


WISCONSIN GFOA

DEBT PLANNING AND RELATED POLICIES

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Michele Wiberg
SVP, MANAGING DIRECTOR

Brian J. Della, CFA
DIRECTOR, PUBLIC FINANCE

PMA SECURITIES, LLC
770 N. JEFFERSON ST
MILWAUKEE, WI 53202

Benefits of Adopting Formal Financial Policies

Institutionalize good financial management practices

Clarify and crystalize strategic intent at the organizational level

Define boundaries for actions that staff may take

Support good bond ratings

Promote long-term and strategic thinking

Manage risk to financial condition

Basic Financial Policy Categories

1. General Fund Reserves
2. Reserves in Other Funds
3. Grants
4. Debt
5. Investment
6. Economic Development
7. Accounting and Financial Reporting
8. Risk Management
9. Procurement
10. Long-Term Financial Planning
11. Structurally Balanced Budget
12. Capital
13. Revenues
14. Expenditures
15. Operating Budget

Purpose of a Debt Management Policy

- Create tools to reconcile capital needs with available resources
- Establishes some basic parameters and principles
- Educate stakeholders
- Board approved policies provide protection against political expediency

Key Components of a Debt Management Policy

Through the Issuance Process

I. Scope and Purpose
II. Uses of Debt
III. Types of Debt Permitted
IV. Debt and Debt Repayment Structure
V. Debt Issuance Practices

Post-Issuance

VII. Ongoing Post-Issuance Administrative Activities

I. SCOPE AND PURPOSE

Debt management policies typically start with a statement of purpose to explain the overall objective of adoption and debt management policy.

Example

"The purpose of this policy is to establish a framework for debt management to work in conjunction with the Capital Improvement Program Development. These guidelines will enhance the quality of decisions, rationalize the decision making process, identify objectives for staff, and demonstrate a commitment to long-term planning.

This Policy will be a positive factor in the municipal market's assessment of the City's credit quality. The City's financial condition and credit ratings should always be the primary considerations when considering the issuance of debt. It should be recognized that these guidelines are not immutable; changing circumstances require flexibility and revision. Anticipation of every future contingency is unrealistic. When adjustments are necessary, the reasons for such policy changes need to be well documented if the City wishes to demonstrate to the credit markets and its citizens that its commitment to sound debt management principles is unchanged."

The Debt policy should consider when is it appropriate to use debt and when it is not appropriate; however, this policy does not exist in isolation. Other Policies intrinsic to Debt Management include:

- Capital Improvement Planning
- Economic Development
- Fund Balance Policy
- Long-term Financial Planning, etc.

Capital and Equipment

- When is it appropriate to use debt for capital projects?
- When is it appropriate to use debt for equipment?
- When is it appropriate to use other funding sources?
  - Operating Levy (PAY GO)
  - General Fund balance
  - Equipment Replacement fund balances

Economic Development Initiatives

- When is it appropriate to use debt for economic development initiatives?
  - Capital Projects vs. Developer Incentive “gap” Payments
- When should interfund loans be used to provide temporary financing?

III. TYPES OF DEBT PERMITTED (WI)

General Obligation (G.O.)
- Promissory Notes (for any public purpose, must mature within 10 years)
- Bonds (limited to specific purposes, generally limited to 20 years)

State Trust Fund Loans (G.O.)

Direct Revenue Bonds
- Typically utilities (Water, Sewer, Electric, Stormwater), but could include other revenues (TID Revenues)

Conduit Revenue Bonds
- Community Development Authorities (CDAs) and ReDevelopment Authorities (RDAs) can issue debt
- The unit of local government pledges to make a lease payment equal to the debt service payment

Special Assessment B Bonds
- Secured by a special assessment against the property

Anticipation Notes
- Short-term or interim financing (must mature within 5 years)

IV. DEBT LIMITATIONS

Debt limitations exist for both:

- Amount of Debt
- Debt Service Requirements

Sources of these limits include:

- **Limits imposed by Law**
  - G.O. Debt Limit for Wisconsin municipalities and counties is 5.0% of Equalized Value
- **Limits imposed by Contract**
  - Revenue Debt – Additional Bonds Test for new debt to be issued “on a parity”with existing debt
  - Revenue Debt – Debt Service Coverage requirements
- **Limits imposed by Rating Agency reaction**
  - Increases to Debt or Debt Service can affect financial ratios that are correlated with a given rating
- **Limits imposed by Policymakers**
  - Stricter limits intended to promote fiscal discipline
  - Can be modified as circumstances change

G.O. RATING METHODOLOGY - MOODY'S

Moody's released a G.O. rating methodology in January 2014 (updated Dec. 2016). There are a number of adjustments to the "simple" scorecard shown below.

MOODY'S INVESTORS SERVICE

Broad Rating Factors	Factor Weighting	Rating Sub-factors	Sub-factor Weighting
I. Economy/Tax Base	30%	Tax Base Size (Equalized Value)	10%
		Equalized Value Per Capita	10%
		Wealth (median family income)	10%
II. Finances	30%	Fund Balance (% of Operating Revenues)	10%
		Fund Balance Trend (5-year change)	5%
		Cash Balance (% of Operating Revenues)	10%
		Cash Balance Trend (5-year change)	5%
III. Management	20%	Institutional Framework*	10%
		Operating History	10%
IV. Debt/Pensions	20%	Debt to Equalized Value	5%
		Debt to Revenue	5%
		Moody's ANPL** (3-yr avg.) to Equalized Value	5%
		Moody's ANPL** (3-yr avg.) to Revenue	5%

* All Wisconsin municipalities, counties and technical colleges receive a score of "A"

** Adjusted Net Pension Liability (pro rata allocation of Moody's calculated WRS liability

S&P released a G.O. rating methodology in September 2013.

There are a number of adjustments to the "simple" scorecard shown below.

S&P's Management score includes a Financial Management Assessment (FMA), which assesses the policies and practices of a local government (not individual managerial quality, organizational efficiency, or any other performance indicators).

Broad Rating Factors	Factor Weighting
I. Institutional Framework*	10%
II. Economy	30%
III. Management	20%
IV. Liquidity	10%
V. Budgetary Performance	10%
VI. Budgetary Flexibility	10%
VII. Debt & Contingent Liabilities	10%

III. Management Financial Management Assessment
Revenue/Expenditure Assumptions
Budget Amendment/Updates
Long Term Financial Planning
Capital Improvement Plan
Investment Policy and Reporting
Debt Management Policy
Reserve (Fund Balance) Policy

* Wisconsin counties and municipalities > 25,000 receive a "2" - Strong. If population < 25,000 then receive a "3" – Adequate.

Per the GFOA, a Debt Management Policy should include guidance on the issuance process including:

- Selection and use of professional service providers, including an independent financial advisor, to assist with determining the method of sale and the selection of other financing team members.
  - Disclosure Counsel for assistance with preparing and documenting the Official Statement?
- Criteria for determining the sale method (competitive, negotiated, private placement) and investment of proceeds.
- Use of comparative bond pricing services or market indices as a benchmark in negotiated transactions, as well as to evaluate final bond pricing results.
- Criteria for issuance of advance refunding and current refunding bonds. (no more TE AR's post 12/31/17)
- Use of credit ratings, minimum bond ratings, determination of the number of ratings, and selection of rating services.

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EXAMPLE DEBT AND DEBT SERVICE LIMITS

Below are example **debt and debt service** limitations from medium-size Wisconsin municipalities.

Example No. 1

Direct Debt to Equalized Value

- Limited to 2/3 of the State's 5.0% limit
- (i.e., 3.33% of Equalized Value)

Direct Debt per Capita

- Target value of $3,000 per capita
- This limit can been exceeded based on the amount of debt that is supported by Tax Incremental District (TID) revenue

Debt Service Levy

- Limit the Debt Service Levy to 30% of the municipality's total Property Tax Levy
- Limit the Debt Service Levy to $2.10 per $1,000 of equalized value

Enterprise Funds

- Water and Sewer utilities should utilize revenue debt to finance capital to the extent practicable.

Example No. 2

Direct Debt to Equalized Value

- Limited to 65% of the State's 5.0% limit
- (i.e., 3.25% of Equalized Value)

Direct Debt per Capita

- Target value of $1,500 per capita
- Has been exceeded because of TID projects

Debt Service Levy

- Limit the Debt Service Levy to 15% of total budgeted expenditures for governmental type funds (general, special revenue, capital project, and debt service funds)

✓ **Credit Rating**

Debt factors commonly considered in a credit rating analysis should be considered for every debt issue

EXAMPLE DEBT STRUCTURE

Below are example **structuring** limitations from medium-size Wisconsin municipalities.

Final Maturity

- Debt for streets and equipment shall be limited to 10 years
- Debt for major infrastructure projects shall be limited to 20 years
- Debt for TID projects shall be limited to 20-years or the maximum life of the TID

Structure

- General Obligation debt service will generally be structured on a level debt service basis unless there is a unique revenue stream supporting the project that warrants an alternative debt service structure.
- Principal payments may be delayed or capitalized interest utilized during project construction.

Below are example debt and debt service limitations from medium-size Wisconsin municipalities.

Example No. 1

Method of Sale

The City may issue debt through either a competitive or a negotiated sale process.

Prior to recommending action on a bond or note sale, the Finance Committee shall consider the circumstances of the issue and make a recommendation to the City Council on the method of sale to be utilized.

Factors to be considered include:

- Use of General Obligation Debt
- Size and Complexity of the Issue
- Volatility of Market Conditions
- Availability of Market Information

Example No. 2

Financial Advisor Involvement

The Municipality will utilize the services of a Financial Advisor when issuing debt.

The Financial Advisor will advise on the structuring of obligations to be issued, inform the Municipality of various options, advice the Municipality as to how choices will impact the marketability of Municipality obligations and will provide other relevant services.

State Statute Limitation on Method of Sale

State of Wisconsin does prescribe the method of sale for "New Money" General Obligation Bonds

- Competitive sale is required per Chapter 67.08(2)

Competitive Sale - Underwriter is not known ahead of time.

- Financial Advisor conducts an open bid and the Bonds are awarded to the Underwriter with the lowest average rate

Negotiated Sale - Underwriter is selected ahead of time by the issuer.

- A formal selection process can be facilitated by a Financial Advisor or the issuer can proceed by itself

Exhibit: Utilizing a Financial Advisor (either Competitive or Negotiated Sale)

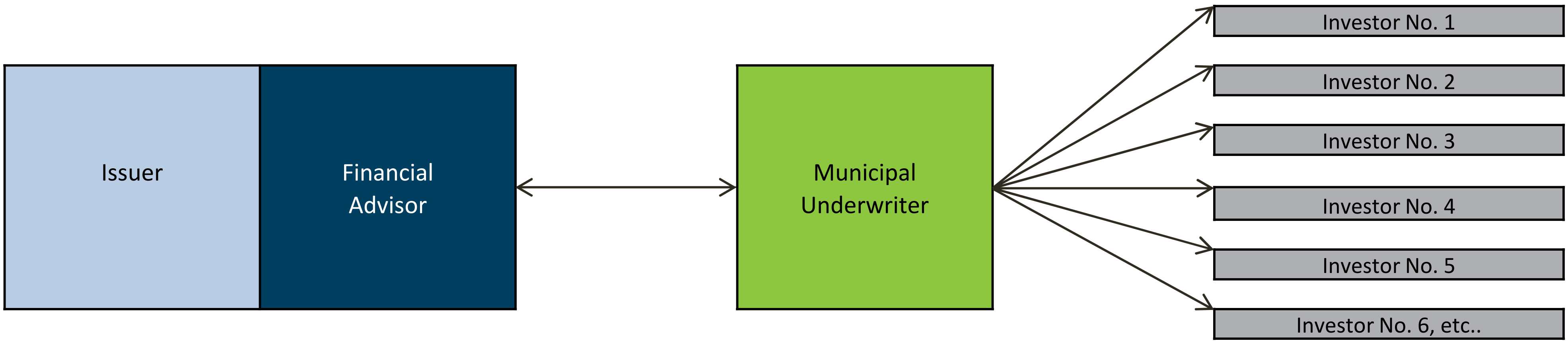
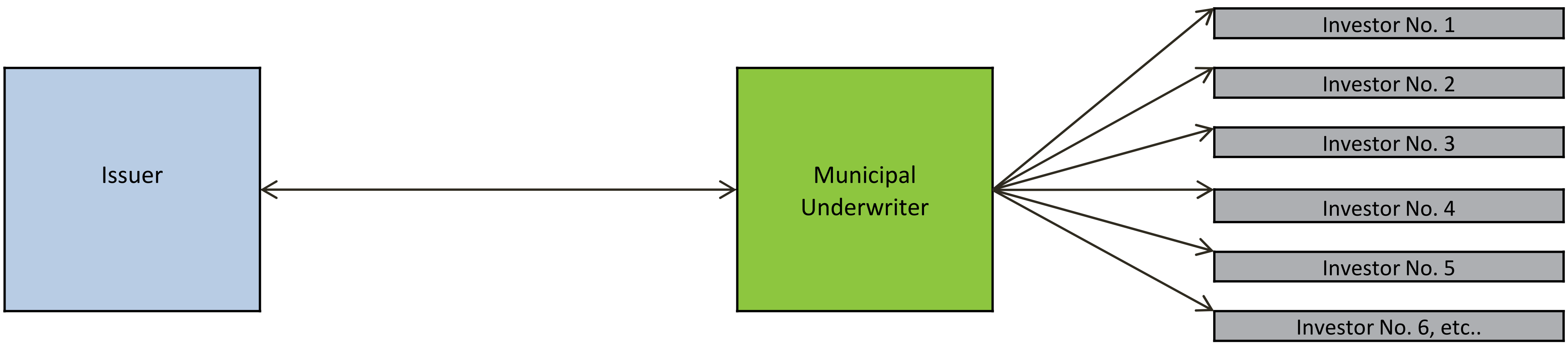


Exhibit: The Absence of a Financial Advisor (requires a Negotiated Sale)



After the Debt is issued there are required **ongoing administrative activities**.

Investment of Bond Proceeds

- IRS: Arbitrage Rebate and Yield Restriction

MSRB Disclosure Requirements

- SEC Rule 15c2-12
- Annual Report preparation and posting on EMMA website (usually within 210 to 365 days)
- Material Events Disclosure (within 10 business days)

Record Retention

- IRS: Life of the Bonds (or life of the refunding bonds) + 3 years

Private Business Use Monitoring

- IRS: If the financed facility has any management contracts, leases or sub-leases

Consider adopting a separate Post-Issuance Compliance Policy to formally designate team members and their ongoing post-issuance responsibilities.

Investment of Bond Proceeds

Arbitrage Rebate and Yield Restriction compliance are two restrictions after issuance.

- **Arbitrage Rebate**
  - Issuers must rebate certain excess earnings on proceeds of tax-exempt bonds to the federal government.
  - There are two notable exceptions that allow issuers to keep any positive arbitrage.
    1. Small Issuer Exception
       - $5 million or less of Tax Exempt debt issued in a calendar year for municipalities.
    2. Spending Test
       - 6-month, 18-month, or 24-month spending exceptions.
  - Perform calculations no later than 5-year anniversary, and if needed make payment within 60 days.
- **Yield Restriction**
  - Prohibits investments that earn a rate higher than the arbitrage yield (i.e., borrowing rate).
  - For a new project, Yield Restriction would typically apply to any unspent bond proceeds remaining after the standard three-year Temporary Period expires.

MSRB Disclosure Requirements – Material Events

The Continuing Disclosure Undertakings for municipal securities issued on or after February 27, 2019, and subject to Securities and Exchange Commission Rule 15c2-12 (the "Rule"), must include two additional reportable events:

1. **The 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 affect security holders, if material
2. A 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**

The above two reportable events are in addition to the 14 enumerated reportable events under the Rule.

ANNUAL DEBT REVIEW
- FINANCIAL PLANNING

The value of a Debt Management Policy can be enhanced with an annual Debt Status and Policy Overview presentation for elected officials.

Annual Debt Status and Policy Overview Presentation (example outline)

- Summarize current Debt Management policies
- Debt by Issue (G.O. / Utility Revenue / Lease Revenue)
- G.O. Debt Service by expected source of repayment (Levy, TID, Utilities, etc.)
- Historical Trends of key G.O. Debt and Debt Service metrics (Debt as % of Equalized Value, etc.)
- G.O. Rating Overview (current rating and trends in key metrics found in rating agency scorecards)
- Estimated borrowing needs over the next five years (5-year CIP summary)
- Model impact to Debt and Debt Service of New Debt Issues by expected source of repayment
  - Levy Supported – Always Include
  - Potentially model impact to G.O. credit rating if there is a material change to key metrics
  - TID or Utility Supported – Can include or can make a separate presentation

Multi-Year Financial Planning is foundational to maximizing the value of creating a Debt Management Policy

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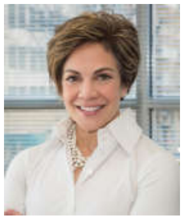
KEY PMA WISCONSIN STAFF

Below are key PMA Wisconsin staff, all of which are a registered Municipal Advisor Representative (Series 50)



Michele Wiberg
Wisconsin Public Finance
SVP, Managing Director

~ Heads PMA's Milwaukee Office
~ 27 years of financial advisory experience to Wisconsin local governments
~ Advised on 216 transactions totaling over $2.5 billion during past five years
~ BS and MBA from Marquette University

Brian Della, CFA
Wisconsin Public Finance
Director

~ Joined PMA in April 2018
~ 14 years of financial advisory experience to Wisconsin local governments
~ Previously employed at consulting engineering firm for five years (PE)
~ BS and MS from UW-Madison / MBA from Indiana University

Philip Hohlweck
Wisconsin Public Finance
Director
Quantitative Analyst

~ Joined PMA in 2012
~ 17 years of financial advisory experience to Wisconsin local governments
~ Full-time quantitative analyst
~ BBA from UW-Madison

Sara Schnoor
Wisconsin Investment Solutions
Associate Vice President

~ Joined PMA in 2006
~ Extensive experience related to investment management/bond proceeds
~ Previously employed at Moody's Investors Services
~ BA from St. Norbert College / MPA from UW-Madison

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