DIVISION OF LOCAL SERVICES
MA DEPARTMENT OF REVENUE

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Informational Guideline Release

Bureau of Accounts
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Supersedes Bulletin 2013-01B and Prior Inconsistent Written Statements

PREMIUMS AND SURPLUS PROCEEDS FOR PROPOSITION 2½ EXCLUDED DEBT

(G.L. c. 44, § 20 and G. L. c. 59, § 21C(k))

This Informational Guideline Release (IGR) explains to local officials the adjustments made to a Proposition 2½ debt exclusion when premiums are received in connection with the sale of the bonds or notes for the excluded borrowing and surplus loan proceeds remain after the project or purpose of the borrowing is completed.

Questions should be referred to the Bureau of Accounts Public Finance Section.

Topical Index Key:

Borrowing
Proposition 2½

Distribution:

Assessors
Municipal/Regional School Treasurers/
Accountants/Auditors
Selectboards/Mayors
City/Town Managers/Administrators
Finance Directors
Finance Committees
City/Town Councils
City Solicitors/Town Counsels

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PREMIUMS AND SURPLUS PROCEEDS FOR PROPOSITION 2½ EXCLUDED DEBT

(G.L. c. 44, § 20 and G. L. c. 59, § 21C(k))

SUMMARY:

These guidelines explain adjustments to an approved Proposition 2½ debt exclusion under G.L. c. 59, § 21C(k) when premiums are received in connection with the sale of the bonds or notes for the excluded borrowing and surplus loan proceeds remain after the project or purpose of the borrowing is completed. The treatment of premiums and surplus proceeds was changed by the Municipal Modernization Act (Act) and these guidelines address the effect of those amendments on the amount of the exclusion. St. 2016, c. 218, § 67. The changes made by the Act took effect on November 7, 2016.

Premiums, net of issuance costs, and accrued interest received as a result of the issuance of bonds or notes, must now be either: (1) used to pay project costs and to reduce the amount of the borrowing authorization by the same amount when the borrowing vote so authorizes; or (2) reserved for appropriation for capital projects for which a loan has been or may be authorized for an equal or longer period of time than the loan for which the premiums were received. G.L. c. 44, § 20. Previously, the premiums were general fund revenue and could only be spent after appropriation.

Surplus loan proceeds in any amount remaining after the project is completed may still be appropriated for any purpose for which the city, town or district may borrow for an equal or greater term than the term for which that loan was issued. When there is a surplus of $50,000 or less, however, the city, town or district now has the option of applying the surplus to the payment of any debt service with the approval of the chief executive officer. G.L. c. 44, § 20.

Additions to the levy limit for a debt exclusion under Proposition 2½ continue to be restricted to the true interest cost incurred to finance the excluded project. G.L. c. 40, § 20. As a result, the amount of the debt exclusion must be reduced when premiums received on bonds or notes are not applied to the costs of the project. In addition, a reduction must be made when surplus loan proceeds from a borrowing excluded under Proposition 2½ are appropriated for a purpose or project that is not excluded. This IGR explains when a reduction in the amount of the debt exclusion for a municipal or regional school borrowing is required and how the reduction is determined.

Please see Informational Guideline Release (IGR) 17-21, *Borrowing* (August), for other changes under the Act that affect municipal borrowing and IGR 02-101, *Proposition 2½ Debt Exclusions* (March), regarding the determination of debt exclusion amounts generally.

BUREAU OF ACCOUNTS **MARY JANE HANDY, DIRECTOR**

These guidelines are in effect. They supersede Bulletin 2013-01B, *Bond Premiums and Debt Exclusions*, and any prior inconsistent written statements.

GUIDELINES:

I. PREMIUMS RECEIVED FOR PROPOSITION 2½ EXCLUDED DEBT

The additional amount raised in property taxes for a borrowing that is the subject of a Proposition 2½ debt exclusion approved under G.L. c. 59, § 21C(k) must reflect the true interest cost of financing the project. G.L. c. 44, § 20. If a premium is received when the bonds or notes are sold for the excluded borrowing, the interest rate is overstated and must be adjusted when computing the annual exclusions for the borrowing. The manner in which the adjustment is made depends on when the bonds or notes were sold.

A. Bonds or Notes Sold before November 7, 2016

Premiums (net of issuance costs paid from the premium) and accrued interest received on bonds or notes authorized and sold before November 7, 2016 are general fund revenue of the city, town or district and cannot be spent without appropriation. G.L. c. 44, § 53.

If a Proposition 2½ debt exclusion was approved by voters for the particular borrowing under G.L. c. 59, § 21C(k), the amount excluded must be adjusted to reflect the true interest cost of the borrowing. G.L. c. 44, § 20. Therefore, general fund premiums received for debt excluded borrowings must either be: (1) appropriated to pay project costs and reduce the amount of the borrowing as explained in Section I-A-1 below; or (2) reserved for appropriation to offset interest paid in future years for the loan and the amount of the exclusion is reduced each year in that amount as explained in Section I-A-2 below.

1. Appropriation of Premium to Pay Project Costs and Reduce the Amount of the Borrowing

   Cities and towns that received a premium from bonds or notes sold before November 7, 2016 on excluded debt must treat the premium as general fund revenue and should, if all the permanent debt for the project has not yet been issued, appropriate by legislative body vote the amount of the premium (less issuance costs if paid from the premium) to: (1) pay project costs directly or (2) pay-down BANs for the project. The legislative body must also vote to amend the borrowing authorization and reduce it by the amount of the premium applied to the project costs.

   Regional school districts with borrowings for which all members have approved debt exclusions may also use this alternative.

Sample Vote

Motion: That the city/town/regional school district appropriate $_____________ from the premium received upon the sale of bonds or notes issued for _______________ (purpose), which are the subject of a Proposition 2½ debt exclusion (by all member cities and towns), to pay costs of the project being financed by the bonds or notes and to reduce the amount authorized to be borrowed for the project by the same amount.

2. Reservation of Premium for Appropriation to Offset Interest Paid in Future Years

If a city or town receives a premium from bonds or notes sold before November 7, 2016 on excluded debt and the permanent debt for the project has already been issued, it must: (1) reserve the premium for appropriation to offset interest paid in future years for the loan, rather than close to unreserved general fund balance at the end of the fiscal year received and (2) reduce the amount excluded for the debt each year by a premium adjustment, as explained in the example below, to that year's interest payment of the debt service. This adjustment ensures that the debt exclusion reflects the true interest cost of financing the project.

Regional school district assessments to a city or town that has excluded debt for a district project must be reserved and adjusted in the same manner to reflect only the net interest cost associated with the project.

The year's gross debt service (principal and interest) and the debt exclusion adjustment in the interest are reported on the Form DE-1 which is used by DLS Bureau of Accounts to establish a city or town's levy limit under G.L. c. 59, §§ 21C and 21D and is completed by the city or town as part of the tax rate setting process. The Form DE-1 is completed and submitted through the DLS Gateway On-line. For more information, please refer to the Annual Levy Limit Instructions and "Tax Rate Recap, Pro Forma Recap Instructions and Certain Supporting Forms."

EXAMPLE

Calculation of Premium Adjustment and Debt Exclusion Reduction

A city or town, before November 7, 2016, sells permanent bonds payable in 20 years in the total principal amount of $18,000,000. It receives a net premium as part of the sale in the amount of $800,000. The total interest payable over the life of the borrowing will be $10,000,000. The interest payable for the fiscal year is $600,000. The calculation to determine the adjustment 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 Adjustment (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 premium adjustment to reduce the amount of the annual debt exclusion throughout the life of the borrowing. It must maintain the reserve for appropriation to offset the interest paid in future years for the loan and adjust the debt exclusion annually until the debt is paid.

Treasurers should consult with bond counsel to ensure that the investment of the premium reserved for appropriation in future years is consistent with federal arbitrage regulations on tax-exempt borrowings.

B. Bonds or Notes Sold On or After November 7, 2016

Premiums (net of issuance costs) and accrued interest received on bonds or notes sold on or after November 7, 2016 must be used either for project costs and to reduce the amount borrowed or reserved for appropriation for capital purposes. G.L. c. 44, § 20.

1. Application of Premium to Pay Project Costs and to Reduce the Amount of the Borrowing

Premiums (net of issuance costs) and accrued interest received on bonds or notes that are the subject of an approved Proposition 2½ debt exclusion under G.L. c. 59, § 21C(k) should be used to pay project costs and to reduce the borrowing authorization by the same amount. Use of this option reduces the amount borrowed, which adjusts the debt service to reflect the true interest cost incurred to finance the excluded project. G.L. c. 44, § 20. Therefore, the full amount of the debt service payable in each year is excluded.

Regional school districts that receive premiums on borrowings for which any member has approved a debt exclusion should also use this alternative. It will reduce the amount borrowed and adjust member assessments to reflect the true interest cost associated with the project.

(a) Authorization to Reduce Amount of Borrowing

The authorization to reduce the amount of a borrowing by the amount of any net premium and accrued interest must be contained in a vote of the legislative body. It may be in the original bond authorization vote or in an amendment of that authorization vote. Bond and municipal counsel should be consulted for language to use in bond authorization votes and to amend existing borrowing authorizations in order to use net premiums and accrued interest to pay project costs and to reduce the amount of the borrowing authorization by the same amount.

Sample Language for Borrowing Authorization

Any premium received by the city/town/regional school district from the sale of any bonds or notes authorized by this vote, less the costs of issuance of the bonds or notes paid from the premium, and any accrued interest may be applied to pay project costs in accordance with Chapter 44, Section 20, and the amount authorized to be borrowed to pay those costs shall be reduced by the same amount applied.

(b) Reservation of Right to Reduce Borrowing

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, town or regional school district should reserve the 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, town or district would then use the premium, net of issuance costs, in addition to the borrowing proceeds to pay project costs.

2. Reservation of Premium for Appropriation for Other Capital Purposes

Net premiums not used to pay project costs and reduce the amount borrowed must be reserved for appropriation for capital projects for which a loan has been, or may be, authorized for an equal or longer period of time than the loan for which the premiums were received. They are not available for appropriation for the payment of annual debt service of the project, unlike the treatment of a premium received on bonds or notes sold before November 7, 2016. See Section I-A-2 above.

a. Restricted Funds

The net premiums and accrued interest received on bonds or notes sold regarding restricted funds, such as debt financed by an enterprise fund under G.L. c. 44, § 53F½ or the community preservation fund under G.L. c. 44B, § 11, remain subject to the relevant restrictions of the fund.

Therefore, if the treasurer does not reduce the amount of the borrowing at the time of the sale, the net premium and accrued interest must be reserved for appropriation for capital projects for which the restricted funds may be spent and for which a loan has been, or may be, authorized for an equal or longer period of time than the loan for which the premiums were received. If the debt is being financed with community preservation funds, a recommendation of the community preservation committee is required for any appropriation of the reserved premiums. G.L. c. 44B, §§ 5(b)(2) and (d) and 7.

b. Debt Exclusion Reduction

The amount of an approved Proposition 2½ debt exclusion under G.L. c. 59, § 21C(k) for bonds or notes for which net premiums and accrued interest are reserved for appropriation for capital projects must be reduced by a premium adjustment unless the amount of the net premium received at the time of the sale is $50,000 or less. This adjustment ensures that the debt exclusion reflects the true interest cost of financing the project. G.L. c. 44, § 20.

The reduction in the debt exclusion when the amount of the premium reserved for the appropriation of capital projects is more than $50,000 is calculated in the same manner as shown in the "Example: Calculation of Premium Adjustment and Debt Exclusion Reduction" in Section I-A-2 above.

EXAMPLE
Calculation of Premium Adjustment and Debt Exclusion Reduction

A city or town, on or after November 7, 2016, sells permanent bonds payable in 20 years in the total principal amount of $18,000,000. It receives a net premium as part of the sale in the amount of $800,000, which is reserved for the appropriation of capital projects. The total interest payable over the life of the borrowing will be $10,000,000. The interest payable for the fiscal year is $600,000. The calculation to determine the adjustment 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 Adjustment (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 premium adjustment to reduce the amount of the annual debt exclusion throughout the life of the borrowing.

II. SURPLUS LOAN PROCEEDS FOR PROPOSITION 2½ EXCLUDED DEBT

A. Completed Project

The proceeds remaining after a borrowing purpose, project or acquisition is completed are available funds for restricted purposes. G.L. c. 44, § 20.

1. Surplus Proceeds of Any Amount

   Surplus proceeds of any amount may be appropriated for any purpose for which the city, town or district may borrow for an equal or greater term than the term for which that loan was issued.

2. Surplus Proceeds of $50,000 or Less

   If the surplus on a loan is $50,000, it may also be applied to the payment of any debt service with the approval of the chief executive officer. In a town, the chief executive officer is the selectboard, in a city, the mayor and, in a district, the prudential committee, if any, otherwise, the commissioners.

3. Determination of Surplus

   The amount of surplus proceeds is the difference between the amount borrowed and the amount actually spent to complete each purpose for which the city, town or district has authorized debt. The amount of the surplus is determined at the time the purpose, project or acquisition is completed, regardless of when the loan was authorized, the bonds or notes were sold or purpose completed.

   Selling bonds or notes for multiple authorized purposes at the same time does not alter the purpose, term or amount of each loan.

   For example, a treasurer sells multi-purpose bonds in the amount of $22,300,000 for four projects for which the city, town or district has authorized debt of: $100,000 (project 1), $2,000,000 (project 2), $20,000,000 (project 3) and $200,000 (project 4). After project completion and payment of all expenses, $750 of the proceeds remain for project 1, $48,500 for project 2, $48,000 for project 3 and $50,001 for project 4. Therefore, at the conclusion of each of the four projects, the available surpluses for projects 1, 2 and 3 may be applied to the payment of debt service on any loan with the approval of the chief executive officer. However, no part of the available surplus for project 4 may be applied to the payment of debt service. All of that $50,001 can only be appropriated for any purpose for which a loan may be authorized for an equal or greater term than the term of the loan for project 4.

4. Restricted Funds

Surplus proceeds remaining after the completion of a project financed with restricted funds, such as an enterprise fund under G.L. c. 44, § 53F½ or the community preservation fund under G.L. c. 44B, § 11, remain subject to the relevant restrictions of the fund.

For example, if there are available surplus proceeds in any amount after the completion of an open space acquisition financed with community preservation funds, the surplus may be appropriated, upon the recommendation of the community preservation committee, for another community preservation purpose for which the city or town may borrow for an equal or greater term than the term for which that loan was issued. If the available surplus is $50,000 or less, the surplus may be applied to the payment of debt service for another community preservation borrowing, upon the recommendation of the community preservation committee and the approval of the chief executive officer. G.L. c. 44B, §§ 5(b)(2) and (d) and 7.

B. Abandoned or Discontinued Project

The proceeds remaining after a borrowing purpose, project or acquisition is abandoned or discontinued may be appropriated for any purpose for which a loan may be authorized for an equal or longer period of time than that for which the original loan, including temporary debt, was issued. G.L. c. 44, § 20. A city, town or district may abandon or discontinue a borrowing purpose, project or acquisition if no liability remains outstanding and unpaid by a two-thirds vote of all of the members of the city council or a two-thirds vote of the voters present and voting at an annual town or district meeting.

Unlike where the project has been completed and surplus proceeds remain, where the project is abandoned or discontinued, there is no option for the chief executive officer to approve the application of the remaining proceeds of $50,000 or less to the payment of debt service.

If the abandoned or discontinued project was funded with restricted funds, such as an enterprise fund under G.L. c. 44, § 53F½ or the community preservation fund under G.L. c. 44B, § 11, the proceeds after abandonment or discontinuance remain subject to the relevant restrictions of the fund.

C. Debt Exclusion Reduction

If there are proceeds remaining from a project funded with bonds or notes that are subject to an approved Proposition 2½ debt exclusion under G.L. c. 59, § 21C(k) when the project is completed, abandoned or discontinued, the amount of the debt exclusion for the borrowing must be reduced proportionately as described in the example below unless (1) the proceeds remaining when the project is completed, abandoned or discontinued equal $50,000 or less, or (2) the debt excluded proceeds are appropriated for a project that is also debt excluded.

The reduction in the debt exclusion when the surplus proceeds are over $50,000 and are appropriated for a project that is not also debt excluded is calculated as shown in the following example.

EXAMPLE
Calculation of Debt Exclusion Reduction

A city or town sells permanent bonds payable in 20 years in the total principal amount of $18,000,000. The total interest payable over the life of the borrowing will be $10,000,000. The borrowing is subject to an approved Proposition 2½ debt exclusion. 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%

Adjustment of Debt Exclusion Interest

Fiscal Year Interest Due	Surplus Adjustment	Debt Exclusion Adjustment (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.