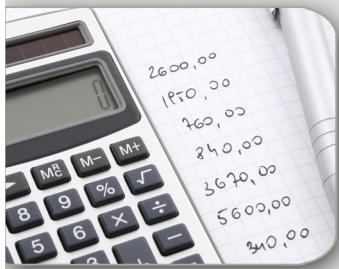




June 2012

## Direct Purchases of Tax Exempt Bonds

A Polsinelli Shughart Update



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As governmental issuers and not-for-profit borrowers continue to pursue alternative sources of capital funding, they are increasingly taking advantage of “Direct Purchase Transactions” where a financial institution (a “Purchaser”) purchases the tax-exempt bonds (the “Direct Purchase Bonds”) rather than initiating a public offering for the bonds. Government issuers, not-for-profit borrowers and borrowers in conduit financings may find these Direct Purchase Transactions appealing for a number of reasons, including:

- *Unrated Transactions.* Purchasers typically do not require that the Direct Purchase Bonds be rated, so the time and expense for obtaining ratings may

be avoided or reduced. Since ratings are typically not required by Purchasers, Direct Purchase Transactions may be most attractive to those issuers or borrowers with no ratings, lower long term ratings on their other outstanding debt or with factors that may adversely affect their ratings, such as variable operating cash flow, significant capital spending plans, significant swap positions with collateral requirements, significant anticipated contribution requirements (e.g., pension contributions and capital calls on investment commitments), limited staff resources for liquidity facility management, or concerns regarding rating agency restrictions on investments.



However, as discussed below, if an issuer or borrower has other rated debt outstanding, there may still be a need to discuss their Direct

Purchase Transactions with rating agencies to understand how such Direct Purchase Transactions might affect the ratings assigned to their other debt obligations.

- **Short-Term Interest Costs.** Often Direct Purchase Transactions are structured with a rate set for a period of time that is shorter than the nominal maturity of the Direct Purchase Bonds. This permits the issuer or borrower to take advantage of lower short-term borrowing costs, but any tender at the end of the particular interest period does expose the borrower or issuer to “put” risk.
- **Limited Disclosure Documents.** In many, but not all, Direct Purchase Transactions, since the Direct Purchase Bonds are not being offered publicly, the Purchaser does not require the issuer or borrower to prepare an offering document. Instead, the Purchaser conducts its own inquiry into the affairs of the issuer or borrower as part of the Direct Purchase Transaction, and the issuer and borrower are able to save the time and expense involved in the preparation of an offering document and obtaining 10b-5 representations and negative assurance letters.

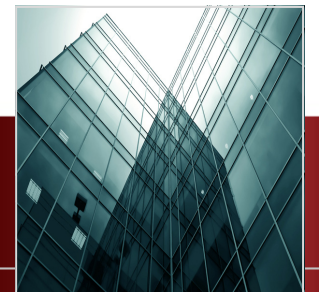
## Risks and Rewards

The benefits of Direct Purchase Transactions also may include:

- Elimination of exposure to the risk of increased cost of borrowing relating to ratings downgrades of any credit and/or liquidity providers supporting the issuer’s or borrower’s variable rate demand obligations (“VRDOs”);
- Fewer restraints on the issuer’s or borrower’s investment management (if the issuer or borrower opts for Direct Purchase Transactions rather than maintaining its own short-term ratings for its debt); and
- More flexibility with respect to financial covenants and any requests for waivers and/or modification of financial covenants, since negotiations would be with the Purchaser rather than bondholders.

Direct Purchase Transactions also carry certain risks not otherwise typically associated with VRDO transactions, including:

- Purchasers often require a mandatory tender or prepayment at the end of a specified period (typically 3-7 years), which may require the issuer or borrower to refinance or remarket the entire outstanding amount of the Direct Purchase Bonds;
- Purchasers may require more stringent operating and financial covenants, and additional/more restrictive provisions regarding events of default, as compared to traditional publicly offered bonds; and
- Purchasers may require shorter amortization schedules, as compared to traditional publicly offered bonds.



## Market Disclosure

As described above, because the Direct Purchase Bonds are privately placed with the Purchaser and not sold to an underwriter, an offering document for the Direct Purchase Bonds is typically not required by the Purchaser nor disseminated to the capital markets. Rating agencies and, more recently, the Municipal Securities Rulemaking Board, have urged issuers and borrowers to disclose the terms of Direct Purchase Transactions at the time they are entered into so that, among other things, the rating agency or an investor does not first learn of the Direct Purchase Transaction in the issuer's or borrower's audited financial statements. Ratings agencies have also indicated that they prefer more detailed disclosure with respect to the terms of Direct Purchase Transactions than what would typically be included in an issuer's or borrower's financial statements. For example, rating agencies would like issuers or borrowers to disclose any differences in the terms of the Direct Purchase Bonds from the terms of such issuer's or borrower's other outstanding obligations. Under the Municipal Securities Rulemaking Board's recently revised Rule G-34, documents that establish obligations to provide liquidity with respect to VRDOs (including stand-by bond purchase agreements and letter of credit agreements) must be provided to the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access website and thereby to investors. Rating agencies and some bondholders have suggested that similar Direct Purchase Transaction documents should also be made available to the market.

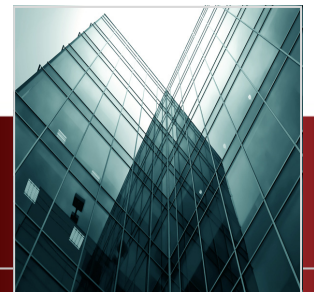
## How Polsinelli Shughart Can Help



Polsinelli Shughart has extensive experience representing issuers, not-for-profit borrowers, and financial institutions in Direct Purchase Transactions. As your organization considers Direct Purchase Transactions, we can advise your organization of the risks and rewards of Direct Placement Transactions.

For questions pertaining to the information presented above, please feel free to contact:

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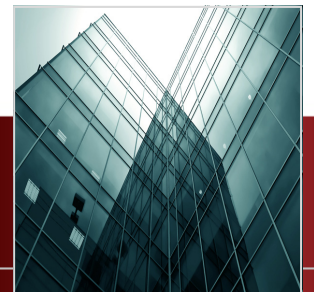
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