

# Planning for Debt Issuance and the Rating Process

AASBO

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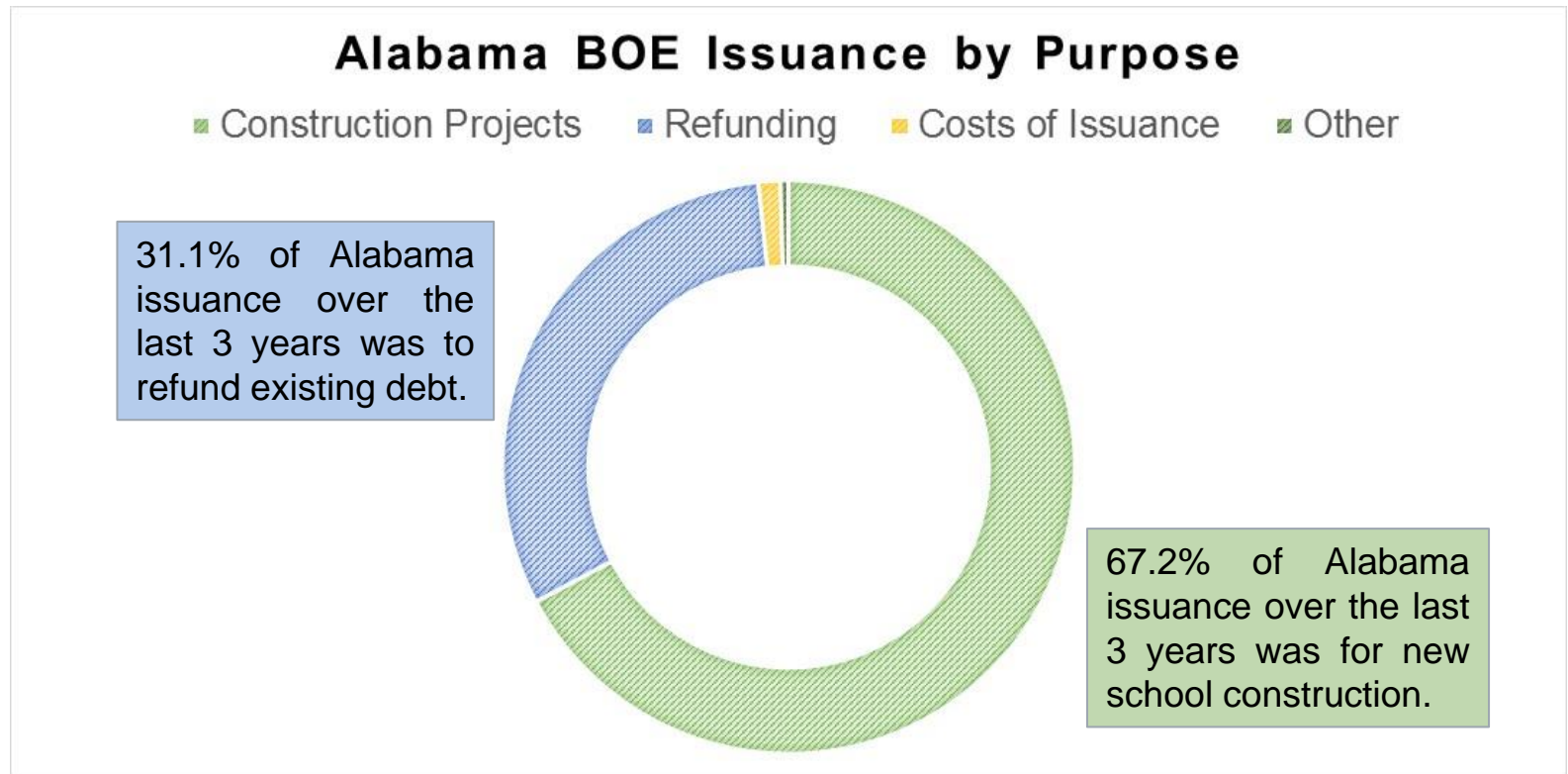
**RAYMOND JAMES**

**How much debt have Alabama BOE's issued in the last three years (2016-2019)?**

- A) Less than \$250 million.**
- B) \$250 million to \$500 million.**
- C) \$500 million to \$750 million.**
- D) \$750 million to \$1 Billion.**

**Alabama BOE's have issued \$975,550,000 over the last three years.**

- **This does not count loans directly with banks, private placements, bus leases, PSF leveraged funds, QZABs, QSCBs, and other structures.**



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How to start the bond issuance process – PLAN!!!

**PICK A TEAM**

**LEGAL STRUCTURE**

**ASK YOURSELF SOME QUESTIONS**

**NAVIGATE THE RATING PROCESS**

**P**PICK A TEAM

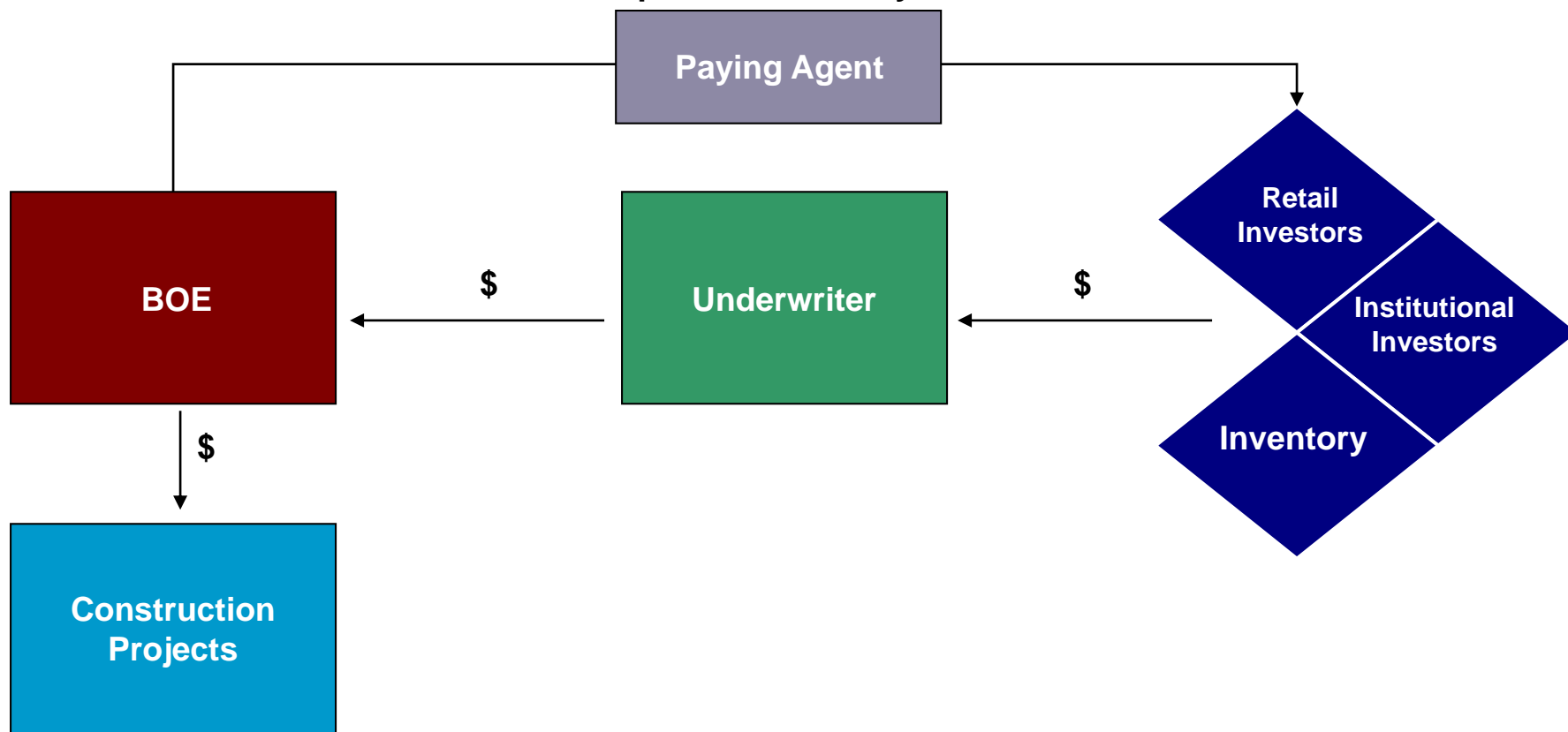
**L**LEGAL STRUCTURE

**A**ASK YOURSELF SOME QUESTIONS

**N**AVIGATE THE RATING PROCESS

- The below chart illustrates the various professionals involved in a negotiated bond issue.
- The BOE typically hires a law firm that specializes in this type of transaction (bond counsel) to prepare the required documents. The underwriter will use these disclosure documents to sell the BOE's bonds/warrants to public investors.

### Principal & Interest Payments



## Underwriter

- Fees
- Experience
- Distribution (Directly effects your interest rate)
- Understanding of coverage & revenue sources

## Bond Counsel

- Fees
- Experience
- Understanding of the Act Authorizing BOE's to issue debt
- Understanding of revenue sources to pledge for repayment



**P**PICK A TEAM

**L**LEGAL STRUCTURE

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**N**AVIGATE THE RATING PROCESS

## • Issue through the Board or some other entity?

Issuing through City	Issuing through the Board
City's generally pledge a general obligation (GO). The BOE would enter into a funding agreement to repay the City.	BOEs may pledge a single tax or a combination of taxes.

- **A tax backed issue can carry a higher rating than a general obligation of a City when:**
  - **The issuer's tax base shows broad economic diversity.**
  - **Revenues show good stability in economic downturns.**
  - **Debt service coverage levels are strong.**
  - **Legal covenants provide strong protection for investors.**

## **Some practical matters:**

- How is your 1 month reserve?**
- Do you have a sales tax levied by a City or County?**
- Do you care about control of the financing process?**
- Who is recommending a particular legal structure and why?**

**P**PICK A TEAM

**L**LEGAL STRUCTURE

**A****SK YOURSELF SOME QUESTIONS**

**N**AVIGATE THE RATING PROCESS

- **How much money do I need?**
  - **Board and Superintendent may answer for you!**
- **How much of an increase in my annual debt payments can I afford?**
- **What taxes do I have to pledge for repayment of the debt?**
- **Are the collections on these taxes enough to “cover” the debt service?**
- **When do these taxes expire?**
- **When does my Board need the money?**

- » **Week 1** – Underwriter and Bond Counsel work with the Board to determine the correct structure of the financing (i.e. how much to borrow, length of the debt, etc.).
- » **Week 2** – Bond Counsel, Underwriter, and Board work to develop a draft of the preliminary official statement. (Several data items are needed and this can take a couple of weeks)
- » **Week 3** – Bond Counsel drafts other financing related documents.
- » **Week 4** – Preliminary Official Statement (POS) and other financing documents submitted to various rating agencies.
- » **Week 5** – Rating call held and receive bond rating.
- » **Week 6** – Warrants/Bonds are priced and sold in the market by the Underwriter.
- » **Week 7** – Bond Counsel finalizes financing documents and drafts the final version of the official statement.
- » **Week 8** – Final official statement is sent to investors, issue closes, and funds are received by the Board for construction.

**P**PICK A TEAM

**L**LEGAL STRUCTURE

**A**ASK YOURSELF SOME QUESTIONS

**N****AVIGATE THE RATING PROCESS**

Because talking to Rating Agencies is not something that CSFOs do every day, many times it can be an intimidating process.



In fact, the Rating Agencies are extremely transparent about the rating process and are happy to answer any questions about how the process works and what factors achieve a better rating.



- An entities rating is similar to a personal credit score. Higher ratings allow entitles to borrow at a lower rate.

<b>Moody's Ratings</b>	<b>S&amp;P Rating</b>	<b>Fitch's Rating</b>
Aaa	AAA	AAA
Aa	AA	AA
A	A	A
Baa	BBB	BBB
Ba	BB	BB
B	B	B
Caa	CCC	CCC
Ca	CC	CC
C	C	C
	C1	RD
	D	D
<p>Moodys’s also supplies numerical modifiers, 1, 2, and 3 in each generic category classification from Aa through C. 1-higher end; 2-mid-range; and 3-lower end</p>	<p>S&amp;P also supplies modifiers, “+” and “-” in each generic category classification from AA through C. “AA+”-higher end; “AA” mid-range; and “AA-”-lower end</p>	<p>Fitch also supplies modifiers, “+” and “-” in each generic category classification from AA through C. “AA+”-higher end; “AA” mid-range; and “AA-”-lower end</p>

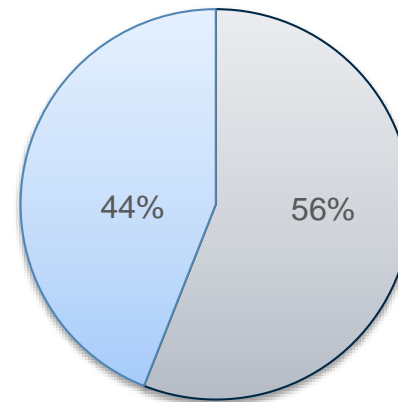
Bond Insurer Ratings Grid

As of 02/04/2019

RATING ISSUED BY	Assured Guaranty (acquired Radian, CIFG)	AGM (formerly FSA)	MAC	NPFG (formerly MBIA) (FGIC novation)	BHAC	BAM
Moody's	A3	A2	-	Baa2	Aa1	-
S&P	AA	AA	AA	NR	AA+	AA
Fitch	WD	WD	-	WD	NR	-
Kroll	AA	AA+	AA+	AA+	-	-
Moody's	STABLE	STABLE	-	STABLE	STABLE	-
S&P	STABLE	STABLE	STABLE	-	STABLE	STABLE
Fitch	-	-	-	-	-	-
Kroll	STABLE	STABLE	STABLE	STABLE	-	-

- % of Bonds Insured:
  - 2018 - 5.9%
  - 2017 - 5.3%
  - 2016 - 5.7%
  - 2015 - 6.6%
  - 2014 - 5.9%
  - 2013 - 3.6%
  - 2012 - 3.5%

Insurer Market Share



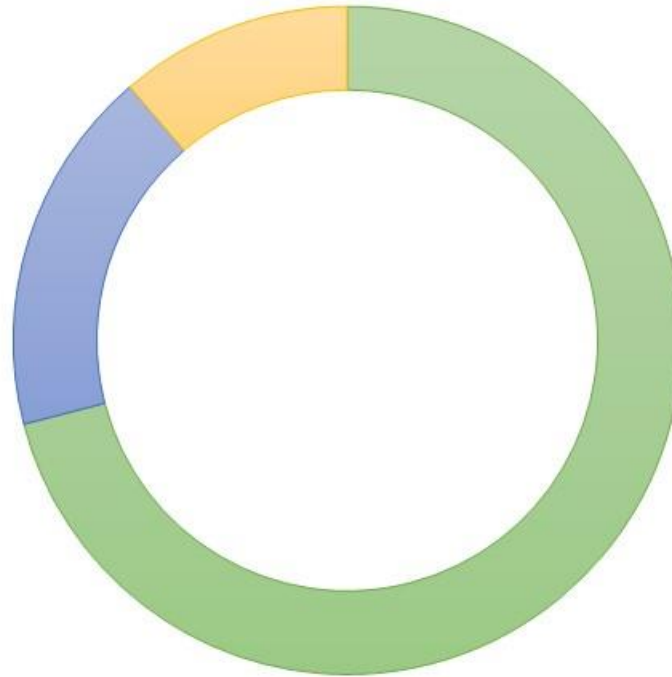
■ Assured Guaranty ■ BAM

### Rating Agencies Used by Alabama BOE's

■ S&P ■ Moody's ■ Both

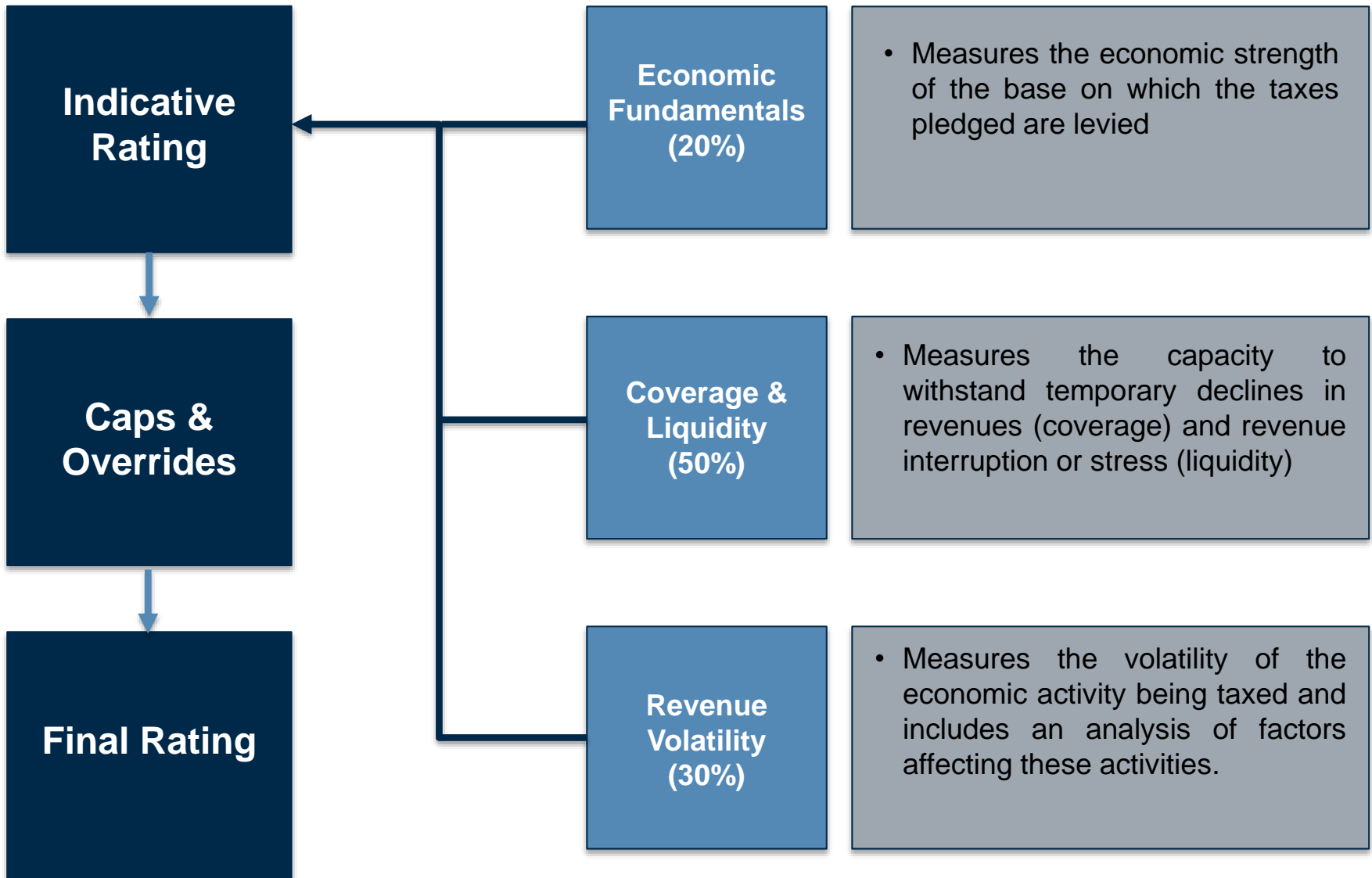
11.3% of Alabama BOE issuance over the last 3 years used both firms as a rating agency.

17.7% of Alabama BOE issuance over the last 3 years used Moody's as a rating agency.



71.0% of Alabama BOE issuance over the last 3 years used S&P as a rating agency.

- **Have I reviewed the discussion topics with my bond counsel, underwriter, and financial advisor?**
- **Have I disclosed any bank loans to the rating agencies?**
- **Do I need anyone on the call to cover topics that I may not be an expert on? (Economy, Industrial Development, Housing, etc.)**
- **Do I need to implement any “formal policies” prior to talking with the rating agencies?**



- Once the indicative rating has been received any caps or overrides are applied.

### CAPS

- Unwillingness to pay debt
- Coverage & liquidity = weak or very weak
- Revenue Volatility = High

### Overrides

- Extraordinarily strong coverage (4x +)

- Other factors can cause the rating to be lower than the indicative

- Pledged tax must be renewed before final maturity
- Budget pressures from a revenue-sharing entity may become risk tax payments stopping.

- **Economic Fundamentals pay close attention to population and income levels.**

### Negative Factors

- **Smaller Population**
- **Low income levels as a % of the national level.**
- **A declining population base (5% or more over the last 3 years)**
- **A concentrated economy**
- **A seasonal economy**

### Positive Factors

- **Larger Population**
- **High income levels as a % of the national level**
- **Being the economic hub for a regional economy**
- **A stabilizing economic presence such as a University or state capital**

Board's must pledge a tax for repayment of its debt.

1. Pledge of a single tax.

- The Board has Constitutional authority to pledge a single tax to the repayment of its debt.

2. Pledge of combined taxes.

- Under new legislation passed in 2011 the Board now has Constitutional authority to pledge multiple taxes as a combined pledge.

Board's should evaluate desired coverage as one factor when determining which tax to pledge.



- Coverage is the amount of pledged revenues divided by the maximum annual principal and interest payment on the bonds.

### Example 1

BOE has \$400,000 in tax receipts from its 3 mill tax, which is pledged to its 2015 bond issue. The 2015 bond issue has maximum annual principal and interest payments of \$200,000. Coverage?

$$\text{\$400,000} / \text{\$200,000} = 2.00x$$

### Example 2

BOE has \$400,000 in tax receipts from its 3 mill tax, which is pledged to its 2015 and 2017 bond issue. The 2015 bond issue has maximum annual principal and interest payments of \$200,000. When the 2017 payments are added the maximum annual principal and interest payments become \$300,000 Coverage?

$$\text{\$400,000} / \text{\$300,000} = 1.33x$$

<b>Ratings Distribution for AL BOEs (2016-2019)</b>		
<b>S&amp;P Rating (or Moody's Equivalent)</b>	<b># of Transactions</b>	<b>Average Coverage</b>
A-	5	1.308
A	10	2.755
A+	31	3.103
AA-	14	3.492
AA	2	3.573

<b>S&amp;P Coverage Categories</b>	
Very Strong	> 2.00
Strong	1.50 - 2.00
Adequate	1.25 - 1.50
Weak	1.00 - 1.25
Very Weak	1.00

- **Are reserves required by the legal documents of the bond issue?**

### Negative Factors

- **BOEs in Alabama will not have a debt service reserve fund or other liquidity measures required by the bond documents.**

- **As a result, we try to stress 1 month reserve requirements and formal policies of your Board that require more than a 1 month reserve.**

## •How volatile are the pledged taxes?

### Negative Factors

- History of volatility
- Taxes come from discretionary spending
- Seasonal/cylical tax base
- Dependence on a part of the economy that is experiencing a slow down

### Positive Factors

- The revenues come from a necessary good or service
- Revenue sharing formulas are stable
  - Splits with City
  - Splits by County BOE with other BOEs
- Diversity of tax base

**Economic  
Fundamentals:  
Adequate**

Population within the taxing boundaries of 10,000 to 50,000, close to a broad and diverse MSA or larger economy.

Income levels 65% to 100% of the national average.

**Coverage &  
Liquidity:  
Strong**

Coverage ~2.0x, with no expectation that it will decrease in the near future.

No legally imposed reserves from the bond documents.

**Volatility:  
Low**

Low volatility in the economic activity being taxed. Demand for the activity is expected to remain stable. Future shifts in technology or society will not impact the economic activity.

**Management Assessment: Good**

TIME TO  
RELAX?



- Rule 15c2-12 is a rule under the Securities Exchange Act of 1934 that requires dealers who underwrite municipal securities to obtain certain information about the securities and issuers.
- In addition, underwriters must make sure that the issuer makes certain information about the securities available on an ongoing basis.
- This is usually done through an agreement called the continuing disclosure agreement (CDA), which is executed at the closing of your bond issue.
- Continuing disclosure information is certain information about a municipal bond that arises after the pricing has been completed.
- This information can be grouped into two categories:
  1. Financial/Operating/Statistical Data (annually – the “Annual Report”)
  2. Material Event Filing (within 10 days of the event – “Material Events Notice”)
- If you have not issued debt after 7/1/2009, your continuing disclosure obligations may be slightly different. Everyone should check specific provisions in their CDA.

- Generally, the CDA specifies that the Board file its audited financial statements AND certain operating/statistical data within a certain period of time after the end of your fiscal year (“Annual Report”).
  - Please check the specific requirements of your CDA – the Annual Report is **more** than merely the audit!
  - If you have multiple CDA’s with different bond counsels make sure that the CDA requirements are the same on each issue.
- When County BOE’s finance bonds we recommend using a longer period of time after the end of your fiscal year (ex: 270 days), because of lack of control over the timing of your audit.
- If possible, have your auditor insert the operating data as part of your MD&A in your audit or as a note.
  - This serves as a reminder each year and allows you to make one filing for the financial and operating data.
- Utilize the EMMA reminder to make sure you are compliant with the terms of your CDA (more to come).



There are 14 enumerated material events under the Rule 15c2-12:

1. *Principal and interest payment delinquencies.*
2. *Non-payment related defaults, if material.*
3. *Unscheduled draws on debt service reserves reflecting financial difficulties.*
4. *Unscheduled draws on credit enhancements reflecting financial difficulties.*
5. *Substitution of credit or liquidity providers, or their failure to perform.*
6. *Adverse tax opinions, certain notices from the IRS or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security.*
7. *Modifications to rights of security holders, if material.*
8. *Bond calls, if material, and tender offers.*
9. *Defeasances.*
10. *Release, substitution, or sale of property securing repayment of the securities, if material.*
11. *Rating changes.*
12. *Bankruptcy, insolvency, receivership or similar event of the obligated person or issuer.*
13. *Consummation of a merger, consolidation or acquisition of, or the sale of all or substantially all of the assets of, an obligated person or issuer, other than in the ordinary course of business, or the entry into or termination of an agreement relating to such actions if other than pursuant to its terms, if material.*
14. *Appointment of a successor or additional trustee or the change in the name of a trustee, if material.*

Additionally, issuers and/or obligated persons must file a notice of failure to comply disclosing any failures to timely file their Annual Report as required by their CDA.

- 15. Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material.*
- 16. Default, event of acceleration, termination event, modification of terms. Or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties.*
- **Financial Obligation – means bank loans, bus leases, PSF leveraged funds, QZAB, QSCB, or other obligations that are material or the guarantee of a debt obligation.**
  - **“If Material” – there is no definition of material in the amendment. Is it important to a reasonable investor?**
  - Many Underwriters/Bond Counsels are already incorporating this into documents, but it must be added for any municipal bonds issued on or after February 27, 2019.

## **QUESTIONS?**

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