

Bond Case Briefs

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The Effective Date of the New Issue Price Regulations is Near.

On December 9, 2016, the United States Treasury Department published regulations (the “Issue Price Regulations”) setting forth new rules for the determination of the issue price of a tax-exempt bond issue. The Issue Price Regulations changed a rule that had been in place for many decades. These new rules become effective for tax-exempt bonds **sold on or after June 7, 2017** and thus will affect bond issues now entering the pipeline.

What Is the Issue Price? The issue price is generally the reoffering price to the public of a tax-exempt bond at which a substantial amount of the bonds of the same maturity are sold. The issue price of the entire issue is the sum of the issue prices of the particular maturities of the bonds of the issue. There are special rules, described in “A Quick Recap of the New Issue Price Rules” below that apply in certain circumstances.

Why Is Issue Price Important? The yield on a tax-exempt bond issue is often relevant to many of the tax determinations made by an issuer with respect to that bond issue during the planning stages and could also affect post-issuance obligations of an issuer with respect to that bond issue. Calculating the yield on a bond issue essentially involves discounting the cash flow (principal and interest payments) on the bond issue back to a target amount, which is the issue price. The discount rate is the yield. Thus, a critical component in determining the yield on a bond issue is the issue price.

When Must the Yield Be Determined and Therefore When Must the Issue Price Be Known? In some cases, the issue price must be known and the yield must be determined on the sale date of the bonds. It is especially important to know the issue price and yield on the sale date in the case of an advance refunding bond issue, where the yield on the reinvestment of the bond proceeds in an escrow fund is limited to the bond yield and the escrow investments must be purchased on the sale date. In other cases, such as a current refunding or a new money bond issue, determining the issue price and the yield is less critical from a timing perspective, but generally still needed for overall compliance.

When Does the Yield on the Tax-Exempt Bond Matter? The yield on a tax-exempt bond issue will matter (i) in an advance refunding, because the escrow yield is restricted to the bond yield, (ii) where arbitrage rebate payments or yield reduction payments may be owed to the IRS, and (iii) where certain moneys derived from or related to the tax-exempt bond issue can only be invested in a fixed relationship to the bond yield (such as conduit bonds and single family mortgage revenue bonds).

What Will Happen Next. We have drafted language that will be included in (i) the Bond Purchase Agreements (for negotiated sales of tax-exempt bonds) and Notices of Sale (for competitively sold tax-exempt bonds) as well as (ii) new Issue Price Certificates that the underwriter or direct purchaser of tax-exempt bonds must sign at closing. The form of the required Issue Price Certificate is included as an exhibit to the Bond Purchase Agreement or the Notice of Sale, as applicable. By

executing the Bond Purchase Agreement for a negotiated bond or submitting a bid for a competitively bid bond, the underwriter or direct purchaser is acknowledging the application of the new rules and its duties to sell the bonds, and in some instances hold the offering price of the bonds, in accordance with the new rules and to supply the necessary information to the issuer to properly document the issue price.

What Should an Issuer or Conduit Borrower of Tax-Exempt Bonds Do Now. As issuers and conduit borrowers plan their upcoming bond or bond anticipation note issues, they should consult with their Bond Counsel and, where applicable, their Municipal Advisors (sometimes referred to as Financial Advisors), to review the new language and the implications of the new Issue Price Regulations. For negotiated sales, the issuers and conduit borrowers should also consult with the underwriter and underwriter's counsel regarding the underwriter's responsibilities in establishing the issue price.

A Quick Recap of the New Issue Price Rules. Generally, the issue price is the first price at which a substantial amount (10%) of the bonds of each maturity are sold to the "public." The public is any "person" other than an "underwriter" or a related party to an underwriter. A person is any individual or entity for tax purposes and so would include corporations and partnerships. An underwriter is any person who agrees in writing with the issuer that it will participate in the initial sale of the bonds to the public or an entity who agrees with a lead underwriter to do so.

There are three special rules. First, if the bonds are sold in a private placement, the issue price is the purchase price paid for the bonds. **Second,** if the issuer chooses, the issue price will be the initial offering price to the public (typically the price shown in the Official Statement for the bonds) if the underwriter agrees to offer the bonds at a price no higher than that initial offering price for the first five business days after the sale date. **Third,** if the issuer conducts a competitive sale and receives at least three qualified bids, the issue price will be the reasonably expected initial offering price stated in the winning bid. A competitive sale is (i) a process in which the issuer offers the bond for sale to underwriters at specified written terms where those bid terms are disseminated in a manner reasonably designed to reach potential underwriters, (ii) all bidders have an equal opportunity to bid, (iii) the issuer receives bids from at least three underwriters who have established industry reputations for underwriting new issuances of municipal bonds, and (iv) the issuer awards the bonds to the bidder who submits a firm offer to purchase at the highest price or lowest interest cost.

An issuer can choose any of the permitted methods of establishing the issue price, but the issuer must identify the method chosen not later than the issue date of the bonds. This will typically be evidenced in the Tax Certificate for the bonds.

All of the rules described above apply to bonds sold for money. If bonds are sold for property, such as in the case of certain lease transactions where the vendor performs certain services in exchange for rent payments under the lease, special rules apply that are beyond the scope of this QuickStudy.

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