SESSION TWO
Debt Structuring and Method of Sale

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Financing Structuring Considerations

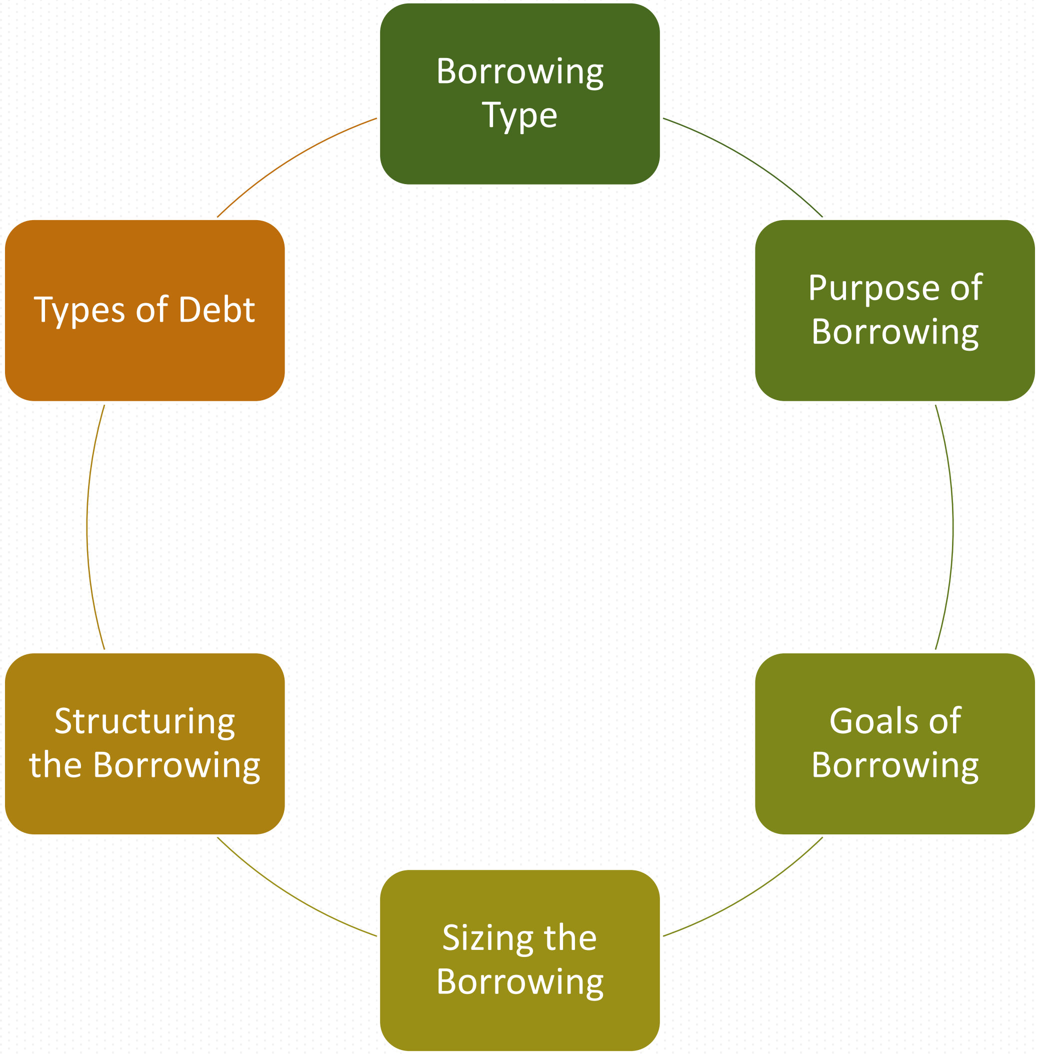
- Purpose and necessity of debt
- Organizational type (Governmental, Enterprise or Other)
- Long-term strategic goals of organization
- Debt policy (SB 1029)
- Current debt burden and debt capacity
- Long-term financial planning
- Intergenerational equity considerations
- Fluid market conditions

Purpose of Debt

- Many municipal entities are responsible for funding public projects
- Characteristics of the project often dictate the appropriate type of funding
- Long-lived infrastructure capital assets have different financing suitability vs. assets with shorter lives

Type of Funding	Advantages	Disadvantages
PAYGO *Pay for capital projects as revenue is saved or received from existing sources*	• Future funds not subject to debt service payments and the payment of interest	• Subject to limitations of available revenue • Rate considerations • Long wait time for new infrastructure
Grant Funding *Apply for State and Federal grants*	• Does not take away from any funding source	• Inconsistent and unreliable • May not cover full project costs • Funds often received on reimbursement basis • May “federalize” project
Borrow *Issue Debt*	• Spreads cost over the useful life of the asset; reduces need for large, regular increases in rates • Funds received when needed • Intergenerational equity	• Repayment includes interest costs • Various forms of borrowing may have specific terms/conditions • Ongoing obligations to lender(s)

Considerations in Structuring a Financing



Borrowing Type

	Public Sale	Private Placement	Federal/State Loan
	Public offering of bonds through either a negotiated or competitive sale	Financing provided by bank	Loan financing provided by Federal or State agency
Benefits	• Mature market • Predictable schedule • Proceeds available immediately • Borrowing terms may be customized	• Time efficient execution • Proceeds available immediately • Borrowing terms may be customized • Disclosure documents not required • Ratings often not required	• Low interest rates (typically) • Interest rate not as sensitive to ratings • State loans may have grants or principal forgiveness
Considerations	• Market conditions • Disclosure and ratings process adds time to schedule	• Market conditions • Borrowing terms may not be as flexible as other options	• Competitive application process • May not finance 100% of needs • Borrowing terms may not be as flexible as other options • Legal covenants may be more restrictive • Funds received as reimbursement • Application process

Public Offering

- Underwriter purchases bonds from Issuer, then sells those bonds to investors
  - Can be accomplished through either a negotiated or competitive sale process
- Preliminary Official Statement is produced and distributed to investors
  - Primary marketing document that investors use to make their investment decision
  - Underwriter and Issuer are responsible for all due diligence
- Bonds are typically rated by a rating agency
  - Ratings provide a third-party determination of the likelihood of timely repayment of debt service
  - Ratings lower the interest rate
- Legal terms and covenants can be tailored – with careful consideration of the marketing and rating implications
- Repayment can be structured to meet the needs of the Issuer – with careful consideration of the marketing, rating and interest rate implications

Private Placement

- Financing provided by a bank not through a public offering
- Offering Statement not required
- Ratings are typically not required, however, banks will perform their own review of Issuer’s credit and set their interest rate and loans terms based on this review
- Legal terms and covenants can be tailored but are subject to negotiation with the bank
- Repayment can be structured to meet the needs of the Issuer but are subject to negotiation with the bank

Method of Sale

	COMPETITIVE SALE	NEGOTIATED SALE	PRIVATE PLACEMENT
Mechanics	▪ Issuer, MA and legal counsel structure transaction and prepare/review transaction documents ▪ A date and time are set on which underwriters submit bids for the bonds ▪ Bonds awarded to underwriter submitting the bid with the lowest true interest cost	▪ Underwriter selected prior to the pricing of the bonds (typically near the outset of the transaction) ▪ Issuer, MA, underwriter and legal counsel structure transaction and prepare/review transaction documents ▪ Underwriter markets bonds ▪ At pricing, interest rates are set based on comparable sales and level of investor interest	▪ Bank is selected based on rate and borrowing terms ▪ May utilize placement agent ▪ Loan terms negotiated directly with bank
Time to Complete Transaction	▪ 3-4 months	▪ 3-4 months	▪ 2-3 months
Offering Statement Required	▪ Yes	▪ Yes	▪ No
Ratings Required / Utilized	▪ Yes (typically)	▪ Yes (typically)	▪ Not usually
Structuring	▪ Flexible	▪ Flexible	▪ Flexible, with potentially limits on the final maturity of the loan
Issuance Expenses	▪ Higher costs of issuance	▪ Higher costs of issuance	▪ Lower costs of issuance
When Most Appropriate (Generally – Situations May Vary)	▪ Well known issuer ▪ Conventional bond structure ▪ High credit quality ▪ Favorable market conditions	▪ Unknown issuer ▪ Complicated structure or large size ▪ Complicated credit ▪ Weak, volatile or challenging market	▪ Smaller borrowings ▪ Shorter term (~10-15 years) ▪ “Story” borrowings

Federal/State Loans

- Financing provided by Federal or State agency (SRF, IEDB, USDA, WIFIA, CWIFP, TIFIA)
- Disclosure through a Preliminary Official Statement typically not required
- Some loans may require a rating
- Legal terms and covenants may be flexible, certain loan programs have standard terms and covenants which may differ from those available under other methods of borrowing
- Repayment structure may be flexible, certain loan programs have greater flexibility than others
- Loan proceeds may be disbursed on a reimbursement basis making cashflow during construction an important consideration

New Money and Refunding

New Money	• Bond proceeds are issued to generate “new” funds • Typically for the construction, rehab or improvements to infrastructure
Refunding	• Refinancing of existing debt • Typically to reduce future debt service costs • Also can be used to restructure debt payments for strategic purposes

Sizing a Financing

- The elements of financing may differ by:
  - Type of borrowing (GO, revenue bond, etc)
  - Project type
  - Issuer financing plan
  - Ratings
  - Use of Proceeds (new money vs. refunding)
- Not all elements will be applicable to various financings

Project / Construction Fund

Capitalized Interest Fund

New Money Only

Escrow

Refundings Only

Debt Service Reserve Fund

Costs of Issuance Fund

Underwriter’s Discount

Bond Insurance

Project / Construction Fund

- Proceeds to fund project acquisition and/or construction
- Based on actual costs or detailed estimates
- Can include contingency funds
- Two methods of funding
  - Gross funded – exact project amount
  - Net funded – less than project amount, interest earnings during construction period used to meet project amount

Capitalized Interest Fund

- Proceeds to pay interest during project construction and / or revenue ramp-up / stabilization period
- May provide necessary cashflow relief during construction or ramp-up period
- Capitalized interest increases overall debt / loan payments over the repayment life (it is not “free money”)

Escrow Fund

- Proceeds to fund the principal and interest costs of refunded debt to its redemption date
- Funded at closing
- Typically invested – permitted investments highly restricted (i.e., SLGS and US Treasuries)
- Escrow fund held by the Escrow Agent
- Typically net funded (interest earned during the escrow period helps pay principal and interest of refunded debt)

Debt Service Reserve Fund

- Funds debt service payments in an event of a payment default
- Provides additional security for investors
- Issuers with high-grade ratings have been able to forgo a debt service reserve fund for certain project types
- Debt service reserve fund requirement typically the lesser of:
  - Maximum annual debt service
  - 125% of average annual debt service
  - 10% of par amount
- If “cash funded”, interest earnings on debt service reserve fund can help pay debt service
- Debt service reserve fund requirement may be met with a surety policy in certain situations

Costs of Issuance

- Funds eligible issuance costs
  - Financing team fees (bond counsel, disclosure counsel, municipal advisor)
  - Trustee / paying agent
  - Rating agency fees
  - Special tax consultant
  - Title insurance
  - State fees
  - Appraisal, feasibility study, engineer’s report
  - Verification Agent
  - Other costs associated with the issuance of obligations

Underwriter’s Discount

- Underwriter’s discount is the compensation the underwriter receives
  - Average takedown
  - Management fee
  - Expenses
- Average takedown is a dollar per bond amount (par amount / $1,000)
- Underwriter’s discount is typically funded with bond proceeds

Par amount of issuance	$25,000,000
Takedown	$2.50 per bond
Total takedown	($25,000,000/$1,000) * $2.50 = $62,500

Bond Insurance

- Bond insurance guarantees the payment of principal and interest to bondholders
- Insured bonds are assigned the credit rating of the bond insurer
- Can improve bond pricing and lessen the costs of borrowing

Premium, Discount and Par Bonds

- Individual maturities can be sold as premium, discount or par bonds

	Original Issue Discount (OID)	Par Bond	Original Issue Premium (OIP)
General Rule	Coupon<Yield Price<100	Coupon=Yield Price=100	Coupon>Yield Price>100

Maturity	Principal	Coupon	Yield	Price	
2026	$1,000,000	4.000%	2.590%	113.444%	Premium Bond
2027	$1,100,000	3.000%	3.000%	100.000%	Par Bond
2028	$1,200,000	3.000%	3.044%	99.500%	Discount Bond

- Price x Principal == Amount Investor Pays and Amount the Municipality Receives

Maturity	Principal	Price	Dollar Price
2026	$1,000,000	113.444%	$1,134,440
2027	$1,100,000	100.000%	$1,100,000
2028	$1,200,000	99.500%	$1,194,000

Bond Sizing Example

Sources:		
Bond Proceeds:		
	Par Amount	9,000,000.00
	Premium	887,784.50
		9,887,784.50
Uses:		
Project Fund Deposits:		
	Project Fund	9,000,000.00
Other Fund Deposits:		
	Capitalized Interest Fund	444,786.00
	Series A Debt Service Fund Deposit	223,998.50
		668,784.50
Delivery Date Expenses:		
	Cost of Issuance	165,000.00
	Underwriter's Discount	54,000.00
		219,000.00
		9,887,784.50

Serial and Term Bonds

- Serial Bonds
  - Principal repayment is made on the stated maturity date
  - Serial bonds are typically structured with maturity dates over regular intervals allowing an issuer to take advantage of different pricing levels across the yield curve
- Term Bonds
  - A bond which matures on a single date with sinking fund redemptions made prior to final maturity
  - Term bonds may be structured to increase the par amount of the maturity to attract additional investor interest

Maturity (7/1)	Par	Coupon	Yield	Type
2025	660,000	5.00%	2.30%	Serial Bond
2026	695,000	5.00%	2.34%	Serial Bond
2027	730,000	5.00%	2.38%	Serial Bond
2028	765,000	5.00%	2.42%	Serial Bond
2029	800,000	5.00%	2.46%	Serial Bond
2030	840,000	5.00%	2.50%	Serial Bond
2031	885,000	5.00%	2.55%	Serial Bond
2032	930,000	5.00%	2.61%	Serial Bond
2033	975,000	5.00%	2.62%	Serial Bond
2034	1,025,000	5.00%	2.64%	Serial Bond
2035	1,075,000	5.00%	2.67%	Serial Bond
2036	1,130,000	5.00%	2.72%	Serial Bond
2037	1,185,000	5.00%	2.75%	Serial Bond
2038	1,245,000	5.00%	2.80%	Serial Bond
2039	1,305,000	5.00%	2.86%	Serial Bond
2040	1,370,000	5.00%	2.97%	Serial Bond
2041	1,440,000	5.00%	3.07%	Serial Bond
2042	1,510,000	5.00%	3.13%	Serial Bond
2043	1,590,000	5.00%	3.20%	Serial Bond
2044	1,665,000	5.00%	3.27%	Serial Bond
2045	1,750,000	5.00%	3.48%	Sinking Fund
2046	1,840,000	5.00%	3.48%	Sinking Fund
2047	1,930,000	5.00%	3.48%	Sinking Fund
2048	2,025,000	5.00%	3.48%	Sinking Fund
2049	2,130,000	5.00%	3.48%	Term Bond Maturity
2050	2,235,000	5.00%	3.56%	Sinking Fund
2051	2,345,000	5.00%	3.56%	Sinking Fund
2052	2,465,000	5.00%	3.56%	Sinking Fund
2053	2,585,000	5.00%	3.56%	Sinking Fund
2054	2,715,000	5.00%	3.56%	Term Bond Maturity

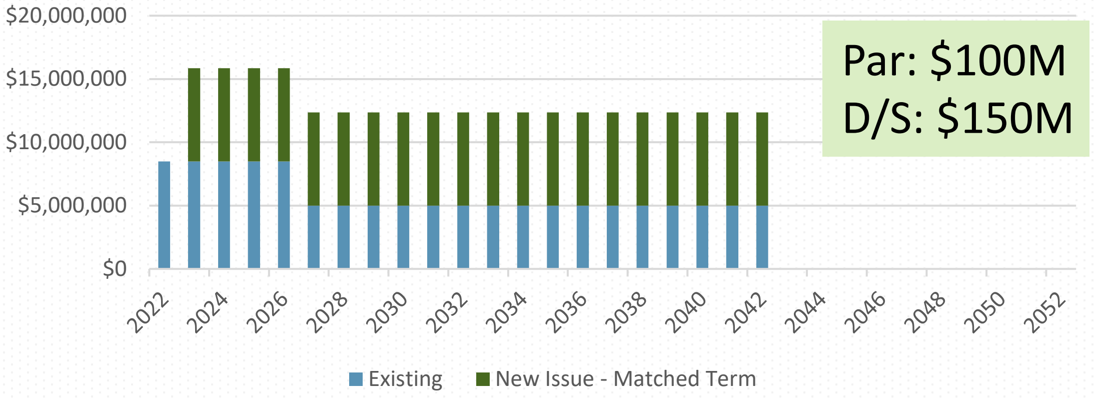
Redemption Features

- Optional Redemption
  - Call is exercised only at the option of the issuer, not the investor
  - Call typically exercised to achieve savings or restructure debt
  - Issuers typically issue Bonds with a 10-year call option
- Mandatory Redemption
  - Call must be exercised on specified date/during specified timeline
  - May be required by law
  - May be required by legal structure of transaction
- Extraordinary Redemption
  - Call exercised upon occurrence of certain events
  - May be optional
- Redemption Prices for Call Vary
  - Par
  - Premium
  - Make-Whole

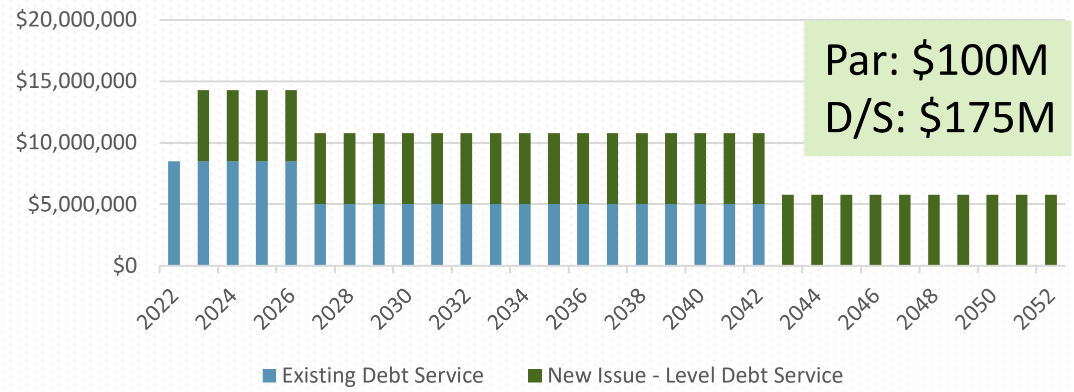
Debt Service Structures – New Money

- Debt structuring decisions are driven by a number of variables
  - Existing debt service shape and structure
  - Assets being financed
  - Anticipated revenue profile
  - Future debt issuance plans

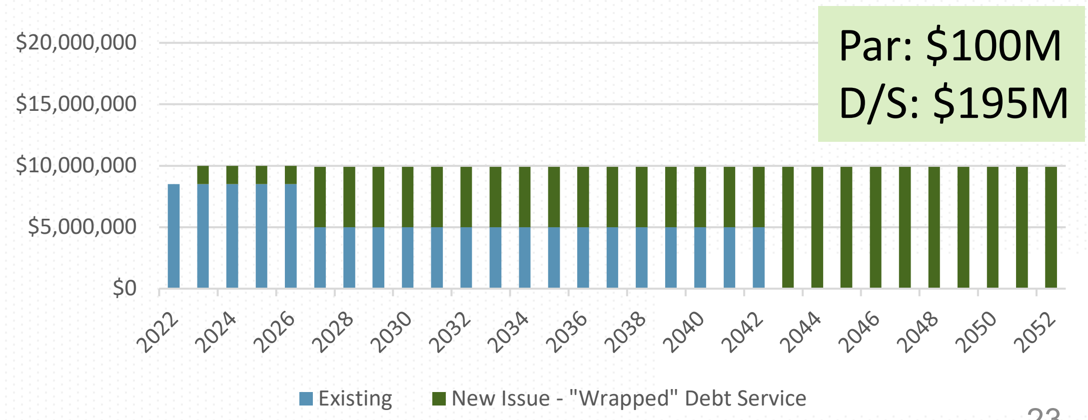
Matched Term Debt Service



Level Debt Service

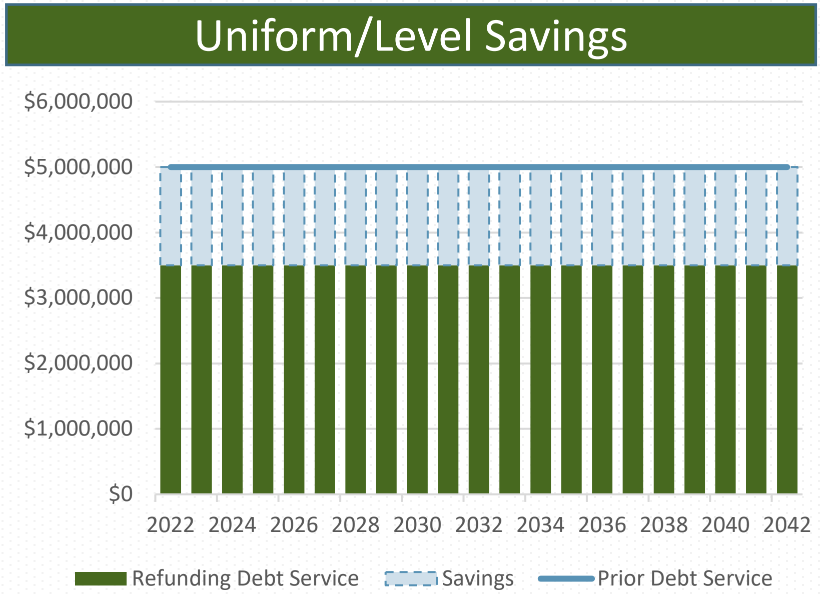


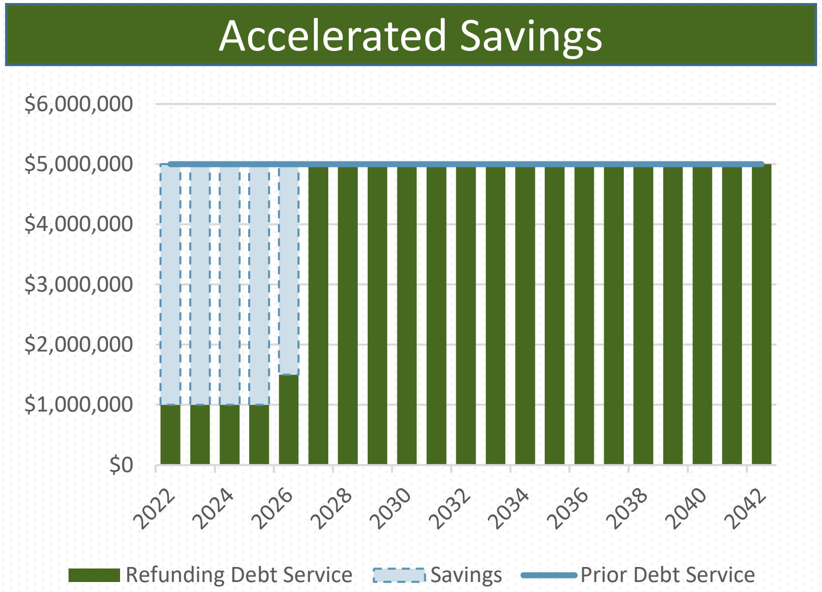
"Wrapped" Debt Service

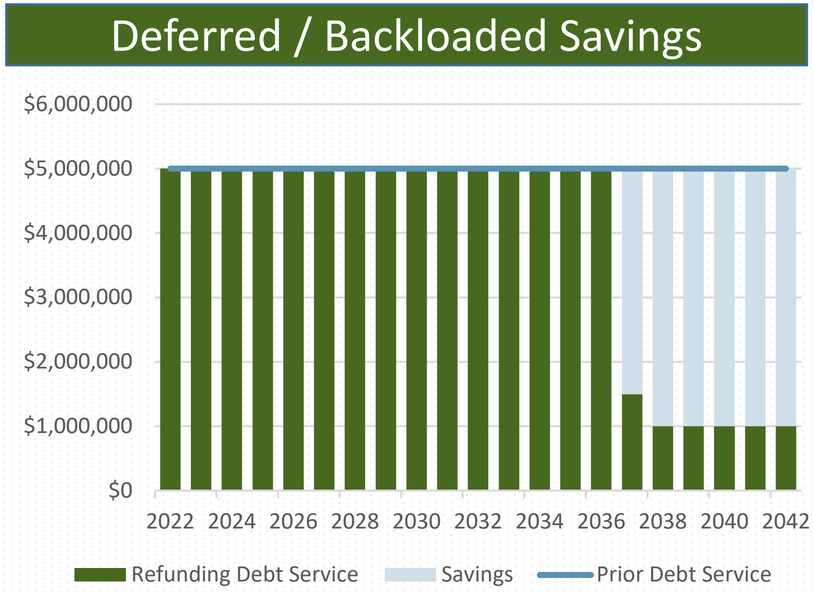


Debt Service Structures – Refundings

- Most common refundings are to refinance debt for interest rate savings
- Debt is also refunded for structuring and / or to eliminate restrictive covenants
- When refunding, one decision will be how to "shape" savings to the debt being refinanced



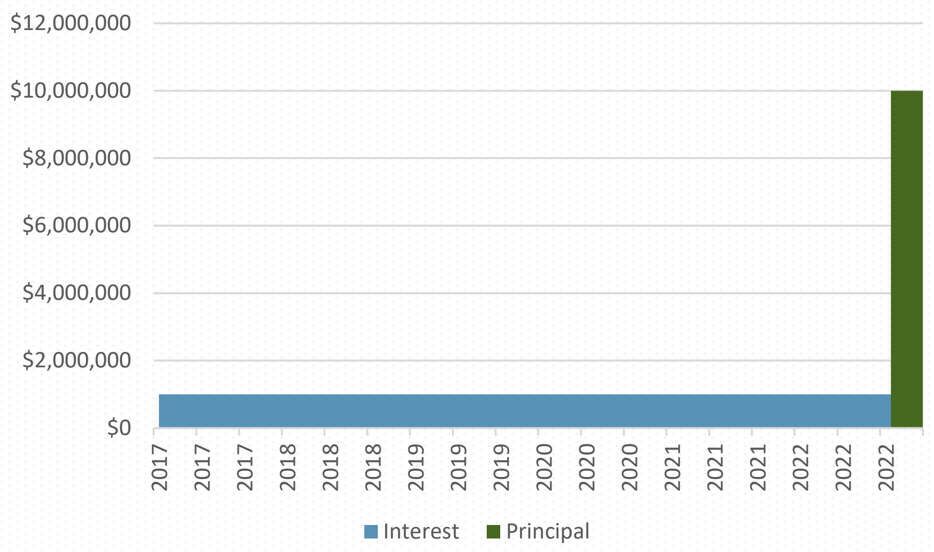




Fixed vs. Variable Rate Debt

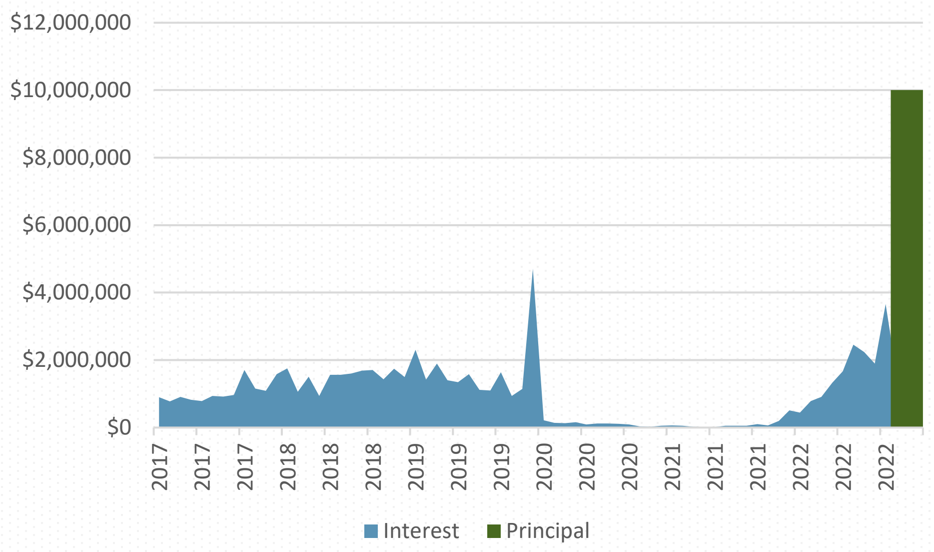
Fixed Rate Debt

- The rates (coupons) are set on the day of the pricing and do not change
- The issuer will pay scheduled interest (usually twice a year) for as long as the bonds are outstanding



Variable Rate Debt

- The rates are reset to different coupons at predetermined points throughout the year
- The issuer's interest payments will vary for the life of the bonds based on market conditions or changes in an index (typically SIFMA)



Considerations for Fixed vs. Variable Rate Debt

- What is the optimal mix between fixed and variable rate debt
- When should issuers consider variable rate debt vs. fixed rate debt?
- What are some of the benefits and considerations for fixed and variable rate debt?

Benefits of Fixed Rate Debt

- Allows for budgetary certainty and administration
- No ongoing credit support needed
- Legal documents are simpler

Considerations of Fixed Rate Debt

- Historically, higher interest rates than variable rate debt, on average
- Less flexible call feature than variable rate bonds

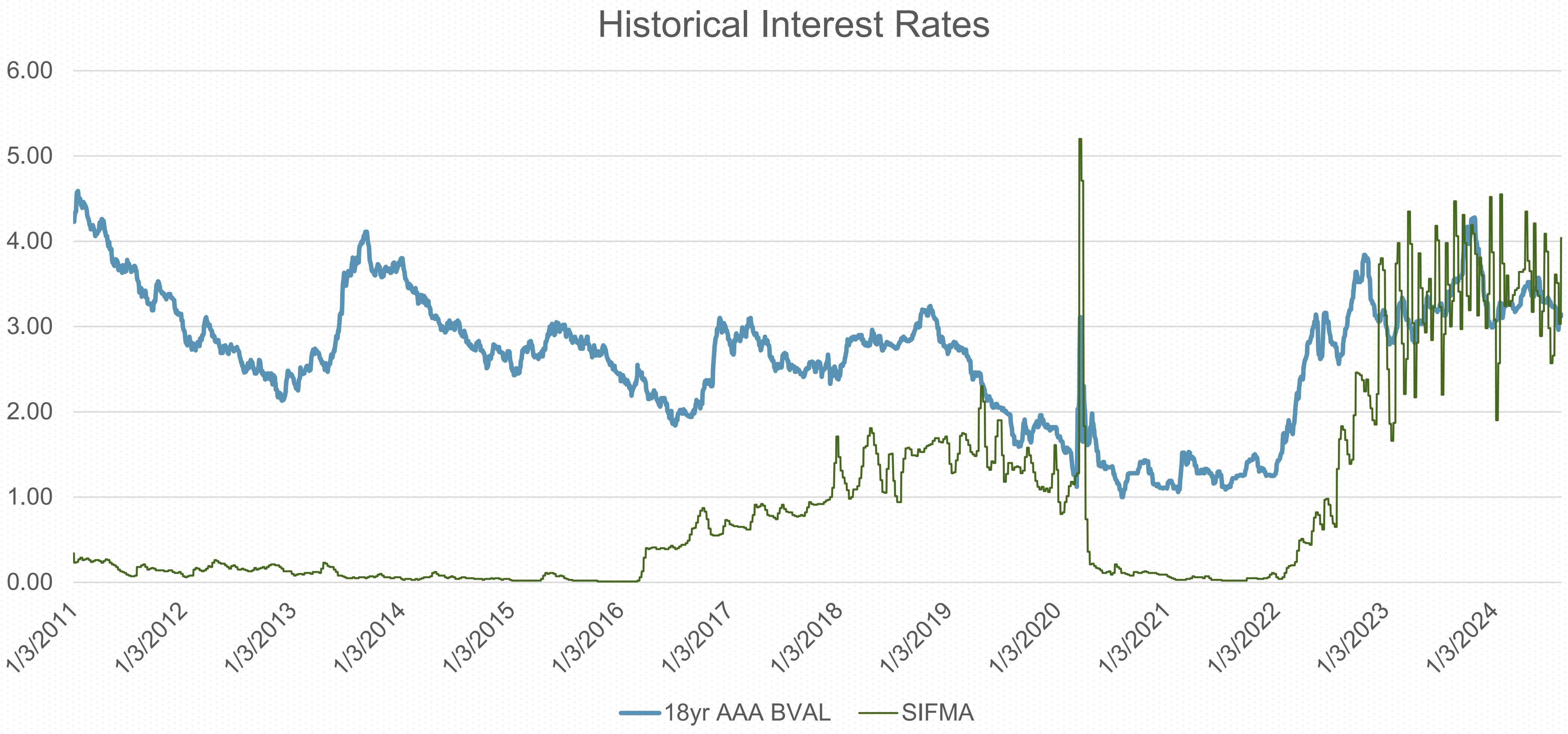
Benefits of Variable Rate Debt

- Creates a natural hedge between short-term assets and liabilities
- Often, more flexible prepayment provisions
- Used to diversify debt portfolio

Considerations of Variable Rate Debt

- Interest rate risk and bank credit risk
- Budgetary uncertainty
- Unpredictable pricing of support costs; typically new LOC/SBPA or mandatory tender required every 1-5 years
- Additional administrative involvement

Historical Interest Rates



Conclusions

- Every municipal entity is unique with their own considerations related to borrowing needs
- There are many different ways of borrowing, each of which may be beneficial in their own ways to a specific municipal entity or in a specific market
- It is important that each borrower carefully analyze what is best for them
- While the future is unpredictable, make borrowing decisions that take into account both near- and long-term considerations
- Debt is a long-term obligation and the decisions made today may govern certain financial decisions down the road
- Make sure you have a team of trusted advisors

QUESTIONS?

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