



TENNESSEE MUNICIPAL LEAGUE

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The Honorable Justin P. Wilson
Tennessee Comptroller of the Treasury
State Capitol, First Floor
Nashville, TN 37243

Dear Comptroller Wilson:

On behalf of Tennessee's municipalities, the Tennessee Municipal League (the League) thanks you for your attention to matters relating to municipal financing and debt management. The League and its member municipalities appreciate your efforts to promote greater disclosure and enhanced transparency relative to the terms, conditions, and risks associated with local government financing. It is readily apparent that you and your staff have invested substantial time and energy in issues associated with derivatives-oriented transactions and the development of the proposed Model Debt Management Policy.

This letter is in response to your request for comments on the proposed Model Debt Management Policy. While you would likely prefer a direct and detailed response to the specific provisions included in the draft, inconsistencies in the phrasing used in the documents circulated, public statements, and press reports associated with this proposal have resulted in confusion concerning its intended use.

The draft model policy appears to include some flexibility that affords covered entities the ability to shape the policy to fit their needs and circumstance; however, it also includes some absolutes. The presence of these absolutes appears to dictate specifics and afford covered entities no freedom to modify policies to conform to their unique needs and circumstances. In addition, many of these absolutes seem to limit existing authority and conflict with current law, while others seem to impose requirements that exceed those imposed under current law.

The degree to which the presence of these absolutes and the ramifications associated with their presence raise concerns or generate objections within the League's membership depends upon the intended application of the proposed policy. Therefore, the League is primarily confined, in this communication, to seeking clarification regarding intent.

As previously stated, the current state of confusion stems from seemingly inconsistent phrasing that has appeared in documents, statements and reports in association with this draft policy. For example, the introduction to the draft speaks of "encouraging" and "recommending" that local governmental entities adopt their own Model Debt Management Policy and implies that the draft proposal is intended to serve as guidelines to assist in the development of such policies.

However, recent comments and press accounts suggest the intended purpose may be evolving from recommendations and guidelines to mandates and a prescribed uniform policy. This apparent transition is evidenced in a recent article that appeared in *The Times-Sean* that stated, "The comptroller's proposals, if adopted by the State Funding Board, would be binding, and his office believes it has sufficient authority to enforce the policies."

These inconsistencies invite several questions concerning intent:

1. Is the intent that the State Funding Board recommend that covered entities adopt a debt management policy and encourage entities to look at this model as best practices that they should aspire to achieve?
2. Is the intent to require covered entities to adopt a debt management policy and to encourage covered entities to use the proposal as a guide in developing their own policy?
3. Or, is the intent to require a covered entity to adopt the Model Debt Management Policy as its own?

Each of these possibilities is very different and the implications associated with each possibility warrants differing degrees of concern and reaction.

Recommending or even mandating that covered entities adopt their own debt management policy is altogether different from dictating the policy that covered entities are required to adopt. While the League and its members would have little or no objection to requiring covered entities to adopt a debt management policy, there would be significant opposition to any effort that mandates adoption of specific policies.

Municipal officials are elected by the members of their respective communities to represent the interest of the community and have been granted the authority to and entrusted with the responsibility of managing local finances, including deciding how and when to borrow funds to finance public projects. Mandating the adoption of any debt management policy that effectively conditions or denies local officials the freedom to modify or eliminate provisions of the policy based upon their own needs, circumstances and experiences violates the principle of local autonomy.

While the guidelines follow the basic tenets of the Best Practices for debt management, as recommended by the GFOA, the level of detail included in the Model Debt Management Policy is far more specific so as to create essentially a uniform policy. A one-size-fits-all policy that prescribes this level of detail is impractical and unworkable.

There are a number of different types of entities covered under the proposed draft with varying purposes and statutory authority. Moreover, there are vast differences between entities within each classification or category of covered entities. Within our membership alone, which accounts for just one of the categories of covered entities, there are differences that would preclude application of a standard policy, including: population; rural; urban; expectations; experiences; needs; taxing capacity; revenue base; financial management history; capital needs; cash reserves; debt service reserves; existing debt portfolios; credit rating; economic conditions; retail base; property values; development potential; etc.

Additionally, should municipalities be required to adopt the policy as presented, it would certainly increase the costs associated with borrowing and constitute a significant unfunded mandate on local governments.

Again, the views of the League and its membership concerning the specific items included in the draft policy are largely contingent upon the intended application. We would welcome the opportunity to share additional thoughts once it is clear to municipalities within what context the specifics of this proposed Model Debt Management Policy should be evaluated.

However, we would like to share a summary compilation of some of the most common questions and concerns expressed concerning the draft.

Amortization and Payment of Principal

- Cities have suggested that the provisions pertaining to the reduction of amortization and acceleration of principal payments might be best pursued as goals that local governments strive to achieve, but they are not the basis for a viable debt policy.
- It has been observed that these provisions appear to be designed to promote pay-as-you-go financing that assumes a willing constituency and places the financing burden squarely on the pocketbooks and wallets of those on the tax rolls at the time. This practice might be acceptable if local governments only financed the purchase of squad cars, fire trucks, backhoes and bulldozers; however, many of the public projects that would be financed under these proposed policies will be enjoyed by the public for decades to come. Why should current taxpayers have to bear the overwhelming majority of the burden for a project that will be enjoyed by future generations? Would it not be more appropriate to distribute the burden more fairly over 25 or 30 years?
- It has been noted that just as there are clear and distinct differences among the entities covered under the proposal, there is also disparity among the various types of projects that would be financed under these policies. Reducing amortization and accelerating principal is not feasible or appropriate for all projects.
- Municipalities have expressed concern that reducing amortization and accelerating principal, in concert, will result in higher monthly payments than would be associated with level debt service over twenty-five years.
- Some have pointed out that these provisions give no consideration to inevitable factors that are beyond a local government's control such as economic downturn, relocation or closure of an industry or business, a reduction in or elimination of federal or state funds, or an unanticipated opportunity for economic development.
- It has been argued that the increased obligations municipalities will be required to assume under these requirements would certainly affect local leaders' ability to manage local responsibilities and to respond to urgent community needs. Moreover, these increased obligations would most likely dictate the use of local taxing authority and advance the imposition of utility rate increases; thus, limiting local leaders' role in a process that has heretofore been their domain.
- Similarly, municipalities have indicated their concern that reducing amortization and accelerating the payment of principal may increase the burden borne by the taxpayers and ratepayers. Conversely, as the threshold for retiring principal is reached and the

justification for the tax or rate increase no longer exists, there would be an expectation that the tax or utility rates would be reduced accordingly. This dynamic could result in taxpayers and ratepayers experiencing significant fluctuations in taxes or utility bills – something not commonly associated with debt amortized over 25 years with level debt payments.

Economic Development

- Municipalities have argued prohibiting the financing of any project not included in the current year's budget will preclude a timely response to unanticipated opportunities, including economic development opportunities, or urgent community needs.
- League members have questioned the rationale for requiring an independent feasibility study and review before financing economic development projects. Cities have argued there are statutes in place that regulate such projects and that such actions are always subject to public review and debate. Moreover, it has been argued that local officials are elected to make such determinations and are directly accountable to the public for their decisions.
- Officials have suggested these provisions seem to exceed any requirements imposed upon the State for such purposes and that any revision to existing authority should be reserved for the General Assembly.

Limits on Debt

- Cities have insisted that limits on the total amount of debt, the allocation of outstanding debt, and annual debt service should be determined locally.
- Municipalities have inquired as to whether the limit imposed on the amount of total debt held that may be financed under an agreement with a variable rate of interest is intended to be applied to existing debt or future debt.
- Municipalities have questioned whether this limit should be applicable to every city or to every transaction. Each city is different. Not all variable rate transactions involve the same type of variable rate product, the same type of project, or the same obligation or risk and, as such, all variable rate transactions are not equal.
- Officials have pointed out that there are varying approaches to avoiding risks associated with certain transactions. One approach is to limit or preclude such transactions, while another is to implement responsible procedures and take prudent actions to mitigate the risks. These officials have expressed the concern that, at the expense of local autonomy, the policy insists upon limiting use of such financing tools rather than allowing for the mitigation of the risk.

Capitalized Interest

- Cities have argued that the proposed restrictions on capitalized interest do not take all types of construction projects into consideration and that it should be allowed for more than 36 months.

Professional Services

- It has been noted that the requirements for retaining the services of professionals addressed under the proposal exceed current law and that some of the conflict of interest provisions may be difficult to verify or satisfy.
- Cities have questioned whether financial advisors are really necessary for every municipality in every transaction and whether these requirements effectively delegate the authority and subject the will of the elected body to that of a contract employee.

Risk Assessments and Reports

- Municipalities argue that it is unnecessary and costly to require a formal risk assessment of every jurisdiction annually, a formal risk assessment of all new debt, and a formal report annually on changes to law and their affect on the management of debt.
- It is argued that this is the responsibility of professional staff.

“Balloon Payments”

- Municipalities recognize the dangers associated with the practice of deferring the payment of principal for extended periods of time and support your attention to payments structured in this manner. However, there are legitimate reasons to defer payment of principal and it is necessary to ensure that any provisions included on this subject continue to allow for legitimate debt leveling activities.

Sincerely,



Tommy Pedigo, President
Tennessee Municipal League

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