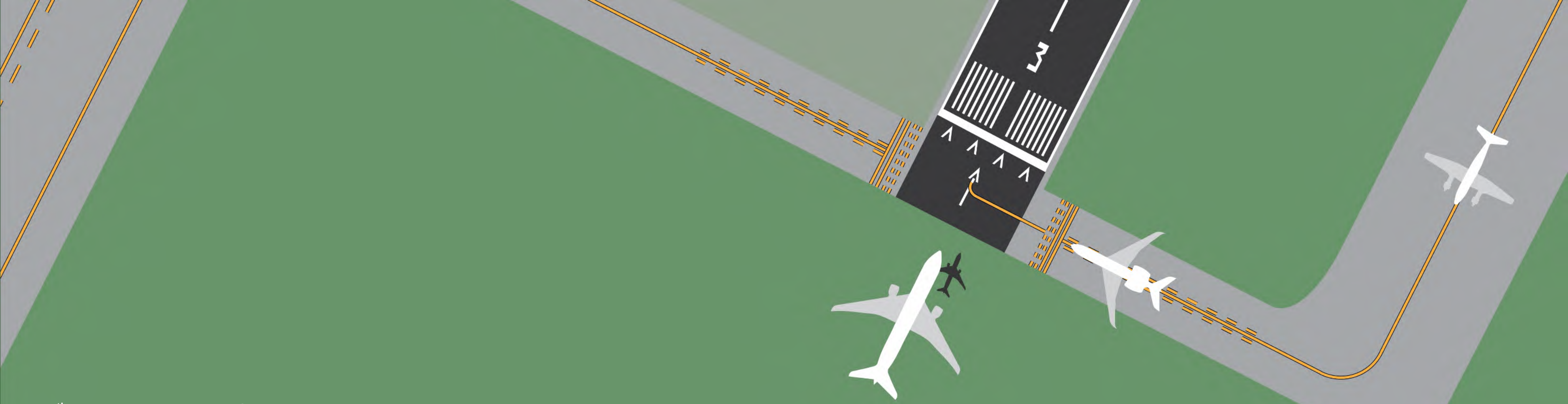

34th Annual Basics of Airport Law Workshop and 2018 Legal Update

Session #18

PUBLIC FINANCING OF AIRPORT INFRASTRUCTURE

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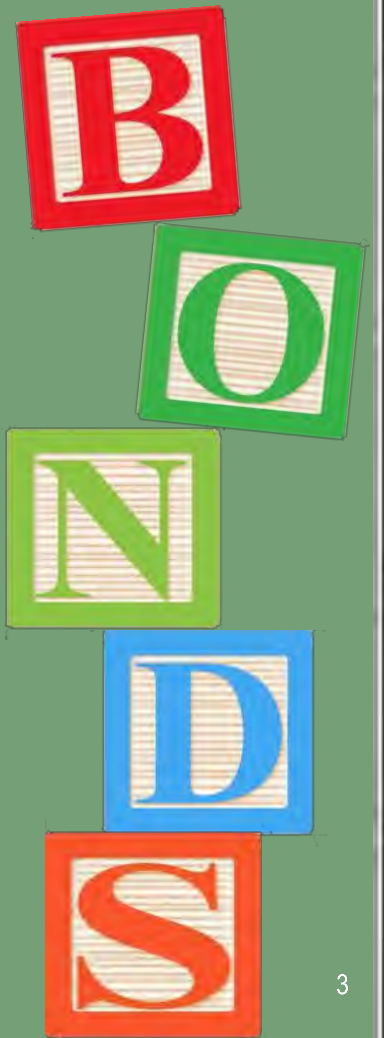
OVERVIEW

- Bond basics – how do bonds work?
- Legal principles
  - Local bond law
  - Federal securities law
  - Federal tax law
- The participants – who are all these people?
- The role of the airport lawyer in a bond issue
- Structuring – variations on a theme
- P3 approaches – alternative financing structures

A BRIEF OVERVIEW OF BONDS

- Bonds are a loan – a secured promise to pay
  - Pledge of specific funds to repayment
  - Single borrower, often multiple lenders
  - Role of the Trustee as lenders' representative
- Airport bonds are typically revenue bonds
  - May be single or multiple sources of revenues
  - May be special facilities bonds
- Authority to issue bonds is a state law issue
- Tax exemption conferred by federal law
- Federal securities law governs disclosure



WHY BONDS?

- Bonds allow for asset/liability matching
  - The repayment term can be better matched to the life of the assets being financed
  - The users of the facilities over time contribute to the capital cost
- With tax-exemption, airports can achieve a favorable cost of capital
- The rating agencies, investors, SEC, and IRS all help ensure prudent financial management focused on long-term viability

LEGAL PRINCIPLES

- Local bond law
- Federal securities law
- Federal tax law

AUTHORITY TO ISSUE BONDS

- State law question – statutorily driven
- Typically interpreted narrowly – look to explicit language
- Compliance with statutory requirements
- Additional UCC requirements, if any
- Every state has its quirks!

SECURITIES LAWS

- What is a "security"?
- SEC's limited power to regulate the municipal market
- Rule 10b-5
  - Materiality
  - Roles and responsibilities of issuers & others
  - Applies to all statements to "the Market"
- Rule 15c2-12
  - Primary disclosure – the Official Statement
  - Secondary disclosure
    - Annual filings
    - Event filings

FEDERAL TAX LAW

- Governmental bonds (Non-AMT)
- Private Activity Bonds (AMT)
  - Airport facilities – what qualifies?
  - What is TEFRA?
- Taxable bonds – rental car and other facilities
  - Non exempt facilities – liquor stores, fitness facilities, non-aviation uses
- Ongoing compliance requirements
  - Rebate and spending requirements
  - Private use and change in use
  - Audits – retaining records

BOND DOCUMENTS

- The bond indenture – covenants and more!
- The Official Statement – materiality and due diligence
- Bond purchase agreement
- Tax certificate
- Why all the certifications?

BOND INDENTURE

- A key airport agreement
- Pledges certain revenues
  - Definition of revenues is important
  - PFCs – "double barrel" or offset?
- Includes covenants for benefit of bondholders
  - Coverage tests
  - Maintenance of assets
- Additional bond test – often multiple series issued under same indenture
- Restrictions on amendment

OFFICIAL STATEMENT

- Describes issuer and bonds
- Issuer’s document
- No material misstatement or omission of information
- “Expertised” documents
  - Audited financial statements or CAFR
  - Feasibility study – projection of ability to repay debt
  - Market study – strength of airport’s market
- Risk factors

CONTINUING DISCLOSURE AGREEMENT

- Underwriter's requirement under Rule 15c2-12
- Annual filing required
  - Financial information
  - Operational data from OS
- Event notices
  - Disclosure within 10 days – need for issuer reporting system
  - New events effective Feb. 27, 2019 – a significant shift
    - Other material "debt-like" obligations and terms
    - Evidence of "financial difficulties"

BOND PURCHASE AGREEMENT

- A "P&S" for bonds
- Conditions precedent to underwriter's obligation to close
  - "Roadmap" of required documents
  - Attached forms of opinions
  - "Outs" for underwriters
- Specifies primary terms of bonds
- Arm's-length transaction between underwriter(s) and issuer
- Letters of representation in conduit financings

TAX AGREEMENT

- Typically required by bond counsel for opinion
- Memorializes tax analysis of transaction
- Sets forth continuing and future obligations
- Finance staff needs to understand these requirements
  - Translate from tax counsel-speak
  - Use as template for annual checklist
- Very helpful for future tax analysis

THE TRANSCRIPT

- In theory, all evidence for validity of bond issue included
- Includes principal documents
- Provides evidence of compliance
  - Statutory requirements
  - Requirements of indenture
  - Tax compliance
- Reference for future, especially refundings

THE PARTICIPANTS

- The airport attorney's role – You know your airport best!
- Working with your finance colleagues
- Bond counsel
- Disclosure counsel
- Underwriters and their counsel
- Financial advisor
- The Trustee
- Feasibility consultants
- Verification agent
- Other professionals

AIRPORT ATTORNEY

- You know your airport
  - Can the airport live with these requirements?
  - Are "factual" statements true?
- Directing traffic – legal project manager and disclosure coordinator
- Prime source for due diligence
- Coordinate documents with other key documents; e.g., NEPA filings
- Interface between working group and internal finance team

BOND COUNSEL

- Renders required legal opinion
  - Legal, valid, and binding obligation of issuer
  - Interest exempt from federal (and state?) taxation
  - Unqualified opinion
- Typically runs legal side of the transaction
- Requires knowledge of local bond requirements
- Inquires into facts for tax analysis
- Assists with structuring

UNDERWRITER

- Will purchase the bonds when issued
  - Bond purchase agreement signed at pricing
  - Bears risk of market change after pricing
  - Only paid at closing – can be a conflict – “G17” letters
- Not an advisor, arm’s-length transaction
- Highly regulated by SEC, MSRB, FINRA…
- Remarkets the bonds, often through a syndicate
- Leads marketing efforts; assists with rating agencies
- Most firms have sector-specific bankers

FINANCIAL ADVISOR

- Municipal advisors regulated since Dodd-Frank
- Fiduciary relationship with issuer
  - Must place client's interest above FA's
  - Compensation typically not dependent on closing
- Assists with structuring, evaluating proposals and bids
  - Relating to bonds and professionals
  - May also be investment advisors
- Often advise clients year 'round – longer term planning
- May develop projections for additional bonds test

THE OTHER PLAYERS

- Disclosure counsel
- Underwriter’s counsel
- Trustee
- Auditors
- Other consultants
- Rating agencies

INVESTORS

- From individual retail to large institutions and banks
  - Bond (mutual) funds and asset managers
  - Insurance companies
  - Hedge funds and arbitrage investors
- Investors are the ones with the money
- Their primary interest is full repayment of principal at maturity
  - Greater emphasis on credit than returns
  - Rely upon ratings from the rating agencies but also do independent credit analysis
- Require ongoing prompt, accurate disclosure

STRUCTURING – THE VARIABLES

1. The pledge – what is the security for the bonds?
2. Public offering or direct placement?
3. Fixed-rate or variable?
4. New money or refunding?
5. Amortization and call options
6. Bond insurance
7. Use of derivatives

1. THE PLEDGE

- Carefully define what is pledged – may last for 30+ years
- Typically not a tax pledge for airports – “GO” = General Obligation
- “Revenues” vs. special facilities
  - Revenue pledge: typically most (or all) revenues
    - Carefully drafted pledge is crucial
    - Exclusions often included: e.g., PFCs and CFCs
    - Provide for later carve-out?
  - Special facilities: limited to single (or limited) source(s)
    - Well suited for “conduit” financings
    - Often used to finance fuel systems, hangars, and discrete projects

2. PUBLIC OFFERING VS. DIRECT PLACEMENT

- Public offering most typical
  - Requires Official Statement
  - Generally a negotiated sale
  - Underwriter(s) purchase bonds for resale
- Direct placements very popular after market crash
  - Often a single purchaser
  - Typically selected through a bid process
  - No OS or ratings
  - Often additional covenants required which must be carefully considered
  - May be a loan or a security

3. FIXED-RATE OR VARIABLE?

- Fixed-rate is more prevalent and requires less ongoing maintenance
- Variable rates allow more customization, but must be managed and incurs additional risks
  - Often require additional security; e.g., letter of credit
  - Interest rate may change on various dates; e.g., daily, weekly, monthly or “commercial paper” (1-270 days)
  - For DPs, interest rate may be tied to indices, e.g., LIBOR or SOFR
  - Auction rate securities failed in 2008 when no bidders
  - Often paired with swaps for “synthetic fixed rate”

4. NEW MONEY OR REFUNDING?

- New money funds new projects
  - Useful life of projects a tax issue
  - Must be for capital expenditures
  - Limitations on acquisition of real property
- Refunding similar to refinancing a mortgage
  - Extending maturity requires additional steps
  - Will often require bond counsel to review prior tax analysis
  - “Advance refundings” prohibited by 2018 Tax Act but were less common for airports than other municipal issuers
  - May allow amendment of indenture

5. AMORTIZATION & CALL OPTIONS

- Term governed by state law, also tax issues
  - Typically cannot exceed useful life of projects
  - “Serials” and term bonds – defined
  - Amortization can be structured to achieve different payment profiles for the airport’s aggregate obligations
    - Level annual payments
    - Deferred or accelerated repayments
- “Embedded” call options allow issuers to redeem bonds early
  - Currently, 10 year par call is standard
  - “Optionality” of calls – “make whole” or shorter term calls; coupon rate
  - Without advance refundings, shorter term may be beneficial
- Consider other reasons for call
  - Change in tax treatment
  - Casualty (especially for single purpose issues)

6. OTHER CONSIDERATIONS

- Bond insurance
- Derivatives
- Reinvestment of bond proceeds and structured investment products

PUBLIC-PRIVATE PARTNERSHIPS (“P3”)

- Airports by their nature require partnership with the private sector
  - Airlines and concessionaires
  - Design and architecture, program and construction management, contractors, and engineers
  - Debt and equity investors
- Many airports have utilized approaches that include airline capital, often in the form of special facility bonds
- More recently airports have explored broader DBFOM solutions to large scale projects
- Also exploring privatization of lines of business
  - Monetize assets
  - Share risk

P3 PROJECTS

Fuel facilities
Fuel Facility LLC at BOS, SEA, SFO, FLL

Parking garage
Philadelphia Parking Authority

Shopping mall/food court
Marketplace Redwood LLC

Cargo port
Airis, Aeroterm

Intermodal facility
MIA and PRV Intermodal Centers (TIFIA)

Rental car center
RACs at IAH, DFW, SFO, BWI, ANC, PHX, BOS

Hotel
DFW IAT Hotel

Terminal
JFK IAT, LGA

P3 APPROACHES

1. Revenue bonds
2. Special facility bonds backed by single user
3. Special facility bonds backed by multiple users
4. Tenant managed projects
   - Completed project purchased by airport
   - Tenant takes risk during construction
5. Project privatization
   - Often involves private equity and debt
   - Airport usually maintains some financial stake
   - Usually concession payments or availability payments
6. Full airport privatization under the FAA Pilot Program

MERGING P3S WITH EXISTING INDENTURES

- If a P3 approach is utilized it must fit within the confines of the existing bond documents
  - Flow of funds and priority of payments
  - Rate covenant
  - Revenue carve-outs
  - Beware on restrictions on sale, mortgage of airport properties
- Impacts to existing investors and ratings must be carefully considered
- P3 projects can be challenging from a disclosure standpoint

WRAP-UP & QUESTIONS

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