AHMO 1st Annual Spring Conference

Financing the Project:

Being Proactive in Planning and Funding Capital Improvements

March 24, 2023

SPECIALIZED PUBLIC FINANCE INC.
FINANCIAL ADVISORY SERVICES

Financing the Project - DISCUSSION TOPICS

- BOND ISSUANCE OVERVIEW
- FINANCING TOOLS AVAILABLE TO TEXAS CITIES
- IMPORTANCE OF BOND RATINGS
- FINANCIAL POLICIES
- DEVELOPING A CAPITAL IMPROVEMENT PLAN

BOND ISSUANCE OVERVIEW

BONDS 101

- Bonds are issued by local political subdivisions.

- They represent an obligation to repay investors an amount of money borrowed (principal) along with interest, according to a debt service schedule.

- Usually matures between 1 – 40 years from issuance date

  - Most debt matures between 20-30 years

- There is approximately $4.0 trillion of outstanding taxable and tax-exempt municipal debt in the U.S.

Buyer of Municipal Bonds

- Retail ("households", "mom and pop") – Consist of individual investors acting either directly with the underwriter or through a broker.

- Professional Retail – consist of financial advisors, money managers, and investor advisors.

- Bond Mutual Funds – include short-term and long-term bonds funds, money market funds and high yield funds.

- Institutional investors – consist of commercial banks, corporations, and property & casualty insurance companies.

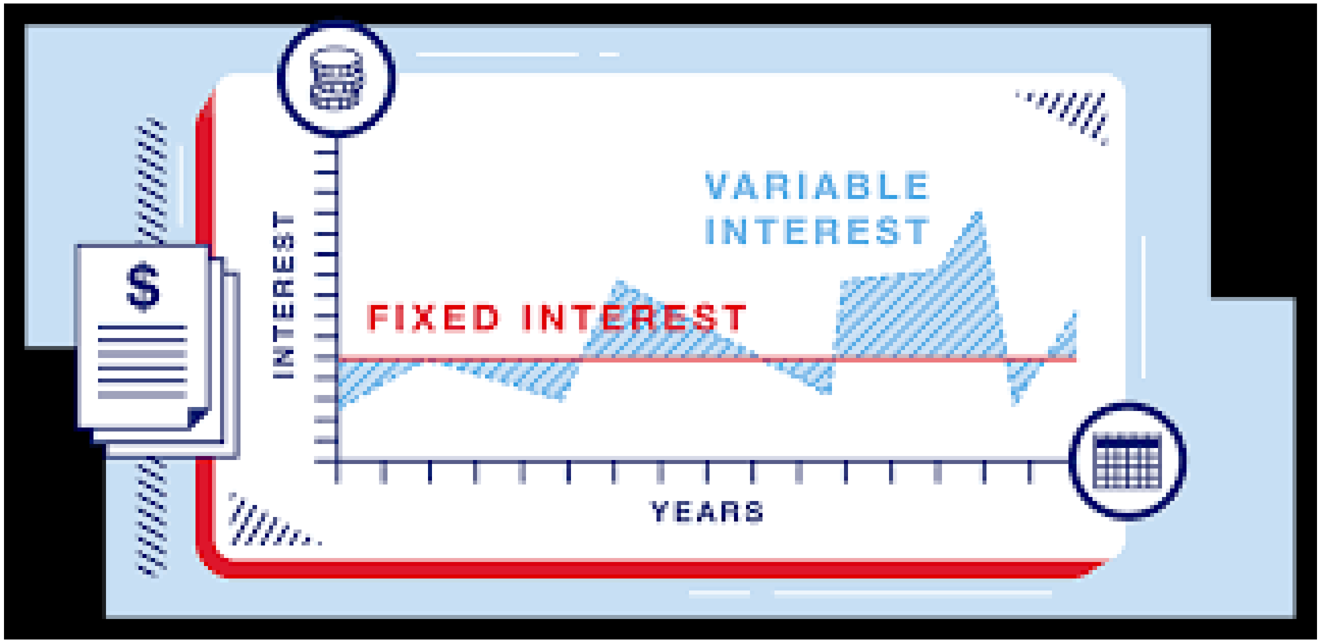
Typically, municipal bond investors benefit from tax exemption due to being in a high tax bracket.

Type of Municipal Bonds

Interest rates may be fixed or variable

- The interest rate (also called a "coupon") on **fixed rate** debt is set at the time of issuance and remains the same until final maturity, is paid twice a year and typically includes a 10-year redemption call option.

- The interest rate on **variable rate** debt is initially set at issuance and reset periodically until maturity and interest is paid monthly, quarterly, or semi-annually.



Who Buys Municipal Bonds?

- Investors purchase the Bonds from the Underwriter.
- Different investors have different preferences within the municipal market.
- Retail (“households”, “mom and pop”) – Consist of individual investors acting either directly with the underwriter or through a broker.
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Municipal Securities – Highly Regulated

The Municipal Bond Industry is one of the most regulated in finance.

- Regulators provide oversight of the securities industry to ensure rules are being followed.

MAJOR REGULATORS:

- **Securities and Exchange Commission (SEC)** - Responsible for administering federal securities laws.
- **Financial Industry Regulatory Authority (FINRA)** - Largest independent regulator for all securities firms doing business in the United States.
- **Municipal Securities Rulemaking Board (MSRB)** - Established to develop rules and set standards regulating firms involved in municipal securities.
- **National Association of Securities Dealers (NASD)** - Develops rules and regulations and conducts regulatory reviews of members that are subject to subject to SEC oversight.
- **Internal Revenue Service (IRS)** – Reviews and audits municipal securities to ensure tax law compliance.

IRS
Department of the Treasury
Internal Revenue Service

Professionals Involved in the Financing Process

FINANCIAL ADVISOR

- **Legal and fiduciary responsibility to the issuer.**
- Advises the issuer on all matters regarding bond issuance.
- Issuer's representative in and to the bond market.
- Example services may include:
  - Debt Capacity and Affordability Study.
  - Debt modeling and tax rate analysis.
  - Evaluation of Financing Alternatives.
  - Conduct negotiated or competitive bid sale of the bonds.
  - Provide ongoing services over the life of the bonds.

BOND INSURANCE

- Insurance companies that lend their higher credit quality for a fee and guarantee debt service payments to the bondholders.

BOND COUNSEL

- An attorney retained by the issuer to give a legal opinion that:
  - Interest on the proposed securities will be exempt from federal income taxation and
  - The issuer has met all legal requirements necessary for issuance.
- Provides all legal documentation related to the issuance.

RATING AGENCIES

- Organizations that evaluate the credit quality of a debt instrument and assign ratings.
- These organizations include:
  - Standard and Poor's
  - Moody's Investors Service
  - Fitch Ratings
- Credit quality is instrumental in determining the market interest rate on the financing.

PURCHASER / UNDERWRITER

- **The underwriter has a legal fiduciary responsibility to the investor.**
- A bank or broker/dealer which purchases a new issue of municipal securities for resale.
- The securities may be acquired by either competitive or negotiated sale.

PAYING AGENT / ESCROW AGENT

- Paying Agent tracks ownership of the securities and coordinates distribution of funds for debt service payments from the issuer to the bondholders.
- Escrow Agent holds bond proceeds in an escrow and distributes funds as described in the bond documents.

Financial Advisory Process

- Long-term capital planning is a key first step to any debt issuance process.

- Developing a capital planning model helps everyone (staff, elected officials, rating agencies) understand if/how the projects can be funded and the resulting financial impact while also ensuring continued compliance with the City's financial policies.

1	2	3	4	5
Establishing and Developing a Financing Plan	**Financial Models**	**Credit Rating Presentation**	**Bond Pricing**	**Closing and Ongoing Services**
Understand the capital needs and financing objectives Develop a long-term Plan of Finance Determine financing schedule based on when the funds are needed and market conditions	Develop comprehensive financial models Develop and determine scenarios which meet the issuer's objectives with a lowest possible cost of borrowing	Prepare and present the issuer's credit to the rating agencies, and apply for bond insurance Develop a detailed strategy for highlighting key strengths and addressing any possible areas of concern	Competitive or Negotiated Bond sale Discuss the timing of the bond sale based on economic indicators, sale calendar and market events	Prepare closing documents and wiring memo Continue to support the issuer with continuing disclosing assistance, update financial models, etc.

A City's Financing Goal: Market Access and Low Interest Rate

Issuer:

FA: Specialized Public Finance Inc. Financial Advisory Services

Issuer Objectives:

- Low Interest Rate
- Maximum Flexibility
  - Call Feature
  - Flexible Bond Covenants
  - Low Reserve Requirements
  - Low Minimum Required Coverage Ratio

Financing Table

Investment Bank / Underwriter

Investors (Bond Funds, Mutual Funds, etc.)

Investor Objectives:

- High Interest Rate
- Maximum Security
  - Non-Callable
  - Strict Bond Covenants
  - High Reserve Requirements
  - High Minimum Required Coverage Ratio

Bond Sale Methods (Negotiated versus Competitive Bond Sales)

NEGOTIATED BOND SALE

- An underwriter is selected to purchase the bonds. The underwriter sells the bonds to its customers. The terms of the bonds are tailored to meet the demands of the underwriter's investor clients, as well as the needs of the issuer.
  - A bank (broker/dealer) is selected months prior to the sale of the bonds.
  - On pricing day, the lead bank (broker/dealer) and the issuer, with the assistance of it's financial advisor, will negotiate the interest rate on the bonds.
  - Negotiated offerings are best for new issuers, "story" credits, or for financings with lots of moving parts.

COMPETITIVE BOND SALE

- Bonds are advertised for sale. The advertisement, or notice of sale, includes the terms of the bond issue. Any broker dealer may bid on the bonds at the designated date and time.
  - On the day of the sale, any bank (broker/dealer) may submit a bid to buy the bonds in a sealed bid process.
  - The bidder with the lowest interest rate wins the bid and is awarded the bonds.
  - As noted in the graphic, the interest rates received will vary.

Bid Award*	Bidder Name	TIC
☑ Reoffering	Stifel Nicolaus & Company, Inc.	2.386973
☐	Fidelity Capital Markets	2.419525
☐	Robert W. Baird & Co., Inc.	2.425345
☐	Citigroup Global Markets Inc.	2.429862
☐	Wells Fargo Bank, National Association	2.434501
☐	SAMCO Capital Markets	2.447852
☐	HilltopSecurities	2.469193
☐	Hutchinson, Shockey, Erley & Co.	2.471038
☐	Bank of America Merrill Lynch	2.502335

Investment of Bond Proceeds

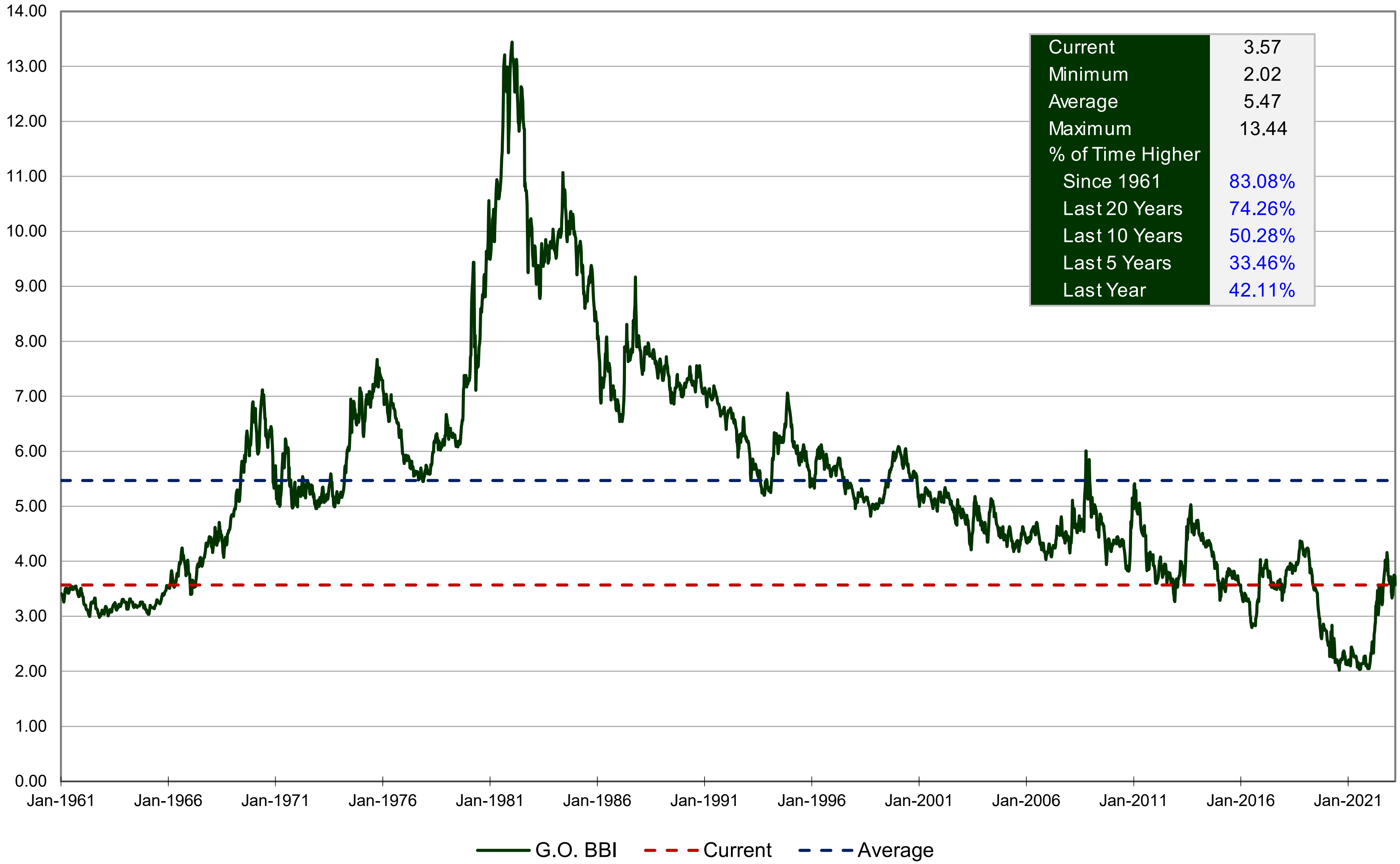
- **Texas Cities are limited to the Texas Public Investment Act**
- **Must be safe and liquid investments**

U.S. Treasury Securities	Commercial Paper
U.S Agencies	Repurchase Agreements
Certificates of Deposit	Mutual Funds including Money Market Funds
Securities Lending	Guaranteed Investment Contracts
State of Texas Securities	Other Political Subdivision Securities
Bankers Acceptances	Investment Pools

Ten-Year History of “AAA” Tax-Exempt Yields (20-Year Maturity)

Current	3.24
Minimum	1.08
Average	2.52
Maximum	4.27
% of Time Higher	12.64%

The Long View on Tax-Exempt Rates: The Bond Buyer's G.O. Index Since 1961



FINANCING TOOLS AVAILABLE TO TEXAS CITIES

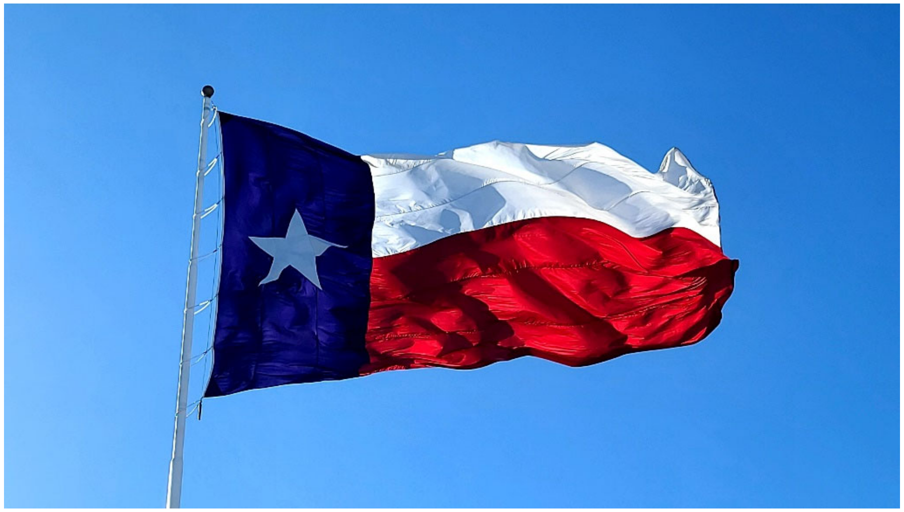


Photo by Pete Alexopoulos

Common Debt Financings Tools

Texas Cities have ***four*** primary and most common debt issuance options that include:

Type:	General Obligation Bonds	Certificates of Obligation [1]	Tax Notes	Revenue Bonds
Purpose:	General Purpose	General Purpose	General Purpose	Enterprise System
Voter Authorization:	Yes	No [2]	No	No
Amortization Requirements	Not to exceed 40 years	Not to exceed 40 years	Initial term limited to 7 years from date of issuance	Revenues
Source of Payment:	I&S Taxes [3]	I&S Taxes [3] and/or revenues	I&S Taxes [3]	Revenues
Interest Rate:	Strongest Credit; Lowest Interest Rates	Similar to General Obligation Bonds	Similar to General Obligation Bonds	Higher than General Obligation Bonds

[1] *If a bond election failed, Certificates may not be issued for that purpose within 3 years of the election.*

[2] *Publication of notice required; petition during notice period could require an election.*

[3] *I&S Tax Rate is not subject to rollback.*

Revenue Bonds

- No voter approval required.
- Issued for revenue producing projects:
  - Water system improvements;
  - Sewer system improvements;
  - Sales tax projects (4B projects);
  - Special projects (HOT projects, i.e., convention projects).
- Secured solely by revenues of the system or project.
- Typically require reserve funds.
- Required coverage.
- Limits on additional bonds.
- Higher interest rates (vs. property tax-secured obligations).

General Obligation Bonds ("GO Bonds")

- Requires bond election.
- Issued for any public purpose project, including:
  - Real property;
  - Personal property;
  - Facilities construction/acquisition.
- Secured by issuer's ad valorem taxing authority ("full faith & credit" pledge).
- Lowest available interest rate.

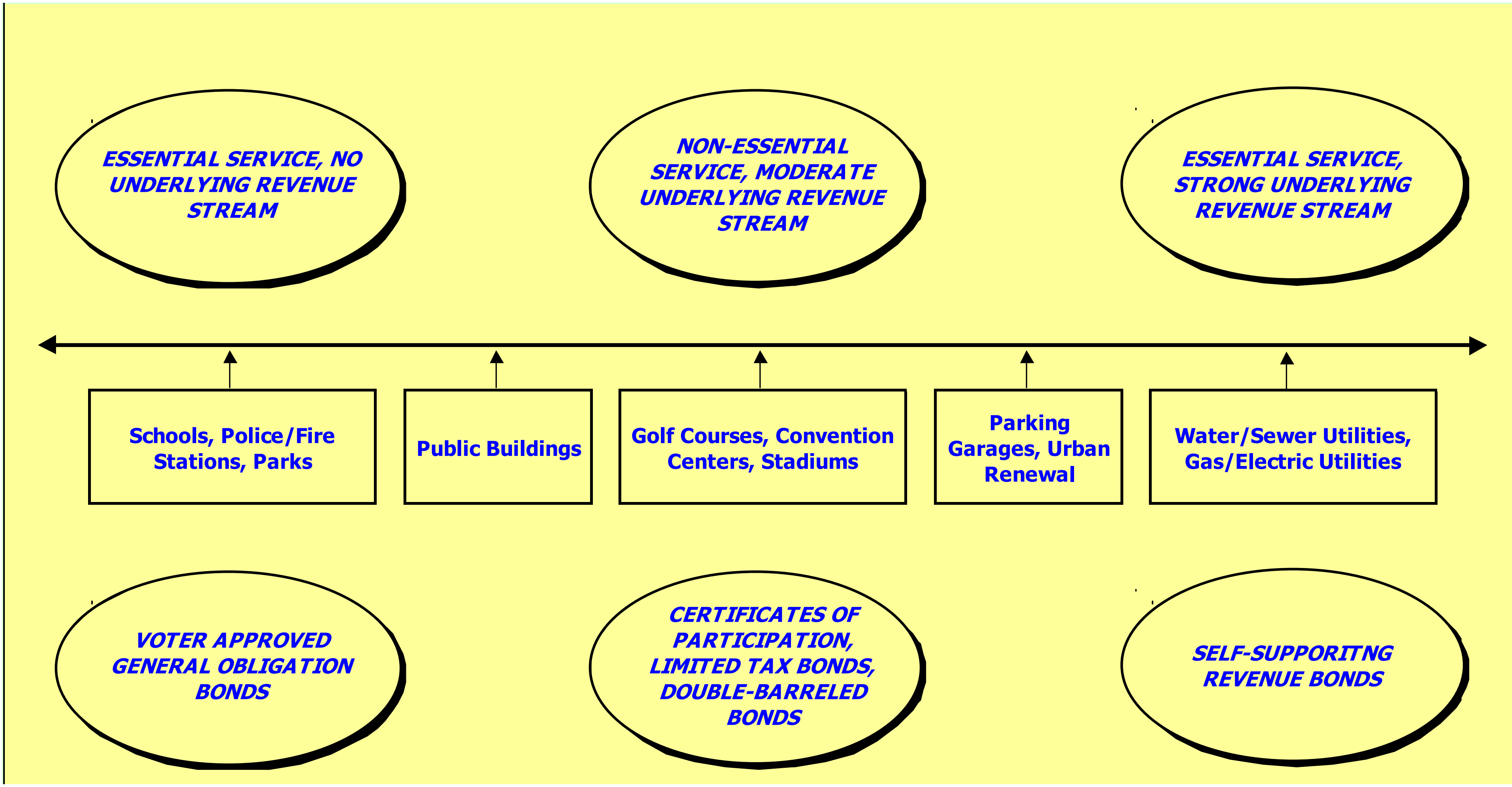
Tax Notes ("Notes")

- No voter approval required.
- No publication of notice.
- Secured by a limited pledge of ad valorem taxes.
- Initial term limited to 7 years from date of issuance.
- May be refinanced for term not to exceed 40 years.
- May be issued for any governmental purpose project.
- Interest rates comparable to GO's.

Certificates of Obligation ("CO's")

- No voter approval required, generally.
- Requires 45-day minimum publication of Notice of Intent to issue (subject to petition).
- Secured by ad valorem property taxes AND specific revenue pledge.
- Dual pledge of tax and system revenue allows for flexibility in which revenue is actually used to pay debt service (property taxes only required to be levied to the extent that system revenue insufficient to make bond payments).
- Interest rates comparable to GO's.

Structuring the Bonds: What type of debt to issue?



Things to consider in “sizing” a debt issue

- Construction Costs
- Land Costs
- Associated Equipment Costs
- Engineering and Related Costs
- Capitalized Interest (Revenue Bonds Only)
- Debt Service Reserve Requirements (Revenue Bonds Only)
- Issuance Costs

THE IMPORTANCE OF BOND RATINGS

Importance of Bond Ratings for Issuers

- Ratings affect the interest rate on an issuer's bonds – their cost of borrowing

- Higher ratings result in lower interest rates

- Most investors do not buy non-rated debt

Rating Scale

Highest Rating

Below Investment Grade

S&P	Fitch	Moody's
AAA	AAA	Aaa
AA+	AA+	Aa1
AA	AA	Aa2
AA -	AA -	Aa3
A+	A+	A1
A	A	A2
A -	A -	A3
BBB+	BBB+	Baa1
BBB	BBB	Baa2
BBB -	BBB -	Baa3
BB	*BB*	*Ba*
B	*B*	*B*
C	*C*	*C*

Factors Considered by the Rating Agencies

Market Position
- Market Reputation
- Scope of Operations
- Student Demand & Pricing Power
- Philanthropic Support

Balance Sheet & Capital Investment
- Wealth
- Liquidity
- Capital Investment

Bond Rating
(Credit Rating)

Legal Security & Debt Structure
- Bondholder Security Provisions
- External Financing Terms and Conditions

Operating Performance
- Cash flow
- Budgetary Flexibility
- Revenue Diversity

Management
- Short and Long-Range Planning
- Benchmarking and Self-Assessment
- Council and Senior Management

FINANCIAL POLICIES

Government Finance Officers Association: Recommended Policies

1. **General Fund Reserves**
2. Reserves in Other Funds
3. Grants
4. **Debt**
5. Investment
6. Economic Development
7. Accounting and Financial Reporting
8. Risk Management and Internal Controls
9. Procurement
10. Long-term Financial Planning
11. Structurally Balanced Budget
12. Capital Planning
13. Revenues
14. Expenditures
15. Operating Budget

General Fund Reserve Policy

Purpose:

- The policy will ensure that the City maintains adequate fund balances and reserves in order to:
    1) Provide sufficient cash flow for daily financial needs;
    2) Secure and maintain investment grade bond ratings;
    3) Offset significant economic downturns or revenue shortfalls; and
    4) Provide funds for unforeseen expenditures
- Fund Balance Reserve Policy will identify the minimum amount of reserves required
- Establishes circumstances in which reserves may be utilized
- Specifically describes how resources will be directed to replenish the use of fund balance

Debt Management Policy

Purpose:

- To comply with all Texas and Federal Law governing debt and existing City debt covenants
- Primary objectives of the policy are the following:
  1) Ensure high quality debt management decisions;
  2) Maintain and/or improves the City's existing debt rating;
  3) Maintain access to capital;
  4) Minimize borrowing costs and risks;
  5) Set policy and procedures for ancillary entities issuing debt

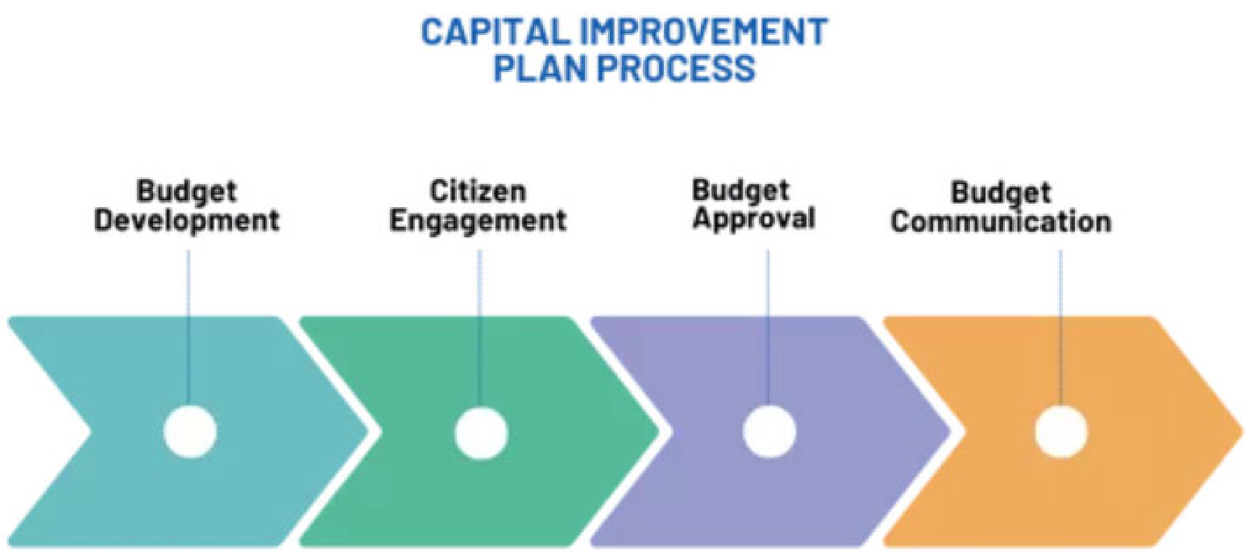
Complying with Financial Policies

- Financial policies are approved by Council via Resolution

- Shows rating agencies and bond investors that minimum financial standards are formalized through policy

- Important to FORMALIZE financial policies, but more important to FOLLOW the policies in place

CAPITAL IMPROVEMENT PLANNING



What are CIPs anyway?

Capital Improvement Project:

- Construction, major maintenance, and renovation. Includes equipment upgrades and replacement.

Capital Improvement Plan:

- A 5 to 20-Year plan to address the Projects
- Working, formalized, document reviewed and updated annually

2 Major Parts of a Capital Improvement Plan

I. Capital Budget – the upcoming year's spending plan for capital items

II. Capital Program – plan for capital expenditures that extends typically five to ten years beyond the capital budget

- Identifies funding sources:
  - Pay As You Go (i.e., cash from current budget)
  - Federal and State Programs (e.g., USDA, TWBD)
  - Debt Financing

What is in the Capital Improvement Plan?

- Listing of the capital projects, equipment needs
- Ranking of projects
- Funding Sources
- Timetable for the completion of the project
- Project justification

CIP Development Process

City of New Braunfels