

The Role of Authority Boards of Directors and Individual Board Members and Bond Best Practices

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What We Will Cover

- I. Introduction & Overview: Authority and Bond Transaction Basics
- II. Authority Board Duties, Liabilities and Protections
- III. Bond Best Practices

I. Introduction & Overview: Authority and Bond Transaction Basics

I. An Overview: Authority and Bond Transaction Basics

What is an Authority?

- Governmental entity created by state statute, often referred to as a “conduit issuer”
- May issue **tax-exempt** bonds and loan proceeds to a “**conduit borrower**”
 - If a bond is “tax exempt,” the interest is excludable from the gross income of the bondholder for federal income tax purposes
 - Tax-exempt interest rates = lower borrowing cost for conduit borrowers
 - Under federal tax law, tax-exempt bonds must be issued by a “state or local government”
 - Conduit borrowers include 501(c)(3) entities and for-profit entities involved in certain public benefit projects
- Otherwise provides borrowers with access to municipal bond markets

I. An Overview: Authority and Bond Transaction Basics

Who are the stakeholders?

Conduit Borrower	Bondholders	Authority	Public	Legislature
<ul style="list-style-type: none"> Authority is available to assist in the financing of projects 	<ul style="list-style-type: none"> Bonds are legal and enforceable 	<ul style="list-style-type: none"> Project benefits the Public 	<ul style="list-style-type: none"> Authority is available to assist in the financing of projects 	<ul style="list-style-type: none"> Authority is operating in compliance with the law
<ul style="list-style-type: none"> Authority offers support and help in the financing process 	<ul style="list-style-type: none"> Project is feasible 	<ul style="list-style-type: none"> Project does not obligate the Authority 	<ul style="list-style-type: none"> Public benefit is “lower interest cost” Projects must otherwise benefit the citizens at large 	<ul style="list-style-type: none"> Authority provides the benefits for which it was created
<ul style="list-style-type: none"> Financing documents are appropriate and reasonable 	<ul style="list-style-type: none"> Bond documents are appropriate 	<ul style="list-style-type: none"> Bonds are legal and enforceable 	<ul style="list-style-type: none"> The State (public) may be an obligor on the Bonds 	
		<ul style="list-style-type: none"> Financing legal documents are appropriate 		
		<ul style="list-style-type: none"> Bondholders have reasonable protection 		

I. An Overview: Authority and Bond Transaction Basics

Who are the stakeholders?

Conduit Borrower	Bondholders	Authority	Public	Legislature
<ul style="list-style-type: none"> Financing process is “known” and efficient 	<ul style="list-style-type: none"> Trustee is competent & experienced 	<ul style="list-style-type: none"> All parties have full disclosure 	<ul style="list-style-type: none"> Authority process is time and cost efficient 	
<ul style="list-style-type: none"> Low interest rates / lower costs 	<ul style="list-style-type: none"> Reasonable security / protection 	<ul style="list-style-type: none"> Financing process is efficient & predictable 		
	<ul style="list-style-type: none"> Fair (high) interest rates 	<ul style="list-style-type: none"> Consultants are competent 		
		<ul style="list-style-type: none"> Fair (low) interest rates 		
		<ul style="list-style-type: none"> Borrower knowledgeable of financing options 		

I. An Overview: Authority and Bond Transaction Basics

Basic Role of the Board and its Members

- **Statute** spells out number of Board members, how appointed, length of terms, etc.
- **Big picture:** guardians of the organization; advance organization's purpose (mission) and strategic direction; provide sound governance and oversight; balance stakeholder interests
- **On the ground:** adopt strategic plan & budget; review/approve Board policies; monitor activities and performance (Executive Director/management, organization, Board); provide appropriate approvals (*e.g.*, financing transactions, budget); Board members may work with staff/management on discrete projects or special assignments (*e.g.*, budget preparation, participation in audits) and/or serve on committees
- Board's role is **different than Management's role**

I. An Overview: Authority and Bond Transaction Basics

Basic Role of the Board and its Members

- **Board has fiduciary duties:** duty of care, duty of loyalty, duty of obedience/commitment
- **Board members may have liability:** based on statute, contract and/or tort
 - State ethics laws may apply
- **Board members also have protections:** by statute, indemnifications (by Authority, state and/or conduit borrowers), insurance, common law protections

I. An Overview: Authority and Bond Transaction Basics

Overview of Applicable Federal and State Laws

Federal		State
Tax	Securities	
<p>Borrower qualifications: a 501(c)(3) organization (for qualified 501(c)(3) bonds under IRC Section 145)</p> <p>Project qualifications: certain projects prohibited (airplanes, skyboxes, liquor stores, etc), economic life requirements</p>	<p>Anti-fraud provisions of federal securities laws: Section 17(a) of Securities Act of 1933, Section 10 of Securities Exchange Act of 1934/Rule 10b-5</p>	<p>Establishes Authority and its board</p>
<p>Eligible uses of bond proceeds: capital expenditures; refinancings; limits on amount of COI and working capital; rules for reimbursements and reserves</p>	<p>SEC Rule 15c2-12</p>	<p>Eligibility of borrowers and projects</p>
<p>Arbitrage & rebate requirements</p>	<p>Registration</p>	<p>Bond parameters (e.g., max term)</p>
<p>Procedural requirements (TEFRA, file 8038)</p>		<p>Application and approval process</p>
<p>Ongoing restrictions on ownership and use of financed projects</p> <p>“Private use” prohibitions</p> <p>“Use” may arise in various ways, including management contracts, service contracts, joint ventures, leases, research contracts, other</p>		<p>May contain other requirements (e.g., compliance with prevailing wage) or limits (amount of bonds issued in a given time (e.g. each biennium) or limits on use of proceeds (e.g., working capital)</p>

I. An Overview: Authority and Bond Transaction Basics

Basic Bond Transaction Process

① Application

② Approvals, notices and hearings:

Authority Board approval

Borrower approval

TEFRA notice and public hearing

State law mandated notices and hearings

Further approvals by elected

official, body of elected officials

③ Due diligence

④ Documentation

⑤ Marketing

⑥ Closing

⑦ Post-issuance compliance

I. An Overview: Authority and Bond Transaction Basics

Basic Bond Transaction Structures

- Public offerings
- Direct purchase/private placement
- Some Authorities have specialized direct purchase or other bond programs, particularly for small borrowers – e.g., “Quick Loans”

I. An Overview: Authority and Bond Transaction Basics

Basic Bond Transaction Participants

- Conduit issuer
- Conduit borrower
- Trustee/fiscal agent [may have counsel]
- Bond purchaser(s)
- Bond counsel
- Issuer's counsel [sometimes]
- Borrower's counsel
- Underwriter's/lender's counsel
- Financial advisors
- Rating agencies

II. Authority Board Duties, Liabilities and Protections

II. Authority Board Duties, Liabilities and Protections

Board Responsibilities

- Duty of Care
 - The duty to act with reasonable care and in good faith and best interest of the Authority
 - Board members may rely on reports and staff and outside experts
- Duty of Loyalty
 - Must act in a way not to harm the Authority or for your own personal benefit
- Duty of Obedience
 - Ensure the Authority is abiding by all applicable laws and regulations and doesn't engage in illegal or unauthorized activities
 - Ensure the Authority faithfully fulfills its legislative purpose

II. Authority Board Duties, Liabilities and Protections

- Ethical Standards of Conduct

- Board members are likely to be subject to the applicable State Code of Ethics as “public employees”
- State ethical codes vary in specifics, but the following are generally applicable:
 - Board member can’t disclose or use confidential information from the Board activities to further member’s own economic interest, accept substantial gifts to influence decisions, or accept a gift given primarily for the purpose of rewarding the Board member for official action.
 - Board member can’t personally acquire interest in business that may be affected by decisions on the Authority
 - Board member must disclose any potential conflict of interest and abstain from both discussion and voting if a conflict of interest arises

II. Authority Board Duties, Liabilities and Protections

- Board Roles: Generally speaking, Boards and management have different roles
 - Board hires and monitors Executive Director (position title may vary) and sets policies
 - Executive Director manages the Board programs and hires, directs and monitors staff
 - Executive Director gets into the weeds
 - Board gives general vision - establishes and approves strategic direction, approves budget, assures reserves and liquidity, directs and evaluates Executive Director, and prevents and manages crisis

II. Authority Board Duties, Liabilities and Protections

- Board Roles (cont.):
 - Protect the Authority from liability arising under contract and tort law
 - Directors have obligations for ensuring that the Authority's contractual obligations are fulfilled:
 - Employees
 - Consultants & independent contractors
 - Borrowers / Obligors
 - Bondholders
 - Directors have obligations for ensuring that the Authority does not incur tort liability
 - A "tort" is a civil wrong, other than breach of contract, for which a remedy may be obtained
 - Many states will limit tort liability for government agencies under the "Public Duty Doctrine"

II. Authority Board Duties, Liabilities and Protections

- Public Employee Immunity

- The details of the immunity vary by state law, but generally, board members are immune for actions taken in their “*official capacity*”
- Exceptions typically arise where violation of ethical norms gives rise to criminal or civil liability— **“actual fraud, actual malice, or corruption”**
 - Examples include accepting bribes, acting to intentionally inflict financial harm on a competitor, insider trading, etc.
 - When in doubt, consult the Board’s legal counsel
 - Remember: Disclose all potential conflicts and when in doubt recuse

II. Authority Board Duties, Liabilities and Protections

- Common Law Protection

- Business Judgment Rule

- Even unwise or unsuccessful decisions are OK from a personal liability standpoint if director acts in an informed, good faith manner, without corrupt motive
- This is a “process” standard of performance not an “outcomes” standard.

III. Bond Best Practices

III. Bond Best Practices

1 Application

Borrowers should submit written application to the Authority that includes:

- Detailed description of project being financed or refinanced, including address/location, intended owner and intended use of project
- Estimated amount of borrowing
- Timing requirements for funding
- Additional information to help determine eligibility under state law

Authority staff makes preliminary determinations regarding eligibility of borrower and project under state law

Authority staff tracks volume cap and state ceiling limitations amount of bonds (if applicable)

Reimbursement Resolution

- Adopt early if borrower intends to reimburse itself with bond proceeds for out-of-pocket expenses paid prior to closing of bond sale

III. Bond Best Practices

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Approvals, Notices and Hearings

- **Authority Approval**

- Typically set parameters (i.e. not to exceed limitations) on principal amount of bonds, outside maturity date, and interest rates, limitations on use of proceeds for approved projects
- Authorize staff to negotiate and execute financing agreements with Borrower
- Make statutory findings establishing eligibility of borrower and project

- **Borrower Approval**

- Borrower approves the financing and financing agreements
- Some borrowers meet infrequently; early attention to schedules may be important

III. Bond Best Practices

2 Approvals, Notices and Hearings (cont.)

- **TEFRA notice and public hearing**
 - Maximum principal amount of the bonds, which may also require relative principal amounts anticipated to be spent on separate projects
 - Legal name of the initial owner and principal user of project
 - Location(s) of project
- **State law-mandated notices and hearings**
- **Further approval** by elected official or body comprised of elected officials
 - Can require significant lead time

III. Bond Best Practices

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Due Diligence

- Some standardization exists around due diligence process but each bond financing has also its own due diligence considerations
 - Time intensive process; commence early
 - Specialized programs (e.g. “Quick Loans”): may be able to develop starting forms of due diligence questionnaires
- Due diligence categories:
 - Tax matters, including whether borrower and project qualify for tax-exempt financing
 - Business operations, regulatory considerations, litigation, revenues sources for repayment of bonds, etc.
 - Covenant compliance (including restrictions under existing debt agreements as to whether additional debt can be incurred)
 - State law compliance
- Due diligence performed by bond counsel, underwriter counsel (in public offering context) and investor counsel (in private placement context)

III. Bond Best Practices

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Documentation

- Financing and security agreements and offering documentation depend on type of financing
 - Public or private
 - Taxable or tax-exempt
 - Secured or unsecured
 - Guarantors
 - Coordination with existing financing documentation and consider future financings
- Preliminary Official Statement/Official Statement
- Bond Purchase Agreement
- Continuing Disclosure Agreement
- Helpful to have standardized documents and/or provisions (e.g., indemnification provisions)

III. Bond Best Practices

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Documentation (cont.)

- Tax matters
 - Borrower generally assumes most or all of the ongoing responsibilities and risk/liability of tax-exemption, including:
 - use of proceeds
 - use of (re)financed project
 - arbitrage/rebate monitoring, calculations and payment (for smaller issuer programs (e.g., “Quick Loans”), consider hiring rebate consultant rather than requiring borrower to do so)
 - Authority assumes limited responsibility, most of which happens pre-issuance (making elections, filing 8038, TEFRA)
 - Authority is considered “taxpayer” in case of audit
 - Responsibilities to be clearly allocated in tax agreement and other transaction/closing documentation

III. Bond Best Practices

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Marketing

- RFP for selecting underwriter or financial institution/bank purchaser
- Rating agency presentation
- Preliminary Official Statement/Official Statement
 - for marketing to investors in a public offering
- Investor presentation
- One on one investor meetings

III. Bond Best Practices

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Closing

- Financing agreements executed and bonds issued
- Requires early and detailed coordination among:
 - Conduit issuer
 - Conduit borrower
 - Trustee/fiscal agent [may have counsel]
 - Bond purchaser(s)
 - Bond counsel
 - Issuer's counsel [sometimes]
 - Borrower's counsel
 - Underwriter's/lender's counsel
 - Financial advisors

III. Bond Best Practices

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Post-Issuance Compliance

- Authority should have a post-issuance compliance policy
- Authority should require that borrowers adopt a post-issuance compliance policy prior to closing
 - Develop a form of post-issuance compliance policy for borrowers

III. Bond Best Practices

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Post-Issuance Compliance (cont.)

Written post-issuance compliance policy should cover:

- Use of bond proceeds
 - Establish system to monitor expenditure of proceeds
- Use of bond-financed property: establish system to monitor use of financed projects
 - Conduct periodic review of private business use
 - Ensure management contracts are reviewed by bond counsel prior to executing
- Investment of bond proceeds
 - Establish system to monitor investment of proceeds and schedule periodic review and rebate calculations
 - Involve bond counsel before bidding investment contracts or executing swaps
- Rebate & yield restriction compliance
- Record retention
- Identification of officer/employee(s) responsible for compliance

III. Bond Best Practices

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Post-Issuance Compliance (cont.)

- Understand post-closing obligations of parties, which may include:
 - Delivery of audited annual financial reports
 - Annual certificates regarding reserves and maintenance of minimum balances
 - Annual certificates regarding insurance coverage
 - Annual certificates regarding no defaults and compliance with all covenants
 - Restrictions regarding issuance new debt and granting of liens/security interests on assets
 - Restrictions on selling assets
 - Coverage ratio requirements (revenue to debt)

III. Bond Best Practices

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Post-Issuance Compliance (cont.)

- Understand post-closing obligations of parties, which may include:
 - Continuing Disclosure Agreement disclosure covenants
 - SEC Rule 15c2-12 (the “Rule”) disclosure obligations
 - Two relatively new disclosure requirements under the Rule:
 - Incurrence of a financial obligation, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation, any of which affect security holders, if material
 - Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation, any of which reflect financial difficulties

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