



CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

SESSION TWO: INITIAL DISCLOSURE

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Why Is Disclosure Necessary?

- ▶ Government agencies issue securities in the public capital markets
- ▶ Investors in municipal securities have rights under federal securities laws
- ▶ All “material” information must be disclosed

Securities Act Of 1933

- ▶ Two substantive rules:
 - Registration requirement
 - Antifraud rule
- ▶ Municipal securities are exempt from the registration requirement, but are subject to antifraud rule
- ▶ Two standards of culpability:
 - Negligence (Section 17(a))
 - Recklessness or willful intent to defraud (Rule 10b-5)

Securities Exchange Act Of 1934

- ▶ Regulates brokers and dealers (such as underwriters of municipal financings)
- ▶ Also contains antifraud provisions (Rule 10b-5)
- ▶ 1975 amendments make clear that antifraud provisions apply to government issuers

Rule 10b-5

“It shall be unlawful for any person . . .

- a) To employ any device, scheme or artifice to defraud,
- b) To make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .”

The “Materiality” Standard

- ▶ “[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest.”
- ▶ Materiality is determined in context of all of the facts and circumstances, but usually on a retroactive basis
- ▶ Guidance comes primarily from court decisions and SEC enforcement cases

What Should Be Disclosed?

- ▶ It depends ...
 - What is the source of payment?
 - Is that source a certainty?
 - What pressure might impact the repayment source in the future?
 - If you were an investor, what would you want to know?
- ▶ Unlike corporate securities, there is no “line item” set of rules for what goes into an Official Statement (“OS”)
- ▶ Look at practices in the industry/recent developments (e.g. pension obligations, continuing disclosure compliance, drought)
- ▶ In the end, the issuer must use its own good judgment

Rule 15c2-12

- ▶ **Binds underwriters, not issuers**
- ▶ **Initial Disclosure**
 - Defines “Official Statement” and permitted omissions from Preliminary Official Statement
 - Requires statement in Official Statement of prior material failures to comply with continuing disclosure obligations
- ▶ **Continuing Disclosure**
 - Requires annual reporting
 - Requires reporting of listed events (most important is changes in bond ratings)

The Official Statement

- ▶ The OS is the offering document to investors
 - Equivalent to prospectus in the corporate context
- ▶ Must contain all “material” information for the particular bond sale (terms of bonds; issuer financial/operating data; risks)
- ▶ **The OS is the issuer’s document**
- ▶ Underwriters, financial advisors, bond counsel and disclosure counsel can help develop the OS, but (per the SEC) the issuer is ultimately responsible for content

Types of Material Information

- ▶ Bond terms
 - Authority for issuance
 - Maturity dates, principal amounts and interest rates
 - Circumstances under which bonds can be redeemed (prepaid)
- ▶ Purpose of financing
 - New projects or refunding?
 - Table of sources and uses of funds
- ▶ Description of security
 - Pledge of taxes/revenues to repay bonds
 - Ability to issue senior or parity debt
 - Rate covenant/foreclosure covenant
 - Reserve fund established?
- ▶ Federal tax treatment of bonds
- ▶ Credit ratings
- ▶ Past compliance with continuing disclosures – required by Rule 15c2-12

Types of Material Information (continued)

- ▶ Description of issuer
 - What type of entity
 - Location within California
 - Population/number of accounts
 - Assessed valuation within service area
 - Other characteristics of service area

- ▶ Description of issuer's finances
 - In particular, the stream of taxes or revenues that are pledged to repayment of the bonds
 - Budget process
 - Historical information in tabular form – audit available?
 - Projected financial information?

Types of Material Information (continued)

- ▶ Description of existing parity and senior debt
 - Don't forget private placements and bank loans
- ▶ Pension/OPEB disclosure
- ▶ Risks of nonpayment
 - Consider addressing current topics of interest to rating agencies and investors or recent news events
- ▶ Material litigation

Sample Disclosure – Utility Credit

TABLE 1
CITY OF STOCKTON
WASTEWATER SYSTEM
Customer Base by Type of Account
As of June 30

	2010	2011	2012	2013	2014
RESIDENTIAL [†]					
Single Family and Condo	74,162	74,264	74,361	74,448	74,535
Multi-Family/Apartments	23,368	23,368	23,368	23,368	23,369
Cal Water ⁽¹⁾	33,819	33,860	33,800	33,970	34,082
COMMERCIAL					
Low Strength	252	254	255	256	257
Medium Strength	4,135	4,140	4,156	4,158	4,171
High Strength	437	438	440	440	440
Cal Water ⁽¹⁾	2,459	2,479	2,461	2,427	2,415
INDUSTRIAL					
Low Strength	38	38	38	38	39
Medium Strength	421	421	435	435	436
High Strength	13	13	13	23	13
Schools [†]	95	95	93	93	94
INSTITUTIONAL	48	48	49	51	51
CAL WATER ⁽¹⁾	235	233	235	236	233
WASTEWATER HAULERS	10	10	15	11	10
TOTAL	139,492	139,661	139,719	139,944	140,145

⁽¹⁾ California Water Service Company ("Cal Water") provides billing and collection services to the City for Wastewater System customers within the water service area of Cal Water. These connections are billed and collected on behalf of the City through Cal Water.

Source: City of Stockton, Utility Billing.

Sample Disclosure – Tax Increment (Redevelopment) Credit

Table 8
SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY OF THE CITY OF STOCKTON
Projected Tax Revenues (All Project Areas)
Assumes No Assessed Value Growth
(Figures in Thousands)

<i>Fiscal Year</i>	<i>Real Property⁽¹⁾</i>	<i>Changes Of Ownership⁽²⁾</i>	<i>Other Property⁽³⁾</i>	<i>Total Value</i>	<i>Value Over Base of \$3,701,741</i>	<i>Tax Increment⁽⁴⁾</i>	<i>Unitary Revenue⁽⁵⁾</i>	<i>Total Tax Increment</i>	<i>Section 33676 Payment⁽⁶⁾</i>	<i>Property Tax Admin. Fees⁽⁷⁾</i>	<i>Negotiated Tax Sharing⁽⁸⁾</i>	<i>Tax Revenues</i>
2016-17	\$5,102,818	N/A	\$638,933	\$5,741,751	\$2,040,010	\$20,400	\$203	\$20,603	\$24	\$404	\$484	\$19,690
2017-18	5,055,763	0	638,933	5,694,696	1,992,955	19,930	203	20,132	24	395	484	19,229
2018-19	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,493
2019-20	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2020-21	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2021-22	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2022-23	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2023-24	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2024-25	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2025-26	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2026-27	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2027-28	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2028-29	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2029-30	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2030-31	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2031-32	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2032-33	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2033-34	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2034-35	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2035-36	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
2036-37	4,980,657	0	638,933	5,619,590	1,917,849	19,178	203	19,381	24	381	484	18,492
Cumulative Total						\$404,721	\$4,255	\$408,976	\$509	\$8,031	\$10,161	\$390,276

(1) Prior Year Real Property held constant in the projections. The value in 2017-18 and 2018-19 have been reduced for estimated appeals impacts.

(2) No changes of ownership included in the no growth projection.

(3) Includes the value of secured and unsecured personal property, and state-assessed railroad and non-unitary property.

(4) Based on the application of 1.00% tax rates to incremental taxable value.

(5) Unitary revenue estimate per County.

(6) Allocations made per Section 33676.

(7) Amount shown reflects estimated property tax administrative fees charged by County at 2.00%.

(8) Negotiated tax sharing payments per agreements.

Source: Fraser & Associates.

Sample Disclosure – Special Tax/Assessment Bond Credit

TABLE 8
Stockton Public Financing Authority
City of Stockton
Combined all CFDs and Reassessment Districts
2015-16 Top Property Owners⁽¹⁾

Property Owner	Land Use	Parcels	Total Direct and Overlapping Debt	% of Total	2015/16 Assessed Value ⁽²⁾	Value to Lien
WALMART REAL ESTATE BUSINESS TR	Commercial	1	\$ 657,332	1.09%	\$ 21,819,883	33.2
LOWES HIW INC	Commercial	1	406,125	0.67	12,640,355	31.1
NCT AMT LLC	Residential	6	82,493	0.14	1,760,000	21.3
AJ HERITAGE HOMES INC	Residential	6	70,274	0.12	1,079,858	15.4
VALLEY FAMILY INVESTORS LLC	Residential	6	63,577	0.10	1,311,356	20.6
ASNANI, MOHAN & BINA ETAL	Residential	4	58,190	0.10	1,159,859	19.9
HOLLOWAY, BRIAN TR	Residential	5	56,811	0.09	960,792	16.9
LE, HENRY & PHUNG THI TR	Residential	4	51,190	0.08	933,028	18.2
SPILLANE, JAMES & CELESTE	Residential	4	48,370	0.08	1,095,577	22.7
SINGH, HARPAL & ASHVINDAR	Residential	3	43,638	0.07	874,000	20.0
All Others	Various ⁽³⁾	4,982	59,038,616	97.46	1,350,539,153	22.9
		5,022	\$60,576,617	100.00%	\$1,394,173,861	23.0

(1) Top property owners are ranked based on lien amounts, then by assessed values greatest to least.

(2) Source: FY 2015/16 San Joaquin County Tax Roll, as compiled by Willdan Financial Services. For newly developed parcels for which tax roll data was unavailable, recorded transaction prices from the developer to the homeowner were used.

(3) Includes Residential, Vacant Residential, School District Properties, and Commercial.
Source: Willdan Financial Services and California Municipal Statistics, Inc.

Sample Disclosure – Special Tax/Assessment Bond Credit

TABLE 10
Stockton Public Financing Authority
Combined all CFDs and Reassessment Districts
Sample Residential Tax Rates⁽¹⁾

District	APN	Land Use	Total Assessed Value ⁽²⁾	Total Taxes Due	Tax Rate
CFD 2001-01 Spanos Park West	066-130-34-0000	Residential	\$302,000	\$4,756	1.57%
AD 2000-01 Morada Ranch	126-300-17-0000	Residential	245,354	3,408	1.39
AD 2002-01 Morada North	124-120-21-0000	Residential	261,275	3,686	1.41
AD 2002-03 Waterford Estates	070-470-19-0000	Residential	326,000	4,504	1.38
AD 2003-01 March Lane / Homan	128-160-43-0000	Residential	260,000	4,358	1.68
AD 2003-03 Waterford Estates East Phase II	070-490-14-0000	Residential	327,875	5,002	1.53
CFD 2003-01 Camera Estates	128-180-35-0000	Residential	231,002	3,781	1.64
CFD 2006-1 Riverbend	128-320-53-0000	Residential	234,650	3,778	1.61
CFD 2006-3 Northbrook	084-180-25-0000	Residential	302,490	4,932	1.63

(1) Sample tax bill for a single family home with the median land use and median home value.

(2) Fiscal Year 2015/16 assessed value, excluding homeowner's exemption.

Source: Willdan Financial Services and County of San Joaquin.

Disclosure Principles

- ▶ Provide main points but don't overwhelm readers with detail
- ▶ Highlight important developments "up front"
- ▶ Is there an underlying story that might place the information provided in a different light?
 - Is the source of ongoing information such that it is reliable?
 - Have the numbers trended or changed course? Tell your story
- ▶ Be consistent – there should not be one story for rating agencies and a different story for investors
- ▶ Bringing all these factors together into final product is ongoing process of give and take

Process

- ▶ Obtain input from involved departments
- ▶ Empower staff at all levels to raise issues
- ▶ While issuer coordinates, counsel helps pull information together and maintains document
- ▶ Drafts reviewed by working group
- ▶ “Due diligence” meeting before distribution of Preliminary Official Statement

Disclosure Considerations

- ▶ Tomorrow's "hot topic" may be different than today's
- ▶ Disclosure must evolve to reflect changing circumstances
- ▶ Read the disclosure with "fresh eyes"
- ▶ If you think something may be a concern, raise the issue with colleagues and the working group
- ▶ There are no "stupid questions"
- ▶ Political sensitivity and confidentiality considerations are not exceptions to disclosure

Disclosure Policy and Training

- ▶ Adopt or update your disclosure policy, ideally before initiating bond disclosure
 - Designate a single responsible person as a coordinator
 - Process for update by subject matter experts, review and sign-off
 - Internal controls over disclosure development and sign-off
 - Follow the disclosure policy
 - Make the policy a “living” document that can be revised and refined over time.
- ▶ Provide periodic training to issuer officials and board members on disclosure

Lessons Learned from SEC Actions

▶ Orange County

- Emphasized that disclosure is issuer's responsibility; reliance on professionals must be reasonable

▶ San Diego

- Focus on lack of disclosure procedures and excessive reliance on outside professionals
- Some individuals paid fines from their own pocket

▶ Incomplete or Misleading Pension Disclosures

- States of New Jersey, Illinois and Kansas – SEC actions against states
- Reinforced lessons of San Diego; importance of disclosure policies and training

▶ Harrisburg

- Speaking to the market; “control person” liability

▶ Miami

- Substantial financial penalties; personal liability for individuals

Summary

- ▶ Have the right people involved – make sure that the personnel involved in disclosure preparation can reasonably be expected to know material information
- ▶ Empower everyone in the organization
- ▶ Give the investors all of the material facts, and let them decide
- ▶ Full and transparent disclosure is essential
- ▶ Investors must be provided with all material information when making their investment decision
- ▶ Officials participating in the disclosure process must be in a position to know material information (i.e., “the right people must be in the room”)
- ▶ Vigorous disclosure program requires buy-in and encouragement from top levels
- ▶ The issuer must have a robust disclosure process, and must continue to be vigilant in training involved officials and maintaining rigorous disclosure practices
- ▶ Have formal policies and procedures and follow them