

AN INTRODUCTION TO
THE LOCAL GOVERNMENT UNIT DEBT ACT

Article IX , Section 10, of the Constitution of the Commonwealth of Pennsylvania was amended in 1968 to provide that the General Assembly prescribe the debt limit of municipalities and school districts, that limit to be a percentage of total revenues as defined by the General Assembly. In 1972, the Legislature implemented that section of the Constitution with the enactment of the Local Government Unit Debt Act, Act 185 of 1972. On April 28, 1978, Act 185 was repealed and reenacted by the Act of 1978-52, 53 P.S. Section 6780-1 et. seq. On December 19, 1996, Act 177 of 1996, which recodified the Act, was signed into law, effective in 60 days. This introduction reflects the recodified Sections.

DETERMINATION OF BORROWING CAPACITY

The starting point of any municipal indebtedness is the determination of the borrowing base and the preparation of the certification of this borrowing base. Section 8002 of the Act defines the borrowing base as the annual arithmetic average of the total revenues for the three full fiscal years immediately preceding the incurring of nonelectoral debt or lease rental debt. Total revenues as defined in Section 8002 means all monies received by the local government unit, except the following:

1. Subsidies or reimbursements from the Federal or State government measured by the cost or given on account of a particular project financed by debt;
2. Revenues, rates, receipts, user charges, special assessments and special levies pledged for specific self-liquidating debt (any excess revenues returned to the local government for general operating purposes shall not be excluded);

3. Interest on moneys in sinking funds or reserves which are pledged for the payment or security of outstanding debt;
4. Grants and gifts designated for a specified project;
5. Nonrecurring receipts such as bond and note proceeds and sale of capital assets or items not considered income under generally accepted municipal accounting principles.

While the annual financial report filed with the Department of Community and Economic Development is an excellent source of information for determining the total revenues, remember that some items properly included as receipts in the annual audit do not constitute revenues within the meaning of Section 8002 of the Act. For example, refunds of money on previously paid accounts and interdepartmental transfers from other accounts do not constitute new revenues.

The borrowing base certificate accompanies and is part of every debt statement filed under the Act. The certificate must be executed by authorized officials of the local government unit or by an independent accountant. This is a change from earlier versions of the Act which required it to be executed by the elected auditor or CPA.

DEBT LIMITS

Once you have determined and certified your borrowing base you can calculate your borrowing capacity. The Act provides two separate basic debt limits, one when incurring nonelectoral debt and the other when incurring lease rental debt. It is important to remember that the local government unit must come within the debt limits imposed for both nonelectoral debt and lease rental debt. This requires that the total outstanding debt must be considered in every instance.

The Act provides in Section 8022 (a) that no local government unit shall incur any new nonelectoral debt if the aggregate net principal amount of such new debt together with all other net nonelectoral debt outstanding would cause the total net nonelectoral debt to exceed:

1. 100% of its borrowing base in the case of a school district of the first class;
2. 300% of its borrowing base in the case of a county; or
3. 225% of its borrowing base in the case of a school district of the first class A through fourth class; or
4. 250% of its borrowing base in the case of any other local government unit.

It further provides in Section 8022(b) that no local government unit shall incur any new lease rental debt or nonelectoral debt if the aggregate net principal amount of such new debt together with any other net nonelectoral debt and lease rental debt then outstanding would cause the total nonelectoral debt plus lease rental debt to exceed:

1. 200% of its borrowing base in the case of a school district of the first class;
2. 400% of its borrowing base in the case of a county; or
3. 225% of its borrowing base for a school district of the first class A through fourth class; or
4. 350% of its borrowing base in the case of any other local government unit

You determine the maximum nonelectoral debt or lease rental debt limit by multiplying the borrowing base (the average of three years' total revenue) by the limit applicable to the

particular local government unit. For example, a city, borough, or township with a borrowing base of \$50,000 would have the following basic limitations:

Nonelectoral debt - $\$50,000 \times 2.5 = \$125,000$
Nonelectoral plus Lease rental debt - $\$50,000 \times 3.5 = \$175,000$

In addition to these basic limits, Section 8022(d) provides an additional limit of 100% to counties where they have assumed county-wide responsibility for such programs as hospitals, air and water pollution, flood control, water sewage and refuse systems, education, highways and public transportation. This additional 100% is available to other local government units when the county has not assumed countywide responsibility and when the local government unit has either before or after the effective date of the Act assumed such responsibility for itself and its adjacent areas.

When it becomes necessary to replace assets as a result of some catastrophe or natural disaster or when funds are required by payment of tort liability or to meet mandated State or Federal programs and the local government unit does not have sufficient borrowing capacity, upon petition to and approval of the Court of Common Pleas of the County where the local government unit is located an additional 50% of the borrowing base may be authorized.

DEBT

Under the Act the definition of debt has been expanded over that previously contained in the Municipal Borrowing Law. Debt as defined in Section 8002 means the amount of all obligations for the payment of money incurred by the local government unit, whether due or

payable in all events, or only upon performance of work, possession of property as lessee or rendering of services by others, except:

1. Currently budgeted obligations, including tax anticipation notes and current payments for the funding of pension plans;
2. Obligations under contracts for supplies and services allocable to current operating expenses of future years;
3. Rentals payable in future years under “true leases”; and
4. Interest or assumed taxes payable on bonds or notes which interest or taxes is not yet overdue.

The method of determining existing net nonelectoral debt and net nonelectoral plus lease rental debt is provided in Section 8028. Gross nonelectoral debt shall be first established by subtracting from the total outstanding indebtedness the sum of debt incurred with the consent of the electors plus the lease rental debt. The net nonelectoral and net lease rental debt shall then be determined by subtracting separately from each:

1. All monies in applicable sinking funds and bond proceeds held for the payment of the project financed by such debt;
2. Current appropriations for the payment of principal and overdue interest on nonelectoral debt or for the payment of net lease rental in the case of lease rental debt except to the extent that the same has already been deposited in sinking funds;
3. Uncollected property assessments for which liens may be filed to the extent that such assessments are available for the payment of the principal amount of such debt.

4. Delinquent taxes and other undisputed municipal liens filed against property less specified deductions;
5. The amount of self-liquidating and subsidized debt properly excluded and concurrently excludable;
6. Surplus cash not appropriated to any other purpose;
7. Solvent debts due; and
8. Insurance coverage indemnifying the local government unit against liability to the extent that it is debt.

Specific provision is made in the Act for excluding subsidized debt and self-liquidating debt evidenced by revenue bonds or notes, general obligation bonds or notes, or a guaranty. See Sections 8024, 8025 and 8026. In addition, procedure is provided in Section 8023 to transfer nonelectoral debt to electoral debt.

All of the above must be considered when determining existing debt and the relevant borrowing capacity. A current debt statement is an integral part of the proceedings that must be filed with the Department. The Act is specific as to what the debt statement must contain. Section 8110 provides that the statement must be prepared and verified under oath or affirmation by the officers so authorized, and must be prepared within sixty days of filing with the Department, showing:

1. Gross indebtedness;
2. Credits and exclusions claimed;
3. The aggregate principal amount of the bonds or notes being issued or evidencing lease rental debt;
4. The borrowing base as shown by the appended borrowing base certificate;

5. The applicable nonelectoral and nonelectoral plus lease rental debt limits; and
6. In the case of a refunding, the principal amount of bonds or notes which will no longer be outstanding.

When debt has been previously excluded, subsequent debt statements should be accompanied by a certification of no change in circumstances so that less debt should be excluded. See Section 8110(b).

BONDS AND NOTES, INCLUDING TAX ANTICIPATION NOTES

Local governments may borrow by issuing bonds or notes. As a general rule, prior approval by the Department of Community and Economic Development is required before they can be transferred to the purchaser. Before issuing lease rental debt by becoming bound on a lease rental agreement or guaranty with an authority, the local government unit must also receive Departmental approval. The exceptions to this rule are tax and revenue anticipation notes, and small borrowings for capital purposes pursuant to Section 8109 of the Act. When Departmental approval is sought for the issuance of bonds or notes, or the incurrence of lease rental debt, proceedings should be filed by the local government unit in the Department's Harrisburg office. Our address for purposes of filing is **Office of Chief Counsel, DCED, Commonwealth Keystone Building, 400 North Street, 4th Floor, Harrisburg, PA 17120.**

Section 8109 of the Act provides a simplified procedure for certain small borrowings. Local government units are authorized to incur debt without filing for Departmental approval provided that: (1) the debt is issued to provide funds for a capital project; (2) the aggregate of such debt incurred pursuant to Section 8109 outstanding at any one time does not exceed the lesser of \$125,000 or 30% of the nonelectoral debt limit; (3) the principal shall mature within

five years from date of issuance; and (4) the debt is within the overall nonelectoral and nonelectoral plus lease rental debt limits. Section 8109 applies only to notes issued by the local government unit, and does not apply to authority notes. If all of the conditions of Section 8109 are met, the local government unit may authorize the note by resolution without the need to publish any notice of its adoption. Also, no Departmental approval is required.

If the proposed note does not meet all of the requirements of Section 8109, it must be authorized by ordinance, as provided in Sections 8103 and 8107, advertised as provided in Section 8003, and submitted to the Department of Community and Economic Development as provided in Sections 8201 and 8210. Except for obligations issued under Section 8109 or tax and revenue anticipation notes, all other bonds or notes issued by a local government unit must be approved by the Department before they can be transferred to the purchaser.

Tax and revenue anticipation notes are not subject to the nonelectoral debt limit but the Act prescribes the procedure for issuing such notes. The Act specifies that the note cannot extend beyond the current fiscal year in which it is issued. The maximum amount that may be borrowed at any time cannot exceed 85% of the taxes and revenues yet to be received in that fiscal year, and during the period in which the note will be outstanding. It requires that prior to each issuance of tax and revenue anticipation notes, a careful estimate be made of the monies to be received in each remaining month of the fiscal year from taxes levied and assessed and revenues (including subsidies or reimbursements) to be received. Such estimates must take into consideration past experience in collection and current economic conditions. In addition, the local government unit may

make a single authorization and then issue portions of such amount whenever desired in that fiscal year.

Obligations incurred in anticipation of taxes and revenues do not require the approval of the Department of Community and Economic Development but Section 8128 provides that the following must be filed with the Department prior to issuance of the notes:

1. A copy of the Resolution authorizing the note;
2. A copy of the accepted proposal to purchase the note;
3. A copy of the certificate of anticipated taxes and revenues.

No tax and revenue anticipation note shall be valid or obligatory in the hands of the original purchaser until certified copies of the items prescribed in Section 8128 have been filed with the Department. You may file these documents related to tax and revenue anticipation notes in any of our regional offices or in our main Harrisburg office. Upon receipt of the documents, a receipt will be issued which you will take to closing.

These comments are intended to introduce you to the Local Government Unit Debt Act and should not be substituted for the Act itself. Copies of the Act, as amended, as well as sample proceedings, are available from the Department of Community and Economic Development. Any questions should be directed to the **Office of Chief Counsel, Department of Community and Economic Development, Commonwealth Keystone Building, 400 North Street, 4th Floor, Harrisburg, PA 17120-0225.**