Office of Christine Lizardi Frazier
Kern County Superintendent of Schools
Division of Administration, Finance and Accountability

Debt Management Workshop
Best Practices and Current Information on Debt
August 9, 2012

Working Agenda

Goal

The goal of this training will be to teach the benefits of good debt management practices through presentation of case studies, discussion, and identification of KCSOS resources available to districts.

Workshop Presenters

Lori Raineri	*President, Govemment Financial Strategies, Inc.*
Jordan Kaufman	*Assistant Treasurer, Kem County*
Mary Barlow	*Assistant Superintendent, KCSOS*
Mark Fulmer	*Deputy Superintendent, KCSOS, retired*

11:30 Welcome, introductions and Review of the Agenda — Mary Barlow, Mark Fulmer

- Each participant will be provided a copy of the Government Finance Officers Association Recommended Best Practices for Debt Management.

  Each participant will be provided a copy of the Notes to their district's Financial Statements, which describe outstanding debt, from the June 30, 2011 Audit Report.

11:45 Presentation of case study #1 — Lori Raineri, Mark Fulmer

- Presentation of a case study of a district which utilized good debt management for a measurable positive outcome
- Discussion of case study presented and applicability in Kern County.

12:30 PM Presentation of a case study # 2 — Lori Raineri

- Presentation of a case study of a district which utilized poor debt management resulting in a negative outcome.

1:15 Debt Review and Discussion — Lori Raineri

- Superintendents and CBOs to review their outstanding debt and discuss with each other thoughts so far using their own Audit report information

1:45 Resources for Districts — Jordan Kaufman, Mary Barlow

- Review and Discussion of (a) AB-2197 reporting requirements (b) the expectations of the Kern County Treasurer
- Review of Education Codes 17150.1 and 42133, and the KCSOS' process.
- Presentation of resources available to districts from KCSOS and the County of Kern

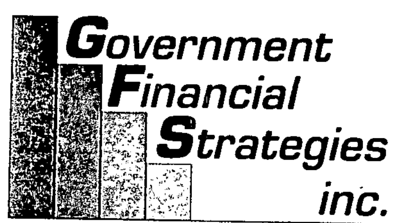
2:45 Concluding Discussion — Mary Barlow, Lori Raineri

- Each participant will be asked to share one idea from the training that they will put into practice.

Government Finance Officers Association

Best Practices Related to
Debt Management and Debt Issuance

April, 2012



limits are often expressed as ratios customarily used by credit analysts. Different financial limits are used for different types of debt. Examples include:

- *Direct Debt* can be measured or limited by the following ratios:
  - Debt per capita,
  - Debt to personal income,
  - Debt to taxable property value, and
  - Debt service payments as a percentage of general fund revenues or expenditures.

- *Revenue Debt* levels are often limited by debt service coverage ratios (e.g., annual net pledged revenues to annual debt service) or credit rating impacts (e.g., additional bonds should not lower ratings) contained in bond covenants.

- *Conduit Debt* limitations may reflect the right of the issuing government to approve the borrower's creditworthiness, the purpose of the borrowing issue, or a minimum credit rating. Such limitations reflect sound public policy, particularly if there is a contingent impact on the general revenues of the government or marketability of the government's direct debt.

- *Short-Term Debt Issuance* should describe the specific purposes and circumstances under which it can be used, as well as limitations in term or size of borrowing.

2. ***Use of Derivatives.*** The Policy should:

- Specify how derivatives fit within the overall debt management program.
- State the conditions under which derivatives can be utilized.
- Identify the types of derivatives that may be employed or are prohibited.
- Identify approach(es) for measuring, evaluating, and managing derivative risk, including basis risk, tax risk, counter-party risk, termination risk, liquidity renewal risk, remarketing risk, and credit risk.
- State the methods for procuring and selecting derivative products.

3. ***Debt Structuring Practices.*** The Policy should include specific policies regarding the debt structuring practices for each type of bond, including:

- Maximum term (often stated in absolute terms or based on the useful life of the asset(s)),
- Average maturity,
- Debt service pattern such as equal payments or equal principal amortization,
- Use of optional redemption features that reflect market conditions and/or needs of the government,
- Use of variable or fixed-rate debt, credit enhancements, derivatives, and short-term debt and ...

GFOA Recommended Practice

Selecting and Managing the Method of Sale of State and Local Government Bonds (1994 and 2007) (DEBT)

Background. State and local government bond issuers should sell their debt using the method of sale that is most likely to achieve the lowest cost of borrowing while taking into account both short-range and long-range implications for taxpayers and ratepayers. Differing views exist among issuers and other bond market participants with respect to the relative merits of the competitive and negotiated methods of sale. Moreover, research into the subject has not led to universally accepted findings as to which method of sale is preferable when taking into account differences in bond structure, security, size, and credit ratings for the wide array of bonds issued by state and local governments.

Concerns have been raised about the lack of a competitive Request for Proposals (RFP) process in the selection of underwriters in a negotiated sale and the possibility of higher borrowing costs when underwriters are appointed based on factors other than merit. As a result, issuers have been forced to defend their selection of underwriters for negotiated sales in the absence of a documented, open selection process.

There is also a lack of understanding among many debt issuers about the appropriate roles of underwriters and financial advisors and the fiduciary relationship that each has or does not have with respect to state and local government issuers. The relationship between issuer and financial advisor is one of "trust and confidence" which is in the "nature of a fiduciary relationship". This is in contrast to the relationship between the issuer and underwriter where the relationship is one of some common purposes but also some competing objectives, especially at the time of bond pricing.

Recommendation. When state and local laws do not prescribe the method of sale of municipal bonds, the Government Finance Officers Association (GFOA) recommends that issuers select a method of sale based on a thorough analysis of the relevant rating, security, structure and other factors pertaining to the proposed bond issue. If the government agency has in-house expertise, defined as dedicated debt management staff whose responsibilities include daily management of a debt portfolio, this analysis and selection could be made by the government's staff. However, in the more common situation where a government agency does not have sufficient in-house expertise, this analysis and selection should be undertaken in partnership with a financial advisor. Due to the inherent conflict of interest, issuers should not use a broker/dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction.

The GFOA believes that the presence of the following factors may favor the use of a competitive sale:

- The rating of the bonds, either credit-enhanced or unenhanced, is at least in the single-A category.

- The bonds are general obligation bonds or full faith and credit obligations of the issuer or are secured by a strong, known and long-standing revenue stream.

- The structure of the bonds does not include innovative or new financing features that require extensive explanation to the bond market.

Similarly, GFOA believes that the presence of the following factors may favor the use of a negotiated sale:

- The rating of the bonds, either credit-enhanced or unenhanced, is lower than single-A category.
- Bond insurance or other credit enhancement is unavailable or not cost-effective.
- The structure of the bonds has features such as a pooled bond program, variable rate debt, deferred interest bonds, or other bonds that may be better suited to negotiation.
- The issuer desires to target underwriting participation to include disadvantaged business enterprises (DBEs) or local firms.
- Other factors that the issuer, in consultation with its financial advisor, believes favor the use of a negotiated sale process.

If an issuer, in consultation with its financial advisor, determines that a negotiated sale is more likely to result in the lowest cost of borrowing, the issuer should undertake the following steps and policies to increase the likelihood of a successful and fully documented negotiated sale process:

- Select the underwriter(s) through a formal request for proposals process. The issuer should document and make publicly available the criteria and process for underwriter selection so that the decision can be explained, if necessary.
- Enter into a written contractual relationship with a financial advisor (a firm unrelated to the underwriter(s)), to advise the issuer on all aspects of the sale, including selection of the underwriter, structuring, disclosure preparation and bond pricing.
- Due to inherent conflicts of interest, the firm acting as a financial advisor for an issuer should not to be allowed to resign and serve as underwriter for the transaction being considered.
- Due to potential conflicts of interest, the issuer should also enact a policy regarding whether and under what circumstances it will permit the use of a single firm to serve as an underwriter on one transaction and a financial advisor on another transaction.
- Issuers with sufficient in-house expertise and access to market information may act as their own financial advisor. Such issuers should have at least the following skills and information: (i) access to real-time market information (e.g. Bloomberg) to assess market conditions and proposed bond prices; (ii) experience in the pricing and sale of bonds, including historical pricing data for their own bonds and/or a set of comparable bonds of other issuers in order to assist in determining a fair price for their bonds; and (iii) dedicated full-time staff to manage the bond issuance process, with the training, expertise and access to debt management tools necessary to successfully negotiate the pricing of their bonds.
- Remain actively involved in each step of the negotiation and sale processes in accordance with the GFOA's *Recommended Practice, Pricing Bonds in a Negotiated Sale*.
- Require that financial professionals disclose the name(s) of any person or firm compensated to promote the selection of the underwriter; any existing or planned arrangements between outside professionals to share tasks, responsibilities and fees; the name(s) of any person or firm with whom the sharing is proposed; and the method used to calculate the fees to be earned.
- Review the "Agreement Among Underwriters" and ensure that it governs all transactions during the underwriting period.

- Openly disclose public-policy issues such as the desire for DBEs and regional firm participation in the syndicate and the allocation of bonds to such firms as reason for negotiated sale; measure and record results at the conclusion of the sale.

- Prepare a post-sale summary and analysis that documents the pricing of the bonds relative to other similar transactions priced at or near the time of the issuer's bond sale, and record the true interest cost of the sale and the date and hour of the verbal award.

References

- *Who are the Parties in My Deal? What are Their Roles? How Do I Sell My Bonds?*, Julia H. Cooper and David Persselin, Government Finance Review, April 2006.
- *An Elected Official's Guide to Debt Issuance*, J.B. Kurish and Patricia Tigue, GFOA, 2005.
- *Debt Management Policy*, GFOA Recommended Practice, 2003.
- *Pricing Bonds in a Negotiated Sale*, GFOA Recommended Practice, 2000.
- *Preparing RFPs to Select Financial Advisors and Underwriters*, GFOA Recommended Practice, 1997.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *Competitive v. Negotiated: How to Choose the Method of Sale for Tax-Exempt Bonds*, GFOA, 1994.
- *Competitive v. Negotiated Sale Debt*, Issue Brief No. 1, California Debt Advisory Commission, September 1992.

Approved by the GFOA's Executive Board, October 19, 2007.

BEST PRACTICE

Selecting Financial Advisors (2008) (DEBT)*

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of State and Local Government Bonds
Selecting Financial Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

Background. State and local governments employ financial advisors to assist in the structuring and issuance of bonds whether through a competitive or a negotiated sale process. Unless the issuer has sufficient in-house expertise and access to market information, it should hire an outside financial advisor prior to undertaking a debt financing. A financial advisor represents the issuer, and only the issuer, in the sale of bonds. Issuers should assure themselves that the selected financial advisor has the necessary expertise to assist the issuer in selecting other finance professionals, planning the bond sale, and successfully selling and closing the bonds. In considering the roles of the financial advisor and underwriter, it is the intent of this Recommended Practice to set a higher standard than is required under MSRB Rule G-23, because disclosure and consent are not sufficient to cure the inherent conflict of interest.

Recommendation. The Government Finance Officers Association (GFOA) recommends that issuers select financial advisors on the basis of merit using a competitive process and that issuers review those relationships periodically. A competitive process using a request for proposals or request for qualifications (RFP) process allows the issuer to compare the qualifications of proposers and to select the most qualified firm based on the scope of services and evaluation criteria outlined in the RFP.

Before starting the RFP process, issuers should decide whether the financial advisor will assist the issuer for a single bond sale, for a multi-year engagement or whether the issuer seeks to establish a qualified pool of financial advisors to choose from for future bond sales. The RFP then can be carefully written in order to result in the form of relationship desired by the issuer. Additionally, issuers should write the RFP to comply with applicable procurement requirements.

If an issuer is contemplating the possibility of selling bonds through a negotiated sale, the financial advisor should be retained prior to selecting the underwriter(s). This allows the issuer to have professional services available to advise on the appropriate method of sale, and if a negotiated sale is selected, to prepare the underwriter RFP and assist in the evaluation of the underwriter responses.

No firm should be given an unfair advantage in the RFP process. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

Due to potential conflicts of interest, the issuer also should enact a policy regarding whether, and under what circumstances, it would permit a firm to serve as an underwriter on one transaction and a financial advisor on another transaction. Additionally, it is recommended that when an issuer has a financial advisor contract with a firm that also is a broker-dealer, there should be a lockout period from the time that the financial advisor contract ends to the time when the broker-dealer can serve as a negotiated underwriter for the issuer.

Request for Proposal Content. The RFP should include at least the following components:

1. A statement from the issuer stating that due to inherent conflicts of interest, the firm selected as financial advisor will not be allowed to resign in order to serve as underwriter for the proposed transaction (See GFOA Recommended Practice, *Selecting and Managing the Method of Sale of State and Local Government Bonds*).

2. A clear and concise description of the scope of work, specifying the length of the contract and indicating whether joint proposals with other firms are acceptable.

3. Clarity on whether the issuer reserves the right to select more than one financial advisor or to form financial advisory teams.

4. A description of the objective evaluation and selection criteria and explanation of how proposals will be evaluated.

5. A requirement that all fee structures be presented in a standard format. Issuers also should ask all proposers to identify which fees are to be proposed on a "not-to-exceed" basis, describe any condition attached to their fee proposal, and explicitly state which costs are included in the fee proposal and which costs are to be reimbursed.

6. A requirement that the proposer provide at least three references from other public-sector clients, preferably from ones that the firm provided similar services to those proposed to be undertaken as the result of the RFP.

Requested Proposer Responses. RFPs should request relevant information related to the areas listed below in order to distinguish each firm's qualifications and experience, including:

1. Relevant experience of the individuals to be assigned to the issuer, identification of the individual in charge of day-to-day management, and the percentage of time committed for each individual on the account.

2. Relevant experience of the firm with financings of the issuer or comparable issuers and financings of similar size, types and structures, including financings in same state.

3. Discussion of the firm's financial advisory experience necessary to assist issuers with either competitive or negotiated sales.

4. Demonstration of the firm's understanding of the issuer's financial situation, including ideas on how the issuer should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.

5. Demonstration of the firm's knowledge of local political, economic, legal or other issues that may affect the proposed financing.

6. Discussion of the firm's familiarity with GFOA's Recommended Practices relating to the selling of bonds and the selection of finance professionals.

7. Disclosure of the firm's affiliation or relationship with any broker-dealer.

8. Analytic capability of the firm and assigned individuals and the availability of ongoing training and educational services that could be provided to the issuer.

9. Description of the firm's access to sources of current market information to assist in pricing of negotiated sales and information to assist in the issuer in planning and executing competitive sales.

10. Amounts and types of insurance carried, including the deductible amount, to cover errors and omissions, improper judgments, or negligence.

11. Disclosure of any finder's fees, fee splitting, payments to consultants, or other contractual arrangements of the firm that could present a real or perceived conflict of interest.

12. Disclosure of any pending investigation of the firm or enforcement or disciplinary actions taken within the past three years by the SEC or other regulatory bodies.

Additional Considerations. Issuers should also consider the following in conducting the financial advisor selection process:

1. Take steps to maximize the number of respondents by using mailing lists, media advertising, resources of the GFOA and applicable professional directories.

2. Allow adequate time for firms to develop their responses to the RFP. Two weeks should be appropriate for all but the most complicated RFPs.

3. Establish evaluation procedures and a systematic rating process, conduct interviews with proposers, and undertake reference checks. Where practical, one individual should check all references using a standard set of questions to promote consistency. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the selection team.

4. Document and retain the description of how the selection of the financial advisor was made and the rankings of each firm.

5. Consider whether to require disclosure of gifts, political contributions, or other financial arrangements in compliance with state and local government laws or other applicable policies.

Basis of Compensation. Fees paid to financial advisors should be on an hourly or retainer basis, reflecting the nature of the services to the issuer. Generally, financial advisory fees should not be paid on a contingent basis to remove the potential incentive for the financial advisor to provide advice that might unnecessarily lead to the issuance of bonds. GFOA recognizes, however, that this may be difficult given the financial constraints of many issuers. In the case of contingent compensation arrangements, issuers should undertake ongoing due diligence to ensure that the financing plan remains appropriate for the issuer's needs. Issuers should include a provision in the RFP prohibiting any firm from engaging in activities on behalf of the issuer that produce a direct or indirect financial gain for the financial advisor, other than the agreed-upon compensation, without the issuer's informed consent.

Form of Contract. As part of the RFP package, the issuer may also include a "Form of Contract" which incorporates elements and provisions conforming to prevailing law and procurement processes and requires RFP respondents to comment on the acceptability of the Form of Contract. The comments on the acceptability of the Form of Contract should be part of the evaluation process. The contract development process should allow for reasonable negotiation over the final terms of the contract. A final negotiated contract should make clear those services that will be included within the basic financial advisor fee and any services or reimbursable expenses that might be billed separately.

References

- *Preparing Requests for Proposals*, Issue Brief No. 3, California Debt Advisory Commission, October, 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *A Guide for Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, GFOA, 1997.
- GFOA Best Practice, "Pricing Bonds in a Negotiated Sale," 2008.
- GFOA Best Practice, "Selecting Bond Counsel," 2008.
- GFOA Best Practice, "Selecting Underwriters for Negotiated Bond Sales," 2008.
- GFOA Best Practice, "Selecting and Managing the Method of Sale of State and Local Government Bonds," 2007.
- Municipal Securities Rulemaking Board Rule G-23, *Activities of Financial Advisors,* http://www.msrb.org/msrb1/rules/ruleg23.htm.

* This Recommended Practice, along with the Recommended Practice on Selecting Financial Advisors, replaces the 1997 RP, Preparing RFPs to Select Financial Advisors and Underwriters.

Approved by the GFOA's Executive Board, October 17, 2008.

Recommended Practice

Selecting Bond Counsel (1998 and 2008) (DEBT)

Background. An essential member of a governmental issuer's bond financing team is bond counsel. Bond counsel renders an opinion on the validity of the bond offering, the security for the offering, and whether and to what extent interest on the bonds is exempt from income and other taxation. The opinion of bond counsel provides assurance both to issuers and to investors who purchase the bonds that all legal and tax requirements relevant to the matters covered by the opinion are met. An issuer should assure itself that its bond counsel has the necessary expertise to provide an opinion that can be relied on and will be able to assist the issuer in completing the transaction in a timely manner.

Recommendation. The Government Finance Officers Association (GFOA) recommends that issuers select bond counsel on the basis of merit using a competitive process and review those relationships periodically. A competitive process using a request for proposals (RFP) or request for qualifications (RFQ) permits issuers to compare qualifications of firms and select a firm or firms that best meets the needs of their community and the type of financing being undertaken. The RFP or RFQ should clearly describe the scope of services desired, the length of the engagement, evaluation criteria, and the selection process. Issuers should have a clear understanding of their service needs (single transaction, multiple transaction, or establishment of a qualified pool of firms) and develop the RFP/RFQ to meet these needs. Additionally, issuers should carefully develop an RFP that complies with state and local procurement requirements.

A RFP or RFQ should require firms proposing to serve as bond counsel to submit information that permits the issuer to evaluate the following factors, at a minimum:

1. Experience of the firm with financings of the issuer or comparable issuers, and financings of similar size, types and structures, including financings in the same state.
2. In preparing the RFP the issuer should determine whether specialized tax advice beyond normal bond counsel services is required. In those instances, the firm's experience in tax matters and the attorneys who practice full time in the area of public finance tax law should be identified in detail. If the firm has no attorneys who specialize in public finance tax law, the response should indicate how the firm intends to provide competent tax advice.
3. Experience of the firm with and its approach to applicable federal securities laws and regulations. In preparing the RFP the issuer should determine whether specialized securities law services beyond normal bond counsel services is required. In those instances, the firm's experience in municipal securities law matters and the attorneys who practice full time in the area of municipal securities law should be identified in detail. If the firm has no attorneys who specialize in municipal securities tax law, the response should indicate how the firm intends to provide competent municipal securities law advice.
4. Knowledge and experience of the attorneys that would be assigned to the transaction, particularly the individual with day-to-day responsibility for the issuer's account.
5. Ability of the firm and assigned personnel to evaluate legal issues, prepare documents, and complete other tasks of a bond transaction in a timely manner.
6. Relationships or activities that might present a conflict of interest for the issuer.

7. Level of malpractice insurance carried, including the deductible amount, to cover errors and omissions, improper judgments, or negligence.

Individuals in the organization with experience in public finance and/or responsible for debt management activities should be involved in the RFP or RFQ development and response review. This may include representatives from the finance department and internal counsel. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the evaluation and/or selection team. In reviewing and evaluating the RFP or RFQ responses, evaluation procedures and a systematic rating process should be established which consider the following:

1. The use of oral interviews of proposers, in which the attorney who would have day-to-day responsibility for the issuer's account should be asked to assume the lead role in presenting the qualifications of the firm.
2. The selection should not be driven solely by proposed fees. The experience of the firm with the type of transactions and the ability to deliver the required legal services in a timely manner are the most important factors in the selection of bond counsel.
3. For issuers that have ongoing needs of a similar nature, continuity should be considered an important factor in the evaluation process.
4. Different fee arrangements are possible depending on the type and nature of the engagement. Fee arrangements include both fixed fee and hourly which may or may not include a cap on the total compensation. Additionally, fees may also be paid contingent on the sale of bonds. Generally bond counsel fees should not be paid on a contingent basis to remove the potential incentive for bond counsel to render legal or tax options that would result in the inappropriate issuance of bonds. However, this may be difficult given the financial constraints of many issuers; in the case of contingent fee arrangements (as well as other fee arrangements), issuers should undertake ongoing due diligence to ensure the bond issue and structure remains appropriate for their organization. Fees and method of compensation (fixed fee, hourly, or retainer) should appropriately reflect the complexity and scope of the services to be provided.
5. Before making a final selection, the issuer should check the references furnished by the prospective bond counsel and determine the outcome of examinations by the IRS or other regulatory agencies of transactions in which the prospective bond counsel was involved. Where practical, one individual should check all references using a standard set of questions to promote consistency.

The issuer may also choose to include a "Form of Contract" in the RFP or RFQ package, which incorporates elements and provisions conforming to prevailing law and procurement processes. The RFP or RFQ should require respondents to comment on the acceptability of the Form of Contract. The comments on the acceptability of the Form of Contract should be part of the evaluation process. The contract development process should allow for reasonable negotiation over the final terms of the contract and/or engagement letter. A final negotiated contract or the engagement letter should make clear those services that will be included within the basic bond counsel fee and any services or reimbursable expenses that might be considered separately billable.

If co-bond counsels are being engaged, the issuer should:

1. delineate in the RFP or RFQ or engagement letter the roles and responsibilities of each firm;
2. assign discrete tasks to each firm in order to minimize cost duplication; and
3. exercise appropriate oversight to ensure coordination of tasks undertaken by the firms.

If co-bond counsels are engaged or if bond counsel firms are rotated, the issuer should:

1. evaluate whether higher costs for legal services will result because of the need for two or more firms to familiarize themselves with the issuer; and

2. consider the possible need to resolve differing viewpoints of each bond counsel.

Throughout the term of the engagement, the performance of bond counsel should be evaluated in relation to the stated scope of services and any areas where service needs to be improved should be communicated to the lead attorney. Ongoing contracts should be reviewed regularly and resubjected to competitive selection periodically.

References

- GFOA Recommended Practice; *Preparing RFPs to Select Financial Advisors and Underwriters*, 1997.
- Patricia Tigue, *A Guide to Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals;* GFOA, 1997.
- "Model Engagement Letters," National Association of Bond Lawyers, 1998.
- "The Selection and Evaluation of Bond Counsel," National Association of Bond Lawyers, 1998.

Approved by the GFOA's Executive Board, February 22, 2008.

BEST PRACTICE

Selecting Underwriters for Negotiated Bond Sales (2008) (DEBT)*

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of State and Local Government Bonds
Selecting Financial Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

Background. State and local governments select underwriters for the purpose of selling bonds through a negotiated sale. The primary role of the underwriter in a negotiated sale is to market the issuer's bonds to investors. Assuming that the issuer and underwriter reach agreement on the pricing of the bonds at the time of sale, the underwriter purchases the entire bond issue from the issuer and resells the bonds to investors. In addition, negotiated sale underwriters are likely to provide ideas and suggestions with respect to structure, timing and marketing of the bonds being sold.

Issuers must keep in mind that the roles of the underwriter and the financial advisor are separate, adversarial roles and cannot be provided by the same party. Underwriters do not have a fiduciary responsibility to the issuer. A financial advisor represents only the issuer and has a fiduciary responsibility to the issuer. In considering the roles of underwriter and financial advisor, it is the intent of this Recommended Practice to set a higher standard than is required under MSRB Rule G-23, because disclosure and consent are not sufficient to cure the inherent conflict of interest.

The issuer's goal in a negotiated bond sale is to obtain the highest possible price (lowest interest cost) for the bonds. To maximize the potential of this occurring, the issuer's goal in the underwriter selection process is to select the underwriter(s) that has the best potential for providing that price. Those underwriters are typically the ones that have demonstrated both experience underwriting the type of bonds being proposed and the best marketing/distribution capabilities.

Recommendation. The Government Finance Officers Association (GFOA) recommends that unless the issuer has sufficient in-house expertise and access to market information, it should hire an outside financial advisor prior to undertaking a negotiated debt financing. The financial advisor can lend objective knowledge and expertise in the selection of underwriters for negotiated sales. GFOA recommends that a firm hired as a financial advisor should not be allowed to resign in order to underwrite the proposed negotiated sale of bonds.

GFOA further recommends the use of a Request for Proposal (RFP) process when selecting underwriters in order to promote fairness, objectivity and transparency. The RFP process allows the issuer to compare respondents and helps the issuer select the most qualified firm(s) based on the evaluation criteria outlined in the RFP. An issuer and its financial advisors should have a clear understanding of the issuer's underwriting needs and should carefully develop an RFP that complies with state and local bidding requirements (including the use of regional, local or disadvantaged firms if deemed appropriate by the issuer).

A negotiated bond sale does not entail the purchase of any goods or services by an issuer from an underwriter. Therefore, an RFP process for underwriters should not be treated as a procurement process for goods or services, notwithstanding the obligation of the issuer to comply with state and/or local procurement requirements. The only legal relationship between the issuer and an underwriter is created by a Bond Purchase Agreement signed at the time of the pricing of the bonds, wherein the issuer agrees to sell the bonds to the underwriter at an agreed upon price.

An RFP process can result in selection of one or more underwriters for a single transaction or result in identification of a pool of underwriters from which firms will be selected over a specific period of time for a number of different transactions. Each issuer should weigh the advantages and disadvantages of each type of arrangement with the assistance of their financial advisor.

No firm should be given an unfair advantage in the RFP process. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

Request for Proposal Content. The RFP should include at least the following components:

1. A clear and concise description of the contemplated bond sale transaction.
2. A statement noting whether firms may submit joint proposals. In addition, the RFP should state whether the issuer reserves the right to select more than one underwriter for a single transaction.
3. A description of the objective evaluation and selection criteria and explanation of how proposals will be evaluated.
4. A requirement that all underwriter compensation structures be presented in a standard format. Proposers should identify which fees are proposed on a "not-to-exceed" basis, describe any condition attached to their fee proposal, and explicitly state which costs are included in the fee proposal and which costs are to be reimbursed.
5. A requirement that the proposer provide at least three references from other public-sector clients, preferably clients where the firm provided underwriting services similar to those proposed to be undertaken as the result of the RFP.

Requested Proposer Responses. RFPs should include questions related to the areas listed below to distinguish firms' qualifications and experience, including but not limited to:

1. Relevant experience of the firm and the individuals assigned to the issuer, and the identification and experience of the individual in charge of day-to-day management of the bond sale, including both the investment banker(s) and the underwriter(s).
2. A description of the firm's bond distribution capabilities including the experience of the individual primarily responsible for underwriting the proposed bonds. The firm's ability to access both retail and institutional investors should be described.
3. Demonstration of the firm's understanding of the issuer's financial situation, including ideas on how the issuer should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.
4. Demonstration of the firm's knowledge of local political, economic, legal or other issues that may affect the proposed financing.
5. Documentation of the underwriter's participation in the issuer's recent competitive sales or the competitive sales of other issuers in the same state.
6. Analytic capability of the firm and assigned investment banker(s).
7. Access to sources of current market information to provide bond pricing data before, during and after the sale.
8. The amount of uncommitted capital available and the ability and willingness of the firm to purchase the entire offering of the issuer, if necessary, in the case of a firm underwriting.

9. Any finder's fees, fee splitting, or other contractual arrangements of the firm that could present a real or perceived conflict of interest, as well as any pending investigation of the firm or enforcement or disciplinary actions taken within the past three years by the SEC or other regulatory bodies.

Additional Considerations. Issuers should also consider the following in conducting the underwriter selection process:

1. Take steps to maximize the number of respondents by using mailing lists, media advertising, resources of the GFOA, resources of the financial advisor and applicable professional directories.
2. Give adequate time for firms to develop their responses to the RFP. Two weeks should be appropriate for all but the most complicated RFPs.
3. Establish evaluation procedures and a systematic rating process, conduct interviews with proposers, and undertake reference checks. Where practical, one individual should check all references using a standard set of questions to promote consistency. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the selection team.
4. Document and retain the description of how the selection was made and the rankings of each firm.

Underwriter's Compensation. The underwriter in a negotiated sale is compensated in the form of an underwriter's discount or "spread", which consists of the negotiated difference between the amount the underwriter pays the issuer for the bonds and the amount the underwriter expects to receive selling the bonds to investors. The underwriter's discount includes up to four components: the management fee, takedown, expenses and underwriting fee. The only component of spread that can be fixed in a proposal is the management fee. The management fee compensates the investment bankers for the time and expertise brought to the negotiated sale by the investment bankers. It is appropriate to ask the proposer for a firm management fee quote, although its weighting in the evaluation criteria should be low. In addition, issuers may want to leave room to negotiate this fee lower or higher, depending on the actual complexities of the transaction.

The remaining components of spread, as noted below, should be determined through the negotiation process.

1. Expenses – includes various fees and overhead expenses and also should not be part of the RFP evaluation criteria. However it is important to note that all underwriter expenses be clearly identified and defined at the appropriate time during the bond negotiation.
2. Takedown – is the "sales commission" of the deal. Current market levels of takedown can be determined by the issuer or its financial advisor just prior to the time of negotiation. The takedown is the principal component of the potential profit to an underwriter in a bond sale. The issuer must weigh the impact of takedown on the resulting true interest cost to the bond issuer. An inadequate takedown may result in less aggressive marketing of the bonds and a higher interest cost to the issuer. A fair balance must be struck between a "market rate" takedown and the cost to the issuer in future interest costs.
3. Underwriting Fee – is almost never part of the final underwriter's discount and should not be part of the discussion at the RFP stage. Discussion of the payment of an underwriting fee may occur during pricing negotiation, but only to the extent the underwriter agrees to underwrite a substantial amount of unsold bonds.

Issuers should include a provision in the RFP prohibiting any firm from engaging in activities on behalf of the issuer that produce a direct or indirect financial gain for the firm, other than the agreed-upon compensation, without the issuer's informed consent. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

References

- *Preparing Requests for Proposals*, Issue Brief No. 3, California Debt Advisory Commission, October 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *A Guide for Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, GFOA, 1997.
- GFOA Best Practice, "Selecting Bond Counsel," 2008.
- GFOA Best Practice, "Selecting Financial Advisors," 2008.
- GFOA Best Practice, "Selecting and Managing the Method of Sale of State and Local Government Bonds," 2007.
- Municipal Securities Rulemaking Board Rule G-23, *Activities of Financial Advisors,* http://www.msrb.org/msrb1/rules/ruleg23.htm.

* This Recommended Practice, along with the Recommended Practice on Selecting Financial Advisors, replaces the 1997 RP, Preparing RFPs to Select Financial Advisors and Underwriters.

Approved by the GFOA's Executive Board, October 17, 2008.

BEST PRACTICE

Expenses Charged by Underwriters in Negotiated Sales (1996, 2010, and 2012) (DEBT)

Background. When selling tax exempt or taxable municipal bonds through negotiated sale, in addition to negotiating the price or yield for each bond, the underwriters' compensation, or so-called "spread," or underwriters discount must be negotiated. There are four components of the spread; the takedown, the management fee, the underwriting risk fee, and underwriters' expenses. Underwriters expenses included in a bond issue should represent fair reimbursement at the least public cost of expenses undertaken by the underwriters for the benefit of the transaction.

Issuers should be familiar with the types of transaction expenses that are encountered in typical bond sales and should be prepared to discuss and agree on how transaction expenses should be treated. Treatment of transaction expenses may be subject to legal constraints of bond resolutions, local ordinances, governing state statutes, or federal tax law. Certain expenses normally are considered issuer's expenses and, if paid from the bond issue, should be characterized as "costs of issuance" rather than the underwriter's expenses.

Issuers need to make sure that the expenses charged are appropriate for the transaction, regardless of how they ultimately are paid. Decisions about including or excluding specific expenses from being part of the underwriter's expenses or costs of issuance require consideration of policy regarding whether certain expenses will be paid from the proceeds of the bond, either paid directly by the issuer or as part of the underwriter spreadover the life of the bond issue by inclusion, paid from available cash outside the bond issue, or paid by the underwriter outside the bond issue as a business overhead expense of the underwriting firm.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local government issuers establish at the beginning of the bond negotiation process what expenses will be directly paid by the issuer or as part of the underwriter spread. This should occur through discussions between the issuer (together with its financial advisor) and the underwriter. Along with establishing which expenses will be paid for by the issuer either directly or through the underwriter spread, , the requirements for documenting each item, and the procedure for disbursing the expense funds at closing should be established and documented. Expense items may be categorized as follows:

Commonly accepted underwriter's expenses:

a. reasonable costs underwriter's counsel;
b. reasonable travel costs incurred as part of the transaction. Issuers may want to establish guidelines regarding travel reimbursement practices including but not limited to mode of travel, airfare, hotels and meals.
c. external data service fees for transmitting information on interest rates, takedowns, and priority of orders;
d. interest/day loan costs;
e. charges for communication, including the rating agency presentation, mailing, printing, and telephone expenses; and,
f. CUSIP fees.

Expenses commonly viewed as issuer's expenses that normally are treated as cost of issuance and may be capitalized within a bond issue (but not within the spread) are:

a. bond counsel fees,
b. rating agency fees,
c. financial advisor fees,
d. necessary rating agency or marketing travel by the issuer,
e. printing of disclosure documents,
f. upfront trustee or fiduciary fees.

Expenses commonly viewed as not essential to a transaction:

a. unnecessary, unreasonable or non-approved travel and meals,
b. celebratory closing dinners,
c. mementos,
d. commuting costs to and from work by the underwriters' staff, computer-or structuring charges, and undocumented clearing charges.

Issuers should be aware that inappropriately denying the underwriter fair reimbursement of necessary and reasonable expenses increases the pressure on the underwriter to compensate itself elsewhere in the bond transaction, specifically in the takedown, the management fee, the underwriting fee, or even in the bond price/yield. This may have the effect of reducing sales incentive among the members of the underwriting syndicate.

Issuers need to be certain that they do not pay for either the MSRB Underwriting and Transaction Assessment fee, which dealers are prohibited to pass along to issuers under MSRB Rule A-13*, nor the SIFMA Municipal Assessment fee, which is no longer in place. Additionally, issuers should not allow the underwriter to pass through to them any fees that are assessed on the underwriter's firm as part of a new Governmental Accounting Standards Board (GASB) fee.

References

- GFOA Best Practice, *Issuer's Role in Selecting Underwriter's Counsel*, 2009.
- GFOA Best Practice, *Pricing Bonds in a Negotiated Sale*, 2009.
- GFOA Best Practice, *Selecting Underwriters for a Negotiated Bond Sale*, 2008
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *Understanding the Underwriting "Spread,"* Issue Brief No. 2, California Debt Advisory Commission, March 1993.

* MSRB Rule A-13(e), " Prohibition on Charging Fees Required Under this Rule to Issuers. No broker, dealer or municipal securities dealer shall charge or otherwise pass through the fee required under this rule to an issuer of municipal securities."

Approved by the GFOA's Executive Board, January, 2012.

BEST PRACTICE

Pricing Bonds in a Negotiated Sale (1996, 2000, and 2010)

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of State and Local Government Bonds
Selecting Financial Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

Background. One of the most important outcomes of the sale of bonds, the cost of borrowing, is established through the pricing process. Unlike a competitive sale, bond pricing in a negotiated sale requires a much greater degree of issuer involvement. The issuer negotiates both the yield on the bonds and the underwriters' compensation (also called underwriter discount or gross spread), which includes the takedown (or sales commission), management fee, underwriting risk, and expenses. An issuer's success in negotiating the price of its bonds depends on its ability and willingness to devote sufficient time to understanding the market and the historical performance of its bonds.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local government issuers strive for the best balance between the yield for each maturity and the takedown to achieve the lowest overall cost of financing. The following actions by issuers are recommended to improve the pricing process:

1. Communicate to the underwriter specific goals to be achieved in the pricing of bonds and expectations regarding the roles of each member of the financing team, including the issuer and an independent financial advisor employed to assist in the pricing process. Identify the issuer representative who has authority to make key decisions and be available throughout the pricing process.
2. Take steps during the underwriter selection process and prior to final pricing to manage the compensation to underwriters by
   - including a provision in the request for proposal that requires respondents to indicate the range of costs for each component of compensation and specify an expected maximum for each,
   - setting a cap on fees and expenses, and
   - obtaining and reviewing information on each component of underwriters' compensation for other recent similar sales.
3. Develop an understanding of prevailing market conditions, evaluate key economic and financial indicators, and assess how these indicators likely will affect the timing and outcome of the pricing. Obtain a pricing book from the underwriter and/or the financial advisor which would include the following information:
   - the supply and expected demand for municipal bonds;
   - the release of key economic indicators, actual or anticipated actions by regulatory or political bodies, and other factors that might affect the capital markets;
   - the interest rates and current market yields of recently priced and outstanding bonds with similar characteristics;

- the interest rates and interest rate indices for bonds with similar characteristics provided by independent services that track pricing performance; and
- the historic benchmark index data for the bond issue being sold and for other bond issues being sold.

4. Issuers should be aware they have an important role in determining how bonds will be allocated among syndicate members and ultimate investors. Issuers should consider order priority and the designation policies in reviewing the preliminary pricing wire and the Agreement Among Underwriters prior to the sale. To a large extent the designation policy controls the distribution of underwriter compensation among the syndicate members.
5. Work with the underwriter to develop an appropriate premarketing effort to gauge and build investor interest. In consultation with outside professionals (e.g., financial advisor, underwriter, pricing consultant), consider providing for retail orders either through a separate retail order period or by identifying certain maturities as retail priorities. If doing a retail order period, issuers should take measures to establish the legitimacy of the retail orders such as limiting order size and disclosure of zip code designation.
6. Request that the senior managing underwriter propose a consensus pricing scale on the day prior to the pricing that represents the individual views of the members of the underwriting syndicate and obtain a number of interest rate scales from other syndicate members.
7. Evaluate carefully whether structural features, such as call features and original issue discount, that impact the true interest cost (TIC) of a bond offering, but limit future flexibility in managing the debt portfolio, will result in greater overall borrowing costs.
8. During the marketing of the bonds, the issuer should have sufficient current market information and be in close contact with the lead underwriter. Consider repricing at lower interest rates at the end of the order period, giving consideration to order flow and order volumes.
9. The issuer should review the proposed allotments of the bonds to ensure achievement of the issuer's objectives.
10. Evaluate the bond sale after its completion to assess the level of up-front costs of issuance, including whether the underwriters' compensation was fair given the level of effort and market conditions; and the pricing of the bonds, both in terms of the overall TIC and on a maturity-by-maturity basis.
11. Develop a database with information on each issue sold with regard to pricing performance, including the types of bonds sold (general obligation or revenue bonds), credit rating, maturities, yield and takedown by maturity, and the TIC.

References

- *Pricing Bonds in a Negotiated Sale: How to Manage the Process*, J.B. Kurish, GFOA, 1994.
- GFOA Best Practice, "Selecting and Managing the Method of Sale of State and Local Government Bonds," 2008.
- GFOA Best Practice, "Selecting Financial Advisors," 2008.
- GFOA Best Practice, "Selecting Underwriters for Negotiated Bond Sales," 2008.
- GFOA Best Practice, "Selecting Bond Counsel," 2008.

Approved by the GFOA's Executive Board, October 15, 2010.

ADVISORY

A GFOA ***advisory*** identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is *not* to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

Using Variable Rate Debt Instruments (1997 and 2010) (DEBT)

Background. Issuing variable rate debt is a sophisticated strategy. In optimal conditions, a government might experience lower borrowing costs or reduce the impact of volatile investment earnings by issuing variable rate securities; however, their use exposes governments to many additional forms of risk. Users of variable rate debt need to be informed about these risks and their implications and possess or retain substantial expertise to mitigate them.

Short-term interest rates are generally lower than long-term interest rates. Governments with debt that resets to prevailing interest rates can save money in their long-term financing if rates stay constant or fall over the life of the debt. If rates rise, governments are better off issuing fixed-rate debt from the outset. This interest rate risk is only one form of risk associated with variable rate debt. Additional risk is introduced by liquidity and remarketing provisions. Variable rate debt programs typically involve regular re-marketing or rollover events, and these provisions determine what happens when there are problems in that process. Those problems can impose sudden principal repayments or large increases in interest rates.

In addition to these forms of risk, governments need staff to actively monitor and manage variable rate debt throughout the time that it is outstanding. Governments without the capacity to manage such a program or who cannot secure the expertise to do so should consider issuing fixed rate debt.

Variable rate debt can be used as a tool for interim financing. Since the expectations of variable-rate investors are, by their nature, short-term, variable rate debt can be redeemed on short notice without any penalty. This feature makes variable rate debt a preferred tool for financing projects for which a prepayment or restructuring is a high probability. Certain variable rate products, most notably commercial paper, can be issued incrementally as funds are needed to finance current construction and reduce the long-term cost of construction financing, and then refunded with a long-term financing when the project is completed. Although variable rate debt is a valuable instrument, issuers should consult with their independent financial advisors and rating agencies to determine the appropriate level of variable rate exposure for their individual circumstances.

Advisory. The Government Finance Officers Association (GFOA) advises governments who plan to issue variable rate debt to exercise caution and carefully evaluate their objectives and consider how this debt and the various risks associated with it will be managed over the long term. Issuance of variable rate debt should be guided by the government's overall financial and debt management objectives and its financial condition. In particular, an issuer should:

1. Review statutes or ordinances governing the issuance of debt, both at the local and state levels, to ensure that the issuance of variable rate debt (including particular instruments) is permitted and to understand any conditions, such as amounts, interest rate ceilings, or requirements governing debt-related funds.

2. Ensure that the government's debt policy specifically addresses the use of variable rate debt, including goals to be achieved, permitted instruments, amounts that may be issued, steps to minimize risk, and monitoring requirements.
3. Evaluate the impact on debt service requirements assuming different interest rate scenarios and develop appropriate contingency plans for a rising interest rate environment, including setting aside reserves consistent with applicable arbitrage regulations or purchasing hedging instruments. An issuer also should consider the impact of changing interest rates on rate covenants and its financial position. Governments using variable rate debt should have adequate financial capacity to accommodate rapid and potential large changes in borrowing costs.
4. Evaluate the total cost of issuing variable rate debt, including fees to tender agents, remarketing agents, and liquidity providers under expected and adverse scenarios (e.g., if tendered bonds cannot be immediately remarketed). If the issuer is considering an interest rate cap, the cost of purchasing the instrument also should be assessed in relation to interest rate risk exposure. The issuer should include the cost of financial advisors or other expertise needed to monitor the variable rate instrument.
5. Evaluate the need for an externally provided liquidity facility. If needed, an issuer should undertake an evaluation of possible providers, including their credit ratings, the consequences of a change in this rating, the posting of collateral, the maximum interest rate if bonds are tendered, and the timing of renewal provisions.
6. Ensure the diversification of remarketing agents, liquidity facility providers and counterparties in their selection. This would assist the issuer in diversifying its exposure in market uncertainties and create competition among the various remarketing agents.
7. Develop a full understanding of the unique risks that arise when variable rate payments are realized through an interest rate swap, including counterparty risk, basis risk, rollover risk, and termination risk.

To evaluate the appropriate amount of variable rate debt to be issued for risk mitigation purposes, the following criteria should be evaluated:

1. Balance sheet risk mitigation. The following factors should be analyzed on the basis of the fund that will be repaying the debt:
   a) The historic average of cash balances over the course of several prior fiscal years;
   b) Projected cash balances based on known demands on a given fund and on the issuer's fund balance policies; and
   c) Any basis risk, such as the difference in the performance or duration of the issuer's investment vehicle compared to the variable rate debt instrument to be used by the government.
2. Interest Rate Risk. In determining the amount of interest rate risk, the issuer should consider the specific fund exposed to the risk and the budgetary flexibility that fund has in accommodating rapid increases in interest rates.
3. Remarketing Risk. Issuers should have specific backup contingencies in the event that they cannot remarket their bonds. These should include sources of funds to cover redemptions and provisions for substitution remarketing.
4. Liquidity/Renewal Risk. Issuers should have a plan that specifies their actions and backup provisions should one or more guarantors to the transaction fail to perform. This also applies to a government's ability to renew its liquidity agreements during a difficult market.
5. Rollover Risk. Issuers should have the flexibility to act quickly if bonds rollover and cannot be sold, in which case remarketing agents effectively "put" their bonds. Documents should clearly indicate how the issuer should handle these bonds.

References.

- GFOA Advisory, *Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy,* 2010.
- GFOA Best Practice, *Debt Management Policy*, 2003.

Approved by the GFOA's Executive Board, March 5, 2010.

BEST PRACTICE

Managing Build America and other Direct Subsidy Bonds (2010 and 2012)

Background. In 2009 and 2010, Congress authorized or expanded several tax-advantaged alternatives for financing governmental infrastructure under the *American Recovery and Reinvestment Act of 2009* (ARRA). The most popular ARRA financing program, Build America Bonds, was used as an alternative to traditional tax-exempt bonds for new money financings of governmental capital projects. BABs were taxable direct subsidy bonds and entitled the issuer to receive a payment from the federal government equal to thirty-five percent (35%) of the interest paid on the bonds (the "subsidy payment") for the lifetime of the bond. In many cases, BABs provided the issuer with a lower net interest cost on the financing (65% of the taxable rate on the bonds) compared with conventional tax-exempt interest rates. The authority to issue new BABs expired at the end of 2010.

Another direct subsidy bond program created in ARRA, that is no longer available, was Recovery Zone Economic Development Bonds (RZEDBs), which provided a 45% subsidy rate for qualifying governmental purpose projects. Additionally, traditional tax credit bond programs - Qualified Zone Academy Bonds (QZABs), Qualified School Construction Bonds (QSCBs), Clean Renewable Energy Bonds (CREBs) and Qualified Energy Construction Bonds (QECBs) – were given federal allocation amounts (administered through each state) in 2009 and 2010, allowing these bonds to be issued as direct subsidy bonds, and receive various subsidy payments. States that have unused allocations may continue to issue these bonds as direct subsidy bonds until the allocation is used.

Governments that issued direct subsidy bonds during 2009 and 2010 need to be aware of post-sale considerations and responsibilities while the bonds remain outstanding.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments that issued BABs or other direct subsidy bonds, be acutely aware of their ongoing responsibilities associated with these bonds and be cognizant of Internal Revenue Service (IRS) actions related thereto. Additionally, if Congress reinstates direct subsidy bond programs, the GFOA advises governments to exercise caution and have a full understanding of the differences between tax-exempt bonds and direct subsidy taxable bonds.

Post Sale and Ongoing Responsibilities

1. Governments should ensure that they have procedures and internal controls in place for the timely filing of IRS Form 8038-CP required for each interest payment date as a condition to receiving the subsidy payment due and to confirm receipt of the subsidy payments from the federal government.

2. Governments should develop appropriate internal controls to ensure that the issuer calculated subsidy payment amount is the same amount as what is received from the U.S. Department of the Treasury. In the event that the subsidy payment is not the same amount, governments should contact the IRS and Department of the Treasury Department to learn why the payment changed.

3. Issuers also should consider requesting that subsidy payments be made by electronic funds transfer (EFT) rather than paper checks via U.S. mail.

4. A reduction in subsidy payments or "offset" can occur for tax liabilities or any other amount that may be owed the federal government by the issuer (e.g., non-compliance with terms or grants or any federally funded program). The federal law authorizing "offsets" is the "Debt Collection Improvement Act of 1996" and the Treasury Offset Program ("TOP") describes the procedures for reducing subsidy payments which is currently linked to the issuer's employer identification number (EIN).

5. In the event that the issuer's subsidy payment is offset, issuers should develop a system within their government to recoup the amount lost from the department where the federal liability exists. In order to effectively manage federal subsidy payments, governments may wish to consider the use of separate EIN or multiple EINs

6. The IRS has been sending direct subsidy bond issuers a tax compliance questionnaire. An issuer's failure to complete the questionnaire could trigger an IRS audit. Governments are encouraged to discuss the questionnaire with their bond counsel, and respond accordingly.

7. Governments should develop written tax compliance procedures. The IRS has stated consistently that issuers should have written tax compliance policies and procedures, and IRS Form 8038 asks governments if such policies and procedures are in place. Additionally, the IRS's Voluntary Closing Agreement Program (VCAP), may have more beneficial terms for issuers that have written qualifying post issuance compliance procedures.

8. The percentage of IRS audits on direct subsidy bonds could be greater than those for tax-exempt bonds, as the IRS has focused its attention on the issue price of the bonds. The IRS is calling into question the true issue price of bonds due to reports that soon after the bonds were priced, they traded higher in the secondary market. Governments may be audited about the initial pricing of bonds issued in previous years, including those for direct subsidy bonds. While issuers should review the issue price of their bonds at the time the bonds are issued as part of their ongoing debt management practices, they are encouraged to maintain this information in case of an IRS audit.

9. Throughout the term of the bonds, issuers must be compliant with all tax laws related to direct subsidy bonds to ensure that they will continue to receive federal subsidy payments. Issuers are encouraged to consult with their bond counsel if any questions arise about tax compliance, for instance if there is a change in the purpose of the project to one that does not qualify as a direct subsidy bond.

10. Governments should look for alerts from GFOA and other organizations in the event that Congress acts to reduce or eliminate the subsidy payments at any time during the years that the federal government will be making direct subsidy bond payments.

Future Considerations if Direct Subsidy Bonds Are Reauthorized by Congress

In the event that direct subsidy bond programs once again become a financing option for state and local governments, the GFOA advises governments to exercise caution and, prior to issuing direct subsidy bonds in the future, have a full understanding of the differences between tax-exempt bonds and these taxable bond instruments. If your government determines that issuing direct subsidy bonds is appropriate, the following items should be taking into consideration.

General Risks

Change in subsidy payments. Consider the risk that the federal government (through an act of Congress) could reduce or eliminate the subsidy payments at any time during the years that the direct subsidy bonds are outstanding and evaluate strategies or techniques to mitigate this risk (i.e., ten year par call option or extraordinary call option).

Direct Subsidy Bond Sale Planning Considerations

1. Consult with an independent financial advisor and analyze whether tax-exempt interest rates or taxable interest rates (net of the subsidy payment) results in a lower borrowing cost.
2. An optimal bond structure may involve the issuance of both tax-exempt bonds (in the shorter maturities) and taxable direct subsidy bonds for longer maturities. When employing a competitive sale process, consider allowing bidders to determine which maturities will be tax-exempt and which will be taxable direct subsidy bonds.
3. Evaluate permitted use of subsidy payments under the bond documents and determine what to do with those payments:
    a. deposit into sinking fund and use to pay debt service - effectively reduces borrowing cost to net interest rate;
    b. pledge subsidy payment as security for bonds – normally requires amendment of bond resolution or indenture; consult bond counsel;
    c. use subsidy payment for some other purpose - however, diverting subsidy payment is effectively borrowing for the other purpose;
    d. other direct subsidy bond planning considerations include:
        i. create a process for filing IRS Form 8038-CP to request the subsidy payment and for verifying that the subsidy payments are received;
        ii. evaluate/quantify potential reductions in bonding capacity from issuing debt at higher interest rate (i.e., taxable rates);
        iii. evaluate the impact that the bonds' gross debt service may have on funding requirements of reserves;
        iv. analyze/amend bond indentures/resolutions to incorporate bond subsidy payments;
        v. quantify the total subsidy payments to be received over the term of the bonds to measure the monetary amount at risk of potential changes in the subsidy rate if retroactive changes are enacted;
        vi. if subsidy payment is to be used to pay debt service, consider modifying debt structure to achieve desired debt payments structure (i.e. level, ascending, descending) after applying subsidy payment;

Transaction Execution

1. Taxable bond market conventions are different than tax-exempt municipal market conventions in several respects, including the terms of the bonds and the sale process.
2. For direct subsidy bonds sold through a negotiated sale, issuers should give attention to the coordination of the taxable and tax-exempt underwriting desks of the book-running senior manager.
3. Issuers should familiarize themselves with terminology used in the taxable market (e.g., price indications, launch print and set the coupon), and the process for marketing taxable bonds in order to effectively manage a negotiated bond sale.
4. Competitive sales of direct subsidy bonds are a viable option. Issuers should evaluate the most effective method of sale to get the lowest interest rate on the bonds.
5. Direct subsidy bonds structured with the standard municipal 10-year par calls have become more viable as direct subsidy bonds have become more common to the market.

6. Call provisions for taxable bonds (including direct subsidy bonds) can be very different than call provisions for tax-exempt bonds. Make-whole calls, typical of taxable bonds, can effectively make bonds prohibitively expensive and preclude the ability to refinance such bonds in the future in order to realize potential debt service savings. Issuers should seriously consider the propriety of selling non-callable bonds or using a make-whole call.
7. General obligation bonds and other bonds for essential public services or with high-grade ratings (AA or better) are well received by the taxable market; lower rated credits or unconventional structures are more challenging in the taxable market and may require extra education of analysts/potential investors.
8. Taxable investors are less familiar with municipal market credits. Special consideration, therefore, should be given to educating analysts/potential investors on the structure and credit (e.g., using web site to educate investors about your entity, investor "road show").
9. Issuers typically will use a combination of tax-exempt bonds and direct subsidy bonds to achieve the lowest possible borrowing cost. Tax-exempt bonds may be more cost effective for some maturities, (particularly shorter maturities), and direct subsidy bonds may be more cost effective for other maturities (historically about ten years and longer).
10. Direct subsidy bonds may be structured as serial bonds, term bonds or some combination of serials and terms. Issuers should evaluate the cost effectiveness of alternative issue structures.
11. Analysis for determining the most cost effective alternative, tax-exempt versus taxable direct subsidy bonds, should be updated immediately prior to sale to enable a modification, if market conditions warrant.
12. The underwriting spread on direct subsidy bonds should not be materially higher than the underwriting spread on tax-exempt bonds absent extenuating circumstances or substantially different issue structures.
13. In the taxable market, underwriting compensation for negotiated sales is typically determined on a "group net basis in which compensation is set and determined ahead of the bond sale and is unrelated to actual underwriting/sales performance. As the direct subsidy bond programs have matured, more issuers are providing underwriting compensation on a "net designated" basis for negotiated sales.
14. Modifications to the preliminary official statement and official statement will need to be made to accurately describe the direct subsidy bonds, the gross debt service schedule, and the tax treatment of interest.
15. Fees for professionals (e.g., bond counsel, financial advisors and disclosure counsel) should not be materially higher in a direct subsidy bond transaction than for tax-exempt bonds absent unusual circumstances.
16. Following the bond sale, issuers should prepare a post-sale analysis to evaluate the estimated savings from using the direct subsidy bond alternative and compare results to pre-sale estimates for future reference in evaluating the potential use of direct subsidy bonds for other financings.

Approved by the GFOA's Executive Board, January, 2012.

BEST PRACTICE

Analyzing and Issuing Refunding Bonds (1995 and 2010) (DEBT)

Background. Bond refinancing ("refunding") is an important debt management tool for state and local government issuers. Refundings are commonly executed to achieve interest cost savings, remove or change burdensome bond covenants, or restructure the stream of debt service payments to avoid a default, or in extreme circumstances, an unacceptable tax or rate increase.

We have defined the following key terms and definitions in order to effectively evaluate a refunding candidate:

- Optional Call Provision / Optional Call Date
- Current vs. Advance Refunding
- Escrow Defeasance Portfolio
- Legal vs. Economic Defeasance

Optional Call Date - Most municipal bond issues are structured with an Optional Call Provision, which allows the issuer to refund/refinance the existing bonds by purchasing the outstanding bonds at a pre-determined price (e.g. 101%), and replacing them with new refunding bonds. The Optional Call Date is typically 10 years from the date of issuance of the bonds.

Current vs. Advance Refunding - There are two types of refundings, as defined by Federal Tax laws; a current refunding in which a refunding takes place (i.e., refunding bonds are sold) within 90 days of the optional call date, and an advance refunding in which refunding bonds are sold more than 90 days prior to the first call date.

Escrow Defeasance Portfolio - The mechanics of a refunding are the same in both cases: issue refunding bonds in an amount sufficient to generate proceeds to fund an Escrow Defeasance Portfolio. The Escrow Defeasance Portfolio or refunding escrow consists of a combination of cash and securities that are sufficient to pay the escrow requirement: the debt service, call premium, and outstanding principal of refunded bonds due on the optional call date.

Legal vs. Economic Defeasance - A legal defeasance typically occurs when an Escrow Defeasance Portfolio is funded with either State and Local Government Series securities ("SLGS") or securities that are direct obligations of the U.S. Government. An economic defeasance occurs when the refunding escrow is funded with permitted investments that do not meet the defined criteria of a legal defeasance, such as Federal Agency securities ("Agencies") or other typically higher-yielding securities. In a legal defeasance, the refunded bonds are legally removed from the issuer's balance sheet, while under an economic defeasance the refunding bonds may remain on the balance sheet.

Recommendation. At the outset of evaluating each refunding, the Government Finance Officers Association (GFOA) encourages issuers to solicit the advice of their bond counsel and financial advisor in order to outline key legal and financial issues.

There are three key concepts that must be taken into consideration when evaluating a refunding candidate:

1. Financial and Policy Objectives
2. Financial Savings / Results
3. Bond Structure and Escrow Efficiency

Financial and Policy Objectives - Refundings may be undertaken for a number of financial and policy objectives, including to achieve debt service savings, eliminate restrictive bond/legal covenants, restructure the stream of debt service payments, or achieve other policy objectives.

Although in most circumstances issuers may undertake a refunding to obtain economic savings, issuers may refund an issue to restructure their debt portfolio in order to obtain budgetary/cash flow relief or to address exposure to other Government Finance costs/liabilities.

Financial Savings / Results - The GFOA recommends that issuers develop formal policy guidelines in their debt management policies to provide a financial framework for decision makers regarding the evaluation of refunding candidates

Formal policy guidelines:
- offer a systematic approach for determining if a refunding is cost-effective,
- promote consistency with other financial goals and objectives,
- provide the justification for decisions on when to undertake a refunding,
- ensure that staff time is not consumed unnecessarily in evaluating refunding proposals,
- ensure that some minimum level of cost savings is achieved, and
- reduce the possibility that further savings could have been achieved by deferring the sale of refunding bonds to a later date.

If a refunding is undertaken to achieve cost savings, the issuer should evaluate:
- issuance costs that will be incurred and the interest rate at which the refunding bonds can be issued,
- the maturity date of the refunded bonds,
- call date of the refunded bonds,
- call premium on the refunded bonds,
- structure and yield of the refunding escrow, and
- any transferred proceeds penalty.

One test often used by issuers to assess the appropriateness of a refunding is the requirement specifying the achievement of a minimum net present value (NPV) savings. A common threshold is that the savings (net of all issuance costs and any cash contribution to the refunding), as a percentage of the refunding bonds, should be at least 3-5 percent. This test can be applied to the entire issue or on a maturity-by-maturity basis. In addition, issuers may establish a minimum dollar threshold (e.g. $100,000 or $1 million NPV savings).

It is important to note that federal tax law typically permits an issuer to conduct one advance refunding over the life of a bond issue. As such, an issuer must take greater care (i.e., require a higher savings threshold) when evaluating an advance refunding candidate.

In certain circumstances, lower savings thresholds may be justified. For example, when an advance refunding is being conducted primarily for policy reasons (other than economic savings), interest rates are at historically low levels or the time remaining to maturity is limited, and as such, future opportunities to achieve greater savings are not likely to occur.

Savings also can be evaluated by additional metrics, such as compared to the optional call value and to historical interest rate trends. Financial analysis of refunding candidates must take into account a number of financial variables. GFOA recommends that issuers utilize an independent financial advisor to assist in performing such analyses.

Bond Structure and Escrow Efficiency - Debt management practices should anticipate the potential for refundings in the future. When bonds are issued, careful attention should be paid to the bond structure to address features that may affect flexibility in the future.

Some examples of such sales practices are:

- optional redemption provisions,
- bond coupon characteristics
- giving up call rights for certain maturities in exchange for a lower interest rate on the bonds,
- call provisions that permit the redemption of bonds in any order of maturity or on any date,
- call provisions that permit the issuer to call bonds at the earliest date without incurring a significant interest-rate penalty, and
- coupons on callable bonds priced as close to par as possible at the time of original issue.

Finally, it is important to create a refunding escrow that is efficient and will optimize savings. An escrow is efficient if escrow securities mature or pay interest when debt service payments of the refunded escrow are due – the lower the cost of the escrow (assuming all legal and permitted investment guidelines are met) the more efficient the escrow.

Issuers may purchase escrow securities in the open market or State and Local Government Securities (SLGS), a special series of U.S. Treasury securities, as well as other permitted investments, and/or use a hybrid structure. In addition, issuers may consider implementing an economic defeasance, as opposed to the standard legal defeasance.

Each option must be evaluated, considering the yield of the escrow securities and the effect of any inefficiency.

Among the issues that should be considered with regard to each type of instrument are the following:

- SLGS can be structured to comply with the federal tax law limits on investment return on escrow securities and eliminate any inefficiency in the escrow.
- Open market securities may have a higher return but may not mature or pay interest on the date when debt payments are due.
- Other permitted investments may provide even higher yields, resulting in greater savings, but often do not allow issuers to meet the requirements for a legal defeasance.

Finally, issuers may be required to increase the issue size or blend higher- and lower-yielding securities to comply with yield-restriction requirements and generate sufficient revenues. Such inefficiency may be eliminated by future escrow substitutions. Additionally, forward supply agreements, guaranteed investment contracts, or float contracts also may be considered to minimize escrow inefficiencies. However, issuers need to be concerned with potential counterparty risk, with these investment instruments.

References.

- GFOA Best Practice, Investment of Bond Proceeds, 2007.
- GFOA Best Practice, Debt Management Policy, 2003
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- "Understanding Current and Advance Refundings," *Government Finance Review*, April 1992.

Approved by the GFOA's Executive Board, February, 2011.

BEST PRACTICE

Establishing and Administering an OPEB Trust (2012)

Background. The GFOA recommends that governments prefund their obligations for postemployment benefits other than pensions (OPEB) once they have determined that the employer has incurred a substantial long-term liability.[1] In most cases, employers can make long-term investments to cover these obligations through a separate trust fund that should, over time, result in a lower total cost for providing postemployment benefits.

Recommendation. The Government Finance Officers Association (GFOA) recommends creating a qualified trust fund to prefund OPEB obligations. To ensure that the trust is established and administered properly, governments should consult qualified legal counsel and fully understand the following issues:

1) The legal authority of the employer to establish an OPEB trust and the forms of trust allowed.

2) The employer's legal obligations to provide benefits and the legal consequences of establishing a trust. This includes how to design trust documents that mitigate the risk of unintended liabilities and provide a way to dissolve or modify the trust, if that should become necessary.

3) The comparative advantages of creating a single-employer trust, which is controlled by the employer and administered by either the employer or an independent board of trustees, versus participating in a multi-employer trust.
   a) **Single-employer trusts**. The following considerations should be addressed:
      i) ***Scope***. Employers need to decide on the scope of the trust, subject to applicable federal and state law. Many OPEB trusts simply provide for the prudent investment of plan assets and perform no other administrative functions, except for disbursements, which can be handled by the trust or employer's staff or a third-party administrator.
      ii) ***Form and governance***. There are three main options for the legal form of the trust and its governance structure. (Governance structure refers to the composition and responsibilities of the governing body and the process for overseeing investments.)[2]
         - **Voluntary employees' beneficiary association (VEBA)**. A VEBA trust is established under section 501(c)(9) of the Internal Revenue Code (IRC) as an employees' association to provide for designated benefits. VEBAs typically operate independently of the sponsoring employer and involve participants in their governance.
         - **Section 115 trust**. An IRC section 115 trust is established as an integral part of a governmental entity that performs an essential government function. The plan sponsor's governing body (for example, its city council or school board) is responsible for the jurisdiction's single-employer 115 trust; an independent governance structure is not required but is sometimes provided for. If an independent governing body is not designated, an oversight committee should be formed. If the plan design includes employee contributions, the representation on the governing body can include employee and perhaps retiree participation.
         - **401(h) trust**. An IRC section 401(h) trust is a separate account, established within an existing qualified pension fund, which is dedicated to paying OPEB benefits. These trusts are usually for single employer arrangements, although some employers have access to a statewide plan. A 401(h) trust is governed by the pension board. A 401(h) trust must meet IRC requirements to avoid jeopardizing its tax-qualified status.

iii) ***Trust personnel.*** Public employers should establish the following fiduciary roles to assist in trust administration:
   - **Trust administrator**. This individual, who may be a municipal official, is typically responsible for authorizing disbursements, carrying out the directives of the governing body, and other oversight tasks. An external vendor could also be named trust administrator, but not as the disbursement official (unless the vendor is engaged as a fiduciary under a separate third-party administrative contract).
   - **Custodian.** The employer can appoint its customary custodian or a different firm selected expressly for the OPEB portfolio. If the trust is independent of the employer, the trust governing body will select the custodian. The custodian, typically a regulated bank trust organization, should be independent of the investment advisor, even if the trust holds mutual funds as its primary investment.
   - **Investment advisor**. Employers with internal professional investment management staff may manage the trust's investments internally, but most governing bodies outsource the investment management of VEBA and 115 trusts to an independent professional investment management organization. The governing body or the delegated oversight body can select an independent investment advisor through a separate contract, which is sometimes appended to the trust document. The governing body can retain either a discretionary advisor, which can make investment decisions within the parameters of the trust's investment policy, or a non-discretionary advisor, which is similar to a pension plan consultant and requires pre-approval of investment decisions. A discretionary advisor is typically a named co-fiduciary, while a non-discretionary advisor leaves primary fiduciary responsibility with the trust's oversight officials.

iv) ***Investment policy***. Investment policies typically cover permitted investments and targets and ranges for asset allocations. [3]

v) ***IRS issues.*** Governments must obtain an Internal Revenue Service (IRS) determination letter before creating VEBA or 401(h) trusts.[4] Governments are not required to apply for an IRS private letter ruling[5] when creating a section 115 trust, but they might wish to do so if the cost is not prohibitive.

vi) ***GASB issues.*** Trusts must conform to the Government Accounting Standard Board's definition of "trust or equivalent arrangement" in GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* to be sure the assets held in trust can be recognized as offsetting plan liabilities.[6]

vii) ***Fees***. When selecting investment service providers – ideally through a comprehensive competitive selection process – governing bodies should evaluate full fee information and disclosures (i.e., of any potential conflicts or third-party compensation received from investment products or providers). Underlying investment costs such as mutual fund expenses should be included in this total cost evaluation. Service-provider costs, which are a legitimate trust expense, are usually lower if they are charged directly instead of through indirect compensation arrangements or retail investment products.

b) **Multilple employer trusts**. These are turnkey programs in which a governmental entity, an intergovernmental organization, or a private firm has already established the trust's investments and governance. The following considerations should be addressed when considering whether to participate in a multi-employer trust:

i) ***Structural questions***. The employer should review the trust's legal documentation, trust structure, and governance. This includes tax considerations and whether the plan has received an IRS private letter ruling, which is imperative for multi-employer plans. Also consider other services provided by the trust, such as asset-liability analyses and disbursement services.

ii) ***Governance***. The trust itself should provide processes for governance, oversight, and reporting, but a participating employer should establish its own processes for monitoring the performance of the trust and its investments, and reporting results and concerns to participants, senior management and the governing body. Also, any written complaints from current or prior trust participants should be investigated, and the trust should provide disclosures regarding other employers' decisions to terminate or reduce participation.

iii) ***Third parties***. The employer should examine the role of the external investment advisor or consultant, including all sources of compensation, along with the custodian's affiliations and independence.

iv) ***Investment features***. The employer should review the trust's investment policy, asset allocation, portfolio composition, and investment expenses, including marketing fees, sample reports, and performance history.

v) ***Portability***. The employer should understand the requirements for moving assets out of the trust to another arrangement.

Notes

[1] See the GFOA best practices, *Ensuring the Sustainability of Other Postemployment Benefits* and *Considerations for Prefundi. OPEB Obligations*, available at www.gfoa.org.

[2] See John Ruggini, "In an OPEB We Trust?" *Government Finance Review*, February 2008.

[3] Smaller plans typically authorize investments in diversified mutual funds, preferably institutional share classes (which have lower fees) or commingled institutional trusts. Larger plans with sufficient portfolio balances might also include individual securities in their portfolios through separately managed accounts. The investment policy should also provide guidance regarding the employer's preferences for active versus passive investment strategies. (Also see the GFOA best practices, *Pension Investment Policies* and *Public Employee Retirement System Investments,* noting that not all components of a pension investment policy will be applicable.)

[4] An IRS determination letter responds to a plan sponsor's request for a determination about both the qualified status of its OPEB plan and the tax-exempt status of its trust.

[5] An IRS private letter ruling is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's represented set of facts.

[6] GASB Statement No. 43 states that a trust or equivalent arrangement is one in which: 1) employer contributions are irrevocable; 2) assets are dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of the plan; and 3) assets are legally protected from creditors of the employer or the plan administrator.

Approved by the GFOA's Executive Board, January, 2012.

BEST PRACTICE

Understanding Your Continuing Disclosure Responsibilities (2010)

Background. Any government or governmental entity issuing bonds has an obligation to meet specific continuing disclosure standards in compliance with Securities and Exchange Commission (SEC) Rule 15c2-12. This rule, which is under the *Securities Exchange Act of 1934,* sets forth certain obligations of (i) underwriters to receive, review and disseminate official statements prepared by issuers of most primary offerings of municipal securities, (ii) underwriters to obtain continuing disclosure agreements from issuers, and other obligated persons to provide material event disclosures and annual financial information on a continuing basis, and (iii) broker-dealers to have access to such continuing disclosure in order to make recommendations of municipal securities in the secondary market.[1]

When bonds are issued, the issuer enters into a continuing disclosure agreement/certificate/undertaking (CDA) for the benefit of the underwriter to meet the SEC's requirements, promising to provide certain annual financial information and material event notices to the public. In accordance with changes made in 2009 to Rule 15c2-12, those filings must be made electronically at the Electronic Municipal Market Access (EMMA) portal (www.emma.msrb.org).

Nothing prohibits issuers from providing periodic voluntary financial information to investors in addition to fulfilling the SEC Rule 15c2-12 responsibilities undertaken in their CDA through EMMA. It is important to note that issuers must disseminate any financial information to the market as a whole and cannot give any one investor certain information that is not readily available to all investors.

In addition to making EMMA filings, a government may choose to post its annual financial information and other financial reports and information on its web site.

Recommendation. The Government Finance Officers Association (GFOA) recommends that finance officers responsible for their government's debt management program adopt a thorough continuing disclosure policy and adhere to the following disclosure practices that are practical for their entity. Governments are encouraged to incorporate robust disclosure practices in order to enhance their credibility in the marketplace, foster liquidity for the securities and demonstrate a solid disclosure track record that will be viewed favorably by investors, credit rating agencies and the public.

Issuers should consider the following elements in order to create a strong continuing disclosure policy:

1. They should have a clear understanding of their responsibilities as defined in the bond's continuing disclosure agreement/certificate/undertaking. This includes being aware of the material events that must be disclosed. Prior to execution, CDAs should be discussed with the transaction's bond counsel, underwriter and financial advisor to ensure a full understanding of issuer obligations.

[1] MSRB Glossary of Terms, www.msrb.org

2. Governments should develop continuing disclosure procedures that:
    a. identify the information that is obligated to be submitted in an annual filing;
    b. disclose the dates on which filings are to be made;
    c. list the material events as stated by the SEC and your CDA; and
    d. identify the person who is designated to be responsible for making the filings.
3. For many governments, a Comprehensive Annual Financial Report (CAFR) may fulfill annual financial information obligations. The information provided in a CAFR does not have to be replicated when filing with EMMA. If within a CDA a government has agreed to furnish information that is outside the scope of its CAFR, that information may be included as a supplement to the CAFR when filing with EMMA.
4. As recommended in the GFOA's Certificate of Achievement for Excellence in Financial Reporting program, a government should complete its audited annual financial information within 180 days of the end of its fiscal year. Upon its completion, the CAFR should immediately be submitted to EMMA.
5. Although the SEC has approved a new voluntary field within EMMA for governments to indicate if they make their filing of annual financial information within 120 or 150 days of the end of the year, such a notation can only be made if the government includes such a commitment within its continuing disclosure agreement. The GFOA does not support the inclusion of such a commitment within a government's continuing disclosure agreement, as such timelines will be very difficult to meet, and if a government fails to adhere to such a timeframe, they would be in violation of their continuing disclosure agreement.
6. Material event notices should be filed according to SEC Rule 15c2-12
    a. For bonds issued after December 1, 2010, the SEC <u>requires</u> issuers to file material event notices within 10 business days of the event.
    b. For bonds issued before December 1, 2010, the rule states that governments should file event notices in a "timely manner." Governments are encouraged to adopt a policy to submit material event notices, within 10 business days.
7. Governments, in consultation with internal and external counsel, may wish to submit other financial information to EMMA (and post it on their web sites) that goes beyond what is specified in the CDA. This information includes annual budgets, financial plans, financial materials sent to governing bodies for council or board meetings, monthly financial summaries, investment information, and economic and revenue forecasts. Additionally, governments are encourged to place this interim financial information on their web sites, and through a new feautre within EMMA that allows governments to post a link to their web site so that investors and the public can directly access the information.
8. Issuers may want to provide additional information to investors about agreements entered into in connection with debt issuance. These disclosures should provide information that will enable investors to make judgements about the volatility and risk exposure of certain kinds of agreements that may embed risks that should be disclosed and quantified. Areas of such risk exposure include:
    a. Letters of credit issued in connection with variable rate debt issuance;
    b. Interest rate swaps entered into in connection with debt issuance;
    c. Investment agreements for bond proceeds, including reserve funds, particularly where such investments may be pledged or anticipated bond security; and
    d. Insurance sureties used to fund reserve fund requirements.

<u>References</u>.

- *Making Good Disclosure*, Government Finance Officers Association, 2002.
- GFOA Best Practice, *Using a Web Site for Disclosure*, 2010.
- GFOA Best Practice, *Maintaining an Investor Relations Program*, 2010.
- GFOA Best Practice, *Using the Comprehensive Annual Financial Report to Meet SEC Requirements for Periodic Disclosure*, 2006.
- *Disclosure Roles of Counsel*, John McNally, Project Coordinator, ABA/National Association of Bond Lawyers, 2009.
- SEC Rule 15c2-12, http://www.sec.gov/rules/final/adpt6.txt.
- Electronic Municipal Market Access (EMMA), http://www.emma.msrb.org.

Approved by the GFOA's Executive Board, October 15, 2010.

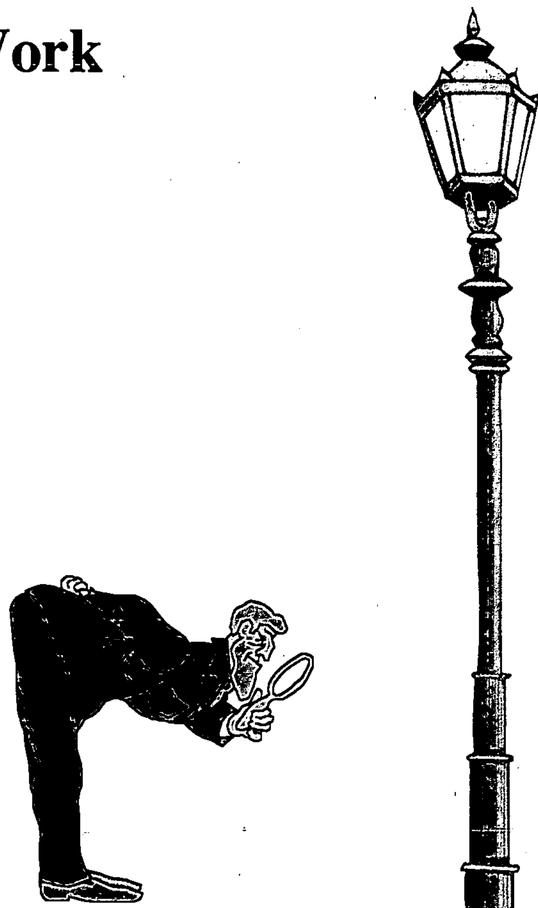
Kern County Superintendent of Schools

Case Studies:
Debt Management Practices

Presented by Lori Raineri
August 9, 2012

Looking and Finding Are Not the Same

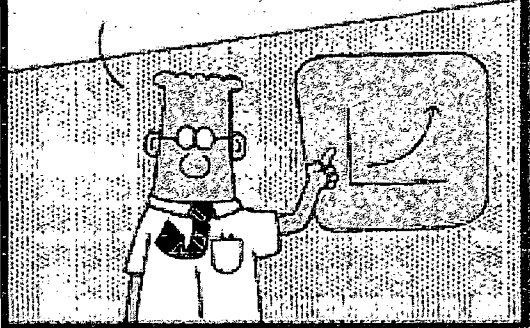
- Finding is Hard Work



Case Study #1 - "Blue Skies Ahead"

- The District had planned on paying for a facilities project with General Obligation Bonds
- The District's financial plan for the June 2008 election included overly aggressive assessed value projections
  - With assessed values lower than projected, the District could not issue the $3.7 million in G.O. Bonds without exceeding the legal maximum tax rate projection
- The District decided to proceed with a $2.7 million BAN
  - Principal repaid in 5 years by the eventual issuance of additional General Obligation Bonds
  - Interest repaid annually by property taxes (legal?)
- When the COE discussed the General Fund obligation, the District was surprised and ask for our firm to review

"Blue Skies Ahead" - Assumptions



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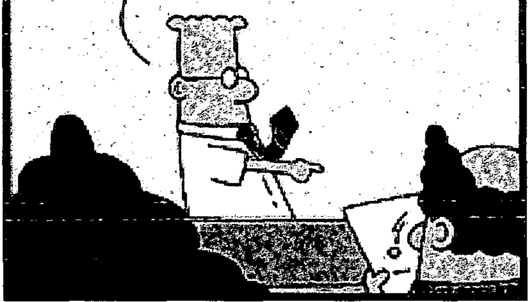

"'Blue Skies Ahead" - Repay (GO Bonds)

- From Financial Advisor's Memorandum:

Estimate				Worst Case				
	AV Growth	Tax Rate	Result		AV Growth	Tax Rate	Difference	Result
2009-10	0.00%	$30	$30 per $100,000 AV results in $94,000 available for debt service - enough for interest on $2.7 MM BAN.	2009-10	-5%	$ 30.98	$ 0.98	Tax rates would increase by $.98-$1.70 to meet debt service requirements.
2010-11	0.00%	$30		2010-11	-2%	$ 31.70	$ 1.70	
2011-12	2.00%	$30		2011-12	0%	$ 31.70	$ 1.70	
2012-13	3.00%	$30		2012-13	1%	$ 31.39	$ 1.39	
2013-14	4.00%	$30		2013-14	1%	$ 31.08	$ 1.08	

- Concern about ability to issue General Obligation Bonds:
  - Estimated AV was 0% for 2009-10, including to justify legal maximum tax levy of $30 per $100,000 of AV
  - Estimated a 5% decline in the "worst case"
  - However, County estimated a 15% decline for 2009-10

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"Blue Skies Ahead" - High Costs

- Concern about high cost of BANs raising taxes
  - Lower AV growth leads to higher tax rates
  - Multiple debt issuances lead to higher upfront costs
    - » Minimum of 2 financings
      - ◦ 1) BANs and then 2) GO bonds to repay BANs
    - » Up to 4 financings
      - ◦ 1) BANs and then 2) portion of GO bonds plus 3) General Fund supported financing, then 4) remaining GO bonds to repay General Fund supported financing
  - Likely 2 to 4 times higher upfront costs than just issuing GO bonds at a later time

"Blue Skies Ahead" - Repay (General Fund)

- **District's financial advisor eventually stated the General Fund could be obligated and estimated the liability:**

  General fund supported financing . A lease-financing for $1.1 million at worst case interest rates would cost $90,000 annually to repay. If assessed values eventually increased enough to support more of the Measure R bonds to be issued, the lease-financing could be paid off with future GOBs.

- **Given County estimating much less AV growth, amount of General Fund supported financing could be larger**

Lease-financing *Amount*	*Approx. Annual* *Repayment*
$1,100,000	$90,000
$1,500,000	$120,000
$2,000,000	$160,000
$2,700,000	$215,000

- **General Fund could not afford repayment without cuts, and District was not prepared to have a General Fund supported financing**

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“Blue Skies Ahead” - Results

- Summary of concerns:
  - Misrepresentation by Financial Advisor of obligation of General Fund
  - Failure of Financial Advisor to quantify the risk of assessed value assumptions
  - The costs for all of the financings were adding up to a very high expense
  - District felt it could not proceed with a financing supported by the General Fund

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“Blue Skies Ahead” - Results

- ☐ **As a result of the concerns, the District:**
  - **Did not issue the BANs**
  - **Delayed its facilities projects**
  - **Waited until more certainty regarding the real estate climate and assessed value growth**
  - **These actions helped to:**
    - » **Mitigate the risk of General Fund encroachment**
    - » **Decrease the expense to taxpayers**
  - **One year later, the District successfully issued bonds, with a third party independent review**

✓ ***The District was surprised and appreciative to learn about the risk; made an informed decision that the risk was not worth the benefit of acting immediately, and acted later and with a different strategy when the risk was less.***

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Insight & Action Are Needed to Improve

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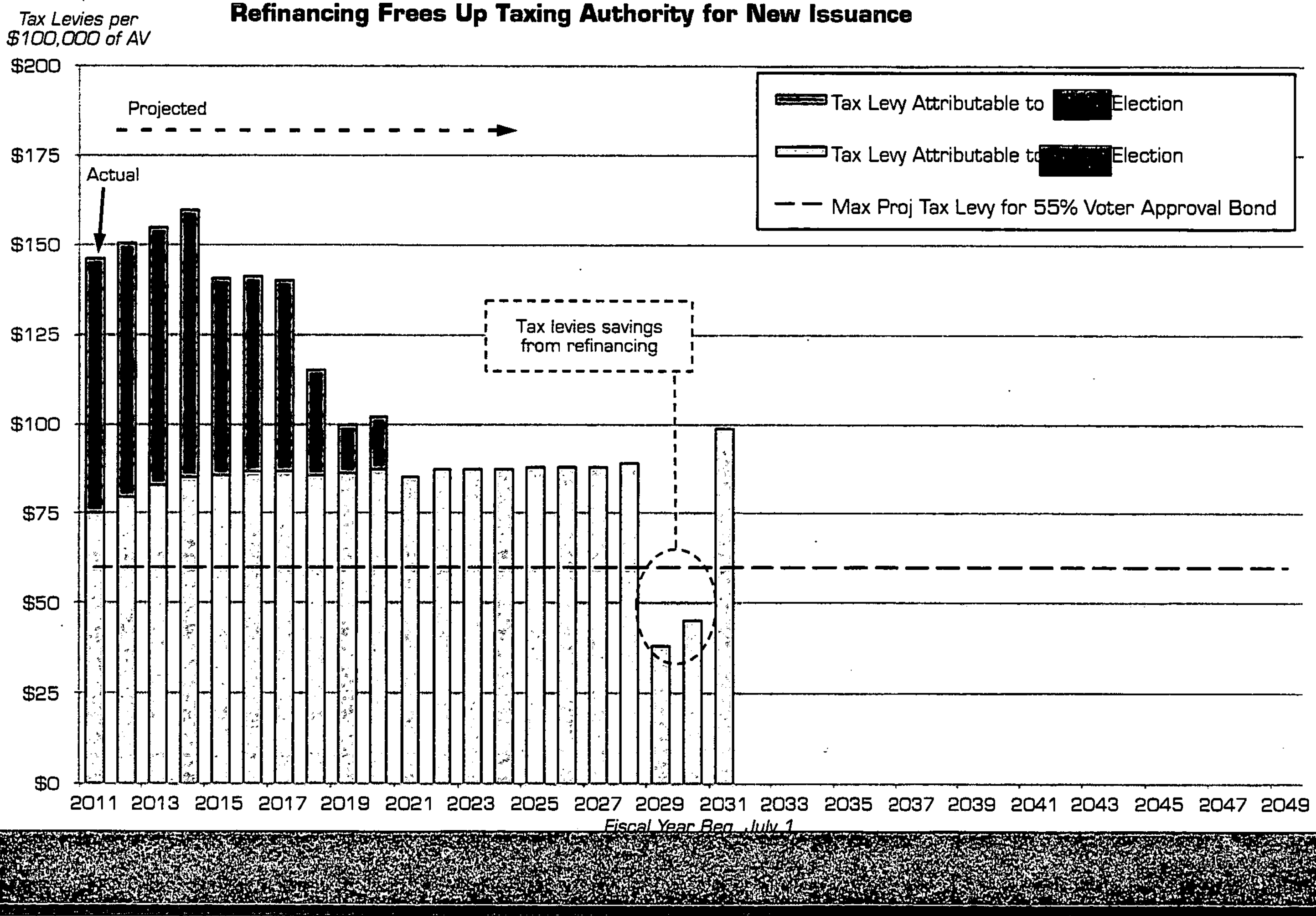
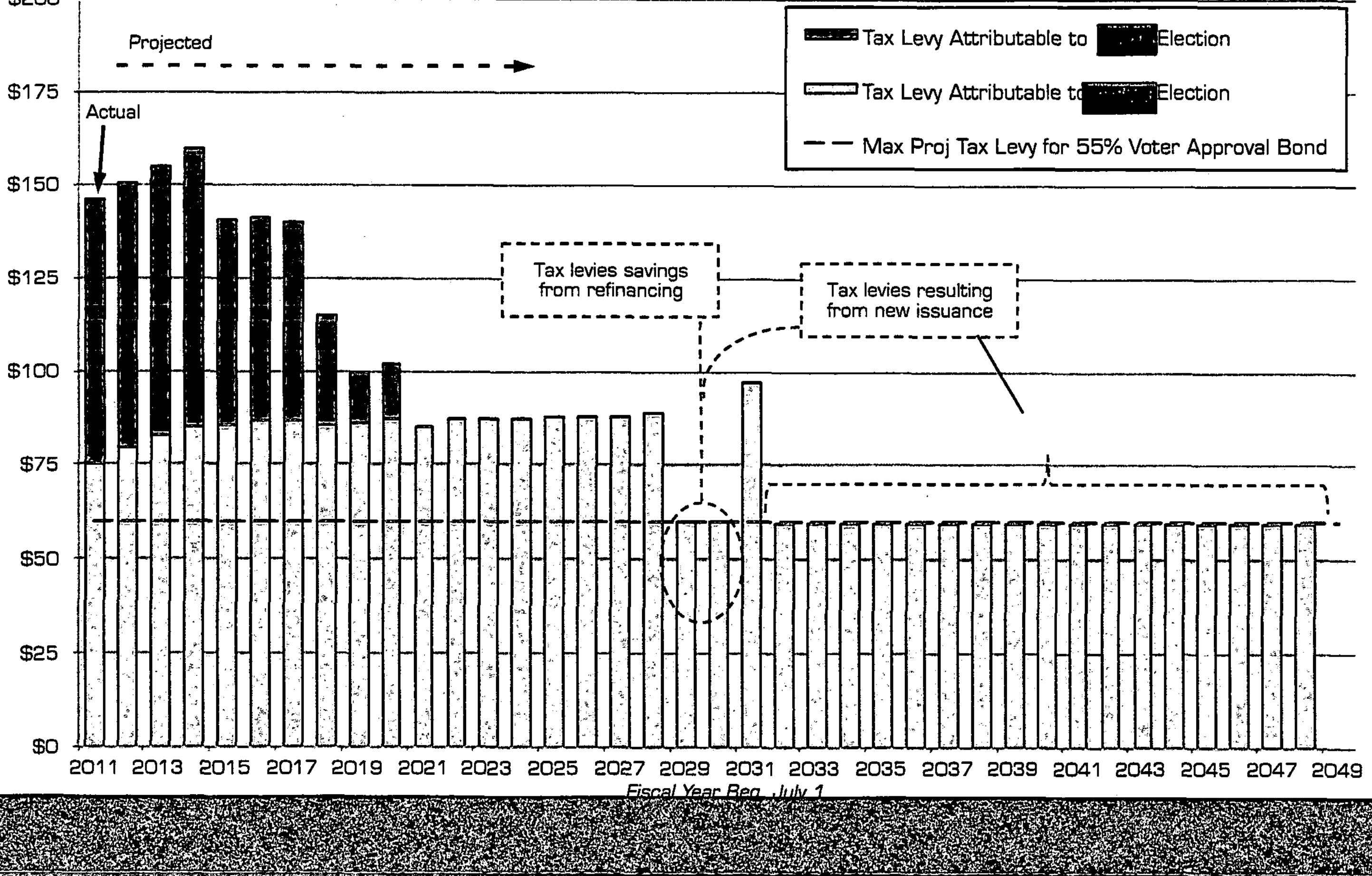
Case Study #2 – Future Can Be Improved

- District had a bond plan with overly aggressive assessed value assumptions.
- When those didn't come to pass, the District issued a Bond Anticipation Note.
- With half the BAN proceeds spent, a new chief business official started, and alarmed by a looming BAN repayment deadline, halted expenditures.
  - The good news was that the District had half the BAN proceeds which could be used to repay the BAN.
  - The bad news was that the BAN repayment due in a few months was equal to twice the funds on hand, and the tax rate was already above $60 per $100,000 of assessed value, and expected to remain > $60.

Look Holistically and Refinance Efficiently



CABs Are Needed, But Less



Summary of Solution

- ☐ By refinancing existing debt in the context of the complete debt portfolio, the effects of a bad situation can be minimized (and any situation can be thus improved).
  - managing the debt portfolio down using
    - » the yield curve
    - » market conditions
    - » best practices
- ☐ Using conservative assessed value assumptions has less risk.
- ☐ CABs are callable.
- ✓ *The District originally focused on achieving facilities goals through political mechanisms. Now, they are focusing on risk management as well.*

Case Study #3 - Charge It

- 2008-09 General Fund revenues were $10 million.
- The District decided to proceed with several projects:
  - Facilities for an early childhood learning center at the elementary school
  - Facilities for an agricultural program at the high school
  - Office and warehouse space for M&O
  - Modular classrooms
  - Buses
- The District decided to finance these projects with:
  - Certificates of Participation
  - Capital Leases

How Financings Reported in Financials

LONG-TERM DEBT

A schedule of changes in long-term debt for the fiscal year ended June 30, 2008, is shown below:

	Balance, July 1, 2007	Additions	Deductions	Balance, June 30, 2008
Certificates of Participation	$ -	$ 6,895,000	$ -	$ 6,895,000
Other Postemployment Benefits	-	203,942	-	203,942
Compensated Absences	34,615	7,180	-	41,795
Capital Leases	56,419	2,726,550	381,540	2,401,429
Totals	$ 91,034	$ 9,832,672	$ 381,540	$ 9,542,166

Future minimum payments are as follows:

Year Ending June 30	Principal	Interest	Total
2009	$ -	$ 329,483	$ 329,483
2010	-	310,507	310,507
2011	240,000	305,707	545,707
2012	110,000	298,708	408,708
2013	110,000	294,307	404,307
2014-18	640,000	1,388,963	2,028,963
2019-23	800,000	1,226,566	2,026,566
2024-28	985,000	1,038,022	2,023,022
2029-33	1,230,000	789,165	2,019,165
2034-38	1,535,000	474,450	2,009,450
2039-40	1,245,000	72,081	1,317,081
Total	$ 6,895,000	$ 6,527,959	$ 13,422,959

Year Ending June 30	Lease Payment
2009	415,219
2010	415,219
2011	415,219
2012	415,219
2013	410,734
2014-17	826,675
Total	2,898,285

What the Auditor Said As a Result

Section II – Financial Statement Findings

FINDING 2008-01
AB3627 Code 30000
Financial Stability

The audit noted several conditions that in aggregate could affect the District's financial stability and, possibly, its ability to continue as a going concern. The conditions are noted below:

Deficit Spending
The District has experienced continued deficit spending every year since fiscal year 2002. The ending fund balance at June 30, 2008 is 54% less than the fund balance at June 30, 2002. Furthermore, the adopted budget for fiscal year 2009 includes another decrease to fund balance of $3,981.

Long-Term Debt
During fiscal year 2008, the District entered into several significant long-term debt arrangements, including Certificates of Participation and Capital Lease Agreements. As a result, long-term debt is more than 100 times larger than one year ago. There are no clear funding sources for the repayment of this debt, which in a few years will amount to $900,000 per year.

Financial Condition of the State
Recent budget cuts by the State of California will further reduce funding to local educational agencies making it even more difficult to balance the 2008-09 and future budgets.

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Case Study #4 - Live for Today

- 2008-09 General Fund revenues were $67 million.
- The District issued variable rate COPs in 2005 and 2007.
- The District now planned to refinance into a fixed rate.
- The repayment source was Mello-Roos CFD revenues.
  - With the real estate market decline, revenues were not sufficient to make the debt service payments.
- The District also wanted to refinance to:
  - delay payments on the COPs
  - reduce General Fund encroachment
  - provide short-term "breathing room"

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How Refinancing Reported in Financials

Liabilities	2007-08 Audit	2008-09 Audit
Accounts payable	$ 6,617,188	$ 6,159,921
Accrued interest	415,158	431,177
Deferred revenue	232,938	644,118
Long-term liabilities		
Current portion of long-term obligations	796,257	775,299
Noncurrent portion of long-term obligations	57,858,106	63,063,219
Total Long-Term Liabilities	58,654,363	63,838,518
TOTAL LIABILITIES	65,919,647	71,073,734

✓ ***On the Statement of Net Assets, Long-Term Liabilities increased by $5.2 million.***

A Closer Look at Long-Term Obligations

NOTE 8 - LONG-TERM OBLIGATIONS

Summary

The changes in the District's long-term obligations during the year consisted of the following:

	Balance Beginning of Year	Additions and Adjustments	Deductions	Balance End of Year	Due in One Year
1998 Certificates of Participation, Series A	$ 8,275,000	$ -	$ 595,000	$ 7,680,000	$ 615,000
2005 School Bridge Funding Program					-
Certificates of Participation	14,000,000	-	14,000,000	-	-
2007 School Bridge Funding Program					
Certificates of Participation	35,000,000	-	35,000,000	-	-
2009 Refunding Certificates of Participation	-	56,035,000	-	56,035,000	-
Discount on Issuance	-	(1,098,727)	-	(1,098,727)	-
Capital leases	313,989	-	153,690	160,299	160,299
Workers' Compensation Equity assessment	47,567	-	47,567	-	-
Accumulated vacation - net	1,017,807	44,139	-	1,061,946	-
	$ 58,654,363	$ 54,980,412	$49,796,257	$ 63,838,518	$ 775,299

✓ ***As a result of refinancing, Additions totaled $54.9 million and Deductions $49 million - an increase of $5.9 million.***

Repayment Increased 60%

2005 COPs:

Year Ending June 30,	Principal	Interest	Total
2009	$ -	$ 302,965	$ 302,965
2010	-	302,965	302,965
2011	-	302,965	302,965
2012	190,000	302,965	492,965
2013	200,000	298,857	498,857
2014-2018	1,220,000	1,423,520	2,643,520
2019-2023	1,660,000	1,272,685	2,932,685
2024-2028	2,240,000	1,070,129	3,310,129
2029-2033	3,020,000	796,158	3,816,158
2034-2038	4,080,000	425,887	4,505,887
2039-2040	1,390,000	15,040	1,405,040
Total	$ 14,000,000	$ 6,514,136	$ 20,514,136

2007 COPs:

Year Ending June 30,	Principal	Interest	Total
2009	$ -	$ 757,422	$ 757,422
2010	-	757,422	757,422
2011	-	757,422	757,422
2012	-	757,422	757,422
2013	390,000	753,202	1,143,202
2014-2018	2,420,000	3,621,125	6,041,125
2019-2023	3,390,000	3,310,474	6,700,474
2024-2028	4,690,000	2,876,147	7,566,147
2029-2033	6,630,000	2,270,642	8,900,642
2034-2038	9,310,000	1,414,756	10,724,756
2039-2041	8,170,000	291,391	8,461,391
Total	$ 35,000,000	$ 17,567,425	$ 52,567,425

Prior Repayment of $73.1 Million on 2005 & 2007 COPs

2009 Refinancing:

Year Ending June 30,	Principal	Interest	Total
2010	$ -	$ 2,830,348	$ 2,830,348
2011	-	2,830,348	2,830,348
2012	-	2,830,348	2,830,348
2013	-	2,830,348	2,830,348
2014	375,000	2,824,723	3,199,723
2015-2019	4,080,000	13,836,874	17,916,874
2020-2024	8,295,000	12,409,687	20,704,687
2025-2029	10,500,000	10,139,562	20,639,562
2030-2034	13,390,000	7,167,062	20,557,062
2035-2039	17,355,000	3,054,756	20,409,756
2040-2041	2,040,000	53,550	2,093,550
Total	$ 56,035,000	$ 60,807,606	$ 116,842,606

New Repayment of $116.8 Million on 2009 Refinancing

How We Can Know What's True

- Knowing what is true…
  - » Is the first step to judging what is right or wrong
- Start with what is readily available
  - » Budget – what we intended to do
  - » Audit – what we did
  - – Review the Budget
    - » Compare to last year's Budget and Audit
  - – Review the Audit
    - » Compare to Budget and last year's Audit

Good Management

- Identify, Quantify, and Mitigate Risks
  - Operational and Financial

- Make Decisions based on
  - What's true
    - » In our organization
    - » In the world

  - An understanding of risks
  - Mission
  - Vision

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Debt Management Workshop Best Practices and Current Information on Debt

August 9, 2012

Presented by
Lori Raineri, President
Government Financial Strategies, Inc.
Jordan Kaufman, Kern County Assistant Treasurer
Mark Fulmer, Retired Deputy Superintendent, KCSOS
Mary Barlow, Assistant Superintendent, KCSOS

Agenda

- 11:30 Welcome Dr. Christine Frazier
- Introductions and Review of the Agenda Mary Barlow
- 11:45 Presentation of case study #1 – Lori Raineri, Mark Fulmer
- 12:30 Presentation of Case Study #2 – Lori Raineri
- 1:15 Debt Review and Discussion – Lori Raineri
- 1:45 Resources for Districts – Jordan Kaufman, Mary Barlow, Mark Fulmer
- 2:45 – 3:15 Concluding Discussion – Lori Raineri

KCSOS Authority

- County Superintendent of Schools statutory authority differs in voter approved debt and non-voter approved debt.

Voter Approved Debt

- KCSOS will review proposed debt and comment on the affordability and the district's ability to repay the debt.
- KCSOS reviews all debt expenditures *after issuance* to ensure expenditures are compliant with the Ed. Code (including public bidding requirements) and board authorized.

AB 2197
Non-Voter Approved Debt

- Effective Jan. 1, 2009, revised Ed Code 17150 and 42133.5, added (17150.1).
- Non-voter approved debt includes debt instruments secured by real property such as:
  - Certificates of Participation (COPs)
  - Lease Purchase (LPs)
  - Qualified Zone Academy Bonds (QZABs)
  - Revenue Bonds
  - Any other debt instrument secured by real property and not subject to voter approval

District Responsibility

- Notify Superintendent of Schools and County Auditor at least **30 days** <u>prior to</u> the governing board's approval (E.C. 17150.1)
- Download materials from KCSOS website
- Use the FCMAT debt disclosure and calculation worksheet
- Preliminary Official Statement (POS)
- Debt repayment schedule
- Impact of Proposed Debt on current year unrestricted revenues
- Cost of issuance (disclosure and amortization)
- Evidence of the ability to repay (MultiYear Projection)

Supplemental Information

- Purpose of the Issue – describe the projects to be completed
- Hardship Status
- Other Indebtedness
- Prior Default
- Litigation
- Real property acquisition or improvement
- Contact information for financial advisor, bond counsel, underwriter

Protected: AB2197 Overview

AB2197 Background Information

AB2197 Debt Disclosure Form & Instructions

AB2197 Debt Disclosure & Calculation Worksheet

FCMAT NEWS

- Chaffey district placing $848M bond on November ballot
- West Contra Costa school district gets OK to close Castro Elementary, relocate Portola Middle School
- Summer ends early for LAUSD students, school starts Aug. 14

ARCHIVES

Select Month

RECENT POSTS

- Employers' Creditable Compensation Guide
- Protected: Ask SSC . . . Layoff Questions from the Governor's Budget Workshop
- Protected: Ask SSC . . . Questions and Answers on Special Education
- Protected: Changes Related to Federal Health Care Reform
- Protected: Ask SSC . . . Questions and Answers about Trigger Cuts—Part 1

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Kern County Superintendent of Schools 1300 17th Street - CITY CENTRE, Bakersfield, CA 93301-4533 (661) 636-4000. - Login

Impact of Proposed Debt on Current Year Unrestricted Reserves

State Reserve Standard

FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

Item	Amount
a. Total Expenditures, Transfers Out, and Uses (Including Cost of Proposed Debt)	
b. State Standard Minimum Reserve Percentage for this District	
c. Projected P-2 ADA	
d. State Standard Minimum Reserve Amount for this District (a x b, or $55,000, whichever is greater, for a district with less than 1,001 ADA)	$55,000.00

Budgeted Unrestricted Reserve (After Impact of Proposed Debt)

Item	Amount
a. General Fund Budgeted Unrestricted Designated for Economic Uncertainties	
b. General Fund Budgeted Unrestricted Unappropriated Amount	
c. Special Reserve Fund 17-Bugeted Designated for Economic Uncertainties	
d. Special Reserve Fund 17-Budgeted Unappropriated Amount	
e. Total District Budgeted Unrestricted Reserves	$0.00

Do unrestricted reserves meet the state standard minimum reserve amount?

Signature Form

The information provided in this document summarizes the financial implications of the proposed nonvoter approved debt and is submitted to the county office of education and the county auditor in accordance with the requirements of Education Code sections 17150 - 17150.1 and Assembly Bill 2197 at least 30 days prior to the district governing board's approval of the debt issuance.

We hereby affirm that the costs incurred by the school district under this agreement can be met by the district during the term of the agreement.

______________________________ Chief Business Official (signature)

Date

Contact Person:

Position:

Email: Phone #:

Disclosure and Amortization | MYP | Signature | Required Info | Supplement

DisclosureofNVADebtFINAL.xls [Read-Only] [Compatibility Mode]

Public Disclosure of Non-Voter-Approved Debt

In Accordance with Education Code section 17150, 17150.1 and Assembly Bill 2197

LEA NAME:

USE THE TABLE BELOW TO LIST EACH OF THE PROJECTS TO BE FINANCED.

	Projects to be Financed	Amount	Date Funds Needed
1			
2			
3			
4			
5			
6			

What are the planned repayment sources for debt payments? List each fund and the amount to be paid from each fund in current and future years over the life of the debt. Complete MYP(s) for the repayment sources

County Superintendent of Schools Responsibility

- Promote and assist the district to adopt best financial practices
- Comment on affordability of debt
- Minimize financial and legal risks
- Protect district fiscal solvency

County Superintendent of Schools Responsibility

- Within 15 days of receipt of documentation, the Superintendent of Schools (and the County Auditor) are authorized to publicly comment to the district's governing board regarding the district's ability to repay the obligation.
- Revenue factors that will be reviewed:
  - Developer fee projections
  - Assessed value projections
  - State funding delays
  - Feasibility of savings projected from energy projects

KCSOS Review Process

- Schedule an initial call with the district to discuss key questions:
  1. Why is the district borrowing?
  2. What will the district's annual obligation be, including debt service payments and administrative costs?
  3. What is the risk that the annual obligation will vary from year to year and by how much?
  4. What are the planned repayment sources?
  5. What is the likelihood the planned repayment sources will be sufficient?
  6. What is the cost of funds and is this reasonable?

KCSOS Review Process

- Review materials including detailed backup documentation
- May require follow up conversations with the district and representatives
- May confer with third party expert (Government Financial Strategies)
- Develop draft response to the district superintendent
- Issue final response to the district board and superintendent within 15 days of receipt of materials

Ed Code 42133

- If a district has had a qualified or negative certification in prior or current fiscal year, the district *may not* issue debt unless the County Superintendent of Schools determines that repayment is “probable”
  - Parallel process as described in 17150.1
  - Timeframes are critical – complete documentation is essential to a KCSOS thorough review
  - Debt includes TRANs and equipment lease-purchases

Ed Code 42133

Also prohibits the proceeds from COPs and other non-voter approved debt secured by real property from being used for a district's general operations, regardless of the district's budget certification.

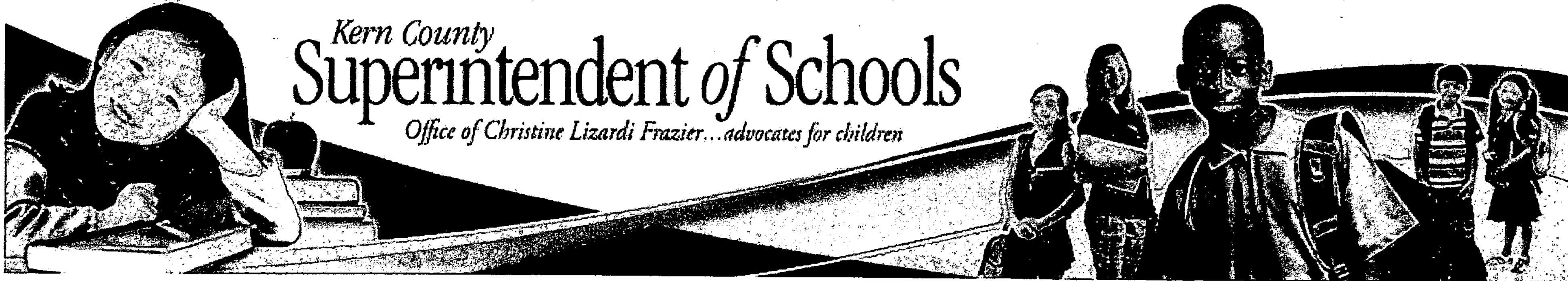
KCSOS Debt Advisory Committee

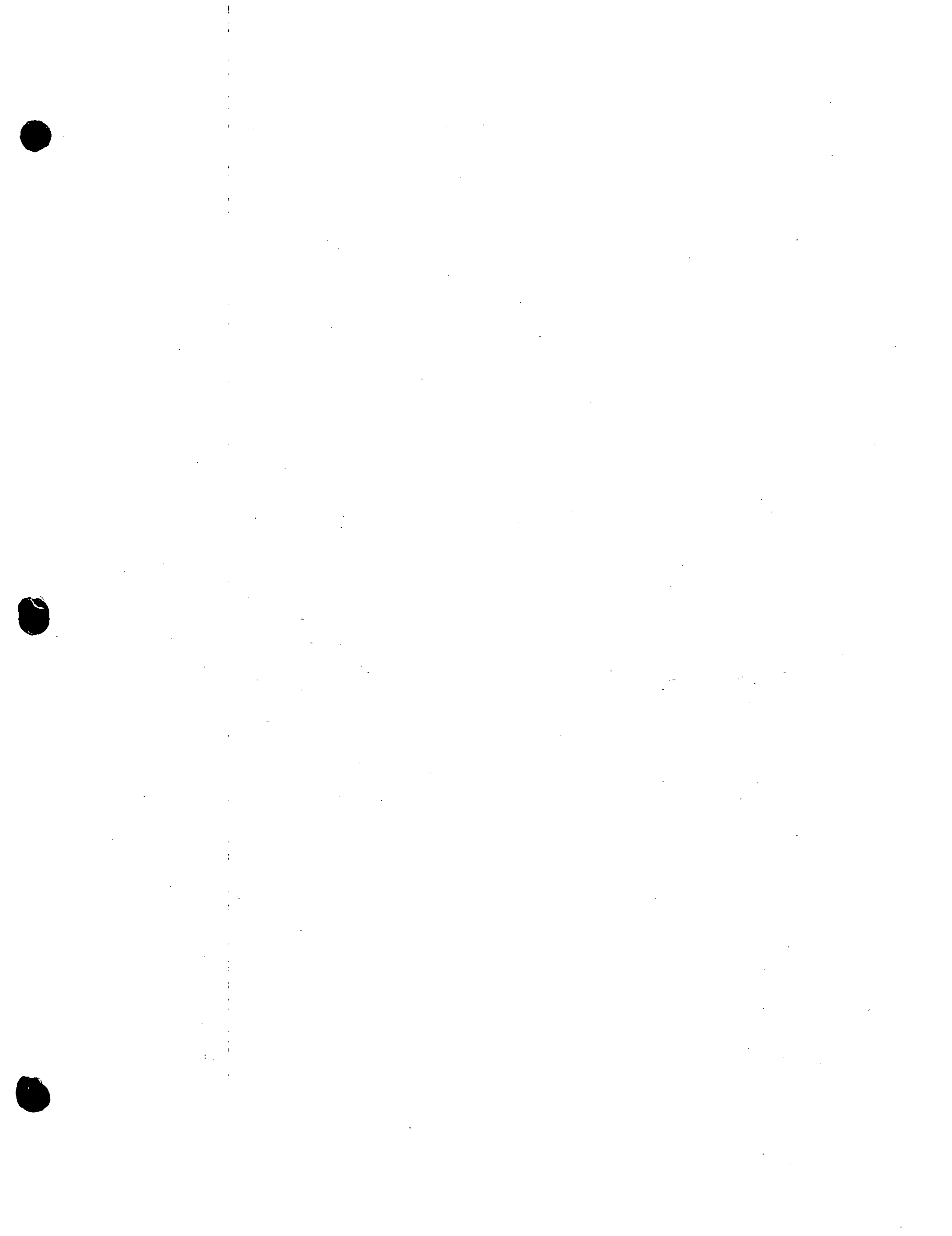
- Purpose - to provide support, information, and training opportunities to District Superintendents and Business Officials in planning and managing debt agreements. Advisory only – no oversight authority
  - May include sample RFP for financial advisors, bond counsel, underwriters or any professional service provider
  - Review of project goal and potential alternative approaches
  - Review and comment on proposed financing
  - Review of application for state facilities program funding

Concluding Thoughts

- KCSOS is available to provide individualized support and expertise to districts. Please contact us at the first consideration of issuing debt or facilities upgrades or construction.

Questions?





Office of Christine Lizardi Frazier
Kern County Superintendent of Schools
...advocates for children

District Advisory Services

DISCLOSURE OF NON-VOTER APPROVED DEBT

AB 2197, effective January 1, 2009, amended Sections 17150 and 42133.5 and added Section 17150.1 to the Education Code and changed the reporting requirements for the issuance of non-voter approved debt. In addition, the bill adds other kinds of non-voter approved debt instruments secured by real property to the list of what must be disclosed, including the following:

- Certificates of Participation (COPs)
- Lease purchases (LPs) secured by real property
- Qualified Zone Academy Bonds (QZABs) secured by real property
- Revenue bonds
- Any other debt instrument secured by real property and not subject to voter approval

School districts are required to notify the county superintendent of schools and county auditor at least 30 days prior to the governing board's approval of the issuance of non-voter approved debt instruments secured by real property. The district must provide information necessary to assess the anticipated effect of the debt issuance, including repayment schedules, evidence of the ability to repay, and costs of issuance. Within 15 days of receipt of the information, the county superintendent of schools and the county auditor are authorized to comment publicly to a district's governing board regarding the district's capacity to repay the debt obligation based on the information provided.

Enclosed is the reporting form and instructions to School Districts within Kern County necessary to comply with the Education Code with regard to public disclosure requirements for proposed non-voter approved debt agreements.

This form and supporting documents must be made available to the Kern County Superintendent of Schools at least thirty (30) days prior to the date the governing board will take action on the proposed non-voter approved debt issuance.

Instructions for completing the forms are provided for your information. Please provide repayment schedules, costs of issuance, and a multi-year (three year) financial projection for all funds pledged for debt repayment. The projection should show the revenue stream being committed to repayment of the debt obligation and the calculations on how the revenues are to be generated. If additional explanation of the terms of the agreement is necessary, please include a written narrative explanation.

If you have any questions, please contact us at:
Office of the Kern County Superintendent of Schools
District Advisory Services
1300 17th Street
Bakersfield California 93301-4533
(661) 636-4276
Fax (661) 636-4121

07/26/12

DISCLOSURE OF NON-VOTER APPROVED DEBT LEGAL REFERENCE

Education Code Section 17150 (a) Upon the approval by the governing board of the school district to proceed with the issuance of revenue bonds or to enter into an agreement for financing school construction pursuant to Chapter 18 (commencing with Section 17170), the school district shall notify the county superintendent of schools and the county auditor. The superintendent of the school district shall provide the repayment schedules for that debt obligation and evidence of the ability of the school district to repay that obligation to the county auditor, the county superintendent, the governing board, and the public. Within 15 days of the receipt of the information, the county superintendent of schools and the county auditor may comment publicly to the governing board of the school district regarding the capability of the school district to repay that debt obligation.

(b) Upon the approval by the county board of education to proceed with the issuance of revenue bonds or to enter into an agreement for financing pursuant to Chapter 18 (commencing with Section 17170), the county superintendent of schools or superintendent of a school district for which the county board serves as governing board shall notify the Superintendent. The county superintendent of schools or the superintendent of a school district for which the county board serves as the governing board shall provide the repayment schedules for that debt obligation and evidence of the ability of the county office of education or school district to repay that obligation, to the Superintendent, the governing board, and the public. Within 15 days of the receipt of the information the Superintendent may comment publicly to the county board of education regarding the capability of the county office of education or school district to repay that debt obligation.

(c) Prior to delivery of the notice required by subdivision (a) neither the county nor its officers shall have responsibility for the administration of the indebtedness of the school district. Failure to comply with the requirements of this section will not affect the validity of the indebtedness.

17150.1 (a) No later than 30 days before the approval by the governing board of the school district to proceed with the issuance of certificates of participation and other debt instruments that are secured by real property and do not require approval of the voters of the school district, the school district shall notify the county superintendent of schools and the county auditor. The superintendent of the school district shall provide information necessary to assess the anticipated effect of the debt issuance, including the repayment schedules for that debt obligation, evidence of the ability of the school district to repay that obligation, and the issuance costs, to the county auditor, the county superintendent, the governing board, and the public. Within 15 days of the receipt of the information, the county superintendent of schools and the county auditor may comment publicly to the governing board of the school district regarding the capability of the school district to repay that debt obligation.

(b) No later than 30 days before the approval by the county board of education to proceed with the issuance of certificates of participation and other debt instruments that are secured by real property and do not require approval of the voters of the county, the county superintendent of schools or superintendent of a school district for which the county board serves as governing board shall notify the Superintendent. The county superintendent of schools or the superintendent of a school district for which the county board serves as the governing board shall provide information necessary to assess the anticipated effect of the debt issuance, including the repayment schedules for that debt obligation, the evidence of the ability of the county office of education or school district to repay that obligation, and issuance costs, to the Superintendent, the governing board, and the public. Within 15 days of the receipt of the information the Superintendent may comment publicly to the county board of education regarding the capability of the county office of education or school district to repay that debt obligation.

42133.5. Regardless of the certification of the budgetary status of a school district or county office of education under subdivision (*l*) of Section 1240 or Section 42131, the proceeds obtained by a school district

from the sources listed in subdivisions (a) to (f), inclusive, shall not be used for general operating purposes of the school district.

(a) The sale of a saleback or leaseback agreement, or interests in the agreement.
(b) A debt instrument payable from payments under a saleback or leaseback agreement.
(c) Certificates of participation.
(d) Other debt instruments that meet both of the following criteria:
(A) They are secured by real property.
(B) They do not require the approval of the voters of the school district.

DISCLOSURE OF NON-VOTER APPROVED DEBT GENERAL INSTRUCTIONS

Pursuant to Education Code Section 17150, 17150.1

1) Please submit this form to the Kern County Superintendent of Schools at least thirty (30) days prior to the date the district's governing board will take action on the non-voter approved debt issuance (the initial approval to proceed with the financing).

2) This form is to be used for all new and refunded issuances of non-voter approved debt.

3) Attachments to this form are to include: debt repayment schedule, costs of issuance, evidence of the ability of the school district to repay the obligation, multi-year financial projections for the funds pledged for the repayment, including assumptions used, and the calculations or data analysis to substantiate growth or revenue projections.

Specific Instructions:

1. **Type of Issue**: Indicate the type of debt instrument, i.e. Certificates of Participation (COP), Direct Capital Lease, Land Bank, Revenue Bonds, or any agreement to finance school construction.
2. **Board Approval Date:** The date the board is expected to approve proceeding with the debt issuance.
3. **Amount of Issue:** The total dollar amount the district is borrowing, including any amounts to refund existing debt issuances.
4. **Anticipated Date of Sale:** The date the debt instrument is expected to be purchased by the investor(s).
5. **Interest Rate %:** The expected rates of interest payable on the debt instrument for the term of the issue. If variable rate, indicate what drives variability, expected rate ranges, and the highest rate of interest that can be charged.
6. **Bond Counsel and Financial Advisory/Underwriter**: Provide the company and individual contact person handling your debt financing.
7. **Purpose of the Issue:** Describe the projects to be covered by the debt issuance, i.e., building a multi-purpose room, district match to state school building project, refunding existing debt issuance for lower interest rate.
8. **Pledged Source(s) of Funds for Debt Repayment as Indicated in the Official Statement**: Indicate the sources of the funds the district is expecting to receive to repay this debt obligation as indicated in the official debt disclosure document (O.S.), i.e., state school building project apportionments, developer fees, and revenue limit apportionments. Provide analysis of projections for developer fees and/or calculations of anticipated student attendance growth for revenue limit pledges.

DISCLOSURE OF NON-VOTER APPROVED DEBT INFORMATION FORM

In accordance with Education Code Section 17150, the following information is being provided to the Kern County Superintendent of Schools and the Kern County Auditor Controller:

School District______________________________ Date ____________________

District Contact______________________________ Phone ___________________

Type of Issue ____

Anticipated Board of Approval Date ____________________

Amount of Issue $ ____________________

Anticipated Date of Sale ____________________

Anticipate Interest Rate ____________________%

Bond Counsel ____

Bond Counsel Contact ____________________________ Phone _______________

FinancialAdvisor/Underwriter____

Financial Advisor/Underwriter Contact____________________ Phone ______________

Purpose of the Issue ____

____

Pledged Source(s) of Funds for Debt Repayment as indicated in Official Statement

____

Alternate Sources of Funding Available for Debt Repayment

____

Attach copies of:

1. Official Statement Debt Repayment Schedule
2. Multi-year Financial Projections and Assumptions for all funds (General Fund, Capital Facilities, etc.) Pledged for Debt Repayment (Include calculations/backup to support anticipated revenue stream.)

Rev: 050611 mf

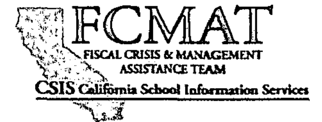
USE THE TABLE BELOW TO LIST EACH OF THE PROJECTS TO BE FINANCED.

	Projects to be Financed	Amount	Date Funds Needed
1			
2			
3			
4			
5			
6			

What are the planned repayment sources for debt payments? List each fund and the amount to be paid from each fund in current and future years over the life of the debt. Complete MYP(s) for the repayment sources on the correct form.

Impact of Proposed Debt on Subsequent Years

Complete the following for the fund(s) that will be the repayment source(s) for the proposed debt.
If more than one fund is involved, complete separate MYPs for each fund.
Attach a separate listing of all assumptions used in the MYP(s).

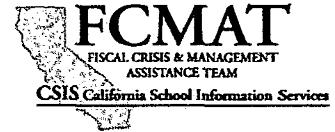


(Insert Name of Fund Here)

	2008-09	2009-10	2010-11
	Total current budget including new debt and issuance costs	First subsequent year including new debt and additional costs	Second subsequent year including new debt and additional costs
REVENUES			
Revenue Limit Sources (8010-8099)			
Federal Revenues (8100-8299)			
Other State Revenues (8300-8599)			
Other Local Revenues (8600-8799)			
TOTAL REVENUES	$ -	$ -	$ -
EXPENDITURES			
Certificated Salaries (1000-1999)			
Classified Salaries (2000-2999)			
Employee Benefits (3000-3999)			
Books and Supplies (4000-4999)			
Services, Other Operating Expenses (5000-5999)			
Capital Outlay (6000-6999)			
Other Outgo (7100-7299) (7400-7499)			
Direct Support/Indirect Cost (7300-7399)			
Other Adjustments			
TOTAL EXPENDITURES	$ -	$ -	$ -
OPERATING SURPLUS (DEFICIT)	$ -	$ -	$ -
OTHER SOURCES/USES			
Transfers In and Other Sources (8910-8979)			
Transfers Out and Other Uses (7610-7699)			
INCREASE (DECREASE) IN FUND BALANCE	$ -	$ -	$ -
BEGINNING BALANCE		$ -	$ -
ENDING BALANCE	$ -	$ -	$ -
COMPONENTS OF ENDING BALANCE:			
	$ -	$ -	$ -

Impact of Proposed Debt on Current Year Unrestricted Reserves

State Reserve Standard



a. Total Expenditures, Transfers Out, and Uses (Including Cost of Proposed Debt)	
b. State Standard Minimum Reserve Percentage for this District	
c. Projected P-2 ADA	
d. State Standard Minimum Reserve Amount for this District (a x b, or $55,000, whichever is greater, for a district with less than 1,001 ADA)	$55,000.00

Budgeted Unrestricted Reserve (After Impact of Proposed Debt)

a. General Fund Budgeted Unrestricted Designated for Economic Uncertainties	
b. General Fund Budgeted Unrestricted Unappropriated Amount	
c. Special Reserve Fund 17-Bugeted Designated for Economic Uncertainties	
d. Special Reserve Fund 17-Budgeted Unappropriated Amount	
e. Total District Budgeted Unrestricted Reserves	$0.00

Do unrestricted reserves meet the state standard minimum reserve amount?

Signature Form

The information provided in this document summarizes the financial implications of the proposed nonvoter approved debt and is submitted to the county office of education and the county auditor in accordance with the requirements of Education Code sections 17150 - 17150.1 and Assembly Bill 2197 at least 30 days prior to the district governing board's approval of the debt issuance.

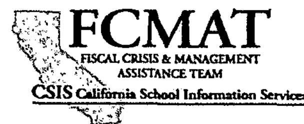
We hereby affirm that the costs incurred by the school district under this agreement can be met by the district during the term of the agreement.

Chief Business Official (signature) ____________________ Date ____________________

Contact Person: ____________________

Position: ____________________

Email: ____________________ Phone #: ____________________



Information to be Provided

Preliminary Official Statement

(e.g., outlines the proposed debt agreement) – Schedule(s) **must** be attached which include the following, as applicable. (The schedule(s) may be prepared by your underwriter.)

Front Cover Sheet with amount and date of actual issuance
Listing that reflects all parties involved in the financing
Maturity Schedule
Debt Repayment Schedule**
Purpose of Issue
Pledged Sources of funds for debt repayment

All submitted information are estimates only. If the final amounts exceed what is presented on this disclosure, a new disclosure must be presented to the governing board and the county office.

****Debt Repayment Schedule**

(e.g., payments) – Schedule(s) **must** be attached which include the following, as applicable. (The schedule(s) may be prepared by your underwriter.)

Required Payment Dates
Total Debt Service
Net Debt Services
Principal
Debt Services Reserve
Surplus Funds Remaining
Coupon
Capitalized Interest
Interest Rate
Interest Payments

All submitted information are estimates only. If the final amounts exceed what is presented on this disclosure, a new disclosure must be presented to the governing board and county office.

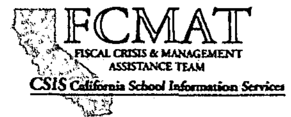
Contingency Plan

Using the space provided below, please indicate what the district's contingency plan is if the pledged sources of repayment do not materialize or the final agreement costs more than originally estimated.

Interim Financing

Using the space provided below, please indicate the interim financing being used pending closure of the non-voter-approved debt.

Supplemental Questions



Hardship Status

Is the district classified as a "hardship" school district by the state for purposes of qualifying for 100 percent state school construction funding?

If yes, please indicate whether the district has applied for or received 100 percent hardship state school construction funding and the dollar amount involved.

Other Indebtedness

Does the district have other outstanding bonds, notes, COPs, or other forms of indebtedness, including lease arrangements, either for this project or any other project?

If yes, identify the issue and specify the outstanding principal and interest amount, and yearly payment schedule. Also, note from which fund the payments are made.

Prior Default

Has the district ever defaulted on any bonded debt?

If yes, please identify and describe current status.

Litigation

Is the district involved in any litigation (real or threatened) concerning its ability to borrow money, either in the form of bonds or otherwise?

If yes, please describe:

Real Property Acquisition or Improvement

If this debt is for real property improvement, does the district presently own the real property necessary for the project(s)?

Reason for Not Applicable:

Supplemental Questions

If the district does not own such property, identify the present owner by name, address and telephone number:

Will the district have to use its eminent domain powers in connection with the acquisition of all or part of the project site(s)?

<u>If yes</u>, please describe the present status of eminent domain proceedings:

Does the district have any information in addition to that provided on this disclosure that leads the district to believe that the debt is affordable?

<u>If yes</u>, please provide the additional information here:

Companies and Contact People Handling the Debt Financing

Bond Counsel

Contact Person and Telephone Number

Financial Advisor

Contact Person and Telephone Number

Underwriter

Contact Person and Telephone Number

EDUCATION CODE 17150

(a) Upon the approval by the governing board of the school district to proceed with the issuance of revenue bonds or to enter into an agreement for financing school construction pursuant to Chapter 18 (commencing with Section 17170), the school district shall notify the county superintendent of schools and the county auditor. The superintendent of the school district shall provide the repayment schedules for that debt obligation and evidence of the ability of the school district to repay that obligation to the county auditor, the county superintendent, the governing board, and the public. Within 15 days of the receipt of the information, the county superintendent of schools and the county auditor may comment publicly to the governing board of the school district regarding the capability of the school district to repay that debt obligation.

(b) Upon the approval by the county board of **education** to proceed with the issuance of revenue bonds or to enter into an agreement for financing pursuant to Chapter 18 (commencing with Section 17170), the county superintendent of schools or superintendent of a school district for which the county board serves as governing board shall notify the Superintendent. The county superintendent of schools or the superintendent of a school district for which the county board serves as the governing board shall provide the repayment schedules for that debt obligation and evidence of the ability of the county office of **education** or school district to repay that obligation, to the Superintendent, the governing board, and the public. Within 15 days of the receipt of the information the Superintendent may comment publicly to the county board of **education** regarding the capability of the county office of **education** or school district to repay that debt obligation.

(c) Prior to delivery of the notice required by subdivision (a) neither the county nor its officers shall have responsibility for the administration of the indebtedness of the school district. Failure to comply with the requirements of this section will not affect the validity of the indebtedness.

17150.1.

(a) No later than 30 days before the approval by the governing board of the school district to proceed with the issuance of certificates of participation and other debt instruments that are secured by real property and do not require approval of the voters of the school district, the school district shall notify the county superintendent of schools and the county auditor. The superintendent of the school district shall provide information necessary to assess the anticipated effect of the debt issuance, including the repayment schedules for that debt obligation, evidence of the ability of the school district to repay that obligation, and the issuance costs, to

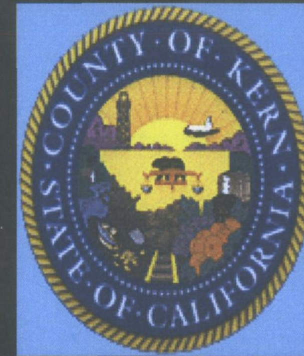
EDUCATION CODE 42133

(a) A school district that has a qualified or negative certification in any fiscal year may not issue, in that fiscal year or in the next succeeding fiscal year, certificates of participation, tax anticipation notes, revenue bonds, or any other debt instruments that do not require the approval of the voters of the district, nor may the district cause an information report regarding the debt instrument to be submitted pursuant to subdivision (e) of Section 149 of Title 26 of the United States **Code**, unless the county superintendent of schools determines, pursuant to criteria established by the Superintendent of Public Instruction, that the district's repayment of that indebtedness is probable. A school district is deemed to have a qualified or negative certification for purposes of this subdivision if, pursuant to this article, it files that certification or the county superintendent of schools classifies the certification for that fiscal year to be qualified or negative.

(b) A county office of **education** that has a qualified or negative certification in any fiscal year may not issue, in that fiscal year or in the next succeeding fiscal year, certificates of participation, tax anticipation notes, revenue bonds, or any other debt instruments not requiring the approval of the voters of the district, nor may the county office of **education** cause an information report regarding the debt instrument to be submitted pursuant to subdivision (e) of Section 149 of Title 26 of the United States **Code**, unless the Superintendent of Public Instruction determines that the repayment of that indebtedness by the county office of **education** is probable. A county office of **education** is deemed to have a qualified or negative certification for purposes of this subdivision if, pursuant to this article, it files that certification or the Superintendent of Public Instruction classifies the certification for that fiscal year to be qualified or negative. For purposes of this subdivision, "county office of **education**" includes a school district that is governed by a county board of **education**.

(c) No later than March 31, 1992, the Superintendent of Public Instruction shall develop and adopt criteria and standards to govern the determination to be made under subdivisions (a) and (b).

SCHOOL DISTRICT FINANCE: COUNTY TREASURER-TAX COLLECTOR'S ROLE



Jordan Kaufman, Assistant Treasurer-Tax Collector

Agenda

- TTC's Role
- Structuring Issues
- Pricing Issues
- Specific Issues of Concern
- Continuing Disclosure

TTC’s Role

- Collects debt service through tax bill
- Fiduciary of school funds
- Responsibility but little authority
- Taxpayer advocacy role

TTC's Role

- Government Code Financing
  - Issued by District directly
  - Max 40 year maturity
  - TTC Role - Suggestive
- Ed Code Financing
  - Issued by BOS on behalf of District
  - Max 25 year maturity
  - Required if qualified or negative interim report
  - TTC Role - Authoritative

During Structuring

- Review Structure
  - CIBs vs. CABs
- Review Prop 39 analysis
  - AV Growth Assumptions
  - Tax Rate Assumptions

During Pricing

- Pre pricing call & pricing call
- Comparison worksheets
- Spreads to MMD
- TIC
- If refunding – PV savings
- Underwriter fees
- Underwriter's willingness to hold bonds

Specific Concerns

- JPA Structures
- Prop 39 Tax Limits
- High Assessed Valuation Est.
- Long Dated CABs
- Bond Premium to pay COI
- Borrowing from bond project funds

Continuing Disclosure

- SEC Rule 15c2-12 and 10b-5
- Initial Disclosure
  - POS / OS
  - Disclosing (and not misstating) all material facts
- Annual Report
  - Updates of the OS plus add'l financial info
  - Everything you need to know is in the CDA

Continuing Disclosure

- 15 Material Events
  - P&I delinquencies
  - Defaults
  - draws on reserves
  - draws on credit enhancements
  - substitution of credit enhancement providers
  - bond calls and/or defeasances
  - rating changes
  - Bankruptcy, insolvency, receivership

Continuing Disclosure

- File reports with MSRB on the EMMA system
  - emma.msrb.org