Transfers, Advances & Cash Flow Management; Basics of Ohio Municipal Debt

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Charter Millage

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- A municipal charter can increase or decrease the amount of inside (unvoted) millage available to a municipality.
- Because inside millage is also used to satisfy the Article XII, Section 11 requirement of the Ohio Constitution that general obligation debt be secured by the levy of a tax, the combination of this requirement and the ten-mill or alternate charter millage limitation is referred to as the “indirect debt limitation” or “ten-mill debt limitation.”
- Depending on applicable charter limitations, a municipality may thus be able to levy more or less unvoted millage for operating expenses and to issue more or less unvoted debt than it otherwise would have been able to under the ten-mill limitation.

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Charter Millage Examples

Marysville Charter – Section 10.01:

"The amount of taxes which the Council may levy upon all real and personal property within the municipality without a vote of the electorate shall be limited to a maximum of **five mills**, exclusive of the amount to which the municipality shall be entitled under the constitutional and statutory 10 mill limitation and exclusive of the amount necessary to be levied for the retirement of bonds heretofore or hereafter approved by a vote of the electorate. The procedure for levying of all taxes upon real and personal property shall be in conformity to the general laws." *[emphasis added]*

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Charter Millage Examples

Upper Arlington Charter – Section XVI:

"The aggregate amount of taxes that may be levied by the Council without a vote of the people, for all municipal purposes, on property which is taxable according to value, shall not exceed **five mills** on each dollar of taxable valuation. Taxes may be levied for such purposes outside of this limitation upon approval by a majority of the electors of the City voting thereon at a November election or in any manner provided by general law for voting levies outside the statutory limitations." *[emphasis added]*

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Introduction to Transfers

Why is this topic important?

- Fund accounting ensures that legally restricted cash is segregated into a fund for a specific purpose.
- Transferring cash out of one fund and into another potentially permits spending the restricted cash in violation of its restricted purposes.
- The guidelines in the Ohio Revised Code and from the Auditor of State help to prevent such errors.

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Transfers

- A transfer is the permanent reallocation of cash or other assets without an equivalent flow of assets in return and without a repayment requirement. Transfers are made pursuant to ORC 5705.14 to 5705.16.
- ORC 5705.14 prohibits fund transfers unless an exception applies.
- In most instances, a transfer is from an unrestricted fund to restricted fund.
- For example, ORC 5705.14(E) allows transfers from the general fund to any other fund.

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Transfers (cont.)

- Once transferred, cash or assets is changed and subject to the restrictions of the receiving fund.
- In rare instances, a transfer may be from a restricted fund to another restricted fund with the same purpose.

Prohibited Transfers

- The proceeds or balances of the following may not be transferred (ORC 5705.15):
  - Loans and bond issues;
  - Special levies for the payment of loans or bond issues;
  - Funds derived from any excise tax levied by law for a specific purpose; and
  - License fees imposed by law for a specific purpose.
- Generally speaking, cash may never be transferred from restricted funds to unrestricted funds absent compliance with Ohio law for certain, limited situations.

Advances

- In contrast to the permanency of a transfer, an advance is a temporary reallocation of cash from one fund to another with an expectation of repayment within 12 months.
- Advances must be from a fund (the "creditor" fund) with statutory authority to use the cash for the same purpose for which the fund (the "debtor" fund) receiving the cash was established.
- AOS Bulletin 97–003 contains the necessary procedures for advances.

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Authorizing Transfers

- All transfers must be authorized by a resolution of the "taxing" (legislative) authority before they occur.
- The ORC does not provide for retroactive transfers.
- The resolution must also appear in the minutes of such legislative authority.

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Authorizing Transfers (cont.)

- Some transfers may be authorized solely by a resolution of the legislative authority as listed in ORC 5705.14 (2/3 vote required for all transfers except transferring cash from a general fund):
  - An unexpended balance in a bond fund may be transferred to a bond retirement fund or a sinking fund from which such bonds are payable (ORC 5705.14(A))
  - An unexpended balance in any specific permanent improvement fund after payment of all obligations incurred in acquisition of the permanent improvements may be transferred to the sinking fund or bond retirement fund if needed for obligations; also may be transferred to special fund for the acquisition of the permanent improvements (ORC 5705.14(B))

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Authorizing Transfers (cont.)

- An unexpended balance in a sinking fund, after all indebtedness, interest, and other obligations have been paid or retired, may be transferred to a bond retirement fund, and vice versa (ORC 5705.14(C))
- An unexpended balance in any special fund, other than an improvement fund, may be transferred to the general fund or the sinking fund or bond retirement fund after the termination of the activity, service, or other undertaking for which the special fund existed, but only after the payment of all obligations incurred and payable from such special fund (ORC 5705.14(D))
- Cash in the general fund may be transferred to any other fund – only requires a simple majority vote of the legislative authority (ORC 5705.14(E))

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Authorizing Transfers (cont.)

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- Most other transfers require a resolution of the legislative authority and tax commissioner approval pursuant to the procedures set forth in ORC 5705.16.
- Such a resolution is adopted by a simple majority vote.
- The tax commissioner's office carefully evaluates each transfer request.
- ORC 5705.16 used to also require approval by the court of common pleas in the county in which the affected funds were held, but the General Assembly removed that requirement in 2017.

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Authorizing Advances

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- All advances must be identified and approved by a formal resolution passed by the legislative authority before the transaction is completed.
- The resolution for the advance must include a specific statement that the transaction is an advance of cash and indicate the fund from which repayment is expected.

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Advance Requirements

Advances must:

- Not violate restrictions on the cash being advanced;
- Be repaid within 12 months;
- If not repaid by the end of the fiscal year, the altered cash balances must be considered in the appropriation resolution for both the creditor and debtor funds; and
- If not repaid within 12 months, the subdivision must use formal transfer procedures to authorize a transfer. The subdivision then must reverse the entries recording the cash advance and repay the advance as a transfer.

Reserving Funds

- ORC 5705.13 allows subdivisions to reserve / reallocate funds for the following specific purposes:
  - Reserve balance accounts, which are sometimes referred to as budget stabilization funds, are essentially "rainy day" funds
  - Special revenue funds
  - Capital projects funds
- "Snow fence" analogy
- Legislative authority must authorize the creation of such a fund / account by a majority vote on a resolution or ordinance.

Reserving Funds

- Not a transfer of funds, but is rather a unique type of fund reallocation permitted by statute.
- Any cash from any fund that is authorized for the same purpose as the reserve balance account, special revenue fund, or capital projects fund may transfer money into such a fund / account without regard to the transfer procedures set forth in ORC 5705.14 to 5705.16.
- The legislative authority, by a simple majority vote, may pass a resolution rescinding such a fund / account. Any cash in such a fund / account is transferred back to the fund from which it came.

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Reserve Balance Accounts

Reserve balance accounts authorized by ORC 5705.13(A) may be established for the purpose of accumulating currently available resources to:

- Stabilize budgets against cyclical changes in revenues and expenditures;
- Provide for payment of claims and deductibles under an individual or joint self-insurance program; or
- Provide for payments of claims, assessments, and deductibles under various types of workers' compensation insurance plans.

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RBAs – Additional Requirements

The legislation establishing a reserve balance account ("RBA") **must** state:

- The purpose for which the RBA is established;
  - Money to the credit of an RBA may be expended only for the purpose for which the account was established.
- The fund in which the RBA is to be established; and
- The total amount of money to be reserved in the RBA.

RBAs – Additional Requirements

As to which fund the RBA may be established in:

- For budget stabilizing RBAs, the account may be in the general fund or any one or more special funds for operating purposes.
  - In other words, more than one RBA may be established for budget stabilization purposes.
- For RBAs for the payment of (1) claims and deductibles under an individual or joint self-insurance program or (2) claims, assessments, and deductibles under various types of worker's compensation insurance plans, the RBA may be established in the general fund or in a separate internal service fund.
  - For each of these two purposes, only one RBA may be established per purpose.

RBAs – Budget Stabilization

- The amount of money to be reserved in an RBA for budget stabilization in any fiscal year shall not exceed 5% of the revenue credited in the preceding fiscal year to the fund in which the account is established. However, for counties and townships, that limit is increased to the greater of the 5% limit or 1/6th of the expenditures during the preceding fiscal year from the fund in which the RBA is established.
- The amount of money in an RBA for budget stabilization does not constitute an unencumbered balance or revenue of the township under ORC Sections 5705.35(A) or 5705.36(A)(1) (subject to a reasonableness determination by the county budget commission pursuant to ORC 5705.29(G)).

Capital Projects Funds

- The taxing authority of a subdivision, by resolution or ordinance, may establish a capital projects fund ("CPF") for the purpose of accumulating resources for the acquisition, construction, or improvement of fixed assets of the subdivision. "Fixed assets" includes motor vehicles.
- More than one CPF may be established and may exist at any time.

CPFs – Additional Requirements

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- Pursuant to ORC 5705.13(C), the resolution or ordinance establishing a CPF must contain the following information:
  1. Identify the fixed assets that the taxing authority intends to acquire, construct, or improve with the money to be accumulated in the CPF;
     - This identification of fixed assets can be done at a reasonable level of specificity.
  2. Identify the source of the money to be used to acquire, construct, or improve such fixed assets;
  3. The amount of money to be accumulated for such purposes; and
  4. The period of time over which that amount is to be accumulated.

CPFs – Additional Requirements

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- Money cannot be accumulated indefinitely in a CFP. A subdivision must begin spending it within 10 years after the legislation establishing the CFP is adopted.
- If a subdivision does not enter into a contract to acquire, construct, or improve the fixed assets before the 10-year period is over, the fiscal officer must transfer all money in the capital projects fund to the funds from which the money originally was transferred or the fund that originally was intended to receive the money.
- A legislative authority can rescind a CPF at any time, in which case money that has accumulated in the CPF shall be transferred to the fund or funds from which the money originally was transferred.
- A legislative authority can also transfer money out of a CPF and back to the fund or funds from which the money originally was transferred without having to rescind the entire CPF.

Special Revenue Funds

- A special revenue fund may be established for the purpose of: (1) accumulating resources for the payment of accumulated sick leave, vacation leave, and payments in lieu of taking compensatory time off upon the termination of employment or retirement of officers and employees of the township or (2) accumulating revenues for the payment of salaries during any year in which the number of pay periods exceeds the customary number of pay periods.
- Sometimes these are referred to as a termination benefits fund or a severance fund.
- As with RBAs and CPFs, a legislative authority can rescind a special revenue fund at any time, in which case money that has accumulated is transferred back to the fund or funds from which the money originally was transferred.

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Cash Flow Borrowings

What if a subdivision faces a revenue shortfall due to the timing of receipt of property tax revenues?

- Current revenue anticipation notes ("CRANs") – securities issued in anticipation of the collection of current property tax revenues.
  - To be federally tax exempt, must comply with IRS regulations.
- Contrast with tax anticipation notes ("TANs"), which are securities issued in anticipation of the collection of a specific, voted property tax levy. TANs are frequently limited to a narrow window of issuance between passage of a levy and receipt of the first collection.

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Cash Flow Borrowings

Several options are available under ORC 133.10:

- ORC 133.10(A) – principal amount borrowed cannot exceed one-half of the estimated amount the subdivision will receive in that fiscal year and during the 6 months following the issuance of the securities, less advances and amounts levied for debt charges on ORC 133.10(C) debt.
    - Such securities must mature no later than 6 months after the month in which the securities are issued and, in any case, no later than the last day of the fiscal year in which they are issued.
    - Available for any "subdivision" within the meaning of ORC 133.01(MM), which is a very broad category.

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Cash Flow Borrowings

Several options are available under ORC 133.10:

- ORC 133.10(C) – principal amount borrowed cannot exceed one-half of the estimated amount the subdivision will receive during the remainder of that fiscal year, less advances and amounts levied for debt charges on ORC 133.10(A) debt.
    - Such securities must mature no than the last day of the fiscal year in which they are issued.
    - Only available for counties, municipalities, townships, and school districts.
- ORC 133.10(B) – subdivision may anticipate up to half of remaining, current revenues (less advances and prior collections) from any source other than property taxes.

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Basics of Ohio Municipal Debt

Overview of Bond Financing and Debt Limitations

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Types of Borrowings

- General obligation ("GO") debt – typically considered the most secure
  - Pledge of full faith and credit
  - Voted vs. unvoted - only voted comes with additional revenue from a property tax levy
- Revenue debt
  - Utility, special assessment, tax increment financing, etc.
- Special obligation debt – backed by a specified tax, but not GO
  - Sales tax, income tax, CRANs, TANs, etc.
- Non-debt – i.e., leases and lease-purchase, including certificates of participation (COPs) – subject to appropriation

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Types of Debt: Bonds

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Bonds

- Typically maturity of one year or more
- If fixed rate, rates are locked in long term – no interest rate risk after issuance
- Typically more preparation required before marketing and sale if large enough to necessitate the preparation of an official statement (“OS”) to disclose information to prospective investors about the bonds and the issuer

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Types of Debt: BANs

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Bond Anticipation Notes (“BANs”)

- Typically have a maturity of one year or less
- Lower interest rate due to shorter maturity
- Maximum maturity of 20 years, although must begin amortizing principal after five years
- Usually quicker to prepare (typically no official statement)

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Types of Debt: Notes

Notes

- Not all "notes" are BANs. Some are longer term that have more in common with bonds and do not "anticipate" a subsequent bond issue.
- Maturities can vary greatly, from less than one year to multi-year issuance as long as a bond issue. However, notes generally connote a shorter or more intermediate maturity than bonds.
- Some statutes use the word "notes," and so that nomenclature is reflected in how the securities are named.
- More common with private placements with one lender (not publicly offered).

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Borrowing Authority

- What is the legal authority for the borrowing?
  - Absent contravening home rule (charter) authority for municipalities, other subdivisions must look to specific statutory authority to issue debt.
  - The willingness of a bank to lend is irrelevant as to whether a debt was legally incurred.
- How much can be borrowed? Must fit within applicable debt limitations.
- For unvoted borrowings, the proper legal authority to borrow is a separate analysis from whether a subdivision has the financial ability to repay the obligation (no new revenue).

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Direct Debt Limitations

- Direct debt limitations are a reference to specific debt limitations directly applied to a particular type of subdivision.
- Apply to both voted and unvoted GO debt.
- Based on a subdivision's total assessed (tax) valuation, which is 35% of appraised true value.
- Exempt debt is excluded for debt limitation calculations.
- Contrast with indirect debt limitation that applies only to unvoted GO debt.

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Municipal Direct Debt Limitations

- Unvoted – 5.5% of total assessed valuation
- Voted and Unvoted – 10.5% of total assessed valuation
- Charter provisions (home rule) can change limits

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County Direct Debt Limitations

- Unvoted – 1.0% of total AV
  - Debt for state highway construction limited to 0.5% of AV
- Voted and Unvoted –
  - IF AV does not exceed $100 million, 3% of AV
  - IF AV exceeds $100 million but does not exceed $300 million, $3 million plus 1.5% of AV in excess of $100 million
  - **IF AV exceeds $300 million, $6 million plus 2.5% of AV in excess of $300 million**

Township Direct Debt Limitations

Townships

- Unvoted – prohibited unless a statutory exception applies
- Voted – 5.0% of total assessed valuation

Limited home rule townships

- Direct debt limits are the same as municipal direct debt limits
- Unvoted – 5.5% of total assessed valuation
- Voted and Unvoted – 10.5% of total assessed valuation

School District Direct Debt Limitations

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- Unvoted – up to 1.0% as follows:
  - 1/10th of 1% (0.1%) of total AV for any purpose
  - 9/10th of 1% (0.9%) of total AV for energy conservation purposes (HB 264)
- Voted –
  - 4.0% of total AV without State consents
  - Up to 9.0% of total AV with State consents
  - If determined to be a “special needs” district (have to show projected average AV growth of at least 1.5% over next 5 years), up to 12.0% of AV as projected over the next 10 years.

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Exceptions to Direct Debt Limitations

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ORC 133.04(B) contains exceptions that apply to all subdivisions, including:

- CRANs
- TANs
- Securities secured by special assessment payments
- Debt to pay court judgments or settlements

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Common Municipal Exceptions

ORC 133.05(B) contains exceptions to the municipal direct debt limitations, including:

- Self-supporting revenue securities for any purpose, include water systems, sanitary sewer and storm water systems, airports, off-street parking facilities, stadiums, jails, etc.
- Securities backed by an income tax (or other municipal tax) pledge

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Common County Exceptions

ORC 133.07(C) contains exceptions to the county direct debt limitations, including:

- Self-supporting revenue securities for any purpose, include water systems, sanitary sewer and storm water systems, off-street parking facilities, stadiums, jails, etc.
- Securities backed by an sales tax pledge
- Securities for jails

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Common Township Exceptions

- ORC 505.37(D) – allows for issuing securities exempt from Chapter 133 (including direct debt limits) for fire purposes, including equipment, buildings, and sites
- ORC 505.262 – by unanimous vote, trustees may authorize securities for equipment, buildings, and sites for any lawful township purpose
  - Debt service charges in first year (including debt service from any prior borrowings under this section) limited to 1/10th of the township's total revenue
- ORC 505.261 – securities for township parks
- ORC 505.267 – lease-purchase agreements (not debt)

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Common School District Exceptions

- ORC 133.06(I) – securities issued to fund the local share of participating in an Ohio Facilities Construction Commission program (CFAP or ELPP) if district-desired locally funded initiatives do not exceed 50% of the basic project cost.
  - However, debt still counts against direct debt limits if considering subsequent debt issues.
- ORC 133.06(D)(1) – School buses and other equipment for student transportation.

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Indirect Debt Limitation

- Frequently referred to as the “ten-mill debt limitation.”
- Recall that the “indirect debt limitation” indirectly results from the combination of (1) the Article XII, Section 11 requirement of the Ohio Constitution that general obligation (GO) debt be secured by the levy of a tax, and (2) the ten-mill (ORC 5705.02) or alternate charter millage limitation on unvoted taxes.
- Applies to all political subdivisions in the state for unvoted, GO debt that is secured by real property taxes.
- Total debt service cannot exceed ten mills in any year for all outstanding debt subject to the indirect debt limit in any taxing district (includes all overlapping subdivisions).

Financing Team

Primary participants in a financing:

- Issuer (political subdivision)
- Bond Counsel
- Underwriter (if publicly offered) or Bank / lender (if privately placed)
- Municipal Advisor (if desired)

Other possible participants (not part of the financing team):

- Rating agencies (Moody’s, S&P, Fitch)
- Bond Registrar / Paying Agent
- Bond Insurer (Assured Guaranty / Build America Mutual)
- Depository Trust Company

Participants – The Issuer

- A municipal debt issuer can be any entity authorized by the ORC and the Internal Revenue Service (IRS) to issue tax-exempt securities.
- The Issuer's duties include:
  - Subject to legal constraints and considering the recommendations of the financing team members, the Issuer retains ultimate control and responsibility of the overall financing plan and the details of the financing structure.
  - Selection of the initial members of its debt financing team, including bond counsel and an underwriter and/or municipal advisor.
  - Assistance with the preparation of disclosure documents to be used in connection with the sale of debt.
  - Supervising, investing, and administering the expenditure of bond proceeds.
  - Collecting or monitoring the collection of revenues to pay debt service.
  - Compliance with all undertakings, covenants, and agreements.
  - Filing of any required reports with various governmental regulators and credit rating agencies.
  - Monitoring post-issuance compliance with federal tax and securities laws and any State requirements.

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Participants – Bond Counsel

- Bond Counsel is the attorney or legal firm that gives the legal opinion delivered with the bonds. Generally, this opinion will state that: (1) the bonds are valid and binding obligations of the issuer; and (2) the interest on the bonds is exempt from federal and state income taxes.
- Bond Counsel's duties include:
  - Responsible for preparation and review of the legal proceedings for the issuance of the bonds, including election proceedings, legislation of the governing body of the issuer authorizing the issuance of the bonds and otherwise relating to the bond issue, and the agreements, certificates, and other documents under which the bonds will be issued and secured.
  - Perform tax due diligence to ensure that the bond issue can be sold as federally tax-exempt.
  - Prepare on the issuer's behalf an Official Statement or other offering document for distribution to potential investors that describes the issuer, the bonds, the security for repayment of the bonds, and any other matters that would be material to an investor.

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Participants – Underwriter

- Unless the securities are competitively sold, an investment banking firm would be retained by the issuer to advise and assist in formulating and executing its debt financing plan and then purchasing the issuer's bonds to resell to investors.
- Underwriter's duties can include:
  - Coordinating rating agency and credit enhancement contact and materials.
  - Distribute the Official Statement to potential bond buyers.
  - Assesses bond market conditions to recommend timing and pricing of the bond sale.
  - Markets the bonds to potential investors.
  - Assist bond counsel in the preparation of closing documents and actual wiring of funds to the Issuer.
  - Typically in Ohio, the underwriter will remit payment for all costs of issuance with proceeds generated from the bond sale.
  - Can assist with pre-ballot calculations of millage based on varying par amounts, final maturities, and interest rates (voted issues only).

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Participants – Municipal Advisor

- Provides advice to an issuer with respect to the issuance of bonds, including advice with respect to the structure, timing, terms, and other similar matters.
- Can pre- and post-issuance financial advice.
- Fiduciary responsibility to issuer, which an underwriter does not have.
- Municipal Advisor's duties can include (some overlap with services provided by Underwriters):
  - Assist with pre-ballot calculations of millage based on varying par amounts, final maturities, and interest rates (voted issues only).
  - Recommend a financing structure including maturity schedule, redemption terms, short term, long term, etc.
  - Coordinating rating agency and credit enhancement contact and materials.
  - Assesses bond market conditions to recommend timing and pricing of the bond sale.
  - Assist with evaluating prospective underwriters and negotiating with the selected underwriter.
  - Provide independent analysis of the underwriter's sale and pricing of the bonds.

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Primary Documents

- Election proceedings (voted issue only)
- Authorizing legislation
- Official Statement (Preliminary & Final)
- Bond Purchase Agreement
- Key Closing Documents
  - Bond Counsel Opinion
  - Bonds
  - Signature & No Litigation Certificate
  - Continuing Disclosure Certificate
  - Tax Compliance Certificate, including IRS From 8038-G
  - Bond Registrar Agreement

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