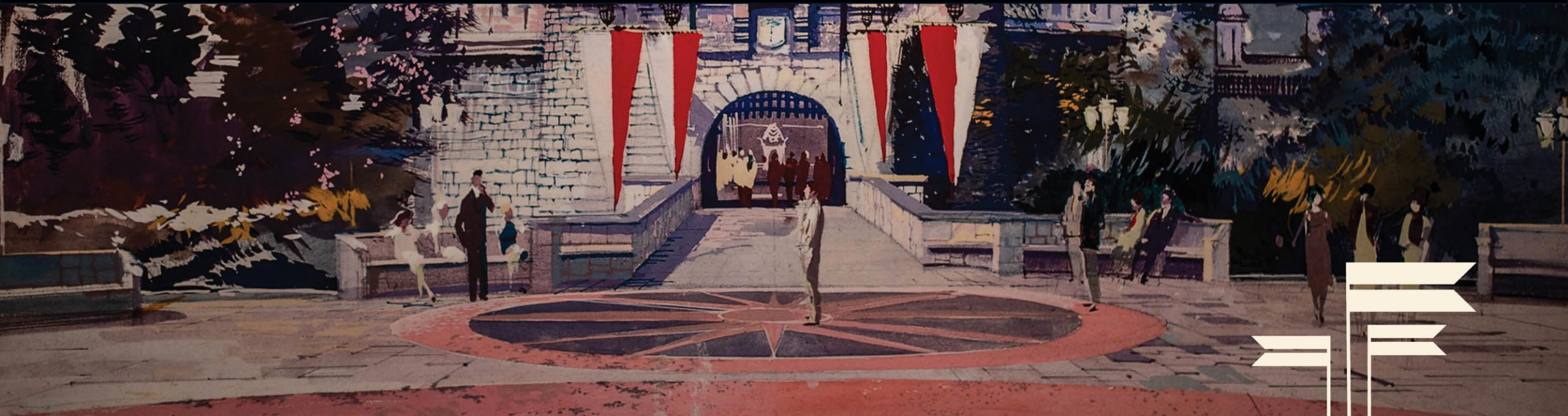




YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
JANUARY 28-31, 2020
DISNEYLAND CA



Purposeful Positioning for Positive Debt Issuance





SPEAKER
PRESENTATION

YESTERDAY, TOMORROW AND FINANCE
2020 CSMFO ANNUAL CONFERENCE
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DISNEYLAND CA

Jeffrey Meyer, Retired – CCWD

Cameron Weist, The Weist Law Firm

Todd Smith, Hilltop Securities



- ❑ District's objectives and responsibilities when issuing debt
- ❑ From the bond counsel's perspective
- ❑ An underwriter's view
- ❑ Examples of debt issuance savings

District's Objectives

- ❑ Secure the lowest cost for ratepayers
 - Cost of issuance, debt service costs
- ❑ Simple, cost effective process
- ❑ Greatest flexibility
 - Ability to issue future debt
- ❑ Minimize ongoing reporting requirements
- ❑ Reasonable to board and ratepayers

Lay the Groundwork

- ❑ Review and update ALL financial policies
 - Investment, reserve, debt management and continuing disclosure
 - Reporting, budget, revenue, rate setting, audit, CIP
- ❑ Can be a time consuming and tedious process
- ❑ Opportunity to educate finance committee/board
- ❑ Policies should be reviewed annually/biannually
- ❑ Adhere to your policies!

Financial Documents

- ❑ Audited financial statements and/or CAFR
- ❑ Five-year O&M financial forecast
- ❑ Five-year CIP plan
- ❑ Debt capacity/coverage plan
- ❑ Water and wastewater rate plans

CIP Funding

- ❑ Key component in review of district's sustainability
- ❑ Use five-year CIP as basis for funding requirements
- ❑ Identify existing funding sources (rate revenue)
- ❑ Explore grant funding
 - Terms and conditions
 - Ongoing reporting and required funding of depreciation
- ❑ Establish capital replacement fund

Rates

- ❑ Rate studies assess ability to fund operations
- ❑ Regular review of rates signals proactive approach to managing district's assets
- ❑ Consider a capital replacement component in rates
- ❑ Easier to stay ahead than play catch-up!
- ❑ Prop 218 can be your friend

Reserves

- ❑ Operating reserves
- ❑ Contingency/emergency reserves
- ❑ Rate stabilization reserve
- ❑ Asset recovery reserve (depreciation)
- ❑ Debt service reserve

It's All About the Team

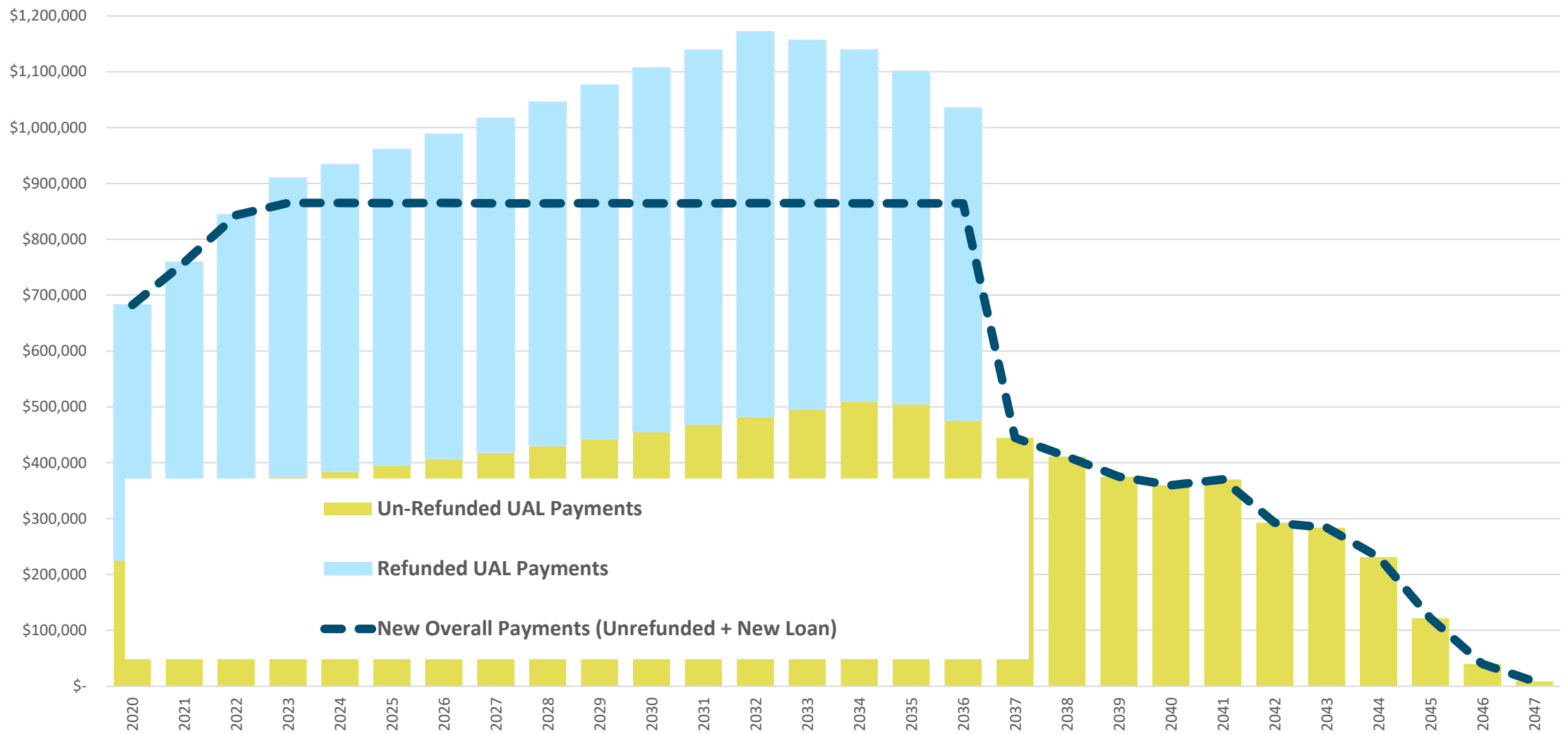
- ❑ Internal team:
 - Finance, general manager, and district engineer
 - Board and finance committee
- ❑ Funding team:
 - Municipal advisor
 - Bond counsel
 - Underwriter
- ❑ Communication is critical

Work with Your Board

- ❑ Involve board and committees early on
- ❑ Keep it simple - it can get complicated
- ❑ Provide key information and talking points to help board explain it to public and ratepayers
- ❑ Show how debt can be a valuable tool

How We Saved on CalPERS

- ❑ Always on lookout for refinancing opportunities to reduce debt costs
- ❑ CalPERS valuations include a 20 year projection of UAL costs as part of Fresh Start program description
- ❑ Fresh Start program offers shorter payoff periods, but does not offer a lower discount rate
- ❑ Worked with financing team to develop innovative strategy to refinance portion of UAL debt



Refinancing Structure

- ❑ Executed a privately placed loan with bank
- ❑ Loan proceeds used to payoff 55% of UAL
- ❑ Interest rate (inclusive of financing costs) – **3.65% taxable** for 17 year loan
- ❑ Loan secured by net revenues of the water and sewer funds

Benefits

- ❑ Leveled out UAL payments to provide budget predictability
- ❑ Cash flow savings - \$2.7 million over 17 year loan
- ❑ Increased UAL funding ratio from 74% to 90%
- ❑ **Increased debt capacity**

How We Did It

- ❑ Worked with a great financing team that was able to think outside the box
- ❑ Challenge was to overcome issues surrounding recent city bankruptcies and POB's
- ❑ Team was committed and supportive of process, which made it a much easier sell to the lenders
- ❑ We were on the leading edge

Key Points

- ❑ Lay the ground work for issuing debt
 - Policies, financial statements
 - Five-year O&M, CIP, and debt coverage forecasts
 - Rate reviews and increases (Prop 218)
- ❑ Reserves!!
- ❑ Assemble a good support team
- ❑ Be prepared to tell your story

End of Presentation

From Bond Counsel's Perspective

Cameron Weist, Attorney at Law

The Weist Law Firm

Los Gatos, CA



Six Keys to Success

- ❑ Policy implementation and updates
- ❑ Five-year Capital Improvement Plan updated annually
- ❑ Five-year Fiscal Sustainability Plan
- ❑ Five-year rate renewal plan
- ❑ Five-year debt service coverage plan
- ❑ Proactive pension management plan



Five-Year CIP Plan

- ❑ Foundation to any rate study
- ❑ Underscores strong management
- ❑ Proactive management of city's assets
- ❑ Provides plan to address aging infrastructure
- ❑ A rolling five-year CIP is even better



Five-Year Fiscal Sustainability Plan

- ❑ Develop and maintain a five-year Fiscal Sustainability Plan addressing the health of the General Fund
 - Invites Council to participate/provide early feedback/direction
 - Leads to better budget strategies and recommendations for Council consideration
 - Provides a basis (baseline) for measuring performance (past and future)
 - Congruent with CIP and Pension Management Plan
 - A ten-year plan is even better
- ❑ Very helpful to transactional credit/rating agencies



Five-Year Rate Renewal Plan

- ❑ Develop and maintain a five-year rate renewal plan
 - Rate covenant compliance (rates and ABT)
 - Basis for measuring performance (past and future)
 - Congruent with CIP and DSC plan
 - Third-party rate consultant efficiency
 - A rolling five-year plan is better
- ❑ Fundamental to transactional credit



Five-Year Debt Service Coverage

- ❑ Develop and maintain a five-year projection
- ❑ A rolling five-year projection is better
- ❑ Assesses ability of district's revenues to cover O&M and finance current and future debt
- ❑ Shows strong planning management
- ❑ Important to rating agencies



Pension Management Plan

- ❑ Develop a Pension Management Plan
- ❑ Learn to read the tea leaves
 - Financial statements
 - CalPERS Annual Valuation report
 - GASB 75 (other postemployment benefits/OPEB) report
- ❑ Understand short, medium and long-term implications
- ❑ Increasing concern of rating agencies and investors



Impediments to Successful Funding

- ❑ Rates don't keep up with funding requirements
- ❑ Prop 218 vulnerability
- ❑ Bond covenants from prior issues place undue restrictions on future issues
- ❑ Inconsistent and/or incomplete financial statements



Impediments to Successful Funding

- ❑ City not addressing pension challenges and/or regulatory requirements
- ❑ CIP plan doesn't adequately address infrastructure and/or funding issues
- ❑ Lack of long-term financial planning



End of Presentation



An Underwriter's View

Todd Smith, SVP, Managing Director

Hilltop Securities, Inc.

Cardiff, CA



Outline

- ❑ What does an underwriter do?
- ❑ What type of debt best suits your needs?
- ❑ Ratings, what are they good for? ... everything
- ❑ Credit enhancement

What Does an Underwriter Do?

- ❑ Purchase bonds from issuer to be re-sold to public
 - Provides issuer access to capital markets
 - Markets and sells bonds to investors (sets interest rates)
 - Provides date and term structure recommendations
 - Cash flow scenarios
 - Market timing recommendations
 - Credit analysis and ratings
 - Credit enhancement procurement

What Does an Underwriter Do?

- ❑ Structure bonds to meet issuer and buyer demands
 - Markets to the appropriate investor base
 - From pre-funding to post issuance market support
 - Market timing recommendations
- ❑ Compensated with an underwriting discount equal to percent (%) of par

Debt Options

- ❑ What are you funding?
 - Equipment or capital improvements
 - Refunding or new money
 - Tax exempt or taxable
 - Borrowing amount and term (useful life)
 - Installment sale/revenue bond/lease/special assessment or special tax

Local or Federal Programs

❑ SRF, USDA, IBANK

- Often times the lowest cost solution
- But often the most difficult process pre-funding and post-funding
- Subject to funding limitations
- Also subject to continued local or state allocations for funding (causing funding delays or uncertainty)
- Up to 40 year final maturity

Private Placements

- ❑ Bank loans with financial institutions
 - Competitive interest rates with ability to lock rates
 - Usually lower fixed costs of issuance versus public sale
 - Basic to complex structuring flexibility
 - Often the easiest and quickest process to fund
 - Final maturity limitations common (banks 10-25 years)
 - Bank lending preferences change often
 - Borrowing amounts range from \$150,000 to +\$500 million
 - Not subject to SEC 15c-212 “Continuing Disclosure Requirements

Public Sale

- ❑ Public offering/underwritings
 - Municipal bond market access (largest investor market) = public sale execution
 - Often the lowest net cost of capital
 - Securities regulators increased scrutiny over muni bond issuances and issuer disclosure practices
 - Often involves rating agencies and credit enhancement (bond insurance)
 - Borrowing amounts range from \$3.0 million up to +\$1 billion
 - Subject to SEC 15c-212 “Continuing Disclosure Requirements”

Ratings, They are Everything

- ❑ Ratings drive the cost of capital – always strive to maximize your rating
- ❑ A credit rating is an opinion, expressed in alphanumeric symbols, on the likelihood of default of a specific issuer with respect to a specific financial obligation
- ❑ Three major rating agencies (S&P, Moody's & Fitch)
- ❑ Are multiple ratings necessary?
 - Split rating risk
 - Cost vs. benefit

Ratings, They are Everything

□ Rating Models

- Purpose is to equate water or wastewater systems across the country
- Provides more consistent ratings for investors across a credit sector
- Rating models provide an indication of where the rating category will be to $\pm 80\%$ accuracy within 1 notch

Ratings, They are Everything

- ❑ What makes the difference between an “A-” rating and an “A”?
 - History of good financial management
 - Budget to actual results and reporting frequency
 - Reserve policy
 - Debt Management policy
 - 5-10 year CIP (updated annually)
 - Continuing Disclosure policy
 - Pension Funding policy
- ❑ Ratings on bond issues are typically limited at issuer’s ICR

Debt Service Coverage Ratios

□ Depend in part on:

- Customer base
- Reserve levels
- Overall credit analysis
- 1.20 to 1.25x is most common rate covenant and Additional Bonds Test (“ABT”)
- Lower rate covenants and ABT possible rating impact

Other Outstanding Debt

- ❑ Senior, parity or subordinate
- ❑ What are the covenants
 - Rate Covenant
 - Additional Bonds Test (ABT)
 - Other limiting covenants

Credit Enhancements

- ❑ Can lower borrowing costs
- ❑ Bond insurance
- ❑ Debt service reserve surety bonds in lieu of cash DSR
- ❑ Cost benefit analysis

Four Takeaways

- ❑ Pick the type of debt that best meets your needs
- ❑ Financial statements must confirm your ability to fund both current and future debt service
- ❑ Ratings, ratings and ratings – what makes a difference between a good rating and a fair rating
- ❑ Perform a credit analysis early in the process

End of Presentation

Future Session Topics



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