Florida Government Finance Officers Association

Debt Administration

Certified Government Finance Officer (CGFO) Review Session

Updated July 2024

The FGFOA is dedicated to being your professional resource by providing opportunities through Education, Networking, Leadership and Information.

Exam Topics

Debt Management – 25%

Financing Team, Players & Roles– 20%

Debt Structures & Financing Methods – 20%

Legal Responsibilities– 15%

Issuance & Refunding – 20%

Debt Management

Debt Management

Reasons Governments Borrow Money

Capital Improvement Program

Financial Policies

Learning Objectives

Identify reasons why governments borrow money

Define a capital improvement program

Recall why a capital improvement program is valuable to the debt process

Define financial policies and importance to the debt process

Identify regulating agencies within the debt process

Reasons governments borrow money

To finance infrastructure projects

- Government office buildings
- Roads and streets
- Water and sewer lines
- Water and solid waste treatment plants
- Airports
- Hospitals

Reasons governments borrow money

- Operating cash shortfall (anticipation notes)
- Community improvement or economic development
- Current revenue stream insufficient to fund capital projects with significant costs and longer useful lives
- Prevention and elimination of slums and blight

Capital Improvement Program

Capital Improvement Plans generally include the following components:

- Description of project
- Estimated costs of capital project by year
- Funding source by project
- Operating costs/savings by project
- Alignment with strategic plan

Capital Improvement Program

- Plan for capital expenditures to be incurred each year over a fixed period of several years (usually five to seven) to meet capital needs
- Financial planning, management and budgeting tool
- Provides an organized and practical method of planning and financing a government’s capital needs
- Lower interest costs and increase credit ratings with debt management policy

Debt Issuance Considerations

Matching type of financing with revenue stream

Coordination of proposed financing with existing debt

Overlapping debt

Project schedule (e.g., design, land acquisition, and/or construction)

Debt Issuance Considerations

- Typically, current revenue stream is not sufficient to cover long-term capital projects with significant costs
- Concept of **Intergenerational equity**
  - Borrowing cash to purchase the item now and paying back the debt with future taxes, ensuring that those who receive benefit from the item in the future will help pay for it.
  - Matching term of financing with estimated useful life of asset

Debt Management Policy

GFOA recommends that a debt management policy is reviewed periodically and should address at least the following:

- Debt limits [1]
- Debt structuring practices
- Debt issuance practices
- Debt management practices
- Use of derivatives

1. Florida law does not impose a debt limit. Instead, it is left up to local governments to determine and include in their debt management policy.

Debt Management Policies

GFOA recommends that state and local governments adopt comprehensive written debt management policies

- ❑ Approved by the issuers governing body
- ❑ Provides for the following
  - Credibility
  - Transparency
  - Debt financing approach
- ❑ Allowable uses of debt proceeds

Debt Limits

- Set specific limits or acceptable ranges for each type of debt
  - Legal restrictions
  - Public policies
    - Purposes for debt proceeds and types of debt prohibited
    - Relationship and integration with the Capital Improvement Program
    - Economic development goals
  - Financial restrictions
  - Debt Capacity
    - Affordability
    - Risk of potential debt
    - Funding of operational services (e.g., personnel)

Debt Limits

- Appropriate debt limits can have positive impact on bond ratings
- Financial limits often expressed as ratios
  - Debt per capita
  - Debt to personal income
  - Debt to taxable property value
  - Debt service payments as a percentage of general fund revenues or expenditures

Debt Limits

Debt Per Capita

- Total Annual Debt Service:

Principal	$1,000,000
Interest	$ 500,000
Total	$1,500,000

- Population 1,000
- Debt per Capita = $1,500

DS – Percentage of Revenues

- Total Annual Debt Service:

Principal	$1,000,000
Interest	$ 500,000
Total	$1,500,000

- Revenue $45,000,000
- Percent of Revenues = 3.33%

Debt Structuring Practices

Policy should include specific guidelines regarding the debt structuring practices including:

- Maximum term
- Average maturity
- Debt service pattern
- Use of optional redemption features
- Use of variable or fixed-rate debt, credit enhancements, and derivatives

Debt Issuance Practices

Policy should provide guidance regarding issuance process:

- Selection and use of professional service providers - Independent financial advisor
- Criteria for determining method of sale and investment of proceeds
- Use of comparative bond pricing services
- Criteria for issuance of advance or current refunding bonds
- Use of credit ratings, number of ratings and selection of rating services

Post Issuance Policies

Policy should provide guidance regarding procedure following the issuance of debt:

- Internal Revenue Service
  - ✓ Compliance and continuing disclosure
  - ✓ Record retention (usually longer than state & local requirements)

- Identify staff responsible for compliance and required training

Debt Management Practices

Policy should provide guidance for ongoing administrative activities including:

- Investment of bond proceeds
- Primary and secondary market disclosure practices
- Budgeting for and making debt service payments
- Arbitrage rebate monitoring and filing
- Federal and state law compliance practices
- Ongoing market and investor relations efforts

Use of Derivatives

- **Derivatives** are financial instruments whose value is basedupon (derived from) the value of another asset

- **Debt management policy** should clearly state whether or not the entity can or should use derivatives

- **GFOA recommends** that local governments exercise extreme caution in using derivative instruments

If use of derivatives is allowed, a separate and comprehensive derivatives policy should be developed

Use of Derivatives

Dodd-Frank Wall Street Reform and Consumer Protection Act Provides for safe harbors* which include:

- Issuer representative
- Qualified Independent Representative who is a professional and independent from the swap dealer
- Understanding of swaps

*Safe Harbors regulations are legal provisions that define business and payment practices that are not considered violations of the federal anti-kickback statute

Covenant and State Shared Revenues

Covenant to budget and appropriate

- Issuer agrees to annually appropriate legally available non-ad valorem revenues
- Cannot use ad valorem taxes
- Be careful which revenues are defined to be used

State shared revenues – can only secure the guaranteed entitlement portion

- **FS218.25** Limitation of Shared Funds

Coverage Ratio

- Covenant to ensure sufficient pledged net revenues to pay annual debt service
- Debt service coverage requirements
  - Pledge to maintain certain percent of net revenues (gross revenues less operating costs) in excess of annual debt service
  - Coverage should be in excess of 1.0, (e.g., 1.25)

    Gross revenues – operating costs = net revenues

    Net revenues / annual debt service = debt service coverage

Bond Covenants

Additional bonds test

- Agreement not to issue additional parity bonds until test is met
- Test of pledged revenues against future combined debt service of parity debt
- Ensures that bond issuers can meet the debt service when issuing additional bonds
- Rate consultant, bond counsel, financial advisor

Debt service reserves

Use bond proceeds as defined in the bond documents

Continuing disclosure

Regulating Agencies

- **Internal Revenue Service (IRS) -** All issuers with bonds greater than $100,000 are required to file information returns at the time of issue
- **Municipal Securities Rulemaking Board (MSRB)**
  - Regulates municipal securities market
  - Manages EMMA

Regulating Agencies

Securities and Exchange Commission (SEC)

- **Rule 15C2-12** requires municipal bond issuers to enter into an agreement with underwriters to provide certain information
- Requires underwriters to
  - Perform due diligence review of the Preliminary Official Statement (POS) and Official Statement (OS)
  - Distribute POS/OS upon request within one day to a potential investor
  - Timely receipt of the OS

Debt Service Payment Procedures

Bond holders want to be paid on time!

- ❑ Follow the flow of funds in the authorizing resolution/ ordinance
- ❑ Prefer electronic funds transfer; keep your money longer
- ❑ Failure to make debt service payments:
  - Result in default
  - Impairment or loss of market access
  - Material Event Notice on MSRB's EMMA

Debt Structuring and Financing Methods

Debt Structuring and Financing Methods

Typical Methods of Financing Capital Projects

Common Types of Debt Issued

Bond Structuring – Interest and Maturities

Learning Objectives

Identify the different sources available for capital projects funding

Recall the advantages and disadvantages for each funding source

Recall different kinds of debt issued, including advantages and disadvantages of each

Identify the options for short-term financing, including advantages and disadvantages of each

Learning Objectives

Define terms describing elements of bond structuring

Recognize different types of maturity schedules

Typical Methods of Financing Capital Projects

Typical Methods of Financing Capital Projects

Typical funding sources for capital projects include:

- Pay-As-You-Go Financing
- State Revolving Loan Fund (SRF) program
- Grants
- Joint Ventures/Privatization

Debt Financing

- General Obligation (GO) Bonds
- Revenue Bonds
- Notes or Short-term Borrowings
- Special Assessment Bonds
- Capital Leases
- Certificates of Participation

Pay-As-You-Go Financing

Pay-As-You-Go Financing is paying for capital projects with cash on hand

Advantages

- Cost savings of interest, fees and expenses of issuing debt
- Financial flexibility preserved
- Perception credit quality enhanced
- Borrowing capacity protected

Disadvantages

- Insufficient funding for capital needs
- Discourages intergenerational equity
- “Lumpy” capital expenditures
- Sudden tax increases

State Revolving Loan Fund (SRF) program

The State Revolving Loan Fund (SRF) program provides low-interest **loans** to local governments to **plan**, design, and build or upgrade wastewater, storm water, and nonpoint source pollution prevention projects.

Advantages

- Low interest rates

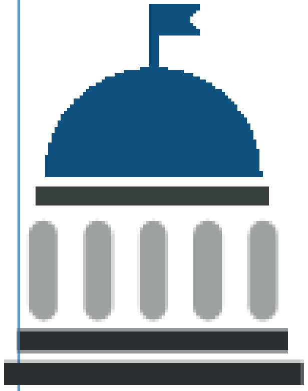
Disadvantages

- Limited to capital projects eligible for the loan

Florida Municipal Loan Council

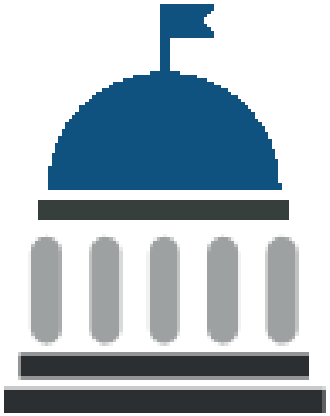
The Florida Municipal Loan Council (FMLC)

- Offers funding options to finance capital projects, renovations, fixed assets additions and land purchases or to refinance existing debt.
- The FMLC works with a team of professionals and advisers to provide greater market access and lower financing costs for its borrowers.



Grants

- Disadvantages
  - Limited availability
  - Administratively burdensome (reporting)
  - Local matches
  - Lack of local knowledge to manage grants
  - Federal compliance rules/regulations



- Advantages
  - Funds are provided by the federal and/or state governments
  - Completing projects that may otherwise not be completed
  - Recovering of local tax dollars sent to Washington and Tallahassee

Joint Ventures/Privatization

- **Privatization** includes complete transfer of service provision to a private company; most governmental services do no generate enough revenue for privatization

- **Joint Ventures** includes a legal entity or other organization that results from a contractual agreement; owned, operated or governed by two or more participants

Debt Financing

Debt financing includes issuance of long-term debt (bonds)

Advantages include:

- Current revenues used each year to repay debt
- Promotes intergenerational equity
- Permits capital improvements to be implemented as needed

Disadvantages include:

- Reduces financial flexibility – debt service requirements must be met
- Perception of credit quality reduced
- Limits future borrowing capacity

Governmental Bonds

Two types of governmental bonds:

- Tax-exempt bonds
- Taxable bonds

Tax-Exempt Governmental Bonds

- Bonds that do not meet the private activity bonds test
- Interest paid to bondholders is not includable in gross income for federal income tax purposes
  - Bondholders willing to accept lower interest rate
  - Cost savings for issuer (government)
- Can also be exempt from state incometax through reciprocal immunity (McCulloch v Maryland, 1819)
- Restricts purpose of debt primarily to public purpose (not meeting the private activity test)
- Fully registered (if maturity is over 1year)

Taxable Bonds

Taxable bonds

- ❑ Meets the private activity test
- ❑ Advance refunding
  - The "2017 Act" repealed the authority to issue tax-exempt advance refunding bonds after December 31, 2017.
- ❑ Interest paid to bondholders is includable in gross income for federal income tax purposes
- ❑ Investor requires higher yields (interest rates)
- ❑ Higher interest costs to the issuer (government)
- ❑ **Examples of taxable bonds -** Pension bonds/workers compensation bonds/advance refunding bonds

Private Activity Test

❑ Private activity test

- Financed asset available for general public use
- Source of debt servicepayments
  - ✓ Governmental revenues
  - ✓ Private lease payments (e.g., rent)

❑ Private activity test standards

- Private purpose use of the asset must be less than 10% of the asset
- Payment of principal or interest from a private source must be less than 10%

Private Activity Bond Test

Exceeding the Private Activity Bond Tests Limits **after** Issuance

- Even if the bonds comply with the limits of the private activity bond tests at issuance, a governmental bond issue can lose its tax-exempt status (from the time of issuance) **if the issuer or a conduit borrower of the bond proceeds takes a "deliberate action**" subsequent to the issue date that causes the issue to exceed those limits . A deliberate action is any action taken by the issuer or conduit borrower that is within its control; intent to exceed the limits is not necessary for an action to be deliberate. A deliberate action occurs on the date the issuer or conduit borrower enters into a binding contract (that is not subject to any material contingencies) with a nongovernmental person for use of the bond-financed property in a manner that causes the limits of the private activity tests to be exceeded.

Private Activity Test

❑ Examples to consider

- Parking garages
- Convention centers
- Marinas

❑ Private activity test

- If in doubt, ask bond counsel and/or financial advisor
- ***Passing the private activity test could result in tax-exempt bonds becoming taxable***

Management and Service Contracts - Contracts for a private entity to manage a bond-financed facility may cause the private business use test to be met. For example, a management contract between a governmental entity and a nongovernmental person under which the nongovernmental person receives compensation for services provided with respect to bond-financed property may result in the bonds meeting the private business use test .

Common Types of Debt Issued

Common Types of Debt Issued

Debt financing includes:

- General Obligation (GO) Bonds
- Revenue Bonds
- Special Assessment Bonds
- Notes or Short-term Borrowings
- Capital Leases
- Certificates of Participation
- Anticipation Notes

General Obligation (GO) bonds

General Obligation (GO) bonds

- Pledge full faith and general credit of issuer; most secure pledge
- Voter approval is required for amount and anticipated use
- Favorable interest rates
- Debt millage limit is based on the local government policy
- Rolled back rate does not apply to millage rates used to pay GO bonds

Revenue & Special Assessment Bonds

Revenue bonds

- Specific revenue pledge to service debt (e.g., water, wastewater, local option taxes, toll roads, etc.)
- Voter approval usually not required
- Coverage covenants usually included
- Higher interest rates than GO bonds

Special assessment bonds

- Debt is secured by limited group of property owners
- Market concerns about defaults
- Higher interest costs due to higher risk
- **Mitigate risks –** Utilizes the Uniform Method of Collection on the annual property tax bills
- More complex than GO bonds

Notes or Short-term Borrowings

Bank notes

- Direct loan by a banking institution
- May be considered as a private placement bond
- Easier to issue

Commercial paper

- Unsecured short-term loan
- Essentially a promissory note secured by the borrower's financial health
- Interest rates are usually variable

Leases

Capital Leases

- Widely used to acquire equipment and facilities

Advantages

- Easy, effective method of obtaining funding
- Potential for lower payments
- Voter referendum are generally not required

Certificates of Participation (COP)

Certificates of Participation (COP)

- Allows an investor to buy a share of the improvements or infrastructure the government intends to fund
- Lease payments are made to relieve the debt
- Does not require a vote of citizens

Bond Structuring
Interest and Maturities

Debt Structure

Debt structure refers to duration and timing of principal and interest payments

- ❑ Maturity dates
- ❑ Serial bonds or term bonds
- ❑ Provisions for calling the bonds

Debt Structure

The Issuer works closely with the municipal advisor in determining the size and structure of the debt

- Determine, define, and establish the number and amount of individual bonds in the issue
- Maturity schedule for individual bonds
- **Timing –** When to bring the bonds to market

Debt Structure -

Methods of Calculating Interest Costs

- **True Interest Cost (TIC) –** rate necessary to **discount** the amounts payable on the respective principal and interest payment dates to purchase price received for new issue of bonds

- **Net Interest Cost (NIC) –** computes overall interest expense associated with bonds

Debt Structure

Annual debt service payments

- **Capitalized interest –** payment of interest from the bond proceeds
- **Level debt service –** principal increases as interest decreases (e.g., mortgages, car payments)
- **Level principal payment –** total debt service decreases as interest decreases
- **Interest only –** payment of interest only for a portion of the term (wrapping new debt around existing debt

Maturity

- Maturity is the date the bond must be repaid
- Maturity matching principle - Debt maturity should approximately coincide with useful life of project being financed

Fixed-Rate Bonds

Each maturity in bond issue has a set interest rate that does not fluctuate throughout life of bonds

- Interest rates are set at the time of sale/closing
- Reduces interest risk to both issuer and bond holder

Two types of fixed-rate bonds

- Serial
- Term

Serial Bonds

- **Serial bonds** are a series of bonds that mature in regular pattern, usually over entire life of bond issue
- **Interest** is paid at regular intervals, usually semi-annually

Serial Bonds

Serial bonds

$52,115,000
CITY OF TAMPA, FLORIDA
Sales Tax Refunding and Improvement Revenue Bonds, Series 2016

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS, PRICES AND INITIAL CUSIP NUMBERS

Maturity (October 1)	Principal Amount	Interest Rate	Yield	Price	Initial CUSIP Numbers* (1)
2017	$4,140,000	5.00%	0.75%	104.261	875232CH1
2018	4,365,000	5.00	0.84	108.267	875232CJ7
2019	4,585,000	5.00	0.96	111.951	875232CK4
2020	4,820,000	5.00	1.08	115.336	875232CL2
2021	5,055,000	5.00	1.20	118.417	875232CM0
2022	5,305,000	5.00	1.37	120.868	875232CN8
2023	5,575,000	5.00	1.48	123.351	875232CP3
2024	5,850,000	4.00	1.61	117.889	875232CQ1
2025	6,090,000	4.00	1.71	119.043	875232CR9
2026	6,330,000	4.00	1.81	119.965	875232CS7

1. CUSIP – Committee on Uniform Securities Identification Procedure number

Term Bonds

- Single final maturity date when the entire principal is repaid
- Usually requires use of sinking fund redemptions

Debt Service Structure

Schedule of table listing periodic payments

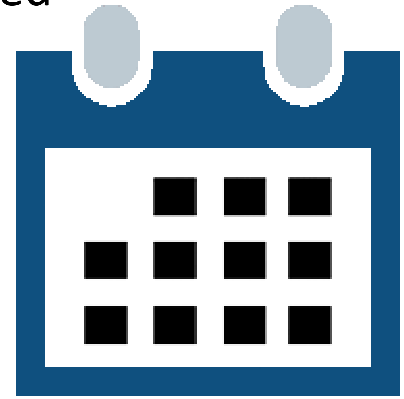
- Principal/interest requirements over life of bonds

Types of debt service structures

- Level debt service
- Level principal
- Graduated principal
- Principal deferral

Debt Service

- **Level Debt Service**
  - Principal and interest relatively constant over life of bonds
  - Easier to budget or project amount of revenues needed



- **Level Principal**
  - Principal is constant
  - Interest due declines

- **Deferred Principal**
  - Deferral of principal for a given period of time, such as construction period
  - Higher interest costs

Graduated Principal

- Little or no principal payments in early years
- Principal payments increase in later years
- Use when have service financed with revenue bonds and will take a few years to reach revenue collections sufficient to pay debt service
- Higher interest costs due to more principal outstanding for longer period of time

Variable Interest Rates

Variable interest rates

- Rates can fluctuate during the life of debt
- Variable-rate demand bonds have a floating rate and can be redeemed at any time by the bond holder
- Commercial paper
- Risks (interest rate, renewal, and rollover)

Interest Rate and Yield

- **Interest rate**

  Market-based

  Interest rate risk

  Credit risk

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2021	5,055,000	5.00	1.20	118.417
2022	5,305,000	5.00	1.37	120.868
2023	5,575,000	5.00	1.48	123.351
2024	5,850,000	4.00	1.61	117.889
2025	6,090,000	4.00	1.71	119.043
2026	6,330,000	4.00	1.81	119.965

- **Yield**

  Price

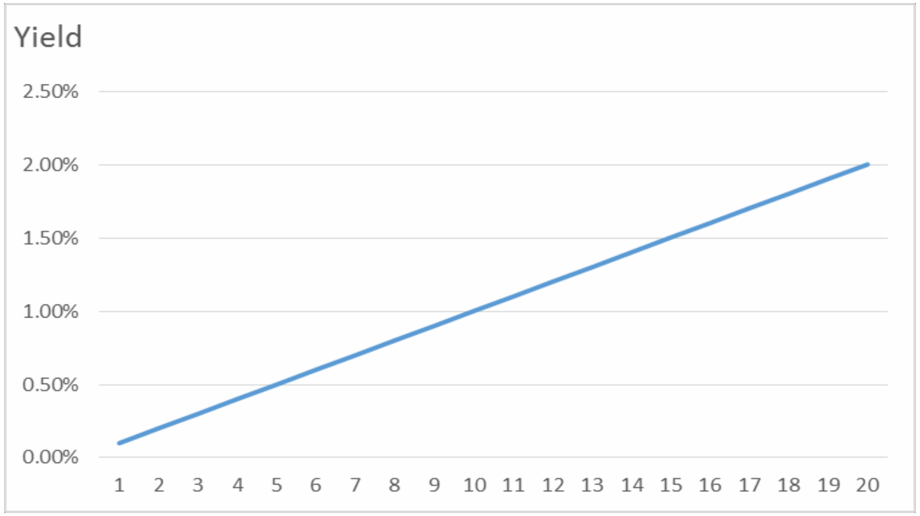
  Interest rate

  Yield curve – graphic illustration showing the yields on bonds of varying maturities

Yield Curve

Normal yield curve

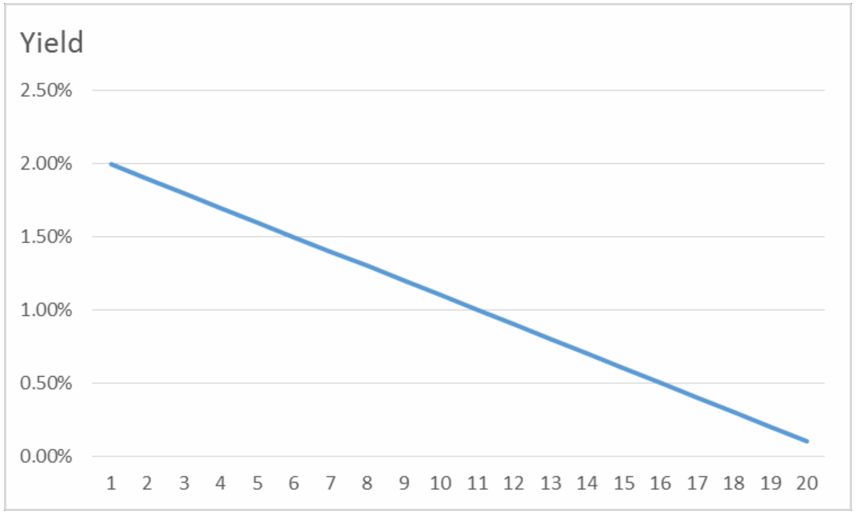
- Yields are low in the near-term and rise for the long-term
- Reflects a good economy; economic expansion



Yield Curve

Inverted yield curve

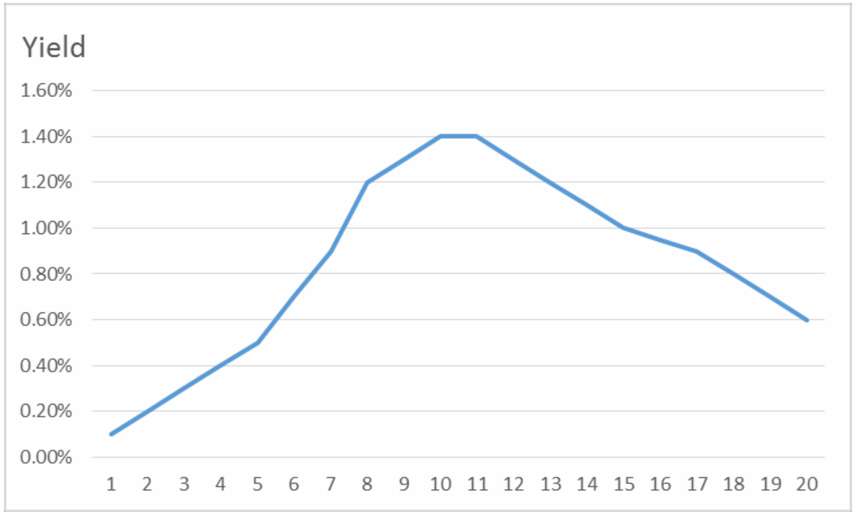
- Long-term yields are projected to fall
- Corresponds to period of economic recession



Yield Curve

Humped yield curve

- Relatively rare
- Yields on medium-term investments are higher than both short and long-term investments
- Also known as a bell-shaped curve
- Seen as a predictor of economic transition



Redemption Provisions

Redemption provisions

- **Mandatory –** annual debt service through the use of a sinking fund
- Optional redemption (call provision)
  - Allows for the bonds to be called
  - Generally at the 10^{th} year anniversary
  - Issuer will pay a premium
  - Issuer will also pay a higher interest rate to call the issue earlier

Ratings Process

Learning Objectives

Recall the definition of a bond rating

Define the various bond rating designations

Recall how ratings are obtained

Identify the available credit enhancements

Ratings Process

- Bond rating is an opinion of the ability and willingness of the issuer of the bonds to make timely payments over the life of the bonds
- Bonds ratings are important not only for their role in informing investors, but also because they affect the interest rate that issuers pay on their outstanding debt

Three largest rating agencies:

- ❑ **Standard & Poors (S&P)**
- ❑ **Fitch**
- ❑ **Moody’s**

Ratings Process

Primary factors considered during the process:

- **Rating agencies evaluate**
  - Debt Burden
  - Management
  - Financial performance
  - Economic base
- **Meetings**
  - Personal meeting is recommended if there has been significant changes since last meeting
  - Telephone meetings are the norm

Ratings Process

- ❑ **Credit rating: determined by a rating committee**

- ❑ **Credit rating report**
  - Public document published by each credit rating agency
  - Evaluates the creditworthiness of the issuer
  - Underlying rating
    - ✓ Rating without any credit enhancements
    - ✓ Published upon request

Bond Ratings

	Moody's	Standard & Poors	Fitch	Explanation
Best Quality	Aaa	AAA	AAA	Carry the smallest degree of risk
High Quality	Aa1 Aa2 Aa3	AA+ AA AA-	AA+ AA AA-	Margins of protection not quite as good as best quality bonds
Upper Medium Grade	A1 A2 A3	A+ A A-	A+ A A-	Security is adequate now but current factors are present to suggest possibility of impairment in future
Medium Grade	Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-	Repayment security appears adequate in present but have certain elements of unreliability

Credit and Rating Enhancements

- **Credit enhancements** is the process of reducing credit risk (and potentially increasing credit ratings) by providing collateral, insurance, or other agreements

- Provides investors with additional assurance that they will be compensated in the event the government is unable to pay the bonds

- Two primary types:
  - Bond insurance
  - Letters of credit

Bond Insurance

- Purchased through an upfront one-time payment of an insurance premium at the time of the bond closing
- Bond ratings are based on the **credit of the bond insurance company**, rather than on the underlying credit of the issuer
- Guarantees principal and interest will be paid as scheduled

Bond Insurance

- Cost-effectiveness depends
  - Interest cost savings exceed premium
  - For smaller governments, may be cheaper and simpler than applying for credit rating

- Premiums are not cheap - 0.1% to 2% of combined principal and interest payable over life of bonds

Bond Insurance

Advantages

- Improved credit rating on the issue
- Results in lower interest costs

Disadvantages

- Must pay upfront insurance premium
- Premium can be expensive
- Sometimes not cost effective

Letters of Credit

- Unconditional pledge of a bank's credit to make principal and interest payments of specified amount for specified period of time

- **Two types**
  - Direct pay
  - Standby

Letters of Credit

❑ Direct Pay Letters of Credit

- All debt service payments made by draws on letter of credit
- Issuer reimburses bank for such payments

❑ Standby Letters of Credit

- Issuer has primary responsibility for making debt service payments
- Letter of credit drawn on if issuer defaults

Letters of Credit

Banks charge two fees for letters of credit:

- **Commitment fee**
  - One-time payment made when bonds are issued
  - Usually ranges from 0.25% to 1.0% of debt amount
- **Draw-down (Drawing) fee**
  - Specified amount due for each draw payable at time of draw
  - Interest charge due for time between draw and reimbursement

Letters of Credit

Advantages

- ❑Improves the bond's credit rating - bonds take rate of the bank
- ❑Simplifies an otherwise complicated security arrangement

Letters of Credit

Disadvantages

- Fee can be substantial
- Must be renewed every 3-5 years
- May not be able to find a bank willing or able to issue letter of credit
- Acceleration of payment in event of failure to reimburse bank for draws

Ratings Process

Rating agency surveillances

- Periodic review by the credit rating agencies by credit
- Can upgrade, affirm, or downgrade credit rating
- Publish a credit report

Players and Roles

Learning Objectives

Recall the roles and responsibilities of players within the debt process

Issuer

The Issuer is one of the primary player(s) involved in the debt process – we are the customer!

Members from the Issuer's team typically include the following from within the government:

- ❑Chief Financial Officer
- ❑Budget/Accounting
- ❑Attorneys
- ❑Clerk's Office
- ❑Department Representatives if applicable (Water, Wastewater, Solid Waste, Storm-water)

Issuer

The roles and responsibilities of the issuer include:

- ❑Works closely with the municipal advisor in determining the size and structure of the debt
- ❑Assists in preparation of the preliminary official statement and providing financial and operating information
- ❑Provides information requested by rating agencies
- ❑Department Representatives provides information related to proposed projects to be funded through the debt – (Water, Wastewater, Solid Waste, Storm-water)

Municipal Advisor

- The Municipal Advisor is an indispensable part of the financing team
- Prior to the 2010 Dodd-Frank Act, activities were largely unregulated
- SEC adopted new rules, effective **July 1, 2014**
  - Seek to protect interests of municipal entities
  - Imparts that municipal advisors have explicit fiduciary duty to government clients
  - Municipal advisor prohibited from serving as underwriter on issuance

Municipal Advisor

The Municipal Advisor is usually hired first and works closely with the issuer

Roles and responsibilities of the Municipal Advisor include:

- ❑Serves as independent financial consultant to issuing government
- ❑Represents the issuing government in the sale of bonds
- ❑Protects issuer's financial interest during entire bond issuance process
- ❑Assists in developing financing requirements, debt structure and choosing the method of sale

Municipal Advisor

Common methods of compensation for the **Municipal Advisor** include:

- ❑Hourly Basis/Fixed Fee
- ❑Flat-dollar amount per bond issued

Bond Counsel

Bond counsel

Certifies legal authority to issue the debt

Provides an opinion that the debt is tax-exempt

Interprets federal, state, and local laws, regulations, constitutions and statutes, charters, and ordinances

May draft ordinance or trust indenture

Bond Counsel

Common Methods of Compensation

- ❑Percentage of bonds sold
- ❑Hourly basis
- ❑Fixed fee

Select one with a strong reputation

Disclosure Counsel

Disclosure counsel:

- ❑ Retained by the issuer
- ❑ Provides advice on issuer disclosure obligation
- ❑ Prepares the official statement
- ❑ Prepares continuing disclosure agreement

Underwriter

Underwriter

- ❑Securities dealer helps the issuer bring bonds to the market
- ❑Key role is to buy bonds from issuer and resell to investors
- ❑Usually investment firm or securities subsidiary of commercial bank

Underwriter

Selection of the underwriter depends on the type of sale:

Negotiated sale

- participates in structuring the deal and selected by the issuer prior to sale date

Competitive sale

- submits a sealed bid and identity is not known until bids are opened

Underwriter

Underwriter

- Should be competent, reasonably priced,and have no conflict of interests
- Compensation is based on type of sale:
  - **Competitive Bid –** Part of bid price
  - **Negotiated Sale –** Paid underwriter spread

Underwriter

Underwriter Spread

Gross Spread – the difference between the price paid by the underwriter to the issuer and the price at which the securities are initially offered to the investing public

Underwriter

Underwriters' spread or compensation has four components:

- **Take-down –** compensation for selling bonds; sales commission
- **Management fee –** managing the activities of the bond preparation
- **Expenses –** incurred in the sale process
- **Underwriter fee or "risk" –** associated with buying and reselling the issue

Underwriter’s counsel

Underwriter’s counsel:

- ❑ Represents underwriter in negotiated sale
- ❑ Prepares the **bond purchase agreement** - Contract for selling bonds to underwriter and how underwriter will resell bonds
- ❑ Should understand the process foe selling bonds via both competitive bids and negotiated sales
- ❑ Absence of any conflicts of interest

Other Players

Other players

Paying agent	
Bond Registrar	
Trustee	
Securities Depository	
Printer	
External Auditors	

Other Players

Committee on Uniform Securities Identification Procedure (CUSIP) number: Allows the market to identify series of bonds

Bond register

- ❑Listing of names and addresses of current bond owners
- ❑Electronically maintained by Deposit Trust and Clearing Corporation (DTC)

Issuance and Refunding

Issuance and Refunding

- The Method of Sale
- Bond Documents
- Arbitrage and Continuing Disclosure Requirements
- Refunding

Learning Objectives

Recall the methods of sale including advantages and disadvantages of each

Identify various elements of bond documents

Recall the bond proceed investment provisions

Define arbitrage and how it relates to bonded debt

Recognize continuing disclosure requirements

Define refunding

List the reasons for refunding

Identify types of refunding's

The Method of Sale

Methods of Sale

The methods of sale include:

- ❑Competitive bid
- ❑Negotiated Sale
- ❑Private placement

Competitive Bid

- **Issuer** prepared bond issue structure
- Publishes a notice of sale requesting bids from **underwriters**
- **Underwriters** submit closed bids to **issuer**
- Bond awarded to **best bidder -** Lowest true interest cost
- **Winning underwriter** resells bonds

Competitive Bid

When to use competitive bid:

- ❑ Market is familiar with issuer, issuer is stable and regular borrower
- ❑ Active secondary market in which to resell bonds
- ❑ Issuer has unenhanced credit rating of "A" or above or can obtain credit enhancement
- ❑ Debt structure is backed by issuer's full faith and credit or historically strong and performing revenue stream
- ❑ Issue is not too large or too small
- ❑ Issue not complex
- ❑ Interest rates are stable, market demand is strong

Competitive Bid

Advantages:

- ❑ Promotes appearance of open and fair process
- ❑ Bonds are sold at the lowest interest cost given market conditions at time of sale

Competitive Bid

Disadvantages:

- ❑ Inflexible to restructuring maturity schedules and interest rates after bonds are awarded
- ❑ Does not encourage underwriters to participate in substantial pre-marketing efforts
- ❑ Issuer has less control in determining underwriting firm and how bonds are resold to investors

Negotiated Sale

- ❑ Issuer works with single underwriter
- ❑ **Selected underwriter assists issuer with:**
  - Structuring bond issue
  - Preparing official statement
  - Obtaining bond rating
- ❑ Underwriter engages in presale marketing and negotiates interest rates with issuer

Negotiated Sale

When to use Negotiated Sale

- Issuer has poor credit
- Unusually large or small bond issue
- New entity
- Unusual financing terms
- Innovative structure or security

Negotiated Sale

Advantages:

- ❑ Underwriter is able to engage in presale marketing efforts prior to bond sale
- ❑ Allows more flexibility in underwriter selection
- ❑ Increases flexibility for issuer with sale date and bond structure

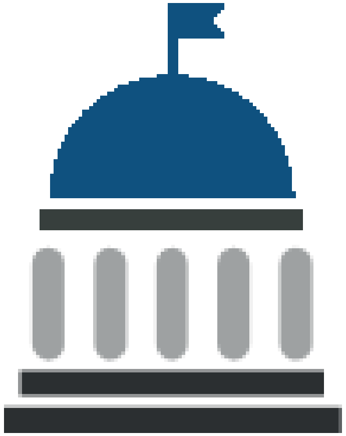
Negotiated Sale

Disadvantages:

- ❑ May appear biased
- ❑ Issuers often do not have adequate information to negotiate effectively with underwriters

Private Placement

- Government markets bonds directly to investors
  - Commercial banks
  - Insurance companies



- Used when a public bond sale is
  - Too expensive
  - Likely to be ineffective

Private Placement

- ❑ Higher interest costs
- ❑ Lower disclosure requirements
- ❑ Faster sales process

Bond Documents

Bond Documents

Bond documents include the following:

- Bond resolution
- Notice of sale
- Bond purchase agreement
- Continuing disclosure agreement
- Tax certificate
- Official statement

Bond Resolution

- Document adopted by the issuer's governing body authorizing the issuance and sale of the bonds

- Includes:
  - Form of the bonds
  - Dollar value of the bonds
  - Security supporting the repayment of the bonds
  - Approval of the offering documents
  - Approval of the terms of the sale

Notice of Sale

Publication by the issuer describing the terms of a competitive bid of an issue of bonds

Notice of Sale

Includes:

- Date and time of sale
- Description of bonds, including redemption provisions
- Form and payment of bonds
- Good faith deposit
- Basis of the award
- CUSIP numbers
- Approving opinion
- Official statement
- Timing and method of the delivery of the bonds
- Credit enhancements, if any
- Bond counsel and municipal advisor

Bond Purchase Agreement

- Used in a negotiated sale
- Contract between the **underwriter** and the **issuer** describing the final terms, prices, and conditions upon which the underwriter will purchase and resell the bonds

Continuing Disclosure Agreement

- Written agreement that the issuer will provide ongoing disclosure
- Underwriters cannot purchase bonds unless the issuer has agreed, in writing, to provide ongoing disclosure
- Underwriter must make a reasonable determination at the time of issuance of the bonds that there will be continuing disclosure

Official Statement

Disclosure document

- ❑Prepared by or for the issuer
- ❑Describes the bond issue, the economic, financial, and social characteristics of the issuer, and the security for the bonds

Disclosure

Principle that accurate and complete information that investors may need to make an informed investment must be made available to potential investors

Official Statement

- Underwriters use a **"preliminary" official statement (POS)** in negotiated sales to market bonds to potential investors
- POS differs from the final Official Statement in that it can omit certain information that will not be known until the time of sale of the bonds

Tax Certificate

- ❑ Provides information about the bond issue that supports bond counsel's opinion relating to the tax status of the bonds
  - ▪ Taxable v. Tax-Exempt
- ❑ Identifies applicable IRS regulations and requirements
  - Arbitrage
  - Rebate
- ❑ Provides information on the anticipated expenditures of the bond proceeds

Arbitrage and Continuing Disclosure Requirements

Introduction

- An issuer's responsibilities does not end with the delivery of the bonds on the closing date
- Each bond issue has disclosure requirements until the final maturity
- Events and requirements occurring after the sale should be considered important components of the debt administration program

Investment of Bond Proceeds

- On the closing date, the issuer will receive **net proceeds** from the sale of the bonds
- First post-sale responsibility = invest the proceeds
  - Investment should follow the investment policy of the government
  - Identify personnel responsible for investments - Conform to all legal, statutory, and regulatory requirements
  - Investment schedule should reflect the anticipated need to access funds for the capital project

Arbitrage

Arbitrage

Prior to the **1986 Tax Reform Act**, local governments could issue tax-exempt, low-interest bonds and then invest the bond proceeds at a higher interest rate

After 1986, local governments must:

- Restrict interest earnings
- Must meet bond proceeds spend down requirements

Arbitrage Restrictions

- **Arbitrage restrictions:** determining whether yield on investments acquired with bond proceeds must be restricted
- **Arbitrage:** spread between the tax-exempt interest rate on the bonds and the rate on investments
  - Negative arbitrage: Interest on bonds exceeds the interest received from investment opportunities
  - Positive arbitrage: Interest on bonds exceed the interest received from investment opportunities
  - Question to ask – can you earn it?
  - Generally, the yield on the investment of proceeds must be limited to the yield on the bonds

Arbitrage Exceptions

A number of exceptions may relieve an issuers of the rebate requirement for all or a part of an issue of bonds:

- **Spending Exceptions**
  - 6, 18, 24 months
- **Smaller Issue Exception**
- **Investment Exceptions**
  - Certain tax-exempt bonds or mutual funds
  - Certain demand deposit securities purchased directly from U.S. Treasury

Rebate Requirements

- **Rebate requirements:** determining whether interest earned on investments must be rebated (or paid) to IRS

- **If you earn it, do you have to pay it to the IRS?**
  - **YES!** Paid to IRS every five years and within six months after the final maturity of the bonds
  - Penalties for noncompliance

Continuing Disclosure

Secondary Market Disclosure – U.S. Securities and Exchange Commission Rule 15c2-12 <u>bars underwriters from buying</u> municipal securities <u>unless the issuer agrees in writing to provide continuing disclosure of certain material information</u> ("continuing disclosure undertaking")

Continuing Disclosure

Annual financial information – at time municipal securities offered for sale, continuing disclosure undertaking must describe:

- Type of information to be provided
- Accounting principles used to prepare financial statements and timing of statements
- Date in each year by which annual financial information will be provided
- Who will be providing the information
- **Listed Events –** specified in the Rule

Continuing Disclosure

- **Underwriters** are obligated to “reasonably determine” that issuer or obligated person has undertaken, in written agreement or contract, for benefit of bondholders, to provide continuing disclosure
- Issuers provide information to the **(MSRB)** via the **MSRB’s Electronic Municipal Market Access System (EMMA)**


MSRB
Municipal Securities Rulemaking Board
EMMA® - Electronic Municipal Market Access
The Official Source for Municipal Disclosures and Market Data
MyEMMA | Alerts | Feedback | Contact
About EMMA
Search
529 Plans
Market Activity
Education Center
EMMA Dataport
Quick Search
Enter CUSIP or Name
Search Securities
Use advanced filters to find municipal securities.
Sign Up for MyEMMA
Get customized access to alerts and saved searches.
Discover Trade Prices
Learn about and view municipal transaction data.
Help Improve EMMA®
Click here to learn how to participate
1
2
3
Read all news on EMMA
EMMA EDUCATION CENTER
In our Education Center you can find a wealth of information to help you learn more about tax-exempt bonds and notes, taxable munis, 529 college savings plans and the full constellation of municipal securities.
Getting Started on EMMA
Watch a Video About Using EMMA
What are Bonds?
What You Should Know Before Investing
Frequently Asked Questions
MARKET ACTIVITY
View market-wide information about municipal securities, including recent trades, daily summaries of market transactions, official statements for new issues and recent advance refundings of outstanding bonds.
Trade Activity
Recent Official Statements
Continuing Disclosure Documents
Market Statistics
MSRB 2012 Fact Book
DOCUMENT SUBMISSION
Municipal bond underwriters and issuers submitting official statements, advance refunding documents and continuing disclosures to EMMA should use the EMMA Dataport. Submitted documents are made available to the public.
Use EMMA's Email Reminder Service for Recurring Financial Disclosures new
Access Online Training about Submitting to EMMA
Primary Market Submission
Continuing Disclosure Submission
529 College Savings Plan Submission

Continuing Disclosure

Continuing disclosure

- ❑ **Electronic Municipal Market Access (EMMA)** system operated by the Municipal Securities Rulemaking Board (MSRB)
- ❑ File material event notice with EMMA in a timely manner, within 10 days of the event occurring
- ❑ File continuing disclosure information through **EMMA** (SEC Rule 15c2-12)

Maintaining Relations

- Bondholders and ratings agencies have an on-going interest in the issuer's debt management practices
- Rating agencies monitor bond issues on a regular basis and can revise bond ratings based on these reviews
- GFOA has a recommended practice – **Maintaining an Investor Relations Program**

Investor Relations

- Dissemination of information to the market:
  - Websites
  - Conference calls
  - Social media platforms
  - Maintain and update content of communication platforms

- Identify a single point of contact to answer inquiries
- Consult with your legal counsel and municipal advisors prior to releasing information publicly

Refunding

Refunding

A bond financing procedure in which the issuer refinances all or certain maturities of an outstanding bond by issuing new bonds

- Proceeds of the new bonds can be used to immediately retire the old debt
- Alternatively, proceeds of the new bonds can be used to purchase securities with cash flows that are used to pay off the old bonds as they mature

Reasons for Refunding*

- Reasons to refund the bonds
- To take advantage of more favorable interest rates
  - Drop of 2 to 2.5%, explore refunding
  - Include issuance costs in analysis
- To change the structure of debt service payments
- To escape from unfavorable bond covenants

*Or optional redemption

Types of Refunding

The two types of refunding are:

- ❑ Current
- ❑ Advance

Advance Refunding

Advance refunding

- Calling the bonds more than 90 days prior tothe call date (usually on the 10th anniversary of the sale date)
- Bond proceeds are placed in irrevocable escrow account to pay the annual debt service until bonds are callable
- Once escrow has been funded, the refunded bonds are legally defeased

Current Refunding

Current refunding

- Occurs within 90 days after of the bonds' call date
- Refunded bonds are defeased on the date the refunding occurs
- Normally exempt from arbitrage restrictions

State of Florida Requirements

Notice of Bond Issues - Local governments are required to furnish the Division of Bond Finance of the State Board of Administration the following:

- ❑Copy of the final official statement, if any is published
- ❑Advanced notice of impending sale of any new issue of bonds
- ❑Complete description of all its new general obligation bonds and revenue bonds

State of Florida Requirements

Notice of Bond Issues - A government unit requesting a rate of interest, in excess of the statewide maximum rate of interest for a specific issue must provide the following to the State Board of Administration:

- ❑The most recent financial statement of the governmental unit
- ❑The resolution or ordinance authorizing the issuance of the bonds
- ❑The official statement or prospectus, if available, or similar information relating to the sale of the bonds

Reference Materials

Reference Materials

- Florida Statutes (www.leg.state.fl.us)
  - FS163.335 Findings and Declarations of Necessity
  - FS200.065 Method of Fixing Millage
  - FS218.25 Limitation of Shared Funds
- IRS Publication 4079, Tax-Exempt Government Entities - IRS

Reference Materials

- GFOA Best Practice Statements and Advisories, Debt Management – GFOA
  www.gfoa.org/services/rp/debt.shtml

Questions?

Thank You!