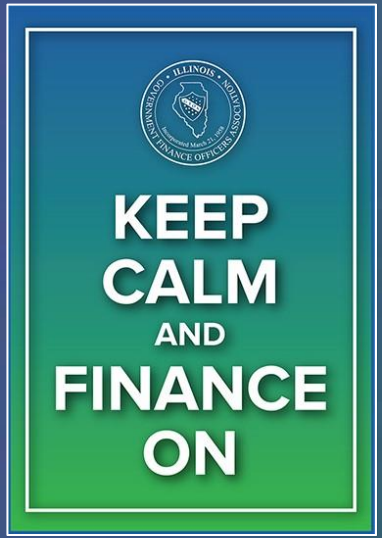

Issuing Bonds - Hot Topics in Public Finance

Carrie Hagerty
Finance Director
City of Rockford, Illinois
carrie.hagerty@rockfordil.gov

Dalena Welkomer
Senior Vice President
Robert W. Baird & Co. Inc.
Naperville, Illinois
dwelkomer@rwbaird.com

Dan Forbes
President
Speer Financial, Inc.
Chicago, Illinois
dforbes@speerfinancial.com

Larry White
Partner
Chapman and Cutler LLP
Chicago, Illinois
white@chapman.com

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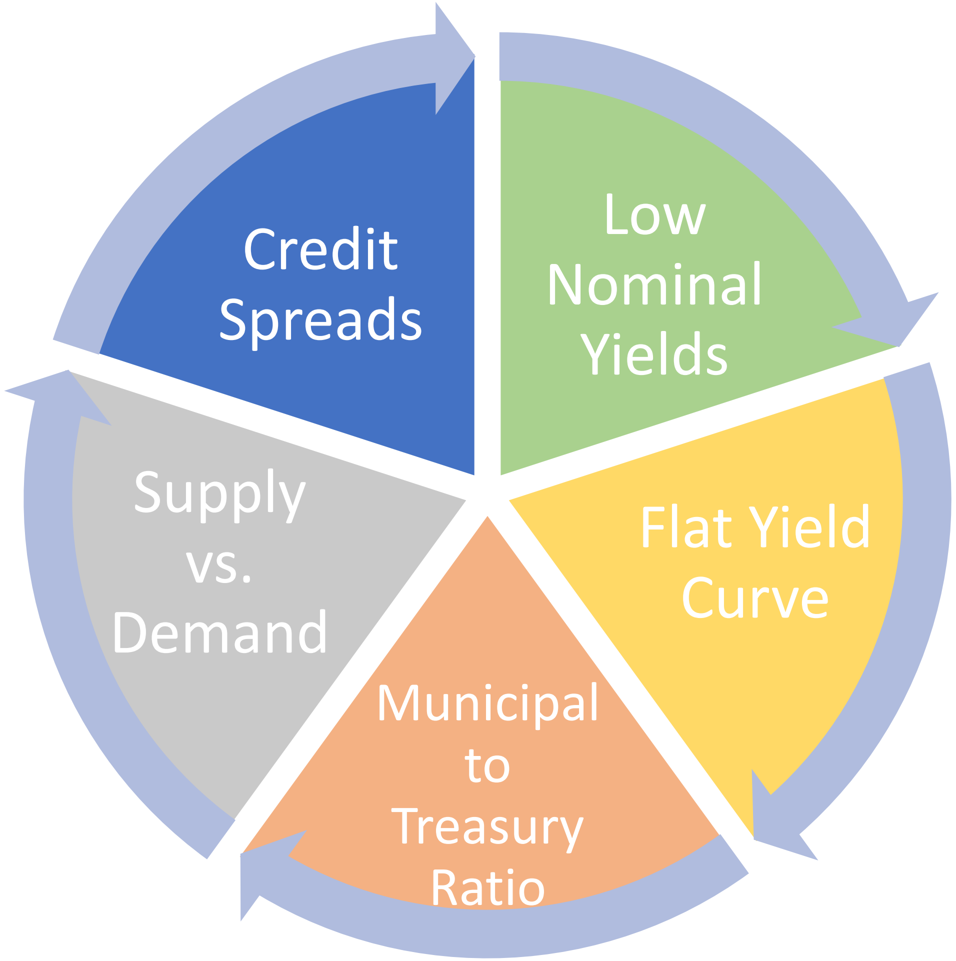
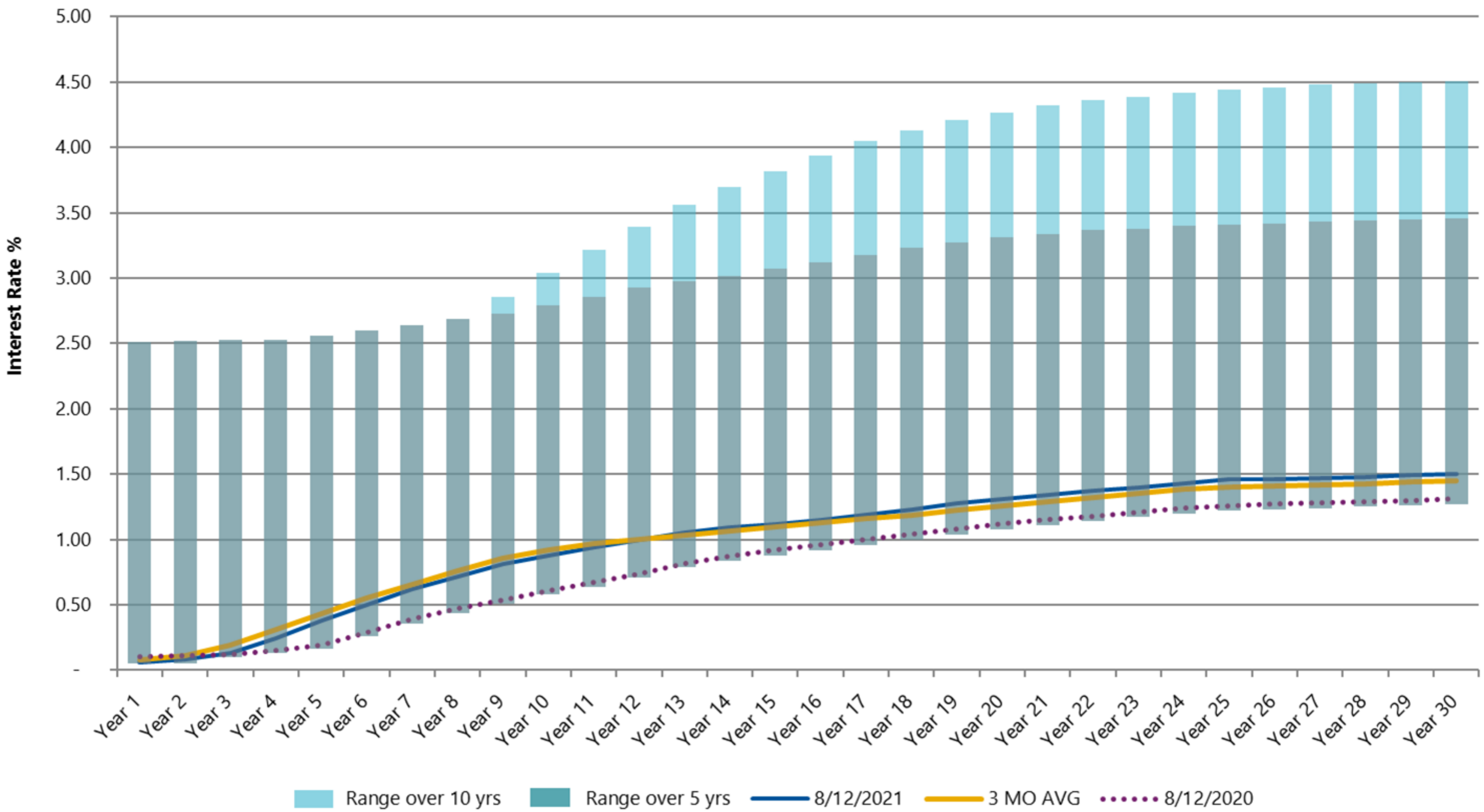
Key Drivers of the Municipal Market



Interest Rate Yield Curve

- Highlights the range of the 1 to 30 year maturities dating back 10 years.
- Illustrates the highs and lows of the yield curve vs. the average and current yield curves.



Source: Refinitiv as of August 12, 2021

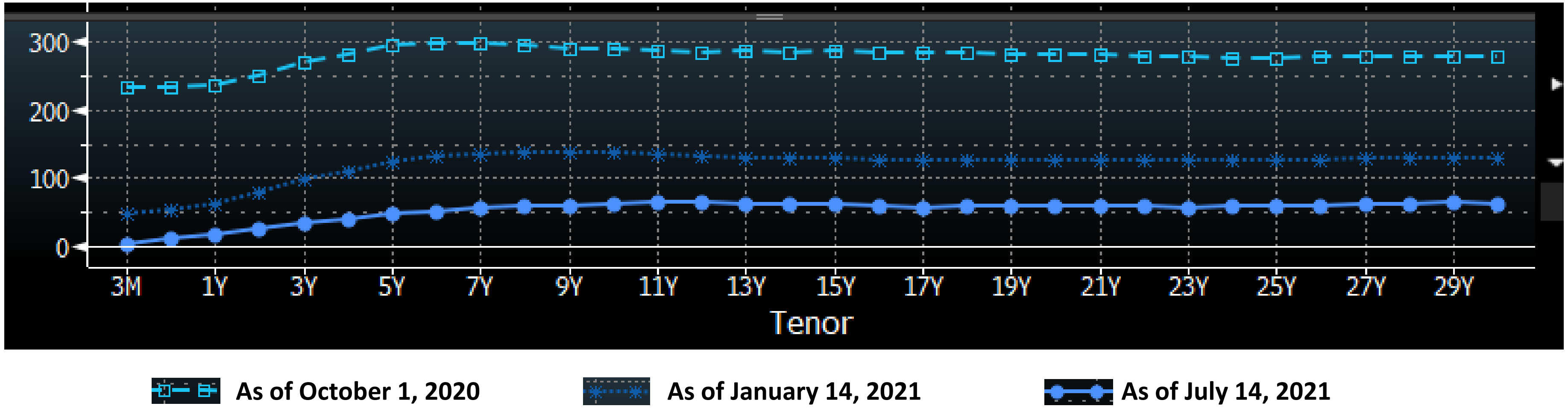
Current Interest Rates for Municipal Bonds are Generally:

a. Higher than historical averages.
b. Lower than historical averages.
c. About the same as historical averages.
d. I am not sure.

State of Illinois Credit Spreads

- Tightened (lowered) around 200 basis points (2.00%) since October 2020.

State of Illinois BVAL Credit Spreads



Source: Bloomberg BVAL Spreads as of July 14, 2021.

- How does it impact your cost of borrowing and investor pool?

- What influences the “Illinois Penalty” and how can you minimize it?

What Lies Ahead for Municipal Bond Market

What Could Impact Muni Market in 2021/2022?

- Infrastructure Bill
- Potential Reconciliation Bill
- Inflationary Pressures
- Economic Recovery
- Pandemic
- Fed Action

How Might These Events Impact Muni Market?

- Short vs. Long-Term Rates
- Shape of Yield Curve
- Credit Spreads
- Supply/Demand

American Rescue Plan Act

1) Respond to the public health emergency created by COVID-19 OR its negative economic impacts, including assistance to households, small businesses and non-profits, or aid to impacted industries like tourism, travel, and hospitality;

2) To respond to workers performing essential work during the COVID-19 emergency by providing premium pay;

American Rescue Plan Act

3) Provision of government services to the extent of the reduction in City revenue, measured against base year actual revenue collected; and

4) To make necessary investments in water, sewer, or broadband infrastructure.

Proposed Legislation that Could Impact Muni Bond Market

REINSTATEMENT OF TAX-EXEMPT ADVANCE REFUNDINGS (LOCAL ACT & LIFT ACT)

Could renew refunding opportunities for state and local governments, school districts, water, sewer and electric utility authorities, higher education and health care institutions and housing authorities which offer more debt service cost savings than the current alternatives available (ex: taxable advance refundings).

RESTORATION OF A DIRECT-PAY BOND (AMERICAN INFRASTRUCTURE BONDS ACT & LIFT ACT)

Similar to the Build America Bond Program, it would be an alternative to tax-exempt financing and promote infrastructure projects through the issuance of taxable bonds with a direct-pay Federal subsidy on interest cost. There are key differences proposed in the House and Senate with regards to reimbursement and sequestration limitations.

INCREASE IN ANNUAL BANK-QUALIFIED LIMIT FROM $10 MILLION TO $30 MILLION (LIFT ACT)

Could potentially lower the borrowing cost on tax-exempt debt issued up to $30 million per year due to the tax benefits bank-qualification offers banks, which are a large purchaser of bank-qualified debt. The increase could bring in more demand for BQ bonds, however, that increased demand needs to be weighed against the additional supply of BQ bonds that would be expanded to $30 million.

EXPAND USE OF PRIVATE ACTIVITY BONDS FOR MULTI-FAMILY HOUSING (AFFORDABLE HOUSING CREDIT IMPROVEMENT ACT)

Would reduce the private activity bond financing threshold from 50% to 25% which could “free” up a portion of the bond cap for other purposes. Separately, there is discussion of legislation that would increase the private activity bond cap to bring more private investment into infrastructure financing at tax-exempt rates.

INCREASES IN CORPORATE TAX RATE FROM 21% TO 28% AND INCOME TAX RATE ON TOP INCOME EARNERS FROM 37% TO 39.6%

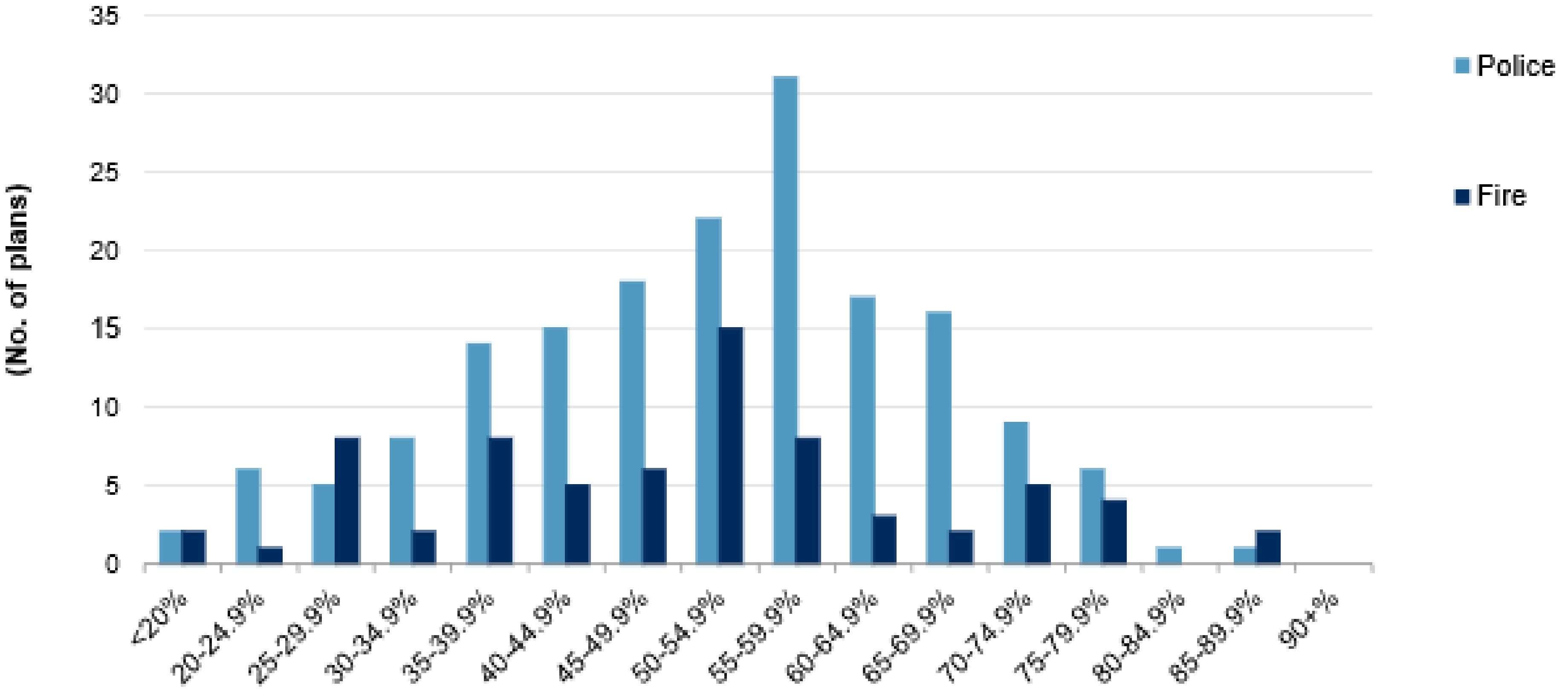
The President’s push to raise the corporate tax rate could lure banks and insurance companies to increase their holdings of tax-exempt municipal bonds. Any increase in taxes will generally increase the attractiveness of tax-exempt securities. A larger pool of investors could potentially lead to more attractive interest rates for municipal market debt issues.

Increasing Acceptance of Pension Obligation Bonds in Illinois

- Since the start of 2020, we have seen **<u>10</u>** POB issuances in Illinois, **<u>6</u>** alone to date in 2021.
  - Geographically spread across the State amongst local municipalities and fire protection districts.
  - Aware of **<u>6</u>** additional local municipalities actively considering POBs.
- Due in large part to:
  - Historically low taxable interest rate environment and flat yield curve.
  - Future consolidation of Illinois police/fire pension plans.
  - Strategy that can fix the Illinois pension ramp (annual amortization payments grow as a constant % of payroll – could grow by 2x by 2040).
  - Rating agencies are net neutral when POBs are structured conservatively.

Illinois Municipalities' Police And Fire Funded Ratio Distribution

S&P Global Ratings universe



Source: Issuers' financial reports.

Local Public Pension Funds for Police and Fire in Illinois are generally:

a. Well Funded (high asset ratio to pension liability).

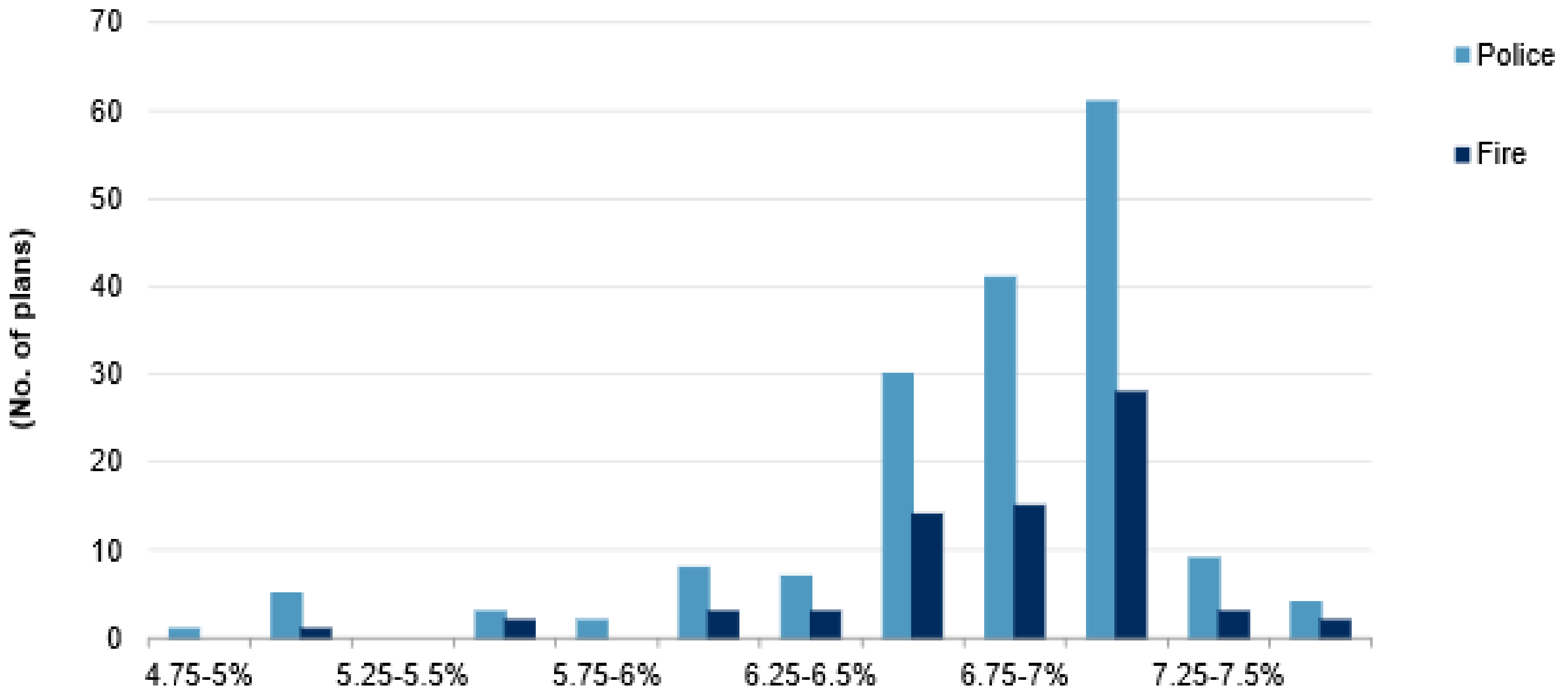
b. Poorly Funded (low asset ratio to pension liability).

c. About equally split between (a) and (b).

d. I am not sure.

Illinois Municipalities' Police And Fire Pension Funds Discount Rate Distribution

S&P Global Ratings universe



Source: Issuers' financial reports.

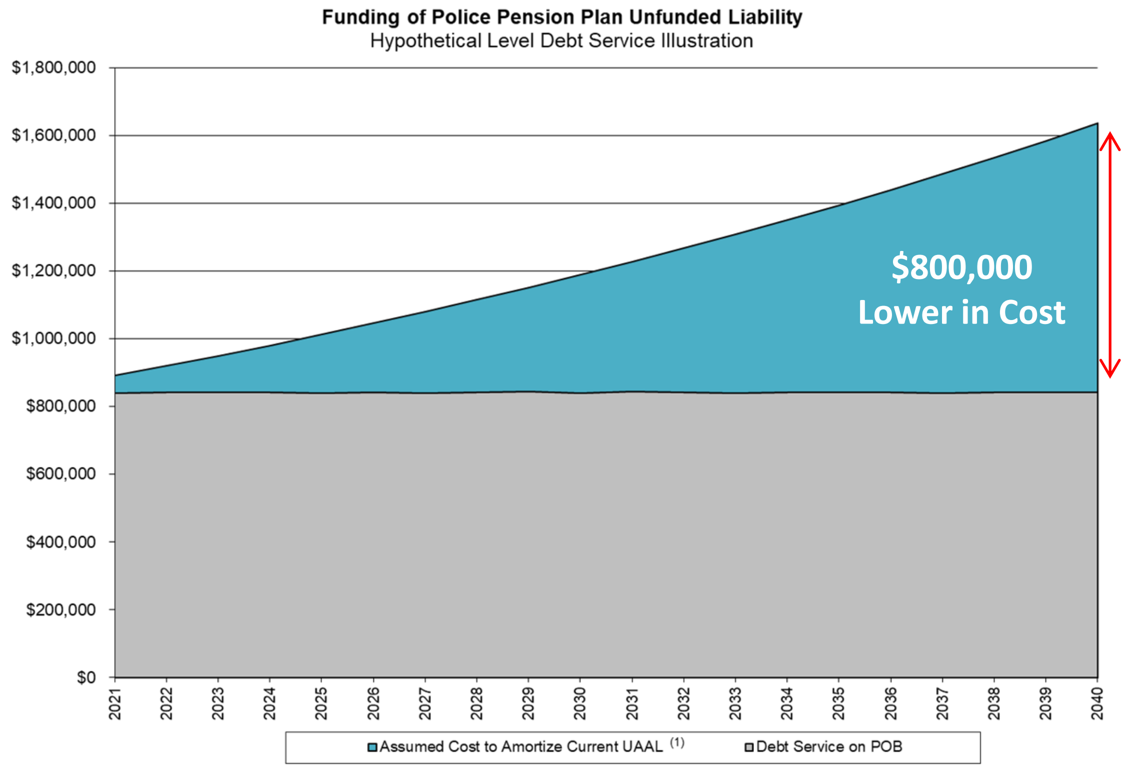
What are Pension Obligation Bonds?

- Pension Obligation Bonds (POBs) are issued to pay off all or a portion of the unfunded liabilities of a pension system.
  - Issued as general obligation bonds (alternate revenue bonds for non-home rule) with the intent to abate the debt service levy each year and use the pension levy to pay debt service.
  - Proceeds are deposited to be invested with other system assets.
  - Issued at taxable interest rates.
  - Typically amortized over the same term as the unfunded liability (e.g. by 2040).
  - Carry the same rating as the issuer's GO debt.
- POBs are attractive when the POB cost of funds is significantly less than the actuarial rate on the unfunded liability (e.g. 6.75%).
  - In the current market, we estimate an all-in TIC of 2.75% for an Illinois taxable UTGO bond rated in the "AA" category.

Potential Benefits of POBs

- Could potentially generate significant expected savings vs. current funding methodology.
- Could prevent future reductions in General Corporate levy.
- No material net increase in liability – replaces on existing legal obligation with another, less costly liability.
- Lowers hurdle rate on investments from actuarial rate to POB cost of funds (e.g. from 6.75% to 2.75%).
- Comply with State funding requirements (90% by 2040).
- Pension plan receives upfront payment, instead of partial payments through 2040 (benefit of compound interest).

- Provides flexibility to level off future payments to more affordable levels.



A potential benefit of pension obligation bonds is:

a. Could potentially generate significant savings compared to current funding methodology depending on investment performance.

b. Could prevent future reductions in the general corporate fund levies.

c. Provides flexibility to level off future payments to more affordable levels.

d. All of the Above.

Potential Risks of POBs

- Principal risk is that investment earnings on POB proceeds are less than the actuarial rate.

Actual Earnings Achieved		Result
Above Actuarial Rate	→	Savings Greater than Expected
Actuarial Rate	→	Expected Savings Received
Below Actuarial Rate, but Above POB Cost of Funds	→	Savings Less than Expected
POB Cost of Funds	→	**No Savings**
Below POB Cost of Funds	→	Loss

- Investing a large dollar amount all at once could result in adverse marketing timing.
- Proceeds must be turned over to be invested with other plan assets.
- POBs are “hard” liabilities while pension payments can be considered “soft” liabilities.

Alternative Refunding Strategies

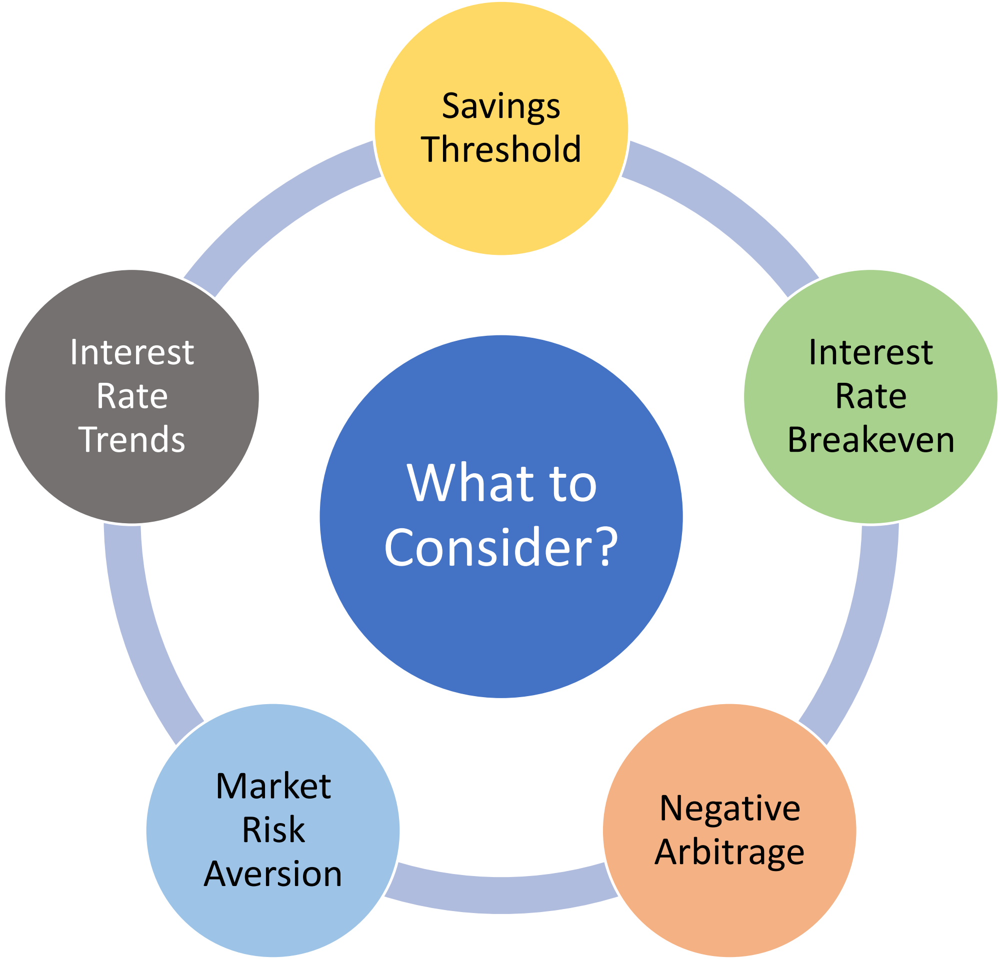
- Tax Cut and Jobs Act of 2017 eliminated the ability to advance refund debt at tax-exempt rates.

Alternative Financing Methods Being Used

Strategy	Definition
Current Tax-Exempt Refunding	Refunding where tax-exempt bond proceeds are set aside to redeem outstanding bonds within 90 days or less from the call date.
Taxable Advance Refunding	Refunding of tax-exempt bonds with taxable interest rates if greater than 90 days from the call date.
Tax-Exempt Forward Delivery	Refunding bonds priced on a set date with a fixed tax-exempt interest rate but settled at an extended date in the future which is within 90 days from the call date.
Cinderella Bonds	Refunding initially issued on a taxable basis that will convert to a tax-exempt status upon the occurrence of a specified condition (e.g. call date on bonds refunded). Taxable and tax-exempt interest rates are established at the time the bonds are issued or converted.

Taxable Advance Refundings

- More issuers are utilizing taxable advance refundings to lock in savings in a historically low interest rate environment.
- Taxable municipal bond issuance represented over 30% of total supply in 2020.
  - Up from the annual average of 8% 2016-2018 and 17% in 2019.
- Increased market acceptance for taxable munis.



Private Placements

- The percentage of bonds sold via private placement has grown in recent years.
  - ~9% of issues 2013-2020 versus <3% 2004-2012.
- The cost/benefit between public offering and private placement fluctuates with market conditions.
  - Private Placements are down ~50% based on par and # issues compared to this time last year.

Public Offering	Considerations	Private Placement
• A broker dealer serves as the underwriter (initial purchaser) and then resells the bonds to investors. • Often sold to multiple investors • Could be done through a negotiated or competitive sale.	• Deal size • Term • Interest rates • Costs of Issuance • How quickly need funds • Banking relationships • Continuing disclosure	• Limited offering to a small, select group of investors. Often local/regional banks • Often purchased by one investor. • An investor typically purchases the bonds directly from the issuer to hold in its portfolio.

QUESTIONS?

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