Bond Case Briefs

Municipal Finance Law Since 1971

Tax-Exempt Lending to Governments and Nonprofits; Bank Loans and Direct Purchases of Municipal Securities: Orrick

Commercial banks and other financial institutions ("lender" or "lenders") have historically provided financing to both governmental entities and nonprofits on a tax-exempt basis through loans and direct purchases of municipal securities. The purchase of municipal securities by a lender is generally referred to as a direct purchase or direct placement. Since bank loans to governmental entities and nonprofit borrowers are generally private transactions not subject to the same reporting requirements applicable to municipal securities, there is less historical and empirical data to track the volume. However, loan reporting provided by large banks to the Federal Reserve reflecting the amount of bank loans to municipalities is significant. Direct purchases and bank holdings of municipal securities are tracked and, prior to the Tax Reform Act of 1986, lenders held almost 40% of outstanding municipal issues of tax-exempt debt. After the Tax Reform Act of 1986 and prior to the 2008 financial crisis, lenders shifted much of their participation in the tax-exempt market through products that provided credit enhancement and liquidity. After the 2008 financial crisis, due to multiple factors, the tax-exempt market once again experienced an increase in bank loans and direct purchases of municipal securities by lenders.

The purpose of this booklet is to provide a roadmap for lenders who are considering lending on a tax-exempt basis and for governmental entities and nonprofit organizations considering incurring tax-exempt debt through a bank loan or a direct placement. Each incurrence or issuance of tax-exempt debt should be reviewed by a qualified bond counsel such as the Orrick Public Finance Group listed on the inside back cover of this booklet.

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