



# 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....."



- <u>Duty</u> 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."



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



#### 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



#### Role of Board:

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



- 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 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"



# 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



### 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
  - > Who Prepares?
    - **▲** Disclosure Counsel
    - ▲ Underwriter's Counsel
  - > Who Reviews?
    - **▲** Staff
    - **▶** Public Officials



#### ❖ 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

- > 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

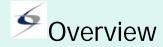


#### ❖ OFFICIAL STATEMENT

- 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**



- → Rule 15c2-12
- → Duty to update



- Annual report
  - → What to include
    - → Audit
    - → Other Specified Information
  - → When to file
  - → How / where to file
    - → MSRB EMMA System
      - → emma.msrb.org



- Material events
  - → Be aware of 11 events
    - → Rating changes (underlying OR creditenhanced rating)
  - → Consult with professionals
  - → Requires filing upon happening of event



- Compliance regime
  - → Understand obligations
  - → Assign responsible officer
  - → Hire consultants



- 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%

→ Investment Rate 6%

→ Arbitrage 1%

- → 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

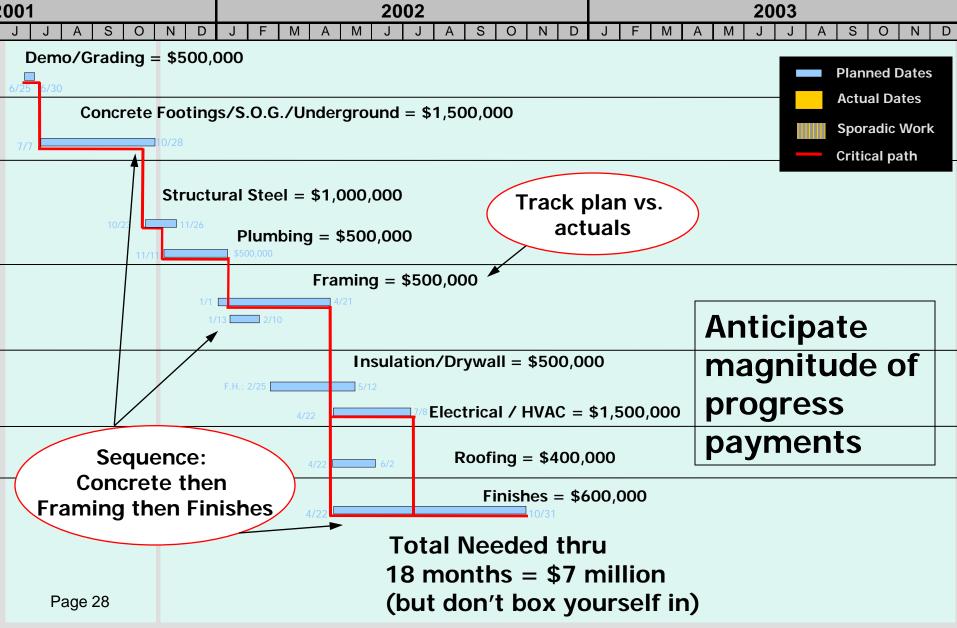


# **Avoiding Arbitrage Situations**

- 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**





# Federal Tax Law Compliance (cont'd)

- → Consequences of Failure to Comply
  - → IRS Audit
  - → Taxability of Bonds
  - → Penalties