



TEFRA Approvals: Considerations for Officeholders When Approving Private Activity Bonds

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New officeholders often ask us to clarify their responsibilities when it comes to public approval of bonds and the consequences for states and their political subdivisions when they approve bonds as tax-exempt. What follows is a brief overview of the public approval process, considerations for granting public approval and the consequences that follow when an officeholder approves the tax-exempt status of private activity bonds.

Public Approval Process

The Internal Revenue Code of 1986, as amended, permits states and their political subdivisions to issue tax-exempt bonds to finance certain projects that benefit for-profit and non-profit entities. These projects include airports and docks, affordable housing, solid waste disposal facilities, small manufacturing facilities and property used by 501(c)(3) organizations to further their charitable purposes.

U.S. Congress restricts the use of tax-exempt bonds because the federal government foregoes income tax revenue by exempting the interest on tax-exempt bonds from the gross income of bondholders. It also restricts them because the over-issuance of tax-exempt bonds increases interest costs throughout the tax-exempt bond market and could make financing traditional governmental projects unaffordable. According to the Joint Committee on Taxation, Congress created the public approval requirement in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) as a method of ensuring that tax-exempt bond-financed projects would serve a legitimate purpose with substantial public benefit. Congress recognized that it would not have the time or local knowledge to make these determinations, so it shifted the responsibility for determining whether issuing tax-exempt bonds to finance particular projects would result in substantial public benefit to states and their political subdivisions.

Generally, the public approval requirement is satisfied if both the state or political subdivision issuing the tax-exempt bonds (the “Issuer”) and the state or political subdivision in whose jurisdiction the tax-exempt bond-financed project will be located (the “Host”) approve the amount of the tax-exempt bonds and the project being financed. Issuer approval is typically given by the state or political subdivision actually issuing the tax-exempt bonds, while a Host approval may be given by the state or any political subdivision whose jurisdiction entirely encompasses the tax-exempt bond-financed project. For example, if a project is entirely located within a city, and the city is entirely located within a county, the city, county, or the state may grant Host approval. Both Issuer approval and Host approval are commonly called TEFRA approvals.

Issuer approval and Host approval may be granted through a referendum of eligible residents of the Issuer and the Host; however, because of the time and expense of voter referendums, certain elected officeholders of the Issuer and the Host may also grant approval after a properly noticed (a “TEFRA Notice”) meeting open to the general public (a “TEFRA Hearing”) has been held that permits public comment regarding the proposed tax-exempt bonds and the nature and location of the proposed project. A TEFRA Hearing is properly noticed if a TEFRA Notice is published no fewer than seven calendar days before the TEFRA Hearing is to be held via a publicly available newspaper of general circulation available to the residents of the Issuer and the Host or in an area of the Issuer’s or Host’s primary public website used to inform the public of events. The TEFRA Notice must provide the time and location (if held in person), or the toll-free number (if held telephonically), of the TEFRA Hearing. The TEFRA Notice must also provide the maximum amount of tax-exempt bonds to be issued for the project, a general functional description of the type and use of the project, the name of the initial legal owner or principal user of the project, and the address of the project to be financed with tax-exempt bonds. If a project is located at multiple locations, then the foregoing information must be provided for each separate site of the project.

Issuers and Hosts may conduct TEFRA Hearings in accordance with their hearing procedures so long as all members of the public have a reasonable opportunity to express their views orally or in writing

about the proposed tax-exempt bonds and the location and nature of the proposed project. TEFRA Hearings may be conducted by third-party hearing officers, and the elected officeholder(s) that will provide public approval for the issuance of the bonds as tax-exempt does not have to attend. Unless held telephonically, the TEFRA Hearing must be held at a location convenient for the residents of the Issuer and the Host, with the location of the seat of government of the Issuer and the Host, as applicable, being presumed convenient. When the Issuer and Host are different governmental entities, they may hold joint TEFRA Hearings, provided that if held in person, they are no farther than 100 miles from the seat of government of the Issuer and each Host.

Officeholders of Issuers and Hosts that may grant the public approval required for bonds to be tax-exempt are called "Applicable Elected Representatives." Persons that may grant public approval are entire legislative bodies, such as city councils or both houses of state general assemblies, chief executive officers, such as city mayors or state governors, the chief legal officer of a state, such as an attorney general, and any officeholder popularly elected by the voters of the Issuer or Host and designated to provide public approval by the chief executive officer of the Issuer or Host or by state or local law, such as a state treasurer. An Applicable Elected Representative must be elected, so appointed city or county administrators may not grant public approval even if they are the chief executive of the city or county.

Additionally, except for legislators which may be elected to represent districts within the Issuer or Host, all Applicable Elected Representatives must be elected pursuant to an election open to all voters within the Issuer or Host, so a village mayor cannot serve as an Applicable Elected Representative in circumstances where the mayor was not popularly elected. Many Issuers such as authorities or commissions may have unelected boards appointed by a mayor or governor. Individuals serving on these boards may not grant Issuer approval of the bonds, but rather an Applicable Elected Representative of the next higher governmental unit from which the Issuer derives its authority must grant public approval. For state authorities with boards appointed by a governor, usually the

governor will grant public approval, and for city commissions with boards appointed by city council, either the popularly elected mayor or the city council may provide public approval.

Public Approval Considerations

The Internal Revenue Code and the regulations permit the Applicable Elected Representative to exercise broad discretion in determining whether tax-exempt bond-financed projects serve a legitimate purpose with substantial public benefit. As noted above, the Applicable Elected Representative does not have to attend the TEFRA Hearing. The Applicable Elected Representative is not required to review any TEFRA Hearing report concerning public comments about the size of the bonds or the location and nature of the project. The Applicable Elected Representative's discretion may be limited by a state constitution or the federal constitution or by certain laws. For example, an Applicable Elected Representative probably could not grant public approval for tax-exempt financings for secular hospitals but decline to grant public approvals for hospitals affiliated with Catholic organizations due to their religious affiliation.

Consequences of Public Approval

When an Applicable Elected Representative grants public approval to bonds of a state or political subdivision, those bonds will be tax-exempt assuming compliance with all other applicable legal requirements. Tax-exempt status may be a necessary condition for financing a project, so if the Applicable Elected Representative does not provide public approval of the bonds, his or her community may lose out on the economic benefit provided by the project. Additionally, approving the bonds as tax-exempt may strengthen the financial performance of the project's owner as less revenues are spent on paying interest, which may permit the owner to expand its operations in the locality of the project or pay higher wages to its employees employed at the project. Granting public approval does not make the Host responsible for the repayment of the tax-exempt bonds and does not make the Issuer responsible for the repayment of the bonds. Granting public approval does not

alter whether state law treats the bonds as debt for purposes of constitutional or statutory provisions.

While granting public approval has many benefits, there are some potential costs. The Issuer will be responsible for maintaining the tax-exempt status of the bonds by maintaining certain records while they are outstanding. The Issuer will also be required to interact with the Internal Revenue Service in the event of an audit, although typically such interaction is minimal, and the conduit borrower is typically responsible for paying legal counsel to respond to the audit. Granting public approval to treat certain bonds as tax-exempt, such as affordable housing bonds, will also use state tax-exempt bond volume cap. Many states currently do not have enough tax-exempt bond volume cap for all projects that Issuers would like to finance with tax-exempt bonds, and approving tax-exempt bonds for a project means that other projects cannot benefit from tax-exempt bonds.

For questions or assistance complying with the public approval requirements or obtaining public approval for projects, please contact the authors or any attorney with Frost Brown Todd's [Public Finance Practice Group](#).

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