SECTION 10 – DEBT MANAGEMENT POLICY

Overview

From capital projects to short-term financing needs, financial intermediaries and traditional lenders offer tax exempt and taxable debt financing alternatives.

Florida Statutory 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, Florida Statutes, General Obligation; Revenue Bonds
- Chapters 130 and 132, Florida Statutes, County Bonds & General Refunding Law
- Section 154.219, Florida Statutes, Revenue Bonds
- Chapter 159, Florida Statutes, Bond Financing
- Section 163.01(7), Florida Statutes, Florida Interlocal Cooperation Act of 1969
- Chapter 166, Part II, Florida Statutes, Municipal Borrowing
- Section 189.051, Florida Statutes, Bond Issuance (Special Districts)
- Section 215.43, Florida Statutes, Public Bonds, Notes, and Other Securities
- Section 215.431, Florida Statutes, Issuance of Bond Anticipation Notes
- Section 215.681, Florida Statutes, ESG Bonds and Prohibitions
- Section 215.84, Florida Statutes, Government Bonds and Maximum Rate of Interest
- Section 215.845, Florida Statutes, Certain Special Laws Establishing Interest Rates on Bonds Prohibited
- Chapter 218, Part III, Florida Statutes, Local Financial Management & Reporting

Policy Statements and 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, (5) issuing debt for periods not to exceed the useful life or average useful lives of the project or projects to be financed with debt proceeds, and (6) setting benchmarks for savings on proposed refinancings.

These are just examples of policy statements reflecting prudent borrowing practices and sound financial management.

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 findings, considering existing capital planning, budgetary, investment, and reporting policies.

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 general obligation bonds" are obligations secured by the full faith and credit of a governmental unit payable from the proceeds of ad valorem taxes, subject to a maximum millage rate.
- "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(s) and any other special funds authorized to be pledged as additional security.
- "Special assessment bonds" are bonds that provide 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 longer-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, typically with reduced costs of issuance.

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 refunding 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) and that the amortization period not be extended.

Municipal Securities Rulemaking Board—Electronic Municipal Market Access (EMMA)

The Municipal Securities Rulemaking Board's Electronic Municipal Market Access system (EMMA) is the official public source for municipal securities data and disclosure documents. EMMA provides free access to official statements, continuing disclosures, trade data, and other municipal-market information. Governments that issue debt should establish responsibility for timely continuing-disclosure filings and periodically review their issuer information and outstanding securities on EMMA.

Selection of Bond Professionals

The Government Finance Officers Association (GFOA) best practices recommend that issuers select financial advisors, underwriters, and bond counsel using a request for proposal (RFP) or request for qualification (RFQ) competitive process. Using a competitive process allows the issuer to compare the qualifications of proposers and to select the most qualified firm based on the scope of services and evaluation criteria outlined in the RFP or RFQ. A competitive process also provides objective assurance that the best services and interest rates are obtained at the lowest possible cost and demonstrates that marketing and procurement decisions are free of self-interest, personal, or political influences. Furthermore, a competitive process reduces the opportunity for fraud, waste, and abuse and is fair to competing finance professionals.

- Independent Municipal Advisor – In many cases, debt financing involves complex transactions requiring specific expertise not always available in local governments. The financial advisor may be chosen through a competitive RFP or RFQ process for a negotiated sale or may be chosen based upon a public bid process through a competitive sale process. 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 or RFQ 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. Due to the inherent conflict of interest, GFOA recommends that issuers not use a broker/dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction.
- 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 or RFQ process and, in most cases, is paid from the proceeds of the debt issuance.
- Disclosure Counsel – The disclosure counsel works on behalf of the bondholders (but is hired by the local government) to ensure compliance with federal laws and regulations related to disclosures required for the issuance of tax-exempt/taxable debt. The disclosure counsel prepares the form of disclosures related to the financing. Additionally, the disclosure counsel may be chosen through a competitive RFP or RFQ 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.

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, enable local governments to enhance the quality of life for its residents and local businesses.

Reporting Requirement

Section 218.38, Florida Statutes, requires local governments to furnish the Florida State Board of Administration's Division of Bond Finance a complete description of new general obligation and revenue bonds, including advance notice of the impending sale of any new issues, and a copy of the final official statement, within 120 days of delivery of the bonds.

References

- Chapter 159, Florida Statutes - Bond financing. Official link
- Chapter 215, Florida Statutes - Financial matters and public debt. Official link
- Section 218.38, Florida Statutes - Bond issue reporting. Official link
- Section 218.385, Florida Statutes - Truth in Bonding Statement and disclosure requirements. Official link
- Municipal Securities Rulemaking Board - EMMA. Official link
- Florida Division of Bond Finance - Debt overview and affordability reports. Official link
- Government Finance Officers Association - Debt management best practices. Official link