



Fundamentals of Debt Administration

Presented by: **John G. Hulsey, CGFM, CPFO**

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Today's Presenter



John Hulsey provides [financial management training](#) for state and local government officials and personnel. He is a certified public finance officer and a certified government financial manager. Prior to joining the Institute of Government in 2012, John served as a finance director in local government. He has over 17 years of local government financial management experience in such areas as accounting, budget, debt management, financial reporting, and project management. John is a past president of the Georgia Government Finance Officers Association, an active member of the Government Finance Officers Association of the United States and Canada (where he also serves as an adviser to the GFOA Committee on Accounting, Auditing, and Financial Reporting), and a member of the Association of Government Accountants.

Learning Objectives

At the end of today's session, you should be able to:

- Recall why governments issue debt,
- Recite the different types of debt instruments, and
- Identify methods of debt sale



Polling Question



Are you involved in your government's debt issuance process?

- Yes
- No

Why Governments Borrow Money



Short-term vs. Long-term Financing Needs



Why Borrow Money?

Need for Facilities/Development

Governments are responsible for a wide array of services that require capital facilities and improvements

Consequences of Delay

Delay of services provided

Inconvenience or endanger of the citizens

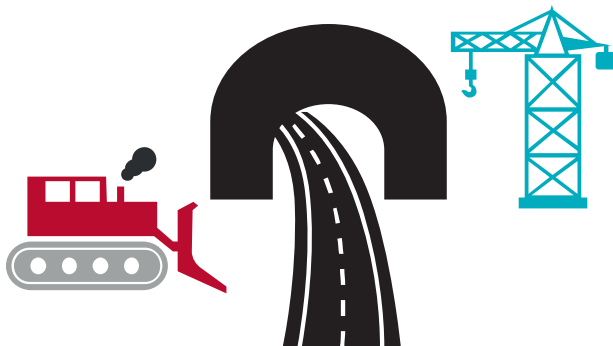
Spreading of Costs Over Useful Life

Most facilities have extended useful lives

Citizens may enjoy facilities for 20-40 years

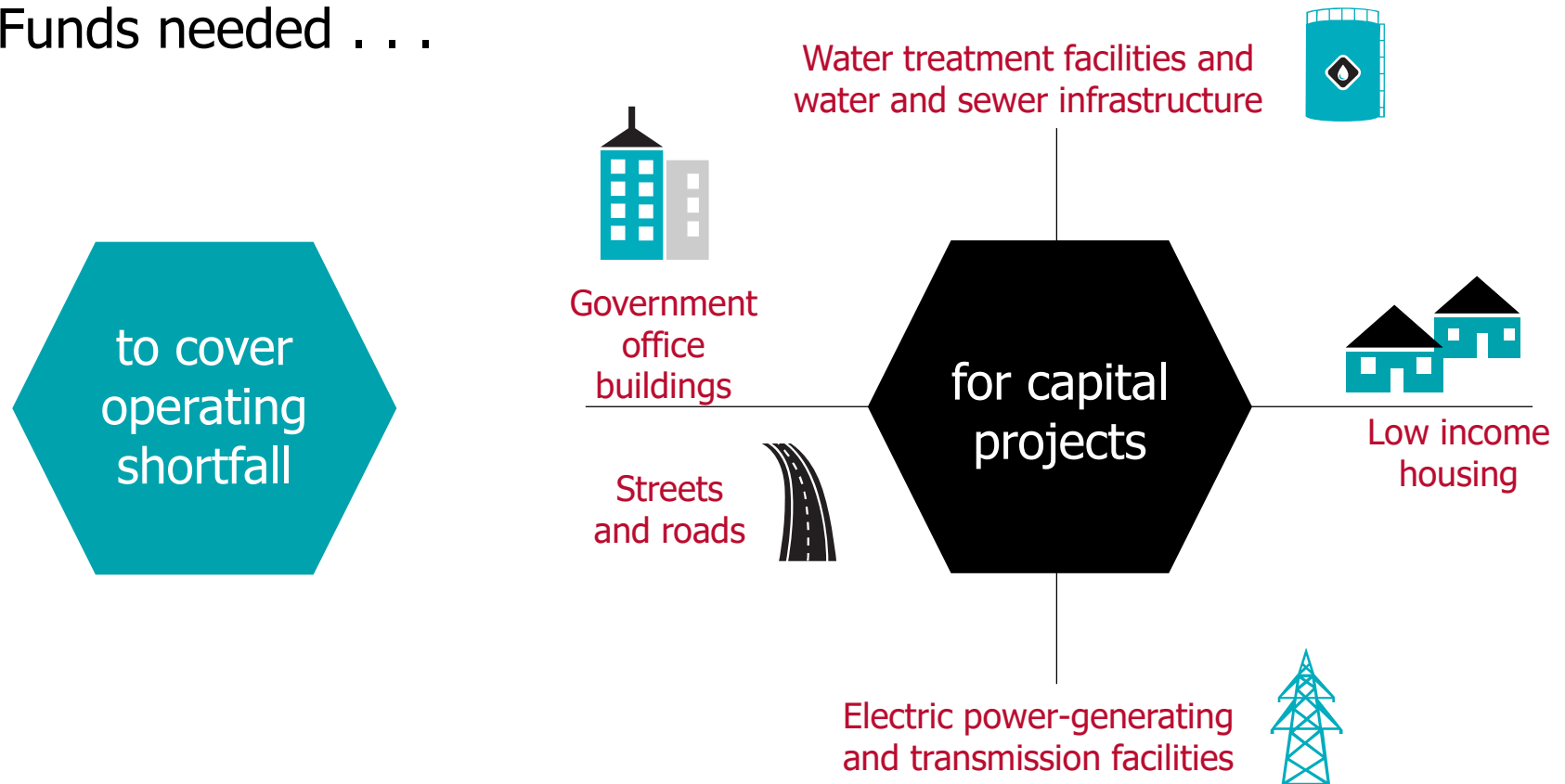
Unfair burden to current taxpayers if required to pay

Financing shares costs with future users of the facilities/services



Why Borrow Money?

Funds needed . . .



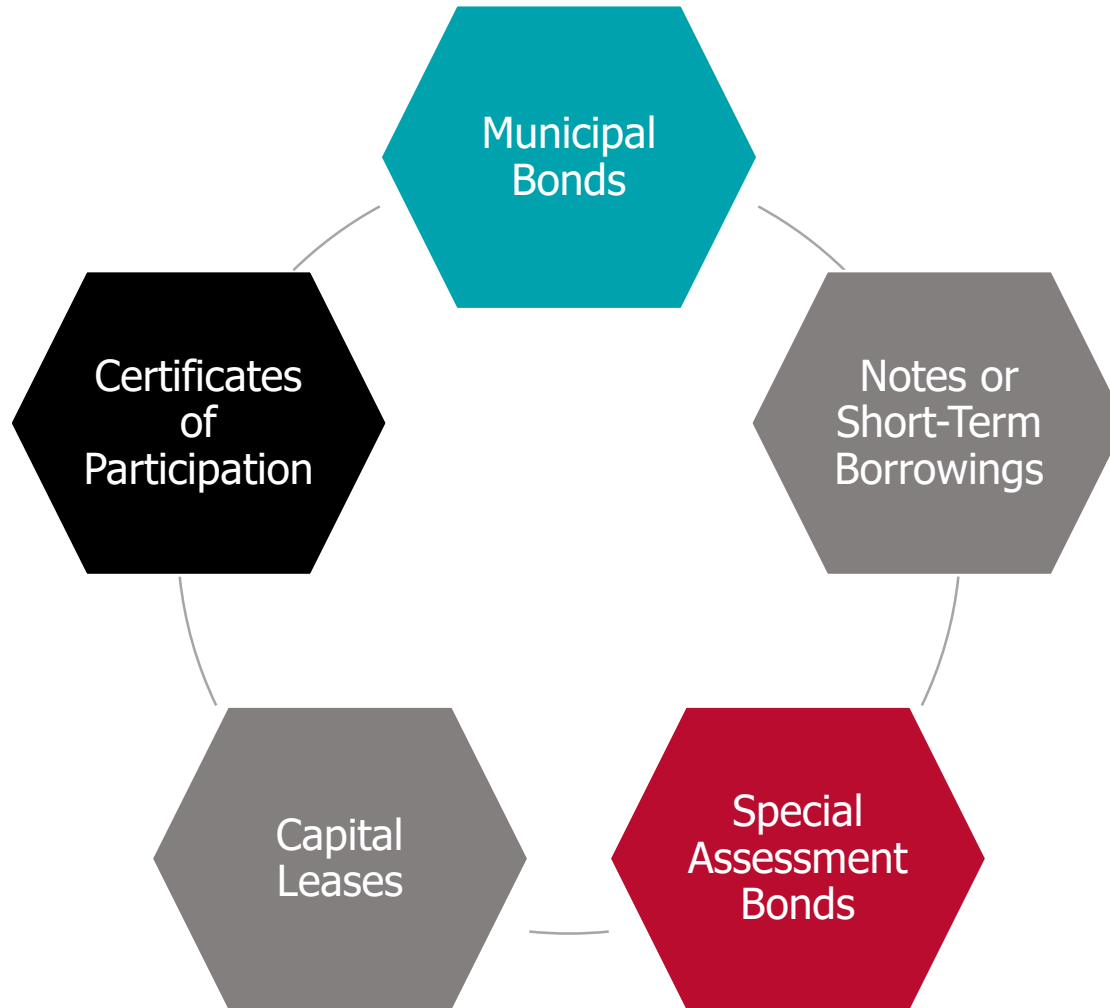
Common Types of Debt



Selecting a Debt Instrument



Common Types of Debt



General Obligation Bonds (“G.O.s”)

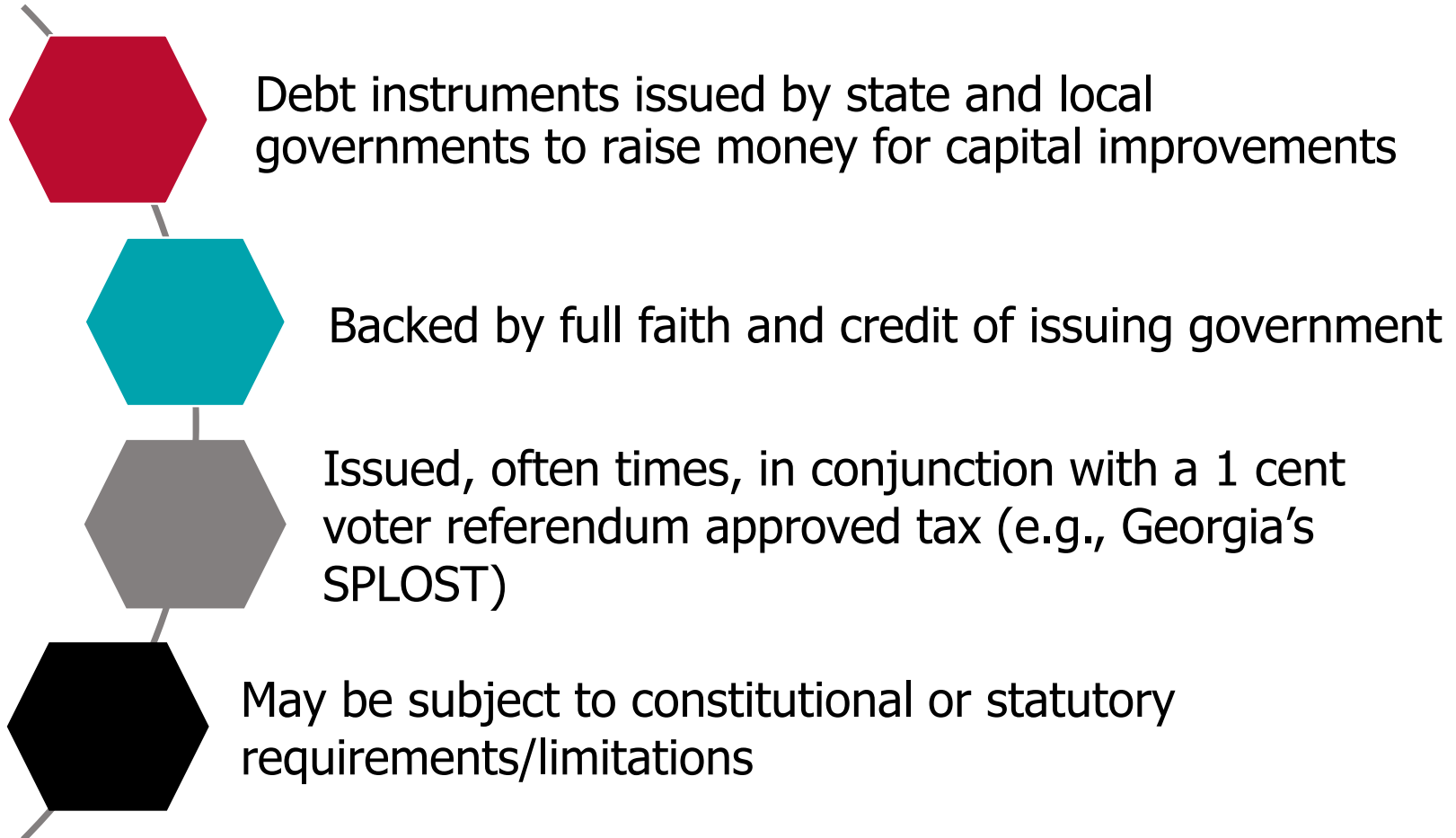
Tool to raise funds for projects that will not provide direct sources of revenue

Roads and bridges, parks, courthouse, administration building

Typically used to fund projects that will serve the entire populace

Not a particular entity or specific population group

General Obligation Bonds (“G.O.s”)



General Obligation Bonds (“G.O.s”)

A look at the advantages and disadvantages . . .


Advantages

- Readily accepted in the municipal marketplace
- Lower interest rate than comparably rated revenue bonds
- Low risk to investors since backed by taxing power of issuer government
- No debt service reserve fund requirement


Disadvantages

- Project delays due to referendum requirement
- Constrained by legal debt limitations


Revenue Bonds



Tool to raise funds for projects that provide direct sources of revenue



Water, sewer and solid waste systems, Gas systems, Mass transit facilities, Public parking facilities, etc.

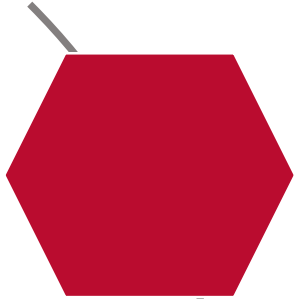


Typically used to fund projects that have a definable user or revenue base

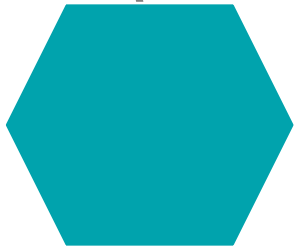


Not the entire populace

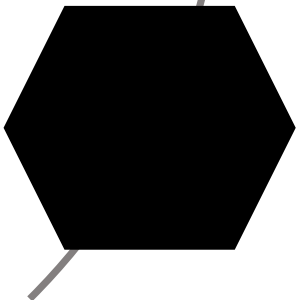
Revenue Bonds



Method of financing projects that have specific revenue stream



May be subject to constitutional or statutory requirements (e.g., Maturity requirement in Georgia of not longer than 40 years)



Make up majority of municipal bonds issued

Revenue Bonds

Debt service reserve fund requirements:

- Amount required by bond documents to be maintained in debt service reserve fund
- Money set aside if revenues not sufficient

Feasibility studies:

- Determines the viability of project's service needs, construction needs, future revenues and expenses
- Describes likelihood project will generate revenues sufficient to meet future operating maintenance and debt service requirements
- Relied upon when issuing bonds



Revenue Bonds

Coverage requirements:

- Issuer's commitment to maintain rates/charges
 - Net revenues divided by annual debt service
- Higher coverage requirements may be required for systems/projects with less dependable revenue streams



Revenue Bonds

Additional bonds test:

- Imposed before more bonds can be issued if secured by same revenues
 - Revenues must be sufficient for current bonds plus new bonds



Revenue Bonds



A look at the advantages and disadvantages . . .

Advantages

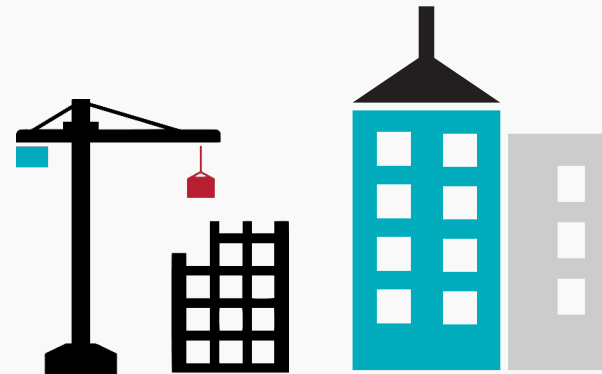
- Voter approval is usually **not** necessary
- Self-supporting revenue bonds are not counted toward debt limits
- Responsibility for repaying bonds is distributed only among the users of the project

Disadvantages

- Higher costs when compared to G.O. bonds
- Require more preparation and administration than G.O. bonds
- Citizens do not have opportunity to approve/disapprove since no referendum

Special Assessment Bonds

Issued
to finance
capital improvements
that benefit
taxpayers in a
particular, carefully
defined area of
the community



Example:

CIDs – Community
Improvement Districts

Capital Leases



Widely used to acquire equipment and facilities . . .

Advantages

- Do not require voter approval
- Easy, effective method of obtaining funding
- Non-appropriation clause

Disadvantages

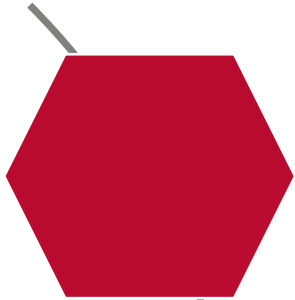
- Higher interest rates

Capital Leases

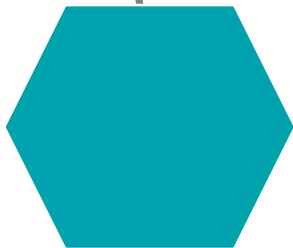
Example of a Non-Appropriations Clause:

Contractor acknowledges that City is a governmental entity, and the contract validity is based upon the availability of public funding under the authority of its statutory mandate. In the event that public funds are unavailable and not appropriated for the performance of City's obligations under this contract, then this contract shall automatically expire without penalty to City thirty (30) days after written notice to Contractor of the unavailability and non-appropriation of public funds. It is expressly agreed that City shall not activate this nonappropriation provision for its convenience or to circumvent the requirements of this contract, but only as an emergency fiscal measure during a substantial fiscal crisis, which affects generally its governmental operations.

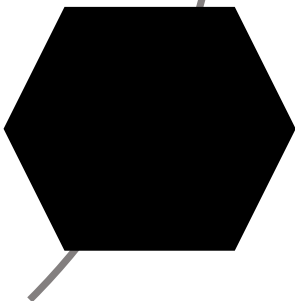
Certificates of Participation (COPs)



Specialized form of lease-purchase agreement

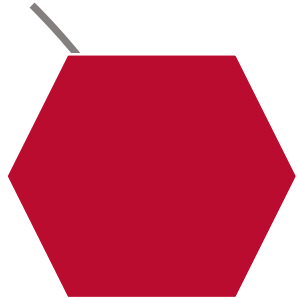


Individual investors buy a share of the lease revenues, rather than interest in project or bonds

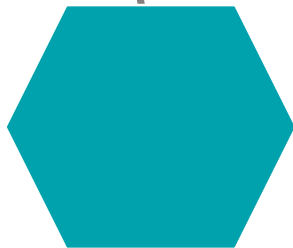


Each certificate represents a proportional interest in the payments that are due under the lease

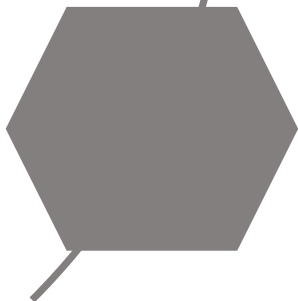
Anticipation Notes



Short-term obligations



Issuer repays a specified principal amount on certain date, together with interest at a stated rate



Usually payable from defined source of anticipated revenues

Examples:

BANs – bond anticipation notes
GANs – grant anticipation notes
TANs – tax anticipation notes

Anticipation Notes



Advantages

Marketed quickly and easily

Low costs

Disadvantage

Overdependence by governments

Avoiding overdependence

Proper budgeting of revenues each year

Maintain recommended general fund unrestricted fund balance

GFOA recommends minimum of 2 months of General Fund operating revenues or expenditures





Low-Interest Loans

State of Georgia offers revolving loan programs through [Georgia Environmental Finance Authority \(GEFA\)](#)

GEFA's programs are environmental focused and include the following:

Water and Sewer Financing	Land Conservation Financing	State Energy Planning	Clean Energy Property Tax Credit
Fuel Storage Tank Program	Energy Initiatives	Weatherization Assistance Program	

Advantages & Disadvantages



Debt	Advantages	Disadvantages
Revenue Bonds	No delays in financing Not counted towards debt limit Repayment of debt is spread among users	Higher interest rates than GO bonds Does not require public approval
General Obligation Bonds	Low interest Approval of voters confirms popular support	Delays in financing Legal debt limits
Special Assessment Bonds	Owners pay for improvements to land	Higher likelihood of default
Capital Lease	Does not require voter approval Easy method of financing capital purchases	Higher interest rates
Certificate of Participation	Provides tax-free investment option	Lessor retains a security interest in the asset
Short-term Notes	Marketed quickly at a low cost	Overdependence by governments

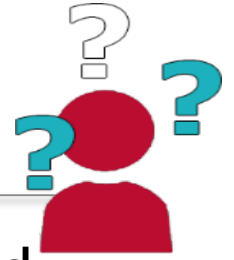
Knowledge Check



Bonds that finance projects having a specific revenue stream are called...

- A. Government obligation bonds
- B. Registered bonds
- C. General obligation bonds
- D. Revenue bonds

Knowledge Check



Debt instruments that are backed by the full faith and credit of the government are called ...

- A. Government obligation bonds
- B. Registered bonds
- C. General obligation bonds
- D. Revenue bonds

The Method of Sale



Competitive Sale, Negotiated Sale, Private Placement





Competitive Bid

- Issuer prepared bond issue structure
- Publishes a notice of sale requesting bids from underwriters
- Underwriters submit closed bids to issuer
- Bond awarded to best bidder
 - Lowest true interest cost
- Winning underwriter resells bonds



Competitive Bid

When to use competitive bid

- Market is familiar with issuer, issuer is stable and regular borrower
- Active secondary market in which to resell bonds
- Issuer has unenhanced credit rating of A or above or can obtain credit enhancement

Continued on Next Slide





Competitive Bid

When to use competitive bid

- Debt structure is backed by issuer's full faith and credit or historically strong and performing revenue stream
- Issue is not too large or too small
- Issue not complex
- Interest rates are stable, market demand is strong



Competitive Bid



A look at the advantages and disadvantages . . .

Advantages

- Promotes appearance of open and fair process
- Bonds are sold at the lowest interest cost given market conditions at time of sale

Disadvantages

- Inflexible to restructuring maturity schedules and interest rates after bonds are awarded
- Does not encourage underwriters to participate in substantial pre-marketing efforts
- Issuer has less control in determining underwriting firm and how bonds are resold to investors





Negotiated Sale

- Issuer works with single underwriter
- Selected underwriter assists issuer with
 - Structuring bond issue
 - Preparing official statement
 - Obtaining bond rating
- Underwriter engages in presale marketing and negotiates interest rates with issuer





Negotiated Sale

When to use Negotiated Sale

- Issuer has poor credit
- Unusually large
- New entity
- Unusual financing terms
- Innovative structure or security



Negotiated Sale



A look at the advantages and disadvantages . . .

Advantages

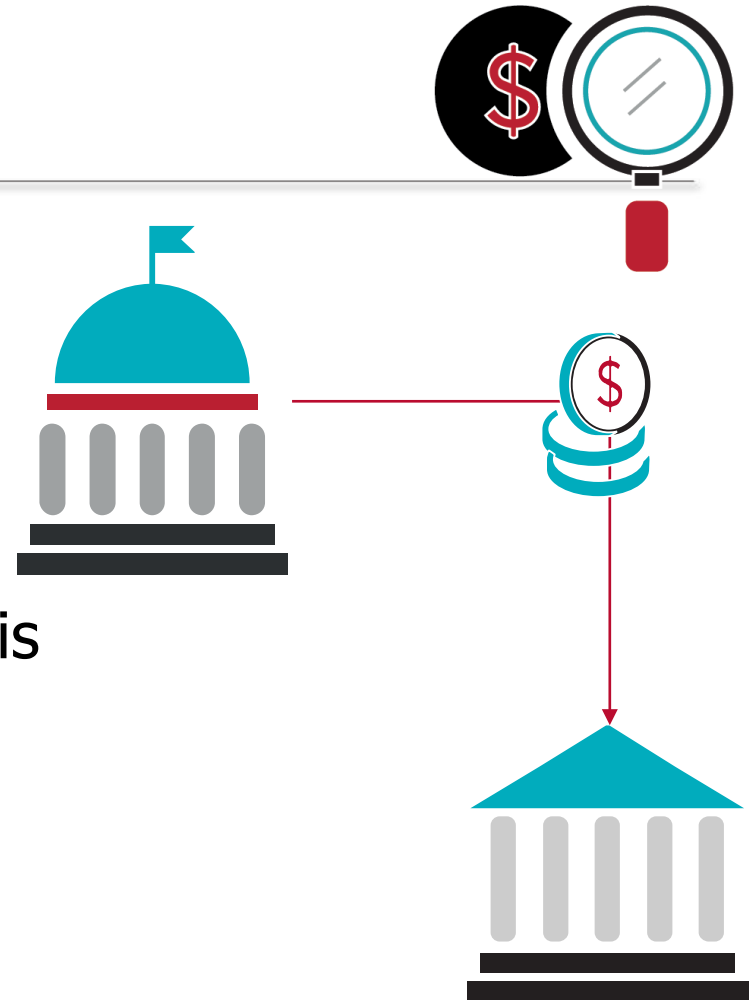
- Underwriter is able to engage in presale marketing efforts prior to bond sale
- Allows more flexibility in underwriter selection
- Increases flexibility for issuer with sale date and bond structure

Disadvantages

- May appear biased
- Issuers often do not have adequate information to negotiate effectively with underwriters

Private Placement

- Government markets bonds directly to investors
 - Commercial banks
 - Insurance companies
- Used when a public bond sale is
 - Too expensive
 - Likely to be ineffective



Private Placement



A look at the advantages and disadvantages . . .

Advantages

- Faster sales process
- Lower disclosure requirements

Disadvantages

- Higher interest costs

Methods of Sale

Advantages/Disadvantages

Method of Sale	Advantages	Disadvantages
competitive bid	fair process; low interest cost	does not allow for restructuring maturity dates and interest rates after bonds are awarded; no premarketing; no choice of underwriter selected
negotiated sale	pre-marketing; allows some choice in underwriter selected; more flexibility with bond structure	may appear biased; issuers may not have enough information to effectively negotiate
private placement	faster sale process; disclosure may not be as stringent	higher interest rates; more restrictive debt covenants

Knowledge Check



An alternative to selling securities in the public marketplace is through ...

- A. Competitive bid
- B. Negotiated bid
- C. Negotiated sale
- D. Private placement

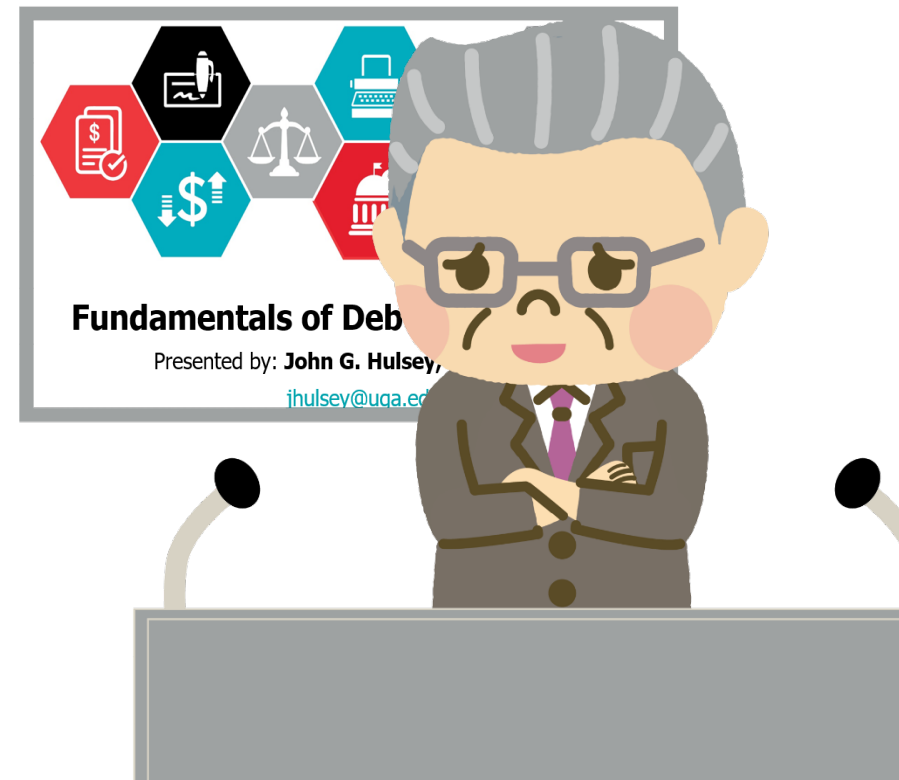
Knowledge Check



The preferred method of sale used for bonds which are backed by the full faith and credit of the issuer is ...

- A. Competitive bid
- B. Negotiated bid
- C. Negotiated sale
- D. Private placement

QUESTIONS?



Thank You for Your Time Today!

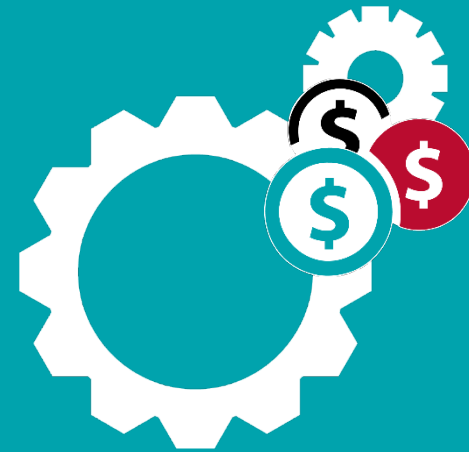
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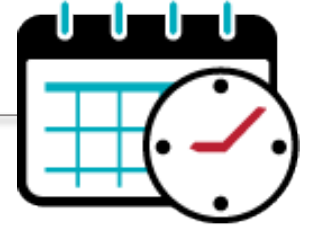
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Join us for our Next Webinar



Topic: Fundamentals of Budgeting

Date: Wednesday, September 15, 2021

Time: 2:00 PM EDT

Presenter: Tracy Arner, Senior Public Service Associate



Thank You!

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