

**National Federation of Municipal Analysts**  
***Recommended Best Practices in Disclosure***  
***for Dedicated Tax Bonds***



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Since its inception in 1983, the National Federation of Municipal Analysts (NFMA), has been at the forefront of efforts to improve disclosure of credit and market risks that have faced analysts and investors in the taxable and tax-exempt municipal bond markets. The NFMA’s work in this regard has been recognized by other industry associations and by various regulatory bodies. The NFMA organization is composed of nearly 1,300 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent mutual funds, insurance companies, separately managed accounts, broker/dealers, bond insurers, and rating agencies, among other stakeholders.

One of the main initiatives of the NFMA is to promote timely and complete disclosure of financial and operating information needed to assess the credit quality and risk of a municipal debt issue. The NFMA’s efforts have ranged from broad disclosure-related issues to more detailed, sector-specific work such as these Recommended Best Practices (RBPs) in Disclosure papers. 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 website at [www.nfma.org](http://www.nfma.org).

In order to develop RBPs in Disclosure for a specific sector, NFMA analysts work with non-analyst professionals such as municipal issuers, industry groups, bond counsel and underwriters who specialize in the particular area of the disclosure to develop best practices guidelines. RBPs are descriptions of the sector-specific financial and operating information needed to enable investors and other market participants to assess risk. The NFMA believes that the best practice in disclosure is one that provides a steady flow of timely information from borrowers to the market. Initial drafts of the RBPs in Disclosure are widely circulated, and input is then solicited from interested parties during an industry comment period. The paper is then revised to incorporate the feedback received.

This paper presents the RBP in Disclosure for Dedicated Tax Bonds. This document is to be used in conjunction with, not to supplant, the guidance provided in the amendments to SEC Rule 15c2-12 (the Rule), which mandates an issuer’s commitment to provide continuing disclosure of financial and operational information on an annual basis (see <http://www.sec.gov/> for further information about these amendments). The NFMA’s disclosure efforts are a continuous process, and the guidelines provided in this paper will be revisited and changed as market conditions warrant. We encourage interested parties to submit comments at any time to Lisa Good at [lgood@nfma.org](mailto:lgood@nfma.org) for consideration in the development of future versions of these RBPs in Disclosure. *The NFMA understands that this RBP is not intended to be a one-size-fits-all recommendation and that all the information requested may not apply to every transaction in the sector.*

## **INTRODUCTION**

This RBP in Disclosure addresses securities known as “dedicated tax” bonds. As “dedicated tax” is not a formal legal term or security type, for purposes of this RBP, we consider “dedicated tax” bonds to include those secured by future receipts of tax and assessment revenues that are not levied on real property. The most common types are those backed by personal income tax, sales and use tax, tourism-dependent tax, and transportation-related tax receipts. More specifically, for tourism-dependent credits, this discussion focuses on hotel occupancy tax bonds while for transportation-related credits the emphasis is on motor vehicle and gas taxes.

While our goal is to include the information analysts believe is key in evaluating the credit quality of the dedicated tax structure, we are aware that not all items requested will be readily available from all issuers. We strongly encourage use of the Municipal Securities Rulemaking Board’s (MSRB) Electronic Municipal Market Access (EMMA) as the means to post these documents.

This RBP in Disclosure is organized in such a fashion as to provide the reader ease of finding which data elements are pertinent and where the information should be disclosed. The most detailed disclosure is generally provided in the preliminary official statement (POS) and the official statement (OS) when the bonds are being issued. Some of this information, while detailed, does not change drastically from year to year. Information that changes, both financial and operational, should be provided in an annual information statement, annual financial report, and/or Comprehensive Annual Financial Report (CAFR), preferably within 120 days after the fiscal year ends. Any information that may materially impact an analyst’s view of the credit quality of the financing is requested to be provided on an interim basis once the information is public.

## **TYPE AND FREQUENCY OF RBPS IN DISCLOSURE FOR DEDICATED TAX BONDS**

### **Primary Market Disclosure**

At the time of a bond offering, the POS/OS should include summaries of the legal documents, information on the use of the funds, legal pledge of the issuer to repay the debt and current economic, financial and operating data relevant to that pledge upon which credit ratings and investment decisions are based. In the event a third party or special purpose entity (SPE) issues the dedicated tax bonds, the relationship of the issuer to the government entity (state or local government) should also be disclosed. The OS should also include a summary of the agreement by the issuer to provide secondary market disclosure to the investing public, stating the frequency with which it will provide annual disclosure under the Rule as well as interim data.

### **Legal Security**

Dedicated tax bonds are intended to help insulate bondholders from a government entity’s general credit risk. This separation may be accomplished to varying degrees by various means, including by legal restrictions on use or time horizon, mechanical and structural provisions that restrict the flow of funds, the imposition of liens and security interests, and even more formal conveyance of the dedicated tax revenues to third party or special purpose entities in securitization type structures.

With recent developments surrounding the treatment of dedicated tax debt by certain fiscally distressed entities, more robust legal disclosure is necessary, with a particular emphasis on the intended separation between the government entity and the pledged revenues and risks associated with distress or bankruptcy.

### **Secondary Market – Annual and Interim Disclosure**

The most common annual secondary disclosure document for governments is the CAFR, which includes audited financial statements and relevant statistical data, including updates on the types of key information provided in the OS. This information includes a description of the underlying economy and demographics of the service area.

The NFMA strongly urges issuers of dedicated tax bonds to issue secondary market updates on a more frequent basis, as financial and operating information can grow stale and inaccurately represent an issuer's profile. In general, interim financial disclosure is recommended on at least a quarterly basis, although a monthly basis is preferable for tax receipt collections. Information to be included in an interim disclosure document need only include items which have changed since the last disclosure document (OS, annual report or last interim disclosure document) was prepared. It is expected that most items recommended to be included in the interim disclosure documents are already being produced, often publicly available, and may be unaudited.

### **Government Entity Disclosure**

Some may question the need for continuing disclosure on the overall financial health of a state or local government for dedicated tax bonds. However, given limited Chapter 9 precedent on the treatment of dedicated tax bonds and what can be severe competing pressures on a government's revenues, we believe ongoing disclosure specific to the government entity is crucial, and that disclosure limited to the performance of pledged revenues while necessary is insufficient alone to provide a complete credit picture.

### **The NFMA's general guidelines for RBPs in Secondary Market Disclosure include the following:**

1. Audited financial statements should be available to interested parties within 120 days of the issuer's fiscal year end or as early as available;
2. Any material event notices, including those required under the Rule, should be released in accordance with the Rule and referenced in the interim disclosure document either immediately preceding or following the event notice;
3. All disclosures should be made through the use of the MSRB's EMMA website (available at <http://emma.msrb.org/Home>);
4. The NFMA strongly encourages issuers to create investor relations sections on their websites for the purpose of posting annual and interim financial and other disclosure information that is available (in addition to the use of EMMA), as well as answers to questions from investors; and,
5. The NFMA encourages issuers and/or their representatives to respond to questions from the investing public about credit matters on outstanding obligations by returning calls and emails within five business days.

## **How to Use this Paper**

There are nine major categories of this RBP, each containing specific items deemed to be material in assessing credit risk. These sections are:

- I. General Description
- II. Economy of Service Area
- III. Revenue Base & Collections
- IV. Financial Metrics
- V. Security/Covenants
- VI. Debt & Financial Obligations
- VII. Environmental/Climate Change/Natural Disaster Readiness
- VIII. Regulatory/Other Issues
- IX. Cyber Security

## **Three Columns – Description and Meaning of “X” and “\*”**

To the right of each item are three columns indicating whether the item should be disclosed in the Official Statement and updated in the Annual Disclosure and/or in the Interim Disclosure. An “X” in the column indicates that the item should be included in that disclosure document. We recommend that items marked with an asterisk (\*) be included in the Interim Disclosure Documents when the information originally disclosed has changed since it was disclosed in the Official Statement, Annual Disclosure and/or last Interim Disclosure.

I. GENERAL DESCRIPTION	Official Statement	Annual Report	Interim Disclosure
Describe the issuer.	X		
If issuer is a third party or SPE:			
<ul style="list-style-type: none"> <li>Description of the conduit along with its relationship to the government entity.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Process for the nomination/ appointment of governing body.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Political and practical independence of voting members.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Power to file for Chapter 9.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Legal authority for creation and governance.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Control of activities, including power to terminate the entity.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Financial reporting structure, including reporting of the securitized assets.</li> </ul>	X		*
<ul style="list-style-type: none"> <li>Location of office and proximity to originating entity.</li> </ul>	X		*
Provide current ratings by rating agencies.	X		*
Provide investor contact information, including link to website where additional information can be found.	X		*
II. ECONOMY OF SERVICE AREA	Official Statement	Annual Report	Interim Disclosure
Location, population, demographics, median household income, per capita income, % of population under poverty line.	X	X	
Major industries, top employers.	X	X	*

<b>ECONOMY OF THE SERVICE AREA,</b> continued	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Employment, including non-farm payroll and unemployment rate	X	X	*
<u>Tourism-Related Dedicated Tax:</u>			
<ul style="list-style-type: none"> <li>• Occupancy rate – specific to entities that generate pledged revenues as well as for relevant peers.</li> </ul>	X	X	*
<ul style="list-style-type: none"> <li>• Competition – Number of establishments subject to the tax vs. those exempt from the tax (e.g., AirBNB)</li> </ul>	X	X	*
<ul style="list-style-type: none"> <li>• Tourism statistics – historical trend of visitors and breakdown of origin, including domestic vs. international, if available</li> </ul>	X	X	*
<b>III. REVENUE BASE &amp; COLLECTIONS</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Trend of pledged revenues, beginning in 2007, including revenue performance during nearest recessionary period broken out by different components, if applicable.	X	X	
Monthly or quarterly collections data.			*
Detailed explanation of factors that influenced pledged revenues.	X	X	*
Top 10 taxpayers. Individual taxpayers % of total. If unavailable, 10 largest in aggregate with comments if any individual taxpayer accounts for greater than 5% of total collections.	X	X	*
Who is responsible for collecting and remitting the dedicated tax to the Trustee?	X	X	
Is there a “lockbox” structure?	X	X	

<b>REVENUE BASE &amp; COLLECTIONS,</b> continued	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Distribution formula and historical changes to distribution formula, if applicable. Make-up provisions to offset changes in federal gas tax.	X	X	
<b>IV. FINANCIAL METRICS</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Debt service coverage ratios for past five years and projected ratios for five years.	X	X	
Debt service schedule. For new deals, include a pro-forma schedule. If applicable, separate schedule by lien and provide separate columns for principal and interest.	X	X	
Detailed explanation and breakdown of how pledged revenues were computed.	X	X	
Issuer's liquidity.	X	X	
<b>V. SECURITY / COVENANTS</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Provide clear and complete description of the revenue sources pledged to the repayment of the bonds as well as bond terms. Security should include: priority of payment from revenue stream, additional bonds test, flow of funds, and bond reserve fund requirement.	X	X	*
State if there can be removal, reduction, or substitution of pledged revenues and whether State agrees not to compromise pledged security.	X		*
Legal and legislative background on pledged revenue stream. Discuss any sunset provisions on pledged revenues.	X		
Powers of the government and any other parties to the transaction to levy and collect or receive the pledged revenues.	X		

<b>SECURITY / COVENANTS, continued</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Identify all other encumbrances on the pledged revenues.	X		
Flow of funds. Can excess funds be taken by the general government?	X		
Describe Additional Bonds Test.	X		
Debt service reserve requirement and how it is satisfied (cash or surety bond). How are any deficiencies in the DSRF requirement satisfied? Do any rating triggers exist on surety bonds that could force a liquidity event for the DSRF?	X		
Legal opinion regarding the nature of the security provided to investors under a Chapter 9 scenario, regardless of whether the state authorizes Chapter 9.	X		
Commentary on whether investors are secured by a lien on revenues of the issuer and identify the revenues that serve as collateral and when the lien attaches to those revenues.	X		
Is the lien valid and binding on the issuer? Reference the statutory or other authority that supports that conclusion.	X		
Has the lien/security interest been perfected? Indicate all steps that have been taken to perfect the lien/security and what those steps are.	X	X	*
Identify who is responsible for perfecting the lien and changes in these responsibilities, if any.	X	X	*
Is there a statutory lien on the pledged revenues?	X		
Are pledged revenues considered special revenues? Include legal opinion.	X		

<u>Third Party/SPE Issuer:</u>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
<ul style="list-style-type: none"> <li>• Legal opinion regarding “true sale” and non-consolidation opinion.</li> </ul>	X		
<ul style="list-style-type: none"> <li>• Is the transfer valid and binding on the originator and creditors of originator?</li> </ul>	X		
<ul style="list-style-type: none"> <li>• To what extent is such transfer immune from subsequent legislative action inside or outside of a bankruptcy or PROMESA proceeding?</li> </ul>	X		
<ul style="list-style-type: none"> <li>• What are the risks of re-characterization of the transfer in a manner that would cause the pledged (or transferred) revenues to be deemed property of the originator rather than that of the issuer?</li> </ul>	X		
<b>VI. DEBT &amp; FINANCIAL OBLIGATIONS</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Provide full schedule showing annual principal and interest payments. If applicable, separate schedule by lien and provide separate columns for principal and interest.	X	X	
Provide detailed information on debt outstanding and the priority of payment. Include information on senior and junior lien bonds and bank loans, if any.	X	X	X
Disclose any liens closed to new issuances.	X	X	*
Identify any existing and past monetary defaults and remedies. Describe impact on credit ratings and outline reasons for downgrade actions. Identify any technical defaults.	X	X	X

<b>VII. ENVIRONMENTAL, CLIMATE CHANGE &amp; NATURAL DISASTER READINESS</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Comment on impact from any recent natural disaster on service area and discuss strategies for future events.	X	X	*
Identify any EPA or Brownfields sites.	X		*
Disclose the potential impact of climate change on service area and pledged revenues.	X		*
Based on a risk assessment (i.e., vulnerability to natural disasters), describe changes to planning including long-term capital investment and risk management.	X	X	*
Describe plans for implementing flood mitigation strategies and other measures for long-term sustainability to address such things as rising sea levels and more intense and frequent storm events, if applicable.	X		*
Describe potential risks to service area from seismic activity or other natural disasters, and any mitigation measures.	X		*
<b>VIII. REGULATORY / OTHER ISSUES</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
List any pending or potential federal/state/local regulatory issues that may have a material impact on pledged revenues, such as higher fuel efficiency standards. Assess potential costs.	X	X	*
List any pending or potential ballot measures that may have a material impact on amount of and/or collection of pledged revenues, such as a change in goods and services subject to a sales tax. Assess potential costs.	X	X	*

<b>IX. CYBER SECURITY</b>	<b>Official Statement</b>	<b>Annual Report</b>	<b>Interim Disclosure</b>
Disclose steps taken to identify and protect against cyber threats.	X		*
Disclose any security breaches or other unauthorized access or actions, regulatory actions, litigation, investigations, and loss of revenue and other potential liability that may arise as a result. Describe Insurance policy coverage for cyber-attacks.	X	X	*

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*NFMA constituent societies, individual members or their firms may not agree with all provisions in these RBPs. The NFMA is not a regulatory agency and compliance with the RBPs advanced herein does not constitute a “safe harbor” from any State or Federal rules and regulations. Nothing in this paper is to be construed as an offer or recommendation to buy or sell any security or class of securities.*