City Council Report

Date: April 1, 2019

To: City Council

Through: Chris Brady, City Manager
Michael Kennington, Chief Financial Officer

From: Ryan Wimmer, Deputy Director - Office of Management and Budget

Subject: 2019 Utility Systems Revenue Bonds – Defeasance and Refundings

Purpose

Defeasance

Approval of the utility systems revenue bonds defeasance would allow the City to utilize restricted utility development impact fee revenue to reduce its financial liability by pre-paying (defeasing) a portion of its outstanding bonds.

A portion of the following bond issuances would be defeased (pre-paid):

- Series 2009 Utility Systems Revenue Bonds (Build America Bonds)
  Amount: $10.0 million (not to exceed $11.0 million)

Refundings

Approval of the two proposed refundings would allow the City to take advantage of favorable interest rates in the municipal bond market to refund (refinance) existing bonds at a lower interest cost over the same timeframe to realize interest savings.

Council approval of the refunding actions would order the sale of the following issuances of bonds:

- Series 2019B Utility Systems Revenue Refunding Bonds
  Amount: $50.3 million (not to exceed $60 million)
- Series 2019C Utility Systems Revenue Refunding Bonds
  Amount: $85.5 million (not to exceed $95 million)

The proceeds from the sale of the refunding bonds would be used to redeem all or a portion of previously issued bonds:

- Series 2009 Utility Systems Revenue Bonds (Build America Bonds)
- Series 2012 Utility Systems Revenue Bonds (Taxable)

Background

Defeasance

1. Series 2009 Utility Systems Revenue Bonds (Build America Bonds)

   In 2013, in response to State legislative changes to development impact fee requirements, the City elected to use impact fee revenue to pay for existing debt on eligible projects until the debt is extinguished. Development impact fees are assessed on development projects to pay for the cost of the infrastructure that was previously constructed in order to allow for development.

   As water and wastewater impact fee revenue collected in recent years has exceeded impact fee-eligible debt service due, a balance of impact fee revenue is available to pre-pay impact fee-eligible debt due in future years. The City similarly used available development impact fee revenue to defease utility system bonds in 2016, 2017, and 2018.

Refundings

1. Series 2009 Utility Systems Revenue Bonds (Build America Bonds)

   These bonds were issued in 2009 with a typical 10-year call option in 2019. The bonds were issued during the Great Recession, when the federal government was offering local governments an interest subsidy on bond offerings (called Build America Bonds, or BABs) as part of the American Reinvestment and Recovery Act (ARRA) stimulus funding. The City normally issues tax-exempt debt because interest costs are typically less than with taxable debt. The 2009 bonds were issued as taxable BABs because the federal government pledged to reimburse the City a certain percentage of the interest cost each year. The higher interest cost of the taxable BABs offset by the partial interest reimbursement from the federal government was less expensive for the City than the interest cost of tax-exempt debt.

   Subsequently, the interest reimbursement percentage was partially reduced during the federal sequestration budget reductions in 2013 and remains so today. By refunding these bonds, the City would lose the federal interest subsidy on the bonds. However, the interest savings from the refunding is significantly greater than the interest subsidy.

   The Series 2019B Utility Systems Revenue Refunding Bonds would replace these bonds and would be tax-exempt.

2. Series 2012 Utility Systems Revenue Bonds (Taxable)

   These bonds were issued in 2012 as part of a City utility debt restructuring as taxable (not tax-exempt) utility systems revenue bonds. The Internal Revenue Service (IRS) only allows tax-exempt bonds to be refunded once and retain tax-exempt status. At least some of the bonds involved in the debt restructuring in

2012 had been refunded previously, so they could not be refunded again as tax-exempt.

This transaction is an advanced refunding. Although the bonds are not callable until 2022, the taxable bonds can be refunded in advance of that date. If approved, proceeds from the Series 2019C Refunding bonds would be put into escrow in order to make debt service payments and call the Series 2012 bonds in 2022 when they become callable.

The Series 2019C Utility Systems Revenue Refunding Bonds would replace these bonds and would be tax-exempt.

Discussion

Defeasance

The defeasance of bonds allows the City to remove debt from the City's financial statements and earn a slightly higher interest rate on savings instruments that have a longer term than those used to invest City funds.

Refundings

The refunding savings would accrue to the City's Enterprise Fund, which is used to account for the City's utility systems.

Fiscal Impact

Defeasance

If approved, the City would use approximately $10.2 million in impact fee revenue to redeem $10.0 million of utility system revenue bond principal. The defeasance would result in a reduction of $18.0 million of utility systems revenue bond debt service (principal and interest).

Refundings

The municipal bond market will continue to be monitored to ensure all refunding issuance will result in present value debt service savings of at least 3% of the principal amount of the bonds being refunded, as required by the City's financial policies.

Preliminary estimates of savings from the recommended refunding transactions are as follows:

	Estimated Savings $ (net present value)	**Estimated Savings % (net present value)**
Series 2009	$4.7 million	8.9%
Series 2012	$7.3 million	8.6%

Alternatives

Defeasance

The City could not move forward with the defeasance. In that case, the City would invest the development impact fee revenue along with other City funds and pay for the eligible debt when the bonds become due or callable.

Refundings

The City could not proceed with the refundings and continue to pay higher than market interest rates on outstanding bond debt. The City could consider refunding the bonds in the future.