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Tax-Exempt Financing for Local Infrastructure Projects

Bond Basics and Beyond

October 2015
IACC Annual Conference

Tax-Exempt Bond Financing

Session overview:
Your community may be able to use tax-exempt bond financing for infrastructure and other projects.

Today we will:

1. Learn the basics of issuing bonds
2. Explore tax-exempt private activity bonds and the Bond Cap Allocation Program
3. Get an update on the possible impacts of federal tax reform proposals





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What is a Municipal Bond?

Debt issued by a city, county, local or other government entity used to fund expenditures such as the construction of highways, bridges or schools.

- Government (issuer) sells the bond to the investor(s)
- Investor(s) provides the capital for the project
- Government promises to re-pay the face-value of the debt **with interest**



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Tax-Exempt Bonds

Municipal bonds can be taxable or tax-exempt

- Tax-exempt bond interest is exempt from Federal income tax
- Therefore the investor is willing to take a lower interest rate
- Lower interest rate = lower financing costs

Tax-exempt bonds have many strings attached

- Governmental purpose
- IRS !!!
- Limits on private activity
- Reasonable expectation for spending proceeds
- Arbitrage restrictions

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Financing Options

Bond vs. Loans

- Bonds have lower interest rates but higher up-front costs
- Bonds work better for larger amounts of money and longer periods of time
- Bank financing works well for interim, variable rate financing
- Most banks will not go longer than 10 years
- Banks often work better for less robust credits

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Municipal Bonds: GO Bonds

General Obligation (GO) Bonds

- Public purposes
- Voted or non-voted
- Payable from property taxes and other revenues
- Debt is secured by full faith and credit of the issuer
- Limited or unlimited taxing authority
- Amount limited by state statute

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Municipal Bonds: Revenue Bonds

Revenue Bonds

- Water, sewer, electric, other enterprise systems
- Payable from specific system/project revenues
- No dollar limit, system revenues create a practical limit
- Certain covenants or conditions: debt service coverage, reserve fund, etc.



More Municipal Bonds

Special Assessment Bonds

- Finance improvements (e.g. roads, sewers) in specific area
- Payable through assessments of properties benefiting from the improvement
- Typically a set up as a Local Improvement District (LID)
- Do not count against statutory debt limitations

Certificates of Participation (COPs)

- Issued by the Office of the State Treasurer
- LOCAL program, www.tre.wa.gov/LOCAL
- Aggregates many local jurisdictions' smaller debt issues
- Payable from jurisdictions' general funds
- Counts against statutory debt limitations



Limitations on Municipal Debt

General Obligation debt is limited by state statute and constitution

Per state statutes: debt is limited to a **percent of assessed valuation** of the taxable properties in the jurisdiction

	Non-Voted	Total		Non-Voted	Total
Counties	1.5%	2.5%	Port GO Bonds *	3/8%	1.25%
Cities	1.5%	7.5%	Water/Sewer	0.5%	2.5%

See: Bond Users Clearinghouse, WA State Department of Commerce
<http://www.commerce.wa.gov/Documents/Limitations-on-Municipal-Debt.pdf>

*Port district debt limitations are influenced by taxable property values, operating revenues, and other factors .



Tax-Exempt Bond Financing

Bond Cap Allocation Program
 WA State Department of Commerce






Private Activity

What if the bond has more than a little bit of benefit to a private business or individual?

Private Activity = Taxable Bond (with a few exceptions)

Private Loan Test:

- >5% used for loans to individuals or non-governmental entities

Private Business Test:

- 10% for private business purpose, AND
- >10% of payments secured by property used



Annual Bond Cap Allocation

Tax-Exempt Private Activity Bonds

- Bond Cap Allocation Program , WA State Department of Commerce
- Authorizes the issuance of tax-exempt private activity bonds
- Ensures statewide issuances are within federal limits (
- Businesses or developers work with public authorities to develop projects and issue the bonds for financing

Significant Benefits to the Public

Projects are eligible if they fit into one of four categories:

- Housing
- Small-issue manufacturing
- Exempt (capital) facilities
- Student loans



Conduit Issuers

Local Conduit Issuers

- Economic Development Corporations
- Industrial Development Corporations
- Local Housing Authorities
- Certain types of special purpose districts

State Conduit Issuers

- Washington State Housing Finance Commission www.wshfc.org
Housing, Energy, 501c3
- Washington Economic Development Finance Authority (WEDFA) www.wedfa.wa.gov
Small Issues, Exempt Facilities, QECBs



Categories Defined

Housing (32%)

Multi-family

- Issuers: HFC, LHA
- New construction and rehab

Single Family

- Issuer: HFC
- Homeownership, such as down payment assistance
- Low and moderate income first-time homebuyers




Categories Defined

Exempt Facilities (20%)

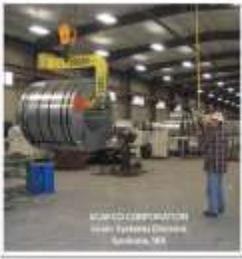
- Issuers: WEDFA, Ports, PUDs, EDCs, IDCs
- Water or sewer (that would be considered a private activity)
- Recycling
- Solid waste
- Electrical generation (that would be considered a private activity)
- Certain other kinds of environmental projects




Categories Defined

Small-Issue Manufacturing (25%)

- Industrial development/manufacturing
- First-time farmer/rancher
- Issuers: WEDFA, Ports, EDCs, IDCs, WSHFC
- \$20 million capital expenditure limit
- \$10 million bond limit




Categories Defined

Student Loans (15%)

- WHEFA is state issuer
- Not used since 2004

Remainder (8%)

- Flexible category
- Used for any eligible project type



Benefits of Tax-Exempt Private Activity Bonds

Tax-Exempt Private Activity Bonds

- Leverage public/private partnerships
- Create jobs
- Support community businesses

Conduit issuer can reduce risk and eliminate debt capacity impacts to the local jurisdiction



Federal Tax Reform

Uncertain Future of Tax-Exempt Bond Financing

Various Federal proposals to **limit or eliminate the tax-exemption**

Current System
 Tax Exemption = Lower Interest Rates = Lower Project Costs

Limiting or Elimination of the tax-exemption
 More Federal Income Tax Burden (Investors) = Higher Interest Rates = Higher Project Cost



Tax-Exempt Bond Financing

Following the Rules






Creating a Finance Team

Your Team

- You (Issuer)
- Bond Counsel
- Financial Advisor (Municipal Advisor)
- Underwriting Firm or Bank
- Underwriter counsel or bank counsel
- Rating Agency
- Bond Insurer

Be sure you understand and are comfortable with the process

- Your team of consultants may use a lot of jargon or make assumptions about your level of knowledge of the bond issuance process
- Ask a lot of questions!



Bond Counsel

Legal Opinion

- Makes sure you are following all the rules
- Prepares/reviews resolutions and official statements
- Ensures proper authorization and enforceability
- Reviews Federal tax law impacts and regulations
- Provides legal opinion that the bonds
 - Have been duly authorized and are valid and enforceable obligations
 - Exempt (or not) from Federal income tax



Municipal Advisor

Fiduciary Responsibility to the Issuer

- Works with an issuer to develop and review a plan of finance and coordinate the overall financing
- Bond structuring and financial analysis
 - Bank vs. underwriting firm
 - Sale Method: Competitive vs. negotiated
- Provide current market-based expertise
- Coordination with rating agencies, bond insurers, underwriters
- Represents the issuer in negotiations with the underwriter
- Facilitates a competitive sale



Underwriting Firm (Bank)

Fiduciary Responsibility to the Investor

- Underwriter: financial institution that sells your bonds to investors
- Bank: purchases your bond to hold as an investment



Paperwork

Bond Resolution / Ordinance

- Provides all the details of the bonds as approved by the governing body (e.g. City Council, Port Commission)
- Approved on the date of sale or ahead of time on a delegated basis

Official Statements

- Disclosure document provided to investors prior to the sale
- Contains information about the project being financed; structure; call provisions; security for the bonds; and details about the issuer, local economy, etc.
- Updated with the pricing details after the sale (Final Official Statement)



More Paperwork – for the life of the bond

Continuing Disclosure

- Obligated to provide certain **annual financial information** and material event notices to the municipal securities market under the SEC's Rule 15c2-12.
- Obligated to report **events that may impact the ability of an issuer to pay** the amounts owed on their bonds
- 15 disclosable events include:
 - Delinquent payments and defaults.
 - Adverse tax opinions, Internal Revenue Service (IRS) determinations, or other material events affecting the tax status of the security.
 - Ratings changes.
 - Bankruptcy, insolvency, receivership, or similar event.



In Conclusion

No Such Thing as Free Money



Understand the long-term implications of issuing bonds

- **Bonds:**
 - Lots of work
 - More disclosure
 - Higher issuance costs
 - Rating requirements
 - More oversight & regulations
 - Continuing disclosure for the life of the bond
 - 6-12 weeks (more if requiring a ballot measure)
- **Other options:**
 - Grants
 - State and Federal Loans
 - Direct lending from a bank
 - State's LOCAL program (www.tre.wa.gov/LOCAL)
 - Private/innovative funding (P3s, etc.)



Questions




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