Why Issue Debt

• Project Type
  – Long-lived capital asset
  – Public Use: tax-exempt eligible

• Project Cost
  – Available resources
  – Above minimum threshold

• Project Purpose
  – Anticipated revenue stream
  – Intergenerational equity
How to Issue Debt

Debt Management Policy

• Debt management policies are written guidelines that guide debt issuance practices

• GFOA recommends that state and local governments adopt comprehensive written debt management policies that reflect local, state, and federal laws and regulations

• Elements of a debt policy include:
  – Purposes for debt issuance
  – Types of debt
  – Limitation on indebtedness
  – Method of sale
  – Method of selecting consultants and professionals
  – Refunding policies
  – Disclosure
# Steps in the Process

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<th>Plan of Finance</th>
<th>Legal Framework</th>
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<td>• Debt size and structure</td>
<td>• Required approvals – voter, governing body, other: notices and hearings</td>
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<td>• Security and source of repayment</td>
<td>• Bond counsel analysis – tax due diligence, legal compliance</td>
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<td>• Method of sale</td>
<td>• Disclosure documentation</td>
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<td>• Finance team</td>
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<tr>
<th>Marketing</th>
<th>Administration</th>
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<td>• Ratings and/or credit enhancement</td>
<td>• Closing/money transfer</td>
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<td>• Underwriter and investor outreach</td>
<td>• Invest bond proceeds</td>
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<td>• Sell and price bonds</td>
<td>• Comply with Arbitrage Rebate Regulations (IRS/Tax Code)</td>
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<td>• Ongoing disclosure by complying with SEC Rule 15(c)2-12</td>
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Tax Status

• Interest received by the investor is not taxed for federal and/or state income purposes:
  – Project being built serves the public
  – No private use
  – Requires counsel opinion
  – Bank qualified (BQ)
    ◦ IRS distinction for “qualified small issuers”
    ◦ Generally, tax-exempt obligations that will be issued during the calendar year cannot exceed $10 million
    ◦ Financial institutions can deduct a portion of the interest from BQ bonds from their income taxes
    ◦ Attracts lower interest rates than comparable non-BQ transactions
Security

• General Obligation Bonds
• Revenue Bonds
• “Subject to Appropriation”, or Lease Revenue Bonds, or Certificates of Participation
• Special Tax Bonds
• Special Assessment Bonds
• Tax Increment Financing (TIF)
Debt Types

• Long-term bonds: term > 10 years

• Short-term notes: term < 10 years
  – In anticipation of:
    ◦ Taxes (TANs)
    ◦ Revenues (RANs)
    ◦ Bonds (BANs)
      ▪ Interim financing used during construction of a project
  – Rollover up to 5 years before reducing principal

• Capital and operating leases
Debt Placement Options

• Debt can be issued via public offering
  – Competitive Sale
  – Negotiated Placement

• Directly purchased by a bank
• Privately placed
Debt Issuance Team

Issuer

- Escrow Agent
- Registrar/Paying Agent/Trustee
- Municipal Advisor
- Bond/Tax Counsel
- Underwriter’s Counsel
- Trustee Counsel
- Financial/Feasibility Consultant
- Verification Agent/Accountant
- Credit Enhancers
- Underwriter/Lender
- Rating Agencies

Every issue
As needed
Municipal Advisor (MA)

- GFOA Best Practice – “GFOA recommends that issuers hire a municipal advisor prior to the undertaking of a debt financing unless the issuer has sufficient in-house expertise and access to current bond market information”

- Advises the issuer throughout the bond issue process
  - Debt structuring
  - Recommending method of sale
  - Selection of the underwriting team
  - Assisting in selection of other finance team members
  - Credit strategy and credit ratings process
  - Price negotiation
Municipal Advisor (MA)

• Role may vary according to:
  – Expertise of issuer staff
  – Type of bonds
  – Method of sale
  – Scope of services

• Relationship may be transactional or on a “Retainer” basis

• MA has a **Fiduciary Responsibility** to represent the issuer and only the issuer

• Assists in a broad array of capital planning and debt issuance tasks

• Often acts as extension of staff
Issuance Costs

- Underwriting spread
  - Takedown
  - Management fee
  - Underwriter expense
- Bond counsel
- Municipal advisor
- Other costs
  - CUSIP
  - DTC
  - Printing
  - Rating agency (if the Issue is rated)
  - Travel
  - Paying agent
  - Ohio Municipal Advisory Committee (OMAC)
  - Verification agent (if refunding)
Role of Credit Rating Agencies

- Rating agencies rate municipal bond issuers in order to categorize the creditworthiness of the security pledge and likelihood of default by an issuer
- Rating agencies view the same credit structure differently – using different methodologies
- Ratings calls or meetings are conducted when a rating is requested for a bond issue
- Once a rating agency provides a rating for an issue, they will conduct regular surveillance while the issue is outstanding
Ratings Categories

- Credit ratings play a role in broadening the investor base for an issuer.
- Usually a stronger rating = lower cost of capital.
- Each category (except triple-A and below Caa/CCC) has 3 “notches”.
- Moody’s modifies with 1, 2 and 3 (i.e., Aa1, Aa2, Aa3).
- S&P and Fitch modify with plus (+) and minus (-) signs (i.e., AA+, AA, AA-).

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<th>Fitch</th>
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<td>BBB</td>
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<td>Non-Investment Grade</td>
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Credit Rating Analysis

- Criteria used by the agencies differs by credit type and by agency, to some extent

- General Obligation Bonds
  - Economy and demographics
  - Financial condition
  - Debt burden
  - Management

- Revenue Bonds
  - Project feasibility
  - Service area
  - Capacity of rates, fees and charges
  - Debt service coverage
  - Legal provisions
Economy and Demographics

• Employment
  – Largest employers, industry mix, by sector, employer concentration, unemployment

• Tax base
  – Size, diversity, structure, assessed value trends

• Wealth
  – Levels relative to region, state, nation

• Population
  – Rising or falling, age, education, labor skills

• Proximity to transportation networks, cities and markets
Financial Condition

• Financial reporting
  – GAAP and GFOA, timeliness, adequacy

• Revenues
  – Trends, diversification

• Expenditures
  – Composition, stability, predictability

• Balance sheet
  – Liquidity, adequacy of fund balance, reserves, inter-fund transfers

• Cash management and investment practices
Debt Burden

- Affordability of obligations compared with available resources
  - Debt service as percentage of annual revenues
  - Debt outstanding as percentage of total assessed value
- Rapidity of debt repayment
- Capital improvement plan
- Mix of fixed versus variable rate debt
- Pension and other post-employment benefit liabilities
Management

• Strong budgeting framework
  – Conservative/accurate revenue projections
  – Expense monitoring and controls
  – Multi-year planning and/or forecasting

• Contingency planning

• Fund balance policies

• Liquidity management

• Capital improvement planning

• Debt planning

• Debt management policy
Bond Insurance

• Bond insurance (also known as “financial guarantee insurance”) is a type of insurance whereby an insurance company guarantees scheduled payments of interest and principal on a bond in the event of a payment default by the issuer of the bond.

• As compensation for its insurance, the insurer is paid an upfront premium by either the issuer or owner of the security to be insured.
Key Timeline Items

• Developing finance schedule – key dates
  – Governing Board approvals
  – Ratings meetings
  – Day of sale
    ◦ Market indices
    ◦ Competing transactions
  – Closing

• Key tasks
  – Debt structuring analyses
  – Document drafts sent to rating agencies
  – Pre-pricing discussions and analysis
  – Post-pricing analyses
  – Closing document signatures and logistics
Post-Issuance Tasks

• Repay the debt, on time
• Track and monitor compliance with arbitrage rebate regulations
• Provide annual and other disclosure to investors as required by SEC Rule 15c2-12
  – As of July 1, 2009, disclosure documents are required to be filed electronically through the “EMMA” system
  – EMMA = Electronic Municipal Market Access
• Rule 15c2-12 requires
  – Notice of material events not more than 10 business days after the event
  – Annual financial and operating data by a certain date
  – Notice of failure to provide annual information
Questions