

# Virginia GFOA Post Issuance Bond Compliance

Richard H Babb, CPA

BNY Mellon

[rick.babb@bnymellon.com](mailto:rick.babb@bnymellon.com)

# Virginia GFOA

## Post Issuance Bond Compliance

### Tax-Exempt Bonds

- Supreme Court - Pollock v Farmers' Loan & Trust Company 157 US 429 (1895) held federal government had no power to tax interest on municipal bonds.
- Sixteenth Amendment codified in the Revenue Act of 1913 to provide for exemption of interest on state and local bonds
- Tax Equity and Fiscal Responsibility Act 1982 – bonds required to be registered

# Virginia GFOA

## Post Issuance Bond Compliance

### Tax-Exempt Bonds

- Sections 103 and 141-150 of the Internal Revenue Code of 1986
- Supreme Court - South Carolina v Baker, 485 US 505, (1988) upheld the registration requirement. Also stated was that Congress could tax interest income on municipal bonds. Tax exemption of municipal bonds is, under this ruling, not protected under the Constitution.

# Virginia GFOA

## Post Issuance Bond Compliance

### Investments

- Local Entity Investment Policy
- State Regulations
- Provisions of Indenture

# Virginia GFOA

## Post Issuance Bond Compliance

### Investments

- Bank Deposits
- Custody of the securities
- Purchased at Market Value
- Devon Capital Management
  - Securities used as collateral on multiple issues
  - Securities settled at prices other than market

# Virginia GFOA

## Post Issuance Bond Compliance

### Investments

- Repurchase Agreements (Repos)
  - Underlying investments
  - Provider Rating
- Forward Delivery Agreements
  - Qualified Instruments
  - Rating Restrictions
  - Penalties

# Virginia GFOA

## Post Issuance Bond Compliance

### Investments

- Guaranteed Investment Contracts (GICs)
  - Collateral
    - Where is collateral held
    - Type of collateral
    - Percentage coverage
  - Ratings Restrictions

# Virginia GFOA

## Post Issuance Bond Compliance

### Defeasance Escrow accounts

- Investments
  - Cash
  - SLUGS
  - Forward Delivery Agreements
  - Market purchase price
- Mandatory Calls

# Virginia GFOA

## Post Issuance Bond Compliance

### Municipal Bonds

- Ratings Agencies Establish Bond Ratings
  - Rating Agencies (See Exhibit)
    - S & P
    - Moody's
    - Fitch
  - Reliance on Audit Report

# Virginia GFOA

## Post Issuance Bond Compliance

Counterparty Rating Database [CoRD]  
Rating Scales (by Agency)

LONG TERM RATINGS				SHORT TERM RATINGS		
S&P	Moody's	Fitch	Rank	S&P	Moody's	Fitch
AAA	Aaa	AAA	01	A-1+	P-1	F1+
AA+	Aa1	AA+	02			
AA	Aa2	AA	03			
AA-	Aa3	AA-	04			
A+	A1	A+	05	A-1		F1
A	A2	A	06			
A-	A3	A-	07	A-2	P-2	F2
BBB+	Baa1	BBB+	08			
BBB	Baa2	BBB	09	A-3	P-3	F3
BBB-	Baa3	BBB-	10			
BB+	Ba1	BB+	11	B	NP	B
BB	Ba2	BB	12			
BB-	Ba3	BB-	13			
B+	B1	B+	14			
B	B2	B	15			
B-	B3	B-	16			
CCC+	Caa1	CCC+	17	C		C
CCC	Caa2	CCC	18			
CCC-	Caa3	CCC-	19			
CC+	Ca1	CC+	20			
CC	Ca2	CC	21			
CC-	Ca3	CC-	22			
C+	C1	C+	23			
C	C2	C	24			
C-	C3	C-	25			
		DDD	50			
		DD	51			
D		D	52			D
	NR		97			
	WD		98			WD
<blank>	<blank>	<blank>	99	<blank>	<blank>	<blank>

INVESTMENT GRADE  
above this line  
under this line

BELOW INVESTMENT GRADE

DEFAULTED ISSUES  
DEFAULTED ISSUES  
DEFAULTED ISSUES  
NOT RATED  
RATING WITHDRAWN  
No Information Available

# Virginia GFOA

## Post Issuance Bond Compliance

### The Credit Enhancement Environment has Recently been Adversely Affected

	CURRENT AS OF APRIL 9, 2009		
	MOODY'S	S&P	FITCH
AMBAC	Ba3 (Dev Outlook)	A (Neg Outlook)	WD
Assured Guaranty	Aa2 (Sta Outlook)	AAA (Sta Outlook)	AAA (Sta Outlook)
BHAC	Aa1 (Sta Outlook)	AAA (Sta Outlook)	Not Rated
CIFG	Ba3 (Dev Outlook)	BB (Dev Watch)	WD
FGIC	Caa1 (Neg Outlook)	CCC (Neg Outlook)	WD
FSA	Aa3 (Dev Outlook)	AAA (Neg Watch)	AAA (Neg Watch)
MBIA	Baa1 (Pos Watch)	AA- (Dev Watch)	WD
XLCA(Syncora Guarantee Inc)	Ca (Dev Watch)	CC (Neg Outlook)	WD

#### Bond Insurer Disruptions

- At the peak of municipal market insurer presence in 2006, there were six monoline bond insurers that maintained AAA ratings from all three rating agencies, but with the downgrade of Berkshire Hathaway (“BHAC”) there are no more that maintain that status.
- As enhanced AAA bonds have become less of a presence in the marketplace, an increased emphasis on underlying credit has become commonplace.
- On Thursday April 9<sup>th</sup>, BHAC was downgraded by Moody’s from AAA to Aa1.

# Virginia GFOA

## Post Issuance Bond Compliance

### Municipal Bonds

- Resolution
- Trust Indenture
- Loan Agreement
- Bond Form
- Official Statement
- Bond Counsel Opinion
- Remarketing Agreement

# Virginia GFOA

## Post Issuance Bond Compliance

### Municipal Bonds (Continued)

- Credit Enhancements
  - Bond Insurance
  - Letter of Credit
    - Direct Pay
    - Standby

# Virginia GFOA

## Post Issuance Bond Compliance

### Bond Funds

- Instructions for Transactions
- Costs of Issuance
- Revenue Fund
  - Collections
  - Flow
- Debt Service Fund
  - Interest
  - Principal

# Virginia GFOA

## Post Issuance Bond Compliance

### Bond Funds

- Maintenance Reserve Fund
  - Balance
  - Requisitions
- Debt Service Reserve Fund
  - Balance
  - Draw Requirements
  - Draw Replacement

# Virginia GFOA

## Post Issuance Bond Compliance

### Bond Funds

- Bond Redemption and Improvement Fund
  - Additions
  - Authorized Disbursements
- Construction Fund
  - Original Funding
  - Additions
    - Revenue Transfers
    - Insurance Proceeds

# Virginia GFOA

## Post Issuance Bond Compliance

### Bond Funds (Continued)

- Construction Fund
  - Requisitions
    - Format
    - Attachments
    - Authorizations
  - Capitalized Interest
  - Completion Certificate

# Virginia GFOA

## Post Issuance Bond Compliance

### Bond Covenants

- Financial Statements
- Insurance
  - Property & Casualty
  - Liability
  - Specific Asset

# Virginia GFOA

## Post Issuance Bond Compliance

### Bond Covenants (Continued)

- UCC Filing Continuations
- Engineers Certificate
- Staff Expertise
- Rate Covenant

# Virginia GFOA

## Post Issuance Bond Compliance

### Dissemination

- Securities and Exchange Commission (SEC) Rule 15c2-12
  - Information to be deposited in Central Repository
  - Offerings in excess of \$ 1,000,000
  - Small Issuer Exemption if less than \$ 10,000,000 aggregate outstanding – must file any information customarily prepared and publicly available (ex. – audits)

# Virginia GFOA

## Post Issuance Bond Compliance

### Dissemination (Continued)

- National Repositories
- Central Post Office – [www.DisclosureUSA.org](http://www.DisclosureUSA.org)
- Municipal Securities Rulemaking Board (MSRB)
  - <http://emma.msrb.org/>
  - Electronic Municipal Market Access (EMMA)
  - May 11, 2009 - Pilot
  - July 1, 2009 - Data in PDF file
  - January 1, 2010 - Data in Searchable PDF file

# Virginia GFOA

## Post Issuance Bond Compliance

### Dissemination (Continued)

- Annual Report
  - Financial Statements
  - Operating Data
- Disclosure Events
  - Principal and Interest payment delinquencies
  - Non-payment related defaults
  - Unscheduled draws on the debt service reserve fund reflecting financial difficulties

# Virginia GFOA

## Post Issuance Bond Compliance

### Dissemination (Continued)

- Disclosure Events

- Unscheduled draws on the credit enhancements reflecting financial difficulties
- Substitution of credit or liquidity providers or their failure to perform
- Adverse tax opinions or events affecting the tax-exempt status of the Bonds
- Modification to rights of holders of the bonds

# Virginia GFOA

## Post Issuance Bond Compliance

### Dissemination (Continued)

- Disclosure Events

- Bond calls (other than regularly scheduled mandatory sinking fund redemptions)
- Defeasances
- Release, substitution or sale of property securing repayment of the Bonds
- Rating changes

# Virginia GFOA

## Post Issuance Bond Compliance

- IRS Bond Compliance
  - Publication 4079 Tax Exempt Government Bonds
  - Form 14002 Governmental Bond Financings Compliance Check Questionnaire

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 1. Do you have written procedures to ensure that governmental bond financings remain in compliance with the following federal tax requirements after the bonds are issued:
  - a. Proper use of bond proceeds?  
If Yes, date they were implemented?
  - b. Timely expenditure of bond proceeds?  
If Yes, date they were implemented?
  - c. Proper use bond-financed property?  
If Yes, date they were implemented?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- **d. Arbitrage yield restriction and rebate?**  
**If Yes, date they were implemented?**
- **e. Timely return filings and other general requirements?**  
**If Yes, date they were implemented?**
- **f. Documenting compliance with other general requirements?**  
**If Yes, date they were implemented?**

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- Describe in detail your procedures for each of the above items (a-f) and how you implement them, including dates of revisions, if any. In lieu of the above descriptions, you may attach a copy of your written procedures. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements.

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 2. Who is primarily responsible for monitoring post-issuance compliance of bond financings?
  - Elected or appointed officials
  - Non-elected or non-appointed officials
  - Staff Person
  - Other Person
  - None

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 3. If more than one individual is responsible for maintaining the records related to bond financings, do you have written procedures for assigning responsibilities that would ensure compliance with these financings?

If Yes, date they were implemented?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 4. Do you provide training or educational resources to personnel that are responsible for ensuring compliance with the post-issuance private use limitations for bond-financed property?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 5. Are you aware of the following options available for voluntarily correcting failures to comply with post-issuance compliance activities?
  - a. Taking remedial actions described under section 1.141-12 of the Income Tax Regulations?
  - b. Entering into a closing agreement under the Tax-Exempt Bonds Voluntary Closing Agreement Program described in Notice 2008-31?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART II - GENERAL RECORDKEEPING**

- 6. Do you maintain records necessary to support the tax-exempt status of the bond financing?

If yes, for how long?

- Less than life of bonds
  - Life of bonds
  - Life of bonds plus 3 years
- 7. How do you maintain your bond records?  
On Paper Combination of paper and electronic

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 8. Do you maintain copies of the following records:
  - a. Your Federal tax or information returns (e.g., Form 8038 series returns)?
  - b. Your audited financial statements?
  - c. Bond transcripts, official statements and other offering documents of your bond financings?
  - d. Minutes and resolutions authorizing the issuance of your bond financings?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 8. Do you maintain copies of the following records:  
(Continued)
  - e. Certifications of the issue price of your bond financings?
  - f. Formal elections for bond financings (e.g., election to employ an accounting methodology other than specific tracing)?
  - g. Appraisals, demand surveys, or feasibility studies for bond-financed property?
  - h. Documents related to government grants associated with construction, renovation or purchase of bond-financed facilities?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

- 8. Do you maintain copies of the following records:  
(Continued)
  - i. Publications, brochures, and newspaper articles for your bond financings?
  - j. Trustee statements for your bond financings?
  - k. Correspondence (letters, e-mails, faxes, etc.) for your bond financings?
  - l. Reports of any prior IRS examinations of your entity or bond financings?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART III - INVESTMENTS AND ARBITRAGE COMPLIANCE**

- 9. Do you maintain records documenting the allocations and earnings and investments related to your bond financings?
- 10. Do you maintain records for investments of your bond financing proceeds related to:
  - a. Investment contracts (e.g., guaranteed investment contracts)?
  - b. Credit enhancement transactions (e.g., bond insurance contracts)?
  - c. Financial derivatives (swaps, caps, etc.)?
  - d. Bidding of financial products?

# Virginia GFOA

## Post Issuance Bond Compliance

IRS Bond Compliance Questionnaire

### **PART III - INVESTMENTS AND ARBITRAGE COMPLIANCE**

- 11. Do you maintain records of the following arbitrage documents related to your bond financings:
  - a. Computations of bond yield?
  - b. Computation of rebate and yield reduction payments?
  - c. Form 8038-T, *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*?
  - d. Form 8038-R, *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART III - INVESTMENTS AND ARBITRAGE COMPLIANCE**

- **12. Do you have written procedures for monitoring instances that will comply with the applicable yield restriction requirements when a subsequent reinvestment of bond proceeds results in a lower investment yield.**
  - If Yes, date they were implemented?**
- **Describe in detail your procedures and how you implement them, including dates of revisions, if any. In lieu of the above description, you may attach a copy of the written procedures. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements. (*Attach sheet with description*)**

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART III - INVESTMENTS AND ARBITRAGE COMPLIANCE**

- 13. Do you have specific written procedures that monitor bond financings you expect will comply with the arbitrage rules as a result of the application of a temporary period exception (section 148(c) and section 1.148-2(e) of the Income Tax Regulations) or a spending exception (Regulations section 148(f)(4) and section 1.148-7(c), (d), and (e))?
  - If Yes, date they were implemented?
  - Describe in detail your procedures and how you implement them, including dates of revisions, if any. In lieu of the above description, you may attach a copy of the written procedures. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements.

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART IV - EXPENDITURES AND ASSETS**

- 14. Do you maintain records documenting the allocation of bond-financing proceeds to expenditures (e.g., allocation of bond proceeds to expenditures for the construction, renovation, or purchase of facilities you own and use in the performance of your public purpose)?
- 15. Do you maintain records documenting the allocations of bond-financing proceeds to bond issuance costs?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART IV - EXPENDITURES AND ASSETS**

- **16. Do you maintain copies of requisitions, draw schedules, draw requests, invoices, bills and cancelled checks related to bond proceeds spent during the construction period?**
- **17. Do you maintain copies of all contracts entered into for the construction, renovation or purchase of bond-financed facilities?**
- **18. Do you maintain records of expenditure reimbursements incurred prior to issuing bonds for facilities financed with bond proceeds?**

# Virginia GFOA

## Post Issuance Bond Compliance

IRS Bond Compliance Questionnaire

### **PART IV - EXPENDITURES AND ASSETS**

- **19. Do you maintain an asset list or schedule of all bond-financed facilities or equipment?**
- **20. Do you maintain depreciation schedules for bond-financed depreciable property?**
- **21. Do you maintain records that track your purchases and sales of bond-financed assets?**

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART V - PRIVATE BUSINESS USE**

- 22. Do you maintain records of trade or business activities by or with non-governmental entities or persons with respect to your bond-financed facilities?
- 23. Do you maintain copies of the following agreements when entered into with respect to your bond-financed property:
  - a. Management and other service agreements?
  - b. Research contracts?
  - c. Naming rights contracts?
  - d. Ownership documentation (e.g., deeds, mortgages)?
  - e. Leases?

# Virginia GFOA

## Post Issuance Bond Compliance

### IRS Bond Compliance Questionnaire

#### **PART V - PRIVATE BUSINESS USE**

- 23. Do you maintain copies of the following agreements when entered into with respect to your bond-financed property: (Continued)
  - f. Subleases?
  - g. Leasehold improvement contracts?
  - h. Joint venture arrangements?
  - i. Limited liability corporation arrangements?
  - j. Partnership arrangements?

# Virginia GFOA

## Post Issuance Bond Compliance

IRS Bond Compliance Questionnaire

### **PART V - PRIVATE BUSINESS USE**

- 24. Do you have any additional comments on how you ensure your governmental bonds remain tax exempt after they are issued?

# Virginia GFOA

## Post Issuance Bond Compliance

- Post-Issuance Compliance Summary
  - Identify Responsible Individual(s)
  - Proper Use of Bond Proceeds
  - Timely Expenditure of Bond Proceeds
  - Proper Use of Bond-Financed Property
  - Record Retention
  - Arbitrage Yield Restriction and Rebate
  - Timely Return Filings
  - Structural Changes

# Virginia GFOA Post Issuance Bond Compliance

## Questions

Richard H Babb, CPA  
BNY Mellon  
[rick.babb@bnymellon.com](mailto:rick.babb@bnymellon.com)