Bond Case Briefs

Municipal Finance Law Since 1971

Key COVID-19 Response Strategies for Development Finance Agencies.

— Bonds, Tax Increment Finance, Revolving Loan Funds —

Development finance has always been at the forefront of recovering from natural disasters and economic challenges. The emergence of the COVID-19 crisis requires a unique and targeted response by the federal government, state and local development finance agencies (DFAs), private banks, and philanthropy.

As the situation surrounding COVID-19 evolves, small businesses and communities across the country are very quickly facing liquidity challenges, job losses, and project stagnation. Credit is tightening and small businesses are struggling to make payroll while communities have been forced to scale back or halt development. Moreover, communities are facing difficulties financing critical infrastructure such as health facilities, broadband networks, and testing centers to address local COVID-19 demands.

DFAs are uniquely positioned to solve these challenges through pragmatic solutions and adjustments to existing initiatives. CDFA understands that DFAs are under considerable stress and pressure to address these immediate challenges while being mindful of the long-term financial health of their organizations and communities. The following set of strategies and recommendations is designed to help DFAs evaluate their portfolios and determine whether modifications are needed for their bonds, tax increment finance, and revolving loan fund programs.

Bond Portfolios

DFAs operate extensive bond portfolios of both recourse and nonrecourse bond issuances. During this crisis, DFAs will face significant pressure to maintain their bond ratings and ensure timely debt service payments for all outstanding bond issuances. DFAs should consider the following:

Outstanding Recourse Bonds – For bonds that are the obligation of the issuer, DFAs should take immediate stock of current debt service payment expectations and prepare the necessary actions to ensure that existing payments are made in a timely fashion. As these are generally general obligation bonds, communities must be prepared to assemble the necessary capital needed to make all existing payments on time to prevent delays and/or defaults. DFAs may want to consult with their financial advisors on options available for refinancing outstanding debt given the low-interest rate environment being afforded by the capital markets and federal relief efforts. Issuers should note that the stimulus package provides that the Federal Reserve may now purchase municipal bonds. The opportunity to refinance debt and issue new bonds remains strong.

Outstanding Non-Recourse Conduit Bonds – While these debt obligations are not generally the responsibility of the DFA directly, CDFA encourages agencies to be in direct contact with their current conduit bond borrowers. Assess the immediate ability for borrowers to make debt service payments and begin the process of workouts and adjustments if necessary. DFAs do not have direct responsibility for these payments but should be leery of reputational risk associated with potential defaults on issuances. Reputational risk can carry long-lasting consequences for issuers once returning to the capital markets on future issuances.

New Deals in Pipeline – CDFA encourages DFAs to continue to work on new issuances of both recourse and nonrecourse bond deals. The capital markets and federal relief efforts are providing significantly low rates and continuing to encourage investments. As noted earlier, the Federal Reserve may now purchase municipal bonds. This stimulus action does not apply to private activity bonds, but the environment for privately-placed PABs should be favorable. Do not halt new deals. Simply work within the parameters of new capital markets realities and prepare issuances with an eye towards recovery.

Ratings – If you are a rated entity, stay in close contact with your rating agency counterparts. Have constructive conversations about your current rating and the impact of COVID-19 on your bond portfolio. Work with the ratings agencies to ensure that they understand your relative financial position and the important steps you are taking to mitigate late payments and/or defaults. Manage reputational risk by determining any conduit deals that need to be addressed in the immediate future. While these bonds are not necessarily your ultimate responsibility, you want to be proactive about working to maintain a strong rating with the services. This includes working with your troubled borrowers and helping to address workouts and late payment situations.

Tax Increment Finance Portfolios

Thousands of existing tax increment finance districts are operating throughout the country. The COVID-19 crisis will put stress on existing debt obligations of these districts and may delay the development of new districts. DFAs should consider the following:

Existing TIF Obligations – This crisis underscores the need for proper TIF evaluation and regular monitoring to mitigate risk. DFAs and communities should explore and understand the changing landscape of property tax impacts on existing projects. In doing so, DFAs should understand timelines for expected property tax payments and revenues and the subsequent debt service obligations on outstanding projects. This includes revisiting the security or collateral in place for each TIF deal. In addition, DFAs should look at LOC agreements, special assessment commitments, and the allowance for tax assessment appeals as these may lead to revenue loss if challenged.

In the immediate, DFAs should continue to make regular and on-time payments on all existing notes, loans, and bonds. However, DFAs need to begin to develop projections on real estate impacts due to the COVID-19 crisis. A prolonged slowdown in economic activity will inevitably result in smaller than expected tax revenue. TIF obligations backed by real estate taxes have a slightly longer horizon of 12-18 months but should be preparing as if any decline in economic activity will result in less tax revenue. TIF obligations backed by sales tax, use or other sources of revenue should begin immediate workout strategies to mitigate against far lower than expected revenue collection. It is important that DFAs and communities act now to ensure that all obligations be met in both the immediate future and in the next 2-3 years of projects in service. For strong and stable TIFs, it may be wise to look into refinancing options based on the availability of low interest rates.

DFAs should check their state statute for use of funds allowances. In the event of lower than projected revenues, some state TIF laws allow for the use of excess revenues to be put into reserve funds now to prepare for an eventual decrease in tax revenues later.

Businesses within TIF Districts – An immediate concern is supporting the tenants and businesses within existing TIF districts. These businesses rely on their regular income to pay their subsequent taxes. These taxes are used to fund the TIF debt service. Some businesses will survive the crisis while others will not. Helping to ensure that businesses stay viable during the COVID-19 crisis will help to mitigate tax revenue loss. If a business does close, DFAs should immediately begin working on finding a replacement business for that space. While this may seem counterintuitive during the crisis, TIF districts cannot go without taxpaying businesses for a prolonged period. Work quickly to shore up lost business opportunities and work to remedy nonperforming businesses as quickly as possible. This is of paramount concern in districts with fewer taxpaying businesses or property owners. If a major anchor of a TIF district closes, DFAs should aggressively work to replace that tenant immediately to safeguard the tax revenue stream.

New Districts and Pipeline Projects – It is likely that new districts and pipelined projects will be delayed, reduced or canceled as a result of this crisis. Many communities will naturally become more risk averse during and after this crisis. However, DFAs should continue to run projects through the feasibility process and continue to work with developers and end-users on a strategy to help projects continue through this process. Projections and feasibility studies may require an updated review based on potential hits to revenue expectations. DFAs should also look at non-traditional sources of financing. With the plethora of federal and state recovery resources in the pipeline, now is a good time to begin to identify new sources of capital for a project. TIF will be a very important tool for recovery and DFAs that look forward with a lens towards recovery will be in a good position to approve and execute new projects once the economic slowdown ends.

Revolving Loan Fund Portfolios

DFAs operate thousands of loan funds throughout the country. CDFA expects these funds to be impacted significantly due to the COVID-19 pandemic, both in the immediate term to address current economic challenges as well as in the long term as business recovery continues. DFAs should consider the following:

Existing Borrowers – Check in with your current borrowers immediately to fully understand their liquidity and debt service constraints. Many small businesses are facing cash flow and liquidity challenges. They may need immediate adjustments to their loan terms, rates, and repayment schedules.

Adjusting Rates and Terms – To the extent possible, consider adjusting current rates, terms, and repayment schedules. Now is not the time for ultra-conservative approaches to loan fund management. Borrowers are facing liquidity challenges and do not have the cash flow to pay debt service. This is through no fault of their own. Consider easing your loan fund repayment schedule to allow borrowers to defer payments for up to one year. While this may result in less cash flow to the fund, it will allow borrowers to focus on immediate challenges with less debt repayment stress.

New Borrowers & Short-Term Disaster Loans – Halt all non-essential new borrowing that is not related to responding to the COVID-19 crisis. New borrowing should be focused on small businesses impacted by the COVID-19 crisis. Require that new borrowers demonstrate the impact that the crisis has had on their business and their need for immediate capital. Provide short term loans of three to six months with zero percent interest to allow these borrowers to continue to make payroll and inventory payments. Defer repayment of these loans for up to one year. Finally, consider requiring new borrowers to refinance their distressed loan after one year if they do not pay it off in advance. DFAs may then be able to charge reasonable, but low-cost interest, on the refinanced loans.

Recapitalizing Funds – Federal and state governments, philanthropy, and the banking industry have been responding aggressively to the crisis but still need to hear from loan fund managers on the demand for low-cost capital. Reach out to your partners at federal and state agencies for a request to recapitalize funds immediately. Consider reaching out to foundations and financial institutions for fund capitalization as well. Be aggressive and request flexible funds to immediately put into new loans to address distressed businesses. If recapitalization is not possible, consider asks for loan loss reserves or loan guarantees to help address current borrowing needs.

Other Considerations

DFAs will face a number of challenges in the coming weeks and months. These challenges are understandable and navigable. DFAs were a big contributor to the nation's recovery during the recession of 2008-2009. During the coming months, DFAs should remain vigilant and focused on addressing immediate challenges while keeping a watchful eye on the future. Operational budgets and capacity may get stretched and tested but DFAs should continue to use sound financial management approaches. Now is the time for the development finance community to rise to the occasion and support our nation's bright future and full recovery.

Toby Rittner, DFCP
President & CEO
Council of Development Finance Agencies
trittner@cdfa.net
Twitter @tjrittner