EHLERS

LEADERS IN PUBLIC FINANCE

Debt Issuance 101

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Discussion topics

1. Introduction
2. Basics of debt issuance
   - ✓ Kinds of debt
   - ✓ State & Federal regulations
   - ✓ Key players
3. Process for issuing, sizing & structuring debt
4. Post issuance considerations
5. Q & A

Introduction

- Well-planned out use of debt can greatly enhance ability to complete projects
- Debt issuance & management successful ***only*** when you:
  - ✓ Understand your financing options
  - ✓ Receive clear information on implications of decisions
  - ✓ Have a basic understanding of the rules and regulations
  - ✓ Know who the players are, their roles, and for whom each of them "works"
  - ✓ Generally understand how bonds are sold in the market
  - ✓ Have a plan for current and potential future borrowings

What is municipal debt?

A municipality borrows money from investors, pledges to repay in the future.

- Two main types:
  - ✓ General Obligation debt secured by irrepealable tax levy
  - ✓ Revenue debt secured by pledge from a revenue generating enterprise, most often a public utility
- Either pledge = contract between the issuer & bond holder

Why borrow?

- Several advantages:
  - ✓ Mitigates impact on taxes or fund balance
  - ✓ Pay for projects over time, addressing “generational equity” by matching useful life of major projects with who pays for them
  - ✓ General Obligation debt payments exempt from levy limits
- Refunding (refinancing) existing debt can save money, provide other advantages

Financing authority

Wisconsin Statutes	Debt Instrument
67.01; 67.03	General Obligation Bonds
67.12(12)	General Obligation Notes
67.12(1)(b)	Bond or Note Anticipation Notes
66.0621	Revenue Bonds
66.0621(4)(2)	Revenue Bond Anticipation Notes
67.12(1)(a)	Tax & Revenue Anticipation Notes
66.0713(4)	Special Assessment B Bonds
Subchapter II, Chapter 24	State Trust Fund Loans

General Obligation (G.O.) debt

- General Obligation debt in Chapter 67
- Debt limit = 5% of equalized market value, including TID
- Three types count
  - ✓ Bonds (up to 20 years)
  - ✓ Notes (up to 10 years)
  - ✓ State Trust Fund loans

General Obligation bonds

- Enumerated purposes - defined by statutes
- Term up to 20 years
- Procedural requirements
- Competitive sale requirement

Promissory notes

- Wisconsin Statutes, Chapter 67.12(12)
- Purpose:
  - ✓ "To pay any general & current municipal expense & refund any municipal obligation"
- Wide market
- Ease of Issuance
- Term up to 10 years

State Trust Fund Loan program

- Administered by Wisconsin Board of Commissioners of Public Lands
- Annual principal & interest due each March 15th - level P&I structure
- Good for taxable development projects
- Pre-payable annually between January 1 & August 31

Current Rates

Loan Term	Interest Rates
2 Years	3.25%
3-5 Years	3.25%
6-10 Years	3.25%
11-20 Years	3.75%

Local bank loan

- May issue General Obligation debt to local bank
- See wide differences in interest rates
- Debt structure?
- Fixed interest rates beyond 3-5 years?
- Generally, pre-payable at anytime without penalty

Utility revenue bonds

- Wisconsin Statutes, Chapter 66
- Ability to issue bonds supported by system revenues of municipal utilities
- Most common revenue bonds: water, sanitary sewer, storm sewer & electric
- No debt limit
- Debt coverage at least 1.25 times
- Clean Water Fund Loans can be G.O. or revenue supported

Other financing options

- Special assessment B bonds
  - ✓ Finance any public improvement
  - ✓ Must formally go through the special assessment process
  - ✓ Amount limited to active assessments
  - ✓ Can be economic development tool
- Community Development Authority bonds (CDA)
  - ✓ Complements TID project
  - ✓ Double tax-exempt (Federal & State)
  - ✓ Requires creation of separate government entity

Other financing options

- "Pay-as-You-Go" revenue bond
  - ✓ Usually associated with a TID
  - ✓ Repayment limited to available TID revenues
  - ✓ Limited risk for municipality
- Tax increment revenue bonds
  - ✓ Repayment from expected future increases in tax revenue
  - ✓ Rise in property taxes from newly completed projects in TID

Restraints on borrowing

- Federal tax-exempt regulations
- Other federal regulations
- State regulations
- Initial disclosure obligation
- Continuous disclosure obligation

Federal regulations: Tax-exempt debt

- Private loan financing test
  - ✓ Amount of issue proceeds used for loans to non-gov't borrows EXCEEDS the lesser of:
    - ➢ $5 million OR 5% of the proceeds
- Two pronged private activity (taxable debt issued if both tests met)
  - ✓ Private business use test: >10% of proceeds used for benefit of private entity
  - ✓ Private security of payment test: >10% of related debt service secured by payments from private parties

Other federal regulations

- Arbitrage requirements and yield restriction
  - ✓ Rules governing the ability to earn interest above the bond yield
- Bank qualification (BQ)
  - ✓ BQ debt enjoys lower interest rates
  - ✓ Can issue up to $10 million in calendar year, maintain BQ status
- Reimbursement
  - ✓ May reimburse for expenses incurred generally within last 18 months
  - ✓ Must declare intent to do so within 60 days of incurring expense

State regulations

- Maximum term
  - ✓ General obligation: 20 years (statutorily defined)
  - ✓ Revenue: 40 years (typically market driven)
- Use of proceeds
  - ✓ Notes (term of 10 years or less): any public purpose
  - ✓ Bonds (term longer than 10 years): restricted purposes; if issued for a purpose not specifically enumerated, referendum required
- General obligation debt limit principal cannot exceed 5% of total equalized value

Key players

Issuing debt generally involves the following:

- Municipal Advisor
- Bond Counsel
- Disclosure Counsel
- Purchaser
- Rating Agency
- Paying Agent

Understanding each player's role, interests and compensation can help you issue debt more successfully.

Key player: municipal advisor

- Represents you in dealings with capital markets participants to help you:
  - ✓ Understand financing options
  - ✓ Develop appropriate finance plan and structure
  - ✓ Execute sale or placement of debt
- Owes you fiduciary duty
  - ✓ Places your interests first…at all times
  - ✓ Works exclusively on your behalf

Key Player: bond counsel

- Provides legal opinions to the benefit of issuer and buyer of debt obligations, including:
  - ✓ Legal, valid, binding obligation of issuer (the contract)
  - ✓ Interest on bonds exempt from federal income tax
  - ✓ Opinions related to state and federal securities laws
- Drafts required legal documents
- Assists in transaction closing
- Issuer pays flat fee for services, but counsel's opinions accrue to benefit all parties involved

Key Player: disclosure counsel

- Reviews official statement
  - ✓ material misstatements or omissions
    - ➢ Against publicly available information
    - ➢ Courts / litigation search
    - ➢ Continuing disclosure compliance
    - ➢ Audit, other relevant materials
- Conducts due diligence call
  - ✓ Issuer completes questionnaire
- Assists in building due diligence file

Key Player: purchaser

- Private purchasers may be broker/dealer firm (underwriter) that resells bonds to customers or a bank that holds bonds in its own portfolio
- Underwriter paid by issuer through “underwriter discount”
  - ✓ Typically expressed in dollars per $1,000 of bonds
  - ✓ $100.00 discount on $1,000,000 issue means underwriter pays issuer $990,000 for $1,000,000 face value of bonds

Key Player: rating agency

- Three main agencies assess relative risk of holding a municipality's debt:
  - ✓ Standard & Poor's
  - ✓ Moody's
  - ✓ Fitch (not commonly used in WI)
- Higher rating generally leads to:
  - ✓ More secure investment
  - ✓ Lower interest rates
- Issuer pays flat fee, generally from bond proceeds

Key Player: paying agent

- Facilitates delivery of payments from issuer to bond holders
- Usually a trust company, but can be issuer
- Ehlers provides paying agent services
- Issuer typically pays flat fee from bond proceeds

Process for issuing debt

1. Choose debt instrument
2. Select method of sale
3. Size & structure debt issue
4. Complete required legal actions
5. Secure a credit rating if beneficial
6. Sell bonds/notes
7. Post issuance considerations

General Obligation (G.O) or Revenue debt?

- G.O. debt usually only option for non-revenue generating projects (e.g. streets)
- Revenue generating projects can use G.O. or revenue debt, with several considerations:

TYPE OF DEBT	BENEFITS	DRAWBACKS
G.O.	Lower interest & issuance costs	Debt outstanding limited to 5% of equalized value
Revenue	No statutory limit on debt outstanding	Higher issuance costs More stringent underwriting Potential debt service reserve requirement

Debt options: G.O.

Type	Advantages	Disadvantages
Commercial market	• Lowest interest rates • Fixed rates up to 20 years • Most cost-effective for larger issues	• Highest costs of issuance • More onerous process • Not typically pre-payable for 7-8 years
Bank loan	• Usually pre-payable at any time • Low costs of issuance • Simple process	• Banks often unwilling to offer fixed rates for longer terms. • May not be available for large transactions
State Trust Fund Loan	• Pre-payable between 1/1 and 8/31 each year • Fixed rate for up to 20 years • Simple process • Doesn’t distinguish between taxable and tax-exempt	• Rates often a little higher than bank or commercial market

Debt options: Revenue

Type	Advantages	Disadvantages
Commercial market	• Fixed rates for up to 40 years. • Available for wide range of projects	• Highest costs of issuance • Not typically pre-payable for 7-8 years • Usually requires debt service reserve
Clean Water Fund Loan (sewer) or Safe Drinking Water Loan (water)	• Fixed rates for 20 years • Rates usually below market • No debt service reserve requirement • Sometimes include principal forgiveness component	• Not pre-payable with specific authorization • Only available for sewer, water and stormwater projects. • Timing/ possible interim financing

Debt options: Revenue (continued)

Type	Advantages	Disadvantages
USDA Rural Development	• Fixed rate up to 40 years • Often includes grant component • Pre-payable at any time • Available for wide range of projects	• Higher rates and high interest cost when repaid over 40 years • Forty-year repayment may exceed life of asset • Requires interim financing
State Trust Fund Loan	• Fixed rate up to 20 years • Pre-payable between 1/1 and 8/31 each year • Available for wide range of projects • No debt service reserve requirement	• Higher rates • Payment date (3/15) & senior position requirement presents problems with issuing other types of revenue debt backed by same revenue source

Method of sale

- State, federal loans placed directly
- Two methods for commercial market or bank loan:
  1. Competitive: bids taken on day of sale, best bid selected
  2. Negotiated: purchaser selected ahead of time, terms negotiated over period leading up to sale day

Method of sale (continued)

- Competitive sale is preferred method for “off the shelf” financings
  - New money G.O. bonds must be competitively sold
- Negotiated sale well-suited to more complex financial situations

Types of sale

Competitive Sale

- Open process
- Underwriters compete against each other
- Market understands type of debt offering
- Active secondary market for issuer’s debt
- Debt backed by issuer’s full faith & credit, historically performing revenue source

Negotiated Sale

- Issuer sells bonds to one purchaser. Why?
  - ✓ “Story” bond
  - ✓ Preference of working with local institution
  - ✓ Unusual call feature or structure
- Involve municipal advisor to represent your best interests

Sizing

- Issue should include project costs, costs of issuance and underwriter's discount
- Revenue bonds may also require debt service reserve that is lesser of:
  - ✓ 10% of debt issue
  - ✓ 125% average annual debt service
  - ✓ 100% of highest annual debt service
- Capitalizing interest *(borrowing for future interest payments)* may be beneficial
  - ✓ Common approach when revenue may not be generated for several years (i.e. TID or utility)

Structure

- Two common ways to structure repayment:
  1. Level: equal payments each year
  2. Wrap-around: principal reduced in earlier years to accommodate existing debt payments
- Why structure debt?
  - ✓ Can reduce short-term tax levy impact for G.O. debt
  - ✓ Can reduce utility rate impact for utility projects
  - ✓ Better match revenues to debt service

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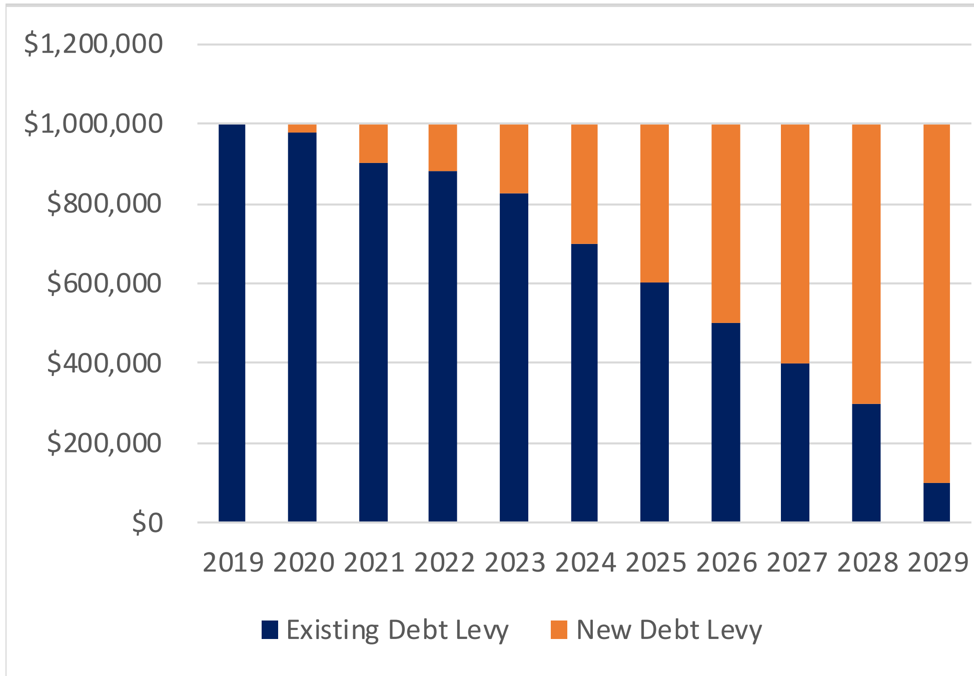
Debt planning: levy impact

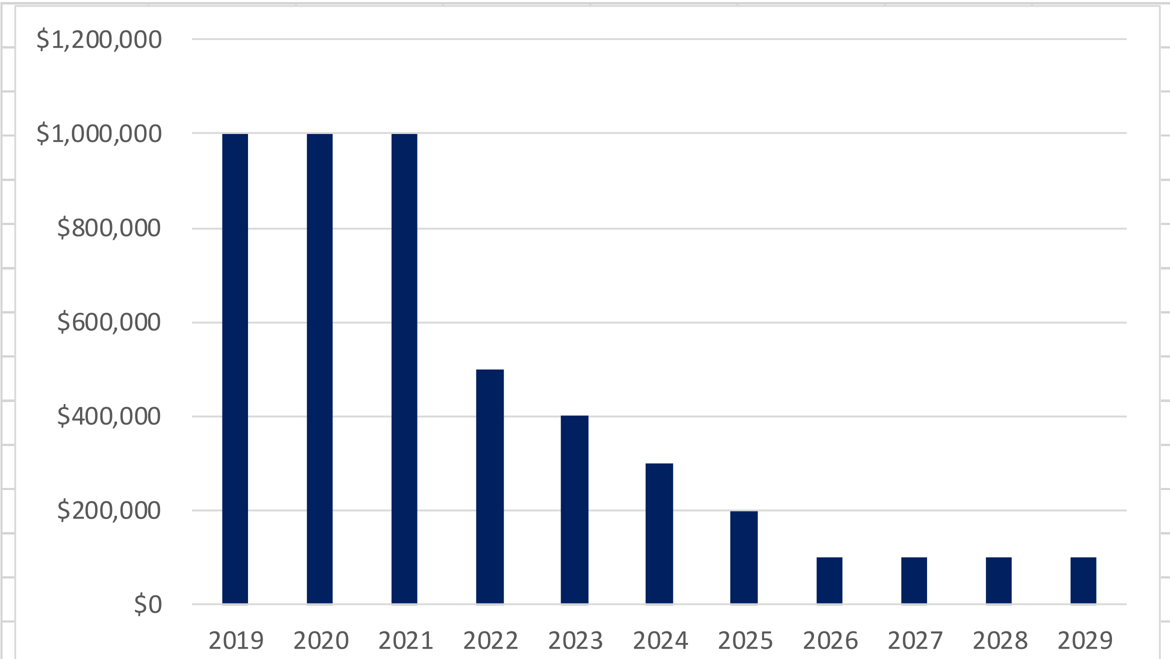
New debt service has net zero impact on levy.



Slide 36

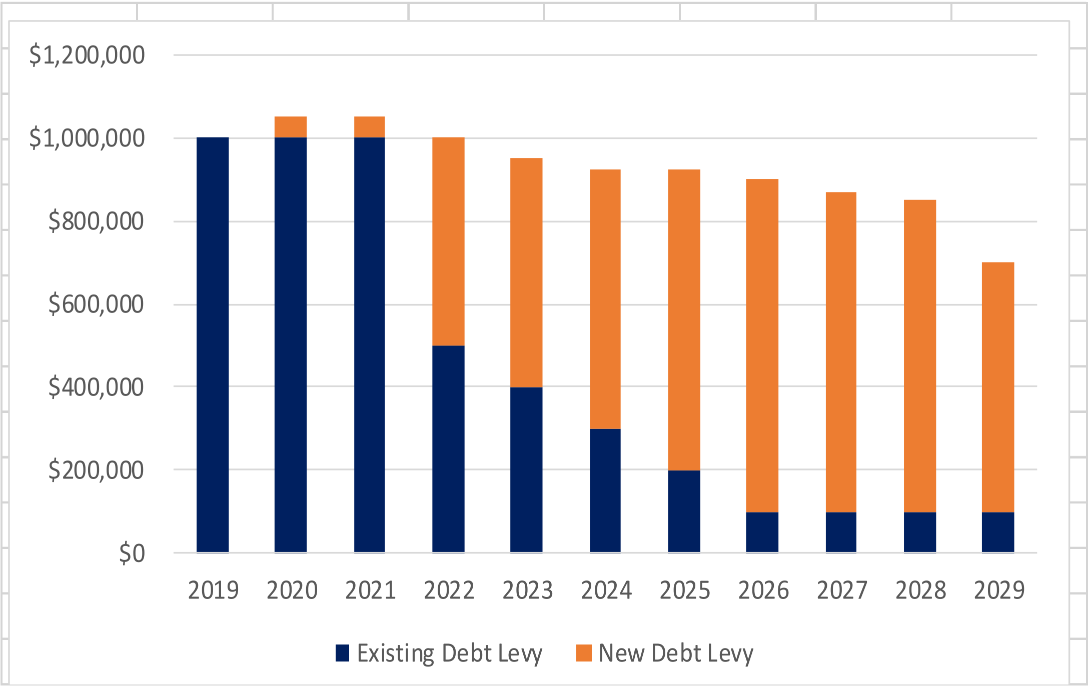
A2 Consider revising this slide to reflect 2020.
Author, 1/16/2020

Debt planning: levy impact



- ✓ Flat levy through 2021 means any near-term project likely to result in levy increase
- ✓ Drop in 2022 is opportunity for significant new borrowing

Debt planning: levy Impact

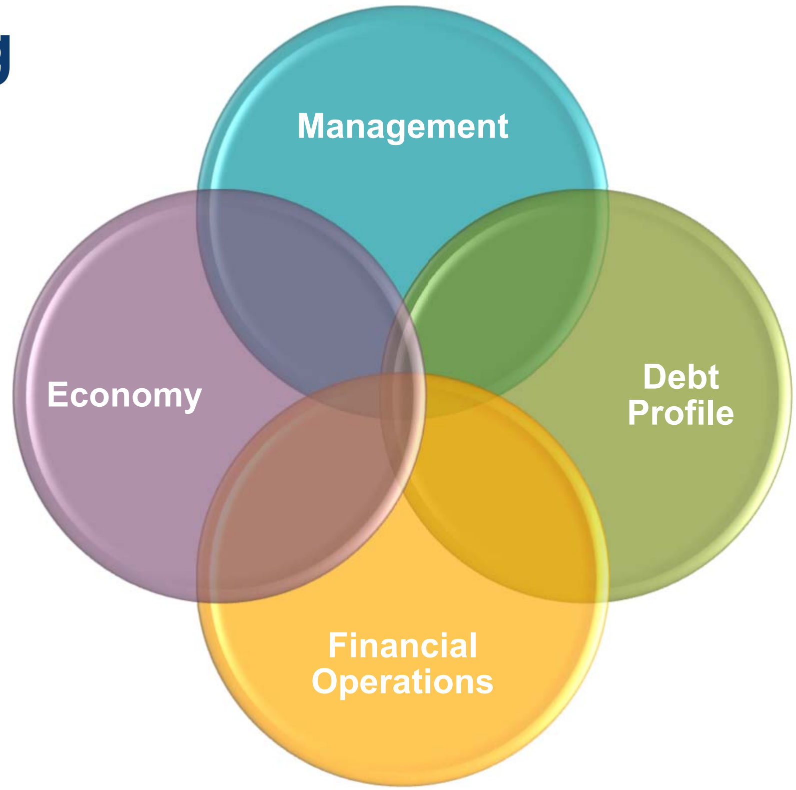


- Small projects from 2020-2021 slightly increase levy
- Large project in 2022 possible without major impact due to drop in debt service

Legal process

- Two steps - different requirements for each type of municipality
    1. Initial resolution
        - May or may not be statutorily required
    2. Sale resolution
        - Formal, authorizing sale result
- Bond counsel assists in preparation of all required resolutions and legal documents

Credit rating



Ratings

	Moody's	S & P	Fitch
Highest	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
Lowest (Investment Grade)	Baa3	BBB-	BBB-

Selling bonds

- Commercial market transaction requires preparation of preliminary Official Statement in advance of sale
- Municipal advisor receives bids *(if competitive)* or final pricing *(if negotiated)* from purchaser
- Adjustments made to best bid
- Bond counsel prepares resolution finalizing:
  - ✓ maturity amounts
  - ✓ interest rates
  - ✓ all other terms to be voted on by governing body on day of sale

Selling bonds

Closing occurs 2-4 weeks later with assistance of bond counsel. ***All terms are set on day of sale.***

Post issuance considerations

- Investment of bond proceeds
- Post-issuance compliance
  - ✓ Arbitrage
  - ✓ Continuing disclosure
- Paying agent
  - ✓ Ensure timely bond payments to DTC
- Surveillance ratings
- Consideration of policies related to future debt issuance and arbitrage compliance

Refunding debt

- **Call date:** date when bonds are pre-payable
- **Current refunding:** any refunding completed within 90 days of call date
  - ✓ May do unlimited tax-exempt current refundings

Tax law changes

- **Municipal tax exempt advanced refundings:** refinancing that takes place >90 days before bonds are callable
  - ✓ No longer available to local governments
- Two methods available to achieve same objective as advanced refundings
  - ✓ Taxable advanced refundings
  - ✓ Forward purchases

Your presenters

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