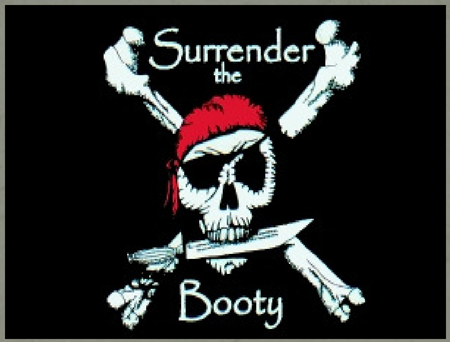
Adventures on the High Seas of Public Finance: A Rollicking Journey to the Edge of Debt Capacity

Presented by Ray E. Jones
and Brent Robertson
October 18, 2015

INTRODUCTION

- Ray Jones
- Swashbuckling Bond Attorney
- Columbia, SC
- Father of Twins



- Brent Robertson
- Chivalrous Financial Buccaneer (i.e., FA, PA, UW)
- Columbia, SC
- Father of Twins

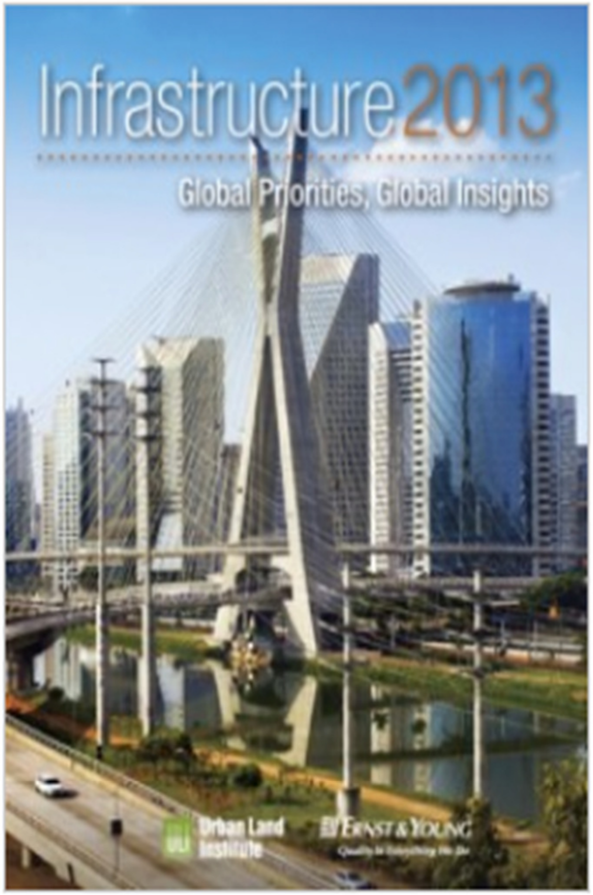
OVERVIEW

I. Find the Treasure! The State of Local Government Finance
II. What's the Best Option for Financing Infrastructure?
III. The Booty
IV. Bond Market Treasure Map


CHEROKEE
SPARTAN-
BURG
PICKENS
GREENVILLE
OCONEE
ANDERSON
MARLBORO
DARLING-
TON
DILLON
MARION
HORRY
GEORGE-
TOWN
BERKELEY
CHARLESTON
HAMPTON
BEAUFORT

State and Local Governments Lead the Way In U.S. Infrastructure Delivery

Posted on **May 16, 2013** by **Robert Krueger**



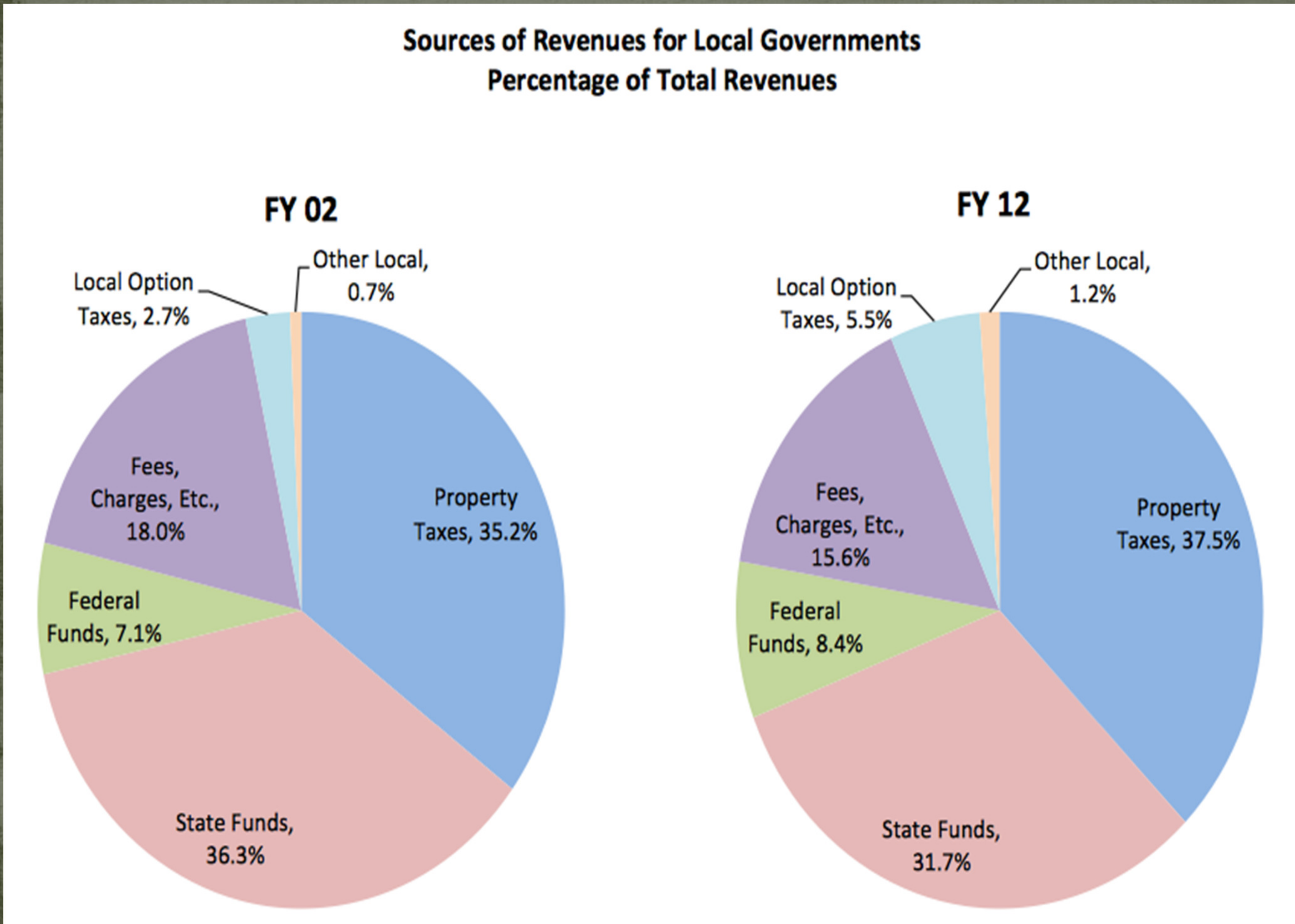
New global report from the Urban Land Institute and Ernst & Young highlights the critical role of local and state governments in meeting US infrastructure requirements

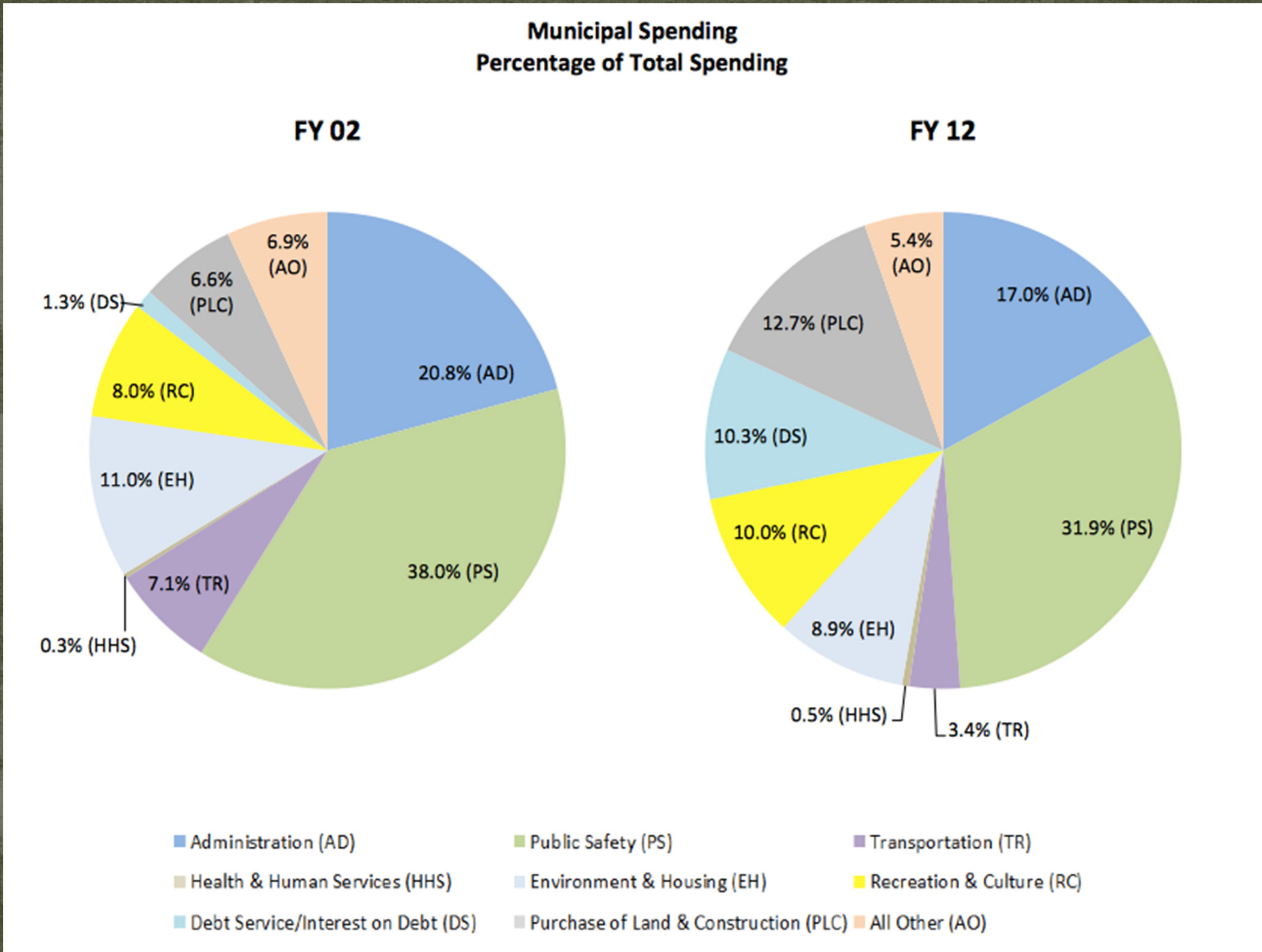
For more information, contact: Trish Riggs (ULI), 202-624-7086; priggs@uli.org

SAN DIEGO (May 16, 2013) State and local governments in the U.S. are leading the way in delivering infrastructure projects against a backdrop of budget constraints and an ongoing lack of consensus about future investments by the federal government, according to *Infrastructure 2013: Global Priorities, Global Insights*, a joint report from the Urban Land Institute (ULI) and Ernst & Young.

The report points out that state and local governments account for approximately 75 percent of all infrastructure spending, with the remainder supplied by the federal government. However despite this expenditure, infrastructure spending as a percentage of GDP has shrunk to only 2.4 percent from its peak of more than 3 percent during the 1960s.

With uncertain federal support, state and local governments are advocating local tax rises and higher user fees and tolls to pay for key infrastructure investments. Governors and mayors, notes the report, are promoting these initiatives to their constituents by emphasizing the benefits of infrastructure projects as employment opportunities and as an economic stimulus.


Sources of Revenues for Local Governments
Percentage of Total Revenues
FY 02
Other Local, 0.7%
Local Option Taxes, 2.7%
Fees, Charges, Etc., 18.0%
Federal Funds, 7.1%
State Funds, 36.3%
Property Taxes, 35.2%
FY 12
Other Local, 1.2%
Local Option Taxes, 5.5%
Fees, Charges, Etc., 15.6%
Federal Funds, 8.4%
State Funds, 31.7%
Property Taxes, 37.5%


Municipal Spending
Percentage of Total Spending
FY 02
FY 12
20.8% (AD)
38.0% (PS)
7.1% (TR)
0.3% (HHS)
11.0% (EH)
8.0% (RC)
1.3% (DS)
6.6% (PLC)
6.9% (AO)
17.0% (AD)
31.9% (PS)
3.4% (TR)
0.5% (HHS)
8.9% (EH)
10.0% (RC)
10.3% (DS)
12.7% (PLC)
5.4% (AO)
Administration (AD)
Public Safety (PS)
Transportation (TR)
Health & Human Services (HHS)
Environment & Housing (EH)
Recreation & Culture (RC)
Debt Service/Interest on Debt (DS)
Purchase of Land & Construction (PLC)
All Other (AO)

Infrastructure Finance

Bonds vs. Cash/Pay-Go Financing:
What's the best option for funding infrastructure?

- **Enterprise Fund Project Considerations**
  - Cash position and desired/targeted liquidity
    - "The flooding is a challenge for the state, its local governments and the South Carolina Public Service Authority (Santee Cooper, A1 stable), the state-owned electric utility, but credit impact from the storm will be minimal. The reliability of Federal Emergency Management Agency (FEMA) reimbursements and the solid liquidity position of the state and local governments themselves will alleviate most long-term credit effects." *(emphasis added)*

      -- *South Carolina, its Local Governments and Santee Cooper Expected to have Minimal Credit Impact from Storm Moody's Sector Comment 7oct2015*
  - Coverage on existing debt and related legal requirements
  - Future borrowing plans
  - Ability to absorb new debt under "static" revenue source (e.g., hospitality fee)
  - Ability to absorb new debt under "dynamic" revenue source and willingness to raise rates/charges if necessary (e.g., water/sewer, parking)
- **General Fund Project Considerations**
  - Cash position and desired/targeted liquidity
    - See extract from Moody's Sector Comment above
  - Existing/projected constitutional 8% debt capacity
  - Future borrowing plans
  - Ability to absorb new debt under existing mill structure
  - Willingness to increase mills to support new debt
- **Other Considerations**
  - "Bad" project use could trigger debt financing for a project being possible only under a taxable structure. Depending on the size and term of the loan desired this could eliminate cost effective debt financing thereby necessitating cash or pay-go funding of the project.
  - Term of the loan … is it too long for a local bank to be interested? If so and a public offering is not an option (e.g., poor credit quality, too small) then cash or pay-go may be the only way to get a project financed.
  - Other debt financing options should also be examined (e.g., SRF, USDA, etc.)

Bond Financing:
Most Common Structures in SC

- **General Obligation**
  - Constitutional 8% Debt
  - Referendum Approved
  - Capital Project Sales Tax
- **Revenue**
  - Water/Sewer/Electric/Gas
  - Parking
  - Hospitality
  - Tourism Development Fee
  - Other (hospital/health care, higher education)

THE BOOTY

Local Hospitality Tax

- The local hospitality tax is a tax imposed by a County, a Municipality, or both, on charges for food and beverages
  - The combined County and Municipality local hospitality tax rate cannot exceed 2% in any geographical area of a County
  - A County cannot impose a local hospitality tax in excess of 1% within the geographical boundaries of a Municipality without the Municipality's approval in the form of a Municipal Resolution
- Revenues from the local hospitality tax can be pledged to repay County or Municipal bonds pursuant to S.C. Code Ann. § 6-1-760(B)

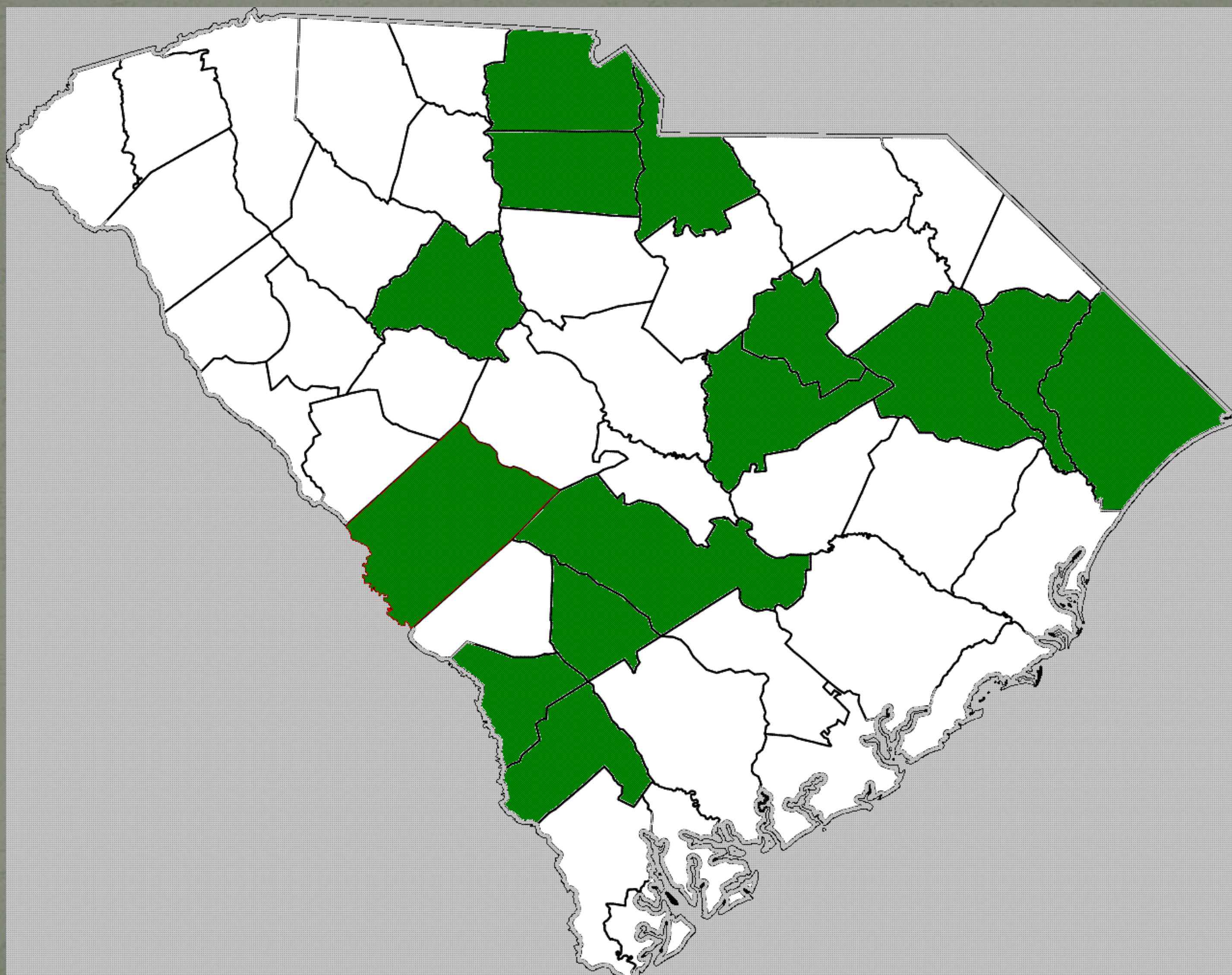
Local Accommodations Tax

- The local accommodations tax is a tax imposed by a County, a Municipality, or both, on the gross proceeds derived from the rental of or charges for accommodations (such as hotel rooms)
  - The combined County and Municipality local accommodations tax rate cannot exceed 3% in any geographical area of a County
  - A County cannot impose a local accommodations tax in excess of 1.5% within the geographical boundaries of a Municipality without the Municipality's approval in the form of a Municipal Resolution
- Revenues from the local accommodations tax can be pledged to repay County or Municipal bonds pursuant to S.C. Code Ann. § 6-1-760(B)

Capital Project Sales Tax

- The capital project sales tax is an additional sales and use tax (in addition to the state sales and use tax) imposed by a County
  - The capital project sales tax rate cannot exceed 1% in any County
  - The capital project sales tax cannot be imposed for more than 8 years (7 years on re-imposition)
- Revenues from the capital project sales tax may be used to defray debt service on bonds issued to pay for projects authorized by the Capital Project Sales Tax Act pursuant to S.C. Code Ann. § 4-10-310
- Senate Bill 683, currently in the Senate Finance Committee, proposes minor technical changes to the Capital Project Sales Tax Act regarding the precise date on which the tax must expire

Counties Levying A Capital Project Sales Tax

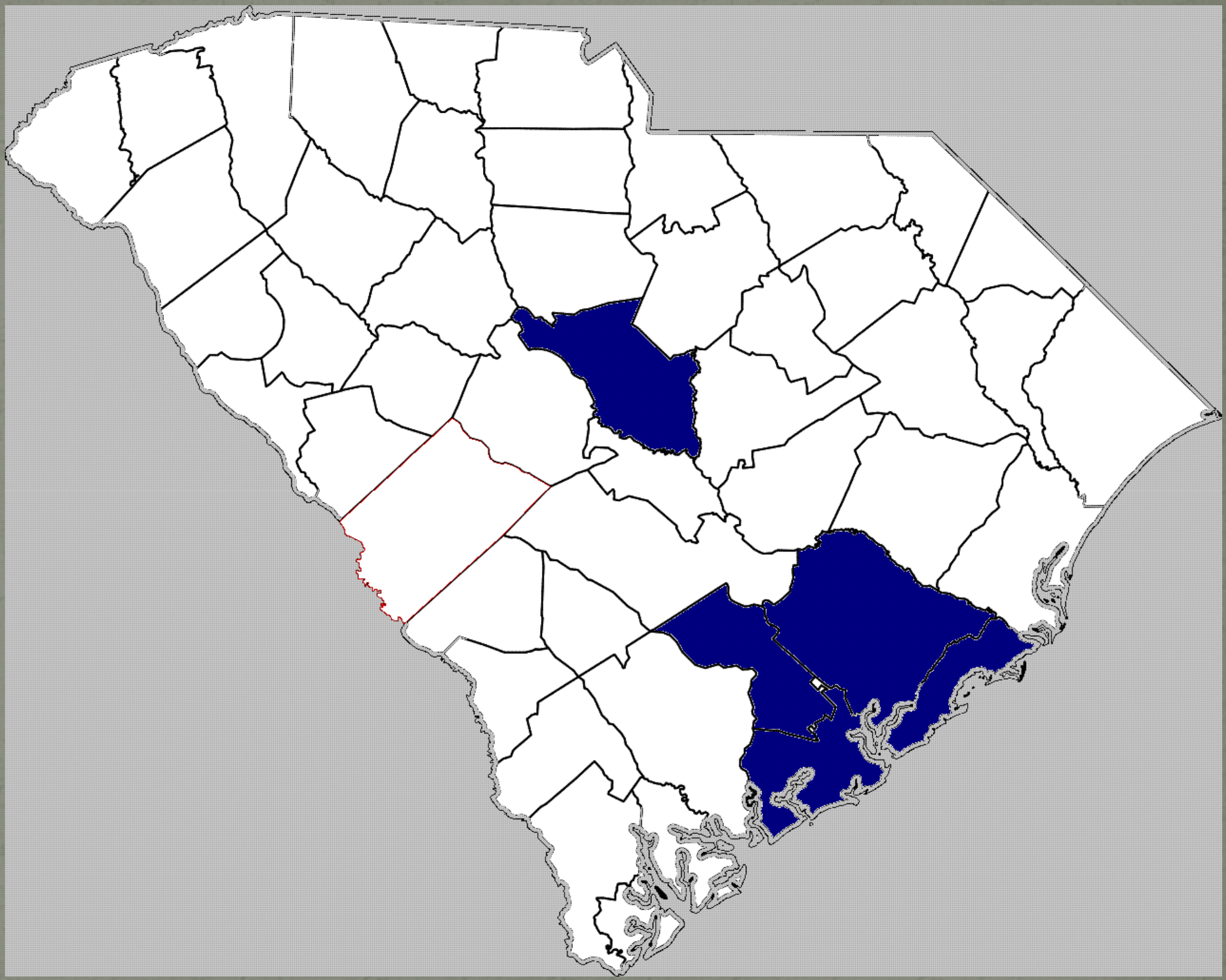


Transportation Sales Tax

- The transportation sales tax is an additional sales and use tax (on top of the State sales and use tax) imposed by a County
  - The transportation sales tax cannot exceed 1% in any County
  - The transportation sales tax cannot be imposed for more than 25 years
- Revenues from the transportation sales tax can only be used for the purposes stated in the imposition ordinance pursuant to S.C. Code Ann. § 4-37-30(A)(15)
  - Such purposes generally are limited to highways, roads, bridges, transit systems, and other transportation-related facilities operated by the County alone or by the County in conjunction with other governmental entities or the Department of Transportation
- Approximately four counties currently impose a transportation sales tax in South Carolina

Counties Levying A Transportation Sales Tax

- Only four:
  - Berkeley
  - Charleston
  - Dorchester
  - Richland
- Future…



TIF ISLAND

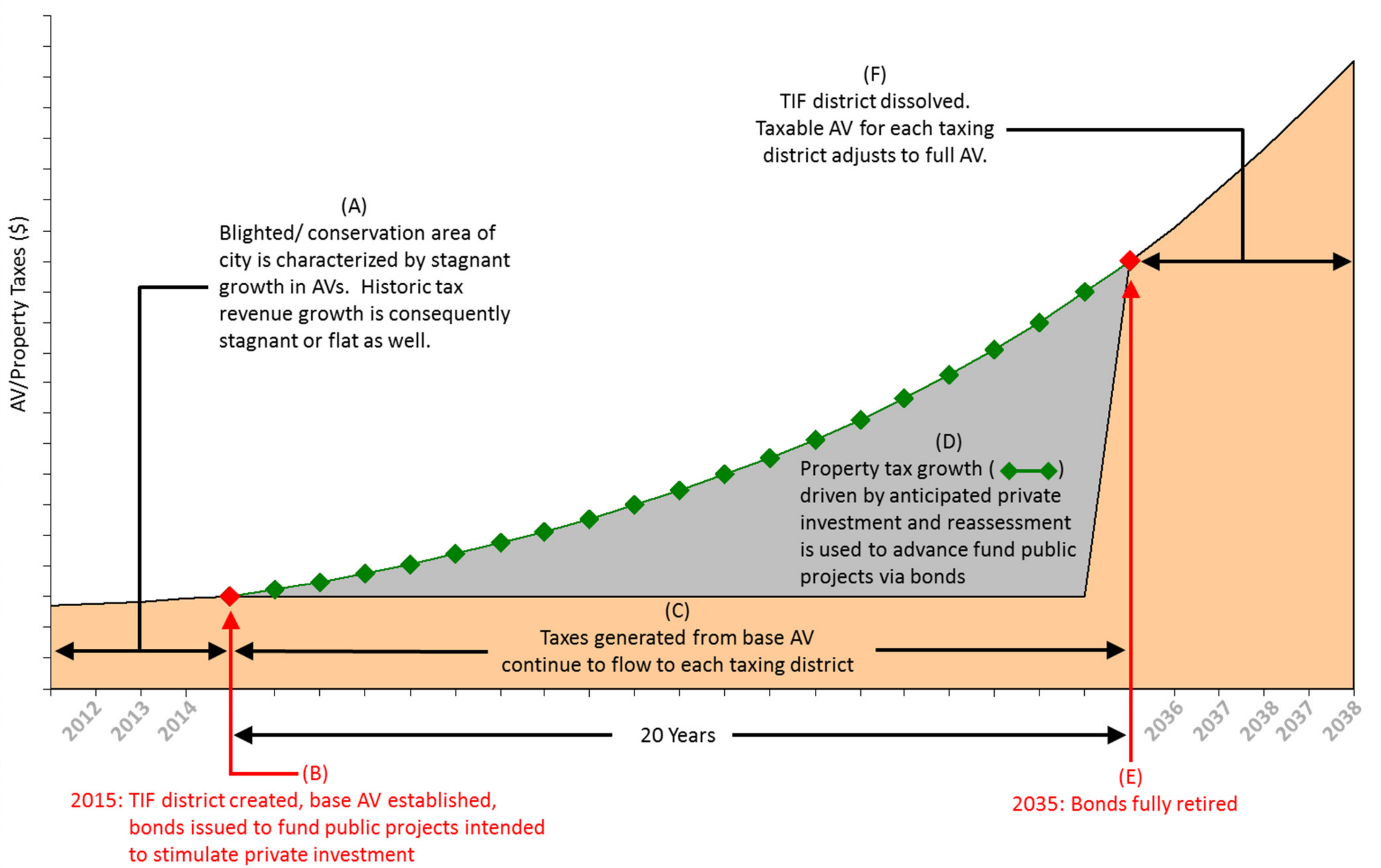
Tax Increment Financing: *Basics*

- **Usage**
  - Tax Increment Financing ("TIF") is available in 49 of 50 states and the District of Columbia
  - First created in 1952 in California to act as a catalyst for redevelopment
- **Defined**
  - A financing structure allowing a local government to capture limited future tax revenues (derived from anticipated private sector real estate investment) to pay for the immediate costs of municipal projects deemed necessary to attract such future private sector investment
  - A tool to use estimated future gains in taxes to finance current improvements which theoretically will create the conditions for those future gains
  - Tax Increment Financing may capture property or sales tax (jurisdiction-specific)
- **Characteristics**
  - Defined geographic area which local government determines will not develop/redevelop without public assistance; can also be project specific
  - Targets elimination of blight or undesirable/inefficient land use
  - Created for finite term
  - Blends land use planning with public and private finance
  - Leverages public resources to motivate private investment
  - May be supported/backstopped by other revenue sources for immediate bond issuance or allowed to season and stand on own security
- **Other Names**
  - Tax Allocation District ("TAD") – e.g., Georgia
  - Revenue Allocation District ("RAD") – e.g., New Jersey
  - Tax Increment Reinvestment Zones ("TIRZ") – e.g., Texas

Tax Increment Financing:
South Carolina Specific Pros and Cons

- **Pros**
  - Encourages development in areas that have yet to achieve their economic potential and are unlikely to do so without public intervention
  - Does not require a millage increase. Redirects tax revenues that would otherwise go to existing taxing districts in favor of redevelopment project costs or debt service on bonds issued to fund redevelopment project costs.
  - Bonds may be issued to advance fund public improvements which are expected to draw private investment
    - Seasoned TIF (i.e., coverage in the ground) vs. Backstopped TIF
  - Adoption of Redevelopment Plan ("Plan") draws the base assessment line in "chalk"
    - May lend comfort to taxing districts looking for proven redevelopment success prior to bonding and drawing the line in "ink"
    - Immediately captures new private sector investment thus accelerating the seasoning process
- **Cons**
  - Act 388 anyone? Formula driven rather than subjective standard for operating mill increases restricts incremental tax revenues going forward
    - Mitigating Factor: new investment as basis for future incremental gains
  - Potential for gentrification of Plan area (i.e., dislocation of existing residents and businesses)
  - Plans too great in size capture areas that would have redeveloped anyway; plans too small in size produce insufficient increment to advance fund public projects
  - Lack of diversification in taxpayer base or concentration in too few taxpayers as a credit weakness
  - Bond issues from unseasoned TIF district may require backstop pledge from existing revenue stream which can erode future direct bonding capacity of the backstop revenue stream
    - Mitigating Factor: MID overlay

Tax Increment Financing: *Mechanics*

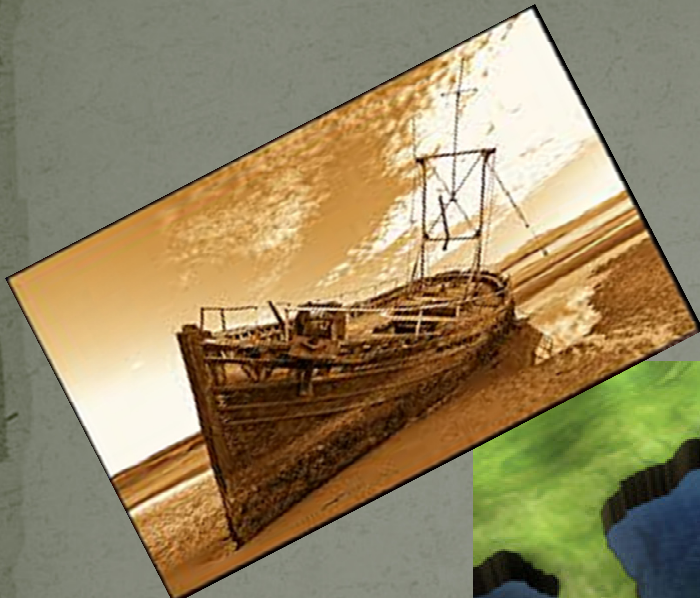


UNCHARTERED TERRITORY
THE MCIP STRAITS!

Special Source Revenues

- Similar concept to TIFs: goal is to capture new revenues
- Instead of a TIF District, use a multi-county industrial park (MCIP) designation
- MCIPs also set aside areas where a County may capture future increased tax revenues and use them to pay for infrastructure
- Properties located in an MCIP pay fees – therefore the county may use all the revenue generated by the property located in the MCIP and not just the portion that is attributable to County millage
- Bonds may be issued and secured by MCIP revenues, and used to finance a broad class of "infrastructure"

THE IPRB TRIANGLE



SC Installment Purchase Revenue Bonds: *Basics*

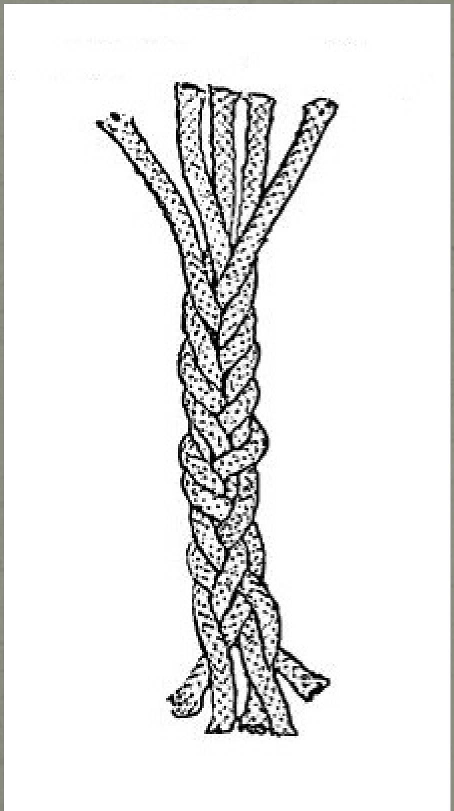
- **Usage**
  - While use by School Districts was specifically prohibited by the General Assembly in 2006, the ability of Cities, Counties and Special Purpose Districts to utilize IPRBs was specifically reserved
- **Defined**
  - A financing structure allowing SC local governments with multiple funding sources to finance infrastructure through a consolidated offering
- **Characteristics**
  - Typically utilized by issuers with multiple revenue sources that individually may not attract funding through either the private or public debt markets
  - To homogenize said multiple payment sources representing varying degrees of credit risk, a local government utilizing the IPRB structure will typically be expected by lenders to make a “best efforts” pledge to preserve sufficient 8% debt capacity going forward allowing for the issuance of GO bonds to make installment payments
  - If structured properly, IPRBs will trade only one-notch off of the ultimate obligor’s general credit rating

Traditional Approach

General Obligation	Property Taxes
Revenue Bonds	Utility Revenues
General Obligation	Sales Tax
Other	Hospitality/ Accommodations Fee-in-Lieu Special Source TIF Assessments

New Approach

- Combining Revenues
- Flexibility
- Strength

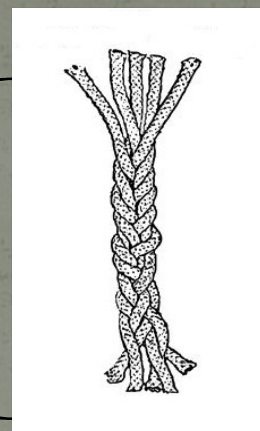


Installment Purchase Revenue Bond Financing

Municipal Facilities Corporation

501(c)3 Corporation formed for the express purposes of financing the construction and acquisition of facilities for the municipality.

MFC and municipality enter into an agreement that requires muni to make semi-annual payments to MFC to pay for the facilities the MFC has financed. MFC in turn utilizes those payments to make payments to bond holders.



Municipality

Municipality may draw on multiple sources of revenues to make payments to MFC. See below.

Source #1
General Obligation

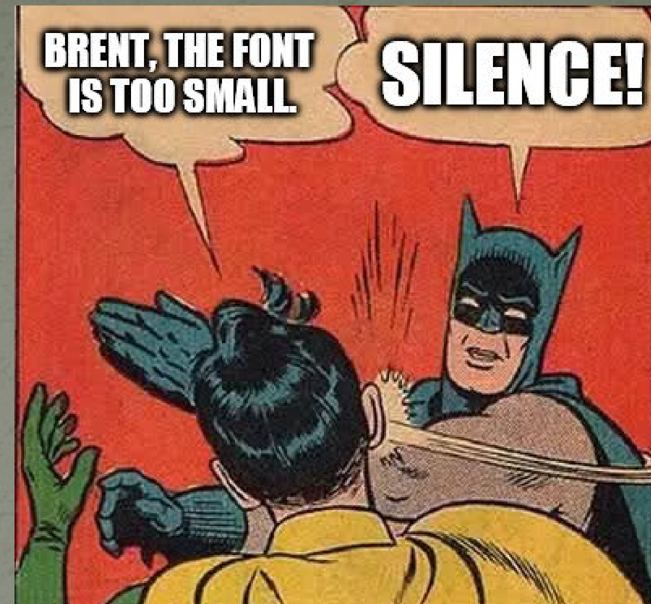
Source #2
Utility Revenues

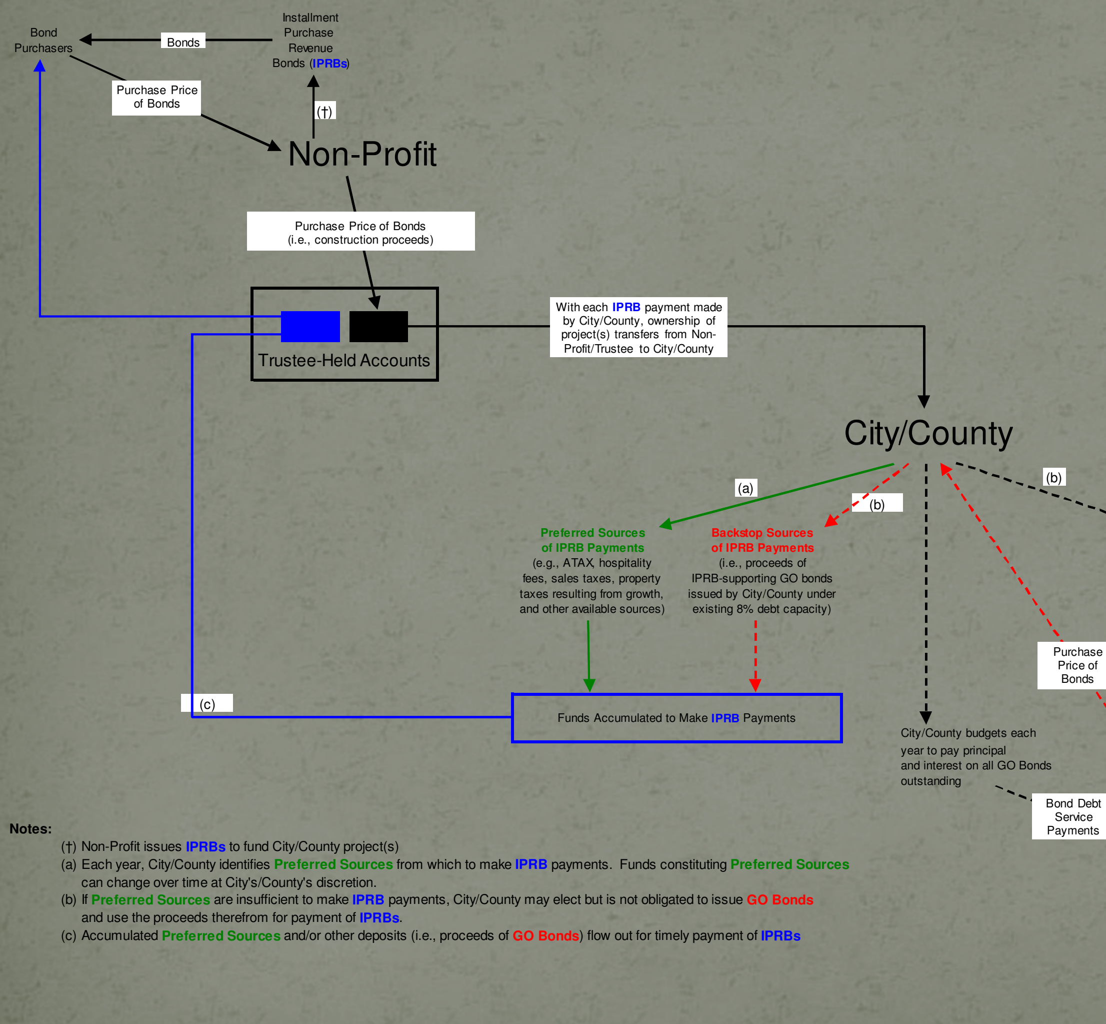
Source #3
Special Source

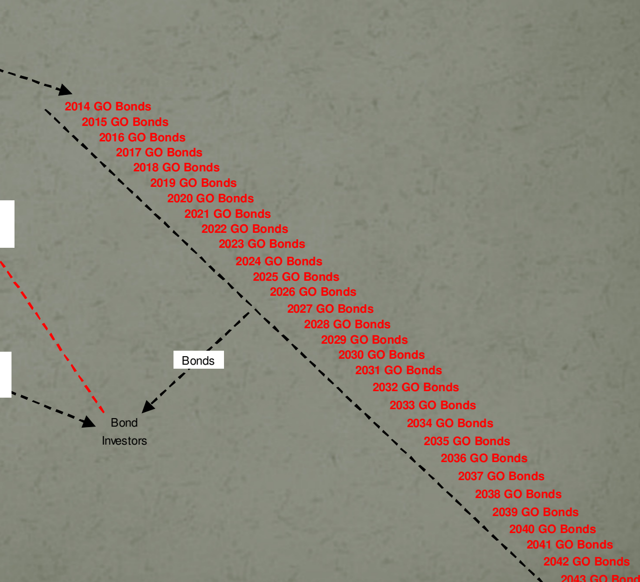
SC Installment Purchase Revenue Bonds: *Specific Pros and Cons*

- **Pros**
  - Allows for the combining of multiple revenue sources by the borrower (which individually may be viewed by lenders as too risky) into a consolidated plan of finance
  - In instances where proceeds of 8% GO debt are viewed as the primary (or even sole) source of making installment payments, the introduction of mills to support such IPRB-supporting GO debt can be more gradual than might otherwise be required by the issuance of GO debt to fund the entire project
  - If structured correctly, IPRB proceeds can be used for both essential and non-essential capital projects
    - Essential: courthouses, jails, administration buildings
    - Non-Essential: parks, conference centers, sporting facilities, amphitheaters
  - Allows for funding of capital projects where insufficient 8% debt capacity exists
  - Enables local government to preserve 8% debt capacity to address future opportunities/emergencies
- **Cons**
  - Detractors assert the IPRB structure is (a) a local government's attempt to get around their 8% debt limit and/or (b) is akin to "paying interest twice-over for the same project". Staff an elected officials should be prepared to address these matters.
  - If not structured correctly or if unreasonable assumptions are used, local government may find itself having to increase debt service related mills to levels beyond what was originally contemplated
  - Where most fixed rate structures (e.g., GO bonds, W&S revenue bonds, etc.) are a "set it and forget it" proposition, IPRBs require active management by the local government to ensure timely payment of debt service.

Installment Purchase Revenue Bonds: *Mechanics*







Notes:

(†) Non-Profit issues **IPRBs** to fund City/County project(s)

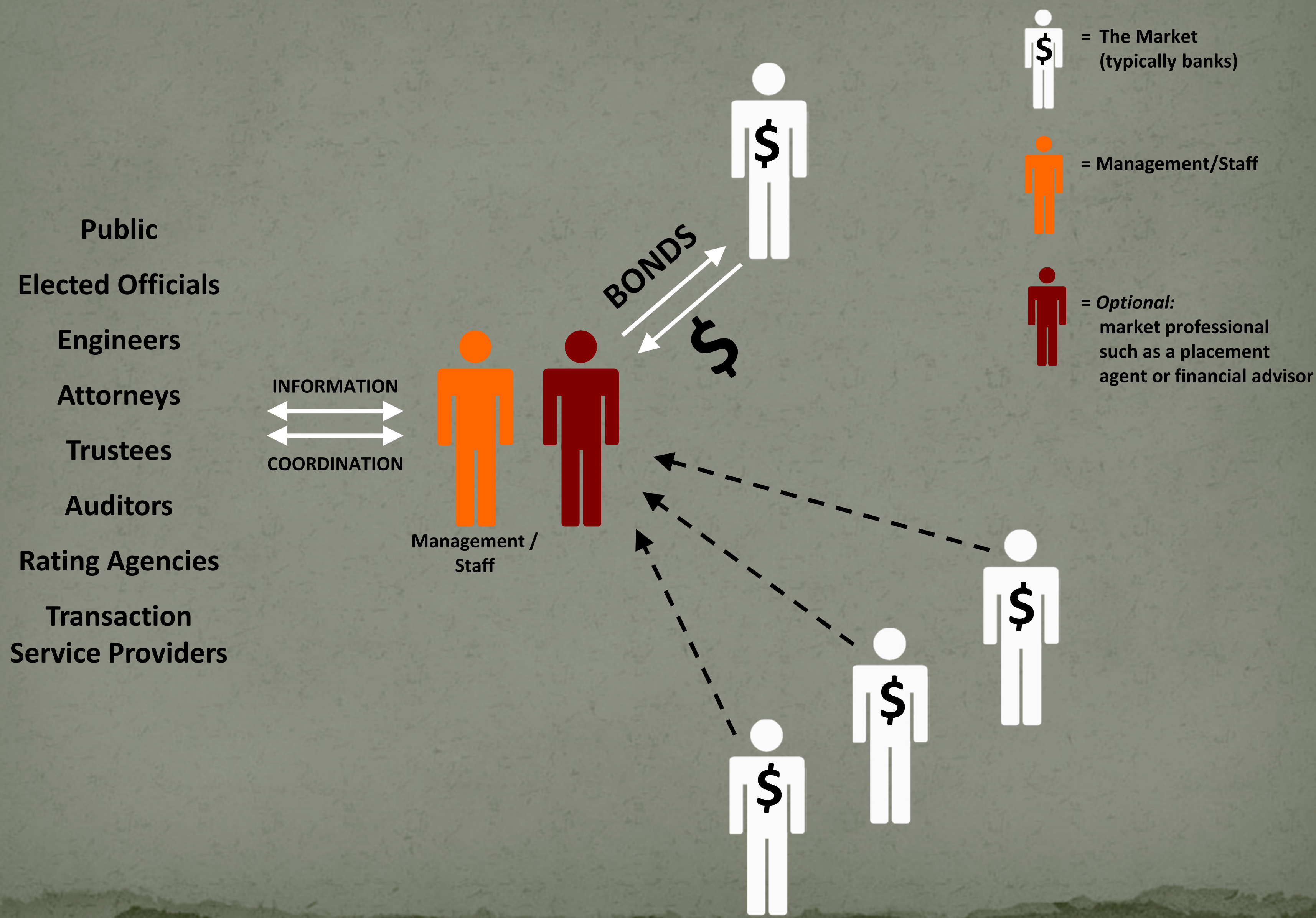
(a) Each year, City/County identifies **Preferred Sources** from which to make **IPRB** payments. Funds constituting **Preferred Sources** can change over time at City's/County's discretion.

(b) If **Preferred Sources** are insufficient to make **IPRB** payments, City/County may elect but is not obligated to issue **GO Bonds** and use the proceeds therefrom for payment of **IPRBs**.

(c) Accumulated **Preferred Sources** and/or other deposits (i.e., proceeds of **GO Bonds**) flow out for timely payment of **IPRBs**

TREASURE MAP
TO
THE BOND MARKET

Planning, Structuring and Selling Bonds:
Private Placement



Planning, Structuring and Selling Bonds: *Public Offering*

Public

Elected Officials

Engineers

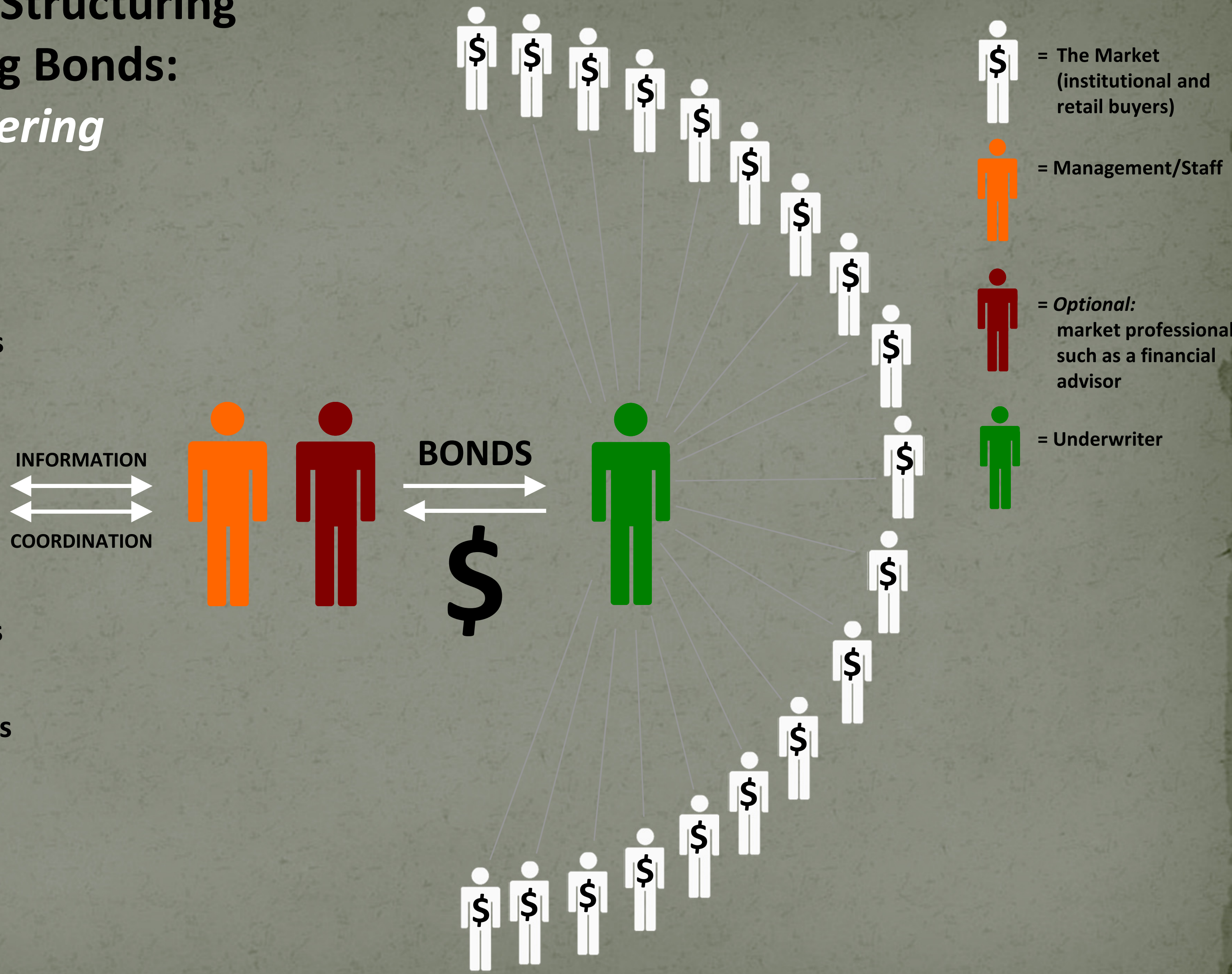
Attorneys

Trustees

Auditors

Rating Agencies

Transaction Service Providers



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