

MEMO

Date: April 5, 2021

To: Matthew Strugis, Town Manager

From: John Quartararo, Finance Director

Re: Short-Term General Fund Borrowing



CC: Debra Lane, Town Clerk and Marcia Weeks, School Business Manager

I am requesting that the Town Council adopt a policy that will allow the Town to provide short-term financing for bond projects from the General Fund using inter-funds loans until other financing is arranged. The other financing may be a bond anticipation note or a bond issue. The following sections describe the issuance of bond anticipation notes, the self-funded option and a suggested council order.

Introduction

This memo concerns the methods by which the Town can secure short-term financing for capital projects for which there is an approved bond order. As described below, the general method is the issuance on bond anticipation notes (BANs). BANs are short-term borrowings in anticipation of the issuance of a bond. The bond is long-term permanent financing for the project. Proceeds from the bond sale pay any outstanding BANs and for the capital improvements. BANs are sold either in the capital markets or to local banks. The best rate and highest costs of issuance are issues through the capital markets. Local banks provide higher rate but lower costs of issuance. The determination of where to sell the BANs is the size of the BAN. This memo will provide a third alternative – self-funding the cash requirement using the Town's cash resources.

Cash Flow Requirements

Large multi-year capital projects financed through a bond will require a source of funds for cash-flow purposes before the issuance of the permanent financing. Generally, the source of those funds is the issuance of one or more BANs. The proceeds of the permanent financing pay the BANs. Another source of cash-flow funds is the use of inter-fund borrowings. In the case of the Town of Cape Elizabeth, the General Fund cash can be lent to the capital project rather than issuing a BAN.

BANs are issued through the capital markets or through local banks. The benefit of a BAN is that a disinterested third party purchases the note. There are different advantages to issuing through capital market and local banks. In the end, the use of a BAN provides cash flow for the project without issuing the permanent financing until the project is at or nearing completion so that the issuer does not borrow more than is needed.

Capital Markets

Generally, capital markets provide the best or lowest interest rate on the borrowed funds, but there can be significant costs. Issuing through the capital markets will require the preparation of an official

statement (OS) which includes the audited financial statements; a credit review and rating; other costs of issuance; legal review and a legal opinion. If our financial advisor prepares the bond deal, the financial advisor will waive his costs to prepare the BAN OS although there are other costs. The larger the BAN issue, the less the costs per dollar borrowed. With BANs issued through the capital markets, the proceeds are available as a lump sum at closing and there is no prepayment of the note.

Local Banks

By issuing through a local bank, the interest costs are generally higher than the capital markets, but there is more flexibility. An OS is not required, although audited financials are required. A credit rating is not required, as the bank's credit committee will rate the offering according to its internal standards. A legal opinion will be required but there will not be other costs of issuance. BANs issued through a local bank can be setup as either a lump sum payout or an "as-needed" basis. In this case, funds are drawn down from the note when they are needed, thereby, reducing the interest cost, but also, reducing the opportunity to earn interest on the BAN proceeds. In addition, with a local bank, you can request the ability to pre-pay the note without penalty.

Self-funding

A third option is to finance the short-term cash flow needs of the capital project internally. The Town can use its own cash resources to fund the short-term costs before the Town issue either a more substantial BAN or the permanent financing. The disadvantage to self-funding is that the Town loses the opportunity to earn interest on its cash resources. To offset the loss of interest earnings, the Town could lend cash to the project at an interest rate set at the monthly cash management interest rate plus 50 basis points. In this way, the projects costs would not have to bear the cost of issuance and legal opinion and the Town's interest earnings would not suffer. In the case of Town projects, the Council order authorizing the use of this process will serve as the written agreement.

There should be a written agreement between the Town and the project's sponsor that sets out:

1. The project being financed;
2. The maximum amount of cash required;
3. The estimated date when the bond or bond anticipation note would be issued that would refund the amount borrowed;
4. The agreed to markup over the bank's cash management rate from its primary banker;
5. Monthly, the project is charged for interest costs based upon disbursement amounts and disbursement dates; and,
6. The written agreement will terminate when the funds advanced under the agreement are paid.

Based upon the information above I am proposing a policy statement to allowing the Town to self-finance short-term cash flow for bonded capital projects in lieu of issuing bond anticipation notes (BANs). Such actions would be subject to a written agreement between the project sponsor and the Town to assure that the General Fund is paid from bond or BAN proceeds issued for the project. The intention of this policy is to reduce the costs of projects but also to compensate the Town for forgone interest earnings.

Summary

As noted above, there are several methods by which cash flow requirements for bond approved capital projects can be met. The primary method is the sale of BANs to the capital market or local banks. A Third method is to use the Town's cash resources to self-fund all or a portion of the project pending issuance of the permanent financing bond. Below is suggested policy language concerning the use of the Town's cash resources in place of issuing a BAN.

Suggested language:

ORDERED that it shall be the policy of the Town of Cape Elizabeth to permit the temporary use of Town cash resources to fund cash flow for Town projects. Those projects will have an approved bond order and the financing will exist until proceeds are received from a bond anticipation note or the permanent financing. The Town Manager is delegated approval of such financing with input from the Finance Director. When the bonded project is a school projects, input from the School Superintendent, and School Business Manager will be included either of whom may execute the agreement. The Town Manager will execute a written agreement between the project sponsor and the Town. The agreement will include the following elements:

- 1. The project being financed;*
- 2. The maximum amount of cash required;*
- 3. The estimated date when the bond or bond anticipation note would be issued that would refund the amount borrowed;*
- 4. The agreed to markup over the bank's cash management rate from its primary banker;*
- 5. Monthly, the project is charged for interest costs based upon disbursement amounts and disbursement dates; and,*
- 6. The written agreement will terminate when the funds advanced under the agreement are paid.*