

CDIAC: Accessing the Market Session Two: Debt Policy and Plan of Finance

1

March 18, 2015

PRESENTED BY:

**ROBERT A. PORR, SENIOR VICE PRESIDENT,
FIELDMAN, ROLAPP & ASSOCIATES**

**SARA OBERLIES BROWN, MANAGING DIRECTOR
STIFEL, NICOLAUS & COMPANY, INC.**

Policies and Plans

2

- **The Policy should come first:**
 - Policies are your “north star” guiding preparation of plans.
 - Policies help make difficult decisions easier by establishing values and priorities 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 existing reserves, pay-as-you-go and debt?
 - Plans change over time as actual results replace assumptions (as soon as the laser jet ink is dry).

DEBT POLICY

3

Purpose of Debt Policy

4

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

What Should be Included in Debt Policy?

5

- 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
- Post Closing Compliance
- Debt Management

What Type of Debt Should be Covered by Policy?

6

- **Direct debt – short term and long term**
- **Revenue Debt**
- **Conduit Debt**
- **State and Federal Subsidized borrowing programs**
- **Interfund Borrowing**

Debt Objectives, Authorization and Limits

7

- **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

8

- **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

9

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

Parameter	Range
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">• Rating agency criteria• Reserve investments to hedge interest rate exposure
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 & Poor’s, “Key General Obligation Ratio Credit Ranges – Analysis vs. Reality”, April 2, 2008.

Key Credit Ratings Medians

10

Municipal Financial Ratio Analysis - US Cities				
	US Local Government Medians			
Selected Indicators	Aaa	Aa	A	Baa
General Fund Balance as % of Revenues	32.90%	30.71%	28.73%	8.79%
Unassigned General Fund Balance as % of Revenues	21.36%	20.42%	20.82%	3.20%
Direct Net Debt as % of Full Value	0.70%	1.02%	1.51%	1.83%
Overall Debt Burden (Overall Net Debt as % Full Value)	2.22%	2.91%	4.36%	4.33%
Full Value Per Capita	\$137,429	\$79,934	\$48,008	\$36,394

Source: Moody's Median Report 2011 US Local Government Medians

Debt Structure

11

- **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

12

- **Criteria for determining the method of sale**
 - Credit rating or “story bonds”
 - Volatility of market
 - Frequency of issuances
- **Selection of professional team**
- **Credit ratings**
 - When is a rating necessary?
 - Which rating agencies?
- **Credit enhancement –**
 - Municipal bond insurance
 - Letters of credit
 - Collateral pledges (reserves)
- **Disclosure – preparing an OS**

Debt Management

13

- 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

14

Three Good Questions to Start

15

- 1. Is this a real projectnow?**
 - Environmental approval
 - Design completion

- 2. What revenues make sense to pay for the project?**
 - Project-specific revenues
 - Scope of benefit: whole vs. partial city

- 3. What non-bond funding sources may be available?**
 - State or federal grants (or low-interest loans)
 - Developer contributions or development impact fees
 - Reserves or one-time revenues

Revenue Sources Determine Type of Bond

16

< Higher Grade		Types of Bonds			Lower Grade >	
	General Obligation	Enterprise Revenue	Lease Revenue (Certificates of Participation)	Special Tax	Special Assessment	
Revenue Pledge	“Full faith and credit” of issuer. Secured by property taxes	Net revenue of a specified enterprise, such as water, sewer, solid waste, or parking	Lease payments for use of government asset; paid from general fund	Lien on property; bonds paid from tax levied in addition to normal 1% ad valorem tax	Lien on property; bonds paid from annual assessment on property that benefits	
Vote?	2/3rds vote threshold; Schools may be 55%	No public vote required	No public vote required	2/3rds vote of property owners by acreage or by vote of registered voters	50% + 1 vote of assesses, weighted by amount of assessment	

Uses of Funds

17

Project Fund

- Gross funded vs. net funded?

Reserve Fund

- Necessary? Standard sizing?

Capitalized Interest

- Able to start paying debt service immediately?

Costs of Issuance

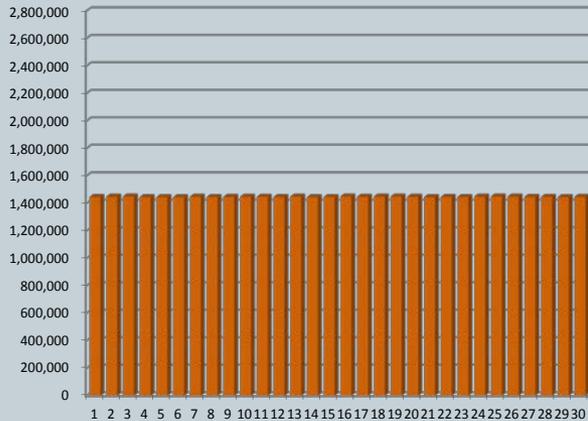
- Lawyers, advisors & bankers...Oh My!

Repayment Terms

18

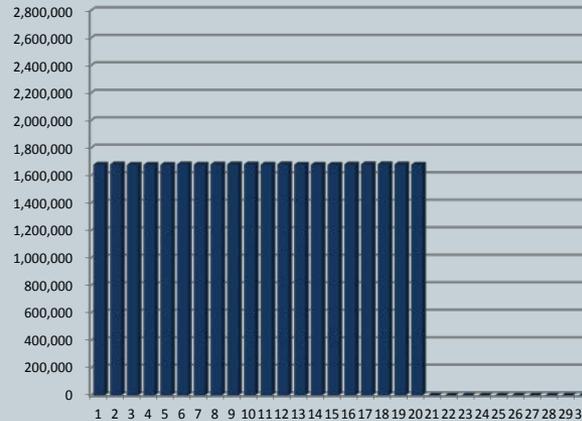
- Issue \$25,000,000
- Debt Service Term: 30 Year, 20 Year & 10 Year Term

30 Year Debt Service



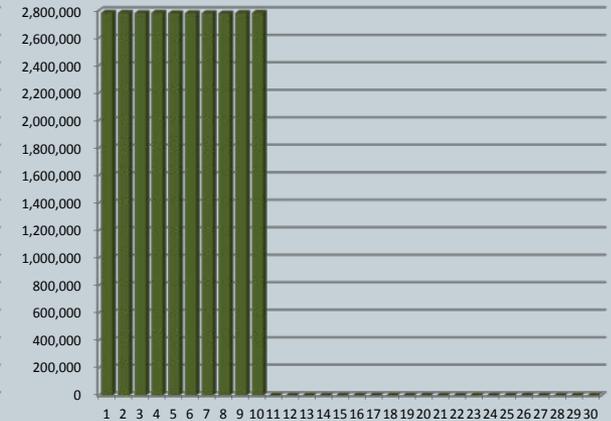
Annual DS: \$1, 450,000
Total Interest: \$18,375,000
Interest Rate: 4%

20 Year Debt Service



Annual DS: \$1, 680,000
Total Interest: \$8,600,000
Interest Rate: 3%

10 Year Debt Service



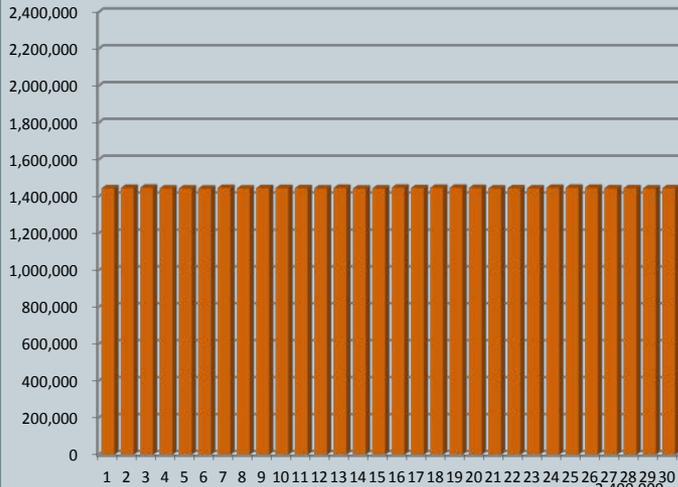
Annual DS: \$2,785,000
Total Interest: \$2,830,000
Interest Rate: 2%

Repayment Terms

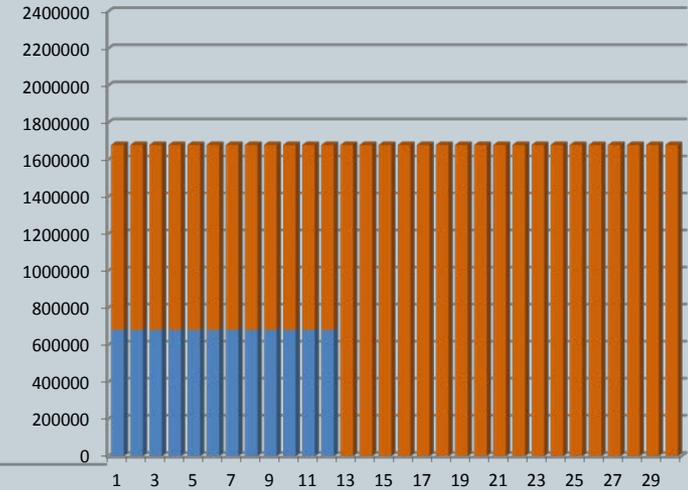
19

- **Debt Service Profile: Level, Escalating or Wrap**

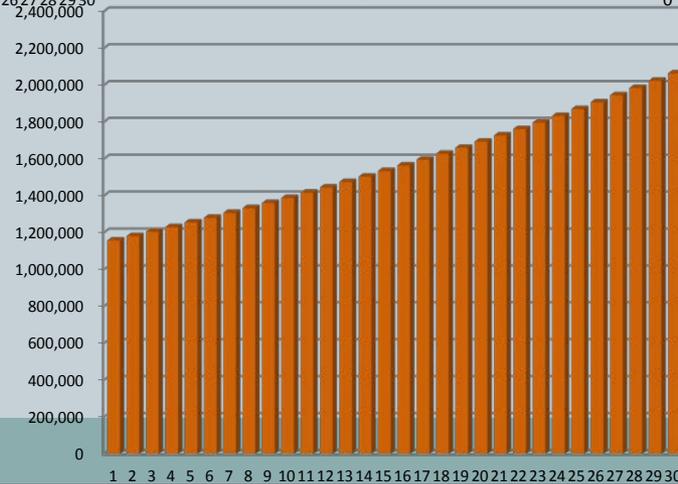
Level Debt Service



Wrapped Debt Service



Escalating Debt Service



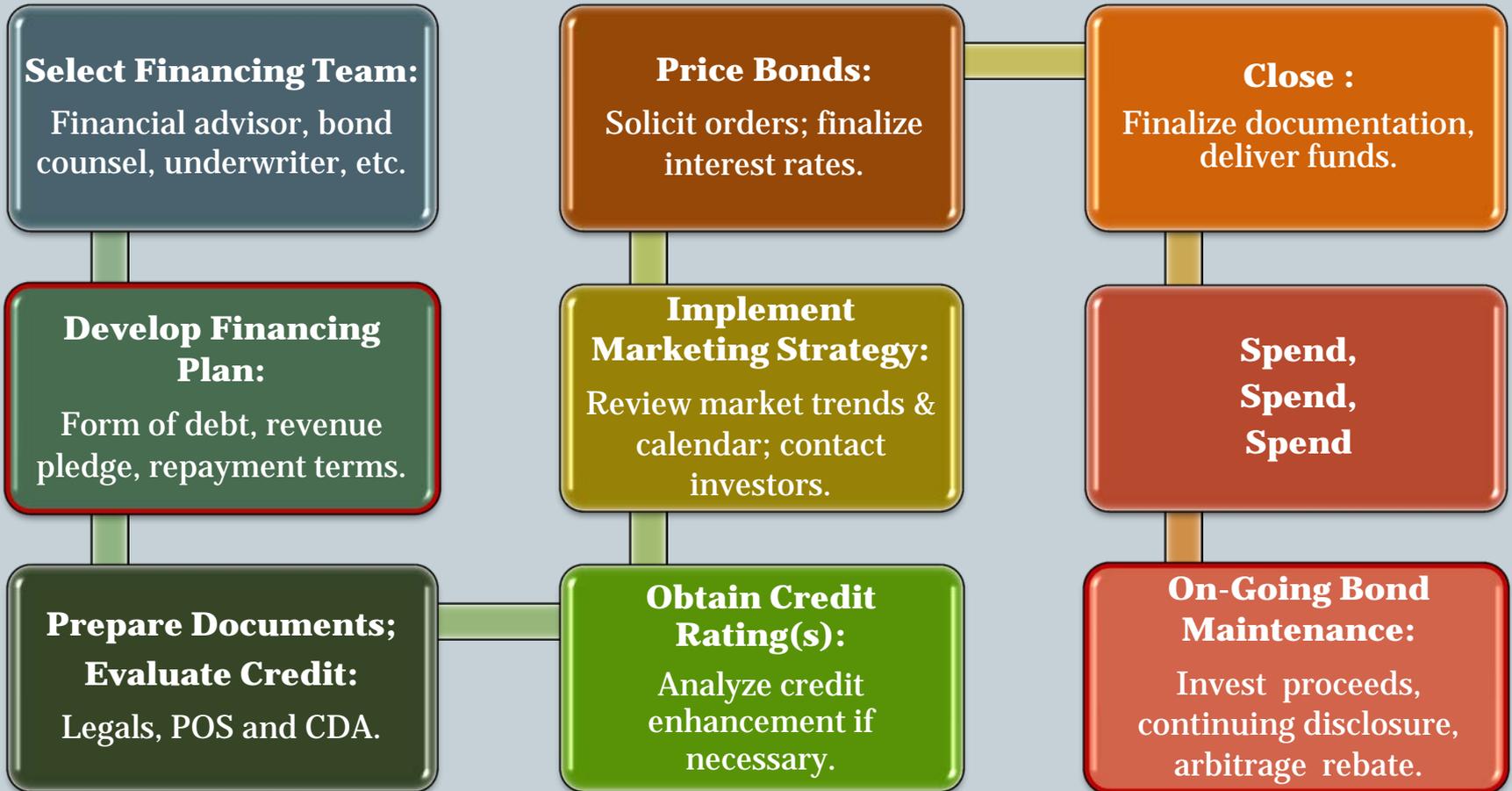
Competitive vs. Negotiated Sales

20

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

Issuing Bonds

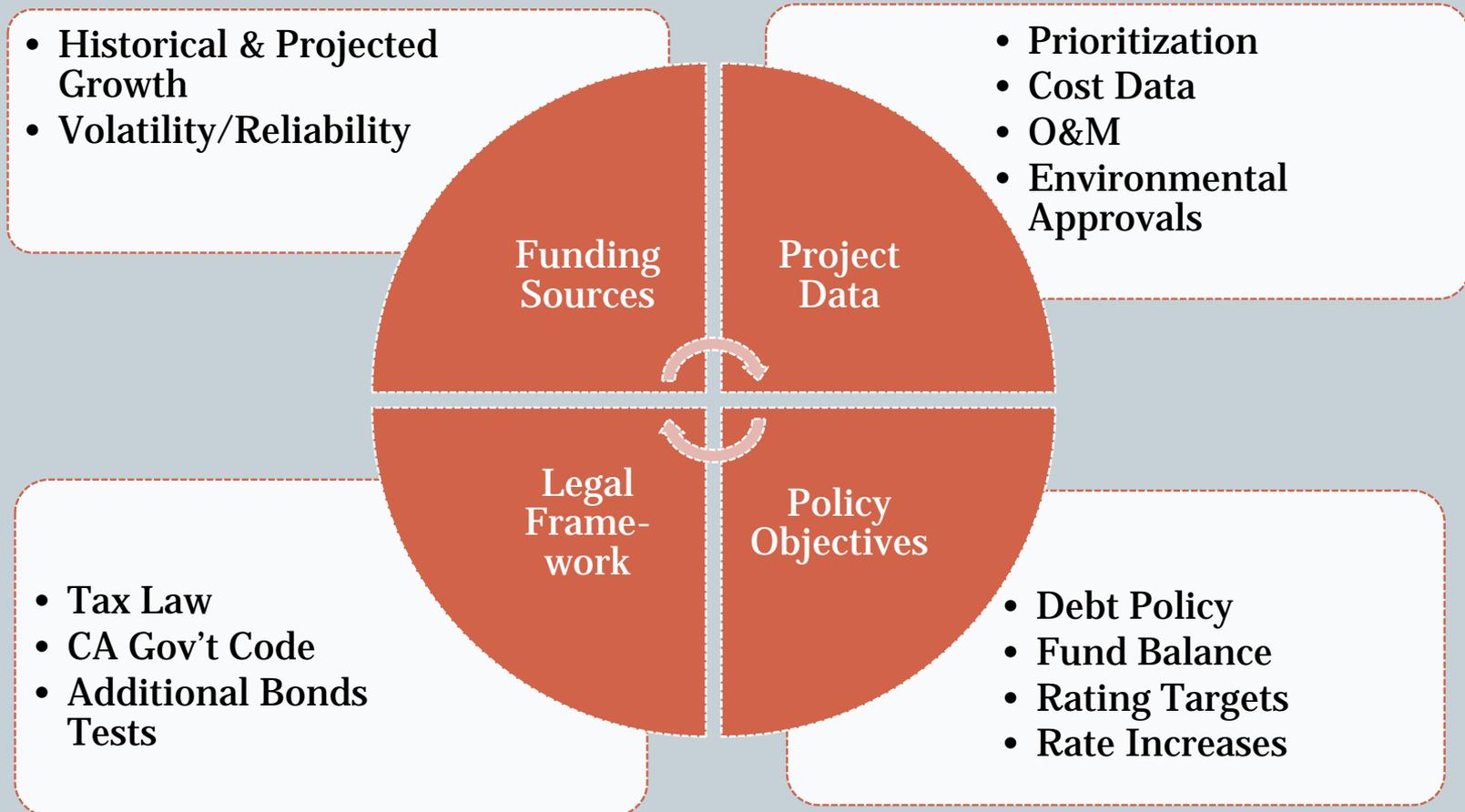
21



Develop Financing Plan

22

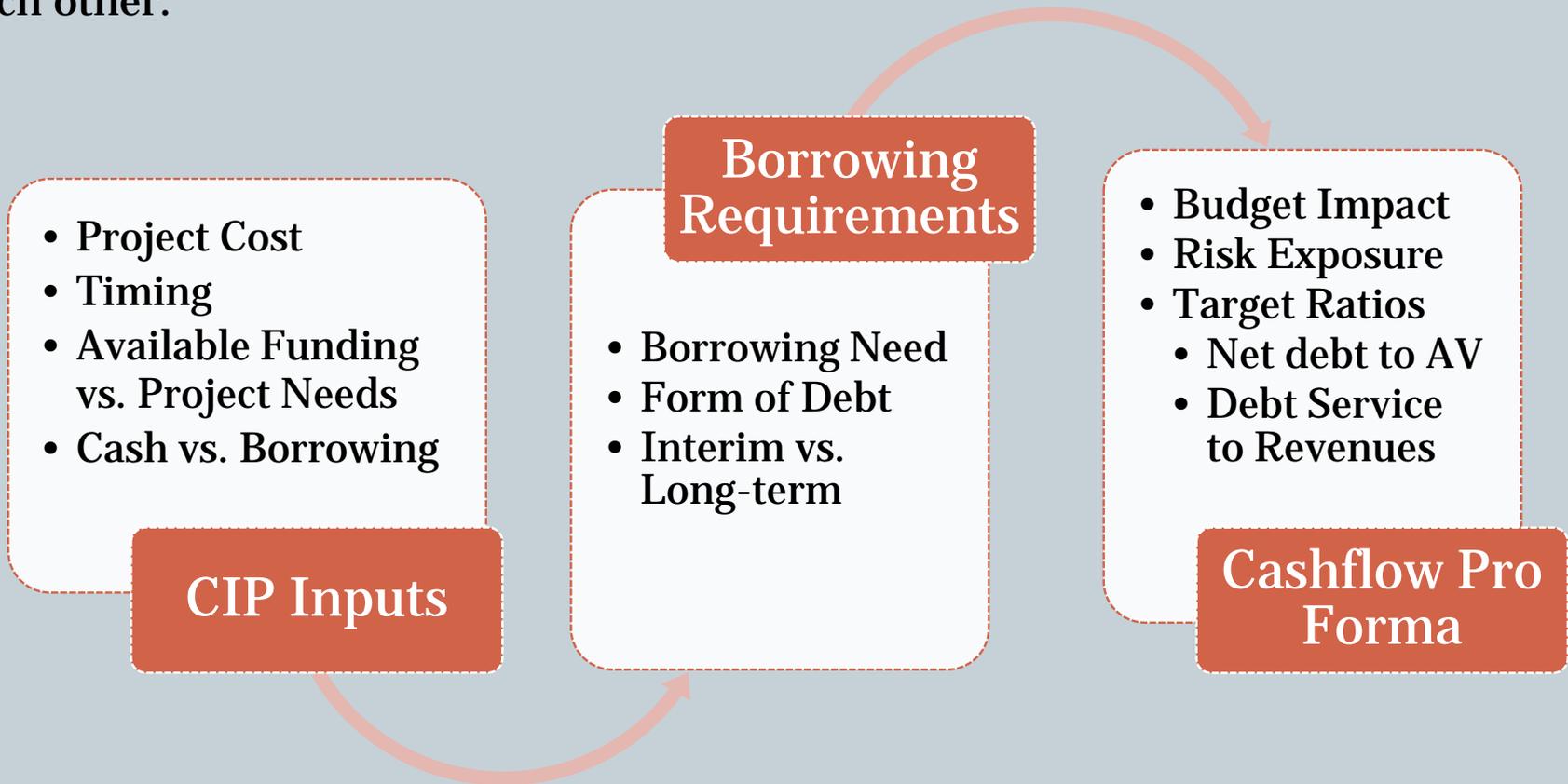
Components of a Financing Plan



Long Term Planning Model

23

Iterative process allows capital planning and financing requirements to inform each other.



On Going Bond Maintenance

24

- **Investment of Bond Proceeds**
 - First 3 years, can earn above the bond rate (yeah, right!)
- **Rebate Requirements**
 - Talk to Bond Counsel or Financial Advisor
- **Continuing Disclosure Obligations**
 - Annual requirement through the life of the bond issue
 - Increased emphasis by the SEC
 - Focus on policies/procedures in place to ensure compliance

General Provisions

25

- **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

26

- **Robert Porr**
Senior Vice President
Fieldman, Rolapp & Associates
rporr@fieldman.com
949-660-7323

- **Sara Brown**
Managing Director
Stifel, Nicolaus & Company, Inc.
sbrown@stifel.com
415-364-6872