

## **Overview of Public Indebtedness**

### **What is public indebtedness?**

Long term borrowing of money by a political subdivision.

1. Borrowing money for longer than one year.
2. Finance a capital improvement project.
3. Pay costs that cannot be covered by current revenues.

### **Who can incur public indebtedness?**

Political subdivisions.

1. State of Oklahoma
2. Counties
3. Cities and Towns
4. School Districts

### **Mechanisms for borrowing money.**

1. Incurring long-term debt by selling municipal bonds.
2. What is a bond?
  - a. Credit instrument.
  - b. Promise to repay a loan.
    1. Payment of interest on predetermined dates.
    2. Payment of principal on predetermined dates.

## Type of Bonds

### 1. General Obligation Bond----(GO)

- a. Payable from ad valorem tax levied for capital improvement project.
- b. Backed by the full ad valorem taxing power of the political subdivision.
- c. Tax exempt status.

Example:     New School Building  
              New Courthouse  
              New Library

### 2. Revenue Bonds

- a. Payable from revenue earned from the capital improvement project.
- b. Backed by the revenue from the project.

Example:     Water delivery and treatment facilities  
              Municipal or county hospital

- c. Special forms are
  - 1) Private Activity Bonds
  - 2) Also called Industrial Development Bonds

Example:     Airports and Industrial Parks

### 3. General Obligation Limited Tax Bond----- (GOLTB)

#### Limited Liability General Obligation Bonds

- a. Does not pledge full resources of political subdivisions to repay debt.
- b. Debt secured by combination of payable mechanisms.
  - 1) Ad valorem (property) tax levied for project.
  - 2) Payable from a specific fee--revenue earned from project.
  - 3) A specific tax levied for the project--sales tax
- c. Ad valorem tax need not be levied if sufficient revenue is earned from the project.

## Limitation on Public Indebtedness

1. Amount of the bond limited to allowable level of public indebtedness.
2. Allowable level of public indebtedness related to net assessed valuation.
  - a. 5% of net assessed valuation of county
  - b. Allowable level of public indebtedness computation.

$$\begin{array}{r} \text{Amount of Indebtedness Sought} \\ + \text{ Amount of Existing Indebtedness} \\ - \text{ Sinking Fund Assets} \\ \hline \text{Allowable Level of Indebtedness} \end{array}$$

- c. Sinking fund assets computation.

$$\begin{array}{r} \text{Cash Credited to Sinking Fund} \\ + \text{ Total Sinking Fund Investments} \\ \hline \text{Sinking Fund Assets} \end{array}$$

Article X, §§ 9B and 26

## Sinking Fund

1. Established to receive annual payment of ad valorem taxes for retiring a debt.
  - a. Retiring a debt refers to payment of principal.
  - b. Annual payments from ad valorem tax if GO bond.
2. Named for the capital improvement project.
  - a. Bond approval and issue can be for more than one capital improvement project.
  - b. Sinking fund created for each project.

### **Par Value**

1. Dollar value of a certificate.
2. Principal amount paid to holder of a certificate.
3. Stated in bond indenture-the legal details of the loan agreement.

### **Mechanisms for Repayment of Long-Term Debt**

1. Term Bonds
  - a. Entire principal retired in a single payment at maturity of debt.
  - b. Can mimic serial bonds by retiring portions of the principal through a call provision in the bond indenture.
2. Serial Bonds
  - a. Referred to as serial maturity.
  - b. Portion of principal comes due periodically.
  - c. Registered Bonds.
    - 1) Names and address of investors registered.
    - 2) Registered by treasurer of Board of Education.
    - 3) Interest paid name of person registered.

70 O.S. 1991 §§ 15-101 and 15-105

## Bond Quality

1. Referred to as credit quality or credit risk.
2. Factors considered in rating a political subdivision.
  - a) Debt burden--total amount of outstanding debt.
  - b) Budget Soundness
    - 1) Budgetary operations.
    - 2) Ease of balanced budget past several years.
  - c) Tax Factors
    - 1) Full value of taxable property.
    - 2) Rate of growth of taxable value.
    - 3) Tax burden.
    - 4) Tax exempt percentage of tax base.
  - d) Overall local economy.
    - 1) Composition of the tax base.
    - 2) Largest employers.
    - 3) Annual rate of population and business growth.
    - 4) Building permit trend.
3. Quality rating impacts interest rate bid.
  - a) Higher quality leads to lower interest rate.
    - 1) Implies less risk from purchasing the bonds.
    - 2) Lowers cost of servicing the debt.
  - b) Lower quality leads to higher interest rates.
    - 1) Implies greater risk from purchasing the bonds.
    - 2) Increases the cost to service the debt.

## **Bond Rating Indices**

1. Suggests Credit Worthiness of Bonds

Interpreted as ability to pay interest and principal on time.

2. Bond rating companies.

- a) Moody Investors Services

Focuses on debt burden and budgetary operations of issuer.

- b) Standard & Poor's

Focuses on the economic environment of issuer.

| Moody's Municipal Bond Ratings |                    |  |
|--------------------------------|--------------------|--|
| Rating                         | Quality            | Definition   |
| Aaa                            | Best quality       | Carry smallest degree of investment risk   |
| Aa                             | High quality       | Margins of protection not quite as large as the Aaa bonds.   |
| A                              | Upper medium grade | Security adequate but could be susceptible to impairment.  |
| Baa                            | Medium grade       | Neither highly protected nor poorly secured--lacks outstanding investment characteristics and is sensitive to changes in economic circumstances. |
| Ba                             | Speculative        | Protection is very moderate.   |
| B                              | Not desirable      | Sensitive to day-to-day economic circumstances.  |
| Caa                            | Poor standing      | May be in default but with a workout plan.   |
| Ca                             | Highly speculative | May be in default with nominal workout plan.   |
| C                              | Lowest quality     | Hopelessly in default.   |

| Standard and Poor's Municipal Bond Ratings |                               |   |
|--|-------------------------------|---|
| Rating                                     | Quality                       | Definition  |
| AAA  | Highest rating                | Extremely strong security.  |
| AA   | Very strong security          | Differs from AAA in only a small degree.                                    |
| A  | Strong capacity               | But more susceptible to adverse economic effects than two above categories. |
| BBB  | Adequate capacity             | But adverse economic conditions more likely to weaken capacity.             |
| BB   | Lowest degree of speculation  | Risk exposure.  |
| B  | Speculative                   | Risk exposure.  |
| CCC  | Speculative                   | Major risk exposure.  |
| CC   | Highest degree of speculation | Major risk exposure.  |
| C  |                               | No interest being paid.   |
| D  | Bonds in default              | Interest and/or repayment of principal in arrears.                          |

## **Professional Services**

1. Consultant Engineer
2. Financial Advisor
3. Bond Counsel
4. Paying Agent

## **Consultant Engineer**

1. Performs feasibility study.
  - a. Estimates of construction costs.
  - b. Site review.
  - c. Project drawings.
  - d. Future operating costs.
2. Prepares detailed engineering design plans and construction specifications.
3. Serves as construction coordinator.
  - a. Assists with construction contract preparation.
  - b. Assists with evaluation of construction bids.
  - c. Provides technical assistance during construction and on final inspections.

## **Financial Advisor**

1. Helps obtain public support for proposed bond.
2. Prepares and overall financial plan with consulting engineer--schedule of cash requirements.
3. Prepares schedule over which debt is issued and repaid.
4. Designs the features for marketing of the bonds.
5. Assists in marketing the bonds.
6. Organizes closing transactions at delivery of bonds.

### **Bond Counsel**

1. Acts as the legal advisor for the political subdivision.
2. Insures the legality of the bond issue.
  - a) Determines whether there is authority to issue bonds.
  - b) Drafts a bond ordinance or resolution.
  - c) Examines transcripts of proceedings to determine.
    - 1) Bonds legally advertised.
    - 2) Bonds legally sold.
    - 3) Bonds properly executed.
  - d) Prepares contracts for sale of bonds.

62 O.S. 1991 § 16

### **Bond Commissioner**

1. Attorney general serves as bond commissioner.
2. Duties include:
  - a) Preparing uniform forms.
    - 1) Transcript of proceedings.
    - 2) Summary of actions taken before issuing the bonds.
  - b) Prescribing procedures political subdivision is to follow when issuing bonds
  - c) Examining bonds before issued.
  - d) Issuing a certificate of approval.

62 O.S. 1991 §§ 11 and 13

## **Paying Agent**

1. Manages the bonds after the sale.
2. Usually contract with a trust department of a bank.
3. Notifies political subdivision of time for sending funds.
4. Makes payments to investors.
5. Maintains records.
  - a. Interest payments.
  - b. Principal payments.
  - c. Maturing bonds.
6. Redeems paid bonds.
7. Reissues bond certificates.
  - a. Bonds sold in primary and secondary markets.
  - b. Lost or destroyed original certificates.

### Steps in Debt Management

| Preliminary Planning for Bond Issue  | Preparing and Selling the Bonds                                     | Using Bonds Proceeds and Repaying Debt  |
|--|---|---|
| <p style="text-align: center;">1.</p> <p>Determine whether to issue bonds</p>    | <p style="text-align: center;">4.</p> <p>Design the bond issue.</p> | <p style="text-align: center;">6.</p> <p>Administer the outstanding debt.</p> |
| <p style="text-align: center;">2.</p> <p>Secure needed specialized services.</p> | <p style="text-align: center;">5.</p> <p>Market the bonds.</p>      |   |
| <p style="text-align: center;">3.</p> <p>Obtain voter approval</p>               |   |   |