

**National Federation of Municipal Analysts**  
***Recommended Best Practices in Disclosure***  
***for Water and Sewer Transactions***



The National Federation of Municipal Analysts (NFMA) is an organization of nearly 1,000 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent, among others, mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

One of the main initiatives of the NFMA is to promote timely and complete disclosure of the financial and operating information needed to assess the credit quality and risk of a municipal debt issue. The NFMA's efforts have ranged from global disclosure-related issues to more detailed, sector-specific work such as these Recommended Best Practices in Disclosure. For further information on the NFMA's continuing work in the area of disclosure, please see the "Disclosure Guidelines" and "Position Statements" pages of the organization's web site at [www.nfma.org](http://www.nfma.org).

In order to develop our Recommended Best Practices in Disclosure, diverse groups of NFMA analysts worked with non-analyst market professionals to develop "best practices" guidelines for certain market sectors. These Recommended Best Practices include descriptions of the sector-specific financial and operating information needed to help analysts do their jobs. The NFMA believes that the best practice in disclosure will always be the one that provides a steady flow of timely information from borrowers to the market. Initial drafts of our Recommended Best Practices in Disclosure were widely circulated, and an industry comment period was used to seek input from interested parties. Subsequent to the comment period, the papers were revised. For certain papers, Comment and Response papers were drafted; these papers are available on the NFMA web site, providing additional information on the comments received.

Following is the most recent version of the Recommended Best Practices in Disclosure for this sector. This document is not intended to supplant the Amendments to SEC Rule 15c2-12, but to be used in conjunction with the guidance provided in those amendments. It is important to note that the NFMA's disclosure efforts are a continuing process. These guidelines are not static documents, and will be revisited and changed as market conditions warrant. We encourage interested parties to submit comments at any time to [lgoog@nfma.org](mailto:lgoog@nfma.org) so that they can be considered in the development of future versions of these Recommended Best Practices in Disclosure.

*The NFMA Recommended Best Practices in Disclosure are not intended to be "one size fits all" recommendations, and all the information requested may not apply to every transaction in the sector. We encourage the providers of information to indicate when a specific item requested in the Recommended Best Practices is not applicable to a specific transaction.*

## **BACKGROUND**

The NFMA Water and Sewer Disclosure Subcommittee (the “Subcommittee”) was formed to write Recommended Best Practices in Disclosure for Water and Sewer Transactions. Members of the subcommittee included buy and sell-side analysts, insurance company analysts, rating agency representatives, and issuer representatives.

## **GOALS**

The goals of these Recommended Best Practices are as follows:

### **1) Improve the timeliness, thoroughness, and accuracy of both primary market and secondary market disclosure in the Water and Sewer sectors.**

In an era of both evolving regulation of water and sewer systems and increasing capital needs, issuers need to be aware that accuracy, timeliness, and thoroughness in reporting are critical for investors and potential investors attempting to assess the system’s relative creditworthiness.

### **2) Improve the consistency of water and sewer system audits post GASB 34.**

We believe a level of standardization in financial reporting will allow auditors to make financial reports and audits much more meaningful to the investment community. Analysts would like to work with issuers and auditors to make disclosure as painless as possible, and the audit more user-friendly.

### **3) Improve the means of dissemination of financial and operational information to make it easier for issuers to provide, and for investors and potential investors to access information, especially for continuing disclosure.**

Operational data related to water and sewer systems is generally maintained by system management and staff, while financial information is often managed by the issuer’s finance department, especially for the preponderance of municipally-owned utilities. Both types of information are important for continued credit evaluation. The issuer, especially cities, should consider designating the same investor contact who handles general inquiries to handle inquiries about the water and sewer system. In addition, we recommend that the institution designate an area of its web site where continuing disclosure information is provided.

## **CONCLUSION**

The following recommendations have been developed as a response to the three goals discussed above, and as a way of helping issuers hit a firm target of disclosure based on investor needs. The specific recommendations directly address the timeliness and content of disclosures that municipal market participants have identified as important in this sector.

In summary, the goal of the Subcommittee is to make financial disclosure more standardized, useful and timesaving for the issuers, as well as more meaningful and accurate for investors and potential investors.

The Recommended Best Practices that follow are divided into two sections: primary market disclosure and secondary market disclosure.

### **RECOMMENDED CONTENT OF PRIMARY MARKET DISCLOSURE FOR WATER AND SEWER TRANSACTIONS**

In addition to the specifics outlined below, institutions should be aware of the following:

- Information should be as current as possible when issuing bonds, including unaudited financials for the current fiscal year if the previous fiscal year's audit is over 12 months old.
- Accurate capacity and compliance characteristics, which are key drivers of future credit quality, must be easily available.
- Issuers should be consistent with quantitative data being released to all venues, including that data released on the institution's web site.
- Data should be defined consistently over time and any changes in definitions or classifications should be clearly highlighted.
- Systems that are part of a consolidated municipal organization report should have discernible financial statements for the system.
- All financial statements submitted should include an income statement, cash-flow statement and balance sheet.
- Annual audited financial statements should include related footnotes and a complete set of comparable audited financial statements for the prior year.

### **UTILITY DESCRIPTION**

Identify services as wholesale or retail; drinking water supply, treatment and/or distribution; wastewater collection, transmission, treatment and/or disposal.

### **ECONOMIC BASE**

1. Define service area
2. Population trends and forecasts
3. Largest employers, unemployment rate

### **MANAGEMENT**

1. Governance. Note selection process for governing body (e.g., mayoral appoint, election, etc.)
2. Rate setting authority. Identify the governmental body with final approval authority for rates and minimum estimated time frame for implementation of rate increases.
3. Statement with respect to rate regulation by a state public utility board or commission. To the extent the rates are subject to regulation, a statement regarding the history of decisions with respect to rate applications.
4. Brief professional background of key administrators, and term of office, years of service;
5. Names, address, phone and fax number, and e-mail for investor contact.

## **STAFF**

1. Five-year trend of staffing with statement of licenses and certifications.
2. Comment on any current labor issues, if material.
3. Retirement plan status.
4. Comment on any formal efforts to enter into contracts with private parties for operation of all or part of the system.

## **RATES**

1. Current rates by customer class and five year history of rate adjustments.
2. Average monthly bill for residential customers based on 7,500 gallons of usage.
3. Comparable rates for similarly sized systems.
4. 10 largest customers by revenues.
5. Statement with respect to any large customer contracts
6. Collections rates and enforcement mechanisms

## **PLANT AND FACILITIES**

1. Current treatment facilities, including year placed in service, major upgrades, capacity, peak and average flows, level of treatment (for wastewater) and treatment process (for drinking water);
2. Source, quality and capacity of water supply
3. Miles of lines of mains, number of interceptors and lift stations
4. Conclusions of engineering studies

## **ENVIRONMENTAL REGULATION**

1. Expiration date of NPDES permit (where applicable); if expired, status of renewal application.
2. Identification of violations under the permit within the past two years, and statement of corrective action. Statement of paid or pending fines.
3. Statement of water quality pursuant to requirements under the Safe Drinking Water Act.
4. Statement of compliance with pending or proposed rules under the Safe Drinking Water Act or Clean Water Act.
5. Statement with respect to the existence of any administrative actions taken by a regulatory agency or any consent decree.

## **FOR WHOLESALE SYSTEMS**

1. Description of contracts, including term, method for calculating rates and other pertinent terms.
2. Identify any step up provisions; identify obligated parties under the step-up provisions.
3. Statement with respect to capital plans of wholesale customers that may impact flow to the issuer's facilities.
4. Terms and conditions for plant expansions and improvements.
5. Information related to obligated parties, including financial disclosure on significant participants representing 10% or more of gross revenues.

## **FOR PURCHASERS UNDER WHOLESALE SYSTEM CONTRACTS**

1. Description of contractual obligation to wholesale provider, including term, method for calculating rates and other pertinent terms.
2. Nature of payment obligation with respect to debt service on current offering (i.e., prior or subordinate obligation).
3. Five-year operating and financial history, including required rates to cover contractual obligations.
4. Prospective capital plan for wholesale provider.

## **TERMS OF DEBT**

1. Amount, security and lien status of (a) outstanding indebtedness, including lease and all contractual obligations, including the use of derivative products and (b) projected and planned indebtedness. Discuss security of debt obligations and, in the case of derivatives, the length of the agreement and potential termination payments.
2. Capital plans for the next five years and expected funding mechanisms, including revolving loan fund and USDA programs.

## **BOND ISSUANCE PLAN** (This may be included in the body of the Official Statement)

1. Project description and timetable, including the following: (a) source and use of funds, including source of equity contribution and timing of receipt; (b) if a refunding issue, reasons for refunding (economic, legal, etc.); and (c) if reimbursing for prior expenditures, or taking out construction loan, include explanation and status of construction.
2. Summary of Security. Refer to operative underlying document.
  - a. Pledged revenues.
  - b. Flow of funds
  - c. Rate covenant.
  - d. Use of rate stabilization funds and connection fees.
  - e. Additional debt test.
  - f. Reserve fund requirements and funding provisions.
  - g. Redemption provisions, including extraordinary call features.
  - h. Legal features
    - i. Litigation risk—Pending proceedings that could affect the system's ability to meet its obligations or questions the validity of the obligation;
    - ii. Taxation risk—Covenant to maintain tax-exemption
    - iii. Events of default and remedies.
  - i. Crossover refundings—discuss if applicable.
  - j. Escrow arrangements, trustees and refunding timetable, if applicable.
3. Statement of sources and uses of funds.
4. Debt Service:
  - i. Debt service schedule, cumulative and by issue on a pro forma basis;
  - ii. Debt service reserve requirement and balance for each issue;

- iii. Debt service coverage by issue and projected.
5. Bond opinion and list of all legal documents with relevant opinions.
6. Continuing Disclosure statement.

#### **FINANCIAL INFORMATION**

1. Audited financial statements—minimum of three years (summary of five), accompanied by auditor's management letters and management's responses.
2. Year-to-date financial statements compared with budget.
3. Budget summaries for most recent fiscal year and current full year projection.
4. Management discussion and analysis. Include discussion of impact of accounting changes.
5. Discuss policies with respect to imposition, collection and use of impact fees.
6. Discuss policies with respect to general fund transfers (or payments in lieu of taxes)

#### **RECOMMENDED CONTENT OF SECONDARY MARKET DISCLOSURE FOR WATER AND SEWER TRANSACTIONS**

The following recommendations have been developed to achieve the goals set forth above. In addition to the specifics outlined below, issuers should be aware of the following:

- Information should be provided in a timely manner by the issuer and should include the name of appropriate contact person, telephone and fax number and e-mail address. This would enable those interested to obtain further clarification on the information disclosed. Information posted on web sites with free access is highly recommended.
- Issuers should try to be consistent with quantitative data being released to all venues, including that data released on its web site.
- Data should be defined consistently over time and any changes in definitions or classifications should be clearly highlighted.
- All financial statements submitted should include an income statement, cash-flow statement and balance sheet and related footnotes. A management discussion is also very helpful.

#### **FINANCIAL INFORMATION**

1. Annual audited financial statements and a complete set of comparable audited financial statements for the prior year should be made available within 120 days of fiscal year end.
2. Management discussion of finances on an annual basis should include:
  - Material changes in financial performance;
  - Identification of any major unplanned expenditure in the prior year;
  - Lines of credit, including amount outstanding, amount available, provider, and collateral pledged;
  - Any significant changes to current year's budget;
  - Significant changes in short or long-term debt;

- Any plans for new projects or capital improvements using contributions, internal funds or debt;
  - Statement that pertinent hazard and liability insurance policies are still in effect;
  - Significant changes in outstanding litigation, if deemed material.
3. Annual audit should contain statement or certification by issuer that they are in compliance with financial covenants required by bond documents or that the auditor opines to their compliance.
  4. If available, interim financial statements shown against respective budget periods should be made available to investors.

## **OPERATING INFORMATION**

1. Operating Information for the period, including the following:
  - Peak and average flows for the year;
  - Change in status of top ten customers;
  - Impact from promulgation of any change in regulatory framework;
  - Status of permits.

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