MESIROW PUBLIC FINANCE

City of Washington

Stormwater Control Financing Alternatives

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Executive summary: Washington can finance $5 million of its $10 million Stormwater Control Project to capitalize on the current very favorable short term investment environment

- **Although interest rates have trended up over last year, bond supply is low and the market is stable. The City last reviewed financing alternatives at its June 12 meeting.**

- **Difference between short-term taxable and longer-term tax-exempt interest rates is substantially higher than 18 months ago. This provides a "positive carry" opportunity for the City.**

- **Short term investment rates now exceed 5% so the City can immediately reinvest bond proceeds for the stormwater project above the current estimated tax-exempt borrowing rate of 3.25 - .50%.**

- **$5 million *annual* IRS "small issuer exception" to arbitrage-rebate provides opportunity for City to reinvest bond proceeds at unlimited yield for up to 3 years. Any positive arbitrage earned is retained by the City.**

- **$5 million "small issuer exception" can outperform a "pay-as-you-go" approach *and* permit the City to accelerate stormwater construction project to head-off raw materials cost inflation. Steep rise in Producer Price Index (PPI) of 34% from Jan. 2020 – May 2023.**

- **A $5 million financing in CY 2023 (15-year level repayment) will use only $500,000 of the $1.1 million annual sales tax revenues, which provides further flexibility to fund future projects as they arise.**

- **Finally, an additional $5 million "small issuer exception" would be again available to the City in CY 2024.**

City Council reviewed long-term capital project funding alternatives at its June 12 meeting

- The following table shows hypothetical financing amounts that could be raised today to fund capital, given different debt service requirements and repayment terms. The analysis is based on the following assumptions:
  - 1x revenue coverage with full leveraging of the indicated revenue stream.
  - Tax-exempt interest rates as of June 9, 2023, assuming underlying issuer credit rating of “A+” or “AA-” with bond insurance.
  - Available proceeds are net of all issuance costs such as legal counsel, underwriting fees, credit rating costs, etc. We’ve assumed issuance costs at 1.5% of the financing amount (approximates: $85,000 for $5.5 million scenario, $130,000 for $8.3 million, and $170,000 for $11.1 million scenario).
  - Available proceeds are also net of the bond insurance policy premium estimated at 0.3% of gross debt service.
- Mesirow will tailor a specific financing solution for Washington based on the city’s specific needs and objectives. Our goal is always to identify and source the lowest-cost capital for our clients within the constraints of their funding requirements.

	Approximate Annual Debt Service			
	$500,000 / Year	$750,000 / Year	$1,000,000 / Year	Estimated Interest Rate
	Approximate Financing Proceeds			
10-Year Level Repayment	$4,100,000	$6,200,000	$8,200,000	3.25%
15-Year Level Repayment	$5,500,000	$8,300,000	$11,100,000	3.65%
20-Year Level Repayment	$6,600,000	$9,900,000	$13,300,000	4.00%

Results are preliminary and subject to change based on market conditions and other factors.

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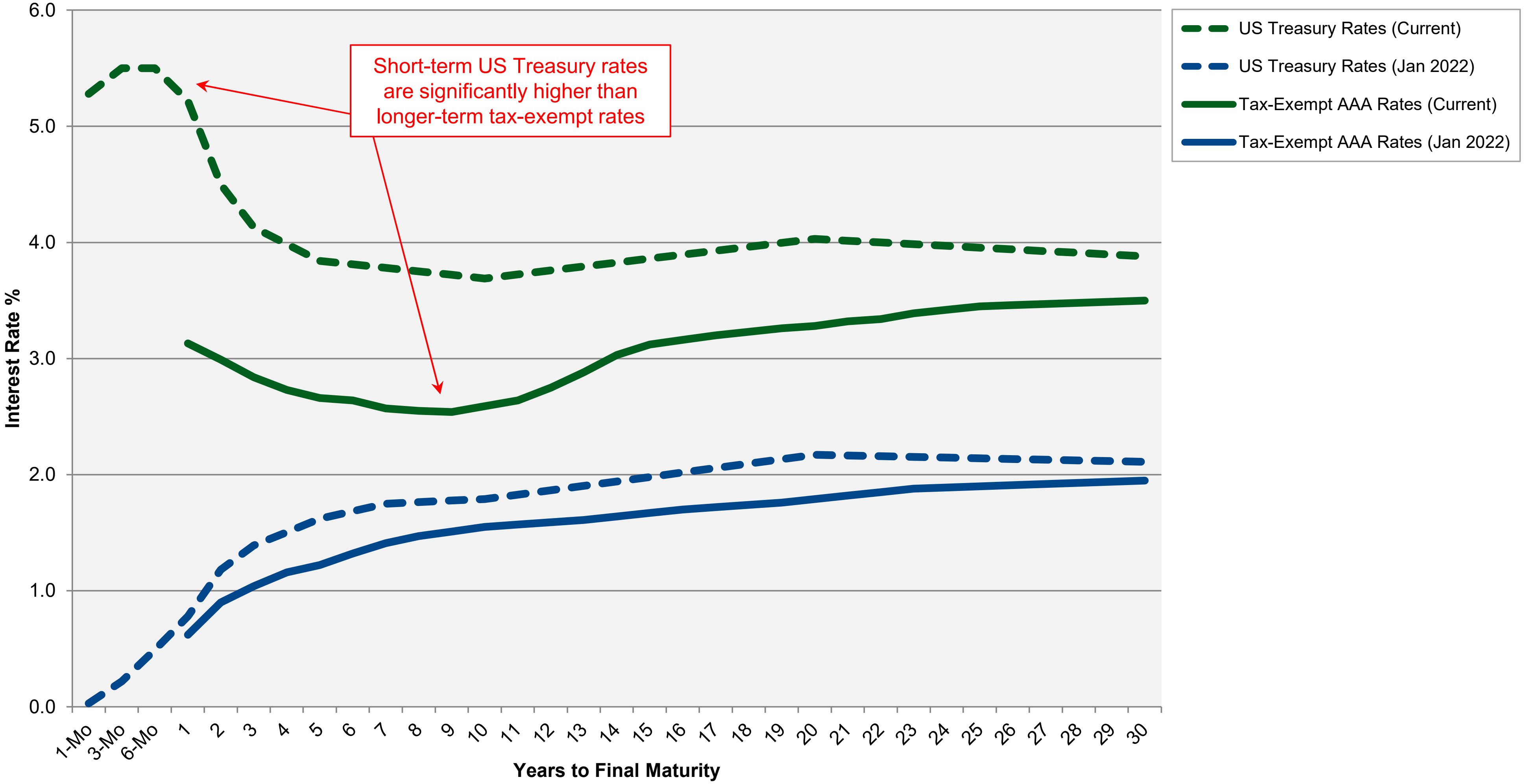
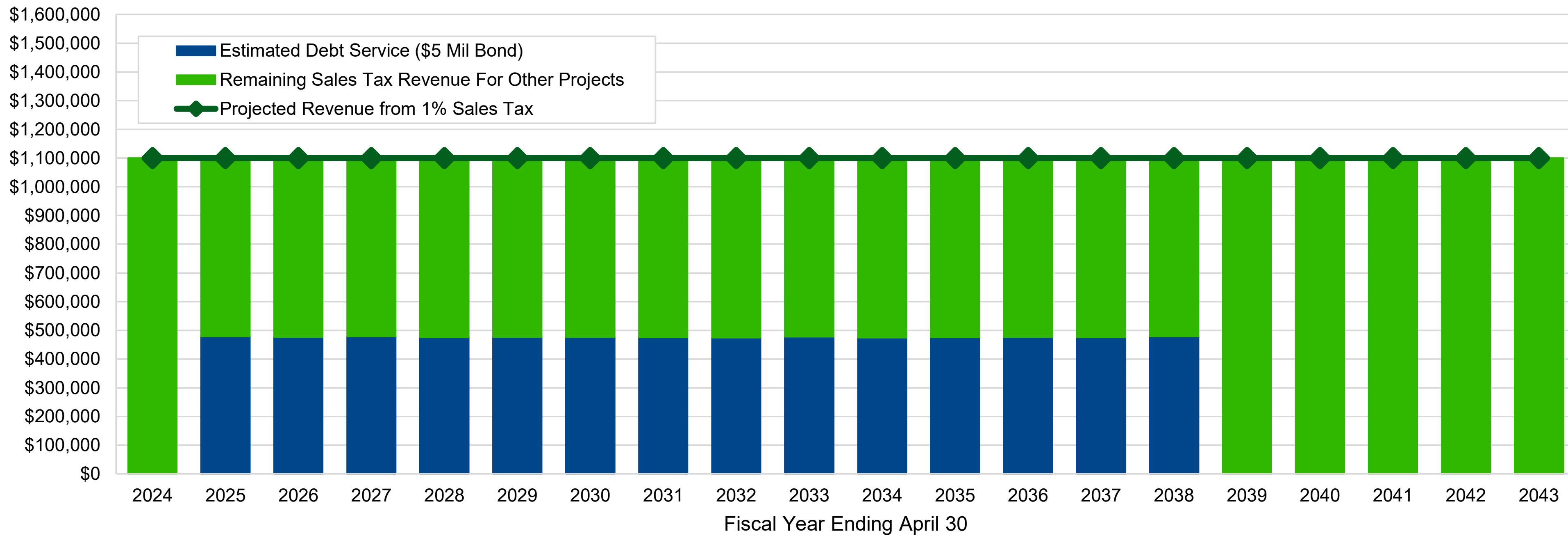
US Treasury investment rates are significantly higher than tax-exempt borrowing rates providing a “positive carry” opportunity



Data Sources: The Municipal Market Monitor (TM3). UST and MMD rates as of June 2, 2023.
US Treasury rates used as an example of low credit risk investment alternative. Past performance is not indicative of future results. Mesirow Financial, Inc. is not an investment advisor.

Even if the City borrows $5 million repaid over 15 years, there remains ample ongoing sales tax revenues to fund other projects

- The City of Washington's 1% sales tax generates approximately $1.1 million of revenue each year.
- The City has ample capacity to borrow against this future revenue stream.
- A $5 million bond repaid over 15 years would encumber approximately $500,000/year of future sales tax revenues.
- After paying debt service, the remaining sales tax revenue would be available for other purposes, or to pledge to future debt.



Estimated debt service based on market conditions as of June 9, 2023, and assumes 'A+/Stable' or equivalent underlying rating with 'AA' bond insurance. Results are preliminary and subject to change based on market conditions and other factors.

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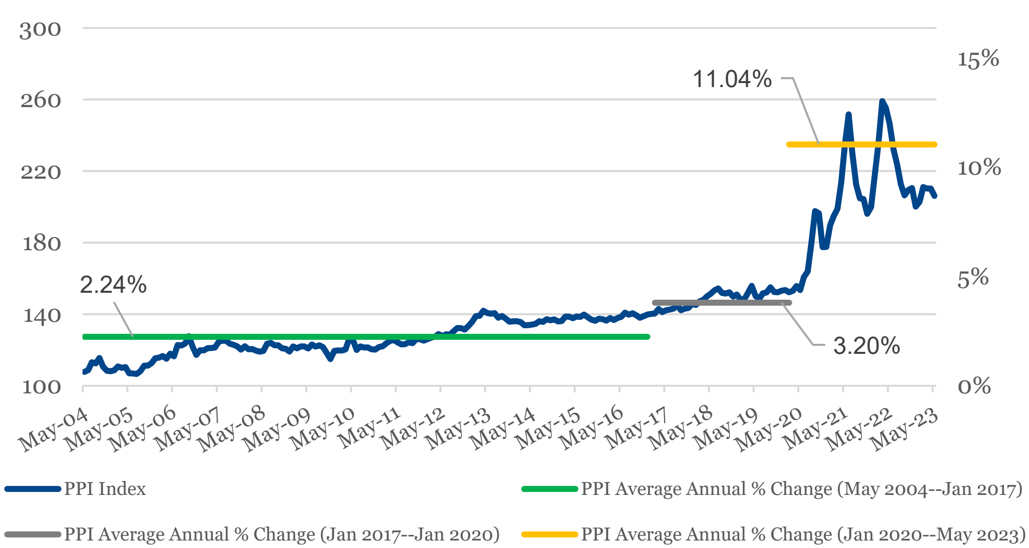
Construction cost inflation creates challenges and provides support for accelerating projects to head off increasing raw material prices

- Construction cost inflation as measured by the Producer Price Index (PPI) will result in public sector project sponsors seeing higher bids from contractors
- Beyond commodity and equipment price increases, shortages of skilled labor and correspondingly wage increases will be enduring
- As measured by PPI, annualized inflation averaged 2.2% from 2004-2017, and 3.2% from 2017-2020. However…
- **Annual inflation increased sharply to average 11% for 2020-present.**

PPI--Building Material AND Supplies Dealers
May 2004--May 2023



- Year-over-year changes in construction material prices for 2020-2022
- The cost escalation range for materials remains wide in 2022
  - Most construction inputs still see sizable price increases
  - Moderate price decrease for some construction materials, but far from recovering from the previous price hikes.

Price Increases for Construction Inputs
Year-over-Year % Change in December PPI

	2020	2021	2022
Steel Mill Products	5.2	128.0	(28.7)
Diesel Fuel	(2.8)	54.2	20.4
Plastic construction products	5.4	35.4	8.3
Aluminum steel shapes	(1.7)	29.5	(5.7)
Copper and brass steel shapes	23.6	23.4	(3.6)
Paint and coatings	1.4	15.7	20.6
Gypsum products	4.6	23.0	17.5
Lumber and plywood	37.2	18.1	(19.9)
Trucking	3.9	20.5	5.4
Truck and offroad tires	0.3	11.0	19.6
Construction machinery/equipment	1.1	10.0	8.8

Sources: S&P Global Ratings research report: *Construction Cost Inflation Weighs On U.S. Public Infrastructure Investment* (April 14, 2022)
U.S. Department of Labor, U.S. Bureau of Labor Statistics, Producer Price Index by Industry: Building Material and Supplies Dealers [PCU44414441], retrieved from FRED, Federal Reserve Bank of St. Louis

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The IRS's $5 million "general small issuer exception" to arbitrage rebate can be particularly helpful to the City's capital project funding

Understanding IRS exceptions helps tax-exempt issuers maximize project fund investment earnings

	24-Month Spending Exception	18-Month Spending Exception	General Small Issuer Exception	School Small Issuer Exception
Par limitation for tax-exempt bonds	No limit	No limit	$5 million or less (per calendar year)	$15 million or less (per calendar year)
Bond proceed usage restrictions to qualify	Construction purposes (75% minimum)	Governmental purposes	Governmental purposes	Construction purposes (amounts over $5 million)
Bond proceed draw-down required to keep arbitrage earnings	Spend with due diligence & at least: 10% in 6-months 45% in 12-months 75% in 18-months 100% in 24-months	Spend with due diligence & at least: 15% in 6-months 60% in 12-months 100% in 18-months	Spend with due diligence & at least: 85% in 3-years (expectation)	Spend with due diligence & at least: 85% in 3-years (expectation)
What if spend down is not met?	Rebate interest earnings exceeding Arb Yield to IRS (3% retainage OK)	Rebate interest earnings exceeding Arb Yield to IRS (3% retainage OK)	Restrict investments to Arb Yield after 3-year period	Restrict investments to Arb Yield after 3-year period

The table is intended only as a general overview of IRS arbitrage rebate requirements. The federal tax code is complex and this summary is not comprehensive or applicable to all situations. Issuers should review specific arbitrage rebate requirements with their tax counsel or other advisors.

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