Best Practices for Debt Management

Sudsina & Associates, LLC
Registered Municipal Advisors

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Presentation Objective

Overview of best practices for debt planning, execution and on-going management, including:

- ✓ Update on new SEC regulations governing issuers, municipal advisors and bond underwriters – Especially the New Issue Price Rules.
- ✓ Method of sale trends
- ✓ Market update

Regulation Update

Dodd Frank

- Requires that municipal advisors have a fiduciary duty to issuers – we represent the Issuer!
- Limits advice provided by underwriters until they are engaged or subjected to an RFP process

- New issue price regulations went into effect on June 7, 2017
- MCDC

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Regulation Update

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- Requires that municipal advisors have a fiduciary duty to issuers
- Limits advice provided by underwriters until they are engaged or subjected to an RFP process
- Under review in the Federal Government

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Regulation Update

New issue price regulations

- Aimed at abuses in the calculation of arbitrage yields
- Effective on June 7, 2017
- Actual Sales Test Adopted for Publicly Offered Bonds
  - 10% of issue ACTUALLY Sold, not just expected to be sold
- Special Rule for Use of Initial Offering Price to the Public (Definition of Public was expanded!)
- Special Rule for Competitive Sales
  - Must get at least 3 bids otherwise subject to special rules

Regulation Update

MCDC - Municipalities Continuing Disclosure Cooperation

- Issuers required to make disclosures regarding finances and debt on a regular basis.
- Underwriters required to make sure issuers comply otherwise they cannot underwrite the debt.
- In Ohio bond counsel generally assists issuers to ensure compliance.
- MSRB's EMMA system helps issuers file disclosure and determine whether they are up-to-date.

Ohio Trends

- Many more issues including advisors on team
  - November ballot
  - May ballot
- Surprising number of bankers leaving the underwriting firms and going with advisory firms

GFOA's Recommended Debt Issuance Practices

The Policy should provide guidance regarding the issuance process, which may differ for each type of debt. These practices include:

- ***Selection and use of professional service providers***, including an independent financial advisor, to assist with determining the method of sale and the selection of other financing team members,
- ***Criteria for determining the sale method*** (competitive, negotiated, private placement) and investment of proceeds,
- ***Use of comparative bond pricing services*** or market indices as a benchmark in negotiated transactions, as well as to evaluate final bond pricing results,
- ***Criteria for issuance of advance refunding and current refunding bonds***, and
- ***Use of credit ratings & credit enhancement***, minimum bond ratings, determination of the number of ratings, and selection of rating services.

Are you equipped to make these assessments alone?

Method of Sale Trends

Negotiated Sale

- Traditionally the preferred method of sale for local governments but has lost some market share with the increased use of municipal advisors.

Competitive Sale

- Becoming more frequent due to current interest rate market and rise in number of municipal advisors in Ohio.
  - Especially successful for Bank Qualified issues

Direct Placement

- Also becoming more popular as banks have come to appreciate the value of municipal bonds.

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Method of Sale Trends – Negotiated Sale

- GFOA recommended when:
  - Low credit rating (Baa/BBB or worse)
  - Issuer is not known in marketplace
  - Unusual structure (PCABs)
  - Unstable market conditions
- Results in best pricing selected underwriter can provide, especially if an RFP process is used to solicit underwriters.

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Method of Sale Trends – Competitive Sale

- GFOA recommended when:
  - High rating (A or better)
  - Issuer is known in marketplace
  - Nothing unusual about structure
  - Market conditions are relatively stable
- Receives best deal entire market can provide (rather than best deal selected underwriter can provide).
- Due to competition generally results in lower interest rates.

Method of Sale Trends – Recent Sale Results

Aa1 Rated Competitive Sale Results

$9,820,000 General Obligation (Limited Tax) Bonds, Series 2016

The following bids were submitted using ***PARITY***® and displayed ranked by lowest TIC. Click on the name of each bidder to see the respective bids.

Bid Award*	Bidder Name	TIC
☑ Reoffering	Fifth Third Securities, Inc.	2.052971
☐	Janney Montgomery Scott LLC	2.071553
☐	FTN Financial Capital Markets	2.073259
☐	Stifel, Nicolaus & Co., Inc.	2.157253
☐	Robert W. Baird & Co., Inc.	2.161995
☐	Northland Securities, Inc.	2.246629
☐	City Securities Corp.	2.247512

$8,200,000 General Obligation (Limited Tax) Bonds, Series 2017B

The following bids were submitted using ***PARITY***® and displayed ranked by lowest TIC. Click on the name of each bidder to see the respective bids.

Bid Award*	Bidder Name	TIC
☑ Reoffering	Janney Montgomery Scott LLC	3.313019
☐	SunTrust Robinson Humphrey	3.402411
☐	FTN Financial Capital Markets	3.489883
☐	Robert W. Baird & Co., Inc.	3.542810
☐	Raymond James & Associates, Inc.	3.929835

$24,440,000 General Obligation (Limited Tax) Bonds, Series 2017

The following bids were submitted using ***PARITY***® and displayed ranked by lowest TIC. Click on the name of each bidder to see the respective bids.

Bid Award*	Bidder Name	TIC
☐	Citigroup Global Markets Inc.	3.928598
☐	Robert W. Baird & Co., Inc.	3.980443
☐	Hutchinson, Shockey, Erley & Co.	4.012602
☐	Bank of America Merrill Lynch	4.030945
☐	Wells Fargo Bank, National Association	4.058816
☐	FTN Financial Capital Markets	4.084592

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Method of Sale Trends – Recent Sale Results

Aa1 Rated Competitive Sale
vs.
AAA Rated Negotiated Sale

Pricing Comparison

Count of Positive Yield Spread	
Competitive	Negotiated
3	3

Issuer	Competitive Sale				Comparable Transaction Negotiated Sale				
Underlying Credit Rating / Insurer	Underlying - Moody's Aa1				Underlying - Standard & Poor's AAA				
Par Amount	$8,200,000				$6,505,000				
Bank Qualified?	Yes				Yes				
Call Features	6/1/22				12/1/25				
Sale Date	4/13/17				4/4/17				
Year	Coupon	Yield	MMD on pricing date	Yield Spread vs MMD	Coupon	Yield	MMD on pricing date	Yield Spread vs MMD	MMD Yield Spread Difference
2017	2.00%	0.90%	1.00%	(0.10%)	2.00%	0.85%	1.00%	(0.15%)	-0.05%
2018	3.00%	1.00%	0.84%	**0.16%**	2.00%	1.02%	0.86%	**0.16%**	0.00%
2019	4.00%	1.20%	0.97%	**0.23%**	2.00%	1.24%	1.00%	**0.24%**	0.01%
2020	4.00%	1.35%	1.11%	**0.24%**	3.00%	1.41%	1.16%	**0.25%**	0.01%
2021	4.00%	1.55%	1.25%	**0.30%**	3.00%	1.58%	1.31%	**0.27%**	-0.03%
2022					4.00%	1.76%	1.51%	**0.25%**	
2023					4.00%	1.92%	1.67%	**0.25%**	
2024	3.00%	2.00%	1.72%	**0.28%**	4.00%	2.05%	1.83%	**0.22%**	-0.06%
2025					4.00%	2.17%	1.98%	**0.19%**	
2026					4.00%	2.26%	2.10%	**0.16%**	
2027					3.00%	2.45%	2.19%	**0.26%**	
2028	3.00%	2.35%	2.17%	**0.18%**	3.00%	2.55%	2.28%	**0.27%**	0.09%
2029					3.00%	2.65%	2.38%	**0.27%**	

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Method of Sale Trends – Recent Sale Results

December 2016 Competitive Sale Received Better Interest Rates Than Three Comparable Negotiated Sales

Issuer	Method of Sale	Type of Sale	Rating	True Interest Cost for Issuer A Using Other District's Interest Rates	Present Value $ Impact on Issuer A Savings
A	Competitive	Refunding	Aa1	2.07% (actual district A)	N/A
B	Negotiated	New Money	AA+	2.11%	$29,063
C	Negotiated	Refunding	AA+	2.18%	$65,708
D	Negotiated	New Money	AA+	2.31%	$135,440

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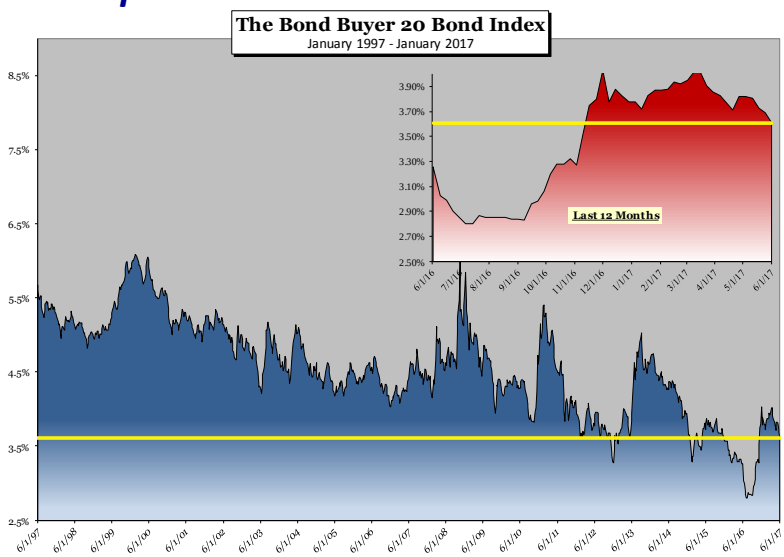
Method of Sale Trends – Direct Placement

- Popular for bonds that have short final maturity (15 years or less)
- Can be done quicker than a conventional financing!
- Can save on issuance costs
- Tradeoff is higher interest rate due to single investor
- Bond underwriter acts as placement agent
- Municipal advisor retains oversight
- Rating Agencies always ask whether you have any Direct Placements during the Rating call

Market Update – Interest Rates



General obligation bonds maturing in 20 years are used to compile this index. The Index has an average rating roughly equivalent to Moody's Aa and S&P AA-minus.

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Market Update – Bond Pricing Trends

5% coupons

- General investor preference to get best overall interest rate
- Provide dealers an advantage when the resell bonds in rising interest rate environment
- Can cause large original issue premium (OIP) to be produced
- OIP limitation = 3 years of interest on bonds
- Can help bolster bond retirement fund against assessed valuation decline or less than expected growth
- May have unwanted county auditor input

Call features

- If 5% gets best interest, and provides dealers that resell bonds a benefit, issuers may want ability to call sooner
- Shorter calls can reduce OIP

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Market Update – Bond Pricing Trends - Example

Interest Rate Scales – Exactly the Same

10-year call example

Maturity	Coupon	Yield
12/01/2017	2.000%	0.900%
12/01/2018	3.000%	1.000%
12/01/2019	4.000%	1.200%
12/01/2020	4.000%	1.350%
12/01/2021	4.000%	1.550%
12/01/2024	3.000%	2.000%
12/01/2028	3.000%	2.350%
12/01/2036	2.750%	2.750%
12/01/2037	3.500%	3.050%
12/01/2038	3.500%	3.100%
12/01/2040	3.750%	3.200%
12/01/2043	4.000%	3.250%

5-year call example

Maturity	Coupon	Yield
12/01/2017	2.000%	0.900%
12/01/2018	3.000%	1.000%
12/01/2019	4.000%	1.200%
12/01/2020	4.000%	1.350%
12/01/2021	4.000%	1.550%
12/01/2024	3.000%	2.000%
12/01/2028	3.000%	2.350%
12/01/2036	2.750%	2.750%
12/01/2037	3.500%	3.050%
12/01/2038	3.500%	3.100%
12/01/2040	3.750%	3.200%
12/01/2043	4.000%	3.250%

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Market Update – Bond Pricing Trends - Example

Purchase Price – 10 Year Call Produces More Premium

			10-year call		5-year call	
Maturity	Type of Bond	Maturity Value	Price	Dollar Price	Price	Dollar Price
12/01/2017	Serial Coupon	370,000.00	100.650%	372,405.00	100.650%	372,405.00
12/01/2018	Serial Coupon	245,000.00	103.155%	252,729.75	103.155%	252,729.75
12/01/2019	Serial Coupon	250,000.00	107.130%	267,825.00	107.130%	267,825.00
12/01/2020	Serial Coupon	260,000.00	109.266%	284,091.60	109.266%	284,091.60
12/01/2021	Serial Coupon	270,000.00	110.823%	299,222.10	110.823%	299,222.10
12/01/2024	Term 1 Coupon	875,000.00	107.012%	936,355.00	104.819%	917,166.25
12/01/2028	Term 2 Coupon	1,295,000.00	105.809%	1,370,226.55	103.102%	1,335,170.90
12/01/2036	Term 3 Coupon	3,060,000.00	100.000%	3,060,000.00	100.000%	3,060,000.00
12/01/2037	Serial Coupon	430,000.00	103.882%	446,692.60	102.106%	439,055.80
12/01/2038	Serial Coupon	445,000.00	103.442%	460,316.90	101.869%	453,317.05
12/01/2040	Term 4 Coupon	940,000.00	104.710%	984,274.00	102.564%	964,101.60
12/01/2043	Term 5 Coupon	1,560,000.00	106.407%	1,659,949.20	103.492%	1,614,475.20
Total		**$10,000,000.00**		**$10,394,087.70**		**$10,259,560.25**
			Less Par Amount	**$10,000,000.00**		**$10,000,000.00**
			Less Costs of Issuance	**$204,318.90**		**$204,318.90**
			Net Original Issue Premium	**$189,768.80**		**$55,241.35**

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Market Update – Bond Pricing Trends - Example

Par amount	$10,000,000	$10,000,000	
Original Issue Premium Deposited to Bond Retirement Fund	$189,768.80	$55,241.35	
True Interest Cost (TIC)	3.10%	3.22%	
Interest paid over 1st 10 Years	$2,704,162.92	$2,704,162.92	
Less: Original Issue Premium	($189,768.80)	($55,241.35)	
Net Interest paid over 1st 10 Years	$2,514,394.12	$2,648,921.57	Difference
Interest paid over 1st 10 Years if Refunded at 3% PV Savings in 5 Years		$2,284,605.95	$229,788.17

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Market Update – Bond Pricing Trends

Call Feature Summary

- Current interest rate environment has investors preferring higher coupons (5%).
- Shorter calls provide more flexibility to refund for debt service savings even if rate rise or if the Federal Government makes changes to the Tax-Exempt status.
- Longer calls produce more premium that can help bolster the bond retirement fund against assessed valuation decline or less than expected growth.
- Excess premium can cause concerns with the county auditor potentially resulting in year-to-year millage adjustment

Post-closing Procedures/Practices

The Policy should provide guidance for ongoing administrative activities including:

- Investment of bond proceeds,
- Pricing Book,
- Primary and secondary market disclosure practices, including annual certifications as required,
- Arbitrage rebate monitoring and filing,
- Federal and state law compliance practices, and
- Ongoing market, rating and investor relations efforts.

Summary

- *Recommended practices exist for executing and managing bond issues.*
- *May want to adopt a debt policy or at least know where to find best practices when the need arises.*
- *Add competition to the process by requesting proposals for professional services.*
- *Be aware of post-issuance requirements and on-going debt management best practices.*
- *Stay tuned for more on SEC compliance requirements.*

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Additional Information Links

GFOA Debt Management Policy Best Practices http://www.gfoa.org/debt-management-policy

*GFOA Debt Issuance Checklist: Considerations When Issuing Bonds*http://www.gfoa.org/sites/default/files/u2/GFOADebtIssuanceChecklistConsiderationsWhenIssuingBonds.pdf

GFOA Government Finance Review Articles:

- **Ensuring a Successful Bond Sale** http://www.gfoa.org/sites/default/files/GFR_FEB_10_16.pdf
- **Back to Basics: What Every Government Should Check Each Time It Issues Debt**http://www.gfoa.org/sites/default/files/GFR_FEB_10_30.pdf
- **Best Practices Optimize Debt Management** http://www.gfoa.org/sites/default/files/GFR_FEB_13_8.pdf

*National Bond Lawyers/GFOA Post Issuance Compliance Checklist*http://www.gfoa.org/sites/default/files/u2/PostIssuanceCompliance.pdf

Municipal Securities Rulemaking Board www.msrb.org

MSRB's Electronic Municipal Market Access system (EMMA) http://emma.msrb.org

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