

Washington Public Ports Association Finance & Administration Seminar

Bonds 101: Ways to Fund Capital Projects June 9, 2023

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What you will learn in today's presentation:

- Today's presentation will answer the following questions (and more!)
 - What is a bond?
 - Who is involved in a bond issuance?
 - What types of bonds are there?
 - What legal considerations might I need to account for?
 - What is a credit rating and what does that process look like?
 - I have existing bonds, should I refinance?
 - After I've issued bonds, are there any ongoing compliance or disclosure requirements?

Types of Debt

- There are many sources of funding which may be a part of your overall debt profile:

- Grants
- State Loans
- Federal Loans
- Vendor financing
- State LOCAL Program
- Lines of Credit



Rule 1: Look for “cheap” money first

- Today, we’ll address issuing bonds by:
 - Public issuance through investment banking firm
 - In the presentation, we’ll refer to this as “Bonds” or “Bond Issue”
 - Direct placement through a bank
 - In the presentation, we’ll refer to this as a “Bank Loan” or “Direct/Private Placement”

Bond Issue or Bank Loan?

- Bond Issue (Publicly Issued)
 - Have lower interest rates but higher up-front costs
 - Work better for larger amounts of money and longer periods of time
 - Allow for interest-only payments and various repayment structures
- Bank Loan
 - Works well for interim, variable rate financing
 - A lot of banks will provide fixed rate financing for short terms; fewer banks will fix the interest rate for a long term (10+ years)
 - Banks often work better for less robust credits
- If the decision is close to a toss-up, consider the “hassle factor”
 - Work with your financing team to help determine the best source of funding

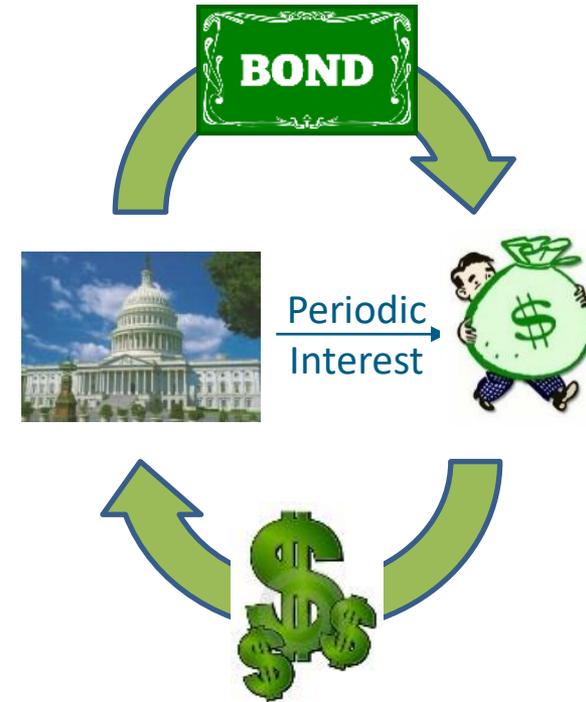
What is a Municipal Bond?

- Issued by municipal governments
 - Government (Issuer) issues a bond to an investor, promising to pay periodic interest (coupon) and repay the face value of the bond at maturity

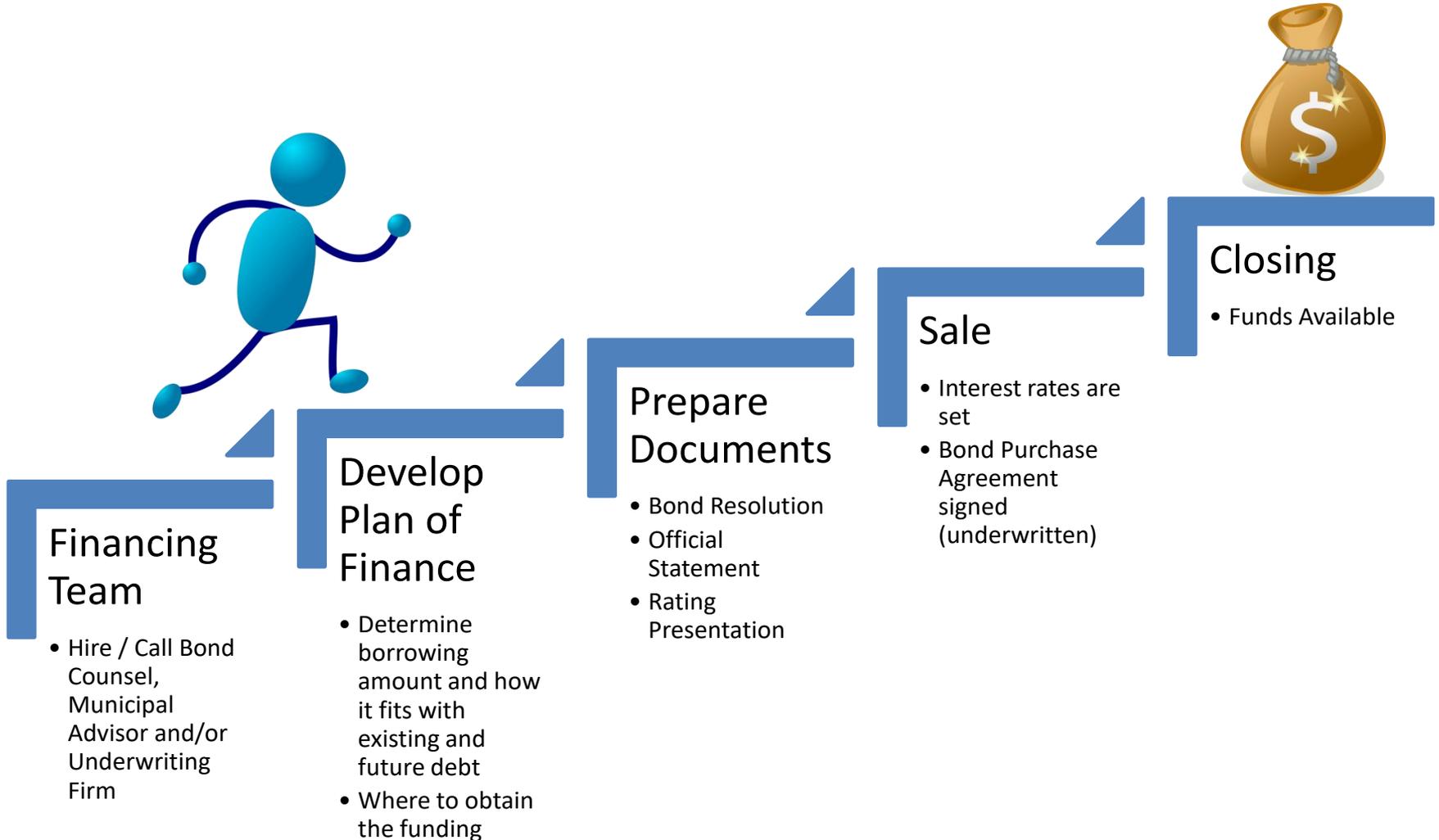
- Bond characteristics

Bond Issue	Bank Loan
Sold to Multiple Buyers	Sold to Single Purchaser
Increments of \$5,000	Any Increment
Each maturity can have a different interest rate	Generally has a single interest rate
Callable: Typically 10 Years	Callable: Varies

- Frequently secured either by
 - Pledge of taxes (general obligation)
 - Pledge of revenues (revenue)

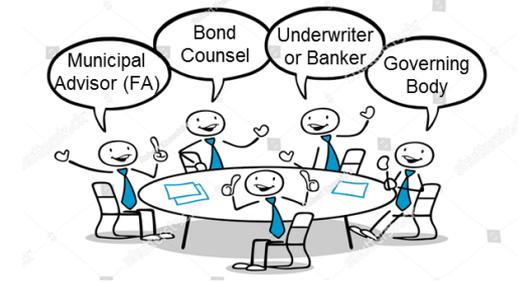


Debt Issuance Flow



Members of a Financing Team

- You, the “Issuer”
- Bond Counsel
 - Disclosure Counsel
- Municipal Advisor (Financial Advisor)
- Banker Representing Underwriting Firm or Bank
 - Underwriter counsel or bank counsel
- Bond Registrar
- Treasurer
- Rating Agency and Bond Insurer as applicable
- Escrow Agent
- Your financing team is there to serve you
 - *Be sure you understand and are comfortable with the process*
 - *Ask a lot of questions!*



Members of a Financing Team: Selection

- How do you select the members of the financing team?
 - Bond Counsel, Municipal Advisor and/or Banker
 - Get recommendations from your peers
 - Meet at the various conferences
 - Issue a Request for Proposals
 - Banker
 - Work with your Municipal Advisor once you have a general idea of the financing (term, size, security)
 - This will dictate whether an investment banking firm or direct placement bank makes sense
 - Depending on method of sale, you may not hire a banking firm up front
 - Other Members (escrow, verification, feasibility, etc.)
 - Working with your financing team will help determine what other members may be needed for a financing

Members of a Financing Team: Bond Counsel

- Your legal counsel
- Specializes in the issuance of bonds
- Prepares election resolutions
- Prepares bond resolutions
- Prepares reimbursement resolutions
- Ensures proper authorization and enforceability
- Reviews Federal tax law impacts and regulations
- Provide unqualified legal opinion that the bonds
 - Have been duly authorized and are valid and enforceable obligations
 - Exempt (or not) from Federal income tax
- Opinion is required by investors and others



Members of a Financing Team: Disclosure Counsel

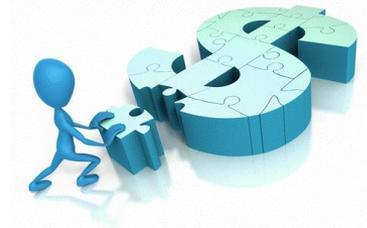
- For a public offering with an Official Statement
 - Whether the OS is being prepared for a negotiated sale to an Underwriter, or a competitive sale
- Bond Counsel may act as DC, or can hire another firm
- DC can take lead on drafting the OS
- DC reviews the information being disclosed to potential investors
 - Reviews information for accuracy and materiality.
 - Looks for any material omissions.
- Provides “10b-5 opinion” that, after review, to DC’s knowledge, the OS accurately represents the information contained and does not omit any material disclosure



Members of a Financing Team :

Municipal Advisor (Financial Advisor)

- Works with an issuer to develop and review a plan of finance and coordinate the overall financing
- Identify source of funds
 - Bank (direct placement) vs. underwriting firm (public sale)
 - Sale Method: Competitive vs. negotiated
 - Represents the issuer in negotiations with the underwriter
 - Facilitates a competitive sale
- Provide current market-based expertise
- Provide bond structuring and financial analysis
- Monitor outstanding debt for refinancing opportunities
- Coordination with rating agencies, bond insurers, underwriters
- Owes a fiduciary responsibility to the issuer



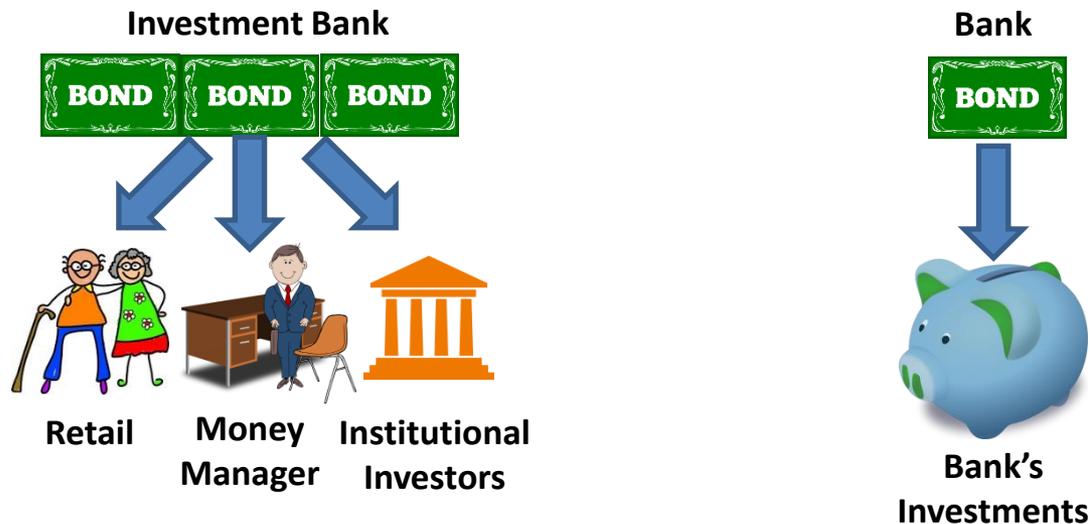
Members of a Financing Team: Investment Banking Firm or Bank

- Banker
 - The person you will work with on a day to day basis, bringing the firm's expertise to the financing team
 - If you don't have a financial advisor, a Banker may perform many of the same tasks
- Underwriter
 - The person in the middle, between the issuer and the investor
 - Sets the interest rates at which the investors agree to purchase the bonds and the issuer agrees to sell the bonds
 - Municipal advisors are integrally involved in the sale process



Members of a Financing Team: Investment Banking Firm or Bank

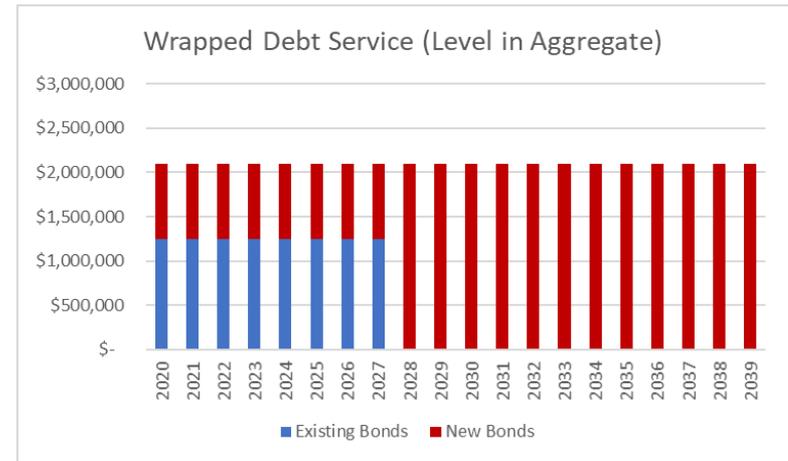
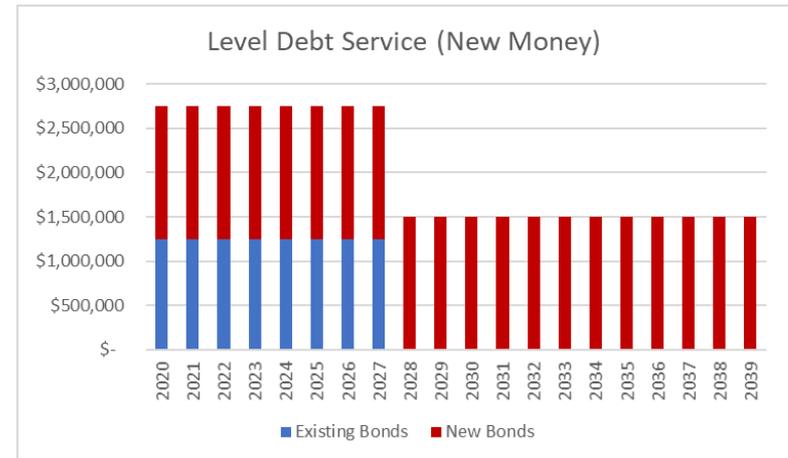
- Financial institution that sells your bonds to investors (investment bank) or purchases your bond to hold as an investment (bank)



- The banking firm
 - Does not have a fiduciary responsibility to the issuer
 - However, must deal fairly with the issuer and investors, and offer a fair price
-

Debt Structure

- “Level” and “wrapped” are examples of common debt structures
- Explore various structures to determine what makes sense for your organization
- When applicable, can frequently structure most expensive debt to be repaid first followed, by least expensive debt



Types of Bonds

- **General Obligation Bonds – Voted & Non-voted**
 - “Full Faith, Credit and [sometimes] Taxing Power”
 - Dollar limit determined by State statute
 - Payable from taxes and other available funds (grants, revenues, etc)
 - Lowest cost of borrowing
- **Revenue Bonds (e.g. General, IDD, Airport, Special Facility, etc.)**
 - Payable solely from revenues (all revenues, or specific pledged streams)
 - No dollar limit, but a practical limit (i.e. revenue)
 - Issuer makes certain covenants and pledges
 - Debt service coverage, reserve fund, additional bonds
 - Cannot be paid from property taxes
- **Assessment-backed Bonds (e.g. Local Improvement District)**
 - Finance improvements (e.g. roads, sewers) funded through assessments
 - Assessment or utility assessment district is based on a special benefit

Types of Bonds: General Obligation Debt Limits

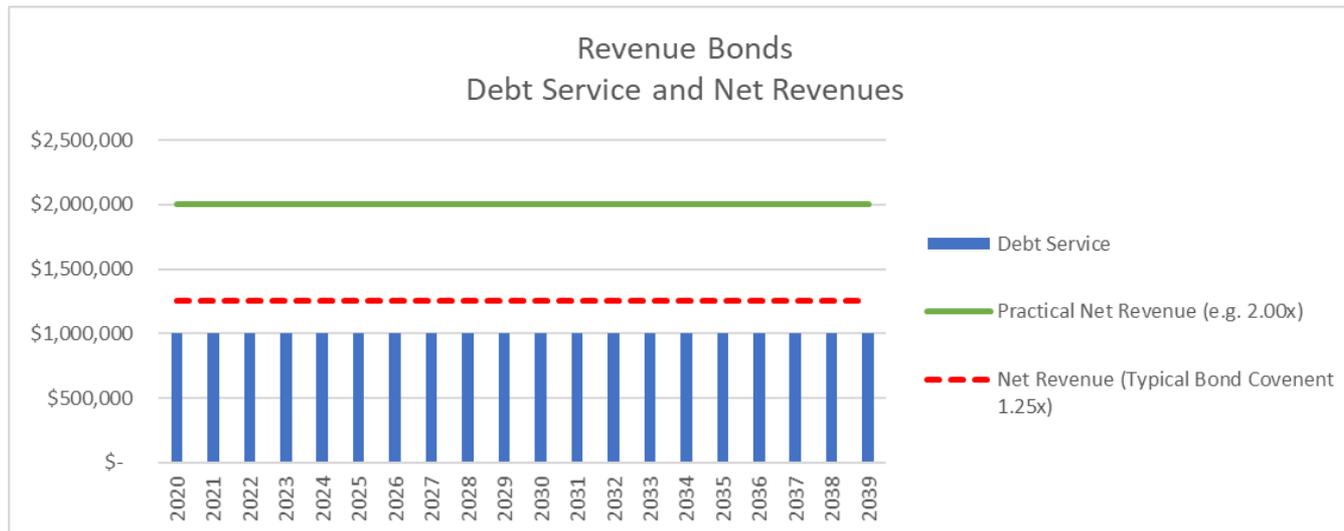
- State law limits general obligation debt
- The limitation is based on the issuer's assessed valuation
- Limitations (% of assessed valuation)

Government Type	Non-Voted	Total
Cities	1.50%	7.50% (General, Utilities, Parks)
Counties	1.50%	2.50%
Ports	0.25%	0.75%
Public Utility Districts	0.75%	1.25%
School Districts	0.375%	5.00%

- May want to maintain capacity for a “rainy day”

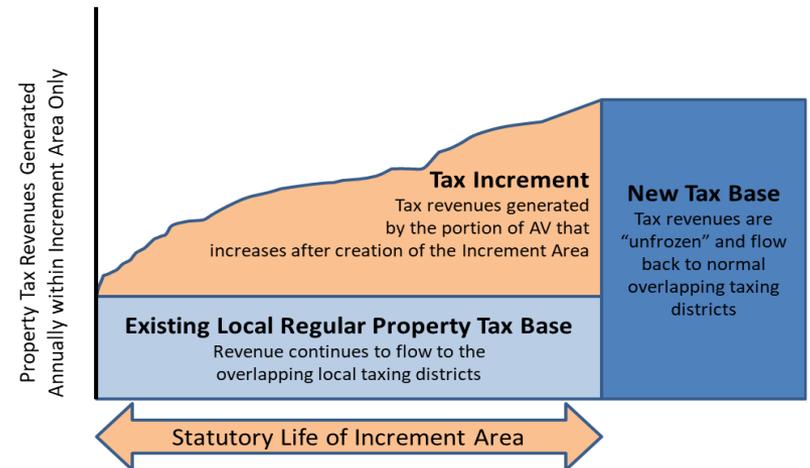
Types of Bonds: Revenue Bonds

- Revenue bond debt does not have a statutory limit, but has a practical limit
- Bond covenants generally require the Net Revenue available to pay debt service is 1.25x (times) greater than the debt service
 - To actually sell the bonds, Net Revenue should be greater than 1.25x



Tax Increment Financing (TIF)

- Allows a port (or a city or county that sets up the Tax Increment Area) to dedicate its incremental tax revenue and those of other taxing districts for up to 25 years
- Intended to fund/finance public improvements owned by a local government for a specific project/site within or serving the Increment Area
 - Must be a degree of certainty that the improvements will directly result in development
 - Outside professionals may be helpful for projections and financial models
- During the statutory life of the Increment Area
 - Existing local regular property tax revenues will continue to flow to the overlapping taxing districts
 - Incremental taxes will flow to the port (in this case) based on the portion of AV that increases after the creation of the area
- LTGO bonds are the primary method of leveraging the tax allocation revenues
 - Counts against the port's debt capacity



Tax Exemption

- Tax-Exempt
 - Bond interest is exempt from Federal income tax
 - Typical requirements
 - Governmental purpose; PAB with public hearing (new rules help here!)
 - Limits on private activity
 - Reasonable expectation for spending proceeds; arbitrage restrictions
 - Bank qualified (BQ): Less than \$10 million of tax-exempt bonds issued in a year (legislation continues to be proposed to increase to \$30m; outlook remains dim)
- Taxable
 - More expensive debt
 - No IRS restrictions
 - Tax credit / Direct subsidy bonds
 - Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds, etc.



**Rule 2: Do not listen to your Municipal Advisor or Banker for tax advice...
Talk to your Bond Counsel!**

Documentation: Bond Resolution

- Governing body authorizes the issuance of the Bonds
- Describes use of proceeds – the projects or refundings
- Pledges for payment – taxes or revenue stream
- Establishes lien position – senior or subordinate
- Contains tax covenants – arbitrage, private use, etc.
- Contains or delegates
 - Bond terms – rate, years, amounts
 - Manner of sale – negotiated, competitive, bank placement
 - Delegation terms
- Additional covenants, usually for revenue bonds
 - E.g., rates and fees, property surplus/sale limits, Debt Service Coverage Ratio percentages, reporting

Documentation: Official Statements

- The disclosure document provided to investors prior to the sale
 - POS or Preliminary Official Statement
- Contains information about the project being financed; structure; call provisions; security for the bonds; and details about the issuer, local economy, etc.
- Updated with the pricing details after the sale (Final Official Statement)

Documentation: Quotable Quote



“Let me ask you this. Does anybody read this [Official Statement]? I mean, only experts read this . . . [M]ost people don’t read this, nobody reads this. They go by what the raters, that is Moody’s, Standard & Poor’s, saying that these bonds are safe to buy.”

*Testimony of City Manager of Miami, Florida,
in SEC administrative proceeding against the City*



**Rule 3: Read the Official Statement and Bond Resolution.
These are your documents.**

Bond Ratings

- Ratings are essential to most Bond Issues
- Three primary rating agencies
 - Moody's Investors Service
 - S&P Global Ratings
 - Fitch Ratings
- Insurance may be used to enhance the rating
- Banks may not require a rating
 - Rating agencies would like to be made aware of additional borrowing
- Meetings with analysts
 - Virtually via Teams/Zoom
 - In-person visit, at your site or the rating agency
 - Conference call

Investment Grade
Rating Categories

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-

Methods of Sale

Negotiated



- A banking firm is selected prior to the sale of Bonds
- Works as part of the financing team
- Sells the bonds to investors on behalf of the issuer
- What is negotiable?
 - Structure, terms, and maturities
 - Interest rates and yields
 - Redemption provisions
 - Underwriting compensation
- Negotiated sales work well for
 - Unusual or complicated structures
 - “Story” bonds
 - Lesser credit
 - Volatile markets

Competitive



- Financial advisor works with client to develop financing plan, structure the issue, prepare the official statement, apply for bond insurance (if available) and bond ratings, and schedule a sale date
- Underwriting firm is selected through bids received electronically
 - Firm providing lowest cost of financing is selected
 - Lowest cost of financing includes interest rates and underwriting fees
- Competitive sale works well for:
 - Straight forward credits with good ratings
 - General Obligation and Essential-service Revenue Bonds
 - Large-sized issues
 - Stable markets

Bond Issue Sale Date

- Negotiated
 - A pricing call takes place the day before
 - Issuer and financing team discusses preliminary interest rates, comparable sales, and schedule for the sale day
 - About a three hour process
 - Underwriter begins order period early in the morning
 - Sales force confirms order amounts and interest rates
 - Issuer and financing team reconvene after order period for an update or, if the bonds have been sold, agree to size and interest rates
- Competitive
 - At the set date and time, underwriters submit interest rate / fee bids
 - Most bids arrive seconds prior to the specified time
- Approval of sale
 - By the “Designated Representative” if delegated, or by governing body

Bond Refundings

- Bonds are most frequently refinanced (“refunded”) for savings
- Bonds typically have a call date
 - Bond holders are protected until the call date
- “Current refunding”
 - New bonds are issued up to 90 days before the call date
- “Advance refunding” of governmental bonds
 - New bonds are issued more than 90 days prior to the call date
 - Bond proceeds are placed in an escrow account until the call
 - Escrow pays principal and interest on the old bonds
 - After 2017 Tax Law change, new bonds are taxable
 - (Legislation to reinstate TE advance refundings is still stalled.)

Bond Refundings

- Bonds are typically refunded for the following reasons:
 - Lower interest rates
 - Restructure debt
 - Modify bond covenants
- Generally, all things being equal, refunding savings improve closer to the call date



Rule 4: Do not rush into a refunding without understanding your options.

Environmental, Social & Governance Bonds

- ESG Bonds are those that incorporate environmental, social and governance factors...
- **Environmental** might include building for climate-related events; cleaner/renewable energy; carbon emissions/pollution control; sustainable public transportation; nature conservation; and sustainable water and wastewater management
- **Social** might include education, healthcare, affordable housing and water for underserved populations
- **Governance** factors such as sound internal controls, financial practices and long-term planning
- Self-certified, or can pay for a 3rd party ESG verifier opinion.

Environmental, Social & Governance Bonds

- Investors looking for “impact investing”, e.g., funds with ESG selection goals
- Credit rating agencies integrated ESG factors in their rating processes
- **Will it save you money?**
Evidence of interest rate savings is scarce
- **But...** A broader base of investors allows your Municipal Advisor greater discretion in structuring your offering
- Increases the target investor groups that your underwriter can market to
- And... the optics of ESG Bonds are great for highlighting the Port’s community stewardship

Post Issuance Compliance

- Bond 101 form for Wa. State Department of Commerce; Form 8038 for the IRS (Bond Counsel will typically file both on your behalf)
- Continuing Disclosure for publicly offered bonds
 - Annual financial statements
 - Other statistics agreed to and specified in bond resolution or Official Statement
 - Material events – now including all debt! Even new bank loans!
 - Posted to Electronic Municipal Market Access website (emma.msrb.org)
- Tax-Exempt Status
 - Watch out for private use: e.g., tenants, sale of property, management contracts
 - Track bond spending and investments for arbitrage calculations
 - Maintain records for the life of the bonds / audit period
- Bond Covenants
 - Debt service coverage
 - Reserve requirement
 - Additional bonds test, other covenants (rates, sale of property, bank reporting)

Summary Comments

- Ask a municipal advisor, banker or your bond counsel – early and often!
- Look for free money and low-interest loans first
- Bonds provide the lowest rates but have higher up-front costs and require more work to issue
- Bank loans are quicker with lower up-front costs and no public reporting requirements
- Rates are impacted by the market, your rating, payment pledge, tax status, bank qualification, coverage and covenants, current events, etc.
 - Your MA, Banker and Bond Counsel are resources for determining your options and impacts!
- Do not let rating agencies dictate how you run your organization
- Do not get talked into something unless you understand it
- If you are worried about repaying the bonds, don't borrow the money
- Do not forget your reporting afterwards!
- **DO NOT DEFAULT ON BONDS**