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August 16, 2013

Memorandum

To: David Fernandez, Assistant City Manager
From: David Moore, Public Financial Management
Nicklas Rocca, Public Financial Management
Re: Sewer System Refunding Revenue Bond, Series 2013 – Recommendation Memo

On July 10, 2013, Public Financial Management, Inc. (PFM) distributed a Request for Proposals (RFP) on behalf of The City of Key West, Florida (the “City”) to identify financial institutions that could provide the City with a fixed rate bank loan in the form of a Sewer System Refunding Revenue Bond (the “Term Loan”). The proposed Term Loan will be used to: (1) refinance the outstanding Sewer System Refunding Revenue Bonds, Series 2003 maturing in the years 2013-2026; and (2) to pay the associated cost of issuance. The principal of and interest on the proposed Series 2013 Bonds will be secured by the Net Revenue derived from the City’s Sewer System.

Prior to the submittal deadline on July 31, 2013, the City received eight (8) proposals from the following firms: Bank of America, N.A., BBVA Compass, First State Bank, Pinnacle Public Finance, Raymond James Capital Funding, Inc., Regions Capital Advantage, Inc., STI Institutional & Government, Inc. (STING), and TD Bank. A summary of each proposal is included as Exhibit A.

A bank loan proposal is different than a “hard bid” proposal in that the unique terms and conditions of each proposal must be considered in order to determine the optimal financing proposal. The actual interest rate charged is the primary factor, but call provision, legal provisions and the potential for adjustment in the “fixed rate” are also critical factors. In this case the critical factors under consideration—in addition to the interest rate—are financing duration, call provisions and change in interest rate provisions.

- Financing duration – The Series 2003 Bonds being refunded have a final maturity of October 1, 2026. The RFP allowed the banks to submit proposals that contained a final maturity of 2024, 2025 or 2026. After analyzing the rates provided for all three term lengths, it was determined that matching the original final maturity (2026) was the best option for the City.
- Call provisions – Typically, tax exempt bonds can be called (paid off) after ten years. Banks offer a wider variety of prepayment options including: non-callable, five or ten year call options, “make-whole call” and a set redemption premium. Conversely, non-callable bonds have the lowest interest rates, but leave the City with limited flexibility. Make-whole call provisions also generally have low interest rates, but in certain interest rate environments, the prepayment penalty can be very large. Finally, shorter call periods and bonds that are



callable at any time offer the greatest flexibility, but typically have higher interest rates. Based on our discussions with staff and due to the term of the financing being only 13 years, we determined it would be preferable to have a par call at 5-years as long as the cost was reasonable.

- Change in interest rate provisions – Bank loans typically include the ability to change the fixed interest rate in the event the bonds are determined to be taxable and/or the Federal corporate tax rate changes. However, in the aftermath of the financial crisis in 2007 and 2008, some banks have developed very broad change in interest rate language. The language allows the bank to increase the interest rate in the event that capital charges change and/or the bank's cost of funds change. These provisions are often vague and difficult to quantify. And, the change in interest rate could be material. While bank loans with these provisions generally have lower interest rates, based on our discussions with staff we determined that the City would prefer to limit the ability of the bank to change the interest rate unless the savings was very material.

Our approach to reviewing proposals is to begin eliminating proposers and get to a list of a few firms for final consideration. In this case, First State Bank's proposal was barely responsive and contained the highest rate, so they were eliminated. BBVA Compass, Pinnacle Public Finance, Raymond James Capital Funding, Inc., and STI Institutional & Government, Inc. (STING) all submitted rates substantially higher than the top three firms which are detailed in greater detail below.

The Bank of America, N.A. proposal contained an attractive indicative rate but the terms and conditions included onerous adjustment to interest rate language. The final two proposals (Regions Capital Advantage, Inc. and TD Bank) were similar to each other in the terms and interest rates. The main difference between the two proposals was Regions provided a fixed rate of 2.65% with a 5-year par call without the City having to enter into any interest rate lock agreement. TD Bank proposed an indicative rate that would float until 3 days prior to closing or the City could of entered into an interest rate lock for an additional fee, but if for some reason the financing did not close the City could potentially face a large penalty for breaking the interest rate lock agreement.

Recommendation

After discussing these options with staff, PFM recommends the City accept the Regions proposal with a final maturity of 2026. The interest rate proposed by Regions on the 2026 maturity is the lowest locked rate and the terms and conditions offer the City the least risk of an increase in interest rate at a later date. By accepting the proposal from Regions and refunding the Series 2003 Bonds, the City will reduce its debt service payments by over \$201,000 per year, equivalent to approximately \$2.2 million (10.7% of the refunded principal amount) Net Present Value Savings. The Regions term sheet also exposes the City to minimal risk if the Term Loan does not close for any reason. In summary, the Regions proposal offers the City the optimal mix of low rates, favorable terms and the ability to avoid additional sewer rate increases in the future.

The City of Key West, Florida
2013 Sewer System RFP Evaluation Matrix
Summary of Term Loan Responses

Exhibit A

		Bank of America, N.A.		BBVA Compass		First State Bank	
Proposal Requirements							
Contact Information		Holly Kuhlman Senior VP / Senior Credit Products Officer		Jerry Heniser Senior VP		Kurt Lewin EVP/Senior Lending Office	
		4501 Tamiami Trail N, Suite 220 Naples, FL 34103		1450 Brickell Avenue, Suite 2000 Miami, FL 33131		1201 Simonton Street Key West, FL 33040	
		239-659-2275 holly.kuhlman@baml.com		305-507-7874 Jerry.Heniser@bbvacompass.com		305-293-7127 Kurtl@keysbank.com	
Loan Amount		\$20,000,000		\$20,000,000		\$20,000,000	
Proposed Rate	Fixed Rate on Term	1). 2024 Final Maturity	2.38% Indicative Rate (78-month Interest Swap Rate + 0.37%)	1). 2024 Final Maturity	2.52% Indicative Rate (65% of 7-Yr LIBOR + 1.10%) OR 2.61% Locked Rate	1). 2024 Final Maturity	3.35%
		2). 2025 Final Maturity	2.52% Indicative Rate (85-month Interest Swap Rate + 0.34%)	2). 2025 Final Maturity	2.62% Indicative Rate (65% of 7-Yr LIBOR + 1.20%) OR 2.71% Locked Rate	2). 2025 Final Maturity	-
		3). 2026 Final Maturity	2.66% Indicative Rate (91-month Interest Swap Rate + 0.38%)	3). 2026 Final Maturity	2.73% Indicative Rate (65% of 7-Yr LIBOR + 1.31%) OR 2.80% Locked Rate	3). 2026 Final Maturity	-
Prepayment Option		Make Whole Call.		Make Whole Call through first 10-years, par call after 10-years.		No prepayment penalty.	
Fees & Expenses		Bank Counsel Fee	\$4,500	Bank Counsel Fee	\$5,000	Bank Counsel Fee	Not Specified
Covenants/Other Conditions		- Pricing formulas valid until August 30, 2013. - Rates will be set 2 business days prior to closing. - CAFR shall be provided with 270 days of fiscal year end. - In an event of default the Bank may accelerate the maturity of the loan. - Waiver of jury trial and mandatory arbitration provision. - If loan becomes subject to Federal income taxation, the Bank's standard "gross-up" provision will apply.		- Locked Rate options are valid for 45 days, must be notified by August 2, 2013. - Interest rates subject to "gross-up" upon an event of taxability.		One page submission, barely responsive. Lacking important details.	

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		Pinnacle Public Finance		Raymond James Capital Funding, Inc.		Regions Capital Advantage, Inc.	
Proposal Requirements							
Contact Information		Blair Swain VP 8377 E. Hartford Drive, Suite 115 Scottsdale, AZ 85255 480-419-3634 Bswain@ppf-inc.com		Cord King Senior VP 710 Carillon Parkway St. Petersburg, FL 33716 727-567-2055 Cord.king@raymondjames.com		Oscar Herrera VP 2800 Ponce de Leon Blvd, 9th Floor Coral Gables, FL 33134 305-774-5152 oscar.herrera@regions.com	
Loan Amount		\$20,000,000		\$20,000,000		\$20,000,000	
Proposed Rate	Fixed Rate on Term	1). 2024 Final Maturity	2.75% Locked Rate	1). 2024 Final Maturity	3.12% Locked Rate (5-Yr Call) 2.97% Locked Rate (10-Yr Call)	1). 2024 Final Maturity	2.46% Locked Rate
		2). 2025 Final Maturity	2.93% Locked Rate	2). 2025 Final Maturity	3.18% Locked Rate (5-Yr Call) 3.03% Locked Rate (10-Yr Call)	2). 2025 Final Maturity	2.56% Locked Rate
		3). 2026 Final Maturity	3.07% Locked Rate	3). 2026 Final Maturity	3.24% Locked Rate (5-Yr Call) 3.09% Locked Rate (10-Yr Call)	3). 2026 Final Maturity	2.65% Locked Rate
Prepayment Option		Subject to prepayment in whole, but not in part, beginning October 1, 2018 at 101%.		See above for call provisions, make whole call before respective 5 or 10 year par call.		Make Whole Call through first 5-years, par call after 5-years.	
Fees & Expenses		Bank Counsel Fee	\$7,000	Bank Counsel Fee	\$5,000	Bank Counsel Fee	\$4,500
Covenants/Other Conditions		- Rates valid through September 1, 2013. - Gross-up provision if obligation becomes taxable prior to maturity. - Default rate in the 3%-5% range. - Reserves the right to include reasonable limitations on the issuance of subordinate debt in the future. - Pinnacle will require the option to assign, in whole or in part, the obligation to a qualified institutional buyer. - Is unable to indemnify the City as requested, willing to supply evidence of Error & Omissions insurance.		- All pricing quotes will expire unless accepted by August 2, 2013. - Gross-up provision in the event of taxability.		- Must deliver audited financials within 210 days of fiscal year end. - DS Coverage of 120%. - Rate Covenant 120%. - Additional Bonds Test 120% of MADS. - Gross-up provision if deemed taxable. - Payment of fees/expenses regardless whether or not Term Loan is closed. - Proposal must be accepted by August 9, 2013.	

The City of Key West, Florida
2013 Sewer System RFP Evaluation Matrix
Summary of Term Loan Responses

Exhibit A

		STI Institutional & Government, Inc. (STING)		TD Bank	
Proposal Requirements					
Contact Information		Steve Leth Senior Vice President 8699 NW 36 Street, 2nd Floor Doral, FL 33166 305-597-6601 Steve.letth@suntrust.com		Marcel Summermatter VP 5900 North Andrews Avenue Ft. Lauderdale, FL 33309 954-233-2991 Marcel.Summermatter@td.com	
Loan Amount		\$20,000,000		\$20,000,000	
Proposed Rate	Fixed Rate on Term	1). 2024 Final Maturity	2.39% (Make Whole) 2.56% (No Make Whole) (Add 15 bps to remove After Tax Language)	1). 2024 Final Maturity	2.33% Indicative Rate (Make Whole) 2.43% Indicative Rate (5-yr Call) (May Lock rate for additional 4 bps)
		2). 2025 Final Maturity	2.52% (Make Whole) 2.69% (No Make Whole) (Add 18 bps to remove After Tax Language)	2). 2025 Final Maturity	2.43% Indicative Rate (Make Whole) 2.53% Indicative Rate (5-yr Call) (May Lock rate for additional 4 bps)
		3). 2026 Final Maturity	2.65% (Make Whole) 2.82% (No Make Whole) (Add 20 bps to remove After Tax Language)	3). 2026 Final Maturity	2.51% Indicative Rate (Make Whole) 2.61% Indicative Rate (5-yr Call) (May Lock rate for additional 4 bps)
Prepayment Option		Callable with Make Whole penalty, in selected options detailed above. No Make Whole rate options are callable four years after closing with no penalty, upon three Business days of prior notice.		Make Whole Call through first 10-years, par call after 10-years.	
Fees & Expenses		Bank Counsel Fee	\$7,500	Bank Counsel Fee	\$4,000
		Lender Fee	\$2,000		
Covenants/Other Conditions		- Gross up language if marginal maximum federal corporate tax rate decreases from 35%. - Rates locked through August 30, 2013. - Annual financial statements shall be submitted to the Bank within 270 days of fiscal year end and the Budget shall be submitted within 30 days of adoption. - Waiver of trial by jury. - Default rate of Prime + 8% or maximum rate allowed by law. - Lender will maintain the right to transfer and assign the Bond in whole or part to accredited investors. - Agree to have payments collected from a SunTrust Lender account of the City's choice. - Additional Parity obligations subject to 120% of MADS test. - 120% rate covenant.		- Rate Covenant of 1.20x Coverage. - Additional Bonds Test 120% MADS. - Periodic loan payments shall be settled via auto debit through account maintained with bank. - Actual rate to be set 3 business days prior to closing unless rate is locked. - Default rate will be + 4%. - 6% late fee charge if payment is more than 15 days overdue. - Shall provide Audited Financial Statements within 210 days of fiscal year end and budget 60 days after approval.	