

Post-Issuance Compliance

Staying Out of Trouble After the Bonds are Issued

Virginia Government Finance Officers Association
Fall Conference

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- I. Why Discuss?
 - Loan Covenants
 - IRS Audits
 - Compliance Check
- II. Post-Issuance Plan - Compliance Officer
- III. Continuing Disclosure Requirements – Rule 15c2-12
- IV. Other Reporting Requirements
- V. Tax Compliance
 - Private Activity Bond Tests
 - Document Retention
 - Arbitrage Yield Restrictions and Rebate Requirements

→ Why Is This An Important Topic?

→ Tax Covenants, Disclosure and Other Requirements – Continue through final maturity of bonds

→ IRS Audits

→ Targeted Audits

→ Random Audits

→ IRS Compliance Check on Governmental Bond Financings

- Questionnaire sent out on January 26, 2009 to 200 governmental issuers
- IRS Form 14002 – Specific List of Questions
- Similar to Compliance Check on 501(c)(3) Financings
- Focus:
 - Document Retention
 - Qualified Use of Bond-Financed Property
 - Arbitrage Yield Restrictions and Rebate Requirements
 - Debt Management Policies and Procedures
 - Awareness of Voluntary Compliance and Educational Resources

- **Establish Written Procedures and Guidelines**
 - Work with bond counsel to establish overall plan and checklist for each financing
 - Sample checklist: National Association of Bond Lawyers (NABL) and Government Finance Officers Association (GFOA) jointly developed checklist to address post-issuance compliance matters
 - NABL/GFOA Checklist addresses three primary areas:
 - Securities matters
 - State law matters
 - Tax matters

- Identify one individual responsible for overseeing post-issuance compliance for all debt
- Provide proper training of staff and access to advisors:
 - Bond counsel
 - Rebate Consultants
 - Financial Advisors
 - Accounting Firm

- SEC Rule 15c2-12 – Continuing Disclosure
 - Purpose: Increases information available after publicly-offered bonds are initially marketed
 - Requires “binding commitment”
 - Requires limited information at limited times
 - Creates need for ongoing procedures and monitoring: *Compliance Officer*

- **Continuing Disclosure Undertaking (“CDU”)**
 - **Written agreement for benefit of bondholders**
 - Make clear what information is subject to CDU
 - **Provide annual financial information and operating data**
 - Timeframe set out in CDU; Provide notice for late filings
 - Mirror the financial information and operating data contained in Final Official Statement
 - Issuers may not reduce CDU by reducing initial disclosure in Official Statement
 - Monitor changes in supplemental tables/exhibits in CAFR

→ Material Event Disclosure

→ Eleven specified events, if material:

- 1) Principal and interest payment delinquencies
- 2) Non-payment related defaults
- 3) Unscheduled draws on debt service reserves reflecting financial difficulties
- 4) Unscheduled draws on credit enhancements reflecting financial difficulties
- 5) Substitution of credit or liquidity providers, or their failure to perform
- 6) Adverse tax opinions or events affecting the tax-exempt status of the bonds

→ Material Event Disclosure

→ Eleven specified events, if material (cont.):

- 7) Modifications to rights of holders of the bonds
- 8) Bond calls
- 9) Defeasances
- 10) Release, substitution or sale of property securing repayment of bonds
- 11) Rating changes

→ File in “timely manner”

→ Voluntary disclosure (information not technically required by CDU)

→ Filing Requirements

- May file directly or may engage a dissemination agent
- Where to file
 - Previously filings made to all “NRMSIRs”
 - Beginning July 1, 2009 all continuing disclosure filings with MSRB
 - Electronic Municipal Market Access (“EMMA”)
 - File electronically at www.emma.msrb.org
- Potential changes coming to Rule 15c2-12

- Reporting Requirements Vary by Lender and Type of Financing
 - Trustees
 - Lenders
 - Rating Agencies
 - Bond Insurers/Other Credit Providers
 - Examples:
 - CAFRs/Budgets
 - No-default certificates
 - Rate covenant certification
 - Proof of insurance
 - Transfer of property

→ Tax Compliance

→ Reasonable expectations

- At closing, bond counsel reviews issuer's reasonable expectations regarding bond issue and private activity tests

→ Deliberate actions

- Deliberate action by issuer (action within issuer's control) after closing can affect tax covenants

→ Tax covenants apply for entire term of bonds (i.e., until final maturity of original bonds or of any refunding bonds)

→ "Significant Modification" to bond documents

- Reissuance?
- File new IRS Form 8038-G

→ Change in Use

→ Private Activity Bond Tests

- Purpose: Generally to prevent benefits of tax-exempt financing being transferred to non-governmental entities, except in limited circumstances of 501(c)(3) financings or exempt facility bonds

→ **Private Activity Bond Tests:**

→ **Private Business Use**

- More than 10% of proceeds of an issue will be used for any private business use

→ **Private Payment/Security**

- More than 10% of the payment of principal and interest on the bond issue is either made or secured (directly or indirectly) by payments or property used or to be used for a private business use

→ **Private Loan Test**

- More than the lesser of 5% or \$5 million of bond proceeds loaned to non-governmental entity

→ Private Business Use Tests:

→ Nongovernmental Person

- Use by nongovernmental person must potentially be counted towards test; federal government is a nongovernmental person

→ Trade or Business

- Activity carried on by a nongovernmental person (other than a natural person – individual acting as member of general public)

→ Use of Proceeds

- Look at use of bond-financed property to determine use of proceeds

→ Private Business Use Tests (cont.):

→ Direct and Indirect Use

- Determining private business use requires examination of direct and indirect use of proceeds and bond-financed property (e.g., lease to governmental person with sublease to nongovernmental person)

→ Aggregation

- Private business use by all nongovernmental persons is aggregated to determine whether private business use test is met

- **Examples of Deliberate Actions – Change in Use:**
 - Sale of facilities – change in ownership
 - Lease of facilities
 - Output contracts
 - Non-qualifying management contracts (Rev. Proc. 97-13 - safe harbors)
 - Non-qualifying research contract (Rev. Proc. 97-14; Rev. Proc. 2007-47 – safe harbors)
 - “Special legal entitlements”
 - Arrangements that convey special rights over bond-financed facilities (e.g., priority rights to the use or capacity of a facility)
 - Special economic benefit in case of a property not available to general public (facts and circumstances)

- Examples of Activities or Arrangements that are not Private Business Use
 - Proceeds used to pay for services rendered
 - Use on same basis as general public (applies only to property that is intended to be available and in fact is reasonably available for use on same basis by natural persons)
 - Use by nongovernmental entity solely as agent of governmental borrower
 - Certain short-term arrangements
 - Certain incidental uses (e.g., vending machines)

→ Remedial Actions

→ Issuer may take remedial action prescribed in Section 1.141-12 of Treasury Regulations to cure deliberate action and preserve tax-exempt status

→ Examples:

→ Redemption or defeasance

→ Alternative use of disposition proceeds

→ Voluntary Closing Agreement Program (VCAP)

→ Provides remedies for issuers who voluntarily come forward to resolve a violation

→ Terms and penalty amounts may vary according to degree of violation as well as facts and circumstances

→ Document Retention

- Material records must be kept as long as the bonds (including refunding bonds) are outstanding, *plus* three years
- Revenue Procedure 97-22
 - Describes requirements for electronic storage

→ Arbitrage Yield Restrictions and Rebate Requirements

→ Arbitrage Compliance Overview

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- Questions?
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