Government Finance Officers Association

Best Practices Related to Debt Management and Debt Issuance

June 2013

Compiled By

Government Financial Strategies inc.

Government Finance Officers Association

Best Practices Related to Debt Management and Debt Issuance

TABLE OF CONTENTS

Best Practices Most Referred to (logical order):

Debt Management Policy 1
Selecting and Managing the Method of Sale of State and Local Government Bonds 4
Selecting Financial Advisors 7
Selecting Bond Counsel 11
Selecting Underwriters for Negotiated Bond Sales 14
Pricing Bonds in a Negotiated Sale 18
Expenses Charged by Underwriters in Negotiated Sales 20
Costs of Issuance Incurred in a Publicly Offered Debt Transaction 22
Managing Build America and Other Direct Subsidy Bonds 25
Analyzing and Issuing Refunding Bonds 29
Post Issuance Compliance Checklist 32
Understanding Your Continuing Disclosure Responsibilities 41

Other Debt Related GFOA Best Practices (alphebtical):

Business Preparedness and Continuity Guidelines 43
Debt Service Payment Settlement Procedures 46
Including Disclosures in Official Statements Related to Pension Funding Obligations 47
Investment of Bond Proceeds 49
Issuer's Role in Selecting Underwriter's Counsel 51
Maintaining an Investor Relations Program 53
Public-Private Partnerships for Economic Development 55
Role of the Finance Officer in Privatization 58
Tax Increment Financing as a Fiscal Tool 60
Using a Web Site for Disclosure 63
Web Site Presentation of Official Financial Documents 66

Advisories (alphebtical):[1]

Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites 69
Evaluating the Sale and Securitization of Property Tax Liens 72
Evaluating the Use of Pension Obligation Bonds 74
Issuing Taxable Debt 76
Need for Considerable Caution in Regard to OPEB Bonds 79
Understanding the Issuer's Role in Secondary Market Securitization of Tax-Exempt Obligations 81
Underwriter Disclaimers in Official Statements 83
Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy 84
Using Variable Rate Debt Instruments 87
Derivatives Checklist 89

[1] 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.

BEST PRACTICE

Debt Management Policy (1995, 2003, and 2012) (DEBT)

Background. Debt management policies are written guidelines, allowances, and restrictions that guide the debt issuance practices of state or local governments, including the issuance process, management of a debt portfolio, and adherence to various laws and regulations. A debt management policy should improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and therefore is likely to meet its debt obligations in a timely manner. Debt management policies should be written with attention to the issuer's specific needs and available financing options and are typically implemented through more specific operating procedures. Finally, debt management policies should be approved by the issuer's governing body to provide credibility, transparency and to ensure that there is a common understanding among elected officials and staff regarding the issuer's approach to debt financing.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments adopt comprehensive written debt management policies. These policies should reflect local, state, and federal laws and regulations. To assist with the development of these policies the GFOA recommends that a government's Debt Management Policy (Policy) should be reviewed periodically (and updated if necessary) and should address at least the following:

1. ***Debt Limits.*** The Policy should consider setting specific limits or acceptable ranges for each type of debt. Limits generally are set for legal, public policy, and financial reasons.

   a. *Legal restrictions* may be determined by:

   - State constitution or law,
   - Local charter, by-laws, resolution or ordinance, or covenant, and
   - Bond referenda approved by voters.

   b. *Public Policies will address the internal standards and considerations within a government and* can include:

   - Purposes for which debt proceeds may be used or prohibited,
   - Types of debt that may be issued or prohibited,
   - Relationship to and integration with the Capital Improvement Program, and
   - Policy goals related to economic development, including use of tax increment financing and public-private partnerships.

   c. *Financial restrictions or planning considerations* generally reflect public policy or other financial resources constraints, such as reduced use of a particular type of debt due to changing financial conditions. Appropriate debt limits can have a positive impact on bond ratings, particularly if the government demonstrates adherence to such policies over time. Financial limits often are expressed as ratios customarily used by credit analysts. Different financial limits are used for different types of debt. Examples include:

- *Direct Debt, including general obligation bonds,* are subject to legal requirements and may be able to 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 often are limited by debt service coverage ratios (e.g., annual net pledged revenues to annual debt service), additional bond provisions contained in bond covenants, and potential credit rating impacts.

- *Conduit Debt* limitations may reflect the right of the issuing government to approve the borrower's creditworthiness, including a minimum credit rating, and the purpose of the borrowing issue. 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 own 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.

- *Variable Rate Debt* should include information about when using non-fixed rate debt is acceptable to the entity either due to the term of the project, market conditions, or debt portfolio structuring purposes.

2. ***Debt Structuring Practices.*** The Policy should include specific guidelines 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, short-term debt, and limitations as to when, and to what extent, each can be used, and
- Other structuring practices should be considered, such as capitalizing interest during the construction of the project and deferral of principal, and/or other internal credit support, including general obligation pledges.

3. ***Debt Issuance Practices***. The Policy should provide guidance regarding the issuance process, which may differ for each type of debt. These practices include:

- Selection and use of professional service providers, including an independent financial advisor, to assist with determining the method of sale and the selection of other financing team members,
- Criteria for determining the sale method (competitive, negotiated, private placement) and investment of proceeds,
- Use of comparative bond pricing services or market indices as a benchmark in negotiated transactions, as well as to evaluate final bond pricing results,
- Criteria for issuance of advance refunding and current refunding bonds, and
- Use of credit ratings, minimum bond ratings, determination of the number of ratings, and selection of rating services.

5. ***Debt Management Practices.*** The Policy should provide guidance for ongoing administrative activities including:

- Investment of bond proceeds,
- Primary and secondary market disclosure practices, including annual certifications as required,
- Arbitrage rebate monitoring and filing,
- Federal and state law compliance practices, and
- Ongoing market and investor relations efforts.

6. ***Use of Derivatives.*** The Debt Management Policy should clearly state whether or not the entity can or should use derivatives. If the policy allows for the use of derivatives, a separate and comprehensive derivatives policy should be developed (see GFOA's Advisory, Developing a Derivatives Policy and Derivatives Checklist).

References.

- GFOA Advisory, Using Variable Rate Debt Instruments, 2010.
- GFOA Advisory, Use of Debt-Related Derivatives Products and the Development of a Derivatives policy, 2010.
- GFOA Derivatives Checklist, 2010.
- GFOA Best Practice, Selecting Bond Counsel, 2008.
- GFOA Best Practice, Selecting Financial Advisors, 2008.
- GFOA Best Practice, Selecting Underwriters for a Negotiated Bond Sale, 2008.
- GFOA/NABL Post Issuance Compliance Checklist, 2003.
- *Benchmarking and Measuring Debt Capacity*, Rowan Miranda and Ron Picur, GFOA, 2000.
- *A Guide for Preparing a Debt Polic*y, Patricia Tigue, GFOA, 1998.

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

BEST 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

- *Competitive v. Negotiated Sale Debt,* Issue Brief No. 1, California Debt Advisory Commission, September 1992.
- *Competitive v. Negotiated: How to Choose the Method of Sale for Tax-Exempt Bonds*, GFOA, 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- GFOA Best Practice, "Preparing RFPs to Select Financial Advisors and Underwriters," GFOA, 1997.
- GFOA Best Practice, "Pricing Bonds in a Negotiated Sale," 2000.
- GFOA Best Practice, "Debt Management Policy," 2003.
- *An Elected Official's Guide to Debt Issuance*, J.B. Kurish and Patricia Tigue, GFOA, 2005.
- "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.

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.

BEST PRACTICE

Selecting Bond Counsel (1998 and 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. 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 Best Practice, "Preparing RFPs to Select Financial Advisors and Underwriters," 1997.
- *A Guide to Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, 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

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.

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

Costs of Issuance Incurred in a Publicly Offered Debt Transaction (2013)

Background. State and local governments incur various costs and fees in conjunction with publicly offered bond transactions. This Best Practice provides an overview of the types of costs and fees that an issuer can expect to pay in a typical bond transaction. Finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable and for legitimate services provided to the issuer.

There are two types of costs that issuers incur in the debt issuance process:

Direct Costs of Issuance: Costs that the debt issuer pays directly to financial and legal advisors, the trustee (if any), paying agents, auditors, rating agencies and other providers of services to the issuer. This is in addition to internal costs incurred by your government for staff work or fees to other government departments.

Underwriter's Discount: Costs paid indirectly by the issuer to the underwriter of the bonds for services relating to selling the bonds to investors and managing elements of the transaction. These costs are deducted from the proceeds of the bonds by the underwriters at closing and therefore issuers typically do not "write a check" for these services.

Finance officers also should be aware that certain costs are embedded within the bids received from underwriters in a competitive sale. These costs and fees are usually not specified in a competitive bid and are outside of the issuer's control. Such costs include CUSIP fees, DTC fees and certain internal expenses of the bidder.

This Best Practice focuses on direct costs of issuance. Best Practices relating to costs paid by issuers through the underwriter's discount may be found in the following Best Practices:

- Selecting Underwriters for Negotiated Bond Sales
- Expenses Charged by Underwriters in Negotiated Sales

Finance officers, working with their financial advisor, should understand all costs and fees, so that they can be controlled and managed throughout the financing process. A thorough discussion with the financial advisor and other professionals involved in the transaction should be expected. These discussions should occur at the time that compensation is being determined for key members of the financing team, including the financial advisor, bond counsel and other service providers. As always, cost must be balanced with quality, as it is of critical importance that the issuer receives high quality services and work products from all parties.

Recommendation. The Government Finance Officers Association (GFOA) recommends that finance officers be aware of the parties likely and necessary to be involved in the transactions and be prepared to select these parties in a manner that ensures that needed services are obtained at a fair and reasonable cost. Additionally, an issuer should carefully review all invoices to ensure that an expense is not billed to multiple parties.

1. **Financial Advisor**. Financial advisors assist the issuer on matters such as selecting the method of sale (competitive, negotiated, private placement, direct bank loan, etc.), structuring the financings, sale timing, marketing, fairness of pricing, obtaining credit ratings, evaluating cost effectiveness of credit enhancement and other matters. Unlike the underwriter of the bonds, the financial advisor has a fiduciary obligation to represent the interests of the issuer and therefore, should be one of the first financing team members retained by the issuer.

The financial advisor should typically be retained prior to selection of the remainder of the financing team and should assist the issuer in determining the appropriate method sale, the selection of other members of the financing team and the negotiation of fees of the financing team members. GFOA recommends that financial advisors be selected as the result of an RFP or RFQ process. Compensation paid to financial advisors can vary based on the scope of services to be provided. If an advisor is being retained for services related to a bond transaction only, then the complexity of the transaction, the type of security and the type of issuer will have an impact on the fees charged. Fees can be paid on an hourly, or fixed fee bases. However, the FA fee may also be based on an $/$1,000 of par value. However, an issuer should use caution if using this payment method, as it could impact the overall size and structure of the transaction

2. **Legal Counsel.**

   a. *Bond Counsel*. Bond counsel's duty is to represent the interests of the bondholders. Bond counsel is retained by the issuer to give a legal opinion that:

      i. Issuer is authorized to issue proposed municipal securities and has met all legal and procedural requirements necessary for issuance.
      ii. If interest on the proposed securities will be excluded from gross income of the holders (Federal and/or State and or local)
      iii. Generally responsible for the preparation of financing documents including Trust Indenture and Bond Resolution; assists with preparation of the Official Statement

   Compensation paid to bond counsel varies depending on complexity of the transaction, the type of security and the type of issuer. These fees can be assessed based on a flat fee or by hourly billing. If the fee is paid by $/$1,000 of par value of the issuance, an issuer should use caution and ensure a reasonable cap is in place.

   b. *Issuer Counsel*. Government's may have in house counsel or may hire outside counsel to represent only the interest of the issuer.

   c. *Disclosure or Tax Counsel***.** In addition to bond counsel, some transactions will involve the use of disclosure counsel and tax counsel.

3. **Bond Trustee**. A financial institution or other required entity with trust powers that acts in a fiduciary capacity for the benefit of the bondholders, enforcing the terms of the trust indenture and often acting as:

   a. Paying agent (transmitting payments from issuer to bondholder)
   b. Dissemination agent (for ongoing disclosure requirements)
   c. Escrow agent on refunding transactions (hold funds in escrow account until time of disbursement)
   d. Disburse bond proceeds based upon procedures established by trust endenture or bond resolution.
   e. Place investment of bond proceeds based on instruction of issuer.

   f. Trustee fees frequently include a one-time upfront fee (acceptance fee), an annual fee (trusteeship fee), and often transaction fees. The selection of the Trustee should be done through an RFP process, with price not being the sole determining factor.

4. **Escrow Verification Agent**. An escrow verification agent should be hired in conjunction with a refunding transaction. The role of the escrow verification agent is to determine that the cash flow from the securities purchased to defease the refunded bonds will be sufficient to make remaining debt service payments on the refunded bonds until the bonds are called, if applicable, or to maturity. It is recommended that the selection of an escrow verification agent is competitively procured.

5. **Auditor.** Under auditing standards generally accepted in the United States of America, independent auditors are presumed not to be associated with financial statements included in an offering statement. Still, an "association" may be created between the independent auditor and the offering statement if the auditor takes one of several actions specified in the auditing standards, such as inserting a provision in the audit contract that requires prior approval before including audited financial statements in an offering statement. It is important to note that the audited financial statements belong to the issuer, which GFOA believes should be free to publish in offering statements. Audit contracts in general should be negotiated to reflect this, but to the extent that consent is required, the level of effort required is minimal and no additional fee should be required.

6. **Rating Agencies**. Rating agency fee quotes can be obtained by your financial advisor or a member of your staff. The fees are and should be considered negotiable. Fees vary by bond size and security type. Consideration should be given to how many ratings are necessary, through discussion with your financial advisor and underwriter. Additionally, considerable caution should be exercised if a rating agency requests that an issuer sign a rating application or rating engagement letter. Legal counsel must be consulted if an issuer is inclined to sign such documents, because they are binding contracts.

7. **Printing and Distribution Costs.** Issuers will typically incur costs relating to electronically posting their official statement to websites and information services that potential underwriters and investors rely upon to access information about proposed bond offerings. In some cases, traditional hard copy printing costs may also be incurred. It has become more common for POS to be electronically posted and for a small number of final OS to be printed. The use of electronic only copies for the POS can save on printing costs.

8. **Pricing Verification Agent**. Issuers should use the services of the financial advisor for the transaction, or obtain the services of a separate financial advisor or other outside professional to review the pricing of a transaction and the underwriter's discount. This fee is usually based on a fixed rate basis.

References

- GFOA Best Practice, Expenses Charged by Underwriters in Negotiated Sales (2012)
- GFOA Best Practice, Pricing Bonds in a Negotiated Sale (2009).
- GFOA Best Practice, Issuer's Role in Selecting Underwriter's Counsel, 2009.
- GFOA Best Practice, Selecting Underwriters for Negotiated Bond Sales (2008)
- 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)
- GFOA Advisory, Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites (2006)

Approved by the GFOA's Executive Board, February 2013.

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.

POST ISSUANCE COMPLIANCE CHECKLIST

The National Association of Bond Lawyers ("NABL") and the Government Finance Officers Association ("GFOA") have jointly developed the following checklist to assist bond counsel in discussing with issuers and conduit borrowers, as applicable, post issuance compliance matters. The checklist is divided into three parts: tax, securities and State law matters. The checklist can serve as a framework for discussion at an appropriate time during the transaction or as a written document prepared by bond counsel and furnished to the issuer or conduit borrower after completion of the financing. Bond counsel may need to explain various items on the checklist to provide the issuer with a more complete understanding of the noted concept. The checklist can be amended or supplemented as needed to address the particular financing issue. Issuers and conduit borrowers are encouraged to contact bond counsel at any time they may have questions or concerns pertaining to tax, securities or State law issues.

In the "document reference" column, where applicable, the financing document pertaining to the referenced point should be named. This will assist others on the finance team – present and future – to be able to locate the original notation. The "responsibility" column should list the various offices/desks within the government or legal or other professional that have been engaged for the purpose of that section who is/are responsible for maintaining the noted task. This list covers a broad spectrum of financing purposes of which only some will apply to your financing. Instances where each line will be completed are unlikely. However, you are encouraged to review the entire document and complete the lines that are applicable to your financing.

The checklist is intended to help issuers and/or borrowers throughout the entire lifetime of the financing to identify matters that need to be analyzed by the issuer and perhaps by counsel. Issuers are encouraged to retain and distribute the checklist to all "responsible" parties and others who may find it useful during the lifetime of a financing. **Keeping the checklist throughout the lifetime of the financing is important. Thus, issuers are encouraged to keep the document with the transcript.**

The completion and distribution of this checklist does not presume a contractual obligation on parties to complete these tasks.

National Association *of* Bond Lawyers

POST ISSUANCE COMPLIANCE CHECKLIST

TRANSACTION PARTIES

Overall Responsible Office for Debt Management Activities	________________
Bond Counsel	________________
Trustee	________________
Paying Agent	________________
Rebate Specialist	________________
Other:________________	________________
Other:________________	________________
Other:________________	________________

A. TAX LAW REQUIREMENTS	**Document Reference**	**Responsibility**
1. **General Matters**.		
(a) Proof of filing Form 8038, 8038-G or 8038-GC. Copies of Form 8038, etc., to State authorities as required by State procedures.		
(b) "Significant modification" to bond documents results in reissuance under Treas. Reg. § 1.1001-3. Proof of filing new Form 8038, etc., plus final rebate calculation on pre-modification bonds.		
2. **Use of Proceeds: Governmental Bonds or Qualified 501(c)(3) Bonds**.		
(a) No private business use arrangement with private entity (includes federal government) beyond permitted *de minimis* amount unless cured by remedial action under Treas. Reg. § 1.141-12.		
(i) Sale of facilities.		
(ii) Lease.		
(iii) Nonqualified management contract. Rev. Proc. 97-13.		
(iv) Nonqualified research contract. Rev. Proc. 97-14.		
(v) "Special legal entitlement."		

(b) Additional requirements for qualified 501(c)(3) bonds.		
(i) No unrelated business activity income in facility beyond permitted *de minimis* amount.		
(ii) No activities jeopardizing 501(c)(3) exemption of 501(c)(3) borrower.		
(c) Remedial action may consist generally of redemption or defeasance of bonds (with notice of defeasance to IRS). Where disposition is a cash sale, remedial action may be an alternative qualifying use of proceeds. If bonds are 501(c)(3) bonds, alternative use must have "TEFRA" hearing and elected official approval prior to sale of original facilities. Proof of filing new Form 8038, etc.		
3. **Private Activity Bonds**. **IRC §142.**		
(a) Exempt facilities—in general.		
(i) Continuing use of exempt facilities in accord with basis of tax exemption.		
(ii) Use excess proceeds for redemption or defeasance (with notice of defeasance to IRS) within 90 days of determination that proceeds will not be spent, or date financed facility is placed in service. Treas. Reg. § 1.142-2(c).		
(b) Residential rental project bonds.		
(i) Meet low-income requirements for qualified project period. IRC §142(d).		
(ii) Proof of filing annual reports of compliance by project operator on Form 8703.		
(c) Qualified mortgage bonds.		
(i) Good faith compliance efforts for mortgage eligibility. IRC §143(a)(2).		
(ii) Spend proceeds or redeem bonds within 42 months of issuance; use mortgage prepayments after first 10 years to redeem bonds at next semiannual debt service date after receipt.		

(iii) Proof of filing annual reports of mortgagor income due 8/15. Treas. Reg. § 1.103A-2(k)(2)(ii).		
(d) Small issue manufacturing bonds using $10,000,000 ($20,000,000 for 2007) capital expenditure limit: monitor capital expenditures during three years after issuance for compliance with limit. IRC §144(a).		
(e) Acquisition of existing facilities: make qualifying rehabilitation within 24 months unless covered by exceptions. IRC §147(d).		
4. **Arbitrage**.		
(a) Rebate. IRC §148(f).		
(i) First installment of arbitrage rebate due on fifth anniversary of bond issuance plus 60 days.		
(ii) Succeeding installments every five years.		
(iii) Final installment 60 days after retirement of last bonds of issue.		
(iv) Monitor expenditures prior to semi-annual target dates for six-month, 18-month, or 24-month spending exception.		
(b) Monitor expenditures generally against date of issuance expectations for three-year or five-year temporary periods or five-year hedge bond rules.		
(c) For advance refunding escrows, confirm that any scheduled purchases of 0% Securities of State and Local Government Series are made on scheduled date.		
5. **Special Rules for Pool Bonds**.		
(a) Redeem bonds at one-year and three-year expenditure target dates. Pay 95% of costs of issuance within 180 days. IRC §149(f), as amended 2006.		
(b) 501(c)(3) pools: redeem bonds at one-year expenditure target date. IRC §147(b)(4).		
6. **Record Retention**.		

(a) Maintain general records relating to issue for life of issue plus any refunding plus three years.		
(b) Maintain special records required by safe harbor for investment contracts or defeasance escrows. Treas. Reg. § 1.148-5.		
(c) Maintain record of identification on issuer's books and records of "qualified hedge" contract. Treas. Reg. § 1.148-4(h)(2)(viii) and § 1.148-11A(i)(3).		
(d) Maintain record of election not to take depreciation on leased property that must be treated as owned by a governmental unit. Treas. Reg. § 1.103(n)-2T Q/A7.		
(e) Maintain record of agreements and assignments between governmental units that affect volume cap allocations under IRC §146. Treas. Reg. § 1.103(n)-3T Q/A8, 13 & 14.		
(f) Maintain record of election to utilize the $10,000,000 small issue bond limit on the books and records of the issuer. Treas. Reg. § 1.103-10(b)(2)(vi).		
7. **Allocations of Bond Proceeds to Expenditures**. Make any allocations of bond proceeds to expenditures needed under Treas. Reg. § 1.148-6(d) and § 1.141-6(a) by 18 months after the later of the date the expenditure was made or the date the project was placed in service, but not later than the earlier of five years after the bonds were issued or 60 days after the issue is retired.		
B. DISCLOSURE REQUIREMENTS		
1. **SEC Rule 15c2-12 Requirements**.		
(a) Determine applicability of continuing disclosure undertaking ("CDU").		
(b) Identification of "obligated person" for purposes of Rule 15c2-12. Governmental Bonds: Issuer. Private Activity Bonds: Issuer or Borrower.		
(c) Name of Dissemination Agent, if applicable.		
(d) Periodically determine that required CDU filings have been prepared, sent to and received by NRMSIR's.		

(e) Information required to be provided to NRMSIR and SID:		
(i) Annual Reports.		
(1) Quantitative financial information and operating data disclosed in official statement.		
(2) Audited financial statements.		
(ii) Other information.		
(1) Change of fiscal year.		
(2) Other information specified in CDU.		
(f) Material Event Disclosure. Notification by obligated person to SID and each NRMSIR, in timely manner, of any following events with respect to bonds, if event is material within the meaning of the federal securities laws:		
(i) Principal and interest payment delinquencies.		
(ii) Non-payment related defaults.		
(iii) Unscheduled draws on debt service reserves reflecting financial difficulties.		
(iv) Unscheduled draws on credit enhancements reflecting financial difficulties.		
(v) Substitution of credit or liquidity providers, or their failure to perform.		
(vi) Adverse tax opinions or events affecting the tax-exempt status of the bonds.		
(vii) Modifications to rights of holders of the bonds.		
(viii) Bond calls.		
(ix) Defeasances.		
(x) Release, substitution or sale of property securing repayment of the bonds.		

(xi) Rating changes.		
(g) Failure of the obligated person to timely file financial information (including audited financial statements) and operating data with SID and either each NRMSIR or MSRB.		
2. **Notification to Underwriters of Bonds**. Determination of whether bond purchase agreement requires issuer of the bonds to notify underwriters for a specified period of time of any fact of event that might cause the official statement to contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading.		
3. **Information Required to be Filed with Other Entities**.		
(a) Trustee.		
(b) Rating Agency(ies).		
(c) Bond Insurer.		
(d) Credit Enhancer.		
Examples: (i) Financial records.		
(1) Annual.		
(2) Quarterly.		
(ii) Budgets.		
(iii) Issuance of additional bonds.		
(iv) Events of default.		
(v) Notices of redemption.		
(vi) Amendments to bond documents.		
4. **Local Disclosure**. State and/or local requirements.		

C. MISCELLANEOUS STATE LAW AND DOCUMENT REQUIREMENTS		
1. **Security**.		
(a) Proof of filing UCC statements with appropriate authorities as required by State procedures.		
(i) Initial UCC financing statements filed with appropriate authorities. UCC 9-515(a).		
(ii) Continuation statements filed by fifth anniversary. UCC 9-515(d).		
(iii) Transfer by government or governmental unit not requiring a UCC statement. UCC 9-102(a)(45) (UCC exception adopted in certain jurisdictions).		
(iv) Public finance transaction in connection with debt securities (all or portion of securities have initial stated maturity of 20 years; obligated party is State or State governmental unit) qualifies for 30-year filing. UCC 9-515(b)		
(v) Other local requirements or exceptions.		
(b) Proof of filing recorded mortgages, deeds of trust with appropriate authorities and proof of delivery of originals to trustee or custodian.		
2. **Insurance**.		
(a) Proof of receipt of final title policy and proof of delivery to trustee or custodian.		
(b) Monitor compliance with property and casualty insurance requirements.		
3. **Financial Covenants**. Monitor compliance with rate covenant or other covenants not included in B(3) above.		
4. **Transfer of Property**.		
(a) Restrictions on transfer of cash.		
(b) Restrictions on releases of property.		
(c) Restrictions on granting liens or encumbering property.		

5. **Investments**. Compliance with permitted investments.		
6. **Derivatives**. Entering into and ongoing compliance of derivatives contracts is complex and a universe in and of itself. GFOA has created a Derivatives Checklist and a Recommended Practice on the Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy to assist issuers with understanding these products. These documents can be found at: http://gfoa.org/services/rp/debt.shtml.		

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.

BEST PRACTICE

Business Preparedness and Continuity Guidelines (2005 and 2008)(BUDGET, DEBT and CEDCP)

Background. Governments face many types of unscheduled disruptions to business operations. Disruptions to business operations may come from a variety of causes such as natural or manmade disasters, terrorism, and technology failures. Threat situations, domestic attacks, and natural disasters all present challenges to maintaining business operations.

Governments have a responsibility to minimize disruptions in the services they provide. Many government services are essential to the public's health and safety and to the protection of property. Disruptions in those essential services may range from temporary inconvenience to significant harm to individuals and the community.

Governments also have the responsibility for mitigating the effects of disasters on the communities they serve. In 1999, the GFOA developed a Recommended Practice, *Technology Disaster Recovery Planning*. This revised recommended practice expands that guidance and addresses additional aspects of comprehensive disaster and recovery planning.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments develop, test, and maintain a plan to continue their basic business operations during and immediately after disruptive events. Governments must be able to anticipate problems, detect threats and determine effective protective actions to enable them to continue to function. A government's response to disruptive events should be consistent with the type and severity of the event. State and local governments must be prepared to react to various disasters immediately, knowing that aid from the federal government may not come in a timely fashion.

1. *Plan Development.* A government must assess its own unique disruption risks. A strategy should be developed to mitigate risk and control costs.

    a. *External Planning Resources.* The federal government, under the auspices of the U.S. Department of Homeland Security, offers a variety of resources to assist governments in ensuring business preparedness and continuity:

        i. *Disaster and Emergency Recovery Plan Assessment.* The Office for Domestic Preparedness (ODP) is a component of the U.S. Department of Homeland Security's Office of State and Local Government Coordination and Preparedness (SLGCP). Its goal is to help states, cities, counties, towns and villages gain an objective assessment of their capability to prevent or respond to and recover from a disaster so that modifications to a plan can be made before an actual event occurs.

        ii. *Disaster and Emergency Recovery Plan Testing.* A government's disaster and emergency recovery plan should be tested periodically. The Homeland Security Exercise and Evaluation Program (HSEEP), which is under the ODP, provides both a rationale and policy for designing, developing, conducting and evaluating testing exercises. HSEEP is a threat- and performance-based exercise program that includes a cycle, mix and range of activities of varying degrees of complexity. HSEEP provides a series of four reference manuals to assist state and local jurisdictions in designing training exercises, conducting the exercises, evaluating the results and improving the plan to correct deficiencies.

iii. *Federal Emergency Management Agency (FEMA) Guidelines.* FEMA is another department within Homeland Security. Governments are encouraged to review preparedness guidance available on FEMA's website that covers (1) Emergency Operations Planning Guidance, (2) Interim Guidelines, Terrorist Incidents, (3) Tool Kit, Terrorist Incidents, (4) State and Local Guide for All-Hazards Emergency Operations Plan, (5) Emergency Operations Center Assessment Checklist, and (6) Continuity of Operations Guidance for State and Local Governments. While most emergency situations are handled locally, when there is a major incident help may be needed from other jurisdictions, the state, and the federal government. National Incident Management System (NIMS) provides a consistent nationwide template for organizations to work together effectively and efficiently to prepare for, prevent, respond to and recover from domestic incidents, regardless of cause, size or complexity, including acts of catastrophic terrorism. An Introduction to NIMS is a Web-based awareness level course that explains NIMS components, concepts and principles. All personnel with a direct role in emergency preparedness, incident management, or response are advised to complete this training.

b. *Other Planning Considerations.* Governments should consider the following items, in addition to the resources provided by the federal government, when designing business preparedness and continuity guidelines.

i. *Emergency Response Plan Compliance.* When developing response plans, governments must make sure that they are compliant with applicable local, state, federal, Occupational Safety and Health Administration (OSHA), and Environmental Protection Agency (EPA) guidelines.
ii. *Risk Management.* The risk manager should assess potential areas of insurance coverage in planning for any type of disruption. The risk manager should be aware of potential pre-qualifications like flood zone compliance, adopted building codes, etc.
iii. *Resiliency.* The concept of resiliency should be an integral part of disaster preparedness. Resiliency emphasizes the capacity of infrastructure, operations, and even social systems to respond to and recover from extreme events. Resilient systems reduce the probabilities of failure, the consequences of failure (such as deaths and injuries, physical damage, and negative economic and social effects), and the time for recovery. To address resiliency, governments should assess the "criticality" and "vulnerability" of their systems. By distinguishing critical systems and recognizing vulnerabilities, resiliency-enhancing projects can be planned and budgeted for.
iv. *Administrative Support Functions.* A government should plan to have such functions as human resources, purchasing, treasury, legal, and risk management accessible during an emergency situation. A back-up system for payment to staff and to make investments or debt payments should be available. For specific items like investments and payments on debt obligations, contact information (office, mobile, and home) for the professional bond and investment team (trustees, remarketing agents, advisors, brokers, banks, etc.) should be available to all members of the finance team, and a copy should be kept off site with these individuals as well (car or home). Confidentiality of information taken offsite should be a consideration. The use of password protected flash drives is an option.
v. *Communication with the Public.* It is essential that a government communicate (with one voice) to citizens during a time of disruption. When a crisis occurs, immediately get the word to available media. The government should direct the public on where to go for more information. Planning in advance will help identify what the most effective way is to communicate with various groups or neighborhoods. While the mode of communication may vary (e.g., Web sites, phone recordings at the government main office, text messaging systems, crisis hot line, radio, television, REVERSE 911,

mailings or newspapers), updates should be given regularly. Gather information as quickly as possible. Monitor media reports and correct errors immediately.

vi. *Outsourced/Recovery Services*. A government should assess the ability of providers of outsourced services themselves (e.g., garbage collection) to recover from unscheduled disruptions.

2. *Plan Implementation.* After developing a business preparedness and continuity plan, the following steps should be implemented.

   a. *Record Keeping.* Governments should develop a plan and procedures for contemporaneous record keeping in a format acceptable to FEMA. Compliance with FEMA regulations will simplify the reimbursement process.
   b. *Personnel Assignments and Communication in the Wake of a Disaster or Emergency.* Governments should formally assign personnel from each department or agency to serve on the disaster and emergency recovery team. The assignment of personnel should be planned. A strong business continuity plan maps out an organizational structure and lists roles and responsibilities, so employees are aware of their tasks. Essential and non-essential classifications may be used. Home and cell phone numbers as well as e-mail addresses for all essential employees should be updated regularly, with a duplicate list kept at a remote site. In addition, governments should establish procedures for assembling the team in the wake of a disaster or emergency. Those procedures should take into account the possibility that one or more ordinary means of communication may not be available in such circumstances (e.g., cell phones, e-mail) and specify appropriate alternative means of communication in such an eventuality. A government may also wish to develop specific policies for disaster service workers during times of emergency.
   c. *Mutual Aid Agreements.* Many state and local governments enter into mutual aid agreements to provide emergency assistance to each other in the event of disasters or emergencies. These agreements often are written, but occasionally are arranged verbally after a disaster or emergency occurs. Mutual aid agreement policies should address both written and verbal mutual aid agreements and the eligibility of costs under the Emergency Management Assistance Compact (EMAC).
   d. *Outsourced/Recovery Services*. A government should negotiate contingent contracts for recovery services in advance. If a government is not legally authorized to negotiate contingent contracts, the government should establish an emergency procurement process and identify criteria that would activate the process.
   e. *Disaster and Emergency Recovery Plan Safeguard.* A government's disaster and emergency recovery plan should be safeguarded to ensure that it is available in the event of a disaster or emergency. Specific incident/emergency management responses may require assembly areas or record keeping at a safe distance from the site of the incident.

References

- GFOA Best Practice, "Technology Disaster Recovery Planning*,"* 1999 and 2007.
- GFOA Best Practice, "Ensuring Adequate Documentation of Costs to Support Claims For Disaster Recovery Assistance," 2008.
- United States Department of Homeland Security. Office for Domestic Preparedness (http://www.ojp.usdoj.gov/odp/).
- United States Department of Homeland Security. Office for Domestic Preparedness, "Homeland Security Exercise and Evaluation Program (HSEEP)" (http://www.ojp.usdoj.gov/odp/docs/hseep.htm).
- Federal Emergency Management Agency (http://www.fema.gov).

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

BEST PRACTICE

Debt Service Payment Settlement Procedures (2003 and 2007) (DEBT AND TIM)

Background. Issuers of government debt have a fiduciary responsibility to manage their funds in a manner that assures timely and accurate payment of debt service principal and interest. That responsibility also includes full use of funds for the benefit of the government until payment due date.

Debt payments were made by check for many years. However, electronic fund transfers now allow governments to ensure timely payment on payment due dates in order to retain use of their funds until that date. Use of electronic fund transfers standardizes payment streams, reduces credit and liquidity risk, provides a complete audit trail, improves efficiency, and reduces loss of the use of funds.

Issuers must establish a plan for the allocation and investment of debt service funds to assure availability of funds. Issuers must also ensure timely payment of funds for payments and negotiating terms with counter-parties that serve both government and bondholders' needs in accordance with bond documents.

Recommendation. To ensure that debt principal and interest payments are made on a timely and cost effective basis, the Government Finance Officers Association (GFOA) makes the following recommendations to state and local governments.

1. Governments should establish procedures that ensure that all parties responsible for making debt service payments fulfill their fiduciary and operational responsibilities. The negotiation of contract terms should serve the government, the trustee/fiscal agent/paying agent, and the bondholders and include:
   a. requirement for timely payment of all funds on the due date;
   b. full utilization of funds by the government until the due date;
   c. requirement for use of electronic fund transfer throughout the payment process; and
   d. requirement that all parties execute transactions in the most cost efficient and effective manner.
2. Issuers should ensure that appropriate contractual terms and internal procedures are in place. Issuers should negotiate terms allowing for full investment of funds by the government until the payment due date by utilizing electronic fund transfer.
3. Issuers should require that trustees/fiscal agents/paying agents invoice the government for debt service payments a minimum of 30 days prior to the due date.
4. Issuers should use electronic fund transfer to assure transfer to the trustee/fiscal agent/paying agent on the payment date. If payment must be made by check, issuers should ensure paying the check no more than five (5) days prior to the payment date through a guaranteed delivery service.
5. Issuers should ensure that all parties to the transaction (internal and external) are kept informed of the procedures established.

References

- Report of the Same-Day Funds Payment Task to the U.S. Working Committee, Clearance and Settlement Project, Group of Thirty, August 1993.

Approved by the GFOA's Executive Board on March 2, 2007.

BEST PRACTICE

Including Disclosures in Official Statements Related to Pension Funding Obligations (2012)

Background. Issuers of municipal securities, with the advice of legal counsel, financial advisors and other professionals, make numerous judgments as to what information should be included in an Official Statement (OS) for a public offering of state and local government debt. Materiality is the guiding principle as to the content and extent of the disclosure that is provided in the OS. Disclosure related to an issuer's pension funding obligations is just one type of information that should be included in an issuer's OS, and the pension obligation should be considered in the broader context of the issuer's resources. While disclosures about pension funding obligations will vary among issuers and types of bonds being issued, all issuers should be aware of the type of information that should be included in the OS, most of which already may be presented within other financial documents (e.g., the comprehensive annual financial report, CAFR). Additionally, the type of pension plan that is used by a government will dictate the amount of disclosure. For instance, those governments that participate in defined benefit (DB) pension plans likely will have more extensive disclosures than those participating in other pension plans, such as defined contribution (DC) plans.

To assist with the development of appropriate disclosures related to pension funding obligations for DB pension plans, the National Association of Bond Lawyers (NABL) issued guidance in May 2012 regarding the application of the federal securities laws to the disclosure of pension funding obligations for DB pension plans. NABL published this guidance following a process that included input from numerous experts in the fields of pensions and debt, including representatives of the Government Finance Officers Association (GFOA). While the guidance is aimed at assisting government issuers that sponsor or participate in DB plans, governments that sponsor hybrid and DC plans may also wish to review and consult the NABL guidance regarding disclosures that might be applicable and appropriate for their jurisdictions.

Of particular significance, the guidance offers the following recommendation regarding the preparation of pension disclosure for an OS:

"Official Statement disclosure is about the credit quality of the bonds being offered. Disclosure about an issuer's pension obligations that is included in the OS should reflect the degree to which such obligations could affect the issuer's ability to make bond payments to investors, or place pressures on the basic functions of government that would affect the creditworthiness of the bonds. This may depend, to varying degrees, on matters such as size of those obligations relative to the issuer's overall budget, the funding status of the pension plan, and identifiable trends and problems that are material to an investor. It will also depend on the degree to which the pension obligation payments and debt service payments are payable from the same source of revenue. The goal of this disclosure, as with all disclosure in an OS, is the appropriate level of information for the issuer's specific situation. Neither too much information nor too little information is helpful to the investor."

In many cases, the government's preparation of its pension disclosure for an OS will be straightforward and the information will already be present in the government's financial documents. However, there may be situations in which a government's pension funding obligations are significant and additional disclosures may become material.

Recommendation. The Government Finance Officers Association (GFOA) recommends that issuers implement appropriate procedures when determining the level of information that needs to be disclosed about their pension funding obligations relative to their financial

position. To help determine the appropriate level of disclosure about the government's pension funding obligations in the OS – including the possibility that more extensive disclosures may be material and may need to be included in the OS–issuers should address, along with the assistance of legal counsel and others on their financing team, the following questions:

1. Is the debt service on the proposed bond issue and the funding of the issuer's pension plan dependent on the same specifically identified revenue source or sources?
2. Is the current and future funding of the pension plan material in relation to the issuer's current and projected budgets?
3. Is the funding of pension obligations currently stressing the issuer's budget or "crowding out" other expenditures, or have the potential of doing so in the future?
4. Are there legal restrictions or requirements related to pension funding that reasonably might be considered placing pension funding senior to debt service payments?
5. Are there known and determinable trends or issues related to pension funding that may be considered material to investors?

If the answers to these questions indicate that pension funding could adversely affect the jurisdiction's ability to pay its debt service, more extensive disclosures may be required. In these instances, the GFOA recommends that issuers consult the NABL guidance, especially Appendix D, to determine what disclosures should be included in an OS. If necessary, sources for additional disclosures may include:

1. Statements and schedules in the issuers' CAFRs or audited financial reports such as financial statements, Required Supplementary Information (RSI), footnote disclosures, statistical tables or Management Discussion and Analysis (MD&A).
2. Pension information included in the issuer's adopted budget.
3. Other publicly available reports, including actuarial reports of the pension plan.
4. Relevant laws, statutes, regulations or other completed legislative actions that affect pension funding and obligations, or the pension plan itself.
5. Information from the pension plan related to specific plan investments and other policies and procedures that could be material to bondholders.

References.

- National Association of Bond Lawyers, *Considerations in Preparing Disclosure in Official Statements Regarding an Issuer's Pension Funding Obligations (Public Defined Benefit Pension Plans)*, http://www.nabl.org/uploads/cms/documents/pension_funding_obligations_document_5-18-12_b.pdf (2012)
- GFOA Advisory, Evaluating the Use of Pension Obligation Bonds, 2007.

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

BEST PRACTICE

Investment of Bond Proceeds (1996 and 2007) (DEBT and TIM)

Background. When governments issue bonds they deposit proceeds or other monies in various accounts, which may include a construction fund, debt service fund, capitalized interest fund, debt service reserve, or an escrow fund in a refunding. Monies allocated to these funds are invested until needed. The investment strategy for each fund will depend, in part, on federal or state statutes and regulations governing the types of instruments permitted to be used, the yield permitted for the fund, requirements from rating agencies and/or credit enhancement providers, and the anticipated drawdown of bond proceeds. Additionally, each of these funds will have different investment objectives, so there are many factors to be considered by the issuer when selecting an investment instrument.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local government issuers develop an understanding of the risks inherent in investing bond proceeds and incorporate steps in their investment strategy for each fund to minimize these risks. Three types of risk are: (1) credit risk *(safety),* the risk of investing in instruments that may default; (2) market risk *(liquidity),* the risk of selling an investment prior to maturity or at less than book value; and (3) opportunity risk *(yield/return)*, the risk of investing long term and having rates rise or investing short term and having rates fall.

Issuers should consider actions to mitigate these risks. These include establishing guidelines for permitted investments to reduce credit risk, developing good cash flow estimates to reduce market risk, and integrating knowledge of prevailing and expected future market conditions with cash flow requirements to reduce opportunity risk. As with investment decisions made with other public funds, the balance is weighted heavily towards avoiding risk; accordingly safety first, liquidity second, and yield third.

Provided that the maximum arbitrage yield can be earned, state and local government series securities (SLGS) are the preferred investment option rather than open market securities for escrows for refunding bonds. The benefits of SLGS include better matching of settlement dates and fewer arbitrage rebate issues for borrowers.

GFOA also recommends that governments develop specific policies and procedures for the investment of bond proceeds to ensure that legal and regulatory requirements are met, fair market value bids are received, and issuer objectives for various uses of proceeds are attained. Investment of bond proceeds should include an evaluation of investment alternatives including: (1) individual securities or portfolio of securities; (2) investment agreements; and (3) mutual or pooled investment funds, including money market funds. The following actions are recommended as part of the evaluation of investment alternatives:

1. A government should have an investment policy which is disclosed and summarized in the official statement that includes the investment of bond proceeds or describes other documents which outline the parameters for investment of bond proceeds.

2. The government should have procedures in place to ensure timely coordination of its debt management and investment activities.

3. The duties of the individual designated by the issuer to be responsible for the investment of bond proceeds (the “Investment Officer”) should be specified and include:

- Working with the financial advisor, bond counsel, and underwriter to determine how bond proceeds will be invested given expectations for the drawdown of proceeds, federal tax law requirements, or other concerns;
- Ensuring that fees paid to investment brokers are reasonable and are within federal guidelines;
- Regular and ongoing monitoring investment and custody of bond proceeds;
- Reinvestment of bond proceeds when necessary;
- Understanding federal tax law, particularly as it pertains to arbitrage restrictions; and
- Maintaining adequate records to comply with arbitrage rebate requirements.

4. The Investment Officer must ensure that investment decisions conform to all legal, statutory, and regulatory requirements, all requirements established by the trust indenture/fiscal agent agreement/bond resolution, and all requirements that might be imposed by rating agencies and/or credit enhancement providers, including:

   - Establishment of funds and accounts;
   - Designation of eligible investment instruments;
   - Purchase of investments at fair market price;
   - Permitted yields, such as those to comply with federal arbitrage requirements; and
   - Monitoring of arbitrage rebate liabilities and establishment of procedures to reserve liabilities for future remittance to IRS.

5. An issuer should require that underwriters and financial advisors report to them on any finder's fees or fee-sharing arrangements. In addition, the issuer should carefully evaluate any conflicts of interest that may arise from having underwriters or financial advisors who are involved in the sale of bonds also charged with the investment of bond proceeds. As a general matter, there should be no fee sharing or finder's fee arrangement. If in fact these arrangements occur, issuers should require that underwriters or financial advisors report this information to them in advance of any such arrangement.

6. An issuer should seek competitive bids and, where required, a minimum of three bids. Additionally, an issuer should require that all fees associated with investments be fully disclosed to ensure that investments are being purchased at a fair market price. Underwriters of the bonds or the financial advisor may bid to invest the proceeds, but issuers should be sure they are getting a fair market price on the investments. In many cases, the IRS requires three bids from parties not related to the transaction. Sufficient records should be maintained to document that investments were purchased at a fair market price.

7. Extreme care and due diligence should be taken to guarantee that the interests of the issuer are represented if outside professionals are used to solicit and evaluate bids. This is generally best accomplished through the use of competitive request for proposal processes to select the necessary outside financial professionals.

References

- "Making Arbitrage Rebate Calculations an Illustration," *Government Finance Review*, October 1991.
- *Guide to Arbitrage Requirements for Governmental Bond Issues* and *1994 Supplement*, Terry Burke, GFOA, 1992 and 1994.
- *ABC's of Arbitrage: Tax Rules for Investment of Bond Proceeds by Municipalities,* Frederic L. Ballard, Jr., American Bar Association, 2002.

Approved by the GFOA's Executive Board on March 2, 2007.

BEST PRACTICE

Issuer's Role in Selection of Underwriter's Counsel (1998 and 2009) (DEBT)

Background. Underwriter's counsel is employed to represent the underwriter in the offering of bonds. The duties of such counsel include drafting bond purchase agreements, and may include drafting official statements and coordinating disclosure documents. Such counsel also assists the underwriter in meeting its legal responsibilities generally in the issuance and sale of the bonds. While underwriter's counsel represents the underwriter, in some cases issuers have assumed a direct role in selecting or approving underwriter's counsel. Among the reasons cited by issuers for being involved in the selection or approval of underwriter's counsel are the issuer's (1) need for assurance that underwriter's counsel is qualified and experienced and will give the highest priority to the transaction, (2) need for assurance that underwriter's counsel understands the issuer's finances and operations, disclosure practices, and other pertinent information, and will help promote full and complete disclosure, (3) desire to control the costs of the underwriter's counsel, which are typically paid directly or indirectly by the issuer, (4) desire to avoid the use of firms where conflicts of interest or pending regulatory enforcement may exist, and (5) compliance with state and local legal or policy requirements.

Recommendation. The Government Finance Officers Association (GFOA) recommends that issuers minimize their involvement in the selection of underwriter's counsel. The GFOA believes that issuers have a legitimate but limited role in the engagement of underwriter's counsel. Specifically, the role of the issuer should be to ensure that underwriter's counsel is competent, has no conflicts of interest, and that costs are reasonable. GFOA recognizes that (1) the underwriter has a reasonable need to rely on such counsel's competence and confidential advice and (2) the potential for conflicts of interest exists if an issuer designates a firm to serve as underwriter's counsel. The issuer, to protect its interests, should have policies and procedures that will facilitate limited involvement, including any or all of the following:

The issuer may draw up a list of general criteria and qualifications to be used by the underwriter and other professionals in the selection of counsel.

Working with the underwriter, the issuer can prepare a list of acceptable firms and leave the final selection to the underwriter

The issuer may ask to review the qualifications of a firm proposed by the underwriter and provide feedback on the selection including retaining the ability to exercise a veto due to concerns relating to cost, qualifications, or conflicts of interest.

Firms should be evaluated based on:

- their general knowledge and experience with disclosure requirements,
- their understanding of and, if applicable, past performance with the issuer, expertise with the securities being offered,
- their ability to complete the transaction in an orderly manner, and
- the absence of any conflicts of interest that might jeopardize the ability of the firm to carry out its responsibilities.

Governmental issuers should also have a role in negotiating with the underwriter the cost of services performed by underwriter's counsel by reviewing the scope of legal services to be provided and obtaining a fixed, not-to-exceed, hourly rate, or other appropriate fee arrangement that takes into account the complexity of the transaction and the scope of counsel's work.

The underwriter bears the ultimate responsibility for the adequacy of its own counsel. Any undue influence by an issuer, however, that calls into question the qualifications or independence of underwriter's counsel may create risk to the issuer and to the underwriter because of the increased potential of inadequate disclosure in the offering of the issuer's bonds and a reduced ability of the issuer to claim reliance on the expertise of its financing team.

References

- *Conflicts Arising from Multiple Representation*, Henry A. Kelly, American Law Institute - American Bar Association, October 17, 1991.
- *A Guide for Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia A. Tigue, GFOA, 1997.
- "Model Engagement Letters," National Association of Bond Lawyers, 1998.
- "The Selection and Evaluation of Bond Counsel," National Association of Bond Lawyers, 1998.
- GFOA Best Practice, "Selecting Bond Counsel," 2008.
- GFOA Best Practice, "Selecting Underwriters for Negotiated Sale," 2008.
- GFOA Best Practice, "Selecting Financial Advisors," 2009.
- *Disclosure Roles of Counsel in State and Local Government Securities Offerings,* Section of Urban, State and Local Government Law, American Bar Association, 2009.

Approved by the GFOA's Executive Board, October, 2009.

BEST PRACTICE

Maintaining an Investor Relations Program (1996, 2003 and 2010)

Background. Investors are a primary source of capital for state and local governments. When a governmental entity sells debt, it enters into a long-term contract to make timely debt service payments to investors. Other stakeholders, such as bond insurers, liquidity providers, rating analysts, trustees, credit enhancers, counterparties, and constituents are interested in obtaining financial and operation information on issuers. An effective investor relations program that responds to the informational needs of these diverse groups **may** lower borrowing costs for issuers.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governmental bond issuers consider developing an investor relations program. The centerpiece of such a program is a commitment to provide full and comprehensive disclosure of annual financial, operating, and other significant information in a timely manner consistent with federal, state and local laws. Issuers may consider and are encouraged to provide additional information to investors beyond that provided for in their contractual commitments. An investor relations program should address the following:

1. Identify the individual(s) who is (are) responsible for speaking on behalf of the issuer. Establish steps to ensure that all external communication regarding disclosure is approved by this (these) person(s).

2. After giving consideration to the size and organizational structure of the entity, consider creating a "Disclosure Board" or other appropriate group, to establish the events to be disclosed and periodicity of disclosure items. Positions on the Disclosure Board may include: the debt manager, the chief financial officer, a representative of the legislative body, an administrative officer, the financial advisor, and bond counsel or issuer's counsel.

3. The Disclosure Board, or other appropriate group, should establish policies and procedures for the Investor Relations Program. Policies and procedures should be simple and clear, and should address:

    a) Identification and selection of information, both positive and negative, to be made available to investors, including material events, changes in financial or operating position, and changes in government policies. Documents that could be a source of such information include:
        - Annual budgets, financial plans or comprehensive annual financial reports,
        - Interim financial information that is sent to governing bodies for council or board meetings, and
        - Ordinances or resolutions adopted by a governing body.
    b) Identification of ways to stay abreast of issues that are likely to be of concern to investors, such as issuer policies and practices pertaining to investments, fund balance, and accounting practices.
    c) Identification and maintenance of a database of investors and analysts who review the purchase of the issuer's debt instruments.
    d) Use of CUSIP (Committee on Uniform Securities Identification Procedures) numbers.
    e) Identification of means of disseminating information. Consideration should be given to: the Electronic Municipal Market Access system (EMMA_, e-mail, websites, postal distribution, and investor meetings.
    f) Format of the document (e.g., .html or .pdf if electronically disseminated).
    g) Timing of a release of information with any sale of debt instruments, if necessary.

h) Responding to investor questions. Consideration should be given to means of communication to all investors when a single investor poses a question.
i) Ensuring the majority of investors have access to the information.
j) Ensuring that preliminary official statements are received one week in advance of a bond sale.
k) Maintaining a good relationship with the rating agencies and fund analysts including distribution of disclosure information and keeping them informed of any changes that could affect credit quality and actions to address financial problems.
l) Ensuring that financial statements or other information needed for disclosure purposes are completed on a consistent schedule from year-to-year and prior to the date established in any contractual commitments.
m) Engaging in marketing activities to alert investors of a pending bond sale, especially if the debt instruments are sold competitively. Such activities may include preparation of special reports for investors, the scheduling of investor meetings, conference calls, and webcasting of issuer conference calls and on-site visits.

4. Consideration should be given to the fact that any record created as a result of the Investor Relations Program may be subject to internal policies and/or federal, state and local laws concerning document retention and freedom of information.

The municipal marketplace is changing, and the need to provide additional information with greater frequency is significant. Issuers should maintain an awareness of changes in current practice in the area of investor relations. Investor Relations Programs that go beyond the legally mandated requirements of Securities and Exchange Commission (SEC) Rule 15c2-12 promote the efficient sale of debt instruments in both the primary and secondary markets and improve the reception of debt offerings. Expansive disclosure practices are encouraged, especially the availability of interim financial information between your annual filings.

References

- *Disclosure Handbook for Municipal Securitie*s, National Federation of Municipal Analysts, 1992.
- "Securities and Exchange Commission Enforcement Actions in the Municipal Securities Markets," *Government Finance Review*, August 1996.
- *Making Good Disclosure*, Robert Dean Pope, GFOA, 2001.
- GFOA Best Practice, "Using a Web Site for Disclosure," GFOA, 2002.
- GFOA Best Practice, Web Site Presentation of Official Financial Documents, 2009.
- GFOA Best Practice, "Understanding Your Continuing Disclosure Responsibilities, 2010.
- *Disclosure Roles of Counsel*, John McNally, Project Coordinator, ABA/National Association of Bond Lawyers, 2009.
- EMMA - http://emma.msrb.org/

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

BEST PRACTICE

Public-Private Partnerships for Economic Development (2008) (CEDCP and DEBT)

Background. The term “public-private partnership” (“partnership”) encompasses many different types of projects. Governments and government finance officers need to understand the different risks and rewards associated with various public-private partnership endeavors. Traditionally, the term “public-private partnership” has referred to private or public-private projects that involve the use of public resources or financing capabilities to promote local economic development. In those arrangements, the public entity is typically asked to provide some combination of tax incentives, public land or other assets, infrastructure investments or financing methods. In consideration of those public contributions, the private entity is asked to make capital investments, commit to provide jobs, contribute development expertise and assume financial risk. These “partnerships” (which typically are not partnerships legally) can have short life spans covering only the construction period for the project, or longer life spans covering debt repayment or long-term operating agreements.

The public-private partnership term has also been used to refer to transactions that are essentially privatization efforts, in which a state or local government enters into a long-term lease of a major asset (e.g., toll road, parking garage, airport, etc.) to a private-sector company and transfers the rights and responsibilities for the leased asset to the private company, or to transactions aimed at privatizing or outsourcing the provision of services that a governmental body had been providing directly. These transactions present a fundamentally different set of opportunities, risks and concerns for governmental participants than the traditional “partnerships” do. For the purpose of this Recommended Practice (RP), we are addressing only public-private partnerships (P3s) in the traditional sense, not privatization transactions. An example of the types of projects intended to be covered by this RP may be found in Exhibit A.

Within the types of “partnership” transactions covered by this RP, a broad range of risk exists for the governmental participants. At one end of the spectrum, the governmental participants may be serving only as an issue of conduit debt, enabling the private borrower to gain access to tax-exempt financing but with no promise to use any other public funds. At the other end of the spectrum, the governmental participant may be guaranteeing a private party’s debt or otherwise placing public funds directly at risk. The nature and extent of the governmental participant’s appropriate diligence will vary depending upon where in the spectrum a particular proposed “partnership” transaction fits. In addition, some transactions may necessitate utilizing the limited resource of private activity volume cap for tax-exempt financing, while others will not. For those that do, the governmental participant should have policies in place to assure compliance and to cause the governmental participant’s use of that resource to reflect its priorities and policies.

In “partnership” arrangements, the public and private parties have both complementary and conflicting objectives. Complementary objectives center on the ongoing success of the development, while conflicting objectives focus on levels of financial participation and risk. The public and private parties have two different perspectives. The public party’s perspective is towards stewardship of the public’s assets and other public benefits (job creation, tax base, elimination of blight), while the private party’s perspective is on return of investment. Both views must be accommodated for a viable development project.

For governmental participants, successful partnering requires an understanding of the transaction’s risks and benefits for both parties, sufficient knowledge of the private parties in order to assess their ability to fulfill their obligations, a fully negotiated development agreement, and agreed-upon methods to resolve future conflicts and

uncertainties. The government finance officer should play a central role in the government's involvement. He or she brings professional expertise in evaluating, structuring, and managing the government's involvement in a proposed public-private partnership and should lead the financial review of public-private partnership development agreements.

Recommendation. The Government Finance Officers Association (GFOA) recommends that finance officers achieve a full understanding of the available options when determining if a public-private partnership agreement is a viable and prudent transaction for their jurisdiction. This includes development of an internal policy that defines the government's criteria for making various contributions to or investments in "partnership" arrangements. Early in the process of analyzing a proposed "partnership" transaction, the finance officer should also assess the nature and extent of any outside consulting or financial analysis services that the governmental body requires for its analysis and negotiation of the transaction.

As noted in the Recommended Practice (RP), *The Role of the Finance Officer in Economic Development*, finance officers are encouraged to participate in and provide essential information to the "partnership" process. This includes developing the objectives for the partnership, analyzing financial aspects of proposed arrangements, making recommendations to elected officials, advising on procurement issues arising from the solicitation and engagement of non-governmental parties, and participating in the negotiation of the development agreement. The finance officer must also determine the total value of the public contribution (participating jurisdiction and others) in the agreement, including non-cash items, to make sure that the public's contributions to and investments in the project are justified and properly compensated. The finance officer must also be mindful of any direct or indirect increased, ongoing public operating costs that may result from the project.

The GFOA recommends that finance officers use the following list as a guide for preparing a comprehensive examination of issues that must be addressed before, during and after the project is determined to be viable and prudent. This list emphasizes that a great deal of due diligence must be completed prior to entering into a contract, since these decisions may have significant and long-lasting ramifications. Actions that should be taken, and issues for which procedures and policies should be in place, include:

1. researching private partners and their business and market;
2. researching the type of transactions being considered;
3. consulting with appropriate professionals about applicable federal and state tax laws;
4. understanding the rights and obligations of each party;
5. setting standards for public financial commitments;
6. evaluating and disclosing the financial and non-financial impacts of the proposals on the public entity; and
7. on-going monitoring of the agreement.

The finance officer involved in a "partnership" should ensure full disclosure and make recommendations that the government's participation in the venture does not bring excessive and unbalanced risk to the public. Preparing a comprehensive list of potential issues that may affect the government, and assuring that the government has sufficient in-house and outside expertise to evaluate these issues, will help to ensure that the P3 venture is beneficial to the public as well as the private partners.

References

- "Project Evaluation for Public Private Partnerships: Aligning Development with Strategic Goals in Virginia Beach," Patricia Phillips, Robert Scott, and Nancy Leavitt, *Government Finance Review,* GFOA, June 2004. http://www.gfoa.org/downloads/ProjectEvaluationforPublic-PrivatePartnerships.pdf.
- *An Elected Official's Guide: Economic Development,* GFOA, 2005.
- GFOA Best Practice, "Role of the Finance Officer in Economic Development," 2006.
- *Issue Brief: Privatization vs. Public Finance Partnerships: A Comparative Analysis*; California Debt and Investment Advisory Committee; August 2007.

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

EXAMPLES OF P3 PROGRAMS

- Land assembly programs, by negotiation or eminent domain
- Urban renewal programs
- Tax increment financing programs
- Tax (property, sales, income, etc.) abatement/rebate programs
- Industrial development revenue bond financing programs
- Note and bond financing programs, including full faith and credit bonds and revenue bonds, for land assembly, site preparation, public facilities or supporting public improvements and infrastructure
- HUD Section 108 loan programs
- Small Business Administration programs
- Economic development administration programs
- Foreign trade zone programs
- Community development block grant programs
- National and state tax credit programs, including New Markets Tax Credits
- Loans or grants to developers
- Public body guarantees of developer loans

TYPICAL P3 PROJECTS

- Development projects involving commercial facilities
- Parking facilities
- Hotels
- Convention centers
- Entertainment complexes
- Multiple redevelopments in various urban renewal projects
- Waterfront development and marina projects
- Port authority projects
- Housing projects
- Neighborhood development projects
- Manufacturing facilities
- Office buildings
- Industrial parks
- Warehouses
- Museum projects
- Theater districts
- Major and minor professional league sports stadium and arena complexes
- Airport improvements
- Pedestrian walkway systems

BEST PRACTICE

Role of the Finance Officer in Privatization (2009) (CEDCP and DEBT)

Background. Funding and maintaining infrastructure and critical services is a vital and recurring government function. The need to provide cost-effective options while maintaining expected levels of service can cause governments to search for alternative service delivery options. While not a guaranteed solution, privatization provides an alternative that, given the proper research and due diligence, may present governments with numerous advantages. Recent examples demonstrate the effectiveness as well as the concerns surrounding privatization initiatives. This recommended practice develops the role of the finance officer and presents a high-level framework for evaluating the policy decisions if a government decides to pursue a privatization initiative.

Within this recommended practice, privatization encompasses the long-term transfer or sale of public assets or asset management rights to a private entity in exchange for a range of government financial, liability transfer, and risk mitigation benefits. Privatization resulting in an outright sale is a permanent transaction where title transfers from the government to a private entity(s). This may consist of all or part of the entire government facilities/asset network. Outright sales may include potential reversionary provisions should the private entity fail to perform, particularly in the sale of core government functions.

As opposed to outright sale, privatization initiatives may also result in management contracts, in which a private entity(s) assumes day-to-day operational responsibility for financial compensation from the government counterparty. Other responsibilities may also include ongoing capital maintenance, repair, and replacement. Operational responsibilities such as staffing and customer service are normally subject to government quality standards and enforcement. In a lease or concession agreement, the private entity(s) assumes operational responsibility and certain incidence of ownership such as rate setting, service area expansion, capital financing (which, as with management contracts, is normally subject to government procedures), mandates, and other limits. In lease agreements, government may retain revenue sharing rights. At the termination of the agreements, all affected asset rights and responsibilities revert to the government entity.

Public institutions assume a fundamental role in developing and pursuing privatization. Included in this role are a number of factors that public institutions often follow. The government entity establishes the direction for the privatization initiative and participates in the due diligence process, which includes confirming or, as necessary, establishing required legal authority to implement the intended privatization approach. Moreover, the public entity defines and documents the government's objectives and major constraints in privatization. This includes identifying available alternatives and establishing a privatization approach that best achieves the stated privatization objectives. When pursing privatization, the government solicits proposals from qualified private entities, which may include a prequalification phase and should determine the feasibility of privatization proposals. This includes establishing a method for accepting a proposal and negotiating a privatization agreement. Following implementation of privatization, the due diligence process expects governments to closely monitor the performance of the private entity throughout the term of the agreement and enforce contract provisions. Effective management and monitoring of privatization includes continued communication and reporting with interested parties throughout the privatization process.

Recommendation. The Government Finance Officers Association (GFOA) recognizes the risks and rewards associated with privatization initiatives and recommends that finance officers play an active role in performing due diligence and facilitating privatization policy decisions. Finance officers should assume the following roles:

- **The Finance Officer should play a central, functional role in considering the feasibility of a long term Privatization.** Many if not most privatization initiatives are driven by a government's financial needs and constraints. As such, the finance officer is well positioned to function as the lead member of the government team exploring privatization. In the decision-making process and in implementation, the finance officer acts as steward to protect the long-term public interest associated with the asset. In the implementation stage, finance officers play a vital role in promoting adequate controls and standards of safety and maintenance. Recognizing that privatization agreements will involve not only public–private entity agreements, but also major intra-governmental financial decisions that include major, complex financial matters (use of privatization proceeds, public debt defeasance, accounting-financial reporting, etc.), the finance officer acts as an interpreter and communicator of financial results to elected officials and the general public.
- **The Finance Officer should lead the development of a process to evaluate and implement a potential privatization.** In leading this process, the finance officer helps establish a competent, experienced team to assist in the entire privatization undertaking. Once constituted, the team works to produce clear, documented objectives of the privatization at the outset along with measurable standards/criteria to gauge achievement of those objectives. This process should include a thorough feasibility analysis and, if justified, a broadly competitive and transparent solicitation of private entities to serve as privatization counterparty(s).
  The finance officer should assume primary responsibility in assessing the financial strength and viability of all bidders to the privatization agreement to evaluate their capacity. The assessment process needs to exhibit professional due diligence in establishing and applying the asset valuation methods used to support the privatization agreement. Within the evaluation process, the privatization agreement should include appropriate enforcement features to promote service quality and compliance with all standards and requirements. The finance officer also helps incorporate suitable accounting, auditing, and financial reporting requirements and standards in the privatization agreement.
- **The Finance Officer should provide options and policy recommendations for the prudent, sustainable application and use of all financial benefits expected as a result of the privatization agreement.** This policy should be in effect prior to the receipt of any funds by the government. The finance officer should help establish a plan for the funds BEFORE the funds are received**.** This includes the disposition and use of government cash proceeds at the beginning of deal. The finance officer should establish a dialogue on how to apply that cash, including the creation of an "endowment" or permanent reserve. This dialogue helps facilitate the decision-making process and determines how financial benefits will be applied. This consideration arises from the potential danger that government will raise service levels or lower taxes in the short term rather than look at the long term. As a result, the finance officer helps establish policies for how to apply this money (e.g., to reduce or eliminate one-time unfunded liabilities instead of taking for short-term benefit).

  During negotiations, the finance officer should keep the CEO and other local elected officials apprised to help these decision-makers fully understand the type and nature of the give and take occurring. This helps to ensure that priorities are laid out in advance to prevent the legislative body from making ill-informed decisions.

  The finance officer helps ensure good stewardship of the proceeds by properly structuring the on-going management of such upfront proceeds. For example, creating a permanent endowment capitalized by the proceeds and establishing a professional board of trustees functioning as a fiduciary for the endowment institutionalizes a permanent public asset. Coupled with the use of a professional advisor and fund managers, this structure would promote long-term return and safety of principal.

References

- GFOA Best Practice, "Managed Competition as a Service Delivery Option," 2006.
- "Alternative Service Delivery," The Civic Federation, December 2006.
- *An Elected Official's Guide Competitive Options: From Managed Competition to Privatization*, GFOA, 2008.
- GFOA Best Practice, "Public-Private Partnerships for Economic Development," 2008.

Approved by the GFOA's Executive Board, February 27, 2009.

BEST PRACTICE

Tax Increment Financing as a Fiscal Tool (2006) (DEBT and CEDCP)

Background. Tax Increment Financing (TIF) has become an important tool for local governments to attract economic development projects, create jobs, foster infrastructure investment and redevelop blighted areas. TIF is a technique for financing a qualifying capital project, or its related infrastructure, from a stream of revenue generated within the geographic area defined as a TIF district. Primary governments with taxing powers often utilize TIF Districts, but redevelopment agencies may also be party to a TIF project. When a redevelopment agency utilizes TIF, the agency will share in property or other taxes imposed by other taxing entities. TIF districts are currently used in more than 40 states. TIF districts generally rely upon incremental property taxes generated in a specific area, but can also apply to other taxes, including sales taxes. TIF's can include a number of different concepts including tax increment districts, urban renewal districts, general improvement districts, special improvement districts, metro districts, and utility districts. The basic principles outlined herein are applicable to any type of TIF.

Most states have established laws and eligibility requirements to designate an area as a TIF district (i.e., blight, dilapidation or deterioration, age of structures, etc). Once an area is legally designated as a TIF district, the amount of the base valuation is "frozen."[1] Improvements to vacant or dilapidated properties within the boundaries of the TIF then generate additional real estate valuation or "increment", which is captured through augmented property taxes and expended solely within the TIF district.[2] This increment can serve as a source of revenue to pay debt service, up-front development costs, or for individual projects on a "pay-as-you-go" basis. The maximum period of time a TIF may exist is determined by state law; generally speaking, legislation allows time for development efforts and a traditional 20-year financing period.

Recommendation. The Government Finance Officers Association (GFOA) recommends that local governments evaluate whether tax increment financing districts may assist the local government in its economic development plans. A TIF policy should be adopted by the local governing body that includes statements regarding when a TIF district is appropriate, including its relationship to an overall development/redevelopment plan. The policy may be based only on enabling statutes, but should provide flexibility for the local governing body. The policy should also address the following steps to evaluate whether a TIF district should be created.

- Management should identify the blighted area or area identified for potential development or redevelopment to determine whether a proposed district meets the criteria under applicable state law and the priorities established by the governing body. TIF districts may vary in size, depending on the applicable state laws and local government objectives.

- Feasibility studies, which include an evaluation and review to determine whether redevelopment could take place within an acceptable timeframe, without economic assistance from the local government (e.g. "but for" the TIF assistance, the development would not be possible). The feasibility studies should also include an evaluation of debt limits, impact on taxing entity's credit ratings, ability to meet the proposed

[1] Depending on state and local laws and regulations, the method of determining the base valuation of real estate tax revenue varies. Each jurisdiction should clearly define the methodology for determining the base prior to formation of a TIF.
[2] Generally, TIFs apply to the capture of the frozen base real estate valuation, but similar methodology can be utilized with other taxes generated within the TIF, such as sales tax revenue.

TIF plan objectives and ability to mitigate potential risks to local agencies, including the inability to repay debt in the event of revenue declines.

- The economic benefit to the local economy, the fiscal impacts to the affected government(s), and overlapping tax entities, such as school districts, and the economic cost of TIF district incentives should be analyzed and subjected to various sensitivity analyses.

- An evaluation should be performed on the risk to the general government operations[3] when the TIF related revenue growth is no longer available, including an evaluation of the total impact of all TIF districts to the tax base.

- The risk sharing between local government and the private developer(s) for the TIF project should be documented in a development agreement that clearly states each party's responsibilities.

- An alternative analysis should be prepared to evaluate pay as you go financing and/or debt financing options that the TIF district would support.

If management believes a TIF district is warranted, the following should be done, in addition to compliance with state and local laws:

- A thorough development or redevelopment plan should be prepared with project(s) identified and an estimate of the incremental increase in real estate valuation created by the proposed projects.

- Public input should be obtained on the TIF plan and adjustments made accordingly, including public hearings if required or desired.

- Appropriate approval should be obtained from the legislative/governing body.

- Periodic review of the TIF district should be undertaken to determine if the TIF plan is functioning as intended. This periodic review should include performance measures of actual performance as compared to projected performance. Measurements could include items such as, actual versus projected tax base, jobs created, and the potential impact of shifting economic development from non-TIF areas to TIF areas.

- Steps should be taken to ensure that the TIF would not adversely affect the operations of other taxing entities.

- If TIF bonds are issued, special provisions for coverage, feasibility studies and other legal requirements should be evaluated. In addition, the related debt service structure should be based upon the availability of TIF district revenues or other monetary sources. Consideration should also be given to the use of additional credit support by the local government.

- If tax-increment supported debt is considered to fund projects at the inception of the TIF district, revenue volatility should also be estimated. Conservative assumptions should be used, and reserve funds established, when establishing a debt service structure to protect against future shortfalls. This will allow for the projects to be developed, become operational, and provide sufficient time for the required increment to come on line to pay debt service.

---

[3] General Government operations include those core services performed by the local agency forming TIF, such as public safety, sanitation, recreation and library services.

References

- "Recommended Practices for State and Local Governments," Economic Development Incentives, 1990.
- "Urban Revitalization and Tax Increment Financing in Chicago," by Healey and McCormick, *Government Finance Review*, Dec, 1999.
- "Tax allocation/Tax Increment Bond Financing Guidelines," Fitch, October 16, 2000.
- *Elected Official's Guide to Tax Increment Financings*, GFOA, 2005.

Approved by the GFOA's Executive Board, February 24, 2006.

BEST PRACTICE

Using a Web site for Disclosure (2002 and 2010)

Background. Technology significantly impacts the way in which information is communicated and, in some cases, has fundamentally changed the way business is conducted. Utilizing technology allows governments to be more efficient and effective in communicating with municipal market participants. Many governments are using their Web sites to provide disclosure information electronically. Preliminary Official Statements (POS), audited financial statements, feasibility reports and other related documents have been made available electronically in connection with bond sales. Continuing disclosure filings and other important financial and budgetary information have been provided on governments' Web sites. Issuer Web sites have also been used in addition to, or in lieu of, traditional press releases to communicate important events. Investors and analysts have applauded the use of Web sites for disclosure. The use of Web sites to disseminate information electronically is the wave of the future and has been embraced by the Securities and Exchange Commission (SEC) as promoting transparency, liquidity and efficiency in the credit markets. As delivery of electronic information gains momentum, the need for guidance to governments on how to prudently incorporate web-based disclosure into their normal business practices becomes ever more important.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments and bond issuers use their Web sites to disseminate information to the municipal securities market regarding their debt, financial condition and other related information. The Internet, in general, and issuers' Web sites, in particular, provide a powerful tool for communicating with, and disclosing information to, credit analysts, investors, underwriters and other municipal market participants. By using a Web site, governments can augment other means of communicating with the municipal market. Web sites can be an integral part of an effective investor relations program, (see "Debt Management Recommended Practices - Maintaining an Investor Relations Program" 1996). A Web site can be used to make POS and other documents used in connection with bond sales available electronically. A Web site can also be used to provide ongoing financial information to the market, in addition to an entity's annual filings that are required under SEC Rule 15c2-12. Lastly, the Web site can be used to archive or store historical documents such as audited financial statements, Comprehensive Annual Financial Reports (CAFRs), continuing disclosure filings and Official Statements (OS) so that they are available to investors for reference purposes.

In order to assist investors and the public with finding your financial and disclosure information on your web site, issuers are encouraged to make a voluntary submission to the EMMA (Electronic Municipal Market Access) system with a hyper-link to the specific pages on your web site that contains this information.

Making disclosure information more accessible will help improve the efficiency of the municipal market and can possibly lower borrowing costs by improving the liquidity of an issuer's bonds. Other advantages to issuers in using their Web site for disseminating disclosure information include:

1. Web sites provide the simultaneous release of disclosure information to the entire market, thus avoiding inappropriate preferential treatment of investors.
2. Issuers control the content and timing of the release of Web site information which assures the accuracy and completeness of information not available when depending on the media for reporting.
3. Web sites provide an efficient, low-cost medium for communicating timely information to investors.
4. The most current information available can be provided to the market and updated as circumstances warrant.

5. Web sites can be used in addition to or, depending on the circumstances, in lieu of, press releases to notify investors of significant events.
6. Web site disclosure can both accelerate and broaden the distribution of timely disclosure information to the market.
7. Web site disclosure can enhance an issuer's reputation in the credit markets and strengthen investor confidence in an issuer.
8. The consistent and ready availability of complete and timely disclosure information can facilitate secondary market liquidity of an issuer's bonds by making them more attractive to investors.
9. Web site disclosure reduces investor inquiries and satisfies investor requests for more accessible and less costly disclosure information.
10. A government should consider posting interim unaudited and/or operating financial information that otherwise routinely prepared by your entity, to help investors and the public understand the finances of your government between annual filings.

However, there are certain burdens associated with providing disclosure information electronically which issuers should evaluate, such as the administrative time, effort and expense necessary to design, deploy and maintain a Web site used for disclosure. In cases in which an government's Web site has been developed for other purposes, a portion of it can be dedicated to information specifically designed for investors with very little or no additional cost. In any case, issuers should evaluate the costs and benefits of using their Web site for disclosure based on their own unique circumstances.

If a Web site is used for disclosure purposes, the government should consider the following in designing, deploying and monitoring the part of their Web site used for disclosure:

1. Terms of use should be included on the Web site so that, prior to accessing the information users are aware of or preferably required to acknowledge limits on how the Web site may be used and what obligations an issuer is undertaking by making disclosure available on its Web site (e.g., the information does not constitute an offer to sell bonds, the historical information speaks as of its date and the issuer has no express or implied obligation to continuously update information).
2. Information solely intended for investors should be segregated from other information and clearly identified as being intended for investors.
3. A formal process for reviewing and approving any information posted on the Web site should be required to ensure the accuracy, consistency and completeness of the information. Statements indicating the most recent date that a web page has been updated should be posted.
4. Care should be taken in the design, organization and selection of information to be included on a Web site to maximize its usefulness to investors.
5. Outdated reports and other stale information (such as prior year's CAFRs or audited financial statements and final Official Statements) should be clearly identified as dated information for historical reference only. Historical or outdated information should be segregated from current information. A "Library" or "Archive" section of the Web site for such information is advisable.
6. Issuers should be familiar with the SEC's Interpretive Release on Use of Electronic Media" or have the any information that is posted on a government's web site or the portion of its Web site dedicated to investors reviewed by counsel (see www.sec.gov/rules/interp/34-42728.htm).
7. If a government chooses to post unaudited interim financial information, it must be clearly described as such on the document, and a government may wish to include additional disclaimer language regarding unaudited information.
8. The security of an issuer's Web site should be evaluated to protect it from manipulation by external or unauthorized persons.
9. Issuers should design a system of internal controls to ensure the accuracy, completeness, consistency and freshness of information posted on the Web site.
10. Issuers should not use hyperlinks to other Web sites in their POS and OS because an issuer may be responsible for the accuracy and completeness of the information on the hyperlinked Web sites. If other hyperlinks are included on a Web site, a pop-up screen warning should be used to notify investors they are leaving an issuers' Web site.

11. Issuers should evaluate which products/technology are best suited for the disclosure of information using electronic media.
12. Documents on the Web site used in connection with a sale of bonds (e.g., POSs, audited financial statements and feasibility reports) should be an exact replica of printed versions of the documents. In addition, information on an issuer's Web site intended for use in a bond sale should be segregated from other information.
13. Issuers should consider the need to involve other departments and professionals to ensure that all necessary parties are involved in developing and deploying disclosure information on the Web site.
14. Issuers should consider ease of use and accessibility in designing a Web site for investors and be specific when referencing or addressing a specific place on the issuer's Web site intended for investors. Issuers should also include a contact person to answer questions or provide users with assistance and consider using CUSIP numbers and the required copyright acknowledgment to assist investors in identifying information related to specific bonds.
15. Issuers should post their continuing disclosure filings on their disclosure Web site. However, they should realize that posting their continuing disclosure on the Web site will not satisfy their obligation to file continuing disclosure documents with EMMA. Issuers that choose not to post their continuing disclosure filings on their Web site should consider the efficacy of providing continuing disclosure filings electronically through private sector vendors.
16. It is appropriate for issuers to evaluate the possibility of increased exposure to liability under the securities laws when evaluating the cost/benefit of using a Web site for disclosure However it should not be given undue weight by a government in determining its best practices.

References

- Interpretive Release on Use of Electronic Media, Securities and Exchange Commission, Release No. 34-42728, April 30, 2000.
- "Making Good Disclosure - The Role and Responsibilities of State and Local Officials under Federal Securities Laws," Robert Dean Pope, GFOA, 2000.
- "Providing Information to the Secondary Market Regarding Municipal Securities," National Association of Bond Lawyers, September 20, 2000.
- "Disclosure for General Obligation and Tax-Supported Debt," National Federation of Municipal Analysts, December 2001.
- GFOA Best Practice, Web Site Presentation of Official Financial Documents, 2009.
- *Disclosure Roles of Counsel*, John McNally, Project Coordinator, ABA/National Association of Bond Lawyers, 2009.
- GFOA Best Practice, Understanding Your Continuing Disclosure Responsibilities, 2010.
- GFOA Best Practice, "Maintaining an Investor Relations Program," GFOA, 2010
- EMMA: http://emma.msrb.org/

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

BEST PRACTICE

Web Site Presentation of Official Financial Documents (2009) (ALL)

Background. The Government Finance Officers Association (GFOA) has long encouraged governments to demonstrate accountability and transparency by making financial information of the highest quality readily accessible to citizens and other interested parties. A government's web site is especially well suited for this purpose. Benefits of using the government's web site to communicate financial information include:

- ***Heightened awareness***. Many potential users of a government's financial information may only discover that it is available because they find it on the web site.
- ***Universal accessibility***. Information furnished on a web site is readily available to a wide range of potential users (e.g., citizens, rating agencies, regulatory agencies, other governments, and the press) without charge.
- ***Increased potential for interaction with users.*** A web site can offer two-way, multi-conversational, or interactive formats. This capacity may be especially helpful for proposed documents or for citizen surveys.
- ***Enhanced diversity.*** A web site may offer the possibility of providing the same financial information in a variety of languages, which may be needed pursuant to the policies of a particular governmental entity.
- ***Facilitated analysis.*** Computerized tools can be used to find, extract, and analyze data presented in electronic form.
- ***Increased efficiency.*** Presenting all financial information in a single location can help to avoid calls for redundant specialized reports (e.g., reproducing data already presented in the comprehensive annual financial report or the budget document).
- ***Lowered costs.*** Electronic publication can be accomplished relatively quickly and can reduce or eliminate many of the costs associated with producing a hardcopy report, including those associated with handling and mailing the reports.
- ***Contribution to sustainability.*** Using a web site to disseminate financial information may reduce paper consumption, thereby contributing to the core value of sustainability.
- ***Broadened potential scope.*** The use of hyperlinks allows for easy referencing of relevant information from other sites.

While posting financial documents on a web site is a tremendous resource to citizens and an important investor relations tool, governments should be reminded that it does not meet the continuing disclosure responsibilities for issuers of municipal debt set forth in Securities and Exchange Commission Rule 15c2-12.[1]

Recommendation. The GFOA encourages every government to use its web site as a primary means of communicating financial information to citizens and other interested parties. Furthermore, the GFOA recommends that a government comply with the following guidelines when presenting official financial documents on its web site:

Formatting. The practical usefulness of a document is enhanced when a government observes the following formatting conventions:

- **Consistency with hardcopy version (if any)**. If a document is issued in hardcopy form, the web site version should be identical.[2] Any subsequent changes should be made to both.

---

[1] Governments with public debt outstanding are urged to consult GFOA's recommended practice *Using a Web Site for Disclosure*. Issuers of public debt also should familiarize themselves with SEC's Interpretive Release on the "Use of Electronic Media" (see www.sec.gov/rules/interp/34-42728.htm).

- **Legibility**. Font size, page layout (i.e., portrait versus landscape), and direction should be consistent throughout the report.
- **Pagination**. Pages should be numbered sequentially.
- **File size**. A single electronic file should be presented for the entire document. Individual files for the various components of large reports might also be presented in view of the limitations that some users face when attempting to download or receive large files. In such situations, the number of individual files should not be so great as to make it difficult to review the material or relate the various sections to one another.

Technological Infrastructure. A number of issues related to a government's technological infrastructure should be considered when presenting financial documents on the government's web site:

- **Security**. The security of the web site should be evaluated and all reasonable steps should be taken to protect documents from unauthorized changes.
- **Placement**. A link to the document should appear prominently on the homepage or there should be some other tool for easily locating the document (e.g., internal search tool).
- **Software compatibility**. The software used should be suitable for the particular information being presented and be broadly compatible with other commonly used software.
- **Features**. The downloaded file should allow for basic features such as zooming and continuous page format (e.g., so rows on financial schedules can be viewed on facing pages). A search mechanism should also be available within the document.
- **Instructions**. General user instructions (e.g., how to download Adobe software) should be provided. A notation also may be needed to direct the user on how best to view the document (e.g., laptop or desktop computer versus a handheld device).
- **Linking**. The table of contents should allow the user to go to specific pages with a click of the mouse. The inclusion of bookmarks also can enhance flexibility and maneuverability in navigating the document.
- **Testing**. Web site-based financial documents should be tested to ensure that they will function with different computer operating systems.

Electronic financial reporting language. Governments should monitor developments in standardized electronic financial reporting (e.g., extensible business reporting language [XBRL]) and apply that language to their electronic document process when appropriate.

Distribution. Electronic publication can also help the government meet the objective of providing financial information on a timely basis. Once published electronically, potential users should be informed that financial documents are available at the web site. Local newspapers, cable television, council meetings, mailings, and the printed document itself (if prepared) can be used for this purpose. For users without access to the Internet, other electronic media (e.g., CDs or flash drives) should be made available at locations such as local libraries or the city hall. Before electronic publication, the government should consult with their counsel to ensure that any legal issues related to the distribution of the financial information have been appropriately addressed, including compliance with all applicable provincial, state and federal laws and regulations (e.g., American Disabilities Act).

Information disclaimer. If applicable, the web site should prominently notify users that the information in the financial document has not been updated for developments subsequent to its issuance.

Historical information. If a government elects to present documents of prior years, the web site should identify those documents as "dated information for historical reference only" and clearly segregate them from current information. A "library" or "archive" section of the web site is advisable for this purpose.

---

[2] However, slight variations that may be necessary for practical reasons to prepare the hardcopy information for publication as an electronic document are acceptable. In cases where there is some type of auditor association with a document, it can be helpful to reach an upfront agreement with the auditor on the nature of the revisions that are acceptable in the preparation of the electronic document.

References.

- GFOA Best Practices
  Improving the Timeliness of Financial Reports (2008)
  Using a Web Site for Disclosure (2002)
  Sustainability (2002)
- *Extensible Business Reporting Language (XBRL) web site,* http://www.xbrl.org/Home/

Approved by the GFOA's Executive Board, February 27, 2009.

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.

Auditor Association with Financial Statements Included in Offering Statements or Posted on Web sites (2005 and 2006) (CAAFR & DEBT)

Background. The Government Finance Officers Association (GFOA) has long been on record encouraging state and local governments to obtain an annual independent audit of their financial statements.[1] Governments desiring to issue debt often include these audited financial statements in their offering statement. Likewise, GFOA encourages every state and local government to make its comprehensive annual financial report, including the audited financial statements, available on its website.[2]

It has not always been clear to all parties concerned what the independent auditor's role should be, if any, when previously audited financial statements are subsequently included in an offering statement. Likewise, some auditors have been reluctant to see financial statements they have audited presented on a website that contains unaudited information.

Under auditing standards generally accepted in the United States of America, the independent auditor is presumed *not* to be associated with financial statements included in an offering statement.[3] Still, an "association" may be created between the independent auditor and the offering statement if the auditor takes one of several actions specified in the auditing standards.[4] For example, some audit firms, as a matter of policy, insert a provision in the audit contract that requires the auditor's prior approval before audited financial statements can be reproduced in an offering statement.

Even when the independent auditor is deemed to be "associated" with an offering statement, the auditor has no obligation to perform any procedures to corroborate unaudited information contained in the offering statement. Rather, the auditor is required only to read any unaudited information contained in the document and consider whether that information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements in accordance with Statement of Auditing

---

[1] GFOA recommended practice on *Governmental Accounting, Auditing, and Financial Reporting* (1983, updated 1997).
[2] GFOA recommended practice on *Using Website to Improve Access to Budget Documents and Financial Reports* (2003).
[3] The American Institute of Certified Public Accountants' (AICPA) audit and accounting guide *State and Local Governments*, 16.06, states that "Because there is no Securities and Exchange Commission (SEC) requirement for auditor association with governmental official statements, an auditor generally is not required to participate in, or undertake any procedures with respect to, a government's official statement."
[4] Those actions are 1) assisting in preparing the financial information included in the official statement, 2) reviewing a draft of the official statement at the government's request, 3) manually signing the independent auditor's report included in the official statement, 4) providing a revised independent auditor's report for inclusion in a specific official statement, 5) issuing a comfort letter, the letter described in SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties*, as amended, or an attestation engagement report in lieu of a comfort or similar letter on information included in the official statement , 6) providing written agreement for the use of the independent auditor's report in the official statement, 7) issuing a report on an attestation engagement relating to the debt offering. (AICPA, *State and Local Governments*, 16.06).

Standards No. 8, *Other Information in Documents Containing Audited Financial Statements*.[5] In the case of audited financial statements appearing on a website, the auditing standards are quite clear that the independent auditor is *not* responsible for other information contained on a website.[6]

Recommendation. The Government Finance Officers Association (GFOA) makes the following recommendations regarding auditor association with audited financial statements included in offering statements and auditor association with audited financial statements posted on a government's website:

1) Having paid for the independent audit, a government owns the audited financial statements and should feel free to use them in any appropriate manner.

GFOA believes that state or local governments, as a general rule, should be free to publish their audited financial statements (including the report of the independent auditor) as they see fit (e.g., incorporated into an offering statement, posted on the government's web site), *without having to obtain prior permission from the auditor*, provided that all of the following conditions have been met:

- The independent auditor's report accompanies the same complete set of financial statements for which an opinion was rendered;
- The financial statements are not used in a potentially misleading manner; and
- No material subsequent event has occurred that might render the financial statements potentially misleading.

2) The independent auditor should not be permitted to create an essentially artificial "association" with audited financial statements included in offering statements or posted on the government's website simply by inserting a clause to that effect in the audit contract

Auditing standards generally accepted in the United States of America do *not* require state and local governments to accept a clause in their audit contract requiring prior permission from the independent auditor before the audited financial statements may be included in an offering statement or posted on the government's web site. GFOA urges state and local governments to resist the inclusion of such a clause in their audit contract. Instead, GFOA encourages governments to include language in their audit contracts that explicitly recognizes the government's ongoing right to use the audited financial statements without first seeking the auditor's permission.[7] GFOA does not object, however, to including a clause in the audit contract that would require that any offering

[5] AICPA, *State and Local Governments*, 16.06.
[6] AICPA, *Professional Standards*, AU Section 9550.4.16-17): **Question**—An entity may make information available in public computer networks, such as the World Wide Web area of the Internet, an electronic bulletin board, the Securities and Exchange Commission's EDGAR system, or similar electronic venues (hereinafter, "electronic sites"). Information in electronic sites may include annual reports to shareholders, financial statements and other financial information, as well as press releases, product information and promotional material. When audited financial statements and the independent auditor's report thereon are included in an electronic site, what is the auditor's responsibility with respect to other information included in the electronic site? **Interpretation**—Electronic sites are a means of distributing information and are not "documents," as that term is used in section 550, *Other Information in Documents Containing Audited Financial Statements*. Thus, auditors are not required by section 550 to read information contained in electronic sites, or to consider the consistency of other information (as that term is used in section 550) in electronic sites with the original documents.

[7] For example, "Use of or Reference to Audited Financial Statements. When delivered to the [name of government], the audit reports and financial statements produced under this contract are public records and will be used (a) to fulfill the requirements of continuing disclosure under SEC rule 15c2-12, (b) as inserts or incorporated by reference in offering documents issued by the [name of government], and (c) for any lawful purpose of the [name of government], all without subsequent consent."

statements with which the auditor is *not* associated include specific language to that effect.[8] Likewise, GFOA has no objection to the independent auditor inserting similar appropriate clarifying language in the engagement letter.[9]

3) When the independent auditor actually does happen to become associated with audited financial statements included in an offering statement, a state or local government should take steps to avoid unwarranted delays and unjustified costs.

GFOA recommends that state and local governments and their independent auditors reach a clear understanding during the audit contracting process, from the preparation of the request for proposals for audit services through the final audit contract, regarding the potential for auditor "association" with future offering statements. The two key elements of that understanding should be as follows:

- A maximum time should be set during which the independent auditor would be required to read the unaudited material accompanying the audited financial statements and
- Because the amount of additional work required of the independent auditor would be minimal (i.e., simply reading the material that accompanies the audited financial statements), no additional fee should be required.

4) The audit contract should clarify that the government is free to post its audited financial statements on its website.

GFOA recommends that the audit contract make clear that the government is free to post its audited financial statements on its website without seeking or obtaining permission from the audit firm.

Approved by the GFOA's Executive Board, February 24, 2006.

---

[8] For example, "(Name of firm), our independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. (Name of firm) also has not performed any procedures relating to this official statement." (*State and Local Governments*, AICPA, Chapter 16.11).

[9] For example: "If you decide to include, publish or otherwise reproduce the financial statements and our report thereon at a date subsequent to their original issuance, such as for inclusion in a bond offering, prospectus or similar document, our firm is presumed not to be associated with such document, and we have no obligation to perform any procedures with respect to such document. If, however, management takes certain actions, such as requesting a written consent form us prior to including our audit report in such an offering document, our firm then becomes associated with the offering and in accordance with professional standards, we will be required to perform certain limited procedures with respect to unaudited information contained in the document. Fees for reissuance or inclusion of our audit report in such a document will be based on our standard hourly rates."

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.

Evaluating the Sale and Securitization of Property Tax Liens (1997) (DEBT)

Background. Governments sell or securitize property tax liens to eliminate backlogs of accumulated delinquent tax receivables and convert those receivables into cash. Tax liens, which are attached to properties for nonpayment of property taxes or other assessments, may be bundled and sold directly to investors through a bulk-sale process. They also may be sold to a trust, where the payment stream is securitized. Bonds backed by the delinquent taxes are then sold to investors and the proceeds of the issue are paid to the government that sold the tax liens.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments contemplating the sale or securitization of property tax liens undertake a careful analysis of benefits and risks both in the current fiscal year and over the long-term. When evaluating the sale or securitization of tax liens, governments should:

1. Ensure they have legal authorization to enter into these types of transactions and understand any conditions or limitations imposed by state or local law.
2. Be clear about the public policy objectives to be achieved, such as improving collections or avoiding costs associated with the ownership of the property on which taxes are owed.
3. Evaluate whether changes in the collection process could reduce the occurrence of delinquencies.
4. Use sale proceeds for non-recurring purposes, particularly if the amount of the sale or securitization is large. Governments using a tax lien sale or securitization as a one-time mechanism to address a current year budget gap should assess the short- and long-term implications for the government's credit quality. They also should consider how gaps will be closed in later years and whether structural budgetary balance is able to be achieved without future tax lien sales or securitizations.
5. Determine that the net return after taking account of transaction costs is acceptable in terms of alternative approaches, including retaining ownership of uncollected receivables.

Once a decision has been made to sell or securitize tax liens, governments should:

6. Examine the lien pool carefully to ensure properties will be acceptable to investors. Lien-to-value ratios of various classes of property, the age of the liens, historical redemption rates in the community, property types, and the number of environmentally impacted properties are among the factors that should be considered.
7. Review statutory cure periods established to permit owners to pay delinquent revenues to ensure that an appropriate balance is struck between government policy objectives and acceptability to investors.
8. Select legal and financial advisors and other service providers with demonstrated experience with these transactions.

9. Select a servicer with a proven track record if such a firm is being used to collect delinquent taxes. Rating agency approval of the servicer is typically required, and will be based, in part, on the record of the servicer. Among the qualifications that should be evaluated are:
   - knowledge of state and local law;
   - due diligence capabilities in the lien selection process;
   - adequacy of the servicing system, including recording, auditing, and financial reporting procedures; and
   - historical performance in servicing liens, including procedures for workouts and foreclosures.
10. Recognize the community relations impact of establishing a private collection mechanism. Governments should take steps to maintain good relations among all affected parties, such as designating an ombudsman or instituting a formal complaint process through which problems that may arise are addressed.

References

- "Tax Lien Securitization: Putting Non-Performing Assets to Work," *Government Finance Review*, GFOA, June 1996.
- "Municipalities Turn to Property Tax Lien Sales," *Standard & Poor's CreditWeek Municipal*, March 25, 1996.

Approved by the GFOA's Executive Board, 1997.

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.

Evaluating the Use of Pension Obligation Bonds (1997 and 2005) (DEBT & CORBA)

Background. An unfunded actuarial accrued liability (UAAL) for pension benefits generally represents the difference between the present value of all benefits estimated to be payable to plan members as a result of their service through the valuation date and the actuarial value of plan assets available to pay those benefits. This amount changes over time as a result of changes in accrued benefits, pay levels, rates of return on investments, changes in actuarial assumptions, and changes in the demographics of the employee base.

State and local governments normally reduce their unfunded actuarial pension liability over time as part of their annual required pension contribution. Some governments, however, have elected to issue pension obligation bonds to reduce their unfunded actuarial liability as a part of the overall strategy for managing its pension costs. Governments should also realize that, while the UAAL may initially be fully funded, actuarial experience may result in over or under funding over time. Policies should be developed to manage potential over or under funding, regardless of the issuance of POBs.

Pension obligation bonds must be issued on a taxable basis because current federal tax law restricts the investment of the proceeds of tax-exempt bonds in higher-yielding taxable securities. From a purely financial perspective, issuing pension obligation bonds can produce savings for a government if the interest rate paid on the bonds is less than the rate of return earned on proceeds placed in the pension plan. However, governments issuing pension obligation bonds must be aware of the risks involved with these instruments and have the ability to manage these risks.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments use caution when issuing pension obligation bonds. If a government chooses to issue pension obligation bonds, they should ensure they are legally authorized to issue these bonds and that other legal or statutory requirements governing the pension fund are not violated. Furthermore, the issuance of the pension obligation bonds should not become a substitute for prudent funding of pension plans.

Governments issuing pension obligation bonds should compare the bond's debt service schedule to the pension system's current UAAL amortization schedule, using the true interest cost of the bond issue as the discount rate to calculate the estimated net present value savings. Additionally, issuing governments should consider the amount of the estimated net present value savings, the spread between the true interest cost of the bonds, and the actuarial investment return assumption of the pension plan.

Even if the analysis indicates that financial benefits appear to outweigh the risks, governments should evaluate other issues that may arise if the bonds are issued, such as the loss of flexibility in difficult economic times because of the need to make timely payments of principal and interest in order not to default on the bonds, potential misunderstanding by policy makers regarding the possibility that an unfunded liability may reappear in the future, and potential pressures for additional benefits by government employees if plans are fully funded and the government's contribution as a percentage of payroll has declined relative to neighboring jurisdictions.

Before deciding to issue pension obligation bonds, a governmental entity should undertake a careful financial analysis that considers the following:

- Adequate disclosure of the fact that even if bonds are sold, governments could still face an unfunded liability in the future resulting from such factors as changes in benefit levels, investment returns, demographics, or other factors that were not anticipated when THE bonds were issued.

- Pension obligation bonds should be structured in a manner that does not defer principal payments. Additionally, the bonds should not have a maturity that is in excess of the current unfunded actuarial accrued liability amortization period.

- Most pension systems have investment practices that are designed to accept smaller incremental contributions than are typical with pension obligation bonds. A review of the system's ability to adequately incorporate a much larger contribution into the system without adversely affecting the system's asset allocation should be considered.

- Issuance of debt to fund pension liability increases debt burden and may use up debt capacity that could be used for other purposes.

- Issuing pension obligation bonds converts a liability that may not be fully reported on the face of the financial statements (i.e., the unfunded actuarial accrued liability) into a liability that is reported on the face of the financial statements (i.e., bonds payable).

- Governments should ensure that the pension system review its cash flow in order to ensure that benefits are paid in a timely manner, since annual employer contributions will be reduced in lieu of debt service payments on the POBs. Analysis should extend through the amortization period of the unfunded liability on a cash flow basis and the debt service period of the POB.

- Special consideration and analysis should be given to the actuarial and cost implications for individual employers participating in multiple-employer systems.

References

- *Financing Retirement Systems Benefits*, Richard G. Roeder, Public Employee Retirement Series, GFOA, 1987.
- "Pension Obligation Bonds: Practices and Perspectives," *Government Finance Review,* GFOA, December 1996.
- "Risky Business? Evaluating the Use of Pension Obligation Bonds," *Government Finance Review*, GFOA, June 2003, pp. 12-17.

Approved by the GFOA's Executive Board, March 2005.

ADVISORY

Issuing Taxable Debt (1998 and 2012) (DEBT)

Background. Debt is commonly issued by governments around the world to finance capital projects. State and local governments in the U.S. have traditionally issued tax-exempt debt; however, the globalization of the capital markets and increasingly burdensome U.S. tax rules relating to tax-exempt financing, have increased the viability of taxable debt as an option for governments seeking to gain operating flexibility or expand their financing options.

In most instances, tax-exempt debt offers lower cost financing. However, there are a number of reasons that an issuer might contemplate the use of taxable debt in its financing structure.

Evaluating the Use of Taxable Debt. The most common reasons that an issuer may consider the issuance of taxable debt is to obtain operating flexibility (e.g., avoid IRS restrictions regarding the operation of projects financed with tax-exempt bonds). Unlike tax-exempt debt, capital projects financed with taxable bonds do not prohibit the use of certain types of management agreements and management contracts, such as those that provide for a profit-sharing arrangement between the issuer and the operator. Consequently, taxable bonds are often issued in conjunction with public-private partnerships (P3s), stadiums/concert venues, and many commercial/retail, housing, and mixed-use projects financed by municipalities. Additionally, bonds issued to finance Pension (POBs) and Other Post Employment Benefit (OPEB) obligations must typically be issued on a taxable basis under IRS regulations. Finally, taxable bonds are not subject to arbitrage restrictions.

This discussion does not cover the issuance of direct subsidy taxable bonds such as Build America Bonds (BABs), which have the same use restrictions as traditional tax-exempt debt but have the same pricing/structuring issues as taxable debt. See GFOA's Best Practice titled "Issuing Build America and Other Direct Subsidy Bonds".

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments carefully consider whether issuing taxable debt is the best financing option for their proposed project, and develop a thorough understanding of the differences between the tax-exempt and taxable markets before proceeding with a planned sale. Each issuer and its financial advisor should conduct an analysis of how these differences will affect the overall financial plan and ability to manage its debt program, and consult appropriate counsel, and advisors. In evaluating whether to issue taxable debt, each issuer should consider the following factors:

Legal

- Evaluate applicable federal and state constitutional and statutory debt legal provisions. Various state and federal securities law requirements apply to both taxable and tax-exempt debt. Taxable offerings often must meet the same state law requirements as tax-exempt debt and issuers should not assume that the absence of some federal tax code restrictions on "private activity bonds" allows for these bonds to be issued without restrictions. In some cases, taxable debt may be subject to various federal, state, and local laws, including state laws restricting the lending of the issuer's credit to private entities ("lending of credit"). Issuers should consult with counsel about the various tax issues that arise with taxable bonds.

- Some jurisdictions may have additional restrictions on the issuance of taxable debt and the jurisdiction's debt policy should be reviewed to determine if it specifies when taxable debt may be issued.

Debt Structure

- Evaluate the total cost of issuing taxable debt, including legal, marketing, and other up-front costs and the interest cost over the life of the bonds, in relation to the financing objectives to be achieved. The cost of taxable debt will generally be higher because investors are not able to deduct interest earnings from taxable income. Consideration also should be given as to how proceeds will be invested to minimize possible negative arbitrage.
- Consider structural features that can provide long-term benefits, such as amortizing debt as quickly as possible or embedding early call provisions in order to have the ability to call debt if the project being financed generates excess cash flows. In some instances issuers may wish to use a hybrid structure: a combination tax-exempt and taxable issue to satisfy certain IRS sizing, cost of issuance, private use restrictions, etc. An "interim" taxable issue may also make sense when there is uncertainty regarding a project's ability to comply with IRS requirements. If an issuer and their bond counsel are uncertain as to the amount of "private use" of a project, it may make sense to issue all or a portion of a financing on a taxable basis, since taxable bonds can be reissued on a tax-exempt basis at a later date, albeit at some cost.

Call Provisions

- Issuers should recognize that some features that enhance flexibility, such as an early call provision, may be more costly to exercise for taxable debt than for tax-exempt debt. "Make-whole call provisions", common in the taxable debt market, generally preclude the opportunity to refinance the bonds in the future for debt service savings.

Market Considerations. Investors of taxable debt are different than those of tax-exempt debt, and may require additional information about state and local government credits in order to better understand the underlying credit of the bonds.

- Develop an understanding of the market well in advance of the planned sale, including types of investors, structural features, and size requirements needed to attract investor interest.
- Evaluate whether there are advantages to selling bonds outside of the U.S. domestic market and the costs associated with this approach, such as the costs of registering with a foreign exchange. Legal counsel familiar with particular international capital markets should be involved in order to review specific regulatory and disclosure requirements that may differ from U.S. markets. Also, governments must be sure they have sufficient staff time and expertise to manage taxable debt offered in the international marketplace.
- Allow sufficient time to educate investors, including potential investors, who may be less familiar with state and local credit, about the offering and the issuer. Care should be taken to properly label an issuer's debt as taxable so that investors and other interested parties are able to distinguish it from tax-exempt debt.

Pricing

- Evaluate the market for taxable state and local government bonds prior to the pricing process, including identification of comparable issues and interest rates, including the use of variable rate debt.

- Issuers and their financial advisor should be especially vigilant since less frequent issuance of taxable state and local government bonds increases the risk that a government may pay an interest rate penalty when its bonds are priced.

References.

- GFOA Best Practice, Managing Build America and Other Direct Subsidy Bonds, 2012
- GFOA Advisory: Need for Considerable Caution in Regard to OPEB Bonds, 2007
- GFOA Advisory: Evaluating the Use of Pension Obligation Bonds, 2005.

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

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.

Need for Considerable Caution in Regard to OPEB Bonds (2007) (CORBA and DEBT)

Background. GASB Statement No. 45, *Accounting and Financial Reporting for Employers for Postemployment Benefits Other than Pensions*, requires public-sector employers to disclose in the notes to the financial statements the full amount of their unfunded actuarial accrued liability (UAAL) for other post-employment benefits earned by employees for services rendered to date.[1] In addition, employers who subsequently fail to fully fund their actuarially determined annual required contribution (ARC) each year will also be required to report the cumulative effect of underfunding the ARC as an accounting liability on the face of their financial statements. Nothing in GASB Statement No. 45 requires employers to advance fund their OPEB obligations. The decision to advance fund OPEB should reflect a given jurisdiction's careful analysis of its own unique financial situation.

In the wake of GASB Statement No. 45, some employers have contemplated the possibility of issuing debt to fund their UAAL for OPEB, as has sometimes been done in connection with pension obligations. In either case, the objective is to invest the proceeds in appropriate qualified investments at a return substantially higher than the interest cost of the debt. The Government Finance Officers Association (GFOA) has already adopted a recommended practice that addresses the issuance of debt in connection with pension obligations: *Evaluating the Use of Pension Obligation Bonds*.[2] While the underlying concept is the same, several crucial additional factors must also be considered for OPEB bonds:

- The unfunded actuarial accrued liability for OPEB is inherently and significantly more volatile than the actuarial liability for pension benefits for several important reasons. First, health-care costs and utilization are less predictable than life expectancy. Second, unlike pension benefits, in many jurisdictions health-care benefits are not guaranteed by state law and employers may choose to reduce, cap, or eliminate these benefits. Third, state or federal health-care initiatives might also significantly change the way health care benefits are provided in the future. Furthermore, it generally has been observed that healthcare cost trends are more volatile and difficult to project than inflation rates for pension costs because the former must take into account ongoing changes in medical technology and societal expectations.
- Some employers may elect to respond to the disclosures required by GASB Statement No. 45 by reducing benefits, capping employer contributions, or moving toward defined contribution arrangements, as

[1] This disclosure normally is not required of employers participating in defined contribution plans (disclosures for costsharing plans are normally provided in the plan report).

[2] Originally issued in 1997 and subsequently revised in 2005. Many of the risks identified for pension obligation bonds in this Recommended Practice also apply to OPEB bonds: (1) OPEB bonds possess an inherent degree of risk to the extent that their economic utility depends upon the reinvestment of the proceeds at a higher rate of earnings than the rate of interest being paid on the bonds. This problem is compounded by the fact that these bonds are taxable bonds bearing a higher interest rate; (2) As a result of debt ceilings set by policy or statute, OPEB bonds may create a loss of flexibility for state and local governments' by using up debt capacity that might be applied to other important projects and tying up revenue streams for an extended period of time; and (3) The influx of cash from a bond issuance will improve the benefit plan's funded ratio even though the jurisdiction has incurred debt and possibly create pressure on elected officials to provide additional benefits.

sometimes occurred following a similar change in private-sector accounting rules that took effect in the 1990s.
- The potential volatility in actuarial estimates described earlier could lead to over-funding. Such overfunding could raise potentially troublesome budgetary or policy issues.
- Rating agencies and similar authorities have yet to determine what constitutes a safe and reasonable funded ratio for OPEB.
- Most jurisdictions have yet to establish trust funds for OPEB that meet the criteria of GASB Statement No. 45. Likewise, state laws that currently may hinder the establishment and permissible investments of such trusts have yet to be addressed.
- Issuing OPEB bonds could require governments to prematurely create an irrevocable trust that might not be warranted.

It is essential that the foregoing factors be taken into account before any decision is made regarding the appropriateness of issuing OPEB bonds.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments exercise considerable caution when contemplating the possibility of issuing OPEB bonds. Despite the similarities between OPEB bonds and other types of debt as financial products, the analysis needed to determine their appropriateness is substantially different. Furthermore, jurisdictions contemplating the possibility of issuing OPEB bonds should not only follow the guidelines already set forth in GFOA's advisory on pension obligation bonds, but also do all of the following:

- Allow sufficient time for a public-policy dialogue to occur between the governing body, employee groups, finance officials, and the public they serve regarding the appropriate funded ratio for OPEB. Failure to do so could produce "solutions" that ultimately fail to reflect the desires and considered judgment of constituents.
- Consider OPEB bonds only upon consultation and advice from a knowledgeable financial advisor who is not also serving, or planning to serve in the future, as an underwriter of the OPEB bonds. As part of their consideration, potential issuers should compare the results of any proposed OPEB bond issuance to both (1) advance funding on the basis of the ARC and (2) pay-as-you-go funding.
- Refrain from issuing OPEB bonds until all issues concerning the proper establishment of a qualified trust fund, investment procedures, and investment guidelines have been resolved.
- Consider, upon consultation with actuaries and other experts, limiting the planned funded ratio to an amount suggested by actuarial and other analysis.

Approved by the GFOA's Executive Board on March 2, 2007.

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.

Understanding the Issuer's Role in Secondary Market Securitization of Tax-Exempt Obligations (2005) (DEBT)

Background. Tax-exempt municipal bonds may be securitized after they are issued in order to create secondary market products. This practice has greatly increased over the past ten years. These securities can take many forms, most notably tender option securities, but also certificates of participation (COPs), putable floating rate receipts, Dutch auction/inverse floater receipts and stripped-coupon municipal securities. In a securitized bond transaction, a financial institution places a government security (or pool of securities) with a trustee or custodian, and the underlying stream of payments is then packaged as a new security and sold to new investors in the secondary market.

As with bonds, securitization is also common with government leases. In a secondary lease securitization, a financial institution places a government lease (or pool of leases) with a trustee or custodian, and the underlying stream of payments is then packaged as a new security, generally COPs, and sold to new investors in the secondary market. Issuers should determine when executing a lease if the issuer intends for the leases to be sold as part of a public offering.
In most cases, the securitization takes place after the debt is issued and the deal is closed, and often the issuer is unaware that their obligations have been securitized. Less frequently, except in the case of tender option bond programs, securitizations occur at the same time of the issuance of the original obligation.

With regard to secondary market securitization, in competitive sales, issuers have less control over what occurs to their bonds in the secondary market, than they have in negotiated sales. In a negotiated sale, and in private placements, issuers ***may*** play a stronger role in determining how their bonds should be treated in the secondary market, and may ask their underwriter for an agreement about these practices prior to the sale of the bonds. However, issuers should recognize that placing such limitations on underwriters could result in reduced market liquidity that could result in higher interest rates paid by the issuer.

In some cases, the securitization may raise questions for the issuer such as:

- Tax counsel may question how secondary market securitizations that occur concurrently with the issuance of the bonds should be treated for purposes of calculating the arbitrage yield for a bond offering.[1] This

---

[1] When a governmental entity sells bonds, it must compute the arbitrage yield on the bonds based on the "issue price" of the bonds. Currently, some tax counsel are uncertain as to the appropriate treatment of such transactions under existing tax law if the securitization is undertaken contemporaneously with the primary offering, such that it raises the question as to public offering price. These tax counsel question whether the "issue price" of securitized bonds must be calculated with reference to the price paid by the purchasers of the securitized interests, or whether it is based on the price paid for bonds by the institution setting up the securitization. Generally though, while many tax counsel may conclude, at least with respect to tender option bond programs, that the "issue price" of the bonds is not affected by the securitization, the form of the issue price certificate may change since secondary market securities are not offered to the general public.

issue is of particular concern in refundings and when documentation is provided in the form of issue price certificates.
- Securitization of leases that were originally structured as private placements may create disclosure issues for an issuer if the securitization takes place without lessee approval and/or involvement.
- Determine which party has the continuing disclosure responsibility with respect to the securitized product.
- An issuer may be uncomfortable with its name being associated with a secondary market product. Due to the current identification system for municipal securities through CUSIP numbers, a new securitized product in the secondary market will be assigned the issuer's current six-digit base CUSIP number, even when the issuer is not involved in the securitization. This may cause confusion by the certificate holders of the securitized product regarding the responsible party as the issuer of the product. It is very important to note that the certificate holders are not direct bondholders of the original issue; the bondholder is the trust which created the new certificate, and the trustee is representing the bondholder's legal and economic interest in the underlying bonds.

Given the increase in secondary market securitized products, and the complexities involved with the transactions, issuers should be aware of the risks and rewards associated with these transactions.

Recommendations. Government Finance Officers Association (GFOA) recommends that certain actions be undertaken by a state or local government to address potential problems associated with secondary market securitization of its tax-exempt obligations. Actions recommended by GFOA are:

1. Issuers should speak with their bond counsel and financial advisors in advance to determine if underwriters in a negotiated sale should be required to make certifications in the bond purchase agreement, as well as in the issue price certificate delivered at closing, that:
   - each of the bonds of the issue is being directly offered to the public, or alternatively;
   - the underwriter expects to offer some or all of the bonds to the public through a securitization format, either directly or through a party related to the underwriter in conjunction with the underwriting, and;
   - ensure that the underwriter provides information to bond counsel in order to properly calculate the arbitrage yield and verify compliance with other tax rules.
2. For leases, the original lease documents should explicitly state what is and is not permissible regarding secondary lease securitization. They should require that any secondary lease documents clearly (a) identify the role and responsibility, if any, of the government as part of the lease offering, including any relationship between the lessee and the new investors; and (b) that the offering is a secondary offering and whether all requirements relating to the tax-exemption of the securities have been met.
3. In a secondary market securitization, the trust, as the bondholder, should receive the same continuing disclosure treatment as any other bondholder. The certificate holders, as purchasers of the trust certificates, are not considered the bondholders of the primary bond issue; but they are the certificate holder of the new product created in the secondary market. The issuer has no disclosure obligations to the certificate holders. If both products – the issuer's original obligations and the trust's new product, have the same six-digit base CUSIP number, an issuer may receive inquiries from the certificate holders regarding the underlying obligations. An issuer should refer these inquiries to the trust and is under no responsibility to act or respond to these inquiries.

References

- GFOA Best Practice, "Selecting and Managing the Method of Sale of State and Local Government Bonds*,"* 1998.
- GFOA Best Practice, "Debt Management Policy*," 2003.*

Approved by the GFOA's Executive Board, October 11, 2005.

This RP replaces two Recommended Practices – *Securitization of Tax-Exempt Bonds* (1996) and *Securitization of Leases* (1993)

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.

Underwriter Disclaimers in Official Statements (2000) (DEBT)

Background. While municipal securities are exempt from registration and reporting requirements of the federal securities laws, they are subject to the antifraud provisions. It is a violation of these antifraud provisions for any person--including municipal issuers and underwriters--to make false or misleading statements of material fact or omit any material fact causing such statements to be misleading.

The official statement for a securities offering is the issuer's document and as such, the issuer has responsibilities under the federal securities laws for its content, regardless of who prepares it. Others participating in the preparation of an official statement for either a competitive or negotiated sale--such as underwriters, attorneys, and financial advisors-- also have legal responsibilities under the federal securities laws.

The inclusion of underwriter disclaimer language is referenced by the Securities and Exchange Commission (SEC) in footnote 103 of its 1994 Interpretive Release on disclosure obligations of governmental issuers and other municipal market participants. It states that, "In light of the underwriter's obligation…to review the official statement and to have a reasonable basis for its belief in the accuracy and completeness of the official statement's key representations, disclaimers by underwriters of responsibility for the information provided by the issuer or other parties, without further clarification regarding the underwriter's belief as to accuracy, and the basis therefore, are misleading and should not be included in official statements."

Disclaimer language has been suggested by underwriters, including the assertion that the underwriters do not guarantee the accuracy or completeness of the official statement. However, the Government Finance Officers Association (GFOA) believes such language is inappropriate.

GFOA believes inclusion of an underwriter disclaimer creates more concerns about obligations under the securities laws than it resolves, and could consequently increase the risk of confusing investors.

Recommendation. The Government Finance Officers Association recommends that issuers not include underwriter disclaimer language in official statements. GFOA further recommends that in the preparation of official statements, issuers should undertake an affirmative review to ensure that any such disclaimer language has not been included.

References

Recommended Uniform Disclosure Practice for Municipal Official Statement, the Securities Industries and Financial Markets Association.

Approved by the GFOA's Executive Board, 2000.

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.

Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy (2003, 2005 and 2010) (DEBT)

Background. In recent years, the use of derivative products became more prevalent in the debt and risk management programs of state and local governments and other issuing authorities. A derivative is a financial instrument created from or whose value depends upon (is derived from) the value of one or more separate assets or indices of asset values. As used in public finance, derivatives may take the form of interest rate swaps, futures and options contracts, options on swaps and other hedging mechanisms such as caps, floors, collars and rate locks.

Derivative products can be important interest rate management tools that, when used properly, can increase a governmental entity's financial flexibility, provide opportunities for interest rate savings, alter the pattern of debt service payments, create variable rate exposure, change variable rate payments to fixed rate and otherwise limit or hedge variable rate payments. Recent market experience has also shown, however, that derivatives, when used to hedge a particular bond issue, can limit an issuer's flexibility with respect to such bond issue.

Issuers are cautioned that recent economic turmoil and associated credit downgrades have resulted in many collateral calls and, in some cases, involuntary terminations at severe cost to governmental entities.

Governmental issuers must learn about and understand the potential risks and rewards of derivative products in order to evaluate them properly as financing tools. Issuers must understand fully the characteristics of derivative instruments, have the ability to determine a fair market price and be aware of the legal, accounting, credit and disclosure issues involved. These instruments should not be used for speculation, but only to manage risks associated with an issuer's assets or liabilities and only in conformity with financial policies that reflect the risk tolerances and management capabilities of the issuer.

Advisory. The Government Finance Officers Association (GFOA) advises that state and local governments exercise great caution in the use of derivative instruments and use them only when the issuers have developed:

1. A sufficient understanding of the products. The GFOA encourages all financial officers to learn about the potential risks and benefits of using derivatives. A decision whether or not to use derivatives should be made on an informed basis. Training is essential both in evaluating the use of derivatives and in managing their use.

2. The internal staffing and expertise to manage, monitor and evaluate these products properly, either on their own or in combination with a swap or financial advisor, tax counsel and/or monitor. Issuers must have in place:
   a. Methods for measuring, evaluating, monitoring and managing risks associated with derivative products, including:
      i. Basis risk – the mismatch between variable rate debt service and the variable rate index used to determine swap payments. This risk can be managed through the creation of an interest rate reserve fund or conservative budgeting strategies.

ii. Tax risk - the risk created by potential tax events that could affect swap payments. Careful attention should be paid to tax event triggers in the underlying swap documents.
iii. Interest rate risk – how the movement of interest rates over time affects the market value of the instrument.
iv. Collateralization risk – the risk that market movements or an issuer downgrade will cause the market value of the swap to decrease enough that the issuer has to post collateral under a Credit Support Annex (CSA). Issuers should be mindful of the different rating standards applied to corporate and municipal credits when evaluating collateralization thresholds and understand that this is a negotiable requirement. Termination and collateral requirements should reflect relative comparable credit strengths of the parties determined on a corporate equivalent or global rating basis.
v. Counterparty risk – the risk that the counterparty fails to make required payments, experiences rating downgrades, or files for bankruptcy protection. This is particularly important if an issuer has more than one swap with a counterparty and the documents contain cross-default provisions. This can be addressed through the establishment of ratings thresholds, guidelines for exposure levels and, particularly, collateralization requirements.
vi. Termination risk – the need to terminate the transaction in a market that dictates a termination payment by one of the counterparties. Market practice allows governmental issuers to limit the instances in which this can occur. This risk can also be mitigated through the identification of revenue sources for and budgeting of potential termination payments, structuring the swap so that refunding bond proceeds can be used for termination payments and subordinating the lien status of potential payments. Issuers are cautioned to ensure that counterparties do not impose excessive or unnecessary fees at termination in excess of amounts allowed for in the swap documents.
vii. Market-access risk – the risk that the markets may be closed or that an issuer may not be able to enter the credit markets due to its own credit quality deteriorating or that credit may become more costly. For example, to complete a derivative's objective, a new money bond issuance or a refunding may be planned in the future. If at that time the markets are not functioning or an issuer is unable to enter the credit markets, expected cost savings may not be realized while the issuer will continue to be subject to its obligations required by the derivative contract.
viii. Rollover or amortization risk – the mismatch of the maturity of the swap and the maturity of the underlying bonds or a mismatch in the amortization of the swap and bonds. This should be eliminated by making the maturity and amortization of the swap coterminous with those of the bonds.
ix. Credit risk – the occurrence of an event modifying the credit rating of the issuer or its counterparty. This should be addressed through minimizing cross defaults and the favorable negotiation of credit event triggers in the underlying documentation.

b. Methods for selecting and procuring derivative products, including when competitive bids and negotiated transactions are warranted, and knowledge of pricing conventions and documentation standards.
c. Guidelines governing the proper disclosure of material information relating to executed derivative products to the issuer's governing body, in financia1 statements, to the rating agencies, to investors in connection with bond offerings, and through secondary market disclosure. Internal disclosure should include information about legal authority, risks, guidelines and market value. The Official Statement and secondary market disclosure should comport with current market practice.
d. Procedures and personnel responsible for internally managing and monitoring the issuer's (i) obligations (also known as operational risk), such as monitoring rates, calculating and making payments, managing collateral, and budgeting and accounting for derivatives appropriately and (ii) exposure, such as counterparty credit, collateral posting levels, variable rate exposure levels and basis risk. Pursuant to applicable accounting requirements, these procedures must include the development of a methodology for providing periodic termination value analyses.

3. A comprehensive derivatives policy. A derivatives policy should include:

a. Evidence of clear legal authorization to enter into such arrangements and guidelines for how derivative products fit within the overall debt management program.
b. A list of the types of derivative products that may be used or are prohibited.
c. The conditions under which these types of products can be utilized *(i.e.* bidding procedures, minimum benefit thresholds, terms of master agreements).
d. The maximum amount of derivatives contracts, or a means of determining such amount, *e.g.,* by reference to floating rate assets.
e. Guidelines for selecting counterparties of high credit quality and addressing the risks presented under item 2 above.

The GFOA recommends that all derivative transactions be documented using standardized forms, as standardized terms make it easier for market participants to analyze transactions, which minimizes costs. "Documentation in the municipal swap market is almost universally accomplished through the negotiation and execution of the forms of documents published by the International Swaps and Derivatives Associations, Inc. (ISDA)."[1] The GFOA also advises that many provisions in such forms are subject to negotiation and therefore recommends that finance officers have advisors familiar with such forms and amend ISDA documents as changing market conditions warrant, provided that such changes benefit the issuer. Specifically, the provision of collateral by one or both parties to a swap under certain circumstances is determined at the time the swap is executed. The form of that potential collateral may also be decided at the point of execution or may be postponed until such collateral is required. Collateral is identified in a Credit Support Annex (CSA), and while it will add legal costs to the original transaction and has the potential of never being used, the GFOA recommends it be completed simultaneous with the execution of the swap to avoid having to negotiate collateral arrangements under distressed circumstances.

Once an issuer has adopted a derivatives policy and executed a derivatives transaction, the issuer should monitor and, to the extent possible, take action to limit its exposure to the risks described above. Because opportunities in the derivatives market change frequently, the GFOA encourages finance officers to keep abreast of such market conditions.

It is also recommended that issuers read and understand the most current material regarding the effect of derivatives on ratings prior to execution of a derivatives contract.

References.

- GFOA Best Practice, *Debt Management Policy*, 2003.
- GFOA, *Elected Official's Guide to Debt Issuance,* Patricia Tigue and J.B. Kurish, 2005.
- *Understanding Municipal Derivatives,* David Taub, *Government Finance Review*, 2005.
- GFOA *Derivatives Checklist*, 2010.
- Fitch Ratings, Guidelines for Interest Rate Swaps and Variable-Rate Debt, May, 2005.
- Moody's Investors Service, Swaps and the Municipal Market: The Impact of Swaps and FASB 133 on Municipal Credit Quality, October 2002.
- Standard & Poor's, *Public Finance Criteria: Municipal Swaps,* November, 2004.

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

[1] National Federation of Municipal Analysts, *White Paper on Disclosure for Swaps* (February 2004)

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.

APPENDIX A

DERIVATIVES CHECKLIST

Introduction

This checklist is a supplement to the Advisory on "Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy (2003, 2005 and 2010) (DEBT)" and is designed to be an attachment to a government issuer's derivatives policy. It is designed to be used prior to entering into any derivatives transaction. This checklist presumes an issuer's compliance with the Advisory—to wit, that the issuer has adopted a derivatives policy and that the issuer's staff has been trained in the evaluation and use of derivative products. An issuer that cannot answer the questions in this checklist is advised to continue its training prior to completing a derivatives transaction.

While the principles enunciated in the Advisory are generally applicable to all derivatives transactions, it is impracticable to create a "one size fits all" checklist to address the specific issues of all derivatives transactions. First, over-the-counter derivatives transactions are not uniform. Each is customized to fit the needs of the parties. Second, the derivatives market and the products being used in that market change over time, sometimes quite quickly, in response to changes in the broader financial markets. Third, the experience and sophistication of users of derivative products varies. Many experienced users of derivatives will already have developed their own means of assuring that all relevant issues in a derivatives transaction have been considered and addressed. Therefore, this checklist is intended mostly to assist issuers that meet the presumptions described above but are relatively new to the derivatives market. The issues addressed in this checklist are broadly applicable, but the form of the checklist is one that issuers are encouraged to adapt to their particular circumstances.

Many of the capitalized terms used in this checklist are used as defined in International Swaps and Derivatives Association, Inc. ("ISDA") documents, and this checklist presumes that an issuer is familiar with such documents.

General Information

1. Name of Governmental Issuer: ____

2. Date of most recent update to Issuer's Derivatives Policy: ________________

3. (a) Names of Official and Backup(s) Responsible for Procurement of Derivative:

   ____

   (b) Names of Official and Backup(s) Responsible for Monitoring Derivative:

   ____

   (c) Have all of them satisfied the training standards prescribed in the Issuer's Derivatives Policy? Yes ___ No ___

4. Independent Derivatives Advisor, if any: ____

5. Independent Derivatives Monitor, if any: ____

Authority

1. Will the Issuer's counsel deliver an unqualified opinion on the Issuer's authority to enter into the derivative? Yes ___ No ___

General Terms

1. Type of Derivative: ____

2. Counterparty/ies: ____

3. (a) Expected Trade Date: __________________
   (b) Effective Date: ___________________
   (c) Scheduled Termination Date: _________________
   (d) If derivative is an option, Exercise Date(s): _______________________________

4. Notional Amount: _________________________

5. Identify debt, or assets, with which the derivative is associated:

   ____

Financial Terms

1. (a) Basis for calculating Issuer's payments: _______________________________
   (b) Frequency of calculation: ___________________________
   (c) Frequency of payment: _______________________
   (d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes ___ No ___
   If yes, explain: ____
   ____
   ____

2. (a) Basis for calculating Counterparty's/ies' payments: ________________________
   (b) Frequency of calculation: ___________________________
   (c) Frequency of payment: _______________________________
   (d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes ___ No ___
   If yes, explain: ____
   ____
   ____

3. Identify any embedded options in the derivative: _________________________________

____
____

4. Will either party make an upfront payment upon execution of the derivative?
Yes ___ No ___

Purpose

1. State the reason(s) for entering into the derivative.
____
____
____

2. Were other means considered for achieving such purpose(s)? Yes ___ No ___
If yes, why was the derivative chosen? ____
____
____

Risks

1. Has the Issuer evaluated the extent to which each of the following risks will be assumed upon execution of the derivative?

(a)	Basis Risk	Yes ___	No ___
(b)	Tax Risk	Yes ___	No ___
(c)	Interest Rate Risk	Yes ___	No ___
(d)	Collateralization Risk	Yes ___	No ___
(e)	Counterparty Risk	Yes ___	No ___
(f)	Termination Risk	Yes ___	No ___
(g)	Market-access Risk	Yes ___	No ___
(h)	Rollover Risk	Yes ___	No ___
(i)	Credit Risk	Yes ___	No ___

2. Are the risks to be assumed within the risk parameters of the Issuer's Derivatives Policy? Yes ___ No ___

3. Has Issuer run, or had run for it, stress tests on how the derivative could affect Issuer's budget and financial position under various market conditions? Yes ___ No ___

4. How do the benefits of entering into the derivative outweigh the risks being assumed?
____
____
____
____

5. Upon execution of this derivative,
(a) How many derivatives will Issuer have outstanding? ___________________

(b) What is the total notional amount of those derivatives? _______________
(c) What percent of Issuer's long-term debt will be associated with derivatives? _______

Documentation

1. Is Issuer's counsel experienced in derivatives transactions? Yes ___ No ___

2. Has Issuer discussed with its counsel:
   (a) Required consents and approvals? Yes ___ No ___
   (b) Relation of derivative payments to bond payments? Yes ___ No ___
   (c) Default provisions? Yes ___ No ___
   (d) Termination provisions? Yes ___ No ___
   (e) Other remedies? Yes ___ No ___

Counterpartv/ies

1. On what basis did Issuer select Counterparty/ies?
   - ❑ Competitive
   - ❑ Negotiated

2. If competitive,
   (a) Who was bidding agent? ________________________
   (b) How many firms were invited to bid? ______________
   (c) How many firms bid? __________________________
   (d) Is bidding agent providing a closing certificate? Yes ___ No ___

3. If negotiated,
   (a) State reasons for negotiating derivative: _________________________________
   ____
   (b) State reasons for choosing Counterparty/ies: ______________________________
   ____
   (c) Estimated spread relative to mid-market or benchmark rate? _______________
   (d) Is Derivatives Advisor providing a certificate as to fair market valuation?
   Yes ___ No ___
   If no, what comfort will Issuer receive that the terms for the derivative are commercially reasonable? ____

4. What are ratings of Counterparty/ies? ____

5. Does Counterparty/ies meet credit criteria of Issuer's Derivatives Policy? Yes ___ No __

6. What percentage of Issuer's total notional amount of derivatives will be with the same Counterparty/ies?______________

7. If Issuer will have more than one derivatives transaction with Counterparty or any of the Counterparties, will there be netting between or among separate derivatives transactions? Yes

___ No ___

Credit Support

1. Credit Support will be provided for:
   (a) Issuer Yes ___ No ___
   If yes, name of provider: ____
   (b) Counterparty/ies Yes ___ No ___
   If yes, name of provider: ____

2. Has Issuer's counsel reviewed Issuer's credit support obligations? Yes ___ No ___

3. Has Issuer established procedures sufficient to:
   (a) Comply with any such obligations? Yes ___ No ___
   (b) Renew or replace Credit Support, if required? Yes ___ No ___
   (c) Monitor the credit level of the Counterparty/ies? Yes ___ No ___
   (d) Receive the benefit of, and comply with any obligations relating to, any credit support obligations of Counterparty/ies? Yes ___ No ___

Tax Issues

1. Tax counsel reviewing the documentation: ______________________________________

2. Has Issuer discussed with tax counsel:
   (a) Integration of the derivative with a bond issue? Yes ___ No ___
   (b) Whether yield monitoring is required? Yes ___ No ___
   (c) Whether the derivative's performance or mark-to-market value should be included in arbitrage compliance calculations? Yes ___ No ___

3. Will tax counsel deliver an opinion in connection with the derivative? Yes ___ No ___

Operations and Monitoring

1. If the Expected Trade Date and the Effective Date are different, is the derivative part of a series of transactions? Yes ___ No ___
   If yes,
   (a) Describe the subsequent transactions being considered: ____________________
   ____
   ____
   (b) Has Issuer established procedures or mechanisms to:
      (i) Determine how and when any subsequent transaction will occur? Yes ___ No ___
      (ii) Evaluate and handle risks to completion of any subsequent transaction? Yes ___ No ___
      (iii) Complete, and pay expenses of, any subsequent transactions? Yes ___ No ___

2. Has Issuer discussed the appropriate accounting treatment for the derivative with its independent auditor? Yes ___ No ___

3. Does the Issuer intend to use hedge accounting? Yes ___ No ___
If yes, has the issuer received or made arrangements to receive confirmation of hedge effectiveness? Yes ___ No ___
If yes, from: ____

4. Who is responsible for confirming payment amounts and making necessary payments? ____

5. What is the source for Issuer's regular payments? ________________________________

6. How are such payments budgeted? ____

7. Who is responsible for monitoring credit ratings of Counterparty/ies? ___________________________

8. Who is responsible for monitoring mark-to-market valuations? _____________________

9. What is the frequency of such monitoring? _________________________

10. Who is responsible for monitoring collateralization requirements of Issuer and Counterparty/ies? ____________

11. If Issuer must post collateral, what will be the source? ___________________

12. If Counterparty/ies must post collateral, who will monitor? ________________

13. What is the frequency of:
    (a) Reporting monitoring results to Chief Executive Officer/Chief Financial Officer? _________________________
    (b) Sharing monitoring results with independent auditor? _______________________

14. Has Issuer discussed this derivative with the rating agencies? Yes ___ No ___

15. Who is responsible for delivery of future documents required by the derivative's documentation? ____________________________

16. Who is responsible for answering investors' questions about Issuer's derivatives exposure? ____
____

Information Provided By:

____
(signature)

1228 N Street, Suite 13, Sacramento, CA 95814-5609
Telephone (916) 444-5100 Fax (916) 444-5109