

The decision to borrow money can be intimidating, and the mechanics involved in issuing debt may be the least understood financial process among citizens, local officials, and even some professional staff. Generally known is the statutory requirement that a town meeting or city council can authorize borrowing only by a two-thirds vote. State law also specifies the expenditure purposes that may be funded through debt and the allowed duration of borrowing terms ([M.G.L. c. 44](#)). A borrowing is made final when a majority of the board of selectmen or mayor signs the required documentation. However, between authorization and issuance much more occurs that is little noticed outside of the treasurer's office.

Communities in Massachusetts have ongoing responsibilities to develop and maintain their capital assets, ideally doing so under capital improvement plans based on analyzed and prioritized community needs. It is the treasurer's responsibility to maintain sufficient cash balances to meet the spending demands of departments within their appropriation limits. Occasionally, communities may find themselves in need of short-term cash infusions for capital or operating purposes. For these and other reasons, Massachusetts General Law authorizes cities and towns to issue debt under certain circumstances and durations.

Often, the reasons for borrowing will dictate the type of debt a community chooses to take on since some options are better suited than others, depending on the nature of the need for funds. To make the discussion simpler, we can conceive of municipal debt as essentially falling into two categories: short-term and long-term.

Short-term Debt

Short-term debt can be best classified as borrowing through the issue of notes in anticipation of either paying them off or permanently financing the debt. A short-term borrowing allows a community to make interest-only payments and usually has a maturity date of no more than two years, though in some cases, statute dictates a shorter time frame. Additionally, a community might choose to reissue short-term debt and/or make principal payments under certain circumstances. The various types of short-term debt vehicles used in Massachusetts include the following:

Revenue Anticipation Notes (RANs) – These notes, issued for a maximum of one year, are used to stabilize cash flow when the treasurer's cash balances are low or forecasted to go negative ([M.G.L. c. 44, § 4](#)). These notes are issued to fill a cash need, usually until receipt of quarterly or semiannual tax payments or local aid distributions from the Commonwealth.

Federal and State Aid Anticipation Notes (FAANs and SAANs) – These notes are issued to fund spending in anticipation of grant receipts with the expectation that the note will be paid off upon receiving federal, state or other funds (e.g., Chapter 90 highway project reimbursements).

Bond Anticipation Notes (BANs) – These notes are issued to provide funding for capital

improvements. BANs are usually paid off with the proceeds of long-term financing instruments, such as general obligation bonds. However, state law allows for the reissue of a BAN for up to five years if principle payments are made in accordance with an amortization schedule that would be required if the outstanding balance were financed as long-term debt ([M.G.L. c. 44, § 17](#)). Since short-term debt normally carries a lower interest rate than permanent debt, this strategy may make sense under certain circumstances.

Long-term Debt

Permanent financing vehicles (i.e., municipal bonds) are typically issued when market conditions make it advantageous to lock in a fixed interest rate or when further refunding of short-term debt is no longer an option because of statutory time limits. The various purposes for which borrowings are permitted are outlined in [M.G.L. c. 44, § 7](#) and [§ 8](#).

Nationwide, general obligation (GO) bonds are by far the most prevalent form of long-term municipal debt, and this is especially true in Massachusetts. GO bonds are backed by the full faith and credit of a municipality and issued for periods ranging from five to 30 years, depending on limitations established by state law.

Additional long-term debt vehicles exist, including pension obligation, revenue, conduit, special tax, and limited obligation bonds. However, these complex options, although fairly common in other states, are almost never issued by Massachusetts communities. This is because they are suited to very specific or unique financing purposes that, in most instances, require special legislation or state approval.

Available State Programs

Additional borrowing options for communities offered by the Commonwealth include state qualified bonds and the State House Notes program.

State Qualified Bonds – A financing alternative unique to Massachusetts, these are bonds for municipalities with marginal credit ratings. The State Treasurer pays the debt service for this type of bond directly from the community's local aid, which thereby reinforces the bond's security, improves its marketability, and thus reduces the borrowing cost. Qualified bonds are authorized by the Municipal Finance Oversight Board upon successful application by a city, town, or regional school district under [M.G.L. c. 44A](#).

State House Notes Program – State House Notes are certified by the Director of Accounts and payable annually. They are usually limited to maturities of five years and principal amounts of up to \$1 million. These notes are particularly attractive to smaller communities because certification fees are low, they require no official statement nor full disclosure, and they are issued in a short period of time. Information about the State House Notes Program can be obtained by contacting the DLS [Public Finance Section](#).

Financial Advisor

The intricacies and nuances of borrowing options available to cities and towns can give rise to many questions and decisions for municipal officials. For this reason, it makes sense for communities to

use the services of Massachusetts-based financial advisors. While helpful at any phase of the borrowing process, the expertise of an advisor is most useful in considering the various options available for structuring debt and navigating the procedures associated with the sale. A financial advisor can assist a community to:

- Choose between the various debt instruments available
- Decide between a competitive versus a negotiated sale
- Communicate information to bond rating agencies
- Analyze the debt service impacts of various repayment schedules
- Determine the short- and long-term costs of purchasing bond insurance

Besides the numerous specialized firms that provide financial advisory services to large and midsized municipalities, for smaller communities, the DLS Public Finance Section can provide guidance on the debt issuance process.

Credit Rating Agencies

In Massachusetts, nearly all communities that carry bond ratings are evaluated by either of two rating agencies, Moody’s Investors Service or Standard & Poor’s, although some communities seek ratings from both. While the ratings process appears shrouded in mystery for some, it is important to remember that the city or town is a client of the rating agency, whose function is to render a third-party opinion on the municipality’s likelihood of default.

In conducting an assessment, a rating agency will perform analyses of financial statements, management capability, fiscal stability, economic condition, and other data. The process will often include in-person or telephone interviews with municipal finance officials. On less frequent occasions, a ratings analyst will make a site visit to a city or town in an effort to gain a more substantial understanding of its assets and management capabilities. Later, the agency will issue a concise report that presents the rating assignment and describes the community’s financial position. Purchasers of municipal bonds and notes use this rating when considering their bids. Typically, the better rated communities garner lower interest rate charges.

Bond Counsel

Another participant in the issuance phase is the community’s bond counsel. Bond counsel is an attorney or law firm engaged to submit an opinion on whether a borrowing has met all legal prerequisites based on examining the required documents (e.g., signed and sealed copies of city council or town meeting votes) before the community puts it to bid on the open market. If bond counsel determines a debt issue does not meet legal sufficiency, corrective action must be taken. This may include going back to town meeting or city council for a debt authorization or some other cumbersome, not to mention embarrassing, requirement. Therefore, it is helpful to consult bond counsel throughout the authorization phase and up to the point of issuance.

Typical Chronology

After city council or town meeting grants the authority to raise money through debt, the actual note or bond issuance may occur months or even years later. For this reason, it is good practice for

local finance officials to meet periodically to review borrowings that have been authorized but not issued to make sure the community's debt position is understood by all.

Once the structure of a borrowing has been determined, a preliminary official statement (POS) is developed under the treasurer's direction and disseminated to the bond market community. Rating agencies use the POS in their analyses of credit worthiness. The POS and the final official statement (OS) are documents prepared for potential investors that contain information about a prospective bond or note issue and financial data about the community. The OS is sometimes referred to as a prospectus or offering circular.

After all the preliminary work has been done and the various experts (e.g., bond counsel, rating agencies) have weighed in on the sale, the bonds or notes are sold to underwriters or broker syndicates, and ultimately to investors. Once payment on the purchase has been made, the community has the funds for the specified capital improvement or operating expenditures. To minimize interest costs or more efficiently assemble borrowing packages, treasurers should always communicate with the department head who will oversee the project or purchase to better understand when the funds will be needed.

By taking a deliberate and thoughtful approach toward debt, cities and towns can optimize their borrowing practices to better maintain capital assets and minimize costs. Having a basic understanding of the process and making use of the knowledge of investment professionals improves the odds of success.