Bond Basics (101)
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Bond Basics
• Background
• Players
• Statutory Authority
• Federal Regulations
• Debt Issuance Process
• Refunding

Debt Issuance and Management
• Most successful if District understands
  • Key players, their roles
  • Rules / regulations
  • Financing options
  • Implications of decisions
  • Bond sale methods
**What is a “Bond”?**

- Many parts
  - A debt security (contract)
  - Under which the issuer (District)
  - Owes the bondholders (investors)
  - Debt (principal)
  - Repaid on a schedule (payment dates)
  - Under agreed on terms (length/call)
  - Including interest (coupon)

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**Marketplace**

**Reasons bonds are purchased**

<table>
<thead>
<tr>
<th>Type of Municipal Bond Investor</th>
<th>Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Investor</td>
<td>Retirement income, federal tax advantages, state tax advantages, diversification</td>
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<tr>
<td>Institutional Investor</td>
<td>Revenue, active marketplace, safety, diversification, yield over treasuries</td>
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</tbody>
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**Factors Important to Investors**

- Investment policy / objectives
- Term
- Credit quality
- Source of funding (G.O. vs Revenue)
- Yield
- Taxable vs. tax exempt
Tax-Exemption

• Interest paid to holders exempt from federal income tax

• In Minnesota, also exempt from State income taxes

Interest Rates (Current)

Interest Rates (Historic)

10 Year Trend
Key Players
- Issuer (School District)
- Municipal Advisor
- Bond Counsel / Attorney
- Rating Agency
- Purchaser (Underwriters, Broker/Dealers, Commercial Banks)
- Paying Agent
- Investors

What are their roles, whom do they represent, and how are they paid?

Municipal Advisor
- Primary role to represent Issuer
- Municipal Advisor owes *fiduciary duty* to Issuer
  - Works exclusively on behalf of Issuer
Municipal Advisor
- Assists with borrowing decision
- If Debt is Issued, assists with:
  - Understanding options
  - Developing finance plan / debt structure
  - Choosing sale method
  - Preparing offering and disclosure documents
  - Rating
  - Sale

Bond Counsel
- Drafts legal documents
- Provides legal opinions
  - Legal, valid, binding obligation
  - Interest exempt from federal income taxation
- Assists with closing

Rating Agency
- Three main agencies
  - Moody's Investors Service
  - Standard & Poor's Global Ratings
  - Fitch
- Independent, third-party creditworthiness assessment
- Higher rating, based on increased security, results in lower interest rates
Purchaser

- Initial purchasers are Underwriters
  - Includes Broker/Dealers and Commercial Banks
  - Generally resells to investors
- Underwriter financial and other interests are different from the issuer's
  - Represents investor interest
  - No fiduciary duty to issuer

Paying Agent

- Tracks and coordinates payments
- Provides issuer debt service payment invoices
- Receives debt service payments from issuer
- Submits payments for distribution to bondholders on behalf of issuer
- Required for Minnesota credit enhancement

Authority to Issue

- Issuing Authority Comes from State Law
  - Multiple authorizing statutes, based on issuer and obligation type
- Tax Exemption Comes from Federal Tax Code
  - IRC Sections 103 and 141-150
Authority to Issue Debt

• Eligible use of debt
  • Minnesota Statutes; Chapter 475
  • General Obligation Bonds
  • Broad authority with voter approval
  • Finance purchase / construction of school buildings & facilities; renovation & improvement projects; infrastructure, and equipment

Statutory Authority To Issue Debt

Long Term Facilities Maintenance Revenue
  • MN Statutes Section 123B.595
  • Authorized by approval of the Commissioner

Annual Allocation
  • Formula allowance $380 per APU
  • Deferred Maintenance (like-for-like)
  • Health and Safety < $100,000

Additional revenue Health & Safety projects > $100,000
  • Indoor air quality (IAQ)
  • Fire alarm and suppression
  • Asbestos
  • Remodeling for voluntary Pre-K

Statutory Authority to Issue Debt

Capital Notes / Certificates of Indebtedness
  • MN Statutes Section 123B.41
  • Board Authorized
  • Purchase vehicles and equipment

Capital Facilities Bonds
  • MN Statutes Section 123B.42
  • Authorized by approval of the Commissioner
  • Finance improvements to buildings, facilities, sites
Statutory Authority to Issue Debt

Abatement Bonds
- MN Statutes Section 469.1812 - 469.1815
- Board Authorized
- Construct or renovate parking lots & parking structures

Tax and Aid Anticipation Certificates
- MN Statutes 123B.78
- Board Authorized
- Cover cash flow deficits

Lease Purchase
- MN Statutes 465.71, 126C.40, subdivision 1
- Finance purchase of buildings, facilities, land, equipment, construction & improvement projects

Other Statutory References - Chapter 475

475.52 - Bond Issue Purposes

475.53 - Limit on Net Debt
- 15% of estimated market value of taxable property

475.54 - Limitation on Term and Amount Maturing in Each Year
- Generally 30 Years
- Rules regulating bond structure
Other Statutory References - Chapter 475

475.58 - Elections to Determine Issue and Exceptions

475.61 - Tax Levies
• Assess at 105% of principal and interest payments, less available funds

475.67 - Refunding Bonds
• Advance refundings
  • 3% present value savings requirement OR
  • Extend the maturity by at least three years

Other Statutory References

126C.55 - State Credit Enhancement Program
• Adopted in early 1990s
• No cost
• State guarantees payments
• Rating
  • Moody's: Aa2; S & P: AAA
• Lower interest rates
• Paying agent required
• Simple process
• Payments must be made 3 days early

Federal Regulations

• Bank Qualification
  • Up to $10 million per calendar year
  • Tax advantages for certain purchasers
  • Typically lower interest rates

• Arbitrage requirements and yield restriction
  • Profit from investing proceeds of tax exempt issue
  • Rules govern ability to earn interest
  • Rebate requirements and exceptions
Federal Regulations

• Reimbursement
  • May reimburse hard cost expenses incurred within last 18 months
  • Declare intent within 60 days

• Continuing Disclosure
  • Reporting requirements for outstanding debt
  • Based on size of each issue and total debt outstanding

Federal Regulations

• Municipal Advisor
  • Protections and benefits to issuers
  • Fiduciary duty
  • Standards, training, and conduct
  • Reduced borrowing and issuance costs
  • Better financing terms
  • Positive impact on taxpayers

Debt Issuance: Step 1 - The Decision to Issue Debt

• Two approaches
  • Pay-as-You-Go
  • Borrowing

• Why borrow?
  • Payments match life of asset
  • Tax rate management
  • Timing of need
  • Affordability
Debt Issuance: Step 2 – Developing Financing Plan

- When and how much to borrow
- Type of financing
- Repayment
  - May dictate structure and type of debt
  - Market or rules / laws may limit
  - Call
- Existing and future debt considerations
  - Affordability and flexibility

How Much: Building a Bond Issue

**Sources and Uses**

- Consider all costs
  - Design, construction, legal and financing
- Include other contributions
- Capitalized Interest
  - Revenue availability
  - Manage tax impact
- Investment Earnings

Debt Issuance: Step 3 – Choosing Method of Sale

Two primary options:

1. **Competitive:**
   - Terms and conditions predetermined
   - Bids solicited based on notice of sale

2. **Negotiated:**
   - Issuer selects underwriter to purchase and market to investors
**Competitive**

- Preferred method
  - Market understands security and structure (e.g. G.O.)
  - Frequent issuer, highly-rated, credit enhanced
- Open and transparent process
  - Purchasers compete on basis of lowest cost proposal
- Default option unless circumstances dictate otherwise
  - GFOA Best Practices

**Negotiated**

- Unusual features, structure, or other provisions
- Interest only from select class of potential investors
- "Story" Bond - requires active marketing to draw investor interest

**Debt Issuance: Step 4 - Preparing for the Sale**

1. Initial authorization
2. Draft Preliminary Official Statement
3. Bond counsel review
4. Credit rating
5. Select other professionals
Rating Factors

Management
Economy
Debt / Pension Profile
Financial Performance

Ratings

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<tr>
<th>Moody's</th>
<th>S&amp;P</th>
<th>Fitch</th>
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Debt Issuance: Step 5 - Day of Sale and Closing

- Municipal advisor receives bids (if competitive) or final pricing (if negotiated)
- Final adjustments to structure
- Bond counsel prepares award resolution with terms of debt
- Closing 2-4 weeks later but **all terms are set on day of sale**
Debt Issuance: Step 5 - Ongoing Management

• Post-issuance compliance
  • Arbitrage / yield restrictions
  • Continuing disclosure

• Managing bond proceeds
  • Segregating funds
  • Unspent bond proceeds

• Managing outstanding debt
  • Timely payments
  • Early redemption
  • Refunding

Refunding Opportunities

• Call date: Prepayment date
  • Part of sale terms
  • Subject to market conditions or negotiation
  • Usually 8 - 10 years for 20 year bonds
  • Earlier call date may result in higher interest costs

• Advance refundings (> 90 days before call date)
  • 2017 Tax bill eliminated tax-exempt
  • Taxable needs to meet 3% State requirement

• Current refundings (within 90 days of or after call date)

• Refunding Benefits
  • Interest savings
  • Restructuring