

Written Testimony of the Department of Community and Economic Development
Senate Local Government Committee
September 9, 2013

The following testimony is submitted on behalf of the Pennsylvania Department of Community and Economic Development.

Early this year the staff of the Local Government Committee shared with the Department of Community and Economic Development an early version of Senate Bill 901 and asked for the Department's input.

One of the most forceful recommendations made at last fall's hearing was that our Department be given a heightened role in the review and approval of local government debt. Under the current law, debt applications are not submitted for review until after the debt is incurred by the local government unit and the bonds are sold. Presently, the Department only has a 20-day period to review the applications.

Senate Bill 901 would replace the single review with a two-step process, and require a local government unit to submit a preliminary application to us before the debt is incurred. As part of our preliminary review, the Department would be authorized to examine and verify the local government unit's compliance with audit and disclosure requirements, determine that adequate security will be in place to insure completion of the project to be funded, and review the facts that would justify treating the debt as "self-liquidating".

We agree with this approach and offered additional suggestions that have been incorporated into Senate Bill 901.

The Department recommended that a limit be placed on the ability of a local government unit to include costs that were incurred more than one fiscal year before the borrowing, as part of the project costs. This was prompted by situations wherein a local government unit attempted to use debt proceeds to reimburse itself for costs that were incurred long before the application for borrowing. For example, a local government unit including in its project cost a land purchase that occurred four or five years before the application for borrowing. The Department does not believe that a local government unit should be permitted to incur debt for an item that, in effect, has been paid for and, therefore, believe there should be some limit on the "look back" period. (See SB901, Section 8007, page 5.)

Next, the Department asked that the local government units be required to provide us with a detailed project description, including a specific breakdown of costs to be financed. Many of the applications that are submitted simply indicate that the debt is being incurred "for various capital projects", with no detail being given. The Department should have more information

about the purpose for which the debt is being incurred. (See SB901, Section 8111(a)(9), page 10).

The Department also asked that the applications be required to contain an estimate of the costs of issuance, including underwriters' discount, counsel fees, financial advisory fees, accounting fees and other costs, and recommended that a cap be placed on those costs so that the total cannot exceed 2 percent of the issue, the same cap that federal tax law imposes on tax-exempt bonds. (See SB901, Section 8111(a)(9), page 10 and Section 147(g) of the Internal Revenue Code).

Next, the Department recommended that no bonds or lease rental debt be sold under a debt ordinance or resolution that is more than one year old, to eliminate local government units from issuing large "parameters" ordinances, sometimes with no well-defined project in mind, and then not selling bonds until many years later. This situation became quite common in connection with the limitations that were placed on school district debt by Act 1. (See SB901, Section 8102.1(e), page 9).

Next, following on the findings of the U.S. Securities and Exchange Commission, and its Report on the Municipal Securities Market, dated July 31, 2012, pages 16-17, which discusses the increased cost to issuers of negotiated offerings versus competitive sales, the Department recommended a limit on the local government unit's ability to sell bonds through private negotiation to a maximum of \$5 million annually, unless the local government unit presents satisfactory evidence that exceeding the limit is necessary and in the best interests of the local government unit. This limit would allow most small issuers to continue with business as usual, and yet insure a competitive process for larger issues and larger issuers. (See SB901, Section 8161(a), page 10).

The Department also believes there should be some controls placed on the refunding activity to insure that the transaction is really in the best long term interests of the local government unit. Senate Bill 901 provides the Department with the vehicle to review refunding applications and seek additional information where, for example, the refunding application appears to generate fees and administrative costs but offer no savings to the local government unit. (See SB901, Section 8102.1(a)(6), page 8).

With Self-Liquidating Debt Reports, the Department thinks there should be some limitation on the user rate increase assumptions in determining project revenues. These reports are submitted for review along with applications wherein the local government unit is requesting that the debt be treated as self-liquidating on the basis that the project revenues will be sufficient to pay all or some defined portion of the project debt service. However, it is common to see engineering reports that simply assume that the user rates will be increased to whatever

is necessary to pay debt service. Allowing these assumptions without any limitation does not always reflect the reality of the rate payers' ability to pay and defeats the purpose of the self-liquidating report. (See SB901, Section 8026(a) (5), page 5).

Finally, due to the increased administrative responsibilities that will be placed on DCED by Senate Bill 901, the Department asked that the Debt Act filing fees, which have not increased in more than 30 years, be increased slightly, and also that the Department be allowed to retain the filing fees to pay for the cost of administering the Debt Act. (See SB901, Section 8203, page 11).

The Department fully supports Senate Bill 901 and urges its passage.

Thank you for your time and attention. We appreciate this opportunity to offer these comments.