2017 MUNICIPAL LAW SEMINAR
WORKSHOP B
TREASURY MANAGEMENT AND DEBT

DISCUSSION SUMMARY
(Prepared For Informational and Training Purposes Only)

This informal summary of the discussion presented at Workshop B is provided for educational and training purposes only. It does not constitute legal advice or represent Department of Revenue opinion or policy, except to the extent it reflects statements contained in a public written statement of the Department of Revenue (Informational Guideline Release or Local Finance Opinion).

Borrowing - Premiums and Surplus Proceeds

1. At its May, 2015 Annual Town Meeting (ATM), Anytown's legislative body voted to authorize the treasurer to borrow $2 million for the construction of a new police station. On November 7, 2016, the treasurer sold the permanent debt, issuing a 20-year bond, and received a considerable premium. How is the premium to be treated?

Borrowing – Premiums

G.L. c. 44, § 20, *After* Municipal Modernization Act

Premiums and accrued interest on bonds or notes sold on or after 11/7/2016 are not general fund revenue. They must either be:

1. **Applied to the costs of the project being financed by the bonds or notes and reduce the amount authorized to be borrowed for the project by like amount (only if the legislative body borrowing vote so authorizes); or**
2. **Reserved in separate fund for appropriation for capital projects:**
   - **Project must be one for which may borrow for equal or longer period than loan for which premium received**
   - **Premium arising from restricted funds project remains subject to any applicable restriction**
   - **If borrowing is the subject of an approved Proposition 2½ debt exclusion, there may be a reduction in the annual excluded amount because G.L. c. 44, § 20 requires "[a]dditions to the levy limit for a debt exclusion are restricted to the true interest cost incurred to finance the excluded project."**

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The sale of the bonds occurred on November 7, 2016, so the Act's changes to G.L. c. 44, § 20 do apply to premiums received as a result of the sale. So the premium is not general fund revenue. The premium must be either:

i. **Applied to pay project costs and reduce borrowing by same amount - if borrowing vote so authorizes; or**
ii. **Reserved in separate fund for appropriation for capital projects. Project must be one for which may borrow for equal or longer period than loan for which premium received**

Because the legislative body's borrowing authorization vote did not authorize the application of the premium to pay costs of the project and reduce the amount of the borrowing authorization, the premiums may not be used to pay the project costs and reduce the amount of the borrowing authorization. The premium must be reserved for appropriation for a project for which the city or town has authorized a borrowing, or may authorize a borrowing, for 20 years or more (equal to or more than the period of time of the original borrowing).

2. Are there any options available to a city or town before permanent debt is issued if the vote authorizing the debt did not include authorization to apply premiums to pay project costs and reduce the amount of the borrowing?

Before the permanent debt is sold, the legislative body could vote to amend its vote authorizing the borrowing to include authorization to apply any premium to pay the costs of the project and reduce the amount of the borrowing authorization by like amount.

3. What action should treasurers take when selling bonds or notes to ensure that the city or town will be able to reduce the size of a bond or note by the amount of any premium received?

Issuers of bonds or notes may reasonably anticipate when a premium will be offered for their bonds or notes at the time of sale. In these instances, the city or town should reserve its right at the time of sale to reduce the size of its bond or note issued by the amount of the premium received from the purchaser of the bonds or notes. The city or town then can apply the premium, net of issuance costs, to pay costs of the project and reduce the overall amount to be borrowed accordingly, provided the borrowing authorization has so provided.

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4. Multi-purpose bonds in the amount of $20,000,000 are sold after 11/7/16, for four projects:

Project 1 - $500,000 Acquisition of vehicles – 5 years	Project 3 - $18,000,000 Acquisition of land – 30 years
Project 2 - $500,000 Acquisition FD Pumper Truck – 20 years	Project 4 - $1,000,000 Municipal building construction – 20 years

The legislative body votes authorizing the borrowings for projects 1, 2 and 4 included authority to apply premiums to project costs and reduce the amount of the borrowing authorization by like amount. A premium of $1,000,000 is received. How is the premium treated?

The premium is allocated to each individual borrowing based upon the proportion that the individual borrowing bears to the total amount borrowed. Each allocated premium is then treated according to G.L. c. 44, § 20 as amended by the Municipal Modernization Act because the bonds were sold after 11/7/16. For the premium allocated to projects 1, 2 and 4, because the legislative body vote included authority to apply premiums to project costs and reduce the amount of the borrowing authorization, the premium allocated to each project must be used to pay project costs and reduce the amount of the respective borrowing authorizations. The premium allocated to Project 3, however, cannot be applied to the costs of project 3 because the borrowing authorization vote did not include the language required to authorize it. So that portion of the premium must be reserved for appropriation for capital projects for which the city or town has authorized a borrowing, or may authorize a borrowing, for an equal or longer period of time than the original $18,000,000 borrowing – 30 years. See below table:

Project 1 - $500,000 **Premium (.025 or 2.5%) = $25,000**	**Project 3 - $18,000,000** **Premium (.9 or 90%) = $900,000**
Project 2 - $500,000 **Premium (.025 or 2.5%) = $25,000**	**Project 4 - $1,000,000** **Premium (.05 or 5%) = $50,000**

5. Same multi-purpose bonds as in the previous question in the amount of $20,000,000 are sold after 11/7/16, for the same four projects, but none of the legislative body votes authorizing the borrowings included authority to apply premiums to project costs and reduce the amount of the borrowing authorization. A premium of $1,000,000 is received. (a) How is the premium treated? (b) What if the land acquisition borrowing is financed with community preservation funds?

(a) Again, the premium is pro-rated among the four projects and treated according to G.L. c. 44, § 20 as amended by the Municipal Modernization Act because the

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bonds were sold after 11/7/16. All four prorated premiums must be reserved for appropriation for capital projects because the legislative body did not include in its borrowing vote language to allow application of the premium to project costs and reduce the amount of the borrowing authorization. And because the statute requires that an appropriation from the capital reserve must be for a capital project for which the city/town has authorized or may authorize a borrowing for an equal or longer period of time than the original borrowing from which the premium is derived, the accounting officer will be required to track each prorated reserved premium separately.

Project 1 - $25,000 premium	**Reserve for appropriation for capital projects for which may borrow for 5 years or more**
Project 2 - $25,000 premium	**Reserve for appropriation for capital projects for which may borrow for 20 years or more**
Project 3 - $900,000 premium	**Reserve for appropriation for capital projects for which may borrow for 30 years or more**
Project 4 - $50,000 premium	**Reserve for appropriation for capital projects for which may borrow for 20 years or more**

(b) If the land acquisition borrowing is financed with CPA funds, the premium can only be appropriated for another CPA project and must first have the recommendation of the Community Preservation Committee.

6. Should all legislative body borrowing authorization votes include the authority to apply any net premium and accrued interest received to the costs of the project and reduce the amount of the borrowing authorization by a like amount?

Yes. All legislative borrowing authorizations should include authority to apply any net premium and accrued interest to the costs of the project and reduce the amount of the borrowing authorization by a like amount because applying the net premium to project costs and reducing the amount of the borrowing authorization:

- **Applies all borrowing proceeds (premiums are borrowing proceeds) to the project for which the borrowing was approved**
- **Will reduce the amount of debt that the community is carrying**
- **Will eliminate the accounting required to maintain a reservation for appropriation for a project for which city/town can borrow for an equal or longer period of time as original project**
- **If a Proposition 2½ borrowing, will eliminate the risk of having the annual debt exclusion reduced**

7. The legislative body authorizes a $2 million borrowing for construction of a police station and authorizes application of any net premium to project costs and reducing the

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amount of the borrowing authorization by like amount. A $1.5 million 20-year bond is sold after 11/7/16 and a net premium of $100,000 is received. There is still $500,000 in project costs to be funded and $500,000 remaining in borrowing authority. The treasurer forgot to reduce the principal amount of the $1.5 million borrowing by the amount of the net premium. There is still $500,000 in both unfunded project costs and available borrowing authorization for the project. Can the treasurer apply the $100,000 net premium to the project costs and reduce the amount of the remaining borrowing authorization by $100,000 to $400,000?

Yes. Although the treasurer should have reduced the principal amount of the $1.5 million bond by the $100,000 net premium, G.L. c. 44, § 20 states that the premium "shall be: (i) applied, if so provided in the loan authorization, to the costs of the project being financed by the bonds or notes and to reduce the amount authorized to be borrowed for the project by like amount." Here, because there is still $500,000 remaining in unfunded project costs and $500,000 remaining in unused borrowing authority, the treasurer is able to apply the $100,000 net premium to pay costs of the project being financed by the bonds and reduce the borrowing authorization by the $100,000. There could have been a problem if there were no unfunded project costs or unused borrowing authority. In that case, the premium would have to be reserved for appropriation for other capital projects for which you could borrow for an equal or longer time than the project for which the premium was paid.

8. What if the facts in the previous question are changed as follows: a $2 million bond is sold and a net premium of $150,000 is received, but the treasurer forgets to reduce the amount of the borrowing by the amount of the net premium? What happens to the $150,000 net premium?

   Because the amount of the borrowing authorization has been fully issued, the amount of the borrowing authorization cannot be reduced. Therefore, the town must reserve the net premium for appropriation for capital projects for which it can borrow for at least 20 years.

9. What if the facts in the previous two questions are changed as follows: the treasurer issues $2 million in bond anticipation notes in anticipation of issuing the permanent debt for the police station construction and receives a $200,000 net premium.

   a. What should the treasurer do with the premium?
   b. What will happen to the borrowing authorization?
   c. What is the amount of the permanent debt to be issued?

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a. **The treasurer should reduce the amount of the BAN by $200,000 to $1.8 million and use the premium to pay costs of the project.**
b. **The borrowing authorization is reduced by the amount of the net premium to $1.8 million.**
c. **Permanent debt should issue in the amount of $1.8 million.**

10. Legislative body authorizes a $2 million borrowing for construction of a police station and authorizes application of any net premium to project costs and reducing the amount of the borrowing authorization by like amount. In this case, however, the voters have approved a debt exclusion for the borrowing under Proposition 2½. A $2 million 20-year bond is sold after 11/7/16 and a net premium of $200,000 is received. How will the premium be treated?

<u>Borrowing – Premiums Received on Debt Excluded under Proposition 2½</u>
See IGR 17-22 - *Premiums and Surplus Proceeds for Proposition 2½ Excluded Debt*

Same two options for premiums received on excluded debt as for premiums received on non-excluded debt. (See text box under question 1 above.) However, for excluded debt, G.L. c. 44, § 20 requires "[a]dditions to the levy limit for a debt exclusion are restricted to the true interest cost incurred to finance the excluded project."

As a result, for excluded debt:

- **If premium is applied to project costs and borrowing reduced, there is no reduction to the annual debt exclusion.**
- **But, if premium is reserved for appropriation, the annual debt exclusion will be reduced as follows, depending upon the amount of the premium received:**

  a. **Total net premium ≤ $50,000 – no reduction to annual debt exclusion (de minimis rule)**

  b. **Total net premium > $50,000 – reduction to the annual debt exclusion (see calculation in next text box below.)**

Note – There is <u>no</u> option to use the premium for the payment of debt service. (This is unlike for premiums received on bonds or notes issued on excluded debt sold before November 7, 2016.)

The treatment of premiums from excluded debt under G.L. c. 44, § 20 is the same as for premiums received from non-excluded debt. They must either be:

i. **Applied to pay project costs and reduce borrowing authorization by same amount if borrowing vote so authorizes; or**
ii. **Reserved in separate fund for appropriation for capital projects (project is one for which may borrow for equal or longer period that original loan).**

Here - because the borrowing authorization included authority to apply the net premium to project costs and reduce the borrowing authorization, that is what the treasurer should do – issue the debt in the amount of $1.8 million and apply the $200,000 to the project costs. The resulting annual debt exclusion amount will be based upon the $1.8 million borrowing and complies with G.L. c. 44, § 20, which requires "[a]dditions to the levy limit for a debt exclusion are restricted to the true interest cost incurred to finance the excluded project." NO reduction to the annual exclusion will be required.

11. City or town sells 20-year permanent bonds on a debt-excluded borrowing in the principal amount of $18,000,000 and receives $800,000 net premium. The legislative body vote authorizing the borrowing did not include authorization to apply the net premium to the costs of the project being financed by the bonds or notes and reduce the amount authorized to be borrowed for the project by like amount. What happens to the premium? What happens to the annual debt exclusion?

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<u>Calculation of Reduction to Annual Debt Exclusion</u>
When net premium received on debt-excluded borrowing is > $50,000 and is reserved for appropriation for capital projects

Example: City or town sells 20-year permanent bonds on a debt excluded borrowing in the principal amount of $18,000,000 and receives $800,000 net premium, which is reserved for appropriation of capital projects. Total interest payable over life of borrowing is $10,000,000. 1st fiscal year interest payment is $600,000. The calculation to determine reduction of interest for the fiscal year debt exclusion is as follows:

Calculation of Premium as Percentage of Interest Cost	
Net Premium	$800,000
Divided by total interest over life of issue	$10,000,000
Premium as % of interest	8%

Calculation of Adjustment of Interest for Debt Exclusion		
Fiscal Year Interest Due	Premium Adjustment	Debt Exclusion Reduction
$600,000	8%	$48,000

The amount of the gross debt service excludable for the fiscal year (principal and interest) and the amount of the exclusion reduction ($48,000) are entered on the DE-1. The net excluded debt service will equal the gross debt service excludable minus $48,000.

The city or town must continue to apply this adjustment to reduce the amount of the annual debt exclusion throughout the life of the borrowing.

You still are required to follow G.L. c. 44, § 20 and the entire $800,000 premium must be reserved for appropriation for a project for which the town has authorized a borrowing, or may authorize a borrowing, for an equal or longer period of time than the original loan. This is because the legislative body vote did not include authorization to apply the net premium to the costs of the project being financed by the bonds or notes and reduce the amount authorized to be borrowed for the project by like amount. <u>No part</u> of the premium may be used to pay debt service – it is all reserved for appropriation for other capital projects.

Additionally, G.L. c. 44, § 20 requires "Additions to the levy limit for a debt exclusion are restricted to the true interest cost incurred to finance the excluded project." Therefore, when the premium received is greater than $50,000, there must be a reduction to the annual debt exclusion. See IGR 17-22. The above insert shows the calculation to reduce the amount of the annual debt exclusion.

12. What is the treatment for premiums received from the sale of refunding bonds under G.L. c. 44, § 21A?

Note: Premiums on Refunding Bonds
- G.L. c. 44, § 21A – governs refunding bond premiums
  - Requires all "proceeds" of refunding bonds be used to pay off bonds to be refunded, including principal, interest, redemption premium
  - "Proceeds" of refunding bonds includes premiums

G.L. c. 44, § 21A establishes the treatment of premiums received from the sale of refunding bonds, not G.L. c. 44, § 20. It requires that premiums received from the sale of refunding bonds must be used to pay off the bonds to be refunded.

Borrowing – Surplus Proceeds

13. Anytown authorized a $2 million borrowing at its May, 2014 ATM to construct a new police station. Permanent debt was issued and sold in the amount of $2 million. The project was completed in March, 2016 and a surplus remained of $75,000. At a September, 2016 Special Town Meeting, $25,000 of that surplus was appropriated for another capital project for which the town could borrow for a similar period of time. May the town now apply the remaining $50,000 of surplus to pay debt service with its CEO approval?

Surplus Proceeds – Completed Project

Surplus borrowing proceeds of a completed project are available funds for restricted purposes under G.L. c. 44, § 20:
- **Surplus proceeds in any amount may be appropriated for purpose for which loan may be incurred for equal or longer period than original loan**
- **Surplus of $50,000 or less may be applied to pay any debt service with approval of CEO**
- **Surplus is difference between amount borrowed and amount spent for each purpose for which the city or town has authorized debt (does not matter if sold in multi-purpose bond)**
- **Amount of surplus is determined at time of completion**
- **Surplus arising from restricted funds project (e.g., enterprise or CPA funds) remains subject to restriction**

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No. As explained in the information box, the amount of surplus proceeds is determined at the time of project completion. In this case, the surplus was $75,000 at the time of the completion. Because the surplus was greater than $50,000, the option to apply the surplus to the payment of any debt service with the approval of the CEO is not available to any part of the surplus. The remaining balance of the surplus is, however, available for appropriation for a purpose for which a loan may be incurred for equal or longer period than original loan.

14. Same facts as above except that the $2 million borrowing was the subject of an approved Proposition 2 ½ debt exclusion and the entire $75,000 surplus has been appropriated to a non-debt-excluded project for which the town could borrow for a similar period of time. Will the annual amount of the debt exclusion be impacted?

Surplus Proceeds – Completed Project Subject to Prop 2 ½ Debt Exclusion

See IGR 17-22 - *Premiums and Surplus Proceeds for Proposition 2½ Excluded Debt*

If surplus proceeds of a completed project subject to a Proposition 2 ½ debt exclusion:

- **Do not exceed $50,000, there will not be a reduction to the annual excluded amount whether surplus is applied to the payment of debt service or appropriated to a non-debt-excluded project (de minimis rule)**
- **Exceed $50,000 and are appropriated for another project that is also debt-excluded, there will not be a reduction to the annual excluded amount**
- **Exceed $50,000 and any part of the surplus is appropriated for another project which is not debt-excluded, there will be a reduction in the annual excluded amount as shown in the following text box.**

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Calculation of Reduction to Annual Debt Exclusion
When surplus proceeds of completed project subject to a Prop 2 ½ debt exclusion are > $50,000 and appropriated for non-debt-excluded project

Example – City or town sells 20-year permanent bonds in the principal amount of $18,000,000. The total interest payable over the life of the borrowing will be $10,000,000. After completion of the project and payment of all expenses, $180,000 in surplus proceeds remains. The legislative body appropriates the $180,000 for one or more capital projects. Each project is for a purpose for which the city or town may borrow for an equal or greater term than the term for which the original loan was issued. However, none of the projects are debt-excluded. The interest payable for the fiscal year is $600,000. The adjustment (reduction) of interest for the debt exclusion reported for the fiscal year is calculated as follows:

Surplus Proceeds	**$180,000**
Divided by total amount borrowed	**$18,000,000**
Surplus Adjustment	**1 %**

Calculation of adjustment of interest for debt exclusion		
Fiscal Year Interest Due	**Surplus Adjustment**	**Debt Exclusion Reduction**
$600,000	**1%**	**$6,000**

The amount of the gross debt service excludable for the fiscal year (principal and interest) and the amount of the exclusion reduction ($6,000) are entered on the DE-1. The net excluded debt service is the gross debt service excludable minus $6,000.

The city or town will be required to continue to apply this surplus adjustment to reduce the amount of the annual debt exclusion throughout the life of the borrowing.

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<u>Surplus Proceeds – Abandoned/Discontinued Project</u>

Under G.L. c. 44, § 20, if a loan has been issued and the project is <u>not</u> completed, but no liability on the loan remains outstanding, the city or town may, by 2/3 vote, abandon or discontinue the project. Unexpended loan proceeds may be appropriated for purpose for which loan may be authorized for equal or longer period of time than original loan. There is no option to apply proceeds (if $50,000 or less) to payment of debt service as with surplus proceeds after project completion.

For debt-excluded borrowings, if proceeds after abandonment/discontinuance

- **Do not exceed $50,000, appropriation(s) for a non-debt-excluded project, will not result in a reduction to the annual excluded amount (de minimis rule)**
- **Exceed $50,000, appropriations for a non-debt-excluded project, will result in a reduction to the annual excluded amount. The reduction is calculated in the same manner as when a project is completed.**

See IGR 17-22 – *Premiums and Surplus Proceeds for Proposition 2½ Excluded Debt*

Yes. There will be a reduction to the annual amount of the debt exclusion calculated as shown in the information boxes.

Lease Purchase Financing Agreements (TELPs)

1. What is a TELP?

A TELP is a lease purchase financing agreement used to finance the acquisition of equipment or some other item where a city, town or district makes payments to the owner of the equipment (usually a financing company) for its use of the equipment during the term of the agreement and, at the end of the agreement, title or ownership of the equipment is transferred to the city, town or district for no or nominal consideration. The payments over the term of the agreement are generally equivalent to the costs of borrowing for the acquisition of the equipment.

2. Beautytown entered into a TELP Financing Agreement recommended by its CEO and approved by a 2/3 legislative body vote - to finance the purchase of a new fire truck. It procured the desired fire truck under G.L. c. 30B and then assigned its purchase order for the fire truck to Fly-by-Night Financing Company which bought the truck and then leased it to Beautytown with pretty good financing terms. At the end of the lease term, the agreement requires Fly-by-Night to transfer title to the truck to Beautytown. Two years after making payments, interest rates drop drastically and the once desirable TELP

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terms are now undesirable. Can Beautytown issue refunding bonds and pay off the TELP Agreement? What other information do you first need to know to answer this question?

TELP agreement under G.L. c. 44, § 21C:
- **Purpose to acquire equipment or improve a capital asset, when the acquisition or improvement could be financed with debt**
- **Term of TELP cannot exceed useful life of asset to be acquired or capital asset improvement**
- **Recommended by CEO (mayor/selectboard)**
- **Legislative Body approval of agreement - 2/3 vote (should identify equipment, maximum agreement term and department. authorized to enter into agreement)**
- **Legislative body appropriation for 1st year agreement payments (majority vote required for appropriation; can be in same vote as authorization vote or in separate vote – i.e., in capital budget or operating budget)**
- **If above requirements are met, agreement is binding obligation as if authorized debt**

Before you can determine whether Beautytown can issue refunding bonds and pay off the TELP agreement, you will need to determine whether the TELP agreement complies with G.L. c. 44, § 21C. If so, the agreement may be treated as the issuance of debt and may be refunded (refinanced) with refunding bonds under G.L. c. 44, § 21A. Here, the legislative body did approve the TELP agreement by a 2/3 vote upon the recommendation of the CEO. But, you also need to know:

i. **The length or term of the TELP agreement and the useful life of the fire engine. This is because TELPS under 44:21C cannot exceed the useful life of the asset to be acquired.**
ii. **Whether the legislative body appropriated the 1st year agreement payments of the TELP.**

If the term of the agreement does not exceed the useful life of asset and the legislative body has appropriated the 1st year agreement payments, then because the municipality has complied with the other requirements of G.L. c. 44, § 21C and the TELP agreement is treated as if it is authorized debt and the municipality may issue refunding bonds to refinance the TELP if it complies with the refunding bond statute – G.L. c. 44, § 21A. Under that statute, if the P&I payments of the refunding bonds do not exceed the P&I payments of the TELP, then refunding bonds may be issued. However, bond counsel should review the transaction, because it will be a new issuance of debt.

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