

Local Government Debt Act

Prime Sponsor: Senator Eichelberger

Senate Bill 340 of the 2015-2016 Session (Passed Senate 50-0 on September 28, 2016)

Previous Cosponsors: Eichelberger, Blake, Folmer, Teplitz, Vulakovich, Vance, Schwank, Boscola, Yudichak and Browne

In the Fall of 2012, the Senate Local Government Committee held hearings to examine the financial situation surrounding the Harrisburg Authority and its relationship to the fiscal distress of the City of Harrisburg. The hearings were in response to a forensic audit which cast serious doubt on the ability of current state laws to protect communities against transactions which threaten their fiscal stability. Several state laws designed to prevent unsound projects and borrowing were called into question by the hearings, including the Local Government Unit Debt Act (LGUDA) and laws pertaining to performance bond requirements and conflict of interest prohibitions.

The LGUDA (53 Pa.C.S. §§ 8001-8049) provides for review of project financings by the Department of Community and Economic Development (DCED), defines the different types of debt a municipality may enter into, and sets limits on the amount of debt a municipality can incur without voter approval. While LGUDA provides for a review of transactions by DCED, the review occurs after the major decisions about borrowing have already been consummated. The review is done by one lawyer in DCED's Office of Chief Counsel, and is essentially a check-off to see if all of the required documents have been filed, rather than a review of the fiscal impacts of the project. At times, questions do arise as to whether documents meet the requirements and definitions contained in LGUDA, but the Department lacks the regulatory ability to delve into deeper issues.

The hearings also called into question many of those definitions and requirements, the use of guarantees, and the Act's overall enforceability. Major examples of this include proper allowable borrowing for the cost of a project and the debt limits imposed on local government units. LGUDA provides that prior borrowing which is "self-liquidating" (i.e. the project generates sufficient revenues to pay its debt service), does not count against a local government's debt limit when it seeks to incur new debt. LGUDA allows borrowing only for permissible "costs of a project." Those costs are defined to include construction costs and one year of working capital/operations costs to get the project up and running. In the Harrisburg instance, borrowing was incurred on multiple occasions to keep the operations of the project incinerator afloat, as well as to reimburse debt service payments made by the city/county under prior debt guarantees and to fill city budget gaps. Clearly, the debt was not self liquidating and the borrowed funds were inappropriately used, but the LGUDA debt limitations were never enforced.

There was also much discussion about the use of guarantees. LGUDA allows a local government unit to guarantee the debt of another local government unit. At the hearings, it became apparent that the guarantees of Harrisburg Authority debt, which were issued by both the city and the county, were relied upon more than the merits of the project. Despite the ongoing history of the project, this enabled the repeated financings. Additionally, fees were charged by both the city and county for the guarantees provided. Those fees were added to the debt, despite not being a bona fide cost of the project, and increased the financial liability to the taxpayers by millions of dollars.

In addition to a lack of adequate regulatory oversight, the Harrisburg situation involved negligence and malfeasance on the part of contractors, government officials, and their advisers. Financial and legal advisers who made hundreds of thousands of dollars from these transactions let down their real clients—the taxpayers. The advisers did nothing to warn of their *in*-advisability, and fatefully assisted the local governments in manipulating around the LGUDA requirements.

These hearings served as an invaluable case study into the various factors that can lead local government units into financial trouble. While some of these factors cannot be cured by

legislation alone, we plan to introduce legislation which would make the following reforms to the Local Government Unit Debt Act:

- Provide more information to the public and DCED before debt is incurred
- Eliminate the ability to charge a fee for issuing a guarantee
- Limit the ability of municipalities to provide unlimited guarantees of other entities' debts
- Amend the "self-liquidating" and "working capital" definitions to prohibit reimbursements for payments made under a guarantee or other non-project-related costs
- Provide for fiduciary duty of advisers and penalties for false filings