

SECURITIES LAW AND OTHER CONSIDERATIONS FOR FORWARD DELIVERIES

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This panel will explore forward deliveries. Forward delivery bonds continue to be an important tool in the market. Issues to be discussed include the mechanics of a forward delivery (what it is and how it works), documentation pitfalls and things to look out for, identifying tax issues, disclosing information about the purchase agreement and associated risks. This session will also look at questions surrounding what to do if there is a material change that needs to be disclosed following the initial closing of the bonds.

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Session Outline

1) Structure Considerations

With the elimination of the ability to issue tax-exempt advance refunding bonds as a result of the enactment of the Tax Cuts and Jobs Act of 2017, issuers of municipal securities (“Issuers”) and underwriters have turned to using forward delivery bonds to achieve the economic benefits of a tax-exempt advance refunding. By engaging in a forward delivery transaction, an Issuer is able to lock in the interest rate(s) in effect at the time the contract is entered for bonds that will be delivered at a future date.

As defined by the Municipal Securities Rulemaking Board (the “MSRB”), a forward is “[a] contract (variously known as a forward contract, forward delivery agreement or forward purchase contract) wherein the buyer and seller agree to settle their respective obligations at some specified future date based upon the current market price at the time the contract is executed. A forward may be used for any number of purposes. For example, a forward may provide for the delivery of specific types of securities on specified future dates at fixed yields for the purpose of optimizing the investment of a debt service reserve fund. A forward may provide for an Issuer to issue and an underwriter to purchase an issue of bonds on a specified date in the future for the purpose of effecting a refunding of an outstanding issue that cannot be advance refunded.” See definition at: <http://www.msrb.org/Glossary/Definition/FORWARD-OR-FORWARD-CONTRACT.aspx>.

Generally, a forward contract is considered to be a “complex municipal securities financing” within the meaning of the MSRB’s interpretative guidance of its fair dealing rules. The Securities Industry Financial Markets Association (“SIFMA”) has developed a model document for underwriters to use when providing disclosures to Issuers about the scope of risks involved in a forward delivery transaction. See <https://www.sifma.org/wp-content/uploads/2017/08/sifmag-17modelriskdisclosuresforwarddeliverybonds.pdf>.

Although the receipt and review of underwriter disclosure pursuant to MSRB Rule G-17 may be considered a standard or boilerplate part of a municipal securities transaction, Issuers, investors and underwriters should take the time to review disclosures in connection with forward delivery contracts closely and consult with their legal and financial advisors before committing to the forward delivery structure.

a. Strategic and Debt Management Considerations

- i *Strategy*. In a forward delivery, the Issuer enters into an agreement with a financial institution (underwriter or direct placement bank) to purchase bonds on a forward basis.
 - 1. Tax-exempt forward delivery bonds are priced in the current market but not issued/delivered until a date in the future when, for example, a current refunding of outstanding tax-exempt debt is legally permitted. Forward periods can run from a few months to up to a period of 24 months.
 - 2. Forward delivery bonds allow the Issuer to lock in rates at levels relatively close to current market rates for a future current refunding.

3. Public offerings generally follow a “typical” bond issuance structure with delayed final delivery/settlement of bonds; private placement structures can offer structural optionality, with more complex authorization and tax considerations.
- ii *Pricing.* Compared to bonds with a standard (up to 30 days) delivery time period, forward delivery bonds are priced with a yield premium to compensate investors for the illiquidity of their investment during the forward period and for committing funds to purchase the bonds on the future delivery date. Yield premiums vary based on market conditions and the length of the forward period. Market conditions remain favorable for forward delivery transactions, although there are additional considerations as result of the current interest rate market.
- iii *Costs.* Several additional cost considerations should be evaluated including increased costs of issuance for delivery of documents at “soft” closing and final delivery of bonds; investors and underwriters seek additional compensation during the forward period to account for interest rate risk, market movements and change in law risks.

b. Issuance Authority and Timing

- i *State Law; Issuance Authority.* Confirm no impediments or limitations under state law. Action by a governing board to authorize issuance of forward delivery bonds should contemplate the forward period. Other legal issues include issuance authority and policy issues related to the forward delivery period and future changes in governing board composition. Review debt policy of the Issuer for any limitations. Evaluate statutory debt capacity concerns if issuance will not occur until the following fiscal/calendar year.
- ii *Existing Bond Documents.* Review existing bond documents for any impediments or limitations, including parity debt, additional bonds tests, other covenants or obligations.
- iii *Timing.* Preliminary closing following pricing (“soft closing”); final settlement and delivery of forward bonds on, for example, current refunding call date or not earlier than 90 days prior to the call date.

c. Tax Considerations

- i *Change in Law Risk.* An adverse law change could occur between the sale date and the projected issue date of the bonds.
 1. Legislation: Legislative changes have tended to key off the issuance date of the bonds.
 - a. Most recent legislative change, the Tax Cuts and Jobs Act of 2017: the prohibition on tax-exempt advance refundings.
 - i. Applicable to bonds issued after December 31, 2017.
 2. Regulations: In contrast, recent IRS regulations have keyed off the sale date of the bonds.
 - a. E.g., the final issue price regulations (December 2016), the final non-issue price arbitrage regulations (July 2016).
 - b. Other recent regulations not keyed to issue date:

- i. Proposed reissuance regulations (December 2018): date of alteration to a debt instrument.
 - ii. IBOR regulations (January 4, 2022): date of alteration to a debt instrument or date of modification to a non-debt contract (*e.g.*, an interest rate hedge).
 - 3. Rulings, revenue procedures, IRS notices:
 - a. Management contracts, Rev. Proc. 2017-13: date of entering into, materially modifying or extending contract.
- ii *Updating Tax Due Diligence.*
 - 1. The longer the period, arguably the greater the chance that something may occur which merits addressing.
 - 2. Bond counsel needs to update its due diligence to be able to render a tax exemption opinion concurrent with the issuance and delivery of the bonds.
 - 3. Often, at the time of “soft closing” (closer to the sale date), bond counsel is asked to deliver a letter setting forth its ability to be able to render a tax opinion on the settlement date subject to there being no change law and having undertaken supplemental due diligence.
- iii *Issue Price.*
 - 1. First, is the financing a public offering or a private placement?
 - 2. Issue price for maturities in a public offering (in a negotiated sale transaction) may be based on the traditional 10% actual sales test or on the “hold the offering price” rule.
 - 3. Issue price for a private placement is based on the price paid by the buyer.
 - a. If there is a private placement and the buyer later resells, such sale will not change the issue price of the bonds.
 - b. Bond counsel should consider what factors will support its comfort level that the transaction is a private placement.
 - i. Representation that the buyer is buying for its own account.
 - ii. Representation that the buyer has no present intention to sell the bonds.
 - iii. How to treat a buyer’s request that it not be constrained from selling the bonds once it takes delivery of them?
 - a. *E.g.*, the buyer refuses to covenant not to sell even though it makes a representation that it has no present intention to sell.
 - iv. As a possible solution, require the buyer, should it sell bonds within X days of delivery, to report the prices of such sales to the Issuer until the 10% threshold is met?
 - a. What about the fact that the Form 8038 (or 8038-G) filing date may have passed?

iv *Application of Issue Price.*

1. Application of issue price:
 - a. Yield restriction
 - b. Arbitrage rebate
 - c. Sizing of a DSRF (the 10% limitation)
 - d. Weighted average maturity
 - e. If a PAB:
 - i. The 2% COI limit
 - ii. The 95% “good cost” requirement

v *The Forward Premium.*

1. Counsel may want to obtain certain representations from the underwriter, or the bank holding for its own account, supporting the size (number of basis points) of the forward premium.
2. Theme is not to overstate the amount of tax-exempt interest being put into the market.

vi *Concurrent Sale of Current Delivery Bonds.*

1. Treated as part of the same issue of obligations if sold at the same time (or in any case less than 15 days apart) pursuant to the same plan of financing.
2. Particular arbitrage/yield considerations
 - a. Would one calculate the yield on the bonds assuming the forward delivery bonds are issued and delivered, or not?
 - b. Is a solution to use the lower of the two yields?
 - c. Assuming no yield-restricted funds, it may not matter, unlike when advance refundings were the other component of the transaction.
 - d. But an 8038 (or 8038-G) needs to be filed setting forth the yield. State the reasonably expected yield (see 8038/8038-G instructions).
 - e. File one 8038 (or 8038-G) or two?
3. Multipurpose allocation considerations:
 - a. Treas. Reg. 1.148-9(h) may constrain single issue treatment by limiting an Issuer’s ability to do a multipurpose allocation of bonds to the several purposes of the bond issue. To the extent a current refunding and a forward delivery are the two elements of the refunding bond issue, an Issuer may naturally opt for the “mirrored debt service” allocation in the above regulation, but that will then place a limit on the Issuer’s ability to modify the overall debt structure – e.g., by extending maturity. In any case, because Section 149(d) of the Code focuses on “bond” and not “issue,” an Issuer should not have to concern itself with attributing a currently delivered bond to the forward refunding of a non-advance-refundable bond.
4. TEFRA Considerations. For private activity bonds, including qualified 501(c)(3) bonds, practitioners should be mindful of the application of the TEFRA current refunding exception in this

context, as well as the time limitations of TEFRA, including in particular the requirement that bonds be issued within one year of the time of TEFRA approval (considering the effect of the forward delivery period). See Treas. Reg. § 1.147(f)-1(f)(7).

vii *Alternatives to Forward Delivery.*

1. “Cinderella” bonds
 - a. Until the IRS provides applicable guidance, most bond counsel require that the transaction build in a need to have the taxable bonds “reissued” as tax-exempt bonds.
 - b. Potential for inflation of tax-advantaged rate by virtue of deflection of portion of taxable rate.
 - c. The parties must ensure that the tax-exempt interest rate (more importantly, the tax-exempt yield) is not overstated.
2. Option structure
 - a. Underwriter or bank holding for its own account pays an upfront amount to the Issuer approximating the present value debt service savings that the Issuer would realize if it issued bonds at current market yields.
 - b. Is this a true “option” premium? Economic compulsion of the underwriter or bank to complete the purchase (much larger than a typical good faith check).
 - c. Any argument that the refunding results in an early issuance of bonds such that there is a prohibited advance refunding?
 - i. If so, how many bonds are considered as newly issued?
 - a. Amount equal to the present value savings?
 - ii. Counterargument: There is only a single set of bonds outstanding at any point in time.
 - d. Is the option premium considered “proceeds” or “gross proceeds” subject to use and/or arbitrage restrictions?
 - e. Does the option structure affect when the issue date occurs? Does that depend on one’s conclusion that the exercise of the option is not a foregone conclusion – i.e., there is true optionality?

2.) Key Documents (Other Than Disclosure). Documentation for forward delivery transactions generally follows standard market formats, with certain key documents delivered at “soft closing” and additional “bring-down” documents delivered at the final settlement of the bonds.

- a. *Purchase Agreement.* Issuer and underwriter/purchaser execute a forward bond purchase agreement (“Forward BPA”) on the pricing date for delivery to occur on a later date that is specified in the Forward BPA. Provisions of the Forward BPA for consideration include:
 - i. Dual Closing. Forward BPA contains both conditions that must be satisfied on the “soft closing” date and conditions that must be satisfied on the delivery date of the forward delivery bonds.

- ii Representations. Issuer representations speak as of the date of the Forward BPA; certain representations will be framed as assumptions or expectations for the future, forward delivery closing date or deemed re-made as of the forward delivery date.
 - iii Termination Provisions. Two sets of provisions to address differing time windows of risk: (1) time period between the pricing and soft closing and (2) time period between the soft closing and the final delivery and settlement of the forward delivery bonds. Consider differences between soft closing “outs” and delivery date “outs.”
 - iv Disclosure. Considerations include timing for delivery of: updated Official Statement (“UOS”) at final settlement; continuing disclosure undertaking and ongoing compliance with continuing disclosure for outstanding bonds; whether underwriters will continue to offer bonds during period between soft closing and final settlement and related considerations concerning disclosure and diligence.
- b. *Expected Forms of Documents*. Documents that take effect upon final settlement of the forward bonds are provided as unexecuted, substantially final documents at the “soft closing” and are then executed and delivered at final settlement and closing.
 - i *Indenture*. Form of document to be delivered at final settlement. All material terms, including covenants, representations, events of default, amendment provisions should be in complete and final form.
 - ii *Tax Certificate and Other Closing Documents*.
 - 1. At “soft closing” with supplement at final settlement.
 - 2. At settlement.
 - iii *Legal Opinions*.
 - 1. Soft Closing Opinions include statements of certain assumptions and expectations.
 - 2. Bond Counsel letter delivered at “soft closing” stating expectation that bond counsel opinion will be issued on the final Settlement Date in the form included in the Official Statement, assuming satisfaction by the Issuer and underwriters of their respective obligations, the issuance of the Bonds in accordance with the legal documents, no change in applicable law, regulations or rulings, or change in material facts and circumstances.

2) Disclosure Documents and Considerations

- a. *Primary Disclosure*. The disclosure should inform investors of the conditions for delivery and settlement of the Forward Delivery Bonds.
 - i *Timing of Disclosure Documents*. Preliminary Official Statement (“POS”) at pricing; final Official Statement (“OS”) delivered within seven business days after pricing; UOS delivered generally within two weeks prior to the final settlement date
 - ii *Purchase Agreement Conditions; Material Events, Actions or Changes*. The POS and OS will include a summary of the Forward BPA provisions

that must be satisfied for the final delivery and settlement of the Forward Delivery Bonds. If certain events or actions occur or do not occur, the Forward Delivery Bonds may not close. Unlike disclosure for current delivery bonds, the forward delivery POS and OS should include the Forward BPA termination events for the forward delivery period. These “outs” typically include any one or more of the following:

1. Intervening change in law that prevents delivery of the required tax opinion on the delivery date;
 2. Intervening change in law that prevents the Issuer from performing or any counsel from delivering a required opinion on the delivery date;
 3. Litigation has been filed or an event of default occurs under the underlying documents;
 4. Failure to hold TEFRA hearing or obtain elected official approval;
 5. Inability to meet ratings requirements applicable on the delivery date of the Forward Delivery Bonds;
 6. Material Adverse Change that prevents the Issuer from meeting the requirements of the Forward BPA to deliver current disclosure information;
 7. Market disruption that prevents settlement of the bond delivery through DTC.
- iii *Risk Considerations.* Because of the intervening time period between the pricing and preliminary settlement date and the final delivery and settlement of the Forward Delivery Bonds, there are additional risks to consider and address in the POS and OS, as well as in the underlying key documents (particularly the BPA), including:
1. Issuer unable to satisfy conditions for delivery
 2. Underwriter unable to perform
 3. Limited universe of potential investors
 4. Alternatives to forward delivery may be better
- iv *Investor Letter/Agreement.* POS and OS may include form of investor agreement (an “Investor Contract”) between the underwriter and investors that sets out the terms and conditions for purchase by investors, discloses risks and limited outs between “soft closing” and final settlement of the Forward Delivery Bonds. Issuers and underwriters should discuss this early in the transaction as underwriters may have developed their own practices, however, the POS and OS remain the Issuer’s documents.
- v *Updated Disclosure and Diligence Considerations During Forward Delivery Period and at Final Settlement.* The Forward BPA should specify what obligations the Issuer has to provide ongoing disclosure or other diligence information to the underwriter during the period between the preliminary settlement date and the final settlement date.
1. These obligations will vary depending on whether the underwriter will be engaged in actively offering the bonds during this period. The Forward BPA will also provide for the delivery of the UOS by a date prior to final settlement.

2. The UOS may take different forms depending on the agreement of the parties specified in the Forward BPA.
3. The Issuer and the underwriter will need to evaluate ongoing representations and 10b-5 considerations for the UOS.
4. In preparation for delivering the UOS, a bring-down due diligence call and/or written diligence questions should be part of the process.
5. Incorporation of material by reference: EMMA filings including material events, CAFR, annual reports/disclosures, other information.
6. Other considerations: Material/recent developments; black-out period for offering securities to investors, disclosure updates. Material events occurring after the Investor Contract is executed should be specified and included as investor outs in the Investor Contract.

b. Continuing Disclosure.

- i *Undertaking for Outstanding Bonds.* Forward BPA will have covenants for ongoing compliance with bond documents and disclosure obligations for outstanding bonds during the forward period and prior to the settlement date of the Forward Delivery Bonds.
- ii *Forward Delivery Bonds as “Financial Obligations.”* Issuers and underwriters should discuss EMMA filings related to any forward delivery transaction under new listed events under Rule 15c2-12.
- iii *Undertaking for Forward Delivery Bonds.*
 1. Compliance with Rule 15c2-12. Analyze structure of forward delivery transaction; when are offers made to investors and related timing considerations under the Rule.
 2. Issuers should ask the underwriter to confirm their requirements for delivery of the continuing disclosure undertaking for the Forward Delivery Bonds.
 3. Underwriters should confirm with internal counsel/compliance timing requirements for delivery of continuing disclosure undertaking for Forward Delivery Bonds.
 4. Underwriters should consider what due diligence procedures around compliance with existing undertakings will be needed in connection with bring-down of primary market disclosure by the Issuer.