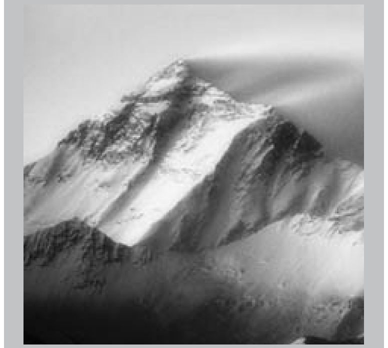

Structuring and Marketing a Negotiated Bond Issue

Presentation to:

cdfa
Council of Development Finance Agencies

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Outline of Discussion

- ☑ Market Update
- ☑ Fixed versus Variable Rate Debt
- ☑ Structuring and Sizing a Bond Issue
- ☑ Bringing a Negotiated Bond Issue to Market
- ☑ Questions and Answers

Market Update

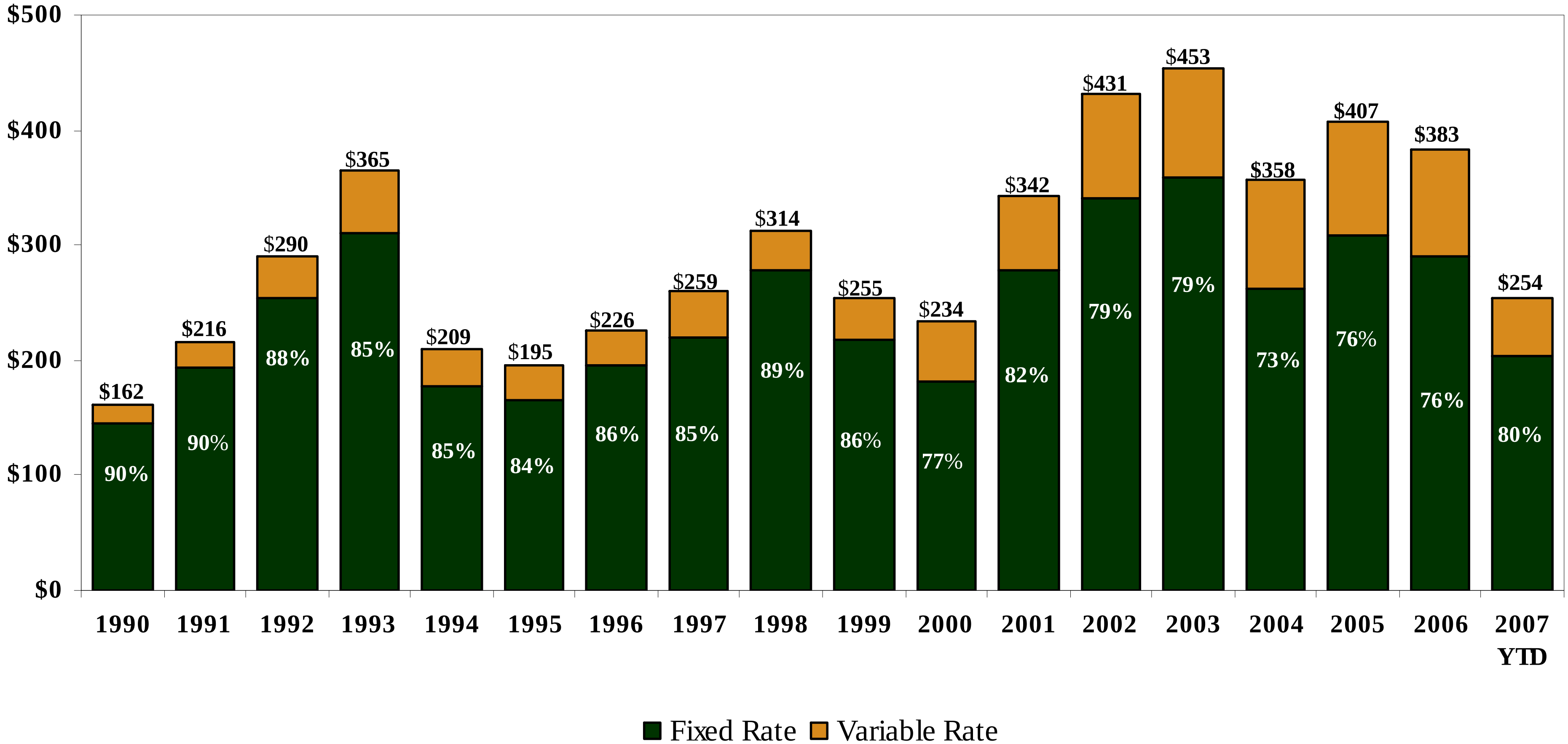
Current Market

- Market Uncertainty
- Volatility
- Variable Rate Market Distress
- Flight to Quality
- “Back to the Basics”
- Derivatives and Synthetic Products Out of Favor

Fixed versus Variable Rate Debt

Fixed and Variable Rate Debt Issuance

Total Municipal Debt
($Billions Par Amount Issued)



Source: Thompson Financial.

Fixed Rate Bonds

Advantages	Disadvantages
▪ No Interest Rate Risk ▪ Budget Certainty ▪ No Liquidity Facility Needed ▪ Tax-Exempt Call Options Are Relatively Cheap and Inefficiently Priced ▪ Include: Bond Funds, Insurance Companies, Arbitrage Accounts, Trust Departments and Retail Investors	▪ Higher Initial and Expected Interest Expense ▪ Inability to Convert to Alternative Modes ▪ Less Flexible Call Feature than Floaters ▪ Higher Issuance Costs ▪ Limited to One Advance Refunding ▪ Negative Arbitrage Needs to be Minimized on Investment of Project Funds

- The Bond Buyer Revenue Bond Index serves as a proxy for long-term tax-exempt fixed rates.

- Fixed rate financings remain the most common approach in the current market, though variable rate financings have become more common.

Variable Rate Bonds

Advantages	Disadvantages
▪ Structuring Flexibility ▪ Lower Expected Cost of Capital ▪ Flexible Call Feature ▪ Pricing Efficiency ▪ Ability to Convert to Alternative Modes, Including Fixed Rates ▪ Ability to Earn Arbitrage on Project Funds ▪ Debt Portfolio Diversification ▪ Buyers Include: Money Market Funds, Corporations and Retail Investors	▪ Interest Rate Risk ▪ Budgeting Uncertainty ▪ Investors Have Right to Tender or "Put" Bonds Back to the Issuer ▪ Pricing of Liquidity Facility Unpredictable ▪ Additional Administrative Involvement ▪ Market Risk

- The Securities Industry and Financial Markets Association ("SIFMA") Index, known previously as the BMA Index, is a seven-day high grade market index composed of tax-exempt variable rate demand obligation bonds, calculated weekly. The Index acts as a market indicator that allows municipal professionals a consistent means to track market movements.

Applications of Tax-Exempt Variable Rate Securities

There are several reasons why variable rate debt could be a permanent part of an issuer's capital program.

- **Asset-Liability Management:** Balance sheet assets invested in short-term instruments can serve as a hedge for variable rate liabilities. When variable rate assets and variable rate liabilities are matched, the volatility of net interest expense – interest income less interest cost – is minimized.

- **Flexibility:** Issuers can redeem the bonds at par at various intervals. Floating rate financing can be easily converted to a fixed rate financing.

- **Diversification of Investor Base:** Short-term tax-exempt investors include tax-exempt money funds, bank personal trust departments, tax-paying corporations, and tax-sensitive high net-worth individuals.

- **Ability to Earn Positive Arbitrage:** Variable rate issue may earn legal positive arbitrage if certain IRS spend-down provisions can be met.

Variable Rate Demand Bonds

Variable Rate Demand Bonds (VRDBs)

Bear interest at a variable (floating) rate that resets daily, weekly, monthly, quarterly, or any integral multiple of three months.

- Investors have right to tender or "put" the bonds back to the Issuer at par
- Requires liquidity support (external or self-liquidity)
- Carry both long- and short-term credit ratings
- Generally use combination of insurance and Standby Bond Purchase Agreement (SBPA) or a Letter of Credit (LOC).
- Most common form of variable rate financings

Profile of Variable Rate Investors

Variable Rate Demand Securities

Tier One

- **Money Market Funds** are the largest and most consistent investors in the short-term market, representing approximately 70% of the total market

Tier Two

- **Corporations** may also be significant investors in short-term notes, representing as much as 20-25% of the total market. However, they typically are "crossover" buyers and enter the market only when yields are attractive as an alternative to taxable investments

Tier Three

- **Commercial banks, trust funds, insurance companies, and retail investors** represent approximately 5-10% of the total short-term market

Structuring and Sizing a Bond Issue

Security Features

- Pledged Revenues
- Bond Covenants
- Other Security Features

Pledged Revenues

- **General Obligation ("GO") Bonds** – Secured by a pledge of the issuer's full faith and credit to repay bonds. The "full faith and credit" backing of a General Obligation bond implies that all sources of revenue, unless specifically excluded, will be used to pay debt service on the bonds.

- **Revenue Bonds** – Revenue bonds are payable from a specific stream of revenues, such as a user fee or dedicated tax, and are not backed by the full-faith and credit of the issuer. They are issued to finance specific enterprises or projects and are usually secured solely by revenues from those projects. Revenue bonds can generally be grouped into six categories:
  - Utilities
  - Higher Education, Healthcare and Other Not-For-Profit
  - Housing
  - Transportation
  - Industrial Development, Pollution Control, and Other Exempt Facility Bonds
  - Securitized Revenue Bonds

Bond Covenants and Other Security Features

Rate Covenants - Under a rate covenant, the issuer pledges that rates will be set high enough to meet operation and maintenance expenses, renewal and replacement expenses, and debt service. An alternative form of rate covenant requires that rates be set so as to provide a safety margin above debt service, after operation and maintenance expenses are met.

Example: *"The Board will fix, charge and collect fees so that the Revenues will at all times be sufficient in each Fiscal Year to pay the Current Expenses and to provide funds at least equal to (i) 115% of (1.15 times) the Principal and Interest Requirements…."*

Additional Bonds Test (ABT) - Protects the security or pledged revenues of existing bondholders. The additional bonds test must be met by the issuer in order to borrow additional debt secured by the same revenue source as the outstanding bonds.

Example: *"The net revenues in each of the two full Fiscal Years immediately preceding the date of issuance of such proposed Additional Bonds must be equal to at least 130% of the estimated Annual Debt Service for the year following the proposed issuance."*

Bond Covenants and Other Security Features (cont.)

Debt Service Reserve Fund - Provides a cushion to make timely debt service payments in the event of temporary adversity. Federal law limits the amount of bond proceeds that can be used to fund the debt service reserve fund to the lesser of:

- *10% of the principal amount of the issue;*
- *Maximum annual debt service; and*
- *125% of average annual debt service on an issue*

Other Covenants - Additional covenants might include a provision for insuring the project, a review by an independent auditor, or a prohibition against the sale of the project's facilities prior to repayment of outstanding debt, among others.

Credit Enhancement

Other Security Features: Credit Enhancement

- **Credit enhancement is a means of substituting the credit of the issuer (really the security pledge) with that of a higher rated third party guarantor.**
  - Enhance the market for bonds.
  - Compare the premium or fee paid for credit enhancement to the expected interest rate savings to determine whether or not credit enhancement is cost effective.
  - Typically takes the form of bond insurance or letters of credit (LOC).

Bond Insurance

- Several well-established bond insurers.
- Premium is based on total debt service and paid up-front as a one time fee.
- In effect for life of bond issue.
- Generally used for fixed rate deals.

Letters of Credit (LOC)

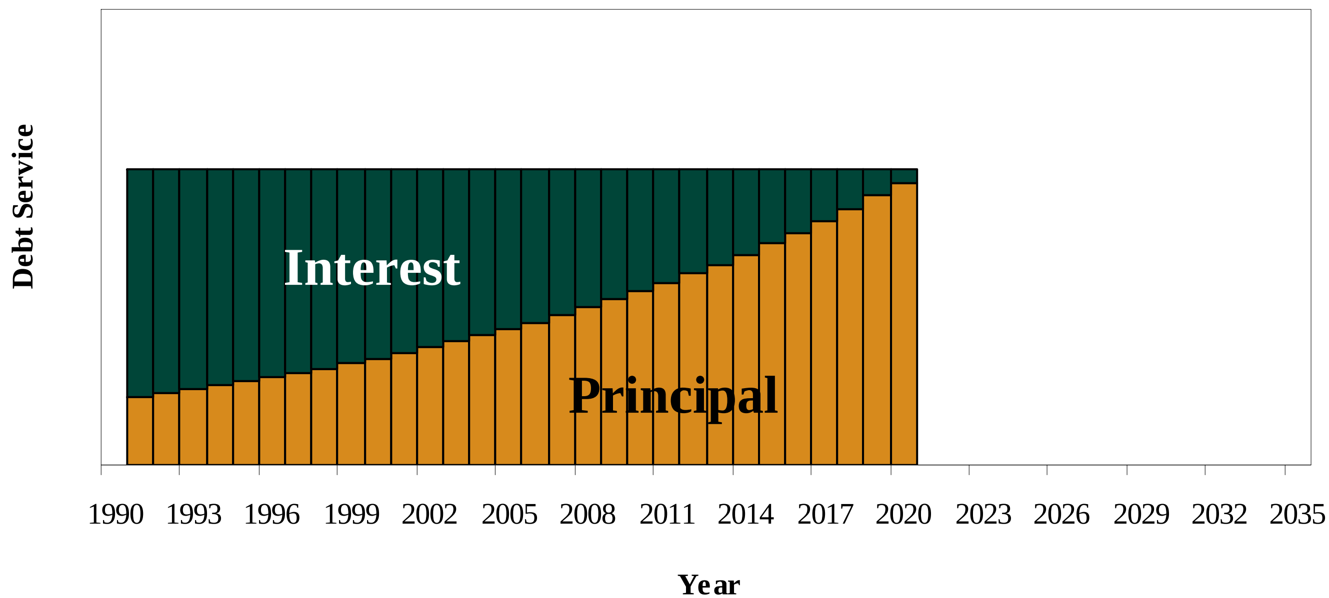
- Typically provided by commercial banks.
- Premium is based on amount of debt outstanding and paid over time.
- Most LOCs carry an initial term shorter than the term of the bonds and must be renewed or replaced at each expiration date.
- Generally used for variable rate deals.

Principal Amortization

Debt Service = Principal + Interest Payments

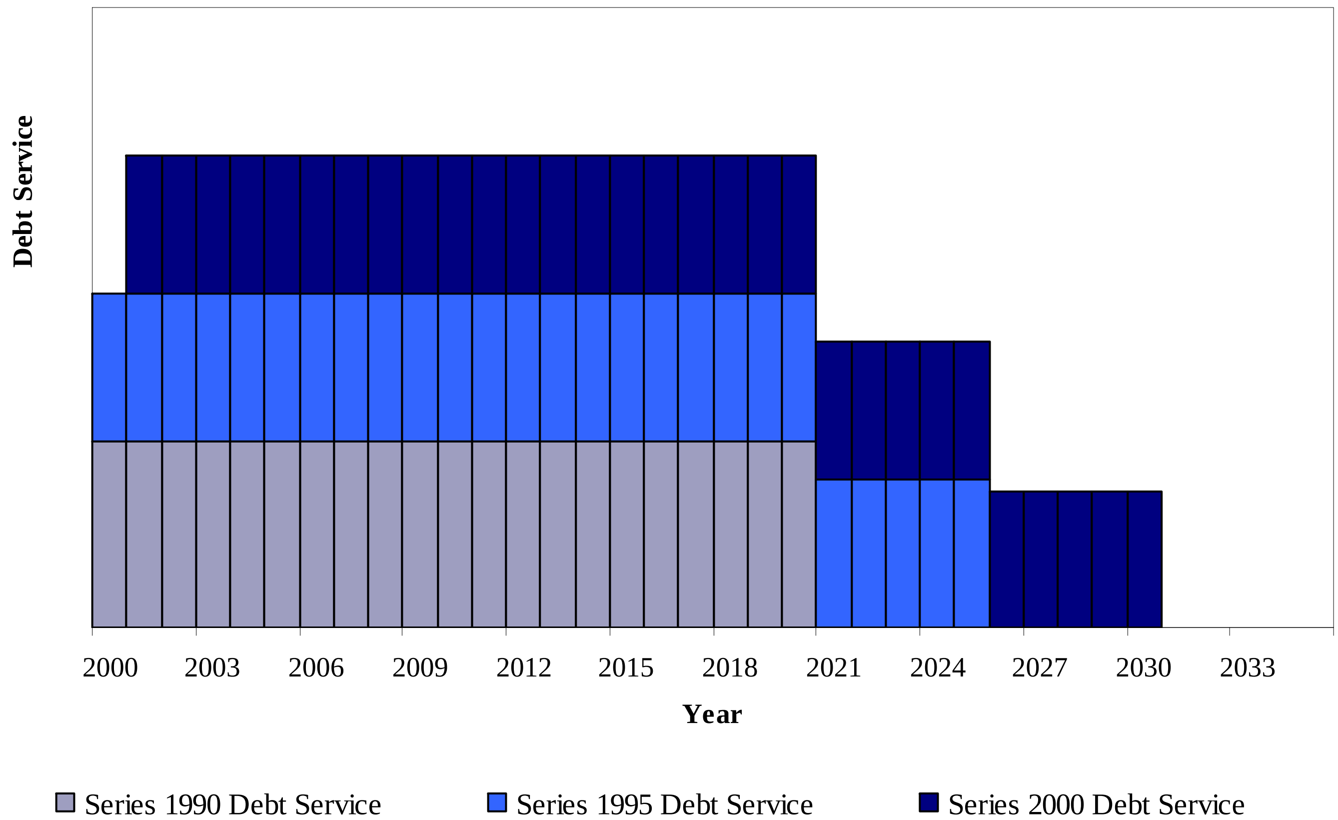
<u>Level Debt Service</u> – principal amortization structured such that annual debt service payments are level or the same throughout the life of a particular bond issue

Level Debt Service Structure



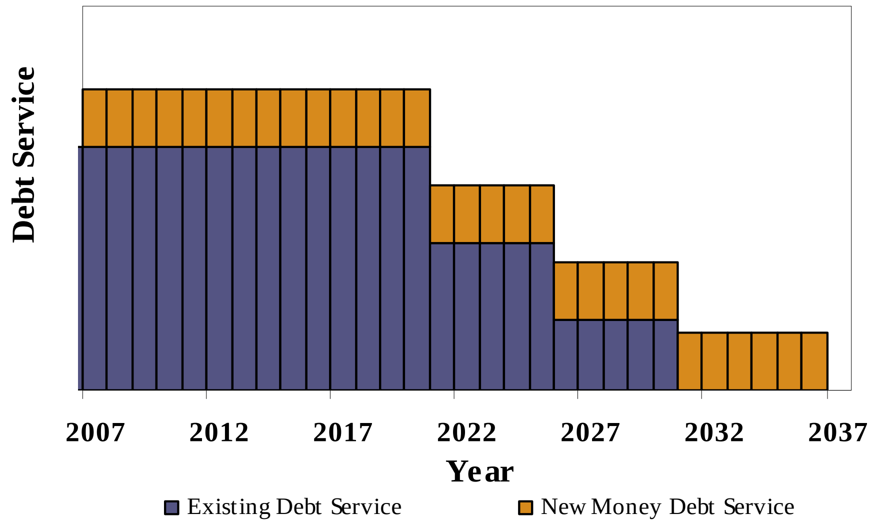
Impact of Issuing Multiple Stand-Alone Level Debt Service Issues Over Time

Multiple Stand-Alone Level Debt Service Structures

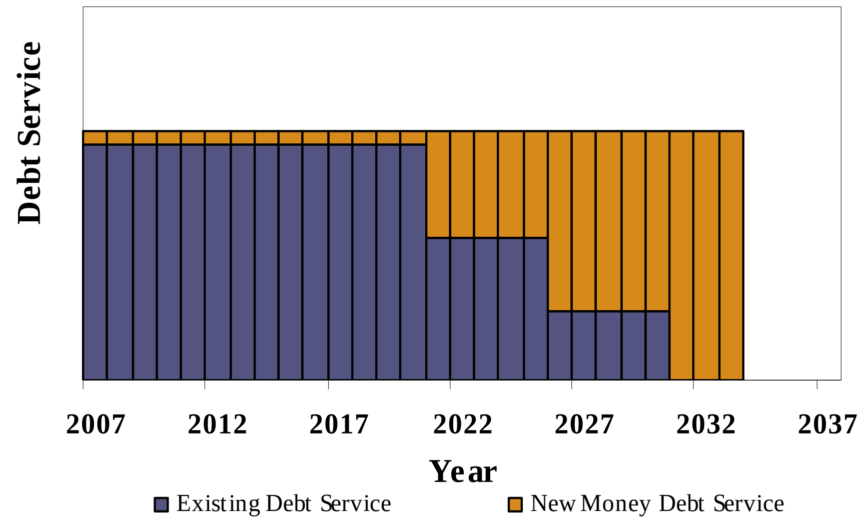


Principal Amortization Options

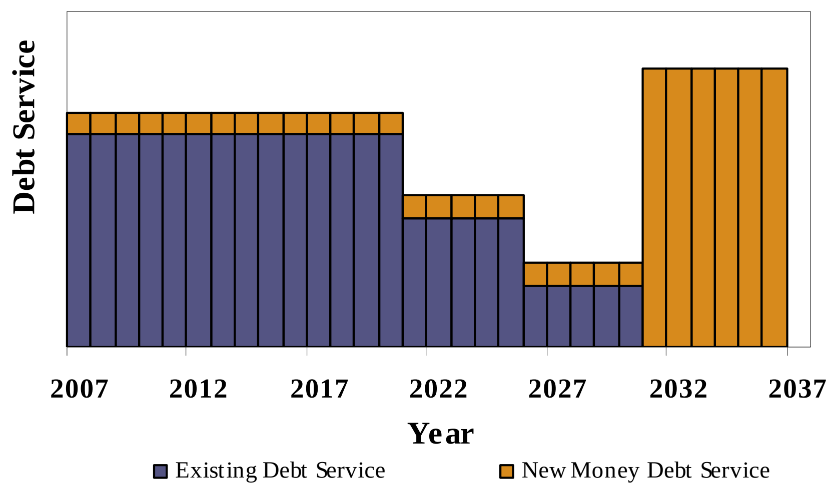
Level Debt Service Structure



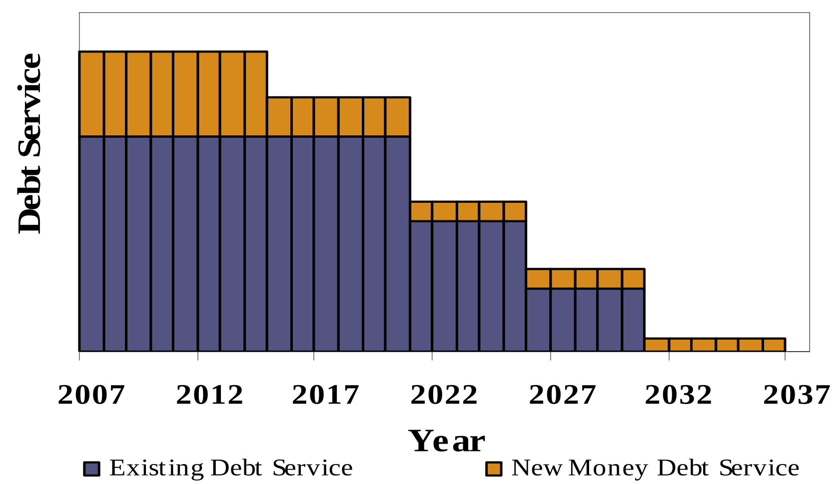
Wrapped Debt Service Structure



Deferred/Back-Loaded Debt Service Structure



Accelerated/Front-Loaded Debt Service Structure



Structural Elements

- Serial versus term bonds
- Call features
- Current interest, discount and premium bonds

Current Interest, Discount and Premium Bonds

	Yield	Coupon	Price	Par Amount Needed to Generate $50 million in Proceeds
Discount Bond	4.50% >	4.25%	95.92	$52,130,000
Par Bond	4.50% =	4.50%	100.00	$50,000,000
Premium Bond	4.50% <	5.00%	103.88*	$48,135,000

** Priced to call @ 100%.*

Sizing the Issue

- Sources and Uses of Funds
- Costs of Issuance

Sources and Uses of Funds

Sample Sources and Uses Table

Based on $50 Million in Capital Financing Needs

Sources:		
Bond Proceeds		
Par Amount	$	56,280,000
Net Premium		1,545,000
Accrued Interest		80,000
Total Sources	$	57,905,000
Uses:		
Project Fund Deposit	$	50,000,000
Other Fund Deposits		
Debt Service Fund (Accrued Interest)	$	80,000
Debt Service Reserve Fund	$	3,607,000
Capitalized Interest Fund	$	2,750,000
Delivery Date Expenses		
Costs of Issuance	$	195,000
Underwriter's Discount		
Takedown	$	281,500
Management Fee	$	55,000
Expenses	$	30,000
Bond Insurance	$	905,000
Other Uses of Funds		
Additional Proceeds	$	1,500
Total Uses	$	57,905,000

Borrower's Costs of Issuance

Sample Costs of Issuance Table

Borrower's Costs of Issuance
- Rating Agency Fees
- Issuer/ Authority Fee
- Bond Counsel Fee
- Borrower's Counsel Fee
- Trustee Fees
  - Acceptance Fee
  - Annual Administration Fee
  - Legal Fees
- Auditor's Fee
- Printing and Mailing Costs
- Miscellaneous and Contingency

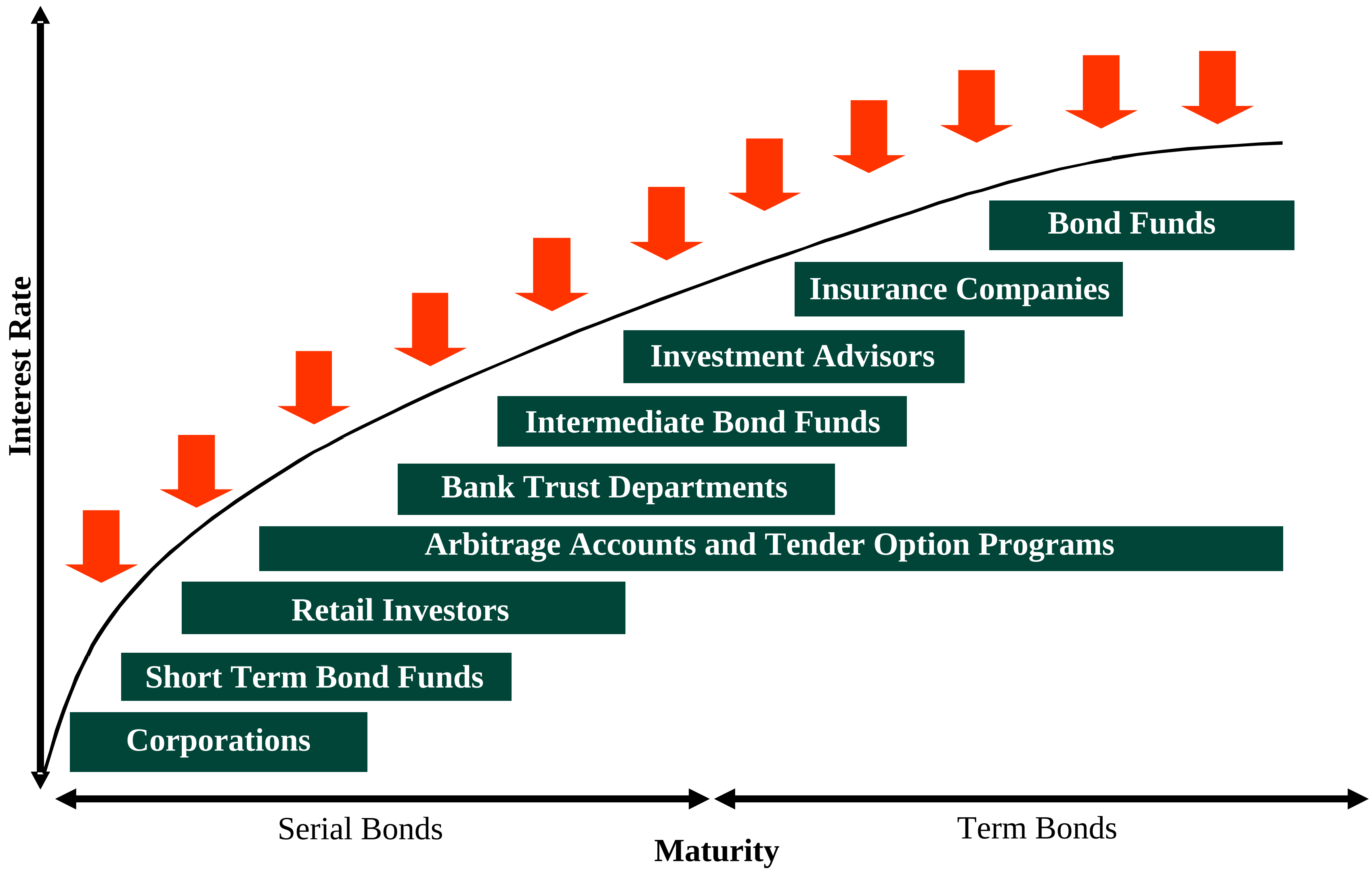
Note: Underwriter's Counsel fee generally included in Underwriter's discount.

Bringing a Negotiated Bond Issue to Market

Bringing a Negotiated Issue to Market

- Develop Target Investor Plan
- Develop Syndicate/ Selling Group
- Develop Bond Allocation Policy
- Negotiate Underwriter's Discount
- Establish Priority of Orders
- Pre-pricing/ Order Period
- Bond Pricing
- Verbal/ Written Award
- Closing
- Post Sale Analysis

Depending on the Maturity of the Bonds, the Underwriter will Target the Appropriate Investor Base.



Types of Orders

Net Group Orders:	◆ An order placed at net (public offering price) where all members of the syndicate share the profit according to their pre-determined liability percentage.
Net Designated Orders:	◆ Orders placed at the offering level with the profit given to the dealers that were designated by the customer. Net designated orders are the most common type of order.
Member Orders:	◆ These orders are placed by members of the syndicate for their own account or for sale to another dealer or investor (for example, an order placed by an individual through their retail dealer). Orders entered by member firms for their own clients receive the lowest priority since only the firm entering the order will receive the profit.
Retail Orders:	◆ Retail investors or bank trust departments.

Priority of Orders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Deal code: GSTEHU0407

                                            $12,550,000
                                    XYZ Facilities Authority
                           Revenue and Refunding Bonds, Series 2006A

                        (NS) TOTAL     MEMBER      PRIORITY
MATURITY          AMT   (S)  ORDERS    ORDERS      ORDERS        BALANCE         MAT
-------------------------------------------------------------------------------------
07/01/07        1,565       2,565       1,565       1,000
                              620         620           0         -1,620          07
07/01/08        1,650       2,000       2,000           0
                              450         450           0           -800          08
07/01/09        1,715         500         500           0
                               90          90           0          1,125          09
07/01/10        1,785         500         500           0
                              410         410           0            875          10
07/01/11        1,855       2,905          50       2,855
                              165         165           0         -1,215          11
07/01/12        1,950       2,200       2,200           0
                            1,960       1,960           0         -2,210          12
07/01/13        2,030       2,030       2,030           0
                            1,160       1,160           0         -1,160          13
-------------------------------------------------------------------------------------
TOTAL          12,550      12,700       8,845       3,855
                            4,855       4,855           0          2,000 LONG
                                                                  -7,005 SHORT
```

Syndicate Member Order, i.e. an underwriter putting in for their own account

Institutional Order

Negative = Oversubscribed

More orders for this maturity than there are bonds to be sold.

Total Orders for this Maturity

Remainder needing to be sold

Total amount for sale

Retail Order

Total oversubscribed

Questions and Answers

Tina K. Neal **Senior Vice President**

Ms. Neal joined Piper Jaffray in June 2008 as Senior Vice President and her primary area of responsibility is in project finance and high yield transactions. Ms. Neal joins us from Ferris Baker Watts where she worked as a public finance banker specializing in a variety of different types of project finance. Her focus has been working on more complex project based transactions including industrial revenue bonds, municipal lease transactions, solid waste financings and various alternative energy projects.

Ms. Neal has over 18 years investment banking experience including: project financing for both corporate and municipal entities, usually in the form of industrial development bonds, solid waste, and taxable and tax-exempt lease financings. Her expertise in project financing allows her to serve a broad range of corporate and municipal investment banking clients, as well as real estate developers and owners. Ms. Neal is also recognized for her role in financing economic development projects and understanding the complex needs of localities and companies.

Ms. Neal also specializes in the financing of energy projects, including performance contracts, energy efficiency improvements, and project finance for traditional or alternative energy ventures. Recent projects include anaerobic digestion facilities, wood waste gasification facilities and landfill gas projects with tax-exempt and taxable bond structures offered to institutional investors.

Ms. Neal is also active in the underwriting of other types of issuances such as housing and healthcare bonds, including retirement facilities, low-to-moderate income tax credit financings and single-family issues. She successfully brought to market the first tax-exempt empowerment zone bond issue paired with New Markets Tax Credits in 2006.

Ms. Neal holds a B.A. from Beloit College and an M.A. in economics from Virginia Commonwealth University. Ms. Neal is also involved in several Professional organizations including the following:

Bond Club of Virginia – Board of Governors (2001 – Present)
Virginia Economic Developers Association
Virginia Chamber of Commerce
Virginia Local Government Management Association
Virginia Association of Counties
Virginia Municipal League
Council of Development Finance Agencies – Board of Directors (2003 – present)
Association of Energy Engineers (AEE)
National Association of Energy Service Companies (NAESCO)
Top Forty Under Forty, Inside Business, 2001