

**TOBACCO SETTLEMENT AUTHORITY
BOARD OF DIRECTORS
Special Meeting**

Minutes

June 7, 2017

The Chair, Ms. Carla DewBerry, called the meeting of the Tobacco Settlement Authority (the “Authority”) to order at 1:00 p.m. on Wednesday, June 7, 2017.

The Special Meeting was held in the Board Room of the Washington State Housing Finance Commission (the “Commission”) located on the 28th floor of 1000 Second Avenue, Seattle, Washington. The Board Chair and Board members Mr. Mike Roberts and Mr. Tim Kerr were present in the board room. Board member Mr. Gavin Cooley was present by telephone. Authority staff members present were Mr. Kim Herman, Mr. Bob Cook, Ms. Carol Johnson and Mr. Cody Field. Finance team members present were Ms. Faith Pettis of Pacifica Law Group, Ms. Debbie Kuykendall of U.S. Bank, Assistant Attorney General, Mr. Rusty Fallis, and Mr. Fred Eoff of Public Financial Management. Joining via teleconference was Ms. Kym Arnone of Jefferies LLC; Mr. Roger Bagley of Hawkins, Delafield and Wood, and Mr. Tom Green and Mr. Paul Creedon of Citigroup Global Markets.

**Approval of the
December 7,
2016 Minutes**

Ms. DewBerry asked for a motion to approve the minutes of the meeting held on December 7, 2016. Mr. Kerr made the motion and Mr. Roberts seconded the motion. The motion was approved unanimously.

**Election of
Secretary and
Treasurer**

Ms. DewBerry introduced Mr. Herman to present the election of Board Secretary and Treasurer. Mr. Herman stated that each year, the Board elects a Secretary and a Treasurer. This past year Mike Roberts served as Secretary and Marlis Petersen Spawn served as Treasurer. Mr. Herman thanked them for their service. Mr. Roberts and Ms. Petersen Spawn were asked if they would be willing to continue to serve in their respective roles. They both indicated that if the Board chooses to nominate and re-elect them, they would be willing to continue to serve.

Ms. DewBerry asked for nomination for the Secretary and Treasurer to continue in their current roles. Mr. Kerr made the motion to nominate and re-elect Mr. Roberts and Ms. Petersen Spawn. The motion was seconded by Mr. Roberts. The motion was approved unanimously.

**Staff
Recommendations
Regarding
Potential
Refunding
Opportunity**

Ms. DewBerry introduced Mr. Herman to present staff recommendations regarding a refunding opportunity. Mr. Herman asked Mr. Fallis to present a report on the status of non-participating manufacturer adjustments and arbitration. Mr. Fallis stated that discovery has been ongoing for the last year or so. Depositions of the participating manufacturer witnesses will occur next week. The common case hearing is expected to begin on June 20th. The common case is an evidentiary hearing made by the states jointly with respect to facts and issues that are common to them. The hearing is a way to educate the panel and provide context for the state specific hearings.

Mr. Fallis mentioned that yesterday the participating manufacturers announced that two states will not have their diligence contested: Massachusetts and Alaska. Washington did not get a free pass and will proceed to arbitration. After the common case is over, the panel will schedule the state specific hearings. These will begin in the fall. Mr. Fallis noted that his colleagues think Washington's hearing probably won't occur until February or March. Final rulings from the panel aren't expected until mid – late summer of 2018. Final decision likely won't be announced until fall of 2018 with major payment implications not occurring until the following April.

Mr. Fallis stated that there has been a dispute between Altria and RJ Reynolds regarding who the company-appointed arbitrator would be. He noted that there are two panels presiding over these arbitrations. One panel has a Phillip Morris arbitrator and the other is appointed by RJ Reynolds and some other companies.

Mr. Fallis stated that subsequent to the commencement of the 2004 arbitration, Rhode Island and Oregon settled with the tobacco companies. They signed what

is referred to as the “term sheet,” which is the settlement approximately 20 other states reached with the tobacco companies. Washington declined to join this settlement.

Ms. DewBerry asked about the discount being taken from states that joined the settlement. Mr. Fallis stated that it was relatively expensive for some of them, in the range of tens of millions of dollars.

Mr. Herman asked Ms. Arnone to present the market update and a briefing on the potential refunding. Ms. Arnone provided a summary of the tobacco securitization market noting that four refunding transactions have occurred since the beginning of 2016 totaling just over \$2 billion. The primary and secondary market for tobacco securitization bonds was extremely strong in 2016 through the election. From the election through early January, the muni market was extremely volatile with outflows totaling \$14.5 billion, including \$4.5 billion of outflows from the high yield funds. Bond fund and high yield fund flows have rebounded totaling almost \$5 billion since early January.

Ms. Arnone stated that MSA shipment data was released on April 21st. Shipments declined roughly 3.96%. OPM shipments for sales year 2016 declined 2.39%. 2017 year-to-date shipments are down roughly 3% for the first quarter.

Ms. Arnone stated that British American Tobacco (BAT), who owns 42.2% of Reynolds American announced that they will acquire the balance of Reynolds. Moody’s has downgraded BAT and S&P placed them on credit watch negative. Since payment obligations under MSA follow cigarette brands, this will be viewed as a credit positive for MSA Bonds.

Ms. Arnone stated that based on the MSA payments received to date, shipments have been in line with the 2013 expectations, but net tobacco revenues have been lower due to the continued NPM adjustment deposits to the Disputed Payments Account (DPA). From 2014 through 2017, the Authority has received almost

\$180 million in pledged TSRs, which is \$21.8 million less than forecast. If IHS Global forecasts continue to be accurate, redemption of early call bonds could be delayed up to three years, increasing the Authority's expected interest cost. If all or portions of the early call bonds are refunded, with careful structuring the Authority could see debt service savings. Ms. Arnone noted that under current market conditions, this refunding would produce roughly \$6 million in total savings and would give the state access to residuals more quickly.

Ms. Arnone stated that Jefferies is working with bond counsel on several legal issues and will be in a position to report back on findings to the board in the next few weeks.

Mr. Kerr asked, relative to the early call bonds, whether bonds could be called in whole or in part within maturities. Ms. Arnone stated she is contemplating a partial refunding by strategically targeting some callable bonds. Mr. Kerr asked if the market has improved since the report was provided to the board. Ms. Arnone stated that the market has been consistent.

Mr. Herman stated that Authority staff has had several conversations with Jefferies LLC, PFM, and counsel regarding the refunding proposal. He noted that a lot of questions have been asked and some items are still being reviewed by counsel. Mr. Herman stated that the Board will be asked to entertain a motion authorizing staff to continue looking into the feasibility of a refunding with the help of counsel, the investment banking team and financial advisors. There are two main priorities for the refunding: the first being that it passes the five percent present value savings test. Secondly, it should return the residual payments to the state as soon as possible.

Ms. DewBerry asked if there were any additional questions regarding the refunding proposal. Hearing none, Ms. DewBerry asked for a motion to authorize staff to move forward with the analysis of whether or not a refunding is appropriate, with the understanding that the refunding would be based on the five

percent savings threshold, with the goal of accelerating the payment of the bonds to return the residual amounts to the state earlier. Mr. Roberts made the motion and it was seconded by Mr. Kerr. The motion was approved by 3 votes. Mr. Cooley was absent during the vote.

Ms. DewBerry asked for a volunteer to serve as a liaison on behalf of the Board to receive information from staff regarding the refunding analysis, and to report back to the Board. Mr. Kerr volunteered to serve in this capacity.

Invoice for Services

Ms. DewBerry introduced Mr. Cook to present the invoice for services. Mr. Cook stated that the invoice for January through March from the Housing Finance Commission; totaling \$5,825.78 has been approved by the Treasurer.

Trustee Report

Ms. DewBerry introduced Ms. Kuykendall to present the Trustee's report. Ms. Kuykendall stated that the projected annual TSR receipt total was \$48,974,357. The actual amount received was \$44,145,484.29. Two Lehman checks were received prior to June 1. TSR receipts, Lehman funds, and investment earnings were used to make the serial bond maturity payment of \$19,025,000. Optional redemptions totaling \$13,630,000 were also called. The bond outstanding total is \$208,745,000.

Ms. Kuykendall noted that 2017 is the last year for receipt of Strategic Contribution Payments. Going forward they will be added to the annual base payment.

Ms. Kuykendall stated that the Trustee has received the annual officer's certificate. She noted that Ms. Debra Stephenson provided a calculation of the annual operating contingency on the certificate and made a request for funds of \$95,000, which includes the rating agency and trustee fee.

The semi-annual report was submitted to the rating agency on May 8 when the cash flow was calculated. The reserve is currently maintained at the required

amount.

**Annual Budget
for the Period
July 1, 2017 –
June 30, 2018**

Ms. DewBerry introduced Ms. Cook to present the annual budget for the fiscal year ending June 30, 2018. Mr. Cook stated that the business objectives are standard including the coordination of a possible refunding. He noted that staff time has been budgeted for this contingency, though overall staff time of reduced 0.08 FTE to 0.4 FTE has been allocated for TSA activities. The actual anticipated actual for fiscal year 2017 is 0.2 FTE.

Mr. Cook stated that minimal income is budgeted for the year. He noted that staff does not anticipate issuing an Officer's Certificate or needing funds. It is expected that the Authority will end the current year with about \$190,000 – \$195,000 in reserves. Mr. Cook also noted that if staff feels the need for operational liquidity before the first quarter of the year when the TSRs are distributed, funds would be requested through an Officer's Certificate at that time.

Mr. Cook stated that \$67,000 in operating revenue was requested this year, which should cover costs for next year.

Ms. DewBerry asked for a motion to approve the budget. Mr. Kerr made the motion and it was seconded by Mr. Roberts. The budget was approved with 3 votes. Mr. Cooley was still absent from the call at this point.

**Financial
Statement**

Ms. DewBerry introduced Mr. Cook to present the financial statement. Mr. Cook stated that the current year net asset sheet shows approximately \$207,000 of assets, just under \$7,700 of liabilities, leaving the Authority with just over \$199,000 of net position. That position is expected to be about \$195,000 by the end of the year.

Mr. Cook stated that income of \$67,000, including the income requested from the Officer's Certificate, and about \$50,000 of expenses leaves the Authority with about \$17,000 of net positive activity for the year. This will probably drop to

around \$10,000 by the end of the year.

Ms. DewBerry asked for a motion to accept the Financial Statement. Mr. Roberts made the motion and it was seconded by Mr. Kerr. The motion was approved four votes to zero.

**Executive
Director's
Report**

Ms. DewBerry introduced Mr. Herman to present the Executive Director's report. Mr. Herman stated that the Authority's contract with PFM expires November 30, 2017. Staff plans to prepare and distribute an RFP. Board members will be invited to participate in the review and potential interviews. He noted that the Authority's legal team is in place through 2021 with the eligible extensions. Contracts with investment bankers will also expire in 2021 if the extensions are exercised.

Mr. Herman provided a summary of the emails from Senior Assistant Attorney General Cam Comfort addressing the 2017 MSA Payments. He reiterated that the amount received was \$44,145,484.29 this year. For comparison purposes, the Authority received around \$44.6 million last year. MSA payments to Washington are still subject to funds being withheld based on claims related to the non-participating manufacturer (NPM) adjustment. Mr. Herman noted that Washington will be in arbitration this year for the 2004 withholdings.

Mr. Herman provided a summary of the articles in the meeting packet. He noted that the Authority continues to have a very good credit in the world of tobacco bonds.

The next regularly scheduled meeting is Wednesday, December 6 unless staff decides to come back to the board with a recommendation to consider and approve a refunding.

Ms. DewBerry asked if there were any comments from the public. There were no comments.

Adjournment

Ms. DewBerry adjourned the meeting at 1:41 p.m.

Ms. Carla DewBerry, Chair