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# Post-Issuance Compliance

## 2019 Updates *From the Front Line*

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# 7<sup>th</sup> ANNUAL POST-ISSUANCE COMPLIANCE WORKSHOP



A Comprehensive Overview of Post-Issuance Tax Law and SEC Secondary Market Disclosure for 501(c)(3) Organizations and State and Local Government Issuers Who Utilize Tax-Exempt Financing

**WHEN:** November 14 and 15, 2019

**WHERE:** The LINE Hotel | Austin, Texas

For information, please visit:

<https://www.blxgroup.com/event/blx-orrick-7th-annual-post-issuance-compliance-workshop/>

\* *Earn CPE/CLE credits*



# BLX Post-Issuance Compliance Services



- Private Business Use Services
  - Detailed calculation of private business use %
    - Annual (Schedule K) Period
    - Tax Measurement Period
  - Orrick legal opinion
  - Tax-exempt bond proceeds and equity expenditure analysis
  - Review of the use of all tax-exempt bond financed facilities
    - Management and service contracts
    - Sponsored research agreements

# BLX Post-Issuance Compliance Services



- Arbitrage Rebate Compliance Services
  - Rebate and Yield Restriction Calculations
  - Refund Fund Claim Services
- Secondary Market Disclosure Services

# 2019 Updates from the Front Line



1. What is New with the IRS?
2. Reemergence of Positive Rebate and Yield Restriction
3. Rule 15c2-12 Amendment
4. Using Floating Equity
5. Management Contracts

# IRS Updates – Final TEFRA Regulations



- *TEFRA – Public Notice of Bond Issue*
  - Applicable to 501(c)(3) Bonds/Private Activity Bonds
- Final TEFRA Regulations issued on December 28, 2018
  - *Replace regulations issued in 1983*

# IRS Updates – Final TEFRA Regulations



- Highlights of New Regulations -
  1. Notice of public hearing now 7 days prior to the public hearing (prior regulations required 14 day notice)
  2. Website publication of notice of public hearing is allowed
    - » *Various process questions raised here*

# IRS Updates – Final TEFRA Regulations



3. Requirement of describing the maximum principal amount for each “project”
4. Post-issuance TEFRA permitted in certain circumstances
5. Helpful safe harbors for insubstantial deviations



# IRS Updates – Audits



- IRS Audit Program
  - Approximately 20 agents (down from a high of 80)
  - IRS closed approximately 577 audits in 2018
- Selection of Bonds for Examination
  - Random
  - Targeted – Excessive costs of issuance (2% limit), “change in use” defeasance, and public safety and jail bonds

# IRS Updates – Audits



## Audit Questions Related to Private Business Use (“PBU”):

1. Provide annual PBU calculations for each year that the bonds have been outstanding
2. Explain how Schedule K (filed with IRS Form 990) PBU numbers were determined
3. Provide list of all bond financed assets
4. Provide copies of all management contracts
5. Provide copies of all research agreements

# Arbitrage Rebate/Yield Restriction



- Reemergence of positive rebate and yield restriction liabilities
  - For the past decade there has been little or no opportunity to invest at rates that create positive arbitrage
  - Changing interest rates are now providing opportunities
  - We are beginning to see rebate liabilities for bond issues that did not meet an exception to rebate
  - In ALL bond audits – the IRS asks for rebate reports and calculations

# SEC 15c2-12 Update



- In August 2018, the SEC amended Rule 15c2-12
- Effective Date: October 30, 2018
- Compliance Date: February 27, 2019

# Two New “Listed Events”



- Amendment includes the addition of the following listed Events:
  - *(15) incurrence of a “financial obligation” of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material.*
  - *(16) default, event of acceleration, termination event, modification of terms or other similar events under a financial obligation of the obligated person, any of which reflect financial difficulties.*

# Financial Obligation



- (i) debt obligation, (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) a guarantee of either (i) or (ii).
- “debt, debt-like, and debt-related obligations” meaning a borrowing of money to be paid back in the future.
- Does not include ordinary financial and operating liabilities incurred in the normal course of business.
- Does not include municipal securities as to which a final official statement has been provided to the MSRB consistent with the Rule.

# Considerations for New Listed Events



- Consult with counsel regarding other potential types of “financial obligations”
- Inventory existing portfolio
- Establish guidelines for reporting new “financial obligations”
- Update Policies and Procedures
- Orrick has assisted issuers with developing individualized policies and procedures that establish guidelines for reporting financial obligations

# Considerations for New Listed Events



*Listed Event (15) - Incurrence of a "financial obligation" of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material*

- An event notice only required for a new, material financial obligation incurred after there is a qualifying CDA.
- A notice is also required if, after a qualifying CDA, there is a material change to an existing financial obligation, whether incurred before or after the qualifying CDA
- There is no simple answer, will depend on facts of the situation



# Considerations for New Listed Events



*Listed Event (16) - Default, event of acceleration, termination event, modification of terms or other similar events under a financial obligation of the obligated person, any of which reflect financial difficulties*

- This event becomes operative and will require reporting of an adverse action immediately upon signed a qualifying CDA, with respect to all of the financial obligations, whether incurred before or after the qualifying CDA. This is why it is imperative to create the inventory of financial obligations and create policies and procedures before signing the first qualifying CDA.

# Using Floating Equity



- IRS Allocation and Accounting Regulations (January 25, 2016)
- Helpful – provides flexibility for dealing with private business use in “mixed use projects”
  - Facilities with governmental/501(c)(3) use AND private business use
  - E.g., university center with food court/bookstore lease to a private party

# Floating Equity



- Floating equity means that any private business use within a mixed use project will be allocated FIRST to “qualified equity” spent on the project, rather than tax-exempt bond proceeds
- Qualified equity = taxable bonds, fund raising and issuer/borrower funds
- Under floating equity, private business use can move from floor to floor, space to space, building to building – provided that bonds and equity finance the same project at the same time.

# Floating Equity



- Things to be aware of when applying floating equity
  - Equity cannot be “frontloaded” or “back-loaded” (e.g., use or lose equity on a yearly basis)
  - Equity cannot float beyond its related “plan of finance”
    - Bonds issued to finance hospital in 1998
    - Bonds and equity applied to finance addition to hospital in 2017
    - No 2017 equity can apply to the 1998 project
  - Annual calculation of PBU is required

# Management Contracts



- Non-employees managing bond financed property
  - Prior guidance – Revenue Procedure 97-13
    - Mechanical rules with a range of contract structures based on term and compensation
  - Current guidance – Revenue Procedure 2017-13
    - Applies principle-based concepts based on control of facility, risk of loss, and who derives the benefits and burdens of bond-financed property

# Management Contracts



- Always need to be on the look-out for whether “management contract” is a lease (who is paying?)
- Benefit of new rules – term of contract can be up to (lesser of) 30 years or 80% of life of assets
- Downside of new rules – more difficult to structure contracts in which the manager is financially at risk to pay all expenses of operation
- Requires more legal analysis – specific requirements regarding control of property

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