

# USDA Rural Development 2019 National Rural Lenders' Roundtable

Raymond James Public Finance

PRESENTED BY

Bob Pennington, Managing Director

Nick Roederer, Managing Director

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Partnering with Capital Markets

December 4, 2019

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**RAYMOND JAMES**

- Full-service securities firm founded in **1962** and public since **1983** (“RJF” on NYSE)
- Fiscal 2018 record net revenue of **\$7.27 billion**; record net income **\$856.7 million**
- Total market capitalization of approximately **\$11.8 billion**; client assets under administration **\$824 billion**
- Over **18,500** employees and independent contractors
- **126** consecutive quarters of profitability



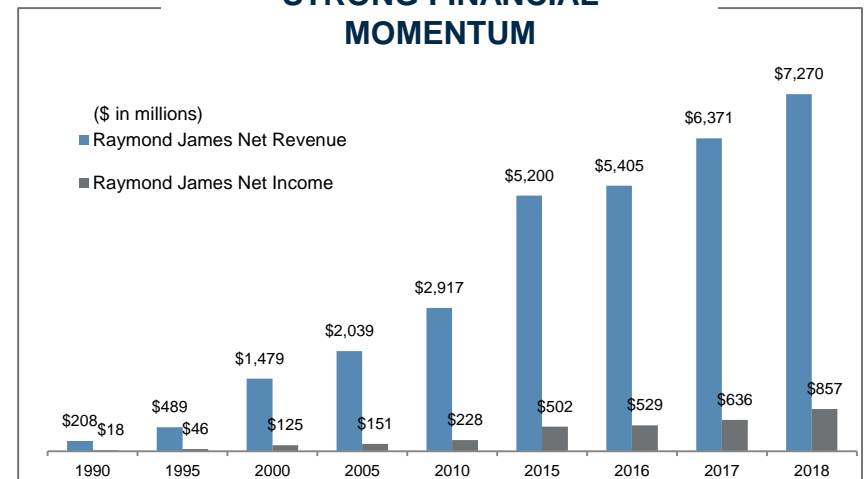
GEOGRAPHIC PRESENCE:

- European operations in the United Kingdom, France, Belgium, Germany and Switzerland
- Nearly **90** North American and international investment banking, public finance and institutional sales offices

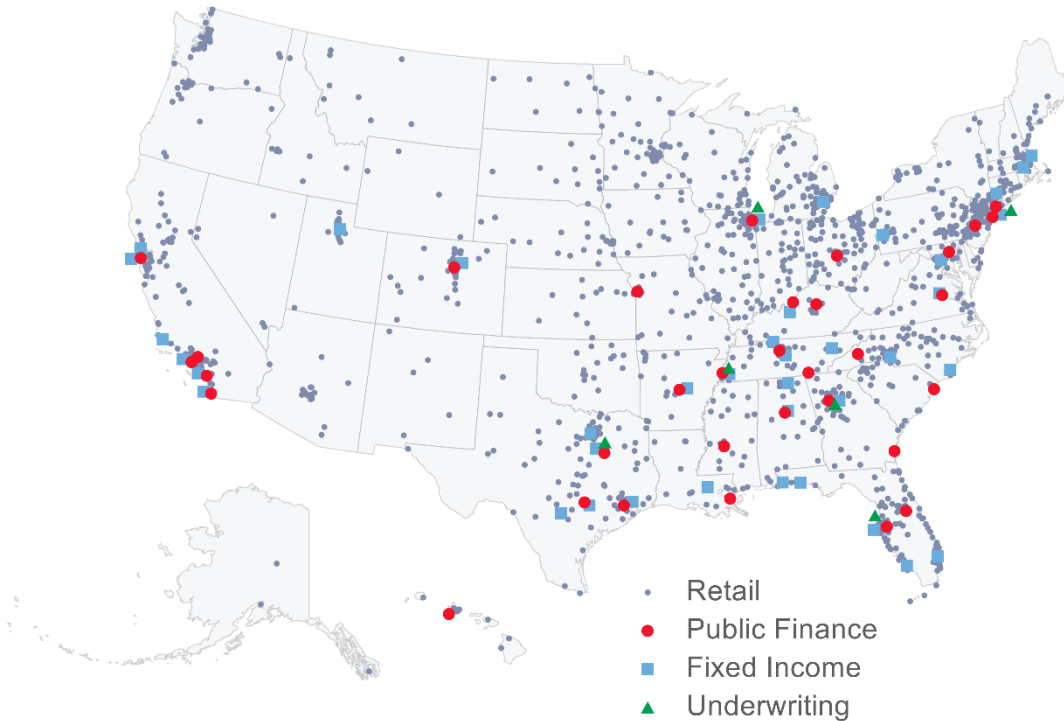
MARKET CAP OF SELECTED GROWTH FIRMS



STRONG FINANCIAL MOMENTUM



**NATIONAL PRESENCE**



**Raymond James Public Finance is consistently ranked as a Top 10 senior managing underwriter nationally\***

**BY THE NUMBERS:**

- 170** | Public Finance professionals
- 33** | Office locations nationwide
- 300+** | Institutional Fixed Income sales and trading professionals
- 7,900** | Financial advisors

**AREAS OF EXPERTISE:**

- General Obligation
- Water & Sewer
- POBs/OPEB
- School Districts
- Special Districts
- Successor Agencies
- Taxable Financings
- USDA Enhanced
- Healthcare
- Higher Education
- Housing
- Privatized Student Housing
- Public Power
- Transportation and Aviation
- Utilities

\*Source: Bloomberg, based on total par amount (2014-2018)

Over 1,100 USDA Projects

Approximately \$8 Billion in USDA Business

Over 85 Years Combined USDA Team Experience

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## **What is the Capital Marketplace?**

- The Capital Marketplace is a vast consortium of investors domestically and internationally
- Investors are short/long term, fixed/variable, rated/non-rated
- Investment types include - Mutual Funds, Bond Funds, Insurance Companies, Banks/Trusts, Pensions, Endowments, State/Local Governments and Retail

## **How can USDA Applicants benefit using the Capital Marketplace?**

- Leverage project funding
  - Interim financing for USDA Direct Loan
  - Tax-Exempt bonds, where applicable as part of the capital stack
- Competitive rates and terms
- Diversify risk
- Additional oversight

## What role does Raymond James play in the capital marketplace?

Raymond James serves in a variety of roles on behalf of the customer/borrower:

- **Underwriter** – Raymond James structures the transactions and purchases bonds/notes (BPA/NPA) from the customer/borrower to be sold to investors in the capital marketplace
- **Placement Agent** – Raymond James structures the transactions and facilitates the placement of customer/borrower bonds/notes directly to investors
- **Financial Advisor** – Raymond James serves in a fiduciary capacity to represent and advise customer/borrower in the structuring and issuance of bonds/notes

Generally, Raymond James serves in an Underwriting or Placement Agent capacity for USDA direct, guarantee loans and interim financing.

Raymond James Fixed Income Division is not a direct lender. However, Raymond James does own a commercial bank, Raymond James Bank, and occasionally provides capital market funding for municipal and non-profit customers. Raymond James Bank also purchases USDA guarantees in the secondary market. Raymond James Bank has \$18 billion dollars in assets.

## What is the Primary Goal for the Customer/Borrower?

**Municipal and non-profit investment banking is extremely competitive. Providing the customer with the most advantageous financing platform and/or debt solution is the objective. This includes:**

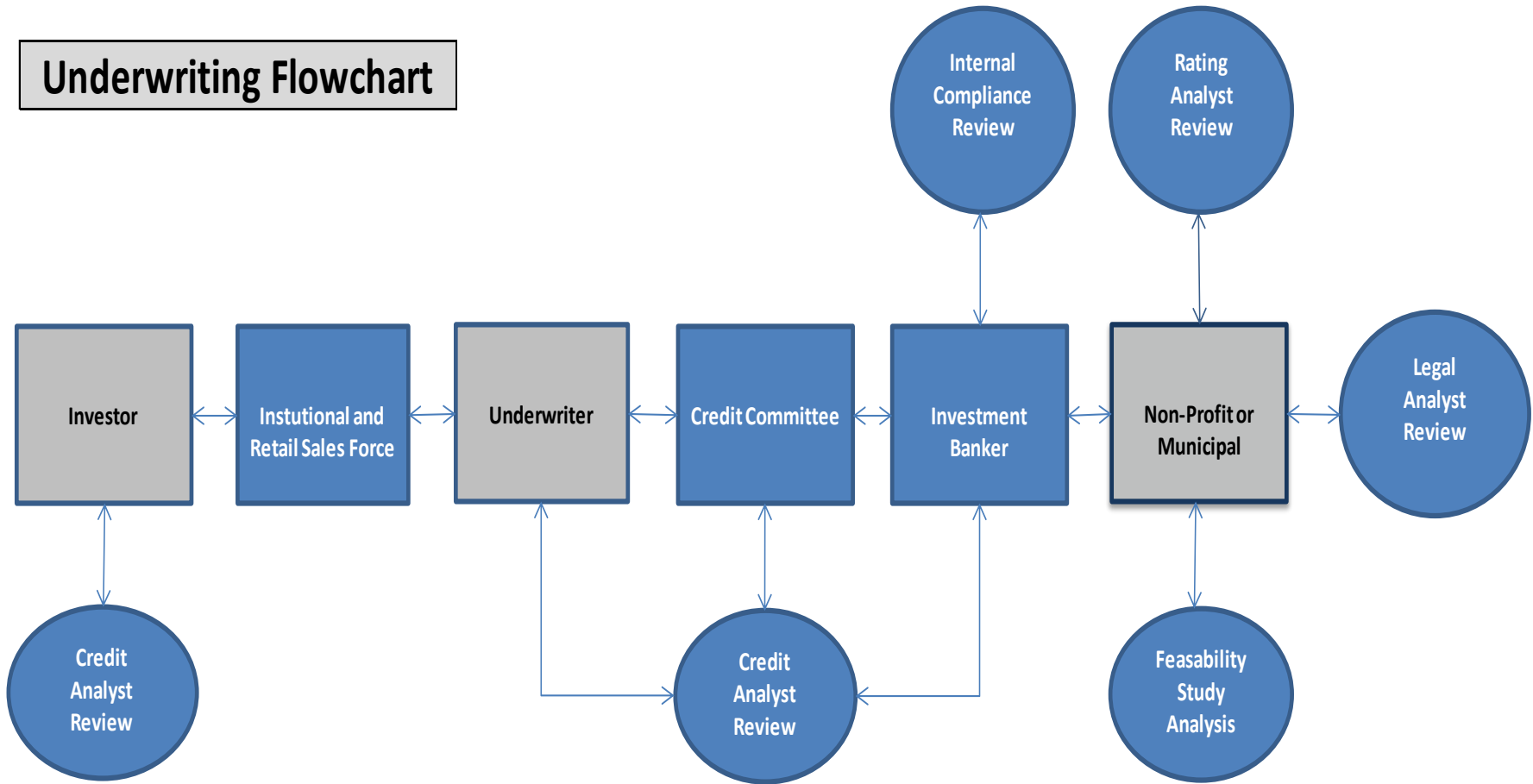
- Securing the lowest cost of funds
- Secure the most favorable terms, conditions, and covenants
- Provide a financing mechanism that is efficient, timely and customer friendly

When a customer/borrower falls within the USDA credit spectrum and meets USDA eligibility, Raymond James will introduce this funding mechanism as an alternative to consider.

Raymond James, through our nationwide network, is exposed to numerous opportunities for USDA to consider.

# What is the Underwriting process in a Capital Markets transaction?

**Underwriting Flowchart**





## Key Interest Rates and Prices

	This Week 11/25/2019	Last Week 11/18/2019	Last Month 10/28/2019	Last Year 11/26/2018
Federal Funds Rate	1.75	1.75	2.00	2.25
Prime Rate	4.75	4.75	5.00	5.25
Treasury - 2 yr	1.62	1.60	1.64	2.83
Treasury - 10 yr	1.76	1.82	1.84	3.05
LIBOR (1 month)	1.70	1.72	1.80	2.34
LIBOR (3 month)	1.92	1.90	1.94	2.71
SIFMA	1.07	1.61	1.75	1.36
SIFMA/1 M LIBOR %	63.0	93.4	97.2	58.2
B.B. 20 Bond Index <sup>1</sup>	2.79	2.85	2.75	4.26
B.B. Rev. Index <sup>2</sup>	3.27	3.33	3.23	4.75
30-Day Visible Supply <sup>3</sup>	9.6 B	16.5 B	13.8 B	9.0 B
10-Year AAA MMD <sup>4</sup>	1.50	1.55	1.54	2.61
10-Year AAA MMD Ratio to Treasury %	85.5	85.4	83.6	85.5
30-Year Treasury	2.20	2.30	2.33	3.31
30-Year AAA MMD <sup>4</sup>	2.09	2.15	2.13	3.27

<sup>1</sup> Represents an estimation of the yield on a portfolio of 20 general obligation bonds that matures in 20 years with a composite AA rating.

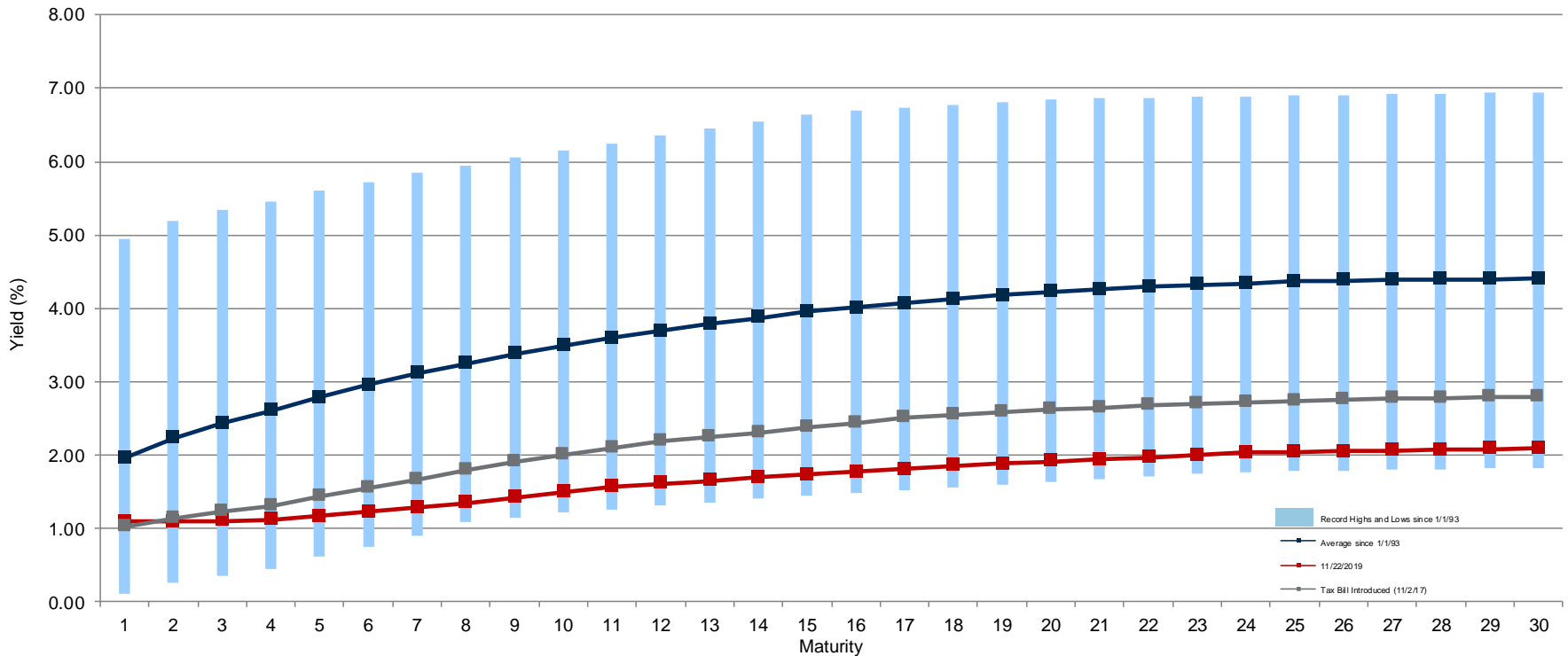
<sup>2</sup> Represents an estimation of the yield that would be offered on 30-yr revenue bonds. The index is comprised of 25 issuers that cover a broad range of type of issues and vary in ratings.

<sup>3</sup> The total dollar volume of municipal securities expected to be offered over the next 30 days.

<sup>4</sup> Represents the benchmark yield for high grade municipal issues, based on a natural "AAA" rated general obligation bond issue. "AAA" MMD is the benchmark for pricing of all tax-exempt municipal issues.

Source: Bloomberg and Thomson Reuters

- The graph below shows the range between the record highs and lows of AAA MMD at each maturity since 1993, along with average rates over this time frame and the current rates.
- AAA MMD rates set multiple record lows in August 2019, and years 9-30 on the curve have remained near these all-time lows.

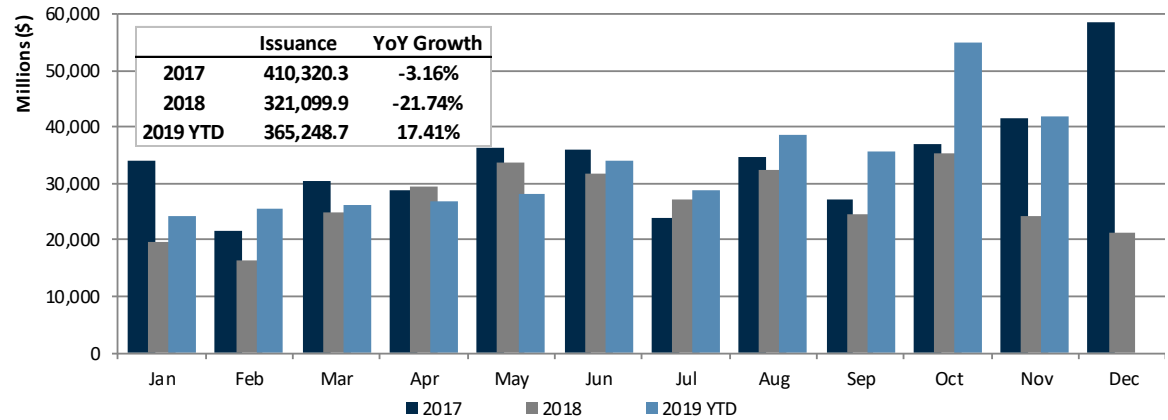


	1	5	10	15	20	25	30
Record Low since 1/1/93	0.11	0.62	1.21	1.44	1.64	1.78	1.83
Record High since 1/1/93	4.95	5.60	6.15	6.65	6.85	6.90	6.95
Average since 1/1/93	1.96	2.78	3.49	3.95	4.22	4.36	4.40
Tax Bill Introduction (11/2/17)	1.03	1.43	2.00	2.38	2.62	2.74	2.80
Current (11/22/19)	1.09	1.17	1.50	1.73	1.91	2.04	2.09

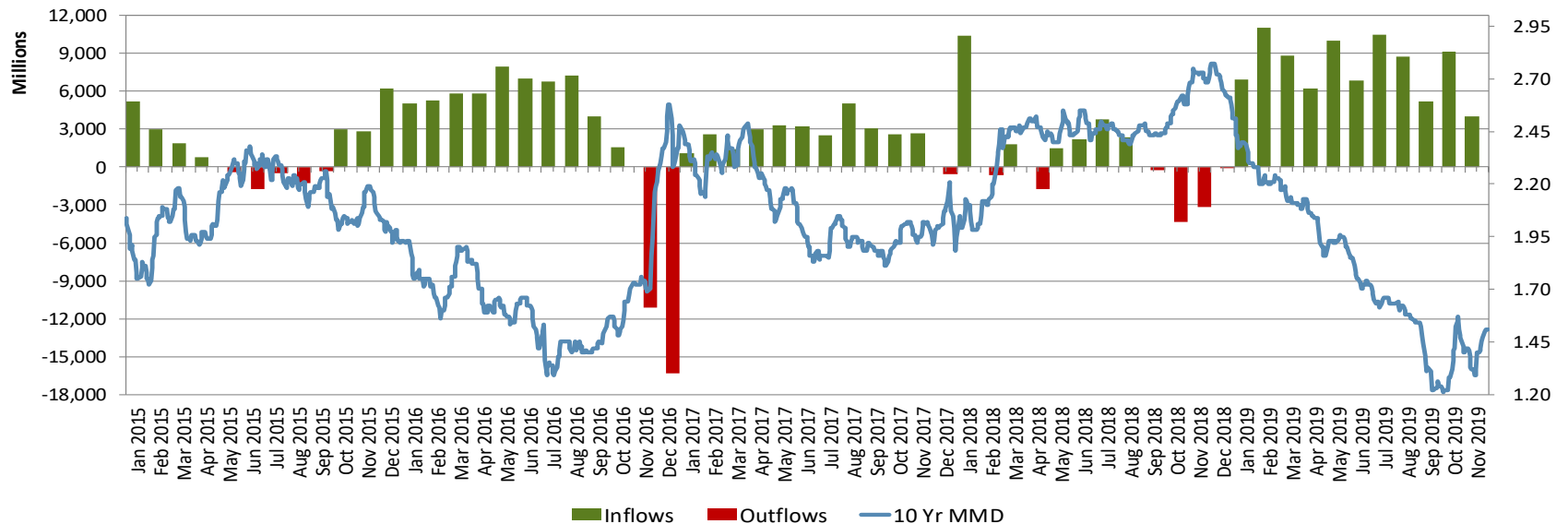
## Current Market Themes

- FOMC Fed Funds Outlook
- US/China Trade Talks
- Municipal Fund Flows
- Muni/TSY Ratios
- Summer Redemptions
- Inflation/Employment
- Geopolitical Concerns
- Iran

## U.S. Municipal Long-Term Issuance Trends

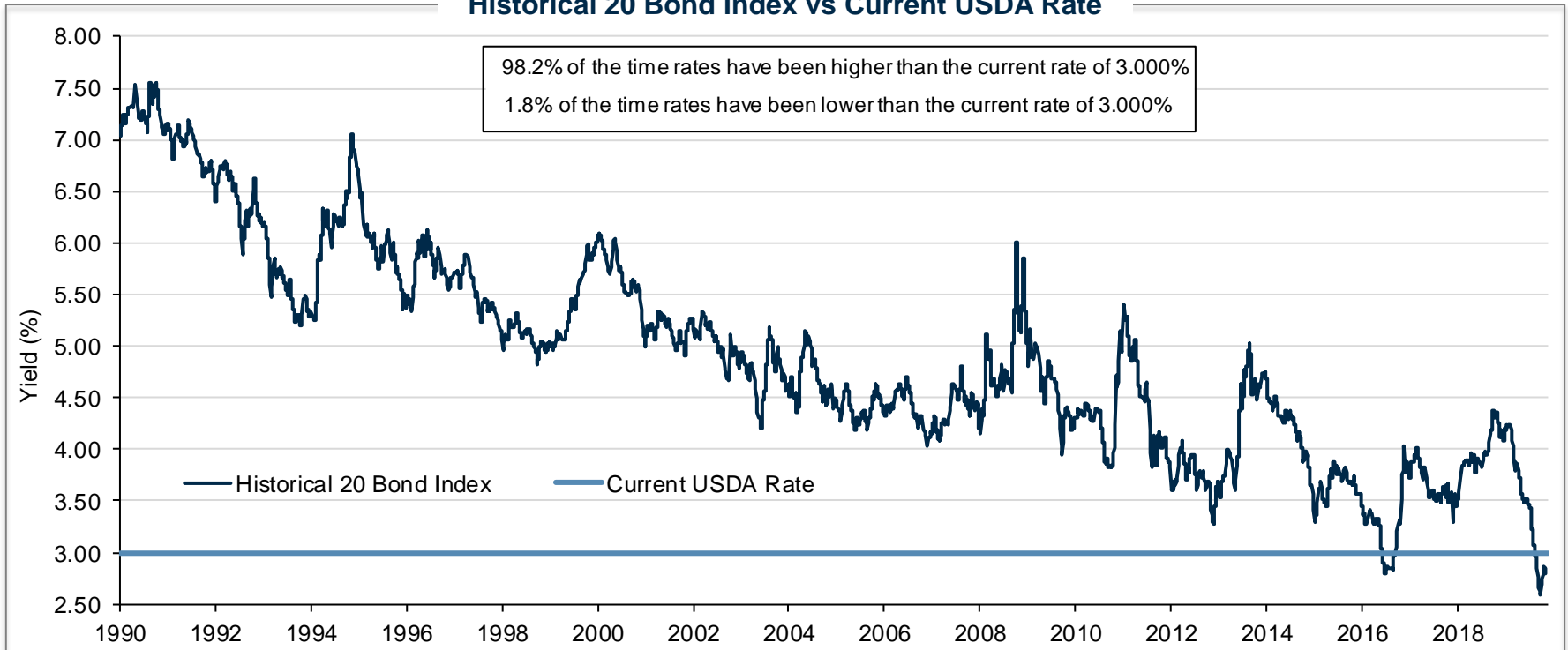


## Municipal Fund Flows and 10-Year MMD



- The USDA has historically set the rate on the 40-year loan through the Community Facilities Direct Loan Program by using the Bond Buyer 20 Bond Index.
- Bond Buyer Indices are indicators published by *The Bond Buyer* showing the price levels for various groups of municipal securities. The 20 Bond Index which represents an estimation of the yield that would be offered on a 20-year general obligation bond with a composite rating of approximately “Aa2” for Moody’s and “AA” for S&P.
- The current rate for the USDA Communities Facilities Direct Loan Program is 3.00%.

### Historical 20 Bond Index vs Current USDA Rate




Total percentage of time may not equal 100% due to rounding and percentage of time where past rate equals current rate.

## What is the target Credit Spectrum?

- Bonds may be issued as rated or non-rated.
- The better the credit quality of the Issuer, the higher the bond rating.
- The higher the bond rating, the more marketable the bonds – lower interest rates.

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa	AA	AA
A	A	A
Baa	BBB	BBB
Ba	BB	BB
B	B	B
Caa	CCC	CCC
Ca	CC	CC
C	C	C

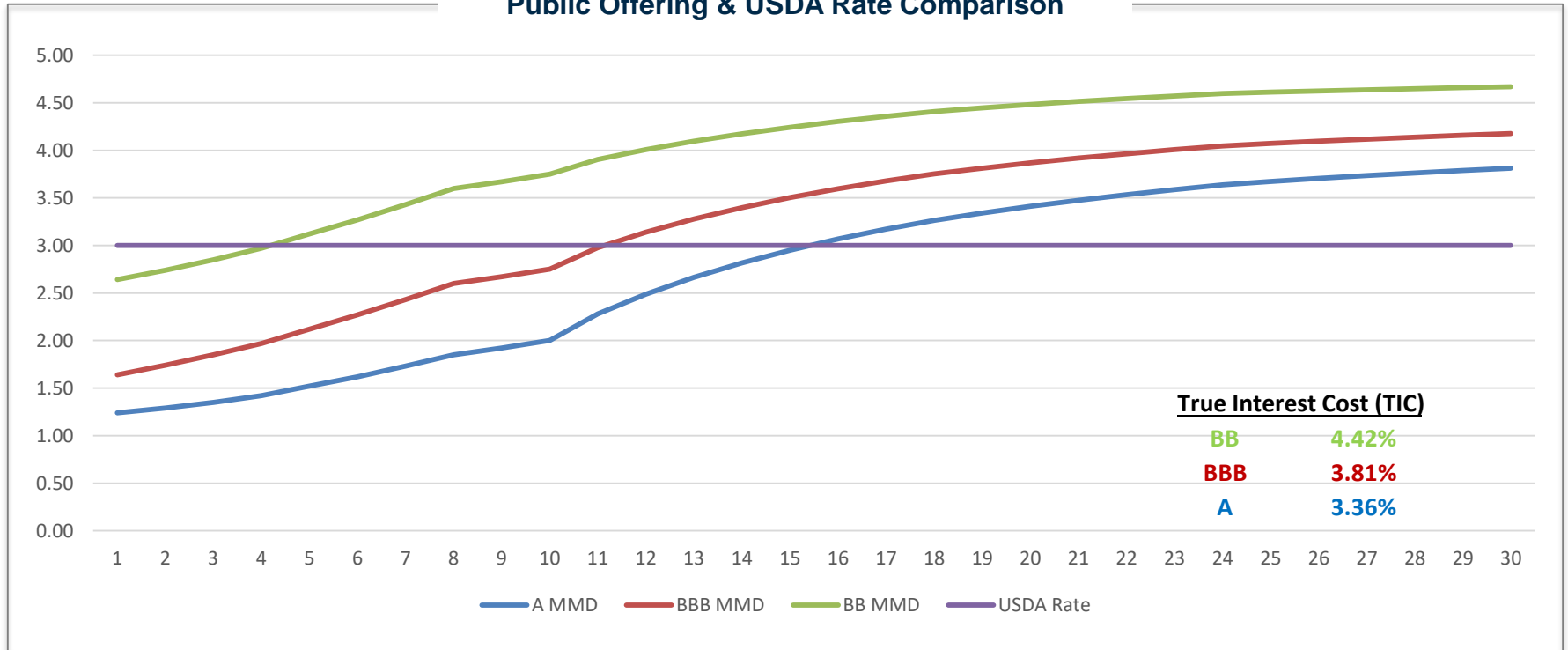
**Target Credit Spectrum**



- A rated credits or higher can generally obtain credit elsewhere
- B rated credits or lower are generally too risky for USDA
- The target credit spectrum is narrow and generally BB and BBB type of credits

- USDA CF borrowers typically fall into the BBB, BB or non-rated categories. Funding costs vary significantly between the rating categories, and even within each rating category (depending on the modifier – minus/flat/plus).
- Borrowers generally hire a capital markets professional to determine the best financing plan for their projects. These professionals would generate a chart like the one below to analyze the route to the lowest cost of funds.
- The tax-exempt bond yield curves below change on a daily basis and are not locked in until the day of pricing. The current rate for the USDA Communities Facilities Direct Loan Program is 3.00% and that maximum rate is locked in upon the acceptance of the Letter of Conditions.

Public Offering & USDA Rate Comparison



## Why partner with the Capital Credit Market?

### Cost Effective

- Tax-exempt bond structures can be a very favorable compliment to USDA (P3)
- Significant market demand (**not relying on just one bank, bank syndicate or one investor group to approve credit and establish the interest rate**)
- Cost of Issuance is competitive and generally outweighed by low tax-exempt interest rates and creative structuring

### Flexible Structures

- Financing can be tailored to fit specific customer needs
- 30-40 year fixed rate options (eliminate interest rate risk, no construction loan)
- Deferred principal options, wrap around options, accelerating principal options
- Capitalized Interest and DSR alternatives
- May or may not have a bond rating
- May or may not have bond insurance
- Investment of proceeds
- Trustee utilization

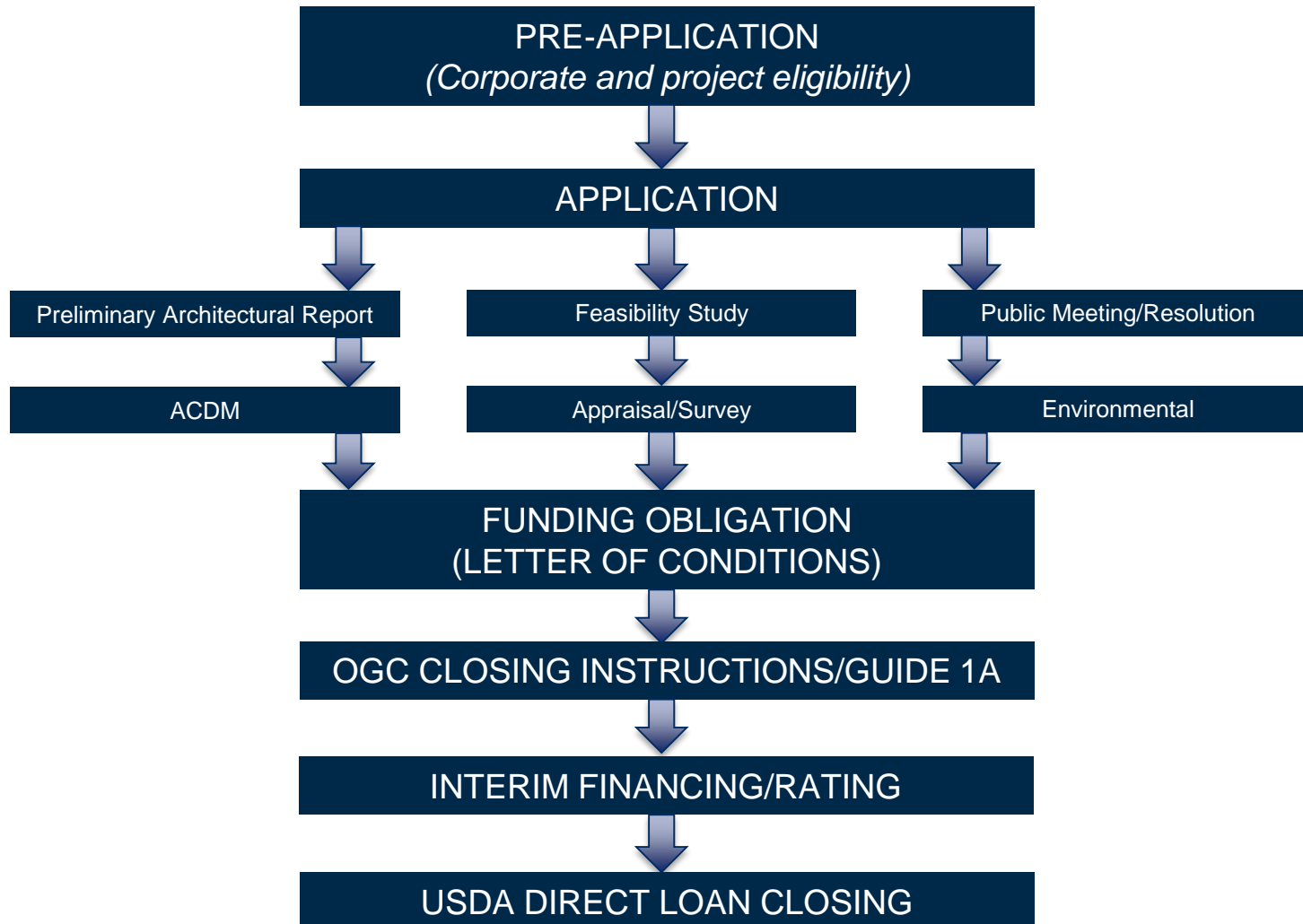
### Custom Security Requirements/Features

- Master Indenture structure (very important in P3 structures)
- Mortgage and Pledge of Revenue
- Additional Bonds Test and Debt Service Coverage
- Other Covenants

## How does Raymond James partner with the USDA?

- Raymond James will assist the customer in determining the capital stack
- Raymond James will engage with a customer to apply for USDA funding
- Raymond James will assist the customer through the application process, prepare a full application package and deliver to USDA
- Raymond James will assist the customer in securing the Direct Loan obligation and/or the Conditional Commitment for Guarantee
- Raymond James will serve as Underwriter in the issuance of short-term construction notes for the USDA Direct Loan and other debt, if applicable in the capital stack
- Raymond James will coordinate the Guarantee Loan with the Lender of Record
- Upon construction completion, Raymond James will coordinate the long-term closing with the customer, USDA and the short-term investor





## General Note Structure

- **Public Offering** – construction notes issued through a conduit governmental entity on behalf of applicant
- **Note Type** – Bond Anticipation Note (“BAN”) or bank loan (bank loans are more difficult for larger requests)
- **Tax Status** – Tax-Exempt (generally)
- **Maturity / Term** – generally 12-36 Months, fixed rate (depending on construction term)
- **Size** - \$5,000,000 – No Maximum
- **Security** – Assignment of USDA Takeout, mortgage (if applicable), pledge of revenues or general obligation
- **Rating** – MIG-1 or MIG-2 (generally)
- **Note Documentation** – Indenture structure for BAN
- **USDA Permanent Loan** – closing documents to include Loan Resolution Security Agreement (1942-9), Promissory Note (1940-16) and mortgage (may also include Master Indenture)
- **USDA Oversight** – approves all disbursements, onsite monthly during construction, provides oversight throughout the process and requires a third-party feasibility study.

## Rating Methodology

- Moody's Investors Service ("Moody's") rates BANs that are secured by a USDA takeout commitment through the Community Facilities Direct Loan Program. Specific criteria revised April 2014.
- The rating methodology of the BANs reflect both the permanent financing commitment from the USDA and the likelihood of substantial project completion prior to the BAN maturity.
- Historically, Moody's has rated the USDA notes either MIG-1 or MIG-2.
- Rating Factors include the following 3 primary considerations:
  - Management (40%) – both construction and operationally
  - Takeout Timing (40%) – ample time between project completion and BAN maturity
  - Liquidity (20%) – operational sustainability during construction
- And also include:
  - Industry sector – healthcare, education, public safety, etc.
  - Corporate type – municipal or non-profit
  - Long-term market risk – loans are approved and funds obligated prior to BAN issuance
- Notching factors – risk of insolvency or bankruptcy, required additional capital, investment policies, capitalized interest funding, and claw back risk if borrower funds utilized.

## USDA Interim Financing

The following are the four primary **benefits of interim financing** a USDA CF Direct Loan:

- Tax-exempt, capital markets note financing can be an effective means of commercial interim financing.
- Interim financing serves as an interest rate hedge for the USDA Direct Loan. Once the USDA Direct Loan is obligated, the interest rate cannot be increased but it can be lowered in the event USDA drops the interest rate prior to the closing of the direct loan.
- Utilizing interim financing will enable the customer to defer its principal for a longer period of time, thus providing a cash flow benefit in the early years of the project.
- Commercial interim financing fulfills the requirements set forth in the USDA regulations:
  - *1942.17(n)(3) – In all loans exceeding \$50,000, where funds can be borrowed at reasonable interest rates on an interim basis from commercial sources for the construction period, such interim financing will be obtained so as to preclude the necessity for multiple advances of Rural Development funds.*

**Estimated Rates**

The following are sample rates for a USDA Direct Loan Program interim construction note (tax-exempt assumption):

***Estimated Rates as of November 22, 2019*****Moody's Investors Service – MIG-1**

Tax-exempt Note (2-Year)	1.45% to 1.55% (est)
Tax-exempt Note (3-Year)	1.60% to 1.70% (est)

**Moody's Investors Service – MIG-2**

Tax-exempt Note (2-Year)	1.90% to 1.95% (est)
Tax-exempt Note (3-Year)	2.15% to 2.25% (est)

- True Interest Cost (TIC) includes the interest rate and the cost of underwriting
- For example, a 3-year MIG-2 note having an interest rate of 2.20% and an underwriting fee of 1% ( $1\% \div 3 \text{ years} = .33\%$ ) would have an approximate TIC of 2.53%

The following is a sample capital stack for a generic hospital:

	<b>Tax-Exempt Bond</b>	<b>USDA Direct Loan/Note</b>	<b>USDA Guarantee Loan</b>	<b>Total</b>
<b>Sources of Funds</b>				
Par Amount of Debt	20,000,000	97,000,000	10,000,000	127,000,000
Equity Contribution	750,000	3,750,000	500,000	5,000,000
<b>Total Sources</b>	<b>20,750,000</b>	<b>100,750,000</b>	<b>10,500,000</b>	<b>132,000,000</b>
<b>Uses of Funds</b>				
Project Fund	18,975,000	95,600,000	9,400,000	123,975,000
Capitalized Interest (2-Year)	1,400,000	3,900,000	900,000	6,200,000
Costs of Issuance/Underwriting	375,000	1,250,000	200,000	1,825,000
<b>Total Uses</b>	<b>20,750,000</b>	<b>100,750,000</b>	<b>10,500,000</b>	<b>132,000,000</b>

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