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Bond Disclosures in Today's New COVID-19 Environment

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Introduction

- Firm History
- Public Finance Practice

Legal Framework

- Municipal Bonds are generally exempt from registration with the Securities and Exchange Commission
- SEC Anti-fraud provisions are applicable
 - Section 17(a), Securities Act of 1933
 - Rule 10b-5, promulgated pursuant to Section 10, Securities Exchange Act of 1934
- Anti-fraud provisions in a nutshell:
 - No fraud/deceit
 - No untrue statements of a material fact or an omission of a material fact
- Rule 15c2-12

Rule 15c2-12

- Requires bond underwriters to enter into a contract with issuer of bonds to ensure:
 - Production of offering document; and
 - Continuing disclosure.

Offering Document

- Comparable to a Prospectus
- Preliminary Official Statement
- Official Statement
- Reoffering Memorandum

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The cover page hereof, this page, the Schedule, and the appendices included herein and any addenda, supplement or amendment hereto, are part of the Official Statement.

Continuing Disclosure

- Annual Reports
- Event Notices

Annual Reports

The District shall file annually with the MSRB (1) within six months after the end of each fiscal year ending in or after 2021, financial information and operating data with respect to the District of the general type included in the final Official Statement authorized by Section 19 of this Order, being the information described in Exhibit "B" hereto, and (2) if not provided as part of such financial information and operating data, audited financial statements of the District, when and if available. Any financial statements so to be provided shall be (i) prepared in accordance with the accounting principles described in Exhibit "B" hereto, or such other accounting principles as the District may be required to employ from time to time pursuant to state law or regulation, and (ii) audited, if the District commissions an audit of such statements and the audit is completed within the period during which they must be provided. If the audit of such financial statements is not complete within such period, then the District shall provide unaudited financial statements within such period and audited for the applicable fiscal year to the MSRB, when and if the audit report on such statements becomes available. Under current Texas law, including, but not limited to, Chapter 44, as amended, Texas Education Code, the District must keep its fiscal records in accordance with generally accepted accounting principles, must have its financial accounts and records audited by a certified or permitted public accountant and must file each audit report with the Texas Education Agency within 150 days after the close of the District's fiscal year. Copies of each audit report must also be filed in the office of the District and with the Secretary, Board of Trustees. The District's fiscal records and audit reports are available for public inspection during the regular business hours of the Superintendent of Schools. Additionally, upon the filing of these financial statements and the annual audit, these documents are subject to the Texas Public Information Act, as amended, Texas Government Code, Chapter 552. Thereafter, any person may obtain copies of these documents upon submission of a written request to the Superintendent of Schools at Texas Independent School District, 123 Main Street, ABC, Texas, and upon paying the reasonable copying, handling, and delivery charges for providing this information.

If the District changes its fiscal year, it will file notice of such change (and of the date of the new fiscal year end) with the MSRB prior to the next date by which the District otherwise would be required to provide financial information and operating data pursuant to this Section.

Event Notices

The District shall provide notice of any of the following events with respect to the Bonds to the MSRB in a timely manner and not more than 10 business days after occurrence of the event:

1. Principal and interest payment delinquencies;
2. Non payment related defaults, if material;
3. Unscheduled draws on debt service reserves reflecting financial difficulties;
4. Unscheduled draws on credit enhancements reflecting financial difficulties;
5. Substitution of credit or liquidity providers, or their failure to perform;
6. Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax-exempt status of the Bonds, or other material events affecting the tax status of the Bonds;
7. Modifications to rights of holders of the Bonds, if material;
8. Bond calls, if material, and tender offers;
9. Defeasances;
10. Release, substitution, or sale of property securing repayment of the Bonds, if material;
11. Rating changes;
12. Bankruptcy, insolvency, receivership, or similar event of the District, which shall occur as described below;
13. The consummation of a merger, consolidation, or acquisition involving the District or the sale of all or substantially all of its assets, other than in the ordinary course of business, the entry into of a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;
14. Appointment of a successor or additional trustee or the change of name of a trustee, if material;
15. Incurrence of a financial obligation of the District, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the Board, any of which affect security holders, if material; and
16. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the District, any of which reflect financial difficulties.

Rule 15c2-12 Amendments

- Effective February 27, 2019
- Adds two new event notices:
 1. Incurrence of a financial obligation of the Board, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the Board, any of which affect security holders, if material; and
 2. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the Board, any of which reflect financial difficulties.
- “Financial Obligations” include private placements, bank loans, capital leases, and other financed purchases.
- For larger entities, will likely require a multi-department education effort and advanced planning.
- Pandemic Assistance could trigger an event filing.
- Private Placement maintenance tax notes, leases, Public Property Finance Act Contracts, and other obligations may trigger an event filing.
 - Also be mindful of any QTEO designations of such obligations and how they may impact your bonds.

MSRB's EMMA System

- Municipal Securities Rulemaking Board (MSRB)
- Established by Congress in 1975 to protect municipal securities investors, municipal entities and the public interest
- Self-regulatory organization that regulates the activities of the broker-dealers that buy, sell and underwrite municipal bonds
- in 2010 Congress expanded MSRB's authority to regulate municipal advisors
- Not authorized to regulate municipal issuers
- Maintains the Electronic Municipal Market Access (EMMA) website which is the official source of municipal securities data and disclosure documents
- EMMA has a mechanism for voluntary disclosures

SEC Public Statement

- On May 4, 2020, SEC former Chairman Jay Clayton and Director Rebecca Olsen of the Office of Municipal Securities issued a Public Statement to encourage municipal bond issuers to provide additional voluntary disclosures regarding the impact of COVID-19 on operations and financial condition.
- Intended to parallel the Corporate Issuer Statement
- Acknowledges differences between corporate capital markets and municipal securities markets, they believe importance of high quality disclosure, particularly in times of uncertainty, is consistent.
- Municipal securities market is dominated by retail investors who hold (directly or indirectly) over 72 percent of the securities.
- Underlies need for quality and up-to-date disclosure.

Market Reaction

- Usually when the SEC “urges” or “recommends” action, action is taken.
- Haven’t seen universal adoption of recommendation.
- Voluntary disclosures have been primarily from “riskier credits”
- Have seen filings from retirement home credits, hospitals, airports, student housing, and hotels.
- Texas ISDs are distinguishable from the above credits in that general obligation bonds are backed by an unlimited tax pledge and most are PSF guaranteed.

What Disclosures are being made by Texas ISDs

- Seeing near universal disclosure in offering documents of Texas ISDs
- TEA has amended its PSF disclosure language to state:
 - COVID-19 likely to adversely impact State economic activity and, accordingly, materially adversely impact financial condition and performance of the State.
 - PSF investments have seen volatility attributed to COVID-19 but are diversified and largely will reflect the general performance returns of the markets in which they are invested.
 - 2020 bond payments were largely unaffected because of mostly fixed rate bonds with semi-annual payments from an unlimited ad valorem tax pledge in which taxes are collected at beginning of calendar year.
 - TEA has implemented “hold-harmless” funding for school districts.

What Disclosures are being made by Texas ISD

Districts have provided statements addressing:

- General background of Governor's disaster declaration and associated rule making power through proclamations and executive orders.
- TEA updates regarding their guidance for school district operations and decisions on attendance based funding.
- Generally that the affect of COVID-19 and impact on bond payments still cannot be quantified at this time.
- State funding of District operations and maintenance in future fiscal years could be adversely impacted by the negative effects on economic growth and financial markets resulting from the Pandemic as well as ongoing disruptions in the global oil markets.

Due Diligence Questions Specific to COVID-19

- How did COVID-19 affect budget performance for FYE 2020?
- How has District budgeted in light of COVID-19 impact?
- How has COVID-19 affected enrollment? Funding concerns?
- How has COVID-19 affected the operation of the District?
- What is/will be the District's instruction model in light of COVID?

Liability

- Anti-fraud violation could lead to:
 - Investor action for damages for reckless or intentional action; or
 - SEC enforcement action for negligent, reckless or intentional action.
 - Fines, penalties, injunctions, criminal liability.
- Liability covers all statements connected to the purchase and sale of securities including statements “reasonably expected to reach investors.”
- Liability reaches to not just the governmental entity but also to officials and staff of such entity.

Uptick in SEC Enforcement Activity

- 2010 reorganization of Enforcement Division to specifically include public finance unit
- MCDC initiative
- Public Statement says will not punish good faith attempts at voluntary COVID-19 related disclosures

Consider Adopting a Disclosure Policy

- Reduces the chance of any material misstatements or omissions or violations of Rule 15c2-12
- Establishes a defense of reasonable care against misstatements or omissions that may still occur
 - If a policy is adopted and then ignored could be used to document failure to exercise reasonable care
- Policy needs to be reasonable but also in line with the District's particular needs and capabilities
- SEC has referenced disclosure policies in practically every enforcement action against an issuer
 - Has cited poor or no policy as cause of violation;
 - Has imposed adoption of policy as a settlement term; and
 - Has cited post-violation adoption of policies as factors in reducing punishment.

Approach for Drafting a Disclosure Policy

- STEP 1: Determine Existing Process
 - The closer the policy is to existing practice the more likely it will be followed
- STEP 2: Determine What Enhancements Need to be Made
 - Are all individuals or departments who possess relevant information involved?
 - Are individuals with knowledge of District wide issues/trends involved?
 - Are individuals and departments involved in disclosure matters working together?
 - Are appropriate District personnel adequately trained?
- See “Crafting Disclosure Policies” by the National Association of Bond Lawyers August 20, 2015.

Questions?
