K&L GATES

Bonds, Beginning, Intermediate and Advanced – and the "Role of the Government"

Washington Public Ports Association – Legal Seminar

www.klgates.com

November 15, 2016

Debt Limits - Why

Statutory – RCW 53.36.030; exception for state and federal loans RCW 39.36.060 and ch. 39.69

What is Debt? And Why Does it Matter?

- In Washington, “debt” is an obligation for borrowed money. Wash. Const. Art. VIII, § 1(d) and § 6
- Case law on this issue has not been so definitive
- Thus, “debt” will include “financing contracts”, e.g., lease-purchase agreements.
- “Debt” is a burden on taxpayers. Debt may be payable from all available sources of income to a taxing district, including general property taxes.

When is a "debt" not subject to constitutional or statutory debt limits

- "Special fund doctrine"(*Winston v. City of Spokane*, 41 P. 888 (Wash. 1895))
- An obligation that is payable solely from a "special fund" is not a "debt"
- These "debts" are referred to as "revenue debt" or "revenue bonds"
- This "debt" is not payable from property taxes; it is payable only from those sources of revenue that are identified in the authorizing documents; thus, the taxpayers are not burdened with this "debt"; the holders of those "revenue obligations" have no recourse against the taxpayers in the port district

Port Revenue Bonds

- No dollar limit on the amount of revenue bonds that can be issued
- Types of revenue bonds that may be issued by a Port

a. General Revenue Bonds ··· all operating revenue bonds of the Port are pledged for the repayment

b. Special Revenue Bonds ··· only the revenues of the particular facility are pledged (e.g., lease revenue bonds

Bonds – Includes other long-term agreements requiring the payment of money

- Bonds
- Notes
- Leases – Financing Leases – FASB 13
- Purchase agreements
- Commercial paper
- Financing agreements

What type of "debt" should your Port issue?

- General Obligation
- General Revenue
- Special Revenue

- Considerations:
  - Debt capacity
  - Interest rate
  - Market acceptance

Add Federal Tax Issues – ranked by interest rate

Type of Debt	Federal Tax Status
General Obligation	Governmental – Tax Exempt (Bank Qualified/Non Bank Qualified)
General Obligation	Private Activity – Tax Exempt
Revenue	Governmental – Tax Exempt (Bank Qualified/Non Bank Qualified)
Revenue	Private Activity – Tax Exempt
General Obligation	Taxable
Revenue	Taxable

Should you issue "Green Bonds?"

- Green bonds were created to help raise funds for projects that have positive environmental and/or climate benefits.
  - Over $50b issued in 2016 (as of September)
  - $42b issued in 2015
- Green designation may help marketing efforts to reach investors with environmental or social responsibility mandates
- May result in lower costs of borrowing by expanding your pool of potential investors (but we are not aware of any studies documenting savings)

“Green” is Largely an Unregulated Label

Considerable latitude exists in labeling your bonds:

- Freedom in determining which of your bonds to call “green”.
- No additional costs to issue “green” bonds.
- Not a separate credit or pledge; still backed by your general obligation, revenue or special revenue pledge.
- No separate regulatory regime with additional requirements for your bonds.

But Bonds Can't Be "Greenwashed"

- Risk of SEC prosecution for false and misleading statements (Section 17(a)(2) of the Securities Act)
- Investors will vet the project – inspect uses of proceeds and/or acquired assets
- Voluntary **Green Bond Principles** regime spearheaded by the International Capital Market Association
  - Markets may expect compliance with Principles
  - Includes project selection evaluation, tracking proceeds, reporting project results, external certification/rating.

If You Do Issue Green Bonds, Think About...

- Formalizing green selection criteria before the project
- Creating a separate project funds and processes for tracking expenditures
- Establishing a location for project reporting – a Web page on your site, posts to EMMA, etc.
- Generating regular (at least annual) updates
- Consider third-party green project review for the offering (consultant, certification, green rating – Moody's & S&P have proposed an assessment process, etc.)

Debt Issuance Process

- Manner of Sale
  - Competitive
  - Negotiated < Public Offering/Private Placement
- The Issuance Process
  - Buyer needs a “bond opinion” –
    - valid and binding obligation
    - tax status of bond
  - Paperwork – Bond Resolution
  - All documents in are in transcript – retained by Port

Bond Ratings

- A higher bond rating results in lower interest rates.

A Guide to Bond Ratings	
Moody's Investors Service – Founded 1918	
Highest Quality	Aaa
↓	Aa1, Aa2, Aa3
	A1, A2, A3
Lowest Quality	Baa1, Baa2, Baa3
	NR (Nonrated)

Rule 15c2-12 – The "Rule" of Future Disclosure

Introduction – Rule issued by Securities and Exchange Commission – SEC

- Requires Underwriters to obtain and review official statement at time bonds are issued
- Requires Underwriters to obtain a commitment from the district to update the operating and financial data in the official statement (financial statements)
- Applies to bonds; not required for Bank loans or financing leases

Rule 15c2-12 – The "Rule" of Future Disclosure - continued

- How often – annually
  - usually 7-9 months after the end of the district's fiscal year
- What is included in the annual report
  - Audited financial statements
    - What if audit is not done in time?
  - Property tax rates and collections
  - Assessed value
- How is this information filed?

SEC – The new "sheriff in town"

Electronic Municipalities Market Access "EMMA"

EMMA is the SEC's official repository for all information related to municipal bonds. It's open to the public at: http://emma.msrb.org

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For State & Local Governments

- Issuing Municipal Securities
- Monitoring Securities
- Disclosing Information to Investors

Disclosing Information to Investors

Access resources for making timely and complete disclosures to investors as required by SEC Rule 15c2-12. Issuers submit these and other voluntary disclosures to the MSRB, which makes them publicly available on the EMMA website.

Watch a short video that explains the roles of key participants involved when a bond is issued.

Understanding Disclosure Requirements

- Financial Disclosures: Protecting Market Access for Issuers
- Making Financial Disclosures: A Guide for Issuers
- The Conduit Issuer's Guide to Continuing Disclosures
- SEC Rule 15c2-12

Preparing to Submit Disclosures

- Providing Disclosure Information to Investors
- Resources for Developing Disclosure Documents
- Flowchart for Identifying Continuing Disclosure Requirements
- Suggested Practices for Submitting Financial Disclosures to EMMA
- Preparing to Submit Financial Disclosures to EMMA
- Setting Up an Organization Account

Using EMMA to Submit Disclosures

- Email Reminders for Recurring Financial Disclosures
- Instructions for Email Reminders for Recurring Financial Disclosures
- Customizing an EMMA Issuer Homepage
- Tutorial on Submitting Financial Disclosures
- Creating and Controlling Groups of Securities
- Posting Preliminary Official Statements on EMMA
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MSRB EMMA

Links to msrb/emma

(Video) Tutorial on Submitting Primary Market Disclosures for a New Issue: http://www.msrb.org/msrb1/Training-Tutorials.asp?section=1&video=0

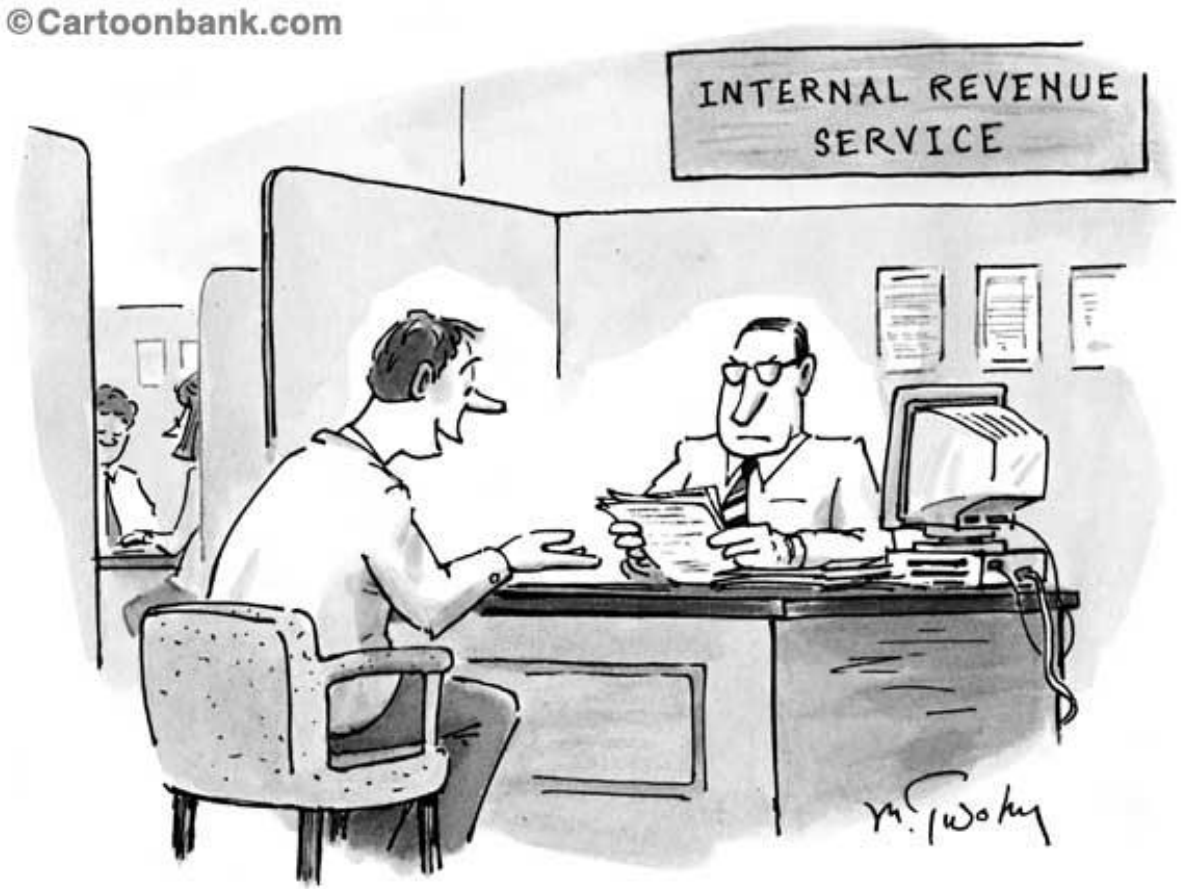
MSRB Podcast for State & Local Governments: Providing Disclosure Information to Investors:

http://www.msrb.org/EducationCenter/library/podcasts.aspx

http://www.msrb.org/EducationCenter/Issuers/Disclosing.aspx

What are Issuers Doing?

- Bank loans?
- How many lawyers can a deal handle?
- Will the presence of multiple lawyers help you in a governmental investigation?



"It's funny how two intelligent people can have such opposite interpretations of the tax code!"

Life After Bond Issue

Ongoing Compliance Policies

- Written procedures that can be followed for the life of the bond issue
- Assign responsibility for monitoring
- Integrate compliance policies with accounting systems
- Record retention policies

Post Issuance Compliance Policy

Purpose

- There is no requirement for any issuer to have a written post issuance compliance policy
- Form 8038-G Questions
- Some future benefits in dealing with the IRS
  - Avoiding arbitrage rebate penalty
  - Avoiding penalties
- Internal organizational benefits

Post Issuance Compliance Policy - continued

What is included ….

- In writing
- Sample to be provided
- Content
  - Bond documentation –
    - Documents to be received
    - Who is responsible for maintaining the documents
  - Identifies the personnel responsible for maintaining records

Post Issuance Compliance Policy - continued

Monitoring Private Use

- What is private use?
- How much use is permitted – 10%
- How is it measured?
- What records of private use should be retained

Monitoring Arbitrage Rebate Compliance

Monitoring Ongoing Disclosure

How long should records be retained – life of bond issue plus three years

Post issuance tax compliance should include

- Establishing Compliance Procedures
- Documenting Proper Issuance
- Monitoring Arbitrage Compliance
- Tracking Private Activity
- Recognizing a Potential Reissuance

Monitoring Arbitrage Compliance

- Choose accounting method.
- Obtain computation of “yield” of bonds and establish procedure to track investment returns.
- Establish procedure for allocation of bond proceeds and interest earnings to expenditures, including reimbursement of pre-issuance expenditures.
- Monitor compliance with “temporary” period expectations for expenditure of bond proceeds.
- Establish procedures to ensure investments acquired with bond proceeds are purchased at fair market value. These can include use of bidding procedures under regulatory safe harbor.

Monitoring Arbitrage Compliance – continued

- Consult with bond counsel before engaging in post-issuance credit enhancement transactions or hedging transactions.
- Identify situations in which compliance with applicable yield restrictions depends on future actions and monitor implementation.
- Monitor compliance with 6-month, 18-month, or 2-year spending exceptions to rebate requirement.
- Arrange for timely computation of rebate liability for timely filing of Form 8038-T and payment of rebate.
- Arrange for timely computation and payment of “yield reduction payments,” if applicable.
- Issuers/borrowers frequently engage outside arbitrage/rebate consultants to do such computations.

Tracking Private Activity

- Establish procedure for mapping which outstanding bond issues financed which facilities and in what amounts.

- Establish procedure for allocation of bond proceeds to expenditures, including reimbursement of pre-issuance expenditures. These procedures must be consistent with those used for arbitrage purposes.

- Establish procedure for allocation of bond proceeds and funds from other sources within a bond-financed project to ensure that bond proceeds are used for qualifying costs.

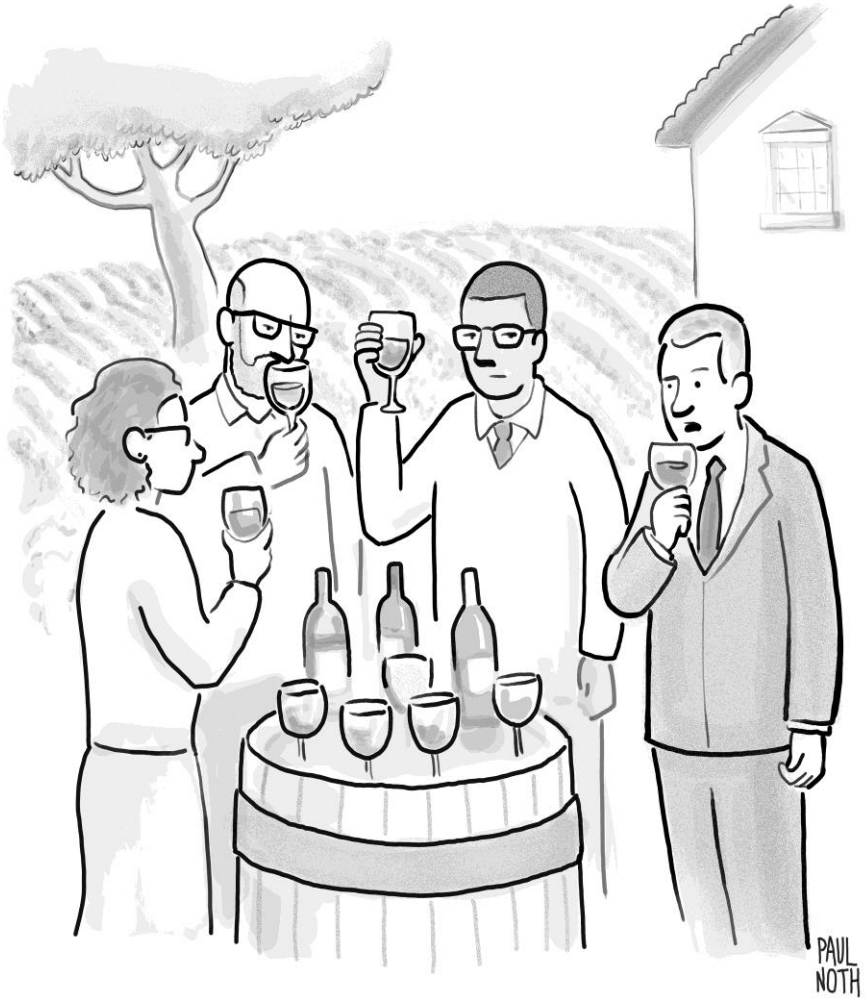
Tracking Private Activity - continued

- Monitor expenditure of bond proceeds for qualifying costs.
- Monitor private use of bond-financed facilities.
  i. Establish procedure for review of amount of existing private use on periodic basis.
  ii. Establish procedure for identifying in advance any new sale, lease or license, management contract, service contract, sponsored research arrangement, or other arrangement involving private use of governmental bond-financed facilities.
  iii. Promptly consult with bond counsel as to any possible private use of bond-financed facilities.

Integration

Post-issuance tax compliance is an integral part of an issuer or borrower's debt management process. In some organizations, compliance may be adequately supported by ad hoc procedures or by the efforts of a single individual. However, consideration should be given to whether ongoing timely, reliable institutional compliance should be supported by practices integrated within the core policies and procedures of the institution.

"It was Socrates, wasn't it, who said, 'The unexamined life is not worth living'?"



"I'm getting subtle hints of what the Fed might do."