



Florida Government Finance Officers Association

Spring 2017 CGFO Exam Review
Course - Debt Administration

Webinar – Part I

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Speaker Information

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Recommended Reading

- Florida Statutes:

<http://www.leg.state.fl.us/Statutes/index.cfm?Mode=View%20Statutes&Submenu=1&Tab=statutes&CFID=61337195&CFTOKEN=805006b04f078c4b-38D48B13-B101-C85F-E43E2B8C3935F901>

- Florida Statutes 163.335 Findings and Declarations of Necessity
- Florida Statutes 200.065 Method of fixing millage
- Florida Statutes 218.25 Limitation of shared funds

Recommended Reading (Cont.)

- IRS Publication 4079, Tax-Exempt Governmental Bonds – IRS:
<http://www.irs.gov/pub/irs-pdf/p4079.pdf>
- FAQs regarding Record Retention Requirements, Government Entities – IRS:
<https://www.irs.gov/Tax-Exempt-Bonds/Tax-Exempt-Bond-FAQs-Regarding-Record-Retention-Requirements>

Recommended Reading (Cont.)

- Recommended Practice Statements, Debt Management – GFOA: http://gfoa.org/best-practices?field_committee_value=All&field_type_value%5B%5D=best_practice&field_type_value%5B%5D=advisory&term_node_tid_depth%5B%5D=3&term_node_tid_depth%5B%5D=98&term_node_tid_depth%5B%5D=94&term_node_tid_depth%5B%5D=97&term_node_tid_depth%5B%5D=96&term_node_tid_depth%5B%5D=95

Recommended Reading (Cont.)

- GFOA Publications:
 - Debt Issuance and Management: A Guide for Smaller Governments
 - Guide to Preparing a Debt Policy
 - An Elected Official's Guide to Rating Agency Presentations
 - An Elected Official's Guide to Debt Issuance
 - Tax Exempt Financing: A Primer
 - Investing Public Funds

Capital Improvement Program

- Financial planning, budgeting, and management tool
- Balances project needs with current and future financing
- Can be accomplished through borrowing, grants, etc.

Capital Improvement Program (con't)

- Pay as you go – Pay for capital improvements from current revenues and/or fund balances
 - When project is expected to be short lived
 - When project is small
 - When debt cannot be issued

Debt Issuance Considerations

- Matching type of financing with revenue stream
- Matching term of financing with useful life of asset
- Evaluation of potential risks and benefits
- Coordination of proposed financing with existing debt
- Overlapping debt

Debt Policy

- Amount of GO debt allowed - % total income, % property value, % past revenue
- Amount of variable rate debt allowed
- **Restriction of debt service term to useful life of asset being financed**
- Should not be too restrictive
- Method for selecting underwriter

Municipal Market

- Consists of the individuals, institutions and processes that result in the sizing, structuring, and sale of obligations by state and local gov't agencies
- Most state & local securities exempt from SEC registration requirements
- Once all conditions for Notice of Sale met, almost any entity can bid on issue

Tax-Exempt Obligations

- Municipal obligations can be tax exempt or taxable
- Tax exempt refers to exemption of interest earnings from federal income tax to bond holders
- Can also be exempt from state income tax through reciprocal immunity (McCulloch vs. Maryland, 1819)

Taxable Gov't Issues

- Could be used for private activity, avoids arbitrage issues
- Could be way to get around debt cap
- Although taxable, state and federal regulations still exist
- Taxable bond issues can be used to pension obligations
- Bank Qualified Bond: Purchased by bank; allows bank to receive interest rate deduction

Federal Limitations

Tax Reform Act of 1986

- Volume of small-issue industrial development bonds (IDBs)
- Restricts purposes for debt primarily to public purposes
- Earnings on bond proceeds limited to same % rate as bond yield; excess subject to rebate action
- One advance refunding per issue
- Fully Registered (if maturity over 1 year)

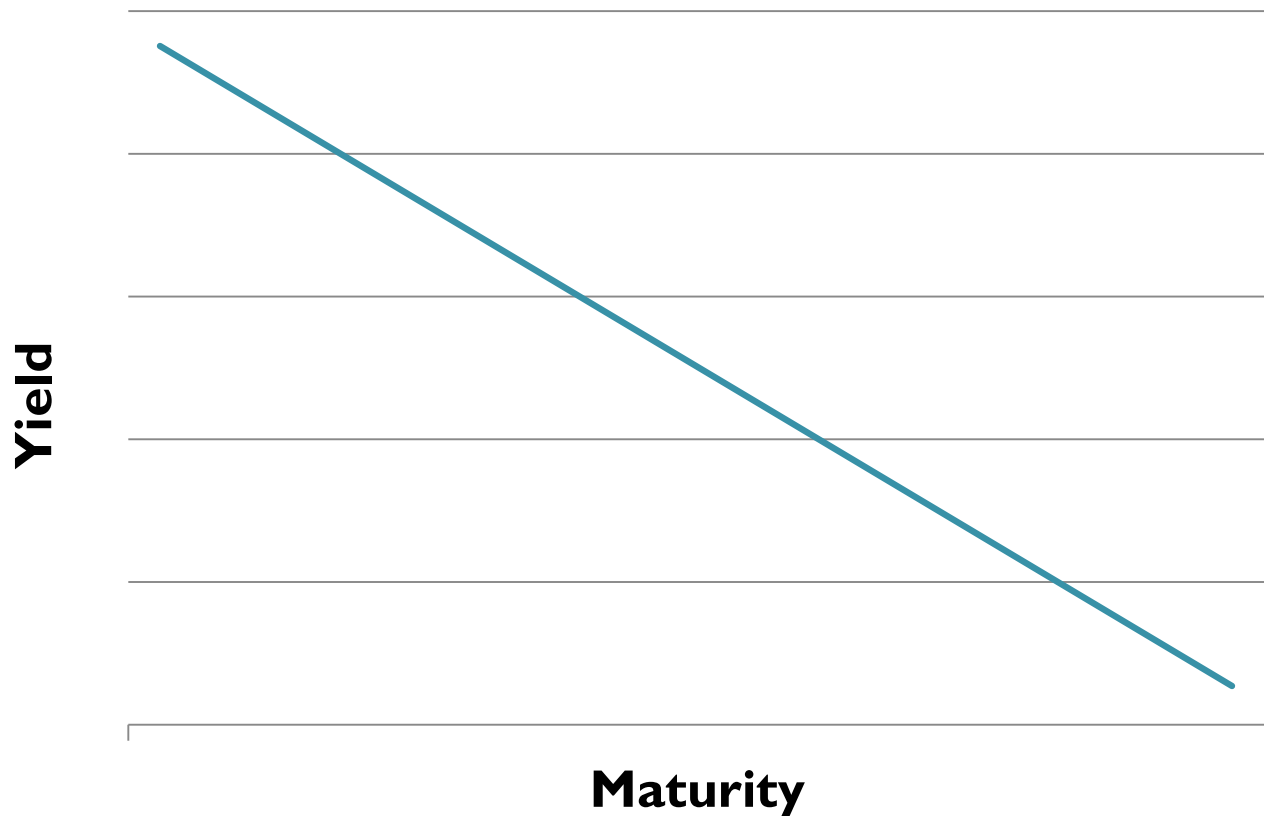
Government Purpose Test

- Financed asset available for general public use as opposed for private benefit
- Payment of the obligation is not obtained from a private firm that will benefit from the project
- Purpose must be < 10% for use by private person / business (= Public Purpose)
- Payment of principal or interest of > 10% of bond by private source (= Private Purpose)
- Simply passing Private Purpose test does not exempt issue from regulation

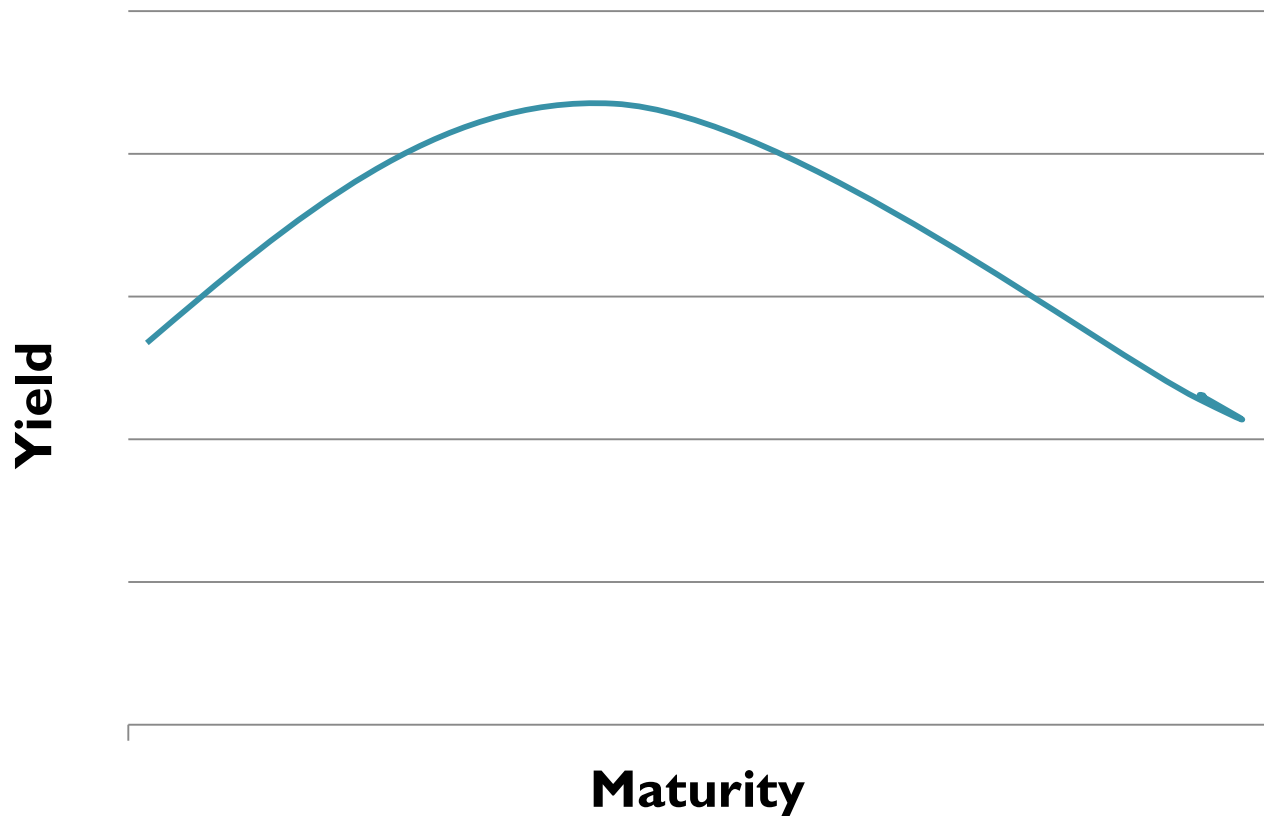
Bond Basics

- Yield Curve: Relationship between the bond interest rate and the bond maturity
- “Inverted” yield curve: unstable market conditions, longer maturities have lower rates of return
- “Humped” yield curve: Intermediate maturities high
- “Normal” yield curve: Longer maturities have higher rates of return
- If interest rates fall significantly,
 - Issuers may exercise call provisions
 - Existing bonds would sell at premium

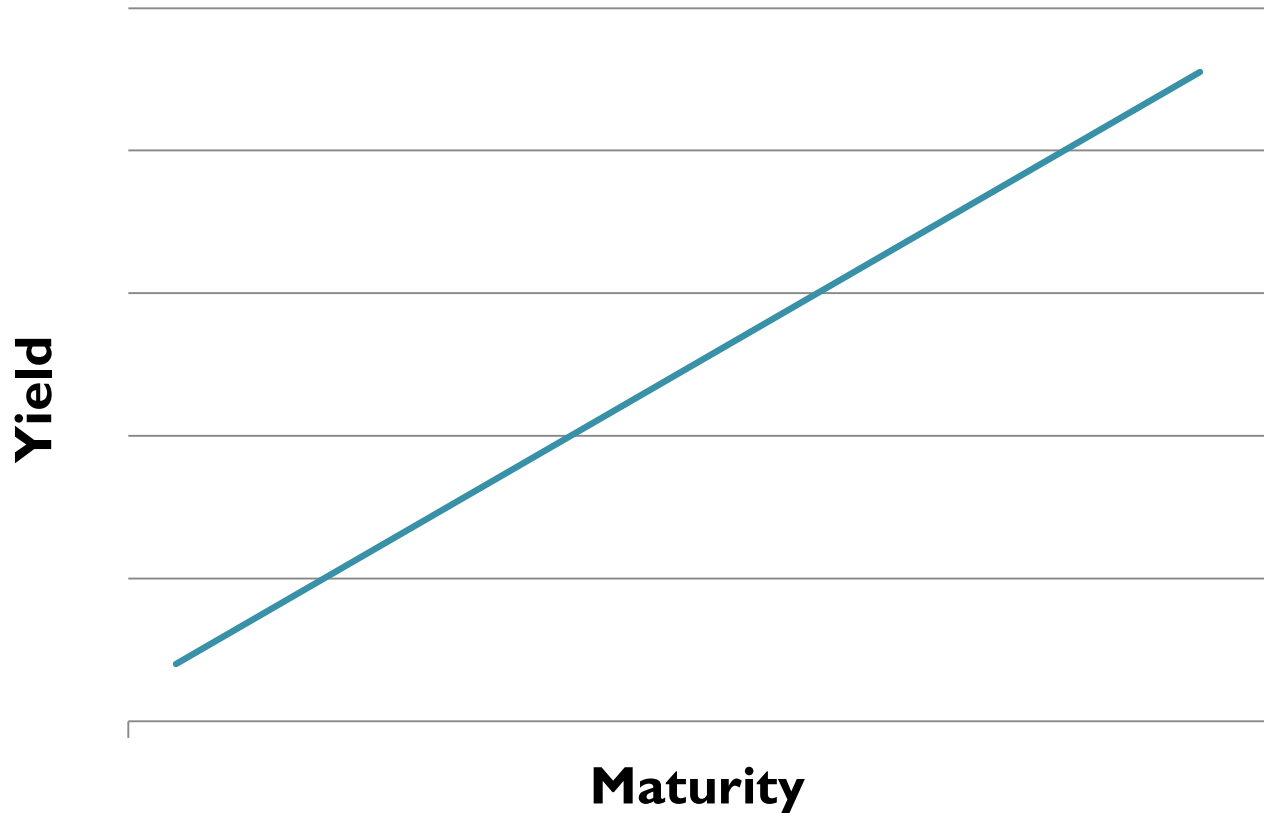
Example of “Inverted Yield Curve”



Example of “Humped Yield Curve”



Example of “Normal Yield Curve”



Difference Between Notes and Bonds

- Bonds
 - Issued in \$5,000 denominations
 - Series with staggered due dates (maturities)
- Notes
 - Typically marketed in denominations of \$100,000
 - Usually have a maturity of 1 year

Municipal Notes

- Two (2) general types
 - Issued in anticipation of receipt of specified revenue (T_{ax} ANs, R_{evenue} ANs)
 - Issued in anticipation of permanent financing (B_{ond} ANs)
- Basis Point = 1/100th of 1% interest
- Interest and sinking fund payments exempt from tax calc for rollback

General Obligation Bonds

- Frequently sold via competitive method
- Favorable interest rates
- Voter approval usually required for amount & anticipated use
- Pledge of full faith and general credit required; is most secure bond
- FL local debt millage limit: Based on gov't debt policy

Revenue Bonds

- Specific revenue pledged to service debt
- Voter approval usually not required
- Debt service reserve may be required
- Coverage covenants usually included
- Trustee required
- Higher interest rates than GOs
- “Double-barreled” bonds = blend of GO and revenue bonds (separate bond resolution)

Special Assessment Bonds

- Voter approval usually not required
- Debt is secured by beneficiaries, limited group of property owners
- Complexity greater than GOs
- Market concerns about defaults
- Limited revenues to secure debt
- Higher interest costs due to higher risk

Certificates of Participation

- Voter approval usually not required
- Complexity greater than GOs
- Subject to annual appropriation
- Less secure than GO bond
- Created as part of lease / purchase; lender receives portion of lease payments

Financing Team

- Financial advisor
- Bond counsel
- Underwriter
- Paying agent / registrar
- Trustee
- Other

Financial Advisor

- Usually hired first, works in the interest of the issuer
- Assists in developing financing requirements and methods
- Assists in selecting the rest of the financing team
- Helps organize and coordinate all steps in process
- Basis of Compensation:
 - hourly
 - flat fee
 - sliding scale

Bond Counsel

- Certifies legal authority to issue the debt
- Provides an opinion that debt is tax exempt
- Interprets federal, state & local laws, regulations, constitutions and statutes, charters and ordinances
- May draft ordinance or trust indenture
- Basis of compensation: hourly rate with cap or flat fee
- Strong reputation key in selection

Underwriter

- Purchases and remarkets the securities
- Usually an investment or commercial bank
- Bids on Competitive Sales
- Participates in structuring negotiated sales
- Basis of Compensation: Underwriter spread
- Should be: competent, reasonably priced and have no conflicts of interest

Underwriter Spread

- Take-down – Compensation for selling bonds; sales commission
- Management fee – Managing the activities of the bond preparation
- Expenses – Incurred in the sale process
- Underwriting fee or “risk” – Risk associated with buying and reselling the issue

Others on the Team

- Paying Agent/Registrar
 - Securities Depository
- Bond Printer
- POS / OS Printer
- Trustee – Acts as fiduciary to protect interests of investors
- Escrow Agent -

Competitive Sales

- Efficient method to sell GO bonds
- Bidding open to underwriters, commercial and investment banks, as well as corporations and individuals
- Notice of Sale
- Bid Form
- POS
- Basis of award
- Good Faith Deposit

Basis of Award

- Net interest cost (NIC) = total interest payments + discount (or less premium) divided by bond-year dollars
- Bond-year dollars = sum of the product of each year's maturity value and the number of years to its maturity
- True interest cost (TIC) is based on the time value of money (greater weight on early interest payments than on future ones) – **preferred method**

Bond Computation Exercise

Pond County issues \$25,000,000 issue with the following maturities.

Years to Maturity	Par Amount	Interest
1	\$4,000,000	1.50%
2	\$5,000,000	2.00%
3	\$5,000,000	2.25%
4	\$5,000,000	2.50%
5	\$6,000,000	2.75%

Bond Year Dollars = _____

Average Maturity = _____

Questions & Answers

