

The Ohio Municipal Bond Market: The Participants, Statistics, and Process

BOND ISSUANCE IN OHIO


In 2006, Ohio state and local governments sold over \$13.6 billion in negotiated municipal bonds and notes through 980 issues, ranking 1st in terms of number of issues and 6th in terms of volume among the states and territories of the United States.

Through August 31, 2007, Ohio had already sold \$6.5 billion in new bonds – a 16% increase in volume from this time last year.

Ohio government finance officers have two primary goals when selling bonds:

- 1) **Secure funding for capital projects**
- 2) **Achieve the lowest possible borrowing cost**

This presentation will walk through the process of issuing negotiated municipal bonds in the State of Ohio, while explaining how the participants and the process together create an efficient, competitive marketplace for realizing both of the above goals for state and local governments.


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Negotiated Bond Sale


Participants

Issuers
Underwriters
Legal Counsel
Rating Agencies
Bond Insurers
Investors

Process

Planning
Authorization
Document Preparation
Bond Rating
Bond Insurance
Marketing
Sale
Closing
Continuing Disclosure

SUCCESSFUL DEBT FINANCING


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ISSUERS OF BONDS IN OHIO – GENERAL OBLIGATION BONDS

Ohio law allows for a diverse range of tax-exempt entities to issue debt securities in a variety of forms. Perhaps the most common, and most secure, bonds are **General Obligation Bonds**, which are secured by the full faith and credit of the issuer. Common issuers of general obligation debt include:

**Local, City, and Exempted Village School Districts (Unlimited Tax)
Municipalities and Townships
Counties
The State of Ohio**

Investors consider G.O. bonds to be the highest quality of municipal bonds available because they are backed by **tax revenues** of the issuer.

Limited Tax – LTGO bonds are secured by taxes that have a legal limit to either the amount or rate that may be levied. For example, cities may levy property taxes only up to their assigned portion of available millage within the 10-mill limitation, which is shared with overlapping entities.


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ISSUERS OF BONDS IN OHIO – GENERAL OBLIGATION BONDS

Unlimited Tax – School districts are in the unique statutory position of being permitted to issue bonds backed by property taxes levied *without limit as to rate or amount*.

- Unlimited taxing power makes school district bonds particularly safe investments, consequently lowering bond yields.
- A big credit consideration becomes the breadth of the district tax base. If everyone left the district except for a single individual, that one person could legally be taxed at a rate high enough to meet debt service requirements – provided their property was that valuable!

Common tax revenue sources for G.O. Bonds:


- Ad valorem property taxes (most common)
- Income Taxes (municipalities, now extended to school districts)
- Sales Taxes (at the county and state level)


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TOP OHIO ISSUERS OF GENERAL OBLIGATION DEBT

2005		2006	
Issuer	Par Amount (\$ millions)	Issuer	Par Amount (\$ millions)
1 State of Ohio	1,179.5	1 State of Ohio	1,330.0
2 City of Columbus	586.0	2 Cincinnati CSD	380.9
3 Ohio State University	279.1	3 Columbus CSD	282.9
4 Cincinnati CSD	139.8	4 City of Columbus	280.2
5 City of Cleveland	121.5	5 Orientangy LSD	207.7
6 Lakota LSD (Butler)	105.4	6 South-Western LSD	76.9
7 Marysville EVSD	93.6	7 Princeton CSD	70.8
8 City of Akron	83.0	8 Pickerington LSD	67.8
9 Dublin CSD	81.1	9 Hilliard CSD	65.0
10 Cuyahoga County	78.4	10 Ohio University	57.3
Total	2,747.4	Total	2,819.5


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ISSUERS OF BONDS IN OHIO – REVENUE BONDS

The other major type of municipal bonds issued in Ohio and nationally is **Revenue Bonds**. These bonds may be secured by revenues of the issuer other than taxes, or revenues from a specific project. In any case, revenue bonds are **not** secured by an issuer's full faith and credit, and thus carry a lower credit rating and potentially higher interest rates.

In Ohio, all of the entities that issue G.O. bonds have also issued revenue bonds (with the exception of school districts). Possible issuers include, but are not limited to:

Cities and Townships

Municipal Authorities

The State of Ohio

State Agencies

Counties


Colleges and Universities

Airports

501(c)3 Corporations

Port Authorities

Conduit Borrowers


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ISSUERS OF BONDS IN OHIO – REVENUE BONDS


In Ohio, revenue bonds have been issued for purposes as diverse as making loans to local municipalities for water system improvements (Ohio Water Development Authority), economic development projects (the Easton and Polaris TIF districts in Columbus), and stadiums (Jacobs Field in Cleveland).

Revenue bonds are typically subject to more credit risk for investors, and many are sold with credit enhancement features (such as a letter of credit for development projects).

Considerations for revenue bonds:

- Economic viability of the project
- Historical performance vs. future projections
- Pledging of multiple revenue sources
- Self-sustainability of debt





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TOP OHIO ISSUERS OF REVENUE DEBT


2005		2006	
Issuer	Par Amount (\$ millions)	Issuer	Par Amount (\$ millions)
1 Ohio Water Development Authority	1,150.1	1 Hamilton County	665.1
2 Franklin County	382.5	2 Ohio Higher Ed Facilities Commission	476.8
3 Ohio Air Quality Development Authority	247.9	3 City of Cleveland	442.2
4 State of Ohio	247.3	4 State of Ohio	430.7
5 Ohio Building Authority	244.0	5 Montgomery County	392.1
6 Hamilton County	221.8	6 Lorain County	375.0
7 Lucas County	188.9	7 Beaver Co. Industrial Development Authority	322.1
8 Cleveland-Cuyahoga Port Authority	150.8	8 Ohio Water Development Authority	308.7
9 Butler County	146.8	9 Ohio Air Quality Development Authority	250.0
10 Ohio State University	130.0	10 Franklin County	217.2
Total	3,090.1	Total	3,879.9


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TOP OHIO ISSUERS 2007 YEAR-TO-DATE

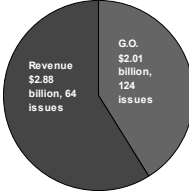
General Obligation		Revenue	
Issuer	Par Amount (\$ millions)	Issuer	Par Amount (\$ millions)
1 State of Ohio	528.0	1 State of Ohio	442.5
2 Franklin County	126.1	2 Dayton-Montgomery Port Authority	330.6
3 City of Cincinnati	102.5	3 American Municipal Power	307.7
4 Lakewood CSD	96.9	4 NE Ohio Regional Sewer District	252.1
5 Ohio Public Facilities Commission	80.0	5 Ohio Higher Ed Facilities Commission	171.1
6 City of Cleveland	73.0	6 Lake County	155.5
7 Hamilton CSD	72.0	7 City of Cleveland	143.6
8 Pickerington LSD	59.9	8 University of Cincinnati	118.4
9 Kettering CSD	57.4	9 City of Middletown	110.0
10 Middletown CSD	55.5	10 University of Toledo	96.5
Total	1,245.3	Total	2,128.0


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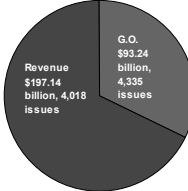
ISSUE TYPES IN OHIO – FIRST HALF 2007

OHIO




Revenue \$2.88 billion, 64 issues
G.O. \$2.01 billion, 124 issues

United States



Revenue \$197.14 billion, 4,018 issues
G.O. \$93.24 billion, 4,335 issues


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ISSUERS OF BONDS IN OHIO – PLANNING A BOND ISSUE

When planning to issue bonds for a facilities project, public issuers have a number of questions to begin resolving:

- What would the useful life of the facilities be?
- What is/are the revenue sources to be pledged for debt service?
- How can debt service be structured given existing debt?
- How can debt service be structured to accommodate future debt?
- What are the legal requirements and tax consequences of proceeds usage?
- What alternative financing vehicles are available?

These can be difficult questions to answer or even begin considering for an issuer with complex borrowing needs or statutory limitations.

Even in the exploratory stages of a possible bond issue, an issuer frequently consults with **Bond Underwriters** and **Legal Counsel** for guidance in navigating the technical and legal environment of the Ohio municipal bond market.


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BOND UNDERWRITERS

Municipal underwriters represent the intermediaries between bond issuers and bond investors. When a transaction is complete, it will be the underwriter who places bonds with investors in return for the capital needed for the public project.

Along the way, the investment bankers of an underwriting firm provide an array of advising services throughout the negotiated bond issue process:

- Analyze financing alternatives (e.g. most effective issuer and securities type)
- Calculate bond issue size
- Determine refinancing options for outstanding bonded debt
- Collaborate with bond traders for market perspective and trends
- Structure issue to meet future debt needs and fiscal conditions
- Facilitate document preparation and rating agency discussions
- Market and sell bonds at the lowest possible interest cost
- Time transaction to deliver bond proceeds to issuer by project deadlines



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BOND UNDERWRITERS IN OHIO

The vast majority of bond issues in Ohio are underwritten by regional public finance and investment banking firms with a strong physical presence in the state. For much larger issues (i.e. over \$100 million par), Wall Street investment banking firms may participate in either a senior or co-managing role.

<p>Regional Firms</p> <p>A.G. Edwards Butler Wick Fifth Third Securities Huntington Investment Co. NatCity Investments RBC Capital Markets Robert W. Baird</p>	<p>Wall Street Firms</p> <p>Banc of America Bear Stearns Citigroup Goldman Sachs J.P. Morgan Lehman Brothers Merrill Lynch Morgan Stanley UBS</p>
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LEGAL COUNSEL

Public entities issuing bonds in Ohio are often subject to a myriad of laws and regulations, including the Ohio Revised Code, Internal Revenue Code, and even the issuer's own debt policies.

To ensure that legal and disclosure requirements are being met by all participants, an issuer will hire and/or retain bond counsel. Services ordinarily provided by bond counsel include:

- Drafting the authorizing legislation (resolution or ordinance) for the bonds
- Drafting the Preliminary Official Statement (POS), which is a prospectus for investors that discloses information about the bonds and the issuer
- Advising on the tax consequences of various structures or financing vehicles during the planning process
- Delivering a legal opinion as to the tax or tax-exempt status of the bonds
- Drafting the final Official Statement (OS) after bond pricing
- Assemble a compendium of all legal proceedings related to the issuance for the issuer's and underwriter's records.

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LEGAL COUNSEL - DISTINCTIONS

In certain (usually large) transactions, issuers may find that more than one legal firm's services are employed. These cases require a distinction between bond counsel and underwriter's counsel.


Bond Counsel: Counsel to the issuer for advising/document preparation regarding authorization, tax status, statutory limitations

Underwriter's Counsel: Counsel to the underwriter (at the issuer's expense) for drafting the POS and OS, collaborating on due diligence, reviewing and drafting certain legal documents

On very large transactions (such as the State's upcoming tobacco securitization), there may even be co-bond and underwriters' counsels.

Top Legal Counsel Firms in Ohio:

Squire, Sanders & Dempsey	Haynes & Haynes
Peck, Shaffer & Williams	Carlisle Patchen
Bricker and Eckler	Murphy
Caffee Halter & Griswold	

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APPROACHING THE BOND SALE

The major milestones in the preliminary stages of the issuance process are:

- 1) Select the financing team, including underwriter and legal counsel
- 2) Determine the plan of finance, including security source for the bonds
- 3) Verify the refinancing potential of existing debt, if possible and applicable
- 4) Begin to draft the preliminary official statement (POS)
- 5) Begin analyzing possible bond structures and features (e.g. call provisions)

After these major steps have been completed, the issuer and underwriter may begin to engage two other major participants in the bond issue process, **Rating Agencies and Bond Insurers/Credit Enhancers.**




Ordinarily, the senior managing underwriter will coordinate meetings, discussions, and (in the case of bond insurance) bidding processes between the issuer and these issue participants. Both rating and insurance analysts will need to examine the bonds' authorizing legislation, the issuer's historical financial statements, the POS, and any other legal documents that have a material bearing on the issue, such as a lease agreement or trust indenture.

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THE RATING AGENCIES

There are three national bond rating agencies:

		
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The job of the rating agencies is to serve investors by weighing the credit strengths and weaknesses of an issuer and its bonds so that a bond "rating" may be delivered. This rating encapsulates the safety of an investor's principal invested in the bonds, i.e. the probability of issuer default.


- Ratings are governed not only by the issuer itself, but also by the historical and prospective factors of the local economy and region.
- The methodology and committee process of the rating agencies yields ratings on a relative, rather than absolute, basis. Ratings over time are influenced by state and national trends regarding issuer and security types.
- Rating agencies may revise an issuer's rating as its condition changes.

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THE RATING AGENCIES

	Moody's	S&P	Fitch
Investment Grade Ratings	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-
	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-

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THE RATING AGENCIES

RATING	DESCRIPTION
Aaa/AAA/AAA	Best Quality
Aa/AA	High Quality by All Standards
A/A/A	Upper-Medium Investment Grade
Baa/BBB/BBB	Medium Grade Obligations; Neither Highly Protected or Poorly Secured
Ba/BB/BB	Speculative Obligations
B/B/B	Lack Characteristics of a Desirable Investment
Caa/CCC/CCC	Poor Standing; May be in Default
C/D/D	Lowest Rated Class of Bonds; Often in Default

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THE RATING AGENCIES

	City			County			School			Other			Totals			Grand Total
	M	S&P	F	M	S&P	F	M	S&P	F	M	S&P	F	M	S&P	F	
Aaa/AAA/AAA	3	2	4	1	1	2	1	0	0	0	0	0	6	4	5	15
Aa1/AA+/AA+	10	4	3	2	2	0	1	3	1	0	1	0	13	10	4	27
Aa2/AA/AA	22	7	0	8	4	2	15	7	5	0	0	0	45	18	7	70
Aa3/AA/AA-	38	7	3	11	1	1	37	11	1	2	2	0	88	21	5	114
A1/A+/A+	36	6	3	9	3	1	29	12	4	0	0	1	74	20	9	103
A2/A/A	33	7	1	8	2	0	30	19	5	0	0	1	71	28	7	106
A3/A-/A-	22	4	0	10	1	0	43	15	0	1	0	0	76	20	0	96
Baa1/BBB+/BBB+	7	1	0	4	0	0	5	3	1	0	0	0	16	4	1	21
Baa2/BBB/BBB	3	0	1	0	0	0	2	1	0	0	0	0	5	1	1	7
Baa3/BBB-/BBB-	3	1	0	1	0	0	2	1	0	0	0	1	6	3	0	9
Issuers	177	38	15	54	14	5	166	73	17	3	4	2	400	129	39	568

Sources: Moody's Ohio Uninsured GO Bond Ratings, December 2006; Standard & Poor's Ratings of Ohio Local Governments, September 2006; Fitch U.S. Public Finance Ratings, November 2006. Compiled by A.G. Edwards. Ratings DO NOT reflect insured issues.

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BOND INSURERS AND CREDIT ENHANCERS

There are nearly a dozen companies that insure municipal bonds, including:

Ambac **FGIC** Financial Guaranty Insurance Company **FSA**

MBIA **CAPITAL ASSURANCE** Triple-A rated provider of financial guarantee insurance

- Bond insurers guarantee payment of debt service to investors in the event that the issuer defaults. This can considerably lower bond interest rates and yields for many issuers.
- Many insurers, like the five above, are rated AAA and thus endow an insured bond issue (not the issuer) with a AAA rating.
- Insurance premiums are designated in basis points, e.g. 25 basis points. \$10,000,000 total debt service (P&I) x 0.0025 = \$25,000 premium

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BOND INSURERS AND CREDIT ENHANCERS

Typically, the underwriter will request insurance bids from the appropriate providers prior to POS delivery, at about the same time that bond ratings are delivered.

For special issues, other kinds of credit enhancement may be necessary.

Economic Development – It is common for project finance transactions (where all pledged revenues are derived from project operation) and economic development issues to carry a bank letter-of-credit (LOC). This protects bondholders from default during the construction phase and early operation of a project with high levels of credit risk in the early stages.

Variable Rate Demand Notes (VDRNs) – These floating-rate securities require a credit facility (usually a bank) that will purchase bonds in the secondary market if they are sold ("put") by an investor and the sell order cannot be matched with a corresponding buy order.

Once credit enhancement and a bond rating are in hand, an issuer may proceed to the marketing and sale of their bonds.

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MARKETING BONDS IN OHIO

In the weeks leading up to the sale of bonds, the issuer and underwriter will market the sale with "tombstone" ads in local newspapers and information in brokerage communications.

Potential investors can also read a calendar of upcoming sales in *The Bond Buyer*, a daily newspaper of the public finance and municipal bond industry with sale listings by state.

The Bond Buyer's Negotiated Sales Calendar Online

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INVESTORS AND THE ORDER PERIOD

- On the morning that bonds are priced, the group of underwriters (the "syndicate") will price the bonds by setting coupons and interest rates at levels indicative of the day's municipal market.
- Investors may submit bids on the bonds either through a participating brokerage or, as is the case with institutional investors, directly with the underwriters themselves.
- Orders placed with the syndicate are finalized, and if any bonds remain at the end of the order period, the underwriters will take down their pro-rata share of the unsold balance in accordance with their stated liability.
- After the bond sale, issuers may legally enter into contracts that utilize the proceeds.

Tier I Institutions
 • Assets for over \$1 billion
 • Top large banks
 • Very prime securities
 → Covered by every National firm

Tier II Institutions
 • Assets of over \$500,000 million
 • Top large banks
 • Moderate price securities
 → Covered by selected firms

Tier III Institutions
 • Assets of \$100-500 million
 • Top and full accounts
 → Coverage limited by many firms

High Net Worth Individuals
 • Relatively small trade orders (\$5 million)
 • Sophisticated investors
 → Major brokerage houses and some regional firms

"Mom & Pop"
 • Small trades
 • Price insensitive
 → Major brokerage houses and some regional firms

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INVESTOR TYPES IN THE OHIO PRIMARY MARKET

Retail investors – High net worth individuals who capitalize on municipal bonds' tax-exempt status for current income. On large issues, the syndicate may utilize a "retail order period," during which only retail investors may order.

Mutual funds – Like equity funds, these companies invest in a basket of securities. However, municipal funds' interest distributions are tax-exempt.

Commercial banks – Invest primarily in small issues. A bank-friendly portion of the tax code states that for issues of \$10 million or less, banks may realize the tax-exempt interest income as well as deduct interest paid on the deposits used to purchase the securities. As a result, bank-qualified (BQ) issues carry substantially lower coupon rates and yields than larger bond issues.

Arbitrage accounts – Take advantage of an upward sloping yield curve by selling short-term notes and using the proceeds to purchase long-term, higher yield bonds.

Money managers and pension funds – Buy and hold municipal bonds in large blocks to fulfill long-term obligations.



CLOSING AND CONTINUING DISCLOSURE

Closing: At bond closing, which usually occurs two weeks following pricing, the final OS has been delivered to those investors who bought the bonds, and the underwriter wires the net proceeds to the issuer. Bond premium is used by the underwriter to pay all costs of issuance on behalf of the issuer.

At closing, the bonds are "dated" and interest begins to accrue on them.

Continuing Disclosure: An issuer's obligation to bondholders goes beyond payment of principal and interest on their securities. Issuers must also transmit to a NRMSIR (Nationally Recognized Municipal Securities Information Repository) documents such as:

- Annual audited financial statements
- Bond defeasances and early redemptions
- Rating changes
- All other "material events"



CONCLUSION

The municipal bond industry and process in Ohio has been continually refined for more than a century. What exists today is a process and a series of participants that allows for the specific needs of a public issuer to be efficiently paired with evolving investor preferences.

- General obligation issuers can have the safety of their securities rewarded with favorable bond ratings, cheaper insurance premiums, and lower long-term bond yields.
- Revenue bond issuers can utilize various securities types and financing vehicles, in conjunction with credit enhancement, to make bonds desirable for investors and affordable for the borrowers.
- Competition in the underwriting and legal counsel industries provides issuers with a constant flow of new and innovative financing options that have grown increasingly tailored to meet unique issuer needs.

In conclusion, the Ohio municipal bond market is an efficient means of achieving low borrowing costs for any variety of public project.

