Rating Strategy and Financial Policy Considerations

Village of ESTERO

PRAG

March 6, 2024

Public Resources Advisory Group

PRAG

National Firm, Local Knowledge

- Established in 1985; headquarters in New York City
- Municipal Advisor registered with the MSRB and SEC
- Florida office located in St. Petersburg; offices in NY, PA and CA
- Local knowledge with national experience

Focused on General Government Advisory

- #1 Ranked General Purpose Municipal Advisor *(Refinitiv - 2023)*
- Full range of independent financial advisory services
- Fiduciary duty to the Village; not a broker-dealer

Recent History with the Village of Estero

- PRAG advised the Village on its $20 million Taxable Revenue Note, Series 2019.
- Recently engaged to assist the Village in developing and implementing a financing plan for the Village's Capital Improvement Program.
- PRAG has analyzed the Village's financial position, advised the Village in developing a reimbursement resolution, and is in the process of developing the final plan of finance.

Potential CIP Funding Sources

- The Capital Improvement Program (CIP) may be funded with various sources:
  - Cash
  - Grants
  - Other State or Federal Sources (e.g. American Rescue Plan Act funds)
  - Assessments
  - Debt Proceeds (Bonds, Bank Loans)
- Given the size of the CIP, municipal bonds may provide a viable funding source to fund a portion of the CIP and still allow the Village to maintain strong cash reserves necessary for emergencies and other unforeseen events.
- Bonds for large financings are generally more cost-efficient than bank loans in today's municipal debt market. They can also go longer (up to 30 years).
- Municipal bonds allow projects to be financed over a period of time that matches the useful life of the assets being constructed or acquired; this serves to lower annual costs.
- When issuing municipal bonds, **a credit rating can help reduce borrowing costs.**

General Ratings Overview

- The majority of municipal bonds are issued with investment grade ratings provided by a rating agency.
- Ratings are based on the security pledged for payment of debt service on the bond.
- A higher rating indicates a greater credit-worthiness of a bond and lower likelihood of a payment default.
- Because **better ratings translate to a lower cost of financing** for the issuer, the rating strategy and process is critical to the bond issuance process.

S&P	Moody's	Fitch	Rating Description
AAA	Aaa	AAA	Prime
AA+	Aa1	AA+	High Grade
AA	Aa2	AA	
AA-	Aa3	AA-	
A+	A1	A+	Upper Medium Grade
A	A2	A	
A-	A3	A-	
BBB+	Baa1	BBB+	Lower Grade
BBB+	Baa2	BBB+	
BBB-	Baa3	BBB-	
BB+	Ba1	BB+	Non Investment Grade Speculative
BB	Ba2	BB	
BB-	Ba3	BB-	
B+	B1	B+	Highly Speculative
B	B2	B	
B-	B3	B-	
CCC+	Caa1	CCC+	Substantial Risks
CCC	Caa2	CCC	Extremely Speculative

Highest Rated Florida Municipalities

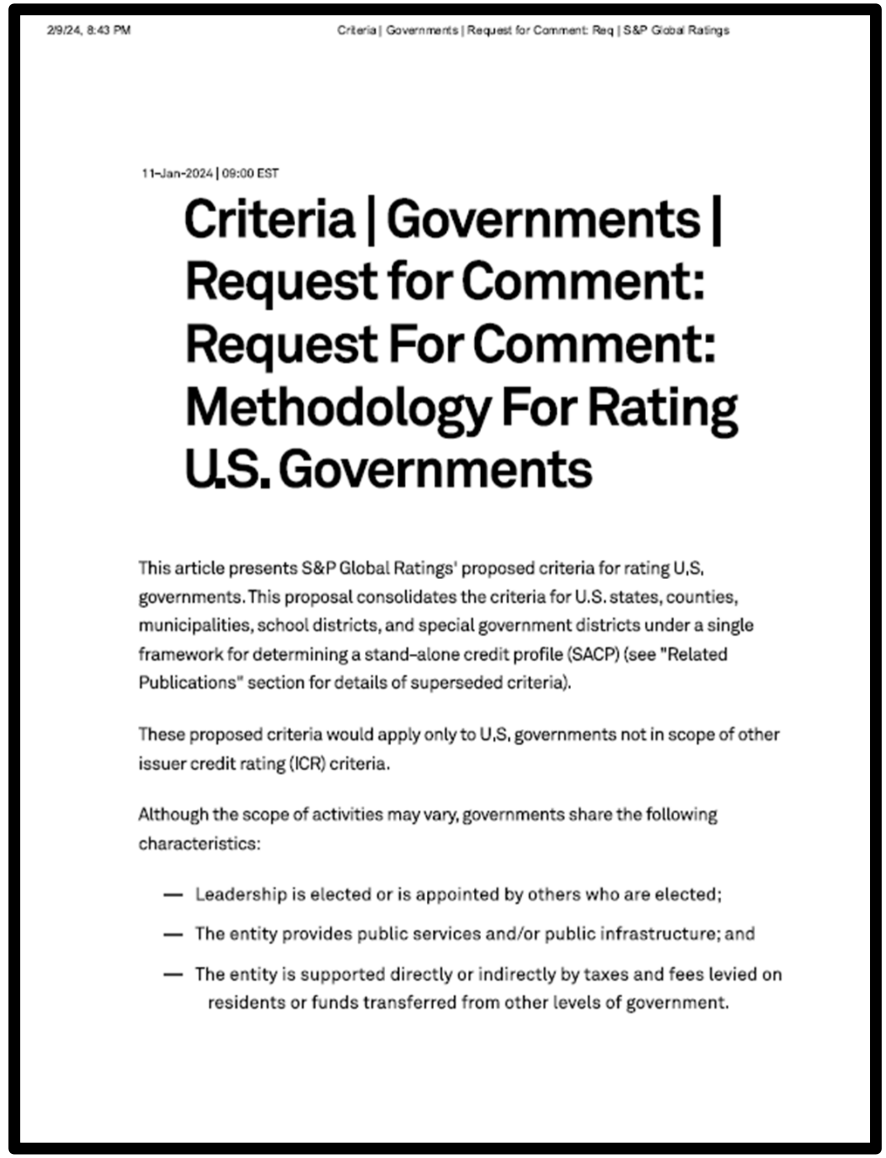
- PRAG has identified 10 cities, towns or villages in Florida that have obtained the highest possible rating (AAA) from at least one major rating agency.
- Notably two municipalities, the City of Coral Gables and the Town of Palm Beach have triple-A ratings from two agencies and one, the City of Boca Raton, has a triple-A from three agencies.
- The newest rating agency, KBRA (formerly Kroll) does not maintain a triple-A rating on any municipality in Florida but also rates significantly fewer municipalities in the State.

S&P	Moody's	Fitch	KBRA
Boca Raton, City of	Boca Raton, City of	Boca Raton, City of	None
Coral Gables, City of	Coral Gables, City of		
Coral Springs, City of	Palm Beach, Town of		
Davie, Town of	Wellington, Village of		
Fort Lauderdale, City of			
Palm Beach, Town of			
Palmetto Bay, Village of			
Pinecrest, Village of			
Tampa, City of			

General Obligation or Issuer Credit Rating based on EMMA search as of February 2, 2024
Does not include utility ratings

Methodology

- Given the significant difference in the number of AAA ratings provided by S&P compared to the other agencies, PRAG believes it is appropriate for the Village to prioritize S&P's criteria when evaluating the Village's potential rating.
- S&P is in the process of revising its City and State Methodology (comment period ends March 11th).
- We expect S&P's new criteria will be in effect in mid-2024.
- PRAG has analyzed the potential rating outcome under both the current and proposed methodology.



2/9/24, 8:43 PM Criteria | Governments | Request for Comment: Req | S&P Global Ratings

11-Jan-2024 | 09:00 EST

Criteria | Governments | Request for Comment: Request For Comment: Methodology For Rating U.S. Governments

This article presents S&P Global Ratings' proposed criteria for rating U.S. governments. This proposal consolidates the criteria for U.S. states, counties, municipalities, school districts, and special government districts under a single framework for determining a stand-alone credit profile (SACP) (see "Related Publications" section for details of superseded criteria).

These proposed criteria would apply only to U.S. governments not in scope of other issuer credit rating (ICR) criteria.

Although the scope of activities may vary, governments share the following characteristics:

- Leadership is elected or is appointed by others who are elected;
- The entity provides public services and/or public infrastructure; and
- The entity is supported directly or indirectly by taxes and fees levied on residents or funds transferred from other levels of government.

Dated: January 11, 2024

S&P Proposed Framework

- S&P will score its Institutional Framework + Individual Credit Profile both on a 1 to 6 scale
- Combined, the "Anchor" score is determined; the strongest "Anchor" is 1.1 (aaa)
- Modifiers may improve or worsen the "Anchor" by one rating level (*none are expected*)
- S&P's holistic analysis is then applied to determine the **Issuer Credit Rating**
    - Forward-looking view on issuer's credit; strengths/weakness not in criteria
    - Peer ratings analysis

--Institutional framework assessment--	--Individual credit profile--										
	1	1.5	2	2.5	3	3.5	4	4.5	5	5.5	6
1	aaa	aaa	aa+	aa	aa-	a+	a	a-	bbb	bb+	bb-
2	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb-	bb	b+
3	aa+	aa	aa-	a+	a	a-	bbb	bbb-	bb+	bb-	b
4	aa-	a+	a	a-	bbb+	bbb	bb+	bb	bb-	b	b-
5	a	a-	bbb+	bbb	bbb-	bb+	bb-	b+	b	b-	b-
6	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-	b-	b-

S&P Request for Comment: Methodology for Rating U.S. Governments January 11, 2024

S&P Proposed Framework (continued)

- **S&P's Proposed Individual Credit Profile (ICP)** scorecard is below
- Each ICP factor will be scored on scales from 1 to 4-6 and each are weighted 20%

	Economy 20%	Financial Performance 20%	Reserves and Liquidity 20%	Management 20%	Debt and Liabilities 20%
Step 1: Establish initial assessment	GCP% of U.S. (50%) County PCPI% of U.S. (50%)	Three-year average operating result (%)	Available reserves (%) of revenues	Budgeting practices (35%) Long-term planning (35%) Policies (30%)	Current cost for debt service and liabilities (50%) Net direct debt per capita (25%) Net pension liabilities per capita (25%)
Step 2: Apply qualitative adjustments	Local Economic Profile	Under or overstated operating results	Under or overstated reserves	Transparency and reporting	Under or overstated current costs
	Economic volatility and concentration	Performance volatility	Projects suggest different assessment	Governance structure	Under or overstated long-term liabilities
	Economic growth prospects	Projections suggest different assessment	Liquidity and contingent liability risks	Risk management, credit culture, and oversight	Projections suggest different assessment

GCP = Gross County Product
PCPI = Per capita personal income

S&P Request for Comment: Methodology for Rating U.S. Governments January 11, 2024

Rating Factors

- **The Village has little to no *short-term ability* to influence certain rating factors** such as Institutional Framework, the Economy and Financial Performance (which uses a three-year average of operating results).
- **Institutional Framework** - stands apart from the ICP scorecard; mostly **qualitative** scoring. State constitutions and laws broadly dictate the terms under which U.S. governments operate; therefore, S&P assesses the Institutional Framework by state & government type.
- The Institutional Framework subfactors are:
  - **Predictability (25%)** – ability of government to forecast its revenues and expenditures
  - **Revenue/expenditure balance and system support (50%)** – the ability of a government to finance services it provides, and degree of ongoing and exceptional support from a higher-level government
  - **Transparency and accountability (25%)** – comparability of a government's relevant financial information

S&P Proposed Economy Assessment

- Initial assessment is driven by County-level per capita gross domestic product (50%) and Per Capita Personal Income (50%) subfactors.

Economy: Initial Assessment	Sub-	Local Government Assessment					
Metric	Weight	1	2	3	4	5	6
GCP per capita as a % of U.S. GDP per capita	50%	>110	110-95	95-85	85-75	75-65	<65
County PCPI as a % of U.S. PCPI	50%	>100	100-90	90-80	80-75	75-70	<70
Economy (20%)							
Gross County Product per Capita		$54,263					
U.S. GDP per Capita		$65,799					
Percentage		82.5%					
County Per Capita Personal Income		$63,568					
U.S. Per Capita Personal Income		$65,476					
Percentage		97.1%					

- **Two-point adjustment** *expected* due to the Village's strong effective buying income (i.e. Median Household Income) vs. the U.S. & County
  - 134% as a percentage of the U.S. MHI
  - 145% as a percentage of the County MHI

- Initial Economy Assessment **estimated** "3" could be improved by "2" = "1"

Sources: Bureau of Economic Analysis; U.S. Census

S&P Proposed Financial Performance Assess.

- Initial assessment is based on the average annual operating result of the three most recent years.

Financial Performance: Initial Assessment	Sub-	Local Government Assessment			
Metric	Weight	1	2	3	4
Operating Result (%)	100%	>3	3-0	0-(3)	<(3)
Financial Performance (20%)					
General Fund		FY23 (Unaudited)	FY22 (Audited)	FY21 (Audited)	
Revenues		$ 21,406,380	$ 20,435,217	$ 13,982,874	
Expenditures		13,217,926	4,992,536	5,021,921	
Excess/(Deficit)		$ 8,188,454	$ 15,442,681	$ 8,960,953	
Less: Transfers Out		(3,620,030)	(19,778,472)	(4,925,024)	
Net Operating Result		$ 4,568,424	$ (4,335,791)	$ 4,035,929	
Net Operating Result as % of Revenues		21.3%	-21.2%	28.9%	
Three-Year Average Operating Result (%)		9.7%			

- The Village has little control over certain aspects of its financial performance and given the three-year lookback, little control over this scoring factor in the proposed Individual Credit Profile

- The Village has experienced notably strong financial performance in recent years (note: large transfer out in 2022 due to debt payoff)

Controllable Rating Factors

- There are certain rating factors that the Village ***can* make a more immediate impact** on as illustrated below:

Rating Factor	Method of Influence
Management	Policies; Procedures
Reserves and Liquidity	Reserve Policies; Fund Balance Levels
Debt and Liabilities	Debt Policies; Debt Levels

S&P Proposed Management Assessment

- **Budgeting Practices (35%)**:
  - Budgets are **forward-looking** with **robust monitoring**
  - Budgets utilize comprehensive planning tools that are **forward-looking** and **realistic**
  - Budget performance is shared with stakeholders and adjustments are made regularly to address for changes throughout the year
- **Long-Term Planning (35%)**:
  - Robust culture of long-term planning; multiyear financial and capital plans are based on realistic assumptions that support long-term structural balance
  - Plans are regularly updated and demonstrate clear project funding
- **Policies (30%):**
  - Robust, well-defined policies with thorough reporting
  - **Investment, Debt Management, and Reserve and Liquidity policies** exist and are well-defined
  - Strong reporting and monitoring mechanisms exist and are functioning
- The final assessment considers adjustments for transparency/reporting, governance structure (e.g. "political gridlock"), and risk management, credit culture, and oversight

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Note: Statements above do not necessarily reflect the Village's management characteristics; rather they are shown to illustrate what S&P considers the strongest characteristics ("1") in their proposed Management Assessment criteria

S&P Proposed Reserves & Liquidity Assessment

- Initial assessment based on the Available Reserves as a Percentage of Revenues
- Establishment of a **strong Fund Balance policy** with minimum levels and internal controls positively impacts an issuer's ability to maintain very strong unrestricted reserves
- Estimates below are based on unaudited FY23 financials and reserve positions are **subject to change** as cash is utilized to fund capital improvement projects

Reserves and Liquidity: Initial Assessment	Sub-	Local Government Assessment				
Metric	Weight	1	2	3	4	5
Available Reserves as % of Revenues	100%	>15%	15%-8%	8%-4%	4%-1%	<1%
Reserves and Liquidity (20%)						
		FY23 (Unaudited)				
Available Reserves		$ 52,441,017				
Total Governmental Revenues		$ 32,029,586				
Reserves as % of Revenues		**163.7%**				

- Moody's requires a higher Fund Balance ratio to reach prime-grade sub-scores in their indicative rating scoring – this subcategory accounts for 20% weight of their indicative score
  - Moody's – Aaa: +35%; Aa: 25-35%; A: 15-25%
- S&P identifies three areas for adjustment to the Reserves and Liquidity initial assessment:
  - Are reserves over or understated and would they align with a different assessment?
  - Would prospective changes to reserves result in a better or worse assessment?
  - Would liquidity pressures worsen the initial assessment?

S&P Proposed Debt & Liabilities Assessment

- Initial assessment based on the subfactors listed below.
- **A strong Debt Management Policy** will memorialize best practices and positively impact the Village's ability to maintain manageable debt levels.
- The Village currently has no bonds or loans outstanding.
- The Village's Pension and OPEB costs are currently minimal.
- **Current Cost for Debt Service and Liabilities (50%)**
  - Annual Debt Service, Pension and Other Post-Employment Benefits expenditures divided by Total Governmental Revenue
- **Net Direct Debt per Capita (25%)**
  - Gross direct debt less self-supporting debt divided by population
- **Net Pension Liability per Capita (25%)**
  - NPL is calculated by subtracting the fund's plan fiduciary net position from the total pension liability as reported in the local government's financial statements (GASB)

FUTURE DEBT PLANS WILL DRIVE THESE CALCULATIONS

Debt and Liabilities: Initial Assessment	Sub-	Local Government Assessment					
Metric	Weight	**1**	**2**	**3**	**4**	**5**	**6**
Current Cost for Debt Service & Liab. % of Revenues	50%	<8	8-14	14-20	20-25	25-30	>30
Net Direct Debt per Capita	25%	<500	500-1500	1500-2500	2500-3500	3500-4500	>4500
Net Pension Liabilities per Capita	25%	<500	500-1500	1500-2500	2500-3500	3500-4500	>4500

Confidential Indicative Rating Process

S&P offers a Rating Evaluation Service that allows an issuer to present multiple alternatives and receive a confidential rating for each alternative.

Benefits

- Acts as a strategic management tool the Village can use to make informed decisions surrounding the funding of capital projects.
- Allows the Village to present structures with differing amounts of debt and reserves to determine the expected rating for each structure.
- Fairly inexpensive way to get **precise guidance** from the rating agency **to maximize the Village's rating and safeguard the Village from over-borrowing.**

Costs

- Approx. $20,000 to $25,000 for the base analysis and approx. $5,000 for each alternative.
- If the Village issues debt rated by S&P within six months of the evaluation, S&P will credit a portion of the evaluation fee to the full rating fee (approx. between $10,000 to $15,000 credit).

Major Tasks Tentative Timeline

Rating Evaluation Service
(Approx. 3-4 weeks)

- Submission of initial package including historical financial statements, recent operating/capital budget, and financial policies
- Engagement letter executed by Village staff
- Rating agency analyst review of Village's credit
- Receipt of rating agency analyst questions
- Presentation to rating agency analysts and response to questions and/or other requests
- Rating Evaluation Committee
- Receipt of confidential indicative rating(s)

January	**Village Council Adoption of Reimbursement Resolution**
February	Develop Financial Policies
March	**Village Council Approval of Financial Policies (2 readings)** Determine Rating Evaluation Service Alternatives
April	Draft FY2023 Audit Available Develop Rating Presentation S&P Rating Evaluation Service Application Rating Presentation
May	**Receive Rating Evaluation Service Results** Determine CIP Funding Plan Begin Debt Issuance Process (if applicable)
June	FY2023 Audit Finalized Debt Documentation
July-Aug.	City Council Approval Post Offering Documents Debt Sale Closing / Funding