

In the Board Room: Show Me the Money! County Revenue Bonds and You

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Attorneys Andy Phillips, Ben Conard,
Andy Guzikowski, and Thomas Cameron





OVERVIEW OF DISCUSSION

1. Review of Types of County Financings
2. Revenue Anticipation Notes
3. Revenue Bond Anticipation Notes
4. Revenue Obligations (i.e., Revenue Bonds)
5. Conduit Revenue Bonds
6. Tax Considerations for County Bonds

Types of County Financings

General Obligation Debt

- Bonds or notes issued to finance county projects (generally capital improvement projects) pursuant to Wis. Stat. ch. 67, which are payable from the county's property tax levy.

Leases

- A tool to finance capital assets where – because the payments are subject to appropriation – the financing does not count toward the county's debt limit.

Revenue Anticipation Notes / Revenue Bond Anticipation Notes

- A short-term debt security which is payable from the anticipated receipt of future payments by a county.

Revenue Obligations

- Bonds or notes issued to finance “public utilities” (e.g., street lights, sewerage systems, parks, swimming pools, hospitals, etc.) pursuant to Wis. Stat. § 66.0621, which are payable from the revenues of that utility.

Conduit Revenue Bonds

- Bonds issued on behalf of private borrowers pursuant to Wis. Stat. § 66.1103, which are payable from the revenues of the borrower/project, not the county.

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 of the county within the scope of the constitutional debt limits. Wis. Stat. § 67.12 (1)(c).

Note: Counties typically issue *Bond* Anticipation Notes (or Revenue *Bond* Anticipation Notes) rather than Revenue Anticipation Notes.



Revenue Bond Anticipation Notes

Revenue Bond Anticipation Notes (Wis. Stat. § 66.0621(4)(L))

Definition:

- A short-term note issued against the anticipated receipt of future debt.
- These notes may be issued for periods of up to 5 years (and may be refunded one or more times).

Revenue Bond Anticipation Notes (cont.)

Benefits to Revenue Bond Anticipation Notes:

1. No tax levy required.
2. Can be used for interim financing for a larger project.
3. NOT considered general obligation debt of the county within the scope of the constitutional debt limits. Wis. Stat. § 66.0621(4)(L)3.

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 of 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.



Revenue Obligations – Real World Example

Lafayette Hospital + Clinics

1. Lafayette County owns and operates Lafayette Hospital + Clinics as an enterprise fund of the County.
2. The County's existing facility was at the end of its useful life and needed to be replaced with a new hospital facility with a cost of approximately \$52 million.
3. Lafayette County was able to finance the project using a multifaceted financing package with the USDA as the permanent lender, including:
 - Revenue Obligations
 - GO Bonds
 - Federal Grants

Revenue Obligations – Real World Example (cont.)

1. How was the County able to utilize Revenue Obligations for a portion of the financing?
 - The hospital qualifies as a “public utility” and is a revenue producing facility (as an enterprise fund of the County).
 - The hospital revenues were pledged as the payment source for the Revenue Obligations.
 - The County also granted a mortgage on the new hospital facility as additional security for the Revenue Obligations. (Note: need to be careful with mortgages; only the facility financed with the Revenue Obligations can be pledged.)
2. The revenue generated by the hospital was not enough to support the entire amount loaned by USDA, so a portion of the project was required to be funded by GO Bonds (i.e., backed by the full faith and credit of the County).
 - However, by utilizing Revenue Obligations (and federal grants), the County only needed to issue \$15 million of GO Bonds to finance the project.
 - The County was able to keep \$30,870,000 issued as Revenue Obligations off its tax roll (and its debt limit).

Conduit Revenue Bonds



- Counties may issue bonds (known as “industrial revenue bonds” or “IRBs”) under Wis. Stat. § 66.1103, to finance projects undertaken by private borrowers.
- Despite the use of the word “industrial,” a wide range of projects can be financed with IRBs, including: Facilities for manufacturing, telecommunication, pollution control, hospitals, sewage, docks, recreation, agriculture, and forestry. Wis. Stat. § 66.1103(2).
- Depending on the nature of the project, another Wisconsin issuer (such as municipal housing and economic development authorities, WHEDA, WHEFA, or the Public Finance Authority) may also be able to issue the bonds.
- IRBs must be repaid within 35 years from the date of issuance. Wis. Stat. § 66.1103(4)(c).



Conduit Revenue Bonds (cont.)

- Not considered “public works,” “public improvements,” or “public construction,” so contracts for work done with IRBs 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).
- Even if IRBs are issued as taxable bonds, a lower interest rate compared to a commercial loan is often still available.



Conduit Revenue Bonds (cont.)



Structure of a Conduit Revenue Bond Transaction:

- County “borrows” money by issuing and selling conduit revenue bonds.
- County lends the sale proceeds to a private borrower to finance an eligible project.
- County “steps aside.”
- The private borrower repays the loan to bondholders (lender) directly or through a bond trustee.



Conduit Revenue Bonds (cont.)

Benefits to Conduit Revenue Bonds:

- Wide range of potential projects and borrowers that can be financed with conduit revenue bonds to promote local employment, economic development, and increases to the tax base.
- Borrower pays all costs associated with issuing the bonds.
- County can truly “step aside” once the bonds are issued.
- Conduit revenue bonds are not a charge against the county’s general credit.
- No tax levy required – debt service paid solely from the borrower via project revenues.
- 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).
- Conduit revenue bonds are not a pecuniary liability of the county.



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 Wisconsin law.



Tax Considerations for County Bonds (cont.)

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.
- Municipal Revenue Bonds – issued by a municipality for a government purpose – say, constructing a city-owned parking structure – secured only by the project and revenues derived from operations of the project.
- Conduit Revenue Bonds – (also known as “private activity bonds”) – bond proceeds are lent to a private entity – which can be either a for profit or non-profit entity – and secured solely by the private entity’s promise to repay.



Tax Considerations for County Bonds (cont.)

Requirements For Tax Exemption:

- Must be issued by a “political subdivision” of a state. Broadly, this means 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.
 - bona fide legal obligation to pay
 - reasonable expectation of payment



Tax Considerations for County Bonds (cont.)

Basic Rules:

- 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 (cont.)

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.

OR

- 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 in effect at the time they were issued.



Tax Considerations for County Bonds (cont.)

Can't Borrow Too Soon

At the time the bonds are issued, the Issuer:

- Must have entered, or reasonably expect that within 6-months it will enter, into a binding contract to spend at least 5 percent of bond proceeds;
- Must reasonably expect to diligently pursue the project; and
- Must reasonably expect to spend at least 85% of the bond proceeds on capital expenditures within a 3-year period.



Tax Considerations for County Bonds (cont.)

Can't Borrow For Too Long

- Weighted average maturity of bonds cannot exceed 120% of the reasonably expected economic life of the project (or projects) being financed.
- Compare borrowing for building construction to borrowing for a fleet of sheriff's vehicles.
 - Different economic life schedules are weighted depending upon the classes of assets being financed.
 - Land does not enter into this equation.



Tax Considerations for County Bonds (cont.)

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.
- If money is set aside/earmarked, it must be spent first before bond proceeds can be spent.



Tax Considerations for County Bonds (cont.)

Arbitrage

- Example: Borrow money at a 3% interest rate and invest the bond proceeds at a 5% interest rate: the difference (2%) is known as “arbitrage.”
- General Rules:
 1. Arbitrage may not be earned on a tax-exempt bond issue at all except for certain categories of bond proceeds for certain periods of time. (The consequence is the loss of tax-exemption.)
 2. Arbitrage that IS earned on a tax-exempt bond issue must be “rebated” to the US Treasury.
 3. There are many exceptions. The most common are:
 - Small (under \$5 million per year) issuer
 - Spenddown (six-month, 18-month, and 24-month (construction) exceptions)
- Can be complicated.



Tax Considerations for County Bonds (cont.)

Audit and Enforcement

- If the IRS were to conduct a random/routine audit of a bond, it would (per its policy) treat the Issuer as the “taxpayer.”
- This practice is intended to ensure equitable treatment for all bondholders, who are the ones who would be harmed if the bonds were declared taxable.
- That does not mean that the Issuer is obligated to pay taxes, interest, or penalties on the bond issue (if any are due). A properly-drafted loan agreement or similar contract with the borrower will allow the Issuer to “turn over” responsibility for the audit to the borrower.
- Any costs incurred by the County will be fully secured by the borrower’s indemnification obligations to the City.



Tax Considerations for County Bonds (cont.)

Borrowing On A Taxable Basis

- Avoid tax rules
- Potentially lower transaction costs
- Can be refunded on a tax-exempt basis



Tax Considerations for County Bonds (cont.)

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) and to maintain confidentiality.






THANK YOU!




Andrew T. Phillips

 414.279.0962

 aphillips@attolles.com




Andrew J. Guzikowski

 414.758.5721

 guzikowski@attolles.com



Bennett J. Conard

 414.828.2682

 bconard@attolles.com



Thomas D. Cameron

 414.279.9271

 tcameron@attolles.com