



National Association of Health and Educational Facilities Finance Authorities

Tax-Exempt 501(c)3 Bonds 201

Legal Authority for Debt Issuance

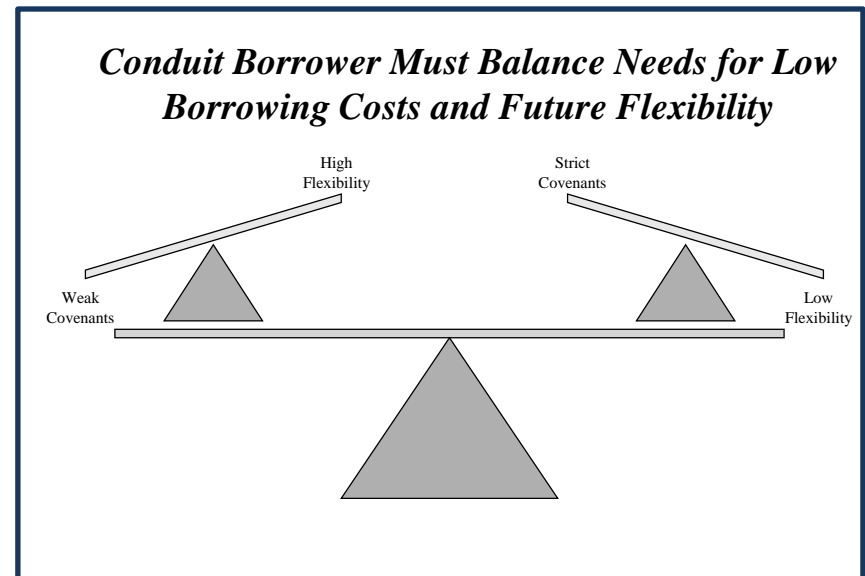
Development of the Offering Statement

- Various federal (primarily the Securities Acts of 1933 and 1934) and state (also known as “blue sky”) laws exist to protect the investing public.
- Basic objectives of securities laws:
 - require disclosure of material information about securities to allow investors to make informed investment decisions; and
 - prohibit misrepresentation or other fraudulent conduct in connection with the purchase or sale of securities.
- Full disclosure/due diligence -- the Official Statement is the document utilized to satisfy these requirements. The issuer has a “continuing obligation” to provide material information to the public under Rule 15c2-12.
- Bottom line: the Official Statement, both as of its date and the date of issuance of the debt instrument, must not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.
- Compliance with federal and state securities laws: registration with the SEC and state “blue sky” authorities is required unless an exemption exists.

Credit and Security Sources

Introduction

- Pledge of Monies for Debt Repayment
 - Enterprise Net Revenues/Fees
- Flow of Funds (Priority)
- Pledge of “Funds” for Debt Repayment
- Financial and Operating Covenants
- Liens on Property
- Credit Enhancement



Credit and Security Sources

Pledge of Monies for Debt Repayment

- Net Revenues
 - Pledge all project net revenues after payment of O&M expenses
 - Mortgage Pledge

Credit and Security Sources

Pledge of Funds for Debt Repayment

- Debt Service Reserve Fund
- Operations and Maintenance Reserve Fund
- Debt Service Fund
- Rate Stabilization Fund

Liens on Property

- First Mortgage
 - A specific asset
 - Broad asset categories and “after-acquired” property clause
- Security Interest

Credit Enhancement

- Bank Letter of Credit
- Federal, State or Local Government Guarantee
- Private Sector Guarantee

Credit and Security Sources

Summary of Potential Sources of Security for Debt

- Pledge of project or system revenues
- Pledge of special assessments imposed by issuer
- Lien on funds held by trustee (such as Debt Service Fund and Reserve Funds)
- Mortgage lien on project and security interest in equipment
- Third party guarantees (federal, state, local, private sector)
- Municipal bond insurance/surety bond policy
- Bank letter of credit

Evaluation and Rating of Credit Sources

What is a Credit Rating?

A rating is an opinion by a rating agency as to the willingness and ability of an issuer to repay principal and interest in full on a timely basis.

Investment Grade		
Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-

Non-Investment Grade		
Moody's	S&P	Fitch
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa	CCC	CCC
Ca	CC	CC
C	C	C
D	D	D

→ *Default*

Evaluation and Rating of Credit Sources

Economic/Demographic Factors

- Population Growth – 1970; 1980-1985, 1985-Present
- Industrial/Commercial/Residential Mix – 1980-Present as % of State and Nation
- Labor Force: Unemployment and Labor Mix
- Largest Customers
- Largest Employers
- Per Capita Retail Sales and Median Household EBI as % of State and Nation

System Factors

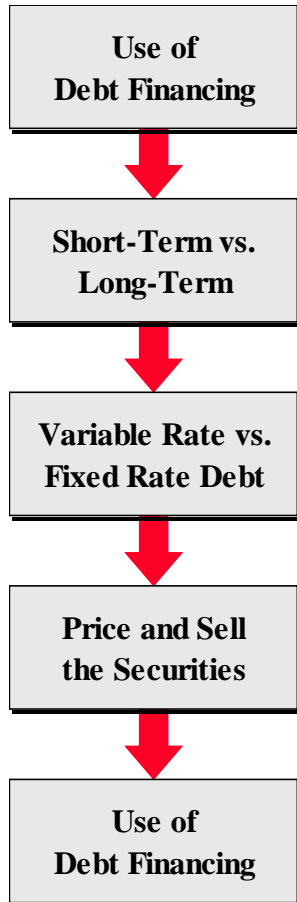
- Supply vs. Demand
- Governing Body Form
- Political Climate
- Budgeting Process
- Rate Setting Mechanism
- State Federal Regulation (rates, environmental requirements, etc.)
- Service Area — Monopoly or Competition

Financial Factors

- Customer Growth
- Largest Customers as % of Revenues
- Rate Increase and Decrease History
- Competitiveness: Pricing Compared to Others in Region
- Additional Assets or Revenue Pledged to Bonds
- Debt Service reserve funds
- Backup revenue pledges
- Covenants

Capitalization

The Conduit Borrower's Decision-Making Process



- Evaluate financing requirements and desired flexibility within borrowing documents.
- Tax status of Issuer.
- Decide upon short-term (cash flow needs) or long-term (assets with 30+ year lives) financing.
- Incorporate ability to issue derivative debt securities into basic structure.

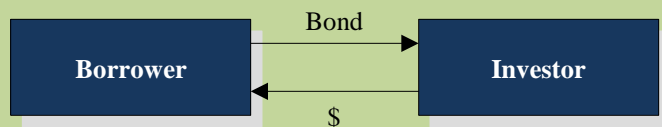
Types of Bonds

What is a Bond?

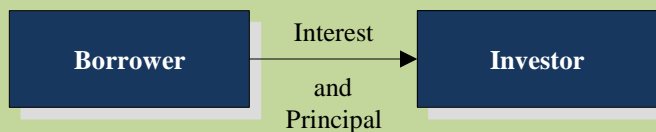
An agreement between an investor and a borrower in which:

- The investors loans the borrower funds
- Borrower agrees to repay the loan with interest and principal payments
- Essentially, the borrower is selling a cash flow stream at a discount

At time of Issuance



Over time



Types of Bonds

- Variable Rate
 - Variable Rate Demand Obligations (VRDO)
 - Commercial Paper
- Fixed Rate Bonds
 - Serial vs. Term
 - Current Interest vs. Capital Appreciation

Types of Bonds

Variable Rate Municipal Debt Products

History

- Commercial paper issuance by corporations exploded in early 1960's.
- Tax-exempt market emerged in 1982 to meet growth of money funds and to avoid high fixed interest rates.
- Over \$300 billion of tax-exempt variable rate demand obligations issued since 1982
- Indices: BMA, LIBOR, 30-day commercial paper.

Structural Features

- Interest rate adjusted periodically (remarketing agent)
- Investors may tender (“put”) bonds for repurchase at par
- Bonds require bank credit enhancement/liquidity (“put”) facility except banks
- Issuer may change interest rate period and/or convert to fixed rates

Types of Bonds

Variable Rate Municipal Debt Products

Purpose

- Provides flexibility and usually lower-cost financing vehicle for issuers (asset/liability matching)
- Gives money market investors an adjustable, market-based investment vehicle.

Type of Product	Remarketing Frequency	Bond Denominations	Interest Payment Frequency	Advance Notice of Bond Tender
Daily	Daily	\$100,000	Monthly	Morning of rate reset
Weekly	Weekly	\$100,000	Monthly	7 days prior to reset
Quarterly	Quarterly	\$100,000	Quarterly	13 days prior to reset
Semi-Annual	Semi-Annually	\$5,000	Semi-annually	15 days prior to reset
Annual	Annually	\$5,000	Semi-annually	15 days prior to reset
Commercial Paper	1 – 270 day periods	\$100,000	Day after end of CP period	Mandatory tender, no notice

Types of Bonds

Fixed Rate Municipal Debt Products

Market for Public Agency Debt

- Tax-exempt fixed rate bonds
- Taxable fixed rate bonds

Products

- Serial bonds (1-15 year maturity range)
- Term bonds (15-40 year maturity range)
- Debentures (taxable market: 10-30 year maturity range)
- Capital appreciation bonds (“CABs” or Zero Coupon Bonds)

Structural Features

- Fixed semi-annual interest payments or bond accretion
- Investors may buy/sell/trade bonds at market prices in secondary market
- Ratings on the bonds: Non-Rated to “AAA”
- Optional redemption for term bonds prior to final maturity (at par)
- Mandatory annual sinking fund redemption for term bonds prior to final maturity (at par)
- Extraordinary redemption prior to maturity for specified reasons (at par)

Purpose

- Provides long-term financing at fixed cost of capital
- Fixed rate investment vehicle for investors

Types of Bonds

Fixed Rate Municipal Debt Products

Type of Product	Interest Bond Denomination	Typical Payment Frequency	Maturity Range (Years)	Redemption Feature	Example	Purpose
Serial Bonds	\$5,000	Semi-Annually	1-15	<ul style="list-style-type: none"> Optional: 10 years Mandatory: on maturity Extraordinary: if permitted event occurs 	2005 – 2020: \$5,000 of maturing principal each year	Reduce cost of Debt with early maturities
Term Bonds	\$5,000	Semi-Annually	15-40	<ul style="list-style-type: none"> Optional: 10 years Mandatory: usually 2-10 years prior to maturity (par) Extraordinary: if permitted event occurs (par) 	\$5,000 with final maturity in 2023: mandatory of \$1,000 per year for 2019 – 2023	Stretch bond repayment period and have equal annual P&L
Debentures (“Mini-Bonds”)	\$1,000	Semi-Annually	10-30	<ul style="list-style-type: none"> Optional: usually 8-10 years Mandatory: none Extraordinary: if permitted event occurs (par) 		

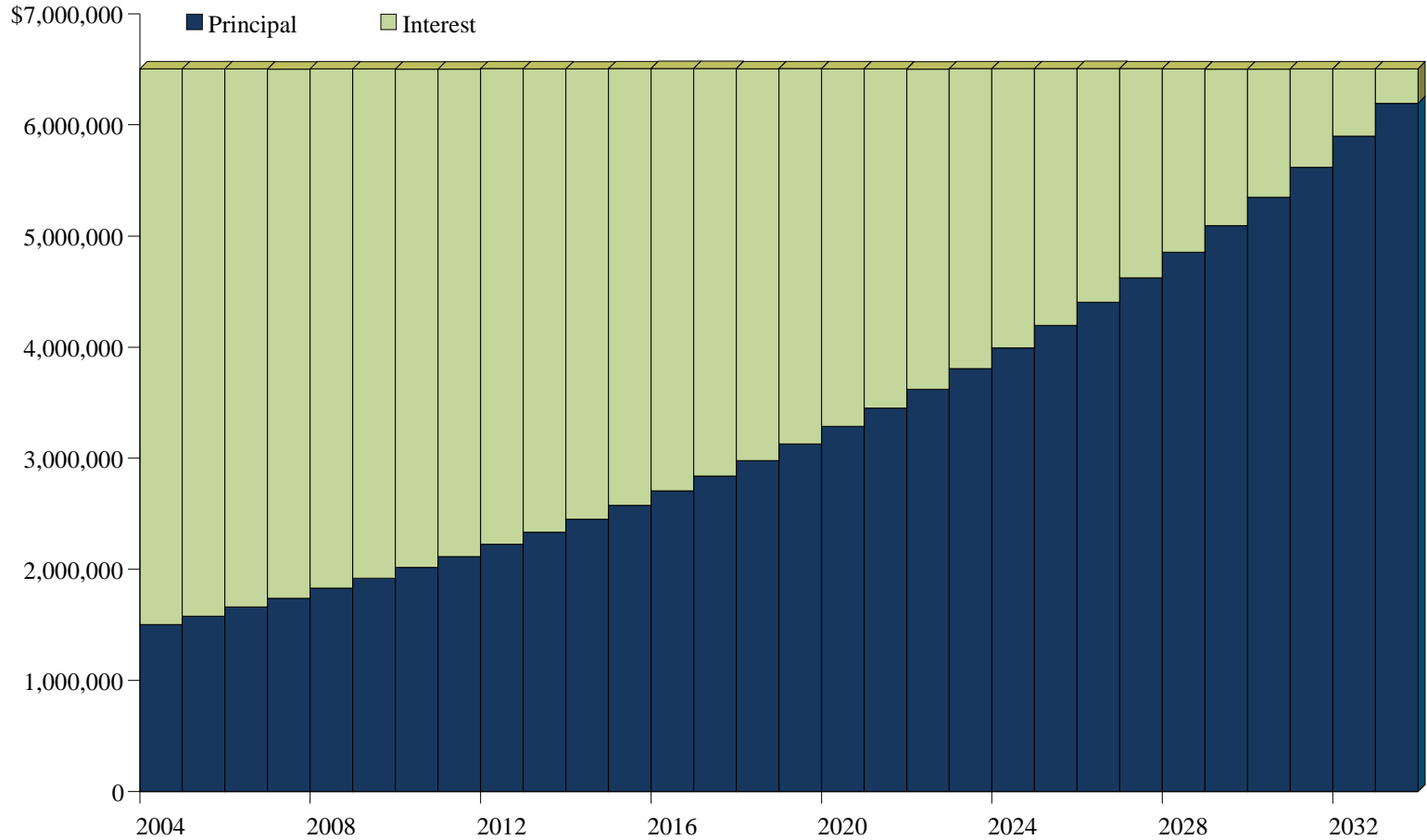
Types of Bonds

Fixed Rate Municipal Debt Products

Type of Product	Interest Bond Denomination	Typical Payment Frequency	Maturity Range (Years)	Redemption Feature	Example	Purpose
Capital Appreciation Bonds (CABs) / Premium CABs	\$5,000 (at maturity)	No payments prior to maturity	1-30	<ul style="list-style-type: none"> Optional: usually none Mandatory: only if term CABs Extraordinary: at accreted value if permitted event occurs 	<ul style="list-style-type: none"> \$5,000 paid on maturity (2013) Bond Yield = 6% Bond sold at price of \$2,768 in 2003 Semi-annual accretion to \$5,000 final payment in 2013 	
Convertible CABs	\$5,000 (upon date of conversion)	Semi-annually (after conversion)	15-30	<ul style="list-style-type: none"> Optional: after conversion Mandatory: same as CABs Extraordinary: at accreted value or par 	<ul style="list-style-type: none"> Same as CABs Upon accretion to \$5,000 bond "converts" to a fixed rate bond Conversion date = 2013 Maturity date = 2023 Semi-annual interest paid from 2013 – 2023 \$5,000 principle paid in 2023 	Temporarily reduce interest rate payments

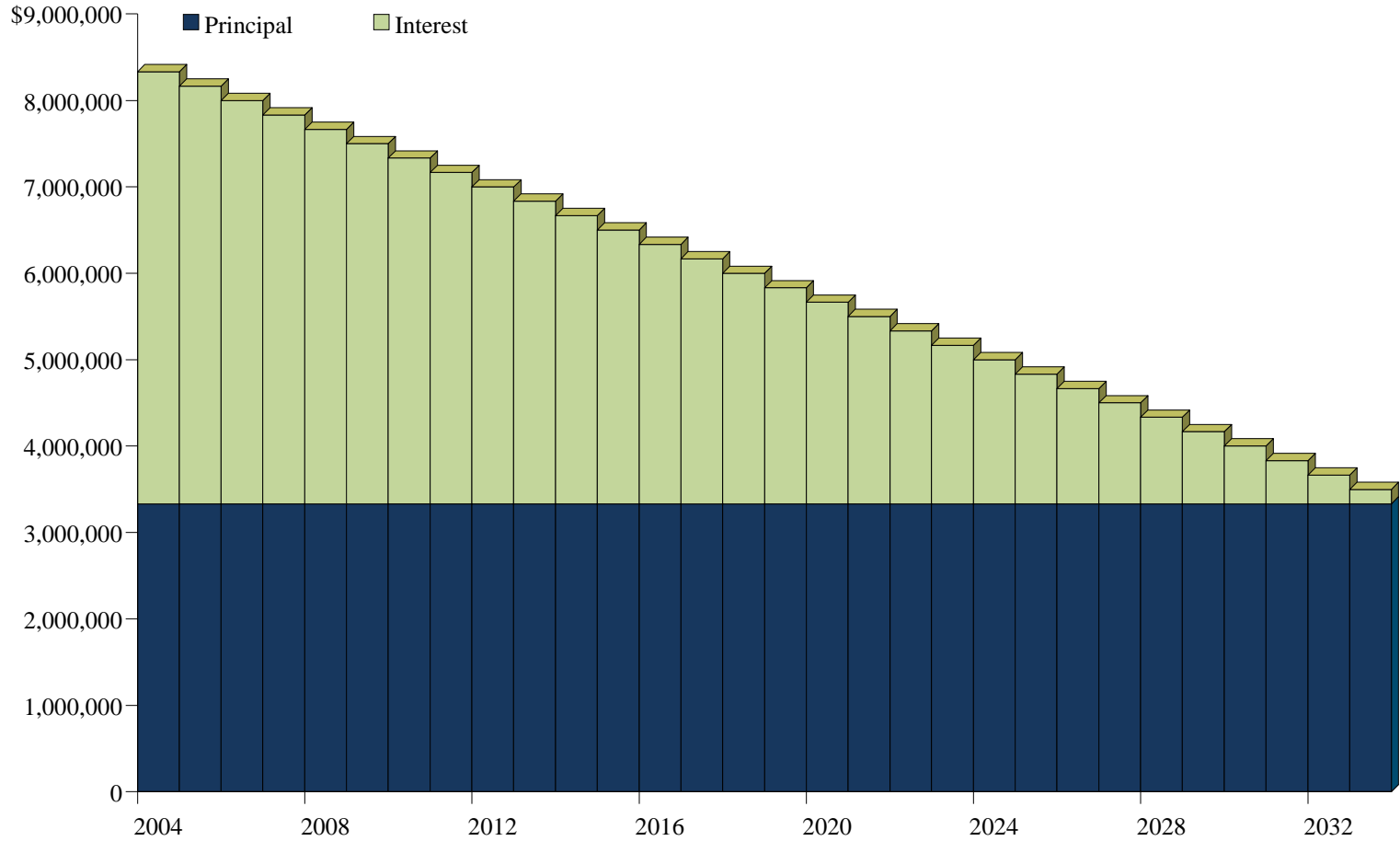
Debt Service Structures

- A bond issue structured with equal annual payments of principal and interest over time is called “level” debt service schedule



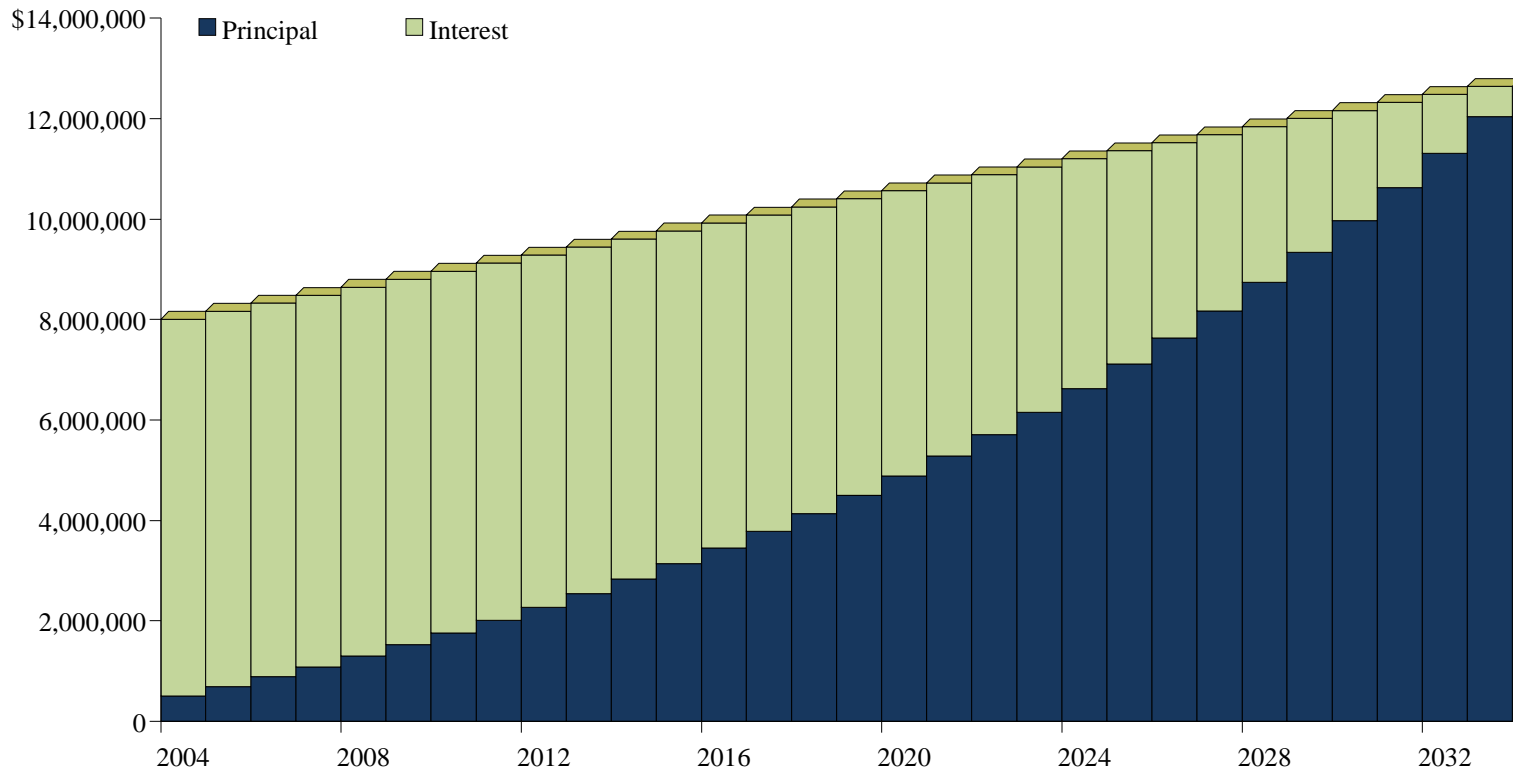
Debt Service Structures

- Level annual repayments of principal in each year produces a declining debt service structure



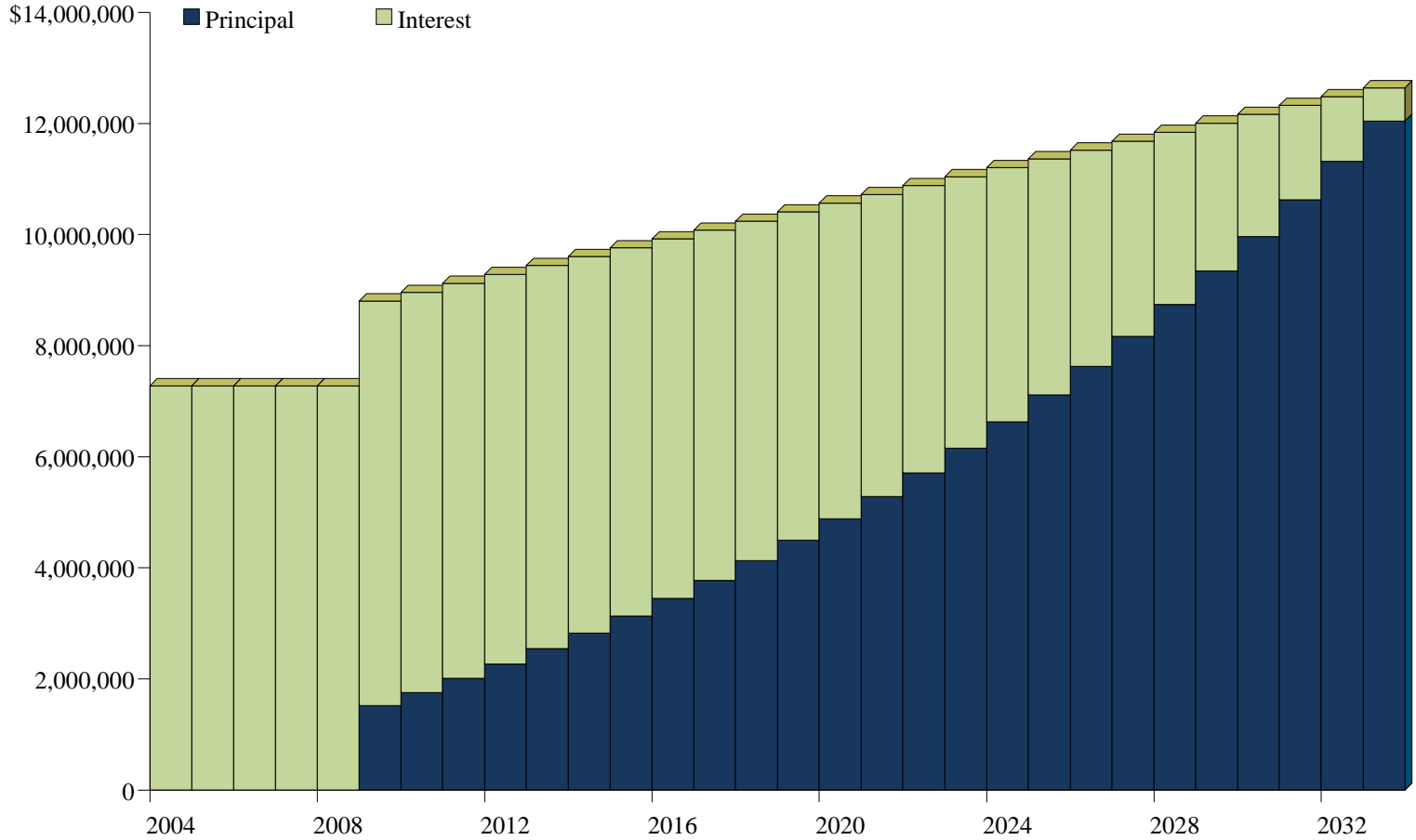
Debt Service Structures

- A bond issue may be structured to conform to an expected stream of cash flows so that there is equal surplus (net income) after debt service each year



Debt Service Structures

- Principal payment may be deferred for a period of time



Underwriting and Marketing Securities

How Securities are Priced

Factors Affecting a Pricing

- Market Psychology
- Economic Indicators
- Market Technicals
- Bond Structure
- The Yield Curve
- Supply
- Ratings
- Investor Participation
- Municipal Bond indices

Market Psychology

- Trends in the Market
 - Interest rates
 - Supply
 - Uncertainty
 - Tax law changes
 - Economic policy changes
- Buyer Philosophy
 - Long-term investors
 - Active traders
 - Retail buyers
 - Specialty/derivative buyers
- Domestic and International Events

Underwriting and Marketing Securities

How Securities are Priced

Economic Indicators

- Federal Reserve Board Policy
- Money Supply Targets
- Calendar of Data Releases
- Monthly Economic Statistics
 - Employment Report
 - Producer Price Index
 - Consumer Price Index
 - Others

Market Technicals

- Comparable Offerings
 - Primary market
 - Secondary market
- Market Supply
 - Weekly new issue calendar
 - New issue syndicate balances
 - Visible supply
 - Blue list
 - Institutional bid wanted lists
- Government and Corporate Bond Market Movement
- Federal and State Income Taxes
- Coupon Reinvestment Dates

Underwriting and Marketing Securities

How Securities are Priced

Bond Structure

- Bond Ratings
 - Underlying issue ratings
 - Credit enhancement
- Structuring Products
 - Serial bonds: premiums and discounts
 - Term bonds: premiums and discounts
 - Capital appreciation bonds
 - Derivative securities

The Pricing Call

- What is it?
 - Discussion of the market and setting the initial interest rates
- When is it?
 - Day prior to, or day of, the actual pricing
- Participants
 - Issuer
 - Financial advisor
 - Underwriter
 - Investment Bankers
- Content of the Call
 - General market summary
 - Public agency/municipal market summary
 - Comparable issue
 - Proposed scale
 - Financial advisor and client approval

Underwriting and Marketing Securities

How Securities are Priced

The Pricing Wire

- The Dalcomp/Dalnet System (Pricing Wire)
- Takedown
 - Purpose
 - Calculation of average takedown
- Call/Redemption Features
 - Importance to investors
 - Reading the wire
 - Date of call
 - DTP
- MSRB Rule G-11 (Syndicate Rules)
- Award Date
- Delivery Date
- Book-Entry
- Printer
- Orders of Managers

The Order Period

- Priority of Orders
 - Net designated
 - Retail
 - Group Net
 - Member orders
- Order Status Review
 - Orders by maturity
 - Orders by type
- Quality of “The Book”
 - “Going away” business
 - Minimum orders
 - Member orders
- Repricing/Restructuring

Underwriting and Marketing Securities

How Securities are Priced

Repricing/Restructuring

- Order Flow and Market Movement
- Pricing Update Call
 - Review market with issuer and financial advisor
 - Suggest alternative prices and structures, if any
 - Commit to underwriting of issue
- Bond Allotment Process
 - Order priority and amounts
 - Retention for each manager
 - Participation of each manager
- Final Forms of Communication
 - Allotments letter
 - Balances wire
 - Final wire
 - CUSIP wire
 - Spread detail wire
 - Free to trade wire

Distribution of Debt Securities

- Market Segmentation: Types of Investors (Maturity Range):
 - Bank trust departments (1-10 years)
 - Investment advisors (5-10 years)
 - Intermediate bond funds (5-15 years)
 - Casualty companies and corporations (10-20 years)
 - Long-term bond funds (20-30 years)
 - Retail (1-15 years)



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<http://naheffa.com/>