Iowa League of Cities Conference

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Outside the Box Finance

D|A DAVIDSON
FIXED INCOME CAPITAL MARKETS

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D.A. Davidson & Co. – National in Scope, Local in Practice

- **D.A. Davidson knows Iowa because our team serves clients in the State from our Des Moines office.**
- D.A. Davidson ranked fifth nationally by number of negotiated transactions underwritten in 2021.
  - ✓ In 2021, D.A. Davidson underwrote 446 negotiated transactions totaling $4.892 billion in par amount nationwide.

Source: Refinitiv

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Municipal Financing - Benefits and Considerations

- Municipal issuers enjoy favorable interest rates because the **interest on municipal bonds is exempt from federal taxes.**
  - ✓ Generally, investors purchasing municipal bonds are willing to accept a lower rate than they would on equivalent U.S. government bonds or corporate bonds.
- Because the bonds are tax-exempt, the IRS is focused on making sure that certain rules are followed in regards to bond issuance.
  - ✓ Must be issued for a public purpose and public benefit.
- Additionally, since the tax-exemption means less taxes are collected, the IRS has created rules to limit the amount of tax-exempt bonds that can be issued.
- Some states also allow certain municipal bonds to be issued as exempt from their respective state taxes for local investors.
- Small issuers (<$10 million in a calendar year) also allow for a special tax benefit to bank investors (bank-qualification) that allow for lower interest rates as well.

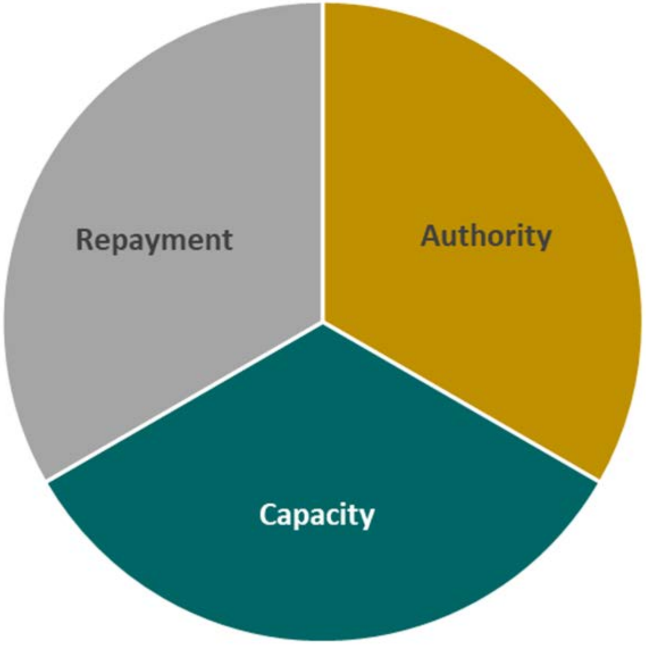
Municipal Financing – Roles and Planning

- Multiple parties may be involved:
  - ✓ City/County/School
  - ✓ Engineers/Architects
  - ✓ Attorneys
  - ✓ Underwriters/Placement Agents
  - ✓ Municipal Advisors

- Cities have varying degrees of capacity for handling these projects.
  - ✓ City Administrator/CFO/Dedicated Finance Staff
  - ✓ City Clerk
- Whatever your situation, it is extremely beneficial to **surround yourself with a team of professionals**.

Long-Term Capital Planning

- **Authority**
  - ✓ How do we gain legal authority to proceed?
    - Public Hearing
    - Referendum
- **Capacity**
  - ✓ When are we able to address these projects?
    - Legal Limits
    - Timing Considerations
- **Repayment**
  - ✓ How do we pay for that?
    - Revenue Sources
    - Financing Sources



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Municipal Financing Authority - Two Main Types of Bonds

- Municipal bonds are issued by states, counties, cities and school districts as well as other territories and possessions of the United States.
- State and local governments are able to issue **General Obligation (G.O.) bonds** based on statutory power granted by state or local laws.
- In Iowa, G.O. bonds can be issued subject to either a public hearing process or referendum (vote).
  - ✓ G.O. bonds can be issued for different purposes, and the purpose determines whether a public hearing or vote is required.
- **Revenue bonds** can be secured by water, sewer, electric, gas, communications, sales tax, urban renewal or road use tax revenues.
  - ✓ If the issuing entity has the authority to collect revenues, borrowing is subject to a public hearing.
  - ✓ Investors will determine the credit quality based on the ability of the revenue stream to support both operations and debt payments going forward.

General Obligation Bonds / Debt Capacity

- Lowest rate of interest among financing options.
- Backed by the full faith and credit of the City.
  - ✓ Can use other revenue sources in addition to property tax levy.
- State of Iowa limits issuer's applicable G.O. debt to **no more than 5% of actual valuation.**
  - ✓ For example, let's say the City of Sample's 1/1/21 valuation (applicable for FY 2022-23) is $200,000,000.
    - G.O. debt limit is $10,000,000.
  - ✓ Currently, the City has $2,500,000 of outstanding G.O. debt that counts towards this limit (25%).
    - Approximately $7,500,000 of current capacity.
      - – Annual appropriation would allow for additional borrowing.

Example of General Obligation Debt Capacity Over Time

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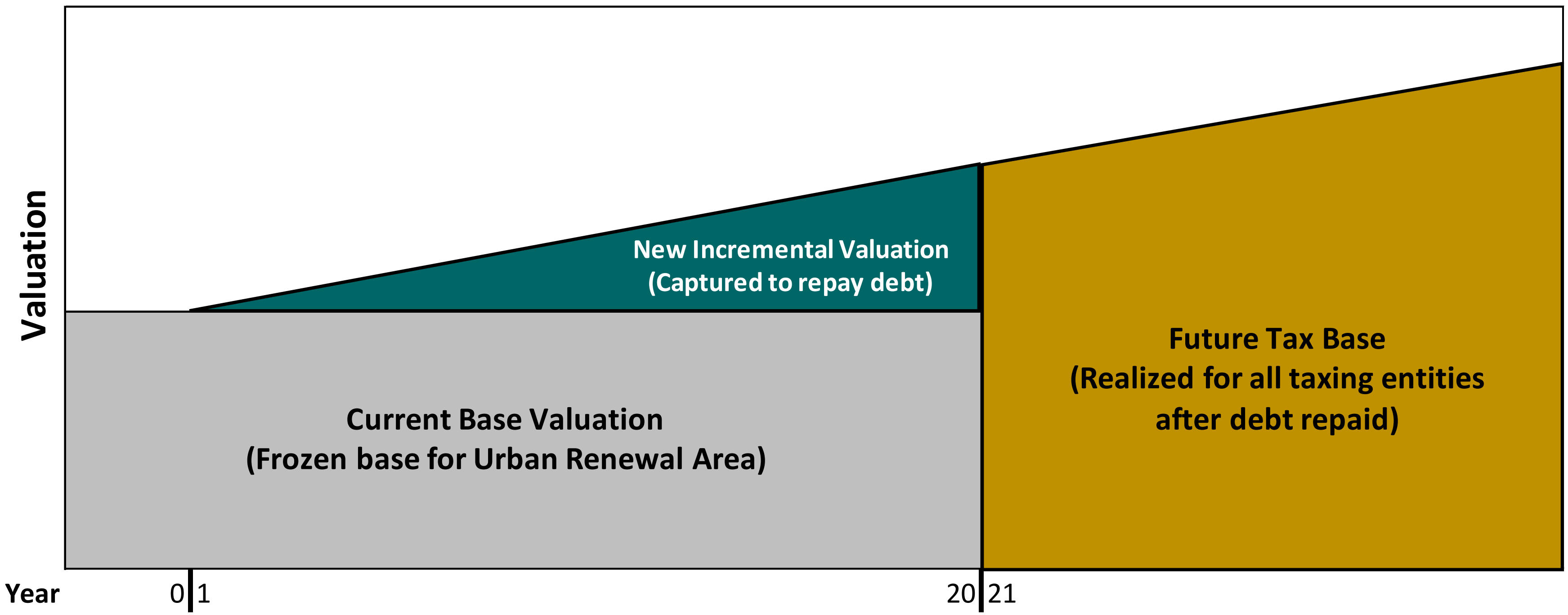
Annual Appropriation Considerations

- Using traditional debt would limit the City of Sample's borrowing to $7,500,000.
  - ✓ May not be able to cover all planned project costs.
- Using annual appropriation debt, the City could be able to finance the entire project amount.
  - ✓ Increases the City's borrowing, but **only the next year's payment counts against the State's 5% limit.**
  - ✓ City Council would then need to appropriate each year's debt payments during the budget cycle.
    - Annual appropriation is higher risk to bondholders, so interest rates are higher.
      - – Annual appropriation does align with urban renewal (TIF) processes, as typically other TIF obligations (rebate agreements) are subject to annual appropriation by Council.

Tax Increment Financing (TIF)

- A vehicle for cities to capture the incremental taxes generated from the new valuation added by buildings and/or expansions in an area of the community (urban renewal area).
  - ✓ Base is established at the time of formation of the area.
  - ✓ **Tax increment revenue is generated only on new valuation above this base valuation.**
  - ✓ Benefit is captured by city in initial years as they have put capital forward to advance the growth.
    - New valuation growth will eventually benefit all taxing jurisdictions (County, Schools, etc.).
- Related debt obligations must be certified by the City to be able to collect future TIF revenues.

TIF Visualized



TIF Debt Considerations

- Rebate agreements are the most common and lowest risk option for cities.
  - ✓ Developer only realizes benefit if they create value (new or increased valuation).
- Typically, cities will issue G.O. bonds (G.O. Urban Renewal Bonds/Notes) that pledge their full-faith and credit security, but are expected to (eventually) be repaid by future TIF revenues.
- TIF revenue debt is another option that cities can leverage to provide funds upfront for projects or related infrastructure.
  - ✓ TIF revenue debt is secured solely by the applicable urban renewal revenue stream (not City-wide G.O. pledge).
    - Higher risk to bondholders, so interest rates are higher, but this can be a desirable option for the City to minimize G.O. exposure.

Utility Revenue Bonds

- Net utility revenues are pledged to repay debt.
  - ✓ Council would be required to set and maintain utility rates to support debt with required coverage (for example: rates must produce $1.10 of net revenues for each $1.00 of debt service).
- Utility revenue bonds **<u>do not</u>** impact the City's G.O. debt limit.
  - ✓ This would include any State Revolving Fund (SRF) water and sewer revenue debt.
  - ✓ Capacity is based on the ability of the revenue source to provide sufficient cash flow to support any new debt obligations.
    - City would need to demonstrate rates and charges are adequate to meet future operating costs and debt service payments.

Waterfall for Utility Revenue Bond Repayment

1	**Operating Revenues**	**Collected**
2	**Operating Expenses**	**Paid**
3	**Debt Service**	**Paid**
4	**Replenish Reserves**	**Funded**
5	**Pay-as-you-Go Projects**	**Funded**

Local Option Sales and Service Tax

- Another financing option could potentially be the use of 1% local option sales and service tax revenues.
- Revenue stream could be leveraged to secure financing for proposed projects.
- Dependent upon flexibility of the ballot language authorizing the collection of the tax.
  - ✓ Capital improvements can be broadly defined or specifically cited in the ballot language.
  - ✓ Common revenue purpose language includes broadly “capital improvements” and/or “street improvements”.
    - ▪ All ballot language must include a percentage (even if 0%) dedicated to property tax relief.
- Any debt securitization would limit City’s annual spending for “pay-as-you-go” projects.

Local Option Sales Tax – Three Financing Options

- City can issue Sales Tax Revenue Bonds secured solely by a pledge of the sales tax revenues (Iowa Code Sections 423B.9(3) and 384.83).
  - ✓ Must be for allowable purpose under voted purpose statement (may not use amounts designated for property tax relief).
  - ✓ Revenue bonds **may** not count against City's G.O. debt limit.
- City can issue G.O. Sales Tax Revenue Bonds secured by a pledge of both sales tax revenues and general obligation backstop.
  - ✓ Debt service levy only used in the event sales tax revenues are not sufficient to cover repayment of debt in given year.
  - ✓ Would count against City's G.O. debt limit.
- City can issue G.O. Bonds secured by a general obligation pledge and abated (in part or in whole) by sales tax revenues.
  - ✓ Same as using water, sewer or road use tax revenues to abate debt service.
  - ✓ Would count against City's G.O. debt limit.

Road Use Tax Revenue Bonds

- Leverages State funding/allocation through the Iowa Road Use Tax Fund (RUTF).
  - ✓ City does not control this revenue stream and is limited based on the historical trend and projected cash flow.
- Interest rate expectations are dependent on factors which impact RUT funds like historic population trends of the City and prospects for future growth.
- Investors will also consider the projected revenue stream's size relative to the debt service requirement.
- Because these funds have no ties to property taxes they **would not** count against the City's debt limit.
- Cities often have road use tax revenues allocated to existing expenditures, so leveraging these funds is often used to accelerate necessary improvements.
  - ✓ Allows City to complete project at current costs in exchange for future interest payments – which makes sense if rates are below inflationary expectations.

Example for Road Use Tax Revenue Bonds

- City of Newton continues to prioritize street improvements throughout the community.
  - ✓ Staff and Council wanted to leverage additional funding without reducing G.O. debt capacity.
- In 2021, City started multi-year process to utilize Road Use Tax Revenue Bonds.
  - ✓ Borrowed $2 million for a 12-year term at 1.56%.

Special Assessments / Special Assessment Bonds

- City has the authority to assess against private property inside the City the cost of construction and repair of public improvements.
  - ✓ Council would determine what owners benefit, and the percentage the owner is responsible for paying and the percentage the City is responsible for paying.
  - ✓ Assessments and interest are a lien on property.
- Special Assessment Bonds can be issued and would be repaid by the property that is benefited.
  - ✓ Amount limited to total of unpaid special assessments and **does not** impact G.O. debt limit.
  - ✓ Principal and interest paid once per year on December 1st.
    - Bonds are repaid as assessments are repaid (even if prepayment).

Housing Development Using Urban Renewal

- Goal to capture new valuation growth related to potential new residential development.
  - ✓ Identify targeted area – urban renewal area.
- There are typically infrastructure costs within the area that are necessary to realize development.
  - ✓ Typically some cost-sharing between City and Developer.
- With implementation by December 1, 2022, the City would be able to realize TIF increment related to any new growth in the area that applies to tax assessments 1/1/23 and beyond.
  - ✓ Could collect revenues as soon as fiscal year 2025.

Note: These steps only allow the City to realize benefit from future valuation growth if agreements/projects are established in the future.

Housing Urban Renewal – Process Requirements

- #1 - Urban Renewal Plan or Amendment to existing Urban Renewal Plan.
  - ✓ Determined on location of project (or phase of project).
  - ✓ This needs to be completed before Development Agreement or Financing process can be formally approved by Council.
- #2 - Development Agreement - can be developed initially for negotiations with Developer.
  - ✓ Will require Urban Renewal Plan or Amendment to start hearing process for formal Council approval.
  - ✓ This should be completed before financing as it will determine the borrowing needs (if any) and projected TIF cash flow to the City.
- #3 - Financing - can be modeled initially, but is subject to Development Agreement requirements for amount, timing and repayment.
  - ✓ In many cases, City could gain authority via simple public hearing due to the essential corporate purpose nature of the infrastructure.
    - ▪ Likely will want to wait for urban renewal authority to repay with future TIF.
    - ▪ **G.O. debt is likely best option due to nature of housing construction timing.**

Example for Housing Development Using Urban Renewal

- City of Woodward has seen continued demand for residential housing and property was made available for development that could include 25 lots in the first potential phase.
  - ✓ Mayor and Council wanted to leverage future valuation to provide incentives for Developer and finance necessary infrastructure.
- In 2020, the City completed the necessary Urban Renewal steps, executed a Development Agreement and issued G.O. bonds to be repaid in-part by future TIF increment revenues.
  - ✓ First 25 lots development started in 2021.

Questions?

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