Council of Development Finance Agencies

CDFA TEDC Webinar:
Creative Approaches and Strategies for Bond Financing

In Partnership with

TEXAS ECONOMIC DEVELOPMENT COUNCIL

Welcome

The webinar will begin at 10:30 AM (Central)

CDFA TEDC Webinar:
Creative Approaches and Strategies for Bond Financing

Audience Questions

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TEXAS ECONOMIC DEVELOPMENT COUNCIL

Andres Caro

Coordinator, Research & Technical Assistance
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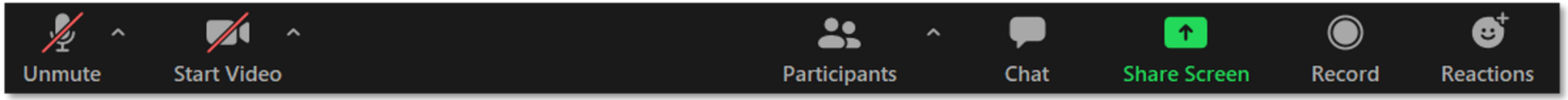

Submit your questions by using the chat function!

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Michela Daliana
Counsel
Katten Muchin Rosenman LLP

Seth Crone
SVP, Relationship Management, Corporate Trust
BNY Mellon

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Now Speaking

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Michela Daliana
Counsel
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PRESENTATION TO

Bonds and the Basics

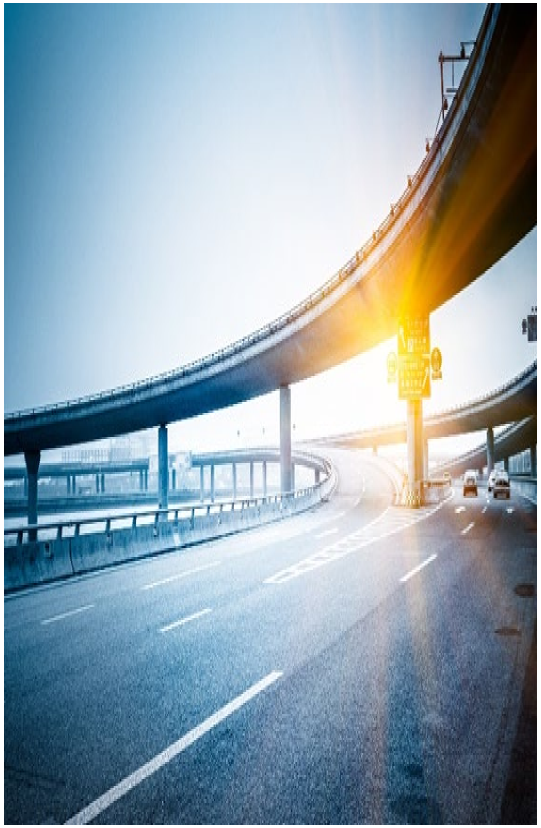
Michela Daliana, Esq.
Katten Muchin Rosenman LLP

What is “Public Finance”?

- In order to raise capital, state and local government bodies will issue bonds. If the provisions of the Internal Revenue Code (the “Code”) are complied with, interest on those bonds can be tax-exempt to the investors.
- The Code imposes limitations on the amount of private business use and payments that may be included in the financed projects. If those limits are exceeded, bonds the interest on which is tax-exempt to the investors may be issued, but only the bonds can be private activity bonds.

Example:

- A city determines that it wants to build a municipal building. Instead of going to the local bank branch to borrow $10,000,000 at 6% interest, the city can issue bonds – certificates of indebtedness – and can sell them to investors in return for the necessary capital to build the school. That same 6% will now cost the city 4%.



Why?

- Congress has exempted from gross income the interest received by purchasers of “qualifying” municipal bonds. Since holders of the bonds do not have to pay tax on the interest they earn, they are willing to accept a lower rate of interest than if the bonds were subject to federal income taxes. The city, as the borrower, reaps the benefit of the difference between the taxable rate and the tax-exempt rate.

Legal Framework

- Federal Tax Law
  - Internal Revenue Code of 1986, as amended, permits exemption of interest earned on state and local government bonds and qualifying private activity bonds from federal taxation.
- State Tax Law
  - State and local income tax laws may also exempt from taxation interest paid on both bonds and notes. Each jurisdiction's laws must be examined for purposes of determining whether an exemption applies.

Types of Tax-Exempt Bonds

- Governmental Bonds
  - Bonds issued by States or their Municipalities for use by the government or the general public.
- Qualified Private Activity Bonds
  - Exempt Facility Bonds
  - Small Issue Industrial Development Bonds
  - 501(c)(3) Bonds

Governmental Bonds

- <u>Private Business Use Limitations</u>
  - Not more than 10% of the proceeds of a governmental bond may be used in a private business use, AND
  - Not more than 10% of the debt service on a governmental bond may be paid by the private business user or secured by property used in a private business use.

  This 10% limitation is reduced to 5% if the private business use is either unrelated or disproportionate to the governmental use.

  If the amount borrowed exceeds $150 million, the permitted amount of private business use is capped at $15 million, unless an allocation of state volume cap is secured in connection with private business use in excess of $15 million.

  <u>Private Loan Limitation</u>

  Not more than the lesser of 5% or $5 million may be loaned to a private business user.

Governmental Bonds – Private Business Use Defined

Private Business Use includes both actual and beneficial use, and can take any of the following forms:

- Ownership;
- Leasehold;
- Management Contract that does not comply with the safe-harbor guidelines set forth in Rev. Proc. 2017-13;
- Incentive Pay Contract;
- Corporate Sponsored Research Agreement that does not comply with the safe-harbor guidelines set forth in Rev. Proc. 2017-14;
- Arrangement conveying priority rights to the use or capacity of a facility; or
- Arrangement providing a “special economic benefit” in property not available to the general public.

Governmental Bonds – Certain Private Business Users

- The Federal Government, as well as its agencies and instrumentalities, and Organizations Described in Section 501(c)(3) of the Code are considered "Private Business Users" for purposes of the Private Business Use provisions applicable to Governmental Tax-exempt Bonds.
- Use by the Federal Government is further limited to 5% of the bonds under the Federal Guarantee prohibition.
- Use by Organizations Described in Section 501(c)(3) of the Code can be financed with the proceeds of a Qualified 501(c)(3) Bond issued under Section 145 of the Code.

Governmental Bonds - Additional Requirements

- Generally, State and Local Governmental Entities borrow to finance capital purposes.
- State and Local laws may limit how long a borrowing may remain outstanding.
- The Code limits the weighted average maturity of the borrowing by the weighted average life of the capital assets financed; this ensures that the economic life of the financed assets is sufficient to support the borrowing.
- Tax-exempt governmental bonds may finance short-term working capital needs or, subject to specific rules and limitations longer term working capital needs..
- State and Local laws often prohibit long-term working capital borrowings.

Private Activity Bonds

Private Activity Bonds must be issued by a State or Local Governmental Entity, the Issuer, authorized to issue such bonds.

Categories of Private Activity Bonds:

- Exempt Facility Bonds
- Small Issue Manufacturing Bonds
- Qualified 501(c)(3) Bonds

Private Activity Bonds - TEFRA Requirements

- The issuer must publish a public notice of a hearing to be held in respect of the bond issue. The notice may be published on the issuer's website, and must include (1) the amount of the financing, (2) the beneficiary of the issue, (3) a description of the facility to be financed, including its location, and (4) the category of bond to be issued.
- The notice should invite members of the public to attend.
- The issuer must hold the public hearing. Members of the public must be afforded a reasonable opportunity to be heard.
- The highest elected official, elected at-large, must approve the issue, subsequent to the public hearing.

Private Activity Bonds - Use of Proceeds

- 95% of the proceeds of the issue must be applied to finance "qualified costs".
- "Qualified Costs" are defined by reference to the category of private activity bond issued.
- Not more than 2% of the proceeds of the bonds may be spent to pay costs of issuance; generally, issuer fees are not considered costs of issuance.
- Not more than 10% of the proceeds of the bonds may be deposited to a reasonably required reserve or replacement fund established for the bonds.
- Deposits to a reasonably required reserve or replacement fund are netted out of the "proceeds" of the issue for purposes of applying the 95% requirement above.

Private Activity Bonds – Volume Cap

- The Code limits the amount of certain categories of Private Activity Bonds that may be issued during a calendar year. This limit is referred to as “Volume Cap”.
- Volume Cap is determined on a State-by-State basis and reflects a certain dollar amount multiplied by the State’s population for the calendar year, subject to a floor for the least populous States. These values adjusted annually based on a cost-of-living adjustment.
- Unused Volume Cap for any year may be “carried forward” for a maximum of 3 years. The issuer must make a carry forward election by timely filing an IRS Form 8328.
- Carried-forward Volume Cap may only be used by the issuer filing the carryforward election form and only for the category of private activity bonds identified on the form.
- Carried-forward Volume Cap should be used on a first-in, first-out basis.

Private Activity Bonds – Volume Cap

All Private Activity Bonds require an allocation of Volume Cap in order to be validly issued, except:

- Exempt Facility Bonds issued for airports, docks & wharves, which facilities are required to be governmentally owned;
- Qualified 501(c)(3) Bonds;
- Bonds that are subject to separate volume cap limitations, e.g., mass commuting facility bonds; and
- Current Refunding Bonds.

Special Volume Cap rules apply to housing bonds.

Exempt Facility Bonds

- Airports*
- Docks and wharves*
- Mass commuting facilities*
- Water facilities
- Sewage facilities
- Solid waste disposal facilities
- Qualified residential rental projects
- Local furnishing of electricity or gas
- Local heating or cooling facilities
- Hazardous waste facilities
- High speed intercity rail
- Hydro-electric generating facilities
- Public educational facilities
- Surface freight transfer facilities

Exempt Facility Bonds

- Can be privately owned facilities* but must satisfy a "public use"
  - *Airports, docks and wharves, and mass commuting facilities must be owned by a governmental unit.

- Often issued by Industrial Development Authorities
  - Example: For-profit water company that serves the public.

Small Issue IDBs

- Qualified Projects
  - Core manufacturing facilities used in the manufacture or production of tangible property.
  - No more than 25% of proceeds used for “directly related and ancillary facilities.”
    - Example: short-term warehouses, on-site labs.
- 2009-2010 Amendments to the Code
  - Intangible Property allowed.
  - 25% limitation removed.

Qualified 501(c)(3) Bonds

- 95% of bond proceeds must be used by a 501(c)(3) organization in connection with activities that are in furtherance of the organization’s exempt purpose.
- All property financed must be owned by a 501(c)(3) organization or a state or local governmental entity.

Reimbursement Bond Rules - Applicable to all Tax-Exempt Bonds

Where proceeds of a tax-exempt bond issue are to be applied to costs paid prior to the issue date of the bonds (a “reimbursement”), the governmental entity, the 501(c)(3) organization, or, in the case of all other types of private activity bonds, the state or local governmental issuer must adopt a resolution of intent to finance.

The resolution must include a description of the project, the amount expected to be financed with the proceeds of a borrowing and an indication that costs paid prior to the issue date of the bonds are expected to be reimbursed from a borrowing.

Project costs paid not more than 60 days prior to the date such resolution is adopted are covered by the resolution.

Bond proceeds must be allocated to a cost not more than 18 months prior to the date cost was paid or not more than 18 months prior to the placed in service date of the project to which the cost relates, but not more than 3 years prior to the allocation date of the bond proceeds. An exception to this rule applies to “preliminary expenditures” in an amount not to exceed 20% of the financed project costs.

Arbitrage Rules Applicable to ALL Tax-Exempt Bonds

The Internal Revenue Code limits the ability to "arbitrage" the investment of proceeds of all tax-exempt bonds: governmental and private activity bonds.

Yield Restriction – In General.

The proceeds of tax-exempt bonds may not be invested at yields in excess of the yield on the bond issue of which such amounts are proceeds.

This restriction applies to amounts that may have been replaced by the proceeds of the issue, as well as amounts reasonably expected to pay debt service on the bonds.

Arbitrage Rules – Temporary Periods

Exceptions to the General Rule – Project Funds.

Temporary Periods: Generally, the Internal Revenue Code affords the beneficiary of a tax-exempt bond issue 3 years to complete a project. If certain requirements are met, proceeds of the tax-exempt bonds may be invested without restriction as to yield, but amounts earned in excess of what would have been earned had the proceeds been invested at the yield on the bonds must be rebated to the federal government ("rebate").

Eligibility for a Temporary Period: If the beneficiary of the bond issue reasonably expects to enter into a binding commitment to spend at least 5% of the proceeds of the bonds within 6 months of the issue date of the bonds AND reasonably expects to spend at least 85% of the proceeds of the bonds, including anticipated investment earnings thereon by the 3-year anniversary of the issue date, such proceeds may be invested at an unrestricted yield, but earnings in excess of what would have been earned had the amounts been invested at the yield on the bonds will be subject to rebate.

Arbitrage Rules – Temporary Periods

<u>Exceptions to the Rebate Requirement for Project Funds</u>

The Code and the Treasury Regulations provide exceptions to the rebate requirement in situations in which the proceeds of the tax-exempt bond issue are spent quickly.

- 2-Year Construction Bond Exception – applies to governmental bonds, 501(c)(3) bonds and private activity bonds which require the financed facilities to be governmentally owned, and at least 75% of the proceeds, including investment earnings will be spend on construction costs.
- 18-month Spending Exception – applies to all tax-exempt bonds, if the proceeds are applied to capital costs.
- 6-month Spending Exception – applies to all tax-exempt bonds.

If a spending exception is not satisfied, the issue will be subject to rebate.

Arbitrage Rules – Other Exceptions

The Code provides and exception to the general yield restriction requirement for reasonably required reserve or replacement funds. A fund is considered reasonable required if the amount held therein does not exceed the least of:

(a) 10% of the proceeds of the issue;

(b) maximum principal and interest in any year; and

(c) 125% of average annual debt service.

Investment earnings in excess of what would have been earned had these amounts been invested at the bond yield are, however, subject to rebate.

An exception to the general yield restriction requirement also applies to the “minor portion”, i.e., the lesser of $100,000 or 5% of the proceeds of the issue.

Other Rules Applicable to All Tax-Exempt Bonds

- Federal Guarantee Prohibition: the payment of debt service on a tax-exempt bond may not be guaranteed by the federal government or any agency or instrumentality thereof.
- 120% Test: the weighted average maturity of the bonds may not exceed the weighted average economic life of the assets financed by more than 20%.
- Information Reporting Requirement: the issuer must timely file an IRS Form 8038G in respect of a governmental bond or an IRS Form 8038 in respect of a private activity bond.
- Post-Issuance Compliance: the issuer and/or conduit borrower must adopt post-issuance compliance procedures to ensure compliance with the use of proceeds requirements and the rebate requirements, including record retention procedures.

The Role of Bond Counsel

- Guide Issuer through the legal processing of issuing debt.

- Provide a legal opinion that the Bonds have been validly issued and (if applicable) are exempt from taxation under Federal and State law.

Public Finance

- Each year Katten attorneys are instrumental in facilitating billions of dollars worth of tax-exempt state and local government issues, serving as bond counsel or as underwriter’s counsel..

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Seth Crone

SVP, Relationship Management, Corporate Trust
BNY Mellon

CDFA-TEDC Webinar

Creative Approaches and Strategies for Bond Financing

Seth Crone, Presenter

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Introduction

- What Is Economic Development?
  - New jobs (commercial and industrial) and redevelopment
  - Infrastructure (water, roads, public facilities, ports)
  - Social services (healthcare, education, other nonprofits)
  - Cultural amenities (museums, theatres, entertainment venues, ballparks)

- Types Of Bonds
  - Issuers: political subdivisions
  - Obligors: municipalities, private companies (for profit and non-profit)
  - Security: property taxes, pledge revenues, mortgage, unsecured etc.

- What Resources Are Available To Support The Debt?
  - Ad valorem property taxes
  - Sales tax revenues
  - Other (excise, utility revenues, special assessment, tax increment)
  - Revenue streams for project
  - Credit support: guarantors, bank letters of credit, etc.

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What Are You Selling And Who Is Buying?

What Resources Are available To Support The Debt?

- Ad valorem property taxes
- Sales tax revenues
- Other (excise, utility revenues, special assessment, tax increment)
- Revenue streams for project
- Credit support: guarantors, bank letters of credit, etc.

Who Buys Municipal Bonds?

- Commercial Banks for loan portfolio or trust departments
- Individuals directly or through bond funds, money market funds
- Underwriters
- Competitive or negotiated sale
- Public distribution, limited offering, direct placement
- Government funds and banks, revolving loan programs

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Who Represents The Bond Holder's Interests?

Issued under bond resolutions

- GOs, and most sales tax and utility revenues
- Paying agent to bill the obligor and to pay DTC.

Issued under a trust indenture

- Special Assessment, Tax Increment, Mortgage-secured and most contract revenue bonds
- Trustee to:
  - Collect revenues under revenue pledge,
  - Hold security interests (deed of trust, collateral agreement, intercreditor agreement, etc.)
  - Maintain funds (e.g. bond payment, debt service reserve funds, arbitrage rebate, etc.)
  - Monitor compliance with covenants (e.g. borrower maintains sufficient cash on hand or cash flow),
  - Provide continuing disclosure if needed. and
  - Enforce remedies if obligor defaults.

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Tax Treatment

Tax Exempt

- Provisions for qualified ownership and use, reinvestment yields.
- Including those PABs subject to alternative min tax for corporations,
- Bank Qualified always banks to purchase without losing all tax deduction for interest expense of carrying the tax-exempt bond.

Taxable

- More readily sold globally,
- Exempt from tax requirements of use, ownership, asset life, yield restriction, arbitrage rebate, etc..

What Is The Interest Rate?

Fixed

- Single coupon, like a mortgage loan
- Serialized: discrete maturities allow lower yields on earlier maturities
- Term bond: as yield curve flattens if future, it's more efficient to bunch up future maturities into a larger term bond; sinking fund redemptions provide continued amortization.
- Capital appreciation (like zero coupon)
- Effect of couponing to lengthen or shorten duration on yield

Floating Rate

- Variable rate demand bonds sold to money market mutual funds
- Index rates bonds based on % of and credit spread to SIFMA, SOFR, LIBOR
- Other: Auction Rate, Inverse Floaters, Cinderella turns taxable into tax-exempts
- Subsidized by buyer (e.g., TWDB) or federal programs (e.g. tax credit payments for Build America Bonds, school districts and green energy)

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Economic Development Bonds Currently Outstanding In Texas

- 421 deals for industrial and economic development or cultural facility issuers,
- 223 are for cultural issuers (healthcare and similarly related).
- 198 deals for economic or industrial development.
- 101 are sales tax related (nearly all paying agency appointments).
- 26 are secured by facilities revenue (mostly for refineries of global corporations)
- 20 are solid waste/waste management (again mostly larger corporations)
- 7 secured by project revenues, mostly bank purchased or bank-backed issuances for private companies.

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GO Deals

Organization	Issue History	Security	Sale	Purchaser	Tax	Term	Comments
Cleveland EDC	City : 20 GO, 2 WWSS	GO ref	C	UW	BQ	12	serials/terms
Meridian EDC	City : 4 GO, 1 WWSS	GO ref	P	bank	BQ	11	single coupon

Limited Tax and Revenue

Organization	Issue History	Security	Sale	Purchaser	Tax	Term	Comments
Dev Corp of Haskell	City GO	City T&R	N	UW	TE	25	serials/terms
Crockett Econ & Indusl Dev Corp	"4A" Sales Tax Corp ; 11 GO; 4 Util	City T&R	P	TWDB	TE	21	serials, cleared DTC
Nolanville EDC	City : 6 GO	City T&R	P	bank	BQ	15	serials
Ingleside Dev Corp	City : 12 GO, 5 WWSS	City T&R	P	UW	TE	30	serials, cleared DTC
City of Waller EDC	City : 29 GO, 5 WWSS	City T&R	N	UW	BQ	29	serials/terms
Presidio Muni Dev Dist	City: 14 GO; 2 WWSS (FHA)	Lim Tax	P	NADBank	Tax	20	single coupon
Pflugerville Com Dev Corp	City GO, util, wwss	Lim Tax	N	UW	TE	30	serials/terms
Aubrey Muni Dev District	City GO, WWSS, PIDs	Lim Tax	C	UW	TE	15	serials/terms

- Source: Municipal Advisory Council

Sales Tax Revenue

Organization	Issue History	Security	Sale	Purchaser	Tax	Term	Comments
Gun Barrel City EDC	1 EDC	Sales	P	bank	BQ	15	single coupon
Marble Falls EDC	6 EDC	Sales	N	UW	Tax	20	serials/terms, insured
Brownsville Com Improv Corp	CID (also 3 IDC, 4 Port as conduit)	Sales	N	UW	TE	11	serials/terms
Converse EDC	1 EDC	Sales	P	bank	Tax	10	single coupon
Marshall EDC	1 EDC, City : 18 GO, 14 WWSS	Sales	N	UW	BQ	20	serials
Mathis EDC	2 EDC, 6 City GO	Sales	P	bank	BQ	13	single coupon
City of Sugar Land	6 "4B" Corp; 6 Dev Corp	Sales	N	UW	TE	15	serials/terms bond insurance

- Source: Municipal Advisory Council

Other Sources of Repayment and Security

Organization	Issue History	Security	Sale	Purchaser	Tax	Term	Comments
GVEC	Coop 11	Mortgage	N	CoBank	Tax	20	
Hillsboro EDC	3 IDC; 3 HFC	Project Revs	P	GE Pub	TE	6	
City of Uhland	1 Imp Dist	Spl Asses	N	UW	TE	30	3 terms
City of Kyle	City: 21 GO; 12+ PIDs; 1 TIRZ	Spl Asses	N	UW	TE	25	2 terms
Temple EDC	City: 64 GO; 20 Util, 1 Airport, 6 TIRZ	TIRZ	N	UW	TE & Tax	20	single coupon
Bee Developmt Auth	formed by Beeville and Bee Co						
Gtr Brownsville Incentives Corp	quarter cent sales tax						

- Source: Municipal Advisory Council

Innovative Bond Strategies

1. Alternatives for refundings, where redemption of refunded bonds has to take place not more than 90 days after escrow deposit.
   - Privately placed “Cinderella” bonds to refund refunding debt on initially a taxable basis with a switch to tax-exempt rates when the old refunded bonds are redeemed.
   - Tenders in which bond not currently callable are solicited in the market for a redemption at closing.
   - Invoking extraordinary circumstances to refund Build America Bonds at par (vs. typical make-whole).
   - Push out tax-backed refunding of tax debt to create more room for non-voted new money in the earlier years.
   - Lock in refunding savings in current market with derivatives (e.g., future starting swaps or caps) or selling a Treasury today to where unwind at time of future debt issuance offsets debt costs if future market yields are higher.

2. Legislative changes
   - Get a new sales tax voted.
   - Perhaps with a reduction/elimination of ad valorem taxes.

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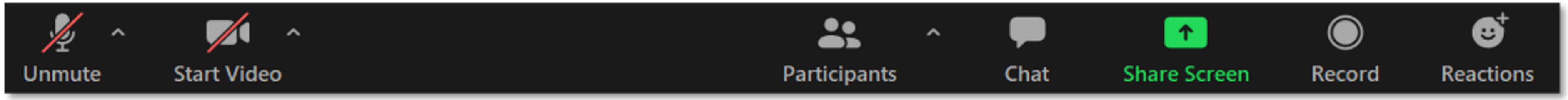
Audience Questions



Submit your questions by using the chat function!

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Creative Approaches and Strategies for Bond Financing

Upcoming Events

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CDFA-Bricker Graydon Webinar Series:
Revitalizing Brownfields with TIFs and Special Assessments
April 9 // 2:00 PM - 4:00 PM Eastern

CDFA // BNY Mellon Development Finance Webcast Series:
Why Bond Deals Go Bad
April 16 // 2:00 PM - 3:00 PM Eastern

CDFA Tribal Finance Webinar Series:
Empowering Native Entrepreneurs Through Access to Capital
April 23 // 2:00 PM - 3:30 PM Eastern

CDFA Food Systems Finance Webinar Series:
Financing Food Systems with Revolving Loan Funds
April 30 // 2:00 PM – 3:30 PM Eastern

Register online at www.cdfa.net

Council of Development Finance Agencies

CDFA TEDC Webinar:
Creative Approaches and Strategies for Bond Financing

Audience Questions

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