City of Missoula Debt Management

Debt in a governmental entity is an effective financial management tool. Active debt management provides fiscal advantages to the City of Missoula and its citizens. Debt can serve several different purposes. It is useful in matching costs to benefits of public assets. It is useful as an economic development tool. It allows governments to build and acquire assets that would not otherwise be able to be built or acquired. Debt eliminates the need for governments to build up large reserve balances to build or acquire assets. In other words, debt is not something that should be avoided or eliminated. Rather, debt is something that should be used and managed effectively. Debt can be mismanaged, however. Over use of debt places a burden on the financial resources of the City and its taxpayers. Thus, it is important to create policies and follow practices to insure debt is used wisely.

Debt management is a critical component of the City of Missoula's financial operations. The City takes an active role in managing its debt. This is done through a variety of means including: debt management policies, bond ratings, comprehensive planning for future bond issues, and management of existing and proposed debt levels, and legal debt margins, and debt service payments. This section of the budget provides an analysis of each of these factors in addition to providing a detailed schedule of future debt service obligations of the City.

Major Bond Issues

Listed below is a brief description of the City's major outstanding bond issues, followed by a graphic overview of all outstanding debt of the City, by purpose.

A. 2012A Aquatics GO Refunding Bond - These bonds were refinanced in 2013. Originally issued in 2004 to construct the new aquatics facilities that were located at McCormick Park and Playfair Park as well as 4 splash decks around the city. The bonds were financed over 20 years. The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued. Interest rate varies from 1.5% to 2.25%.

TOTAL FUND DEBT SERVICE EXPENDITURES = $ 595,148

B. 2013 GO Refunding Bond – These bonds were issued on July 1, 2013 to provide funds for refunding the City's outstanding General Obligation Bonds, Series 2006 (partial advance refunding) and Series 2007 (full refunding). The bonds were financed over 20 years. The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued. The interest rate varies from 1.5% to 2.25%.

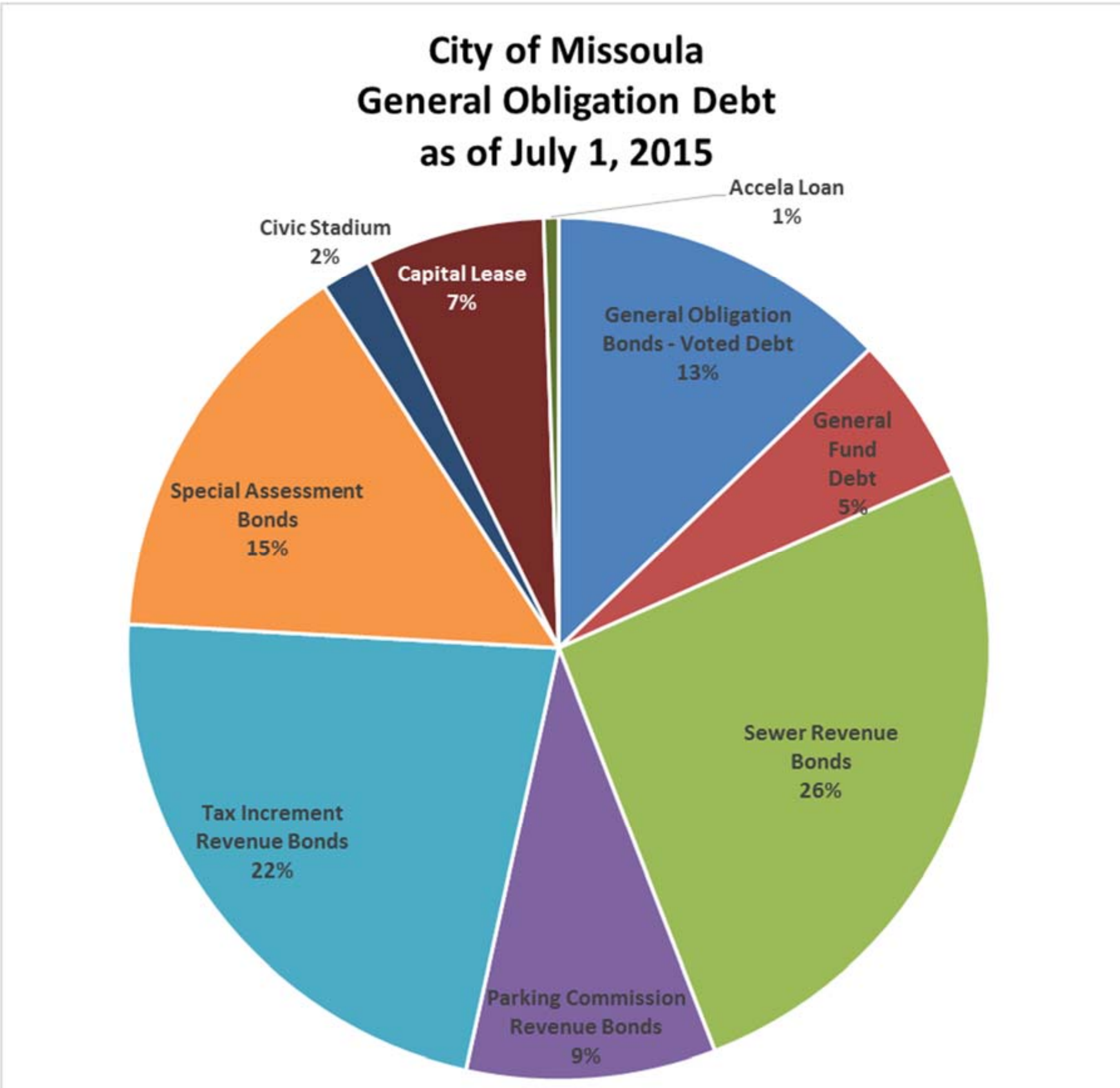
TOTAL FUND DEBT SERVICE EXPENDITURES = $ 688,926

C. 2006 Fire Station GO Bond – Voted. Issued in 2006 to provide funds for construction and equipping of new fire station #5 and remodel fire stations #2 and #3. The bonds were issued on September 13, 2006 with a true interest cost of 4.4169%.The bonds will be repaid with property tax revenue, specifically dedicated for that purpose. When the bonds have been repaid, the property tax levy will be discontinued. The majority of these bonds were partially advance refunded in 2013. The remaining outstanding balance of the bonds will mature in 2016.

TOTAL FUND DEBT SERVICE EXPENDITURES = $ 280,151

Outstanding Debt

Shown on the following page is a pie chart which presents the City's current outstanding indebtedness by purpose. As shown by the graph, voted General Obligation indebtedness (for open space acquisition, public safety and recreation facilities) represents a substantial component of the City's debt and this reflects the priorities of the public and the City Council. Despite the several categories of outstanding debt reflected below, the City of Missoula actually has a relatively low level of outstanding debt, which is more fully described below.



At the end of the current fiscal year, the City of Missoula had a total of $76,155,853 of long term debt outstanding of which $73,237,964 was bonded debt. Of this amount, $9,750,000 comprises debt backed by the full faith and credit of the government and $11,394,176 is special assessment debt for which the government is liable in the event of default by the property owners subject to the assessment, although this debt is collateralized with liens on the properties against which the debt is assessed. The majority of the remainder of the City of Missoula's bonded debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

CITY OF MISSOULA'S OUTSTANDING DEBT

	Governmental Activities		Business-type Activities		Total	
	2014	2015	2014	2015	2014	2015
General Obligation Bonds	$ 11,020,000	$ 9,750,000	$ -	$ -	$ 11,020,000	$ 9,750,000
Limited Obligation Bonds	4,575,000	4,210,000	-	-	4,575,000	4,210,000
Revenue Bonds	-	-	46,212,706	43,827,354	46,212,706	43,827,354
Sewer - Eko Compost Land	-	-	497,521	-	497,521	-
Spec. Assessment Bonds	12,738,346	11,394,176	-	-	12,738,346	11,394,176
Accela Loans & Notes Payable	534,747	427,513	1,465,398	1,430,114	2,000,145	1,857,627
Compensated Absences	4,490,263	4,832,041	345,585	326,536	4,835,848	5,158,577
Post Employment Benefits	1,614,558	1,924,244	169,753	199,381	1,784,311	2,123,625
Capital Lease	3,201,446	4,967,415	232,295	149,281	3,433,741	5,116,695
Total Outstanding Debt	$ 38,174,360	$ 37,505,388	$ 48,923,258	$ 45,932,666	$ 87,097,618	$ 83,438,054

The City of Missoula's total debt was decreased by $3,420,596 (3.7%) during the 2014 fiscal year, because more debt was paid off than new debt issued. The new debt issued included $2,153,420 of new capital equipment leases.

State statutes limit the amount of general obligation debt a governmental entity may issue to 2.5%of its total assessed valuation. The current debt limitation for the City of Missoula is $182,578,455, which is significantly in excess of the City of Missoula's outstanding general obligation debt. As of fiscal year end, the City of Missoula was only utilizing 5.3% of its legal, voted general obligation bond limit. In addition, the City was utilizing 15.2% of its legal debt limit for non-voted General Fund (limited obligation) debt.

Debt Capacity – Legal Debt Margin

The schedule below provides a visual presentation of the city's projected debt capacity (legal debt margin) with any proposed new debt within the current fiscal year included. This reflects the philosophy of the City Council in holding down the level of debt on the taxpayers, despite the city's rapid development and growing population.

VOTED GENERAL OBLIGATION BOND

Maximum Allowable Debt - City of Missoula, Montana

Assessed Valuation: FY 16 Certified Market Value	7,303,138,213	
Factor Allowed for Indebtedness	2.50%	
Total Indebtedness Allowed		$ 182,578,455
Less Current Indebtedness:		
2006 Fire Station Bonds	270,000	
2012A Aquatics Refunding	4,800,000	
2013A Refunding Bonds	4,680,000	
Intercap Equipment Loans	-	
Total Current Indebtedness		$ 9,750,000
Maximum Indebtedness Available (7-1-2015)		$ 172,828,455
Proposed Debt FY 16:	-	
Total Proposed Debt		$ -
Net Amount of Debt Available		**$ 172,828,455**

Proposed Debt in the Next Five Years

Listed below is a brief description of the city's proposed debt issuances, with the proposed debt amount, over the course of the next five year period. Following the narrative's description, is a graphic depiction of the City's current debt capacity and the proposed future debt will affect the remaining debt capacity for the City of Missoula. The graphic representation is a useful tool for the City Administration and City Council to utilize in reviewing and scheduling the timing of future projects that will result in a minimal tax increase to the citizens while providing needed infrastructure improvements.

A. $ 210,000 in Special Improvement District bonds for the Missoula Art Museum project. This assessment covers upgrading the curbs, sidewalks, drainage improvements, utilities and landscaping in part to meet current ADA standards and to create a public walk friendly block to be utilized for outdoor gatherings.

B. $1,400,000 combined in special improvement bonds for road and infrastructure improvements on increased use and aging right of way around Missoula. These future projects include reconstruction of: Old US Highway 93; Duncan/Greenough Drive; Lower Miller Creek Road; VanBuren Street; and Cregg Lane.

C. $1,600,000 in special improvement bonds for the Hillview Way project. The scope of this project is to widen the road with curbs, sidewalk and drainage improvements from Black Pine to 55th Street due to increased use and new development on either side of the road.

D. $1,800,000 per year of special curb, gutter, sidewalk, and alley approach bonds to address aging infrastructure in the city that directly benefits the adjacent, abutting landowners.

E. $1,000,000 - $2,500,000 per year of short term capital leases to replace aging vehicles, equipment and dated software.

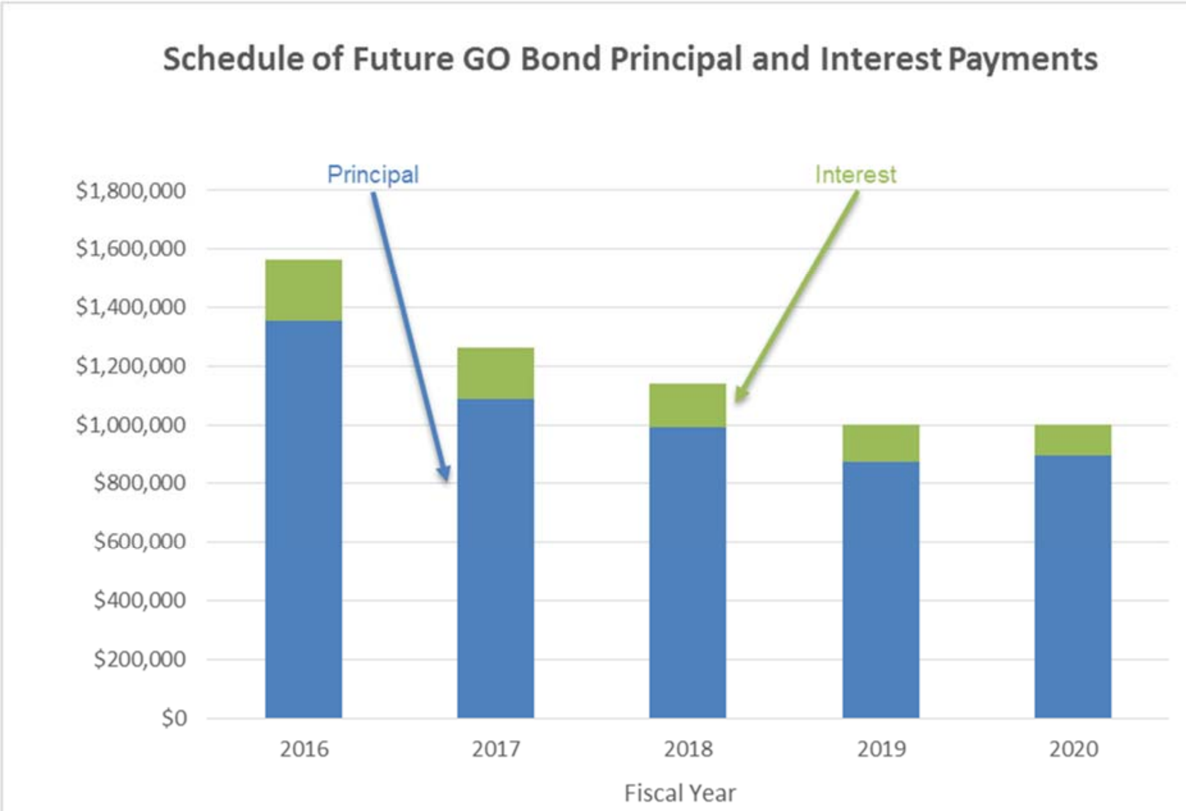
F. $1,600,000 of General Fund debt to increase storage space, update locker room and restroom to meet the needs of an expanding Police Department.

G. $2,200,000 of General Fund debt to provide energy efficient heating and cooling for all City buildings.

H. $6,000,000 of planned redevelopment agency projects providing infrastructure in blighted areas of the city.

Debt Service

The graph below shows the City's principal and interest payments in the current budget year and five years beyond. As shown by the graph, principal payments and interest payments decline in four of the next five years. This reflects the declining debt level as the result of the scheduled payments the City will be making.

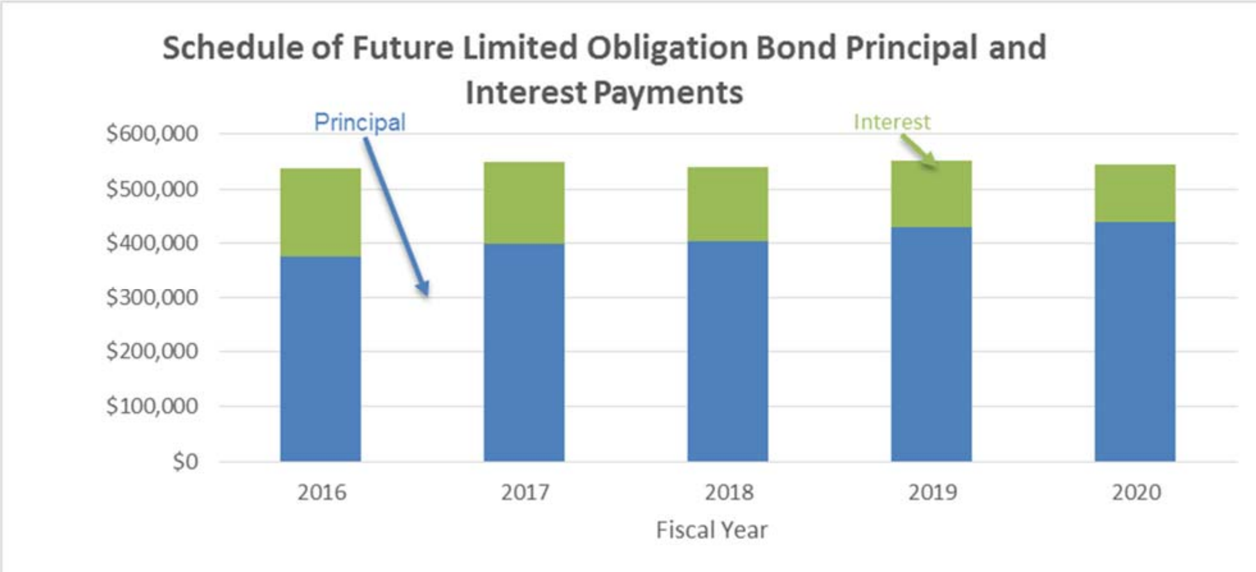


General Obligation Debt

Year	2016	2017	2018	2019	2020
Principal	$ 1,355,000	$ 1,090,000	$ 990,000	$ 875,000	$ 895,000
Interest	210,524	173,555	148,628	126,027	107,391
Total	**$ 1,565,524**	**$ 1,263,555**	**$ 1,138,628**	**$ 1,001,027**	**$ 1,002,391**

Most major debt obligations for the City are typically structured with declining interest payments and increasing principal payments—thereby resulting in relatively level debt service payments over the life of the bonds.

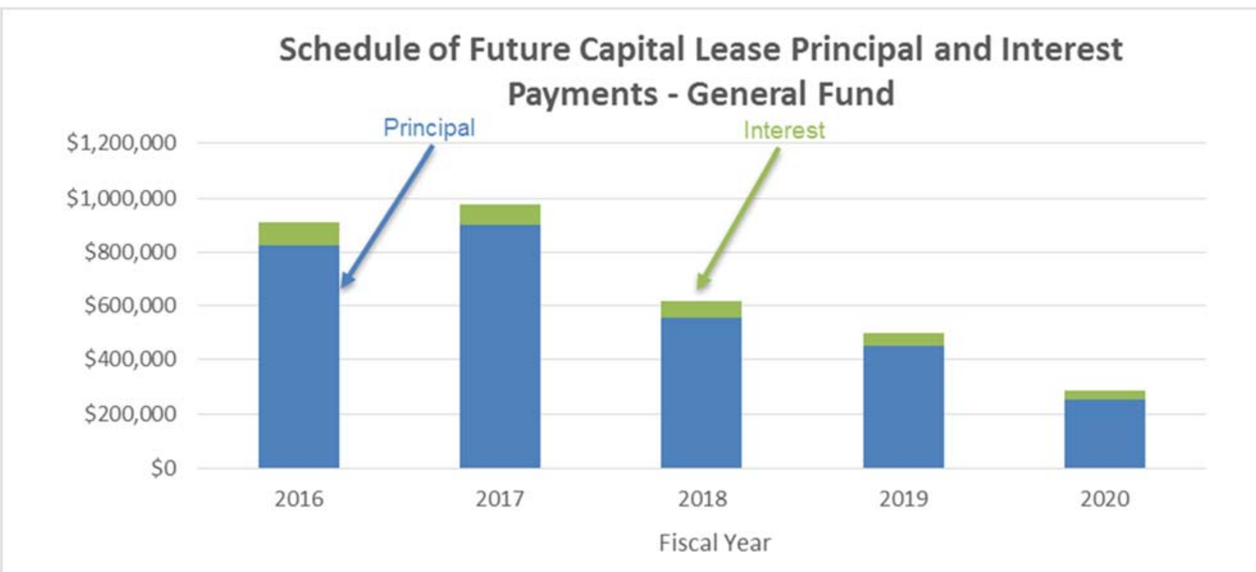
As can be seen from the graph above, the voted GO debt service requirements will decline by approximately $301,000 (2.71 mills) after FY 2016 due to the final maturity of a portion of the advance refunded 2006 GO Bonds, which will be paid off at that point. This will result in a 2% reduction in property tax requirements starting in FY 2017 due to a reduced GO bond debt service levy in that year.



Limited Obligation Debt

Year		2016		2017		2018		2019		2020
Principal	$	375,000	$	400,000	$	405,000	$	430,000	$	440,000
Interest		162,769		150,218		136,173		121,355		105,320
Total	$	537,769	$	550,218	$	541,173	$	551,355	$	545,320

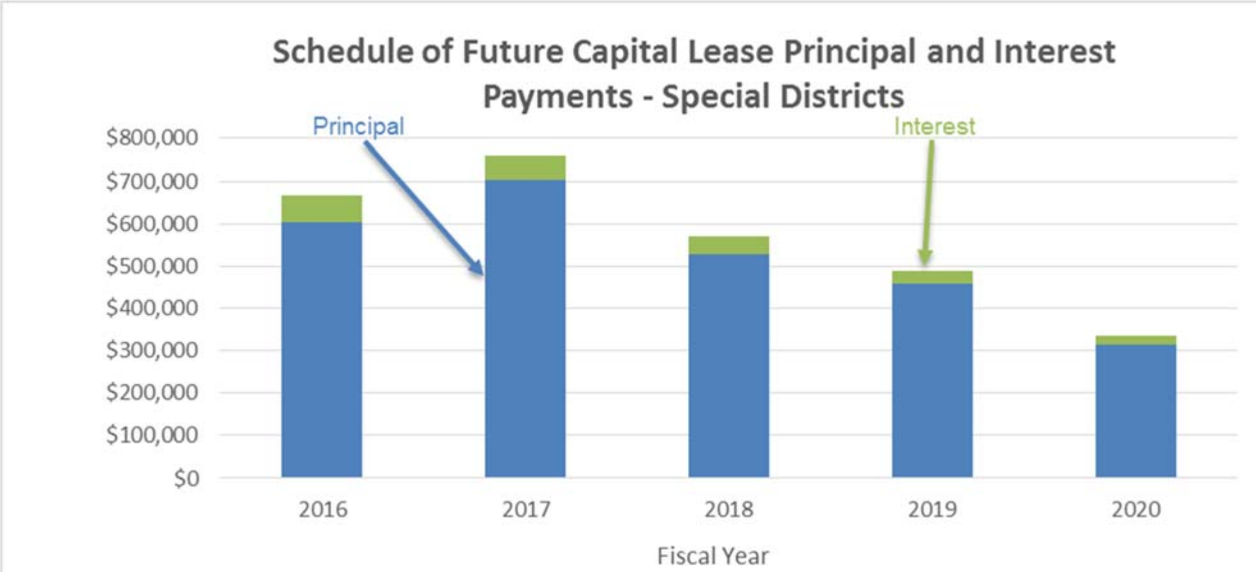
As can be seen in the table above, the General Fund's limited obligation debt service requirements will remain fairly constant over the next five years.



Capital Lease - General Fund

Year		2016		2017		2018		2019		2020
Principal	$	823,535	$	902,467	$	556,033	$	453,572	$	250,651
Interest		85,299		74,538		58,534		45,310		34,609
Total	$	908,833	$	977,005	$	614,567	$	498,882	$	285,260

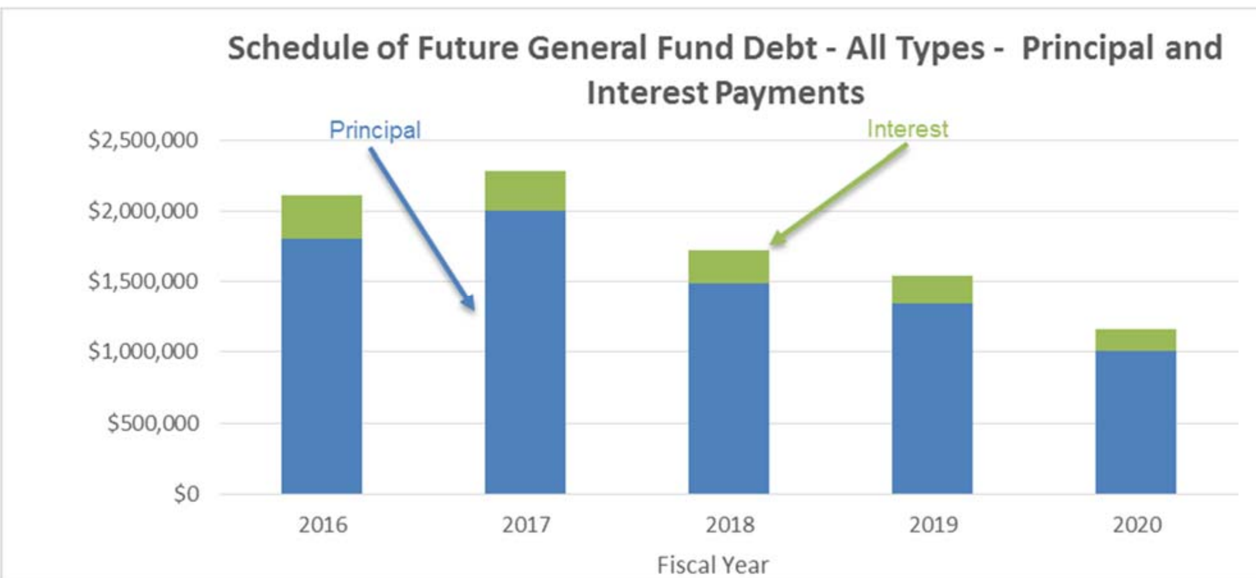
The graph and table above illustrate the declining impact of future capital lease payment on the General Fund after FY 2017.



Capital Lease - Special Districts

Year	2016	2017	2018	2019	2020
Principal	$ 605,002	$ 702,346	$ 526,967	$ 458,390	$ 313,019
Interest	61,813	57,622	44,077	31,926	21,111
Total	$ 666,815	$ 759,968	$ 571,044	$ 490,316	$ 334,131

The graph and table above illustrate the declining impact of future capital lease payment on the Special Districts after FY 2017.



Total General Fund Debt - All Types

Year	2016	2017	2018	2019	2020
Principal	$ 1,803,537	$ 2,004,813	$ 1,488,000	$ 1,341,963	$ 1,003,670
Interest	309,880	282,377	238,784	198,590	161,040
Total	**$ 2,113,418**	**$ 2,287,190**	**$ 1,726,783**	**$ 1,540,553**	**$ 1,164,710**

When all of the various types of General Fund indebtedness are combined into one graph and table, as seen above, it is apparent that after FY 2017, each future year has a smaller debt service requirement than the preceding year. This fact, combined with reduced GO bond debt requirements after FY 2016, will eventually free up in excess of $850,000 per year of tax supported projects. This information will be utilized as future budgets and capital financing needs must be addressed. All of these various financing mechanisms are used to pay for the cost of city infrastructure over time, as the benefit provided by maintaining our infrastructure is realized over time. This approach matches future costs with future benefits to be received.

Bond Rating

Bond ratings reflect the relative strength of the city's financial management and planning capabilities and the quality of its elected and administrative leadership, as well as its wealth and social characteristics. Bond ratings serve as a statement of a locality's economic, financial and managerial condition and represent the business community's assessment of the investment quality of a local government. Highly rated bonds are more attractive and are more competitive in the market and thereby help lower interest costs paid by City residents. High-grade ratings reduce the cost of raising capital for City projects and a substantial savings for the City taxpayers.

The City of Missoula continues to seek ways to improve and maintain these ratings so as to provide the finest quality services and lowest cost. Concentrated efforts have been made to maintain and improve the City's "high-grade" ratings for its general obligation bonds through innovations in financial and debt administration. In May of 2014, Standard and Poor's of New York increased the assigned rating from AA- to AA+ for all of the City's outstanding voted GO debt. This rating upgrade was based on the City's continued economic expansion and management's maintenance of good reserve levels, very strong management at the City, strong liquidity, strong budget flexibility and performance, strong debt and contingent liabilities, and a strong and adequate institutional framework along with an ongoing stable outlook for the city.

STANDARD & POOR'S PUBLIC FINANCE

AA+

The City of Missoula's "AA+" Bond Rating saves city residents thousands of dollars annually.

Quoted below are excerpts from the Standard & Poor's May 22, 2014 rating upgrade.

Credit Profile		
Missoula Gen Fund Oblig Bnds		
Long Term Rating	AA/Stable	Upgraded

Ratings Detail (As Of May 22, 2014)		
Missoula Gen Fund Oblig Rfdg Bnds ser 2010A		
Long Term Rating	AA/Stable	Upgraded
Missoula GO rfdg bnds		
Long Term Rating	AA+/Stable	Upgraded
Missoula Ltd Tax GO Bnds		
Long Term Rating	AA/Stable	Upgraded
Missoula GO		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded
Missoula GO (CIFG)		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) on Missoula, Mont.'s unlimited-tax general obligation (GO) bonds to 'AA+' from 'AA-', based on its local GO criteria released Sept. 12, 2013. At the same time, we raised our long-term rating on the City's previously issued general fund GO bonds to 'AA' from 'A+'. The outlook is stable.

An unlimited ad valorem property tax pledge secures the GO bonds. Lease payments from Missoula secure the city's limited-tax general fund bonds.

The ratings reflect the following factors for the City, specifically its:

Strong economy

Missoula is in Missoula County and is the state's second-largest city, with a population estimate of 68,000. It serves as a regional trade and service center for an 11-county area with a population estimate of more than 350,000 in western Montana. The area economy has ties to health care, retail, and tourism-related activities. The city's local economy is, in our opinion, strong, supported by a broad and diverse economy and is home to the University of Montana. The economy has what we consider adequate income indicators: Per capita phased-in market value and projected per capita effective buying income are roughly $101,600 and 88% of the national average, respectively. The county unemployment rate (2013) was 5.3%, according to the Bureau of Labor Statistics.

Very strong management

We believe Missoula's management conditions are very strong with "strong" financial practices under our Financial Management Assessment methodology, indicating practices are strong, well embedded, and likely sustainable. Key items include the monthly reporting of the city's financial position and investment performance to the governing body with procedures for budget adjustments in place if needed; management typically performs adjustments just once a year. Missoula has a comprehensive five-year capital improvement plan with identified funding sources, which it updates annually; the plan is linked to the operating budget via a five-year financial plan that management uses for internal planning purposes. Management updates the financial master plan during its annual budget process with identified possible out-year expenditure pressure. Officials have recently adopted formal ongoing debt management policies that include specific target debt level guidelines for various types of city-issued debt, as well as refunding targets and the use of derivatives, which the state is not allowed to use. The city also recently adopted a formal unreserved fund balance policy equal to 7% of general fund budgeted expenditures.

Strong budgetary flexibility

We believe Missoula's budgetary flexibility is strong, with available reserves at 10.7% of operating expenditures in fiscal 2013, equivalent to about $4.7 million. Budgeted numbers indicate balance and therefore we don't anticipate a major draw on the city's reserves.

Very strong liquidity

We believe very strong liquidity supports city's finances, with total government available cash to government fund expenditures and cash to debt service above 15% and 120%, respectively. Based on past issuance of debt, we believe that the issuer has strong access to capital markets to provide for liquidity needs if necessary. Initial numbers for 2014 indicate a balanced budget and therefore we don't anticipate a major change in the city's overall cash position. However, should cash fall slightly, we still view the city's access to external markets as strong, which would keep the city's overall liquidity assessment as very strong.

Strong budgetary performance

In our opinion, Missoula's budgetary performance is strong overall, with a surplus of 3.1% for the general fund and basically balanced results for the total governmental funds in fiscal 2013. Budget numbers indicate a close-to-balanced general fund. There are no projections for total governmental funds. Historically, total governmental funds have been either close to balanced or run small deficits. The budgetary performance results for 2014 are currently ambiguous, but we do not anticipate a substantial weakening in either fund.

Strong debt and contingent liabilities

We feel Missoula's debt and contingent liabilities profile is strong. Initially, the debt profile is adequate with about 9% of carrying charge and net direct debt 50% of revenue. The city also anticipates issuing additional debt in the medium term. However, offsetting an increase in the debt burden is rapid amortization with more than 65% of debt amortized in 10 years and a low overall debt level at less than 3% of market value. Missoula participates in the state's pension program, and it has contributed the annual required contribution payments each year, The city's 2013 contribution represented 5% of total governmental expenditures.

Adequate institutional framework

We consider the Institutional Framework score for Montana municipalities strong.

Outlook

The stable outlook reflects our opinion of Missoula's very strong financial flexibility, supported by strong financial performance and very strong liquidity. In our opinion, the city's very strong management provides additional stability to the rating.

Investment Policy

The investment of capital funds is incorporated into the City’s cash management program. All unexpended bond proceeds are deposited into a consolidated treasurer’s account and invested with other funds in order to obtain maximum earnings. The segregation of each project’s equity is preserved and reported separately.

Interest earned on capital funds during the construction period is credited to the respective project’s fund or enterprise fund wherein the debt service is paid.

Management of Debt and Equity Funding of Capital Needs

An integral part of the City's financial strength has been to aggressively take advantage of the marketplace and refund outstanding debt, thereby reducing interest expense while using excess surpluses wisely to equity fund (pay with cash) capital project expenses and to fund depreciation of capital assets. This actively managed debt program allow us to pass along savings from the refunding of outstanding debt along to the taxpayers through reductions in the tax rates.

[redacted]

Debt Management Policies

The City of Missoula has developed a set of financial management policies that cover all aspects of its financial operations. Policies on debt management are one component of those financial policies. All of the City's financial management policies on included in the Executive Summary. Listed below are excerpts from those policies, which relate specifically to debt management.

Restrictions on Debt Issuance

1) **Repayment of Borrowed Funds.** The city will repay borrowed funds, used for capital projects, within a period not to exceed the expected useful life of the project. This policy reflects the view that those residents who benefit from a project should pay for the project. Adherence to this policy will also help prevent the government from over-extending itself with regard to the incurrence of future debt.

Limitations on Outstanding Debt

1) **Reliance on Long-Term Debt.** The City will limit long-term debt to capital improvements which cannot be financed from current revenues. Incurring long-term debt serves to obligate future taxpayers. Excess reliance on long-term debt can cause debt levels to reach or exceed the government's ability to pay. Therefore, conscientious use of long-term debt will provide assurance that future residents will be able service the debt obligations left by former residents.

2) **Debt Not Used for Current Operations.** The city will not use long-term debt for financing current operations. This policy reflects the view that those residents who benefit from a service should pay for the service. Utilization of long-term debt to support current operations would result in future residents supporting services provided to current residents.

Debt Refinancing

1) **General Refinancing Guidelines.** Periodic reviews of all outstanding debt will be undertaken to determine refinancing opportunities. Refinancing's will be considered (within federal tax law constraints) under the following conditions:

- There is a net economic benefit.
- It is needed to modernize covenants that are adversely affecting the City's financial position or operations.
- The City wants to reduce the principal outstanding in order to achieve future working capital to do so from other sources.

2) **Standards for Economic Savings.** The federal government has placed significant conditions on the tax-exempt refunding of outstanding issues. Refunding's have two general categories:

   - Current refunding's, where the refunding bonds are settled within 90 days of an optional prepayment date; and
   - Advance refunding's, where refunding's are settled more than 90 days in advance of an optional prepayment date. The federal restrictions are that any issue can only be advance refunded once on a tax-exempt basis.

On advance refunding's the City will seek to obtain a minimum present value savings level of 3% of the present value of refunded debt service. State law requires a demonstration of savings of 0.5% reduction in the average coupon interest rate between the refunding and refunded bonds.

The complete debt management policy for the City of Missoula can be found in the appendix to this budget document.