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Finance Committee

Briefing on Tax Exempt Financing and Debt Limit

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Title
Briefing on Tax Exempt Financing and Debt Limit

Recommended Action
City Manager Recommendation:
Briefing and discussion.

Report
Issue:
Discussion of municipal debt issuance and debt limits

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Background and Analysis:
Tax exempt financing is used by state and local governments to raise funds to finance public *capital* improvements that are important to sustained economic growth. Debt financing is accomplished by issuing bonds to pay for specific projects or services. The goal of Olympia's debt policy is to maintain the ability to provide high quality, essential services in a cost effective manner. Unlike corporate debt issues, the interest received by holders of state and local governments is generally exempt from federal taxes and most state and local taxes. Consequently, investors will accept a lower interest rate on tax exempt issues; reflecting their reduced tax burden. This lower rate reduces borrowing costs for most governments by approximately 25%.

There are two types of tax exempt bonds: general obligation bonds and revenue bonds. General obligation bonds are backed by the "full faith and credit" of the city. This means the City pledges to guarantee the repayment of the debt. In Washington state there are two types of general obligation bonds: councilmanic and voter approved. Councilmanic bonds are authorized (within state limits) by a simple majority of the City Council; whereas voter approved bonds must be authorized by the voters. Voter approved debt (e.g. 4th Fire Station) requires a 60% approval from the voters to increase their property taxes to repay the debt. Councilmanic debt is repaid within the general operating budget.

Revenue bonds are issued for a specific project, such as constructing a sewer pipe line, and are paid from the revenues (rates) received from the utility. Because they are not backed by the full faith and credit of the issuer, revenue bonds generally pay a slightly higher interest rate than general obligation bonds to reflect the fact they are backed by a particular stream of revenue. As a matter of policy, the City of Olympia raises any necessary rates *prior* to issuing debt.

Different than most local government functions, tax exempt financing is controlled first and foremost by the federal government - specifically the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB). Additionally, Washington State constitution limits the amount/type of debt that may be issued. To ensure existing and future bonds holders have relevant financial and operating information about the City, the City Treasurer must provide or disclose information about the bonds and the city before, during, and *after* issuing municipal securities. Since certain municipal bonds are exchanged between buyers and sellers in a secondary market; continuing disclosure remains necessary for decisions being considered by investors in the municipal market. Electronic Municipal Market Access (EMMA) is the portal that must be used by the City to provide ongoing disclosure.

So what are the steps/pieces of a debt issuance?

1. <u>Formally adopt a Capital Facilities Plan (CFP).</u>
   Before undertaking any long term debt program the City must have a clear understanding of the types of projects they intend to finance and when and how expenditures for projects will be made.

2. <u>Decide what type of debt to issue?</u>
   Is the issuance general obligation or revenue debt? In some cases the City may want to issue revenue bonds but fear the revenue stream is not sufficient to pay the debt. In this case we would issue a “double barrel” bond; pledging the revenues as well as the full faith and credit of the city. For example; in 2009, the City wanted to widen Harrison Avenue using impact fees but feared a decline in development reducing the impact fee revenue stream. Impact fees were pledged, but if they were not sufficient the general fund would have to make up any difference.

3. <u>Determine the size of the issuance and the length of the debt.</u>
   The length of the debt (typically 10-, 20-, or 30-year debt) should not be greater than the life expectancy of the project. In determining the size of the issuance you need to consider any cash or grant that you can pledge to reduce the size of the issuance. Most of the City’s debt is 20-year debt. The largest exception to the 20-year rule is the debt for City Hall. We issued 30-year “back loaded” debt for this building. That means the debt service is backload (larger at the end of the debt) at 10-year intervals. So when the debt on the 4th Ave Bridge is paid off the money is then pledged to pay off City Hall debt.

4. <u>Prepare an Official Statement (OS).</u>
   The OS discloses pertinent information regarding the debt offering. In the corporate capital market it is the same as an offering circular or a prospectus.

5. Adopt a bond ordinance/resolution.
   The City Council adopts an ordinance/resolution authorizing the treasurer to proceed with the sale. The ordinance/resolution describes the nature of the bond offering, terms and conditions of the sale and the obligations of the issuer to the bondholders.

6. Select the method of sale.
   The City may issue the bonds on a competitive or negotiated basis. In a competitive sale, the city solicits bids from firms to purchase its bonds and sells to the firm offering the lowest true interest cost. The City's debt policy states that Olympia will issue bonds on a competitive basis whenever possible.

7. Have the bonds rated by a rating agency. Prepare the rating presentation.
   Olympia has always had their bonds rated by both Moody's and Standard and Poor's Rating Agencies. This step includes a presentation to the agencies about the City of Olympia and the particulars about the bonds.

8. Take bids from investors.
   Take the bids at the specified time and award the bids based on the lowest interest cost.

9. Have the bond closing.
   Approximately one month later, the City will have a bond closing with the investor. The City receives its money and the investor with the lowest interest cost will receive the City's bonds. This step includes a series of closing documents as well as both parties must begin the disclosure process.

Layered on top of the federal process for the issuance of debt are the State of Washington Debt limits. Staff has reviewed the limitation on debt with the planning commission and Council. The budget document, beginning on page 159, explains the limits and outlines all of our existing debt obligations (including state loans). The key to remember is the debt limit is a function of Assessed Value (AV). In the 3 years our AV went down we lost $10 million of capacity without issuing any debt. We currently have a total of $63 million of outstanding debt capacity. Within that amount we could issue up to $23.5 in councilmanic debt. In addition to these limits the City had debt authority with a vote of the people of 2.5% each for Parks and utility purposes. Olympia has never accessed this authority.

Neighborhood/Community Interests (if known):
N/A

Options:
N/A

Financial Impact:
N/A