The Finance Officer's Role in a Bond Election

BY JENNIFER BROWN

Most cities regularly issue some form of tax-backed debt, and getting authorization from voters to pursue bond projects is typically a necessary step in the process. But sometimes a bond election is out of the ordinary, such as when the city of Sugar Land, Texas, went to the voters in November 2013 for general obligation bond approval—only the second bond election in the city's 54-year history, and 14 years since the last bond election.

Three propositions were on the ballot, totaling $50 million:

- $18.54 million for a community sports park
- $21.30 million for the Brazos River park and festival site
- $10.16 million for hike and bike trails

Election results were mixed: Voters approved propositions two and three, but proposition one narrowly failed.

BACKGROUND

Sugar Land is a vibrant, diverse community of approximately 87,000 residents located near Houston, Texas. Residents are proud of the quality of life that the city provides, and many use parks and trails in the evenings and weekends to relax with families and friends. Despite the importance of park projects, the city has struggled to identify a consistent source of funding for them over the last decade. As the city ages, parks tend to be viewed as a "want" rather than a "need" in the community, with infrastructure and public safety needs taking priority for capital dollars, particularly in the area of street and drainage rehabilitation.

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The city has a history of lowering its tax rate, which limits the city's capacity to fund capital projects. In 2010, the city council's financial policies provided for an increase of just 3 percent increase in property tax revenues—barely enough to keep up with the cost of inflation, much less fund a park bond program. Debt capacity was generated by declining debt service schedules and growth in assessed valuation as the city developed.

Long-range financial planning showed that the tax, combined with an estimated 3 percent annual growth in tax revenue and declining debt service payments on existing debt, could support infrastructure needs such as significant street reconstruction and drainage improvements. The funding model did not indicate adequate capacity for quality-of-life projects, however, relegating them to the unfunded project list in the five-year capital plan.

To fund the quality-of-life projects the community had become accustomed to, city leaders decided to go to the voters for approval of a specific funding source. The elected leadership initially identified four major park projects to be considered, estimated at $50 million in total.

PROCESS OVERVIEW

The issue was part of the city council's fiscal 2012-16 annual budget and five-year capital improvement program (CIP) discussion. The CIP included a list of projects that had no source of funding, mostly park projects. The only projects approved for funding were those that could be accomplished without affecting the tax rate and without going to the voters for approval.

The challenge to staff for the next year was identifying debt capacity so the government could consider funding projects through a potential general obligation bond election. In determining how much debt capacity the city could manage within a set of assumptions, the variables included project amounts, tax rate impact, project types, and effects on the operating budget. After reviewing the financial analysis with the city council, staff conducted a tax tolerance survey with residents to gauge their level of tolerance for a tax increase that would be used to fund park projects.

The survey showed:

- 74 percent felt that the city's current tax structure was appropriate
- 58 percent were confident that the city spends tax dollars wisely
- the majority of respondents were not likely to approve funding for all the projects at once
- respondents preferred a phased implementation—increasing taxes by one cent every few years—over an increase of five cents all at once

- 74 percent expected their home values to increase in the next five years

Taking this information into account, the finance/audit committee suggested a debt capacity of $50 million over five years, with a maximum tax rate impact of five cents, for both the debt issuance and operating impacts after construction. In January 2013, the city council authorized a resolution for a bond election in the November 2013 general election in an amount not to exceed $50 million for the four new park projects. The resolution also established a citizen's bond committee.

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A month later, the city council approved a resolution that appointed a citizens' bond committee to advise on prioritizing the parks for the bond election. Any resident who wished to participate could submit an application. The mayor and city council appointed two co-chairs of the executive committee and eight additional executive committee members to oversee the four committees. A total of 101 citizens were able to provide input on the bond election through this process. The committees carefully reviewed and studied the components of each of the four projects and made a recommendation to the city council in July 2013.

After a public hearing that garnered significant feedback and support, the city council called an election for three propositions to be placed on the November ballot.

RESIDENTS CHOOSE

"Parks for a Proud Sugar Land." Texas Election Code prohibits the use of political subdivision resources to produce or distribute political advertising in connection with an election. It is permissible, however, to provide communications that factually describe a measure's purpose, without advocating its passage or defeat.

The city crafted educational materials, ensuring that no public funds were spent to promote the bond propositions. They addressed the size, scope, and location of projects, frequently asked questions, and the anticipated tax impact if all propositions were approved. The city also held several public meetings, giving residents the opportunity to see a presentation and review further details about the proposed projects. A page on the city's website also provided information.

Results and Implementation. Voters approved two of the three propositions by a two to one margin, for a total of $31.46 million. The third proposition narrowly failed, but city leaders consider the election a success. After the results were in, the city started working on the implementation and timing of the projects, which hadn't been included in the adopted fiscal 2014 CIP program. The city council directed staff to phase in the projects so that they could be funded using no more than a one-cent tax increase every other year, for a total of three cents over five years. The first projects were included in the fiscal 2015 CIP, with contracts ready to award in November 2014.

Through strategic planning and forecasting, the city has raised the tax rate by just 0.7 cents in the first three years, rather than the anticipated two-cent increase. This is mainly due to higher-than-anticipated property values; the financial assumptions included a 3 percent growth in taxable value. Values in 2015 (the second year of the program) were also higher than expected. The city council decided that it wouldn't give those funds back by decreasing the tax rate, since the financial plan showed another one-cent increase the following year. Instead, the tax rate was kept flat, avoiding the anticipated increase in 2016. Funding for the remaining $10.2 million in projects is anticipated to require a final increase of one cent in 2018.

Three years after the election, city staff continues to update residents and elected officials about the progress of the projects. Two series of bonds have been issued for the projects, with the final issuance of $10.2 million scheduled for 2018-19.

The city council and city management receive quarterly updates on capital project progress. Due to material increases driven by the high level of construction activity in 2014-15 in Houston, the first construction package for the bond projects came in 21 percent over budget. The city was able to adjust project phasing to accommodate what it could afford to do within the first bond issuance, and later, as construction costs came back down, the phasing plan allowed all planned work to be accommodated within the amount of approved funding to date.

Key Points. The finance officer's role is critical in the planning and implementation of the proposed bond referendum and subsequent bond issues. Bond rating agencies will also want to see this information.

- *Affordability.* How much debt can the tax base support? Build the financial analysis around conservative financial assumptions based on the jurisdiction's experience. If Sugar Land's finance office had been pushed to assume a higher growth rate than it had experienced, the city would have needed every cent of that tax increase, and possibly more. Put it into terms that elected officials and residents can understand, such as: "A one-cent increase to the tax rate can support $10 million in construction costs."
- *Quantify the Impact:* Residents want to know what the impact will be to their pocketbook, not just this year, but down the road as well. The finance department's estimates showed that each one-cent increase to the tax rate means and increase of approximately $27 per year for the average residential tax bill.
- *Sensitivity Analysis:* What will happen if values don't come in as anticipated? Does the government have the flexibility to adjust the tax rate, or will projects have to be deferred? Have a financial sensitivity analysis completed to answer these kinds of questions.
- *Flexibility:* How specific are the bond propositions? More restrictive resolutions leave less flexibility. All three of Sugar Land's propositions included the general language, "parks and recreational facilities, including…" This wording makes it possible to shift funding from one bond proposition to another. Are alternate priorities identified if additional funds are available? The citizen's bond committee report included a list of alternates just in case the main projects came in under the budgeted amount, which gave the bond committee a say in where the additional funds got allocated.
- *Construction Escalation:* Have a contingency plan in place, as construction costs can vary. The unexpected will happen. Contingency funds can help ensure that the project can be completed within the authorized amount of funding. Work closely with engineers to ensure that project estimates are accurate and reflect the most current market conditions. Define and use escalators clauses and contingency percentages to determine project estimates.
- *Follow Up:* Ensure that bond funds are being spent according to the authorization. Most tax-exempt bond issues are subject to IRS regulations and arbitrage-reporting requirements. Have controls in place to keep bond funds from being spent on uses that aren't authorized.
- *Cash Flow:* Time bond issues to meet the project cash-flow needs. If the projects will be built over five to seven years, it makes no sense to issue all of the bonds upfront. Work closely with the engineers on the project to establish a project funding or draw down schedule, and match it as closely as possible.

Communicating Capital Improvement Strategies

Public participation and stakeholder involvement during the planning, design, and construction of capital projects are extremely important. Projects of all sizes require a communication strategy that informs the public, and a way to solicit and use feedback—allowing the organization to effectively communicate capital needs and the impact to service levels or current asset condition, should the project not proceed. In addition, developing a process for involving the public during project planning is a key step in assessing priority and determining if the project will meet service-level goals and community expectations.

The GFOA best practice, *Communicating Capital Improvement Strategies*, recommends that organizations develop a communications plan for public participation that focuses on explaining capital needs, options, and strategies, and facilitating feedback before any major capital program is undertaken. The messaging should be clear and consistent, providing accurate information on the costs, duration, impact, and benefits associated with the project. When using communications methods that give the opportunity for stakeholders to provide feedback, governments should be receptive to ideas and address any significant issues.

The communications plan must be implemented early enough for staff to use the information to make modifications, and the government should continue to inform stakeholders through the end of the project, reporting on results.

Communicating Capital Improvement Strategies, along with other best practices about capital improvements, is available at http://gfoa.org/best-practices.

FOLLOW UP ON FAILED PROPOSITION

The narrow failure of one of the propositions left the city council struggling with how to address the development of the 65-acre park that was proposed for funding. The proposal for this site was a community park with a 12-court tennis center and multipurpose sports fields for access to activities such as soccer, cricket, lacrosse, rugby, and flag football, and it was the most controversial of the three.

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The city already owns the land, which was donated by the developer through parkland dedication requirements. In follow-up discussions, the city council has requested that the Parks, Recreation, and Open Space Master Plan address the best use for the space so the city can address funding once the approved bond projects are completed. The voters will likely have some say in what type of park is developed on the site.

CONCLUSIONS

When the City of Sugar Land went to its voters for general obligation bond approval, the election was somewhat out of the ordinary. The city decided that funding for its quality-of-life projects needed to have a specific funding source, and after a public information effort, residents were asked to vote for three parks and recreation propositions that totaled $50 million. Two were approved, for a total of $31.46 million. The finance officer's role was critical in planning and implementing the bond referendum and the debt issues, ensuring that: the project is affordable; the impact is accurately quantified; a sensitivity analysis is conducted; the terms are sufficiently flexible; increased construction costs are allowed for; bond funds are being spent only for approved allocations; and bond issues are timed to meet cash-flow needs.

JENNIFER L. BROWN is director of finance for the City of Sugar Land, Texas. She has 22 years' experience in municipal finance and is a member of GFOA's Committee on Governmental Debt Management.