Municipal Bonding Basics

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Municipalities often borrow money to pay for long-term improvements such as water and wastewater systems, roads, public buildings, and major equipment. Municipal borrowing follows specific legal steps, and small errors in a vote warning, ballot, or financing document can delay or invalidate the process.

The most important advice for a municipal official who is new to bonding is to involve bond counsel early. Bond counsel helps the municipality understand its legal authority, prepare required documents, conduct the vote correctly, and complete the financing.

This resource provides general information only. It does not provide legal advice or replace advice from qualified bond counsel. Borrowing requirements depend on the project, financing structure, municipal charter, funding source, and current law.

Start with the basic terms

Bond

A bond is a formal promise to repay borrowed money over time, with interest. Municipal bonds generally follow detailed legal requirements for voter authorization, documentation, repayment, and use of the proceeds.

Note

A note is also a promise to repay borrowed money, but it may offer more flexibility than a bond. The required approval process depends partly on the length and purpose of the borrowing. A note with a longer repayment period

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may require the same voter approval process as a bond.

Bond anticipation note

A bond anticipation note, often called a BAN, provides short-term financing while a municipality waits to issue long-term debt. It is often used to pay construction costs before final project costs and long-term financing are known.

A municipality generally must already have authorization for the long-term borrowing before issuing a BAN. Keeping a BAN outstanding for more than a short period can affect the remaining amount and term of the final bond.

General obligation bond

A general obligation bond is backed by the municipality's commitment to repay the debt (the full faith and credit of the municipality). If the project's expected revenue or other funding is not enough, the municipality remains responsible for making the payments.

Revenue bond

A revenue bond is repaid and secured by revenue from a particular utility or system rather than by the municipality's general tax base. Revenue bonds may be available for certain water, wastewater, or electric utility projects and follow different requirements.

Tax-exempt borrowing

With tax-exempt borrowing, the interest received by the lender or investor is generally exempt from federal income tax. This may result in a lower interest

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rate for the municipality.

Tax-exempt borrowing also comes with federal requirements governing when money is borrowed, how it is spent and invested, and whether a private person or business may use the financed property.

Taxable borrowing

Taxable borrowing does not provide the same tax benefit to the lender and may have a higher interest rate. However, it may provide more flexibility when a project involves substantial private use or cannot meet tax-exempt financing requirements.

Bond counsel can help the municipality compare the legal and financial effects of taxable and tax-exempt options.

Prepare before contacting bond counsel

A municipality does not need a final design or confirmed financing package before contacting bond counsel. Early contact can help officials avoid decisions or expenses that create problems later.

Be prepared to discuss:

- The problem the project will address
- The proposed improvement or purchase
- The estimated project cost
- Grants, reserves, or other funding that may reduce borrowing

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- The estimated amount to be borrowed
- When project expenses will begin
- The expected construction or purchase schedule
- The possible repayment term
- How the debt may be repaid
- Whether a private person or business will use, lease, manage, or own any part of the financed property
- Whether the municipality has already spent money that it may want to repay from future loan proceeds
- Whether the project is subject to special program requirements, such as the Community and Housing Infrastructure Program (CHIP)

Bond counsel can identify which decisions must be made before a vote and which details may be decided later by the legislative body.

Address early project expenses

A municipality may begin paying for studies, design, engineering, or other eligible costs before it closes on a loan.

If the municipality may want to reimburse itself from future tax-exempt loan proceeds, bond counsel may recommend adopting a **declaration of official intent** before or near the time those costs are incurred. This declaration records the municipality's expectation that future borrowing may repay certain earlier project expenses.

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Adopting the declaration does not require the municipality to complete the project or borrow the money. It preserves an option that could otherwise be lost. Ask bond counsel about this issue before using municipal funds for project costs.

Understand the bond vote process

The exact process depends on the type and term of the borrowing, the municipality's charter, and other applicable law. For a typical municipal bond vote, bond counsel may prepare or review several important documents.

Necessity resolution

The legislative body adopts a resolution establishing the need for the project and borrowing. The resolution generally describes the project, its estimated cost, the proposed debt, and related decisions.

Meeting warning

The warning formally notifies voters of the meeting and vote. Bond votes have specific warning, posting, and publication requirements that may differ from the requirements for other annual or special meetings.

Do not assume that including the warning in the municipal report or following the municipality's usual meeting process will satisfy the bond requirements. Confirm the process and deadlines with bond counsel and the municipal clerk.

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Ballot language

The ballot article asks voters to authorize the borrowing. The wording must accurately describe what voters are being asked to approve.

The authorization may distinguish between:

- The total estimated project cost
- The maximum amount the municipality may borrow
- Grants, reserves, or other expected funding
- The purpose of the borrowing
- Any limits placed on the interest rate or other terms

If the voters approve a maximum interest rate or another financing limit, the legislative body must remain within that authorization. Bond counsel can help preserve needed flexibility without leaving voters unclear about the decision.

Vote documentation

After the vote, the municipal clerk documents the result and compliance with posting, publication, and voting requirements. Bond counsel relies on this record when determining whether the municipality has legal authority to borrow.

Careful recordkeeping is essential. Keep copies of resolutions, warnings, newspaper notices, posting records, ballots, meeting minutes, vote results, and clerk certificates.

Explain the full decision to voters

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Legal compliance is only the starting point. Voters also need clear, factual information about:

- Why the project is needed
- What the project will provide
- The estimated total cost
- The maximum borrowing authorization
- Expected grants and other funding
- Estimated principal and interest
- The proposed repayment period
- Possible effects on taxes, rates, or fees
- Important risks and uncertainties
- What may happen if the project does not move forward
- What will happen after approval

Clearly distinguish between the estimated project cost and the maximum amount that may be borrowed. If grants or other funding could reduce the borrowing, explain that without promising funding that has not yet been awarded.

Public information may supplement the legal warning and ballot, but it does not replace them. Municipal materials should be factual and educational rather than campaign for a particular result.

Allow time after the vote

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A successful vote does not mean the municipality can close on the loan immediately. Vermont law generally provides a period during which voters may seek reconsideration or rescission of the vote.

After the applicable period has passed, bond counsel can prepare a preliminary legal opinion confirming the municipality's authority to borrow for the approved project. Lenders may require this opinion before completing an application or offering final financing.

Municipalities may speak with potential lenders before the vote to learn about likely terms, schedules, and requirements. Final financing usually occurs after the municipality has the necessary voter authorization and legal documentation.

Compare funding and borrowing options

Possible financing sources may include:

- Vermont Bond Bank programs
- State Revolving Funds
- Local or commercial banks
- Federal or state loan programs
- Private placement of municipal debt
- Public sale of bonds in the capital market

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Each option may have different interest rates, repayment terms, application schedules, closing costs, security requirements, and legal conditions.

The lowest interest rate is not the only consideration. Municipal officials should also consider:

- Whether the funding schedule matches the project schedule
- Whether the repayment term matches the useful life of the improvement
- Whether funds are provided at closing or as costs are incurred
- Whether early repayment is allowed
- Whether the loan is taxable or tax-exempt
- What financial reporting is required
- Whether grants or loan forgiveness may be available
- Whether the municipality must pledge its general taxing authority or a specific revenue source

The Vermont Bond Bank encourages municipalities to make early contact for illustrative debt-service schedules and information about its application process.

Know that municipal debt has limits

Vermont law limits the amount of debt a municipality may incur for public improvements. Certain obligations may be excluded from the calculation, and a municipal charter or special law may establish different requirements.

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Before proposing new borrowing, ask the treasurer, municipal financial adviser, and bond counsel to review:

- Existing debt
- Authorized but not yet issued debt
- Proposed new borrowing
- Applicable exclusions
- Charter provisions
- The municipality's ability to make future debt payments

The legal debt limit is not the same as the amount a municipality can comfortably afford. Municipal officials should also consider the effect of new debt on taxes, utility rates, operating budgets, and other planned projects.

Understand the rules for tax-exempt borrowing

Tax-exempt financing can reduce borrowing costs, but the municipality must follow federal requirements throughout the life of the debt.

Borrow only what is needed and when it is needed

Federal tax rules generally restrict borrowing substantially more money than the project requires or borrowing too far in advance of when the money will be spent.

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Follow investment restrictions

A municipality generally cannot borrow at a tax-exempt rate and then invest the proceeds at a higher rate to earn money for unrelated municipal purposes. These restrictions are commonly called arbitrage rules.

Watch for private use

Tax-exempt financing generally limits the amount of financed property or loan proceeds that may benefit or be used by private parties. Potential issues can arise when a municipality:

- Sells part of a financed property
- Leases space to a private business
- Enters into a management or service agreement
- Gives a private party special rights to use the property
- Uses proceeds for an improvement that primarily benefits a private development

Private involvement does not automatically prevent tax-exempt financing, but it should be reviewed before the municipality commits to a financing structure or agreement.

Continue monitoring after closing



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Assign someone to monitor the debt and the financed property until the debt is paid. Keep records showing:

- How loan proceeds were spent
- How unspent proceeds were invested
- Whether the property remains in governmental use
- Whether any lease, sale, management agreement, or change in use has occurred
- Whether required tax filings and lender reports were completed

Contact bond counsel before changing the ownership, use, lease, or management of property financed with tax-exempt debt.

Know what to expect at closing

The closing is when the municipality formally enters into the debt and receives or gains access to the loan proceeds.

Closing documents may include:

- The bond or note
- A legislative body resolution approving the financing
- A legal opinion from bond counsel
- A tax or non-arbitrage certificate
- Federal tax reporting forms
- A loan or purchase agreement

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- A security agreement
- A lease agreement
- Certificates from municipal officials

Municipal officials should allow time for document review, signatures, meeting schedules, and lender requirements.

Budget for repayment

Borrowing creates a long-term obligation. A municipality issuing general obligation debt must budget for principal and interest payments. A utility using revenue-backed debt must establish rates and budgets sufficient to meet its obligations.

Before borrowing, develop a repayment plan that identifies:

- The first payment date
- Annual principal and interest
- The revenue source
- Possible changes in taxes, rates, or fees
- The effect on other municipal priorities
- Responsibility for monitoring and making payments

Continue reporting debt costs and project changes clearly to the legislative body and the public.

Additional requirements for CHIP projects

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CHIP projects have requirements beyond the general municipal borrowing process. Before the public vote, the municipality must provide information about the proposed debt and project, including:

- The amount and types of debt
- Principal, interest, fees, and other related costs
- The debt terms
- The housing infrastructure project to be financed
- The housing development expected because of the infrastructure
- The terms of the housing infrastructure agreement
- The municipality's continuing responsibility for the debt if tax increment is insufficient

For general obligation debt, the municipality remains responsible for full payment even if the expected tax increment does not cover the principal and interest. This risk should be explained clearly to voters. Vermont's CHIP debt and public-information requirements appear in 24 V.S.A. § 1910a.

Municipalities should work with bond counsel and the Vermont Economic Progress Council to confirm current CHIP requirements, required notices, documents, timing, and reporting.

Other borrowing tools may be available

Depending on the circumstances, a municipality may have access to other financing tools, including:

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- Short-term notes
- Grant anticipation notes
- Emergency borrowing
- Equipment or property leases with non-appropriation provisions
- Interfund loans
- Revenue bonds
- Refunding of existing debt

Some of these tools may not require the same voter approval as a traditional bond, but each has specific legal and financial requirements. Do not select an alternative borrowing method simply to avoid a vote. Ask bond counsel whether the tool is authorized and appropriate for the project.

Questions to ask bond counsel

When beginning a project, ask:

- What borrowing authority applies to this project?
- Is voter approval required?
- What vote format is required?
- What must appear in the warning and ballot?
- What are the posting and publication requirements?
- Should we adopt a declaration of official intent?
- Can earlier project costs be reimbursed?
- Should the borrowing be taxable or tax-exempt?
- Does private use create a tax issue?
- What debt limit applies?

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- What documents and deadlines should we expect?
- How long must we wait after the vote?
- What records must we retain?
- What responsibilities continue after closing?
- Are there additional program-specific requirements?

A simple process at a glance

1. Define the project and develop a preliminary cost and funding plan.
2. Contact bond counsel and potential funding partners early.
3. Decide what voters must authorize.
4. Prepare and adopt the required resolution.
5. Warn, publish, and conduct the vote correctly.
6. Document the vote and complete any required waiting period.
7. Compare financing options and select a lender.
8. Complete the legal review and closing documents.
9. Spend and track the proceeds for the approved purpose.
10. Budget for repayment and monitor compliance until the debt is paid.

What municipal officials should remember

Municipal bonding is more than a vote or loan closing. It is a legal and financial process that begins during project planning and continues until the debt is repaid.

Contact bond counsel early, keep complete records, explain the proposal clearly to voters, and continue monitoring the debt and financed property after closing. Early

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guidance can help the municipality avoid delays, preserve financing options, and meet its ongoing responsibilities.

This resource is educational and does not constitute legal advice. Municipalities should consult qualified bond counsel about their specific project, borrowing authority, vote, documents, financing structure, and continuing obligations.

This resource was drafted with assistance from Eli Emerson at Primmer Piper Eggleston & Cramer.

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