LEAGUE OF WISCONSIN MUNICIPALITIES

2019 CLERKS, TREASURERS & FINANCE OFFICERS INSTITUTE

DEBT MANAGEMENT & RATING CONSIDERATIONS

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PRESENTATION OUTLINE

Available Credit Pledges

Common G.O. Funding Options

I. The Capital Markets
II. A "Local" Bank Loan
III. A Direct Placement
IV. State Trust Fund Loan (STFL) Program

Resolutions For Debt Issuance / Notes vs. Bonds

Credit Rating Considerations

Tax-Exemption Compliance

Today's PMA Presenters

ITEMS FINANCED BY MUNICIPALITIES WITH DEBT

Below are common Capital and Non-Capital items that are financed by municipalities with debt.

Common Municipal Capital Projects

- New Buildings
- Building Repair and Renovation
- Vehicles and Equipment
- Streets and Stormwater
- Water Distribution & Sewer Collection
- Water and Sewer Plant
- Recreational Facilities (swimming pools)
- Economic Development
  - Infrastructure
  - Developer Incentive Payments

Other Reasons to Borrow

- Unfunded Pension Liability
  - Most entities have paid off their WI ETF lability
- OPEB Liability
  - Fund a trust to offset future OPEB expenses

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AVAILABLE CREDIT PLEDGES

General Obligation (G.O.)

- Levy Property Taxes in an amount sufficient to make debt service payments

Direct Revenue Bonds

- Typically utility projects (Water, Sewer, Electric, Stormwater), and require rates to be set such that net revenues are sufficient to make debt service payments.
- Other revenue pledges are possible but much less common (e.g., TID Revenues, Room Tax Revenues)

Conduit Revenue Bonds

- Community Development Authorities (CDAs) and ReDevelopment Authorities (RDAs) can issue debt
- The unit of local government pledges to make a lease payment equal to the debt service payment

Special Assessment B Bonds

- Secured by a special assessment against the property and must be structured as level principal payments

Anticipation Notes

- The promise to issue new debt (G.O., Revenue, etc.) to financed the short-term Anticipation Notes
- Interim financing must mature within 5 years

GENERAL OBLIGATION (NOTES VS. BONDS)

General Obligation Notes

- Must mature within 10 years
- Can be issued for any public purpose

General Obligation Bonds

- Generally must mature within 20 years (Section 67.07 has exceptions)
- New money G.O. bonds must be issued via a "competitive" sale (Section 67.08(2))
- Refunding bonds can be issued via either:
  - competitive sale (underwriter determined as result of public bid)
  - negotiated sale (preselect the underwriter)
- Can be authorized via an Initial Resolution by the governing body of a city or village <u>only</u> for specific purposes (streets, libraries, police facilities, etc., per Section 67.05(5)(b))
- Potential Referendum (Section 67.05)
  - <u>Required Referendum</u>: If purpose is not enumerated (a new Village Hall is a common example)
  - <u>Permissive Referendum</u>: Cities are required to publish all Initial Resolutions within 15 days of adoption. A referendum vote can be forced if within 30 days of the Common Council passing an Initial Resolution there is a petition delivered to the Clerk signed by electors numbering at least 15% of the votes cast for governor at the last general election.

GENERAL OBLIGATION (REPAYMENT)

When a community issues General Obligation debt is has pledged to levy property taxes as necessary, but that doesn't mean it must levy property taxes if other sources of revenue are available. Common sources of revenue used to repay General Obligation debt include:

- Property Taxes
- Water or Sewer System Net Revenues
- Tax Incremental District (TID) Revenues
- Special Assessments

Financing a simple street project with 10-year Notes would often have three (3) expected repayment sources.

	Property Tax Levy Street Reconstruction		Water System Main Replacement		Sewerage System Collection Replacement		Total		
Year	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	D.S.
2020	135,000	37,500	--	8,750	--	8,750	135,000	55,000	190,000
2021	135,000	34,125	--	8,750	--	8,750	135,000	51,625	186,625
2022	140,000	30,750	--	8,750	--	8,750	140,000	48,250	188,250
2023	145,000	27,250	50,000	8,750	50,000	8,750	245,000	44,750	289,750
2024	145,000	23,625	50,000	7,500	50,000	7,500	245,000	38,625	283,625
2025	150,000	20,000	50,000	6,250	50,000	6,250	250,000	32,500	282,500
2026	155,000	16,250	50,000	5,000	50,000	5,000	255,000	26,250	281,250
2027	160,000	12,375	50,000	3,750	50,000	3,750	260,000	19,875	279,875
2028	165,000	8,375	50,000	2,500	50,000	2,500	265,000	13,375	278,375
2029	170,000	4,250	50,000	1,250	50,000	1,250	270,000	6,750	276,750
Total	1,500,000	214,500	350,000	61,250	350,000	61,250	2,200,000	337,000	2,537,000

COMMON G.O. FUNDING OPTIONS

I. The Capital Markets

- The most common method of financing large projects.
- A "security" which means it is readily transferable between two parties and the owner is subject to risk.
- No matter how many different investors hold "your bonds", the municipality only sends its payment to The Depository Trust Company (DTC), which acts as securities depository for the debt issue.

II. A Local Bank Loan

- Historically associated with shorter-term or smaller-sized borrowings, but there are always exceptions.

III. A Direct Placement

- Historically the least common financing method in Wisconsin, but becoming more common.
- Medium to large banks, with or without a local presence, want to purchase municipal debt to as an investment for their balance sheets.

IV. State Trust Fund Loan (STFL) Program

- Administered by the Board of Commissioners of Public Lands.
- Do not need to worry about compliance with tax-exempt IRS rules, as this borrowing is <u>not</u> tax-exempt.

I. CAPITAL MARKETS (FINANCIAL ADVISOR)

The first question a municipality must answer when planning to issue capital market securities is whether to (i) engage a Financial Advisor to represent the municipality, or (ii) negotiate directly with the Underwriter.

Financial Advisor

- A Financial Advisor (FA) is an advocate for it's clients' interests, including negotiating on behalf of its client with Underwriters.
- Primary technical responsibilities include: (i) long-term financial planning, (ii) current debt issue structuring, and (iii) taking the lead in coordinating all activities associated with the debt issuance process.
- A Financial Advisor owes its clients a fiduciary duty when performing municipal advisory activities.
  - The fiduciary duty includes a duty of loyalty and a duty of care.

Underwriter

- Also known as a Municipal Broker-Dealer.
- Primary responsibility is to purchase the debt from the municipal issuer and resell the debt to investors.
- A Broker-Dealer relationship is an arm's length transaction with no fiduciary duty to the issuer.
- The Underwriter is required to deal fairly at all times with both municipal issuers and investors.

Note: An Underwriter may engage in incidental financial advisory services, including advice as to the structure, timing, terms and other matters concerning the issuance of municipal securities.

The second question a municipality must answer when planning to issue capital markets securities is whether to sell the debt via (i) a competitive sale process, or (ii) a negotiated sale process.

Competitive Sale

- Underwriter is not known ahead of time.
- Offering documents are widely disseminated by the Financial Advisor for Underwriters to bid on.
- Bonds are awarded to the Underwriter whose bid yields the lowest average borrowing rate (the "TIC").
  - The True Interest Cost (TIC) calculation is based on (i) purchase price and (ii) timing of debt service.

Negotiated Sale

- Underwriter is selected ahead of time by the municipality.
  - A formal selection process can be facilitated by a Financial Advisor
- The municipality can, but is not required to, employ the services of a Financial Advisor to represent the municipality in negotiations with the Underwriter.

I. CAPITAL MARKETS (FINANCIAL ADVISOR RELATIONSHIP)

Exhibit: Utilizing a Financial Advisor (either Competitive or Negotiated Sale)

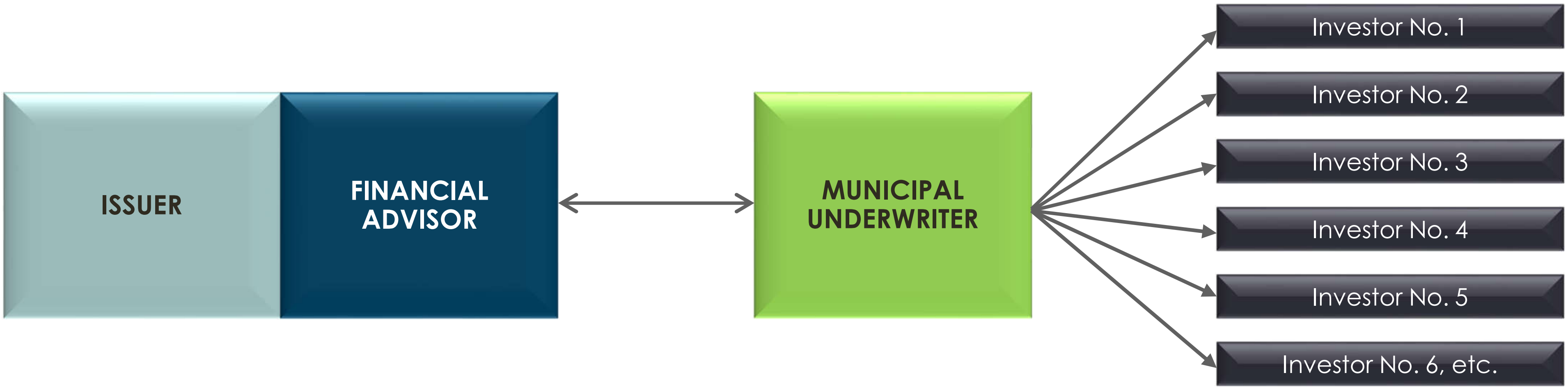
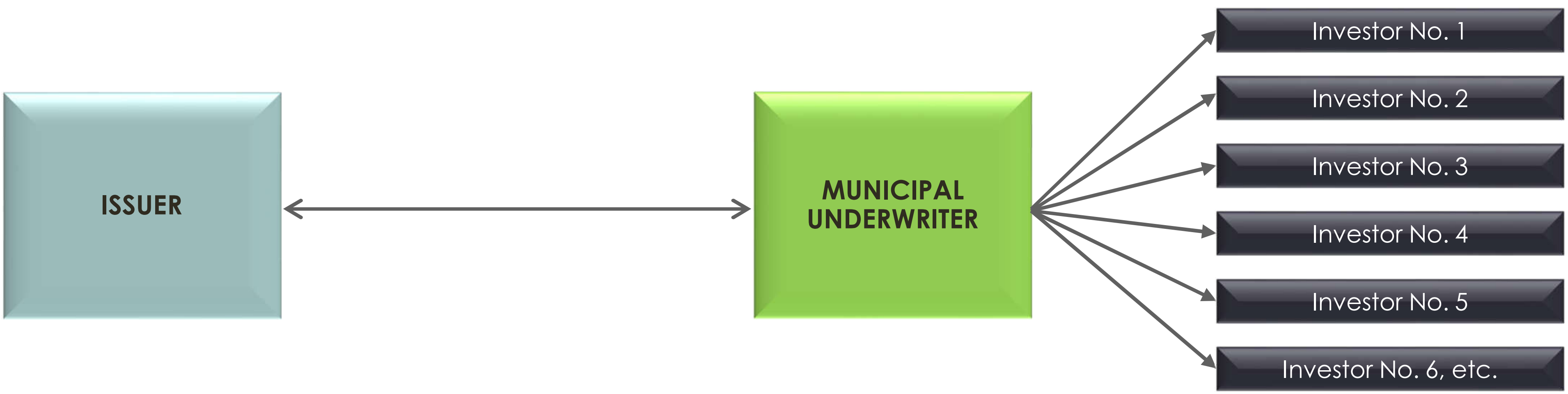
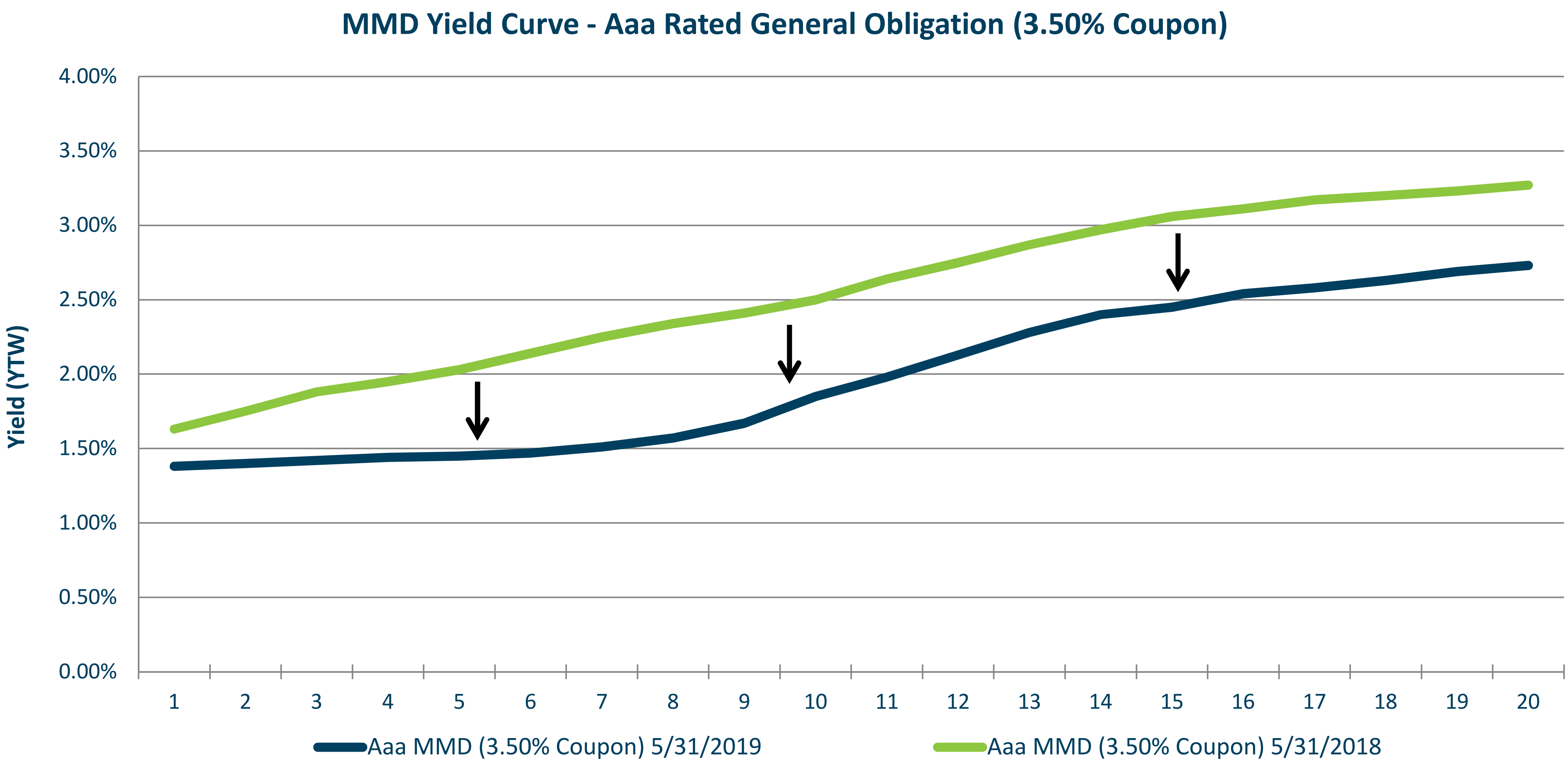


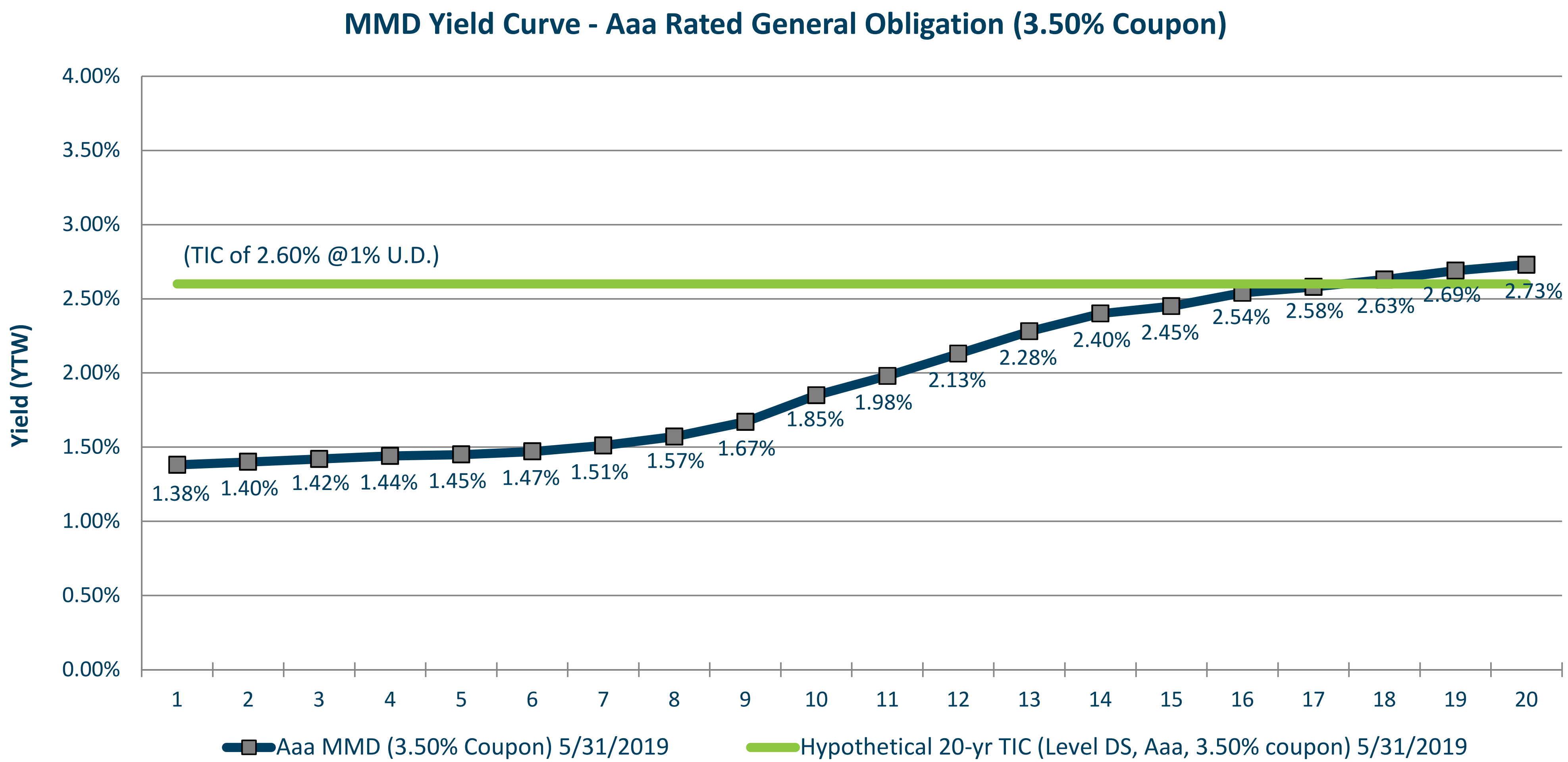
Exhibit: The Absence of a Financial Advisor (requires a Negotiated Sale)



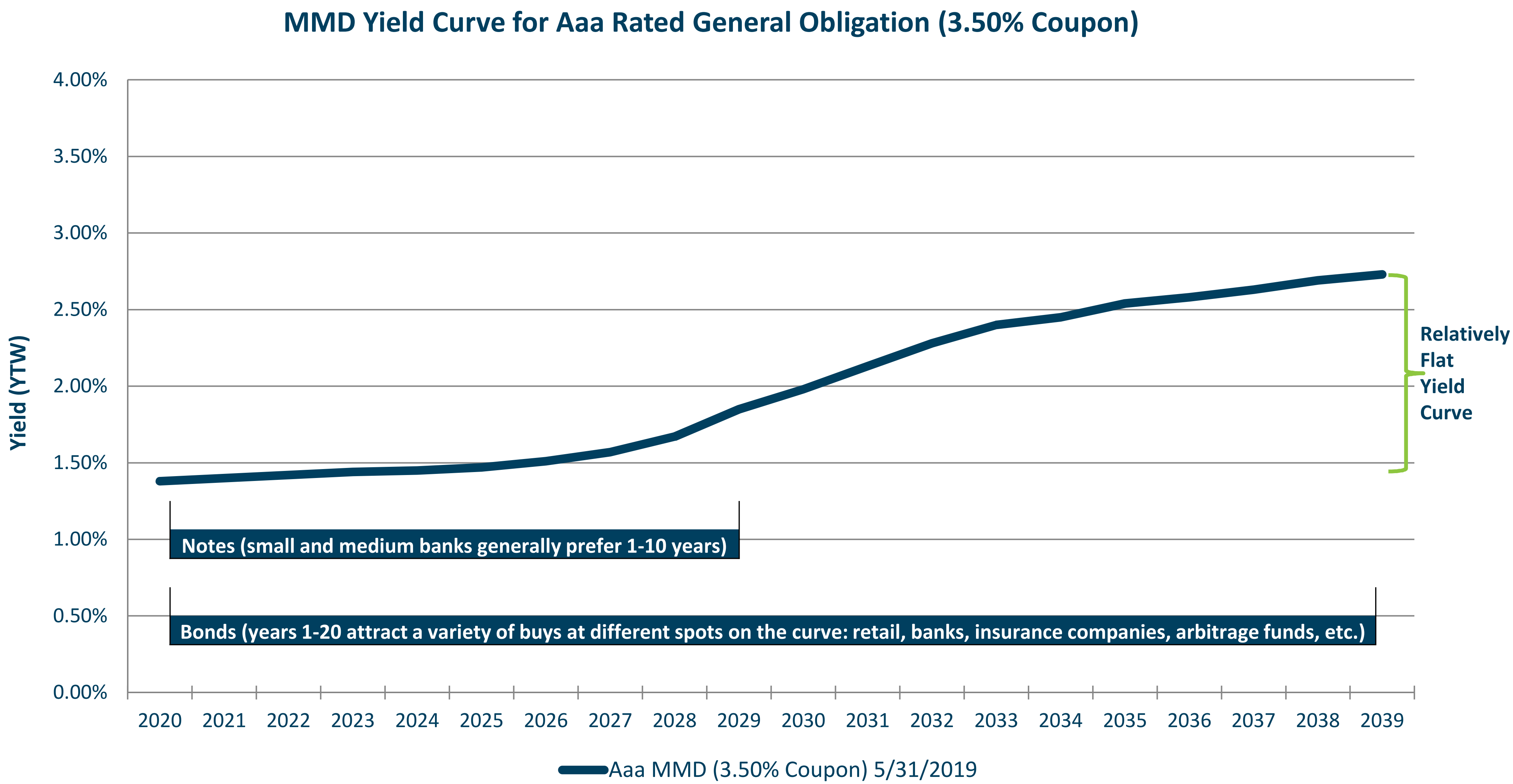
A 20-year, capital markets bond issue is effectively 20 separate bonds wrapped up into a single debt issue. Each of the 20 maturities has a different yield, and investors pick and choose which maturities they would like to purchase. Below are two Thomson Reuters Municipal Market Data (“MMD”) tax-exempt yield curves. Rates have fallen over the past year.



Below is the May 31, 2019 Thomson Reuters MMD yield curve from page 11, with the individual reoffering yields displayed. Also shown is a hypothetical single average rate (the "TIC"), for a 20-year bond issue structured with level annual payments, and an estimate for the Underwriter's compensation. Competitive Sales are awarded to the bidder with the lowest TIC.



Below is the May 31, 2019 Thomson Reuters MMD yield curve from page 11, with buyer notations.



II. "LOCAL" BANK LOAN

There are instances when Local Banks want an entire loan for their portfolio, and not just purchase select maturities of a larger Capital Markets municipal debt issue.

Local banks have historically been associated with shorter-term or smaller-sized borrowings, however, there are always exceptions.

Unlike a Capital Markets issue, Bank Loans are <u>typically structured at a single rate</u>.

A common benefit of a Bank Loan is that these loans are often able to be <u>prepaid without a penalty at nearly anytime after issuance</u>.

One pitfall associated with <u>certain</u> Bank Loans are acceleration provisions for certain credit events. Although not common, these acceleration provisions can be viewed very negatively by the rating agencies and simply need to be negotiated out of any loan documents.

If a municipality has a group of local banks that have expressed interest in financing a project, it is possible for the municipality to employ the services of a Financial Advisor to assist with structuring and the bid evaluation process.

Bank Loans are <u>generally viewed as not being securities</u>.

What is being referred herein as a Direct Placement can vary in nature.

Sometimes Direct Placements are more like a security (i.e., a Capital Markets issue), in the fact that they have separate rates for each maturity and have CUSIPs.

Other times Direct Placements are more like a Bank Loan in the fact that they have a single rate and no CUSIPs.

Regardless, medium to large banks, with or without a local presence, want to purchase municipal debt to as an investment for their balance sheets, and a Financial Advisor can guide the municipality through the process.

A common benefit of a Direct Placement is that these debt instruments are often able to be prepaid without a penalty at nearly anytime after issuance (just like what has been described herein as a Bank Loan).

Another benefit is that most banks that offer a Direct Placement do not require, or in some cases don't want, a credit rating on the specific borrowing.

IV. STATE TRUST FUND LOAN

The State of Wisconsin Board of Commissioners of Public Lands (BCPL), makes loans to units of local government through its State Trust Fund Loan (STFL) program.

Loans can be used for public purpose projects including economic development, local infrastructure, capital equipment and vehicles, building repairs and improvements, and refinancing existing liabilities. Current general obligation borrowing rates are as follows:

Loan Term	Interest Rate
2 Years	3.75%
3 - 5 Years	3.75%
6 - 10 Years	3.75%
11 - 20 Years	4.00%

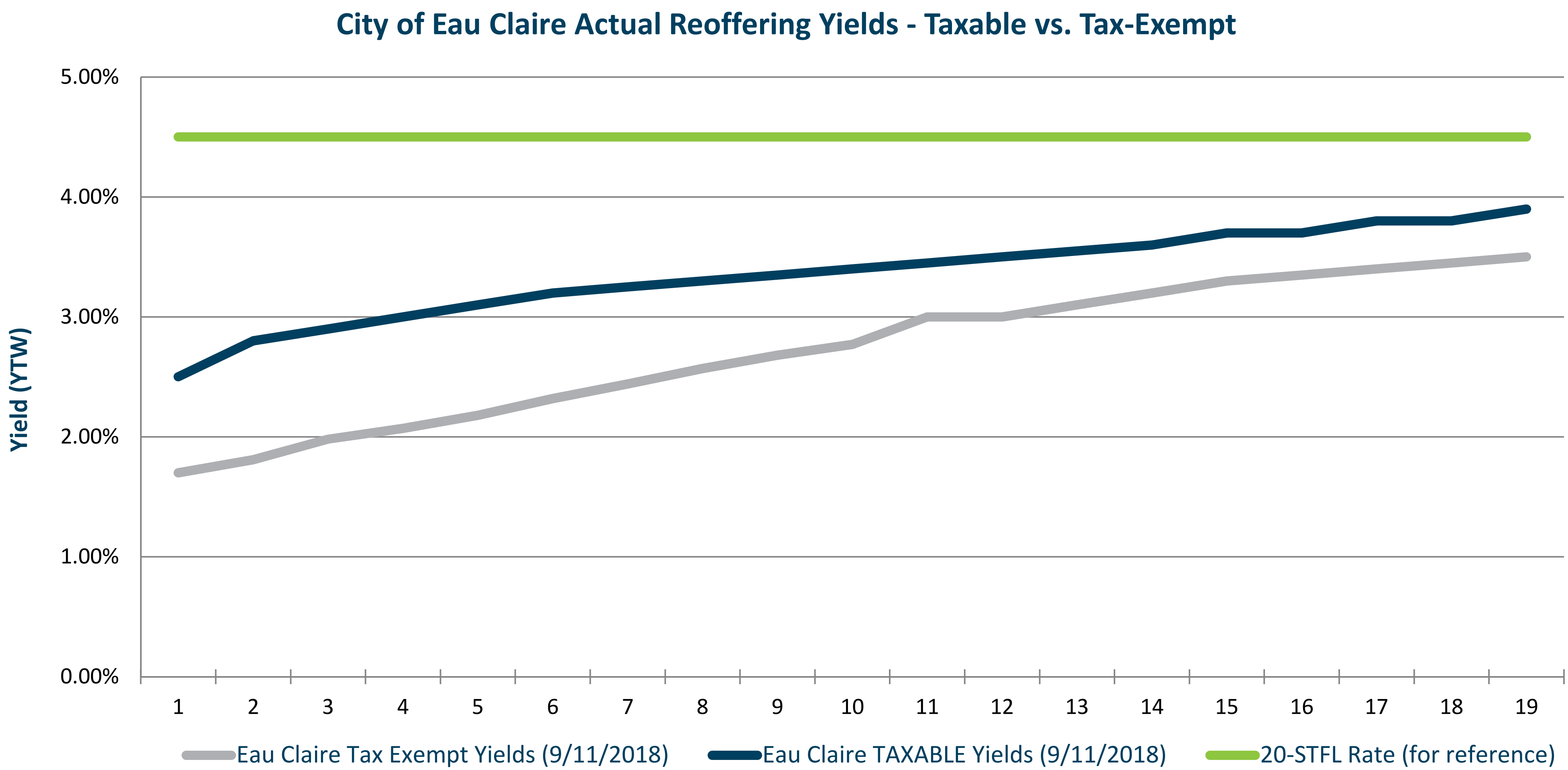
The STFLs can be prepaid without penalty from January 1 through August 31 of each year.

Because the pool of money that the BCPL loans was not "seeded" with tax-exempt bond proceeds, the loans are not considered tax-exempt (i.e., Taxable).

For reference, Federal Tax Status from most advantaged to not advantaged is as follows:

I. Bank Qualified Tax-Exempt (generally less than $10 million in a calendar year)
II. Tax-Exempt
III. Tax-Exempt subject to the Alternative Minimum Tax (AMT) (airport bonds are a common example)
IV. Taxable (the combination of private benefit and private pay triggers a taxable financing)

On September 11, 2018 the City of Eau Claire (Moody's Aa1), sold both tax-exempt bonds and taxable bonds, and the reoffering yields are presented below. The "cost" of taxability was approximately 0.50% on an apples-to-apples basis.



RESOLUTIONS FOR DEBT ISSUANCE / NOTES VS. BONDS

TYPICAL RESOLUTIONS FOR A LARGE PROJECT

Project Resolution

- This optional resolution provides the governing body's general approval for the project and typically directs staff to continue to work with professional consultants (e.g., engineers, architects, and financial advisors).

State Law Requirements for Borrowing Related Resolutions

- Common Council: a majority vote of all members.
- Village Board: a majority vote of the members present.

Initial Authorizing Resolution

- This would authorize the entire project borrowing in one or more series of notes or bonds.
- It may or may not provide a mechanism for a sale (if not, the mechanism is the "Set Sale Resolution").

Set Sale Resolution(s)

- Set Sale Resolutions are generally separate from the Initial Authorizing Resolution, particularly when the plan of finance contemplates issuing one or more debt issues to finance the project.

Award Resolution(s)

- The day the notes or bonds are sold, the pricing (i.e., interest rates) is finalized and a resolution prepared.
- Typically the day of sale is on the same day as a regularly scheduled Board meeting.

REIMBURSEMENT RESOLUTION

There are instances when a municipality needs to advance monies from its general fund for a project expense prior to passing the Initial Authorizing Resolution.

To the extent that a municipality wants the ability to pay itself back with bond proceeds it should pass a Reimbursement Resolution.

Reimbursement Resolution

- Requires a majority vote of the members present.
- Has a 60-day lookback window from the date of adoption.
- Generally, the advance must be repaid with bond proceeds not later than 18 months after the later of:
  - The date of the original expenditure, or
  - The date the project is placed in service, but in no event more than three years after the expenditure.

Don't Advance Funds Beyond December 31st

- It's OK to advance General Fund monies for a project in anticipation of repayment with bond proceeds, but always repay any advances by December 31st so the audit "looks good" for the rating agency review.

CREDIT RATING CONSIDERATIONS

Capital Market debt issues often, but are not required to, receive a rating.

Should a Municipality Purchase a Credit Rating?

- The economics of receiving a credit rating are as follows:
  - The issuer pays for the cost of the rating for a specific debt issue out of bond proceeds
  - A "good" credit rating lowers the interest rate that investors will accept / require
  - General Question: Are future reduced interest payments worth the upfront cost of a rating?
  - Answer: It's always issuer and issue specific, but generally the answer is yes.
    - Based on size of borrowing, length of borrowing, and credit rating

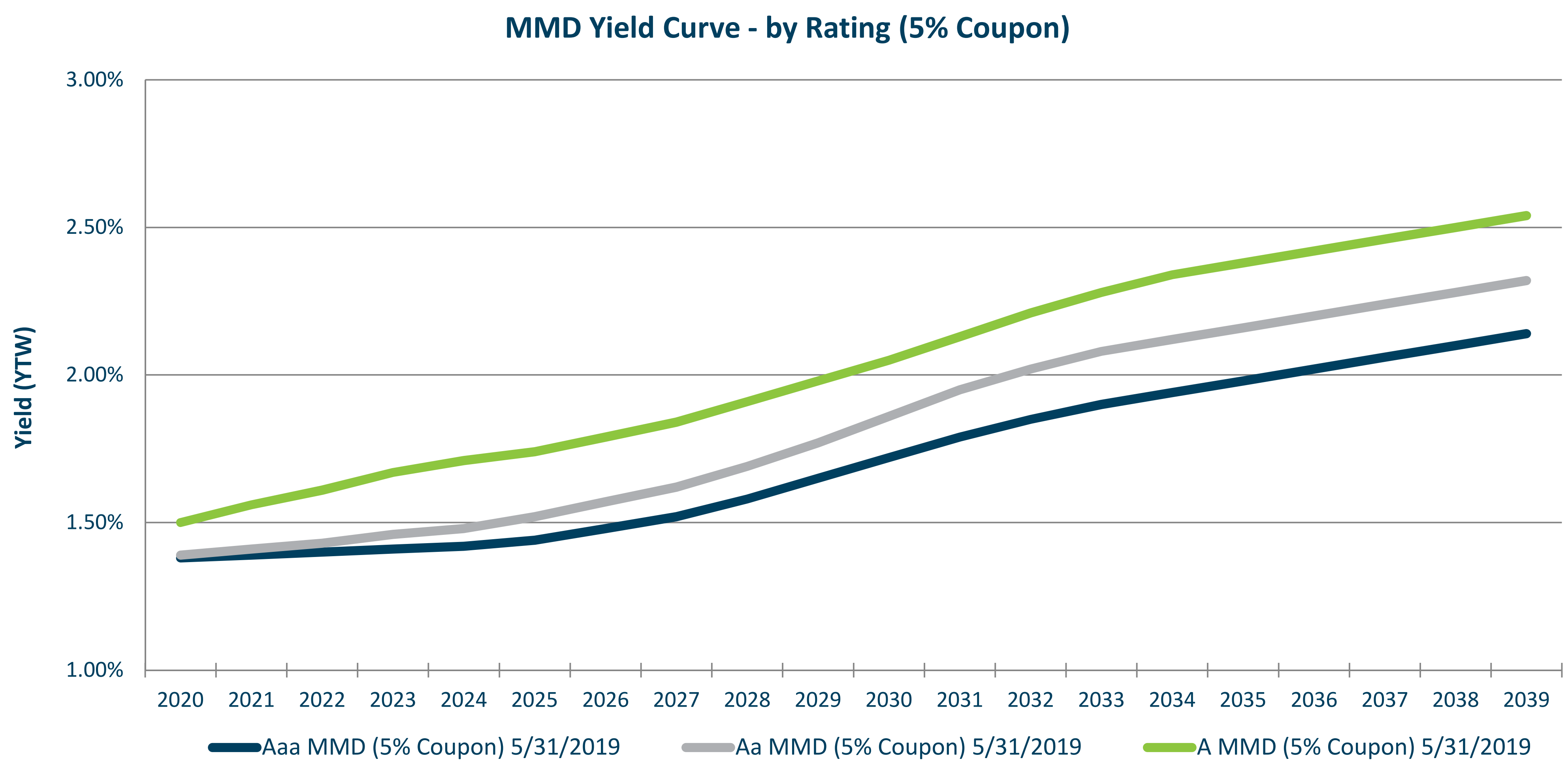
Rating Agency Options

- Moody's Investors Service
- S&P Global Ratings
- Fitch Ratings
- Kroll Bond Rating Agency

- Adjacent are Moody's and S&P "Investment Grade" rating scales

Moody's	S&P
Aaa	AAA
Aa1	AA+
Aa2	AA
Aa3	AA-
A1	A+
A2	A
A3	A-
Baa1	BBB+
Baa2	BBB
Baa3	BBB-

Thomson Reuters generates tax-exempt general obligation MMD yield curves by rating category (Aaa, Aa, A, and Baa). The below chart illustrates that there is generally a larger increase in reoffering yields between A and Aa, than there is between Aa and Aaa.



PMA SECURITIES

G.O. RATING METHODOLOGY - MOODY'S

Moody's released a G.O. rating methodology in January 2014 (updated Dec. 2016). There are a number of adjustments to the "simple" scorecard shown below.

MOODY'S INVESTORS SERVICE

Broad Rating Factors	Factor Weighting	Rating Sub-factors	Sub-factor Weighting
I. Economy/Tax Base	30%	Tax Base Size (Equalized Value)	10%
		Equalized Value Per Capita	10%
		Wealth (median family income)	10%
II. Finances	30%	Fund Balance (% of Operating Revenues)	10%
		Fund Balance Trend (5-year change)	5%
		Cash Balance (% of Operating Revenues)	10%
		Cash Balance Trend (5-year change)	5%
III. Management	20%	Institutional Framework*	10%
		Operating History	10%
IV. Debt/Pensions	20%	Debt to Equalized Value	5%
		Debt to Revenue	5%
		Moody's ANPL** (3-yr avg.) to Equalized Value	5%
		Moody's ANPL** (3-yr avg.) to Revenue	5%

* All Wisconsin municipalities, counties and technical colleges receive a score of "A"

** Adjusted Net Pension Liability (pro rata allocation of Moody's calculated WRS liability

S&P released a G.O. rating methodology in September 2013.

There are a number of adjustments to the "simple" scorecard shown below.

S&P's Management score includes a Financial Management Assessment (FMA), which assesses the policies and practices of a local government (not individual managerial quality, organizational efficiency, or any other performance indicators).

Broad Rating Factors	Factor Weighting
I. Institutional Framework*	10%
II. Economy	30%
III. Management	20%
IV. Liquidity	10%
V. Budgetary Performance	10%
VI. Budgetary Flexibility	10%
VII. Debt & Contingent Liabilities	10%

III. Management Financial Management Assessment
Revenue/Expenditure Assumptions
Budget Amendment/Updates
Long Term Financial Planning
Capital Improvement Plan
Investment Policy and Reporting
Debt Management Policy
Reserve (Fund Balance) Policy

* Wisconsin counties and municipalities > 25,000 receive a "2" - Strong. If population < 25,000 then receive a "3" – Adequate.

TAX-EXEMPTION COMPLIANCE

The U.S. Tax Code allows states, units of local government, and certain non-for-profits to issue debt that has interest earnings which are not subject to U.S. Federal Income Tax. The Federal tax exemption lowers the interest rate that units of local government pay on their debt.

Example Individual Investor Break Even Analysis	Taxable Example	Tax-Exempt Equivalent
Investment Amount	$ 100,000	$ 100,000
Investment Rate	4.00%	3.04%
Total Annual Interest Earned	4,000	3,040
Less Taxes Owed (24% Marginal Tax Bracket)	(960)	--
Net Interest Earned	$ 3,040	$ 3,040

Because the Federal Government views this tax exemption as costing it tax revenues, the U.S. Tax Code places a number of restrictions on the issuance of tax-exempt debt.

This presentation will briefly highlight a two broad areas of tax compliance, on a very limited, non-comprehensive basis.

I. **Pre-Issuance Tax Compliance**

II. **Post-Issuance Tax Compliance**

I. Pre-Issuance Tax Compliance

U.S. Tax Code places a number of restrictions at the time of issuance.

- Limits the dollar amount of bonds issued.
- Limits how early bonds can be issued ahead of expected project draws.
- Limits the ability to refinance tax-exempt debt with tax-exempt refunding debt.
  - Tax-exempt refunding issues must close within 90 days of the date of redemption.
  - "Tax Cuts and Jobs Act" eliminated tax-exempt advance refundings of tax-exempt bonds after December 31, 2017.
- Limits Private Use of tax-exempt facilities to 5% for unrelated use and 10% for related use.
  - It's rare, but think of a for profit coffee shop, gift shop, or dental clinic in a public building
  - Naming rights for a public building by a for-profit company can create tax consequences.

II. Post-Issuance Tax Compliance

Arbitrage Rebate and Yield Restriction compliance are two restrictions after issuance.

- **Arbitrage Rebate**
  - Issuers must rebate certain excess earnings on proceeds of tax-exempt bonds to the federal government.
  - There are two notable exceptions that allow issuers to keep any positive arbitrage.
    1. Small Issuer Exception
       - $5 million or less of Tax Exempt debt issued in a calendar year for municipalities.
    2. Spending Test
       - 6-month, 18-month, or 24-month spending exceptions.
  - Perform calculations no later than 5-year anniversary, and if needed make payment within 60 days.

- **Yield Restriction**
  - Prohibits investments that earn a rate higher than the arbitrage yield (i.e., borrowing rate).
  - For a new project, Yield Restriction would typically apply to any unspent bond proceeds remaining after the standard three-year Temporary Period expires.

Continued….

II. Post-Issuance Tax Compliance

Additional post-issuance compliance requirements includes:

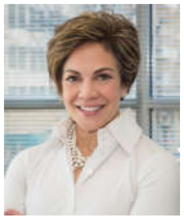
- **Record Retention**
  - Life of the Bonds + three (3) years
  - If the Bonds are refunded, life of the Refunding Bonds + three (3) years

- **Private Business Use**
  - Must continue to monitor any management contracts, leases or sub-leases.
    - A private company that is contracted to manage the operations of an Arena or a Convention Center that is financed with tax-exempt debt must maintain a Qualified Management Agreement ("QMA") under Internal Revenue Service ("IRS") regulations, to protect the tax-exempt status of the debt.

Take Away: Consider adopting a Post-Issuance Compliance Policy to formally designate team members and their ongoing post-issuance responsibilities.

Today’s PMA Presenters

TODAY'S PMA PRESENTERS



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