Post-Issuance Compliance Webinar

2022 UPDATES

Presented By:
Alan Bond & Amy Kron (BLX)
Ed Oswald & Aviva Roth (Orrick)

May 3, 2022

2022 POST-ISSUANCE COMPLIANCE WORKSHOP
Hybrid Event

A Comprehensive Overview of Post-Issuance Tax Law and SEC Secondary Market Disclosure for 501(c)(3) Organizations and State and Local Government Issuers Who Utilize Tax-Exempt Financing

November 3-4, 2022
Virgin Hotels Nashville* & Virtual

Registration opens today!

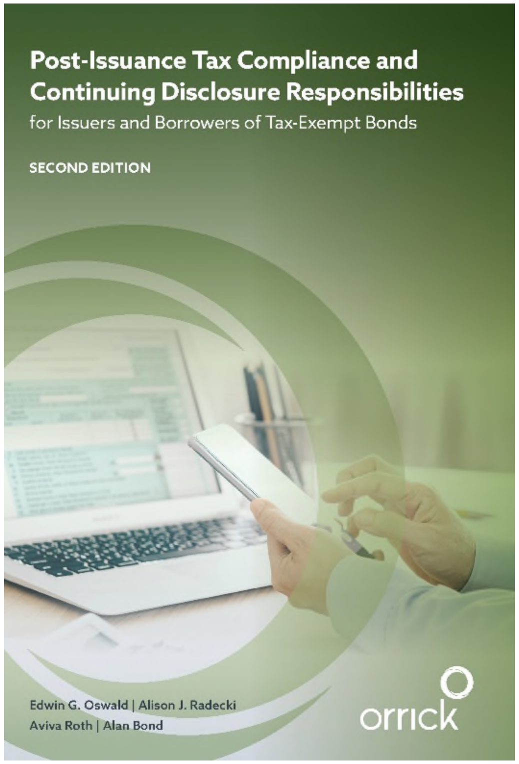
For information and to register, please visit:
www.blxgroup.com/picworkshop2022

** In-person attendance will be limited to 50 attendees.*

Orrick Green Book Series

***Second Edition* – Post-Issuance Compliance and Continuing Disclosure Responsibilities**

https://www.orrick.com/en/Insights/2022/02/Post-Issuance-Tax-Compliance-and-Continuing-Disclosure-Responsibilities-for-Issuers-and-Borrowers



Discussion Outline

I. Current Events
   A. The Fed and Rising Interest Rates
   B. Tax Implications Relating to Discontinuation of LIBOR
   C. Telephonic Public Approval Hearings Permanently Permitted
   D. New IRS Information Returns
II. IRS Enforcement Update
III. Review of Post-Issuance Compliance Basics

CURRENT EVENTS

The Fed and Rising Interest Rates

On March 16th, the Fed raised interest rates for first time since 2018

- Benchmark federal-funds rate increased by a quarter percentage point to a range between 0.25% and 0.5% in March
- Market expecting a half percentage point hike at the May 3rd/4th meeting
- Plans for <u>six</u> more increases this year
- In total, will lift the rate to nearly 2% (or higher) by the end of the year (slightly higher than the level that prevailed before the pandemic, when they slashed rates to near zero) with projections of 2.75% by the end of 2023

The Fed and Rising Interest Rates

- The most aggressive pace in more than 15 years
- Rate hikes intended to slow inflation by –
  - Restraining spending
  - Slowing the economy

The Fed and Rising Interest Rates

Impact on the municipal bond market

- Bond issuance by state and local governments dropped 8% in the first quarter
- Investors pulling funds from the market – large outflows in munis
  - Funds have less money to buy new issuances
- Issuing bonds at a higher rate

➢ Your project will cost you more

The Fed and Rising Interest Rates

Impact on short-term interest rates

- Short-term Treasury yields are on the rise
  - 04/30/22 – 2-year Treasury -- 2.72% yield
  - 12/31/21 – 2-year Treasury -- .74% yield
- Rates on very short-term investments (money market funds, savings accounts) are on the rise but still relatively low overall yields
- Households have funds on hand and may not be investing
- Rates still so low that people may not be motivated to invest

Short Term Interest Rates: April 2022

	1 Year Treasury	2 Year Treasury	Local Agency Investment Fund Monthly Effective Yield	TexPool	Ticker PISXX WF Allspring Treasury Money Market Fund
12/31/21	0.38%	0.73%	0.20%	0.03%	0.01%
01/31/22	0.78%	1.18%	0.23%	0.05%	0.01%
02/28/22	0.99%	1.43%	0.28%	0.08%	0.01%
03/31/22	1.61%	2.34%	0.37%	0.27%	0.14%
04/30/22	2.07%	2.72%	0.60%*	0.32%	0.23%

* As of 4/27/22

The Fed and Rising Interest Rates

What does this mean for arbitrage rebate?

- Rebate – comparison of your bond yield and your investment yield
- As investment rates rise, yields on invested bond proceeds may inch closer to their arbitrage yields
  - Arbitrage yields in recent past have been quite low
  - Possible opportunities to invest bond funds into higher yielding investments
  - Important to stay current with your arbitrage rebate calculations

Tax Implications Relating to Discontinuation of LIBOR

- Changes to the terms of a bond may cause a “tax reissuance” (i.e., a new bond issue is deemed issued)
- A tax reissuance is the equivalent of a current refunding
  - File a new 8038
  - Rebate if any must be paid
  - New Tax Certificate
  - New tax opinion
  - Tax due diligence must be undertaken

Tax Implications Relating to Discontinuation of LIBOR

- Treasury and IRS issued new final regulations to facilitate the discontinuance of LIBOR
  - Applies to bonds and derivatives
- Generally, if the change to the bond is a "Covered Modification" the change will not cause a tax reissuance

Tax Implications Relating to Discontinuation of LIBOR

– Examples:
  - the terms of a bond that pays interest at a rate referencing US – dollar LIBOR are “modified” to provide that the bond pays interest at “Qualified Rate” referencing SOFR
  - the terms of a bond that pays interest at a rate referencing US – dollar LIBOR are “modified” to include a “Qualified Rate” as a fallback rate
  - the terms of a bond that references a rate referencing US – dollar LIBOR as a fallback rate are “modified” to replace a fallback rate that is a Qualified Rate

Tax Implications Relating to Discontinuation of LIBOR

- Qualified Rate
  - Includes SOFR, plus broad language for other rates endorsed by the central bank, reserve bank as a replacement for LIBOR etc.
  - The regulations are complex and technical; bond counsel are still evaluating certain aspects

Telephonic Public Approval Hearings Permanently Permitted

For tax-exempt private activity bonds, the Code requires approval of a bond issue through a public hearing following a reasonable public notice

- May 4, 2020, IRS provided <u>temporary</u> guidance regarding the public approval requirement permitting telephonic hearings for purposes of satisfying the public approval requirement – extended several times

Telephonic Public Approval Hearings Permanently Permitted

- Rev Proc 2022-20 -- eliminates the time period limitation on holding public hearings telephonically
  - Applies to public hearings held on or after March 18, 2022
  - Telephonic hearings may be offered, but toll-free number access is required

New IRS Information Returns

Form 8038 – Tax-Exempt Private Activity Bonds

- New questions relating to proceeds used for "qualified broadband projects" and "qualified carbon dioxide capture facilities"

Form 8038-CP – Credit Payments to Issuers of Qualified Bonds

- *Used by issuers to claim direct pay bond credit payments (BABs, RZEDBs, NCREBs, QECBs, QZABs, and QSCBs)*
- Revised to facilitate <u>mandatory</u> electronic filing starting later in 2022
- New schedule attachment for several of the types of qualified bonds
- Issuer assigned report number needs to be included with each filing

IRS ENFORCEMENT UPDATE

IRS Enforcement Update

IRS Enforcement Trend

- Fewer total audits
  - 2020 and 2021 -- even fewer due to COVID-19
- Historically 300 to 400 issues being audited at any time
- More targeted audits / less "random" audits

IRS Enforcement Update

- The IRS is hiring
  - 2021 – 132 new revenue agent positions
- Budget increases
  - 2021 -- 10% = additional $1.2 billion
  - 2022 -- 6% = additional $675 million
- Upgrading business systems
- Investing in technology

➢ ***Increasing their enforcement capabilities***

IRS Enforcement Update

- Market Segment Identification for Examination
  - Data driven approaches (reduces the IRS's subjective decisions in deciding who should be selected for audit)
  - Yield restrictions on Form 8038-G (governmental bonds)
- Continuation of FY20 Bond Audit Targets
  - Public Safety Bonds: private management contracts for prisons
  - Variable Rate Bonds: rebate and arbitrage restriction
  - Tax Credit Bonds: overfunding of sinking funds

IRS Enforcement Update

- New 2022 – <u>new</u> examination program for examining compliance with tax law requirements applicable to tax-exempt bonds issued by Indian Tribes
  - New area of focus and represents an opportunity for the IRS to learn about the special tax rules that apply
  - Randomly selected 50 bond issues for examination

IRS Enforcement Update

<u>2021 Accomplishments Letter</u>: enhanced our data collection and analysis capabilities that will provide for better return selection for examination and focused outreach efforts

Information about tax-advantaged bonds, including tax-exempt, tax credit and direct pay bonds:

https://www.irs.gov/tax-exempt-bonds

IRS Enforcement Update

- Recent Comprehensive First IDR Request:
  - Reimbursement and expenditure of bond proceeds—including amounts paid, dated paid, accounts, payees, purpose of expenditure
  - All leases, management and research contracts
    - Compliance with Rev Proc 2017-13 and Rev Proc 2007-47
  - Calculation of % of Private Business Use/Unrelated Business Use
  - Latest rebate report

REVIEW OF PIC BASICS

Review of PIC Basics

In general, post-issuance tax compliance related to tax-exempt debt involves 2 main components –

- Tracking your bond proceeds (arbitrage rebate compliance)
- Tracking your bond-financed assets or projects (private business use compliance)

Review of PIC Basics

- Arbitrage rebate compliance
  - Know how your proceeds are invested (<u>rising interest rates</u>!!)
  - Know your bond year and filing dates (5 yr, 10 yr, etc.)
  - Know your arbitrage yield
  - Know your temporary periods
  - Know your transferred proceeds rules
  - Know your record retention requirements

Review of PIC Basics

- Private business use compliance
  - Know your bond-financed assets (by location/address)
  - Know your "other proceeds" – equity, taxable proceeds
  - Know your pbu limits (5%, 10%, or $15M)
  - Know your COI funding
  - Know who is using your facilities
    - Short-term use
    - Long-term use
    - Indirect use (central utility plants, sponsored research)

Review of PIC Basics

- Private business use compliance (cont.)
  - Know your management and service contract rules (Rev Proc 2017-13)
  - Know your sponsored research agreement rules (Rev Proc 2007-47)
  - Know your record retention requirements
  - *For non-profit organizations* – Know your exempt purpose and what users of your facilities are considered "related" and which are "unrelated"
  - *For non-profit organizations* – Know your Schedule K requirements and filing dates

Review of PIC Basics

Benefits of an Effective Post-Issuance Compliance Program

- Good risk management
- Generate efficient and prompt response to any IRS inquiry
- Easy and cost-effective review process at <u>time of refunding</u>
- Ease in completion of Schedule K (for nonprofit organizations)
- Identify remaining portion of bond proceeds allowed for private use

CONTACT INFORMATION

BLX Group

Alan Bond (New York)
abond@blxgroup.com, 212.506.5275

Amy Kron (New York)
akron@blxgroup.com, 201.963.6663

Orrick

Ed Oswald (Washington, D.C.)
eoswald@orrick.com, 202.339.8438

Aviva Roth (Washington, D.C.)
aroth@orrick.com, 202.339.8636

BLX orrick