

## **General Obligation and Revenue Bonds-Overview**

### **GENERAL OBLIGATION (GO) BONDS**

General Obligation (GO) Bonds are the predominant municipal bonds and are unsecured bonds that are backed by the "the full faith and credit" of the local or state government that issued the bond.

- **Advantages:**
  - Provides cheapest rate of financing
  - Conservative structure
- **Disadvantages:**
  - Counts against any statutory debt limits, Debt affordability targets
  - Impact net-tax supported debt levels used by rating agencies

### **REVENUE BONDS**

Revenue bonds are characterized by a guarantee of repayment solely from a **designated** revenue source and not the full faith and credit of the issuer or revenues such as tolls, fees, bills, tickets, or other services generated by a specified revenue-generating entity associated with the purpose of the bonds. No general taxing authority including income tax or property taxes are levied or pledged.

Legally, bondholders do not have recourse against the full-faith and unlimited power of the government and these bonds are expected to be fully self-supporting. There are some practical limitations to this in terms of an entities participation and reputation in the bond market.

- **Advantages:**
  - Governments have the ability to finance traditional projects without pledging the power to tax, reserving this power for other services.
  - Often greater nexus between the revenue source and intended use.
  - Relies solely on “ability to pay”, subject to rating agency and bond market issues noted above.
  - Flexible structure
  - “Fence Off” revenues for a specific purpose instead of competing for GO bond authority.

#### **Disadvantages:**

- Higher cost of capital since repayment of revenue depends on the continuity of the revenue source.
- Higher coverage requirements (i.e. revenues compared to debt service).

- Requirement to maintain a debt service reserve.
- Generally require more complex financial arrangements.

#### **Types of revenue Bonds:**

- Enterprise Revenue Bonds Enterprise Revenue Bonds finance projects that are expected to generate revenues to repay the debt.
- Special Revenue Bonds Special Revenue Bonds are secured by some special revenues such as an assessment or gasoline tax. The funds are directed to a special fund established for the purpose of bond repayment. The contents of the fund form the bonds security and payment source.
- Sales tax revenue Bonds General sales tax dedicated at least in part to some public purpose.
- Others depending on the source of revenue (tolls, income tax, etc)

#### **“DOUBLE BARREL” BONDS**

This is a municipal bond that is backed by a special tax or by a specific source of revenue, as well as by the full faith and credit of the issuer and therefore a hybrid of revenue and GO bonds. The primary source of funds to pay the debt service is the designated revenue source. The general obligation source acts as a back-up.

- **Advantages:**

- These bonds have the additional security of an unlimited or limited tax pledge should revenues be insufficient to meet debt service.
- Seeks to optimize the credit rating attributes of general obligation debt while reducing the coverage ratios (i.e., the amount of revenue designated to pay debt service), thereby reducing the cost of capital.

- **Disadvantages:**

- Under certain circumstances, it could adversely impact the GO rating and impact capital debt affordability targets.

**NOTE:** Whether a Revenue Bond or a “double barrel” bond, bonds financed by existing streams of revenue are generally part of your “net tax supported debt calculation” by the rating agencies.

## **PRIVATE ACTIVITY BONDS (PAB)**

Private activity bonds are securities issued by or on behalf of a local government to provide debt financing for projects used most often by a private user. Private activity bond financing normally results in reduced financing costs since interest on the bonds is not subject to federal income taxes. The state or local government does not generally pledge its credit for payment of the bonded debt. Private activity bonds are normally payable solely from payments made by the private user of the property financed. They bear numerous restrictions imposed by federal and state regulations.

The federal tax code authorizes each state an allocation of tax-exempt bond cap. Each state's "volume cap" is calculated according to a formula established by federal tax law: a certain dollar amount per person (determined each year by the IRS) multiplied by the state's official population (as estimated by the Census Bureau). In addition, unused volume cap may be carried forward for future use; carry-forward amounts expire after three years.

The Internal Revenue Code provides that only the following private activity bonds may bear tax exempt interest:

- **Exempt facility bonds:**
  - Airports, docks and wharves, mass commuting facilities and high speed intercity rail facilities.
  - Facilities for the furnishing of water.
  - Sewage facilities and solid waste disposal facilities.
  - Residential rental projects.
  - Local furnishing of electric energy or gas.
  - Local district heating or cooling facilities.
  - Qualified hazardous waste facilities.
  - Environmental enhancements to hydroelectric generating facilities.
  
- **Mortgage revenue bonds**
  - Private activity bonds issued to fund mortgage loans to finance owner-occupied residential property.
  - Qualified mortgage bonds are often referred to as single family mortgage revenue bonds.
  
- Student loan bonds.
  
- Qualified development bonds.
  
- Qualified 501(c)(3) bonds. Private activity bonds issued to finance a facility owned and utilized by a 501(c)(3) organizations.

- **Advantages:**
  - A frequent advantage of PABs is the private-use of a municipality's tax-exempt name as a conduit to tax-exempt interest rates.
  - This type of a bond results in reduced financing costs because of the exception of federal tax
  - The local government issuer incurs no legal responsibility to repay private activity conduit bonds; rather, the private business's credit quality provides the security for the debt financing and ultimately all repayment responsibilities.
- **Disadvantages:**
  - Projects to be financed on a tax-exempt basis with private activity bonds must comply with the Internal Revenue Code and its regulations and various state statutes. Restrictive.
  - Limited by volume cap causing competition for resources, although not an issue in the current low interest rate environment and spreads between taxable and tax-exempt debt.