So, You Want to Issue Bonds?

Municipal Finance Institute
December 15, 2023

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Topics

• What’s a bond?
• Preparing for financing
• Credit rating process
• Financing team roles and responsibilities
• Methods of sale and types of debt
• Disclosure requirements
• Market update
What’s a Bond?
What’s a Bond?

- A bond is a promise to pay – a series of loans
- Tax Exemption – benefits and obligations
- Voter Approval – When is it necessary?
- Methods of Sale:
  - Public Offering (Municipal Bonds)
  - Private / Direct Placement (Loans)
  - Government Loan (SRF, USDA, WIFIA, etc.)
How Exactly Are We Paying for This?

- Ad Valorem Taxes:
  - General Obligation Bonds – Voter Approval Required
- Enterprise Fund: Water, Wastewater, etc.:
  - Revenue Bonds – Prop 218 Process
- General Fund:
  - Lease Revenue Bonds / Certificates of Participation
- Special Taxes / Assessments:
  - Mello Roos CFD / Assessment District Bonds – Voter Approval Required
Key Considerations

- **Legal:**
  - Constitutional Debt Limitation and Exceptions
  - Statutory Authority
  - Federal Tax Law (if tax exempt)
  - Federal Securities Law (if public sale)
  - Debt Management Policy

- **Credit:**
  - Source of Repayment
  - Credit Rating / Enhancements
  - Area Demographics
  - Issuer Management
  - Reporting
Preparing for Financing

- Start planning early:
  - Engineering and financing studies
  - Financial stability and resiliency
  - Generational equity
  - Government loans and grants
  - Policies and rating process

Successful financing is an outcome of strategic planning and careful execution.
# Rating Agency Factors

## Rating Factors (GO, COPs, Lease)

<table>
<thead>
<tr>
<th>Economy</th>
<th>• Demographics</th>
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<tbody>
<tr>
<td></td>
<td>• Household Income</td>
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<td>• Property Tax Base &amp; Growth</td>
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<td></td>
<td>• Local Economic Trends</td>
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<tr>
<td>Financial Performance</td>
<td>• Available Fund Balances</td>
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<tr>
<td></td>
<td>• Liquidity Ratio</td>
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<tr>
<td></td>
<td>• Operating Surpluses</td>
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<tr>
<td>Leverage</td>
<td>• Long Term Debt Liabilities</td>
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<td>• Pension &amp; OPEB Liabilities</td>
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<tr>
<td>Management</td>
<td>• Management Team</td>
</tr>
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<td></td>
<td>• Management Policies</td>
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<tr>
<td>Institutional Framework</td>
<td>• Control Over Revenues Sources</td>
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<td></td>
<td>• Revenue Caps and Limitations</td>
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</tbody>
</table>

## Rating Factors (Utility Revenue Bonds)

| System Characteristics | • System Size          |
|                        | • Asset Condition      |
|                        | • Customer Base / Demographics |
| Financial Strength     | • Days Cash on Hand    |
|                        | • Fixed vs. Variable Revenues |
| Leverage               | • Debt Service Coverage|
|                        | • Debt to Operating Revenues |
| Management             | • Rate Management      |
|                        | • Regulatory Compliance|
|                        | • Management Team      |
|                        | • Management Policies  |
| Legal Provisions       | • Rate Covenant        |
|                        | • Reserve Requirement  |
Best Practices: Management Policies

- Debt Management Policy (Required)
- Reserve Policy
- Multiyear CIP Policy & Funding Plan
- Budgetary and Financial Policy
- Investment Policy
- Pension Management Policy
Financing Team Members
Financing Team Members

Issuer

Underwriter / Placement Agent
- Structures financing, sets pricing, purchases bonds to sell to investors or places debt

Municipal Advisor
- Fiduciary duty to Issuer; advises on structure, pricing, terms, etc.

Rating Agency *
- Credit rating for the Bonds

Bond Insurer *
- Enhances rating by guaranteeing repayment

Trustee *
- Commercial bank; administers payments and redemptions

Bond Counsel
- Legal advice to Issuer; prepares bond documents and tax-exempt opinion

Disclosure Counsel *
- Prepares Official Statement that describes bonds and the risks to investors

* Public Offering Only
Method of Sale: Public Offering Overview

- Agency issues municipal bonds
- 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
Method of Sale: Private Placement Overview

- Agency takes a loan from a commercial bank or investment fund
- Became popular in the aftermath of Great Recession
- Financing provided by lenders through RFP or negotiated sale process
- Specialized public finance divisions of lenders
- Strong coverage by multiple lenders
- Recently less lenders are active, higher interest rates
## Public Sale vs. Private Placement

<table>
<thead>
<tr>
<th></th>
<th>Public Sale</th>
<th>Private Placement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit Rating</strong></td>
<td>Typically Required</td>
<td>Not Required</td>
</tr>
<tr>
<td><strong>Official Statement</strong></td>
<td>Required</td>
<td>Not Required</td>
</tr>
<tr>
<td><strong>Due Diligence</strong></td>
<td>Issuer, Counsel, Rating Agency</td>
<td>Lender</td>
</tr>
<tr>
<td><strong>Time to Close</strong></td>
<td>3+ Months (≈45 days over private placement)</td>
<td>2+ Months</td>
</tr>
<tr>
<td><strong>Issuer Involvement Level</strong></td>
<td>High</td>
<td>Low to Moderate</td>
</tr>
<tr>
<td><strong>Structure</strong></td>
<td>Rigid and Standardized</td>
<td>More Flexible</td>
</tr>
<tr>
<td><strong>Pricing</strong></td>
<td>Lower Rate, Higher Cost of Issuance</td>
<td>Higher Rate, Lower Cost of Issuance</td>
</tr>
<tr>
<td><strong>Debt Service Reserve</strong></td>
<td>More Often</td>
<td>Less Often</td>
</tr>
</tbody>
</table>
# Which Method is Appropriate?

<table>
<thead>
<tr>
<th></th>
<th>Public Sale</th>
<th>Private Placement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit Quality</strong></td>
<td>Investment Grade, Limited “Story”</td>
<td>Investment Grade and “Storied” Credits</td>
</tr>
<tr>
<td><strong>Size</strong></td>
<td>Flexible</td>
<td>Up to $30M (smaller credits)</td>
</tr>
<tr>
<td><strong>Term</strong></td>
<td>Up to 40 years; typically 30</td>
<td>Up to 20 years (shorter term)</td>
</tr>
<tr>
<td><strong>Rate Environment</strong></td>
<td>Stable</td>
<td>Volatile</td>
</tr>
<tr>
<td><strong>Interest Rate Lock</strong></td>
<td>At Pricing</td>
<td>Up to 60 Days</td>
</tr>
<tr>
<td><strong>Prepayment Flexibility</strong></td>
<td>Limited without Cost</td>
<td>Various Options</td>
</tr>
<tr>
<td><strong>Time Commitment at Issuance</strong></td>
<td>Higher</td>
<td>Lower</td>
</tr>
<tr>
<td><strong>Continuing Disclosure</strong></td>
<td>Strict and Extensive</td>
<td>More Flexible and Simpler</td>
</tr>
</tbody>
</table>
Government Loans Overview

- Offered by various state and federal government agencies
  - Examples: USDA, SRF, WIFIA, TIFIA, iBank, 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, extensive conditions of approval
- Make sure you understand covenant structure
Best Practices: Selecting Financing Method

- Interest Rate vs. Total Cost
- Complexity and Staff Involvement
- Prepayment Options
- Continuing Disclosure
- Market Environment
- Financing size and term
Uses of Bond Proceeds

- Project / Construction Fund
- Capitalized Interest Fund
- Debt Service Reserve Fund
- Costs of Issuance
- Underwriter’s Discount
- Credit Enhancement: Bond Insurance / LOC

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Yield Curve

- What is yield curve?
- Why does it matter?
- Short-term vs. long-term
- Interest earnings and arbitrage
Disclosure Requirements
Disclosure Requirements

- Stem from Federal Securities Laws (SEC Rules 10b-5 and 15c2-12)
- Issuers must provide:
  - **INITIAL disclosure** to potential investors
  - and
  - **CONTINUING disclosure** to bondholders
SEC Rule 10b-5: Fraud in Sale of Securities

- It is unlawful for any person engaged with purchase or sale of securities to “make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”

- Governs all participants in the marketplace – issuers and underwriters – to ensure true and correct information regarding securities (both in the primary and secondary market)

- “Materiality” is not defined, depends on facts and circumstances – reasonable investor standard (Basic Inc. v. Levinson, 1988)
SEC Rule 15c2-12: Continuing Disclosure

- Underwriter may not purchase/ sell primary offering of securities unless issuer or “obligated person” undertakes to provide continuing disclosure
- Disclosure requirements set forth in Continuing Disclosure Agreement
- Two types of reporting:
  - Annual report
    - Financial information or operating data of the type included in the OS
    - Audited financial statements, when and if available
  - Event disclosure
    - Failure to file annual report
    - 16 listed events (i.e. nonpayment, covenant breach, rating changes, bond calls, etc.)
Best Practices: Continuing Disclosure

- Training for Staff & Legislative Body
- Calendar Ticklers
- Internal Controls & Systems
- Monitor Rating Agency Changes
- Designate Responsible Staff Members
- Engage Dissemination Agent
Over the last 30 years, the 10-Year and 30-Year MMD have been higher than today’s values 62% of the time.
Key Takeaways

- 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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