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FINANCING OPTIONS USING BONDS FOR ILLINOIS PARK DISTRICTS

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What is a bond and why would park districts want to issue a bond?

Municipal bonds are a form of debt. In the public sector, "borrowers" or "issuers" of bonds are states, cities, villages, park districts and other local government entities that need money for a variety of reasons. Typically, a park district will want to issue a bond—and pay principal and interest over time to spread out the burden of paying for new projects, improvements and other capital needs over the period of expected useful life of the financed assets—as opposed to increasing taxes or impacting its budget over a shorter term. Borrowing by a park district is highly restricted and must be done in accordance with Illinois law.

Use of bond proceeds by a park district

Illinois park districts do not have as many statutory options to issue general obligation bonds as most other Illinois units of local government. The Park District Code of the State of Illinois, as amended (the "Code"), does have a provision that permits the issuance of smaller bonds each year limited to no more than .575% of the equalized assessed value ("EAV") of the park district. Many Illinois park districts issue annual "rollover" bonds subject to such limitation or they issue debt certificates. Municipal bonds may be issued by park districts for a variety of purposes, provided that such issuance accords with Illinois law. The Code contains the guidelines for bond issuance by park districts. Commonly, park districts issue municipal bonds for capital projects, working capital needs, or refinancing of prior debt. Many Illinois park districts issue these so-called annual rollover bonds to accomplish their financing needs.

A. New Projects. Generally, a park district compiles an annual capital improvement budget or prepares a "needs list," which consists of projects the park district considers to be important by means of its impact on the safety, resources and general well-being of the community served by the park district. In addition, the Board of Park Commissioners may also prepare a capital improvement plan spanning multiple years. Capital projects can be funded by federal or state grants and other miscellaneous revenue available for general purpose use. However, the primary sources of district funding to pay for capital projects are generally derived from the proceeds of municipal bonds. Projects involving the condemnation or purchase of land for parks or boulevards, and the building, maintaining, improving and protecting of the same, are examples of park district projects that are commonly financed with bonds. Thus, generally speaking, if a park district is building a new capital project, it is likely that the proceeds of a municipal bond issuance are financing all or a portion of the project.

Issuing bonds to fund a capital project allows current and future taxpayers within the district to pay related costs over the life of the project as they avail themselves of the benefits it bestows upon the district.

B. Covering short-term (or long-term) needs. Park districts may issue bonds to fund working capital expenditures that arise from a variety of circumstances. Traditionally, working capital bonds have been issued as short-term obligations where the proceeds are used to cover a district's temporary cash flow or operating deficit. Short-term budgetary deficits can arise from a mismatch between the receipt of annual revenues (property taxes or other) and the timing of annual expenditures of the district within a year. Tax anticipation warrants ("TAWs") are often issued in anticipation of taxes levied, but not yet collected. TAWs may be issued in an amount up to 85% of the district's last known EAV multiplied by the maximum permitted tax rate of the district for the particular fund against which the TAWs are issued. Longer-term working capital bonds have become more commonplace in recent times due to financial difficulties stemming from the recent economic crisis, which caused significant declines in property values. Park districts use these longer-term working capital bonds to address structural deficits that are not the result of a mismatch of revenues and expenses. Tax anticipation notes ("TANs") allow a park district flexibility to balance out its revenue collections from anticipated levies with anticipated expenditures. A park district is permitted to incur debt by issuing a TAN in an amount not exceeding 85% of the taxes levied for the particular fund against which the notes are issued. Further, a TAN is required to mature within two years and may not be issued if (i) there is an unpaid note from any prior year, or (ii) there are TAWs outstanding against the taxes to be anticipated bv the TANs. Although TANs are generally a means of balancing a park districts operating expenses with revenue collections, these notes may sometimes be used as a bridge to fund a pending capital project while the park district structures more permanent funding by the end of the year. Unlike TAWs, TANs count against a park district's debt limit.

C. Refundings/Refinancings. Like a homeowner who refinances a mortgage when interest rates drop, a park district with outstanding debt may issue refunding bonds in order to take advantage of lower rates. Refunding bonds may also be issued to avoid a default or restrictive debt burden. A refinancing may be done in either of two ways: (i) as a "current" refunding, which means the old bonds are called or mature within 90 days of the issuance of the refunding bonds, or (ii) as an advance refunding (limited to one occurrence) in which the old bonds are called on a specified call date (91 or more days after the issuance of the refunding bonds). Proceeds of the new refunding bonds are typically held in an escrow account until such later call date. Refundings generally do not need to satisfy direct or backdoor referendum requirements.

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Types of bonds

There are a number of different forms of bonds/debt that a park district may issue to meet its financing needs. Types of obligations that a park district may issue include general obligation bonds, alternate revenue source bonds, debt certificates/installment contracts, leases, tax anticipation warrants, tax anticipation notes and revenue anticipation notes. Refunding bonds have been issued more frequently in recent years due to the lower interest rate environment.

A. General Obligation Bonds. General obligation bonds or "GOs" are debt issued by a park district representing its full faith and credit and backed by its ad valorem taxing power, unlimited as to rate or amount (unless the park district is subject to the Property Tax Extension Limitation Law of the State of Illinois, as amended (the "Limitation Law")). A general obligation may be issued for any lawful purpose for which ad valorem taxes may be levied subject to constitutional, statutory, or other limitations (such as debt limitations discussed further below) and pursuant to proper constitutional, statutory, or other procedures.

In general, the Code limits the amount of bonds that a park district may issue for a particular purpose. The Code also establishes the debt limit, or maximum amount of money a park district can borrow. The overall debt limit for park districts is 2.875% of the EAV of the district, with the approval of the majority of the district's voters. A majority of the park district's voters may approve at referendum to increase this debt limit to 5.75%. GOs, as well as installment contracts, leases, debt certificates, judgments, and tax anticipation notes, are among the borrowing options which count against a park district's debt limit. In general, however, alternate bonds, revenue bonds, and tax anticipation warrants do not count against the debt limit.

Alternatively, a park district may issue bonds without referendum. However, the non-referendum debt limit for park districts is 0.575% of the EAV of the district. All of a park district's outstanding non-referendum GOs count against this debt limit, but referendum-approved GOs and, generally, alternate bonds do not.

It is a common practice for park districts to issue non referendum bonds in November or December of each year (a "rollover"). The bond proceeds from this rollover are used either (i) to pay debt service due on an outstanding obligation (for example, an alternate bond), or (ii) to provide funds for capital projects on an annual basis.

The Code requires that general obligation bonds and notes issued to pay the cost of capital projects and for the payment of certain expenses secured by an ad valorem tax on all property in the district without limitation as to rate or amount must be approved by voters of the issuer by referendum, if the principal balance of such unpaid obligations will, at issuance, exceed the district's 0.575% debt limit.

B. Revenue Bonds. Revenue bonds are debt issued by a park district payable solely from the revenues generated from the project or projects they finance. Park districts are authorized to issue revenue bonds under the applicable section of the Code depending the project or projects being financed. The projects a park district is authorized to fund using revenue bonds include swimming pools, artificial ice rinks, golf courses, zoos, recreation facilities and harbors or marinas. In general, revenue bonds may be issued without referendum; however, the park district board must adopt and publish an authorizing ordinance that describes the project and issuance of the bonds. If a petition, signed by at least 10% of the registered voters of the park district, is filed with the secretary of the park board within 30 days of the publication of the authorizing ordinance, the issuance of the bonds must be submitted to referendum. An additional limitation on the issuance of revenue bonds is a timing requirement, providing that the bonds must mature within the period of usefulness of the project, as determined by the park board.

C. Alternate Revenue Bonds. Alternate revenue bonds or "double-barreled" bonds are essentially revenue bonds issued under the Debt Reform Act, with the general obligation of the park district serving as backup security for the payment of the bonds. Park districts are authorized to use any lawfully available revenue source as a pledge of security for the payment of principal and interest on alternate bonds. Many Illinois park districts utilize an annual commitment to issue rollover bonds described above as all or a portion of the revenue source pledged to the issuance of alternate bonds.

The intent of the Debt Reform Act is to permit the issuance of the alternate bonds assuming the pledged revenue source is sufficient so that the tax levy relating to the debt service on the alternate bonds does not need to be extended. The coverage requirements of the Debt Reform Act provide that the park district must demonstrate that such pledged revenue source be sufficient in each year the bonds remain outstanding to provide not less than 1.25 times (1.10 times if the revenue source is either (i) federal or state funds that the park district has received in some amount during each of the three fiscal years preceding the issuance of the alternate bonds or (ii) revenues to be received from another governmental unit under an intergovernmental cooperation agreement) debt service on all outstanding alternate bonds payable from such revenue source and on the alternate bonds proposed to be issued.

Apart from coverage requirements, alternate bonds are subject to a backdoor referendum. The backdoor referendum gives registered voters the opportunity to petition the district to submit the question of issuing the alternate bonds to the voters of the district at referendum. However, the petition must be submitted within 30 days after publication of the authorizing ordinance and be signed by the greater of (i) 7.5% of the registered voters of the district or (ii) the lesser of 200 of the registered voters or 15% of the registered voters.

"Many Illinois park districts utilize an annual commitment to issue rollover bonds described above as all or a portion of the revenue source pledged to the issuance of alternate revenue bonds."

> *"The Code and the Debt Reform Act authorize park districts to purchase or improve or repair any real property, equipment, machinery or other personal property through the use of installment contracts not exceeding 20 years in length."*

D. Leases. Park districts are empowered to enter into multi-year lease, purchase and lease-purchase contracts for real and personal property to be acquired. A park district's obligation to pay under a lease is a binding and enforceable promise for which the district agrees to appropriate funds on an annual basis. There are a number of conditions imposed upon such lease agreements. Leases related to real estate and the construction of capital improvements for district-related purposes may be entered into for a term not exceeding 99 years if so authorized by the affirmative vote of two-thirds of the park board. The principal amount of the borrowing and the interest related under any such lease agreement must be repaid within 40 years. Leases related to equipment and machinery for district-related purposes may be entered into for term not exceeding five years when authorized by the affirmative vote of two-thirds of the park board. A form of lease that may be offered to the public is known as a Certificate of Participation ("COPs"), which is a repayment obligation governed pursuant to an installment contract or lease agreement. Under the Debt Reform Act, a park district's ability to issue debt certificates, as described below, make the issuance of COPs unnecessary.

E. Debt Certificates/Installment Contracts. Park districts are authorized to borrow money by entering into installment finance agreements. There are statutory specifications as to what constitutes an installment contract. The Code and the Debt Reform Act authorize park districts to purchase or improve or repair any real property, equipment, machinery or other personal property through the use of installment contracts not exceeding 20 years in length, and may bear interest at any rate or rates permitted on park district bonds. Debt certificates, authorized by the Debt Reform Act, may be issued by a governmental unit to evidence the payment obligations of the governmental unit under a lease or installment contract subject to statutory debt limit. There is generally, however, no separate tax levy available for the purpose of making such lease payments or installment payment; it is considered a promise to pay by way of budgetary appropriation. However, a park district may enter into an installment contract payable from the proceeds of the issuance of a general obligation bond. The debt certificates are valid regardless of whether an annual appropriation is included in any annual or supplemental budget adopted by the district.

F. Limited Bonds. These bonds are issued in lieu of GOs that have otherwise been authorized by applicable law as described herein. These bonds are payable from a separate property tax levy with no limit on the rate, but the Limitation Law restricts the amount of taxes that may be used to pay the bonds. These bonds are payable from a park district's debt service extension base.

TABLE OF FINANCING OPTIONS USING BONDS FOR ILLINOIS PARK DISTRICTS

Type of Debt	Security	General Requirements
General Obligation Bonds	Full faith and credit and backed by the ad valorem taxing power of the district.	Statutory Debt Limit applies. Referendum may be required to issue up to 2.875% of district's EAV.
"Rollover" Bonds	Full faith and credit and backed by the ad valorem taxing power of the district.	Statutory Debt Limit applies; however, referendum is not required so long as district does not exceed .575% of its EAV.
Alternate Revenue Bonds	"Double-barreled" – payable from a specific revenue source with the general obligation of the district serving as backup security.	Pledged revenues must meet 1.25 times debt service coverage requirement. Backdoor referendum procedures and BINA public hearing required. In general, no Statutory Debt Limit.
Debt Certificate	No separate tax levy backing, obligation is a promise to pay by means of budgetary appropriation (no annual appropriation risk).	Borrow money by entering into installment contract agreement. Statutory Debt Limit applies.
Limited Bonds	Full faith and credit and backed by the ad valorem taxing power of the district.	Bonds otherwise authorized pursuant to applicable law and payable from debt service extension base unlimited as to rate, but limited as to amount.

Types of Bond Sales

Once the park district makes a decision to raise capital by means of bonding, it must next consider which method of finding a "lender" or buyer of the bonds works best. Illinois park districts have flexibility as to the method of sale. A competitive sale of park district bonds is not required. The method by which to attract potential investors of bonds can be a critical component to the resulting interest rate the park district will pay to service its bonds. A credit rating is not legally required to be obtained by the park district in order to issue bonds. However, a credit rating may help lower interest costs, particularly in the case of public bond issuances. The following parts of this section discuss different forms of offering bonds to investors or "lenders" that are typically used.

A. Negotiated sale. In a negotiated sale, the process begins with the issuer choosing an underwriter (or managing underwriter if more than one underwriter). The issuer and the underwriter then negotiate the terms of the offering. Once terms of the offering and assuming all procedural issuance requirements are met by the issuer, the underwriter will buy the bonds from the issuer and remarket the bonds to its investors accordingly.

B. Competitive sale. In a competitive sale, bonds are advertised for sale. The announcement, by way of a notice of sale, includes both the terms of the sale and the terms of the bond issue. Any investment bank, broker-dealer or dealer bank may bid on the bonds at the designated date and time in a "blind" fashion, meaning each bidder does not have knowledge of the other bids. The bidder with the lowest interest cost is awarded the bonds.

C. Direct placement. Direct placement or direct lending in the context of municipal bonds refers to any arrangement in which a single lender/buyer, such as a bank, pension fund, mutual fund, etc., purchases the bonds of the park district directly. This form of sale may also be described as a private placement, a direct purchase or a bank loan. Advantages such as avoiding instability in public markets, avoiding continuing disclosure requirements, and avoiding the rating process make direct placements an attractive option for issuers.

D. Bank qualified or non-bank qualified. Pursuant to Section 265(b)(3) of the Tax Code, banks and savings and loans are not permitted to deduct interest expenses attributable to tax-exempt bonds acquired after the passage of the Tax Reform Act of 1986, or August 1, 1986, unless the "small issuer exemption" applies. If a park district anticipates that it will not issue more than $10 million of tax-exempt debt during the calendar year and the debt is designated as a "qualified tax-exempt obligation" pursuant to Section 265(b)(3), the restriction on the deduction for interest expense does not apply. Issuing so called bank-qualified bonds or "BQ" bonds can reduce the interest rate on the bonds since banks that purchase bank-qualified bonds do not have a restriction on its interest expense deduction.

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Relevant Laws

Adherence to federal and state laws is a required component of any bond issuance for the borrowing to be binding and legally valid. Below is a sampling of current laws governing the borrowing activities of park districts.

A. Illinois State Law. The Code, the Debt Reform Act, the Limitation Law, the Bond Issue Notification Act of the State of Illinois, as amended ("BINA"), the Bond Authorization Act of the State of Illinois, as amended (the "Authorization Act"), the Registered Bond Act of the State of Illinois, as amended (the "Registered Bond Act"), and the Bond Replacement Act of the State of Illinois, as amended (the "Replacement Act") all authorize and govern the issuance of municipal bonds by park districts in the State of Illinois.

The Debt Reform Act was adopted by the Illinois General Assembly to provide supplemental authority to local governmental units regarding the issuance and sale of bonds to accommodate market practices that resulted in additional costs for those citizens residing in local governmental units which were affected by higher rates than would otherwise be necessary. Pursuant to the Debt Reform Act, whenever the authorization of or the issuance of bonds is subject to either a voter referendum or a backdoor referendum, the approval, once obtained, remains effective (a) for five years after the date of the referendum or (b) for three years after the end of the petition period for the backdoor referendum.

Pursuant to BINA, park districts proposing to sell non-referendum general obligation bonds or limited bonds, except refunding bonds, must hold at least one public hearing concerning the park district's intent to sell the bonds. Notice of the hearing must be published in a newspaper having general circulation in the park district by the secretary of the park board not less than seven but not more than 30 days prior to the hearing. At least 48 hours prior to the hearing, the notice must be posted at the park board's primary office. The notice must appear above the name or title of the secretary of the park board. The governing board must then wait at least seven days following the hearing before adopting an ordinance providing for the issuance of the bonds.

B. Property Tax Extension Limitation Law of the State of Illinois. The Limitation Law limits the annual growth in the amount of property taxes to be extended for certain Illinois non-home rule units of government. In general, the annual growth permitted under the Limitation Law is the lesser of 5% or the percentage increase in the Consumer Price Index during the calendar year preceding the levy year (a "tax cap"). Taxes may also be increased due to new construction, referendum approval of tax rate increases, mergers and consolidations. The Limitation Law currently applies to Cook County, the collar counties, and counties that have specifically approved the Limitation Law by referendum. Under the legislation, the county board of any such county may initiate a binding tax cap referendum at any regularly scheduled election other than the consolidated primary, which is the February election in odd-numbered years. If the referendum is successful, then the Limitation Law will become applicable to those non-home rule taxing bodies having all of their equalized assessed valuation in the county beginning January 1 of the year following the date of the referendum. Park districts subject to the Limitation Law are able to issue limited bonds in lieu of general obligation bonds authorized by applicable law payable from a separate tax levy unlimited as to rate but limited in amount pursuant to the Limitation Law. Limited bonds are payable from the park district's debt service extension base (generally non referendum bond levy (excluding alternate bonds) for the year to which Limitation Law first applied). The Limitation Law restricts neither referendum approved general obligation bonds nor alternate bonds.

C. Federal Income Tax Law. The Internal Revenue Code of 1986, as amended (the "Tax Code") and certain arbitrage and rebate regulations (the "Regulations") govern the tax-exempt status of municipal bonds. Upon the issuance of any municipal bond, the park district will agree to follow certain federal rules and regulations in order to maintain the tax-exempt status of the bonds. These covenants include reasonable expectations that the bonds are not private activity bonds, meaning they generally benefit a private entity, nor are they arbitrage bonds, which are issued to profit from the difference between tax-exempt and taxable rates, pursuant to the Tax Code and the Regulations.

D. Securities Laws.
Rule 10b-5. Rule 10b-5 of the Securities Exchange Act of 1934 (the "Rule 10b-5"), states that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any national securities exchange,
>
> (a) To employ and device, scheme or artifice to defraud.
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 17 C.F.R. §240.10b-5.

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> *"Recent SEC-enforcement actions indicate a vigorous enforcement initiative on bad disclosure practices targeting issuers and their officials."*

Rule 10b-5 sets out the general statement of federal intent to protect investors against misleading statements or omissions of important facts in official statements or other documents pertaining to the bond issuance. Full disclosure for bond purposes means disclosure of all information material to investors. Recent SEC-enforcement actions indicate a vigorous enforcement initiative on bad disclosure practices targeting issuers and their officials. Issuers should adopt "best practices" to protect themselves and their officials from antifraud provisions including, but not limited to, hiring of disclosure counsel, which is a law firm typically representing the issuer on disclosure issues, and the adoption of effective disclosure policies and procedures that ensure appropriate disclosure. Based on recent enforcement actions against big and small issuers (ranging from large states to small local municipalities), claiming "small unsophisticated issuer" as a defense may not be viable.

Continuing Disclosure. Rule 15c2-12, governs the preparation and distribution of official statements for municipal securities. While this Rule applies primarily to directly regulated entities such as underwriters, broker-dealers and dealer banks, a significant portion of the burden of compliance with Rule 15c2-12 falls on the issuer to supply certain information and disclosure and to take the proper steps to comply with Rule 15c2-12 in a timely fashion. As an example of the importance of meeting continuing disclosure requirements, the Securities and Exchange Commission ("SEC") recently charged an issuer in Indiana and a municipal bond underwriter with falsely stating to bond investors that the issuer had been properly providing annual financial information and notices required as part of its bond offerings. Without admitting to or denying the SEC's findings, the issuer was ordered to cease and desist from violating securities laws and undertake remedial actions; the underwriter agreed to a $580,000 fine along with a one-year collateral bar and permanent supervisory bar for one of its employees.

In recent years, the SEC announced its Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative") to address potentially widespread violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents. The MCDC Initiative provided issuers and underwriters an opportunity to self-report materially inaccurate statements made in final official statements regarding prior compliance with their continuing obligations as described in Rule 15c2-12 and offered favorable settlement terms to those who self-reported. The MCDC Initiative began March 10, 2014 and ended for issuers at 12:00 a.m. EST, December 1, 2014 (the deadline for underwriters was September 10, 2014).

On August 24, 2016, the SEC announced enforcement actions against 71 municipal issuers and other obligated persons for violations in municipal bond offerings. Certain Illinois issuers, including a park district, self-reported violations under the MCDC Initiative. In one instance, an Illinois park district reported that it had affirmatively misstated in an official statement for municipal securities that it had materially complied with prior agreements to provide continuing disclosure. The park district agreed to settle the charges without admitting to or denying the findings. The settlement included consenting to an order to cease and desist from committing or causing any future violations of Section 17(a) of the Securities Act, adopting appropriate written policies and procedures and periodic training regarding its continuing disclosure obligations, complying with existing continuing obligations, cooperating with any future enforcement investigation, and disclosing the settlement terms related to the case in any future bond offerings. The SEC has now filed a total of 143 actions against 144 respondents as part of the MCDC Initiative.

State Blue Sky Laws. The offering, sale and purchase of securities in Illinois are governed by the Illinois Securities Law of 1953, 815 ILCS 5/1 (the "Blue Sky Law"). The Blue Sky Law provides for registration of securities, licensing and regulation of securities broker-dealers, agents, investment advisors, and investment advisor representatives. Subject to statutory exemptions or exceptions, offers and sales of securities in Illinois which are not covered by federal securities law must be registered by coordination or qualification procedures, as applicable. Registration statements for offerings registered by qualification in Illinois must contain full and fair disclosure of all material facts regarding the investment offered and present specific categories of information and financial statements pursuant to the Blue Sky Law.

Municipal Advisor Rules. September 20, 2013 marked the official adoption by the Securities and Exchange Commission ("SEC") of its final rules for municipal advisors ("Final Rules"), as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Further, the SEC released additional guidance in May of 2014.

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While underwriters have long been regulated by the SEC and other regulatory bodies, the regulation of municipal advisors pursuant to the Final Rules is relatively new. The Final Rules took effect on July 1, 2014. Issuers of municipal securities will likely notice changes. While the issuer is not required to hire a municipal advisor, the Final Rules require registration of municipal advisors, define who is a municipal advisor, and impose certain limitations on underwriters. An underwriter is exempted from registering as a municipal advisor so long as certain protocols are followed. To qualify for the underwriter exemption, the underwriter must have an engagement to act as underwriter on a specific issuance of municipal securities. Inclusion in a pre-approved underwriting pool is not sufficient. An engagement letter may state that it is preliminary and non-binding, is subject to applicable procurement laws, formal governing body approval, final bond structuring and execution of a bond purchase agreement, may be terminated by either party without liability, and does not prevent the issuer from engaging other underwriters, or from selecting a different underwriting group. Oral or written acknowledgment of an engagement from the issuer/obligated person is permitted. A preliminary, non-binding engagement is permitted so long as issuer/obligated person reasonably expects to formally engage the broker-dealer as underwriter. Multiple engagements are permitted, and there is no need to specify status as senior or co-manager.

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