**AGENDA STATEMENT**

**City of Bellaire**

**MEETING:** City Council - May 06 2024
**PREPARED BY:** Todd Gross
**DEPARTMENT:** Finance

**ITEM TITLE:**

Presentation by the City's Financial Advisor James Gilley, of U.S. Capital Advisors LLC, on Public Finance 101 as it relates to Council's FY 2025-2027 Adopted Strategic Plan - Submitted by Terrence Beaman, Chief Financial Officer.

**RECOMMENDATION:**

Terrence Beaman, Chief Financial Officer, recommends that City Council conduct the workshop.

**BACKGROUND/SUMMARY:**

As we prepare the FY 2025 budget and consider funding sources for large capital projects, staff thought it would be helpful to have the City's financial advisor, U.S. Capital Advisors, LLC, conduct a workshop on the fundamentals of bonds and debt issuance for educational purposes.

U.S. Capital Advisors has been the City's financial advisor for over 30 years. During this time, they have provided guidance on the issuance of approximately 38 individual bonds, including general obligation bonds, general obligation refunding bonds, and certificates of obligation bonds. U.S. Capital Advisors assists the City with bond rating presentations, advises on maintaining the City's AAA bond rating, provides tax-rate analyses on an as-needed basis, and provides the annual continuing disclosure filing at no charge, among other services. In addition, they have assisted the City with numerous bond elections over the decades, including four successful bond elections with $170,480,000 in total ballot propositions since the year 2000. Finally, they regularly monitor refunding opportunities to achieve debt service savings for the City, and they have advised the City on an estimated 14 GO refunding bond issuances.

**CITY ATTORNEY REVIEW:**

☐ **Yes** ☑ **No**

# City of Bellaire, Texas

## City Council Workshop
## Public Finance Overview

Monday, May 6th, 2024

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**Austin** **Houston** **Dallas**

US Capital Advisors

U.S. Capital Advisors

# Issuing Bonds:
# Summary of Common Debt Instruments

| Instrument | Max Term (Years) | Typical Uses | Timing to Issue (days) | Pro/Con |
|---|---|---|---|---|
| General Obligation Bonds | 40 | City buildings, roads, public safety, parks | 120-150 | "Mandate from voters" but dependent on election cycle |
| Certificates of Obligation ("COs") | 40 | Same as GO Bonds but also utilities, emergencies | 75-90 | Faster than GO Bonds but subject to petition |
| Contractual Obligations ("KOs") | 40 | Performance contracting, equipment, appliances, furnishings | 60-90 | Faster than COs but limited in authorized uses |
| Tax Notes | 7 | Short-lived assets, e.g. vehicles | 45-60 | Not subject to petition or election but limited in term |
| Revenue Bonds | 40 | Utility improvements or economic development projects | 60-75 | Not subject to petition or election but typically higher interest rates |

# Issuing Bonds:
# New Money Financing
## Common Tax-Backed Debt Instruments



- **General obligation bonds ("GO bonds")**
  - Security: limited ad valorem tax
    - Payable from any lawful source
  - ALL TAX-BACKED DEBT: maximum total tax of up to $2.50 for Home-Rule / $1.50 for most General Law cities
    - AG requires "bond allowable" tax test – proof debt service can be paid from $1.50 HR / $1.00 GL debt tax rate assuming 90% collection rate
  - Require approval of majority of voters at uniform election May/November
  - Longest to issue due to election timeline ~ at least 120 – 150 days to funding
  - Typical uses: municipal facilities, street/sidewalk improvements, public safety, other items where citizens' consensus is desired
  - Maximum term of 40 years but should be appropriate to useful life of improvements. Investors may be reluctant to purchase 40-year bonds

# Issuing Bonds:
# New Money Financing
## Common Tax-Backed Debt Instruments



- **Certificates of obligation ("CO"s)** (limited to H.R. or G.L. cities)
  - Security: limited ad valorem tax
    - Payable from any lawful source (must have nominal revenue pledge to be sold for cash)
  - Subject to AG "bond allowable" tax test
  - No election required, but publication of Notice of Intention ("NOI") required, states 'not to exceed' amount of bond issuance
    - NOI posted on website & published for 2 consecutive weeks in local paper
    - Bonds cannot be issued until 45 days after date of 1st publication
    - Citizens can compile valid petition with 5% registered voter to require CO's be put to election
  - Timing: approximately 75 – 90 days to closing and receipt of funds
  - Typical uses: same as GO bonds, but often for health and safety projects, public works and capital projects as permitted by state law, where revenues (not tax) will pay for debt service, e.g. utility system
  - Maximum term of 40 years but should be appropriate to useful life of improvements. Investors may be reluctant to purchase 40-year bonds

# Issuing Bonds:
# New Money Financing
## Common Tax-Backed Debt Instruments



- **Contractual obligations ("KO"s)**
  - Security: limited ad valorem tax
    - Payable from any lawful source
  - Subject to AG "bond allowable" tax
  - No election, no publication of "NOI" required
  - Timing: approximately 60 – 90 days to closing and receipt of funds
  - Limited to moveable or fixed personal property, e.g. appliances, equipment, furnishings, etc.
  - Example of use: performance contracting (e.g. energy efficiency improvements)

# Issuing Bonds:
# New Money Financing
## Common Tax-Backed Debt Instruments



- **Tax notes**
  - Security: limited ad valorem tax
    - Payable from any lawful source
  - Subject to AG "bond allowable" tax
  - No election required, no publication of "NOI" required
  - Very quick to issue: as little as 45 – 60 days
  - Typical uses: public improvements, current expenses, or shorter-lived assets
    - Can be more economical alternative to vehicle/equipment lease financing
  - Limited to 7-year term – final maturity no longer than 7 years after date of AG approval (or 1 year if used to pay current expenses/cash flow deficit)

# Issuing Bonds: New Money Financing

## Common Tax-Backed Debt Instruments

- **General obligation refunding bonds**
  - Security: limited ad valorem tax
    - Payable from any lawful source
  - Subject to AG "bond allowable" tax
  - No election required
  - Can be used to refinance ("refund"):
    - GO bonds, CO's, KO's, tax notes, other GO refunding bonds, revenue bonds, etc.
  - Timing: approximately 60 – 90 days to closing

# Issuing Bonds:
# New Money Financing

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## Common Revenue Backed Debt Instruments

- **Utility system revenue bonds**
  - No voter approval required, but cannot be paid from ad valorem taxes
  - Typical security: pledge of net revenues of the utility system
    - Gross revenues minus operating expenditures excluding depreciation
    - Can be subordinate or junior lien – typically done to get around existing senior lien debt covenants, or if senior lien is closed
  - Typical covenants:
    - Rate covenant ~ 1.10 – 1.35: utility rates must be set annually to produce net revenues equal to X times debt service
    - Bond reserve fund ("BRF"): liquidity enhancement
      - Lesser of: 125% average annual debt service, maximum annual debt service ("MADS"), or 10% principal
      - Market is more accepting of average annual debt service
      - Surety policy in lieu of reserve
    - Additional bonds test ("ABT") ~ 1.10 – 1.35: Can issue additional parity bonds if net revenues are at least equal to X times average annual debt service
      - Likely requires 12-month certification that net revenues meet ABT
      - CPA certification for forward-looking if rate increase is required

# Issuing Bonds: New Money Financing

## Common Revenue Backed Debt Instruments

- **Sales tax revenue bonds**
  - No voter approval required (except for authorization of sales & use tax)
  - Typically issued by an economic development corporation ("EDC")
    - Contact bond counsel for different entity types (i.e. 4A or 4B)
  - Typical security: pledge of gross sales tax revenues of the EDC
  - Typical covenants:
    - Bond reserve fund ("BRF"): liquidity enhancement
      - Lesser of: 125% average annual debt service, maximum annual debt service ("MADS"), or 10% principal
      - Market is more accepting of average annual debt service
      - Surety policy in lieu of reserve
    - Additional bonds test ("ABT") ~ 1.35 – 1.50: Can issue additional parity bonds if gross revenues are at least equal to X times some multiple of annual debt service
      - Likely requires certification that historical 12-month net revenues meet ABT

→ NO RATE COVENANT

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# Issuing Bonds:
# Tax-Backed or Revenue Backed for Utility?

**Certificates of obligation**

- Subject to petition for election
- Slower to issue due to 45-day notice period
- Stronger credit due to tax pledge translates to lower interest rates in market
- Can be designated “self-supported”, e.g. 50% paid from utility revenues

**Revenue bonds**

- Typically higher interest rates due to less secure revenue pledge
- Carry covenants that make it more expensive to finance
- Not subject to vote or petition
- Can be issued on a faster timeline than CO’s

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# Issuing Bonds: Parties Involved

- Bond Counsel – specialized attorney who prepares required legal documents, ordinances, facilitates bond election, writes tax-exempt opinion, submits transcript of proceedings to Texas Attorney General, etc. BC represents **you** – it is the city's job to procure qualified bond attorney
- Municipal ("Financial") Advisor – licensed professional who advises on appropriate debt instruments, debt structure, method of sale, market conditions; collaborates with BC to draft offering documents, etc. MA owes **fiduciary responsibility** to act in your best interest
- Underwriter (purchaser) – initial purchaser of bonds who may or may not resell; does **not** act as your fiduciary
- Paying agent/registrar – financial institution handles closing, registers owners of bonds, and facilitates debt service payments from city to bondholders
- Escrow agent – financial institution that holds bond funds in trust; typical in a refunding closed in advance of the call date
- Verification agent – financial institution that certifies sufficiency of funds in escrow to pay off debt
- Credit rating agencies – provide bond rating for each individual issuance upon request, and conduct periodic surveillance to maintain rating. Common in public market bond issuance, less common in private (or "direct") placements
- Attorney General of Texas – reviews transcript of proceedings submitted by bond counsel to determine if bonds have been lawfully issued (required on most securities issued in Texas)

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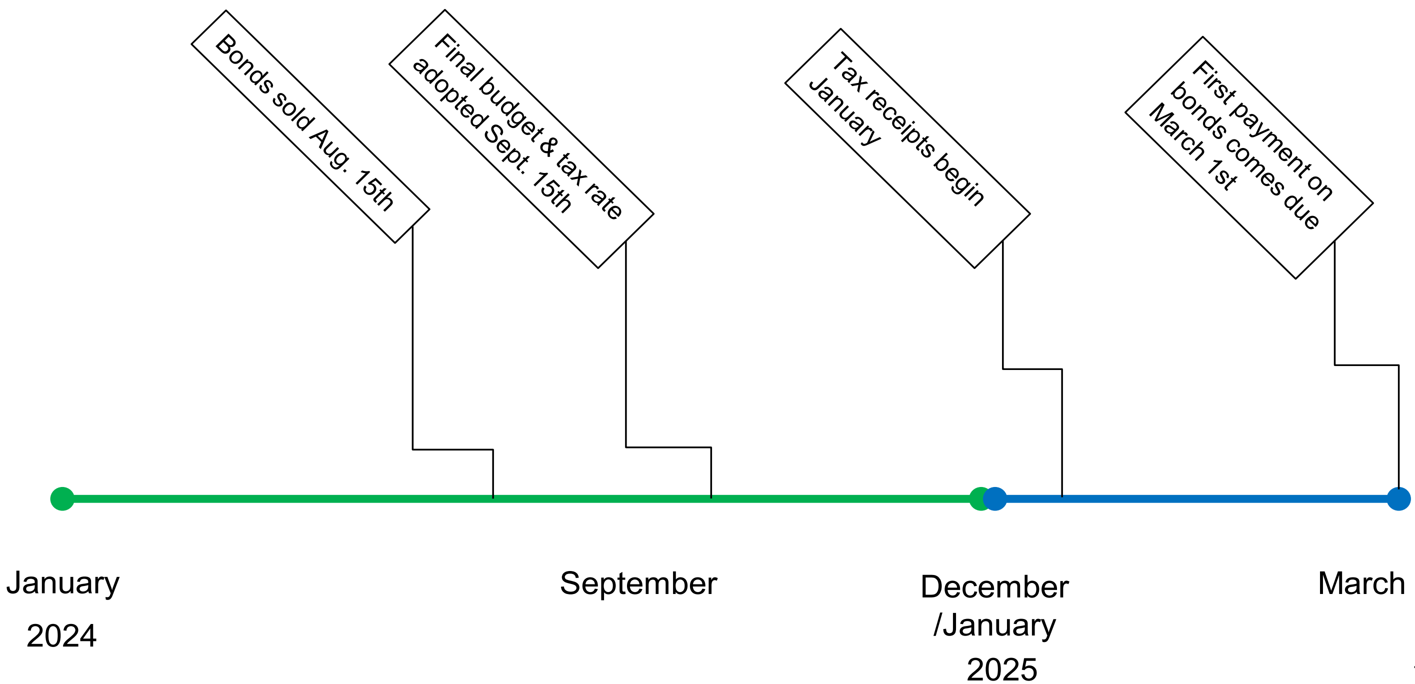
# Issuing Bonds: When to Issue?

- Bonds paid by ad valorem taxes
  - Consider timing bond issuance to coincide with budget and tax rate setting process to ensure tax revenues are received prior to first bond payment coming due



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# Issuing Bonds: When to Issue?

- Bonds paid by other revenue sources (e.g. utility, sales taxes, etc.)
  - Assuming revenues are received with relative consistency throughout the year, there is more flexibility with timing of bond issuance
  - Issue as close as possible to when funds are needed for project expenditures to minimize paying interest on bond proceeds not yet needed
  - If a large amount of revenues are typically received during a particular season (e.g. water revenues in spring), consider structuring principal payment around that time

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# Issuing Bonds: Interest Rate Considerations



- Bond market and stock market are typically inversely related:
  - When the stock market is up, bond prices go down (yields go up)
  - When the stock market is down, investors turn to bonds and demand drives up prices (yields go down)
- Interest rate risk:
  - City decides to wait to issue bonds, and interest rates go up afterwards
  - City decides to issue bonds now, and interest rates drop afterwards
- Solution: issue bonds when you need the money
  - Consider arbitrage rebate compliance and

    small issuer/safe harbor exceptions

    → Consult with Bond Counsel

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# General Fund v. Enterprise Fund: General Fund

- Typical General Fund projects (paid by ad valorem taxes)
  - Streets and drainage
  - Municipal facilities (city hall)
  - Police, fire, EMS
  - Parks

    → Consider using taxes to fund projects that don't produce income
- Texas House Bill 1869
  - Attempted to reform property taxes by requiring all legal "debt" be voted
    - Would have treated unvoted debt as M&O expense – subject to no-new-revenue calculations
  - Final form amendments allowed for "debt" to include self-supported, state/federal financing, designated infrastructure, existing facility projects, etc.

    → Consult with Bond Counsel

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# General Fund v. Enterprise Fund: Enterprise Fund

- Typical Enterprise Fund projects (paid by non-tax revenues)
  - Water and wastewater improvements
  - Electrical system improvements
  - Airport, convention center, etc.
- Bonds issued for each enterprise project should be paid from the revenues generated from that enterprise
- Consider annual revenue adjustments to keep up with rising costs/inflation
  - ex. Better to raise water rates $1.00 every year for 10 years rather than $10.00 after 10 years
  - Maintaining good margins in Enterprise Fund will help to maintain bond rating and will make issuing additional bonds easier

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