

SESSION TWO

EVALUATING EWPS: RISK ASSESSMENTS

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Professional Standards and Guidance

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- 1) Third Party Expert Reports/Are Commonplace in Municipal Deals to Assess Financial, Technological and Market Success and Challenges of a Project
- 2) Limited Industry Expert Report Preparation of Presentation Standards.
- 3) GASB Has No Standards to Guide Issuer's Generating "Financial Projections". See Exhibit B for GASB Preliminary Views (2011).
- 4) AICPA Has Standards to Generate Examination Opinions Only on Financial Projections – But No Other Economic, Technological and Market Aspects of a Transaction.
- 5) NMFA Has a Whitepaper on Expert Work Products (2011). See Exhibit C.

Securities Law Issues With Expert Reports; Due Diligence Responsibilities & Liabilities

- 1) Under Section 11(a)(4) of the Securities Act, If Expert Report Not Prepared by an “Expert” (appraiser, Engineer, or CPA), the Issuer and Underwriter May Have a “Duty” of “Independent Investigation” That the Expert Report Does Not Contain a Material Fact Misrepresentation or Material Fact Omission. (See Exhibit F)
- 2) Lack of Consensus on Responsibilities & Liabilities of Issues and Underwriters to “Vet” Expert Reports.
- 3) See Exhibit D: Excerpts From Disclosure Roles of Counsel, Third Ed., ABA Section of State & Local Govt (2009) Re Expert Reports Re Applicability of Section 11 to Municipal Offerings.

Recent Securities Fraud Cases, SEC Enforcement Actions & Other Litigation/Bad Press

- 1) Greater Wenatchee Regional Events Center Public Facilities District—Disclosure of Prior Projections. Issuer & Underwriter SEC Liability. (See Exhibit G)
- 2) Las Vegas Monorail Deal—Bondholder Lawsuit Against Underwriter Re Disclosure of Prior Feasibility Report. (See Exhibit G)

Key Problems with Feasibility Studies

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- 1) Inexperienced Developer Provides Projections and Assumptions.
- 2) Feasibility Consultant That Is Not Held to Any Objective Standard (i.e. not CPA, Engineer or MAI Appraiser).
- 3) Does Feasibility Report Contain “Feasibility Opinion?”
- 4) What Does Rate Need To Be in Order To Make Project Work?”

What Does Buy-Side Look for In Expert Reports?

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- 1) Professional “Opinions” Not Just Recitation of Facts/Trends (E.g., Feasibility Opinion);
- 2) Address the Reasonableness of Assumptions Used by Borrower in Its Projections (Fiscal & Development);
- 3) Avoid Stale Information;
- 4) Address Existence & Findings of Prior Reports/Studies – Source of Securities Fraud Claims;
- 5) Independence of Expert-Disclose Prior Projects for Issuer, Borrower & Underwriter;
- 6) Expert Consent to Report Include in Offering Documents. If Not, No Expert Liability Under Section 11(a)(4) of Securities Act.

What Does Buy-Side Look for In Expert Reports? (continued)

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- 7) Missing Expert Reports – A Red Flag!!
 - a) If Not Requested – Explain Why.
 - b) If Obtained, But Not Included, Explain Why.
If Unfavorable Report, Failure to Disclose May be Actionable Fraud.
- 8) Expert Qualifications: Besides CPA Certification and MAI Designated Member, Other “Experts” Need to Demonstrate Their Expertise:
 - a) Go Beyond Recitation of Academic Degrees;
 - b) Recite Studies Done in Last Five Years with Authors

Expert Report Disclaimers: Must Be Reasonable

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- 1) No Industry Disclaimer Standards.
- 2) Types of Expert Disclaimers:
 - a) Forecasts subject to risk and uncertainty
 - b) Differences caused by unforeseen events
 - c) Reliance on information provided by others
 - d) Consideration of the whole study (not select parts)
 - e) No responsibility for updating information beyond date of the report.
- 3) May Not Be Enforceable Under Federal Securities Laws.
(E.g., “Forward Looking” Statement Disclosures)

Expert Reports: Need Executive Summary with Conclusions & Opinions

- 1) Lengthy Expert Reports With Limited or Unstated Conclusions & Opinions Are not Helpful.
- 2) “Feasibility” Study Needs to identify Key Assumptions and Present A Feasibility “Opinion” That Project Can Be Accomplished by Borrower In the Know Time Frame & Budget.
- 3) Expert Reports Must Identify the Important Facts That Underlie the Key Assumptions Made by Borrower.

Problem of Continuing Disclosure

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- 1) If Expert Report Contains Material Information to Assess Future Results & Projections, Is It Publicly Available to be Updated? Example, City Specific Population Trends, Types of Taxpayers, Retail Sales Trends, Etc. See Exhibit E from ABA Disclosure Roles of Counsel, Third Ed (2009).
- 2) If Such Material Information Is Not Publicly Available, Should the Issuer/Borrower Be Required to Update as Part of Continuing Disclosure?
- 3) If Issuer/Borrower Cannot Update, Should Expert Report Be Used in POS or Should a Specific Risk Disclosure Be Used?

Expert Report Panel Materials

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Exhibit A. AICPA Financial Projection & Forecast Standards

(Excel Spreadsheet: Types of AICPA Reviews)

- 1) Examined Financial Projections and Opinions;
- 2) Compiled Financial Projections;
- 3) Agreed-Upon Review Procedures

Expert Report Panel Materials

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Exhibit AB GASB Economic Condition Reporting – Issuer Financial Projections Project

- 1) Examined Financial Projections and Opinions;
- 2) Compiled Financial Projections;
- 3) Agreed-Upon Review Procedures



CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

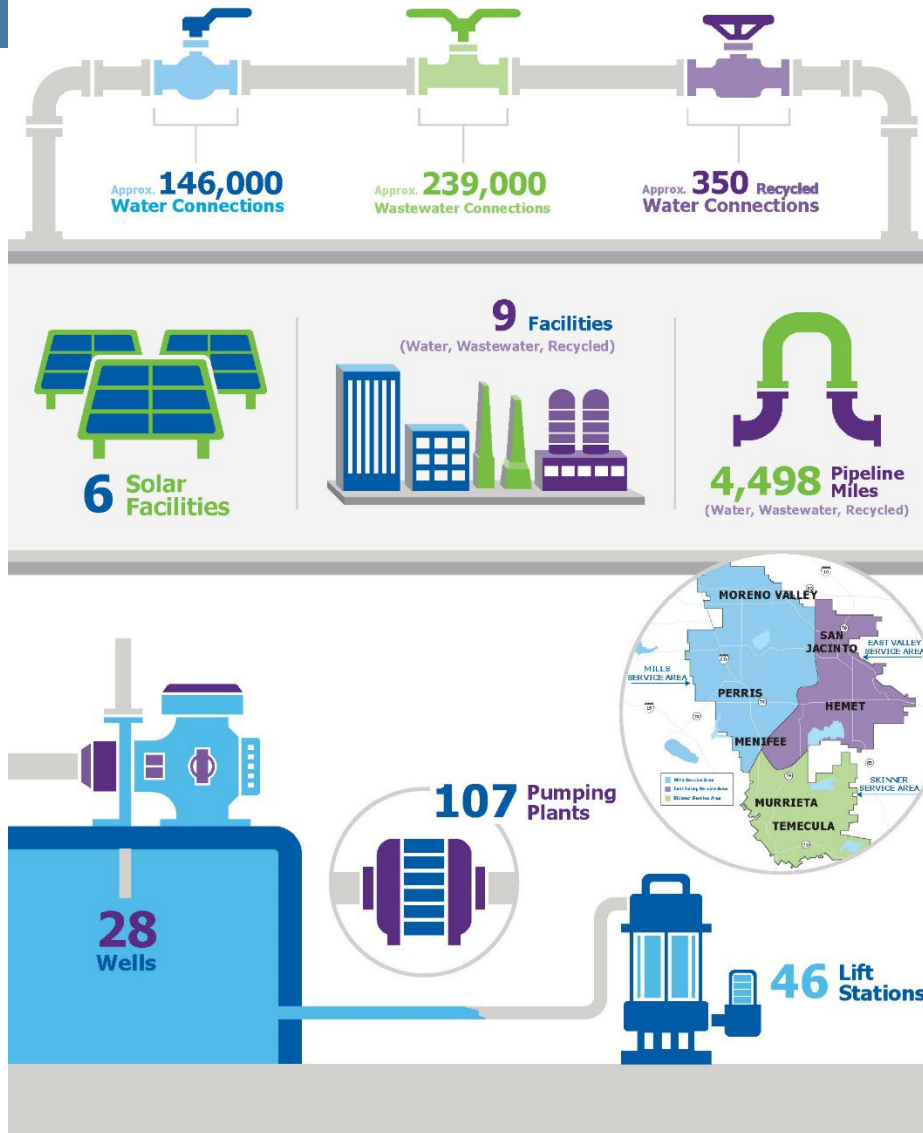
EVALUATING EWPS: RISK ASSESSMENTS

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About EMWD

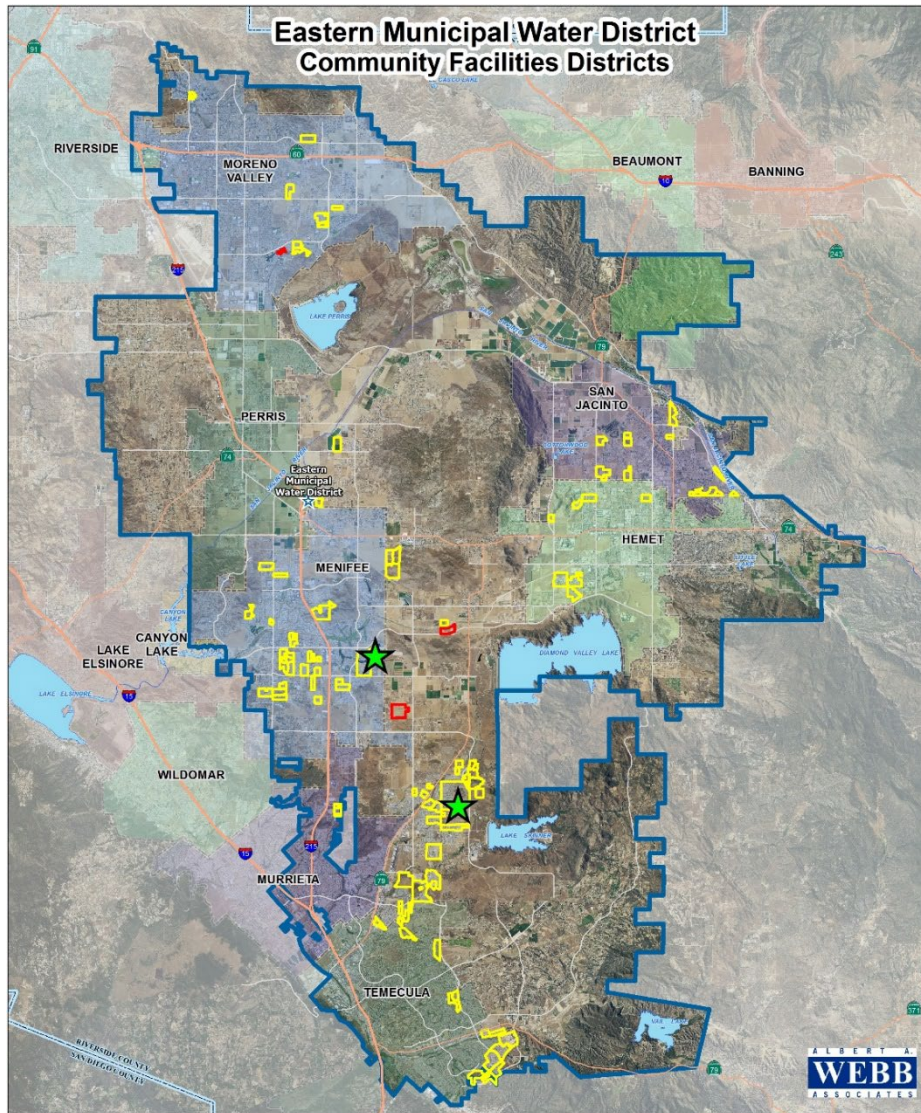
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- Established in 1950
- Agency serving:
 - ▣ Water/wastewater/recycled
 - ▣ Wholesale and retail
- 555 square miles –Riverside County, California
- Population 804,000
- Five district-elected board members
- Annual operating & capital budget of \$398 million for FY 2017-18
- Debt Ratings – S&P/Fitch/Moody's
 - ▣ Senior Lien AA+/AAA/Aa2
 - ▣ Working Lien AA+/AA+/Aa3
- 38 percent built-out

Land-Secured Financing

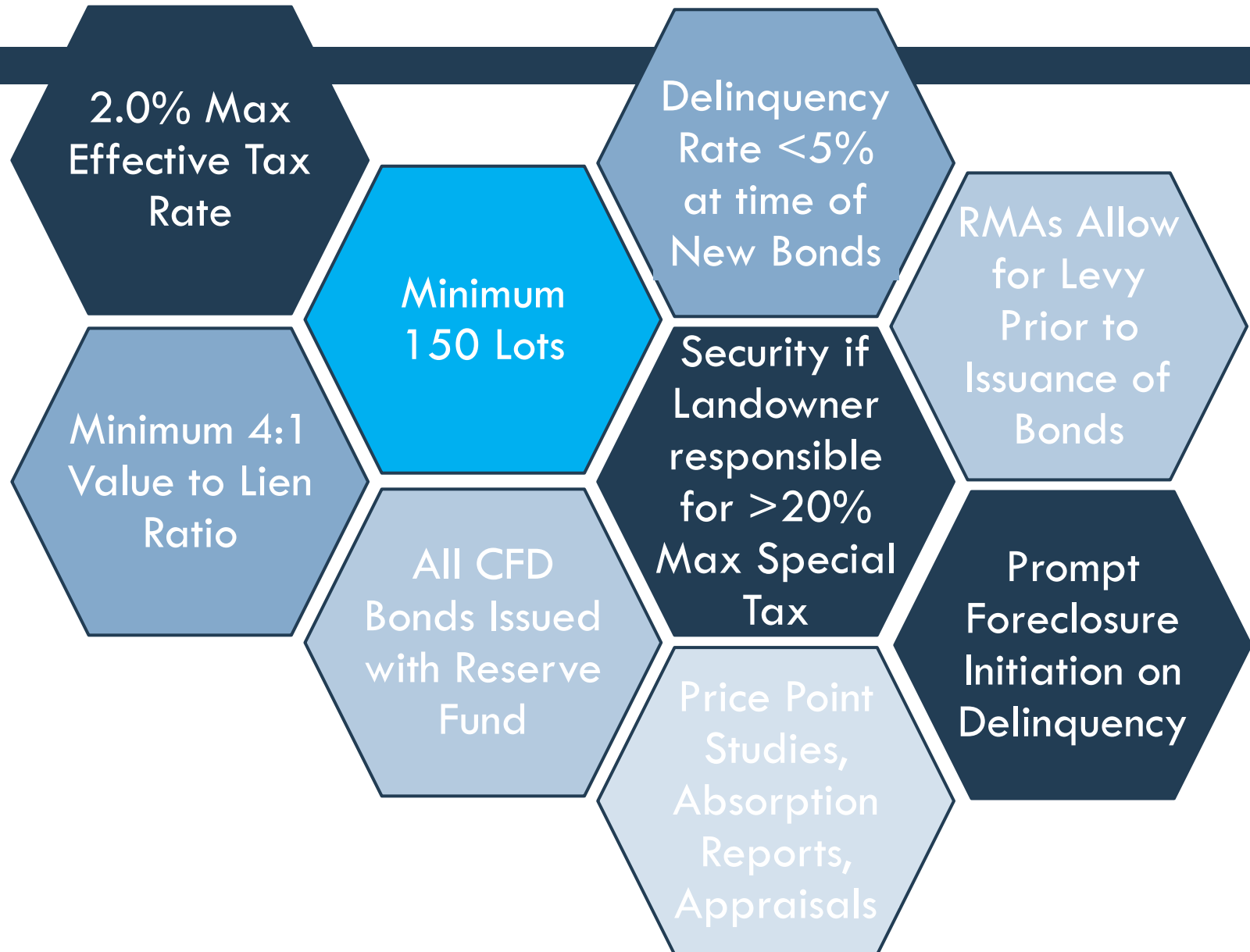
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- Forming 78th CFD
- 55 Active Community Facilities Districts
 - ▣ 92 Separate Financing Areas
 - Improvement Areas/Tax Zones
- Actively levying 14,191 parcels
 - ▣ Total annual debt service \$13.7m
- Typically unrated
- Sometimes privately placed
- Pooled Financings issued through Western Riverside Water & Wastewater Financing Authority (WRWWFA)
- No Defaults or Draws on Reserves

Policy Principles Mitigate Investor Risk

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Mitigating Risks with Consultant Engagement

- Consultant Contracts are Competitively Bid on Regular And Recurring Basis
- Consultants are Independent, Are Paid By The District, Not By Advocate Or Third-parties
- Consultant Contracts Include Insurance Requirements, Indemnifies District for Errors Related to Work Product
- Advocate (Developer) Makes A Deposit To Fund Initial Analyses, But District Hires Consultants, Oversees Work Product, And Pays For the Work
- EWPs Are Incorporated Into The Public Record
 - Staff Reports Include the EWP, Such As Appraisals, Special Tax Consultant Report, Price Point Studies, And Other Analyses

Land-Secured Financing: EWPs

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- Formation – Special Tax Consultant/Program Manager Prepares Preliminary Formation Analysis
 - Development Status/Lots
 - Estimated Revenue Constraint, VTL, Overlapping Tax Rate
 - Proposed Use of Proceeds
- Change Proceeding to Increase Special Tax Rates - Absorption Analysis and/or Price Point Study from Economics Consultant
- Bond Sale – Special Tax Consultant/Program Manager Provides Update of Formation Analysis for Review Prior To Moving Forward
- Analysis of Overlapping Debt
- Depending on Development Activity
 - Absorption Report and/or Price Point Study
 - Independent Appraisal
 - Calculation of Landowner Security if responsible for >20% Max Special Tax

San Diego: State Route 125 Debt Restructuring



- 10-mile toll road in southern San Diego County
- Opened in 2007, Acquired by SANDAG in 2011 from bankrupt for-profit consortium
- SANDAG Purchase financed with high-interest loans
- Restructuring should save ~\$60 million
- *Need a Traffic and Revenue Study*

San Diego: State Route 125 Debt Restructuring

Procurement Process:

- “Full and Open Competition”
- “Clear and Accurate Description of Technical Requirements”
- No “Actual, Potential, or Apparent” Conflicts of Interest

Key Traffic and Revenue Study Assumptions:

- Traffic
 - Demographics of catchment area
 - Traffic on alternate routes
- Toll assumptions and customer response
- Economic Conditions/Development

QUESTIONS