Are You Prepared for Required Post Issuance Compliance After Your Bond Sale?

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Why Continuing Disclosure (CD)?



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Overview of Rule 15c2-12

Municipal Securities are exempt from most securities laws...BUT

While municipal bonds are exempt from most securities laws, they are still subject to anti-fraud regulations, which would cover statements made in official statements and continuing disclosure documents.

Prior to purchasing municipal securities, SEC Rule 15c2-12 (the "Rule" or "15c2-12") requires an underwriter to:

- Obtain an official statement from a local government issuer;
- Review an issuer's secondary disclosure practices at the time of issuance of the new offering of securities; and
- Have the issuer agree to provide certain financial and operating information, as well as notice of certain events, on an ongoing basis as long as the bonds subject to the requirement are outstanding.

The Rule applies if the bonds are publicly offered and do not meet one of the exceptions to the Rule.

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WHAT IS INVOLVED WITH THE CD REQUIREMENT?

Continuing Disclosure Comes in Different Flavors

Full Disclosure: Over $1M in par amount and over $10M in outstanding debt (including the new offering)

- Annual Financial Information/Operating Data
- Audited Financial Statements
- Material Events

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WHAT IS INVOLVED WITH THE CD REQUIREMENT?

Continuing Disclosure Comes in Different Flavors *cont.*

Limited Disclosure: Over $1M in par amount, but less than $10M in outstanding debt (including the new offering)

- Audited Financial Statements
- Material Events

Limited Disclosure: New offering has a stated maturity of 18 months or less

- Material Events

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WHAT IS INVOLVED WITH THE CD REQUIREMENT?

Exemptions from the Rule

- The par amount of the issue is less than $1M
- The securities are issued in denominations of $100,000 or more and are sold to no more than 35 sophisticated investors
- The securities are issued in denominations of $100,000 or more and mature in nine months or less
- The securities were issued prior to July 1, 1995

The exception to the exemptions

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Material Events

1. Principal and interest payment delinquencies
2. Non-payment related defaults, if material
3. Unscheduled draws on debt service reserves reflecting financial difficulties
4. Unscheduled draws on credit enhancements reflecting financial difficulties
5. Substitution of credit or liquidity providers, or their failure to perform
6. Adverse tax opinions or events affecting the tax-exempt status of the security
7. Modification to rights of security holders, if material
8. Bond calls, if material, and tender offers
9. Defeasances
10. Release, substitution or sale of property securing repayment of the securities, if material
11. Rating changes
12. Bankruptcy, insolvency or receivership
13. Merger, acquisition, or sale of all issuer assets, if material
14. Appointment of successor trustee, if material
15. Incurrence of a financial obligation of the issuer or obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the issuer or 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 the terms of the financial obligation of the issuer or obligated person, any of which reflect financial difficulties

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Timeframe for Submission of Secondary Disclosure Documents

- Annual Disclosure: timeframe specified in CD agreement
  - typically 12 months from the issuer or obligor's fiscal year end
  - Sometimes as short as 6 months
- Material Events
  - Required to be filed within ten (10) business days of the occurrence of the event
- Failure to File Notices
  - In a timely manner (as soon as the failure is known)
  - Any CD failures must be reported in official statements for five (5) years

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ALL EYES ON DISCLOSURE

Heightened focus on regulation

- Over the past 20 years, regulatory interest in oversight of the municipal market has grown.
- The Financial Crisis of 2008 brought about a heightened focus on disclosure. The result was more enforcement actions.
- The development of the MSRB's Electronic Municipal Market Access (EMMA) website:
  - Provided more market transparency
  - Allowed for the ability to check compliance with continuing disclosure undertakings.

March 2014 – Municipalities Continuing Disclosure Cooperation Initiative ("MCDC"), a self reporting program designed to address perceived widespread violations of the federal securities laws, was launched.



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WHAT HAPPENED & WHAT'S NEXT

MCDC impacts

- Showed compliance failures were committed by issuers of all types and sizes
- Placed heightened awareness on compliance both from an underwriter and issuer standpoint
- Provided notice that the SEC is monitoring compliance

Post MCDC:

- Stronger focus on written policies and procedures
- SEC enforcement activity in the municipal market likely more frequent and not limited to investigations after default, and may include fines assessed against municipal issuers and officers

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GET READY NOW

Post-issuance policies and procedures

- Consider adopting post-issuance polices/procedures
- If already in place, consider revising policies/procedures
- Consider full disclosure, not just post issuance policies/procedures.
- Make sure the following things are addressed:
  - Who is the compliance team?
  - How will financial obligations be monitored?
  - Does the compliance officer and his/her designee have a sufficient handle on outstanding debt?
  - How will it be determined that a new financial obligation is material?

Share any policies/procedures with your dissemination agent (should allow for input prior to adoption).

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LOOKING AHEAD

Future considerations

Although the SEC has not provided guidance on materiality, any future guidance the SEC provides should be incorporated into any local policies.

The market may develop its own strategies which can be beneficial. Baker Tilly and bond counsel will continue to provide updates to local issuers as they become available.

Make sure to provide future flexibility.

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What is Arbitrage? Is it allowed? Is it a good thing?

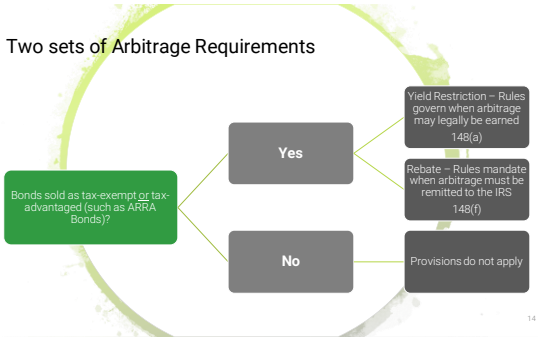
- Arbitrage is basically buying a security in one market and simultaneously selling it in another market at a higher price, profiting from the temporary difference in prices.
- The act of earning arbitrage does NOT make the bonds taxable or "arbitrage bonds."
- It can be a good thing since there are scenarios where excess earnings can be kept and used for the project.

Source: www.investopedia.com

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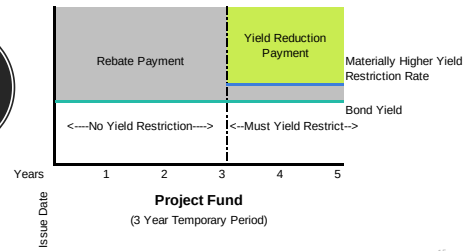
Two sets of Arbitrage Requirements



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Interaction of Yield Restriction and Rebate



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Summary of Temporary Periods

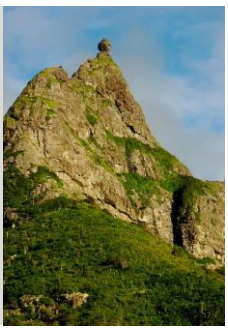
1. Capital Projects	1. 3 Years
2. Current Refunding	2. 90 Days
3. Working Capital	3. 13 Months
4. Replacement Proceeds	4. 30 Days
5. Bona Fide Debt Service Fund	5. 13 Months
6. Investment Proceeds	6. 1 Year
7. Other	7. 30 Days



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What is "materially higher"?

Type of Investment	Materially Higher
1. General rule	1. 1/8 of one percent
2. Refunding Escrow	2. 1/1000 of one percent
3. Replacement Proceeds	3. 1/1000 of one percent
4. Program Investments	4. 1-1/2 percent (1.5%)
5. Qualified Student Loans	5. 2 percent (2%)
6. Investment in tax-exempt bonds, generally (non AMT)	6. No yield limitation



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When can an issuer keep excess earnings on original project proceeds?

Small Issuer Exception

- Governmental issuer
- Sells $5M or less in a calendar year
- For school districts, an additional $10M if used to finance construction of public school facilities (Bonds issued after Jan. 1, 2002)
- No private activity
- 95% or more used for local governmental activities

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When can an issuer keep excess earnings on original project proceeds?

Spending Exceptions

- 6-month
  - For governmental or 501(c)(3), extended to 12 months, if the amount unspent after 6 months does not exceed 5% of proceeds
  - Can apply to any type of tax-exempt bond; only exception available to refunding and working capital issues

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When can an issuer keep excess earnings on original project proceeds?

Spending Exceptions *cont.*

- 18-month
  - Can apply to any type of bond for a capital project
  - Gross proceeds are allocated to expenditures incurred, as follows:
    - 15% within 6 months
    - 60% within 12 months
    - 100% within 18 months

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When can an issuer keep excess earnings on original project proceeds?

Spending Exceptions *cont.*

- 2-year
  - Must be a construction issue (75% for construction)
  - Must finance property to be owned by a governmental entity or 501(c)(3)
  - Available Construction Proceeds (ACP) must be allocated to expenditures incurred, as follows:
    - 10% within 6 months
    - 45% within 12 months
    - 75% within 18 months
    - 100% within 24 months
- De Minimis Rule – Lesser of 3% of Issue Price or $250,000
- Reasonable Retainage – 5% of Net Sale Proceeds

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Debt Service Funds

Under Regulations §1.148-1(b), a bona fide debt service fund is:

- Used primarily to achieve a proper matching of revenues with debt service payments within each bond year AND
- Depleted at least once each bond year except for a reasonable carryover amount not to exceed the greater of (1) the earnings on the fund for the immediately preceding bond year or (2) 1/12th of the principal and interest payments on the issue for the immediately preceding bond year.

A bona fide debt service fund is not subject to yield restriction.

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Debt Service Funds *cont.*

In addition, if the fund is bona fide and any of the following criteria are met, the fund is not subject to rebate.

- Earnings on the fund do not exceed $100,000 for the bond year OR
- Average annual debt service that is not in excess of $2,500,000 OR
- Average maturity greater than 5 years, having rates of interest that do not vary and not comprised of any private activity bonds

Amounts to be used for debt service which are not part of a bona fide debt service fund are subject to the Arbitrage Rules.

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IRS as Regulator

Fiscal Year 2020 Program Letter - Tax Exempt & Governmental Entities (TE/GE)

- IRS is engaged in an ambitious drive to "improve efficiency, modernize its systems and business processes, and find ways to better serve taxpayers."
- IRS is becoming more tech savvy. They will continue to analyze data, including returns and historical information, to identify the areas that present the highest risk of noncompliance.
- For 2020, they will focus on public safety bonds, variable rate bonds and Tax Credit Bonds with sinking funds, such as QSCBs.
- IRS receives referrals from sources within and outside the IRS. They carefully review claims for overpayment of rebate and claims for credit payments on Direct Pay Bonds.
- Interaction could be in the form of education, soft letter, compliance check, correspondence or field examination.

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What is expected of issuers and conduit borrowers?

- **Records:** Code requires records be maintained to support the continued exclusion from gross income of interest on the bonds. Generally, must be retained for 3 years following final redemption date of the bonds. For refunded issues, 3 years after redemption of refunding bonds, if later.
  - Bond Transcript
  - Account activity (revenues, disbursements and earnings) associated with funds that held gross proceeds of the bonds while outstanding (i.e. project, escrow, reserve, bond fund, etc.)
- **Calculation Frequency:** The first calculation date can be set any time up to the 5th bond year; then in 5-year increments. Payments, if any, must be made within 60 days of the calculation date. Early redemption or final maturity also start the 60-day clock.

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Who are these guys?

Fun is good

Arbitrage is good

Arbitrage is Fun

Unpaid or unanticipated liabilities are not fun!

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QUESTIONS

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