Tax-Exempt Bonds and Federal Government

- Legislative proposals relating to tax-exemption

- Role of Securities and Exchange Commission (SEC)
  - Mission of SEC “is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation”
  - Office of Municipal Securities – reviewed municipal securities market and issued comprehensive report in 2012, focusing on:
    - Disclosure and transparency
    - Financial reporting and accounting
    - Investor education and protection

"We certainly are upping our scrutiny in this area"
Andrew Ceresney, Director of SEC’s Division of Enforcement, in regards to municipal securities (The Bond Buyer, Nov 10, 2014)
SEC

- SEC Office of Municipal Securities staffing
  - As few as 2 people in 2013
  - On Sept 11, 2015, announced staffing up to 30 in eight areas around country

- Recent areas of SEC enforcement
  - Charging public officials with fraud for misleading public statements in connection with bond financings (Miami, Allen Park, Mich.)
  - Emergency action to halt bond sale (Harvey, Ill.)
  - Pursuing primary market bond pricing abuses (Edward Jones)

Source: SEC Website, The Bond Buyer, Sept 11, 2015
Due Diligence and Disclosure for Bond Issues

- Content and timeliness of financial information in primary offerings
- SEC Rule 15c2-12 - underwriter’s duty to have “a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offering”
- SEC has clearly stated that official statement is legally issuer’s document
- Although market participants that assist issuer are subject to antifraud provisions of federal securities laws, issuer has:
  - Ultimate responsibility for ensuring that official statements meet disclosure standards of securities laws, and
  - Primary liability for failure to meet them
- Due Diligence Questionnaires and calls with underwriters

Overview of Municipal Bond Market

- Over 80,000 issuers of municipal bonds in U.S. with approximately $3.7 trillion outstanding
  - U.S. Treasury securities market is largest and most liquid market in world, with $10.9 trillion outstanding
  - Approximately $9.1 trillion in corporate debt outstanding
Primary and Secondary Market

- New issues occur when municipality initially offers bonds to market of buyers, similar to an initial public offering of stock.
- After initial issue, trades occur in secondary bond market.
- Secondary market is over the counter, as bonds are bought and sold through broker/dealers, not on regulated exchanges like stocks.

[Graph: U.S. Municipal Bond Issuance (In USD Billions) from 1996 to 2014]
Municipal Bond Market Volume

- 8.9 million trades municipal bonds in 2014 totaling $2.8 trillion
- Average of 35,000 trades per day totaling $11 billion
  - 1,703 trades in Florida municipal bonds per day in 2014

### Total number of trades

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>10,396,795</td>
<td>9,713,065</td>
<td>10,631,332</td>
<td>8,910,994</td>
</tr>
</tbody>
</table>

### Total par amount traded in $ millions

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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</thead>
<tbody>
<tr>
<td>Total</td>
<td>3,285,766</td>
<td>3,225,803</td>
<td>3,119,816</td>
<td>2,774,556</td>
</tr>
</tbody>
</table>

Source: MSRB 2014 Fact Book
FOMC Expected to Raise Fed Funds Rate in December

- October FOMC minutes indicated December rate increase likely
- FOMC members felt “conditions could well be met by the time of the next meeting” in December
- Fed expected to aggressively emphasize gradual pace for future rate hikes
- Futures market pricing in 72% likelihood of December hike, up from 66% mid November
- With inflation barometers in check, market participants expect flatter yield curve

<table>
<thead>
<tr>
<th>Interest Rates Last Week:</th>
<th>13-Nov</th>
<th>20-Nov</th>
<th>Change (bp)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UST 5</td>
<td>1.65</td>
<td>1.69</td>
<td>4</td>
</tr>
<tr>
<td>UST 10</td>
<td>2.27</td>
<td>2.26</td>
<td>-1</td>
</tr>
<tr>
<td>UST 30</td>
<td>3.05</td>
<td>3.02</td>
<td>-3</td>
</tr>
<tr>
<td>MMD 5</td>
<td>1.31</td>
<td>1.29</td>
<td>-2</td>
</tr>
<tr>
<td>MMD 10</td>
<td>2.17</td>
<td>2.06</td>
<td>-11</td>
</tr>
<tr>
<td>MMD 30</td>
<td>3.15</td>
<td>3.01</td>
<td>-14</td>
</tr>
</tbody>
</table>

Source: RBC Capital Markets, Bloomberg, Thomson Municipal Market Data
What Drives Tax-Exempt Interest Rates

**U.S. Treasury Yield Curve Changes**

**Municipal GO AAA MMD Yield Curve Changes**

Source: Bloomberg and Thomson Municipal Market Data
Municipal Market Data Index

- Broker/dealers primarily use Thomson Reuters Municipal Market Data (MMD) AAA Curve as index off of which bonds are priced, in addition to viewing secondary market trades.

- MMD AAA MMD Curve is proprietary yield curve that provides offer-side of “AAA” rated state general obligation bonds, as determined by MMD analyst team.

- AAA MMD scale is published every day at 3:00 p.m. EST, with earlier indications of market movement provided throughout day.

- MMD AAA scale represents MMD analyst team’s opinion of AAA valuation, based on institutional block size ($2 million+) market activity in both primary and secondary municipal bond market.

Source: TM3, Thomson Reuters
Current Municipal Market Conditions: AAA MMD

### AAA MMD January 1, 2007 to Present

- **10 Yr**
- **20 Yr**
- **30 Yr**

### Shift in AAA MMD Since Nov 2014

- **10 Year**
- **20 Year**
- **30 Year**

<table>
<thead>
<tr>
<th>Year</th>
<th>10 Year</th>
<th>20 Year</th>
<th>30 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum</td>
<td>4.860%</td>
<td>5.740%</td>
<td>5.940%</td>
</tr>
<tr>
<td>Minimum</td>
<td>1.470%</td>
<td>2.100%</td>
<td>2.470%</td>
</tr>
<tr>
<td>Current</td>
<td>2.060%</td>
<td>2.770%</td>
<td>3.010%</td>
</tr>
</tbody>
</table>

### Shift in 30-year "AAA" MMD

<table>
<thead>
<tr>
<th>Year</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.790%</td>
<td>-0.900%</td>
<td>0.520%</td>
<td>-1.130%</td>
<td>-0.740%</td>
<td>1.330%</td>
<td>-1.340%</td>
</tr>
</tbody>
</table>

Source: TM3, Thomson Reuters. 10, 20, and 30 year "AAA" MMD shown to represent different average lives of municipal transactions. Rates as of November 20, 2015.
Comparison of AAA MMD

### 2014 & 2015 Comparison

- **Min**
- **11/18/2015**
- **Max**

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>2014 &amp; 2015</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Min</td>
<td>1.31</td>
<td>0.94</td>
</tr>
<tr>
<td></td>
<td>Max</td>
<td>1.34</td>
<td>0.94</td>
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<tr>
<td>10</td>
<td>Min</td>
<td>2.11</td>
<td>1.72</td>
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<td></td>
<td>Max</td>
<td>2.12</td>
<td>1.72</td>
</tr>
<tr>
<td>15</td>
<td>Min</td>
<td>2.57</td>
<td>2.12</td>
</tr>
<tr>
<td></td>
<td>Max</td>
<td>2.57</td>
<td>2.12</td>
</tr>
<tr>
<td>20</td>
<td>Min</td>
<td>2.83</td>
<td>2.35</td>
</tr>
<tr>
<td></td>
<td>Max</td>
<td>2.83</td>
<td>2.35</td>
</tr>
<tr>
<td>25</td>
<td>Min</td>
<td>3.00</td>
<td>2.45</td>
</tr>
<tr>
<td></td>
<td>Max</td>
<td>3.00</td>
<td>2.45</td>
</tr>
<tr>
<td>30</td>
<td>Min</td>
<td>3.07</td>
<td>2.50</td>
</tr>
<tr>
<td></td>
<td>Max</td>
<td>3.07</td>
<td>2.50</td>
</tr>
</tbody>
</table>

### Historical Ten Year Comparison

- **Min**
- **11/18/2015**
- **Max**

Source: Thomson Municipal Market Data
Example Credit Spreads to AAA MMD

![Credit Spread Graph]

**Source:** Thomson Municipal Market Data
## Investor Maturity Preferences

<table>
<thead>
<tr>
<th>Buyer Category</th>
<th>Term / Maturity (Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25</td>
</tr>
<tr>
<td>Money Market Funds</td>
<td></td>
</tr>
<tr>
<td>Corporate Cash Managers</td>
<td></td>
</tr>
<tr>
<td>Short-Duration Bond Funds</td>
<td></td>
</tr>
<tr>
<td>Municipalities</td>
<td></td>
</tr>
<tr>
<td>Professional Retail</td>
<td></td>
</tr>
<tr>
<td>Individual Retail</td>
<td></td>
</tr>
<tr>
<td>Intermediate Bond Funds</td>
<td></td>
</tr>
<tr>
<td>Bank Trust Departments</td>
<td></td>
</tr>
<tr>
<td>Insurance Companies</td>
<td></td>
</tr>
<tr>
<td>Long-Term Bond Funds</td>
<td></td>
</tr>
<tr>
<td>Relative-Value Buyers</td>
<td></td>
</tr>
<tr>
<td>Bank Portfolios</td>
<td></td>
</tr>
</tbody>
</table>

Source: RBC Capital Markets
Municipal Bond Funds

In mid-November, weekly municipal bond funds reported $384 million of inflows, up from previous week’s $329 million of inflows

- Until fund flows stabilize, tax-exempt rates will remain volatile
- Latest inflow totals 26 out of 47 weeks this year that funds have seen cash flowing in
- Inflows year to date are positive, totaling over $3 billion

Lipper Municipal Fund Flows

Source: Lipper. Period ended November 18, 2015
Ratings Criteria

- Principals, methodologies and assumptions that rating analysts use to assign ratings
- Framework to assess creditworthiness
- Foundation for comparisons
- Forward-looking analysis
- Incorporate stability

A balance of quantitative and qualitative evaluations

Assigned Credit Ratings

Single ratings scale across regions, sectors, and asset classes

Credit Analysis

Criteria

Source: Standard & Poor's Guide to Ratings Criteria
Key Water and Wastewater Credit Ratios

S&P has 6 main factors:

- Economics
- Financial data/CIP
- Rate criteria
- Operations
- Management
- Legal provisions

Key Ratios:

- Income levels – household/per capita effective buying income as % of avg U.S.
  - Below 65% Low
  - 65% - 90% Adequate
  - 90% - 110% Good
  - 110% - 130% Strong
  - Above 130% Very Strong

- Moody’s: Service area wealth correlates to stronger operating performance for higher-rated utilities. More affluent services areas have greater capacity to bear higher service rates, which better allows utilities to support operations, debt and capital needs.

Key Ratios

- Debt Service Coverage
  - 1.0x to 1.25x Adequate
  - 1.26x to 1.50x Good
  - > 1.50x Strong
  - Also consider target levels in addition to actual coverage

Utilities Demonstrate Overall Consistent Debt Service Coverage

Source: Moody’s Investors Service
Key Ratios

- Liquidity – reasonable level of unrestricted cash or equivalents for working capital
  - Also give credit to designated cash and investments ultimately available for lawful purposes such as R&R or rate stabilization fund
    - 30 to 60 days Adequate
    - 60 to 120 days Good
    - > 120 days Strong
Key Ratios

- Total Debt to Net Property, Plant & Equipment (debt to plant)
  - 0% means no debt outstanding and 100% means as much debt outstanding as net depreciable value of assets
  - Also consider debt per retail account for non-wholesale systems
  - Indicates amount of pay-go, rate flexibility and debt capacity
    - <40% Low
    - 40% to 60% Moderate
    - 60% to 80% Moderately high
    - >80% High

- Example: excerpt from Moody’s 2015 report for Miami Beach Stormwater System - *debt ratio was average 47.6% in FY 2014, which will increase significantly with current issuance and decline moderately as proceeds reinvested into system* 

Source: Standard & Poor’s Guide to Ratings Criteria, Moody’s Investors Service
Key Ratios

• Top 10 Customers as % of Total Operating Revenues
  • <15% Very diverse
  • 15% to 25% Diverse
  • 26% to 40% Moderately concentrated
  • >40% Concentrated

Source: Standard & Poor’s Guide to Ratings Criteria
Key Ratios

- Fixed-Charge Coverage

  - Some utility systems distribution-only and/or collection-only, w/ treatment plants built, owned & operated by other entity
  
  - Obligations to 3rd parties typically off-balance sheet & treated as operating expense, not debt
  
  - S&P treats any recurring long-term obligation as fixed, especially capacity payments or other minimum demand costs that must be paid regardless of delivery
  
  - Adjusted debt service coverage calculation removes fixed charges from operating expenses & treats as if debt, allowing for more meaningful comparison

    - 1.0x to 1.20x Adequate
    
    - 1.21x to 1.40x Good
    
    - >1.40x Strong

- Example: East Central Regional Wastewater Treatment Facilities, Palm Beach Co. - revenues derived from wastewater flow charges (WFCs) received from member entities – Palm Beach Co., West Palm Beach, Lake Worth, Riviera Beach, Palm Beach

    - Member’s monthly WFCs are O&M expenses of respective utilities, superior in priority to member’s own debt

Source: Standard & Poor's Guide to Ratings Criteria
## Moody’s FY 2013 US Water & Sewer Medians by Rating Category

### Medians for Aaa-rated US Water and Sewer Utilities

<table>
<thead>
<tr>
<th>Selected Indicators</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>3-Year Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Condition: (Remaining Useful Life)</td>
<td>36</td>
<td>35</td>
<td>34</td>
<td>35</td>
</tr>
<tr>
<td>System Size: (O&amp;M in 000s)</td>
<td>67,746</td>
<td>70,565</td>
<td>64,785</td>
<td>67,699</td>
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<tr>
<td>Service Area Wealth: (2012 MFI)</td>
<td></td>
<td></td>
<td></td>
<td>125%</td>
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<tr>
<td>Annual Debt Service Coverage</td>
<td>2.8</td>
<td>3.6</td>
<td>2.9</td>
<td>3.1</td>
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<tr>
<td>Days Cash on Hand</td>
<td>317</td>
<td>352</td>
<td>378</td>
<td>349</td>
</tr>
<tr>
<td>Debt to Operating Revenues</td>
<td>1.9</td>
<td>1.8</td>
<td>1.7</td>
<td>1.8</td>
</tr>
</tbody>
</table>

### Medians for Aa-rated US Water and Sewer Utilities

<table>
<thead>
<tr>
<th>Selected Indicators</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>3-Year Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Condition: (Remaining Useful Life)</td>
<td>31</td>
<td>32</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>System Size: (O&amp;M in 000s)</td>
<td>16,365</td>
<td>16,882</td>
<td>17,375</td>
<td>16,874</td>
</tr>
<tr>
<td>Service Area Wealth: (2012 MFI)</td>
<td></td>
<td></td>
<td></td>
<td>102%</td>
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<tr>
<td>Annual Debt Service Coverage</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Days Cash on Hand</td>
<td>354</td>
<td>399</td>
<td>409</td>
<td>387</td>
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<tr>
<td>Debt to Operating Revenues</td>
<td>2.5</td>
<td>2.4</td>
<td>2.2</td>
<td>2.4</td>
</tr>
</tbody>
</table>

### Medians for A-rated US Water and Sewer Utilities

<table>
<thead>
<tr>
<th>Selected Indicators</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>3-Year Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Condition: (Remaining Useful Life)</td>
<td>29</td>
<td>28</td>
<td>29</td>
<td>29</td>
</tr>
<tr>
<td>System Size: (O&amp;M in 000s)</td>
<td>5,166</td>
<td>5,274</td>
<td>5,324</td>
<td>5,255</td>
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<tr>
<td>Service Area Wealth: (2012 MFI)</td>
<td></td>
<td></td>
<td></td>
<td>89%</td>
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<tr>
<td>Annual Debt Service Coverage</td>
<td>1.7</td>
<td>1.8</td>
<td>1.7</td>
<td>1.7</td>
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<tr>
<td>Days Cash on Hand</td>
<td>270</td>
<td>309</td>
<td>297</td>
<td>292</td>
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<tr>
<td>Debt to Operating Revenues</td>
<td>2.5</td>
<td>2.4</td>
<td>2.5</td>
<td>2.5</td>
</tr>
</tbody>
</table>
## Bond Insurance

- Used to be four major AAA rated insurers

<table>
<thead>
<tr>
<th>Insurer</th>
<th>Moody's</th>
<th>Standard &amp; Poor's</th>
<th>Kroll Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACA</td>
<td>Not Rated</td>
<td>Not Rated</td>
<td>Not Rated</td>
</tr>
<tr>
<td>AMBAC</td>
<td>Not Rated</td>
<td>**R</td>
<td>Not Rated</td>
</tr>
<tr>
<td>Assured Guaranty</td>
<td>A3 (negative outlook)</td>
<td>AA (stable outlook)</td>
<td>Not Rated</td>
</tr>
<tr>
<td>Assured Guaranty Municipal Corp.</td>
<td>A2 (stable outlook)</td>
<td>AA (stable outlook)</td>
<td>AA+ (stable outlook)</td>
</tr>
<tr>
<td>Berkshire Hathaway</td>
<td>Aa1 (stable outlook)</td>
<td>AA+ (negative outlook)</td>
<td>Not Rated</td>
</tr>
<tr>
<td>Build America Mutual</td>
<td>Not Rated</td>
<td>AA (stable outlook)</td>
<td>Not Rated</td>
</tr>
<tr>
<td>CIFG</td>
<td>Not Rated</td>
<td>Not Rated</td>
<td>Not Rated</td>
</tr>
<tr>
<td>FGIC</td>
<td>Not Rated</td>
<td>Not Rated</td>
<td>Not Rated</td>
</tr>
<tr>
<td>Municipal Assurance Corporation</td>
<td>Not Rated</td>
<td>AA (stable outlook)</td>
<td>AA+ (stable outlook)</td>
</tr>
<tr>
<td>National Public Finance (MBIA)</td>
<td>A3 (negative outlook)</td>
<td>AA- (stable outlook)</td>
<td>AA+ (stable outlook)</td>
</tr>
<tr>
<td>Syncora</td>
<td>Not Rated</td>
<td>*R</td>
<td>Not Rated</td>
</tr>
</tbody>
</table>

*R-Regulatory Supervision (NYS Insurance Department), **R-Regulatory Supervision (Wisconsin Insurance Department)

Source: RBC Wealth Management
Green Bonds are standard bonds dedicated to financing projects with clearly identified environmental and climate benefits.

Green Bond Principles (GBP) recognize broad categories of Green Projects:

- Clean water and/or drinking water
- Renewable Energy
- Energy Efficiency (including efficient buildings)
- Sustainable waste management
- Sustainable land use
- Biodiversity conservation
- Clean transportation

GBP recommend that projects provide clear environmental benefits that can be described, assessed, and quantified.

Green Bonds Have Risen to Prominence in Municipal Sector

- Over $3 billion financed in 2015 YTD
- In corporate bond market, Green Bond issuance has grown significantly: $2 billion in 2012, $14 billion in 2013, and $36 billion in 2014
Municipal Green Bond Issuance

Green Bonds Imply Commitment to Environmental Standards

- Use of Green Bond proceeds have clearly stated environmental benefits
- Green Bond issuers may have reporting requirements on use of proceeds

Green Bonds have recently been issued by:

- Water and Sewer issuers such as City of Venice, FL, East Central Regional Wastewater Treatment Facilities Operations Board (Palm Beach County), DC Water and Sewer Authority, Hartford County, Metropolitan Water Reclamation District of Greater Chicago
- Higher education institutions such as MIT, University of Cincinnati, and Indiana University
- State-level issuers such as California, Indiana Finance Authority (SRF), NY Environmental Facilities Corp and Massachusetts
The Bond Buyer: Green Bond Funds Take Interest in Municipals

- Municipal fund managers seeing demand from investors for socially responsible investments
- Municipal green bonds account for 1.83% of Standard & Poor’s Green Bond Index
- Fund managers found interest in green funds is result of investors motivated by desire to promote conservation or help offset global warming
- No green bond funds have yet been devoted entirely to municipal debt – those in existence include corporate and asset-backed bonds
- Municipal green bond issuers have been able to attract new investors
- Bond funds have also been able to increase and diversify type of investors in funds by going green

Source: September 2014 The Bond Buyer article “A Flood of Green Debt Stands Out”
Bond Alternatives

**SRF Loans**
- State Revolving Fund run by DEP for water, wastewater and stormwater projects
- Interest rate subsidized by state and federal government
- Loans up to 20 years with level annual debt service
- May be wage act requirements
- SRF loans can be subordinate to outstanding bond issues and bank loans

**Bank Loans**
- Can be more economical than publicly offered bonds if amortization 20 years or less
- Many banks limited on length of financing, with few that can go out 20 years
- May have tax risk, where bank can increase rate if tax laws change
- Acceleration in the event of default and default interest rate (not present in bond issues)
Today’s 4.04% level is lower than 100% of historical rates since September 1979.

Source: Bloomberg as of November 19, 2015. Weekly yields and indexes released by the Bond Buyer. Updated every Thursday at approximately 6:00pm EST. 25 Revenue Bond Yield with 30 year maturity, rated A1 by Moody’s and A+ by S&P Arithmetic Average of 25 bonds' yield to maturity.
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