

Public Hearing on Proposed Regulations
REG-138526-14: *Proposed Rulemaking – Issue Price Definition for Tax-Exempt Bonds*

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Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC

Good morning, my name is Nancy Winkler and I am here today representing the Government Finance Officers Association of the United States (or GFOA). I also serve as the City Treasurer and Deputy Finance Director for the City of Philadelphia, Pennsylvania, which is a frequent issuer of municipal securities. The City has in excess of \$8 billion dollars in tax-exempt municipal securities outstanding, and we have plans to issue approximately \$8-9 billion more over the next ten years to support our capital program, which will address the City's capital needs in a wide variety of areas, including general public infrastructure for parks, recreation, roads, public safety, economic development, water, sewer and storm water management, aviation and upgrades to our municipal gas utility. On behalf of the GFOA and its 18,000 members, many of whom work for state and local governments that issue municipal securities like Philadelphia, I appreciate the opportunity to provide comments at this public hearing on the proposed rulemaking regarding the issue price definition for tax-exempt bonds.

The definition of issue price is essential for determining the yield of a tax-exempt bond issue for arbitrage compliance purposes. Currently, the issue price is determined by a reasonable expectations standard, which is established as the "first price at which a substantial amount of the bonds (defined as 10 percent or more) is reasonably expected to be sold to the public." The proposed rulemaking would maintain that the issue price of the bonds is the first price at which a substantial amount of the bonds is sold to the public as of the sale date, but replace the reasonable expectations standard with a 10 percent actual sales test. The proposal goes on to provide an alternative method of determining the

issue price for bonds when a substantial amount is not sold pursuant to orders received from the public as of the sale date. The GFOA commends the IRS for this proposal, as it is a significant improvement on the issue price amendments proposed in 2013. However we do have some concerns and suggestions with respect to the 2015 proposal, which we discussed in our comment letter.

Regarding the move to a 10 percent actual sales standard from a reasonable expectations standard, the GFOA has concerns with the new standard's impact on pricing. Treasury representatives have recognized, and I would like to reiterate, that a principal difficulty with satisfying a 10 percent actually sold test by the sale date is the serialization of municipal issues. State or local laws frequently mandate annual principal payments; so a bond issue is fully repaid before the end of the economic lives of the assets they finance. The use of actual sales prices likely will result in lower bond offering prices so as to ensure that each maturity of an issue would meet the 10 percent threshold. These lower bond prices would increase borrowing costs for issuers, increase bond yields for arbitrage purposes, and increase federal tax subsidies, while likely reducing net proceeds to issuers. This adversely impacts all governments.

Small issuer issues may be more adversely impacted the market demand for small maturities is frequently less than the demand for larger maturities, which are perceived to be more liquid. When an underwriter prices an issue that contains small maturities, a 10 percent actually sold test could well result in a reduction in the prices of all of the maturities to sell the small maturities while maintaining an even yield curve for the entire issue.

To address our concerns in this area we suggest the following alternative method for negotiated sales:
In cases in which underwriters have not sold at least 10 percent of each maturity of an issue by the time

the bond purchase agreement is signed, the issue price could still be established at the time of BPA signing if the underwriter had sold at least 50 percent of the entire issue by that time.

Another core concern of GFOA members related to the proposed rule's change is that it would make it more difficult for governments to execute a competitive sale. The nature of the competitive sale process should generate the lowest yield to the issuer, but due to the process, underwriters in competitive sales will frequently be unable to meet the 10 percent actually sold test by the time they place their bids, so they will be forced to use the alternative rule. Treasury representatives have publicly said that only the small maturities will be left after the sale and, therefore, subject to the alternative rule. This is a complete misconception in the case of competitive sales. In fact, most of the maturities will be subject to the alternative rule in a competitive sale and our concerns about the cost to issuers of the alternative rule will be exacerbated. The competitive bid process is the purest way of establishing the market price of the bonds, and the proposed regulations should not change the way that issue price is determined for such issues. GFOA has consistently encouraged issuers to work to achieve the lowest cost of borrowing in bond sales, and notes in the GFOA Best Practice *Selecting and Managing the Method of Sale of Bonds* that competitive bond sales can present opportunities for issuers to achieve this goal.

We need a safe harbor for competitive sales, which we believe should be to use the current rule for establishing issue price. Competitive sales perform an important function in our market, establishing transparency of pricing and this safe harbor would support that continued role. Without the safe harbor, underwriters in competitive sales will build more of a risk premium into prices they are willing to bid, or may no longer participate in competitive sales because they will have few orders prior to the bid. This will also increase yields to issuers. We believe that the competitive market as it currently functions,

with multiple bids from underwriters submitted on a set day and time establishes the market yield for a bond issue and we see no need for a change in the rule as it relates to competitive sales.

The last point I want to raise concerns timing. It is essential that the issue price be able to be established at the time the BPA is signed, which needs to be typically within hours or at most a day from the time of sale. As drafted, the description of the alternative rule in the proposed regulations is unclear about the consequences of a sale by a member of an underwriting syndicate or selling group member of bonds at a price higher than the initial offering price prior to the closing date. If the current form of the alternative rule is adopted, it should be clear that the alternative rule can be satisfied as of the BPA signing if all of the members of the syndicate and selling group, if any, commit in an agreement among underwriters or selling group agreement, as applicable, to comply with the terms of the alternative rule. However, the current version of the alternative rule also would concern itself with sales pursuant to “other arrangements,” a very vague term and one that would likely be impossible to monitor. For these reasons, it is GFOA’s strong preference that Treasury adopt another alternative rule that could easily be satisfied at the time of BPA signing. Under that rule, if the underwriter had been unable to sell at least 10 percent of each maturity by the BPA signing, the issue price could be satisfied at that time if the underwriter had sold at least 50 percent of the entire issue.

In conclusion, the GFOA urges IRS and Treasury staff to revisit the underlying assumptions of the proposed rulemaking to and modify its proposed amendment to establish a safe harbor for competitive sales, rework the proposed amendment on negotiated sales and provide clarity on timing with respect to the alternative rule applying to bonds priced higher than those sold at the initial offering price.

With this, I conclude my remarks and look forward to continuing the discussion and advancing our shared goal of establishing a fair and reasonable issue price. I thank you again for the opportunity to testify and I am happy to answer any questions that you may have.