

# CDIAC: Accessing the Market

## Session Two:

### Debt Policy and Plan of Finance

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# Policies and Plans

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- **The Policy should come first:**
  - Policies are your “north star” guiding preparation of plans.
  - They help make tough decisions easier by telling you what your values are before they are placed under stress by adverse circumstances.
- **A good Plan comes next:**
  - Any debt issuance should be preceded by longer-term financial and capital improvement plans:
    - ✦ What do you plan to do?
    - ✦ How do you plan to pay for it?
    - ✦ What’s the “right” combination of pay-as-you-go versus debt financing?
  - Plans change over time as actual results replace assumptions (like, as soon as the laser jet ink is dry).

# DEBT POLICY

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# Purpose of Debt Policy

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- **Set parameters on agency debt:**
  - When, why and how debt can be issued
  - Amount, type, issuance process, management of a debt portfolio
  - When to use “pay as you go” versus issuing debt
- **Facilitate the financing process**
- **Manage debt within available resources**
- **Promote objectivity in the decision-making process**
- **Provide an opportunity to discuss policy elements on a regular (annual or semi-annual) basis**
- **Provide guidance and training for elected officials on debt process**
- **Provide transparency to stakeholders**
- **Demonstrate sound financial management to rating agencies and investors**

# What Should be Included in Debt Policy?

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- Debt objectives
- Authorization requirements
- Debt limits (affordability measures)
- Debt instruments
  - Depends on the project and its nexus to the source of repayment
- Debt structure
- Debt issuance process
- Ongoing debt management

# What Type of Debt Should be Covered by Policy?

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- **Direct debt – short term and long term**
- **Revenue Debt**
- **Conduit Debt**
- **State Revolving Loan Funds and Pools**
- **Interfund Borrowing**

# Debt Objectives, Authorization and Limits

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- **How will the agency determine whether to issue debt?**
  - Capital project funding should be equitable, cost effective, and fiscally prudent
  - Funding options, including debt, evaluated on case-by-case basis
- **Type of debt authorized and the authorization process**
- **Limits imposed by State and/or federal law**
- **Limits imposed by parity debt covenants**

# Debt Instruments

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- **When is it appropriate to use, and what limitations apply to:**
  - Leases or COPs
  - G.O. Bonds
  - Revenue bonds
  - Notes
  - Derivatives / Swaps
  - Commercial paper

# Debt Affordability Limits

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- How much debt can be outstanding? May want to set parameters – targets as well as maximums – for measures such as:

<b>Parameter</b>	<b>Range</b>
Debt per capita	\$1,000-\$5,000 per capita
Debt as a % of the market value of taxable property	2% - 5% of full market value
Debt service as % of revenues or expenditures	8% - 15% of expenditures
Principal amortization	50% or more within 10 years
Annual Tax Rate	Target may depend on taxpayer tolerance and legal limits
Variable rate debt	<ul style="list-style-type: none"><li>• Rating agency criteria</li><li>• Reserve investments to hedge interest rate exposure</li></ul>
Additional bonds test under existing documents	Compliance with net revenue and debt coverage tests

**Sources:** FitchRatings “To Bond or Not to Bond: Debt Affordability Guidelines and Their Impact on Credit”, June 21, 2005, and Standard & Poors, “Key General Obligation Ratio Credit Ranges – Analysis vs. Reality”, April 2, 2008.

# Debt Structure

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- **Term**
  - Should not exceed useful life of asset
- **Repayment pattern**
  - Escalating versus level payments
  - Desire / need to wrap around existing debt
- **Amortization**
  - Deferral of principal - completion of project
- **Redemption features**
- **Variable vs. fixed interest rates**
- **Capitalized interest**

# Debt Issuance Process

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- **Criteria for determining the method of sale**
- **Selection of professional team**
- **Credit ratings –when is a rating necessary? which rating agencies?**
- **Other credit enhancements – insurance, letters or lines of credit, reserves**
- **Disclosure – preparing an OS**

# Debt Management

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- Who is responsible for ongoing responsibilities related to debt?
- Parameters for refundings/refinancing
- Integrating capital planning with debt management
- Maintaining communications with credit agencies and investors
- Recognition of obligations for:
  - IRS restrictions and arbitrage rebate
  - Continuing disclosure
  - Change in use / private use
- Keeping records – how long, where, what format?

# PLAN OF FINANCE

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# Funding Guide

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- **Pursue grants and low interest loans from Federal and State Agencies**

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- **Weigh the Impacts of Using Cash Reserves vs. Reserves & Debt vs. Issuing Debt**
  - May reduce interest expense, especially for taxable debt, while maintaining prudent reserves levels for operations and credit ratings

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- **Review Debt Policy to determine appropriate form of debt and issuance process**

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- **Issue Lowest-Cost Debt**
  - Assemble team – review contracts, negotiate fees
  - Seek rating upgrades
  - Evaluate variable rate versus fixed rate interest
  - Evaluate reserve fund options
  - Evaluate credit enhancement options

# Forms of Debt

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- **Loans, Leases or COPs**: not considered debt, useful financing mechanism for general fund supported governmental facilities, e.g. city hall, county public safety facilities or schools. Requires an underlying asset that is leased, the lease payments are the source of revenues that secure the lease revenue bonds or COPs.
- **G.O. Bonds and other direct levy supported debt**: can finance a broad range of facilities, but requires voter approval; bonds secured by the pledge and levy of ad valorem taxes.
- **Revenue bonds**: specific revenue pledged from an asset usually an “enterprise” that secures the bonds; typically no other source of revenues is pledged.
- **Short term instruments (Notes, Commercial paper)**: interim financing used to begin construction; temporary shortfall in revenues until plan of finance/source of revenues is crystallized.

# Competitive vs. Negotiated Sales

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	Competitive Sale	Negotiated Sale
<b>Issuer Characteristics</b>		
<b>Market Familiarity</b>	Well-known, established issuer	New or infrequent issuer
<b>Credit Strength</b>	"A" rating or higher	Less than an "A" rating
<b>Program Complexity</b>	Simple program, one or two issues	Complex program, multiple objectives
<b>Policy Goals</b>	Broad, non-specific market participation desired	Policy to include specific firms in distribution
<b>Transaction Characteristics</b>		
<b>Form of Debt</b>	Issue possesses "commodity"-like characteristics	Issuance is unconventional or uses derivative products
<b>Issue Size Complexity</b>	Issuance is of a conventional size	Issuance is comparatively large, small, or complex
<b>Market Condition</b>	Stable interest rates	Volatile market
<b>Market Dynamics</b>		
<b>Rate Environment</b>	Financing success not rate dependent	Financing is highly rate-sensitive
<b>Supply and Demand</b>	High demand; Good liquidity	Highly saturated market; excess supply

# Issuing Bonds

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**Select Financing Team.**  
**Determine method of sale.**

**Plan of finance & credit strategy.**  
Form of debt, repayment sources and bond structure.

**Document transaction.**  
Legals, POS and CDA.  
**Obtain credit rating(s).**  
Analyze credit enhancement if necessary.

**Marketing and investor relations strategy.**  
Review market trends, calendar and interest rate environment.  
Offer debt to market.

**Price, Close & On-going Management:**  
Final pricing, closing documentation, investment strategy.



# Financial Considerations

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- Overall debt affordability and maintenance of strong credit ratings and compliance with financial policies
- Intergenerational Equity
  - Debt versus Pay-as-you-Go cash financing
  - Hybrid solution
- Timing of bond issuance versus actual spend-down of proceeds
  - “Negative carry” may result from a low short-term interest rate environment
- Market Conditions
- Repayment Term
- Bond Structure and Risk Tolerance

# General Provisions

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- There should be an identified repayment source
- Limitation on debt issued to cover operating needs
- Project should be incorporated into the capital improvement plan
- Adequate revenues to cover all O&M
- Issuance should be consistent with adopted credit strategy, and debt service

# Contact Information

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# Appendices

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# Interest rates have been Volatile

**Change in 'AAA' MMD Yields**  
(August 1, 2008 through September 27, 2013)

— 'AAA' MMD 10-Year Yields — 'AAA' MMD 30-Year Yields



**Historical Change in 'AAA' MMD Yields**  
May 2, 2013 through September 27, 2013

— 'AAA' MMD 30-Year Yields



**Change in 'AAA' MMD Yields**  
(May 2, 2013 through September 27, 2013)

— 'AAA' MMD 10-Year Yields

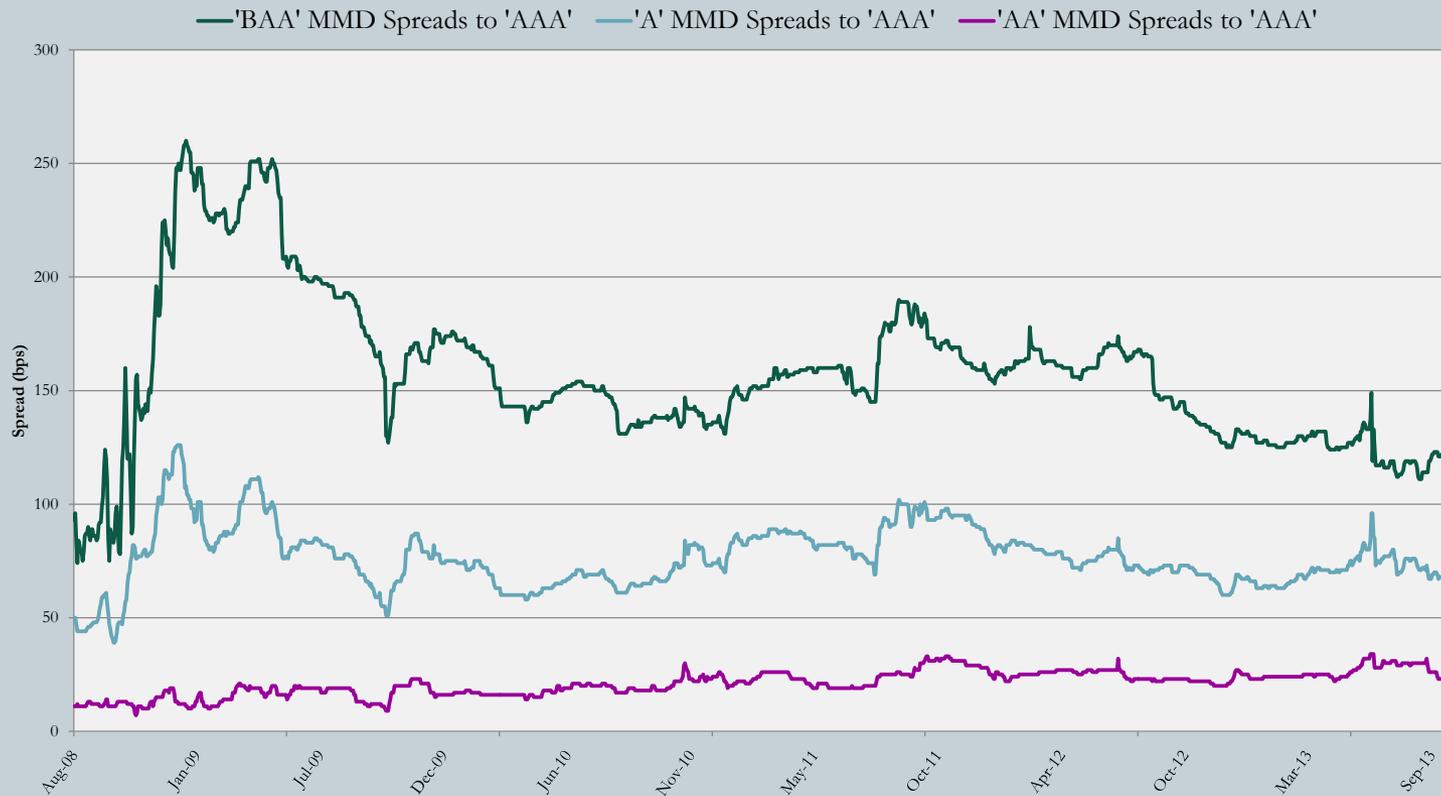


# Credit Spreads

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## 30-Year MMD Credit Spreads

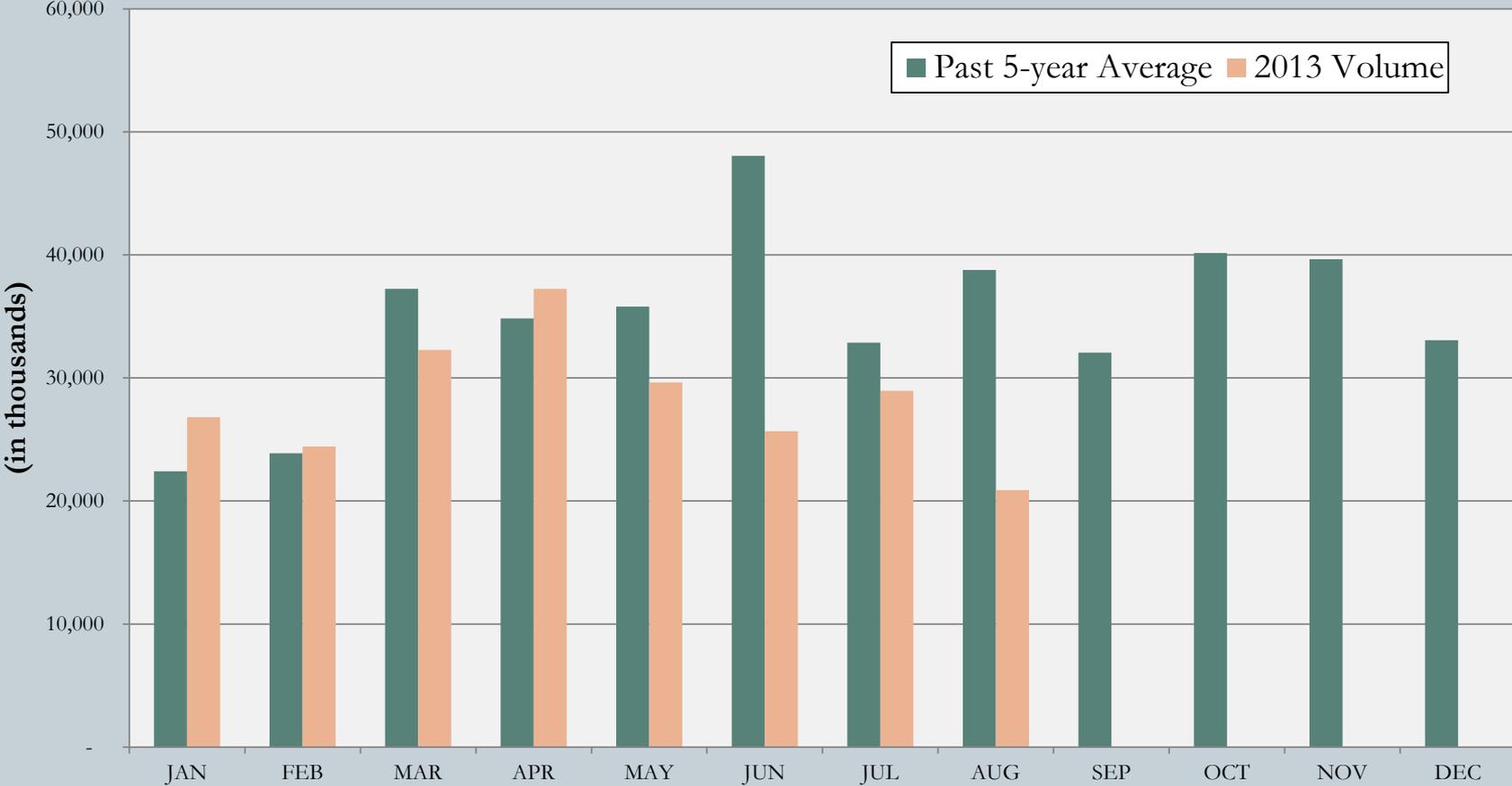
August 1, 2008 through September 27, 2013



Source: Thomson Municipal Market Monitor

# 2013 Sales Volume has decreased as rates rose

## Long-term Bonds Sales

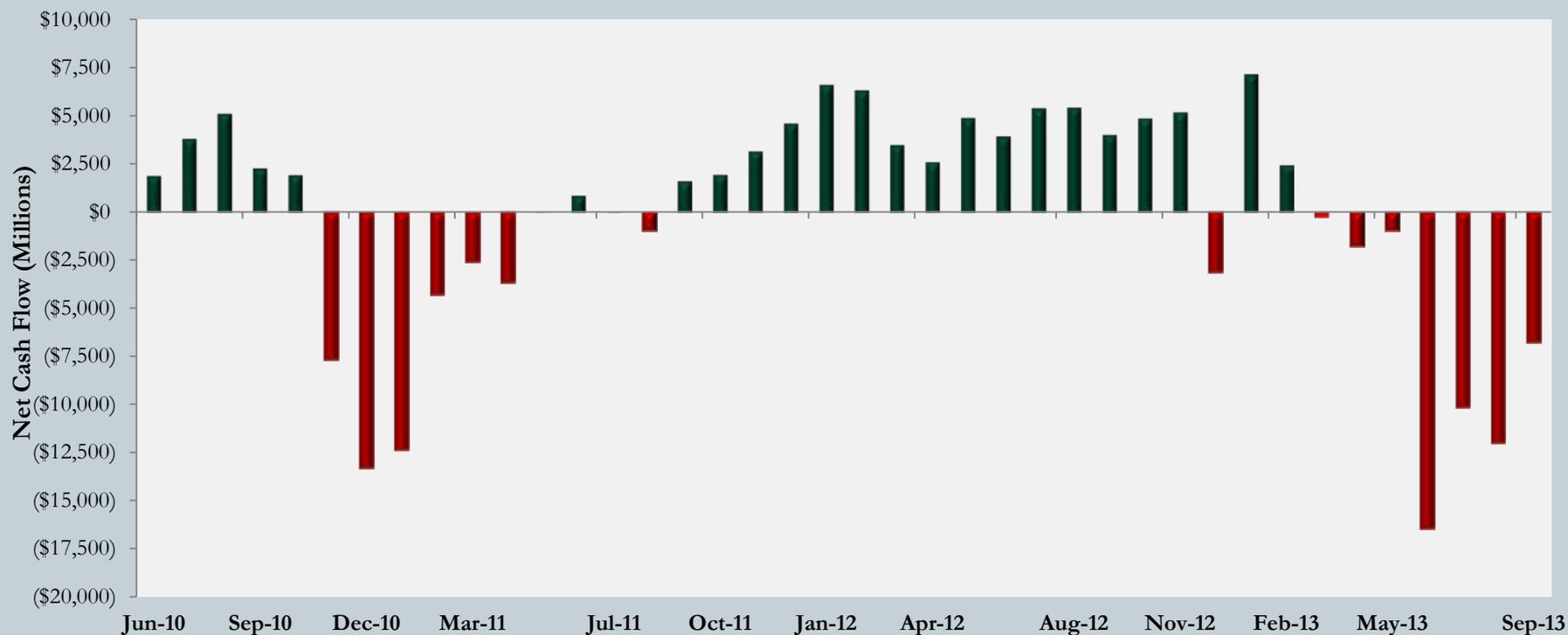


Source: The Bond Buyer

# 18 Consecutive Weeks of Outflows

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## Monthly Flow of Funds Municipal Bond Mutual Funds



Note: Far right red column is for the month of September, as of September 25, 2013.

# Moody's 2011 US Local Government Medians

## Municipal Financial Ratio Analysis – Local Government Medians

Selected Indicators	US Counties	US Cities
Median Moody's GO/Issuer Rating	Aa2	Aa3
Total General Fund Revenues (000)	\$51,370	\$20,371
General Fund Balance as % of Revenues	30.90%	29.72%
Unassigned General Fund Balance as % of Revenues	20.56%	20.28%
Direct Net Debt as % of Full Value	0.56%	1.12%
Overall Debt Burden (Overall Net Debt as % Full Value)	2.31%	3.07%
Total Full Value (000)	\$8,252,612	\$1,958,174
Population 2010 Census	78,241	17,514
Full Value Per Capita	\$80,453	\$88,611
Ten Largest Taxpayers as % of AV	6.02%	8.85%
Per Capita Income (2010 ACS)	\$24,072	\$26,115