

Testimony of  
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Before the  
Planning and Development Committee  
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S.B. 441 – AAC the Issuance of Bonds for Municipal Sewerage Systems

I am pleased to submit testimony in support of S.B. 441, making amendments to the Municipal Sewerage Act, Chapter 103 of the General Statutes. I am a partner at Finn Dixon & Herling in Stamford, Connecticut, where I practice in the municipal bond field.

The changes proposed would modernize Chapter 103 in several respects that will make it a more useful tool in financing sewerage projects.

A critical purpose of Chapter 103 is to allow sewer bonds to be issued as revenue bonds, payable from pledged revenues. To be effective, pledges of revenues by municipal issuers need to be valid as against third persons and have priority over other claims. As originally adopted in 1935, Chapter 103 permitted pledges of revenues but did not provide as to the validity or priority. The statutory language now common for such pledges appears in the proposed amendment.

As originally adopted in 1959, Article 9 of the Uniform Commercial Code (governing security interests such as pledges) did not apply to governmental pledges, such as pledged revenues, and it became common for the statutes authorizing pledges of revenues to provide for validity and priority. In 2003, P.A. 03-62 amended Article 9 of the Uniform Commercial Code to apply to governmental pledges unless another statute specifically governed creation and perfection. At the same time, an effort was made to conform all of the statutory pledge provisions so that they would all be outside the scope of Article 9. Unfortunately, Chapter 103 was not so amended. Currently, therefore, the revenue pledge authorized by Chapter 103 is within the scope of Revised Article 9, requiring filings with the Secretary of the State and the application of commercial principles to statutory pledges. One effect of this Bill would be to conform Chapter 103 to the other statutory pledges.

Another change is to provide more flexibility in the use of premium. In the current low interest rate environment, institutional purchasers of bonds offer the best yields when bonds have a high coupon, typically 5%. This results in pricing of the bonds at a significant premium. Chapter 103 currently provides (somewhat conflictingly) for either no premium or for premium to be applied to the first principal payment. This is awkward under federal tax law and means an issuer cannot offer at the lowest yield. Allowing bonds to be priced at a premium and for premium to be used for project costs would be a considerable improvement in the current interest rate environment, and would allow municipalities to reduce the size of their issues. I would note that this does not affect the amount that municipalities could spend, since that would be governed by the appropriation, not the size of the bonds.

While institutional purchasers of bonds require a high coupon, retail purchasers typically are looking for the coupon to approximate market yield and the bond to be priced at par. To tap this

market, issuers will often have two bonds with the same maturity, one priced for the retail market and one for the institutional market. This currently is not permitted by Chapter 103, and removing this restriction would be another way issuers could achieve the best results.

Chapter 103 constrains the principal amortization schedule an issue can have. S.B. 411 proposes that for more sizeable issues, this constraint be relaxed. The idea is that larger issues will be part of an overall plan of finance, and the overall plan will have a responsible structure. Individual issues may be more flexibly structured within the overall plan, to take advantage of market conditions. In the course of reaching out to colleagues for comment on this bill, some have suggested to me that the language at lines 92 to 96 should be more closely crafted to that purpose, and on the attachment I have suggested better language.

The proposed bill clarifies the nature of any agreement with bondholders. Such an agreement often takes the form of a trust indenture with a corporate trustee and usually limits the powers of individual bondholders. I do not mean to suggest that the existing statute does not permit trust indentures with these provisions—I think it does—but the clarification I think is a useful improvement.

Last, another suggestion that has been made to me is that it may be efficient for a municipality funding a project to include the project within general obligation bond anticipation notes issued by the municipality, and then refund those notes with sewer revenue bonds. A separate bond anticipation note limited to sewer revenues may be too small to market separately. I think this should already be possible under the existing statute, but I have suggested on the attachment language that could be used to clarify that this is allowed.

Thank you for the opportunity to testify in support of this bill.

Suggested alternative language:

1. To be added in place of the language at lines 92-96:

“[.] provided, however, that these requirements will be deemed to have met with respect to any issue if they would be met by the issue taken together with all other bonds, notes or other obligations theretofore issued, whether issued under this chapter or otherwise, which are declared by the municipality to be part of a single plan of finance.”

2. To be added after the addition in line 28:

“Bonds may be issued by a municipality hereunder for the purposes of refunding bonds theretofore issued by the municipality under authority of this chapter or otherwise.”§