THE ABCs OF MUNICIPAL BONDS

A GUIDE FOR PENNSYLVANIA LOCAL GOVERNMENT OFFICIALS

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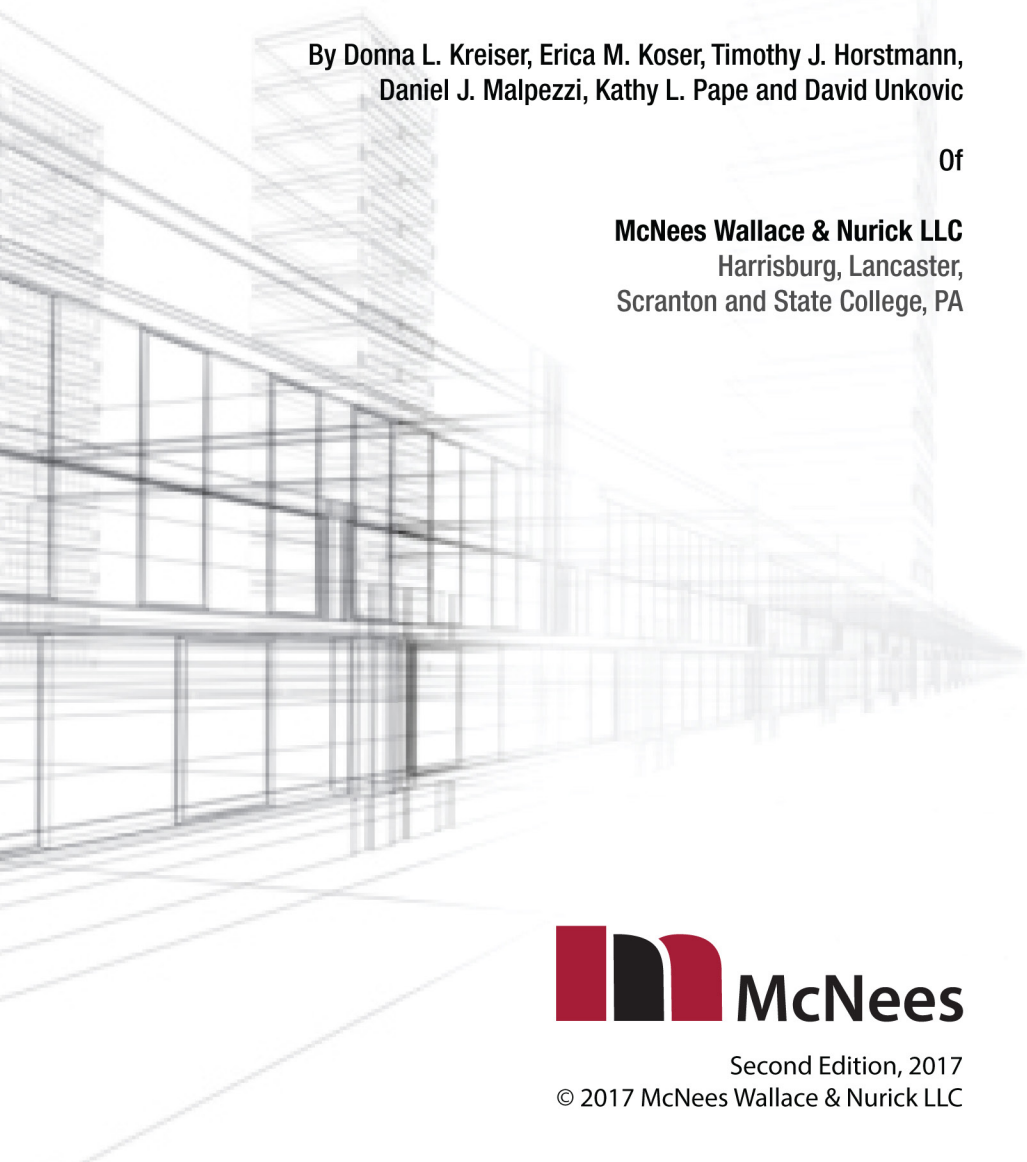

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I. INTRODUCTION

For many local government officials and solicitors in Pennsylvania, a bond issue is a rare occurrence perceived to be shrouded in mystery. Like most things in life, it is only mysterious because it is unfamiliar. Once you understand the participants and the steps, the process makes more sense.

The main goal of this pamphlet is to set forth for you the basic elements of how a bond issue works: who is involved, what are the steps, what are the structures used, and how are bond issues regulated? As an additional aid, there is a Glossary of Municipal Bond Terms included at the end of this pamphlet.

Even though this pamphlet is intended as an introductory piece, an important second goal is to make you aware of the real risks involved in bond issues – risks arising from certain debt structures, and risks arising from the federal tax laws and securities laws related to bonds.

It is important that you receive excellent financial and legal advice when you undertake a bond issue. That advice will help you develop a favorable debt structure for your needs, and it will help you protect your local government and each of you individually in the complex world of securities regulation.

II. THE PARTICIPANTS

Issuer. The most important participant in a bond issue is the municipal issuer of the bonds. The issuer is undertaking the financing for one of two purposes: (1) to finance capital projects or (2) to refund existing debt. All of the other participants are there to assist the issuer in the process of raising the money.

Solicitor. The issuer's regular lawyer is referred to as the solicitor. The solicitor represents the issuer in the financing and delivers a legal opinion at the closing. The solicitor's opinion usually covers the following matters: the issuer validly exists, the issuer's officers

validly hold their offices, the public meeting at which the bond issue is approved was properly called and held, and there is no material litigation pending against the issuer which would adversely affect the bond issue.

In many cases, the solicitor is not an expert in public finance. But the solicitor is usually an experienced lawyer who understands the issuer's operations better than any other professionals involved in the bond issue. Therefore, the solicitor should be diligent in protecting the interests of the issuer by asking questions. If the solicitor and the issuer are not comfortable with anything related to the bond issue, then the solicitor should slow down the process until he or she is comfortable. It is particularly important that the solicitor reviews the description of the issuer in the disclosure document for the bonds (commonly called the official statement, or "OS"), and that the solicitor makes sure the issuer is prepared to comply with the issuer's post-issuance responsibilities (described below).

Bond Counsel. Because the solicitor is often not an expert in public finance, the issuer usually also retains a law firm which regularly represents issuers in public finance transactions to work with the solicitor on the legal aspects of the bond issue. This lawyer is commonly referred to as bond counsel. Bond counsel's primary role is to ensure that the bond issue complies with the complex federal and state tax rules to qualify the issue for an exemption from income taxation and to issue an opinion to enable the bonds to be sold to investors. The issuer should make sure that bond counsel identifies the issuer as its client in its engagement letter.

Bond counsel cooperates with the issuer and the financial advisor or underwriter in structuring the transaction, with particular emphasis on legal matters related to state law approvals and compliance with the federal tax and securities laws. Bond counsel also delivers an opinion at the closing which covers the following points: the issuer has properly authorized and issued the bonds, the bonds are enforceable under the law, and interest on the bonds is exempt from federal income tax and certain state taxes (to the extent applicable). Bond purchasers rely on

the bond counsel opinion when they buy the bonds.

Financial advisor and/or underwriter. There are two financial functions that take place in a bond issue. First, the issuer may hire a financial firm to advise it on the structuring of the bond issue. Second, the issuer may hire a financial firm to buy the bonds with the intent to sell them to purchasers.

In the last few years, the United States Securities and Exchange Commission (SEC) has been changing and expanding the rules governing what types of firms can perform these two functions.

Traditionally, the issuer could hire an underwriter (also called an investment banker) to perform both of these functions in a negotiated offering. The underwriter would provide structuring advice and then market the bonds to purchasers. Or, the issuer could hire a financial advisor solely to advise the issuer on structuring the bond issue. (The financial advisor would not sell the bonds.) The issuer would then, with the advice of the financial advisor, sell the bonds either through a competitive sale in which multiple underwriters bid, or through a negotiated offering in which a selected underwriter agrees to buy the bonds and then sell them to purchasers.

Financial advisors were seen as having a fiduciary duty to the issuer, but financial advisors were largely unregulated. Underwriters did not have a fiduciary duty to the issuer (just an obligation to deal fairly), but underwriters were heavily regulated.

In response to the financial crisis of 2008, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act. Dodd-Frank invested the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB) with new or expanded jurisdiction over financial advisors and other participants in municipal bond transactions.

In 2010, the SEC required financial advisors to register with it as "municipal advisors". In 2013 and thereafter, the SEC has been

publishing a series of final regulations governing the duties of municipal advisors.

The bottom line is that the days of unregistered financial advisors are over; these advisors are now registered as "municipal advisors" and have a fiduciary duty to the issuer; and issuers now have to acknowledge that their underwriters do not owe a fiduciary duty to the issuers.

Paying agent or trustee. Once the bond issue has closed, debt service payments are made by the issuer to the bondholders through a paying agent or trustee, which is typically the trust department of a commercial bank chosen by the issuer. Depending on the structure of the bond issue, the paying agent or trustee may also hold certain moneys of the issuer in a reserve fund or other funds. If the bond issue ever goes into default, the paying agent or trustee often represents the bondholders in remedial proceedings against the issuer.

Credit Enhancers. It sometimes makes economic sense for the issuer to utilize a third party to guarantee the bond issue -- this is called credit enhancement. For instance, a municipality may agree to guarantee the bonds of a municipal authority; an insurance company may issue an insurance policy guaranteeing payment of debt service on the bonds; a bank may issue a letter of credit guaranteeing payment of debt service on the bonds; or a bank may enter into a standby bond purchase agreement under which the bank will pay the purchase price of bonds that may be tendered by bondholders. Regardless of the form of credit enhancement used, the goal is the same – to improve the marketability of the bond, and secure a better interest rate for the issuer.

Borrower in Conduit Financing. Sometimes the issuer, such as a municipal authority or an industrial development authority, is acting as a "conduit issuer". In such a case, the issuer issues the bonds and loans the proceeds to a third-party borrower, which is often a nonprofit corporation such as a health system or university. The borrower, not the conduit issuer, is responsible for paying the debt service on the bonds.

Swap Counterparty. In more complicated financing structures, the issuer may enter into an interest rate swap agreement or other derivative with a swap counterparty. Such counterparties are often large international banks. Under the swap agreement, the issuer and the swap counterparty agree to make certain payments to each other which are layered on top of the payments being made on the related bonds. The swap counterparty does not owe a fiduciary duty to the issuer, so the issuer should make certain it is receiving advice from competent independent financial professionals as to the relative risks and benefits of any derivatives transaction.

Swap Advisor. If the issuer plans to enter into an interest rate swap agreement in connection with a bond issue, the issuer should retain an experienced financial advisor to advise it on the swap, and the issuer should make sure it understands the risks involved in the transaction. The issuer's financial advisor may also sometimes serve as the issuer's swap advisor.

III. THE STEPS IN A BOND ISSUE; AND DEBT STRUCTURES

Reimbursement Resolution. If you intend to cover the initial costs of a capital project with non-bond proceeds, and later reimburse yourself for those expenditures with bond proceeds, you should consult with your solicitor or bond counsel about having your governing body adopt a "reimbursement resolution" that sets forth your intention to reimburse such costs. Failure to adequately address this issue at the time the expenditures are made could prevent you from being able to reimburse these costs from tax-exempt bond proceeds at a later time.

Selection of participants and structuring the transaction. The first step is for the issuer to select bond counsel and the financial advisor or underwriter. This selection should be undertaken almost immediately after the issuer has identified a project to be financed by a bond issue.

The issuer and the solicitor work with these participants to structure the financing. Some basic questions need to be answered: (1) what is the purpose of the issue -- to fund a capital project, to refund prior debt,

or a combination of both? (2) what are the legal parameters involved -- does the capital project serve a proper legal purpose, can the debt be refunded under the federal tax rules? (3) how should the bonds be sold -- through negotiation with one underwriter or through a competitive bidding procedure with multiple underwriters? (4) does credit enhancement make economic sense (that is, is the cost of the insurance or letter of credit less than the resulting debt service savings to the issuer)? (5) will a derivative, such as an interest rate swap, be utilized? (6) what are the benefits and risks of each structure?

If the structure is one in which bond proceeds will be held for some time after closing, such as in a reserve fund or a construction fund, the issuer and its financial advisor should focus well before the closing on the investment strategy for the bond proceeds.

Once the structure is formulated, the issuer needs to select the paying agent or trustee and, if applicable, the credit enhancer and swap counterparty, and all the participants begin to prepare the required documentation. Bond counsel drafts the ordinance, resolution or indenture and other legal documents. The underwriter or financial advisor and the issuer prepare the initial disclosure document which is usually called the preliminary official statement.

Although the financial advisor or underwriter usually prepares the draft of the preliminary official statement and the final official statement, it is really the issuer's disclosure document. The issuer and its solicitor should carefully review its contents. The official statement should contain no misstatement of a material fact, and no material fact about the issuer should be omitted from the official statement.

Marketing the bonds and the bond sale. When the preliminary official statement is in proper form, it is distributed by the underwriter to potential purchasers. The marketing period usually lasts about one week.

At the end of the marketing period, the issuer holds a public meeting at which time the bond sale is held. If the issuer has chosen a negotiated

offering with one underwriter, then the underwriter comes to the public meeting with a firm purchase proposal. If the issuer has chosen a competitive offering with bids from multiple underwriters, then the financial advisor collects the bids on the day of the public meeting usually utilizing an internet bidding process. The issuer then accepts the purchase proposal at the public meeting by adopting the ordinance or resolution prepared by bond counsel.

The purchase proposal contains the specific terms of the bond issue: principal amount of the bonds, interest rates, amortization schedule and prepayment provisions. It also sets forth the conditions of closing. Once the deal is "cut" at the bond sale and the purchase proposal has been accepted by the issuer, a final official statement is prepared which includes the final pricing information. The underwriter then sends the final official statement to the purchasers, and the participants proceed toward the closing.

Sometimes an issuer may want to adopt an ordinance or resolution which approves "parameters" and delegates approval of the final pricing of the bonds to a specific municipal official or to the borrower. In such a case, the bond sale occurs after the governing body takes its official action. When the deal has priced, the designated municipal official signs an addendum to the purchase proposal setting forth the final pricing.

If a swap is being utilized, it will usually be priced at the same time the bonds are priced.

DCED approval and the closing. If the issuer is a township, borough, city, county or school district, bond counsel will prepare a package to be filed with the Pennsylvania Department of Community and Economic Development (DCED) in accordance with the requirements of the Local Government Unit Debt Act (LGUDA). DCED has 20 days to approve the bond issue. Other issuers of debt in Pennsylvania, such as authorities, have different statutory approval requirements.

Usually the closing takes place about one month after the bond sale.

Prior to the closing, the bond counsel will distribute for review drafts of various agreements, certificates and legal opinions. At the closing, the participants execute the various closing documents. The underwriter wires the purchase price for the bonds to the paying agent or trustee. The paying agent or trustee, at the direction of the issuer, pays the costs of issuance and applies the balance to fund a construction or project fund or to refund the prior debt. After the closing, bond counsel distributes a complete set of the closing documents to each participant (often on a CD).

Post-issuance compliance. After a bond issue closes, there are requirements under the Tax Code and under the securities laws that continue to apply to the bonds. On the tax side, there are regulations governing the investment and spending of bond proceeds and the use of the bond-financed facilities. On the securities law side, there are requirements to make annual financial disclosures and special event disclosures with the Municipal Securities Rulemaking Board (MSRB).

Both the Internal Revenue Service and the SEC strongly encourage issuers to adopt and follow written post-issuance compliance policies. And all of the regulators are becoming more and more aggressive in supervising the post-issuance requirements. Before the bond issue closes, the issuer and solicitor should work closely with bond counsel and the financial advisor or underwriter to help the issuer develop these post-issuance compliance policies. After the closing, the issuer and its solicitor should make sure the issuer takes these policies seriously and follows them. It is often a good idea for the issuer to retain a third party "dissemination agent" to assist it in monitoring and filing required post-issuance continuing disclosure.

Bank Loans. Instead of using an underwriter and selling bonds to the public, an issuer can instead enter into a two-party loan transaction in which the issuer receives a loan from a bank or some other entity such as an insurance company or a hedge fund. It is a good idea for the issuer to use its solicitor, bond counsel and financial advisor on these transactions. It is also possible that a paying agent, credit enhancer or swap counterparty may also be involved in these loans.

The issuer typically will enter into a loan agreement with the bank and will issue a single bond or note to the bank evidencing the issuer's repayment obligation. For conduit issuers who are issuing bonds for the benefit of qualified private parties (such as nonprofit hospitals or colleges), the financing agreement is a three party loan agreement among the bank, the conduit issuer and the conduit borrower.

General Obligation Bonds and Revenue Bonds. The two most common types of security for municipal bonds are represented by general obligation bonds and revenue bonds.

With a general obligation bond, the issuer pledges its full faith, credit and taxing power to secure the bonds, and it agrees to budget, appropriate and pay the debt service due on the bonds each year. In a default situation, the bondholders can have a court force the issuer to raise real estate taxes in an amount sufficient to pay the debt service.

With a revenue bond, the issuer pledges the revenues of a particular project, such as a sewer system, to secure the bonds, and it agrees to set rates at a level sufficient to pay the debt service.

It is possible to combine both of these concepts in a bond issue. For example, a municipal authority may issue revenue bonds secured by the revenues of its sewer system, and a municipality may also secure the authority's bonds with a municipal guaranty which operates essentially as a general obligation. These are called guaranteed revenue bonds.

As a result of recent municipal bankruptcies, such as in Detroit, the strength of these security structures has been subject to serious analysis. As with many legal concepts, the devil is in the details, and the meaning of "general obligation" or "revenues" can vary depending on the specific laws in effect in each state.

Tax and Revenue Anticipation Notes (TRANS). Under the Local Government Unit Debt Act, a municipality may borrower money to

cover cash flow shortages during the municipality's fiscal year. The TRANS are secured by the municipality's tax revenues and must be repaid prior to the end of the fiscal year.

IV. SOME BASIC TAX CONCEPTS

The interest on municipal bonds is usually intended to be tax-exempt to the bondholder. That is, the interest earned on the bond is excluded from the bondholder's gross income on the bondholder's tax return. The interest is also usually tax-exempt under state and local income taxes if the bondholder lives in the state in which the issuer is located.

The "winners" in this arrangement are the bondholder, who gets tax exempt income, and the issuer, who issues the bond at a lower tax-exempt rate thereby receiving a lower cost of capital. The "loser" is the federal government which cannot collect taxes on the bondholder's interest earnings on the bond.

The anomaly in this situation is that the "loser" (the federal government) is the one making the rules governing tax-exempt debt – through statutes passed by Congress and regulations promulgated by the U.S. Treasury Department. These tax rules are set forth primarily in Sections 103 and 141 to 150 of the U.S. Tax Code and in the U.S. Treasury regulations under those sections of the Tax Code. The statutes and regulations are lengthy and extremely complicated.

The federal government pursues its policies with respect to tax-exempt interest through three main types of restrictions:

Limiting Private Benefit. The rules limit the ability of private parties to benefit from tax-exempt financed facilities. States and their political subdivisions are the main entities intended to benefit. Some rules allow nonprofit institutions, such as hospitals, colleges or volunteer fire companies, to benefit. But, with limited exceptions, private parties such as for-profit companies do not benefit.

Municipal issuers should consult with bond counsel before allowing

a private party to lease or use or manage a facility financed with tax-exempt bonds. This is true even after the bonds are issued. The tax-exempt status of the interest on the issuer's bonds can be lost if a subsequent change in use violates the rules.

Controlling the Outstanding Volume of Tax-Exempt Debt. The federal government tries to limit the "drain" on the U.S. Treasury by limiting the amount of tax-exempt bonds which may be issued. This is done in various ways. For example, there are some bonds allowed to be issued to benefit private parties, such as small manufacturing industrial development bonds, but there are specific volume caps by state on how many of these bonds may be issued. There are also rules that limit the situations in which an issuer can issue bonds to refund prior bonds without promptly paying off the bonds being refunded (avoiding having two sets of tax-exempt bonds outstanding for the same project).

Controlling Arbitrage. The rules limit the ability of issuers to earn a "profit" on bond proceeds by borrowing at tax-exempt rates and investing the proceeds in taxable investments. From time to time, such as in the 1980's, it is possible to borrow at long-term tax-exempt rates and then immediately invest the proceeds at higher short-term taxable rates and earn a "profit" until the bond proceeds are finally spent on the construction project. This profit is called "arbitrage".

The rules in this area are extremely complex and not at all intuitive. Under certain situations, issuers must actually "rebate" their investment profits back to the U.S. Treasury. It is a good idea for an issuer to retain a "rebate agent" to help the issuer make the necessary arbitrage calculations.

V. SOME BASIC SECURITIES LAW CONCEPTS

Municipal securities are regulated by the U.S. Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB). Under the securities laws, there is a provision called the "Tower Amendment" (named after the late Senator John Tower of Texas) which prohibits the SEC and the MSRB from requiring any

issuer of municipal securities, either directly or indirectly, to make any filings with the SEC or the MSRB prior to the sale of securities. The MSRB is further limited in its ability to require any municipal issuer to furnish it or any purchaser or prospective purchaser with any documents. (See, Section 15B(d)(1) and (2) of the Securities and Exchange Act of 1934.)

In spite of these restrictions, the SEC and the MSRB have become more and more aggressive in requiring municipal issuers to make specific disclosures and to file documents of various types with the MSRB. Under SEC Rule 15c2-12, an underwriter (which is regulated by the SEC) may not market municipal bonds unless it obtains a written commitment from the municipal issuer to make periodic disclosure filings. This results in indirect regulation of the issuer.

These written commitments are usually called "Continuing Disclosure Agreements" or "CDAs". Under the CDA the issuer agrees to file with the MSRB the issuer's financial statements and certain operating data on an annual basis. In addition, under the CDA the issuer agrees to file with the MSRB notices of the occurrence of certain significant events (such as rating changes or defaults on the bonds). The filings are made with an electronic system established by the MSRB called EMMA (see, http://emma.msrb.org/).

The SEC has not been satisfied with the level of compliance over the years by municipal issuers with the filing requirements of Rule 15c2-12. In 2014, the SEC got the attention of the municipal market by instituting a voluntary self-reporting program under which issuers and underwriters could self report if they were involved in bond issues in the last five years in which the official statements did not accurately report the issuer's historic compliance with Rule 15c2-12. This was called the Municipalities Continuing Disclosure Cooperation Initiative (MCDC).

The SEC has also become more aggressive in the last few years in bringing actions against issuers and individual officials of issuers for inadequate disclosure in official statements (for example, inadequate disclosure regarding the funding of pension plans).

VI. SOME THOUGHTS ON RISKS FOR MUNICIPAL ISSUERS

Municipal bond issues involve a lot of money. The debt being incurred by the issuer has a significant effect on the finances of the issuer. If problems arise with respect to a bond issue, those problems can also have a profound effect on the finances of the issuer.

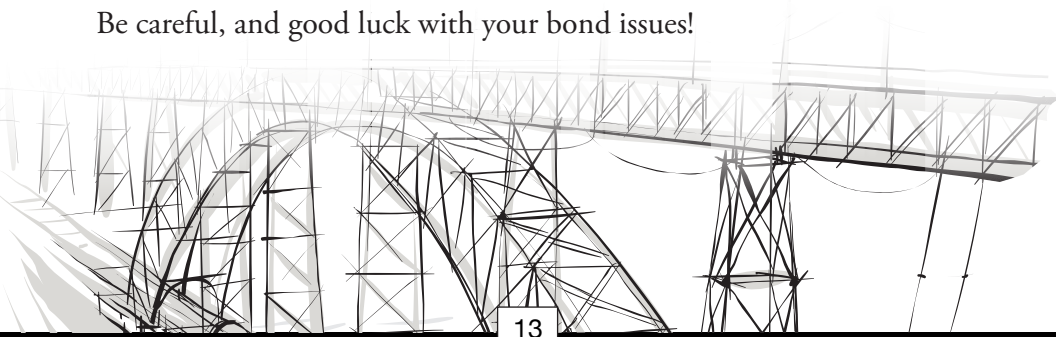
As a result, issuers should approach bond issues very seriously. Make sure you as the issuer retain financial and legal advisors with experience, high ethical standards and good judgment.

Make sure you understand the structure of any bond issue – both its potential benefits and potential risks. If you do not understand a structure, do not use it. Some structures, such as auction rate bonds, have had basic structural defects. Other structures, such as interest rate swaps, have significant potential risks and should be used only if those risks are adequately assessed and understood.

Be sure to be diligent and thorough in the quality of the disclosures you make in your official statements. Have knowledgeable employees and your solicitor review these disclosures to ensure accuracy and to make sure all material facts are being disclosed.

In the complicated regulatory environment of municipal bonds, make sure you have a strong understanding of your responsibilities in tax and securities matters. Develop a written post-issuance compliance policy which sets forth your responsibilities after closing a bond issue. Make sure a specific person or persons are tasked with the responsibility of following the post-issuance compliance policy.

Be careful, and good luck with your bond issues!



We hope you have found the general information in this pamphlet to be helpful. Every bond transaction has unique aspects and you should not rely on this pamphlet as a source of specific legal advice. All of the rules and requirements discussed herein are complicated, and there are many more exceptions, qualifications and interpretations which are not included in this pamphlet, but which may be applicable to the transactions which you may undertake. In all cases, consult with qualified bond counsel on your transactions.



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GLOSSARY OF MUNICIPAL BOND TERMS

Acceleration: A provision present in many bond contracts providing that the unpaid principal becomes immediately due and payable upon the occurrence of one or more specified events.

Accrued Interest: The dollar amount of interest, based upon the stated rate of interest, that has accumulated on a bond from the most recent interest payment date (or, in certain circumstances, the original dated date of the bond), up to but not including the date of settlement of a transaction in such bond.

Advance Refunding: For purposes of certain tax and securities laws and regulations, a refunding in which the refunded bonds remain outstanding for a period of more than 90 days after the issuance of the refunding bonds. Typically, such refunded bonds are secured solely by an escrow funded with the proceeds of the refunding bonds. The escrow is generally invested in U.S. Treasury securities or federal agency securities, with principal and interest from these investments being used to pay principal and interest on the refunded bonds. See "SLGS" below.

Arbitrage: Arbitrage refers to the difference between the interest paid on tax-exempt bonds and the interest earned by investing the proceeds of the tax-exempt bonds in higher-yielding taxable securities.

Bank Qualified (or BQ): Designation given to a public purpose bond issue by the issuer if it reasonably expects to issue no more than $10 million of bonds in the calendar year in which such bonds are issued. The exact rules for BQ are extremely complex; consult with bond counsel. When BQ bonds are purchased by a commercial bank for its portfolio, the bank may deduct a portion of the interest cost of carry for the position.

Basis Point (or bp): One one-hundredth of one percent (.01%), used in expressing the yield on bonds or investments. The difference between 5.00% and 5.10% is 10 bps.

Bond: A written evidence of debt, with a stated principal amount and stated interest rate, which entitles the bondholder to payment of such principal and interest on specified dates. The terms "bond" and "note" are often used interchangeably, although often "note" is used for debt of shorter duration and "bond" for debt of longer duration.

Call: The right of an issuer to optionally prepay or redeem its bond prior to the stated maturity date of the bonds on or after a specified date at a specified price. See "Optional Redemption" below.

Capitalized interest: A portion of the proceeds of a bond issue that is set aside to pay interest on the bonds for a specified period of time, usually during the anticipated construction period for the project being financed.

Competitive Sale: A method of sale chosen by an issuer, in which the issuer publishes a notice of sale, and underwriters submit firm offers to purchase the bond issue. Competitive sales are usually conducted using an internet platform that allows multiple rounds of bids. The issuer awards the bonds to the "winning" underwriter.

Conditional Call: A notice of redemption published by an issuer in which the issuer reserves the right to rescind the notice and cancel the redemption. This is often employed when the issuer wants to call the refunded bonds on the date of closing of the refunding bonds thereby eliminating the need for an escrow fund.

Conduit Borrower: The borrower in a conduit financing. The "real" party-in-interest who is expected to pay the bonds. For example, a hospital or college on whose behalf the bonds are being issued.

Conduit Financing: The issuance of bonds by a governmental conduit issuer to finance a project to be used primarily by a third party, which may be, for example, another governmental entity or a nonprofit such as a hospital or college.

Conduit Issuer: A governmental entity that issues bonds for a conduit financing. In Pennsylvania, this is often an authority such as a municipal authority or an industrial development authority.

Continuing Disclosure Agreement (or CDA): The agreement or undertaking by the issuer of bonds or another obligated person (such as a conduit borrower) to disseminate annual financial information, certain operating information and disclosures concerning certain events to the marketplace pursuant to SEC Rule 15c2-12. The underwriter is required to obtain this agreement from the issuer or obligated person.

Costs of Issuance: The costs associated with the initial issuance of bonds, including underwriter's discount, legal fees, fees of the trustee or paying agent, rating agency fees, bond insurer premiums, filing fees and similar costs.

Coupon: The stated interest rate on a bond (not taking into account the sale premium or discount). A vestige of the old days when municipal bonds were in bearer form, and the bond included a small coupon for each interest payment that could be clipped and presented for payment.

Current Refunding: For purposes of certain tax and securities laws and regulations, a refunding in which the refunded bonds remain outstanding for a period of not more than 90 days after the issuance of the refunding bonds.

CUSIP Number: CUSIP stands for Committee on Uniform Securities Identification, and a CUSIP number is an identification number assigned by the CUSIP Service Bureau to each maturity of a bond issue. For municipal bonds, the CUSIP number is usually nine digits long, the first six digits of which identify the issuer, and the last three digits of which relate to the specific bond maturity, e.g., 987654AB3.

Debt Act (or LGUDA): The Pennsylvania Local Government Unit Debt Act, 53 Pa.C.S. ch. 80-82, which is the statute that governs the issuance of debt by a county, city, township, borough or school district.

Debt Limit: The maximum principal amount of debt that a municipal issuer may have outstanding at any time under constitutional or statutory provisions. Under the Debt Act the debt limit for a municipality is based on a factor times the average annual revenues for the last three fiscal years.

Debt Service (or Debt Service Requirement): The amount necessary to pay principal of and interest on outstanding bonds during a specified period. "Annual debt service" means the total debt service required to be paid in a particular year. "Total debt service" means the total debt service paid throughout the life of a bond issue. "Average annual debt service" means the average debt service payable each year on an issue. "Maximum annual debt service" means the amount of debt service for the year in which the greatest amount of debt service payments are required.

Debt Service Reserve Fund: A fund in which moneys are placed to be applied to pay debt service on the bonds if the issuer fails to pay the debt service. It is usually funded with original bond proceeds.

Defeasance: Bonds are "defeased" when money or investments are irrevocably pledged to pay the bonds. This is usually done when proceeds of refunding bonds are placed in an escrow fund and invested in U.S. Government securities and are used to pay the debt service on the refunded bonds through maturity or earlier redemption. This process is called "defeasance". In certain cases, the original security for the bonds, such as a trust indenture, is released once the escrow is established.

Depository Trust Company (or DTC): A company in New York which serves as a depository and clearing agency for bonds. Broker-dealers who are members of DTC can effect securities trades through DTC. Almost all public bond issues utilize the registration and transfer services of DTC.

Derivative: In the municipal context, a contract between the issuer or a borrower and a financial institution which provides for payments that are intended to interrelate with the debt service payments on the bonds so as to provide a different debt structure for the issuer. For example, an interest rate swap agreement may transform a variable rate bond issue into a "synthetic" fixed rate bond issue. Derivatives can create significant risks for the issuer that are not present in traditional bond issues.

Discount Bond: A bond that is purchased at less than its par (or face) value.

Drawdown Schedule: A schedule that shows the estimated dates and amounts of expenditures expected to be made from bond proceeds or other available moneys for the costs of a construction project.

Due Diligence: Efforts made to investigate facts so as to determine and assure that proper disclosure is being made in the official statement.

Escrow Account: A fund held solely to pay debt service on bonds that have been refunded. The moneys in such fund are usually invested in SLGS or other U.S. Government securities. See "SLGS" below.

Fair Dealing: The requirement that all municipal securities dealers and municipal advisors deal fairly with all persons (including issuers) and not engage in deceptive, dishonest or unfair practices. This requirement is set forth in MSRB Rule G-17.

General Obligation (or GO) Bond: A bond payable from the general funds of the issuer. Under the Debt Act, the issuer pledges its full faith, credit and taxing power to secure the GO Bond.

Gross Refunding: An advance refunding under which the entire principal and interest payable on the refunded bonds is provided for from bond proceeds, and there is no reliance on investment earnings under the escrow account for the payment of that debt service.

Guaranty: An agreement under which a third party guarantees to pay all or a portion of the debt service on bonds. A guaranty by a municipality is a form of debt under the Debt Act.

Indenture: A contract between the issuer and a trustee, for the benefit of the bondholders, which sets forth the terms of the bonds, covenants of the issuer, a pledge of security, events of default and remedies in the event of default.

Initial Offering Price: The price, stated as a percentage of par, at which a new issue of bonds is offered to the public at the time of original issuance.

Interest Payment Date: A date on which interest on a bond is due and payable. In a typical fixed rate bond issue, interest payment dates are every six months. In a typical variable rate bond issue, interest payment dates are monthly.

Interest Rate Swap: See "Derivative" above.

Investment Banker: A firm which purchases bonds from the issuer for resale to investors.

LIBOR: Stands for "London Interbank Offered Rate". The interest rate, set in London, at which banks make deposits available to other banks for a given term. LIBOR is an internationally recognized benchmark for interest rates used in financing transactions, including certain bond issues or interest rate swaps.

Mandatory Redemption: A redemption of bonds prior to maturity which the issuer is required to make. For example, a specified portion of Term Bonds that are callable on a given date. See "Term Bond" below.

Maturity Date: The stated date on which the principal on a bond is due and payable.

Moral Obligation Bond: A bond with respect to which the issuer or another party, such as the state, has made a non-binding promise to pay the debt service. The promise is not legally enforceable.

Municipal Securities Rulemaking Board (or MSRB): A self-regulatory organization, consisting of representatives of securities firms, bank dealers, municipal advisors, issuers, investors and the public, which is charged with primary rulemaking authority over the municipal securities industry.

Negotiated Sale: A method of sale chosen by an issuer, in which the issuer negotiates with a specific underwriter or group of underwriters chosen by the issuer to purchase the bond issue.

New Money Issue: A bond issue, the proceeds of which will be applied to the costs of capital projects.

Non-Arbitrage Certificate: A certificate of the issuer, delivered at closing, setting forth the issuer's reasonable expectations regarding the use of the bond proceeds and related matters. This certificate forms the basis for the conclusion that the bonds do not violate the arbitrage requirements of the Tax Code.

Noncallable Bonds: Bonds that may not be optionally redeemed by the issuer prior to their maturity date.
Note: See "Bond" above.

Offering Price: The price, stated as a percentage of par, at which the underwriter offers bonds to investors.

Official Statement: The disclosure document, or prospectus, of the issuer used in the primary offering and sale of the issuer's bonds.

Optional Redemption: The optional right of an issuer to call its bonds prior to maturity. Such option is usually exercisable on or after a specified date at a specified price. See "Call" above.

Original Issue Discount: The discount from par value of a bond at the time the bond is originally issued.

Original Issue Premium: The excess over par value of a bond at the time the bond is originally issued.

Overissuance: Under the Tax Code, an issuance in which the original proceeds of the bonds exceed the amount necessary for the governmental purpose of the issue by a specified amount.

Par: The face value of a bond. The principal amount of the bond due at maturity.

Parity Debt: Debt that is secured on an equal basis with other debt.

Pledged Revenues: Revenues of an issuer that are pledged as security for bonds, such as a municipal authority pledging the revenues of its sewer system to secure its sewer revenue bonds.

Preliminary Official Statement: A preliminary version of the Official Statement without final pricing information, maturities and other details of the bonds.

Premium Bond: A bond that is purchased in excess of its par (or face) value.

Primary Offering: An offering of bonds by or on behalf of the issuer.

Private Placement: A primary offering of the bonds directly to one investor or a small number of investors.

Public Sale: See "Competitive Sale" above.

Rate Covenant: A covenant in which the issuer agrees to charge rates (such as sewer rates for a sewer system) at levels sufficient to produce revenues sufficient, on an annual basis, to cover the issuer's operating expenses and the debt service on its bonds (oftentimes at a percentage of such debt service in excess of 100% of the debt service due in such year; e.g. 110%).

Rating: An evaluation of the creditworthiness of a bond issued by a rating agency, expressed by using letter and number symbols, e.g., AA+.

Rating Agency: Organizations which provide ratings, such as Fitch, Moody's and Standard & Poor's.

Rebate: Certain arbitrage earnings on bond proceeds which the issuer must pay to the U.S. Treasury Department generally once every five years. See "Arbitrage" above.

Redemption: The payment of a bond by the issuer prior to its stated maturity date. See "Call", "Mandatory Redemption" and "Optional Redemption" above.

Refunding: The issuance of new debt to pay off old debt. Similar to an individual's refinancing of a house mortgage. See "Advance Refunding" and "Current Refunding" above.

Reimbursement Resolution: A resolution in which the issuer expresses its intention to later reimburse itself from bond proceeds for the payment by the issuer of initial costs of a capital project with non-bond proceeds. Such a resolution is required under the Tax Code to enable an issuer to reimburse itself for certain costs of a project paid before the bonds are issued for the project.

Remarketing. An offering of bonds which are already outstanding. Often occurs in bond issues in which an existing bondholder can require the issuer to take back a bond that is then reoffered to another.

Revenue Bond: Bonds that are secured by the pledge by the issuer of revenues of a specific project or system. A revenue bond that is also guaranteed by a municipality is a Guaranteed Revenue Bond.

Rule 10b-5: A rule of the SEC which makes it unlawful for any person, in connection with the purchase or sale of bonds, to (a) employ any device, scheme, or artifice to defraud; (b) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Rule 15c2-12: A rule of the SEC that governs municipal securities disclosure. See Part V of the forepart of this pamphlet.

Secondary Market: The market in which bonds trade after their initial sale and delivery.

Securities and Exchange Commission (or SEC): A federal agency which supervises and regulates the securities markets.

Self-Liquidating Debt: Under the Local Government Unit Debt Act, if there are sufficient revenues generated by a project to pay both its operating costs and the debt service on the bonds issued to finance the project, such bonds are self-liquidating and are not counted against the issuer's or guarantor's debt limit.

Serial Bonds: Within a bond issue, bonds that have maturities in each year over a number of years. As opposed to Term Bonds. You can have both Serial Bonds and Term Bonds within a single series of bonds.

Series of Bonds: A designated aggregation of related bonds. See "Serial Bonds" and "Term Bonds".

Sinking Fund: A fund, usually held by the trustee or paying agent, from which redemption payments are made on bonds.

SLGS (or State and Local Government Series): Special U.S. Treasury Department securities which are tailored for use in escrow funds for advance refundings of tax-exempt bonds. See "Advance Refunding" above.

Swaps: See "Derivative" above.

Taxable Bond: A bond, the interest on which is includable in the gross income of the bondholder for federal income tax purposes. Sometimes a municipal issuer will issue taxable bonds because all or a portion of the proposed project does not qualify for tax-exempt bond status under the Tax Code. In certain situations, the issuer may finance a project with a combination of tax-exempt bonds and taxable bonds.

Tax and Revenue Anticipation Notes (or TRANS) or Tax Anticipation Notes (or TANS): Short-term financings intended to cover cash flow shortages during an issuer's fiscal year. Must be repaid prior to the end of the fiscal year.

Tax Code: The Internal Revenue Code of 1986, as amended. The sections of the Tax Code which contain most of the provisions related to tax-exempt bonds are 103 and 141 to 150. There are also regulations promulgated by the U.S. Department of the Treasury under these sections.

Tax-Exempt Bond: A bond, the interest on which is not included in gross income of the bondholder for purposes of federal income taxation. It is not uncommon in Pennsylvania for a bond which is taxable for federal purposes to still be tax-exempt for purposes of state or local income taxation.

Term Bonds: Within a bond issue, bonds that have a single maturity date, and specified bonds within such maturity are subject to mandatory redemption in specified amounts in years prior to such maturity date. As opposed to Serial Bonds. You can have both Serial Bonds and Term Bonds within a single series of bonds.

Trust Indenture: See "Indenture" above.

Underlying Rating: If a bond issue has a rating due to the rating of an insurer or other credit enhancer, the underlying rating is the rating assigned by the rating agency based on the credit worthiness of the issuer without regard to the credit enhancer. For example, a bond issue may be rated "AA" due to bond insurance with an underlying rating of "A" based solely on the creditworthiness of the issuer.

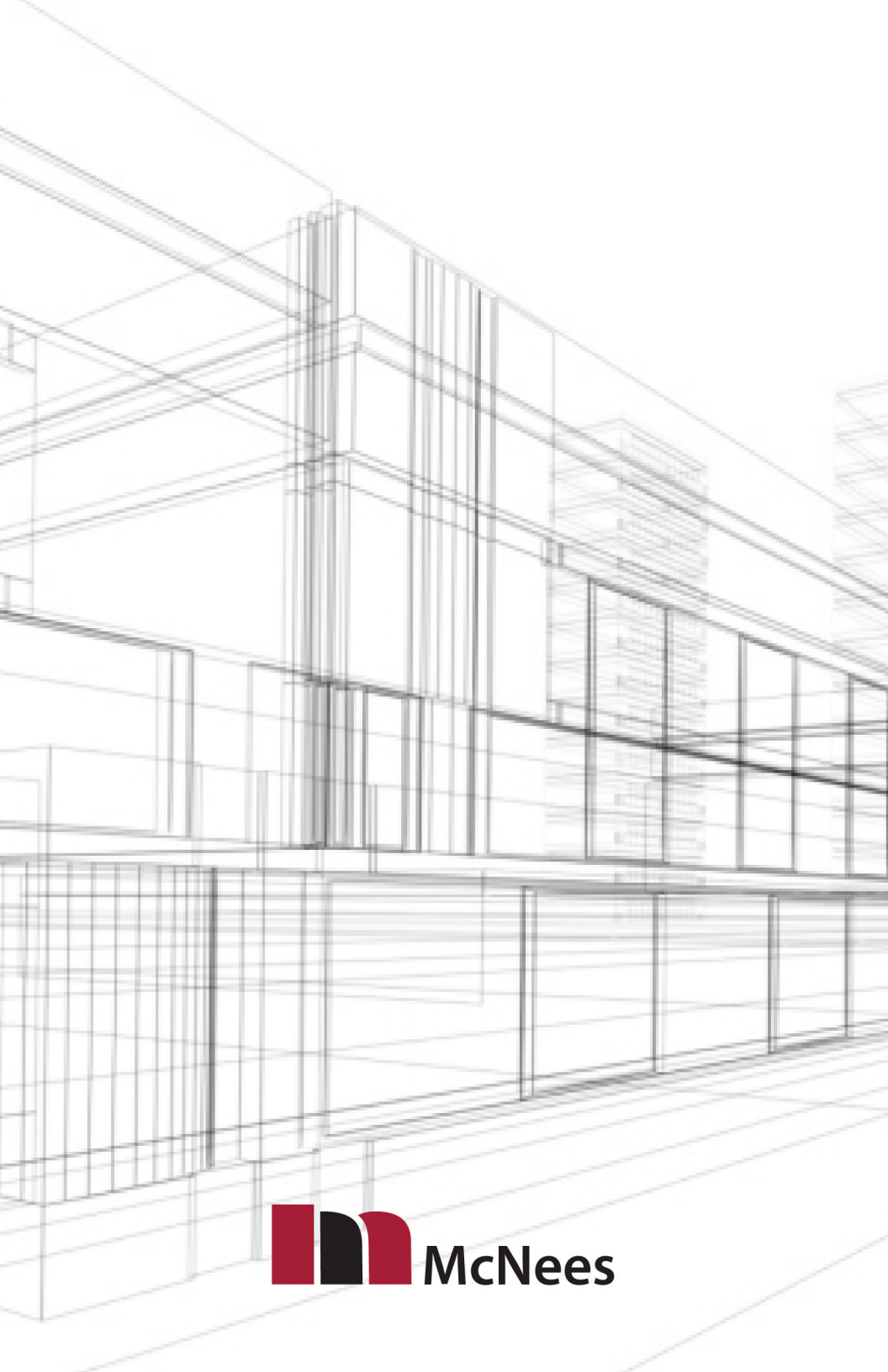
Underwriter: See "Investment Banker".

Verification Report: In connection with a refunding, a report by a certified public accountant or other expert that the moneys in the escrow fund, together with the earnings on investments therein, will be sufficient to pay the debt service payments on the refunded bond when due.

Wraparound Debt: Debt structured to wrap around the aggregate debt service schedule of the issuer's other debt so as to produce a desired result such as overall level debt.

Zero Coupon Bond: A bond structured with significant original issue discount and on which no periodic interest payments are made. The bond contains an imputed interest component based on semiannual compounding. Zero coupon bonds are typically not prepayable prior to maturity, and an issuer should be very sure it understands the risks inherent in these bonds before issuing them.

Note: The Municipal Securities Rulemaking Board has an exhaustive glossary of municipal bond terms on its website at http://www.msrb.org/glossary.aspx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