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Selling the Project and Borrowing Money

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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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:

Step 1 – County determines its needs and potential costs.

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

Step 3 – 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.

Step 4 – 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.

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