

# Bonding & Other Financing Options

2024 Clerk's Institute  
May 10<sup>th</sup>, 2024



**DDA**

David Drown Associates, Inc.

Presented by: Mike Bubany

# Why bother with bonds?

- ▶ State law **requires** a City to borrow money **only** using bonds or notes – Cities have **NO** AUTHORITY to take out a conventional loan at the local bank! (*but you can place bonds at the local bank*)
- ▶ Many bonds feature **tax-exempt** interest benefits -- this lowers the interest rate on borrowing. (typically, by about 0.75% to 1%)
- ▶ Most bonds carry the City's "general obligation pledge" (i.e. full taxing authority backs the bonds). This lowers risk and probably knocks another 1% off of the interest rate.
- ▶ *While the bond process may appear complicated, its mostly common sense and tradition -- you **can** understand it!*

# What is a Bond?

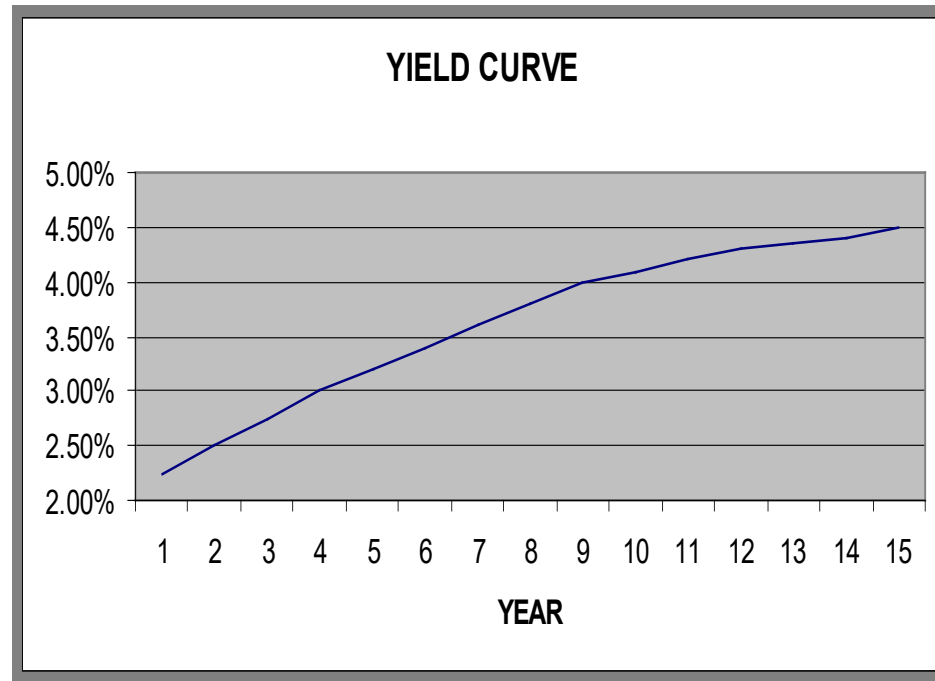
- ▶ A bond is a written promise to repay borrowed money at a ***set future date***, and to pay interest in the meantime. Not amortized like a loan.
- ▶ Typically, there is no formal lien such as a mortgage.
- ▶ Bonds are evidenced by Certificates
  - ▶ With ***Bearer Bonds*** the certificate itself is evidence of ownership and attached “coupons” were cashed-in to collect interest payments.  
***ROB THE TRAIN, HOSS!***
  - ▶ With ***Registered Bonds***, actual ownership records are maintained by a third party. The certificate has no actual value. Likewise, interest is paid automatically to the registered owner.

# Bonds versus Loans

- Bonds can have custom principal structures to help achieve a City's goals, such as wrapping payments around existing debt or to match up with identified revenue streams. Loans are typically structured as level payments without regard to such things.
- While bond issuance is more costly than a commercial loan, due to the "general obligation pledge" and tax-exempt status, bonds are typically charged a lower interest rate.
- When the "general obligation pledge" is provided, there is no collateral (i.e. mortgage or other sort of lien). And due to the strength of that pledge, bonds can finance full project costs whereas loans typically are only at 70% or 80% loan to value.
- Remember, cities can work directly with a bank in a debt issuance, they simply must structure the bonds in accordance with law.

# Serial Bonds

- ▶ Most municipal bonds are structured as *serial bonds*
- ▶ Each principal payment acts as a separate “IOU” issue with a unique interest rate
- ▶ Interest rates are higher as term is longer



# Bond Payment Schedule

Bonds are *really* a lot different than loans.

- ▶ Think of this issue as 10 *separate* little bonds.
- ▶ Each principal payment has *its own* separate interest rate.
- ▶ Interest payments are the *sum* of all little bonds interest payments.
- ▶ Serial bonds *can* be designed to produce increasing or decreasing payments.
- ▶ 30 day month 360 day year convention

## Payment Schedule & Cashflow

12-Month Period ending	Principal	Rate	Interest	Payment Total
2/1/2005				
2/1/2006	45,000	2.25%	16,575	61,575
2/1/2007	45,000	2.50%	15,563	60,563
2/1/2008	45,000	2.75%	14,438	59,438
2/1/2009	45,000	3.00%	13,200	58,200
2/1/2010	50,000	3.20%	11,850	61,850
2/1/2011	50,000	3.40%	10,250	60,250
2/1/2012	50,000	3.60%	8,550	58,550
2/1/2013	55,000	3.80%	6,750	61,750
2/1/2014	55,000	4.00%	4,660	59,660
2/1/2015	60,000	4.10%	2,460	62,460
	<u>500,000</u>		<u>104,295</u>	<u>604,295</u>

# Bond Payment Schedule

Bonds are *really* a lot different than loans.

Payment Schedule & Cashflow				
12-Month Period ending	Principal	Rate	Interest	Payment Total
2/1/2005				
2/1/2006	-	2.25%	2,460	2,460
2/1/2007	-	2.50%	2,460	2,460
2/1/2008	-	2.75%	2,460	2,460
2/1/2009	-	3.00%	2,460	2,460
2/1/2010	-	3.20%	2,460	2,460
2/1/2011	-	3.40%	2,460	2,460
2/1/2012	-	3.60%	2,460	2,460
2/1/2013	-	3.80%	2,460	2,460
2/1/2014	-	4.00%	2,460	2,460
2/1/2015	60,000	4.10%	2,460	62,460
	<u>60,000</u>		<u>24,600</u>	<u>84,600</u>

Payment Schedule & Cashflow				
12-Month Period ending	Principal	Rate	Interest	Payment Total
2/1/2005				
2/1/2006	-	2.25%	4,660	4,660
2/1/2007	-	2.50%	4,660	4,660
2/1/2008	-	2.75%	4,660	4,660
2/1/2009	-	3.00%	4,660	4,660
2/1/2010	-	3.20%	4,660	4,660
2/1/2011	-	3.40%	4,660	4,660
2/1/2012	-	3.60%	4,660	4,660
2/1/2013	-	3.80%	4,660	4,660
2/1/2014	55,000	4.00%	4,660	59,660
2/1/2015	60,000	4.10%	2,460	62,460
	<u>115,000</u>		<u>44,400</u>	<u>159,400</u>

# Bond Details & Structure

## Official Statement

- ▶ **Official Statement** – the document prepared to let potential buyers of the bonds know about your City and what the bonds are financing
  - ▶ Describes the debt and issuer in detail.
  - ▶ Used by investors to evaluate risk and credit-worthiness.
  - ▶ Not always necessary, sometimes an Offering Memorandum is sufficient (typically for smaller deals/ bank placements)



# Bond Details & Structure

## Call Protection

- ▶ **Call Protection** – a promise *not* to pay off bonds ahead of schedule until the *call date*.
  - ▶ Investors prefer *long* call protection so they have certainty in future bond payments.
  - ▶ Cities prefer *short or no* call protection so you can prepay or refund bonds without limitation, such as penalties and/or restricted prepayment dates.
  - ▶ “Normal” call protection is 7 to 8 years.
  - ▶ Make sure to ask, what are the terms?!? **IMPORTANT!!** On any date? Penalties? How much notice?

# Bond Details & Structure

## Call Protection

City of Grand Meadow, Minnesota

\$480,000

General Obligation Tax Increment Finance Bonds, Series 2002A

RBC Dain Rauscher, Inc.

### Uses of Funds

Construction Costs		341,829
Estimated Engineering Fees and Inspection		57,230
Contingency		34,183
Total Project Costs (const'n and engr.)		433,242
Underwriter's Discount Allowance	1.6547%	7,943
Fiscal Fee		13,000
Bond Counsel		5,000
Pay Agent/Registrar		500
Printing & Misc		1,000
Rating Agency Fee		-
Capitalized Interest		44,458
		<u>505,142</u>

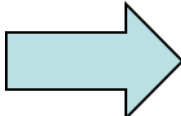
### Sources of Funds

Bond Issue	480,000
Cash Contribution of Phase III (Private Site Improvements)	25,142
Construction Fund Earnings	-
	<u>505,142</u>

### Bond Details

Set Sale Date	8/12/2002
Sale Date	9/9/2002
Dated Date	9/1/2002
Closing Date	9/23/2002
1st Interest Payment	2/1/2003
Proceeds spent by:	12/31/2003
	<i>to Dated Date</i>
Purchase Price	472,057.50
Net Interest Cost	189,893.02
Net Effective Rate	4.1965%
Average Coupon	4.021%
Average Life	9.4271

### Call Option

 **2/1/2010**  
 Purchaser  
 RBC Dain Rauscher, Inc.  
 Bond Counsel  
 Briggs & Morgan, P.A.  
 Pay Agent  
 U.S. Bank, N.A.

# Bond Details & Structure

## Capitalized Interest

### ▶ Capitalized Interest

- ▶ Additional principal added to the bond issue for the purpose of making initial interest payments until identified revenue sources begin to kick in.
- ▶ Principal can be deferred for a maximum of 3 years on General Obligation bonds (with exceptions – you can “blend” GO debt to soften this rule).

# Bond Details & Structure

## Capitalized Interest

### Payment Schedule & Cashflow

<i>Payment Schedule</i>						<i>Revenues</i>		<i>Account Balances</i>	
12-Month Period ending	Principal	Rate	Interest	Payment Total	TOTAL PLUS 5%	Tax Increments	Tax Levies*	Surplus (deficit)	Account Balance
9/1/2002	-	0.00%	-	-	-				
2/1/2003	-	0.00%	7,701	7,701	<b>7,701</b>	-	-	(7,701)	37,887
2/1/2004	-	0.00%	18,481	18,481	<b>18,481</b>	-	-	(18,481)	19,405
2/1/2005	-	0.00%	18,481	18,481	<b>19,405</b>	6,515	-	(12,890)	6,515
2/1/2006	30,000	3.000%	18,481	48,481	<b>50,905</b>	24,756	37,876	(6,515)	-
2/1/2007	35,000	3.125%	17,581	52,581	<b>55,210</b>	41,959	30,454	-	-
2/1/2008	35,000	3.250%	16,488	51,488	<b>54,062</b>	41,959	12,103	-	-
2/1/2009	35,000	3.500%	15,350	50,350	<b>52,868</b>	41,959	10,909	-	-
2/1/2010	35,000	3.625%	14,125	49,125	<b>51,581</b>	41,959	9,623	-	-
2/1/2011	40,000	3.750%	12,856	52,856	<b>55,499</b>	41,959	13,540	-	-
2/1/2012	40,000	3.875%	11,356	51,356	<b>53,924</b>	41,959	11,965	-	-
2/1/2013	40,000	4.000%	9,806	49,806	<b>52,297</b>	41,959	10,338	-	-
2/1/2014	45,000	4.125%	8,206	53,206	<b>55,867</b>	41,959	13,908	-	-
2/1/2015	45,000	4.250%	6,350	51,350	<b>53,918</b>	41,959	11,959	-	-
2/1/2016	50,000	4.375%	4,438	54,438	<b>57,159</b>	41,959	15,201	-	-
2/1/2017	50,000	4.500%	2,250	52,250	<b>54,863</b>	41,959	12,904	-	-
	480,000		181,951	661,951	<b>693,739</b>	492,816	190,779	(45,587)	

**Capitalized Interest & Accrued Interest >> 45,587**

# Bond Details & Structure

## Net Effective Interest Rate

### ▶ Net Effective Interest Rate (NEI)

- ▶ Is a calculation of total interest paid and the underwriter's discount.
- ▶ Sometimes referred to as Net Interest Cost (NIC)
- ▶ Higher discount = higher NEI
- ▶ Longer term = higher NEI
- ▶ "Back-ending" principal = higher NEI

### ▶ Competitive sales award based on lowest NEI (or NIC)

# Bond Details & Structure

## Net Effective Interest Rate

**\$7,943.00** ←

**Underwriter's Discount Allowance 1.6547%**      **Net Effective Rate 4.1965%**

Payment Schedule & Cashflow						Revenues		Account Balances	
<i>Payment Schedule</i>						Tax	Tax	Surplus	Account
12-Month	Principal	Rate	Interest	Payment	TOTAL	Increments	Levies*	(deficit)	Balance
Period ending				Total	PLUS 5%				
9/1/2002	-	0.00%	-	-	-	-	-	-	45,587
2/1/2003	-	0.00%	7,701	7,701	7,701	-	-	(7,701)	37,887
2/1/2004	-	0.00%	18,481	18,481	18,481	-	-	(18,481)	19,405
2/1/2005	-	0.00%	18,481	18,481	19,405	6,515	-	(12,890)	6,515
2/1/2006	30,000	3.000%	18,481	48,481	50,905	24,756	37,876	(6,515)	-
2/1/2007	35,000	3.125%	17,581	52,581	55,210	41,959	30,454	-	-
2/1/2008	35,000	3.250%	16,488	51,488	54,062	41,959	12,103	-	-
2/1/2009	35,000	3.500%	15,350	50,350	52,868	41,959	10,909	-	-
2/1/2010	35,000	3.625%	14,125	49,125	51,581	41,959	9,623	-	-
2/1/2011	40,000	3.750%	12,856	52,856	55,409	41,959	13,540	-	-
2/1/2012	40,000	3.875%	11,356	51,356	53,924	41,959	11,965	-	-
2/1/2013	40,000	4.000%	9,806	49,806	52,297	41,959	10,338	-	-
2/1/2014	45,000	4.125%	8,206	53,206	55,867	41,959	13,908	-	-
2/1/2015	45,000	4.250%	6,350	51,350	53,918	41,959	11,959	-	-
2/1/2016	50,000	4.375%	4,438	54,438	57,159	41,959	15,201	-	-
2/1/2017	50,000	4.500%	2,250	52,250	54,863	41,959	12,904	-	-
	<b>480,000</b>		<b>181,951</b>	661,951	<b>693,739</b>	492,816	190,779	(45,587)	

# Bond Details & Structure

## Design Issues

- ▶ **Principal Payment Structure (GO)**
  - ▶ 3 year deferral limitation
  - ▶ Largest principal payment may not exceed smallest by more than five times
  - ▶ Both of these rules can be ***softened*** by “combining” new debt with existing debt
  - ▶ Each maturity is to be in increments of \$1,000, but industry standard is \$5,000 for conventional open market sales

# Bond Details & Structure

## Design Issues

### ▶ Revenue Streams

- ▶ Payments should be designed to coincide with designated revenue streams.
- ▶ Tax levies, tax increments, tax abatements, and special assessments are collected semi-annually.
- ▶ Utility user fees are collected usually monthly, sometimes quarterly.
- ▶ SAC/WAC, connection fees collected erratically with development.



# General Obligation Bonds

- ▶ General Obligation means that the bonds are guaranteed by the **full, faith and credit** power of the City.
- ▶ G.O. Bonds are not necessarily paid with taxes (G.O. Revs) but...
- ▶ If pledged revenues fail, the City **must levy taxes** to cover bond payments (*if the City refuses, the County Auditor will levy them*)
- ▶ G.O. bonds are very secure – generally very easy to sell at low interest rates.

# “Pure” Revenue Bonds

- ▶ Revenue bonds are paid with a ***specific source of revenue***
- ▶ The full faith and credit of the issuer is ***NOT pledged*** to guarantee bond payments. Revenue bonds can (and do) default.
- ▶ Revenue bonds are often harder to sell, and have ***higher*** costs and interest rates.
- ▶ When there is a recorded lien (rare) it is typically with these types of bonds....

# Bond Issuance Process

## ▶ Competitive Sale

- ▶ Solicit bids for the purchase of a City's bonds, and award to the lowest cost bidder (NEI or NIC).
- ▶ Let market competition select the underwriter to work with.

## ▶ Negotiated Sale

- ▶ First, select a bank or underwriter to work with
- ▶ Then negotiate the terms and rates for the issue.
- ▶ **New regulations make direct bank placements more difficult.....but not impossible!**

# Issuance Process: **Competitive Sale**

- ▶ Competitive sales work best when:
  - ▶ General Obligation issues (easy for bidders to quickly understand)
  - ▶ Rated issues
  - ▶ Issue size is fairly large
  - ▶ Time is not critical
- ▶ Most larger city bonds are sold through competitive sale.
- ▶ You are confident of getting the lowest cost financing.

## Issuance Process:

# Competitive Sale Process

- ▶ Select financial advisor and bond counsel.
- ▶ Design the bond issue.
  - ▶ Statutory authority, term, payments, call, revenue sources
- ▶ Pass resolution setting date to receive bids
- ▶ Prepare and distribute an ***Official Statement***
- ▶ Apply for Moody's or S&P rating (optional)
- ▶ Receive bids and pass resolution awarding to low bidder.
- ▶ Close and wire funds

Process usually takes about **1.5 to 2 months**

# Issuance Process: Competitive Sale Process

## Bond Details

Set Sale Date	8/12/2002
Sale Date	9/9/2002
Dated Date	9/1/2002
Closing Date	9/23/2002
1st Interest Payment	2/1/2003
Proceeds spent by:	12/31/2003
	<i>to Dated Date</i>
Purchase Price	472,057.50
Net Interest Cost	189,893.02
Net Effective Rate	4.1965%
Average Coupon	4.021%
Average Life	9.4271
Call Option	2/1/2010

Purchaser  
Bond Counsel  
Pay Agent

RBC Dain Rauscher, Inc.  
Briggs & Morgan, P.A.  
U.S. Bank, N.A.

## Issuance Process:

# Negotiated/Local Placement Sale Process

- ▶ Negotiated sales work best when:
  - ▶ Bond issue is complicated or involves risk
    - ▶ certain Revenue Bonds
    - ▶ IDBs, Lease deals
  - ▶ Very *small* issues -- need to **control** issuance **costs** (i.e. Offering Memorandum vs. Official Statement, no Underwriter typically).
  - ▶ Very **LARGE** issues -- need to work closely with the underwriters to find enough buyers.
  - ▶ You want to **control** who buys the bonds and where they are sold.
  - ▶ Timing is critical -- some **refundings**

## Issuance Process:

# Negotiated/Local Placement Sale Process

- ▶ Select a banker or underwriter.
  - ▶ Interview process to select banker
  - ▶ Work with local banks to “keep business in town.”
    - ▶ *AGAIN, new rules make this more difficult*
- ▶ Design the bond issue
- ▶ Negotiate final rates and terms
- ▶ Pass resolution and close

Process usually takes about 2 to 6 weeks



# Issuance Process:

## Other Items

- ▶ Bonds are governed by many different statutes. I call them “pockets” of authority (described later).
- ▶ Some General Rules:
  - ▶ Bonds payable **solely** from property taxes cannot exceed 3% of the estimated market value of a City - ***the statutory net debt limit***
  - ▶ Most bonds paid primarily by property taxes are usually subject to referendum vote or reverse referendum criteria.
  - ▶ Bonds over \$1.2 million must be sold **competitively**, unless the city is represented by independent financial advisor.

## Issuance Process: **Other Items**

- ▶ **General Obligation** bonds must have revenue sources sufficient to cover 105% of actual payments, and in a very few cases the coverage must be 110%.
- ▶ Bonds can be ***tax-exempt*** if:
  - ▶ Project is ***City owned*** and operated – streets, water systems, parks, etc; ***or***
  - ▶ If project privately owned, City must have sole responsibility for bond payments -- ***no developer guarantees.***
  - ▶ Tax exempt status equates to an interest rate approximately 1% lower than a taxable deal.

## Issuance Process: **Other Items**

- ▶ **Arbitrage** -- investing bond money at a higher rate than the bonds.
  - ▶ ***Generally Not Legal.***
  - ▶ Fed limits yield on bond funds.
  - ▶ Proceeds must be spent by a certain time frame.
  - ▶ Can't reimburse prior cash purchases with tax-exempt bonds unless you ***declare beforehand*** via a Reimbursement Resolution.

# Continuing Disclosure: What is it?

- ▶ SEC Rule 15c2-12
- ▶ An agreement to provide financial and/or operating information on the City for the life of the bonds
- ▶ All bonds are subject to either Limited or Full Continuing Disclosure (CD) (*with very few exceptions*)
  - ▶ **Full Disclosure** – Contains financial and operating information on the City (similar to an Official Statement); filed annually according to the CD Undertaking/Agreement
  - ▶ **Limited Disclosure** – Typically, an Agreement to file a copy of the City audit annually according to the CD Undertaking/Agreement

# Continuing Disclosure: Significant Events

- ▶ 16 events that can happen during the life of a bond issue
- ▶ **MUST** be reported within 10 days of their occurrence for *both* Full and Limited CD
- ▶ Most common are:
  - ▶ Rating Changes
  - ▶ Bond calls/refinancings
  - ▶ Late payments
  - ▶ Borrowing from debt service reserve

# Continuing Disclosure: Significant Events

- ▶ For Bonds closing on or after February 27, 2019 must also report:
  - ▶ The issuance of ANY new debt...including PFA loans, equipment lease purchases, USDA RD deals. Any issuance that requires the City to make payments
  - ▶ Any financial activity that may reflect financial difficulties of the City

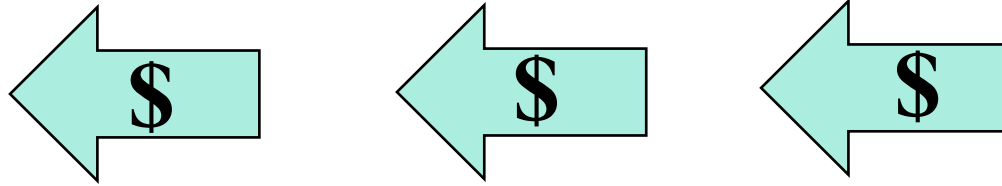
**If in doubt – always call your Municipal Advisor  
to ask the question!**

# The Bond Industry

Matching Investors with Borrowers...



Issuers



Investors

## Industry Participants

- ▶ Investors
- ▶ Underwriters
- ▶ Municipal Advisors
- ▶ Bond Attorneys
- ▶ Rating Agencies
- ▶ Pay Agents/ Registrars

# Industry Participants: Investors

- ▶ Investors like Municipal Bonds
  - ▶ Low risk
  - ▶ Tax Exemption -- no tax on interest earnings
- ▶ **Individuals** buy over half of all muni bonds
- ▶ **Institutions** are also big buyers
  - ▶ Mutual funds, insurance companies – tend to buy “investment quality” rated debt.
  - ▶ Commercial banks often buy **unrated** bonds
- ▶ Most investors buy bonds through an intermediary brokerage firm (underwriter).



Industry Participants:

## **Underwriter** (*Investment Banker*)

- ▶ Underwriters are the “wholesale buyers” of the bond industry.
  - ▶ They bid or negotiate to buy bonds in ***bulk***
  - ▶ Their brokers then ***resell*** them to their customers.

## Industry Participants:

# Underwriter (*Investment Banker*)

- ▶ Underwriters are able to receive compensation through two sources.

## Source 1 – Underwriter's Discount

- ▶ Underwriters are paid from the Discount or "*spread*";
  - ▶ They buy from issuers at a discount -- the *underwriters discount* is typically 1/2 to 2% of the issue.
  - ▶ They resell bonds to customers at a price that is sometimes at *par* (face amount of bonds.); or

# Industry Participants:

## Underwriter *(Investment Banker)*

City of St. Peter, Minnesota

\$805,000

General Obligation Water & Sewer Revenue Bonds, Series 2004C

**Miller Johnson Steichen Kinnard**

### Uses of Funds

Construction & Engineering - Sanitary	121,975
Construction & Engineering - Water	362,115
Construction & Engineering - Storm	285,330
Contingency	8,000
<b>Total Project Costs (const'n and engr.)</b>	<b>777,420</b>
<b>Underwriter's Discount Allowance</b> 1.50%	<b>12,075</b>
Fiscal Fee	8,000
Bond Counsel	4,000
Pay Agent/Registrar	350
Printing & Misc	1,000
Rating Agency Fee	3,500
Capitalized Interest	-
	<b>806,345</b>

### Sources of Funds

Bond Issue	805,000
Cash (City Utility Funds)	-
Construction Fund Earnings (Excess Proceeds)	1,345
	<b>806,345</b>

### Bond Details

Set Sale Date	9/27/2004
Sale Date	10/25/2004
Dated Date	11/1/2004
Closing Date	11/10/2004
1st Interest Payment	2/1/2005
Proceeds spent by:	12/31/2005
	<i>to Dated Date</i>
Purchase Price	792,925.00
Net Interest Cost	164,281.25
Net Effective Rate	3.7411%
Average Coupon	3.466%
Average Life	5.4550
Call Option	2/1/2011

### Purchaser

Bond Counsel  
Pay Agent

**Miller Johnson Steichen Kinnard**

Briggs & Morgan, P.A.  
U.S. Bank N.A., St. Paul, MN

Industry Participants:

# **Underwriter** (*Investment Banker*)

## **Source 2 – Reoffering Price – Selling at a Premium**

- ▶ The reoffering price is a second source of income for underwriters that most people are not aware of. Often times it will be listed at the bottom of a sales results tabulation.
- ▶ Particularly in a negotiated sale, it is the reoffering price that can generate a significant amount of revenue for the underwriter.

## Industry Participants:

# Underwriter (*Investment Banker*)

- ▶ Underwriters usually resell bonds to investors for a price near *par* (face amount); however, they are able to reoffer the bonds to an investor at premium.
- ▶ This sales premium can serve as a significant second source of income for the underwriter.

Industry Participants:

## **Underwriter** (*Investment Banker*)

- ▶ Underwriters **do not work for you** - **they** they want higher rates and low prices - you want the opposite.
- ▶ A competitive sales process is the best way to ensure that every one is charging a fair price, and the City is receiving the lowest overall cost of borrowing.

## Industry Participants:

# Underwriter (*Investment Banker*)

- ▶ **Syndicates** – are used when bond issues are too large for one firm to handle alone.
  - ▶ One firm “runs the books” – others just sell bonds
  - ▶ Local banks often participate in syndicates to secure a portion of a bond issue.
  - ▶ Syndicates are often *issuer-specific* – the same firms bid together each time a certain issuer goes to market.
  - ▶ Issuers typically don’t get involved in syndication, except to ensure a local bank/underwriter gets some of the bonds.

# Industry Participants: the Municipal Advisor

- ▶ The *Issuer's* finance expert and advisor.
- ▶ Must be licensed with SEC.
- ▶ They represent YOU. Now LEGALLY REQUIRED to represent your best interests over their own. They owe their clients a duty of loyalty and care.
- ▶ Job duties include:
  - ▶ Help develop a **strategy** for project financing
  - ▶ **Design** the **details** of the bond issue – amount, term, payment requirements, revenue sources, etc.
  - ▶ Prepare the Official Statement



# Industry Participants: the Municipal Advisor

## Job Duties *(continued)*

- ▶ Negotiate price and rate, or administer the competitive bidding process.
- ▶ Make an award recommendation
- ▶ Coordinate closing and transfer of funds
- ▶ Assist after the sale with accounting, arbitrage compliance, etc.

# Industry Participants: the Municipal Advisor

City of St. Peter, Minnesota

\$805,000

General Obligation Water & Sewer Revenue Bonds, Series 2004C

## Uses of Funds

Construction & Engineering - Sanitary		121,975
Construction & Engineering - Water		362,115
Construction & Engineering - Storm		285,330
Contingency		8,000
<b>Total Project Costs (const'n and engr.)</b>		<b>777,420</b>
Underwriter's Discount Allowance	1.50%	12,075
<b>Fiscal Fee</b>		<b>8,000</b>
Bond Counsel		4,000
Pay Agent/Registrar		350
<b>Printing &amp; Misc</b>		<b>1,000</b>
Rating Agency Fee		3,500
Capitalized Interest		-
		<u>806,345</u>

## Sources of Funds

Bond Issue		805,000
Cash (City Utility Funds)		-
Construction Fund Earnings (Excess Proceeds)		1,345
		<u>806,345</u>

Miller Johnson Steichen Kinnard

## Bond Details

Set Sale Date	9/27/2004
Sale Date	10/25/2004
Dated Date	11/1/2004
Closing Date	11/10/2004
1st Interest Payment	2/1/2005
Proceeds spent by:	12/31/2005
	<i>to Dated Date</i>
Purchase Price	792,925.00
Net Interest Cost	164,281.25
Net Effective Rate	3.7411%
Average Coupon	3.466%
Average Life	5.4550
Call Option	2/1/2011

Purchaser	Miller Johnson Steichen Kinnard
Bond Counsel	Briggs & Morgan, P.A.
Pay Agent	U.S. Bank N.A., St. Paul, MN

# Municipal Advisors are your Financial “Engineer”

## *Engineers do...*

- ❑ Feasibility Studies
- ❑ Street/Utility Design
- ❑ Plans and Specs
- ❑ Advertise for Bids
- ❑ Tabulate sealed bids
- ❑ Award to lowest qualified bidder

## *Municipal advisors do...*

- ❑ Plan of Finance / CIP
- ❑ Bond Issue Design
- ❑ Official Statement
- ❑ Solicit Bids
- ❑ Tabulate sealed bids
- ❑ Award to lowest qualified bidder

# What to look for in a good Municipal Advisor

- ▶ Commitment to long-term financial strength
  - ▶ Long term vs. transaction orientation.
  - ▶ Capital financial planning.
  - ▶ Goal to preserve financial strength.
- ▶ Willingness to help you avoid and control the issuance of new debt.
- ▶ Willingness to tailor the process to your needs.
  - ▶ Negotiated sales & competitive sales as appropriate.
  - ▶ Use of non-market debt (Rural Development, PFA, etc.) despite the fact those deals typically don't involve fees for the advisor

## Industry Participants:

# the Bond Attorney *(Bond Counsel)*

- ▶ Specialist attorneys – perhaps a dozen firms in Minnesota recognized as experts
- ▶ Bond attorneys duties are to:
  - ▶ Interpret federal, state, local (city charter) and ***securities laws*** and make sure the City complies with them.
  - ▶ Prepare bond documents, resolutions, agreements and other related legal documents.

Industry Participants:

# the Bond Attorney *(continued)*

and perhaps most importantly....

- ▶ Issue a written *legal opinion*
  - ▶ certifies a City has the *authority* to issue the bonds
  - ▶ certifies that interest on the bonds will be *exempt* from federal and/or state taxation.

# Industry Participants:

## the Bond Attorney *(continued)*

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Purchaser  
**Bond Counsel**  
 Pay Agent

Miller Johnson Steichen Kinnard  
**Briggs & Morgan, P.A.**  
 U.S. Bank N.A., St. Paul, MN

# Industry Participants: the Ratings Agencies

- ▶ Major agencies are Moody's, S & P and Fitch
- ▶ What they do:
  - ▶ For a **fee**, rating agencies will issue a “credit rating” for a specific bond issue.
    - ▶ AAA, AA, A, Baa (investment quality)
    - ▶ Ba and lower (non-investment quality)
  - ▶ Ratings give investors an ***independent opinion*** about risk and credit quality.



# What is a credit rating worth?

- ▶ Depending on market conditions – one grade means 5 to 10 basis points. Rated vs Non-Rated could mean 75 bp or more!
- ▶ So, the difference between an A and an A+ rating for instance doesn't equate to HUGE dollars, it is more valuable to Council members politically....looks good in the newspaper dont'cha know?
- ▶ Depending on the rating, a long term \$1 million bond issue, a \$13,500 rating could save an issuer up to several times that amount in interest paid over the life of the deal.

Industry Participants:

# the Pay Agent/Registrar

- ▶ Bonds of an issue may be owned by *dozens of investors* scattered throughout Minnesota.
- ▶ Pay Agent/Registrars make your job easier in future years by:
  - ▶ Keeping the official “register” of bond owners – update when bonds trade owners
  - ▶ Sending reminders to City about upcoming payments
  - ▶ Receiving City payments and distributing them in the right amounts to the investors.

# Your Auditor

- ▶ Bond documents generally require the City to account for bond issues in a specific way.
- ▶ Usually, several separate funds and accounts are required:
  - ▶ Construction Account – a short-term capital project account used to make project payments.
  - ▶ Debt Service Account – a long-term account to make bond payments and account for revenues pledged to bond payments.

# Bonds are heavily regulated...

- ▶ **General rules** found in M.S. Chapter 475 govern all types of bond issues.
- ▶ **Special rules** are scattered throughout State Statutes – each has unique requirements and exceptions to general rules.
- ▶ When bonds are issued, a specific statute is cited as the “**Authority**” for the bonds.
- ▶ Challenge is to match each project’s needs with the proper Authority.

# General G.O. Bond Rules

- ▶ **Statutory Net Debt Limit** – Bonds payable *solely* from property taxes cannot exceed 3.0% of the estimated market value of a jurisdiction.
- ▶ **Competitive Sales** – required for GO Bonds over \$1.2 million, *unless* the jurisdiction is represented by *independent* financial advisor.
- ▶ **3-year Rule** – requires some principal payment within 3 years
- ▶ **5 times Rule** – max and min. principal payments cannot differ by more than 5 times
- ▶ **105% Coverage** – pledged revenues must exceed bond payments by 5%.

- ▶ Minnesota law ***allows*** almost all bonds to carry a ***G.O. pledge***, even when paid from non-tax sources.
- ▶ Common revenue bonds (non GO):
  - ▶ Electric Revenue Bonds – by law, no GO
  - ▶ Natural Gas Utility Bonds – can only have GO with voter approval, otherwise revenue only
  - ▶ Tax Increment Revenue Bonds – can have a GO pledge, but exposes City to financial risk they need to be aware of

# Bond Authorities

Different Statutes work best for certain projects...

## Sample Authority Matrix

Chapter:	412.301	475	115	444	429	469
	Equipment Certificates	"Pure GO" CIP & Street Reconstruction	Disposal Bonds	Utility Rev Bonds	Special Assmt Bonds	TIF Bonds
Buildings		X				
Equipment	X					
Wastewater			X	X	X	
Water				X	X	
Solid Waste			X			
Drainage				X	X	
Streets & Walks		X			X	
Parks		X			X	
Econ. Developmt						X

# Tax Anticipation Certificates

## Cashflow Borrowing

Authority: ▶ Chapter 412.261

Typical Projects: ▶ Cash flow

- Special rules or limits:
- ▶ Amount limited to uncollected tax levies
  - ▶ Mature by April of following year
  - ▶ Must be sold at par – max interest rate of 7.0%
  - ▶ Not subject to referendum vote



# Equipment Certificates

Authority: ▶ Chapter 412.301

Typical Projects: ▶ Fire trucks, snow plows, computers, etc.

- Special rules or limits:
- ▶ If amount exceeds 0.25% of estimated taxable market value of jurisdiction they are subject to reverse referendum (*petition signed by 10% of voters requires referendum*)
  - ▶ Debt counts against 3% of net debt limit
  - ▶ Maximum term is 20 years

# “Pure” GO – paid entirely from property tax

Authority: ▶ Chapter 475

Typical Projects: ▶ City halls, fire stations, parks, community centers

Special rules or limits: ▶ Must be authorized by jurisdiction-wide *referendum vote* prior to issuance.

▶ Amount counts against 3% statutory net debt limit

▶ **exception:** fire stations when township services payments are pledged to bond payments so not 100% tax funded

# Capital Improvement Plan Bonds

*One alternative to referendum vote*

Authority: ▶ Chapter 475.571

Typical Projects: ▶ City halls, libraries, public safety, public works  
▶ *Not* community centers or other admin. buildings

Special rules or limits: ▶ Must first adopt 5-year capital plan after a public hearing  
▶ Levy can't exceed 0.16% of City estimated taxable market value  
▶ 3/5<sup>th</sup> vote required to issue bonds  
▶ Subject to net debt limit if over 2,500 population

# Lease Purchase Deals

*One alternative to referendum vote*

- ▶ Often used when referendum vote or 3% debt limit is a problem.
- ▶ Typical Structure:
  - ▶ EDA issues a **revenue** bond (not subject to G.O rules)
  - ▶ EDA signs an **annual appropriation lease** with City -- uses lease payments to cover bond payments.
  - ▶ City **must** be able to cancel lease in any year.
- ▶ Works best for **essential-purpose** structures where City unlikely to cancel the lease.
- ▶ Interest usually w/in .25% to .5% of G.O. rates

# G.O. Improvement Bonds

*Paid using Special Assessments*

Authority: ▶ Chapter 429

Typical Projects: ▶ Streets/walkways, sewer and water projects, drainage and other

Special rules or limits:

- ▶ City must assess **at least 20%** of project costs.
- ▶ **Any other** source of revenue can be used to cover remaining costs.
- ▶ Can **combine** projects (*including some with no assessments*) as long as you declare intentions at a public hearing and **overall** you meet the 20%.
- ▶ **Not** subject to referendum or net debt.

# PIR Fund Bonds

## *A better version of Improvement Bonds?*

- ▶ Improvement bonds **pledge all** assessments to the underlying bond issue
  - ▶ Prepaid assessments in the bond fund can **only** be used to retire the underlying bonds.
- ▶ PIR Bonds are **better** because;
  - ▶ **don't** tie up assessments -- prepaid assessments can be used to fund new projects.
  - ▶ Arbitrage issues...
  - ▶ can help reduce size of future bond issues.
  - ▶ Can help control reinvestment losses.
- ▶ **Warning:** PIR Bonds need **careful management** to avoid surprises. Best for VERY ACTIVE borrowers

# Street Reconstruction Bonds

## *Avoiding Special Assessments*

Authority: ▶ Chapter 475.58

Typical Projects: ▶ Street reconstructions & utility replacement (NOT widening or new curbs)

▶ May add blacktop where none previously existed

Special rules or limits: ▶ Total flexibility in choosing revenue sources for debt payments:

- ▶ Sewer Rates & charges
- ▶ Assessments
- ▶ Even 100% property taxes

▶ Not subject to net debt or referendum

# G.O. TIF Bonds

Authority: ▶ Chapter 469

Typical Projects: ▶ Development subsidies  
▶ Related public improvements

Special rules or limits: ▶ Tax Increments must fund at least **20%** of principal payments any source for balance  
▶ Bonds and expenditures must be authorized in a TIF Plan.  
▶ Not subject to net debt or referendum.



# Essential Function Bonds

## *Corporate Purpose Bonds*

Authority: ▶ Chapter 469.034

Typical Projects: ▶ Low income housing  
▶ Elderly housing

Special rules or limits: ▶ Can carry G.O Pledge if:

- ▶ Project revenues projected to cover 110% of bond payments
- ▶ Project used for low income housing
- ▶ Project used for elderly housing (no income limits)

▶ City-owned and operated.

▶ Projects subject to payment in lieu of taxes.

# A few others.....

- ▶ Tax Abatement Bonds

- ▶ Tax abatements must cover 100% of principal

- ▶ Storm Sewer District Bonds

- ▶ 100% tax levies for storm sewer projects

# Just a Few Other Financing Sources *(sales methods)...*

## ▶ Public Facilities Authority (20 yr)

**Wastewater Infrastructure Fund**: provides grants and below market loans for meeting a community's existing wastewater needs. Not eligible for projects due to future growth. Can be used in conjunction with Rural Development programs. Payments can be deferred until Rural Development obligations are met.

**Drinking Water Revolving Fund**: provides below market loans for water storage, treatment and distribution systems. Typically 20 year maximum term, cannot be for growth. Must make Priority Listing and be within Fundable Range.

for more information: 1-800-657-3858

# Just a Few Other Financing Sources *(sales methods)...*

## ▶ USDA (up to 40 yrs — **REQUIRES CONST. FINANCING!**)

**Rural Utilities**: This program provides much-needed infrastructure improvements to rural communities. These include water and waste treatment, electric power and telecommunications services.

**Community Facilities**: This program provides affordable funding to develop essential community facilities in rural areas. Often used for “ineligible” costs when accessing the Rural Utilities loans.

# Just a Few Other Financing Sources *(sales methods)...*

## ▶ MN Rural Water Association - Micro & Midi Loans

1. Easy, risk free, open ended application process
2. Low issuance costs
3. Very quick turnaround times
4. Flexible repayment terms
5. “Rated-like” payments without a rating

**DISCLOSURE:** *David Drown Associates serves as financial advisor to MN Rural Water Association and I am the advisor tasked with processing loan requests.*

for more information: 507-346-7895



## Year 2: Bonding & Other Financing Options

May 10, 2024, 10:15 AM – 12:45 PM



Scan code to check out of your session  
Read directions below  
DO NOT USE YOUR CAMERA APP

**Scan the QR code to check in on your phone**

A confirmation email will be sent when you successfully check in.

Scan through the Whova app

From the home page, tap "QR Check-in" under Additional resources.

