First Tryon Advisors

SIMPLIFYING PUBLIC FINANCE

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South Carolina Association of Counties

Alternative Debt Options & Importance of Capital Planning

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Debt Authorization

- Under Article X of the South Carolina Constitution, political subdivisions “shall have the power to incur indebtedness in the following categories and in no others:”
  - General obligation debt;
  - Indebtedness payable only from a revenue-producing project or from a “special source not involving a tax or license”; and
  - Indebtedness payable from incremental tax revenues issued for redevelopment purposes (TIF).

- Based on this authorization, the government has the following credit types at its disposal to secure financing:
  - General Obligation Bonds
  - Enterprise Revenue Bonds
  - Lease-Purchase Agreements
  - Installment Purchase Revenue Bonds
  - Hospitality/Accommodations Fee Revenue Bonds
  - Tax Increment District (TIF) Bonds
  - Special-Source Revenue Bonds
  - Limited / Special Obligation Bond

General Obligation Bonds

- General obligation bonds are backed by the full faith, credit, and taxing power of the issuing entity and are often repaid by a dedicated debt service millage.

- General obligation bonds can be issued pursuant to a voter referendum or without voter approval under an entity's constitutional debt limit.
  - There is no limit on the amount of voter-approved general obligation bonds an entity can issue.
  - For non-voter approved general obligation bonds, the SC Constitution limits the amount outstanding to no more than 8% of the assessed value of all taxable property within the boundaries of the entity.

- General obligation bonds are subject to a 30-year maximum term, unless sold to federal agency (e.g., USDA) or approved by referendum, in which case subject to a 40-year maximum term.
  - Repayment of principal must begin within five years.

Pros	Cons
Most secure structure Highest credit rating Lowest interest cost Simplest and most commonly used structure	Limited capacity for if not voter approved Referendum debt requires longer lead time

Enterprise Revenue Bonds

- Bonds secured by a pledge of revenues of an enterprise system;
  - Pledge can be on a "gross" or "net" (after payment of operating and maintenance expenses) basis
- Enterprise revenue bonds primarily include water, sewer, stormwater, solid waste and airports.
- Pledged revenues are trapped in a revenue fund and then paid out in a specified order (i.e., a "waterfall"), which ensures payment priority.
- Contractual obligations help protect investors while providing some operational flexibility to the issuer:
  - Rate covenant
  - Additional bonds test
  - Waterfalls/payment priority
- No constitutional/statutory debt limit and maximum term of 40-years but subject to self-imposed rate covenant and additional bonds test.

Pros	Cons
• Straight forward, common structure • Typically include ongoing covenants (rate covenant, additional bonds test) • Rating / interest rate dependent on strength of revenue pledge and other legal provisions	• Only available for revenue producing systems that stand on their own • Typically include ongoing covenants that must be managed to (rate covenant, additional bonds test) • Rating / interest rate dependent on strength of revenue pledge and other legal provisions

Lease Purchase Agreements

- Typically issued to finance shorter useful life assets such as vehicles and/or equipment.
- Secured by the assets being financed and subject to annual appropriation by the issuing entity.
- Title / lien on the vehicles and equipment transfer to entity at the end of the financing term.

Pros	Cons
• Straight forward, common structure • Does not impact 8% capacity • Wide universe of lenders willing to extend credit	• Requires pledge of collateral to secure financing • Limited to non-real estate related assets

Installment Purchase Revenue Bonds

- Financing structure available to only cities and counties.
- The city/county enters into a long-term base lease with a newly created, single-purpose, not-for-profit corporation for the real estate on which the project will be constructed (or another, unencumbered asset that is being used as collateral).
- The Corporation issues the bonds and use the proceeds to construct the project.
- The Corporation then enters into a purchase and use agreement / facilities agreement with the underlying entity pursuant to which the entity makes semi-annual or annual installment payments to the Corporation in an amount equal to the debt service on the bonds for the use of the building.
  - With each payment, the entity is acquiring a percentage ownership of the underlying asset so that at the end of the term, the entity will own the asset outright.
- Payments by the entity under the purchase and use agreement / facilities agreement can be made from any legally available source of funds (or combination of funds), including debt service millage, via annual appropriation.
- IPRBs are a debt of the Corporation and therefore do not count against the underlying entity's 8% debt limit.
  - However, lenders/bondholders/rating agencies look to the creditworthiness of the underlying entity given that the entity will be the ultimate source of payments on the bonds via the installment payments.

Pros	Cons
• Does not count against government's 8% debt limit • No specific revenues pledged; can be repaid from any legally available source of funds including debt service millage via issuance of annual 8% GO bonds • Rated one notch off GO rating	• Requires hard asset to be used as collateral • Higher interest rate than GO bond (0.25 – 0.35%) • More complicated structure • Higher cost of issuance

Hospitality/Accommodations Fee Revenue Bonds

- Proceeds must be used for a specified category of tourism related projects.
- Similar revenue pledge and covenants as with an enterprise revenue bonds (i.e. additional bonds test, waterfall of funds but no rate covenant since entity is statutorily limited on the tax/fee it can impose).
- Pledged revenues are subject to more volatility due to economic cycles.

Pros	Cons
• Does not count against the government's 8% debt limit • Simple security structure (i.e. single, identified revenue stream)	• Government has less control over pledged revenue stream (i.e. limited on ability to increase it) • Subject to volatility • Typically lower credit rating • Higher interest cost than GO bond and essential service enterprise system revenue bonds • Typically requires additional bonds test

Tax Increment District (TIF) Bonds

- Used to construct publicly owned infrastructure/assets to help spur redevelopment in blighted areas.
- Pledged revenues are the incremental tax revenues generated in the redevelopment area above a baseline assessed value.
- Allows for the participation of multiple taxing districts (city, county, school district).
- District is in place for a specified term.
- Requires a redevelopment plan describing the improvements to be funded and amount of bonds to be issued.

Pros	Cons
› Does not count against government's 8% debt limit › Carves out revenue from redevelopment to help fund infrastructure improvements in blighted areas › Can allow for participation from multiple taxing entities	› Requires significant work to establish District › Requires development to generate revenues available to pay debt service › New TIF Districts have difficulty getting financing without a backstop. › Higher interest cost › Higher cost of issuance › Only certain types of improvements can be funded

Special-Source Revenue Bonds

- May be issued for any infrastructure serving the entity or a qualified project.
- Secured by and payable from fee-in-lieu of tax payments made by property owners located in a multi-county business or industrial park.
- Additional debt issuances governed by an additional bonds test, similar to an enterprise revenue bond.

Pros	Cons
• Does not count against government's 8% debt limit • Allows payments from entities within a business park to fund improvements within that business park	• Very difficult to get investment grade rating without backstop given narrow revenue stream/limited payers • Requires significant work to establish multi-county business/industrial park • Higher interest rate • Higher cost of issuance

Limited / Special Obligation Bonds

- Specific, identified revenue is pledged as primary security (i.e. hospitality, accommodations, tax increment, stormwater).
- In addition, entity covenants that if the pledged revenue stream is insufficient to pay the debt service, it will pull from any legally available funds (subject to appropriation by governing body).
- Appropriation backstop language is sufficient for one rating agency to rate the bonds off of an entity's GO rating thereby enhancing the credit quality and lowering the interest rate vs. standalone pledge of weaker revenue stream.
- Same covenants as standalone revenue bonds (additional bonds test, waterfall of funds and potentially rate covenant).
- Does not require the pledge of real estate as collateral and does not count against 8% debt limit.

Pros	Cons
› Does not count against government's 8% debt limit › Appropriation backstop language enhances credit quality of weaker revenue stream › Rating notched off of GO rating (by one agency) resulting in lower interest rate vs. standalone revenue pledge › Does not require real estate collateral	› Only one rating agency gives full "credit" for appropriation backstop › Better suited for public market issuance as opposed to bank placement › Still requires revenue pledge, additional bonds test and potentially rate covenant

Marketplace to Issue Debt

- Issuers have two primary marketplaces to issue bonds – public market and bank placement.
  - Bonds sold in the public market are sold to a variety of different investors (mutual funds, insurance companies, individuals) and require the preparation of an offering / disclosure document and obtaining credit ratings.
  - Bonds sold via a direct placement are sold directly to a single bank / lender and do not require an offering / disclosure document or credit ratings.
- In addition, issuers can look to state (i.e. State Revolving Fund loans) or federal (i.e. USDA) sources if the entity and project meet their requirements.
- The appropriate marketplace for a financing depends on several factors including size, security, credit quality, desired term, interest rate and market conditions.

Public Sale vs. Bank Placement vs. SRF vs. USDA

Marketplace	Public Sale	Bank Placement	SRF	USDA
Cost of Issuance	High	Medium	Low	Low
Staff Time Commitment	High	Medium	Medium	Medium
Maximum Fixed Term Likely	30 Years	15-20 Years	20-30 Years	30-40 Years
Flexibility to Customize Repayment	High	Medium	Low	Low
Covenants	Medium	Medium	Low	Low
Credit Rating / Public Disclosure	High	Low	Low	Low
Interest Rate Risk	High	Medium	Low	Low

Pros and Cons of Bank vs. Public Market

Bank Placement		
Pros	1)	More streamlined issuance process with lower staff time commitment and the ability to lock in interest rates sooner
	2)	Lower upfront costs of issuance
	3)	Greater prepayment flexibility
	4)	No credit rating requirements
	5)	No (or limited) ongoing reporting requirements
Cons	1)	Subject to changes in interest rate / market environment
	2)	Subject to changes in banks' interest / willingness to lend

Public Sale		
Pros	1)	Large market with broad buyer base
	2)	No issue securing long-term financing (30+ years)
Cons	1)	Not able to lock in interest rate until closer to closing
	2)	More in-depth issuance process with greater staff time commitment
	3)	Higher upfront costs of issuance
	4)	More restrictive prepayment provisions (typically 10-year no prepayment option)
	5)	Ongoing reporting / continuing disclosure requirements
	6)	Initial and periodic rating agency interactions

Current Environment

- Given the sharp and continuous increase in rates over the first 10 months of 2022, many issuers "flipped" from the public market to the bank market due to:
  - Less day-to-day volatility in the bank market;
  - Lower interest rates in the bank market; and
  - Ability to lock in the interest rate earlier in the process.

- However, following the collapse of Silicon Valley Bank in March 2023 and the ensuing liquidity crunch that many banks faced, many issuers have "flipped" from the bank market to the public market due to:
  - Tightening of credit conditions by certain banks;
  - Shortening of financing terms by certain banks;
  - Higher interest rates than the public market; and
  - Heightened focus by banks on existing / prospective clients (i.e. those that come with deposits)

- The dynamic between the bank market and the public market can change quickly.

Life Cycle of a Bond Transaction

- Once an entity selects its desired financing structure, it can begin the debt issuance process.
- The primary steps involved in a financing schedule include:
  - Assembling the working group
  - Documenting the transaction
  - Obtaining credit ratings (public sale only)
  - Pricing the bonds
- The typical life cycle of a financing is 60 to 100 days depending on the complexity of the financing and the market in which the debt is issued (public market vs. bank placement).

Public Sale

Date	Task
Week 1	Assemble Financing Team / Working Group Kick-Off Meeting
Week 4	Distribute 1st Draft of Bond / Underwriting Docs
Week 5	Document Review Call
Week 6	1st Issuer Approval
Week 7	Distribute 2nd Draft of Bond / Underwriting Docs
Week 8	Rating Agency Meetings / Calls
Week 9-10	Receive Ratings 2nd Issuer Approval
Week 11	Finalize Docs / Post POS
Week 12	Price Bonds
Week 15	Closing

Bank Placement

Date	Task
Week 1	Working Group Kick-Off Meeting
Week 2	Distribute 1st Draft of Bond Docs Distribute RFP to Banks
Week 3	Issuer Approval(s)
Week 4	Bids due from Banks
Week 6-7	Documents finalized
Week 8	Closing

Equipment / Rolling Stock Financings

- Typically financed in bank / leasing corp. market
- Terms commensurate with useful life of assets
- Master financing structure is more advantageous (rates, ease of execution)
- Escrow feature for multiple asset financing
- Prepayment for assets (fire trucks are primary example)
  - Payment / Performance Bond
  - Municipality listed as dual beneficiary

The Importance of Capital Planning

- A key element to the financial health of an organization and its ability to deliver services to citizens and businesses is a properly prepared capital plan.

  - Allows governments to properly procure, design, construct, maintain, and operate key capital assets such as infrastructure, technology, and equipment.

  - Critical to essential public services such as water, sewer, transportation, etc.

  - Important element of a government's economic development program and strategic plan.

- Without a sound multi-year capital plan that identifies capital needs, funding options, and operating budget impacts, it can be difficult for governments to address the needs of their citizens, both current and long-term.

Source: GFOA

Identifying a Need

- Effective capital planning allows a government to identify needs, both in the near-term and long-term.
- Once a need is identified, the next step is to determine the best way to fund the need.
- Having an effective capital planning model can make it easier to determine whether certain needs are funded using cash, grants, or debt.

Turn Projects on or off

Specify project description, amount, and timing

Specify funding type / revenue source

Customize repayment structure

Projects Under Consideration

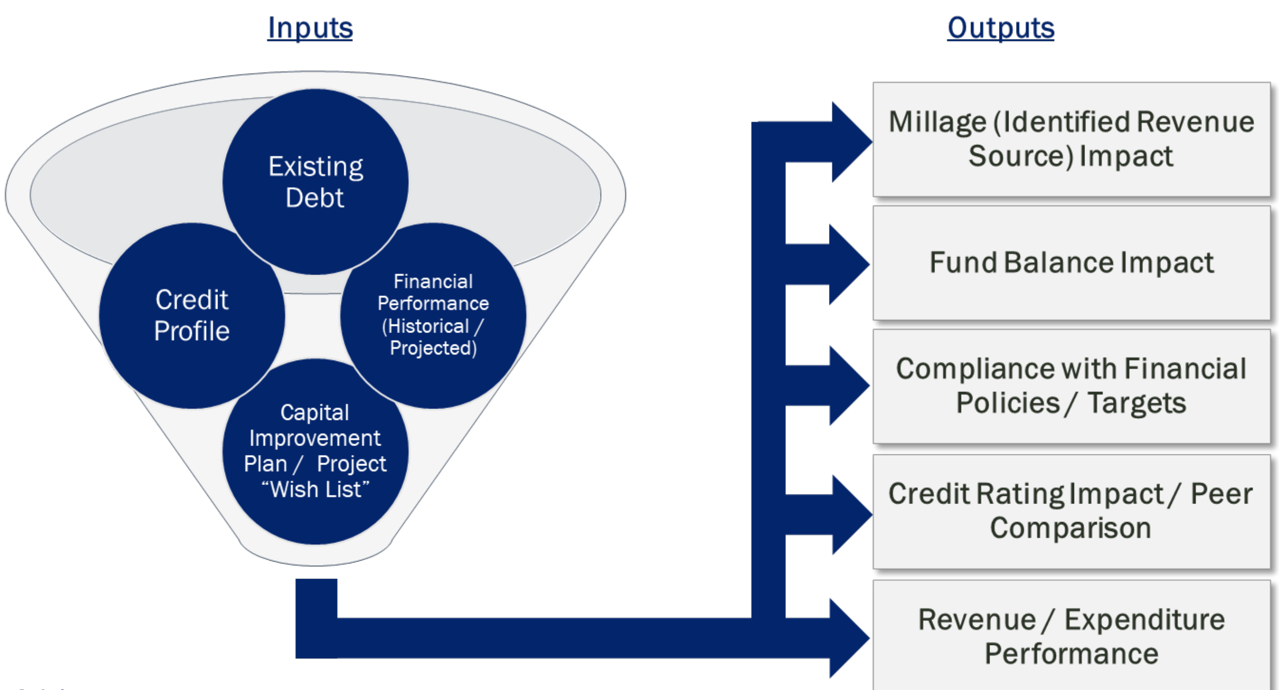
1	2	3	4	5	6	7	8	9	10
On/Off	Description	Amount	Timing (FY)	Fund / Revenue Source	Funding Type	Structure	Term	Principal Deferral	Rate
On	City Hall	2,500,000	2024	General Fund	G.O.	Level D/S	20	0	4.25%
On	Public Safety Downtown Surveillance	500,000	2024	General Fund	Fund Balance				
On	Fire Truck	1,200,000	2025	General Fund	G.O.		5	0	3.00%
On	Park Renovations	750,000	2025	General Fund	Fund Balance				
On	Water and Sewer Upgrades	5,000,000	2026	Water & Sewer	Revenue Bond	Level D/S	25	2	4.75%
On	Parking Garage	7,000,000	2027	General Fund	G.O.	Level Principal	25	0	4.50%
On	Vehicles and Equipment	1,000,000	2027	General Fund	G.O.	Level D/S	5	0	3.00%
On	Sidewalks	700,000	2027	General Fund	Fund Balance				
Off	Fire Station Renovation	2,000,000	2027	General Fund	G.O.	Level D/S	7		3.25%
Off	Vehicles and Equipment	1,000,000	2027	General Fund	Fund Balance				

Source: GFOA

SAMPLE

Incorporating the Capital Plan into a Financial Model

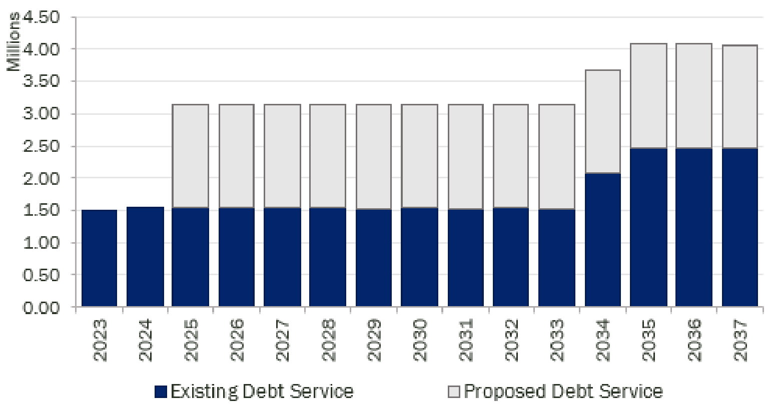
- A capital planning model is most efficient and effective when it has the following attributes:
  - Simple and easy to use by staff
  - Dynamic enough to run scenarios live
  - Provides clear outputs
  - Specific to the government's situation
  - Holds the attention of non-finance people (elected officials, managers, etc.)
  - Analyzes a problem and provides a solution



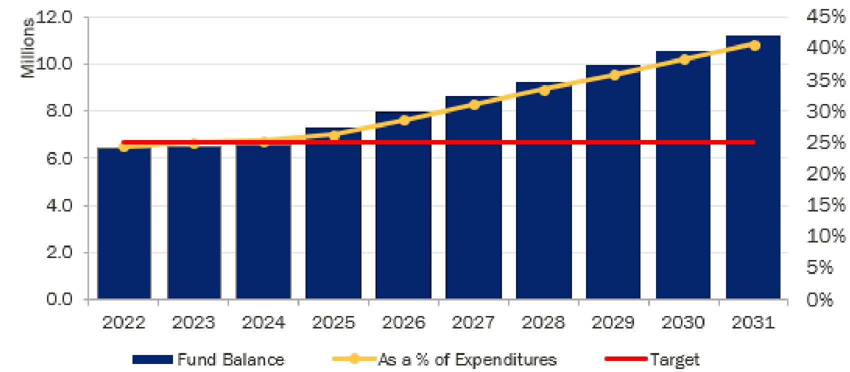
Dashboard Graphics / Outputs

Dashboard Graphics

Annual Debt Service Requirements (General Fund)

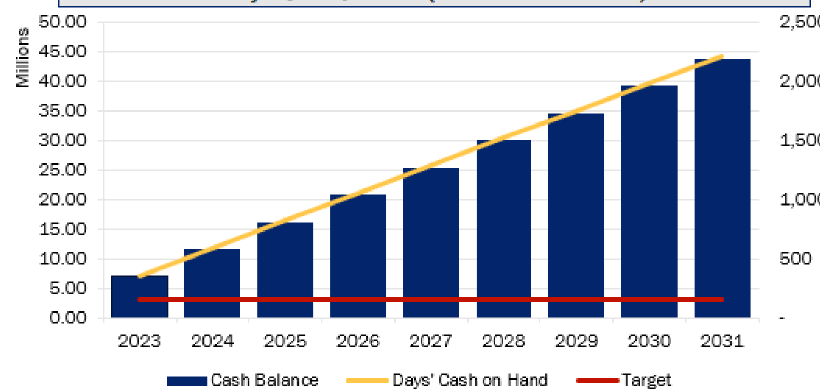


Fund Balance (General Fund)



Debt Service Coverage (Water & Sewer Fund)

Days' Cash on Hand (Water & Sewer Fund)



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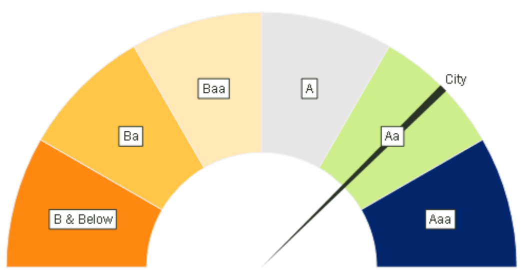
Dashboard Graphics / Outputs

Observe the immediate and future credit impact of a proposed financing in real time as the City develops the optimal plan of finance

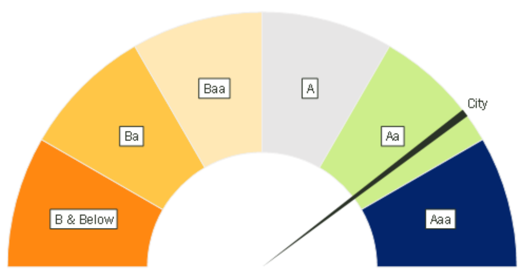
Year	2023
Rating	Aa2

Current Moody's Rating



Year	2025
Rating	Aa1

Projected Moody's Rating



Track future credit performance to ensure the City is on track to meet credit goals

	Weight	2025 Value	2025 Rating
Economy/Tax Base			
Tax Base Size (full value) (000's)	10.0%	2,836,083	Aa3
Full Value Per Capita	10.0%	114,437	Aa2
Wealth (median family income)	10.0%	120.7	Aa2
Finances			
Fund Balance (% of revenues)	10.0%	73.2	Aaa
Fund Balance Trend (5-year change)	5.0%	8.6	A1
Cash Balance (% of revenues)	10.0%	64.5	Aaa
Cash Balance Trend (5-year change)	5.0%	-28.8	B1
Management			
Institutional Framework	10.0%	GA	Aaa
Operating History	10.0%	1.4	Aaa
Debt/Pensions			
Debt to Full Value	5.0%	1.1	Aa1
Debt to Revenue	5.0%	1.6	A2
Moody's-ANPL (3-year average) to Full Value (%)	5.0%	0.4	Aaa
Moody's-ANPL (3-year average) to Revenue (X)	5.0%	0.6	Aa2
Implied Rating		1.72	Aa1

SAMPLE

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