GFOA – Changes in the Municipal Bond Market

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Federal Tax Regulation

- Prop. Reg. 148659-07 (Sept 2013)
  - Issue Price modifications
    - Issue price for sales to the public
      - Who is the public?
        - Related parties sales exception
        - Bonds held for investment exception
      - How to establish issue price
        - Compare credit and payment terms of each bond
        - Actual sales
          - First price test at which substantial amount or safe-harbor is met
          - Sales thresholds to meet safe-harbor are increased from 10% to 25% of each maturity
          - Removal of reasonable expectation standard
          - Removal of definition of "substantial amount"
          - Offering period and orders limitation
          - Effect on marketing and pricing to issuers
    - Yield reduction payment allowance

- Swap accounting modifications
  - Swap Provider certifications
  - Hedge modification rules
    - Offsetting hedges
    - Swap modifications
    - Assignments
    - Refundings of outstanding hedged bonds
      - Termination payments
  - General accounting convenience
- Guarantee Fund Exception
  - Regulatory adoption of existing guidance
  - Public charter schools

- Working Capital Financing
  - Short-term financings
    - Regulatory adoption of 13-months maturity limitations
  - Long-term financing
    - Working capital reserve – 5% test
    - Monitoring of available amounts in each year
      - Testing date questions
    - Retirement of working capital issue or investment in non-AMT municipals as remedial steps
- Taxpayer Reliance on Prop. Regs.

- Arbitrage ("A nickel ain't worth a dime anymore")
  - Arbitrage restrictions on the investment and use on the proceeds of tax-favored bonds.
    - Yield restriction requirement and a rebate requirement.

  - Rebate Requirement Exceptions
    - Spending exceptions (6 months, 18-months, 2 years)
    - Small issuer exception
    - Bona fide debt service funds (with limitations)

  - Yield restriction exceptions to the requirement are provided for the investment of moneys held in:
    - Construction funds during the initial temporary period
    - Reserve fund, subject to certain limitations
    - Bona fide debt service fund (so long as it is expected to be used within one year of receipt to make debt service payments on the bonds)

    - Note: the small issuer exception to arbitrage is not an exception to yield restriction

- Post-Issuance requirements (“It ain't over 'til it's over”)
  - Record Retention Policies
    - Life of the original bonds, or any subsequent refunding bonds, plus 3 years thereafter
  - Voluntary Closing Agreements (“VCAP”)
    - Why entering into a VCAP
      - Remedial actions
    - When entering into a VCAP
    - New submission form
    - Favorable settlement if written procedures
  - IRS Examinations
    - Various types of audits
    - New segment based approach and broader approach

- Post issuance Compliance and Written Procedures

  "Issuers should adopt written procedures, applicable to all bond issues, which go beyond reliance on tax certificates included in bond documents provided at closing. Sole reliance on the closing bond documents may result in procedures insufficiently detailed or not incorporated into an issuer's operations."

  - Why?
    - The goal is to identify and resolve noncompliance on a timely basis to preserve the preferential status of tax-advantaged bonds.
    - Following extensive market studies the IRS has determined that, generally, an issuer that has established and followed comprehensive written procedures is less likely to violate the federal tax requirements related to its bonds than an issuer that does not have such procedures.

  - Written Procedures and tax filings
    - 8038 disclosure of written procedures and reimbursement amounts

- How to follow the money ("If you don't know where you are going, you'll end up someplace else")
- Written procedures basics:
  - Due diligence review at regular intervals;
  - Identifying the official or employee responsible for review;
  - Training of the responsible official/employee;
  - Retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds);
  - Procedures reasonably expected to timely identify noncompliance; and
  - Procedures ensuring that the issuer will take steps to timely correct noncompliance.
- What can you do to ensure that your organization's procedures meet these characteristics?

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