July 18, 2011

The Chehalis city council met in special session on Monday, July 18, 2011, in the Chehalis city hall. Mayor Ketchum called the meeting to order at 5:30 p.m. with the following council members present: Terry Harris, Dr. Isaac Pope, Daryl Lund, Chad Taylor, and Dennis Dawes. Councilor Spahr was absent (excused). Staff present included: Merlin MacReynold, City Manager; Judy Schave, City Clerk; Eva Lindgren, Finance Manager; and Herta Fairbanks, Public Works Director. Members of the news media included Bruce Hunting from KITI.

1. **Discussion on Issuance of Debt**. Finance Manager Eva Lindgren gave a brief overview on the history of the debt. She noted with the purchase of city hall and the remodel, the city ended up going out for a short-term loan with Bank of America, which had to be repaid in 2007. Ms. Lindgren reported, in September 2008, Jim Nelson from Martin Nelson and Company gave a presentation to the council on bond financing, to lay the groundwork and explain how the process worked. In October 2008, the city council approved an interfund loan with the Water and Wastewater funds as a short-term fix.

Ms. Lindgren reported in April 2010, she called for some informal quotes on a 15 year fixed rate loan from a number of local banks and a couple located outside our jurisdiction. She stated most banks do not want to go out as far as 15 years because it exposed them to interest rate change fluctuation risk. Ms. Lindgren reported they also had some feelers out with a Federal agency that does long-term loans; however, since the project was already complete the city didn't qualify.

Ms. Lindgren reported, per state requirements, they need to pay back the interfund loan by October 2011. She noted there were many factors which need to be taken into consideration when contemplating the issuance of debt:

- The length of the loan (loan maturity)
- Taxable vs. non-taxable debt
- Fixed rate vs. variable rate debt
- Funding options: bond issue; bank loan; or private placement
- The debt type: general obligation; revenue debt; or LID debt
- Debt issuance costs financed or paid out-of-pocket

Ms. Lindgren introduced Scott Bauer with A. Dashen & Associates and Hugh Spitzer from Foster Pepper PLLC to present the funding options, and to talk about the bonding process.

Mr. Bauer reported they looked at various funding options to repay the water and wastewater funds, which included: a bond issue with an underwriting firm; a bank loan; and private placement. He stated they also looked at issuing tax-exempt Limited Tax General Obligation bonds ( LTGO), adding the city had a maximum of $9.49 million in LTGO debt capacity.

Mr. Bauer summarized the details of each of the potential funding sources, as followed:

- Bond Issue
  - Bonds would be issued through a public offering via an underwriting firm
  - Bonds are typically sold to multiple investors
  - Bonds generally have higher costs of issuance, but lower interest rates
  - The bond issuing process usually takes about 6 to 8 weeks and requires the preparation of an official statement and obtaining a credit rating
  - Bonds could be issued for nearly any term: 15 to 20 years would not be an issue

- Bank Loans
  - Bank loans work well for interim, variable rate financing (tied to Prime or LIBOR)
  - Most banks will not lend for longer than 15 years
  - Most banks will not lend at a fixed rate for 15 years
  - Typically lower costs of issuance than a bond issue

- Private Placement
  - — Loan is placed with interested investor or investors
  - — May offer a fixed rate for 15 years
  - — Typically lower costs of issuance than a bond issue

Mr. Bauer reported they contacted several banks to obtain indicative rates for each option. He noted, with regard to a bond issue, they contacted two underwriting firms and received the following feedback from one firm:

- — 15 year interest rates average 3.45%
  - Average annual debt service of $103,205
  - Total Debt Service $1,565,291
- — 20 Year interest rates average 4.02%
  - Average annual debt service of $88,250
  - Total Debt Service $1,779,475
- — Costs of issuance are estimated at $39,200 (includes: financial advisor, bond council, document preparation, and underwriter compensation)
- — With costs of issuance included, interest rate is 3.91% (15 year) and 4.39% (20 year)

Mr. Bauer reported they contacted several banks that they frequently work with that are familiar with tax-exempt municipal debt. He indicated they would be happy to entertain any competitive bid from any local bank. Mr. Bauer provided the following information received from the one bank that responded:

- — Would provide a loan for 15 years, with adjustment in rates every 5 years
- — Years 1-5, interest rates are fixed at an estimated 3.50% to 3.60%
- — Years 6-10, interest rates increase to a fixed 4.75% to 4.80%
- — Years 11-15, interest rates are tied to a spread off of an index
- — Cost of issuance are estimated at $16,400

Mr. Bauer reported they contacted a bank that does private placement, and noted the following results:

- — Would provide a loan for 15 years
- — The interest rate would be fixed for the term at 4.95%
- — Costs of issuance are estimated at $16,400

Mr. Bauer recommended pursuing a bond issue, noting even with higher costs of issuance, a bond issue appeared to provide the lowest cost of financing; however, as they go through the process they would want to revisit the other options since markets and interest rates change. He recommended they issue tax-exempt LTGO Bonds for approximately $1.2 million for a 15 year term.

Councilor Harris asked if there would be any pre-pay penalties. Mr. Bauer noted generally bonds have the 10 year call date, so it would be very inefficient to try to refinance before the 10 year period was up. Mr. Spitzer stated if the city had a strong reason for wanting a shorter period, because it might be able to pay it off in five to seven years, the city would end up paying a higher rate. Mr. Bauer stated that was correct, noting the customary call was 10 years and if they city was interested in a shorter period they would have to pay an interest rate penalty.

Mayor Ketchum inquired as to why it was so different for governments to go through a bank than it was for an individual. Mr. Spitzer stated there are very different markets for different kinds of products, noting there were banks that loan to individuals and banks that do commercial loans for businesses, and some that are doing both. He noted many banks are not familiar with governments as borrowers, and governments are typically interested in borrowing on a tax-exempt basis. Mr. Spitzer reported most banks don't know how to calculate the tax benefits. He stated there was also the provision of how a bank deducts their costs of carrying funds. Mr. Spitzer indicated another big factor was that banks don't make money on tax-exempt paper. Ms. Lindgren added mortgages were supported by the federal government, which was one of the reasons why banks are willing to make those loans.

Mr. Bauer reported the next steps would include:

— Receive Council direction on funding option
— If pursuing tax-exempt option, identify eligible water and wastewater capital projects
— Prepare detailed schedule
— Select a bank
— Prepare documents
— Objective is to complete by October 2011

Councilor Dawes asked, with regard to all the talk about the Federal Government not getting their act together, if they pick a short-term fix to boot the issue through to the next election how would that affect the rates between now and October. Mr. Bauer noted he asked several underwriters about that and their sense was the rates would increase as or when the economy picks up. He reported he didn't expect the issue to have any impact on the rates; however, it the government defaults that was a whole different issue and he had no idea what would happen then.

Councilor Harris inquired about the credit rating for the city. Mr. Bauer stated they told the underwriters to assume the city would be rated to at least an "A." Councilor Harris asked what factors were taken into consideration when they do a credit rating analysis, noting the city had very little debt. Mr. Bauer reported with a general obligation (GO) bond they would look at things, such as: the city's tax base; how the assessed value did over the past several years; what the general economy was around the area, and such. He stated Lewis County was an "AA3" and the City of Centralia was at an "A+," which made him think Chehalis would be in the "A" category. Councilor Harris stated the only thing that concerned him was that a lot of the city's budget was sales tax based. Mr. Bauer suggested sales tax would be a component, but since this was a GO type debt the primary thing they would look at is property tax.

Councilor Dawes asked what the proposed funding revenue source would be if the council were to issue something. City Manager MacReynold reported, as part of the Three Year Financial and Organizational Strategy, the administration identified one element of payment as being the REET Funds, which the city knows has a consistent revenue stream of about $60,000 to $80,000 per year. He stated he would request the council take formal action to identify that revenue as a funding source for the bond payments. City Manager MacReynold indicated any additional amount needed to pay the annual payments would come from the general fund, which would vary depending on what the cost will be on an annual basis.

City Manager MacReynold reported, at some future date, the city will start receiving money from the National Avenue mitigation bank that will total about $1.2 million. He stated at the point that revenue starts coming in the administration would come back to the council asking them to commit that money to the facilities reserve fund to reduce the stress on the general fund and make the REET money available for other things.

Mr. Spitzer briefly explained his role during the transaction, adding bond counsel was a special type of lawyer used for municipal and state transactions. He stated they work with the city and the financial advisor in structuring the transaction, and provide the following services:

- Draft the bond authorizing ordinance and other documents relating to bonds to make sure everything is consistent with applicable state law
- Look at the federal securities' laws that apply, which require language in the bond ordinance relating to on-going securities disclosure in the market
- Look at the documents drafted by Mr. Bauer and his company to make sure they accurately reflect bond documents and securities, and tax law
- Make sure in the case of tax-exempt bonds that everything is done to allow the bonds to carry the tax-exempt status, so that the purchasers of the bonds are not paying income tax on the interest they earn

Mr. Spitzer reported the reason the tax-exempt bonds were something of a challenge was because the city will use the proceeds of the bonds to repay the loan from the water and sewer funds. He noted from the Internal Revenue Service's view, the city is borrowing money to pay for the operating fund.

Mr. Spitzer reported, after talking the situation through with Ms. Lindgren, it was realized the city could issue the bonds and repay the water and sewer funds allowing those two funds to essentially commit to using the $1.2 million to help fund capital improvement projects (CIP). He suggested the utilities could then use the money it would have spent on capital projects for other things. Mr. Spitzer indicated they could structure the transaction in such a way that the bonds would be tax-exempt, which would save the city a significant amount of money.

Councilor Lund suggested they take the money owed to the utilities and pay it towards the loan on the wastewater treatment plant. Ms. Lindgren noted that would be refunding, which was an entirely different transaction. City Manager MacReynold reported the loan on the new treatment plant was a Public Works Trust Fund loan at zero percent interest. Mr. Spitzer suggested the rate payers would do better to use current income to pay off the no interest loan and to use this money for projects already on the CIP.

Councilor Dawes stated he understood the concerns of Councilor Lund; however, there were a number of projects that both utilities had put off for the last few years in order to not raise taxes or rates, which have to be done.

Councilor Lund suggested, if the National Avenue mitigation bank project was such a good thing, why not just borrow the money from a local bank and pay it off when the money comes in.

Councilor Dawes reported, as one of the members of the budget committee, this issue was one of particular high interest to him. He noted they need to get something done with it not only because of the statutory limitations, but because it's the right thing to do. Councilor Dawes noted, from past experience, bonds were probably the preferable way to go, adding he would rather go with something that's fixed. He suggested if the economy improves they could be looking at higher rates down the road.

Councilor Dawes moved that a 15 year tax-exempt bond issue be pursued and that the City Manager be authorized to retain the services of A. Dashen and Associates and Foster Pepper PLLC for the purposes of the G.O. debt issuance of approximately $1.2 million.

The motion was seconded by Councilor Harris.

Councilor Lund stated he would be voting against the motion because he felt they should spend their money locally and pay it off faster than 15 years.

The motion carried 4-1, with Councilor Lund being the descending vote.

There being no further business to come before the council, the meeting adjourned at 6:18 p.m.

______________________________
Mayor

Attest:

_____________________________________
City Clerk

**SUGGESTED MOTION**

**I move that the council approve the minutes of the special city council meeting of July 18, 2011.**