



Credit Solicitation

California Municipal Treasurers Association 2022 Annual Conference

Colin Bettis, County Debt Officer, County of Sacramento

Sarah Hollenbeck, Managing Director, PFM Financial Advisors LLC

May 5, 2022



Presentation Objectives

- ◆ Discuss key considerations and best practices relating to various forms of credit solicitations: direct placements, letters of credit, and revolving lines of credit, as well as bond insurance
- ◆ Explore the characteristics of these products, how and when they are typically used, and how to approach solicitation to enhance both participation in the process and the ultimate outcome for the borrower
- ◆ Learn what to expect in a credit solicitation and subsequent negotiation with the credit provider, who the involved parties are, and how to avoid common pitfalls that can create obstacles to a successful process



Overview

- ◆ Types of Credit Facilities/Credit Enhancement
 - Letter of Credit
 - Revolving Line of Credit
 - Direct Purchase
 - Bond Insurance
- ◆ The Solicitation Process
 - Parties Involved
 - Drafting RFPs/RFQs
- ◆ Key Considerations in Selecting a Credit Provider



Letters of Credit (LOC)

- ◆ Letters of Credit typically used to provide credit enhancement and liquidity support for Variable Rate Demand Bonds (VRDBs) or Commercial Paper (CP)
- ◆ VRDBs: LOC provider must purchase any VRDBs that are “put” if they are not successfully remarketed to other investors
- ◆ CP: When CP matures, LOC is drawn upon to repay the investors. Simultaneously new CP is marketed to new investors and those proceeds are utilized to reimburse the LOC Bank
- ◆ In the event of a failed (re)marketing of VRDBs or CP, the issuer must reimburse the LOC Bank in accordance with the “Reimbursement Agreement” between the issuer and the LOC Bank
- ◆ Ratings on debt supported by a Letter of Credit are based on the ratings of the bank providing the LOC



Revolving Lines of Credit

- Revolving lines of credit provides borrowers flexibility to draw funds as needed up to a maximum amount, repay, and then draw again
- Interest rates may be short-term fixed or variable
 - Interest rate on funds drawn, referred to as the “Utilized Rate”
 - Most commonly variable, based on an index plus a fixed spread
 - Minimum commitment fee on undrawn balance is referred to as the “Unutilized Rate”
- Not publicly traded securities
 - No offering document; disclosure limited, as required by line of credit provider
 - May not require ratings



Direct Purchase/Private Placement

- ◆ In a direct purchase, also referred to as a private placement, the issuer places its debt directly with a lender
 - No offering document
 - Typically no ratings
- ◆ May be structured as a purchase of securities or as a loan
- ◆ Can be executed on a fixed rate or variable rate basis
- ◆ Commonly used for smaller financings
 - Can save time and cost vs. public offering process that requires disclosure document (Official Statement) and ratings
- ◆ Term often limited to 12-15 years, though some lenders will go longer

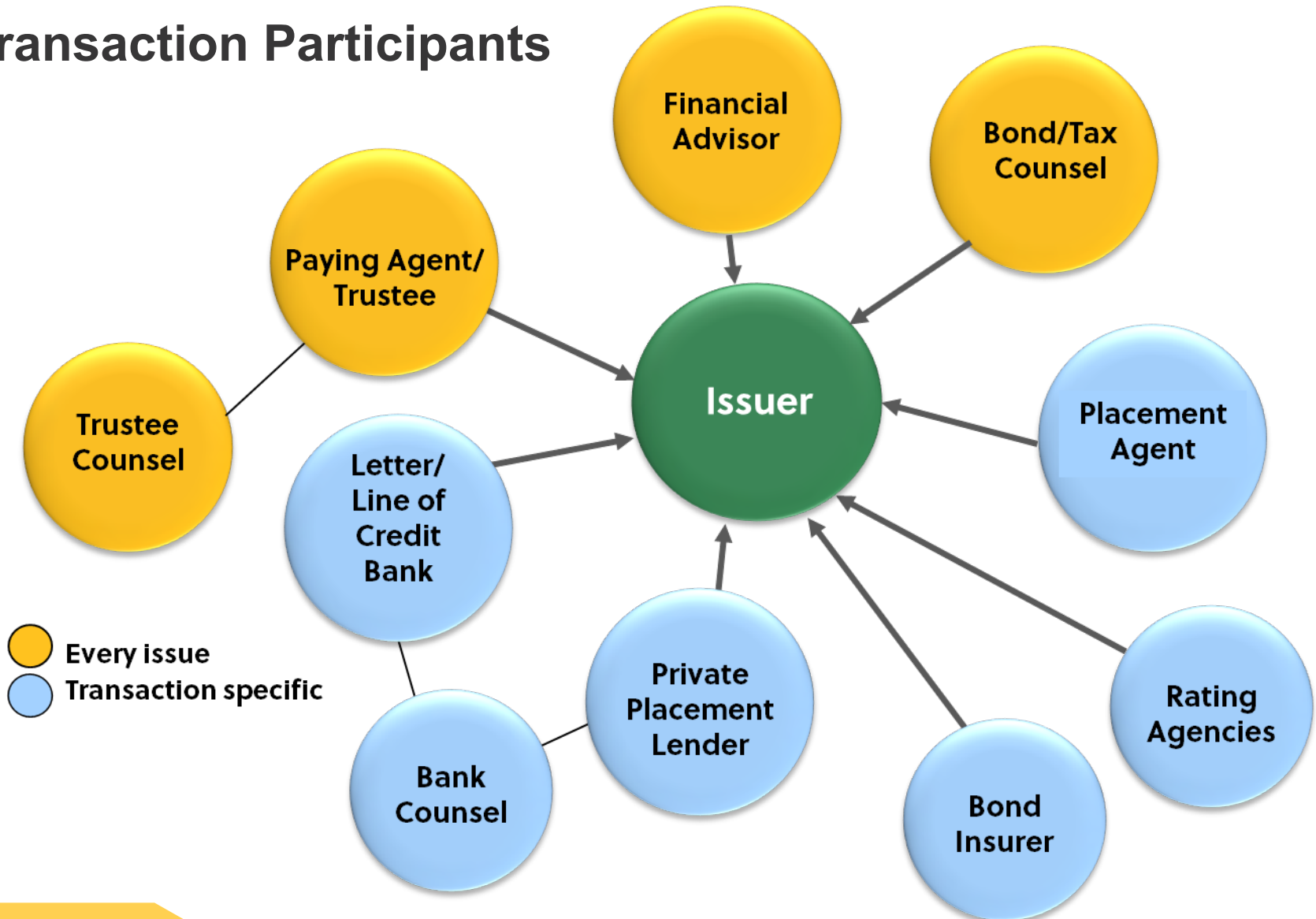


Bond Insurance

- ◆ Bond insurance is provided by a third-party insurance company, who in return for a premium, insure the timely payment of the principal of and interest on the bonds
- ◆ The bonds carry the insurer's ratings, rather than the ratings based on the underlying credit
 - Two active bond insurers, both rated in the "AA" category
 - Typically bond insurance provides economic benefit on lower rated credits, but sometimes can benefit bonds with AA-category ratings
- ◆ Remains in place for the entire term of the bonds
- ◆ Issuer pays the bond insurer a premium on the date of issuance of the bonds
- ◆ Even if the bonds are insured, the obligor (conduit borrower or issuer) remains the party primarily responsible to make payments of debt service on the bonds



Transaction Participants





Key Considerations in Selecting Credit Providers

- ◆ Fees – Utilized and Unutilized (if applicable)
- ◆ Terms
 - Covenants, prepayment provisions, limitations on additional bonds, disclosure requirements, other requirements (e.g., deposit requirements)
- ◆ Ratings of provider – for VRDBs and CP, affects interest rate paid by issuer
- ◆ Overall credit needs – size of program, ability to expand if needed
- ◆ Diversification of providers – need to balance depth/strength of relationship with lender against risk of having all eggs in one basket



Consider the Lender's Perspective

- ◆ Overall opportunity
 - What are opportunities for the bank aside from providing credit?
- ◆ Risk evaluated based on issuer's organization as a whole, not just individual transactions or credits
 - Banks consider credit exposure on aggregate level
- ◆ Existing customers typically come first



Solicitation Process

- ◆ Credit providers typically solicited through a competitive process – RFP or RFQ
- ◆ Solicitation document should:
 - Describe the financing and project and the issuer's key objectives
 - Identify credit product or products being sought
 - Allow lenders to propose alternatives that meet the issuer's objectives
 - Include links to current and prior year audited financials
 - Note opportunities for lender to provide other services to issuer



Solicitation Process, continued

- Allow adequate time for responses – 2-3 weeks minimum
 - Provide lenders time to obtain credit approval
- As appropriate, provide form of legal document(s) with RFP
 - Or at minimum, highlight key terms that issuer will require
 - Soliciting bank feedback on document terms as part of RFP surfaces issues early
 - Helps in selection of lender
 - Helps facilitate negotiation of documents once lender is selected



Questions?



Appendix



Key Legal Terms of Credit Facilities

Key Terms for Credit Facilities	
Termination Fee	The cost to the issuer for terminating or reducing the credit facility size prior to the expiration date (usually is a make-whole provision; but only in effect for one year)
Term / Expiration Date	Date on which the facility expires (can be anywhere from 1-5 years)
Reimbursement Obligation	If VRDBs or CP cannot be sold to new investors, issuer incurs a reimbursement obligation to the LOC Bank equal to the draw on the LOC
Term Loan	When issuer incurs a Reimbursement Obligation, it has a set period of time to pay back the bank
Term out Provisions	Provisions of the Term Loan, timing and period in which the issuer must pay back the LOC Bank (usually paid in equal quarterly/semiannual payments ranging from 2-5 years)
Term Loan Rate or Bank Rate	Interest rate on the Term Loan (typically a step-up structure after 90-180 days)
Default Rate	If an event of default occurs, the Reimbursement Obligations owed to the LOC Bank are charged a Default Rate that is a very high, penalty rate
Downgrade Provisions	Increases to the facility fee if the issuer is downgraded below certain thresholds

Contact:

Sarah Hollenbeck, Managing Director

PFM Financial Advisors LLC

hollenbecks@pfm.com

415.269.7237

