Not All Bonds are Created Equal

Strategically Implementing Your Capital Plan

August 3, 2019

Overview

- Counties are increasingly developing detailed capital plans
- How this plan is implemented matters; choosing Option A now may foreclose Option B later
- Making the best decision requires a good understanding of the tools available and how they interrelate

Limitations on Borrowing: State Law

- Public entities cannot "sign a note" at a local bank.
- State Constitution and statutes must be observed in order for a borrowing to be valid.
- Art. X of the Constitution: Political subdivisions "shall have the power to incur indebtedness in the following categories and in no others:"
- (a) General obligation debt;
- (b) Indebtedness payable only from a revenue-producing project or from a "special source not involving a tax or license"; and
- (c) Indebtedness payable from incremental tax revenues issued for redevelopment purposes (TIF).

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Implementing Your Capital Plan | Limitations on Borrowing

Limitations on Borrowing: State Law

- Other than general obligation bonds and TIF bonds, which each have their own authorization, all local government bonds are, from a constitutional standpoint, revenue bonds, secured by revenues from a revenue-producing project, e.g., utility system, or from a special source not involving a license or tax.
- All debt must be issued pursuant to a "general law."
- All borrowings must serve a "public purpose" and also serve a "corporate purpose" of the particular issuer.

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Implementing Your Capital Plan | Limitations on Borrowing

Limitations on Borrowing: State Law

- The S.C. Supreme Court has remarked that public purpose is a "fluid concept"—it changes over time. The concept focuses on the primary beneficiary of state action. For example, courts now recognize expenditure of public funds, including general obligation bond proceeds, to promote economic development serves a public purpose. The analysis takes into account the public benefit to be derived and guards against speculative expenditures.
- "Corporate purpose" is a narrower concept, and focuses on the specific powers granted to the entity by the Constitution and statutes. Each form of local government has a limited set of powers. An activity may serve a public purpose, e.g. defense against foreign enemies, but maintenance of a militia is likely not the corporate purpose of a county government.

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Implementing Your Capital Plan | Limitations on Borrowing

Limitation on Borrowing: Debt Limit

- Why Do We Have to Go Through All of This?

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Implementing Your Capital Plan | The Toolbox

Local Governmental Borrowing Tools

- General Obligation Bonds
- Utility Revenue Bonds
- Lease-Purchase Agreements
- Installment Purchase and Use Agreements
- Hospitality/Accommodations Fee Revenue Bonds
- Public Improvement Assessment District Bonds
- Tax Increment District (TIF) Bonds
- Special-Source Revenue Bonds

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Implementing Your Capital Plan | GO Bonds

General Obligation Debt

- Often for "brick and mortar" projects, particularly where the project does not produce a stream of revenues to support revenue bonds
- Typical uses include courthouses, jails, parks, libraries, administrative facilities and the like
- "full faith, credit and taxing power"
- Political subdivisions may issue bonds for any corporate purpose
- Given lack of revenue stream, general obligation bonds are typically repaid from ad valorem property taxes.

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Implementing Your Capital Plan | GO Bonds

General Obligation Debt

- General obligation debt must be authorized by ordinance, following public hearing.
- County general obligation debt is also subject to voter initiative (15% voter petition) in the 60-day period following adoption of approving ordinance. 60 days can be reduced to 20 days, but petition requirement drops from 15% of voters to only 5 (not percent) voters.
- 30 year maximum term, unless sold to federal agency (e.g., Rural Development) or approved by referendum, in which case 40 year maximum term. *Some* principal must be repaid within five years, but practically any repayment schedule is permissible, subject to lender flexibility.

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Implementing Your Capital Plan | GO Bonds

General Obligation Debt

- Debt Limits: Unless approved by referendum or issued for a special taxing district, all general obligation debt is subject to the county's debt limit: 8% of assessed value
  - Referendum-approved bonds and special tax district bonds do not count against the debt limit, at issuance or thereafter
  - Certain statutes which promote economic development and tax relief have an impact on growth in assessed value and thus debt limit:

    MCIP, FILOT

    Act 388 limitations on assessed value growth

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Implementing Your Capital Plan | Sales Tax Borrowings

"Sales Tax Bonds"

- Strictly speaking, there are no "sales tax bonds" in South Carolina. No State law authorizes issuance of bonds secured solely by sales tax
- Bonds that have been issued in connection with an optional local sales tax are general obligation bonds, secured by ad valorem taxes and also secured by sales taxes
- Several general laws, the Capital Project Sales Tax and the Transportation Sales Tax, as well as local legislation for a number of school districts, authorize the imposition of a sales tax following a referendum and application of sales tax proceeds to debt service.

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Implementing Your Capital Plan | Utility Revenue Bonds

Utility Revenue Bonds

- Typical uses for counties include water and sewer and solid waste
- Secured by revenues of a "System"
- The revenues of the System are applied to repay the revenue bonds
- No legal debt limit; strength of revenue stream and bond covenants drive ability to borrow
- No limitations on payment structure, except 40 year maturity limitation.

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Implementing Your Capital Plan | Lease-Purchase

Lease Purchase Agreements

- The South Carolina Supreme Court has held on several occasions that a financing contract containing a "non-appropriation" clause does not constitute general obligation debt and is not subject to the 8% constitutional debt limitation.
- A "non-appropriation" clause allows a local government to deliberately fail to appropriate money for debt service for a given fiscal year.
- Upon non-appropriation, the borrower gives up possession of the collateral, but is not obligated to pay any further amount or penalty under the financing contract.

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Implementing Your Capital Plan | Lease-Purchase

Lease Purchase Agreements

- In 1995, the General Assembly began limiting the use of appropriation-based financing, and has continued to modify the limits where new ideas arise.
- S.C. Code § 11-27-110 as originally adopted treats lease-purchase agreements as general obligation debt and subjects them to the debt limit:
  - Exception for financing of equipment and other personal property.
  - Amended in 1999 to create further exception where repayment will be made through an "enterprise fund": utility fees, hospitality and accommodations fees.
  - Amended in 2006 to stop the use of installment purchase agreements by school districts; this amendment did not extend this prohibition to other political subdivisions, however.

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Implementing Your Capital Plan | Lease-Purchase

Lease Purchase Agreements

- In a typical equipment lease-purchase financing:
  - Financing institution provides funds and "leases" the assets to the issuer, although title to the equipment typically is stated to rest in the issuer.
  - Lease payments have principal and interest components to qualify the lease as federally tax-exempt.
  - Assets will pass to issuer free and clear upon conclusion of lease term and payment of nominal consideration.
  - Issuer's obligation to pay must be subject to annual appropriation.
  - Non-substitution clauses disfavored.
- To be considered:
  - Can issuer make payments under Act 388 (operating budget) millage increase limitations? Issue bonds to make payments?
  - Counsel should review agreement for various issues, including appropriation, remedies and insurance provisions.

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Implementing Your Capital Plan | Installment-Purchase

Installment Purchase and Use Financing

- Typically uses include essential county facilities, i.e. courthouses, public safety functions, administration complexes
- Not a great fit for parks, raw land, and similar on a standalone basis
- Variant of lease-purchase, with a few important exceptions
- Title to financed asset is in the name of a nonprofit corporation, with ground lease to nonprofit for term of bonds plus (typically) 5-10 years.
- The buildings are, in effect, leased, subject to appropriation, to the county for a term matching or exceeding the bond maturity and in exchange for payments matching the debt service on the bonds.

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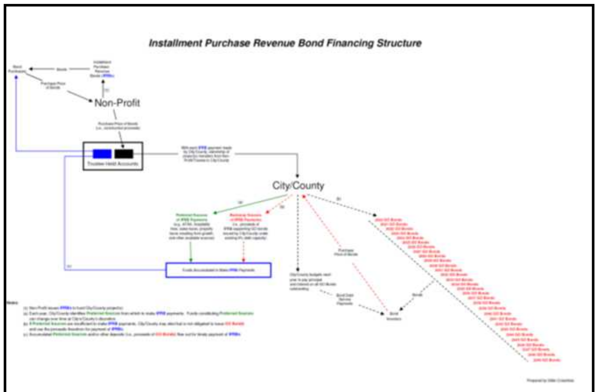

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Implementing Your Capital Plan | Fee Revenue Financings

Accommodations and Hospitality Financings

- Must be used for tourism-related capital projects – parks, museums, cultural centers, transportation infrastructure providing access to tourism related facilities
- A “tourist” is anyone who enters your jurisdiction for the purpose of leisure or recreation
- Accommodations: 1½% maximum, or 3% with municipal consent, subject to 3% cumulative rate for impositions authorized after 1996
- Hospitality: 1% maximum, or 2% with municipal consent, subject to 2% cumulative rate for impositions authorized after 1996

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Implementing Your Capital Plan | Fee Revenue Financings

Accommodations and Hospitality Financings

- Until 2010, there was no general law authorizing the use of the fees as security for revenue bonds, however, and, therefore, financings were undertaken as lease-purchase transactions.
- Since adoption of legislation, the transactions have tended to be undertaken in the form of revenue bonds, as the risk of non-appropriation is avoided.
- Covenants are similar, as appropriate, to utility revenue bond financings.
- Revenues can be applied only to certain "tourism-related" facilities. A recent trial court opinion ruled that a fitness facility intended to attract users living outside the municipal limits was "tourism-related." Further legislative action?

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Implementing Your Capital Plan | Assessment Districts

Public Improvement Assessment District Bonds

- Counties may create assessment districts to fund the cost of various publicly-owned improvements therein through assessments imposed on property within the assessment district
- Once imposed, the assessment constitutes a lien on the property
- Typically, apportionment is based on a calculation of relative benefit conferred by an improvement on a given parcel of property

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Implementing Your Capital Plan | Assessment Districts

Public Improvement Assessment District Bonds

- Bonds are typically payable solely from the assessments and thus qualify as revenue bonds under the SC Constitution.
- The enabling legislation provides that assessments cannot be imposed on owner-occupied real property without the consent of the owner. Accordingly, assessment districts are an appropriate tool for undeveloped property and developed commercial property, but not for developed residential areas, absent unanimous consent of homeowners.
- Lender must assess creditworthiness of developer and the value of land if foreclosure is necessary.

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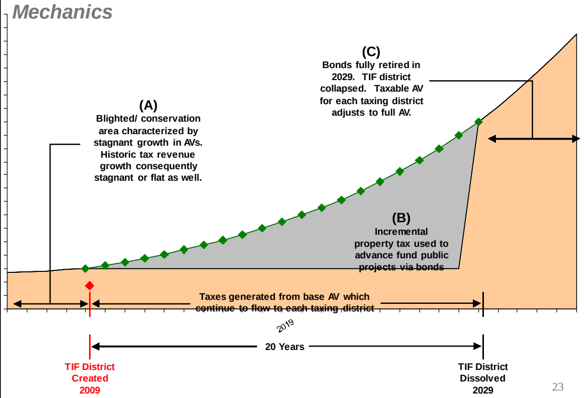
Tax Increment Financing (TIF) Bonds

- Used to construct publicly owned infrastructure to help redevelop an area
- Purpose is to reallocate money away from other taxing entities
- Counties may create "redevelopment project areas" upon a finding of blight and analogous conditions
- Once a redevelopment project area is created, the issuer may issue tax increment bonds to fund public improvements intended to remedy the adverse conditions
- Upon the adoption of a qualifying ordinance, the assessed value of property in the redevelopment project area is established as a baseline

Tax Increment Financing:
Mechanics



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Tax Increment Bonds

- Issuance of bonds is often delayed until a large investment is set to come online
- For new developments, growth risk has in some cases been reduced through a hybrid structure using both TIF bonds and assessment district financing
- Under this hybrid structure, both a redevelopment project area and an assessment district are created over the property in question
- Assessments are imposed, and are collected each year to make debt service on TIF bonds until such time as the tax increment is sufficient to make all debt service payments—developer takes risk

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Implementing Your Capital Plan | Tax Increment Financings

Tax Increment Bonds

- A major challenge with TIF Bonds flows from a 2005 amendment, which afforded overlapping taxing jurisdictions the right to "opt out" of a TIF financing program—exercise of the opt out by a school district, for example, removes the majority of the incremental revenues otherwise available for debt service from the program
- A 2012 amendment allows overlapping jurisdictions to agree to the devotion of an agreed-upon portion of revenues to TIF bond debt service
- Growing prevalence of synthetic TIFs using multi-county parks

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Implementing Your Capital Plan | SSRBs

Special Source Revenue Bonds

- May be issued for any infrastructure serving the County or a qualified project
- Counties often have significant multi-county park revenue
- Counties hold nearly all of the cards in diverting tax revenues issue SSRBs
- Synthetic TIFs
  - TIFs have become difficult to implement
  - Synthetic TIF may be created using multi-county park structure

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Implementing Your Capital Plan Financing Considerations

Financing: Government Building

- Does the facility itself generate revenues? Is the revenue stream sufficient and stable?
- Does the facility house administration of a revenue producing enterprise, i.e., water, sewer, solid waste?
- Is the facility tourism-related?
- Does the entity have sufficient available debt limit to finance the facility outright?
- Does the entity have sufficient debt limit to finance on an installment-purchase basis?
- Is the facility serving new growth that would support TIF financing?

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Implementing Your Capital Plan | Financing Considerations

Financing: Recreation Facility

- Does the facility itself generate revenues? Sufficient for debt service?
- Is the facility tourism-related?
- Does the county have sufficient available debt limit to finance the facility outright?
- If a county, consider a special tax district for recreation facilities.
- Does the entity have sufficient debt limit to finance on an installment-purchase basis?
- Is the facility serving new growth that would support TIF financing?

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Financing Considerations | Public Safety Facility

Financing: Fire/Law Enforcement

- Does the facility itself generate revenues?
- Is the facility tourism-related?
  - a. No, but 50% or 100% ($900,000 in accommodations taxes) of prior year revenue can be used for fire/law enforcement operations directly attendant to listed tourism-related facilities.
- Does the entity have sufficient available debt limit to finance the facility outright?
- Does the entity have sufficient debt limit to finance on an installment-purchase basis?
- Is the facility serving new growth that would support TIF financing?

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Implementing Your Capital Plan | Needs

Capital Needs

- County Council has determined that the following items are priorities in the next five years:
  - $30 million for new jail
  - $10 million for economic development site work at MCBP
  - $10 million for new park
  - $15 million for roads
- County has $30 million of 8% GO bond capacity remaining
- Total of $65 million in identified needs

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Implementing the Capital Plan | Options

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- $30 million for new jail
  - Use all of 8% capacity?
  - Essential facility – IPRB available

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- $10 million for economic development site work at MCBP
  - Use portion of 8% debt limit?
  - Issue SSRBs
  - Combine with jail financing using an IPRB?

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Implementing the Capital Plan | Options

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- $10 million for new park
  - Use portion of 8% debt limit?
  - Create special tax district?
  - Use A-Tax of H-Tax financing?
  - Combine with jail IPRB?

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- $15 million for roads
  - Use portion of 8% debt limit?
  - Create special tax district?
  - Use A-Tax of H-Tax financing?
  - Combine with jail IPRB?

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Implementing the Capital Plan | Options

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- Council decides that interest rates are at historic lows and wants to do everything now – the entire $65 million. But how?
- Option 1 – GO bond referendum for all projects
  - Benefit
    - Lowest cost of borrowing
    - No impact on debt limit
- Downside
    - Referendum may fail
    - Each project must be listed separately and not all may be approved
    - Timing

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Implementing the Capital Plan | Options

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- Council decides that interest rates are at historic lows and wants to do everything now – the entire $65 million. But how?
- Option 2 – IPRB for all projects
  - Benefit
    - Undertake all projects at once
    - Can use essentiality of jail to bootstrap other projects
    - Use variety of sources to make acquisition payments
    - Preserve debt capacity under 8% debt limit
  - Downside
    - Somewhat higher cost of funds
    - Complexity

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Implementing the Capital Plan | Options

Implementing the Capital Plan

- Council decides that interest rates are at historic lows and wants to do everything now – the entire $65 million. But how?
- Option 3 – Separate Financings
  - $30 million IPRB for jail
  - $10 million SSRB for MCBP
  - $15 million GOB for roads
  - $10 million H-Tax bond for park
  - Benefit
    - Hard to say
  - Downside
    - Higher cost of funds
    - Complexity
    - Staff burden

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Implementing the Capital Plan | Take-Aways

Implementing the Capital Plan

- Timing is everything
- Issuing a GO bond for the jail first forecloses many other options
- Referenda are now more difficult to use to address an entire capital plan
- Conserving GO bond debt capacity is critical to flexibility

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