

# GOVERNMENT FUNDING AND BONDING ISSUES

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## ZIONS BANK PUBLIC FINANCE



## PARTICIPANTS IN A BOND ISSUE

- ✕ Issuer
- ✕ Financial Advisor
- ✕ Bond Counsel
- ✕ Underwriter/Purchaser
- ✕ Trustee/Paying Agent/Bond Registrar
- ✕ Issuer's Counsel

## PARTICIPANTS MAY ALSO INCLUDE

- ✗ Disclosure Counsel
- ✗ Underwriter's Counsel
- ✗ Rating Agencies
- ✗ Escrow Agent
- ✗ CPA Verification Agent

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## ISSUER (BORROWER)



- ✗ Selects financing team members
- ✗ Approves financing terms and documents, and ultimately issues the debt instruments
- ✗ Responsible for repayment of debt (unless Issuer is “conduit” issuer)
- ✗ Responsible for the accuracy and completeness of the debt offering document (i.e., Official Statement, Private Placement Memorandum)
- ✗ Responsible for complying with terms and covenants in financing documents

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## UTAH ISSUER RANKINGS 2012



Entity	Amount (millions)
✖ 1. Utah State Board of Regents	\$638.9
✖ 2. Utah Housing Corporation	298.5
✖ 3. Utah Transit Authority	295.5
✖ 4. Utah County	277.4
✖ 5. Riverton City	200.0

(Source: Thomson Reuters)

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## FINANCIAL ADVISOR



- ✖ Has a fiduciary duty to the Issuer (acts in the Issuer's best interests) (MSRB Rule G-17 and proposed Rule G-36)
- ✖ Assists Issuer in the selection of other financing team members
- ✖ Advises on wide range of financial issues; may be specific to an issuance of debt, or ongoing
- ✖ Quarterbacks the bond issuance process; runs the calendar; coordinates other team members

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## FINANCIAL ADVISOR



- ✕ Position of Trust
- ✕ Recent SEC definition
- ✕ Strong GFOA Recommendation

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## NATIONAL FA RANKINGS - 2012

✕	Firm	Volume (000s)
✕1	Public Financial Management Inc.	\$ 56,923.5
✕2	Public Resources Advisory Group	26,475.3
✕3	First Southwest	24,063.5
✕4	Lamont Financial Services Corp.	14,975.1
✕5	Acacia Financial Group Corp.	10,651.0
✕6	Government Development Bank for Puerto Rico	7,632.3
✕7	KNN Inc., ZBPF ID, ZBPF NV, ZBPF UT	6,609.4
✕8	Seattle-Northwest Securities Corp.	5,697.0
✕9	A.C. Advisory Inc.	5,282.4
✕10	Ponder & Co.	5,152.9

✕ (Source: Thomson Reuters.)

## BOND COUNSEL



- ✘ Nationally recognized law firm with experience in municipal debt financing (Red book)
- ✘ Works with the Issuer and the financing team on behalf of bondholders (for whom does bond counsel work?)
- ✘ Has primary responsibility for preparation of legal documents (resolutions, indentures, security documents, trust agreements, tax certificates, etc.)
- ✘ Renders opinion concerning the validity of the bond issue with respect to statutory authority, constitutionally, procedural conformity and, if tax-exempt, exemption of interest from Federal and State income taxes

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## BOND COUNSEL – UTAH 2012



Firm	Volume (millions)
✘ Chapman and Cutler	\$ 1,421.9
✘ Ballard Spahr	1,379.5
✘ Blaisdell & Church	5.6
✘ Chamberlain & Associates	4.9

\* (Source: Thomson Reuters)

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## UNDERWRITER



- ✗ Investment bank (broker-dealer) hired to sell the bonds into the marketplace. Initially purchases the bonds for immediate resale
- ✗ May provide input into structuring the financing and drafting the Official Statement and related documents
- ✗ Directs the pre-sale marketing efforts to investors
- ✗ Proposes interest rates and offering terms based on market feedback; accepts orders from investors, and may commit capital to underwrite unsold bonds
- ✗ Inherent conflict with the Issuer

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## TOP 10 U.S. UNDERWRITERS (MARKET SHARE IN 2012)

✗ Bank of America Merrill Lynch	14.5%
✗ JP Morgan Chase	11.8
✗ Citi	11.6
✗ Morgan Stanley	6.6
✗ RBC Capital Markets	5.7
✗ Barclay's Capital	5.5
✗ Wells Fargo & Co	5.3
✗ Goldman Sachs & Co	5.1
✗ Raymond James/Morgan Keegan	3.3
✗ Piper Jaffray	2.5

(Source: Thompson Reuters)

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## TRUSTEE/PAYING AGENT/REGISTRAR



- ✖ Retained by Issuer, but represents bondholders' interests
- ✖ Manages trustee-held bond funds (reserves, construction funds, etc.)
- ✖ Receives interest and principal payments from Issuer/Borrower and distributes to Bondholders
- ✖ Maintains the list of owners of the bonds
- ✖ Holds liens and security interests and exercises remedies, for bondholders, in the event of a default

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## NATIONAL TRUSTEE RANKINGS 2012



Firm	Volume (millions)
✖ 1. Bank of New York Mellon	\$76,313.4
✖ 2. U.S. Bank	59,395.1
✖ 3. Wells Fargo Bank	20,788.4
✖ 4. Manufactures & Traders Trust	5,450.5
✖ 5. Deutsche Bank	4,382.1
✖ 6. Regions Bank	3,755.1
✖ 7. Banco Popular de Puerto Rico	3,119.0
✖ 8. Union Bank	3,063.5
✖ 9. California State Treasurer	2,533.2
✖ 10. Huntington National Bank	2,072.5
✖ 11. Zions First National Bank	2,041.6

(Source: Thomson Reuters)

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## COUNSEL TO THE ISSUER



- ✖ May be internal (City Attorney, County DA) or outside or general counsel; not hired specifically for bond issue
- ✖ Reviews all legal documents on behalf of Issuer
- ✖ May assist in drafting an Offering Statement and additional disclosure documents, and may opine as to accuracy
- ✖ Issues the required local counsel's opinion

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## LOCAL COUNSEL'S OPINION



- ✖ No litigation is pending or threatened that would:
  - + Question the legality or validity of the bond issue;
  - + Question the right of elected officials to hold and act in their offices;
- ✖ The Issuer is a valid legal entity, duly created
- ✖ The debt has been duly authorized
- ✖ The bonds are valid, legal, and binding obligations of the Issuer
- ✖ The Preliminary and Final Official Statements do not contain untrue statements, are not misleading, and do not omit any information that would be material to an investor
- ✖ No additional approvals are required to issue the debt

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## UNDERWRITER'S COUNSEL



- ✗ Nationally recognized law firm representing the underwriters, with experience in debt financing
- ✗ Advises and opines on matters relating to the Offering Statement, including matters relating to disclosure under SEC regulations and other standards; may have the principal role in drafting Offering Statement
- ✗ Prepares underwriting documents – Blue Sky Survey, Legal Investment Memorandum, Agreement Among Underwriters, Selling Group Agreement, and the Bond Purchase Contract
- ✗ Responsible for participating in “due diligence” before the bond issue is offered to investors

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## RATING AGENCIES



- ✗ National organizations that provide rating on debt of public and private organizations
  - + Standard & Poor's Corporation
  - + Moody's Investor Service, Inc.
  - + Fitch Ratings
- ✗ Authoritative sources that assess a borrower's ability to repay
- ✗ Ratings have direct impact on cost of borrowing



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## CURRENT ISSUES

1. SEC Charges Against Issuers
2. Threat to Tax-Exemption
3. SEC's New Definition of Municipal Advisor
4. New MSRB Rules
5. Municipal Bankruptcy

## SEC CHARGES AGAINST ISSUERS

1. **State of New Jersey (2010)**  
Charged with securities fraud for failing to disclose that the state was underfunding its two largest pension plans.
2. **State of Illinois (2013)**  
Charged with securities fraud for misleading investors about the state's approach to funding its pension obligations.
3. **Miami City, Florida (2013)**  
Budget Director charged for making transfers from CIF to the General Fund to mask operating losses.
4. **West Clark Community Schools, Indiana (2013)**  
School District and underwriter were charged with making false claims about compliance with continuing disclosure obligations.

Source: SEC Press Releases dated: 8/18/10, 3/11/13, 7/19/13, and 7/29/13.



## THE THREAT TO TAX-EXEMPTION

- ✗ Most hostile threat since the 1986 Tax Act
- ✗ Factors include:
  - + Deficit reduction
  - + Tax reform (simplification)
  - + Progressive argument about fairness  
(Obama administration's proposed cap of 28%)

## FEDERAL DEFICIT REDUCTION

- ✗ \$2 Trillion Deficit Reduction
  - + Elimination of tax-exemption on municipal bonds helps fill 15% of a \$2 trillion deficit reduction goal.

Deduction	Projected value (2013-17) (MM)	% of \$2 Trillion Deficit Reduction Goal
Exclusion of employer contributions for medical ins.prem.and medical care	1,012,320	51%
Deductibility of mortgage interest on owner-occupied homes	606,420	30%
Net Exclusion of Contributions to 401(k) plans	428,760	21%
Accelerated depreciation of machinery and equipment (normal tax method)	374,640	19%
Exclusion of net imputed rental income	337,380	17%
Exclusion of capital gains (except agriculture, timber, iron ore, and coal)	321,470	16%
Exclusion of interest on state and local bonds	306,170	15%
Net exclusion of pension contributions and earnings for employer plans	298,040	15%
Deductibility of state and local taxes other than on owner occupied homes	295,050	15%
Deductibility of charitable contributions, other than education and health	238,720	12%
Deferral of income from controlled foreign corporations	216,020	11%
Step up basis of capital gains at death	182,210	9%
Capital gains exclusion on home sales	171,110	9%
Social Security benefits for retired workers	149,280	7%
Exclusion of interest on life insurance savings	140,630	7%

Source: Morgan Stanley, Office of Management and Budget estimates of February 2012

## THE THREAT TO TAX-EXEMPTION

- ✗ What would be the effect on local governments?
  - + Higher borrowing rates (about 1/3)
  - + Fewer public projects (not enough revenue)
  - + Tax increases to pay for new projects?

## SEC'S DEFINITION OF A MUNICIPAL ADVISOR

- ✗ New definition released on September 18<sup>th</sup>
- ✗ Anyone who provides advice on the issuance of municipal securities...is considered a municipal advisor and must permanently register with the SEC as such.
- ✗ Registration comes with the following duties:
  - + Periodic Testing
  - + Annual registration fees
  - + Continuing education
  - + Record Keeping
  - + Reporting

(Source: Chapman and Cutler Bulletin dated September 19, 2013)

## SEC'S DEFINITION OF A MUNICIPAL ADVISOR

### ✕ Those not required to register as FAs:

- + **Public Officials**  
(so long as they are acting in the scope of their official capacity)
- + **Public Employees**  
(so long as they are acting in the scope of their employment)
- + **Underwriters**  
(so long as their advice concerns a particular bond issue)
- + **Attorneys**  
(so long as they are only giving legal advice – not financial advice)
- + **Engineers**  
(so long as they are giving engineering advice which may include cash flow analysis and feasibility studies – not financing advice)
- + **Accountants**

(Source: Chapman and Cutler Bulletin dated September 19, 2013)

## MSRB RULES G-17 AND G-36



## G-17

- ✖ In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.
- ✖ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 expanded MSRB's jurisdiction to protect state and local governments.
- ✖ In light of this, the MSRB prioritized a reassessment of existing duties of underwriters to state and local governments.
- ✖ A new Interpretive Notice was effective August 2, 2012.

## G-17

- ✖ The Interpretive Notice does the following:
  - + Clarifies the relationship of an underwriter to its clients
  - + Creates affirmative obligations for underwriters
  - + Requires an underwriter to disclose important information to an issuer to help the issuer assess proposed financial transactions

## G-17

- ✗ The required disclosure from an underwriter must include (in part):
  - + A statement to the effect that, unlike municipal advisors, the underwriter does not have a fiduciary duty to issuers and is not required to act in the issuer's best interests without regard to its own financial or other interests;
  - + All actual or potential conflicts of interest;
  - + Its method of compensation;
  - + Risks of "complex transactions";

## G-17

- ✗ The required disclosure from an underwriter must be made:
  - + In writing;
  - + In a manner that makes the subject and implications clear to the issuer;
  - + To an official with appropriate authority to bind issuer by contract.
- ✗ The Underwriter must request written acknowledgment of receipt of disclosures from issuer and document any failure to receive such acknowledgement.

## G-36

- ✖ With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the MSRB was expressly directed by Congress to protect municipal entities.
- ✖ Accordingly, on August 23, 2011, the MSRB proposed a rewrite of Rule G-36 and an interpretive notice thereunder to address the fiduciary duty of municipal advisors (FAs) to municipal entity clients.
- ✖ The proposed rule has been withdrawn waiting for the SEC to issue a definition of who is a Municipal Advisor (FA).

## G-36

- ✖ The initial definition was overly broad and would have included any individual who provided advise concerning the terms, timing, or structure of a municipal debt issue. This may have included Council Members and other public service officers.
- ✖ The proposed rule also outlined a “Duty of Loyalty” and a “Duty of Care” for Financial Advisors in their relationships with Municipal issuers.
- ✖ The proposed rule also included a requirement for Financial Advisors to disclose any conflicts surrounding the method of compensation included in any FA contract.



## GFOA RECOMMENDED PRACTICES

- ✦ “The relationship between issuer and financial advisor is one of ‘trust and confidence’ which is in the ‘nature of a fiduciary relationship’. This is in contrast to the relationship between the issuer and underwriter where the relationship is one of some common purposes but also some competing objectives, especially at the time of bond pricing.”

GFOA Debt Committee Draft “Best Practices” Document Dated June 9, 2007

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## MUNICIPAL BANKRUPTCY

## STOCKTON, CA



- ✖ In June, 2012, Stockton, California was given legal authorization by a court to go through bankruptcy proceedings

## DETROIT, MI



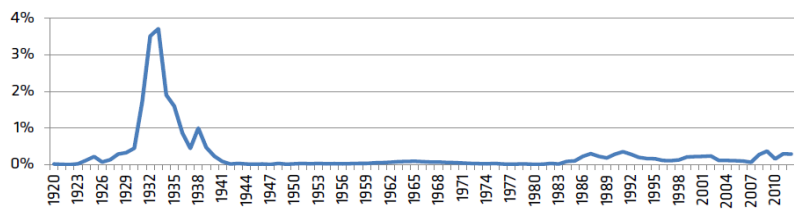
- ✖ In July, 2013, Detroit, Michigan filed the largest municipal bankruptcy in U.S. history.

## CHAPTER 9 MUNI BANKRUPTCY

- ✕ Vallejo, CA
- ✕ Stockton, CA
- ✕ Jefferson County, AL
- ✕ San Bernadino, CA
- ✕ Harrisburg, PA
- ✕ Detroit, MI

Source: Kroll BondRatings Report dated September 23, 2013

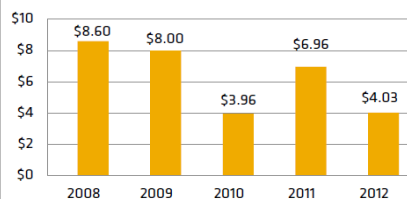
US Municipal Bond Default Rate: Count of Issuers



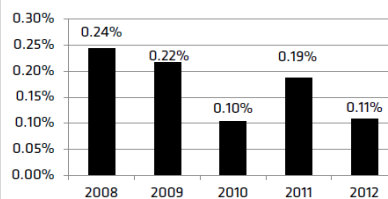
Data Source: KBRA, Income Securities Advisors, SIFMA

The charts below show the absolute par amount of defaulted debt and the par default rate for in each year from 2008 through 2012.

Defaulted Par Amount 2008-2012 in Billions



Municipal Bond Default Rates 2008-2012



Data Source: Income Securities Advisors



## MUNICIPAL BANKRUPTCY

- ✗ Is a **decision** that reflects an issuer's willingness to repay its debt;
- ✗ Results from poor planning, management, or the lack of political will;
- ✗ Increase in filings reflects a change in attitude toward repayment of debt;
- ✗ Has challenged the existing wisdom regarding risk in municipal bonds;
- ✗ Suffers from a lack of case law.

Source: Kroll BondRatings Report dated September 23, 2013

## MUNICIPAL BANKRUPTCY

- ✗ Ability to file Chapter 9 varies from state to state (Utah law doesn't allow it);
- ✗ A municipality can't be forced into bankruptcy by its creditors;
- ✗ A municipality can't be liquidated to satisfy debt obligations;
- ✗ Once in bankruptcy, a municipality may be able to restructure or reject contracts under state law (collective bargaining agreements, pension obligations, retiree benefits, etc.).

Source: Kroll BondRatings Report dated September 23, 2013

## MUNICIPAL BANKRUPTCY – KEY ISSUES

- ✗ Will federal bankruptcy or state municipal law determine the priority of payments;
- ✗ How will general obligation bonds be treated relative to other obligations (secured vs unsecured - Detroit);
- ✗ What does “full faith and credit” mean;
- ✗ Will there be a distinction between a limited tax G.O. pledge and an unlimited G.O. pledge.

Source: Kroll BondRatings Report dated September 23, 2013