Appendix C

DEBT FINANCING TERMS AND CONCEPTS

This appendix is designed to provide definitions drafted in plain English for terms and concepts used in connection with debt issuance. To be consistent with customary industry practice, the term bonds is used to mean either long-term bonds or, more generally, bonds, notes, commercial paper, certificates of participation, and other types of evidence of debt. The index to the *California Debt Issuance Primer (Primer)* may contain cross-references to terms not defined here in alphabetical order.

ACCELERATION

A remedy provided in many security agreements (including many indentures and bond resolutions) by which the trustee may declare all future payments of principal immediately due and payable after the occurrence of certain specified events—usually called events of default.

In some security agreements the trustee may be required to accelerate upon the occurrence of an event of default. Sometimes acceleration can occur only upon the consent or direction of a credit enhancement provider or only upon the request of the holders of a specified percentage of the bonds (often 25 percent).

Generally, unless the security agreement provides otherwise, acceleration results in available monies being used first to pay interest pro rata on all the bonds and, if interest is fully paid, to pay principal pro rata on all maturities. As a result, all the bonds are placed on an equal footing, regardless of their scheduled maturity.

ACCRUED INTEREST

In general, interest that has been earned on a bond but not yet paid—usually because it is not yet due.

More specifically, this term is often used to refer to interest earned on a bond from its dated date to the closing date.

ADDITIONAL BONDS

Additional bonds is a term found in indentures, trust agreements, bond resolutions, and other bond issuance documents referring to bonds that may be issued in the future in addition to the bonds being issued under the current document. Almost always, these bonds are on a parity with the bonds being issued initially and may not be issued without meeting certain conditions involving the level of revenues available to repay the initial bonds and additional bonds, maximum amount limitations, and other conditions. These conditions are often referred to as the additional bonds test. See **Parity**.

AD VALOREM TAXES

An annual tax that is a uniform percentage of the value (or assessed value) of property.

ADVANCE REFUNDING

See **Refunding**.

ALL-HOLD RATE OR HOLD RATE

The interest rate on any auction date equal to a percentage of a variable index specified in the indenture or the trust agreement—typically the Bond Market Association (BMA) Index or the London Interbank Offered Rate (LIBOR)—provided such rate does not exceed the maximum auction rate specified in the indenture or the trust agreement.

ALTERNATIVE MINIMUM TAX (AMT)

An income tax based on a separate and alternative method of calculating taxable income and a separate and alternative schedule of rates.

With respect to bonds, the interest on certain types of qualified private activity bonds—not including qualified 501(c)(3) bonds—is included in income for purposes of the individual and corporate alternative minimum tax.

In addition, the interest received by a corporation on all bonds held by it is included in federal corporate adjusted net book income and adjusted current earnings, a portion of which may increase the alternative minimum taxable income of such corporation.

AMORTIZE

To retire the principal of an issue by periodic payments either directly to bondholders, or first to a sinking fund and then to bondholders. Compare to **Balloon** and **Bullet**.

ANNUAL REPORT

The annual report is the report containing annual financial and operating data prepared and filed with the Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) and state information depository (SID)—if any—pursuant to Securities and Exchange Commission (SEC) Rule 15c2-12.

Applicable Auction Rate

The rate per annum at which interest accrues on an auction rate security for any auction rate period.

Arbitrage Bonds

See **Chapter 3, General Federal Tax Requirements**.

Arbitrage Yield Restriction

With respect to municipal bonds, arbitrage is the profit made by issuing bonds bearing interest at tax-exempt rates, and investing the proceeds at materially higher taxable yields.

The Internal Revenue Code limits the opportunity for borrowers to use monies associated with tax-exempt bonds to acquire materially higher yielding taxable investment property. However, certain exceptions are provided—in particular for reserve accounts and for investments during temporary periods.

To the extent arbitrage is legally earned in respect of tax-exempt bonds issued after August 15, 1986, it may be required to be paid over to the federal government pursuant to the rebate requirement.

If it is necessary for the yield on the investment of proceeds to be limited, the yield restriction may not be used as a device to transfer the benefits of arbitrage to another person or entity. As a result, the yield-restricted investment must be in either state and local government series (SLGS) or tax-exempt bonds or must be in taxable investments that are purchased at a market price and which are of an appropriate maturity (without regard to yield).

Assessments

Assessments are charges in the nature of taxes upon property owners to pay the costs of facilities or improvements that benefit the property.

Payment of the amount assessed (together with interest if not paid upon assessment) is secured by a direct fixed lien on the property. The assessed payments are either used directly to pay the costs of the facilities and improvements or, if paid over time, are used to repay bonds issued to finance such costs. Special assessment financing proceeds are used for improvements relating to the property, such as sidewalks, streets, gutters, sewers, and water systems. Benefit assessment financing proceeds are used for items with a less tangible relationship to the assessment and are based on a determined benefit to the landowner (i.e. parking and flood control projects).

See also **Chapter 6, Types of Financing Obligations – Assessment Bonds**.

AUCTION

An electronic competitive process through which auction rate securities (ARS) are sold at the lowest yield rate (priced at par) at which sufficient bids are received to sell all securities offered. ARS are sold at the clearing yield established by the auction to the investors placing bids at or below the clearing yield. All ARS in a series will bear interest at the clearing auction rate for the next auction period.

AUCTION AGENT

A third-party institution responsible for conducting the auction used in connection with the periodic reset of the interest rate.

AUCTION DATE

The business day immediately preceding the first day of each auction rate period for an ARS.

AUCTION PROCEDURES

The process and timing for conducting the auction as set forth in the bond indenture or trust agreement and summarized in the auction agreement.

AUCTION RATE

The rate of interest per annum resulting from the implementation of the auction, provided such rate does not exceed a maximum rate specified in the bond indenture or trust agreement.

AUCTION RATE PERIOD

The initial auction rate period established by the underwriter at the time of issuance of the ARS and, subsequently, each period during which a specific auction rate is in effect as a result of an auction. The auction rate period commences on the business day after the auction date and ends and includes the day preceding the next interest rate reset date.

AUCTION RATE SECURITIES

See **Chapter 8, Fixed and Variable Interest Rate Structures – Variable Interest Rate Debt – Auction Rate Securities.**

AUTHENTICATING AGENT

The agent of the issuer appointed to authenticate bonds (i.e. to sign them as being authentic) upon initial issuance or upon transfer or exchange.

See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Trustee/Fiscal Agent/Paying Agent/Registrar/Authenticating Agent**.

BALLOON

Principal of an issue to be paid in a single final maturity that constitutes a large percentage of the total principal of the issue. See also **Bullet**.

BANK ELIGIBLE BONDS

Bonds (including certificates of participation or COPs) that are eligible under federal banking law—the Glass-Steagall act—to be underwritten by commercial banks.

Bank eligible bonds generally include bonds that are directly or indirectly the obligations of the general fund of a city, county, or state and bonds for single-family or multifamily housing.

BANK QUALIFIED BONDS

Tax-exempt bonds that are issued by certain qualified small issuers and which do not need to be taken into account for purposes of determining the portion of certain financial institutions' interest expense, which is disallowed as a deduction for federal tax purposes, because such interest expense is allocable to debt (including deposits) deemed to have been incurred by the financial institution to carry tax-exempt bonds.

BASIS POINT

See **Point/Basis Point**.

BLIND POOL ISSUE

See **Pooling of Debt Issues**.

BLUE SKY LAWS/BLUE SKY SURVEY OR MEMORANDUM

Blue Sky laws are the state statutes that regulate the manner of offering and selling of securities, bonds, investment contracts, and stocks.

These statutes are commonly referred to as Blue Sky Laws because their purpose is to prevent, as the U.S. Supreme Court posited in 1917, "speculative schemes which have no more basis than so many feet of blue sky."

Generally, in a public offering, a memorandum called a Blue Sky Survey is prepared, which summarizes the treatment of the issue under the securities laws of each state and, occasionally, the laws of Puerto Rico, Guam, the District of Columbia, and the U.S. Virgin Islands. The preliminary form of this memorandum specifies the states in which the issue need not be registered in a manner similar to SEC registration (i.e. no filings need be made), those states in which action will be taken by the issuer to register the offering, and those states in which registration is required but not contemplated and in which the securities are not, therefore, permitted to be offered or sold. The final Blue Sky Survey generally reports that the registration actions contemplated by the preliminary survey have been taken.

Certain types of securities are usually exempted from registration under most Blue Sky Laws on the theory that the issuer either is a government organization or is supervised by a government organization (even if the government organization has not approved the specific security to be issued). One common exemption is for municipal bonds. However, several states do not exempt some or all conduit financings from registration unless there is an independent exemption for the nongovernmental borrower (e.g. the exemptions for exchange-listed or “blue chip” companies or public utilities).

Certain transactions are also exempted, whether or not the securities being sold are exempted securities. The most familiar are the private placement exemption and the exemption for offers and sales to broker/dealers and institutional investors such as banks, savings institutions, trust companies, insurance companies, investment companies, and pension or profit-sharing trusts.

The above exemptions—whether for certain securities or transactions—are only exemptions from registration of the issue and not exemptions from the anti-fraud provisions of the state law or from the requirement for a broker/dealer to register as such.

BOND COUNSEL

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Bond Counsel**.

BOND INSURANCE

Noncancellable insurance purchased by the issuer from a bond insurer pursuant to which the insurer promises to make scheduled payments of interest, principal, and mandatory sinking fund payments on an issue if the issuer fails to make timely payments.

Bond insurance is never a substitute for the underlying creditworthiness of the issuer.

Payment of an installment by the insurer does not relieve the issuer of its obligation to pay that installment. The issuer remains liable to pay that installment to the insurer.

Insurance agreements are subject to negotiation. Often, insurers will require that the indenture or bond resolution treat the insurer as if it were a major owner of the bonds. The insurer's consent is often necessary to amend the financing agreements. In addition, the insurer is sometimes given the right to accelerate the payment of principal if the insurer is ever required to make a payment.

See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Credit Enhancement Provider**.

BOND PRINTING

The printing of bonds on special paper designed to be difficult to counterfeit.

BOND PURCHASE CONTRACT OR AGREEMENT

In a negotiated sale, the bond purchase contract is an agreement between an issuer and an underwriter or a group of underwriters—a syndicate or a selling group who have agreed to purchase the issue.

A bond purchase contract generally contains the following:

- The purchase price to be paid by the underwriter (including any premium or discount). See also **Underwriter's Gross Spread (Underwriter's Discount)**.
- Certain terms of the bonds, such as interest rates, maturities, redemption provisions, and original issue discount
- The circumstances under which the underwriter may cancel its obligation to purchase the issue (e.g. changes in the tax treatment of the bonds and other events that would make it substantially more difficult for the underwriter to sell the bonds to investors
- The good faith deposit, if any
- The conditions to the closing of the issue, which often include documents, certificates, and opinions that are to be delivered on the closing date
- Any restrictions on the liability of the issuer

Other common terms for a bond purchase contract are contract of purchase or bond purchase agreement.

In a competitive sale, the notice of sale, the underwriter's bid, and the issuer's acceptance of the bid together constitute a bond purchase contract. Generally, these three items taken together contain items similar to those in a negotiated bond purchase contract.

See **Chapter 1, Overview of a Debt Financing – Basic Legal Documents**.

BOND RESOLUTION

See **Indenture/Bond Resolution (General, Supplemental, and Series)**.

BOOK ENTRY ONLY REGISTRATION

A form of registration of the ownership of registered bonds in which the owners of bonds are not entitled to the receipt of printed bonds. Rather, the terms of the bonds are specified by the indenture or bond resolution or by the form of a single bond delivered to a securities depository, and the beneficial ownership of bonds is determined by entries on the registration books of the registrar or by the records of members of the securities depository.

The sale of a bond issued in book entry form is evidenced by a receipt provided by the broker/dealer to the investor and not by the issuance of a new registered bond with the owner's name.

BROKER/DEALER AGREEMENT

An agreement between the issuer or auction agent and a broker/dealer specifying the procedures for conducting the auction of the ARS and the settlement procedures for the payment and delivery of the ARS.

BULLET

Principal of an issue to be retired in a single final maturity that constitutes the entire principal of the issue.

A bullet issue has no amortization of principal or sinking fund redemption prior to its final maturity. There may, however, be a sinking fund to accumulate the amount necessary to make the final maturity payment.

CALL

To give notice of redemption; to redeem.

CAPITAL APPRECIATION BOND

See **Compound Interest Bond**.

CAPITALIZED INTEREST (FUNDED INTEREST)

Bond proceeds reserved to pay interest on an issue for a period of time early in the term of the issue—also called funded interest. Capitalized interest may also refer to the interest to be so paid.

Commonly, in a project financing, interest is capitalized through the date on which it is anticipated that construction of the project being financed with the proceeds will be completed and the date when the project will be operating and capable of providing revenues for repayment of debt service.

CASH FLOW

A comparison of cash receipts (revenues) to required payments (generally, debt service and operating expenses).

A cash flow may demonstrate that receipts by an issuer from a project's revenues or a mortgage portfolio, or from collection of a tax, fee, or other charge will be sufficient to equal or exceed, in each year the sum of payments of principal and interest on an issue and related expenses, generally on the basis of specified assumptions, which may include a "worst case" scenario.

A cash flow may also be used in the context of showing that payments of principal and interest received on investments held in an escrow will be received at such times and in sufficient amounts to equal or exceed debt service on the issue for which the escrow fund has been established, such as is required for an advance refunding.

Finally, in a tax and revenue anticipation note financing, a cash flow may be used to determine the amount of the issuer's operating deficit, which is a factor in determining the permitted size of the issue under federal tax rules. See **Chapter 6, Types of Financing Obligations – Tax and Revenue Anticipation Notes (TRANs)**.

CASH FLOW FINANCING

A financing in which the proceeds of the issue are used to pay current expenses of the issuer when the issuer's current income is temporarily insufficient for that purpose.

Also sometimes called TRANs, TANs, or RANs (tax and revenue anticipation notes). The issue is customarily scheduled to be repaid when current income exceeds current expenses. The issue typically has a term of one year or less. See **Chapter 6, Types of Financing Obligations – Tax and Revenue Anticipation Notes (TRANs)**.

CERTIFICATE OF PARTICIPATION (COP)

A certificate (which looks very much like a bond) representing an undivided interest in the payments made by a public agency pursuant to a financing lease (or an installment purchase agreement).

A portion of each lease payment (and, therefore, a portion of each interest in a lease payment) is designated as being principal and the remainder as interest. Even though COPs are not treated as indebtedness of the issuer under state law (particularly the California Constitution), the federal tax law treats the lease obligation as if it were a debt, and, as a result, the interest component of each lease payment may be treated as tax-exempt interest.

See also **Chapter 6, Types of Financing Obligations – Financing Leases and Certificates of Participation**.

CLEARING RATE

The lowest interest rate bid at which all ARS shares can be sold at par. The rate is paid on the entire issue for the upcoming period.

CLOSING DATE (DELIVERY DATE)

The date on which an issue is delivered by the issuer to, and paid for by, the original purchaser (often an underwriter). Also called the delivery date.

This may be a different date than the sale date or the dated date.

COMFORT LETTER

A letter provided by the issuer's (or sometimes in a conduit financing by the nongovernmental borrower's) certified public accountant at the time the bond purchase contract is signed and on the closing date. The letter confirms that specified financial information regarding the borrower contained in the Preliminary Official Statement or final Official Statement is presented in conformity with generally accepted accounting principles and that no changes in the financial position of the borrower since the date of the last audited financial statements, other than those changes disclosed in the comfort letter or in the Official Statement, have occurred.

The comfort letter often contains items of "special comfort," which generally confirm that financial information presented in the Official Statement (preliminary or final) is accurately presented or calculated. The content of comfort letters is regulated by the American Institute of Certified Public Accountants and, as a result, the content and style differ only minimally among accounting firms.

COMMERCIAL PAPER

Notes of varying very short-term maturities (generally one to ninety days), which are intended to be rolled over in a series of current refundings as portions of the issue mature from time to time.

Generally, the maturity of the commercial paper sold on each rollover is determined by market conditions at the time of rollover. See also **Line of Credit** and **Letter of Credit**.

COMPETITIVE SALE

The sale of bonds to the bidder presenting the best sealed bid at the time and place specified in a published notice of sale (also called a public sale).

When bonds are to be sold at a competitive sale, the issuer typically specifies all the terms of the issue other than interest rates and purchase price. When the issue is ready to market, the issuer solicits bids by placing a notice of sale in one or more industry publications such as *The Wall Street Journal* or *The Bond Buyer* and, if required by law, in a local newspaper of general circulation. In the notice of sale, the issuer announces that it will accept sealed bids until a certain date and time. Prior to presenting bids the underwriters evaluate the credit quality of the issue and the municipal market and may form syndicates or selling groups. The bonds are awarded to the underwriters presenting the best bid based on the criteria specified in the notice of sale. Possible criteria include the Net Interest Cost (NIC) method or the net effective interest rate or True Interest Cost (TIC) method of comparing the cost to the issuer of the financing. See also **Negotiated Sale**.

COMPOSITE ISSUE

Two or more issues having substantially identical terms and which are sold and delivered at the same time (by one or more issuers).

Generally, each issue is used to finance a separate project or purpose. The proceeds are not pooled but instead, the issues are pooled into a composite issue for purposes of marketing. A single Official Statement is used to sell the issues. These issues usually require bond insurance or a letter of credit to guarantee each issue so that the credit rating and marketing of the bonds is based on the insurance company or bank. This equalizes unlike credits in the eyes of investors. See also **Pooling of Debt Issues**.

COMPOUND

To treat accrued interest as if it were principal, so that interest thereafter accrues on the sum of the principal and the compounded interest.

COMPOUND INTEREST BOND

A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount.

These bonds are also called capital appreciation bonds or CABs and are sometimes misnamed zero coupon bonds.

CONDUIT FINANCING

A financing in which the proceeds of the issue are loaned to a nongovernmental borrower who then applies the proceeds for a project financing or—if permitted by federal tax law for a qualified 501(c)(3) bond—for working capital purposes.

Typically, the project financed is owned and operated by the borrower, but projects may also be financed for lease to the private user or for sale pursuant to an installment sale contract. Statutes authorizing conduit financings generally specify the nature of the projects that may be financed and limit such projects to those with a specified public purpose. See also **Chapter 6, Types of Financing Obligations – Conduit Revenue Bonds: General**.

CONDUIT ISSUER

A governmental agency that issues bonds in connection with a conduit financing.

CONTINUING DISCLOSURE

The ongoing disclosure provided by an issuer or obligated person pursuant to an undertaking entered into to allow the underwriter to comply with SEC Rule 15c2-12. See **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

CONTINUING DISCLOSURE AGREEMENT

An agreement (sometimes a certificate) of an issuer or an obligated person containing undertakings to provide annual reports and event notices pursuant to SEC Rule 15c2-12. See **Chapter 1, Overview of a Debt Financing – Basic Legal Documents**.

COP

See **Certificate of Participation (COP)**.

COSTS OF ISSUANCE

Costs of issuance are the expenses paid by or on behalf of the issuer in connection with the sale and issuance of bonds.

These expenses may include, but are not limited to, bond counsel's fees, disclosure counsel fees, trustee's fees, financial advisor's fees, feasibility consultant's fees, accounting fees, costs of printing the bonds, costs of printing the Official Statement or other disclosure documents, costs associated with obtaining a credit rating, and underwriter's gross spread. For some types of bonds the costs of issuance can be paid from the proceeds. For other types of securities, for example qualified private activity bonds, the costs of issuance borrowed as part of the issue are limited to 2 percent of the proceeds.

COUPON BOND

A bond that generally has a number of interest coupons attached to it and which is transferable merely by delivering it to its new owner.

Each coupon is a negotiable instrument representing interest to be paid on the bond for a specified period, usually six months. To receive an interest payment on a coupon bond, the holder must detach the coupon and present it at the office of the trustee or paying agent—or at the holder's own bank if the bank is willing to provide the service of presenting the coupon for payment.

Coupon bonds are sometimes referred to as bearer bonds, since payment may be made to any bearer of the bond or coupon, rather than to a particular registered owner. Coupons that represent less or more than six months' interest are sometimes referred to as short coupons or long coupons, respectively.

Tax-exempt coupon bonds with maturities longer than one year may no longer be issued. However, the interest rate on a bond is still sometimes referred to as the coupon rate. Compare to **Registered Bond**.

COVENANTS

Contractual obligations in financing agreements whereby the party making the promises agrees to perform or refrain from performing certain actions or to comply with certain requirements.

Most issuer covenants are found in the indenture or bond resolution pursuant to which the bonds are issued. However, in a conduit financing, the covenants of the nongovernmental borrower are often set forth in a loan agreement. The following covenants are typical issuer covenants:

- Payment of bonds—a covenant that the issuer will punctually pay the principal of and interest on the bonds from the revenues that have been pledged to pay the bonds
- Extension of payment of the bonds—a covenant that the issuer will not extend or consent to the extension of the maturity of the bonds
- Offices for servicing bonds—a covenant that the issuer will maintain a relationship with an agency, such as a paying agent, in a designated location where bonds may be presented for payment, registration, transfer, or exchange
- Further assurances—a covenant, to the extent authorized by law, to comply with reasonable requests of the trustee to perform, execute, or deliver such acts as may be necessary to confirm the pledge under the indenture

- Rate covenant—a covenant that the issuer will establish and collect charges with respect to the project or the program loans sufficient to meet expenses and debt service, perhaps with coverage

- Restriction on sale or disposal—a covenant not to sell or lease the project or to sell program loans, except as specifically authorized in the financing documents

- Limitation on operating expenses and other costs—a covenant not to incur operating expenses and other costs in excess of the reasonable and necessary amount of such expenses

- Insurance covenant—a covenant to maintain insurance against various events, such as fire, casualty, flood, earthquake, theft, liability or, in the case of a lending program, mortgage default

- Reconstruction; application of insurance proceeds—a covenant to repair or reconstruct the project with the proceeds of insurance, or if it does not make economic sense to repair or reconstruct the project, insurance proceeds would be applied to the redemption of the bonds

- Payment of taxes and charges—a covenant to pay and discharge all taxes and fees imposed in connection with the project or the program except taxes and fees which are contested by proper legal proceedings

- Tax covenant—a covenant that the issuer will not take any action or consent to any party taking any action that will cause interest on the bonds to be subject to federal income taxation or to cause the bonds to be arbitrage bonds

- Maintenance of the project—a covenant by the issuer to use its best efforts to acquire, construct, and maintain the project with due diligence and in a sound and economic manner

- Additional bonds—a covenant not to issue any bonds whose security is equal to or superior to that of the existing issue unless certain additional bonds tests (often including historical or projected coverage ratios) are satisfied

- Maintenance of books and records—a covenant to maintain financial records relating to project or program revenues and costs in accordance with generally accepted accounting principles

- Noncompetition—a covenant not to operate, and perhaps (to the extent permitted by law) not to permit the operation of, competing enterprises

COVERAGE

The extent to which revenues in addition to the amount necessary to pay operating expenses and debt service are required to be collected by a rate covenant or by the conditions to the issuance of additional parity bonds.

For example, the bond resolution pursuant to which water revenue bonds are issued may require the issuer to maintain fees and charges for the sale of water at levels sufficient to enable it to collect in each year the amount necessary to pay all of its water system operating expenses, debt service on the bonds, plus an amount equal to 25 percent of debt service on the bonds. The additional 25 percent is referred to as coverage.

CREDIT ENHANCEMENT PROVIDER; CREDIT ENHANCEMENT

See **Chapter 1 – Overview of a Debt Financing—Roles and Responsibilities of Principal Participants – Credit Enhancement Provider**.

CREDIT RATING/CREDIT RATING AGENCY

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Credit Rating Agencies**.

CROSSOVER REFUNDING

See **Refunding**.

CURRENT REFUNDING

See **Refunding**.

CUSIP

The acronym for Committee on Uniform Security Identification Procedures, which was established under the auspices of the American Bankers Association to develop a uniform method of identifying municipal, United States government, and corporate securities.

A separate CUSIP number is assigned for each maturity of each issue and is printed on each bond.

DATE OF ISSUANCE/ORIGINAL ISSUANCE DATE

The date of issuance is the same as the closing date. However, the original issuance date, as used on the standard registered bond form, is the same as the dated date.

DATED DATE

The first date from which interest is deemed to accrue on a bond.

The dated date is typically printed on the front of the bond and can be before or as of the closing date, but not after the closing date. For fixed rate bonds, the dated date is generally the first day of the calendar month in which the bonds are sold. For variable rate bonds, the dated date is generally the closing date.

DEBT LIMIT

A statutory or constitutional limit on the amount of debt that an issuer may incur or that it may have outstanding at any one time.

The constitutional debt limit for California cities and counties is found in the California Constitution at Article XVI, Section 18, and for the State of California is found at Article XVI, Section 1. See **Chapter 4, State Constitutional Limitations – The 1879 Constitution – The Debt Limit.** California statutes also provide debt limits for a number of different entities. See generally, **Chapter 6, Types of Financing Obligations**.

DEBT SERVICE

The total of interest, principal, and mandatory sinking fund payments.

DEBT SERVICE ACCOUNT (BOND ACCOUNT OR PRINCIPAL, INTEREST, AND REDEMPTION ACCOUNTS)

The account or accounts into which the issuer makes periodic deposits to assure the timely availability of sufficient monies for the payment of debt service on an issue.

DEBT SERVICE RESERVE ACCOUNT

See **Reserve Account (Bond Reserve Account** or **Debt Service Reserve Account).**

DEDICATED POOL

See **Pooling of Debt Issues**.

DEEMED FINAL

Under SEC Rule 15c2-12, prior to bidding for, offering, or selling bonds, an underwriter must obtain and review an Official Statement (usually a Preliminary Official Statement) deemed final as of its date by the issuer.

DEFAULT/EVENT OF DEFAULT

Failure to make prompt payment on a bond or otherwise comply with other covenants in the financing agreements.

Indentures and bond resolutions commonly provide for some short period of time—a cure period—to correct a failure to comply with a covenant before a simple default becomes an event of default that allows acceleration and certain other remedies to be pursued. In conduit financings, a default may also occur if the nongovernmental borrower becomes the subject of bankruptcy proceedings.

DEFEASANCE

The termination of the rights and interests (including the pledge of revenues but not including the right to payment) of the bondholders under the indenture or bond resolution upon final payment or provision for payment of all debt service on the bonds, all in the specific manner required by the indenture or bond resolution.

In an advance refunding, the defeasance of the bonds being refunded is generally accomplished by placing in an escrow sufficient high quality investments to provide for payment of debt service on the bonds to redemption or maturity.

DELIVERY DATE

See **Closing Date (Delivery Date)**.

DEMAND BOND (PUT BOND OR TENDER OPTION BOND)

A bond that the holder has the right to sell back to the issuer, a nongovernmental borrower, or another party at specified times and for a specified price (usually par).

Variable rate bonds generally have a demand feature. The demand feature gives the holder investment flexibility and protection against fluctuating market interest rates and other risks. The interest rate rises or falls in step with market rates, and the holder has the option to keep the bond or to demand the purchase of the bond in accordance with the holder's investment needs.

Demand bonds are sometimes referred to as put bonds or tender option bonds because the holder can “put,” or has an option to tender, the bond back to the issuer.

Put bonds that are tendered are customarily remarketed. If not, they may be purchased using monies available for that purpose, including advances under a line of credit or draws under a letter of credit.

DENOMINATION

The face amount of a bond—generally its original principal amount. Usually the denominations are $5,000 or any integral multiple of $5,000. In some short-term or variable rate financings, denominations may be multiples of $100,000 or in multiples of $5,000 in excess of $100,000.

For compound interest bonds, denominations may be expressed in terms of either the original principal amount (in which case they may be odd dollar amounts, such as $127.55) or compounded maturity or conversion amount (in which case they will commonly be multiples of $5,000).

DISCLOSURE

Providing to investors (usually in the form of an Official Statement) all material facts relating to an issue.

DISCLOSURE COUNSEL

See **Chapter 1, Overview of a Debt Financing Roles and Responsibilities of Principal Participants – Underwriter's Counsel and Disclosure Counsel – Disclosure Counsel**.

DISCOUNT

The amount, if any, by which the principal amount or par value of a bond exceeds its sale price. See also **Underwriter's Gross Spread (Underwriter's Discount)**.

Original issue discount (OID) is the amount by which the principal amount or par value of a bond exceeds the offering price to the public at the time it is originally sold, or if sold in a private placement, the price to its first purchaser.

If the original issue discount is greater than approximately two percent or three percent, the bonds are sometimes referred to as deep discount bonds. The original issue discount is generally treated as tax-exempt income to the investor if held to maturity and interest on the bond is otherwise tax-exempt to the investor. When the investor sells the bond before maturity, any profit realized on such sale is determined (for federal income tax purposes) with respect to the investor's adjusted basis in the security. The adjusted basis is determined by adding to the investor's original cost the portion of the original issue discount allocable to the period that the investor held the bond.

The total amount of original issue discount and its allocation over time are determined in accordance with the provisions of the Internal Revenue Code and the rules and regulations of the Internal Revenue Service. To the extent the sale price of bonds exceeds their original cost plus allocable OID, such excess may be treated as taxable gain. Conversely, if the sale price is less than the original price plus allocable OID, the difference may be treated as a loss for federal income tax purposes.

Dissemination Agent

An agent appointed pursuant to a continuing disclosure agreement for the purpose of filing annual reports and event notices with NRMSIRs and state information depositories. See, generally, **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

Due Diligence

The inquiry made to reveal or confirm facts about the issuer, the issue, and the security for the issue that would be material to a prudent investor in making a decision to purchase the issue.

Due diligence inquiries are made by underwriters and lawyers to determine, for example, whether the issue follows the purpose and scope outlined by the enabling legislation, statutes, and resolutions of the issuer and whether all material facts have been accurately disclosed in the Official Statement. Courts have generally concluded that participants who demonstrate that they have conducted reasonable investigations resulting in a reasonable belief in the accuracy and sufficiency of the disclosure document have satisfied their responsibilities under the disclosure laws relating to municipal bonds.

Economic Useful Life

The period over which an asset may reasonably be expected to yield economic benefit to its owner.

Because economic factors can render property useless for its intended purpose long before the property deteriorates physically, the economic useful life of an asset is often different from its physical life. The maturity of an issue of bonds generally may not exceed 120 percent of the weighted average useful life of financed facilities if interest on the bonds is to be tax-exempt. In determining the economic useful life for this purpose, a safe harbor is available by reference to periods prescribed by the Internal Revenue Service under its Asset Depreciation Range (ADR) system.

Enterprise

A defined revenue producing set of facilities that are operationally integrated and which have a common service purpose.

An enterprise may consist of all of the facilities of a special district, such as a municipal water district, or may consist of only a portion of the assets of a general purpose governmental entity, such as the water system of a city.

With respect to certain types of revenue bonds, the specification of the extent of the enterprise is important, because it is the revenues of the enterprise that provide the security for the bonds.

Escrow Agent

With respect to an advance refunding, the commercial bank or trust company retained to hold the investments purchased with the proceeds of the refunding and, customarily, to use the amounts received as payments on such investments to pay debt service on the refunded bonds.

Event Notice

A notice delivered to the NRMSIRs and any state information depository in connection with a listed event. See generally, **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

Exempt Facilities

As defined in the Internal Revenue Code, airports, docks and wharves, mass commuting facilities, facilities for the furnishing of water, sewage facilities, solid waste disposal facilities, qualified residential rental projects, facilities for the local furnishing of electric energy or gas, local district heating or cooling facilities, and qualified hazardous waste facilities.

Qualified private activity bonds may be issued for exempt facilities.

Failed Auction

An auction that occurs in which, due to a lack of demand for the auction rate securities (ARS) on the auction date, insufficient clearing bids were received. In the event of a failed auction, existing holders maintain their positions (or some pro rata portion) in the ARS at the maximum rate until a subsequent successful auction. Failed auctions are rare and, to the extent they do occur, are usually associated with downgrades in the credit ratings of the issuer or the insurer.

Feasibility Consultant

The person or firm retained, customarily by the issuer, to express an opinion (generally printed as an appendix to the Official Statement) on the economic feasibility of a facility, enterprise, or lending program to be undertaken with the proceeds of an issue.

Feasibility consultants are retained for a wide variety of different types of financings, ranging from large single projects such as a hydroelectric power plant to lending programs such as a multideveloper single-family mortgage revenue program. The objective of a feasibility report is to provide an assessment of one or more aspects of the economic feasibility of the purpose of a financing. The views of the feasibility consultant are taken into account by the credit rating agencies and investors in the process of marketing the bonds.

FINANCIAL ADVISOR

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Financial Advisor**.

FINANCING LEASE

The document by which the issuer leases to another public entity (the obligor) the project to be acquired or constructed with the proceeds of the issue and by which the obligor agrees to make periodic lease payments to the issuer, generally for the period of time the issue is outstanding.

An installment purchase contract or installment sale agreement is a similar instrument by which the issuer sells, rather than leases, the project to the obligor, which agrees to purchase the project by making periodic payments (installments). Whether lease payments or installments, such payments are designed to be sufficient to pay debt service on the issue. The choice whether to structure a financing utilizing the municipal lease, installment purchase contract, or loan agreement often depends upon state law requirements such as constitutional debt limits and the authorization to lease property.

FISCAL AGENT

A commercial bank or trust company designated by an issuer under the indenture or bond resolution to act as a fiduciary and as the custodian of monies relating to an issue.

The fiscal agent's duties typically are limited to receiving monies from the issuer that are to be held in funds and accounts created under the indenture or bond resolution and, when acting as paying agent, paying out principal and interest to bondholders. See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Trustee/Fiscal Agent/Paying Agent/Registrar/Authenticating Agent**.

FIXED RATE

An interest rate that is set at the time a bond is issued and that does not vary during the term of the bond.

Compare to **Variable Rate**.

FLOATING RATE

See **Variable Rate**.

FLOW OF FUNDS

The provisions of an indenture or bond resolution pursuant to which pledged revenues are periodically allocated in a specified priority to accounts, if any, for operating expenses, debt service, the bond reserve account, redemption of bonds prior to maturity, other reserves, surplus, etc.

FORECLOSURE

A lawsuit by which the issuer of assessments or Mello-Roos bonds enforces the payment obligation against a defaulting landowner by suing to have the property sold to repay the debt. Issuers in these land-secured financings promise in the bond documents to prosecute foreclosure actions against defaulting landowners.

FORECLOSURE AND WORKOUT

The incidence of defaults and other payment problems on Mello-Roos and assessment bonds has risen markedly over the past several years, due largely to the fluctuation of the real estate market in California. Because issuers have a duty under the bond documents to enforce the special tax or assessment payment obligations, they have often been compelled to file foreclosure actions against defaulting landowners. In many cases the payment problems have also led to workout efforts by issuers, sometimes with the assistance of the original financing team, and other times with a new team brought in for this purpose.

Some issuers have shown flexibility in forgiving interest and penalties, which can be helpful in resolving a payment problem. Also, there is a procedure that allows the issuer to seek permission from bondholders to sell foreclosed property for less than the amount owing on the special tax lien, but this procedure is cumbersome and may involve a principal loss to the bondholders. There is also recently enacted legislation in California that would permit landowners to tender Mello-Roos bonds in lieu of payment, which means that if the bonds could be purchased for a discount on the open market, the special tax lien can be extinguished for less money than if it were paid in cash.

Finally, the increasing number of defaults in Mello-Roos and assessment financings over the past several years has shown that those financings can be severely affected by a downturn in the real estate market. To avoid future problems, more scrutiny may be appropriate at the outset. Some of the questions that might be posed include:

- Is the financing wise from a public policy perspective?
- If a real estate developer is involved in the financing, does the developer have a good track record?

- Have the appraisals supporting the financing been prepared by competent and experienced professionals?

- Is the real estate market likely to support the financing long-term?

GOOD FAITH DEPOSIT

A deposit made by an underwriter with the issuer of a new issue as assurance that the underwriter will proceed with the closing of the purchase of the issue if the issuer meets all of the conditions of the bond purchase contract.

The good faith deposit is commonly one percent of the par value of the issue, and generally is provided in the form of a certified or cashier's check. In the case of a competitive sale, each bidder submits a good faith check with its bid, the check is returned to the bidder if its bid is not accepted, and the deposit of the successful bidder is retained by the issuer until the issue is delivered and paid for at the closing. In a negotiated sale, the underwriter delivers the good faith deposit at the time the bond purchase contract is entered into and the deposit is held by the issuer until the closing. In the event the winning bidder or underwriter fails to take delivery of and pay for the new issue for reasons other than those permitted under the notice of sale or the bond purchase contract, the good faith deposit may be retained by the issuer as liquidated damages.

GOVERNMENTAL BONDS

Bonds that are issued by a public agency and not private activity bonds.

GROSS PROCEEDS

See **Proceeds/Sale Proceeds/Investment Proceeds/Gross Proceeds/Net Proceeds**.

GROSS REVENUES

See **Revenues/Gross Revenues/Net Revenues**.

GUARANTEED INVESTMENT CONTRACT.

See **Investment Agreement**.

HEDGE BONDS

Bonds issued substantially in advance of when monies will be needed for the purpose being financed, in order to hedge against subsequent interest rate increases.

The Internal Revenue Code contains specific limitations on tax-exempt hedge bonds (as defined therein).

INDENTURE/BOND RESOLUTION (GENERAL, SUPPLEMENTAL, AND SERIES)

An agreement executed by an issuer and a trustee (or fiscal agent) that pledges certain revenues and other property as security for the repayment of the issue, sets forth the terms of the bonds, and contains the responsibilities and duties of the trustee and the rights of the bondholders.

The responsibilities and duties of the trustee may include, among others, the following:

- Regulating the disbursement of proceeds of the issue for the intended purpose
- Funding transfers to assure that bondholders receive timely and complete payment
- Protecting the assets of the trust if a default occurs, and
- Exercising a specified standard of care in the administration of those trusts

The rights of bondholders are set forth in indenture provisions relating to the timing of interest and principal payments, interest rate setting mechanisms (in the case of variable rate bonds), redemption provisions, events of default, remedies, and the mailing of notices of various events. The indenture typically also contains the text to be printed on the bond.

A bond resolution differs from an indenture in that the issuer unilaterally adopts the resolution, which is then accepted as an agreement by the trustee or fiscal agent in a separate document. The provisions of a resolution used in this manner do not differ substantially from those of an indenture.

The term bond resolution is often also used to mean a resolution that authorizes the issuance of bonds, and may or may not also authorize the execution of an indenture.

General and series indentures are used when several issues of parity bonds are to be issued. The general indenture customarily specifies the matters that will be common to all series of bonds, and the series indenture is a supplemental indenture that specifies the terms of the particular series and any other features that are unique to that series.

A supplemental indenture is an indenture that amends or supplements a prior indenture, whether that prior indenture stands by itself, is a general indenture, or a series indenture. See also **Chapter 1, Overview of a Debt Financing – Basic Legal Documents**.

INDUCEMENT RESOLUTION

A very preliminary resolution of the governing body of an issuer confirming its then current intent to issue qualified private activity bonds for a specified project.

An inducement resolution is not legally binding on the issuer, but serves to mark the time under federal tax rules after which costs expended on the project qualify for financing with tax-exempt bonds.

INFORMATION REPORTING REQUIREMENT

The requirement to report to the Internal Revenue Service certain information about a new issue if interest on the issue is to be tax-exempt. These reports must be filed on IRS Form 8038, 8038G, or 8038GC and must be submitted no later than the fifteenth day of the second month following the close of the calendar quarter in which the bonds are issued.

INSTALLMENT PURCHASE CONTRACT

See **Financing Lease**.

INSTALLMENT SALE AGREEMENT

See **Financing Lease**.

INTERCEPT PROGRAM

An intercept program is a program by which the bond documents permit the bond trustee to intercept revenues from a third party that would otherwise flow to the issuer in order to pay debt service on the bonds. The most common such program in California relates to motor vehicle license fee revenues, which are normally collected by the state and distributed to cities and counties pursuant to a formula. Under Government Code Section 37351.5 (for cities) and Section 25350.55 (for counties), cities and counties can elect to have certain lease obligations (such as COPs or lease revenue bonds) secured by a pledge of motor vehicle license fee revenues. If the issuer then fails to make a lease payment when due, the trustee can notify the State Controller and obtain funds directly from the issuer's account within the State Motor Vehicle License Fee Fund to make the lease payment.

INTEREST/INTEREST RATE

A charge paid to the bondholder by the issuer for the use or borrowing of money. The interest rate is the interest charge expressed as a percentage of principal (which generally corresponds roughly to the amount borrowed) accruing over a specified period (generally a year) so long as the debt remains unpaid.

Interest may be paid or may compound at intervals different from the period used to express the interest rate. For example, interest on current interest fixed rate bonds generally is expressed as an annual rate, but is paid semiannually, with each semiannual payment being one-half of the amount that would accrue over an entire year. Interest on compound interest fixed rate bonds generally is compounded semiannually and paid at maturity. Interest on variable rate bonds accrues at a rate which changes from time to time (perhaps as often as daily), but each such rate is nevertheless generally expressed as a percentage per year.

The amount of interest that has accrued over a period shorter than the payment or compounding interval may be determined by one of several different rules. For example, if interest accrues "on the basis of a 360-day year of 12 30-day months," the amount of interest that has accrued since the last payment or compounding date is calculated assuming that 1/12th of one year's interest accrues for each complete calendar month and 1/360th of one year's interest accrues for each additional day. On the other hand, if interest is calculated on the basis of a year of 365 days and the actual number of days elapsed, the amount of interest accrued since the last payment or compounding date is calculated assuming that 1/365th of one year's interest accrues each day.

Generally, interest on fixed rate bonds is calculated on the basis of a 360-day year and interest on variable rate bonds is calculated on the basis of a 365-day year.

INVESTMENT AGREEMENT

An agreement, typically purchased by the trustee for an issue from a financial institution, in which the financial institution agrees to guarantee a certain investment return on monies—often proceeds of the issue—invested under the agreement.

The return provided by the investment agreement may be fixed at a stated interest rate for each fund or account held by the trustee, or may float at a level related to the yield on the bonds (if the bonds bear interest at a variable rate) or some other index. Monies that may be invested include a fund for the construction or acquisition of the project or the program loans to be financed, a reserve account, and a fund in which monies to pay debt service on the issue are accumulated. An investment agreement is usually provided by a highly rated financial institution, in most instances a commercial bank or insurance company, because the credit rating on the bonds may be based in part on the credit rating (or the rating of the claims-paying ability) of the institution providing the investment agreement.

Investment agreements are sometimes used as a convenient means of managing the investment of monies that are subject to arbitrage yield restriction or rebate.

INVESTMENT OF PROCEEDS

The investment of proceeds and other monies relating to an issue is typically governed by state law and by the indenture or bond resolution.

Either document may prescribe both the types of investments that may be purchased (e.g. U.S. Treasury obligations, bank certificates of deposit, or corporate obligations with a specified rating) and the maximum maturity of investments of certain funds (e.g. short-term investments for monies to be used to make the next debt service payment or longer term investments for reserves). The arbitrage rules under federal tax law may regulate the yield at which proceeds may be invested and may require rebate of certain investment earnings.

INVESTMENT PROCEEDS

See **Proceeds**.

INVESTORS/INSTITUTIONAL INVESTORS/RETAIL INVESTORS

Investors are persons or firms who purchase bonds. They are in effect loaning their money (the amount of their investment) to the issuer of the bonds in exchange for the issuer's obligation to repay them with interest. Investors are often thought of in two broad classes: institutional and retail.

An institutional investor is a mutual fund, insurance company, bank, or other financial institution that buys bonds, usually in very large blocks (sometimes in the tens of millions of dollars). Institutional investors have professional staffs whose purpose is to analyze credit risk, monitor investments, and manage the investor's assets.

A retail investor is an individual who purchases bonds, usually in small blocks—as small as $5,000. Retail investors vary from the quite unsophisticated investor with a small amount of savings (often colloquially referred to as the "widows and orphans") to so called "high net worth" individuals who may have significant holdings and experience in the bond market.

See, generally, **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Investors**.

ISSUE

One or more bonds initially delivered by an issuer in a substantially simultaneous transaction and which are generally designated in a manner that distinguishes them from bonds of other issues.

Bonds of a single issue may vary in maturity, interest rate, redemption, and other provisions. Under a revolving credit agreement or line of credit, obligations recorded or delivered representing the obligation to repay draws under the credit facility are commonly aggregated into a single issue.

For federal income tax purposes, the meaning of the term issue may depend upon the context in which it is used and may differ from definitions used under state law or in bond documents. For example, bonds of different issuers sold at substantially the same time, payable from substantially the same source of funds, and sold pursuant to a common financing plan may be a single issue for certain federal tax purposes.

ISSUER

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Issuer**.

LEGAL INVESTMENT MEMORANDUM OR SURVEY

An informational document setting forth the probable eligibility of the bonds for investment by certain potential investors in the specific jurisdictions covered by the survey (usually all 50 states, the District of Columbia, and Puerto Rico).

A legal investment memorandum is used by underwriters in the marketing of bonds, especially to institutional investors. The investors included in the memorandum are commonly savings banks, trust funds, and insurance companies. The legal investment memorandum is usually prepared by counsel to the underwriters, who reviews the current investment laws of the jurisdictions and summarizes the results of such review in the memorandum. The legal investment survey is usually circulated to appropriate dealers and investors with the Preliminary Official Statement and the preliminary Blue Sky Survey.

LENDER LOAN AGREEMENT

A loan agreement under which the nongovernmental borrower is a lending institution that agrees to relend the proceeds for purposes and under terms designed to achieve the public purpose for the issue.

LESSEE/LESSOR

See the sections in **Chapter 6, Types of Financing Obligations** on **Public Lease Revenue Bonds** and **Financing Leases and Certificates of Participation**.

LETTER OF CREDIT

An arrangement with a bank that provides additional security that money will be available to pay debt service on an issue.

Customarily, a letter of credit is issued by a commercial bank directly to the trustee and is irrevocable until a specified date. The letter of credit entitles the trustee, if certain conditions are met, to draw upon the letter of credit by submitting to the bank a written request for payment (a draft) and other carefully specified documents and certificates. If the documents submitted for the draw meet the requirements specified in the letter of credit, the bank must pay as provided in the letter of credit.

Letters of credit are also used as liquidity facilities in connection with obligations such as commercial paper or demand bonds. The trustee may draw upon the letter of credit if commercial paper has matured and not been rolled over by issuing new commercial paper, or if demand bond owners put them to the issuer, and the remarketing agent is unable to find new purchasers. See also **Line of Credit**.

A draw on a letter of credit results in an obligation by the account party on the letter of credit to reimburse the bank for the amount of the draw, plus interest if reimbursement is not immediate. The account party may be either the issuer or, in the case of a conduit financing, the nongovernmental borrower.

A letter of credit may be either a “direct pay letter of credit” or a “standby letter of credit.” A direct pay letter of credit entitles the trustee to draw on the letter of credit for all debt service payments. Monies that would otherwise be available to pay debt service are then used to reimburse the bank. Because payments of principal and interest are made from monies of the bank rather than of the issuer, receipts by the owners of bonds are not subject to being reclaimed from the owners of bonds under the federal Bankruptcy Code.

In the case of a standby letter of credit, the trustee only draws on the letter of credit in the event monies available to pay debt service are insufficient. In this type of financing, to assure that payments to owners of bonds are not subject to being reclaimed in a bankruptcy, monies for debt service are typically required to be on deposit several months in advance of the date on which payments are made to the owners of bonds. These monies are then “seasoned” for the period required to extinguish any potential claim to them in a bankruptcy.

See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Credit Enhancement Provide**r.

LINE OF CREDIT

A line of credit is a contract between the issuer and a bank that provides a source of borrowed monies to the issuer in the event that monies available to pay debt service (e.g. on commercial paper) or to purchase a demand bond are insufficient for that purpose.

If a draw on a line of credit is necessary, the issuer notifies the bank and executes a note for the amount of the loan.

The bank extending the line of credit may refuse to make the loan if the issuer is involved in a bankruptcy proceeding and for certain other events, whereas a letter of credit is usually designed to be available even under these circumstances.

See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Credit Enhancement Provider.**

LIQUIDITY

The ease with which an investment may be converted to cash, either by selling it in the secondary market or by demanding its repurchase pursuant to a put or other prearranged agreement with the issuer or another party.

LIQUIDITY FACILITY

See **Letter of Credit** and **Line of Credit**.

LISTED EVENT

An event which, if material, is required to be reported to the NRMSIRs and any state information depository pursuant to an undertaking to provide continuing disclosure pursuant to SEC Rule 15c2-12. See generally **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

LOAN AGREEMENT

An agreement under which the proceeds of a conduit financing are loaned to the nongovernmental borrower and the borrower agrees to pay to the issuer or the trustee the amounts necessary to pay debt service on the issue.

A loan agreement usually includes a set of covenants, financial tests, and restrictive provisions governing the borrower and the project financed. See **Chapter 1, Overview of a Debt Financing – Basic Legal Documents**.

LOWER FLOATER

See **Variable Rate**.

MANAGEMENT FEE

See **Underwriter's Gross Spread (Underwriter's Discount)** and **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

MANAGING UNDERWRITER

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

MARKET AGENT

In an auction rate securities (ARS) transaction, an investment bank retained for the purpose of adjusting the applicable percentage used in determining the maximum auction rate, the percentage used in determining the all-hold rate, and the percentage used in determining the interest rate in the event of a payment default. Generally, the market agent and the broker/dealer will be the same party for each series of ARS issued. A market agent may or may not be required on a transaction depending on the document structure. If an ARS program does not require a market agent, the broker/dealer assumes these responsibilities. There is no fee for this service.

MATERIAL/MATERIAL FACTS

Facts that a reasonably prudent investor would want to know in making an investment decision. See also **Disclosure, Official Statement** and **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

MATURE

With respect to principal, to become due and payable pursuant to a bond's original terms (not by acceleration). See also **Maturity**.

MATURITY

With respect to a single bond, the date upon which the principal of the bond is stated to be due. With respect to an issue, all of the bonds of an issue that are due on a single date.

For example, the bonds listed in the first line of the example under the definition of **Serial Bonds** in this appendix have a maturity in the year 1988, whereas the entire issue has serial maturities in the years 1988 through 2000 and a term bond maturity in the year 2011. See also **Term**.

MAXIMUM AUCTION RATE

On any auction date of an auction rate security, the interest rate per annum specified in the bond indenture or trust agreement, or the maximum rate, if any, established under the laws of the state for obligations of public agencies, if less than the rate specified in the indenture or trust agreement.

MELLO-ROOS BONDS

Created under the Mello-Roos Community Facilities District Act of 1982. See **Chapter 6, Types of Financing Obligations – Mello-Roos Bonds**.

MULTI-MODAL BONDS

Bonds that can be converted to different interest rate modes at the option of the issuer—or in the case of conduit bonds, the borrower. Typically, multi-modal bond documents permit bonds to be remarketed in daily, weekly, or monthly interest rate modes as variable rate tender option bonds and in term or fixed rate modes as well. Sometimes, "commercial paper mode" or "flexible rate mode" is included to allow the bonds to be broken up into pieces that have different interest rate periods.

MUNICIPAL SECURITIES RULEMAKING BOARD (MSRB)

An independent, self-regulatory organization established by Congress in 1975 having general rulemaking authority over municipal securities market participants (generally, brokers and dealers).

The MSRB is required by federal law to propose and adopt rules in the areas of professional qualification standards, rules of fair practice, record keeping, the scope and frequency of compliance examinations, the form and content of municipal bond quotations, and sales to related portfolios during the underwriting period.

The 15 MSRB members include 5 from each of 3 categories—securities firms' representatives, bank dealer representatives, and public members. All market participants subject to MSRB jurisdiction are required to register with the SEC. Its jurisdiction does not extend to issuers of municipal securities. In recognition of the existing regulatory structure in place for banks and securities firms, the MSRB does not have inspection or enforcement authority.

NATIONAL ASSOCIATION OF SECURITY DEALERS (NASD)

A self-regulatory organization established as a "registered securities association" pursuant to the Securities Exchange Act of 1934 for the purpose of preventing fraudulent and manipulative acts and practices, promoting just and equitable principles of trade among over-the-counter brokers and dealers, and promoting rules of fair practice and self-discipline in the securities industry.

All securities firms (other than those dealing solely in government and federal agency securities) must be NASD members. The SEC holds certain residual powers over the activities of NASD. The NASD has very limited rulemaking authority with respect to municipal securities and is primarily responsible for enforcing members' compliance with Municipal Securities Rulemaking Board rules.

NEGOTIATED SALE

A sale of bonds, the terms and price of which are negotiated by the issuer through an exclusive agreement with a previously selected underwriter and/or underwriting syndicate.

Unlike a competitive sale, the underwriter is customarily active in all aspects of structuring the negotiated deal. Selection of the underwriter can be based on many different considerations including, but not limited to, expertise with a particular type of issue, market expertise, reputation, guaranties of maintaining a maximum gross spread, as well as prior relationships with the issuer.

In addition to negotiating the terms and covenants of the issue, the issuer and the underwriter also negotiate pricing of the issue. One advantage of a negotiated sale is that the issue can be brought to market at the most advantageous time giving special consideration to a volatile interest rate environment for the particular issue. Negotiated sales are often used for complex financings that may require targeting to specialized investors due to the financing structure or the nature of the security for the bonds.

The underwriter's gross spread is generally larger on a negotiated sale than on a competitive sale, because it includes compensation for additional services, including analytical services, due diligence, structuring, and making markets in these securities after the issue has been completed (secondary market transactions).

NET DIRECT DEBT

With respect to any given issuer the amount of all outstanding debt of such issuer (direct debt), less the sum of any amounts accumulated in sinking funds for such debt and the amount of such debt that is self-supporting.

NET INTEREST COST (NIC)

A measure of the interest cost of an issue derived by adding together all interest payments for the term of the issue and dividing that sum by the sum for all bonds of the amount of each bond multiplied by the number of years it is outstanding.

If the bonds are to be issued at a discount, the amount of the discount is added to the interest total as if it had been paid by the issuer. If the bonds are to be issued at a premium, that amount is subtracted from the interest total. The formula is as follows:

$$\text{NIC} = \frac{\text{Total Interest Payments + Discount (or - Premium)}}{\text{Bond Year Dollars}}$$

The denominator, bond year dollars, measures the amount of bonds outstanding over the time they are outstanding. Bond years equal the number of bonds outstanding (in $1,000 denominations) multiplied by the number of years they are outstanding. One bond year is one

$1,000 bond outstanding for one year. Bond year dollars are the number of bond years multiplied by $1,000 for each bond.

NIC is distinguished from the True Interest Cost (TIC) measure in that the NIC does not take into account the time value of money.

Consider the following example of the NIC calculation. The NIC is computed for a $3 million offering with 3 serial bond maturities and a fixed interest rate of 5 percent for each maturity.

Example 1

Years to Maturity	Par Value	Interest Rate	Interest Payments Per Maturity	Bond Year Dollars
1	$1,000,000	5%	$ 50,000	$1,000,000
2	1,000,000	5%	100,000	2,000,000
3	1,000,000	5%	150,000	3,000,000
Total	$3,000,000		$300,000	$6,000,000

The total interest payments come to $300,000, paid out as follows:

- $50,000 is paid out for the first maturity, which is due in a year
- $50,000 per year is paid out for two years on the second maturity, and
- $50,000 per year for three years on the third maturity

The bonds were issued at par so there is no addition or deduction from the total interest payments for a discount or premium. Bond year dollars equal $6,000,000. The NIC equals 5 percent.

$$\text{NIC} = \frac{\text{Total Interest Payments}}{\text{Bond Year Dollars}} = \frac{\$300{,}000}{\$6{,}000{,}000} = .05 \text{ or } 5.0\%$$

Because the interest rate was the same for all three issues and there was no discount, the NIC was equal to the interest rate. A more complicated example will help make the calculation clearer. An issuer chooses to sell $10 million of bonds in five separate maturities. The serial maturities and the interest rates follow. There are no discounts or premiums.

Example 2

Years to Maturity	Par Value	Interest Rate
1	$1,000,000	5.0%
2	2,000,000	5.1%
3	2,000,000	5.2%
4	2,000,000	5.25%
5	3,000,000	5.3%

The total interest payments and bond year dollars follow, in order of maturity.

	Interest Payments per Maturity	Bond Year Dollars
	$ 50,000	$ 1,000,000
	204,000	4,000,000
	312,000	6,000,000
	420,000	8,000,000
	795,000	15,000,000
Total	$1,781,000	$ 34,000,000

$$\textbf{NIC} = \frac{\textbf{Total Interest Payments}}{\textbf{Bond Year Dollars}} = \frac{\$1{,}781{,}000}{\$34{,}000{,}000} = .05238 \text{ or } 5.238\%$$

Had the issue been sold at a discount, the NIC would be higher. For example, if the issue had sold at an average price of 97 percent, the issuer would have had $300,000 less in proceeds. To compute the NIC, the $300,000 would be added to total interest payments. The NIC rises to 6.12 percent.

$$\textbf{NIC} = \frac{\$1{,}781{,}000 + \$300{,}000}{\$34{,}000{,}000} = \frac{\$2{,}081{,}000}{\$34{,}000{,}000} = .06121 \text{ or } 6.121\%$$

Note that in these examples, the NIC was a function only of the total amount of interest and did not take into account the consideration of when the interest payments would be made. In other words, all $1,781,000 of interest could have been paid in the first year and the NIC would have still equaled 5.238 percent.

The NIC is sometimes used to compare bids at a competitive sale. See also **True Interest Cost (TIC)**.

NET OVERALL DEBT

With respect to any given issuer, the amount of such issuer's net direct debt plus the issuer's share of the overlapping net direct debt of other public entities.

NET REVENUES

See **Revenues/Gross Revenues/Net Revenues**.

NO-LITIGATION CERTIFICATE

A certificate signed on behalf of the issuer and dated as of and delivered at the closing to the effect that no litigation is pending that would adversely affect the financing.

If litigation is pending, it is customarily described in the no-litigation certificate and, presuming that the bonds are to be issued in spite of such litigation, the issuer and the purchasers of the bonds must be able to conclude that the litigation does not present a material risk to the investors. One method of reaching that conclusion is to obtain, if available, an opinion of counsel to the effect that there is “no merit” to the adverse claims presented in the litigation.

NONGOVERNMENTAL BORROWER

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Nongovernmental Borrower**.

NOTICE OF SALE

The document that issuers use to solicit bids from prospective underwriters for a competitive sale of bonds.

The notice will commonly be published in a financial industry journal, usually *The Bond Buye*r or *The Wall Street Journal* (and, if required by law, a local newspaper of general circulation) and will list the details concerning an issue. This may include:

- The date, time and place of the sale
- The amount of the issue, maturity schedule, and redemption provisions
- Legal authority for the sale
- The manner in which the bid is to be delivered
- The type of security (general obligation, pledge of revenues, etc.)
- Limitations on interest rates and interest payment dates

- Denominations and registration provisions (registered, book entry, etc.)
- Names of bond counsel and any other attorneys delivering opinions, credit enhancement facilities, and other details

The notice of sale, the winning bid and the issuer's acceptance of the winning bid together constitute an agreement for the purchase and sale of the issue in a competitive sale. See also **Chapter 1, Overview of a Debt Financing – Basic Legal Documents**.

NRMSIR

Nationally Recognized Municipal Securities Information Repository—NRMSIRs are the repositories for all annual reports and event notices filed under SEC Rule 15c2-12. NRMSIRs are required to be approved by the MSRB. A list of all the currently approved NRMSIRs is contained in **Appendix B – Resources and Contacts**. See **Chapter 10, Continuing Disclosure and Investor Relations Programs**. See also **State Information Depository (SID)**.

OBLIGATED PERSON

Any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part, of the obligations on the municipal securities (other than providers of credit enhancement). See generally **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

OFFICIAL STATEMENT/PRELIMINARY OFFICIAL STATEMENT

A document containing information about the bonds being offered, the issuer, and the sources of repayment of the bonds.

Federal securities laws generally require that if an Official Statement is used to market an issue, it must fully disclose all facts that would be of interest (i.e. material) to a potential buyer of bonds of the issue. For example, for a general obligation issue, the most important information may concern the financial health of the issuer, its tax base, and the economic health of the jurisdiction. For a water revenue issue, the most important information may be the financial health and physical condition of the water system enterprise, water supply, and the economic health of the service area. For a conduit financing, the most important information may concern the financial health of the nongovernmental borrower. The materiality of such information may also depend upon whether or not credit enhancement is utilized. See also **Deemed Final**.

Under MSRB rules, a final Official Statement—which is printed only after the final terms of the bonds are available—must (if available) be delivered by the broker or dealer to purchasers of bonds no later than the settlement date of the transaction. An Official Statement may also be called an Offering Circular, Offering Memorandum, or bond prospectus. See also **Chapter 1,**

Overview of a Debt Financing – Basic Legal Documents and **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

A Preliminary Official Statement is the version of an Official Statement or Offering Circular used by the issuer or underwriters to inform the marketplace of the terms of the bonds being issued prior to receipt of bids at a competitive sale or prior to the determination of interest rates and purchase price in a negotiated sale.

The Preliminary Official Statement is often referred to as the "red herring" because of the sentence, printed in red on the cover page, to the effect that the information contained in the Official Statement is subject to change and that there are conditions to the taking of orders by underwriters. Generally, however, few substantial changes are made between the Preliminary and final versions of the Official Statement.

ORGANIC ACT

The statute under which a particular governmental entity is organized.

Generally, this term is used to describe an act that specifies the manner of organization and the powers of a single agency, authority, or district named in the act, rather than the type of statute under which, for example, any city or county could cause to be created an agency of the type described in the statute. Compare, for example, the statute under which the California Housing Finance Agency is organized (Health and Safety Code Sections 50900 et seq.) with the statute under which a city or county may create a housing authority (Health and Safety Code Sections 34200 et seq.).

ORIGINAL ISSUANCE DATE

See **Date of Issuance/Original Issuance Date**.

ORIGINAL ISSUE DISCOUNT

See **Discount**.

OUTSTANDING

In general, as used with respect to the principal of an issue, the amount remaining unpaid.

However, the terms of indentures and bond resolutions often provide that bonds, which are not yet paid but are the subject of a defeasance or an advance refunding, are treated as no longer being outstanding.

OVERLAPPING DEBT

With respect to any given issuer, debt of other public entities the jurisdictions of which overlap the jurisdiction of such issuer.

The issuer may partially overlap another public entity (e.g. a special district may contain parts of several counties), may be wholly within another public entity (e.g. a city is entirely within a county), or may wholly encompass another public entity (e.g. a county normally contains a number of cities).

The term may be used with respect to both general obligation debt payable from ad valorem taxes (in which case it is generally apportioned on the basis of relative assessed value), or may be used with respect to special assessment, special tax, or other revenue based debt, in which case other methods of apportionment may be used, such as relative amounts of benefit or service delivered.

PAR/PAR VALUE

Par or par value refers to the principal amount of a bond.

A bond may be purchased at par—meaning the price of the bond is equal to its principal amount, below par—meaning the price is below its principal amount, or above par—meaning the price is above its principal amount. See also **Discount** and **Premium**.

PARITY

Having equal security with other obligations.

For example, two issues of revenue bonds are said to be on parity with each other if the revenues, projects, program loans, and other assets securing the first issue also secure the second issue, and vice versa.

Issues may be on parity with each other with respect to one level of security but not with another level of security. For example, one issue may be the subject of bond insurance, while another is not, in which case they would be on parity with respect to the basic revenues, but not with respect to the insurance.

PAYING AGENT

The institution—usually a commercial bank or trust company—appointed in the indenture or bond resolution to act as the agent of the issuer to pay principal and interest from monies provided by or on behalf of the issuer. See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Trustee/Fiscal Agent/Paying Agent/Registrar/Authenticating Agent**.

PLACEMENT AGENT

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

PLEDGE

To grant a security interest in or lien on an asset to provide security for the repayment of bonds or the performance of some other obligation.

A pledge may cover an existing asset (such as a reserve account) or a stream of revenues to be received in the future (such as the income of a defined enterprise).

POINT/BASIS POINT

Point is a shorthand reference to 1 percent.

Because municipal dollar prices are quoted relative to $1,000, a point is worth $10 regardless of the actual denomination of a bond. Thus, a bond discounted 2.5 points, or $25, is quoted at 97.5 percent of its value, or $975 per $1,000.

Basis point is a shorthand reference to one one-hundredth of one percent (.01 percent). The term is generally used to describe interest rates rather than prices. For example, if an interest rate increases from 8.25 percent to 8.5 percent, the difference is referred to as a 25 basis point increase.

POOLING OF DEBT ISSUES

This term encompasses two different concepts, pooled financings (including both blind pools and dedicated pools), and composite issues.

The users of the proceeds of pooled financings may be public or private entities. Generally, the issuer (or the trustee on behalf of the issuer) holds the proceeds of the issue until they are loaned to users. The issue is typically secured by the proceeds until expended, a reserve fund, and the loan agreements with the users. Because repayment of the bonds depends on the repayment of each loan, the creditworthiness (and, therefore, the rating of the issue) is based on the credit of the weakest user or borrower. Generally, the default of one borrower has no effect on the obligations of any other borrower—that is, no borrower is required to make up any payment not made by another borrower. To strengthen the credit of the issue that would otherwise be determined by the weakest credit, pooled financings commonly require either that each loan be insured or guaranteed or that the issue be secured by bond insurance or a letter of credit. As a result, the rating of the issue is based on the insurance company or bank rather than on the individual borrowers.

Local agencies may pool issues under the Marks-Roos Local Bond Pooling Act of 1985 (Government Code Sections 6584 et seq.).

Blind Pool Issue

An issue the proceeds of which are used to make or finance loans to, or projects for, entities that are not identified at the time the bonds are issued.

If some but not all of the users are identified, the pool is partially blind.

Dedicated Pool

An issue the proceeds of which are to be used to finance loans to, or projects for, entities that are identified and committed to the financing at the time the bonds are issued.

See **Chapter 6, Types of Financing Obligations – Marks-Roos Bonds** for a further discussion of pooled financings.

PRELIMINARY OFFICIAL STATEMENT

See **Official Statement/Preliminary Official Statement**.

PREMIUM

The amount by which the price of a bond exceeds its principal amount or par value.

A redemption premium is the premium an issuer is required (by the terms of a bond) to pay to redeem (call) the bond prior to its stated maturity.

See also **Discount**.

PRICING/REPRICING

The determination (or redetermination) by the underwriters in a negotiated sale of the interest rates and reoffering prices at which an issue will be offered to investors.

Generally, the underwriters will have mailed a Preliminary Official Statement to potential investors and to other underwriters approximately one to two weeks prior to the pricing date. On the pricing date the underwriters will price the issue at the lowest marketable interest cost to the issuer. The price must be agreeable to the issuer. The underwriters then offer the bonds to investors on the agreed terms and if an appropriate number of orders are received, the issuer and the underwriters enter into a bond purchase contract on those terms. If not enough or too many orders are received on the original terms, the issue may be repriced to be more attractive to investors or to give a better rate to the issuer, as the case may be.

PRINCIPAL

With respect to a loan, the amount loaned and to be repaid, i.e. the amount for the use of which interest is charged. Similarly, with respect to a bond, principal is the amount on which interest accrues and which is to be paid to the bondholder on the maturity date (not including simple interest or compounded interest).

The principal of a bond is sometimes referred to as its face amount since the amount to be paid at maturity is printed on the front (the face) of the bond. See also **Original Issue Discount** and **Par/Par Value**.

PRIVATE ACTIVITY BONDS

In general, bonds of which 10 percent or more of the proceeds are used in the trade or business of nongovernmental persons and 10 percent or more of the debt service is secured by or derived from property used in the trade or business of nongovernmental persons, or 5 percent or more of the proceeds are loaned to nongovernmental persons.

For this purpose, nongovernmental persons are treated as users of facilities that they lease and of facilities the output of which they agree to purchase. Nongovernmental persons may be treated as users of facilities by reason of long-term management contracts. The U.S. government is treated as a nongovernmental person.

Interest on private activity bonds is tax-exempt only if they are qualified private activity bonds.

With the exception of qualified 501(c)(3) bonds and certain bonds for government owned seaports or airports, qualified private activity bonds must be exempt from that requirement under an exception for refunding bonds. See **Chapter 3, General Federal Tax Requirements**.

PRIVATE PLACEMENT

The offer and sale of an issue by the issuer directly to one or more investors, rather than through an underwriter.

Often, the terms of the issue are negotiated directly between the issuer and the investor. Sometimes, an investment banker will act as placement agent, bringing the parties together and acting as an intermediary in the negotiations. Instead of an Official Statement, an Offering Circular, Offering Memorandum, or Private Placement Memorandum may be prepared.

PRIVATE PLACEMENT MEMORANDUM

A memorandum that takes the place of an Official Statement in a private placement and contains a description of the bonds, the financing structure, and the issuer.

It is normally prepared in very small quantities for very limited distribution. It is not normally as extensive as with public offerings because the investor generally does its own investigation of the credit risk of the issue.

PROCEEDS/SALE PROCEEDS/INVESTMENT PROCEEDS/GROSS PROCEEDS/NET PROCEEDS

Proceeds are comprised of sale proceeds and investment proceeds. Sale proceeds are the amount paid by the ultimate purchasers (not including an underwriter) of a new issue, excluding any accrued interest.

The term gross proceeds refers to all of the monies relating to an issue, which are subject to arbitrage limitations and rebate under the Tax Code. Gross proceeds include sale proceeds, investment proceeds, and any other monies pledged to pay debt service and expected to be used to pay debt service, including monies in a sinking fund and monies in a reserve account.

The term net proceeds refers to all proceeds less any investment proceeds earned after completion of the financed project.

See **Chapter 3, General Federal Tax Requirements**.

PROJECT FINANCING

An issue for the purpose of financing all or a portion of the costs of acquiring, constructing, and/or renovating a specified project for a public or private entity.

Generally, the term is used in situations in which the issue is to be repaid with revenues relating to the project financed, although other revenues and guarantees may also secure the issue. See also **Conduit Financing**.

PUBLIC OFFERING

The sale of bonds (generally through an underwriter) to the general public (or a limited section of the general public).

The offer is usually disclosed by an Official Statement in which the terms of the financing and its structure are set forth, allowing the investor to make an informed decision about the merits of the proposed securities. The issuer may market a proposed public offering either via competitive sale or negotiated sale.

In addition to public offerings, bonds are also sold in limited public offerings and private placements.

PUBLIC SALE

See **Competitive Sale**.

PUT BOND

See **Demand Bond (Put Bond or Tender Option Bond)**.

QUALIFIED PRIVATE ACTIVITY BONDS

See **Chapter 3, General Federal Tax Requirements**.

QUALIFIED 501(C)(3) BONDS

Private activity bonds issued for certain nonprofit organizations (including hospitals and universities) described in Section 501(c)(3) of the Internal Revenue Code. See **Chapter 3, General Federal Tax Requirements**.

See also the sections in **Chapter 6, Types of Financing Obligations** on **Conduit Revenue Bonds: General, Conduit Revenue Bonds: Hospital and Health Care Facilities; Certificates of Participation,** and **Conduit Revenue Bonds: Educational Facility Bonds**.

RATING

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Credit Rating Agencies**.

REBATE REQUIREMENT

To pay to the U.S. government (or in the case of certain qualified single-family mortgage revenue bonds, to mortgagors) amounts earned from the investment of gross proceeds at a yield in excess of the yield on the issue.

Generally, the amount of this rebate requirement should be computed at least annually, and at least 90 percent of the cumulative rebate amount must be paid to the federal government every 5 years. Certain exceptions are provided—and no rebate of arbitrage need be paid—for example, if all proceeds (other than certain debt service accounts and reserve accounts) are spent within six months or, with certain limitations, eighteen months or even two years, after the date of issuance, or the amounts are earned with respect to monies in debt service funds that generate gross investment receipts of not more than $100,000 during the year.

See **Chapter 3, General Federal Tax Requirements**.

REDEMPTION

The payment of principal of a bond, whether at maturity, or—under certain circumstances described in the bond—prior to maturity. Redemption of a bond by the issuer prior to maturity is sometimes referred to as calling the bond. Redemption prior to maturity may be optional, mandatory, or extraordinary (sometimes also called special).

Optional redemption provisions give the issuer the option to redeem the bonds prior to maturity from any available funds of the issuer on certain specified dates at specified prices. A redemption price may consist of the principal amount plus a premium expressed as a percentage of the principal amount. Since a purchaser of a bond has made an investment decision based in part on the date the principal is to be repaid, the purchaser generally wants to know under what circumstances the bond may be redeemed prior to its maturity. There is often a minimum period of time during which the issuer may not optionally redeem the bond, giving the owner what is referred to as call protection.

After the call protection period, an issuer may be required to pay the owner a premium to redeem a bond prior to its maturity. The premium percentage generally decreases the longer the issuer waits to optionally redeem the bond. For example, the issuer might be required to pay 103 percent of the principal amount of the bond (100 percent of principal plus a premium of 3 percent) to optionally redeem the bond in the eleventh year after its issuance, 102 percent in the twelfth year, 101 percent in the thirteenth year, and 100 percent in the fourteenth year, and each year thereafter until maturity.

Mandatory redemption provisions require the issuer to redeem all or a portion of an issue at certain times, or upon the occurrence or nonoccurrence of certain events. Generally, the issuer is not required to pay a premium for mandatory redemption and the risk of a mandatory redemption is taken into account by an investor when purchasing the bond. For example, single-family mortgage revenue bonds are generally subject to mandatory redemption from proceeds not used to acquire mortgage loans and from prepayments of mortgage loans.

Another example is mandatory sinking fund redemption, which requires the issuer to regularly redeem a portion of a term bond of an issue prior to its stated maturity in accordance with a schedule in the indenture or bond resolution. Mandatory sinking fund redemption results in the periodic retirement of the principal of term bonds in a manner similar to the periodic retirement of principal by the payment of serial bonds at maturity. For example, an issue might consist of $5,000,000 of term bonds maturing in 2011. Mandatory sinking fund redemption provisions for such bonds might require the issuer to redeem $1,000,000 of the term bonds in each of the years

2007 through 2011. In each of those years the issuer (or the trustee or fiscal agent) would choose $1,000,000 of the term bonds at random for repurchase.

Extraordinary redemption provisions allow the issuer to repurchase bonds prior to their maturity upon the occurrence of certain unforeseen and extraordinary circumstances, such as destruction of the facilities that were intended to generate revenues to pay the bonds. Extraordinary redemption is sometimes allowed to be made at the option of the issuer upon the occurrence of the extraordinary event, or may be required to be made upon such occurrence as an extraordinary mandatory redemption. For example, the issuer may be permitted to rebuild the facilities with insurance proceeds or use the insurance proceeds to redeem bonds.

REFUNDING

An issue of new bonds (the refunding bonds) to pay debt service on a prior issue (the refunded bonds).

Generally, the purpose of a refunding is either to reduce the debt service on the financing or to remove or replace a restrictive covenant imposed by the terms of the refunded bonds (for example, an excessive coverage ratio).

The proceeds of the refunding bonds are either deposited in escrow to pay the refunded bonds when subsequently due (see **Advance Refunding**) or applied immediately to the payment of the refunded bonds (see **Current Refunding**).

For accounting purposes, refunded bonds are not considered part of the issuer's outstanding debt because the refunded bonds are to be paid from the proceeds of the refunding bonds and not from the revenues originally pledged. Refunded bonds may continue to hold a lien on the revenues originally pledged, however, unless the indenture or bond resolution provides for defeasance of the refunded bonds prior to maturity or redemption.

Advance Refunding

A refunding in which the refunding bonds are issued more than 90 days prior to (in advance of) the date upon which the refunded bonds will be repaid. Compare to **Current Refunding**.

Typically, the proceeds of the refunding bonds are placed in escrow and invested in obligations of the federal government (although other investments such as federal agency obligations may be used). See also **SLGS**. Payments received on the investments held in escrow are then applied to make payments on the refunded bonds as they become due (including by redemption) or, in some cases, are applied to pay interest on the refunding bonds until also applied to pay principal of the refunded bonds.

Refunded bonds are considered “prerefunded” when the proceeds of the refunding bonds are placed in escrow and invested until a date upon which the refunded bonds may be redeemed.

The escrow (including earnings thereon) is applied to the payment of interest, principal maturing prior to the redemption date, and the redemption price of the refunded bonds.

Refunded bonds are considered "escrowed to maturity" when the proceeds of the refunding bonds are placed in escrow, invested, and applied to payments on the refunded bonds when due, without redemption prior to maturity.

Generally, in an advance refunding, the revenues originally pledged to the payment of the refunded bonds become pledged to the payment of the refunding bonds on the date the refunding bonds are issued. Payment of the refunded bonds is then secured by the escrow. See **Crossover Refunding**.

Crossover Refunding

A refunding in which the revenues originally pledged to secure the refunded bonds continue to be applied to pay the refunded bonds until the refunded bonds mature or are redeemed.

On the date the refunded bonds are paid in full, the pledged revenues "cross over" and are thereafter pledged to pay the refunding bonds.

During the period when both the refunded and the refunding bonds are outstanding, the escrow containing the proceeds of the refunding bonds pays interest on the refunding bonds. Then on the crossover date, the escrow pays the principal of the refunded bonds.

Current Refunding

A refunding in which refunding bonds are issued not more than 90 days before the date upon which the refunded bonds will be paid.

Generally, the proceeds of the refunding bonds are applied immediately to pay the refunded bonds. Thereafter, the revenues originally pledged to the payment of the refunded bonds are pledged to the payment of the refunding bonds.

REGISTERED BOND

A bond for which the name and address of the legal owner is required to be listed on the bond registration books of the trustee or a registrar.

Generally, interest payments on a registered bond are made by check or wire sent to the registered owner. The registered owner may not be the beneficial owner of the bond, but rather a nominee for the beneficial owner. If the registered owner is a broker/dealer acting as nominee for a client, the bond is referred to as being held in "street name." Registered bonds are often held in the name of a securities depository or in the name of a nominee for a securities depository, such as Depository Trust Company, which then keeps a record of the broker/dealers whose clients are the beneficial owners of the bonds. Compare to **Coupon Bond**.

REGISTRAR

The agent of the issuer appointed to maintain a list of the names and addresses of all registered owners of the bonds and to record transfers and exchanges of the bonds.

See also **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Trustee/Fiscal Agent/Paying Agent/Registrar/ Authenticating Agent**.

REIMBURSEMENT RESOLUTION

See **Chapter 3, General Federal Tax Requirements**.

REMARKET

To buy and resell to the public previously issued bonds that have been or are required to be purchased from the original or subsequent holders of the bonds by the issuer or another party upon the occurrence of certain events specified in the legal documents.

With respect to variable rate bonds, remarketings commonly occur in connection with:

- A tender of the bonds at the option of the holder
- The conversion from one interest rate mode (e.g. weekly variation) to another interest rate mode (e.g. quarterly variation)
- The conversion of the variable rate bonds to fixed rate bonds, or
- The termination or other alteration of the letter of credit, standby purchase agreement, or other credit enhancement facility or liquidity facility

With respect to an issue the proceeds of which were escrowed upon closing, a remarketing would occur upon satisfaction of the requirements for breaking the escrow and disbursing the proceeds for the purposes for which the bonds were issued.

In a remarketing, bonds tendered by their holders (perhaps mandatorily) for purchase are sold to new purchasers. A remarketing is usually conducted on behalf of the issuer by an investment bank or commercial bank acting as remarketing agent pursuant to a remarketing agreement entered into at the time of the original issuance of the bonds. Frequently, the remarketing agent is the same firm that acted as the managing underwriter for the original issue.

In many instances, including a conversion to fixed rate or the breaking of escrow, a remarketing will resemble a new issue in many respects, including the preparation and distribution of a new

Official Statement, often called a Reoffering Circular. Unlike a new issue, however, the proceeds of remarketing do not go to the issuer. Rather, remarketing proceeds are used to pay the purchase price of the tendered bonds to the previous owners or to reimburse the credit facility provider for draws made on the credit facility for such purchase.

REMARKETING AGENT

The investment bank or commercial bank retained to remarket bonds that have been tendered for purchase by the issuer or another party pursuant to an option to sell (a put) that accompanies the bond.

See also **Remarket**, **Demand Bond (Put Bond or Tender Option Bond),** and **Variable Rate**.

REOFFERING

Literally, offering again.

This term is used in two contexts. First, it is used to describe the offering of bonds by the underwriter to the public. For example, the initial offering price to the public is often referred to in shorthand as the reoffering price. Second, the term reoffering is used to describe a form of remarketing in which an issuer exercises the right to require bondholders to mandatorily tender their bonds for reoffering to the public, customarily in the context of a conversion from a variable rate to a fixed rate.

REQUEST FOR PROPOSAL

See **Chapter 1, Overview of a Debt Financing – Using a Request for Proposal to Select Financing Team Members**.

REPRICING

See **Pricing/Repricing**.

RESERVE ACCOUNT (BOND RESERVE ACCOUNT OR DEBT SERVICE RESERVE ACCOUNT)

An account from which monies may be drawn to pay debt service on an issue if pledged revenues and other amounts available to satisfy debt service are temporarily insufficient.

A reserve account may be funded to its agreed requirement with bond proceeds, or it may be only partly funded at the time of issuance and expected to reach its full requirement over time through the accumulation of pledged revenues or other available monies. If a bond reserve account is used in whole or part to pay debt service, the issuer usually is required to replenish the reserve account from revenues available after payment of debt service.

A typical reserve requirement for an enterprise revenue bond would be an amount equal to maximum annual debt service on the issue, but not more than 10 percent of the original principal amount of the issue.

The size of the reserve account and the investment of the monies held therein are subject to restrictions contained in the federal tax law for tax-exempt bonds. Investment earnings on bond reserve account monies may also be subject to yield restriction and rebate.

Sometimes, reserve account requirements are satisfied by the provision of a surety policy instead of a deposit of cash. See **Surety**.

REVENUES/GROSS REVENUES/NET REVENUES

The income produced by a given source.

In the context of revenue bonds, revenues typically means the income and receipts generated from the operation of the project or loan program being financed, or from the enterprise of which the project or loan program is a part, or from other nontax sources—for example, water charges in the case of water revenue bonds, lease payments in the case of lease revenue bonds, or loan repayments in the case of mortgage revenue bonds or a conduit financing. Such revenues would normally be pledged to the payment of the revenue bonds.

Gross revenues refers to the total receipts derived from the operation of the project, program, or enterprise. Net revenues refers to the amount available after subtracting certain costs and expenses, most commonly for operation and maintenance, from gross revenues.

REVERSE VALIDATION ACTION

This term is sometimes used to describe the exclusive procedure under the California law for an interested person to challenge the legality of a bond financing. The validation statutes provide that if the issuer does not file a validation action concerning the financing, then any interested person may file an action within 60 days from when the financing is approved—a so-called reverse validation action. Once an interested person files a reverse validation action, the case proceeds in a manner similar to a validation action by the issuer.

SEC REGISTRATION

The filing of information with the SEC in accordance with the Securities Act of 1933 as a prerequisite to selling or marketing securities.

Most bonds issued by or on behalf of state or local governmental entities are exempt from such registration requirements.

SEC RULE 15C2-12

A rule promulgated by the SEC under the Securities Exchange Act of 1934 concerning disclosure and continuing disclosure requirements for municipal securities. The full text of SEC Rule 15c2-12 is contained in **Appendix D – Legal References – Federal Laws of General Application to Public Finance**. See also **Chapter 10, Continuing Disclosure and Investor Relations Programs.**

SECONDARY MARKET

The market in which bonds are purchased from bondholders who have held such bonds for investment purposes, as opposed to being purchased directly from the issuer or from the issuer through an underwriter.

SECURITY

The features of a debt instrument designed to reduce the risk of nonpayment or late payment, including the sources of monies for timely payment.

For example, a pledge of revenues that restricts the use of the revenues solely to payment of operating expenses of an enterprise and debt service on bonds issued to finance that enterprise provides security for the repayment of those bonds. Similarly, credit enhancement also provides additional security.

SELF-INSURANCE RESERVE FINANCING

A financing in which the proceeds of the issue are deposited in an insurance reserve fund that is used to pay liability claims against participating entities as such claims arise.

The fund is invested and, depending upon the investment earnings and the claims paid, may require additional deposits from participating entities.

Typically, an entity separate from the participating entities, such as a joint powers authority, is the issuer of the bonds and is responsible for the administration of the insurance reserve fund, including the investment of the fund and the payment of claims (although a separate entity may administer these functions through a contractual arrangement with the issuer). Insurance is provided to participating entities (which may be cities, counties, and other public entities) that pay premiums for the coverage. The premiums paid by the participating entities constitute the revenue source for the repayment of the issue.

SELLING GROUP

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

SERIAL BONDS

Bonds of an issue, which are payable as to principal in amounts due at successive regular intervals, generally annual or semiannual and usually in the early years of the term of the issue. An issue may consist of both serial bonds and term bonds.

For example, an issue in the total principal amount of $4,000,000 might consist of serial bonds maturing in the years 1988 through 2000 and $2,595,000 of term bonds maturing in 2011 (but subject to mandatory sinking fund redemption in the years 2001 through 2010) as follows:

Year	Serial Maturities	Term Bond Mandatory Sinking Fund Payments
1988	70,000	
1989	75,000	
1990	80,000	
1991	85,000	
1992	95,000	
1993	100,000	
1994	105,000	
1995	110,000	
1996	120,000	
1997	130,000	
1998	135,000	
1999	145,000	
2000	155,000	
2001		165,000
2002		180,000
2003		190,000
2004		200,000
2005		215,000
2006		230,000
2007		245,000
2008		265,000
2009		280,000
2010		300,000
		325,000*
		* Payment at maturity

SINKING FUND PAYMENTS OR INSTALLMENTS

Payments made by an issuer (often into a sinking fund) to provide for the redemption or payment at maturity of term bonds. Also called mandatory sinking account payments or sinking fund installments.

Generally, sinking fund payments are mandatory in a specified amount for each payment period to provide for the periodic redemption of term bonds prior to their final maturity. See the example under the **Serial Bonds** definition. The individual term bonds to be redeemed each year are customarily selected at random by the trustee.

SLGS

An acronym (pronounced "slugs") for a type of U.S. Treasury obligation, the complete name of which is United States Treasury Securities - State and Local Government Series.

SLGS are an investment vehicle made available by the U.S. Bureau of Public Debt for investment of gross proceeds. The Bureau of Public Debt offers three types of SLGS, which are commonly referred to as Demand Deposit SLGS, Time Deposit SLGS, and Zero SLGS. Generally, Time Deposit SLGS are acquired in connection with an advance refunding. The SLGS are held in escrow, and principal and interest received on the SLGS are used to pay debt service on the prior issue. Because the issuer can specify the rate (subject to the maximum rate specified in a weekly schedule) earned on the SLGS, the issuer may design the escrow investment to meet any yield restrictions while maximizing its permitted investment return. Demand Deposit SLGS are intended for the investment of monies subject to the rebate requirements. Earnings on Demand Deposit SLGS are not subject to the rebate requirement. The interest rate on the Demand Deposit SLGS is determined weekly, effective each Monday and is calculated based upon a formula which takes into account the Federal Funds Rate which is published by the Federal Reserve Board and an estimated average marginal tax rate of owners of short-term municipal securities and an administrative fee. The estimated marginal tax rate and the administrative fee may be changed periodically by the Bureau of Public Debt. Zero SLGS bear interest at 0 percent, have flexible purchase and redemption terms, and are designed to be used to average down investment yields on open market securities for yield restriction purposes.

SPECIAL TAX COUNSEL

A law firm retained by the issuer to render the opinion that interest on an issue is tax-exempt under circumstances where the firm retained as bond counsel either does not have the expertise or is otherwise unable to render that opinion.

SPREAD

See **Underwriter's Gross Spread (Underwriter's Discount)** and **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

STANDBY PURCHASE AGREEMENT

An agreement between an issuer and a financial institution, usually a bank, whereby the bank agrees to purchase bonds in the event the bondholders tender them to the issuer and they are not remarketed to new purchasers.

See also **Demand Bond (Put Bond or Tender Option Bond)** and compare to **Letter of Credit** and **Line of Credit**.

STATE INFORMATION DEPOSITORY (SID)

An information depository for a particular state approved by the MSRB in accordance with SEC Rule 15c2-12. Currently, there is no state information depository for California. See generally, **Disclosure** and **Continuing Disclosure**.

SURETY

In the public finance context, a surety policy is a form of insurance provided by a bond insurer to satisfy a reserve fund requirement for a bond issue. Under this arrangement, instead of depositing cash in a reserve fund, the issuer buys a surety policy by paying a one-time premium equal to some percentage of the face amount of the policy. If the reserve fund is needed to make a debt service payment, the trustee notifies the surety provider and the provider makes the payment, up to the face amount of the policy. The issuer then has an obligation to reimburse the provider for the payment, plus interest.

SYNDICATE

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

TAKEDOWN

See **Underwriter's Gross Spread (Underwriter's Discount)** and **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**.

TAX ALLOCATION (TAX INCREMENT)

See **Chapter 6, Types of Financing Obligations – Tax Allocation and Other Redevelopment Bonds**.

TAX CODE

The Internal Revenue Code of 1986, as amended. See also **Treasury Regulations**.

TEFRA NOTICE, HEARING, AND APPROVAL

See **Chapter 3, General Federal Tax Requirements**. The published notice, public hearing, and approval by elected officials required by Section 147(f) of the Internal Revenue Code for qualified private activity bonds; originally enacted in the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982.

TEMPORARY PERIODS

See **Chapter 3, General Federal Tax Requirements**. The periods during which the federal tax rules relating to arbitrage yield restriction permit certain gross proceeds of an issue to be invested at a yield that is materially higher than the yield on the issue.

The most important of these is the temporary period generally available for the investment of monies in construction funds or loan acquisition funds after the date the governmental obligations are issued. In addition, a 13-month temporary period is provided for monies in certain debt service funds—generally including funds used primarily to achieve a proper matching of revenues and debt service within each year.

10B-5 STANDARD

10b-5 standard refers to the formulation of the anti-fraud rule in securities law contained in SEC Rule 10b-5. See **Appendix D – Legal References – Federal Laws of General Application to Public Finance**. The language of the 10b-5 standard is often contained in legal opinions or closing certificates. It is generally required that an issuer and/or a nongovernmental borrower certify that the descriptions of their financial condition and operations contained in an Official Statement meet the 10b-5 standard as a part of the closing documentation, as well as in connection with the execution of a bond purchase agreement. See generally **Chapter 10, Continuing Disclosure and Investor Relations Programs**.

TENDER OFFER

The process by which a potential purchaser of bonds (which may be the issuer of the bonds) solicits from the holders of such bonds offers to sell those bonds to the purchaser upon the terms specified in the solicitation.

This technique borrows its name from the corporate securities arena, where shares in a company may be acquired by the purchase of common stock on the open market pursuant to a tender offer. In the context of public finance, a tender offer may be a refinancing method in which an issuer distributes, by publication or otherwise, to the owners of its bonds an offer either to purchase a specific aggregate amount of such bonds at a specific price if such bonds are tendered by a specified date, or to utilize a stated amount of money to purchase the bonds by accepting tenders of the bonds in order of price until the stated amount is exhausted. Bonds purchased by an issuer pursuant to a tender offer are usually deemed retired and no longer outstanding under the indenture or bond resolution.

While an issuer may utilize the tender offer technique to reduce its outstanding debt by use of excess cash on hand, it is more commonly used as an alternative to an advance refunding. In such a case, a new issue might be issued subsequent to or concurrently with the tender offer to provide the monies with which to purchase tendered bonds.

TENDER OPTION BOND

See **Demand Bond (Put Bond or Tender Option Bond)**.

TERM

With respect to a single bond, the period of time until the maturity date of the bond and with respect to an issue, the period until the maturity date of the last bond of the issue to mature.

TERM BONDS

Originally, the maturity due at the end of the term of an issue; now, more commonly, a maturity that is subject to redemption over a specified period from sinking fund payments.

See also **Redemption** and **Sinking Fund Payments or Installments**.

TRANCHE

A colloquial term used to refer to a portion of financing for a project or program. Sometimes used to describe a series of bonds (i.e. "The Series 2005 bonds represent the first *tranche* of financing for the airport expansion project.") Derived from the French, the term originally meant a series of bonds issued for sale in a foreign country.

TREASURY REGULATIONS

The federal income tax regulations adopted by the U.S. Department of Treasury. Treasury Regulations are designed to provide additional detail and interpretation of the Tax Code.

TRUE INTEREST COST (TIC)

A measure of the interest cost of an issue that accounts for the time value of money.

The obligation to pay a dollar today is not the same as the obligation to pay a dollar 10 years from now. Presumably, one could take a much smaller sum, invest it today and let the interest on that investment accumulate and compound until one had a dollar on the date 10 years from now. The smaller sum is called the present value of having that dollar 10 years from now, and the interest rate necessary to accumulate and compound that smaller sum up to that dollar 10 years from now is called the discount rate. If one knows the future value (the dollar 10 years from now) and the discount rate, the process of calculating the present value is called discounting the future value to the present. With these general concepts in mind, the TIC of an issue can be more fully defined and compared to the NIC for the same issue. The TIC is sometimes also called the internal rate of return or the net effective interest rate.

The TIC for an issue is the annual discount rate which, when used to discount all debt service payments on the issue to the date of initial delivery of the issue, using a compounding interval equal to the interest payment periods for the issue, results in the aggregate present value of such debt service payments being equal to the original purchase price (including accrued interest) of the issue. For the purpose of calculating the TIC, sinking fund payments for any term bonds are considered principal payments. Because there is no algebraic formula for the direct computation of the TIC, it must be determined either by successive approximation on a computer or calculator or by using present value tables.

Consider the following example: An issuer chooses to sell $10,000,000 of bonds in 5 separate maturities (1 year through 5 years) at par values of $1,000,000, $2,000,000, $2,000,000, $2,000,000, and $3,000,000, respectively, and at interest rates of 5.0, 5.1, 5.2, 5.25, and 5.30 percent, respectively. The price paid for the issue is par, i.e. $10,000,000. See Example 2 under the definition of **Net Interest Cost** (NIC)—the NIC in that example is 5.238 percent. The TIC as demonstrated by the chart below is 5.236 percent.

Time of Payment (Months)	Interest Paid	Principal Paid	Present Value Payments Discounted by 5.235 percent
6	$ 260,000		$ 253,370
12	260,000	$1,000,000	1,196,530
18	235,000		217,470
24	235,000	2,000,000	2,015,500
30	184,000		161,700
36	184,000	2,000,000	1,870,300
42	132,000		110,150
48	132,000	2,000,000	1,733,800
54	79,500		63,000
60	79,500	3,000,000	2,378,180
Total	$1,781,000	$10,000,000	$10,000,000

The TIC is the rate that will discount all future payments so that the sum of their present values equals the price. Note that the sum of the present value of all the cash flows equals $10,000,000 when discounted at 5.236 percent. Interest is assumed to be compounded semiannually.

If the price paid for the issue had been 97 percent of par, the TIC would have differed even more from the NIC. The price would have equaled $9,700,000. The TIC that would discount the present values to $9,700,000 is 6.24 percent, whereas the NIC for the same issue would be 6.12 percent. See **Net Interest Cost**. The TIC is often used to compare bids at a competitive sale. See also **Yield**.

TRUSTEE

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Trustee/Fiscal Agent/Paying Agent/Registrar/Authenticating Agent**.

UNDERWRITE

To agree to purchase bonds, generally upon initial issuance, in a guaranteed amount, for a guaranteed price, and with the intention to resell the bonds to investors.

In a best efforts underwriting, the underwriter agrees only to use its best efforts to resell bonds to be purchased from the issuer and only agrees to purchase those bonds if the underwriter can resell them.

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/Placement Agent/Purchaser**. See also **Competitive Sale** and **Negotiated Sale**.

UNDERWRITER

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter/ Placement Agent/Purchaser**.

UNDERWRITER'S COUNSEL

See **Chapter 1, Overview of a Debt Financing – Roles and Responsibilities of Principal Participants – Underwriter's Counsel**.

UNDERWRITER'S GROSS SPREAD (UNDERWRITER'S DISCOUNT)

The difference between the purchase price paid to the issuer for a new issue and the sum of the prices at which the bonds are initially offered to the investing public by the underwriter.

To the extent that the initial offering prices are subsequently lowered by the underwriter, the full amount of the spread may not be realized by the underwriter. The spread is usually expressed in points or fractions thereof. The spread generally consists of:

- **Management Fee**. A fee paid to the managing underwriter for handling the affairs of the syndicate, including, in the case of a negotiated sale, structuring the issue and negotiating with the issuer.

- **Expenses**. Any advertising and printing costs to the underwriter, underwriter's counsel's fees and expenses, computer expenses, travel expenses, MSRB fees, CDIAC fees, and other similar expenses.

- **Takedown**. Normally the largest component of the spread, similar to a commission, the takedown represents the income derived by the selling broker or dealer from the sale of the bonds. If bonds are sold by a member of a syndicate, the seller is entitled to the full takedown (also called the total takedown). If bonds are sold by a dealer, which is not a member of the syndicate, such seller receives only that portion of the takedown known as the concession or dealer’s allowance, with the balance (often termed the additional takedown) retained by the syndicate.

- **Risk**. This is the amount of compensation for risks incurred by the underwriter in underwriting the bond issue, relating to the difficulty of marketing the issue, bond market conditions, and the amount of bonds remaining to be resold after the execution of the bond purchase agreement. There is rarely a risk component in the underwriting spread.

In the case of a syndicated offering, a portion of any residual is generally paid to each underwriter within the syndicate on a pro rata basis according to the number of bonds each dealer has committed to sell without regard to the actual sales by each member.

VALIDATION

Sometimes refers to the process of undertaking a validation action. Validation may also refer to the validating acts passed each year by the California Legislature to validate certain types of actions taken by local agencies—including bond financings. These acts, however, do not protect a bond financing from challenge on the grounds of unconstitutionality under the California Constitution.

VALIDATION ACTION

A special procedure under California law that allows an issuer to have the legality of a bond financing approved, including any issue regarding constitutionality of the bond issue. The issuer files a lawsuit naming “all interested persons” as defendants. Notice of the lawsuit is given by publication in the newspaper and by posting public notices. If no interested person comes forward and challenges the financing, the issuer may ask the court for a judgment declaring that the financing is valid. This process takes approximately 45 days. Once the court issues a validation judgment, and the 30-day appeal period expires, the financing cannot later be challenged in court. However, if an interested person does step forward in a timely manner to challenge the financing, the process can take much longer.

VARIABLE RATE

An interest rate that periodically changes based upon an index or a pricing procedure.

For example, the interest rate may be a specified percentage of the weekly U.S. Treasury bill auction rate or of the Federal Home Loan Bank borrowing rate, or may be the rate established by the remarketing agent as the rate necessary to remarket the bonds at par. The variable rate may change on a daily, weekly, monthly, or other periodic basis.

Variable rate bonds generally have a demand feature (see also **Demand Bond (Put Bond or Tender Option Bond)**) allowing the owner to demand that the issuer or another party repurchase the bond upon a specified number of days' notice or at certain times which reflect the intervals at which the rate varies. For example, a variable rate bond bearing interest at a rate, which is set each week, customarily has a demand feature allowing the bondholder to put the bond on one week's notice. Investors treat such a bond as having a term of one week. Because interest charged on money borrowed for a short term is normally less than interest on money borrowed for a long term, variable rates are normally lower than long-term fixed rates.

A variable rate is often called a floating rate. Since variable rates are lower than long-term fixed rates, variable rate bonds are also referred to as lower floaters.

VOLUME CAP

See **Chapter 3, General Federal Tax Requirements**. Under federal tax law, the limit on the aggregate amount of certain tax-exempt qualified private activity bonds that may be issued during any calendar year.

See also **Appendix A – Working With State Agencies – California Debt Limit Allocation Committee**.

WINNING BID RATE

The lowest rate specified in the bids submitted by potential holders for an auction rate security, which if selected by the auction agent as the auction rate, will result in the sale of all of the securities subject to the bid orders.

WORKOUT

The process of trying to resolve a default or other payment problem in a bond financing. A workout may involve assembling a workout team of professionals to assist in the process. Workouts often involve negotiations with the bondholders (such as seeking approval to restructure the debt) and with the persons who are obligated to provide funds for repayment of the bonds (such as defaulting landowners in an assessment district).

YIELD

See **Chapter 3, General Federal Tax Requirements**. As used in the Tax Code, the discount rate that makes the present value of all payments with respect to an investment equal to its purchase price or, in the case of bonds, equal to the initial offering price at which a substantial amount of the governmental obligations is sold to the public.

If proceeds are used to make loans to nongovernmental persons (as is often the case with qualified private activity bonds), the underwriter's gross spread, costs of issuance, and costs of originating, carrying, or selling the conduit obligations may be recovered under the conduit obligations without increasing the yield on those conduit obligations.

Additionally, premiums for bond insurance and other credit enhancement fees may be treated as additional interest, thereby increasing the yield of the issue.

YIELD CURVE

Yield curve means the curve obtained by plotting the yield of investment or debt instruments (on the x-axis) against time (on the y-axis). The typical yield curve is upward sloping, so that the shorter the maturity of the instrument, the lower the yield of that instrument. However, this is not always true, and sometimes yield curves flatten out or even become inverted. The yield curve varies over time in response to general economic conditions and the yield curve may be differently sloped for different types of instruments depending on credit quality, tax-exempt status, and other factors.

YIELD RESTRICTION

See **Arbitrage Yield Restriction**.

YIELD VERIFICATION CONSULTANT

The firm retained by the issuer to verify the calculations leading to the conclusion that the yield on investments acquired with the proceeds of an issue does not exceed the amount permitted under the federal arbitrage rules.

For example, a yield verification consultant is often retained to verify that the yield on the escrow purchased with the proceeds of an advance refunding does not exceed the yield on the refunding bonds.

Similarly, such a firm is also often retained to verify that the effective rate of interest on mortgages acquired with the proceeds of a single-family mortgage revenue bond does not exceed the yield on the bonds by more than 1-1/8 percentage points.

ZERO COUPON BONDS

See **Compound Interest Bond**.