

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 19, 2018 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 1:30 p.m. on Tuesday, June 19, 2018, in the 35th Floor Conference Room, Office of Budget and Management, James A. Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio, pursuant to notice of meeting given by the Secretary of the Authority pursuant to Section 4.2 of its Bylaws.

*[Copies of the items marked * are attached hereto and made a part of these minutes.]*

The Chairman called the meeting to order.

Mr. Kauffman, as Assistant Secretary, reported that two new designations had been filed since the last meeting of the Authority. The Governor of the State of Ohio designating Mike Grodhaus and the Treasurer of State designating Jonathan Azoff and Lisa Eisenberg, in the alternative.

Pursuant to Section 3.1 of the Bylaws, Mr. Grodhaus presided as Chair of the meeting. Upon roll call, the Chairman declared a quorum to be present. The following member and designees of members of the Authority, eligible to vote at the meeting, were present:

Mike Grodhaus, Office of the Governor

Tim Keen, Office of Budget and Management

Jonathan Azoff, Office of the Treasurer of State

Among others present were Kurt Kauffman (Assistant Secretary); Amber Teitt, Larry Scurlock, and Joy DeMarco (Office of Budget and Management); Lisa Eisenberg (Office of the Treasurer); Allison Binkley (Squire Patton Boggs); and Carol Mosholder and James Wakely (Attorney General's Office).

The Assistant Secretary filed the certificate of compliance* with the public meeting notice provisions of Section 121.22 of the Revised Code.

Mr. Kauffman noted a revision to the circulated draft minutes of the June 9, 2017 Authority meeting. Following discussion, Mr. Grodhaus then moved, seconded by Mr. Keen, to revise the draft minutes of the June 9, 2017 Authority meeting as noted. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Keen, Azoff; Nays – None. Mr. Grodhaus then moved, seconded by Mr. Keen, to approve the minutes of the June 9, 2017 Authority meeting as revised. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Keen, Azoff; Nays – None. The Chair declared the motions passed and those minutes approved as revised.

Mr. Kauffman provided an overview of the Fiscal Year (FY) 2017 financial statement preparation and audit process and presented a brief summary of the audit results.* Mr. Kauffman noted that the FY 2017 financial statements were found to fairly present, in all material aspects, the financial position of the Authority in accordance with Generally Accepted Accounting Principles. He also noted that the audit opinion was 'unqualified' and the audit did not identify any material weaknesses or significant deficiencies in internal controls or any instances of noncompliance with material laws and regulations.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2018.* He explained that CY 2018 receipts were 23% higher than CY 2017 receipts and that the increase can be attributed to: i) 2018 being the first year in which 100% of the

TSRs are part of the base annual payment amount (of which Ohio's share is 5.04%) due to the scheduled end of Strategic Contribution Fund payments (of which Ohio's share was 2.78%); and ii) a reduction in the amount deposited into the disputed payment account (DPA), as RJ Reynolds/Lorillard did not make a DPA deposit in 2018 having deposited two-years of such disputed amounts in 2017. Mr. Kauffman reported that the TSRs, together with estimated available interest earnings, are sufficient to fully pay the annual debt service for 2018 and fund the redemption of \$44.59 million of turbo term bonds. In response to a question from Mr. Keen, Mr. Kauffman explained that turbo term bonds had been redeemed previously but this was the first redemption in several years. Mr. Kauffman also noted the Reserve Fund balance was \$233.3 million as of June 1, 2018.

Ms. Mosholder then provided an update regarding the status of arbitration relating to tobacco settlement payments that were disputed by tobacco manufacturers and deposited into the DPA as provided for under the MSA. She explained that the arbitration process for the 2004 sales year Non-Participating Manufacturer (NPM) adjustment is progressing, albeit very slowly. Ohio is one of ten states participating in the arbitration and concluded its state specific hearing in March 2018. Ms. Mosholder expects the 2004 arbitration process to be completed in the fall of 2019 with winning states receiving payment in April 2020. In response to questions by Mr. Grodhaus, Ms. Mosholder explained that the State's record of diligent enforcement has improved annually and the states are hopeful that consecutive successful arbitrations may set a favorable precedent for future arbitrations. In response to questions by Mr. Keen, Ms. Mosholder explained that the states who jointly settled outside of arbitration are receiving approximately \$0.60 per \$1.00 on NPM Adjustments for years 2003 through 2015 and will have to arbitrate NPM adjustments after 2015. In response to a question by Mr. Azoff, Ms. Mosholder noted that the disputed amounts deposited in connection with the 2004 sales year (made in 2007) were not part of the Buckeye Tobacco securitization.

Mr. Scurlock then presented the Authority's operating budget for FY 2018 and its proposed operating budget for FY 2019.* He reviewed the FY 2017 year-to-date expenses, noting that underspending relative to the budgeted amount is due to lower-than-budgeted expenses for legal and financial advisory services. Mr. Scurlock then reviewed the proposed FY 2019 budget, noting that it includes all of the customary expenses. In response to questions from Mr. Keen, Mr. Scurlock explained that the Trust Indenture sets an operating cap that is annually adjusted for inflation. Mr. Scurlock noted that the Authority's FY19 budget totaling \$130,000 is well below that operating cap.

In other business, Mr. Azoff reported that per the Authority's direction at its last meeting, the Treasurer of State's Office in July 2018 entered into an agreement with Public Financial Management (PFM) to serve as the Independent Registered Municipal Advisor (IRMA) to the Authority. Following discussion, Mr. Azoff explained that by designating PFM as its IRMA, municipal underwriting firms may submit ideas and recommendations with respect to the Authority's bonds and remain in compliance with the Securities and Exchange Commission (SEC) Municipal Advisor rule. In response to questions from Mr. Grodhaus, Mr. Azoff further explained that the agreement provides for hourly compensation for work performed and that the Authority's utilization of PFM's services is driven by external factors including bond market conditions.

There being no further business, the meeting was adjourned.

Timothy S. Keen, Secretary
Buckeye Tobacco Settlement Financing Authority



THE BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

JOSH MANDEL, TREASURER
TREASURER OF STATE

JOHN R. KASICH, CHAIRMAN
GOVERNOR

TIMOTHY S. KEEN, SECRETARY
DIRECTOR OF BUDGET AND MANAGEMENT

CERTIFICATION REGARDING NOTIFICATION OF MEETING TO THE PUBLIC AND NEWS MEDIA

The undersigned, Assistant Secretary of the Buckeye Tobacco Settlement Financing Authority, hereby certifies that the notice of the time, place and purposes of the meeting of the Authority of June 19, 2018 at 1:30 p.m. was posted on Tuesday, June 12, 2018 in the State House press room, the Office of Budget and Management (34th Floor, 30 East Broad Street), and the Office of the Treasurer of State (9th Floor, 30 East Broad Street), all in accordance Section 121.22 of the Revised Code and the Open Meetings Rule for notification of meetings to the public and news media adopted by the Authority July 2, 2007.

Dated: June 19, 2018

Kurt Kauffman
Assistant Secretary of the
Buckeye Tobacco Settlement Financing Authority



BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
STAFF PRESENTATION
June 19, 2018

FY 2017 Audit Process

- § U.S. Bank (bond trustee) and BTSFA staff provided the account statements, reports, and other information to Rea & Associates (REA) for compilation of the FY 2017 financial statements.
- § Once the financial statements were compiled, Secretary Keen, TOS and OBM met with REA to review the report, confirm the cash balances, and examine all line-items that experienced a variance of 5% or more from its prior fiscal year value.
- § Financial Statements were turned over to the Independent Auditor (Kennedy Cottrell Richards, LLC) in late August and the audit work was completed by early October.
- § The Report of the Independent Auditor, including the audited financial statements, was reviewed by the Auditor of State and accepted on November 9, 2017.
- § The Opinion of the Independent Auditor was ‘unqualified’ and the financial statements were found to present fairly, in all material aspects, the financial position of the Authority in accordance with Generally Accepted Accounting Principles.
- § The Audit did not identify any significant deficiencies or material weaknesses in internal controls nor any instances of noncompliance with material laws and regulations.
- § The Audit did not include a management letter.

Financial Matters Update

CY 2018 Tobacco Settlement Receipts versus Debt Service Requirements (*\$ in Millions*)

Calendar Year (CY)	Pledged MSA Tobacco Settlement Receipts	Interest Earnings	Total Pledged Funds	Less Operating Expenses	Less Debt Service Payments	Surplus/ (Shortfall)
2008	\$333.1	\$22.4	\$355.5	(\$2.6)	(\$352.7)	\$0.2
2009	\$364.9	\$5.4	\$370.2	(\$2.6)	(\$367.8)	(\$0.3)
2010	\$305.6	\$1.7	\$307.3	(\$1.3)	(\$306.0)	\$0.0
2011	\$289.3	\$1.4	\$290.7	(\$0.3)	(\$297.7)	(\$7.4)
2012	\$294.6	\$1.2	\$295.8	(\$0.1)	(\$294.7)	\$0.9
2013	\$295.0	\$1.1	\$296.0	(\$0.2)	(\$309.4)	(\$13.5)
2014	\$292.5	\$1.0	\$293.5	(\$0.3)	(\$320.3)	(\$27.1)
2015	\$285.8	\$1.2	\$287.1	(\$0.3)	(\$321.7)	(\$34.9)
2016	\$297.1	\$1.7	\$298.8	(\$0.2)	(\$328.5)	(\$29.9)
2017	\$270.2 ¹	\$4.5	\$274.8	(\$0.1)	(\$330.6)	(\$56.0)
2018 Est.	\$331.8	\$5.6	\$337.3	(\$0.1)	(\$334.1) ²	\$3.2 ²

¹ Excludes \$8.5M received from the settlement of the reserve fund claim that was deposited to the SLRA.

² Includes \$44.59 million turbo term bonds redemption.

³ Includes \$3.25 million estimated interest earned and retained in the senior liquidity reserve account.



- § Pledged Tobacco Settlement Receipts (TSRs) for CY 2018 totaled \$331.8 million, an increase of 23% from CY 2017 TSRs.
- The CY 2018 TSRs reflect an estimated decline of 4.5% in domestic cigarette consumption in CY 2017 which was offset by the minimum 3.0% inflation adjustment, Ohio's annual payment share applying to the entire payment amount (i.e., the end of the strategic contribution fund payments), and other components of the MSA payment formula.
 - The decline in domestic cigarette consumption increased to 4.5% compared to the CY 2016 decline of 4.0%. Consumption increased by 1.9% in CY 2015 versus declines of 3.5% in CY 2014, and 4.9% in CY 2013.
- § Tobacco manufacturers again paid a portion of their 2018 payment (\$20.0 million) to disputed accounts.
- The RJ Reynolds/Lorillard deposit to the disputed account was minimal in 2018 due to their 'double' withholding of both the 2014 and 2015 NPM adjustments, totaling \$25.1 million and \$24.6 million respectively, in connection with their 2017 MSA payment.
- § The 2018 TSRs along with interest earnings on those receipts are sufficient to cover principal and interest payments required to be paid in 2018.
- Current interest turbo term bonds totaling \$44.59 million were redeemed on June 1, 2018.
 - The reserve fund balance was \$233.2 million on June 1, 2018 and no reserve fund draws are anticipated this calendar year.
- § Amounts potentially due and payable to Ohio (and pledged to the BTSFA bond holders) currently on deposit in disputed accounts or withheld is approximately \$391 million.
- This amount currently on deposit in disputed accounts and pledged to bondholders relates to sales years 2005 through 2015 due to the 3-year lag.
 - Resolution of disputed amounts continues to be the subject of ongoing arbitration related to the Non-Participating Manufacturer (NPM) adjustment included in the MSA payment formula.
 - The NPM adjustment is disallowed if States can demonstrate 'diligent enforcement' of their qualifying statutes that require NPMs to make escrow deposits analogous to the MSA required payments.
 - The Attorney General's office will be providing an update on this arbitration process later in today's meeting.



**Buckeye Tobacco Settlement Financing Authority
FY 2018 Operating Budget**

Service or Activity	FY 2018 Budget	FY 2018 Year-to-Date	Variance	Approved & Submitted For Payment	Notes
Rating Agency Annual Surveillance Fees:	<u>25,000</u>	<u>25,000</u>	0		
-- Moody's	10,000	10,000		10/24/17	annual surveillance
-- S&P	15,000	15,000		10/19/17	annual surveillance
U.S. Bank Annual Trustee Fee	550	<u>550</u>	0		
-- Annual Trustee Fee		550		2/8/18	annual invoice
Financial Statement Preparation	5,300	<u>6,148</u>	(848)		
-- REA & Associates		5,000		9/7/17	financial statement preparation
		848		3/12/18	financial statement preparation
		300		3/26/18	financial statement preparation
Financial Statement Audit	<u>30,720</u>	<u>31,559</u>	(839)		
-- KCR on behalf of AOS	29,970	24,100		9/19/17	FY17 financial statement audit
		7,085		11/14/17	FY17 financial statement audit
-- Auditor of State	750	374		12/1/17	FY17 financial statement audit
Financial Advisor	25,000	<u>1,650</u>	23,350		
		1,650		5/1/18	financial advisory services
Continuing Legal, Disclosure & Reporting	53,000	<u>0</u>	53,000		
					\$8,000 estimated to be incurred and paid in FY 2018 for disclosure reporting and annual meeting
Contingency/Other	10,430	<u>5,000</u>	5,430		
		5,000		2/20/18	Arbitrage Calculations
FY 2018 Total:	150,000	69,907	80,093		



**Buckeye Tobacco Settlement Financing Authority
FY 2019 Operating Budget**

Service or Activity	FY 2019 Budget	FY 2019 Year-to-Date	Variance	Approved & Submitted For Payment	Notes
Rating Agency Annual Surveillance Fees:	<u>25,000</u>	<u>0</u>	25,000		
-- Moody's	10,000				
-- S&P	15,000				
U.S. Bank Annual Trustee Fee	550	<u>0</u>	550		
-- Annual Trustee Fee					
Financial Statement Preparation	6,450	<u>0</u>	6,450		
-- REA & Associates					
Financial Statement Audit	<u>33,400</u>	<u>0</u>	33,400		
-- KCR on behalf of AOS	32,400				
-- Auditor of State	1,000				
Financial Advisor	25,000	<u>0</u>	25,000		
Continuing Legal, Disclosure & Reporting	30,000	<u>0</u>	30,000		
Contingency/Other	9,600	<u>0</u>	9,600		
FY 2019 Total:	130,000	0	130,000		