

CPIM

CENTER FOR PUBLIC INVESTMENT MANAGEMENT



A PROGRAM BROUGHT TO YOU BY:

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FINANCE 202

Borrowing for Small Governments

Topics To Be Discussed

- Debt
- General Obligations
- Revenue (Special) Obligations
- Lease Purchase Financing
- Other Types of Financing Options
- Components of a Bond
- State Law Issues
- Federal Securities Law Issues
- Federal Tax Law Issues

Debt

What Is Debt?



***Webster's Dictionary:* "something owed ... obligation"**

Debt

- A duty or obligation to pay money, deliver goods or render service under an express or implied agreement
- Example: obligation to make annual payments, plus interest for the cost associated with the reconstruction of a City street
- Repayment terms evidenced by a Note

Debt

- How does a political subdivision in Ohio borrow money?
- Can I go to the local bank and get a loan?



Debt

The Ohio Constitution says:

“No bonded indebtedness of the state, or any political subdivisions thereof, shall be incurred or renewed unless, in the legislation under which such indebtedness is incurred or renewed, provision is made for levying and collecting annually by taxation an amount sufficient to pay the interest on said bonds, and to provide a sinking fund for their final redemption at maturity.”

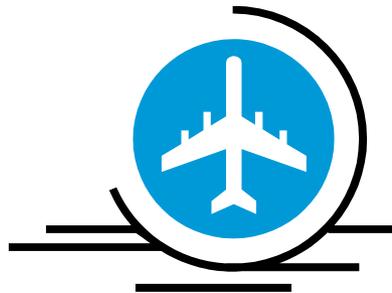
– Article XII - Section 11

Debt

- Rules for most issuers dictated by State law
 - Limits amount of debt that can be issued
 - Places fiscal responsibility on its officials
 - Protects taxpayers from unlimited debt burden
- Legislation to authorize borrowing required
- Legislation authorizes security, source of repayment and other terms

State Law – Purpose

Subdivisions may issue bonds to finance projects of all types. Many projects such as airports, roads, sewers, and schools are secured by payments from tax collections or project revenues.



Eligible projects

- Water and sanitary sewer improvements
- Park land, greenspace, land for road construction
- Administration buildings, maintenance buildings
- Fire and police stations
- Community, recreation and convention centers
- Road and street improvements, extensions
- Fire equipment, fire trucks, road equipment, trucks
- Landscaping, furniture, office equipment
- Energy conservation, 911 systems

Types of Debt

- Notes and Bonds
 - General Obligation
 - Revenue
- Lease obligations
 - Capital lease obligations
 - Operating lease obligations
 - Lease purchase (appropriation) agreements
- Loans

What Are General Obligations?

- Ohio Revised Code Chapter 133
- Permanent Improvements
- Security and Sources of Payment
 - Ad Valorem Property Taxes
- Debt Limitations
 - Voted
 - Unvoted

Security & Sources of Payment

- General Obligations are secured by property taxes (and all other resources of issuer)
- Source of repayment may come from other sources such as
 - Municipal Income Tax
 - Special Assessments for the Project Financed
 - Other Nontax Revenues (Enterprise Funds)
- Limited obligations provide for a specific pledge
 - Taxes Limited to Particular Purpose
 - Pledged Utility Revenues
 - Special assessments for specific projects

Debt Limitations

- Direct Debt Limitations, Based on Assessed Valuation
 - Apply to “Net Indebtedness” – Some Exceptions
 - Direct Debt Limitations for Different Subdivisions
- Exemptions
 - “Self-Supporting”
 - Municipal – Income Tax Covenant
 - Utility Revenue and Other Non-General Obligation Debt
 - County – County Jails
 - Township – Fire Protection

Debt Limitations

- Direct Debt Limitations example
 - City of Grandview Heights
 - Assessed value \$240,784,950
 - Voted debt limit of 10.5% - \$25,282,420
 - Unvoted debt limit of 5.5% - \$13,243,172

Debt Limitations

- ◉ Indirect Debt Limitation – 10-Mill Limitation
 - Applies to Unvoted General Obligation debt
 - Constitution and Revised Code
 - All Overlapping Subdivisions
- Grandview Heights – overlapping subdivisions
 - Franklin County
 - Columbus City School District
 - Grandview Heights City School District
 - Grandview Heights Library District

Revenue (Special) Obligations

- Revenue obligations pledge a specific revenue
 - Utilities
 - Income Tax
 - Sales Tax
- Projects and Systems Have Identifiable Users
- Sold Without Voter Approval
- Debt Service Reserve Fund (DSRF)

Revenue (Special) Obligations

- Coverage Covenants
- Additional Bonds Test
- Debt Limitations
- Market limitations

Capital Leases & Operating Leases

- Capital Lease
 - Capital asset financing where Lessee (borrower) owns asset at the end of the lease term
- Operating Lease
 - Lessee makes lease payments for term of lease
 - Fair market purchase option at end of lease
 - Lessee returns asset to Lessor at end of term

Lease Appropriation Financing

- Annually Renewable Lease
- Subject to Annual Appropriation
- Not “Debt” for state law purposes
 - Can help borrowers stay within debt limits
- Appropriation measure is less secure than a general obligation or revenue pledge
- Used for essential assets of issuer

Other Types of Financings - Loans

- Ohio Public Works Commission (OPWC)
- Ohio Water Development Authority (OWDA)
- State Infrastructure Bank (SIB)
- Private Placement aka “Bank Loan”
- Loans can be secured in a number of ways
- Repayment terms negotiated between parties

Types of Securities

Bond Anticipation Notes

- Issued in anticipation of specified revenues or permanent financing.
- Usually mature within 13 months.
- Can be marketed quickly and inexpensively.
- Low interest rates.
- Deferment of permanent financing.

Types of Securities

Bonds

- Permanent financing
- Usually mature over longer period (20 years)
- Marketing that takes longer and more expensive
- Higher interest rates

Components of a Bond

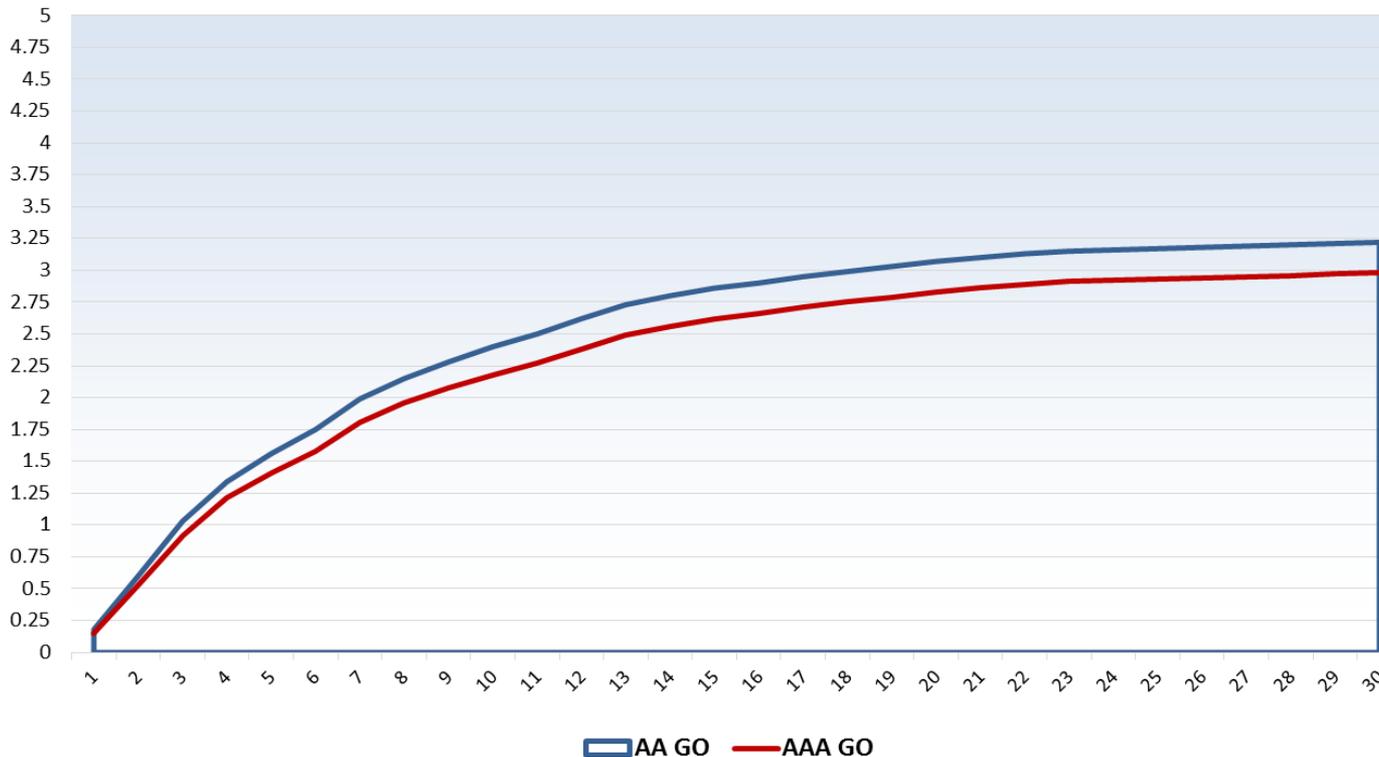
- Principal/Par Amount
- Maturity Date
- Interest Rate
- Call provisions
 - Par Call
 - Premium Call
 - Make Whole Call

Interest Rates & Yield Curves

AAA GO MMD vs. AA GO MMD

As of 3/11/2015

SOURCE: Thompson Reuters



Years	AAA GO	AA GO
1	0.15	0.18
2	0.53	0.6
3	0.92	1.03
4	1.21	1.34
5	1.41	1.56
6	1.58	1.75
7	1.81	1.99
8	1.96	2.15
9	2.08	2.28
10	2.18	2.4
11	2.27	2.5
12	2.38	2.62
13	2.49	2.73
14	2.56	2.8
15	2.62	2.86
16	2.66	2.9
17	2.71	2.95
18	2.75	2.99
19	2.79	3.03
20	2.83	3.07
21	2.86	3.1
22	2.89	3.13
23	2.91	3.15
24	2.92	3.16
25	2.93	3.17
26	2.94	3.18
27	2.95	3.19
28	2.96	3.2
29	2.97	3.21
30	2.98	3.22

Debt Service Schedule

- Details how much principal and interest will be paid each year and at maturity.
- At the time of issuance, the public funds manager or finance director can decide how many bonds to pay off each year.

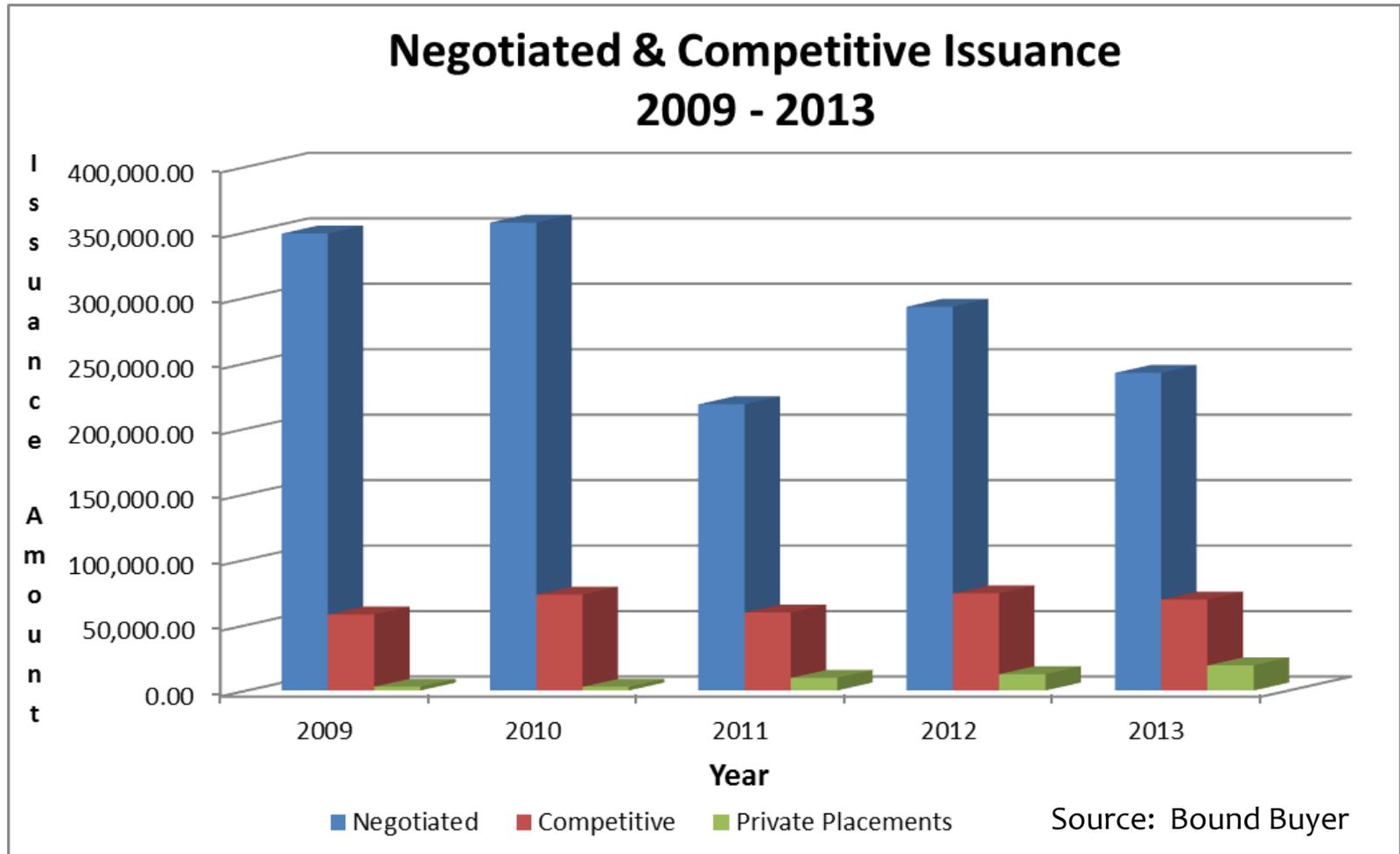
Negotiated Sale

- The issuer selects an underwriter or underwriting syndicate.
- Better control over major aspects of the financing.
- Can postpone or cancel the bond sale if market conditions become unsettled.
- Able to structure bonds based on market conditions and investor demand.
- Shifts the risk to the underwriter(s).

Competitive Sale

- Common for General Obligation bonds.
- Issuer has limited control over most aspects of the bond sale and assumes the risks.

Negotiated vs. Competitive Sale



What Is A Rating?

- Provide an analysis (and rating) of the issuer's credit quality.
- There are three primary rating agencies:
 - Standard & Poor's (S&P)
 - Moody's
 - Fitch

STANDARD
& POOR'S



Moody's Investors Service

FitchRatings

Credit Rating

MOODY'S
INVESTORS SERVICE

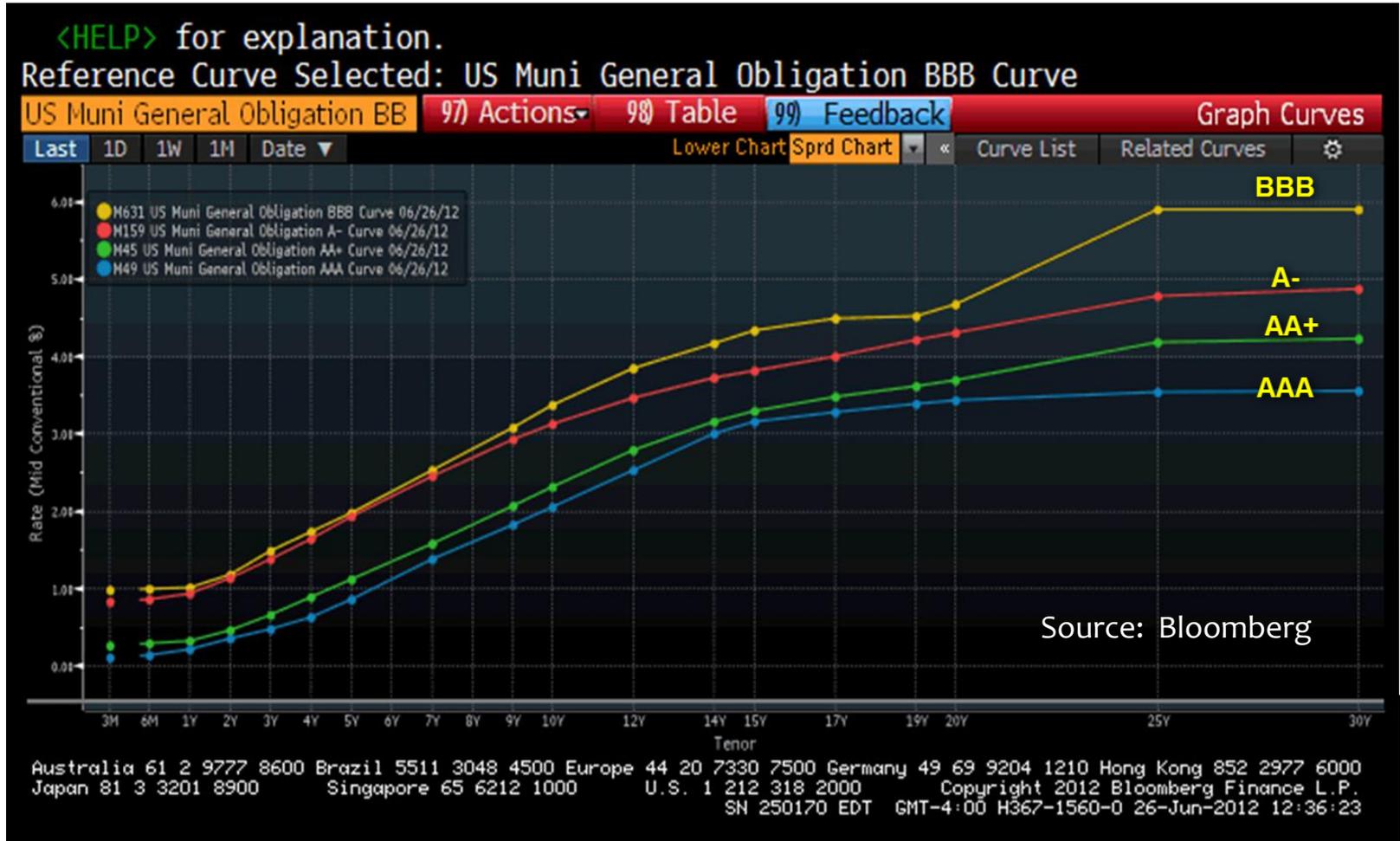
STANDARD
& POOR'S

FitchRatings
KNOW YOUR RISK

Indication to Investors

MOODY'S	STANDARD & POOR'S	FitchRatings	Indication to Investors
Aaa	AAA	AAA	Highest Quality Maximum Safety
Aa1	AA+	AA+	High Grade Very Strong
Aa2	AA	AA	
Aa3	AA-	AA-	
A1	A+	A+	Medium Grade Strong
A2	A	A	
A3	A-	A-	
Baa1	BBB+	BBB+	Lower Medium Grade Adequate
Baa2	BBB	BBB	
Baa3	BBB-	BBB-	
Ba1	BB+	BB+	Non-Investment Grade

Ratings & Interest Rates



Credit Ratings

- Rating agencies review overall health of issuer
 - Economy
 - Finances
 - Management
 - Debt burden



Marketing the Bonds

- How does an issuer sell its bonds?
- Who assists me with this process?
- A *Preliminary Official Statement* (POS) is sent to prospective investors (via hardcopy and/or electronic distribution).
- Retail Investors
- Institutional Investors

New Money vs. Refunding

- New Money bonds issued in order to obtain the initial funding necessary for a particular project.
- Refunding involves issuing new bonds to retire existing bonds.
- Refundings are done to reduce interest expense (savings threshold), eliminate restrictive covenants or restructure existing debt

Legal Considerations: Bond Issuance

- Federal Tax Law – “Tax-Exempt”
 - Use of Tax-Exempt Financed Facility – Private Use
 - Payment of Debt Service – Private Payment
 - Bank Qualification – QTEO
 - Arbitrage /Rebate
- Federal Securities Law
 - No Omission or Misstatement of Material Facts
 - Primary and Secondary Disclosure



SEC Disclosure: Bond Issuance

- Some issuers send periodic credit updates to bondholders.
- Others send an annual report to bondholders.
- Continuing disclosure materials *MUST* be sent to rating agencies and MSRB's EMMA system.

Working Group

- Issuer
 - Financial Advisor
 - Bond Counsel
 - Underwriter(s)
 - Underwriters' Counsel
 - Rating Agencies
 - Bond Insurer
 - Trustee, Registrar, Paying Agent
- Verification Agent
 - Escrow Agent
 - Bond Printer
 - Bondholders

Questions?

