Municipal Bonds

Sharon L. Rollins, P.E.
Technical Consulting Program Manager

September 11, 2012

The Municipal Technical Advisory Service (MTAS) is a state-wide agency of the University of Tennessee Institute for Public Service, and helps municipalities in Tennessee with technical consulting, training and field services. Through MTAS cities and towns are supported by and have available technical experts dedicated solely to their service.

MTAS links the expertise of Tennessee colleges and universities with cities and towns to provide timely and valuable information and assistance on issues of critical importance.

THE UNIVERSITY of TENNESSEE UT
MUNICIPAL TECHNICAL ADVISORY SERVICE

In cooperation with the Tennessee Municipal League

MUNICIPAL BONDS

Private financial institutions are a traditional source of funding for municipal public works.

CONTACT

Go to a local financial institution with public finance expertise. Look for a full-service institution that can

1. Analyze a local government's current financial condition and develop projections of future performance;
2. Develop capital facilities plans and assess current needs;
3. Prepare detailed plans for debt issues and coordinate timing with project requirements;
4. Help select bond counsel and prepare notices, resolutions, and other documentation;
5. Prepare and arrange for printing preliminary and final official statements;
6. Analyze the need for and help with bond insurance, letters of credit, and other credit enhancements;
7. Make presentations to rating agencies or bond insurers;
8. Give advice on selecting a financial institution to act as registrar, paying agent, or trustee;
9. Choose the proper timing of a bond sale, prepare the advertisement, and distribute official statements to prospective investors;
10. Arrange printing, proof of authenticity, and delivery of bonds at closing;
11. Assist the issuer and bond counsel;
12. Advise issuer on the best investment plan for bond proceeds and help with arbitrage situations;
13. Assist the issuer with post-issue financial reporting that meets state and federal regulations.

The various types of municipal bonds include general obligation bonds, special tax bonds and special assessments, revenue bonds, industrial revenue bonds, and double-barrel bonds. General obligation bonds are backed by the full faith and credit of the municipality. The municipality pledges its full taxing authority as security for payment of the loan. Special tax bonds and assessments are secured by special taxes created specifically to pay off the bond. Revenue bonds are payable from receipts from specific sources, such as water sales or wastewater service revenues. Industrial revenue bonds are used to finance building an industrial facility that will be leased to a business with lease payments pledged to pay off the bond. A double-barrel bond is backed by collateral from at least two sources. For example, revenues from water sales and the full taxing authority of the municipality could be pledged as security for a double-barrel bond.

WHO QUALIFIES?

Any local government authorized to incur debt.

Local governments generally should consider using bond issues for large, long-term debt of more than $1 million and for longer than 12 years.

Applicants must be credit-worthy or insurable. In other words, they must be ratable by a recognized rating agency such as Moody's or Standard and Poor's.

HOW ARE THE FUNDS USED?
Bonds are an unlimited source of money. The local government determines the maximum amount of the bonds and they sometimes are used to complement funding from other sources, particularly grant funding.

WHAT ARE THE TERMS?
Interest rates vary.

Applicants must be aware of the federal tax law's effects on bond issues.

Applicants should consider the costs associated with issuing bonds, such as legal, insurance, publications and advertising notices, printing, rating agency, bond registration, and financial advice. These costs are usually equal 1–3 percent of the bond issue.

The borrower can lower the interest rate by reducing the amount borrowed, shortening the payback period, taking advantage of arbitrage allowed by federal tax laws, and enhancing credit worthiness. It is advisable to seek legal and financial advice on arbitrage and insurance.

It takes about six weeks to issue bonds for a local government that has been through the process before and has established credit. If the local government has not issued bonds previously, the process takes from eight weeks to six months.

It is important to involve a financial adviser early in the process.

Pitfalls local governments may face in issuing bonds include
1. User rates that are insufficient to cover debt service;
2. Costs incurred on the project before the bonds are issued that may not be covered;
3. Inaccurate record keeping during the project;
4. Using bond money for other than the stated purpose.

HOW TO APPLY
Use the following steps to select a full-service financial institution to assist in all phases of issuing municipal bonds.

1. Study project details. Define the project and think through time and budget constraints.
2. Solicit information. Begin the selection process with an invitation to submit information.
3. Think expertise, not cost. Base financial services on competence, creativity, and performance first. Weigh cost second.
4. Review qualifications. Consider technical expertise, experience with similar projects, reputation with existing clients, workload, and factors peculiar to your project.
5. Narrow the field. Short-list the few most qualified firms and schedule separate presentations.
6. Hear presentations. Select a committee or use the entire council to hear presentations from each firm.
7. After the presentations, rank the firms in order of preference. It's helpful to use prepared score sheets.
8. Negotiate. Begin with the top-ranked institution. If negotiations fail, go on to the second firm and so forth. Define the scope of the work and the fees.
9. Put the agreement in writing.

WHEN TO APPLY
Application may be made at any time.