May 01, 2025

Debt Management

Dear Reader:

The following document was created from the CTAS website (ctas.tennessee.edu). This website is maintained by CTAS staff and seeks to represent the most current information regarding issues relative to Tennessee county government.

We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

Sincerely,

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Debt Management

Reference Number: CTAS-1746

Terminology, Theories, Philosophy and Beliefs

Reference Number: CTAS-1747

In understanding and developing a debt management program we must have a basic comprehension of the terminology used in the financial industry, as well as the theories, philosophies and our personal beliefs of how we view debt. You may not agree with all of the theories, philosophies, and even our assumptions and related conclusions of debt management, but you must be able to reconcile your understandings about debt management with that of your fellow policy makers.

Terminology

Reference Number: CTAS-1748

- Backloaded, Balloon or Bullet Debt - Considered debt that a borrower would pay, predominately interest, the first number of years before any reduction in principal would be made. This type of financing would cause higher interest cost over the time of a loan as compared to straight-line amortization or advanced payment of principal.
- Balance Sheet - An accounting statement that reflects the assets, liabilities and net worth of an entity at a point in time.
- Bond Counsel - A firm or lawyer who insures that the local government complies with the legal obligation of issuing debt.
- Capital Projects Committee - An advisory committee established by the county commission to develop policies and advise the commission, county mayor/executive and finance department on the matters of long-term asset management and replacement.
- Capital Improvement Policy - A formal statement, generally an adopted county commission resolution, which states how the county government intends to identify, acquire, maintain and replace assets that have a high cost and long life expectancy.
- Capital Improvement Plan/Budget - A formal or informal written statement and/or series of spreadsheets that depict an anticipated cost in acquiring, maintaining, and replacing high cost and long life expectancy assets. The plan or budget notes specific revenue to support the anticipated cost of the new asset.
- Conflicts of Interest - Occur in situations where parties in a transaction have multiple interests or relationships that could possibly corrupt the motivation to act. The presence of a conflict of interest indicates the potential for divided loyalty and does not automatically indicate wrong doing.
- Costs - Means fees and expenses of professionals and service providers and other similar fees and expenses, whether or not payable at the time the debt is incurred. “Costs” also means recurring and nonrecurring fees and expenses during the life of the debt.
- Credit Rating - An assignment of risk or quality of a loan or security placed on certain debt by rating agencies (Moody’s, Standard and Poor’s and Fitch). The higher rating of the loan would indicate a lower risk, thus a lower interest rate.
- Credit Enhancements - A separate insurance or letter of credit that would be purchased to insure a higher credit rating, thus a lower interest rate.
- Credit Reviews - The process used to examine a potential debt issuance risk and then the assignment of a debt credit rating. Credit reviews generally look at two broad areas: (1) quantitative analysis (audit opinions, fund balances, debt levels and ratios) and (2) qualitative factors (management experience, political and economic climate, and policy and procedures).
- Debt - Means indebtedness lawfully issued, executed or assumed by a public entity. Debt is created when a public entity agrees to pay over time to someone else, in exchange for receiving

an upfront payment or loan or for acquiring an asset. "Security" refers both to debt that can be transferred or delivered to another party, as well to property or assets pledged as collateral for a debt. Common instruments or evidence of debt are:

- Bonds - Debt instruments issued for a period of one year or longer, usually for permanent financing.
- Notes - Debt instruments issued for a short period of time, often for interim financing. Notes may be rolled to bonds. Examples are Capital Outlay Notes, Tax and Revenue Anticipation Notes, Bond Anticipation Notes, and Grant Anticipation Notes.
- Capital leases or a lease purchase - Written agreements allowing the use of property in exchange for payment of funds.
- Loans - Debt agreements usually with a financial institution such as a local bank or an organized loan program such as the Tennessee Municipal Bond Fund or the State Revolving Loan Program. Loans are also internal loans between funds within the entity or seller financed loans.

- Debt Committee - An advisory committee established by the county commission to develop policies and advise the commission, county mayor/executive, and finance department on debt management policies and practices.
- Debt Resolution(s) - A resolution or series of resolutions that preliminarily approve the issuance of debt, or specifically and legally approve the issuance of debt.
- Debt Service - A series of payments including **interest** (the amount or fee earned or paid for use of money or credit, calculated on the amount of principal) and **principal** (the amount of money borrowed or credit provided) required on a debt over time. The rate of interest can be **variable** or **fixed**. A few terms related to debt service include:

- Schedule - The plan listing the amount and when debt service will be paid.
- Backloading **-** Refers to delaying repayment of principal until the end of the financing term. A standard or default structure for debt service is level debt service payments, similar to a standard home mortgage. Backloading should be considered only when 2 beneficial to the overall amortization of debt, upon the occurrence of natural disasters, or when project revenues are not available during the early years of a project.
- Maximum total level of debt - The maximum principal amount of debt a public entity will have outstanding at any time, usually for each type of debt issued.

- Debt Service Policy - A formal statement, generally an adopted county commission resolution, that expresses the type of indebtedness the county believes is most effective and efficient, such as, whether debt should mirror the life expectancy of the assets or be a percentage of years less than the life expectancy; whether the county debt should be a mixture of fixed and variable rates; whether the county should anticipate hiring a financial advisor; whether a multi-year debt budget will be presented before the issuance of new debt; and when an existing debt should be considered for refinancing or early payoff.
- Debt Service Payment Calendar - A calendar that a county uses to track a schedule of when its indebtedness is due, scheduled to be paid, and to whom it is to be paid.
- Federal Compliance Issues - The ongoing responsibilities of a public entity after issuing debt. If the debt is sold as being "federally tax-exempt," then the entity will have to comply with federal tax law. If the debt is a "security" for federal securities laws, then the public entity is subject to anti-fraud provisions and possibly is subject to continuing disclosure obligations.
- Finance transaction - Both debt obligations and derivatives. A derivative is a financial product deriving value from a separate security. This term refers to many different products. "Derivative" includes an Interest Rate Agreement as defined in Tennessee Code Annotated Section 9-22-103 and other transactions as identified by the State Funding Board.
- Financial Advisor - An individual or firm who assists and advises the local government of its debt financial needs, existing debt obligations, refunding debt opportunities, funding needs for new debt obligations, arrangements for bond counsel, bidding procedures, advertisement of bonds, preparation of debt resolutions and official bond or loan documents.
- Financing Structure - Deals with matters in which an entity would issue debt, taking into consideration items such as principal amortization, call provisions, coupon/yields, fixed or variable rates, credit enhancement and interest swap provisions.
- Fixed Asset Policy - A formal statement, generally an adopted county commission resolution, which identifies by type (in dollar amounts and life expectancy), assets that will be placed on or in

the accounting records to be tracked and maintained over a period of time.

- Fund Balance Policy - A formal or informal statement that establishes how much excess revenue over expenditure should be accumulated and carried over from year to year. The policy should address how the county should use or accumulate funds if the fund balance is not at the optimal level. A fund balance policy would address, on a fund by fund basis, what the respective fund balance target should be. The policy would be expressed either as a percentage or dollar amount fund balance compared to the annual appropriation or revenue budget.
- Guidelines - The document adopted by the Tennessee State Funding Board providing statutorily required guidance on Interest Rate and Forward Purchase Agreements. The current version became effective November 1, 2009. The Guidelines are available on the internet at https://www.comptroller.tn.gov/sl/pdf/revguidelines.pdf.
- Professionals - Individuals or firms advising or offering to provide professional services to a public entity with respect to a finance transaction. Examples of professionals are:
- Advisor - An individual or firm with a deep knowledge in a specific area, engaged in the business of advising others. It can include a Financial, Swap, or Program Administrator.
- Counsel - A legal advisor or attorney, whether an individual or a firm, representing a client. It can include Bond, Disclosure, Issuer, Swap, Tax, or Underwriters Counsel.
- Counterparty - The other party or participant in an agreement or contract; usually it refers to the other party in an Interest Rate (or swap) Agreement.
- Lender - An individual or firm who loans a borrower money.
- Paying Agent - An individual or firm that transfers the periodic interest and principal payments from the public entity to the investors.
- Registrar - The individual or firm responsible for maintaining a record or list of owners or investors in debt (sometimes referred to as holders of the debt).
- Remarketing Agent - The firm responsible for reselling to new investors debt instruments that have been “tendered” for purchase by their holders. The remarketing 3 agent is also usually responsible for resetting the interest rate for variable rate debt instruments.
- Underwriter - The firm that buys new debt for reselling to the public for a profit. The underwriter may acquire the debt either through negotiation or by award on the basis of competitive bidding.
- Verification Agent **-** Usually a certified public accountant or other independent third party that determines that the cash flow from investments purchased with proceeds of a refunding debt issue, along with other money, will be sufficient to pay the refunded bonds.
- Project Budget Resolution - A resolution that establishes a capital budget for a particular acquisition or construction of an asset. The project budget, if in a capital project fund, will last to the duration of the project.
- Public Entity - A governmental organization or unit that has a legal existence and is authorized to borrow money or enter into debt. It includes the State, state agencies, local governments, local government instrumentalities, and any other authority, board, district, instrumentality, or entity created by the State, a state agency, local government, a local government instrumentality, or any combination of the above. It does not include legal entities without debt authority, such as a county school board; however, a special school district with debt authority is included.
- Governing Body - The group of individuals with the authority to make decisions for a public entity, often referred to as the “legislative body.” Governing bodies are subject to the Tennessee Open Meetings Law (requiring public notice and recording of minutes).
- Members - The individuals serving on the governing body.
- Conduit Entity - A governmental entity or agency that borrows money to lend to another entity, and not to finance a project for itself. Examples of conduit issuers are health and education boards, economic development boards, and public building authorities
- Matching Principles - The accounting theory stating that expenses should be matched or related to the revenue produced by the expenses, or the expenses charged to the asset, over the asset’s useful life. Depreciation is an example of the practice of the matching principle.
- Multi-Year Debt Budget - A planning document that estimates future revenues and estimated or known scheduled debt payments along with project fund balances over time until all debts are fully paid.
- Risk - Refers to the uncertainty (downside) involved in a debt transaction, including investment,

business, credit, market, liquidity, operations, tax, and basis risks.

- Spectrums - A graphic or photographic representation of a sequence or range of related qualities, ideas or activities.
- State Agency Loan Program **-** Refers to programs offered by the state or state agencies, such as the State Revolving Loan Program offered by the Tennessee Local Development Authority or the Qualified School Construction Bond program offered by the Tennessee State School Bond Authority.
- State Funding Board - The state entity whose members are the Governor, the Commissioner of Finance and Administration, the Comptroller, the State Treasurer, and the Secretary of State. The State Funding Board is created by Tennessee Code Annotated Section 9-9-101.
- Straight-line Amortization - Is a level (same dollar amount) repayment schedule over the term on the loan that would reflect smaller principal payments increasing to larger principal payments over the life of the loan, and conversely larger interest payments reducing to smaller interest payments over the life of the loan. A typical home mortgage has a straight line amortization payment schedule.
- Tax Exempt Debt - Debt of which the holder does not have to pay income tax on the earnings.
- Underwriter - A firm or group of firms that are selected to purchase and re-market the debt to the public or investment community.
- Wrapped Debt Service - Is the practice of reviewing an entity's existing debt payment schedule and insuring that the new debt payment schedule would reflect that the new payments of interest and principal would create a straight line or level payment structure over the life of all debt. This practice generally would create the payment of more interest over the life of a loan as compared to straight-line amortization.

Basic Debt Practices and Beliefs

Reference Number: CTAS-1749

Here are some Basic Best Practices and Beliefs regarding county financial management:

1. You should be as efficient in use of taxpayer money as possible. There may be disagreement on how this is achieved, but there should be agreement that we want efficiency.
2. Tax rates and the related tax levy should be in most circumstances stable and not fluctuate up or down from year to year. There is little benefit in raising a tax one year, only to reduce the tax the next year, only to raise it again the third year.
3. Issuance of debt should not exceed the life expectancy of the asset being purchased or constructed.
4. Understand to the best of our ability how we perceive risk and the related cost of that risk. You should have an understanding of the risk of interest rate changes and the changes in the value of money, along with the risk of making and not making decisions or putting off a decision.
5. Decisions are made based on the facts at hand, and that better decisions are made based on the best facts. However, you should realize that you will never have all the facts, and you will not always make the best decision. This limitation should not impede you from trying to understand your current situation and facts and how that will impact the future. You should not make capital investment decisions hastily, or draw the decisions out over a number of years.
6. Money has a value, and that value changes over time. The changes in the value of money are related to a number of factors, the greatest of which are inflation and interest rate changes. This concept is known as the time value of money.
7. Capital projects can be funded out of current revenue and savings, debt obligations, or a mixture of the savings, current revenue and debt obligations. A county's capital project plan and debt service plan should address these funding issues.
8. Excessive debt or no debt can be bad policy for your government and citizens. This is based on the theory that individuals who use an asset should assist in the payment of that asset by the payment of debt service, and also that if a county has excessive debt, generally the interest rates are higher than considered normal and their flexibility in current operations

can be hindered due to a larger percentage of revenue required to pay debt interest and principal.

9. As we discuss being conservative or aggressive in our approach to debt management, we are not drawing a conclusion whether one approach is better than the other; however, we are saying that you and the county must understand the risk involved in being conservative, aggressive or moderate in your debt management approach.

Accounting Theory/Philosophy-Matching Principle

Reference Number: CTAS-1750

We would be negligent if we did not discuss the matching principle of accounting as it relates to the annual operation of the local government. An easy way to describe this principle is the philosophy that an asset should be paid for during the time the asset is in use. This principle has some weakness, but a straight forward example of this matching is as follows: A government purchases land and constructs a library building at the cost of $1 million. The land has an infinite life expectancy, but the building, properly maintained, may be used for 30 years. Should the taxpayers who have access to the use of the building 30 years from today pay a portion of the cost? If you answer yes, then this is a belief in the matching principle. In the new approach to making government accounting look more like commercial accounting, we now use depreciation to reflect this cost. However, depreciation is not a cash accounting entry; but if debt is issued, the payment of principal and interest is a cash payment and therefore a 30-year bond payment schedule reflects what is paid by current and future taxpayers throughout the useful life of the loan, thus the use of the building.

Now the matching principle as it relates to payment of debt is never exact with the asset's useful life, but it can fairly represent matching use of the asset with payment for the use of the asset. Some weakness in pure matching deals with time value of money; useful life exceeding or being less than planned debt or planned life; and more or fewer taxpayers making debt payments or using the asset over time along with issues of changes in value of property. Figure 1 reflects a pure relationship with a set number of taxpayers.

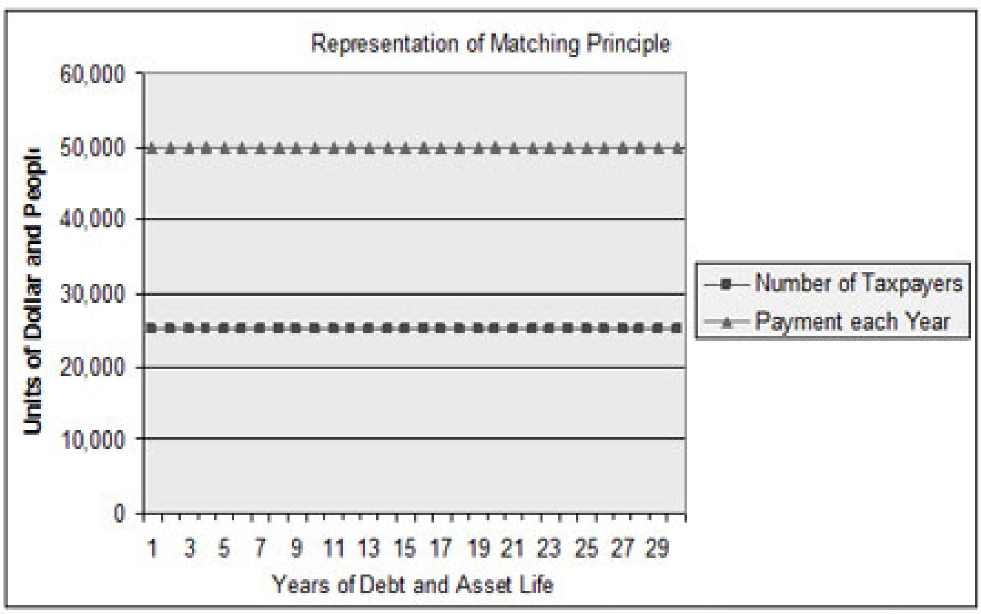

Figure 1

Figure 1 reflects that each taxpayer pays $2 per year for the assets use for 30 years.

Debt Percentage and Interest Rate Mixture Spectrums

Reference Number: CTAS-1751

As we talk about the matching theory, we also must talk about the debt management and how this philosophy has been developed over time as we have managed our personal debt. The approach used as we manage our personal debt transfers to our beliefs, and sometimes our practices, of managing public debt. Some of us (or at least our parents) may not believe in having any debt, and if we believe in debt, have a very conservative approach to debt management. Others have a very aggressive management approach and thus one would anticipate having more debt. Consider that some of our parents, or even some of your classmates, may have paid cash for their homes. They built their houses as money was available or waited until they had accumulated enough money before they purchased their homes. Some people may have borrowed from family members (similar to an inter-fund loan). Others were willing to have a mortgage, but would never borrow money for any other items. Others would borrow for a house and an investment property, but nothing else. And still others would borrow to purchase a house, car, boat, investments, vacations, and maybe even their meals. These beliefs in debt management in our personal life impact our thoughts and decisions on how our government should borrow and pay back its debt.

What is important to know is that our approach to managing our government's capital improvement and debt has a lot to do with our personal philosophy of debt management, which varies from person to person. This philosophy carries over further as we evaluate fixed or variable interest rate debt instruments.

We must personally examine to what extent and how strong our beliefs are on answering questions such as the following:

1. Is it acceptable to have debt?
2. What are acceptable assets for which to borrow money?
3. Should our debt be fixed rate, variable rate or mixed debt?
4. How long a time frame should money be borrowed?

Even if our personal belief is that we should pay as we go and not incur any debt for all practical purposes, it is almost impossible for the local government to acquire large assets without debt. However, even if we don't like having debt and recognize the necessity for the local government in acquiring expensive assets, we can structure the debt policies and practices that only borrow for long life and high cost assets.

As we answer the questions above, we explore our risk tolerance in having debt.

We must examine our risk tolerance on whether debt should be all fixed interest, all variable interest, or a combination of both fixed and variable rates; and if so, what percentage should be fixed and variable.

The following spectrums will deal with our risk tolerance.

The concepts of our personal beliefs in debt, how much debt, and should debt be fixed or variable interest rates, can be depicted in the following low (conservative) to high (aggressive) risk tolerance spectrums. The first spectrum (figure 2) is a Debt Percentage Spectrum of total assets or an individual asset. The second spectrum (figure 3) is considered an Interest Rate Mixture spectrum.

If one were to place a home mortgage on the spectrum below, you could see this relationship of the risk as it relates to being conservative or more aggressive. Mortgage brokers generally like to loan no more than 80 percent of the value of a home, and if they loan more than 80 percent, they require the future homeowner to buy Purchase Mortgage Insurance (PMI) for the additional risk. A homeowner would like to have no mortgage debt, but may be willing to accept up to 90 percent mortgage in order to have the home asset.

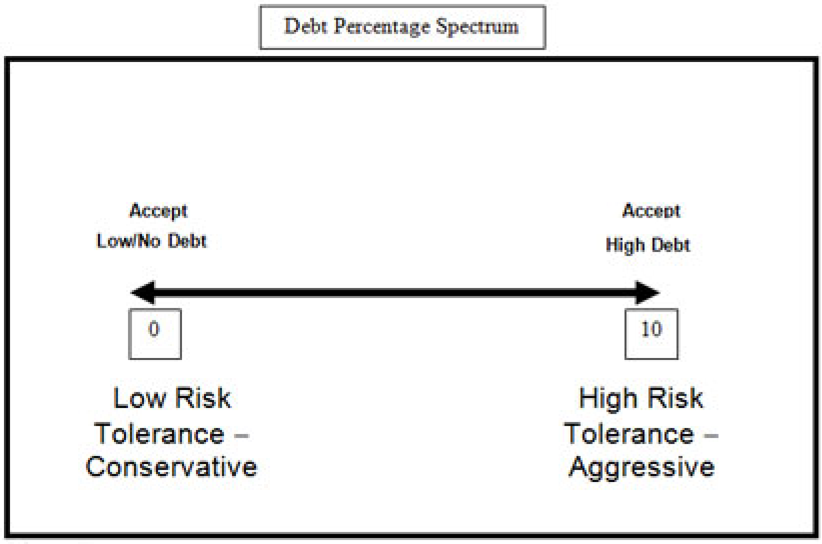

Figure 2

This spectrum reflects a debt percentage of an asset or group of assets. Zero assumes that no money was borrowed to purchase the asset, and 10 assumes that 100 percent was borrowed to purchase the asset.

Using the same home mortgage and asset, you could plot a risk tolerance of whether the interest rate is fixed or variable. An individual may have a fixed rate if he/she has a large mortgage. The same individual may be willing to have a variable rate if the mortgage is lower, all depending on the risk tolerance of the individual and his/her expectation of future interest rates.

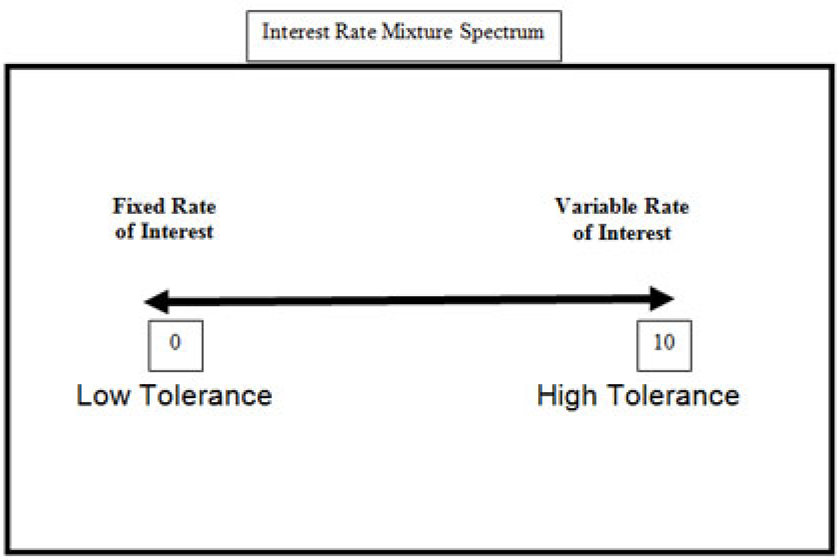

Figure 3

This spectrum reflects the extent that debt is either on a fixed rate, variable rate or mixture of rates. Zero represents that one does not like to be surprised by any change in an interest rate, and thus interest payments. Ten represents that one accepts, and will not be bothered by, a change in interest rates or interest payments. One could also speculate that a zero would be betting that interest rates are expected to go up, and a 10 would be betting that rates would go down.

Risk tolerance is not an exact measurement, but deals more with one's disposition of how he/she feels about risk.

These debt spectrums can be developed to address the following four basic questions:

1. Is debt acceptable and at what level?
2. What are acceptable assets for which to borrow money?
3. Should debt be fixed or variable?

4. How long a time frame should money be borrowed?

Accounting for Debt

Reference Number: CTAS-1752

Budgets

Reference Number: CTAS-1753

Budgets are plans of financial activity anticipated over a period of time to support a plan of service. From the government perspective, budgets are in two major categories: Operating Budgets and Capital Budgets.

<u>Operating Budgets</u>

An operating budget is annually developed and approved by the local government for the receipts and expenditures of funds during a 12-month timeframe beginning July 1 and ending June 30 (fiscal year). The operating budget is the government's plan of services depicted in financial estimates of revenues and anticipated expenditures. The expenditures would include salaries, supplies and materials, interest and principal on outstanding debt, and other current period (fiscal year) operating expenses. The duration of an operating budget is 12 months. Operating funds are separate accounting entities where certain activities are accounted for independently with their own financial statements of balance sheets and statements of revenue and expenditures. Examples of operating funds would be the General Fund, Solid Waste Fund, Highway and Road Fund, School Funds and the Debt Services Funds. Specifically note that debt services funds are operating budgets in that these funds account for the 12-month period of the fiscal year's revenue and expenditures (payment of interest and principal).

<u>Capital Budgets</u>

A capital budget is a finance plan and program to purchase or contract for purchase items (or the construction of items) that are expensive in cost and have a long life expectancy of use. Examples of items in a capital improvements budget would be land, buildings, large expensive pieces of equipment, major expansions of buildings, major renovations of buildings and equipment. Generally the funding for capital items comes from the issuance of debt by bonds, notes, and in limited cases, annual revenue. A capital budget usually exceeds 12 months, and always extends until the completion of the specific project.

Recommended Practice: Establish a Capital Budget

<u>Debt Service Budgets/Funds</u>

Most all county governments at some time or other have borrowed money, and thus issued debt instruments. Upon the issuance of debt, county governments are generally required to establish, and have a separate accounting for, the receipts of revenues (property taxes and other revenue sources) and the expenditures of paying of the principal and interest payment on the indebtedness. This separate account/fund(s) is known as the Debt Service Fund. The Debt Service Fund is an operating fund. Upon the establishment of the fund, annual budgets must be adopted to reflect the anticipated activity of annual revenues and expenditures. The debt service funds are used exclusively for the payment of principal and interest; however, principal and interest do not exclusively have to be paid out of the debt service funds. Generally, it is the best practice to have all debt paid from the Debt Service Fund. However, we recognize that in certain circumstances a county may have the school system and/or highway department pay their debt directly from their respective funds.

Recommended Practice: Payments of all Debt from the Debt Service Funds

<u>Annual Comptroller Approval of Operating Budgets</u>

Various statutes in Tennessee require local governments to adopt budgets at the beginning of each fiscal year. If a county has outstanding debt, an annual budget must be submitted to the Comptroller Office Division of Local Finance for approval. The Comptroller has prescribed the requirement and form in which the budget must be submitted. For further information, see Procedures under the Operating Budget topic.

Fund Structure

Reference Number: CTAS-1758

The fund structure has been established by the Comptroller of Tennessee. The structure of accounts is known as a Uniform Chart of Accounts. It is used in each county of the state with some variations. The operating funds, which include the debt service funds, work in unison with the capital project funds. See Chart of Accounts under the Operating Budget topic for more information.

The Comptroller's Chart of Accounts regarding Debt Service

The County Uniform Chart of Accounts used to assist in accounting for financial activities related to the payment of debt, has established seven operating funds with account numbers set aside for additional funds if needed. These funds are as follows:

151	General Debt Service
152	Rural Debt Service
153	Industrial Debt Service
154	Special Debt Service
155	Hospital Debt Service
156	Education Debt Service
157	School Bond Trust
158 - 169	Other Debt Service funds

The Comptrollers' Chart of Accounts Regarding Capital Projects

The County Uniform Chart of Accounts used to assist in accounting for financial activities related to using capital project funds, has established eight capital funds with account numbers set aside for additional funds if needed. These funds are as follows:

171	General Capital Projects
172	Community Development/Industrial Park
173	Sanitation Projects
174	Nursing Home Projects
175	HUD Grant Projects
176	Highway Capital Projects
177	Education Capital Projects
178 - 188	Other Capital Projects funds
178	Other Capital Projects

The Comptroller's Chart of Accounts that encompass all Operating and Capital Funds

The County Uniform Chart of Accounts is used to account for all financial activities of the government. Certain account codes can be used in any fund. The Chart of Accounts has been established by a three-digit fund number; a five-digit revenue number for the revenue side of the ledger; a five-digit function (also known as department or line item) for expenditure departments; and a digit object code for the expenditures' details.

The following would be an example of a General Debt Service Revenue and Expenditure budget:

151 General Debt Service

Revenue
40110 Current Property Tax

Expenditures
82110 Principal on General Government
601 Principal on Bonds
602 Principal on Notes
82210 Interest on General Government
603 Interest on Bonds
604 Interest on Notes

Debt Service Accounting Relationship

Reference Number: CTAS-1759

Figure 4 shows the Debt Service Accounting relationship. Figure 5 shows the Flow of Money relationship. In summary, monies are borrowed from banks and financial institutions and receipted into an operating fund (other than debt service) or capital fund(s). These operating funds or capital funds are used to purchase the asset(s). The indebtedness due to the borrowed monies is then paid annually by the retiring of this debt by way of the annual debt service operating budget.

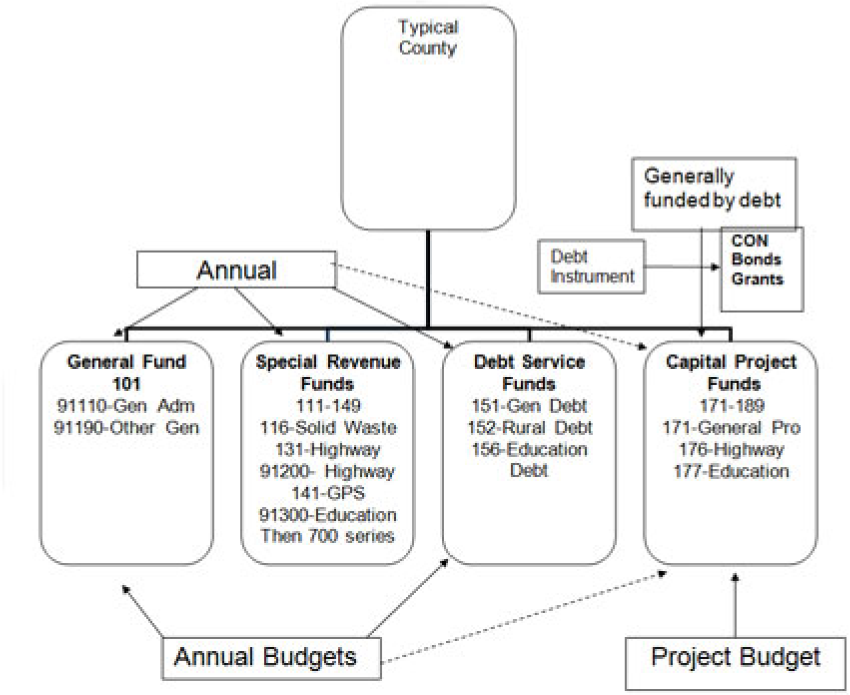

Figure 4

Flow of Money-The Debt Service Fund

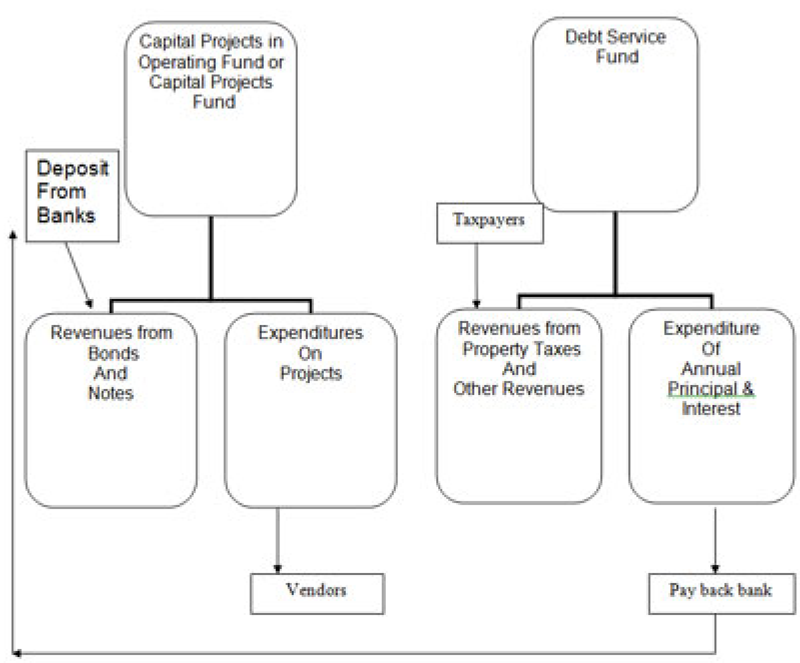

Figure 5

Unfunded Pension or Other Post Employment Benefits

(OPEB)

Reference Number: CTAS-1760

Unfunded pensions and Other Post Employment Benefits (OPEB) are considered an obligation of a county, and generally are long term in nature. These obligations were established when a government made promises to employees to be paid out at a future time with future revenues. These promises, in one sense, are no different than the current promise to pay obligations of notes, bonds and leases. However, the treatment of unfunded pensions and OPEB are entirely different. Further, most Tennessee county governments are members of the Tennessee Consolidated Retirement System that holds the retirement assets, and thus these liabilities. If any unfunded pensions exist, they are held by the retirement system. County obligations, if any, are OPEB. An example is when a county has promised retired employees that the local government will pay a portion of the health insurance premium until the retired employees are Medicare eligible. Thus the employee is no longer working, but is receiving benefits where the cost of the benefits has not been set aside into a trust. Tennessee law allows a local government to issue debt for certain unfunded pension obligation (reference T.C.A. § 9-21-127).

Legal Authority Guidance

Reference Number: CTAS-1761

Tennessee Code Annotated (T.C.A.) Title 9, Chapter 21 and Title 12, Chapter 10 specifically address the issuance of debt and related budget requirements. Further the Comptroller of the Treasury Division of Local Finance publishes a "Guide for the Issuance of Notes by the Counties, Consolidated Governments and Municipalities of Tennessee" as a reference for the issuance of notes.

Accounting Posting for the Receipt of Borrowed Funds

Reference Number: CTAS-1762

For the accounting staff that will be posting the accounting records for the county, the following journal entries (figures 6, 7, 8 and 9) would typically be found.

For Monies to be Received into the General Capital Projects Fund

Figure 6

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$9,675,000.00	
Expenditures						
	171	91100	605	Underwriter's Discount	$125,000.00	
	171	91100	606	Other Debt Issuance Charges	$200,000.00	
Revenue						
	171	49100		Bond Proceeds		$10,000,000.00
To Record the issuance of $10,000,000 of Bonds for General Capital Projects						

For Monies to be Received into the Education Capital Project Fund

Before we list the accounting postings, note that these postings can vary from accounting system to accounting system. Also note that the recommended postings have changed in the last number of years due to the implementation of GASB #34. Since boards of education do not have debt issuance authority, they are prohibited from receiving notes/bonds/loans proceeds directly. The borrowed money must come into the primary government, and then the primary government can make a contribution to the component unit of schools. This contribution creates another question of the contribution being the total issuance proceeds less issuance cost, or the total proceeds and then allowing the issuance cost to be capitalized as a cost of the asset. Either accounting procedure of the issuance cost is permissible, along with allowing the cost of the issuance to be expensed in the debt service fund.

Recommended Practice: A county's debt service policy should address how the issuance cost will be expensed or capitalized –not only for the education capital borrowing, but also for the general capital borrowing.

The following scenario (Figure 7) is of a county that has a General Capital Project Fund and desires to issue debt for a school building project with the issuance cost being capitalized as a part of the asset.

Figure 7

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$9,675,000.00	
Expenditures						
	171	91100	605	Underwriter's Discount	$125,000.00	
	171	91100	606	Other Debt Issuance Charges	$200,000.00	
Revenue						
	171	49100		Bond Proceeds		$10,000,000.00
To Record the issuance of $10,000,000 of Bonds for School Projects						
					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee		$9,675,000.00
Expenditures						
	171	91300	605	Underwriter's Discount		$125,000.00
	171	91300	606	Other Debt Issuance Charges		$200,000.00
	171	91300	316	Contributions	$10,000,000.00	
Balance Sheet						
	177	11140		Cash with Trustee	$9,675,000.00	
Revenue						
	177	44570		Contributions		$10,000,000.00
Expenditures						
	177	91300	605	Underwriter's Discount	$125,000.00	
	177	91300	606	Other Debt Issuance Charges	$200,000.00	
To Record Contributions from 171 General Capital Projects to 177 Education Capital Projects along with the related issuance expense to be capitalized						

This second scenario (figure 8) relates to the issuance of debt for educational purposes, and reflects the debt service cost in the debt service fund and not capitalized.

Figure 8

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$9,675,000.00	
Revenue						
	171	49100		Bond Proceeds		$9,675,000.00
To Record the issuance of $10,000,000 of Bonds for School Purposes						
					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee		$9,675,000.00
Expenditures						
	171	91300	316	Contributions	$9,675,000.00	
Balance Sheet						
	177	11140		Cash with Trustee	$9,675,000.00	
Revenue						
	177	44570		Contributions		$9,675,000.00
Revenue						
	151	49100		Bond Proceeds		$325,000.00
Expenditures						
	151	91300	605	Underwriter's Discount	$125,000.00	
	151	91300	606	Other Debt Issuance Charges	$200,000.00	
To Record Contributions from 171 General Capital Projects to 177 Education Capital Projects along with the related issuance cost being expensed in the Debt Service Fund						

These postings reflect that many options are available to receive and expend funds on capital projects. Other postings also are allowed. One should consult auditors or a CTAS consultant if questions arise on the posting of these proceeds.

Further, the above posting brings out a very important issue that often is overlooked and can cause shortages in the capital project. An asset cost generally is the full cost to put the asset into use. This cost includes the cost of the issuance of the debt. The project budget was originally established at $10 million. However, the first expense was not pertaining to the actual construction of the asset, but rather to the issuance of the indebtedness. The examples above reflect that the project has cash available that is $325,000 less than anticipated for the project.

A debt and/or capital projects policy should address the following: issuance cost; if additional funds should be borrowed for issuance cost; if this cost is included in the capital budget where the expense will be incurred; or if the cost of issuance would be absorbed by the debt service fund as noted in figure 9. Also note that the Debt Service Fund is a budget fund, and the budget should be amended to include any revenue and additional expenses.

Figure 9 reflects the Debt Service Fund paying the cost of the debt issuance.

Figure 9

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$10,000,000.00	
Revenue						
	171	49100		Bond Proceeds		$10,000,000.00
To Record the issuance of $10,000,000 of Bonds for School Purposes						
					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee		$10,000,000.00
Expenditures						
	171	91300	316	Contributions	$10,000,000.00	
Balance Sheet						
	177	11140		Cash with Trustee	$10,000,000.00	
Revenue						
	177	44570		Contributions		$10,000,000.00
Revenue						
	151	11140		Cash with Trustee		$325,000.00
Expenditures						
	151	91300	605	Underwriter's Discount	$125,000.00	
	151	91300	606	Other Debt Issuance Charges	$200,000.00	
To Record Contributions from 171 General Capital Projects to 177 Education Capital Projects along with the related issuance cost being expensed in the Debt Service Fund						

Further depending on how the funds are borrowed, there could be interest earnings from the idle funds not yet expended and interest expensed during the construction phase. For example, the above $9.67 million could earn interest until used. These interest earnings would accrue to the Debt Service Fund and could be used to recoup the issuance cost and defray the interest cost of borrowed monies during construction. The earned interest is not eligible to accrue to the capital project fund.

Recommended Practice: Make sure all parties understand where the cost of the debt issuance will be charged and any interest earning deposited. Reflect this cost and revenues estimates in a budget.

While we are on the subject of cash availability, your debt policy should also address, either on a case by case basis or specifically state in the debt resolution, what will be the disposition of any unused funds after a project is complete. Generally the borrowing instruments state the proceeds shall be for capital outlay, thus allowing the county to use the proceeds for the project approved and any future approved project. Outside the broad language, the remaining funds are transferred back to the Debt Service Fund for the repayment of debt.

Recommended Practice: Allow all excess funds to be available for other capital projects upon specific approval.

Recommended Practice: If a permanent Capital Project Fund has not been established, then a county should take the opportunity to establish a Capital Project Fund with any excess cash.

Posting a Budget for Borrowed Funds and Annual Appropriations

Reference Number: CTAS-1763

The comptroller's office accepts the bond or note approval by the county commission as authorization to establish an appropriations budget. It is highly recommended that an official budget be established reflecting the receiving of the borrowed funds along with the expenditure budget. This receipt and expenditure budget would be in either a Capital Project Fund or an Operating Budget. Figure 10 reflects a sample budget being established for the receipts and expenditures of a Highway Capital Project Fund. The annual expenditures of interest and principal are required to be annually appropriated. This appropriation should be reflected in the appropriations resolution and broken down by the respective classification in which the funds were borrowed. Figure 11 reflects an excerpt from an appropriation resolution.

Recommended Practice: An official capital budget should be established and filed with the county legislative body before or after the issuance of debt.

Recommended Practice: A budget amendment may be needed if new indebtedness causes the payment of interest and/or principal in the year of issuance.

			Current Budget	Amendment	Amended Budget
Highway Capital Projects (176)					
Fund Balance and Designations					
176	39000	Undesignated Fnd Balance	0	0	0
Revenues and Transfers In					
176	44570	Contributions	0	2,500,000	2,500,000
		Total Revenue	0	2,500,000	2,500,000
Expenditures					
Highway & Street Capital Projects					
176	91200	399 Other Contracted Service	0	1,250,000	1,250,000
	91200	404 Asphalt- Hot Mix	0	250,000	250,000
	91200	405 Asphalt- Liquid	0	215,000	215,000
	91200	409 Crushed Stone	0	500,000	500,000
	91200	703 Asphalt Plant Equipment	0	0	0
	91200	714 Highway Equipment	0	250,000	250,000
	91200	606 Other Debt Issuance Charge	0	35,000	35,000
		Total Expenditures	0	2,500,000	2,500,000
Fund Balance and Designations					
177	39000	Undesignated Fnd Balance	0	0	0

Figure 10

Excerpted from a part of Section 1 of an appropriation resolution.

SECTION 1. ...

151 GENERAL DEBT SERVICE FUND	
82110 Principal-General Government Debt Service	672,295
82120 Principal-Highway and Street Debt Service	507,061
82130 Principal-School Debt Service	750,000
82210 Interest- General Government-Debt	473,968
82220 Interest- Highway and Street Debt Service	66,039
82230 Interest- School Debt Service	250,000
82310 Other Debt Service	15,000
Total General Debt Service Fund	2,734,363

Figure 11

Managing Your County's Debt

Reference Number: CTAS-1764

Develop a Capital Projects Improvement Plan and Budget

Reference Number: CTAS-1765

One of the first steps in developing the most efficient Debt Management plan is to have in place a Capital Projects Plan, also known as Capital Improvement Plan(CIP) or Capital Outlay Budget, that includes the related budget. However, a Capital Projects Plan is not required in starting a good debt management program. The Capital Project Plan assists the county leaders in understanding their current capital assets, the replacement schedule of those assets, as well as future needs that have been identified. The Capital Project Plan should entail a project or project(s) budget with implementation dates and funding needs to be fulfilled by use of savings, annual revenues or the issuance of debt. One should be aware of whether the cost of the debt issuance will be included in the funds requested to be borrowed, and whether interest earned on idle funds will accrue to the debt service fund or capital project fund.

For more information, see Basic Steps of Establishing a CIP and Policy Considerations under the Capital Budgets topic.

Recommended Practice: Development of a Capital Project/Improvement Plan and Budget

Develop a Multi-Year Debt Budget

Reference Number: CTAS-1766

In order to have an efficient Debt Management program, the county should develop a multi-year debt budget for all the related debt service funds the county manages. The budget should include the most recent prior year’s audit, the current year’s operation and then extend annually until the final payments are made on the county’s remaining debt. The budget will become a useful tool in analyzing the needed revenue to support the existing debt obligations. The budget should reflect revenues, expenditures and fund balances over the term of the county indebtedness. The fund balance can then be monitored to see if this balance is consistent with the county fund balance policy, if one exists. The fund balance, upon reaching an optimal level, can then be maintained by showing an adjusted property tax rate each year. Even though a county may have other revenue sources that support the debt service funds, the property revenue estimate is the ultimate benchmark of activity. If revenue is shifted from another fund, there is still a cost of the indebtedness that is best measured by the property tax levied.

In developing a multi-year debt budget, the county will gain a better understanding of its current outstanding debt and the debt instruments (interest rates, projects, when the debt was originally issued and whether the debt has been refunded). By reviewing your multi-year debt budget, you will begin to understand future available debt capacity or a potential future debt financial crisis. The Multi-Year Budget must be viewed in conjunction with the Capital Budget and future borrowing should be planned accordingly.

Sample county multi-year debt budget. From this sample multi-year debt budget, Sample County Debt is created reflecting the tax rate overtime with the existing debt, along with adding $14 million bonds straight-line amortized. We can draw a number of conclusions from our exhibits and graphs:

1. In the near future, the county is paying off most of its existing debt.
2. Adding $14 million, even with paying off existing debt, will create a need for additional revenue.
3. Based on the existing debt being paid off in the next few years, there is an opportunity for wrapping some debt to level out debt service payments and thus debt tax.
4. With the existing debt expenditures being paid off in the near future, the county should review any debt for short term, lower cost items. If these are recurring (purchase on vehicles, roof repairs, etc.), they should take the opportunity with the potential debt tax reduction to transfer the tax to a capital projects fund and begin paying for the items annually; therefore not issuing debt for these recurring low cost, short-lived assets.

Recommended Practice: Development of a Multi-Year Debt Budget

Recommended Practice: Development of a Fund Balance Policy for the Debt Service Funds

Determine Your Current Debt Position -Statistics and Ratios

Reference Number: CTAS-1767

In order to have an efficient Debt Management program, you should have an understanding and working knowledge of your current debt position. Various ratios will be used in determining or measuring your debt capacity. Comprehension of the ratios should assist the local government in the following ways: (1) understanding whether your debt will have an acceptable rating by the debt rating agencies, and (2) determining whether the citizens have the ability to pay for the future indebtedness.

Debt Per Capita Ratio – This ratio is used in evaluating the county's ability to pay off its debt by taking the total principal on outstanding debt divided by the citizens in the county.

Total debt of a County[1] = *Debt per capita*
County's population[2]

The overall net debt per capita should not exceed $1,200 per capita nationally.[3]

Debt as a Percentage of Personal Income– This ratio incorporates an ability to pay concept into the assessment of debt burden. It uses the total personal income (including wages, dividends, interest, rent, and government payments) divided by the total population.

Total personal income[4] = *Per capita personal income*
County's population[5]

The overall net debt per capita should not exceed 15% of per capita personal income.[6]

Debt to Assessed Property Value – This ratio examines the county's current indebtedness to the assessed property value. It shows the wealth available to support present indebtedness so the county can include any planned debt to calculate an anticipated ratio, thus helping determine whether the county has capacity to meet present and future obligations.

Total debt of a County = *Debt to assessed value*
Assessed property Value

(Property assessor plus public utilities from Trustee's office)

The overall net debt should not exceed 10 percent of assessed value.[7]

These ratios are a benchmark of your county as monitored by the bond rating agencies. All three ratios must be considered along with other economic and financial data for the county, region and state. Further the agencies review your annual audits and the quality of management in determining your overall rating.

Statistical Reference

As of June 2010, the following data is being provided to allow the reader to have reference of the debt or potential need for capital improvement in county governments throughout Tennessee. See the Debt by County Table for various calculated ratios.The information provided in this table is believed to be accurate, but you should verify and research the most current available data for a final determination related to your county.

Further summary of data

- The highest debt county is Davidson County at more than $2 billion.
- The lowest debt county is Van Buren County at $1 million.
- Davidson County's debt per capita is over $3,445.
- Van Buren County's debt per capita is $200.
- Of the 95 counties in Tennessee, Giles, McMinn, and Tipton Counties are the only that are debt free.

According to the Tennessee Advisory Commission on Intergovernmental Relation "Building Tennessee's Tomorrow: Anticipating the State's Infrastructure Needs July 2009 through 2014," the outstanding capital needs are $37.5 billion or $6,075 per capita.

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[1] Only the principle amount from the county's most recent annual audit report or financial statement.
[2] U.S. Census or TACIR

[3]"Municipal Benchmarks: Assessing Local Performance and Establishing Community Service Standards", David N. Ammons. – 2001, p. 119.
[4] Bureau of Economic Analysis (BEA)
[5] U.S. Census or TACIR
[6] Municipal Benchmarks: Assessing Local Performance and Establishing Community Service Standards, David N. Ammons. – 2001, p.119.
[7] Municipal Benchmarks: Assessing Local Performance and Establishing Community Service Standards, David N. Ammons. – 2001, p.119.

Find Out your Debt Rating

Reference Number: CTAS-1768

County governments in Tennessee are predominately rated by Moody's Investor Services and Standard and Poor's (S&P). A summary of the ratings are as follows**:**

> *Moody's* - Investment grade has 10 grades, ranging from a high of "Aaa," "Aa1," "Aa2," "Aa3" to a low of "Baa3." Any rating less than a "Baa" is considered speculative; a "C" rating is default.
>
> *Standard and Poor's* - Investment grade has only four grades, from high to low: "AAA," "AA," "A," and "BBB." Any rating lower is considered non-investment grade; a "D" rating is default.

Your county's last rating will be provided on your last debt instrument. Any future rating will be provided prior to the debt being issued.

Establish a Debt Service Payment Calendar

Reference Number: CTAS-1769

For your accounting department's management of existing debt, a Debt Service Payment Calendar should be developed. This calendar will assist the accounting department by insuring that the correct debt payments are being made on time, to the right debt holder and in the correct amount. Situations have occurred in counties where debt payments have been late and paid twice to the same debt holder. These problems of payments are due to a lack of internal control related to the payment of the debt obligations. It is highly recommended that a Debt Service Payment Annual Calendar be established. See sample Debt Service Payment Calendar.

Recommended Practice: Establishment of a Debt Service Payment Calendar

The county should also have a debt payment schedule for the duration of debt payments. This is used to reconcile with the annual calendar, annual debt budget and multi-year budget. Figure 13 is a sample of a payment schedule for the duration of the debt.

	Gov't. Improv. Bond, Series II-D-1 Issued October 1, 1996 $10,000,000		G.O. Bond, Series 2005 Issued June 30, 2005 $15,000,000		Solid Waste Disposal Issued July 14, 2006 $200,000		School Refunding Bonds, Series 2001 Issued June 30, 2001 $10,000,000		
F/Y	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Total
2008	-	$496,000	$475,000	$683,500	$65,000	$6,278	-	$500,000	$2,225,778
2009	-	496,000	500,000	659,750	70,000	3,255	-	500,000	2,229,005
2010	-	496,000	525,000	634,750			-	500,000	2,155,750
2011	-	496,000	550,000	608,500			-	500,000	2,154,500
2012	-	496,000	575,000	581,000			-	500,000	2,152,000
2013	-	496,000	600,000	552,250			-	500,000	2,148,250
2014	-	496,000	625,000	522,250			-	500,000	2,143,250
2015	-	496,000	675,000	491,000			-	500,000	2,162,000
2016	-	496,000	700,000	457,250			-	500,000	2,153,250
2017	-	496,000	725,000	422,250			$1,450,000	500,000	3,593,250
2018	-	496,000	775,000	386,000			1,530,000	427,500	3,614,500
2019	$1,485,000	496,000	825,000	347,250			1,615,000	351,000	5,119,250
2020	1,970,000	422,344	850,000	306,000			1,705,000	270,250	5,523,594
2021	2,070,000	324,632	900,000	263,500			1,800,000	185,000	5,543,132
2022	2,180,000	221,960	950,000	218,500			1,900,000	95,000	5,565,460
2023	2,295,000	113,832	1,000,000	171,000					3,579,832
2024			1,050,000	121,000					1,171,000
2025			1,100,000	68,500					1,168,500
2026			270,000	13,500					283,500
Total	$10,000,000	$7,034,768	$13,670,000	$7,507,750	$135,000	$9,533	$10,000,000	$6,328,750	$54,685,801

Figure 13

Data for Debt Management Plan

Reference Number: CTAS-1770

As we start our Debt Management Plan, we must determine where we can find the appropriate data to help us understand our current financial position and assist in our debt policies considerations and Debt Management Plan in general.

Debt generally always purchases assets. Therefore, a county should understand what assets they have acquired, where they are in service, and if they are being maintained. It also is important to know what assets are currently being paid with debt and what assets are in use and may have no debt outstanding. We must further understand that valued booked on the accounting statements will not reflect current value or replacement cost of the assets.

Inventory and Insurance Schedules

Reference Number: CTAS-1771

Inventory and insurance schedules are two basic schedules reflecting assets in use and containing value. These schedules reveal assets that would often need replacement due to their use in meeting public needs. As we review these schedules, we need to understand whether the assets listed have outstanding debt; would need debt to replace the assets; and whether the assets are short life, lower cost or long life, higher cost type of assets. This understanding assists in our capital planning, which in turn helps develop our debt service plan. One should further understand if the insurance schedule reflects asset purchase cost or replacement cost.

Recommended Practice: Maintain current inventory and insurance schedules as part of your Debt Management Plan

GASB34 in Debt Management

Reference Number: CTAS-1772

The General Accounting Standards Board (GASB) is the organization that develops uniform accounting reporting requirements for our local government. This organization has adopted various standards and statements over the years to assist governments and the financial market in understanding the organization operations from a financial standpoint. Statement No.34, *Basic Financial Statements - and Management's Discussion and Analysis-for State and Local Government,* was formally adopted in 1999. Statement No. 34 requires government-wide financial statements that reflect the overall financial picture of the government on an accounting basis, similar to commercial accounting including accrual accounting. The implementation of GASB 34 should assist the county government in obtaining a better understanding of the assets' liabilities (including debt) and the service provided to their citizens. The preparation of GASB 34 should not only help management better understand debt management, but also the end product of a Statement of Net Assets, a Statement of Activities, and other information and statements used in formulating a Debt Management Plan and making future debt decisions.

There is a lot to be learned on how the financial markets will use the statements in assessing credit risk, and how the data's year-to-year comparison will help formulate policy; but certain information can be derived from the new statements.

The Sample Statement of Net Assets reflects the following: the total booked assets of the county; liabilities; and the difference, which are net assets. Looking at the statement closer, one can see the capital assets which are not being depreciated, and the assets that are being depreciated (net of the depreciation). A further look shows the current and non-current liabilities and related long debt obligations. One also sees these relationships in a Governmental or Business Type Activities and Total.

In the Sample Statement of Activities a lot is yet to be learned on all the beneficial uses of the statement, but one can specifically note the net assets at the beginning and ending of the accounting period. This analysis should help clue the governmental officials on the financial direction the government is going.

Recommended Practice: Insure your county complies with GASB statements and become familiar with information within the statements.

GASB 54 Statement

Reference Number: CTAS-1998

Statement 54 was approved by GASB in February 2009 and was released on March 11th, 2009. The intent of the statement is to enhance governmental fund balance reporting in order for financial statements to be more consistent and comparable between similar government entities. The Debt Service Fund will be used to account for and report financial resources that are restricted, committed or assigned to expenditure for **principal and interest**. The Debt Service Fund should never be used to directly purchase capital expenditures.

Annual Audits

Reference Number: CTAS-1773

Probably one of the most important of all documents that will help formulate a Debt Management Plan is the audit. The annual financial audit includes information about the county that is statistical in nature, expresses an opinion of the county finances, and, to a certain degree, how they are managed. The audit includes much information, but specifically county officials should review:

- Audit Highlights - summarizes the scope of the audit, results and any findings related to the financial operations. Below is an example.

Audit Highlights

Annual Financial Report

Sample County, Tennessee

For the Year Ended June 30, 20____

Scope

We have audited the basic financial statements of Sample County as of and for the year ended June 30, 20____.

Results

Our report on Sample County's financial statements is unqualified. Our audit resulted in no findings.

- The Opinion Letter/Independent Auditors Report - this letter explains the work performed in the audit, whether the county complied with generally accepted accounting standards or exception to those standards.
- A Management's Discussion and Analysis Letter (if the county is complying with GASB 34) - the letter may specifically address issues related to Capital Asset and Debt Administration.
- Statement of Net Assets (if the county is complying with GASB 34) - addresses some debt issues.
- Statement of Activities (if the county is complying with GASB 34) - addresses some debt issues.
- Reconciliation of Balance Sheet of Governmental Funds to the Statement of Net Assets (if the county is complying with GASB34) - addresses some debt issues.
- Notes to the Financial Statements -a written section that addresses significant accounting policies and, specifically, notes information about Capital Assets, Long-term Obligations, and Long-term Debt, and Net Assets.
- Miscellaneous Schedules - schedules that include the following:
  - Changes in Long-term Notes, Other Loans and Bonds.
  - Schedule of Bond and Interest Requirements by Year.
- Further exhibits in the audit that reflect the status of the Debt Service Funds.

The most recent audits of your county can be located on the Comptroller of Tennessee's Web site, under the Division of Local Government Audit.

Recommended Practice: Become familiar with your county's audit and financial management

Issuance Documents

Reference Number: CTAS-1774

The county should maintain a permanent record location for all documents related to debt issues. Various documents exist related to your county debt. Some documents may be a bound bond book; other information may be in a notebook or binder, or a manila folder. Each issue should be separately labeled, filed and kept in a secured location.

Recommended Practice: Have all your county debt instruments (documents) collectively in one secure location

Prior Budgets and Audits

Reference Number: CTAS-1775

The prior year's budgets and audits should be reviewed to establish a baseline of where your county has been; to gain a better understanding of what changes have taken place over the years; and what direction it would appear your county is going. Some budget preparers include additional information about the county debt service funds, and debt and capital management within the annual budgets.

Recommended Practice: Review prior year budgets and audits

Selling the Project and Borrowing Money

Reference Number: CTAS-1776

Selling the Project

Reference Number: CTAS-1777

Basic Steps of Establishing a CIP and Policy Considerations can be found under the Capital Budgets topic. Included is information on a committee or governing structure that identifies and starts the approval process for the capital program and funding approval.

A guide for approval of a capital project and related funding should follow the same procedures as adoptions of the operating budget; that guidance can be found in T.C.A. § 9-11-115. In summary, the code references adoption of an appropriation resolution, and then the related tax resolution for the operating budget. However, in the case of a capital project, a county could adopt a project budget known as the Project Budget Resolution (an example of a Project Budget Resolution is noted in figure 15) and then adopt the bond/note/loan resolution which we shall refer to as the Debt Resolution. Due to the legal nature of debt obligation as an attorney approved resolution, Debt Resolution allowing the government to levy taxes to repay the indebtedness will be required. This two step process allows the county's related committee structure to work through gaining commission and public support for a project and related debt by gaining an understanding of the project needs and how the purposed project will meet the public purpose prior to action on a Debt Resolution.

We recognize that all counties do not approve a capital project and related debt in a two step process, but approve only the Debt Resolution. If only a Debt Resolution is approved, the budget approval is implied.

Recommended Practice: Establish a Capital Budget and post the budget on the accounting record. Provide it to the legislative body even if only a Debt Resolution has been adopted.

				Current Budget	Amendment	Amended Budget
Highway Capital Projects (176)						
Fund Balance and Designations						
176	39000		Undesignated Fund Balance	0	0	0
Revenues and Transfers In						
176	44570		Contributions	0	2,500,000	2,500,000
		Total Revenue		0	2,500,000	2,500,000
Expenditures						
	Highway & Street Capital Projects					
176	91200	399	Other Contracted Service	0	1,250,000	1,250,000
	91200	404	Asphalt- Hot Mix	0	250,000	250,000
	91200	405	Asphalt- Liquid	0	215,000	215,000
	91200	409	Crushed Stone	0	500,000	500,000
	91200	703	Asphalt Plant Equipment	0	0	0
	91200	714	Highway Equipment	0	250,000	250,000
	91200	606	Other Debt Issuance Charges	0	35,000	35,000
		Total Expenditures		0	2,500,000	2,500,000
Fund Balance and Designations						
177	39000		Undesignated Fund Balance	0	0	0

Figure 15

Local Government Obligations Acts of 1986 and Title 49 Education

Reference Number: CTAS-1778

Once the Project Budget Resolution has been adopted, the county mayor and finance department (if they haven't already) should become familiar with the "Local Government Public Obligations Acts of 1986" found in Title 9, Chapter 21 of the Tennessee Code Annotated. In cases of school projects, a Debt Resolution can be issued under T.C.A. § 49-3-1002. Unlike Title 9, which allows a referendum to be called by the people to vote on whether or not to issue debt, Title 49 does not allow such a referendum. School debt can be approved under either Title 9 or Title 49. Information about Bonds Issued Under Local Government Public Obligations Acts of 1986 and School Bonds can be found under the Capital Budgets topic.

Assuming you have approved a Project Budget Resolution or will have your project approved with only a Debt Resolution, your next step is to determine whether bond or notes will be issued. In the case of potentially having notes issued, you then can consider whether you have the capacity to have internal funding of the debt. In other words, either the trustee purchases the debt as an investment or accounting handles the transaction as an inter fund loan. If it has been decided that notes can be issued, then you should consult the Comptroller of the Treasury Division of Local Finance and review their publication a "Guide for the Issuance of Notes by the Counties, consolidated Governments, and Municipalities of Tennessee."

Special Consideration on School Debt, T.C.A. § 49-3-1005

Reference Number: CTAS-1779

In a county having a city or special school district, both the county school board and commission should be aware of the requirements of the sharing of bond or loan proceeds where the indebtedness will be repaid from a county wide tax. State law and court cases have addressed the situations where the bonds or loan proceeds will be divided with the city or special school district based on the respective prorating of students if the entire county is charged with repaying the debt. A county can chose only to tax the properties outside of a city or special school district, and thus are not required to share in the bond or loan proceeds. This taxation is generally referred to as a Rural School Tax. T.C.A. § 49-3-1005 addresses the bond and loan proceeds and taxation issue.

In determining whether to issue county-wide debt or rural school debt, the county generally will determine the pro-rated value of property outside the city system and compare the property value to prorating of students between the two systems. For example, if the value of property outside of the city or special school district is 75 percent of the total county value and the county school system has 80 percent of students; the county may choose to issue county-wide debt. This county-wide debt would then reflect the county system receiving 80 percent of the funds and the city receiving 20 percent, but with the city property paying for 25 percent of the debt repayment cost.

How to Borrow the Money

Reference Number: CTAS-1780

T.C.A. § 9-21-102. Intent. "It is the intent and purpose of this chapter to provide a uniform and comprehensive statutory framework authorizing any local government to issue general obligation bonds and revenue bonds for public works projects, general obligation bonds for certain unfunded pension obligation, general obligation refunding bonds, revenue refunding bonds, bond anticipation notes, capital outlay notes, grant anticipation notes, and tax anticipation notes, and to authorize the destruction of bonds, notes and coupons." This T.C.A. chapter describes in detail issues of all debt obligation and related purposes of debt.

T.C.A. §9-21-103. No indebtedness limit. **"**Bonds or notes may be issued under this chapter, notwithstanding and without regard to any limit on indebtedness provided by law." The law allows unlimited indebtedness; however, a county's debt ratios would gauge the amount of risk indebtedness the county may have, and thus would be a factor in determining the interest rates.

Money can be borrowed for the capital projects, as well as for anticipated borrowing purposes such as, tax, grant and revenue anticipation notes. These instruments are not covered in detail since their purpose is short term in nature (generally less than one year) and repaid upon revenue being received or permanent debt being issued. The following describes the issuance of debt instruments which are considered longer term in nature.

Tax Exempt Debt

Reference Number: CTAS-1781

Debt issued in compliance with the Tennessee Code and Federal law is considered exempt for income tax purposes to the holder of the debt instruments.

Comptroller's Office Filing

Reference Number: CTAS-1782

Public Debt Entity Form (Comptroller Form CT-0253) is required to be filed by the local government within 45 days of entrance into a debt obligation.

Issuance of Notes

Reference Number: CTAS-1783

The Comptroller of the Treasury Division of Local Finance publishes a "Guide for the Issuance of Notes by the Counties, Consolidated Governments and Municipalities of Tennessee". This publication includes information, description and sample resolutions which can be used for the issuance of: Bond Anticipation Notes, Capital Outlay Notes, Grant Anticipation Notes, Tax Anticipation Notes, Health Care Anticipation Notes, and Revenue Anticipation Notes. The publication also includes State Form CT-0253 which reports to the Comptroller's Office a summary of your new debt obligation related to amount, type of debt, cost of the issuance, interest rate and other information. Form CT-0253 and related instructions.

Various factors will determine whether the county's debt issuance is by way of note or bond. Below are the major factors to be considered:

1. Amount of Issuance
2. Type of Asset specifically the asset life expediency
3. How the new debt will fix into the existing multi-year debt service budget or plan-Term of Bond/Loan.

Notes generally will be less expensive to issue due to the local government being able to handle the transaction locally and absorbing most, if not all, financial cost of issuance; however, notes that are large in dollar denomination may require placement outside of a local financial institution. Small dollar denomination notes are often sold to the local financial institutions via a bid process**.** Sample Request for Quote form for local financial institutions. You should consult your purchasing department to coordinate the purchasing effort.

Inter-Fund Capital Outlay Note

Reference Number: CTAS-1784

When the decision has been made to issue capital outlay notes, the county should further consider whether an inter-fund loan would be in the county's best financial interest. An inter-fund loan is where one accounting fund, such as the General Fund, loans (via capital outlay note) monies for a project. The General Fund is repaid the money via the Debt Service Fund, or the operating fund that purchased the capital asset. The inter-fund loan is often used to save the county money by absorbing all debt issuance cost, and potentially saving the difference in the investment rate of return on the county money versus the interest rate charged to borrow the funds. The internal funding also can be the County Trustee purchasing the note as an investment. Special accounting treatments must be considered to book the indebtedness.

Financial Leases

Reference Number: CTAS-1785

Financing leases are another avenue in which a county can acquire a capital asset. This avenue is generally the least used and often the most expensive means of financing. Generally speaking, a county can issue capital outlay notes and purchase an asset, as opposed to the leasing of the asset. Interest rates are often higher in lease contracts than a county can receive via inter-fund loan or capital outlay notes issued to a local financial institution. A county should fully understand the cost of the asset and borrow cost imputed, as well as, whether they intend to use the asset through the end of it useful life. The county should also conduct an analysis of purchase versus lease cost. The Comptroller of the Treasury Division of Local Finance "Tennessee Debt Manual for Local Governments" set out various requirements for a county to enter into a lease agreement.

Issuance of Bonds (General Obligation Bonds) and Loan Agreements

Reference Number: CTAS-1786

The Debt Resolution is used when bonds or longer term loans are issued. The resolution is generally prepared by the county's bond counsel and adopted at either a regular or specially called meeting of the county commission. This Debt Resolution pledges the full faith, credit and unlimited taxing power of the local government as to all taxable property in the local government or a portion of the local government.

The Debt Resolution T.C.A. § 9-21-108

- Is not required to be posted or published before adoption, but must be posted/published after adopting T.C.A. § 9-21-206 in order to allow the eligible voters to call for a referendum. Referendums are not allowed for school projects if debt is issued under Title 49.
- Can not be vetoed by the chief executive officer (mayor or executive).

- Takes only a majority vote of the commission.
- May delegate authority to the chief executive officer of the local government to sell notes or bonds.

Borrowing in the Bond Market or from a Loan Pool

Reference Number: CTAS-1787

Once it has been determined that the project will be supported with a bond or loan, the county must select the best avenue to issue the debt.

Financial Advisor

Reference Number: CTAS-1788

Some counties have chosen to have financial advisors employed to assist in their county debt management. Depending on the county's debt positions and understanding of their debt and future needs, the value of this service could be questioned. First, if a county has a debt management program, the county should have a good understanding of their financial needs. Second, if a financial advisor under contract with the county also is involved in the underwriting, trading, or sale of the debt; there exists a question of enough independence in the relationship. Due to the nature of some borrowing and the lack of understanding and knowledge of the issuer, there are cases where the financial advisor is a needed professional for your county. If a financial advisor is needed, it is recommended that the county do a request for proposals to secure these services. The purchasing professionals with CTAS have available specifications for solicitation of a financial advisor.

Recommended Practice: If you desire to have a financial advisor, it is recommended to request proposals for their services

Underwriter

Reference Number: CTAS-1789

An underwriter is a firm or group of firms selected to purchase and re-market the debt to the public or investment community. An underwriter usually is an investment banker or commercial bank. The underwriter puts together an offering price to purchase the debt with the intent to re-sell the debt in smaller pieces to other investors, making a profit on the difference in the purchase price and selling price.

Bond Sales

Reference Number: CTAS-1790

If a county is having its debt issued by bonds, the county and its advisor can select to have a competitive, negotiated or private placement of the bonds. If a competitive sale is selected, then a financial advisor, issuer, or bond counsel will develop legal notices, bid forms, and various disclosures regarding the issue, along with a time and date to receive bids. The county should be aware that Federal law prohibits what is know as arbitrage - where a county receives tax exempt debt funds and re-invests those funds to generate earnings greater than the interest cost. Generally when the bonds are sold, all proceeds are then turned over to the county. A specific drawdown of the money on the capital project is planned and anticipated to prohibit an arbitrage issue.

Loans

Reference Number: CTAS-1791

Issuing debt by loans has been an option taken by many governments over the years as a way to reach a more economic scale in the issuance cost. A loan program involves a firm developing a program where bonds are issued in a large denomination (several $100 million) through a public building authority. This money is then loaned to the local government. Loans can be on variable or fixed rates. In cases where governments borrow under a loan program, generally there should be a reduced issuance cost due to the issuance cost for the one large denomination bond being spread over many loans, as opposed to issuance cost on individual bonds. Further, the need for a financial advisor is minimized due to the individual bonds not having to be underwritten. If a county is considering loans, these loans also should be on a request for proposals. Further arbitrage issues do not arise on these loans since the government receives the funds on a drawdown as needed basis.

Recommended Practice: If your county has selected to issue loans for their debt, then the county should solicit loan rates and related cost

Time Frame for Receiving Monies

Reference Number: CTAS-1792

The county should consult with its financial advisor or the loaning firm on the availability of money. Public notices may be necessary to determine if a referendum is required. If a referendum is held, the process could take up to six months. Upon loans being approved, the time of receiving money can be three to five weeks.

Cost Associated with Bonds and Loans

Reference Number: CTAS-1793

The county needs to understand the full and total cost of the issuance of debt. There generally is a cost associated when the transaction is complete, and then the on-going monthly and annual cost of the issue. These costs should be fully disclosed during your solicitation process for a financial advisor and debt issue. State form CT-0253 should be used in the solicitation process.

Summary of Steps in Issuing Debt

Reference Number: CTAS-1794

This is a brief summary of the major steps in making the decision on financing a project:

<u>Step 1</u> – County determines its needs and potential costs.

<u>Step 2</u> – County determines if funds are currently available. If not, step three.

<u>Step 3</u> – County determines if capital outlay notes are a viable option.

- If yes, then the county determines if sufficient funds can be borrowed internally.
- If so, should the county borrow internally?
- If no internal borrowing, then can funds be borrowed at local financial institutions?
- If not, then consider loan pools as an option for capital outlay notes.
- If capital outlay notes are not an option, proceed to step four.

<u>Step 4</u> – Should the county borrow from a loan pool or issue bonds?

- If loan pool, then contact loan pool representatives for quotes.
- If bonds, then solicit financial advisor to assist in bond sale.

Policies and Committee Considerations

Reference Number: CTAS-1795

In planning the county’s financial future, various policies and committees are often established to advise the legislative body and the executive branch. Review the following comments on policy, committees and planning considerations.

Fixed Asset Policy

Reference Number: CTAS-1796

Due to the Governmental Accounting Standard Board statement 34 all counties should have a Fixed Asset Policy. This policy will give guidance in formulating a Capital Improvement Plan by identifying classifications of capital assets.

Capital Improvement Plan/Budget

Reference Number: CTAS-1797

The Capital Improvement Plan should identify the current assets in use, their anticipated replacement date and any anticipated needed or planned future assets. As this plan is classified by asset and year, then an estimated replacement and purchase cost can be assigned to each asset. Related revenue can then be identified to acquire the replacement or new asset. If the revenue assigned is notes or bond proceeds, then this cost is considered a part of the Debt Management Plan.

See Reasons for a Capital Improvement Plan/Budget under Capital Budgets.

Fund Balance Policy

Reference Number: CTAS-1798

A Fund Balance Policy will assist in the long-term stability of the government finances by establishing an ending fund balance goal of each respective accounting fund. For instance, the Highway Fund is typically made up of state revenues that are transmitted monthly to the county. Thus with this constant consistent revenue stream, the Highway Department has monthly operating cash that often matches monthly operating expenditures. In this example, the Highway Fund may require only an extra month fund balance, or 1/12 of the annual budget could be the fund balance goal. In the case of the General Fund, which is predominately supported by property tax collected mainly in December and February, (a full six and eight months into the fiscal year) a larger fund balance would be needed to support operations until the revenue is received.

In establishing a Fund Balance Policy for the Debt Service Fund, we often recommend that a county have 50 percent to 150 percent of its current appropriation budget. The fund balance is higher in the Debt Service Fund for a number of reasons:

1. Reflects a conservative debt policy to debt rating agencies; therefore, more stability in financial operations and hopefully better interest rate opportunities.
2. Allows for the idle funds to be invested at a steady revenue stream of interest earning. Often interest earnings are annual revenues to the debt service funds.
3. Allows more flexibility in structuring future debt payments by allowing the fund balance to increase and decrease over time to smooth out the debt service tax levy.

You would generally see a county’s debt service fund balance begin to increase in anticipation of future capital project and debt, and decrease as existing debt is paid off.

Debt Management Policy

Reference Number: CTAS-1799

Legal Requirements:

“Pursuant to TCA Section 9-21-151(b)(1), the State Funding Board is authorized to develop model financial transaction policies for the State, State Agencies, local governments and local government instrumentalities. The State Funding Board on December 15, 2010, adopted a **statement on debt management** that reflects three principles for strong financial management in the public sector:

1. Understand the transaction
2. Explain to citizens what is being considered
3. Avoid conflicts of interest
4. Disclose costs and risks

State and local governments and government entities that borrow money are directed to draft their own debt management policies by January 1, 2012, using this model policy as a guideline."[1]

Objectives:

The following objectives meet the minimum statutory requirements:

1. Make the decision process transparent
2. Address hiring outside professionals

3. Address any potential conflict of interest issues

Minimum Language Required

1. Transparency

The Entity shall comply with legal requirements for notice and for public meetings related to debt issuance. In the interest of transparency, all costs (including interest, issuance, continuing, and one-time) shall be disclosed to the citizens/members, governing body, and other stakeholders in a timely manner. (*The method for disclosure of costs and other information, including documentation of compliance with the policy, shall be developed and outlined in the policy.*)

2. Professionals

a. The Entity shall require all professionals engaged in the process of issuing debt to clearly disclose all compensation and consideration received related to services provided in the debt issuance process by both the Entity and the lender or conduit issuer, if any. This includes "soft" costs or compensations in lieu of direct payments.

b. Counsel: The Entity shall enter into an engagement letter agreement with each lawyer or law firm representing the Entity in a debt transaction. (*No engagement letter is required for any lawyer who is an employee of the Entity or lawyer or law firm which is under a general appointment or contract to serve as counsel to the Entity. The Entity does not need an engagement letter with counsel not representing the Entity, such as underwriters' counsel.*)

c. Financial Advisor: If the Entity chooses to hire financial advisors, the Entity shall enter into a written agreement with each person or firm serving as financial advisor for debt management and transactions.

d. Whether in a competitive or negotiated sale, the financial advisor shall not be permitted to bid on, privately place or underwrite an issue for which they are or have been providing advisory services for the issuance.

e. Underwriter: If there is an underwriter, the Entity shall require the underwriter to clearly identify itself in writing (*e.g.*, in a response to a request for proposals or in promotional materials provided to an issuer) as an underwriter and not as a financial advisor from the earliest stages of its relationship with the Entity with respect to that issue. The underwriter must clarify its primary role as a purchaser of securities in an arm's-length commercial transaction and that it has financial and other interests that differ from those of the Entity. The underwriter in a publicly offered, negotiated sale shall be required to provide pricing information both as to interest rates and to takedown per maturity to the governing body (*or its designated official*) in advance of the pricing of the debt.

3. Conflicts

a. Professionals involved in a debt transaction hired or compensated by the Entity shall be required to disclose to the Entity existing client and business relationships between and among the professionals to a transaction (including but not limited to financial advisor, swap advisor, bond counsel, swap counsel, trustee, paying agent, underwriter, counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall include that information reasonably sufficient to allow the Entity to appreciate the significance of the relationships.

b. Professionals who become involved in the debt transaction as a result of a bid submitted in a widely and publicly advertised competitive sale conducted using an industry standard, electronic bidding platform are not subject to this disclosure. No disclosure is required that would violate any rule or regulation of professional conduct.

A county may adopt the minimum language as their debt policy.

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[1] https://www.comptroller.tn.gov/sl/pdf/DebtPolicy.pdf

Additional Considerations to the Minimum Language

Capital Projects Committee

Reference Number: CTAS-1800

A Capital Projects Committee assists in developing the Capital Project Plan/Budget and policies. See Basic

Steps for Establishing a Capital Improvements Plan (CIP) and Policy Considerations under the Capital Budgets topic for additional information on developing a Capital Project/Budget or Capital Improvements Plan.

Debt Committee

Reference Number: CTAS-1801

The Debt Committee assists in developing the debt service program and fund balance policies, along with helping the county understand all aspect of its debt. The committee should make recommendations on when to issue debt and what type of debt to issue. This committee should have an in-depth understanding of the existing Debt Service Funds, the current outstanding debt instruments and the multi-year debt service budget. This committee should work with the county mayor/executive and finance department in the overall Debt Management Program, and follow the committee charge outlined in the Debt Policy

Recommended Practice: Establish committees to assist in debt management activities

Recommended Best Practices

Reference Number: CTAS-1802

In order to have an effective debt management program, your county must have an understanding of your current debt position and your capital needs. This understanding can be evolutionary in nature due to the changes in laws requiring service and regulating debt issuance; market conditions; and the ever-changing needs of the citizens. Various policies and committees may be established to assist you in understanding debt management.

In summary, you should develop, comply and/or adopt the following:

- Establish a Capital Budget
- Make all payments of debt from a Debt Service Fund
- Debt policy should address issuance cost
- Make sure all parties know where the issuance cost will be charged
- Allow any excess funds from capital projects to establish other capital projects
- Establish a permanent Capital Project Fund
- An official Capital Budget should be established after issuance of debt
- Make needed budget amendments if interest or principal is paid during the year debt is issued
- Develop a Capital Improvements Plan/Budget
- Multi-year debt service budgets
- Develop a fund balance policy for the Debt Service Fund
- Establish a Debt Payment Schedule/Calendar
- Maintain current inventory and insurance schedules
- Make sure your county complies with GASB standards
- Become familiar with your county’s audit and financial management
- Have all your county debt instruments in one location
- Review prior year budgets and audits
- Establish a Capital Budget and post the budget on the accounting records
- If you desire to have a financial advisor, request proposals
- If you select to issue loans, then solicit loan rates and related cost
- Establish a committee to assist in debt management activities

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