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**“Financial Management: Bonds and Financing Projects”**

**September 12, 2013**

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**Ability to Borrow**




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- Municipalities generally cannot “sign a note” at a local bank
- Restrictions under State law, which relate to the validity of the borrowing
- Restrictions under Federal law, which relate to “tax exemption” of interest

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**Basic Municipal Borrowing Tools**




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- General Obligation Bonds
- Revenue Bonds
- Lease-Purchase Agreements
- Tax Increment Bonds (TIF)
- Interim Financing
- Special Tax-Based Financing
- Municipal Improvement Districts (MID)

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**Knowing Your Professionals**




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- Bond Counsel: Required to deliver validity opinion for borrowing
- Local Counsel: Know day to day operations; required to deliver an opinion as to underlying documents and litigation
- Trustee: Fiduciary for bondholders (not involved in every transaction)
- Financial Advisor (FA): Evolving role, far more involved in transactions; perform roles that Bond Counsel in South Carolina has traditionally performed. Should have discussions with Counsel or existing FA about role in transactions or on-going operations
- Underwriter: Only for Market-sold deals
- Other Counsel: Represent Trustee, Underwriter, Issuers (i.e. Disclosure or Special Tax matters)

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**General Obligation Issues**



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Full Faith and Credit

- The borrowing is secured by the taxing power of the municipality.
- If taxes are insufficient to pay debt service, the municipality must raise taxes.
- Typically used for brick & mortar or real estate projects
- Generally the project will be a “general benefit” for the residents of the municipality (public purposes – an ever evolving concept)

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## General Obligation Issues

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Bond Counsel Involvement

- General obligation issues require the assistance of bond counsel
  - \* Eight percent of the assessed (not appraised) value of property in the municipality
  - \* Referendum exception
- Ordinance (two readings) at public meetings
- Debt filing (applies to all debt)
- Debt limit certificate

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## General Obligation Issues

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Debt Limit - How to Calculate:

Fiscal Year	Tax Year	Real Property	Personal Property	Total AV*
2013-2014	2013	\$70,000,000	\$30,000,000	\$100,000,000

$\$100,000,000 \times 0.08 = \$8,000,000$  of Debt Limit

If \$5,000,000 in GO Bonds are outstanding, \$3,000,000 of capacity remains

\* Does not include merchant's inventory, motor carrier reimbursement, manufacturer's depreciation or property in a multi-county park

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## General Obligation Issues

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- Unless the debt is (a) less than \$1,500,000 and (b) repayable over ten years or less, it must be sold at a public competitive sale
- Notice of public sale must be published at least seven days prior to the sale date
- For private sales, notice must be published at least seven days prior to the closing date

**\*\*\* Important \*\*\***

- Be sure payments are structured to come due in Spring time (March, April, May) so that taxes can be levied

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## Revenue Issues for Infrastructure

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Types of Revenue Streams

- Typically utility services, including water/sewer systems, solid waste, gas, and electrical
- Recreation fees
- Parking fees
- Other dedicated sources of non-tax revenues

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**Revenue Issues for Infrastructure**

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Secured by Revenue Stream

- A limited pledge
- Bond documents will establish a "waterfall" to control the flow of revenues
- Generally debt service on the bonds will come before O&M expenses (gross pledge) or after (net pledge)

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**Revenue Issues for Infrastructure**

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Coverage Ratios

- Rate Covenant – requires that rates be maintained at a certain level (a multiple of O&M and debt service)
- Additional Bonds Test – requires certain coverage before the issuance of new debt

Additional Debt

- "Parity" bonds enjoy the same lien status as the prior bonds, and must meet the additional bonds test
- Junior lien bonds may be issued at any time
- Special projects, lease/purchase exceptions in bond documents

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**Revenue Issues for Infrastructure**

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Other Considerations

- A feasibility study will be important
- Among other things, the municipality should compare revenues to expenses (including debt service) and thoroughly plan the improvements

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**Lease Purchase Agreements**

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Not a "True" Lease

- Financing institution provides funds and "leases" the assets to the municipality
- Lease payments have principal and interest components
- Assets will pass to municipality free and clear upon conclusion of lease term

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**Lease Purchase Agreements**

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Debt Limit Considerations

- Previously all lease-purchase transactions were exempt from the debt limit
- Statute passed in 1995 disallows debt-limit exemption for real property and fixtures
- Now lease-purchase agreements are used almost exclusively for vehicles, equipment, and rolling stock
- Paid out of Operations; Not considered debt – Now limited by Act 388

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**Lease Purchase Agreements**

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Importance of Appropriate Documentation

- Approving resolution
- Lease Purchase Agreement (non-appropriation, no non-substitution)
- IRS filing, closing certificates
- Retention of bond counsel?

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**Tax Increment Bonds**

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Municipal Redevelopment Tool

- Allows a municipality to foster growth in a "blighted" or "conservation" area
- Upon creation of a TIF District, all taxes from growth in tax base will be available to the municipality for improvements
- Used to redevelop downtown or other depressed areas
- Limited by amendments (other taxing entities and Act 388)

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**Tax Increment Bonds**

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Other Considerations

- May use utility revenues as secondary revenue pledge to support debt
- Recent statute allows counties to form tax increment districts and prohibits municipalities from including tax increment of entities that do not consent
- Use of IGA – recent MASC legislative action

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**Interim Financing**

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- Tax Anticipation Notes (TANS)
- Bond Anticipation Notes (BANS)
- Grant Anticipation Notes
- Interim Financing for Federal Programs


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**Special Tax-Based Financing**

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- Capital Project Sales Tax
- Hospitality and/or Accommodations Taxes
- Lease-Lease Back Transactions

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**Municipal Improvement Districts (MIDs)** 


- Creation process for a MID takes several months
- Assessments on real property which allows development to pay for development
- Assessments can take several different forms which gives flexibility to the municipality in structuring its needs for a particular area
- City is issuer

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**“Bank Loans”** 


- “Hometown” Bank
- Problems:
  - \* Not a recognized structure
  - \* No council action typically taken
  - \* Ignores public notice requirements – generally no ordinance
  - \* No IRS reporting
  - \* No debt filing with State Treasurer

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**Credit Issues: More Important Than Ever Before** 


- Long Term: Fund Balance/Reserves
- Short Term: Cash Flow Ratios
- Leverage Ratio: Net Assets in comparison to Total Liabilities
- Tax Base Changes-Fluctuations in Revenue
- Large Capital Outlays
- Political Issues: Annexation, etc.

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**Transaction Structures** 


- Taxable v. Non-Taxable
- “Bank Qualified” v. “Non-Bank Qualified”
- Private Placement v. Publicly Sold Transaction

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**Borrowing Processes and Roles of Involved Parties** 

- Council-Governing Body
- Finance Director
- Public Sale v. Negotiated
- Role of Financial Institution
- Role of Bond Counsel
- Financial Advisor


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**Additional Legal Considerations** 

- Continuing Disclosure
- FOIA
- Arbitrage and rebate
- Spend down requirements
- Bank-Qualified
- Tax Covenants (Ownership)

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**Tips for a Smoother Borrowing Experience**



- Financial Statements (be timely)
- Define the project: sizing of issue
- Stability in financial administration
- Stability in professionals, including bank and bond counsel
- Pricing is important, but not sole determining factor
- Discussion on front end of expectations – don't agree to things you do not understand

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**Basic Determining Factors**



- Term
- Issue Size/Type
- Flexibility
- Issuance Costs
- Disclosure Issues
- Rate Differentials

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**Terms of Transactions**



- Bank Loans
  - \* Terms Typically from 1-15 years
  - \* Amortization period may be longer, but may involve rate resets or calls
- Underwritten Transactions
  - \* May provide longer term options
  - \* Most Transactions twenty years or longer are underwritings

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**Issue Size and Type**



- Issue size often drives the decision for a shorter or longer term (coverage ratios, etc.)
- Type of issue may also impact the decision:
  - \* Security interest/Pledged revenue stream
  - \* Historical performance

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**Transaction Flexibility**



- Ability to prepay transactions
  - \* Bank Loans provide a high level of flexibility
  - \* Useful especially for dynamic, changing entities
- Investor Call protection

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**Issuance Costs**



- Differential between Bank Loan and Underwritings typically substantial
- Cost/Benefit analysis essential
- Components of Issuance Costs
  - \* Official Statements
  - \* Ratings
  - \* Insurance
  - \* Legal
  - \* Underwriting fees
  - \* Debt Service Reserves

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**Bank Qualification**



- "Small" Issuer: \$10,000,000 or less in calendar year
- Tax treatment by Banks
- Rate Differential: May be important determining factor in decision for underwriting or bank loan


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**Rate Differentials between Underwritings and Bank Loans**



- **Current Bank Loan Rates (G.O. Bonds):**
  - Ten year term: 4.00%-4.20% (bank qualified)  
4.50%-4.65% (non bank qual.)
  - Fifteen yr. term: 4.09%-4.20% (bank qualified)  
4.55%-4.70% (non bank qual.)
- **Current Rates for Underwritten Transactions (G.O. Bonds):**
  - Ten year term: 4.10% (insured)
  - Fifteen year term: 4.28% (insured)
  - Twenty year term: 4.40% (insured)

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**Questions?**

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