Disclosure: The Good, The Bad and The Ugly

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Franklin Municipal Bond Department

As of February 29, 2012

- Over $77 Billion Under Management
- 34 Funds
- Long-term, Intermediate-term, Limited-term, Money Market, Investment grade–national and state specific, Insured, High-Yield[1]
- 12 Portfolio Managers
- 17 Analysts
- Average Tenure: 16 Years

1. High-yield bonds, also known as "junk bonds," are subject to additional risks such as the increased rate of default.

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Good disclosure benefits everyone!

Issuers, the market and investors

Disclosure in Public Finance:
The Good, the Bad and the Ugly

- The Good: What a difference a decade makes! How 15c2-12 has worked. The benefits of EMMA, technology and the web.

- The Bad: Where has the system failed? Will the analyst community ever be happy? Move to direct lending/bank loans.

- The Ugly: The market has changed dramatically over the past several years. We continue to suffer from ongoing economic weakness. Municipalities are doing more with less.

It's a New World

- 2008: Meltdown of the auction rate market, bank and insurer collapse.
- 2010: Bank analyst Meredith Whitney is featured on *60 Minutes* predicting "hundreds of billions" in local government defaults.
- 2012: First two California municipalities enter AB506 process. There are municipalities not appropriating for "essential" leases.
- Local governments nationwide continue to struggle from economic weakness and unprecedented budget pressures.
- Budget battles often take place in the press. Pensions are headline making news.

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What does this mean for issuers?

- Issuers no longer have it as good as they used to.
- Analysts will be asking new and different questions that require more in-depth answers.
- Timely release of information is now more important than ever.
- Renewed interest by SEC, GAO, GASB.

The Bonds f.k.a Insured

- Most insured bonds trade differently today then a year ago.
- All bonds should have a public underlying rating. Period.
- How do credit analysts look at insured bonds? This can be a good or bad thing for an issuer.
- What about the bonds that don’t have underlying ratings?
- What could this mean next time you issue bonds?

“Are issuers rewarded for good disclosure?”

- Who is the “market?”
- How are bonds priced in the primary?
- How are bonds priced in the secondary or on an ongoing basis?
- Large versus small issuers
- Real world examples

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Types of Disclosure

- Primary Market
- Secondary Market
- Surveillance

Primary Market Disclosure

- Primary market disclosure is generally very good and has improved over the past few years.
- How do credit analysts look at deals in the primary?
- Continuing Disclosure Agreements
- Do issuers benefit from good primary market disclosure after the deal prices?

Secondary Market/Surveillance

- Why disclosure is important even *after* bonds are sold.
- We are required by law to price bonds daily and any bond can trade at any time.
- Disclosure timing

So what do we want?

Timely and complete disclosure of the financial and operating information needed to assess the credit quality and risk of a municipal debt issue.

- Historical financial results (audited)
- Current financial snapshot (interim reporting, unaudited is fine)
- We need taxes broken out. Chances are while property taxes are declining, sales taxes are increasing. We want to give you credit for that.
- Tax Base, Demographic profile, Economic snapshot
- Liquidity
- Other long term obligations
  - Long Term Debt
  - Pensions, OPEB
  - Direct Lending/Bank loans

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Example of how issuers can benefit from interim disclosure

Let's set the stage..

- Today is May 3, 2012.
- I have two secondary market opportunities on my desk.
- Both are California cities with a 6/30 fiscal year end.

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City A

•FY10 results are the most recent posted. It shows that general fund revenues for FY10 are down 8% from FY09.
•“Taxes” are all grouped together and are down 11.2%
•Fund balance has declined in each of the last three years and in FY10 fund balance was negative.
•When I call the finance director I get the run-around and never get a return call.

City B

•FY 11 results show general fund revenues are flat.
•Property taxes are down 4% and sales taxes are down 2%
•I can see that this is the third year of property tax declines, but sales taxes have declined less in FY10 and FY11.
•City B has posted mid-year unaudited results for the first 6 months of FY12. I see that property taxes are still down, but sales taxes have increased 10%.

What do I do?

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What if City A actually had timely disclosure…

- What if FY11 results actually showed that revenues increased? What if taxes were flat, but sales taxes increased and helped make up for ongoing property tax declines? Because the city doesn't break up taxes, this is hard to deduce.

- What if FY12 sales taxes are improving even more and as a result a surplus is expected for FY12 due to better-than-expected sales taxes?

- You want me to know this!

- What happens next time that city comes to the market?

Where do institutional investors get information?

- Offering Statements
- Continuing Disclosure filings
- Issuer websites
- Calls to management
- Sometimes we have to get creative

For more information

- National Federation of Municipal Analysts

  www.nfma.org

Good Disclosure Benefits Everyone!

- Improves transparency
- Improves access to capital
- Improves pricing
- Increases liquidity

THANK YOU!

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