

Capital Finance for Local Governments: Intro to Debt Financing

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Financing Options for Purchasing / Constructing Capital Assets

Current Revenues	Savings	Grants / Gifts / Partnerships	Special "Levies"	Borrowing Money
General Fund Revenues	Fund Balance	Federal Grants	Special Assessments	General Obligation (G.O.) Bonds
Enterprise Fund Revenues	Capital Reserve Fund	State Grants	Special Tax Districts	Revenue Bonds
		Private Grants	Development Exactions	Special Obligation (S.O.) Bonds
		Private Donations "CrowdFunding"	Capital Fees for Public Enterprises	Installment Financings (COPs, LOBs,) (Synthetic TIFs)
		Public/Private Partnerships <i>Leases Reimbursements Downtown Development Urban Redevelopment</i>		Project Development Financings (TIFs)



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“The General Assembly shall enact **general laws** relating to the **borrowing of money secured by a pledge of the faith and credit** and the **contracting of other debts** by counties, cities and towns, special districts, and other units, authorities, and agencies of local government.”

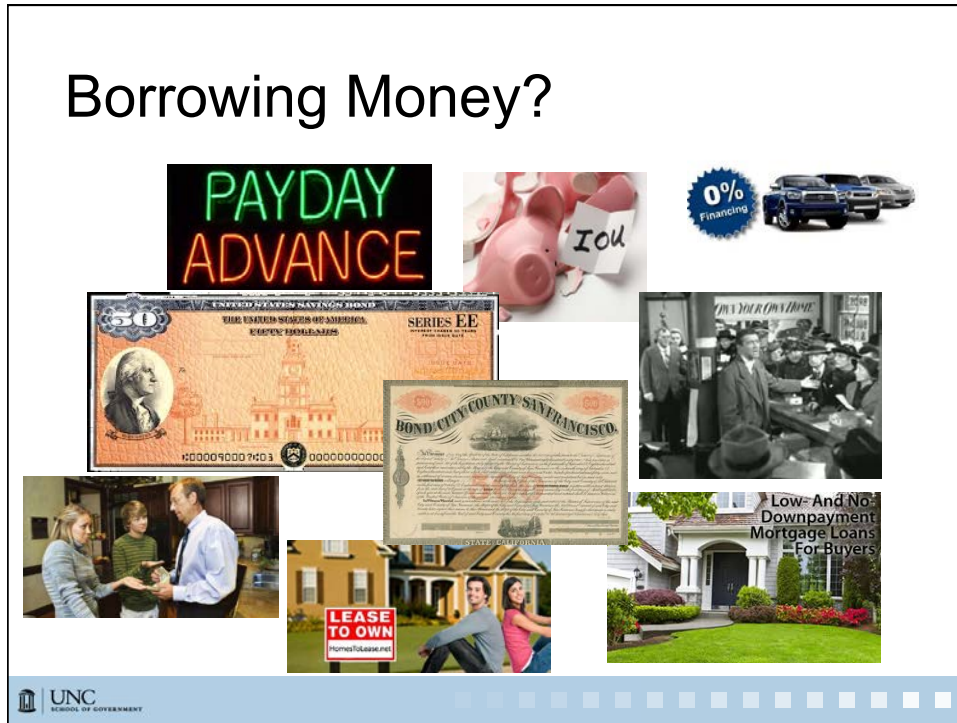
“A **debt is incurred** ... when a county, city or town, special district, or other unit, authority, or agency of local government **borrows money.**”

NC Const. Art. V, Sect. 4(1) & (5)

Borrowing Money (Incurring Debt)

- ✓ Are we borrowing money?
- ✓ Can the borrowing method legally be used to fund project (state law)?
- ✓ What is the security for the borrowing (state law)?
- ✓ What funds will be used to repay the loan (state law)?
- ✓ What are the procedural requirements for the borrowing (state law / federal law)?
- ✓ Is voter approval required (state law)?
- ✓ Is Local Government Commission approval required (state law)?
- ✓ Is the borrowing method feasible (market)?
- ✓ Is the borrowing method tax exempt (federal law)?

Borrowing Money?



Is It a Borrowing?

1. A county receives \$2.5 million from a local bank to fund a repair project to the county library. The county will repay the money to the bank over a ten-year period, plus 3.6 percent interest per year.
2. A city has run into short-term cash-flow problems. It approaches the county for an appropriation of \$400,000 to meet its payroll obligations for the month. The city will return the funds to the county with a small additional interest payment next month.

Is It a Borrowing?

3. A town issues revenue bond anticipation notes in order to finance a water infrastructure project. Once the project is completed, the town will borrow money from the USDA and use the monies to repay the bond anticipation notes.
4. A county purchases a fire truck from the vendor. The vendor allows the county to pay for the truck over a 4-year period at 0% interest.

Is It a Borrowing?

1. If there is an acquisition of capital asset, with payment over time, it likely constitutes a borrowing
2. If there is an **effective** acquisition of capital asset, with payment over time, it may constitute a borrowing

Effective Acquisition

- A village enters into a ten-year contract to lease a building that it will use to house its recreation department. Under the terms of the lease, the village will pay \$750,000 per year for full use of the facility and a private developer (the lessor) will maintain the building and conduct all repair work during the lease period. At the end of the ten year period, the village has the contractual right to purchase the building for \$1.

Capital Lease

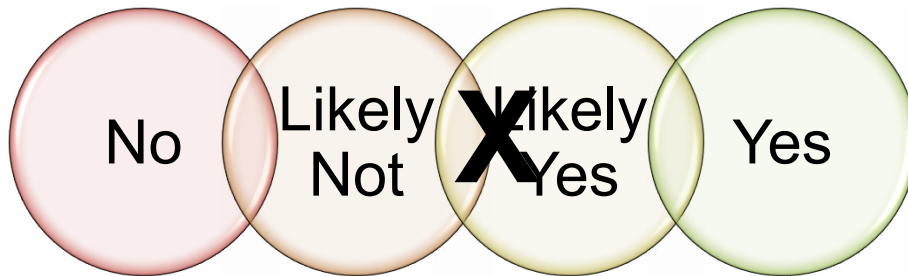
When is a lease a capital lease? GAAP Guidance

- The “lease” passes title to the “lessee” by the end of the “lease” term;
- The “lease” permits the “lessee” to purchase the property for substantially less than its fair market value;
- The “lease” term is at least 75% of the property’s estimated remaining economic life; **or**
- The present value of the minimum “lease” payments is at least 90% of the property’s fair market value.

Is a capital lease a type of borrowing under NC law?



A city/county is authorized to lease as lessee, with or without option to purchase, any real or personal property for any authorized public purpose.



Statutory Authority for Borrowing Money

1. Local Government Bond Act (G.S. 159, Art. 4)
2. Revenue Bond Act (G.S. 159, Art. 5)
3. Special Obligation Bonds (G.S. 159I)
4. Installment Financings (G.S. 160A-20; G.S. 115C-528 (schools))
5. Project Development Financing Act (G.S. 159, Art. 6)
6. Capital Leases (G.S. 160A-19; G.S. 153A-165; G.S. 115C-531 (schools))



Debt Financing Terminology

- Bond Counsel
- Rating Agencies
- Underwriters
- Official Statement
- Evidences of Debt
- Tax Treatment
- Security
- Arbitrage

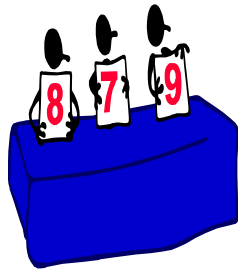


Bond Counsel

- ✓ Issues Opinion Letter
 - ✓ Describes bond issuance in detail
 - ✓ States that bonds are valid, binding obligations of the unit
 - ✓ Describes security
 - ✓ Details whether interest tax exempt or not
- ✓ Prepares most borrowing documents and supervises process
- ✓ Assists in preparing official statement used in marketing securities



Rating Agencies



- ✓ Provide ratings for bond issue which serve as measure of issuer's financial strength
- ✓ Rating applies to a particular bond issuance
- ✓ Ratings based on: general economy, debt structure, financial condition, demographic factors, management practices of governing board and staff
- ✓ Agencies: Moody's, S&P, Fitch, Carolina's Municipal Advisory Council

Underwriters



- ✓ Analyzes financing alternatives
- ✓ Coordinates the financing process to structure the bond issue
- ✓ Underwrites the bonds initially and sells them to the public
- ✓ Provides liquidity in the form of maintaining a secondary market in the bonds
- ✓ Assists with investment of proceeds



Types of Bond Sales

Public Offering	Private Placement
<p>Competitive Sale</p> <ul style="list-style-type: none"> • Bonds advertised for sale (notice includes terms of sale and terms of bond issue) • Any broker dealer or dealer bank may bid on bonds at designated date/time • Bonds are awarded to the bidder offering the lowest interest cost 	<ul style="list-style-type: none"> • Provides funding through direct negotiation with one or a select number of private financial institutions • Bonds are not publicly issued or publicly traded and typically do not require a rating from credit rating agency
<p>Negotiated Sale</p> <ul style="list-style-type: none"> • Underwriter selected to purchase the bonds • Underwriter sells bonds to its investor customers • Involves presale process -- terms of bonds are tailored to meet the demands of investor customers, as well as needs of issuer 	

Official Statement

- ✓ Describe essential terms of bonds
- ✓ Provides financial and/or operating data about issuer
- ✓ Includes summaries of the material terms of relevant legal documents relating to the bonds, a copy of bond counsel's legal opinion, and a copy of the bond insurance policy

<http://emma.msrb.org/EP791556-EP612792-EP1014334.pdf>

Evidences of Debt

- ✓ Bonds
- ✓ Notes (BANs)
- ✓ Certificates of Participation (COPs)
- ✓ Limited Obligation Bonds (LOBs)
- ✓ Loan Agreement, Promissory Note, Deed of Trust
- ✓ Installment Financing Agreement
- ✓ Lease/Purchase, Capital Lease, Financing Lease
- ✓ Financing Agreement

Is the Borrowing **TAX** Exempt?

Government Bonds

- Only government directly benefits from financed project
- Tax exempt

Private Activity Bonds

- Any bond issued as part of an issue which meets:
 - the private business use test (10%) and the private security or payment test (10%), OR
 - the private loan financing test (5%).
- *Includes management contracts and rental agreements*
- Not tax exempt
- Certain exceptions

Parking Decks

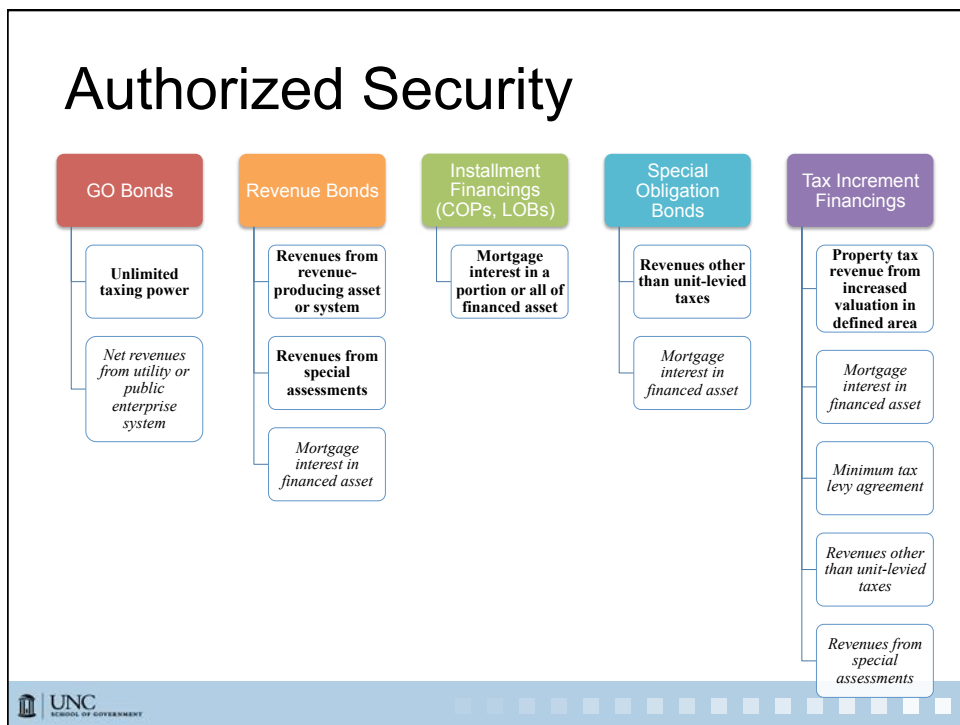
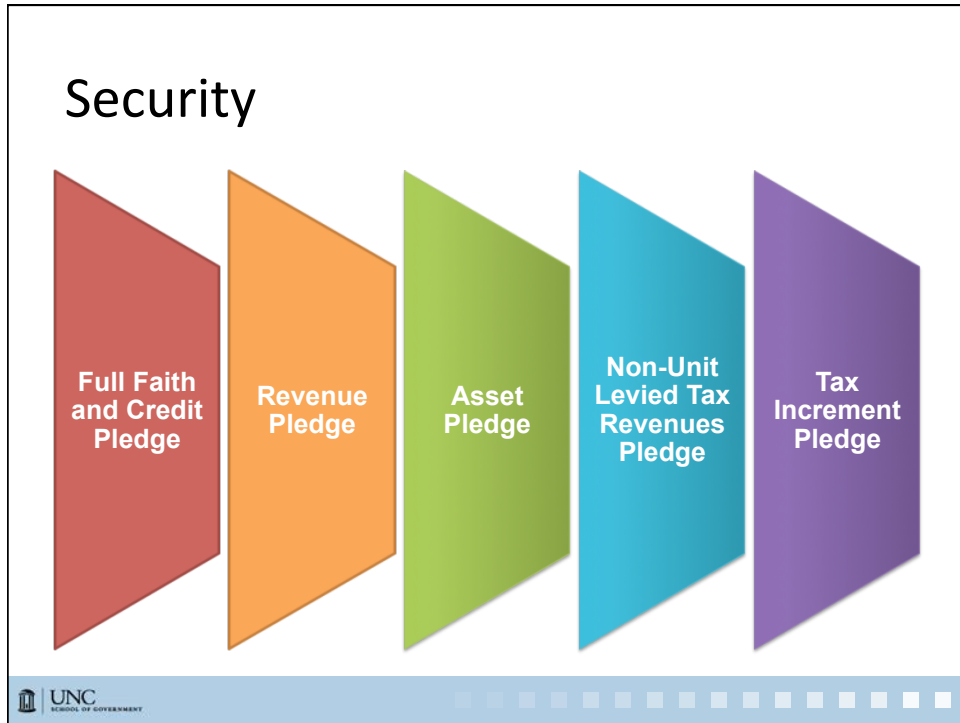
- Will deck be managed by private entity?
- Will deck be leased by private entity?
- Will a portion of parking spaces be dedicated to private use?
- Will parking deck provide special economic benefit to private trade or business?

Security



What lender can
require borrower to do
or require borrower to
give up if borrower
fails to make debt
service payments





What Security May be Pledged?

- Issuing revenue bonds to add capacity to the city's water system to serve a new subdivision
- Issuing limited obligation bonds to fund a new elementary school
- Issuing tax increment bonds to fund the a new park to benefit a new mixed-use development

Knowledge Check

The city has entered into an installment financing contract to finance a downtown parking garage. The security for the financing is a mortgage interest in the garage itself. The city plans to use parking fee revenues to make debt service payments. It turns out that the net revenues are inadequate to meet debt service. May the city constitutionally appropriate tax money from the general fund to pay the debt service on the garage financing?

Arbitrage



- Unit may not invest “gross proceeds” of a bond issue at a yield “materially” higher than the yield on the bonds
 - Certain exceptions allowed
- If gross proceeds are invested at a yield higher than the bond yield, the excess earnings must be rebated to the US in five-year installments
 - Certain exceptions allowed