SAMCO Capital

CITY OF FAIR OAKS RANCH, TEXAS

Overview of Types of Municipal Debt and Financing Related Considerations

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CITY OF FAIR OAKS RANCH • TEXAS

Types of Municipal Debt

Relevant Parties to a Municipal Debt Issuance

Relevant Party	Responsibility
City Council	Elected officials responsible for setting policy and making decisions in consultation with the City Staff and advisors to meet the needs and expectations of the citizens of the City
City Staff	City Manager, Director of Finance and City Engineer, etc. responsible for managing the operations of the City and executing the will of the City Council
Financial Advisor	• Works for the City and maintains a fiduciary duty to the City and no other party; • Creates a plan of finance and serve throughout the year on an as needed consultative basis; • Coordinates the issuance of municipal debt
Bond Counsel* ________ ** Not the same as the City Attorney*	• Special attorney who works for the City and coordinates all legal documents pertaining to a bond election and debt issuance process • Oversees the approval process of Attorney General of the State of Texas approval of debt issuances
Underwriter/Purchaser	Investment bank who purchases the City's debt and sells the debt to investors either through a negotiated or competitive offering
Paying Agent/Registrar	Firm who receives the City's semi-annual debt payment and is responsible for distributing the payment to individual bond holders
Rating Agency	S&P/Moody's/Fitch – Independent rating agency who determines the underlying credit worthiness of the City to create a comparison of the credit worthiness of the City's debt against all other similar credits in the U.S. to be relied upon by bond investors **Fair Oaks Ranch currently rated 'AA+' by S&P.**

Types of Municipal Debt

General Obligation Bonds

- Authorized by a successful bond election or multiple bond elections for multiple projects
- If voters turn down a bond election the City is prohibited from issuing COs for the same project for 2 years
- Secured by ad valorem tax levy
- Typically used for general improvements in the City (street improvements, drainage improvements, municipal facilities, rolling stock, etc.)
- NOT typically used to fund enterprise fund improvements (i.e. utility system improvements)
    - Main reason for not seeking voter approval for a utility system improvement (as an example) is that utility system improvements are often necessary or in many cases mandatory and IF voters turned down the project at an election, the City may be forced (by TCEQ administrative order or otherwise) to proceed with a financing to make such improvements to the System
- Bond Elections alone carry an added cost (renting election machines, legal fees for drafting election ordinance, etc.) typically around $15,000 - $30,000 regardless of election success
- Lead time for issuing General Obligation Bonds (once approved by the voters) is roughly 60 days

Types of Municipal Debt

Revenue Bonds

- No election required
- Ad valorem taxes are NOT allowed in repayment of the Bonds
- Would only be allowed for making improvements to enterprise that is responsible for repayment
- Often carry a higher cost of borrowing due to weaker security of the bonds (utility system revenues/sales tax revenues versus ad valorem taxes)
- Stricter bond covenants that can make revenue bonds much more difficult to issue requiring higher utility rates as a result.
    - A typical covenant would require prior year's net revenues (i.e. revenues of the system less operating expenses) of 1.25X the average debt service of all utility system debt outstanding (including the issuance of the Bonds)
    - Debt Service Reserve Fund must be created and funded over the course of 60 months in an amount equal to the average annual debt service of the revenue bonds
- Lead Time for issuing Revenue Bonds is roughly 60 days

Types of Municipal Debt

Certificates of Obligation

- No election required, but voters retain the right of referendum
- City Council must adopt a Notice of Intent ("NOI") Resolution and publish the notice in its paper of record for two consecutive weeks, as well as the City's website so citizens are aware of the upcoming financing
    - Notice of Intention includes the maximum amount of debt to be borrowed (financing can always be less but never more than the amount set in the NOI), the purposes of the financing and the Council meeting date that CO's will be considered for sale
- Subject to petition by the registered voters of the City
    - If a petition is submitted with 5% of the qualified voters contesting the issuance of the COs then the issuance of COs is paused until a bond election can be called and held. Only after a successful election could the COs be sold
- Sale can only proceed once 45 days has elapsed since the publication of the Notice and no valid petition has been filed with the City
- Ad valorem taxes and utility system revenues may be pledged in repayment of the Obligations depending on which fund(s) supports the project
- Allows the City to finance multiple projects with multiple sources of repayment together to create economies of scale and reduce issuance costs
- Lead time for issuance is roughly 90 days
- Cities may no longer issue COs, to be repaid from the I&S portion of the tax rate, for NEW city halls and NEW libraries (renovations of existing facilities are still allowed)

Types of Municipal Debt

Pros and Cons of Certificates of Obligation

Pros:

- Less costly than issuing general obligation bonds (no election cost);
- Cheaper (lower interest rate) than issuing revenue bonds and less restrictive bond covenants;
- Quicker process than having a bond election and issuing GO Bonds;
- Fund multiple projects at one-time
  - i.e. can fund general fund projects and utility system projects together rather than issue two separate bonds and incurring twice the cost

Cons:

- Less perceived input from the voters
  - Voters are made aware of the City's intention to sell debt and retain the right of referendum
  - Very low threshold (5% of qualified voters) to stop a CO issuance and force an election
- Potential public perception that you are circumventing the voters
  - Elected officials are tasked with directing the City based upon their insight of the various issues facing the city

Types of Municipal Debt

Timing Considerations for Revenue Bonds and Self-Supported COs

- Municipal debt (COs and Revenue Bonds) to be repaid from revenue sources other than property tax levy can be issued throughout the year;
- Important to note that analysis must be performed that shows the supporting fund will generate sufficient revenues to repay the debt;
- Analysis should include assumptions for rate increases (implemented or planned) that will generate sufficient revenues.

Types of Municipal Debt

Tax Notes

- No election required
- Not subject to referendum by the citizens
- Maximum maturity of 7 years
- Used primarily for financing assets with a shorter useful life
- Quickest process to issue debt and have the funds deposited into the City’s accounts
- Typically, a cheaper borrowing alternative to Lease Purchase Agreements
- Can be used to finance improvements repaid from any lawfully available source (Enterprise Funds, Ad Valorem Taxes, EDC, etc.)
- Lead time is roughly 30-60 days

Timing and Other Considerations

Timing Considerations for Ad Valorem Tax Supported Debt

- Ad valorem tax supported debt (GO Bonds, Tax Notes or COs) to be repaid from the City's ad valorem tax levy are generally sold AFTER the City receives its certified taxable assessed values from the appraisal districts (late July of each year) but BEFORE to adopting the tax rate for the upcoming year;
- The debt is therefore sold in August or September and included in the next year's 'Truth-in-Taxation' worksheet so that the tax rate levied by the City is sufficient to begin repaying the new debt;
- The first principal and/or interest payment is scheduled for February of the following year so that property tax revenues are available to make the debt payment;
- Bond elections may be held on the uniform election dates (May and November) of each calendar year; and
- City Council must call the Bond Election no sooner than 90 days and no later than 78 days to the election day (generally mid-February and mid-August, respectively).

Other Considerations

- IRS dictates that 85% of tax-exempt debt proceeds should be spent within 3 years of the financing, so the City should only finance projects that it expects to complete within 36 months of receiving proceeds.
    - Relative to the IRS spend down requirements, the City can seek voter authorization for funds that will be issued over more than 3 years as the authorization will not be interpreted to go 'stale' if the plan of finance that is communicated as part of the bond election references the intention to issue the debt over some different length of time.

Timing and Other Considerations

Bond Election Planning

- City can create a volunteer Citizen Advisory Committee to review and understand the current and future needs of the City as it grows/ages;

- Citizen Advisory Committee to work with City staff, Engineers, Architects, Legal Counsel and Financial Advisors to understand capital improvement needs and determine a priority of projects;

    - The benefit of this approach is creating awareness and responsibility in which the committee has determined a list of projects they are supportive of and thereby become advocates of a Bond Proposal and furthering the chance of a successful bond election;

Timing and Other Considerations

Bond Election/Project Financing Planning

1. City develops list of capital improvement plan ("CIP") along with estimated costs and identifies revenue stream of support (i.e. water tower cost $5MM and supported by the W&S utility)

2. City creates a citizen committee to meet on a regular interval to learn about the capital improvement needs of the City*. Outside consultants (engineers, architects, rate consultants, financial advisors, etc.) to participate as needed. ***(see next slide)***

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   ** City Council participation is recommended to ensure everyone is working in the same direction as the citizen committee's ultimate recommendation should not come as a surprise when it is made to the Council*

3. Citizen committee ultimately recommends its priority of projects which considers the estimated financial impact (tax rate and utility rate increases, for instance) to accomplish the plan to be brought to the voters through a bond election and/or use of revenues bonds/certificates of obligation. ***(see next slide)***

4. City council approves the 'plan' (either formally or informally) and provides City staff and consultants feedback to proceed with some combination of calling a bond election, issuing certificates of Obligations or issuing revenue bonds to accomplish the agreed upon plan of finance.

5. Bond election called for one of the two uniform election dates (May or November), if recommended, or otherwise establish the plan of finance to fund the project(s) as determined through the planning process.

Timing and Other Considerations

Establishing and Prioritizing the Capital Improvement Plan and Financings

Often the Citizen Advisory Committee and City Council work to first identify all needed capital improvements over some time horizon (1, 5, 10 or 20 years for example).

1. Engineers, architects and City staff assist in establishing the priority for each project based upon growth projections, utilization projections, and status of current assets' need for replacement to establish a baseline.

2. Financial advisor can then map out a plan of finance from the established baseline to model the projected impact of the projects for the Committee and Council's review and input.

3. Re-prioritization of projects can occur based upon the viability of the modeled financial impact and additional financial modeling can be undertaken iteratively until there is a consensus established among parties.

End Result: Capital Improvement Plan and Plan of Finance for Council to rely upon and guide a bond election and/or begin a debt financing program to achieve the goals of the CIP.

The process works to ensure that all parties agree to the established priority of projects and plan of finance that results in tax rates and utility rates that all parties are comfortable with.

Timing and Other Considerations

Example of Bond Election Process Timing

Date of Action	Action Taken
September 2023	Create Citizen Advisory Committee
Weekly, Bi-Weekly, etc.	Committee to meet, review CIP and consult with various parties
January 2024	Committee makes recommendation to City Council
February 15, 2024	Call Bond Election (adopted by Ordinance)
May 4, 2024	Bond Election Date
July 25, 2024	2023 Certified Values received from appraisal districts
September 5, 2024	Issue Bonds
September 19, 2024	Set Tax Rate
September 25, 2024	Bonds Close; Funds available to the City for Construction
January 31, 2025	Taxes Due
February 1, 2025	First payment on debt
July 31, 2027	Project Completion Deadline (~3 Years from receipt of proceeds)