

So, You Want to Issue Bonds?



Municipal Finance Institute
December 15, 2023

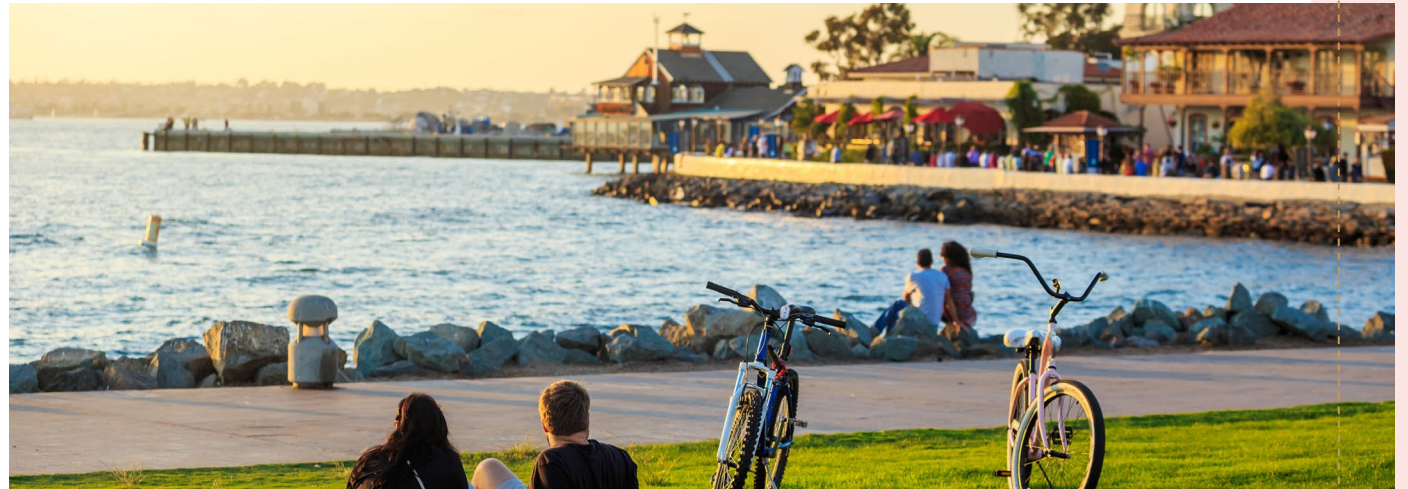
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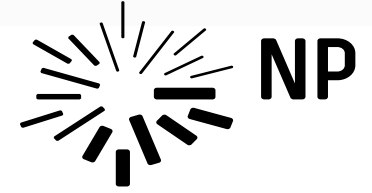


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Topics

- ♦ 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)

Economy	<ul style="list-style-type: none"> • Demographics • Household Income • Property Tax Base & Growth • Local Economic Trends
Financial Performance	<ul style="list-style-type: none"> • Available Fund Balances • Liquidity Ratio • Operating Surpluses
Leverage	<ul style="list-style-type: none"> • Long Term Debt Liabilities • Pension & OPEB Liabilities
Management	<ul style="list-style-type: none"> • Management Team • Management Policies
Institutional Framework	<ul style="list-style-type: none"> • Control Over Revenues Sources • Revenue Caps and Limitations

Rating Factors (Utility Revenue Bonds)

System Characteristics	<ul style="list-style-type: none"> • System Size • Asset Condition • Customer Base / Demographics
Financial Strength	<ul style="list-style-type: none"> • Days Cash on Hand • Fixed vs. Variable Revenues
Leverage	<ul style="list-style-type: none"> • Debt Service Coverage • Debt to Operating Revenues
Management	<ul style="list-style-type: none"> • Rate Management • Regulatory Compliance • Management Team • Management Policies
Legal Provisions	<ul style="list-style-type: none"> • 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



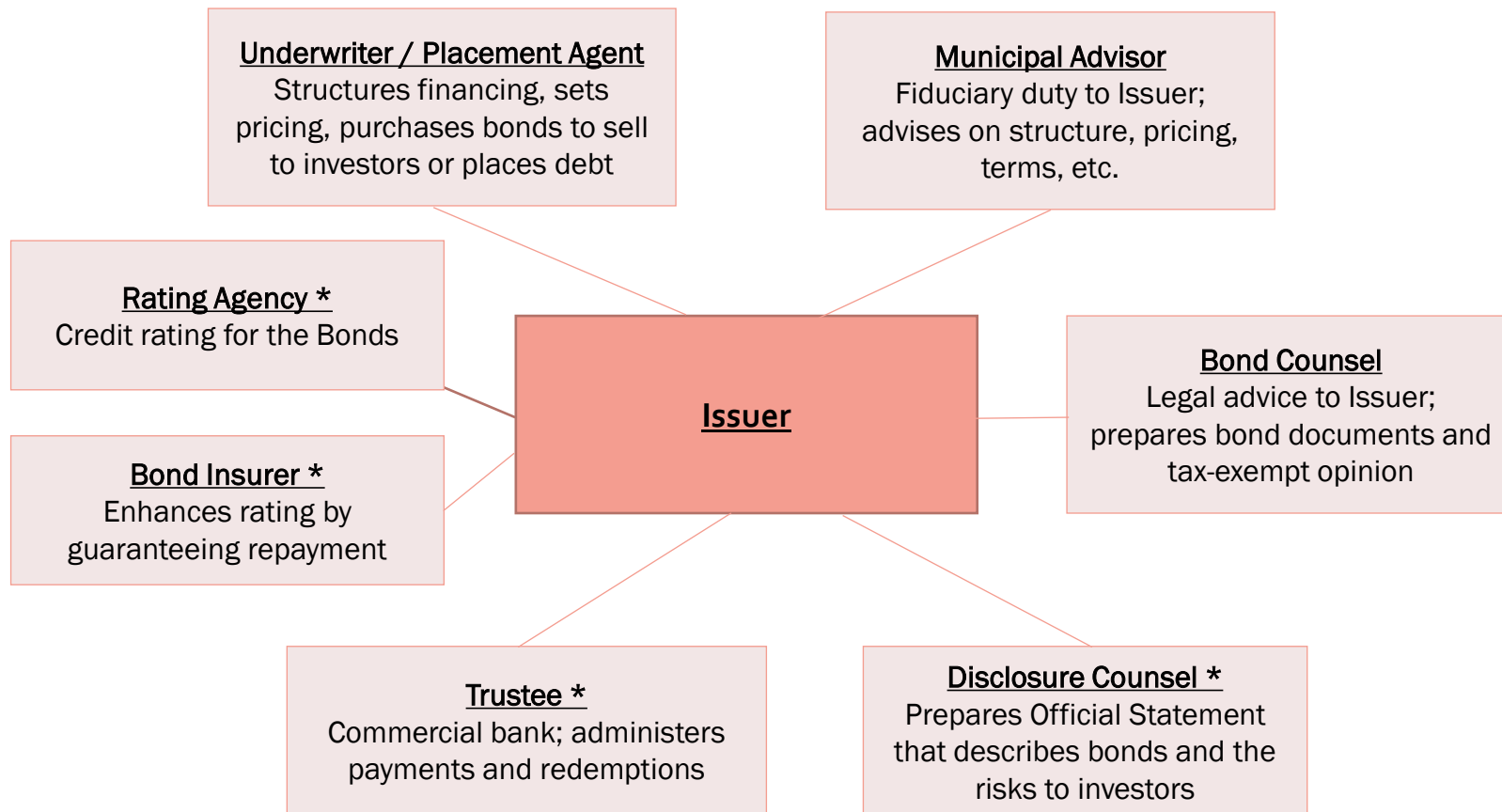
Pension
Management
Policy



Financing Team Members

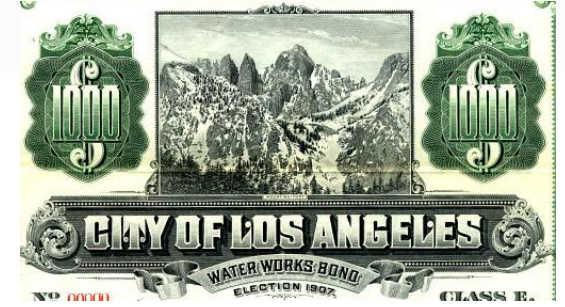


Financing Team Members



*** 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

	Public Sale	Private Placement
Credit Rating	Typically Required	Not Required
Official Statement	Required	Not Required
Due Diligence	Issuer, Counsel, Rating Agency	Lender
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 Cost of Issuance	Higher Rate, Lower Cost of Issuance
Debt Service Reserve	More Often	Less Often

Which Method is Appropriate?

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

Government Loans Overview

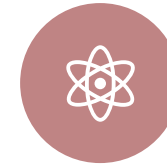


- ♦ Offered by various state and federal government agencies
 - ♦ Examples: USDA, SRF, WIFIA, TIFIA, iBank, etc.
- ♦ Key advantages: subsidized rates, longer terms (up to 40 yrs), flexible repayment
- ♦ May come with grant funding for disadvantaged communities
- ♦ Key disadvantages: very long and complicated application process (6-18 months), competitive awards, could have high fees, extensive conditions of approval
- ♦ Make sure you understand covenant structure

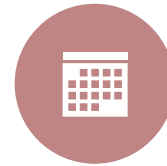
Best Practices: Selecting Financing Method



Interest Rate vs.
Total Cost



Complexity and
Staff Involvement



Prepayment
Options



Continuing
Disclosure

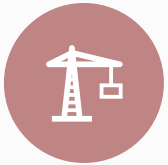


Market
Environment



Financing size
and term

Uses of Bond Proceeds



Project /
Construction
Fund



Costs of Issuance



Capitalized
Interest Fund



Underwriter's
Discount



Debt Service
Reserve Fund



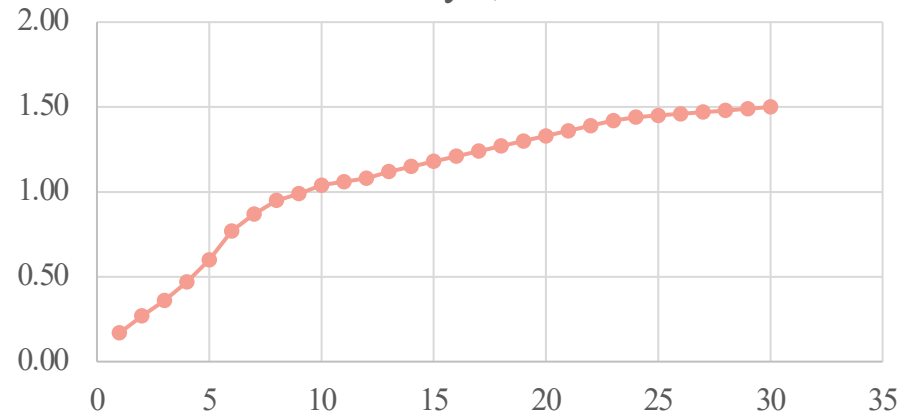
Credit
Enhancement:
Bond Insurance /
LOC



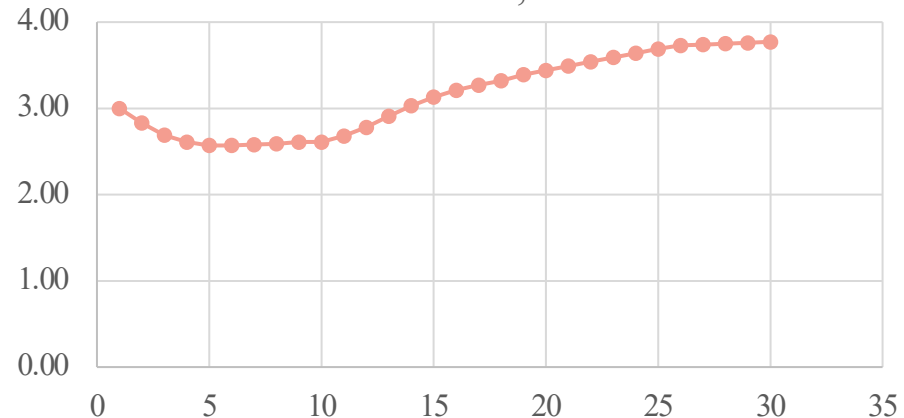
Yield Curve

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

Example of a Normal MMD Yield Curve
January 1, 2022



Today's Inverted MMD Yield Curve
December 4, 2023



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



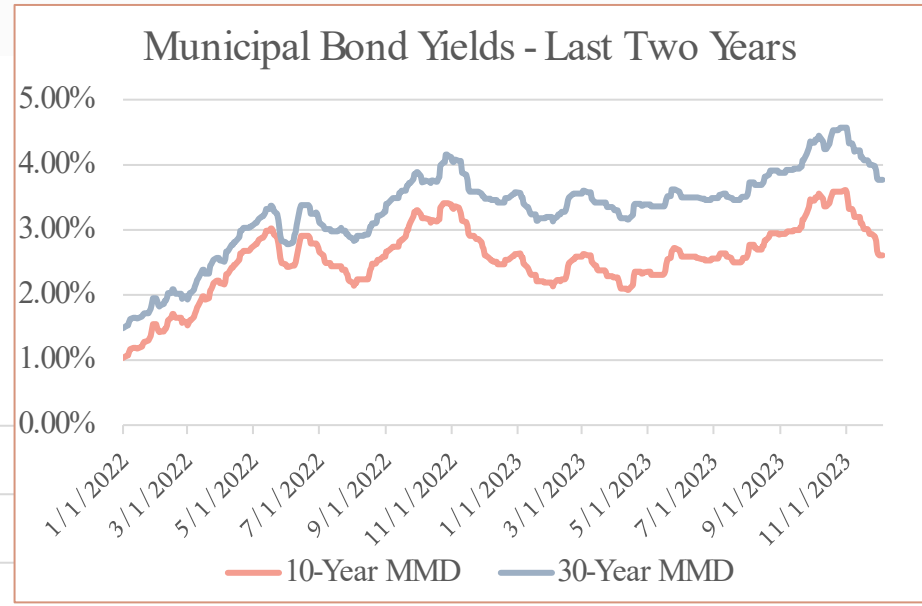
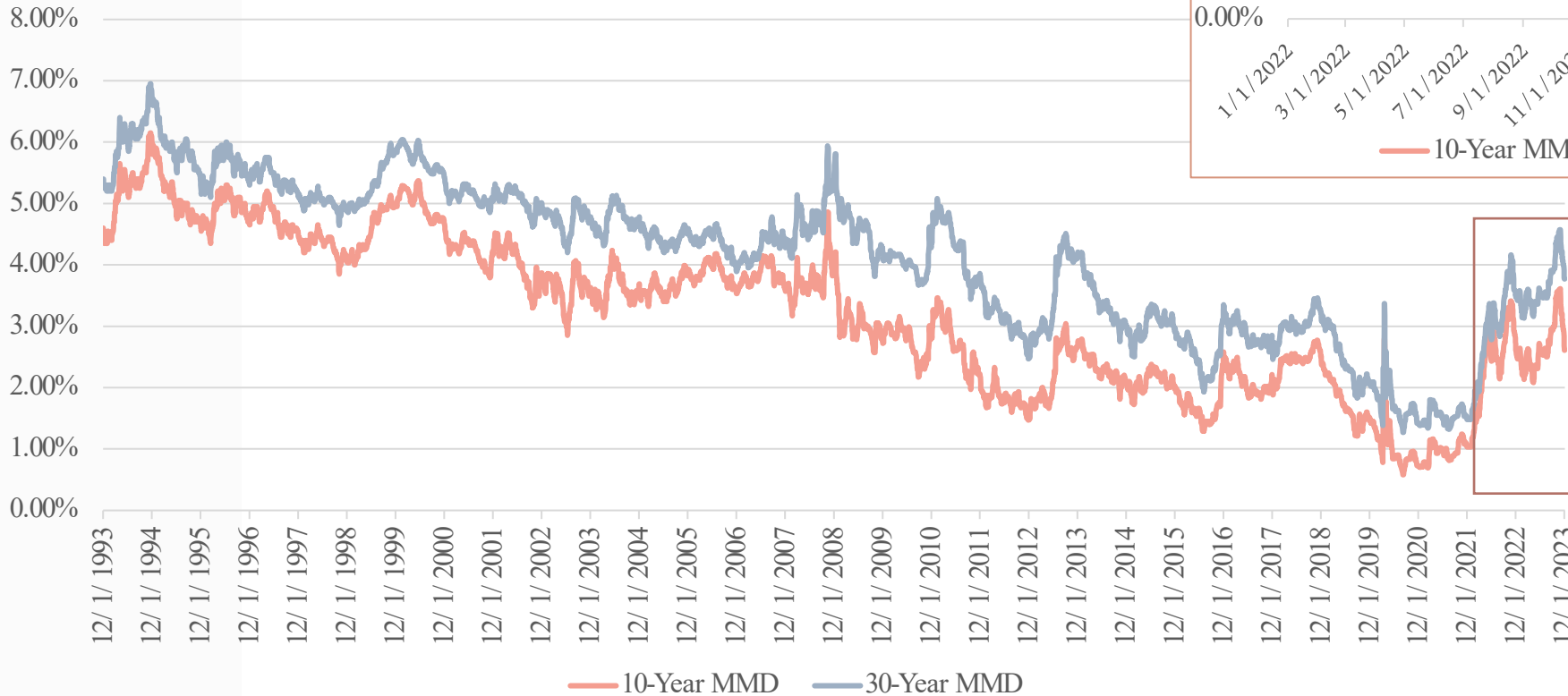
Designate
Responsible Staff
Members



Engage
Dissemination
Agent

Market Update

Historical Municipal Bond Yields - Past 30 Years



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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