TFA Monthly Newsletter

March 2013

Headline News:

2/27/13: Report: Indian Casino Revenues Up Slightly in 2011
(www.wsj.com)

2/25/13: Yurok Tribe Votes to Put Settlement Funds Toward First Hotel and Casino
(indiancountrytoday.com)

2/18/13: Rincon case may affect previous slot machine deals
(www.pe.com)

2/14/13: Another Shot at a Clean Carcieri Fix in the House
(indiancountrytoday.com)

2/13/13: Mille Lacs Hotel Deal Part of Tribe Diversification Trend
(minnesota.publicradio.org)

2/06/13: Navajo Nation To Open First Arizona-Based Casino in May, Hire 800
(indiancountrytoday.com)

Should Tribes Carry a Permanent Layer of Debt?

by Kristi Jackson

We often see tribal councils striving for their tribe to be completely debt-free. Having too much debt can be crippling to the economic vitality of a tribe and tribal leadership is well served in efficiently managing their financial house. However, is having no debt always the most practical financial strategy? Imagine a long-term line of credit with a perpetual maturity - the lenders will just keep extending the line. Unlike a credit card which typically carries a high rate of interest - what if the balance remains outstanding and you only pay a nominal interest expense for the use of the money? Your credit score (rating) would not be penalized - and you would be in good standing with your lenders for this practice. Far-fetched? While not without its risks, this so-called "permanent layer" of debt may be helpful to a tribal operation. Will it work for your tribe?

Many corporations seek an optimal debt-equity capitalization. Basic finance theory holds that using appropriate levels of debt (known as "leverage") can improve the returns of an investment dramatically - assuming the right set of circumstances. A corporation's typical cost of equity is much greater than debt. A tribal government doesn't have "equity" in the same true financial accounting sense as a corporation; however, there are always alternative investment opportunities. Assuming a business, or a tribe, can use "other people's money" at a cost less than the potential returns on its investments and projects - theory tells us that this should be encouraged. If you are never required by the lenders to repay that debt - the return is even greater as all cash flow earned from the investment can be used for the benefit of the owners.

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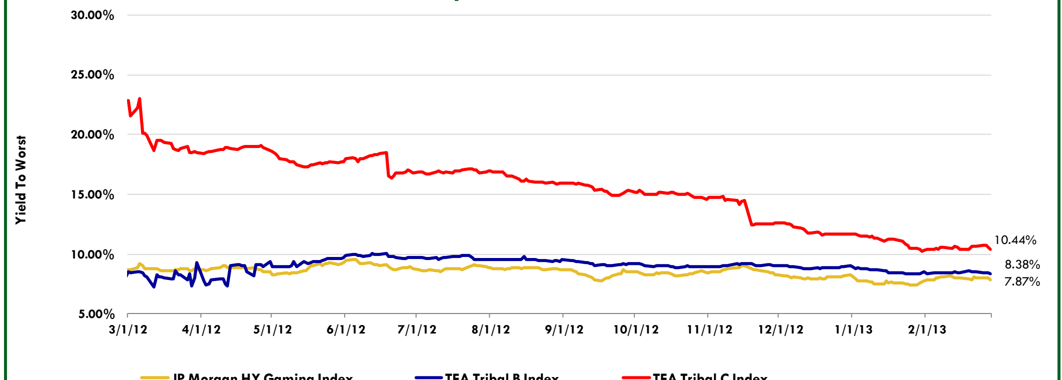
TFA Index Chart: A Comparison of HY Bond Interest Rates



Source: Wall Street High Yield Research

Notes: Yield to Worst represents the current average interest rate on bonds that comprise each index. Composite Gaming Index represents the average market interest rate of over 80 corporate and Tribal high yield gaming issues

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Many corporations carry a permanent layer of debt. They borrow these funds and manage their business - making investments and paying dividends - with this certain principal amount always left outstanding. They choose a level of debt or leverage that they have no concerns about refinancing.

Why again, would an entity do this? Because this permanent layer of capital costs them very little relative to the investment opportunities they have and continue to make. If for example, the cost of this debt is 5% yet each time they have free cash flow, they are able to reinvest it in growth opportunities that yield 10% - the return is highly positive (or accretive).

Tribes are no different in this regard. There may be a continual flow of opportunities that allow returns greater than the cost of debt. Tribes with low levels of debt or leverage currently can employ this capitalization too. It is important to note, that this strategy only makes sense if the proceeds that would have otherwise gone to repay the principal balance the outstanding debt, are used to for investment opportunities. Should the opportunities not be yielding returns greater than the ongoing cost of debt - this strategy does not work.

The principal risk is that the permanent level of debt selected is too great to be refinanced. If the maturity comes along and there is no market (bank or bond) in which to refinance, the business or tribe is left with no avenue and either dips into precious reserves, or, defaults and suffers the consequences for years to come.

The method for navigating this risk is to choose a permanent level so low that it can virtually always be refinanced. This is the "low leverage" we hear about. What level this is will depend on the business and the size of the overall operation. A leverage ratio (total debt divided by cash flow) that is well under 1:1 would fit this description.

Given how low interest rates are right now, it may be worthwhile to further explore this financing strategy. While not right for everyone - it could result in business expansion and higher profitability for your tribal enterprises.

TFA will be attending the upcoming NIGA 2013 conference in Phoenix, AZ.

We welcome the opportunity to meet with you.

Tribal Financial Advisors

Kristi Jackson
(310) 341-2335
kjackson@tribaladvisors.com

David Howard
(310) 341-2795
dhoward@tribaladvisors.com

Jeffrey Heimann
(310) 341-2518
jheimann@tribaladvisors.com

William Crader
(310) 341-2336
wcrader@tribaladvisors.com

Alex Clatterbuck
(310) 341-2339
aclatterbuck@tribaladvisors.com

Braxton Sato
(310) 341-2337
bsato@tribaladvisors.com

TFA Tribal Board of Advisors

Rick Hill
Chairman, Tribal Board of Advisors
(310) 341-2796
rhill@tribaladvisors.com

VaRene Martin
varene@nafoa.org

Valerie Spicer
vspicer@tribaladvisors.com

Kip Ritchie
kritchie@tribaladvisors.com

John Tahsuda
jtahsuda@tribaladvisors.com

Tom Rodgers
tom@carlyleconsult.com

Daniel Tucker
ssilva@sycuan-nsn.gov

El Segundo, CA • Charlotte, NC
(310) 341-2332
www.tribaladvisors.com