Senate Local Government Committee

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SENATE BILL 340 – P.N. 474

EXISTING LAW

The Local Government Unit Debt Act, 53 Pa.C.S. §§ 8001-8049, ("LGUDA") provides for review of borrowing and project financings by the Department of Community and Economic Development (DCED), defines the different types of debt a municipality may enter into, and sets limits on the amount of debt a municipality can incur without voter approval. The Act has not seen significant change since 1998.

At the Local Government Committee hearings on the Harrisburg fiscal situation, and on version of the bill itself, inadequacies and problems with the Act in its current form became evident. This summary includes some of those findings as examples of the effect of changes proposed by Senate Bill 340.

SUMMARY

1. **The Process**. LGUDA currently provides for a review by DCED of a list of documents that occurs after a borrowing ordinance has already been passed. Unfortunately, by the time that review takes place, a local government unit has already bound its taxpayers to a transaction, which would be nearly impossible to unwind should problems exist. Senate Bill 340 would require preliminary filings with DCED before the final vote to enable adequate examination in a timely fashion to insure the original intent of LGUDA is followed. The preliminary filings largely consist of information which is already prepared or readily available to a municipality contemplating a borrowing, including:

   - the local government unit is current in filing its annual financial statements with commonwealth agencies, including the debt statement required by section 8110 ;
   - a description of the intended borrowing and the intended uses of debt proceeds;
   - a statement of the intended manner of sale of the bonds or notes;
   - the local government unit is current on its municipal securities disclosures per 17 CFR §240.15c2-12;
   - if the local government unit intends for the proposed debt to be self-liquidating, information that the debt will qualify as self-liquidating;
   - the estimated net debt service impact of the transaction the plan to provide the tax or other revenues necessary to pay the debt service on the debt;
   - a copy of any interest rate management plan prepared or reviewed by an independent financial advisor with respect to a proposed qualified interest rate management agreement ("swap").

2. **Guarantees.** Under LGUDA, local governments are required to ensure that the revenues necessary to pay the debt will be generated. Although mentioned in the law, a guaranty by one local government unit of another unit's debt is not intended to be a substitute for appropriate evaluation of the risk of a bond issuance in the marketplace. A project should be designed to stand on its own

merits before a guaranty should be allowed to bind another government's taxpayers. Senate Bill 340 would provide that a local government unit may only issue a guaranty of debt of another local unit if it has conducted its own due diligence to determine the risks involved in the transaction, including the impact on its own future financial condition, the financial condition of the entity seeking the guaranty, the sources and reliability of revenue to cover the underlying obligation, and the likelihood of default of the entity seeking the guaranty. A guaranty would be made by vote of the governing body after a public meeting at which the foregoing due diligence is demonstrated.

The bill also eliminates the ability of one local government to charge a fee to another local government for its guaranty, the cost of which increases the underlying debt.

3. **Definition changes**. A "self-liquidating" debt is a debt which pays for itself and therefore is not counted against a local government's debt limit. If a debt is being paid for by another local government under a guaranty, it clearly indicates that the expected revenue stream is not there and the debt is not self-liquidating. In the Harrisburg situation, repeated false filings were made with DCED indicating debt being paid under a guaranty was self-liquidating. Senate Bill 340 amends the definition to address payments under guarantees. Senate Bill 340 would also amend the "working capital" definition to more clearly prohibit borrowing for ongoing operational costs. The current law allows for borrowing for up to one year for operating costs to get the project up and running and able to earn those revenues. As indicated, a project must have a revenue stream to pay debt service. Ongoing borrowing for daily operating costs had never been intended by LGUDA, and the bill would clarify this.

4. **Participants in the process**. Both the hearings on the Harrisburg issues and the hearing on proposed changes to LGUDA revealed that participants in the borrowing process were often either unrepresented in a transaction, or were confused as to whom was acting as an advisor in their behalf. In Harrisburg, for example, not one person involved in the process presented a negative scenario to warn the city or prospective bond purchasers. Around the Commonwealth, the same individuals frequently appear on various sides of these multiple transactions.

Senate Bill 340 would provide that participants in these transactions make it clear, and declare in writing, who it is they represent. Although called "municipal advisors" by the federal government, representatives of financial institutions are in fact sellers of a product to the local government. They do not owe the municipality a fiduciary duty, and they do not have the best interests of the municipality at heart. The person who indicates representation of the municipality would owe a fiduciary duty to that municipality. Local government units are entitled to know whether they are proceeding without someone who represents their interests or whether they need to retain someone to do so, if they do not already have someone on staff.

Additionally, LGUDA since its inception has contained no enforcement provisions within it. While the violations found in Harrisburg could have been enforced through other laws or the ethics commission, the lack of clear provisions in the act was found to be an impediment. Senate Bill 340 makes false filings and other violations of LGUDA enforceable, and provides alternate means for their enforcement.

5. **Other provisions:**
   - Increases the amount of "small borrowings", which can be done by resolution and without DCED review, from $125,000 to $250,000 and exempts them from preliminary filings;
   - Adds a definition for "financial advisors" consistent with federal law;
   - Improves review of debts claimed to be self-liquidating by requiring updated filings;
   - Provides that LGUDA records are public, open to inspection and must be retained;
   - Effective Date: 60 days.

AMENDMENT #A03718 TO SB340

This amendment is primarily technical in nature and further clarifies the original intent of several provisions of the bill.

Specifically, the amendment clarifies language pertaining to the definition of "working capital." Borrowing is currently allowed for one year of working capital to get a project up and running. Borrowing for more than one year indicates that the project is not generating revenue and therefore amounts over that should be considered "unfunded" under the Local Government Unit Debt Act (LGUDA).

The amendment also contains language to clarify that the provisions regarding guarantees pertain to situations where a local government unit is considering a guaranty of the debt of a separate and distinct government unit, and not an authority which it itself incorporated.

Amendment A03718 also clarifies that the provisions regarding fiduciary duty only pertain to financial advisors retained and compensated directly by the municipality, not persons such as representatives of a lender or underwriter who are otherwise covered by federal securities laws.