



# **Best Practices for Post Issuance Compliance**

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# **Best Practices for Post Issuance Compliance**

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# Presentation Overview

- Preclosing Activities
- Post Issuance Compliance
- Preparing for IRS Audit
- Summary & Concluding Comments



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# Pre-Closing Activities

## “Get your Ducks in a Row”



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# Managing the Documents

- Pre-Debt Issuance
  - Use of web-based applications for document distribution
  - Making primary disclosure documents available to all
  - Understanding Business Terms
  - Develop procedures to ensure appropriate disclosure in the Official Statement or other offering documents
- Post Debt Issuance Record Retention
  - Tracking Compliance (Regulatory and Bond Covenants)
  - Budgeting and Accounting
  - Review continuing disclosure obligations and develop procedures to ensure timely filings



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# Document Review – Tax Certificate and Form 8038

- *Don't view as closing certificate*
- Review early in process, ensure consistency
- Lack of project specificity can be a **red flag** during IRS audit
- Understand the document; ask questions
- What is your bond year and why do you care?
- Do you have annual calculation requirements?
- What representations are being made regarding --
  - Project, Use of funds, Spend-down of proceeds and Yield Restriction



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# Understand YOUR Responsibilities in Closing Process

- Have you, as issuer, designated a closing coordinator?
- Does the issuer need to wire funds to the Trustee?
- Is an issuer representative expected at the preclosing/closing?
- Are funds being wired to the Issuer?
- Final reports/documentation/certificates of issuer?



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# Plan for Executing Documents & Providing Certificates

- Designate a closing coordinator to interface with bond counsel
- Require bond counsel to send packet of draft closing certificates and documents in advance of execution for internal review
- Ensure that your authorized representatives are available to execute documents



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# Provide Instructions for Initial Investment of Funds

- Obtain Projected Cash Flow and Encumbrance Schedules from project managers
- Bid Investment Agreements or purchase of securities as needed
- Develop process for monitoring balances in trustee held accounts
- Actively monitor construction activities
- Develop procedures for reinvestment of bond proceeds



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# Post-Issuance Compliance Activities

*“Where have all my Friends Gone?”*



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# Trustee Oversight and Management

- Use technology to your advantage
- Get online access from day of closing
- Online reporting reduces paper
- Methodology for monitoring activity



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# Budget Actions – “You’ve got to Pay it Back”

- Annual budget actions necessary to appropriate debt service and related payments
- Who in your organization is responsible for debt repayment activities
- How are reserve fund earnings treated?
- How are you going to annually “clean out” your debt service payment funds



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# Debt Service Payments

- Identify responsible unit(s) for debt service activities
- Require Trustee/Fiscal Agent to send debt service invoice
- Ensure sufficient time for internal wire/check processing
- Work with investment/cash management staff, debt service critical component of any cash flow analysis



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# Budgeting Variable Rate Debt

- Create a methodology
- Involves a programmatic budgetary trade-offs
- Assume average rate in effect through next budget period
- Objective: minimize programmatic impact by making a reasonable interest rate assumption
- Annual debt service = principal x interest rate
  - Future interest rates are unknown for variable rate debt



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# Post-Issuance Compliance Checklist Highlights

- Tax Law Requirements
  - General Matters
  - Use of Proceeds
  - Private Activity Bonds
  - Arbitrage
  - Pool Bonds
  - Record Retention
- Disclosure Requirements
  - SEC Rule 15c2-12
  - Use of EMMA commenced July 1, 2009
  - Notification to Underwriters of Bonds
  - Info Requirements to Other Entities



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# Post-Issuance Compliance Checklist Highlights

- Miscellaneous Requirements
  - Security
  - Insurance
  - Financial Covenants
  - Transfer of Property
  - Investments
  - Derivatives

Copy of checklist can be found on GFOA website



<http://www.gfoa.org/downloads/PostIssuanceCompliance.pdf>

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# Disbursement of Bond Proceeds

- Establish Procedures for Disbursement of Bond Proceeds and Train Staff
  - Project staff
  - Finance staff
- Understand eligible expenditures
  - Working capital limits
  - Private Activity limits/restrictions
  - Use of proceeds
  - Develop procedures for allocation expenditures of bond proceeds to Projects



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# Record Retention

- Establish Record Retention Requirements and Procedures
- IRS record retention requirements
- IRS Website
  - <http://www.irs.gov/taxexemptbond/index.html>
  - FAQ's -- Record Retention Requirements  
[www.irs.gov/taxexemptbond/article/0,,id=134435,00.html](http://www.irs.gov/taxexemptbond/article/0,,id=134435,00.html)



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# Investment of Bond Proceeds

- Principals of good investment management and understanding of inherent risks in investing bond proceeds critical
  - Establish good guidelines for permitted investments to reduce credit risk – **SAFETY**
  - Good cash flow estimates mitigate market risk – **LIQUIDITY**
  - Integration of knowledge of expected and future market conditions with other cash flows to reduce opportunity risk – **YIELD**



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# Investment of Bond Proceeds

- Initial investment – generally "*easier part*"
  - Project cash flows
  - Capitalized Interest
  - Debt Service Reserve Fund
  - Cost of Issuance
- Reinvestment – generally "*really hard part*"
  - Develop process to monitor and make reinvestment decisions
  - Use of cash flow expectations v. reality



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# Arbitrage Rebate Compliance Activities

- Internal monitoring of rebate compliance
- Recommend annual calculations during construction period
- Paying rebate is not bad, just need to monitor and pay as required
- Pay attention to requirements in Tax/Arbitrage Certificate **BEFORE** you sign!



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# Bond Covenants and Agreements Compliance

- Develop internal tickler system from beginning
- Keep up-to-date
- Don't reinvent the wheel with every deal; similar reporting requirements are okay and always preferred
- Keep as simple as possible
  - Consider providing multiple parties to deal the same compliance reports



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# Credit/Liquidity Provider Administration

- Ultimate Credit - Determines Ratings
- Bond Insurance Premium
  - Up-front vs. Periodic Payment
- Prompt Invoice Payment for Liquidity Facilities
- Track expiration dates
- Research extension terms and fees to current market conditions; take into account internal costs
- Remarketing Agent/CP Dealer Key Player



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# Continuing Disclosure and Annual Reporting

- Designate key contact for disclosure decisions
- Contents of Annual Report
- EMMA commenced July 1, 2009  
(<http://emma.msrb.org/>)
- Create universal e-mail address for reporting and noticing
  - Example: [debt.management@sanjoseca.gov](mailto:debt.management@sanjoseca.gov)



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# Bond Call Redemption Management

- Follow Provisions in Indenture
- Track Source of Funds
- Principal Reductions
  - Reserve Requirement
  - Basis for administrative invoices



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# Budget Preparation and Monitoring

- Annual Budgeting for Debt Service
- Budgeting for Variable Rate Debt
- Gross v. Net Debt Service
- Process for “cleaning out” debt service accounts at issuer level



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# Annual Audit Activities

- Get CAFR in electronic form for Annual Disclosure Requirements
  - Native, word searchable PDF will be EMMA requirement
  - Make it a requirement of printer or auditor
- Work closely with Accounting Staff
  - Prepare appropriate Notes to Financial Statements
  - Keep data centralized
  - Report consistently same information in all financial/budget reports
  - Keep good records on source of data and calculation methods



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# Bond Project Monitoring

- Critical to complete reinvestment activities
- Active involvement with project staff
- Review project encumbrance and expenditure needs
- Understand project delays



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# Active Bond Proceeds Disbursement Review

- Reimbursement or Trustee Disbursement
  - Contractor payments
  - City costs/reimbursements
- Investment Liquidity in Construction Fund
  - Monitor security maturities
  - LAIF – rolling 30 day draw window
- Requisition
  - Sufficient detail to show qualified expenditures
  - Accuracy of expenditures and requisitions
  - Record Retention



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# Bond Project Monitoring – Facility Use

- Maintain records of facility use
  - See Record Retention Requirements
- Review all agreements for facility use
  - Potential impact on tax-exemption
- Everything must be reviewed by bond/tax counsel
  - Solar panels on roof top or cellular phone receiver on roof top could negatively impact tax-exemption
  - Operator Agreements for facilities can also impact tax-exemption



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# Contract Management – Consultants & Service Providers

- Establish Contract Procedures
- Track Payments and Encumbrances
- Contract Payment Process



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# Refunding Analysis

- Part of overall good debt management
- Review in context of multiple factors:
  - New money needs
  - Consolidation of refunding candidates to increase savings, minimize workload
  - Saving thresholds
  - Debt restructuring opportunities



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# Database Development & Maintenance

- Key Elements of outstanding debt issues
- Credit Exposure
- Weekly rates tracking for variable rate programs
- Development of comparables of weekly rates to your portfolio, SIFMA (tax-exempt ) and LIBOR (taxable)



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# Preparing for an IRS Audit



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# IRS Audit Program for Tax-Exempt Bonds

- **Targeted audit** -- initiated based on the specific factors
- **Random Audit Program**
  - IRS selects transactions at random for the purpose of gauging compliance with tax-exempt bond tax rules



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# Preparing for an IRS Audit

- Odds of any one bond issue being audited are relatively low
- Good recordkeeping is essential
- Ensuring proper allocation of bond proceeds critical



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# What to Do When Faced with IRS Audit

- First, don't panic
  - In case of a questionnaire -- IRS is only asking questions, it is not asserting that there is anything wrong with your bonds
  - In the case of the audit, the IRS may also be simply checking to see if the bonds are in compliance with tax rules
- Second, **don't ignore** the questionnaire or the audit notice



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# What to Do When Faced with IRS Audit

- Timelines for Response -- Questionnaire or audit notice will have a time limit for a response
  - Questionnaires
  - Audit



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# What to Do When Faced with IRS Audit

- Representation by Counsel -- If you want to counsel to represent you in responding to the IRS, you need to have a power of attorney on file with the IRS before the IRS will speak with your counsel
- In responding to a questionnaire or audit, it is generally a good idea not provide more information than you were asked for



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# Summary and Concluding Comments



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# Summary - Tips for Issuers

- Create an e-mail address for notification purposes – not an individual
  - debt.management@sanjoseca.gov
- Create electronic ticker system for entire debt management team
  - Track everything!
- Monitor for compliance on regular basis (daily, weekly, monthly)
- Invest in Adobe Professional and Scanning capabilities
  - Save everything you can electronically



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# Summary

- It is just you and the trustee in the end
- Must be active, diligent and engaged
- City of San Jose spends 75% of debt management resources on monitoring portfolio
- Prepare periodic reports on debt management activities to elected officials, public and senior management

• **Debt Management is NOT a passive sport**



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# GFOA--Best Practices for Post Issuance Compliance

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**NIXON PEABODY**<sub>LLP</sub>  
ATTORNEYS AT LAW

# Why?

- Federal law
  - IRC Restrictions
  - IRS Initiatives
- State law
- Bond documents
- Market mayhem



# How?

- Division of responsibilities
- Time
  - Turnover
  - Records
- Education and coordination
- Check list
  - <http://www.gfoa.org/downloads/PostIssuanceCompliance.pdf>



# Investment of Bond Proceeds and Compliance with Arbitrage Regulations



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# Overview of Arbitrage Restrictions

- Arbitrage Rebate
- Arbitrage Yield Restrictions



# Investments

- Construction Fund
- Debt Service Fund
- Debt Service Reserve Fund
- Escrow Fund



# Construction Fund

- Including:
  - Capitalized Interest Account
  - Cost of Issuance Account
- Expect to spend < 3 years
- Expect shorter average life
- Bond document restrictions



# Construction Fund (cont'd)

- Liquidity
- Negative arbitrage
- Reinvestment
- Collateral?



# Debt Service Fund

- Regular and predictable
- Bond document restrictions
- When fund?
- Agreement?
- Collateral?



# Debt Service Reserve Fund

- Bond document restrictions
- Treasuries
- Collateralized GIC
- Liquidity
- Earnings
- Negative arbitrage?



# Escrow Fund

- Tax and accounting restrictions
- SLGS
- Open-market Treasuries



# Other Investments

- Guaranteed Investment Contracts
- Certificates of Deposit



# Private Use



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# Overview of Private Activity Bond Restrictions

- Private use and private payment rules
- Private loan restrictions
- Other tax restrictions



# Example of Private Use

- Leases to nongovernmental persons
- Sales of bond-financed property to nongovernmental persons
- “Bad” management contracts



# Post-Issuance Compliance and Remedial Action

- Importance of post-issuance compliance
- Remedial actions:
  - Redemption/defeasance
  - Alternative use of facility
  - Alternative use of disposition proceeds
- IRS VCAP program



# Post-Issuance Compliance Process

- Determine facilities financed and the amount of proceeds allocable to each facility
- Determine private business use of each such facility
- Determine if the private business use limits are exceeded
- Importance of having supporting records



# Post-Issuance Compliance Process

- Who is responsible?
- Where different persons are responsible, how do they coordinate?
- Are there written post-issuance compliance provided?
- Is there a process for consulting with Bond Counsel?



# Build America Bonds

- Issue Price Determinations
- Capital Expenditure Requirement
- Filing requirements



# What Types of Records Should be Retained

- Use of proceeds and expenditures of proceeds
- Contracts related to uses of proceeds and facilities financed with proceeds
- Little IRS guidance on record-retention



# Swap Monitoring



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# Swap Advisor

- Education
- Terms
- Alternative structures
- Pricing



# Swap Monitor

- Payment confirmation
- MTM Valuation
- Ratings Monitor
- Collateral Monitor
- MTM alerts



# Outsourcing vs. “In-sourcing”

- Pros and Cons
- What services are available?
  - Continuing disclosure
  - Arbitrage Rebate
  - Private use
  - Swap valuation and monitoring

