

## **DEBT MANAGEMENT**

### **PURPOSE**

Pursuant to Massachusetts General Law, municipalities may issue debt to finance capital projects and, under extraordinary circumstances, for non-capital purposes. The purpose of this policy is to guide the Town of Montague in making decisions regarding the issuance of debt needed to maintain capital assets, yet at a level that recurring revenue can support without adversely affecting the delivery of local services.

### **APPLICABILITY**

This policy applies to the Select Board, Town Administrator, Finance Committee and the Capital Improvement Committee in their capacity as budget decision makers, and to the Town Accountant and Treasurer/Collector in regard to their responsibility to manage the issuance of debt.

### **DEFINITIONS**

Annual Budget – comprised of requests for funding for general fund operations, enterprise fund operations and capital projects.

Arbitrage - investing funds borrowed at a lower interest cost in investments providing a higher rate of return.

Betterment or Special Assessment - a special property tax that is permitted where real property within a limited and determinable area receives a special benefit or advantage, other than the general advantage to the community, from the construction of a public improvement.

Bond anticipation note (BAN) – a short-term note issued to provide cash for initial project costs. BANs may be issued for a period not to exceed five years but require a reduction of principal after two years. At maturity a BAN can be retired in full, or converted to a long-term bond.

Bond counsel – special legal counsel with expertise in the issuance of municipal bonds hired to ensure that all aspects of a bond issue - from town meeting authorization to bond sale to post-sale reporting and disclosure - conforms to all applicable state and federal law and regulation.

Capital Outlay Expenditure Exclusion – authorized by Massachusetts General Laws (M.G.L. c. 59, § 21C (i1/2)) is a mechanism that allows a community to raise the total dollar cost of a capital purchase or capital project through a one-year increase in the tax levy. In this way, the municipality avoids long-term interest costs, if it were to borrow the needed funds. A capital exclusion can only be used to fund purposes, specified in Ch. 44 Sec. 7 and Sec. 8, for which a community may incur debt.

Debt service – the annual amount of principal and interest paid on a bond, typically twice a year with one payment for principal and interest and the other for interest only.

Enterprise Fund - a separate accounting and financial reporting mechanism for which revenues and expenditures are segregated into a fund with financial statements separate from all other governmental activities. An enterprise fund identifies the total direct and indirect costs to provide the service and the

sources and amounts of revenues that support a service for which a fee is charged in exchange for the service, an example being the delivery of sewer services.

Exempt debt – authorized by Massachusetts General Laws (M.G.L. c. 59, § 21C (j)) is General Fund debt financed outside the limits of Proposition 2 ½ pursuant to a debt exclusion vote approved by a majority vote of registered voters in the town.

Financial Advisor – hired by a municipality to advise on the structure of a bond issue, finalize bond financing plans, develop offering documents, prepare for any rating agency and investor presentations, market the bond offering to investors, price the bonds, close the transaction and assist with any post-closing disclosure requirements.

General Fund - the primary fund used by a governmental entity. This fund is used to record all revenues and expenditures that are not associated with special-purpose funds. e.g., enterprise funds, grant funds and revolving funds. The activities being paid for through the general fund constitute the core administrative and operational tasks of a municipality.

Non-exempt debt – General Fund debt financed within the limits of Proposition 2 ½

Official Statement - a document containing information about a prospective bond issue or a note issue which contains information about the issue and the issuer and is intended for the potential investor. The official statement is sometimes published with a notice of sale. It is sometimes called an offering circular or prospectus.

Proposition 2 ½ - pursuant to Massachusetts General Law (M.G.L. c. 59, § 21C (f)), a limit in the annual increase in a municipality's property tax levy to 2 ½ percent plus an increase attributable to new construction in the town. In addition, upon voter approval property taxes may increase beyond the limits of Proposition 2 ½ on a permanent basis to fund increases in the operating budget or on a temporary basis to fund capital improvements.

## POLICY

The Town's policy regarding debt management shall be as follows:

- The means of identifying projects that are candidates for debt financing shall be an annual capital planning process (see the Town's Capital Planning and Financial Reserves policies).
- It is recognized that large capital investments, other than those voted through a capital outlay expenditure exclusion pursuant to Proposition 2 ½, cannot be financed on a pay-as-you go basis with current revenue without the risk of adversely affecting general fund or enterprise fund operating budgets. Therefore, it shall be policy that capital projects in excess of \$25,000 are appropriate for financing through the issuance of debt.
- Major new construction projects or significant renovations and capital expenditures in excess of \$500,000 to be funded in the General Fund shall be subject to voter approval through a Proposition 2 ½ debt exclusion.

**Commented [RA1]:** The Town's 2014 policy speaks to funding capital with a cost less than \$25K and a useful life less than 5 years with current revenue in the operating budget.

Does policy want to address the minimum project cost to be funded through debt with those projects between \$25K and the minimum debt threshold to be funded in special articles on a pay-as-you-go basis with general fund revenue, non-recurring revenue and/or reserves (free cash, capital stabilization funds, overlay surplus, etc.?)

Do you want to work language in here from the 2014 policy that states the following:

*"The Town will, to the extent possible, use available funds such as Free Cash, prior year special article surpluses, grants, etc. to reduce the amount of borrowing required for a Capital Project."*

**Commented [RA2]:** The term "capital expenditures" is from the 2014 policy. If the town needed to buy a major piece of equipment in excess of \$500,000, would the requirement for a debt exclusion vote be applicable?

**Commented [RA3]:** I added this reference so that enterprise fund projects would not be subject to this requirement.

- The Town will endeavor to structure non-exempt, exempt and enterprise fund debt in a manner that will minimize the impact on taxpayers and ratepayers.
- Projects recommended for funding through the issuance of debt shall not be approved without an estimate of the annual debt service that will result from bonds issued and consideration of the impact the debt service will have on the Town's annual budget. In this regard, the Town will endeavor to manage debt so as not to exceed the following target:
  - Total General Fund, non-exempt, long term debt service (including the Town's share of GMRSB debt service) as a percentage of the Town's Prior Year's General Fund Operating Revenue shall not exceed 10 percent with a target of 5 percent. In addition, as a general rule, the Town shall strive to maintain a debt service floor of 2 percent of the Prior Year's General Fund Operating Revenue representing a commitment to maintaining its capital assets from recurring revenue.
- Annual debt service in a given fiscal year shall not grow at a rate that exceeds the projected percentage increase in general fund revenue for that year.
- Notwithstanding the maximum terms allowed by Massachusetts General Law (M.G.L. c. 44, §§ 7-8) for the issuance of bonds, the Town will (1) seek to limit the term so that it is equal to or less than the Town's estimate of the useful life of the asset being financed; (2) for a given purpose, strive to issue debt for a shorter period than the maximum term allowed when that term exceeds 10 years; and, (3) except for major buildings, sewer projects and land acquisition, limit bond maturities to no more than 10 years. Under no circumstances should the Town schedule debt for repayment for a term greater than 30 years unless required to do so by the USDA.
- In an effort to free up capacity within the annual general fund debt service budget to accommodate proposed capital projects to be financed through the issuance of debt, The Town will (1) attempt to maintain a long-term debt schedule so that at least 50% of the outstanding principal will be retired at the end of 10 years; and, (2) generally, issue debt on a level principal/declining interest basis (so that annual debt service will decline over the term of the bond).
- The Town, with advice from its financial advisor, shall endeavor to issue debt with call dates to facilitate refunding if the interest rate environment changes to the Town's advantage.
- The Town will strive to maintain, if not enhance, its bond rating through the development of policies and procedures that address the following evaluative criteria used by rating agencies in evaluating a municipality's creditworthiness.
  - Debt Factors: debt per capita, debt as a percentage of equalized valuation, rate of debt amortization and the amount of exempt versus non-exempt debt.

**Commented [RA4]:** Is the reference to USDA still relevant?

- Financial Factors: Operating surpluses or deficits, free cash as a percentage of revenue, state aid reliance, property tax collection rates, unfunded pension liability.
  - Economic Factors: property values, personal income levels, tax base growth, tax and economic base diversity, unemployment rates and population growth.
  - Management Factors: governmental structure, the existence of a capital improvement plan, the quality of accounting and financial reporting, etc.
- Short-term financing for capital projects, reimbursable grants or in anticipation of property tax collections through internal borrowing or the issuance of bond, grant or tax anticipation notes is appropriate. Internal borrowing shall be in compliance with Massachusetts General Laws (M.G.L. c. 44, § 20A) based on the Treasurer’s assessment of the Town’s cash flow position and the availability of surplus cash, and the current interest rate environment for (1) the investment of Town funds, and (2) rates for short and long-term borrowing, with the understanding that an internal borrowing not retired by June 30 of a fiscal year through the issuance of a short-term note, a bond or the receipt of grant funds may adversely affect the Department of Revenue’s certification of the Town’s free cash.
  - Notwithstanding the maximum terms for the issuance of debt prescribed by Massachusetts General Laws (M.G.L. c. 44, §§ 7-8 ), it shall be the policy of the Town to limit the term of a bond issued to finance a project that yields a special benefit or advantage to property owners within a limited and determinable area, and whose costs will be recovered through the assessment of a betterment pursuant to Massachusetts General Laws (M.G.L. c. 80, § 13), to 15 years or less.

**PROCEDURES.**

It shall be the responsibility of Treasurer, with the assistance of the Town Accountant, as follows:

- Work with bond counsel to draft motions for review by the Town Administrator and the Select Board for transmittal to town meeting for approval of debt authorizations.
- Work with department heads responsible for managing capital projects to project the cash flow needs of individual projects and schedule bond and or BAN sales accordingly.
- Coordinate the compilation of information from town departments and the school department for transmittal to the Town’s financial advisor for inclusion in the Official Statement.
- Identify town staff to participate in presentations to bond rating agencies, lead the presentation, and coordinate timely responses to any questions raised by a rating agency.
- Work with bond counsel and the Town’s financial advisor to draft motions required to be voted by the Select Board at the time of the award for the sale of bonds.
- For capital projects authorized to be funded through the issuance of debt, in order to avoid arbitrage penalties, insure that the amount borrowed at any given time for individual bond

**Commented [RA5]:** The 2014 policy cites Chapter 371 of the Acts of 2010 which is a special act authorizing the Town of Dennis to borrow in anticipation of reimbursements from betterments assessed. I have removed this reference and replaced it with the applicable citations.

**Commented [RA6]:** Does the Treasurer actually manage the issuance of debt or simply act as the signatory on documents with the actual management and coordination of debt issuance falling to someone else. The language I have here is only a placeholder.

authorizations can be expended on a schedule that complies with Internal Revenue Service requirements.

- To ensure that bond proceeds are segregated, and insure that they are expended for the purpose for which they were borrowed.
- To ensure that the investment of bond proceeds complies with limitations imposed by the Internal Revenue Service.
- In consultation with the Town’s financial advisor, insure that all debt-related filings with the federal government (the Internal Revenue Service and the Municipal Securities Rulemaking Board) and the Massachusetts Department of Revenue be done timely.

**REFERENCES**

M.G.L. c. 41, § 59	M.G.L. c. 41, § 61
M.G.L. c. 44, § 4	M.G.L. c. 44, § 6
M.G.L. c. 44, § 6A	M.G.L. c. 44, § 7
M.G.L. c. 44, § 8	M.G.L. c. 44, § 17
M.G.L. c. 44, § 19	M.G.L. c. 44, § 20
M.G.L. c. 44, § 20A	M.G.L. c. 44, § 21A
M.G.L. c. 59, § 21C (f)	M.G.L. c. 59, § 21C (i1/2)
M.G.L. c. 59, § 21C (j)	M.G.L. c. 80, § 13
26 USC § 148	

Massachusetts Department of Revenue, Division of Local Services - DLS Best Practice: [Understanding Municipal Debt](#)

Massachusetts Department of Revenue, Division of Local Services - [DLS Borrowing Guidelines: Asset Useful Life - Borrowing Limits](#)

Massachusetts Department of Revenue, Division of Local Services - [DLS Informational Guideline Releases 17-21: Borrowing and 17-22: Premiums and Surplus Proceeds for Proposition 2½ Excluded Debt](#)

Government Finance Officers Association Best Practice: [Refunding Municipal Bonds](#)

Internal Revenue Service Guidance: [Arbitrage Guidance for Tax-Exempt Bonds](#)

**ADOPTED BY:**

**DATE ADOPTED:**