

Best Practices in Debt Management - Update on Bank Placement and Bond Financing Options

*October 16, 2023 10:00 am – 11:40 am
Fort Myers, Florida*

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Best Practices in Debt Management

Presentation Outline

	<u>Section</u>
INTRODUCTIONS	
DEBT MANAGEMENT –	
What is the Project? And Traditional Financing Options	1
FINANCE PLAN – Key Considerations	2
UPDATE ON BANK PLACEMENT MARKET	3
MUNICIPAL BOND MARKET - History & Market Update	4
DEBT MANAGEMENT - Developing A Financing Plan	5
A REVIEW OF RATING AGENCY CONSIDERATIONS	6
TYPICAL ISSUES AND RECOMMENDATIONS	7
QUESTIONS & ANSWERS	8
APPENDIX	9
• Speaker's Bio	

DEBT MANAGEMENT

What is the project?

Section 1

What is the Project?

Initial Questions

1. Amount: _____
2. Timing: _____
3. Priority, and Source of Request? _____

4. What assets would be financed?

Corresponding term of debt? _____

5. General Fund or Enterprise Fund Project?

6. Other Considerations:
Fixed Rate Versus Floating Rate,
Covenants, Prepayment Ability, O&M Needs,
Others

DEBT MANAGEMENT

Traditional Financing Options

Financing Options

A. Pay-As-You-Go Options

Advantages: No Interest Expense
 No Other Costs of Issuance

Disadvantages ? Timing
 ? Size of Project
 ? Project Feasibility
 ? Current Availability of Net Excess Revenues

Financing Options

B. Lease Option

Why Lease?

Obsolescence

Examples of
Leased Assets

Telephones, Computer Equipment, Others

Buy Option

Why Buy?

Valued, long term asset, control

Examples:

Water and Sewer lines, County Building, City Hall,
Proprietary Equipment, Public Safety;
Design/ Build, Lease To Buy, 6320 Options

Financing Options

C. Short-Term Vs. Long-Term Market Options

These variables change, but typical rules of thumb have been:

1. **BAN's, TAN's GAN's**

Purpose:

Short-Term bridge financings, in anticipation of greater project definition, or long term “financing” solution or receipt of seasonal revenue source

Term: 6 months to 3 years.

Important Issue:

Typically need long term “take-out” source also approved/arranged when bridge is structured. May result in two closings and higher cost of issuance. Need to review bond/loan covenants to avoid “additional bonds test” violations.

Financing Options

2. Bank Financing Options

Bank Credit Facilities to short term notes (including BAN's) to medium term notes – traditionally available up to 10 years, sometimes longer. Some banks and bank leasing “affiliates” have gone out 20 years. Bank's lending capacity/appetite subject to change. **Dynamic, changing environment, no longer a “vanilla” or easy process.**

Advantages: Reduce legal/financing costs and fees; “easier process,” privately placed. “Bank qualified” status, or “Public Use” are keys to understand. Short form RFP process helpful.

Disadvantages: **Bank qualified vs. Non Bank Qualified.** Shorter term, tax risk, repayment restrictions, “bank credit culture,” rate reset mechanism, beware embedded “fixed rate” via swaps. Illiquid. Tax appetite and liquidity changes. **Lenders may require varying degrees of a depository/investments and/or banking services relationship.**

“Bank Qualified” means: _____

“Public Use” means: _____

“Prepayment Penalty” means: _____

Financing Options continued

3. Bond/Capital Markets Option:

Advantages: Available up to 30+ years. If over \$10 million and over 10 years, traditionally has been most attractive. Lower interest rates offset higher cost of issuance. Was traditionally a very broad market, with ready access, and multiple “credit enhancement options”. **Bond Insured/credit enhanced options have changed drastically over last 3 years! Importance of Issuers proactively obtaining and maintaining minimum “A” category underlying credit ratings.** Single issue and “pooled loan program” options also exist, but many changes here also due to liquidity and provider downgrades. Availability of State/Federal subsidized Loan programs.

Disadvantages: Higher cost of issuance, more involved issuance process (i.e. bond and offering documents.) Secondary, ongoing disclosure issues. Requires Finance Team. **Since Summer 2008 “Market Freeze”, investor base has shrunk by 40-50%, down to one current AAA/ AA bond issuer. Bank AAA/ AA Letter of Credit capacity either non-existent or prohibitively expensive.**

Financing Options continued

Typical “Finance Team” Members include:

- City/County/Authority/District Staff
- Financial Advisor
- Project Consultant
- Investment Banker/Underwriter(s)
- Bond Counsel
- Underwriter's Counsel/Disclosure Counsel
- Rating Agencies
- Credit Enhancement Providers (Bank LOC or Bond Insurer)
- Consulting Engineers/Feasibility & Rate Consultants
- Other

Section 2

FINANCE PLAN

Key Considerations

Financing Plan

A. General Fund Versus Enterprise Fund-General Questions

- ☐ Available net revenues for debt service
- ☐ Is this a cash flow contributing project or enterprise?
- ☐ Existing versus new revenue sources?

B. Details on Financing Plan?

- ☐ Role of Credit Enhancement (Bond insurance, letter of credit, etc.)
- ☐ Rated versus non rated
- ☐ Repayment Plan
- ☐ Construction Schedule (Capitalized interest, investment program)
- ☐ Historical and projected debt service coverage levels
- ☐ “Reliability “of pledged revenues
- ☐ “Sunset “on pledged revenues
- ☐ Do we need a Referendum? (general obligation, sales tax, county surtax, etc.)

Financing Plan

B. Details on Financing Plan? (continued)

- ☐ If enterprise, existing rate structure? (rate study/feasibility study, do we have “believable” and dependable projections, with a margin for error)
- ☐ Increased Opportunities for Public/Private/Public Partnerships
Examples: Public/Private: _____
 Public/Public: _____
- ☐ Contingencies
 - ☐ Project completion risk
 - ☐ “Lease up” or cash flow ramp up period
 - ☐ “Sleep at night” account, Restricted Surplus Fund
 - ☐ “Trust but verify”
- ☐ Tax issues - TEFRA 1986
 - 1) Ability to borrow
 - 2) Substantive project (no ghost \$)
 - 3) “Arbitrage” considerations; Spend-down estimates!
 - 4) “Public Purpose”

Section 3

Update on Bank Lending Options

Bank Lending for Local Governments

What are the ways a Bank hears of a Muni Loan Opportunity?

- ☐ Direct RFP
- ☐ RFP via online portal
- ☐ RFP from a Financial Advisor

Bank Lending for Local Governments

What does a Bank look at in order to propose?

- ☐ Relationship
- ☐ Existing proximity of Branches
- ☐ Term
- ☐ Security of the RFP

Bank Lending for Local Governments

Indicative Rates **(Subject To Change Based on Changing Market Conditions)**

	November 2019	June 2022	Current Tax Exempt	Current Taxable
10 years	2.08-2.40%	3.30-3.55%	TBD	TBD
15 years	2.38%	3.40-3.65%	TBD	TBD
20 years	2.55-2.80%	3.75-3.95%	TBD	TBD

Bank Lending for Local Governments

Covenants in Bank Loans (Annual Monitoring)

- ☐ Liquidity
- ☐ DSC
- ☐ Leverage

Section 4

MUNICIPAL BOND

Market History & Market Overview

Municipal Markets: A Changed Landscape

Credit Support at a Higher Cost

- Letter and lines of credit conditions have changed
 - Tougher credit terms
 - Shorter duration
 - Fewer providers
 - Higher costs

Federal Programs

- New programs authorized under Stimulus Act of 2009 have come and gone
 - Direct subsidy (BABs, Recovery Zone)
 - Tax Credit (BABs, Energy, Education)
 - Tax subsidy (Recovery Zone Facility Bonds)
 - Bank Qualified Bonds (\$30 million to \$ 10 million)
 - AMT holiday

Investor Municipal Credit Sensitivity

- Credit analysis is much more important to the investor
 - Demise of bond insurers
 - Focus on fiscal health of state & local governments
- Rating agencies
- ESG Considerations

Economic & Market Conditions

- Fed posture
- Domestic economy
- Commodity prices
- Middle East instability
- Japanese economy
- End of QE2
- Growth of middle market buyers importance

Municipal Markets Update

- ☐ Investors continue to look for clues as to future Fed actions after multiple rate increases in Fed Funds in 2023
- ☐ U.S. home sales are lower due to rate hikes
- ☐ Volatility in rates expected as investors monitor economic and geopolitical news
- ☐ Recent outflows in muni bond funds
- ☐ Early FY 2023 bond volume is very light
- ☐ Treasury notes have been volatile on signs of moderating growth in U.S. economy, stubborn inflation numbers

Federal Reserve Rate Increases

Tax Exempt Yields (%)

	April 2014	July 2021	October 2022	January 2023	September 2023
1 year	0.58	0.21	3.07	2.39	3.55
5 years	1.86	0.65	3.25	2.30	3.22
10 years	3.00	1.18	3.61	2.55	3.26
15 years	3.50	1.41	4.14	3.18	3.76
20 years	3.85	1.55	4.33	3.45	3.96
25 years	3.93	1.68	4.50	3.64	4.07
30 years	4.02	1.73	5.13	3.69	4.17

Credit Enhancement & Ratings

AAA	AAA	AAA
AA	AA	AA
A	A	A
BBB	BBB	BBB
BB	BB	BB
B	B	B
CCC	CCC	CCC
CC	CC	CC
C	C	C
	D	DD
		D

Credit Enhancement & Ratings



<u>Bond Insurers</u>	<u>Fall 2004 Rating</u>	<u>Update Ratings/Outlook</u>
ACA Financial Guaranty Corp.	A	NR / NR / NR (RunOff Only)
AMBAC	AAA/Aaa/AAA	Bankruptcy Filing – November 2010 (In Suspense)
Assured Guaranty Corporation (AGC) Assured Guaranty Municipal (AGM) (ex FSA)	N/A	AA (Stable) / A1 (Stable, Moodys) Fitch (NA)
Berkshire Hathaway Assurance Corp.	N/A	AA+ (Stable) / Aa2 (Stable) / AA (Not Active)
Build America Mutual (BAM)	NA	AA (Stable) S&P
FGIC	AAA/Aaa/AAA	NR / NR / NR (In Suspense, Book to MBIA)
FSA	AAA/Aaa/AAA	NA; Part of Assured Guaranty
MBIA	AAA/Aaa/AAA	B (Neg) / Ba3 (Negative) / NR
National Public Finance Guar. Corp (f/k/a MBIA Insurance Corp. of Illinois)	N/A	BBB (Developing) (Dev)/ Baa1 (Dev) / NR
Radian Asset Assurance Inc.	N/A	BB- (Dev) / Ba1 (Dev) / NR
Syncora Guarantee Inc. (f/k/a XL Capital/Security Capital)	AAA/Aaa/AAA	NR / NR/ NR (Regulator told to suspend claims payments)

Source: Bond Buyer; Insurer Websites, Ratings are in order of S&P / Moody's / Fitch. Subject to change.

Larson Consulting Services, September 2023

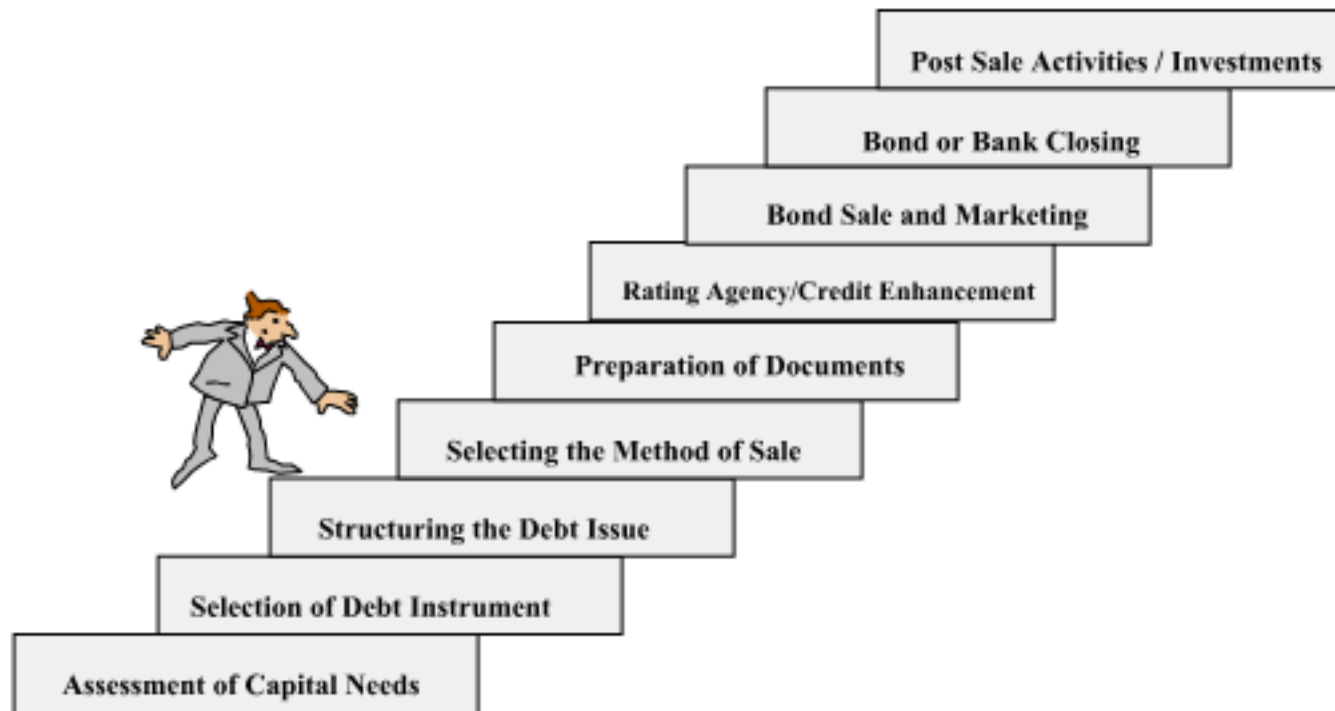
Section 5

DEBT MANAGEMENT

Developing A Financing Plan

Bond Issuance Process

Steps to a Bond or Bank Issue ⁽¹⁾



(1) Slight changes if a Bank Placement

Fiscal Objectives

Prior to Finance/Project Team being selected or engaged to proceed, Issuer Staff should develop understanding of:

- Scope of Project
- Timing of Need
- Status of Internal Approvals
- City/County Manager/Authority/District's Objectives, Requirements, Sensitivities
- Elected Officials' Objectives, Concerns, Mandate

Fiscal Objectives

Following Finance Team Engagement, Finance Officers/City/County Manager, should:

- 1. Go over key objectives with Finance Project Team**
- 2. Determine more specific financing parameters such as:**
 - Pledged Revenues**
 - Legal Challenges**
 - Timing**
 - Existing and Proposed Financial Covenants**
 - Performance Parameters and Objectives Regarding Costs, Capital Costs, Ratings, Credit Enhancement**
- 3. Finance Director's Comments and Recommendations From Bond Issuance, Refunding and Bank Placement Recent Experiences**

Section 6

BEST PRACTICES IN DEBT MANAGEMENT: A Review of Rating Agency Considerations

Importance of Ratings

- A. What is a Rating and Why Does It Matter?
- B. Key Rating Considerations
- C. How to Prepare for a Rating Presentation or Annual Surveillance Review

What Is a Rating?

- Forward-looking independent assessment of credit quality
- Letter representation of the likelihood of full and timely repayment over the life of a specific financial obligation
- Based on issuer's **ability and willingness** to pay on time
- Ability to pay - quantitative
- Willingness to pay – qualitative, historical actions and policies

Why Do Ratings Matter?

- A bridge between issuer and investors
- Increased investor knowledge and acceptance
- Higher underlying ratings = lower interest rates = lower annual debt service costs

Four Keys to Credit Analysis

- Economy
- Debt and other long-term liabilities
- Financial performance
- Management and administration

Economy

- Jobs, jobs, jobs
- Economic diversity
- Taxpayer mix
- Income and wealth
- Labor force characteristics
- Quality of life attraction
- Tax burden

Debt and Other Long-Term Liabilities

- Evaluation of debt against economic resources
- Debt affordability guidelines
- Routine evaluation of capital and debt needs
- Debt structure – know your risk

Financial Profile

- Support of near- and long-term obligations
- Focus on general fund and other discretionary sources
- Consistency of results
- Sound reserve levels

Management and Administration

- Tenured management with relevant job experience
- Institutionalized and prudent policies
- Focus on budgeting practices
- Efficient decision making process
- Taxpayer, political, and labor environment

Budgeting Practices

- Long-term financial planning
- Reasonable assumptions
- Maximize structural solutions
- Develop “what if” scenarios and contingency plans
- Regular interim budget reviews
- Mid-year adjustments

Fiscally Prudent or Popular?

- Productive relationship with labor
- Employee benefits
- Evaluate delivery of municipal services
- Cooperation of elected officials
- Effective communication
- Disclosure practices

The Rating Process

- Offering and legal documentation
- Data and management discussion
- Rating committee, communication and dissemination through the financial newswires
- Appeal process, if necessary
- Surveillance

Section 7

TYPICAL ISSUES AND RECOMMENDATIONS

Post Bank / Bond Activities

- Actual Versus Projected Results
 - Accounting Issues
 - Keep “Interested Parties” Informed Via City/County Website or Dissemination Agent i.e., (DAC) Authority/District Web Page
-
- ☐ Investors
 - ☐ Underwriter(s)
 - ☐ Financial Advisor
 - ☐ Rating Agencies
 - ☐ Bond Insurers/Banks
 - ☐ Elected Officials

Bond Closing/Post Sale Activities

Investments

- ☐ Transactional Versus Managed
- ☐ Investment Contracts

Investment Options

- ☐ GICs, Flex Repos
- ☐ Laddered Portfolio – Competitively Bid
- ☐ LGIP, Money Market Fund, Prime Fund, or Equivalent
- ☐ (Qualified Public Depositories – QPD's)

Recommendations

1. Plan well, get organized and then run hard.
2. Hire a good core team at the beginning of the process.
3. Don't be afraid to ask questions.
4. Create clear and measurable objectives, review.
5. Set up an achievable timetable, with appropriate input, and seek help from the core team members to help manage process (Good cop vs. Bad cop.)
6. Keep elected officials comfortable with process – use “KISS” principle language.
7. Let results speak for themselves – don't be afraid to summarize good news.

Section 8: Questions?

Section 9

APPENDIX

- Speaker Bio

- Based in Orlando, and as President of Larson Consulting Services ("LCS"), an independent SEC and MSRB registered financial advisory firm, Jeff has successfully closed a wide range of municipal project finance and corporate financings totaling over \$8 billion. Florida projects have ranged from negotiating and structuring a \$2.7 Billion rapid rail project, higher education project financings, extensive water and wastewater capital expansions, investments support services, economic development and redevelopment initiatives, utility enterprise restructurings, refinancing and restructuring, downtown redevelopment, CRA TIF financings, debt and lease purchase private placements, public/private partnership project finance issues, and Charter School financings. In May of 2011, Jeff and FMAS was asked by the AAAM rated FL SAFE Local Government Investment Pool ("LGIP"), to serve as its Administrator and Executive Director. He has served many Florida governments since 1992 as an Investment Banker, Financial Consultant, Administrator, or Financial Advisor.
- Prior to establishing LCS and FMAS, Jeff managed D.A. Davidson's Southeast Regional Investment Banking Office. Prior to joining D.A. Davidson, Mr. Larson was the S.E. Regional Director Investment Banking and Consulting Services with Kirkpatrick Pettis, the investment banking arm of Mutual of Omaha, the Managing Director for Stifel Nicolaus/Hanifen Imhoff, and a Vice President, Investment Banking for SunTrust Capital Markets in Orlando, Florida. Recruited by these firms, he specialized since 1992 in Florida with the structuring and marketing of a variety of public finance and capital markets products. Prior to that, he spent ten years with C & S/Sovran in Atlanta and Barclays Bank PLC in Atlanta and San Francisco as a corporate finance, large corporate/Fortune 500, and Middle Market Banker.
- Mr. Larson received his MBA degree on an academic scholarship from Emory University, Atlanta, Georgia, in 1982. As part of his MBA graduate work, Mr. Larson worked, studied, and taught in Germany and Austria and was a Fulbright Scholar at the Johannes Kepler University in Linz, Austria. He received an A.B. in Business Administration with honors in 1980 from Franklin & Marshall College, Lancaster, PA. Mr. Larson's professional licenses with the SEC and MSRB include a Series 50 Municipal Advisor and Series 54 Municipal Advisor Principal.
- Jeff is a frequent speaker at industry conferences including the annual FGFOA, FCCMA, Florida Bond Buyer, FICPA, Florida Redevelopment Association (FRA), Florida Bar Association, Florida League of Cities, FL Tax Collector's Conference, FGFOA Webinars, Regional FGFOA Chapter meetings, FGFOA Career Seminars, Annual FGFOA Institute (School of Governmental Finance) and Special District conferences on topics ranging from "the Bond Issuance Process", "Best Practices in Debt Management", "Best Practices in Investment Management", "Planning and Capital Financing", to "Public-Private Partnership Financings." Jeff has also served as a member of the FGFOA Annual Conference Program Committee for over 20 years.

Larson Consulting's Team of Professionals provide financing solutions for many types of clients in Florida, the Southeast, and across the country. We specialize in a number of practices in which we have significant expertise. Our primary areas of focus include the following:

- Infrastructure Financings
- Special Districts and Land Development
- Higher Education
- Resort Communities
- Housing Agencies
- CRA & TIF Improvement Districts
- Tribal Finance
- Healthcare Finance
- Charter Schools
- Growth Management and Capital Planning
- Developer Project Negotiations
- Arbitrage Support
- Workforce Housing
- Project Financings
- Utility Financings
- Public Private Partnerships
- School Districts
- Project Consulting Services
- Lease-Purchase Financings
- Internet-Based Public Sales
- Alternative Energy
- Rural Water
- State Governments
- Utility Acquisition Analysis
- Refundings and Restructurings