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, management of existing and proposed debt levels, 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. **Aquatics Bond 2004A – Voted.** This bond issue was approved by the voters on November 4, 2003 in the original principal amount of $8,100,000 for the purpose of replacing existing aquatic facilities and spray decks around located throughout the City of Missoula. The bonds were issued on May 24, 2004 with a true interest cost of 4.2339%. 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 City received an A rating on these bonds from Standard & Poors. The purchaser of the bonds chose to have the bonds insured with an AAA rating from Standard and Poors.

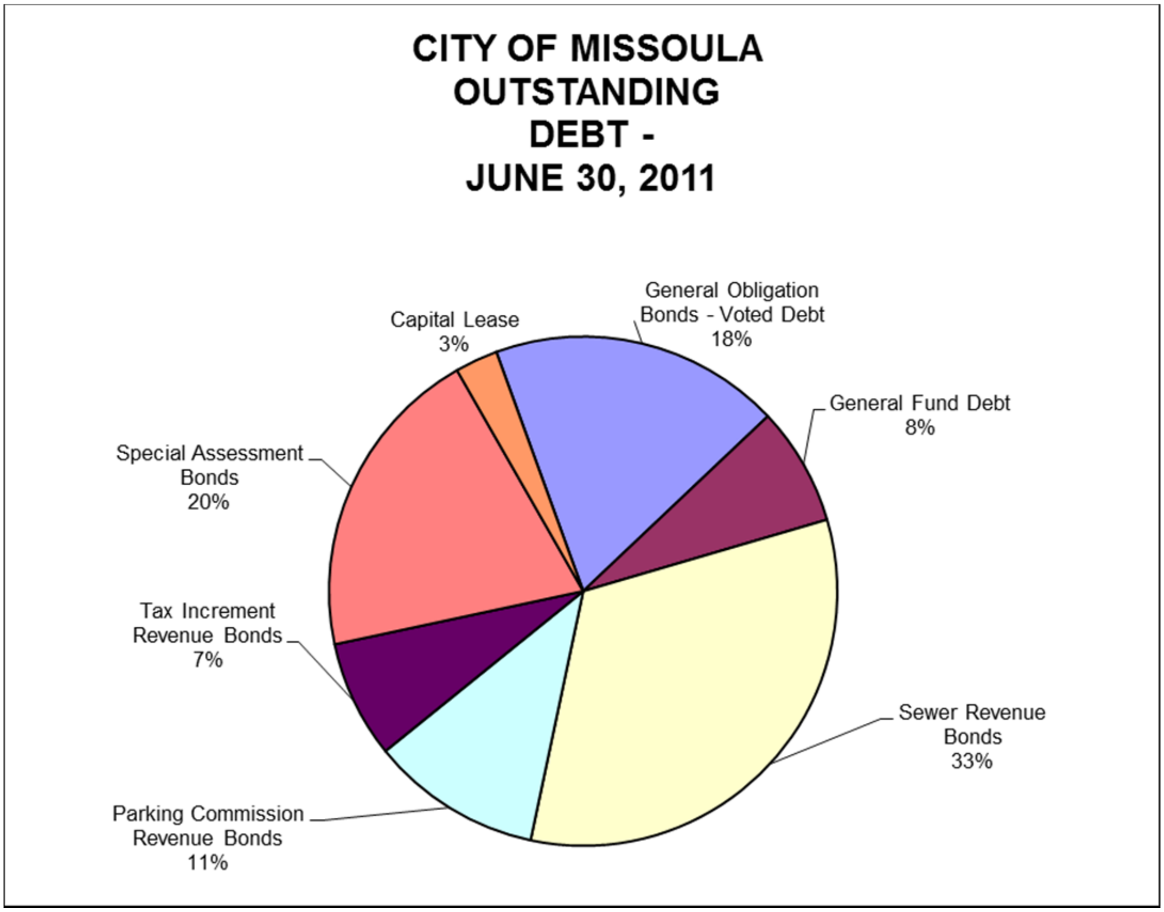
B. **Refunding Bond 2004B – Voted.** This bond issue was refinanced on June 29, 2004 for the purpose of reducing interest costs associated with bonds issued in 1993 and 1994 resulting from bond elections in 1992 and 1988, both of which were for fire station construction projects while the 1992 referendum also included funds for the expansion of City Hall. The bonds were issued on June 29, 2004 with a true interest cost of 3.5427%. The bonds were financed over the remaining term of the original 20 years for each series refunded. 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 City received an A rating on these bonds from Standard & Poors. The purchaser of the bonds chose to have the bonds insured with an AAA rating from Standard and Poors.

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.

D. **Refunding Bond Series 2007A GO Bond Open - Voted.** This bond issue was refinanced on February 1, 2007 for the purpose of reducing interest costs associated with bonds issued in 1996, 1997 and 1998 resulting from bond elections in 1995 and 1997, of which the 1995 bond election was for the purchase of open space and the 1997 bond election was for fire and police equipment purchases. The bonds were issued on February 1, 2007 with a true interest cost of 3.7527%. The bonds were financed over the remaining term of the original 20 years for each series refunded. 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.

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, 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 $78,984,434 of long term debt outstanding of which $72,776,530 was bonded debt. Of this amount, $13,840,000 comprises debt backed by the full faith and credit of the government and $15,021,055 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	
	2010	2011	2010	2011	2010	2011
General Obligation Bonds	$ 15,065,000	$ 13,840,000	$ -	$ -	$ 15,065,000	$ 13,840,000
Tax Anticipation Note	-	-	-	-	-	-
Limited Obligation Bonds	4,935,000	5,625,000	-	-	4,935,000	5,625,000
Revenue Bonds	-	-	20,527,410	38,290,475	20,527,410	38,290,475
Spec. Assessment Bonds	14,250,241	15,021,055	-	-	14,250,241	15,021,055
Sidewalk & Curb Warrants	-	-	-	-	-	-
State Board of Investment Loans	159,063	125,646	-	-	159,063	125,646
Compensated Absences	3,586,736	3,754,795	238,364	# 296,461	3,825,100	4,051,256
Capital Lease	1,378,125	2,031,002			1,378,125	2,031,002
Total Outstanding Debt	$ 39,374,165	$ 40,397,498	$ 20,765,774	$ 38,586,936	$ 60,139,939	$ 78,984,434

The City of Missoula's total debt was increased by $18,844,495 (31.3 percent) during the 2011 fiscal year, because $24,681,684 of new debt was issued this last year, which included $1,010,000 of Limited Obligation Debt, $12,207,098 of Sewer revenue bonds, $2,479,586 of Special Assessment bonds, $8,135,00 of Parking Commission revenue bonds and $850,000 of new capital equipment leases. Total principal reductions in outstanding debt totaled $5,998,346. FY 2011 was a year in which the culmination of many pending capital projects was accomplished.

State statutes limit the amount of general obligation debt a governmental entity may issue to 2.5 percent of its total assessed valuation. The current debt limitation for the City of Missoula is $103,517,132, 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 13.5% of its legal, voted general obligation bond limit. In addition, the City was utilizing 58% of its legal debt limit for non-voted General Fund (limited obligation) debt.

Proposed Debt in the Next Five Years

Listed below is a brief description of the city's proposed debt issuances over the course of the next five year period. Following the narrative's description, is a graphic depiction of the relative effects of these proposed debt issuances in relation to the city's current debt and its remaining debt capacity.

A. $1,000,000 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.

B. $500,000 per year of short term capital leases to replace aging equipment.

Debt Capacity – Legal Debt Margin

The schedule below shows a graphic presentation of the city's projected debt capacity (legal debt margin) with any proposed new debt 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.

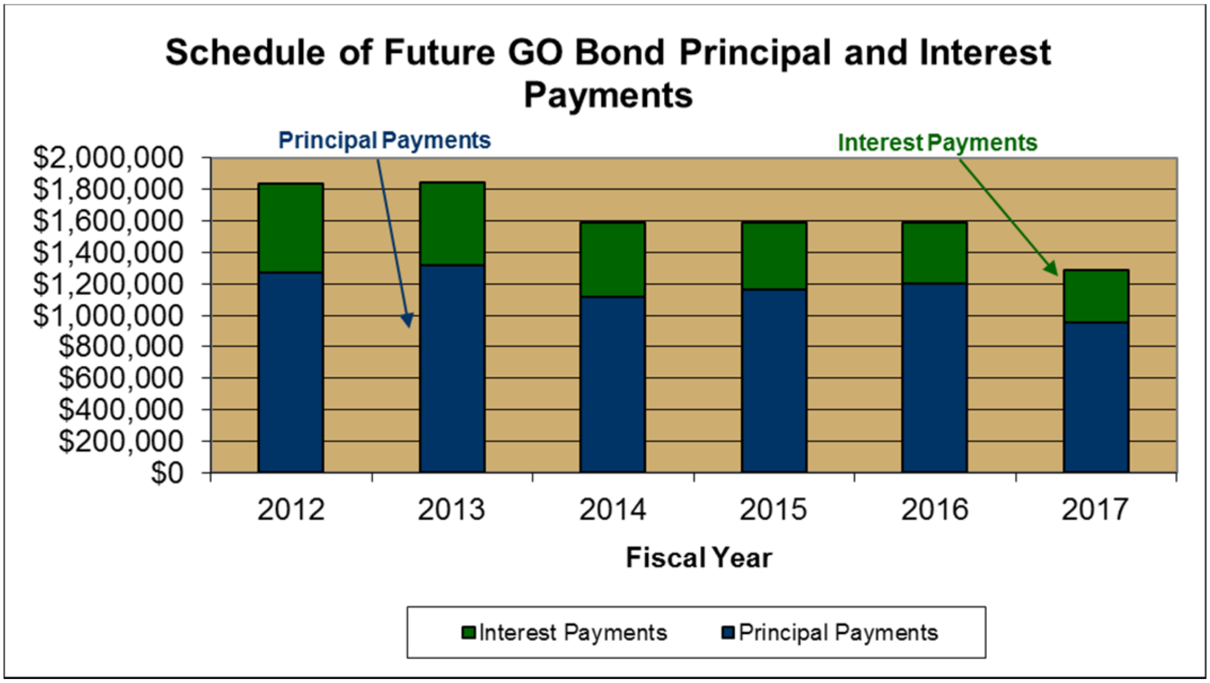
VOTED GENERAL OBLIGATION BOND

Maximum Allowable Debt - City of Missoula, Montana

Assessed Valuation: FY 12 Certified Market Value	4,140,685,284		
Factor Allowed for Indebtedness	2.50%		
Total Indebtedness Allowed		$	103,517,132
Less Current Indebtedness:			
2004A Aquatics G.O. Bond	5,855,000		
2004B Refunding - Fire - G.O.Bond	490,000		
2006 Fire Station	4,710,000		
2007 Refunding	2,785,000		
Intercap Equipment Loans	129,002		
Total Current Indebtedness		$	13,969,002
Maximum Indebtedness Available (7-1-2010)		$	89,548,130
Proposed Debt FY 12:			
	-		
	-		
	-		
	-		
	-		
Total Proposed Debt		$	-
Net Amount of Debt Available		**$**	**89,548,130**

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 are increasing for two more years and then decline as do the interest payments. This reflects the declining debt level as the result of the scheduled payments the city will be making.

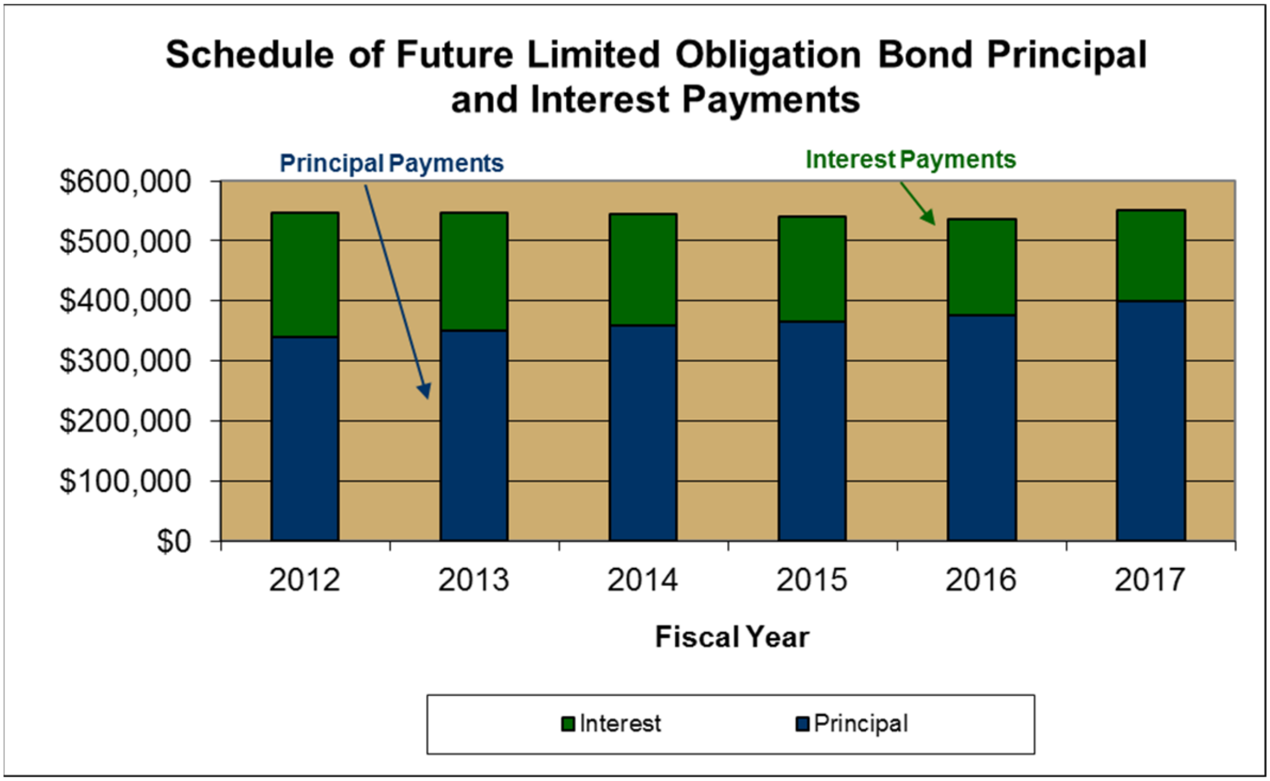


General Obligation Debt

Year	2012	2013	2014	2015	2016	2017
Principal	$ 1,270,000	$ 1,320,000	$ 1,115,000	$ 1,160,000	$ 1,205,000	$ 950,000
Interest	569,748	521,133	470,433	427,753	382,470	334,758
Total	**$ 1,839,748**	**$ 1,841,133**	**$ 1,585,433**	**$ 1,587,753**	**$ 1,587,470**	**$ 1,284,758**

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.

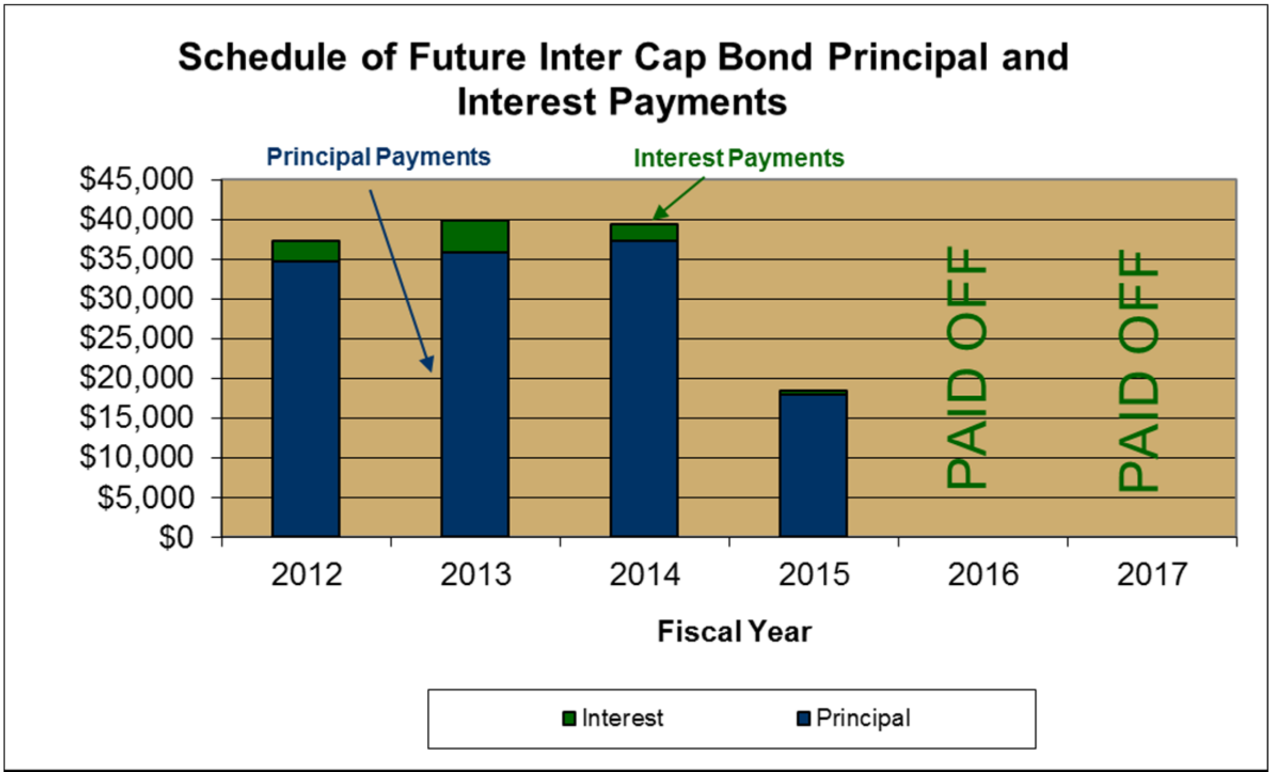
As can be seen from the graph above, the voted GO debt service requirements will decline by approximately $255,000 per year (2.4 mills) after FY 2013 due to the final maturity of the 2004 Refunding Bonds, which will be paid off at that point. This will result in a 1% reduction in property tax requirements starting in FY 2014 due to a reduced GO bond debt service levy in that year.



Limited Obligation Debt

Year	2012	2013	2014	2015	2016	2017
Principal	$ 340,000	$ 350,000	$ 360,000	$ 365,000	$ 375,000	$ 400,000
Interest	206,816	195,795	185,335	174,283	161,109	150,218
Total	546,816	545,795	545,335	539,283	536,109	550,218

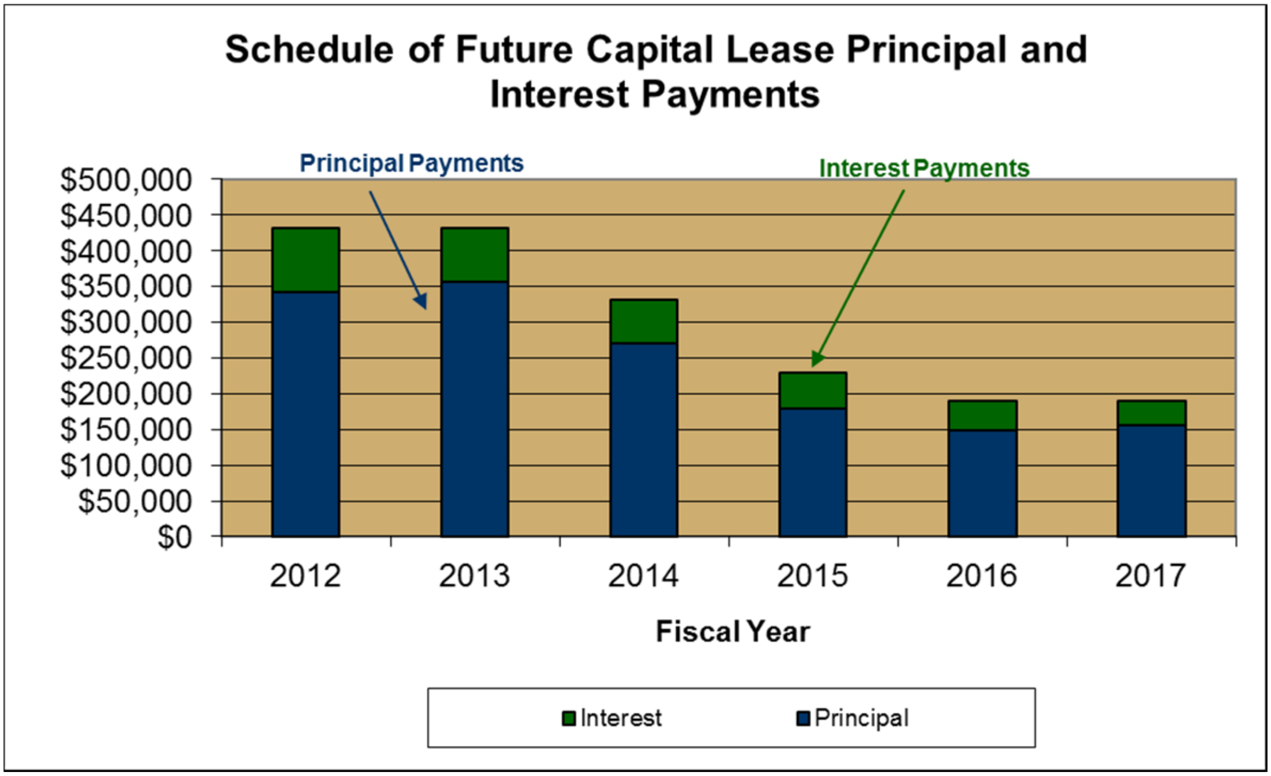
As can be seen in the table above, the General Fund's limited obligation debt service requirements will remain fairly constant over the next five years.



Inter Cap Debt

Year	2012	2013	2014	2015	2016	2017
Principal	34,631	35,888	37,194	17,933	Paid Off	Paid Off
Interest	2,592	3,901	2,180	426	Paid Off	Paid Off
Total	37,223	39,789	39,374	18,359	Paid Off	Paid Off

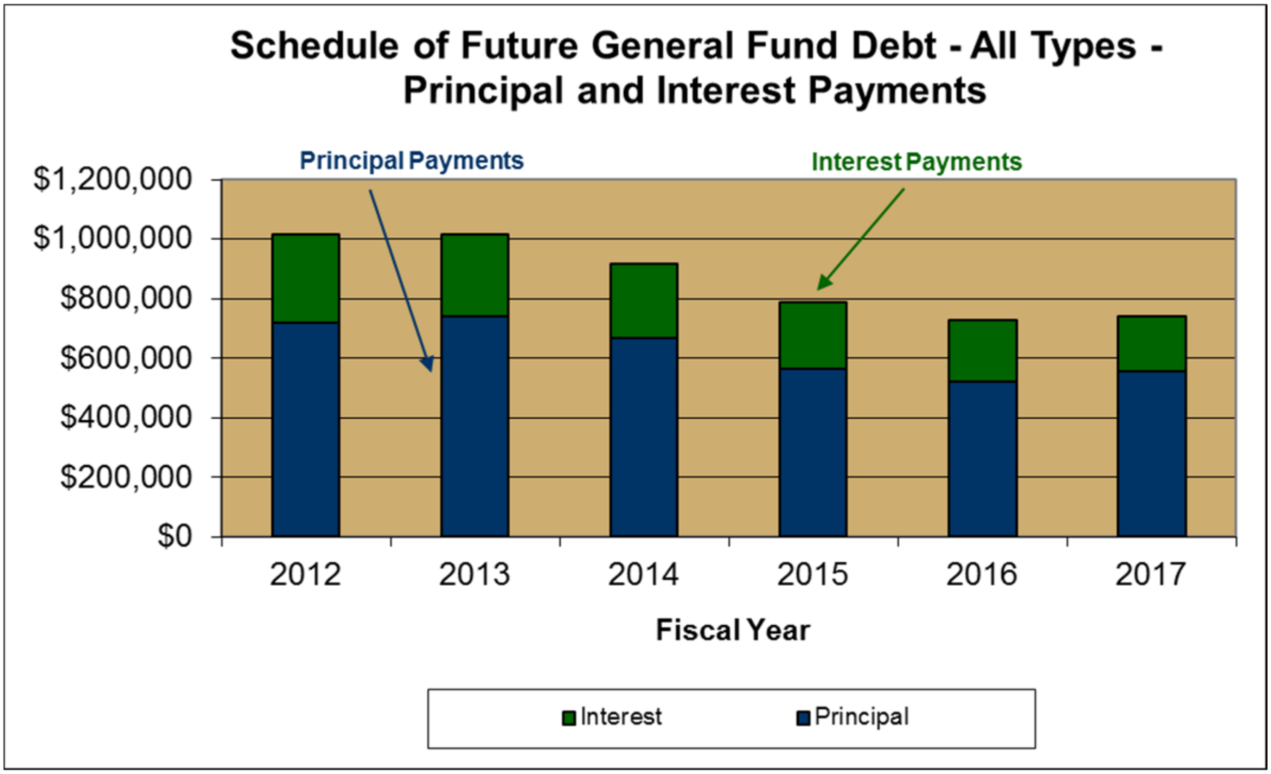
The General Fund has 3.5 years left of modest debt service payments for the a fire engine financed through the State of Montana's Inter-cap lending program.



Capital Lease

Year	2012	2013	2014	2015	2016	2017
Principal	342,232	355,848	270,056	179,538	148,106	155,145
Interest	89,146	75,530	61,362	50,115	41,973	34,934
Total	431,378	431,378	331,418	229,653	190,079	190,079

The graph and table above illustrate the declining impact of future capital lease payment on the General Fund after FY 2013.



Total General Fund Debt - All Types

Year	2012	2013	2014	2015	2016	2017
Principal	716,863	741,736	667,250	562,471	523,106	555,145
Interest	298,554	275,226	248,877	224,824	203,082	185,152
Total	$ 1,015,417	$ 1,016,962	$ 916,127	$ 787,295	$ 726,188	$ 740,297

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 2013, each future year has a smaller debt service requirement than the preceding year. This fact, combined with reduced GO bond debt requirements after FY 2013, will eventually free up $350,000 to $440,000 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 April 2008, Standard and Poor's of New York assigned an AA- rating to all of the city's outstanding voted GO debt, which formerly had an A rating. This rating upgrade was based on the city's continued economic expansion and management's maintenance of good reserve levels.

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 14, 2010 rating affirmation.

Missoula GO		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Standard & Poor's Ratings Services assigned its 'AA-' standard long-term rating, and stable outlook, to all of the City of Missoula's outstanding voted GO debt.

The ratings reflect our view of the city's:

- *Diverse local economy, anchored by the University of Montana, which serves as a regional services, health care, and retail hub for the surrounding communities;*
- *The city's gradually expanding property tax base due to a low cost of living and an educated labor force as compared with the rest of the region;*
- *Additional liquidity of $3.7 million, or 9% of expenditures, as of April 2010 outside the general fund available for general fund purposes of, which helps to bolster the city's low general fund reserve position;*
- *Historically below-average and relatively more stable unemployment levels, with the city's unemployment rate as of March 2010 at 7.7% versus 9.7% for the U.S.; and*
- *Low overall debt burden with no GO or general-fund-related debt issuance plans.*

Outlook

The stable outlook reflects our expectation that the local economy's diversity and steady growth will continue, especially given the presence of the university. The stable outlook also reflects our expectation that the city will make the budget adjustments it deems necessary to improve reserves from levels deemed only marginally adequate for the rating. Additional stabilizing factors for the rating are the city's low debt burden and lack of additional general-fund-related or GO bonding plans, which should allow for a continuing low debt service carrying charge.

The City's high ratings are an objective indication of sound financial management, recognition that its overall debt profile is characterized by good debt service coverage from pledged revenues and by sound legal provisions ensuring full and timely payment of its debt service obligations. Overall net debt is very low at $851 per capita, or 1.9% of estimated true property value.

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.

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. Refundings have two general categories:

- Current refundings, where the refunding bonds are settled within 90 days of an optional prepayment date; and
- Advance refundings, where refundings 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 refundings 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.