

# ILLINOIS ASBO Annual Conference

Wednesday, May 4, 2022

## After the Bonds are Issued: Now What?

Presented by:

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PMA Securities LLC

**Anjali Vij**  
Partner, Chapman and Cutler LLP



# Introductions

Christine Green (Moderator)  
- *Director of Business Services, CSBO*  
*Lake Zurich 95*



Tammie Beckwith Schallmo (Speaker)  
- *Senior Vice President, Managing Director,*  
*PMA Securities LLC*



Anjali Vij (Speaker)  
- *Partner, Chapman and Cutler LLP*



# Topics for Discussion

- Post Issuance Compliance  
(Federal Tax Law Requirements)
  - Arbitrage rebate
  - Private use
  - Record retention
- Continuing Disclosure  
(Securities Law Requirements)



# Post-Issuance Compliance with Federal Tax Laws



# Tax Exemption

- Bonds are issued with tax-exempt or taxable interest rates. What does it mean to be tax-exempt?
  - Interest on a State or local government bond is not included in the gross income of the bondholder for federal income tax purposes
- What qualifies for tax-exemption?
  - Generally public purpose capital projects qualify as tax-exempt. Must demonstrate need (to prevent abuses).
  - Often borrowing for operations requires taxable interest rates.
  - Refundings – within 90 days prior to call date
- Requires post-issuance compliance



# Goals of this Session

- Enable you to respond quickly and effectively to an IRS bond audit
- Help you identify potential issues early, to allow for remedial actions and preserve tax-exemption
- Help you retain proper records to demonstrate continuing compliance with arbitrage and private use restrictions
- Help you establish procedures that can be understood and implemented over time, even as personnel change

# IRS Enforcement

- Various consequences of non-compliance with tax rules:
  - In an audit, the interest could be declared taxable
  - Loss of BAB/QSCB subsidy, if applicable
  - Additional arbitrage rebate may be owed (non-paid or underpaid rebate amounts, plus interest)
  - Penalties



# Track Investment of Bond Proceeds – Arbitrage Rebate Rules

- Arbitrage: Difference between (i) what would have been earned if tax-exempt bond proceeds were invested at bond yield and (ii) the earnings on the investment of such tax-exempt bond proceeds in higher yielding securities.
- Rebate: Issuer must pay (or rebate) arbitrage profits to federal government.
- Anything above bond yield gets paid to the US Treasury, unless you meet one or more exceptions:
  - Small issuer exception
  - Spend-down exceptions



# Track Spenddown of Bond Proceeds

- Issuers of tax-exempt bonds must (generally) qualify for a 3-Year Temporary Period — Capital Projects Only
  - Based on reasonable expectations at the time of issuance
  - Must expect to spend sale and investment proceeds as follows:
    - *Expenditure Test—85% within 3 years*
    - *Time Test—5% within 6 months*
    - *Due Diligence Test*
- Keep records of when the bond proceeds were spent and what facilities the bonds funded

# Unspent Bond Proceeds?

- After 3 years from the closing date (upon expiration of the Temporary Period), tax-exempt bond proceeds:
  - Must be yield restricted
  - May not be invested in investments guaranteed by the federal government (such as FDIC-insured CDs)
    - Exception: may invest in U.S. Treasury Securities

# Arbitrage Rebate

- Checklist for post-issuance compliance:
  - Track Arbitrage Rebate (investment returns against bond yield)
  - Keep separate account/accounting of expenditure of bond proceeds and bond-financed projects
  - Monitor compliance with temporary period expectations for expenditure of bond proceeds
  - Monitor compliance with 6-month, 18-month or 2-year spending exceptions to rebate, if relevant
  - Arrange for timely computation of rebate liability and, if rebate is payable, for timely filing of Form 8038-T and rebate payment



# Monitor the Use of Bond Financed Facilities -- Private Business Use and Payments

- Tax exemption does not apply to any “private activity bond”, with limited exceptions
- A private activity bond is a bond that has excessive private business use AND has excessive private payments/security
- De Minimis allowance
  - Private business use is limited to 10%, but
  - 5% limit for “unrelated” or “disproportionate” private business use (with little guidance from the IRS), so most tax counsel use the 5% limit as the baseline

# Private Business Use and Payments

- “Private business use”
  - More than 5% of bond proceeds finance a public facility used by a non-governmental trade or business
  - Examples of private use:
    - Sale, transfer or lease of property to private user
    - Management of property by private user under a management contract
- “Private payment or security”
  - More than 5% of debt service on the bonds is secured by an interest or derived from payments related to private use
  - Example of private payment:
    - Payments of lease rentals to the issuer by a private operator



# Private Business Use and Payments

- Checklist for Post-issuance compliance:
  - Allocate bond proceeds and funds from other sources to ensure that bond proceeds are used for qualifying costs
  - Map out what outstanding bond issue financed which facilities and in what amounts; monitor private use of bond-financed facilities to ensure compliance with applicable percentage limitations
  - Identify in advance any new sale, lease or license, management contract, or other arrangement involving private use
  - Keep records of leases and management contracts even if expired



# Record Retention

- Sufficient records must be retained to support the tax status over the term of the Bonds, plus 3 years after the final maturity date
  - For a refunding issue, material records relating to the original new money bonds and material records related to the refunding issue should be maintained until 3 years after the final redemption of both bond issues
- Consequences if adequate records are not maintained
  - Difficult to calculate private business use
  - Difficult to demonstrate tax compliance in the event of audit



# Post-Issuance Tax Compliance Policy

- *Written* procedures that can be understood and implemented over time even as officials responsible for compliance change
  - Having written post issuance compliance procedures may allow for more favorable settlement treatment from the IRS
    - 1) Designate a Compliance Officer
      - Assign responsibility for monitoring
      - Include training with regard to tax and disclosure requirements
    - 2) Retain accurate records



# Post-Issuance Tax Compliance Policy, cont.

- 3) Implement procedures reasonably expected to timely identify and timely correct noncompliance
  - Integrate monitoring of tax law compliance with existing accounting systems (for example, use special coding on a ledger to review sales, leases or contracts involving bond financed property)
  - Use a compliance checklist
  - Due diligence at regular intervals
    - Principal and interest payment dates are good benchmarks
    - Self-help remedial actions may only be taken within specified time frames.
- 4) Report compliance efforts to elected officials (annually)

# Continuing Disclosure Securities Law Requirements



# Primary Market Disclosure

- The official statement is a document prepared by, or on behalf of, the school district in connection with a primary offering of its bonds.
- The official statement discloses all material information on the offering for potential investors.
- Main source of anti-fraud liability in a municipal transaction
- Obligation for the accuracy and completeness of the disclosure lies with the district
  - Experts may assist, but cannot completely discharge, the district's obligation – It is Your Document!
  - District, Underwriter, Financial Advisor, Attorneys all have potential anti-fraud liability for material misstatements and omissions in an official statement



**SALE DATE AND TIME:**  
March 7, 2019  
10:00 A.M. CST

**NEW ISSUE – BOOK-ENTRY ONLY**

**RATING: MOODY'S "Aa1"**

*Subject to compliance by the District with certain covenants, in the opinion of Chapman and Cutler LLP, Chicago, Illinois ("Bond Counsel"), under present law, interest on the Bonds is excludable from gross income of the owners thereof for federal income tax purposes and is not included as an item of tax preference in computing the federal alternative minimum tax for individuals. Interest on the Bonds is not exempt from present State of Illinois income taxes. See "TAX EXEMPTION" herein for a more complete discussion.*

**\$12,720,000\***

**COMMUNITY UNIT SCHOOL DISTRICT NUMBER 202  
DUPAGE COUNTY, ILLINOIS  
(LISLE)**

**GENERAL OBLIGATION LIMITED TAX SCHOOL BONDS, SERIES 2019**

**Dated: Date of Issuance**

**Due: December 30, as Shown on the Inside Cover Page**

The General Obligation Limited Tax School Bonds, Series 2019 (the "Bonds"), of Community Unit School District Number 202, DuPage County, Illinois (the "District"), are issuable as fully-registered bonds under the global book-entry system operated by The Depository Trust Company, New York, New York ("DTC"). Individual purchases will be made in book-entry system form only. Beneficial owners of the Bonds will not receive physical delivery of the Bonds. The Bonds are issued in fully-registered form in denominations of \$5,000 and integral multiples thereof, and will bear interest payable on June 30 and December 30 of each year, with June 30, 2019, as the first interest payment date. Wells Fargo Bank, National Association, Minneapolis, Minnesota, will act as registrar and paying agent for the Bonds. Details of payment of the Bonds are described herein. Interest is calculated based on a 360-day year consisting of twelve 30-day months.

Proceeds of the Bonds will be used to (i) increase the District's working cash fund and (ii) pay costs associated with the issuance of the Bonds.

The Bonds, in the opinion of Bond Counsel, are valid and legally binding upon the District and are payable from any funds of the District legally available for such purpose, and all taxable property in the District is subject to the levy of taxes to pay the same without limitation as to rate, except that the rights of the owners of the Bonds and the enforceability of the Bonds may be limited by bankruptcy, insolvency, moratorium, reorganization and other similar laws affecting creditors' rights and by equitable principles whether considered at law or in equity, including the exercise of judicial discretion. The amount of said taxes that may be extended to pay the Bonds is limited as provided by law. See "THE BONDS – Limited Bonds" herein.

The Bonds are subject to optional redemption prior to maturity on the dates and at the redemption price described herein under "THE BONDS – Optional Redemption".

The Bonds are offered at public sale, subject to the approval of legality by Bond Counsel. Chapman and Cutler LLP, Chicago, Illinois, is also acting as Disclosure Counsel to the District. Delivery of the Bonds through the facilities of DTC will be on or about March 22, 2019.



AS FINANCIAL ADVISOR

The date of this Official Statement is March \_\_, 2019.

\*Preliminary, subject to change.  
+See "BOND RATING" herein.

Competitive Sale Date and Time

Dated Date

Legal Use of Bond Proceeds

Optional Redemption Feature

Official Date of Offering Document (Sale Date of Bonds)

Bond Rating

Total Par Amount, Legal Name of Issuer and Bond Title

Interest Payment Dates

Bond Security and Authority

Delivery Date

This Preliminary Official Statement and the information contained herein are subject to completion and amendment. Under no circumstances shall this Preliminary Official Statement constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds, in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such jurisdiction.



# Secondary Market Disclosure

- Continuing Disclosure Undertaking (CDU)
  - SEC Rule 15c2-12
    - Requires an underwriter to enter into an agreement with issuers to provide audited financial information, other financial information (possibly) and event disclosures to the market
    - SEC believes this information is important for market transparency and to promote a fair and efficient market
- Filings must be made electronically at the EMMA (Electronic Municipal Market Access) portal [[www.emma.msrb.org](http://www.emma.msrb.org)]
- Recent focus on timeliness of EMMA filings
  - New “submission calendar” on EMMA will show the number of days between the posting of an annual financial disclosure and the end date of the financial period, allowing investors to consider “staleness” of the information being filed.



# CDU Filing Requirements

- If new issue is sold directly to an investor: No CDU (generally)
- If new issue is less than \$1,000,000: No CDU
- If new issue is at least \$1,000,000 and issuer has less than \$10,000,000 of debt, issuer must agree to provide:
  - Audited financial statements
  - Reportable events
- If new issue is at least \$1,000,000 and the issuer has over \$10,000,000 of debt, issuer must agree to provide:
  - Annual financial information
  - Audited financial statements
  - Reportable events



# CDU Filing Requirements (continued)

- “Annual Financial Information” (AFI)
  - Defined in reference to certain information and charts in the Official Statement, such as:
    - Debt Service Extension Base (DSEB)
    - Financial Information and Economic Characteristics: Trend of EAV, Tax Rates, Tax Extensions and Collections, Outstanding Debt, Debt Ratios
    - Summary of Operating Funds: Changes in Fund Balance, General Fund Revenue Sources, Budget
- Audit (and AFI, if applicable) must be filed with EMMA typically 210 days after fiscal year close, or in some cases within 30 days after receipt by the Board of Education, whichever is first

# CDU Filing Requirements (continued)

- Reportable Events – must be filed within 10 business days after the occurrence of the event
- Prior to February 27, 2019, there were 14 Reportable Events
- Most common:
  - Rating changes
  - Bond calls
  - Payment delinquencies
  - Non-payment defaults





# Two New Reportable Events

- School Districts subject to the new amendments will now be required to disclose:
  - (1) (a) the incurrence of a financial obligation, if material, or  
(b) an agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation, any of which affect security holders, if material; and
  - (2) a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation, any of which reflect financial difficulties

# Consequences for Failure to Comply with CDU Obligations

- Bondholders may sue for specific performance
- Rule 15c2-12 requires issuers to disclose CDU non-compliance in official statements (five year look back)
- May impact access to market or result in increased interest rates on new issuances
- Districts that fail to make CDU filings may also face SEC action for other statements that reach the market, if materially misleading

# Disclosure Policies and Procedures

- Main components: Designating a disclosure officer; adopting procedures for primary disclosure (official statements), for producing and filing annual financial information on EMMA and filing Reportable Events on EMMA.
- Incorporating robust disclosure practices/procedures and demonstrating a solid disclosure track record benefits an issuer by encouraging regulatory compliance and by enhancing credibility among investors, credit rating agencies and the public.
- All participants in the disclosure process should be encouraged to raise additional potential disclosure items at all times in the process.
- Disclosure questions should be discussed with appropriate management team members.



# CDU Post-issuance Compliance Checklist

- Review your CDUs for deadlines and filing requirements
- Implement policies and procedures and training for bond issuance and post bond issuance, especially in light of the new continuing disclosure requirements
- Identify individuals responsible for CDU items and have a succession plan
- For annual filings consider including the required tables in your audit
- Subscribe to EMMA for email reminders
- Consider hiring a Third Party or Dissemination Agent



# Questions and Answers

*We thank you for your time!*



# Presenters:

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