

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

**Minutes**

**December 7, 2017**

Board Chair, Ms. Carla DewBerry, called the meeting of the Tobacco Settlement Authority (the “Authority”) to order at 1:03 p.m. on Wednesday, December 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 98104.

In addition to the Chair, board members Mr. Tim Kerr, Mr. Mike Roberts, and Ms. Marlis Petersen Spawn were present in the board room. Authority staff members present were Mr. Kim Herman, Executive Director; Mr. Bob Cook, Senior Finance Director; Ms. Carol Johnson, Affiliates Manager; Ms. Debra Stephenson, Senior Controller; and Mr. Mike Gary, Program Assistant.

Finance team members present were Ms. Faith Pettis of Pacifica Law Group; Ms. Debbie Kuykendall of US Bank; and Assistant Attorney General, Mr. Rusty Fallis. Also present was Ms. Amy Sutherland of Moss Adams. Joining via teleconference was Ms. Kym Arnone of Jefferies LLC, and Mr. Roger Bagley of Hawkins, Delafield and Wood.

**Approval of the  
June 7, 2017  
Special Meeting  
Minutes**

Ms. DewBerry asked for a motion to approve the minutes of the meeting held on June 7, 2017.

Mr. Roberts made the motion and it was seconded by Mr. Kerr. The minutes were approved unanimously, 4-0.

**Consider & Act  
on Staff  
Recommendations  
Regarding  
Selection  
of a Financial  
Advisor**

Ms. DewBerry introduced Mr. Herman to present staff recommendations regarding selection of a financial advisor for the Authority.

Mr. Herman stated that the Authority is required at least once every two calendar years to select finance team members through a competitive process. He referred to the memo found under Tab 2 in the board packet.

Mr. Herman stated that on October 12, 2017 the Request for Proposals (RFP) were posted both to the Authority's website and to the State's General Administration Database System (WEBS). The RFP notice published in the *Daily Journal of Commerce* for two days. Mr. Herman stated that on October 13, the RFP was e-mailed and mailed to all eight firms on the Authority's current approved roster of financial advisors. Two responses were received on October 31, one from Public Financial Advisors LLC (PFM), the Authority's current financial advisor, and the other from Hilltop Securities.

Mr. Herman stated that in addition to himself, Authority staff members Ms. Johnson, Mr. Cook, Ms. Stephenson, and Deputy Director Mr. Paul Edwards, along with Ms. Pettis from Pacifica Law Group, reviewed the submitted proposals. Based upon that review, they agreed to recommend that the Authority Board retain Public Financial Advisors LLC (PFM) and determined no formal interviews were necessary. He concluded that both firms have been informed of the panel's recommendations to the Board.

Mr. Herman presented the panel's recommendation to approve the selection of the Authority's current financial advisor, Public Financial Advisors LLC (PFM) for an initial period of two years, with options to extend for up to a total of five years.

Mr. Roberts asked Mr. Herman where Hilltop Securities is located and if they had any branch offices located in Washington. Mr. Herman replied that Hilltop is based out of Texas, and they currently do not have any branch offices in

Washington. Mr. Herman added that Hilltop Securities works with the Authority's affiliate agency, the Washington State Housing Finance Commission. He noted that Hilltop's RFP to the Authority utilized a different team of professionals and that the work was unrelated to work done for the Commission.

Ms. DewBerry asked Ms. Pettis to briefly summarize the competitive bidding aspect of the RFP. Ms. Pettis stated that the Authority is not required to take the lowest bid in competitive bidding. She stated that there are extenuating circumstances with a contract of this type, such as very specialized knowledge and the make-up of the team. Mr. Herman added that price is not the sole factor and that judging criteria are listed in the RFP.

Ms. Petersen Spawn asked how PFM's current bid compared to their previous contract. Ms. Johnson replied that the minimum fee increased, the charge per \$1,000 in par value increased, and the hourly rate of their various officers increased. After discussions with staff, PFM lowered their initial quote for the minimum fee and the charge per \$1,000 of par value.

Ms. Dewberry asked for a motion to approve staff recommendations regarding selection of a financial advisor, with the selection of Public Financial Advisors LLC (PFM) for an initial period of two years and options to renew up to a maximum term of five years. Mr. Roberts made the motion and it was seconded by Mr. Kerr. The motion was approved unanimously, 4-0.

**Consider & Act  
on Acceptance of  
Final Audit  
Report**

Ms. DewBerry introduced Mr. Cook to present the audit report.

Mr. Cook stated the Audit Report for year ending June 30, 2017 was prepared by Moss Adams LLP. A summary handout was distributed to board members during the meeting. He added that Moss Adams delivered their opinion dated November 16, 2017 with confirmation that the statements are fairly presented with no qualifications.

Mr. Cook then introduced Ms. Amy Sutherland from Moss Adams to present the auditor's required communications.

Ms. Sutherland presented her report noting the audit was performed in accordance with the initial plan and was issued on November 16, 2017. The audit is an unmodified opinion. No material misstatements or errors were identified within the financial statements. The auditors did not identify any material weaknesses or significant deficiencies.

Ms. Sutherland summarized the responsibilities under Generally Accepted Accounting Principles of the United States (US GAAP). She mentioned that the disclosures in the financial statements were clear and consistent, and made reference to Notes 5 and 7. She added that there were no difficulties encountered during the audit and no disagreements with Management. No material misstatements or uncorrected items that were identified. She concluded that Management did not consult with other accounting firms and no significant issues or instances of fraud or noncompliance were noted. Ms. Sutherland reaffirmed Moss Adams' independence with respect to the Authority and thanked both Mr. Cook and Ms. Stephenson for their cooperation during the audit.

Ms. DewBerry, after hearing no further questions or comments from board members, asked for a motion to accept the audit report. Mr. Kerr made the motion and it was seconded by Ms. Petersen Spawn. The motion was approved unanimously, 4-0.

**Review &  
Consider  
Acceptance of  
Financial  
Statement**

Ms. DewBerry introduced Mr. Cook to present the unaudited current financial statement. Mr. Cook stated that the financial statement for the three-month period through October 31, 2017 shows assets of approximately \$192,000 with approximately \$23,000 of payables leaving a net unrestricted position of around \$170,000. There was about \$700 of interest income earned and a decrease to net position of \$21,686, leaving a deficit so far for the year, which was anticipated.

Ms. DewBerry asked for a motion to accept the unaudited financial statements

through October 31, 2017. Ms. Petersen Spawn made the motion and it was seconded by Mr. Kerr. The motion was approved unanimously, 4-0.

**Invoice for  
Services**

Mr. Cook stated that the invoices from the Housing Finance Commission for a six-month period from April 1 through September 30, 2017 totaling \$12,263.04 have been reviewed and approved by Board Treasurer, Ms. Petersen Spawn.

**Tobacco  
Securitization  
Market Update**

Ms. DewBerry introduced Ms. Arnone to present the tobacco securitization market update.

Ms. Arnone presented her report noting that the general bond market has been extremely busy and volatile with the recent tax reform legislation. She mentioned that the markets had over \$20 billion in issuance and that there were record amounts of bond activity. This is due to possible reduced bond activity in 2018 as a result of tax reform legislation that might affect the issuance of tax-exempt private activity bonds and advanced refundings.

Ms. Arnone stated that sometime in December, 2017, the Federal Reserve Bank is projected to raise interest rates by 25 basis points. She also mentioned that on July 28, 2017 that the Food and Drug Administration (FDA) announced a plan for tobacco and nicotine regulation, which is expected to take a number of years to implement. Finally, the FDA is looking to ban menthol, which constitutes approximately 30 percent of the market.

Ms. Arnone stated that for the nine month period, ending September 30, 2017, estimated total industry shipments by Altria, the parent company of Philip Morris USA, declined 3.5%, which is in line with the IHS Global forecast of -3.58% for 2017. She noted that Reynolds American no longer reports industry shipments as a result of being acquired by British American Tobacco.

Ms. DewBerry asked Ms. Arnone what might impact rates on tobacco bonds for 2018. Ms. Arnone replied that there could be a possible rally/net positive if the

tax reform legislation is passed. Investors may be looking for more high-yield bonds in the market.

Ms. DewBerry thanked Ms. Arnone for the report and her continued support of the Authority's activities.

## **Trustee Report**

Ms. DewBerry introduced Ms. Kuykendall to present the Trustee's Report.

Ms. Kuykendall stated the report was located under Tab 7 in the board packet. She reported that this was the time of the year where more compliance activities are occurring than cash movements.

She mentioned that on December 1, 2017, bondholders were paid \$5,342,837.50 in interest and that \$135,000 of bonds were redeemed, leaving an outstanding bond amount of \$208,610,000.

Ms. Kuykendall then stated that she submitted to the rating agencies the required semi-annual report on November 10, and posted to EMMA the audited financial statements that were just approved along with the annual disclosure statement. She concluded that reserves are still maintained at the required dollar amount.

Ms. DewBerry thanked Ms. Kuykendall for the Trustee's Report.

## **Status report on Nonparticipating Manufacturer (NPM) Adjustment Arbitration**

Ms. DewBerry introduced Mr. Fallis, Assistant Attorney General, from the Washington State Attorney General's Office (AGO) to give a status report on Nonparticipating Manufacturer (NPM) Adjustment Arbitration.

Mr. Fallis reported that there has been a little progress since he last reported to the Authority a few months ago. He reminded board members that there are 19 states participating in the NPM Adjustment Arbitration, with 26 states that have already settled under the term sheet. He noted that two states, Alaska and Massachusetts, were initially part of the arbitration, but have since been dismissed by the

participating manufacturers because of very small NPM markets.

Mr. Fallis said the evidentiary hearing began in June, with a joint presentation by the participating states. The state-specific hearings, where the individual state's due diligence is tested, began in the fall of 2017. Washington's hearing is scheduled for April 9, 2018 and is expected to last about one week. He added that the last state-specific hearing will be held sometime in November of 2018. He estimated the decision from the arbitration panel to be made in April of 2019.

Ms. DewBerry asked what the best and worst cases would be. Mr. Fallis replied that under the MSA, the worst case scenario would be that a state that is not diligent could lose up to a year's payment from the MSA for the 2004 sales year. The best case scenario is that a state is found diligent, there would be no NPM adjustment, and that the state would receive a return of some money that the participating manufacturers have withheld from the states pending the outcome of the arbitration. He added that in Washington's case, the amount could be up to \$15,000,000.

Ms. Petersen Spawn asked if this decision affects subsequent years after 2004. Mr. Fallis replied that there was no language in the MSA regarding this and that every arbitration would have a different arbitration panel.

Mr. Kerr asked how a state proves its diligence. Mr. Fallis replied that the underlying statute is an escrow statute that requires a state to collect money on a certain universe of cigarettes the NPMs sell. That determination is based on how much money the state has collected on those packs. This is a legal issue that includes determining what the universe for those cigarettes is. There will also be testimony from auditors, tax examiners from the state Department of Revenue, and AGO staff and lawyers. He mentioned that there were some NPMs in the early days of the MSA that manufactured many cartons of cigarettes and then abruptly disappeared and changed their corporate structure.

**Executive  
Director's  
Report**

Ms. DewBerry thanked Mr. Fallis for his report.

Ms. DewBerry introduced Mr. Herman to present the Executive Director's Report.

Mr. Herman gave an update on the proposed refunding that was planned this past fall. He stated that it was necessary to identify if any of the capital projects that the Authority paid to the State from the 2002 original bond issue had any useful life remaining. He stated that he consulted with both the Office of Financial Management (OFM) and the State Treasurer's Office. The records were found insufficient to determine how much useful life was remaining for those projects. He concluded that the Authority had paid off all the bonds related to the operating capital.

Mr. Herman mentioned that the current payoff date of 2023 would still occur as part of this refunding with net substantial savings. Now another complication has occurred with the proposed tax reform legislation.

Mr. Herman stated that under the proposed legislation by the Republican controlled House, tax-exempt private activity bonds including advance refundings would no longer be issued by bond issuers, effective January 1, 2018. He added that in addition to student loans, this affects activities of the Authority's two affiliate agencies, the Housing Finance Commission and the Higher Education Facilities Authority (WHEFA). This also impacts other issuers in the state such as the Health Care Facilities Authority (WHCFA) and the Economic Development Finance Authority (WEDFA). He mentioned that approximately 30% of the bond market is private activity bonds. He concluded that because of the flurry of bond issues and the inability of the ratings agencies to rate the proposed TSA refunding, it was prudent to postpone the bond refunding to a future date in early 2018.



Mr. Herman stated that the Authority's tobacco bonds were governmental bonds and should not be affected by the proposed tax reform legislation.

Mr. Herman then referenced articles featuring the Authority's affiliate agencies and the proposed tax reform legislation under Tab 8 of the board packet. He also mentioned that outreach has been done by all of the State's bond issuing agencies to Republican members of Congress through letters, meetings, and news articles.

Mr. Herman stated that the next scheduled Authority board meeting is Wednesday, June 6, 2018, but there is a good chance that an additional board meeting would occur before then. Board members, finance team, and interested parties will be notified well in advance.

**Public  
Comment**

Ms. DewBerry asked if there were any comments from the public. Hearing none, she then asked for those in the audience to introduce themselves.

Ms. Caitlin Caldwell & Mr. Odin Atkinson from KeyBanc Capital Markets introduced themselves. Ms. Johnson introduced Mr. Mike Gary who has been assisting the Authority since the departure of the previous Program Assistant, Mr. Cody Field.

**Adjournment**

Ms. DewBerry adjourned the meeting at 1:45 p.m.

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Ms. Carla DewBerry, Chair