Bond Case Briefs

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Rent-A-Muni Issuer Scored Market Access for Bond Now at 11 Cents.

- **The PFA in Wisconsin has issued debt for businesses nationwide**
- **After jet-engine leasing deal, company owner accused of fraud**

Long before federal regulators would accuse him of fraud for running a Ponzi-like scheme, Victor Farias decided to raise some cash in the municipal bond market.

Farias, 47, couldn't tap the market without help. His startup jet-engine-leasing business based in the San Antonio, Texas suburbs wasn't exactly the kind of venture normally financed in the safe and stodgy world of state and local government debt. But there was an agency that could do it for him: the Public Finance Authority of Madison, Wisconsin. The PFA was set up a decade ago with the sole purpose of renting out its power to issue municipal debt to businesses all over the country — from real-estate developers and colleges to nursing homes.

It was June 2015 when Farias's business moved to borrow through the PFA, submitting a five-page application that mostly provided contact information. The PFA didn't review Integrity Aviation's financial statements, revenue projections or demand a feasibility study, according to a bond offering statement. Farias, a former bond salesman, had almost zero experience in the aviation business, bond offering documents would later show. A month later, the PFA approved his proposal, and his business issued about $11 million of taxable debt, broken into $5,000 lots, small enough for mom-and-pop investors to buy them.

Today, Integrity Aviation is in shambles. Bondholders have accused Farias of siphoning about $275,000, and a company that leased five of its engines filed for bankruptcy. And the muni bonds are trading for just 10.5 cents on the dollar in secondary markets, a price that indicates traders believe Integrity won't be able to repay the debt when due next year.

Such market blowups are becoming a familiar tale for investors who have flocked to riskier debt in search of increasingly elusive yields. The economic fallout from the pandemic has exposed the risks from bonds that, like Integrity's, are backed only by a project's revenue.

This has pushed up the number of defaults even in the municipal-bond market, a haven marketed overwhelmingly toward Americans seeking safe and steady returns. There have been 70 so far this year, the most since 2012, according to Municipal Market Analytics.

No issuer has had more of those than than the PFA. Twelve entities that borrowed through the agency have defaulted, according to data compiled by Bloomberg, 10 of them tied to a nursing home chain in the U.S. Southeast. In all, about $180 million in defaulted PFA debt represents 9% of payment defaults by dollar value this year, the fourth-highest by issuer, according to data compiled by Bloomberg.

Farias's saga also puts a spotlight on the practices of local government agencies that generate fees by selling bonds that they aren't on the hook to pay back. Such conduits — and PFA is the most active of those that sell bonds for corporations nationwide — allow borrowers and local governments to avoid the more burdensome federal regulations imposed on those who issue debt in the corporate bond market.

Since 2010, PFA has issued more than $11 billion of bonds for projects in 44 states that qualify because they're deemed to promote social good or economic growth. The agency, which has no staff, generated nearly $30 million in fees between 2014 and 2019, almost all of it for the financial advisory firm that effectively runs it, Walnut Creek, California-based GPM Municipal Advisors, LLC.

"These deals get done because the PFA sells itself, saying you pay our fee and you could use us as an issuer," said Tom Metzold, former co-head of municipal investments at Eaton Vance Corp. who now serves as an expert witness in municipal bond securities cases.

Wisconsin law doesn't require the PFA to perform due diligence on proposed projects, but the agency reserves the right to require an independent study, according to its policies.

In a statement, the PFA said its bond deals finance projects that create jobs, build affordable housing and improve communities, all with no risk to taxpayers. It said it relies on the underwriters and lawyers engaged in the proposed projects to evaluate their financial viability. The fees it generated in 2019 amounted to 21 cents per $100 of bonds issued, the agency said.

"The underwriters, underwriters' counsel, tax counsel, bond counsel, bond purchasers' counsel, and other professionals with whom PFA works on each transaction conduct significant due diligence to determine if a particular transaction is credit-worthy — i.e., the bonds backed solely by the revenues generated on a transaction are highly likely to be repaid," PFA said.

"To the extent there are questions surrounding any specific project," it said, the professionals "involved with the project are in the best position to provide information." PFA's bond issues are subject to rules set by the Municipal Securities Rulemaking Board, the market's self regulatory organization, the agency said.

Mike LaPierre, the general manager of GPM, the advisory firm that works for the PFA, didn't return phone calls and emails seeking further comment. Farias didn't respond to emails and a letter sent to the home address where he was served a court summons in August.

While some conduit issuers perform their own underwriting and due diligence for projects to see if they're viable, others avoid it. A passive approach permits issuers to disclaim future responsibility for the project's performance, according to a 2017 pamphlet by Orrick, Herrington & Sutcliffe LLP, which helped local government officials in Wisconsin draft the legislation that created the PFA. That approach, which requires less work and staff time, also generates more fees. A spokesperson for Orrick declined to comment.

Two years before Farias turned to the PFA to issue muni-bonds, he began funding his business by selling promissory notes to individual investors in the San Antonio area, many of them retired police officers and other emergency workers, according to a U.S. Securities and Exchange Commission complaint.

Of the $14 million he raised, the SEC said he diverted more than $11.6 million from the company — $6.5 million to pay investors Ponzi-like returns, $2.7 million to invest in a friend's convenience store, $1.6 million into his own bank account and another $800,000 on travel, jewelry, golf and country club expenses. Integrity never purchased jet engines with the money raised from the promissory notes, said the SEC, which sued Farias in July for fraud.

Farias has asked a federal judge in San Antonio for more time to respond to the SEC's complaint and is currently in talks aimed at settling the case, according to a Nov. 4 filing by the SEC. Farias is representing himself in the case.

When Farias pitched the muni-bond deal in 2015, a PFA board made up largely of Wisconsin mayors and county officials approved the application after reviewing a roughly two-page summary from board advisory firm GPM.

According to GPM's report, "affiliates and principals" of Integrity had substantial experience in the manufacturing, overhaul, repair and leasing of aviation assets. The bonds, GPM said, would be guaranteed by a company called Turbine Engine Center Inc., which operated a 70,000 square-foot engine repair station in Miami.

By the time the bonds were marketed to investors, however, prospective buyers were given a somewhat different picture.

According to an offering memorandum, Farias's Integrity Aviation would guarantee the bonds, not Turbine Engine Center. Farias's extensive experience in the business was limited to the purchase and leasing of one engine. Three other employees — two of whom were former securities brokers — had no experience in the industry, the documents show.

Integrity used proceeds of the PFA bond offering to buy at least four engines from a company registered to Matthew Marsenison. Marsenison also served as Turbine Engine Center's chief executive officer and was characterized as a member of Integrity's management team in a document sent to promissory note investors.

Neither Marsenison nor Turbine Engine Center have been accused of any wrongdoing. Marsenison, who no longer owns the company, didn't respond to a letter sent to his address.

Farias also formed a company with the banker who led the deal, Patrick Dertien of National Alliance Securities LLC, three months after the bonds were sold, according to public records. Dertien was fired in September 2018 for unauthorized and undisclosed outside business activities and for failing to respond to inquiries from regulators, according to broker registration records.

The broker records didn't specify the outside business.

Dertien didn't return calls seeking comment. National Alliance received $800,000 to underwrite the bonds, almost 5 times the average for high-yield muni issues in 2015, data compiled by Bloomberg show.

Fred Bush, National Alliance's chief financial officer, didn't respond to calls and emails seeking comment. Alysse Hollis, who previously worked at Cincinnati law firm Jones Walker and served as both bond counsel and underwriters' counsel on the bond issue, didn't return calls seeking comment.

Farias leased five engines to Odyssey Engines LLC, the parent of Turbine Engine Center. Odyssey filed for bankruptcy in June, allowing it to stay lawsuits from two banks that said the company defaulted on more than $60 million in loans.

In a 2019 lawsuit, Integrity alleged Odyssey hadn't made lease payments and refused to return the engines — two of which were in storage in Ethiopia. Another, the suit alleged, was in pieces in one of Odyssey's facilities.

Odyssey's chief executive officer, David Alan Boyer didn't respond to emails seeking comment. No one answered the phone at Odyssey Engines. In a response to the lawsuit, Odyssey denied Integrity's allegations and said the case should be dismissed because it concerns transactions in Florida that were beyond the Texas court's jurisdiction.

As for the buyers of Integrity's muni bonds, those acting on their behalf filed a secured claim in Odyssey's bankruptcy case for $6.8 million and have also sued to recover $275,000 that Farias allegedly stole from the bond account.

In the five years since the debt was issued, Integrity has never filed audited financial statements, a reflection of the loose disclosure regulations in the muni market. But Integrity did say in a regulatory filing in Feb. 2018 that it generated $1.25 million in revenue in 2017, $2.3 million less than was projected to investors in bond marketing documents.

In April 2018, bondholders including Barnett & Company Inc., a Chattanooga, Tennessee-based wealth management firm, hired National Alliance to examine Integrity's books.

Rob Halder, head of research and special situations at National Alliance, was granted "view only" access to an Integrity bank account set up to receive lease payments and quickly saw there was no money, according to a lawsuit filed on behalf of bondholders that accused Farias of siphoning between $25,000 and $35,000 a month from the business between April and December 2018. Halder didn't return phone calls seeking comment. Christopher Hopkins, a vice president at Barnett & Company who represented bondholders, declined to comment.

In an Oct. 2018 email, Halder asked Farias where the money was, according to the bondholders' lawsuit.

"Now that we have confirmed that all the monies have been moved out of the revenue account despite direction otherwise, can you tell me where the money has been transferred to? When will it be returned?"

Farias never responded, according to the lawsuit.

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