proceeds not being loaned within the allowable origination period. At the time of the bonds were redeemed, the credit provider was called upon to make up the shortfall in unamortized issuance costs, also referred to as non-asset bonds. This redemption, called by the issuer (Gulf Breeze) in its desire to properly redeem unloaned bond proceeds, resulted in the credit provider paying in excess of \$2 million to bondholders. Remaining borrowers within the program were not assessed for this redemption liability. The AG office correctly observed a number of bond professionals and insurers earn fees for this and other programs. The AG office failed to recognize these professionals assume significant risk and have had to directly pay the fallout of such risks. In the meantime, the borrowers having taken advantage of these programs have realized the benefit of a much lower cost of capital than could otherwise be attained by these borrowers.

*Response: We note the AG office states that no loss was incurred by the citizens of the state of Florida due to any lack of success from some of the programs cited. We emphasize the low cost of borrowing achieved by those program borrowers obtaining financing as a benefit to the citizens. We must conclude the citizens of the state of Florida having realized no liability and having obtained loans at a low rate, result in the pool programs providing public benefit even though the percentage of loaned proceeds admittedly should have been better.*

Finding No. 2 Out of State Loans Summary

In this audit criticism, the AG points to two entirely separate bond programs having as a part of their formulation two separate validations from the courts of this state. The courts apparently found, due to the bond issues in question receiving proper validation from those courts, benefits to the citizenry for the issuance of the bonds. If issuing bonds outside the state create a wider market to disperse costs associated with a bond issue, borrowers within our state reap those benefits.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

Letter-Monroe  
May 6, 2003  
Page Three

*Response: Although the AG questions the courts of this state in the application of the laws governing validations of bond issues, we find the laws provided by the legislature and the rulings by more than one court are in keeping with the statutes. We find no harm has been done to the citizens of the state and, thus, no reason to presume the laws are inadequate.*

Finding No. 3 - Bond Validations Summary

In this criticism, the AG again points to the bond validation process as being improperly administered by the courts and the legislature, in the opinion of the AG, not properly requiring a statement of the purposes of the bond issues. The AG did not find any examples of the issuers violating the statutes.

*Response: We find no reason to question the legislature or the courts since we find no citizens of the state have incurred liability due to the issuance of the bonds.*

Finding No. 4 - Related Parties Summary

As identified by the City of Gulf Breeze Attorney in a letter dated December 2, 2002, to audit coordinator Charles McClellan, a prohibition upon conflicting employment or contractual relationships as set forth in Florida Statutes Section 112.313(7) (a) applies only to an employee of an agency who has an employment or contractual relationship with another agency, which is subject to the regulation of, or is doing business with the agency. As Gulf Breeze Financial Services (GBFS) is an arm and instrumentality of the City of Gulf Breeze, it is not an agency contemplated by the foregoing statute as being subject to the regulation of or doing business with the City of Gulf Breeze. Rather, GBFS is part of and one in the same as the City of Gulf Breeze.

In addition, the City Managers relationships with the City of Gulf Breeze and the City's GBFS are specifically exempted from the conflicting employment or contractual relationships prohibition of Florida Statutes Section 112.313(7)(a). Gulf Breeze Financial Services is the only source within the City of Gulf Breeze of the activities and services which it renders. Florida Statutes Section 112.313(12) provides that no person shall be held in violation of subsection (7) of that statute if the entity involved is the only source of supply within the political subdivision and there has been full disclosure by the employee of his interest in the entity. Since it appears that the Gulf Breeze City Council was not only aware of the City Manager's involvement with GBFS, but actually required the City Manager to have such involvement, the exemption of the foregoing statute would appear to apply. Just as importantly, the governing body of the City, being the party entering into the agreement with the City Manager, has done so fully cognizant of any conflicts which may result from his responsibilities as the City Manager and administration of bond programs. The City Council has been given the AG recommendation to consult with the Florida Commission on Ethics to determine if a conflict of interest exists in violation of the statutes.

APPENDIX - C (CONTINUED)  
LOCAL GOVERNMENT BOND POOLS  
STATEMENTS FROM AUDITED OFFICIAL

Letter-Monroe  
May 6, 2003  
Page Four

Response: *The City Council of Gulf Breeze appreciates the AG office 's analysis, and will take appropriate action.*

Finding No. 5 – Determination of Bond Sale Method and Selection of Bond Service Providers Summary

Probably no other finding of the AG report speaks to the level of specialization inherent in these programs being analyzed by staff of the AG who, by their own acknowledgment, have little background in the area of innovative public finance. Bond programs having a pooling of borrowers means that loans will be made for a wide range of public projects. Revenues to be pledged will be from a wide range of local government sources. Buyers of such bonds will typically be institutional and highly sophisticated. Indentures prepared for each issuance must provide for a host of circumstances ranging from converting bonds to fixed or variable modes, to what to do in the event of a credit failure by one borrower, or a remarketing failure by the remarketing agent, just to name a few. Further, professionals must be employed to provide analysis of rebate liability, material disclosure reporting, and computation of variable loan rates. All of the above limited examples of the complexity of a pool program point to reasons why making the statement noted in the last sentence of the findings becomes bad business. This sentence speaks to having procedures in place to assure services are obtained at the lowest cost consistent with size, nature, and complexity of the bond issues. We also note, again, the AG does not cite any violation of statutes or any liability passed on to the citizens of the State. Florida statutes clearly allow issuing agencies authorization to sell bonds at a private sale instead of a public sale if it finds such a sale is the best way for the bonds to be marketed. The legislature has already made the decision to allow bonds to be sold and professionals be selected without the competitive process. If the Auditor General disagrees with this provision of law, using this audit as a means of trumpeting this disagreement as if to imply citizens are being harmed is inappropriate. Transmitting to the legislature the AG office recommendations should be done through a forum other than an audit which finds no laws have been violated.

Response: *The AG points to prior recommendations, evidently in prior audits that are unrelated to this report, submitted to the legislature to amend statutes related to local government bond issues. Based only on the AG findings noted, we cannot see reasons why the AG is so critical of the legislature. Thus, we do not concur with the recommendation and believe consideration by the legislature of the AG recommendations based solely on this report, would be time better spent on more pressing issues facing the citizens of Florida.*

Finding No. 6 – Accountability and Reporting of Bond Transactions Summary

In this finding, the AG is critical of records kept on bond issues issued by Gulf Breeze and other issuers due to the conclusion that: “The only records available to account for these bond issues were the records kept by the trustees.” The AG draws the analogy of relying on bank corporate trust departments to properly account for transactions as similar to a local government relying

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

Letter-Monroe  
May 6, 2003  
Page Five

on a bank to properly account for transactions involving deposit accounts. This analogy is correct as it relates to reliance on the ledgers and accounting of monies flowing through the various funds. The analogy is misleading as it relates to internal controls and ultimate safekeeping of assets. Gulf Breeze made the decision going back to 1985 when its first loan program was established, to relinquish control and access to the large amount of funds in bond programs to corporate trust officers who make it their profession to administer funds in accordance with explicit instructions provided within bond indentures. Unlike deposit accounts flowing through banks where employees of local government can negotiate and draw upon checks of a local government with the only requirement of the bank being to verify signatures on the check, trustees assume much more accountability and liability for bond funds. With such accountability being vested with corporate trustees, the city felt contracting with trustees having a reputation for performing such services would be of benefit to the programs, and thus the borrowers. Trustees providing these services can do so far more economically than the issuer due to the trustee having the automated systems, trained staff, and internal audit function all under one roof.

Investors have committed hundreds of millions of dollars to the trustee with the confidence the trustee will properly administer those bonds and make sure the bonds are repaid. If these investors are satisfied with the current process, it makes little sense that the Auditor General would criticize the City of Gulf Breeze on the lack of documentation.

Despite the economies of scale realized by having a professional trustee, the City acknowledges the trustee has made mistakes and accounting corrections were required. The mistakes noted are sufficient reasons to justify augmenting the trustee services with more internal staff to monitor trustee reports. Toward this end, Gulf Breeze Financial Services, as the administrator for the City's bond programs, has added another accounting position. A person has already been hired to fill the position. The City intends to increase its monitoring of the trustee statements. The City does not, however, intend to assume disbursement responsibilities being fulfilled by the trustee. We maintain the belief that internal controls are better when the trustee can only disburse funds in accordance with covenants of the bond indentures. If documentation received by the trustee is believed to be sufficient, the City is not in the position to further review each expenditure. The duplication of effort would be unjustified.

*Response: Although the recommendation of the AG to the legislature to require local governments operating loan programs, provide a full accounting for all related transactions sounds prudent, the fact is this practice is already being employed. The issue in dispute is what constitutes full accounting. The city proposes maintaining a monthly statement from a recognized trust services provider operating in accordance with established covenants of the bond indenture is the first step. The added monitoring provided by the issuer in delegating to a qualified person responsibility to check the statements for accuracy would seem to fulfill the*

APPENDIX - C (CONTINUED)  
LOCAL GOVERNMENT BOND POOLS  
STATEMENTS FROM AUDITED OFFICIAL

Letters-Monroe  
May 6, 2003  
Page Six

*Auditor General office's concerns. Although errors have occurred and corrections had to be made, we find no evidence the public has been harmed and thus no need to institute legislative mandates. As an added recommendation to this finding, the AG suggest audits of loan operations be made annually in accordance with accepted auditing standards. Such audits are now being performed as a separate reporting entity apart from the prior audits showing such audits as an operating unit within the City. The City has contracted for such services under a separate audit contract being performed by an outside CPA firm.*

Finding No. 7 – Payments to Bond Service Providers Summary

In the strictest sense of governmental accounting standards, it is reasonable for the AG office to question the format and invoicing associated with the issuance of a municipal bond. The practical side of this criticism is the fact that teams organized to formulate the legal, financial, and operational intricacies of these programs quote the fees in advance based on established industry norms for providing such services. At the closing of the bond issue, culminating many months of due diligence, legal research, and document preparation, invoices are provided to the trustee for payment at closing. Throughout the process, disputes often arise as to legal positions, covenants required, changes instituted by credit providers, market conditions being different, and laws newly legislated. Upon any or all of these factors taking place, a bond issue as originally envisioned may evolve into a much different type of program targeting a very different public purpose. This also means the scope and level of services initially required by a member or members of the financing team may change dramatically. This often necessitates renegotiation of fees to be paid, downward or upward, depending on the consultant in question. All of the above is an attempt to describe how dynamic a bond program can be with the need for flexibility being so very important.

This probably also illustrates why the following question is often posed: Why don't other governmental agencies seek to sponsor financing programs such as Gulf Breeze? The answer lies, in part, in the position taken by the AG office in the finding----the need for the strictest of documentation and exact criteria when employing professionals. For government to be innovative and creative, it must act in accordance with business practices, which fit those objectives----innovation and creativity. Since the risk of sponsoring finance programs is not born by the citizens of the state, but rather by credit providers and bond buyers who are given full disclosure of those risks, the City believes its practice of employing nationally recognized consultants, law firms, and other professionals fulfills its fiduciary responsibility to sponsor such programs deemed to be for lawful public purpose. In the course of employing such professionals, a certain level of trust must be maintained and a high level of flexibility provided in order for the professionals to concentrate on the proper structure of the financing rather than the burden of adhering to exact and defined contractual agreements under a defined and inflexible compensation arrangement engaged long in advance of the program coming to market having many changes along the way.

*Response: We disagree with the AG analysis finding large amounts of invoicing documentation inadequate. Although the City agrees it should make a diligent effort to better address concerns*

APPENDIX - C (CONTINUED)  
LOCAL GOVERNMENT BOND POOLS  
STATEMENTS FROM AUDITED OFFICIAL

Letter-Monroe  
May 6, 2003  
Page Seven

*of the AG analysis, it cannot state all of the examples deemed inadequate by the AG office will not occur again in the future. We communicate this due to, again, our disagreement as to the criteria which the AG believes must be met in order to cure this alleged deficiency.*

Finding No. 8 - Oversight Related to Bond Issues

In this finding, it should come as no surprise to the AG office of our disappointment, as often expressed during the audit examination, that the state office assigned and paid by the citizens to protect the assets of the citizens of Florida have spent many hours in researching and attempting to opine on statutes of the Internal Revenue Code (IRC). Finally, due to the recognition by the AG of the often technical, and often ambiguous nature of the IRC, it recommends a state agency be formed, or an existing one enlarged, to make sure local governments receive regulation and oversight from someone who supposedly can provide such expertise.

*Response: We believe the professionals employed, the qualifications of whom must be real and proven in order for any financing to be successfully marketed, provide adequate checks and balances that regulations are being adhered to. In the opinion of those retained to interpret the law and opine as to the legitimacy of the bonds being issued, all IRC regulations have been met. We do not presume the Internal Revenue Service (IRS) may not question details of a financing program in the future. We do not agree a state agency can employ and obtain expertise at such a higher level than local government so as to totally absolve bond issues from potential IRC questions.*

Finding No. 9 - Potential Need for Additional Bond Pools Summary

To quote the AG report-Bond pools can provide local governments improved marketability and lower issuance and borrowing costs than could be achieved through individual bond or other long-term debt issues. It appears that there may be a need to make additional bond pool financing available to local governments.

*Response: We agree with the AG finding that there may be a need to make additional bond pool financing available to local governments. It may even make sense to create another state agency to oversee or monitor this activity. Such monitoring should not interfere however, with the ability of local government to continue to establish finance programs as it has in the past. A protection should be added to benefit taxpayers that requires any agency created for this purpose to be funded only through fees generated by that agency.*



*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

Letter-Monroe  
May 6, 2003  
Page Eight

If you need any further information, please do not hesitate to call me at (850) 934-5115.

Sincerely,



Lane Gilchrist  
Mayor

MLG:sfb

cc: Jeb Bush, Governor, State of Florida  
Holly Benson, State Representative District Three  
Charlie Clary, State Senator District Four  
City Council  
Edwin A. Eddy, City Manager  
Ed Gray, GBFS  
Richard Lott, Miller Canfield  
Matt Dannheisser, City Attorney

Letter03/0506Monroe

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**CAPITAL PROJECTS  
FINANCE AUTHORITY**

3949 Evans Avenue  
Suite 402  
Fort Myers, Florida 33901  
Ph (239) 277-3950  
Fax (239) 277-0078  
[www.capfa.org](http://www.capfa.org)

May 1, 2003

Mr. William O. Monroe, C.P.A.  
Auditor General  
State of Florida  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, FL 32399-1450

Dear Mr. Monroe:

On April 3, 2003, the Capital Projects Finance Authority received the report of the preliminary and tentative findings of your audit of:

City of Moore Haven Capital Projects Finance Authority  
Local Government Bond Pool Revenue Bonds, Series 1997A,  
and Variable Rate Demand Revenue Bonds, Series 1998A (Hospital) and 2000H (Airport)

This submission is the Authority's response to those preliminary and tentative findings as required by Section 11.45(4)(d), Florida Statutes. This submission is organized so that a point-by-point response is made to the findings that involve one or more of the three bond issues referenced above. After that section, there is also a summation that discusses the broad findings of your audit.

We appreciate the opportunity to present this response, and be assured that we would be available to work with your staff in efforts that would enhance the accounting and reporting of pool bond activity.

Respectfully submitted,



Philip C. Bennett  
Program Administrator

Cc: R. G. Harris, Chairman  
William L. Zvara, Esq.  
Bradley Waterman, Esq.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**RESPONSES TO SPECIFIC PRELIMINARY AND TENTATIVE AUDIT FINDINGS**

On page 7, you present a schedule of bonds issued, loans made, and costs of issuance associated with those bonds. The last column of that schedule calculates a “Percent costs/Loans made”. Your discussion of this column indicates that the costs associated with the loans made is high. We would submit that this calculation is meaningless. None of the costs of the bond issuance was paid by the borrowers. In fact, the loan origination costs paid by the borrowers was very low, normally less than ½ of 1 percent. Additionally, none of the bond issuance costs was paid from bond proceeds. All such costs were paid from funds outside the trust estate of the bonds. We would submit that the program minimized the costs that each borrower paid for its respective loan.

On page 8, you state that “Efforts made . . . . . to assess credit worthiness and likelihood of participation of identified potential borrowers was minimal”. We take exception to that comment as it relates to the three CaPFA pool bond issues. In all cases, we worked very closely with bond and tax counsels to assure that reasonable expectations existed for the ultimate borrowing of at least 95% of the bond proceeds. Such efforts included the submission of a list of respondents to our demand surveys to the credit provider for the bonds to assure that each entity would likely qualify to participate. Furthermore, we obtained a list of credit underwriting criteria from the credit provider and satisfied ourselves that each entity would likely qualify under that criteria. Additionally, every potential participant of the 1998A pool had taken prior official action and conducted public hearings before the bonds were issued. In summary, we maintain that we performed most of the due diligence steps you list at the bottom of page 8 of your findings.

On page 12 and 13, you discuss the shortcomings of Chapter 75, F.S., regarding bond validation, especially as such actions relate to out-of-state loans. We would submit that our validation petitions and the subsequent final judgments issued comply in all ways with the statutes. Your conclusion that the complaint did not adequately explain the benefit to Florida citizens of out-of-state loans is contradicted by the final judgment issued by the Court. We maintain that the Courts found that the public benefit was adequately explained. We would also point out that, to the best of our knowledge, there is no provision within the Florida Statutes that required the validation of any of these bonds. CaPFA voluntarily submitted to the validation process so as to resolve any potential legal challenges to such issues as out-of-state loans. On three separate occasions, such validation processes were pursued by CaPFA.

On page 15 and 16, you properly stipulate that Florida Statutes do not currently require competitive selection of financial consultants and other professionals associated with bond issues, nor is there a requirement to document the criteria and rationale for the selection of such professionals. As such, we fail to see the reason for this finding to be included in this report. This may indeed be a policy issue that the Auditor General wishes to have addressed by the Legislature, but we feel it is not relevant to this specific audit. We have complied with the current law regarding this selection process. We would further point out that competitive selection of professionals is not always in the best interests of the issuer. Unique bond transactions like bond pools require specific expertise that many professionals do not possess. Different firms have different expertise, and cost is not always the most important factor. Even the Division of Bond Finance has determined that negotiated selection of professionals is more appropriate in certain situations.

On page 17, we note that you recognized that we maintained adequate accounting records and oversight of the trustee on two of the three bond pools. We would point out that the accounting responsibilities for the third pool were specifically and totally assigned to a third party. Any inadequacies that may have occurred should be addressed with that party and not CaPFA.

On page 18, we would submit that your request for a “sources and application of funds” statement was confusing and not relevant to the purposes for which we maintained financial records. We review, analyze, and adjust the monthly financial reports prepared by the trustee into a set of financial statements that conform with generally accepted accounting principles. As such, we make certain adjustments and close out activity at the conclusion of certain accounting periods. Your sources and application schedule was not something which could be easily prepared by our staff. However, we did assist in the preparation of those schedules by your staff and did verify the schedules for the two pools for which we had administrative responsibilities.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

On page 19, you correctly point out that “there is no provision for separate audits of local government bond pool operations except as prescribed in Section 163.01(5)(q) Florida Statutes, for finance commissions.” Yet, your comment goes on to state “however, the seven bond issues we reviewed for these entities were not included within the scope of those audits” (meaning the audits of the general governments. We worked very closely with the City’s independent auditors to determine the proper reporting of the activities of the pools. As you mention, there is no requirement for a separate audit. In fact, our discussions with the Department of Community Affairs (the agency responsible for administering special districts) revealed that the only appropriate way to report such operations was in a manner similar to industrial development authorities, etc. We were advised, and the City’s auditors concurred, that the proper reporting of these activities should take the form of a footnote disclosure in the audit reports of the general government. DCA advised us that there was no provision for separately reporting bond pool activity to the State. Accordingly, we maintain that proper disclosure was provided in the City’s annual audit.

On page 20 and 21, we take exception to your comment that adequate documentation was not generally available to support payments of professional services. While we cannot speak to the documentation maintained by others, we feel that adequate documentation was maintained. In the case of all closing costs, an independent trustee was retained to disburse funds and to verify the legitimacy of each expenditure. In all cases, invoices that clearly detailed the services provided were submitted to the trustee. In some cases, primarily involving legal fees, there was no formal engagement letter drafted, but the retention of bond and tax counsel is often done so with no such formal agreement. In all cases, these legal fees were paid in accordance with mutual understandings and pursuant to the submission of a properly detailed invoice that was reviewed and approved by the various parties.

Additionally, we would again point out that no closing costs were paid from the proceeds of the bonds issued. All such costs were outside the trust estate.

On page 22, we would take exception to your statement that “we noted that bond disclosure forms filed with the Division ..... were not complete as to issuance costs”. All such forms were prepared and submitted by bond counsel. He advises, and we concur, that proper disclosure was made for all issuance costs.

On page 23 and 24, you describe and refer to certain provisions of various requirements for the issuance of tax exempt bonds contained in the Internal Revenue Code, and that failure to comply with these provisions could have serious consequences on the tax status of these bonds. We have the following comments regarding these observations:

Under Section 149(f) of the Code, when an issuer issues pooled financing bonds it must reasonably expect to loan 95% of the net proceeds within three years. The issuer is not required to secure binding commitments from prospective borrowers. Indeed, Congress rejected a binding commitment requirement;

Over the years, the IRS has promulgated highly detailed regulations relating to various tax exempt bond provisions of the Code. These regulations are designed to ensure compliance with respect to both the technical requirements of the Code and the general provisions underlying tax exemption. However, the IRS has not promulgated regulations under Section 149(f) regarding pools, even though it was enacted 15 years ago. Consequently, CaPFA and its advisors were required to operate on a best efforts and good faith basis without the benefit of detailed guidance;

The “differing interpretations” you cite in your report are, in our opinion, a product of the failure of the IRS to promulgate regulations under Section 149(f), and with respect to Section 147(e) and 147(f), regulations providing guidance for pooled financing arrangements in particular. CaPFA was advised by nationally recognized professionals who were compelled to render advice regarding highly technical matters without the benefit of IRS guidance. There is no indication, and there is no reason to believe, that the advice was inconsistent or otherwise at odds with the general requirements of the Code. If the IRS’ views differ, it is because the IRS is relying on technical interpretations that either do not exist or were not disclosed to the public when the advice was rendered;

Despite the lack of guidance, CaPFA took significant steps to assure that the bonds issued for these three transactions were done so in compliance with the Code as we understand it

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**GENERAL OBSERVATIONS AND CONCLUSIONS**

While we may take exception to certain findings within the preliminary report, there are several findings and positions therein with which we concur and encourage action.

First, we concur with your recommendation relating to finding 9. There is clearly a need for pooled financings within the State. The vast majority of local governments in the State are small and infrequent issuers of tax exempt debt. As such, most of the 400+ cities, 67 counties, and 1000+ special districts in the State could benefit from the efficiencies offered by a pooled financing. Whether that takes the form of a state agency, one or more finance commissions, or by other appropriate means, the benefits for pooled financings are clear.

We also do not disagree with the designation of a state agency that would have oversight authority for pool bond financings. Clarification of duties and responsibilities would enhance the accountability of pool bond issuers. However, before the Legislature takes action on such a proposal, there needs to be clarification of many of the issues raised in this report. Some of these clarifications must be made by agencies other than the State of Florida, specifically by the IRS. To this extent, your comment that “many efficiencies and increased assurances of compliance with IRS requirements could be achieved by designating an oversight agency to communicate with the IRS on certain issues of compliance and to review the proposed bonds prior to issuance” is misplaced because it assumes incorrectly that the IRS has issued adequate guidance, and thus, could provide meaningful assistance to an oversight agency.

However, while the IRS continues to “clarify” its position on pooled financings, we would encourage the Auditor General to continue his efforts to provide oversight on other issues. Proper and adequate reporting of pooled financing activity is such an area. As we described previously, there is no mechanism for reporting pooled financing activity to the State, nor is there any guidance on the proper level of audit of such activities. Clearer guidance from the Legislature regarding this issue would be of great assistance to issuers of pool bonds.

Within this report, you have once again raised the issue of competitive selection of professionals and documentation of the method of sale. We have no disagreement with the observations contained in your audit report No. 01-075, findings number 10 and 11 regarding these issues. We would observe that even the Division of Bond Finance recognizes that negotiated sales of certain types of securities is often in the public’s best interest, so any requirement for competitive selection and sale for all cases would be counter-productive. However, documentation of the rationale of determining the most appropriate method of sale and selection of the best qualified professionals is reasonable.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

May 2, 2003

**VIA EMAIL AND REGULAR MAIL**

William O. Monroe, CPA  
Auditor General, State of Florida  
674 Claude Pepper Building  
111 West Madison Street  
Tallahassee, FL 32399-1450

**Re: Orange County Health Facilities Authority - Preliminary and  
Tentative Audit Findings and Recommendations Regarding Local  
Government Bond Pools**

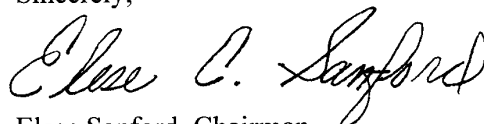
Dear Mr. Monroe:

I submit to you the attached written statements of explanation concerning the findings applicable to the Orange County Health Facilities Authority, including any actual or proposed corrective actions. Please accept the attached statements in response to the preliminary and tentative audit findings in your report submitted to us under your cover letter dated April 2, 2003.

Also enclosed is the certificate addressed to you that you requested be sent simultaneously with the attached statement.

If you have any questions or wish to further discuss any of the comments made in the attached statements, please feel free to contact me or our attorneys, Lou Frey, Esquire or Michael Ryan, Esquire at the law firm of Lowndes, Drosdick, Doster, Kantor & Reed, P.A.

Sincerely,



Elise Sanford, Chairman  
Orange County Health Facilities Authority

0012195\092046\642567\1

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 1: LOAN COMMITMENTS

When the Orange County Health Facilities Authority issued its Variable Rate Demand Revenue Bonds (Florida Hospital Association Pool Loan Program) 2000 Series A in the principal amount of \$330,000,000.00, it intended and reasonably expected that \$300,000,000 of the proceeds from the bond issue would be loaned to health care providers. In fact, while the Pool Loan Program was in effect (July, 2000 through November, 2002), health facility projects of Florida Hospital Association members were financed with the Authority's issuance of specific project bonds totaling in excess of \$350,000,000. In the view of the Authority and the FHA Management Corporation, the decision of Florida Hospital Association members not to borrow from the Pool Loan Program (as they had indicated they would prior to the Authority's issuance of its Pool Loan Program bonds) was primarily because of the unforeseen effects of Internal Revenue Service examinations of other pool bond issues. The decision of Florida Hospital Association members not to borrow from under the Pool Loan Program does not in any manner indicate a lack of proper due diligence by the Authority, the FHA Management Corporation, bond counsel, the Authority's financial advisor, or the Authority's general counsel. Florida Hospital Association members chose to do project specific new bond deals rather than borrow from the Authority's Pool Loan Program because of the risk of an IRS audit and the affect that any threatened audit might have on the variable rates offered under the Pool Loan Program.

The Preliminary Report states that the "efforts made (of record)" by the Orange County Authority "to assess the credit-worthiness and likelihood of participation of identified potential borrowers was minimal." We respectfully submit that this statement is incorrect. The Florida Hospital Association had in its files extensive financial and utilization statistics and forecast assumptions for each of the potential borrowers. Unlike the Escambia County Authority, the FHA Management Corporation did not need to request such information for the first time, because it had access to all of the Florida Hospital Association information and, in fact, had a more detailed understanding of each of the potential borrowers through its historical relationship with them. One of the principal functions of the FHA Management Corporation is in fact to obtain financial and utilization data regarding the members of the Florida Hospital Association members and to compile that data into comprehensive reports. By assembling this data and producing these reports, the FHA Management Corporation conducted a rigorous due diligence process.

The due diligence review of credit-worthiness and likelihood of participation of potential borrowers was in fact more detailed and rigorous in the case of the Orange County Authority pool bonds issue than in the cases of the other pool bond issues in which neither the issuers nor their administrators appeared to have an extensive and pre-existing relationship with the potential borrowers

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

Also, we note that many of the Florida Hospital Association members had previously undertaken loans from tax-exempt bond pools for which the FHA Management Corporation had previously acted as program administrator. This history of member participation was in itself an important factor in the due diligence review.

FHA Management Corporation undertook an extensive demand survey among its Association members. While binding commitments were not obtained from demand survey participants, it is relevant to note that Section 149(f) of the Internal Revenue Code requires that when an issuer issues pooled financing bonds, it must reasonably expect to loan 95% of the net proceeds within the next three years, but does not require binding commitments from prospective borrowers. Indeed, Congress rejected a binding commitment requirement. Over the years, the IRS has promulgated highly detailed regulations relating to various tax exempt bond provisions of the Code to ensure compliance with both the technical requirements of the Code and the general principles underlying tax exemption. However, since Section 149(f) was enacted nearly 15 years ago, the IRS has failed to promulgate any regulations regarding what extent of documentation would justify a "reasonable expectation" that the pool financing bond proceeds would be loaned. Consequently, the Authority, its administrator, and their advisors were required to operate under best efforts on a good faith basis without the benefit of detailed guidance.

Despite the absence of guidance, the Authority, its administrator and their advisors did take significant steps to support a reasonable expectation that loans would be made within the next three years. Florida Hospital Association members actually signed demand survey forms indicating in excess of \$600,000,000 worth of demand, and after personal interviews by bond counsel with representatives of the various health facilities, bond counsel recommended that the available loan proceeds be reduced to \$300,000,000. Representatives of the hospitals were present at the meeting at which the Authority approved the bond issue urging the Authority to establish the pool loan program.

So long as the Internal Revenue Service is auditing pool loan programs and the rules governing those programs are evolving, it is unlikely that the Authority will receive any request by the Florida Hospital Association, or any other association, for the issuance of pool bonds, nor will the Authority favorably consider any such request.



*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 2: OUT-OF-STATE LOANS

We agree with the recommendation of the Auditor General that out-of-state loans should not be made from the proceeds of any Authority bond issue in the absence of a demonstrated benefit to Florida citizens. None of the proceeds of the Authority's Pool Loan Program were earmarked for out-of-state projects. However, one of the hospitals substantially benefited by the Authority's ability to issue tax exempt bonds is Adventist Health System/Sunbelt, Inc. whose national headquarters is in Orange County. The Adventist system owns and operates substantial health facilities in Orange County, throughout the State of Florida, and in numerous other states. The issuance of bonds by the Authority to finance Adventist's out of state as well as in state health facilities, saves Adventist substantial issuance costs, thus benefiting Orange County and Florida citizens who are served by having a strong Adventist health system in the State.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 3: BOND VALIDATIONS

Bond validations are not required by Florida law, but can be of great benefit to issuers and their counsel if there is any bond issue question regarding the authority of the issuer to incur the bonded debt or the legality of the proceedings in connection therewith. Your recommendation that additional statements be required to be made in a bond validation complaint regarding public purposes and benefits to the citizens of the State of Florida, are not objectionable, although they are of questionable effectiveness. The recommendation that the validation complaint specify a time period limitation on the validation gives rise to the question as to the effect of that time period passing. A lack of validation does not make bonds invalid.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 4: RELATED PARTIES

Neither the Authority nor any of its members or officers have held or currently hold any employment or contractual relationship with the Florida Hospital Association or the FHA Management Corporation, with any of the hospital members of the Association, or with the underwriter or any of the bond service providers involved in the Pool Loan Program bond issue. Finding No. 4 and the related recommendation are not applicable to the Orange County Health Facilities Authority.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 5: DETERMINATION OF BONDS, SALE METHODS AND SELECTION OF  
BOND SERVICE PROVIDERS

The Florida Hospital Association ("FHA") requested that the Authority issue bonds to finance an FHA sponsored Pool Loan Program. The FHA Management Corporation introduced the Authority to an underwriter/bond counsel team that had effectively closed another Pool Loan Program in Kentucky the year before. The structure of the program was extremely complicated and required a great deal of up-front work by the FHA Management Corporation, the underwriter, and bond counsel prior to its presentation to the Authority. The Authority's authorizing resolution includes a finding that the timing, size and complexity of the financing and the volatility of the municipal bond market and the financial instruments authorized requires that the terms of financing be negotiated at a private sale rather than competitive bid. The guaranteed investment contract and the liquidity facility were competitively bid. The Authority's financial advisor (Public Financial Management) reviews each of the Authority's bond transactions and all of its financial aspects.

A competitive selection process for some bond services may be appropriate, although different firms have different capabilities and experience and, though cost is important, it is not and should not be the controlling factor. A competitive bid process is not always appropriate.

In a typical project specific bond transaction, where the health facility borrower is involved at the closing, the borrower and its chosen underwriter with whom the borrower has worked closely to structure the requested financing, typically negotiate the fees so as to minimize the cost to the borrower, thus keeping the bond service providers fees reasonable. The suggestion in Finding No. 7 that a written understanding be reached up front as to how fees will be charged for such services is a good suggestion.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 6: ACCOUNTABILITY AND REPORTING OF BOND TRANSACTIONS

The Orange County Health Facilities Authority relied upon its administrator, FHA Management Corporation, and the trustee, Bank of New York, to maintain the records necessary to ensure proper accountability for the bond funds. Both the administrator and the Trustee are paid fees in order to accomplish this, have the personnel and systems set up to accomplish this, and are well experienced at performing these functions. The Authority has neither the staff nor the revenues required to do so. If the Authority were required to maintain duplicative records, there is a resulting cost which would have to be borne by someone, presumably the not-for-profit health facilities.

We emphasize that in fact the State Auditor General found no incorrect payments or other discrepancies in connection with the 2000 Series A Bonds.

Your suggestion that pool loan programs should be audited has merit.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 7: PAYMENTS TO BOND SERVICE PROVIDERS

Typically, the Authority will require that invoices be provided by the service providers and the invoices are kept by the Trustee who has responsibility for disbursing the funds. The suggestion that invoice copies should also be kept by the Authority, as well as the suggestion that there be a written understanding as to the basis for the compensation and reimbursable expenses, have merit.

Note that none of the bond service provider fees in the Authority's 2000 Series A Pool Loan Program were paid from the bond proceeds or any public funds, but were provided by the Remarketing Agent.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 8: OVERSIGHT RELATED TO BOND POOL ISSUES

In the issuance of its 2000 Series A pool bond issue, the Authority relied upon the opinion of nationally recognized bond counsel that the bonds were tax exempt. Thus far there has been no determination, preliminary or final, that the bonds issued by the Authority are not tax exempt. Oversight by a state agency with the expertise to analyze and provide constructive comments on pool bond issues merits consideration, although there will be some concern as to whether the state agency will have the necessary expertise and as to the affect of such oversight on the expense and timing of the bond issue.

The Auditor General's observation that "many efficiencies and increased assurances of compliance with IRS requirements could be achieved by designating an oversight agency to communicate with the IRS on certain issues of compliance and to review the proposed bonds prior to issuance" assumes incorrectly that the IRS has issued adequate guidance and thus could provide meaningful assistance to an oversight agency. The "differing interpretations" cited by the Auditor General are a product of the failure of the IRS to promulgate regulations under Section 149(f) and with respect to Section 147(e) and Section 147(f), regulations providing guidance for pooled financing arrangements in particular. The Authority was advised by nationally recognized professionals who are compelled to render advice regarding highly technical matters without the benefit of IRS guidance. There is no indication, and there is no reason to believe, that the advice was inconsistent or otherwise at odds with the general requirements of the Code. If the IRS' views in fact differ, it is because the IRS is relying on technical interpretations that either did not exist or were not disclosed to the public when the advice was rendered.

*APPENDIX - C (CONTINUED)*  
*LOCAL GOVERNMENT BOND POOLS*  
*STATEMENTS FROM AUDITED OFFICIAL*

**Orange County Health Facilities Authority - Statement in Response  
to Auditor General Report**

FINDING NO. 9: POTENTIAL NEED FOR ADDITIONAL BOND POOLS

The findings and recommendations under Finding No. 9 are of a statewide political nature as to which the Orange County Health Facilities Authority has little input or influence.

It is encouraging that the Auditor General recognizes that, notwithstanding the issues relating to implementation, there are good reasons why pool bond issues should be allowed to continue.