In the Board Room: County and Municipal Borrowing Basics

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OVERVIEW OF DISCUSSION

1. Types of County Financings
2. General Obligation Debt
3. Authority, Purposes, and Conditions for County Borrowing for G.O. Debt
4. Revenue Anticipation Notes
5. Revenue Obligations
6. Conduit Revenue Bonds
7. Tax Considerations for County Bonds
8. Levy Limits; Referendum Process to Exceed County's Levy Limit; Exceptions

Types of County Financings

General Obligation Debt

- Issuance of bonds or notes to finance county projects (generally capital improvement projects) pursuant to Wis. Stat. ch. 67.

Revenue Anticipation Notes

- A short-term debt security issued against the anticipated receipt of future payments by a county.

Revenue Obligations

- Issuance of bonds or notes to finance "public utilities" (e.g., street lights, sewerage systems, parks, swimming pools, hospitals, etc.). Wis. Stat. § 66.0621.

Conduit Revenue Bonds

- Counties may issue industrial revenue bonds on behalf of private borrowers pursuant to Wis. Stat. § 66.1103, other exempt facilities bonds, and other private activity bonds. Such bonds are secured by the revenues of the borrower/project, not the county.

General Obligation Debt

Constitutional Debt Limits

- County borrowing for most capital improvement projects is issued pursuant to Wis. Stat. ch. 67 and is secured by the full faith and credit of the county (including an irrepealable direct annual tax).
- General obligation debt is subject to constitutional and statutory debt limits.
- Wis. Const. art. XI, § 3, sub. (2) provides that no county may contract to become indebted in amount that exceeds the <u>5% of total equalized value of taxable property located in the county.</u>

General Obligation Debt (cont.)

General obligation debt must be:

- (a) secured by a direct annual tax sufficient to pay the full principal and interest on the debt; and
- (b) repaid within 20 years.

Wis. Const. art. XI, § 3

General Obligation Debt (cont.)

- Counties have to follow the procedures set out by the legislature when they want to borrow money so that municipalities do not become overburdened by municipal obligations. *City of Hartford v. Kirley*, 172 Wis. 2d 191, 204 (1992).

- The goal of Article XI, § 3, sub. (2) is to impose the burden of repaying municipal obligations on those who create (vote for) them; rather than upon future generations. *School District v. Marine National Exchange Bank of Milwaukee*, 9 Wis.2d 400, 404 (1960).

General Obligation Debt (cont.)

What counts as "debt" subject to the constitutional debt limit?

- No statutory definition, but the WI Supreme Court has attempted to define what "debt" is.
- Debt includes "all absolute obligations to pay money, or its equivalent, from funds to be provided, as distinguished from money presently available or in the process of collection and so treatable as in hand." *Owen v. Donald*, 160 Wis. 21, 59 (1915).
- The test is whether the municipal body is under an obligation to pay, and the creditor has a right to enforce payment against the municipal body or its assets. *Dieck v. Unified Sch. Dist. of Antigo*, 165 Wis. 2d 458, 470 (1991).
- "Debt" is an obligation backed by the full faith and credit of the municipality (i.e., a general obligation) payable from general property tax revenue or secured by mortgages on property or assets already owned by the county (the pre-existing asset doctrine). *City of Hartford*, 172 Wis. 2d 191, 208 (1992).

General Obligation Debt (cont.)

What doesn’t count as “debt” subject to the constitutional debt limit?

- Any obligation that is not: (1) a general obligation of the municipality entitling creditors to look to the municipality's revenue for repayment nor (2) secured by any asset owned by the municipality prior to its incurring the obligation.
- Any financing scheme where the county may avoid its obligation or if conditions precedent exist before the obligation must be repaid. *Dieck*,165 Wis. 2d. at 471.

General Obligation Debt (cont.)

Examples:

- Loans secured by "special assessments," (i.e., special taxes assessed in addition to general property taxes only on the "special improvement" properties they benefit).
- Revenue obligations (i.e., obligations payable solely out of the property acquired or constructed, or out of revenue generated from the project)
- Lease-Purchase arrangements are not considered "debt" if the agreement contains a "non-appropriation" option (or some other mechanism by which the county can terminate the agreement with no future payment obligation)
- Bond or Revenue Anticipation Notes

Authority, Purposes, and Conditions for County Borrowing for G.O. Debt

Authority to Borrow:

- General authority – Individual municipalities may issue general obligation bonds or notes to finance any "project" undertaken for a "public purpose" subject to the procedures in Wis. Stat. ch. 67. Wis. Stat. § 67.04 (2)(a)
- "Public purpose" means "the performance of any power or duty of the issuing municipality." Wis. Stat § 67.04(1)(b).
- "Project" means "the acquisition leasing, planning, design, construction, development, extension, enlargement, renovation, rebuilding, repair or improvement of land, waters, property, highways, buildings, equipment or facilities." Wis. Stat. § 67.04(1)(ar).

Authority, Purposes, and Conditions for County Borrowing for G.O. Debt (cont.)

Examples

- The acquisition, construction, equipping, furnishing, renovation or other capital improvements made upon or to create any public utility, governmental building, or other property.
- e.g., county courthouse, administrative buildings, parks, jail, public safety facilities, etc.
- Building and improving roadways, bridges, and other public infrastructure.
- Note: Counties generally may not issue debt to finance operating expense of the county’s general fund or any special revenue fund supported by property taxes.

Authority, Purposes, and Conditions for County Borrowing for G.O. Debt (cont.)

Conditions to issuing municipal obligations – Wis. Stat. § 67.045

- A county may not issue bonds or promissory notes unless one or more of the following apply:
    1. A referendum is held that approves the debt issuance;
    2. The county board adopts a resolution setting forth its reasonable expectation that the anticipated debt issue will not require the county to increase the debt levy rate;
    3. The debt is to be issued for the specific purposes enumerated under Wis. Stat. § § 67.05 (7)(c), (cc), (f), (h) or (i);
    4. The debt is issued to fund or refund outstanding bonds or notes;
    5. The county board adopts a resolution to issue the debt by at least 3/4 vote of the members elect; or
    6. The debt is issued for the purpose of acquiring or installing energy efficient equipment

Authority, Purposes, and Conditions for County Borrowing for G.O. Debt (cont.)

Direct Annual Irrepealable Tax Levy

- Counties must levy a direct annual irrepealable tax (i.e., a property tax for the county's debt levy) for the purpose of paying debt service on the bonds. Wis. Stat. § 67.05(10).
- Levied by recording a resolution of the governing body of the county describing that the express purpose of the tax levy is to (i) pay interest on the bonds or notes as it falls due and (ii) discharge the principal thereof at maturity.
- The amount of tax carried into the tax roll may be reduced in any year by the amount of any surplus money in the debt service fund for the bonds/notes,
- The county may also make an appropriation in advance of the authorization of the bonds to provide funds for any payment coming due on the bonds prior to the first collection of taxes levied for that payment.

Revenue Anticipation Notes

Revenue Anticipation Notes (Wis. Stat. § 67.12(1)(a))

- Definition:
  - A short-term note issued against the anticipated receipt of future revenues by a county (e.g., federal or state aids, taxes levied, or other deferred payments).
  - The anticipation notes must be issued in the same fiscal year in which the county is entitled to receive the payments.
  - The notes may not exceed 60% of the anticipated revenues.
  - The Notes must be repaid within 18 months of the first day of the fiscal year in which they are issued

Revenue Anticipation Notes (cont.)

Benefits to revenue anticipation notes:

1. No tax levy required.
2. NOT considered general obligation debt the county within the scope of the constitutional debt limits. Wis. Stat. § 67.12 (1)(c).
   - Note: Counties typically issue Bond Anticipation Notes, where the proceeds of bonds or notes already authorized by a county are pledged to the repayment of short-term notes.

Revenue Obligations

Revenue Obligations (Wis. Stat. § 66.0621))

- Issuance of bonds or notes to finance “public utilities”
- “Public utility" means any revenue producing facility or enterprise owned by a municipality (including counties) and operated for a public purpose (e.g., streetlights, sewerage systems, parks, swimming pools, hospitals, etc.).
- Bonds are secured by a pledge of the revenues to be derived from the public utility once it’s been bought, built, leased, improved, etc., by the municipality with bond proceeds
- Interest on bonds must be paid at least annually to bondholders
- The Bonds or notes must be repaid within 40 years from the date of issuance

Revenue Obligations (cont.)

Benefits to revenue obligations:

1. No tax levy required – debt service paid solely from public utility revenues
2. Not secured by any other assets of the county
3. NOT considered general obligation debt the county within the scope of the constitutional debt limits. Wis. Stat. § 66.0621(3)
4. Counties may issue "refunding" bonds to refinance one or more outstanding issues of revenue bonds, regardless of when issued or how many public utilities' revenues are pledged to their payment

Conduit Revenue Bonds

Conduit Revenue Bonds

- Counties may issue industrial revenue bonds (IRBs), certain exempt facilities bonds, or other private activity bonds on *behalf* of certain private borrowers. Wis. Stat. § 66.1103.
- Facilities that can be financed with proceeds of conduit revenue include, among others, facilities for manufacturing, telecommunication, pollution control, hospitals, sewage, docks, recreation, agriculture, and forestry) Wis. Stat. § 66.1103(2).
- IRBs and certain exempt facilities bonds must be repaid within 35 years from the date of issuance. Wis. Stat. § 66.1103(4)(c)
- Not considered “public works,” “public improvements,” or “public construction,” and contracts for work done with IRBs, etc. are typically not “public contracts” for purposes of competitive bid laws.
- Provides a mechanism to provide tax-exempt financing to private projects (subject to numerous federal tax law requirements and restrictions).

Conduit Revenue Bonds (cont.)

Benefits to conduit revenue bonds:

1. No tax levy required – debt service paid solely from borrower via project revenues
2. Conduit revenue bonds are limited obligations of the county and are not considered an indebtedness of the municipality or county. Wis. Stat. § 66.1103(4)(a)
3. Conduit revenue bonds are not a charge against the county's general credit
4. Conduit revenue bonds are not a pecuniary liability of the county
5. Wide range of potential projects and borrowers that can be financed with conduit revenue bonds.

Tax Considerations for County Bonds

Counties are often able to issue their bonds exempt from federal income tax

- Results in a lower interest rate because investors do not have to pay income tax on their earned interest.
- Effectively a subsidy by the federal government.
- Applies to FEDERAL tax exemption – bond interest (generally) not exempt under WI law.

Tax Considerations for County Bonds

Three Basic Kinds of Bonds for tax purposes

- General Obligation ("G.O.") Bonds – secured by the issuer's "full faith and credit" and ad valorem taxes levied for repayment.
- Private Activity Bonds – (also known as "conduit revenue bonds") bond proceeds are lent to a private entity – usually a 501(c)(3) nonprofit – and secured solely by the private entity's promise to repay.
- Municipal Revenue Bonds – issued by a municipality for a government purpose – say, constructing a city parking structure – secured only by the project and revenues derived from operations of the project.

Tax Considerations for County Bonds

Requirements For Tax Exemption

- Must be issued by a "political subdivision" of a state
    - Broadly, any entity that has a meaningful amount of the traditional "police powers:"
        - (a) levy a tax;
        - (b) make and enforce laws; or
        - (c) exercise power of eminent domain.
- Must be validly issued under State law;
- Must constitute "indebtedness" under State law.
    - reasonable expectation of payment

Tax Considerations for County Bonds

Basic Rule

- Can’t borrow:
  - too much (more than you need);
  - too soon (before you need it); or
  - for too long.
- Can’t “exploit” difference between taxable and tax-exempt interest rates (“arbitrage”)

Tax Considerations for County Bonds

Can’t Borrow Too Much

- 90% of proceeds must be used for capital expenditures
  - Remainder can be used for
    - costs of issuance (underwriter, legal, etc.);
    - accrued interest;
    - bond insurance;
    - Non-capital expenditures/working capital.

<u>OR</u>

- 100% of proceeds must be used to refinance outstanding bonds that were tax-exempt or were issued on a taxable basis but would have met the requirements for tax exemption.

Tax Considerations for County Bonds

Can’t Borrow Too Soon

- Issuer must diligently pursue the project once the bonds are issued
- Bond proceeds generally must be spent within a 3 year period

Tax Considerations for County Bonds

Can’t Borrow For Too Long

- Weighted average maturity of bonds cannot exceed 120% of the reasonably expected economic life of the project being financed.
- Compare borrowing for building construction to borrowing for a fleet of sheriff’s vehicles.

Tax Considerations for County Bonds

You Don’t Have To Be “Broke” To Borrow

- May have cash available to pay for the project, but
- As long as it is not set aside/earmarked for that purpose, borrowing is not restricted.

Tax Considerations for County Bonds

Arbitrage

- Example: Borrow money at a 3% interest rate and invest that same money at a 5% interest rate: the difference (2%) is known as “arbitrage.”
- General rule is that arbitrage earned on a tax-exempt bond issue must be “rebated” to the US Treasury.
- Many exceptions – most common are
  - small issuer
  - spenddown (primarily 24-month exception).
- Can be complicated.

Tax Considerations for County Bonds

Borrowing On A Taxable Basis

- Avoid tax rules
- Can be refunded on a tax-exempt basis

Tax Considerations for County Bonds

Role of Bond Counsel

- Serve as an independent third-party “expert” to render an unqualified opinion that interest on the Bonds will be exempt from Federal income tax.
- Puts some constraints on the lawyer’s obligation to zealously “advocate” for its client (the issuing entity) or to maintain confidentiality.

Levy Limits

Issue

- Levy limits provide the maximum amount a county may increase its property tax levy from the previous year, which makes it difficult for most counties to keep up with rising costs.
- As noted earlier, counties are also generally prohibited from borrowing to pay operating expenses.
- As a result, counties are increasingly turning to referendums to increase their levy.

Referendum Process to Exceed County's Levy Limit

Wis. Stat. § 66.0602(2) allows counties to exceed the county's levy limit by (i) the county board's adoption of a resolution and (ii) approving the resolution via referendum.

1. The county board resolution must specify:
    a) the proposed amount of increase in the levy beyond the amount that is allowed;
    b) the purpose for which the increase will be used; and
    c) whether the proposed increase is for the next fiscal year only or if it will apply on an ongoing basis.
2. The "question" certified by referendum must track the form printed in Wis. Stat. § 66.0602(4)(c)

Referendum Process to Exceed County's Levy Limit (cont.)

3. The resolution must then be approved through referendum.
   - Timing of the referendum under Wis. Stat. § 66.0602(4)(b)
     - For referenda relating to increasing the tax levy in <u>odd</u> numbered years, a county may call a special referendum on the same election dates as when a school board may call for a referendum under s. 121.91 (3).
     - For referenda relating to increasing the tax levy in <u>even</u> numbered years, the referendum may be held at the spring primary or election or partisan primary or general election occurring that year.

Exceptions to the Levy Limit
Wis. Stat. § 66.0602(3)

Under Wis. Stat. § 66.0602(3), annual levy increase limit rules generally do not apply to counties in regard to:

- amounts levied to make general obligation debt service authorized by or after 7/1/2005
- amounts levied to make up a revenue shortfall for the debt service on a special assessment B Bonds issued under Wis. Stat. § 66.0713(4)
- amounts levied to support a county children with disabilities education board
- amounts levied for bridge and culvert construction and repair
- amounts levied to make payments to public libraries under Wis. Stat. § 43.12
- amounts levied for a countywide emergency medical system
- amounts levied for police protection services

A county incurring responsibility to provide county services by way of transfer from another county can increase its levy limit by the price to render such newly received services. Wis. Stat. § 66.0602(3)(b).


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