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PUBLIC RESOURCES ADVISORY GROUP

MEMORANDUM TO:	Marshall Labadie, Town Manager, Town of Highland Beach, FL (the "Town")
FROM:	Public Resources Advisory Group ("PRAG")
SUBJECT:	Response to Comments & Recommendations of Financial Advisory Board
DATE:	February 6, 2019

PRAG submitted a memorandum to the Town Manager on January 22, 2019 (the "PRAG Memo" or the "Memo") which focused on the Town's proposed $45 million financing of the Ocean Walk & More project and its possible credit rating implications. This memorandum is a response to the Summary Comments & Recommendations from the Town's Financial Advisory Board (the "FAB") Meeting dated January 24, 2019, which have been attached to the FAB's February 6, 2019 Special Meeting Agenda and posted to the Town's website. Our purpose is to provide the Town with additional information as it reviews the proposed "Ocean Walk & More" project financing.

The FAB indicated in its comments that *"analyzing the town based on 'average' or 'median' resident income is a poor method of measuring the residents' ability to absorb tax increases."* The PRAG Memo did not attempt to measure the residents' ability to absorb tax increases; rather its purpose was to utilize Moody's Investors Service ("Moody's") methodology to analyze the possible credit implications of issuing $45 million in general obligation debt. Moody's is a nationally recognized credit rating agency and they are relied upon by investors for insight into the creditworthiness of borrowers across the United States. As indicated in our Memo, Moody's provides a "scorecard" to provide a reference tool that local governments can use to estimate their respective credit profile, and it is not a final rating calculator. 10% of the Moody's scorecard's weight focuses on the Median Family Income as a percentage of the US Median sub-factor. According to Moody's, "an important measure of the strength and resilience of a tax base is the income level of its residents. A community with higher wealth levels may have relative flexibility to increase property tax rates in order to meet financial needs." The Town's wealth levels are well above national averages and our initial analysis shows the Town scores the maximum "Aaa" for this sub-factor.

The FAB indicated in its comments that the Memo *"implies that property values will remain the same."* This is correct, as our analysis arrived at an indicative rating utilizing the Moody's methodology and the Town's financials as of FY 2017. We specifically note in our Memo that certain metrics "may vary depending on a number of factors, including future financial performance." Should the US experience an economic downturn and the Town's property values decline, as they could decline across the country, the Town's credit rating could be affected. 10% of the Moody's scorecard weight focuses on Tax Base Size of local governments. The Town reported $2.7 billion in Actual Just Value for the fiscal year ended 2017 demonstrating a full recovery from the Great Recession. We estimate a double-A level "Aa3" for this sub-factor. The scorecard also weights 10% on the Town's Full Value per Capita, which takes the Town's valuation divided by its population. Our initial estimate of the Town's rating for this sub-factor is the maximum "Aaa" given the Town's extremely strong value per capita. According to Moody's, "looking at the magnitude of taxable property in tandem with taxable property gives a clearer picture of tax base strength than looking at the magnitude of taxable property alone."

The FAB concludes its comments by stating that the Memo *"attempts to fit our unique characteristics into a national model, and while it may be an acceptable first cut at an analysis, it should not be relied upon."* Our initial analysis is based on the Moody's Rating Methodology for US Local Government General Obligation Debt which "is a tool that acts as a starting point before the rating is notched up or down depending on other individualistic characteristics of the local government's credit." Moody's makes below-the-line adjustments based on a number of factors which can move the scorecard rating up or down due to positive or negative attributes; these adjustment factors are listed as Appendix A of this memorandum. While some downward notching could occur based on the individual characteristics of the Town and its financing, we reaffirm our initial conclusion that the Town would maintain strong credit ratings (Double-A range) should it move forward with the $45 million GO issuance.

The FAB also provided comments regarding the Town's Financing Proposal. The FAB indicated that a Florida Municipal Loan Council ("FMLC") issued bond may consist of the Town's *"borrowing to be pooled with the borrowing of other towns and the rate on the bonds would be based on the weakest municipality in the pool."* The Town's borrowing <u>will not be part of a pooled program</u> but will be issued as stand-alone debt. The Town's rates will be determined by the market's view of the Town's credit profile as a stand-alone borrower. The FAB also noted that FMLC has issued callable bonds in the past which *"could be problematic as [the Town] may have to replace the bonds (refunding) at an inopportune time."* While the call features of the proposed bonds have yet to be determined, in the event they were included with the bond offering, the Town would not be obligated to call the bonds at an inopportune time. A call feature would give the Town the flexibility to refund the existing debt on or after certain predetermined dates at the <u>option</u> of the Town and the FMLC. If interest rates drop in the future, the Town may consider refunding existing debt to achieve interest cost savings. However, <u>neither the Town nor the FMLC would be obligated to call the bonds</u>.

The FAB indicated the FMLC charges an administration fee and *"it is not clear if there was an analysis performed by the finance director that concludes that the fee is justified and appropriate relative to the alternative of the town issuing bonds directly without the FMLC."* The upfront fee FMLC charges on a $45 million bond issue is expected to be approximately $22,500 with annual administration fees of $10,000 that will decline as principal is paid off. The FMLC will provide specific services to the Town in connection with the bond issue, and FMLC staff can address the details of those services.

The FAB notes that a 4.35% interest rate has been assumed in the 30-year financing option presented by the Town's finance director. While the ultimate true interest cost is not "locked in," based on market conditions and an initial assessment of the Town's credit profile, the tax-exempt general obligation bond interest rate being utilized for debt service estimates appears to be conservative with a cushion for contingency. Since December 12, 2018, the municipal market has seen yields decline along the yield curve; however, there is no guarantee that yields will continue to fall.

Please contact Marianne Edmonds at 727-822-3339 if you need additional information.

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APPENDIX A

Below-the-line adjustment factors that may result in a rating notch upward or downward, according to Moody's:

- Unusually weak or strong security features
- Unusual risk posed by debt structure
- History of missed debt service payments
- Very high or low debt service relative to budget
- Very high or low debt burden
- Heavy capital needs implying future debt increases
- Unusually slow or rapid amortization of debt principal
- Other post-employment benefits, the most significant of which is retiree healthcare liabilities, when they have the potential to significantly constrain operational flexibility