Current Financial Practices for Debt Service Coverage and Reserve Requirements for Tax Increment Finance (TIF) Debt

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May 23, 2012

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Debt Service Coverage

Debt Service Coverage

- Internal policies are based on rating agencies' criteria and industry standards
  - Generally Market Standard - 125% annual coverage
    - Generally viewed as the minimum acceptable coverage level
    - Coverage is a standard requirement in order to issue parity debt
      - Parity bonds have equal lien on the security funding the debt
  - Internal policy - 150% annual coverage
    - Allows for additional security and protection against unknowns
      - TIF revenues are dependent on property values and property tax collections
      - Changes in legislation
      - Large number of appeals

Debt Service Coverage (Continued)

- What is the appropriate level? Is it 150% or 200% or something else?
  - Cannot be answered in a "One Size Fits All" approach but should be reviewed based on the specific make-up of the TIF allocation area
    - If the TIF area has a very diverse taxpayer base – then 150% or 200% may be sufficient
    - If the TIF revenues are generated by one primary taxpayer or type of industry, then the coverage may need to be greater than 150% or 200%
    - (This question is important to rating agencies too)

Debt Service Coverage (Continued)

- Moody's report (IU Health transaction) dated April 18, 2011
  - TIF Bonds funded the public infrastructure components related to IU's Neuroscience Center project

  - Highlights / Strengths noted in the Moody's report
    - Strong and conservative coverage - 150% coverage
    - Sufficient levels of Debt Service Reserves
    - Stabilization fund
    - Large and diverse tax base
    - Income levels
    - History of appropriation of moral obligation
    - Manageable debt (given reserve balances)
    - Local economy remains resilient even with economic downturn

Debt Service Coverage (Continued)

- Moody's Report dated April 18, 2011 (Continued)
  - Weaknesses noted in the Moody's report
    - Pressured reserves as income taxes weaken
    - Elevated debt levels

- Items that could Negatively Impact the Current Rating
  - Weakened financial flexibility and reserve levels
  - Declining tax base
  - Increase in vacancy rates
  - Increase in foreclosure or delinquent tax collections
  - Downturn in commercial, industrial and residential development
  - Significant increase in debt

Reserves

Reserve Requirements – Debt Service Reserve (DSR) Bond Ordinance Requirement

- Very common for all revenue-supported debt
  - TIF, COIT, EDIT, etc.
- Purpose of DSR is additional source of security in case the identified revenue stream is insufficient to meet debt payments
- Reserves are restricted assets on the balance sheet for the life of the bonds
- Draw on a DSR would result in an Event Notice as required by Municipal Securities Rulemaking Board (MSRB)
  - Potential (likely) outcomes:
    - Rating review and downgrade
    - Higher borrowing costs
    - Difficulty attracting investors for future bond issuance

Reserve Requirements – Debt Service Reserve (DSR) Bond Ordinance Requirement (Continued)

- IRS Test - Lesser of:
  - 125% of the average annual debt service
  - Maximum annual debt service (MADS)
  - 10% of the par amount of the amount bonds

- Rating Agency Requirements
  - MADs results in higher bond rating (“AA” category) and lower borrowing overall costs

Reserve Requirements – Debt Service Reserve (DSR) Bond Ordinance Requirement (Continued)

- Consolidated TIF - DSR Funding for Senior and Subordinate Level Debt
  - Senior DSR (1992D Bonds) - MADS
    - Senior DSR transfers down to the Subordinate Reserve when the Senior Bonds mature (2014)
  - Subordinate DSR requirement - MADS at the subordinate level for the next three years (1999E, 2002G, 2009B, 2009C, 2011F)
  - In 2009, the Bond Bank chose to remove the risk of funding up the DSR at points in the future (based on conversations with rating agency and underwriting team)
    - Bond Bank funded the combined DSR at aggregate MADS over the life of the outstanding bonds attributable to Senior DSR

Reserve Requirements – Additional Reserves

- Discretionary reserves based on professional fiduciary judgment
- Additional Reserve = 10% of the outstanding principal balance of the bonds
- Designed to provide additional security to protect against default and risks:
  - TIF revenues are dependent on property values
  - Economic conditions impact property values
  - Changes in legislation
  - Large number of appeals
- Consolidated TIF is now the largest credit source for the City (given the sale of the water and sewer utilities)

Reserve Requirements – Stabilization Fund and Appeals Reserve

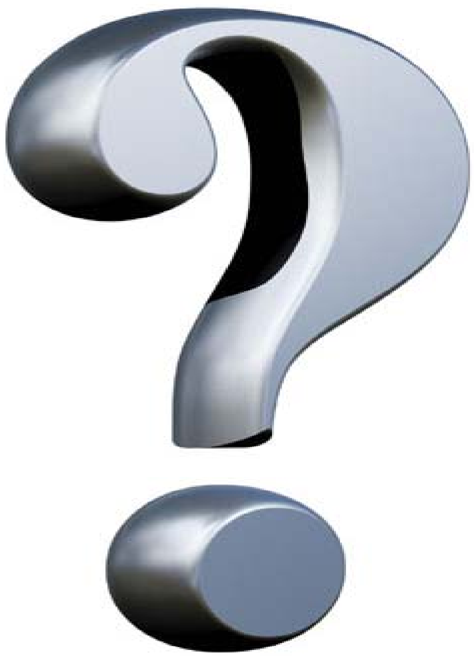
- Stabilization fund (required by bond ordinance)
  - Solely to be used to (1) meet the Senior and/or Subordinate debt service payments in the event revenues are insufficient or (2) to pay a required amount to the provider of any interest rate agreement (if applicable)

  - Appeals reserve

Flow of Funds – Consolidated TIF

Senior Principal and Interest Account
↓
Senior Reserve Account
↓
Subordinate Principal and Interest Account
↓
Subordinate Reserve Account
↓
Junior Subordinate District Bond Account
↓
Program Expense Account
↓
Tax Increment Revenue Stabilization Subaccount
↓
General Subaccount*

*Purposes under Redevelopment Act or pay costs for redevelopment project that benefits the Consolidated TIF Allocation Area.



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