Methods to Reduce Interest Cost When Issuing Bonds

Introductions

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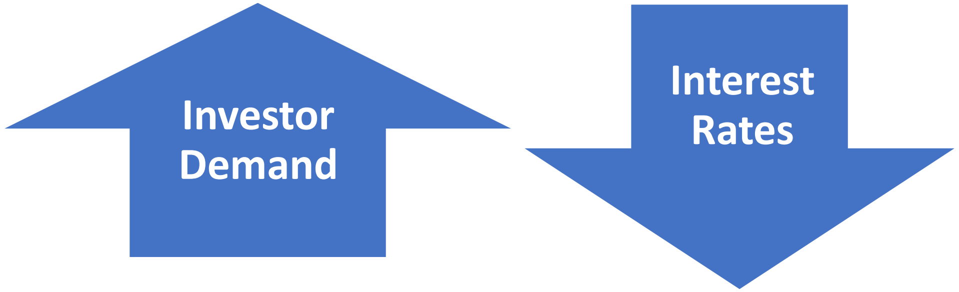
What Drives Interest Rates On Bonds?

- The interest cost is the largest cost component when issuing bonds.
- Several factors influence interest rates:
  - Market trends, including economic data, equity market shifts, global and domestic events (including elections) can affect rates.
  - Investor demand, however, is a very large driver of interest rates.



Items that Influence Investor Demand

- ❑ Bond Rating – Coley will discuss the process in detail.

Bond Rating	↑	Interest Rate	↓
Bond Rating	↓	Interest Rate	↑

- ❑ Supply in the market:
  - ❑ Does supply exceed investor demand?
  - ❑ Are there similar credits or higher-rated credits or larger issuances on the same day?
- ❑ Size of issuance:
  - ❑ Is it large enough to justify public sale vs. placement?
  - ❑ Investor interest typically increases with the size of the issue.
- ❑ Structure and Block size per maturity:
  - ❑ Short amortization or longer? Frontloaded vs. Backloaded?
  - ❑ Level or irregular principal amortization?

Items that Influence Investor Demand (cont.)

- Tax status (Taxable or Tax-Exempt):
  - What is the purpose for your borrowing?
  - Can you minimize the taxable portion of your borrowing in any way?
  - Can you structure the taxable portion first, followed by the tax-exempt?
- Call provision or optional redemption:
  - Investors want certain protections regarding your ability to call bonds.
  - How much flexibility do you have regarding call provisions?
- Credit enhancements (i.e. bond insurance):
  - Bond insurance might be beneficial if your bond rating is lower than “AA”/“Aa2”.

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Moody's rating process for new sales

STEP 1: ASSIGNMENT → STEP 2: METHODOLOGY → STEP 3: ANALYSIS → STEP 4: DISCUSSIONS → STEP 5: COMMITTEE → STEP 6: PUBLICATION

» Step 1: Assignment of the lead analyst upon notification of the sale.

» Step 2: Selection of a methodology based on the security of the debt. Examples of commonly-used methodologies for US local governments include: GO, special tax, and lease, appropriation, moral obligation and comparable debt.

» Step 3: Analysis of sale-related documents; legal information; tax base data; census information; audited financial data; debt and pension information; operating budgets; and capital improvement plans.

» Step 4: Discussions between the Moody's analyst(s) and the issuer.

» Step 5: Moody's rating committee determines the rating outcome.

» Step 6: The lead analyst communicates the rating outcome to the issuer and, after the issuer's review of the draft report, publishes the rating and the credit opinion report.

Moody's Long-Term Rating Scale

Global Long-Term Rating Scale

Aaa	Obligations rated Aaa are judged to be of the highest quality, subject to the lowest level of credit risk.
Aa	Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.
A	Obligations rated A are judged to be upper-medium grade and are subject to low credit risk.
Baa	Obligations rated Baa are judged to be medium-grade and subject to moderate credit risk and as such may possess certain speculative characteristics.
Ba	Obligations rated Ba are judged to be speculative and are subject to substantial credit risk.
B	Obligations rated B are considered speculative and are subject to high credit risk.
Caa	Obligations rated Caa are judged to be speculative of poor standing and are subject to very high credit risk.
Ca	Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.
C	Obligations rated C are the lowest rated and are typically in default, with little prospect for recovery of principal or interest.

Note: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category. Additionally, a "(hyb)" indicator is appended to all ratings of hybrid securities issued by banks, insurers, finance companies, and securities firms.*

GO Rating Methodology for US Local Governments

Factors and Sub-Factors	Scorecard Weights
Factor 1: Economy and Tax Base	**30%**
Full Value (market value of taxable property)	10%
Full Value per Capita	10%
Median Family Income	10%
Factor 2: Finances	**30%**
Fund Balance as % of Operating Revenue	10%
5-Year Dollar Change in Fund Balance as % of Revenues	5%
Cash Balance as % of Revenues	10%
5-Year Dollar Change in Cash Balance as % of Revenues	5%
Factor 3: Management and Governance	**20%**
Institutional Framework	10%
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	10%
Factor 4: Debt and Pensions	**20%**
Net Direct Debt / Full Value	5%
Net Direct Debt / Operating Revenue	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues	5%

Strategies Utilized to Reduce Interest Cost

- One rating or two?
- Bond Insurance?
- “Year end straddle” for bank qualification
- Call Provision or Optional Redemption – standard vs. non-standard
- Structure – size and amortization pattern
- Which bond sale type to utilize?
- Advance Refunding vs. Current Refunding
- For Tax-Capped Issuers
  - DSEB Assumptions: Flat vs. Ascending
  - Restructuring vs. Capital Appreciation Bonds

Front Cover of Official Statement

- Official Statement is the offering document used to market bonds to investors.
- They can range from 30 pages to 70+ depending on the bond issuance.

Ratings:
S&P: "AA" (Stable Outlook)
BAM Insured
Moody's: "A1" Underlying
See "Bond Ratings" herein

[redacted] *Chicago, Illinois ("Bond Bonds is excludable from gross income of the owners ce in computing the federal alternative minimum tax ncludible in gross income of the owners thereof for Illinois income taxes. See "Tax Treatment" herein*

New Issue
Book-Entry Only
Tax – Exempt – Series 2020A Bonds and Series 2020C Bonds
Taxable – Series 2020B Bonds and Series 2020D Bonds

Ratings:
S&P: "AA" (Stable Outlook)
BAM Insured
Moody's: "A1" Underlying
See "Bond Ratings" herein

Subject to compliance by the District with certain covenants, in the opin[redacted]hicago, Illinois ("Bond Counsel"), under present law, interest on the Series 2020A Bonds and the Series 2020C Bonds is excludable from gross income of the owners thereof for federal income tax purposes and is not included as an item of tax preference in computing the federal alternative minimum tax for individuals. Interest on the Series 2020B Bonds and the Series 2020D Bonds is includible in gross income of the owners thereof for federal income tax purposes. Interest on the Bonds is not exempt from present State of Illinois income taxes. See "Tax Treatment" herein for a more complete discussion.

[redacted]

$145,000 General Obligation Limited Tax Refunding Park Bonds, Series 2020A
$2,435,000 Taxable General Obligation Limited Tax Refunding Park Bonds, Series 2020B
$12,850,000 General Obligation Refunding Park Bonds, Series 2020C
$8,860,000 Taxable General Obligation Refunding Park Bonds, Series 2020D

Dated: September 3, 2020 **Due: November 1, as further described on the inside cover page**

The General Obligation Limited Tax Refunding Park Bonds, Series 2020A (the *"Series 2020A Bonds"*), Taxable General Obligation Limited Tax Refunding Park Bonds, Series 2020B (the *"Series 2020B Bonds"*), General Obligation Refunding Park Bonds, Series 2020C (the *"Series 2020C Bonds"*), and Taxable General Obligation Refunding Park Bonds, Series 2020D (the *"Series 2020D Bonds"* and [redacted] together with the Series 2020A Bonds, Series 2020B Bonds and Series 2020C Bonds, the *"Bonds"*), o[redacted] County, Illinois (the *"District"*), will be issued in fully registered form and will be registered initially only in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York (*"DTC"*). DTC will act as securities depository for the Bonds. Purchasers of the Bonds will not receive certificates representing their interests in the Bonds purchased. Ownership by the beneficial owners of the Bonds will be evidenced by book-entry only. Payments of principal of and interest on the Bonds will be made

One Rating or Two?

- Larger issuances can benefit from getting two major bond ratings.
  - Many investors will only buy large issues with two ratings.
  - This is especially true if the issue is over $50 million.
- Smaller issuances generally do not benefit from additional ratings.
  - This would typically include most Working Cash or other Limited Bonds ranging in size from $0 - $50,000,000 in par amount.

Bond Insurance

- Depending on the bond rating, bond insurance can be utilized.
- Bond insurance can enhance the creditworthiness of an issuer.
- Bids are solicited to determine which provider might be awarded.
- Fee is quoted as a percentage of total debt service of the new bonds (principal + interest).
- Lowest bid is subjected to a cost-benefit analysis by underwriter or municipal advisor.
- Insurance is only utilized if it provides a reduction in interest cost vs. the upfront cost of the insurance premium.
- If analysis does not prove it is beneficial, bids can and should be rejected.

Both major insurers are rated "AA" by S&P

Moody's	S&P or Fitch	Rating Grade Description (Moody's)	
Aaa	AAA	Investment Grade	Minimal credit risk
Aa1	AA+		Very low credit risk
Aa2	AA		
Aa3	AA-		
A1	A+		Low credit risk
A2	A		
A3	A-		
Baa1	BBB+		Moderate credit risk
Baa2	BBB		
Baa3	BBB-		

Straddle for Bank-Qualification

- The Internal Revenue Code of 1986 (“the Code”) allows certain tax-exempt bonds to be designated as Bank Qualified (“BQ”).
- BQ bonds increase the desire for banks to purchase vs. Tax-Exempt Non-BQ bonds.
- Specific criteria needs to be met:
  - Issued by a “qualified issuer” under the Code .
  - Issued for public purposes.
  - Designated as Qualified Tax-Exempt Bonds (< $10 million in par amount in calendar year).
- If your needs are between $10,000,000 and $20,000,000, you might want to utilize the “straddle”.
  - The benefit of BQ vs Non-BQ rates on a particular transaction will vary with market movement and can be analyzed by your underwriter or municipal advisor.

Example

2020
First Stage of Borrowing is done at $10,000,000 or less in one year

→ Calendar Year End →

2021
Second Stage of Borrowing is done at $10,000,000 or less in the following year

→ Calendar Year End →

2022
Issuer would have to wait until year 3 to resume utilizing Bank Qualification on a new issuance

Optional Redemption

- Optional redemption (or call) provision allows the issuer to redeem the bonds prior to maturity.
- This allows for future flexibility and provides efficiency when refinancing bonds.
- Bonds that are “callable” can be redeemed after a specified period, and future interest payments on refunded bonds are eliminated and replaced by the new, refunding bonds.
- A 10-year call provision has been accepted by investors as the standard.
- Presently, 8-year call provisions are accepted by most investors without an interest rate penalty.
- Pushing for shorter than 8 years on the call provision can adversely impact your interest rate, or, in certain situations create a higher “kick” to maturity, benefiting the investor and not the District.
- Using 8 to 10-year call should satisfy most investors.

Structuring

- Institutional Investors prefer larger bond issues, larger block sizes, especially when selling taxable bonds.
- The issuer's needs or goals, coupled with any statutory limitations, dictate the structure.
- The block sizing and amortization is something that can be strategically utilized.
  - i.e. Debt Certificates, Unlimited Bonds, Alternate Revenue Source Bonds.
  - Limited Bonds are sometimes difficult to structure strategically, but not always.
- Principal repayment can be structured strategically.
  - Adequate size maturing each year, if possible.
  - "Term Bonds" can be utilized to increase size of maturities.

Bond Sale Types Explained

Public Sale

–District sells the bonds to an underwriter, who resells the bonds to investors.
–Bond offering document is Official Statement.
–Bonds are generally rated and may be insured.
–Costs of issuance include financial advisor, underwriter, ratings and counsel, but often a lower interest rate than private placement.
–Typically, more than one investor will ultimately purchase bonds.

Competitive Sale

– Underwriters submit bids for the bonds at specific date/time.

– Bonds are likely awarded based on the lowest true interest cost.

Negotiated Sale

– The issuer selects an underwriter prior to the bond sale and negotiates terms with the selected underwriter.

– Provides additional premarketing compared to competitive sale.

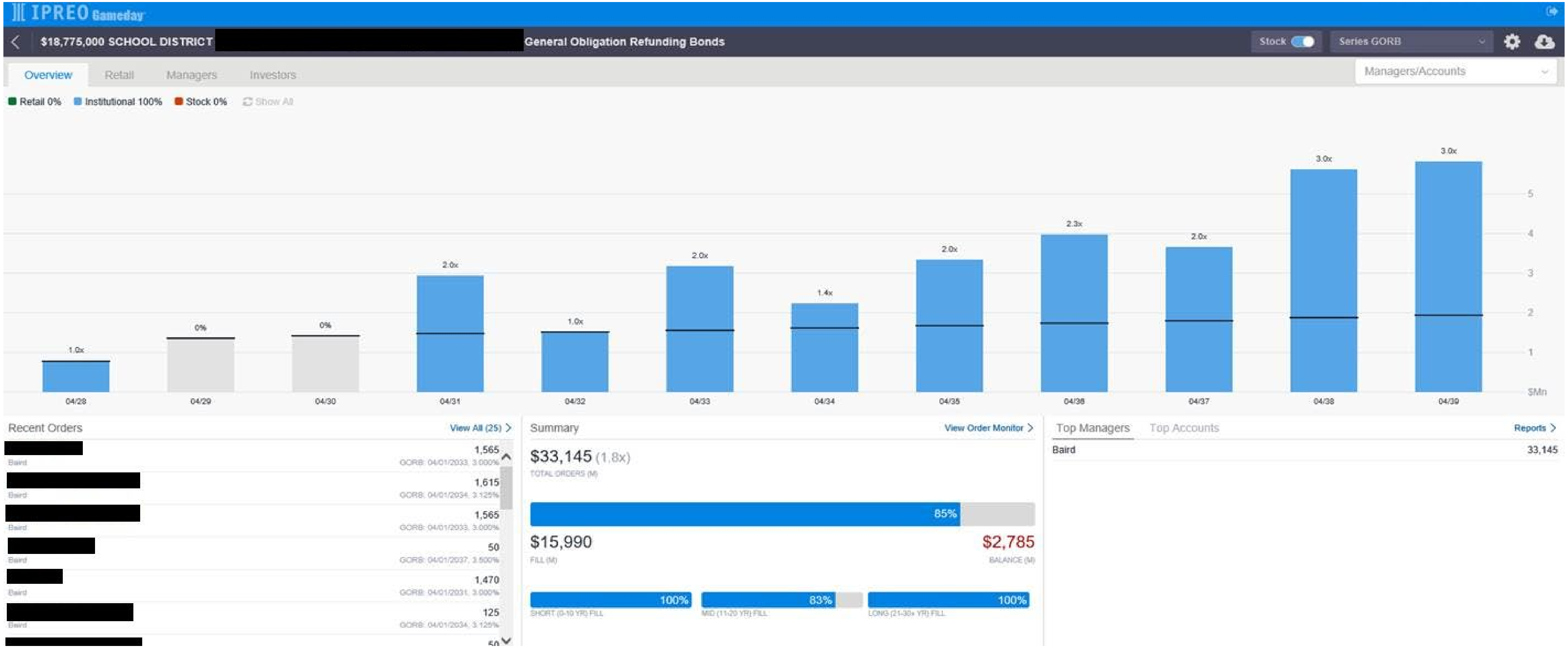
Private Placement (Single Purchaser)

- Bonds are offered through a Term Sheet (no Official Statement).
- Purchaser is generally a bank, but maybe another governmental entity or specialized investor.
- Typically results in lower issuance costs
- Interest Rate might not be as competitive as Public Sale.
- Investor interest ebbs and flows depending on cost of funding.
- Timeline is typically much shorter.

Bond Sale Types – Pros & Cons

	Public Sale		
	Negotiated	**Competitive**	**Private Placement**
Interest Rates	Generally lower than private placements. More stability in pricing.	Generally lower than private placements. More sensitive to market dynamics on day of pricing. Ability to point to a "best bid".	May be higher or lower than public offerings depending on market dynamics.
Upfront Costs of Issuance	Higher. Requires official statement and, usually, rating.	Higher. Requires official statement and rating.	Lower. Term sheet and typically no rating.
Flexibility	Greater flexibility with structure on pricing day, including size, terms and optional redemption. Ability to adjust to economic and market conditions, investor demand and overall supply.	Less flexibility to change structure and pricing date after posting notice of sale. Minor adjustments can be made to the timing, structure or size.	Pricing is typically with one investor so terms, size, optional redemption and dates can be negotiated and mutually agreed upon.
Timing	Typically 10-12 weeks.	Typically 10-12 weeks.	Typically 5-6 weeks; no official statement or rating.
Rating	Required by most investors.	Required.	Typically not required or needed. Credit evaluated by investor.
Term	No limitation other than statutory limitations.	No limitation other than statutory limitations.	Limited investor interest beyond 10-15 years.
Counsel Fees	Bond Counsel required. May also utilize disclosure or underwriter's counsel with an added cost.	Bond Counsel required. May also utilize disclosure counsel with an added cost.	Bond Counsel required. Bank counsel may also be included at an additional cost.
Investors	Those who desire to hold bonds but do not have direct market access (funds, banks, retail).	Winning bidder (the underwriter) sells issuer's bonds in secondary market.	Select investor, typically a bank, which can be retained through bidding process.
Disclosure	Subject to continuing disclosure filings and Rule 15c2-12.	Subject to continuing disclosure filings and Rule 15c2-12.	Typically not subject to continuing disclosure filings and Rule 15c2-12. Considered a material event for outstanding bonds issued on or after February 2019.

Example Pricing – Negotiated Sale



Example Pricing – Competitive Sale

	Bidder	Firm	TIC	Time	Gross Interest	+ Discount/ (Premium)	Total Interest	Bid No.	Cumulative Improvement	Open Auction Savings
1st	RWBA-DK	Robert Baird	3.428090%	11:14:55 am	$4,315,642.64	39,095.60	$4,354,738.24	2	0.049447%	$ 28,435.30
2nd	BAKE-SF	The Baker Group LP	3.454866%	11:16:37 am	$4,485,300.42	(41,521.85)	$4,443,778.57	2	0.004010%	-
3rd	NORT-DS	Northland Securities	3.488996%	11:16:32 am	$4,403,209.86	49,950.00	$4,453,159.86	9	0.368292%	-
4th	HUTC-JV	Hutchinson Shockey Erley	3.663477%	11:14:10 am	$4,726,905.42	(25,857.60)	$4,701,047.82	2	0.029511%	-
5th	DADA-JS	DA Davidson	3.670452%	11:16:46 am	$5,013,270.28	(196,818.80)	$4,816,451.48	6	0.123159%	-
6th	RAYM-EB	Raymond James	3.805351%	11:16:51 am	$5,083,466.67	(175,161.60)	$4,908,305.07	4	0.042632%	-
							Total Bids:	25		

*Preliminary, subject to change

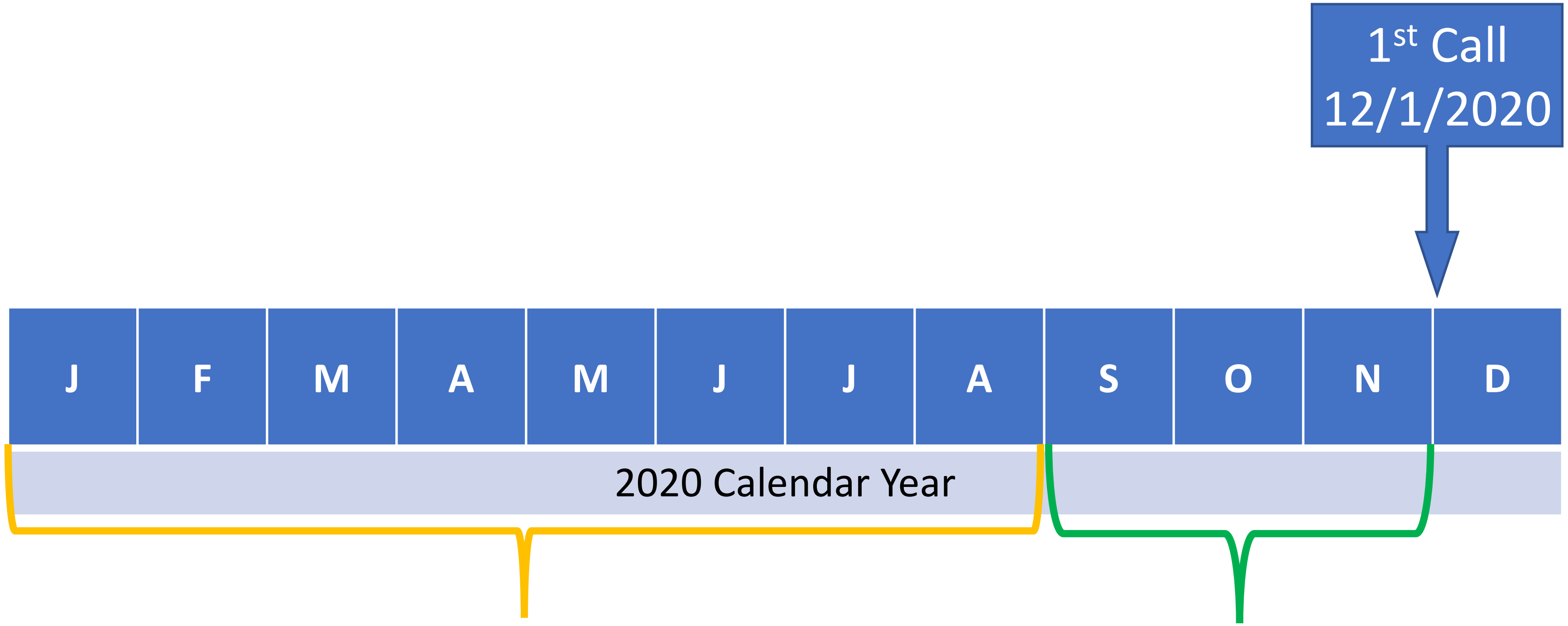
Example Pricing – Private Placement

	MMD 1/30	Est. Public Sale		Bank #1 Noncallable Scenario		Bank #1 Callable Scenario		Bank #2		Bank #3 Noncallable Scenario		Bank #3 Callable Scenario	
Maturity		Scale	Spread to MMD	Scale	Spread to MMD	Scale	Spread to MMD	Scale	Spread to MMD	Scale	Spread to MMD	Scale	Spread to MMD
2018		1.90%											
2019	1.49%	2.00%	0.51%										
2020	1.58%	2.20%	0.62%										
2021	1.66%	2.30%	0.64%										
2022	1.74%	2.45%	0.71%										
2023	1.85%	2.60%	0.75%										
2024	1.97%	2.80%	0.83%										
2025	2.09%	2.90%	0.81%										
2026	2.20%	3.05%	0.85%	2.64%	0.44%	2.77%	0.57%	3.04%	0.84%	3.05%	0.85%	3.35%	1.15%
All-In True Interest Cost		3.68%		3.18%		3.31%		3.63%		3.55%		3.85%	
Gross Debt Service Savings		$40,976		$69,738		$62,408		$44,448		$49,900		$31,977	
Present Value Debt Service Savings		$21,222		$47,644		$39,751		$20,568		$24,973		$7,328	
Present Value Debt Service Savings as %		1.74%		3.91%		3.26%		1.69%		2.05%		0.60%	
Costs of Issuance		$52,752		$27,300		$27,300		$30,300		$25,300		$25,300	
Optional Call Date		Noncallable		Noncallable		11/1/20 @ 100		Noncallable		Noncallable		11/1/20 @ 100	
CUSIPs		-		Not Required		Not Required		Not Required		Not Required		Not Required	
DTC Eligible		-		Not Required		Not Required		Not Required		Not Required		Not Required	
Award By		-		2/1/2018		2/1/2018		2/28/2018		2/7/2018		2/7/2018	
Closing By		-		2/12/2018		2/12/2018		Not Stated		3/2/2018		3/2/2018	
Special Requirements		-		Reporting Requirements within 270 days of fiscal year end: (i) audited financial statements, (ii) top ten taxpayers, and (iii) overlapping debt statement.		Reporting Requirements within 270 days of fiscal year end: (i) audited financial statements, (ii) top ten taxpayers, and (iii) overlapping debt statement.		None		Requires internal credit approval. Upon request, the District shall provide the audited financial statements within 270 days of fiscal year end.		Requires internal credit approval. Upon request, the District shall provide the audited financial statements within 270 days of fiscal year end.	
Special Fees		-		$2,000		$2,000		$5,000		None		None	
Counsel		-		ABC Counsel		ABC Counsel		Not Noted		Not Noted		Not Noted	

Common Bond Sale Type Situations

- There is no "best way" to sell your bonds. The choice is situation specific and subjective. Consider:
  - Commonly Sold Competitively:
    - Well rated issue, common security type, attractive structure, good market.
  - Commonly Sold Negotiated:
    - Lower rated issue, less common security, first time issuer, odd structure with need for flexibility, shaky market.
  - Commonly Sold Via Private Placement:
    - Uncommon terms, short final maturity, no other debt outstanding.

Advance vs. Current Refunding of Existing Bonds*



"Advance Refunding" occurs more than 3 months prior to the 1st Call Date

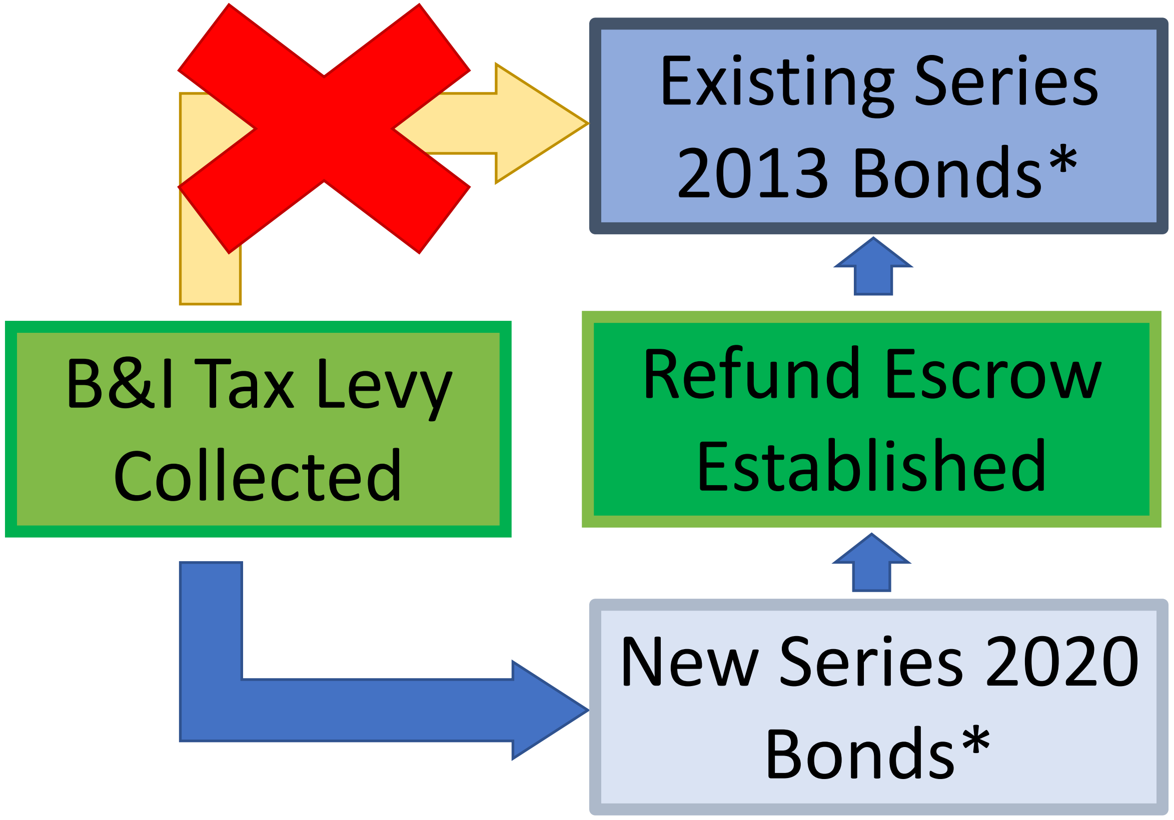
"Current Refunding" can occur within 3 months of the 1st Call Date, or after

* This is a hypothetical bond series for discussion purposes only

Advance Refunding vs. Current Refunding

- For advance refundings, under current tax law, the new bonds are taxable regardless of the tax status of the prior bonds.
- For current refundings, the taxability (or exemption) depends on the refunded bonds.
- Advance refundings typically create some level of negative arbitrage.
- Current refundings are more efficient, usually having little to no negative arbitrage.
- Your municipal advisor or underwriter can help weigh the options between current or advance refunding of your outstanding debt.

Mechanics of a Typical Advance Refunding



- ✓ 2013 Bonds are paid from Levy
- ✓ 2020 Refunding Bonds are issued
- ✓ B&I Levy now pays new 2020; not 2013
- ✓ New 2020 Bond creates escrow
- ✓ Escrow pays Debt Service on 2013 Bonds (old 2013 levies abated)

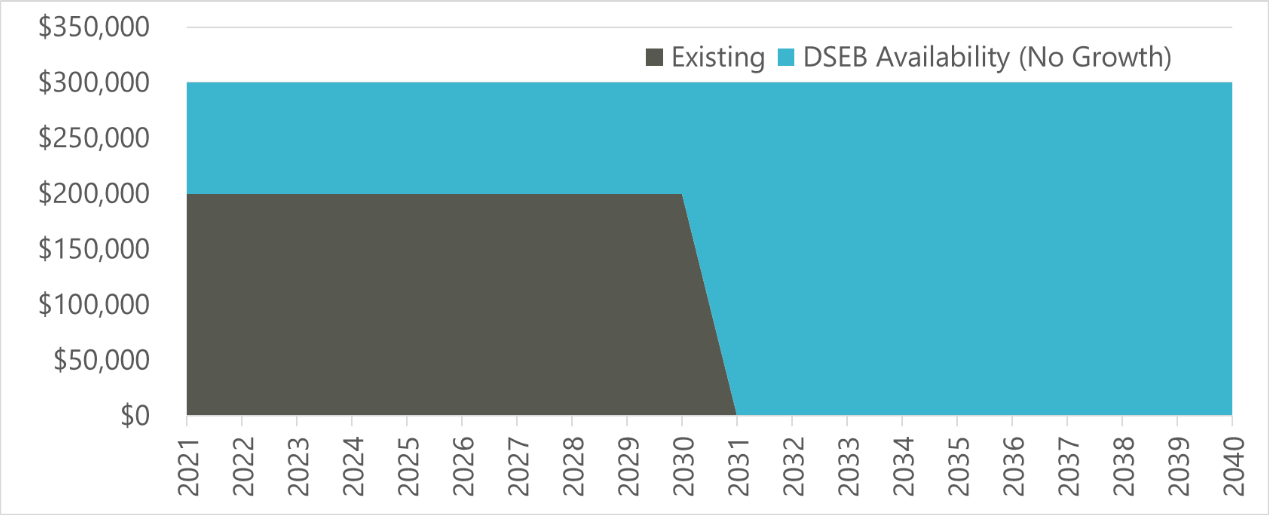
* These are hypothetical bond series for discussion purposes only

Flat DSEB vs Growth Assumption

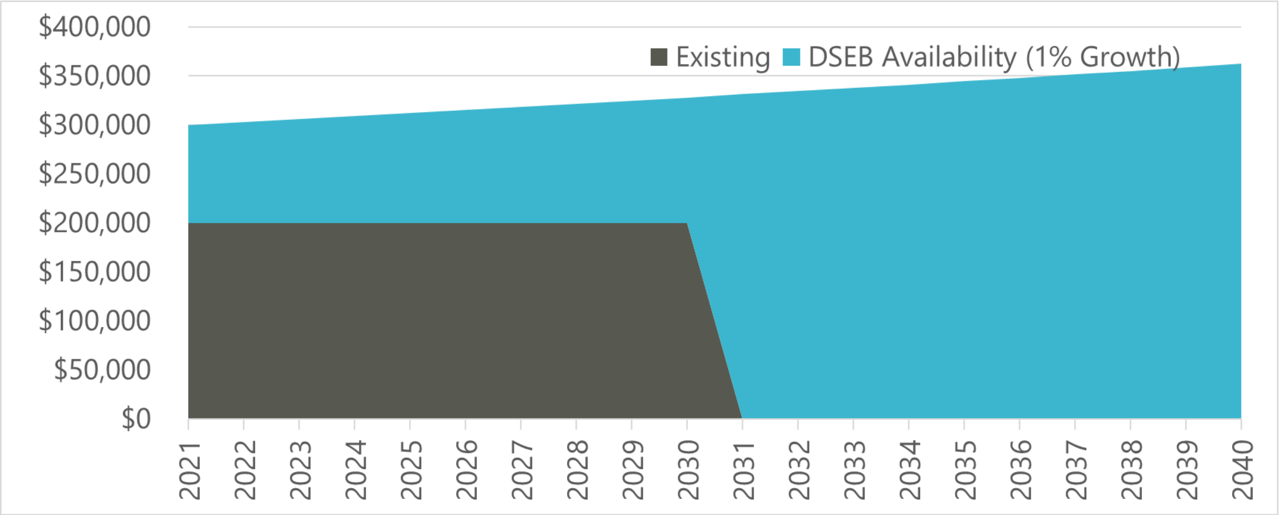
- Issuers in tax-capped counties have additional limitations, primarily the DSEB constraint.
- In 2009, the Debt Reform Act was amended to allow the DSEB to grow by the lesser of CPI or 5%.
- When issuing bonds, assumptions can be made regarding DSEB:
  - Flat DSEB – more conservative to assume no growth over time.
  - Ascending DSEB – more aggressive to assume growth factor over time (i.e. 1.0% annual growth).
- If DSEB was voted by referendum, growth may not be allowed.
- Assuming growth in the base can allow for more bonds to potentially be issued up front.
- However, the additional interest might inhibit future borrowing.

Comparison of Flat DSEB vs. Growth

Flat DSEB



1% DSEB Growth



Limited Bond Strategies (cont.)

Restructure vs. Capital Appreciation Bonds

- When selling limited bonds, existing limited bonds become a hurdle
- This can be handled one of 3 ways:

Do not Refinance <u>any existing bonds</u>

- Smallest amount of new money (sometimes nominal)
- Reduces overall borrowing size

Refinance necessary bonds to <u>maximize new money</u>

- Maximizes new money
- Also increases overall issue size
- Might refinance non-callable maturities
- Fairly common practice

Use Capital Appreciation Bonds <u>to eliminate need to refinance</u>

- Maximizes new money
- Reduces or eliminates refinancing
- Considerable increase to interest cost would impact new money
- Not common in IL

Questions and Answers

We thank you for your time!

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