TEXAS PUBLIC POLICY FOUNDATION

# Certificates of Obligation: Nonvoter Approved Debt

Certificates of Obligation (COs) are an instrument of public debt made available to the governing bodies of cities, counties, and certain special districts. COs can be issued "without voter approval (unless a referendum is petitioned) and are backed by tax revenue, fee revenues or a combination of the two," according to the Texas Comptroller.

Current state law (LGC §271.045) specifies that COs must be issued for: 1) the construction of any public work; 2) the purchase of materials, supplies, equipment, machinery, buildings, land, and rights-of-way for authorized needs and purposes; and 3) the payment of contractual obligations for professional services, including those provided by tax appraisers, engineers, architects, attorneys, map makers, auditors, financial advisors, and fiscal agents.

While COs were originally created to give local governments a tool for emergency spending, there's a growing body of evidence suggesting that nonvoter approved debt is being issued for capital improvement projects that are either controversial or discretionary, such as public art projects, swimming pools, and parks. As a result, CO debt is on the rise.

## On The Rise

CO issuances have seen a steady uptick in recent years. "Since fiscal 2007 CO debt outstanding has increased by 63.0 percent ($5.12 billion) from $8.13 billion outstanding in fiscal 2007 to $13.25 billion outstanding at August 31, 2016," according to the Bond Review Board's *2016 Local Government Annual Report*. Over the same period, population and inflation has only increased by a combined 32.7 percent.

Of all outstanding CO debt, almost half, or 44 percent, has been issued by just 20 political subdivisions, the overwhelming majority of which are city governments.

## The Consequences

Increased CO debt can burden a community in at least 3 distinct ways. First, more debt generally means more taxes, creating the conditions for fewer economic opportunities. Second, increased debt service requirements reduce budgetary resources available for other core government programs. Finally, an environment of elevated debt can put a community's credit rating at risk resulting in higher future borrowing costs.

## Progress Made, But More Work to Be Done

During the 84th Legislature, legislation was passed to improve the accountability of CO issuances. Specifically, the passage of House Bill 1378 prohibits COs to be used for any project(s) that voters rejected in the preceding three years, except in instances related to public calamity, public health, unforeseen damage, or state and federal regulatory compliance.

In spite of last session's progress, there is still more work to be done on the issue of nonvoter approved debt, including:

- **Achieving Greater Government Transparency.** Require a lengthier notification period and make sure that the issuer has a website and that details related to the issuance are posted online in a timely manner.
- **Making it Easier for Voters to Appeal.** Reform the petition process so that 5 percent of the total number of voters that voted in the most recent gubernatorial election can compel a public vote.
- **Tighter Use Restrictions.** Because debt issuances are not approved by voters, the kind of capital improvement projects eligible to be funded with COs should be more tightly defined.

**Top 20 Certificate of Obligation Issuers, FY 2016**
**(CO Debt Outstanding in Millions)**

| | | | | | |
|---|---|---|---|---|---|
| 1 | Bexar County | $941.4 | 11 | Sugar Land | $197.7 |
| 2 | Bexar County Hospital District | $690.5 | 12 | Travis County | $165.1 |
| 3 | Lubbock | $662.2 | 13 | Irving | $161.3 |
| 4 | El Paso | $533.8 | 14 | Waco | $147.4 |
| 5 | Denton | $410.9 | 15 | Grand Prairie | $147.1 |
| 6 | San Antonio | $310.2 | 16 | San Angelo | $137.9 |
| 7 | Frisco | $260.7 | 17 | El Paso County Hospital District | $132.6 |
| 8 | Fort Worth | $225.8 | 18 | League City | $130.7 |
| 9 | Austin | $219.9 | 19 | Laredo | $126.5 |
| 10 | Abilene | $203.1 | 20 | Amarillo | $116.0 |
| *Subtotal:* $5,920.8 | | | | | |
| *TOTAL CO Debt Outstanding:* $13,248.6 | | | | | |

*Source:* Bond Review Board, *2016 Local Government Annual Report*