



## Fundamentals of Debt

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Presented by:

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- Kinds of Debt & Debt Limitations
- Borrowing
- Federal Tax Law Matters
- Federal Securities Law Matters

## Kinds of Debt and Debt Limitations

“A billion here, a billion there, and pretty soon  
you’re talking real money.”

~ Everett Dirksen



- State law dictates the rules for most issuers:
  - Limits kind and amount of debt that can be issued
  - Places fiscal responsibility on its officials
  - Protects taxpayers from unlimited debt burden
  - Legislation required to authorize borrowing
  - Legislation must authorize security, source of repayment and other terms

- General Obligations
  - Bonds vs. Notes
- Revenue (Special) Obligations
- Lease-Purchase Financing

# General Obligations – Security and Sources

- Secured by Property Taxes (and all other resources of issuer)
  - Voted
  - Unvoted
- Full Faith and Credit
  - Repayment may come from Other Available Revenues
    - Municipal Income Tax
    - Special Assessments for the Project Financed
    - Other Nontax Revenues (Enterprise Funds)
    - Exceptions
      - Taxes Limited to Particular Purpose (e.g., motor vehicle fuel and license taxes)
      - Pledged Utility Revenues
      - Special assessments for specific projects

# General Obligations - Debt Limitations

## ▪ Direct Debt Limits

- Basics
  - Based on Assessed Valuation
  - Apply to “Net Indebtedness” (with some exceptions)
  - Different kinds of subdivisions have their own limitations
- Exemptions
  - “Self-supporting” debt
  - Municipal Income Tax Covenant
  - Utility revenue and other non-general obligation debt
  - Statutory Exceptions
    - County – County jails
    - Township – Fire protection



# General Financial Statement

City of \_\_\_\_\_, Ohio  
\$5,210,000 Various Purpose Improvement Bonds, Series 2020

I, the fiscal officer of the City of \_\_\_\_\_, Ohio, certify that the following statements are true and correct:

|     |  |                 |
|-----|--|-----------------|
| 1.  | The tax valuation of the City (as shown by the tax lists and duplicates for the year 2019, which are the latest at this date) .....  | \$1,049,040,190 |
| 2.  | (a) Total principal amount of all outstanding bonds and notes of the City, <b>including the captioned issue</b> and excluding any bonds or notes to be retired by the captioned issue(*) ..... | \$ 31,020,000   |
|     | (b) Of that total, the total of voted and unvoted general obligation bonds and notes .....   | \$ 31,020,000   |
| 3.  | Principal amount of exempt securities included in item 2(a):   |                 |
|     | (a) Bonds and notes issued in anticipation of the levy or collection of special assessments (excluding the City's portion) .....   | \$ -0-          |
|     | (b) General obligation bonds and notes that are "self-supporting securities" as defined in R.C. 133.01 (LL):   |                 |
|     | <u>Category</u>  |                 |
|     | Sewer System .....   | \$ 450,000      |
|     | Recreational Facilities .....  | \$ 8,275,000    |
|     | Water System .....   | \$ 1,950,000    |
|     | Total .....  | \$ 10,675,000   |
|     | (c) Securities to extent authorizing legislation contains covenants to appropriate, levy and collect municipal income taxes (R.C. 133.05(B)(7)) .....  | \$ 13,460,000   |
|     | (d) Tax Increment Financing .....  | \$ 6,885,000    |
| 4.  | Total of item(s) 3(a) through (d) .....  | \$ 31,020,000   |
| 5.  | 10-1/2% of tax valuation .....   | \$ 110,149,219  |
| 6.  | Total principal amount of voted and unvoted bonds and notes subject to 10-1/2% overall debt limitation [2(a) minus 4] .....  | \$ -0-          |
| 7.  | Debt leeway (**) within 10-1/2% limitation [5 minus 6] .....   | \$ 110,149,219  |
| 8.  | 5-1/2% of tax valuation .....  | \$ 57,697,210   |
| 9.  | Total principal amount of unvoted bonds and notes subject to 5-1/2% unvoted debt limitation .....  | \$ -0-          |
| 10. | Debt leeway (**) within 5-1/2% unvoted debt limitation [8 minus 9] .....   | \$ 57,697,210   |

(\*) Including the amount of bonds and notes apportioned to the City and excluding the amount of bonds and notes apportioned to another municipal corporation, as a result of the acquisition or loss of territory. Also excluding any hospital revenue bonds or industrial development bonds issued under R.C. Chapter 140 or 165, respectively.



- **Indirect Debt Limit (“ten-mill” limitation)**

- Applies to Debt Service on Unvoted General Obligation Debt
- Constitution and Ohio Revised Code 5705.02
- Municipal charter limitation may be different
- *Article XII, Section 11*
  - “No bonded indebtedness of the state, or any political subdivision thereof, shall be incurred or renewed unless, in the legislation under which such indebtedness is incurred or renewed, provision is made for levying and collecting annually by taxation in amounts sufficient to pay the interest on said bonds, and to provide a sinking fund for their final redemption at maturity.”
- *Article XII, Section 2*
  - “No property, taxed according to value, shall be so taxed in excess of 1% of its true value in money for all state and local purposes, but laws may be passed authorizing additional taxes to be levied outside of such limitation either when approved by at least a majority of the electors of the taxing district voting on that proposition, or when provided for by the charter of a municipal corporation.”

# Supplemental Financial Statement



## SUPPLEMENTAL FINANCIAL STATEMENT (UNVOTED GENERAL OBLIGATION BONDS AND NOTES)

I, County Auditor of \_\_\_\_\_ County, Ohio, certify in connection with the following proposed issue of Notes: Issuer: City of \_\_\_\_\_, Ohio \$2,606,900 Various Purpose Notes, Series 2021, dated July 21, 2021 that:

The tax rates required to produce an amount to pay the highest annual aggregate debt charges for the proposed issue and all other general obligation securities of the Issuer and the subdivisions overlapping it, which are payable from taxes subject to the 10-mill limitation of Article XII, Section 2, Ohio Constitution and applicable Revised Code provisions, based on the facts set forth below *and assuming that all levies were to be made for those debt charges* on the general tax list and duplicate, are as follows:

| Overlapping Subdivisions   | Tax Valuation   | Bonds and Notes Outstanding Payable from Taxes Inside 10-Mill Limitation | Present Principal Amount | Debt charges for calendar year in which they will be the highest (2023) |              | Required Tax Rate in Mills for Two Previous Columns |
|----------------------------|-----------------|--|--------------------------|---|--------------|---|
|                            |                 |  |                          | For Principal   | For Interest |   |
| _____ County               | \$2,517,095,530 | (a) Special Assessment Bonds and Notes.                                  | None                     | None  | None         | 0.0000  |
|                            |                 | (b) All other Bonds and Notes.   | \$24,847,000             | \$1,670,000   | \$569,210    | 0.8896  |
| City of _____              | \$119,480,710   | (a) Special Assessment Bonds and Notes.                                  | None                     | None  | None         | 0.0000  |
|                            |                 | (b) All other Bonds and Notes.   | \$125,000                | None  | None         | 0.0000  |
| _____ City School District | \$177,821,000   | Bonds and Notes.   | \$175,000                | \$35,000  | \$4,463      | 0.2219  |
| _____ Joint Vocational SD  | \$3,119,451,500 | Bonds and Notes  | None                     | None  | None         | 0.0000  |
|                            |                 | Proposed Issue   | \$2,606,900              | \$85,000  | \$151,614    | 1.9804  |
|                            |                 |  |                          |   | Total        | 3.0919  |

**INSTRUCTIONS:**

1. When Notes constitute the proposed issue or are otherwise included above, use the estimated debt charges for the Bonds anticipated by the Notes as described in the note legislation.
2. If the Issuer is a county, the information should relate to the county, and the combination of overlapping city/village, school district, township and other political subdivisions requiring the highest millage for debt charges inside the 10-mill limitation.
3. Do not include voted bonds or notes.
4. Fill in all blanks, using the word "NONE" where applicable.
5. Include all required millage for debt charges even though no taxes are currently levied for those debt charges.

- Revenue (or Special) Obligations
  - Examples
    - Utilities
    - Income Tax or Sales Tax Supported Obligations
  - Sold without voter approval
  - Not subject to debt limitations
  - Trust Indenture
    - Coverage Covenants
    - Debt Service Reserve Fund
    - Additional Bonds Test

## ■ Lease-Purchase Financing

- Types of Assets Financed: Equipment and Buildings
- If Structured Properly, Not “Debt” for State Law Purposes
- Subject to Annual Appropriation
- Can help issuers stay within debt limits
- Less Secure, Higher Borrowing Cost
- No New Tax Levied as Source of Payment
- Publicly marketed as COPs



# Borrowing

“Gentlemen prefer bonds.”  
~ Andrew Mellon



# Borrowing - Participants

## Underwriter Investment Bankers

- Perform due diligence on disclosure
- Provide financing plan assistance
- Provide rating agency & bond insurer preparation
- Provide investment advice

**Sales Force** - Market the bonds

## Issuer

- Approve bond legislation
- Assist with preparation of disclosure data
- Develop financing plan
- Make rating & insurance presentations (if applicable)
- Make bond payments

## Municipal Advisor

- Provide financing plan assistance
- Provide rating agency & bond insurer preparation
- Provide investment advice

## Bond Counsel (Legal Opinion)

- Prepare bond resolution/ordinance
- Provide Official Statement/disclosure preparation assistance
- Prepare various deal related legal documents
- Provide legal opinion to investors

# Borrowing - Participants

## Rating Agencies / Credit Enhancement

- Review credit worthiness of the Issuer
- Rating agencies issue bond rating

## Trustee / Registrar (P&I Payments)

- Authenticate bonds
- Receive interest and principal payments from Issuer
- Make interest and principal payments to investors

## Investors

- Purchase bonds
- Receive interest and principal payments from paying agent

- Components of Bonds (Municipal Securities)
  - Principal or Par Amount
  - Maturity Date
  - Interest Payment Date
  - Interest Rate (Fixed Rate or Variable Rate)
  - Redemption Provisions





# Borrowing – Maximum Maturity

- ABC Municipality is issuing \$50M for a new city hall.
  - Cost Detail:
    - Land acquisition = \$5,000,000
    - Furniture, Fixtures and Equipment = \$5,000,000
    - Construction of building = \$40,000,000
  
  - Maximum Maturity Per ORC 133.20
    - Land = 40 years
    - F,F&E = 10 years
    - Buildings = 40 years
  
- **Calculation is as follows** (Weighted Avg. Method):
  - Land =  $\$5/\$50 = 10\%$        $10\% \times 40 \text{ yrs.} = 4 \text{ yrs.}$
  - FF&E =  $\$5/\$50 = 10\%$        $10\% \times 10 \text{ yrs.} = 1 \text{ yrs.}$
  - Building =  $\$40/\$50 = 80\%$        $80\% \times 40 \text{ yrs.} = \underline{32 \text{ yrs.}}$
  
- **Maximum Maturity of the Issuance = 37 yrs.**

# Borrowing – Transcript of Proceedings

- First Set of Proceedings (Authorization)
  - Fiscal Officer's Certificate
  - Bond Legislation
- Sales Documents
  - Preliminary Official Statement
  - Certificate of Award
  - Bond Purchase Agreement
  - Official Statement
- Second Set of Proceedings
  - General Certificate
  - Debt Limitation Statements
  - Signature and No-Litigation Certificate
  - Receipt for Payment
  - Tax Documentation (including IRS Form 8038-G)
  - Concluding Certificate

# Federal Tax Matters



## ▪ Tax Exemption Matters

- Exclusion of Interest from Gross Income for Federal Income Tax Purposes
- State Income Tax Exemption
- Qualified Tax-Exempt Obligations (QTEOs)
  - \$10,000,000 per year and per issue limitation
  - Attractiveness to Financial Institutions
    - Deductibility of Interest Carrying Cost (in addition to exclusion of interest from gross income)
- Reimbursement of Prior Expenditures
  - Declaration of Official Intent



## ▪ Arbitrage and Rebate Matters

- Arbitrage is basically investing the proceeds of tax-exempt securities at a taxable yield in excess of the yield on those securities
  - Municipalities, townships, counties, etc. are not taxpayers
  - Requirement is to “rebate” positive arbitrage to federal treasury, subject to exceptions below
  - Negative arbitrage environment
  - Exceptions exist
- Reasonable Expectations Test at Time of Issuance
  - Within 6 months of the issuance date, the municipality, county, township, etc. will incur substantial binding obligations to third parties to expend at least 5% of the net sale proceeds on the project costs;
  - At least 85% of the net sale proceeds will be allocated to project expenditures by the end of three years; and
  - Completion of the project and allocation of the Net Sale Proceeds to project expenditures will proceed with due diligence to completion.



- **New Money Issues**
- **Refundings**
  - Purposes: Reducing Interest Expense, Restructuring, and Removing Restrictive Covenant
  - Refund~~ing~~ Bonds v. Refund~~ed~~ Bonds
  - Kinds of Refundings:
    - Current Refundings
      - Pay off Refunded Bonds within 90 days of issuance of Refunding Bonds
    - Advance Refundings
      - Refunding securities issued more than 90 days in advance of payment of Refunded Bonds
      - Eliminated (sort of) in 2017



# Federal Securities Law Matters



- Tower Amendment
- Exception: Anti-Fraud Provisions (SEC Rule 10b-5)
- SEC Rule 15c2-12 (Primary Offering Disclosure)
- SEC Rule 15c2-12 (Continuing Disclosure)
  - Annual Information Filing
  - Audited Financial Statements
  - Material Event Notices
  - Electronic Municipal Market Access (EMMA)
- SEC's Municipal Continuing Disclosure Cooperation (MCDC) Initiative







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