POST-ISSUANCE COMPLIANCE WEBINAR

2023 UPDATES

Presented By:
Alan Bond, Amy Kron and Sandee Stallings (BLX)
Ed Oswald (Orrick)
Emily Brock (GFOA)

April 4, 2023

BLX orrick

2023 PIC Workshop – Hybrid Event

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

November 16-17, 2023
1 Hotel West Hollywood & Virtual

Registration opens in mid-May

More details coming soon – http://www.blxgroup.com/picworkshop2023

Discussion Outline

I. Washington Update

II. Rising Interest Rates

   A. Opportunities for Investing Bond Proceeds

   B. Implications for Arbitrage Rebate

III. Discontinuation of LIBOR

IV. IRS Audit of Tax-Exempt Bonds Preparedness

DC UPDATE

Government Finance Officers Association

Emily Swenson Brock
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Federal Policy Director
April 4, 2023

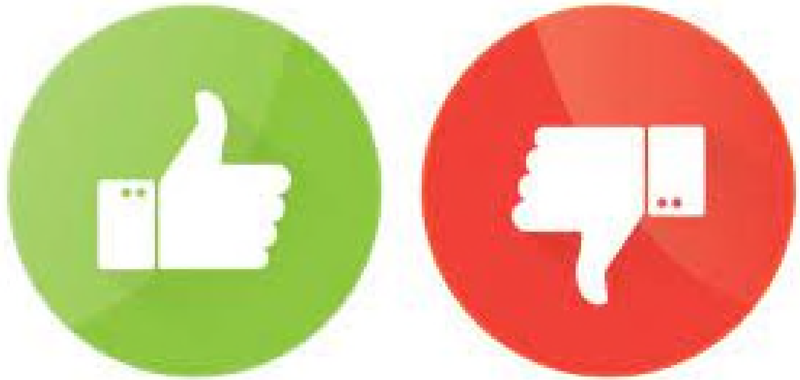
ROADMAP

- 117th Close-out
- 118th Looking forward
- The Inflation Reduction Act
  - And the Climate of Climate
- Ongoing Implementation Efforts
  - IIJA and ARPA

117th Congress Recap

How did it all end?

- Omnibus Spending Deal and Public Finance Priorities
  - What made it in
  - What was left out
  - Future implications
- Financial Data Transparency Act



S. 3011 SLFRF Flexibility

THE UNITED STATES CONFERENCE OF MAYORS — NLC NATIONAL LEAGUE OF CITIES — NACo — ICMA INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION — NATIONAL GOVERNORS ASSOCIATION — NCSL — CSG The Council of State Governments

November 8, 2021

The Honorable Nancy Pelosi
Speaker
United States House of Representatives (CA)
(Sent Via Email)

The Honorable Kevin McCarthy
Republican Leader
United States House of Representatives (CA)
(Sent Via Email)

Dear Speaker Pelosi and Leader McCarthy:

RE: Support for the State, Local, Tribal, and Territorial Fiscal Recovery, Infrastructure, and Disaster Relief Flexibility Act

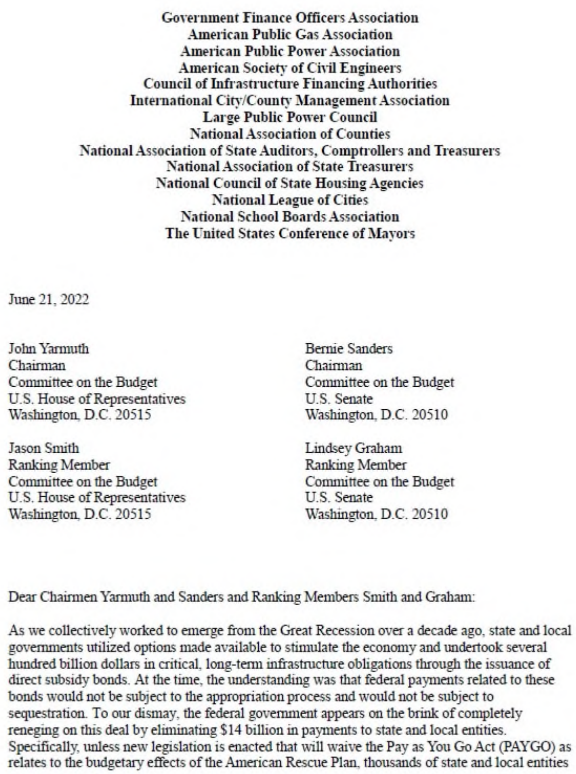
On behalf of the nation's state and local governments, we strongly endorse the bipartisan *State, Local Tribal, and Territorial Fiscal Recovery, Infrastructure, and Disaster Relief Flexibility Act* (S. 3011) – co-sponsored by Senators Alex Padilla (CA) and John Cornyn (TX) – that would provide additional flexibility under the Coronavirus State and Local Fiscal Recovery Funds (CSLFRF) that was included in the American Rescue Plan Act (ARPA). This bill was approved by unanimous consent in the Senate on October 19, and we strongly urge House passage so that the bill can be sent to President Biden for his signature.

Since the enactment of ARPA, we have been working collaboratively with our respective memberships, the White House and the U.S. Department of the Treasury to implement the $350 billion provided under the law. We believe that this new legislation would both streamline and strengthen this historic program in three key ways.

First, it would allow state and local governments to allocate up to $10 million of ARPA funds for the provision of government services without using complicated budgetary analysis to calculate lost revenue, while at the same time retaining the original provision of the law that would allow for a higher amount to be used if justified under Treasury's revenue loss calculator.

Second, it would allow the greater of $10 million or 30 percent of the total ARPA allocation provided to a state or local government to be used under a new, separate provision that further allows infrastructure-related activities authorized

Got BABs??



Government Finance Officers Association
American Public Gas Association
American Public Power Association
American Society of Civil Engineers
Council of Infrastructure Financing Authorities
International City/County Management Association
Large Public Power Council
National Association of Counties
National Association of State Auditors, Comptrollers and Treasurers
National Association of State Treasurers
National Council of State Housing Agencies
National League of Cities
National School Boards Association
The United States Conference of Mayors

June 21, 2022

John Yarmuth
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, D.C. 20515

Bernie Sanders
Chairman
Committee on the Budget
U.S. Senate
Washington, D.C. 20510

Jason Smith
Ranking Member
Committee on the Budget
U.S. House of Representatives
Washington, D.C. 20515

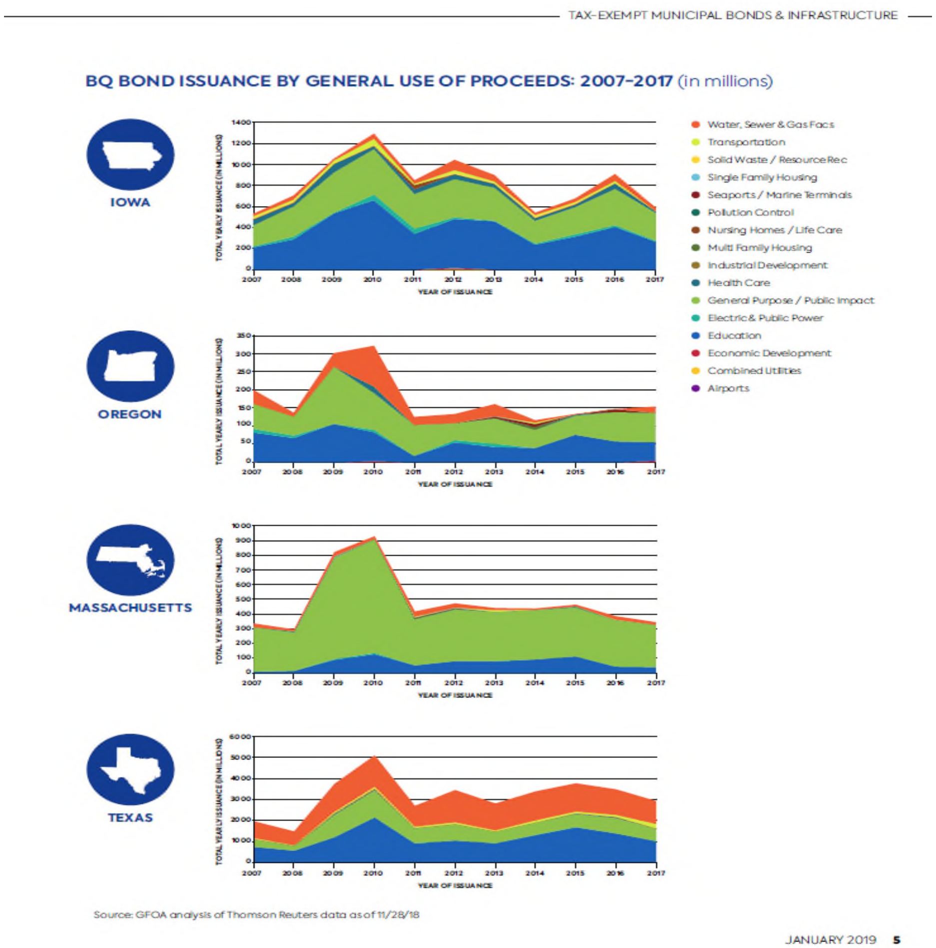
Lindsey Graham
Ranking Member
Committee on the Budget
U.S. Senate
Washington, D.C. 20510

Dear Chairmen Yarmuth and Sanders and Ranking Members Smith and Graham:

As we collectively worked to emerge from the Great Recession over a decade ago, state and local governments utilized options made available to stimulate the economy and undertook several hundred billion dollars in critical, long-term infrastructure obligations through the issuance of direct subsidy bonds. At the time, the understanding was that federal payments related to these bonds would not be subject to the appropriation process and would not be subject to sequestration. To our dismay, the federal government appears on the brink of completely reneging on this deal by eliminating $14 billion in payments to state and local entities. Specifically, unless new legislation is enacted that will waive the Pay as You Go Act (PAYGO) as relates to the budgetary effects of the American Rescue Plan, thousands of state and local entities

- Since 2013, sequestration cuts have reduced BABs payments
- Cuts extended by IIJA through 2031
- ARPA could have initiated additional cuts after end of 117th Session – **PAYGO waived for now**

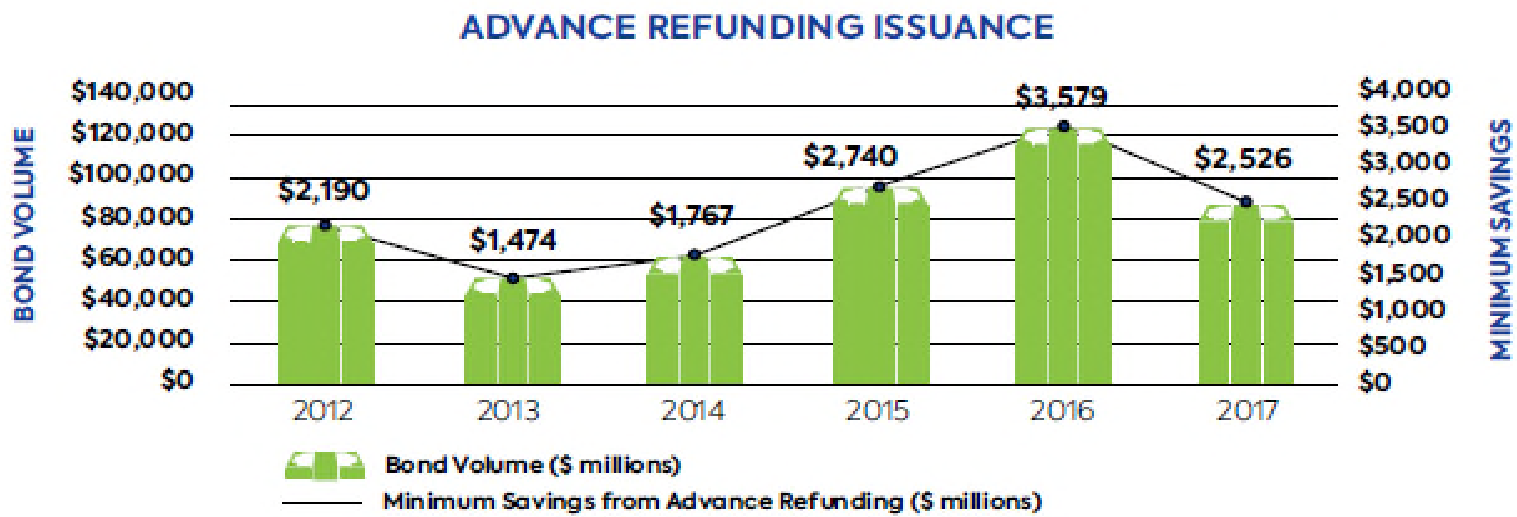
Refresher - Bank Qualified Debt (aka Small Issuer Exception)



- Small Issuer Exception allows smaller jurisdictions working with community banks to issue TE BQ debt
- Right now the cap is \$10m per issuer, we are asking to raise the cap to \$30m, pegged to inflation and based at the level of the borrower
  - Cost- NOMINAL!
- Reintroduce legislation similar to HR 2634 *LIFT Act (117th)*

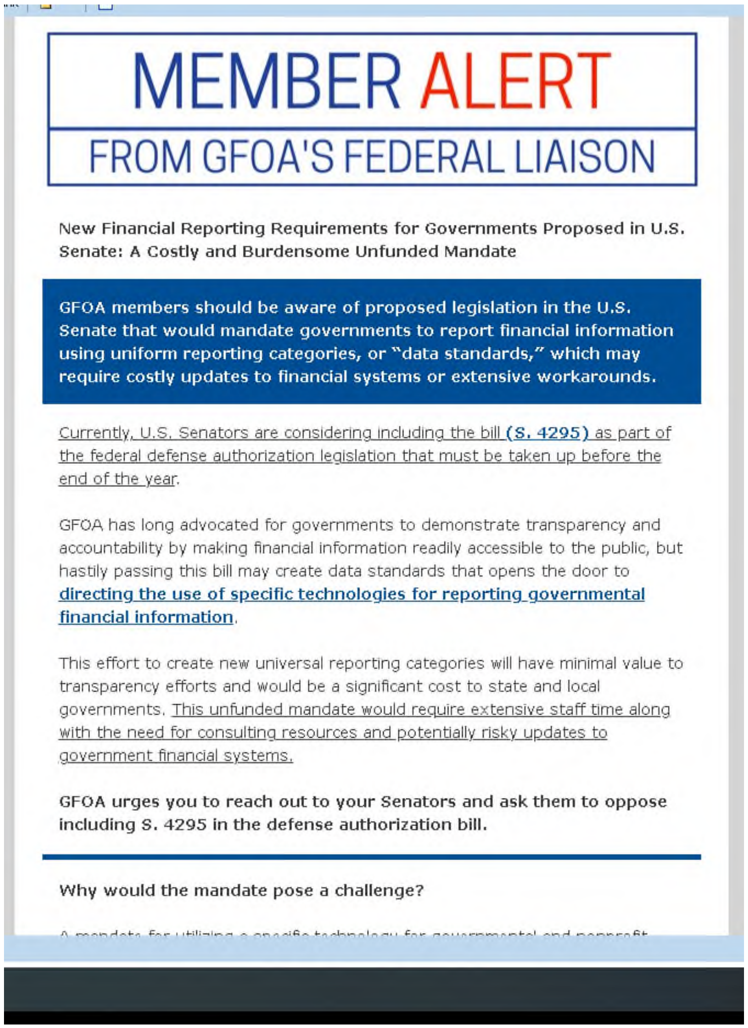
Refresher – Advance Refunding

- Savings of 3-8% of par foregone
- Reintroduce legislation similar to HR 2634 *LIFT Act* (AR, BQ, AIB)
- Reintroduce legislation similar to S479 *LOCAL Infrastructure Act or* HR 2288 *Investing in Our Communities Act* (bipartisan effort with 31 cosponsors from both parties)



Source: GFOA analysis of Thomson Reuters data

MEMBER ALERT


MEMBER ALERT
FROM GFOA'S FEDERAL LIAISON

New Financial Reporting Requirements for Governments Proposed in U.S. Senate: A Costly and Burdensome Unfunded Mandate

GFOA members should be aware of proposed legislation in the U.S. Senate that would mandate governments to report financial information using uniform reporting categories, or "data standards," which may require costly updates to financial systems or extensive workarounds.

Currently, U.S. Senators are considering including the bill (S. 4295) as part of the federal defense authorization legislation that must be taken up before the end of the year.

GFOA has long advocated for governments to demonstrate transparency and accountability by making financial information readily accessible to the public, but hastily passing this bill may create data standards that opens the door to directing the use of specific technologies for reporting governmental financial information.

This effort to create new universal reporting categories will have minimal value to transparency efforts and would be a significant cost to state and local governments. This unfunded mandate would require extensive staff time along with the need for consulting resources and potentially risky updates to government financial systems.

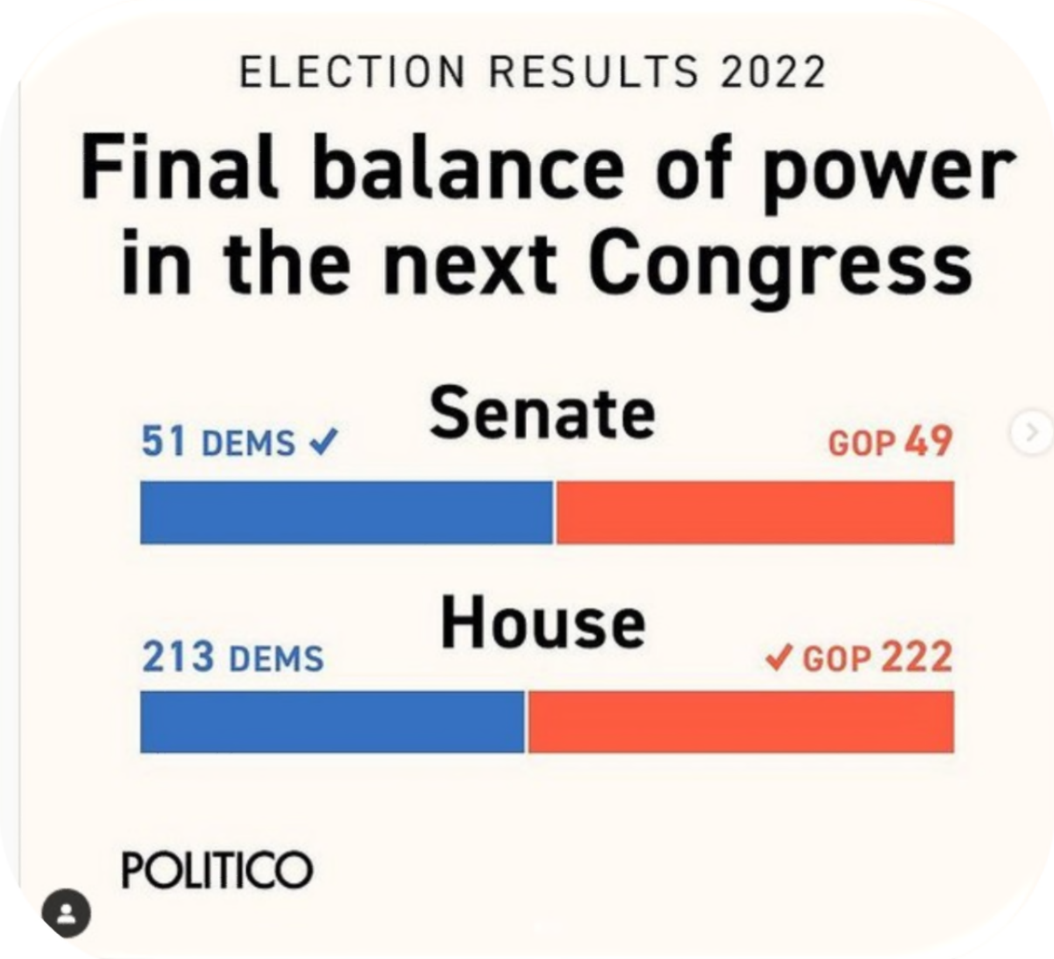
GFOA urges you to reach out to your Senators and ask them to oppose including S. 4295 in the defense authorization bill.

Why would the mandate pose a challenge?

- S4295
  - Establish (New) Data Standards
  - Reporting of Financial Information
- Why unfunded mandate?
  - Identical taxonomies across all types of public entities
  - Reconfiguration of financial systems
  - Implementation of new software
  - Authorizes "joint rulemaking" of entities with no jurisdiction

Looking ahead at the 118th

Midterms – Not What Many Expected



118th Freshmen Class

Change is Coming

- Variety in perspectives and backgrounds
- Turning back the clock
- A lot of "firsts"

New Ways and Means Members

Rep. Mike Carey (OH-15)	Rep. Blake Moore (UT-01)
Rep. Randy Feenstra (IA-04)	Rep. Michelle Steel (CA-45)
Rep. Michelle Fischbach (MN-07)	Rep. Greg Steube (FL-17)
Rep. Brian Fitzpatrick (PA-01)	Rep. Claudia Tenney (NY-24)
Rep. Nicole Malliotakis (NY-11)	Rep. Beth Van Duyne (TX-24)

What's on Tap?

- **New Chairman - Jason Smith (MO-08)**
- **IRS Focus**
- **Child tax credit**
- **Public finance priorities??**

Inflation Reduction Act

IRA: Key Provisions

Tax Provisions

- Deficit Reduction
- Energy Security

Health Care Provisions

- Prescription Drug Pricing Reform
- Affordable Care Act Subsidies

Climate, Energy, and Infrastructure Provisions

- Funding agricultural, environmental and conservation programs

Transportation Related Tax Credits

Commercial Clean Vehicle

- Electrification of police fleet, school buses, garbage trucks, etc.
- Covers upfront purchase

Alternative Fuel Refueling Property

- Installing electric vehicle charging stations and related infrastructure
- Covers upfront installation
- Low-income or

Alternative Fuel Excise Tax Credit

- Purchasing alternative fuel for vehicle fleet
- Covers ongoing purchase of fuel

Production & Investment Tax Credits

Production Tax Credit

- Wind
- Biomass
- Municipal solid waste
- Geothermal
- Hydropower, marine, hydrokinetic energy
- Solar facilities
- Geothermal facilities

BEGIN CONSTRUCTION BY JANUARY 1, 2025

Investment Tax Credit

- Solar
- Fiber-optic
- Fuel cell
- Small wind
- Offshore wind
- Combined heat and power
- Waste energy recovery
- Energy storage technology
- Linear generators
- Microgrid controllers
- Dynamic glass and biogas property

BEGIN CONSTRUCTION BY JANUARY 1, 2025

Direct Payment in Lieu of Tax Credits

- Direct payment in lieu of tax credits will allow tax-exempt entities to pursue renewable energy projects without relying on outside financing.
  - Tax credit claimed after project placed into service
- Projects may be 100% financed with tax-exempt bonds and receive a production tax credit (PTC) or investment tax credit (ITC).
  - If this combined financing is used, the tax credit will be reduced by up to 15%.
- Credits available for tax years beginning after December 31, 2022 and are effective through 2032
- The IRA is BOTH domestic energy and domestic labor (for construction that begins after January 29,2023)

The Climate of Climate in DC

Choose Your Words Carefully!

ESG for Risk-Based Disclosures

- **ESG Risks that have a "nexus to credit"**
- Communicate to investors the risk of default
- Disclosures may be voluntary
- Credit Rating Agency criteria

ESG for Procurement or Investment

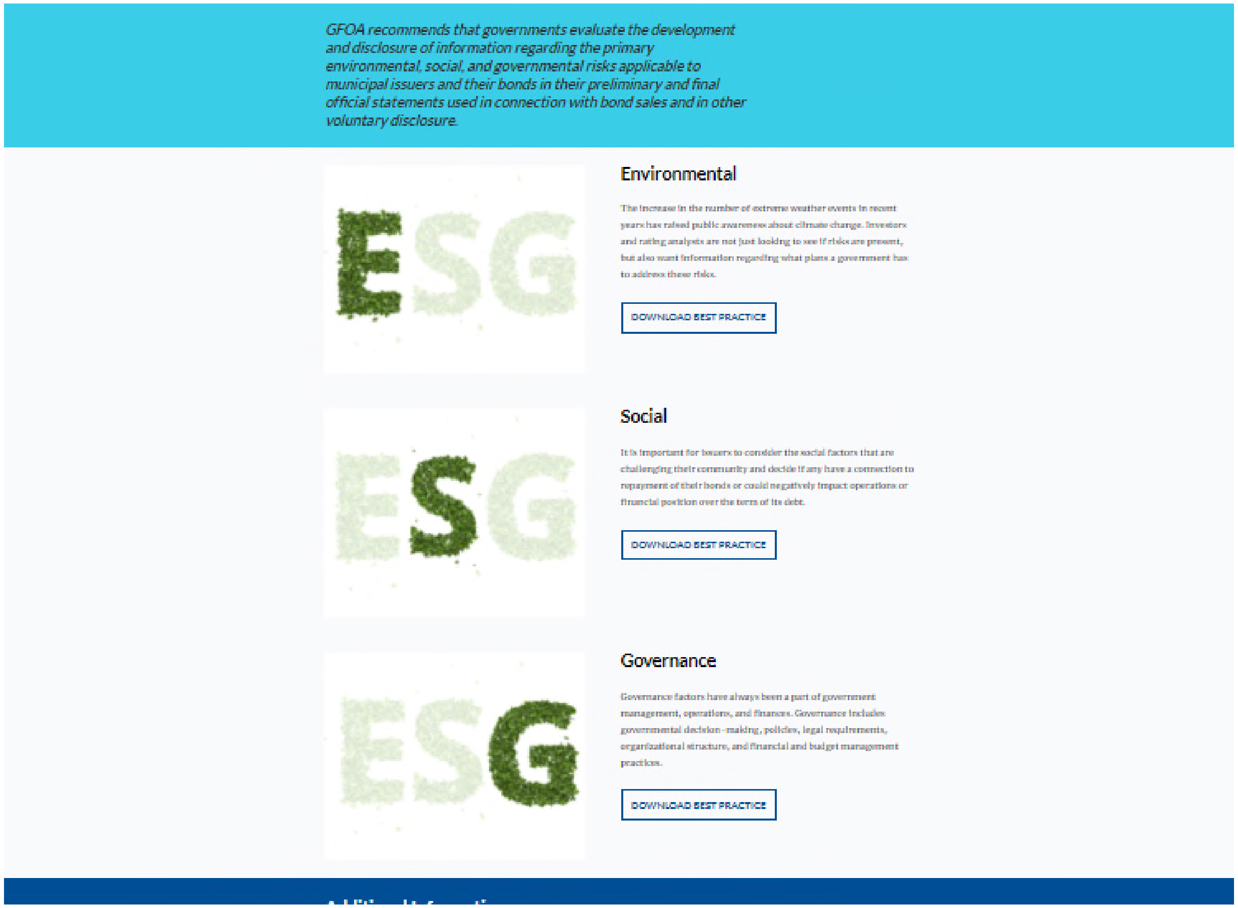
- **Policy-directed or Policy-prohibited guidelines for ESG**
- May play a role in competitive criteria
- Re-prioritizes competitive vs negotiated
- Gensler/SEC very interested

Green Bonds/Social Bonds/Other Labels

- **There's no such thing as an "ESG Bond"**
- Can be taxable or tax-exempt
- Requires specific disclosures in official documents
- May diversify (possibly increase) investor demand

Gfoa.org/esg

- Risk Disclosures Key Points:
  - Nexus to Credit
  - Finance Office must “socialize”
  - Voluntary Disclosures
  - Talk with your Bond Counsel



Ongoing Implementation

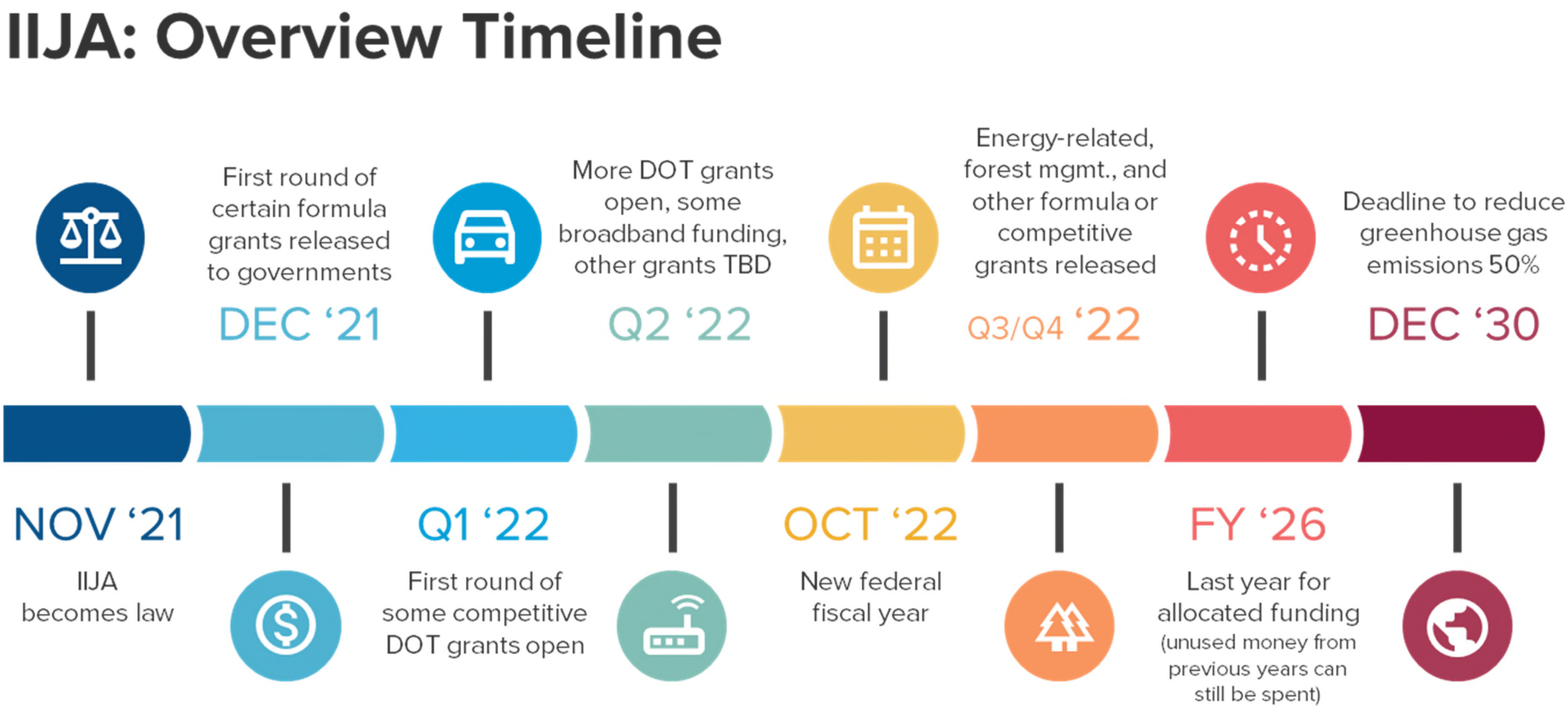
ARPA Update: One Thing is for Certain…

HOUSE COMMITTEE ON

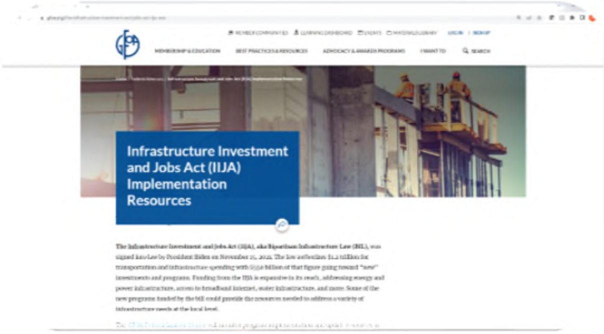
OVERSIGHT

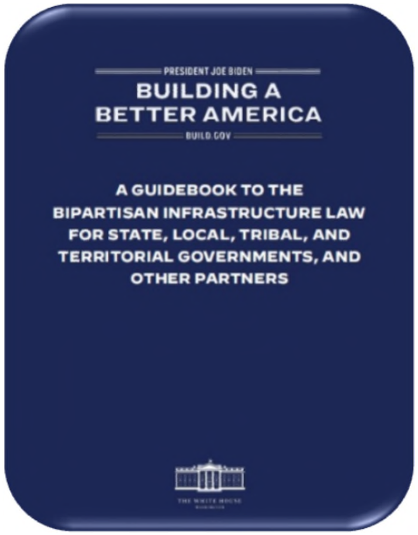
And Government Reform

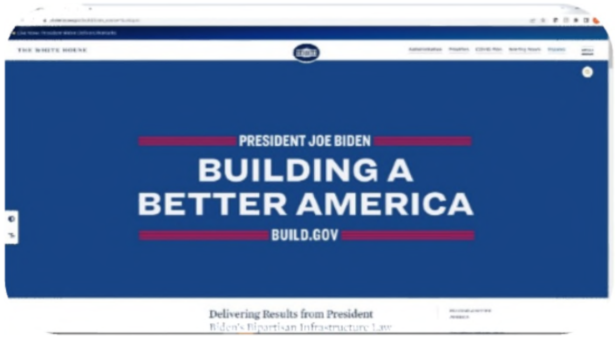
IIJA - Where are we now?



Further Resources (Link in Images)







THANK YOU!

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RISING INTEREST RATES

The Fed and Rising Interest Rates

- Since March 1, 2022:
  - 9 rate hikes, totaling 4.75%
  - Most aggressive pace in more than 15 years
  - Today's rate – 5%, highest since mid-2007
- Impact on the municipal bond market:
  - Bond issuance down 21% in 2022 and 30% YOY average/month in 2023
  - Issuing bonds at a higher rate
  - Investing proceeds at a higher rate
  - Potential for positive arbitrage

Rising Interest Rates

- Opportunities for Investing Bond Proceeds
  - Previously Issued Bonds & New Issues
  - Permitted Investments
  - Investment Options
  - Investment Rate Indications
  - Case Study

Rising Interest Rates

- Previously Issued Bonds & New Issues
  - Consider investment options for bond proceeds taking into consideration:
    - Safety, liquidity & yield
  - Previously Issued Bonds
    - Bond proceeds may be sitting in money market funds
    - Time to re-evaluate investments

Rising Interest Rates

- Previously Issued Bonds & New Issues
  - New Issues
    - Consider investing bond proceeds when issuing the bonds
    - Need to consider arbitrage rebate

Rising Interest Rates

- Permitted Investments
  - Previously issued bonds
    - Bond documents
    - Investment policy
    - Local state statutes
    - Rating agency/bond insurance requirements

Rising Interest Rates

- Permitted Investments
  - New Issues
    - Review Permitted Investments before going to market
    - Things to look for
      - Specific securities language
      - Broad structured products language (allows for market changes)
      - Money market funds / Local pools etc…

Rising Interest Rates

- Common Tax-Exempt Bond Proceeds Investment Options
  - Money market funds
  - Securities
    - US Treasury securities
    - Various US Agency securities
    - Managed portfolio / Buy and hold portfolio

Rising Interest Rates

- Common Tax-Exempt Bond Proceeds Investment Options
  - Structured Products
    - Investment Agreement
    - Repurchase Agreement
    - Forward Delivery Agreement

Rising Interest Rates

Money Market Fund	4.76%

PROJECT FUND	
2 Year Average Life	**Approximate Rate**
Treasuries	4.42%
Investment Agreement	5.15%
Repurchase Agreement	3.90%

* *Rates are for illustration purposes only and subject to change. Rates continuously fluctuate based on economic and market conditions.*

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Rising Interest Rates

RESERVE FUND			
Maturity:	**2 Year**	**5 Year**	**10 Year**
Treasuries	3.98%	3.51%	3.41%
Investment Agreement	4.25 - 4.60%	4.30 - 4.50%	4.20 - 4.40%
Repurchase Agreement	3.85%	3.39%	3.42%

* *Rates are for illustration purposes only and subject to change. Rates continuously fluctuate based on economic and market conditions.*

CASE STUDY: CITY OF ANYTOWN

Rising Interest Rates

- 2021 Issue
- $14 million Reserve Fund
- Arbitrage yield: 2.063%
- First call date: 5/15/2031
- Final maturity date: 5/15/2054
- Current negative arbitrage: $197,053
- Breakeven investment rate: 2.2679% to first call date
  - We were able to bid out to the first call date and get 4.62%

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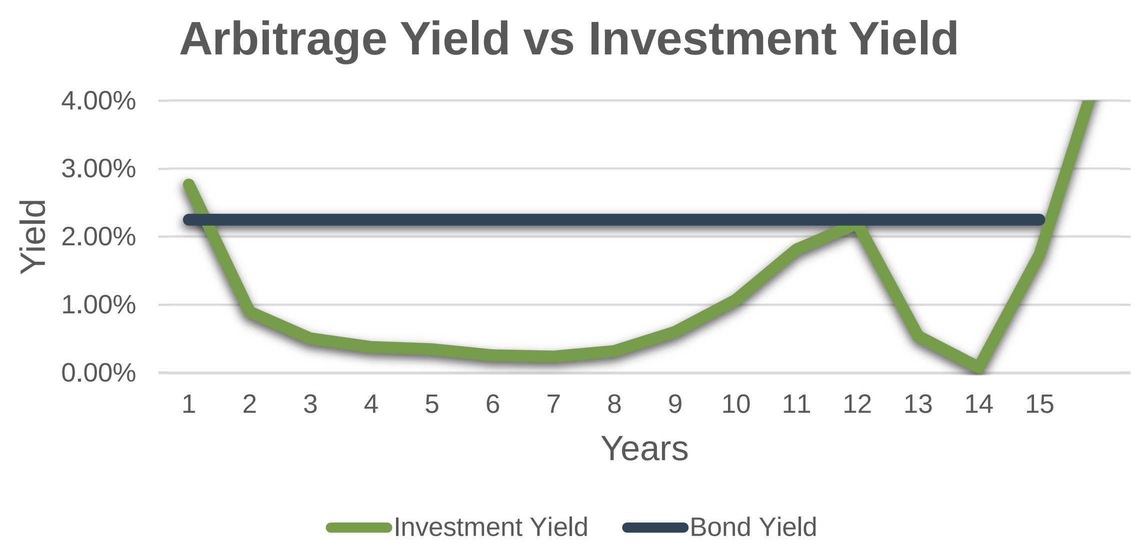
What is Arbitrage?

- Borrow at tax-exempt rates and invest at higher taxable rates without incurring any additional risk
  - Disparity between markets because of federal subsidy
  - Negative arbitrage for over a decade
  - Positive arbitrage NOW and for the foreseeable future
  - Many staffers are not familiar with the requirements / nuances

Historical Trends



Why is the IRS interested?

Tax-exemption of interest seen as a federal subsidy / lost tax revenue

What is the IRS interested in specifically?

Minimizing tax-exempt bonds in the market (and minimize subsidy) by removing an issuer's incentive to…

- Issue <u>more</u> bonds than needed
- Issue bonds <u>sooner</u> than needed
- Keep bonds <u>outstanding longer</u> than needed

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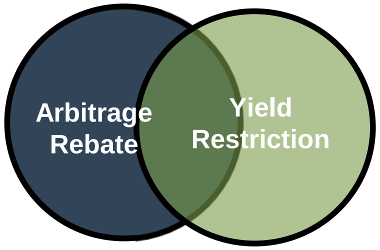
TWO SEPARATE REQUIREMENTS

Arbitrage Rebate & Yield Restriction Compliance



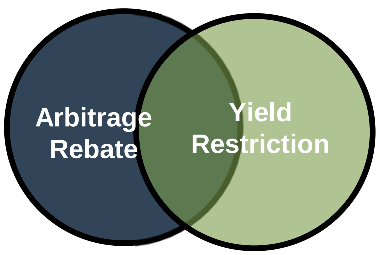
Arbitrage rebate – issuers can achieve compliance by

- Remitting a rebate payment to the IRS
- Cumulative computation required at five-year intervals for the life of the bonds

Yield restriction – issuers can achieve compliance by

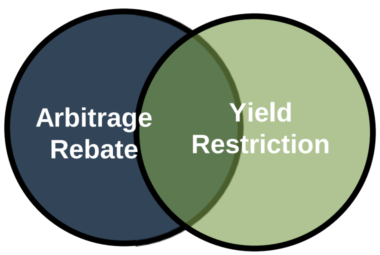
- Investing yield restricted amounts at a yield below the bond yield or…
- Remitting a yield reduction payment to the IRS
- Looks and acts like a rebate payment, but only relates to yield restricted funds

Arbitrage Rebate & Yield Restriction Compliance



- Yield restricted funds are a subset of your proceeds subject to rebate
  - Unexpended project funds after three-year temporary period
  - Amounts in excess of a reasonably required reserve
  - Advance refunding and defeasance escrows

Arbitrage Rebate & Yield Restriction Compliance



- Can owe a yield reduction payment even if no rebate is due
  - Rebate is a five-year, cumulative reporting cycle
  - Yield restricted proceeds can not be blended with unrestricted proceeds
    - Example: Unexpended project proceeds after year three

Monitoring Positive Arbitrage

- Historically low weighted average bond yields on recent issuances
- Watch short term notes and variable rate debt
  - Less than 5 years for computation period
  - Lower arbitrage limit
  - Reissuance (final computation) triggered due to remarketing / restructuring

Monitoring Positive Arbitrage

- Be mindful of reporting cycles and exceptions to the rule
  - Spending exceptions, may require advance planning to meet specific benchmarks
  - Bona fide debt service fund exception
  - Small issuer exception (does not mean exempt from yield restriction or record retention)
- Positive arbitrage is a good thing but need to monitor

DISCONTINUATION OF LIBOR AND AUDIT PREPAREDNESS

Discontinuation of LIBOR

- The END is fast approaching – June 30, 2023
- Level of market preparedness for transition varies considerably
- Issuers/borrowers of LIBOR-based tax-exempt bonds should evaluate whether changes to financing documents are necessary to implement a replacement rate – changes are likely
- New IRS Regulations provide helpful guidance on how to structure replacement rate as a "covered modification"
- Consult with bond counsel before finalizing any changes

IRS Audit Preparedness

- IRS Enforcement Update
  - Impact of IRS staff size changes and COVID-19 lead to fewer total audits in 2020 and 2021
  - The IRS enforcement staff is now growing given new funding
  - Expect more tax-exempt bond audits
  - Audits are technical and time consuming – outside expertise is practically required

IRM PROVISIONS REGARDING TEB HAVE BEEN UPDATED

IRS Audit Preparedness

- Provide more specificity regarding records to reviewed in audits
- Trustee Statements
- General Ledger
  - amount paid;
  - dates paid;
  - payee;
  - purpose
- Inconsistent approach among agents

SELECTION OF BOND FOR EXAMINATION

IRS Audit Preparedness

- Random or Targeted
  - IRS Identifies market segments each year to review
- Referrals from outside the IRS
- Rebate refund and credit payment claims
- Late rebate payments

INFORMATION ROUTINELY REQUESTED

IRS Audit Preparedness

- Management / Service Contracts; Leases
- Research Agreements
- Comprehensive list of bond-financed assets financed by the issue
- Calculation of *annual average private use* %s since the bonds were issued
  - 501(c)(3) borrowers are required to undertake this calculation in Schedule K, filed with IRS 990 Form
  - Copy of the arbitrage rebate analysis

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INFORMATION ROUTINELY REQUESTED

IRS Audit Preparedness

- Description of the status of the bonds and schedule of interest paid
- Full transcript
- Description of the project
- Copies of all trustee statements
- General ledger or other detailed schedule of use of proceeds
- Construction vouchers and requisitions

Contact Information

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