Post-Issuance Compliance

ICCCFO Spring Conference

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The bonds are issued, now what?

1. Spending the Proceeds
2. Continuing Disclosure
3. Record-Keeping
Spending Bond Proceeds

- Three year temporary period
  - Can invest above bond yield
  - Can invest in federally guaranteed investments
- At time of issuance, must reasonably expect to meet:
  - Time test
    - Binding commitment within 6 months to spend 5%
  - Expenditure test
    - Spend 85% on capital projects during 3-year temporary period
  - Due diligence test
    - Proceed to spend with due diligence
Spending Bond Proceeds

- Three year temporary period can be extended to five years
  - Complicated projects, architect/engineer certification
- Importance of temporary period
  - May be able to keep arbitrage earned (if certain spend-down benchmarks are met)
  - Evidence that bonds are not issued too early for governmental purposes
Unspent Bond Proceeds

- What happens when:
  - Project is unexpectedly canceled
  - Project completed below budget
  - Spending priorities change
  - Something happens outside the control of the issuer and project no longer needs to be financed with bond proceeds

- What can be done with unspent bond proceeds?
  - Spend on other capital projects
    - Federal tax law limitations (e.g., private business use)
    - State law limitations (specific authorizations for specific projects), Board authorization limitations
Unspent Bond Proceeds

- Hold for anticipated future projects
  - If after temporary period, yield restriction/no federally guaranteed investments

- What can be done with bond proceeds that will never be spent?
  - Declare as unexpected excess sale proceeds and use to pay principal or interest
    - If no projects to spend on
    - Demonstrate why the unspent proceeds were unexpected
      - What changed the expectations at the time of closing
      - Keep a record in the event of an audit
  - Can call bonds (if callable) or pay next coming due principal and interest
    - May create surplus in the bond fund if tax not abated
    - Yield restrict/no federal guarantees for excess portion
Unspent Bond Proceeds

- If proceeds remaining when temporary period expires:
  - Yield restrict
  - No investment in federally guaranteed investments
    - No FDIC insured investments
    - Exceptions: US Treasuries, certain agency obligations
- Bonds do not lose tax-exempt status BUT, during IRS audit, agent may question reasonable expectations
  - Keep records to demonstrate why (actual facts may be different from expectations)
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 in outstanding bonds
  - 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
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
Private Activity Bonds

- Must take care to ensure that the bonds do not become private activity bonds, by establishing procedures for:
  - mapping which 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
Post-Issuance Compliance Summary

- Provide for continuing focus on investment of bond proceeds, use of bond-financed property and disclosure to the market
- Identify existing policies, those responsible, the applicable procedures and the affected population
- Use tools to help with compliance
  - Bond record-keeping 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
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