



Basic Fundamentals of Debt : Debt Issuance for Governmental Entities

Presentation – October 7, 2022

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Where we are headed today...



- Sources of funding capital and operating expenses
- Common Debt Terms
- Theory of Public Finance Projects
- Debt authority
- Types of debt
- Debt limitations
- The Anatomy of a Bond Issue
- Federal Income Tax and Securities Law Issues



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Sources of Funding Permanent Improvements

- Cash
 - Property Taxes
 - Income Taxes
 - User Fees
 - Other Government Revenues
 - Economic Development Compensation Payments
- Debt Issuance-highly regulated by statutes

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Common Debt Terms

- **Bonds** – long-term obligations to repay money, usually over a period of 1-30 years
- **Bond Anticipation Notes** – notes issued prior to the issuance of bonds
- **Notes** – short-term obligations to repay money, usually over a period of one year or less
- **General Obligation** – pledge for payment of bonds through property taxing power
- **Limited tax bonds** – bonds that are supported by unvoted property taxes
- **Unlimited tax bonds** – bonds that are supported by voted property taxes
- **Special Obligations** – bonds that supported by a specific tax, but not GO

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Theory of Public Finance for Capital Projects

- **Why do communities issue debt?**
 - Costs are too high for cash payment of a project
 - Spread the cost of a project over current and future generations
 - Benefits are spread over several generations – costs could be as well
 - One generation should not subsidize the next
- **Payments equate to useful life of assets or less**

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First Steps to Issue Debt

- **Authority to Issue Debt**
 - Public Purpose
 - Debt Limits
 - Maturity Limitations
- **Methods of Sale**
 - Private Placement
 - Negotiated Sale
 - Competitive Sale

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Theory of Public Finance for Capital Projects

- **Must be for a public purpose**
 - Example of public purposes for which debt is issued:
 - Building Schools – both for K-12 and higher educational institutions
 - Road Projects – new roads and highways as well as maintenance on existing roads
 - Public Power Projects
 - Sewer & Water and Other Utilities
 - Economic Development
- **Why Tax-Exempt?**
 - Tax-Exempt Municipal Bonds enjoy special advantageous status in the investment community because the interest paid on most municipal debt is not subject to federal income taxation to bond investors and that generally translates to lower interest rates.

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Debt Authority

- State of Ohio
- Political Subdivisions
 - Taxing Districts
 - Municipalities, counties, townships, school districts, etc.
 - Special purpose districts without taxing power

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Debt Authority: State of Ohio

- Article VIII, Section 1 – Ohio Constitution
 - Ability to borrow for deficit limited to \$750,000
- Article VIII, Section 2 – Ohio Constitution
 - Specific amendments (approved by voters from time to time) to permit issuance of debt for capital projects

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Debt Authority: Political Subdivisions

Taxing Districts

- Municipalities
- Townships
- Counties
- School Districts

Special Purpose Districts

- Port Authorities
- Fire Districts
- Library Districts
- Park Districts
- Conservancy Districts
- New Community Authorities
- Community College Districts
- Joint Hospital Districts
- Water and Sewer Districts
- Regional Transit Authorities

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Types of Debt

- Bonds, Notes, Bond Anticipation Notes
- General Obligations
 - Voted vs. Unvoted
- Revenue or Special Obligations
- Conduit Obligations
- Non-Debt
- Capital vs. Operating Borrowings

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Types of Debt: General Obligation Debt

- "Full Faith and Credit and general taxing power" of subdivision is pledged to pay debt service
- May be paid out of General Fund of Issuer
- Voted debt and Unvoted debt
- Priority over operating expenses
- Subject to direct and indirect debt limits

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Types of Debt: General Obligation Debt

- Voted G.O. Debt
 - specifically approved by voters
 - special tax authorized (but not required to be levied)
 - unlimited as to rate or amount
 - most secure of all debt (best security, highest rating, lowest interest cost)
- Unvoted G.O. Debt
 - first claim against revenues but no special tax
 - includes most special assessment debt

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Types of Debt: Special or Revenue Obligations

- Limited pledge of only a specific revenue stream to pay debt service
 - Utility revenues (water, sewer, electricity, etc.)
 - TIF revenues
 - Sales tax revenues (county – ORC 133.081)
 - Income tax revenues (municipality – home rule)
 - Special assessment revenues (ports)
- Less secure than G.O. debt

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Types of Debt: Conduit Obligations

- The government acts as an issuer pursuant to an arrangement with a private conduit borrower in order for the debt to be tax-exempt.
- The conduit borrower is solely responsible for making debt service payments.
- Conduit obligations are not considered debt of the government issuer.

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Types of Debt: Non-Debt

- Leases
- Lease-purchase agreements
 - Municipal – ORC 715.011
 - County – ORC 307.02
 - Township – ORC 505.26; ORC 505.267
 - School district – ORC 3313.374
- Installment purchase agreements
- Certificates of participation (“COPs”)

Non-debt transactions do not count against debt limitations

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Types of Debt: Capital vs. Operating

- Limited authority to borrow for operating expenses
 - Final judgments or settlements
 - Emergencies
 - Anticipating a voted tax levy
 - Requirement to show a deficit

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Debt Limitations

- Direct debt limitations
 - Municipalities
 - Counties
 - Townships
 - School districts
 - Exemptions
- Indirect debt limitation
 - The “ten-mill” limitation

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Municipal Direct Debt Limitations

- Unvoted debt limitation is 5.5% of total assessed valuation
- Voted + unvoted debt limitation is 10.5% of total assessed valuation
- Example: total assessed valuation of city X is \$400,000,000, so unvoted debt capacity is \$22,000,000 and total debt capacity is \$42,000,000

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Municipal Direct Debt Limitations

- Municipal Exemptions in ORC 133.05
 - Urban renewal or industrial development (ORC Chs. 725 and 761)
 - Utility, parking, healthcare, waste management, urban redevelopment, public attraction, natural resource, and correctional facilities (ORC 133.05)
 - Income tax appropriation bonds (ORC 133.05)
 - Motor vehicle license and gasoline tax bonds (ORC 133.05)
 - Police and fireman pension funds (ORC 742.30)
 - Public improvements (ORC 5709.40(D))
 - Sports facility projects (ORC 307.673)
 - Educational or cultural facility projects (ORC 307.672(B)(2))
 - Energy conservation (ORC 717.02)

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County Direct Debt Limitations

- Unvoted debt limitation is 1% of total assessed valuation
 - Example: total assessed valuation of county X is \$400,000,000, so total unvoted debt capacity is \$4,000,000

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County Direct Debt Limitations

- **Voted + unvoted debt limitation**
 - 3% of first \$100,000,000 of total assessed valuation
 - \$3 million plus 1.5% of next \$200,000,000 in total assessed valuation
 - \$6 million plus 2.5% of total assessed valuation exceeding \$300,000,000
- **Example:**
 - total assessed valuation of county X is \$400,000,000
 - Unvoted debt limitation is equal to:
 - \$100,000,000 x 3% = \$3,000,000 *plus*
 - \$200,000,000 x 1.5% = \$3,000,000 *plus*
 - \$100,000,000 x 2.5% = \$2,500,000 *equals \$8,500,000*

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County Direct Debt Limitations

- **County exemptions in ORC 133.07**
 - Hospital facilities (ORC Ch. 140; ORC 339.14(K))
 - Water/sewer, scrap, parking, healthcare, public attraction, natural resource, and correctional facilities (ORC 133.07(C))
 - Highway permanent improvements (ORC 133.07(C))
 - Energy conservation (ORC 307.041)
 - Sports facility projects (ORC 307.673)
 - County renewal projects (ORC 303.46)
 - Notes for roadway construction (ORC 5549.02(A))

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Townships: Direct Debt Limitations

- **Non-limited home rule townships**
 - No general authority for unvoted debt (only specific statutory authorizations)
 - Voted debt limitation is 5% of total assessed valuation
- **Limited home rule townships**
 - Unvoted debt limitation is 5.5% of total assessed valuation
 - Voted + unvoted debt limitation is 10.5% of total assessed valuation

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Township Direct Debt Limitations

- Township Exemptions in ORC 133.09
 - Fire equipment and facilities (ORC 505.37)
 - Township park acquisition (ORC 505.261)
 - Buildings, equipment and sites (ORC 505.262)
 - Township police district facilities (ORC 505.53)
 - Energy conservation (ORC 505.264)
 - Notes for roadway construction (ORC 5549.02(A))

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School Districts: Direct Debt Limitations

- Unvoted debt limitation is 0.10% of total assessed valuation
 - Unvoted debt limitation for “energy conservation measures” is 0.90% of total assessed valuation (ORC 133.06(G))
 - Unvoted debt payable from payments in lieu of taxes may be issued with approval of superintendent of public instruction

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School Districts: Direct Debt Limitations

- Voted + unvoted debt limitation is 9% of total assessed valuation, but consent of superintendent of public instruction required for debt in excess of 4% of total assessed valuation
 - “Special needs” districts may exceed 9% limit with
 - Consent of superintendent of public instruction,
 - Consent of tax commissioner,
 - Projected assessed valuation growth of 1.5% annually for the next five years (based on historically 10-12 year growth)
 - Total debt including new issue does not exceed 12% assuming projected assessed valuation in 10 years
 - Debt in excess of 4% and 9% limits may be issued to provide local share of OSFC project (ORC Ch. 3318)

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School Districts: Direct Debt Limitations

- School District Exemptions in ORC 133.06
 - School buses (ORC 3327.08)
 - Computers and computer hardware (ORC 3313.37)
 - Certain loans (ORC 133.06(D)(4))
 - School share of dissolved JVS debt (ORC 3311.217)
 - Administrative office facilities (ORC 3313.374)
 - OSFC/Additional classroom facility assistance (ORC 3318.042)
 - Energy conservation (ORC 3313.372)

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Direct Debt Limitations: General Exemptions

- General exemptions for municipalities, counties, townships, and school districts contained in ORC 133.04
 - Special assessment debt
 - Current revenue anticipation debt
 - Voter-approved tax anticipation debt
 - Extraordinary expenses
 - Delinquent tax debt
 - Judgment debt
 - Federal or state grant anticipation debt
 - Self-supporting debt
 - Other special categories

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Debt Limitations: Indirect Debt Limitation

- ORC 5705.02 imposes a ten-mill (1.0%) limitation on each dollar of tax valuation
- The “ten-mill limitation” applies to the aggregate amount of taxes which may be levied for payment of debt service (principal and interest) on UNVOTED general obligations issued by all overlapping subdivisions taxing the same property
- Voter approval means the “ten-mill limitation” does not apply

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Debt Limitations: Indirect Debt Limitation

- Millage calculation example:
 - Annual debt service for unvoted debt of subdivision X is \$200,000; total assessed value of subdivision X is \$100,000,000
 - Millage calculation:

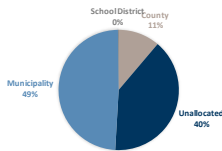
$$\frac{\text{Total annual debt service}}{\text{Total assessed valuation}} \times 1000$$

$$(\$200,000 / \$100,000,000) \times 1000 = 2 \text{ mills}$$
- Ten-Mill Certificate

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Example of 10-Mill Allocation:



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Types of Issuers: Special Purpose Issuers

- Port authorities
 - Fire districts
 - Library districts
 - Park districts
 - Conservancy districts
 - New community authorities
 - Community college districts
 - Joint hospital districts
 - Water and sewer districts
 - Regional transit authorities
- Port authorities can issue unvoted debt on behalf of other political subdivisions

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**Types of Issuers:
Special Purpose Issuers**



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Types of Issuers: Port Authorities

- Specific territory
- Cooperative agreements with other political subdivisions
- Issues bonds for "authorized purposes"
 - Transportation, economic development, housing, recreation, education, governmental operations, culture, or research
 - Ohio Constitution, Art. VIII, Sections 13 (economic development) and 16 (housing)

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Types of Issuers: Port Authorities

- Bonds are non-recourse to port authority and paid by identified revenues
- Loans to private companies
- Cooperative agreements with other political subdivisions
- Public-private partnerships using tools such as:
 - TIFs
 - Special assessments

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The Anatomy of a Bond Issue

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Participant Roles & Responsibilities

Issuer	Municipal Advisor	Underwriter	Bond Counsel (Legal Opinion)
<ul style="list-style-type: none"> Approve bond legislation Assist with preparation of disclosure data Make rating & insurance presentations (if applicable) Make bond payments Post sale responsibilities 	<ul style="list-style-type: none"> Provide financing plan assistance Develop schedule Provide rating agency & bond insurer preparation assistance Provide structuring advice Provide market comps 	<ul style="list-style-type: none"> Perform due diligence on disclosure Assist with financing plan, structuring, and credit rating Provide market information and comps from trading desk Market and sell the bonds 	<ul style="list-style-type: none"> Prepare bond resolution Provide Official Statement/disclosure preparation assistance Prepare various deal related legal documents Provide legal opinion to investors

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Participant Roles & Responsibilities

Rating Agencies / Bond Insurers	Investors	Paying Agent / Registrar (P&I Payments)
<ul style="list-style-type: none"> Review credit worthiness of the issuer Rating agencies issue bond rating Insurance companies insure issue (if economically beneficial) 	<ul style="list-style-type: none"> Purchase bonds Receive interest and principal payments from paying agent 	<ul style="list-style-type: none"> Authenticate bonds Receive interest and principal payments from issuer Make interest and principal payments to investors

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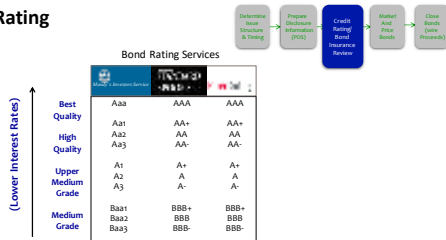
Official Statements

- Unimpressive Prospectus
- Contents include:
 - Principal amounts, maturities, and interest rates for the bonds
 - Description of the authority for the bonds
 - Security for the bonds
 - Redemption provisions for the bonds
 - Description of the Issuer
 - Leadership team
 - Tax Base
 - General Fund Revenues
 - Audited Financials of the Issuer

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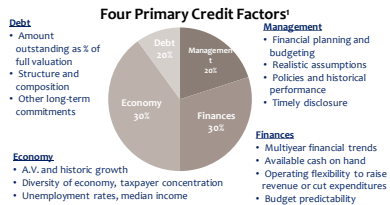
Credit Rating



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Rating Factors



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Marketing and Pricing

- Active Pre-Marketing
 - Investment Broker
 - Branch manager memorandum
 - Sales force conference call
- Wide Distribution
 - Institutions
 - Banks
 - Individual Investors



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Closing the Issue



- Underwriter wires funds to issuer.
- Issuer confirms to the underwriter that all funds are received.
- Bond counsel confirms everything is in place for closing.
- Underwriter & Paying Agent call Depository Trust Company (DTC) to release the bonds to investors.

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Primary Documents for a Bond Transaction

- Election proceedings (voted issue only)
- Authorizing legislation
- Official Statement (Preliminary & Final)
- Bond Purchase Agreement
- Key Closing Documents
 - Bond Counsel Opinion
 - Bond Certificates
 - Signature & No Litigation Certificate
 - General Certificate
 - Tax Compliance/Arbitrage Certificate
 - IRS Form 8038-G

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Federal Income Tax Issues

- Section 103, Internal Revenue Code of 1986, as amended:

“...gross income does not include interest on any State or local bond.”

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Federal Income Tax Issues: Arbitrage

- Arbitrage bond
 - A bond is not tax-exempt if it is an “arbitrage bond” under Section 103(b)(2) of the Internal Revenue Code
 - **Arbitrage bond** is any bond issued in which the proceeds of such issue are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly:
 - To acquire higher yield investments, or
 - To replace funds which were used directly or indirectly to acquire higher yield investments

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Federal Income Tax Issues: Exceptions to Arbitrage

- **Temporary period exception three-part test**
 - *Expenditure test* – 85% of proceeds must be spent within three years of the date of the issue
 - *Time test* – within six months of the date of the issue, the issuer must incur a substantial binding obligation (5% of debt proceeds)
 - *Due diligence test* – work on the project must proceed with due diligence
- *All three parts apply to a “reasonable expectation” at the date of the issue*

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Federal Income Tax Issues: Exceptions to Arbitrage

- Small issuer exception
 - Municipalities, counties, townships
 - Must issue less than **\$5 million** of "new" money in any calendar year
 - "New" money means non-refunding (current) issues
 - Example:
 - 2021 - \$5 million of "new" money
 - 2022 - \$4 million of "new money; \$5 million of refunding money
 - **Result** – Neither issue is subject to rebate (assuming the temporary period exception is met)

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Federal Income Tax Issues: Exceptions to Arbitrage

- Small issuer exception
 - School districts
 - Must issue less than **\$5 million** of "new" money in any calendar year, **plus**
 - An additional **\$10 million** of proceeds which are allocated to the construction of school facilities
 - Example:
 - \$5 million on working capital or land acquisition
 - \$10 million on construction of school facilities (bricks & mortar)

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Federal Income Tax Issues: Refunding

- Refunding issues
 - *Current refunding issue*
 - Refunding which occurs within 90 days of the maturity date of the issue which is being refunded
 - Notes
 - Callable bonds
 - Unlimited number of current refundings
 - Ohio law – after five years, issuer must begin to pay down principal on notes

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Federal Income Tax Issues: Refunding

- Refunding issues
 - *Advance refunding issue*
 - Refunding which occurs outside of 90 days of maturity date of the issue which is being refunded
 - Only taxable advance refundings permitted

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Federal Income Tax Issues: Rebate

- Rebate
- Exceptions to rebate:
 - Small issuer exception
 - 6-month expenditure exception
 - 18-month expenditure exception (15%, 60%, 100%)
 - 24-month expenditure exception (10%, 45%, 75%, 100%)

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Federal Income Tax Issues: Private Business Use

- Private business use (Private activity bonds):
 - No more than 10% of the bond (or note) proceeds are used in the trade or business of any person other than a governmental unit, and
 - The payment of the principal and interest on bonds (or notes) representing more than 10% of the total issue is secured by or derived from property to be used in the trade or business of non-governmental persons

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Federal Income Tax Issues: Other Issues

- Reimbursement of prior expenditures:
 - Issuer must pass reimbursement resolution within 60 days of expenditure
 - Reimbursements permitted for up to 18 months
 - Certain preliminary expenditures fall outside restrictions
- Bank qualification (\$10,000,000): Certain financial institutions get a deduction for 80% of that portion of the financial institution's interest expense allocable to interest on tax-exempt securities

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Federal Securities Law Issues

- Primary market disclosure
 - Offering documents (official statement)
- Continuing disclosure
 - Annual disclosure
 - Material event disclosure
- Certain exemptions
 - Bonds offered in minimum denominations of \$100,000 and
 - Term of nine months or less **OR**
 - Sold to no more than 35 "sophisticated" investors

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Federal Securities Law Issues: Primary Market Disclosure

- Offering document required by the SEC for issues of debt greater than \$1,000,000
- Preliminary official statement (final terms of bonds omitted)
- Final official statement (final terms of bonds included)

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Federal Securities Law Issues: Continuing Disclosure

- SEC requirement that issuer provides disclosure of pertinent financial information each year and at certain events until outstanding bonds are paid
- Information filed online with EMMA (Electronic Municipal Market Access System)
 - Electronic filings
 - Word searchable PDF files
 - No more NRMSIRs
- emma.msrb.org

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Federal Securities Law Issues: Continuing Disclosure

- Annual disclosure
 - Requirements contained in continuing disclosure certificate or agreement
 - Financial statements
 - Additional information:
 - Property tax collections
 - Largest taxpayers
 - Election history
 - Utility fees and collections

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Federal Securities Law Issues: Continuing Disclosure

- Material event disclosure
 - Defaults
 - Draws on reserves or credit enhancement
 - Adverse tax events
 - Unscheduled redemptions
 - Defeasances
 - Rating changes
 - Incurrence of a financial obligation
 - Etc.
- Rule 15c2-12 requires material event disclosure within 10 days of event




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Post Issuance Compliance Policy

- Internal Procedures & Policies
 - For purposes of complying with Federal Tax Law, Federal Securities Law, and Bond Proceedings, the issuer should develop and implement a Post Issuance Compliance Policy.

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