

CPIM
CENTER FOR PUBLIC INVESTMENT MANAGEMENT



A PROGRAM BROUGHT TO YOU BY:

ROBERT SPRAGUE

OHIO TREASURER

TAX-EXEMPT FINANCING: CURRENT MARKET CONDITIONS AND RECENT REGULATORY IMPACTS

Presenters

The logo for Dinsmore & Shohl LLP, featuring the word "Dinsmore" in a blue serif font with a small blue triangle above the letter 'i'.

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The logo for Hilltop Securities, featuring the text "Hilltop Securities" in a blue sans-serif font, with "A Hilltop Holdings Company." in a smaller blue font below it, and a red silhouette of a bison to the right.

Eric Prall

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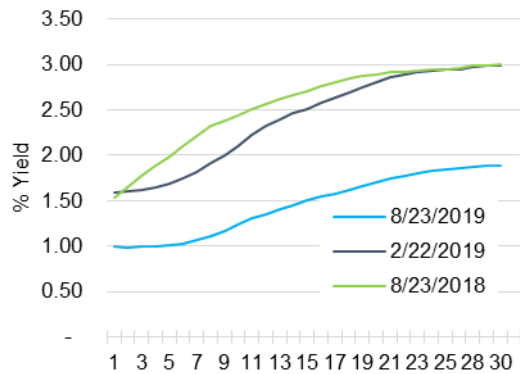
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Today's Discussion Topics

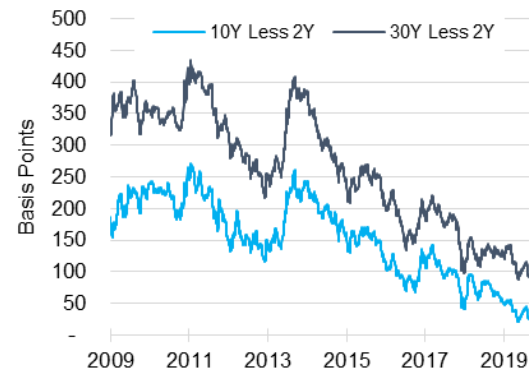
- Current Market Conditions
- Opportunities for Issuers In Current Market
- Current Regulatory Environment For Municipal Bonds
- Compliance and Strategies

Overview of Current Market

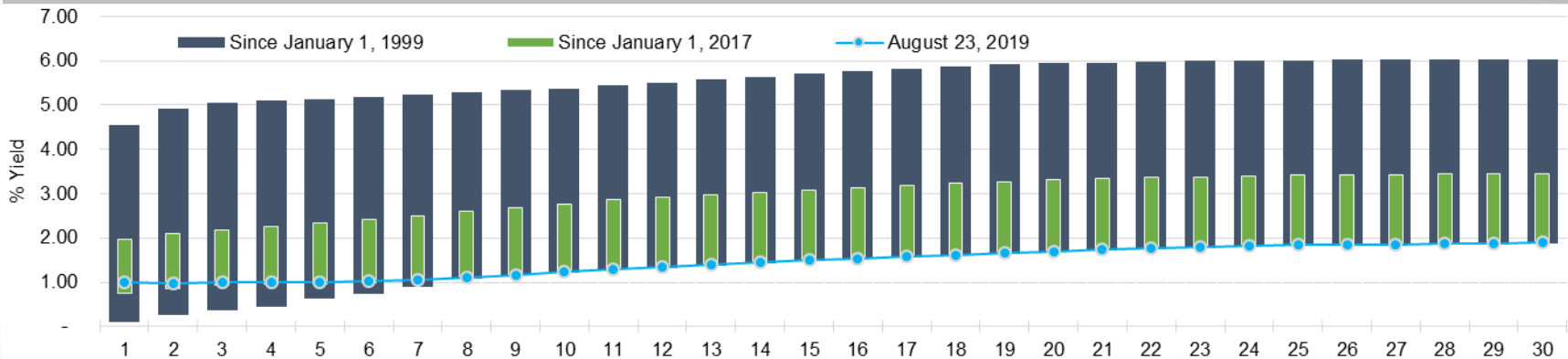
AAA MMD Historical Yield Curve Comparison



AAA MMD Historical Yield Curve Steepness

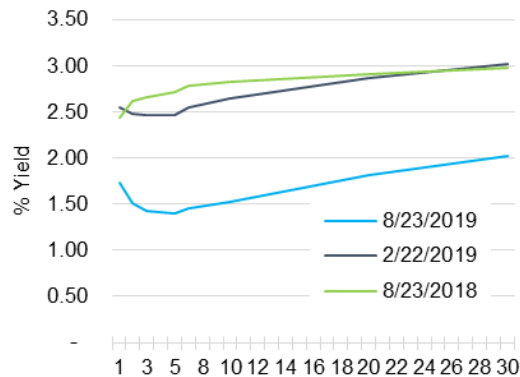


Maximum and Minimum AAA MMD Yields

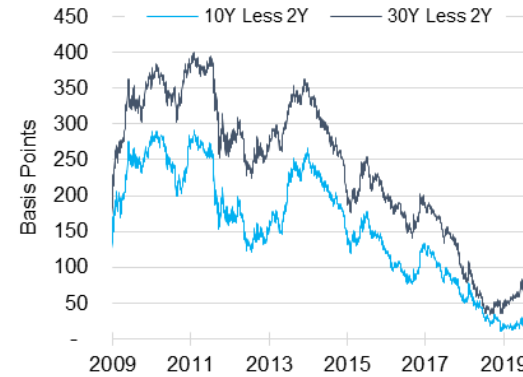


Overview of Current Market

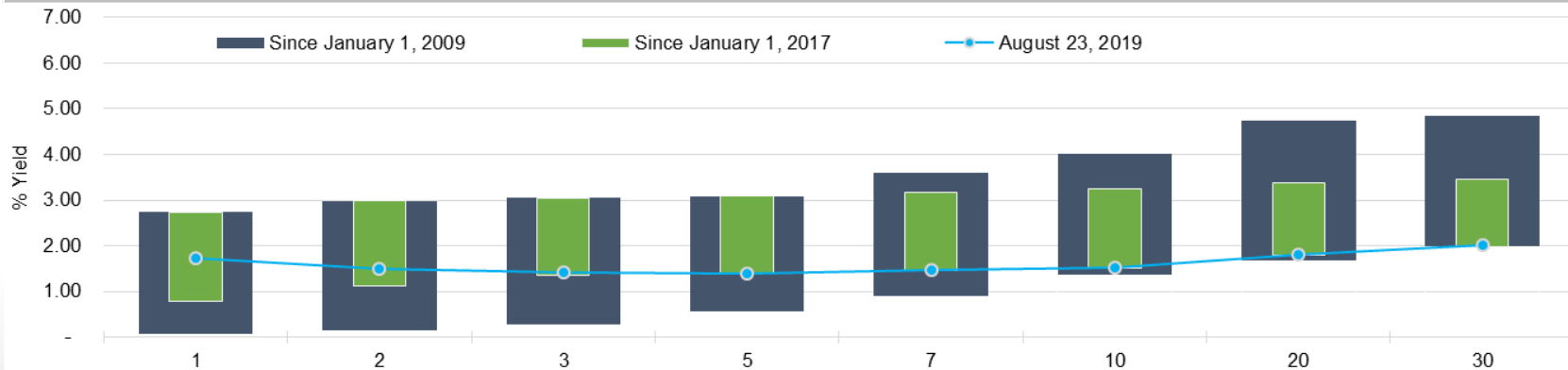
UST Historical Yield Curve Comparison



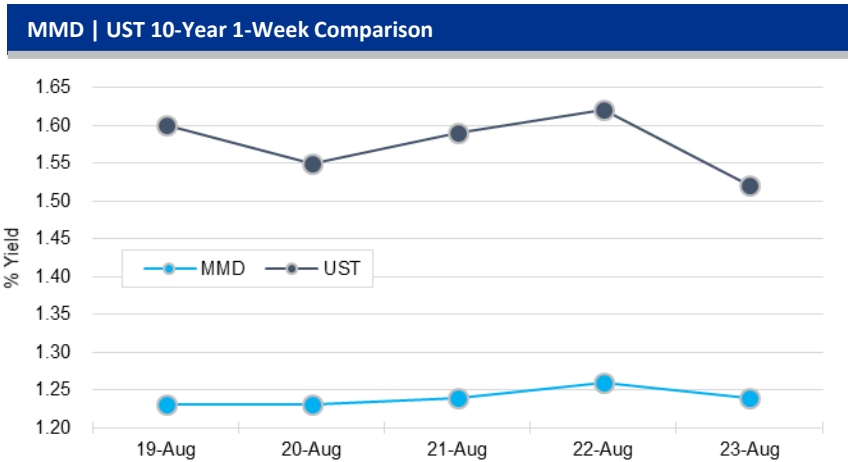
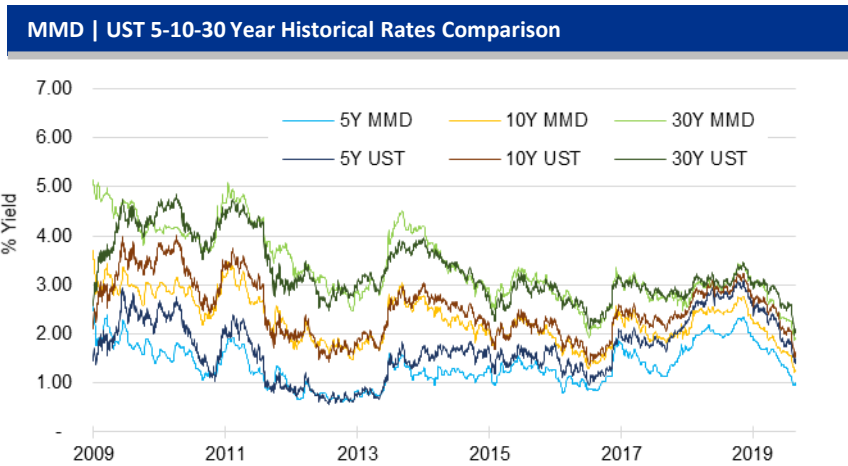
UST Historical Yield Curve Steepness



Maximum and Minimum UST Yields

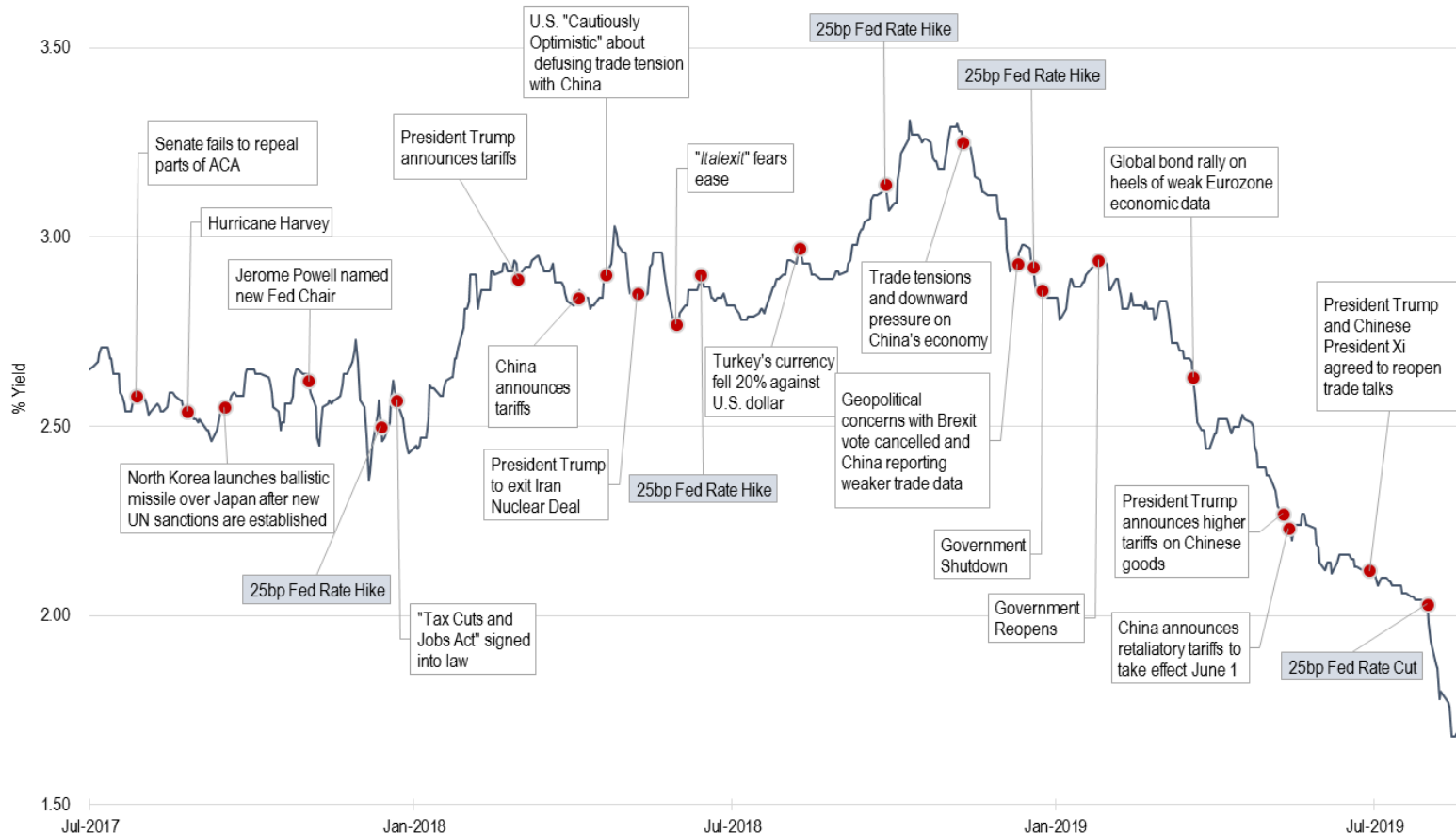


Relationship of Treasuries to MMD



Overview of Current Market

Change in 20-Year MMD with Market Commentary



Inverted Yield Curves

- Inverted Yield Curve: Yields on long-term bonds are lower than yields on short-term bonds
- Inverted yield curves are often seen as bad omens. Markets could be anticipating a recession:

The Slope of the Yield Curve (10 year - 2 year Treasury Yield)

Generally, an inverted yield curve can sometimes prove as an indicator of an impending recession.



Source: Haver Analytics/US Treasury Department.
Note: Shaded blue bars indicate NBER recession dates.

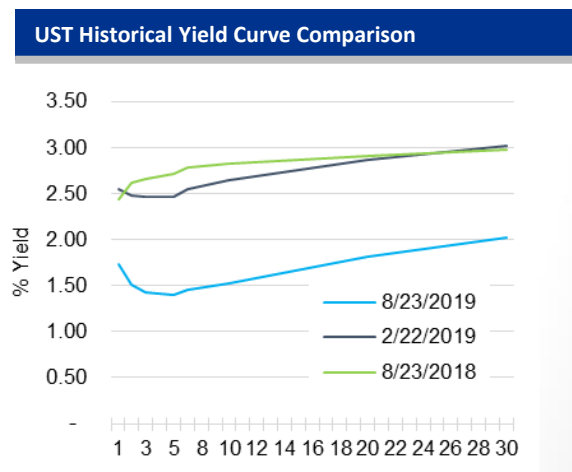
 Hutchins Center
on Fiscal & Monetary Policy
at BROOKINGS

- Inverted yield curves often precede recessions. But they are no guarantee that there will be a recession soon, or at all

Inverted Yield Curves

Term	1 Mo.	2 Mo.	3 Mo.	6 Mo.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	7 Yr.	10 Yr.	20 Yr.	30 Yr.
Yield	2.05	2.02	1.97	1.87	1.69	1.43	1.36	1.32	1.40	1.47	1.77	1.97

- Short-term treasury yields (maturities from one month to one year) are higher than the yields of Treasury instruments maturing from two to seven years
- The yield of a six month Treasury instrument is higher than the yield of a one-year and ten-year Treasury instrument



Source: U.S. Treasury Department
Rates as of September 4, 2019

Opportunities Given Current Market Conditions

- Tax-exempt rates remain near historical lows
- How can issuers take advantage of this? Refinancing?
- Many bonds have optional redemption features: a right to redeem or call all or a portion of an outstanding issue of bonds prior to its stated date of maturity
- Optional redemption features allow issuers to pay off bondholders early (i.e. 'refund' the bonds)
- Example language:
 - The Bonds maturing on December 1, 2020 and thereafter are subject to optional redemption prior to maturity, in whole or in part on any date in any order maturity as determined by the City and by lot within a maturity, at the option of the City on or after December 1, 2019 at par plus accrued interest thereon to the date of redemption

Opportunities - Refundings

- A refunding is an issuance of new bonds at lower interest rates to defease, or retire, outstanding bonds with higher interest rates
- The sole purpose of this refunding is to reduce the issuer's interest costs and save issuers interest on the repayment of prior bonds
- The Government Finance Officers Association recommends a minimum of 3-5% savings for refunding bonds, unless the refunding bonds are being issued for reasons other than economic savings
 - By refunding Build America Bonds, issuers are able to opt out of any potential further cuts to the Bonds' subsidy
 - This reduces legislative risk to the issuer
 - Restructuring debt for reasons other than economic savings
 - Ex: adjusting debt service to match revenues

Opportunities - Refundings

- The passage of time allows refunding opportunities – created by the Yield Curve
- Seven years after the original issuance, a 20-Year bond interest rate can be replaced with a 10-Year bond interest rate
- Today’s market allows issuers to capture:
 1. “Rolling down the Yield Curve”
 2. Considerably lower rates

2007 Market Interest Rates																				
Maturity	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Yield	3.70	3.73	3.77	3.82	3.86	3.90	3.94	3.99	4.04	4.10	4.15	4.18	4.21	4.24	4.26	4.28	4.30	4.32	4.34	4.36

7 Years Later (Same 2007 Interest Rates)												
Maturity	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Yield	3.99	4.04	4.10	4.15	4.18	4.21	4.24	4.26	4.28	4.30	4.32	4.34

7 Years Later (Current Market Interest Rates)												
Maturity	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Yield	0.15	0.30	0.52	0.81	1.13	1.53	1.88	2.16	2.35	2.49	2.62	2.75

Opportunities - Refundings

- **Current Refunding**

- A transaction where the bonds being refunded will all mature or be redeemed within 90 days or less from the date the refunding bonds are issued
- Current market conditions are favorable to current refundings
 - Tax-exempt rates remain below historical averages and near 20-year lows
 - High short-term taxable rates allow issuers to earn more in their escrow accounts

- **Advance Refunding**

- A transaction where the bonds being refunded will all mature or be redeemed within a period of more than 90 days from the date the refunding bonds are issued
 - Tax Cuts and Jobs Act passed in late 2017 (the “TCJA”), amended Section 149(d) of the Internal Revenue Code to preclude the issuance of tax-exempt bonds to advance refund outstanding tax-exempt bonds
 - The TCJA does not preclude the issuance of tax-exempt bonds to advance refund non-tax advantaged taxable bonds (like Build America Bonds)
 - The TCJA does not preclude the issuance of taxable bonds to advance refund outstanding tax-exempt bonds

Tax-Exempt Refundings of Taxable Bonds

- An IRS Chief Counsel memorandum released October 26, 2018 states that ‘Section 149(d), as amended by § 13532 of the 2017 Act, does not preclude the issuance of tax-exempt bonds to advance refund non-tax-advantaged, taxable bonds’
- Ex: Build America Bonds (BABs)
- Extraordinary Optional Redemption Features
 - Ex: The Series 2010 Bonds will be subject to extraordinary optional redemption prior to their stated maturities until December 1, 2020, at the option of the District, upon the occurrence of an Extraordinary Event from any source of available funds, as a whole or in part, by lot, at the Extraordinary Redemption Price
 - “An Extraordinary Event will have occurred if there is any guidance published by the Internal Revenue Service....pursuant to which the Direct Payment is reduced or eliminated”
- The benefit of issuing bonds at lower, tax-exempt rates can outweigh the loss of the subsidy payment on the outstanding taxable bonds, allowing the issuer to realize debt service savings
- Refunding a BAB issue also reduces some legislative risk; the issuer no longer risks larger interest payments in the event the federal subsidy is eliminated or reduced

Alternatives to Advance Refundings – Taxable Advance Refundings

- Taxable advance refundings
 - 2017 Tax Reform did not prohibit taxable advance refundings
 - Refund outstanding tax-exempt bonds by issuing taxable bonds
 - The tax-exempt bonds being refunded will all mature or be redeemed within a period of more than 90 days from the date the taxable refunding bonds are issued
 - Current market conditions - taxable advance refundings
 - Short-term taxable rates are near ten-year highs
 - Negative arbitrage

Alternatives to Advance Refundings – Forward Delivery Bonds

- Forward Delivery Bonds
 - Can be issued as a public offering or private placement
 - Price/sign Bond Purchase Agreement and lock in deal now
 - Closing at a later date allows the issue to be a current refunding
 - Investors typically demand a premium to compensate for the interest rate risk they incur from forward rate locks. For example, an investor may require an additional 0.05% for each additional month between the pricing and closing dates

Example:

- Price/sign BPA: April 1, 2019 (holds rates)
- Close: September 5, 2019
- Pay off Prior Bonds: December 1, 2019
 - Closing is within 90 days = Current Refunding
 - Closing occurs five months after pricing (there are four additional months between pricing and closing)
 - (four additional months) * (0.05% premium for each additional month) = 0.20% estimated penalty

Other Alternatives to Advance Refundings

- Shorter par call dates
- Make-whole calls prior to par call
- Synthetic advance refundings
- Taxable sandwich structures
 - Taxable bonds are issued to advance refund an issue
 - These taxable bonds are later refunded by tax-exempt bonds
- “Cinderella” structures,
 - Taxable bonds which convert to tax-exempt bonds on a certain date

Public Offering or Private Placement?

- **Public Offering**
 - Issuer sells the bonds to an underwriter who resells the bonds to retail investors and institutional investors on established securities markets
- **Private Placement**
 - Issuer borrows money directly from a banking institution or other financial institution

Public Offering or Private Placement?

- **Public Offering**

- Issuer sells the bonds to an underwriter who resells the bonds to retail investors and institutional investors on established securities markets
 - Substantial flexibility of final maturity
 - Usually lower interest rates than a direct bank placement/ private placement
 - Higher costs of issuance
 - Long-term obligations
 - Bond insurance and state credit enhancement can provide additional credit support to bring down interest rates
 - Public offerings require Issuers to supply offering disclosure and continuing disclosure
 - Rating agencies provide ratings that affect the desirability of the bonds to investors
 - Limited offering – 35 or fewer sophisticated investors
 - \$100,000 denominations

Public Offering or Private Placement?

- **Private Placement**

- Issuer borrows money directly from a banking institution or other financial institution
 - May not require a bond rating
 - Low costs of issuance - may have higher interest rates
 - Banks consider public issuers to be low risk ways to invest capital
 - Public issuers generally have high quality assets to pledge
 - Generally, no disclosure document is needed
 - No official statement or offering memorandum is needed because bonds, loan agreements, or leases are held by banks or sold privately to institutional investors
 - Bank financings must still satisfy federal tax laws to ensure interest on bonds, loans, and leases remains tax-exempt
 - Still need legal authority for the transaction
 - Same constitutional and statutory debt limit restrictions apply
 - Make all necessary arbitrage rebate and yield reduction payments
 - Recent Examples
 - School Bus Financing lease purchase vs. general obligation
 - Recent financing - Flexible Call Features
 - Callable anytime? Cost?

Public Offering or Private Placement?

- **Private Placement (continued)**

- Placements can be fast, less complicated and minimize origination expenses due to the following:
 - Committed rate
 - Normally requires no official statement, trustee, or paying agent
- Placements not competing with bonds offered in the public marketplace -booked in the bank's portfolio
- Intent to hold until maturity
- Evaluate by determining all-in cost to the issuer

Current Regulatory Environment

- Greater Focus by Regulators on Primary and Continuing Disclosure
 - Primary Disclosure
 - Accuracy
 - Adequacy
 - Continuing Disclosure
 - Contents
 - Timeliness

Current Regulatory Environment

- What is Rule 15c2-12?
 - SEC Rule
 - Designed to address fraud by enhancing disclosure in the municipal securities market
- Currently, SEC Rule 15c2-12 does not require continuing disclosure as a condition to a private placement
 - Under a private placement, there is no need to enter into a Continuing Disclosure Agreement.
 - Transaction documents may require disclosure or lender public information to obtain financial records.

Current Regulatory Environment

- Rule 15(c)2-12 - governs primary offering disclosure and continuing disclosure, including submission of annual financial information and material event notices
 - Primary offering of municipal securities in principal amount of \$1 million or more, subject to exceptions
 - Directly governs underwriters and indirectly governs issuers and obligated persons

Official Statement

- What is Primary Offering Disclosure?

Issuer

- Issuer overview
- Projections
- Facilities data
- Financial outlook
- Financial Statements

Bond Counsel

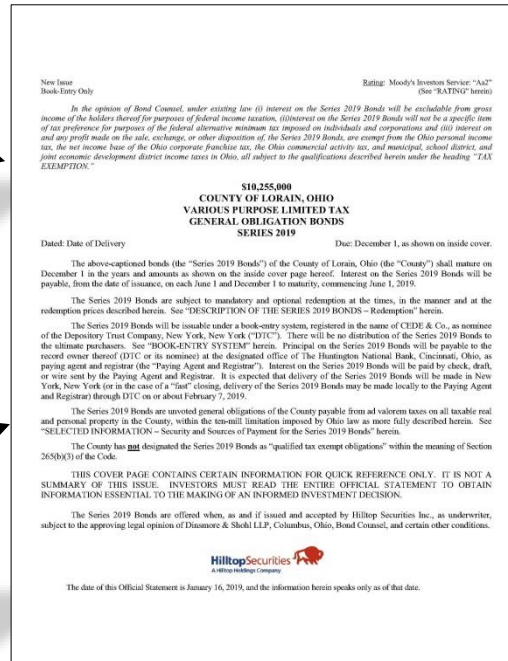
- Demographic info from Census & other sources
- Description of tax base and other sources of revenue
- Debt limitation tables
- Debt tables
- Bond counsel opinion
- Interface with County Auditor
- Actual production of document

Underwriter/MA

- Structuring information
- Continuing disclosure agreement
- Economic Development

County Auditor

- Assessed Valuation data
- Tax tables
- Largest taxpayer list



Continuing Disclosure

- Required by SEC Rule 15(c)2-12
- Selected financial and operating data from Official Statement must be filed annually while the bonds are outstanding



Continuing Disclosure Agreements

- Issuer subject to Rule 15(c)2-12 must enter into a continuing disclosure undertaking
 - Continuing Disclosure Agreement
- Continuing Disclosure Agreements
 - Annual filing date
 - Sets forth what needs to be filed:
 - Audited financials*
 - Selected annual financial/operating data from the Official Statement (largest taxpayers, tax collection rates, assessed valuation, etc.)
 - Material Event Notices (rating change, late payment, etc.)

*if audit not available by filing date, is to be filed once it becomes available

Continuing Disclosure – Two New Events for 2019

	Events	Materiality
1	principal and interest payment delinquencies	Without regard to materiality
2	Non-payment related defaults	If material
3	unscheduled draws on debt service reserves reflecting financial difficulties	Without regard to materiality
4	unscheduled draws on credit enhancements reflecting financial difficulties	Without regard to materiality
5	substitution of credit or liquidity providers, or their failure to perform	Without regard to materiality
6	adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the securities, or other material events affecting the tax status of the securities	Without regard to materiality
7	modifications to rights of Holders of the securities	If material
8	bond calls and tender offers	If material
9	defeasances	Without regard to materiality

Continuing Disclosure – Two New Events for 2019

	Events	Materiality
10	release, substitution, or sale of property securing repayment of the securities	If material
11	rating changes	Without regard to materiality
12	bankruptcy, insolvency, receivership or similar event of the obligated person	Without regard to materiality
13	the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the Obligated Person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material	If material
14	appointment of a successor or additional trustee or the change of name of a trustee, if material	If material
15	incurrence of a financial obligation of the Obligated Person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a Financial Obligation of the Obligated Person, any of which affects security holders, if material	If material
16	default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the Obligated Person, any of which reflect financial difficulties	Without regard to materiality

Compliance Strategies

- Compliance Strategies
 - Post-Issuance Compliance Policy
 - Dissemination Agent
 - EMMA e-mail reminders

FIN 330: Trends in Capital Improvement Refinancing

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Disclosure

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