City of Annapolis, Maryland

Capital Funding Strategies

September 2, 2010

Prepared By
Davenport & Company LLC
Member NYSE ● FINRA ● SIPC

Key Observations

- In light of the country's macroeconomic situation, the City of Annapolis has recently experienced General Fund cash flow difficulties.

- In addition, the City has identified roughly $97 million of priority Capital Improvements to be funded through Fiscal Year 2016.

- Of this total, approximately $25 million represents mandated Water Capital Projects to be funded over the near term.

- Based upon the operating requirements of the utility system and the debt service associated with the prior bond issues, utility rate increase requirements going forward will be substantial.

- Sustaining structural budgetary balance in the Utility Funds will be critical to avoiding shortfalls, which would have to be made up by the General Fund.

- **Question: How can the City simultaneously free up General Fund cash flow and minimize Water and Sewer rate increases tied to its Capital Plan?**

Goals & Objectives – Debt Restructuring

- Provide immediate cash flow savings to the General Fund, such that reserves can be replenished more quickly and the City can reduce/avoid the use of short-term borrowing for cash flow.

- Provide sufficient funding to meet Capital Needs, particularly all mandated Utility Improvements in a timely manner.

- Minimize rate requirements to meet existing and new debt service.

- Sustain / Enhance regional competitiveness and business retention through effective utility rate management.

- Generate enough surplus cash flow in the Utility Fund so that a reasonable level of reserves is maintained such that the following objectives are met:
  - City's General Fund is protected;
  - Credit ratings are not harmed; and
  - Ability to respond effectively to emergency repairs / unanticipated costs.

Scenarios

- <u>**Case One:**</u> **Traditional New Money Issuance**

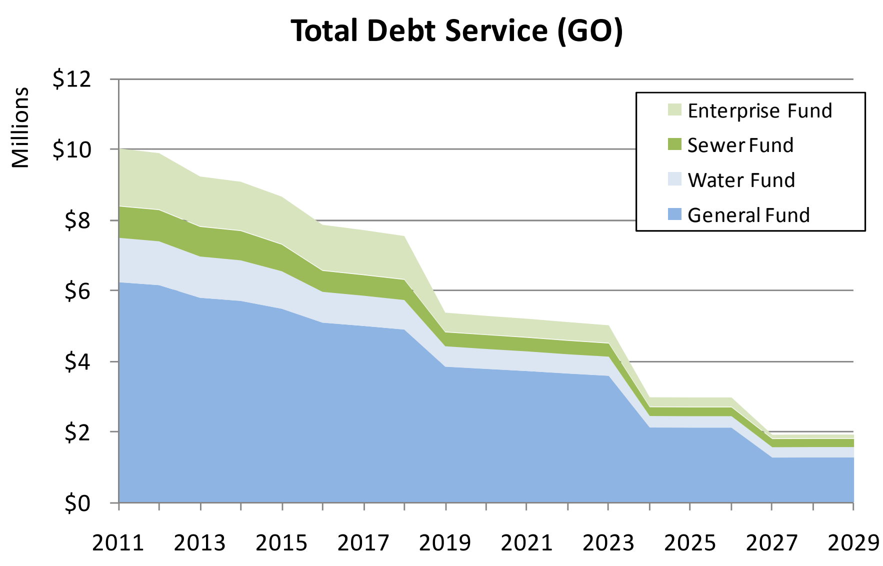
  The City's current 5-Year Capital Improvement Program is funded in its traditional manner over 20 years, on top of the City's current debt profile. <u>No restructuring is assumed</u>.

- <u>**Case Two:**</u> **Strategic Restructuring + New Money Issuance**

  The City's current debt profile is restructured to allow for near-term cash flow relief and to set the stage for the strategic layering-in of the City's 5-Year CIP. The new money projects are structured to minimize short-term debt service spikes.

Existing Debt Service

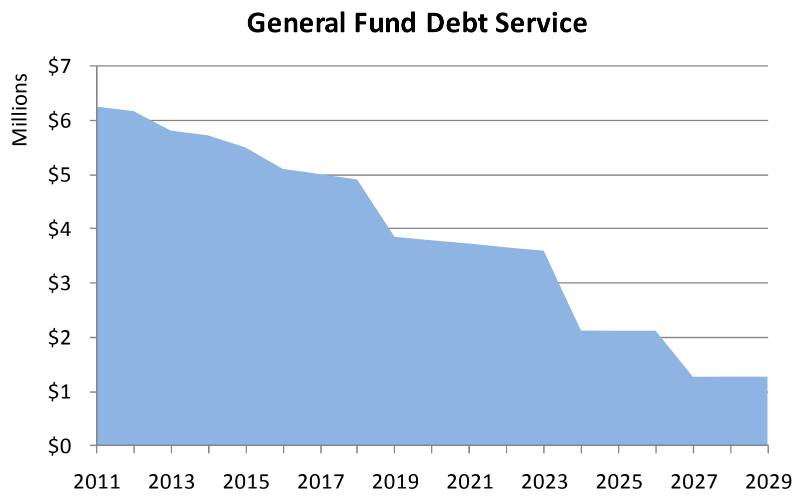
- The City has $83,875,000 in outstanding debt (all General Obligation) allocated between the following funds:
  - General $55,026,790
  - Water 10,150,881
  - Sewer 7,116,005
  - Enterprise 11,581,324 (Consists of Parking, Dock, Market, Transportation and Stormwater Funds)
  - Total $83,875,000

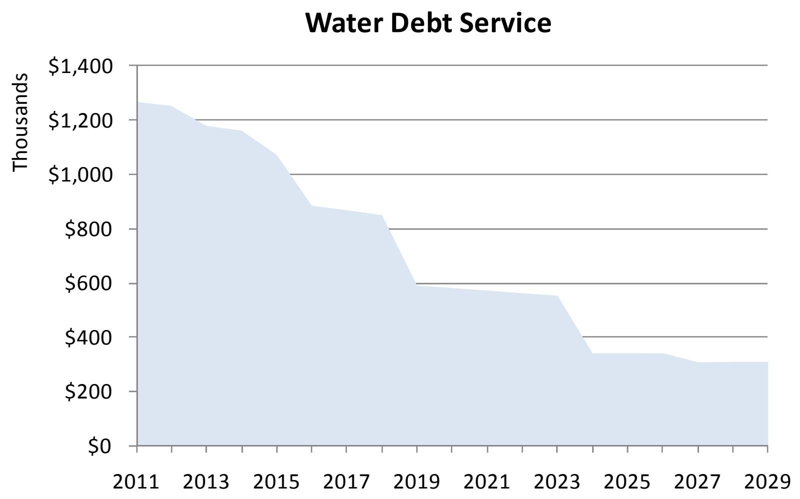


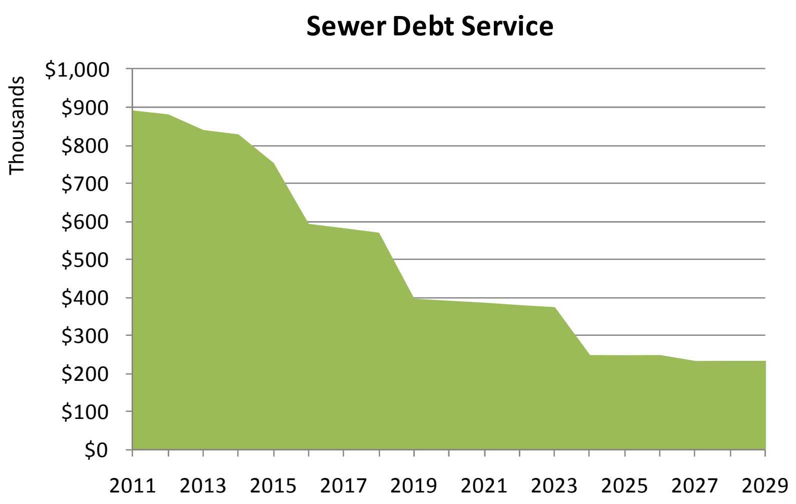
Fiscal Year	Total Debt Service
2011	$10,020,918
2012	9,886,694
2013	9,222,366
2014	9,076,559
2015	8,652,051
2016	7,856,699
2017	7,704,349
2018	7,540,237
2019	5,370,800
2020	5,279,774
2021	5,196,681
2022	5,099,307
2023	5,012,781
2024	2,973,864
2025	2,968,540
2026	2,969,271
2027	1,912,925
2028	1,918,213
2029	1,918,200
Total	$110,580,229

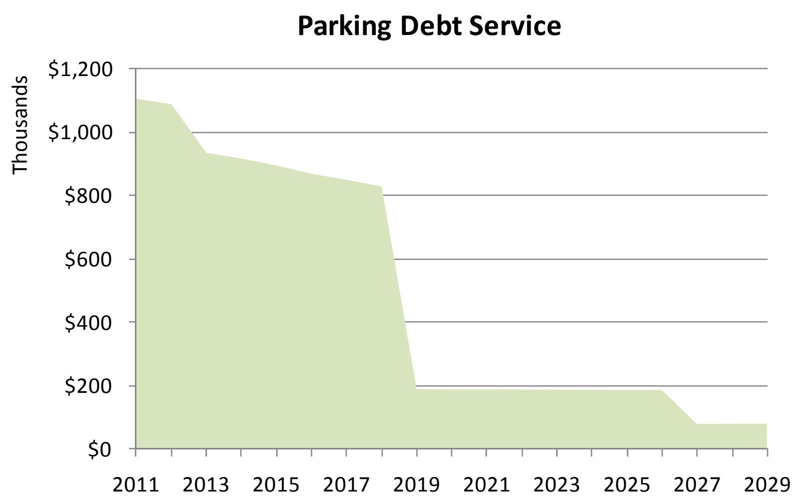
Existing DS Breakdown (by Fund)

City of Annapolis









- The City's current 5-Year Capital Improvement Plan ("CIP") has the following debt funding requirements:

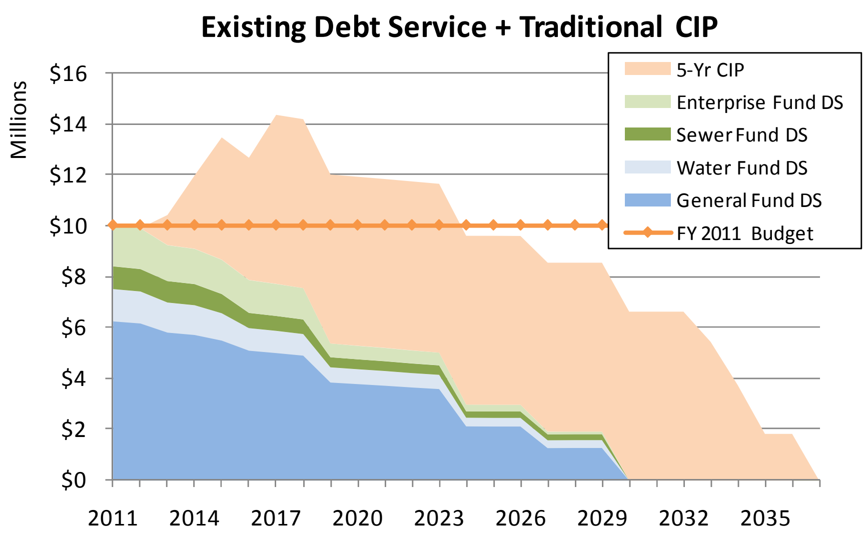
#	Project Name	FY12	FY13	FY14	FY15	FY16	Total
	General Fund						
205	Eastport Fire Station	$5,959,180	$0	$0	$0	$0	$5,959,180
455	Smithville/Russell Improves	0	0	0	0	1,526,500	1,526,500
462	Taylor Avenue Improvements	0	2,526,740	0	0	0	2,526,740
472	Maryland Avenue Improvements	189,200	790,800	5,000,000	0	0	5,980,000
475	Traffic Signal Control	0	89,090	896,160	0	0	985,250
476	Barbud Lane Reconstruction	154,820	0	500,000	0	0	654,820
477	General Roadways and Sidewalks	2,000,000	2,000,000	2,000,000	0	2,000,000	8,000,000
522	Public Works Garage	4,609,420	0	0	0	0	4,609,420
524	City Hall Restoration	250,000	3,096,910	0	0	0	3,346,910
525	Roof Replacement Program	250,000	275,000	300,000	0	0	825,000
531	Non-Profit Capital Funding	260,000	0	0	0	0	260,000
532	Building Upgrades	210,000	550,000	0	0	0	760,000
	Subtotal	$13,882,620	$9,328,540	$8,696,160	$0	$3,526,500	$35,433,820
	Water Fund						
704	Water Tank Rehabs	$338,000	$0	$0	$0	$0	$338,000
724	Water Plant Upgrades	0	12,421,440	12,421,440	0	0	24,842,880
734	Water Storage Tank	0	1,175,000	1,175,000	0	0	2,350,000
738	Water Distribution Upgrades	754,600	594,600	999,200	0	434,600	2,783,000
	Subtotal	$1,092,600	$14,191,040	$14,595,640	$0	$434,600	$30,313,880
	Sewer Fund						
736	Sewer Rehabs	$1,370,270	$0	$2,740,540	$0	$2,740,540	$6,851,350
737	Pump Station Upgrades	397,400	397,400	363,400	0		1,158,200
	Subtotal	$1,767,670	$397,400	$3,103,940	$0	$2,740,540	$8,009,550
	Off Street Parking Fund						
732	Hillman Garage Replacement	$300,000	$0	$0	$1,530,380	$20,022,790	$21,853,170
	Dock Fund						
731	Harbormaster Building	$132,880	$995,180	$0	$0	$0	$1,128,060
	Totals	**$17,175,770**	**$24,912,160**	**$26,395,740**	**$1,530,380**	**$26,724,430**	**$96,738,480**

CASE ONE:

Traditional New Money Issuance

Case 1: Traditional New Money

- The City has traditionally issued 15-20 year debt amortized as Level Debt Service.
- The following case assumes the full 5-Year CIP is layered-in over 20 years with Level Debt Service.
  - One bond issue is done per year starting in FY 2012 and going until FY 2016.
  - All costs of each issue are assumed to be financed.
  - The smaller FY 2015 debt funding requirement of $1.5 million has been combined with the FY 2014 issue to achieve economies of scale.
  - Note: Debt Service tops out at $14.3 million in FYs 2017 and 2018 (which is $4.3 million <u>above</u> the FY 2011 Budget of $10 million).

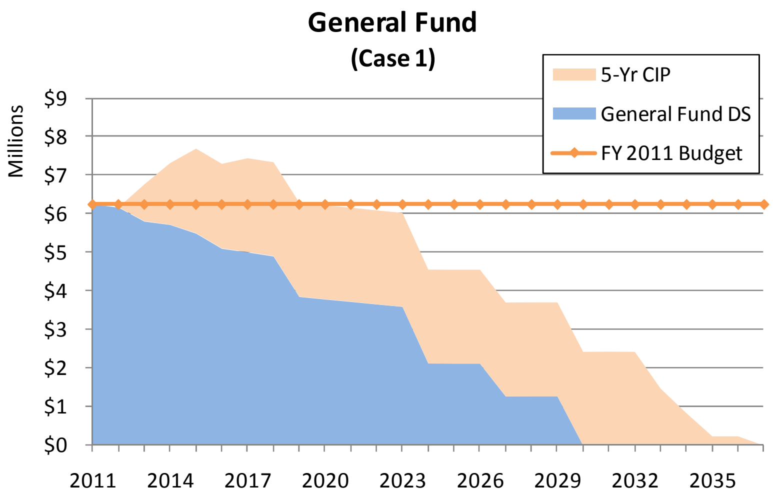


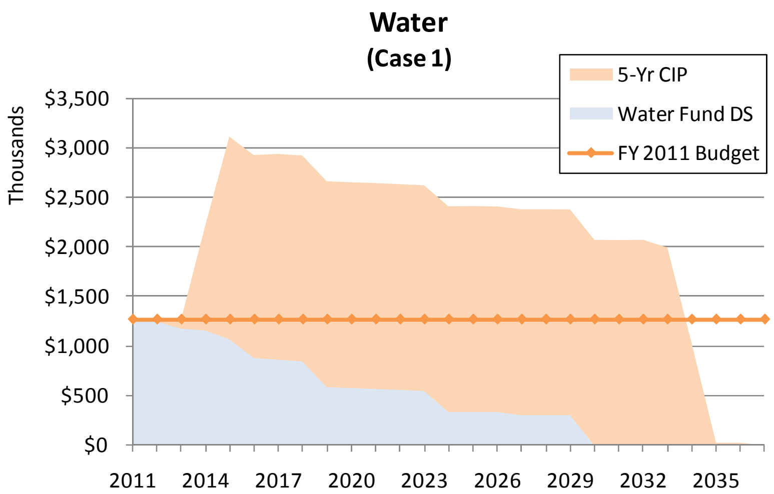
<u>MADS</u>:

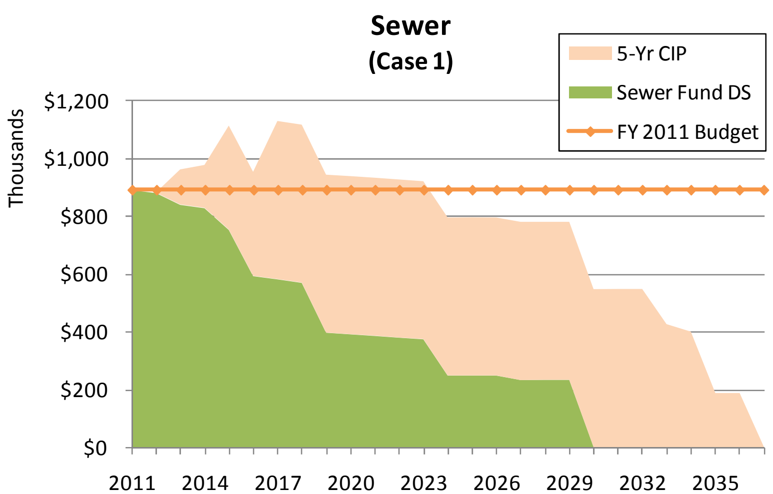
Case 1 (FY17)
$14.3 million

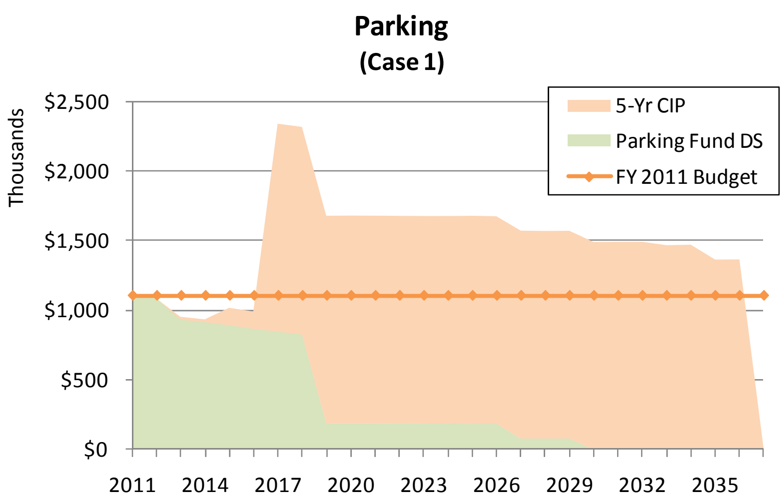
Case 1: Debt Service Breakdown (by Fund)

City of Annapolis









Case 1: Observations

- If bonds are sold using the City's traditional approach, maximum cash flow pressure is placed on all affected funds.
- This approach also does not take advantage of time-limited Stimulus programs, such as Build America Bonds, which can help to lower the cost of capital.
- Nothing has been done to reduce future utility rate requirements.

<u>CASE TWO</u>:

Restructuring + New Money Issuance

Case 2: Debt Restructuring with New Money

- The City has the ability to couple a debt restructuring with its 5-Year CIP in order to reduce near-term debt service expenditures while smoothing out overall debt service levels.

- As of June 30, 2010, the City had six outstanding bond issues totaling **$83,875,000**, which are potential restructuring targets:

Issue	Outstanding	Call Provisions
Series 1998	$5,085,000	Currently callable at par
Series 2002	11,120,000	April 1, 2012 at 101%
Series 2003*	3,995,000	Non-callable
Series 2005	12,730,000	August 1, 2015 at par
Series 2007	25,135,000	August 1, 2017 at par
Series 2009	25,810,000	June 1, 2019 at par

- In addition, Case 2 assumes the full 5-Year CIP is layered-in annually as follows:

General Fund Projects	20 Years	(Traditional term)
Water and Sewer Projects	30 Years	(More in line with economic life)
Parking and Dock Projects	25 Years	(More in line with economic life)

- Case 2 includes additional cash flow strategies, such as Interest Only Periods, Stimulus Act Taxable Build America Bonds ("BABs"), and strategic principal structuring.

*Series 2003 has not been included in the following analysis since it is an advance refunding issue itself. To the extent it is permitted and desired to be restructured as well, it would potentially serve to enhance any cash flow relief.

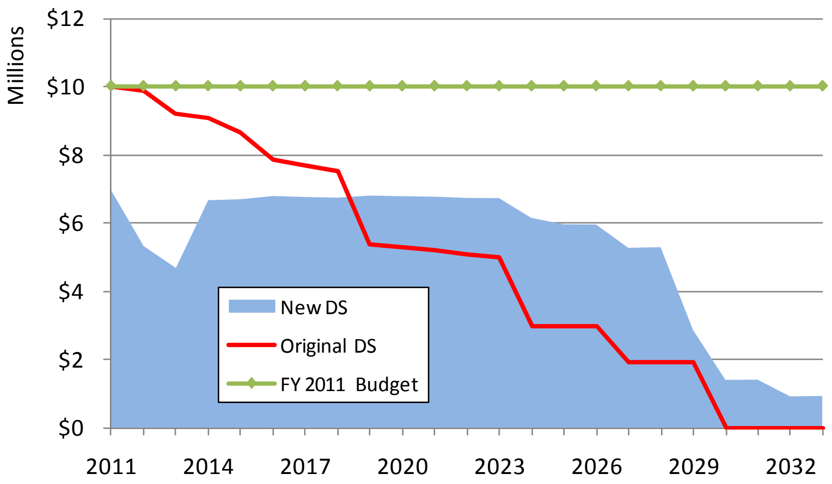
Case 2: Results of a Targeted Restructuring

- The City can strategically target a restructuring in order to carve out near-term debt service, while smoothing overall debt levels and allowing for the implementation of the 5-Year CIP in a more strategic and affordable fashion.
  - The restructuring, as envisioned, would refinance approximately $30M of the $84M outstanding (or just over one-third of the City's debt profile).
  - McGuireWoods LLP, bond counsel to the City, will need to sign off on certain matters.
  - General Fund is extended up to 5 years, W/S out to a 30 year final maturity, and Parking to 25 years.
  - From FY 2011 through FY 2018, the City can "free up" approximately **$19.3 million** in cash flow relief compared to the existing debt payment schedule.
  - Starting in FY 2014, the restructured debt service will start to smooth out at approximately $6.8 million per year (and stay at/below that level going forward).
  - All restructured debt service remains below the FY 2011 Debt Service Budget of $10 million.

Cash Flow Savings (mil $)

FY 2011	3.1
FY 2012	4.5
FY 2013	4.5
FY 2014	2.4
FY 2015	2.0
FY 2016	1.1
FY 2017	1.0
FY 2018	0.7
	19.3

Restructuring Cash Flows



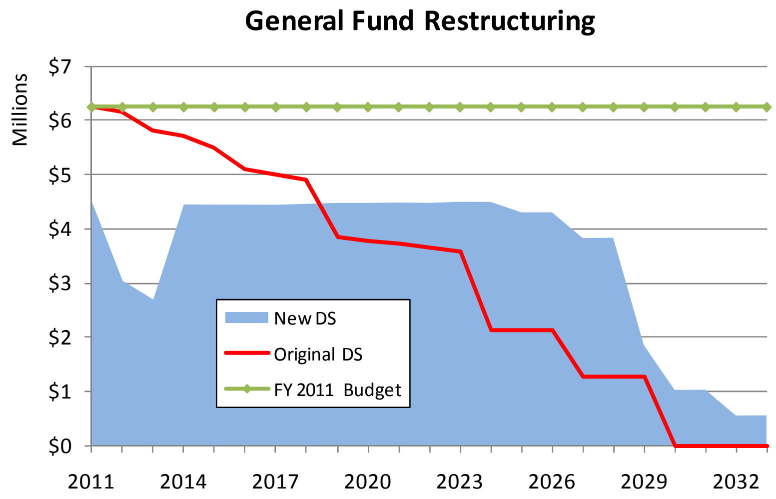
MADS:

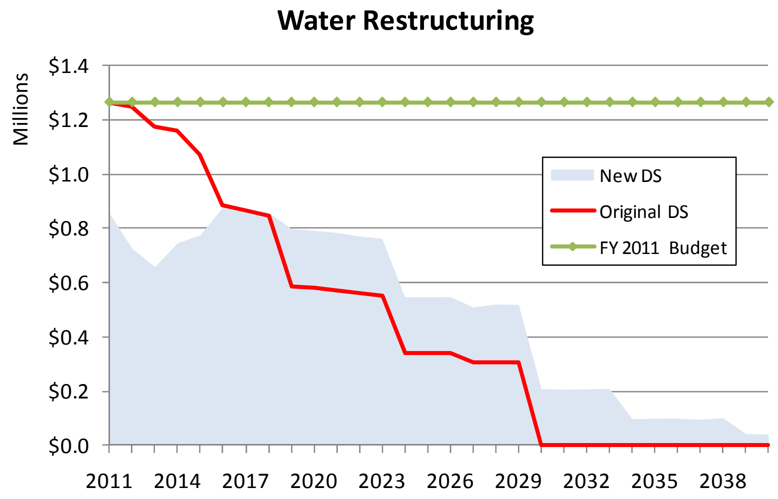
Existing DS (FY 11)
$10 million

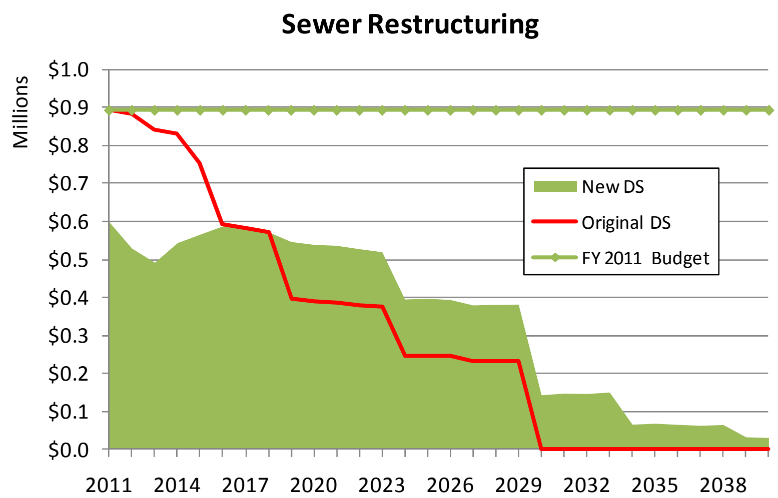
Restructured DS (FY11)
$6.9 million

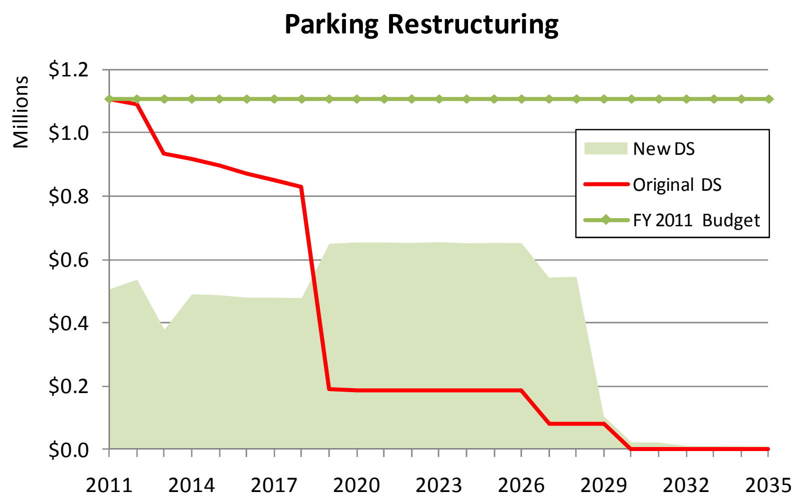
Note: Present Value cost of the restructuring is approximately $2.2M.

Case 2: Restructuring Results Only (by Fund)









Case 2: New Money CIP

- In order to reduce both the number of bond issues necessary to fund the City's CIP and the program's total issuance costs, we've made the following assumptions regarding bond issuances:

In order to expedite the critical Water Plant Upgrades, we've assumed the funding gets pulled into FY 2011.

		Funded in FY 2011 (Dec '10)		Funded in FY 2014		Funded in FY 2016	
#	Project Name	FY12	FY13	FY14	FY15	FY16	Total
	General Fund						
205	Eastport Fire Station	$5,959,180	$0	$0	$0	$0	$5,959,180
455	Smithville/Russell Improves	0	0	0	0	1,526,500	1,526,500
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477	General Roadways and Sidewalks	2,000,000	2,000,000	2,000,000	0	2,000,000	8,000,000
522	Public Works Garage	4,609,420	0	0	0	0	4,609,420
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525	Roof Replacement Program	250,000	275,000	300,000	0	0	825,000
531	Non-Profit Capital Funding	260,000	0	0	0	0	260,000
532	Building Upgrades	210,000	550,000	0	0	0	760,000
	Subtotal	$13,882,620	$9,328,540	$8,696,160	$0	$3,526,500	$35,433,820
	Water Fund						
704	Water Tank Rehabs	$338,000	$0	$0	$0	$0	$338,000
724	Water Plant Upgrades	0	12,421,440	12,421,440	0	0	24,842,880
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	Off Street Parking Fund						
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	Dock Fund						
731	Harbormaster Building	$132,880	$995,180	$0	$0	$0	$1,128,060
	Totals	**$42,018,650**		**$27,995,400**		**$26,724,430**	**$96,738,480**

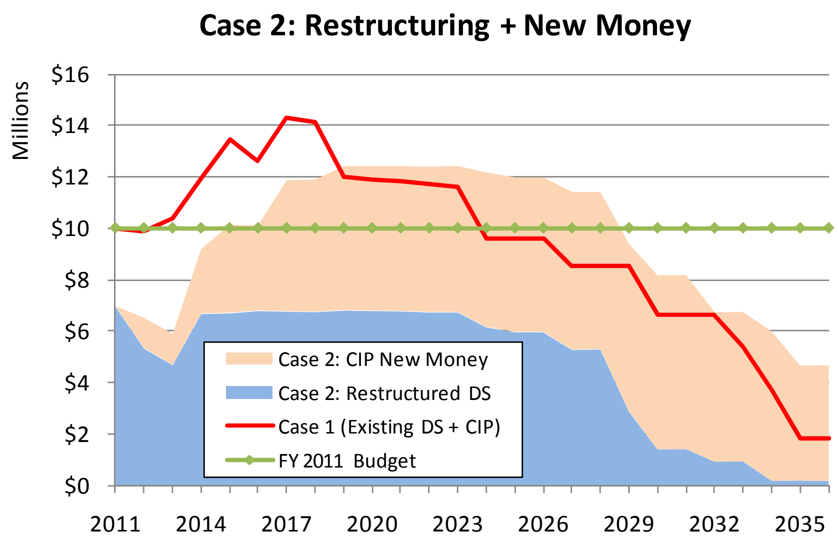
Case 2: Build America Bonds

- Build America Bonds (BABs):
  - Taxable Bonds – opens up new universe of buyers to municipal debt.
  - 35% interest subsidy paid by the US Government.
  - Any otherwise tax-exempt projects; refundings not eligible.
  - Available through public markets or bank financing.
  - Significant share of municipal market; have made tax-exempt rates more attractive.
  - No allocations – unlimited availability, although federal legislation may impose future limits.
  - Authorization currently set to expire at the end of calendar year 2010.

- BABs have the ability to save the City a material amount on future debt service payments.
  - Based on current market rates, BABs can save the City approximately <u>$6 million</u> in debt service on the assumed December 2010 issuance.
  - In Case 2 we have not assumed BABs will fund any other portion of the 5-Year CIP, as the ability to use them after calendar year 2010 is uncertain at present.

Case 2: Restructuring + New Money

- Taking advantage of a restructuring and slightly longer new money amortizations than the City has used in the past (which should be more in line with the economic life of the projects), the City is able to:
  - Create near-term cash flow relief ($19.3 million through FY18).
  - Reduce maximum annual debt service, inclusive of the CIP, from $14.3 million (Case 1) to $12.4 million (Case 2), which is nearly a $2 million reduction.
  - Push out the timing of the maximum annual debt service payment from FY17 (Case 1) to FY23 (Case 2).
- Case 2 includes additional cash flow strategies, such as Interest Only, BABs, and strategic principal structuring.

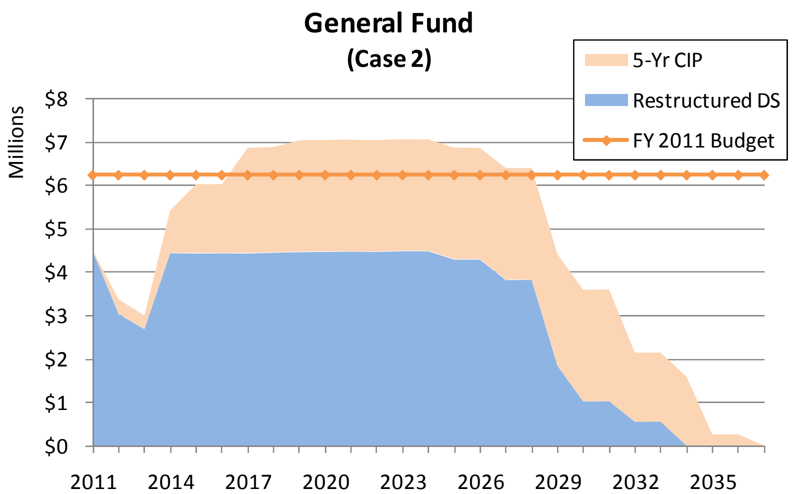


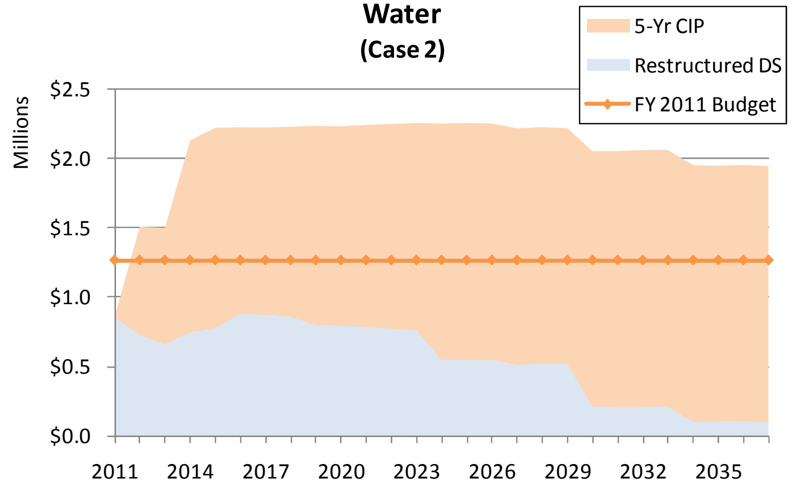
MADS:

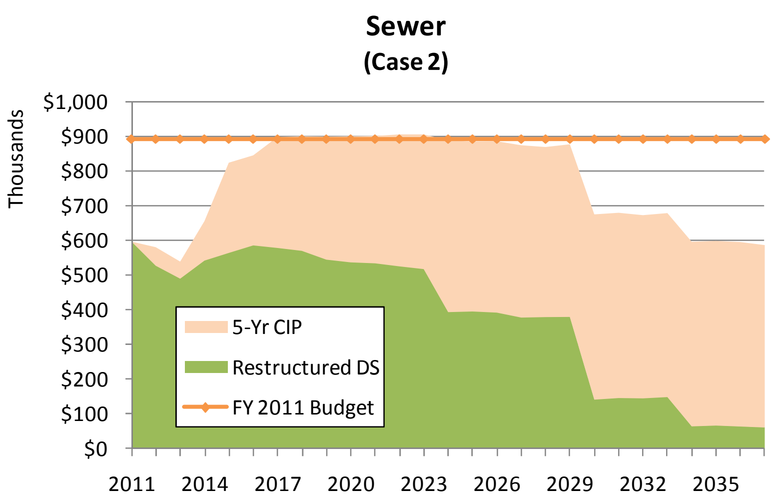
Case 1 (FY 17)
$14.3 million

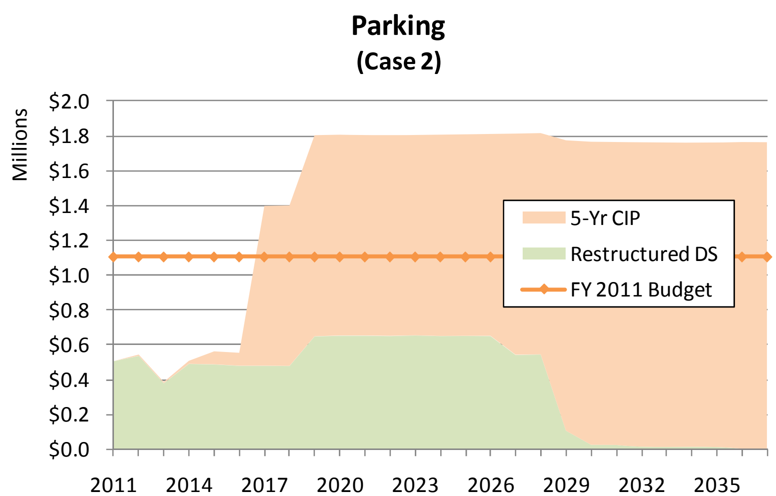
Case 2 (FY 23)
$12.4 million

Case 2: Restructuring + New Money (by Fund)









Case 2: Observations

- As shown in the tables below, the restructuring and strategic approach to new money borrowing provides the following immediate and medium term benefits:
  - General Fund reserve balances / working capital can be more quickly replenished;
  - Enterprise Fund cash flow requirements are reduced, thereby trimming the level of future rate increases; and
  - Enterprise Fund cash flow savings could be used to modestly reduce planned borrowing amounts.

	Restructuring - Savings By Fund (in mil $)				
FY	General	Water	Sewer	Parking	Total
2011	1.8	0.4	0.3	0.6	3.1
2012	3.1	0.5	0.3	0.6	4.5
2013	3.1	0.5	0.3	0.6	4.5
2014	1.3	0.4	0.3	0.4	2.4
2015	1.1	0.3	0.2	0.4	2.0
2016	0.7	-	-	0.4	1.1
2017	0.6	-	-	0.4	1.0
2018	0.4	-	-	0.3	0.7
Total	12.1	2.1	1.4	3.7	19.3

	Case 1	Case 2	Difference
MADS:			
General Fund	$7,680,000	$7,055,000	($625,000)
Water	3,110,000	2,260,000	(850,000)
Sewer	1,130,000	905,000	(225,000)
Parking	2,350,000	1,820,000	(530,000)

Case 1: Existing DS + CIP DS

Case 2: Restructured DS + CIP DS

Summary and Next Steps

- Davenport has worked with more than a dozen localities in Virginia and Maryland to restructure existing debt during this once in lifetime economic downturn.

- The continued weakness in the economy does not offer comfort regarding an improved revenue environment over the near term.

- Service cutbacks are increasingly hard to find in an effort to sustain balanced operations.

- The availability of Stimulus programs, coupled with a favorable construction cost picture, argues for moving ahead now, particularly in cases where a project is mandatory and must eventually be funded.

- Davenport recommends that the Working Group (the City, Davenport, Bond Counsel) move expeditiously to ready a bond sale through the following next steps:
  - Validate assumptions regarding restructuring candidates with Bond Counsel.
  - Update/Amend analysis as necessary in order to show additional cases, if desired by the City.
  - Present the updated analysis to the City's Finance Committee and answer any follow-up questions.
  - Prepare for a presentation to the Board of Alderman to garner approval for the bond sale.
  - Obtain necessary legal authorizations.
  - Update disclosure documents, including POS and Credit Presentation from 2009.
  - Target bond pricing in mid-November, with closing to occur early December.