

Government Financial Management Part 3: Debt Management



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The webinar will begin at 10 a.m. CT.

Administration



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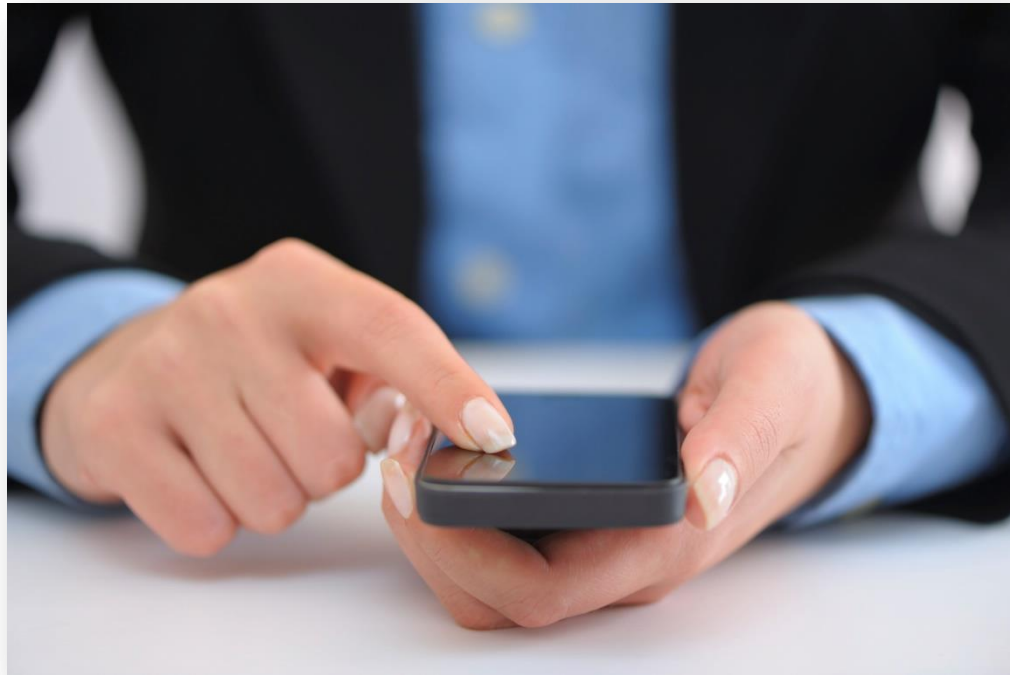
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Meet the Speaker

Benjamin Hart



Provides dual insights of a governmental CFO along with experience of governmental auditing for a public accounting firm

Brings extensive expertise in governmental budgeting, financial and internal controls, public sector leadership and more

Consistently earned the GFOA certificate for Excellence in Financial Reporting with his CAFRs

Learning Objectives

- Understand the role of debt and different types of debt instruments for governments
- Outline the financial officer's and outside advisors' roles in taking on and managing debt
- Learn the GFOA's recommended best practices for debt management
- Recognize types of policies needed to guide debt management in government

How Does the Process Start?

Priority-based budgeting

Matching resources with priorities

Capital budget and planning

Governmental-type activities
Business-type activities

Consideration of the repayment



Other Considerations of Issuance

Maturity: Short-term versus long-term

Temporary notes

Security – Repayment streams

Use of proceeds – Projects or refunding

Private vs. public use

Private AND tax exempt

Types of Debt

General Government

Direct Debt - General Obligation

Supported by the taxing power of the entity

Repayment from 'full faith and credit'

Can be measured or limited by certain ratios

- Debt per capita

- Debt to personal income

- Debt to taxable property value

- Debt service payments as % of general fund revenues/exp.

General Government - cont'd

Typically the most credit-worthy of debt sold on the bond market

Used for variety of “general” public projects

Municipal buildings, roads, schools, parks



Specific Type

Revenue Debt

Supported by the specific revenue sources

Repayment from specific revenue generation abilities – charges or services, fees

Can be measured or limited by:

- Coverage ratios

- Added bonds tests, bond covenants

- Credit rating impacts



Specific Type - cont'd

Credit rating applied on the source, i.e., utility fund.

Used for specific public projects with revenue generation abilities

Water, sewer, electric infrastructure

Tax Increment Financing, Community Improvement Districts

Standard Setting

Regulations vs. Best Practice

Regulations

Internal Revenue Service

State legislation and restrictions

Municipal Securities Rulemaking Board

Government Accounting Standards Board

Best Practice

National Federation of Municipal Analysts

National Association of Bond Lawyers

Government Finance Officers Association



Debt Management Roles

Internal

Governing body

Policy-setters, authorization

City management

Policy implementation, planners

Financial staff

Finance director, debt coordinator/analyst,
budget analyst

Execution of funding sources



External

Municipal advisors

Financial advisors

Typically independent of underwriters

Review debt strategy

Coordinate the Official Statement

Manage the rating process

Hire the underwriters/coordinate the sale



External -- cont'd

Underwriter

Group or single, separate from advisor

Markets or offers a purchase on the bonds

Bond Counsel

Issues opinion on validity of:

- The bond offering

- The security for the offering

- Whether and to what extent interest on the bonds is exempt from income and other taxation

Polling Question #1

Key Best Practices

Key Best Practices

- Pension obligation bonds
- Selecting and managing municipal advisors
- Selecting bond counsel
- Selecting and managing the method of sale of bonds
- Settlement procedures for debt service payments
- Understanding your continuing disclosure responsibilities
- Debt management policy



Key Best Practices

- Pension obligation bonds
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Selecting Municipal Advisors

One of a group of BPs related to sale of bonds

Recommends the use of a municipal advisor

Prior to the undertaking of debt

Selection based on merit in competitive process,
RFP/RFQ

Selection standards included in the debt policy

Selecting Municipal Advisors - cont'd

Assisting in competitive or negotiated process

Specific to transaction or all future transactions

Selected prior to underwriter

No unfair advantages in the selection process

Check references

Selecting Bond Counsel

Selection based on merit in competitive process

Include experience in type of financing/issuer

Is specialized tax advice needed?

Experience with federal securities laws
Practice full time in municipal securities

Knowledge and experience of specific attorneys

Ability to evaluate legal situations

Check references



Settlement Procedures for Debt Service

Fiduciary responsibility for timely and accurate payment

Establish written procedures

- Include requirement of timely payment

- Full utilization of funds until the due date

- Use of EFT in process

- Cost effectiveness and efficiency

Ensure appropriate contract terms and internal procedures are in place

Settlement Procedures for Debt Service – cont'd

Trustees/fiscal agents/paying agents invoice government timely

Recommend use of EFT to assure transfers on payment date

All parties are informed of the procedures documented.

Understanding Continuing Disclosures

Adopt a written policy related to continuing disclosures.

Clear understanding of requirements

Procedures that:

- Identify information required to be filed

- Dates of which filing due

- List of material events from SEC and CDA

- Identify person designated responsible

Understanding Continuing Disclosures – cont'd

Assess timeliness of annual financial reports (CAFR)

Use of “EMMA” for filing

Consider going beyond what’s in CDA (budgets, plans, other materials).

Consideration of other agreements related to debt, i.e., letters of credit, interest-rate swaps, investment agreements

Polling Question #2

Debt Management Policy Considerations

“A debt management policy should improve the quality of decisions, articulate policy goals, provide guidelines for issuance, and demonstrate a commitment to long-term capital and financial planning.”

GFOA Best Practice, Oct. 2012

The Stakeholders

Citizen taxpayers

Commercial taxpayers

Governing body

Departmental staff

Bond investors

Bond-rating agencies



What Policies Aren't – A Review

A set-it-and-forget-it tool

A summation of regulations governing specific decisions

A document drafted, discussed, and implemented by a party of one!

Just more **red tape**

The Basics of Good Policy

Written, written, written
Encompass plain language
Transparent and accessible
Complements strategic plans
Define specific elements
Complement procedures
Expire



What's the Point ? Making the Case

Adherence signals management strength

Specific to issuer's needs

Establishes common understanding, credibility, and transparency

Articulate goals

Provide concrete issuance guidelines

Long-term capital planning guidelines



Key Components

Limits

Structuring practices

Issuance practices

Management policies

Derivatives policies



Debt Limits

Legal restrictions

Public policy

Financial or planning restrictions

- Direct debt

- Revenue debt

- Conduit debt

- Short-term issuance

- Variable rate

Debt Limits – An Example

Limitation of Indebtedness

In addition to the limitations required by the RCW, the City's indebtedness is further limited by this policy to assure strong financial health. The limitations are applied to the assessed value of the City to arrive at a dollar value of indebtedness. For example, the 2008 assessed valuation used to determine the 2009 property tax levy was \$31.5 billion, and the statutory limitation for general obligation debt is 2.5%. Therefore, the City's statutory debt limitation is \$787.5 million. The following matrix shows the general limitation by type of debt. These limitations may be modified by the City Council up to the statutory limitation at the Council's discretion.

Type of Debt	Statutory Limitations	Policy Limitations	2006 Bellevue Actual
General Obligation:	2.5%	1.75%	0.70%
Non-Voted	1.5%	1.0%	0.69%
Voted	1.0%	0.75%	0.01%
Open Space and Parks	2.5%	1.75%	0.01%
Utilities	2.5%	1.75%	0.00%
Revenue	no limit	no limit *	NA
Local Improvement District	no limit	no-limit *	NA

Debt Structuring Practices

Maturity term – length of obligation

Average maturity goals

Structure patterns

Optional redemption features

Variable or fixed-rate debt, credit enhancements

Usage of proceeds

Capitalized interest/deferral of principal

Structuring Practices - Example

3. Structuring Practices

- 3.1. Variable rate obligations shall not exceed 15% of the County's outstanding long-term obligations.
- 3.2. Derivative products, such as interest rate swaps, will be considered only if they meet the economic goals and policy objectives of the County as outlined in the Swap Policy of the Debt Advisory Committee.
- 3.3. Long-term obligations taken on by organizations utilizing the County as a conduit issuer must qualify for an investment grade rating by one of the nationally recognized rating agencies (either with or without alternative credit enhancement). An exception to this requirement would be private placements subject to approval by the Debt Advisory Committee.

Issuance Practices

Selection and use of
service providers

Criteria to determine
sale method



Method of Sale

Method of sale

Competitive, negotiated or private placement

In conjunction with a financial advisor, the City will select a method of sale that is likely to produce the lowest cost of borrowing given current market conditions. In some instances, the City may choose to employ a negotiated sale or private placement instead of a competitive sale when:

1. Market conditions exist where underwriters are unwilling to take reasonable risk to underwrite bonds, as required for successful competitive sales
2. The City rejected competitive bids after a failure to receive market-justified yields
3. Debt structures would benefit from a sale targeted directly to retail investors or governmental agencies
4. Bonds are unique or “story bonds” where the leadership of an underwriter from the beginning of the transaction would reasonably be expected to produce the best execution



Polling Question #3



Issuance Practices

Selection and use of service providers

Criteria to determine sale method

Bond pricing services or indices

Refunding criteria

Credit ratings



Management Practices

Proceeds investment policy

Primary and secondary market disclosure practices including annual

Arbitrage monitoring and filing

Federal and state law compliance practices

Market and investor relations efforts

Management Practices

4. Management Practices

- 4.1. The County shall encourage and maintain good relations with credit rating agencies, investors in the County's long-term financial obligations, and those in the financial community who participate in the issuance or monitoring of the County's long-term obligations. A policy of full and open disclosure on every financial report and long-term obligation transaction will be enforced, an investor relations web site will be maintained with current and accurate information, and a credit rating agency presentation/update shall be conducted annually.
- 4.2. The County of San Diego shall comply with all on-going disclosure conditions and shall file such required documents in a timely manner.
- 4.3. The County of San Diego shall monitor earnings on bond proceeds and rebate excess earnings as required to the U.S. Treasury to avoid the loss of tax-exempt status.
- 4.4. The County of San Diego will enforce filing notices of completion on all projects within five years of their financing.
- 4.5. The County shall continually review outstanding obligations and aggressively initiate refinancings when economically feasible and advantageous pursuant to the Refunding Policy of the Debt Advisory Committee.

Use of Derivatives

Allow the use?

Location of a separate
and comprehensive policy
addressing derivatives



Other Considerations

Definitions (types of debt)

Roles within the process

Internal

Financial Advisor

Bond Counsel

Underwriter

Responsibility

Authority to issue and manage debt is derived from BCC 2.37.030. This section gives the Finance Director authority to act in the capacity of City Treasurer, which includes the duties of debt management.

This section also authorizes the Finance Director to appoint a subordinate employee from the Department to assist in the performance of the duties of City Treasurer. The Finance Director has appointed the Investment and Debt Manager to act as the Debt Manager to assist in the duties of debt issuance, interest payments, principal repayments and other debt-related activities.

The Finance Director is responsible for assuring that the activities related to the issuance and payment of bonds or other obligations not jeopardize the bond rating.

Other Considerations – cont'd

Operating reserves

Specific to funds (General Government vs Proprietary)

The maintenance of adequate operating reserves is essential to the financial strength and flexibility of the city as a whole. They are an integral part of the financial structure of the city and help make it possible for the city to issue debt. Operating reserves are a significant factor considered in evaluating and assigning credit ratings by the bond rating agencies. In order to meet potentially unanticipated needs it shall be the goal of the city to maintain the following reserves:

1. An annual reserve in the general fund operating budget equal to a range of ten (10) to fifteen (15) percent of annual revenues.
2. A sixty (60) day unrestricted reserve in enterprise funds, as well as all reserves required by revenue bond indentures to remain in complete compliance with bond issue covenants.
3. An annual cash basis and contingency reserve in the debt service fund of at least ten (10) percent of the annual principal and interest and capital improvement lease payments. This includes beginning debt service fund cash, current year revenues, transfers, and general fund revenues dedicated towards COP's, etc., divided by current liabilities of G.O. debt plus COP's, etc.

Polling Question #4

Making it Strategic

Written to the specific needs of the organization

Establish budgetary concrete capital planning & reserve goals

Establish limits, benchmarks & warning signs

Common understanding of complex topic



Thank you!



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