The New Era of Tax-Exempt Financing

Information Prepared For
ICCCFO 2012
Spring Conference
April 25, 2012

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Tackling your five most pressing questions?
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1. Who are the CAVE people?
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2. What’s G23 and why should you care?
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5. Is there any GAIN with all the pain?
1. Who are the CAVE people?
We’re in a New Era…

“The Great Recession” or Global Financial Crisis

Primary Cause

• Housing bubble burst

Net Result

• Collapse of large financial institutions
• Bailouts of banks by national governments
• Decline in global stock markets
• Significant decline in economic activity

Root Causes

• Incorrect pricing of risk
• Insufficient regulatory framework

Political Environment increasingly dictates the debt issuance decisions of state and local governments.
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The Emergence of the CAVE People
CAVE People

Citizens Against Virtually Everything
(especially debt)
And what fuels CAVE people concerns?

- Rapidly growing federal debt
- Debt loads of many European nations
- Unfunded pension liabilities
- Other post-employment benefits (OPEB)
- Persistent high unemployment
- Lingering housing slump
- Rising commodity prices, notably gasoline
And what fuels CAVE people concerns?

- Rapidly growing federal debt
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- Rising commodity prices, notably gasoline
- FOX News
Why should we care about the Anti-Debt Movement?
Why should we care about the Anti-Debt Movement?

• It’s called the need for “voter approval”...
  - Bond ballot measures
  - Board elections
  - Trust of institution
2. What’s G-23 and why should you care?
Municipal Market Players

- Issuers
  - Administrators
  - Elected Officials
- Federal Government
- Bond Counsel
- Issuer’s Counsel
- Underwriter’s Counsel
- Public Finance Investment Bankers
- Financial Advisors
  - Rating Agencies/Bond Insurer
  - Bond Trustee/Registrar/Paying Agent
- Investors
  - Banks
  - Insurance Companies
  - Municipal Funds
  - Retail (Trust Department Advisors and Money Managers)

What’s the difference?
Financial Advisor vs. Public Finance Investment Banker

**Financial Advisor**

- A fiduciary relationship to the issuer.
- Makes recommendations on all aspects of the financing, including rates, terms and conditions of the proposed obligations.
- Assists with preparation for, and participates in, meetings and conference calls with investors, rating agencies and credit enhancement providers.
- Manages the entire competitive sale process.

**Public Finance Investment Banker (Underwriter)**

- Makes recommendations on all aspects of the financing, including rates, terms and conditions of the proposed obligations.
- Assists with preparation for, and participates in, meetings and conference calls with investors, rating agencies and credit enhancement providers.
- Manages the entire sale (negotiated) and assures that the bonds will be efficiently and fairly priced.
- Actively participates in buying and selling of municipal bonds in both the primary and secondary market.
- Underwrites the bonds
**Purpose**
The purpose and intent of this rule is to establish ethical standards and disclosure requirements for brokers, dealers and municipal securities dealers who act as financial advisors to issuers with respect to the issuance of municipal securities.

**Relationship**
A financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue.

A financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter and not as a financial advisor, a broker, dealer or municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities.

**Agreement**
An agreement shall be put in writing prior to, upon or promptly after the inception of the relationship.

**Underwriting Activities**
If you are in a financial advisory relationship on an issue, you are prohibited from underwriting the issue.

**Bottom Line:**
Investment bankers and financial advisors must define their role in working with you.
3. Are interest rates ever going up?
Today’s Capital Markets

- **Municipal supply has averaged $6.2 billion per week in 2012** compared to an average of approximately $9.0 billion over past five years.
- **Supply in recent weeks has been elevated** ($7.1 billion week of 4/2 and $8.6 billion week of 4/9) due to numerous current and advance refundings in the market.
- **Long-term interest rates continue to remain favorable for issuers** of tax-exempt debt – continued domestic and international economic concerns have offset the recent uptick in new issuance volume.

<table>
<thead>
<tr>
<th>Maturity</th>
<th>“AAA”</th>
<th>“AA”</th>
<th>“A”</th>
<th>“BBB”</th>
<th>Non-Rated</th>
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<td>5-year</td>
<td>0.83%</td>
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<td>10-year</td>
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<td>3.55</td>
<td>4.04</td>
<td>4.88</td>
<td>6.40</td>
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Source: Municipal Market Data (MMD)
George K. Baum & Company market view for non-rated
Historical ‘AAA’ MMD

The graph below shows “AAA” MMD (Municipal Market Data), the industry benchmark, for the last three years as of April 13, 2012. Ten-year MMD is currently 118 basis points lower than it was last year at this time.
Tax-Exempt Bond Issuance

- Tax-exempt bond issuance in 2011 was down over 40% from 2010 and is the lowest since 2000
- Weekly issuance in Q4 2011 averaged approximately $6.7 billion versus $9.2 billion in 2010
- Weekly issuance in 2012 has averaged $6.2 billion
Municipal Bond Fund Capital Flow

- Municipal bonds funds have seen net inflows of the approximately $8.06 billion since January 1, 2012.

- With few defaults in 2011, outflows from municipal bond funds--the primary purchaser of fixed rate bonds--have stabilized and demand for tax-exempt bonds has slowly returned to the market.

- Since September 1, 2011, municipal bond funds have experienced inflows in 29 of 32 weeks.
4. Why do the rating agencies have insomnia?
- Increased focus from analysts regarding unfunded pension liabilities and Other Post Employment Benefits (OPEB)
- Impact of Federal budget cuts on state and local governments
- Persistent strain on property taxes
- Decreased state aid
- Rising healthcare benefits
- Rating downgrades expected to continue to outpace rating upgrades
- Lag in impact on public entities
- Housing market challenges not going away quickly
- No more one-time fixes
• Increased focus from analysts regarding unfunded pension liabilities and Other Post Employment Benefits (OPEB)

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Meredith, is it true? Hundreds of billions?
“50 to 100 sizeable defaults... amounting to hundreds of billions of dollars...within 12 months”

Meredith Whitney
December 19, 2010
Prediction on 60 Minutes
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Markets listened.
Reality:

Meredith was off by a couple hundred billion...

Depending on the source, defaults in 2011 were between $2.1 billion to $6.0 billion in a $3.7 trillion market.
Recent Developments:

S&P has proposed changes to its rating methodology for general obligation issues of local governments (includes community colleges).

**Intent**

- Transparency into S&P’s Rating Process
- Enhance Ratings Comparability
- Formulate the Forward-looking Rating Component

**Expected Ratings Impact**

- 65% Remain the Same
- 32% Ratings Increase
- 3% Ratings Decrease
Illinois Community College Ratings

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<th>Moody’s</th>
<th>Aaa</th>
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5. Is there any GAIN with all the pain?
There are big opportunities for many issuers…

In August, 2011 three potential refunding candidates were identified in the Village of Oak Lawn. Unfortunately, timing issues kept delaying the sale date. By the time the financing was ready to proceed, it was near the end of the year. In order to take advantage of the rate benefit of bank-qualified bonds, the Board elected to proceed with two of the issues in December, with the third issue to be sold in January.

- The Village sold $7,975,000 in general obligation refunding bonds in mid-December with a maturity schedule from December 1, 2013 - 2026.
- The Village realized 14.86% or $1,180,562 in present value savings.
- The Village’s third transaction initially involved getting the bond holders to tender their bonds prior to the call date. Then, in mid-January, the Village sold $4,750,000 in general obligation refunding bonds.
- This transaction realized the Village 24.77% or $1,119,607 in present value savings.

Things to consider:
- Working with professionals with direct market access.
- Working closely with the Finance Team to evaluate all possible options.
- Having prior approval by the governing body allowing management to execute the transaction with short notice.
Financing Strategies for 2012

Evaluate existing debt portfolio
- Seek advice on market conditions and impact to portfolio
- Review revenues to determine affordability for existing and new debt
- Consistent review for capital planning needs

Take advantage of historically low interest rates
- Where feasible, refund existing loans/bonds to take savings
- Structure based on needs of the district

Consider policy framework for financial management and credit strength
- Review and revise existing debt management policies
Bonus Question:

Are the CAVE people the death of us all?
Not if you have a banker who know how to respect the taxpayer…
Appendix A

A Case Study of Credit and Debt Capacity Analysis

Lakeland Community College
Lake County, Ohio