


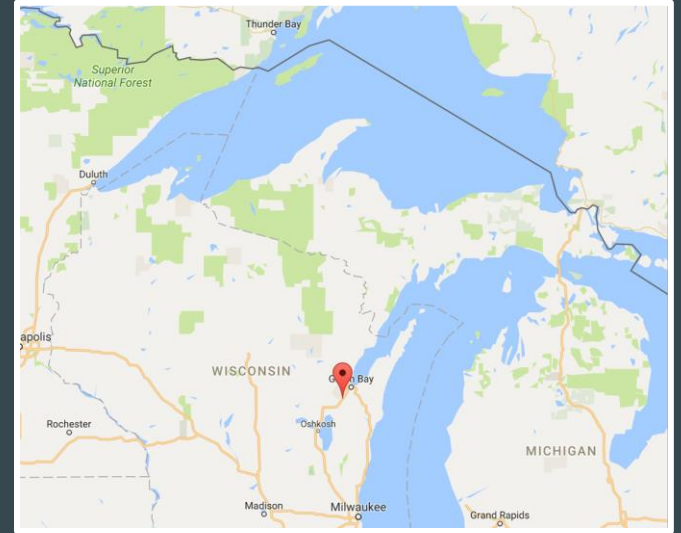
Private Placement in California: Lessons from California's Mandatory Disclosure Rule



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Why do bank loans matter?

- 09/2015: Lawrence, Wisconsin
- Credit downgrade: AA to BB+
- \$4.6M = 3X annual revenue
- Direct loans, unusual clause
- Phenomenon of bank loans as alternative financing



Outline

Definitions & Background

Research Questions

Data and Methodology

Findings

Implications

Policy Recommendations



Deciding between Bank Loans & Public Bonds

Private Placements & Direct Loans	Public Bonds
● Few investors	● Numerous investors
● More flexibility	● More documentation
● No federal disclosure regulation	● Disclosure regulated federally

Research Questions

What are the characteristics of private placements and direct loans in California?

- Descriptive statistics: number, volume, purpose

What are the effects of private placement and direct loan provisions on municipal borrowing and investors?

Is there a role for public policy to improve the market for municipalities?

Data

Interviews

Municipal borrowers, financial institutions, bond counsels,
regulatory agencies, professional organizations

California Debt and Investment Advisory Commission (CDIAC)
issuance data

Direct loan documents, part of CDIAC

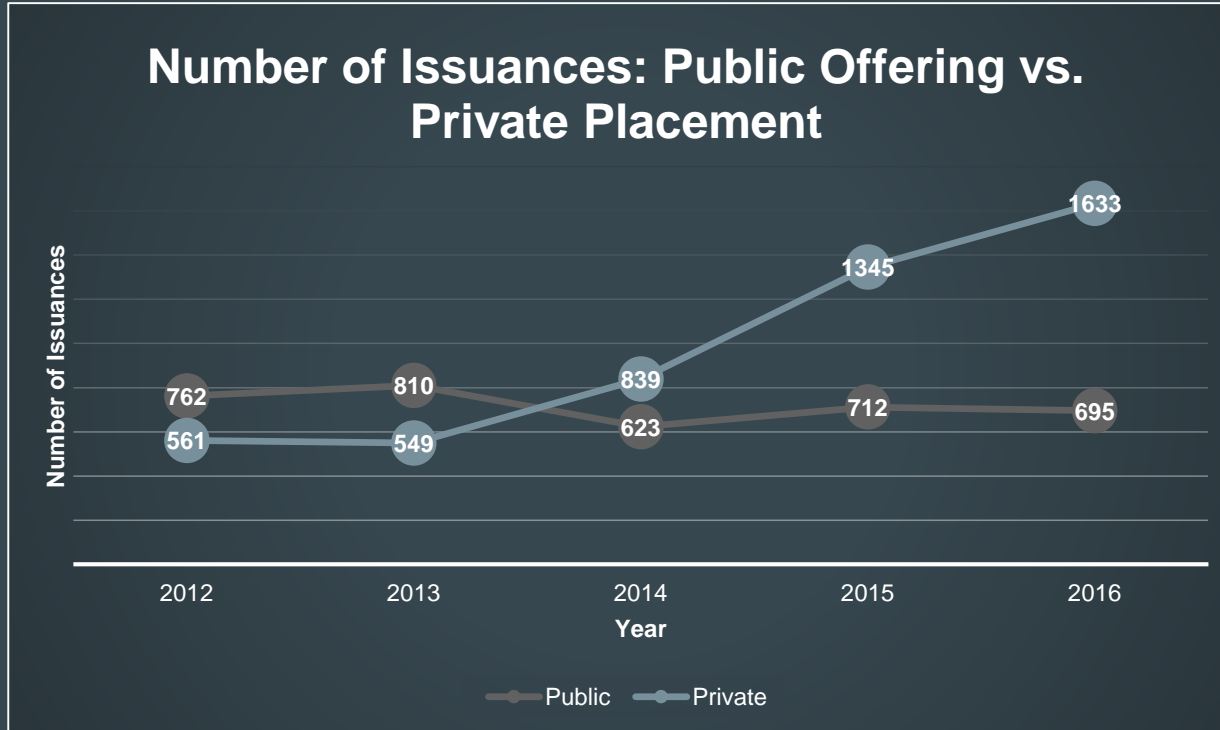
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Have private placements changed over time?

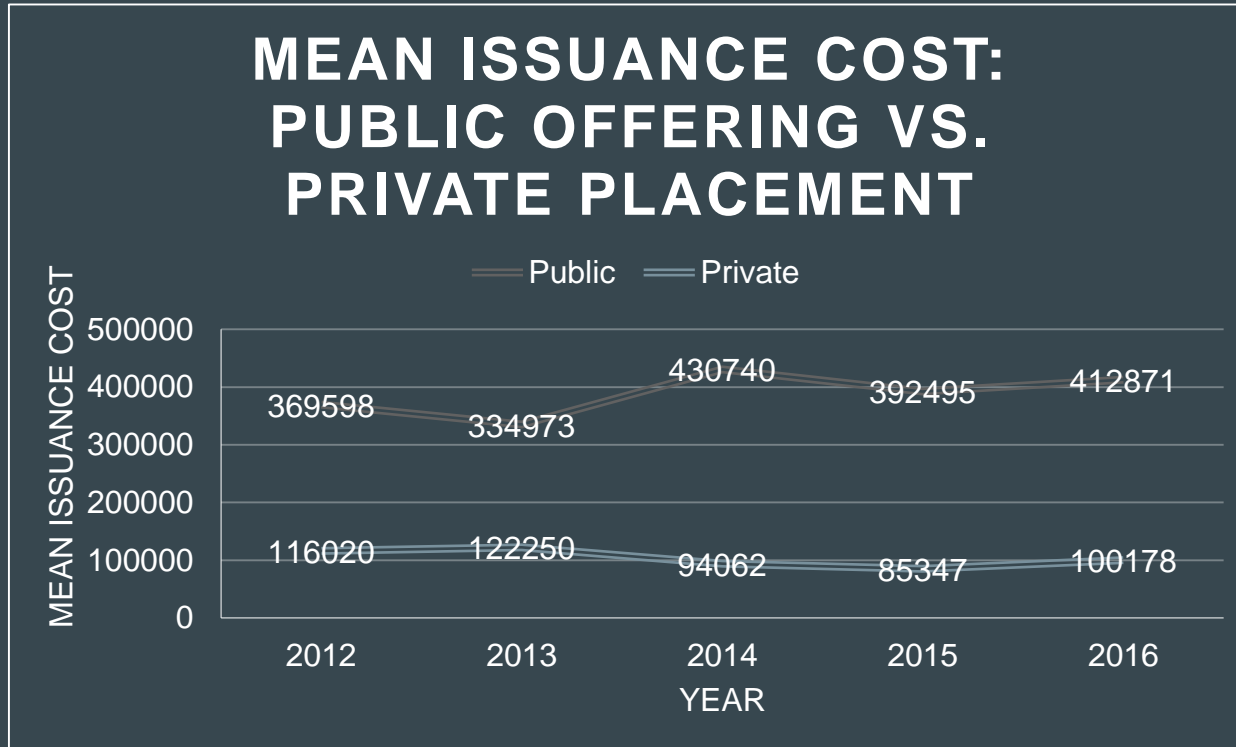
How do private placements differ from public offerings?

What are private placements being used for?

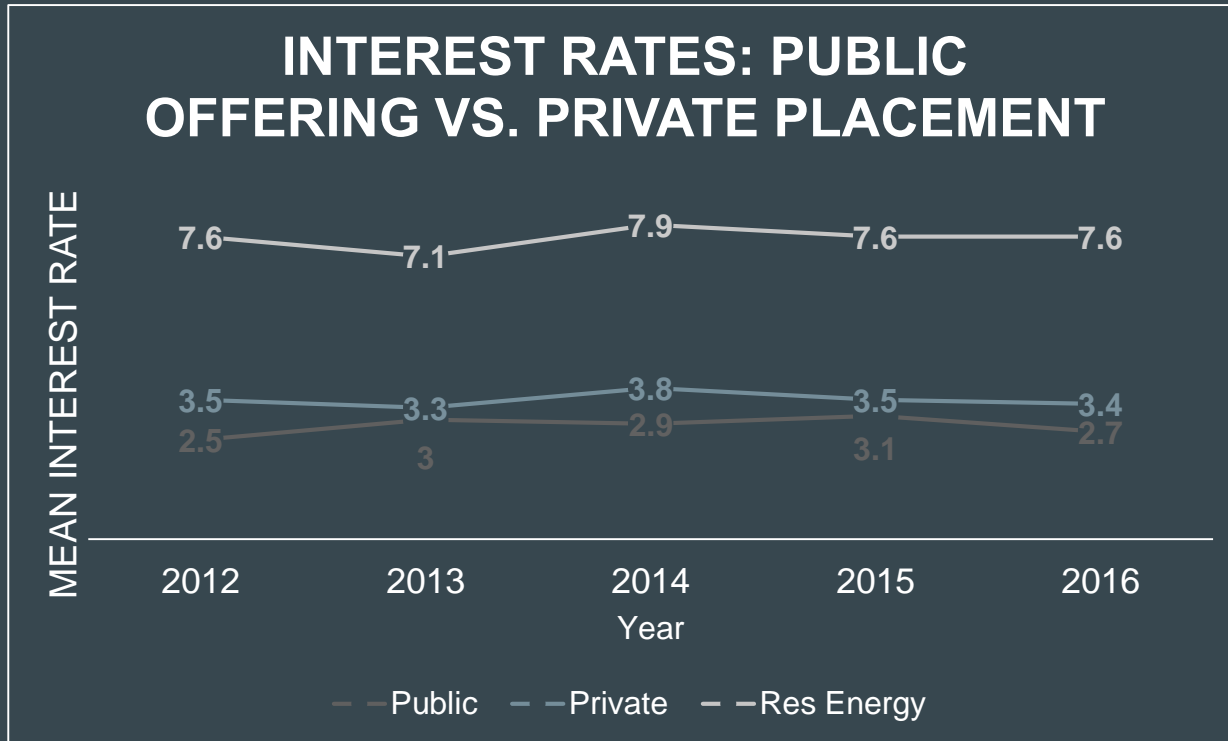
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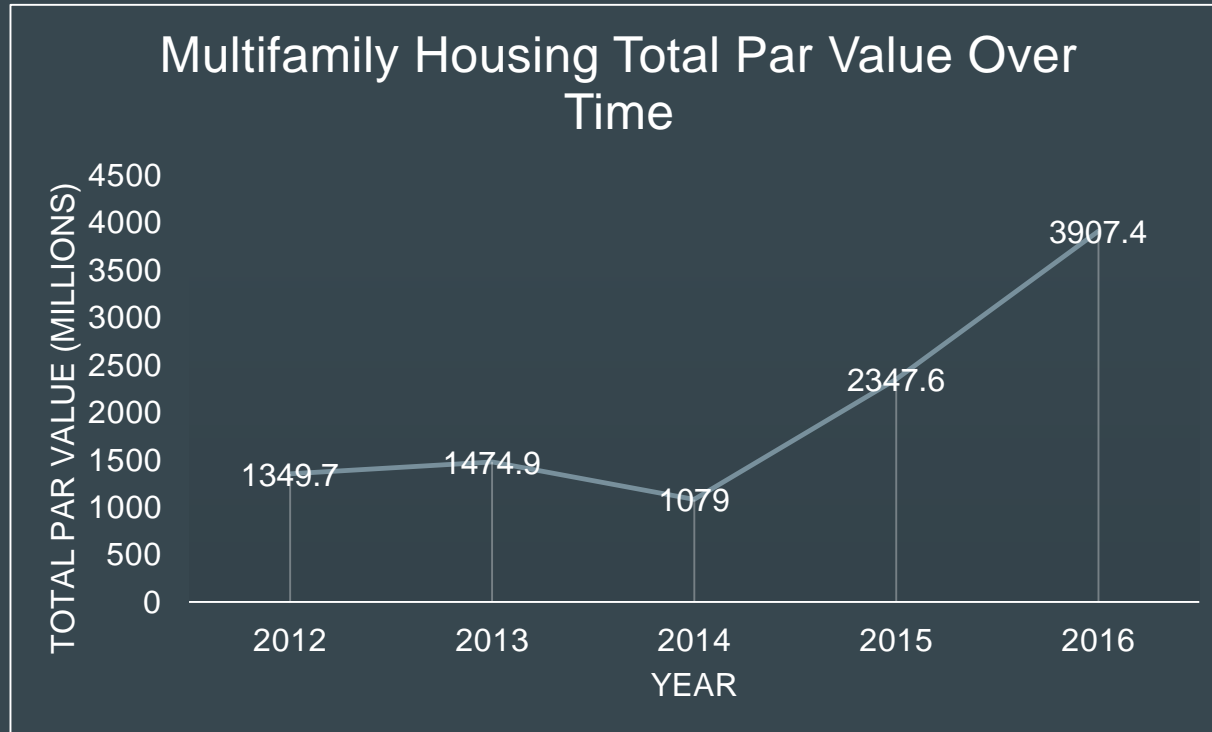
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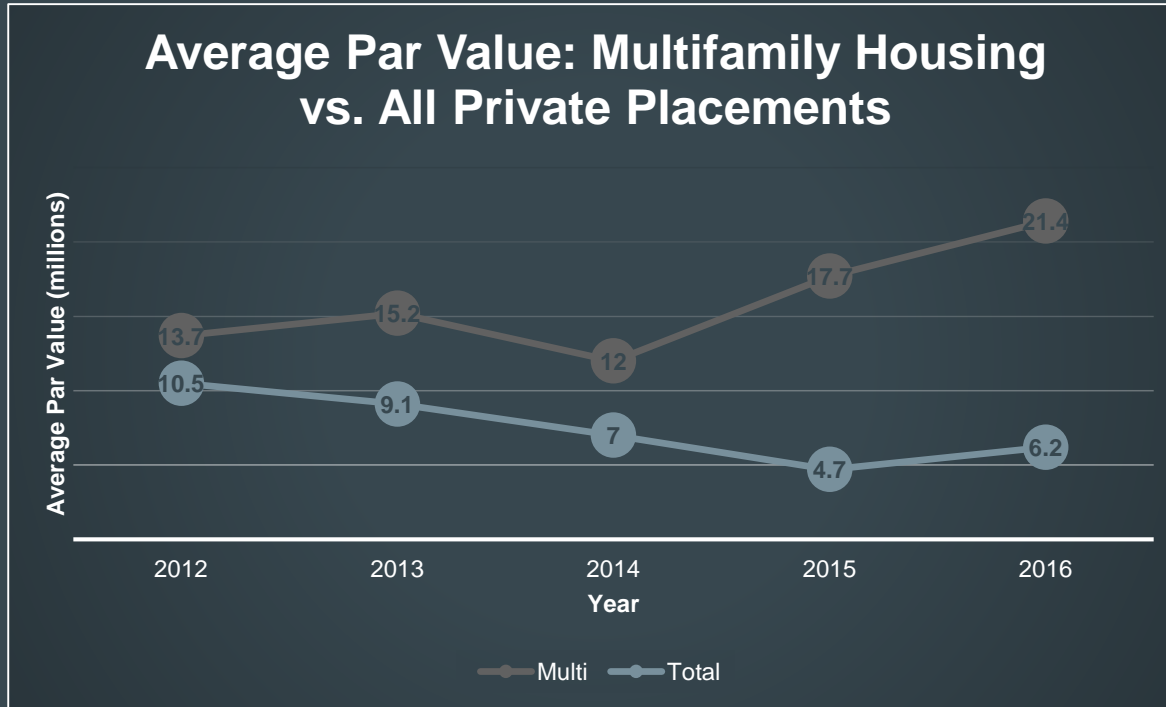
What are private placements being used for?

Purpose of Funding (2016)	Sum Principal (\$)
Multifamily Housing	3,907,421,177
Residential Energy Conservation, Improvement	1,379,362,038
K-12 School Facility	841,561,684
Health Care Facilities	750,712,245
Public Transit	457,000,000
Power Generation/Transmission	428,119,192
Multiple Capital Improvements, Public Works	338,941,586
Hospital	280,662,000
Pollution Control	242,900,000

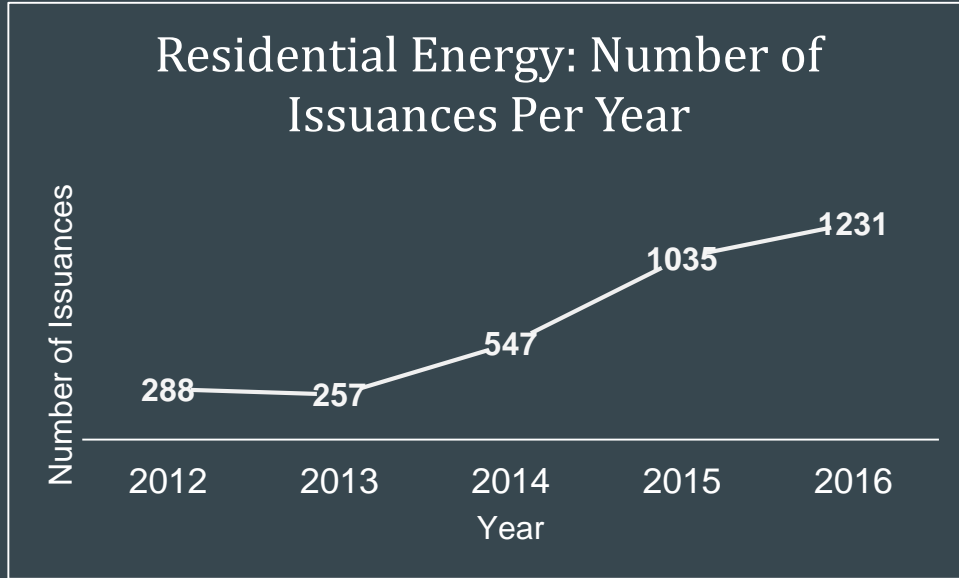
A Closer Look at Multifamily Housing



A Closer Look at Multifamily Housing



A Closer Look at Residential Energy



Private Placement		
Purpose	Count	%
Residential Energy Conservation, Improvement	3419	60.31%
Multifamily Housing	628	11.08%
K-12 School Facility	455	8.03%
Multiple Capital Improvements, Public Works	178	3.14%
Water Supply, Storage, Distribution	92	1.62%

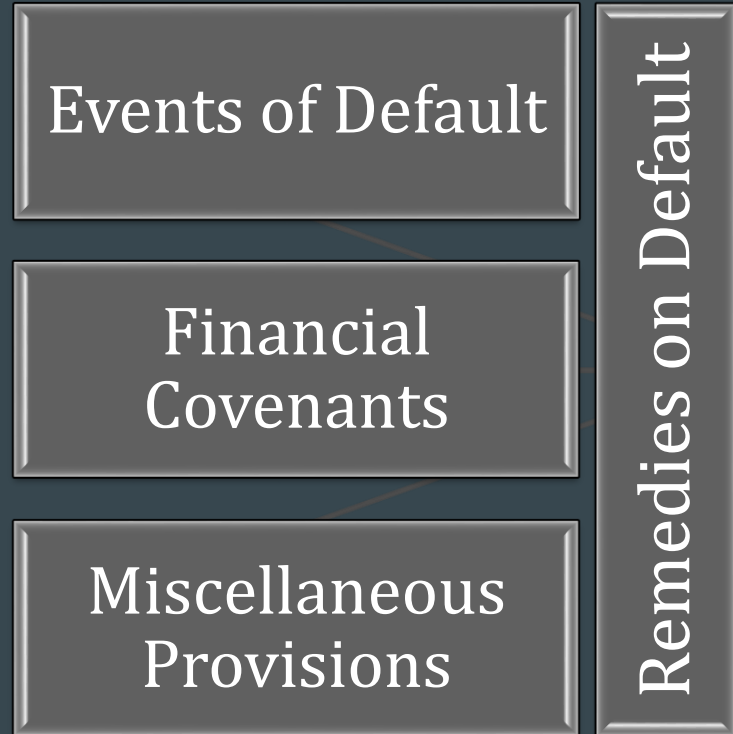
A Closer Look at Residential Energy: WRCOG

- Western Riverside Council of Governments
- JPA representing 17 cities in Riverside County
- Partnered with bond issuer to start a green energy program throughout state in 2013-2014

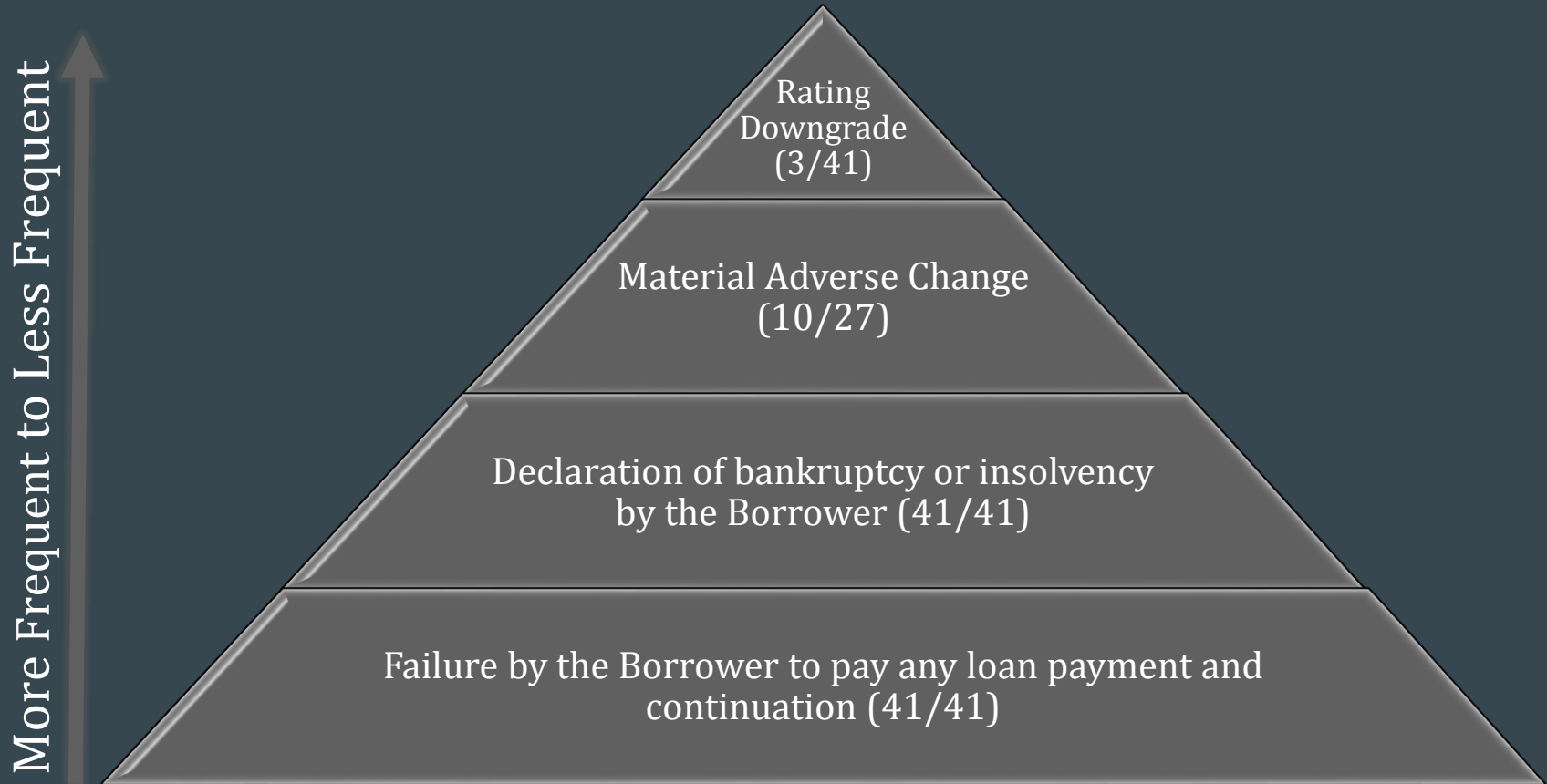
Direct Loan Analysis

41 Direct Loan
Documents in CDIAC
(2012 - 2016)

Structure of Each Loan
Document



Events of Default



Financial Covenants

Debt Service Coverage Ratio

$$= \frac{\text{Available Revenues}}{\text{Debt Service Requirement}} > 1.25$$

Net Liquid Assets

= Cash & Level I Investments

– Permanently Restricted Assets > x

Remedies on Default



- Cease to extend credit to the Municipality



- Proceed by court action to enforce performance by the Municipality



- Accelerate the immediate repayment of the loan

Findings - Implications

What do the gross trends tell us?

- Bank loans are growing, but still a small share
- Public offerings have low interest rates, high issuance
- Sector changes

What does the direct loan analysis tell us?

- Harmful provisions to less sophisticated municipalities
- Potential rise in cost of borrowing
- Risk to municipal investors

State Based Policy Recommendations

- Greater enforcement of California's 2014 law to increase reporting
- Market Penalties for not reporting to CDIAC
- Outreach/Education to Municipalities

Federal Policy Recommendations

- Committee on Uniform Security Identification Procedures (CUSIP) Numbers for Private Placement
- Adopt SEC Amendments
- Clarify Material Events Notice
- Expand Definition of Financial Obligations

SEC Amendments to Rule 15c-12: Underwriters must require issuers to notify MSRB of (1) the incurrence of direct loans, direct purchases and all material events and (2) occurrences of accelerations and defaults