



# ICCCFO Annual Conference

## You've Issued Your Bonds — Now What?

Wednesday, April 19, 2023

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# Timeline

- Bond Issuance Process (2-3 months)
  - Required Corporate Actions (Conduct of Public Hearing; Adoption of Authorizing Ordinance, Bond Ordinance)
  - Preparation of Marketing/Disclosure Document
  - Sale
  - Closing
- Post Issuance Compliance
  - Federal Tax Law Requirements (from closing until final maturity, plus 3 years)
    - Arbitrage rebate
    - Private use
    - Record retention
  - Securities Law Requirements (from closing until final maturity)
    - Continuing Disclosure
  - Post-Issuance Compliance SEC Enforcement Actions and Takeaways

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# Post-Issuance Compliance — Federal Tax Law

# Tax Exemption

- Bonds are issued with tax-exempt or taxable interest rates. What does it mean to be tax-exempt?
  - Interest on the bond is not included in the gross income of the bondholder for federal income tax purposes
- What qualifies for tax-exemption?
  - Public purpose capital projects
  - Refundings (within 90 days prior to call date)
  - Often, borrowing for operations requires taxable interest rates

# IRS Enforcement

- Various consequences of non-compliance with tax rules:
  - Interest on the bonds could be declared taxable
  - Loss of BAB subsidy, if applicable
  - Additional arbitrage rebate may be owed (non-paid or underpaid rebate amounts, plus interest)
  - Penalties

# Track Investment of Bond Proceeds — Arbitrage Rebate Rules

- Arbitrage: Difference between (i) what would have been earned if tax-exempt bond proceeds were invested at bond yield and (ii) the earnings on the investment of such tax-exempt bond proceeds in higher yielding securities
- Rebate: Issuer must pay (or rebate) arbitrage profits to federal government
- Anything above bond yield gets paid to the US Treasury, unless you meet one or more exceptions:
  - Small issuer exception
  - Spend-down exceptions

# Track Spenddown of Bond Proceeds

- Issuers of tax-exempt bonds must (generally) qualify for a three-year temporary period
- Qualification for three-year temporary period is based on reasonable expectations at the time of issuance
  - Must reasonably expect to spend bond proceeds as follows:
    - *Expenditure Test*—85% within 3 years
    - *Time Test*—5% within 6 months
    - *Due Diligence Test*
- Arbitrage/Rebate, however, is based on actual facts: Issuers must keep records of how the bond proceeds were invested, when the bond proceeds were spent and what facilities/improvements the bonds funded

# Unspent Bond Proceeds?

- After three years from the closing date (upon expiration of the three-year temporary period), tax-exempt bond proceeds:
  - must be yield restricted; and
  - may not be invested in investments guaranteed by the federal government (such as FDIC-insured CDs)
    - Exception: may invest in U.S. Treasury Securities

# Arbitrage/Rebate

- Checklist for post-issuance compliance with arbitrage rebate:
  - If not small issuer rebate exempt, track investment return against bond yield
  - Keep separate account/accounting of expenditure of bond proceeds and bond-financed projects
  - Monitor compliance with temporary period expectations for expenditure of bond proceeds
  - If not small issuer rebate exempt, monitor compliance with 6-month, 18-month or 2-year spending exceptions to rebate, if relevant
  - Arrange for timely computation of rebate liability and, if rebate is payable, for timely filing of Form 8038-T and rebate payment

# Monitor the Use of Bond Financed Facilities — Private Business Use and Payments

- Tax exemption does not apply to any “private activity bond,” with limited exceptions
- A private activity bond is a bond that has excessive private business use AND has excessive private payments/security
- De minimis allowance
  - Private business use is limited to 10%, but
  - 5% limit for “unrelated” or “disproportionate” private business use (with little guidance from the IRS), so most tax counsel use the 5% limit as the baseline

# Private Business Use and Payments

- “Private business use”
  - More than 5% of bond proceeds finance a public facility used by a non-governmental trade or business
  - Examples of private use:
    - Sale, transfer or lease of property to private user
    - Management of property by private user under a management contract
- “Private payment or security”
  - More than 5% of debt service on the bonds is secured by an interest or derived from payments related to private use
  - Example of private payment:
    - Payments of lease rentals to the issuer by a private operator

# Private Business Use and Payments

(continued)

- Checklist for post-issuance compliance:
  - Allocate bond proceeds and funds from other sources to ensure that bond proceeds are used for qualifying costs
  - Map out what outstanding bond issue financed which facilities and in what amounts; monitor private use of bond-financed facilities to ensure compliance with applicable percentage limitations
  - Identify in advance any new sale, lease or license, management contract, or other arrangement involving private use
  - Keep records of leases and management contracts even if expired

# Record Retention

- Sufficient records must be retained to support the tax status over the term of the Bonds, plus three years after the final maturity 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 three years after the final redemption of both bond issues
- Consequences if adequate records are not maintained
  - Difficult to calculate private business use
  - Difficult to demonstrate tax compliance in the event of audit

# Post-Issuance Tax Compliance Policy

- *Written* procedures that can be understood and implemented over time even as officials responsible for compliance change
  - Having written post issuance compliance procedures may allow for more favorable settlement treatment from the IRS
    - 1) Designate a Compliance Officer
      - Assign responsibility for monitoring
      - Include training with regard to tax and disclosure requirements
    - 2) Retain accurate records

# Post-Issuance Tax Compliance Policy

(continued)

- 3) Implement procedures reasonably expected to timely identify and timely correct noncompliance
  - Integrate monitoring of tax law compliance with existing accounting systems (for example, use special coding on a ledger to review sales, leases or contracts involving bond financed property)
  - Use a compliance checklist
  - Due diligence at regular intervals
    - Principal and interest payment dates are good benchmarks
    - Self-help remedial actions may only be taken within specified time frames
- 4) Report compliance efforts to elected officials (annually)

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# **Post-Issuance Compliance — Securities Law**

# SEC Rule 15c2-12

- Requires underwriters to obtain and review an official statement that had been “deemed final” by an issuer before offering securities to investors
- Requires underwriters to determine that an issuer had undertaken to file annual financial information and material event notices with the MSRB’s Electronic Municipal Market Access (EMMA) system

# Primary Market Disclosure

- The official statement is a document prepared by, or on behalf of, the community college district in connection with a primary offering of its bonds
- The official statement discloses all material information on the offering for potential investors
- Main source of anti-fraud liability in a bond transaction
- Obligation for the accuracy and completeness of the disclosure lies with the district
  - Experts may assist, but cannot completely discharge, the district's obligation – It is your document!
- Although an official statement is not legally required for a private placement, some sort of disclosure document (e.g. term sheet) is usually prepared and disseminated
  - Statements in a Term sheet are subject to federal securities anti-fraud laws

# Secondary Market Disclosure

- Continuing Disclosure Undertaking (CDU)
  - SEC Rule 15c2-12
    - Requires an underwriter to enter into an agreement with issuers to provide audited financial information, other financial information (possibly) and event disclosures to the market
    - SEC believes this information is important for market transparency and to promote a fair and efficient market
- Filings must be made electronically at the EMMA (Electronic Municipal Market Access) portal [[www.emma.msrb.org](http://www.emma.msrb.org)]
- Recent focus on timeliness of EMMA filings

# CDU Filing Requirements

- If new issue is sold directly to an investor (*i.e.* private placement): No CDU (generally)
- If new issue is less than \$1,000,000: No CDU
- If new issue is at least \$1,000,000 and issuer has less than \$10,000,000 of debt, issuer must agree to provide:
  - Audited financial statements, annually
  - Reportable events, within 10 days of occurrence
- If new issue is at least \$1,000,000 and the issuer has over \$10,000,000 of debt, issuer must agree to provide:
  - Annual financial information, annually
  - Audited financial statements, annually
  - Reportable events, within 10 days of occurrence

# CDU Filing Requirements

(continued)

- “Annual Financial Information” (AFI)
  - Defined in reference to certain information and charts in the Official Statement, such as:
    - Debt Service Extension Base (DSEB)
    - Financial Information and Economic Characteristics: Trend of EAV, Tax Rates, Tax Extensions and Collections, Outstanding Debt, Debt Ratios
    - Summary of Operating Funds: Changes in Education and Operations and Maintenance Fund Balance, Education and Maintenance Fund Revenue Sources
- Audit (and AFI, if applicable) must be filed with EMMA; filing deadline is usually 210 days after fiscal year close

# CDU Filing Requirements

(continued)

- Reportable Events – must be filed within 10 business days after the occurrence of the event
- There are 16 Reportable Events
- Most common:
  - Rating changes
  - Bond calls
  - Payment delinquencies
  - Non-payment defaults
  - Financial obligations

# Two New Reportable Events

- Districts subject to the new amendments will now be required to disclose:
  - (1) (a) the incurrence of a financial obligation, if material, or  
(b) an agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation, any of which affect security holders, if material; and
  - (2) a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation, any of which reflect financial difficulties
- Only applicable to districts which entered into a CDU on or after February 27, 2019

# Consequences for Failure to Comply with CDU

- Bondholders may sue for specific performance
- Rule 15c2-12 requires issuers to disclose CDU non-compliance in official statements (five year look back)
- May impact access to market or result in increased interest rates on new issuances
- Districts that fail to make CDU filings may also face SEC action for other statements that reach the market, if materially misleading

# Disclosure Policies and Procedures

- Main components: Designating a disclosure officer; adopting procedures for both primary disclosure (official statements) and continuing disclosure (producing and filing annual financial information on EMMA and filing Reportable Events on EMMA)
- Incorporating robust disclosure practices/procedures and demonstrating a solid disclosure track record benefits an issuer by encouraging regulatory compliance and by enhancing credibility among investors, credit rating agencies and the public
- All participants in the disclosure process should be encouraged to raise additional potential disclosure items at all times in the process
- Disclosure questions should be discussed with appropriate management team members

# CDU Post-Issuance Compliance Checklist

- Know your CDU filing requirements and deadlines
- Implement policies and procedures and training for bond issuance and post issuance compliance
- Identify individuals responsible for CDU items and have a succession plan
- For annual filings, consider including the required tables in your audit
- For annual filings, consider hiring a third-party dissemination agent
- Subscribe to EMMA for email reminders

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# **Post-Issuance Compliance Enforcement — Actions and Takeaways**

# Trends in SEC Enforcement Actions

- Emphasis on issuer controls and procedures
- Willingness to pursue anti-fraud charges against negligent (not just intentional) disclosure failures
- Willingness to pursue fraudulent statements in documents or statements that are not provided to investors
- Emphasis on individual liability for involvement in fraud

# Takeaways

- Issuers need to know and understand their obligations under the federal securities laws
- Disclosure should not be a routine procedure of inserting new numbers in the last official statement
- Issuers should adopt, and follow, policies and procedures for updating and reviewing disclosures
  - May involve formalization of existing procedures (e.g., hiring disclosure counsel or other municipal finance professionals to assist with disclosure)

# Takeaways (continued)

- SEC clearly expects underwriters to enforce market access penalty for CDU non-compliance
- Issuers that repeatedly fail to make CDU filings will not be able to access public market
- Issuers that fail to make CDU filings may also face SEC action for other statements that reach the market, if materially misleading
- Statements that are reasonably expected to reach the securities market, even if not prepared for that purpose, cannot be materially misleading



# Questions and Answers

*We thank you for your time!*



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# Disclosure

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