CPIM

Center for Public Investment Management

A Program Brought to You By:

Josh Mandel

State Treasurer of Ohio

FINANCE 201:

Debt Administration

2013 CPIM Academy

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Introduction

- What is Post-Issuance Compliance
- Post-Issuance Compliance
- Federal Tax Requirements
- Federal Securities Requirements
- Bond Covenants
- Consequences of Failed Post-Issuance Compliance
- Best Practices
- Record Keeping
- Internal Controls
- Arbitrage & Rebate
- Refunding Opportunities
- Swaps

What Is Post-Issuance Compliance?

- Post-issuance compliance refers an issuer's responsibilities that must be observed after the issuance of tax exempt or "tax preferred" debt to ensure compliance with:
  - Federal Income Tax Laws
  - Federal Securities Laws
  - Covenants contained in bond proceedings

Post-Issuance Compliance

- Factors that create/influence post-issuance compliance responsibilities:
  - ***Federal Tax Law*** – requires monitoring of such things as use and expenditure of proceeds, investment of proceeds, changes in use of financed facilities, changes in security and credit enhancement, changes in hedges and modification of terms of bonds.
  - ***Federal Securities Law*** – requires attention to gathering and disclosure of material information regarding the issuer in connection with continuing disclosure obligations and future financings.
  - ***Bond Proceedings*** – may contain covenants and other obligations related to or independent of the foregoing; also may contain matters related to state law compliance.

Federal Tax Requirements

Federal Tax Law Legal Requirements

- Critical to preservation the tax-exemption (or tax-preference) for existing debt of an issuer.
- Interest paid on bonds (or other obligations) is exempt from federal, state, and local income taxes (or issuer receives subsidy in connection with obligations).
- Two areas:
  - Proceeds
  - Facilities

Compliance With Respect to Facilities

- Monitor Private Business Use
  - ***Private Business Use*** – "use" of bond financed property by a person or entity in a trade or business in excess of 10% of proceeds.
    - Leases create "use".
    - Management and service contracts create "use".
    - Other special legal entitlements create "use".

Compliance With Respect to Facilities

Private Payment or Security – debt service on bonds is derived or secured directly or indirectly by a private source of payment or security (i.e., rent).

Private Loan Financing – not more than the lesser of 5% or $5 million of proceeds may be loaned to nongovernmental persons.

Compliance With Respect to Proceeds - Arbitrage

Temporary Period Exception – the ability of the issuer to invest proceeds in an unrestricted yield for a period of 3 years.

Three Part Test

Expenditure Test: 85% of proceeds must be spent w/in 3 years of the date of issue.

Time Test: Within 6 months of the date of issue, the issuer must incur a substantial binding obligation (5% of debt proceeds)

Due Diligence Test: Work project must proceed with due diligence to completion.

Compliance With Respect to Proceeds - Arbitrage

- Important Considerations
  - All three parts apply to a "***reasonable expectation***" at the date of the issue.
  - Qualified School Construction Bonds require that 100% of proceeds be spent within three years or bonds must be redeemed.

Compliance With Respect to Proceeds

- Additional Considerations
  - Three-year temporary period can be extended to five years if:
    1. Both the issuer and either licensed architect or engineer certify that the longer period is necessary to complete the capital project; ***and***
    2. The issuer "reasonably expects" to spend proceeds of the issue within following periods:
       - 1 year - 10%
       - 2 years - 30%
       - 3 years - 60%
       - 5 years - 85%

Compliance With Respect to Proceeds - Rebate

- ***Rebate***: Requirement that the issuer refund to the Federal government any arbitrage earned on bond proceeds.
- **Exceptions to Rebate**
  - Small Issuer Exception
  - 6-month expenditure exception
  - 18-month expenditure exception
    - 6 months – 15%
    - 12 months – 60%
    - 18 months – 100%

Compliance With Respect to Proceeds - Rebate

- Exceptions to Rebate
  - 24-month expenditure exception for a "construction issue" – 75% of "available construction proceeds" will be allocated to construction expenditures, and proceeds spent within following periods:
    - 6 months – 10%
    - 12 months – 45%
    - 18 months – 75%
    - 24 months – 100%

Other Tax Requirements

- Execution of Tax Compliance Certificate and IRS Reporting Form
- Changes to IRS Form 8038-G – requirement that the issuer indicate whether or not it has written procedures in place.

8038-G Information Return for Tax-Exempt Governmental Obligations

IRS Forms

Form 8038	**Information Return for Tax-Exempt Private Activity Bond Issues**
Form 8038-G	**Information Return for Tax-Exempt Governmental Obligations**
Form 8038-CP	**Return for Credit Payments to Issuers of Qualified Bonds**
	Form 8038-CP filed for fixed rate bonds must be filed no later than 45 days and no earlier than 90 days prior to the relevant interest payment date
	The IRS will send a separate Form CP 152 acknowledging receipt of each Form 8038-CP filed.
	For Qualified Energy Conservation Bonds (and new clean renewable energy bonds) the refundable credit payment for each maturity must be requested on a separate Form 8038-CP for each interest payment due.

IRS Forms

Information Provided on IRS Forms

- Reporting Authority
- Name of Bond Issue
- Officer to be Contacted
- Type & Principal Amount of Issue
- Bond Maturity, Issue Price, Yield
- Use of Proceeds
- Description of Property Financed
- Description of Refunded Bonds
- TEFRA Hearing Date
- Volume Cap
- Loans to Other Governments
- Return for Credit Payments to Issuers of Qualified Bonds
- Payment of Interest Rate Credit

Federal Securities Requirements

Federal Securities Requirements

- Established through SEC Rule 15c2-12 and Continuing Disclosure Agreement executed at the time of a bond closing.
- ***Initial Disclosure*** required under Rule 15c2-12 – Official Statement generally required for issues over $1,000,000 and having a maturity of one year or more. Certain exemptions include:
  - Big Boy Criteria – 35 sophisticated investors and sold in $100,000 denominations.
  - Sold in $100,000 denominations with a maturity of nine months or less.

Official Statement Information

- Underwriter(s), Bond Counsel
- Bonds Authorization, Purpose, Amount
- Use of Bond Proceeds
- Security & Sources of Payment
- City Demographic & Organizational Information
- Financial Information
- General Fund Revenues
- City Debt & Ratings
- City Officials
- Continuing Disclosure Agreement

Continuing Disclosure Agreements

- Continuing Disclosure Agreement executed at the time of a bond closing.
- State and local governments, and obligated persons submit continuing disclosures to the ***Municipal Securities Rulemaking Board (MSRB)*** based on contractual agreements established when bonds are issued
  - Annual Disclosure of annual financial report set forth in Continuing Disclosure Agreement through EMMA (Electronic Municipal Market Access System)
  - Comprehensive Annual Financial Report
  - www.emma.msrb.org

Disclosure of Material Events

Disclosure of material events must occur within ***10 days*** of an occurrence of a material event.

- Ratings Downgrade/Upgrade
- Default (non-payment or technical)
- Fiscal Emergency
- Bond Redemptions
- Defeasances
- Adverse Tax Opinions or Events Affecting Tax-Exempt Status of Bonds

EMMA®

- EMMA currently allows state and local governments to provide additional information to market participants.
- State and local governments may voluntarily post pre-sale information, such as preliminary official statements, to EMMA.
- Issuers can post information about the timing and accounting standard used to prepare annual financials and an investor website address.
- Actions listed above are **voluntary**.

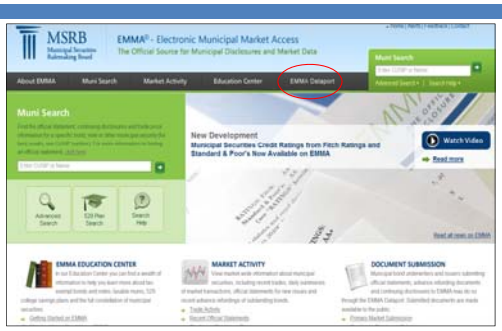
Voluntary Disclosure

- MSRB is encouraging state and local governments to voluntarily make available on EMMA information about bank loan financings.
- Potential investors may not be aware of bank loans incurred by a state or local government or their impact on the municipal government's outstanding debt until the release of audited financial statements.
- Voluntary disclosure through EMMA would provide timely access to this information for market participants.

Submission Process for EMMA

- To submit continuing disclosures to EMMA, all users must register with the MSRB.
- Municipal securities issuers, obligated persons and secondary agents must:
  - Create an account in MSRB Gateway
  - Select submission role(s)
  - Accept the terms and conditions for making continuing disclosure submissions

EMMA® Homepage



EMMA® Homepage

The EMMA website, at http://emma.msrb.org, is a centralized collection of municipal disclosure documents and trade data that provides access to key market information free of charge.

Bond Covenants

- Bond Proceedings Legal Requirements
  - Relates to Compliance with Bond Proceedings and Legal Documents (i.e., Trust Indenture)
    - Maintenance of Pledges or Other Security
    - Notice Provisions
    - ***Ratios*** or other ***special performance or financial achievement covenants*** (i.e., cash on hand, debt service coverage ratio).

Consequences of Failed Post-Issuance Compliance

Lost of Tax-Exempt or Tax-Preferred Status

- Loss of **tax-exempt status** of interest, in the case of tax-exempt bonds.
- Loss of **subsidy payment**, in the case of tax credit bonds such as Build America Bonds.
- Loss of **preferred status**, in the case of certain other ARRA-authorized bonds.

Remediation Requirements Under Federal Tax Law

- When proceeds of a bond issue are used in a manner for which tax-preferred debt may not be employed, such as in the case of a change in the expected use of a facility, an issuer may be able to preserve the tax-preferred status only through undertaking certain remedial actions.
- The conditions to the availability of such actions, as well as the costs associated with several aspects (e.g., defeasance of bonds) can be onerous.

Penalties & Interest

- In lieu of a declaration of taxability or loss of some other tax-favored status, the Internal Revenue Service could require a payment to preserve the status, measured with reference to the benefit the tax-favored transaction provides to the issuer.
- In the case of rebate amounts, failure to pay in a timely fashion, in addition to threatening the tax status of the bonds, increases the financial exposure to the issuer by incurring interest on unpaid amounts.

Securities Law Enforcement

- Failures to adequately disclose material information by an issuer could lead to enforcement action by the Securities & Exchange Commission (SEC), including cease and desist orders.
- The general process undertaken by the SEC in connection with such matters is public and costly and often heavily weighted in favor of the federal authorities.
- Failure to make the disclosures required by continuing disclosure agreements are often required to be disclosed themselves for five years following the failure.

Market Disapproval

- Issuers with a reputation for securities law irregularities or tax difficulties will often be penalized by the market in the form of higher interest rates on new debt.
- In extreme cases, the municipal bond market may refuse to purchase the securities of certain issuers.
- Serious problems may make it impossible to even go to the market to borrow because lack of knowledge of the status of material matters by the issuer may create a situation where the mere offer would constitute a violation of federal securities laws.

Litigation & Citations by the Auditor of State

- To the extent that any adverse regulatory actions caused loss to bondholders, they may seek to recover from the issuer.
- Even in the absence of action by regulators, disclosure of previously undisclosed issues or the discovery of non-compliance could also adversely affect the market value of bondholders' portfolios, giving them a cause of action for such loss.
- Failure to comply with continuing disclosure requirements could result in a citation from the Auditor of State.

General Adverse Publicity

- Issuers dependent on community support for debt offerings could generally suffer to the extent that a failure in post-issuance compliance creates ***negative perceptions for community or alumni donors***.
- Particularly egregious situations could lead to ***civil or criminal prosecutions*** in connection with the events connected with the failure in compliance.

Best Practices

Internal Procedures & Policies

- For purposes of complying with Federal Tax Law, Federal Securities Law, and Bond Proceedings, the issuer should develop and implement a Post-Issuance Compliance Policy.

Development of Post-Issuance Compliance Policy

A written policy should:

- Assign responsibility to "Compliance Officer(s)" for monitoring compliance.
- "Compliance Officers" assigned responsibility in the policy should include representatives from the issuer's Finance and Legal Departments.
- Outline a schedule for action items.
- Develop a protocol for the retention of records necessary to evidence the post-issuance compliance efforts required by law.
- Complement existing institutional policies.

Implementation of Post-Issuance Compliance Policy

- Implementation of the policy using: (i) Compliance Officers (financial and legal representatives), (ii) institutional personnel and resources, and (iii) outside experts.
- Train the Compliance Officers with respect to the policy.
- Periodically review the policy to address: (i) experience, (ii) institutional changes, (iii) changes in law.
- Integrate the policy with the information gathering process associated with securities law disclosure (i.e., the preparation of annual financial statements) so that information required for future bond issues can be identified quickly and consistently.

Record Keeping

- Records Retention
  - Retention of audited financial statements not less than seven years.
  - Retention of bond proceedings for the term of the outstanding bond issue plus three years, including:
    - Bond transcript documents
    - Expenditure of bond proceeds
    - Investment of bond proceeds
    - Use of bond-financed property
- Audit Requirements (IRS & State Auditor)

City of Powell as Issuer

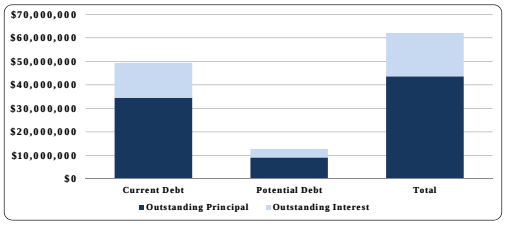
City of Powell

AND

City of Powell with
Liberty Community Infrastructure
Financing Authority

City of Powell with Powell Community
Infrastructure Financing Authority

City of Powell Debt Profile



**Numbers as of 3/25/13*

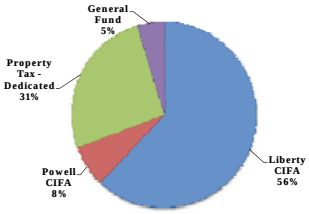
Type of Debt	Outstanding Principal	Outstanding Interest	Outstanding Debt Service*
Current	$29,680,000	$9,076,974	$38,756,974
Potential	$9,100,000	$3,650,000	$12,750,000
Total	$38,7800,000	$12,726,974	$51,506,974

City of Powell Debt

City of Powell Bond Ratings

- Aa1 Moody's
- AA+ Standard & Poor's

The City is working to improve its rating to AAA.



Liberty and Powell CIFA: General Obligation Bonds paid with a community development charge. City started debt process as revenue bonds.

Property Tax – Dedicated: General Obligation Bonds paid with voted property tax and voted tax incremental funds.

General Fund: General Obligation Bonds paid with General Fund revenue.

Internal Controls – City of Powell

Investment Policy	*Fiscal Responsibility & Management Policy*
• Provides for the investment of proceeds • Maximum Maturity • Suitable and Authorized Investments • Investment Earnings Allocation	• Provides accountability • Monthly and Annual Financial Reports • Internal Control Procedures • Revenue and Procurement Payment System

Internal Controls – City of Powell

Debt Management Policy demonstrates commitment to long-term financial planning.

Authority & Limits	• External Limits • Charter Limits • Policy Limits
Cash & Debt Funding	• Preferences • Layman Explanations
Structural Features	• Preferences • Layman Explanations
Refunding & Refinancing Guidelines	• Cost-effective and Minimum Present Value Savings

Internal Controls – City of Powell

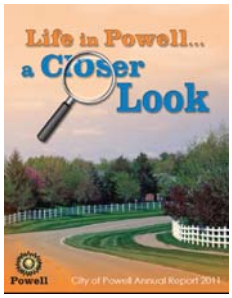
- ***Post-Issuance Compliance Policy*** promotes and ensures compliance with Federal Securities laws, bond covenants and Internal Revenue Service filings.
  - Designate responsibility.
  - Dates when filings are to be made.
  - Layman explanation of compliance requirements such as "EMMA", Material Event Disclosure, CAFR filing, Arbitrage, IRS Form 8038-CP, information requests and record retention.

Internal Controls – City of Powell

- Other Policies – protect and enhance the City's credit rating.
  - ***Fund Balance Policy*** – formalizes the framework and plan for reserves and unassigned fund balances.
  - ***Audit Committee Policy*** – practical means to provide needed oversight and independent review of the financial processes including selecting independent auditor.
  - ***Asset Management Policy*** – assessment, care and replacement for capital assets and controlled capital-type items.
  - ***Other Best Practice Policies*** – such as: economic development policy, disaster recovery planning, budgeting and financial planning.

Continuing Disclosure – City of Powell

- Managed by the Finance Department
  - City Policy Ordinance 2011-12
- Comprehensive Annual Financial Report
  - Available online and filed on MSRB's EMMA website
  - CAFR fulfills SEC Continuing Disclosure Rule 15c2-12
  - Material Event Notices



Arbitrage & Rebate – City of Powell

- City Finance Department
  - Tracks bond proceeds spend-down schedules.
  - Sends list of issues requiring calculations to "specialist".
- City Finance Department
  - Contracts with rebate consultant to perform spend-down test and rebate exception calculations, provide analysis for commingled funds, advise on arbitrage rebate compliance matters, calculate arbitrage rebate and yield restriction liability, and provide any other advice related to these matters.
  - As paying agent for the City, submits any rebate or liability payments to IRS.
- Maintain records, copies of reports

Records Retention – City of Powell

- Public Records Policy and approved Historical Society Records Schedule
- Bond Transcripts – 10 years after issue redeemed
- Bonds – 2 years after issue is paid off
- Sinking Fund Electronic Fund Transfer Records – 10 years
- Bond Issue Ledger, Record of Registered Bonds and Sinking Fund Ledger or Journal – Permanent

Administration of Subsidy Bonds

- Use of Subsidy Bond Subsidies
  - Can be placed in bond retirement fund, general fund, or any other fund of the issuer.
  - Issuer must designate by legislative action which fund they intend to put the subsidy in prior to first interest payment.
  - Issuer can put subsidy in different fund(s) over the life of the bond issue.
  - Issuer must re-designate, by legislative action, new fund they intend to put the subsidy in prior to receipt of the subsidy payment.
  - Failure to make proper designation could subject the issuer to a citation by the Auditor of State.

Refunding Opportunities

- Issuers generally do not have policies in place to monitor refunding opportunities.
- Investment bankers generally monitor refunding opportunities and notify issuers of potential refundings.
- Issuers are allowed unlimited "current refundings" under Federal tax law and one "advance refunding".
- Threshold for savings for an advance refunding is usually 3%.
- Savings report must indicate savings in every year.
- Interest rates are at historic lows.

Swaps

- Most issuers generally stay away from swaps from a risk and political standpoint.
- Some issuers have recently taken steps to reverse swaps that they have entered into.
- It is important to evaluate any future or existing swaps with the guidance of your legal and finance experts.