

CDIAC MUNICIPAL DEBT ESSENTIALS

Debt Structuring & Method of Sale

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SESSION 2 | DEBT STRUCTURING & METHOD OF SALE

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Topics

1. Current market environment
2. Financing team roles and responsibilities
3. Methods of sale and types of debt
4. Sizing the issue and debt service
5. Yield curve – how it informs the conversation
6. Reserves and insurance considerations
7. Conclusion and questions



Introduction

- Purpose and necessity of debt
- Organizational type (Governmental, Enterprise or Other)
- Long-term strategic goals of organization
- Debt policy (SB 1029)
- Current debt burden and debt capacity
- Long-term financial planning
- Intergenerational equity considerations
- Fluid market conditions



Current Market Environment

- Interest Rates have continued to rise in response to actions by the Federal Reserve to fight persistent inflation.
- Unexpectedly strong recent economic data has only strengthened the Federal Reserve's argument that the economy can continue to withstand these interest rate increases.
- The 10- and 30-Year MMD have risen by over 150 bps (1.5%) since the beginning of the year and over 40 bps (0.4%) in the month of August alone.

Where We Are in the Process

- Decision to issue debt has been made:
 - Financing need established
 - Source of debt repayment identified
- It is now time to:
 - Assemble the financing team
 - Structure the debt

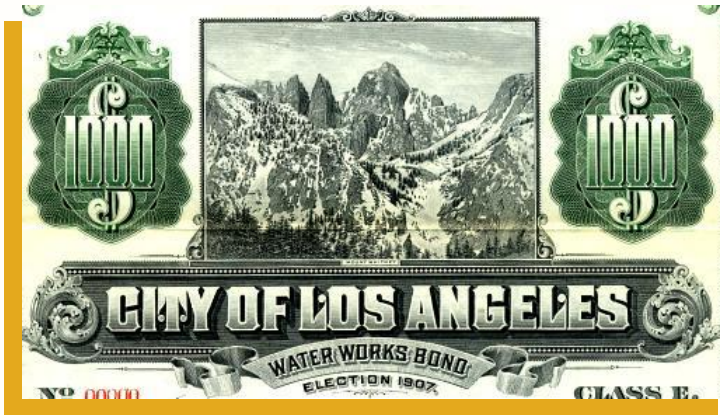


Financing Team Roles & Responsibilities

- Municipal Advisor
 - Fiduciary to issuer
 - Must be licensed
 - Prepares financing plan
 - Makes financing recommendations
- Broker-Dealer / Placement Agent
 - Presents market info
 - Sources capital
 - Performs numerical analysis
 - Prices and sells bonds to investors
- Bond Counsel / Disclosure Counsel
 - Attorney to issuer
 - Prepares all legal documentation
 - Provides legal and tax opinions
 - In public sale, prepares Official Statement



Types of Debt



Public Sale
(Municipal Bonds)



Private Placement
(Bank Loans)



Government Loans
(USDA, SRF, WIFIA, etc.)

Types of Municipal Debt

Long-Term Debt

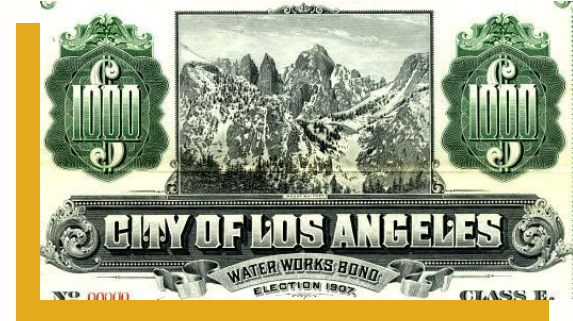
- General Obligation Bonds
- Revenue Bonds
- Lease Revenue Bonds
- Certificates of Participation
- Assessment & Special Tax Bonds
- Tax Allocation Bonds
- Sales Tax Bonds
- Pension Obligation Bonds

Short-Term Debt

- Notes:
 - TANs
 - BANs
 - RANs
 - GANs
- Lines of Credit



Method of Sale: Public Offering Overview



- Underwriter purchases bonds from Issuer, then sells to investors
- Preliminary Official Statement (POS) is produced and distributed to investors
 - Contains terms of financing and credit quality of issuer
 - Underwriter & Issuer are responsible for all due diligence
- Bonds typically rated by rating agency
 - Increased cost of issuance
 - Overall lower interest costs
- Typically 30-35 year maximum term

Method of Sale: Private Placement Overview



- Became popular in the aftermath of Great Recession
- Financing provided by banks through RFP or negotiated sale process
- Specialized public finance divisions of banks
- Strong coverage by a dozen banks

Public Sale vs Private Placement

	Public Sale	Private Placement
Credit Rating	Required	Not Required
Offering Statement	Required	Not Required
Due Diligence	Issuer, Counsel, Rating Agency	Bank
Time to Close	3+ Months (~45 days over private placement)	2+ Months
Issuer Involvement Level	High	Low to Moderate
Structure	Rigid and Standardized	More Flexible
Pricing	Lower Rate Higher Costs of Issuance (~2x of private placement)	Higher Rate Lower Costs of Issuance
Debt Service Reserve	More Often	Less Often
Relationship Pricing	Not available	Banks may offer lower rate with depository relationship



Which Method is Appropriate?

	Public Sale	Private Placement
Credit Quality	Investment Grade, Limited “Story”	Investment Grade and “Storied” Credits
Size	Flexible	Up to \$30M
Term	Up to 40 years; typically 30	Up to 20 years
Rate Environment	Stable	Changing, Volatile
Interest Rate Lock	At pricing	Up to 60 days
Time Commitment at Issuance	Higher	Lower
Prepayment Flexibility	Limited without cost	Various Options
Draw Down Structure	Not available	Available
Continuing Disclosure	Strict	More Flexible Options

Government Loans Overview



- Offered by various state and federal gov't agencies
USDA, SRF, WIFIA, TIFIA, etc.
- Key advantages: subsidized rates, longer terms (up to 40 yrs), flexible repayment
- May come with grant funding for disadvantaged communities
- Key disadvantages: very long and complicated application process (6-18 months), competitive awards, could have high fees
- Make sure you understand covenant structure

Sizing the Issue

- Bond proceeds uses vary and depend on debt and project type and financing plan.

Project / Construction Fund

Capitalized Interest Fund

Debt Service Reserve Fund

Costs of Issuance

Underwriter's Discount

Bond Insurance

Project / Construction Fund

- Proceeds to fund project acquisition and/or construction
- Based on actual costs or detailed estimates
- Should include contingency funds
 - Gross funded – exact project amount
 - Net funded – less than project amount, made up with interest earnings during construction period





Capitalized Interest Fund

- Proceeds to pay interest during project construction and/or revenue ramp-up / stabilization period
- Preserves issuer's reserves
- Increases overall interest costs



Debt Service Reserve Fund

- Funds debt service payments in an event of payment default
- Provides additional security for investors
- Primarily used in revenue and land-secured bonds
- Recently used less, especially for higher-rated debt
- Tax code limits reserve fund to the lesser of:
 - Maximum annual debt service
 - 125% of average annual debt service
 - 10% of par amount
- Invested, with earnings used to help pay debt service
- May be replaced with Surety Policy

Costs of Issuance

- Funds eligible issuance costs
 - Financing team fees
 - Trustee / paying agent
 - Rating agency fees
 - Special tax consultant
 - Title insurance
 - CDIAC fees
 - Appraisal, feasibility study, engineer's report
 - Other costs



Underwriter's Discount

Underwriter's discount (compensation) includes 3 main components:

- Average Takedown
- Management Fee
- Expenses

Underwriter is compensated by underwriter's discount at closing.

- Underwriter pays for amount of bonds less underwriter's discount
- For Example:
 - \$10,000,000 PAR Amount
 - (\$85,000) Less Discount of \$8.50/Bond
 - \$9,915,000 Purchase price for Bonds

Bond Insurance

- Bond Insurance guarantees the payment of principal and interest to bondholders.
- Insured bonds are assigned the credit rating of the bond insurer (AA rating, S&P).
- Can materially improve bond pricing and lessen the costs of borrowing to issuers.

Final Pricing Insurance Comparison	Series 2021A		Series 2021B	
	Uninsured	Insured	Uninsured	Insured
Bond Insurance Cost:	\$0.00	\$11,295	\$0.00	\$9,219
Arbitrage Yield/Interest Rate:	2.1123%	2.0596%	2.1071%	2.0535%
Total Debt Service:	\$7,079,593	\$7,059,548	\$5,779,122.50	\$5,762,156
Savings from Insurance:		\$20,044		\$16,967

Premium and Discount Bond Structure

Premium Bond - A bond selling above its face value, typically with a coupon rate higher than it's yield

Discount Bond - A bond selling below its face value, typically with a coupon rate lower than it's yield

	Premium Bond Structure	Discount Bond Structure
Closing Date	10/7/2021	10/7/2021
Par Amount	9,050,000	10,095,000
Net Issue (Premium)	1,705,937	666,074
Cost of Issuance	255,937	261,074
Project Fund	10,500,000	10,500,000
True Interest Cost	2.66%	2.29%
All-In True Interest Cost	2.81%	2.43%
Final Maturity	5/1/2051	5/1/2051
Balance after 5/1/31 Payment	7,165,000	7,820,000
TOTAL DEBT SERVICE		
Average FY Debt Service	527,483	502,388
Total Debt Service	15,592,133	14,850,874

Bond Sizing Example

Sources:

Bond Proceeds:

Par Amount	9,000,000.00
Premium	887,784.50
	<u>9,887,784.50</u>

Uses:

Project Fund Deposits:

Project Fund	9,000,000.00
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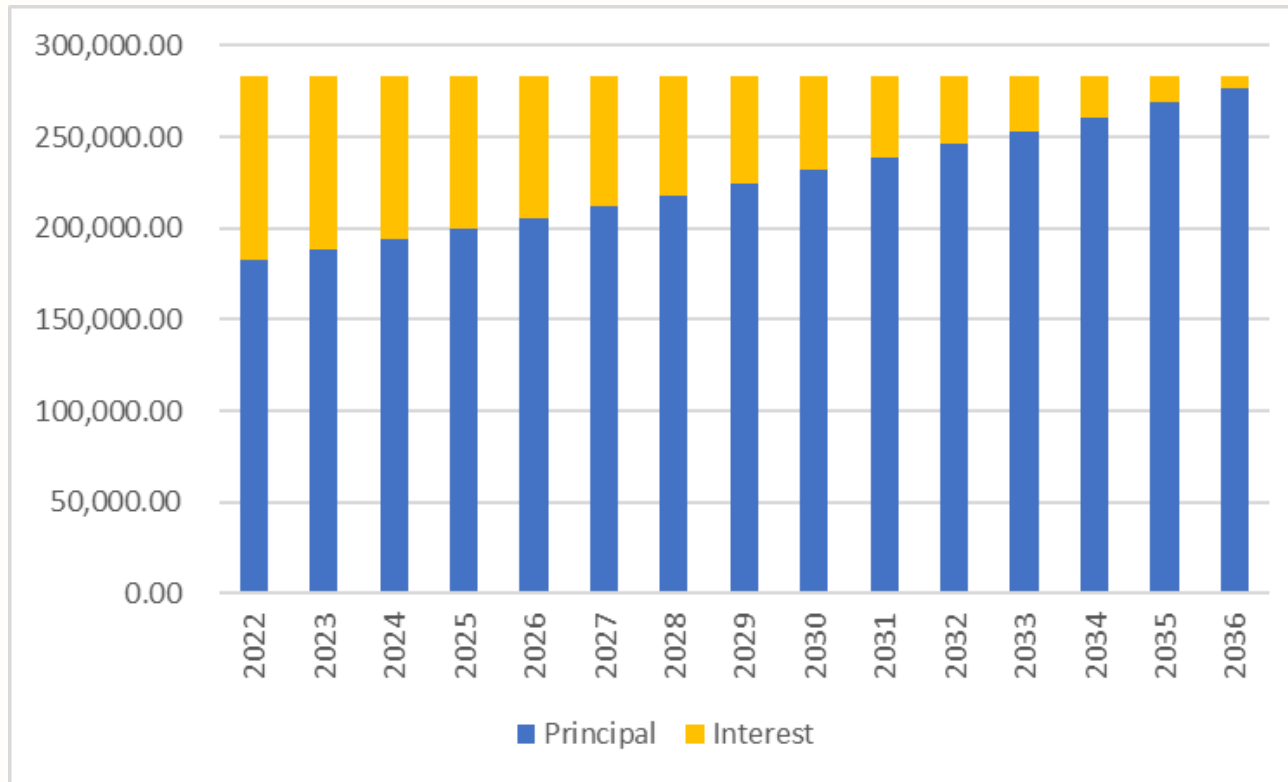
Other Fund Deposits:

Capitalized Interest Fund	444,786.00
Series A Debt Service Fund Deposit	223,998.50
	<u>668,784.50</u>

Delivery Date Expenses:

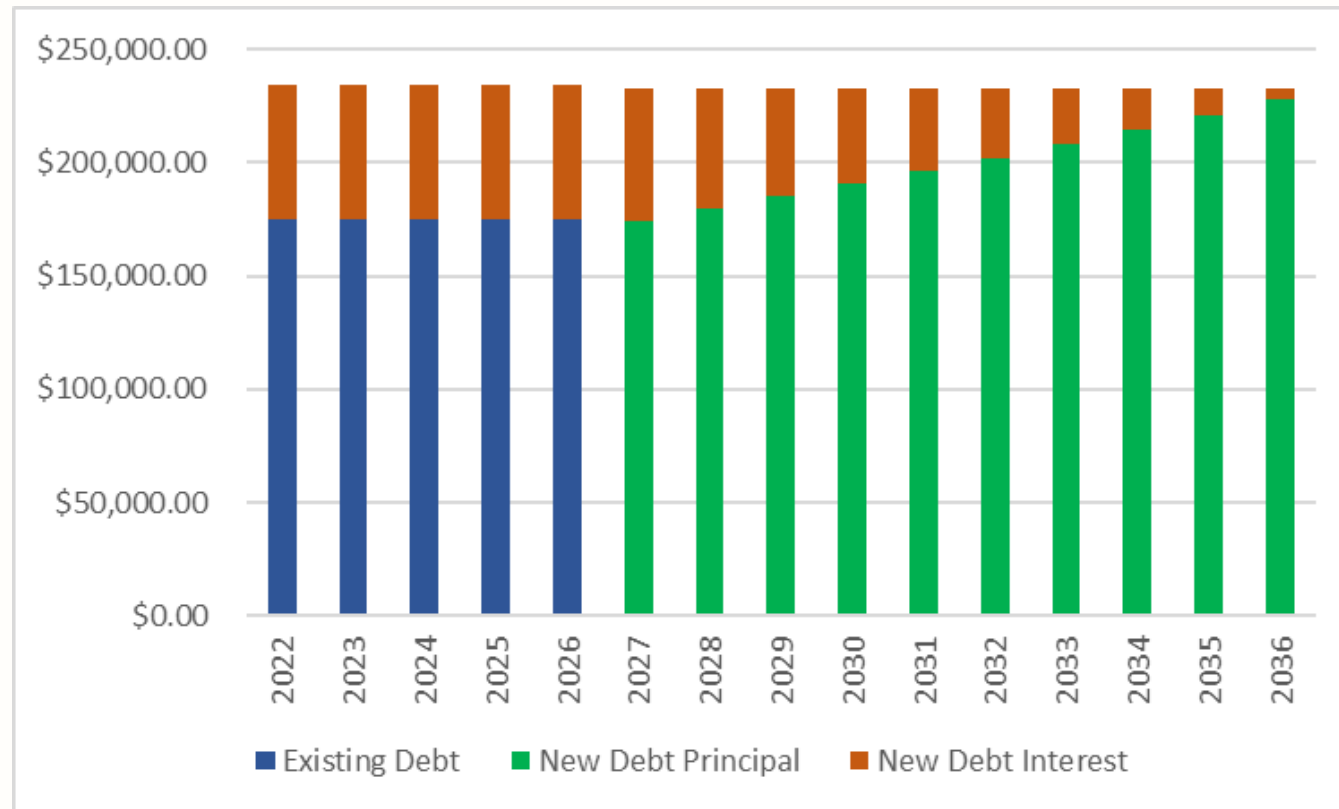
Cost of Issuance	165,000.00
Underwriter's Discount	54,000.00
	<u>219,000.00</u>
	<u>9,887,784.50</u>

“Level” Debt Service



- Same total annual payment
- Usually semi-annual interest and annual principal
- Payment frequency options available in private placements

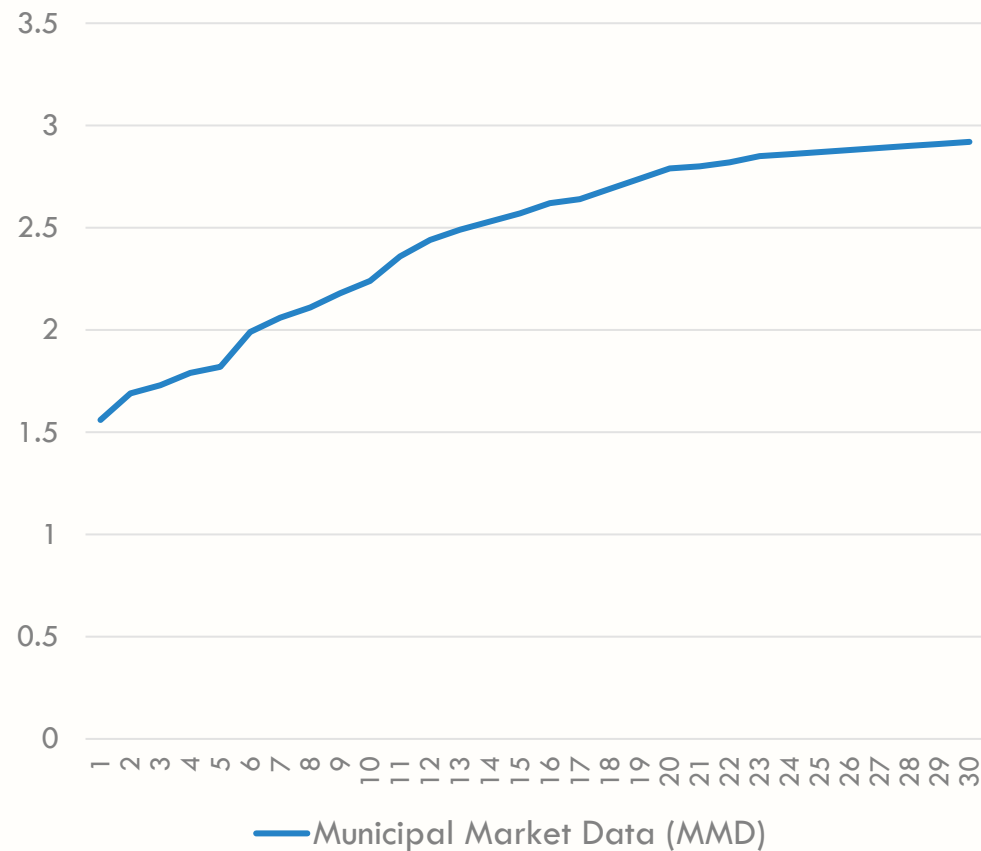
Structuring Debt Service for Multiple Issues



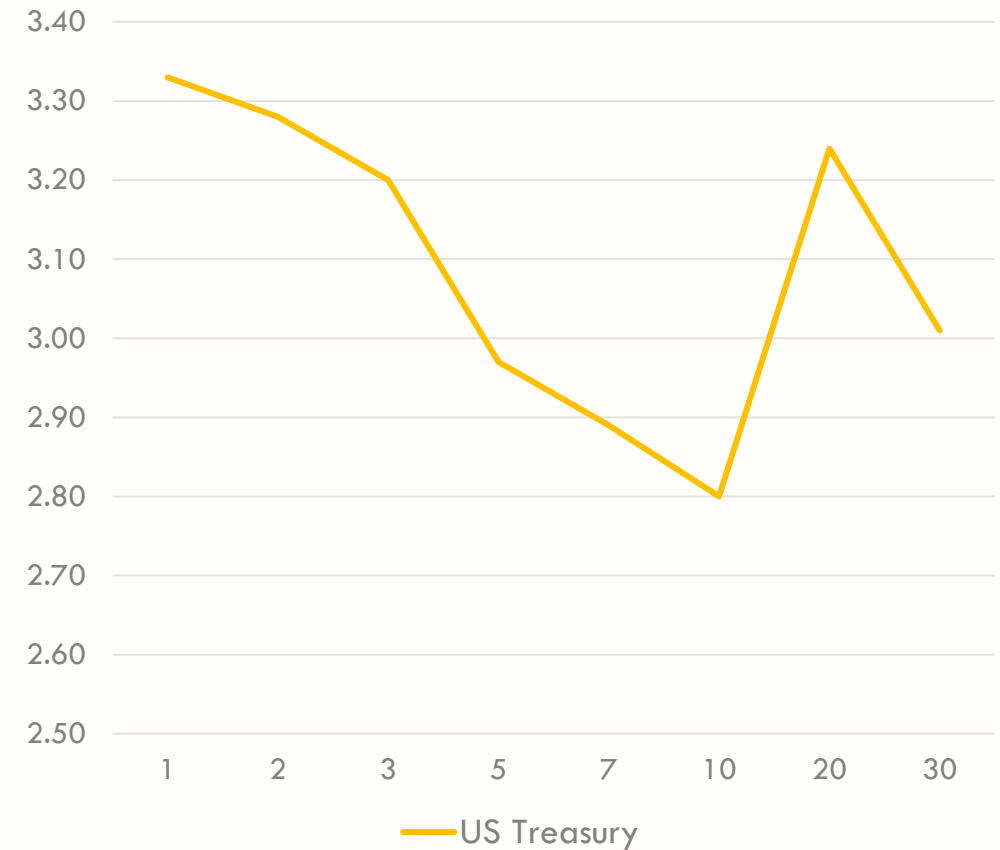
- Long-term cash flow management
- Example:
 - Current debt matures in 5 years
 - New debt structured as interest only for first 5 years
 - Achieves level long-term debt service

Yield Curve

Yield Curve – MMD (8/9/22)



Yield Curve – US Treasury (8/9/22)



Serial and Term Bonds

Serial Bonds – Bonds structured with maturity dates over regular intervals. This structure allows an issuer to take advantage of different pricing levels across the yield curve.

- For example: Years 2022-2038

Term Bonds - A bond which matures on a single date.

- For example: Years 2042, 2047, 2052

Sale Date	4/28/2022				
	Enterprise Revenue Bonds, Series 2022				
Issue Size	\$16,860,000				
Type	Water and Wastewater Revenue Bonds				
U/L Rating	AA				
Call Feature	12/1/32 at par				
Maturity	Par Amt. \$1000s	Coupon	Yield	Spread	4/27/22 Int. MMD
2022	210	5.000	1.77	-11.0	1.88
2023	250	5.000	2.17	6.0	2.11
2024	265	5.000	2.46	19.0	2.27
2025	275	5.000	2.53	18.0	2.35
2026	290	5.000	2.63	26.0	2.37
2027	305	5.000	2.75	33.0	2.42
2028	320	5.000	2.85	36.0	2.49
2029	340	5.000	2.93	37.0	2.56
2030	355	5.000	3.01	41.0	2.60
2031	375	5.000	3.13	46.0	2.67
2032	395	5.000	3.20	50.0	2.70
2033	415	5.000	3.28	53.0	2.75
2034	435	5.000	3.34	57.0	2.77
2035	455	5.000	3.40	60.0	2.80
2036	480	5.000	3.45	65.0	2.80
2037	500	5.000	3.47	65.0	2.82
2038	525	5.000	3.49	65.0	2.84
2042	2,400	5.000	3.60	70.0	2.90
2047	3,675	4.000	4.14	116.0	2.98
2052	4,595	5.000	3.83	80.0	3.03



Fixed & Variable Rate Debt

- Most current municipal debt issues have fixed interest rate through maturity
- **Variable interest rate debt** – interest rate is tied to an index (LIBOR, 3-month US Treasuries, etc.) and resets periodically:
 - Can become popular in steep yield curve environment – short term rates are much lower than long term rates
 - Exposes issuer to interest rate risk due to rising short-term interest rates
 - If short-term interest rates rise, could result in significant debt service increase
 - In 2017, rates were adjusted due to tax law changes

Redemption Features

- Optional Redemption
 - Debt is paid off with refinancing proceeds or cash
 - Prepayment penalty
 - Public Offering: at par in 8-10 years or up to 3% if under 10 years
 - Private Placement: typically 5 years at par, but can be as early as anytime at par
 - If possible, structure with any date call (not any payment date)
- Extraordinary Redemption
 - Debt is paid off with insurance payout proceeds, grant funding, surplus bond proceeds, or proceeds from General Obligation bond issuance
 - Should not have a penalty, but there are cases in which a penalty exists
- Mandatory Redemption
 - Usually structured with a sinking fund payment schedule
 - Part of planned debt amortization

Conclusions



- Market is always changing
- Many different financing options
- Best terms look different for each agency
- Financing decisions you are making will affect your agency and constituents for decades
- Make sure you have a team of trusted advisors



Questions?

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