Refresher on Bonding Basics

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What is a bond?

- A bond is a debt instrument -- a way for the issuer to borrow money, with a commitment to pay it back over time in installments with interest

General Obligation Bonds

- Backed by "full faith and credit" of state
- Can only be used for projects that:
  - Have a public purpose – req'd for all state money
  - Are specified in law (Art. XI, sec. 7)
  - Are for one of the listed purposes (Art. XI, sec. 5)
- Bonds must mature in no more than 20 years
- Bill that authorizes g.o. bonds must originate in the House

Purposes for public debt

- To acquire and to better public land and buildings and other public improvements of a capital nature
- To repel invasion or suppress insurrection
- To borrow temporarily through certificates of indebtedness
- To establish and maintain highways subject to constitutional limitations on highway bonds
- To promote forestation and prevent and abate forest fires
- To construct, improve, and operate airports and other air navigation facilities
- To develop the state's agricultural resources by extending credit on real estate
- To improve and rehab public or private railroad rights-of-way and other rail facilities up to $200 million par value
- As otherwise authorized in the constitution.

Projects to “acquire and better public land and buildings”

- Most common purpose of G.O. bonds

- Must be a capital project
  - Fixed asset
  - Long-lived (at least 10 yrs)
  - Substantial improvement
  - Not predictable or recurring; not repairs

- Must be publicly owned – by state or local govt

- Requires three-fifths vote in House and Senate

Debt capacity guidelines

- No constitutional or statutory limit on amount of debt state can take on (since const'l amdt in 1962)

- MMB POLICY – three debt capacity guidelines:

1. Total tax-supported principal outstanding shall be 3.25% or less of total state personal income

2. Total amount of principal (both issued and authorized but unissued) for state general obligations, state moral obligations, equipment capital leases, and real estate capital leases are not to exceed 6% of state personal income

3. 40% of general obligation debt shall be due within five years and 70% within ten years

Two Funding Requirements

- Nonstate match of 50%
- Project must be fully funded

Nonstate Match

- Statute requires a 50% match of NONSTATE money for capital projects of local governments
  - Other state money appropriated for the project or granted to the local government for the project do not count as nonstate money
  - Money spent on earlier phases of the project do not count toward the match for the phase of a project funded in the bill
  - The legislature can waive the requirement for a 50% nonstate match when there is a “compelling reason.”

Full Funding

- A project must be fully funded before MMB will release bond proceeds for the project.

- Local government has to show that full funding is committed to the project

Tax-exempt Status

- Federal law determines whether bonds can be sold as tax-exempt
- One of the requirement for tax-exempt status is a limit on the amount of private use.
- Private use can be an issue in situations where private vendors will have space
- Projects with significant private use should probably be funded with cash or other non-g.o. bond financing instrument

Bond proceeds come with strings

- Local governments must enter into a grant agreements
- Restrictions on the sale of state bond-financed property.
  - Sale has to be for market rate, unless the sale is for another public entity to use for the same purpose
  - Bonds have to be repaid from the proceeds of the sale first
- See MMB's "After the Bonding Bill" document

Cancellations

- Appropriations for capital projects (whether from the g.o. bond proceeds or the general fund) do not cancel at the end of the biennium, like other appropriations

- Unspent, unencumbered portions of appropriations for capital projects cancel after 4+ years.

Other financing options

- Revenue bonds
- Appropriation bonds – state- or agency-issued
- Certificates of participation
- Lease-purchase financing for equipment or real estate

Revenue bonds

- Backed by a dedicated revenue stream
- Market value, and therefore the interest rate, depends on how reliable and predictable the revenue stream is
- Example: 2011 tobacco settlement revenue bonds

State-Issued Appropriation bonds

- New in 2011; held valid by MN S.Ct. in 2012
- Not backed by “full faith and credit”
- Not backed by a revenue stream
- Just a promise that the state will make appropriations for bond payments
- Interest rate – higher than G.O. bonds
- Have authorized them five times:
  - 2011: to refund tobacco settlement revenue bonds
  - 2011: Pay for Performance program
  - 2012: Professional football stadium
  - 2015: Lewis and Clark water project
  - 2017: Lewis and Clark water project

Agency-Issued Appropriation Bonds

- Agency issues bond. State appropriates money (typically through a statutory appropriation) to pay the debt service on them

- Examples:
  - MHFA: Housing Infrastructure Bonds
  - U of M: Clinical research building in Gov's 2018 bonding bill