
We Issued Bonds - Now What?

Complying with security and tax law requirements after
issuing bonds

October 25, 2013

Foster Pepper PLLC
Seattle, Washington

Presented by:



Presentation

Presented by:



We Issued Bonds – Now What?

Complying with security and tax law requirements after issuing bonds

October 25, 2013

Agenda

- Disclosure Obligations – Nancy Neraas
- Recent Developments in SEC Enforcement Actions - Marc Greenough
- Continuing Disclosure – Lindsay Coates
- Practical Tax Tips - Barbara Jane League and Bill Tonkin

Disclosure Obligations

- Municipalities are not subject to most securities act provisions
- Issuers of securities may not “engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”
- Securities laws govern disclosure for a bond issue, require certain ongoing disclosure and provide certain restrictions after a bond issue

Official Statements

- Prepared for public offerings of municipal securities and contain information material to potential purchasers (“it would affect the investment judgment of a reasonable investor”)
- It is the issuer’s document, although typically prepared by the underwriter or bond counsel
- Beware of stale financial statements and simply relying on the last disclosure document
- Think of any material issues that should be brought to the attention of the finance team
- Both positive and negative information must be included
- SEC expects legislative body to review official statements

Official Statements (cont'd)

- Get internal review by subject matter experts within issuer
- Adopt procedures for senior management to review
- Provide training opportunities
- Consider adopting policies and procedures
- Document compliance with procedures or steps taken

Speaking to the Market

- When issuer provides information that “can reasonably be expected to be relied on by the market,” must ensure the information is not inaccurate or misleading
- Designed to protect holders of securities against misleading information that could impact market price of securities
- Examples of information relied on by the market include audited financial statements, investor presentations, ongoing disclosure, investor websites, financial information, press releases on financial matters
- Insider trading rules apply to municipal securities

Conflicts of Interest

- RCW 42.23.030 prohibits a municipal officer from having a beneficial interest in any contract made by or under supervision of such officer
- Bond ordinance/resolution is a contract
- Council or Board members, Finance Manager, and Managers should avoid purchasing bonds

Municipal Advisor Rules

- Municipal advisors (provide advice to municipalities re: financial products or securities and investment of bond proceeds and escrows) must register with SEC
- Excluded from rules are:
 - Appointed Board members and other public officials acting in official capacity
 - Lawyers providing legal advice
 - Investment advisors except as provided above
 - Underwriters
 - Engineers providing pro-formas, rate studies, etc.

Municipal Advisor Rules (cont'd)

- Underwriters can only give advice on structuring, and timing of and whether to issue securities and products if
 - They are responding to an RFP
 - They have been hired for a specific securities issuance
 - They (1) have confirmation that issuer has a municipal advisor providing advice with respect to same aspects of the product or security, (2) receive written confirmation that issuer will rely on municipal advisor, (3) provide issuer written disclosure that they are not an advisor and have no fiduciary responsibility to issuer

Securities Law

- Rule 15c2-12
 - Official Statement
 - Continuing disclosure
- Rule 10b-5:
 - Full and fair disclosure

Rule 10b-5

Unlawful, in connection with the purchase or sale of securities in interstate commerce

- (a) to employ any device, scheme, or artifice to defraud,
- (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

Recent SEC Enforcement Actions

- Increased initial and continuing disclosure
- Protection of individual investors
- Regulation of state and local government issuers
- Enforcement in the absence of defaults

Case Study: New Jersey

- No written policies for offering documents
- One-time use of mark-to-market and subsequent use of five-year smoothing not disclosed
- From 2002 to 2007, UAAL grew to \$17 billion (over 100% of covered payroll)

Case Study: Illinois

- No disclosure procedures
- Pension schedule inadequate to amortize UAAL
- Failed to disclose effect of pension holidays

Case Study: Harrisburg

- Near bankrupt and under state receivership
- No continuing disclosure: information vacuum
- Statements in budget and financial reports

Case Study: South Miami

- Tax-exempt bond-financed public/private parking
- Subsequent revisions to lease violated tax law
- No procedures to ensure continuing compliance

Case Study: West Clark Community Schools

- OS: in compliance with prior 15c2-12 undertakings
- No diligence to uncover noncompliance
- Underwriter also charged

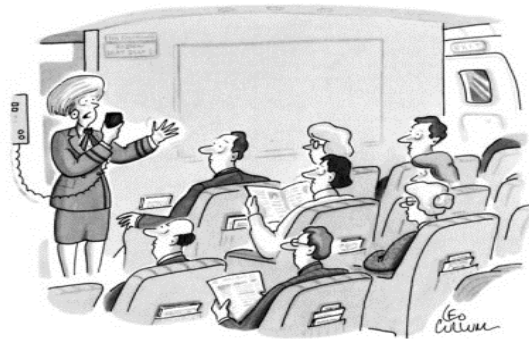
Case Study: Miami

- Failed to disclose transfers of restricted funds
- Violated previous order

Disclosure of General Obligation Credit

- General Obligation Bonds
 - Unlimited Tax General Obligation (UTGO)
 - Voter-approved
 - Limited Tax General Obligation (LTGO)
 - Non-voted (commissioner bonds)

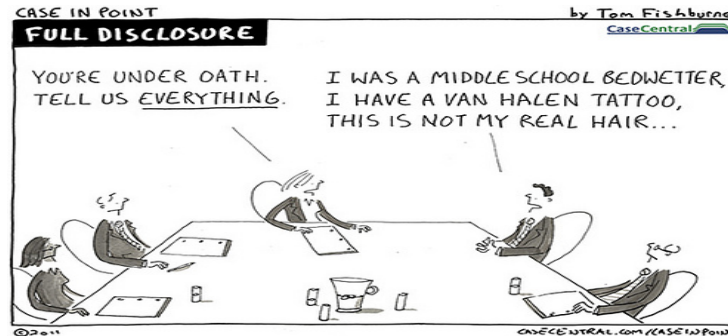
Disclosure of Bankruptcy Matters



"Ladies and gentlemen, is there a bankruptcy attorney on board?"

Recommendations

- Adopt disclosure procedures
- Designate responsible individual



20

Continuing Disclosure

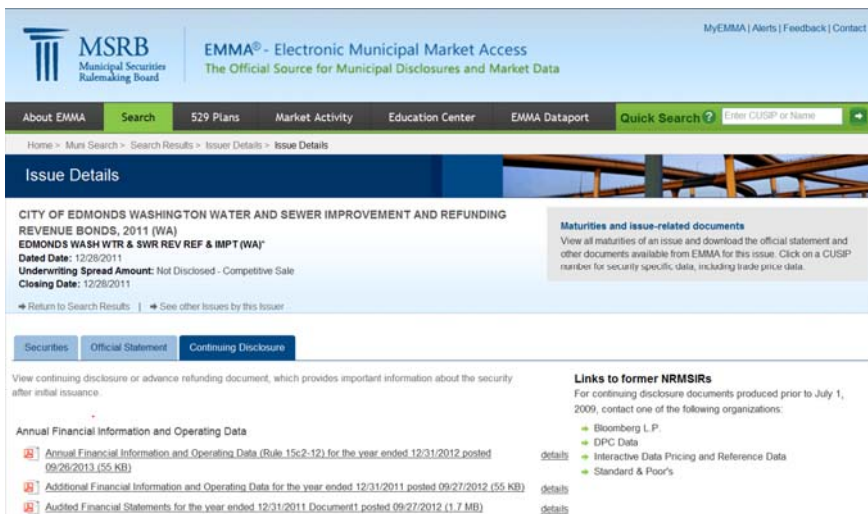
- SEC Rule 15c2-12 "Undertaking"
 - An agreement with the underwriter to periodically report certain information and material events
 - Obligation set forth in bond ordinance/resolution or certificate when bonds are issued
- Exceptions:
 - Issues less than \$1 million
 - Maturities less than 9 months
 - Certain private placements

21

Continuing Disclosure (cont.)

- Issuer or Obligated Person
 - Someone committed to support debt service payments
- Required Information
 - Financial information and operating data
 - Within specified period after fiscal year end (often 9 months)
 - Audited financials once available
 - Timely notice of listed events, if material (timely in generally 10 days)

Continuing Disclosure (cont.)



MSRB Municipal Securities Rulemaking Board

EMMA® - Electronic Municipal Market Access
The Official Source for Municipal Disclosures and Market Data

MyEMMA | Alerts | Feedback | Contact

About EMMA Search 529 Plans Market Activity Education Center EMMA Dataport Quick Search? Enter CUSIP or Name

Home > Muni Search > Search Results > Issuer Details > Issue Details

Issue Details

CITY OF EDMONDS WASHINGTON WATER AND SEWER IMPROVEMENT AND REFUNDING REVENUE BONDS, 2011 (WA)
EDMONDS WASH WTR & SWR REV REF & IMPT (WA)
Dated Date: 12/28/2011
Underwriting Spread Amount: Not Disclosed - Competitive Sale
Closing Date: 12/28/2011

Return to Search Results | See other issues by this issuer

Securities Official Statement **Continuing Disclosure**

View continuing disclosure or advance refunding document, which provides important information about the security after initial issuance.

Annual Financial Information and Operating Data

- Annual Financial Information and Operating Data (Rule 15c2-12) for the year ended 12/31/2012 posted 09/28/2013 (55 KB) [details](#)
- Additional Financial Information and Operating Data for the year ended 12/31/2011 posted 09/27/2012 (55 KB) [details](#)
- Audited Financial Statements for the year ended 12/31/2011 Document1 posted 09/27/2012 (1.7 MB) [details](#)

Maturities and issue-related documents
View all maturities of an issue and download the official statement and other documents available from EMMA for this issue. Click on a CUSIP number for security specific data, including trade price data.

Links to former NRMISRs
For continuing disclosure documents produced prior to July 1, 2009, contact one of the following organizations:

- Bloomberg L.P.
- DPC Data
- Interactive Data Pricing and Reference Data
- Standard & Poor's

Continuing Disclosure (cont.)

- Heightened Attention
 - SEC enforcement actions/Increase in underwriter due diligence
 - Failure to comply can result in inability to issue bonds and securities violation
- Compliance Tools and Practices
 - Make sure employee's job description includes obligations to comply with continuing disclosure
 - Sign-up for the EMMA email reminder
 - Include all required information in CAFR/financial statements

Tax Discussion Topics

- Practical Tips for Complying with Arbitrage and Rebate
- Tracking Private Use
- Post Issuance Compliance Procedures

Practical Tax Tips

Tip #1

- Make someone responsible for compliance
- Put it in a job description

Arbitrage and Rebate

- Arbitrage and Rebate rules apply to:
 - Earnings on investments of bond proceeds prior to being spent, and
 - Earnings on investments of certain revenues set aside to pay bonds

Arbitrage and Rebate

- Arbitrage and Rebate rules
 - Limit the amount that can be earned in excess of the arbitrage yield (yield restriction)

OR

- Make the issuer pay some of the earnings in excess of the arbitrage yield to the federal government (rebate)

Arbitrage and Rebate

Tip #2

- You do not have to worry about the yield restriction or rebate if you can show that you did not invest above the bond's arbitrage yield
- *In other words, don't hire a rebate consultant*

Arbitrage and Rebate

- Rules are applied to each pot of money separately
- Most common pots of money
 - Project Funds
 - Debt Service Funds
 - Reserve Funds
 - Refunding Escrows (Advance Refundings Only)

Arbitrage and Rebate

Tip #3

- Know how to avoid yield restriction and rebate for each pot of money

Arbitrage and Rebate

Pot of Money	How to Avoid Yield Restriction	How to Avoid Rebate
Project Fund	Do Not Overissue and Spend Quickly	Do Not Overissue and Spend Quickly Note – May run into “hedge bond” issues if don’t expect to spend 85% in 3 years
Debt Service Fund	Do Not Overfund	Do Not Overfund
Reserve Fund	Do Not Overfund	<i><u>Subject to Rebate - unless small issuer exception is met</u></i>
Advance Refunding Escrow	Invest in SLGs or bid Treasuries	Invest in SLGs or bid Treasuries

Arbitrage and Rebate

- Project Funds
 - Yield Restriction – Avoid by (1) reasonably expecting on date of issue to spend 85% of bond proceeds within 3 years and (2) entering into binding contract within 6 months after issue date to spend 5%
 - Rebate – Avoid by meeting a spending exception: 2 years, 18 months or 6 months
 - Use “official intent declaration” for reimbursement, so bond proceeds are treated as spent when reimbursed
 - Must reimburse within 18 months after later of (i) date expenditure paid or (ii) date project placed in service – but not more than 3 years after expenditure paid
 - Declaration must be in proper form – call bond counsel

Arbitrage and Rebate

Tip #4

- Do not issue more bonds than you can spend in three years
 - This may not get you out of rebate, but it will keep your bonds from becoming taxable due to overissuance

Arbitrage and Rebate

Tip #5

- Clean out your debt service fund every year
 - Call bond counsel if you have not been doing this

Arbitrage and Rebate

Pot of Money	How to Avoid Yield Restriction	How to Avoid Rebate
Project Fund	Do Not Overissue and Spend Quickly	Do Not Overissue and Spend Quickly
Debt Service Fund	Do Not Overfund	Do Not Overfund
Reserve Fund	Do Not Overfund	<i>Almost Always Subject to Rebate</i>
Advance Refunding Escrow	Invest in SLGs or bid Treasuries	Invest in SLGs or bid Treasuries

Tracking Private Business Use

- Private use rules limit the use of bond-financed facilities by private business users
- Examples of arrangements that can result in private use include:
 - Leases
 - Management Contracts
 - Cell Tower Leases
 - Naming Rights
 - Service Contracts
 - Preferential Rates
 - Rights of first refusal
 - Ownership by nongovernmental person
 - Loans to nongovernmental persons

Management Contracts

- Revenue Procedure 97-13 provides safe harbors for management/service contracts which, if met, means that contract will not result in private business use
 - Periodic Fixed Fee Contracts – 95%, 80% and 50%
 - Per Unit Contracts
 - Percentage of Revenue Contracts
- For all safe harbors, compensation must be reasonable and not based on net profits
- Educate your local attorney about these restrictions and call bond counsel

38

Tracking Private Business Use

Tip #6

- Follow the Golden Rules for tracking private business use

39

Tracking Private Business Use

Golden Rules for Tracking Private Use

Make someone responsible for tracking private use

Involve "operating" departments ("users") and counsel who may be involved in agreements with private parties for use of facilities

Provide training for the responsible person

Follow your post issuance compliance policy

Call bond counsel if you are not sure – It's free!

Take advantage of remedial action rules, if necessary

40

Post Issuance Compliance Procedures



- IRS wants issuers to have written procedures providing for:
 - Due diligence review at specified regular intervals
 - Identification and training of employees responsible for review
 - Retention of adequate records to substantiate compliance
 - Procedures reasonably expected to identify and correct noncompliance in a timely matter

41

Post Issuance Compliance Procedures



- Newest IRS Guidance
 - Wants due diligence review done at least annually
 - Adopting and following written procedures helps you get most favorable settlement possible if something goes wrong with your bonds
 - Penalty is measured from date of discovery, rather than issue date
 - Adopting written policies and failing to follow them is not good

Post Issuance Compliance Procedures

Tip #7

- Follow the Golden Rules for Post Issuance Compliance Policies

Post Issuance Compliance Procedures

Golden Rules for Post Issuance Compliance Procedures

Adopt a written post issuance compliance policy

Make someone responsible for implementing

Provide training for the responsible person

Call bond counsel if you are not sure – It's free!

Summary

- **Arbitrage and Rebate**
 - Adopt procedures and make someone responsible for following them
 - Don't worry if you can't invest above the arbitrage yield
 - Know the rules for the various pots of money
 - Do not issue more than you can spend in three years
 - Clean out your debt service fund each year
- **Private Use Tracking and Post Issuance Compliance Procedures**
 - Adopt procedures and make someone responsible for following them
 - Train that person

Questions?



46

 FOSTER PEPPER LLP

 FOSTER PEPPER LLP

We Issued Bonds – Now What?

Complying with security and tax law requirements after issuing bonds

October 25, 2013

Speaker Bios

Presented by:



FOSTER PEPPER LLC

Nancy Neraas



Member, Seattle
206.447.6277
neran@foster.com

Nancy has more than 25 years of experience as bond counsel for cities, counties, and special districts (public utility districts, water, sewer, park, school, and fire protection) in Washington and other states on municipal financings, including general obligation bonds, revenue bonds and special assessment district financings. Nancy has worked on numerous electric utility financings for various cities, public utility districts, and other special districts. Nancy is disclosure counsel for many issuers, including the State of Washington.

Professional Background

- Foster Pepper PLLC, Member, 2009-Present
- K&L Gates LLP, Partner, 1984-2009

Marc Greenough



Member, Seattle
206.447.7888
greem@foster.com

Marc is a member of the firm's Municipal Government and Public Finance practices and serves as bond counsel, underwriters' counsel, and disclosure counsel on general obligation, revenue, and special obligation financings by state, local, and tribal governments. In addition, Marc has extensive experience in structuring municipal and public/private ventures and in providing representation in administrative proceedings and litigation.

Professional Background

- Foster Pepper PLLC
 - Member, 2005-Present
 - Associate, 1997-2001
- Orrick, Herrington & Sutcliffe LLP, 2001-2005
- Seattle City Council, Legislative Analyst, 1994-1997
- Morgan Stanley & Co. Incorporated, 1986-1990
- Nippon Kokan K.K., 1984-1986

Lindsay Coates



Associate, Seattle
206.447.

coatl@foster.com

Lindsay focuses her practice on municipal and public finance law, including general municipal issues pertaining to state and local governments, public authorities, civil service, and public employment. She also supports various aspects of clients' public finance transactions and participates in a wide range of roles, including bond counsel, underwriter's counsel, and borrower's counsel. Prior to obtaining her law degree, Lindsay brokered directors' and officers' liability insurance on behalf of publicly traded and complex private companies.

Lindsay received her J.D. from Seattle University School of Law (*summa cum laude*) in 2009.

Professional Background

- Foster Pepper PLLC
 - Associate, 2010-Present
 - Summer Associate, 2008
- U.S. District Court, Western District of Washington, Hon. James L. Robart, Extern, 2008
- Federal Trade Commission, Summer Law Clerk, 2007
- Marsh & McLennan Companies, Inc., Assistant Vice President/Client Advisor, 2002-2006

Barbara Jane League



Of Counsel, Seattle
206.447.6217

leagb@foster.com

Barbara Jane League is Of Counsel to the firm and represents municipal and nonprofit clients on a variety of municipal tax, federal tax law and public finance matters. Formerly an attorney with the Chief Counsel of the Internal Revenue Service, Barbara has represented clients before the IRS in a variety of matters including audits, employment tax issues, lien/levy situations, private letter ruling requests, exemption applications and payment agreements. Barbara was also a municipal tax lawyer at Preston Gates & Ellis.

Professional Background

- Foster Pepper PLLC, Of Counsel, 2013-Present
- Barbara Jane League, P.A. (Jacksonville, FL), President and Managing Attorney, 2004-2012
- Title Solutions of America (Jacksonville, FL), Owner, 2008-2010
- Preston Gates & Ellis LLP (Portland, OR), Senior Associate, 2000-2004
- Office of Chief Counsel, Internal Revenue Service (Washington, D.C.), Docket Attorney, 1998-2000
- Spilman, Thomas & Battle, PLLC (Charleston, WV), Associate Attorney, 1997

William Tonkin



Member, Seattle
206.447.8967
tonkw@foster.com

Bill's practice is focused on public finance, specializing in federal tax requirements and restrictions, including arbitrage and arbitrage rebate requirements, applicable to all kinds of tax-exempt obligations, including state and local bonds, qualified 501(c)(3) bonds, qualified small issue (industrial development) and exempt facility bonds. He has extensive experience in general business and corporate area emphasizing federal taxation and securities regulation.

Professional Background

- Foster Pepper PLLC
 - Member, 1976-Present
 - Associate, 1969-1976
- Idaho Supreme Court, Justice McQuade (Boise, ID) Law Clerk, 1968-1969