# Not All Bonds Are Created Equal

## Strategically Implementing Your Capital Plan

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**Capital planning** is, in no small part, the practice of avoiding unintended consequences. Not too far in the past, counties engaged with their outside financing team to assist them in obtaining capital for a specific project without reference to any larger context. If another capital project was planned for the next fiscal year, it may or may not have been discussed. This resulted in money and political goodwill being left on the table.

Informed capital planning requires two things—a realistic assessment of needs and an understanding of the tools available and how those tools interrelate. That interrelation of financing tools is the focus of this article.

### Know Your Financing Tools

Generally speaking, counties may borrow money (issue municipal bonds) backed by either property taxes, or utility revenues and fees. Bonds backed by taxes, known as general obligation bonds, often represent the lowest-cost option from an interest rate perspective, making this tool relatively more appealing to the county. But this tool is limited by a constitutional debt limit. Absent a referendum, the South Carolina Constitution imposes a general obligation debt limit at an amount equal to 8 percent of the assessed value of the property in the county, which can significantly constrain use of this tool. By contrast, revenue bonds are not subject to the borrowing limit and, for the most part, may be issued in any amount a lender thinks the county can pay back. To maintain separation between these tools, the South Carolina Constitution prevents counties from using taxes or licenses to secure revenue bonds.

The result is that all bonds are not created equal and some are better suited to certain tasks than others. A county would not want to exhaust all of its scarce general obligation bond capacity for the foreseeable future with a nice-to-have quality of life project if it anticipated that the general obligation bonds would be needed for a critical public safety project within the next few years. Similarly, even if roads were the top priority of county council, the expense of large-scale transportation projects would exhaust the debt capacity and financial resources of the county without a capital project sales tax or transportation sales tax referendum, each of which requires substantial lead time to implement.

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### Plan Now to Have Options Tomorrow

Comprehensive capital planning is not a panacea, but it will become increasingly necessary as escalating pension contributions put pressure on the general fund, infrastructure from past decades wears out, and economic development places new challenges on service delivery. Said another way, what is cutting edge now will become a necessary aspect of county fiscal fitness in the years to come.

Informed capital planning should be conducted with a view toward preserving flexibility. Using general obligation debt capacity today precludes use of the same capacity tomorrow (until the bonds are paid down). Referenda, revenue bonds, and installment purchase transactions preserve flexibility, but often at a somewhat higher interest cost and through more complex transactions. The capital planning process helps the county to understand how much it values that flexibility and whether it is important in making sure the county is prepared for challenges and opportunities in the future.

### An Example

The following example may be helpful in bringing the issue to life. The fictional County Council of Rutledge County, South Carolina has identified $65 million of capital projects to be initiated in the next five years. County council expects to spend $30 million on a new jail, $10 million on economic development site work and infrastructure in their multi-county industrial park, $10 million for a new recreation and sports facility, and $15 million for roads. Rutledge County presently has $35 million of 8 percent general obligation capacity.

For the jail financing, Rutledge County could issue general obligation bonds for the entire $30 million, leaving only $5 million of capacity for the remaining projects. On the other hand, because the jail is an essential facility, it may be a good candidate for an installment purchase transaction that would preserve all of its debt capacity for the remaining projects.

For the $10 million of economic development improvements, Rutledge County could consider special source revenue bonds payable from the fees-in-lieu of taxes generated from its multi-county parks, issue general obligation bonds, or combine the financing with an installment purchase transaction.

For the $10 million for the new recreation and sports complex or the $10 million road financing, Rutledge County could issue general obligation bonds, create a special tax district within a portion of the county benefiting from the park or road to levy millage and issue

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general obligation bonds of the county that would not count against the 8 percent debt limit, leverage hospitality or accommodations fees assuming the park or road had a sufficient tourism purpose, or combine the park or road financing with a larger installment purchase transaction.

If Rutledge County issues $30 million for the jail, it may be some time before it has debt capacity for roads. If Rutledge County undertakes an installment purchase financing for all $65 million of projects, it would preserve flexibility and debt capacity for future projects, but may pay a higher interest rate on the relatively more complex financing. If, on the other hand, Rutledge County undertakes separate financings for each project, it may lose the benefits of scale through higher transaction costs and staff burden. Additional financings can also result in additional covenants in the bond documents that impact how your county does business.

These considerations highlight the need to conscientiously allocate scarce resources, carefully select financing tools, and avoid the opportunity costs associated with considering capital projects in isolation and outside of a broader context. Comprehensive capital planning can help your county find the right mix of flexibility, cost of funds, and debt capacity, and ensure you have the right tool available at the right time to meet the needs of your county.

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