

City of Missoula Debt Management

Debt in a governmental entity is an effective financial management tool. Active debt management provides fiscal advantages to the City of Missoula and its citizens. Debt can serve several different purposes. It is useful in matching costs to benefits of public assets. It is useful as an economic development tool. It allows governments to build and acquire assets that would not otherwise be able to be built or acquired. Debt eliminates the need for governments to build up large reserve balances to build or acquire assets. In other words, debt is not something that should be avoided or eliminated. Rather, debt is something that should be used and managed effectively. Debt can be mismanaged, however. Over use of debt places a burden on the financial resources of the City and its taxpayers. Thus, it is important to create policies and follow practices to insure debt is used wisely.

Debt management is a critical component of the City of Missoula's financial operations. The city takes an active role in managing its debt. This is done through a variety of means including: debt management policies, bond ratings, comprehensive planning for future bond issues, management of existing and proposed debt levels, legal debt margins, and debt service payments. This section of the budget provides an analysis of each of these factors in addition to providing a detailed schedule of future debt service obligations of the city.

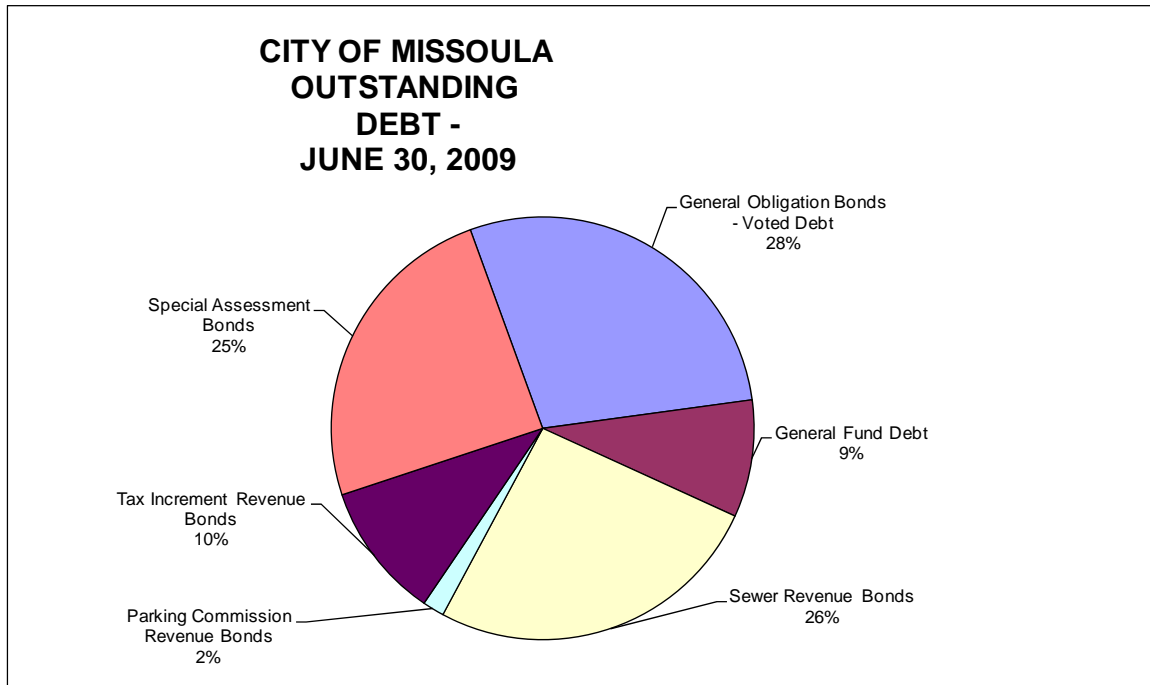
Major Bond Issues

Listed below is a brief description of the city's major outstanding bond issues, followed by a graphic overview of all outstanding debt of the city, by purpose.

- A. Aquatics Bond 2004A – Voted.** This bond issue was approved by the voters on November 4, 2003 in the original principal amount of \$8,100,000 for the purpose of replacing existing aquatic facilities and spray decks around located throughout the City of Missoula. The bonds were issued on May 24, 2004 with a true interest cost of 4.2339%. The bonds were financed over 20 years. The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued. The City received an A rating on these bonds from Standard & Poors. The purchaser of the bonds chose to have the bonds insured with a AAA rating from Standard and Poors.
- B. Refunding Bond 2004B – Voted.** This bond issue was refinanced on June 29, 2004 for the purpose of reducing interest costs associated with bonds issued in 1993 and 1994 resulting from bond elections in 1992 and 1988, both of which were for fire station construction projects while the 1992 referendum also included funds for the expansion of City Hall. The bonds were issued on June 29, 2004 with a true interest cost of 3.5427%. The bonds were financed over the remaining term of the original 20 years for each series refunded. The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued. The City received an A rating on these bonds from Standard & Poors. The purchaser of the bonds chose to have the bonds insured with an AAA rating from Standard and Poors.
- C. 2006 Fire Station GO Bond – Voted.** Issued in 2006 to provide funds for construction and equipping of new fire station #5 and remodel fire stations #2 and #3. The bonds were issued on September 13, 2006 with a true interest cost of 4.4169%. The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued.
- D. Refunding Bond Series 2007A GO Bond Open - Voted.** This bond issue was refinanced on February 1, 2007 for the purpose of reducing interest costs associated with bonds issued in 1996, 1997 and 1998 resulting from bond elections in 1995 and 1997, of which the 1995 bond election was for the purchase of open space and the 1997 bond election was for fire and police equipment purchases. The bonds were issued on February 1, 2007 with a true interest cost of 3.7527%. The bonds were financed over the remaining term of the original 20 years for each series refunded. The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued.

Outstanding Debt

Shown on the following page is a pie chart which presents the city's current outstanding indebtedness by purpose. As shown by the graph, voted General Obligation indebtedness (for open space acquisition, public safety and recreation facilities) represents a substantial component of the city's debt and this reflects the priorities of the public and the City Council. Despite the several categories of outstanding debt reflected below, City of Missoula actually has a relatively low level of outstanding debt, which is more fully described below.



At the end of the current fiscal year, the City of Missoula had a total of \$61,181,792 of long term debt outstanding of which \$57,461,875 was bonded debt. Of this amount, \$16,235,000 comprises debt backed by the full faith and credit of the government and \$14,030,295 is special assessment debt for which the government is liable in the event of default by the property owners subject to the assessment, although this debt is collateralized with liens on the properties against which the debt is assessed. The majority of the remainder of the City of Missoula's bonded debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

CITY OF MISSOULA'S OUTSTANDING DEBT

	Governmental Activities		Business-type Activities		Total	
	2009	2008	2009	2008	2009	2008
General Obligation Bonds	\$ 16,235,000	\$ 17,500,000	\$ -	\$ -	\$ 16,235,000	\$ 17,500,000
Tax Anticipation Note	-	-	-	-	-	-
Limited Obligation Bonds	5,130,000	5,360,000	-	-	5,130,000	5,360,000
Revenue Bonds	-	-	21,775,023	22,918,231	21,775,023	22,918,231
Spec. Assessment Bonds	14,030,295	15,510,165	-	-	14,030,295	15,510,165
Sidewalk & Curb Warrants	100,248	120,923	-	-	100,248	120,923
State Board of Investment Loans	191,309	222,425	-	-	191,309	222,425
Compensated Absences	3,474,814	3,442,644	245,103	226,651	3,719,917	3,669,295
Total Outstanding Debt	\$ 39,161,666	\$ 42,156,157	\$ 22,020,126	\$ 23,144,882	\$ 61,181,792	\$ 65,301,039

The City of Missoula's total debt was decreased by \$4,119,247 (6.3 percent) during the 2009 fiscal year. Virtually no new debt was issued this last year which resulted in a net decrease in outstanding debt at year end.

State statutes limit the amount of general obligation debt a governmental entity may issue to 2.5 percent of its total assessed valuation. The current debt limitation for the City of Missoula is \$93,949,249, which is significantly in excess of the City of Missoula's outstanding general obligation debt. As of fiscal year end, the City of Missoula was only utilizing 17.5% of its legal, voted general obligation bond limit. In addition, the City was utilizing 58% of its legal debt limit for non-voted General Fund (limited obligation) debt.

Proposed Debt in the Next Five Years

Listed below is a brief description of the city's proposed debt issuances over the course of the next five year period. Following this narrative description, is a graphic depiction of the relative effects of these proposed debt issuances in relation to the city's current debt and its remaining debt capacity.

- A. New Police Station - voted.** Due to the growth of the City of Missoula, the current police facility is in need of expansion. This issue is proposed to be put in front of the voters in November of 2011 as voted general obligation debt. The estimated cost, including land acquisition, would be \$15,000,000.

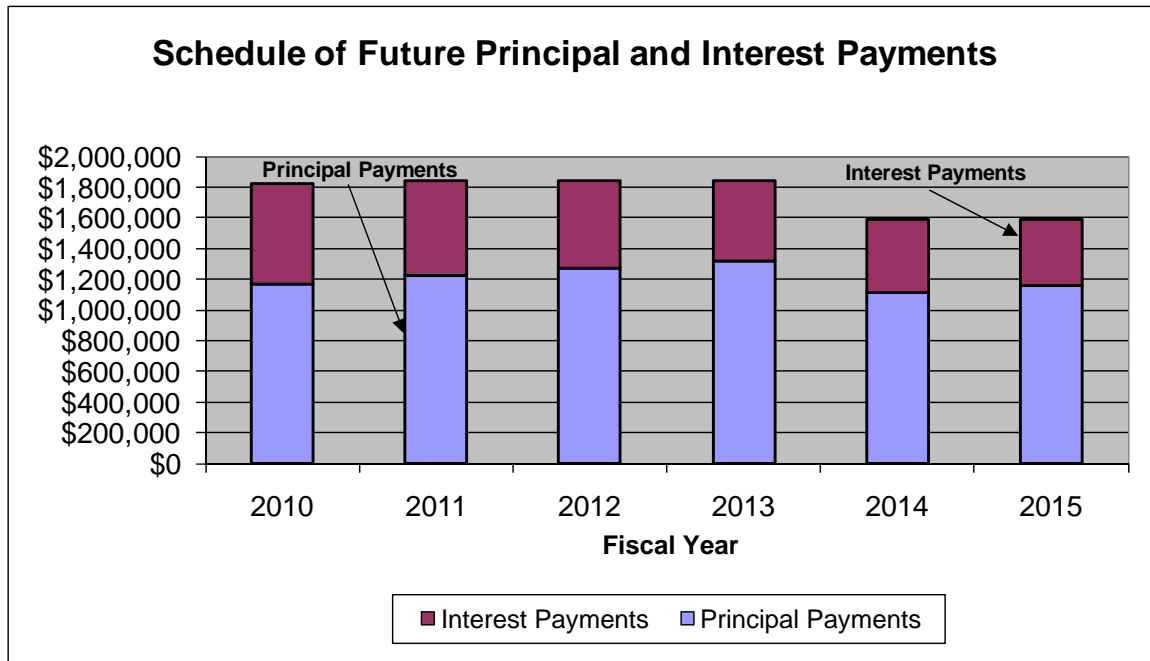
Debt Capacity – Legal Debt Margin

The schedule below shows a graphic presentation of the city's projected debt capacity (legal debt margin) with any proposed new debt included. This reflects the philosophy of the City Council in holding down the level of debt on the taxpayers, despite the city's rapid development and growing population.

VOTED GENERAL OBLIGATION BOND						
Maximum Allowable Debt - City of Missoula, Montana						
Assessed Valuation: FY 10 Certified Market Value					3,757,969,949	
Factor Allowed for Indebtedness					2.50%	
Total Indebtedness Allowed						\$ 93,949,249
<u>Less Current Indebtedness:</u>						
2004A Aquatics G.O. Bond					6,545,000	
2004B Refunding - Fire - G.O.Bond					950,000	
2006 Fire Station					5,145,000	
2007 Refunding					3,595,000	
Intercap Equipment Loans					191,309	
					-	
Total Current Indebtedness						\$ 16,426,309
Maximum Indebtedness Available (7-1-2009)						\$ 77,522,940
<u>Proposed Debt FY 10:</u>						
					-	
					-	
					-	
					-	
					-	
Total Proposed Debt						\$ -
Net Amount of Debt Available						\$ 77,522,940

Debt Service

The graph below shows the City's principal and interest payments in the current budget year and five years beyond. As shown by the graph, principal payments are increasing, while interest payments are decreasing. This reflects the declining debt level as the result of the scheduled payments the city will be making.



Most major debt obligations for the City are typically structured with declining interest payments and increasing principal payments—thereby resulting in relatively level debt service payments over the life of the bonds.

Bond Rating

Bond ratings reflect the relative strength of the city's financial management and planning capabilities and the quality of its elected and administrative leadership, as well as its wealth and social characteristics. Bond ratings serve as a statement of a locality's economic, financial and managerial condition and represent the business community's assessment of the investment quality of a local government. Highly rated bonds are more attractive and are more competitive in the market and thereby help lower interest costs paid by City residents. High-grade ratings reduce the cost of raising capital for City projects and a substantial savings for the City taxpayers.

The City of Missoula continues to seek ways to improve and maintain these ratings so as to provide the finest quality services and lowest cost. Concentrated efforts have been made to maintain and improve the City's "high-grade" ratings for its general obligation bonds through innovations in financial and debt administration. In April 2008, Standard and Poor's of New York assigned an AA- rating to all of the city's outstanding voted GO debt, which formerly had an A rating. This rating upgrade was based on the city's continued economic expansion and management's maintenance of good reserve levels.



AA-

The City of Missoula's "AA-" Bond Rating saves city residents thousands of dollars annually.

Quoted below are excerpts from the Standard & Poor's April 2008 rating upgrade.

Standard & Poor's Ratings Services assigned its 'AA-' standard long-term rating, and stable outlook, to all of the City of Missoula's outstanding voted GO debt.

The ratings reflect the city's:

The 'AA-' rating on Missoula, Mont.'s outstanding voted GO bonds reflects the city's:

- *Diverse local economy, which is anchored by the University of Montana and serves as a regional services, health care, and retail hub for the surrounding rural communities;*
- *Expanding property tax and economic bases due to a low cost of living and an educated labor force compared with the rest of the region;*
- *Historically low and stable unemployment levels; and*
- *Low overall debt burden with manageable future capital needs and limited debt issuance.*

Outlook

The stable outlook reflects the expectation of the local economy's continued diversity and steady economic growth. The city's low reserves levels preclude a higher rating at this time. The city's

ability to benefit from new retail development and its current sizable base in the future due to changes in state legislation could lead to rating improvement if additional revenue flexibility allows the city to build reserves levels.

The City's high ratings are an objective indication of sound financial management, recognition that its overall debt profile is characterized by good debt service coverage from pledged revenues and by sound legal provisions ensuring full and timely payment of its debt service obligations. Overall net debt is very low at \$906 per capita, or 1.9% of estimated true property value.

Investment Policy

The investment of capital funds is incorporated into the City's cash management program. All unexpended bond proceeds are deposited into a consolidated treasurer's account and invested with other funds in order to obtain maximum earnings. The segregation of each project's equity is preserved and reported separately.

Interest earned on capital funds during the construction period is credited to the respective project's fund or enterprise fund wherein the debt service is paid.

Management of Debt and Equity Funding of Capital Needs

An integral part of the City's financial strength has been to aggressively take advantage of the marketplace and refund outstanding debt, thereby reducing interest expense while using excess surpluses wisely to equity fund (pay with cash) capital project expenses and to fund depreciation of capital assets. This actively managed debt program allow us to pass along savings from the refunding of outstanding debt along to the taxpayers through reductions in the tax rates.

Debt Management Policies

The City of Missoula has developed a set of financial management policies that cover all aspects of its financial operations. Policies on debt management are one component of those financial policies. All of the City's financial management policies on included in the Executive Summary. Listed below are excerpts from those policies, which relate specifically to debt management.

Restrictions on Debt Issuance.

- 1) **Repayment of Borrowed Funds.** The city will repay borrowed funds, used for capital projects, within a period not to exceed the expected useful life of the project. This policy reflects the view that those residents who benefit from a project should pay for the project. Adherence to this policy will also help prevent the government from over-extending itself with regard to the incurrence of future debt.

Limitations on Outstanding Debt

- 1) **Reliance on Long-Term Debt.** The City will limit long-term debt to capital improvements which cannot be financed from current revenues. Incurring long-term debt serves to obligate future taxpayers. Excess reliance on long-term debt can cause debt levels to reach or exceed the government's ability to pay. Therefore, conscientious use of long-term debt will provide assurance that future residents will be able service the debt obligations left by former residents.
- 2) **Debt Not Used for Current Operations.** The city will not use long-term debt for financing current operations. This policy reflects the view that those residents who benefit from a service should pay for the service. Utilization of long-term debt to support current operations would result in future residents supporting services provided to current residents.

Debt Refinancing

- 1) **General Refinancing Guidelines.** Periodic reviews of all outstanding debt will be undertaken to determine refinancing opportunities. Refinancings will be considered (within federal tax law constraints) under the following conditions:
 - There is a net economic benefit.
 - It is needed to modernize covenants that are adversely affecting the City's financial position or operations.
 - The City wants to reduce the principal outstanding in order to achieve future working capital to do so from other sources.
- 2) **Standards for Economic Savings.** The federal government has placed significant conditions on the tax-exempt refunding of outstanding issues. Refundings have two general categories:
 - Current refundings, where the refunding bonds are settled within 90 days of an optional prepayment date; and
 - Advance refundings, where refundings are settled more than 90 days in advance of an optional prepayment date. The federal restrictions are that any issue can only be advance refunded once on a tax-exempt basis.

On advance refundings the City will seek to obtain a minimum present value savings level of 3% of the present value of refunded debt service. State law requires a demonstration of savings of 0.5% reduction in the average coupon interest rate between the refunding and refunded bonds.

The complete debt management policy for the City of Missoula can be found in the appendix to this budget document.