

## Water & Sewer Financing for Small Governmental Units

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## Dillon's Rule

- Political subdivisions have only those powers expressly granted to them by the legislature or necessarily implied.
- Alive and well in Ohio.
- Applies to townships, but has limited application to municipal corporations, because . . .

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## Municipal Home Rule

- Municipal Home Rule turns Dillon's Rule on its head.
- Municipal corporations have all powers of local self-government, and authority to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws. Ohio Const. Art. 18, Section 3.

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## Municipal Home Rule

- But the General Assembly may limit municipal corporation's ability to levy taxes and incur debts. Ohio Const. Art 18, Section 13.
- General Assembly may limit taxation, assessment, borrowing money, contracting debts, and loaning credit. Ohio Const. Art. 13, Section 6.

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## Township Limited Home Rule

- Township Home Rule is a limited grant of authority, given by the General Assembly to townships. R.C. 504.
- Because it's not constitutional, General Assembly can take it away.

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## Authority to Own & Operate (Municipal Corporations)

Is power to own and operate a power of local self-government? It is unnecessary to answer that question because the constitution itself provides that authority:

- Any municipality may acquire (by condemnation or otherwise), construct, own, lease, and operate within or without its corporate limits, any public utility to supply the municipality or its inhabitants. Ohio Const. Art 18, Section 4.

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### Authority to Own & Operate (Municipal Corporations)

- A municipality may acquire the property and franchise of any company or person supplying the municipality or its inhabitants with utility services. Ohio Const. Art. 18, Section 4.

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### Authority to Own & Operate (Municipal Corporations)

Power to sell product or service outside of municipality.

- Any municipality, owning or operating a public utility . . . may also sell and deliver to others . . . the surplus product. Ohio Const. Art. 18, Section 6.

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### Authority to Own & Operate (Municipal Corporations)

- May acquire property for any municipal purpose. R.C. 715.01.

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### Authority to Own & Operate (Municipal Corporations)

- Provide for water supply and necessary production and distribution system. R.C. 715.08.
- Construct or acquire waterworks for supplying water to the municipal corporation and its inhabitants and extend the waterworks system outside of the municipal corporation limits. R.C. 717.01(G).

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### Authority to Own & Operate (Municipal Corporations)

- Extend aqueducts and water pipes outside municipal corporation limits. R.C. 743.12 -.16.
- Or in contiguous municipal corporation with “assent” of other municipal corporation. R.C. 743.17.

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### Authority to Own & Operate (Municipal Corporations)

- Provide sewage disposal system, sewers, drains, & ditches. R.C. 715.40.
- Repair or reconstruct sewer, ditch, or drain. R.C. 729.46.
- Construct and maintain sewer pumping stations, building, machinery, & apparatus. R.C. 729.47.
- Acquire land outside municipal corporation limits for sewer farm. R.C. 729.48.
- Construct sewers, sewage disposal works, flushing tunnels, drains, and ditches. R.C. 717.01(J).

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## Authority to Own & Operate (Townships)

There is no authority for a township to own and operate sewer or water facilities, except:

- a statutory, limited home rule township;
- a township TIF.

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## Authority to Own & Operate (Townships)

Limited Home Rule Township:

- Created by statute, not by Constitution.
- Can be created in a Township with a population > 3,500.
- Powers include: construct and operate water supply facilities and sewer improvements to supply water and provide sewer services in unincorporated area of township. R.C. 504.20 (A).

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## Authority to Own & Operate (Townships)

Township TIF. R.C. 5709.73-75.

Definition of public infrastructure improvement in R.C. 5709.73(A)(5)—same meaning as in R.C. 5709.40 (municipal corporation TIF):

“Public infrastructure improvement” includes, but is not limited to, water and sewer lines; stormwater and flood remediation projects, including such projects on private property when determined to be necessary for public health, safety, and welfare.

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## Authority to Own & Operate (Townships)

- Lease-purchase agreement to acquire the any real or personal property that township is authorized to acquire. R.C. 505.267(B).
- Acquire hydrants and provide for a water supply for fire-fighting purposes. R.C. 505.37.
- Repair and maintain "private sewage collection tiles" (sanitary sewers installed by private person and serving at least 5 one-, two- or three-family residences), and assess the costs against the benefitted property owners. R.C. 521.
- Make loans and grants to other political subdivisions for water or sewer facilities. R.C. 505.705.

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## Authority to Contract with Others (Municipal Corporations)

- Any municipality . . . may contract with others for any . . . product or service of a public utility. Ohio Const. Art. 18, Section 4.
- **Water.** Contract with any individual or an incorporated company for supplying water. R.C. 743.24.
  - Contract must be ratified by voters.
  - Same power to protect the water supply and prevent the pollution of the water supply as if the water works were owned by municipal corporation.
- **Sewer.** Sewer contract with the County to acquire sewer facilities, and may jointly use them with County. R.C. 6117.05(B).

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## Authority to Contract with Others (Municipal Corporations)

Agreement with other municipal corporation or political subdivision for joint construction or management of any public utility or for the joint exercise of any power conferred on municipal corporations or other political subdivisions by the constitution or laws. R.C. 715.02.

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## Authority to Contract with Others (Municipal Corporations)

- Contract with other municipal corporations to create Joint Economic Development Zone (JEDZ). R.C. 715.69.
- Both may contribute to improvements in JEDZ, including services, money, and equipment.
- Share income tax.
- If already have utility agreement, amendment or renewal can't be part of consideration, unless determination of economic development benefit, other consideration, and no duress.

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## Authority to Contract with Others (Municipal Corporations)

- Two municipal corporations may jointly construct main sewer and branches, R.C. 729.42, and jointly own and operate. R.C. 729.45.
- Two municipal corporations may jointly construct and maintain waterworks. R.C. 743.19.
- Contract to supply water to other municipal corporation. R.C. 743.18.

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## Authority to Contract with Others (Townships)

- Contract with County. Township pays all or portion of cost of constructing, maintaining, repairing, or operating any water supply improvement established within the limits of the township. R.C. 6103.031.
- May levy taxes to pay contract obligations, subject to R.C. 5705, and issue bonds, subject to R.C. 133. R.C. 505.263.

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## Authority to Contract with Others (Townships)

- Contract with private water company or sewage disposal company to supply water to, or dispose of sewage from, Township public places. R.C. 4933.01.
- No provision to contract with County for sewage disposal under R.C. 6117, unlike municipal corporations.
- Make loans and grants to other political subdivisions for sewer and water facilities, including costs of construction and debt service. R.C. 505.705. Including a regional water & sewer district.

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## Authority to Contract with Others (Municipal Corporations & Townships)

- Municipal corporation may contract with township to create a JEDZ.
- Both parties may contribute to improvements in JEDZ, including services, money, and equipment.
- Board of Directors of JEDZ may levy income tax, which may be used for purposes of JEDZ and municipal corporation. R.C 715.691.

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## Authority to Contract with Others (Municipal Corporations & Townships)

- Municipal corporation & townships may contract to create Joint Economic Development District (JEDD). R.C. 715.70 - .90  
Separate provisions for charter counties.
- Each party may contribute to improvements in JEDD, including services, money, real & personal property, facilities, and equipment.
- Share revenues from taxes levied by a contracting party if revenues may be lawfully applied to that purpose under legislation levying the tax.
- Can't use to coerce amendment, renewal, or termination of existing utility contract. Rebuttably presumed to be coercion if within 5 years, unless otherwise proven by clear and convincing evidence.

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## Authority to Contract with Others (Municipal Corporations & Townships)

- Create regional water & sewer district under R.C. 6119.
- Can supply water and sewer services in its area.
- Can contract with municipal corporations and townships to provide those services.

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## Authority to Finance (Municipal Corporations)

Ohio Constitution – Mortgage Revenue Bonds

- Any municipality which acquires, constructs or extends any public utility . . . may issue mortgage bonds . . . beyond the general limit of bonded indebtedness prescribed by law. Ohio Const. Art. 18, Section 12.
- Mortgage bonds . . . shall not impose any liability upon such municipality, but shall be secured only upon the property and revenues of such public utility. Ohio Const. Art. XVIII, Section 12.

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## Authority to Finance (Municipal Corporations)

General Obligation (GO) securities. R.C.133.

- Authorized to issue securities to pay cost of any permanent improvement that the political subdivision is authorized to acquire or construct. R.C.133.15.

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## Authority to Finance (Municipal Corporations)

Finance Joint construction & ownership.  
R.C. 715.02.

- Each municipal corporation or other political subdivision may issue bonds for its portion of the cost of any utility if Chapter 133 would authorize the bonds if the municipal corporation or other political subdivision were acting alone. R.C. 715.02(D).

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## Authority to Finance (Municipal Corporations)

- OWDA loan. R.C. 6121. Borrow from OWDA to pay costs of water development projects, which includes sewer and water facilities.
- OPWC loans. R.C. 164. Loans for water and sewer purposes.

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## Authority to Finance (Townships)

Limited Home Rule Township.

- GO Securities.  
R.C.504.20(B). R.C. 133.15.
- Special Assessment GO Securities  
R.C. 504.18(C). R.C. 133.15, R.C. 133.17.

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## Authority to Finance (Townships)

### Township Notes.

- Contract for the purchase of equipment, buildings, and sites, or for the construction of buildings, for any lawful township purpose. R.C. 505.262.
- Issue securities of the township to finance purchases and construction.
- Probably doesn't include water and sewer supply and distribution facilities, but would include buildings, land, and equipment in connection with those facilities.

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## Authority to Finance (Townships)

### Township TIF Bonds. R.C. 5709.73.

- Finance public infrastructure improvements.
- Pledge service payments by private entity.

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## Rates & Charges

### Municipal Corporations – Villages

- Board of Trustees of Public Affairs (BTPA) establishes water rents and charges. R.C. 735.29.
- If Village Administrator, BTPA is abolished and Village Council establishes the rates. R.C. 735.273.
- BTPA manages sewer system and collects sewer charges, unless there's a Village Administrator. R.C. 729.50.
- But Village Council establishes sewer rates. R.C 729.49.

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## Rates & Charges

Limited Home Rule Townships.

- Board of Trustees establish rates and charges for water supply and sewer services. R.C. 504.20(C).

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## Rates & Charges

Use of revenues. Municipal corporation Sewer Fund.  
R.C. 729.52 .

- Cost of management, maintenance, operation, and repair of the sewerage system.
- Surplus used for the enlargement or replacement of the system and works, for construction and reconstruction of main and interceptor storm sewers, for the payment of debt incurred for the construction.
- **Surplus shall not** be used for the extension of a sewerage system to serve unsewered areas or for any other purpose.

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## Rates & Charges

Use of revenues. Municipal corporation Water Fund. Sections R.C. 735.05, R.C. 735.06.

- Pay expenses of conducting and managing the water works.
- Any surplus **may** be applied to the repairs, enlargement, or **extension** of the works or of the reservoirs, and payment of principal and interest on debt.

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## Rates & Charges

Limited Home Rule Township.

- Pay costs of constructing and otherwise improving, and operating, maintaining, and repairing system. R.C. 505.20(C).

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## Rates & Charges – Assessments

Municipal corporations.

- Assess for storm and sanitary sewer improvements and water system improvements, including planning costs.
- Assess benefitted property owners.
- Assessments can't exceed benefits, and can't exceed 1/3 of value of assessed land. R.C. 727.03.
- Assessments for main sewers can't exceed cost of "ordinary" sewer, and can't assess land that is "adequately drained." R.C. 727.03.

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## Rates & Charges – Assessments

- Cooperative agreement between two municipal corporations if improvement to be in boundary street. R.C. 727.41.
- Two municipal corporations may jointly construct main sewer and branches, R.C. 729.42, and assess the cost. R.C. 729.43.
- Municipal corporation may establish districts for sanitary sewerage, storm sewerage, and water supply, R.C. 727.44 and assess costs within each district, separately, as a single improvement. R.C. 727.49.
- Municipal corporation may require water and sewer connections. R.C. 729.06 If work not done by property owner within 30 days, municipal corporation may do the work and assess property owner.

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## Rates & Charges – Assessments

Finance Joint construction & ownership. R.C. 715.02.

- An agreement may provide for either of the following:
  - Assessing the cost of the joint construction, maintenance, or management upon abutting property.
  - Assessing the cost of constructing, maintaining, or managing any utility upon the property within a district.

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## Rates & Charges – Assessments

Limited Home Rule Townships.

- Assess costs of water supply facilities and sewer improvements, including plans, damages, and costs of improvement. R.C. 504.18(C), R.C. 504.19.

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## Types of Financing (Municipal Corporations)

Our old friend, Mortgage Revenue Bonds

- Mortgage bonds . . . shall not impose any liability upon [the] municipality, but shall be secured only upon the property and revenues of such public utility. Ohio Const. Art.18, Section 12.
- [Security includes] a franchise stating the terms upon which, in case of foreclosure, the purchaser may operate [the utility], which franchise shall in no case extend for a longer period than twenty years from the date of the sale of such utility and franchise upon foreclosure. Ohio Const. Art.18, Section 12.

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## Types of Financing (Municipal Corporations)

Mortgage Revenue Bonds.

- Secured only by revenues of utility and a mortgage on the utility (hence the name), and a franchise to operate the utility.
- No other revenues of the Village may be charged for the payment of principal and interest.

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## Types of Financing (Municipal Corporations)

General Obligation (GO) Bonds and Bond Anticipation Notes (BANs).

- The full faith and credit of the Village is pledged for the payment of principal and interest on the securities.
- That means all revenues of the Village may be used (with minor exceptions), and are pledged to that payment.

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## Types of Financing (Municipal Corporations)

Voted GO Securities.

- Authorized by the voters. Requires majority vote.
- Voters authorize a tax to pay principal and interest at the same time they authorize the issuance of the bonds.

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## Types of Financing (Municipal Corporations)

Unvoted GO Securities.

- Authorized by action of Village Council.
- Requires a majority vote of Council, unless an emergency measure.

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## Types of Financing (Municipal Corporations)

GO securities (both voted and unvoted) may also be supported by a pledge of utility revenues.

- This is called a “double-barreled” security.
- Helps the marketability, and hence the interest rate.

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## Types of Financing (Municipal Corporations)

Special Assessment Bonds and BANs.

- Also a double-barreled security: full faith and credit and special assessments.
- Could also pledge the revenues of the utility, and make it a triple-barreled security.

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## Types of Financing (Townships)

Limited Home Rule Townships.

- General Obligation (GO) Bonds and Bond Anticipation Notes (BANs)
- The full faith and credit of the Township is pledged for the payment of principal and interest on the securities
- That means all revenues of the Township may be used (with minor exceptions), and are pledged to that payment.

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## Types of Financing (Townships)

Voted GO Securities.

- Authorized by the voters. Requires majority vote.
- Voters authorize a tax to pay principal and interest at the same time they authorize the issuance of the bonds.

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## Types of Financing (Townships)

Unvoted GO Securities.

- Authorized by action of Board of Township Trustees.
- Requires a majority vote of Trustees.

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## Types of Financing (Townships)

- GO securities may also be supported by a pledge of utility revenues – double barreled.
- Helps the marketability, and hence the interest rate.

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## Types of Financing (Townships)

Special Assessment Bonds and BANs.

- Also a double-barreled security: full faith and credit and special assessments.
- Could also pledge the revenues of the utility, and make it a triple-barreled security.

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## Types of Financing (Townships)

- Township Notes under R.C. 505.262, to finance purchases under that section. Buildings and equipment. Probably not lines and other facilities.
- GO bonds under R.C. 133 to finance costs of water supply improvements under contract with County under R.C. 6103. R.C. 505.263.

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## Types of Financing (Townships)

Township TIF notes for public infrastructure improvements. R.C. 5709.73(H).

- Not subject to R.C. 133.
- Payable solely from TIF service payments.
- Money in tax increment equivalent fund used to pay costs of public infrastructure improvements. R.C. 5709.75(B).

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## Limits on Financing Direct Debt Limit

- This only applies to GO debt. Mortgage Revenue Bonds are not subject to this limit.
- This limit is measured by a percentage of the governmental unit's assessed valuation.
- Municipal corporations' limits are
  - 5-1/2% of AV for unvoted, non-exempt debt.
  - 10-1/2% of AV for all (voted and unvoted), non-exempt debt.

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## Limits on Financing Direct Debt Limit

- Limited Home Rule Townships' limits are same as municipal corporations—5½% and 10½%.
- Townships' limits are
  - 0% for unvoted, non-exempt debt
  - 5% for all (voted and unvoted) non-exempt debt.

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### Limits on Financing Direct Debt Limit

- The good news – exempt debt.
- Some utility Debt is exempt from the direct debt limit:
  - Self-supporting debt – the revenues from the utility are sufficient to pay O&M, and debt service
  - Special assessment debt.

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### Limits on Financing Indirect Debt Limit

- Only applies to unvoted GO debt.
- Mortgage Revenue bonds not affected.
- Voted GO debt not affected.
- Sometimes referred to as the 10-mill limit.
- Debt exempt from direct debt limit is **not** exempt from the indirect debt limit.

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### Limits on Financing Indirect Debt Limit

- Total annual tax burden on a parcel required in any year to pay principal and interest on all unvoted debt of all overlapping subdivisions can't exceed 10 mills.

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## Limits on Financing Indirect Debt Limit

### Example

- County has \$2 billion AV, and \$50 million of unvoted debt.
- Village has \$500 million AV, and \$25 million of unvoted debt.
- School District has \$1 billion AV, and \$1 million of unvoted debt.
- Township has \$100 million AV, and \$2 million of unvoted debt.



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## Limits on Financing Indirect Debt Limit

- County's annual debt service is \$5 million, which requires a tax levy of 2.5 mills.
- Village's annual debt service is \$2.5 million (5.0 mills).
- School District's annual debt service is \$100,000 (0.1 mill).
- Township's annual debt service is \$200,000, (2.0 mills).



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## Limits on Financing Indirect Debt Limit

- The sum of the County, Village, and School District levy is 7.6 mills, which leaves 2.4 mills available.
- The sum of the County, Township, and School District levy is 4.6 mills, which leaves 5.4 mills available.



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### Limits on Financing Indirect Debt Limit

- Village proposes to issue \$25 million of additional unvoted GO debt.
- Would require an additional 5.0 mills of taxes.
- Total millage would be 12.6 mills, so the Village couldn't do that.
- Maximum unvoted debt Village could issue is about \$11.5 million – and that would leave no room for County or School District to issue any more debt.

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### Limits on Financing Indirect Debt Limit

- Township proposes to issue \$6 million of additional unvoted GO debt.
- Would require an additional 6.0 mills of taxes.
- Total millage would be 10.6 mills, so the Township couldn't do that.
- Maximum unvoted debt Township could issue is about \$5.3 million – and that would leave no room for County or School District to issue any more debt.

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### Limits on Financing Revenue Coverage Limits

- This is a practical or contractual limit.
- Applies to revenue issues, but also important for GO issues expected to be paid from utility revenues.
- Rates and charges for service of utility must produce, annually, a sufficient amount to pay O&M, to pay debt service, and to provide a reserve for future repairs & restoration.

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### Limits on Financing Revenue Coverage Limits

- If you have Mortgage Revenue Bonds outstanding, this will be a covenant in your indenture.
- Will require Village to set rates and charges so as to produce sufficient revenues to pay O&M, set aside reserves, and cover DS by a certain percentage – 115% for example.

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### Limits on Financing Revenue Coverage Limit

- For a first issue of mortgage revenue bonds, the market may demand a feasibility study to demonstrate projected coverage.
- Usually performed by an engineering or accounting firm.

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### Limits on Financing Federal Tax Laws

- These only apply if the interest on the debt will be tax-exempt.
- In the current market, that may not be such an advantage.

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## Limits on Financing Federal Tax Laws

Private activity bonds.

- No more than 10% used in the trade or business of a non-exempt person.
- Raises the question of lending aid and credit under Ohio Const. Article 8, Section 6.

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## Limits on Financing Federal Tax Laws

Arbitrage & Arbitrage Rebate.

- Can't invest bond proceeds at a yield greater than the yield on the bonds.
- Exceptions for temporary construction period (3 years), minor portion (lesser of 5% or \$100,000), and reasonably required reserve fund (only available for revenue bonds).
- Must rebate arbitrage profit to IRS every 5 years.

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## Limits on Financing Federal Tax Laws

Bank Qualified Bonds (Qualified Tax-exempt Obligations).

- Available to small issuers to permit them to sell bonds to a bank at a tax-exempt rate.
- Maximum \$10 million.

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## Limits on Financing Federal Securities Laws

- Requires primary and secondary market disclosure.
- Primary is the disclosure document used to market the bonds – the official statement.
- Secondary is an annual continuing disclosure filing with MSRB.
- Overlay to these disclosure requirements are the anti-fraud provisions.

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## Jefferson County, Alabama

Can it Happen to You?

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## Jefferson County, AL

- What happened in Jefferson County probably can't happen to you unless you really try.
- Because here's what happened in Jefferson County:
  - Fraud – bribes in the project.
  - Mismanagement – too much variable debt.
  - More Fraud – bribes in the bond issues.
  - Default.
  - Bankruptcy (and lots of litigation).

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## The Project

- In 1997, Jefferson County entered into a consent decree with the Federal Environmental Protection Agency with respect to its sewer system.
- The County agreed to:
  - Pay a \$750,000 fine; and
  - Improve the system at an original estimated cost of \$1.5 billion. Costs eventually blossomed to \$3 billion.

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## The Fraud

- From 1997-2002, approximately \$1.4 billion in sewer revenue warrants were issued.
- By 2002, an FBI investigation into the sewer system's construction program results in the conviction of 21 people, including former county commissioners, county employees, and sewer contractors, mostly related to giving or receiving bribes in connection with construction of the sewer project.

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## Mismanagement

- Beginning in 2002, the county began refinancing its sewer debt, generally by issuing variable rate debt with swaps.
- Prior to these transactions, approximately 95 percent of the sewer bonds were traditional fixed-cost securities.
- After the refinancings, 93 percent of the bonds carried variable interest rates, including \$2.1 billion of auction-rate securities.

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## Fraud

- For bribes relating to the debt issuance and the interest rate swaps:
  - JP Morgan Chase settled with the SEC and paid a \$25 million fine and forfeited \$648 million in swap termination fees.
  - The President of the County Commissioners, a local investment banker, and a local lobbyist ended up being indicted and pleading or being found guilty of conspiracy, bribery, and fraud.
  - Sentences ranged from 4 to 15 years in prison.

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## More Fraud

- Remember those variable rate bonds? They were synthetically fixed through various interest rate swaps with a notional value of \$6.2 billion.
- It is estimated that the County was overcharged by approximately \$100 million dollars in swap fees, mostly in connection with various bribes.

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## Default

- Not surprising, with all of its variable rate debt (with much of it inflated as a result of the fraud), the County was ill prepared to handle the 2008 market meltdown.
- Auction-rate bonds and letter-of-credit-backed bonds all went to the default rate after downgrades of the insurers or the credit-facility providers.
- While the rates on the bonds were rising, the interest rate on the swaps were plummeting, meaning the swaps weren't working.

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## Default

- In addition, a local tax that provided 1/3 of the County's funds was ruled unconstitutional, as were several other attempts to reinstitute the tax.
- So at the same time the variable rate and swaps stopped working, the County lost a huge portion of its general fund revenues.
- Chaos results.

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## So What's the Take-Away?

- Malfunctioning variable rate debt certainly played a role in Jefferson County's default/bankruptcy, but it wasn't the "cause."
- Nonetheless, if you issue variable rate debt, you must understand what happens if it "stops working."
  - What's the all-hold or default rate for failed auctions or remarketings?
  - What's the period for reimbursing the letter of credit provider for an advance?
  - What happens when a swap stops "working?"

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## THE END

(Now you know everything I know.)

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