



DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

It Takes a Team: The Role of External Professionals in a Successful Issuance | Part 1

Module 5 explores the functions, fiduciary responsibilities, interests, and compensation of external finance team members and discusses their roles in the context of the typical debt issuance process. Other topics include the elected official's role and responsibilities during the issuance process and key members of the agency's internal finance team.

Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC) and it believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers.

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Narrator: As an elected official, you will make decisions that directly shape your agency's debt financing. Your role as a fiduciary requires that you have a fundamental knowledge of the debt issuance process and then exercise independent and sound judgment in approving debt structures, issuance methods, and disclosures made to investors. However, your independence and decision-making does not suggest that you are on your own. Designing and executing a financing plan that meets legal requirements and achieves your agency's goals will require specialized knowledge and participation from professionals outside the agency.

This module addresses the roles and responsibilities of your external finance team, along with your agency's obligations in selecting, compensating, and managing them throughout the life of the debt issuance. In addition, this module will provide a high-level review of the phases of a debt issuance and highlight the roles played by external finance professionals throughout the issuance process.

The complexity of the transaction, method of sale, and skills and experience of an issuer's finance staff will factor into the composition and level of participation of an external financing team. While unique financing circumstances influence the need for external expertise, even the most straightforward borrowings with experienced staff require experts to access the market and conduct a successful issuance.

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Narrator: A municipal advisor or financial advisor assists in the formulation and execution of a debt financing plan. A municipal advisor's role is usually performed by a municipal advisory firm, investment banking firm, or commercial bank, but if a banking firm is selected, they may not also act as an underwriter. Unlike other professionals on your financing team, the municipal advisor has an explicit fiduciary duty to the issuer, as a matter of law. The municipal advisor will provide strategic analysis and recommendation of financing options; advise on marketing and method of sale; assist with the development of required disclosures; as well as support the process to select other financing team members.



Municipal advisors must meet examination standards and be registered with the SEC's rulemaking body known as the Municipal Securities Rulemaking Board or MSRB. Other MSRB rules prohibit dishonest and unfair dealings and require disclosure of any material relationship with the underwriter or other potential conflicts of interest.

The municipal advisor is generally paid from proceeds of the issue based on an hourly contract or retainer. California law does not allow for the compensation of a municipal advisor to be based on a percentage of the issuance. Many issuers expect to pay the fees of a municipal advisor on a contingent basis. Issuers should carefully consider whether a contingency arrangement could create a conflict of interest for the municipal advisor over whether to issue debt.

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Narrator: Debt issuance necessitates the use of specialized legal counsel to perform functions and provide opinions with a market-required level of objectivity and independence that cannot be provided by the agency's internal counsel. These roles, including bond counsel, disclosure counsel, and underwriter's counsel, may be performed by one or more individuals from the same or different firms. These attorneys will perform many required elements of the issuance, including preparation of the legal documentation for approval by the agency's governing body, and may also interpret and advise on tax law and contractual matters.

Bond Counsel is the attorney, law firm, or group of firms hired by the issuer that gives the legal opinion that the debt issuance is a legally valid and binding obligation of the issuer and, if tax-exempt debt, that interest on the debt qualifies for federal and state income exemption. Bond counsel will also draft documents used to authorize the issuance and secure the debt.

Disclosure Counsel represents the issuer and plays an expanded role in transactions where underwriters are competing to purchase the debt. They provide advice on the securities law disclosure obligations and coordinate the preparation of the official statement. This is the document that provides investors all of the material information they need to know to make an investment decision, including detailed discussion of agency financial condition, bond terms, projects, risks, and repayment. Disclosure counsel will also draft the continuing disclosure agreement. This is an agreement between the underwriter and the issuer, required by the SEC, which commits the issuer to disseminate material information about the debt and the agency's financial condition post-issuance. Disclosure counsel may also be engaged on an on-going basis to advise on disclosure obligations over the life of the debt.

Underwriter's Counsel is hired by and represents the underwriter in transactions where the underwriter is preselected. In this case, underwriter's counsel will work in cooperation with disclosure counsel to develop the official statement and the continuing disclosure agreement. They will also prepare the purchase agreement between the issuer and underwriter.

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Narrator: Specialized Services Counsels perform a variety of regulatory and administrative tasks. They include tax counsel and bank counsel. In addition, the issuer will have their internal legal counsel participate in an oversight role. The compensation of legal counsel is made by the represented party—bond and disclosure counsel by the issuer and underwriter's counsel by the underwriter. The basis of compensation may be fixed, hourly, or a percentage of the issue, and may or may not be contingent on successful issuance. Proceeds of the issue are



typically the ultimate source of repayment with the underwriter passing along the costs of its counsel to the issuer as expenses.

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Narrator: An underwriter is a banking firm or a syndicate (a group of underwriting firms) that purchases bonds directly from the issuer with the intent of selling the bonds to investors. The underwriter's unique position provides a depth and breadth of market knowledge along with marketing abilities that can reduce or eliminate your marketing risk, allowing your agency to achieve the lowest interest rate that will facilitate a successful transaction.

Most municipal bonds are sold using two basic methods: either a competitive or a negotiated sale. The underwriter's role will be determined by the method employed. In a competitive sale, underwriters compete to buy the debt, with the lowest-cost bid determining the winner. The issuer has limited contact with potential underwriters prior to the sale. In a negotiated sale, an underwriter is preselected to purchase the bonds. The underwriter, in turn, sells the bonds to investors. The terms of the bonds are tailored to meet the financing needs of the issuer and the demands of the underwriter's investor clients.

Underwriters are required to register with the SEC and to comply with rules promulgated by the MSRB. However, underwriters do not have a fiduciary duty to issuers. Under federal rules underwriters are not allowed to also serve in a dual role as a municipal advisor on the issuance. Under either sale method, the underwriter is responsible for assuming the risk and expense of selling your bonds into the market and requires compensation for doing so. Simply put, underwriter compensation is the difference between the price they pay the issuer for the debt and the price they sell the debt to investors. This is referred to as the underwriter's spread. The underwriter is required to adhere to regulations for fair dealing and has an interest in striking a balance between the objectives of issuers and investors, but the underwriter's goal is to buy as low and sell as high as the market will accept.

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Narrator: The trustee is responsible for carrying out the administrative functions required in the indenture for the benefit of the bondholders. The indenture is the part of the debt contract that establishes the rights, duties, responsibilities, and remedies of the issuer and trustee. Typically, the trustee role is performed by a large commercial bank, but in the case of school district issues, the County Treasurer performs these functions in a comparable role known as paying agent. Trustee responsibilities include establishing accounts and holding funds relating to the debt issue, authenticating the bonds, maintaining a list of bondholders, paying principal and interest to bondholders, and representing bondholders' interests in the event of a default. Trustees are selected and paid by the issuer. Trustee costs include a one-time upfront fee, an annual fee, and sometimes transaction-based fees.

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Narrator: Financing team members are normally chosen by the issuer through a solicitation process such as a Request for Proposal or Request for Qualifications that will be described in the agency's Debt Management Policy. These methods of selection promote fairness and transparency, allow the issuer to compare costs and qualifications in a systematic and consistent manner, and open competition to a number of qualified consultants.



The basic elements of a solicitation consist of desired qualifications and experience, scope of work, format for providing costs, evaluation criteria, and procedures for communicating with potential applicants. Other elements of the solicitation will help the issuer to uncover and mitigate conflicts of interest.

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Narrator: It is important to remember that underwriters should not promise specific interest rates in response to a solicitation and issuers should not allow hypothetical interest rate illustrations to influence underwriter selection. Potential conflicts of interest may arise when financing team members or firms have economic interests in the underlying assets being financed or in the securities being offered.

The state constitution and statutes generally prohibit financing team firms from making contributions to bond election campaigns in exchange for agreements to provide services after a successful election. Also, elected or appointed public officials must recuse themselves from decisions on contracts with any prospective financing team participants if the official has a financial interest in the firm. Policies and procedures for the selection process must account for the real or perceived conflicts of agency officials and potential financing team participants.

The reliance on work done by external financing team professionals does not relieve the issuer of its oversight responsibility. It is important for you, as an elected official, to institutionalize and follow a comprehensive debt management policy that recognizes the importance of unambiguous standards for ethics, transparency, and disclosure, and maximizes the value of your financing team.



DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

It Takes a Team: The Role of External Professionals in a Successful Issuance | Part 2

Module 5 explores the functions, fiduciary responsibilities, interests, and compensation of external finance team members and discusses their roles in the context of the typical debt issuance process. Other topics include the elected official's role and responsibilities during the issuance process and key members of the agency's internal finance team.

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Narrator: Now that you are familiar with the members of your financing team, let's look at how they participate in the debt issuance process. While the issuance process varies, most financings follow a path that includes four common phases: planning, pre-issuance, issuance, and ongoing administration. During the planning phase the municipal advisor will work with the issuer's finance, public works, and legal staff to determine if debt financing is an appropriate tool. This analysis will be guided by the strategic, capital improvement, and long-term financial plans, but may require the expertise of specialized consultants, such as appraisers and engineers, to determine the scope, feasibility, and life-cycle cost of the project, and if the agency has, or needs to develop, capacity for repayment. If debt issuance is aligned with agency planning and is financially feasible, the next step in this phase is to develop a more specific plan of finance that is consistent with the agency's debt management policy and addresses amount, timing, type, structure, security pledge, and repayment schedule.

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Narrator: Once an agency is on the path toward debt issuance, it enters the pre-issuance phase. One of the first steps in this phase is to fill out the financing team with the professionals needed to guide the execution of the plan of finance. As discussed, the composition of the team varies based on the method of sale, complexity of the transaction, and the experience of the agency staff, but should be guided by the plan of finance and the debt management policy. The method of sale, either competitive, negotiated, or private placement, will drive the composition and activities of your financing team. Absent any legal requirements to use a certain sale method, the municipal advisor and issuer's staff will determine the appropriate method of sale based on their experience with similar issues and the debt management policy.

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Narrator: The competitive sale method supports goals of objectivity and transparency and is generally thought to offer a lower total cost. In a competitive sale, bonds are advertised for sale by way of a notice of sale which includes both the conditions of the sale and the terms of the bond issue. Underwriters bid on the bonds at a pre-



determined date and time. The bids are opened, and the bonds are sold to the underwriter offering the lowest total cost to the issuer.

Most municipal bonds are sold through a negotiated method because circumstances of the issuer or structure of the debt dictate this method as more effective. In a negotiated sale, the underwriter is pre-selected through a solicitation process. The underwriter will play a significant role in structuring and marketing the issue, in order to tailor the bonds to account for the demands of targeted investors, as well as issuer's cost and distribution goals. In a negotiated sale, the municipal advisor will help oversee debt structuring and marketing and engage in price negotiation on behalf of the issuer.

While the underwriter is keenly interested in a successful financing and a satisfied issuer, they do not have a legal responsibility to act in the interest of the issuer.

A private placement is a form of negotiated sale where the debt transaction takes place directly between the agency and selected accredited investors or a bank. Official disclosure responsibilities are reduced because the investors or bank are responsible for their own due diligence of the proposed financing. A placement agent, a licensed broker-dealer, may work with the agency and its municipal advisor to identify potential qualified investors and negotiate the key terms, conditions, and interest rates. The private placement method is used frequently with debt that may be difficult to sell into the broader municipal market because the issue is too small or complex.

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With a method of sale and corresponding experts selected, the entire financing team and agency staff will assemble to determine the need for authorizations and approvals, and to fine-tune the debt features including size, type, maturities, options, repayment sources, and interest type.

Other structuring decision points include obtaining a credit rating and using credit enhancement to achieve a higher rating and lower overall borrowing costs. These discussions may also entail the development of a marketing strategy for potential investors. The issuer's finance and legal staff will be deeply involved in this process to ensure that the implications of the structuring alternatives under consideration are well understood and consistent with the agency's goals, objectives, and policies.

During the pre-issuance phase, legal counsel will prepare the required resolutions, documents, and initial disclosure that formalize the structure of the debt and set out the rights and responsibilities of the involved parties. These financing documents, approved by the governing body, are the means by which the agency acts upon its authority to issue debt and makes its commitments to investors. Greater detail on these documents is provided in a separate module in this series.

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Narrator: At the beginning of the Issuance Phase, the financing structure should be determined. Credit enhancement, if used, will be finalized and the issuance will receive its credit rating. At this stage, all parties agree to the ultimate terms of the debt issuance and you, as the elected official, will have approved, in effect, final versions of the financing documents.



The next step is to market and price the bonds. The price is the amount the underwriter will pay the issuer for each type of security in the issuance. It establishes the return the investors will receive and, most importantly, the interest cost the agency will pay. Under a competitive sale, the underwriter that bids the price that provides the agency the lowest interest cost is selected. Under a negotiated sale the final pricing will be agreed upon by the underwriter and issuer after investors have indicated interest in the offering at a price that provides them a specific investment return. Once pricing is determined either by winning bid or negotiation, the underwriter and issuer execute the purchase agreement to finalize the underwriter's purchase of the debt. To complete the sales process, legal counsel will finalize and publish the Official Statement with the pricing details and distribute it to interested parties.

The issuance phase ends at closing, when the final executed financing documents are delivered, including final statements and the tax certificate. The tax certificate is prepared by bond counsel and contains the issuer's certifications of compliance with the Internal Revenue Code for the issuance of tax-exempt debt. Closing concludes when the underwriter takes delivery of the securities and transfers the proceeds from the bond sale to the trustee. Then, pursuant to the indenture or trust agreement, the proceeds of the financing become accessible to the issuer.

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Narrator: Given the intensity of activity around issuance and the excitement of starting a new capital project in your community, it can be easy to forget the length of the debt commitment and that the agency must perform ongoing administration to ensure that the financing is ultimately successful. This commitment to ongoing administration includes compliance with requirements for investment, control and use of the bond proceeds; timely debt service payments; and adherence to covenants and agreements with lenders, including continuing disclosure.

Issuers are required to comply with rules governing disclosure by abiding by the terms of their continuing disclosure agreement. Annual financial reports and material events notices are prepared per the agreement, often with guidance from disclosure counsel. Many issuers directly manage the tasks of submitting documents to the MSRB, while others use the Trustee or a dissemination agent to manage this responsibility. Issuers will invest the proceeds of a bond sale, not scheduled for immediate use, according to the language contained in the indenture covering permitted investments. Issuers with the capacity and experience may manage the investment of bond proceeds in-house or utilize the service and counsel of the trustee and municipal advisor. School districts deposit their proceeds with the County Treasurer who makes investments on their behalf. Agency staff who will be responsible for post-issuance compliance and controls should be involved in the early phases of the bond issue.

Even when consultants are acting as agents, issuers will need to monitor performance and work product. A lack of oversight will lead to very high financial and legal risks to you and the agency. Ultimately, it is the issuer who is responsible for adhering to these compliance requirements.

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Narrator: The overall complexity of bringing a municipal bond to market and managing it through its life is an imposing task. Selecting the financing team that will guide your agency on the financing path that best matches



your agency's goals requires careful consideration of internal capacity, sales methods, debt structures, conflicts of interest, costs, and selection procedures.

A comprehensive debt management policy will position your agency to assemble the financing team that will deliver on the objectives of your financing and support you in your fiduciary obligations. Although the SEC has established rules that protect issuers and investors, it has also made clear that the issuer's elected body is primarily responsible for the debt issuance and administration decisions and the agency's performance of its legal obligations. You may delegate tasks, but not responsibilities. As an elected official and fiduciary, you have a duty to oversee the process while striving to obtain the greatest value for your constituents.