

CMTA Presentation

“So your Agency has Issued Debt, Now What?”

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Continuing Disclosure and Reporting Requirements Background

Why is Disclosure Necessary?

Municipality issues securities in the public capital markets

Investors rely on disclosure to make decision on purchasing municipal securities (primary and secondary markets)

Investors have rights under federal securities laws

All “material” information must be disclosed

Securities Acts of 1933 and 1934

Securities Act of 1933 has two substantive rules:

- Registration Requirement (municipal securities are exempt)
- Antifraud Rule (applies to municipal securities)
 - Prohibits any person from, directly or indirectly, obtaining money or property by means of any untrue statement of a material fact or by a misleading omission
 - Negligence standard (should have known)

Securities Exchange Act of 1934:

- Creates ongoing disclosure requirements for public companies
- Also contains antifraud provisions (Rule 10b-5)
- Antifraud provisions apply to government issuers

Rule 10b-5: “It shall be unlawful for any person...

- To employ any device, scheme or artifice to defraud,
- To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading...”

The “Materiality” Standard

“[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest”

Materiality is determined in context of all the facts and circumstances

Guidance comes primarily from court decisions and SEC enforcement cases

When Do Disclosure Rules Apply?

**New Offerings
(Official Statement)**

**Any other circumstances
where an Issuer is “speaking
to the market,” including
speeches and presentations
by senior staff and by
elected officials**

**Annual Report
under Rule 15c2-12**

**Rule 15c2-12
Material Event
Notices**

**This training focuses on Rule 15c2-12—for training on
Disclosure Rules related to Official Statements and “speaking
to the market”, consult with Disclosure Counsel**

Continuing Disclosure Requirements

SEC Rule 15c2-12

Adopted in 1989, Rule 15c2-12 requires broker dealers to ensure that municipal securities issuers enter into agreements to provide certain information to the MSRB about their securities on an ongoing basis

Annual disclosures made available on EMMA on or before date specified in Continuing Disclosure Agreement throughout life of bonds

- 5-Year Lookback of Non-Compliance and Plan for Ongoing Compliance Disclosed in Official Statements

Consists of important information about municipal bonds that arises after initial issuance

- Reflects financial health or operating conditions of the issuer as it changes over time
- Occurrence of specific events that can have an impact on key features of the bonds

Intended to assist investors in determining suitability of a bond and potential risks associated with the credit

Failure to File Notice, Notice of Termination of Reporting Obligation

Content of Annual Reports



Audited financial statements



Update to information (i.e., Official Statement tables) identified in the Continuing Disclosure Agreement/Certificate

-Tables should contain all elements described in the Content of Annual Reports section (information and timeframe)



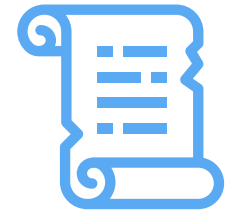
Additional voluntary information

- Consider Rule 10b-5 implications—is there more you should be saying?
- Has anything happened since the date of the audited financial statements that has materially impacted your financial condition?

Material Event Notices

Obligation to file notices of specified events within 10 business days:

- (1) Principal and interest payment delinquencies
- (2) Non-payment related defaults, if material
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties
- (4) Unscheduled draws on credit enhancements reflecting financial difficulties
- (5) Substitution of credit or liquidity providers, or their failure to perform
- (6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security
- (7) Modifications to rights of security holders, if material
- (8) Bond calls, if material, and tender offers
- (9) Defeasances

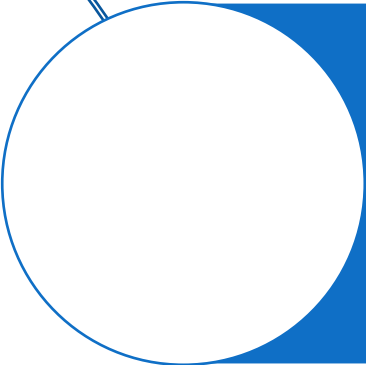


Material Event Notices (cont.)

- (10) Release, substitution, or sale of property securing repayment of the securities, if material
- (11) Rating changes
- (12) Bankruptcy, insolvency, receivership or similar event of the obligated person
- (13) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material
- (14) Appointment of a successor or additional trustee or the change of name of a trustee, if material
- (15) Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material
- (16) Default, event of acceleration, termination event, modification of terms or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties

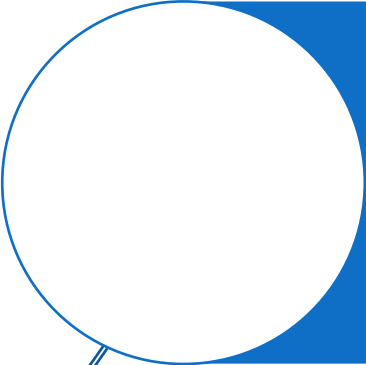
Amendment to Rule 15c2-12

Added two material events:



(15) Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material

NOTE: Modifying or amending an existing financial obligation can also trigger a notice obligation



(16) Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties

NOTE: Only events which reflect negatively on the creditworthiness of the obligated person are required to be disclosed. Whenever an obligated person is experiencing financial difficulties, it should monitor for events described in paragraph (16), which are typically significant in nature


What is a “Financial Obligation”?

The term “**financial obligation**” means:

(i) a **debt obligation**

(ii) a **derivative instrument** entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or

(iii) a **guarantee** of (i) or (ii)



The term “**financial obligation**” excludes municipal securities for which a **final official statement** has been provided to the MSRB consistent with Rule 15c2-12

SEC Guidance on Amendment

SEC has provided only limited guidance on determining what constitutes a “financial obligation”:

- ***Any obligation that acts like a debt, meaning a borrowing of money intended to be repaid over time, regardless of its duration (short or long) or its name.***

In public comments, representatives of the SEC have declined to provide a definition of a “guarantee” or a “debt obligation” but have indicated that the SEC will not necessarily look to state law definitions of such terms.

Likely Financial Obligations

- Bank loans or other obligations which are privately placed
- Letter of credit reimbursement agreements, including letters of credit which are provided to third parties to secure the obligated person's obligation to pay or perform
- Capital leases for property, facilities or equipment, the structure of which operate as debt
 - Vehicles, computers, energy efficiency/solar projects
- Agreements which guarantee the payment or performance obligations of a third party (regardless of whether the agreements constitute guarantees under California law)

Financial Obligations (in certain circumstances)

- Payment agreements which obligate the issuer or obligated person to pay a share of another public agency's debt service
- Service contracts with a public agency or a private party pursuant to which the issuer or obligated person are obligated to pay a share of such public agency or private party's debt service obligation
- Agreements pursuant to which the issuer or obligated person are obligated to pay amounts expressly tied to the other party's debt service obligations, regardless of whether service is provided or not
- Agreements which include a rate component that expressly passes through debt service or capital obligations of the other party
- An agreement the payments under which are not characterized as an operation and maintenance expenses for accounting purposes if such agreement could be characterized as the borrowing of money

What Determines Materiality?

“[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest”

- Source of security pledged for repayment of the financial obligation
- Rights associated with such pledge
- Principal amount or notional amount of the instrument
- Covenants
- Events of default
- Remedies
- Other similar terms that affect securities holders
- Size of overall balance sheet
- Size of existing obligations
- Size of the overall bond portfolio

Amendment Compliance Dates

The amendments impact only those continuing disclosure agreements entered into in connection with offerings that occur **on or after February 27, 2019**



With respect to paragraph (15): Issuers and obligated persons with a continuing disclosure agreement entered into **on or after February 27, 2019** must disclose material financial obligations incurred on or after the date on which such a continuing disclosure agreement was entered into



With respect to paragraph (16): A “default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties” that occurs on or after the compliance date must be disclosed regardless of when such financial obligation was incurred (i.e., **before or after February 27, 2019**)

Practical Considerations

- Issuers should assess universe of “financial obligations,” create a working list and reporting schedule, and have procedures in place to provide notice when needed
- Recommend parity bond issuances require same Content of Annual Reports in Continuing Disclosure Agreements
- Issuers should also have a process in place to ensure that the incurrence of future “material financial obligations” are disclosed timely
- The adoption of policies and procedures (including ongoing training) makes it easier for an underwriter to conclude that an issuer will comply with a continuing disclosure undertaking
- Ensure senior-level manager is assigned the primary responsibility of ensuring compliance with continuing disclosure undertakings
- Consider engaging a Continuing Disclosure Consultant/ Dissemination Agent

California Debt and Investment Advisory Commission (CDIAC) Reporting Requirements

CDIAC Community Facilities District (CFD) Mello-Roos Yearly Fiscal Status Report

Government Code Section 53359.5 of the Mello-Roos Community Facilities Act of 1982: All issuers selling Community Facilities District (CFD) bonds after January 1, 1993 are required to report certain information about the bond issues via the Yearly Fiscal Status Report

Principal amount of bonds outstanding, balance in bond reserve fund, balance in capitalized interest fund, delinquency and foreclosure information, balance in any construction fund, assessed value of all parcels subject to special tax to repay the bonds

Filed with CDIAC through their online portal on or before October 30 of each year

CDIAC Marks-Roos Yearly Fiscal Status Report

Government Code Section 6599.1(b) of the Marks-Roos Local Bond Pooling Act of 1985: Any joint powers authority selling bonds pursuant to the Act **on or after January 1, 1996** is required to report annually on the fiscal status of the local obligations acquired until the final maturity of the acquired local obligations

Requires separate Yearly Fiscal Status Reports (YFSRs) for the Authority and the Local Obligor(s)

Filed with CDIAC through their online portal **on or before October 30** of each year

CDIAC Annual Debt Transparency Report

Pursuant to Senate Bill 1029, state and local issuers are required to submit an Annual Debt Transparency Report (ADTR) to the California Debt and Investment Advisory Commission (CDIAC) for all bond issues with a Report of Final Sale on or after January 21, 2017

Purpose is to track how bond proceeds are spent after issuance

Filed with CDIAC through their online portal on or before January 31 of each year

Arbitrage and Rebate Overview

Outline

Arbitrage and Rebate Rules -
Purpose and Framework

**Arbitrage
Restrictions**

**Rebate Restrictions
and Exceptions**

Arbitrage and Rebate – Purpose

Arbitrage and Rebate rules are designed to ensure that tax-exempt bonds are timely used to pay for capital projects and not a way to exploit the difference in price between taxable and tax-exempt bond markets

- Compliance required for tax-exemption

Arbitrage Rules – Yield
Restriction

Question to Ask: Can I earn it?



Rebate Rules – Return of
Excess Yield

Question to Ask: Can I keep it?

Arbitrage Rules – Requirements

Yield restriction applies to investment of any “proceeds” of an issue unless an exception applies

- Arbitrage yield determined on each “issue” which may include one or more series of obligations
- For example, impacts on investing of project funds, debt service funds, and reserve funds

Arbitrage rules look at both expectations and facts

- Reasonable expectations at time of issuance
- Actual facts to the time of final maturity/redemption

Anti Abuse Rules

- Overburdening the market – e.g. is the issue outstanding longer than necessary
- Overissuance – e.g. is the issue larger than needed for the expected project

Arbitrage & Rebate Rules – What does it apply to?

Proceeds of the Bonds (Gross Proceeds)

- Sales Proceeds
- Investment Proceeds
- Transferred Proceeds (prior issue proceeds)
- Replacement Proceeds

Exclusions?

Arbitrage Rules – “Temporary Periods”



New Money Issues (Reasonable Expectations)

- 1) Construction/Building/Project Fund (3 Years) IF certain requirements are met at issuance
- 2) *Bona Fide* Debt Service Fund (13 months)
- 3) Reasonably Required Reserve Fund (lesser of three test) – above 15% no yield reduction payments available



Refunding Issues

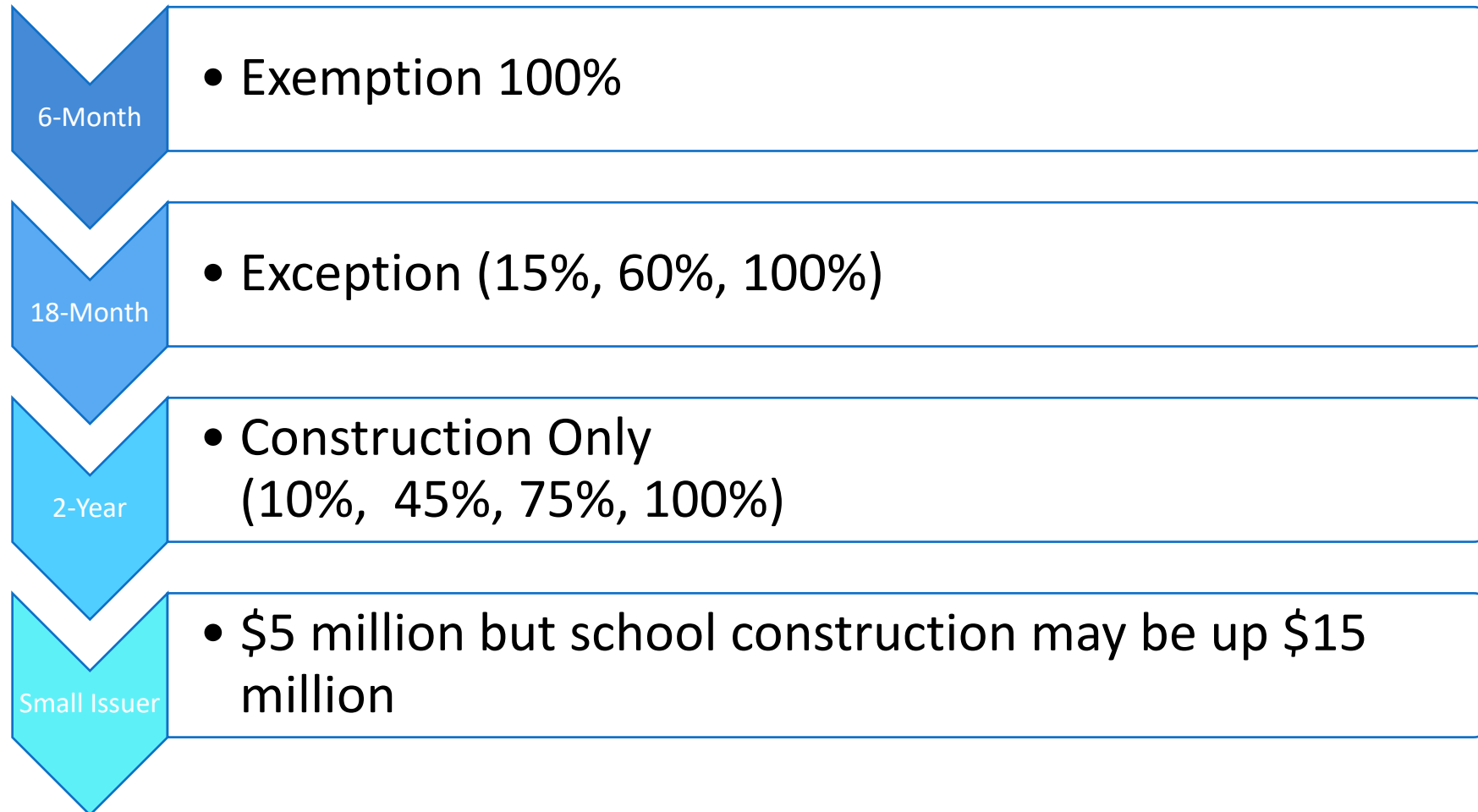
- 1) Current Refunding Escrow – (90 days)
- 2) Advance Refunding – Taxable; Tax Credit Bonds – (30 days) – Check for Universal Cap issues
- 3) Reasonably Required Reserve Fund (lesser of three test)



What happens afterwards?

- 1) Yield restriction; or
- 2) Yield reduction payments (IF AVAILABLE)

Rebate Rules - We earned it. Can we keep it?



Rebate – Calculation and Due Date

Due no later than every 5 years from issue date

- Allocations must be set by the end of the 5-year period
- 90% of rebate liability owing must be paid

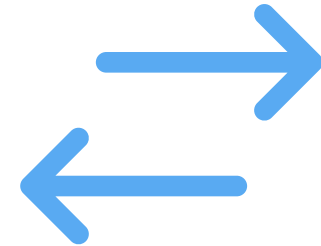
Final Payment due 60 days after final redemption

- 100% of liability must be paid within 60 days of redemption

Bond Fund Investment Opportunities

Investment Requirements

- Regulations §1.148-5 addresses valuation of and yield on investments
- Investments held in certain types of funds may need to be yield-restricted to a yield not materially higher than the bond yield
- Yield-restricted investments must generally be initially valued at fair market value
- §1.148-5 contains safe harbors that, if followed, will permit the FMV and yield of certain classes of investment to be legally established



Investment Options

- Direct Purchase of Open Market Securities
 - U.S. Treasury Securities
 - U.S. Agency Securities
 - AID and REFCO with explicit guaranty
 - GSEs (FNMA, FHLMC & FHLB) with implicit guarantees
 - Municipal Securities
 - Corporate Securities
 - Commercial Paper
 - (270 day duration or less)
 - Certificates of Deposit (CDs)

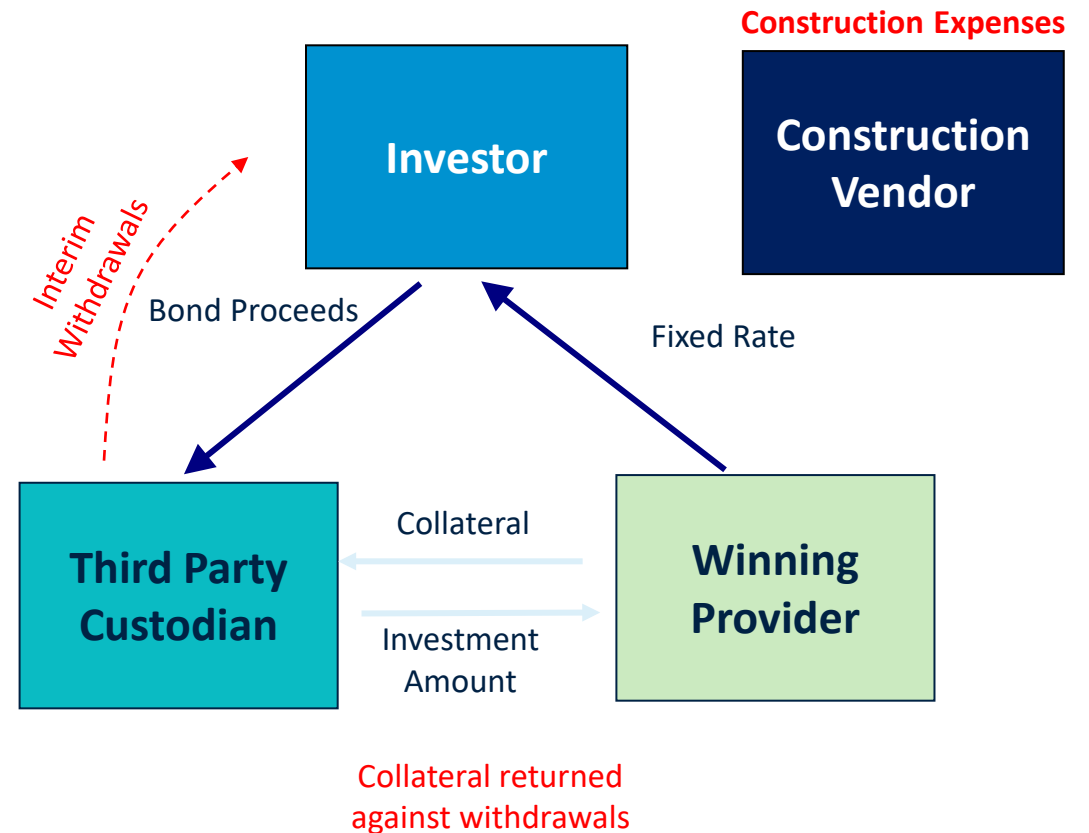


Investment Options (Continued)

Investment Contracts

- GIC (Unsecured)
- Repurchase Agreement (REPO) – “Collateralized”
- Forward Delivery Agreement (FDA)
- Float Contract (type of FDA)

Repurchase Agreement Mechanics



Defeasance Escrow Options

State and Local Government Series “SLGs”

- Direct through the Treasury
- Facilitates Yield Compliance

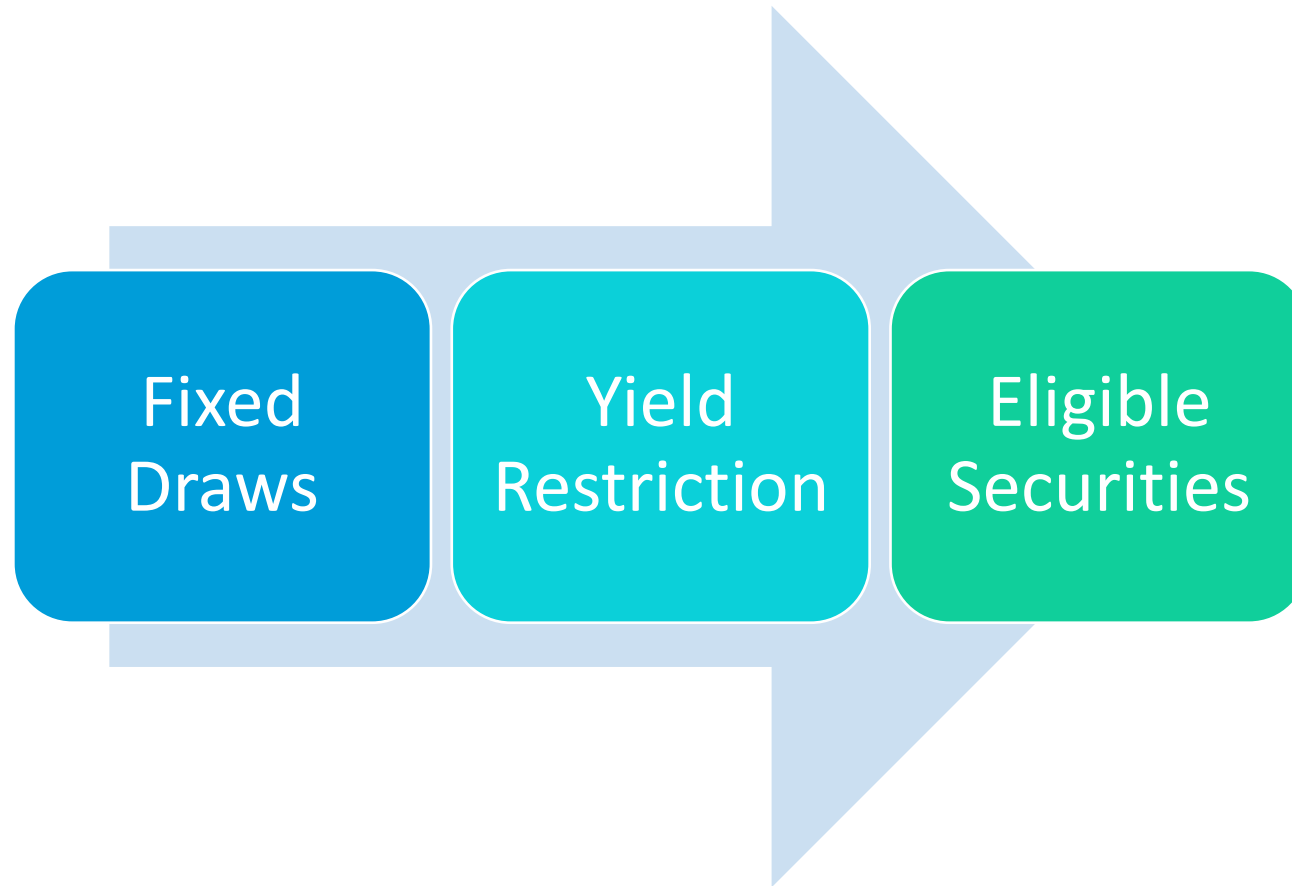
Open Market Securities

- U.S. Treasury Securities
- Agency Securities
- Municipal Securities
- Corporate, Commercial Paper
- CDs
- Often cheaper than SLGs

Forward Delivery Agreement “Float Contract”

- Useful when SLGS, etc. result in material negative arbitrage in higher yield environments by taking advantage when eligible collateral provides for “inefficient cash flows”

Defeasance Escrow Considerations



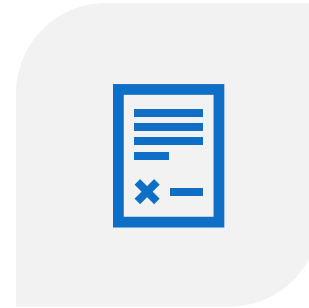
Project Funds Options



Laddered Portfolio of
Open Market Investments



Managed Portfolio of
Open Market Investments



Repurchase Agreement



Guaranteed Investment
Contract (Unsecured GIC)

Project Fund Considerations



Variable Draws



Arbitrage Considerations
– Yield and Safe Harbor



Credit



Liquidity

Reserve Funds Options



Direct Investment in
Open Market Securities



Repurchase Agreement



Guaranteed Investment
Contract (Unsecured GIC)



Forward Delivery
Agreement

Reserve Fund Considerations



Arbitrage Considerations
– Yield and Safe Harbor



Valuation

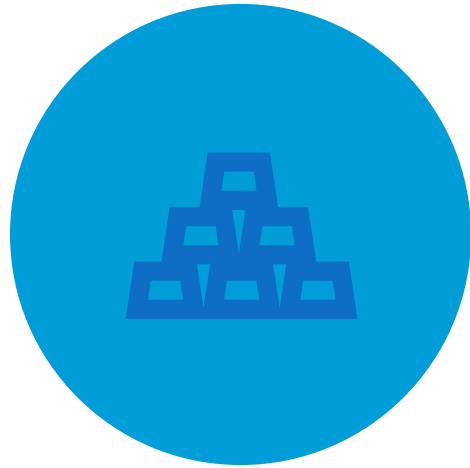


Credit



Liquidity

Sinking Funds Options



Direct Investment In Open Market
Securities – Rolled Or Laddered



Forward Delivery Agreement