

MEMORANDUM

January 15, 2015

TO: Board of Mayor & Aldermen
Eric Stuckey, City Administrator

FROM: Russ Truell, ACA/CFO

RE: Plan of Refinancing Industrial Development Bonds

The original bonds used to finance the 50-acre parcel of land for the Nissan North America headquarters were issued with a rising amortization schedule that was intended to parallel the growing property taxes from the McEwen Economic Development district. That payment schedule, showing the principal payments for each year, is attached. The final maturity for the original bonds was April 1, 2030.

Because of the accelerating rate of development in the Economic Development District, and because of the unusually low prevailing interest rates, proposals were requested to ascertain whether a better financing structure might exist and the degree of competition in the rate environment among financial institutions. Numerous responses were received, including proposals offering slightly different financing formats. It was determined that a "direct bank purchase" format would be more beneficial to the Industrial Board and therefore the City of Franklin.

Moving to a direct bank purchase mechanism is beneficial in several ways. First, it removes the reliance on continual remarketing of the Industrial Board bonds. By allowing a bank or banks to purchase the bonds directly for a fixed term, the risk of constantly reselling and repricing the bonds on a weekly basis is eliminated. Secondly, it removes the need for a standby letter of credit. Because of continually escalating restrictions on banks by the regulatory authorities, it has become a practice of banking institutions to obtain a higher return on letter of credit commitments than was customary in 2005, the year of issuance. That results in higher costs for bond issuers like the IDB, even when the standby credit is seldom if ever

utilized. Finally, a direct bank purchase allows additional flexibility in structuring the repayment of the bonded debt. Instead of a fixed principal amount due and payable each period, banks can tailor the principal payments to correlate to the proceeds from the tax increment (TIF) district. If property taxes accumulate faster than forecasted, additional principal payments can be made without prepayment penalties or restructuring the outstanding loan balances.

In the most recent year, the “all-in” cost of financing the bonds was about 1.5%. That was comprised of a letter of credit cost of 1.00%; remarketing and trustee costs of approximately 0.20%; and variable interest rates of around 0.27%. Because the letter of credit costs and the variable interest rates are scheduled to rise in the coming year, the “all-in” cost estimate for 2015 is around 2.5%, or \$255,645.

In the submitted financing proposal that was deemed to be the best offer, there was a five-year term at a 2.72% fixed interest rate; a seven-year term at 3.14% fixed rate; and a ten year term at a 3.51% fixed rate. Similar proposals were received based on a floating interest rate (one-month Libor) plus a “spread” rate of roughly 70 basis points (0.70%). Using this best proposal, Public Financial Management and City staff have compared three approaches to refinancing the outstanding balance.

The fixed rate solution would raise the annual interest payments as follows:

5 year term	2.72%	\$335,920
7 year term	3.14%	\$387,790
10 year term	3.51%	\$433,485

The variable rate solution would decrease the annual interest payments for the first year as follows:

5 year term	0.86%	\$106,210
7 year term	0.88%	\$108,680
10 year term	0.91%	\$112,385

The caveat for the variable rate solution would be that interest rates are expected to rise over the next several years. The current one-month Libor rate is 0.16%. In comparing the costs over the next five years, staff used an annual increase of 0.50% in calculating the overall cost of the

variable rate program. The numbers are included in an attachment to this memo.

We are also exploring a third “hybrid” option with the financial institution deemed to have the best proposal. We are also conferring with the IDB bond attorney to make certain that such an option conforms to all laws and the technicalities of the original bond documents. In the hybrid option, the goal would be to take advantage of both fixed and variable offers. Using the known amount of tax increment revenue from the most recent year, a five-year fixed rate structure would be established. This would take advantage of the extremely competitive fixed rate offered by the bank without any risk of under collecting future tax revenues to make guaranteed payments. Whatever principal amount that could be defeased by the known revenues would be locked in a guaranteed five year payout. The interest cost would be greater than using the variable rate vehicle, but the certainty of payments would lower the overall risk. The remainder of the outstanding bonds would be placed in a second tier, subject to the variable rate but without a firm principal reduction schedule. Technically it would be an “interest only” payment schedule, but it would allow payments in variable amounts without prepayment penalties. If the tax increment grows at a rate of \$200,000 per year, as expected, that amount would be used to pay the interest first and the remainder would apply to principal. If by the third or fourth year, over \$800,000 would available, any amount in excess of the interest payments would go toward principal.

The advantage of the hybrid approach is that it would take advantage of the unusually low short term interest rates while still guaranteeing that roughly half of the outstanding balance is protected from any spikes in the interest rates. It is a very conservative position; if you will, a “belt and suspenders” approach. Because half of the financing would be done at the fixed interest rate, the five year cost would be higher than the variable rate option. It would, however, reduce the risk of an unexpectedly rapid rise in short term interest rates. Current indications are that the economy will be unlikely to grow rapidly enough to justify interest rate hikes that are larger than those included in the model calculations.