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# MEMORANDUM

**TO:** Steve Parker
Heather Hurlbert
City of San Marcos

**FROM:** Dan Wegmiller
Specialized Public Finance Inc.

**DATE:** September 13, 2017

**RE:** Debt Issuance and Bond Call/Defeasance

This memo addresses debt issuance timing and structuring as well as tax rate management tools including calling or defeasing existing debt. Tax-supported Debt (Certificates of Obligation, General Obligation Bonds or Limited Tax Notes) issuance is guided by a couple of considerations including tax rate impact, project timing and the ability to spend the proceeds in a timely manner.

The obvious major force is the ability to support the debt within the tax rate constraint. If there is not enough current taxable value to support the debt then it is not unusual to phase in the debt over a period of time. Additionally, the readiness of projects may not necessitate issuing debt until certain costs are known or environmental and other approvals are secured – today's current issues as it relates to the hurricanes and potential costs of materials rising and labor availability is an example of project elements that need to be assessed. There are pros and cons as it relates to when the City issues debt such as paying interest on the debt while it waits to be spent however there is also comfort in knowing the long-term interest rate has been locked in and will not be negatively affected by future market moves in interest rates.

If the City can implement the entire tax rate but elects to phase the issuance of debt over time then the City can structure the new debt phases by stair stepping or laddering the new debt service over time to fit within the tax rate. The City takes on some interest rate risk over time but avoids having bond proceeds issued and then having a project delayed or stalled due to any number of factors. Another option is if the tax rate is allocated all towards debt we can adjust the structure to meet the debt service tax rate revenue collected annually or we can structure a call or defeasance of existing debt. Defeasing or calling debt simply means the City takes the debt service tax revenue collected and pays off portions of existing debt that is not scheduled in the current year. A debt call is when the specific call date for an existing issue is coming up within 90 days of the payoff and a defeasance requires an escrow to be set-up until the call date is reached which could be outside of 90 days up to a few years out. In either case the debt that is paid off early is no longer

reflected as outstanding debt of the City. In addition, the debt that is paid off results in eliminating interest that would have been paid on that debt as previously scheduled to maturity. Calling/defeasing debt is part of a tax rate management strategy to avoid volatility in the tax rate while trying to phase in debt issuances.

As you can probably see, there is not a right or wrong answer as to whether a City should sell all its authorized debt at one time or take the approach to phase it in. One scenario eliminates interest rate risk on future issues while assuming project delivery and cost inflation exposure with debt proceeds in hand. While the other option allows for the projects to be ready and sometimes to "afford" the debt but assumes future interest rate risk. A very general sentiment is if you can spend the debt funds down in 3 years (also a Federal tax issue/expectation) then certainly consider issuing up to that amount of debt if the projects are ready.

Please let me know if any further discussion or questions arise from this summary of debt issuance and tax rate management through calling/defeasing of debt.