

National Federation of Municipal Analysts

Recommended Best Practices in Disclosure for State Revolving Fund Revenue Bonds



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 over 1,200 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.

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 sectors-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 State Revolving Fund Revenue 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 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 covers State Revolving Funds (SRFs), including Clean Water SRFs and Drinking Water SRFs managed at the federal level by the Environmental Protection Agency (EPA). These guidelines are applicable to debt secured by revenue generated from the SRFs, with these revenues typically consisting of loan repayments or other similar debt obligations (each referred to as a “loan”, herein) payable from a pool of specified local governmental borrowers (the “pool participants” or “obligors”) and specifically pledged under an indenture or resolution to related bondholders.

As used in this paper, a “pool” refers to each separately secured portfolio of loans supporting the repayment of a series or multiple series of bonds as identified in the flow of funds of each related master bond indenture or resolution, including any supplements to each of these documents. Further, each “separately secured pool” is deemed to infer the consolidation of the Drinking Water SRFs and Clean Water SRFs where there is a legal cross-collateralization of these programs and also the consolidation of pools with "open" master indentures or similar wherein each supplemental series indenture pledges its loans to the related master indenture or resolution.

While our goal is to include the information analysts believe is key in evaluating the credit quality of SRFs, 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 to enable the reader to easily find the data elements that are pertinent to SRF disclosure and where the information should be disclosed. The most detailed disclosure is generally provided in the preliminary or final official statement (Official Statement) when the bonds are being issued. Some of this information, while detailed, does not change significantly from year to year. Information that changes, both financial and operational, should be provided in an annual financial report or in the Annual Comprehensive Financial Report (either referred to herein as Annual Report), preferably within nine months after the fiscal year ends. Any information that may materially impact an analyst’s view of the credit quality of the issuer is requested to be provided on an interim unaudited basis once the information is public.

TYPE & FREQUENCY OF RBPs IN DISCLOSURE FOR STATE REVOLVING FUND REVENUE BONDS

Primary Market Disclosure

At the time of a bond offering, the Official Statement should include summaries of all legal documents, information on the use of the bond proceeds, legal pledge of the issuer to repay the debt, pool-level data including obligor names and aggregate amount of loans (outstanding and new), additional state support or grants, annual debt service coverage ratios or cash flows relevant to that pledge upon which credit ratings and investment decisions are based, and information regarding any significant obligor(s). The Official Statement should also include a summary of the commitment by the issuer to provide secondary market disclosure to the investing public, stating the information to be provided and the frequency with which it will provide annual disclosure under the Rule.

Secondary Market – Annual and Interim Disclosure

The most common annual secondary disclosure document for SRFs is the Annual Report, which typically includes audited or unaudited financial statements and relevant supporting information. Interim financial disclosure is recommended upon the occurrence of a material event, or an event that may significantly impact an analyst's view of the credit quality of the issuer. Examples of a material event include but are not limited to: (i) a downgrade of the credit rating of the issuer's parity obligations by a nationally recognized statistical ratings organization (NRSRO); (ii) a payment delinquency of a significant obligor (defined herein as one with aggregate loan amounts accounting for 20% or more of the pledged pool); (iii) the downgrade of a rating of a significant obligor to below investment-grade by any of the NRSROs; or, (iv) weakening in credit quality of any other large counterparties such as investment-agreement providers to which the SRF has material financial exposure.

Information to be included in an interim disclosure document should include items that have changed

since the last disclosure document (Official Statement, Annual Report, or last interim disclosure document) was published. We expect that most items recommended to be included in the interim disclosure documents are already being produced, often publicly available, and may be unaudited.

In situations where an issuer is facing an emergency event that will have a material impact on its financial health and/or operational sustainability (Emergency Event), the NFMA has provided guidance for primary and secondary market disclosures in its White Paper on Guidance & Insights Regarding Emergency Event Disclosure Affecting State & Local Governments: COVID-19 Focus, June 2021 (White Paper). While COVID-19 is one such Emergency Event, the White Paper focuses on disclosures for any future Emergency Events such as large-scale tropical storms, disease outbreaks, fires, and significant weather damage. See [www.nfma.org/Resources/Best Practices in Disclosure](http://www.nfma.org/Resources/Best_Practices_in_Disclosure) to locate this white paper.

The NFMA’s general guidelines for RBPs in Secondary Market Disclosure include the following:

1. Annual Reports should be available to interested parties within nine months 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>); and,
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®); and,
5. The NFMA encourages issuers and/or their representatives to respond promptly to questions from the investing public about credit matters on outstanding obligations by returning calls and emails promptly.

HOW TO USE THIS PAPER

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

- I. Summary/General Description of the Issuer
- II. Pledged Obligors
- III. Significant Obligors
- IV. Obligor Performance
- V. Forecast Financial Metrics
- VI. Legal Authority & Bond Security
- VII. Legislation/Litigation
- VIII. ESG/Cybersecurity/Risk Management & Resiliency

- IX. Debt Portfolio Structure & Market Risks
- X. Governance & Management

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 Report 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 when the information originally disclosed has materially changed since it was disclosed in the Official Statement and/or Annual Report.

I. SUMMARY/GENERAL DESCRIPTION	Official Statement	Annual Report	Interim Disclosure
Provide a description of the issuer and indicate its relationship to the state.	X		
Provide a description of the outstanding SRF program(s), including fund type, purpose, and projects typically financed.	X		
Provide a description of any other state agencies or departments, responsible for the administration of the SRF program(s).	X		
Provide a link to website where, investor information, ratings and issuer contact information may be found.	X		*
II. PLEDGED OBLIGORS	Official Statement	Annual Report	Interim Disclosure
For each separately secured pool, provide a list of each individually pledged obligor. Include full legal names, legal security supporting the repayment of borrowed funds, aggregate amount of principal funded including any undrawn amounts, term of the longest-dated obligation, and the percentage of each obligor of the overall pool or portfolio.	X	X	
III. SIGNIFICANT OBLIGORS	Official Statement	Annual Report	Interim Disclosure
For each separately secured pool, provide a list of any obligors representing 20% or more of the aggregate pool total.	X	X	*

IV. OBLIGOR PERFORMANCE	Official Statement	Annual Report	Interim Disclosure
<p>For each separately secured pool, provide a list of any obligors currently accounting for more than 1% of the pool total experiencing delinquencies of more than 90 days. Describe any plans in place to remedy or prevent write-offs that could impact financial coverage ratios. Obligor accounting for more than 5% of the pool that are experiencing such delinquencies should be reported on an interim basis.</p>	X	X	*
V. FORECAST FINANCIAL METRICS	Official Statement	Annual Report	Interim Disclosure
<p>For each separately secured pool, in a tabular format, provide projected annual revenues, expenses, net revenue available for debt service, debt service, and financial coverage ratios. Debt service coverage ratios provided in the Annual Report should be calculated based on the methodology specified in the Official Statement.</p>	X	X	
<p>Include balances of funds pledged to bondholders.</p>	X	X	
VI. LEGAL AUTHORITY & BOND SECURITY	Official Statement	Annual Report	Interim Disclosure
<p>Provide a clear and complete description of the revenue sources pledged to the repayment of the bonds. Include priority of payment from revenue stream, additional bonds test with an explanation of how the calculation is made, flow of funds including any surplus release requirements/deallocation rules, cross-collateralization mechanics, bond reserve fund requirements and how they are satisfied (cash or surety bond).</p>	X		*
<p>Discuss perfection of liens, if applicable.</p>	X		
<p>Describe state law and whether the SRF or obligors are permitted to declare bankruptcy. Discuss bankruptcy implications of the structure.</p>	X		
<p>For each separately secured pool, describe all funds and accounts to be established, including minimum funding levels, replenishment requirements and any restrictions on use of bond proceeds.</p>	X		

LEGAL AUTHORITY & BOND SECURITY, continued	Official Statement	Annual Report	Interim Disclosure
Provide details on the different restrictions, if applicable, (bond covenants, board policy, statutory requirements) for the issuer’s reserves.	X		
Describe available enforcement mechanics for obligor delinquencies, such as the ability to intercept any state aid.	X		
VII. LEGISLATION/LITIGATION	Official Statement	Annual Report	Interim Disclosure
Disclose and describe in detail any material ongoing litigation that may affect operations, operational autonomy, revenue collection, expense management, or overall financial performance.	X	X	*
Disclose any legislation that may affect capitalization grants or other types of state or federal funding.	X		
VIII. ESG/CYBERSECURITY/RISK MANAGEMENT & RESILIENCY	Official Statement	Annual Report	Interim Disclosure
Discuss existence of Environmental, Social, and Corporate Governance (ESG) rating or third-party verification of environmentally sustainable (Green)/ESG status, if any.	X	X	
Describe policies and procedures in place to address emergency preparedness planning for environmental, cybersecurity, and health crises. Include related insurance coverages.	X		*
Disclose material cybersecurity breaches, or any unauthorized access data disclosure over the last three years. If dependent on another agency for cybersecurity, describe interagency coordination and safeguards.	X	X	*

IX. DEBT PORTFOLIO STRUCTURE & MARKET RISKS	Official Statement	Annual Report	Interim Disclosure
Describe restrictions on additional bond issuances (minimum debt service coverage, priority of payment) and the ability to refinance.	X		
Disclose any liens closed to new issuances.	X		
Describe issuer’s interest rate swaps, variable rate debt, or any other derivative instruments outstanding. Include how swap payments are treated in the flow of funds priority. Discuss thresholds for collateral posting and termination payments. Include most recent available mark-to-market valuation for swaps. Elaborate on termination triggers, if applicable. For issuers with multiple swaps, provide a summary chart listing swaps by the associated bond series.	X		
X. GOVERNANCE & MANAGEMENT	Official Statement	Annual Report	Interim Disclosure
Provide clear and complete description of governance structure and organization, including composition of board, election or appointment and qualification requirements, terms, and current member tenure.	X		
Describe senior management team, organizational structure, hiring or appointment, and qualification requirements, current senior management staff, including professional biographies and tenure.	X		
Is there a chief information officer (CIO) and staff dedicated to addressing cybersecurity vulnerabilities and risks?	X		
Describe underwriting/origination policies, including:			
Criteria and/or priorities for approval of projects to be financed. Process for monitoring ongoing construction/ implementation of projects and compliance with all federal and state requirements.	X		
Are ratings or other forms of credit assessment required? If yes, are they published or private, monitored, or non-monitored?	X		

GOVERNANCE & MANAGEMENT, continued	Official Statement	Annual Report	Interim Disclosure
What is the historical and projected minimum debt service coverage requirement for revenue borrowers?	X		
What are the requirements for general obligation borrowers?	X		
Are there any reserve requirements?	X		
What is the percentage of private entities in the pool?	X		
Are there loans with additional security pledges?	X		
Are exceptions to underwriting policies allowed? If so, under what conditions?	X		
Describe monitoring policies, including:			
What is the review process for obligors?	X		
How often are obligors reviewed?	X		
With respect to significant obligors, is financial reporting consistent from year-to-year? Have there been any unusual restatements of financial results or delays in financial reporting?	X		
With respect to borrowers, are there clear policies, guidelines, procedures, and internal controls to ensure consistency in financial reporting?	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.