Defining Tennessee Finance

A Glossary of Finance Terms

VOLUME I / 2019

Justin P. Wilson, Comptroller of the Treasury

Tennessee Comptroller of the Treasury

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TENNESSEE
COMPTROLLER
OF THE TREASURY

Preface

One of the most important functions of the Comptroller's Office is to participate in the financial management and oversight of state government and local governments.

The Comptroller's Office carries out a host of responsibilities in this area, such as:

- helping make decisions about the issuance of all the state's general obligation debt, the issuance of bonds and the provision of loans to local governments and other entities, and the issuance of bonds and notes to finance public higher education facilities projects,
- providing assistance, oversight, and review for certain debt issuances, budgets, and investments of local government entities, and
- staffing the State Funding Board, the Tennessee Local Development Authority, and the Tennessee State School Bond Authority.

The technical terms and jargon of public finance can impede understanding, even among those who are experienced policy makers. In furtherance of our office's mission to make government work better, we have created this glossary with definitions of commonly used terms and their relevance to public finance in the State of Tennessee.

The glossary contains over 180 entries covering many essential public finance-related terms, from balloon indebtedness to general obligation bond to revolving credit agreement.

We hope you find this publication to be a helpful resource when considering public finance matters. An online version of this glossary is also available on our office's website.

Sincerely,

Justin P. Wilson	Jason E. Mumpower
Comptroller of the Treasury	*Deputy Comptroller*

Aa

accretion

Accretion is essentially the opposite of amortization, and is an accounting process used to adjust the overall amount, or book value, of bonds outstanding on financial statements. Amortization involves writing down the book value of a bond issued at a premium; accretion involves writing up the book value of a bond issued at a discount.

When a bond is issued at a discount — it sells for less than its face value — the issuer will record the bond on its financial statements at par value less the discount. Term bonds with a face value of $100 million, for example, may sell for $95.5 million: $100 million in par value with a $4.5 million discount. The bonds are initially recorded on the financial statements at $95.5 million.

The $4.5 million discount is accreted, or gradually decreased, each year. Because the discount is subtracted from the bonds' par value, accreting the discount increases the value of the outstanding bonds on the financial statements. When the bonds near maturity, they will be recorded at their par value. For example, the bonds originally reported at $95.5 million will be recorded as $100 million – their face value – immediately before they mature.

See also:
- *amortization*
- *bond discount*
- *book value*

accrued interest

Accrued interest is the amount of interest that has been earned on a security, such as a bond, between interest payments. Most municipal bonds pay interest every six months; in the interim, however, the bond gradually accrues interest until one payment is made at the six-month mark.

When a bond or security is purchased between interest payment dates, the price of the bond includes the accrued interest. The buyer pays the seller the accrued interest as, otherwise, the seller will not receive any of the interest earned while holding the security for a partial period.

For convenience, accrued interest is usually calculated based on a 360-day year, which assumes each month has 30 days.

For example, a 4 percent, $5,000 bond may pay $100 in interest each January 1 and July 1. If a buyer purchases the bond on May 1, four months of interest, or $67, has accrued. In other words, the seller has already earned $67 by holding the bond until May. When the buyer purchases the bond, the money paid to the seller will include the $67 in accrued interest earned by the seller.

The entirety of the $100 interest payment on July 1 will go to the buyer holding the bond as of that date. Thus, by paying the $67 of accrued interest to the seller when purchasing the bond, the buyer effectively earns $37 in interest in that period, or the equivalent of holding the bond for two months from May 1 to July 1.

See also:

- *interest*

advance refunding

Bond refundings are typically used to save money by refinancing to take advantage of lower interest rates. Bonds may also be refunded to eliminate certain covenants or obligations imposed on the issuer. In a current refunding, the refunding happens immediately: new bonds are issued within 90 days of the existing bonds being called, and proceeds from the new bonds are used to pay off the old bonds.

In some cases, however, the need for a refunding may occur before the bonds are eligible to be called. In this scenario, there are two outstanding bond issues for the same project. Because the existing bonds cannot yet be called, however, proceeds from the new bonds are not used to immediately pay off the existing bonds. Instead, they are set aside in an escrow account to be used to pay periodic interest on the existing bonds, plus principal when the original bonds eventually reach their call date and are redeemed.

The proceeds from the new bonds in the escrow are usually invested in very low-risk securities, such as State and Local Government Securities (SLGS) offered by the federal government. Although these securities have low yields, they nevertheless earn some income. The timing for receipt and the amount of the investment income is included in the calculation of the amount of refunding bonds that need to be issued to fund the escrow to pay interest and principal on the original bonds. The escrow is structured to have funds timely available to make principal and interest payments on the existing bonds.

In this way, the original, higher-rate debt is functionally replaced with new, lower-rate debt. The issuer now pays interest and principal on the new, lower-rate bonds from the same sources — e.g., taxes — used for debt service on the original bonds. Debt service on the original bonds, however, is paid out of the escrow with money from the new bond proceeds. From the issuer's point of view, it is no longer responsible for the original bonds, which have been defeased: they are no longer recorded on the financial statements as a liability, and certain bondholder rights may be terminated (looking to the escrow and not the issuer for payment).

From the original bondholders' points of view, they continue receiving scheduled interest payments on their bonds, with the understanding that the issuer has set in place the process to call the bonds when they reach their call date.

The federal government determined that some issuers abused the advantage of unlimited tax-exempt advance refundings and reduced the number of times an issue could be refunded on a tax-exempt basis. The federal Tax Cuts and Jobs Act of 2017 prohibited further use of tax-exempt advance refundings as of January 1, 2018. Although state and local governments may still advance refund their bonds, the new refunding bonds must now be taxable. As a result, the refunding bonds will likely offer higher interest rates, thereby reducing the money saved on interest payments. Even so, taxable advance refundings may still offer worthwhile savings in some cases.

See also:

- *current refunding*
- *escrow account*
- *present value (PV) savings*
- *refunding trust*
- *verification agent*

alternative minimum tax (AMT)

Congress enacted the alternative minimum tax in 1969 to try to curb excessive use by higher income persons of legally available federal tax deductions in an attempt to avoid paying federal income tax. High income persons must calculate their tax liability twice, both under the regular tax system and under the AMT, paying the higher amount. Interest received from investment in private activity bonds, excluding 501(c)(3) bonds, issued after August 7, 1986, is subject to the AMT.

amortization

In the context of municipal bonds, amortization is the process of periodically paying off the principal of a bond issue and reducing the amount of debt outstanding. Principal payments may be made to the bondholders themselves or, in the case of term bonds, to a sinking fund that "saves up" in advance for one large principal payment when the bonds mature.

The State of Tennessee structures its amortization schedules, or debt service schedules, for its general obligation bonds with level principal payments. The Tennessee State School Bond Authority (TSSBA) and most local governments use level debt service structures.

Specifically regarding bond premiums, amortization is an accounting process used to decrease the overall amount, or book value, of bonds outstanding on financial statements. When a bond's coupon rate, or the interest paid to bondholders, is higher than current market rates, the bond will sell at a premium, or for more than its face value. For example, bonds with a face value of $100 million may sell for $104.7 million: $100 million in par value with a $4.7 million premium. The bonds are initially reported on the financial statements at $104.7 million.

Similar to depreciation for capital assets, the $4.7 million premium is amortized each year, or gradually written down. As the premium is amortized, the total book value of the bonds reported on the financial statements decreases. When the bonds approach maturity, they will be recorded at their par value; the bonds originally reported at $104.7 million, for example, will be recorded at $100 million – their face value – immediately before they mature.

See also:

- *accretion*
- *book value*
- *debt service*
- *debt service schedule*

arbitrage

In the context of municipal bonds, arbitrage involves a state or local government issuing debt at relatively low interest rates due to its federal tax-exempt status, and then investing the proceeds from that debt in the taxable market to earn a higher return.

To help state and local governments save money on interest costs for public projects, the federal government allows the issuance of tax-exempt bonds. Because they keep more of the interest earned rather than paying a portion in taxes, bondholders may be more willing to invest in a municipal bond with a lower yield than a federal or corporate bond with a higher yield. Consequently, state and local governments can typically issue bonds with lower interest rates than their federal or corporate counterparts.

A government might then take the proceeds from the tax-exempt debt and invest them in the higher-yielding taxable market. For example, a local government might issue tax-exempt debt at 3 percent interest, then invest those proceeds in taxable securities yielding 3.5 percent. The government would keep the difference and essentially "make money" off the additional 0.5 percent.

This practice – arbitrage – disadvantages the federal government and reduces its tax revenues. Accordingly, several federal laws restrict or prohibit arbitrage in two main ways:

- **Yield restrictions.** Generally, governments may not invest bond proceeds above the yield on that bond issue. There are several exceptions; governments may have a short window at the beginning of the project to invest their proceeds without restrictions, for example.

- **Arbitrage rebates.** If governments do have arbitrage earnings, they must generally send the excess interest to the IRS.

average coupon

Unlike fixed-rate loans, which typically have the same interest rate over the entire period – e.g., 3.5 percent for 20 years – different maturities of bonds in a single bond issue may have different coupon rates. Maturities toward the beginning of the overall term of the bond issue may have lower interest rates than maturities toward the end of the term. For example, a bond maturing within a year may have a 2 percent coupon, while the bond maturing in 20 years may have a 5 percent coupon.

See also:
- *bond year*
- *coupon or coupon rate*

authorizing resolution

A local government's governing body must authorize the issuance of bonds. This may require the passage of several resolutions. To begin with, an issuer may approve a master resolution, which establishes the general provisions for a type of bond and its issuance. Among other things, the master resolution may set a cap on the total amount of debt an issuer may have outstanding at any given time, or outline the revenues that will be used for debt service.

After the governing body passes the initial resolution, it is published in a local newspaper. With local government general obligation debt, if 10 percent of voters file a petition within 20 days objecting to the bonds, they are subject to a voter referendum. The state does not have a similar process.

The authorizing resolution contains more detail about the structure and repayment of the bonds, any call provisions, and other legal matters.

See also:
- *bond referendum*

Bb

balloon indebtedness

Balloon indebtedness refers to a debt structure where all or a substantial portion of the principal is not repaid until the final maturity. Under Tennessee state law, local government balloon indebtedness is defined as debt that:

- takes more than 30 years to mature;
- postpones paying principal or interest for more than three years after the debt is issued; or
- does not have "substantially level" or declining debt service – principal is concentrated in a few large payments at the end of the term, or matures all at once in a bullet maturity.

Local governments must get approval from the state Comptroller's Office to issue balloon debt.

See also:

- *term bond*

bank bond

Bank bonds are bonds purchased by a provider of a liquidity facility (usually a bank) in the event of a failed remarketing.

When interest rates rise, for example, bondholders may exercise a put option that requires the state or local government issuer to buy back its bonds, generally at their par value. If the bonds cannot be immediately remarketed to new investors, a bank providing a liquidity facility, such as a standby bond purchase agreement, steps in to purchase the bonds. The bonds are termed bank bonds until they are sold to other investors, or other terms of the standby bond purchase agreement are met. During the time the bonds are held by the bank, the interest rate is usually set at a higher rate.

See also:

- *liquidity facility*
- *standby bond purchase agreement*

bank qualified (BQ)

Bank qualified (BQ) is a designation for a small subset of municipal bonds that provide an economic benefit for commercial banks. Municipal bonds issued by a "qualified small issuer" or an issuer that issues $10 million or less of tax-exempt bonds during a calendar year can be designated as bank qualified.

When commercial banks invest in municipal bonds, provisions in federal law essentially cancel out the benefit of tax-exempt interest. While the bond interest itself is technically tax-exempt, as a result of holding the bonds, banks cannot make deductions they would otherwise take to reduce their overall tax burden. These provisions disincentivize commercial banks from buying municipal bonds, though a commercial bank that invests in bank qualified bonds is able to deduct a portion of the carrying cost of municipal bonds.

To help smaller governments obtain financing for public projects, the federal government created the bank qualified designation. If an issuer does not plan to issue more than $10 million in bonds in a year, it may issue tax-exempt, bank qualified bonds. When commercial banks purchase such bonds, they can take deductions that lower their overall tax burden and make the bonds a more attractive investment.

basis point (bp)

Commonly used in relation to interest rates and yields, one basis point (bp) is 1/100th of 1 percent, or 0.01 percent. For example, if a bond's yield has increased from 3.25 percent to 3.50 percent, it has increased by 25 basis points.

bearer bond

Largely defunct today, bearer bonds are considered property of the "bearer," or person or entity that holds them. As opposed to registered bonds, no record of ownership or sale is kept for bearer bonds – only a physical bond certificate serves as proof of ownership. To receive interest, physical coupons are detached from the certificate and mailed to the bond issuer or the issuer's paying agent, and the certificate itself is presented at the maturity date for payment of principal.

Historically, the anonymity of bearer bonds made them a popular vehicle for tax evasion and money laundering. As a result, a 1982 federal law prohibited federally tax-exempt and tax-advantaged bonds from being issued in bearer form.

bond

Issuing bonds is a way to borrow money, often for large projects (e.g., office buildings or parking garages) that are too expensive to pay for with current funds in a single payment. A bond is the borrower's promise to repay a set amount of money, plus periodic interest, on a specific date.

Unlike a car loan or a house mortgage, a government's borrowing is structured differently. Instead of establishing a repayment schedule based on a single interest rate and single maturity date, when a government issues bonds, the repayment schedule is based on multiple maturity dates with different interest rates. Thus, at any given time, the government may owe money to thousands of different individuals, businesses, or governments holding its bonds and not just to a single lender.

Both private businesses and government entities issue bonds, and bonds share common characteristics:

- The issuer is the entity borrowing money, such as a state or local government.
- The bond's par or face value is the amount of money that will be repaid at the bond's maturity date. Most municipal bonds are issued in multiples of $5,000, requiring a rounding up or down of the amount borrowed.
- The bond's coupon or coupon rate is the interest rate that will be paid to the bondholder, often every six months. For example, a $5,000 bond with a 5 percent coupon will pay $250 in interest each year, or $125 every six months.

A bond may be bought, sold, and held by many investors over its life before it is paid off. When bonds are originally issued or are traded later on the secondary market, they may not sell for their par amount. A bond's price depends on how its coupon rate compares to current interest rates on the market for similar investments. If a bond's coupon rate is lower than the market rate, the bond will be less attractive to investors and will sell for less than its par amount, or at a discount.

In Tennessee, the authority for the state and local governments to issue bonds is found in the Tennessee Constitution and statutes. At the state level, the four primary debt issuers are:

- the State Funding Board, which issues the state's general obligation debt for capital projects, as authorized by the Tennessee General Assembly.
- the Tennessee Housing Development Agency (THDA), which uses bonds to finance low- and moderate-income home loan programs.
- the Tennessee Local Development Authority (TLDA), which is authorized to issue bonds and notes to make loans to local governments, small businesses, and nonprofits for specific purposes, such as water and sewer recovery facilities.
- the Tennessee State School Bond Authority (TSSBA), which uses bonds to finance capital projects for the state's colleges and universities.

State law authorizes many local government entities to issue bonds, including counties, cities, metropolitan governments, utility districts, and Industrial Development Boards (IDBs). County and city school districts, however, do not have the legal authority to issue bonds.

See also:

- *bearer bond*
- *Local Government Public Obligations Act of 1986*
- *long-term debt*
- *registered bond*
- *yield curve*

bond anticipation note (BAN)

A bond anticipation note (BAN) is a type of short-term borrowing used prior to issuing long-term bonds. BANs may be used to generate funding to pay for the construction or acquisition phase of a project. When the project is finished, bonds are issued, and the bond proceeds are used to pay off the bond anticipation notes.

Commercial paper is one example of a bond anticipation note.

See also:

- *commercial paper*
- *note*

bond closing

When an issuer sells a new issue of municipal bonds to an underwriter, the transaction is finalized on the closing date: the issuer and its financing team, along with the underwriter and its legal counsel, sign closing documents. At that point, the underwriter pays for the bonds and the issuer delivers the bonds to the underwriter.

See also:

- *delivery date*
- *delivery versus payment (DVP)*

bond counsel

Along with the financial advisor, the bond counsel is an integral part of the issuer's financing team. The bond counsel looks at legal issues related to a bond issue and subsequently gives a legal opinion. The opinion generally confirms that the issuer is legally authorized to issue the bonds; that the bond issue is a legally binding obligation; and, in the case of tax-exempt bonds, that the bond interest is indeed exempt from specified taxes. The opinion does not address the issuer's creditworthiness. The bond counsel may also draft or review various documentation, including bond contracts and official statements.

See also:

- *rating agency*

bond covenant

A bond covenant is a legal provision in the bond contract that sets restrictions on the issuer to protect investors. For example, covenants may require the issuer to:

- raise enough taxes and fees to pay debt service;
- maintain the financed facility at an acceptable level and provide casualty insurance;
- not issue new bonds or debt unless certain thresholds are met – e.g., revenues available for debt service are at least 1.25 times the amount needed for proposed and outstanding debt;
- not take any action that would change the tax status of the bonds from tax-exempt to taxable.

bond discount

When bonds are issued or sold for less than their par value, the bond discount is the difference between their price and their par value (i.e., face value).

When bonds are originally issued or traded later on the secondary market, they may sell for more or less than their par value. A bond's price depends on how its coupon rate, or the interest rate it will pay to bondholders, compares to current market interest rates for similar credits.

If a bond's coupon rate is lower than the current market rate, it will be less attractive to investors, and it will sell for less than its par value, or at a discount. For example, if $100 million of 20-year term bonds pay 3 percent interest while the market rate is 4 percent, the bonds may sell for $86 million: $100 million of par value less a $14 million discount.

The original issue discount is the bond discount when the bond is issued. After the bonds are issued, the issuer records them on its financial statements at their book value: their par value less the original issue discount. As time passes, the discount is accreted, or gradually decreased – as the discount decreases, the bonds' book value correspondingly increases. Before the bonds mature, they are recorded on the issuer's financial statements at $100 million, their par value.

See also:

- *accretion*
- *book value*
- *par value*

bond insurance

Bond insurance is a type of credit enhancement where an issuer essentially pays money to increase the credit rating on its bonds. Through a bond insurance policy, an insurance company agrees to pay principal and interest on the insured bonds if the issuer defaults. The issuer's lower bond rating on the issue prior to insurance is thus upgraded to the insurance company's higher claims-paying rating (analogous to a bond rating). The premium the issuer pays to the insurance company is offset by the reduced bond interest the issuer pays to bondholders due to the enhanced credit rating.

Because the State of Tennessee has a triple-AAA bond rating — the highest possible rating — bond insurance is not needed to upgrade the ratings on its general obligation bonds.

See also:

- *credit enhancement*

bond premium

When bonds are issued or sold for more than their par value, the bond premium is the difference between their price and their par value (i.e., face value).

When bonds are originally issued or traded later on the secondary market, they may sell for more or less than their par value. A bond's price depends on how its coupon rate – the interest rate it will pay to bondholders – compares to current interest rates on the market.

If a bond's coupon rate is higher than the current market rate, it will sell for more than its par value, or at a premium. For example, if $100 million of 20-year term bonds pay 5 percent interest while the market rate is 4 percent, the bonds may sell for $114 million: $100 million of par value and a $14 million premium.

The original issue premium is the bond premium when the bond is issued. After the bonds are issued, the issuer records them on its financial statements at their book value, which is their par value plus the original issue premium. As time passes, the premium is amortized, or gradually decreased, and the bonds' book value correspondingly decreases. Right before the bonds mature, they are recorded on the issuer's financial statements at $100 million, their par value.

See also:

- *amortization*
- *book value*

bond price

A bond's price is the amount of money paid to buy the bond, either when the bond is originally issued or sold later on the secondary market. Depending on how a bond's coupon rate, or the interest it pays to investors, compares to current market interest rates, the bond's price may be higher or lower than its par value. For example, if current interest rates are 3 percent, a $5,000 bond with 10 years to maturity and a 2.5 percent coupon may sell for $4,785.

bond proceeds

When bonds are issued, the proceeds are the amount of money the issuer receives from the buyers, or underwriters. Depending on how the bonds' coupon rates compare to current market interest rates, the proceeds may be more or less than the bonds' par value. In other words, the issuer may receive more or less money when the bonds are originally sold than it will eventually repay in principal.

For example, if $100 million of 20-year term bonds are priced with a 4 percent coupon rate while current market rates are 3 percent, the issuer may receive $115 million in proceeds, or more than the $100 million of par value.

Bond proceeds may be used only for the purposes as provided in the bond contract or authorizing documents.

bond purchase agreement (BPA)

When an issuer sells a new issue of municipal bonds to an underwriter, the bond purchase agreement (BPA) outlines the final terms of the sale. Among other legal information, the contract outlines information about the bonds, such as maturity dates, interest rates, and call provisions; the purchase price and underwriter's fees; and any conditions that would allow the underwriter to withdraw from the agreement. The BPA is usually signed and executed on the day of sale.

bond purchaser

In general, a bond purchaser is any person or entity that buys a bond. The purchaser may be an underwriter; an institutional investor, such as a fund, bank, or insurance company; or a retail investor, such as a household or individual.

bond referendum

Through a bond referendum, voters of the entity that is planning to issue bonds vote on whether or not to allow the bonds to be issued.

In Tennessee, state bonds, school bonds issued by counties, and revenue bonds issued by local governments do not need voter approval to be issued. General obligation bonds of cities and counties, however, may be subject to a voter referendum.

As outlined in state law, after local governments adopt an initial resolution to issue general obligation bonds, they must publish notice in a local newspaper. If a petition objecting to the bonds is signed by at least 10 percent of voters and filed within 20 days, the bonds are subject to a referendum. If the vote fails, the bonds cannot be issued at that time, and the local government must wait at least three months before trying again.

bond trustee

The bond trustee, generally a trust company or a trust division of a bank, enforces the bond contract with the issuer. The trustee acts on behalf of the bondholders in a fiduciary capacity, rather than the issuer, ensuring compliance with bond covenants and overseeing operation within approved budgets.

When principal and interest payments are due, the issuer sends the money to the bond trustee. In practice, the trustee may serve in multiple capacities for the issuer, including as the registrar that maintains the list of bondholders and the paying agent that makes payments to investors.

See also:

- *trust indenture*

bond year

A bond year is a figure used to calculate the weighted average maturity of an issue and its net interest cost. Regardless of the bond's denomination – e.g., whether a bond is issued in multiples of $5,000 – a bond year is a unit of $1,000 of debt that is outstanding for a 12-month period.

To find the number of bond years, the amount of principal maturing in each year is multiplied by the number of years to maturity. The resulting figure – bond year dollars – is then divided by $1,000 to find bond years.

See also:

- *average coupon*
- *net interest cost (NIC)*
- *weighted average maturity (WAM)*

bond yield

A bond's yield is its annual return to an investor based on its price, coupon rate, and how long the investor holds it before it matures or is sold. The yield may not match the stated interest rate on the bond.

If a bond's coupon rate is higher than market interest rates, the bond will trade for more than its par value, or at a premium. For example, if current interest rates are 3 percent, a bond with a $5,000 par value and a 4 percent coupon may sell for $5,430. Although the investor will receive higher interest payments than it would have if it had purchased another bond with a lower coupon, it paid an additional $430 up front to purchase the bond. Thus, the bond's yield, which takes into account both the bond's price and coupon, will be lower than the 4 percent coupon rate.

Multiple yields may be calculated for the same bond based on structure and how long the investor holds it:

- Yield to maturity (YTM) assumes the investor will hold the bond until it matures;
- Yield to call (YTC) assumes the issuer will pay off the bond before its maturity date;
- Yield to put (YTP) assumes the investor will force the issuer to repurchase the bond before it matures; and
- Yield to worst (YTW) is the lowest of yield to maturity, yield to call, and any other associated calculation.

See also:

- *yield to maturity (YTM)*

book-entry only

A book-entry only security is not issued in physical form and does not have a physical bond certificate for each individual bondholder. Instead, ownership records are kept electronically and updated each time the bond is sold. Almost all municipal bonds are in book-entry only form.

See also:
- *Depository Trust Company (DTC)*

book value

From an issuer's standpoint, book value is the amount at which outstanding bonds are reported on its financial statements, or "carried on the books." When the bonds are first issued, book value is the par value of the bonds, plus any premium or less any discount. As time passes, the premium is amortized or the discount is accreted, and the book value of the bonds is accordingly adjusted up or down. More specifically, each time the premium or discount decreases, the bonds' book value approaches their par value. Immediately before the bonds mature, their book value will equal their par value.

Depending on how the market has changed since the bonds were issued, book value may not correspond to the bonds' fair market value, or how much the bonds would sell for on the secondary market.

See also:
- *accretion*
- *amortization*
- *fair market value*

broker-dealer

Many companies act as both brokers and dealers, and are thus called broker-dealers.

A broker is a person or company that brings together buyers and sellers of securities, such as stocks or bonds. For example, if the broker's customer wants to buy stock of a particular company, the broker finds a seller, facilitates the trade, and charges a commission on the transaction.

A dealer, by contrast, directly participates in the transaction. For example, a dealer may buy shares of stock from the other party for its own accounts, or sell shares it already owns. While brokers make their money off trade commissions, dealers make money on the difference between the money they pay for the security and the money they sell it for.

Build America Bonds (BABs)

The federal American Recovery and Reinvestment Act of 2009 (ARRA) included a provision that created the Build America Bond program. The program intended to make municipal bonds more attractive to investors and help state and local governments finance capital projects.

Unlike most municipal bonds, Build America Bonds (BABs) are subject to federal income taxes. Two types of benefits – tax credits and direct subsidy payments – nevertheless made these taxable bonds more advantageous than some tax-exempt bonds.

For the direct subsidy payment BABs, the federal government directly paid issuers 35 percent of the interest they owed to bondholders. In other words, the issuer was responsible for only 65 percent of the interest payment from its own money – for a 6 percent bond, the federal government paid 2.1 percent interest and the issuer paid the remaining 3.9 percent. With the federal subsidy for interest payments, state and local governments could issue bonds at higher, more competitive interest rates.

In lieu of the federal government directly helping states and local governments with interest payments, tax credit bonds offered bondholders a federal income tax credit equal to 35 percent of the interest received. While investors received lower interest payments from the state or local governments than they would have with direct payment BABs, they also paid less in income taxes due to the tax credit.

Cc

call

A call is a provision that allows the issuer to "call" in – redeem or pay off – an outstanding bond ahead of schedule. In doing so, the issuer pays bondholders the par amount of the bond, plus any interest that has been earned in the partial period before the next interest payment. Depending on the bond contract, the issuer may also pay an additional amount to bondholders, or a "call premium" if a call provision is included. If bonds are not subject to call, they are said to have "call protection."

Bonds are generally called when current interest rates drop below the interest rates on the existing bonds. For example, an issuer may have issued 20-year, 5 percent bonds that may be called after 10 years. If interest rates for a bond maturing in 10 years have dropped to 3 percent at the 10-year call date, the issuer may save money by calling in its existing 5 percent bonds and issuing new 10-year bonds that pay 3 percent interest.

As set in its debt management policy, the State of Tennessee has a preference for issuing long-term general obligation bonds that can be called.

call date

With regard to callable bonds, the call date is the date the bonds may be redeemed and paid off early, as specified by the bond contract. The State of Tennessee's debt management policy for general obligation bonds allows for call dates to be set no more than 10 years from the date the bonds were issued.

See also:

- *call*

capital appreciation bond (CAB)

Capital appreciation bonds (CAB) do not pay periodic interest to bondholders. Like zero-coupon bonds, capital appreciation bonds are sold for substantially less than their par value, then pay out their full value at maturity. For example, a 10-year, $5,000 capital appreciation bond may sell for $3,365. Although the bondholder will not receive periodic interest over the ensuing 10 years, it will receive the full $5,000 when the bond matures.

See also:

- *zero-coupon bond*

capital outlay note (CON)

A capital outlay note is a type of short- to intermediate-term financing used by Tennessee local governments after receiving prior written approval by the Comptroller of the Treasury or his designee. Capital outlay notes may be used to finance the construction phase of large projects or to purchase smaller assets, such as vehicles or equipment. Capital outlay notes may remain outstanding for up to 12 years.

See also:

- *note*

capital project

Capital projects involve large-scale projects, such as buying land, building a new facility, or renovating an existing building. Because these large assets last for many years, they may be financed with bonds to spread the cost of the project over its life.

certificate of public purpose and necessity (CPPN)

When a local government issues general obligation bonds to finance certain statutorily-required projects for private businesses, a certificate of public purpose and necessity (CPPN) is required. Local governments apply to the Tennessee Department of Economic and Community Development for a CPPN. The application must outline the scope of the project, explain how it will benefit the public, and break down costs and proposed repayment.

If the certificate is granted, the local government may then issue general obligation bonds for the project, and thus finance the developments intended for private businesses.

commercial paper (CP)

Commercial paper (CP) is a type of short-term borrowing where the borrower sells promissory notes that mature from two to 270 days. Although the CP must be paid at maturity, it is often “rolled” — the matured commercial paper is paid off with newly issued commercial paper. In this way, short-term debt may be extended for a longer period of time. Each issue of commercial paper may have a different interest rate.

The State of Tennessee’s current commercial paper program allows the state to borrow up to $350 million, which can be rolled continuously for up to 10 years. CP is used to fund the construction phase of a project; when the project is completed, bonds are issued and the proceeds are used to pay off the commercial paper.

See also:

- *bond anticipation note (BAN)*
- *note*
- *short-term debt*

competitive sale

In a competitive sale, the issuer publishes a notice of sale, which announces its intent to issue new debt. The notice usually includes the date and time of the sale, as well as the specifics of the debt, such as the total amount to be issued, the type, and any parameters for the interest rates.

Bonds are usually awarded to the bid adhering to the requirements of the official notice of sale that will result in the lowest interest cost to the issuer.

The State of Tennessee prefers to use competitive sale for its general obligation bonds.

See also:

- *method of sale*
- *negotiated sale*
- *private placement*

conduit financing

In a conduit financing, the entity issuing the bonds passes the proceeds to another governmental entity or to a nongovernmental entity, such as a private business or charitable organization, usually pursuant to a loan agreement.

Interest on state and local bonds is exempt from federal income taxes, so long as the bonds are used to finance public projects, such as government office buildings or parks. Bonds that primarily benefit private individuals or companies – private activity bonds – are generally taxable, unless they are used for certain purposes outlined in federal law. Among other things, these "qualified private activity bonds" may be used to build low-income housing or facilities for charitable organizations.

Because this subset of private activity bonds is tax-exempt, money may be borrowed by the government at lower interest rates than if the private entity issued its own taxable bonds. Thus, a governmental issuer, the "conduit issuer," issues the bonds, and typically loans the proceeds to the private entity, or "conduit borrower." The private entity is responsible for associated principal and interest payments.

See also:

- *private activity bond (PAB)*

continuing disclosure agreement/undertaking

Securities and Exchange Commission (SEC) Rule 15c2-12 provides for continuing disclosure of information regarding municipal bonds. When state and local governments issue bonds, the underwriters must make sure that the issuers have agreed to provide ongoing information to the Municipal Securities Rulemaking Board (MSRB) and investors over the life of the debt.

Examples of such disclosures include:

- financial information and annual financial reports;
- failures to make principal or interest payments on time;
- changes in the bonds' status from tax-exempt to taxable; and
- changes in credit ratings.

These disclosures are publicly posted on the MSRB's Electronic Municipal Market Access (EMMA) website at https://emma.msrb.org. If the information provided is incorrect, or important information is omitted, the issuer may face penalties or fraud charges.

See also:

- *Electronic Municipal Market Access (EMMA)*
- *event notice*
- *Municipal Securities Rulemaking Board (MSRB)*
- *SEC Rule 15c2-12*

coupon or coupon rate

A bond's coupon, or coupon rate, sets the amount of interest the bondholder will receive while holding the bond. Although interest on municipal bonds is typically paid twice a year, the coupon is usually expressed as an annual percentage of the principal amount. For example, a $5,000 bond with a 4 percent coupon will pay $200 in interest each year, or $100 every six months.

For fixed rate bonds, the coupon is set in the bond contract when the bond is issued; it is legally binding and does not change over the term of the bond. As such, it is not affected by subsequent changes in market interest rates – the $5,000 bond with a 4 percent coupon will continue to pay $200 in interest each year, even if interest rates decrease to 3 percent or increase to 5 percent.

A variable interest rate, by contrast, may periodically change or "reset" as it tracks with a specific index (e.g., the London Interbank Offered Rate, or LIBOR).

See also
- *bearer bond*

credit enhancement

In a credit enhancement, an issuer pays a third party to provide a "backup" source of funding for principal and interest payments on its bonds. This added guarantee reduces the risk that payments will not be made to bondholders, and thus allows the issuer to obtain a higher credit rating for its bonds. The new bond rating is based on the credit rating of the entity providing the enhancement, rather than the issuer.

Bond insurance is an example of a credit enhancement: an issuer buys a bond insurance policy from an insurance company, and in return, the insurance company agrees to pay interest and principal on the insured bonds if the issuer defaults. The insurance company's claims-paying rating — analogous to a bond rating — is used for the bonds.

A letter of credit from a bank is another form of credit enhancement. In this case, a commercial bank makes an irrevocable commitment to pay principal and interest if the issuer cannot make payments. When the bonds are issued, the bank's credit rating, rather than the issuer's, is used.

See also:

- *bond insurance*
- *credit facility*

credit facility

A credit facility is an instrument, such as a bond insurance policy or letter of credit, that enhances an issuer's credit. By using a credit enhancement, an issuer upgrades the rating on its bonds by paying a third party to provide a "backup" funding source for principal and interest payments.

See also:

- *credit enhancement*

current refunding

In a bond refunding, an issuer refinances its debt, often to take advantage of lower interest rates. In a current refunding, new bonds are issued within 90 days of the existing bonds being called, and the new refunding bond proceeds are immediately used to pay off the original refunded bonds. By contrast, in an advance refunding, the call date of the existing bonds is more than 90 days away.

For example, an issuer may have issued 20-year, 6 percent bonds that may be called after 10 years. After 10 years, interest rates for bonds maturing in 10 years may have dropped to 4 percent. The issuer may then issue new bonds maturing in 10 years at 4 percent interest. The issuer calls the existing 6 percent bonds and pays them off with the proceeds from the 4 percent bonds. In doing so, the issuer borrows the same amount of money overall, but saves money on debt service by paying less interest to bondholders

See also:

- *advance refunding*
- *call*

CUSIP number

CUSIP number stands for Committee on Uniform Security Identification Procedures number, and is a nine-digit code that uniquely identifies an individual financial instrument (e.g., a stock, a bond, a certificate of deposit).

The first six characters of each CUSIP number are unique for every company or issuer – for example, the first six digits for each issue of the state's general obligation debt are 880541. The seventh and eight digits denote the type of security – debt or equity – and the ninth digit is a "check" figure based on the previous eight characters.

Dd

debt

In general, debt refers to borrowing money and repaying it with interest, sometimes over an extended period of time. Short-term debt is usually repaid within a year, whereas long-term debt may not be fully paid off for 20 years or more.

The Tennessee State Constitution does not allow the state to borrow money for its operating expenses unless it is repaid within the fiscal year. Local governments may issue long-term, so-called "funding bonds" for operating purposes only in extreme circumstances and under strict oversight by the state Comptroller's Office.

Instead, the state and local governments typically use long-term debt to finance capital projects – large projects, such as office buildings, that will last for many years and may be too expensive to pay for at the time of construction with current funds. By repaying the debt over a longer period of time, the cost of the project is spread over its life.

Bonds, notes, loan agreements, and capital leases are forms of debt.

See also:

- *bond*
- *lease*
- *long-term debt*
- *note*
- *short-term debt*

debt capacity

Debt capacity refers to how much debt an entity, such as a state or local government, can support – in other words, how much it can afford to borrow based on its available resources. Various statistics and ratios can be used to measure debt capacity, including debt per capita and the ratio of revenues available for debt service compared to the money actually needed for debt service.

See also:

- *debt ratios*

debt limit

Debt limit refers to the maximum amount of principal an issuer may issue or have outstanding at any given time. This may be imposed by the State Constitution, statute, charter provision, or policy. For example, under state law, the State of Tennessee cannot issue additional general obligation bonds if the maximum annual debt service on its existing bonds is more than 10 percent of the state tax revenues allocated to the general fund, highway fund, and debt service fund.

There is not a statutory specified debt limit for local governments in Tennessee.

debt management policy

A debt management policy is a guiding document regarding the types and amounts of debt an entity may issue and how that debt is managed. The policy helps to ensure that financial resources are sufficient to fulfill a long-term capital plan. For example, a debt management policy may:

- outline preferences or limitations on the structure of debt – e.g., bond terms no longer than 20 years or level principal payments;
- establish preferences for using competitive sale, negotiated sale, or private placement when bonds are issued;
- set savings thresholds that must be met before refunding bonds; and
- provide guidance on the use of credit enhancements, such as bond insurance and letters of credit.
- The Tennessee State Funding Board requires all local government entities that issue debt to adopt a written debt management policy. The Funding Board sets minimum requirements and provides model language for such policies covering transparency, the professionals used in the transaction (e.g., financial advisor, underwriter), and conflicts of interest.

See also:

- *Tennessee State Funding Board's Statement on Debt Management*

debt ratios

Debt ratios are statistics that provide a measure of an issuer's outstanding debt in relation to various other economic or demographic factors. Rating agencies may use these ratios to determine the credit quality of the issuer or an individual bond issue.

Common ratios include:

- **debt per capita:** the issuer's total outstanding debt divided by its population.
- **debt service coverage:** the ratio of revenues available to pay annual debt service – principal and interest – to the amount actually needed for debt service. For example, if an issuer will pay $15 million annually in debt service and has $20 million to do so, its coverage ratio is 1.33.
- **interest coverage:** similar to the debt service coverage ratio, the interest coverage ratio considers the ratio of revenues available to pay annual debt service to the amount needed for interest payments.

debt service

Debt service is the amount of money needed to pay both interest on all outstanding bonds and the principal of any matured bonds.

See also:

- *debt service schedule*

debt service fund

When bonds are issued, money to make principal and interest payments is typically deposited into and paid out of a debt service fund, restricting or committing the funds for that use. Governments may have several debt service funds, or they may use one fund to account for multiple bond issues.

debt service reserve fund (DSRF)

A debt service reserve fund is a source of "backup" funding used to pay interest and principal if the money otherwise used – e.g., taxes or fees – is not enough to make payments.

Debt service reserves may be particularly important with revenue bonds, where bonds are repaid only with revenues generated by the project being financed. Because these revenues – generally fees or other charges for services – may fluctuate or be unpredictable, investors may be concerned with the issuer's ability to pay principal and interest on time. As a result, the bond contract may include a debt service reserve requirement that requires issuers to maintain a certain amount of money in a debt service reserve fund (the maximum annual debt service or 10 percent of the bonds' par value, for example).

Debt service reserves may be funded with bond proceeds; if the issuer needs $100 million for projects and $10 million for its debt service reserve, for example, it may structure its bonds to receive $110 million in proceeds. Debt service reserves may also be funded with any excess revenue generated by the project being financed, or guaranteed with a letter of credit or surety bond purchased from a third party.

debt service schedule

A debt service schedule, or amortization schedule, lists all periodic payments of both principal and interest over the life of the bonds.

There are various ways to structure debt service:

- Level principal structures pay equal amounts of principal each year over the life of the debt. As a result, interest payments, and therefore total debt service, decline each time as less interest is accrued off the decreasing principal balance. The State of Tennessee's general obligation debt is structured with level principal.
- Level debt service structures are similar to many loans with equal installment payments. In a level debt service arrangement, the combined amount of principal and interest payments stay relatively constant each year. Toward the beginning of the term, interest makes up a larger portion of these payments; as principal is paid over the life of the debt, interest makes up a smaller portion of later payments. The Tennessee State School Bond Authority (TSSBA) and most local governments use level debt service structures.
- Ascending debt service may involve deferring principal or interest in early years, or principal payments that gradually increase over time. Ascending debt service may be used when revenues to pay off the debt are expected to grow over time, such as with a new facility or system.

See also:

- *amortization*
- *debt service*

default

An issuer defaults when it fails to pay bond interest or principal on time, or does not comply with other provisions in the bond contract.

- In a **monetary default**, the most serious type of default, the issuer does not pay interest or principal to bondholders on time or in full.
- In a **technical** or **nonpayment default**, the issuer continues to make payments on time, but may violate other conditions in the bond agreement. For example, a portion of the project financed with the bonds may be used for private purposes, changing the tax status of the debt from tax-exempt to taxable.

An *event of default* may occur following a monetary default, or if a technical default is not corrected after a certain period of time. The bondholders may then demand the legal remedies outlined in the bond contract – for example, with a private activity bond default the entire amount of unpaid principal may become due immediately or in a general obligation bond default the government may be required to increase revenues to remedy the delinquent payment and to provide additional coverage for the future.

delivery date

When securities, such as bonds, are sold, the delivery date is the date the transaction is completed and the bonds are "delivered" to the new owner. At that point, the new owner may sell the bonds to another investor.

The delivery date is generally a day or more after the trade date, or the day the buyer and seller agree on the transaction. In the past, when stocks and bonds had physical certificates, the delivery date may have lagged further behind the trade date while the certificate was transferred between brokers.

See also:

- *delivery versus payment (DVP)*
- *Depository Trust Company (DTC)*

delivery versus payment (DVP)

Delivery versus payment (DVP) is a way of settling transactions when securities, such as bonds, are bought and sold. In DVP, actions on both sides of the transaction are timed to occur at the same time: the buyer's payment is processed when the seller delivers the securities to the buyer.

This method reduces risk on both sides of the transaction – there is less risk that the buyer will not pay after the securities are received, and less risk that the seller will not deliver the securities after payment is made.

See also:

- *delivery date*
- *Depository Trust Company (DTC)*

Depository Trust Company (DTC)

Depository Trust Company (DTC), a subsidiary of the Depository Trust & Clearing Corporation (DTCC), is one of the largest securities depositories facilitating payment and transfer of securities. Most large banks and broker-dealers are members, and the parent company, Depository Trust & Clearing Corporation, reports processing over 100 million financial transactions a day.

See also:

- *delivery date*
- *delivery versus payment (DVP)*

depreciation

Depreciation is a method of reducing the value of a large asset as it "wears out" over time.

Certain large assets – capital assets, such as buildings or expensive equipment – lose value as they age, but nevertheless last for many years. Thus, from an accounting perspective, these capital assets are not used up all at once. For example, a $100,000 piece of equipment that will last for 10 years does not "cost" the entire $100,000 in the first year it is purchased.

Through depreciation, the full cost of the equipment is spread out gradually while it is in use. One method of depreciation allocates the $100,000 purchase price evenly over the life of the equipment: each year, the equipment will depreciate and lose $10,000 in value.

See also:

- *amortization*
- *useful economic life*

direct pay subsidy bond

A direct pay subsidy bond is a type of municipal bond where the issuer receives money from another entity, such as the federal government, to help with interest payments.

Some Build America Bonds (BABs), for example, were direct pay subsidy bonds. Although the bonds were issued by state and local governments, the federal government directly paid issuers 35 percent of the interest they owed to bondholders. That is, the state or local government was only responsible for 65 percent of the interest payment from its own money; thus, for a 6 percent bond, the federal government paid 2.1 percent interest and the issuer paid the remaining 3.9 percent. With the federal subsidy for interest payments, state and local governments could issue bonds at higher, more competitive interest rates.

See also:

- *Build America Bonds (BABs)*

discount bond

A discount bond is sold for less than its par value. When a bond is originally issued or traded later on the secondary market, its price depends on how its coupon rate – the interest rate it will pay to bondholders – compares to current market interest rates.

If a bond's coupon rate is lower than the market rate, it will be less attractive to investors. As a result, it will sell for less than its par value, or at a discount. For example, if a $5,000, 15-year term bond pays 2.5 percent interest while the market rate is 3 percent, it may sell for $4,700.

See also:

- *bond discount*

dissemination agent

A dissemination agent publicly posts ongoing information regarding issuers of municipal bonds, and may be the issuer itself or a third party.

Securities and Exchange (SEC) Rule 15c2-12 requires that certain information about municipal issuers be periodically disclosed over the life of their bonds. Before purchasing bonds from state and local governments, underwriters must make sure that the issuers have agreed to provide ongoing information to the Municipal Securities Rulemaking Board (MSRB).

The dissemination agent submits such information – such as annual financial reports and notices of significant events, such as defaults or rating changes – to the MSRB. The issuer may serve as its own dissemination agent, or may hire a private company to make these disclosures on its behalf.

See also:

- *continuing disclosure agreement/undertaking*
- *SEC Rule 15c2-12*

Ee

Electronic Municipal Market Access (EMMA)

The Electronic Municipal Market Access (EMMA) system, operated by the Municipal Securities Rulemaking Board (MSRB), is an online source for information regarding municipal bonds. Among other things, EMMA serves as the central repository for official statements and other documentation for new bonds, as well as continuing disclosures (e.g., annual financial reports) related to outstanding debt.

The searchable EMMA website provides free access to members of the public, and is available at https://emma.msrb.org/.

See also:

- *Municipal Securities Rulemaking Board (MSRB)*

escrow account

In general, an escrow is an arrangement where a third party, such as a bank, holds money on behalf of one party. The third party then pays out the money in the escrow account to other parties based on contractual arrangements.

In the context of municipal bonds, escrow accounts are typically used in conjunction with advance refundings. In an advance refunding, interest rates drop before outstanding bonds may be called and paid off early. To “lock in” the lower interest rate and corresponding savings, new bonds are issued at the lower interest rate, and the proceeds are put into an escrow account.

The proceeds from the new bonds in the escrow are then used to pay periodic interest on the existing higher-rate bonds, plus principal when the original bonds eventually reach their call date and are redeemed.

See also:
- *advance refunding*
- *refunding trust*
- *verification agent*

event of default

See default.

event notice

Event notices – sometimes referred to as material event notices – are the public disclosure of certain events related to municipal bonds that may be relevant to investors. Under the continuing disclosure requirements of Securities and Exchange Commission (SEC) Rule 15c2-12, underwriters must make sure that issuers of municipal bonds agree to provide ongoing information to the Municipal Securities Rulemaking Board (MSRB), including event notices.

Examples of event notices include:

- delays or failures to make principal and interest payments;
- unscheduled use of debt service reserves or credit enhancements;
- changes in the bonds' status from tax-exempt to taxable;
- changes in credit rating; and
- bankruptcy or insolvency.

See also:
- *continuing disclosure agreement/undertaking*
- *SEC Rule 15c2-12*

Ff

face amount

See par value.

fair market value

Fair market value, or market value, is the amount a bond or other security could be sold for in the current market. Depending on market conditions, fair market value may not correspond to the security's book value, or the value at which the issuer reports the security on its financial statements.

See also:

- *book value*

Federal Deposit Insurance Corporation (FDIC)

The Federal Deposit Insurance Corporation (FDIC) is a federally owned corporation that guarantees customers' deposits at member banks. Created in 1933, the FDIC was intended to restore public confidence in banks following the failures and bank runs of the Great Depression.

Currently, the FDIC insures up to $250,000 per depositor on their deposits – e.g., checking or savings accounts, money market accounts, and certificates of deposit. In other words, if an FDIC-insured bank goes bankrupt, customers will not lose their money: the FDIC will reimburse them, dollar for dollar, up to $250,000. The FDIC does not cover stocks, bonds, mutual funds, or other securities.

The FDIC also directly supervises some banks and checks for compliance with several consumer protection laws, such as the Fair Credit Reporting Act and the Truth-In-Lending Act.

The FDIC does not receive taxpayer money, but is primarily funded by membership dues of participating banks.

federal tax status

Under federal law, an investor may or may not have to pay federal income taxes on debt interest. Earnings on corporate bonds and securities from the U.S. Treasury and other federal entities are subject to income taxes. Interest received from certain municipal debt, however, may be exempt from federal taxes.

Municipal bond interest may be exempt from federal income taxes if the bonds are used for governmental purposes, e.g., building a state or local government building. In addition to the federal exemption, state law may exempt interest from municipal bonds from corresponding state and local taxes.

financial advisor

Along with the bond counsel, the financial advisor is a key player in the bond issuance process. The financial advisor looks at current market conditions and offers advice on how to structure, price, and market the new issue, including whether to use competitive or negotiated sale. After the bonds have been sold, the financial advisor may prepare a post-sale report with the final cost of issuing the bonds.

In addition to helping with new issues, the financial advisor may also periodically evaluate whether the issuer could save money by refunding outstanding bonds.

fiscal year

A fiscal year is a 12-month period used for budgeting, accounting, and preparing financial statements. A fiscal year may or may not coincide with the calendar year; in Tennessee, for example, the state and local fiscal year runs from July 1 to June 30, as set in state law. The federal fiscal year begins October 1 and ends September 30.

fixed interest rate

A fixed interest rate does not change over the life of the security, such as a bond. For example, if a bond's coupon is fixed at 4 percent, it will pay 4 percent interest semiannually until it matures.

A variable interest rate, by contrast, may periodically change or "reset" as it tracks with a specific index (e.g., the London Interbank Offered Rate, or LIBOR).

See also:

- *coupon rate*
- *interest*
- *interest rate*

forward purchase agreement

An agreement that provides for the purchase of bonds or other obligations of a governmental entity when delivery of such bonds or other obligations will occur on a date greater than 90 days from the date of execution of such agreement.

full faith and credit

Full faith and credit is normally used in conjunction with general obligation bonds. Generally, pledging full faith and credit means that the issuer is committed to repaying its bonds from all money it may legally use, and will increase taxes to raise additional funds, if necessary.

See also:

- *general obligation (GO) bond*

funding bond

In Tennessee, funding bonds allow local governments in extreme fiscal distress to issue long-term debt for current operations. Because best practices in fiscal management strongly discourage this practice, funding bonds have rarely been used and are subject to strict oversight by the state Comptroller's Office.

Although state law allows local governments to issue funding bonds, the Tennessee state constitution forbids the state from issuing debt for operating purposes unless it is repaid within that fiscal year.

Gg

general obligation (GO) bond

As opposed to a revenue bond, which is paid from the revenues generated by the project being financed, a general obligation (GO) bond is guaranteed by the issuing government at large. General obligation bonds are normally backed by the full faith and credit of the government, meaning that the government will use any money available – or raise taxes, if needed – to pay them off. Limited-tax general obligation bonds, however, may limit how much taxes may be raised in this case.

The State of Tennessee's GO debt, for example, may be paid from any state tax revenues in the general fund, highway fund, and debt service fund that are not legally restricted. In other words, payment of the state's GO bonds takes priority: unless money in those funds is already set aside in law for a specific purpose, it may be used for debt service, if necessary, rather than other state activities.

See also:

- *revenue bond*

governmental bond

A governmental bond is a state or local government bond issued to finance governmental purposes, meets the federal eligibility requirements to treat interest on the bond to be excludable from the gross income of the bondholder, and is not a private activity bond.

See also:

- *private activity bond*

grant

Unlike bonds, loans, and notes, grants do not have to be repaid – in a sense, grant funding is "given" to the recipient. Grants are often made by higher levels of government to lower levels of government; for example, the federal government has many grants for state and local governments.

Although grant money does not have to be paid back, the entity making the grant (the grantor) typically requires that the entity receiving the grant (the grantee) use the funding for a specific purpose, such as a particular education program. Grants may contain clawback provisions where the grantor can take back the grant money if the grantee does not comply with all provisions of the grant.

Many grants are funded on a reimbursement basis. For example, the eventual grant recipient first spends its own money for the specified purpose, such as buying equipment. The grant recipient then sends supporting documentation, such as a receipt or an invoice, to the grantor. If the spending is approved, the grantor reimburses the grant recipient for the cost of the equipment.

See also:

- *grant anticipation note (GAN)*

grant anticipation note (GAN)

Grant anticipation notes (GANs) are a type of short-term borrowing. Many grants are funded on a reimbursement basis: the entity receiving grant funding must first spend its own money for authorized purposes, and is later repaid with grant funds. Rather than using its own funds for the initial expenditures, however, the grant recipient may instead spend money borrowed through grant anticipation notes. The notes are later paid off when the grant funding is received through the reimbursement process.

See also:

- *note*
- *short-term debt*

Ii

Industrial Development Board (IDB)

In Tennessee, industrial development boards (IDBs) have broad statutory rights to finance, acquire, own, lease, or dispose of properties so that corporations may maintain and increase employment opportunities, increase the production of agricultural commodities, or increase the quantity of housing available in affected municipalities. IDBs also have a role in controlling and eliminating pollution that results from commerce and industry that is essential to the economic growth of the state.

A city, county, or coalition of local governments can create an IDB. Two common tools used by IDBs to promote industry are tax increment financing (TIF) and payments in lieu of taxes (PILOT

See also:

- *conduit financing*
- *private activity bond (PAB)*
- *Tax Increment Financing (TIF)*

interest

In general, when a person or entity borrows money, they must repay not only the original amount borrowed, or principal, but an additional amount, or interest, in return for using the borrowed money. This arrangement extends to most municipal bonds: a government promises to pay the bond's principal at maturity, plus periodic interest until that date. Interest is generally expressed as an annual percentage of principal – a $5,000 bond that pays $200 in interest each year has a 4 percent interest rate, or a 4 percent coupon.

See also:

- *interest rate*

interest payment date

The interest payment date is the date on which interest payments are due to bondholders. Municipal bonds typically pay interest semiannually, or twice a year.

See also:

- *accrued interest*
- *coupon or coupon rate*
- *interest*

interest rate

In general, when an entity borrows money, it must repay both the amount originally borrowed, or principal, and an additional amount, or interest, to compensate the lender for using the borrowed money. The amount of interest is based on an interest rate, often expressed as an annual percentage of the amount borrowed.

With regard to bonds, the interest rate – also called the coupon or coupon rate – is the amount of interest the issuer annually pays to investors. For example, if a $5,000 bond has a 3 percent coupon rate, it pays $150 in interest each year.

See also:

- *interest*

interfund loan (notes)

Interfund loans involve loaning money from one of a local government's funds to another.

In some cases, money may be transferred or lent between funds – money from the general fund may be transferred to the highway fund, for example. In other cases, money may not be transferred. For example, in Tennessee, county and city utilities must be self-sufficient: utilities must operate off of revenue from its customers, and cannot be subsidized with tax revenues.

investment grade

A bond or other debt security is considered investment grade when a rating agency judges it relatively likely to pay principal and interest on schedule. The three largest credit rating agencies, Moody's Investors Service, Standard and Poor's (S&P), and Fitch Ratings, have similar rating scales. Investments rated Baa/BBB or higher are considered investment grade.

Investment grade	Aaa/AAA	The highest rating – considered the highest quality, with minimal risk of default.
	Aa/AA	Considered high quality with very low risk.
	A	Considered upper-medium grade with low risk of default.
	Baa/BBB	Considered medium-grade; may have speculative characteristics.
Non-investment grade – speculative or "junk" bonds	Ba/BB	Considered to have some speculative elements and substantial risk of default.
	B	Considered speculative with high risk of default.
	Caa/CCC	Considered poor quality with very high risk of default.
	Ca/CC/C	Considered highly speculative, and likely in default or close to default; some chance of recovering principal and interest.
	C/D	The lowest rating – usually in default with little chance of recovering principal and interest.

Depending on the rating agency, modifiers of 1, 2, and 3, or +/- are added to each rating classification – e.g., Aa1 or BB+ – to indicate whether the security falls into the low or high end of the range. Definitions adapted from Moody's Investors Service.

issuer

With regard to bonds, the issuer is the entity borrowing money, such as a state government, county, or city.

In Tennessee, the authority for the state and local governments to issue bonds is found in the Tennessee Constitution and statutes. At the state level, the four primary debt issuers are:

- the State Funding Board, which issues the state's general obligation debt for capital projects, as authorized by the Tennessee General Assembly.
- the Tennessee Housing Development Agency (THDA), which uses bonds to finance low- and moderate-income home loan programs.
- the Tennessee Local Development Authority (TLDA), which is authorized to issue bonds and notes to make loans to local governments, small businesses, and nonprofits for specific purposes, such as water and sewer recovery facilities.
- the Tennessee State School Bond Authority (TSSBA), which uses bonds to finance capital projects for the state's colleges and universities.

State law authorizes many local government entities to issue bonds, including counties, cities, metropolitan governments, utility districts, and Industrial Development Boards (IDBs). County and city school districts, however, do not have the legal authority to issue debt.

issuing and paying agent

When an entity, such as a state or local government, issues bonds, hundreds or thousands of investors may buy and hold the bonds at any given time. Rather than keeping track of various interest and principal payments to each individual investor, the issuer generally uses a paying agent.

When principal and interest is due, the issuer sends the total amount of money to make the payments to the paying agent. The paying agent, often a trust company or a trust division of a bank, then arranges for the proper interest and principal payment to be transmitted to each investor. If the bonds are sold in certificated, and not book-entry only, form, the agent "issues" new bond certificates when ownership is transferred prior to maturity.

In practice, the paying agent may provide multiple services for the investor: the bond trustee often serves as paying agent, the registrar keeping the list of bondholders, and the transfer agent transferring ownership of each bond when it is bought and sold.

See also:

- *bond trustee*
- *registrar*

Kk

kicking the can

"Kicking the can" refers to deferring repayment of debt until in the future, such as with balloon indebtedness and the practice of refunding bonds to extend the maturity date and further defer principal payments. For example, a government may issue $100 million of 20-year term bonds to finance a building with a useful life of 40 years, but defers any repayment of principal until the date that the bonds will mature in 2020. When 2020 arrives, however, the government may not have the funds to pay $100 million of principal. Instead, it may kick the can – it may issue new bonds to generate the $100 million needed to pay off the old bonds. Like the original bonds, the new bonds may also have a 20-year term, and thus mature in 2040. In this way, the government effectively defers $100 million in principal payments for another 20 years at the time when the facility no longer has a useful life.

A state law passed in 2014, the "Anti-Kicking the Can Act," limits local governments' use of balloon indebtedness and kicking the can and requires the prior approval of the state Comptroller's Office.

See also:

- *balloon indebtedness*

L l

lease

Rather than outright buying an asset, such as a building or piece of equipment, a lease is a contractual agreement that allows one party (the lessee) to use the asset in exchange for payments to the owner (the lessor).

From an accounting standpoint, there are two types of leases:

- In a **capital lease,** certain specific provisions must be met regarding purchase options or the value of the lease payments in relation to the property. For example, the lessee may lease a building for 20 years, then purchase the building at the end of the lease for a nominal amount (e.g., $1).
- In an operating lease, the lessee uses the asset, but does not purchase it at the end of the lease. Any lease that does not meet the criteria of a capital lease is considered an operating lease.

See also:

- *debt*

lien

In general, a lien is a lender's legal right to a borrower's property to guarantee repayment – a bank may seize the borrower's car if the car loan is not repaid, for example.

Generally in the context of municipal bonds, debt is backed by a lien on revenues, and not on the asset(s) financed. Although multiple bond issues may be repaid from the same revenue sources – e.g., sales tax or property tax – the payment of some issues may take priority over others in case of revenue shortfalls or bankruptcy.

- Senior lien bonds have a priority claim on revenues pledged for debt service and take precedence over other debt.
- Junior lien bonds, also called second lien bonds or subordinate lien bonds, are subordinate to other bonds with a more senior claim on revenues for debt service and would be repaid after other debt.
- Parity bonds have the same priority claim on revenues for debt service – in other words, none of the individual bond issues takes priority over the others.

liquidity

Liquidity is a measure of how quickly an asset or investment can be converted to cash. Stocks and bonds may generally be bought and sold quickly without losing value, and are thus liquid. On the other hand, real estate may take much longer to sell, and is therefore more illiquid.

liquidity facility

A liquidity facility, such as a letter of credit or a standby bond purchase agreement, is a backup source of funding an issuer may use to purchase its own bonds when they cannot quickly be sold to new investors.

For example, when interest rates rise, investors may exercise a put option and require an issuer to buy back its bonds, typically at the bonds' par value. If the bonds cannot be immediately remarketed to new investors, the issuer will have to come up with the funding to purchase them; the issuer may not have enough funding available, however, or may need those funds for another purpose. With a liquidity facility, the entity providing the facility – likely a bank – buys the bonds, or gives the issuer money to buy the bonds, until they can be remarketed.

See also:

- *put or tender option*
- *standby bond purchase agreement*

Local Government Public Obligations Act of 1986

The Local Government Public Obligations Act of 1986 was intended to provide a uniform and comprehensive statutory framework for local government debt issuance. It provides the authorization for general obligation and revenue debt for various purposes. The Act made many existing statutory limits on local government indebtedness inapplicable. Certain provisions in the Act apply to state entities as well as local government entities.

London Interbank Offered Rate (LIBOR)

The London Interbank Offered Rate (LIBOR) is the interest rate that large, global banks operating in London financial markets could pay other banks for short-term loans. LIBOR covers seven different maturities, from overnight to one year, in five different currencies.

LIBOR is often used as a benchmark for setting short-term interest rates. An interest rate may be set to the three-month LIBOR plus 20 basis points, for example.

long-term debt

Debt that will take more than one year to be fully repaid may be considered long-term debt. Bonds, which are often paid off over 20 years or more, are one type of long-term debt. Additionally, some types of notes – capital outlay notes, for example, which may have maturities up to 12 years – may sometimes be considered long-term debt.

See also:

- *bond*
- *debt*
- *short-term debt*

Mm

make-whole redemption/call

A make-whole call is a type of call provision that essentially guarantees that the investor cannot lose money when a bond is redeemed early. With a typical call provision, the issuer pays off bonds early at their par value or their par value plus a call premium. For example, an issuer may call in $50 million of 20-year bonds once 10 years have passed, and pay investors the bonds' par value, or $50 million.

If interest rates have dropped since the bonds were issued, however, the market value of the bonds may be worth more than $50 million. As a result, when the bonds are called early at their par value, the investor loses money, as they could have sold the bonds for more than $50 million on the secondary market.

If interest rates have dropped and the bond is trading at a premium, as in the above example, the second option will be higher. In this case, the investor is "made whole" and basically receives the same amount of money from the issuer as they would have if they had sold the bonds to another investor. Because make-whole calls can be expensive for the issuer, they are rarely exercised.

maturity or maturity date

Payment of the principal of a municipal bond is due to the bondholder on the maturity date. For example, a bond with a par value of $5,000 may have a 2 percent coupon and a maturity of 20 years. The bondholder receives $100 in interest each year; additionally, at the maturity date after 20 years, the bondholder receives the $5,000 of principal.

maximum effective interest rate

Tennessee's commercial lending laws set a cap on the maximum interest rates for various types of loans and financing arrangements. Although specific types of loans may have their own limits, interest in general is limited to a "formula rate." The formula rate is the average prime loan rate published by the Federal Reserve – the rate banks use when lending to their best customers – plus 4 percent, or 24 percent, whichever is lower.

The Tennessee Commissioner of Financial Institutions calculates and publishes the formula rate each week. In calendar year 2018, the formula rate ranged from 8.5 to 9.45 percent.

While interest rate limitations in law apply to commercial banks and lenders, the State of Tennessee's bond acts authorizing the issuance of state general obligation debt cap interest at the formula rate.

method of sale

Method of sale refers to how a bond is sold when originally issued. There are three methods of sale:

- In a competitive sale, underwriters bid on the bonds, and the bonds are awarded to the bid that will result in the lowest borrowing cost to the issuer.
- In a negotiated sale, the issuer chooses an underwriter in advance. The issuer and the underwriter then negotiate the bonds' interest rates, call provisions, and purchase price, among other things.
- In private placement, bonds will not be offered to the general public, but are sold directly to a single investor or a small number of investors, such as a bank.

Local governments selling up to $2 million of capital outlay notes may also use an informal bid process. After obtaining approval from the state Comptroller's Office, the local government contacts at least three banks, if possible, to receive quotes for interest rates on the notes.

See also:
- *competitive sale*
- *negotiated sale*
- *private placement*

municipal advisor

Following the 2008 financial crisis, the federal Dodd-Frank Wall Street Reform and Consumer Protection Act contained various provisions to protect state and local governments and the integrity of the municipal securities market. The act created a new class of regulated entities – municipal advisors – and required them to register with the Securities and Exchange Commission (SEC).

As set in law, the definition of "municipal advisor" includes financial advisors, broker-dealers, and other entities that may not previously have been considered municipal advisors. Municipal advisors have a fiduciary duty to their state or local government clients, and must put their clients' best interests above their own interests.

The Dodd-Frank Act also required the Municipal Securities Rulemaking Board (MSRB), in conjunction with the SEC, to adopt new rules for municipal advisors. Among other things, the rules require professional qualifications for municipal advisors, outline standards of conduct, and restrict the advice and recommendations that may be provided by underwriters not serving as municipal advisors.

See also:

- *financial advisor*

municipal bond

Bonds issued by state or local government entities, including counties, cities, and utility districts, are termed municipal bonds. Corporate bonds, by contrast, are issued by private companies, and the federal government issues Treasury bills, notes, and bonds.

Federal law allows state and local governments to issue federally tax-exempt municipal bonds within certain limitations, such as that the proceeds must be used for public purposes (e.g., constructing a state or local government office building). Similarly, Tennessee state law exempts municipal bonds from most state and local taxes.

Because municipal bondholders keep more of the interest earned rather than paying a portion in taxes, a municipal bond with a lower yield is equivalent to a federal or corporate bond with a higher yield. As a result, state and local governments can typically issue bonds with lower interest than their federal or corporate counterparts, and thus save money on debt service.

Municipal Securities Rulemaking Board (MSRB)

In 1975, Congress created the Municipal Securities Rulemaking Board (MSRB) to protect investors in municipal securities and help regulate the municipal securities market. The MSRB is overseen by the U.S. Securities and Exchange Commission (SEC).

While the MSRB does not regulate municipal issuers, such as state and local governments, it regulates and sets rules for broker-dealers, municipal advisors, and other parties. Such rules cover required professional qualifications for dealers and municipal advisors, standards of conduct, and fair pricing, among other things.

The MSRB also increases transparency by providing free, public access to information regarding municipal bonds and issuers on its Electronic Municipal Market Access (EMMA) website.

See also:

- *bond*

Nn

negative arbitrage

In the context of municipal bonds, arbitrage relates to the investment of bond proceeds. In the case of positive arbitrage, which is restricted by federal law, a state or local government issues tax-exempt bonds at relatively low interest rates, then invests those bond proceeds in the higher-yielding taxable market.

Negative arbitrage is essentially the opposite: a state or local government issues bonds and the proceeds, when invested, earn less than the interest paid on the bonds. For example, the government may issue bonds paying 3 percent interest; due to market conditions, however, the government may earn only 2 percent off the invested proceeds.

See also:

- *arbitrage*

negotiated sale

As opposed to a competitive sale, in which bids are received on a new issue of bonds, the issuer chooses an underwriter in advance for a negotiated sale. The issuer and the underwriter then negotiate the bonds' interest rates, call provisions, and purchase price, among other things.

The State of Tennessee prefers to use competitive sale for its general obligation bonds but has also used negotiated sale depending on market conditions.

See also:

- *competitive sale*
- *method of sale*
- *private placement*

net interest cost (NIC)

Net interest cost (NIC) is one measure of an issuer's overall interest cost related to a bond issue, and may be used to pick the winning underwriter in a competitive sale. NIC looks at the issuer's total interest expense – all coupon payments to bondholders, plus any discount or less any premium – in relation to the overall amount of principal and time to maturity.

Unlike true interest cost (TIC), another measure of an issuer's interest cost, net interest cost does not take into account the time value of money, or the idea that money today is worth more than the same amount of money in the future because it has time to earn interest. As a result, NIC is typically higher than TIC for the same bond issue.

See also:

- *true interest cost (TIC)*

non-conforming obligation

When a local government issues notes – e.g., capital outlay notes or tax and revenue anticipation notes – it must comply with various provisions in state law (passing an authorizing resolution or obtaining approval from the state Comptroller's Office, for example). Any notes that did not comply with such requirements are considered non-conforming obligations.

Upon identifying a non-conforming obligation, the Comptroller's Office sends notice to the local government, and the local government must establish a plan to bring the note into compliance.

See also:

- *note*

non-investment grade

A bond or other debt security is considered non-investment grade when a rating agency judges it a relatively risky investment. Also called "speculative" or a "junk bond," a non-investment grade bond has a higher risk of falling behind schedule on principal and interest payments, or not making payments at all.

The three largest credit rating agencies, Moody's Investors Service, Standard and Poor's (S&P), and Fitch Ratings, have similar rating scales. Investments rated Ba/BB or lower are considered non-investment grade.

	Rating	Definition
Investment grade	Aaa/AAA	The highest rating – considered the highest quality, with minimal risk of default.
	Aa/AA	Considered high quality with very low risk.
	A	Considered upper-medium grade with low risk of default.
	Baa/BBB	Considered medium-grade; may have speculative characteristics.
Non-investment grade – speculative or "junk" bonds	Ba/BB	Considered to have some speculative elements and substantial risk of default.
	B	Considered speculative with high risk of default.
	Caa/CCC	Considered poor quality with very high risk of default.
	Ca/CC/C	Considered highly speculative, and likely in default or close to default; some chance of recovering principal and interest.
	C/D	The lowest rating – usually in default with little chance of recovering principal and interest.

Depending on the rating agency, modifiers of 1, 2, and 3, or +/- are added to each rating classification – e.g., Aa1 or BB+ – to indicate whether the security falls into the low or high end of the range. Definitions adapted from Moody's Investors Service.

If a rating agency judges that an issuer has become less likely or able to make payments on its bonds – revenue shortfalls require an issuer to spend its reserves, for example – the rating agency may downgrade the issuer's rating one or more levels.

In May 2016, the State of Tennessee's bond rating was upgraded to "Triple-AAA," meaning all three major rating agencies considered the state to have the highest credit rating and lowest risk of default.

note

Unlike a bond, which is repaid over many years, a note is a form of short-term borrowing. In selling a note, the issuer promises to repay the amount of principal borrowed, plus interest, on a certain date. Notes are generally repaid in one year or less.

Types of notes include:

- bond anticipation notes, sometimes used to fund the construction phase of the project and later paid off when bonds are issued;
- commercial paper, a type of bond anticipation note;
- grant anticipation notes, often issued to fund initial spending that is later reimbursed through a grant; and
- tax and revenue anticipation notes, issued to provide operating money until other revenues are collected.

An additional type of note – capital outlay notes – may be used to finance the construction phase of large projects or to purchase smaller capital assets, such as vehicles or equipment. Capital outlay notes may remain outstanding for up to 12 years, but in some cases, may be used similarly to bond anticipation notes and eventually converted into bonds. Any note conversion that takes place more than two years after the note was issued requires approval from the state Comptroller's Office.

See also:

- *bond anticipation note (BAN)*
- *capital outlay note (CON)*
- *commercial paper (CP)*
- *grant anticipation note (GAN)*
- *short-term debt*
- *tax and revenue anticipation note (TRAN)*

notice of redemption

Through a notice of redemption, an issuer publicly announces that it will call and pay off its outstanding bonds prior to their maturity date.

See also:

- *call*
- *call date*

notice of sale

In a competitive sale, a notice of sale is an announcement from the issuer describing the terms of its upcoming bond issue. The notice generally contains, among other things, the date and time of the sale, the amount and type of bonds, the maturity schedule, and how the winning bid will be chosen.

See also:

- *competitive sale*

Oo

Office of State and Local Finance (OSLF)

The Office of State and Local Finance (OSLF) is a division within the Office of the Comptroller of the Treasury for the State of Tennessee. The major functions of OSLF include managing the state's debt programs and providing assistance, oversight and review for certain debt issuances, budgets, and investments of local governments.

See also:

- *Tennessee State Funding Board (SFB)*
- *Tennessee Local Development Authority (TLDA)*
- *Tennessee Housing Development Agency (THDA)*
- *Tennessee State School Bond Authority (TSSBA)*

official statement (OS)

When bonds are issued publicly, the issuer and its financing team prepare the official statement (OS). The document typically includes information regarding:

- the terms of the bonds, such as minimum denominations, interest rates, maturity dates, and call provisions;
- the revenue used to repay the bonds; and
- financial information and economic data about the issuer, such as other outstanding debt, debt limits, and any pending legal issues (e.g., lawsuits) that may affect repayment.

Before the official statement is finalized, a preliminary official statement (POS) provides much of the same information, but may exclude prices, delivery dates, or other information that depends on the market when the bonds are issued.

Underwriters are required to submit official statements for municipal bonds to the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access (EMMA) website at https://emma.msrb.org.

optional redemption

An optional redemption, or call provision, allows the issuer to redeem or pay off its outstanding bonds ahead of schedule. In doing so, the issuer pays investors the par amount of the bond, plus any interest that has been earned in the partial period before the next interest payment. Depending on the bond contract, the issuer may also pay an additional amount to bondholders, or a "call premium."

Generally, optional redemptions cannot take place before a date specified in the bond contract (e.g., 10 years after the bonds have been issued).

See also:

- *call*

Pp

par value

A bond's par value, or face amount, is the amount of principal that will be paid to the bondholder when the bond matures – the owner of a 20-year bond with a par value of $5,000 will receive $5,000 at the end of the 20-year term, in addition to any periodic interest previously paid.

Depending on how the bond's coupon rate compares to current market interest rates, the bond may be issued or traded for more or less than its par value. If the market rate is 5 percent, for example, a $5,000 bond with a 4 percent coupon will be less attractive to potential buyers than other investments. As a result, the bond will sell for less than $5,000, its par value, or at a discount. Conversely, a $5,000 bond with a 6 percent coupon will sell for more than its par value, or at a premium.

parity bonds

Parity bonds have the same priority or equal claim on revenues promised to pay debt service.

At any given time, a state or local government may have multiple bond issues outstanding – a government may issue new bonds for capital projects each year, for example. These bonds may be repaid from the same revenue sources, such as the sales tax or property tax.

If the issuer does not have enough money to pay debt service on all of its bonds, the issuer may have a classification scheme for which bonds to pay first. Parity bonds have the same priority claim on revenue for debt service – in other words, none of the individual bond issues take priority over the others in the order of payment.

All State of Tennessee general obligation indebtedness is secured on a parity, except that "Special Taxes" secure only general obligation bonds outstanding on July 1, 2013.

See also:

- *lien*

pension obligation bond (POB)

A pension obligation bond is issued by a state or local government to fund its payment obligations to its pension plan, and hinges on the general concept of arbitrage. Best practices in fiscal management require an entity to fund its pension plan each year by contributing a portion of payroll costs for its current employees using currently available funds. It is anticipated that these contributions will grow with investment income all of which are available to pay benefits for those employees when they retire.

Governments generally contribute their own revenues – e.g., taxes – to their pension plans. Pension obligation bonds, however, are an alternative way to finance current pension funding obligations: the government issues bonds and contributes the bond proceeds to the pension plan in addition to, or in lieu of, its own revenues.

Federal law specifies that pension obligation bonds must be taxable; while the issuer therefore pays more interest to bondholders than it would with tax-exempt bonds, the bond proceeds are not subject to arbitrage restrictions or earning restrictions.

After the bonds are issued, the proceeds are invested along with the rest of the pension plan. Although most governments invest their idle cash in low-risk, low-yield investments, pension plans often invest in a wider range of potentially riskier securities, such as stock, that may earn a higher return.

In some environments, stock or other pension investments may generate a higher return than the interest the government is required to pay on its pension obligation bonds. Thus, the government "makes money" off the difference, which may further reduce its unfunded pension liability and its required annual contribution. For example, a government may issue taxable pension obligation bonds that pay bondholders 6 percent interest, while the government's pension plan may have a target 7.5 percent return on its investments.

In practice, pension obligation bonds may not ultimately save the government money, as the investments of the bond proceeds may not perform as well as anticipated. Furthermore, pension obligation bonds are often structured to postpone paying principal in early years, increasing overall borrowing costs.

Tennessee state law does not allow the state or local governments to issue pension obligation bonds.

See also:

- *arbitrage*

pledged revenues

Pledged revenues are revenues for paying debt service that have been promised in the bond contract. For example, all money in the state's general fund, debt service fund, and highway fund is pledged for the payment of its general obligation debt, as well as any money held in the state treasury not otherwise legally restricted.

post-issuance compliance

After a state or local government sells a new issue of municipal bonds, it must continuously monitor the use of the money raised from the issuance of the bonds and financed facilities until the debt is repaid. In addition to continuing disclosure requirements involving public reporting of financial information and certain events, issuers must ensure that they comply with all federal provisions for tax-exempt bonds.

With some exceptions, issuers must:

- make sure bond proceeds are spent within any applicable deadlines, and that the proceeds are used for allowable purposes;
- ensure that the facilities financed with tax-exempt bonds are used for public, rather than private, purposes; and
- make sure that tax-exempt bond proceeds, when invested before spent, do not earn a higher yield than that paid on the bonds.

See also:
- *arbitrage*

present value (PV) savings

In the context of municipal bonds, present value (PV) savings are one measure of money saved in an advance refunding. Present value hinges on the concept of the time value of money. The time value of money assumes that money in the present day is worth more than the same amount of money in the future – not necessarily because inflation erodes its purchasing power, but because the earlier money is invested, the more time it has to earn interest.

See also:

- *advance refunding*

principal

A bond or note's principal is the face amount, or par value, that will be paid at the maturity date. Principal does not include any interest paid over the life of the bond. For example, a 4 percent, 20-year bond with a par value of $5,000 will pay $200 a year in interest to bondholders, or $4,000 over the full term. The $4,000 in interest is independent of the $5,000 principal.

Depending on how the bond market has shifted since the bond was issued, the bond may not trade for exactly the value of its principal. If the market rate is 5 percent, for example, the $5,000 bond with a 4 percent coupon will be less attractive to potential buyers than other investments. As a result, the bond will sell for less than $5,000, or at a discount. Conversely, a $5,000 bond with a 6 percent coupon will sell for more than its principal, or at a premium.

private activity bond

Federal law distinguishes between two general types of municipal bonds: governmental bonds and private activity bonds. Governmental bonds, as their name suggests, are used for public purposes, such as government office buildings, parks, or prisons. Private activity bonds, by contrast, are used for projects that primarily benefit private companies or individuals.

Generally, governmental bonds are exempt from federal, state, and local income taxes. Depending on their use and the type of project financed, private activity bonds may be taxable or tax-exempt. A municipal bond is considered a private activity bond if it meets one of two criteria:

- More than 10 percent of the proceeds are for private business use, and principal or interest payments on more than 10 percent of the proceeds are secured by an interest in the property used for private business use or payments received from such use; or
- More than the lesser of 5 percent or $5 million of bond proceeds are used to make loans to private entities.
- Even if a municipal bond meets the above criteria and is thus a private activity bond used for private purposes, it may still be tax-exempt if it is used for a qualified project.
- To be considered a qualified private activity bond, proceeds may be used for 27 types of projects grouped into seven overall categories:
- Exempt facility bonds are used to build, renovate, or maintain facilities that may be privately owned or primarily used by private entities, including airports, high-speed rail lines, and other transportation-related projects; certain residential rental properties, such as low-income apartment complexes; and certain privately owned utilities, including water, sewer, and electricity.
- Qualified mortgage bonds, sometimes referred to as single family mortgage revenue bonds, are used to make low-interest loans for first-time homebuyers within income limitations.

- Qualified small issue bonds are bond issues used to finance manufacturing facilities.
- Qualified redevelopment bonds are used to buy land or buildings in a blighted area, relocate inhabitants, rehabilitate the buildings, or clear the land for redevelopment.
- Qualified veterans' mortgage revenue bonds are used to make low-interest home loans to veterans.
- Qualified 501(c)(3) bonds are used to finance facilities owned and used by charitable organizations.

In general, most of the qualified projects above count toward an overall state cap on the amount of tax-exempt private activity bonds that may be issued by each state every year. Federal law and regulations are complex, however, and some of the projects are not subject to the cap, or may have other restrictions. Each state receives either a flat minimum or, for more populous states, an amount based on population. In 2018, for example, states could issue up to $105 per capita in qualified private activity bonds; Tennessee's cap was over $700 million.

In Tennessee, the Department of Economic and Community Development (ECD) allocates Tennessee's state cap for qualified private activity bonds among the state and local governments. Thirty-five percent of Tennessee's annual cap goes to the Tennessee Housing Development Agency (THDA) for single- and multi-family housing bonds. In past years, THDA has not used its full allocation in the year of receipt; unused allocations may be carried forward for up to three years.

Local governments may apply to ECD for allocations to issue small issue bonds for manufacturing or exempt facility bonds for other qualified projects.

- conduit financing
- governmental bond
- Tennessee Housing Development Agency (THDA)

private placement

Private placement is a method of selling a new issue of bonds. In a competitive sale and a negotiated sale, bonds are eventually offered to the public. In private placement, by contrast, the bonds will not be offered to the general public – instead, bonds are sold directly to a single investor, such as a bank, or a small number of investors. In some cases, the investor may be required to hold the bonds until they mature, or may be subject to other restrictions regarding selling them.

The State of Tennessee prefers to use competitive sale for its general obligation debt, but may consider private placement if the issue is too small or too complicated for public issuance, or if there are a limited number of potential investors.

See also:

- *competitive sale*
- *method of sale*
- *negotiated sale*

private business use

Private use refers to when a project financed by municipal bonds is used in trade or business of an entity other than a state or local government entity. The amount of private use determines whether the bond interest is exempt from federal income taxes.

Bonds issued by state and local governments and related entities are tax-exempt if they are used to finance projects for state or local governmental purposes (e.g., an office building or state prison). Private use, by contrast, refers to use by a private entity, such as a corporation. Common examples of private use include management contracts, cafeterias with commercial food vendors, ATMs, and vending machines, as well as research contracts at higher educational facilities. Use by the federal government is also considered private use (e.g., a federal post office in an office building).

Private use is determined by looking at the aggregate of both direct and indirect use by all nongovernmental persons. Bonds may contain a certain amount of private use – e.g., 10 percent – and remain tax-exempt, but bonds with private use above the threshold are taxable.

Public Building Authority (PBA)

In Tennessee, governments may create Public Building Authorities (PBA). PBAs were first authorized in state law in 1971, and were intended to help governments construct new buildings and renovate aging buildings. Structurally similar to Industrial Development Boards (IDBs), Public Building Authorities are government-owned corporations that are legally separate from, but closely linked to, the government (e.g., the county or city).

PBAs issue bonds to finance capital projects for their governments – city hall or a courthouse, for example – and then loan the bond proceeds to the government. Although PBAs issue revenue bonds, the loan agreement is a general obligation of the borrowing government; as a result, PBA revenue bonds are treated like general obligation bonds.

public works project

Except in extreme circumstances, local governments in Tennessee cannot borrow money for their day-to-day operating expenses, such as paying employee salaries and providing services. Local governments may use bonds, however, to finance public works projects – large-scale, expensive projects that will last for many years.

As defined in state law, public works projects include:

- government buildings, including office buildings, courthouses, libraries, museums, jails, and schools;
- utilities, such as electric plants, natural gas systems, water and sewer facilities; and
- infrastructure, including sidewalks, highways, roads, bridges, and storm water drainage systems.

See also:
- *capital project*

put or tender option

A put option, or tender option, is essentially the opposite of a call provision, and allows the investor to require early repayment. When the put option is exercised, the issuer buys back the bond and pays the investor a previously specified price, often the bond's par value. At that point, the issuer can remarket the bond to another investor.

Put options are generally exercised when interest rates rise and it is more profitable for the investor to buy similar bonds with higher yields.

See also:
- *call*
- *remarketing agent*

Qq

Qualified School Construction Bonds (QSCB)

The federal American Recovery and Reinvestment Act of 2009 included a provision that authorized Qualified School Construction Bonds (QSCB). In 2009 and 2010, the Tennessee State School Bond Authority issued QSCBs. The 2009 QSCBs were issued as tax credit bonds, while the 2010 series were issued as direct subsidy payment bonds. Bond proceeds were used to make loans to local governments for building or renovating schools; the loans could also be used to buy land or equipment for qualified projects. As of fiscal year 2017-18, 23 local governments had loans outstanding for their school districts through the QSCB program.

Rr

rating agency

Rating agencies provide, for a fee, opinions on the credit quality of an entity that issues bonds, or a specific bond issue – in other words, how likely the issuer is to pay principal and interest on time. In determining a rating, the rating agency reviews, among other things, the issuer's financial reports, tax structure and related laws, demographic data, and economic statistics.

The three major rating agencies are Moody's Investors Service, Standard and Poor's (S&P), and Fitch Ratings.

See also:

- *investment grade*
- *non-investment grade*
- *rating (bond or credit)*

rating (bond or credit)

In issuing a bond or credit rating, a rating agency gives its opinion on the bond or other security's quality and creditworthiness – in other words, how likely the issuer is to make principal and interest payments on time. In determining a rating, the rating agency reviews the issuer's financial reports, tax structure and related laws, demographic data, and economic statistics, among other things.

Bond ratings are divided into two general categories: investment grade and non-investment grade. Investment grade bonds have been judged relatively likely to pay principal and interest on schedule; non-investment grade bonds, or junk bonds, by contrast, have a higher risk of falling behind schedule or not making payments at all.

The three major rating agencies are Moody's Investors Service, Standard and Poor's (S&P), and Fitch Ratings.

Investment grade	Aaa/AAA	The highest rating – considered the highest quality, with minimal risk of default.
	Aa/AA	Considered high quality with very low risk.
	A	Considered upper-medium grade with low risk of default.
	Baa/BBB	Considered medium-grade; may have speculative characteristics.
Non-investment grade – speculative or "junk" bonds	Ba/BB	Considered to have some speculative elements and substantial risk of default.
	B	Considered speculative with high risk of default.
	Caa/CCC	Considered poor quality with very high risk of default.
	Ca/CC/C	Considered highly speculative, and likely in default or close to default; some chance of recovering principal and interest.
	C/D	The lowest rating – usually in default with little chance of recovering principal and interest.

Depending on the rating agency, modifiers of 1, 2, and 3, or +/- are added to each rating classification – e.g., Aa1 or BB+ – to indicate whether the security falls into the low or high end of the range. Definitions adapted from Moody's Investors Service.

If a rating agency judges that an issuer has become less likely or able to make payments on its bonds – revenue shortfalls require an issuer to spend its reserves, for example – the rating agency may downgrade the issuer's rating one or more levels.

In May 2016, the state's bond rating was upgraded to "Triple-AAA," meaning all three major rating agencies considered the state to have the highest credit rating and lowest risk of default.

See also:

- *investment grade*
- *non-investment grade*

recurring costs

Recurring costs are paid regularly and repeatedly. Employee salaries and utility bills, which may be paid monthly, are recurring costs.

Nonrecurring costs, by contrast, are one-time expenses. Buying a piece of large equipment, for example, is a nonrecurring cost.

redemption date

The redemption date is the date on which outstanding bonds will be redeemed and the par value of the bonds will be repaid to bondholders. This may be the bonds' original maturity date – 20 years after a 20-year bond is issued, for example – or the call date if the bonds are paid off prior to their stated maturity.

See also:

- *call*
- *call date*

refunded bond

In a bond refunding, the refunded bonds are the issuer's "original" bonds that are being refinanced. The refunding bonds, by contrast, are the "new" bonds issued to take advantage of lower interest rates and replace the refunded bonds.

See also:

- *advance refunding*
- *current refunding*
- *refunding bond*

refunding bond

In a bond refunding, the refunding bonds are the issuer's "new" bonds that are used to replace the issuer's refunded bonds, or the "original" bonds. An issuer may consider a refunding for savings (e.g. interest rates have dropped), for elimination of bond covenants, or due to a change in project use or ownership.

See also:

- *advance refunding*
- *current refunding*
- *refunded bond*

refunding trust

Refunding trusts are used in conjunction with advance refundings to make interest and principal payments on the refunded bonds.

In an advance refunding, new bonds are issued, and the proceeds from the new bonds are put into an escrow account that is part of a refunding trust.

The refunding trustee, likely a bank, manages the money and investments in the refunding trust. From the proceeds of the new bonds, the trustee makes periodic interest payments on the existing higher-rate bonds, plus principal when the original bonds reach their call date.

To guarantee that payments will be made to bondholders, refunding trusts are generally irrevocable, and cannot be modified or revoked after the agreement has been signed.

See also:

- *advance refunding*
- *escrow account*
- *verification agent*

registered bond

Almost all municipal bonds in existence today are registered, as required by federal law in order for the interest on the bonds to qualify for federal tax-exempt status. Bond owners are kept on record by a registrar, which maintains a list of bondholders for the issuer. That record is updated each time a bond is sold, and principal and interest are payable only to the registered owner.

In lieu of a physical bond certificate that is transferred when bonds are sold, most municipal bonds are issued in book-entry form and tracked electronically.

See also:

- *bearer bond*
- *registered owner*
- *registrar*

registered owner

With regard to registered bonds, the registered owner is the person or entity holding or owning the bond listed on the records of the issuer. Principal and interest are payable only to the registered owner, and the record is updated each time the bond is sold or transferred.

See also:

- *bearer bond*
- *registered bond*
- *registrar*

registrar

Virtually all municipal bonds are now issued in registered form: a list of owners is kept and updated each time a bond is sold or transferred. The registrar is the company that keeps track of bondholders for the issuer.

The registrar works closely with the paying agent, the entity responsible for making interest and principal payments to bondholders. In practice, the entity acting as registrar may serve in several roles for the issuer – the bond trustee may serve as registrar, paying agent, and transfer agent.

See also:

- *registered bond*

reimbursement resolution

A reimbursement resolution allows an issuer, such as a state or local government, to reimburse itself with bond proceeds for money it spent on a project from its own sources.

When an issuer begins a capital project, such as building a new office building, it may use bond proceeds or a bond anticipation note to finance the construction phase of the project. If the issuer has funding available (e.g., in the general fund) and does not want to wait through the issuance process to start building, however, it may begin the project early and pay for construction with its own money.

In that case, the issuer passes a reimbursement resolution outlining its intent to reimburse itself with bond proceeds when the bonds are issued. Under federal law, the issuer can typically reimburse spending made up to 60 days before passing the resolution.

remarketing agent

A remarketing agent is a securities dealer that resells bonds or other securities to the public. For example, when an investor exercises a put or tender option, the issuer must buy back the bond at a pre-specified price (usually the bond's par value). Once the bond has been tendered, the remarketing agent sells it to another investor.

See also:

- *put or tender option*

report on debt obligation (state form CT-0253)

In Tennessee, any governmental entity that takes on debt must complete a report shortly after the debt is issued. The report must be submitted to the governmental entity's governing body (e.g., the county commission) within 45 days, and an additional copy must be filed with the state Comptroller's Office.

As approved by the Tennessee State Funding Board, state form CT-0253 includes various information about the debt incurred, such as:

- the type of debt – bond, note, loan, or capital lease – and its purpose (e.g., general government, education, refunding or refinancing of prior debt);
- the par value of the debt and any discount or premium;
- the interest cost, and whether the interest is taxable or tax-exempt; and
- the method of sale, cost of issuance, and professionals involved on the financing team.

If an entity does not submit the form with the required information by the deadline, it may not issue any additional debt until the form is filed with the appropriate state and local officials.

revenue anticipation note (RAN)

See tax and revenue anticipation note (TRAN).

revenue bond

Unlike a general obligation bond, which is payable from a government's general resources, a revenue bond is paid off only with certain specified revenues. These revenues may be generated by the project being financed – in other words, the project pays for itself.

The Tennessee State School Bond Authority (TSSBA), for example, issues revenue bonds for certain projects at the state's universities and community colleges. These projects, such as parking garages or sports stadiums, generate fees or ticket revenue that is then used to pay off the bonds.

See also:

- *general obligation (GO) bond*

revolving credit agreement (RCA)

Unlike an installment loan, where a lender and borrower agree on a set schedule of equal payments to repay a fixed amount borrowed, a revolving credit agreement (RCA) allows a borrower to borrow and repay up to a set amount without a fixed repayment schedule. Similar to a credit card, a revolving credit facility, often provided by a bank, agrees to lend the borrower money up to a maximum amount. The borrower can draw down any amount, up to the limit, and repay all or part of it at any time. The revolving credit facility may charge a commitment fee for the use of the funds, and the interest rate for each individual loan may fluctuate.

For example, the Tennessee State School Bond Authority (TSSBA) has a revolving credit agreement with two banks that have agreed to lend TSSBA up to $300 million. TSSBA may thus draw down $200 million, repay $50 million, and still have another $150 million available to borrow.

See also:

- *revolving credit facility (RCF)*

revolving credit facility (RCF)

A revolving credit facility (RCF) is an entity, such as a bank, that lends money under a revolving credit agreement. In a revolving credit agreement, the terms are established governing the borrower's ability to borrow and repay money, up to a maximum amount, without a fixed repayment schedule. For example, a borrower may draw down $150 million of its $200 million limit, repay $75 million, and still have another $125 million available.

The revolving credit facility may charge a commitment fee for the use of the funds, and the interest rate for each individual draw may vary with market conditions.

See also:

- *revolving credit agreement (RCA)*

risk

Generally speaking, risk is the uncertainty associated with debt or the chance that something may occur that will affect the value of debt.

Various types of risks are associated with municipal bonds:

- Credit risk is the risk that a borrower – e.g., an entity that has issued bonds – will default on its debt. Credit risk is lower for issuers and debt obligations with high credit ratings.
- Interest rate risk, from a borrower's standpoint, is the risk that interest rates will rise after issuing variable rate debt. As the interest on variable rate bonds and notes increases in tandem with a specific index (e.g., the London Interbank Offered rate, or LIBOR), the issuer must make larger interest payments to investors.
- Liquidity risk generally refers to several things. For one, when interest rates rise, investors may exercise a put option that requires the issuer to buy back its bonds, usually at their par value. If those bonds cannot immediately be remarketed to new investors, the issuer will have to come up with money other than from a remarketing to purchase them. Additionally, an issuer may purchase a liquidity facility – e.g., a standby bond purchase agreement – for a shorter term than the bonds' maturity. For example, if the issuer purchases a 10-year facility for 20-year bonds, it may have to pay a higher fee after 10 years for a new liquidity facility, or may not be able to buy a new liquidity facility at all due to market conditions.
- Political risk is the risk that legislative or regulatory changes may jeopardize the programs or projects being financed, or the funding used to pay debt service.
- Tax risk relates to changes in the federal tax code or that a transaction may have unforeseen adverse tax consequences. Tax-exempt municipal bonds are attractive to investors because they keep the entirety of the interest earned, rather than paying a portion in taxes.

As a result, investors are willing to invest in tax-exempt municipal bonds with interest rates lower than the rates for taxable bonds. If the federal tax code is changed to reduce or eliminate the tax exemption for municipal bonds, however, the benefit of holding a tax-exempt bond is lessened. In addition, bonds may lose their tax-exempt status if an issuer fails to fulfill its tax covenants.

Additional risks are associated with swap agreements:

- Basis risk is the risk that payments from a swap dealer are not enough to make payments on the issuer's variable rate bonds, and that the issuer must use its own money to make up the rest.
- Counterparty risk is the possibility that the counterparty to a swap agreement (e.g., a swap dealer) will default and be unable to make payments to the issuer.
- Operational risk is the risk that the issuer will not have the systems in place or technical expertise to make payments to the swap dealer or comply with other provisions of the swap agreement and that, as a result, the agreement will be terminated early.
- Rollover risk comes into play when the term of a bond does not match the term of the associated swap. For example, an issuer may enter into a five-year swap agreement for 20-year bonds. After five years have passed, the issuer will need another swap agreement for the remaining 15 years until the bonds mature. Depending on how the market has shifted, the new agreement may be more expensive to the issuer.
- Tax risk relates to the possibility the federal tax code might be changed to reduce or eliminate the tax exemption for municipal bonds. In that case, variable interest rates on municipal bonds may rise, and if the issuer has entered into an interest rate swap agreement, payments from the swap dealer may not cover the increase in interest payments to investors.

See also:

- *swap*

rural school bonds

Rural school bonds raise money for county school districts without having to share the proceeds with city school districts located within the county.

In Tennessee, multiple local entities may levy property taxes, including counties, cities, and special districts, such as special school districts. As a result, depending on where residents live, they may pay multiple property taxes at various rates. A person living within a city, for example, may pay two "sets" of property taxes: one to the county and one to the city.

Just as multiple governmental entities within a county may impose property taxes, multiple school districts may operate within a county. For example, a city school district may serve all students living within the city boundary, while the county district serves the remaining students.

Unlike county and city governments, however, local school districts may neither levy property taxes nor issue bonds. To finance capital projects, the county instead issues school bonds for the school system. These bonds are repaid over many years, likely at least in part by property taxes and sales tax.

If the county issues bonds for the county school district, the county property taxes used for debt service are paid by both city and county residents. In this scenario, since city residents help bear the cost of the debt used for county schools, state law requires that the proceeds of the bonds be shared with the city school district to provide proportionate funding for children of city taxpayers. The bond proceeds are split proportionately between the county and city school district based on school attendance.

If the county does not want to share bond proceeds with the city school district, it may issue rural school bonds. In this case, the bonds are repaid only with property taxes levied on areas outside the city school district. Because city residents are not helping pay for debt service on the bonds, they are not entitled to a share of the proceeds.

Ss

SEC Rule 15c2-12

When underwriters buy new issues of municipal bonds, Securities and Exchange Commission (SEC) Rule 15c2-12 requires the underwriters to make sure that the state or local government issuing the bonds has agreed to provide ongoing information to the Municipal Securities Rulemaking Board (MSRB). These continuing disclosures are periodically made over the life of the bonds, and include financial reports, notices that the issuer did not make principal or interest payments on time, and information regarding changes in credit ratings or the tax status of the bonds.

See also:

- *continuing disclosure agreement/undertaking*
- *event notice*
- *Municipal Securities Rulemaking Board (MSRB)*

Securities Industry and Financial Markets Association (SIFMA)

The Securities Industry and Financial Markets Association (SIFMA) is a trade association for investment banks, broker-dealers, and asset managers. SIFMA lobbies on behalf of its members regarding legislation, regulations, and policies.

security

Security can refer to revenue or assets pledged to the repayment of debt or can refer to a financial instrument that has some sort of monetary value, and is bought, held, or sold by an investor to make money. Financial instrument securities fall into two general categories: debt and equity.

serial bond

A term bond comes due in a single maturity several years after the date of its issuance – for example, $50 million of 20-year term bonds would pay interest every year for 20 years, with the entire $50 million in principal due at the end of the 20th year.

Serial bonds, by contrast, can be thought of as a collection or series of term bonds. A bond issue with serial bonds is structured so that rather than waiting to pay principal until the very end of the term, portions of principal are paid in installments every year, along with periodic interest. For example, to finance a project over 20 years, an issuer could structure a bond issue to have bonds maturing each year for 20 years, with an amount of principal payable each year, in addition to interest. This could be structured with equal amounts of serial bonds maturing each year or having level payments of principal and interest.

Each set of serial bonds in a bond issue may have different interest rates based on their maturities. Maturities toward the beginning of the overall term usually have lower interest rates than maturities toward the end of the term.

See also:

- *debt service schedule*
- *term bond*

short-term debt

Short-term debt refers to current liabilities and is debt that is to be repaid within a year. Various notes may be considered short-term debt, including:

- bond anticipation notes, sometimes used to fund the construction phase of a project and later paid off when bonds are issued;
- commercial paper, a type of bond anticipation note;
- grant anticipation notes, often issued to fund initial spending that is later reimbursed through a grant; and
- tax and revenue anticipation notes, issued to provide operating money until other revenues are collected.

See also:

- *bond anticipation note (BAN)*
- *commercial paper (CP)*
- *debt*
- *grant anticipation note (GAN)*
- *note*
- *tax and revenue anticipation note (TRAN)*

sinking fund

In the case of term bonds, interest is paid each year, but the entire amount of principal matures at once at the end of the term. A sinking fund may be used to "save up" in advance for the one large principal payment when the bonds mature, or it may be subject to so-called mandatory redemption requirements. Under these requirements, the term bond is subject to redemption in part by lot on payment dates, usually beginning a few years prior to the maturity date. By reducing the amount of bonds held by bondholders, the issuer pays less in debt service each year; thus, in some respect, a sinking fund arrangement is functionally similar to later maturing serial bonds. For example a term bond issued in 2019 maturing in 2040 may have redemption dates beginning in 2036.

See also:

- *term bond*

special assessment bond

A special assessment bond is repaid with revenues from a special assessment, rather than general revenues.

Most municipal bonds finance projects that benefit the general public, such as a new office building for county employees that will benefit all residents of the county. Some projects, however, primarily benefit a specific area – e.g., sidewalks or sewer lines in a particular area that comprises a local improvement district.

In the case of special assessment bonds, rather than repaying the bonds with revenue paid by the general public – sales tax or property tax, for example – the bonds are repaid with a special assessment. The special assessment is levied only on residents and businesses in the areas that benefit from the projects. In this manner, those benefiting from the project bear the cost, rather than the general public.

standby bond purchase agreement

A standby bond purchase agreement is a type of liquidity facility where a third party, such as a bank, "stands by" to purchase an issuer's bonds if they cannot be immediately remarketed to new investors. When interest rates rise, for example, bondholders may exercise a put option that requires an issuer to buy back its bonds (generally at their par value). If the issuer cannot immediately remarket the bonds to new investors, the third party under the standby bond purchase agreement buys the bonds. These agreements often include a provision requiring a higher rate of interest to be paid during the time the standby bond purchaser holds the bonds.

See also:

- *bank bonds*
- *liquidity facility*

State and Local Government Series (SLGS)

State and Local Government Series (SLGS) are a type of low-yield, low-risk federal securities. In essence, SLGS are similar to Treasury notes or bonds purchased only by state and local governments to more easily comply with arbitrage restrictions when investing their bond proceeds.

Federal arbitrage restrictions do not allow state or local governments to invest their tax-exempt bond proceeds in investments that earn more income than is paid in bond interest and retain the additional investment return. Arbitrage restrictions and calculations are complex, however, and governments may be assessed substantial penalties for failing to comply. In response to early arbitrage laws, the federal government created SLGS to give state and local issuers a way to safely invest their bonds proceeds while guaranteeing that they are in compliance with arbitrage restrictions.

SLGS are most often used in conjunction with advance refunding arrangements. When proceeds from refunding bonds are deposited in an escrow account, they are often invested in SLGS until the existing bonds are called and paid off with the refunding bonds.

See also:
- *arbitrage*
- *advance refunding*

State Infrastructure Fund (SIF)

See Tennessee Local Development Authority (TLDA).

State Revolving Fund (SRF)

See Tennessee Local Development Authority (TLDA).

state-shared taxes

State-shared taxes are taxes levied by the State of Tennessee that are shared with local governments. Portions of multiple state taxes are shared with counties, cities, or other entities, such as the Municipal Technical Advisory Service (MTAS) at the University of Tennessee.

State-shared taxes include but are not limited to:

- state sales and use tax;
- businesses taxes, including the state business tax; payments in lieu of taxes from the federal Tennessee Valley Authority; and a portion of the excise tax, in certain circumstances;
- fuel taxes, including the gas tax, motor fuel (diesel) tax, and special petroleum tax;
- alcohol taxes, including the alcoholic beverage tax, beer tax, and mixed drink tax; and
- severance taxes on coal, crude oil, and natural gas.

surety bond

A surety bond is a contract between three parties that is often intended to keep one of the parties accountable to another. Although surety bonds are not insurance and differ in their use and technical aspects, both are designed to protect against losses.

Public officials – e.g., county trustees – may be required to purchase a surety bond upon taking office. If the public official does not fulfill his or her official duties, the surety company will pay up to the bonded amount to the appropriate government. Unlike insurance, the public official must repay the surety company for the total amount of the government's claim.

With regard to municipal bonds, surety bonds may be used to guarantee funds for a debt service reserve fund in lieu of funding it with cash (whether from additional bond proceeds or the issuer's other revenue). If money must be drawn from the reserve fund, the company providing the surety bond will provide the funding, up to a predetermined amount to be repaid at a later date by the issuer.

swap

A swap is a type of derivative. Derivatives have no intrinsic value of their own; instead, their value is "derived" from, or based on, some underlying investment or agreement. For example, a derivative may make greater payments as interest rates on a debt obligation increase.

While some investors use derivatives to make money, governments typically use them to hedge against risk, or protect from future uncertainty and changes in the market. Governments may also use derivatives to try to lower their borrowing costs. The State Funding Board has published guidelines for interest rate and forward purchase agreements which are available on the Comptroller's website. Tennessee law requires swaps to be connected with debt issues and there is no authority to enter into purely speculative swaps.

In a swap agreement, two parties "swap" payments or some type of financial instrument. Generally, retail investors – households and individuals – do not enter into swap agreements. Instead, swap dealers, such as banks and insurance companies, make up most of the swap market. To help evaluate the complexities of swap agreements, governments and other purchasers should hire a swap advisor.

Interest rate swaps are the most common type of derivative for governments. A government may issue variable rate bonds linked to a specific index – the bonds may pay the one-year LIBOR rate, plus 50 basis points, for example. In a floating-to-fixed-rate swap, the government "swaps" the variable rate interest payments with another party (the counterparty) and essentially converts the variable rate debt to fixed rate debt. The government makes unchanging, fixed payments – e.g., equivalent to 3 percent interest on the bonds' principal amount – to the counterparty on schedule with interest payments. The counterparty pays the government a variable amount equal to the interest payments on the debt, which fluctuates over the life of the agreement.

The International Swap and Derivatives Association (ISDA), a trade association, has developed the ISDA master agreement to help govern swap transactions. While parties to swap agreements still negotiate the various financial terms – rates, prices, and maturities, for example – the ISDA master agreement sets general conditions regarding defaults and events that may end swap agreements early, among other things.

syndicate

See underwriter.

Tt

tax and revenue anticipation note (TRAN)

Tax and revenue anticipation notes, or TRANs, are a form of short-term debt used to “smooth” tax and revenue collections. Different revenue streams have various due dates, and may not be received evenly throughout the year. Local property taxes, for example, are often collected in large amounts toward the middle of the fiscal year. Until that money is received, a local government may not have enough cash on hand to operate. To generate funding, the government may issue tax and revenue anticipation notes at the beginning of the fiscal year, then repay the notes later in the year when taxes and revenues are received.

State law requires TRANs to be repaid by the end of the fiscal year; in other words, money borrowed in one year must be repaid with money collected in that same year. The State of Tennessee has not issued tax and revenue anticipation notes, and has no intent to do so. Local governments are encouraged to maintain large enough reserves that TRANs are not needed to finance current operations and must receive approval by the Comptroller’s Office prior to issuance.

See also:

- *note*
- *short-term debt*

tax anticipation note (TAN)

See tax and revenue anticipation note (TRAN).

tax credit bond

A tax credit bond is a type of municipal bond where bondholders receive credits against their federal income tax returns in lieu of or in addition to interest payments.

Some Build America Bonds (BABs), for example, were tax credit bonds. In addition to interest payments from state or local government issuers, investors received a federal income tax credit equal to 35 percent of the interest. The tax credit allowed state and local governments to offer lower interest rates and still market the bonds as an attractive investment.

See also:

- *Build America Bonds (BABs)*

tax increment bond

A tax increment bond is one method of Tax Increment Financing (TIF) that is paid off with "incremental" tax revenue generated from any increase in property taxes or other economic activity. These bonds are often used to finance redevelopment of blighted areas.

Before a TIF project begins, the local government calculates the "base" property tax revenue generated by the property. The government or an associated governmental unit, such as an Industrial Development Board (IDB), may then issue tax increment bonds to finance the project.

Once the TIF project is finished, the debt service on the bonds is paid with the additional, or "incremental," property tax revenue resulting from the new construction that is generated over the base. Thus, tax increment bonds are a type of revenue bond where the financed project "pays for itself."

See also:

- *Tax Increment Financing (TIF)*

Tax Increment Financing (TIF)

Local governments can use Tax Increment Financing (TIF) as an economic development and redevelopment incentive in targeted locations, such as blighted areas. TIF is often used to buy and prepare land for development (e.g., putting in utility connections or demolishing old buildings).

Before a TIF project begins, the local government calculates the "base" property tax revenue generated by the property. The government or an associated governmental entity – typically an Industrial Development Board (IDB) – then issues bonds or takes out a loan to finance the project.

After the project is completed, the bonds or loans are paid off with "incremental" property tax revenue, or the additional property tax revenue over the base amount that is generated from the new construction. In other words, the TIF project "pays for itself" through reallocated property tax revenue, and the business does not have to pay some of the costs associated with its property.

State law requires the Comptroller of the Treasury and the Commissioner of Economic and Community Development to review certain TIF plans to determine whether the financings are in the best interest of the State of Tennessee.

See also:

- *Industrial Development Board (IDB)*
- *tax increment bond*

Tennessee Housing Development Agency

The Tennessee Housing Development Agency (THDA) is a separate legal entity created by the State in 1973 that provides affordable housing and financing for low- and moderate-income citizens.

THDA administers several federal grant programs and subsidies, including the Section 8 Rental Assistance Program, which subsidizes rent payment for low-income residents, and the HOME Program, which helps local governments implement plans for affordable housing. THDA also issues mortgage revenue bonds to finance low- and moderate-income home loans to assure a steady production of new housing units. Pursuant to the Tennessee Allocation Plan for Private Activity Bonds, the Tennessee Department of Economic and Community Development awards THDA a portion of the state's private activity volume cap to be used for housing purposes. THDA was awarded $248.8 million in volume cap, or 35 percent of the $710.8 million allocated to the state. THDA utilizes a portion of its award for single family housing and reallocates a portion to local government issuers for multi-family housing.

THDA is a political subdivision and instrumentality of the state and is governed by a board of directors.

See also:

- *private activity bond (PAB)*

Tennessee Local Development Authority (TLDA)

The Tennessee Local Development Authority (TLDA) primarily helps local governments finance sewer and drinking water projects. Although TLDA is authorized to issue bonds and notes to generate funding for loans, it has not issued any debt since 2006.

TLDA works with three programs:

- The State Revolving Fund (SRF). Administered in cooperation with the Tennessee Department of Environment and Conservation (TDEC), the State Revolving Fund includes two revolving loan programs: the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund. Each year, the state makes over $80 million in low-interest loans to counties, cities, and utility districts for sewer and drinking water projects. Loans are originally made with federal funding from the U.S. Environmental Protection Agency (EPA) and a corresponding 20 percent state match. Both loan programs are self-supporting to some degree: when loans are repaid, that money is used to make new loans.
- The State Infrastructure Fund (SIF). In cooperation with the Tennessee Department of Transportation, TLDA has loaned almost $2.2 million to one participating local government for transportation infrastructure projects. All available funding has been loaned out, and no new loans are being made.
- Qualified Energy Conservation Bonds (QECB). Previously, TLDA worked with TDEC to approve Qualified Energy Conservation Bonds issued by cities and counties. The QECB program, expanded under the American Recovery and Reinvestment Act of 2009, allowed states and local governments to issue federally subsidized bonds for projects that reduced energy consumption or produced renewable energy. The federal Tax Cuts and Jobs Act of 2017 discontinued the QECB program, and no new bonds may be issued.

The Tennessee Local Development Authority (TLDA) is an instrumentality of the state and has a seven-member board.

Tennessee State Funding Board (SFB)

The Tennessee State Funding Board issues the state's general obligation debt, which is used to finance capital projects for office buildings and other state properties (e.g., state parks and prisons). Such projects must be approved in the annual appropriations act and the bonds authorized in the bond bill. No additional approval is needed from voters or other state agencies to issue debt.

Five members serve on the SFB:

- the Governor, chair;
- the Comptroller of the Treasury, secretary;
- the Secretary of State;
- the State Treasurer; and
- the Commissioner of Finance and Administration.

As part of the state's budget process, the SFB develops estimates of state revenues for the current fiscal year and next succeeding fiscal years. The SFB is also charged with the establishment of policy guidelines for the investment of state funds and is authorized to develop model policies related to debt and derivatives for use by public entities. The SFB also prescribes information that public entities must file related to debt and derivatives.

The Comptroller's Office of State and Local Finance serves as staff to the SFB.

Tennessee State Funding Board's Guideline for Interest Rate and Forward Purchase Agreement

Under Tennessee state law, the State Funding Board must establish rules and guidelines regarding local governments' use of interest rate swap agreements, other interest rate hedging agreements, and forward purchase agreements. Furthermore, the state Comptroller's Office must ensure that any such proposed arrangement complies with the guidelines before the local government moves forward. The guidelines are intended to ensure that governments have the technical expertise to understand these types of complicated transactions and the risks associated with them.

See also:

- *risk*
- *swap*

Tennessee State Funding Board's Statement on Debt Management

The Tennessee State Funding Board requires all government entities that issue debt to adopt a written debt management policy. In its statement on debt management, the State Funding Board sets the minimum requirements and provides model language and other resources for such policies.

As outlined in the statement, four overarching principles should guide local governments' policies and transactions:

- understand the transaction;
- explain what is being considered to citizens;
- avoid conflicts of interest; and
- disclose costs and risks.

See also:

- *debt management policy*

Tennessee State School Bond Authority (TSSBA)

The Tennessee State School Bond Authority (TSSBA) helps the state's community colleges and universities finance capital projects. TSSBA makes loans to higher education institutions through financing agreements with the two systems of higher education and issues bonds to generate money to fund the loans. By going through TSSBA, the University of Tennessee system, Tennessee Board of Regents, and the six locally governed institutions can reduce the cost of borrowing by sharing the fees and costs associated with issuing bonds, such as working with a financial advisor and obtaining a bond rating. Tennessee Colleges of Applied Technology (TCATs) are not eligible to receive loans from TSSBA.

TSSBA issues revenue bonds to pay for projects that are self-supporting; examples include parking garages, dormitories, or sports stadiums. These projects generate funding, such as fees or ticket revenue, that is then used to pay off the bonds. Projects that do not generate their own revenue, such as classroom buildings, are financed with the state's general obligation debt.

As of June 30, 2018, 19 community colleges and universities had almost $1.8 billion in outstanding loans from TSSBA for 230 projects.

In the past, TSSBA has also participated in several federal programs to provide financing for local school districts:

- In 2005, TSSBA sold its last issue of Qualified Zone Academy Bonds (QZABs), which provided bondholders with a federal income tax credit in lieu of interest from the state. Bond proceeds were used to make loans to local school districts to renovate classroom buildings or purchase equipment. Sixteen school districts participated in the program.

- The federal American Recovery and Reinvestment Act of 2009 included a provision that authorized Qualified School Construction Bonds (QSCB). In 2009 and 2010, the Tennessee State School Bond Authority issued QSCBs. The 2009 QSCBs were issued as tax credit bonds, while the 2010 series were issued as direct subsidy payment bonds. Bond proceeds were used to make loans to local governments for building or renovating schools; the loans could also be used to buy land or equipment for qualified projects. As of fiscal year 2017-18, 23 local governments had loans outstanding for their school districts through the QSCB program.

The TSSBA was created in 1965 as a governmental agency and instrumentality of the state. There are seven members of the TSSBA.

See also:
- *Build America Bonds (BABs)*
- *revenue bond*

term bond

Rather than paying a portion of principal each year, a term bond comes due in a single maturity, or bullet maturity. For example, a 20-year, $5,000 term bond would pay interest each year, but would not pay any principal until it matured at the end of 20 years.

Issuers of term bonds may set aside money each year in a sinking fund. Even though principal may not be paid to bondholders for many years, money for the eventual payment is periodically saved in advance so that it is available when the bond matures.

See also:
- *balloon indebtedness*
- *serial bond*

true interest cost (TIC)

True interest cost (TIC) is a measure of an issuer's overall interest cost related to a bond issue, and may be used to pick the winning underwriter in a competitive sale. Like net interest cost (NIC), true interest cost considers the issuer's total interest expense through coupon payments to bondholders, plus any discount or less any premium, in relation to the overall amount of principal and time to maturity.

Unlike NIC, however, TIC also takes into account the time value of money; in other words, true interest cost assumes that money today is worth more than the same amount of money sometime in the future, because the current-day money has more time to earn interest. As a result, TIC is typically lower than NIC for the same bond issue.

Another type of TIC, the all-in true interest cost, uses the same concept as true interest cost, but takes the cost of issuance out of the calculation. By subtracting the cost of issuance from the total bond proceeds, the issuer essentially borrows less money in the all-in TIC calculation than the TIC calculation. Because interest payments to bondholders are the same for both calculations, however, the all-in TIC is slightly higher than the TIC.

See also:

- *net interest cost (NIC)*

trust indenture

A trust indenture is a contract between the issuer and the bond trustee, the entity that enforces the bond contract on behalf of bondholders. The trust indenture outlines the revenues that are pledged to pay debt service, the issuer's responsibilities, and the bondholders' rights. While other documents, such as the official statement and bond purchase agreement, describe or reference some of the same information about the bonds as the trust indenture, the trust indenture is the source of investors' legal protections.

In some cases, municipal issuers may use a bond resolution, rather than a trust indenture, to set forth the rights of the bondholders.

See also:

- *bond trustee*

Uu

underwriter

In the context of municipal bonds, an underwriter is a company, such as an investment bank, that buys a new issue of bonds directly from the issuer. Rather than selling the bonds directly to hundreds or thousands of individual investors, the issuer instead sells the entire issue to the underwriter. After purchasing the bonds, the underwriter then sells them to investors, such as companies or individuals. If it cannot find enough buyers, the underwriter holds the remaining bonds until it can sell them at a favorable price.

The underwriter makes its money off the underwriting spread, or the difference between the price it pays the issuer for the bonds and the price at which it sells the same bonds to other investors. The underwriter may purchase the bonds through a competitive bid or negotiated sale.

To share the risks or pool their money for a large issue, multiple underwriters may form a group called a syndicate. The senior managing underwriter takes the lead role, and often works closely with the issuer in a negotiated sale. The senior manager, also called the bookrunning manager, allocates the bonds to be sold to investors between itself and the other underwriters (co-managers) according to the agreement among underwriters.

A smaller selling group may be formed within the syndicate. Broker-dealers may be part of the selling group without being co-managers. While members of the selling group help sell the bonds to investors, they are not required to hold or underwrite any bonds that cannot be sold. In return, they receive a smaller share of the profits.

See also:

- *underwriter's discount*

underwriter's discount

With regard to a new issue of municipal bonds, the underwriter's discount, also known as the underwriter's spread, is the difference between the price the underwriter pays the issuer for the bonds, and the price at which the underwriter then sells those bonds to investors.

Underwriters make their money through the spread, which has four components:

- The management fee is paid to the underwriter for its investment banking services.
- Expenses are costs incurred by the underwriter that may be reimbursed by the issuer, such as travel, advertising costs, or fees to the Municipal Securities Rulemaking Board (MSRB).
- The underwriting fee compensates the underwriter for the risk that it may not be able to sell all of the bonds at a favorable price and so may need to hold them until the market improves. The size of the fee relates to the bonds' risk – for high-quality bonds in a strong market, the fee may be low or waived entirely.
- The takedown is the largest part of the spread, and is essentially a commission paid to the underwriter for selling the bonds. The takedown varies for each individual maturity in an issue, and will normally be smaller for bonds with a high rating and larger for longer maturities. The average takedown for all maturities in the issue is often quoted for convenience.

The underwriter's discount is of less concern to an issuer in a competitive sale, because it is embedded in the underwriter's overall bid. For example, an underwriter with a larger spread may also be willing to pay more for the bonds, and so have a lower overall bid than an underwriter with a smaller spread. In a negotiated sale, however, the issuer agrees to sell the bonds to one underwriter or group of underwriters, and so cannot rely on competition to keep underwriting costs low.

See also:

- *underwriter*

useful economic life

Useful economic life is the period of time an entity expects to be able to use a capital asset, such as a building or a piece of equipment. From an accounting standpoint, the asset's value is gradually reduced, or depreciated, over that period. One method of depreciation allocates the cost of the asset evenly over its useful economic life. For example, if a piece of equipment costs $100,000 and has a useful life of 10 years, each year it will depreciate and lose $10,000 of value.

In practice, the useful economic life may be shorter than the equipment's physical life – the $100,000 piece of equipment above may last for 12 years in actuality. After the initial 10 years, however, it is fully depreciated and has lost its value from an accounting standpoint.

In terms of debt, Tennessee state law and best practices in fiscal management do not allow the term of a bond to exceed the financed asset's useful economic life. If equipment is expected to last for 15 years but due to changing technology will be useful for only 10 years, for example, the bond used to pay for it cannot be repaid over more than 10 years.

See also:

- *depreciation*

Vv

verification agent

When bonds are advance refunded, a verification agent confirms that enough money has been set aside in escrow to pay interest and principal on the original refunded bonds.

In an advance refunding, interest rates drop before outstanding bonds may be called and paid off early. To nevertheless "lock in" savings from the lower rates, new bonds are issued, and the proceeds from the new bonds are put into an escrow account. In most advance refunding arrangements, the money in the escrow is used to pay periodic interest on the existing bonds, plus principal when the original bonds eventually reach their call date and are redeemed.

The proceeds from the new bonds in the escrow are invested in very low-risk securities, such as State and Local Government Securities (SLGS) offered by the federal government. Although these securities typically have low yields, they nevertheless earn some income. With this investment income, the issuer needs less in proceeds from the new bonds than will be needed to pay interest and principal on the original bonds.

A verification agent – an independent third party, such as a CPA firm – mathematically calculates and verifies that the money in the escrow will be enough to make principal and interest payments on the existing bonds.

See also:

- *advance refunding*
- *escrow account*
- *refunding trust*

Ww

writ or order of mandamus

A writ, or order of mandamus, is a court order compelling a government or other entity to fulfill a duty (e.g., a requirement set by statute). If a government does not make interest or principal payments on its bonds, for example, investors may seek an order of mandamus from a court to order the issuer to make payments.

Yy

yield curve

The yield curve shows the relationship between returns on investment and maturity dates (e.g., three months, one year, 20 years) for bonds of similar quality. The yield curve may have three basic shapes:

- A normal yield curve slopes upward – in other words, bonds with longer maturities have higher returns on investment than bonds with shorter maturities. Because there is more risk and uncertainty involved in holding a bond for a longer time period – interest rates may change unfavorably for the investor, for example – investors typically require higher yields in exchange for tying up their money for long periods of time. The variation in interest rates is generally greater for bonds with shorter maturities. While a two-year bond has double the maturity of a one-year bond, from the investor's standpoint, a 25-year bond and a 30-year bond are both similarly long-term investments and thus have similar yields.
- An inverted yield curve slopes downward: bonds with longer maturities have lower returns on investment than bonds that will mature sooner. Inverted yield curves are unusual, and have historically preceded many economic recessions. When investors anticipate that interest rates will decrease in the future, they may purchase more long-term bonds to lock in the yields. Increased demand then lowers the yield on bonds with longer maturities.
- A flat yield curve has relatively equal yields for short-,

medium-, and long-term bonds. The yield curve may flatten when adjusting between normal and inverted shapes.

See also:

- *bond yield*

yield to maturity (YTM)

Yield to maturity (YTM) is a measure of an investor's return on a bond, assuming the investor holds the bond until it matures. A bond's yield to maturity may be different than its coupon rate, the interest payments it makes to investors. If a bond's coupon rate is lower than current market interest rates for similar investments, the bond will trade at a discount, or for less than its par value – if current interest rates are 3 percent, a bond with a $5,000 par value and a 2 percent coupon may sell for $4,570, for example.

Although the investor will receive smaller interest payments, it will receive an additional $430 when the bond matures. As a result, the bond's yield to maturity – the investor's overall rate of return – will be higher than the 2 percent coupon rate.

See also:

- *bond yield*

Zz

zero-coupon bond

Zero-coupon bonds, sometimes called deep discount bonds, do not pay periodic interest or coupons, hence the term "zero-coupon." In lieu of interest, zero-coupon bonds are sold for substantially less than their par or face value, then pay out their full value at maturity. For example, if current interest rates are 5 percent, a 10-year, $5,000 zero-coupon bond may sell for $3,050. Although the bondholder will not receive any interest over the ensuing 10 years, they will receive the full $5,000 when the bond matures.

State law authorizes the Tennessee State Funding Board and the Tennessee State School Bond Authority (TSSBA) to issue zero-coupon "college savings" or "college appreciation" bonds. TSSBA issued college savings bonds in 1989, and the bonds matured in 2009.

See also:

- *capital appreciation bond* (*CAB*)

Acronyms

FINANCE TERMS

AAU	agreement among underwriters
AMT	alternative minimum tax
BQ	bank qualified
BP	basis point
BAN	bond anticipation note
BPA	bond purchase agreement
BAB	Build America Bond
CAB	capital appreciation bond
CON	capital outlay note
COP	certificate of participation
CPPN	certificate of public purpose and necessity
CFO	chief financial officer
CP	commercial paper
CAFR	comprehensive annual financial report
COB	convertible option bond
DSRF	debt service reserve fund
DVP	delivery versus payment
EMMA	Electronic Municipal Market Access
EESI	Energy Efficient Schools Initiative
GO	general obligation
GAAP	generally accepted accounting principles
GAN	grant anticipation note
IDB	industrial development board
ITIF	Intermediate Term Investment Fund

IRC	Internal Revenue Code
LOC	letter of credit
LGIP	Local Government Investment Pool
LIBOR	London Interbank Offered Rate
MADS	maximum annual debt service
NRMSIR	Nationally Recognized Municipal Securities Information Repository
NIC	net interest cost
NPV	net present value
OS	official statement
OID	original issue discount
OIP	original issue premium
OPEB	other post-employment benefits
PILOT	payments in lieu of taxes
POB	pension obligation bond
PAC	planned amortization class
POS	preliminary official statement
PV	present value
PAB	private activity bond
PBA	Public Building Authority
P3	Public Private Partnership
QECB	Qualified Energy Conservation Bond
QSCB	Qualified School Construction Bond
QZAB	Qualified Zone Academy Bond
RAN	revenue anticipation note
RCA	revolving credit agreement
RCF	revolving credit facility

SLGS	State and Local Government Series
SIF	State Infrastructure Fund
SPIF	State Pooled Investment Fund
SRF	State Revolving Fund
TRAN	tax and revenue anticipation note
TAN	tax anticipation note
TIF	tax increment financing
TIC	true interest cost
VRDB	variable rate demand bond
VRDO	variable rate demand obligation
WAL	weighted average life
WAM	weighted average maturity
YTM	yield to maturity

GOVERNMENTAL CERTIFICATIONS

CCFO	Certified County Finance Officer
CGFM	Certified Government Financial Manager
CMFO	Certified Municipal Finance Officer
CPFO	Certified Public Finance Officer

ORGANIZATIONS AND ENTITIES

COT	Tennessee Comptroller of the Treasury
CUSIP	Committee on Uniform Security Identification Procedures
DTC	Depository Trust Company
FDIC	Federal Deposit Insurance Corporation
FOMC	Federal Open Market Committee
FRB	Federal Reserve Board
FINRA	Financial Industry Regulatory Authority
GASB	Governmental Accounting Standards Board
GFOA	Government Finance Officers Association
IRS	Internal Revenue Service
ISDA	International Swap and Derivatives Association
MSRB	Municipal Securities Rulemaking Board
OSLF	Office of State and Local Finance
OCC	Office of the Comptroller of the Currency
SEC	Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association
SBC	State Building Commission
SFB	Tennessee State Funding Board
TGFOA	Tennessee Government Finance Officers Association
THDA	Tennessee Housing Development Agency
TLDA	Tennessee Local Development Authority
TSSBA	Tennessee State School Bond Authority

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general obligation bond
balloon indebtedness
negotiated sale
investment grade
municipal bond
bond
note
issuer
commercial paper
Office of State and Local Finance
kicking the can
competitive sale
municipal bond
debt
par value
negotiated sale
commercial paper
amortization
general obligation
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