

## Chapter 2

# CHECKLIST OF STEPS IN A DEBT FINANCING

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This chapter describes the five steps, along with their timeframes and responsibilities, that may be used as a general guideline when undertaking a financing.

The legally required procedural steps vary widely among the different types of public debt financing. For example, some types of debt require voter approval, some require approval by ordinance subject to referendum, while others may be approved by simple resolution of the governing body of the issuer. Some types of debt require action (such as the granting of a Volume Allocation under federal tax rules) by official bodies other than the issuer and others need only be approved by the issuer.

Nevertheless, much of the process is common to virtually all types of public debt. Broadly speaking, the issuer must undertake the following steps:

- Determine that a project or program to be financed is necessary or desirable
- Select the financing team
- Structure the financing
- Obtain formal approval by the governing body of the issuer and, in applicable, conduit borrower
- Market and close the issue

The issuer also must live with the issue after the closing. The post-closing issuer responsibilities include:

- Ensuring that continuing disclosure undertakings are fulfilled
- Responding to investor inquiries
- Calculating and filing arbitrage rebate returns
- Administering any assessments or special taxes securing the issue
- Administering any construction or acquisition programs

- Complying with ongoing covenants
- Dealing with any workout-related issues

These steps are not independent and are not entirely sequential. For example, the legal and financial feasibility of a particular method of securing the bond issue under a proposed financing structure may determine whether the proposed project is feasible, and, therefore, whether the project and financing will be undertaken. The possibility of political controversy or legal action also may play into the feasibility analysis. As a result, a preliminary analysis of the feasibility of each step may be necessary prior to undertaking any of the steps in the proposed financing, and that preliminary analysis may involve informal consultation with experts prior to selection of the project team.

This chapter outlines many of the common steps in a public debt issue. Because of the variables which may be present in different financings, the reader should be aware that steps may be accomplished in a different order and, in some cases, the time required may be more or less than indicated.

The chronology outlined in this section is broadly applicable to financings that are public offerings (not private placements) of debt being issued to finance a project (either governmental or nongovernmental) or a lending program (such as a single-family mortgage program). Although the process for a private placement or for tax and revenue anticipation notes is similar, this discussion does not cover steps that may be unique to those types of financings. In general, the word “project” is used rather than “program” to describe the purpose of the issue.

The description below of each step indicates the members of the team commonly responsible for completing the step by using the abbreviations described in the following table.

**Table 2-1  
Responsible Team Members**

I	<b>Issuer</b>
FA	<b>Financial Advisor</b>
SA	<b>Swap Advisor</b>
BC	<b>Bond Counsel</b>
UW	<b>Underwriter</b>
UC	<b>Underwriter's Counsel</b>
NB	<b>Nongovernmental Borrower</b>
T	<b>Trustee/Fiscal Agent</b>
RC	<b>Rebate Compliance Consultant</b>
IA	<b>Investment Advisor</b>

The team members that actually perform the steps in any given financing may vary. For example, if the debt is to be sold at negotiated sale and no financial advisor is engaged by the issuer, the tasks indicated as being performed by the financial advisor will generally be performed by the underwriter. Conversely, in a competitive sale, the tasks performed by the underwriter (except for the actual purchase and distribution of the bonds) will normally be performed by the financial advisor. Also, if disclosure counsel is employed, they may perform many or all of the tasks indicated as being performed by underwriter's counsel. A nongovernmental borrower will only be present for certain types of conduit financings.

## STEP 1

### DETERMINATION THAT A PROJECT (OR PROGRAM) TO BE FINANCED IS NECESSARY OR DESIRABLE

(Time: one week to three years)

This initial step in the financing process is potentially the most time-consuming because this when the basic business decisions regarding the project—its scope, cost, and the approach to financing—are made. Issuers should carefully consider their own policies and long-range objectives at this early stage, so that during the actual process of preparing, selling, and closing the issue, these policy decisions are firmly in place. It may be appropriate for the issuer to inquire of other agencies that have financed similar projects to get ideas and obtain the benefit of their experience. Similarly, this is the time at which any constituent input—for example, citizen’s advisory committees or neighborhood groups—should be consulted to help shape the decisions being made. Although listed before Step 2, Selection of the Financing Team, it may be necessary or desirable to identify and retain bond counsel, a financial advisor, and/or underwriter to assist with this first step as these team members may be useful in accomplishing the tasks identified below.

<b>Governmental Projects and Programs</b>	<b>Nongovernmental Projects and Programs (Conduit Financings)</b>
Defining the nature and scope of the projects.	If the financing is proposed by the nongovernmental borrower, is it the kind of project that the issuer wants to encourage and support? (I)
Technological feasibility. (I)	
Financeability. (I, FA, UW)	Public purpose (practical as well as legal). (I)
Statutory authorization. (BC)	Technological feasibility. (I, NB)
Project and size of debt issue. (I, FA, UW)	Financeability. (I, FA, UW, NB)
Available revenues or other security for repayment. (I, FA, UW, BC, SA)	Statutory authorization. (BC)
Feasibility study. (I, FA, UW)	Does issuer need to be created? (I, BC)
Credit support. (I, FA, UW)	Size of debt issue. (I, FA, UW, NB)
Are other approvals necessary?	Available revenues or other security for repayment. (I, NB, BC)
Voter approval. (I, BC)	Feasibility study. (I, FA, UW)
Federal permits or grants. (I)	Credit support. (I, FA, UW, NB)

<b>Governmental Projects and Programs</b>	<b>Nongovernmental Projects and Programs (Conduit Financings)</b>
State permits, allocations or grants. (I, BC)	Should the issuer actively market its ability to finance certain types of projects? (I, FA, UW)
Local land use permits. (I)	Analyze the likelihood of political controversy or litigation in opposition to the financing. (I, NB, BC)
Analyze the likelihood of political controversy or litigation in opposition to the financing. (I, BC)	Environmental impact evaluation. (I, NB)
Environmental impact evaluation. (I)	Private activity bond volume cap (if necessary). (B, FA, UW, BC)
	State (CIDFAC) approval (if necessary). (I, BC, NB)

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## STEP 2

### SELECTION OF THE FINANCING TEAM

**(Time: one week to three months)**

The second step in the financing process is critical to the ultimate success of the project and should be undertaken carefully. At this stage (unless previously done as discussed above), the issuer should decide whether to hire a financial advisor (whether or not a negotiated sale is expected) or rely on an underwriter to help with the initial structuring of the issue, which may depend upon the decision to sell the bonds through a competitive or negotiated sale. In some cases, issuers who have worked with a particular underwriter on prior projects may work with that underwriter at the earliest stages in shaping the transaction. Similarly, a financial advisor is often called upon very early in the process to help anticipate the financing options available. It also may be advantageous to consult with bond counsel early on in the process to determine the legal avenues available for the project and the financing.

- ❑ Determination of the positions to be filled (I)
  - Will a financial advisor or underwriter be initially retained to assist in structuring the issue? (I)
  - Is the debt to be sold at competitive or negotiated sale? (I, FA, BC)
  - If negotiated, will the underwriter adequately perform the advisory role, or will the separate advice of a financial advisor be necessary or desirable? (I)
  - If negotiated, should a single underwriter be selected or a team of managing underwriters? (I, FA)
  - Will the issuer hire a separate disclosure counsel? (I)
  - Is there a need for varying types of banking expertise? (I, FA, UW)
  - Will a feasibility consultant be necessary to demonstrate the financeability of the project or program? (I, FA, UW)
  - If an interest rate swap is used, will a Swap Advisor be utilized? (I, FA, UW)
  - Will special tax counsel be necessary or desirable? (I, UW, BC)
  - Will a credit enhancement provider be necessary? (I, FA, UW, SA)
  - Will a trustee, fiscal agent or paying agent be used? (I, FA, UW, BC)

- ❑ Procedural alternatives for selecting each position on the financing team (I)
  - Does a statute or local ordinance require competitive selection?
  - Reliance upon previously established relationships
  - Use of a request for proposals
  - Appointment of the firm(s) that proposed the financing
  - Recommendations from other issuers or from other team members
  - Competitive sale of bonds (for selecting underwriter)
- ❑ Determination of method of compensation of each team member (I)
- ❑ Determination and selection of post-issuance team members
  - Continuing disclosure
  - Administration (for assessment and special tax issues)
  - Arbitrage rebate compliance services

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## STEP 3

### STRUCTURING THE FINANCING

**(Time: one week to three months)**

At the third stage in the process, the consultants that have been retained will bring their expertise to bear on the financial and legal structuring issues. Typically, this stage will include several all-hands meetings and discussions as the documentation for the financing takes shape. Issuers need to remain keenly involved in this process so that the structuring alternatives being chosen are well understood and match up as closely as possible with the issuer's goals and objectives. Issuers should understand why each decision is being made and pay particular attention to the covenants, agreements, security features, and other obligations they are undertaking. Similarly, the issuer should be fully involved in reviewing and evaluating the disclosure being developed. Issuers may not rely entirely on the professionals they hire to ensure that adequate disclosure is provided. Similarly, "boilerplate" provisions in the documents, while often needed and appropriate, should not be glossed over by the issuer. If the issuer has concerns over any part of the documents, adequate explanations should be forthcoming from bond counsel and the other team members with respect to the inclusion of each provision being included.

- Initial organizational meeting (All)
  - Identify security structure alternatives and either select from among them or determine the criteria for selection (All)
  - Determine the approximate size of the issue, taking into account amounts needed for costs of issuance, reserve accounts, and capitalized interest, as well as the project or program being financed
    - Is credit enhancement necessary? (I, FA, UW)
    - Are supplemental revenue sources necessary or available? (I, FA, UW, BC)
    - What should be the terms of any underlying arrangements, including covenants of, and/or security provided by, any governmental entity using the project or any nongovernmental borrower? (I, FA, UW, NB)
    - Is debt service coverage necessary? If so, how much? (I, FA, UW)
    - Is casualty insurance necessary? If so, how much? (I, FA, UW)

- Are other covenants of issuer necessary or desirable? (I, FA, UW, BC)
- Evaluate legal, political, and regulatory constraints (All)
  - How do federal tax laws affect any or all of above? (BC)
  - How do federal and state securities laws affect any or all of the above? (BC, UC)
  - Are there state statutory constraints and what legal proceedings will be required? (BC)
  - Has an environmental review been satisfactorily completed? If not, will one be completed before an “approval” takes place? (I, BC, UW)
  - What financial and operating data will be included in the issuer’s annual report under SEC Rule 15c2-12? (BC, UC, UW)
  - Will any additional types of listed event notices be required (other than the 11 categories specified in SEC Rule 15c2-12)? (I, UC, UW, FA)
  - Should any steps be taken to resolve or reduce political controversy, or to forestall a possible reverse validation action? (I, BC)
  - Is there a debt policy in place that establishes goals/restrictions for the financing? (I, BC, FA)
- Develop timetable for accomplishing remaining tasks (All)
  - Are any specific filings required? (I, BC, UC, NB)
  - Are approvals necessary other than by issuer (such as private activity bond volume cap)? (BC)
  - Other time constraints (All)
  - Construction constraints
  - Negotiations with other parties, e.g. credit enhancement provider
  - Refunding date
  - Agree upon allocation of responsibilities for tasks to be accomplished (All)
- Prepare major legal documents relating to the financing, including indenture (or bond resolution), agreements defining any underlying arrangement (such as loan agreements, lease, or credit enhancement agreement), Official Statement, notice of sale or bond purchase agreement, and Continuing Disclosure Agreement (BC, UC, FA, UW, I)

- ❑ Meeting(s) or conference calls to review and negotiate terms of the major legal documents (All)
- ❑ Due diligence review of all facts material to the investor's decision to buy the bonds (All, but especially UC)
- ❑ Consideration of investment alternatives for bond proceeds. Will a guaranteed investment contract be used? If the issue includes refunding, will the escrow be funded with open market securities or SLGS? (I, IA, FA, UW, BC)
- ❑ Credit rating agency review of the major legal documents and other relevant information (I, FA, UW)
- ❑ Adoption by the governing body of the necessary resolutions or ordinances authorizing issuance of the bonds and execution of the legal documents either approving the notice of competitive sale or authorizing execution of the bond purchase agreement (I, BC)
- ❑ File a validation action if such is determined to be necessary or appropriate (I, BC, or other counsel)
- ❑ Advise CDIAC of proposed sale 30 days in advance of proposed sale date (I, BC)

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## STEP 4

### MARKETING AND CLOSING

(Time: one week to three months)

At this point, the financing should be completely structured and all parties should be in agreement as to the ultimate terms of the financing (except the pricing terms themselves). It is important to have worked out any major structuring issues or document provisions necessary to obtain a satisfactory rating or credit enhancement in advance of this stage, so that the final approvals by rating agencies and credit enhancers can go smoothly. Nevertheless, it is possible that as a result of the first few steps outlined below, an issue will surface which requires the team to reassess some of the decisions made in Step 3. Once the rating and/or credit enhancement is in place, it is time to go out into the market and price the issue. At this stage, the final interest rates, sizing, and other financial terms of the borrowing will be determined.

#### □ Preparing for marketing

- Obtain the credit rating (I, FA, BC, UW)
  - Provide final information to credit rating agencies
  - Meet with rating analysts (if necessary or appropriate)
  - Site visit by rating analysts (if necessary or appropriate)
- Obtain final commitments from credit enhancement provider (if necessary) (I, FA, UW, NB)
- Obtain commitment for investment of bond proceeds (See text box at right and **Chapter 11, Investment of Bond Proceeds**) (I, IA, FA, UW, T)
- Design the proposed maturity structure and redemption terms of the bonds (I, FA, UW, NB)
- Final review and approval of Preliminary Official Statement (All)

#### Investment of Bond Proceeds

The process of investing bond proceeds can vary tremendously depending upon the type of investments used. In the case of a simple investment of funds in a money market fund or in a pooled investment vehicle such as LAIF (the Local Agency Investment Fund of the State of California), this step can easily be accomplished at or shortly after the closing of the issue. On the other hand, if open market treasury securities (especially for a refunding escrow) or a guaranteed investment contract will be used, a bidding procedure like the one outlined below for GICs will be required. This should be done in advance of the closing of the issue.

- ✓ Determine appropriate investment vehicles (I, IA, FA, UW, BC)
- ✓ Prepare and circulate for review a request for bids for investments (IA)
- ✓ Evaluate responses (IA)
- ✓ Negotiate final terms of investment agreement with winning bidder (I, BC, T)

- If competitive sale, determine rules for selecting winning bidders (I, FA, BC)
  - If negotiated sale, determine whether syndicate or selling group is appropriate and who should be members (I, UW)
- ☐ Marketing
- Mail Preliminary Official Statement to syndicate or selling group members (or potential bidders) and potential investors (if competitive sale, include notice of sale)
  - Hold information meetings with investors and dealers, if necessary or appropriate (usually reserved for very large issues)

Competitive Sale	Negotiated Sale
Answer any additional questions from analysts for potential bidders. (I, FA, BC)	Preliminary pricing discussion. (I, UW, FA, NB)
Open bids at time and place specified in Notice of Sale. (I, FA, BC)	Look at comparable sales for rates and prices. Timing of sale.
Determine winning bidder by applying rules specified in Notice of Sale. (I, FA, BC)	What is the supply in the near future of issues that would compete for sales?
If winning bid is acceptable, award bonds to winning bidder, creating, in effect, a Bond Purchase Agreement between the issuer and the winning bidder. (I)	Which direction is market moving? Are certain types of investors noncommittal? Finalize proposed pricing scale.
	Send out pricing wire to solicit orders from target markets. (UW)
	Reprice if too many or too few orders. (I, UW, FA, NB)
	Agree upon the final rates and prices. (I, UW, FA, NB)
	Sign Bond Purchase Agreement. (I, UW, NB)

- ❑ Finalize and print Official Statement, describing final maturity schedule, interest rates, and reoffering prices to the public, as well as conforming descriptions of bonds and project to final design (All)
- ❑ Prepare to close the bond issue (deliver the bonds for payment)
  - Arrange for printing of the bonds (not necessary if book-entry-only issue) (I, BC, T)
  - Prepare closing documents, review (usually by phone), and arrange for execution (All, but especially I and BC)
    - Various certificates, opinions, and other letters
    - Final forms of major legal documents
    - Tax-related filings
  - Execute and/or authenticate bonds (I, T)
  - Inspect executed and authenticated bonds (not applicable for book-entry-only issues) (UW)
- ❑ Pre-close the day before the bonds are delivered and paid for (All)
  - Final meeting to execute documents and ensure that all required documents are present and in the agreed-upon form
- ❑ Close (All)
  - Receipt for bond proceeds
  - Receipt for bonds
  - Execute investment of bond proceeds
  - Payment of necessary fees
  - Recordation of real estate deeds, leases and encumbrances
  - Transmittal of tax roll information to tax-collecting entity (for land-secured financings)
  - Compliance with MSRB requirements for delivery of final Official Statement, escrow agreements (for refundings), and any other post-issuance filings (UW)
  - Notice of final sale to CDIAC

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## STEP 5

### LIVING WITH THE ISSUE AFTER CLOSING

During the busy time of preparing for a bond issue, marketing, and closing, it is easy to forget that the bond issue will usually be in existence for a long period of time. After closing, the issuer and nongovernmental borrower will have to perform many tasks to assure that the financing is ultimately successful. It is important that staff members of the issuer/borrower be designated to take responsibility for the ongoing compliance and monitoring functions described below. During the initial structuring phases described in the previous steps, the post-issuance compliance issues should be kept in mind. Ideally, the people who will be responsible for post-issuance compliance on behalf of the issuer/borrower should be involved in the early phases of the project as well. The issuer/borrower will need to determine what consultants it will hire to perform these tasks and which tasks it will take on itself. Even when consultants (such as rebate compliance providers, continuing disclosure consultants or counsel, investment advisors, and others) are retained, issuers will need to monitor their performance and work product. Ultimately, it is the issuer/borrower who is responsible for adhering to these compliance requirements.

- ❑ Evaluate performance of financing team (I, NB)
- ❑ Monitor the progress of the construction project or lending program (I, NB)
  - Administrative duties of issuer
  - Monitor compliance with tax rules for expenditures and use of project
  - Monitor compliance with program rules for expenditures and use of project.
  - Provide financial and project reports to investors
- ❑ Monitor the trustee's performance (I, NB)
  - Collection of revenues
  - Maintenance of accounts
  - Investment of monies
  - Paying agent functions
- ❑ Comply with ongoing covenants (I, NB)

- Monitor interest rates and value of swap (if any) (I, NB, SA)
- Annual financial statements (I, NB)
- Annual report filed with Central Post Office and NRMSIRs (I, NB)
- Monitor need for listed event notices (I, NB)
- Other annual reports, such as CDIAC, Mello-Roos, and Marks-Roos Bonds Yearly Fiscal Status Report (I)
- Ensure arbitrage rebate compliance (I, RC)
- Interpret financing documents (I, BC)
  - Covenants, e.g. concerning use of project
  - Additional bonds tests
  - Subordinate financing tests
- Refinancing or refunding (if needed or appropriate) (I, FA, UW)
- Engage in a workout if necessary to resolve any problems in connection with pending or actual default (I, BC, others)

Respond to any inquiries or audits by the Internal Revenue Service or the Securities and Exchange Commission (I, BC, others)