Meeting of the Suffolk Tobacco Asset Securitization Corporation (STASC)
November 7, 2011

Minutes

Attendees: Jim Morgo, Chairman and President, STASC; Terrence Pearsall, Treasurer & Secretary, STASC; Robert Fonti, Independent Director, STASC; Connie Corso, ex-officio STASC Director and County Budget Director; Eric Naughton, Deputy County Executive for Financial Affairs, , Dennis Brown, Bureau Chief, Municipal Law; Christina Capobianco, Chief Deputy Comptroller, Amy Engel, County Senior Management Analyst, Colleen Capece, County Accountant, Anthony Nash, Capital Markets Advisors, and Rich Tortora, Capital Markets Advisors.

Attendees via conference: Bob Smith, Hawkins, Delafield and Wood.

Minutes Approved: The minutes from the October 21, 2011 meeting were approved.
T. Pearsall made the motion, R. Fonti seconded. Approved unanimously.

The meeting was called to order as a working session to review and evaluate RFP responses from potential underwriters for the securitization purposes of the County's Ownership interest in the Residual Certificate.

Discussion of Securitization of Residual Tobacco Settlement Revenues:

Use of Proceeds to Defease Debt

R. Tortora estimated that the bond proceeds would be between $30 and $35 million. The amount ultimately realized is dependent upon the interest rate which the market will bear. The proceeds will be used to defease debt providing $20 million of relief in 2012 with the balance to provide relief in 2013.

Proceeds Will Not Fund Working Capital

The point was raised that the proceeds will not be used as operating funds. Instead of funding working capital, they will be used to defease debt. Bob Smith explained that in order to do so, the County would have to state that it was in "fiscal distress." The County is not in such distress as evidenced by its high bond ratings. Additionally, if a surplus was realized in a later year, the County would be required to use it to defease debt. T. Pearsall asked if the bonds were taxable would the County obtain the same relief. Rich Tortora stated that if the bonds were taxable, the County would see a 20-30% decrease in proceeds.

Evaluation of RFP Respondents:

Lack of Respondents

It was noted that three responses were received: Citi, Jefferies, and Roosevelt & Cross. As Roosevelt & Cross seeks to be a co-manager, no further discussion was had with respect to their proposal. J. Morgo expressed concern that there were so few respondents as compared to the 2008 transaction. R. Tortora stated that there were 7 respondents in 2008. Many of those firms have since merged with other banks or have ceased to exist. J. Morgo was surprised that Barclay's did not respond. J. Morgo asked D. Brown to provide an opinion stating that the procurement process was in compliance with PAAA. D. Brown responded that it was in compliance as evidenced by the fact that there was a full RFP, an ad was placed in the Bond Buyer, the County official newspapers and there was direct solicitation.

Citi Proposal versus Jefferies Proposal

The Citi proposal does not provide a "turbo bond" structure while the Jefferies proposal does. Discussion had with respect to the use of turbo bonds in the 2008 financing. In that deal the residuals were all pledged and were used to advance redeem the bonds. This will not be the case with the Citi proposal. Instead, the residual will flow back to the County. Because of this structure, R. Tortora believes that the deal could get an A rating from S&P. E. Naughton inquired whether the present structure provides more security to investors. R. Tortora responded that it does.

C. Capobianco inquired about tobacco deals that used this structure in the past 12 months. B. Smith responded that there were three; one in NY, one in MN and one in AL. The AL deal will close in early 2012. Two other deals were delayed in MI and SC. J. Morgo asked whether the County deal could be delayed due to market conditions and R. Tortora responded that it is possible. B. Smith also mentioned that a mass tort litigation in WV is presently on trial which could affect market conditions for tobacco bonds. A decision in that case is expected in early December 2011.

Additional factors in Citi's favor were discussed. Citi believes that a rating from only one rating agency is sufficient and a costly report from Global Insight is not required. The Jefferies proposal contemplates the inclusion of both. Therefore, costs of issuance would be lower if Citi were selected.

Closing 2011 versus 2012:

B. Smith inquired as to why the County wanted to close this year. T. Pearsall responded that the Omnibus group needs to know in order to complete the budget for 2012. J. Morgo responded that "closing this year is preferable but not essential." A. Nash believes that we could close this year.

Use of One Rating Agency:

R. Tortora and A. Nash believe that use of just one rating agency is fine. R. Tortora stated that a rating of "A" from S&P would result in significant interest savings. A. Nash stated that it would not be beneficial to obtain more than one rating. He noted that Fitch caps its ratings on tobacco bonds at "BBB." C. Corso raised a concern about relying solely on an S&P rating since they have the County on a "negative watch." A. Nash explained that the tobacco bonds are analyzed separately by a different set of analysts. The County will not be analyzed; only the revenue stream that is being securitized will be examined. J. Morgo asked if assurances could be obtained from Citi that, in the event they are awarded the contract, they will not reduce their work force in the County. R. Fonti commented that any such assurance would only be an "empty promise."

Further Review of Citi Proposal:

Sources and Uses of Funds (Appendix C, pg 1)
J. Morgo asked A. Nash to provide a review. A detailed walk through was then provided by A. Nash. Significant points made:

1. Original Issue Discount is preliminary.

2. The Deposit to Working Capital Fund is the amount which will be escrowed to defease debt.

3. A deposit to the Capitalized Interest Fund will be required since there is not pledge of TRS in 2012. This deposit of bond proceeds will "preserve County revenue in 2012."

4. The Debt Service Reserve Fund will set aside an amount equal to the maximum annual debt service for the bonds and could be tapped if revenues fall short in a given year. This is industry standard. Per B. Smith it provides "liquidity for delay or stoppage in the pipeline."

5. Citi estimates Costs of Issuance to be $415,000. R. Tortora, A. Nash and B. Smith were in agreement that this amount might be too conservative. R. Tortora stated that the S&P fee is the “wild card” and Citi believes that it could be in the $200,000-$250,000 range. It was noted that the fee was $350,000 in the Railsplitter ($1.5 billion issue). Citi does not believe that a report is needed from Global Insight, but Jefferies does. That would save between $150,000 and $200,000. The report is not needed because Citi is pricing the bonds with an aggressive assumption with respect to the reduction in tobacco consumption. Other costs include verification agent, escrow agent, trustee fees, bond counsel and underwriter counsel. D. Brown asked CMA to look into whether any of the attorneys’ fees could be negotiated.

6. Coverage is a function of the TSR pledge and annual debt service. The range provided by Citi is 1.7% to 4%. A. Nash sated that usually a range of 1.2% -1.5% is acceptable and anything greater than 2% provides more comfort to investors. A. Nash explained that as the bonds mature and annual debt service decreases, TSR will increase. As a result, coverage increases. J. Morgo stated that he is happy with this structure since he thought the County would not receive any revenues once the deal was done. A. Nash responded that the transfer of risk is key and that the County is still at risk for the TSR and it could disappear.

<u>Summary of Results – Debt Service, Residuals, Coverage (Appendix C, pg 3)</u>
As explained by A. Nash, the table analyzes the stress placed on the TSR revenue stream when smoking declines. C. Corso asked what a reasonable decline would be. A. Nash stated that the Global Insight base case provides for a decline somewhere between 3% and 4%. Citi’s table shows that the TSR could decline by as much as 8% and still have some residuals left to be distributed to the County. R. Fonti was concerned about the fact that STASC “could go bust.” C. Corso explained that STASC was designed to eventually run a deficit. As the number of smokers decline, the residuals decline. The goal was to transfer the risk for the loss of residuals from the County to STASC. A. Nash pointed out that as the number of smokers continues to decline the 2008 transactions “looks better.” The current deal is not as attractive to the County. However, market conditions for tobacco bonds have changed.

D. Brown asked how realistic Citi’s proposals are. A. Nash responded “investor appetite is there” especially with coverage for up to an 8% decline.

Non- Recourse and Director Liability:

D. Brown inquired, “How secure is non-recourse component?” B. Smith responded that there was no recourse, that this was a “real securitization and a real transfer of risk to STASC and the bondholder.” He continued to state, “If STASC ran out of money, it is set up as a legally separate stand-alone credit payable only from tobacco pledged revenues, bond proceeds and liquidity reserves.” R. Fonti and J. Morgo expressed concern with respect to director liability. They asked whether the Errors & Omissions insurance would cover directors. D. Brown stated that there was insurance, but liability could always be disclaimed by an insurer. It was suggested that STASC could request a disclosure opinion similar to that obtained by underwriter’s counsel. The opinion would cover 10(b)(5) security fraud liability and would mitigate risk. J. Morgo and R. Fonti stated that they would like to have this opinion obtained.

November 9 Meeting:

It was agreed that a meeting would be held on November 9 to discuss the RFPs needed for this transaction. At the meeting a vote will be held to select the underwriter and to determine whether an RFP will be issued for disclosure counsel.

Additional Items and Comments:
C. Corso asked if she could obtain a copy of the Global Insight report because it becomes difficult to project cash flows for budgetary purposes. B. Smith said that he would send her the link.

T. Persall commented that the present securitization was not the “bullet” that the budget needs. C. Corso commented that it “will help the County.”

A brief discussion was had with respect to the notice to be provided of Wednesday meeting. D. Brown believes that the statute states “reasonable notice” so long as a meeting is not scheduled a week or more in advance, but will review the exact language.

Adjourn: Motion to adjourn was made by T. Pearsall, seconded by R. Fonti. Approved unanimously.