



Municipal Debt 101

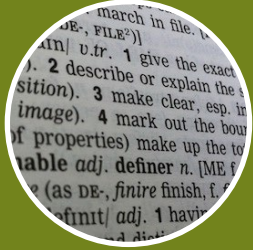
From Planning to Post-Issuance Compliance



Bond Basics: Today's Topics



Key
Concepts



Terms



Market
Players



Issuance
Process



Post
Issuance
Obligations



Why Minnesota Governments Borrow

- Capital projects with valid authorization under state law
 - ✓ Equipment
 - ✓ Facilities
 - ✓ Infrastructure
- May also issue conduit revenue bonds
 - ✓ Multi-family housing
 - ✓ For non-profit organizations
- Refundings



Capital Financing Alternatives

“Pay As You Go”

Cash & Reserves

- Use existing cash
- Efficient for short-lived assets
- Sometimes difficult to save enough
- Those who “paid” may not benefit

“Pay As You Use”

Interfund Loans

- Loan between fund(s)
- Involved funds should be treated fairly
- May cause fund balance & cash flow issues

Debt

- Preserve existing cash
- Asset amortized over useful life
- Asset “paid” for & benefited by users
- Better manage tax rates & user fees

Types of Municipal Debt

Bonds

Notes

Securities

Warrants

**All general
terms for
debt!**

What is a Municipal Bond?

A debt instrument issued by a government agency to support capital outlays...

1. An obligation to pay

2. A stated amount or "principal"

3. At a given time or "maturity"

4. With a stated interest rate

May be Fixed or Variable

Capital Financing: Legal Authority & Limitations

Issuance & Repayment Authority

- Procedural requirements
- Project type(s)
- Pledge & repayment source
- Subject to voter approval?
- Other limits by charter, ordinance or policy

Debt Limitations

- Net debt limit & exceptions
- Maximum amount of debt and/or annual debt service
- Maximum term
- Other limits by charter, ordinance or policy

Types of Pledge & Security

- General Obligation
 - ✓ Full faith & credit (any available source)
 - ✓ Irrevocable pledge to levy property taxes
- Limited Obligation
- Revenue Obligation
 - ✓ Gross revenue
 - ✓ Net revenue
- Appropriation Pledge



Key Terms

Par

- The face value or principal amount of debt issued

Principal

- The face value or par amount of a security payable on a maturity date



Key Terms, Continued...

Maturity

- Refers to the date the contract between debt issuer & investor(s) ends
- Issuer makes periodic and/or final principal payment(s)



Key Terms, Continued...



Coupon: The stated interest rate of debt issued

Fixed
Variable



Yield: The measure of investor return through maturity or prior redemption

Yield may not equal coupon

Key Terms, Continued...

Optional Redemption or “Call” Feature

- The ability for an issuer to pay debt **prior** to maturity at specified time(s) & prices
- “Par call” = date debt can be paid at face value

Official Statement

- Municipal securities primary offering & disclosure document
- “Preliminary” prepared prior to issuance & “Final” published after sale/pricing

Tax-Exempt Debt

- Municipal debt issued for public purposes tends to be tax-exempt & carries more favorable interest rates
- Interest paid to debt holders generally exempt from Federal & State income taxes
- Tax-exemption is a privilege
 - ✓ Must comply with federal regulations
 - ✓ U.S. Treasury is governing body & IRS enforces regulations

Municipal issuers can also issue taxable debt.

Debt Issuance Players

- Who are they?
- What role do they play?
- Who do they represent?
- How do they get paid?

Municipal Advisor

Who are they?

A registered firm of licensed financial professionals
Your primary guide for debt issuance process

What role do they play?

Recommend structure, timing, terms & method of sale
Help prepare offering & disclosure documents

Who do they represent?

Only the issuer – duty of care and loyalty
Maintain a fiduciary responsibility to the issuer

How do they get paid?

Typically paid flat fee from issuance proceeds

Bond Counsel

Who are they?

Law firm with attorney(s) that specialize in public finance

What role do they play?

Provide the validity and tax opinions for the bond issue
Prepare legal documents, agenda text & agreements

Who do they represent?

Attorney/Client relationship with issuer
Opinions have benefit for all transaction participants

How do they get paid?

Typically paid flat fee from issuance proceeds

Credit Rating Agency

Who are they?

Private, for-profit companies
S&P Global, Moody's Investor Services, Fitch Ratings

What role do they play?

Provide credit opinion of the issuer and transaction
Monitor credit via ongoing surveillance

Who do they represent?

Provide an independent credit opinion
Will disclaim any recommendation to buy/sell

How do they get paid?

Typically paid flat fee from issuance proceeds
Potential for ongoing surveillance fees

Underwriter

Who are they?

- A registered financial institution comprised of licensed professionals
- May be a “syndicate”

What role do they play?

- Purchase the entire bond issue from the issuer
- Resell the bond issue to investors in “pieces”

Who do they represent?

- Themselves & their own commercial interests
- Adheres to suitability & fair dealing standard with investors/issuers

How do they get paid?

- Paid by issuer through an “underwriter discount”
- Difference between purchase & sale prices of securities owned

\$10 Discount = \$10/\$1,000 or 1.00% face value

\$1,000,000 issue

\$10,000 discount

Underwriter pays \$990,000 for \$1,000,00 in bonds

Issuing Debt: Process & Timing



Planning & Authorization

What	Who
<ul style="list-style-type: none">• Determine amount to borrow• Structure transaction (type, terms, etc.)• Establish timing of debt sale	<ul style="list-style-type: none">• Issuer• Municipal Advisor
<ul style="list-style-type: none">• Obtain legal authorization<ul style="list-style-type: none">✓ Initial authorization & public notice✓ Report or study adoption?✓ Referendum?• Determine tax-exempt status	<ul style="list-style-type: none">• Issuer• Municipal Advisor• Bond Counsel

Legal Documents & Official Statement

Bond Marketing & Sale: Borrowing Options

Negotiated Underwriting

Issuer works with
Municipal Advisor to
select underwriter

Effective for unique features,
new or challenged credits,
difficult market conditions

Competitive Underwriting

Bonds offered through
competitive bid

Sale awarded to lowest interest
cost proposal

Bond Marketing & Sale: Borrowing Options

Securities Offering

- Bonds sold in capital markets through underwriter
- Preliminary Official Statement serves as offering document

PRELIMINARY OFFICIAL STATEMENT DATED APRIL 8, 2021

In the opinion of Fryberger, Buchanan, Smith & Frederick, P.A., under existing federal and Minnesota laws, regulations, rulings and decisions, and assuming the accuracy of certain representations and continuing compliance with certain covenants, interest on the Bonds is excludable from gross income for federal income tax purposes and from taxable net income of individuals, estates and trusts for Minnesota income tax purposes; is includable in the income of corporations and financial institutions for purposes of the Minnesota franchise tax; and is not a specific tax preference item for purposes of the federal alternative minimum tax or the Minnesota alternative minimum tax imposed on individuals, trusts and estates.

The Bonds will be designated as "qualified tax-exempt obligations" for purposes of Section 265(b)(3) of the Internal Revenue Code of 1986, as amended, relating to the ability of financial institutions to deduct from income for federal income tax purposes, interest expense that is allocable to carrying and acquiring tax-exempt obligations. No opinion will be expressed regarding other state or federal tax consequences caused by the receipt of accrual of interest on or arising with respect to ownership of the Bonds. See "TAX EXEMPTION" herein.

New Issue

Rating Application Made: S&P Global Ratings

CITY OF HERMANTOWN, MINNESOTA
(St. Louis County)

**\$4,035,000* GENERAL OBLIGATION IMPROVEMENT AND REFUNDING BONDS,
SERIES 2021A**

PROPOSAL OPENING: April 19, 2021, 11:30 A.M., C.T.

CONSIDERATION: April 19, 2021, 6:30 P.M., C.T.

Bond Marketing & Sale: Borrowing Options

Direct Placement

- Banks & other institutions active lenders to public entities
- No Official Statement required
- Can be suitable for smaller issues, unique features
- Bank demand changes over time
 - ✓ Compare “all-in” costs to capital market options



Still must follow process when working with local banks!

Bond Marketing & Sale: Borrowing Options

**MN Public
Facilities
Authority**

Loan
programs for
sewer, water,
other
projects

Transportatio
n loan
programs

**USDA Rural
Development**

Loan
programs for
community
facilities,
sewer &
water
projects

Grant
programs for
similar uses

Bond Sale & Closing

Sale

- Finalize rates, terms and structure
- Approve awarding documents
- Prepare & distribute Final Official Statement, if needed
- Receive “good faith” deposit (competitive sale)

Closing

- Deliver funds to issuer
- Distribute fees to third-party professionals
- Complete accounting entries
- Segregate, invest and monitor funds until expenditures

You've Secured Funding! Now What?



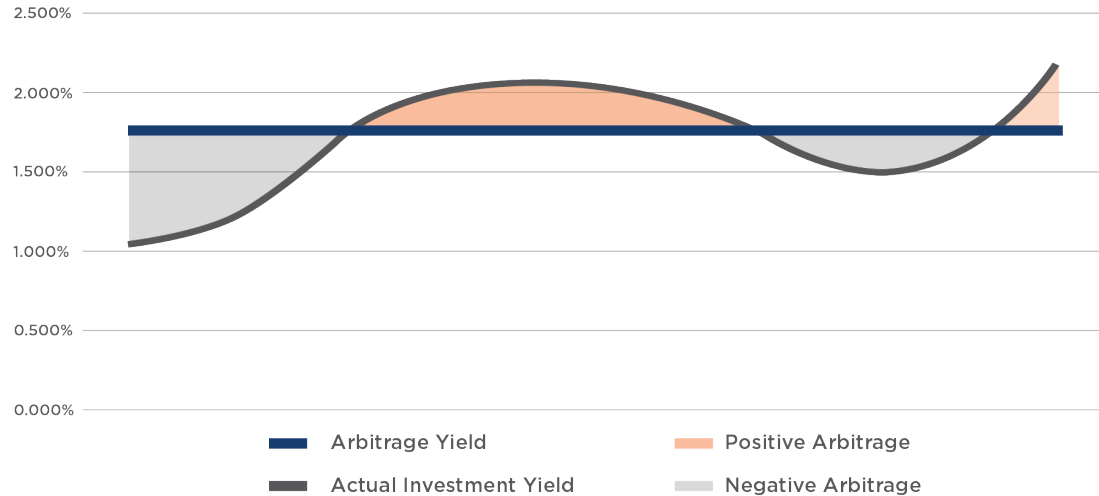
Arbitrage: What exactly is it?

ARBITRAGE CREATION



Arbitrage: What exactly is it?

ARBITRAGE MONITORING



Arbitrage: General Considerations

Planning	At Closing
Reimbursement Allocations & Official Intent	
✓ Spend-Down Duration	✓ Updated Draw-Down Schedules
✓ Financing Complexity	✓ Investment Policy & Strategy
✓ Project & Debt Service Accounting	✓ Arbitrage Compliance Plan

Continuing Disclosures: What are they?

SEC Rule No. 15c2-12

- Issuers of municipal securities bound by Continuing Disclosure Agreements to disseminate:
 - ✓ Financial & operating information
 - ✓ Material event notices
- Disclosures filed with MSRB via EMMA



Investors are watching!

Continuing Disclosures: Specific Requirements

Full Disclosure: \$10 million+ in outstanding debt subject to CDA

- Annual financial info & operating data
- Audited financial statements
- Event notices

Limited Disclosure: <\$10 million in outstanding debt subject to CDA

- Audited financial statements
- Event notices

Continuing Disclosures: Required Information



**CURRENT
PROPERTY
VALUATIONS**



DIRECT DEBT



**TAX LEVIES &
COLLECTION**



**POPULATION &
EMPLOYMENT
TRENDS**

- Vary by obligation type & pledged revenues
- Defined by Continuing Disclosure Agreement (CDA)

Continuing Disclosures: Required Event Notices

Must be filed within 10 business days of occurrence.

Principal & interest
payment
delinquencies

Non-payment
defaults

Unscheduled draws
on debt reserves

Unscheduled draws
on credit
enhancements

Substitution of
credit or liquidity
providers

Events affecting
tax-exempt status

Modifications to
security holders'
rights

Securities calls &
tender offers

Continuing Disclosures: Required Event Notices

Must be filed within 10 business days of occurrence.

Defeasances

Release,
substitution or sale
of securing
property

Rating changes

Bankruptcy,
insolvency or
receivership

Merger, acquisition
or sale

Trustee successor
appointment,
addition or name
change

Material incurrence
of a financial
obligation

Default,
acceleration,
termination, term
modification

Final Thoughts

- Capital financing can be achieved through both “pay-go” & debt issuance
- Many allowable uses for issuing public debt
- Proper planning is critical – today’s decisions can last for 20 years or more
- Prudent debt administration is as, if not more , important than issuing debt itself
- Seek guidance from public finance professionals



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