Capital Planning: 
A Story of Debt, Uncertainties and the Importance of Fiscal Policies

Importance of Capital Planning

Capitol building for sale

Where are we going today?

2. Capital Project Financing 201
3. Comfort in Policies
4. What can we control? And what can't we control?
What are government leaders focused on in 2018 & 2019?

State of the Cities 2018

Top 10 Issues

1. Economic 88%
2. Infrastructure 56%
3. Budgets & Management 49%
4. Public Safety 35%
5. Police/Courts 34%
6. Homelessness 33%
7. Health 32%
8. Transportation 30%
9. Housing 29%
10. Parks & Recreation 28%

2. Infrastructure, budgets, and housing rise in importance this year, overtaking public safety. Mayors offered more detailed infrastructure plans this year, while presenting a narrower scope of discussion on public safety.
Theory of Public Finance of Capital Projects

• Why do communities issue debt?
  – Costs are too high for cash payment of a project
  – Spread the cost of a project over current and future generations
    • Benefits are spread over several generations – costs could be as well
    • One generation should not subsidize the next
  • Payments equate to useful life of assets or less
Theory of Public Finance of Capital Projects

• Example of public purposes for which debt is issued:
  -- Building Schools – both for K-12 and higher educational institutions
  -- Road Projects – new roads and highways as well as maintenance on existing roads
  -- Public Power Projects
  -- Sewer & Water and Other Utilities
  -- Economic Development

• Why Tax-Exempt?
  -- Tax-Exempt Municipal Bonds enjoy special advantageous status in the investment community. The interest paid on most municipal debt is not subject to federal income taxation to bond investors. That generally translates to lower interest rates.

First Steps to Issue Debt

• Authority to Issue Debt
  -- Public Purpose
  -- Debt Limits
  -- Maturity Limitations

• Methods of Sale
  -- Private Placement
  -- Negotiated Sale
  -- Competitive Sale

Types of Bonds

• Governmental Purpose Bonds
  -- Debt instrument issued by governmental issuer
  -- May be general obligation, self-supporting OR paid by either income tax or some clearly defined revenue stream
  -- Bonds and bond anticipation notes

• Conduit Bonds
  -- The government acts as an issuer pursuant to an arrangement with a private conduit borrower in order for the debt to be tax-exempt
  -- The conduit borrower is solely responsible for making debt service payments
  -- Conduit bonds are not considered debt of the government issuer
Types of Governmental Bonds

• Special Assessment Bonds

• Double Barreled Bonds
  — Secured by both a defined source of revenue (other than property taxes) and the full faith and credit or taxing power of an issuer (General Obligation)

• Lease-Purchase Financings; Certificates of Participation (COPs)
  — Secured by the revenue stream of the lease payments that are subject to annual appropriation
  — The certificate generally entitles the holder to receive a share, or participation, in the payments
  — If structured correctly, lease-purchase financings/COPs are not considered debt under Ohio law

Refinancing Bonds

• Refunding Bonds
  — Applies to all types of bonds
  — Most bonds are callable after 10 years; sometimes a redemption premium applies
  — Refund in lower interest rate environment (hi to low)
  — Current refundings only. Bonds being refunded are outstanding < 90 days after the date of the refunding.

• Tax Cuts and Jobs Act (enacted on December 22, 2017)
  — Eliminates tax-exempt advance refunding bonds (an “advance refunding bond” is a refunding bond that is issued more than 90 days before the date that the bond that it will refund can be redeemed)

Debt Limitations

• Indirect Debt Limitation/10 Mill Limitation – Applies to all political subdivisions in the State for unvoted debt

• Direct Debt Limitations
  — Municipality
    • Unvoted – 5.5% of total assessed valuation (20% of total value)
    • Voted and Unvoted – 10.5% of total assessed valuation
  — Home Rule Power can increase limits
Debt Limitations (con’t)

- School District
  - Unvoted – 1/10 of 1% of total tax valuation
  - Energy Conservation debt – 2/10 of 1% of total tax valuation
  - Voted – 4/9% of total tax valuation (can exceed with state approval)

- County
  - Unvoted – 1% of total assessed valuation
  - Voted – 4% / 9% of total tax valuation

Participant Roles & Responsibilities

<table>
<thead>
<tr>
<th>Role</th>
<th>Municipal Advisor</th>
<th>Issuer</th>
<th>Bond Counsel</th>
<th>Underwriter</th>
<th>Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Task</td>
<td>Provide financing plan assistance</td>
<td>Approve bond legislation</td>
<td>Prepare bond resolution</td>
<td>Perform due diligence on disclosure</td>
<td>Purchase bonds</td>
</tr>
<tr>
<td>Task</td>
<td>Develop schedule</td>
<td>Assist with preparation of disclosure data</td>
<td>Provide Official Statement/disclosure preparation assistance</td>
<td>Assist with financing plan, structuring, and credit rating</td>
<td>Receive interest and principal payments from paying agent</td>
</tr>
<tr>
<td>Task</td>
<td>Provide rating agency &amp; bond insurer preparation assistance</td>
<td>Make bond payments</td>
<td>Prepare various deal related legal documents</td>
<td>Provide market information and comps from trading desk</td>
<td>Make bond payments</td>
</tr>
<tr>
<td>Task</td>
<td>Provide structuring advice</td>
<td>Provide legal opinion to investors</td>
<td>Provide market comps from trading desk</td>
<td>Provide legal opinion (if applicable)</td>
<td>Post sale responsibilities</td>
</tr>
<tr>
<td>Task</td>
<td>Provide legal opinion to investors</td>
<td>Make rating &amp; insurance presentations</td>
<td>Prepare various deal related legal documents</td>
<td>Make bond payments</td>
<td>Post sale responsibilities</td>
</tr>
</tbody>
</table>

Bond Issue

Example: November 5, 2019 Election

- 90 Days Prior to Election (August 7, 2019) – File all materials with the Board of Elections
  - Resolution of Necessity
  - County Auditor’s Certification
  - Resolution to Proceed

- Post Election
  - Board of Elections Certification
Ballot Millage Considerations for a Voted Bond Issue

- Project Amount
- Equal Principal Payments
- Assessed Valuation (No Growth Assumed)
- Interest Rate Assumption (vs. Current Market)
- Maximum Maturity (ORC 133.20; useful life of the assets)
- Average Millage for Ballot

Activities & Time Frame

<table>
<thead>
<tr>
<th>Weeks 1-6</th>
<th>Weeks 5-7</th>
<th>Week 8</th>
<th>Week 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determine Issue Structure &amp; Timing</td>
<td>Prepare Disclosure Information</td>
<td>Credit Rating</td>
<td>Market And Price Bonds</td>
</tr>
<tr>
<td>Close Bonds (use Proceeds)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Participants:
- Issuer
- Municipal Advisor
- Underwriter
- Bond Counsel

Proceedings With a Bond Issuer (Post Election)

- Governing body passes authorizing legislation
- Bond counsel prepares disclosure document
- Underwriter structures issue (two components):
  - Plan of Issuance
    - Ensure availability of funds when needed
    - Maximize construction period investment earnings
    - Minimize or avoid arbitrage rebate
  - Plan of Repayment
    - Manage impact of tax increase
    - Optimize benefits of structuring features (calls, discounts, premiums, etc.)
    - Consider future capital plans
- Prepare for Rating Presentation

Note: Some advisory duties may be performed by a municipal advisor, or underwriter, or both. New rules require underwriters to provide advice under one of three exemptions: 1) Underwriter Letter of Intent, 2) Independent Registered Municipal Advisor Exemption, or 3) Request for Proposal Exemption.
**Determine Issue Structure & Timing**

**Inputs**
- Premium Bonds
- Serial Bonds
- Capital Appreciation Bonds
- Final Maturity
- Investor Preferences
- Term Bonds

**Variables**
- Premium Bonds
- Serial Bonds
- Capital Appreciation Bonds
- Final Maturity
- Investor Preferences
- Term Bonds

**Output**
- Optimal Structure
- Costs of Issuance
- Call Features

**Prepare Disclosure Information**

**Issuer**
- Issuer name
- Rating
- Financial statements

**Municipal Advisor**
- Structuring information
- Issuer statements

**Bond Counsel**
- Demographic data
- Financial statements
- Debt limitation tables

**Underwriter**
- Structuring information
- Continuing disclosure agreement

**County Auditor**
- Assessed valuation data
- Building permits info
- Tax tables

**Issuer**
- Demographic info
- Description of tax base and other sources
- Debt limitation tables

**Rating Factors**

**Four Primary Credit Factors**
- Debt
- Economy
- Management
- Finances

1. Moody's Investors Service

**Debt**
- Amount outstanding as % of full valuation
- Structure and composition
- Other long-term commitments

**Economy**
- A.V. and historic growth
- Diversity of economy, taxpayer concentration
- Unemployment rates, median income

**Management**
- Financial planning and budgeting
- Realistic assumptions
- Policies and historical performance
- Timely disclosure

**Finances**
- Multiyear financial trends
- Available cash on hand
- Operating flexibility to raise revenue or cut expenditures
- Budget predictability
Marketing and Price Bonds

- Active Pre-Marketing
  - Investment Broker
  - Branch manager memorandum
  - Sales force conference call

- Wide Distribution
  - Institutions
  - Banks
  - Individual Investors

Sale of Bonds

### Retail Market

- Consists of individual investors and smaller "institutions" (e.g., banks, savings and loans, etc.)
- Large, broad market
- Less sophisticated in terms of credit and/or security requirements of a bond issue
- Includes individual investors and smaller institutional buyers
- Maturities 1 to 15 years

### Institutional Market

- Consists of money market funds, corporations, bond funds, large banks, insurance companies, and trust companies
- Very sophisticated and stringent credit and/or security requirements
- Companies investment alternatives available and demand market interest rates
- Maturities beyond 15 years

### Local Supporters

- Consists of local taxpayers (e.g., residents or taxpayers of the issuer)
- Very small market size
- Less concerned with credit or security issues
- Accepts below market interest rates
- Maturities 1 to 10 years

Closing the Bond Issue

- Underwriter wires funds to issuer.
- Issuer confirms to the underwriter that all funds are received.
- Bond counsel confirms everything is in place for closing.
- Underwriter & Paying Agent call Depository Trust Company (DTC) to release the bonds to investors.
Primary Documents for a Bond Transaction

- Election proceedings (voted issue only)
- Authorizing legislation
- Official Statement (Preliminary & Final)
- Bond Purchase Agreement

Key Closing Documents
- Bond Counsel Opinion
- Bond Certificates
- Signature & No Litigation Certificate
- General Certificate
- Tax Compliance/Arbitrage Certificate
- IRS From 8038-G

Refinancing Bonds

Refunding Bonds:
- Applies to all types of bonds.
- Most bonds are callable after 10 years; sometimes a redemption premium applies.
- Refund in lower interest rate environment (high to low).
- Current refundings only. Bonds being refunded are outstanding < 90 days after the date of the refunding.

Tax Cuts and Jobs Act (enacted on December 22, 2017)
- Eliminates tax-exempt advance refunding bonds (an "advance refunding bond" is a refunding bond that is issued more than 90 days before the date that the bond that it will refund can be redeemed)

Questions for Local Governments

Current:
- For outstanding bonds, what options remain?
  - How can we still achieve the economic benefits of refundings?

Future Issuance:
- How do we issue bonds that enable us to have refunding/financing flexibility?
- What features should we incorporate?
- How should we address our options in the bond documents?
Comfort in Policies

GFOA recommends that governments develop and adopt capital planning policies that take into account their unique organizational characteristics including the services they provide, how they are structured, and their external environment.

Capital planning policies should provide, at minimum:

1. A description of how an organization will approach capital planning, including how stakeholder departments will collaborate to prepare a plan that best meets the operational and financial needs of the organization.
2. A clear definition of what constitutes a capital improvement project.
3. Establishment of a capital improvement program review committee and identification of members (for example, the finance officer, or budget officer, representatives from planning, engineering, and project management, and, as deemed appropriate, operations departments most affected by capital plans, along with a description of the responsibilities of the committee and its members).
4. A description of the role of the public and other external stakeholders in the process. (The level and type of public participation should be consistent with community expectations and past experiences.)
5. Identification of how decisions will be made in the capital planning process including a structured process for prioritizing need and allocating limited resources.

Source: http://www.gfoa.org/capital‐planning‐policies
4. A requirement that the planning process include an assessment of the government's fiscal capacity so that the final capital plan is based on what can realistically be funded by the government rather than being simply a wish list of unfunded needs.

7. A procedure for accumulating necessary capital reserves for both new and replacement purchases.

8. A policy for linking funding strategies with useful life of the asset including identifying when debt can be issued and any limitations on the length of debt.

9. A requirement that a multi-year capital improvement plan be developed and that it include long term financing considerations and strategies.

10. A process for funding to ensure that capital project funding is consistent with legal requirements regarding full funding, multi-year funding, or phased approaches to funding.

11. A requirement that the plan include significant capital maintenance projects.

12. Provisions for monitoring and oversight of the CIP program, including reporting requirements and how to handle changes and amendments to the plan.

Source: http://www.gfoa.org/capitalplanning.policies.
What are our options?

- **Tax-exempt Current Refunding:**
  - Determine the call date
  - Review market conditions
  - If favorable, move forward with a current refunding (not more than 90 days) before the bonds become subject to optional redemption.

- **Taxable Advance Refunding:**
  - Review market conditions
  - If favorable, move forward with an advance refunding using taxable bonds

What are our options? (cont.)

- **Forward Delivery Bonds:**
  - Issue “forward” bonds to lock in savings prior to the current refunding date
  - Subject to cost of the forward delivery

- **Forward-Starting Swap:**
  - Execute an interest rate swap
  - Could be current or forward-starting
  - Goal is to lock in current rates and achieve some economic benefits
What are our options? (cont.)

• "Cinderella" Bonds:
  – Refund outstanding bonds with taxable "Cinderella" Bonds
  – Such bonds could be converted to tax-exempt obligations in the future

• Cash Optimization:
  – Use cash on-hand to defease/pay-off outstanding bonds
  – Then, fund new money capital projects with tax-exempt bonds (in lieu of cash funding)

• Still have taxable Build America Bonds?
  – Consider the possibility of a tax-exempt refunding.

Considerations for Government Leaders

• Additional borrowing costs
• Interest rate risk / Market risk
• Opportunity cost
• Tax code risk
• Credit risk
• Counterparty risk
• Credit risk

Legal consideration

• State law
• Federal tax law
• Existing bond indentures
• Existing trust agreements
What are the bond features post-Tax Reform?

• Derivative products

• Variable rate debt (VRDNs and VRDBs)
  - Callable anytime
  - Lower interest costs – shorter on the yield curve
  - Need to factor in LOC or liquidity provider cost
  - Issuer needs to feel comfortable with variable rate debt

• Short-term fixed rate debt
  - Lower interest costs – shorter on the yield curve
  - Market risk – need to roll the debt in future years

What are the bond features post-Tax Reform? (cont.)

• Make-Whole to Par Call (MWPC)

• Shorter call features
  - 5 years
  - 7 years

Federal Tax Law – Post-Issuance Compliance

• Arbitrage/Rebate

• Private activity
  - Management contracts, leases, naming rights, etc.

• Disposition of property
### Questions?

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Megan N. Kilgore</td>
<td>City Auditor, City of Columbus</td>
<td>Columbus City Auditor, 90 W. Broad St, Rev. 100, Columbus, OH 43215, <a href="mailto:mnkilgore@columbus.gov">mnkilgore@columbus.gov</a>, 614.645.7615</td>
</tr>
<tr>
<td>Katie Johnson</td>
<td>Partner, Bricker &amp; Eckler LLP</td>
<td>Columbus Office, 100 South Third Street, Columbus, OH 43215, <a href="mailto:kejohnson@bricker.com">kejohnson@bricker.com</a>, 614.227.2349</td>
</tr>
</tbody>
</table>

Columbus, OH 43215