



ICCCFO FALL CONFERENCE

Bond Basics

TAMMIE BECKWITH SCHALLMO
SENIOR VICE PRESIDENT
PMA SECURITIES, INC.

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- The Official Statement
- Rating Agency Preparation
- Refundings
- Method of Sale

The Official Statement

- The Preliminary Official Statement (POS) and Final Official Statement (OS) are prepared by, or on behalf of, the College in connection with a primary offering of its bonds
- The OS discloses all material information on the offering
- The OS is the main source of anti-fraud liability in a municipal transaction
- The obligation for the accuracy and completeness of the disclosure lies with the College
 - Experts may assist, but cannot completely discharge, the College's obligation
 - The College, Underwriter, Financial Advisor, Attorneys (Underwriter's Counsel/Disclosure Counsel/Issuer's Counsel) all have potential anti-fraud liability for material misstatements and omissions in an OS

- Reviewed by rating agencies and insurers when evaluating credit
- Used to market the securities to prospective investors
 - Gauge interest prior to sale
 - Provides material disclosure information needed to make an informed investment decision
 - The POS and OS have become more important in light of insurer downgrades and current credit environment

- The ISSUER'S document
 - YOU are the expert on YOUR college!
- Stringent legal disclosure requirements
 - The College's Board of Trustees and administration are held accountable for the adequacy of the information disclosed

- *Material* information concerning the issuance of debt
 - Prospective investors review the Preliminary Official Statement (POS) in order to make informed decisions regarding credit quality and risk
 - Focus should be on relevant factors regarding creditworthiness of the Issuer
 - All facts that could impact the creditworthiness of the Issuer need to be disclosed
- Your financial advisor and underwriter should allow sufficient time to review a first and second draft of the POS
- Consider engaging disclosure counsel to review the adequacy of disclosure in the POS

- General disclosure items regarding the securities
 - Purpose
 - Authorization
 - Security
 - Tax status

- Expenditures
 - Pension benefits
 - OPEB
- Debt and financial obligations
 - Outstanding debt
 - Overlapping debt of the College
 - History of default
 - Future financings
- Cash flow financings (if applicable)
 - History of short-term borrowings
 - Short-term borrowings could be a sign of stress

- Financial statements
 - Audited financial data
 - Budget summary
- General revenue base
 - Five years of historical data for all revenue sources
 - Discussion of major changes ($\pm 10\%$), if applicable
 - Breakdown and growth of equalized assessed value
 - Historical tax rates for the Issuer and overlapping bodies
 - Largest taxpayers
 - Applicability of tax caps

- **Demographics and local economy**
 - General history of Issuer
 - Census data (regarding wealth levels, home value, education levels)
 - Age of residents
 - Largest employers
 - Unemployment statistics

- The POS document framework is continuously evolving
 - Nature of data and narrative descriptions are frequently reviewed for updates as the municipal market seeks to meet investor demands for information
- Recent focus
 - Capacity of facilities
 - Pension and OPEB funding
 - Expanded continuing disclosure and MCDC initiative

- Benefits of complete and accurate disclosure
 - Facilitates investor relations and improved market access
 - Sufficient disclosure of favorable information strengthens a positive credit profile
 - Sufficient disclosure of unfavorable information demonstrates management's understanding of potential problems and its proactive approach to remedying them
 - *Sufficient disclosure keeps the College out of the SEC's crosshairs*

- Purpose: to allow the Underwriter and Disclosure Counsel the opportunity to ask questions about the College that may be material to investors
 - Another important step in making sure the POS/OS is as thorough as possible
- Timing: at the time of the rating call or earlier

Rating Agency Presentations

- A credit rating is an opinion about credit risk
 - Ability and willingness of an issuer to meet its financial obligations in full and on time
 - Likelihood of default
- Helps investors determine whether to invest in a community college's bond issue
- Higher credit rating = lower cost of borrowing

| | <u>Moody's</u> | <u>S&P</u> | <u>Fitch</u> | <u>Kroll</u> | |
|-----------------------------|----------------|----------------|--------------|--------------|---|
| Investment Grade | Aaa | AAA | AAA | AAA | Extremely strong capacity to meet financial obligations. |
| | Aa1 | AA+ | AA+ | AA+ | Very strong capacity to meet obligations. |
| | Aa2 | AA | AA | AA | |
| | Aa3 | AA- | AA- | AA- | |
| | A1 | A+ | A+ | A+ | Strong financial capacity but susceptible to adversity. |
| | A2 | A | A | A | |
| | A3 | A- | A- | A- | |
| | Baa1 | BBB+ | BBB+ | BBB+ | |
| | Baa2 | BBB | BBB | BBB | Adequate financial capacity but adverse conditions will lead to weakness. |
| | Baa3 | BBB- | BBB- | BBB- | |
| Non-Investment Grade | Ba1 | BB+ | BB+ | BB+ | Non-Investment Grade Speculative |
| | Ba2 | BB | BB | BB | |
| | Ba3 | BB- | BB- | BB- | |
| | B1 | B+ | B+ | B+ | Highly Speculative |
| | B2 | B | B | B | |
| | B3 | B- | B- | B- | |
| | Caa | CCC+ | | CCC+ | |
| | Ca | CCC | CCC | CCC | Extremely Speculative |
| | C | CCC- | | CCC- | |
| | | | | DDD | CC |
| | | | DD | C | |
| | D | D | D | D | |
| | | | | | |

- Key variables in a municipal credit analysis*
 - Management (20%)
 - Local economy (30%)
 - Financial position (30%)
 - Direct and Overlapping Debt as well as pensions (20%)

*Weights are for Moody's

- Deliver a detailed credit rating presentation to the credit rating analyst
 - In person or over the phone
- Ask for the credit rating that you believe should be assigned to the College's bonds

- Development that is taking place within your College's boundaries
- Status of existing TIFs and the possibility for additional TIFs
- Expected EAV trends
- Status of significant property tax appeals (PTAB)
- OPEB liability
- Enrollment trends
- Union contracts
- Revenue raising flexibility

- Various policies
 - Fund balance
 - Investment (and frequency of reports to the Board)
 - Debt Management
- Capital improvement plan
- Fund balance history
- How close the College's individual tax rates are to the statutory maximum rates
- Budget-to-actual performance
- Direct purchase debt
- Future facilities/financing needs

- Provides a rating agency with an opportunity to make sure credit ratings do not become “stale”
 - Accountability to the investor community
 - Regulations require at least a “passive” review annually
- Frequency of active surveillance may vary, but it is happening more often than before
- The College will be provided a list of questions
 - Be responsive

- Treat the surveillance call like a rating presentation for a bond sale
 - Take time to prepare detailed responses to each question
- Talk the analyst through your written responses
- Consult with your financial advisor and/or underwriter as soon as you receive the email or phone call requesting the surveillance call

- Has the College done everything communicated the during the last rating review?
 - Review the most recent rating report
 - Be prepared to address differences
- What circumstances have changed since the last rating review?
- Has anything made it difficult to achieve what was anticipated during the last rating review?

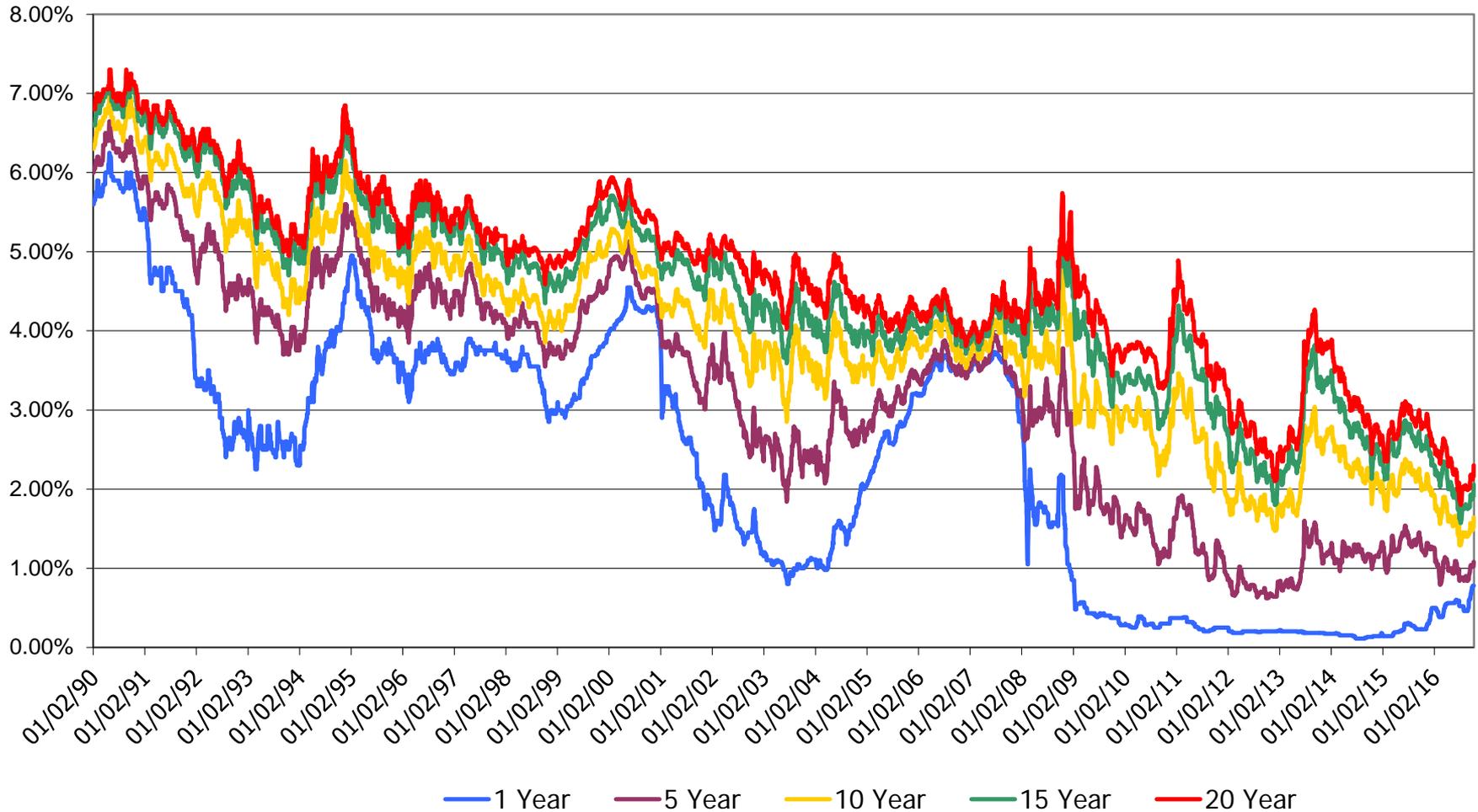
- Issuer Comment Reports were launched by Moody's earlier this year
 - Updates key ratios and other data
- Will be provided annually
 - The goal is to provide the investor community with up-to-date credit information about an issuer
 - It does not announce a rating action

- Moody's should contact the College at least two weeks before it forwards a draft of the ICR for review
 - The District will have three days to review the draft
 - Ask your financial advisor or underwriter to review it for you

- Moody's will continue to review a College's credit rating each year
 - The ICR fills in the "gap" in between the formal rating review

Refundings

- Community colleges may issue refunding bonds to refinance previously issued bonds
- Under most circumstances, the refunding bonds do not require further approval by the public as long as the refunding bonds are issued pursuant to the prior authorization
- Refunding bonds are issued for the following reasons:
 - To reduce debt service payments like a home mortgage refinancing
 - To restructure bonds/change the debt repayment schedule



*The Municipal Market Data "MMD" is a AAA municipal bond market index produced by TM3. As of October 6, 2016.

- A community college issues new refunding bonds
- The proceeds from the refunding bond issue are deposited into an escrow
- The proceeds and escrow interest earnings must be sufficient to pay refunded principal and interest up the call date

- The call date is the date on which the issuer can payoff the remaining principal of its bond issue (municipal bonds are not immediately callable)

- Advance refunding
 - Refunding bond issue that closes 91 or more days in advance of the call date
 - Refunding proceeds invested in an escrow until the call date
 - The U.S. tax code only allows for one *tax-exempt* advance refunding in the “life” of a bond issue
 - The Government Finance Officer Association recommends an advance refunding should generate a minimum of 3% to 5% in savings

- Current refunding
 - Current refunding bonds need to close within 90 days of the call date
 - At this time, U.S. tax code allows for multiple current refundings

- When short-term investment rates are low, longer escrows can be inefficient
- When evaluating an advance refunding, a community college must balance the benefit of locking in the savings (or portion thereof) versus waiting until the call date to reduce the escrow inefficiency
 - Value of bank qualification
 - Calculate the break even market movement which is the amount rates can increase to be indifferent between an advance refunding and a current refunding

- In an advance refunding, the proceeds of the refunding bonds are invested in US Government securities held in escrow that mature at the call date
- State and Local Government Securities (SLGs) were designed by the Bureau of the Debt to be used in refunding escrows
- When the Federal Government exceeds its debt limit, US Treasury Securities may be purchased in a Refunding Escrow

- Low short term interest rates in a refunding escrow can harm refunding savings
- If the refunding escrow can't earn at least up to the yield on the refunding bonds, the difference between the bond yield and the escrow yield results in negative arbitrage
- Negative arbitrage causes the refunding bond issue to be larger than it otherwise would be given higher short term interest rates and deducts savings from the refunding (inefficient escrow)

- Utilizing a State and Local Government Securities (U.S. Treasury Securities) funded escrow, PMA's current PV saving estimate: \$345,187 or 6.68% of the bonds refunded
 - The maximum allowable escrow yield is higher than the yield from SLGS which reduces the amount of PV savings ("Negative Arbitrage")

Escrow Fund Cashflow

| Date | Principal | Rate | Interest | Receipts | Disbursements | Cash Balance |
|--------------|-----------------------|----------|--------------------|-----------------------|-----------------------|--------------|
| 12/01/2016 | - | - | - | 0.42 | - | 0.42 |
| 01/01/2017 | 102,337.00 | 0.240% | 2,544.06 | 104,881.06 | 104,881.25 | 0.23 |
| 07/01/2017 | 89,645.00 | 0.500% | 15,236.80 | 104,881.80 | 104,881.25 | 0.78 |
| 01/01/2018 | 5,254,904.00 | 0.570% | 14,976.47 | 5,269,880.47 | 5,269,881.25 | - |
| Total | \$5,446,886.00 | - | \$32,757.33 | \$5,479,643.75 | \$5,479,643.75 | - |

Investment Parameters

| | |
|--|---------------------------------|
| Total Cost of Investments | \$5,446,886.42 |
| Target Cost of Investments at bond yield | \$5,373,544.00 |
| Actual positive or (negative) arbitrage | (73,342.42) |
| Yield to Receipt | Economic Constraint: 0.5693835% |
| Yield for Arbitrage Purposes | Legal Constraint: 1.8629756% |

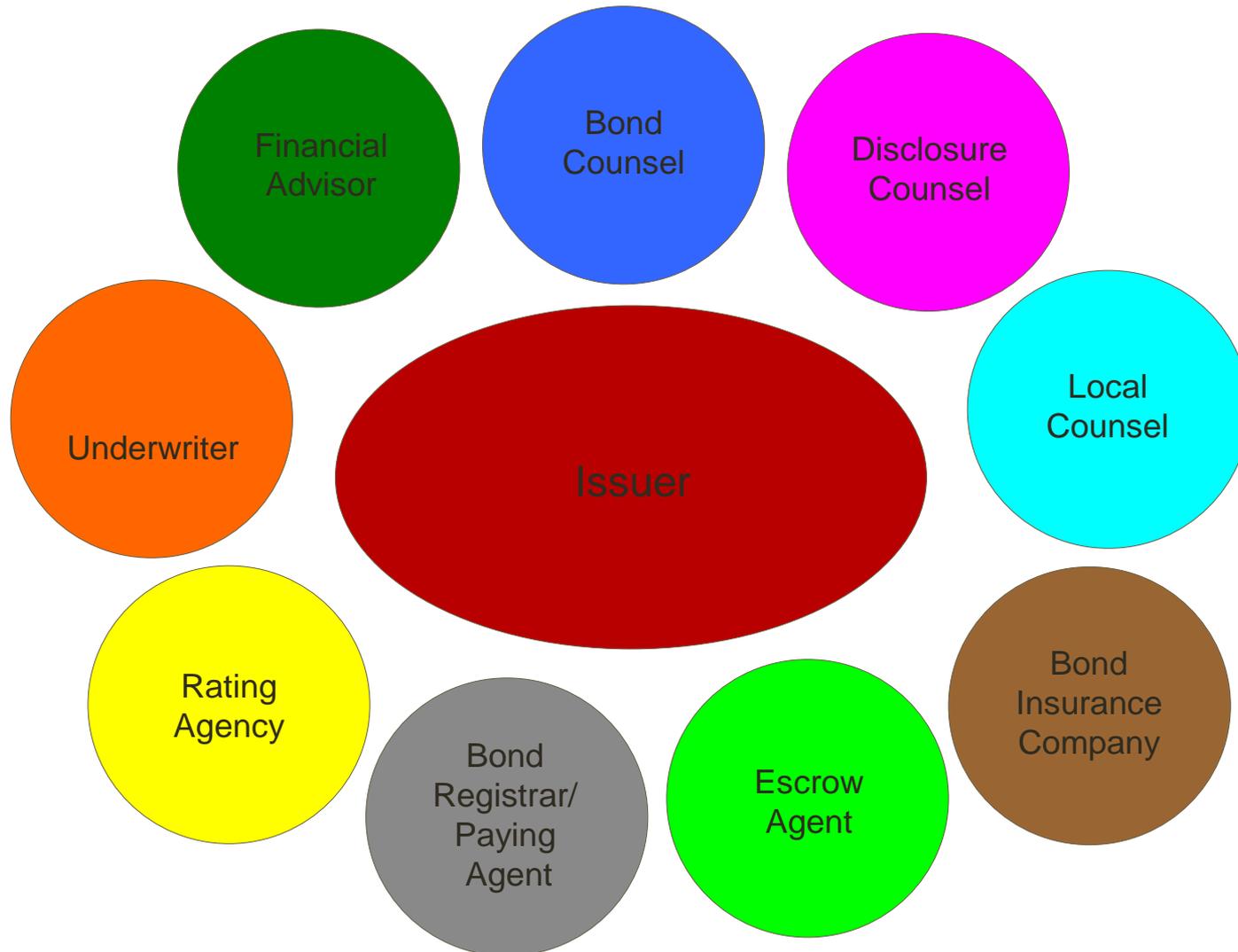
(1) Based on current market conditions, plus 0.25%.

- Most refundings are done for savings where the interest cost on the new bonds is less than the old bonds, thereby creating savings
- Debt service savings can be equal in each year over the life of the bonds, taken all upfront, taken at the end of the debt service schedule or something in between

- Acceleration – typically saves interest cost
- Stretch out – typically costs more over time
- Restructure to create room for new money needs, thereby reducing future tax increases

- When bonds are not advance refundable, a forward starting refunding may be appropriate in order to avoid future interest rate increases
- A forward refunding occurs like a normal refunding but with a delayed closing
- The closing can be delayed up to 9 months, however investors will require additional yield on the bonds up to 5-7 (.05% -0.07%) per additional month

Method of Sale



- The two most common methods of sale are **competitive** and **negotiated**
 - The goal is to select the method of sale that will achieve the lowest cost of borrowing
- Negotiated sale
 - The District preselects an underwriter to sell its bonds to investors
 - The underwriter's fee is negotiated
 - Interest rates and yields are negotiated on the sale date, based upon feedback from the underwriter and financial advisor

- **Competitive sale**
 - The College engages a municipal/financial advisor to manage this process
 - An underwriter is selected via a competitive sale in which multiple bids are received to purchase the District's bonds
 - The bonds are awarded to the underwriter who offers the combined lowest interest rate and underwriting fee
- **Direct placement**
 - Less documentation, no rating, no underwriter or fewer legal fees
 - A term sheet is sent out to banks and other local units of government that will provide a proposal to purchase the bonds directly
 - This process had proved effective for relatively smaller bond issues paid off in approximately seven years or less

- **A competitive sale is appropriate when:**
 - Issuer has a strong underlying credit rating at least in the “A” category
 - General obligation bonds or full faith obligations (e.g. limited tax bonds, alternate revenue bonds or debt certificates)
 - Structure does not include special features that would require extensive explanation to the market
 - Issue size and average life is conducive to attracting investors

- **A negotiated sale is appropriate when:**
 - Issuer has a credit rating lower than “A”
 - Bond insurance is unavailable
 - Debt structure is complicated
 - Issuer wants input in how bonds are allocated among underwriting firms
 - Issuer wants to target retail investors



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