

TO: Participating Counties

FROM: Munesh Patel

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RE: **Tobacco Bonds - Formation and Ongoing Administration of Tobacco Asset
Securitization Corporations**

The following is a list of commonly asked questions and answers regarding the formation of Tobacco Asset Securitization Corporations. Should you have further questions or comments, do not hesitate to contact me, Shawn Griffin, Justin Miller, or Bob Ryan at (800) 685-1429.

1. Q: Why did each participating County have to create a Local Development Corporation ("LDC")?

A: The structure of the transaction requires a true sale of tobacco assets by the County to the LDC, an instrumentality of the County. The net proceeds of the borrowing by the LDC would be paid to the County to purchase the tobacco assets. Under this structure, the borrowings by the LDC are not a debt of the County.

2. Q: Can a County have more than one LDC? (*i.e.*, others unrelated to tobacco bonds)

A: Yes. Section 1411 of the Not-for-Profit Corporation law (the statute which allows for establishment of LDC's) places no limits on the number of LDC's that may be formed by a particular entity or group of individuals.

3. Q: What is the Public Authority Accountability Act of 2005 and the Public Authorities Reform Act of 2009 (collectively, the "Act")?

A: The Act was signed into law on January 13, 2006 as Chapter 766 of the Laws of 2005, as amended by the Public Authorities Reform Act of 2009. The primary intent of the legislation is to insure greater accountability and openness of public authorities across New York State (the "State").

4. Q: Does the Act apply to LDCs?

A: Yes. The Act applies to State and local public authorities. The definition of local public authorities includes any not-for-profit corporation affiliated with, sponsored by, or created by a county, city, town or village government.

5. Q: How does the Act affect our LDC?

A: First, the Act establishes certain reporting requirements. The LDC must file its budget, annual, and independent audit reports with the State and the County. Secondly, the Act establishes certain requirements for board directors. Any board director appointed on or after January 13, 2006 must participate in State-approved training and certain board directors must meet specific independence requirements. Third, the board must establish certain committees made up of independent directors. Fourth, the LDC board directors, officers, and employees must file annual financial disclosure statements with the County pursuant to Article 18 of the General Municipal Law. Fifth, the board must

adopt numerous codes, policies, and guidelines regarding a code of ethics, whistleblower protection, investments, personnel, and the acquisition and disposal of property. Lastly, the Act requires Public Authorities to dispose of property for at least fair market value after publicly advertising for bids.

6. Q: Is the independent director requirement of the Act the same as the independent director requirement in the LDCs Articles of Incorporation?

A: No. Except for board directors that serve ex-officio, the Act requires the majority of the remaining board directors who are appointed on or after January 13, 2006 to be independent (independence as defined in the Act, not in the LDC's Articles of Incorporation). In addition, the Act requires the audit and governance committees to be comprised of independent members. The Act defines an independent member as one who: (i) is not, and in the past two (2) years, has not been, employed by the LDC, or an affiliate in an executive capacity or been employed by an entity that received remuneration valued at more than \$15,000 for goods and services provided to the LDC or received any other form of financial assistance valued at more than \$15,000 from the LDC, (ii) is not a relative of an executive officer or employee in an executive position of the LDC or an affiliate, and (iii) is not, and in the past two (2) years, has not been a lobbyist registered under a state or local law and paid by a client to influence the management decisions, contract awards, rate determinations or any other similar actions of the LDC or an affiliate.

7. Q: What are the annual operating costs for an LDC?

A: Annual operating costs are partially driven by decisions to be made by the respective LDCs concerning services, but will include, at a minimum, costs related to: an annual audit; annual reporting requirements; directors and officer's liability insurance and liability insurance policies; rating agency fees and payments to the County as administrator and/or to an administrative agent. The costs related to the annual audit, the annual reporting requirement and liability policies can be minimized by the having the various LDCs retain one entity to provide these services for all the participating LDCs. If each LDC controls their annual meeting costs (*i.e.*, attorney fees and advisor fees, if any) and the amounts paid by the LDC to the County for its activities as administrator, the annual operating costs should be well within the estimates provided by the financial advisors.

In addition, the LDC should rent office space from the County. This reinforces the argument that the LDC is a separate and distinct entity from the County.

8. Q: Does the cost to operate an LDC fluctuate from small to large counties?

A: Generally, no. However, the insurance and accounting services described above may be allocated on a pro rata basis based on the respective bond amounts.

9. Q: Do the operational costs for the LDC come from the tobacco proceeds, or do Counties have to annually budget from the tax base?

A: A TASC's operating costs are paid out of annual tobacco revenues. The board of the LDC and its officers will approve any necessary expenditures, rather than the County. These costs are obligations of the LDC and not the host County and thus are not part of the host County's annual budget. Operating costs are paid before residual payments are made to the County. Therefore, although the County does not pay these costs, the amount does affect how much is received by the County as a residual payment. The residual amount, once received by the County on an annual basis, will be subject to appropriation.

10. Q: How much money should the LDC maintain in its Bank account?

A: At a minimum, the LDC should maintain enough funds in their Bank account to cover a year's worth of operating expenses. This would allow the LDC to operate if, for whatever reason, it did not receive its operating funds from the Trustee. We have arbitrarily recommended that the excess build to three times annual operating budget to provide a healthy cushion for unanticipated expenses.

11. Q: How long does the LDC have to stay in existence?

A: Until the debt is repaid, which could be for a period as long as 40-45 years if certain cigarette industry specific events slow the amortization of the bonds.

12. Q: Why does the LDC have to hold an annual meeting?

A: An LDC holds an annual meeting for purposes of electing Appointed Directors, approving the annual financial report and approving the LDCs budget. In addition, holding an annual meeting is part of the LDCs corporate governance, which establishes the LDC as a separate and distinct entity from the County. If an LDCs legal existence was ever challenged, the LDC could argue that it has demonstrated good corporate governance by holding annual meetings. Maintaining such a governance procedure was considered by the underwriters when issuing the reduced premium pooled Director and Officer liability policy.

13. Q: Who attends the annual meeting?

A: Your chosen Directors must be available for this meeting. The Directors must be present at the meeting, they cannot participate by conference call.

14. Q: Do the operational costs remain constant over the years, or do they decline?

A: They should remain constant. However, certain premiums and accounting fees could fluctuate.

15. Q: In the deals to date, who have been the reps on each LDC? In other words, have County executives and legislators been appointed to act as the majority?

A: County officials generally serve "ex-officio" as the member and two or more of the board seats. Ex-officio means by virtue of the office and under these circumstances the county official is on the board for so long as he or she is in the identified office. The transaction required a majority (3 of 5 or 2 of 3) of the board seats be filled by County officials (as ex-officers or by appointment) such that the LDC is considered an instrumentality of the County. An Independent Director must also be appointed to make the LDC independent from the County for bankruptcy purposes. The Independent Director cannot have a relationship with the County.

16. Q: What are the terms of office for the Appointed Directors?

A: Appointed Directors, which includes the Independent Director, serve one year terms. There is no limit on the number of terms an Appointed Director can serve.

17. Q: Is the function of the LDC to issue bonds and pay the debt service? Does the LDC have a say in the use of proceeds? What if the local law leaves flexibility as to capital expenditures, what assurances are available to the legislators and executives that the LDC will follow their wishes?

A1: The LDC is formed and its activities are strictly limited to:

- 1) acquiring the tobacco assets from the host County;
- 2) issuing bonds, the net proceeds of which are paid to the host County for the tobacco assets; and
- 3) remaining in existence during the term of the bonds and providing the annual reports to bondholders.

A2: The bonds are special obligations of the LDC payable solely out of tobacco revenues and amounts held by the Trustee in certain reserves. The bonds are not an obligation of the host County.

A3: Transaction costs are approved by the LDC. Net proceeds are paid to the host County as the purchase price and, thereafter, subject to appropriation.

A4: The County controls the net proceeds. The local law references approximate use of proceeds at the request of the host County's accountants and, therefore, can be flexible (in terms of generally describing capital expenditures "consistent with the County's capital plan"). The accountants generally want specificity with respect to how much of the net proceeds will be used by the County for defeasance (repayment of existing debt).

18. Q: What actions (other than appointing an Independent Director) should be taken to make the LDC independent from the County for bankruptcy purposes?

A: For ease of administration, the address for the LDC should be the County finance department or other appropriate County address. From that point, it is a matter of degree, but to date, other Counties have:

- 1) created letterhead for the LDC under which LDC business is conducted;
- 2) identified a separate desk/area or file cabinet where LDC documents are separated from other County matters;
- 3) established a separate LDC phone line and identified the LDC office location on marquees in the County building; and
- 4) Rental based on market conditions and costs related to the foregoing are charged to the LDC on an annual basis by the County as administrator.