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State and Municipality Update: CARES Act, Policy and Restructuring

May 8, 2020

Introduction and Overview

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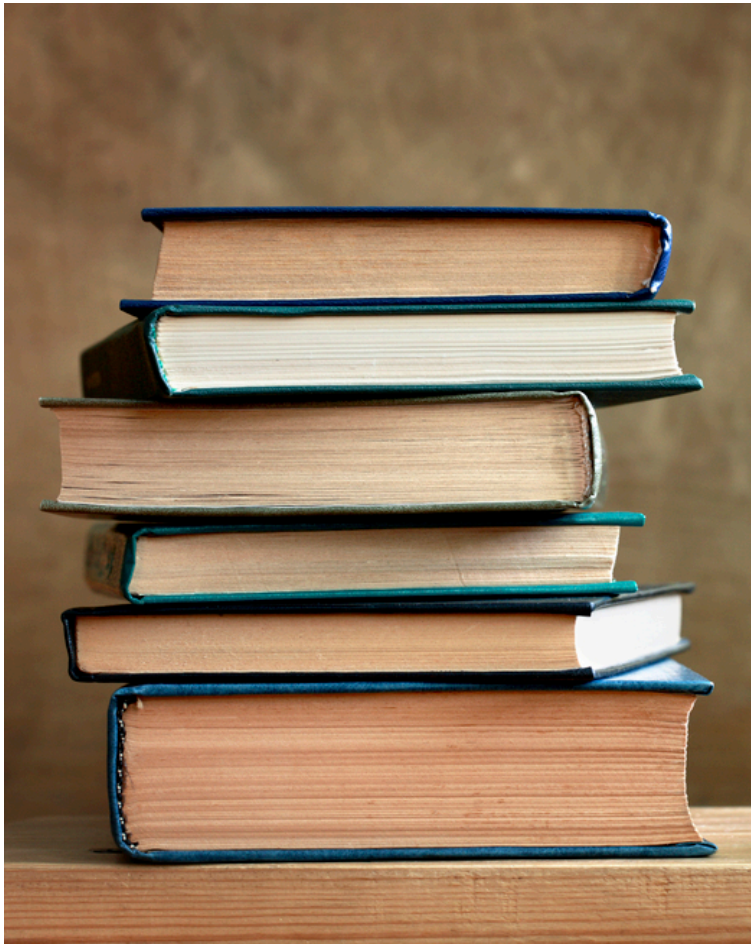
Goals for Today's Webinar

- Update on Federal Reserve's Expansion of the Municipal Liquidity Facility
- Policy behind CARES Act and Response to Dire Municipal Financial Need
- Restructuring and Bankruptcy
- Financial Projections
- Transparency and Communication with all Stakeholders
- Declaration of Fiscal Emergency
- Generating Options



Municipal Liquidity Facility (“MLF”): Overview

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On April 9, 2020, the Federal Reserve established a Municipal Liquidity Facility (MLF), which will purchase up to US$500 billion of short-term municipal notes from selected states, counties, cities and, in accordance with the Federal Reserve Board’s April 27, 2020 Guidance, Multi-State Entities (Eligible Issuers).

Municipal Liquidity Facility ("MLF"): Eligible Issuers

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The Federal Reserve Board's Guidance adds a new type of Eligible Issuer and reduces the population threshold for cities and counties to qualify as an Eligible Issuer as follows:

- US states and the District of Columbia
- US counties with a population exceeding 500,000 residents (rather than two million residents)
- US cities with a population exceeding 250,000 residents (rather than one million residents), and
- Multi-State Entities or an entity that was created by a compact between two or more states with the approval of Congress

All Eligible Issuers must be solvent, and US Territories are not included as Eligible Issuers.

The Eligible Issuers are required to meet certain criteria:

- State, city or county (or an entity that issues securities on behalf of the state, city or county for the purpose of managing its cash flows) must be rated at least BB-/Ba3 by two or more major NRSROs
- A Multi-State Entity must be rated at least BBB-/Baa3 by two or more major NRSROs

Municipal Liquidity Facility ("MLF"): Eligible Notes

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- The SPV will purchase only newly issued TANs, TRANSs, BANs.
- The Federal Reserve Board's Guidance increases the Eligible Notes' maturity from no later than two years to no later than three years from the date of issuance.
- Closing requirement includes certification that the Eligible Issuer is unable to "secure adequate credit accommodations from other banking institutions and that it is not insolvent."
- G.O. or Revenue Pledge depending on the Eligible Issuer
- 20% Limit to Purchase Eligible Notes
- Credit Risk Allocation for Lending in excess of 20%

Policy Behind CARES Act and Response to Dire Municipal Financial Need

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- CARES 1.0
- Intermediate Package
- Positioning Underway for CARES 2.0

Context of Where We Are Today

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Year-over-year change in state tax revenues

April 2020 vs. April 2019, select states

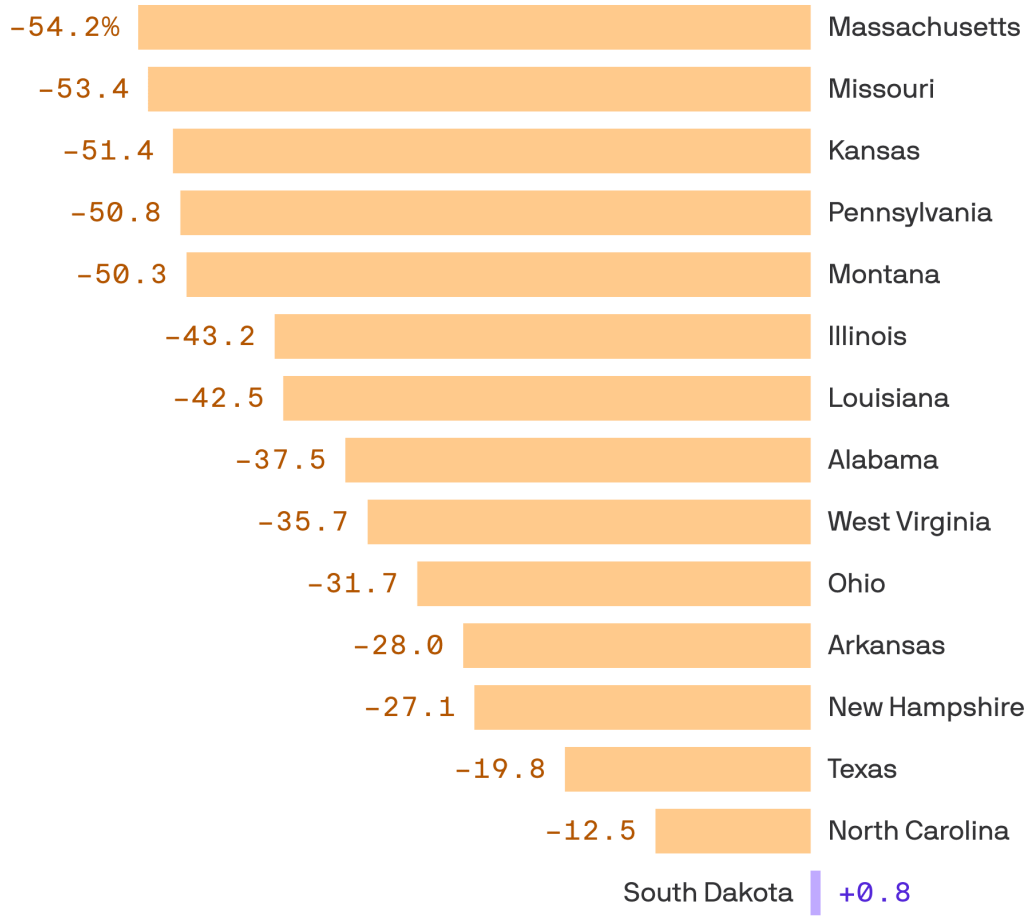

Chart. Year-over-year change in state tax revenue. Adapted from "Axios AM" by M. Allen, 2020, *axios.com*. Data: L. Dadayan/The Urban Institute. Chart: A. Withersppon/Axios. Retrieved May 8, 2020, from www.axios.com/newsletters/axios-am. Copyright Axios Media, 2020.

What's Comes Next in Washington, DC?

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Bankruptcy for States – Not So Fast

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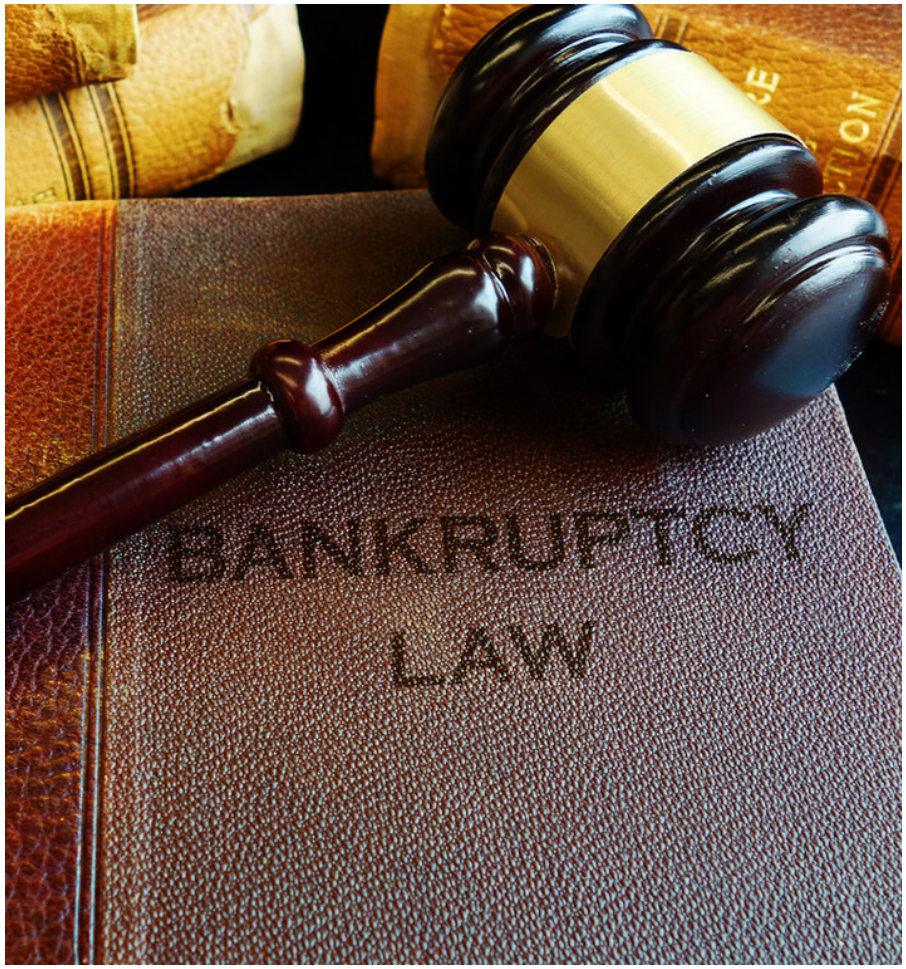
- Bankruptcy is a bad fit for any municipality – particularly states
  - 10th and 11th Amendment issues
  - States for the most part do not want a bankruptcy option
  - Bankruptcy Code could be amended to include states as debtors
  - If bankruptcy becomes available, cost of finance for states is going to increase
  - State G.O. obligations are underwritten on the assumption that there is no bankruptcy process
  - Moral hazard



Municipal Restructuring

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- Out-of-court restructuring needs to be more sophisticated and we need to be quick about it
- Avoiding the expense and contentiousness of a Chapter 9 should be a goal
- Chapter 9 can always be used for leverage
- No creditor, employee or retiree constituency likes anything that has happened to them in a Chapter 9
- There is a consensus it is a horrible process that does not fit the needs a municipality has

Why Talk About Restructuring Now

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- Cities are facing a significant general revenue shortfall for the next two fiscal years, maybe longer
- If stay-at-home orders are extended or new orders initiated the shortfall will increase
- Cities with high dependency on sales taxes and hotel and occupancy taxes are most severely impacted
- Cities are reporting across the US that they are decreasing staff and reducing services
- Service reductions included police and fire
- Cash infusions are needed to address shortfall
- Strong desire to avoid bankruptcy
- Need to address unfunded pensions as one of many pressure points

Strategic Out-of-Court Restructuring

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Planning is Key

- It is all about cash flow
- Denial is dangerous – Must consider immediate impact of losses
  - Sales tax and add-on (voter approved) sales tax
  - Transportation sales tax
  - Hotel occupancy tax
  - Business operations tax
  - Parking tax, parking meter tax, admissions tax
  - Property tax and transfer tax
- Need to be realistic about when tax revenue will increase and consider possibility of permanent reduction due to changes in consumer behavior

Develop Realistic Projections

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Recognize uncertainty reigns when it comes to revenues

- Expense projections are easier and unfortunately, unless reductions are negotiated, constant
  - Cash needed to deliver acceptable level essential services – health, safety and welfare
  - Expense reduction
    - Eliminate non-essential costs
    - Identify alternative options for delivery of essential services (joint service agreements, etc.)
- Develop initial “Ask” of stakeholders – The “Ask” are the concessions needed to survive and provide an acceptable level of essential services
  - Bondholders
  - Creditors
  - Employees
  - Retirees
  - Taxpayers

Out-of-Court Restructuring

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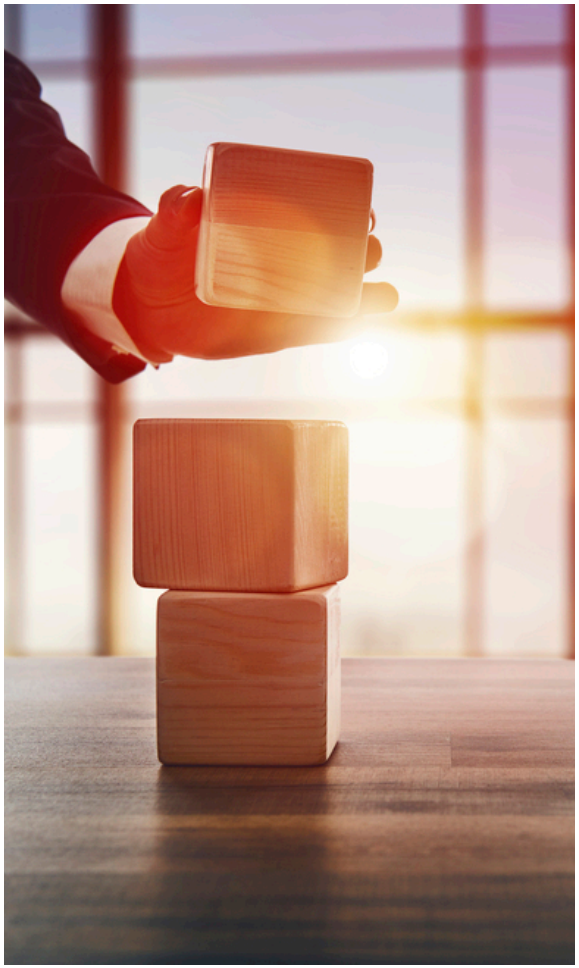
It's all about the Rubik's Cube

- Hiring a Credible Professional Team
  - Need help in "selling" financial information supporting the "Ask"
  - Help includes a team of financial advisors, auditors, actuaries and lawyers
  - A credible outside team of professionals can be invaluable in negotiating the "Ask"
- Building a Short Term and Medium Term Plan
- Engaging with all stakeholders to build political will to make difficult decisions
- Identify opportunities for better fiscal management and opportunities for cost savings



Declaration of Fiscal Emergency

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Carefully Consider Benefits/Detriments

1. Collective Bargaining
2. Ability to propose general tax ballot measures to voters
3. Politically risky for mayor and council members
4. Too many declarations lack credibility
5. Consider risk in terms of attracting employees
6. Jeopardizes new financing; can help with restructuring existing financing if back up for declaration is credible
7. Declaration needs to be consistent with certifications made in connection with CARES Act financing
8. Do not include empty threats of bankruptcy filings if you do not mean it

Summing it Up

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Municipal Bankruptcy

- Lessons learned should make everyone at the table better at negotiating.
- Essential services must be provided at some agreed upon level. Cutting costs will not solve the lost revenue problem.
- Municipalities have learned from watching prior bankruptcies that they need professional assistance to design credible “Asks” and provide support for financial information.
- Political willingness to take steps necessary to implement a restructuring that stabilizes a municipality for the longer term is changing given the dire straits many municipalities are in.
- Mediation, hated as it is by many, may be the life boat stakeholders of municipalities cling to. It is better than any port in a storm. Particularly if the port is municipal bankruptcy.

Speakers

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Global Coverage

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Caribbean/Central America
India
Israel
Italy
Mexico
Turkey
Ukraine

- Office locations
- Regional desks and strategic alliances