Municipal Bond Market Update & A Look Ahead

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Central Florida Government Finance Officers Association

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Municipal Market Update

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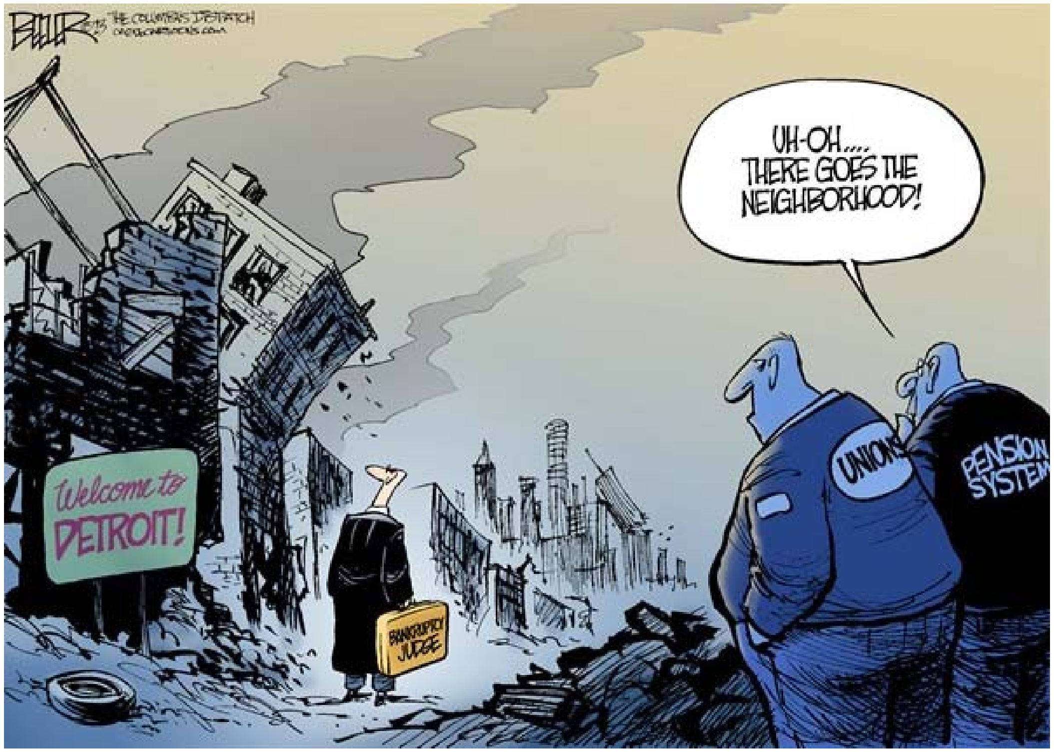
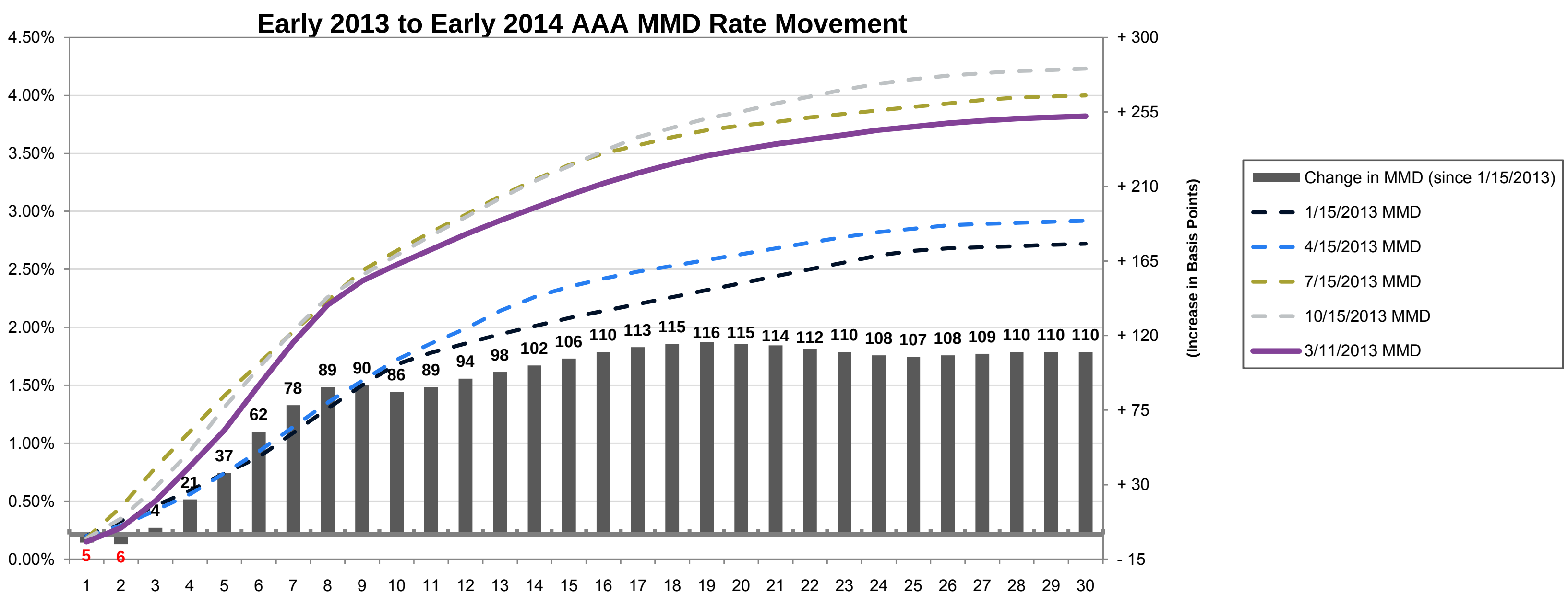


2013 Market Rate Movement

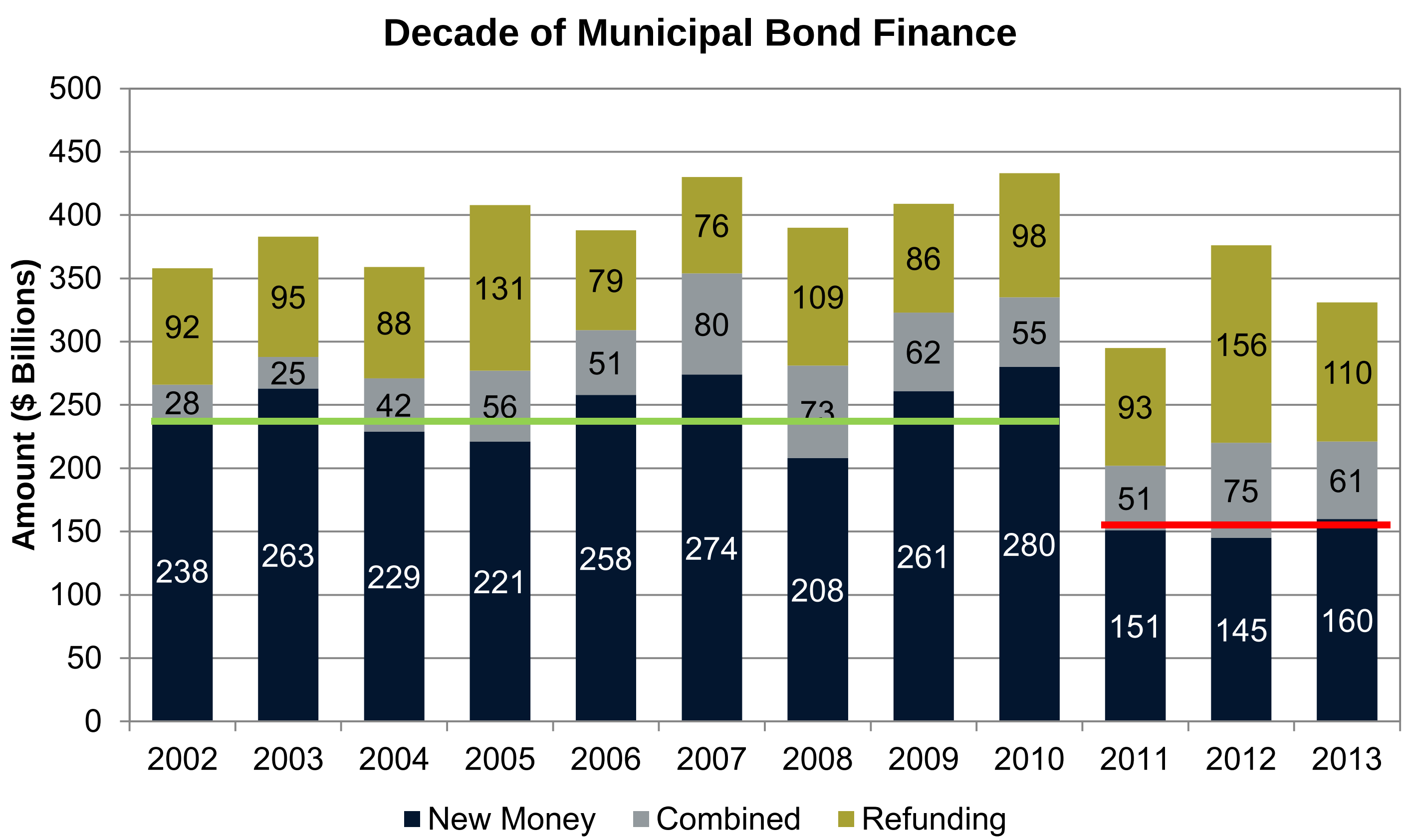
- The rise in rates was significant on the long end of the curve during 2013, rising by 105bps and 136bps in the 10 year “AAA” MMD and 30 year “AAA” MMD rates, respectively, however since the start of 2014 rates have improved by 25bps and 38bps
- This upward trend in rates started in May and gained momentum in late June when Federal Reserve Chairman Bernanke indicated that reduced “downside risks to growth” could allow the Fed to slow the pace of its bond buying efforts
- The municipal market was particularly hard hit as these comments came during a prolonged period of bond fund outflows that coincided with the negative sentiment caused by Detroit’s bankruptcy filing and Puerto Rico’s budget difficulties



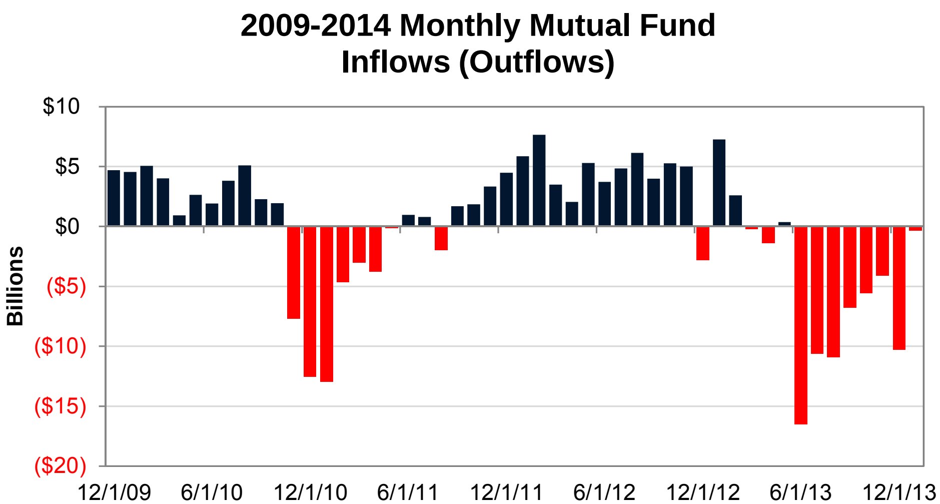
Source: Bloomberg & TM3

Municipal Market Volume

- Municipal market volume decrease in 2013 as refunding volume declined starting in April
  - Total issuance in 2013 fell by \$50B to \$331B which is down ≈15% versus 2012 issuance

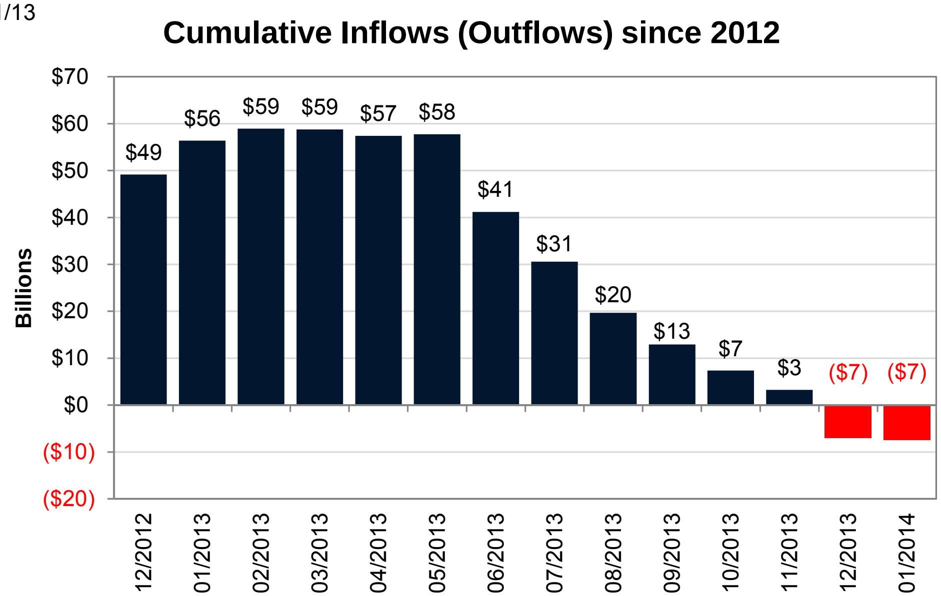


Demand – Mass Exodus from Munis in 2013



- Consecutively since April 1st, the municipal market has seen $67 billion flow out of mutual funds
- In 2013, bond funds were positive for only 11 weeks

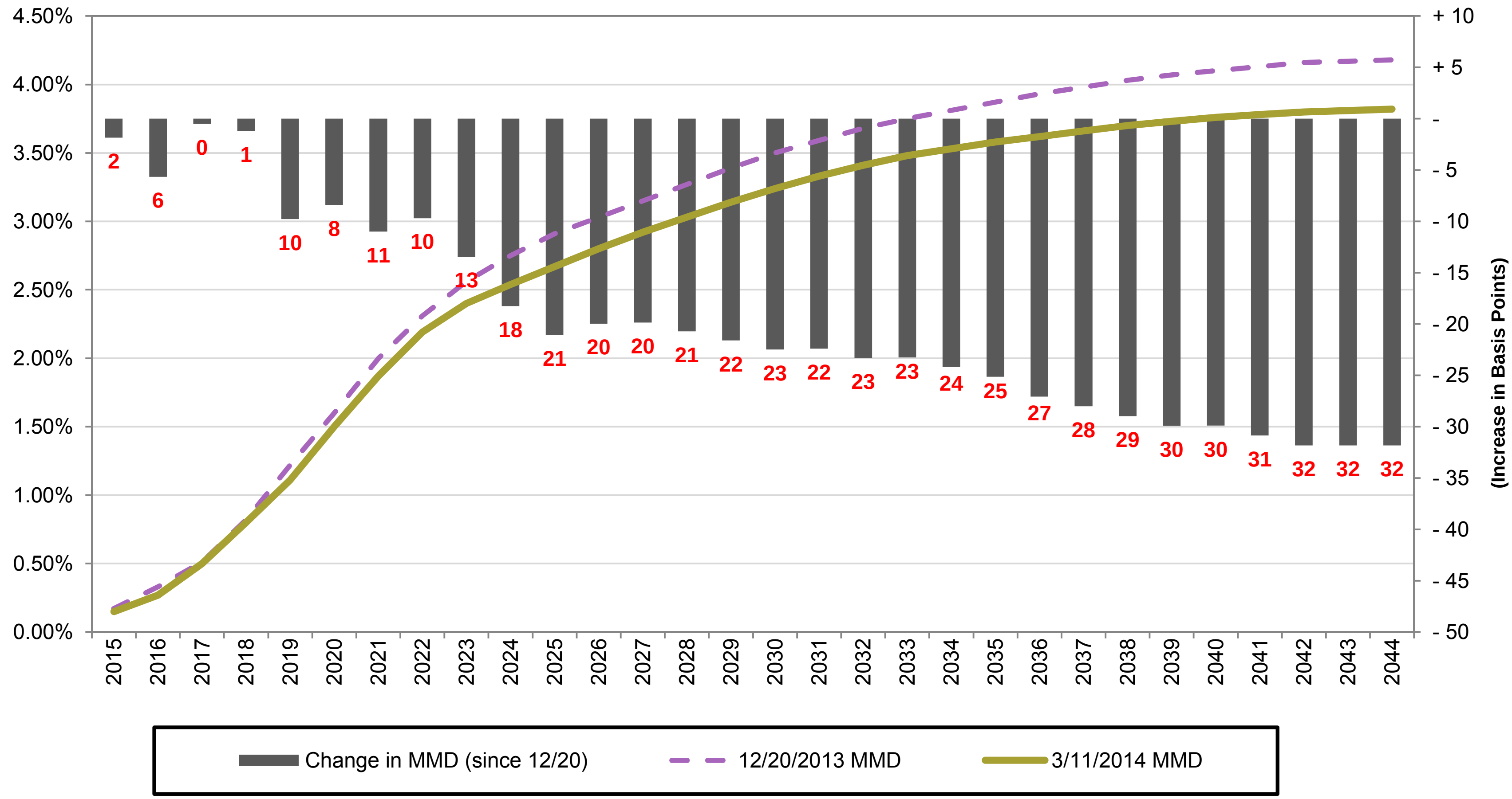
- Since the beginning of 2009, the municipal market has seen wild swings in fund flows. After four years, total fund flows are near a net wash



Source: Bloomberg & TM3

Recent Market Rate Movement

- Low supply has helped keep rates in check
- Fund flows have turned from negative to slightly positive renewing demand

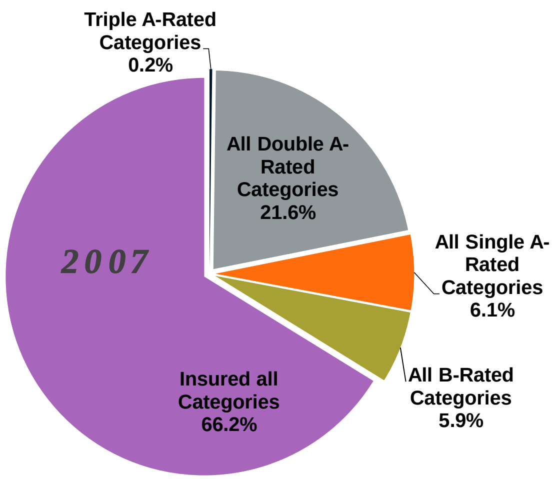


Source: TM3

Municipal Market Composition

Pre-Crisis
2007

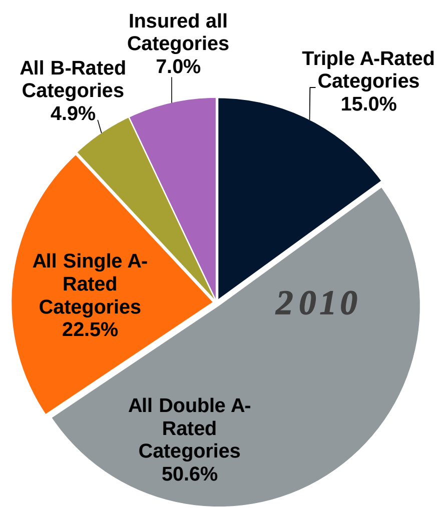
Municipal Bond Issuance
% of Total Par by Rating Category



In 2007, 2/3s of the market was insured; just 0.2% of all issuances were natural triple-As. Nearly 90% was of all issuances were double-A rated or better

Post-Monolines
2010

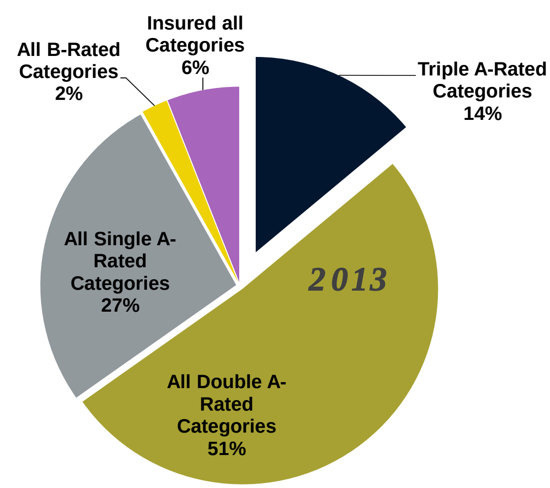
Municipal Bond Issuance
% of Total Par by Rating Category



In 2010, insured issuance dropped to 7%, natural triple-A issuance increase to 15%. And, double-A rated or better issuance fell to 65%

Now
2013

Municipal Bond Issuance
% of Total Par by Rating Category

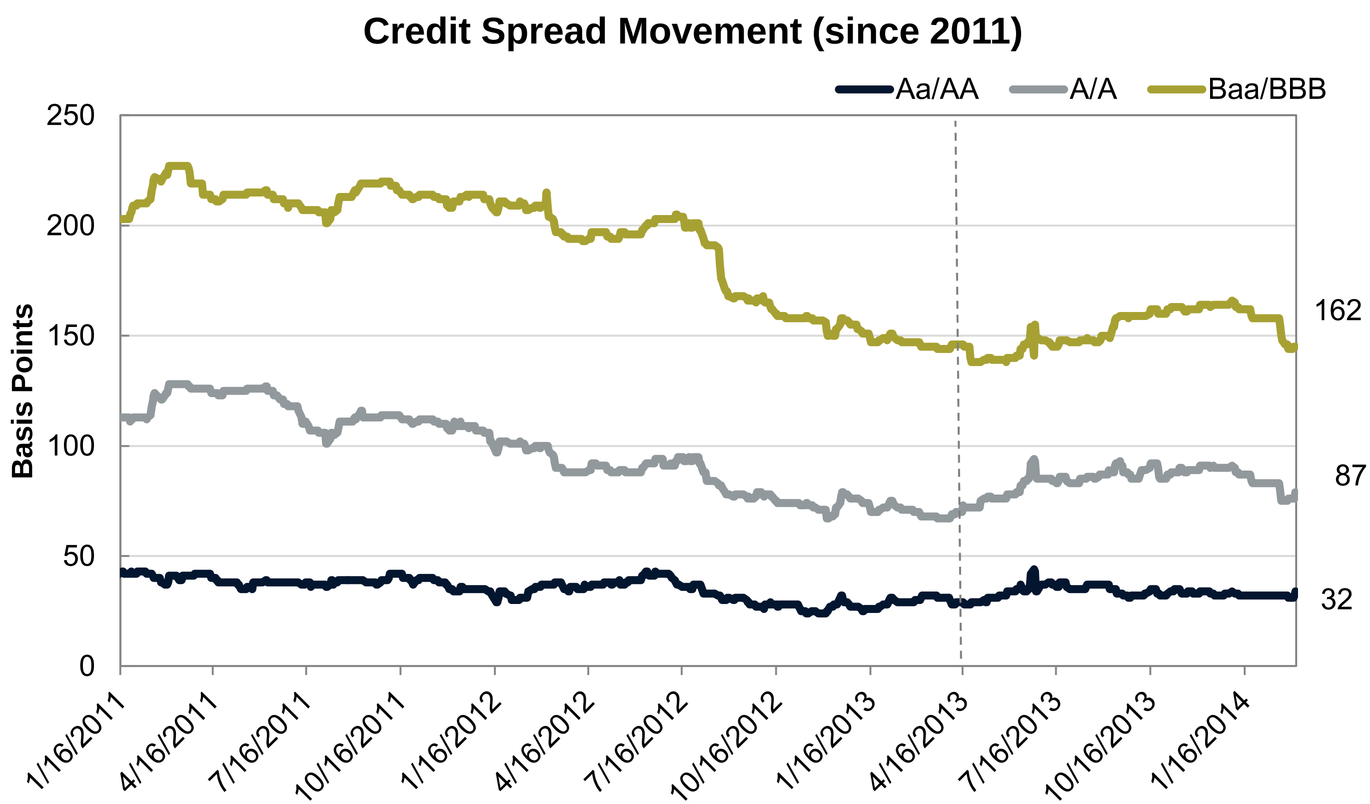


Issuance breakdowns in 2013 remained similar to that from 2010, with issuances of lower credits falling slightly, however the market has now adjusted to a vastly more complicated credit landscape

Source: Bloomberg & TM3

Credit Spread Volatility Persists

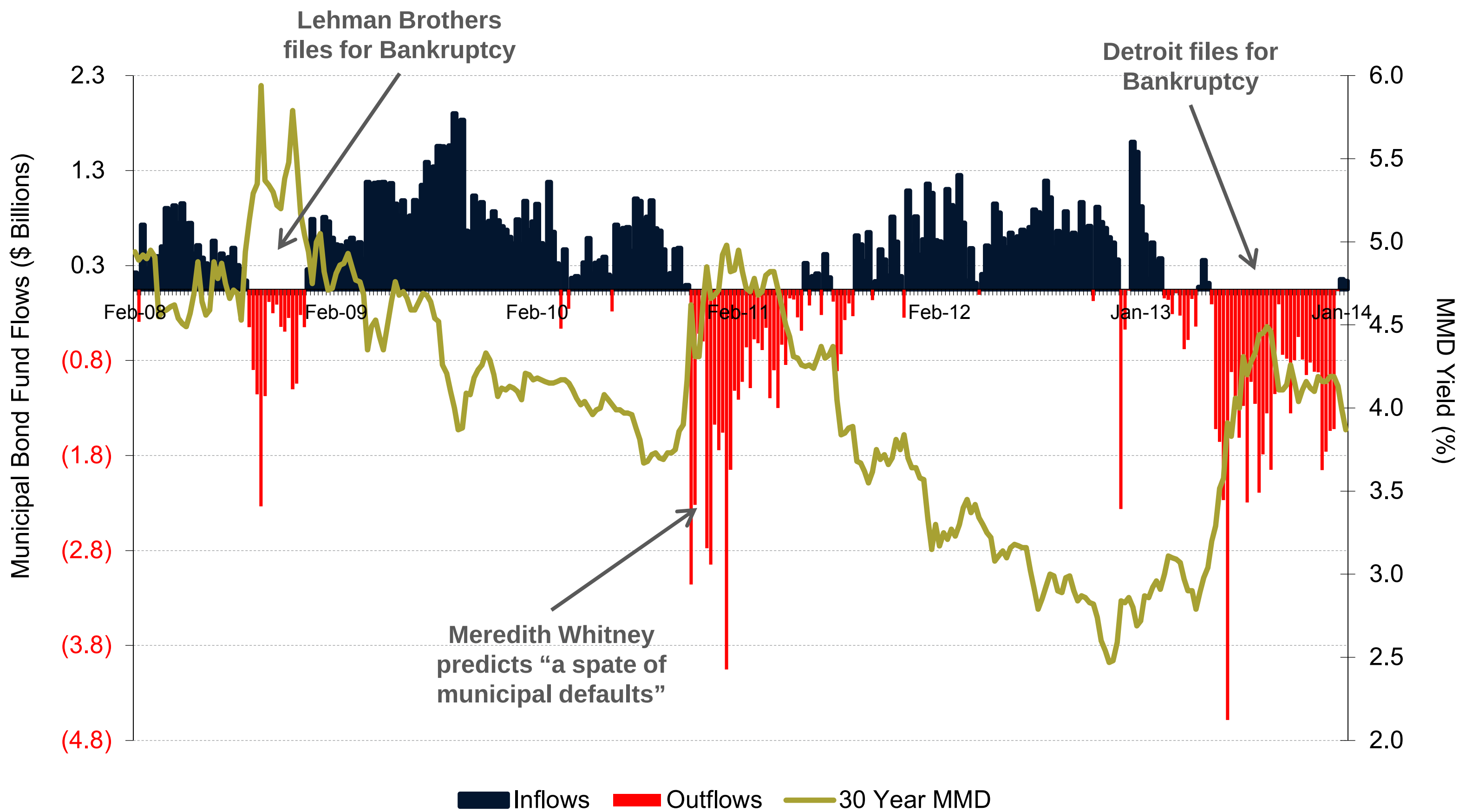
- Low yields on high-grades continue to push investors out the credit curve in search of yield
- However, due to large fund liquidations beginning in April, credit spreads saw upward pressure for the second half of 2013



Source: TM3

Headline Risk Creates Market Challenges

- Fear of bankruptcy and defaults creates market volatility that impacts all local government credits



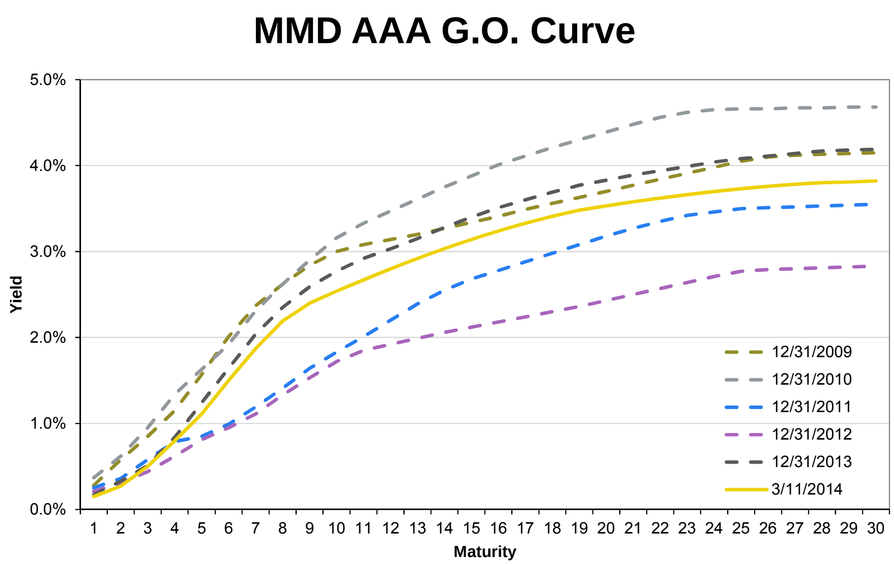
Source: Bloomberg & TM3

Municipal Bankruptcies

- Many of the largest municipal bankruptcies in history have occurred in the past few years

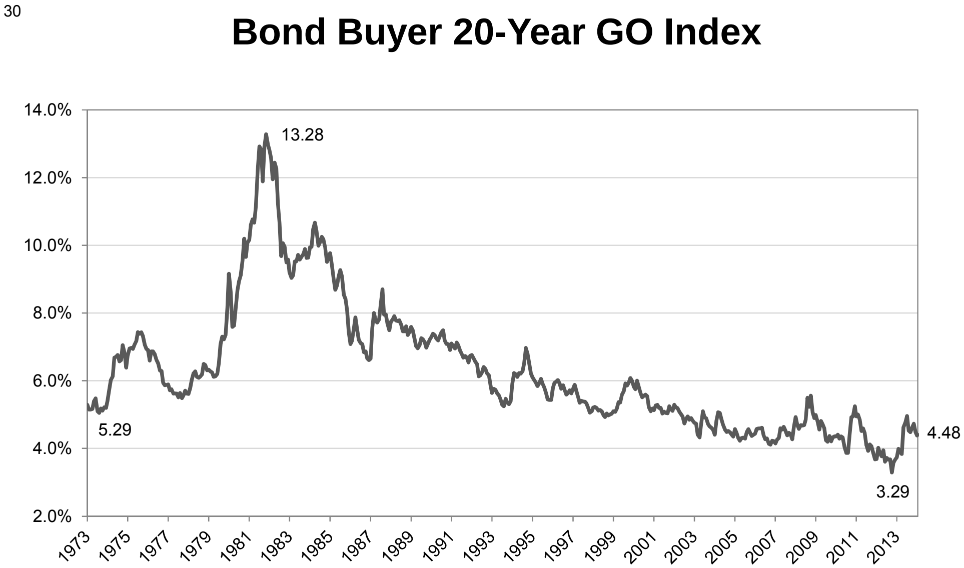
Largest Municipal Bankruptcies In U.S. History		
Issuer	**Year**	**Debt**
Detroit, MI	2013	$18 billion
Jefferson County, AL	2011	$4 billion
Orange County, CA	1994	$2 billion
Stockton, CA	2012	$1 billion
San Bernardino County, CA	2012	$500 million

Current Municipal Market Rates in Perspective



- Current rates are towards the middle of the range seen over the past five years

- In a broader historical context, rates still look very attractive
- Inflation will always be the biggest determinant of absolute levels



Source: Bloomberg & TM3

Looking Ahead

- In 2014, attention will be on fund flows, headline events, regulatory concerns and Fed policy
- Fund outflows and their negative impact on liquidity continue to present challenges. Hopefully, fund flows stabilize or turn positive in early 2014
- Eyes will be on Puerto Rico, as well as Detroit
  - There has been much debate and media discussion surrounding Puerto Rico's finances and credit ratings. With more the 75% of U.S. municipal mutual funds owning Puerto Rico debt, any event associated with Puerto Rico and its ≈$70 billion of outstanding debt will certainly impact the broader municipal market
- Regulatory environment
  - Market participants will continue working through the impacts of the SEC Municipal Advisory rules, the Volcker Rule and Basel III, as well as the IRS's proposed changes to the determination of the new issue price
- Federal Reserve
  - Attention will be on Fed Chairwoman Janet Yellen. Fed policy focus is likely to shift from QE tapering to the Fed Funds target rate. 2013 saw long-term rates spike in anticipation of Fed tapering. If the Fed sees enough positive economic news in 2014, the Fed Funds target rate could rise with municipal rates following the lead of short-term Treasury rates. The municipal curve could flatten.
- Consensus wisdom from the market prognosticators is for municipal market supply to remain flat to slightly down from 2013

Commercial Banks Continue to Play in 2014

- Multiple factors have driven commercial banks to play an active role in the municipal market

Evolution of Bank Credit Ratings in the Last Decade

Ratings	April 2001	July 2007	January 2014
Aaa		Bank of America Royal Bank of Scotland Bank of New York Mellon UBS Citibank Wells Fargo Bank JP Morgan Chase Bank	
Aa1	Bank of America Wells Fargo Bank Credit Agricole UBS	Banco Santander Deutsche Bank Barclays Bank HSBC Bank BBVA ING Bank BNP Paribas Nordea Bank Credit Agricole Societe Generale Credit Suisse State Street Bank & Trust	
Aa2	Bank of New York Mellon ING Bank Barclays Bank JP Morgan Chase Bank BBVA Royal Bank of Scotland Citibank State Street Bank & Trust HSBC Bank	BPCE (Banque Populaire) SMBC BTMU UniCredit Mizuho Corporate Bank	Bank of New York Mellon
Aa3	Banco Santander Deutsche Bank BNP Paribas Societe Generale BPCE (Banque Populaire) UniCredit	Goldman Sachs Bank Morgan Stanley	BTMU State Street Bank & Trust HSBC Bank SMBC JP Morgan Chase Bank Wells Fargo Bank Nordea Bank
A1	Credit Suisse	Bank of China	Bank of China Mizuho Corporate Bank Credit Suisse Standard Chartered
A2	BTMU Standard Chartered	Standard Chartered	Barclays Bank Goldman Sachs Bank BNP Paribas ING Bank BPCE (Banque Populaire) Societe Generale Credit Agricole UBS Deutsche Bank Citibank
A3	SMBC Mizuho Corporate Bank		
Baa1	Bank of China		Royal Bank of Scotland
Baa2			Banco Santander Morgan Stanley Bank of America UniCredit
Baa3			BBVA

Commercial Banks Continue to Play in 2014

- Role of banks in municipal finance
  - Traditional role
    - Bank qualified (less than $10 million) and short financings
  - Current role
    - Larger & longer financings
      - 15 to 20 years for some banks
      - Par amounts over $100 million for some institutions
    - Replace letter of credit backed VRDOs with direct placement bank variable rate obligations
  - Factors to consider
    - All bank proposals are NOT created equal
    - Call provisions
    - “Make whole” language is rarely “make whole”
    - Terms and conditions
      - » Increased costs
      - » Rating downgrade triggers
      - » Term out in the event of a default

Financing Trends

What Types Of Bonds Are There?

- **Municipal Bonds**, also called “munis,” are debt securities issued by states, cities, counties and other government entities
  - **General Obligation Bonds** are bonds backed by the full faith and credit of the issuer, which has the power to tax residents to pay bondholders
  - **Revenue Bonds** are bonds that are backed by revenues from a specific project or source, such as highway tolls, utility revenues, hospital revenues, sales tax, etc.
  - **Certificates of Participation** are secured by annual lease payments (subject to annual appropriation) derived from a specific revenue source, basket of revenues, or any other available revenues
  - **Conduit Bonds** are issued by governments on behalf of private entities such as non-profit colleges or hospitals -- these “conduit” borrowers agree to repay the issuer who in turn pays the interest and principal on the bonds – if the conduit borrower fails to make a payment, the issuer usually is not required to pay the bondholders

Tax Status Of Municipal Bonds

- **Tax-Exempt Bonds**
  - The interest earnings on most municipal bonds (depending on purpose of financing) generally is ***exempt from federal tax and also may be exempt from state and local taxes for residents in the states where the bond is issued***, making them an important investment vehicle for institutions and high net worth individuals
  - Issuance must be authorized by a governing body and proceeds must be used for state and local government purposes
  - Subject to arbitrage rebate and advance refunding restrictions
  - Interest rate based off tax-exempt MMD scale
- **Taxable Bonds**
  - A fixed-income security issued by a government or related agencies, the income from which is not exempt from taxation
  - Generally issued to finance a project or activity that does not provide a major benefit to the public -- in such cases, the federal government will not permit tax-exemption
  - Not subject to arbitrage rebate (can invest proceeds at a profit) or advance refunding restrictions
  - Interest rate based off taxable U.S. Treasuries
- **Alternative Minimum Tax (AMT) Bonds**
  - The AMT is designed to prevent taxpayers from escaping their fair share of tax liability through various tax breaks
  - Depending on their purpose, some municipal bonds can be exempt from federal taxes, but still be subject to AMT
  - Interest rate based off tax-exempt MMD scale

Why Issue Taxable Municipal Bonds?

1. Because You Have To

- Project or activity does not provide a major benefit to the public (private activity bonds)
  - Parking garage at an airport that is used by rental car companies
  - Pension obligation bonds
  - Some sports facility projects
  - Pre-event financings for catastrophe related issuers
  - Advance refunding of bonds that cannot be advance refunded with tax-exempt debt

2. Because You Want To

- Provides issuer more operational flexibility
- Provides issuer a larger investment base
- Provides issuer with a better interest rate than tax-exempt bonds
  - Build America Bonds (portion of interest is subsidized by federal government)
  - Tax Credit Bonds (issuers receive tax credit on their federal tax returns)

Interest Rate Mode

- **Fixed Rate Debt**
  - Interest rate is fixed through the final term of the loan at time of pricing
  - Most municipal fixed rate debt is structured with semi-annual interest payments and annual principal payments
  - Traditionally associated with long-term debt but is also available for interim and short-term debt
  - Bonds, COPs, state revolving loans/programs, bank loans, notes
- **Variable Rate Debt**
  - Interest rate resets weekly, bi-weekly, monthly or yearly based on an index or open market pricing
  - Commonly structured with monthly interest payments and yearly or semi-annually principal payments
  - Depending on type of debt, may require issuer to secure external liquidity (letter of credit)
  - Variable Rate Demand Obligations (VRDO), SIFMA/LIBOR Floating Rate Notes, Auction Rate Securities (ARS) , bank loans
- **Synthetic Fixed or Variable Rate Debt**
  - Interest rate mode of underlying debt can be changed via a separate interest rate hedge agreement
  - Debt issued in variable rate mode can be converted to fixed rate mode and vice-versa
  - Requires a higher level of sophistication and understanding than traditional fixed or variable rate debt
  - Mark-to-market (MTM) can result in substantial penalties to terminate the contract voluntarily or involuntarily

How Can We Finance This Project?

- A City Manager is directed by his/her City Council to build a new municipal complex comprised of a city hall, fire station and various recreational facilities

- The City Manager approaches you, the Finance Director, asking how the City can best finance this project?

- **Factors to consider / Questions to ask:**
  - What is the estimated cost of the project? How quickly are the funds needed?
  - Can the City afford to pay the debt from existing revenues or will it require a new revenue source?
  - If it requires a new revenue source, does the City Council have the legal authority to impose a new fee/tax or increase an existing fee/tax? If not, is the City Council willing to put a measure on the ballot? Will it pass?
  - If the funds are coming from existing revenues, how much can the City afford and does the City have legal authority per state law and city charter to pledge a certain revenue(s) to secure debt?
  - How much of this potentially pledged revenue does the City collect annually? Is it fairly stable? Can this revenue source be taken away by the state or county at any time in the future?
  - What is the most efficient financing structure given these parameters?

How Can We Finance This Project?

- A County Administrator is directed by his/her County Commission to their community, which result in the building of a new stadium and practice fields

- The project is estimated to cost $50 million and the minor league baseball team would like to lease the stadium from the County for 25 years at $1.5 million per year

- **Factors to consider / Questions to ask:**

  - Since the $1.5 million lease payments will not cover principal and interest, how can the County minimize its financial exposure?

  - Does the project qualify for tax-exemption? How much private money (naming rights, parking operators, other events) is expected to be generated from the project and does that affect its tax-status? Are there any state grants available?

  - Other than County funds, what other revenues might be available to secure the debt? Special assessments, tax increment revenues, tourist development tax (hotel bed tax) revenues?

  - What is the most efficient financing structure given these parameters?

Publically Offered Bonds

- Very efficient for longer term transactions – 30 years (rates fixed for entire term)
- Can accommodate innovative and creative financial solutions beneficial to the issuer
- Highest cost of issuance
- Debt rating and/or credit enhancement (bond insurance) may be required. Less so in today's market versus pre-credit crisis.
- Funding of Debt Service Reserve Fund required for most credits (General Obligation Bonds are the exception).
- Risk of future changes in tax laws passed in investors (i.e., no "gross up" language)
- Sold either competitively or negotiated
- Initial disclosure requirements (official statement) can be burdensome
- Continuing disclosure required after bonds are sold
- Flexible call features (10 year par call is standard)

Privately Placed Bank Loans

- Does not require that transaction be rated or insured
- No offering documents or registration required
- Banks usually do not require a Debt Service Reserve Fund
- Disclosure usually limited to receipt of CAFR and budget (no official statement)
- Minimal cost of issuance
- The purchase of tax-exempt loans by non-bank subsidiaries and affiliates of commercial banks debt has resulted in more efficient “nonbank qualified” pricing

Privately Placed Bank Loans

- Risk of future tax law changes retained by the issuer. Bank loans usually contain interest rate “gross up” language; providing the bank the right to increase the loan rate should tax law changes negatively impact the bank’s after tax yield

- Term limited to 20 years and some banks will not provide a fixed rate for the entire term. Instead, the bank would have a “put” option during the term of the loan (5 , 10, or 15 years). This gives the bank the option to “put” the loan back to the issuer and force them to refinance at the then current market rates.

- Level of municipal finance expertise varies. Larger banks have dedicated professionals; while smaller institutions may not.

Commercial Paper

- Small to Medium Project Cost
- Ability to Drawdown Proceeds over time to fund Project
- Desired Repayment is short (5 years or less) and repayment timing is flexible
- Interest rate is variable
- Letter of Credit (LOC) may be required from bank, which is costly in current market (up to 100+ basis points). Also leaves issuer exposed to credit risk of the bank as well as renewal risk on LOC.
- Early Prepayment Flexibility
- Bridge/Interim Financing

SRF Loan

- State Revolving Fund Loans (SRF) are limited to water and sewer type projects.

- State of Florida issues bonds to generate a pool of funds, which are then used to make loans to local governments.

- Issuer must complete application about projects to be financed, which is then reviewed by the State. Assuming the projects qualify and funds are available then all or a portion of the project may receive SRF funding.

SRF Loan

- Interest rates are generally lower than what is available through public bond market or private bank market because interest rates are subsidized by the State (2.00% to 3.00%).
- The term of these loans is 20 years with debt service paid on a level annual basis. As a result, the issuer has little structuring flexibility.
- Revenue pledged as security typically subordinate to other water and sewer debt of the issuer (very important to make sure SRF documents comply with existing water and sewer bond documents to the extent issuer has other debt).
- Funds are generally provided on a reimbursement basis so some type of interim financing or internal financing may be required.
- Limited amount of capacity and typically abundant demand.
- Stringent ongoing reporting/compliance requirements (a lot of paperwork).

Summary of Options

Type of Financing	Pros	Cons
Publicly Offered Bond	• Able to reach a broad market of investors • Can issue bonds out to 30-years • Flexible schedule	• Need ratings or credit enhancement • Higher costs of issuance • Greater administrative requirements
Privately Placed Bank Loan	• Does not require ratings or credit enhancement • Lowest rates available if structured to enable banks to receive tax advantage (Bank Qualified rates) • Minimal cost of issuance • Fewer administrative requirements (continuing disclosure)	• Typically longest allowable term is 15-20 years • Interest rate subject to increase if tax laws change
Commercial Paper	• Generally low interest rates (short term) • Flexible repayment schedule • Early prepayment allowed	• Interest rate is variable • Requires letter of credit, which can be costly (credit risk)
State Revolving Fund Loan Program	• Interest rates are usually lower than what is available to smaller local governments • The SRF takes care of sale process and arbitrage compliance • Potential for principal forgiveness through legislative appropriation • Typically subordinate pledge of revenues	• Stringent application process • Specific coverage requirements • Term limited to 20 years with level debt service • Loans are disbursed on a cost incurred basis, not upfront (reimbursement) • Limited amount of capacity available

Ratings and Credit Considerations

Bond Ratings

- What is a Bond Rating?
  - Measure of risk to bondholders
  - Reflects issuer’s ability & willingness to repay debt on time and in full (who, how, what?)
  - Factors in expected loss and recovery
  - Denotes credit quality by rating level
  - Independent opinion (subjective process)
  - Forward looking projection

Bond Ratings

- Bond Rating is Not
  - Audit
  - Recommendation to buy, sell or hold a security
  - Static or permanent
  - Opinion of community's quality of life
  - Performance evaluation of current political leadership
  - Judgment of quality of service delivery

Rating Scale

Highest Rating

Below Investment Grade

S&P	Fitch	Moody's
AAA	AAA	Aaa
AA+	AA+	Aa1
AA	AA	Aa2
AA-	AA-	Aa3
A+	A+	A1
A	A	A2
A-	A-	A3
BBB+	BBB+	Baa1
BBB	BBB	Baa2
BBB-	BBB-	Baa3
BB	*BB*	*Ba*
B	*B*	*B*
C	*C*	*C*

Changes in Rating Criteria

- Changes in Moody's Rating Methodology for Local Government General Obligation Debt

Factor 1 Economy/Tax Base	Factor 2 Finances	Factor 3 Management	Factor 4 Debt/Pensions
30%	30%	20%	20%
Was 40%	Unchanged	Unchanged	Was 10%

- Rationale for change in weightings:
  - Factor 1 weighting lowered to reduce the influence of tax base size
  - Factor 4 weighting increased to include a specific quantitative measure for pensions

Factors & Sub-Factors	Weights
Factor 1: Economy/Tax Base	**30%**
Full Value (market value of taxable property)	10%
Full Value per Capita	10%
Median Family Income	10%
Factor 2: Finances	**30%**
Fund Balance as % of Operating Revenue	10%
5-Year Dollar Change in Fund Balance as % of Revenues	5%
Cash Balance as % of Revenues	10%
5-Year Dollar Change in Cash Balance as % of Revenues	5%
Factor 3: Management	**20%**
Institutional Framework	10%
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	10%
Factor 4: Debt/Pensions	**20%**
Net Direct Debt / Full Value	5%
Net Direct Debt / Operating Revenue	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues	5%

Source: Moody's Investor Services

Moody's Outlook

STABLE

States

Stabilizing national economy supports growth in state revenues and reserves.

Revised to STABLE

Local Governments

"The New Stable" reigns as the era of constrained resources persists but the worst is over.

NEGATIVE (K-12 STABLE)

Higher Education Not-for-Profits K-12 Schools

Expense growth to outpace revenue growth for all sectors except Independent K-12 Schools.

NEGATIVE

Not-for-Profit Hospitals

Revenue growth will decline; margins will contract on new investments.

STABLE

State Housing Finance Agencies

State HFAs have evolved to meet the demands of the new lending environment.

STABLE

US Public Power

Utilities' unregulated ability to establish electric rates to meet sound debt service coverage rations drives our stable outlook

STABLE

US Airports

Slight growth in enplanements, or the number of seats sold on a flight, drives our stable outlook

Revised to STABLE

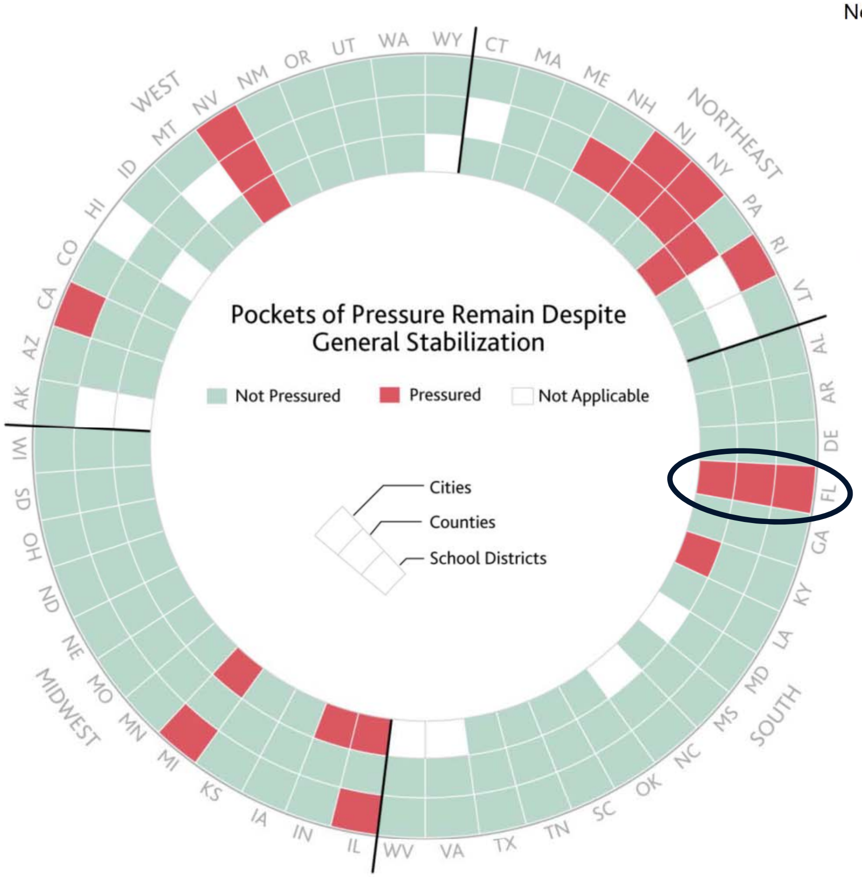
US Toll Roads

Traffic growth is set to rise about 1.5%, marking a sustainable comeback from recession lows

Source: Moody's Investor Services 2014 Outlook: US Public Finance

Moody's Outlook – Local Governments

Local Government Outlook Summary



	Stressed Sectors
New Hampshire	Subsidies for nursing homes will pressure financial performance of counties.
New Jersey	Along with a lagging economic recovery, declining fund balances and limited revenue increase will weigh on cities and counties.
New York	Both cities and counties are facing rising pension and healthcare costs.
Pennsylvania	While coping with declining state aid, many issuers are also coping with strained tax bases and rising costs.
Rhode Island	Cities continue to deal with weak revenue and economic growth and large pension liabilities.
Florida	Still recovering from the downturn, tax levels are still suppressed and many issuers still need to achieve structural balance.
Kentucky	Schools are strained by lease issues.
Illinois	Pension pressures weigh on cities, while delayed state aid is worrisome for school districts.
Indiana	State aid is being held flat and raising property taxes has become more difficult.
Michigan	Cities are coping with shrinking tax base and revenues. Schools face lower enrollment and lower state aid.
California	Significant revenue raising constraints and pension liabilities are above average due to generous benefits.
Nevada	Not yet recovered from the downturn, tax levels have not rebounded and budgets are still cut.

Source: Moody's Investor Services 2014 Outlook: US Public Finance

Additional Rating Information

- Standard & Poor's "Detroit's Bankruptcy Filing is Becoming a Long and Costly Row to Hoe"
  - https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1223365&SctArtId=199805&from=CM&nsl_code=LIME
- Standard & Poor's does not View Detroit's Chapter 9 Filing as the Start of a New Trend
  - https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1165511&SctArtId=170485&from=CM&nsl_code=LIME
- Standard & Poor's "An Aging Population Puts Pension Plans to the Test"
  - https://ratings.standardandpoors.com/us-public-finance/An-Aging-Population-Puts-Pension-Plans-To-The-Test.html

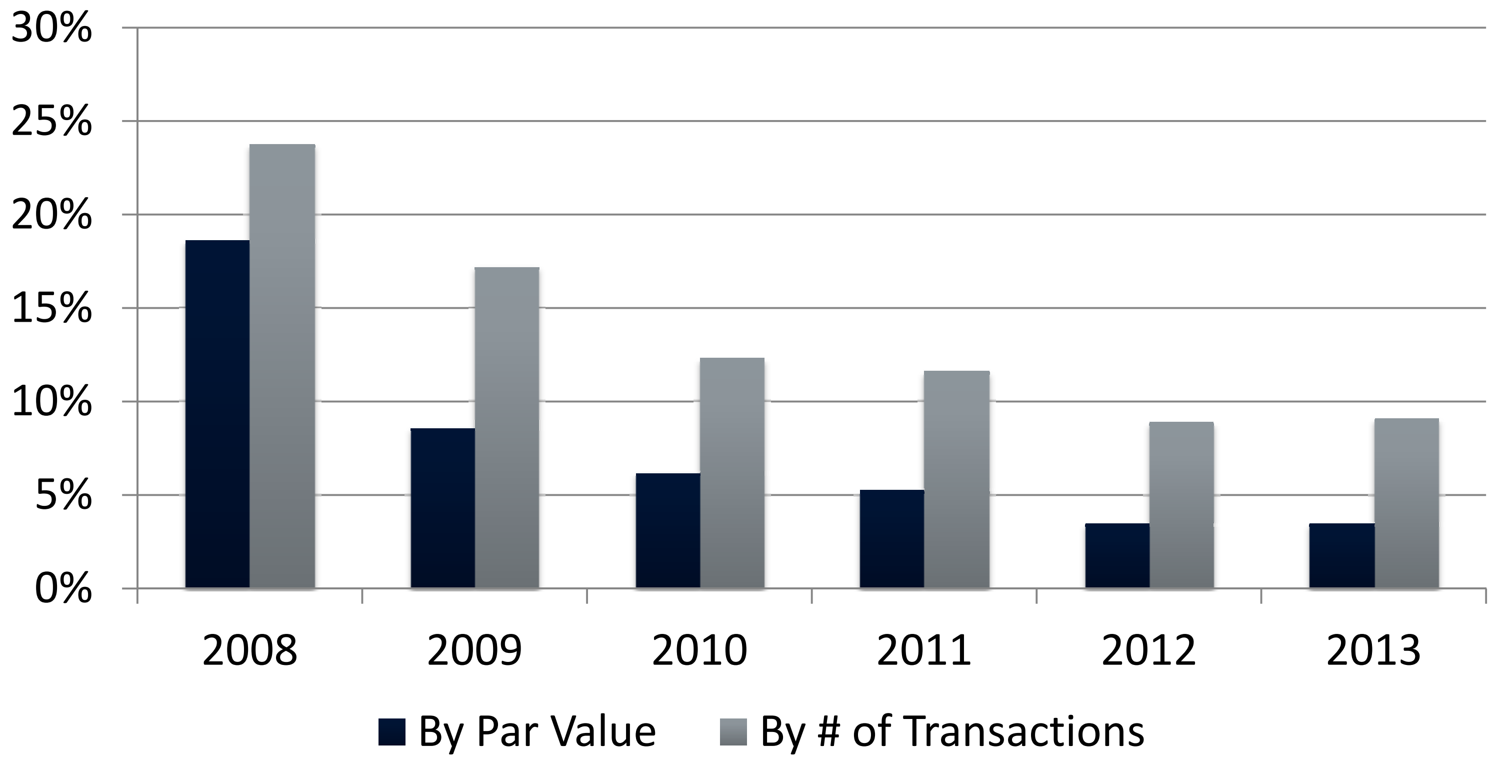
- Articles available upon request
  - Fitch Local Government Tax-Supported Rating Criteria
    - Released: August 2012
  - Moody's Adjustments to State and Local Government Reported Pension Data
    - Released: April 2013
  - Standard & Poor's: Bank Loans And Bond Ratings: What to Disclose?
    - Released: June 2013
  - Standard & Poor's: US Local Governments General Obligation Ratings Methodology and Assumptions
    - Released: September 2013

Bond Insurance

- An insurance policy purchased by the issuer at pricing that guarantees the timely payment of principal and interest on the bonds. The issuer benefits from its bonds pricing at lower interest rates that reflect the credit enhancement provider's credit ratings – but, of course, the issuer must pay a fee for this benefit.

- Prior to 2007/2008, there were seven "Aaa/AAA/AAA" rated insurance providers -- today there are none.

- Insured Penetration Stabilized in 2013, after declining every year since 2005.



Bond Insurance

- Assured Guaranty Municipal Corp. (AGM) and Build America Mutual (BAM) are the two most prevalent bond insurers in today's market
  - Assured Guaranty Municipal Corp. (AGM) is currently rated "A2" (stable) by Moody's and "AA-" (stable) by Standard & Poor's
    - In July 2013, Assured Guaranty launched Municipal Assurance Corp. (MAC), a new municipal bond insurance company that will insure only select categories of U.S. municipal bonds
  - Build America Mutual (BAM) is currently rated "AA" (stable) by Standard & Poor's
- Based on the issuer's credit rating, insurance premium and pricing benefit of the insurance, does it make sense to purchase insurance?
- Does insurance need to be purchased in order to obtain a DSRF surety? If so, how much insurance?

Debt Service Reserve Fund

- The DSRF is an amount often required to be set aside to cover one year of principal and interest payment
- DSRFs are often used with revenue bonds although we have seen many essential service (water and sewer, electric, etc.) revenue bonds being done without DSRFs recently
- Do the outstanding bonds have an existing DSRF?
- How is this DSRF funded? Is it funded with cash, surety or letter of credit?
- Are the new refunding bonds required by the authorizing documents and/or the market to have a DSRF?
- If required to have a DSRF, can existing cash funded DSRF be transferred into refunding deal (usually it can) or can existing insurance/surety providers be transferred over (usually they cannot)?
- If required to substitute an existing surety policy with either cash or bond proceeds due to lack of surety providers in the current market, is it economically feasible to do so?
- If new bonds are not required to fund a DSRF, can existing cash funded DSRF be released

Post Issuance Compliance

A Change In IRS Focus

- Prior focus on pre-issuance type compliance problems
  - Is the project financeable with tax-exempt bond proceeds?
  - Less focus on post-issuance compliance, such as arbitrage rebate
- Beginning in 2007, shift in focus to post-issuance compliance
  - “Soft contact” surveys sent to 501(c)(3) organizations and governmental entities to assess post-issuance compliance
  - Significant increase in IRS audits
  - Emphasis on <u>written</u> policies and procedures to manage post-issuance compliance
  - Change in IRS Forms to include acknowledgement of written procedures (IRS 8038, IRS 990 Schedule K)
- Two main measurements**: Arbitrage rebate** and **Private Business Use**

Thoughts & Considerations

- The IRS is focused on post-issuance compliance
  - Attempting to influence issuers to adopt and implement written post-issuance compliance procedures
    - Audits, “soft-contact” surveys
    - Changes to 8038 series forms
- Arbitrage rebate and yield restriction compliance is an integral part of post-issuance compliance
  - Keeping good records, making timely allocations, and proactively monitoring arbitrage rebate and yield restriction liabilities will mitigate audit risk
- Developing process for identifying and quantifying private use when planning for the issue and after

Compliance Program Considerations

- Written policies & procedures
- Team to manage compliance process
- Arbitrage rebate & yield restriction compliance
- Record retention
- Private business use compliance
- Staff training and education
- Continuing disclosure requirements

Adopt Written Procedures

- Create a framework to manage and implement your compliance program
- IRS is strongly encouraging issuers to adopt written procedures that address:
  - Due diligence reviews at regular intervals
  - Identifying the person responsible for review
  - Training of the responsible person
  - Retention of adequate records
  - Procedures to timely identify noncompliance
  - Steps to timely correct noncompliance
- Detailed, relevant and implemented
- Plan, execute, review and audit

The New IRS Form 8038

Form **8038-G**
(Rev. September 2011)
Department of the Treasury
Internal Revenue Service

Information Return for Tax-Exempt Governmental Obligations
▶ **Under Internal Revenue Code section 149(e)**
▶ **See separate instructions.**
Caution: *If the issue price is under $100,000, use Form 8038-GC.*

OMB No. 1545-0720

42 If the issuer has superintegrated the hedge, check box . . . . ▶ ☐
43 If the issuer has established written procedures to ensure that all nonqualified bonds of this issue are remediated according to the requirements under the Code and Regulations (see instructions), check box . . . . ▶ ☐
44 If the issuer has established written procedures to monitor the requirements of section 148, check box . . . . . ▶ ☐

- IRS revised Form 8038-G in September 2011 to include lines #43 and #44
- Issuers that are unable to check the boxes on the Form 8038 / 8038-G may receive greater scrutiny

Record Retention Requirements

- Requirements are burdensome and may not be consistent with document destruction policies
  – Life of the Bonds + 3 years
  – If the Bonds are refunded, life of refunding bonds + 3 years

- Consider separate document collection, storage and destruction policies for bond related records

- Consider electronic storage systems

Examples – Records to Retain

- Board minutes, resolutions
- Appraisals
- Bond transcripts
- Newspaper ads, misc. correspondence
- Investment records
- Expenditure histories
- Invoices
- IRS Filings
- Records related to acquisition of investment agreements and interest rate swaps
- Payments for credit facilities
- Arbitrage rebate and yield restriction compliance reports

Wrapping it up!

- If you have written policies and procedures – make sure you follow them!
- Create internal controls and processes just like other business functions – you can’t report what you didn’t identify and measure

Municipal Advisors

"The new regulations arrived earlier today."

Definition of Municipal Advisor

- Dodd-Frank defines "municipal advisor" as a

PERSON

(Not a municipal entity or an employee of a municipal entity)

THAT

PROVIDES MUNICIPAL FINANCIAL ADVICE

Includes "Advice" Regarding the Structure, Timing, Terms, or Other Similar Matters

OR

SOLICITS BUSINESS FOR MUNICIPAL FINANCIAL PRODUCTS ON BEHALF OF UNAFFLILIATED 3rd PARTIES

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

Municipal Advisor Regulations

- Advice
  - Construed broadly
  - Objective determination based on all relevant factors
  - Factors include:
    - Whether person makes a “Particularized Recommendation”
    - Whether the content, context and manner of presentation would reasonably cause someone to take action OR refrain
    - How individually tailored the information is to a specific OR targeted group of muni entities or obligated persons
  - Term excludes: general information

- “Effective Date”
  - Originally: 60 Days After Federal Register Publication – January 13, 2014
  - Postponed until July 1, 2014

- What is Effective?
  - All Rules
  - All Forms

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

Rule References Incentives for Using MAs

- Fiduciary duty
- Reduced borrowing and issuance costs
- Better financing terms
- Improve capital formation
- Positive impact on taxpayers
- Regulatory oversight over standards, training and conduct

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

Providing Municipal Financial Advice

- What is advice under Rule 15Ba1-1(d)(1)(ii)

Recommendations of municipal financial products

Recommendations for the issuance of municipal securities

Recommendations based on the structure, timing, and terms of municipal products or issuance of municipal securities

Recommendations particularized to the specific needs, objectives, and/ or circumstances of municipal entity or obligated person

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

General Information Not Considered to be Advice

- What is NOT advice under Rule 15Ba1-1(d)(1)(ii)

Publicly held information (outside of municipal entities or obligated person)

Unspecific Information (not specific to a particular municipal entity or type of municipal entity)

Factual information (no assumptions/opinions/viewpoints)

Educational material (instructional or explanatory info)

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

Rule of Thumb

- If the advice can be reasonably viewed as a specific suggestion to the municipal entity to either act or refrain from acting with regard to municipal financial products or the issuance of municipal securities, then it is Advice under the Rule

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

Types of Advice Covered

No Incidental Exemptions or Exclusions
for DeMinimis Advice

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.

Underwriter Exemptions

- Underwriters can only provide “advice” in certain defined situations
- Exemptions
  - “Underwriter exemption”
    - Dealer has been engaged to underwrite a specific issue, but not as part of an underwriting pool if the firms are not actively working on a specific transaction
    - Provide advice regarding structure, timing, terms and other similar advice regarding specific issues, if they are engaged for that particular issue
  - “RFP exemption”
    - Responses to Request for Proposals and Requests for Qualification for a particular issue, including mini-RFPs to an underwriting pool
  - “Independent Registered Municipal Advisor (IRMA) exemption”
    - Issuer has hired an independent Municipal Advisor (PFM) that is not the proposed underwriter
      - Independent MA is engaged to evaluate proposals from underwriters
      - Independent MA cannot be associated with proposed underwriter within the past two years

Source: Page 777 of the Full Rule (http://www.sec.gov/rules/final/2013/34-70462.pdf). Please note this is for informative purposes only and should not be considered legal advice.