



Disclosure Obligations and On-Going Administration of Bonds and Other Debt

CDIAC ABCs of School Debt Financing Concord – April 9, 2010



What To Get From This Session

- Your role and responsibilities
- Professionals and others who can help
- When in doubt, ask



What We'll Be Discussing

- Disclosure
- Official Statement
- Continuing disclosure
- Tax law –
 - Private Use
 - Private Loan
 - Arbitrage and Rebate
- Project Management
- Accounting Issues



Disclosure Due Diligence

- ❖ Federal Securities Laws
 - Section 17(a) of 1933 Act – Antifraud Provisions
 - Rule 10b-5 – Antifraud Provisions
- ❖ Rule 10b5
 - “It shall be unlawful for any person.....
 - (a) To employ any device, scheme or artifice to defraud,
 - (b) To make any untrue statement of a *material* fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.....”



Disclosure Due Diligence (continued)

- ❖ Duty - Disclose all material facts (i.e., facts that are important to an investor in making an informed investment decision) and do not misstate any material facts
- ❖ The “Materiality” Standard
 - “[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest.”



Disclosure Due Diligence (continued)

- ❖ WHEN DO DISCLOSURE RULES APPLY?
 - New offerings
 - Annual Report under Rule 15c2-12
 - Any other circumstance where an Issuer is “speaking to the market.”



Disclosure Due Diligence (continued)

- ❖ Role of Staff:
 - Provide information to consultants
 - Review drafts of Preliminary Official Statement
 - Notify Board members of duty to review and disclose
 - Schedule conference call to review draft of Preliminary Official Statement
 - Distribute final version of Preliminary Official Statement to Board for review



Disclosure Due Diligence (continued)

Role of Board:

- Oversight
- Review draft Preliminary Official Statement
- Ask questions of staff and consultants
- Approve distribution of Preliminary Official Statement



Disclosure Due Diligence (continued)

- ❖ Questions for the Board to Ask:
- ❖ Am I aware of any information about the District that would be important for an investor to know?
- ❖ Is there any pending or threatened litigation against the District that could have a negative impact on the District's finances or ability to repay the debt?
- ❖ Are there any circumstances that exist or that are now unfolding that could place a demand on District reserves or create budget difficulties for the District?



Disclosure Due Diligence (continued)

Disclosure Considerations:

- ❖ Tomorrow's "hot topic" may be different than today's
- ❖ Disclosure must evolve to reflect changing circumstances
- ❖ Read the disclosure with "fresh eyes"
- ❖ If you think something may be a concern, raise the issue with colleagues and the working group
- ❖ There are no "stupid questions"



Disclosure Due Diligence (continued)

What can go wrong?

- ❖ Main avenue for attacks on disclosure is SEC enforcement
- ❖ SEC has power to bring civil actions or refer to Justice Department for criminal action
- ❖ SEC will bring actions against municipal issuers, also targets other participants
- ❖ SEC Investigation – fees for lawyers and consultants
- ❖ Adverse publicity
- ❖ Reduced market access
- ❖ May have to impose new procedures and oversight to settle SEC actions



Disclosure Due Diligence (continued)

Summary:

- ❖ Make sure that responsible officials are familiar with disclosure
- ❖ Review the entire POS
- ❖ Seek information and ask questions of the officials, employees, and professionals who supplied information to be included in the POS
- ❖ Ask follow up questions to determine the reasonableness of any assumptions or estimates that were used in the POS



Official Statement

- ❖ OFFICIAL STATEMENT
 - Preliminary vs. Final
 - ✎ Preliminary used to market certificates/bonds to potential investors
 - ✎ Final delivered to actual purchasers
 - Issuer's Document
 - Guidance
 - ✎ Federal Securities Law (Rule 15c2-12 and 10b-5)
 - ✎ Professional Guidelines (CDIAC, GFOA)



Official Statement (continued)

- ❖ OFFICIAL STATEMENT
 - Who Prepares?
 - ✦ Disclosure Counsel
 - ✦ Underwriter's Counsel
 - Who Reviews?
 - ✦ Staff
 - ✦ Public Officials



Official Statement (continued)

❖ OFFICIAL STATEMENT

- Liability
 - ✚ Issuer strictly liable
 - ✚ Underwriter
 - “Due diligence” defense - reasonable investigation
- Rule 15c2-12
 - ✚ Deemed Final Preliminary Official Statement
 - ✚ Permitted Omissions of Pricing Data



Official Statement (continued)

❖ OFFICIAL STATEMENT

➤ Contents

- Description of Certificates or Bonds
- Security and Sources of Payment
- Estimated Sources and Uses
- The Leased Premises
- The Project
- The Issuer (General Description and Financial Matters)
- Risk Factors
- Continuing Disclosure



Official Statement (continued)

❖ OFFICIAL STATEMENT

➤ Contents (continued)

↘ Concluding Information

- Tax Matters
- Ratings
- Litigation

↘ Appendices

- Economic and Statistical Data re Issuer
- Audited Financials
- Form of Bond Counsel Opinion
- Summary of Legal Documents
- Credit Enhancement



Continuing Disclosure

Overview

Rule 15c2-12

Duty to update



Continuing Disclosure (cont'd)

Annual report

What to include

Audit

Other Specified Information

When to file

How / where to file

MSRB EMMA System

emma.msrb.org



Continuing Disclosure (cont'd)

Material events

Be aware of 11 events

Rating changes (underlying OR credit-enhanced rating)

Consult with professionals

Requires filing upon happening of event



Continuing Disclosure (cont'd)

Compliance regime

Understand obligations

Assign responsible officer

Hire consultants



Continuing Disclosure (cont'd)

Failure to comply

Disclosure requirement for 5 years

Statements to the Market – Potential Fraud
Liability



Federal Tax Law Compliance

General Principles

No Private Use (5% exception)

Sale

Subleases

Management Contracts

No Private Loan

E.g., sale or lease of surplus property



Federal Tax Law Compliance (cont'd)

Arbitrage/Rebate

Arbitrage

The investing of bond proceeds at an interest rate above the bond yield

Bond Yield	5%
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Investment Rate	6%
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Arbitrage	1%
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Rebate

Return to federal government all arbitrage not fitting within an exception

Spending exceptions 6, 18 and 24 month



Federal Tax Law Compliance (cont'd)

Arbitrage Rules

Construction Fund

Yield Restriction after 3 years

Debt Service Fund

Annual Cleanout

Invested Sinking Fund



Accounting and Reporting Issues

Understand arbitrage and rebate rules

Tax laws to know and adhere to

Track each project with unique accounting codes

Sub-fund: each debt issuance

Cost center: each construction project

Use a calendar based tracking system



Avoiding Arbitrage Situations

Know your arbitrage window

6, 18 or 24 months?

Issue only the amount you need for the next window

but allow for delays, increases, change orders, etc.

Work closely with your facilities manager, architect, contractors

Establish a project tracking system

Will be useful later if you need to litigate for errors & omissions, critical delays, etc.



Example Planned Schedule

2001							2002												2003											
J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D

Demo/Grading = \$500,000

6/25 6/30

Concrete Footings/S.O.G./Underground = \$1,500,000

7/7 10/28

Structural Steel = \$1,000,000

10/27 11/26

Plumbing = \$500,000

11/11 \$500,000

Framing = \$500,000

1/1 4/21

1/13 2/10

Insulation/Drywall = \$500,000

F.H.: 2/25 5/12

4/22 7/8 Electrical / HVAC = \$1,500,000

4/22 6/2 Roofing = \$400,000

4/22 10/31 Finishes = \$600,000

- Planned Dates
- Actual Dates
- Sporadic Work
- Critical path

Track plan vs. actuals

Anticipate
magnitude of
progress
payments

Sequence:
Concrete then
Framing then Finishes

Total Needed thru
18 months = \$7 million
(but don't box yourself in)



Federal Tax Law Compliance (cont'd)

Consequences of Failure to Comply

IRS Audit

Taxability of Bonds

Penalties