

McGUIREWOODS

The Role of Bond Counsel in Virginia Local Government Financings

T.W. Bruno - McGuireWoods LLP

Prepared for the VGFOA / SPIA
Regional Supplemental Education Program
Debt Management Workshop
June 15, 2017
Richmond, Virginia

McGUIREWOODS

Please note that this presentation is factual in nature and is not legal advice.

Please consult with your attorney regarding any specific questions.

What is a Bond Counsel?

Why do we need one?

- Background
 - In the late 19th century many localities issued bonds (mostly railroad related) and defaulted
 - The defaulted bonds were found to be illegally issued and unenforceable
 - Localities could not honor the debt even they wanted to
- Bond counsel is an “independent” lawyer that provides an opinion regarding the validity (and tax status of interest) of the bonds
- Market-driven requirement

Evolution of the Role

- Institution of federal income tax and subsequent changes to tax law (e.g., 1986 tax reform)
- Bond counsel now provide advice on a range of matters:
 - Continuing tax compliance
 - Economic incentives
 - Security structures
 - Disclosure (primary and secondary)
 - Securities law compliance
 - Disclosure Policies and Procedures

Who does Bond Counsel represent?

- Historically, bond counsel was “counsel to the transaction”
- Typically, bond counsel represent the issuer (the locality) and in some cases this would include the economic development authority

Best Practices

- Find a Way of Interacting with Bond Counsel that Works for You
- You are the Guru of Local Knowledge – No One Knows Your Issuer Better than You
- What is the Typical Procedure for Public Notices/Public Hearings?
- What Existing Documents May Have an Impact on the New Debt?
- Have Local Officials Taken Their Oaths of Office? Filed Their Financial Disclosure Forms?
- Any Other Recent or Future Debt to Count Against Bank-Qualified Status? Leases for School Buses or First-Responder Vehicles?
- Read all of the Documents
- If you don't Understand Something, Ask
- No Right or Wrong Way to Organize Documents or Breakdown the Requirements

Virginia Constitutional Limitations

- Article VII, Section 10
- For Towns and Cities, a Limit of 10% of the Assessed Valuation of Real Property
 - Exceptions for Revenue Bonds and Short-Term Notes
- **Look for:** Certifications Regarding Outstanding Principal Amount of Bonds + New Bonds and Latest Assessment for Taxation
- For Counties, no Bonds Unless Approved by the Voters in a Referendum
 - Exceptions for Revenue Bonds, Short-Term Notes, Refunding Bonds and School Bonds sold to the Literary Fund, VPSA or VRS (County's that elect to be treated as a City)
- **Look for:** Compliance with an Exception or Information Regarding the Referendum
- Article VII, Section 7
- Ordinance or Resolution Appropriating or Borrowing Money Requires a Recorded Yes Vote by a Majority of the Governing Body – Role Call Vote
- Look for: Certifications Regarding such Votes

Public Finance Act 15.2-2600, et seq.

- Usually Governs the Issuance of Debt by Localities
- May Use Charter Provisions, Instead
- Public Notice Once a Week for Two Successive Weeks Prior to a Public Hearing
- Public Hearing not Necessary for Bonds Approved at Referendum, Short-Term Notes or Refunding Bonds
- Authorize Certain Officers to Sign and Seal Bonds
- Should Authorize More than One Person to do so
- Authorize Certain Officers to Determine the Final Terms of the Bonds Within Stated Parameters
- **Look for:** Certifications Regarding Public Hearing, Status of Officers, Final Terms are Within Parameters
- Statute of Repose – 30 days between filing of resolution to sale date

Virginia Water and Waste Authorities Act 15.2-5100, et seq.

- Governs the Issuance of Debt by Public Service Authorities and Community Development Authorities
- Provisions for the Creation of the Authority
- Provisions for the Membership of the Authority
- Provisions for the Authorization of the Debt and the Revenues to be Pledged to the Debt
- For CDAs, Provisions for Special Assessments, Special Taxes and Other Revenues
- **Look for:** Certifications Regarding the Creation of the Authority, the Status of the Members and Officers, the Projects to be Financed and the Revenues to be Pledged
- For CDAs, Look for: Detailed Information Regarding Revenues

Industrial Development and Revenue Bond Act 15.2-4900, et seq.

- Governs the Issuance of Debt by Industrial Development Authorities/Economic Development Authorities
 - includes Lease Revenue Bonds
- Provisions for the Creation of the Authority
- Provisions for the Appointment of Members
- Oaths Upon Appointment or Reappointment
- Local Residents
- Provisions for Projects to be Financed and Revenues to be Pledged
- Provisions Regarding Public Notice/Public Hearing/Public Approval Process for Private Activity Bonds (“TEFRA”)
- **Look for:** Certifications Regarding Authority, Bylaws (if any), Status of Members, TEFRA Requirements, Projects and Revenues

Background: Securities Laws and Requirements applicable to Municipal Bonds

- Under the “Tower Amendment” municipal bonds are generally exempt from the requirements of the securities laws except for the “anti-fraud” provisions:
 - Section 17(a) of the 1933 Act
 - Section 10(b)(5) of the 1934 Act
 - Both require full and fair disclosure to the market
- Most commonly felt in the primary market
(i.e., the Official Statement)
- Also applies ***to any public statement that could reasonably be foreseen to reach investors***
(press release, CAFR, newspaper quote, etc.)

Securities Law Violations – Standards of Proof

- Under Section 17(a)(2) and (a)(3) of the 1933 Act, the SEC must show **negligence**
 - Most of the recent SEC actions in the municipal securities market have charged violations of Section 17(a)(2)
- Under Section 17(a)(1) of the 1933 Act and Rule 10b-5, the SEC must show **intentional** conduct or **recklessness**

Background: Materiality / Recklessness

- A fact is “**material**” if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision.
- “**Recklessness**” is an extreme departure from the standards of ordinary care that presents a danger of misleading buyers or sellers that is so obvious that the actor must have been aware of it.

Recent SEC Enforcement Actions

- March 2013 – State of Illinois (Pension Disclosure)
- May 2013 – City of Harrisburg (Fraudulent Statements in the City’s annual report / budget documents)
- November 2013 – Greater Wenatchee Regional Events Center (Financial Projection Disclosure / Feasibility Studies)
- June 2014 – City of Harvey (IL) (Conflicts of Interest / Misuse of Bond Proceeds; Mayor and Controller)
- November 2014 – Allen Park (MI) (Public Statements Bond-Financed Projects; Mayor and Administrator)
- April 2016 – Ramapo (NY) (Financial Misstatements – 4 officials)
- September 2016 – City of Miami (Financial Misstatements – Budget Director)

Harrisonburg

- In 2011, Harrisburg declared bankruptcy, following years of financial decline
- Prior to the bankruptcy, no CAFRs since 2007
- Did post on City website: (1) budgets, (2) “State of the City” address, and (3) 2009 mid-year report
- Budgets indicated that City was AAA rated (but was actually rated Baa1)
- “State of the City” failed to accurately reflect City’s obligations under a guarantee (\$260 million contingent liability)
- Mid-Year Report did not mention any guarantee payments (totaled \$2.3 million; 7% of General Fund Expenditures)

Allen Park

- City sold \$31 million of general obligation bonds to finance a movie studio project
- Disclosure documents discussed “movie studio” and repayment stream (lease payments)
- When bonds were issued, bonds were actually going to be used to finance vocational school
- Disclosure documents used outdated budget documents (omitted \$2 million budget deficit)
- Mayor and Administrator personally charged under “control person” liability both settled with SEC
- Disclosure Policies were a condition of settlement

Ramapo

- 1st Criminal Charges (and conviction) in Muni Bond case
- Town issued three series of bonds to finance a baseball stadium through its “Development Authority”
- Town guaranteeing payment on the bonds (Voters rejected this previously by a 70%-30% vote)
- Officials inflated fund balances and masked operating revenue shortfall related to a receivable from the Development Authority
- Town Supervisor (think Manager/Administrator): inflated general fund balance, misled auditors about nature of receivable, certified as to accuracy of disclosure documents
- Development Authority Executive Director: certified as to accuracy of disclosure documents that contained the Town’s financial statements and statements about operating revenue to make existing bond payments
- **There is no allegation or finding of “improper benefit” or “self-dealing”**

Miami, FL

- City was previously subject to SEC cease-and-desist order
 - false statements in offering documents and CAFRs
- Jury trial against Budget Director and the City
- Budget Director made transfers from CIP Fund to General Fund to mask General Fund deficits
- Budget Director and City asserted a defense of reliance on auditors – jury rejected that defense
 - Factors to rely on experts:
 - Complete disclosure of the facts
 - Seek advice about the specific course of action
 - Receive advice
 - Rely on advice and follow it in good faith

Responsibilities

- Do you know facts that are material?
- If so, you must either read the offering documents or make sure that the appropriate individuals are advised of the facts
- Exercise reasonable diligence to ensure that any material facts of which the individual is aware are either:
 - Read disclosure documents
 - Reviewed with appropriate individuals/advisors
- May not authorize disclosure documents known to be false or recklessly disregard facts

What Should You Be Doing?

- Become familiar with disclosure documents
- Question staff / appropriate advisors
- Disclosure Policies – Positive Factor in Remediating
 - Clear statement of the process
 - How to document the process
 - Process for adequate supervision / disbursement of responsibilities
- Avoid “Silo Effect” and Remove Political Considerations

McGUIREWOODS