Municipal Finance Fundamentals - Overview

Presented to:

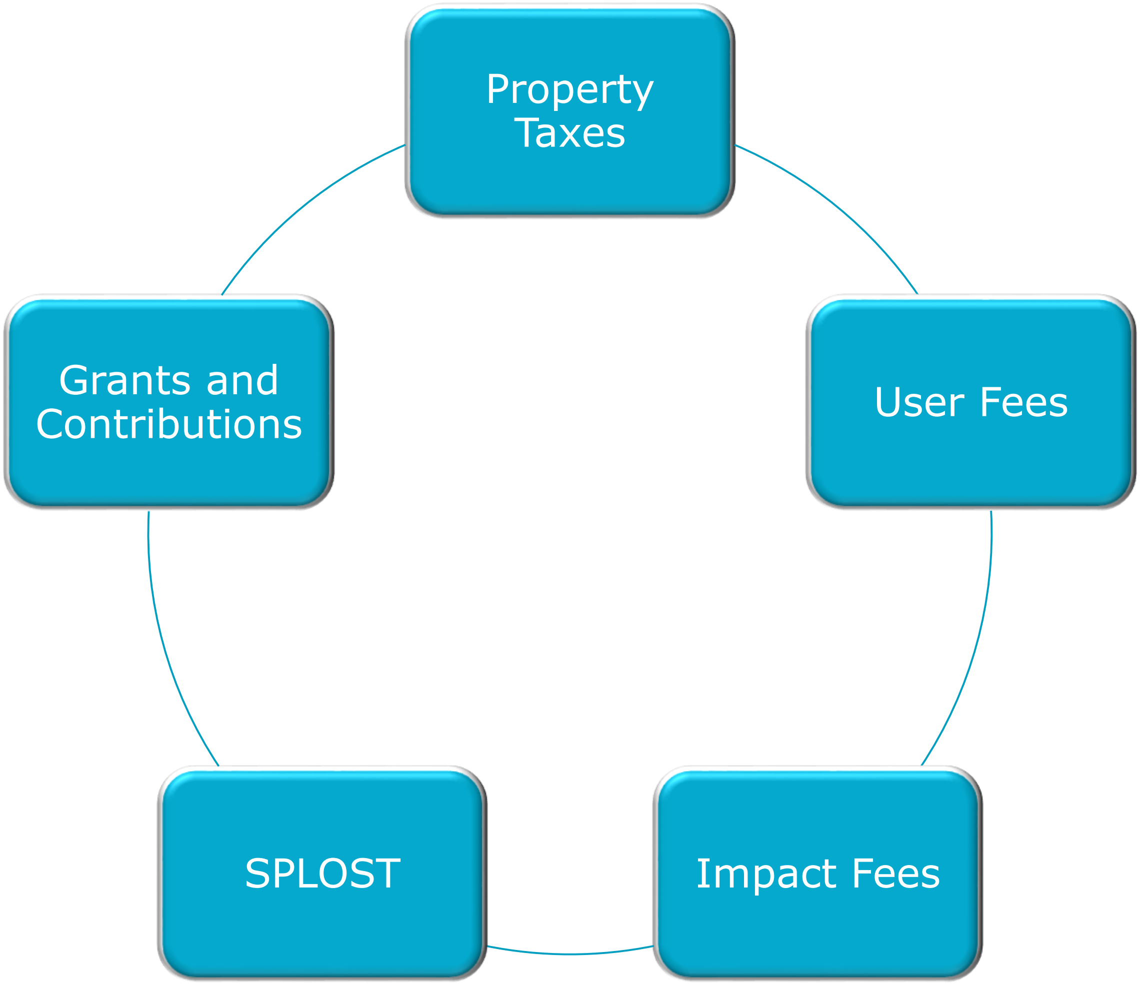
City of Johns Creek, Georgia

October 11, 2010

Todd Barnes
3282 Northside Parkway
Suite 225
Atlanta, GA 30327
404.264.2233
tbarnes@rwbaird.com

Ellen Dickson
3282 Northside Parkway
Suite 225
Atlanta, GA 30327
404.264.2234
edickson@rwbaird.com

Pay-As-You Go Funding Options



Funding Options

- **Borrowing**

Borrowing funds might be the preferred approach for one or more of the following reasons:

- Project costs exceed available funds
- Acquire needed assets/facilities sooner
- Spread cost over current and future users
- Preserve cash reserves
- Interest cost less than construction inflation

Funding Options

- **Borrowing Options**

  Presented below is a list of the types of financing that are available to fund capital assets on either a long-term or a short-term basis:

Bonds

Lease Purchase

Loans

Bond or Grant Anticipation Notes

Commercial Paper

Bonding Options

General Obligation

- Secured by unlimited ad valorem taxing power
- Term cannot exceed 30 years
- Issued for any purpose taxes can be levied
- Must be approved by voter referendum. Different project types must be separate ballot questions
- Total bond amount and repayment terms are established in referendum
- Total outstanding cannot exceed 10% of assessed value of taxable property

Authority (IGA)

- Three types:
  - Constitutional
  - General Statute
  - Local Legislation
- Secured by Intergovernmental Agreement with City
- Term cannot exceed 50 years
- Fund public buildings and revenue undertakings identified in Revenue Bond Law
- No referendum required. Authorized by Article IX of the GA Constitution
- IGA can be limited tax pledge or full faith and credit depending on type of project and authority
- City's millage cap of 4.731 mills limits the borrowing capacity

Revenue

- Secured by dedicated revenue stream
- Term cannot exceed life of project
- Issued for self-sustaining projects: water & sewer, parking, jails, etc.
- Do not need voter approval
- Rates must be set to cover debt service
- Bond covenants required: rate covenants, additional bonds test & operation and maintenance requirements
- May need Debt Service Reserve Fund
- Can also secure bonds with general obligation

COPs

- Secured by general operating fund or SPLOST
- Term cannot exceed one year, subject to annual appropriation
- Do not need voter approval
- 100% financing requirement, no equity can be in property/asset
- Par amount outstanding on all lease-purchases cannot exceed $25MM
- Must be added to 10% limit
- Must have public hearing and publish notice in newspaper 2 weeks prior
- Cannot have been part of a referendum that has failed in last 4 years
- Essentiality of projects is very important

GO Referendum

- Election Dates where referendum can be offered for a vote:
  - Odd numbered years: 3rd Tuesday in March or General Election in November
  - Even numbered years: Presidential Preference Primary, General Primary or General Election in November

2011	2012
March 15th	February 7th
November 8th	August 21st
	November 6th

- Call for referendum must occur at least 90 days prior to vote
- Request for pre-clearance with U.S. Justice Department must be filed at lease 60 days prior to the vote
- A Notice of Election must be published in the local legal organ for not less than 30 days immediately preceding date of vote
- Notice of Election must include:
  - Purpose of the bonds
  - Maximum Par amount of bonds
  - Maximum interest rate
  - Maximum principal amount for each maturity

GO Referendum & Financing Schedule

? - Oct	Project planning; Assemble financing team
Oct - Nov	Size & Structure Bond Issue; Finalize bond parameters for referendum
Dec. 15th	Call for Referendum
Jan. 14th	Request pre-clearance with U.S. Justice Department
Feb. 11th	Begin publishing Notice of Election in local legal organ
March 15th	**Referendum date**
Week of April 4th	Kick-off call Circulate 1st draft of bond documents & POS
Week of April 11th	Provide comments on bond documents & POS
Week of April 18th	Circulate 2nd draft of bond documents & POS
Week of April 25th	Due diligence call Provide comments on bond documents & POS Send package to rating agencies & insurance provider
Week of May 2nd	First validation ad published Conference call with rating agency
Week of May 9th	Second validation ad published Finalize POS
Week of May 16th	Validation hearing Receive rating & insurance quote Print & distribute electronic & hard copy of POS
Week of May 23rd	Price bonds (Tues) Bond Resolution & Bond Purchase Agreement adopted and signed (Wed)
Week of May 30th	Finalize, print & distribute OS Distribute closing documents
Week of June 6th	Pre-closing of Bonds (Wed) Closing of Bonds (Thurs)

Methods of Sale – When to Use Each

BAIRD

Negotiated	Competitive	Private Placement
Underwriter selected early in financing and active throughout the financing. At pricing, City negotiates with the selected Underwriter on the terms of the bonds.	Underwriter is not present throughout the financing process. At pricing, City accepts public bids to purchase all bonds. Bidder with lowest true interest cost wins.	Direct sale of bonds to an investor by a Placement Agent without the use of an underwriter.

Negotiated

- When the new issue does not have a large par amount
- When issuer is not a frequent issuer of debt
- When issuer wants flexibility on the timing of the sale
- When issuer has had a recent change in management
- When issuer has experienced some financial difficulties recently
- Volatile market conditions

Competitive

- When issuer has high credit ratings
- When issuer has name recognition in the markets
- When issuer comes to market on a regular basis
- When the bond structure is straightforward
- Stable market conditions

Private Placement

- When the financing is small and can benefit from decreased costs of issuance
- When bond proceeds are needed quickly – private placements provide a faster sale process
- When a financing is complex and needs to be explained directly to investors
- When the financing is not rated

Credit Ratings

- Bond ratings are evaluations of the Issuer's credit risk by the rating agencies and then assigning a value to that risk
- Currently there are three rating agencies: Moody's Investors Service, Standard & Poor's and Fitch Ratings

Long Term Investment Grade Ratings		
Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1 Aa2 Aa3	AA+ AA AA-	AA+ AA AA-
A1 A2 A3	A+ A A-	A+ A A-
Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-

Rating Agency Process

The rating agency process described below takes approximately 3 – 4 weeks

- **Send credit package to rating agencies**
  - Credit package will include the POS, most recent set of numbers, pertinent legal documents, audits & budgets, financing schedule and distribution list
  - This needs to be sent at least one week ahead of the ratings presentation

- **Ratings Presentation**
  - Either done by conference call or on-site visit
  - Underwriter/Financial Advisor will collaborate with the Issuer and put together a presentation providing information about the Issuer as well as the financing
  - Before the actual call, the Underwriter/Financial Advisor reviews strengths and challenges with the Issuer in order to anticipate analyst questions. For the challenges, solutions will need to be addressed, such as developing and putting into place new debt policies or other specific plans to mitigate or eliminate the challenges.
  - Gives the analyst an opportunity to ask for additional information needed for the rating analysis

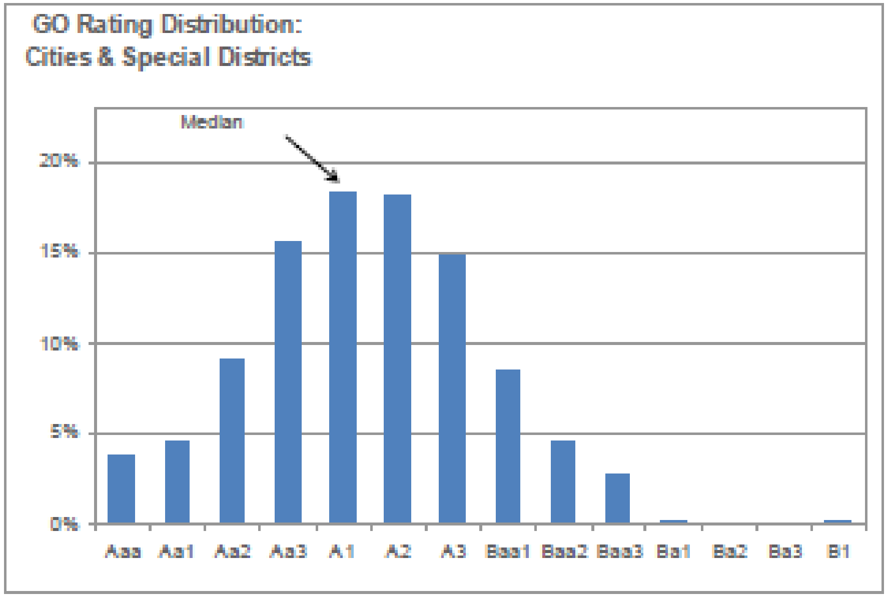
- **Committee meeting**
  - Analyst goes over all information provided, puts together a summary and takes the financing to a committee where the rating will be determined

- **Rating report**
  - Summarizes the rationale for the credit rating, including the credit strengths and weaknesses of the Issuer and the financing.

- **Monitoring of rating**
  - Rating agency will continue to monitor the rating and provide updates when necessary

General Obligation Rating Methodology

- **Economic Growth**
  - Size and growth trend
  - Type of economy
  - Socioeconomic and demographic profile
  - Workforce profile
- **Financial Strength**
  - Balance sheet/liquidity
  - Operating flexibility
  - Budgetary performance
- **Management and Governance**
  - Financial planning and budgeting
  - Debt management and capital planning
  - Management of economy/tax base
  - Governing structure
  - Disclosure
- **Debt Profile**
  - Debt burden
  - Debt structure and composition
  - Debt management and financial impact/flexibility
  - Other long-term commitments and liabilities



Credit Enhancement – Bond Insurance

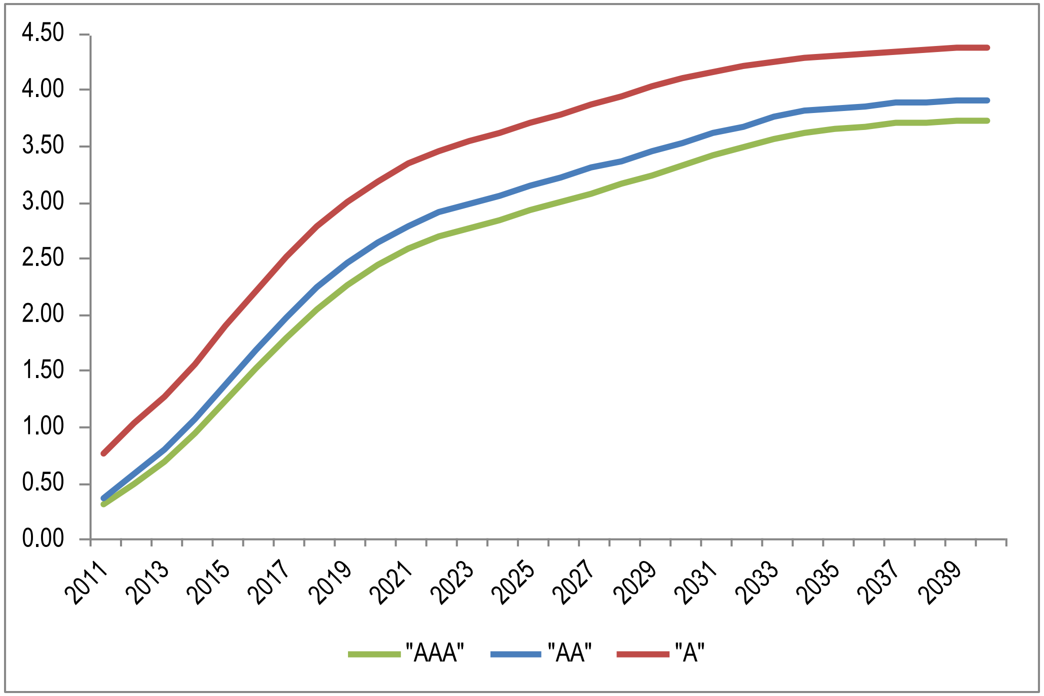
- Insurance providers insure the full and timely payment of debt service on the bonds in the event the City is unable to make payments to the bondholders.
- If insured, the financing carries the ratings of the insurance provider.
- Bond insurance provider conducts a credit review, issues an insurance commitment and provides an insurance premium quote.
- Bond insurance premium is a one-time fee paid at closing and is based on a percentage of the total debt service of the new financing.

	Moody's Investors Service	Standard & Poor's	Fitch Ratings
Berkshire Hathaway Assurance Corp.	Aa1 stable outlook	AA-plus stable outlook	not rated
Assured Guaranty Corp.	Aa3 negative outlook	AAA negative outlook	not rated
Assured Guaranty Municipal Corp.	Aa3 negative outlook	AAA negative outlook	not rated
National Public Finance Guarantee Corp. (formerly MBIA Insurance Corp. of Illinois)	Baa1 outlook developing	A outlook developing	not rated
Radian Asset Assurance Inc.	Ba1 stable outlook	BB- negative outlook	not rated
MBIA Insurance Corp.	B3 negative outlook	BB-plus negative outlook	not rated
Ambac Assurance Corp.	Caa2 on review for upgrade	R	not rated
Syncora Guarantee Inc. (formerly XL Capital Assurance Inc.)	Ca outlook developing	R*	not rated
ACA Financial Guaranty Corp.	not rated	not rated	not rated
CIFG Assurance North America Inc.	not rated	not rated	not rated
Financial Guaranty Insurance Co.	not rated	not rated	not rated

**Regulatory Intervention*

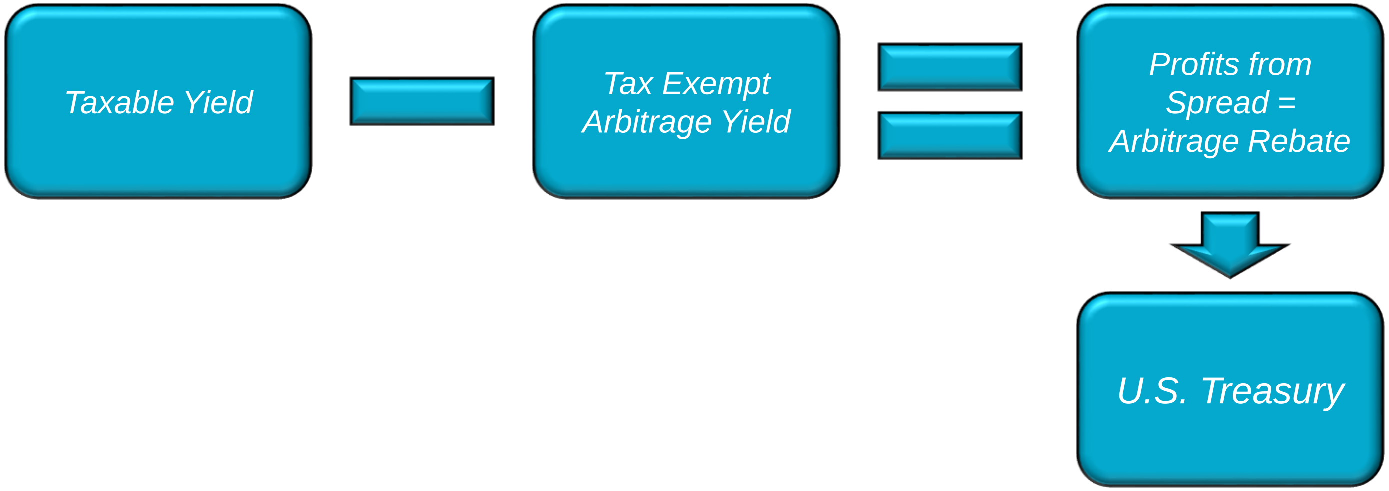
Credit Enhancement - Insurance

- Ratings make a significant difference in interest rates
- As can be seen by the graph to the right, a "AA" rated financing on average is 52 basis points lower in yield than a "A" rated financing
- On a $10 million, 30-year financing, this spread equates to a little over a $1 million increase in interest expense to the Issuer
- The FA or Underwriter will provide the Issuer with an insurance break-even analysis before pricing to determine if insurance is cost-effective.



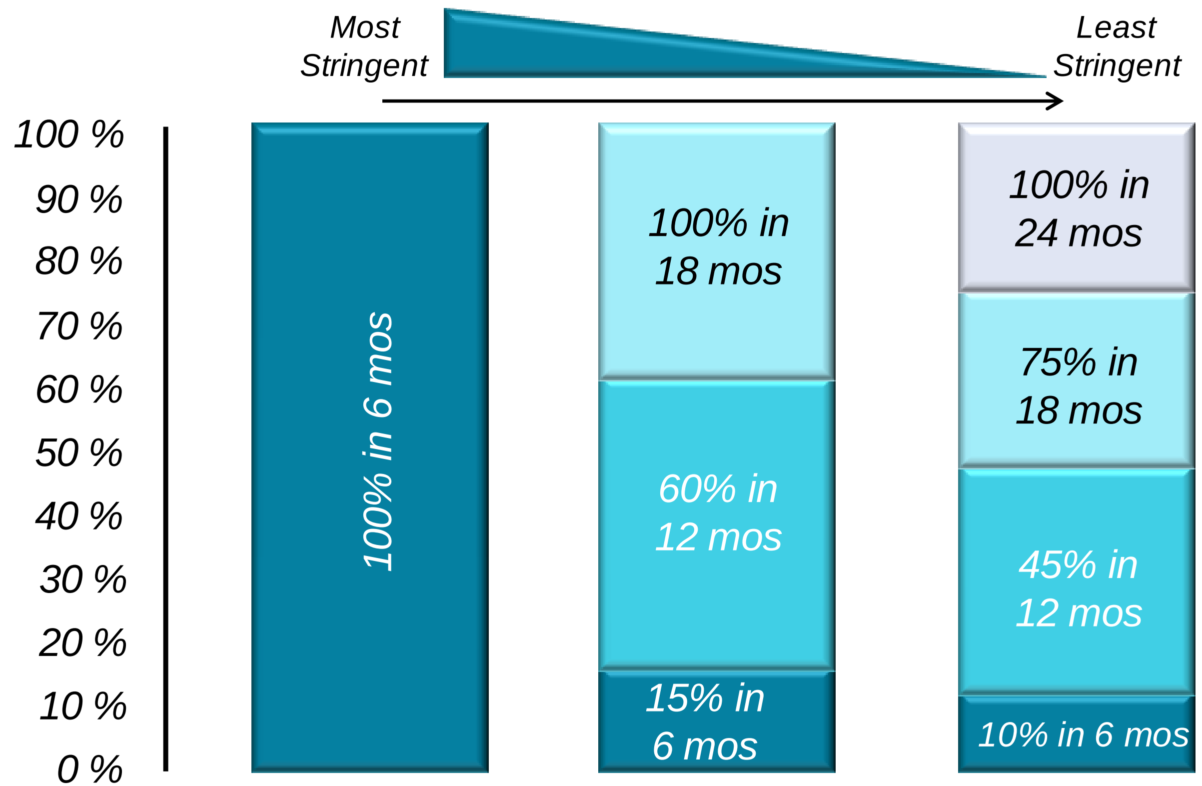
Arbitrage Rebate

- Issuers borrow at lower tax-exempt rates and invest at higher taxable rates
- Arbitrage rules have been enacted so issuers cannot profit from the spread between tax-exempt and taxable rates
- The rules require the issuer to return to the U.S. Treasury any earnings above the arbitrage yield of the bonds issue (“arbitrage rebate”)
- This rebate must be calculated by the issuer every five years, starting from the closing date on all bond financings and every time a bond financing matures. But it is good practice, and required by some bond counsels, to do these calculations annually.



Arbitrage Rebate Exemptions

- **Small Issuer Exemption** – an Issuer plans to issue $5 million or less ($15 million or less for public schools) in any calendar year
- **Spend-down Exemption** – an Issuer is able to meet the spend down requirements of any of the three described below



Continuing Disclosure

- Rule 15c2-12 requires an underwriter have the Issuer sign an agreement stating the Issuer will submit in a certain timeframe the items listed below to all Nationally Recognized Municipal Securities Information Repositories (“NRMSIR”)
  - Annual Information Filing
  - Audits
  - Material Event Filing
  - Notice of Failure
- Electronic Municipal Market Access System (“EMMA”) – serves as a centralized repository. Issuer only needs to send continuing disclosure to EMMA, then EMMA circulates information to all other NRMSIRs
- Exceptions – Issuer does not have continuing disclosure requirements on private placements or certain limited offerings. Issuers with less than $10 million outstanding are exempt from the annual filings.
- If Issuer fails to file continuing disclosure:
  - Must go back and submit all missing continuing disclosure before they can issue new debt
  - Must disclose failure to file in next OS
  - Interest from the market may decrease
  - Party could possibly sue for damages
- Dissemination Agent – can hire firm who will remind Issuer when to file, help put together information for filing, and file the information with EMMA on behalf of the Issuer