

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



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Importance of Capital Planning

Capitol building for sale

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Where are we going today?



1. State of the Cities 2018 – infrastructure, infrastructure, infrastructure
2. Capital Project Financing 201
3. Comfort in Policies
4. What can we control? And what can't we control?

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State of the Cities 2018

infrastructure, infrastructure, infrastructure

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What are government leaders focused on in 2018 & 2019?

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State of the Cities 2018

Top 10 Issues

By percent of speeches that significantly covers each topic.

Economic Development 58%	Housing 39%
Infrastructure 56%	Public Safety 36%
Budgets & Management 49%	Health & Human Services 34%
	Education 28%
	Energy & Environment 25%
	Arts & Recreation 14%
	Transportation 12%

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.

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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.

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First Steps to Issue Debt

- Authority to Issue Debt
 - Public Purpose
 - Debt Limits
 - Maturity Limitations
- Methods of Sale
 - Private Placement
 - Negotiated Sale
 - Competitive Sale



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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

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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

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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)

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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 (35% of total value)
 - Voted and Unvoted – 10.5% of total assessed valuation
 - Home Rule Power can increase limits

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Debt Limitations (con't)

- School District
 - Unvoted – 1/10 of 1% of total tax valuation
 - Energy Conservation debt – 9/10 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 and Unvoted
 - AV not exceeding \$100,000,000, 3% of AV
 - AV exceeding \$100,000,000 but not exceeding \$300,000,000, \$3,000,000 plus 1½% of AV in excess of \$100,000,000
 - AV exceeding \$300,000,000, \$6,000,000 plus 2½% of AV in excess of \$300,000,000

Participant Roles & Responsibilities

<p>Issuer</p> <ul style="list-style-type: none"> • Approve bond legislation • Assist with preparation of disclosure data • Make rating & insurance presentations (if applicable) • Make bond payments • Post sale responsibilities 	<p>Municipal Advisor</p> <ul style="list-style-type: none"> • Provide financing plan assistance • Develop schedule • Provide rating agency & bond insurer preparation assistance • Provide structuring advice • Provide market comps 	<p>Underwriter</p> <ul style="list-style-type: none"> • Perform due diligence on disclosure • Assist with financing plan, structuring, and credit rating • Provide market information and comps from trading desk • Market and sell the bonds 	<p>Bond Counsel (Legal Counsel)</p> <ul style="list-style-type: none"> • Prepare bond resolution • Provide Official Statement/disclosure preparation assistance • Prepare various deal related legal documents • Provide legal opinion to investors
<p>Rating Agencies / Bond Insurers</p> <ul style="list-style-type: none"> • Review credit worthiness of the Issuer • Rating agencies issue bond rating • Insurance companies insure issue (if economically beneficial) 	<p>Investors</p> <ul style="list-style-type: none"> • Purchase bonds • Receive interest and principal payments from paying agent 	<p>Paying Agent / Registrar (PA/ Registrars)</p> <ul style="list-style-type: none"> • Authenticate bonds • Receive interest and principal payments from issuer • Make interest and principal payments to investors 	

Bond Issue

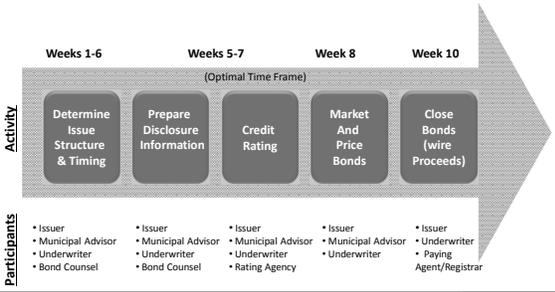
Example: November 5, 2019 Election

- 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



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. 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

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

- | | | |
|--|--|---|
| <p>Retail Market
<i>(typically 15% to 25% of the Bonds)</i></p> <ul style="list-style-type: none"> • Consists of Individual Investors and Smaller Ohio "Institutional Buyers" • Large, Almost Endless Market Size • Less Sophisticated in Terms of Credit and/or Security Requirements of a Bond Issue • Probably Compares Investment Alternatives Available but Accepts Below Market Interest Rates • Prefer Maturities 1 to 15 years | <p>Institutional Market
<i>(typically 50% to 75% of the Bonds)</i></p> <ul style="list-style-type: none"> • Consists of Money Market Funds, Corporations, Bond Funds, Large, Mid-Size and Small Banks, Insurance and Trust Companies • Buy in Very Large Quantities • Very Sophisticated and Stringent Credit and/or Security Requirements • Compares Investment Alternatives Available and Demands Market Interest Rates; these are the Market Makers • Prefer Very Early (1-5 Years i.e. Money Market Funds and Banks) or Very Long-Term Maturities (Beyond 15 years i.e. Insurance Companies, Trust Companies and Corporations) | <p>Local Supporters
<i>(typically 5% to 10% of the Bonds)</i></p> <ul style="list-style-type: none"> • Consists of Residents or Taxpayers of Issuer • Very Small Market Size • Not as Concerned with Credit or Security Issues and Will Not Compare Investment Alternatives • Accepts Below Market Interest Rates • Prefer Maturities 1 to 10 years |
|--|--|---|

Closing the Bond Issue

Closing Activities



- 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 Form 8038-G

Refinancing Bonds

Refunding Bonds:

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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

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A FOUNDATION OF FISCAL POLICIES

Forecasting 10 years planned out; conservative	Transparency award winning for 38 years in a row	Fees & Rates low; 2.3% average over last 5 years
Asset Management monitoring technology = savings	Rainy Day Fund \$75 million set aside	Investment Policy strong, stable \$1.8 billion in investments
Fund Balance Goals large cash reserves in each utility	Debt Management Policy simple, conservative, and	Debt - Rapid Amortization 74% of debt paid off in 20 years

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Capital Planning 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:

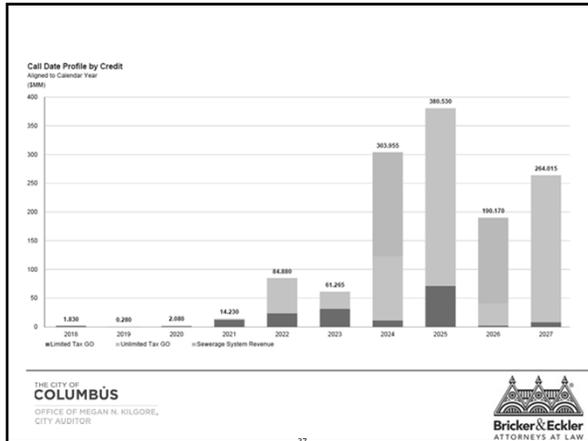
1. A description of how an organization will approach capital planning, including how stakeholder departments will collaborate to prepare a plan that best meets the operational and financial needs of the organization.
2. A clear definition of what constitutes a capital improvement project.
3. Establishment 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>

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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

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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

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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?

Megan N. Kilgore

City Auditor, City of Columbus



Columbus City Auditor
90 W. Broad St, Rm 109
Columbus, OH 43215
mnikilgore@columbus.gov
614.645.7615

Katie Johnson

Partner, Bricker & Eckler LLP



Columbus Office
100 South Third Street
Columbus, OH 43215
kejohnson@bricker.com
614.227.2349

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