

# Debt Service

Debt Service is required to be reported in the budget certification statement to the Maryland State Department of Education under the Public School Laws of Maryland 1978, Chapter 22 of the Annotated Code of Maryland. Debt Service represents the periodic payments of principal and interest on bonded long and/or short-term indebtedness, and all costs associated with bond sales, issues, and cost to service debt.

Harford County Public Schools does not have the authority to issue such long-term debt. The School system does have the authority to enter into alternative financing mechanisms such as leases and lease purchase transactions. The Harford County Government determines the long-term debt financing levels to be used in conjunction with the Board of Education's Capital Improvements Program to be funded through the School Construction Fund. The County Treasurer's Office is responsible for administration of debt service, and the County Budget Office has graciously provided the following debt-related financial data. Before County General Funds are used to pay Board of Education Debt Service, the County utilizes recordation taxes, transfer taxes and school development impact fees. Both of these taxes were instituted to assist in debt payments and capital construction for the School's Capital Improvement Program.

## Recordation Tax

The recordation tax was established by the Annotated Code of Maryland and local County law, recordation taxes are assessed at the rate of \$6.60 per \$1,000 value of recorded instruments filed with the Clerk of the Circuit Court for Harford County. Of this assessed amount, \$4.40 is dedicated for school debt service first, then new construction, major and capital improvements to existing school facilities and portable classrooms; \$1.10 is dedicated to an open space land and recreational fund for the purchase of park lands and development of parks and recreation facilities; and \$1.10 is dedicated for watershed protection and restoration projects.

## Transfer Tax

The voters of the County on a 1992 ballot question approved a transfer tax. County Council Bill No. 93-3 adopted the local transfer tax effective July 1, 1993. The transfer tax is imposed at the rate of 1 percent of the consideration payable for instruments of writing recorded with the Clerk of the Circuit Court for Harford County or filed with the State Department of Assessments and Taxation. The proceeds of the tax are distributed 50 percent to Agricultural Land Preservation and 50 percent to school site acquisitions, school construction, or school debt.

## Impact Fee

The School Development Impact Fee was established by the County Government for all new residential building permits applied for on or after July 1, 2005. The fees were established to assure that new development contributes its fair share towards the costs of public schools reasonably necessitated by such new development. Impact fee revenue may only be used for school site acquisition, school construction, school renovation, school debt reduction, or school capital expenses. The revised fees are imposed as of December 2009 and are \$6,000 for a single family detached home, \$4,200 for a townhouse/duplex and \$1,200 for all other residential dwellings including mobile homes.

### County Government Debt Service on behalf of HCPS

Table 1<sup>1</sup>

| <b>Debt Service Fund</b>  |                     |               |                     |               |                     |               |                     |               |                     |               |
|---------------------------|---------------------|---------------|---------------------|---------------|---------------------|---------------|---------------------|---------------|---------------------|---------------|
|                           | Actual FY 2014      |               | Actual FY 2015      |               | Actual FY 2016      |               | Projected FY 2016   |               | Projected FY 2017   |               |
|                           | Amount              | Percent       | Amount              | Percent       | Amount              | Percent       | Amount              | Percent       | Amount              | Percent       |
| <b>PRINCIPAL PAYMENTS</b> |                     |               |                     |               |                     |               |                     |               |                     |               |
| School Bonds              | \$17,533,083        | 100.0%        | \$18,551,614        | 100.0%        | \$20,082,460        | 100.0%        | \$19,732,161        | 100.0%        | \$19,800,175        | 100.0%        |
| Short Term Notes          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          |
| Lease Purchase            | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          |
| <b>TOTAL</b>              | <b>\$17,533,083</b> | <b>100.0%</b> | <b>\$18,551,614</b> | <b>100.0%</b> | <b>\$20,082,460</b> | <b>100.0%</b> | <b>\$19,732,161</b> | <b>100.0%</b> | <b>\$19,800,175</b> | <b>100.0%</b> |
| <b>INTEREST PAYMENTS</b>  |                     |               |                     |               |                     |               |                     |               |                     |               |
| School Bonds              | \$12,639,231        | 100.0%        | \$12,144,266        | 100.0%        | \$10,932,277        | 100.0%        | \$11,977,328        | 100.0%        | \$11,236,789        | 100.0%        |
| Short Term Notes          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          |
| Lease Purchase            | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          | \$0                 | 0.0%          |
| <b>TOTAL</b>              | <b>\$12,639,231</b> | <b>100.0%</b> | <b>\$12,144,266</b> | <b>100.0%</b> | <b>\$10,932,277</b> | <b>100.0%</b> | <b>\$11,977,328</b> | <b>100.0%</b> | <b>\$11,236,789</b> | <b>100.0%</b> |
|                           |                     |               |                     |               |                     |               |                     |               |                     |               |
|                           |                     |               |                     |               |                     |               |                     |               |                     |               |
| <b>SUMMARY</b>            |                     |               |                     |               |                     |               |                     |               |                     |               |
| Principal                 | \$17,533,083        | 58.1%         | \$18,551,614        | 60.4%         | \$20,082,460        | 64.8%         | \$19,732,161        | 62.2%         | \$19,800,175        | 63.8%         |
| Interest                  | \$12,639,231        | 41.9%         | \$12,144,266        | 39.6%         | \$10,932,277        | 35.2%         | \$11,977,328        | 37.8%         | \$11,236,789        | 36.2%         |
| <b>TOTAL</b>              | <b>\$30,172,314</b> | <b>100.0%</b> | <b>\$30,695,880</b> | <b>100.0%</b> | <b>\$31,014,737</b> | <b>100.0%</b> | <b>\$31,709,489</b> | <b>100.0%</b> | <b>\$31,036,964</b> | <b>100.0%</b> |

<sup>1</sup> Data provided by Harford County Government.

# Debt Service

## COUNTY PRACTICE

It is Harford County's practice to conduct an annual bond sale contingent on capital project needs and the economic conditions of the bond market. Prior to selling bonds, the County will issue Bond Anticipation Notes (short term financing) or use existing cash flows to start the construction of capital projects based on cash flow needs. Revenues from the county sources of pay go funds, recordation taxes, transfer taxes, impact fees, and County general funds support the FY 2017 County debt service payments as outlined in the following chart:

*County Government Debt Service for HCPS  
Table 2<sup>2</sup>*

| <b>Harford County, Maryland<br/>Fiscal Year 2017 Budget<br/>General Fund - Principal and Interest Payments for Harford County Public Schools</b> |               |                 |                     |                     |
|--|---------------|-----------------|---------------------|---------------------|
|  |               |                 | <b>PRINCIPAL</b>    | <b>INTEREST</b>     |
| <b>SCHOOL BONDS:</b>   | 2007          | Bonds           | \$4,493,804         | \$296,348           |
|  | 2009          | Bonds           | \$3,688,668         | \$648,451           |
|  | 2009          | Refunding Bonds | \$464,305           | \$53,338            |
|  | 2010 Series A | Bonds           | \$5,751,300         | \$1,309,178         |
|  | 2010 Series B | Bonds           |                     | \$3,203,777         |
|  | 2010          | Refunding Bonds | \$1,160,775         | \$276,796           |
|  | 2012          | Refunding Bonds | \$494,310           | \$96,786            |
|  | 2012          | Bonds           | \$720,460           | \$376,181           |
|  | 2013          | Bonds           | \$507,992           | \$330,261           |
|  | 2013          | Refunding Bonds | \$1,217,304         | \$1,606,994         |
|  | 2014          | Bonds           | \$193,058           | \$136,979           |
|  | 2015          | Bonds           | \$590,894           | \$428,399           |
|  | 2015          | Refunding Bonds |                     | \$1,955,995         |
|  | 2016          | Bonds           | \$517,306           | \$517,306           |
| <b>TOTAL SCHOOL BONDS</b>  |               |                 | <b>\$19,800,175</b> | <b>\$11,236,789</b> |

While Debt Service Table 2 indicates the specific amounts of bonded indebtedness undertaken by Harford County Government for the Board of Education in FY 2007 through FY 2016, the following information is provided to clarify the fiscal policies of Harford County, which is responsible, for issuing, managing, and retiring debt obligations associated with Harford County Public Schools. The Board of Education has no authority to issue long-term debt such as General Obligation Bonds.

Debt management is an important component of a county's financial management practices. Governments use the option of debt financing to pay for large projects, such as schools, when paying for governmental activities with roads, schools, libraries, and public buildings being the more common uses of bond proceeds.

Debt management is important to ensure that:

- The amount of debt issued by the County is affordable given the County's anticipated revenue levels and operating needs;
- The County issues the kinds of debt appropriate to given projects at the lowest possible interest cost; and,
- The County issues debt in compliance with all relevant laws and regulations.

Section 524 of the Harford County Charter states that the County may incur debt. Furthermore, no indebtedness for a term of one year or greater shall be incurred by the County to meet current operating expenses. All County indebtedness for a term in excess of one year shall become due no later than 30 years after the date of issuance, except debt incurred to finance water, sewer and wastewater facilities, which shall become due no later than 40 years after the date of issuance.

<sup>2</sup> Data provided by Harford County Government.

# Debt Service

## **LONG-TERM FINANCING TECHNIQUES**

**General Obligation Bonds** – General Obligations Bonds are known as full faith and credit bonds since their payment is based on the general credit and taxing power of the County. The quality of the general obligation bonds is derived from the fiscal and economic strengths of the County and its ability to assure repayment of monies borrowed. General Obligation Bonds, being tax-supported, are typically used to finance the capital portion of tax supported general public purpose capital projects.

**Lease Purchase/Certificates of Participation** – Obligations of a public entity secured by an installment sale or leaseback arrangement with a public entity lease. The lessee generally pledges general operating revenues to pay the lease payments, which may or may not be reimbursed by revenues from the project. These obligations do not constitute indebtedness under state constitutional debt limitation. Payment to be made under valid leases are payable only in the year in which use and occupancy of the leased property is available, and lease payments may not be accelerated.

## **BOND RATINGS**

The County's General Obligation AAA bond rating by Moody's Investors Service, Standard and Poor's, and Fitch reflect the County's strong credit rating. All three rating services awarded AAA status to Harford County. Each rating service said the County's future outlook is "stable". Credit ratings are designations by the investor's services to give a relative indication of credit quality, with Aaa/AAA/AAA being the highest achievable rating. Factors contributing to the County's relative high ratings include historically strong financial performance, along with tax raising flexibility, a low debt profile, and ongoing growth and diversification in the economic base.

## **DEBT MANAGEMENT**

Traditionally, Harford County sold bonds only for construction of capital projects within the Capital Improvement Program during the period of 1948 through 1982. Projects must have legislative approval before engineering or construction contracts can be awarded. A pay-as-you-go (PAYGO) policy was implemented in July 1984 for funding capital projects for the general county, education, fire, library, college, highways, and certain water and sewer projects.

In order to provide an adequate physical infrastructure, improved services, and channel growth while maintaining the County's quality of life, a more balanced approach to capital funding has been adopted. Projects within the General Capital Program will be financed with PAYGO funding when feasible rather than long term debt. The County has established a policy where they will keep bonded debt and its resulting debt service to as small a portion of the General Fund Budget as is realistically possible, while not tied to a set ratio. The County will hold conservative, yet fluid and responsive, debt management to be fiscally prudent.

*County Government Legal Debt Margin  
Table 3<sup>3</sup>*

| Statement of Legal Debt Margin<br>as of June 30, 2015 |               |                    |
|---|---------------|--------------------|
| Debt Margin Calculation                               | Bonded Debt   | Debt Limit         |
| Legal Debt Limit                                      |               | \$1,712,790,162    |
| Amount of Debt applicable to Debt Limit               | 683,930,945   |                    |
| Less:   |               |                    |
| Self-sustaining Debt:                                 | (200,701,066) |                    |
| Total Amount of Debt Applicable to Debt Limit         |               | <u>483,229,879</u> |
| Legal Debt Margin                                     |               | \$1,229,560,283    |

<sup>3</sup> Debt Service data is from Harford County Government Comprehensive Annual Financial Report for the year ended June 30, 2015, page 155.

# Debt Service

## **DEBT LIMITATIONS**

According to state law<sup>4</sup>, the County, as a charter county, is limited in the amount of general obligation supported debt that it can issue to an amount equal to a total of 6 percent of the assessable value of real property of the County and 15 percent of the assessed value of the personal property in the County. As of June 30, 2015, the estimated debt limit of the County is \$1,712,790,162.

The County's estimated outstanding general obligation supported debt as of June 30, 2015, exclusive of self-supporting/self-liquidating debt not applicable to the debt limit, is \$483,229,879. This allows for an excess of allowable debt over outstanding non-self-liquidating debt of \$1,229,560,283 as calculated in Debt Service Table 3.

*County Government Debt Service Table 4<sup>5</sup>*

| Debt Ratios FY 2010 to 2015      |            |            |            |            |            |            |
|----------------------------------|------------|------------|------------|------------|------------|------------|
|                                  | FY<br>2010 | FY<br>2011 | FY<br>2012 | FY<br>2013 | FY<br>2014 | FY<br>2015 |
| Ratio of Debt to Personal Income | 5.53%      | 5.31%      | 5.10%      | 5.03%      | 4.94%      | 4.87%      |
| Ratio of Debt per Capita         | \$2,590    | \$2,619    | \$2,670    | \$2,647    | \$2,683    | \$2,735    |

## **DEBT BURDEN**

Debt burden is a measurement of the relationship between the debt of the County supported as a percentage of personal income and population. The broadest and most generally available measure of wealth in the community is debt as a percentage of personal income. In addition, debt can be compared to population to determine a per capita burden level.

The County makes these comparisons each time it offers bonds for sale. They are included in the official statements that are distributed to prospective investors. Additional ratio comparisons are provided to help understand the debt load in Debt Service Table 4.

## **BUSINESS PLAN**

In order to help understand the framework used by the County government in establishing funding for Harford County Public Schools, it is useful to become familiar with the Harford County Government's Business Plan. Under the plan, the annual budget is to be adjusted as a result of economic conditions in the County, state, and nation. Capital projects may progress more rapidly or more slowly depending on population growth, economic, and funding sources.

The County has developed a business model for capital project funding for the current and the next succeeding five fiscal years. The model sets the following goals:

1. Expenditures will be reviewed and approved based on real versus perceived need;
2. Each function, service, project, and expenditure as to its affordability;
3. New sources of revenue will be identified and advanced;
4. Prepare, integrate through planning, and maintain conservative annual operating budgets and multi-year spending plans;
5. Plan for and preserve a prescribed year-end fund balance to maintain the credit rating and provide for emergency needs; and,
6. Develop and implement a new five-year capital program based on affordability and sound debt management practices.

Pay-as-you-go (PAYGO) funding will continue to be used for minor renovation and repair projects which have an asset life of less than ten years. The PAYGO policy has allowed the County to plan more efficiently how annual budgets and capital improvements programs will be undertaken while maintaining the same property tax rate.

<sup>4</sup>Annotated Code of Maryland, Article 25A, §5(P)

<sup>5</sup> Debt Service data is from Harford County Government Comprehensive Annual Financial Report for the year ended June 30, 2015, page 154.

## Debt Service

The General County Capital Program includes general government, education, police/sheriff/fire, community college, libraries, highway, landfill, and parks and recreation projects. Lease-purchase financing of capital assets will be analyzed and assessed as an alternative to long-term bond financing. Utility capital projects will be financed with long-term debt, only after funding sources have been established to pay the annual debt payments, such as PAYGO funding and/or assessments to property owners who will benefit from the improvements.

The County has issued a combination of debt<sup>6</sup> (general obligation bonds, lease purchase agreements) in financing capital projects for the school system. The July 1, 2015 outstanding balance of debt issued for the school system projects was \$267,181,665; principal payments during FY 2016 were \$20,082,460. Additional debt was issued on behalf of the school system in fiscal year 2016 of \$10,346,131. The outstanding balance of debt at June 30, 2016 was \$257,445,336.

### **HARFORD COUNTY PUBLIC SCHOOLS DEBT**

Harford County Public Schools does not have the authority to issue long-term debt. The School System does have the authority to enter into alternative financing mechanisms such as leases and lease purchase transactions. The School System entered into energy performance construction contracts in 2001 and 2002, which were financed with equipment lease purchase transactions. Both transactions had a 15 year term. The School System entered into a lease purchase for the construction of a new administration building in September 2004 for a 25 year term.

Due to favorable interest rates, in early 2012 the energy performance and administrative building leases were refinanced over the remaining life of the original leases. The original interest rates for the administration building (5.0%), energy performance phase I (5.0%) and energy performance phase II (4.3%) were refinanced at lower interest rates of 3.3%, 1.9% and 2.0% respectively.

In addition, the school system has completed negotiations for an additional energy performance lease in the amount of \$14,248,426 with an annual interest rate of 2.1%. The energy lease phase three will be funded beginning in fiscal year 2014 and ending in fiscal year 2030. These transactions were approved by the County Executive and County Council. Payments are included in the Unrestricted Funds Budget and are identified in Table 5.

*Debt Service Table 5<sup>7</sup>*

| <b>Public Schools Debt Service</b>  |                           |                           |                           |                           |                           |
|-------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
|                                     | <b>Actual<br/>FY 2014</b> | <b>Actual<br/>FY 2015</b> | <b>Actual<br/>FY 2016</b> | <b>Budget<br/>FY 2016</b> | <b>Budget<br/>FY 2017</b> |
| <b>PRINCIPAL PAYMENTS</b>           |                           |                           |                           |                           |                           |
| SunTrust Lease Energy Phase I - A   | \$ 367,191                | \$ 374,160                | \$ 391,611                | \$ 391,611                | \$ 495,427                |
| SunTrust Lease Energy Phase II - B  | 404,418                   | 412,395                   | 410,176                   | 410,176                   | 324,183                   |
| SunTrust Lease Energy Phase III - C | -                         | -                         | 822,306                   | 822,306                   | 838,975                   |
| US Bank Administration Bldg - D     | -                         | 371,258                   | 508,418                   | 508,418                   | 525,043                   |
| <b>TOTAL</b>                        | <b>\$771,609</b>          | <b>\$1,157,813</b>        | <b>\$2,132,511</b>        | <b>\$2,132,511</b>        | <b>\$2,183,628</b>        |
| <b>INTEREST PAYMENTS</b>            |                           |                           |                           |                           |                           |
| SunTrust Lease Energy Phase I - A   | 28,734                    | 21,757                    | 14,757                    | 14,757                    | 4,632                     |
| SunTrust Lease Energy Phase II - B  | 41,657                    | 33,509                    | 25,456                    | 25,456                    | 17,758                    |
| SunTrust Lease Energy Phase III - C | 297,769                   | 287,390                   | 283,265                   | 283,265                   | 266,596                   |
| US Bank Administration Bldg - D     | 327,544                   | 327,544                   | 315,404                   | 315,404                   | 298,779                   |
| <b>TOTAL</b>                        | <b>\$695,704</b>          | <b>\$670,200</b>          | <b>\$638,882</b>          | <b>\$638,882</b>          | <b>\$587,765</b>          |
| <b>SUMMARY</b>                      | <b>Actual<br/>FY 2014</b> | <b>Actual<br/>FY 2015</b> | <b>Actual<br/>FY 2016</b> | <b>Budget<br/>FY 2016</b> | <b>Budget<br/>FY 2017</b> |
| Principal                           | 771,609                   | 1,157,813                 | 2,132,511                 | 2,132,511                 | 2,183,628                 |
| Interest                            | 695,704                   | 670,200                   | 638,882                   | 638,882                   | 587,765                   |
| <b>TOTAL</b>                        | <b>\$1,467,313</b>        | <b>\$1,828,013</b>        | <b>\$2,771,393</b>        | <b>\$2,771,393</b>        | <b>\$2,771,393</b>        |

<sup>6</sup> Debt data is the most current information from Harford County Government, Treasury Department for the year ended June 30, 2016.

<sup>7</sup> Data is from Harford County Public Schools Budget Office.

