

## Section Nine - Debt Management Policy

### OVERVIEW

In recent years, affordability and access to credit markets has made debt financing for small local governments a viable funding source. From capital projects to short term financing needs, financial intermediaries and traditional lenders offer tax exempt and taxable, debt financing alternatives.

### COMPREHENSIVE STRATEGIC FINANCIAL PLAN

To determine if debt financing can benefit a governmental unit, a debt management policy, as part of a comprehensive strategic financial plan, should be in place. The financial plan should contain guidance on strategies, objectives and requirements of debt issuance, in an effort to support the best allocation of the local government's financial resources. The debt management policy should provide local governments with a procedural framework to assess the costs and benefits of overall debt financing or potential fundings, in light of existing capital planning, budgetary, investment and reporting policies.

### FLORIDA STATUTE CITATIONS

The Internal Revenue Code, Florida Statutes, local charter and/or ordinances outline legal borrowing authority, restrictions and compliance requirements while the Florida Constitution and Statutes authorize the issuance of bonds by counties, municipalities and certain special districts.

- Section 125.013 – General Obligation & Revenue Bonds
- Chapters 130 & 132 – County Bonds & General Refunding Law
- Section 154.219 – Public Health Facilities Revenue Bonds
- Chapter 159 – Bond Financing
- Section 163.01(7) – Bonds Issued by Entities Created by Interlocal Agreement
- Chapter 166, Part II – Municipal Borrowing
- Section 215.43 – Financial Matters: General Provisions
- Chapter 218, Part III – Local Financial Management & Reporting

### TYPES OF DEBT

A wide range of financing vehicles, with a variety of terms can meet most municipal needs, including:

"Bond anticipation notes" are notes issued by a governmental unit in anticipation of the issuance of general obligation or revenue bonds.

"Commercial Paper" is short-term debt (from one to 270 days) to finance capital projects. Commercial paper provides an alternative to the traditional fixed-rate debt for both short-term (interim) financing needs and possibly for diversification of the long-term debt portfolio.

"General obligation bonds" are obligations secured by the full faith and credit of a governmental unit payable from the proceeds of ad valorem taxes.

"Limited revenue bonds" are obligations issued by a governmental unit to pay the cost of improvements of a project or combination of projects payable from funds of a governmental unit, exclusive of ad valorem taxes, special assessments, or earnings from such projects.

"Revenue bonds" are obligations of a governmental unit issued to pay the cost of improvements of a self-liquidating project, or combination of projects payable, from the earnings of such project and any other special funds authorized to be pledged as additional security.

"Special assessment bonds" are bonds that provides for capital improvements paid in whole or in part by levying and collecting special assessments on the abutting, adjoining, contiguous, or other specially benefited property.

## BOND POOLS

A bond pool offers governmental units an opportunity to joint venture with other entities to borrow funds for capital improvements, renovations, fixed asset additions or refinancing existing debt. Advantages of bond pools may include improved marketability and reduction in issuance costs through economies of scale. Bond pools may provide either long-term fixed-rate or variable rate debt products.

## BANK BORROWINGS

Financial institutions offer short term financing needs for governmental units to alleviate temporary cash flow timing differences (e.g. bond, revenue, or tax anticipation notes). In addition, banks can provide long-term financing solutions for capital projects. Traditional revolving credit facilities and other financing vehicles, such as leasing arrangements, can also provide local governmental units an additional source of funds.

## INDEPENDENT FINANCIAL ADVISOR

In many cases, debt financing involves complex transactions requiring specific expertise not always available in small governments. Depending on the funding purpose and level of debt required, it is recommended that an independent financial advisor be engaged to represent the governmental unit during the debt issuance process. This individual or firm would be responsible to the appropriate governmental decision makers and recommend the best method of sale and structure for the debt issue. Assistance with the selection of other financial professionals, for bond preparation, disclosure and compliance documentation, necessary to consummate a transaction, could also be assembled by this individual or firm. In most cases, the financial advisor is paid from debt proceeds.

## UNDERWRITER

The underwriter purchases the bonds of the local government and markets, usually as a fee based on a percentage of the issue, the bonds to the ultimate bond purchasers. The

underwriter may be chosen through a competitive RFP process for a negotiated sale, or may be chosen based upon a public bid process through a competitive sale process. The underwriter is also compensated from the proceeds of the bond sale.

## BOND COUNSEL

The bond counsel works on behalf of the bondholders (but is hired by the local government) to ensure compliance with federal laws and regulations related to the issuance of tax-exempt debt. The bond counsel prepares the legal documents related to the financing and oversees the closing process for the bonds. Additionally, the bond counsel may be chosen through a competitive RFP process and, in most cases, is paid from the proceeds of the debt issuance.

## CREDIT RATING AND CREDIT ENHANCEMENTS

Various independent bond rating agencies assess the credit quality of the borrowing entity and debt offerings. Superior ratings by these organizations command favorable borrowing rates, resulting in lower overall cost of funds. Many governmental units strive to maintain or improve their bond rating in order to maintain easy access to credit markets.

These and other variables affect the overall rate of interest paid by the governmental unit. The use of credit enhancements can also reduce overall borrowing costs and improve the quality of the debt issuance. Surety bonds or insurance (guaranteeing the repayment of the obligation) enhance the offering to potential investors by providing additional strength to the issue. The current availability of bond insurance is very limited and the future of such instruments is uncertain.

## POLICY STATEMENTS & OBJECTIVES

Many governmental units adopt additional financial parameters over and above those required by law. Such policy guidelines often reflect overall constituent and management philosophy regarding public finance. Debt policies often include 1) Committing to complete and full public disclosure of all financing transactions, 2) mandating specific required uses to borrow funds, 3) restricting overall debt service as a percentage of available resources to annual debt requirements, 4) requiring interest rate analysis to be conducted for each issuance as well as at regular intervals, and 5) issuing debt for periods not to exceeding the useful life or average useful lives of the project or projects to be financed with debt proceeds. These are just examples of policy statements reflecting prudent borrowing practices and sound financial management.

## REFUNDING

Capital projects can be funded with bond proceeds with extended repayment terms. A governmental unit's debt management policy should address significant changes in the interest rate environment in order to consider potential savings of refinancing higher interest rate debt with proposed lower interest rate obligations. For such refundings to be considered, many governmental units establish a threshold percentage to compare the existing obligation's costs with the costs of the proposed debt refinancing in terms of

the net present value of interest cost savings (expressed as a percentage savings of the refunded bonds).

## CONCLUSION

The issuance of debt instruments by a governmental unit can provide significant benefits to the governmental unit, residents and local businesses alike. To adequately assess, manage and maintain such obligations, a debt management policy, as a component of a comprehensive strategic financial plan must be in place. Such a policy provides guidelines and procedures to determine whether debt financing would be a beneficial funding option. The ability to incur debt by a governmental entity provides added flexibility and responsiveness that is important in today's ever-changing financial landscape. Sound financial management practices, including continued review and monitoring of existing obligations, enables local governments to enhance the quality of life for its residents and local businesses.

## ADDITIONAL RESOURCES

### REFERENCES:

2008 Florida Statutes

Florida League of Cities, Inc.

<http://www.flcities.com/financial/bonds/>

Joseph, James C., [Debt Issuance and Management: A Guide for Smaller Governments](#)  
Government Finance Officer's Association, Chicago, IL 2005.

Government Finance Officers Association, Recommended Practices: Governmental Debt Management. <http://www.gfoa.org>

2007 Debt Affordability Report, State of Florida, Division of Bond Finance  
<http://www.sbafla.com/bond/pdf/publications/DARrpt07.pdf>

Florida Auditor General, Performance Audit Report: Local Government Bond Pools,  
May 22, 2003. <http://www.myflorida.com/audgen>