AN INTRODUCTION TO REINVESTMENT AGREEMENTS

(GICS, FORWARD DELIVERY AGREEMENTS AND REPOS)

National Association *of* Bond Lawyers

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PART I.
INTRODUCTION AND SCOPE

A. Background

The National Association of Bond Lawyers ("NABL") has prepared this publication to serve as a resource for members who are evaluating "Investment Agreements." Investment Agreements are a form of investment vehicle for governmental bodies and beneficiaries of tax-exempt financings structured to provide predictable and, in comparison to United States securities, typically higher yielding rates of return. With interest rates expected to rise at the time of preparation of this publication in 2016, and with bond issuers and borrowers looking for ways to maximize investment returns, an increase in the use of these instruments can be anticipated over the next several years.[1]

There is often a time lag between the date an issuer receives bond proceeds and the date or dates on which such funds are spent. In an effort to offset borrowing costs, issuers commonly invest proceeds until needed in permitted investments. Additionally, funds or accounts (for example, debt service reserve funds) may hold proceeds for possible uses (e.g., payment of debt service) for periods of time that are uncertain or are not set prior to the issuance of the bonds. Investment Agreements are contracts offered by banks, insurance companies and other financial institutions for issuers[2] to invest bond proceeds and other funds pending their ultimate application.

When compared to more traditional products like U.S. Treasury securities and bank certificates of deposit, Investment Agreements may be advantageous because they frequently offer higher yields. They also offer the ability to tailor investment cash flows for financings that require investments maturing at different times and with varying rates of interest. Investment Agreements may therefore be suitable for structured financings, although they may be equally useful in the most basic debt structure (such as for the purpose of investing construction fund proceeds from a new money governmental bond financing).

The three most common Investment Agreements are (1) Guaranteed Investment Contracts, (2) Repurchase Agreements, and (3) Forward Delivery Agreements. Each of these is discussed at length below. Funds commonly invested in Investment Agreements include: (i) project fund moneys to be used to finance capital projects, (ii) debt service fund moneys to be used to make principal and interest payments on the bonds, (iii) debt service reserve funds, and (iv) refunding escrow funds. The type of Investment Agreement selected and certain key provisions thereof reflect the purpose(s) of the funds being invested. Annex I hereto contains sample provisions of

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[1] Offsetting this somewhat are the current ratings of Investment Agreement providers. Investment Agreements were more frequently used prior to the financial crisis in 2008. Since that time, the provider universe has contracted, and many of the remaining providers have had their credit ratings downgraded such that most are rated in the "A" to "BBB" category, with no known "AAA" providers currently in the market.

[2] The term "issuer" as used in this publication will refer to issuers of bonds as well as conduit borrowers.

certain key provisions described in detail in Parts III and IV of this publication. A summary of the basic elements of each type of Investment Agreement discussed herein is attached hereto as Annex II.

Bond practitioners may encounter Investment Agreements in a variety of scenarios. Investment Agreements are often considered by issuers in connection with the closing of a new money financing in order to maximize interest earnings during project construction or when structuring an investment plan for a refunding. Investment Agreement transactions may also be executed after bond issuance, and practitioners may find it necessary from time to time to assist issuers with modifications or early terminations of Investment Agreements. Documentation for Investment Agreements can be complex and nuanced, and the drafting of Investment Agreements can have a material impact on fundamental economic aspects of the transactions such as preservation of capital, perfection of security and transferability of the investment and other rights otherwise expected to be firmly in place.

This publication is introductory in nature and intended to offer a basic orientation for NABL members who do not regularly work with Investment Agreements. It provides an overview and background of Investment Agreements, analyzes common legal and documentation issues, and highlights many of the key legal provisions included in these instruments. This publication is not intended to, and does not, address all of the material legal and documentation issues that may be in play when advising clients on Investment Agreements.[3]

B. Scope of Publication

This paper is divided into five parts. This Part I addresses certain introductory matters. Part II describes the basic structure and economics of Investment Agreements, the customary parties to these transactions, and the process many issuers use to acquire an Investment Agreement. Part III describes the structure and basis for the three most common forms of Investment Agreements. Part III also analyzes key provisions inherent in these instruments. Part IV addresses the various roles and tasks that may be allocated among an issuer, an investment provider, counsel, and other professionals involved in implementing an Investment Agreement. Part IV also addresses certain issues of state law and other legal authority that often apply. Part V offers some conclusory remarks.

[3] This publication is intended solely as an educational resource for NABL members and others and not to establish or imply any particular best practices or standards of care.

C. Topics Not Covered

Apart from some passing informational references, this publication does not cover the following:

(1) Compliance with Securities Laws

The disclosure of Investment Agreements as part of an official statement or other offering materials used in the marketing of bonds under applicable securities laws, or the treatment of Investment Agreements as "securities" for federal and state law purposes.

(2) Accounting Treatment

The appropriate treatment of Investment Agreements for accounting purposes under existing or proposed standards or rules.

(3) Bankruptcy Issues

Issues concerning the treatment of Investment Agreements under any federal or state bankruptcy, insolvency or similar laws.

(4) Laws Specific to Any Particular Jurisdiction

An issuer's authority under applicable state and local law to enter into a particular type of Investment Agreement. Investment Agreements are often collateralized or secured by different types of securities, with different rating and other salient requirements. Many of these requirements will be driven by state and local law. Although this publication seeks to identify certain state law issues that typically must be considered in connection with Investment Agreements, such issues are identified only in general form, and the discussion in this paper of such issues should not be viewed as exhaustive.

PART II.
BASIC STRUCTURE AND ECONOMICS OF INVESTMENT AGREEMENTS

A. Economics of Investment Agreements for Issuers

Issuers generally use Investment Agreements as a vehicle to maximize earnings on the investment of bond proceeds and thereby lower financing costs. For example, bond proceeds held to finance a new building are generally in possession of the issuer on the closing date, but most may not be released to pay construction costs for months or even years afterwards. By investing proceeds in an Investment Agreement, an issuer may earn a return on proceeds that would be higher than returns on alternatives like U.S. Treasury securities or bank certificates of deposit.

Investment Agreements are particularly attractive in declining high interest rate environments because a higher rate of return can be locked in for the duration of the investment. Investment Agreements tend to be less attractive options in rising or low interest rate environments since issuers have alternative investment options that may yield a similar rate of interest without the additional documentation, and some of the added risks and restrictions, associated with Investment Agreements. Examples of such risks and restrictions include limitations on the issuer's ability to terminate the investment prior to maturity when an opportunity to reinvest in higher-yielding assets arises and the possibility of a default by, or a rating downgrade of, the Investment Agreement provider.

B. Customary Parties; Roles

Investment Agreements are typically offered by a bank, other financial institution or insurance company (referred to herein as the "Provider"). When a bond trustee (referred to herein as a "Trustee") is involved in a financing, it is frequently the counterparty to the Provider since the Trustee typically holds the proceeds of the bond issue.[4] Depending on the parties' preferences and the type of Investment Agreement, an issuer may be a party to an Investment Agreement, together with the Trustee.

When an issuer is not a party to an Investment Agreement, the bond documents normally contain a written direction by the issuer directing the Trustee to enter into the contract. The issuer may be asked by the Provider in these cases to execute an acknowledgement agreement under which it agrees to pay termination and other costs and fees associated with the Investment Agreement. *See Annex I – Provider Event of Default – Two-Way Termination Payment Provision* for an example of a termination payment provision.

[4] Circumstances may be different if the bond is directly purchased by an investor such as a bank, or in cases in which all of proceeds of the issue are expended at closing or not held by a custodial bank. In these types of transactions, the Investment Agreement may be among the Provider, the issuer (if no trustee is involved) and, possibly, the bank purchasing the bonds.

C. Process to Obtain Investment Agreement; Tax Matters Incident to Selection of Provider

(a) *Process and Selection*. Investment Agreements are not readily available through an established securities market. Accordingly, they must be obtained directly from the Provider either through a competitive bidding process or by negotiation with a specific Provider.

(1) Competitive Bidding. The competitive bidding process for Investment Agreements is typically conducted on behalf of the issuer by a bidding agent or broker (referred to herein as a "Broker"). This is particularly the case when the bonds are issued on a tax-exempt basis. Soliciting an Investment Agreement through a bidding process has advantages in terms of assuring that the highest yield is achieved and satisfying applicable federal tax requirements (as discussed in greater detail below). In such instances, a Broker will solicit bids from insurance companies, banks and other financial institutions interested in providing the agreement. The solicitation will involve the distributions of a term sheet to potential bidders that describes the features of the underlying financing and all material terms sought in the rating requirements for eligible bidders, downgrade provisions, and the anticipated deposit, withdrawal and/or maturity schedule. If the repayment obligation of the Provider is to be collateralized (*i.e.*, secured by cash and/or marketable securities), the term sheet will contain the details for the collateral. Principally, this consists of the type of security (*e.g.*, U.S. Treasuries or certificates of deposit) and rating requirements and minimum values for the same. Potential Providers submit bids at the time and in the manner specified in the solicitation, typically in the form of an interest rate offered on the funds to be invested under the Investment Agreement or on some other basis that reflects the yield offered by the bidder.

The process with respect to competitively bid Investment Agreements begins with the preparation of the bid solicitation. This process requires collaboration by the issuer, the Broker, bond counsel and, if one is engaged, the issuer's financial advisor. Once finalized, bid specifications are distributed to potentially interested Providers. Interested Providers will respond with a proposed rate of interest or other proposed term that serves as the basis of award under the solicitation and may sometimes include certain conditions to a bid that the bidder proposes as a modification or supplement to the terms as provided in the solicitation. Once a Provider's bid is accepted, counsel to the Provider will typically draft and distribute the Investment Agreement documentation and handle document negotiations.

(2) Direct Placement. In some cases the Investment Agreement is placed directly with a Provider. In such a case, the Broker will generally assist the issuer in selecting a Provider and securing an acceptable type of Investment Agreement. In the municipal market, acquisitions of Investment Agreements by direct placement are considerably less common than through a bidding process, and may raise issues for the issuer, *e.g.*, whether direct placement will conflict with a

borrower's governing body's investment policy and whether the investment will comply with applicable federal tax law requirements. Whether or not the Investment Agreement is the result of a bidding process or direct placement, it is essential that bond counsel, issuer's counsel and any financial advisor determine that the method of selecting a Provider is consistent with the limitations imposed by the governing bond documents, the financial requirements of the issuer and applicable law.

(b) *Tax Considerations Incident to Acquisition of Investment Agreements*. The Internal Revenue Code of 1986, as amended (the "Code") and the Treasury regulations promulgated thereunder (the "Treasury Regulations") generally prohibit issuers from issuing "arbitrage bonds" on a tax-exempt basis. The arbitrage bond rules: (i) place restrictions on the investment of the proceeds of a tax-exempt bond issuance in investments that produce a yield higher than the yield on the underlying bonds, and (ii), in order to establish the yield on such investments, require that such investments be purchased at fair market value. Accordingly, issuers and their bond counsel investing in an Investment Agreement generally will want to consider whether and how to establish and document that an Investment Agreement has been acquired at fair market value. However, because (as noted above) Investment Agreements are not available to be acquired or traded in an established securities market, it will typically be difficult or impossible for bond counsel to form a firm conclusion as to the firm market value (and yield) on an Investment Agreement and thus to render an unqualified opinion that the tax-exempt bonds to which the Investment Agreement related are not "arbitrage bonds."

One way to do this is to utilize a "safe harbor" bidding process under Section 1.148-5(e)(2) of the Treasury Regulations. Investment Agreements that are acquired in this manner are treated as presumed to have been purchased at a fair market value. As a qualifying investment, the interest rate is considered the fair market value for purposes of the arbitrage bond rules.[5] In order for an Investment Agreement to qualify for this treatment, the following requirements must be met:

Distribution of Written Bid Specifications. Written bid specifications, including all of the material terms of the Investment Agreement, must be timely distributed to potential Providers.[6]

Commercially Reasonable. The terms of the bid specifications must be commercially reasonable.[7]

[5] These rules relate solely to the determination of fair market value and do not create an exception to the rebate requirements imposed by the Code and the Treasury Regulations. Yield earned on an Investment Agreement in excess of the yield on the underlying bonds often must be rebated to the federal government, unless an exception to rebate applies. In certain circumstances the yield on the Investment Agreement cannot be higher than the bond yield.

[6] A term is considered material if it may directly or indirectly affect the yield on the Investment Agreement.

[7] A term is considered commercially reasonable if there is a legitimate business purpose for the term other than to reduce the yield on the Investment Agreement.

Equal Opportunity to Bid. All potential providers for the Investment Agreement must have an equal opportunity to bid, and no bidder can be given the opportunity to review other bids before bidding or have a "last look" or "right to match" after other bids are submitted.

No Bids by Broker. No Broker used to conduct the bidding for the Investment Agreement may bid to provide the Investment Agreement.

Three Reasonably Competitive Providers. At least three of the Providers solicited by the Broker must be reasonably competitive providers of investments such as the Investment Agreement being bid (*i.e.*, Providers that have established industry reputations as competitive providers of the type of Investment Agreement being bid).

Bidder Financial Interests. At least three of the Providers that submit a bid must not have a financial interest in the underlying bonds, and at least one of such bidders must be a reasonably competitive provider.

Bidder Representations. The bid specifications must include a statement notifying potential Providers that submission of a bid is a representation that the potential Provider did not consult with any other potential Provider about its bid, that the bid was determined without regard to any other formal or informal agreement that the potential Provider has with the issuer and that the bid is not being submitted solely as a courtesy to the issuer for purposes of satisfying the requirements of the safe harbor bidding rules.

Deposit and Withdrawal Schedule. The determination of the terms of the bid specifications must take into account the reasonably expected deposit and withdrawal schedule for the amounts to be invested, if applicable.

Provider Selection. The Investment Agreement must be awarded to the qualifying bidder offering the highest yield, unless there is a valid justification for not taking the highest bid such as a concern over the credit quality of the Provider compared to a higher rated Provider.

Provider Representations. The Provider of the Investment Agreement must certify the administrative costs that it is paying or expects to pay to third parties in connection with the Investment Agreement.

Record Retention. The issuer must retain the following records with the bond documents:

(i) A copy of the Investment Agreement.

(ii) A receipt or other record of the amount actually paid by the issuer for the Investment Agreement.

(iii) A record of administrative costs paid by the issuer.

(iv) For each bid submitted, the name of the bidder, the time and date of the bid and the bid results.

(v) The bid solicitation form. If the terms of the final Investment Agreement deviate from the bid solicitation form, a statement must be included in the records explaining the deviation(s) and the reason(s) for the deviation(s).

It should be noted that certain costs incurred to purchase, carry, sell or retire certain types of investments, such as Investment Agreements, are not permitted to be taken into account in computing the yield of such investments for arbitrage purposes. In other words, such costs are not permitted as a positive adjustment to the purchase price of such investments (or a negative adjustment to receipts from such an investment) that has the effect of reducing the yield of such investment. However, the Treasury Regulations permit the recovery of "qualified administrative costs," which are defined as reasonable, direct administrative costs, other than carrying costs, such as separately stated brokerage or selling commissions, but *not* indirect costs such as legal and accounting fees and record-keeping or custodial costs. Similarly, issuer overhead costs (such as staff salaries and office expenses) are not qualified costs, nor are any costs incurred in making necessary arbitrage rebate computations. Administrative costs are not reasonable and, thus, not recoverable for arbitrage yield purposes, unless they are comparable to administrative costs that would be charged for the same investment or a reasonably comparable investment if acquired with a source of funds other than tax-exempt bond proceeds.

The Treasury Regulations provide that a Broker's commission or similar fee paid with respect to an Investment Agreement is a qualified administrative cost for determining the yield of the Investment Agreement if the fee is reasonable. The Treasury Regulations include a two part safe harbor for a Broker's fee to be deemed reasonable. First, the fee cannot exceed the lesser of $39,000 (in 2016, adjusted annually on the basis of inflation) and 0.20% (20 basis points) of the "computational basis," or $4,000 if such calculation yields an amount less than $4,000. For Investment Agreements, the computational basis is the total amount the issuer reasonably expects to invest pursuant to the Investment Agreement over its term.[8] For defeasance escrow investments, the computational basis is the amount initially deposited in such investments.[9] Under this "per investment" test, the broker's fee would not exceed $39,000[10] or be less than $4,000.[11] Second, the

[8] Treas. Reg. § 1.148-5(e)(2)(iii)(B)(2)(i).

[9] Treas. Reg. § 1.148-5(e)(2)(iii)(B)(2)(ii).

[10] Originally $30,000 in Treas. Reg. § 1.148-5(e)(2)(iii)(B)(1)(i); adjusted for inflation under § 3.23 of Revenue Procedure 2015-53 to a 2016 value of $39,000.

[11] Originally $3,000 in Treas. Reg. § 1.148-5(e)(2)(iii)(B)(1)(i); adjusted for inflation under § 3.23 of Revenue Procedure 2015-53 to a 2016 value of $4,000.

total Broker fees paid with respect to a particular bond issue cannot exceed $110,000.[12] This prong is known as the "per issue" test.

PART III.
COMMON FORMS OF INVESTMENT AGREEMENTS AND MATERIAL PROVISIONS

Described below are the three most common forms of Investment Agreements – Guaranteed Investment Contracts, Repurchase Agreements and Forward Delivery Agreements. It is important to note that Providers typically have their own document templates and preferred terms for these instruments. However, like any contract, such terms can be negotiated, and as discussed herein one role of counsel to issuers is to review and negotiate these terms to cover legal or business issues incident to the underlying bond transaction and to the Investment Agreement itself, as well as local jurisdiction concerns.

A. Guaranteed Investment Contracts

(1) Structure and Security

Guaranteed Investment Contracts (also referred to herein as "GICs") are perhaps the most commonly used, and basic, form of Investment Agreement.[13] Guaranteed Investment Contracts are contracts, typically unsecured, pursuant to which funds are deposited with the Provider, earn a set rate of return for a stated period, and can be withdrawn upon request, subject to negotiated restrictions. Issuers which acquire an unsecured GIC rely solely upon the Provider's credit rating with respect to the ability of the Provider to make payments as required under the Guaranteed Investment Contract, and are at significant risk in the event of a Provider bankruptcy. A GIC may also be structured to require the Provider to post collateral (usually in the form of U.S. Treasury securities) to secure payment. These are known as "Collateralized GICs."

Guaranteed Investment Contracts are used to invest most types of funds held in connection with a bond issuance. Guaranteed Investment Contracts, like other forms of Investment Agreements, typically require that Providers maintain certain minimum credit ratings. Unsecured GICs would typically have higher rating requirements compared to other forms of Investment Agreements, such as collateralized GICs and Repurchase Agreements.

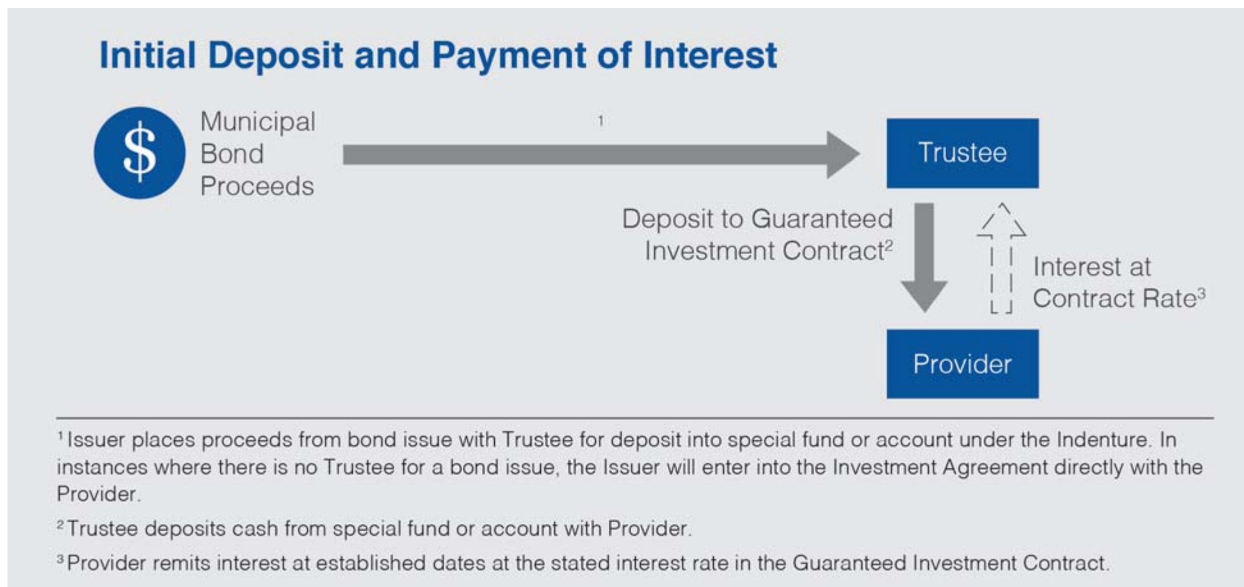
(2) Deposits and Withdrawals

Deposits. An initial deposit pursuant to a Guaranteed Investment Contract is generally made on the day of bond closing. It is not uncommon for bond proceeds from a project fund invested in a Guaranteed Investment Contract to be limited to a one-time initial deposit. Guaranteed Investment Contracts for funds that will or may fluctuate over time, such as debt

[12] Originally $85,000 in Treas. Reg. § 1.148-5(e)(2)(iii)(B)(1)(ii); adjusted for inflation under § 3.23 of Revenue Procedure 2015-53 to a 2016 value of $110,000.

[13] The actual legal document is often called an "Investment Agreement," and each Provider typically has its own form.

service funds or reserve funds, will typically permit additional deposits with certain limitations. For instance, subsequent debt service fund deposits may be not be permitted in excess of a certain threshold and subsequent reserve fund deposits may be capped at the reserve requirement and permitted only to replenish previous withdrawals from the Guaranteed Investment Contract for permitted reserve fund uses. The following illustrates the structure and flow of the deposit of funds under a Guaranteed Investment Contract:



Withdrawals. Guaranteed Investment Contracts typically include an anticipated withdrawal schedule, although flexibility to vary from the schedule may be negotiated. Guaranteed Investment Contracts generally require funds withdrawn to be applied to a permitted use under the applicable bond documents within a specified period of time. Additionally, Guaranteed Investment Contracts usually limit the number of withdrawals that can be made in a certain time period (typically once a month). The following illustrates the structure and flow of withdrawals of funds under a Guaranteed Investment Contract:

(3) Interest

Interest on a Guaranteed Investment Contract is calculated based on the amount of funds invested at the stated interest rate. GIC interest payment dates typically correspond with the debt service payment dates on the underlying bonds. The terms of the GIC may provide that the issuer receives interest payments on each interest payment date or that the accrued interest will be reinvested in the Guaranteed Investment Contract.

B. Repurchase Agreements

(1) Structure and Security

Repurchase Agreements (often referred to as "Repos") are secured investment vehicles in which invested funds are initially used to purchase specific securities owned by the Provider (the "Purchased Securities"). The Provider contracts on the date of execution of the Repo to "repurchase" the Purchased Securities from the issuer at certain times at pre-determined prices. Until repurchased by the Provider, the Purchased Securities are typically held by a third-party custodian (herein referred to as a "Custodian"), usually selected by the Provider.

Whereas Guaranteed Investment Contracts simply reflect an arrangement for the deposit and subsequent withdrawal of funds, Repurchase Agreements reflect a sale of securities by the Provider to the issuer (or the Trustee on behalf of the issuer), though they might be treated differently for tax purposes. Accordingly, in addition to the Provider's credit rating, the Provider's obligation is secured by the Purchased Securities. Apart from their enhanced security features, however, such agreements function similarly to GICs and are commonly used to invest all types of funds held in connection with a bond issue.

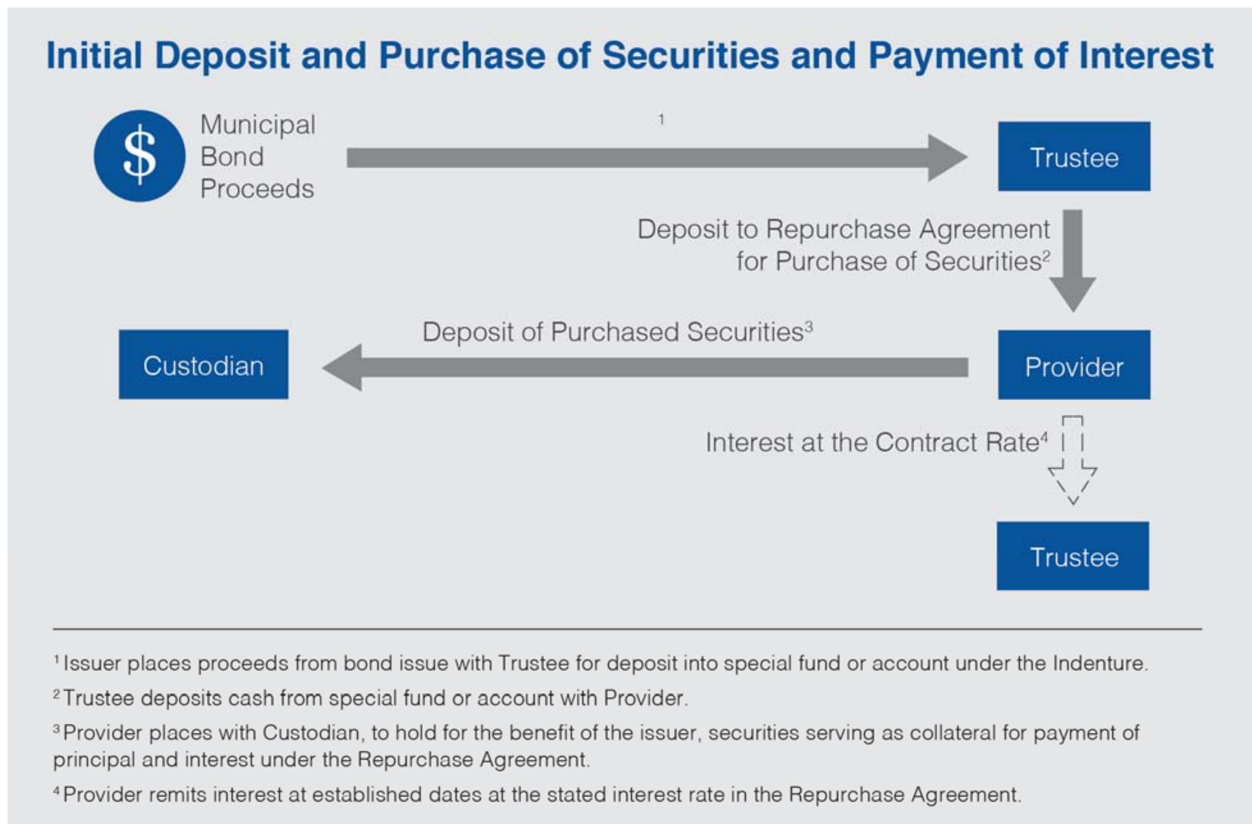
Repurchase Agreements in the municipal market almost always take the form of the Securities Industry and Financial Markets Association (SIFMA) Master Repurchase Agreement, September 1996 Version, with an annex attached to reflect the specific terms agreed to by the Provider and the issuer (and the Trustee, if applicable). As mentioned above, the Provider and the Trustee typically will enter into a related agreement with the Custodian (herein referred to as a "Custodian Agreement"). Under the Custodian Agreement, the Custodian is charged with holding the Purchased Securities until a repurchase is directed by the Trustee (or a substitution is made by the Provider), as well as valuing the same from time to time over the life of the arrangement.

(2) Custody and Valuation of Purchased Securities

Purchased Securities typically include U.S. Treasuries and securities of certain agencies of the federal government. Generally, the Provider will be permitted some degree of flexibility with respect to the type of securities eligible for purchase under the Repurchase Agreement, subject to the constraints of the underlying bond documents and state law. The Provider must maintain Purchased Securities in a specified amount, typically valued above 100% of the amount of invested funds, with the Custodian. Purchased Securities are commonly valued, or "marked," to market by the Custodian on a weekly basis, and the Provider will have a specified period (such as 3 business days) to cure any minimum valuation deficiencies by the deposit of further securities or cash or substitution of other securities.

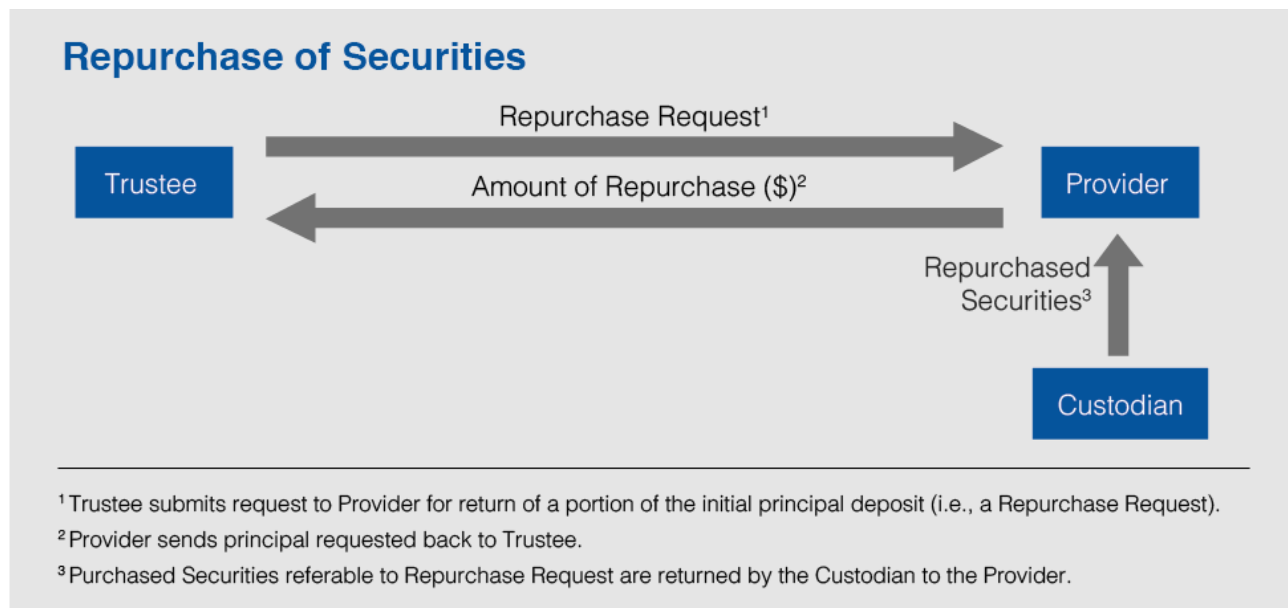
(3) Purchase and Repurchase of Securities

Purchases. Generally, purchases in connection with a Repurchase Agreement are similar to deposits into a Guaranteed Investment Contract with respect to timing and limitations. As discussed in (B) above, the frequency of purchase requests will depend on the type of fund proceeds invested in the Repurchase Agreement. The following illustrates the structure and flow for the initial deposit and purchase of Purchased Securities under a typical Repurchase Agreement:



Repurchases. Repurchases are requested by the issuer (or a Trustee) and correspond to the times when funds must be withdrawn from the Repurchase Agreement for their ultimate use. In such instances, a request is made of the Provider to repurchase Purchased Securities (*i.e.*, the

securities previously purchased). The Custodian then transfers securities in the amount requested to the Provider, and the Trustee receives cash in the amount of the repurchase request. The following illustrates the structure and flow of the withdrawal of funds and repurchase of Purchased Securities under a Repurchase Agreement:



(4) <u>Interest</u>

Interest on Repurchase Agreements is fixed as a function of the purchase price of the securities purchased under the Repurchase Agreement. Interest may be paid to the Trustee or reinvested under the Repurchase Agreement and used to purchase additional securities. As a result of Repurchase Agreements being secured by collateral held by the Custodian for the benefit of the issuer, interest rates on Repurchase Agreements are generally lower than those offered under Guaranteed Investment Contracts. Nevertheless, more conservative issuers may be willing to trade the lower yield for the added security. Also, in some cases state law may require collateral when investing bond proceeds such that a Repurchase Agreement rather than a Guaranteed Investment Contract is required. There are two different interest-based cash flows under a Repurchase Agreement: (i) the Price Differential (*i.e.*, the daily application of a per annum percentage rate to the Purchase Price on an actual/360 day basis), and (ii) interest income from the securities.

Price Differential. The repurchase price (*i.e.*, the price paid by the Provider to repurchase the securities) minus the purchase price (*i.e.*, the price originally paid by the issuer for the securities) equals the Price Differential, which represents the imbedded return on the cash the issuer is effectively lending to the Provider (otherwise known as the "repo rate," which usually factors in interest expense).

Interest Income from the Securities. On the second cash flow, income is defined as any principal and all interest, dividends or other distributions on the underlying securities. On the date income is received by the issuer, the issuer either (i) transfers (or credits) the income to the Provider, or (ii) applies cash income to reduce any amounts the Provider may owe to the issuer at the end of the transaction.

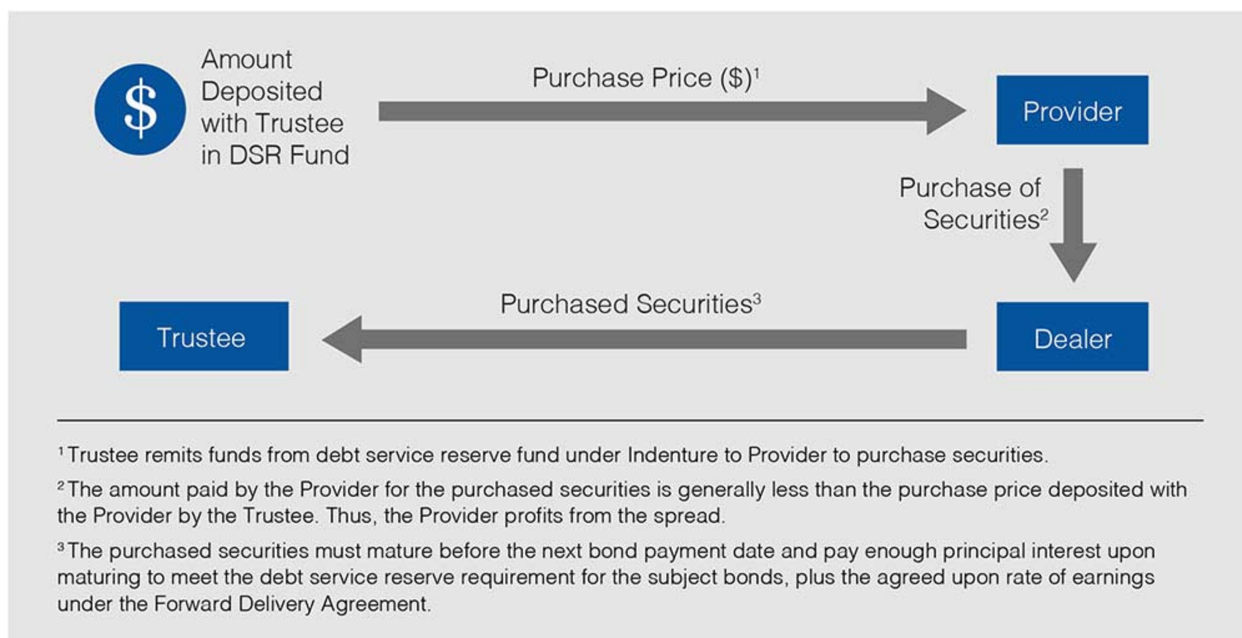
C. Forward Delivery Agreements

(1) Structure and Security

Forward Delivery Agreements are arrangements whereby an issuer agrees to purchase, and a Provider agrees to sell, securities for a delivery at a later date at a upfront price. Forward Delivery Agreements differ from Guaranteed Investment Contracts and Repurchase Agreements in that the funds invested are not available for withdrawal and not typically used for construction funds. Rather, funds are used to purchase a package of securities that will yield a minimum amount of principal and interest upon maturity. Pursuant to a Forward Delivery Agreement, a Provider agrees to enter into a series of transactions in which such securities are delivered to an issuer (or the Trustee on behalf of the issuer) at various times and predetermined prices. The maturity dates for the securities are scheduled to correspond to payment dates on the underlying bonds. The securities delivered to the issuer must mature prior to the next succeeding bond payment date and are required to provide a payment upon maturity at least equal to the amount invested plus interest at the agreed upon rate. The accrued interest on the delivered securities is retained by the issuer. Compensation to the Provider is in the form of one or more up-front payments.

Forward Delivery Agreements are most commonly used to invest funds held in a debt service reserve fund or a debt service fund. Funds held in a debt service reserve fund and a debt service fund are intended only to be accessed on bond payment dates. Accordingly, issuers and do not need the more flexible withdrawal features commonly present in Guaranteed Investment Contracts and Repurchase Agreements.

Pursuant to a Forward Delivery Agreement, the issuer will direct the Trustee to purchase securities in the amount of the funds held in the debt service reserve fund or debt service fund in connection with the underlying bonds. The Provider will sell securities to the Trustee (on behalf of the issuer) that mature prior to the next bond payment date and that will provide a payment at maturity equal to at least the amount of debt service reserve fund or debt service fund proceeds invested, plus the agreed upon rate of return. The function of a typical debt service reserve fund Forward Delivery Agreement is depicted as follows:



(2) <u>Purchase and Sale of Securities</u>

As discussed above, in a Forward Delivery Agreement to be utilized for investment of a debt service fund, securities will usually be purchased on the closing date of the Forward Delivery Agreement and on predetermined future dates, which often (but need not) correspond with the interest payment dates on the underlying bonds. Securities eligible for purchase under a Forward Delivery Agreement typically include (subject to negotiation) U.S. Treasury securities, highly-rated short-term commercial paper, agency securities and any other investment permitted under the applicable bond documents. Securities are sold directly to the Trustee (on behalf of the issuer) in a Forward Delivery Agreement, as opposed to the custodial arrangement utilized in most Repurchase Agreements.

(3) <u>Interest</u>

On each securities sale date under a Forward Delivery Agreement, the Provider establishes a purchase price equal to the amount of funds that the Trustee intends to use for the purchase of securities. The securities sold to the Trustee must have a maturity amount not less than the purchase price plus the agreed upon rate of interest under the Forward Delivery Agreement. The difference between the purchase price and the market value of the securities as established by a qualified dealer in such securities is retained by the Provider. For example, if the agreed upon

yield on the Forward Delivery Agreement for a debt service reserve fund with delivery dates every six months is 5% and the amount on deposit is $1,000,000, the Provider would deliver securities with a value of $1,000,000 that would mature six months later in the amount of at least $1,025,000 (generating a return of 5% over the six month period). If the Provider purchased the securities for $950,000, it would retain $50,000 as profit.

D. Material Provisions

The following are several structural provisions common to most Investment Agreements. Additional provisions that are primarily legal in nature are discussed in Part IV. Annex I contains sample provisions of the type described below and in Part IV of this publication.

(1) Downgrade Provisions

Investment Agreement Providers are usually required to maintain a certain credit rating throughout the term of the Investment Agreement. *See Annex I – Downgrade of Provider* for sample language of a typical downgrade provision applicable to a provider of an Investment Agreement.

Rating requirements can vary depending on the requirements of the underlying bond documents and the rating on the bonds. Upon a downgrade in rating below a predetermined level, Providers generally have the option of curing the downgrade by performing a remedial measure. Examples of common remedial measures are:

> *Assignment.* A Provider may be permitted to cure a downgrade by assigning the Investment Agreement to a Provider with sufficient credit ratings. Assignment is a common remedy for all types of Investment Agreements discussed herein. Unless the documentation expressly provides otherwise, an issuer typically must accept the assignment if the substitute Provider has the applicable ratings and assumes all of the obligations of the Provider under the Investment Agreement.
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> *Collateralization.* A Provider often may be permitted to cure the downgrade of an unsecured or undersecured Guaranteed Investment Contract by collateralizing the agreement, usually at predetermined collateral levels. In many instances, a Repurchase Agreement will replace an outstanding unsecured Guaranteed Investment Contract if the collateralization remedy is undertaken.
>
> Repurchase Agreements will often contain a provision allowing the Provider to cure a downgrade by providing increased collateral levels in the event that a Provider downgrade occurs. A downgrade under a Forward Delivery Agreement can usually be cured by posting collateral equal to the termination amount that may be owed to the issuer. Collateral requirements resulting from a Provider ratings downgrade can vary, but typically range from 102% to 110% of the amount of funds invested in the Investment Agreement.

Guaranty/Insurance. A Provider may be permitted to cure a downgrade by obtaining a guaranty or insurance from an entity with sufficient credit ratings. This remedy is common for all types of Investment Agreements discussed herein.

Termination. Issuers are typically permitted to terminate a Guaranteed Investment Contract, Forward Delivery Agreement or Repurchase Agreement following a ratings downgrade if the Provider is directed to take one of the above remedial actions and fails to take such action within a specified time frame.

(2) Termination; Termination Payments

Investment Agreements typically contain provisions as to when the agreement terminates. Most Investment Agreements contain automatic termination provisions, such as upon the maturity or redemption of the underlying bonds, or in some cases the defeasance of the underlying bonds. Investment Agreements also sometimes require payment of a termination fee based on the reason for the termination.

Investment Agreements containing a termination payment provision generally provide for calculation and payment of a termination payment upon the occurrence of a specific event, which usually includes a Provider event of default or an uncured Provider downgrade. In some cases, an optional termination is also negotiated under which an issuer is permitted the right of early termination without cause. The termination amount is intended to represent the difference in expected earnings between the Investment Agreement being terminated and an Investment Agreement offered under then-current market conditions with substantially the same terms as the existing Investment Agreement. This type of termination payment provision is commonly found in each of the types of Investment Agreements discussed herein. *See Annex I – Calculation of Termination Amount* for sample language of a typical termination amount provision. A termination amount payable in such instances is often calculated as follows:

Burdened Parties. Trustees and issuers are typically considered to be the "burdened party"[14] for purposes of calculating a termination payment with respect to terminations resulting from a Provider event of default or uncured Provider ratings downgrade. The Provider is typically (though not necessarily) the burdened party with respect to terminations occurring in connection with an optional termination of an Investment Agreement by a Trustee or an issuer and with respect to terminations resulting from an issuer event of default or in connection with the early redemption, refunding or other retirement of the bonds to which the agreement relates.

Bids by Qualified Providers. Bids are generally solicited from at least three qualified providers of the type of Investment Agreement being terminated. Bidders are usually asked to provide an amount that such bidder (i) would either pay, or (ii)

[14] A "burdened party" is the equivalent of a non-defaulting party, i.e., the party "burdened" by the other party's failure of performance.

require as payment, to enter into a substitute Investment Agreement as Provider under substantially similar terms as the Investment Agreement being terminated.

Calculation of Termination Amount. An Investment Agreement with a termination payment provision will describe the manner in which the bids solicited from qualified providers will be used in calculating the termination amount. Such provisions will usually provide that the termination amount is equal to the average of the bids received, discarding the high and low bids.

Payment of Termination Amount. Termination payment provisions in Investment Agreements are drafted as either "one-way" or "two-way" payment provisions. With respect to one-way termination provisions, only the burdened party is entitled to a termination payment. In other words, if calculation of the termination amount as described above shows that the burdened party would benefit from entering into an Investment Agreement under current market conditions, then no termination amount would be payable. With respect to two-way termination provisions, both the burdened party and the non-burdened party are entitled to a termination payment, depending on calculation of the termination amount. If calculation of the termination amount as described above shows that entering into a new Investment Agreement under current market conditions would result in a loss to the burdened party, such burdened party would be owed a termination amount. However, if calculation of the termination amount determines that the burdened party would benefit from entering into an Investment Agreement under current market conditions, then the non-burdened party would be entitled to payment of the termination amount. See *Annex I – Provider Event of Default: Two-Way Termination Payment Provision* for sample language for a two-way termination payment provision. There were situations in the bankruptcy of Lehman Brothers Holdings, Inc. where the estate of the defaulted Provider was determined to be entitled to significant payment.

The following chart provides an illustration as to when termination amounts are payable to burdened and non-burdened parties:

One-Way Termination Provision

Current Market Conditions	Termination Amount Payable
More Favorable to Burdened Party	None
Less Favorable to Burdened Party	Owed to Burdened Party

Two-Way Termination Provision

Current Market Conditions	Termination Amount Payable
More Favorable to Burdened Party	Owed to Non-Burdened Party
Less Favorable to Burdened Party	Owed to Burdened Party

The above description is indicative of the most common type of termination payment provisions in an Investment Agreement. However, instances arise where termination payments are negotiated between the issuer and the Provider. This occurs most frequently when a party wants to terminate an Investment Agreement, but the Investment Agreement does not contain a termination payment provision. In such instances, the Provider will often be asked to provide an estimate of the difference in value between the Investment Agreement being terminated and a similar agreement entered into under current market conditions. If current market conditions are more favorable to an issuer than the terms of the Investment Agreement being terminated (*i.e.* the Provider is the burdened party), then the issuer will owe the termination amount to the Provider. If current market conditions are less favorable to an issuer than the terms of the Investment Agreement being terminated (*i.e.* the issuer is the burdened party), then the Provider will owe the termination amount to the issuer.

PART IV.
CERTAIN LEGAL CONSIDERATIONS

In addition to describing the basic structure of various types of Investment Agreements, an important goal of this publication is to highlight, from an issuer's point of view, various state and federal law and other legal considerations that need to be addressed in connection with entering into an Investment Agreement. Depending on the nature of the particular Investment Agreement, the applicable parties and the legal jurisdiction, such considerations will include the source of the issuer's authority to enter into the transaction, together with the other applicable provisions of law that bear on particular aspects of the Investment Agreement.

A. Analysis of Legal Authority

(1) Authority, Generally

Issuers and their counsel must determine the issuer's authority under state law to enter into an Investment Agreement and any limitations and restrictions on such authority. An analysis should be undertaken to determine whether the Investment Agreement is considered a "contract" for state law purposes, followed by a determination of the issuer's authority to enter into such an agreement. Authority may be implied or express under applicable statutes. All parties to a transaction should examine their organizing documents, investment policies and governing state law to determine the extent to which the parties to the transaction are permitted to undertake their obligations thereunder.

(2) Home Rule Authority

In some states, certain local governments operate under "home rule" authority. Although the laws may vary among jurisdictions, generally, home rule government may act in any area in which it has some interest and which is not strictly prohibited or preempted by statute. However, it cannot act in an area that is strictly of statewide concern unless given express authority to do so. In a home rule jurisdiction, there is a constitutional or statutory power of initiative in local areas of concern, without requiring state legislative delegation. Home rule jurisdictions are generally governed by a charter and a code of ordinances. Practitioners should review the charter and code of ordinances to determine whether any specific prohibitions exist which would prevent entering into the types of Investment Agreements being considered. One area often overlooked is the issuer's own investment or debt policies, which need to be consistent with, or not prohibit, entry into the Investment Agreement. As part of a thorough due diligence process, counsel should review those policies, including determining whether the investment policy applies to the investment of bond proceeds.

(3) Dillon's Rule Authority; State Law

Many states operate under "Dillon's Rule" of law. Dillon's Rule is a rule of statutory construction that limits governmental powers to: (i) those granted in express words (enumerated), (ii) those necessary or fairly implied or incident to express powers (implied) and (iii) those essential to the accomplishment of the declared purpose (essential). In the absence of "home rule" authority, courts tend to narrowly construe a local government's authority. Counsel practicing in a Dillon's Rule state should determine whether there is express or implied authority to enter into an Investment Agreement, and whether such authority permits, requires or restricts the types of collateral incident thereto.

In addition to understanding the laws of the issuer's local jurisdiction, counsel must consider any applicable state law. Practitioners need to consider both express prohibitions in statutory law as well as any permissive statutes. A number of state statutes will either expressly prohibit certain types of Investment Agreements (such as GICs) as an investment vehicle or expressly permit them. Certain state statutes may also dictate the types of collateral that can, or must, be used to collateralize an Investment Agreement.

B. Approval by the Issuer's Governing Body

Prior to entering into an Investment Agreement, the governing body of an issuer may be required to take certain actions, such as adopting an ordinance or resolution or making certain findings (that may be required under state law or the issuer's investment policy) in consideration of the approval of the Investment Agreement, including approval of the forms of any documents to be executed by the issuer in connection with the transaction. Issuer's counsel generally will be involved in the preparation of the approval documents and participate in the presentation of the documents to the governing body of the issuer. Items that may need to be addressed in connection with the issuer's authorization to enter into an Investment Agreement include the following:

(i) Any notice, public hearing or other formalities that need to be adhered to in connection with the issuer taking official action.

(ii) A recitation of findings or other matters that may be required or helpful in demonstrating compliance with state or local laws relating to investment of public funds. For example, a finding that the proposed Investment Agreement is consistent with the issuer's current investment policy and governing law may be included.

(iii) Approval of the forms of the documents that will govern the Investment Agreement, including any collateral or custody documentation and any amendments that may be required to, or by, the issuer's existing financing documents.

(iv) A designation of the officials charged with approving the final terms of the Investment Agreement and the final forms of the documents and whether such officials may act individually or must act in concert with one or more other officials.

(v) Any parameters that the governing board of the issuer may deem appropriate in delegating authority to one or more officials to approve the final terms of the investment agreement, such as the maximum principal amount to be invested, the maximum term of the Investment Agreement, or the minimum yield or investment return to be achieved.

C. Tasks Undertaken for the Benefit of an Issuer by Legal Counsel

Legal counsel is frequently engaged to advise an issuer that is entering into an Investment Agreement. Such legal counsel may be the issuer's in-house or outside counsel, bond counsel, or a combination of them performing various tasks. Matters with respect to which an issuer may wish to seek advice in connection with entering into an Investment Agreement may include the following, some of which are discussed in greater detail in other parts of this publication:

(i) Ascertaining the legal authority for the issuer entering into the Investment Agreement, including any limitations on that legal authority imposed by state or local law or by the issuer's financing documents or investment or debt policies (see Part IV.A and IV.B above).

(ii) If required, assisting in the preparation of an investment policy for the issuer or amendments to its existing policy that are necessary to accommodate the proposed Investment Agreement. The financial and risk considerations relating to this task should be addressed by the issuer's financial or other investment advisors, not its legal counsel.

(iii) Preparing any ordinance or resolution that may be required as part of the issuer's approval of the Investment Agreement.

(iv) Negotiating various provisions of the Investment Agreement on behalf of the issuer, including modifications of the Provider's standard agreement that may be necessary as a result of provisions of the issuer's financing documents, its policies or any particular requirements imposed by state law, and also to strike more balanced terms and obligations among the parties to the contract.

(v) Assisting in the presentation of the approval documents for the Investment Agreement to the governing body of the issuer. This could include a discussion of any legal and financial risks inherent in entering into the Investment Agreement, such as the risk and potential cost of early termination.

(vi) Reviewing the documentation and process used by the issuer's financial advisor or Broker to solicit bids from potential providers of the proposed Investment Agreement to ensure compliance with the safe harbor provisions of the Treasury Regulations relating to arbitrage (see Part II. C.(b) above).

(vii) Assisting in coordinating the proper execution and closing of the Investment Agreement.

(viii) Rendering any legal opinions on behalf of the issuer that may be required in connection with entering into the Investment Agreement (see E below).

D. Review and Negotiation of Documentation

Issuers will often engage various advisors to assist in the review and negotiation of the legal documents to be used in connection with a particular Investment Agreement. These advisors may include counsel to the issuer, bond counsel and, with respect to the financial implications of the transaction, the issuer's independent financial advisor. Unlike the legal documentation related to interest rate swaps and other derivative transactions, which has been greatly standardized as a result of the efforts of the International Swaps and Derivatives Association, Inc., the form and substance of the legal documents used in connection with Investment Agreements can vary significantly depending on the type of Investment Agreement being entered into and the particular Provider involved.

The following discussion highlights several types of provisions contained in Investment Agreements that may require increased scrutiny and negotiation by the issuer and its advisors, including its counsel, particularly in connection with Investment Agreements that will have long durations. The particular points that are proper subjects of negotiation will of course vary depending on the nature of the transaction and the business goals of the issuer involved.

(1) Defeasance or Refunding

Each of the types of Investment Agreements discussed herein can be implemented to provide for the long-term investment of moneys on deposit in a fund or account associated with a particular bond issue, such as a debt service reserve fund or a debt service fund. In many cases such Investment Agreements mature long after the first optional redemption date for the particular bond issue. In other cases, the size and frequency of the investment or the purchases of investment securities made by, or on behalf of, an issuer pursuant to such an Investment Agreement are inextricably tied to certain attributes of the bond issue, such as the reserve requirement or the size of the required monthly deposits to the debt service fund. As a result, it may be in the interest of the issuer to negotiate specific provisions in the agreement relating to the consequences of a partial or full redemption or defeasance of the related bond issue prior to the expiration of the term of the Investment Agreement. In the case of a reduction in the size of the reserve requirement or debt service fund deposits as a result of a partial refunding or early repayment of the bond issue, the issuer can negotiate the right to terminate (at its option) the agreement in part and revise the amount of future purchases of investment securities to match the requirements of the non-refunded portion of the bond issue. In the case of a full refunding or defeasance of the bond issue, the issuer may want to negotiate the right to transfer the existing agreement to the refunding bonds and make the necessary adjustment to the amount of the required investments based upon the debt service requirements of the refunding bonds. This will typically result in a partial termination of the Investment Agreement as a result of a reduction of the issuer's debt service requirements in connection with the refunding. The economics of these issues are for the issuer's financial advisor or other economic professional to consult on. However, as legal counsel, it may be beneficial to require the terminations be optional to the issuer rather than required. *See Annex I – Defeasance or Refunding* for sample language of a typical defeasance or refunding provision.

(2) Cross Default; “Specified Indebtedness”

The default section of certain Investment Agreements will specify as an event of default by the issuer any default, event of default or similar condition or event that occurs in respect of the issuer under other specified agreements, debt instruments, or arrangements of the issuer (which may not be related to the bonds to which the Investment Agreement relates). The Investment Agreement typically defines these other agreements, instruments and arrangements as “specified indebtedness.” This type of provision is more commonly found in Repurchase Agreements and Forward Delivery Agreements than in GICs.

Such a cross default provision should be of particular concern to an issuer, particularly where “specified indebtedness” is broadly defined. For example, it is not uncommon for a Provider to seek to define “specified indebtedness” as including “any bond, note or other evidence of indebtedness” of the issuer. If the Provider does not agree to remove the cross default entirely from the Investment Agreement, the issuer may wish to negotiate a narrower definition of specified indebtedness and perhaps a threshold amount below which a default on other debt of the issuer would not trigger the cross default in the Investment Agreement. An issuer may also wish to negotiate a cross default based on other debt of the issuer that is triggered only if that debt is accelerated. Where the Investment Agreement relates to the investment of proceeds or other amounts with respect to bonds issued pursuant a master resolution or indenture or other similar financing document, the issuer may attempt to narrow the definition of specified indebtedness to include only obligations issued and secured under that master financing document. At the very least, specified indebtedness can be defined to exclude obligations secured by a totally unrelated source of revenue or any conduit obligations of the issuer on behalf of unrelated conduit borrowers. *See Annex I – Cross Default (Issuer)* for sample language of a typical cross default provision.

(3) Incorporation by Reference

Certain Investment Agreements related to one or more bond issues outstanding under a master financing document will contain a provision that incorporates into the Investment Agreement financial and operating covenants of the issuer contained in the master bond document. This type of provision functions much like the “Covered Indenture” provisions found in many municipal interest rate swap agreements. Issuers generally will be inclined to resist a wholesale incorporation of all its bond covenants into the Investment Agreement. If the Provider insists on some type of incorporation, issuers should consider limiting the incorporated provisions to those absolutely necessary to secure the contractual rights of the Provider. This provision of the Investment Agreement will often limit the issuer’s ability to amend, supplement or modify provisions of the master bond documents in a manner that adversely affects the rights or obligations of the Provider without the Provider’s prior written consent. The issuer may seek to clarify that no Provider consent is required for any supplement to the master bond documents necessary for the issuance of additional debt in compliance with the terms of the existing financing document. Rather than incorporating by reference into the Investment Agreement issuer covenants and other provisions of the financing documents, the issuer instead will likely take the position that the Investment Agreement is a stand-alone document, setting forth in the Investment

Agreement only those covenants necessary to protect the specific interests of the Provider. *See Annex I – Incorporation by Reference* for sample language of a typical incorporation by reference provision.

(4) Sovereign Immunity

Many Investment Agreements contain a representation by the issuer that it is not entitled to claim immunity on the grounds of sovereignty or other similar grounds with respect to itself or its revenues or other assets in connection with any proceedings brought with respect to the Investment Agreement. If such sovereign immunity exists under applicable state law, the Investment Agreement will often provide that the issuer agrees to waive such immunity. Various states have laws as to the extent to which governmental entities have rights of sovereign immunity with respect to themselves or their assets. An issuer will want to consider whether, or the extent to which, it is capable of making this type of representation consistent with any type of immunity available under state law. Also, the laws in a particular state may restrict a governmental entity from waiving its immunity or require statutory authority for the waiver. In addition, under some state statutes or applicable common law, a governmental entity may be limited in its ability to waive the defense of sovereign immunity with respect to certain assets. *See Annex I – Sovereign Immunity* for a sample sovereign immunity provision.

(5) Governing Law and Jurisdiction

An Investment Agreement will commonly provide that the contract will be governed by and construed in accordance with the laws of the State of New York, sometimes with a proviso that the obligations of the issuer are governed by and construed in accordance with the law of the state in which such issuer is located. Issuers need to be aware that "choice of law" statutes in some states may restrict the ability of a governmental entity (and others) to select the laws of another jurisdiction to govern a particular contractual relationship. In addition to governing law provisions, certain Investment Agreements contain a provision setting forth the parties' consent to the jurisdiction of the courts of a particular jurisdiction, such as the State of New York. The laws concerning the ability of governmental entities to consent to the jurisdiction of the courts of other jurisdictions vary from state to state and a provision consenting to jurisdiction outside the Issuer's jurisdiction may be unenforceable as being against public policy. *See Annex I – Governing Law* for sample governing law language. *See also Annex I – Jurisdiction* for a sample jurisdiction provision.

(6) Set-Off Provisions

Investment Agreements typically contain a provision stating that the Provider's obligation to repay the funds invested in an Investment Agreement is an unconditional obligation of the Provider and not subject to any rights of setoff that the Provider may have against the issuer or Trustee. If such a provision is not included, the issuer generally will seek to have one inserted.

E. Legal Opinions

Providers often request a legal opinion concerning various matters with respect to the issuer and the Investment Agreement entered into by the issuer. Although this opinion can often be rendered by issuer's counsel, in some cases the Provider may require certain matters to be addressed in an opinion by bond counsel. Matters typically covered in legal opinions rendered on behalf of an issuer entering into an Investment Agreement include the following (opinion scope may differ, particularly on bracketed language):

(i) The issuer's legal right, power and authority to enter into the Investment Agreement, including its authority to authorize a third party, such as a trustee or custodian, to make purchases of, and hold, investment securities in accordance with the terms of the Investment Agreement.

(ii) The Investment Agreement and the related financing documents have been duly authorized, executed and delivered by the issuer.

(iii) [To the extent that the Investment Agreement provides that New York law will govern the Investment Agreement, such stipulation is enforceable under the laws of the state in which the issuer is located.]

(iv) The Investment Agreement and the related financing documents constitute legal, valid and binding obligations of the issuer, enforceable against it in accordance with the terms of the Investment Agreement. When this opinion is being rendered by non-New York counsel, it is often qualified by the assumption that the laws of the state in which such counsel is licensed and the laws of the State of New York are deemed to be the same for purposes of the opinion. As with most other enforceability opinions, it is given subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights.

(v) The issuer's execution and delivery of the Investment Agreement [and the performance of its obligations thereunder] do not [and will not] conflict with or constitute or result in a default under or a breach or violation of any other agreement, instrument, law, judgment, injunction or order applicable to the issuer.

(vi) The issuer is subject to suit with respect to its obligations under the Investment Agreement (except to the extent that jurisdiction or venue may be limited by applicable laws) [and the issuer is not entitled to claim immunity from enforcement of any judgment arising from its obligations under the Investment Agreement on the grounds of sovereignty or similar grounds, or that any such immunity has been validly waived.]

(vii) All consents, authorizations and approvals requisite for the issuer's execution, delivery and performance of the Investment Agreement have been obtained from any governmental authority or regulatory body.

(viii) The Investment Agreement or the securities to be purchased pursuant to the Investment Agreement are permitted investments under the bond resolution or other financing document as well as any investment policies of the issuer and under applicable law.

The ability of counsel to deliver opinions such as those described above will depend to a great extent on laws of the applicable jurisdictions, as well as the issuer's charter or other organizational documents.

Part V.
Conclusion

Investment Agreements offer attractive options for issuers seeking to earn a greater return on invested bond proceeds and other funds or to achieve a particular cash-flow objective for financings that require investments maturing at differing times and with varying rates of interest. Issuers can select from among the various types of Investment Agreements, including those described herein, to obtain an investment that provides the desired rate of return, security and withdrawal flexibility that it seeks. Investment Agreement documentation tends to be complex and highly specialized. Accordingly, practitioners advising issuers should be aware of the various issues common to Investment Agreements and to an issuer's ability to enter into the agreement.

Investment Agreements are designed to provide a guaranteed rate of return on invested bond proceeds. Each of the different types of Investment Agreements discussed herein has unique characteristics and features:

Guaranteed Investment Contracts. Guaranteed Investment Contracts have the benefit of simplicity, but are the least secure type of Investment Agreement. Guaranteed Investment Contracts function like a bank certificate of deposit in many ways, in that funds deposited earn a specified rate of return until withdrawn.

Repurchase Agreements. Repurchase Agreements are similar to Guaranteed Investment Contracts, but provide additional security through the purchase of securities with the invested funds. Funds are withdrawn from a Repurchase Agreement through the repurchase by the Provider of such securities. Due to this security requirement, Repurchase Agreements generally yield a lower rate of return than a Guaranteed Investment Contract and require more complex documentation.

Forward Delivery Agreements. Forward Delivery Agreements are highly specialized Investment Agreements in which the invested funds are used to enter into a series of transactions. Forward Delivery Agreements are most commonly used to invest funds deposited in a debt service reserve fund or a debt service or sinking fund. In such transactions, the funds deposited in the debt service reserve or other fund are used to purchase securities that will mature prior to the next

scheduled purchase date and yield a required minimum amount of principal and interest upon maturity.

A chart summarizing the basic features of each type of Investment Agreement discussed herein is attached as Annex II.

ANNEX I
SELECTED SAMPLE PROVISIONS FROM INVESTMENT AGREEMENTS

Calculation of Termination Amount

"Termination Amount" means an amount, as determined by the Provider in good faith on the basis of the arithmetic mean of quotations from at least three Dealers, of the amount, if any, that each such Dealer would require the Burdened Party to pay to the Dealer (expressed as a positive number if the Burdened Party is the Provider and a negative number if the Burdened Party is the Issuer) or would pay to the Burdened Party (expressed as a negative number if the Burdened Party is the Provider and a positive number if the Burdened Party is the Issuer) in consideration of such Dealer entering into an agreement with the Burdened Party (with such documentation as the Dealer and the Provider may in good faith agree) which would have the effect of preserving for the Burdened Party the economic equivalent of its investment rights under this Agreement commencing on the termination date of this Agreement and terminating on the last Bond Payment Date set forth on Exhibit A to this Agreement (assuming for these purposes that this Agreement had not terminated on the termination date); provided, however, that:

(i) if more than three quotations are provided, the Termination Amount will be the arithmetic mean of such quotations, without regard to the quotations having the highest and lowest values,

(ii) if exactly three quotations are provided, the Termination Amount will be the quotation remaining after disregarding the highest and lowest quotations, for purposes of clauses (i) and (ii), if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded, and

(iii) if the Provider is unable to obtain three such quotations, the Termination Amount shall be the amount, as reasonably determined by an independent third-party entity mutually acceptable to the Provider and the Issuer, which acceptance shall not be unreasonably withheld, and which fee for such determination shall be paid by the party whose actions caused the Termination Amount to be calculated, to be the Burdened Party's total losses and costs (expressed as a positive number if the Burdened Party is the Provider and a negative number if the Burdened Party is the Issuer), or gains (expressed as a negative number if the Burdened Party is the Provider and a positive number if the Burdened Party is the Issuer) in connection with a termination of this Agreement, including any loss of bargain, cost of funding or, at the election of the Provider but without duplication, any loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position, and; provided further, however, that in any event the Termination Amount shall also include any unpaid amounts due the Provider or the Issuer as of the date of termination of this Agreement.

For purposes of determining the Termination Amount, "Burdened Party" means, (i) in the case of (A) an Issuer or Security Custodian Event of Default, or (B) a termination of this Agreement by the Issuer following a redemption, defeasance or refunding of the Bonds, the Provider and (ii) in the case of a Provider Event of Default, the Issuer.

<u>Comments</u>:

The first paragraph makes it clear that the Provider runs the termination amount process even if the Provider in the defaulting party. An Issuer should consider asking for the right to appoint a qualified third party to determine the amount (in the same manner as is set forth in the first paragraph) in the event of a Provider default, i.e., where the Issuer is the "Burdened Party".

If the process does not result in the requisite number of quotations (three), the parties agree on a third party to make the determination, the costs of which are paid by the non-Burdened Party, i.e., the party whose actions resulted in the termination amount becoming due. This determination includes loss of bargain or costs of funding and, without duplicating any amounts otherwise taken into account, any other loss of the Burdened Party, which may result in a significantly different (and potentially higher) amount payable than under the initial method.

Although not identical, these termination payment methodologies are similar to "Market Quotation" and "Loss" under the 1992 ISDA Master Agreement for swaps.

Cross Default (Issuer)

The following shall constitute Issuer Events of Default for purposes of this Agreement:

(_) A default, event of default or similar condition or event (however described), including, without limitation, a default in making all or any portion of one or more payments on the due date thereof (after giving effect to any applicable notice requirement or grace period), occurs in respect of the Issuer under any of the Financing Documents or one or more agreements or instruments relating to the Specified Indebtedness of the Issuer. For purposes of this subparagraph, the term Specified Indebtedness shall mean any bond, note or other evidence of indebtedness, including without limitation the Bonds, or any guarantee.

<u>Comments</u>:

An Issuer should consider two modifications to this Cross Default provision: (1) setting a threshold below which the cross default does not constitute a default under the investment agreement; and (2) requiring that the cross default have resulted in a declaration of an event of default and an acceleration of the indebtedness in question that materially impairs the Issuer's ability to perform. Otherwise, the cross default provision is similar in effect to a most favored nations clause, effectively transferring other covenants into the investment agreement even in the absence of action on those covenants by the creditor in question.

Defeasance or Refunding (For use in certain Forward Purchase Agreements)

(a) The Issuer may, by giving the Provider at least ten (10) Business Days' prior notice, but without the consent of the Provider, redeem, defease, refund, or repurchase the Bonds as provided in the Financing Documents, <u>provided</u> <u>that</u> if the Issuer takes any such action (i) if the Termination Amount is a positive number, the Issuer shall pay or cause the Security Custodian to pay to the Provider in immediately available funds the Termination Amount and (ii) if the Termination Amount is a negative number, the

Provider shall pay such amount to the Issuer; provided, however that no Termination Amount shall be payable by any party hereto with respect to an Economic Refunding. If a Termination Amount is payable pursuant to this Section ___, the party owing such amount shall promptly but by no later than the later of (A) one Business Day after receipt of notice of the Termination Amount from the Provider or (B) the date of such redemption, defeasance or refunding pay such amount. Such payment shall be made in immediately available funds, to or at the direction of the party to whom such Termination Amount is due.

(b) Immediately upon payment of the Termination Amount in accordance with this Section ___, this Agreement shall terminate. The Issuer agrees that it shall not, nor shall it direct the paying agent under the Resolution, as applicable, to redeem, defease, refund or repurchase the Bonds unless it shall have sufficient funds to pay any Termination Amount which may be due as provided herein. Notwithstanding the above, in connection with any redemption, refunding, repurchase or defeasance of less than all the Bonds, this Agreement shall, upon the payment of the allocable portion of any Termination Amount that would otherwise be due in accordance with this Section ___, continue in effect with respect to the Bonds outstanding under the Financing Documents immediately after any such transaction.

(c) If pursuant to clause (a) above, this Agreement would be terminated in connection with a refunding of the Bonds and a Termination Amount would be payable to the Provider, the Issuer may, by written notice to the Provider, request that the Provider continue this Agreement and have it apply to such refunding Bonds (the "Refunding Bonds"). The Provider agrees that if it receives such a request it shall agree to so continue this Agreement with respect to the Refunding Bonds and the Bonds remaining outstanding after such refunding provided that:

(i) the Provider receives such request (together with all relevant details relating thereto) at least 30 days in advance of such refunding;

(ii) the Refunding Bonds are to be issued under the existing Financing Documents or such other financing documents which is approved by the Provider and the Provider is otherwise satisfied with the Bond documentation relating to the Refunding Bonds;

(iii) on or prior to the date the Bonds are to be refunded (the "Refunding Date") the Issuer and the trustee of the Refunding Bonds enter into such amendments of this Agreement with the Provider (the "Amended Agreement") as are necessary to have this Agreement pertain to the Deposit Amounts, Delivery Dates and Bond Payment Dates applicable to the Refunding Bonds and to any Bonds which remain outstanding after giving effect to such refunding (the "Amended Cash Flows");

(iv) the last Delivery Date under the Amended Agreement is no later than the last Delivery Date hereunder;

(v) at the time such request is received and on the Refunding Date no Issuer Event of Default or Security Custodian Event of Default has occurred or would, with notice or the passage of time, result in such a default;

(vi) the Provider receives any opinions and other assurances it may reasonably request to assure that the protections afforded it hereunder will continue under the Amended Agreement;

(vii) other than in connection with an Economic Refunding, if as determined on the Refunding Date, the Termination Amount to the Provider of its investment rights with respect to the Deposit Amounts, Delivery Dates and Bond Payment Dates which would be remaining hereunder on such date, assuming that the Bonds were not then refunded (the "Original Cash Flows") would be greater than the Termination Amount to the Provider of its investment rights with respect to the Amended Cash Flows, the Issuer shall on or before the Refunding Date pay to the Provider the amount of such difference; and

(viii) the Refunding Bonds have a credit rating at least equivalent to the credit rating of the Bonds without giving effect to any bond insurance and are secured by revenues at least equivalent to those securing the Bonds.

If the conditions described in paragraphs (i) through (viii) are satisfied but the Termination Amount to the Provider of its investment rights with respect to the Amended Cash Flows would be greater than the Termination Amount to the Provider of its investment rights with respect to the Original Cash Flows, the Provider may, at its option, pay the Issuer the amount of such difference or retain investment rights only with respect to such portion of the Amended Cash Flows as would have a Termination Amount equal to the Termination Amount of the Original Cash Flows.

[**Note**: For purposes of the above provision relating to a defeasance or refunding, the term "Economic Refunding" would be defined as any refunding of the related Bonds which produces positive present value savings to the Issuer at the time of such refunding.]

Comments:

An "Economic Refunding", defined as producing positive present value savings to the Issuer, does not, under clause (a), result in a Termination Payment becoming due. This would include a large number of refundings, which are entered into for the express purpose (and in many cases in order to meet statutory criteria) of achieving present value savings. While the "no payment" provision applies to both parties, an Issuer may want to negotiate this provision out of the investment agreement; whether it should do so will depend on a financial analysis conducted by the Issuer or its financial advisor which takes into consideration the likelihood of the Issuer otherwise receiving a termination payment at the time of an Economic Refunding.

The portions of this provision which require prior notice to the Provider and prevents a refunding from occurring without assurance to the Provider of it being paid any amount due to it is something that Issuers should be aware of (including any associated timing) as the Issuer enters into a plan of refunding. As the provision indicates, under certain circumstances the Issuer may be able to keep the investment agreement in place with respect to the refunding bonds. These include a matched maturity and equal or greater credit rating (not taking into account bond insurance, i.e., based on the Issuer's credit rating) and no negative change in revenues securing the new (refunding) bonds. Where appropriate, Issuers should consider negotiating a refunding provision that does not require notice of, or termination upon, a refunding.

Finally, the provision relating to the Amended Cash Flows is designed to ensure that the Provider does not as of right receive a greater Termination Amount than otherwise would be the case. This agreement allows the Provider to receive that greater amount only if the Provider pays the difference to the Issuer.

Downgrade of Provider

(a) In the event that the rating assigned to the senior unsecured long-term debt obligations of the Provider is suspended, withdrawn or falls below "A-" by S&P or "A3" by Moody's, the Provider shall provide written notice of such event to the Issuer within 15 Business Days of its occurrence. Following the delivery of such notice, the Issuer shall have the right to terminate this Agreement by delivery of 15 Business Days' prior written notice to the Provider. If within 45 days after receipt of the written notice from the Provider of such downgrade event, the Issuer has not delivered the notice electing to terminate this Agreement, the Issuer's right to terminate by reason of the occurrence of such downgrade event shall lapse and terminate. In the event that the Issuer delivers the written notice of its election to terminate this Agreement by reason of such downgrade event as provided above, the Provider shall have the right to (i) assign this Agreement on or prior to the termination date set forth in the Issuer's notice to a party the senior unsecured long-term debt obligations or claims-paying ability of which are rated "A-" or higher by S&P or "A3" or higher by Moody's: (ii) obtain a guaranty of its obligations under this Agreement on or prior to the termination date set forth in the Issuer's notice from a party the senior unsecured long-term debt obligations or claims-paying ability of which are rated "A-" or higher by S&P or "A3" or higher by Moody's; or (iii) post additional Eligible Securities to secure its obligation to pay any Termination Amount hereunder. The Issuer agrees to cooperate with the Provider in order to facilitate such action. In the event that the Issuer elects to terminate this Agreement as provided above and action is not taken by the Provider as provided above, this Agreement shall terminate on the date specified in the Issuer's notice of termination.

(b) If a Termination Amount is payable pursuant to this Section ___, the party owing such amount shall promptly, but no later than one Business Day after notice that such amount is due, pay such amount, in immediately available funds, to or at the direction of the party to whom such Termination Amount is due.

<u>Comments</u>:

An essential part of the bargain for an Issuer is the maintenance by the Provider of a minimum rating, in this case A- or A3. Failure to meet that required level (here a drop below either will trigger that right even if the other rating meets the minimum requirement) allows the Issuer the right to decide whether to terminate the investment agreement, which will bring into play a number of economic and other considerations, including whether the Issuer may have to pay a termination payment and whether it can enter into a replacement agreement acceptable to it. If the Issuer gives notice of termination, the Provider can maintain the agreement by one of three actions: (1) assignment to an entity rated A- or A3 or higher; (2) providing a guaranty of the Provider's obligations from an entity rated A- or A3 or higher; or (3) providing further collateral against payment of a termination amount.

As written, this termination provision becomes active if the Provider is downgraded by either S&P or Moody's, but does not require the assignee or guarantor to have more than one of the two minimum ratings required to be held by the Provider. Under these circumstances, an Issuer may want to make certain that the assignee or guarantor has similar, dual rating, requirements, or the Provider may want to have the right to termination occur if both of its ratings fall below the minimum levels, i.e., the requirements should be consistent. An Issuer may also want to consider whether any additional conditions for the assignee or

guarantor are appropriate, such as the absence of fraud convictions, the existence of negative credit watch or similar indicators of declining credit quality, etc.

Governing Law

This Agreement shall be governed by and construed in accordance with the laws of the State of New York without regard to conflict of laws principles; provided, however, that the obligations of the Issuer hereunder shall be governed by and construed in accordance with the laws of the State of [location of the Issuer].

Comments:

In most circumstances, the Issuer will want to (or may be required to) to have its obligations subject to the law of its jurisdiction of creation or incorporation. In other cases, where that is not legally required, both parties' obligations may be subject to New York law. Counsel from jurisdictions other than New York often may assume in their opinions that New York law is the same as the law of their jurisdiction for purposes of an opinion in favor of the Provider, and may be asked to provide a conflict of laws opinion.

Incorporation by Reference

The Issuer agrees that each of its covenants and other agreements in the Financing Documents that materially affect the rights and obligations of the Provider (the "Incorporated Provisions") are incorporated herein as fully as if set forth herein and the Provider were a named beneficiary thereof (including, without limitation, the right to consent to certain actions subject to consent under the Financing Documents and the right to receive financial statements and other notices and information). The Issuer will observe, perform and fulfill each such agreement in the Financing Documents. If any Financing Document ceases to be in effect prior to the termination of this Agreement, the Incorporated Provisions (other than those provisions requiring payments in respect of bonds, notes, warrants or other similar instruments issued under the Financing Documents) will remain in full force and effect for purposes of this Agreement as though set forth herein until such date on which all of the obligations of the Issuer under this Agreement have been fully satisfied. Any amendment, supplement, modification or waiver of any of the Incorporated Provisions without the prior written consent of the Provider shall have no force and effect with respect to this Agreement if such amendment, supplement modification or waiver would have an adverse effect on the rights of the Provider hereunder. Any amendment, supplement or modification for which such consent is obtained shall be part of the Incorporated Provisions for purposes of this Agreement.

Comments:

Both parties may find that it is best to designate which specific provisions of the Financing Documents are to be incorporated into the investment agreement to avoid any disputes as to what constitute "covenants and other agreements . . . that materially affect the rights and obligations of the Provider" as well as specifically defining which of those would continue after termination of the Financing Documents.

Similarly, there may be differences between the Issuer and the Provider as to which provisions that are amended, supplemented, modified or waived may "have an adverse effect on the rights of the Provider" under the investment agreement. An Issuer may consider these types of provisions to be less appropriate

in situations where its duties to perform are limited, such as for Guaranteed Investment Agreement products. These can be avoided by a supplement to the investment agreement setting forth or identifying the specific provisions.

Jurisdiction

The Provider, the Trustee and the Issuer each hereby irrevocably submits to the non-exclusive jurisdiction of any court of the State of New York located in the Borough of Manhattan or the United States District Court for the Southern District of the State of New York located in the Borough of Manhattan for the purpose of any suit, action or other proceeding arising out of this Agreement, or any of the agreements or transactions contemplated hereby, at the election of the party initiating any such suit, action or other proceeding, which is brought by or against the Provider, the Trustee or the Issuer, and the parties each hereby irrevocably agrees that all claims in respect of any such suit, action or proceeding may be heard and determined by any such court.

[Note: For Investment Agreements to which the Issuer is a party, Issuer may want the agreement to provide for the non-exclusive jurisdiction of the courts of the state in which the Issuer is located. In some states, a provision that requires a governmental entity to submit to jurisdiction outside of its home jurisdiction may be unenforceable as against public policy.]

<u>Comments</u>:

Provisions allowing non-exclusive jurisdiction, whether in New York or the state in which the Issuer is located, are intended to allow the party bringing suit to determine the jurisdiction in which the litigation will proceed. Provisions requiring parties to submit to the exclusive jurisdiction of the state and/or federal courts of any one jurisdiction (except where all parties are located in that jurisdiction) should be avoided if possible (i.e., except where a specific jurisdiction could be required under an Issuer's statutory or other legal authority to enter into an investment agreement).

Provider Event of Default: Two-Way Termination Payment Provision

Upon the occurrence of a Provider Event of Default, the Issuer shall have the right to immediately terminate this Agreement; whereupon Provider shall determine the Termination Amount and (i) if the Termination Amount is a negative number, the Provider shall promptly, but no later than one Business day after notice that such amount is due, pay such amount, in immediately available funds, to the Issuer and (ii) if the Termination Amount is a positive number, the Provider may demand payment by the Issuer of the Termination Amount in which case the Issuer shall promptly, but no later than one Business day after notice that such amount is due, pay, in immediately available funds, the Termination Amount to the Provider. If such amount is not paid when due, the party owing such amount shall pay interest on such amount for each day such amount is due but not paid at the Default Rate. Notwithstanding anything to the contrary in this Agreement, if the Provider fails to determine the Termination Amount within three Business Days of the notice from the Issuer or the Security Custodian of the occurrence of a Provider Event of Default, then the Issuer shall make such determination as if it were the Provider and the amount so determined by the Issuer shall for purposes of this Section __ be deemed the Termination Amount.

Comments:

This termination provision allows the Provider, if it acts in a timely manner, to determine the termination amount where the Provider's event of default is the reason for termination of the investment agreement. An Issuer may want to negotiate its right to determine, or cause to be determined (by a qualified party) the termination amount in any case of a Provider's default resulting in an Issuer termination of the investment agreement. Recall situations in the bankruptcy of Lehman Brothers Holdings Inc., where two-way termination provisions resulted, in some instances, in payments to the Provider's estate.

Sovereign Immunity

The Issuer represents and warrants to the other parties hereto that it is not entitled to claim, and shall not assert any claim, with respect to itself or its revenues, assets or property (irrespective of the use or intended use thereof), of immunity on the grounds of sovereignty or similar grounds from suit, jurisdiction of any court, relief by way of injunction, order for specific performance or for the recovery of property, attachment of its assets (whether before or after judgment, in aid of execution, or otherwise) and execution or enforcement of any judgment to which it or its revenues, assets or property might otherwise be entitled in any suit, action or proceeding related to this Agreement in the courts of any jurisdiction, nor may there be attributed to the Issuer or its revenues, assets or property any such immunity (nor shall such attribution be claimed by the Issuer).

Comments:

For Issuers which are permitted to waive sovereign immunity (not all are), this provision likely will be critical to any Provider entering into an investment agreement with a municipal, state or other governmental entity which may have the right to claim sovereign immunity in respect of certain of its obligations. Providers will want to ensure that this representation and warranty is supported by an opinion of Issuer's counsel to the same effect and may want to have their own counsel perform certain diligence with respect to the issue. For Issuers which are not permitted to waive sovereign immunity, the Provider will be interested in ensuring that it nevertheless has a means or redress (suit on the contract) in the event of an Issuer default.

Annex II

Type of Product	Typical Use			Basic Description	Nature of Security	Deposits	Withdrawals	Interest/ Income
	Project Fund	**Reserve Fund**	**Escrow/ Debt Service Funds**					
Guaranteed Investment Contract	Yes	Yes	Yes	Deposit of funds that can be withdrawn on demand or pursuant to schedule of withdrawals. Similar to savings account.	Unsecured - Based on Provider's Rating	One time deposit at closing or multiple deposits	Based on an anticipated or fixed schedule	Based on amount of funds at stated rate
Repurchase Agreement	Yes	Yes	Yes	Similar to Guaranteed Investment Contracts, except that deposited funds are used to purchase securities from a Provider that serve as collateral for a Provider's repayment obligations.	Purchased Securities held by Custodian	One time deposit at closing or multiple deposits	Repurchases of Purchased Securities at based on anticipated or fixed schedule	Based on amount of funds at stated rate
Forward Delivery Agreement	No	Yes	Yes	Bank, Financial Institution or Insurance Company	Purchased Securities	Series of purchases at predetermined times	None	Spread based on purchase price paid by Issuer and market price of securities