



# Managing in a rising interest rate environment

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# Meet your presenter



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ATTENTION

# DISCLAIMER

The information provided here is of a general nature and is not intended to address the specific circumstances of any individual or entity. In specific circumstances, the services of a professional should be sought.



## AGENDA

# Managing in a rising interest rate environment

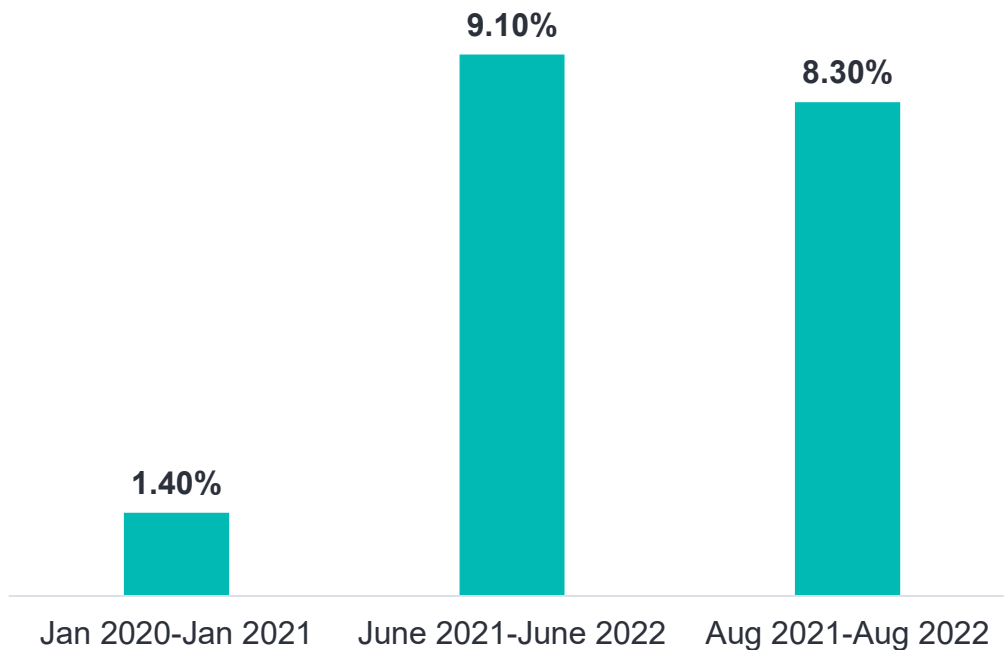
1. Market and economic update
2. Capital project financing strategies
3. Cash management
4. Arbitrage



# **1. Market and economic update**

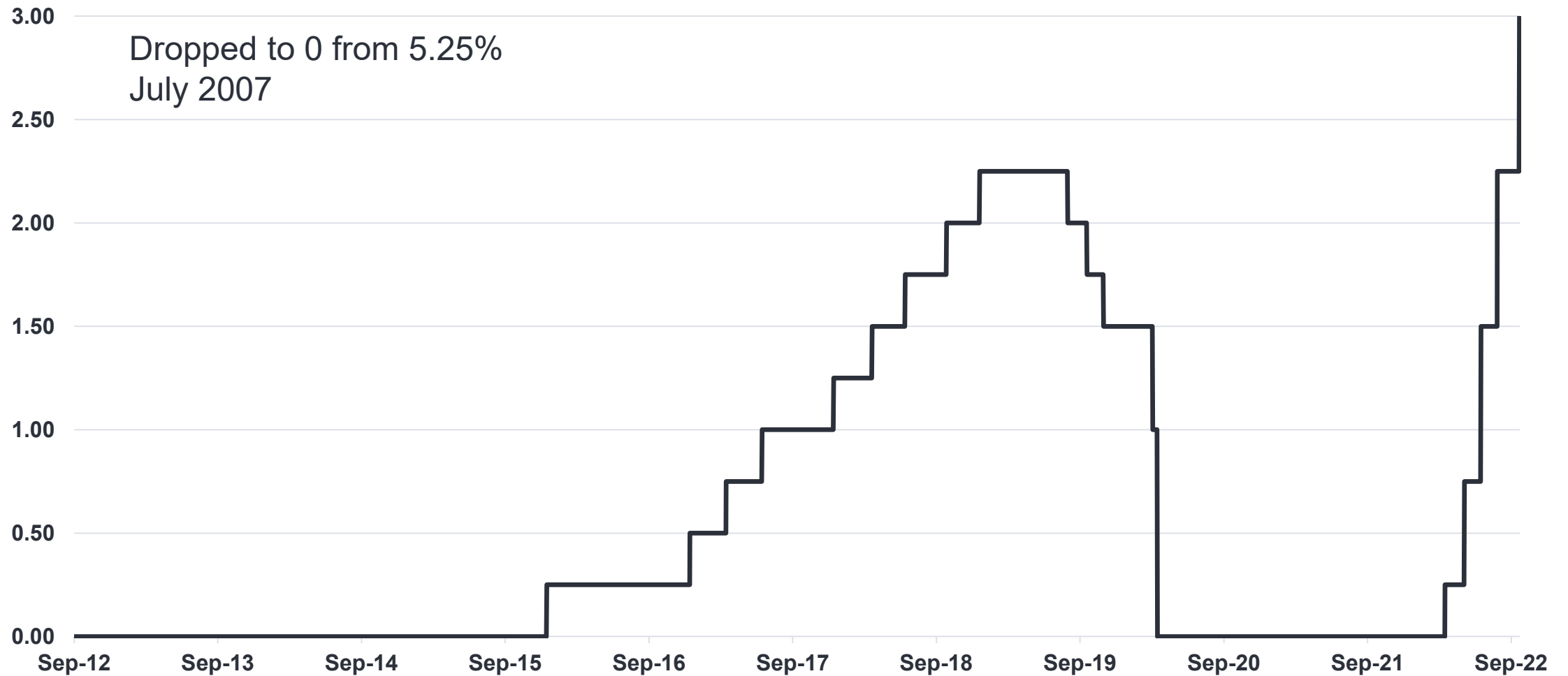
## A. Understanding how we got here

Consumer Price Index

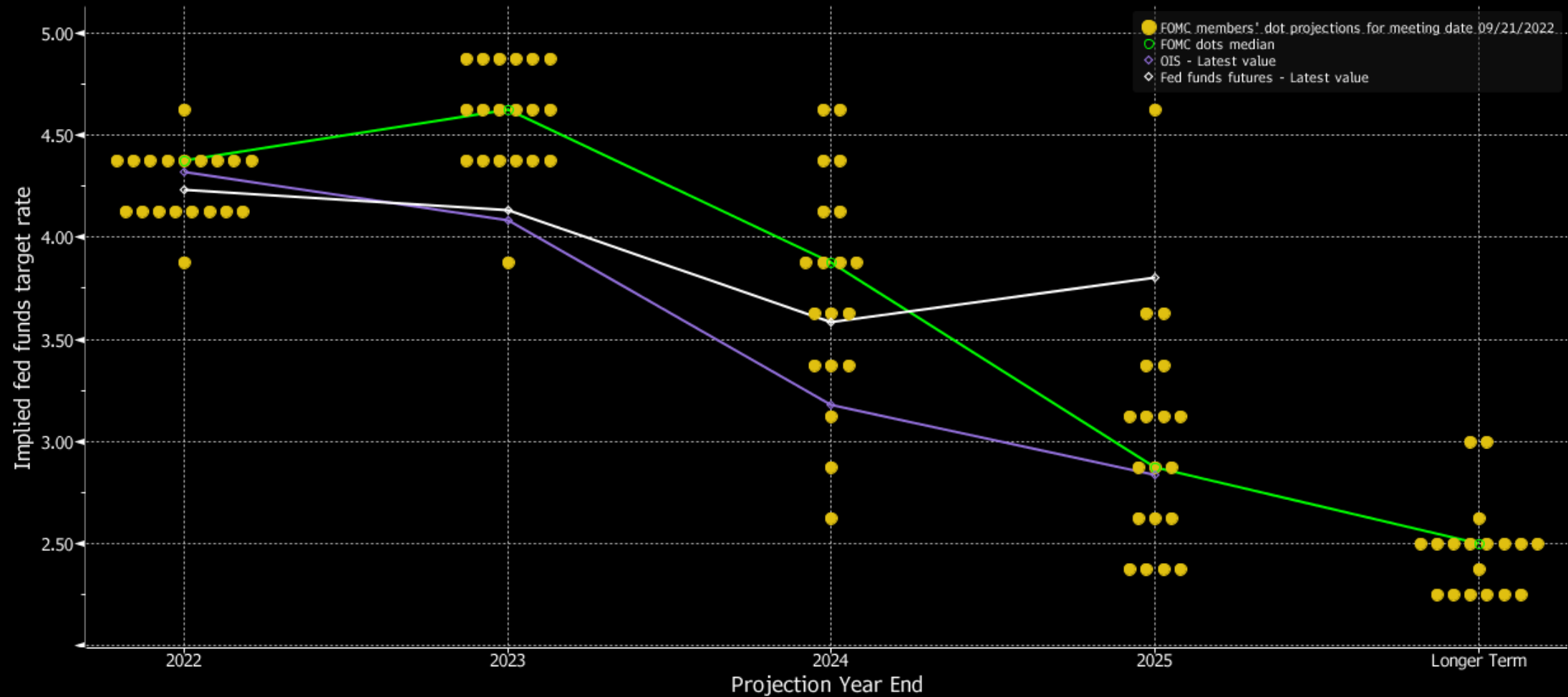


- Causes
  - Historically low federal funds rate
  - Lesser degree: COVID-19 supply chain disruptions and Ukraine war
- Most effective monetary policy is to increase interest rates

# Fed funds rate (lower bound)



# The Fed's New Dot Plot



Source: Federal Reserve

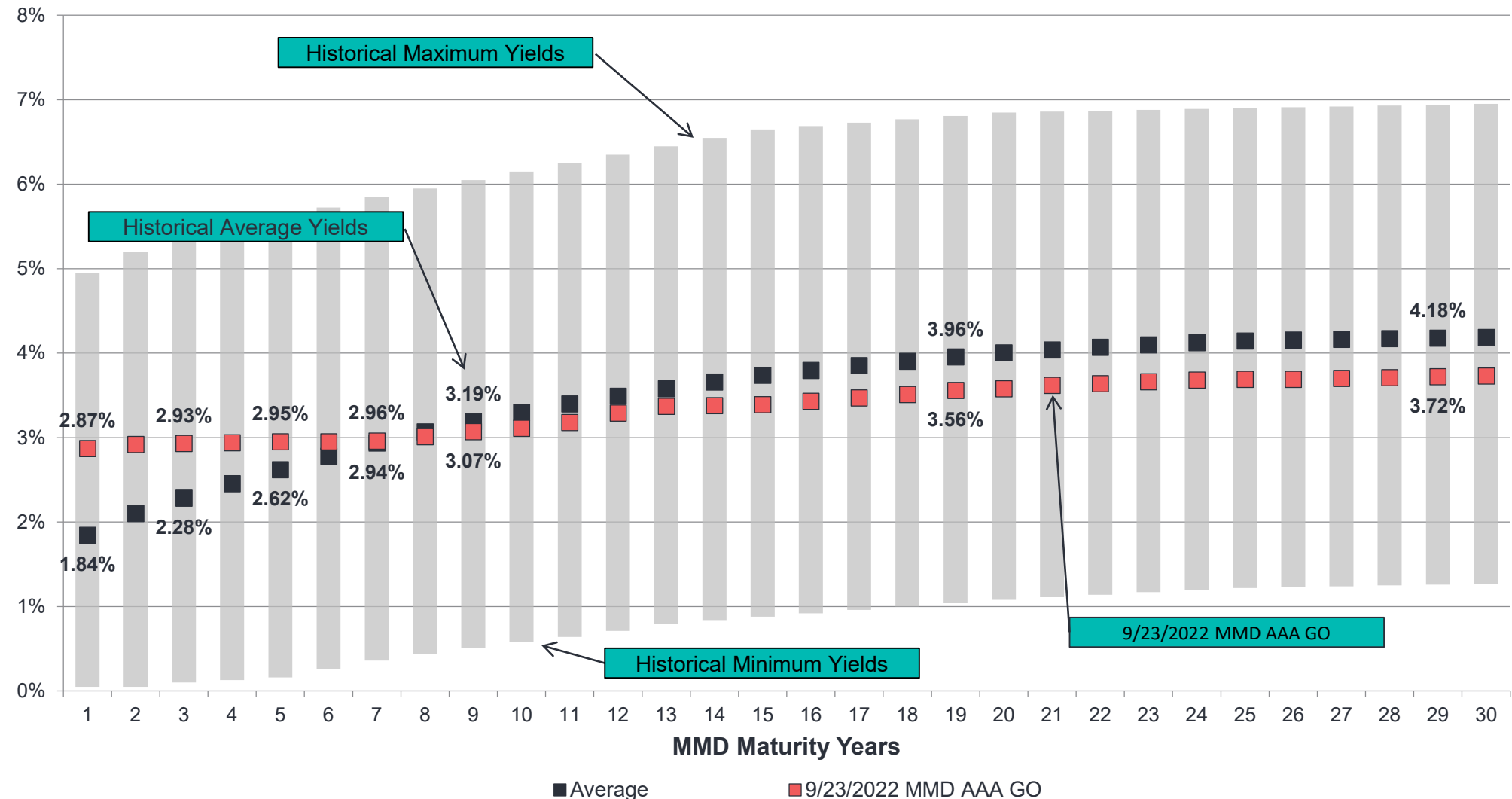




# US Treasury rates



# MMD yield curve vs historical since 1993



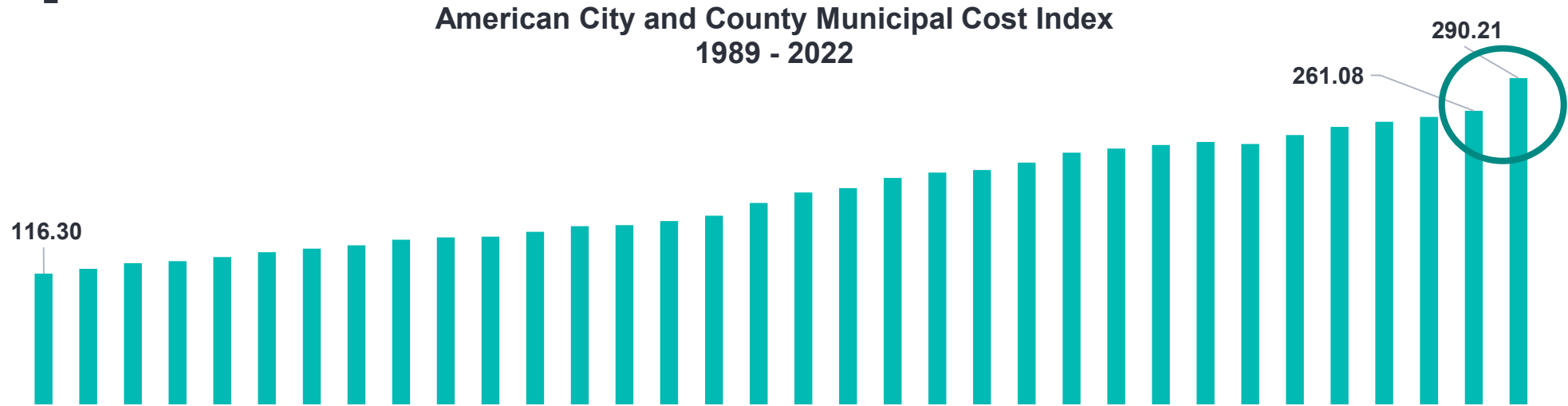
## **2. Capital project financing strategies**

## A. Stay calm

***“The Fed is going to cause ‘unbelievable calamities’ if they keep hiking...” - CNBC***

- Media sensationalizes market events
- A 50 bps (0.5%) increase on \$1 million in principal equates to \$5,000 in additional annual interest cost
- Inflation can result in increased governmental revenue via higher taxable sales and property values

## B. Be patient



- Transitory or long-term problem?
- Is it possible to delay projects until supply chain and labor tightness subsides?
- Use this time to get your projects “shovel ready”
- How much can rates rise before your project becomes unfeasible?

**“I always knew we’d make better decisions  
when we had less money”**

## C. Act strategically

- Leverage interim (short-term) financing
- Controls to get the most for your money – construction audit
- Diversify project funding sources



### Construction Audit Results: \$190mm Wastewater Treatment Plan

| Finding  | Financial impact                              |
|--|---|
| Double billed holiday and vacation time  | \$684,000                                     |
| Unauthorized travel:<br>Contractor CEO did a site visit traveling on the corporate jet | \$16,750                                      |
| Subcontractor overcharges in excess of cost incurred                                   | \$137,800                                     |
| Unauthorized personnel additions to the project  | \$262,900                                     |
| Subcontractor default insurance overcharge   | \$190,000                                     |
| Total  | \$1,291,450<br>Construction audit ROI:<br>8:1 |

## Intersections



SURFACE  
TRANSPORTATION



ECONOMIC  
DEVELOPMENT



EDUCATION



CLIMATE CHANGE



HOUSING



WATER



WASTEWATER



BROADBAND



ENVIRONMENTAL  
REMEDATION



DISPROPORTIONALLY  
IMPACTED COMMUNITIES



## D. Scenario planning

- We live in a time of rapid change
- Today's disruptive economy requires multiple financing plans based on varying assumptions and the flexibility to make adjustments along the way
- The battle between capital and people

| Factors   | Degree of Difficulty |
|---|----------------------|
| Potential for community pushback                      | Low-Medium-High      |
| Implementation technical and operational difficulty   |                      |
| Likelihood of meeting necessary implementation timing |                      |
| Disruptive impact on service delivery                 |                      |
| Disruptive impact within City organization            |                      |

# **3. Cash management**

## Reserve operating funds

### Investment considerations as rates are rising:

- Keep investment maturities short between 3-12 months
- As investments mature, stay in the 3- to 12- month range until Fed signals a pause in rate increases
- In the months preceding a Fed rate pause, begin extending maturities to 18- to 36- months as long as you are confident of liquidity needs

# Bond proceeds

## Investment considerations as rates are rising:

- Liquidity extremely important when investing construction funds
- Most large projects take 24- to 36- months to complete
- Despite rate environment, it is still prudent to match investments to the draw schedule by building a monthly investment ladder
- To take advantage of rising rates, all monthly maturities could be invested at 15-20% more than expected draws and reinvest the difference
- As always, make sure draw schedule is accurate and updated when reinvesting

# **4. Arbitrage**

## **Practical advice**

- It's been a while since we've had to worry about this
- Arbitrage is not a bad word. Maximizing earnings within the confines of investment policies is fiscally responsible and expected by the IRS
- With rates on the rise, opportunity to earn arbitrage increases and makes monitoring more important than ever
- If you have fallen behind on reporting, discuss with your municipal advisor

# Overview

- State and local governments benefit from ability to issue tax-exempt debt
- Issuers must comply with requirements under Internal Revenue code and applicable regulations through the life of the bonds
- Gross proceeds include
  - Sale proceeds
  - Investment proceeds
  - Transferred proceeds
  - Disposition proceeds
  - Replacement proceeds, such as sinking, debt service, and reserve funds
- Depending on type of proceeds, there may be an exception from rebate and subject to different rules and temporary periods



## General reporting requirements

- Analysis is required within 5-years from date of issue, then every 5<sup>th</sup> year until final redemption
- Rebate or yield reduction payments must be paid to the IRS within 60 days of computation date
- 50% to 100% penalties for late or unpaid liability
- If no liability is identified, there is no IRS filing requirement and report is retained by the issuer in the event of a future inquiry
- Issuers must maintain records through final redemption date plus 3 years



## Wrapping it up

- We've been here before
- Stay calm
- Be patient
- Act strategically
- Reap the investment benefits (and plan for arbitrage)

# Questions?

# Thank you!

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