



## DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

### *Implications and Documentation of Your Long-Term Debt Commitments | Part 1*

Module 7 discusses the high-level policy implications of the most frequently issued types of long-term debt and summarizes the fundamental documentation used to formalize the commitments made through debt issuance. Other topics include the elected official's role and responsibility in documenting the issuance transaction.

*Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC) and it believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers.*

**00:00:12**

**Narrator:** After comprehensive and deliberate planning, your agency may determine that utilizing long-term debt is a prudent method of meeting your agency's capital finance objectives. As an elected official, you will personally be required to take the procedural actions necessary to approve the financing. As a policymaker and fiduciary, you need to understand how your actions will commit your agency and your community, and have confidence in those commitments for the life of the financing. This module focuses on the policy implications of the commitments you make on behalf of stakeholders and examines the documentation that will formalize these commitments to investors, regulators, and constituents.

Whether your agency issues debt that impacts all constituents, such as general obligation bonds or lease financing, or more targeted forms of debt, such as land secured or revenue bonds, it is important to understand how you are committing your agency and constituents for a time period that will likely exceed your term in office.

**00:01:17**

**Narrator:** Voter approval and issuance of general obligation bonds, or GO bonds, commits property owners within the agency's jurisdiction or sub jurisdiction to pay property taxes at a rate that is always sufficient to meet the debt service obligations to bond holders. This commitment holds even if the market value of the taxed property declines. Even with voter authorization, the use of GO bonds has limitations, statutory limitations, distinct from and in addition to the constitutional limitations, constrain an agency's GO bond issuance capacity.

Other taxing districts often overlap the boundaries of counties, cities, and school districts. It is possible that the GO debt of the individual jurisdiction is within the statutory limit, but when the tax burden of the GO debt is combined with that of overlapping districts, the total tax burden for property owners becomes very onerous.

All types of debt require administrative commitments, but school district GO bonds issued under Proposition 39 also require a commitment to post-issuance oversight by a citizen committee, along with annual financial and performance audits of the bond program.



**00:02:32**

**Narrator:** Lease financing creates long-term obligations structured to take advantage of the lease exception to the constitutional debt limit and avoid voter authorization. With lease financing, the debt service is paid through the rental payments an agency makes to use an essential public facility. The facility becomes security for the debt. Rental payments are made from available resources, most often the agency's general fund. By itself, lease financing does not raise taxes or create new revenues. Therefore, agencies must carve out the rental payments in general fund budgeting for the life of the debt. Meeting this long-term commitment using the general fund may leave other community or operational priorities underfunded in any given year. This general fund tension in the absence of voter authorization can make lease financing particularly challenging in times of fiscal stress, even when project benefits are assumed to be broadly shared.

**00:03:31**

**Narrator:** Land-secured debt is repaid by special assessments or special taxes approved by property owners or voters. Projects financed with assessment debt must convey a quantifiable special benefit to the property assessed and the amount assessed cannot exceed the reasonable cost of the special benefit.

The concept that tax burden and benefits should be equal is fundamental to assessment debt, but the complexity of committing to this formula can be legally and administratively challenging. Special taxes applied to individual parcels are the repayment source for community facilities district or Mello-Roos bonds. These are issued to finance the basic infrastructure for new housing.

Mello-Roos debt allows home buyers to finance the costs of neighborhood infrastructure at tax-exempt rates, rather than have the home builders' higher private financing costs pass through in the price of the new home. However, this long-term debt carries special tax commitments that extend to future buyers who may be years removed from the financing benefit and perceive the tax burden difficult to justify.

Land-secured debt carries the agency's commitment to set and collect an annual assessment or special tax levy to pay debt service. These assessments and special taxes are collected with the annual county property tax collection, so your agency must keep careful records of the amounts allocable to any assessment or community facilities district. In the event of non-payment, the agency commits to bond holders to exercise its authority to foreclose and force a sale of the property to collect the unpaid assessment or tax. The threat or use of this authority may not be entirely popular with constituents.

**00:05:13**

**Narrator:** Revenue bonds are issued by revenue-producing public enterprises without voter authorization under the special fund exception to the constitutional debt limit. Repayment of these bonds is limited to revenues generated by the enterprise and does not compete with other budget priorities in the agency's general fund.

Fundamental to the issuance of revenue bonds is the public finance principle that those directly benefiting from the financed project should bear the repayment burden of the debt. Revenue bonds require a covenant from the issuer that enterprise revenues will be more than enough to meet the debt service on the bonds. In effect, the agency is committing rate payers to this covenant. Typically, revenue bond issuers must evaluate and frequently enact service rate increases to meet and maintain the covenant. While the bond issue does not require voter



approval, rate increases are subject to constitutional provisions that engage rate payers and limit increases to the reasonable cost of the services provided.

**00:06:14**

**Narrator:** The issuance of debt creates agency specific long-term commitments that require thorough consideration as you seek to structure a sustainable and equitable financing. The next section examines how your agency's commitments become real and binding through the fundamental documentation for an issuance of debt.



## DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

### *Implications and Documentation of Your Long-Term Debt Commitments | Part 2*

Module 7 discusses the high-level policy implications of the most frequently issued types of long-term debt and summarizes the fundamental documentation used to formalize the commitments made through debt issuance. Other topics include the elected official's role and responsibility in documenting the issuance transaction.

*Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC) and it believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers.*

**00:00:03**

**Narrator:** Understanding the fundamental documentation for long-term debt financing is extremely important. It formalizes your agency's planning and commitments, but if incorrect or misleading, it may create serious consequences for your agency, constituents, and you personally as an elected official. As a member of the governing body and a fiduciary, you are ultimately responsible.

The documentation and format will vary with the agency type, sale method, debt type, security and repayment terms, and other characteristics. Most of the documentation will come before you for formal approval as a member of the governing body. Other documents may not be officially presented to the governing body, but will be developed, executed, and made binding through the governing body's authorization. The documents may also have of a variety of names but carry out common functions at typical stages of the issuance process.

**00:01:00**

**Narrator:** During the planning phase, you may be asked to approve a reimbursement or inducement resolution. This resolution allows the agency to be reimbursed from bond proceeds for project costs incurred prior to the final issuance authorization. Under federal tax laws, an issuer may not generally reimburse itself using proceeds of tax-exempt bonds for expenditures made more than 60 days prior to the approval of the reimbursement resolution. This resolution must generally describe the project for which the original expenditure was made and state the maximum principal amount of the debt expected to be issued for the project. Its function is to allow for reimbursement from bond proceeds, but it does not obligate the agency to issue the debt.

**00:01:49**

**Narrator:** A few days to a few weeks before the pricing and sale of the debt, you will receive documentation from your internal finance team that will cover all known elements of the transaction and the binding commitments your agency is making to investors, regulators, and counterparties. Typically, documents will include a staff report accompanied by a resolution or ordinance that will incorporate the form of nearly all the documents, including the indenture, lease or loan agreements, preliminary official statement, bond purchase agreement or notice of sale, and continuing disclosure agreement, that will become binding upon the issuer and parties involved. The



only details not included in these documents are those not known until issuance: the final pricing and interest rates. To proceed with the issuance, the documents must be approved by the governing body.

**00:02:45**

**Narrator:** The resolution allows you to officially exercise your authority to issue debt. It is drafted by bond counsel and specifies the purpose, amount, terms, and security, permits issuance and sale, authorizes execution and delivery of documents, and delegates specific agency officials to take necessary actions to complete the financing. The resolution will also incorporate statutorily required public disclosure of the estimated cost of financing, including the true interest cost, cost of issuance, expected proceeds upon closing, and the total amount of debt service until maturity. For some structures, the resolution establishes constraints for maximum amount, term, and interest rate, and authorizes issuance pursuant to the terms of a separately incorporated indenture. For others, the trustee will agree to a very detailed resolution as the indenture.

**00:03:42**

**Narrator:** The indenture or trust agreement establishes the rights, duties, and responsibilities of the issuer and the trustee who represents the interests of the bond holders. It is the fundamental security document for the transaction and includes maturities, payment dates, redemption provisions, use of pledged revenues, collateral, remedies in case of a default, covenants - including limitations on additional debt, reserve fund requirements, and permitted investments.

As a controlling document, the indenture details how bond holders are paid and establishes the accounts needed to support the flow of revenues, use of proceeds, and debt service. If the debt issuance is structured as a lease financing or includes a loan, the documentation will include the form of the lease agreement or loan agreement inclusive of all terms and responsibilities of the parties.

**00:04:41**

**Narrator:** The preliminary official statement is circulated to investors prior to the pricing day and issuance of the bonds. It is required by the SEC for all publicly sold debt. Under federal securities laws, the issuer is obligated to disclose in this statement all information that a "reasonable investor" would consider important when deciding to purchase the bonds. As an elected official of the issuer, you can be held personally liable for material misstatements and omissions. Preliminary official statements include information about the legal authority, debt terms, security and sources of repayment, use of proceeds, tax status, risk factors, issuer's financial and operating data, litigation, continuing disclosure compliance record, and general information about the issuer. The preliminary official statement converts to final once the final pricing information is known and included.

**00:05:41**

With a negotiated sale method, you will review the form of the bond purchase agreement to be executed after the bonds are priced. This agreement provides for the sale of the bonds, including agreements on underwriter, spread, interest rates, and terms for repayment of the purchase price. It specifies other documents to be delivered, payment of expenses, and the representations, warranties, and conditions for the underwriter to purchase the bonds at closing. If a competitive sale method is used, you will review the form of the notice of sale that specifies the date and requirements for submitting a bid. The notice of sale, the winning underwriters bid,



and the issuer's acceptance of the bid operate collectively in the same manner as a bond purchase agreement under the negotiated method.

**00:06:30**

The Continuing Disclosure Agreement formally commits the issuer to providing post-issuance disclosure of annual financial information, similar to that in the official statement and event notices pursuant to SEC rules. This agreement is required of all publicly sold debt for the benefit of bondholders. It details the required annual disclosure content, establishes filing deadlines, and specifies amendment provisions. These are serious commitments that are legally enforceable by bond holders, and remain in place for the life of the debt.

**00:07:06**

**Narrator:** In the pre-issuance phase, you will be asked to affirm that the documents presented for your approval fully and accurately describe the commitments your agency is willing and capable of making and fulfilling. Be sure the financing schedule includes adequate time to read and understand everything. If not, extend it. If you have questions about any provision of any document presented to you at this stage, consult internal and external counsel and your finance team. Don't be satisfied until you completely understand the answers you are given.

**00:07:41**

**Narrator:** At the time of issuance, the documents approved in the pre-issuance phase are completed and conformed to the dates and final pricing of the transaction. The agency officials that have been delegated authority by the governing body will execute and deliver all final documents for completion of the financing. Among these documents is the tax certificate. Drafted by bond or special tax counsel, the tax certificate contains certifications to the IRS requirements for tax exemption and establishes the rules for the investment of bond proceeds, arbitrage compliance, and the use of bond proceeds.

Additional documents known collectively as closing documents include certificates, receipts, written directions, and requisitions. These documents cover required representations, compliance with the law and contracts, receipt and deposit of proceeds, and payment of costs. Elected Officials must be confident that agency staff will scrutinize the closing documents, including the tax certificate, to ensure accuracy of the representations, warranties, and certifications of the payment, deposit, and transfer amounts.

**00:08:56**

**Narrator:** As an elected official, it is your responsibility to understand the long-term commitments you are making through the issuance of debt. You should be confident that your course of action will achieve your vision for your community and constituents. Your comprehensive debt management policy and financing team will guide a prudent course, but arrival at your destination requires complete and accurate documentation that you are ultimately responsible to deliver. Read it all. Make sure you understand the provisions and that they are consistent with your plans and policies. If something doesn't look right, speak up and get your questions answered. You must have confidence that your agency's commitments, formalized through the documents you review and approve, will be met for the life of the debt.