

PROCEDURES FOR ISSUING
BANK-QUALIFIED DEBT

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- Governments generally cannot “sign a note” at a local bank.
- State Constitution and statutes must be observed in order for a borrowing to be valid and enforceable.
- Art X of the Constitution: Political subdivisions “shall have the power to incur indebtedness in the following categories and in no others:
 - (a) General obligation debt; and
 - (b) Indebtedness payable only from a revenue-producing project or from a special source.

- General obligation debt is defined as “any indebtedness which shall be secured in whole or in part by a pledge of its full faith, credit and taxing power.”

--Art. X, Sec. 14, South Carolina Constitution

General Obligation Bonds: Limitations

1. Public Purpose.
2. Corporate Purpose.
3. 8% Debt Limit or Referendum.

Uses of General Obligation Bonds

- General obligation bonds used by municipalities, typically, for projects that neither:
 - (a) generate self-sustaining revenue, such as water and sewer systems,
 - nor
 - (b) have a special source of funding available for debt service payments, such as hospitality and accommodations fees.

Uses of General Obligation Bonds

- Jails.
- Administration Facilities.
- Solid Waste Handling.
- Animal Shelters.
- Public Safety.

Revenue Bonds

- Used typically to finance utility or other infrastructure with associated user fees, or where there is a dedicated non-tax revenue stream for debt service.
- By law, a revenue bond is paid “from a revenue-producing project or a special source, which source does not involve revenues from any tax or license...”
- “Public utility systems”, such as water, sewer, gas, or electric systems cannot be established by a municipality unless first approved by referendum.
- Secured by revenues of a “System.” May include water, sewer, waste disposal, natural gas, electrical generation and distribution, hospitals, piers, docks, terminals, airports, toll roads, markets, auditoriums, and other public buildings or structures.

Lease-Purchase (It's NOT Debt)

- Computers and other small items may still be handled comfortably within some operating budgets.
- Larger, more expensive items, may require that payment be made over a period of years in order to be affordable.
- For many years, general obligation bonds were the only available means of financing such purchases.
- But general obligation bonds require debt limit.
- Lease-purchase - termed “debt limit avoidance” by academics, developed in 1980s. S.C. Sup. Court held in 1987 that lease-purchase is not subject to debt limit where the financing contract contains a “non-appropriations” clause.
- 1995 and 2006 legislation does not effect lease-purchasing for equipment. It still doesn't count against the debt limit.

Procedures for Debt Issuance

- Project identification.
- Authorizing ordinance.
- Satisfaction of applicable sale requirements
- Satisfaction of notice requirements.
- Selection of lender.
- Drafting and negotiation of transactional documents.
- Filing of debt service notice with State Treasurer.
- Filing of Transcript of Proceedings with Clerk of Court.
- Filing of Form 8038-G with Internal Revenue Service.
- Opinions.

Procedures for Debt Issuance

- Project Identification
 - Purpose of borrowing should be clearly identified.
 - Purpose must satisfy public/corporate purpose standards.
 - Material change in purpose may require amendment of authorizing ordinance and, in some cases, approval of lender
 - Beware of insufficiently developed project proposals.
 - Federal tax law requires (for tax-exemption of interest) that project be *bona fide* undertaking of the municipality, not merely a possible or potential undertaking.
 - Federal tax law further requires that proceeds of borrowing be spent according to schedules imposed by statute/IRS regulation.

Procedures for Debt Issuance

- Adoption of authorizing ordinance.
 - S.C. Code Ann. Sec. 5-7-260: Acts of municipal council which are required to be done by ordinance:
 - ...*(5) Authorize the borrowing of money.*
 - State law does not require public hearing. Does any local ordinance?
 - Petition and recall provisions: Bond ordinance (general obligation bonds only) subject to recall process by petition of at least 15% registered voters in municipality filed within 60 days of adoption of authorizing ordinance. The period can be shortened to around 23 days, with risk: the recall petition only requires 5 signatures.
 - Query: Is execution of a lease purchase contract "borrowing money"?

Procedures for Debt Issuance

- Contents of Authorizing Ordinance:
 - Recitals as to purpose and satisfaction of public purpose/corporate purpose requirement. The debt must fit into one of the permitted constitutional categories.
 - Recitals as to constitutional and statutory authority.
 - Estimate of cost of project.
 - Recitals as to debt limit, if applicable.
 - Details of obligation: Amount, interest rate, repayment schedule, redemption features. May be delegated.
 - Mechanics of periodic payments; registration of owner of obligation
 - Method of sale.
 - Tax-exemption.
 - Authorize Mayor and administrative personnel to handle the process, sign appropriate documents, etc.

Procedures for Debt Issuance

• Sale Requirements:

- Lease-purchase and revenue debt may be sold by “negotiation” under State law.
- General obligation debt must be sold by competitive sealed bid if principal amount exceeds \$1,500,000 or term exceeds 10 years.
- Some procurement ordinances are drafted broad enough to require some form of competitive bidding despite exclusion in State law.

Procedures for Debt Issuance

• Notice of Sale for General Obligation Debt:

- Sealed bid sale requires prior publication of notice of sale 7 days prior to bid opening in a newspaper of general circulation in the State. (Is there such a thing anymore?)
- Negotiated sale requires publication of notice of sale 7 days prior to closing.
- Does any local ordinance alter these provisions?

Procedures for Debt Issuance

• Selection of Lender:

- Local banks
 - Often more willing to overlook credit quality.
 - Interest rate may or may not be competitive.
 - Less knowledgeable in many cases of the finer points.
- Regional and nation-wide banks.
 - Specialized municipal bankers on staff.
 - More focused on credit quality.
 - More likely to be competitive on interest rates.
- USDA-Rural Development
 - Provides long-term (up to 40 years) financing for qualified borrowers
 - Can take several years to qualify and have funding approved.
- State Revolving Loan Fund (water and sewer only)
 - Attractive interest rates, up to 20 year terms. Limited funds availability and significant period to quality.
- Equipment vendor
 - Avoid: Higher rates, less flexibility.

Procedures for Debt Issuance

- Selection of Lender:
 - In most cases, goal is to obtain the lowest cost of funds for client.
 - In some instances, source of lowest cost funds, e.g. public offering or USDA, may also present a burden with respect to staff allocation and time.
 - Public offering will typically provide lowest cost of funds to issuer with good credit ratings, but maybe not so as to issuers with lower or no ratings.
 - Issuer should go through the exercise of comparing available rates before making final determination. This becomes more compelling as the size of the financing increases.

Procedures for Debt Issuance

- Selling the Debt—Talking to your banker:
 - Be clear as to the type of debt, the term, the frequency of payments, the tax status.
 - Revenue debt will require negotiation of various covenants; must make sure that any prior covenants then in place are satisfied.
 - Establish any terms in addition to covenants that the bank will require: origination fees, payment of bank counsel fees, continuing disclosure and audit availability requirements.
 - Will the bank require a depository relationship? To what extent?
 - Agreement as to schedule: banks will typically hold a fixed rate for no longer than 30 days; 45 days is possible in a few cases.
 - What opinions will bank require at closing?
 - Will the bank require a bond counsel opinion?

Procedures for Debt Issuance

- Transactional Documents:
 - Authorizing ordinance.
 - Proof of debt limit availability for g.o. bonds.
 - Affidavits of Publication.
 - Proof of compliance with applicable bidding rules.
 - Filing of Debt Issuance Notice with State Treasurer.
 - Closing certification from municipal officials.
 - Instructions for handling of money.
 - Tax Certificate (if > \$1 million).
 - IRS Form 8038-G.
 - Opinions.
- Filing Transcript of Proceedings with Clerk of Court:
 - Required by Section 11-15-10.
 - Commences 20 day statute of limitations.
 - Probably doesn't apply to lease-purchase.

Procedures for Debt Issuance

- **IRS Form 8038-G**
 - Must be filed to establish tax-exempt status of borrowing.
 - Deadline is 15th day of second month of calendar quarter following quarter in which closing occurs.
 - New form requires additional information, including a question as to whether the issuer has adopted procedures to remedy non-qualified bonds and track requirements of Section 148 of the Internal Revenue Code. Dilemma.

Procedures for Debt Issuance

- **Opinions:**
 - Legal status of issuer.
 - Due enactment and enforceability of authorizing ordinance.
 - Enforceability of debt obligations.
 - Compliance with applicable laws and regulations.
 - No unfulfilled predicate consents.
 - Compliance with issuer's procurement rules (lease-purchase).
 - Absence of relevant and material litigation, pending or threatened.
 - Tax opinions:
 - State.
 - Federal.
 - 265(b)(3)(B) - "Bank-Qualified."

Procedures for Debt Issuance

- **Opinions:**
 - Federal tax exemption conditions:
 - All procedures followed (only valid borrowings can be exempt).
 - Tax certificate executed if borrowing > \$1 million.
 - Arbitrage and private use issues.
 - Bank Qualification conditions:
 - Obligation may be federally tax-exempt, but not "bank qualified"
 - May be designated as "bank qualified" if \$10 million or less of tax-exempt debt issued by the issuer in current calendar year. May provide favorable interest rate from bank.
 - "Issuer" may include subordinate entities, such as a city housing authority.
 - Special rules for dealing with refunding obligations
 - Includes all tax-exempt debt, e.g., equipment lease-purchase, as well as general obligation bonds and revenue bonds.

- Opinions: Review Professional Liability Coverage

- Does your carrier insure against opinions regarding tax-exempt obligations?
- Does your carrier insure against opinions regarding the issuance of securities?
