
Municipal Bonds

Introduction to Debt Issuance



Altadena
Libraries
Bringing PEOPLE + IDEAS Together

Altadena Library Board Workshop

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Financing Options: Capital Projects for Altadena Library District

- **Pay as you go** (*Internal Financing*) – Pay for capital projects with cash on hand/in reserves.
 - Pro
 - No financing cost.
 - Good for less expensive items with short useful lives.
 - Con
 - Expensive projects with long useful lives requires annual excess revenue be accumulated over a period of years.
 - Taxpayers don't get the benefit of current taxes paid.

- **Pay as you use** (*External Financing*) – Expensive capital projects are financed over their useful lives.
 - Pro
 - Project costs are spread out over long periods of time which is budget friendly.
 - Current and future taxpayers get the benefit of the capital projects that are paid with their tax dollars over the life of the financing.
 - Con
 - Financing costs are incurred.

Financing Options: External Financing

- There are two primary debt options for Altadena Library District.
 - Bank Loan/Private Placement
 - Issuance of Municipal Bonds

External Financing	Number of Investors	Restrictions on Resale	Limits on Loan Size or Maturity
Bank Loan	One	Yes, usually in whole or not at all. Negotiated and described in loan documents.	Depends on lender. Term usually <i>15 years or less</i> . Like a mortgage, it has one interest rate with a series of payments
Muni Bonds	Usually many (more than 50 e.g.)	Usually no restrictions on transfer unless debt is non-investment grade. Municipal market is large.	Bond market is large with many investors. Loan is generally 30+ years and broken into separate maturities <i>with different interest rates</i> and sold to different investor classes.

➤ **Bank Loan/Private Placement**

- Best terms for loans under **\$20 million** with a final maturity \leq **15 years**.
- Lower loan fees.
 - Bank loans/Private Placement loan fees are lower as sophisticated investors do their own credit evaluation.
 - Less regulatory issues, lower attorney fees.
- These investors prefer shorter term debt which makes payments higher.

➤ **Issuance of Municipal bonds**

- Best for loans above **\$7 million** with a final term of **10 - 30 years**.
- Low Interest Rates.
 - Current rates are low.
 - Lower annual payments, which is taxpayer/budget friendly.
- Higher loan fees due to:
 - Laws related to public sale of securities.
 - Securities disclosure requirements
 - Credit ratings process etc.

- Who are the common participants?
- Whom should be selected first?
- Why are so many people involved and what role does each consultant play?

Professionals in a Municipal Bond Issue

MUNICIPAL
ADVISOR

BOND
COUNSEL

DISCLOSURE
COUNSEL

TRUSTEE
BANK

ALTADENA
LIBRARY
DISTRICT

BOND
RATING &
INSURERS

SPECIAL TAX
CONSULTANT

➤ Municipal Advisor

- Government Finance Officers Association (GFOA) best practices recommends that government agency borrowers, retain a Municipal Advisor (“MA”) prior to undertaking a debt financing unless they have sufficient in-house expertise and current access to bond market information.
- The MA and/or a municipal law firm should be the first consultant retained.
- GFOA recommends retention prior to underwriters and other professionals.

- Duties MA' s are fiduciaries pursuant to rules adopted by the SEC. Services performed include:
 - Team leader on the financing, prepare a financing calendar, recommend a debt structure and bond/loan covenants. Present financing options to staff and board. Prepare a plan of finance which contemplates future debt.
 - Assist Bond Counsel in drafting and review of bond legal and sale documents. Work with Disclosure Counsel in the preparation and review of the offering documents and continuing disclosure.
 - Assist other consultants in the preparation and review of other documents.
 - Meet with staff and Board for review, discussion, consideration and approval of financing documents.
 - Direct and assist in the bond sale.
 - Assist in closing the bond issue and assisting staff after receipt of funds. Be available after closing the transaction.



Professionals in a Municipal Bond Issue - Continued

- Legal Counsel – Assists Issuer in complying with legal and administrative tasks for issuing debt.
 - Includes negotiating with other parties and drafting documents for Issuer approval by:
- Bond Counsel
 - Drafts Legal documents.
 - Formalizes bond structure providing the rights and obligations of financing parties.
 - Bond documents contain:
 - Standard provisions
 - Term, interest rate, and redemption features that define the basic terms of the issue.
 - Provides bond tax opinion.

➤ Disclosure Counsel

- Assists in preparation of an offering document
 - Complete and accurate material information to investors for investment decisions.
 - Reasonable investigation of the issuer and its financial position. Diligence efforts include:
 - Obtain representations as to the completeness and accuracy of disclosure.
 - Document review
 - Reviews documents and other information, questions key officials.

➤ Bank Trustee

- Independent third party, enforces the provisions of the bond Indenture.
- Receives debt service payments from issuer and pays investors.

➤ Special Tax Consultant

- (Pre-election) Provides assistance in developing financing structure for the Community Facilities District (CFD) including developing a Rate and Method of Apportionment of the Special Tax within CFD boundaries.
- May include a service component for an issuer's General Fund and providing a funding source for acquisition and construction of capital improvements.
- (Post Election) Provides continuous annual service to issuer including annual tax levy and other administrative functions.
- Assists with annual reporting to the state and investors.



Professionals in a Municipal Bond Issue - Continued

➤ Bond Rating Agencies

- Provides credit analysis and rating on debt.
- Higher credit rating results in lower interest cost.
- Rating request is made after cost/ benefit analysis by the MA or underwriter.
- After commencement of rating:
- Rating fee payable regardless of result or completion of debt issuance.
 - Multiple ratings may be requested for a single debt issuance, e.g. Moody's and S & P or S & P and Fitch.
 - The cost is paid for out of the proceeds of the debt financing.

Fitch	S&P	Moody's	Rating grade description (Moody's)	
AAA	AAA	Aaa	Investment grade	Minimal credit risk
AA+	AA+	Aa1		Very low credit risk
AA	AA	Aa2		
AA-	AA-	Aa3		
A+	A+	A1		Low credit risk
A	A	A2		
A-	A-	A3		
BBB+	BBB+	Baa1		Moderate credit risk
BBB	BBB	Baa2		
BBB-	BBB-	Baa3		

MOODY'S
INVESTORS SERVICE

S&P Global
Ratings

Fitch
Ratings

➤ Bond Insurers

- Two active insurance companies.
- Guarantees timely debt service payments for bonds. Fee is paid by the Issuer based upon:
 - Percentage of the debt service insured.
 - Insurance may cover some or all of the debt issue.
- Economic benefit analysis
 - Issuers use bond insurance if debt service is lower including the cost of the insurance.
- The final decision can be made at the time of the bond sale



BAMSM
BUILD AMERICA MUTUAL





Professionals in a Municipal Bond Issue - Continued

➤ Underwriter (UW)

- Buys the bonds from the issuer at an agreed upon price.
- Sells the bonds to investors, their customers, at a higher price.
- UW may purchase bonds without customer orders.



- Customers may include retail and Institutional investors
- Under SEC rules, underwriter is **not a fiduciary**, but is required to “deal fairly” with issuers.

➤ Competitive Sale

- Features of a competitive sale:
 - The bond issue has been structured.
 - Legal documents are near final
 - Rating(s) has been received.
 - Debt offered by issuers through an internet auction style process at a specified date and time.
 - The underwriter offering the **lowest interest cost** is awarded the bonds.
 - Underwriters form a syndicate to spread the risk of reselling the bonds at a profit.
- When to use competitive sale?
 - Common bond structure
 - Investment grade rating
- How is underwriter compensation determined?
 - Difference between purchase price of the bonds from the issuer and sales price to investors.

➤ Negotiated Sale

➤ **Features of a negotiated sale :**

- Underwriter (UW) is selected prior to the bond sale.
 - Selection may be early in the issuance process or, like the competitive sale, after legal documents are in near final form, and rating and insurance commitments received. UW negotiates his fee with the issuer with the assistance of the municipal advisor.
- UW suggests a specific date for the bond sale.
- UW provides recent comparable bond sale information to Issuer and MA and suggests bond pricing.
- UW holds an order period for the bonds and discusses results of sales efforts with Issuer and MA.
- Interest rates are negotiated and adjusted according to the results of the offering.
- Bond purchase agreement is executed.
- The underwriter's compensation is the difference in the purchase price paid to the issuer and the sales price received by investors.

➤ **When is a negotiated sale preferred?**

- Large debt issues
- Unique/complicated structures or requirements
- Pre-sale participation from underwriter allows for:
 - input on the structure, maturity and loan covenants,
 - Input on timing of the bond sale
- Issuer may include multiple underwriters for the bond issue.

➤ Closing of the Bond Issue

➤ Pre-closing

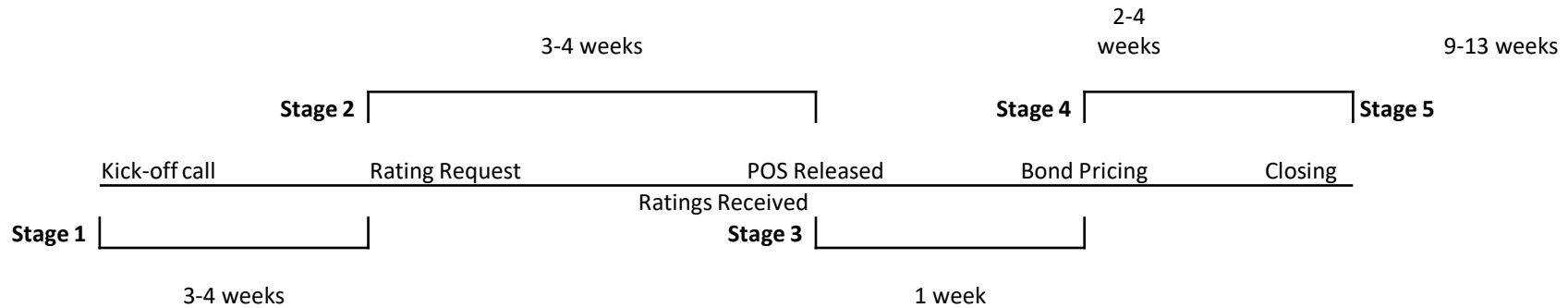
- The day prior to closing, Bond counsel has received executed copies of all documents required to close the transaction.
- Underwriter has wire transfer information for Trustee.
- Trustee has bonds to deliver to the Underwriter upon the receipt of the purchase price of the bonds.

➤ Closing

- The underwriter sends funds to the Trustee for purchase of bonds.
- Trustee notifies the finance team that funds have been received.
- Conference call is held to confirm receipt of funds for issuer. Trustee transfers bonds to the underwriter.



Time-Line for a Municipal Bond Issue



Stage 1 Bond Structure is confirmed and legal documents are drafted

Stage 2 Offering documents are drafted. Legal documents are near final and sent, along with offering documents, to rating agencies and approved by the Board.

Stage 3 Bond rating received and disclosed in offering documents which are distributed to potential investors.

Stage 4 *In a competitive sale*, on the date and at the time bids are to be received, brokerage firms submit bids. MA reviews and confirms bid. District awards the bonds to the lowest bidder.

In a negotiated sale, the underwriter recommends a sale date and offers bonds for sale at recommended interest rates. At the end of the order period, the results of the offering are discussed with the District. Adjustments to interest rates are made and an agreement to purchase is executed.

Stage 5 The offering and legal documents are updated to reflect the bond sale, documents are executed, and on the date of closing, the purchase price of the bonds is wire transferred to the Trustee bank for deposit for the benefit of the District, the bonds are transferred to the underwriter and the transaction is closed.