Disclosure: What Investors Want and Why They Want It

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Why we want it?

• Issuer behavior has changed when it comes to willingness to pay—Wenatchee, WA, Detroit, MI, Harrisburg, PA, and Scranton, PA.

• The number, complexity, and variety of municipal bonds issues has increased. This has occurred at a time when the percentage of issues covered by bond insurance has dropped from approximately 50% to less than 10%, thereby increasing the need for and importance of credit analysis.

• New issue practices are not as heavily regulated as corporate issues. For a number of reasons, including (a) legal rulings and historic traditions that underlie the US Federal System of government and that in turn limit SEC and MSRB authority over municipal issuers, and (b) the multitude and diversity of different municipal issuers and offerings.

• Wide variety of idiosyncratic offering practices by municipal issuers and underwriters is available.

• Insufficient market guidance regarding event that occur during the pre-pricing period and in the preparation of the POS.
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- Pre-Pricing Practices:
  - Internet-Based Road shows: Internet-based roadshows can be helpful to investors and analysts; they are a useful complement or substitute for “in-person” roadshows. We believe internet road shows can be improved by implementing the following practices:
    - *Live Q&A*: This presents a very valuable way when a physical investor meeting is not an option.
    - *Security Discussion*: With the uncertainty in Detroit’s GO pledge, a discussion of the security provisions.
    - *Portability*: Recommend municipal underwriters follow the corporate practice of making roadshow materials available to investors after bonds are issued.
  - POS Release Considerations: Reasonable period of time between the release of the POS and the pricing date. For high-grade bonds, we recommend three business days. For lower-grade bonds, we recommend at least ten days.
  - Site Visit Timing: If a site visit is offered by the issuer or underwriter, it should take place after the release of the POS in order to allow investors sufficient time to understand the transaction and to formulate relevant questions.
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POS Contents:

• Issue Name: The name of the bond should reflect the revenue stream that secures the bonds rather than the purposes for which proceeds are spent.

• Defining General Obligation in the POS—Because the definition of these terms vary from state to state, only stating that the bond is a “general obligation bond” or that it is backed by an issuer’s “full faith and credit” can be misleading. Recommend a discussion of the following:
  • What specific taxes, revenues, or funds are dedicated to pay debt service?
  • What is the legal authority governing the use of property taxes earmarked for the payment of debt service? Is it constitutional or statutory? Are there provisions giving budgetary priority to the allocation of taxes to debt service?
  • Is new or additional voter or other approval needed to generate the requisite taxes, revenues, or funds?

• Public Ratings Placement: They should be on the front cover of the POS. Many times they are hidden in the body where they are much more difficult to find.

• Variable Rate/Reset Periods: For these transactions include how the rates and terms are set along with a table that shows the applicable rate setting, rate periods, redemption, and maturity modes.

• Debt service schedule: Include an estimated debt service schedule with an assumed coupon, with separate columns for outstanding and new debt as well as interest rate assumptions on any variable rate debt.

• Financial Covenant Identification and Calculation: For issues that include financial covenants (e.g., debt service coverage, liquidity, and leverage), we recommend a table that illustrates these ratios—both historical and projected—should appear early in the POS.
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Security Section:

- Clearly Identify the Sources of Revenues that Will Pay Debt Service on the Bonds: There needs to be greater clarity in the description of the revenues legally pledged to pay debt service. We recommend that the cover page of the POS state that the securities are “generally secured by xyz revenues as further described herein,” and that the introductory summary section include a description of the security and sources of payment for the bonds.

- Clearly Describe Key Legal Provisions in the Security Section: This should be stated clearly and in such a way that they will not be subject to misinterpretation in the future.

- Provide a Table Detailing the Issuer’s Debt Obligations: The table should show by revenue stream, the associated amount of debt, including the par amount and dated date, the rate, and the amortization profile, along with subtotals for each column.

- Provide Flow of Funds Diagrams: We recommend that the POS contain a flow of funds/waterfall diagram, both pre- and post-default.

- Bankruptcy Eligibility, Receivership, and Authorization Procedures: Brief section on bankruptcy/receivership eligibility, authorization procedures, and conditions for or limitations on eligibility, if any, be included in the “risks” section of the POS. If state law is unclear or nonexistent regarding these issues, that should be noted as well.
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- Bank Loans and Similar Private Financings: We recommend that material terms and covenants of these transactions be disclosed in an issuer’s POS when the issuer publicly offers securities that will be paid from the same GO pledge or revenue stream as other privately placed bank financings.

- Swaps and Derivatives: POS should provide a full description of all the issuer’s swaps and derivatives.

- Specific Investment Risk: It’s recommended that transaction-specific risks be placed in the beginning of the POS and the more generic risks disclosed in later in some order of priority.

- Refunding Bonds: It’s recommended that the POS expressly state if the refunded bonds are being legally defeased or economically defeased.

- Full Disclosure of Basis for Bond Council: If bond council is relying on an opinion of special tax council or on the opinion of another law firm, that reliance should be disclosed in the body of the POS and the supporting legal opinions should be attached.
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• Underwriter as Initial Purchase Consents: We recommend that if there are changes to the security provisions and thereby changing the security for all outstanding parity bonds, this should be clearly stated in the Summary and the Risks/Investment Considerations sections of the POS.

• Third-Party/Expert Work Products: We recommend the POS should disclose the existence of all Expert Work Products known to the issuer or underwriter.

• Selective Disclosure of Information to Rating Agencies: For publicly rated debt, we believe all material information should be included in the POS, and that selective disclosure of material information provided to the rating agencies but not investors is not warranted.

• Prioritizing documents in POS:
  • Material Documents- We recommend that the material provisions of those documents be summarized in the appendices to the POS. The POS should contain a URL for each supporting document.
  • Financial Statements
  • Updating the Initial POS before pricing
## What does Good Disclosure Really Mean to the Market

<table>
<thead>
<tr>
<th>School District #1</th>
<th>School District #2</th>
<th>School District #3</th>
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<tbody>
<tr>
<td><strong>Less than 90 days</strong></td>
<td><strong>Between 180 and 270 days</strong></td>
<td><strong>Greater than 270 days</strong></td>
</tr>
<tr>
<td>Rated: NR/A+</td>
<td>Rated: NR/A+</td>
<td>Rated: NR/BBB-</td>
</tr>
<tr>
<td>Issued in June 2013</td>
<td>Issued in May 2013</td>
<td>Issued in September 2013</td>
</tr>
<tr>
<td>3.5% coupon due in 2029</td>
<td>5% coupon due in August 2030.</td>
<td>6.25% coupon due August 2030</td>
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<tr>
<td>Yield at issuance: 3.68%</td>
<td>Yield at issuance: 3.17%</td>
<td>Yield at issuance: 5.98%</td>
</tr>
<tr>
<td>Triple A Scale at issuance: 3.25%</td>
<td>Triple A scale at issuance: 2.71%</td>
<td>Triple A Scale: 3.71%</td>
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<tr>
<td>Spread Difference: 43 basis points</td>
<td>Spread difference: 46 basis points</td>
<td>Spread difference: 227 basis points</td>
</tr>
<tr>
<td>Single A scale at issuance: 4.11%</td>
<td>Single A scale at issuance: 3.48%</td>
<td>Triple B scale at issuance: 5.17%</td>
</tr>
<tr>
<td>Spread Difference: (43) basis points</td>
<td>Spread Difference: (31) basis points</td>
<td>Spread Difference: 81 basis points</td>
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