GO ITEM #1
July 20, 2020
Worksession

M E M O R A N D U M

July 15, 2020

TO: Government Operations and Fiscal Policy (GO) Committee

FROM: Gene Smith, Legislative Analyst
Aron Trombka, Senior Legislative Analyst, OLO

SUBJECT: Resolution to authorize Montgomery County to procure lines of credit for the purpose of providing funds for the payment of operating expenses

PURPOSE: Make recommendations to the Council

Expected Attendees:
Mike Coveyou, Department of Finance (Finance)
Jacqueline Carter, Finance
Karen Hawkins, Finance
Rich Madaleno, Office of Management and Budget
Marc Hansen, Office of the County Attorney
Paul Shelton, Bond Counsel to the County Government

The County Executive requests that the Council approve a resolution to authorize the County Government to procure lines of credit to address potential timing issues related to the State's income tax distributions due to the COVID-19 pandemic. See the Executive's transmittal memorandum and proposed resolution on ©1-6. **The full Council is tentatively scheduled to act on this resolution on July 28, 2020**.

Council staff recommends approval of the proposed resolution with two amendments.

1) Council staff recommends including a sunset provision on December 31, 2022 since the purpose of this authority is to address a specific issue resulting from the current pandemic.
2) Executive staff have requested a technical amendment to Section 4 of the resolution to clarify better the intent of renewals and repayments for the lines of credit.

A. Background

Councilmembers may not be familiar with lines of credit as the County has never previously employed this method of borrowing. As such, Council staff presents the following background material extracted from a recent Office of Legislative Oversight (OLO) paper on public sector line of credit borrowing. A copy of the complete OLO paper appears on ©7-11.

Definition: A line of credit is a type of bank loan that allows incremental borrowing up to a set dollar amount for a specified term. At the outset, the bank and the borrower agree on the maximum loan amount that will be available under the line of credit. **In the case of a public sector borrower, the government provides a note to the bank that is backed by the full faith and credit of the jurisdiction**.

The borrower may draw funds from the line of credit up to the maximum loan amount. Lines of credit typically have a specified duration (term), such as one, two, or five years. The borrower pays a service fee to the bank to secure access to the specified funds throughout the term of the line of credit loan. During the term of the loan, the borrower may repay some or all the borrowed funds and then redraw funds again up to the maximum amount minus any unpaid principal until the term expires. A line of credit bank loan may carry a fixed or variable interest rate. The borrower pays interest on the loan balance (that is, the amount actually borrowed) during the term of the loan and must repay the entire outstanding balance at the end of the term.

Use of Borrowed Funds: A government may use line of credit funds for operating or capital expenditures. The County's Finance Department intends to procure lines of credit to assure that the County has ready access to funds in the event that timing, and amount of State tax disbursements are not adequate for the County to pay ongoing operating expenses. Finance has characterized the line of credit as "insurance" against a severe and long-term recession.

Comparison to Other Forms of Borrowing: Lines of credit differ from General Obligation (G.O.) Bonds, leases, and other more traditional forms of County borrowing in several respects, including:

- *Use of funds*: The County has taken on debt almost exclusively to finance capital projects or to acquire durable equipment. A line of credit would provide cash to meet operating expenses or to pay debt service on past borrowing.
- *Term*: County G.O. and revenue bonds typically have a term of 20 or more years. Equipment leases often have terms that extend seven years. Lines of credit may have much shorter terms.
- *Payback Schedule*: For most forms of borrowing, the County receives funds at the outset and then subsequently repays the debt in fixed installments over a specified term. In contrast to long-term debt, the County would pay interest on a line of credit loan balance while the line is open and may repay borrowed funds in one or multiple payments any time during the loan term.

Charter Restriction: The Charter authorizes the County to incur debt. However, the Charter limits the use of debt to fund operating expenses. Section 312 of the Charter states that "no indebtedness for a term of more than one year shall be incurred by the County to meet current operating expenses." As such, if the County were to use a line of credit to fund operating expenses, then any dollars borrowed from the line of credit would have to be repaid within 12 months.

Advisability: While taking on debt to pay government operating expenses is not sound fiscal policy during normal swings in the economic cycle, this practice is more justified when used to provide a fiscal buffer in times of severe and unanticipated revenue drop and cash flow challenges. Bank lines of credit are an established form of government borrowing during times of cash flow challenges spurred by sudden revenue loss and unanticipated demand for emergency services. The Government Finance Officers Association (GFOA) considers use of lines of credit a "best practice" when a government develops specific policies and procedures to address the legal and financial aspects of using bank loans.

Credit Ratings: State and local governments must disclose most bank loans in their financial statements. As such, rating agencies are aware of these loans when evaluating the credit worthiness of a jurisdiction. In some cases, rating agencies have cited a jurisdiction's increased reliance on lines of credit as a cause for an increasing debt position which, in turn, was a contributing factor for a ratings downgrade. On the other hand, the availability of a line of credit could bolster a government's credit worthiness by offering a government an additional source of liquidity. In a report on the effect of the COVID-19 crisis on state and local government credit conditions, Standard and Poor's identifies the absence of lines of credit and other sources of liquidity to address short-term cash needs as a risk factor for a ratings downgrade.

B. Summary of Executive's Proposed Resolution

The Executive's proposed resolution defines and details the County processes for executing and using the proposed Lines of Credit Agreement(s) (the "Agreements"). Council staff summarizes Sections 1-8 of the resolution with additional notes following each section for the committee's consideration.

Section 1. **Limits the maximum amount to $300 million for any Agreements authorized by this resolution**.

> Finance indicates that it will execute Agreements based on actual cash flow needs for FY21, but the maximum amount will be $300 million. The maximum limit was chosen based on the typical value of the County's largest income tax distributions; the maximum amount allowed is also about half of the County's estimated FY21 starting reserves.

Section 2. **Allows the County to issue one or more Agreements**.

> Finance indicates it will execute Agreements with two financial institution (i.e., two Agreements with different negotiated terms).

Section 3. **Grants general authority to the Director of Finance to negotiate the specific terms for the Agreements**.

> The relevant agreement terms that will be negotiated are: 1) origination fees; 2) undrawn commitment fees; 3) repayment terms; and 4) drawdown interest cost. **Each of these terms has a fiscal impact for the County**. Finance staff note that through December 31, 2020 these fees are eligible for reimbursement from the Federal grant related to COVID-19.

Since the contracts have not been executed, specific terms are unable to be disclosed because they are subject to change until both parties execute the agreement.

Section 4. **Limits certain terms of the Agreements**.

- *Interest rate*. Restricts the maximum rate to 6%. Finance notes that the actual rate will be much lower than this threshold. The actual rate will fluctuate based on market conditions (i.e., a variable rate).
- *Agreement Renewal*. Executive staff requested an amendment to this section as described on page 6. The amended language allows the County to renew these Agreements with the only restriction that any drawn funds must be repaid in 12 months. This condition meets the requirement in §312 of the Charter to repay any loans for operating expenses within 12 months.

Section 5. **Requires that the County to pledge its full faith and credit to repay any borrowed funds**. Per the resolution, the County will levy property taxes at a rate sufficient to repay any of the funds drawn by the lines of credit, including interest. This section ensures that the County repays the loans within 12 months of drawing upon them. Whether the Council will need to consider a property tax rate to repay any borrowed funds will depend on actual revenues and expenditures in FY21, as well as the total amount of borrowed funds.

Section 6. **The Director of Finance determines when funds are drawn from the Agreements but must notify Council once it happens**.

The conditions that must be met before the Director of Finance may consider borrowing funds from the Agreements are:

1) an event has occurred that has a materially adverse impact on the operations or financial condition of the County; and

2) either the County's Revenue Stabilization Fund (RSF) has insufficient funds to address the County's unmet funding needs; and/or b) the Council is in recess and cannot approve the use of the RSF.

The Director of Finance must notify the Council three days after any funds are drawn under the Agreements.

The Council likely will have an indication prior to the three days after funds have been borrowed from the Agreements since the use of the RSF is stipulated in the resolution. Use of the RSF requires Council approval; however, it is important to note that as written, the Director of Finance may determine that funds must be borrowed without any prior notice to the Council. This provides flexibility to the County to address cash flow needs immediately.

Reserve Primer

The decision to borrow funds from the Agreements is partly conditioned on the County's reserves. The County tracks two reserve funds – the Unrestricted General Fund and the

Revenue Stabilization Fund. The values of these two funds are reported each year in the Fiscal Plan Summary (see lines 31-44 ©12). The ending values in FY20 that were estimated by the County for each portion was:

1) Unrestricted General Fund portion: $154.1 million; and
2) Revenue Stabilization Fund portion: $382.2 million.

These estimates are based on the economic and financial information in May. Actual reserve levels will be updated throughout the year based on actual revenues and expenditures.

The Unrestricted General Fund is the most liquid of the two reserve funds. This fund includes the unappropriated portion of the County's tax revenues each year. The County Charter restricts this amount to a maximum of 5% of tax revenues from the previous year. Most special or supplemental appropriations that are funded throughout the year use this reserve fund to fund those appropriations, unless a State or Federal grant is the source of funding. This amount fluctuates based on the County's actual revenues and actual expenditures during the fiscal year.

The RSF is created in County Code §§20-64 through 72. **The RSF is best understood as the County's "Rainy Day Fund."** Funding is added to the RSF when certain volatile tax revenues (e.g., income, recordation) exceed the estimated projections for those revenues during the fiscal year. Use of the RSF is more restrictive than the Unrestricted General Fund reserves.

- The County can only use RSF funds by an affirmative vote by six Councilmembers, after a public hearing.
- The Council is expected to receive an update on relevant economic indicators and seek the Executive's recommendation before approving the use of RSF funds.
- Use of the RSF, if approved by the Council, is restricted to appropriations that have become unfunded during the fiscal year.

Section 7. **Grants the Executive and Chief Administrative Office broad authority to ensure that the County can execute and meet the conditions of the Agreements**.

Section 8. **Notifies the Council that the planned Agreements at $300 million does not exceed 75% of the total taxes levied and the amount of uncollected taxes in FY21**.

C. Proposed Amendments

1. Executive Staff Requested Amendment

Executive staff recommends replacing the language for Section 4 on ©5 with the following language to clarify the interest and repayment terms of a line of credit authorized under the resolution.

> The Notes shall bear interest at a rate not to exceed six percent (6%) and shall mature, and any funds advanced to the County for operating expenses pursuant to the Loan Documents, together with the interest thereon, shall be repaid to the Lender no later than twelve months after the Notes are issued to secure an advance to the County. Such Notes may be renewed; provided such renewal notes shall mature no later than twelve months after the original issuance of the Notes.

2. Council Staff Recommendation

The unprecedented fiscal challenges brought on by the current pandemic warrant taking extraordinary action to preserve the County's financial standing. The County should undertake several steps to maintain its ability to pay on-going operating obligations. With the prospect of a deep decline in revenues during the next couple of years, the County must take action to control spending and to access funds necessary to pay its bills. Procurement of lines of credit is a reasonable strategy to meet cash flow needs as the County navigates its way through the pandemic-induced economic downturn.

Council staff recommends approval of the resolution with two amendments.

1. Borrowing to procure funds to pay operating expenses should be limited to periods of extreme economic challenges such as the current pandemic. The County should not rely on line of credit borrowing when the economy recovers from the current recession; therefore, Council staff recommends adding a sunset provision to the resolution. Specifically, we suggest appending the following language to the end of Section 11 of the resolution:

   > *The authority granted in this Resolution to the Executive and the Director of Finance to enter into a line of credit agreement, note purchase agreement, loan agreement, or similarly titled agreement between the County and a Lender expires on December 31, 2022.*

2. Staff concurs that the revised Section 4 proposed by the Executive provides helpful clarification and should be approved as requested.

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OFFICE OF THE COUNTY EXECUTIVE
Rockville, Maryland 20850

Marc Elrich
County Executive

MEMORANDUM

June 30, 2020

TO: Sidney Katz, President
Montgomery County Council

FROM: Marc Elrich
County Executive

SUBJECT: Resolution to authorize Montgomery County, Maryland to Issue Notes to Provide Funds for the Payment of Current Obligations of the County under a Line of Credit Agreement

Attached please find a Resolution which provides the authority for the County to issue short-term notes upon the full faith and credit of the County to supplement funds required to pay County operating expenses. The Notes may be issued by private negotiation to a financial institution, or group of financial institutions, to evidence the County's repayment of obligations under a Line of Credit (LOC) Agreement.

As detailed in the Resolution and attached Certification, the County pursuant to Enabling Acts, may issue indebtedness (LOC advances) in anticipation of the collection of taxes or other current revenues. Each advance secured by the short-term notes would mature and be payable within 12 months. Given the potential negative impact on the cash flows caused by the COVID-19 pandemic, the County is negotiating with two financial institutions for lines of credit not exceeding $300 million.

While it cannot be determined with certainty at this time if short-term borrowing will be necessary, our cash flow projections indicate that it might be prudent to start drawing advances under the lines during the Spring of 2021. As disruptions caused by the pandemic have resulted in shortages, and increasing prices for short-term liquidity, it is necessary that the County secure financing now. Undrawn commitment fees, approximating $144,000 per month are planned to be funded with CARES Act proceeds at least through December 31, 2020. Debt service on advances, if needed, will be based on a variable interest rate.

I would appreciate it if you could arrange to have this Resolution placed on the County Council Calendar for introduction on Tuesday July 7th. If you have questions or need further clarification, please contact Michael J. Coveyou.

Thank you.

ME:jdc
Attachments

CERTIFICATION IN CONNECTION WITH RESOLUTION AUTHORIZING THE ISSUANCE OF SHORT-TERM NOTES

TO: President and Members of the Montgomery County Council

I am providing this statement in compliance with Section 20-10, Chapter 20 of the Montgomery County Code ("Section 20-10") in connection with the transmittal of a Resolution authorizing the issuance of short-term notes upon the full faith and credit of the County to provide funds, if necessary, to fund operating expenses pending the collection of taxes and revenues.

Section 20-10 limits the face value of the short-term notes that may be issued to provide funds for current obligations of the County to an amount that does not exceed 75% of the total levied and uncollected taxes and the estimate of the uncollected revenues in the current fiscal year. The amount of levied and uncollected taxes for FY21 is $3,981,000,000 and the estimated amount of uncollected revenues for FY21 is $232,000,000 or a total of $4,213,000,000. Seventy Five percent of such taxes and revenues is an amount of $3,159,750,000 (the "Maximum Amount"). The County has not heretofore issued any notes under the authority of Section 20-10. The Resolution authorizes short-term notes in an aggregate principal amount not to exceed $300,000,000. Therefore, the face value of the short-term notes authorized by the Resolution does not exceed the Maximum Amount. In connection with the issuance of such short-term notes, the County shall not borrow any funds in an amount in excess of the Maximum Amount.

The repayment of any advances to the County under a credit or loan agreement would be secured by the short-term notes. The County would be able to obtain advances from time to time as necessary during the term of the credit or loan agreement. In compliance with Section 312, Article 3 of the Montgomery County Charter, each advance secured by the short-term notes would mature and be payable within 12 months after such advance to the County.

While it cannot be determined with certainty at this time if short-term borrowing will be necessary, the County can preserve this option by entering into an agreement that will provide for the availability of funds. Some financial institutions have reached their limits in providing short-term liquidity; therefore, the County is acting prudently to avoid the unpredictability of the short-term liquidity market.

By: Michael J. Coveyou

Name: Michael J. Coveyou
Title: Director of Finance
Date: 6/30/2020

Resolution No._________
Introduced:____________
Adopted:______________

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: County Council

SUBJECT: **To authorize Montgomery County, Maryland (the "County") to issue notes upon the full faith and credit of the County for the purpose of providing funds for the payment of current obligations of the County constituting operating expenses; to provide for the sale of such notes; and generally to provide for and determine various matters in connection with such notes.**

Background

1. **Pursuant to Section 10-203 of the Local Government Article of the Annotated Code of Maryland, as amended, Section 312 of the Montgomery County Charter, and Section 20-10 of Chapter 20 of the Montgomery County Code, as amended (the "Code") (collectively, the "Enabling Acts"), Montgomery County, Maryland (the "County") is authorized to issue upon its full faith and credit, in anticipation of the collection of taxes and other current revenues, tax or revenue anticipation notes in the aggregate principal amount not to exceed $300,000,000 (the "Notes") to provide funds necessary for the payment of current obligations of the County constituting operating expenses.**

Action

The County Council for Montgomery County, Maryland, hereby approves the following resolution:

Section 1. Montgomery County, Maryland (the "County") is hereby authorized pursuant to the Enabling Acts, to issue, sell and deliver at one time or from time to time, in anticipation of the collection of taxes or other current revenues, notes or other form of indebtedness of the County and renewals of such notes or other obligations in the aggregate principal amount not to exceed $300,000,000 (the "Notes") for the purpose of providing funds necessary to meet current operating expenses of the County.

Section 2. The Notes may be issued and sold in one or more series by private negotiation to a financial institution or group of financial institutions (the "Lender") to evidence the County's repayment obligations with respect to funds loaned to the County by such Lender under a Line of Credit Agreement (hereinafter defined). The County Executive of the County (the "County Executive") is hereby authorized to select the Lender upon the recommendation of the Director of Finance of the County (the "Director of Finance") that the lending terms offered by such Lender are in the best interest of the County and consistent with the provisions of this Resolution. The issuance and sale of the Notes in the manner provided in this Resolution is hereby determined to be in the best interest of the County.

Section 3. The Director of Finance is hereby authorized to negotiate the terms of a line of credit agreement, note purchase agreement, loan agreement or similarly titled agreement (the "Line of Credit Agreement" and, together with the Notes, the "Loan Documents") between the County and the Lender. The Loan Documents will be in such form and include such terms and provisions as the County Executive shall approve consistent with the provisions of this Resolution. The County Executive's execution and delivery of the Loan Documents shall constitute conclusive evidence of such approval and of the selection by the County Executive of the Lender party thereto.

Section 4. The Notes shall bear interest at a rate not to exceed six percent (6%) and shall mature no later than ninety days after the expiration of the fiscal year in which such Notes are issued and shall not thereafter be renewable or payable by the issuance of renewal notes except that any such renewal notes issued within three months prior to the expiration of any one fiscal year may mature at any time during the fiscal year next succeeding the fiscal year in which the original notes were issued, *provided however*, that any funds advanced to the County for operating expenses pursuant to the Loan Documents, together with the interest thereon, shall be repaid to the Lender no later than twelve months from the date such funds are advanced to the County.

Section 5. The County hereby covenants and agrees that in any fiscal year in which any of the Notes are outstanding, it will levy or cause to be levied ad valorem taxes upon all the assessable property within the corporate limits of the County in rate and amount sufficient to provide for the payment, when due, of the interest and premium (if any) on and principal of all the Notes maturing in each such fiscal year, and in the event the proceeds from the ad valorem taxes so levied in any such fiscal year prove inadequate for the above purposes, it will levy additional taxes in the succeeding fiscal year to make up for such deficiency, all in accordance with the provisions of the Enabling Acts.

Section 6. The Director of Finance is hereby authorized to make a determination that an event shall have occurred that has, or economic conditions are such that with the passage of time such conditions would have, a materially adverse impact on the operations or financial condition of the County and upon such determination seek the approval of the County Council in accordance with Section 20-72 of the Code to withdraw funds from the Revenue Stabilization Fund in the amount that the Director of Finance determines is sufficient to prevent the materially adverse impact.

In the event the Director of Finance determines that the withdrawal from the Revenue Stabilization Fund approved by the County Council is insufficient to prevent the materially adverse impact, or that the County Council is in recess and is unable to take action to approve or disapprove the requested withdrawal in a sufficiently timely manner, to prevent the materially adverse impact, the Director of Finance may effect draws up to the maximum principal amount available under the Line of Credit Agreement.

No later than three (3) days after effecting the initial and any subsequent draw of funds under the Line of Credit Agreement, the Director of Finance shall provide notice to the County Council setting forth the date of such draw, the principal amount of such draw and the purpose of the funds drawn.

Section 7. The County Executive and the Chief Administrative Officer of the County (the "Chief Administrative Officer") may, by executive order or otherwise, specify, prescribe, determine, provide for, approve, execute and deliver (where applicable) such other matters, details, forms, documents or procedures, as are necessary, proper or expedient to consummate the authorization, sale, security, issuance, delivery or payment of or for the Notes.

Section 8. The Director of Finance has provided and the County Council has accepted a statement showing that (i) the amount of levied and uncollected taxes for the current fiscal year is $ 3,981,000,000, (ii) the estimated amount of uncollected revenue for the current fiscal year, excepting taxes is $ 232,000,000, (iii) the County has not previously issued any tax or revenue anticipation notes pursuant to Section 20-10 of the Code during the current fiscal year or in any previous fiscal years, (iv) the face value of the Notes authorized by this Resolution does not exceed in the aggregate 75% of the total (i) and (ii) above, and (v) the face value of all notes issued pursuant to Section 20-10 during the current fiscal year are payable within one year and three months.

Section 9. Notwithstanding any of the foregoing, all or a portion of the Notes authorized hereby may alternatively be issued and sold to the Municipal Liquidity Facility established under Section 13(3) of the Federal Reserve Act.

Section 10. The members of the County Council, the County Executive, the Chief Administrative Officer, the County Attorney, the Director of Finance and the Clerk of the Council, for and on behalf of the County, are hereby authorized and empowered to do all things, execute all instruments, and otherwise take all such action as may be necessary, proper or expedient to carry out the authority conferred by this Resolution.

Section 11. This Resolution shall take effect upon its adoption.

This is a correct copy of Council action.

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Selena Mendy Singleton
Clerk of the Council

Office of Legislative Oversight
SPOTLIGHT
May 7, 2020

Line of Credit Borrowing

By Aron Trombka
www.montgomerycountymd.gov/olo

The Department of Finance soon will submit to the Council a proposal for the County to procure lines of credit to potentially access funds during the upcoming decline in revenues resulting from the Covid-19 health crisis. The County has never previously procured lines of credit. This memo provides information about line of credit. The Department of Finance will provide Council with details about the County's line of credit proposal in a separate submission expected in the next week or two.

1. What is a line of credit?

A line of credit is a type of bank loan[1] that allows incremental borrowing up to a set dollar amount extended over a specified period of time. At the outset, the bank and the borrower agree on the maximum loan amount that will be available under the line of credit. In the case of a public sector borrower, the government provides a note to the bank that is backed by the full faith and credit of the jurisdiction.

The borrower may draw funds from the line of credit up to the maximum loan amount. Lines of credit typically have a specified duration (term), such as one, two, or five years. The borrower pays a service fee to the bank to secure access to the specified funds throughout the term of the line of credit loan. During the term of the loan, the borrower may repay some or all of the borrowed funds and then redraw funds again up to the maximum amount. A line of credit bank loan may carry a fixed or variable interest rate. The borrower pays interest on the loan balance (that is, the amount actually borrowed) during the term of the loan and must repay the entire outstanding balance at the end of the term.

A government may use line of credit funds for operating or capital expenditures. The County's Finance Department intends to use the lines of credit to maintain cash flow as necessary to meet operating expense obligations in the wake of the COVID-19 revenue downturn. Finance has characterized the line of credit as "insurance" against a severe and long-term recession.

[1] Bank loans taken by a public sector entity are also referred to as "direct placements."

2. How does a line of credit compare to other forms of County borrowing?

Public sector entities, including Montgomery County, borrow funds in a variety of ways. Generally, County borrowing is intended to help finance capital projects or equipment acquisition. Common forms of County borrowing include:

General Obligation (GO) Bonds: GO bonds are secured by the full faith and credit and taxing power of the County. Bonds are issued in serial maturities of one to 20 years, normally with five percent of the principal retired each year.

Revenue Bonds: Revenue bonds finance revenue producing projects such as parking garages and solid waste facilities. Bonds are repaid from revenues generated from these projects.

Bond Anticipation Notes (BAN)/Commercial Paper: BAN/commercial paper are a type of short-term borrowing with the expectation that the principal will be repaid with the proceeds of long-term general obligation bonds.

The County also employs other forms of borrowing including capital leases for construction or acquisition of certain facilities as well as certificates of participation, master leases, and short-term leases for equipment acquisition.

Lines of credit differ from more traditional forms of County borrowing in several respects.

a. Use of funds: The County has taken on debt almost exclusively to finance capital projects or to acquire durable equipment. A line of credit would provide cash to meet operating expenses or to pay debt service on past borrowing.

b. Term: County GO and revenue bonds typically have a term of 20 or more years. Equipment leases often have terms that extend seven years. Lines of credit may have much shorter terms. A recent Brookings Institution study found that state and local government lines of credit most commonly extend for two to three years.[2] (See next question for information a possible legal constraint regarding County line of credit borrowing.)

c. Payback Schedule: For most forms of borrowing, the County receives funds at the outset and then subsequently repays the debt in fixed installments over a specified term. In contrast, with a line of credit, the County would pay interest on the loan balance while the line is open and also could repay borrowed funds any time during the loan term.

d. Borrowing Cost: Short-term bank loans (including lines of credit) and long-term bond issuances are distinct debt markets with differing borrowing cost considerations. As noted by the Government Finance Officers Association (GFOA), "because bank loans are typically not executed in an environment that is as transparent as the bond market, an issuer may have limited ability to assess whether the proposed interest rate(s), fees and

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[2] Ivanov, Ivan T, and Zimmermann, Tom, *The "Privitization" of Municipal Debt*, Brookings Institution Hutchins Center on Fiscal and Monetary Policy, September 2018, https://www.brookings.edu/wp-content/uploads/2018/08/WP45.pdf

terms are competitive with a publicly offered bond issue and typically are of shorter duration." [3]

3. Are there any legal restrictions on the County's use of lines of credit?

The County Charter authorizes the County to incur debt. However, the Charter limits the use of debt to fund operating expenses:

> *No indebtedness for a term of more than one year shall be incurred by the County to meet current operating expenses.*[4]

According to a 1991 County Attorney opinion, operating expenses mentioned in the Charter are "generally understood to mean the normal cost of maintaining and operating County programs. Operating expenses usually involve the costs associated with physical maintenance, administration, salaries, claims, insurance, and rentals."[5] As such, if the County were to use a line of credit to fund operating expenses, then any dollars borrowed from the line of credit would have to be repaid within 12 months.

4. Is borrowing through lines of credit an advisable practice for local governments?

While taking on debt to pay government operating expenses is not sound fiscal policy during normal swings in the economic cycle, this practice is more justified when used to provide a fiscal buffer in times of severe and unanticipated revenue drop and cash flow challenges.

The Brookings Institute found that state and local governments are more likely to borrow from banks during periods of "transitory shock," that is, an episode of falling revenues and sudden, unanticipated costs. The Brookings study did not envision a pandemic, but instead discussed the effects of prolonged, severe winter weather.

> *To the extent that businesses in the municipality lose revenues because of unexpected adverse winter weather, the municipality will collect less in tax revenues, leading to reductions in total income. Similarly, unexpected adverse winter weather could increase the operating costs of municipal entities through lost employee productivity, further reducing municipal income. We find that counties use credit lines to buffer adverse transitory income shocks. Consistent with the transitory nature of these shocks, outstanding credit line drawn amounts increase following these transitory shocks. Overall, our evidence on both permanent and transitory income shocks suggests that in a scenario of economic*

[3] Government Finance Officers Association, *Bank Loans and Direct Placements,* https://www.gfoa.org/bank-loans-and-direct-placements.
[4] Montgomery County Charter, Section 312.
[5] Memorandum for Marc P. Hansen, Senior Assistant County Attorney to Charles L. Short, Director of Department of Family Resources, October 23, 1991, http://www.amlegal.com/pdffiles/MCMD/10-23-1991.pdf.

stress municipal entities are likely to shift debt structure towards private debt and therefore accelerate the trend higher reliance of public entities on bank loans. [6]

Bank lines of credit are an established form of government borrowing, particularly during times of cash flow challenges spurred by sudden revenue loss and unanticipated demand for emergency services. In fact, lines of credit are one the most common forms of bank lending to states and local governments.[7] The Government Finance Officers Association (GFOA) characterizes bank loans, including lines of credit, as **"**an important tool in a government's financing toolkit" that may be simpler to execute and incur lower issuance costs than a bond issuance.[8]

The GFOA considers use of lines of credit a "best practice" when a government develops specific policies and procedures to address the legal and financial aspects of using bank loans. GFOA recommends that governments establish these policies after taking into account multiple considerations including legal limitations, accounting and disclosure requirements, government debt capacity, the competitiveness of interest rates, and repayment terms. [9]

5. What are the disclosure requirements for line of credit borrowing?

Public disclosure of bank loans (including lines of credit) is required in government financial statements. State and local governments must report their bank loan capacity, including unused portions of lines of credit, to inform investors about the resources available to meet debt service obligations. A statement by the Government Account Standards Board (GASB) concluded that "financial statement users need information about unused lines of credit …. Disclosure of information related to unused lines of credit … provides users with information about potential sources for principal and interest repayments that could be accessed if cash resources of the indebted government are insufficient."[10] The GASB requirements do not limit disclosures of lines of credit to those used to repay debt, but include all lines of credit that could provide a potential source of liquidity.[11]

In February 2019, amendments to Security Exchange Commission (SEC) Rule 15c2-12 took effect regarding government bond issuances. In many cases, these SEC rule amendments will require state and local governments to disclosure of bank loans. The SEC rule clarifies that, for reporting purposes, government financial obligations include "direct placements, loans, lines of

[6] Op. cit., Ivanov and Zimmermann.
[7] Ibid.
[8] Op. cit., Government Finance Officers Association, *Bank Loans and Direct Placements.*
[9] Ibid.
[10] Governmental Accounting Standards Board, *Statement No. 88: Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, March 2018, https://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176170308047&acceptedDisclaimer=truehttps://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176170308047&acceptedDisclaimer=true
[11] Governmental Accounting Standards Board, *GFOA Member Alert: Implementing GASB 88*, https://www.gfoa.org/gfoa-member-alert-implementing-gasb-88

credit or other credit arrangements with private lenders or commercial banks."[12] In addition, GFOA advises that "many market participants have suggested that providing information about outstanding bank loans is necessary to assess an issuer's outstanding debt obligations and general credit quality."[13]

6. How do bond rating agencies view line of credit borrowing?

As mentioned above, state and local governments must disclose most bank loans in their financial statements. As such, rating agencies will be fully aware of these loans when evaluating the credit worthiness of a jurisdiction. According to the GFOA, "rating agencies treat bank loans akin to a bond issue or other long-term debt."[14] In some cases, rating agencies have cited a jurisdiction's increased reliance on lines of credit as a cause for an increasing debt position which, in turn, was a contributing factor for a ratings downgrade.

On the other hand, the availability of a line of credit could bolster a government's credit worthiness by offering a government an additional source of liquidity. According to a Standard and Poor's public sector ratings guide, the measurement of "liquidity and reserves" includes "all lawfully available cash reserves and external working capital or liquidity sources, including bank lines in force within the life of any short-term obligations."[15] Indeed, in a report on the effect of the Covid-19 crisis on state and local government credit conditions, Standard and Poor's identifies the <u>absence</u> of lines of credit and other sources of liquidity to address short-term cash needs as a risk factor for a ratings downgrade.[16]

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[12] Government Finance Officers Association, *Understanding Your Continuing Disclosure Responsibilities*, https://www.gfoa.org/understanding-your-continuing-disclosure-responsibilities-0.
[13] Op. cit., Government Finance Officers Association, *Bank Loans and Direct Placements.*
[14] Ibid.
[15] S&P Global Ratings, *U.S. Public Finance Ratings Criteria – Tax-Secured and Utilities*, July 2016, page 222, https://www.spratings.com/documents/20184/1282625/USPF+Criteria+Book+-+Oct16+-+Tax/22725e62-301b-4d1f-98e6-11a1436702d0
[16] Padilla, Oscar, and Little, Timothy W., S&P Global Rating, *The COVID-19 Outbreak Weakens U.S. State and Local Government Credit Conditions*, April 2, 2020, https://www.spglobal.com/ratings/en/research/articles/200402-the-covid-19-outbreak-weakens-u-s-state-and-local-government-credit-conditions-11411641

DRAFT County Council Approved FY21-26 Public Services Program

Tax Supported Fiscal Plan Summary

($ in Millions)

		App. FY20	Est. FY20	% Chg. FY20-21	App. FY21	% Chg. FY21-22	Projected FY22	% Chg. FY22-23	Projected FY23	% Chg. FY23-24	Projected FY24	% Chg. FY24-25	Projected FY25	% Chg. FY25-26	Projected FY26
31	**Beginning Reserves**														
32	**Unrestricted General Fund**	164.2	103.3	-6.1%	154.1	4.7%	161.4	10.2%	177.9	4.6%	186.1	3.3%	192.3	3.6%	199.3
33	**Revenue Stabilization Fund**	340.8	341.5	12.1%	382.2	2.2%	390.8	-2.8%	379.8	1.3%	384.8	2.2%	393.3	2.3%	402.3
34	**Total Reserves**	505.0	444.9	6.2%	536.3	3.0%	552.1	1.0%	557.7	2.4%	570.9	2.6%	585.6	2.7%	601.5
35															
36	**Additions to Reserves**														
37	**Unrestricted General Fund**	8.1	50.8	-11.0%	7.2	128.1%	16.5	-50.5%	8.2	-24.0%	6.2	11.5%	6.9	-7.5%	6.4
38	**Revenue Stabilization Fund**	23.1	40.6	-62.9%	8.6	-228.2%	-11.0	145.5%	5.0	70.0%	8.5	5.9%	9.0	14.4%	10.3
39	**Total Change in Reserves**	31.3	91.5	-49.4%	15.8	-65.1%	5.5	138.2%	13.2	11.7%	14.7	8.3%	15.9	4.9%	16.7
40															
41	**Ending Reserves**														
42	**Unrestricted General Fund**	172.3	154.1	-6.3%	161.4	10.2%	177.9	4.6%	186.1	3.3%	192.3	3.6%	199.3	3.2%	205.7
43	**Revenue Stabilization Fund**	363.9	382.2	7.4%	390.8	-2.8%	379.8	1.3%	384.8	2.2%	393.3	2.3%	402.3	2.6%	412.6
44	**Total Reserves**	536.2	536.3	3.0%	552.1	1.0%	557.7	2.4%	570.9	2.6%	585.6	2.7%	601.5	2.8%	618.2
45	**Reserves as a % of Adjusted Governmental Revenues**	**10.0%**	**10.0%**		**10.2%**		**10.0%**		**10.0%**		**10.0%**		**10.0%**		**10.0%**
46	**Other Reserves**														
47	**Montgomery College**	4.5	24.3	395.1%	22.3	0.0%	22.3	0.0%	22.3	0.0%	22.3	0.0%	22.3	0.0%	22.3
48	**M-NCPPC**	5.0	2.9	-0.1%	5.0	3.0%	5.1	2.2%	5.2	2.3%	5.3	2.3%	5.5	2.3%	5.6
49	**MCPS**	0.0	25.0	n/a	0.0	n/a	0.0	n/a	0.0	n/a	0.0	n/a	0.0	n/a	0.0
50	**MCG Special Funds**	0.8	-23.7	95.5%	1.5	10.2%	1.7	4.6%	1.8	3.3%	1.8	3.6%	1.9	3.2%	2.0
51	**MCG + Agency Reserves as a % of Adjusted Govt Revenues**	**10.2%**	**10.5%**		**10.7%**		**10.5%**		**10.5%**		**10.5%**		**10.5%**		**10.5%**
52	**Retiree Health Insurance Pre-Funding**														
53	Montgomery County Public Schools (MCPS)	**78.5**	**78.5**		**69.4**		**71.2**		**66.2**		**60.5**		**53.9**		**53.9**
54	Montgomery College (MC)	**5.4**	**5.4**		**5.5**		**5.6**		**5.4**		**5.3**		**5.2**		**5.2**
55	MNCPPC	**2.8**	**2.8**		**3.0**		**2.9**		**2.9**		**2.8**		**2.8**		**2.8**
56	MCG	**34.7**	**13.5**		**12.3**		**10.8**		**7.5**		**4.2**		**0.7**		**0.0**
57	**Subtotal Retiree Health Insurance Pre-Funding**	**121.4**	**100.3**		**90.1**		**90.5**		**82.0**		**72.9**		**62.6**		**61.8**
58	**Adjusted Governmental Revenues**														
59	**Total Tax Supported Revenues**	**5,095.9**	**5,105.8**	**1.2%**	**5,158.7**	**2.6%**	**5,295.3**	**2.6%**	**5,434.4**	**2.8%**	**5,588.0**	**2.6%**	**5,731.8**	**2.5%**	**5,872.5**
60	**Capital Projects Fund**	**145.7**	**145.7**	**-11.2%**	**129.4**	**5.9%**	**137.0**	**-2.6%**	**133.4**	**1.2%**	**135.0**	**6.5%**	**143.7**	**6.1%**	**152.4**
61	**Grants**	**119.2**	**119.2**	**7.4%**	**128.0**	**1.6%**	**130.1**	**1.6%**	**132.1**	**1.6%**	**134.2**	**1.6%**	**136.3**	**1.5%**	**138.4**
62	**Total Adjusted Governmental Revenues**	**5,360.9**	**5,370.8**	**1.0%**	**5,416.1**	**2.7%**	**5,562.4**	**2.5%**	**5,699.9**	**2.8%**	**5,857.3**	**2.6%**	**6,011.9**	**2.5%**	**6,163.4**