HOUSE BILL 2396
Opponent written testimony

WITHOUT AN EXCEPTION FOR BOND AND INTEREST LEVIES FOR GENERAL OBLIGATIONS OF LOCAL GOVERNMENT ENTITIES, THERE LIKELY WILL BE A NUMBER OF NEGATIVE AND UNINTENDED IMPACTS. KANSAS MUNICIPALITIES WILL CONTINUE TO HAVE CAPITAL FINANCING NEEDS AND ENSURING EFFICIENT ACCESS TO THE MARKET SHOULD BE TAKEN INTO CONSIDERATION WITH RESPECT TO LEGISLATION RESTRICTING AD VALOREM TAXATION:

(1) The current version of the bill will result in difficulty complying with existing statutes requiring necessary debt service levies, adding a statutory layer where there is already a robust statutory scheme, including a debt limit, relating to bond issuance, and potential difficulty repaying general obligation debt, as required, without budget cuts in other important areas

- In Kansas, general obligation bonds have always come with an unlimited full faith and credit backing. The exact security language provides that such bonds *are "payable from ad valorem taxes which may be* ***levied without limitation as to rate or amount*** *upon all the taxable tangible property within the territorial limits of the [entity]. The full faith, credit and resources of the [entity] are hereby irrevocably pledged for the prompt payment of the principal of and interest on the bonds as the same become due."* In this regard, **K.S.A. 10-113** is applicable, and requires, for general obligation bonds, that it "***shall be the duty*** *of the proper officers charged with the levying of taxes* ***to levy in each year a sum sufficient to pay the interest on such bonds, and the bonds falling due in that year****, and any such officer failing to make such levies shall be guilty of a misdemeanor."*

- State law already limits the amount of general obligation debt that can be issued overall—the statutory "debt limit." State law also already provides processes/procedures—notice, protest, and even election requirements--before you can issue certain types of general obligation debt. These processes to some extent gatekeep whether and what amounts of general obligation debt an entity can issue. If bonds been approved through these prescribed processes on the front end, why on the back end impinge the ability for the entity to pay off the approved financing

- Any language that restricts the ability to levy ad valorem taxes would cause both existing/outstanding bonds and future bonds to become or be limited tax general obligation bonds, rather than unlimited tax general obligation bonds, which carries negative financial implications for issuers of general obligation bonds and their constituent taxpayers.

(2) Negative impact/pressure on credit ratings for Kansas local government entities.

- In rating general obligation debt, rating agencies consider something called "institutional framework." Institutional framework is established state-wide for all local governments of a certain type (e.g., all cities in Kansas have the same institutional framework). Moody' provides the following explanation regarding institutional framework:

    - The institutional framework is important because it affects the ability of a local government entity to match recurring revenue with expenditures. The statutory and legal framework under which a local government entity operates defines the scope of services it is required to provide and establishes its revenue structure.

These determine how much flexibility an entity has to increase revenue or reduce spending.

- Were the current form of the bill to pass, Moody's would likely lower the institutional framework score for Kansas local governments, causing some to see immediate credit downgrades and others to see pressure emerge on their ratings where none exists today. As applied, if Kansas entities currently have the ability to get a Moody's score of 100%, with this legislation, the best they could do would be a score of 90%, which means even the entities with the best credit would be on the bubble to drop a grade.

- By way of example, if bonds are issued and repayable over 20 years, repayment is contingent on the bond issuer annually budgeting those funds for 20 years into the future. If in any year there is a cap on the amount that may be levied, the bond issuer must still pay debt service (because nonpayment of debt would have a disastrous impact on the credit of the bond issuer and ability to access markets in the future). It is not possible to reduce the budget for general obligation debt that is currently outstanding like on some other services or operational costs, as the debt payment schedules for general obligation bonds are fixed the day the bonds are issued. If operating under a cap, without an exception for bond and interest levies, a fixed debt service budget won't change, and that may mean other essential costs/services would perhaps unintentionally have to make up any bond and interest levy shortfall caused by a cap.

(3) Negative response from bond market and reduced appetite for Kansas bonds, perhaps leading to increased costs, with less of an ability to budget for repayment

- The proposed legislation effectively turns all Kansas general obligation bonds—outstanding and prospectively issued--into limited tax general obligation bonds (LTGO), rather than unlimited tax general obligation bonds (ULTGO). There are a number of implications.

    - If bonds of Kansas entities become LTGO, rather than ULTGO, as a result of this legislation***, the market will see LTGO as a weaker credit than an ULTGO and as a result, investors would charge more for the incremental risk of not having an unlimited property tax pledge backing the LTGO bonds.***

    - Transforming what was previously an ULTOGO into a LTGO impairs the contracts Kansas local governments have already made with their bondholders. There will be consequences of that, not on the interest rates of the bonds outstanding (which cannot be changed), but on future investor interest in Kansas general obligation bonds. ***Investors might reduce their exposure to Kansas general obligation bonds or even abandon the state altogether, at least for a while, in retaliation for their current holdings suffering a loss in value because of the pledge impairment.***

    - One would expect fewer bidders on competitive Kansas bond sales, a result that almost certainly drives up borrowing costs on average.

    - Investors would likely demand higher yields in order to induce them to buy Kansas bonds.

- Preliminary market analysis from financial professionals is that large and well-rated cities will still have market access with this legislation, but borrowing costs might increase by 10-15% versus today, all other things equal. Smaller local government entities—especially ones that do not currently secure bonds ratings—may see their market access disappear completely. Kansas is comprised of many small to medium-sized cities that are not rated by the major rating agencies.

(4) The voter approved general obligation bond exception in the bill is only prospective and doesn't apply to the vast majority of Kansas general obligation bond issues, for critical infrastructure, including for new development, that do not require an election, and instead must comply with other processes and limitations.

- The change to the bill before it passed out of committee to exempt voted general obligation bonds solves the problem only for Kansas school bonds and other debt that requires an election. Nearly all city general obligation debt in Kansas and much county general obligation debt does not require an election--see debt limit and other statutory processes discussion above.

(5) The current form of HB 2396 is unlike other past tax lid or limitation, relative to bond and interest levies

- While there have been tax lids and other legislative efforts to provide tax limitations and restraints in the past, those have provided protections/exceptions to ensure that Kansas general obligation bonds remained a truly unlimited pledge. A change in that practice today will almost certainly increase borrowing costs for most Kansas local government entities and may, at least for the short- and mid-term, turn investors off from Kansas bonds due to a lack of clear understanding of how exactly a local government entity would resolve a situation where it could not produce enough tax revenues to pay their debt service obligations. It is possible to achieve the stated goal of restricting increases in ad valorem taxation while still preserving efficient market access for Kansas municipalities.

(6) The current form of HB 2396 could impact many loan agreements among local government entities and KDHE under the Public Water Supply Loan and Water Pollution Control Loan programs, which are secured by and payable from ad valorem taxes.