Memorandum
Office of Jenine Windeshausen
Treasurer-Tax Collector

To: Placer County Board of Supervisors

From: Jenine Windeshausen, Treasurer-Tax Collector

Date: October 6, 2020

Subject: Tobacco Securitization Refunding

Action Requested

a) Receive information on the opportunity to refund the County's Tobacco Settlement Asset-Backed Bonds (Gold Country Settlement Funding Corporation), Series 2006 related to the proposed 2020 Tobacco Refunding Bonds, and approve the following actions recommended by the County Finance Committee and directed by the County Executive Officer:
   1. to proceed with the issuance of Tobacco Settlement Bonds (Gold Country Settlement Funding Corporation) Series 2020 (the "2020 Tobacco Bonds"), refunding the County's Tobacco Settlement Asset-Backed Bonds (Gold Country Settlement Funding Corporation), Series 2006 (the 2006 Tobacco Bonds"), and
   2. to use the proceeds to finance infrastructure improvements at the DeWitt Center (including sewer, water and roadway improvements), and costs related to the construction of a new Health and Human Services Building, including reimbursement of project funds spent to date, and additional projects approved by your Board to ensure all proceeds are spent.

b) Request the Treasurer to return to the Board with the necessary resolution approving documents and other matters at its October 27, 2020 Board meeting.

c) Approve the following non-contingent contracts for services related to the 2020 Tobacco Refunding Bonds and authorize the Treasurer and County Executive Officer to execute the contracts:
   1. A contract for bond and disclosure counsel services with Norton Rose Fulbright in an amount not-to-exceed $205,000 (a maximum of $105,000 is non-contingent on the issuance of bonds).
   2. S & P Global Ratings for bond rating services in an amount of $150,000, non-contingent on the issuance of bonds, and an additional amount of $20,000 per year for ongoing monitoring and ratings over the life of the bonds.

Background

The Tobacco Master Settlement Agreement

For almost 45 years individuals sued tobacco companies for damages related to negative health consequences from smoking tobacco. Most of these suits failed to recover any damages. However, in 1997, after approximately three years of litigation, four states who sued tobacco companies to recover public health care costs related to treating the effects of smoking tobacco entered into settlements with the largest tobacco companies. Subsequently in late 1998, after several years of litigation, the California State Attorney General along with attorney generals from forty-six states and several other US jurisdictions (the "Settling States") entered into the Master Settlement Agreement (MSA).

The MSA resulted in the largest civilian legal settlement in US history. The MSA imposed certain restrictions, prohibitions, and requirements on tobacco companies, as well as a significant financial settlement. The restrictions, prohibitions and requirements included:

- Restrictions on marketing, including advertising targeting youth
- Prohibitions on lobbying to suppress research, or to hide or misrepresent negative information on tobacco use
- Requirements for the disclosure of previously secret industry documents on the negative impacts of tobacco use
- Requirements for the creation and funding of tobacco prevention foundation
- Disbanding and prohibiting tobacco industry trade organizations from conspiring to hide negative information, publicize misleading information, or cast doubt on research and information about tobacco use[1]

The MSA provisions regarding the financial settlement resulted in up-front payments for the first five years after the settlement, and **annual payments in perpetuity.**

Each year seven tobacco companies (the “Participating Manufacturers”), with the largest market share at the time of the settlement, are required to make annual payments based on their market share of tobacco sales. These payments are sent to the attorneys general of the Settling States based on percentage allocations designated in the MSA.

Pursuant to the MSA, the schedule of annual payments to the Settling States was expected to be as follows:

- 2000 - $4.5 billion
- 2001 - $5 billion
- 2002 and 2003 - $6.5 billion
- 2008 – 2017 - $8.14
- 2018+ perpetuity $9 billion

However, these amounts have been and continue to be subject to numerous adjustments, including inflation and volume of cigarettes sold. Adjustments for inflation have been significantly outpaced by reductions in the number of cigarettes sold. For example, the actual amount distributed to the Settling States for 2018 was $7.2 billion, not $9 billion due to these adjustments. Declines in tobacco consumption have been primarily due to increases in tobacco taxes and increases in market share by tobacco companies other than the Participating Manufacturers. Another factor that has affected distributions are regular payment disputes raised by the Participating Manufacturers which require the disputed amounts to be withheld in escrow pending resolution of the disputed payments. These adjustments have proven to be an important benefit of the County securitizing its MSA payments, as prior tobacco bond proceeds have been based on higher than expected tobacco sales. Since the MSA payments have been less than expected, the County’s prior tobacco securitizations have shifted the risk of smaller MSA payments to bondholders.

The MSA required the Settling States to release and discharge all future claims against the Participating Manufacturers. The MSA defined Releasing Parties to include state agencies and

[1] The Center for Indoor Air Research, The Tobacco Institute and the Council for Tobacco Research were all organizations sponsored by the tobacco industry. The purpose of these entities was to cast public doubt and undermine cancer research linking tobacco as a cause of cancer and other health problems.

political subdivisions. As a result, all 58 California counties, including Placer and four cities who provide public health services agreed to release and discharge claims against the Participating Manufacturers by entering into memorandums of understanding (MOUs). The MOUs also provide for the distribution of payments and the resolution of disputes. Accordingly, the California Attorney General distributes a share of the MSA payments to the 58 counties and four cities. The share for each county and city is determined by population and other factors in proportion to statewide totals.

Total payments for Placer County from the first payment received in December of 1999, through the most recent payment received April 2020, is $63,164,175.61.

Tobacco Securitization

In simple terms, tobacco securitization involves the sale of a defined set of future MSA payments in exchange for a lump sum. *Recall the lottery winner who learns their winning amount will be paid-out over an extended period and decides to sell the payment stream on a discounted basis in exchange for a lump sum.*

Many MSA payment recipients, including states, counties and cities and other government agencies, have chosen to securitize their payments to fund current capital projects, endowments for future capital projects, and endowments for non-capital programs. While, tobacco bond proceeds can be used to fund current capital projects, tobacco bond proceeds for future capital projects and non-capital programs are subjects to endowments. Tobacco bond proceeds for future capital projects and non-capital programs must be deposited into an endowment which is utilized to limit withdrawals to ensure IRS disbursements caps are not exceeded. The caps are designed to prevent tobacco bond proceeds from being used for investment arbitrage purposes. The tobacco bond proceeds placed in endowments must be invested to ensure the investments earnings do not exceed the interest yield on the tobacco bonds. Additionally, the amount that can be withdrawn annually is limited to a derivative of annual MSA payment designated for the county or city.

Tobacco bonds are structured to take into consideration various legal requirements related to the MSA, as well as to address issues and requirements of the Internal Revenue Service (IRS), the Securities and Exchange Commission, California bond laws, and rating agencies, as well as the overall marketability to prospective bond buyers. Tobacco bond structures in California require the involvement of several different entities including the county, a statewide JPA and a single purpose not-for-profit corporate entity.

Placer County Tobacco Securitization History

Placer County initially securitized its MSA revenues and issued tobacco bonds in 2002. In 2006, the County refunded the 2002 bonds and extended the MSA payments dedicated to repaying bonds to receive an additional lump sum amount. The County has used the proceeds from the sale of tobacco bonds to fund various capital improvements.

Tobacco bonds are structured to address provisions in the MSA, as well as to address federal tax requirements. The structure involves two entities, in addition to the County: 1) a statewide joint powers authority, the California County Tobacco Securitization Agency (the “JPA”) whose nine county members have all issued tobacco bonds, 2)the Gold Country Settlement Funding Corporation (the single purpose not-for-profit corporation, the “Corporation”) formed by the County when it issued its 2002 Tobacco Bonds.

Initial Issuance 2002. Placer County securitized its tobacco revenues from the MSA and sold its first tobacco bonds. Proceeds in the amount of $41,590,000 were used to construct the Community Development and Resource Agency Building at the DeWitt Center.

Refunding 2006. In 2006, the County refunded (refinanced) its 2002 tobacco bonds, extended the maturity and committed additional future MSA revenues. The 2006 refunding tobacco bonds were sold for $59,372,117.50. After paying off the 2002 bonds, the County netted $13,567,697.71 which was used to construct the South Placer Justice Center. Those bonds have a final maturity of 2046.

The total amount of tobacco bond proceeds received by the County for the 2002 and 2006 Tobacco Bonds, net of prior bond pay-off is $55,157,697.

Proposed Refunding 2020. The proposed 2020 refunding bonds are estimated to have an aggregate principal amount of $64 million in proceeds. Approximately, $61 million will be used to pay-off the 2006 Tobacco Bonds. Depending on interest rates at the time of the sale, it is estimated $3 million to $5 million will be available for County projects after the remaining balance on the 2006 bonds are paid-off.

The County Executive's Office has recommended using the proposed 2020 Tobacco Refunding Bond proceeds for DeWitt Center infrastructure, including sewer, water, and roadway improvements and the Health and Human Services Building. Additionally, the Board approved a reimbursement resolution (Res. No. 2019-217) which allows the County to reimburse itself for project expenses made 30 days prior to the resolution through the time of bond issuance for the HHS Building, Crime Lab and Tahoe Justice Center. Other projects approved by your Board will also be included in the list of projects eligible for bond proceeds to ensure that all bond proceeds will be utilized.

On September 15, 2020, in anticipation of issuing the 2020 Tobacco Bonds, the full Commission of the California County Tobacco Securitization Agency considered and unanimously approved the County of Placer's request to proceed with a potential refunding transaction by taking action to approve the waiver of the restriction in the By-laws for such a refunding transaction. Transfer restrictions under Article VII of the JPA's Bylaws require either: (i) that non-rated bonds be issued in minimum denominations of $250,000 maturity amount and that their initial purchase and any subsequent transfer be limited to "qualified institutional buyers" or "QIBs" (as defined in the rules of the Securities and Exchange Commission), or (ii) that the full Agency Commission (rather than a subset thereof which would include the County's Commissioners) approve the waiver of the restrictions for each of the proposed refunding transactions. This action was non-binding on the County to issue bonds.

If the Board wishes to proceed with the proposed refunding of the County's 2006 Tobacco Bonds, the Board and the Corporation Board will need to adopt respective resolutions approving certain documents. It is anticipated, the Board will be presented with the necessary resolution approving documents and other matters at its October 27, 2020 Board meeting. At that time, a more detailed review of the documents and the relationship of the related entities will be provided as background and information for your Board's consideration in adopting the County resolution.

For reference, the primary underlying documents for tobacco bonds include:

- Indenture
- Supplemental Indenture
- Loan Agreement
- Escrow Agreement
- Official Offering Statement
- Contract of Purchase (for bonds)
- Disclosure Certificate
- Authorizing Resolutions of the JPA, the Corporation and the County

Consultants and Contracts Required for Tobacco Securitization

The following consultants and advisors are needed to assist staff in the issuance of the bonds and to ensure that the bonds comply will all state and federal laws and regulations:

- Bond Counsel – Norton Rose Fulbright
- Independent Registered Municipal Advisor – Del Rio Advisors
- Bond Underwriter (and Underwriter's Counsel) – Stifel
- Bond Trustee – Bank of New York Mellon
- Verification Agent - TBD
- Rating Agency - S & P Global Ratings
- Tobacco Consumption Consultant - IHS Markit

Bond proceeds are net of all costs of issuance. Ongoing annual fees are paid out of MSA revenues prior to payment of debt service. The County can decline or defer issuance of the bonds at any time up until the sale of bonds. Should the bond pricing not produce the expected proceeds, the County may decline awarding bonds to bidders. The County would likely decline awarding bonds if the most competitive bids failed to produce net proceeds of at least $3.5 million. Fees for underwriting are contingent on sale of bonds and are calculated as a percentage of bond proceeds, incorporated into the bond pricing. The sum of all fees and charges paid to third parties is estimated to be $1.2 million.

Costs of Issuance:

Item		Amount
Bond Counsel*		125,000.00
Disclosure Counsel*		80,000.00
Municipal Advisor		72,500.00
Rating Fee (S&P)**		150,000.00
IHS Global Inc. Fee		125,000.00
Verification Agent		3,500.00
Trustee		7,500.00
Printer		2,500.00
Miscellaneous		12,750.00
Total Costs	**$**	**578,750.00**
(*) Norton Rose's non-contingent fee is 50% of the proposed amounts.		
Non-contingent amount		**252,500**

If the County should determine not to issue the bonds, the non-contingent amount of $252,500 will still be due to bond counsel and Standard and Poor's. A budget revision will be required to allocate the cost from the General Fund. All other consultant fees are contingent upon the sale of bonds and are not payable unless bonds are sold. All fees are paid out of bond proceeds, except non-contingent fees due if bonds are not sold.

Next Steps

If the Board approves the recommended actions, staff will return to the Board with a proposed resolution to approve the proposed issuance of the 2020 Tobacco Refunding Bonds on October 27, 2020. At that time, an outline of the documents proposed to be approved by the resolution as well as an explanation of the structure of the tobacco bonds will be presented to the Board. Additionally, all other contracts necessary which are contingent upon the sale of the bonds will be provided to your Board for approval.

In late October, the Gold Country Settlement Funding Corporation will also schedule a meeting to consider a resolution approving issuance of the tobacco bonds and related documents.

Bond pricing is currently scheduled the week of November 16, 2020 and closing is planned for the week of November 23, 2020.

Fiscal Impact

If the proposed 2020 tobacco refunding is completed, the County is estimated to receive between $3.5 million and $5 million in net proceeds after paying off the County's Tobacco Settlement Asset-Backed Bonds (Gold Country Settlement Funding Corporation), Series 2006 and all costs of issuance. The actual amount will depend on interest rates at the time of issuance with a greater amount resulting from lower interest rates. The net proceeds will be used to offset the cost of PCGC improvements and the Health and Human Services Building. After issuance, staff will return to the Board for approval of budget adjustments to reflect the bond proceeds and allocations to projects.

Should the County not complete the issuance of the 2020 Tobacco Refunding Bonds, the County will be obligated to pay non-contingent costs, not to exceed $252,500. In this event, staff will return to the Board for approval of a budget adjustment for this expense to the County General Fund.

Attachments:
- Norton Rose Fulbright US LLP Contract
- S & P Global Ratings Contract