

## SDCTA “101” on Governmental Long-term Liabilities

This document is meant to serve as a review of various types of general governmental long-term liabilities. The review is not meant to be an exhaustive list of every type of long-term liabilities governments can incur.

### 1. Bonds

A bond is a formal contract between two parties in which a borrower receives a specified sum of money in exchange for future periodic repayments with interest at fixed intervals. Interest payments made on fixed intervals are typically referred to as coupons. The following are types of bonds typically issued by governments:

- i) **General Obligation Bond** – A bond in which future payments are secured solely by the municipality’s legal authority to produce revenue using all available resources, specifically future tax collections. A municipality must obtain 2/3 voter approval prior to issuance of a general obligation bond.

*Example:* The City of San Diego issued \$25.5 million in general obligation bonds in 1991 to fund the City’s Public Safety Communications Project. The bonds are backed by the City’s “pledge to levy ad valorem property taxes without limitation” as necessary to meet the City’s debt obligation.

- ii) **Pension Obligation Bond** – A bond in which a municipality uses generated revenue to fund the expected cost of outstanding employee pension obligations (Unfunded Actuarially Accrued Liabilities for pension) and/or other post employment benefits. Municipalities are not required to obtain voter approval to issue pension obligation bonds.

*Example:* In 1994 the City of Chula Vista issued a series of pension obligation bonds to cover the cost of Unfunded Actuarially Accrued Liabilities for pension owed by the City to its retirement system CALPERS. The amount of the bond issuance was \$8.82 million, as of June 2009, the City had retired \$1.82 million of the total issuance, leaving \$7 million outstanding.

- iii) **Revenue Bond** – A bond in which the payments are made from the revenues generated from a specific project or facility which was funded through the proceeds of the bond. Municipalities are not required to obtain voter approval to issue revenue bonds.

*Example:* In 1995, the City of Poway issued revenue bonds totaling \$3.38 million to help finance water facility improvements. A portion of the City’s future water operations revenue is dedicated to the debt service of these revenue bonds.

- iv) **Special Assessment Bond** – A bond in which future payments are secured by future collections. Collections are derived from the levy of a special assessment made on a specific set of property owners whom benefit from the provision of local improvements or service increases.<sup>1</sup> Municipalities are not required to obtain voter approval to issue special assessment bonds.

*Example:* In 1991, the County of San Diego issued \$28.8 million in special assessment bonds to fund improvements in the 4-s Ranch community. Debt service on these bonds is paid through a special assessment levied by the County on property owners in the 4-s Ranch community.

- v) **Tax Allocation Bond** – Tax allocation bonds are associated with community redevelopment agencies. A tax allocation bond is a bond agreement in which a municipality uses generated revenue to fund the current projects of a redevelopment agency and issues repayment from future property tax increment collections that are generally appropriated to the redevelopment agency. Municipalities are not required to obtain voter approval to issue tax allocation bonds.

*Example:* In 1997, the Redevelopment Agency of the City of San Marcos issued a series of tax allocation bonds totaling \$9.5 million to fund redevelopment projects. The majority of the bonds had a maturity date of 2027. The interest on these bonds is funded by property tax increments collected by the Redevelopment Agency.

## 2. Lease Obligations

A Lease obligation is any contract in which a municipality rents or retains ownership of property or capital asset for a specified period of time in exchange for a series of deferred payments. Lease agreements can be arranged with the supplier of the property or capital asset, with a third-party, or through a securities market. Municipalities are not required to obtain voter approval to incur any form of lease obligation. The following are types of lease obligations governments typically enter into:

- i) **Certificates of Participation** –A type of financing that allows investors to purchase a share of future lease revenue paid by a municipality for a specified project. A certificate of participation allows a municipality to obtain financing for a large capital project or purchase that could otherwise not be obtained through an agreement with a single investor or third-party. Certificates of participation are not subject to indebtedness restrictions placed upon local governments by the State Constitution.

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<sup>1</sup> See SDCTA analysis on Prop 218

*Example:* The City of San Diego established in the San Diego Facilities and Equipment Leasing Corporation (SDFELC) to acquire and lease to the City of San Diego real and personal property to be used in municipal operations. In 1996, the SDFELC issued certificates of participation totaling \$33.43 million used to lease property necessary to carry out ongoing municipal operation.

- ii) ***Tax-exempt lease obligation*** –Any form of capital lease obligation in which the interest component of the payments to the principal are tax-exempt.

### 3. Other Liabilities

The following is a list of the other types of liabilities that governments typically incur:

- i) ***Notes Payable*** – A promissory note representing a municipality’s obligation of repayment of a loan to a bank or other creditor; in other words, the cost of all future payments on a municipality’s outstanding loans (not including bonds and lease agreements).

*Example:* In 2004 the Encinitas Housing Authority acquired 30 year term loans totaling \$1,905,388 from commercial lenders for the purpose of purchasing 16 affordable housing units.

- ii) ***Compensated Absences*** – All types of employee absences for which municipalities are required to provide compensation including vacation, sick leave, and sabbatical leave. Compensated absences must be recorded as they are accrued by employees, and become a liability when they are not funded by the municipality at the time of accrual. A municipality’s total compensated absences liability represents the total amount of unfunded employee accrued compensated absences that have yet to be collected by employees.

*Examples:* The City of Lemon Grove accounts for all accrued and unused vacation and sick leave as compensated absences liability. While accrued uncollected vacation time is paid out to the employee upon termination or retirement, sick leave is most commonly forfeited unless it can be converted to retirement credit through CALPERS. In 2009, the City of Lemon Grove accounted for \$662,831 in compensated absences liability.

- iii) ***Other Post Employment Benefits*** – In addition to pensions, municipalities often offer other post employment benefits (OPEB) as part of a total compensation package. Examples include healthcare, dental, and life insurance. Similar to compensated absences, other post employment benefits can become a liability when a municipality does not presently fund the expected future payments necessary to meet the post employment obligations made to employees.

*Example:* The City of Chula Vista offers employees the opportunity to purchase retiree healthcare coverage through the City's medical plan. The City's OPED liability represents the future healthcare costs of all employees that have bought into the plan. In 2009, the City of Chula Vista had a Net other post employment benefits liability of \$638,752.