DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

Strategy Drives Structure | Part 1: Authority to Use Debt

Module 3 covers structuring debt that is consistent with the agency's authority to borrow and raise revenue for repayment and the taxpayer equity implications of common debt structures and sources of repayment. Other topics include the pros and cons of voter-approval vs. approval by the governing body and considerations for the appropriate use of proceeds, including tax and securities law.

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Narrator: In the preceding modules, you learned about the conditions under which using debt financing for a capital project can be prudent public policy. Your decision to use debt financing will be based on strategic planning that integrates your community's vision and financial sustainability with capital project objectives.

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Narrator: But beyond the decision to use debt financing, decisions on the debt structure will impact whether your financing is considered successful over the long-term and whether the vision is achieved. Debt structure is where strategic planning unites with project and financial objectives to form the contracts and agreements your agency will make with lenders, regulators, and constituents.

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Narrator: The first and second sections of this module explore an agency's legal authority to issue debt and repay it. Whether these authorities are vested in the governing body or must be obtained from voters is fundamental to the structure of your debt. The California Constitution has established limits on your agency's ability to issue debt and to raise the revenues used to repay it. Most notably, conditions under which voter approval is required. The constitution does provide legal exceptions that do not require voter approval of your agency's debt financing and repayment method, but these exceptions are not without political, legal, and financial risks.

The third section of this module examines how certain structural features, like the term and interest rate, strongly influence whether your debt financing plan is consistent with the vision for how the project will serve your community for years to come. As an elected official, your goal is to approve a debt structure that limits risks, establishes equity among taxpayers, and accounts for the will of the agency's constituents today and tomorrow.

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Narrator: The California Constitution and state laws authorize how an agency may borrow money for capital projects and repay it. As an elected official, you should become familiar with your agency's authority to use debt because it will affect how your debt is structured.

The California Constitution states that cities, counties, and school and community college districts must obtain two-thirds voter approval (67%) to issue debt. If the debt exceeds expected income and revenue for that year, this is known as the constitutional debt limit.

In 2000, Proposition 39 amended the constitutional debt limit to allow school and community college districts to issue debt for the construction of school facilities with only 55% voter approval, as long as they agreed to specific additional voter accountability standards. Only debt that is repaid with revenues derived from the same fiscal year in which the debt was issued, is exempt from voter approval. Agencies, especially schools, will issue debt under this exemption to help with annual cash-flow shortages, but generally not for capital projects.

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Narrator: The constitutional debt limit imposes real constraints on debt issuance, but there are exceptions that can be used when voter approval is not the most prudent and practical approach. The three most frequently used exceptions are the lease exception, the special fund exception, and the obligations imposed by law exception

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Under the lease exception, the debt is structured as a lease instead of the standard principal and interest payments of a bond or loan, the agency makes lease payments for use of the financed capital facilities. This structure is frequently facilitated by a joint exercise of powers agency, or JPA - a separate entity not subject to the constitutional debt limit.

The JPA finances the development of the capital facilities by issuing lease revenue bonds or certificates of participation, which are repaid by the lease payments from the public agency using the facilities. Typically, the facilities are used as collateral for the debt and the agency takes ownership after all the scheduled lease payments have been made.

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The special fund exception can be used if the principal and interest are paid solely from a special fund, separate from the public agency's general revenues. The special fund exception is typically used to finance improvements to municipal enterprises like water or sewer utilities, through the issuance of enterprise revenue bonds. This exception requires a connection between the debt's purpose and the special fund used to repay the debt. For example, it would be appropriate to use a special water utility revenues fund to repay debt used to finance water system improvements. However, that special fund could not be applied to repay debt used to finance a city parking structure.

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The exception for obligations imposed by law is less frequently used, but important to remember. It is based on the concept that the obligation the agency seeks to finance is legally imposed, not discretionary, and not subject to voter approval. This exception is used for pension obligation bonds or debt issued to fund an obligation imposed by a legal judgment.

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Narrator: Generally, public agencies cannot borrow outside of the authority provided by state statutes. In the case of special districts, the constitutional debt limit does not apply and therefore the statutes governing their debt issuance become paramount.

California public agencies are formed and organized by state statute. Some organizational statutes apply only to a single entity, while others apply to a category of entities such as counties or school districts. These statutes are frequently where public agencies derive their authority to issue debt. Over time, the state legislature has adopted additional general statutes that apply to all public agencies and also affect how debt is structured and issued. When state statute authorizes a public agency to issue debt and prescribes how it must be done, the agency must use that method or structure. For example, if a statute establishes a maximum interest rate or term, the agency must comply and structure the debt accordingly.

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Narrator: While all public agencies are subject to the California Constitution, charter cities derive their authority to issue debt from their city charters. It is rare for charter cities to have debt issuance authority not also provided to general law cities, but the charter may require methods or procedures different from those outlined in statute, some can be more restrictive. Regardless of the type of agency, your authority to issue debt is derived from law: the California Constitution, state statute, or in some cases, a city charter. The law provides structural options to account for some circumstances of a project financing, but it also imposes limitations that must be carefully considered to achieve a successful financing.

DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

Strategy Drives Structure | Part 2: Authority to Collect Revenues

Module 3 covers structuring debt that is consistent with the agency's authority to borrow and raise revenue for repayment and the taxpayer equity implications of common debt structures and sources of repayment. Other topics include the pros and cons of voter-approval vs. approval by the governing body and considerations for the appropriate use of proceeds, including tax and securities law.

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Narrator: An agency that decides to use debt to finance a project must decide how the debt will be repaid. Who among the public agencies, residents, businesses, property owners, and customers should bear the burden of debt repayment? This question of taxpayer equity is fundamental to any debt structuring decision, but your answer may affect other priorities in your community.

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Narrator: An agency must be cautious that a commitment to repay debt from a specific source of funds will not endanger the agency's ability to meet its service mission if the source is at risk of interruption or reduction. For instance, an agency could repay debt used for a parking garage from its general fund or from the parking revenues from the garage once opened.

On one hand, using the parking revenues may be the best choice in terms of taxpayer equity, and it spares general fund revenues for other important and equitable priorities. On the other hand, the agency may conclude that the parking revenues are not sufficient or are not reliable enough to meet the debt service.

To ensure that the debt is repaid, an agency will commit one or more assets or revenue sources to secure the debt; this is known as the security pledge. The source for the repayment of the debt is usually the same as the source that secures the debt. Sometimes, however, the security pledge may include a source of repayment that is committed to back up the agency's preferred revenue source for debt service payments. This structure is used when the sufficiency of the preferred revenue source is not well established.

In the example of the parking facility financing, the agency may decide to use the general fund as the security pledge, but ultimately use the parking revenues to make the debt service payments. An agency's decisions regarding the revenues that can be used as the security pledge for a financing ultimately hinge on what the law allows.

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Narrator: Amendments to the California Constitution over the last several decades, including Proposition 13, 218, and 26, among others, have imposed fundamental limitations and procedural requirements for the taxes, levies, assessments, fees, and charges that comprise local government revenue. This has affected agency's ability to generate revenues, to pay debt service, and has influenced their decisions regarding the type and structure of debt.

The revenue that your agency uses to repay debt comes from your constituents, those who benefit most from the project now and in the future. The law that directs the generation of revenue used to repay debt can have as much or more impact on the structure than the law authorizing the debt.

Under the California Constitution, these revenue sources can be grouped into one of three categories: historical taxes, voter-approved taxes, and other charges approved under procedural requirement.

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Narrator: Historical taxes include ad valorem property taxes, a tax on the assessed value of real property. In California, these taxes are calculated as 1% of the assessed valuation collected by the county. The tax revenues are allocated to the county and to cities, special districts, and school districts within the county. Historical property tax revenue is available for general purposes and used to pay operations, maintenance, and debt service. Short-term cash flow borrowings and debt structured as a lease under the lease exception use property tax revenue as the source of repayment. The general-purpose nature of these revenues means if they are committed to repay debt, they are not available for other agency priorities.

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Narrator: Voter-approved taxes include ad valorem property taxes used specifically to secure debt, general taxes, and special taxes. Agencies may obtain voter approval of a measure that authorizes the issuance of a specific amount of debt and a companion ad valorem property tax above the historical 1% limit to repay the debt. These are known as general obligation bond measures and they require approval by 2/3 of an agency's voters – except, as discussed earlier, Proposition 39 allows school and community college districts to choose an alternate method that requires 55% voter approval.

If property values were to decline, and historical ad valorem tax receipts drop, voter approval of the general obligation bond measures authorizes an increase in the tax rate to whatever level is required to pay the debt service. General obligation bond measures raise property tax revenues that are not general purpose and may only be used to repay the approved bonds. The agency's general fund is not part of the security pledge and is preserved for other priorities.

General taxes may be levied by a city or county for general purposes but require approval by a majority of voters. A “general tax” may not be imposed for specific purposes, but like historical property tax revenues, general taxes flow to the general fund and are a source of repayment for short-term cash flow borrowings and debt structured as a lease.

Special taxes fulfill a specific purpose or are used by limited-purpose agencies like school districts and special districts. Unlike general taxes, special taxes require approval by 2/3 of voters, and they may only be used for the voter-approved purpose. Special taxes are used to repay Mello-Roos bonds, a type of debt used to finance infrastructure for new residential development. General taxes used for a specific purpose, like transportation sales taxes are also special taxes and subject to the higher vqwqwqwqwwqqwqwqwq2 oter approval threshold.

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Narrator: Besides historical and voter-approved taxes, an agency can generate revenues through charges approved under procedural requirements that ensure community input. These include assessments on real property and other types of fees and charges. Assessments are charges on real property assessed in proportion to the cost of the project that confers special benefit to the property.

The cost of a project's general benefits may not be included in the assessment. Agencies use assessment revenue to repay assessment bonds, a type of debt used to finance public improvements such as streets, streetlights, sidewalks, and water-sewer infrastructure. The procedural requirements for an agency to charge assessments include public hearings and approval by majority vote of governing board and property owners.

Agencies choosing to enact fees and charges must establish that they are not taxes or assessments, by demonstrating that the fee or charge does not exceed the fair and reasonable cost to provide the benefit or service. Other fees and charges typically repay enterprise revenue bonds, including those used to finance the capital projects of water, wastewater, and solid waste utilities. Property owners must be notified of any proposed fees, and a public hearing must be held. If a majority of the property owners submit written protests, the fee or charge may not be imposed.

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Narrator: While still subject to the state constitution, charter cities may have greater revenue generation authority. Their authority to levy taxes and impose charges may create additional revenues to secure the issuance of debt obligations. Developing the security pledge and repayment plan for your agency's debt is often technical and complicated. But a broad understanding of your agency's legal authority and procedural requirements will help you to determine whether the debt structures proposed by your staff and advisors uphold your agency's strategic project goals as well as service and equity commitments to your constituents.