Preparing to Access the Capital Markets

North Carolina Local Government Investment Association

July 20, 2017
In today’s market environment, credit quality – whether determined by the rating agencies or banks and other investors – has become increasingly important to a successful debt issuance.

When preparing for a debt issuance, an issuer should consider credit related items as part of the pre-transaction and planning process.

Effectively accessing the capital markets is often times the culmination of a three phased approach to planning for and issuing debt:

– Phase 1: High Level Strategy and Planning

– Phase 2: Develop Plan of Finance

– Phase 3: Implement Plan of Finance
Since the financial downturn, the credit quality of a local government has become more important than in previous market environments.

Credit rating agencies, banks and investors have increased the level of due diligence performed on transactions.

A local government should not manage itself exclusively for rating agencies and investors; however, often times good planning and credit strategies are aligned.

- Strategic Planning and Goals.
- Multi-year Financial Planning.
- Economic Development (locally and regionally).
Moody’s Investor’s Service GO Rating Methodology

Implemented in January 2014

<table>
<thead>
<tr>
<th>Category</th>
<th>Rating Percentage</th>
<th>Short Term Control</th>
<th>Long Term Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy / Tax Base</td>
<td>30%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Finances</td>
<td>30%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Management</td>
<td>20%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Debt / Pensions</td>
<td>20%</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

- The information shown above outlines the **Quantitative** elements of the rating methodology. In addition to these factors, other **Qualitative** elements are considered in the ultimate rating outcome.
## Standard and Poor’s GO Rating Methodology

**Implemented in September 2013**

<table>
<thead>
<tr>
<th>Category</th>
<th>Rating Percentage</th>
<th>Short Term Control</th>
<th>Long Term Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional Framework</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Economy</td>
<td>30%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Management</td>
<td>20%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Budget Flexibility</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Budgetary Performance</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Liquidity</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Debt and Contingent Liabilities</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

- The information shown above outlines the **Quantitative** elements of the rating methodology. In addition to these factors, other **Qualitative** elements are considered in the ultimate rating outcome.
Moody’s Investor’s Service Utility Rating Methodology

Implemented in December 2014

<table>
<thead>
<tr>
<th>Category</th>
<th>Rating Percentage</th>
<th>Short Term Control</th>
<th>Long Term Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>System Characteristics</td>
<td>30%</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Financial Strength</td>
<td>40%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Management</td>
<td>20%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Legal Provisions</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

- The information shown above outlines the **Quantitative** elements of the rating methodology. In addition to these factors, other **Qualitative** elements are considered in the ultimate rating outcome.
Standard and Poor’s Utility Rating Methodology

Implemented in January 2016

<table>
<thead>
<tr>
<th>Risk Assessment Category</th>
<th>Factor</th>
<th>Rating Percentage</th>
<th>Short Term Control</th>
<th>Long Term Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise</td>
<td>Economic Fundamentals</td>
<td>45%</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Market Position</td>
<td>25%</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Industry Risk</td>
<td>20%</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Operational Management Assessment</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Financial</td>
<td>Debt Service Coverage</td>
<td>40%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Liquidity</td>
<td>40%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Debt and Contingent Liabilities</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Financial Management Assessment</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

The information shown above outlines the **Quantitative** elements of the rating methodology. In addition to these factors, other **Qualitative** elements are considered in the ultimate rating outcome.
High Level Strategy and Planning

HIGH LEVEL STRATEGY AND PLANNING
- Strategic Vision
- Board / Council Communication
- Capital Improvement Plan
- Budget Forecasting

IMPLEMENT PLAN OF FINANCE
- LGC Coordination
- Working Group and Financing Schedule
- Credit Rating Strategy
- Post Issuance

DEVELOP PLAN OF FINANCE
- Financial Policies
- Benchmarking
- Debt Capacity / Debt Affordability
- Funding Approach
Establish a strategic vision for your organization. This may include a series of internally or externally generated planning documents.

Establish an effective Board / Council communication strategy, working with Staff to further define and implement the vision.

Develop a series of next steps and an implementation plan to achieve the goals established in the strategic vision and planning documents – capital investments are often a major piece of these strategies.

Identify requested capital projects that could help achieve the strategic vision.
The development of a multi-year Capital Improvement Plan (“CIP”) includes:

- Identifying realistic capital and maintenance needs (not a wish list).

- Assigning funding sources for all projects with a balanced approach of pay-as-you-go cash, grants, reserves and debt.

- Analyzing potential operating budget impacts associated with planned capital projects.

- Revisiting this process at regular intervals.

- Adopting a plan at the governing level.
While in the process of developing a long-term Capital Improvement Plan the locality may consider implementing a multi-step CIP Development process in order to achieve a balanced & fully funded CIP that addresses identified capital needs:

1. Identify financial resources available to fund capital projects.
2. Identify capital needs for the next 5-10 years.
3. Determine funding capacity/affordability.
4. Develop an initial CIP and Funding Plan.
5. Revise CIP to maximize project funding within identified resources.
6. Finalize and approve the CIP.
7. Revisit CIP on an annual basis.
Budget Forecasting

- Development of a long-term budget planning process can be another important element when preparing for to interact with rating agencies and investors.

- Elements of the long-term budget planning process can include:
  - Historic Trend Analyses.
  - Forward looking projections for key revenue and expenditure line items.
  - Sensitivity analyses to identify potential cash flow implications of board / management initiatives.
Develop Plan of Finance

HIGH LEVEL STRATEGY AND PLANNING

- Strategic Vision
- Board / Council Communication
- Capital Improvement Plan
- Budget Forecasting

DEVELOP PLAN OF FINANCE

- Financial Policies
- Benchmarking
- Debt Capacity / Debt Affordability
- Funding Approach

IMPLEMENT PLAN OF FINANCE

- LGC Coordination
- Working Group and Financing Schedule
- Credit Rating Strategy
- Post Issuance
Financial Policies

- Financial policies can provide benefits to a number of parties by:
  - Establishing a policy / decision making framework for staff and elected officials.
  - Providing comfort to Rating Agencies, Banks and Investors that a local government will manage itself in a responsible fashion.
  - Offer transparency to citizens / customers.

- A Financial Policy and Procedures Document may include:
  - Cash Management and Investment Policies
  - Budgeting Policies
  - Capital Improvement Planning Policies
  - Tax-Supported and Utility-Supported Debt Policies
  - Fund Balance Policies
Develop a meaningful peer group to evaluate key financial ratios and economic indicators such as:
- Debt and Contingent Liability Ratios
- Fund Balance / Liquidity Ratios
- Demographic Information
- Tax Base / Customer Information

Peer Groups may include
- Credit Rating Categories
- Population / Customer Ranges
- Regional Jurisdictions / Utilities

Resources for benchmarking include:
- Credit Rating Agency Publications
- Local Government Commission Reports
- School of Government / Environmental Finance Center Resources

Unassigned General Fund Balance as a % of Revenues

Water and Sewer Unrestricted Cash as a % of O&M
Calculate Key Debt Ratios to provide perspective on current debt burden and future capacity.

Key Tax-Supported Debt Ratios Include:
- Debt to Assessed Value.
- 10-Year Payout Ratio.
- Debt Service vs. Expenditures.
- Debt vs. Governmental Revenue.
- Debt Per Capita.

Key Utility-Supported Debt Ratios Include:
- Debt Service Coverage.
- Debt to Net Plant.
- Days Cash on Hand.
Debt Affordability

- Aggregate annual tax-supported debt service and other capital funding requirements:
  - Existing Debt Service Payments.
  - Estimated CIP Debt Service.
  - Pay-as-you-go Capital.
  - Operating Impacts of Capital Projects.

- Identify Revenue Sources in current Fiscal Year budget dedicated to debt service and capital:
  - Sustainable General Fund Budget Revenues.
  - Fund Balance / Reserves.
  - State Revenues (e.g. Sales Tax, Lottery, etc.).
  - Federal Revenues / Subsidies.

- For Utility-Supported projects, develop a forward looking Pro-Forma Financial model to forecast future revenues, operating / capital expenses and existing / future debt service payments.
Types of Credit and Issuance Approaches

Credit Types:
- General Obligation Bonds.
- Limited Obligation Bonds / Certificates of Participation / Installment Financings.
- Revenue Bonds.
- Special Obligation Bonds.

Issuance Approaches:
- Public Sale (Competitive or Negotiated).
- Direct Bank Loan (RFP or Negotiated).
- USDA Financing.
- State Revolving Loans.
- Short Term vs. Long Term Funding.
Develop Plan of Finance

HIGH LEVEL STRATEGY AND PLANNING
- Strategic Vision
- Board / Council Communication
- Capital Improvement Plan
- Budget Forecasting

DEVELOP PLAN OF FINANCE
- Financial Policies
- Benchmarking
- Debt Capacity / Debt Affordability
- Funding Approach

IMPLEMENT PLAN OF FINANCE
- LGC Coordination
- Working Group and Financing Schedule
- Credit Rating Strategy
- Post Issuance
Implement Plan of Finance

- Coordinate with the Local Government Commission.

- Establish the Working Group.

- Developing the Financing Schedule, including Board/Council Approvals.

- Develop Rating Agency Strategy.

- Sell Bonds / Issue Bank Loan.

- Close on Financing and Begin Project Construction.

- Post Issuance Continuing Disclosure Requirements.
Local Government Commission Considerations

- Hold LGC Pre-Application Meeting.

- Demonstrate Repayment Plan.

- Determine Procurement Approach.

- Develop Project Construction Schedule.

- Determine Design Time Frame, Permits Required, Construction Bids, Guaranteed Maximum Price.

- Submit Joint Legislative Committee Letter (if necessary).

- Submit Current Audit / Respond to Outstanding Unit Letter (if any).
Working Group and Financing Schedule

- Working group members may include:
  - Bond Counsel.
  - Financial Advisor.
  - Underwriter / Lender.
  - Underwriter’s Counsel / Lender’s Counsel.
  - Trustee.
  - Feasibility Consultant.

- Financing Schedule will include:
  - Project Design, Bid, Construction Schedule.
  - Board / Council Actions with ample time to educate and discuss with elected officials.
  - Document Development Timeline.
  - Sale Date
  - Closing Date.
Rating Agency Strategy

- **Preliminary Internal Credit Assessment and Scorecard Methodology:**
  - Conduct an internal credit review evaluating various financial, demographic, and economic factors.
  - Identify credit strengths and challenges.
  - Develop a peer comparative group.
  - Utilize internal rating scorecard models to replicate the rating agencies’ quantitative approach.

- **Development of Credit Presentation:**
  - Develop a detailed credit presentation to serve as a guide for discussion.
  - Highlight areas of credit strengths and initiatives implemented to offset credit challenges.
  - Provide rating analysts with key information to conduct quantitative analysis.
  - Offer perspective for rating analysts that may result in qualitative adjustments that could otherwise go unnoticed.

- **Rating Interactions:**
  - Determine preferred rating interaction strategy (i.e. rating calls, site visits, or rating meetings).
  - Prepare Staff / Officials for rating interactions.
  - Coordinate logistics of the rating interaction.
  - Utilize confidential / indicative credit rating strategies when available and appropriate.

- **Follow Up:**
  - Address immediate analyst questions and observations prior to receipt of ratings.
  - Coordinate review and publishing of formal credit rating reports.
  - Continue to develop relationship with rating analyst through regular communication.
  - Prepare for periodic rating surveillance.

*An effective rating agency strategy will assist the rating analysts with their credit analysis such that they are both better informed about the credit strengths and better armed to serve as your advocate to the rating committee.*
Post Issuance

- Establish a process and / or policies for continuing disclosure requirements:
  - Audits.
  - Budgets.
  - Key Financial Information.
  - Material Events.

- Establish a rating agency surveillance process.

- Review investment of bond proceed options
  - Project Draw Schedule.
  - Allowable Investments.
  - Investment Strategy.
Implement Ongoing Process

HIGH LEVEL STRATEGY AND PLANNING
- Strategic Vision
- Board / Council Communication
- Capital Improvement Plan
- Budget Forecasting

DEVELOP PLAN OF FINANCE
- Financial Policies
- Benchmarking
- Debt Capacity / Debt Affordability
- Funding Approach

IMPLEMENT PLAN OF FINANCE
- LGC Coordination
- Working Group and Financing Schedule
- Credit Rating Strategy
- Post Issuance
Municipal Advisor Disclosure

The U.S. Securities and Exchange Commission (the “SEC”) has clarified that a broker, dealer or municipal securities dealer engaging in municipal advisory activities outside the scope of underwriting a particular issuance of municipal securities should be subject to municipal advisor registration. Davenport & Company LLC (“Davenport”) has registered as a municipal advisor with the SEC. As a registered municipal advisor Davenport may provide advice to a municipal entity or obligated person. An obligated person is an entity other than a municipal entity, such as a not for profit corporation, that has commenced an application or negotiation with an entity to issue municipal securities on its behalf and for which it will provide support. If and when an issuer engages Davenport to provide financial advisory or consultant services with respect to the issuance of municipal securities, Davenport is obligated to evidence such a financial advisory relationship with a written agreement.

When acting as a registered municipal advisor Davenport is a fiduciary required by federal law to act in the best interest of a municipal entity without regard to its own financial or other interests. Davenport is not a fiduciary when it acts as a registered investment advisor, when advising an obligated person, or when acting as an underwriter, though it is required to deal fairly with such persons.

This material was prepared by public finance, or other non-research personnel of Davenport. This material was not produced by a research analyst, although it may refer to a Davenport research analyst or research report. Unless otherwise indicated, these views (if any) are the author’s and may differ from those of the Davenport fixed income or research department or others in the firm. Davenport may perform or seek to perform financial advisory services for the issuers of the securities and instruments mentioned herein.

This material has been prepared for information purposes only and is not a solicitation of any offer to buy or sell any security/instrument or to participate in any trading strategy. Any such offer would be made only after a prospective participant had completed its own independent investigation of the securities, instruments or transactions and received all information it required to make its own investment decision, including, where applicable, a review of any offering circular or memorandum describing such security or instrument. That information would contain material information not contained herein and to which prospective participants are referred. This material is based on public information as of the specified date, and may be stale thereafter. We have no obligation to tell you when information herein may change. We make no representation or warranty with respect to the completeness of this material. Davenport has no obligation to continue to publish information on the securities/instruments mentioned herein. Recipients are required to comply with any legal or contractual restrictions on their purchase, holding, sale, exercise of rights or performance of obligations under any securities/instruments transaction.

The securities/instruments discussed in this material may not be suitable for all investors or issuers. Recipients should seek independent financial advice prior to making any investment decision based on this material. This material does not provide individually tailored investment advice or offer tax, regulatory, accounting or legal advice. Prior to entering into any proposed transaction, recipients should determine, in consultation with their own investment, legal, tax, regulatory and accounting advisors, the economic risks and merits, as well as the legal, tax, regulatory and accounting characteristics and consequences, of the transaction. You should consider this material as only a single factor in making an investment decision.

The value of and income from investments and the cost of borrowing may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions or companies or other factors. There may be time limitations on the exercise of options or other rights in securities/instruments transactions. Past performance is not necessarily a guide to future performance and estimates of future performance are based on assumptions that may not be realized. Actual events may differ from those assumed and changes to any assumptions may have a material impact on any projections or estimates. Other events not taken into account may occur and may significantly affect the projections or estimates. Certain assumptions may have been made for modeling purposes or to simplify the presentation and/or calculation of any projections or estimates, and Davenport does not represent that any such assumptions will reflect actual future events. Accordingly, there can be no assurance that estimated returns or projections will be realized or that actual returns or performance results will not materially differ from those estimated herein. This material may not be sold or redistributed without the prior written consent of Davenport.