

The Basics of Long-Term Debt Issuance and Management

Issuing long-term debt can be a complex, multifaceted process. Here are the basics.

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To be fiscally responsible, school districts should have a solid debt policy that includes guidelines for long-term debt issuance and management. Elements of that policy should govern (a) what long-term debt should and should not be used for financing, (b) maximum district indebtedness, and (c) the standards for debt issuance.

Issuing long-term debt is a multifaceted process. Although the process varies by state, typically the school business official and the district solicitor work with the financing team, which includes a financial adviser, bond counsel, underwriter, rating agency, and possibly a bond insurance agent, paying agent, and architect.

Reputable bond counsel and a financial adviser with significant experience in various types of debt can help district officials determine the type of debt that makes financial sense for the district. The bond counsel ensures that all the documents are appropriately filed and prepares a permanent record of the issue.

The documentation required to issue debt is complex and requires board action on several fronts. It typically takes our district three board meetings to issue bonds; depending on your state requirements, you may need more or less board involvement.

The first critical document is the preliminary official statement. This document is the “marketing document”

that indicates your need to borrow and outlines why you are a good risk for investors in your debt instruments, such as bonds. This statement includes a good deal of legal assurances for the borrowing purpose, as well as financial and demographic information about your district. Because outside investors rely on this information, it must be provided annually once your debt is issued.

The other documents to be filed include the following:

- Final official statement
- Resolution directing sale
- Tax-exempt certificate
- Continuing disclosure certificate
- Terms and conditions of issuance
- Summary of settlement

Specific filing documentation varies from state to state, but each issue typically requires about 50 original signatures by the board president and secretary.

Continuing Disclosure

All business officials should be aware of the continuing disclosure certificate. When bonds are issued, the issuer enters into a continuing disclosure agreement, promising to provide certain annual financial information. If a bond issue is \$10 million or more, continuing disclosure is required. This requirement means you promise to continue to disclose (at least annually) financial information that may affect an investor’s decision to purchase or sell your bonds. Although continuing disclosure is legally required only for issues of \$10 million or more, underwriters usually recommend it for smaller issues as well.

The information reported annually is the same information prepared for the official statement, such as the audited financial report, property valuation and rate information, overlaying debt (debt of other governments with which you share property valuation), major employers and taxpayers, unemployment rates, and retail sales. Therefore, you should work with your financial adviser to create the information included in the original official statement based on the knowledge that the same information is needed annually during the life of the issue.

Your financial adviser may help you compile and file this information, but you should be aware that this is your obligation once the debt is issued. The information is filed with a national repository and must be in a word-searchable PDF format. Your certificate will determine when this information must be filed, so allow enough time to complete your audit report. In addition to the annual disclosure, you will be responsible for reporting any major change in your district's demographics or tax base, such as the closure of a large employer, at the time the change occurs. These reports are known as event notices.

Ongoing Debt Management

To manage your debt, you will need to know the requirements of your reserve fund and sinking fund. An outside paying agent is usually required for bonds. The paying agent will hold your reserve fund and sinking fund and will make the principal and interest payments as they become due.

The terms of issuance will determine the frequency of your payments into the sinking fund (i.e., monthly, semiannually, or annually). Although these funds may be held by an outside entity, they are maintained as assets on the district's balance sheet and the revenues and expenditures recorded in the appropriate fund.

If the bonds are issued for capital projects, the funds are usually maintained in the debt service fund. If backed with enterprise revenues, they are typically maintained in the enterprise fund. Consult with your external auditors for proper accounting treatment. Funds are deposited to the reserve fund and sinking fund by interfund transfer (if necessary). Principal and interest payments are usually made out of the debt service fund.

Our District's Experience

During the past 10 years, we have constructed five new elementary schools and two new middle schools with revenue bonds backed by local option sales tax. For most of our projects, we have issued bond anticipation notes (BANs) as short-term financing during construction, refunded with long-term bonds.

In each instance, we reviewed the interest environment to determine the best route to take. Sometimes we issued BANs with a consortium of local banks on a drawdown basis to minimize interest payments and because the investing rates were not good. At other times, we received the proceeds up front and invested them during construction at rates higher than the borrowing rates to gain positive arbitrage. For our most recent building project (fall 2009), we went directly to 20-year bonds to lock in historically low interest rates.

Each of our debt issues typically required a 10% reserve fund. Because of the uncertainty in the economy at the time of our last bond issue, we voluntarily agreed to set up a super reserve to give the market extra

TERMS TO KNOW

Arbitrage: The interest earned on debt proceeds during construction. If the debt remains bank qualified (\$10 million issued in one calendar year—temporarily increased to \$30 million by the federal stimulus legislation), there is no limit on the amount of arbitrage you can make. If it is not bank qualified, proceeds must be spent within two years or limitations may apply.

Bond anticipation note: Short-term debt issued by a state or municipality to be paid off with the proceeds of an upcoming bond issue.

Continuing disclosure certificate: A written agreement between the underwriter and the issuer that represents the issuer's promise to provide annual financial information and event notices to the bondholders. It specifies the information that must be disclosed annually and the types of changes that trigger an event notice.

Coverage ratio: The amount of revenue expected in relation to the revenue bonds being issued. Typically you must have \$1.20 to \$1.50 of revenue for \$1 borrowed.

Debt service fund: A fund used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest except that payable from proprietary, fiduciary, or special assessment funds.

Enterprise fund: A fund that provides goods or services to the public for a fee that makes the entity self-supporting.

Enterprise revenues: Revenues generated by a self-supporting government activity.

Reserve fund: An amount of bond proceeds held in reserve for future payment, normally 10% of issuance.

Sinking fund: The amount accumulated to pay off a debt.

Super reserve: A voluntary reserve over and above that normally required for a debt issue to provide extra assurance during uncertain economic times.

Tax exemption certificate: A legal document stating that the issuer can issue debt that is exempt from taxation.

reassurance. We agreed to the super reserve during construction or until the coverage ratio reached a certain level, whichever was longer.

There is no arbitrage limit on the standard reserve fund; however, on our super reserve, we cannot earn interest at a rate higher than the rate on the bonds. This restriction is not a problem at today's investment rates, but it's something that we will have to monitor for as long as the super reserve exists.

Issuing debt and the related ongoing responsibilities can be daunting, but at sometime in your career you will need to issue long-term debt. Good bond counsel, financial advisers, and external auditors help immensely, and once you've been through the process, you will find that it has some standard procedures that are consistent over the life of the debt issuance.

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