Pocket Checklist for Issuing Bonds

1. Select and retain recognized bond counsel.

2. Select and retain a financial advisor and/or an investment banker to assist with the planning and authorization of the bond sale.
   a) A list of Oregon Bond Counsel, Financial Advisors and Underwriters can be obtained from the Debt Management Division of the Oregon State Treasurer's Office. A sample request for proposal to assist in the selection process of bond finance professionals is on the "Samples" section of the web site.

3. Determine the amount of funds needed and the corresponding size of the issue. Include, as a minimum, the following:
   a) Capital costs such as: land, building construction, permits, furnishings and equipment, architect and engineer fees, etc.
   b) Bond issuance costs such as: bond counsel and attorney fees, underwriter and financial advisor fees, registration costs, principal and interest paying costs, bond insurance (if applicable), printing, advertising, etc.
   c) When estimating debt service and revenues, include an estimate for uncollected taxes and revenues. For revenue bonds, the bond proceeds should be enough to fund a reserve account which is adequate to cover debt service in the next fiscal year.
   d) Allow for underwriting discount, if applicable.

4. Determine available cash flows and alternatives to pay debt service on the bonds.

5. Structure the bonds to match needs with cash flow and minimize costs and other considerations.

6. Determine the role the public will play in the issuance.
   a) Will a citizen advisory committee be formed?
   b) Will or could property taxes or public user fees be affected?
   c) Will the issue require a public vote?

7. Adopt resolutions authorizing the sale of the bonds or, if necessary, an election and ballot title:
   a) Ensure bond counsel and the financial advisor review the resolution and ballot title before adoption.

8. Budget for the bonds:
   a) Use a Capital Improvement Fund to expend the bond proceeds on the projects and to collect the earnings on the investment of proceeds.
   b) Use a Debt Service Fund to pay the principal and interest. Ensure there is a carry-over for the next fiscal year's first payment, since it may occur prior to the collection of taxes.

STEP 2: HIRING BOND PROFESSIONALS TO ASSIST WITH THE BOND SALE

THE FINANCING TEAM

Most financings require the services of experienced legal and financial professionals. This step deals with the various specialists who may be employed by local government issuers. Some are essential, such as Bond Counsel, whereas others may be retained at the discretion of the issuer, such as a Financial Advisor. It is advisable to periodically review contracts with long-standing paid advisors. Requests for Proposals (RFPs) should be sent to several specialist candidates when a new private sector service is needed. The proposals received can then be compared and evaluated and will form the basis for selection of the professionals.

The Debt Management Division can provide lists of private sector professionals with whom a municipality may contract for services. Large municipalities may have in-house staff with sufficient experience to plan and execute a significant portion of the work related to a bond sale.

The Municipal Debt Advisory Commission (MDAC) exists for the purpose of assisting local municipalities with bond sales and encourages local officials to make use of its services. It is recommended that all districts with borrowing authority acquire at least a procedural knowledge and understanding of debt issuance before attempting to sell bonds.

ISSUER/BORROWER

Issuers are the legal entity responsible for authorizing the documents related to the bond sale. This role is generally filled by a local, regional, or state government. The Issuer is generally the Borrower but in some instances, the two roles may be different. While the Issuer is the legal entity enabling the sale, the Borrower is the entity that, either directly or through additional documentation, is the party that receives the proceeds of the bond issue and is obligated to repay the bonds. Issuers are governed by elected or appointed government officials that authorize the issuance of the bonds. Some Issuers authorize the issuance of bonds for other entities not directly affiliated with the Issuer. This type of issuance is often called a conduit financing. In Oregon, conduit financings are most common for private college, non-profit, housing, and healthcare facilities.

ISSUER AND/OR BORROWER LEGAL COUNSEL

Issuers and Borrowers often have their own legal counsel. Bond investors need assurance that the Issuer and/or the Borrower have properly authorized the bonds. Each entity must comply with both state laws and local authorizations. Thus, it is important that the legal counsel has a close working relationship with the Issuer/Borrower and understands authorization rules. It is also often important that the Issuer/Borrower counsel review bond documents to ensure accuracy and that any Issuer/Borrower commitments in the bond documents do not run afoul of the Issuer/Borrower's other policies and rules.

Local attorneys often play an important role in bond sales. They are especially vital in ensuring that municipalities are in compliance with local election, meeting, filing, disclosure laws, and other regulations or actions related to the borrowing. Usually in concert with recognized Bond Counsel, they advise in a legal capacity prior to the actual issuance of a legal opinion on the bonds. While the local attorney may perform many of the same or similar legal functions of the Bond Counsel, they do not act as recognized Bond Counsel.

BOND COUNSEL

Bond Counsel is an important resource in the debt issuance process. Bond Counsel opines on the legality of the bond offering, thereby acting as legal advisor to the ultimate investor.

Prior to World War I, the purchaser of the bonds employed Bond Counsel. This practice was changed when local governments found an advantage in using Bond Counsel prior to the bonds being sold. Use of Bond Counsel was one of several reforms that occurred as a result of many defaults on railway bonds in the late nineteenth century. Today, Bond Counsel serves two primary functions:

- Counsel ensures the bonds are legally authorized and issued.

- Counsel issues a legal opinion as to the tax-exempt status of the bonds. The legal opinion must be unconditional and is essential for a bond issue to be marketable.

Because of market demands, only a law firm that is recognized as Bond Counsel through experience should act as Bond Counsel. A local attorney or law firm inexperienced in bond matters will rarely be acceptable to the market. Local attorneys may be, and often are, employed for other purposes to assist with debt issuance. Although Bond Counsel are not specially certified or licensed, they must command the confidence and respect of the investment community.

Bonds that are to be marketed nationally should use a "nationally recognized" Bond Counsel. *The Bond Buyer's Municipal Marketplace (the "Red Book")* is a trade periodical which lists firms that are recognized nationally as Bond Counsel. "National" firms are those whose legal opinion is recognized in any geographic area. The Debt Management Division can also provide a list of names and addresses of Bond Counsel firms doing business in Oregon and the Pacific Northwest.

The services of Bond Counsel include:

- Determining whether legal and binding authority exists to issue the bonds.
- Drafting a bond ordinance, resolution, or a trust indenture (for revenue bonds).
- Drafting the notice of sale.
- Examining all or part of the Official Statement.
- Examining transcripts of proceedings to determine that the bonds were legally advertised and sold.
- Submitting a written legal opinion on the tax-exempt status of the offering.
- Determining that the bonds were legally executed.
- Answering questions of the issuer, investment banker, or public official.

FINANCIAL ADVISORS

Financial Advisors (FA) may provide a wide range of services to the municipal debt issuer. In general, the Financial Advisor will coordinate all elements of the bond sale from inception to closing. Optimally, a financial advisor is competent and thoroughly knowledgeable in areas of local government laws and practices, investor attitudes and preferences, rating considerations, and the bond and money markets. In Oregon, Financial Advisor services are not currently regulated. The MSRB, however, has a list of registered municipal advisors. Financial advisory services are provided by independent consulting firms and by banks. The role of the financial advisor is to provide advice to the issuer in regards to the best practices for the sale of the bonds and to negotiate the best terms on the bond sale with the Underwriter.

The Financial Advisor manages the sale process leading up to the sale of the bonds and advises the Issuer on business terms and the sale process.

Financial advisors may prepare an overall financing plan, advise on marketing the bonds, assist with a presentation to rating agencies, calculate the timing of a bond sale, determine the range of interest costs for different alternative means of financing, provide an estimate of the underwriters' fees, help decide on the bond structure and call provisions, set bid requirements, participate in a negotiated sale, evaluate the sale when it is finished, and participate in the preparation of the Official Statement to satisfy the informational needs of the prospective investors. The Financial Advisor may also assist the Issuer in preparing a request for proposal (RFP) for other services.

It is prudent to develop an RFP that describes the specific services the municipality desires from a Financial Advisor. This RFP should be sent to several consulting firms. The Debt Management Division maintains a list of financial advisors who have expressed an interest in working with Oregon bond issuers. Responses to RFPs from interested advisors enables a municipality to choose which firm's services will best meet their needs. (See Sample Request for Proposal (RFP) for Underwriting Services).

If a financial advisor is retained, it is recommended that a formal, written contract be signed which specifies the duration of the engagement, services to be provided, and the amount of compensation. It is advisable that the Financial Advisor not be allowed to bid on bonds in a competitive sale or act as underwriter in a negotiated sale. It is also recommended that Financial Advisors not be able to change roles (i.e. resign as Financial Advisor and become Underwriter) in the middle of a transaction. Advisors may bill on the basis of a flat rate; the amount of bonds sold, or time expended. If the advisor is paid from bond proceeds, care should be taken to ensure the legality of such payment, in terms of the bond resolution and to plan for payment (if any), should the bonds not be sold.

UNDERWRITER / PRIVATE PLACEMENT AGENT / PURCHASER

Underwriters are securities firms and commercial banks that purchase an issuer's debt securities with the intention to resell the securities to investors at a profit. They can provide the issuer services in planning and design of the borrowing, spreading the risk of the borrowing among several firms, and marketing the securities in the regional and national public debt markets.

The underwriter's functions and responsibilities vary significantly, depending on whether the securities are sold using the competitive bid or negotiated method of sale. In a competitive sale, the Issuer is responsible for the planning and design of the bond offering. The Issuer (generally with the assistance of a Financial Advisor) solicits bids from competing underwriters for the purchase of the municipality's securities. The Underwriter in a competitive sale is also referred to as the Purchaser. In a negotiated sale, the underwriter is usually retained at the beginning of the issuance process that culminates with the underwriter purchasing the bonds on terms mutually agreeable to the issuer and underwriter.

Private placement agents are generally banks or securities firms and act for the issuer in the arrangement of a bond sale directly to a private placement purchaser. They differ from underwriters in that a private placement agent does not actually purchase the bonds from the issuer; rather they arrange the bond sale to a third party for a fee.

UNDERWRITER'S COUNSEL

In negotiated sales, private placements or direct purchase, the Underwriter (or Placement Agent or Purchaser) will often retain their own counsel. This firm (generally the same firms that act as Bond Counsel), will review various aspects of the bond transaction to give assurances to the Underwriter that the bonds are authorized, and that all is in order. Underwriter's Counsel is solely responsible to the Underwriter and therefore may negotiate terms on behalf of the underwriter. Underwriter's Counsel fees are often paid from the expense component of the Underwriter's Gross Spread.

DISCLOSURE COUNSEL

A separate Disclosure Counsel is sometimes hired to prepare the Official Statement. In Oregon, the Official Statement is most often prepared by the Bond Counsel, the Financial Advisor, or the Underwriters Counsel. Some issuers, who are frequently in the market with different teams of underwriters, prefer to retain a single firm to prepare the Official Statement to keep it consistent across many different transactions. As part of the closing documents, Disclosure Counsel will generally provide an opinion to the investors in regards to the completeness of the information included in the Official Statement.

PAYING AGENT/FISCAL AGENT/REGISTRAR/TRUSTEE

The paying agent, fiscal agent or registrar facilitates transactions with investors. The Paying Agent pays to the investors (who purchased the bonds) the periodic principal and interest payments throughout the life of the bonds. The registrar registers the issue upon its sale and re-registers the issue as it is traded on the secondary market. The registrar is responsible for maintaining records on behalf of the issuer. When the paying agent is a commercial bank or trust company, it is recommended that the issuer establish a contract containing time limits regarding forwarding funds to the paying agent to provide for payment of interest and maturing bonds. The contract would also specify the use of funds not needed to pay debt service, fees to be charged and specific services to be performed. The paying agent must be equipped to pay interest on and redeem bonds as they are due, to cancel bonds and coupons and handle lost or stolen bond issues.

Certain municipalities may serve as their own paying agent, use the County Treasurer, or enter into agreements with financial institutions to serve as the municipality's paying agent and registrar. For convenience and to facilitate timely and accurate payment of interest and principal when due, the same financial institution normally serves as both paying agent and registrar.

Trustees are used for revenue bonds and in the case of an advance refunding of revenue or general obligation bonds. In the case of an advance refunding, the trustee accepts the proceeds from the new or refunding bond issue and repays the refunded issue. The trustee also advocates for the interests of the bondholders, taking appropriate administrative and legal actions on their behalf to enforce the requirements of the bond obligation entered into by the issuer.

Prior to the 1990s, the Paying Agent and Trustee kept record of the investors so that timely payments could be made (either by mail or wire) to the bond holders. With the advent of electronic record keeping and banking, the Depository Trust Company (DTC) became the record keeper for most bond sales and therefore greatly reduced the role in tracking of bond holders by Paying Agents and Trustees. These roles continue to exist, for the payment of bonds, largely as a backup should the DTC ever discontinue this service.

AUDITORS / VERIFICATION AGENTS

The Official Statement for a bond issue should contain the issuer's audited financial statements. Most Oregon districts are required by statute to have independent audits. The auditor may also review the Official Statement to ensure that the financial statements are correctly presented and that other directly-related information is consistent with the financial statements. Alternatively, statements may be copied verbatim from the audit.

When an Issuer sells Advance Refunding Bonds, the proceeds of the bond issue are placed in an escrow account and invested in non-callable securities (usually Treasury bonds). In this type of financing, an auditing firm (usually a CPA), plays an additional role - that of Verification Agent. Both MDAC and investors require an independent verification that the securities placed in the escrow account will be sufficient to pay off the refunded bonds.

RATING AGENCIES

Credit rating agencies such as Moody's Investors Service, Inc., Standard and Poor's Corporation, and Fitch Investors Service appraise, analyze, and monitor the credit quality of a bond issuer. These firms provide credit ratings for use by retail and institutional investors to gauge the credit risks inherent in the bond issue. The fee for the rating service is paid by the issuer and based on the issue size, type, and complexity. The importance of a rating is dependent on a variety of conditions. The Debt Management Division can assist municipalities with informational requirements for a bond rating and advice on the desirability of an issuer presentation to the rating agencies.

CREDIT ENHANCEMENT PROVIDERS

An issuer may chose to obtain a credit enhancement provider for its bonds if they have a lower rating from a credit rating agency. This enhancement can be in the form of a Letter of Credit issued by a bank, a Bond Insurance Policy issued by a specialty insurance company, or the Oregon School Bond Guaranty by the State Treasurer's Office.

Bond insurance essentially allows an insurance firm to "lend" their rating to a bond issuer for a fee. The insurance acts to raise the credit quality of the issuer for each insured issue, which results in lower interest costs to the issuer. Bond insurance costs vary, based on the size of each issue and the issuer's underlying credit worthiness. The costs are also based on the total amount of future debt service requirements. Issuers should compare the cost of the insurance with the potential savings resulting from lower interest rates due to the higher credit rating. The insurance is only worthwhile if the interest savings from bond insurance exceeds the cost of the enhancement, or if the issuer has been given a prohibitively low credit rating.

In 2008-09, the bond insurance climate changed dramatically. All of the previously operating bond insurers lost their AAA rating, some falling to below investment grade. These events have shaken the market's perception of bond insurance and the rating process which maintained the AAA ratings until they suddenly fell to lower levels without significant advance warning. A few new firms have been formed which have been assigned a new AAA rating, and some firms continue to operate, using lower ratings.

OFFICE OF THE STATE TREASURER

The Office of the State Treasurer (OST) has a wide range of financial responsibilities, including managing the investment of State funds, issuing all State bonds, serving as the central bank for State agencies, and administering the Oregon 529 College Savings Network.

The Debt Management Division (DMD) provides central coordination for all State-issued debt, including general obligation bonds, revenue bonds, and certificates of participation. The Division monitors local and national bond markets, as well as financial and economic trends that impact bond issuance structures and interest rates. Fees charged for DMD services are detailed in OAR 170-061-0015.

Oregon School Bond Guaranty Program

Oregon voters approved Ballot Measure 54 at the November 1998 General Election. This Oregon Constitutional amendment allows the State to guaranty qualified general obligation bonds of eligible school districts, education service districts, and community colleges throughout Oregon. As a result, the program allows qualified districts to have their bonds rated based on the State's current credit rating. The program saves districts thousands of dollars in interest costs over the life of the districts' bonds and can be used alone or in conjunction with bond insurance.

The Oregon School Bond Guaranty Program (OSBG), as defined in Oregon Revised Statutes 328.321 to 328.356, is administered by the OST. OST, in this capacity, filed Oregon Administrative Rules 170-063 which guides administration of the program. OST began accepting requests for participation in January 1999.

The OSBG program requires the jurisdiction to submit an application, fee, current audited financial information, and an authorizing resolution to the OST. Once the information is analyzed, a “Certificate of Qualification” is sent to the applicant. Issuers then choose to participate in the OSBG program based on their own cost-benefit analysis. For those issuers who choose to use the OSBG program, a “Confirmation Letter” is sent to the issuer once the Bond Counsel opinion and the final official statement is received by OST.

Further information on the OSBG program is available on the OST web site:

http://www.oregon.gov/treasury/Divisions/DebtManagement/LocalGov/Pages/Oregon-School-Bond-Guaranty.aspx

Private Activity Bond Committee

Private Activity Bonds (PAB) are government tax-exempt debt instruments that provide a direct benefit to private businesses. They bear numerous restrictions imposed by federal and state regulations. Specifically, they are subject to the limitations and provisions of the Federal Tax Reform Act of 1986, section 141 of the Internal Revenue Code, ORS 286A.605 to 286A.645.

PABs use a municipality's tax exempt status as a conduit to obtain tax-exempt interest rates. The local government issuer incurs no legal responsibility to repay private activity conduit bonds; rather, the private business's credit quality provides the security for the debt financing and ultimately all repayment responsibilities.

State statue ORS 286A.615 empowers the Private Activity Bond Committee to carry out the following functions:

- Adopt by rule standards for amounts allocated to the Committee for further allocation for economic development, housing, education, redevelopment, public works, energy, waste management, waste and recycling collection, transportation and other activities that the Committee determines will benefit the citizens of the State of Oregon.
- Develop strategies for reserving and allocating the limit that are designed to maximize the availability of tax exempt financing among competing sectors of the Oregon economy.
- Survey the expected need for private activity bond allocations at least once each year.

The Legislative Assembly allocates the amount of federally authorized private activity bond volume cap among State agencies and the Private Activity Bond Committee for the two calendar years that begin in a biennium. Any volume cap not allocated by the Legislative Assembly is allocated by the Private Activity Bond Committee.

OAR 170-071-005 and 170-061-0015 governs the PAB Committee's fees, operations, and allocation rules. Any volume cap that is not used by December 15 of each year is returned to the Private Activity Bond Committee. This unused volume cap then becomes carry forward, to be allocated during the first Private Activity Bond Committee meeting of the next calendar year. The carry forward allocation is able to be used within three years, and expires December 30th of the third year. If this carry forward is not used, it is then permanently expired.

The PAB Committee shall, by statute and Administrative Rule:

- Support projects that increase the number of family wage jobs in this state.
- Promote economic recovery in small cities heavily dependent on a single industry.

- Emphasize development in underdeveloped rural areas of this state.
- Utilize educational resources available at institutions of higher education.
- Support development of the state's small businesses, especially businesses owned by women and members of minority groups.
- Encourage use of Oregon's human and natural resources in endeavors that harness Oregon's economic comparative advantages.

The PAB Committee meets quarterly and the staff of the Debt Management Division of the Office of the State Treasurer provides services to the PAB Committee. The Committee is responsible for processing requests by State and local issuers for PAB current and carry-forward allocations. The PAB staff maintains the State's private activity bond volume cap records and provides all administrative support to the Private Activity Bond Committee.

Municipal Debt Advisory Commission

The Oregon Municipal Debt Advisory Commission (MDAC) was established in 1975 to assist local governments in the cost-effective issuance, sale, and management of their debt. The Commission is composed of seven members, including the State Treasurer (or his designee), three local government finance officers, one representative for the special districts, and two other public members.

State statue ORS 287A.634 empowers the Municipal Debt Advisory Commission to carry out the following functions:

- Collect, maintain, and provide information on bonds sold and outstanding and serve as a clearinghouse for all local bond issues.
- Maintain contact with municipal bond underwriters, credit rating agencies, investors, and others to improve the market for public body bond issues.
- Undertake or commission studies on methods to reduce the costs of state and local issues.
- Recommend changes in state law and local practices to improve the sale and servicing of local bonds.
- Perform any other function required or authorized by law.
- Pursuant to ORS Chapter 183, adopt rules necessary to carry out its duties.

The MDAC strives to improve existing services and to initiate new programs and legislation aimed at lowering borrowing costs and improving debt management practices for local governments, particularly in the area of capital planning and debt administration.

Debt Management Division staff provides Commission staffing and services to local issuers. The MDAC staff can provide information on various aspects of bond sales, including general items such as current market conditions, broad guidance on Oregon State laws and potential financing alternatives.

Annual Report

State law ORS 287A.634 requires the MDAC to prepare an annual report describing activities of the Commission in the preceding year. This report is available on the Debt Management Division website.

Oregon Bond Calendar

The MDAC keeps a record of upcoming bond sales of local districts and State agencies in Oregon and monitors bond market trends and interest rates. The *Bond Calendar* is available at no charge and may be obtained on the Debt Management Division web site or via email at DMD@ost.state.or.us. It is distributed to interested entities in the state including banks, underwriters, local government organizations, and the general public. To optimize marketing of all Oregon bonds, issuers should review the *Bond Calendar* to minimize scheduling conflicts with other issuers.

The *Bond Calendar* lists all planned, completed, and postponed bond sales for competitive, negotiated, or privately placed sales. This information is based upon notification of issues (via the MDAC Form 1) and Preliminary and Final Official Statements received from municipalities that issue bonds. Also included in the *Bond Calendar* are events related to municipal bonds such as election dates, bond election results, and the *Bond Index* (a measure of bond interest rate trading levels in the secondary market). The index is a weekly average obtained from bond dealers in Oregon for ten and twenty year maturities of both State of Oregon GO bonds and local (A-rated) unlimited general obligation (ULTGO) bonds and provides a handy reference for the trend and level of tax exempt bond interest rates in Oregon.

Statewide Database

The Debt Management Division maintains a database of all outstanding bond issues for all municipalities in the state. For each bond issue sold, the Bond Tracker database is populated with information obtained from the MDAC forms. The system is updated annually with revised population statistics and true cash values of tax code areas for Oregon municipal districts in order to calculate overlapping debt for issuers with a reported tax base.

Pursuant to the requirements of ORS 287A.634, the Debt Management Division requests municipal districts verify their long-term financial debt every other year. This is done to ensure the accuracy of information contained in the Bond Tracker system and is especially important in reporting municipal district overlapping debt for disclosure purposes. Each municipality is asked to respond - either acknowledging the amounts are correct or, if inaccurate, the municipality is asked to correct inaccurate data or add missing data.

Overlapping Debt Report

Using the Bond Tracker system, the Debt Management Division is able to aggregate information on the municipality's total debt issued (to which any given jurisdiction is subject). This information is used to create a standardized report called the "Overlapping Debt Report." The report includes information concerning maturity dates, amounts, interest rates, and overlapping percentages as a proportion of True Cash Value (TCV) for all general obligation debt. For example, the residents of a certain city may be indebted through government borrowing by their city, county, school district, and various special districts such as water, sewer, fire, etc.

Free overlapping debt reports may be requested from the Treasurer's Office by municipalities contemplating issuing or retiring debt, by capital market analysts, rating agencies, or by the public.

STEP 3: DEBT POLICY CONSIDERATIONS

While there are no national standards for debt policies, many state and local governments have adopted written policies in order to enhance their position in debt-related matters. Formal debt policies are often used as a means of establishing credibility with bond rating agencies. The Government Finance Officers Association (GFOA) encourages municipalities to establish a formal, comprehensive debt policy. This policy establishes debt limits and parameters while providing sufficient flexibility to respond to changing circumstances. The debt policy also furnishes instructive guidance for debt management decision-makers and be formally adopted by the local elective or appointed government body.

Many local governments and special districts have incorporated informal debt policies into a variety of documents. These documents frequently include official budgets, capital improvement plans, general or comprehensive plans, charters, grant applications, council resolutions, and/or administrative practices. However, when these policies are scattered, unwritten, or developed on a case-by-case basis, it is unlikely that decisions will be made with consideration of other current, past, or future policy alternatives. Having a formal set of policies assists debt managers in the decision-making process and helps identify conflicts, inconsistencies, and gaps in a municipality's approach to financial policy and debt management. Potential benefits of formal policies include:

- Consistency in financial decisions.
- Prescription of improvements that are desired.
- Identification of strengths and weaknesses in the overall financial system.
- Establishment of standard operating procedures to guide daily financial activities.
- Measures of performance.
- Improvement in bond rating translating into money saved.
- Linking of long-term financial planning with day-to-day operations.
- Attention to the total financial picture versus single issue.
- Significant ability to insulate from fiscal crisis.

Formal debt policies describe local government policies and procedures currently in use. Policies also integrate short and long-term capital infrastructure objectives with reasonably conservative estimates of available financial resources. Formal debt policies may also include:

- Purposes for which debt can be issued
- Integration of capital spending and debt financing
- Debt limitations
- Types and criteria for which debt can be issued
- Debt structure
- Use of taxable debt
- Credit policy
- Method of sale
- Selection of the finance team
- Refunding policy
- Disclosure requirements
- State and Federal tax compliance
- Investment of bond proceeds

The sample debt management policy and statements are offered for general use when developing a formal debt policy. The items listed in the guide are not exhaustive nor are they appropriate for all situations and municipalities. They are presented as examples of policies and/or ideas which may be evaluated, altered, and used as appropriate.

CONSIDERATIONS

The process of issuing municipal bonds begins well before the issuer holds a bond election, prepares an Official Statement, or sells the bonds. The framework for responsible debt management is established in advance by the development of a long-term plan for capital improvements and expenditures. The first step to creating a long-term plan is preliminary analysis involving three broad considerations:

1. Project feasibility (a cost-benefit assessment).

2. Various financing options (e.g. bank loan, local option levy, bonds, etc.).

3. The advantages of a public offering (negotiated sale or competitive bid) as opposed to private placement, where private placement is legally allowed. *As a*

general rule, the debt redemption schedule should not extend beyond the useful life of the project being financed.

Issuers should review proposed debt offerings against statutory debt ceiling limitations as early in the debt issuance process as possible - when capital needs and tentative amounts are considered. See the statutory general obligation debt limits for most Oregon districts and municipalities. The Debt Management Division also provides issuers with overlapping debt reports for comparison of total debt outstanding to each applicable debt ceiling.

Capital Improvement Plan

A well-thought-out long-term capital planning program is composed of all the levels of needs and desires for community facilities, balanced by the realism of government's limited resources to serve its population. The equation must include a cost-benefit analysis that produces an objective measure of the best choice, given the variables.

Once a formal capital improvement plan is developed, it is submitted to the municipality's elected officials for approval. If properly prepared, a capital improvement plan will demonstrate a community's commitment to infrastructure improvements and long-term economic well being. It will also show a realistic and thoughtful self-evaluation of community financial liabilities and funding resources. This can be a strong positive credit quality indicator to investors and credit rating agencies. Typically, a good plan identifies the following:

- Those community needs that are appropriate for debt financing and do not exceed the statutorily permitted debt levels.
- A ranking of each proposed capital improvement project and expenditure item.
- A timeline of when the improvements will commence and the number of years to complete construction.
- The amount budgeted for each year.
- The financing method proposed and a systematic review of all funding alternatives such as tax revenues, user fees, rents, intergovernmental grants and loans, and public-private financing partnerships.

Capital Improvement Budget

The capital improvement budget is adopted based on the capital improvement plan which is typically approved by the governing body. It should include enacting statutes for appropriations and the necessary bond issues. The capital budget may differ from the long-term capital improvement plan because of financial constraints and changing circumstances. After adoption of the capital budget, the capital plan should be updated to include any changes necessary in future years as a result of current budget revisions. Future operating costs must be determined once a capital project has been selected. These costs include debt service and the maintenance and operational expense of any physical facility. Operating expenditures should be estimated and adjusted for anticipated inflation.

Capital Improvement Projects

Local governments should evaluate their past economic growth and financial performance, current conditions, and the implications of these trends for the future. Governments experiencing significant community growth usually require capital expenditures on a variety of projects. Capital project construction and improvements are expected to have a useful life of more than one year and are defined in ORS 310.140. Capital improvements generally do not include items such as normal operating budgets, routine maintenance and repairs, consumables, and personnel salaries. The following are some examples of capital projects:

- Land acquisition.
- Major recreational and cultural facilities.
- New construction and improvement or replacement of older facilities to meet the rising expectations and standards of the community.
- General community services and infrastructure needs such as schools, sewer and water facilities, police and fire protection equipment.
- Other projects which may be specific or unique to a particular local government jurisdiction (i.e. sometimes projects may arise in response to the needs of certain groups).

Tax Anticipation Notes

Local governments sometimes find that the timing of expenditures and the timing of tax receipts do not always align well. To bridge the gap between expenditures and tax receipts, a government may issue tax anticipation notes. Since these notes are a form of cash flow borrowing, rather than a capital project borrowing, some additional policy considerations are appropriate. The local jurisdiction should create additional policies for the following:

- Arbitrage considerations
- Maximum sizing of notes
- Reinvestment risks and repayment timing

Public Employee Retirement System (PERS) – Pension Obligation Bonds

Employers must assess certain risks prior to making a lump sum payment as this affects the anticipated value of the payment or the rate relief that the employer is anticipating. These risk variables include, but are not necessarily limited to:

- *Unfunded Actuarial Liabilities (UAL) and Lump-sum Payment Treatment*
  UAL is the difference between the present value of "accrued liabilities" and the value of assets (either smoothed or fair market value) as of a specific date. Lump-sum payments will not change accrued liabilities, as these actuarial liabilities represent future benefits to be paid to members or their beneficiaries. Instead, lump-sum payments will be treated as prepaid contributions, which will increase the actuarial value of assets attributed to the employer making the payment. By increasing the value of assets to offset the actuarial liabilities, the UAL will be reduced, therefore reducing the employer's rate.

  A lump-sum payment does not affect the accrued liabilities attributed to the employer making the payment. The lump-sum payment will be used to increase the assets attributed to the employer, which will be used to offset the employer's liabilities, thus reducing the employer's overall UAL.

  The reduction in the individual employer's contribution rate will be equivalent to an amortization of the lump-sum payment over the expected payroll of the employer, increasing with wage inflation over the course of the remaining amortization period, and discounted at the assumed earnings rate. The rate relief, as a percentage of employer's payroll, may change over time depending on the actual future payroll of the employer and assumptions and methods adopted by the Board for financing the system's obligations.

- *Basis for Lump-sum Payments*
  The most recent actuarial valuation will become the basis for calculating UALs. Lump-sum payments made after completion of the valuation will be based on those results.

  An employer may have an outstanding UAL that was calculated on an individual employer basis, or as a participant in an actuarial funding pool. A lump-sum payment may be made to offset all, or a portion of, the outstanding UAL regardless of its source.

- *Changing Nature of UALs*
  Each time a valuation is conducted, it provides a new assessment of the system's financial position. Employer UALs are an important product of each valuation. Valuations represent a financial "snap-shot" of employer pension obligations as of a particular point in time. As subsequent valuations are conducted, they provide a fresh look at the system's pension obligations. These obligations can experience significant changes from valuation period to valuation period. This, in turn, can cause the UAL of the system and of individual employers to also change.

- *Assumed Rate of Return on Investments*
  The PERS actuarially assumed rate of return on investments is currently 8.00%. More information can be found on the PERS website. This estimate is what the PERS Fund expects to earn, on average, over a 30-year period and is the basis for amortizing employer liabilities and surpluses. This would also be the basis for amortizing employer lump-sum payments. Because this assumption is subject to review during each valuation, it could change if necessitated by a change in long-term market projections.

  A decrease in the assumed rate from the current 8% would cause a reduction in the anticipated value of the unamortized portion of the lump-sum payment, thus reducing the amount of rate relief associated with the lump-sum payment as a percentage of payroll. In turn, an increase in the assumed earnings rate will result in an increase in the anticipated value of the unamortized portion of the lump-sum payment, thus increasing the amount of rate relief as a percentage of payroll. Given current market conditions, if a change were made, it would likely result in a reduction in the assumed rate.

- *Side Fund*
  If a supplemental lump-sum contribution is made by an employer participating in either the State and Local Government Revenue Pool (SLGRP) or the School Districts Pool, it will be held, with interest, in a Side Fund according to provisions of the PERS administrative rule (OAR 459-009-0084). This is necessary so that

the employer making the supplemental contribution receives the benefit of that contribution, rather than being included with the entire pool. The value of the side fund is treated as an employer asset to offset the UAL. The Net UAL is the UAL less the value of the Side Fund.

- *Earnings Crediting Policy*

  Earnings credited to the employer via lump-sum payments will be actual regular account earnings, or losses, adjusted for administrative costs and charges used to fund the contingency reserve. This can directly impact the value of the unamortized portion of a lump-sum payment in future crediting periods.

  Because lump-sum payments will be amortized based on the assumed earnings rate (currently 8% per year), any crediting of earnings to the lump-sum payment that is below the 8% assumed earnings rate would result in a reduction in the anticipated value of the lump-sum payment and the employer would receive less of an offset to the employer's UAL costs than originally anticipated. Likewise, earnings credited in excess of the assumed rate would result in an increase in the anticipated value of the lump-sum payment, which would provide a greater offset to the cost of an employer's pension liabilities.

- *Projected Payroll of Employer*

  The reduction in an employer's contribution rate attributable to a lump-sum payment is based on a projection of the last known payroll of the employer. If the payroll of the employer increases, either faster or slower than assumed, the employer contribution (as a percentage of payroll) will decrease or increase, but the dollar amount of annual rate relief will remain unchanged.

  Just as a change in the assumed earnings rate or the amortization period may affect the rate relief, a change in the assumed growth in payroll will also impact the rate relief as a percentage of payroll.

- *Effect of Legal Contingencies*

  Unsolved questions of law, including, but not limited to, those raised by litigation, may change the calculation of liabilities or assets.

Derivatives

With the onset of the financial crisis in 2008, the risks related to derivative products such as swaps, hedges and rate locks are now more widely understood. Derivative products can be used as part of a total portfolio but carry with them many risks normally not born by the investors of fixed rate debt. It is important that clear policies be developed long before entering into transactions which involve derivatives. MDAC has a sample swap policy from the City of Portland and the Port of Portland. Any derivative policy should address the following areas:

- Responsible Parties
- Process for approval
- Purpose
- Form of agreement
- Method of procurement
- Risk Analysis
- Risk Mitigation
- Counter party credit ratings
- Collateralization and downgrade provisions
- Monitoring & Mark to Market
- Termination

Step 4: Types of Debt Instruments

A decision on the type of debt to use can be made once capital project funding is approved. The following list briefly summarizes the types of debt and financial instruments that are currently authorized for Oregon local governments. For further definitions and information on varying types of bonds, see the MSRB Glossary.

General Obligation Bonds

General Obligation (GO) bonds typically benefit a community as a whole and are secured by the full-faith-and-credit and taxing power of the issuing municipality. The municipality pledges unconditionally to pay the interest and principal on the debt as it matures. For Oregon local governments, a GO pledge means that all unrestricted resources of the issuer may be used to meet debt service, including an *unlimited property tax* on all taxable property within the district. Local government GO bonds may only be issued if authorized by a ballot election of the issuing jurisdiction. Voter Authorized General Obligation bonds are supported by an unlimited tax levy outside of the limits imposed by Article XI, Section 11 and 11b of the Oregon Constitution.

Under ORS 287A.050-287A.145 general obligation debt can be incurred for capital construction and improvements having an expected useful life of more than one year. This does not include maintenance and repair (the need for which could be reasonably anticipated), supplies, and equipment that are not intrinsic to a structure. General obligation debt has been the traditional form of financing for capital projects such as land acquisition, schools, water facilities, sewerage facilities, and roads that are owned and operated by governments. GO bonds can also be issued to replace outstanding general obligation bonds, and are commonly referred to as Refunding Bonds.

There are several types of GO bonds which place varying emphasis on the full-faith-and-credit security and the issuer's taxing ability. These types of Unlimited Tax GO (ULTGO) bonds are categorized by source of repayment, as follows below.

Non Self-Supporting GO Bonds

Non-self-supporting GO bonds or tax-supported bonds are those which are paid for by property taxes or other tax sources. School district bonds in Oregon are traditionally supported by property taxes and are historically GO Non-self-supporting bonds. Non Self-Supporting and partially self-supporting GO bonds determine a district's Net Bonded debt. Net Bonded debt is a measure of the debt burden on property of the district.

Self-Supporting GO Bonds

Self-Supporting GO bonds are debt issues paid from a project's revenue. The proceeds of Self-Supporting bonds are used to construct a revenue-generating enterprise or facility or there is an independent source of funds for bond repayment. These may be fully Self-Supporting or only partially Self-Supporting. If fully self-supporting, the bonds are not included in the Net Bonded debt of the district, but are included in its Gross Bonded debt. If only partially Self-Supporting, they are included in the Net Bonded debt and Gross Bonded debt calculations. (See "Computing Net Direct Debt"). Another name for these types of bonds is Double-Barreled bonds.

Appropriation Bonds

Certificates of Participation (COPs), sometimes referred to as "Lease Purchase Agreements", may be an alternative to issuing bonds and are often used to finance real property or equipment, construction of public facilities, and facility maintenance and renovation. COPs are authorized under ORS 271.390. COP's principal and interest (debt service) payments are not secured by a particular revenue source nor does the government have the authority to levy extra taxes beyond constitutional limits to pay debt service. COPs are secured by an obligation of the government to make regular payments to meet debt service and, most commonly, a security pledge of the real property or equipment. In the typical COP, if the issuer defaults, the structure or asset is "repossessed." The security of the instrument, in the eyes of the investors, lies in the expectation that the government will choose not to forgo use of the structure or asset which may be a facility critical to the government's function. COPs differ from Full Faith and Credit Obligations in that COPs are subject to annual appropriation and therefore are not bonds. Since they are subject to annual appropriation, collateral (if used) is generally viewed as one means to incent the issuer to keep appropriating or lose access to an essential public asset. Since the real credit is the annual appropriations of the issuer, highly rated issuers sometimes issue COPs with little or even no collateral. In these cases, future access to the capital markets would be eliminated should they fail to appropriate for the payment of the COP.

Some attributes of Certificates of Participations include:

- No voter approval is required, nor is adherence to the restrictions of the Uniform Revenue Bond Act (ORS287A.150).
- General fund revenues, at the option of the governing body, can be used to pay the debt service.
- Interest rates are generally higher because the payments are subject to annual appropriation and lack a pledge of specific taxes.
- COPs are more complex than GO bonds. This may result in higher issuance costs and fees.
- COPs are typically rated at least one notch below the district's GO rating.

Full Faith and Credit Obligations

Full Faith & Credit Obligations (FF&C) may be secured by a variety of pledges except as restricted by the Oregon Constitution or Statutes or by local charter. FF&C bonds are authorized under ORS 271.390. In such a case, the municipality is still required to use all legally available resources to meet its obligations. FF&C bonds are backed by the general revenue and taxing power of the issuer within the limits of Sections 11 and 11b of Article XI of the Oregon Constitution. FF&C obligations are not subject to an annual appropriation process and are therefore often seen as a better credit than COPs.

FF&C (Self-Supporting) bonds are generally perceived by investors to have a higher risk than the unlimited-tax general obligation bond, but are still perceived to be less risky than COPs. The difference in interest rates will depend on numerous factors, including the financial condition and reputation of the issuer, the revenue source used to repay the debt, the security pledge, and the nature of the asset being financed.

Rating agencies will typically rate FF&C obligations one step below the full unlimited-tax general obligation rating of the district.

There are two types of FF&C bonds which place a varying emphasis on credit security and the issuer's taxing ability. These types of obligations are categorized below.

Full Faith & Credit (Non Self-Supporting)

FF&C Non Self-Supporting obligations are paid by property taxes or other tax sources up to the limit imposed by Oregon's Constitution, Article XI, Section 11(b).

Full Faith & Credit (Self-Supporting)

FF&C Self-Supporting obligations are paid from a project's revenue stream. The proceeds are used to construct revenue generating enterprises or facilities, or there is an independent source of funds for repayment. The taxing authority behind the security pledge on the obligation is limited by Sections 11 and 11b of Article XI of the Oregon Constitution.

Revenue Obligations and Bonds

Revenue Bonds are usually payable from revenues generated by the project or enterprise. They may be issued under the authority of the Oregon "Uniform Revenue Bond Act" (ORS 287A.150) and must adhere to applicable state and federal statutes and regulations. Alternatively, Revenue Obligations may be issued under ORS 271.390. Both bonds and obligations have the same security structure and considerations with the note that revenue bonds are more widely recognized by investors outside of Oregon markets. No ad valorem property taxes are levied or pledged. Revenue bondholders do not have recourse against the full-faith and unlimited or limited taxing power of the government and these bonds are expected to be fully self-supporting. The bonds are generally repaid from user charges, grants, excise taxes or from enterprise earnings and do not rely on the ad valorem taxing powers of the government for their security. The following are advantages to issuing Revenue Bonds:

- Governments have the ability to finance traditional projects without pledging the power to tax, reserving this power for other services. Special districts have been created to promote projects as an alternative to general government action. Although they don't have the power to tax, they may have the power to float bonds and serve as conduits for financing non-governmental activities in the tax-exempt market.
- Those responsible for the payment are those who benefit reflecting a "user pays" philosophy.
- Revenue bonds are usually not restricted by various debt limitation statutes.
- Voter approval is usually not required. However, bonds issued pursuant to the "Uniform Revenue Bond Act" may be subject to voter approval if sufficient petition signatures are gathered during the 60-day period following publication of the bond notice.

Revenue Bonds often have other associated requirements and several distinctive disadvantages such as:

- Repayment revenue depends on the continuity of the revenue source. This may result in significantly higher interest rates and issuance costs than ULTGO bonds because of their limited security.
- Higher coverage requirements (i.e. revenues compared to debt service).
- Requirement to maintain a debt service reserve.
- Generally require more complex financial arrangements.
- Bonds (not Obligations) require adherence to Oregon's Uniform Revenue Bond Act, which has a 60-day notice period during which the bond cannot be sold and is subject to voter referral.

Revenue Bonds are often categorized by source of revenue. Some examples of different types of Revenue Bonds follow.

Enterprise Revenue Bonds

Enterprise Revenue Bonds finance projects that are expected to generate revenues to repay the debt. The bonds are issued under the provisions of the Uniform Revenue Bond Act (ORS 287A.150) or under other specific statutes.

Special Revenue Bonds

Special Revenue Bonds are secured by special revenues such as an assessment or gasoline tax. These funds are directed to a special fund established for the purpose of bond repayment. The contents of the fund form the bond's security and repayment source.

Double-Barreled Revenue Bonds

Some revenue bonds are dually secured with a dedicated revenue source and a jurisdiction's qualified or unqualified tax pledge. This enhancement generally results in a higher credit rating for the security which can result in lower interest rates for the bonds.

Industrial Development Revenue Bonds

Industrial Development Revenue Bonds (IDBs or IDRBs) are revenue bonds authorized to be issued in Oregon through the Oregon Business Development Department, port districts, and cities of over 300,000 in population. These bonds finance construction of facilities for eligible private enterprises to increase employment and to promote economic development and diversity. IDBs are private activity bonds and require an allocation of the State's private activity bond volume cap to qualify as tax exempt.

Urban Renewal Bonds

Tax Increment (Urban Renewal) Bonds, are authorized for cities, designated agencies of cities, and counties as authorized by Article IX, Section 1c of the Oregon Constitution and ORS Chapter 457 (Urban Renewal of Blighted Areas—Tax Increment Financing of Urban Renewal Financing). Urban Renewal Bonds are similar to GO bonds in that they are repaid by property taxes. Also, they may be used for similar infrastructure improvements such as streets, sewers, property acquisition and housing development. A difference is that they must be issued for the purpose of remedying “blighted’ conditions within a specific community. These bonds are repaid through taxes on any increase in assessed value above the frozen level, rather than the entire assessed value of the property as in GO bonds. This is referred to as “Divide the Taxes Revenues”. To use these bonds, an urban renewal area must be designated and property assessments for this designated area are then “frozen” at prevailing rates.

Taxes Revenues are calculated by multiplying the Incremental Assessed Value of an urban renewal area by the consolidated billing tax rate. The consolidated billing tax rate is the sum of the tax rates of taxing districts that overlap the area. The incremental assessed value is the difference between the assessed value of all taxable property in the Area from the date the area was formed adjusted for certain later changes to the area and the current assessed value of all taxable property in the area.

The security for the borrowing is the expected growth in property tax revenues resulting from the urban renewal improvements. These bonds may be considered riskier than General Obligation or Revenue Bonds because there is no guarantee that resultant property values and tax revenues will increase. Consequently, this usually results in higher interest rates paid on the bonds.

Local Improvement District Financing

Local Improvement District Bonds, known as Assessment Bonds are authorized in ORS 223. These bonds are secured by charges or assessments to property owners who benefit from the improvements. To collect the charges or assessments, municipalities may form Local Improvement Districts (LID) within which the improvements are to be made.

Special districts, such as county road districts, may use special assessment procedures and authority to issue bonds to finance various local improvements such as sewer, water and streets. Special assessment bonds are issued for the amount of the unpaid assessments and an amount necessary to establish a debt service fund and pay issuance costs. Properties that benefit from the improvements are proportionately assessed the actual cost of the improvement. The method of distributing the cost of the improvements among the benefitted properties may be determined in a number of different ways and is determined by the governing body. The assessment payments are used to meet debt service obligations. Since assessment payments are notoriously unpredictable, the timing of payments is uncertain, and the credit quality of the bond is diminished. Some assessment financings are issued as Full Faith and Credit Obligations (ORS 271.390) with the assessments as the basis for the bond payments but offering the issuer’s full faith and credit as security for the obligations.

If the issuer uses its full faith and credit to secure the obligations, it is important that the issuer develop internal guidelines sufficient to protect the issuer from having to pay the bonds without getting offsetting assessment payments. These guidelines, or policies, should include a maximum loan to assessment ratio which considers all liens on the property, the maximum size of the assessments, concentration of assessed property ownership and financial capacity of the property owner to make payments. Some issuers require additional collateral from property owners that own large portions of the LID, whose assessed value versus assessment ratio does not meet the guideline or may not meet the financial standards of the issuer.

Historically, Oregon had a special kind of assessment bond known as a Bancroft bond. These bonds were additionally secured by an unlimited general obligation of the issuer and did not require voter approval. Oregon's Constitution was amended to prohibit this type of bond issuance.

Private Activity Bonds

Private Activity Bonds (PAB) are government debt instruments issued for the direct benefit of private businesses. These bonds bear numerous restrictions imposed by federal and state regulations. Specifically, they are subject to the limitations and provisions of the Federal Tax Reform Act of 1986, section 141 of the Internal Revenue Code, and ORS 286A.605 to 286A.625.

A frequent advantage of PABs is the private-use of a municipality's tax-exempt name as a conduit to tax-exempt interest rates. Another advantage is that the government issuer incurs no legal responsibility to repay private activity conduit bonds; rather, the private business' credit quality provides the security for the debt financing and ultimately all repayment responsibilities.

The paramount consideration for the issuance of PABs in the State of Oregon is to maximize economic benefits to the citizens of the State by the promotion of appropriate economic development and other public purposes. PABs are issued to increase the number of family wage jobs, promote economic recovery and development and support the development of Oregon's small businesses, including businesses owned by women or minority groups and assist lower income families to obtain housing.

Private Activity Bonds authorized for a variety of uses including: single family mortgage, small issue industrial development, student loans, water/sewer/solid waste, hazardous waste facilities, district heating and cooling, local gas and electric, and tax-increment financing bonds.

Private Activity Bonds are subject to a statewide bond volume cap limit. The amounts allocated for PABs, as provided in ORS 286A.615, are determined on a per capita basis using U.S. Federal government census data for Oregon's population. The Oregon Legislature determines PAB allocations each calendar year for the various state agencies such as the Oregon Economic Development Commission, Business Development Department, Housing and Community Services Department, Office of Energy, and the PAB Committee. The current volume cap and allocations are located at:

http://www.oregon.gov/treasury/Divisions/DebtManagement/Pages/Private-Activity-Bond-Committee.aspx

The Oregon State PAB Committee is responsible for the allocation and reallocation of PABs among local governments, districts, and other public issuers. Oregon Administrative Rule 170-71-0005, "Allocation of Private Activity Bond Limit," provides PAB allocation guidance and procedures for Oregon local governments and municipalities. For additional information, contact the State Treasurer's Debt Management Division.

Short Term Debt

By convention, short-term debt is defined as debt with a stated final maturity at the time of sale of 13 months or less. General Obligation and Revenue Bonds are classified as long-term debt, whereas short-term debt instruments are usually referred to as notes or warrants. Local governments, districts and agencies may, pursuant to ORS 287A.180, pledge anticipated taxes, grants, anticipated bond proceeds, or other revenues when entering into contracts with lending institutions for short-term financing. The Office of the State Treasurer, Debt Management Division does not track municipal debt of less than 13 months. Several types of short-term instruments are described below.

Tax Anticipation Notes and Warrants

Tax Anticipation Notes (TANs) and warrants are both issued to provide interim financing for operations to which taxes are committed but not yet collected. In general, these instruments are used to alleviate a cash flow situation in which collections do not coincide with expenditure needs. Usually TANs are retired from tax collections, and only from proceeds of the tax levy whose collections they anticipate. Under Oregon Revised Statute 287A.180, short-term debt, such as TANs, may not be issued prior to the beginning of the fiscal year in which the taxes or other revenues are expected to be received. Additionally, TANs must be repaid no later than the end of the fiscal year in which the borrowing occurs. Obligations issued in anticipation of taxes or other revenues may not be issued in an amount greater than 80 percent of the amount budgeted to be received in the fiscal year in which the obligations are issued.

Bond Anticipation Notes

Bond Anticipation Notes (BANs) are issued to provide immediate funds to begin a project prior to issuing approved bonds. Bond anticipation notes, under authority of ORS 287A.180, may be repaid according to the schedule determined by the governing body. Obligations issued to provide interim financing for capital assets must mature not later than one year after the estimated completion date or acquisition of the capital assets. In periods of market instability and volatile interest rates, bond anticipation notes may be used to delay the sale of a long-term debt issue until the market climate becomes more favorable to the issuer. BANs may be sold in a fashion similar to bonds or more commonly they are sold as direct bank placements or as lines of credit. Other considerations related to the issuance of BANs include:

- Difference between long term rates or cost of capitalizing interest versus short term rates.
- Timing of ratings on long term debt.
- Coverage requirements related to revenue bonds.
- Actual cost of the project.

It is important to note, however, that deferring long term debt involves the risk that interest rates may rise from the time of the planning phase of the project to the actual issuance of the permanent financing. Care must be taken in financial projections to allow sufficient room in projections to allow for some upward movement in interest rates.

Revenue Anticipation Notes

Revenue Anticipation Notes (RANs) are used as interim financing prior to collection of revenues that will be generated once a project is completed. RANs may also be used for operating purposes prior to collection of specific revenues.

Grant Anticipation Notes

Grant Anticipation Notes (GANs) may be used to finance a project for which a state or federal grant has been committed.

Refunding Bonds

Refunding bonds are issued to replace or refinance previously issued debt with new debt. Refunding is typically used to restructure debt, to save borrowing costs through lower interest rates and revise legal restrictions or covenants. There are two principal types of refunding bonds as noted below.

Current Refunding

Current refunding usually involves selling new bonds to refinance outstanding bonds prior to their maturity date but slightly before or after their "call date". The current refunding may take place no earlier than three months before the "call" and any time after the call. Under federal law, the payment of bonds must occur within 90 days of selling the new bonds, otherwise the refunding will be considered an "advanced refunding." Under Oregon Law, the redemption of the bonds must occur within one year to be considered a current refunding and not fall under the State's advance refunding rules. The refunding is normally done to create interest cost savings or remove a covenant the municipality considers onerous. The new bond is sold for the remaining principal of the old bond plus any interest accrued until the date the bonds are called. Current Refundings are authorized by ORS 287A.360.

Advance Refunding

Advance refunding occurs when outstanding bonds are refinanced 90 days prior to or "in advance of" their maturities and prior to the call dates for Federal Law purposes and one year for Oregon purposes. Bond proceeds are placed and invested in an irrevocable escrow structured so that they produce interest and maturing principal to pay off the previous debt as it matures or is called. Accordingly, the refunded bonds do not count as part of the municipality's debt limitations. To insure the escrowed proceeds are available and do produce the expected payments, normally non-callable, full faith and credit obligations of the US Government are used.

The federal government restricts yield on the investment of the proceeds of an advance-refunding bond. State regulations also limit the size of the refunding bond and the manner in which the proceeds can be invested. State regulations require that advance-refunding bonds be sold only to achieve a net dollar benefit to the issuer or for debt reorganization purposes. To achieve a net benefit, an advanced refunding must satisfy the State "Significant Savings Tests" pursuant to OAR 170-062-00. This requires present value savings of the advance refunding to equal or surpass any one of the three following criteria:

- Present value savings of $5 million or more, or
- A minimum savings ratio of 3.0 percent, or
- An annual "tax rate impact" of $0.15 per $1,000 or more.

Advanced refunding proceeds are most often invested in special State and Local Government Series (SLGS) Securities. SLGS are securities offered by the U.S. Treasury to state and local government entities as an investment alternative which assists issuers of tax-exempt securities in complying with yield restrictions and arbitrage rebate provisions of the Internal Revenue Code. SLGS securities are issued in book-entry form and are non-marketable. The SLGS demand deposit security is a one-day certificate of indebtedness. The principal and daily-accrued interest is automatically rolled over each day until redemption is requested. The interest rate on SLGS demand deposit securities is based on an adjustment of the average yield in the most recent auction of the 13-week U.S. Treasury bills.

SLGS securities are purchased through the U.S. Treasury and additional information can be obtained at http://www.treasurydirect.gov.

Issuers of advance refunding bonds that are issued more than one year prior to a call must comply with ORS 287A.360-2787A.380 and the State Treasurer's Administrative Rule detailing the "Procedure for Submission, Review and Approval of an Advance Refunding Plan", OAR 170-62-000).

Zero Coupon, Capital Appreciation, and Deferred Interest Bonds

Typical fixed rate bonds pay interest every six months until they mature. These are also referred to as "Current Interest" bonds. Zero Coupon, Capital Appreciation (CABs), and Deferred Interest Bonds (DIBs) do not pay current interest, but rather delay payment to the investor until maturity. This may provide a payment option that better meets the issuer's ability to pay the debt service. It is important to note that these types of bonds appeal to a different segment of the bond market and therefore may pay different yields than current interest bonds.

Variable Rate Bonds

Variable rate bonds do not have a fixed interest rate, rather the interest rate is allowed to fluctuate in response to a particular market rates. The rate is periodically "reset" based on a period that is generally set by a remarketing agent, who is hired by the issuer and remarkets the bonds each period at the lowest rate that the remarketing agent believes is necessary to remarket all of the outstanding bonds. This period can range from every day to several years. Alternatively, an auction process has been employed for the re-pricing of bonds. These products are called auction rate securities. The bonds that are remarketed are called Variable Rate Demand bonds. Since it is possible that a remarketing may fail, variable rate demand bonds require a bank to provide liquidity to buy any un-remarketed bonds. This market is very large and trades occur quickly. It is also a market for only the highest rated securities so if an issuer is not at least AA rated, the bonds will probably need credit enhancement, most commonly provided by the same banks that provide the liquidity. These transactions bear significant risks related to interest rates, bank credits, and enhancement/liquidity renewals. Additionally, these transactions may be complicated and have higher issuance costs, and therefore may not be suitable for all issues. Since the interest rates vary on variable rate bonds, the issuer must be prepared to pay high interest rates at any point in time. However, the long term average interest rate for this type of transaction is well below the long term average rate on fixed rate debt.

STEP 5: METHOD OF SALE

The three main methods of a bond sale are competitive, negotiated, and private placement. Prior to 1991, ORS Chapter 287A provided that most GO bonds issued by municipalities be awarded through public advertising and competitive bid. However, the 1991 legislature changed this law to allow the negotiated sale of GO issues. Revenue bonds and most other types of obligations continue to have the flexibility to be issued through competitive or negotiated sales.

The lack of definitive empirical evidence that would favor one method of bond sale over the other (i.e. negotiated vs. competitive) has resulted in a divergence of views as to the relative merits of each of the two methods. It is recommended that the issuer carefully consider the merits of each kind of sale and make an independent decision as to which type of sale best suits the needs of the issuer for each bond sale. It is optimal for the issuer to have policies in place which ensure that:

- The most appropriate method of sale is selected in light of financial, market, transaction-specific, and issuer-related conditions.
- The method of sale is evaluated for each bond issue, including an assessment of the different risks associated with each method.
- The governmental entity should be able to explain the rationale for its decision.

Competitive Sales

Competitively bid sales are a frequent method of choice for well-rated issuers selling reasonably sized bonds because competition drives the cost of the issue to the lowest possible level. Consequently, underwriters bid for these bonds with the comfort of knowing that investors understand and buy them without an extensive educational process. Conditions that generally favor a competitive sale include:

- The issuer has significant public borrowing experience with a positive reputation in the financial debt markets.
- There is an active secondary market for the issuer’s securities.
- The debt structure is backed by the issuer’s full-faith-and-credit or a strong, historically performing revenue source backs the debt structure.
- The issue is not viewed by the market as carrying complex or innovative features or requires explanation as to the bonds' security.

- Interest rates are stable, market demand is strong, and the financial debt market is able to absorb a reasonable amount of buying or selling at reasonable price changes.
- Policy considerations can be reasonably addressed through specifications of the Notice of Sale. An example of a policy consideration would be a disadvantaged business enterprise (DBE) and regional firm participation that relate to syndicate membership and bond allocations.

A general outline to a competitive bond sale is as follows:

1. The issuer hires outside professionals (usually a Bond Counsel and Financial Advisor) to review the nature of the project and help them determine the financing requirements.

2. The issuer, with the assistance of the Bond Counsel and Financial Advisor, prepares a preliminary official statement (POS) which describes the issuer, the credit structure, the finances, and other items that would be important to potential bond investors.

3. The Bond Counsel and Financial Advisor prepare legal documents related to the sale including a Notice of Sale (NOS) describing the process for bidders (usually investment banking firms) to submit bids for the bonds.

4. The issuer's governing body passes the needed authorizations to sell the bonds.

5. The Bond Counsel and Financial Advisor arrange for the dissemination of the POS and NOS.

6. On the date and time specified in the NOS, the issuer receives bids for the bonds. The bidders provide bids based on their review of the bond credit worthiness and their perception of investor interest in the bonds. Bids are received via online bidding programs. The issuer awards the bonds to the lowest cost bidder. Once the bids are awarded, the winning bidder owns the bonds and can then resell the bonds to investors. The amount of profit the winning bidder receives is based on the price at which they resell the bonds to investors.

Official Bid Form

For competitively issued bonds, issuers should include a Notice of Sale (NOS) in the preliminary official statement (POS). Most commonly, competitive issues use an electronic platform to accept bids. Two nationally recognized platforms are Grant Street Group and i-Deal. Issuers submit the NOS to the electronic bidding service and the details of the sale are posted on a website. Bidders sign up and submit bids using a standardized format which does not allow submittal of bids that do not meet the requirements of the NOS. The issuer may view the sale results, confirm the bid calculations, and award the bid electronically after the sale has closed.

Awarding the Bid on Competitive Sales

Acceptable bids must strictly adhere to the terms and conditions of the NOS; any conditional and qualified bids must be discarded. The issuer, Bond Counsel, and Financial Advisor should be in close contact during the sale. One bid should be identified as the apparent winner, subject to later verification. The winning bid should be awarded based on the lowest True Interest Cost (TIC). Generally the Financial Advisor or Bond Counsel will verify the computation provided by the electronic bidding platform for the winning and cover bids.

Issuers commonly require a good faith deposit at the time of the bid. This can be arranged by the bidder providing a surety at the time of the bid and later sending the deposit if they win the bid. The nature and amount of the good faith deposit should be included in the NOS. Not all issuers require a good faith deposit in advance of the bid, as some issuers allow the winning bidder to make a good faith deposit shortly after the award of the bid. Historically, cashiers' checks for the good faith deposit were required as part of the bid. Given the logistical difficulties of getting an actual check to the issuer from the money centers that bid on bonds, checks are no longer standard. Frequently, underwriters use Sure-Bid which offers a surety bond in lieu of a check.

Negotiated Sale

In a negotiated bond sale, after preliminary discussions and interviews, a single firm or syndicate of firms is selected to purchase and resell the issue. The price is negotiated at the time at which the bond purchase agreement is signed. This allows discussion of the specifics of the issue and its merits and facilitates an exchange of information between issuer and underwriter. Negotiated bond issues allow the underwriter to know several weeks in advance that it will have a specific product to sell. The underwriter's sales and marketing force can then determine how receptive the market is to the bond issue. There is time for the issuer to change some aspects of the bond, such as the bond's size, terms, security, conditions, yields, maturities, or call provisions to make it more appealing (if necessary).

Conditions that favor a negotiated sale include:

- The issuer has limited public borrowing experience and no reputation in the financial debt markets.
- The issue has a non-enhanced credit rating of below A and can obtain a credit enhancement prior to the sale.
- The revenue stream backing the debt is weak, uncertain, or has no history.
- The issue is too large to be easily absorbed by the market or too small to attract investors without a concerted sales effort.
- The issue is viewed by the market as carrying complex or innovative features or requiring explanation as to the bonds' soundness.
- Last minute changes in disclosure are likely due to legal or legislative issues.
- Policy considerations, such as disadvantaged business enterprise (DBE) participation and regional firm participation that relate to syndicate membership and bond allocations, or targeting specific investors.

If a negotiated sale is to be used, issuers should make sure that the process is equitable and defensible and keep thorough records throughout the selection process. Issuers must be aware that the negotiated method of sale does not always promote the "appearance" of an open and fair process that is inherent to the competitive bid method of sale. The underwriter selection process can be susceptible to allegations of partiality and unseemliness, political favoritism, and "pay-to-play" abuses. It is imperative that issuers guard against any appearance of impropriety or abuse of the public trust and select underwriters and other municipal finance players based on the merit of their qualifications and cost to the taxpayer.

To potentially lower costs and to provide market and negotiated sale process knowledge, issuers (especially small municipalities) hire a Financial Advisor (FA) to assist in the sale. See Step 2 for more information on the FA's role and functions.

The negotiated method of sale may be appropriate when certain conditions (previously described) do not allow for a competitive bond sale. In such cases, it is recommended that finance officers adhere to the following practices before entering into a negotiated sale and throughout the negotiated sale process:

- Ensure fairness by using a competitive underwriter selection process through a Request for Proposals (RFP), a Request for Qualifications (RFQ), or another form of solicitation that ensures that multiple proposals are considered.

- Remain actively involved in each step of the negotiation and sale processes to uphold the public trust.
- Ensure that either an employee of the issuer or an outside professional (other than the underwriter), is familiar with, and abreast of, the conditions of the municipal market and is available to assist in structuring the issue, and pricing/monitoring of sales activity.
- Avoid potential conflicts of interest that may occur if the services of a professional financial advisor are used for a particular bond issue and that financial advisor also acts as underwriter of the same bond issue.
- Request that financial professionals disclose the name or names of any person or firm (e.g. attorneys, lobbyists, and public relations professionals), compensated to promote the selection of the particular financial entities.
- Request all financial professionals submitting joint proposals or intending to enter into joint accounts or any fee-splitting arrangements in connection with a bond issue to fully disclose to the issuer. This disclosure would include any plan or arrangements to share tasks, responsibilities, and fees earned as well as disclosing the financing professionals with whom the sharing is proposed, the method used to calculate the fees to be earned, and any changes thereto.
- Review the "Agreement Among Underwriters" (AAU), and ensure that it is given to the issuer and that it governs all transactions during the underwriting period.

A general outline to a negotiated bond sale is as follows:

1. The issuer's governing body passes the needed authorizations to sell the bonds.

2. The issuer hires outside professionals (usually a Bond Counsel and Financial Advisor) to review the nature of the project and determine the financing requirements.

3. The Financial Advisor and issuer prepare a solicitation for Underwriters and distribute the solicitation to qualified firms. A selection should be made based on a review of received proposals, and those proposals should include both the firm's experience and the fees they would charge.

4. The Underwriter prepares a preliminary official statement (POS) which describes the issuer, the credit structure, the finances, and other items that could be important to potential bond investors.

5. The Underwriter, Bond Counsel, and Financial Advisor work with the issuer to prepare legal documents related to the transaction.

6. The Underwriter arranges for the dissemination of the POS to potential investors.

7. On the day of the sale, the Underwriter discusses the bonds with investors and determines, in consultation with investors, the rates and structure that will result in sufficient investor interest to sell all of the bonds. The Underwriter takes orders for the bonds and adjusts the interest rates based on actual orders, to optimize the sale.

Private Placements

A private placement is a special type of negotiated sale in which the issuer sells bonds directly to the investor. The investor is most generally a bank. The issuer either directly contacts a bank or prepares a solicitation, which is circulated to a limited group of banks. The issuer generally specifies the preferred terms of the loan and the bank responds with conditions and terms that it would require. The transaction does not generally include disclosure documents (such as the official statement) and is generally limited to a loan document prepared by either the bank's counsel or Bond Counsel. The private placement can be a cost effective means of financing in that issuance costs are very low. Therefore, short transactions or small transactions can bear a slightly higher interest rate and still have an overall lower effective borrowing cost.

A private placement generally follows the following steps:

1. The issuer determines financing needs.

2. The issuer discusses financing options with a Financial Advisor to determine that a private placement is the most cost effective approach.

3. The Bond Counsel and Financial Advisor prepare authorizing documents for the financing which the issuers' governing body approves.

4. The issuer and Financial Advisor prepare a term sheet to describe the transaction.

5. The issuer contacts their bank or the financial advisor prepares a short RFP to solicit proposals from banks.

6. The issuer and Financial Advisor review proposals and select bank.

7. Bond Counsel (usually) or the bank's counsel prepares the loan documents.

8. Money transfers at closing.

Governmental Agency Direct Loans

There are a number of direct lending programs at State agencies. These include programs for clean water, wastewater, highways, and general governmental infrastructure. The availability of funds and the timing of funds vary greatly from program to program and from year to year. Issuers may contact DEQ, Business Oregon, or ODOT to inquire about these programs. These programs often make funds available at lower costs than market-based transactions.

STEP 6: PREPARING FOR A BOND SALE

Planning

Each bond sale needs a plan of finance. The key considerations, which your finance team can help you with, are:

- **Size** – How much does the issuer need to borrow? This involves an analysis of project costs, a schedule of expected expenditures, and the costs of selling bonds that will be capitalized as part of the bond sale.
- **Timing** – When does the issuer need the money? This involves the spending schedule but focuses on how long the issuer might take to spend the proceeds. The IRS limits the earnings on bond proceeds and the issuer will need to work with tax counsel to ensure compliance with federal rules. Further, from a policy standpoint, market timing is not generally considered the best approach to timing but rather to time the sale of bonds in accordance with when the funds are needed.
- **Security** – What will be pledged to repay the bonds? The bonds, unless they are supported by a new property tax levy, will need a repayment source from existing funds. In addition, many bond issues have one source of intended payment but are secured by additional sources to improve the credit worthiness. The issuer must examine the ability to repay prior to selling bonds.
- **Repayment Structure** – How long will it take to repay the bonds? Most municipal debt is structured to be repaid over a 20-year period of time, with level annual payments. Municipal bonds are structured to pay interest twice a year and principal once a year. The issuer needs to examine the timing of the revenue source that will be used to repay the bonds to match up the repayment structure with the revenue structure.
- **Method of Sale** – How will the bonds be sold? See "Method of Sale" for a discussion of the various considerations and methods for selling bonds.

Developing Bond Documents

A bond is a special type of loan and as such, a set of legal documents must be developed to formalize the details of the loan between the investors and the issuer. The major legal documents are prepared by Bond Counsel. These take various forms: bond declarations, loan agreements, trust indentures, and bond resolutions are all forms of basic bond documents. The specific type of document depends on the type of bond the issuer is selling and the types of promises (pledges) being made. Since these documents form the agreement between the investors and the issuer, and since the details of these documents establish legal underpinnings of the bonds, it is important that the issuer seek outside counsel in determining the best options. The documents are a balance between giving security to the bond investors and preserving operating flexibility on the part of the issuer. Bond documents should be developed in conjunction with the issuer's Bond Counsel and Financial Advisor. If the sale is negotiated, the Underwriter should be involved as well, but it is important to remember that Underwriters are tasked with selling bonds to investors and therefore may have a bias towards investor security.

Official Statements

The Official Statement (OS) is a strategic item in the offering process and effectively serves as the "notice of bonds for sale." The Preliminary Official Statement (POS) is the primary source of information for underwriters, investors, and rating agencies in evaluating the value and creditworthiness of the bonds and the issuer prior to the sale. The POS is used to introduce and develop primary purchase commitments prior to the sale or marketing of the bonds. The POS, per Securities and Exchange Commission (SEC) Rule 15(c)(2)(12) is deemed "near final." After the sale, the POS is updated with any pertinent information which has become available including: the sale price, bond rating, final maturity schedule, and interest rates determined at the sale closing. This updated document is then published as the Final OS, or prospectus, for the bond issue.

The various sections of the Final and Preliminary Official Statements are prepared by the issuer, Bond Counsel, Financial Advisor, and Underwriter. These documents typically include general sections concerning the municipality or local government, its economy, fiscal condition, financial structure, revenue sources, revenue data, debt authority, and any outstanding litigation. The OS also includes sections which describe:

- The issuing agency,
- The project to be financed,
- Financial information concerning the issuer,
- Specific details of the issue (including term and interest payment structure, as well as forecast revenues which may be used to repay bonds), and
- The Bond Counsel's opinion as to the tax-exempt status of the bonds.

While several organizations may contribute to the preparation of the OS, the issuer needs to recognize that the OS is the issuer's document and therefore it is the issuer's responsibility to ensure that the OS contains all material information needed to comply with federal and state requirements.

Official Statements (OS) from bond sales are available at no cost at the Municipal Securities Rulemaking Board's website. Also, MDAC staff is available for any questions at the Debt Management Division of the Office of the State Treasurer.

Credit Ratings

One of the most important factors determining the interest rate paid on bonds is the perceived quality of a district or municipality's credit. This perception is most often based on its rating by one of the national ratings firms. The significance of bond ratings on the cost of borrowing is substantial. Consequently, borrowers that improve their ratings can reduce their borrowing costs.

There are three main firms that rate municipal bonds: *Fitch Ratings*, *Moody's Investors Service*, and *Standard & Poor's Corporation.* Other organizations rate municipal bonds but have not gained the widespread acceptance of these three firms. Bonds are rated for a fee that is charged when the bonds are sold. There is no charge to maintain a rating over the life of an issue. However, the issuer should keep the agency apprised of financial circumstances. The rating is a measure of quality and credit risk and is reviewed periodically as long as bonds are outstanding.

Once a rating agency is provided with all required data, a rating will be issued in about two weeks. An application for a rating should be submitted as soon as the preliminary official statement is available. A draft preliminary official statement is acceptable provided the final version is sent to follow up.

The need for a rating on an issue depends on a variety of factors, including:

- The size of the offering (typically, issues under $5 million do not need a rating).
- Whether or not outstanding issues of the same security are rated.
- The perceived market for the bonds.
- The likelihood that an investment grade rating can be obtained. The issuer may consider the potential purchasers in making a determination to obtain a rating.

Although small municipalities may not find it essential to have their bond issues rated, it is advantageous to keep ratings current once they are acquired. The importance of keeping current ratings is often overlooked when a long period of time has passed between issues. Maintaining a bond rating requires a prompt response to all subsequent requests by the rating agency for updated information and providing the annual audit to the agency. When an issuer applies for and uses the rating assigned to a bond issue by a rating agency, that issuer effectively contracts to provide the rater with the information (e.g. annual financial statements) necessary to maintain or keep the rating up to date. The rating agency has the option of confirming the existing rating, upgrading the rating, or downgrading the rating - depending on the changing financial status of the issuer. The bond rating is an assessment of credit quality that remains important throughout the life of the issue. It is shortsighted to pay attention to the rating only at the time of a bond sale because the interest of traders and bondholders in credit quality remains as long as bonds are outstanding.

Many investors will only buy rated bonds because such securities carry an independent evaluation of credit quality. Others are required by law to hold only rated bonds. If the municipality fails to provide the rating agencies with the information required to keep this quality assessment current, the rating is withdrawn and the bondholder is left with an investment of indeterminate security. A rating withdrawal can have a negative impact on the resale or trade value of a bond. For this reason, investors and traders have a strong interest in the maintenance of ratings. When ratings are withdrawn due to inadequate information, underwriters will note this as a lack of sound debt management practices when the issuer next enters the market, which often results in higher interest costs in the future. Accordingly, issuers should give careful thought to the matter of whether or not a rating should be requested for the current bond issue.

Even if a new offering is rated, bidders are likely to view this rating with some skepticism if the issuer has demonstrated a lack of concern regarding the maintenance of previous ratings. Management of municipal finance is an ongoing process and each decision or policy affects investors' overall view of management quality.

Many segments of the market are trying to standardize municipal financial reporting. It is recommended that reports be consistent with Generally Accepted Accounting Principles (GAAP) for governmental units.

Rating Criteria Overview

The rating agency is primarily interested in the strength of the security pledged to the repayment of debt. The lower the amount of debt in relation to the resources pledged to repayment normally results in a higher rating. Many factors that enter into the rating may be beyond the issuer's immediate control, such as the state of the local economy. However, issuers can influence factors that may enhance credit quality.

General Obligation Bonds

Four principal factors are evaluated in order to rate a GO bond:

1. **Debt**
    - Debt burden
    - Debt history and trends
    - Debt policy
    - Debt as a percentage of current budget revenues
    - Borrowing plans

Burden is expressed as net direct and overall (or overlapping) debt per capita and net direct and overall debt as a percent of estimated full value of property within the municipality's boundaries.

2. **Financial**
    - Fiscal performance
    - Budgetary control
    - Revenue adequacy and diversity
    - Financial administration
    - Historical trends

3. **Economy**
    - Natural resources and population
    - Income
    - Employment
    - Industrial diversification
    - Economic structure and amount of capital
    - Economic performance and prospects

4. **Administration or Management**
    - Organization
    - Services
    - Performance
    - Policies

Revenue or Limited-Liability Bonds

Rating analysis for revenue or revenue-supported bonds is similar to that of GO bonds. The focus shifts from the taxing power of the entity to the earning power of the project. The following principal factors are evaluated to rate a revenue bond:

1. **Legal Protection**
    Legal protection for the bondholders and the governmental entity is outlined in the bond indenture. The bond indenture authorizes the bond issuance, defines the bondholder's security, the issuer's responsibilities, and provides the rate covenant.

2. **Demand-Creating Potential**
    Demand-creating potential includes basic economic trends and trends relating to the specific revenues pledged. Providing feasibility studies or management projections are helpful in the evaluation process.

3. **Administration or Management**
   Administrative or management of a municipality is evaluated on the basis of organization, services, performance, and policies.

4. **Finances**
   Key factors analyzed for the finances of an entity are: debt service coverage, stability, balance sheets, liquidity, future financing needs, and projected operations.

Information Requirements

To perform a rating review, the rating agencies require the following information:

General Obligation Bond Issues

Moody's

- Preliminary Official Statement
- Audit reports/audits from the past three years
- Latest operations budget
- Capital budget or planning document
- Bond Counsel's legal opinion
- All legal documents relative to security debt

Moody's may also request:

- Description of the economy
- Last five years' assessed valuation
- Building permit activity
- List of ten largest taxpayers
- Current population estimate
- Last five years' tax rates, levies, current and total collections
- Pending litigation

Standard & Poor's

- Preliminary Official Statement
- Audit reports/audits from the past three years
- Latest operations budget
- Planning document and land-use map
- Authority for debt issuance
- Statement of borrowing, levy and rate capacities

Standard & Poor's may also request:

- Description of the economy
- List of ten largest taxpayers
- Pension funds' status
- Last five years' tax rates, levies and current and total collections
- Pending litigation
- Recent addition/losses of industry or employers

Fitch

- Preliminary Official Statement
- Audit reports/audits from the past three years
- Latest operations budget
- Planning document and land-use map
- Authority for debt issuance
- Statement of borrowing, levy and rate capacities

Fitch may also request:

- Description of the economy
- List of ten largest taxpayers
- Pension funds' status
- Last five years' tax rates, levies and current and total collections
- Pending litigation
- Recent additions/losses of industry or employers

Revenue or Limited-Liability Bonds

Moody's

- Trust indenture or bond resolution
- Nature and term of lease obligations
- Any engineering report on feasibility and construction
- Any lease agreement applicable

Standard & Poor's

- Bond security covenants
- Ten-year trend of receipts
- Any engineering report on feasibility and construction
- Economic data related to specific purpose of financing
- Nature and term of lease obligations

Fitch

- Bond security covenants
- Ten-year trend of receipts
- Any engineering report on feasibility and construction
- Economic data related to specific purpose of financing
- Nature and term of lease obligations

Credit Evaluation

Credit evaluation is both an objective and subjective exercise. Because of this, rating recommendations undergo an internal "rating committee" review process. A consensus is required before the proposed rating is assigned.

Ratings and the Bond Market

Moody's ratings, beginning with the highest, are: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C and, CON for a conditional rating. Bonds in the Aa, A, Baa, Ba and B groups are further broken down into sub-ratings of 1, 2 or 3. For example: Aa1, Aa2 or Aa3, with Aa1 representing the rating that Moody's believes possesses the strongest investment attributes within that group.

Standard & Poor's ratings, beginning with the highest, are: AAA, AA, A, BBB, BB, B, CCC, CC, C and D for bonds in default. Ratings from AA to BB may be modified by the addition of a (+) **plus** or (-) **minus** sign to show relative standing within the major rating categories.

Fitch Ratings are: AAA, AA, A, BBB, BB, B, CCC, CC, C. DDD, DD and D are used for bonds in default. Ratings from AA to BB may be modified by the addition of a (+) **plus** or (-) **minus** sign to show relative standing within the major rating categories.

The ratings of the three agencies are roughly comparable, from Aaa/AAA to C/C. Ratings of Baa and BBB are the lowest acceptable rating for bonds to be considered of investment grade and therefore of interest to institutional buyers.

Investors use Bond ratings for various purposes. Large institutional investors may do their own credit research to supplement the rating agency evaluations. Ratings may be used as a screening mechanism to narrow a list of potential investment choices.

A municipality may want to follow the secondary market trends of bonds to compare the performance of their own bonds to others of similar credit quality. The bond rating, in addition to a variety of other factors, has a direct bearing on the interest rate paid by an issuer.

Credit Enhancements

Enhancing the creditworthiness of an issuer by shifting credit-related risks to a third party through the use of bond insurance can be a means of lowering borrowing costs. There are several nationwide firms that offer bond insurance. Bond insurance is used to guarantee payment of the entire principal and interest of the issue or, in some cases, specific maturities within an issue. Such insurance may not be necessary and may not reduce overall borrowing costs after the insurance premiums are factored in. Bond insurance is not always desirable or available, but may be suitable and may lower borrowing costs in some cases. Prior to 2008, common beliefs were that bond insurers would keep their AAA ratings forever. In 2008, that perception changed as several bond insurers suffered significant downgrades although some bond insurers remain viable.

Structuring

When determining the maturity schedule for a bond issue, it is important to match bond and interest payment dates to the available cash flow. If the bonds are self-supporting, the bond principal repayment dates should be scheduled to coincide with revenue collections. If the bonds are dependent on tax collections, plan payment dates to match historical collection experience. Municipalities that fail to make this match have had to issue short-term debt repeatedly to meet temporary cash flow deficits that could have been avoided by selection of the appropriate maturity schedule.

After matching bond issue debt service to available cash flow, a second factor to consider in designing a maturity schedule is overall cash flow. Decide how the new debt service schedule will impact the existing maturity schedules. Project future borrowing needs as defined in the capital improvement plan. Make sure the new maturity schedule has been optimally designed for the issuer's cash flow capacity.

Maturity schedules can be designed either to yield level debt (roughly equal installment) payments or level principal (declining installment) payments or some combination of these two schedule types.

Debt service is most often scheduled as "level"; that is, the sum of principal and interest remains relatively constant throughout the life of the bonds. Thus, principal payments begin low and increase, while interest payments decrease.

Another common maturity schedule is to have debt service rise as revenues rise. While this structure may work best for revenue constrained issuers, it generally backloads the principal and is considered a rating negative by the investors and rating agencies.

Most municipal bonds are structured with serial bonds – bonds that mature each year and are structured with different coupons and yield related to the length of the maturity. Generally, interest rates rise as maturities lengthen in a concept known as the “yield curve”. Bond issues may also be structured as term bonds. In the instance of term bonds, the entire principal of the term bond is paid at a single maturity date. With term bonds, issuers are usually required to make annual sinking fund payments to provide for principal repayment when due.

In general, longer bonds will pay a higher interest rate because of greater risk to the investor (positive yield curve). Most GO bonds are structured with maturities of ten to twenty years. Bond Computations explain the procedure which may be used to estimate level debt service schedules.

Debt instruments may be issued using any of the following interest payment formats or combination of formats:

- Be paid at regular intervals at a defined coupon rate.
- Be deferred until the principal matures (zero coupon bond).
- Be set at a fixed interest rate for the term of the obligation.
- Vary with a specified market interest rate (floating rate).

Call options allow bond issuers to refund securities earlier than their stated maturity. Most government borrowers choose to issue long-term, fixed coupon debt knowing that a ceiling has been placed on future debt service outlays. However, issuers also prefer to have the ability to refinance their debt if interest rates fall. The call option permits issuers this flexibility. This option does have a price, however, in the form of higher initial interest rates and in some cases a premium to be paid to the bondholder upon exercising the option.

Credit factors may also contribute to the decision to sell callable bonds. If an issuer’s credit position improves; a call provision would allow refunding at a later date in a more favorable environment. On the other hand, if conditions worsen, the issuer is not compelled to call bonds at the optional date.

Issuing refunding bonds incurs additional cost, but the benefits may well outweigh the costs. Current Oregon laws may not require a vote on a refunding issue, though other normal bond issuing and administrative costs remain. A need or desire for financial flexibility should provide the principal justification in determining whether a call feature is to be included. The technical aspects of a call feature include:

- The amount of premium (if any), to be paid.
- The number of years before the call.
- The order in which the bonds are to be called.

In recent years, called bonds have been redeemed at premiums of zero to two percentage points at the first optional call date. In each successive year, the premium is reduced until the call is at par or face value. Thus, in the first option year, bonds might be redeemed at 102 percent, in the second year at 101 percent and so on to 100 percent.

A call date is usually scheduled five to fifteen years after the date of issue, depending on current interest rates, the length of the bond issue and projections of revenue available for redemption. On twenty year bonds, a call date around ten years after issuance is common and rarely bears a high interest rate penalty.

Regardless of the fact that coupon bonds are no longer issued, the interest rate on any bond is still referred to as its "coupon" rate. Issuers may set the conditions for coupon rates bid by purchasers. Typical restrictions include:

- Requiring the same coupon rate for all bonds in a single maturity.
- Requiring coupon rates in multiples of $^{1}/_{20}{}^{th}$ or $^{1}/_{8}{}^{th}$ of one percent.
- Requiring that coupon rates be in increasing (non-descending) order over the life of the bonds toward maturity.

Fewer restrictions on coupon rates may encourage more bidders. The advantages of rate restrictions to an issuer must be balanced against the potential consequences of such restrictions. Consequences could include higher interest costs, but this is not normally the case if the restrictions are familiar to the bond community. The restrictions cited above rarely demand a premium for their imposition.

Oregon municipalities may establish their own maximum interest rate which is generally calculated using the True Interest Cost (TIC) computation for determining an overall average interest rate. The TIC method is that TIC considers the time value of money involving a present value calculation and gives a "true" picture of the cost involved.

Sale Date

Although market conditions are difficult to predict, timing of a bond sale is very important. In periods of high interest rates, districts may postpone construction of a project or use interim financing arrangements. When rates are lower, districts with bond issues outstanding which have call provisions may issue advance refunding or current refunding bonds to refinance higher interest rate debt.

In addition, short-term considerations, such as the day-to-day schedule of other bond sales, are important. In general, bond sales are most successfully scheduled mid-week rather than on Mondays or Fridays. Interest rates are most unpredictable (most volatile) just before and after holiday periods and long weekends. Furthermore, when an issue is sold to a bank or syndicate, the bonds are usually re-offered the same day or the next.

Issuers should try to avoid periods of unsettled monetary or bond market conditions and should avoid large competitors (other bond sales), which will weaken the demand for bonds. Issuers can use the Oregon Bond Calendar to assist in scheduling their bond sale.

Choosing a sale time involves planning. When choosing the time of day for accepting bids on competitive sales of bonds, issuers should make sure that they are in a position to award the underwriting assignment to the winning bidder shortly after the winning bid has been established. The time at which bids are to be awarded may also need to be coordinated with a special board or council meeting. Also, verifying complex bidding constraints or bid calculations (such as TIC) may require extra time.

Required Filings

State and municipality bond sales are reported to the Municipal Debt Advisory Commission (MDAC). Sales not reported to the MDAC consistent with ORS 287A.640 and OAR 170-61-000 will be in non-compliance with the law. Bond professionals in Oregon are aware of this provision of the statute and should assist their client municipalities in meeting this requirement. Issuers should also forward a copy of their final official statement for the bond issue within seven (7) days of a bond sale. (See OAR 170-61-000, Notice by Public Bodies of Intent to Issue New Bonds.)

MDAC Form 1 (Bond Sale Notice)

In accordance with OAR 170-61-000, all local governments, municipalities and agencies are required to notify the Commission of all bond sales. Official notice is accomplished by filing a "Bond Sale Notice" (MDAC Form 1) with the Commission. This is usually submitted by bond professionals through the use of the Bond Tracker system managed by the Debt Management Division of the Office of the State Treasurer.

The notice of the bond sale must be submitted not less than 10 days preceding the bond marketing date (ORS 287A.640 and OAR 170-61-000). It must include preliminary bond sale information such as:

- The issuing entity and address

- Type of bond
- Anticipated bond marketing (sale) date
- Bond par amount
- Project or purpose of the bond issue
- Source of revenues used to repay the bonds
- Anticipated closing date
- Bond counsel
- Financial advisor (if applicable)
- Underwriter (if sale is negotiated)
- Bond Issuance costs (if available)
- Other summary information identified on MDAC Form 1

The Commission will provide the public body and appropriate bond counsel a letter verifying receipt. The letter will indicate whether the bond sale is in compliance or non-compliance with OAR 170-61-000. Postponed or changed bond sales require submission of an updated MDAC Form 1 to the Commission as soon as the new information is available. Postponed or changed bond sales do not require another copy of the preliminary official statement unless a new printing occurs.

MDAC Form 2 (Bond Sale Result)

Public entities issuing bonds will also report all bond sale results to the Commission by filing a "Bond Sale Result" document (MDAC Form 2). The form must be submitted not later than seven days after the bond marketing date. The form is usually submitted by bond professionals through the use of the Bond Tracker system managed by the Debt Management Division of the Office of the State Treasurer. The public body and its bond counsel will receive written notice of non-compliance if sale results are not reported.

Distribution of NOS & POS

In order to ensure compliance with the legal requirements, Bond Counsel normally prepares the Notice of Sale. Sales are now advertised nationally using a variety of means. Some jurisdictions still require advertising in local press while State law now allows for bypassing local printed press and using national electronic media services. Most advisors believe this second method reaches all prospective bidders in a competitive sale.

The Notice of Sale (NOS) is the official offer to sell the bonds and provides the official description of the security and the bidding process. It also directs the interested bidders to the POS for a full discussion of the security and information provided by the issuer related to the bond sale.

Most issuers now use one or more electronic media networks to provide the notice of the bond sale to potential investors and to distribute the Preliminary Official Statement (POS). Additionally, issuers may publicize sales by distributing POSs directly to banks and investment banking firms. The Debt Management Division can provide a list of local dealers who purchase small issues within the State. Larger issuers should maintain their own mailing list of national underwriters.

Bond Registration

In the past, municipal bonds could be issued in either coupon or registered form. However, federal legislation passed by Congress on August 20, 1982 -- the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) requires all bonds of one year or longer duration sold after June 30, 1983 be issued in registered form. Accordingly, it is no longer legal to issue bearer bonds for issues of one year or longer duration.

Registered Bonds

Registered bonds have a recorded ownership and must be re-registered to the new owner each time they are sold or transferred. Such bonds do not have coupons and may be registered in denominations substantially larger than $5,000. A paying agent automatically sends interest payments to the owners, which is usually a financial institution.

Book-Entry Only Registered Bonds

"Book-Entry Only" registered bonds are recorded ownership bonds which are not available in physical form. Such bonds are held by a securities depository and recorded by computer or other permanent means for the benefit of the bond owner. No individual certificates are issued, but all other features of a registered bond cited above remain. The main advantage of this type of bond is reduced issuance expense for the issuer. Book-Entry bonds are generally registered through DTC.

Responsibilities of the Registrar

Responsibilities of the registrar include registration of bonds at the time of issuance (i.e. following a sale) and transfer of bonds during the life of the issue. The registrar is usually a bank or other financial institution; however, the issuer, in some cases, may choose to assume the responsibility. Selection of a registrar should be based upon an assessment of the market of an issuer's bonds. The registrar should be located as close as possible to the primary market for an issuer's bonds and should guarantee prompt transfer of ownership.

Performance standards must be met by transfer agents (registrars) in order to comply with the Securities and Exchange Commission rulings, and the Municipal Debt Advisory Commission's (MDAC) Administrative Rule—OAR 170-61-010 "Terms and Conditions to be Satisfied by Registrars for Municipal Bonds of Oregon Municipalities".

Issuers may, from time to time, solicit proposals for paying agents. The MDAC maintains a list of qualified banks that provide these services.

The following costs and fees may be borne by a municipality or local government entity when issuing bonds:

- Underwriter's fee/Discount
- Bond Counsel fee
- Financial Advisor fee
- Official Statement cost
- Bond Printing cost
- Out-of-Pocket costs such as travel, financial data preparation, etc.
- Other costs such as Blue-Sky search fees (i.e. state securities law), Paying Agent/Registrar, Underwriter's Counsel fee, and Trustee fee

Closing

The purchaser of an issue pays the fiscal or paying agent the price set in the purchase agreement in exchange for the bond certificates. The bonds must be available on the closing date for delivery to the purchaser. The bidder to whom the bonds were awarded may have the option to refuse delivery if the bonds do not meet specifications or are not available when promised.

If the closing date is the same as the dated date or issue date of the bonds, then no accrued interest need be paid. If the closing date is after the dated date, then accrued interest based on the coupon rates must be paid to the issuer. Accrued interest is usually calculated for each separate maturity in the issue, multiplying that maturity's coupon rate, the number of days out of a 360-day year/30-day month and the principal maturing on that date.

The amount due at closing is equal to the principal amount, plus the premium or less the discount, if any, plus accrued interest for days past the issue date, and less the amount of the good faith deposit. The bonds are signed and delivered to the purchaser on receipt of the closing amount, usually in Federal Funds or other guaranteed funds. The bond issue does not become a debt of the issuer until the time of closing.

Often, proceeds from the bond sale are not spent immediately and are held until needed for the project. The Internal Revenue Code strictly regulates the investment of bond proceeds. Subject to ORS 294.040 and 294.135–294.155, the bond proceeds custodial officer may, after having obtained a written order from the governing body which is in the governing body's minutes or journal, invest any sinking fund, bond fund or surplus of funds in his/her custody in any approved investments. See "Summary of Investments Available to Municipalities" and ORS 294.035 for details on permitted investments for local government bond proceeds.

TYPES OF DEBT REPORTS AND FORMS

Debt records should be kept for each debt issue. A complete transcript for each issue is normally provided by bond counsel to the municipality, at the time of or shortly after closing. The transcript includes all of the necessary documents required for administering and accounting for the debt issue. Documents containing information which will be regularly used over the life of the issue are:

- Schedules of future debt service,
- Paying agent/registrar data, and the
- Escrow agreement.

While the paying agent typically provides an invoice to the issuer prior to a debt service payment date, it is the issuer's responsibility to ensure that payment is made to the paying agent according to the bond documents. Sometimes payments are required to be made well in advance of the payment date due to requirements of credit enhancers such as bond insurers, the State of Oregon School Guaranty Program, or bond covenants.

For each debt issue, records are required for:

1. Efficient administration during the period the debt is outstanding,
2. External financial reporting purposes, and
3. Budgeting purposes.

DEBT ACCOUNTING & REPORTING

Bond Accounting

When bonds are issued for general government purposes, the proceeds are recorded in governmental funds. This may be in the general fund, a special revenue fund or, if the debt is to be used for capital construction, a capital projects fund. The obligation for the debt is recorded in the separately from the governmental type funds for reporting purposes. When debt is issued for proprietary funds, both the proceeds and the obligation for the debt are recorded in the fund itself.

The face amount of debt, underwriter's discount, original issue discount and premium, and cost of issuance must all be separately recorded in the accounting records. It is not appropriate to record only the net amount of cash received. If there is accrued interest earned and payable from date of issuance to date of sale of the debt, it is recorded in the fund that will be making the debt service payments. This interest is normally used to offset some portion of the first interest payment.

Often, the official bond documents require that the government establish reserves, which will be used for the payment of interest or principal on the debt near the end of the life of the issue. Those reserves generally will be held in a separate fund. Direct recording of the proceeds or intrafund transfers are used to record the required reserve amount from the fund holding the proceeds into the fund where the reserve will be held.

Deferred costs such as issuance costs and underwriter's discounts are amortized over the life of the debt issue using a systematic and rational method. Original issue premium and discounts are also amortized. Amortization is recorded in the proprietary fund for proprietary fund obligations. Amortization of original premiums and discounts for general government debt should be calculated and reported in the government-wide Governmental Activities statements.

At year end, an accrual for interest payable must be recorded. This interest payable is equal to the amount of interest attributable to the period involved. The accrual is made in the proprietary fund or as an adjustment to the government–wide governmental activities statements, depending on what fund type the liability is related. Interest payable is not accrued in governmental funds **unless** cash has been transferred to a debt service fund for payment of principal or interest just after the end of the fiscal year. Because the cash would then be a current resource available in the debt service fund for payment of principal and interest immediately after the fiscal year end, it is appropriate to also accrue the payable against that cash. This prevents an overstatement of current resources available for expenditure in the next period. If this accrual is made in a governmental fund, no accrual is required in the government-wide reporting fund.

Bond Financial Statement Reporting

In the governmental fund financial statements, bond proceeds are reported as an "Other Financing Source". Expenditures related to bond issuance are reported as other debt service expenditures. In the proprietary fund financial statements, bond proceeds and principal payments are never reported in the income statement/statement of changes in net assets.

For the government-wide financial statements, governmental funds are adjusted to reflect debt transactions for the reporting period. Governmental Activities statements will not report proceeds and principal payments (after adjustments). For financial reporting purposes, the principal due within one year is reported separately from the long-term debt.

Governments must include required long-term debt disclosures in the notes to their financial statements. Relevant disclosures at year end include:

- A description of the types of long-term debt authorized to be issued.
- Schedules showing the changes in outstanding debt for each type of long-term debt for both governmental and business-type activities.
- Schedules of future debt service requirements (principal and interest displayed separately) for each type of long-term debt for both governmental and business-type activities.
- Terms and interest rates associated with variable-rate debt.
- Amounts of long-term debt due within one year of the date of the financial statements.
- Specific information related to demand bonds.

DEBT REFUNDING & ADVANCE REFUNDING

General Information

Debt refundings involve the issuance of new debt whose proceeds are used to repay previously issued ("old") debt. The new debt proceeds may be used to repay the old debt immediately (a current refunding), or the new debt proceeds may be placed with an escrow agent and invested until they are used to pay principal and interest on the old debt at a future time (an advance refunding). Most advance refundings result in defeasance of debt.

Defeasance of debt can be either legal or in-substance. A *legal defeasance* occurs when debt is legally satisfied based on certain provisions in the debt instrument even though the debt is not actually paid. An *in-substance defeasance* occurs when debt is considered defeased for accounting and financial reporting purposes even though a legal defeasance has not occurred. When debt is defeased, it is no longer reported as a liability in the accounting records; only the new debt is reported as a liability.

Debt is considered defeased in-substance for accounting and financial reporting purposes when:

- Assets are placed in irrevocable escrow to be used solely for the purpose of making payments of interest and principal on the old debt.
- The possibility that the debtor will be required to make future payments on that debt is remote.
- The assets in the escrow account are essentially risk-free as to amount, timing, and collection of interest and principal.
- The timing of collections approximately coincides with the timing and amount of scheduled interest and principal payments.

Accounting for Refunding of General Government Debt

When accounting for a refunding of general government debt, the proceeds of the new debt, and the payment of funds into escrow for the old debt, are reported in the governmental fund. The debt itself is reported in the government-wide reporting fund. The amounts issued for refunding (new) debt are reported as an "Other Financing Source" and those same amounts, when used to refund old debt, are reported as an "Other Financing Use". Resources used from sources other than refunding debt are reported as debt service expenditures. In addition, premiums and discounts are reported gross as either an "Other Financing Source" or "Other Financing Use", respectively. Issuance costs are reported as expenditures of the governmental fund.

Proceeds from refunding debt that are paid to the escrow agent and used to refund the old debt should be reported as an "Other Financing Use", even if the actual payment went directly from the counter party to the escrow agent. If the government uses funds from sources other than the refunding debt proceeds, such as a bond sinking fund, the payment should be charged to debt service expenditures rather than other financing uses.

The new debt liability is recorded in the government-wide reporting fund. The bonds in the government-wide reporting fund should be recorded at face value unless they are zero coupon or deep discount bonds.

In addition to recording the new debt, the government must remove the old debt from the accounting records. That includes any deferred charges, underwriter's discounts, and discounts/premiums related to the old debt. The deferred gain or loss on the refunding must also be reported in the Governmental Activities statements. This is the difference between the reacquisition price and the net carrying amount.

Deferred charges, discounts/premiums, and underwriter's discounts are amortized, as they would be for any other debt issue. The deferred loss/gain should be amortized over the shorter of the life of the new debt or the remaining life of the old debt. All balances should be amortized using a systematic and rational methodology.

Accounting for Refunding Debt in Proprietary Funds

Refunding debt transactions are recorded in proprietary funds using the same methodology as governmental funds. Other Financing Sources and Uses are not reported in the GAAP financial statements for proprietary funds.

Financial Statement Reporting of Refunded Debt

A general description of debt refunding transactions must be included in the notes to the financial statements. In the year of the refunding, disclosures must include the difference between the cash flows required to service the old debt and the cash flows required to service the new debt. When measuring the difference between the two cash flows, additional cash used to complete the refunding (e.g., for issuance costs or payments to the escrow agent) paid from resources other than proceeds of the new debt should be added to the new debt cash flows. Accrued interest received at the bond issuance date should be excluded from the new debt cash flows. The economic gain or loss resulting from the transaction must also be disclosed. Economic gain or loss is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at the effective interest rate and adjusted for additional cash paid.

Although the liability for refunded bonds is no longer reported on the face of the financial statements, the amount of in-substance defeased debt must be disclosed in the notes to the financial statements until it is fully paid by the escrow agent. The amount of defeased debt is listed separately to distinguish between governmental activities, business-type activities, and fiduciary fund activity.

ADDITIONAL ACCOUNTING & REPORTING RESOURCES

Governments accounting and reporting for bond activity should ensure that staff has access to the following resources:

- *Governmental Accounting, Auditing, and Financial Reporting* (often referred to as "The Blue Book"), published by the Government Finance Officers Association.
- Governmental Accounting Standards Board (GASB) codification, original pronouncements, and implementation guides. Hard copy or electronic versions of these documents can be obtained from GASB at http://gasb.org/.
- The *State and Local Governments – Audit and Accounting Guide*, published by the American Institute of Certified Public Accountants.

MAINTENANCE OF RATINGS DURING LIFE OF THE ISSUE

For issuers or bonds that are rated by a rating agency, it is important that the issuer keep each rating current by supplying information to the appropriate rating agencies on a regular or yearly basis to avoid a possible rating withdrawal. This, in turn, could reduce marketability for the municipality's outstanding bonds.

A withdrawal due to inadequate information will negatively affect investors' opinions about management of the issuer and will impair future desirability of the issuer's bonds. It is a disservice to taxpayers and also to bondholders to allow the flow of information to rating agencies to deteriorate between bond sales.

Rating maintenance generally consists of forwarding annual reports and updated debt and economic information to the agencies. Rating maintenance may also require responding to rating agency questionnaires. It is especially important to make special contact whenever an unusual financial or economic event occurs which affects the issuer.

NOTICE OF EARLY REDEMPTION

The majority of bonds issued today are held in a book-entry only system (the "Book-Entry System"), where the registered owner of all of the bonds will be The Depository Trust Company (DTC), New York, and the bonds will be registered in the name of Cede & Co., as nominee for DTC. The issuer enters into a Blanket Issuer Letter of Representations (the "Letter") wherein the issuer represents that it will comply with the requirements stated in DTC's Operational Arrangements as they may be amended from time to time.

The issuer and the registrar may treat DTC (or its nominee) as the sole and exclusive registered owner of the bonds registered in its name for the purposes of:

- Payment of the principal, redemption price, premium (if any), and interest on the bonds;
- Selecting the bonds or portions thereof to be redeemed (if any);
- Giving notice as required under the authorizing resolution;
- Registering the transfer of bonds;
- Obtaining any consent or other action to be taken by the owners; and
- All other purposes needed.

ADVANCE REFUNDING AS A DEBT ADMINISTRATION TOOL

An advance refunding is a procedure by which bonds are refunded early. Typically, this involves the sale of an issue prior to the first call date of the original issue. The Office of the Treasurer is responsible for assessing the merit of proposed advance refunding issues and authorizing those having a significant beneficial impact. Advance refundings are usually executed to realize debt service savings when new bonds are sold at rates significantly below those of the original issue. An advance refunding may also be undertaken to reorganize permanent debt or to remove restrictive covenants.

The Legislative Assembly declares that the issuance of advance refunding bonds and the authority to effect a forward current refunding are matters of general statewide concern, and ORS 287A.360 to 287A.380 preempt all local statutory or charter authority to issue advance refunding bonds or to effect a forward current refunding.

A public body may issue advance refunding bonds or enter into current refundings in compliance with ORS 287A.360 to 287A.380; and rules adopted by the Office of the State Treasurer.

Types of Advance Refundings

Net or Net Cash Defeasance

The most common type of advance refunding is the net cash defeasance method. Bond proceeds are placed in an escrow account and are invested, usually in U.S. Treasuries, so that interest and principal of the investments **at their maturity** are sufficient to pay the principal, interest, and any call premiums on the refunded issue. Once proceeds of the advance refunding issue are invested and placed in the escrow and all legal requirements are met, the refunded issue is no longer considered outstanding (see ORS 287A.195). The refunded debt no longer counts toward any constitutional or statutory debt limit.

Crossover Refunding

On a crossover refunding, the proceeds of the advance refunding issue are invested in an escrow account so that the interest earnings and maturing principal are used to meet debt service requirements on this new obligation until the pre-arranged **"crossover" date**.

The crossover occurs on or after the first call date of the refunded issue. The municipality continues to make debt service payments on the old issue until the crossover takes place. *The original bonds are not defeased until they are actually retired and any covenants associated with the original debt remain in effect until the call.*

Treasurer's Office Review and Approval

Advance refunding issuance policy is governed by U.S. Treasury regulations relating to arbitrage bonds. The general purpose of the arbitrage rules, contained in Section 103 of the Internal Revenue Code, is to prevent municipalities from making a "profit" by selling tax-exempt bonds and investing the proceeds in higher-yielding taxable securities. Any bond, the proceeds of which are not invested in conformity with the specific yield restrictions of Section 103, is considered to be an arbitrage bond.

The Office of the State Treasurer must review and approve all proposed advance refundings in Oregon in accordance with ORS 287A.370 and OAR 170-062-000. The law mandates that the refunding plan be submitted to the State Treasurer following adoption of the ordinance or resolution approving of the refunding plan.

Rule G-36 of the Municipal Securities Rulemaking Board (MSRB) requires that the underwriter send to the MSRB the refunding escrow trust agreement or equivalent, together with completed Forms G-36 (ARD) within five business days after delivery of the securities by the issuer to the underwriters.

Advance refunding financings are often complex. The MDAC recommends that any issuer considering an advance refunding contact the Debt Management Division of the Office of the State Treasurer for information about the steps in the process toward debt refinancing.

STEP 8: SECURITIES LAW DISCLOSURE FOR MUNICIPAL SECURITIES

WHAT IS DISCLOSURE?

Disclosure is the act of providing all material facts (whether favorable or negative), which then enables investors to make informed decisions. Disclosure begins with the Preliminary Official Statement (POS) and must continue over the life of the bonds.

NEW ISSUE DISCLOSURE

The Securities Act of 1933 generally requires that securities must be registered with the U.S. Securities Exchange Commission (SEC) before they can be offered to investors. The Securities Exchange Act of 1934 imposes reporting requirements on issuance of securities. There is an exception for municipal securities. Generally, a security issued or guaranteed by any State, political subdivision of a State/territory, or any public instrumentality of a State/territory is not subject to the registration and reporting requirements.

While municipal securities are exempt from registration and reporting requirements, they are subject to the antifraud provisions of the federal securities law.

SEC Rule 15c2-12 requires an Underwriter of municipal securities to:

1. Obtain and review an issuer's official statement that, except for certain information, is "deemed final" by an issuer prior to making a purchase, offer, or sale of municipal securities;
2. Provide the issuer's most recent preliminary official statement (if one exists) to potential customers (for negotiated sales);
3. Deliver to customers, upon request, copies of the final official statement for a specified period of time; and
4. Contract to receive, within a specified time, sufficient copies of the issuer's final official statement to comply with the rule's delivery requirement, and the requirements of the rules of the Municipal Securities Rulemaking Board (MSRB).

The issuer of the securities has the primary legal responsibility for the accuracy and completeness of information in the disclosure document and may be held primarily liable under the federal securities laws for misleading disclosure. Under SEC Rule 10b-5, it is unlawful to make an untrue statement of a material fact or to omit to state a material fact resulting in fraud or deceit. Accordingly, the official statement must disclose material information about the securities to allow investors to make informed decisions.

WHAT MUST BE DISCLOSED?

The issuer must disclose all material information with no material omissions. An omitted fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

Materiality is a facts and circumstances test. The SEC has determined to be material:

- Intended use of bond proceeds.
- Accurate disclosure of financial condition.
- Any financial interest in transaction
- Potential taxability of bonds.

The SEC has suggested that the governing body of the issuer review the disclosure documents two weeks prior to its distribution.

SECONDARY MARKET DISCLOSURE (SEC RULE 15C2-12)

For municipal securities issued after July 3, 1995, SEC Rule 15c2-12 (the Rule) mandates continuing disclosure unless the bonds qualify for an exemption from the Rule. "Continuing disclosure" generally refers to a process of providing financial and other material information to the marketplace on a regular basis for as long as securities are outstanding. The Rule does not apply to municipal securities issued before July 3, 1995.

Historically, local governments have been largely exempt from ongoing reporting requirements for their bonds, notes or other securities. The practice in the industry was to prepare disclosure, usually in the form of an official statement, only when engaged in a new offering of municipal securities. Now, however, the rules have changed. Disclosure does not stop upon successful completion of the primary offering. Rather, the SEC has declared that future investors trading in the secondary market are entitled to receive virtually the same level of information that was furnished in the primary offering stage.

WHO MUST PROVIDE CONTINUING DISCLOSURE?

The Rule applies to "obligated persons," which the SEC defines as:

> *"…any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account ... committed by contract or other arrangement to support payment of all, or part of the obligations on municipal securities..."*

In most cases, the governmental unit that is issuing bonds will be an obligated person subject to the continuing disclosure requirements. However, this does not always hold true. The key to identifying the obligated person(s) is to carefully read the contract or other document describing repayment of the bonds. The Rule does not require a disclosure commitment from *each* issuer or obligated person. Instead, only those parties for whom financial information and operating data are presented in the official statement are covered. Thus, a purely conduit issuer of non-recourse revenue bonds may opt out of continuing disclosure so long as the conduit borrower contracts to provide secondary market information. For pooled financings with multiple participants, objective criteria (e.g. percentage of overall payment support) will determine who the appropriate disclosure parties are.

The Rule excludes providers of most forms of credit enhancement (bond insurance, letters of credit or other liquidity facilities) from the definition of obligated person.

HOW ARE DISCLOSURE OBLIGATIONS DETERMINED?

The undertaking to provide continuing disclosure may be included in the principal documents under which the securities are issued (e.g. the trust indenture, ordinance, or resolution). More typically, it is included in a separate agreement or certificate entered into for the benefit of bondholders.

An Underwriter must receive reasonable assurance regarding the continuing disclosure commitment <u>before</u> agreeing to act as underwriter. In negotiated offerings, this assurance will be obtained at the time of signing the underwriting agreement or bond purchase contract. In competitive offerings, such assurance should be contained in the issuer's notice of sale.

The Rule allows for delegation of information dissemination responsibilities to designated agents or to indenture trustees. The Rule does not enumerate the consequences if an issuer breaches its disclosure undertaking. Remedies for breach will vary under state law and, the SEC concludes, are a subject for negotiation between the parties. The Rule does require, however, that issuers disclose in their final official statements all instances in the previous five years in which they have failed to comply with any continuing disclosure obligations.

WHAT CONSTITUTES CONTINUING DISCLOSURE?

Two things must be disclosed under the Rule: annual financial information and certain material events. Annual financial information is defined as:

> *"…financial information or operating data, provided at least annually, of the type included in the final official statement with respect to an obligated person."*

The Rule does not dictate strict form and content requirements for what constitutes the "annual financial information." The written undertaking by the issuer or obligated person, as well as the final official statement, must specify in reasonable detail those categories of information that will be included. The undertaking must also specify the date by which the annual financial information will be provided (e.g. X days following the end of the fiscal year).

The undertaking must describe the accounting principles used in preparation of the annual financial information, including whether or not audited financial statements will be prepared. An undertaking that references generally accepted accounting principles, as modified by the Government Accounting Standards Board (GASB), or mandated state statutory principles (as in effect from time to time) would satisfy this provision of the Rule.

"Operating data" is a subset of annual financial information and refers to quantitative information given in the official statement to help investors place the financial information in context. For example, in a health care financing, operating data would include a description of hospital administration and management, service area and economic base, capital plan and operating statistics (such as bed use), admissions criteria, payor utilization, etc.

Since the Rule's enactment, the final official statement has assumed even greater significance because it serves as the template for future disclosure. It establishes which elements of a financing are material and, therefore, subject to ongoing disclosure. Issuers and obligated persons should carefully consider both the content and the context of how financial information is presented in the final official statement.

In addition to annual disclosure of financial information, the Rule requires "timely" disclosure of eleven listed events:

1. Principal and interest payment delinquencies.
2. Non-payment related defaults.
3. Unscheduled draws on debt service reserves reflecting financial difficulties.
4. Unscheduled draws on credit enhancement reflecting financial difficulties.
5. Substitution of credit or liquidity providers or their failure to perform.
6. Adverse tax opinions or events affecting the tax-exempt status of the securities.
7. Modifications to rights of security holders.
8. Bond calls.
9. Defeasances.
10. Release, substitution or sale of property securing repayment of the security.
11. Rating changes.

Failure to provide annual financial information by the date specified in the written undertaking is also a disclosure item.

The determination of whether other events should also be the subject of notification is left to the parties, but issuers should beware of any undertakings to provide notice of material events beyond those specifically listed in the Rule. Issuers may provide notice of other events as they see fit, but should not contractually obligate themselves to do so. Undertakings that expand the list of eleven with open-ended disclosure commitments like "...and any other material events" should be avoided.

The SEC does not specify what constitutes "timely" disclosure due to the wide variety of events and issuer circumstances. In general, the determination must take into account the time needed to discover the event, assess its materiality, and prepare and disseminate the notice.

WHERE TO DISCLOSE?

In December 2008, the SEC approved rulemaking changes to its Rule 15c2-12. Effective July 1, 2009, filings are no longer made to the NRMSIRs. Municipal bond issuers will be required to submit annual financial information and any material event notices to the Municipal Securities Rulemaking Board (MSRB). These submissions must be in electronic form through the MSRB's web-based system known as EMMA, which stands for Electronic Municipal Market Access. The MSRB will initially require that documents be filed in a word-searchable portable document format (PDF). Filing via EMMA is free.

MODIFICATION OR TERMINATION OF DISCLOSURE OBLIGATIONS

Generally, the undertaking to provide continuing disclosure may not be modified after the fact. However, an undertaking that includes an amendment provision may comply with the Rule if certain conditions are met. Samples of Continuing Disclosure Certificates can often be found in the Appendix of an Official Statement (which can be found on EMMA).

An Issuer or obligated person may terminate their continuing disclosure obligations when they cease to have any liability for payment on the bonds. The SEC has stated that this occurs upon full redemption of the securities, or the legal defeasance and release of any lien securing the bonds.

Although it is not expressly permitted by the Rule, many issuers include a provision authorizing them to terminate their disclosure undertaking if they obtain an opinion of bond counsel.

EXEMPTIONS FROM THE RULE

Bond issues of less than $1 million in aggregate principal amount are exempt from the Rule altogether. Bond issues in large minimum denominations (i.e., $100,000 or more face value) are exempt from the Rule if:

- They are privately placed with no more than 35 sophisticated investors; or
- They have a maturity of 9 months or less; or
- They may be optionally tendered at par at least every 9 months.

Effectively, this means that most private placements and variable rate issues are exempt from the Rule. Short-term notes and other municipal securities whose stated maturity is 18 months or less are exempt from the financial information disclosure requirements of the Rule. However, issuers must still undertake to provide timely notice of material events.

Municipal securities whose issuer or obligated person has less than $10 million aggregate outstanding amount of municipal securities (including those being issued) on the issuance date qualify for a limited exemption from the Rule. Specifically, it is an exemption from the annual financial information-filing requirement. However, the obligated person(s) must still provide financial information or operating data upon request. The information and data must include at least that which is customarily prepared by such obligated person and is publicly available. Furthermore, under the limited exemption, the obligated person must undertake to provide timely notice of material events.

LINKS / RECOMMENDED READING

Rule 15c2-12 affects different bonding programs in different ways, particularly with respect to the "obligated person" analysis. Issuers must consider the kinds of debt they issue (e.g. general obligation, revenue, special assessment, etc.) and their own unique circumstances. This would include establishing a protocol for who will speak on an issuer's behalf and when, what they will say, and how they will say it. Issuers with multiple bonding programs should also try to maintain consistency in their contractual undertakings. Standardizing the form of undertaking and the schedule for reporting should ease some of the administrative burden of providing continuing disclosure on numerous programs. Finally, when in doubt about disclosure obligations, issuers should consult with their bond counsel. The following are some helpful links in regards to disclosure:

GFOA Blue Book

Securities Industry and Financial Markets Association (SIFMA)

Municipal Securities Rulemaking Board (MSRB)

Securities Exchange Commission (SEC)