



Financing Alternatives

Debt Options For Ohio Political Subdivisions

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Topics Addressed

- Sources of funding capital and operating expenses
- Theory of Public Finance Projects
- Debt authority
- Types of debt
- Debt limitations and issuers of debt
 - Municipalities
 - Counties
 - Townships
 - School districts
 - Port authorities and other special purpose districts
- The Anatomy of a Bond Issue
- Federal income tax issues
- Federal securities law issues

Sources of Funding Capital and Operating Expenses



- Cash
 - Property taxes
 - Income taxes
 - Utility revenues
 - State funding
- Borrowing/Debt issuance

Theory of Public Finance of 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

Theory of Public Finance of Capital Projects



- 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.

First Steps to Issue Debt



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



Debt Authority



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

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

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

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

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
- Priority over operating expenses of issuer
- Subject to specific Constitutional and statutory limitations

Types of Debt: General Obligation Debt



Voted G.O. debt

- Specifically approved by voters
- Special property 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)

Types of Debt: General Obligation Debt



Unvoted G.O. debt

- Backed by property taxes of the political subdivision
- First claim against revenues but no special tax
- Includes most special assessment debt
- Also may be used with TIF

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

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.

Special Assessment Debt



- Primarily done by municipalities and counties
- Extensive process
 - Multiple resolutions / ordinance
 - Ability for property owners to object
- Three ways to assess:
 - by a percentage of the tax value of the property assessed
 - in proportion to the benefits that may result from the improvement
 - by the front foot of the property bounding and abutting upon the improvement

Special Assessment Debt



- Assessment may not exceed 1/3 of actual value of property as improved
- A small portion of project must still be paid by political subdivision (2% and cost of intersections)

Considerations for Special or Revenue Obligations



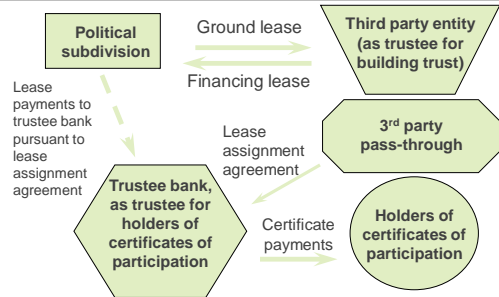
- Revenue source (TIF, utility, levy, tax)
- Number and type of users
- Coverage ratio
- Debt service reserve fund
- Additional security
- Trust indenture and related documents
- Disclosure

Types of Debt: Non-Debt



- Types
 - Leases
 - Lease-purchase agreements
 - Municipal – ORC 715.011
 - County – ORC 307.02
 - Township – ORC 505.26; ORC 505.267
 - School district – ORC 3313.375
 - Installment purchase agreements
 - Certificates of participation (“COPs”)
- Non-debt transactions do not count against debt limitations

COPs Transaction Flow-Chart



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

Debt Limitations



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

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

Municipal Direct Debt Limitations



- Municipal exemptions in ORC 133.05
- Exemptions:
 - 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)

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

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

County Direct Debt Limitations



- County exemptions in ORC 133.07
- Exemptions:
 - 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))

Township 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

Township Direct Debt Limitations



- Township exemptions in ORC 133.09
- Exemptions:
 - 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))

School District 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

School District 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)

School District Direct Debt Limitations



- School district exemptions in ORC 133.06
- Exemptions:
 - 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)

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

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

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:

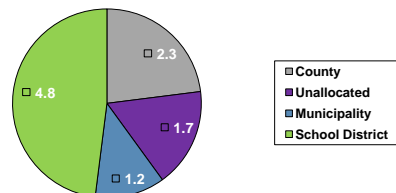
$$\frac{\text{Total annual debt service}}{\text{Total assessed valuation}} \times 1000$$

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

Debt Limitations: Indirect Debt Limitation



Hypothetical "inside millage" representing ten mills of property tax actually levied and allocated to political subdivisions:



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

Types of Issuers: Special Purpose Issuers



Ohio Port Authorities



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)

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

The Anatomy of a Bond Issue

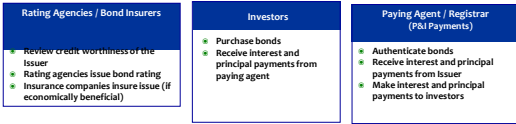


Participant Roles & Responsibilities

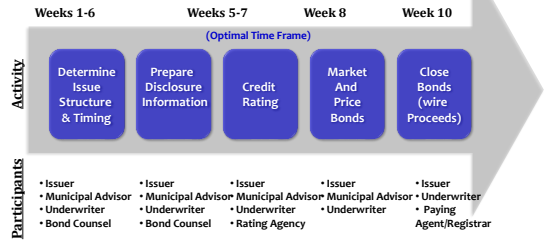


Issuer	Municipal Advisor	Underwriter	Bond Counsel (Legal Opinion)
<ul style="list-style-type: none"> • Approve bond legislation • Assist with preparation of disclosure data • Make rating & insurance presentations (if applicable) • Make bond payments • Post sale responsibilities 	<ul style="list-style-type: 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

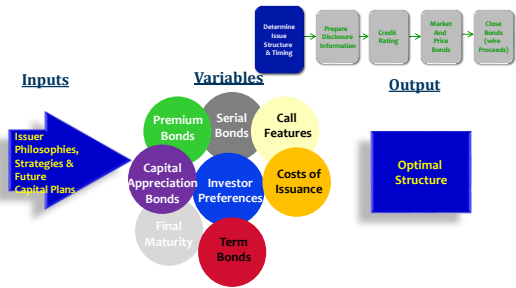
Participant Roles & Responsibilities



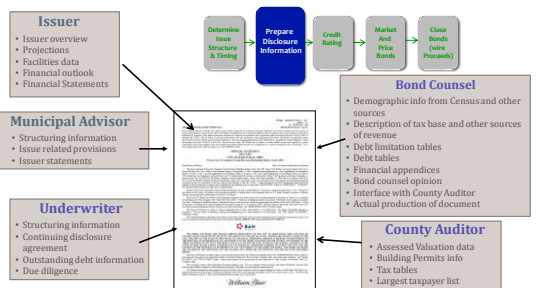
Activities & Timing



Determine Issue Structure & Timing



Prepare Disclosure Information

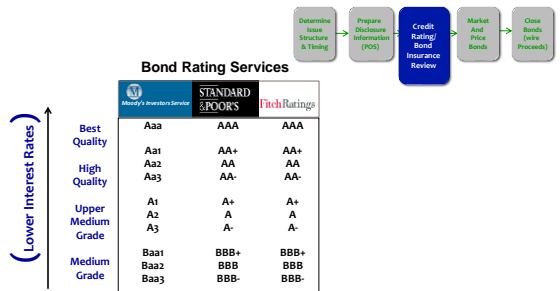


Official Statements



- 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

Credit Rating



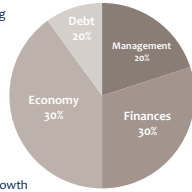
Rating Factors



Four Primary Credit Factors¹

Debt

- Amount outstanding as % of full valuation
- Structure and composition
- Other long-term commitments



Management

- Financial planning and budgeting
- Realistic assumptions
- Policies and historical performance
- Timely disclosure

Finances

- Multiyear financial trends
- Available cash on hand
- Operating flexibility to raise revenue or cut expenditures
- Budget predictability

Economy

- A.V. and historic growth
- Diversity of economy, taxpayer concentration
- Unemployment rates, median income

¹ Moody's Investors Service

Marketing and Pricing



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



Closing the Issue



Closing Activities



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.

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

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.”

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

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

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:
 - 2018 - \$5 million of “new” money
 - 2019 - \$4 million of “new money; \$5 million of refunding money
 - **Result** – Neither issue is subject to rebate (assuming the temporary period exception is met)

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)

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

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
 - No longer an option

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%)

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

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

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

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)

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

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

Federal Securities Law Issues: Continuing Disclosure



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

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.

Questions?



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