



payments. Those revenues that are tax revenues are projected to grow over a long period of time (i.e., a 15 to 20-year build out), but the bonds to finance the station would need to be issued before nearly all of the development occurs. Most development related revenue bonds have a shorter build out period and therefore represent less risk to the bond holders.

If revenue bonds were issued, they would either have to be non-rated or low rated bonds given the development risk. (Note, however, that the City is planning to address this development risk by taking a final look at the “market” and commitment of the developers to proceed with the planned development before committing to the bond issuance on or about 2014.) Second, to reduce that risk, the City could provide a credit enhancing moral obligation pledge to get the bonds to AA or AA+ status. However, in providing that pledge the rating agencies would then count the moral obligation debt amount in with the City’s general obligation debt in their ratings analysis. The fact that the bonds also rely on real estate tax revenues for a large part of their financing also causes the ratings agency to consider these bonds as closely related to the City’s overall debt burdens.

In today’s environment, where the default of many municipal bonds is being predicted by some analysts, and given the recent history of development related municipal bond defaults, issuing revenue bonds for \$275 million would be highly unlikely without some credit enhancing moral obligation pledge by the City. It may be possible to carve out a portion of the bonds and make some of them revenue bonds, but that will be a decision to be considered when the station financing decisions are closer on or about 2014.

Finally, it is the City’s intent to re-review all aspects of this bond issuance in the months prior to the bond issuance to ensure that the right balance of interest costs and bond structure are achieved. With the municipal bond market constantly changing, today’s answer might not be the best answer three years from now.

Q4. Would the same apply to the proposed add-on tax supported bonds?

A4. While the bond rating agencies would look favorably on investments in transportation, the projects on the add-on list are numerous, spread geographically, and not tied to a specific large scale granting of major new density. That is what makes this different than Potomac Yard. The rating agencies would recognize a new dedicated funding stream, but since that stream is comprised of real estate taxes, and since any related bond funding would be general obligation bonds, the bonds would be considered more like the City’s other core debt issued for public buildings and schools.

Q5. Then how does the City leverage the taxes collected to pay for the debt if bonds are issued as general obligation bonds? If the bonds are general obligation bonds, how can the add-on tax collected be used to retire the debt?

- A5. The word “leverage” in regard to the add on tax means (1) that by using bond financing more projects can be done in the short term than just the tax revenues alone, and (2) that some of the add on tax revenues could be used as match to state and federal programs (such as the 80% federal funding for the streetcar projects).

“General obligation bonds” refers to the ultimate legally binding pledge (i.e., the “obligation”) of a locality to repay and not the repayment funding source. The add-on tax can be used to retire the debt of general obligation bonds.

- Q6. The rationale behind the City’s desire to “leverage” the revenue stream derived from the Commercial Add-on Tax (CAT) through bond financing and federal/state matching fund programs is understood. Of course, this leverage can be accomplished using general fund revenue just as easily as with CAT revenue. It would merely be a matter of budget allocation of general revenue funds to transportation capital improvement projects.

At its most basic level, general obligation bonds create an obligation by the City to repay bondholders over time for funding given to the City based on the City’s bond ratings and projected revenue stream. It seems that the City anticipates that CAT revenue would be used to pay general obligation bonds. General obligation bonds can, of course, fund a variety of City projects. If that is the case, how does the City reconcile this position with the statutory limitation under Section 58.1-3221.3(B)(1)(iv), which limits the use of CAT revenue to specific, transportation-related uses outlined in subsections (i), (ii) and (iii) of this provision? Would the general obligation bonds to which you refer be limited solely to qualified transportation uses?

- A6. This is a complex and arcane area of public finance. As a result, confusion may arise from what general obligation bonds are by definition, and how they are most often repaid in practice. “General obligation bonds” mean that the locality has made a legally binding pledge (i.e., a binding contract) to repay those bonds. The pledge has no legal link to the planned sources of the repayment on general obligation bonds. To quote from our bond prospectus, the City states that its “full faith and credit and unlimited taxing power of the City is irrevocably pledged.” This is standard general obligation bond language. Most general obligation bonds are repaid with general fund revenues of a locality of which real estate taxes are often the largest general fund revenue source.

General obligation bonds can also be planned from the outset to be repaid with a specific revenue stream. This is sometimes the case with water and sewer bonds which are issued as general obligation bonds, but which have a dedicated water and sewer revenue stream paid by rate payers to repay those bonds. Bond rating agencies look more favorably on bonds that have a dedicated reliable and stable revenue stream, as well as a general obligation pledge.

In regard to the legality of the commercial add on tax (“CAT” as some have labeled it) funding of general obligation bond debt service, the debt service on the portion of the general obligation transportation bonds issued for CAT identified projects and to be repaid with CAT revenues will be specifically identified and matched up with the CAT

revenues planned to be used for debt service on those general obligation bonds. CAT revenues will not be used to fund the debt service of non-CAT general obligation transportation bonds or other categories of City bonds. As a result, the City will meet the requirements of Section 58.1-3221.3(B)(1)(iv). This section of the State Code does not limit the type of bonds that can be issued, and leaves it open for a locality to issue general obligation bonds for this purpose as long as the revenues raised are used solely for the purposes outlined in that section of the State Code. The City's proposals are consistent with the requirements of the State Code.

- Q7. In what manner might the rating agencies demonstrate their favorable view on dedicated revenue stream, such as the CAT? And would this be an added incentive for structuring the general obligation bond from the outset as a transportation bond, similar to a water and sewer bond?
- A7. The bond ratings agencies are a bit like the Wizard of Oz. You don't get to see what is behind the curtain; you only get a limited number of carefully worded pronouncements. The best the City would likely get from the bond rating agencies would be a positive oral acknowledgement at our annual meeting with them, no negative comments, and then the CAT funded bonds being included in their formal write-ups as a factual statement of City plans. For any general obligation bond that was going to be CAT funded to pay for transportation projects in the CAT plan, if the CAT is approved, we would plan on presenting the CAT funding as a positive financial structural decision in that there is a new dedicated income stream, and we were funding needed long-term priority transportation projects (the rating agencies know that transportation needs are a major issue in the DC Metro region). That all said, the rating agencies will include those CAT bonds in our overall debt ratios when they calculate the debt ratios, and look at the resultant debt ratios in relation to other jurisdictions. They will not consider the CAT bonds in the same manner as water and sewer fee funded general obligation bonds (which are excluded in debt ratio calculations), because the CAT bonds are using real estate tax revenues as their financing source.