Qualified Energy Conservation Bonds

and

Post Issuance Compliance

ICCCFO Fall Conference

October 5, 2011
Qualified Energy Conservation Bonds (QECBs)

What is a QECB?

- Taxable interest bond
- Provide bondholders with a tax credit or provide issuer with subsidy
- Credit (or subsidy) is 70% of the tax credit rate determined by the Treasury
- Typically will require some supplemental interest coupon
- Should result in lower overall interest cost to the issuer
What projects can be financed with QECBs?

- “Qualified Conservation Purpose”
  - Capital Expenditures; or
  - Research facilities and certain research expenditures
What capital expenditures can be financed with QECBs?

- Reducing energy consumption in public buildings by at least 20%
- Implementing green community programs
- Electricity production from renewable energy sources in rural areas
What capital expenditures can be made with QECBs? (continued)

- Any of these facilities that meet certain IRS criteria (and produce electricity)
  - Wind Facilities
  - Closed or Open Loop Biomass Facility
  - Geothermal or Solar Energy Facility
  - Small Irrigation Power Facility
  - Landfill Gas facility
  - Trash Facilities
  - Qualified Hydropower Facility
  - Marine and Hydrokinetic Renewable Energy Facility
What research expenditures can be made with QECBs?

- Development of cellulosic ethanol or non-fossil fuels
- Technologies for the capture and sequestration of carbon dioxide from produced through the use of fossil fuels
- Automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation
- Technologies to reduce energy use in buildings
Other uses for QECBs?

- Mass commuting facilities that reduce energy consumption or pollution from mass commuting vehicles
- Demonstration projects to promote commercialization of
  - Green building technology
  - Conversion of agricultural waste for use in the production of fuel
  - Advanced battery manufacturing technologies
  - Technologies to reduce peak use of electricity
  - Technologies for the capture and sequestration of carbon dioxide emitted from the combustion of fossil fuels to produce electricity
- Public education campaigns to promote energy efficiency
QECB restrictions

- 100% spent in 3 years
  - Any unspent proceeds must be used to redeem bonds
- 2% cost of issuance limitation
- Subject to federal prevailing wage restrictions (Davis-Bacon)
- Subject to available volume allocation
  - Illinois $133,846,000 (How much is left?)
- Filing of IRS Form 8038-CP (if direct pay QECBs)
The Bonds are issued, now what?
Post Issuance Compliance

- Federal Tax Issues
  - Overview of IRS Enforcement
  - Arbitrage Rebate
  - Private Activity Bonds
  - Record Retention

- Securities Law Issues
  - Continuing Disclosure

- Post Issuance Compliance Summary
  - Post Issuance Compliance Checklist
  - Additional Considerations
Tax Issues – Overview of IRS Enforcement

• Increased enforcement by the IRS
  – Specifically with respect to Build America Bonds
    ▪ As of May 2010, IRS planned “soft contact” with 100% of issuers (receipt of compliance check questionnaire by issuer) and “focused exam” for 50% of BAB issuers
    ▪ Has since retracted this
    ▪ As of May 2011, IRS was examining 30 BAB issues
    ▪ Made $4 billion in payments; received 4,000 8038-CPs
  – Focus on Advance Refundings
    ▪ Sent out 270 compliance check questionnaires
    ▪ 75 audits conducted independent of such questionnaires
Arbitrage Rebate Rules/Exceptions

- **Arbitrage:** Spread between the interest due on tax-exempt bonds and the earnings on the investment of such tax-exempt bond proceeds in higher yielding taxable securities.

- **Rebate:** Issuer must pay (or rebate) arbitrage profits to federal government.

- **Effects of non-compliance:**
  - An issue may be declared taxable.
  - Required payment of non-paid or underpaid rebate amounts, plus interest and penalties.
Arbitrage Rebate Rules/Exceptions (continued)

- When is rebate due?
  - At least once every 5 years
  - At least 90% of the excess earnings to be paid
  - Within 60 days of the final retirement of the bonds

- Exceptions to rebate:
  - Small issuer exception
    - $5 million annual limit
    - $10 million annual limit (school construction)
    - $15 million annual limit (school construction, expires 2013)
  - Spend-down exceptions
Arbitrage Rebate Rules/Exceptions (continued)

- 6-Month Exception - no rebate payment required if all proceeds of the issue are spent within 6 months of the issue date.
- 18-Month Spend-down Exception

<table>
<thead>
<tr>
<th>Period</th>
<th>Spend-down Requirement</th>
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<tbody>
<tr>
<td>6 months</td>
<td>15%</td>
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<tr>
<td>12 months</td>
<td>60%</td>
</tr>
<tr>
<td>18 months</td>
<td>100%</td>
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Arbitrage Rebate Rules/Exceptions (continued)

- Two-Year Construction Spend-down Exception
  - At least 75% of the proceeds must be spent on construction expenditures

<table>
<thead>
<tr>
<th>Period</th>
<th>Spend-down Requirement</th>
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<tr>
<td>6 months</td>
<td>10%</td>
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<tr>
<td>12 months</td>
<td>45%</td>
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<tr>
<td>18 months</td>
<td>75%</td>
</tr>
<tr>
<td>24 months</td>
<td>100%</td>
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Arbitrage Rebate Rules/Exceptions (continued)

- Certain refunding issues
  - Small Issuer Exception applied to the refunded obligations.
  - Average maturity of the refunding obligations is not later than the average maturity date of the refunded obligations.
  - No refunding obligation has a maturity date later than 30 years of the issue date of the original obligation.
Private Activity Bonds

- Must take care to ensure that the Bonds do not become private activity bonds, by establishing procedures for:
  - mapping what outstanding bond issue financed which facilities and in what amounts
  - identifying in advance any new sale, lease or license, management contract, research arrangement or other arrangement involving private use of bond-financed facilities

- Promptly consult with bond counsel as to any possible private use of bond-financed facilities — remedial actions may need to be taken
Record Retention

- What needs to be retained:
  - Basic records relating to the bond transaction
    - Indenture, resolution, ordinance
    - Bond counsel opinion
    - Tax Compliance Certificate and Agreement
    - Final Official Statement
    - Transcript
  - Documentation evidencing expenditure of proceeds
  - Documentation evidencing use of bond-financed property by public and private sources (e.g., leases, management contracts)
Record Retention (continued)

- What needs to be retained (continued):
  - Documentation evidencing record keeping policy is in place
    - Key Features include:
      - Designation of compliance officer
      - Internal reporting of compliance efforts
      - Plan to educate staff regarding bond tax requirements
  - Documentation evidencing all sources of payment or security for the bonds
  - Documentation pertaining to any investment of bond proceeds
    - For example, purchase and sale of securities, SLGS subscriptions, yield calculations for each class of investments, rebate calculations
Record Retention (continued)

- Generally, material records should be kept as long as the bonds remain outstanding, plus 3 years after the final redemption date
  - For a refunding issue, material records relating to the original new money bonds and material records related to the refunding issue should be maintained until 3 years after the final redemption of both bond issues
  - General record keeping policy may need to be revised to reflect the bond record retention policy
Record Retention (continued)

- Various consequences if adequate records are not maintained
  - Issuer may have difficulty demonstrating compliance with federal tax law applicable to the bond transaction in the event of an IRS examination
  - Noncompliance can have various outcomes
    - Interest treated as taxable
    - Loss of BAB/RZEDB subsidy, if applicable
    - Additional arbitrage rebate may be owed
    - Penalties
Continuing Disclosure Undertaking

- Rule 15c2-12
- EMMA – Electronic Municipal Market Access system of the Municipal Securities Rulemaking Board
- Word-searchable PDF format
- Over $10,000,000
  - Full continuing disclosure
  - Annual financial information
  - Audited financial statements
  - Reportable events
Continuing Disclosure Undertaking (continued)

- Over $1,000,000 but less than $10,000,000
  - Limited continuing disclosure
  - Financial information annually
  - Reportable events

- Less than $1,000,000
  - No continuing disclosure

- Consequences for failure to comply
  - Bondholder may sue for specific performance
  - Disclose failure in future disclosure documents
  - Ratings possibly affected
Reportable Events

To be filed within 10 business days

- Principal and interest payment delinquencies
- Non-payment related defaults, if material
- Unscheduled draws on debt service reserves reflecting financial difficulties
- Unscheduled draws on credit enhancements reflecting financial difficulties
- Substitution of credit or liquidity providers, or their failure to perform
- Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security
- Modifications to the rights of security holders, if material
- Bond calls, if material, and tender offers
Reportable Events (continued)

- Defeasances
- Release, substitution or sale of property securing repayment of the securities, if material
- Rating changes
- Bankruptcy, insolvency, receivership or similar event of the Issuer
- The consummation of a merger, consolidation, or acquisition involving the Issuer or the sale of all or substantially all of the assets of the Issuer, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material
- Appointment of a successor or additional trustee or the change of name of a trustee, if material
Post-Issuance Compliance Summary

- Provide for continuing focus on investment of bond proceeds, use of bond financed property and disclosure to the market
- Identifying existing policies, those responsible, the applicable procedures and the affected population
- Use tools to help with compliance
  - Bond recordkeeping policy
  - Post-issuance compliance checklist
    - Identify the Bond transaction documents that reference each item on the checklist
    - Identify the name & title of person responsible for each item
Additional Considerations

- Obtain and store closing transcript and other key transaction documents
- Establish procedures that can be understood and implemented over time even as officials responsible for compliance change
  - Procedures may vary substantially depending on the size and complexity of the issuer, the complexity of the financing, the type of bonds, number of bond issues to be monitored, etc.
- Follow procedures that are put in place
  - Only circumstance worse than failing to implement procedures is to adopt and ignore them