Bond Case Briefs

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Charter Proposal to Pay Bonds with Sales Tax Could Lead to Trouble.

One night in the 1980s, a skinny red-headed kid tried in vain to get into a Guns N' Roses show in Los Angeles. Now matter how much he pleaded, his name wasn't on the list and he couldn't get a ticket.

This is how Axl Rose got locked out of his band's show and Duff McKagen became lead singer for a night, probably not one of their better shows.

What on earth does this have to do with Tucson's bonding capacity and sales tax revenues from the general fund? Everything.

The Charter Review Committee has forwarded a recommendation to the City Council to ask voters to give the city the power to use sales tax money to pay down debts without voter approval. To make gosh-darn sure voters didn't think this was a tax increase the committee full of smart people also refused to advise an increase to the city's sales tax limit beyond where it is now — just two percent.

The net effect would be to burden future city leaders with bond debts paid from a typically cash-strapped general fund or worse, instigate a revolt against "back room bonds" a new council may seek to disavow themselves of with disastrous results.

Bond dollars are VIP dollars that need to be dropped off back stage. They need a clear path from the city coffers to the bond holder's wallets and have nowhere else to go. The minute they are in competition with other money or the crowd out front trying to talk their way in, bad things can happen.

That's it in a nutshell, but because a smart reader is a stronger citizen let's talk about why.

Warning: The degree of dorking out that will follow may not be suitable for some readers. Whatever discretion leads you to watch "Dancin With the Stars" is advised.

Bonding. It's just debt. It's how cities, states and businesses pay for debt. We first need to disabuse folks of the ideas that debt is always bad or that the federal debt is anything like municipal bonds. Debt allows for you to pay for today's big ticket "capital" costs with tomorrow's more powerful dollars. In that sense, it's good. It's smart financial planning. It's why even if you have $200,000 in cash laying around, you would be smarter to mortgage it.

Say you could put that $200,000 into an investment that would earn about $8,000 a year, tax-free. That would be enough — according to Zillow — to pay off your mortgage with other people's money. Then, when you are done, you would get the original $200,000 back.

Now that $200,000 in 30 years isn't what it was today but that's the point.

Tomorrow's dollars are bigger and more powerful than today's so you are addressing big purchases with financial force. Also every dime of income that you would have spent on a mortgage instead went into a retirement account that has you set for life (note, this is for an insanely low interest rate and to qualify these days, you better have never missed a homework assignment in 7th grade. But even if it pays half your mortgage — you get the point). What is this wonder, tax-free, safe-as-can-be investment we're talking about?

A municipal bond.

It's how the other one percent lives. In fact, munis as they are called, are one way that super-rich does invest in America, providing the financing for roads, libraries, etc., while getting their annual live-on money tax free.

The city's budget stays in balance even as it takes on debt because there is a dedicated funding source to cover the cost of paying off bonds.

That's the secondary property tax. Primary property taxes pay for pencils, cop cars and salaries. The secondary property can only tax pay for roads and new buildings and bond holders know the money is coming. However, to keep everyone cool with the debt, voters have to approve it. The city, the voters and the bondholders are all on the same page.

In fact, when those evil Koch Brothers decide to pay for an expansion somewhere, they probably finance it this way — choosing to let tomorrow's dollars pay for today's investments and using other people's money to do it. It's smart.

Debt isn't bad. It's a tool. It's like a drill. So long as you aren't powering it through your thigh or into the antique China, it's good to use if you use it right. How do you use it wrong? Glad you asked.

The federal deficit and debt is something completely different. That's Dodge City and Wild West accounting. The feds use deficits to finance day-to-day operations. The city ledgers would more or less make sense to a corporate accountant. That same accountant would look at the federal deficit and wail, "Oh God! My eyes!"

So back to the Charter Review Committee, whose idea is to let the Council simply have more flexibility to pay for today's needs with tomorrow's dollars and it has what bureaucrats would call "merit."

The rest of us would say it's not as completely stupid as it sounds.

Say the city had this ability in 2010. Potholes would have been fixed a lot sooner. The city could have taken out $50 million in debt an repaid it over 10 years, probably saving some money because potholes just get bigger.

Plus, there are some items the City Council might want to bond to buy that are just a few million dollars, meaning holding a special election costing a million bucks doesn't make much sense, city officials would say. So, it allows the Council to react smartly and pay for things with a degree of agility.

But, the Council would simply be siphoning off the existing sales tax revenues to pay for them and that's when the trouble stars and Axl gets angry.

Sales taxes are nothing like secondary property taxes. The secondary property tax provides the undisturbed path for VIP dollars. Bondholders like that. Secondary property tax debt is something called G.O. (general obligation) debt.

If for some reason, the city can't pay, well, then bondholders can take it to a judge who will force the necessary tax hike to get G.O. debt repaid. The bondholders love that. There's not a lot of risk and interest rates are low. The city is happy. Bonds paid with sales taxes carry higher interest rates because lenders can't go to a judge and take over Speedway if the city doesn't pay up in time.

Bond interest rates aren't usually debilitatingly high. "Revenue bonds" are used all the time to pay for new water lines and the Pima County Regional Transportation Plan is being paid for this way. However, the RTA also carried with it an extra funding source: sales taxes were raised a half cent to pay for it. So the county scoops up that dedicated money, puts into an account and zips it over to bondholders. Everyone is happy, except for the Pima Association of Taxpayers, who are never happy.

The charter committee wanted to give the Council the authority to be financially nimble but were worried voters would see a sales tax coming their way and revolt. So, committee members figured the way to head that off (because reason always carries the day in public debate) was to not allow the city to raise any more sales tax revenues. Problem solved. The city gets nimble. The voters won't fear sales taxes. Right?

Well, true enough but it just creates all sorts of havoc on the back end.

The Council has the ability to raise sales taxes with a 4-3 vote but can't today without smacking into a two-cent sales taxes limit in the Charter. The Council also has the ability to bond without voters' approval. It agrees to let, for instance, Tucson Water build new water lines and pay back bonds out of water rates. It can also use something called certificates of participation to pay for physical assets, such as a parking garage. Fees paid by users will pay the cost of building it and bondholders could take possession of the garage if the city defaults.

Neither of these powers has any real effect on the general fund, which is the $480 million in discretionary money for services that do not pay for themselves. Parks. Parks are paid for with the general fund. Police. Police are paid for with the general fund. After-school programs are paid with the general fund. The general fund money is almost exclusively paid for with sales taxes — the same ones the committee thinks should be used to pay off bonds.

If that happens, the sales taxes that cannot be raised would now be available for bonds and would be in direct competition with other general fund programs.

Now the problem becomes acute. The general fund more often than not during the past 15 years has been … what's the word? Oh! Broke. After the last two recessions, the budget doesn't have much to give, or for the conservatives in the room, it doesn't have much that isn't a sacred cow. Nipping and tucking $10 million here and $20 million there turns into a brutal cat fight.

Had the review committee raised the sales tax limit by just a smidge for the purposes of bonding, the city would be able to issue a limited amount of small-ticket debt without putting more pressure on the already hard-pressed general fund. Then the situation starts to resemble Axl Rose at the door,because the money is milling around with a bunch of non-VIP (that feel pretty VIP to those who get them) and the path between the dollars and bond holders gets dicey.

The real-world truth is that bondholders aren't that worried. Cities and counties issuing these debts know full freaking well that every time a city issues debt it puts its full faith and credit on the line. That money comes out first — the theory goes.

However, the Legislature in Phoenix is trying to undo the social contract at every level in Arizona and slashing state-shared sales taxes. Our pension system isn't paying for itself. Arizona sluggishly limps behind the rest of the country in terms of economic growth. The last thing the general fund needs right now is another big slice paid out.

Sales taxes rerouted to debt would almost certainly force general fund cuts in services voters expect, pitting cops against parks yet again. Worse, the situation could make the prospect of defaulting or reworking debt that much less unthinkable. Without voter buy-in on debt that had been issued, future Councils could decide “Know what? Screw it,” and win elections running against “back-room debt.”

A weakness of democracy is how voters believe that at the end of the day elected leaders are not full-bore crazy, and is that a dangerous assumption.

Over time, the new power to issue bonds without voter approval could come back to haunt the city, when 10 years on the Council looks at the municipal ledger and wonders, “How is it we have $40 million in annual debt payments to make from the general fund? When did that happen?”

That’s when the new city manager says, “Yeah, that was two city managers ago, but you are still on the hook.”

It’s not at all a leap that at that very moment the Council member looking at his or her sacred cow then becomes an instant hero asking the follow up: “Is there any way we can tell the bond market that they can bite me?”

It wasn’t that long ago that the prospect of defaulting on our debt at the national level was utterly unthinkable. Today, it’s a tweetable chirp with 140-character appeal to voters.

After the last war, the last recession and Rio Nuevo, never ever, ever listen to a smart guy in a suit last line of defense says, “Oh, but they’ll never be that stupid.” Charters exist for that very reason: to prevent idiocy before it starts.

Dollars for debt must get VIP treatment and be delivered safely to bondholders. Once they start milling around with the rabble, they become less distinguishable. That’s when Axl can’t get back stage and Duff must sing. On the municipal level, services are cut and the full faith and credit of the city is at risk.

The hair’s breadth between this idea having merit and it being a dangerous is in the political calculation the review committee made: a hope of being able to sell the change as not being a tax increase. They essentially decided to drop Axl off at the front of the club, telling him to fight his way past security. Does it sound smart?

I’m not simply here to cast aspersions because two tools remain to give the city agility, protect bond holders and city programs. One, is raising the sales tax limit by a fraction and the other is to carve out a small portion of the budget for non-discretionary sales tax dollars and swallow the hit to the general fund. Codify it. Add it to the Charter. The money is just gone for any and all general fund purposes, not in practice, but by law.

If the Council wants to have the power but can’t think of a way to pay for it, then Tucson is already turning off the road from wise debt to the kind that blinds accountants and, truthfully, wins City Hall reporters a bunch of awards (First Place Beat Reporting when debt money in Flagstaff wound up in the general fund).

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