Red River Authority of Texas

Direct Financing Arrangements

A tax-exempt direct financing arrangement (DFA) is a useful financing alternative available to state and local governments, including water supply districts and corporations through the Authority.

Since the DFA is a contract obligation between the Authority and the entity, the debt actually becomes an operating expense and aids in the conservation of the entity's working capital. Therefore, the DFA becomes a very flexible alternative as compared to depleting cash reserves to purchase needed assets.

The DFA contracts vary broadly in size; special DFA contracts can be custom designed to meet the overall needs of the entity or a group of entities up to $500,000,000. Typically, DFA contracts range between $1 million and $10 million, but may be tailored to specific needs of the entity. Funds may be utilized to acquire a wide variety of facilities, including water and / or wastewater development projects, parks and recreation development projects, urban renewal and economic development projects, and various types of maintenance equipment. For example, an entity may construct public parks and pools, reservoirs, administrative offices, or solid waste disposal facilities.

Interim financing may be obtained for most development projects, which can then be included in the overall DFA contract.

When to Consider a DFA

When acquiring an asset, a governmental unit usually has four options: purchase with cash, rent the facility or equipment without a definite obligation, issue long-term debt in the form of bonds or certificates of obligations, or purchase it through a contracted sale agreement or installment payment program. The latter option leads to the Authority's DFA Program.

Acquisition Without Debt Obligation

The Authority's DFA is not a rental agreement, but rather an option of ownership that does not create a debt obligation for the entity in the traditional sense.

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The DFA contract is between the Authority and the individual entity or entities, with the specific language to provide non-appropriation. It establishes that all payments are made from operating budget funds or capital appropriations available in the current fiscal year period.

Equipment and other assets are paid for through installment payments, which include principal and interest. The actual equity in the asset grows with each installment payment. At the end of the DFA contract, the asset is owned free and clear by the entity.

All parties involved in the DFA contract must understand that the entity desires to own the asset and fully intends to make installment payments over the agreed term.

A successful DFA program requires that all parties deal in good faith on two basic points:

1. The entity will have the use of and be responsible for the facilities over the entire term of the DFA contract.

2. The entity intends to retain unencumbered title to the facilities after the final installment of the DFA contract with the intention of enhancing or improving public benefit.

The Authority's DFA financing is not always the best option if the entity does not intended to utilize the financed facilities for the entire term of the DFA contract. Equipment and / or facilities may not be financed longer than their expected useful life.

Funding the DFA Contract

Once the actual capital cost needed has been determined and agreed upon by the Authority and the entity, the Authority would issue its Contract Revenue Bonds, which are typically sold in the Municipal Bond Market, to the State of Texas, Investment Brokers and Bankers, or individual banks offering the best financial arrangement for a fixed term. They may purchase the entire amount or designated portions offered by the Authority to achieve the best overall transaction individually or as a group of investors.

The DFA funding does not look to any third party for payments, but depends solely on the expectation that the entity will fulfill its financial obligation throughout the term of the contractual agreement.

Most DFA bond issues are generally sold in the public bond market to generate the funds required for the entity. However, depending upon market conditions, fund sources may be solicited on a private placement basis such as banks and secured financial institutions.

After the bonds are sold and funds are made available, the DFA works through a Supervised Construction Account (SCA) that is operated and maintained by the entity. Funds deposited in the SCA are then used as needed for the payment of partial deliveries as they are accepted or during portions of the project construction.

During the time the funds are in the entity's depository, they may be invested in governmental securities, which earn interest. The net interest earnings may then be applied toward unexpected construction or equipment requirements, funding reserve accounts, or other cash requirements relevant to the DFA Project. The SCA earnings may serve to reduce the entity's net interest cost of the DFA.

The Cost of Financing

The DFA contract may be designed to meet the cash flow needs of the individual or group entities applying for funding. The associated cost of financing is divided into four basic components:

Interest is determined at the bond closing, usually near or below the current market rate.

Issuance Fees are a one-time cost paid out of the proceeds of the bond issuance, which includes legal, financial, and administrative costs associated with the preparation, issuance, and sale of bonds.

Maintenance Fees are paid annually to the Authority for inspection, accounting and auditing costs associated with the financing arrangement, and typically are a fixed annual fee.

Miscellaneous Expenses are cost incurred relating to the issuance and marketing of the Authority's bonds, which include public meetings and / or hearings, advertisements and notices, bond printing, travel, and bond closing. Miscellaneous costs vary slightly depending on the size, amount of time required, and complexity of the DFA issue.

The Authority's Role

The Authority is actually incurring the debt on behalf of the entity utilizing the funds for the designated purpose. The Authority does not purchase and resell equipment or specific facilities to be used by the entity and does not benefit from ownership. Therefore, warranties expressed or implied are that of the manufacturer, contractor or vendor. The Authority is only the vehicle to be utilized in obtaining the necessary capital for the entity or entities to achieve its short and long-range development goals.

The entity may request additional assistance of the Authority in the form of engineering, permitting, legal, inspection, operation, and maintenance under separate contracts, as desired. Any other service contracts shall not impede or affect the DFA and may be terminated at the option of the entity.

The Authority will service the DFA contract throughout its term, which may include invoicing and receiving installment payments, insuring compliance of all applicable regulations and statutes relevant to the financing arrangements.

The Authority has only a security interest in the project being financed and therefore exhibits no material control over the contractors or vendors, unless contracted to do so by the entity itself.

Application for Financial Assistance

A public entity may make application to the Authority for direct financing of any type project providing the project is within the Authority's territorial jurisdiction, is deemed beneficial to the public, is technically and economically feasible, and is acceptable to the principal participants of the project.

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