



# **Debt Administration**

**Certified Government Finance Officer (CGFO)  
Combined Study Guide**



# **PowerPoint Review Presentations**



Florida Government Finance Officers Association

# **Debt Administration**

## **Certified Government Finance Officer (CGFO)**

### **Review Session**



The FGFOA is dedicated to being your professional resource by providing opportunities through Education, Networking, Leadership and Information.



# Exam Topics

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**Issuance / Refunding – 35%**

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**Debt Structuring and Financing Methods – 20%**

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**Policies and Regulations – 20%**

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**Players and Roles – 15%**

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**Ratings Process – 10%**





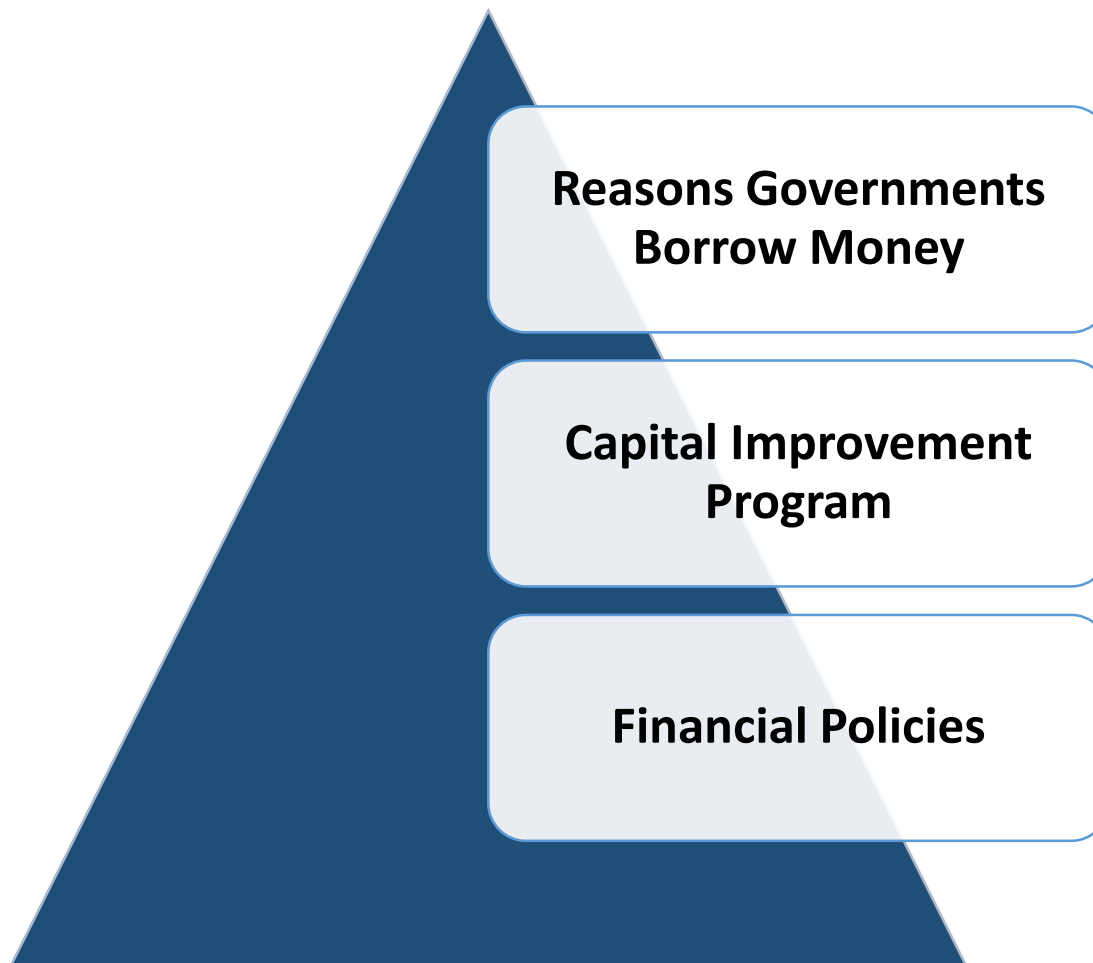
# Policies and Regulations

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# Policies and regulations

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# Learning Objectives

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**Identify** reasons why governments borrow money

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**Define** a capital improvement program

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**Recall** why a capital improvement program is valuable to the debt process

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**Define** financial policies and importance to the debt process

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**Identify** regulating agencies within the debt process





# Reasons governments borrow money

## To finance infrastructure projects

- Government office buildings
- Roads and streets
- Water and sewer lines
- Water and solid waste treatment plants
- Airports
- Hospitals







# Reasons governments borrow money

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- Operating cash shortfall
- Community improvement or economic development
- Current revenue stream insufficient to fund capital projects with significant costs and longer useful lives
- Prevention and elimination of slums and blight





# Prevention and Elimination of Slums and Blight

## FLORIDA STATUTES REFERENCES:

### 163.335 Findings and declarations of necessity.—

(1) It is hereby found and declared that there exist in counties and municipalities of the state slum and blighted areas which constitute a serious and growing menace, injurious to the public health, safety, morals, and welfare of the residents of the state; that the existence of such areas contributes substantially and increasingly to the spread of disease and crime, constitutes an economic and social liability imposing onerous burdens which decrease the tax base and reduce tax revenues, substantially impairs or arrests sound growth, retards the provision of housing accommodations, aggravates traffic problems, and substantially hampers the elimination of traffic hazards and the improvement of traffic facilities; and that the prevention and elimination of slums and blight is a matter of state policy and state concern in order that the state and its counties and municipalities shall not continue to be endangered by areas which are focal centers of disease, promote juvenile delinquency, and consume an excessive proportion of its revenues because of the extra services required for police, fire, accident, hospitalization, and other forms of public protection, services, and facilities.





# Capital Improvement Program

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- Plan for capital expenditures to be incurred each year over a fixed period of several years (usually five to seven) to meet capital needs
- Financial planning, management and budgeting tool
- Provides an organized and practical method of planning and financing a government's capital needs

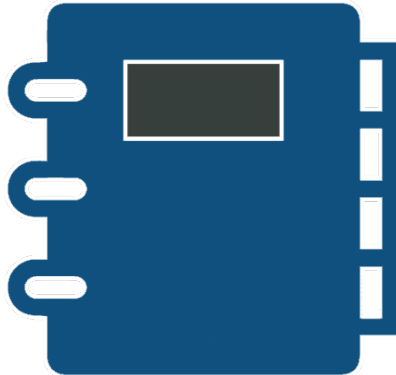




# Capital Improvement Program

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**Capital Improvement Plans** generally include the following components:



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Description of project

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Estimated costs of capital project by year

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Funding source by project

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Operating costs/savings by project

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Alignment with strategic plan

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# Debt Issuance Considerations

- ❑ Typically, current revenue stream is not sufficient to cover long-term capital projects with significant costs
- ❑ Concept of **Intergenerational equity**
  - Borrowing cash to purchase the item now and paying back the debt with future taxes, ensuring that those who receive benefit from the item in the future will help pay for it.
  - Matching term of financing with estimated useful life of asset





# Debt Issuance Considerations

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Matching type of financing with revenue stream

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Coordination of proposed financing with existing debt

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Overlapping debt

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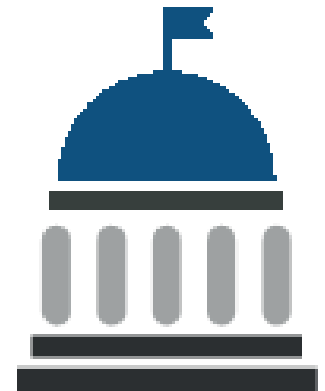
Project schedule (e.g., design, land acquisition, and/or construction)





# Financial Policies – Debt Management

**GFOA** recommends that state and local governments adopt comprehensive written debt management policies

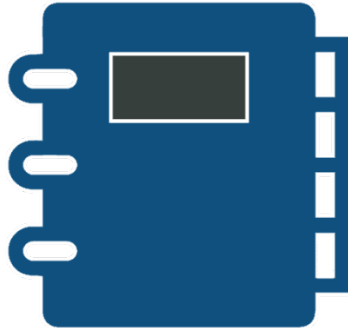




# Debt Management Policy

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**GFOA recommends that a debt management policy is reviewed periodically and should address at least the following:**



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Debt limits <sup>(1)</sup>

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Debt structuring practices

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Debt issuance practices

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Debt management practices

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Use of derivatives

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1. Florida law does not impose a debt limit. Instead, it is left up to local governments to determine and include in their debt management policy.





# Debt Limits

## □ Debt limits:

- Set specific limits or acceptable ranges for each type of debt
  - Legal restrictions
  - Public policies
    - Purposes for debt proceeds and types of debt prohibited
    - Relationship and integration with the Capital Improvement Program
    - Economic development goals
  - Financial restrictions





# Debt Limits

- ❑ Appropriate debt limits can have positive impact on bond ratings
- ❑ Financial limits often expressed as ratios
  - Debt per capita
  - Debt to personal income
  - Debt to taxable property value
  - Debt service payments as a percentage of general fund revenues or expenditures





# Debt Structuring Practices

**Policy** should include specific guidelines regarding the debt structuring practices including:

- Maximum term
- Average maturity
- Debt service pattern
- Use of optional redemption features
- Use of variable or fixed-rate debt, credit enhancements, and derivatives





# Debt Issuance Practices

## Policy should provide guidance regarding issuance process:

- Selection and use of professional service providers
  - Independent financial advisor
- Criteria for determining method of sale and investment of proceeds
- Use of comparative bond pricing services
- Criteria for issuance of advance or current refunding bonds
- Use of credit ratings, number of ratings and selection of rating services





# Debt Management Practices

**Policy should provide guidance for ongoing administrative activities including:**

- Investment of bond proceeds
- Primary and secondary market disclosure practices
- Arbitrage rebate monitoring and filing
- Federal and state law compliance practices
- Ongoing market and investor relations efforts





# Use of Derivatives

- **Derivatives** are financial instruments whose value is based upon (derived from) the value of another asset
- **Debt management policy** should clearly state whether or not the entity can or should use derivatives



If use of derivatives is allowed, a separate and comprehensive derivatives policy should be developed



# Covenant and State Shared Revenues

## Covenant to budget and appropriate

- Issuer agrees to annually appropriate legally available non-ad valorem revenues
- Cannot use ad valorem taxes
- Be careful which revenues are defined to be used

## State shared revenues – can only secure the guaranteed entitlement portion

- **FS218.25** Limitation of Shared Funds





# Bond Covenants

- ❑ Enforceable promise to do or refrain from doing some defined act
- ❑ Debt service coverage requirements
  - Pledge to maintain certain percent of net revenues (gross revenues less operating costs) in excess of annual debt service
  - Coverage should be in excess of 1.0, (e.g., 1.25)  
Gross revenues – operating costs = net revenues  
Net revenues / annual debt service = debt service coverage







# Bond Covenants

## Additional bonds test

- Agreement not to issue additional parity bonds until test is met
- Test of pledged revenues against future combined debt service of parity debt
- Rate consultant, bond counsel, financial advisor



## Debt service reserves

## Use bond proceeds as defined in the bond documents

## Continuing disclosure





# Regulating Agencies

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- ❑ **Internal Revenue Service (IRS)** - All issuers with bonds greater than \$100,000 are required to file information returns at the time of issue
- ❑ **Municipal Securities Rulemaking Board (MSRB)**
  - Regulates municipal securities market
  - Manages EMMA





# Regulating Agencies

## Securities and Exchange Commission (SEC)

- **Rule 15C2-12** requires municipal bond issuers to enter into an agreement with underwriters to provide certain information
- Requires underwriters to
  - Perform due diligence review of the Preliminary Official Statement (POS) and Official Statement (OS)
  - Distribute POS/OS upon request within one day to a potential investor
  - Timely receipt of the OS



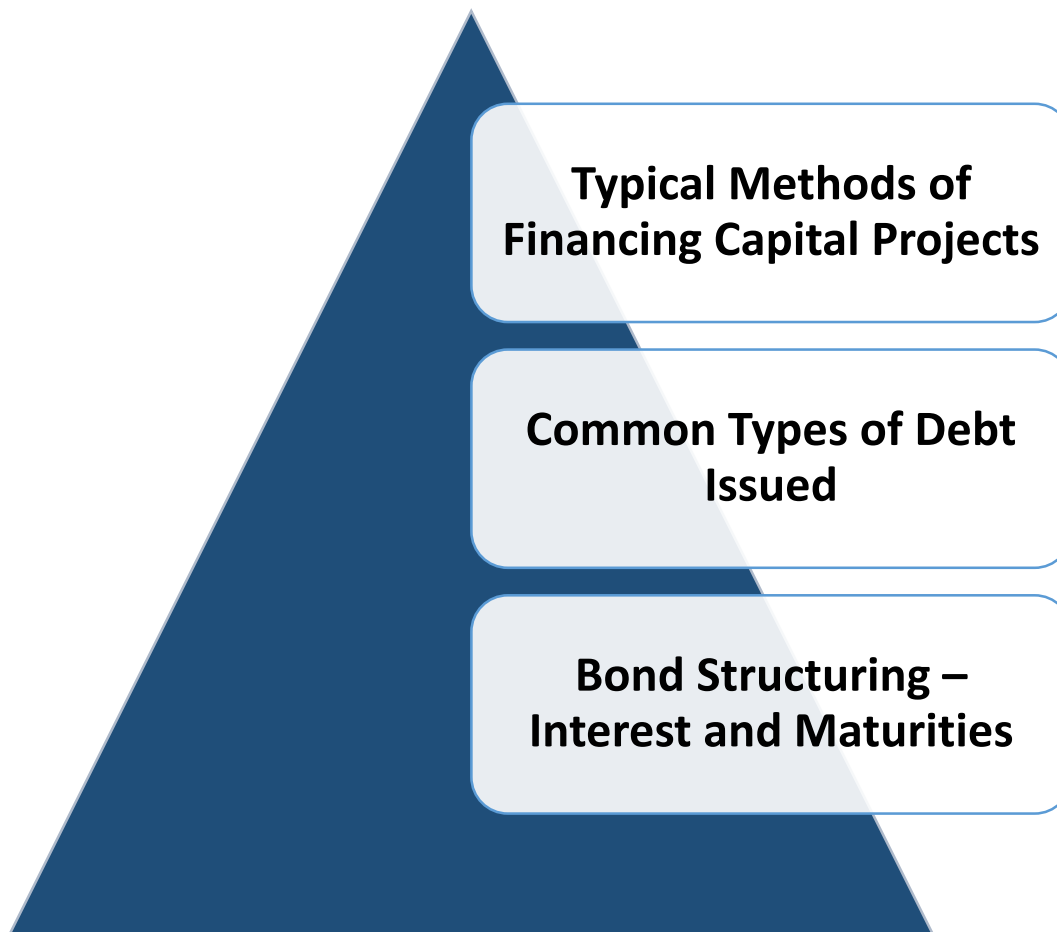


# Debt Structuring and Financing Methods

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# Debt Structuring and Financing Methods





# Learning Objectives

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**Identify** the different sources available for capital projects funding

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**Recall** the advantages and disadvantages for each funding source

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**Recall** different kinds of debt issued, including advantages and disadvantages of each

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**Identify** the options for short-term financing, including advantages and disadvantages of each





# Learning Objectives

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**Define** terms describing elements of bond structuring

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**Recognize** different types of maturity schedules





# Typical Methods of Financing Capital Projects

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# Typical Methods of Financing Capital Projects

## Typical funding sources for capital projects include:

- Pay-As-You-Go Financing
- State Revolving Loan Fund (SRF) program
- Grants
- Joint Ventures/Privatization

### Debt Financing



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General Obligation (GO) Bonds

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Revenue Bonds

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Notes or Short-term Borrowings

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Special Assessment Bonds

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Capital Leases

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Certificates of Participation

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# Pay-As-You-Go Financing

**Pay-As-You-Go Financing** is paying for capital projects with cash on hand

## Advantages

Cost savings of interest, fees and expenses of issuing debt

Financial flexibility preserved

Perception credit quality enhanced

Borrowing capacity protected



## Disadvantages

Insufficient funding for capital needs

Discourages intergenerational equity

“Lumpy” capital expenditures

Sudden tax increases





# State Revolving Loan Fund (SRF) program

The **State Revolving Loan Fund (SRF)** program provides low-interest **loans** to local governments to **plan**, design, and build or upgrade wastewater, storm water, and nonpoint source pollution prevention projects.

## Advantages

Low interest rates

## Disadvantages

Limited to capital projects eligible for the loan

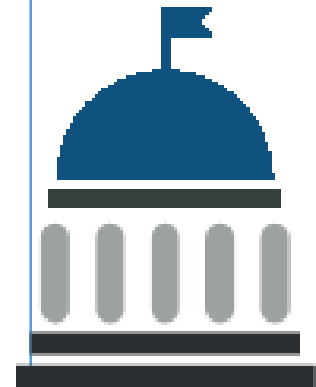




# Florida Municipal Loan Council

## The Florida Municipal Loan Council (FMLC)

- Offers funding options to finance capital projects, renovations, fixed assets additions and land purchases or to refinance existing debt.
- The FMLC works with a team of professionals and advisers to provide greater market access and lower financing costs for its borrowers.

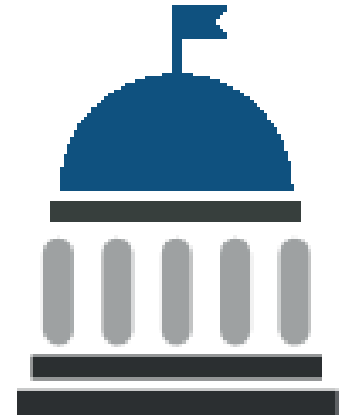




# Grants

## Grants

- Advantages include funds are provided by the federal or state government
- Disadvantages include limited availability and can be administratively burdensome





# Joint Ventures/Privatization

- **Privatization** includes complete transfer of service provision to a private company; most governmental services do not generate enough revenue for privatization
- **Joint Ventures** includes a legal entity or other organization that results from a contractual agreement; owned, operated or governed by two or more participants





# Debt Financing

## Debt financing includes issuance of long-term debt (bonds)

### Advantages include:

- Current revenues used each year to repay debt
- Promotes intergenerational equity
- Permits capital improvements to be implemented as needed

### Disadvantages include:

- Reduces financial flexibility – debt service requirements must be met
- Perception of credit quality reduced
- Limits future borrowing capacity





# Governmental Bonds

## Two types of governmental bonds:

- Tax-exempt bonds
- Taxable bonds







# Tax-Exempt Governmental Bonds

## Tax-Exempt Governmental Bonds

- Bonds that do not meet the private activity bonds test
- Interest paid to bondholders **is not** includable in gross income for federal income tax purposes
  - Bondholders willing to accept lower interest rate
  - Cost savings for issuer (government)
- Can also be exempt from state income tax through reciprocal immunity (*McCulloch v Maryland*, 1819)





# Tax-Exempt Governmental Bonds

## Tax-Exempt Governmental Bonds

- Restricts purpose of debt primarily to public purpose (private activity test)
- Fully registered (if maturity is over 1 year)





# Private Activity Test

## Private activity test

- Financed asset available for general public use
- Source of debt service payments
  - Governmental revenues
  - Private lease payments (e.g., rent)

## Private activity test standards

Private purpose use of the asset must be less than 10% of the asset

Payment of principal or interest from a private source must be less than 10%





# Taxable Bonds

## Taxable bonds

- Meets the private activity test
- Advance refunding
  - The “2017 Act” repealed the authority to issue tax-exempt advance refunding bonds after December 31, 2017.
- Interest paid to bondholders **is** includable in gross income for federal income tax purposes
- Investor requires higher yields (interest rates)
- Higher interest costs to the issuer (government)



## Examples of taxable bonds

- Pension bonds/workers compensation bonds/advance refunding bonds





# Private Activity Bond Test

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## Exceeding the Private Activity Bond Tests Limits **after** Issuance

- Even if the bonds comply with the limits of the private activity bond tests at issuance, a governmental bond issue can lose its tax-exempt status (from the time of issuance) if the issuer or a conduit borrower of the bond proceeds takes a “deliberate action” subsequent to the issue date that causes the issue to exceed those limits . A deliberate action is any action taken by the issuer or conduit borrower that is within its control; intent to exceed the limits is not necessary for an action to be deliberate. A deliberate action occurs on the date the issuer or conduit borrower enters into a binding contract (that is not subject to any material contingencies) with a nongovernmental person for use of the bond-financed property in a manner that causes the limits of the private activity tests to be exceeded.





# Private Activity Test



## ☐ Examples to consider

- Parking garages
- Convention centers
- Marinas

### \* Management and Service Contracts

Contracts for a private entity to manage a bond-financed facility may cause the private business use test to be met. For example, a management contract between a governmental entity and a nongovernmental person under which the nongovernmental person receives compensation for services provided with respect to bond-financed property may result in the bonds meeting the private business use test .





# Private Activity Test

## Private activity test

- If in doubt, ask bond counsel and/or financial advisor
- Failing the private activity test could result in tax-exempt bonds becoming taxable





# Common Types of Debt Issued

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# Common Types of Debt Issued

## Debt financing includes:

- General Obligation (GO) Bonds
- Revenue Bonds
- Special Assessment Bonds
- Notes or Short-term Borrowings
- Capital Leases
- Certificates of Participation





# General Obligation (GO) bonds

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## **General Obligation (GO) bonds**



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Pledge full faith and general credit of issuer;  
most secure pledge

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Voter approval is required for amount and  
anticipated use

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Favorable interest rates

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Debt millage limit is based on the local  
government policy

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Rolled back rate does not apply to millage  
rates used to pay GO bonds

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# Revenue Bonds

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## Revenue bonds

- Specific revenue pledge to service debt (e.g., water, wastewater, local option taxes, etc.)
- Voter approval usually not required
- Coverage covenants usually included
- Higher interest rates than GO bonds

**Double-barreled bonds** – blend of GO and revenue bonds that require separate bond resolutions





# Special Assessment Bonds

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## Special assessment bonds

- Debt is secured by limited group of property owners
- Market concerns about defaults
- Higher interest costs due to higher risk
- **Mitigate risks** – Utilizes the Uniform Method of Collection on the annual property tax bills
- More complex than GO bonds





# Notes or Short-term Borrowings

## Bank notes

- Direct loan by a banking institution
- May be considered as a private placement bond
- Easier to issue

## Commercial paper

- Unsecured short-term loan
  - Essentially a promissory note secured by the borrower's financial health
- Interest rates are usually variable
- Florida League of Cities, Florida League of Counties



## Leases





# Capital Leases

- Widely used to acquire equipment and facilities

## Advantages

- Easy, effective method of obtaining funding





# Certificates of Participation (COP)

## Certificates of Participation (COP)

- Allows an investor to buy a share of the improvements or infrastructure the government intends to fund
- Lease payments are made to relieve the debt
- Does not require a vote of citizens





# Bond Structuring Interest and Maturities

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# Debt Structure

**Debt structure refers to duration and timing of principal and interest payments**

- ☐ Maturity dates
- ☐ Serial bonds or term bonds
- ☐ Provisions for calling the bonds





# Debt Structure

**The Issuer** works closely with the municipal advisor in determining the size and structure of the debt



- Determine, define, and establish the number and amount of individual bonds in the issue
- Maturity schedule for individual bonds
- **Timing** – When to bring the bonds to market





# Debt Structure

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**True Interest Cost (TIC)** – rate necessary to **discount** the amounts payable on the respective principal and interest payment dates to purchase price received for new issue of bonds

**Net Interest Cost (NIC)** – computes overall interest expense associated with bonds

$$\frac{\text{Total Interest Payments} + \text{Discount} - \text{Premium}}{\text{Bond Year Dollars}}$$





# Debt Structure

## Annual debt service payments

- **Capitalized interest** – payment of interest from the bond proceeds
- **Level debt service** – principal increases as interest decreases (e.g., mortgages, car payments)
- **Level principal payment** – total debt service decreases as interest decreases
- **Interest only** – payment of interest only for a portion of the term (wrapping new debt around existing debt)





# Maturity

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**Maturity** is the date the bond must be repaid

- Maturity matching principle
  - Debt maturity should approximately coincide with useful life of project being financed





# Fixed-Rate Bonds

**Each maturity in bond issue has a set interest rate that does not fluctuate throughout life of bonds**

- Interest rates are set at the time of sale/closing
- Reduces interest risk to both issuer and bond holder

## **Two types of fixed-rate bonds**

- Serial
- Term





# Serial Bonds

- ❑ **Serial bonds** are a series of bonds that mature in regular pattern, usually over entire life of bond issue
- ❑ **Interest** is paid at regular intervals, usually semi-annually





# Serial Bonds

## Serial bonds

**\$52,115,000**  
**CITY OF TAMPA, FLORIDA**  
**Sales Tax Refunding and Improvement Revenue Bonds,**  
**Series 2016**

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS,  
 PRICES AND INITIAL CUSIP NUMBERS**

<u>Maturity</u> <u>(October 1)</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>	<u>Yield</u>	<u>Price</u>	<u>Initial CUSIP</u> <u>Numbers*</u> <sup>(1)</sup>
2017	\$4,140,000	5.00%	0.75%	104.261	875232CH1
2018	4,365,000	5.00	0.84	108.267	875232CJ7
2019	4,585,000	5.00	0.96	111.951	875232CK4
2020	4,820,000	5.00	1.08	115.336	875232CL2
2021	5,055,000	5.00	1.20	118.417	875232CM0
2022	5,305,000	5.00	1.37	120.868	875232CN8
2023	5,575,000	5.00	1.48	123.351	875232CP3
2024	5,850,000	4.00	1.61	117.889	875232CQ1
2025	6,090,000	4.00	1.71	119.043	875232CR9
2026	6,330,000	4.00	1.81	119.965	875232CS7

1. CUSIP – Committee on Uniform Securities Identification Procedure number







# Term Bonds

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- ☐ Single final maturity date when the entire principal is repaid
- ☐ Usually requires use of sinking fund redemptions





# Debt Service Structure

## Schedule of table listing periodic payments

- Principal/interest requirements over life of bonds

## Types of debt service structures

- Level debt service
- Level principal
- Graduated principal
- Principal deferral





# Level Debt Service

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- ☐ Principal and interest relatively constant over life of bonds
- ☐ Easier to budget or project amount of revenues needed





# Level Principal

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- Principal is constant
- Interest due declines





# Graduated Principal

- ☐ Little or no principal payments in early years
- ☐ Principal payments increase in later years
- ☐ Use when have service financed with revenue bonds and will take a few years to reach revenue collections sufficient to pay debt service
- ☐ Higher interest costs due to more principal outstanding for longer period of time





# Deferred Principal

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- Deferral of principal for a given period of time, such as construction period
- Higher interest costs





# Variable Rate Bonds

- Called “floaters”
- Act like short-term notes



- Interest rate is adjusted on **prearranged dates**

Can tender bonds for repayment on interest rate adjustment date

If hold bonds, new interest rate applies

- Typically secured by letter of credit
- Risks include interest rate risk and market risk



# Variable Interest Rates

## Variable interest rates

- Rates can fluctuate during the life of debt
- Variable-rate demand bonds have a floating rate and can be redeemed at any time by the bond holder
- Commercial paper
- Risks (interest rate, renewal, and rollover)







# Interest Rate and Yield

- **Interest rate**

Market-based

Interest rate risk

Credit risk

<u>Maturity (October 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>Price</u>
2017	\$4,140,000	5.00%	0.75%	104.261
2018	4,365,000	5.00	0.84	108.267
2019	4,585,000	5.00	0.96	111.951
2020	4,820,000	5.00	1.08	115.336
2021	5,055,000	5.00	1.20	118.417
2022	5,305,000	5.00	1.37	120.868
2023	5,575,000	5.00	1.48	123.351
2024	5,850,000	4.00	1.61	117.889
2025	6,090,000	4.00	1.71	119.043
2026	6,330,000	4.00	1.81	119.965

- **Yield**

Price

Interest rate

Yield curve – graphic illustration showing the yields on bonds of varying maturities

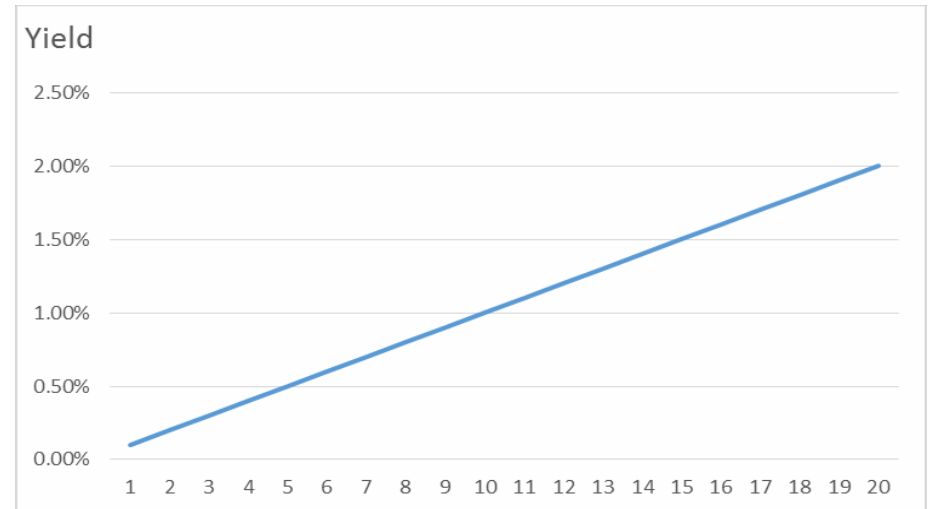




# Yield Curve

## Normal yield curve

- Yields are low in the near-term and rise for the long-term
- Reflects a good economy; economic expansion

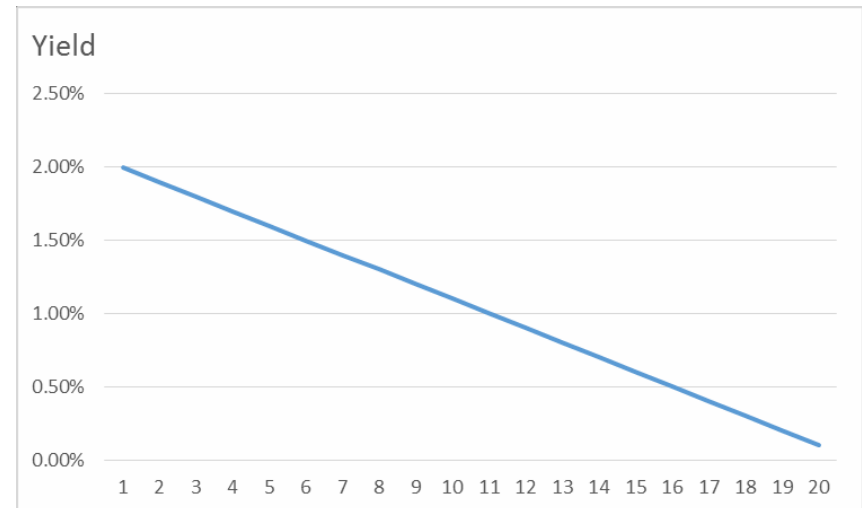




# Yield Curve

## Inverted yield curve

- ❑ Long-term yields are projected to fall
- ❑ Corresponds to period of economic recession

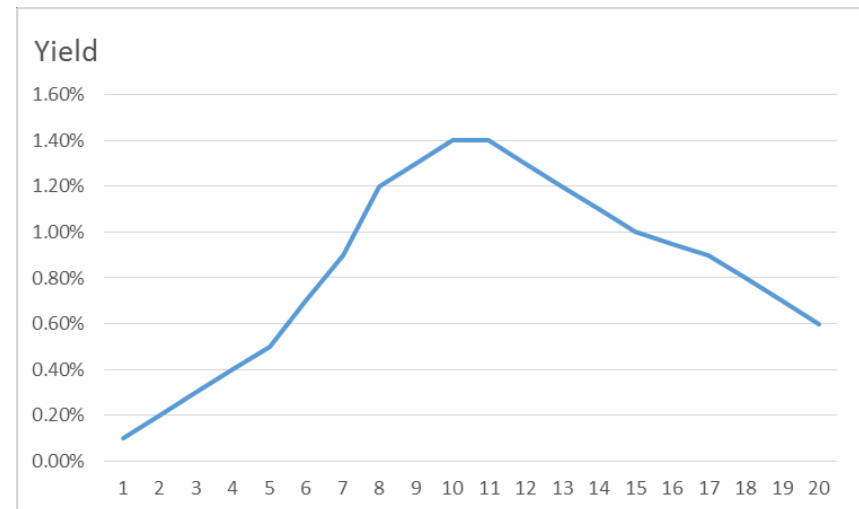




# Yield Curve

## Humped yield curve

- Relatively rare
- Yields on medium-term investments are higher than both short and long-term investments
- Also known as a bell-shaped curve
- Seen as a predictor of economic transition





# Redemption Provisions

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## Redemption provisions

- ☐ **Mandatory** – annual debt service through the use of a sinking fund
- ☐ Optional redemption (call provision)
  - Allows for the bonds to be called
  - Generally at the 10<sup>th</sup> year anniversary
  - Issuer will pay a premium
  - Issuer will also pay a higher interest rate to call the issue earlier





# Ratings Process

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# Learning Objectives

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**Recall** the definition of a bond rating

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**Define** the various bond rating designations

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**Recall** how ratings are obtained

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**Identify** the available credit enhancements





# Ratings Process

- Bond rating is an opinion of the ability and willingness of the issuer of the bonds to make timely payments over the life of the bonds
- Bonds ratings are important not only for their role in informing investors, but also because they affect the interest rate that issuers pay on their outstanding debt

## Three largest rating agencies:

- ☐ Standard & Poors (S&P)
- ☐ Fitch
- ☐ Moody's







# Ratings Process

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Primary factors considered during the process:

## ☐ Rating agencies evaluate

- Debt Burden
- Management
- Financial performance
- Economic base

## ☐ Meetings

- Personal meeting is recommended if there has been significant changes since last meeting
- Telephone meetings are the norm





# Ratings Process

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**Credit rating:** determined by a rating committee

## Credit rating report

- Public document published by each credit rating agency
- Evaluates the creditworthiness of the issuer
- Underlying rating
  - Rating without any credit enhancements
  - Published upon request





# Bond Ratings

	Moody's	Standard & Poors	Fitch	Explanation
Best Quality	Aaa	AAA	AAA	Carry the smallest degree of risk
High Quality	Aa1 Aa2 Aa3	AA+ AA AA-	AA+ AA AA-	Margins of protection not quite as good as best quality bonds
Upper Medium Grade	A1 A2 A3	A+ A A-	A+ A A-	Security is adequate now but current factors are present to suggest possibility of impairment in future
Medium Grade	Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-	Repayment security appears adequate in present but have certain elements of unreliability



# Credit and Rating Enhancements

- **Credit enhancements** is the process of reducing credit risk (and potentially increasing credit ratings) by providing collateral, insurance, or other agreements
- Provides investors with additional assurance that they will be compensated in the event the government is unable to pay the bonds





# Credit and Rating Enhancements

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- Two primary types are **bond insurance** and **letters of credit**





# Bond Insurance

- Purchased through an upfront one-time payment of an insurance premium at the time of the bond closing
- Bond ratings are based on the **credit of the bond insurance company**, rather than on the underlying credit of the issuer
- Guarantees principal and interest will be paid as scheduled





# Bond Insurance

- Cost-effectiveness depends
  - Interest cost savings exceed premium
  - For smaller governments, may be cheaper and simpler than applying for credit rating
  
- Premiums are not cheap
  - .1% to 2% of combined principal and interest payable over life of bonds





# Bond Insurance

## Advantages

Improved credit rating on the issue

Results in lower interest costs

## Disadvantages

Must pay upfront insurance premium

Premium can be expensive

Sometimes not cost effective







# Letters of Credit

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- Unconditional pledge of a bank's credit to make principal and interest payments of specified amount for specified period of time
- **Two types**
  - Direct pay
  - Standby





# Letters of Credit

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- **Direct Pay Letters of Credit**
  - All debt service payments made by draws on letter of credit
  - Issuer reimburses bank for such payments
- **Standby Letters of Credit**
  - Issuer has primary responsibility for making debt service payments
  - Letter of credit drawn on if issuer defaults





# Letters of Credit

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Banks charge two fees for letters of credit:

- **Commitment fee**

- One-time payment made when bonds are issued
- Usually ranges from .25% to 1% of debt amount

- **Draw-down (Drawing) fee**

- Specified amount due for each draw payable at time of draw
- Interest charge due for time between draw and reimbursement





# Letters of Credit

## Advantages

- Improves the bond's credit rating
  - Bonds take rate of the bank
- Simplifies an otherwise complicated security arrangement





# Letters of Credit

## Disadvantages

- Fee can be substantial
- Must be renewed every 3-5 years
- May not be able to find a bank willing or able to issue letter of credit
- Acceleration of payment in event of failure to reimburse bank for draws





# Municipal Bond Pools

## Municipal bond pools

- Bond offering in which a sponsor sells an issue of bonds with proceeds used by a number of governmental agencies – increases the size of the investor pool
- Pool permits small cities with low borrowing requirements to reduce the underwriting and interest costs associated with a small issue
- Because of the varying credit risks associated with cities in a single bond pool, nearly all bond pools are insured





# Ratings Process

## Rating agency surveillances

- Periodic review by the credit rating agencies by credit
- Can upgrade, affirm, or downgrade credit rating
- Publish a credit report





# Players and Roles

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# Learning Objectives

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**Recall** the roles and responsibilities of players within the debt process





# Issuer

One of the primary player(s) involved in the debt process is the **Issuer**

Members from the Issuer's team typically include the following from within the government:

- Chief Financial Officer
- Budget/Accounting
- Attorneys
- Clerk's Office
- Department Representatives if applicable
  - Water, Wastewater, Solid Waste, Storm-water





# Issuer

## The roles and responsibilities of the issuer include:

- Works closely with the municipal advisor in determining the size and structure of the debt
- Assists in preparation of the preliminary official statement and providing financial and operating information
- Provides information requested by rating agencies
- Department Representatives provides information related to proposed projects to be funded through the debt
  - Water, Wastewater, Solid Waste, Storm-water





# Municipal Advisor

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- ❑ The Municipal Advisor is an indispensable part of the financing team
- ❑ Prior to the 2010 Dodd-Frank Act, activities were largely unregulated
- ❑ SEC adopted new rules, effective **July 1, 2014**
  - Seek to protect interests of municipal entities
  - Imparts that municipal advisors have explicit fiduciary duty to government clients
  - Municipal advisor prohibited from serving as underwriter on issuance





# Municipal Advisor

**The Municipal Advisor** is usually hired first and works closely with the issuer

## Roles and responsibilities of the Municipal Advisor include:

- Serves as independent financial consultant to issuing government
- Protects issuer's financial interest during entire bond issuance process
- Assists in developing financing requirements, debt structure and choosing the method of sale





# Municipal Advisor

Common methods of compensation for the **Municipal Advisor** include:

- Hourly Basis/Fixed Fee
- Flat-dollar amount per bond issued





# Bond Counsel

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## Bond counsel

Certifies legal authority to issue the debt

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Provides an opinion that the debt is tax-exempt

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Interprets federal, state, and local laws, regulations, constitutions and statutes, charters, and ordinances

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May draft ordinance or trust indenture

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# Bond Counsel

## Common Methods of Compensation

- Percentage of bonds sold
- Hourly basis
- Fixed fee



- Select one with a strong reputation







# Disclosure Counsel

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## Disclosure counsel:

- Retained by the issuer
- Provides advice on issuer disclosure obligation
- Prepares the official statement
- Prepares continuing disclosure agreement





# Underwriter

## Underwriter

- Securities dealer helps the issuer bring bonds to the market
- Key role is to buy bonds from issuer and resell to investors
- Usually investment firm or securities subsidiary of commercial bank





# Underwriter

Selection of the underwriter depends on the type of sale:

## Negotiated sale

participates in structuring the deal and selected by the issuer prior to sale date

## Competitive sale

submits a sealed bid and identity is not known until bids are opened





# Underwriter

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## Underwriter

- ☐ Should be competent, reasonably priced, and have no conflict of interests

Compensation is based on type of sale:

- **Competitive Bid** – Part of bid price
- **Negotiated Sale** – Paid underwriter spread





# Underwriter

## Underwriter Spread

- **Gross Spread** – the difference between the price paid by the underwriter to the issuer and the price at which the securities are initially offered to the investing public





# Underwriter

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**Underwriters' spread or compensation has four components:**

**Take-down** – compensation for selling bonds; sales commission

**Management fee** – managing the activities of the bond preparation

**Expenses** – incurred in the sale process

**Underwriter fee or “risk”** – associated with buying and reselling the issue





# Underwriter's counsel

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## Underwriter's counsel:

- ☐ Represents underwriter in negotiated sale
- ☐ Prepares the **bond purchase agreement** -
  - Contract for selling bonds to underwriter and how underwriter will resell bonds





# Other Players

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## Other players



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Paying agent

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Bond Registrar

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Trustee

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Securities Depository

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Printer

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External Auditors

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# Other Players

**Committee on Uniform Securities Identification Procedure (CUSIP) number:**  
Allows the market to identify series of bonds

## Bond register

- Listing of names and addresses of current bond owners
- Electronically maintained by Deposit Trust and Clearing Corporation (DTC)



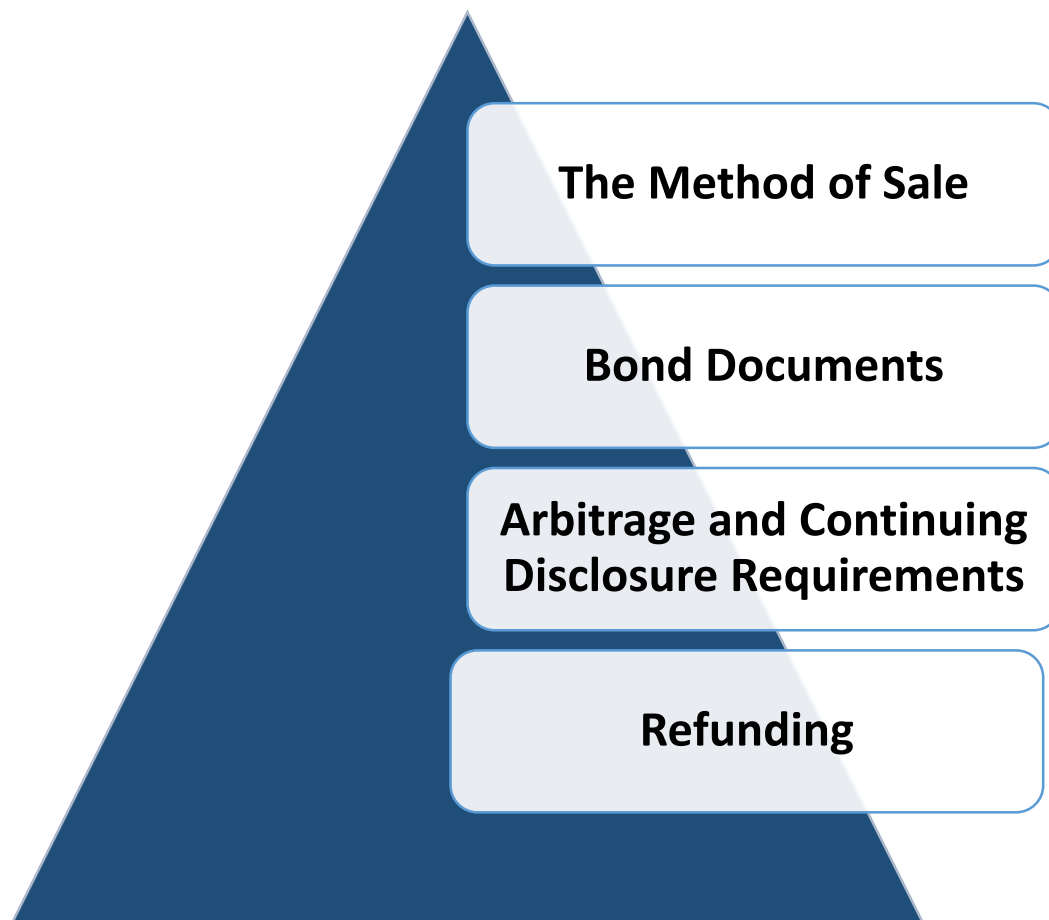


# Issuance and Refunding

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# Issuance and Refunding





# Learning Objectives

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**Recall** the methods of sale including advantages and disadvantages of each

**Identify** various elements of bond documents

**Recall** the bond proceed investment provisions

**Define** arbitrage and how it relates to bonded debt

**Recognize** continuing disclosure requirements

**Define** refunding

**List** the reasons for refunding

**Identify** types of refunding's





# The Method of Sale

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# Methods of Sale

The methods of sale include:

- Competitive bid
- Negotiated Sale
- Private placement





# Competitive Bid

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- **Issuer** prepared bond issue structure
- Publishes a notice of sale requesting bids from **underwriters**
- **Underwriters** submit closed bids to **issuer**
- Bond awarded to **best bidder**
  - Lowest true interest cost
- **Winning underwriter** resells bonds





# Competitive Bid

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## ☐ When to use competitive bid:

- Market is familiar with issuer, issuer is stable and regular borrower
- Active secondary market in which to resell bonds
- Issuer has unenhanced credit rating of A or above or can obtain credit enhancement







# Competitive Bid

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## ☐ When to use competitive bid:

- Debt structure is backed by issuer's full faith and credit or historically strong and performing revenue stream
- Issue is not too large or too small
- Issue not complex
- Interest rates are stable, market demand is strong





# Competitive Bid

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## Advantages:

- Promotes appearance of open and fair process
- Bonds are sold at the lowest interest cost given market conditions at time of sale





# Competitive Bid

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## Disadvantages:

- Inflexible to restructuring maturity schedules and interest rates after bonds are awarded
- Does not encourage underwriters to participate in substantial pre-marketing efforts
- Issuer has less control in determining underwriting firm and how bonds are resold to investors





# Negotiated Sale

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- Issuer works with single underwriter
- **Selected underwriter assists issuer with:**
  - Structuring bond issue
  - Preparing official statement
  - Obtaining bond rating
- Underwriter engages in presale marketing and negotiates interest rates with issuer





# Negotiated Sale

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## When to use Negotiated Sale



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Issuer has poor credit

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Unusually large or small bond  
issue

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New entity

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Unusual financing terms

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Innovative structure or security

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# Negotiated Sale

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## Advantages:

- Underwriter is able to engage in presale marketing efforts prior to bond sale
- Allows more flexibility in underwriter selection
- Increases flexibility for issuer with sale date and bond structure





# Negotiated Sale

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## Disadvantages:

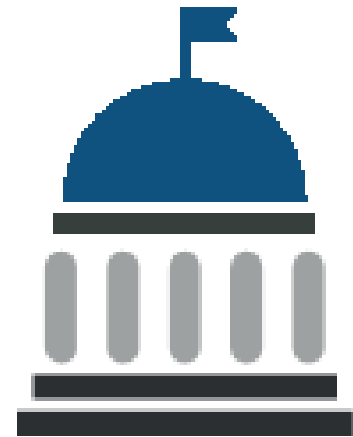
- May appear biased
- Issuers often do not have adequate information to negotiate effectively with underwriters





# Private Placement

- ☐ Government markets bonds directly to investors
  - Commercial banks
  - Insurance companies
  
- ☐ Used when a **public bond sale** is
  - Too expensive
  - Likely to be ineffective







# Private Placement

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- Higher interest costs
- Lower disclosure requirements
- Faster sales process





# Bond Documents

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# Bond Documents

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**Bond documents include the following:**



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Bond resolution

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Notice of sale

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Bond purchase agreement

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Continuing disclosure agreement

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Tax certificate

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Official statement

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# Bond Resolution

- ❑ Document adopted by the issuer's governing body authorizing the issuance and sale of the bonds
  
- ❑ Includes:
  - Form of the bonds
  - Dollar value of the bonds
  - Security supporting the repayment of the bonds
  - Approval of the offering documents
  - Approval of the terms of the sale

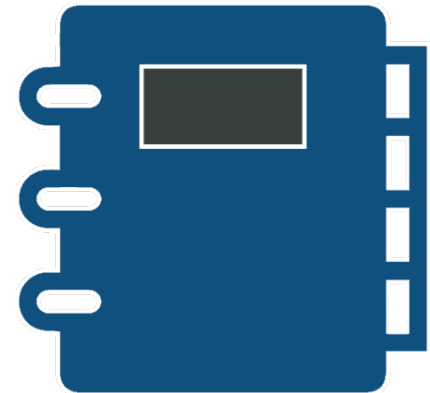




# Notice of Sale

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- ❑ Publication by the issuer describing the terms of a competitive bid of an issue of bonds





# Notice of Sale

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- **Includes:**
  - Date and time of sale
  - Description of bonds, including redemption provisions
  - Form and payment of bonds
  - Good faith deposit
  - Basis of the award
  - CUSIP numbers
  - Approving opinion
  - Official statement
  - Timing and method of the delivery of the bonds
  - Credit enhancements, if any
  - Bond counsel and municipal advisor





# Bond Purchase Agreement

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- Used in a negotiated sale
- Contract between the **underwriter** and the **issuer** describing the final terms, prices, and conditions upon which the underwriter will purchase and resell the bonds





# Continuing Disclosure Agreement



- Underwriters cannot purchase bonds unless the issuer has agreed, in writing, to provide ongoing disclosure
- Underwriter must make a reasonable determination at the time of issuance of the bonds that there will be continuing disclosure





# Official Statement

## Disclosure document

- Prepared by or for the issuer
- Describes the bond issue, the economic, financial, and social characteristics of the issuer, and the security for the bonds



## Disclosure

- Principle that accurate and complete information that investors may need to make an informed investment must be made available to potential investors



# Official Statement

- ☐ Underwriters use a **“preliminary” official statement (POS)** in negotiated sales to market bonds to potential investors
- ☐ POS differs from the final Official Statement in that it can omit certain information that will not be known until the time of sale of the bonds





# Tax Certificate

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- ☐ Provides information about the bond issue that supports bond counsel's opinion relating to the tax status of the bonds
  - Taxable v. Tax-Exempt
- ☐ Identifies applicable IRS regulations and requirements
  - Arbitrage
  - Rebate
- ☐ Provides information on the anticipated expenditures of the bond proceeds





# Arbitrage and Continuing Disclosure Requirements

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# Introduction

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- ☐ An issuer's responsibilities do not end with the delivery of the bonds on the closing date
- ☐ Each bond issue has disclosure requirements until the final maturity
- ☐ Events and requirements occurring after the sale should be considered important components of the debt administration program





# Investment of Bond Proceeds

- ❑ On the closing date, the issuer will receive **net proceeds** from the sale of the bonds
- ❑ First post-sale responsibility = invest the proceeds
  - Investment should follow the investment policy of the government
  - Identify personnel responsible for investments
    - Conform to all legal, statutory, and regulatory requirements
  - Investment schedule should reflect the anticipated need to access funds for the capital project





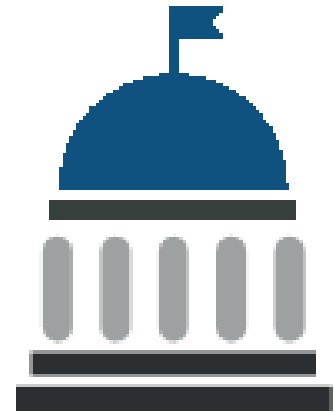
# Arbitrage

## Arbitrage

- Prior to the **1986 Tax Reform Act**, local governments could issue tax-exempt, low-interest bonds and then invest the bond proceeds at a higher interest rate

After 1986, local governments must:

- Restrict interest earnings
- Must meet bond proceeds spend down requirements





# Arbitrage Restrictions

- ❑ **Arbitrage restrictions:** determining whether yield on investments acquired with bond proceeds must be restricted
- **Arbitrage:** spread between the tax-exempt interest rate on the bonds and the rate on investments
- Question to ask – can you earn it?
- Generally, the yield on the investment of proceeds must be limited to the yield on the bonds







# Rebate Requirements

**Rebate requirements:** determining whether interest earned on investments must be rebated (or paid) to IRS

- ☐ **If you earn it, do you have to pay it to the IRS?**
  - **YES!** Paid to IRS every five years and within six months after the final maturity of the bonds
  - Penalties for noncompliance





# Continuing Disclosure

**Secondary Market Disclosure – U.S. Securities and Exchange Commission Rule 15c2-12** bars underwriters from buying municipal securities unless the issuer agrees in writing to provide continuing disclosure of certain material information (“continuing disclosure undertaking”)





# Continuing Disclosure

## Annual financial information

– at time municipal securities offered for sale, continuing disclosure undertaking must describe:



Type of information to be provided

Accounting principles used to prepare financial statements and timing of statements

Date in each year by which annual financial information will be provided

Who will be providing the information

**Listed Events** – specified in the Rule



# Continuing Disclosure

- ❑ **Underwriters** are obligated to “reasonably determine” that issuer or obligated person has undertaken, in written agreement or contract, for benefit of bondholders, to provide continuing disclosure
- ❑ Issuers provide information to the **(MSRB)**
  - via the **MSRB’s Electronic Municipal Market Access System (EMMA)**



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- ➔ [Continuing Disclosure Documents](#)
- ➔ [Market Statistics](#)
- ➔ [MSRB 2012 Fact Book](#)



### DOCUMENT SUBMISSION

Municipal bond underwriters and issuers submitting official statements, advance refunding documents and continuing disclosures to EMMA should use the EMMA Dataport. Submitted documents are made available to the public.

- ➔ [Use EMMA's Email Reminder Service for Recurring Financial Disclosures<sup>NEW</sup>](#)
- ➔ [Access Online Training about Submitting to EMMA](#)
- ➔ [Primary Market Submission](#)
- ➔ [Continuing Disclosure Submission](#)
- ➔ [529 College Savings Plan Submission](#)



# Continuing Disclosure

## Continuing disclosure

- **Electronic Municipal Market Access (EMMA)** system operated by the Municipal Securities Rulemaking Board (MSRB)
- File material event notice with EMMA within 10 days after becoming aware of the event
- File continuing disclosure information through **EMMA** (SEC Rule 15c2-12)







# Maintaining Relations



- Bondholders and ratings agencies have an on-going interest in the issuer's debt management practices
- GFOA has a recommended practice – **Maintaining an Investor Relations Program**
- Rating agencies monitor bond issues on a regular basis and can revise bond ratings based on these reviews



# Refunding

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# Refunding

**A bond financing procedure** in which the issuer refinances all or certain maturities of an outstanding bond by issuing new bonds

- Proceeds of the new bonds can be used to immediately retire the old debt
- Alternatively, proceeds of the new bonds can be used to purchase securities with cash flows that are used to pay off the old bonds as they mature





# Reasons for Refunding

- ☐ Reasons to refund the bonds
- ☐ To take advantage of more favorable interest rates
  - Drop of 2 to 2.5%, explore refunding
  - Include issuance costs in analysis
- ☐ To change the structure of debt service payments
- ☐ To escape from unfavorable bond covenants





# Types of Refunding

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The two types of refunding are:

- Current
- Advance





# Advance Refunding

## Advance refunding

- Calling the bonds more than 90 days prior to the call date (usually on the 10<sup>th</sup> anniversary of the sale date)
- Only allowed one advance refunding per issue
- Bond proceeds are placed in irrevocable escrow account to pay the annual debt service until bonds are callable
- Once escrow has been funded, the refunded bonds are legally defeased





# Current Refunding

## Current refunding



- Occurs within 90 days after of the bonds' call date
- Refunded bonds are defeased on the date the refunding occurs
- Normally exempt from arbitrage restrictions



# Yield Burning

## Yield burning

- Illegal practice of marking up the prices on bonds for the purpose of reducing the yield on the bond after the bonds are placed in a refunding escrow
- **State and Local Government Series (SLGS)** are securities sold by the U.S. Treasury to comply with arbitrage restrictions





# Reference Materials

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# Reference Materials

- ❑ Florida Statutes ([www.leg.state.fl.us](http://www.leg.state.fl.us))
  - FS163.335 Findings and Declarations of Necessity
  - FS200.065 Method of Fixing Millage
  - FS218.25 Limitation of Shared Funds
- ❑ IRS Publication 4079, Tax-Exempt Government Entities - IRS





# Reference Materials

- ❑ GFOA Best Practice Statements and Advisories, Debt Management – GFOA

[www.gfoa.org/services/rp/debt.shtml](http://www.gfoa.org/services/rp/debt.shtml)





Florida Government Finance Officers Association

# Questions?



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Florida Government Finance Officers Association

# Thank You!



The FGFOA is dedicated to being your professional resource by providing opportunities through Education, Networking, Leadership and Information.



# **GFOA Best Practice**



# BEST PRACTICE

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## Debt Management Policy

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### Notice:

**Issuers of municipal securities should be aware of new disclosure requirements in SEC Rule 15c2-12, effective on securities issues on or after February 27, 2019. GFOA recommends issuers consult counsel prior to the effective date to determine how these changes may impact debt portfolios and debt management policies and procedures.**

**The Continuing Disclosure Agreements will include affirmation by governments for debt issues on or after February 27, 2019 to:**

- disclose additional information about material financial obligations (e.g., guarantees, capital leases, and bank loans) for securities entered into after the effective date
- make event filings of any material changes reflecting financial difficulties should any occur to outstanding or new financial obligations

### BACKGROUND:

Debt management policies are written guidelines, allowances, and restrictions that guide the debt issuance practices of state or local governments, including the issuance process, management of a debt portfolio, and adherence to various laws and regulations. A debt management policy should improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and therefore is likely to meet its debt obligations in a timely manner. Debt management policies should be written with attention to the issuers specific needs and available financing options and are typically implemented through more specific operating procedures. Finally, debt management policies should be approved by the issuers governing body to provide credibility, transparency and to ensure that there is a common understanding among elected officials and staff regarding the issuers approach to debt financing.

### RECOMMENDATION:

GFOA recommends that state and local governments adopt comprehensive written debt management policies. These policies should reflect local, state, and federal laws and regulations. To assist with the development of these policies GFOA recommends that a governments Debt Management Policy (Policy) should be reviewed periodically (and updated if necessary) and should address at least the following:

1. **Debt Limits.** The Policy should consider setting specific limits or acceptable ranges for each type of debt. Limits generally are set for legal, public policy, and financial reasons.

a. *Legal restrictions* may be determined by:

- State constitution or law,
- Local charter, by-laws, resolution or ordinance, or covenant, and
- Bond referenda approved by voters.

b. *Public Policies* will address the internal standards and considerations within a government and can include:

- Purposes for which debt proceeds may be used or prohibited,
- Types of debt that may be issued or prohibited,
- Relationship to and integration with the Capital Improvement Program, and
- Policy goals related to economic development, including use of tax increment financing and public-private partnerships.

c. *Financial restrictions or planning considerations* generally reflect public policy or other financial resources constraints, such as reduced use of a particular type of debt due to changing financial conditions. Appropriate debt limits can have a positive impact on bond ratings, particularly if the government demonstrates adherence to such policies over time. Financial limits often are expressed as ratios customarily used by credit analysts. Different financial limits are used for different types of debt. Examples include:

- *Direct Debt, including general obligation bonds*, are subject to legal requirements and may be able to be measured or limited by the following ratios:
  - Debt per capita,
  - Debt to personal income,
  - Debt to taxable property value, and
  - Debt service payments as a percentage of general fund revenues or expenditures.
- *Revenue Debt* levels often are limited by debt service coverage ratios (e.g., annual net pledged revenues to annual debt service), additional bond provisions contained in bond covenants, and potential credit rating impacts.
- *Conduit Debt* limitations may reflect the right of the issuing government to approve the borrowers creditworthiness, including a minimum credit rating, and the purpose of the borrowing issue. Such limitations reflect sound public policy, particularly if there is a contingent impact on the general revenues of the government or marketability of the governments own direct debt.
- *Short-Term Debt Issuance* should describe the specific purposes and circumstances under which it can be used, as well as limitations in term or size of borrowing.
- *Variable Rate Debt* should include information about when using non-fixed rate debt is acceptable to the entity either due to the term of the project, market conditions, or debt portfolio structuring purposes.

**2. Debt Structuring Practices.** The Policy should include specific guidelines regarding the debt structuring practices for each type of bond, including:

- Maximum term (often stated in absolute terms or based on the useful life of the asset(s)),
- Average maturity,
- Debt service pattern such as equal payments or equal principal amortization,
- Use of optional redemption features that reflect market conditions and/or needs of the government,
- Use of variable or fixed-rate debt, credit enhancements, derivatives, short-term debt, and limitations as to when, and to what extent, each can be used, and

- Other structuring practices should be considered, such as capitalizing interest during the construction of the project and deferral of principal, and/or other internal credit support, including general obligation pledges.

**3. Debt Issuance Practices.** The Policy should provide guidance regarding the issuance process, which may differ for each type of debt. These practices include:

- Selection and use of professional service providers, including an independent financial advisor, to assist with determining the method of sale and the selection of other financing team members,
- Criteria for determining the sale method (competitive, negotiated, private placement) and investment of proceeds,
- Use of comparative bond pricing services or market indices as a benchmark in negotiated transactions, as well as to evaluate final bond pricing results,
- Criteria for issuance of advance refunding and current refunding bonds, and
- Use of credit ratings, minimum bond ratings, determination of the number of ratings, and selection of rating services.

**4. Debt Management Practices.** The Policy should provide guidance for ongoing administrative activities including:

- Investment of bond proceeds,
- Primary and secondary market disclosure practices, including annual certifications as required,
- Arbitrage rebate monitoring and filing,
- Federal and state law compliance practices, and
- Ongoing market and investor relations efforts.

**5. Use of Derivatives.** The Debt Management Policy should clearly state whether or not the entity can or should use derivatives. If the policy allows for the use of derivatives, a separate and comprehensive derivatives policy should be developed (see GFOAs Advisory, Developing a Derivatives Policy and Derivatives Checklist).

#### Notes:

- Post Issuance Compliance Checklist
- Debt Issuance Checklist: Considerations When Issuing Bonds

The County of San Diego, CA was awarded the GFOA Award for Excellence for outstanding use of GFOA's Best Practice on Debt Management Policy. To learn more about the County's implementation process, please visit their award page.

#### References:

- GFOA Advisory: Using Variable Rate Debt Instruments, 2010.
- GFOA Advisory: Use of Debt-Related Derivatives Products, 2010.
- GFOA Derivatives Checklist, 2010.
- GFOA Best Practice: Selecting Bond Counsel, 2008.
- GFOA Best Practice: Selecting and Managing Municipal Advisors, 2014.
- GFOA Best Practice: Selecting Underwriters for a Negotiated Bond Sale, 2008.
- GFOA Best Practice: Post-Issuance Policies and Procedures, 2017.
- GFOA Best Practice: Primary Market Disclosure, 2017.
- GFOA/NABL Post Issuance Compliance Checklist, 2003.

- Debt Management Policy Examples
- *Benchmarking and Measuring Debt Capacity*, Rowan Miranda and Ron Picur, GFOA, 2000.
- *A Guide for Preparing a Debt Policy*, Patricia Tigue, GFOA, 1998.





# Florida Statutes

FLORIDA GOVERNMENT FINANCE OFFICERS ASSOCIATION

CERTIFIED GOVERNMENT FINANCE OFFICERS EXAM

REFERENCE MATERIALS GUIDE

DEBT ADMINISTRATION

FLORIDA STATUTES REFERENCES

**163.335 Findings and declarations of necessity.—**

(1) It is hereby found and declared that there exist in counties and municipalities of the state slum and blighted areas which constitute a serious and growing menace, injurious to the public health, safety, morals, and welfare of the residents of the state; that the existence of such areas contributes substantially and increasingly to the spread of disease and crime, constitutes an economic and social liability imposing onerous burdens which decrease the tax base and reduce tax revenues, substantially impairs or arrests sound growth, retards the provision of housing accommodations, aggravates traffic problems, and substantially hampers the elimination of traffic hazards and the improvement of traffic facilities; and that the prevention and elimination of slums and blight is a matter of state policy and state concern in order that the state and its counties and municipalities shall not continue to be endangered by areas which are focal centers of disease, promote juvenile delinquency, and consume an excessive proportion of its revenues because of the extra services required for police, fire, accident, hospitalization, and other forms of public protection, services, and facilities.

(2) It is further found and declared that certain slum or blighted areas, or portions thereof, may require acquisition, clearance, and disposition subject to use restrictions, as provided in this part, since the prevailing condition of decay may make impracticable the reclamation of the area by conservation or rehabilitation; that other areas or portions thereof may, through the means provided in this part, be susceptible of conservation or rehabilitation in such a manner that the conditions and evils enumerated may be eliminated, remedied, or prevented; and that salvageable slum and blighted areas can be conserved and rehabilitated through appropriate public action as herein authorized and the cooperation and voluntary action of the owners and tenants of property in such areas.

(3) It is further found and declared that the powers conferred by this part are for public uses and purposes for which public money may be expended and police power exercised, and the necessity in the public interest for the provisions herein enacted is declared as a matter of legislative determination.

(4) It is further found that coastal resort and tourist areas or portions thereof which are deteriorating and economically distressed due to building density patterns, inadequate transportation and parking facilities, faulty lot layout, or inadequate street layout, could, through the means provided in this part, be revitalized and redeveloped in a manner that will vastly improve the economic and social conditions of the community.

(5) It is further found and declared that the preservation or enhancement of the tax base from which a taxing authority realizes tax revenues is essential to its existence and financial health; that the preservation and enhancement of such tax base is implicit in the purposes for which a taxing authority is established; that tax increment financing is an effective method of achieving such preservation and enhancement in areas in which such tax base is declining; that community redevelopment in such areas, when complete, will enhance such tax base and provide increased tax revenues to all affected taxing authorities, increasing their ability to accomplish their other respective purposes; and that the preservation and enhancement of the tax base in such areas through tax increment financing and the levying of taxes by such taxing authorities therefor and the appropriation of funds to a redevelopment trust fund bears a substantial relation to the purposes of such taxing

authorities and is for their respective purposes and concerns. This subsection does not apply in any jurisdiction where the community redevelopment agency validated bonds as of April 30, 1984.

(6) It is further found and declared that there exists in counties and municipalities of the state a severe shortage of housing affordable to residents of low or moderate income, including the elderly; that the existence of such condition affects the health, safety, and welfare of the residents of such counties and municipalities and retards their growth and economic and social development; and that the elimination or improvement of such condition is a proper matter of state policy and state concern and is for a valid and desirable public purpose.

(7) It is further found and declared that the prevention or elimination of a slum area or blighted area as defined in this part and the preservation or enhancement of the tax base are not public uses or purposes for which private property may be taken by eminent domain and do not satisfy the public purpose requirement of s. 6(a), Art. X of the State Constitution.

History.—s. 2, ch. 69-305; ss. 1, 22, ch. 84-356; s. 1, ch. 98-201; s. 6, ch. 2006-11.

#### **200.065 Method of fixing millage.—**

(1) Upon completion of the assessment of all property pursuant to s. [193.023](#), the property appraiser shall certify to each taxing authority the taxable value within the jurisdiction of the taxing authority. This certification shall include a copy of the statement required to be submitted under s. [195.073](#)(3), as applicable to that taxing authority. The form on which the certification is made shall include instructions to each taxing authority describing the proper method of computing a millage rate which, exclusive of new construction, additions to structures, deletions, increases in the value of improvements that have undergone a substantial rehabilitation which increased the assessed value of such improvements by at least 100 percent, property added due to geographic boundary changes, total taxable value of tangible personal property within the jurisdiction in excess of 115 percent of the previous year's total taxable value, and any dedicated increment value, will provide the same ad valorem tax revenue for each taxing authority as was levied during the prior year less the amount, if any, paid or applied as a consequence of an obligation measured by the dedicated increment value. That millage rate shall be known as the "rolled-back rate." The property appraiser shall also include instructions, as prescribed by the Department of Revenue, to each county and municipality, each special district dependent to a county or municipality, each municipal service taxing unit, and each independent special district describing the proper method of computing the millage rates and taxes levied as specified in subsection (5). The Department of Revenue shall prescribe the instructions and forms that are necessary to administer this subsection and subsection (5). The information provided pursuant to this subsection shall also be sent to the tax collector by the property appraiser at the time it is sent to each taxing authority.

(2) No millage shall be levied until a resolution or ordinance has been approved by the governing board of the taxing authority which resolution or ordinance must be approved by the taxing authority according to the following procedure:

(a)1. Upon preparation of a tentative budget, but prior to adoption thereof, each taxing authority shall compute a proposed millage rate necessary to fund the tentative budget other than the portion of the budget to be funded from sources other than ad valorem taxes. In computing proposed or final millage rates, each taxing authority shall utilize not less than 95 percent of the taxable value certified pursuant to subsection (1).

2. The tentative budget of the county commission shall be prepared and submitted in accordance with s. [129.03](#).

3. The tentative budget of the school district shall be prepared and submitted in accordance with chapter 1011, provided that the date of submission shall not be later than 24 days after certification of value pursuant to subsection (1).

4. Taxing authorities other than the county and school district shall prepare and consider tentative and final budgets in accordance with this section and applicable provisions of law, including budget procedures applicable to the taxing authority, provided such procedures do not conflict with general law.

(b) Within 35 days of certification of value pursuant to subsection (1), each taxing authority shall advise the property appraiser of its proposed millage rate, of its rolled-back rate computed pursuant to subsection (1), and of the date, time, and place at which a public hearing will be held to consider the proposed millage rate and the tentative budget. The property appraiser shall utilize this information in preparing the notice of proposed property taxes pursuant to s. [200.069](#). The deadline for mailing the notice shall be the later of 55 days after certification of value pursuant to subsection (1) or 10 days after either the date the tax roll is approved or the interim roll procedures under s. [193.1145](#) are instituted. If the deadline for mailing the notice of proposed property taxes is 10 days after the date the tax roll is approved or the interim roll procedures are instituted, all subsequent deadlines provided in this section shall be extended. The number of days by which the deadlines shall be extended shall equal the

number of days by which the deadline for mailing the notice of proposed taxes is extended beyond 55 days after certification. If any taxing authority fails to provide the information required in this paragraph to the property appraiser in a timely fashion, the taxing authority shall be prohibited from levying a millage rate greater than the rolled-back rate computed pursuant to subsection (1) for the upcoming fiscal year, which rate shall be computed by the property appraiser and used in preparing the notice of proposed property taxes.

(c) Within 80 days of the certification of value pursuant to subsection (1), but not earlier than 65 days after certification, the governing body of each taxing authority shall hold a public hearing on the tentative budget and proposed millage rate. Prior to the conclusion of the hearing, the governing body of the taxing authority shall amend the tentative budget as it sees fit, adopt the amended tentative budget, recompute its proposed millage rate, and publicly announce the percent, if any, by which the recomputed proposed millage rate exceeds the rolled-back rate computed pursuant to subsection (1). That percent shall be characterized as the percentage increase in property taxes tentatively adopted by the governing body.

(d) Within 15 days after the meeting adopting the tentative budget, the taxing authority shall advertise in a newspaper of general circulation in the county as provided in subsection (3), its intent to finally adopt a millage rate and budget. A public hearing to finalize the budget and adopt a millage rate shall be held not less than 2 days nor more than 5 days after the day that the advertisement is first published. During the hearing, the governing body of the taxing authority shall amend the adopted tentative budget as it sees fit, adopt a final budget, and adopt a resolution or ordinance stating the millage rate to be levied. The resolution or ordinance shall state the percent, if any, by which the millage rate to be levied exceeds the rolled-back rate computed pursuant to subsection (1), which shall be characterized as the percentage increase in property taxes adopted by the governing body. The adoption of the budget and the millage-levy resolution or ordinance shall be by separate votes. For each taxing authority levying millage, the name of the taxing authority, the rolled-back rate, the percentage increase, and the millage rate to be levied shall be publicly announced prior to the adoption of the millage-levy resolution or ordinance. In no event may the millage rate adopted pursuant to this paragraph exceed the millage rate tentatively adopted pursuant to paragraph (c). If the rate tentatively adopted pursuant to paragraph (c) exceeds the proposed rate provided to the property appraiser pursuant to paragraph (b), or as subsequently adjusted pursuant to subsection (11), each taxpayer within the jurisdiction of the taxing authority shall be sent notice by first-class mail of his or her taxes under the tentatively adopted millage rate and his or her taxes under the previously proposed rate. The notice must be prepared by the property appraiser, at the expense of the taxing authority, and must generally conform to the requirements of s. [200.069](#). If such additional notice is necessary, its mailing must precede the hearing held pursuant to this paragraph by not less than 10 days and not more than 15 days.

(e)1. In the hearings required pursuant to paragraphs (c) and (d), the first substantive issue discussed shall be the percentage increase in millage over the rolled-back rate necessary to fund the budget, if any, and the specific purposes for which ad valorem tax revenues are being increased. During such discussion, the governing body shall hear comments regarding the proposed increase and explain the reasons for the proposed increase over the rolled-back rate. The general public shall be allowed to speak and to ask questions prior to adoption of any measures by the governing body. The governing body shall adopt its tentative or final millage rate prior to adopting its tentative or final budget.

2. These hearings shall be held after 5 p.m. if scheduled on a day other than Saturday. No hearing shall be held on a Sunday. The county commission shall not schedule its hearings on days scheduled for hearings by the school board. The hearing dates

scheduled by the county commission and school board shall not be utilized by any other taxing authority within the county for its public hearings. A multicounty taxing authority shall make every reasonable effort to avoid scheduling hearings on days utilized by the counties or school districts within its jurisdiction. Tax levies and budgets for dependent special taxing districts shall be adopted at the hearings for the taxing authority to which such districts are dependent, following such discussion and adoption of levies and budgets for the superior taxing authority. A taxing authority may adopt the tax levies for all of its dependent special taxing districts, and may adopt the budgets for all of its dependent special taxing districts, by a single unanimous vote. However, if a member of the general public requests that the tax levy or budget of a dependent special taxing district be separately discussed and separately adopted, the taxing authority shall discuss and adopt that tax levy or budget separately. If, due to circumstances beyond the control of the taxing authority, the hearing provided for in paragraph (d) is recessed, the taxing authority shall publish a notice in a newspaper of general paid circulation in the county. The notice shall state the time and place for the continuation of the hearing and shall be published at least 2 days but not more than 5 days prior to the date the hearing will be continued.

(f)1. Notwithstanding any provisions of paragraph (c) to the contrary, each school district shall advertise its intent to adopt a tentative budget in a newspaper of general circulation pursuant to subsection (3) within 29 days of certification of value pursuant to subsection (1). Not less than 2 days or more than 5 days thereafter, the district shall hold a public hearing on the tentative budget pursuant to the applicable provisions of paragraph (c).

2. Notwithstanding any provisions of paragraph (b) to the contrary, each school district shall advise the property appraiser of its recomputed proposed millage rate within 35 days of certification of value pursuant to subsection (1). The recomputed proposed millage rate of the school district shall be considered its proposed millage rate for the purposes of paragraph (b).

3. Notwithstanding any provisions of paragraph (d) to the contrary, each school district shall hold a public hearing to finalize the budget and adopt a millage rate within 80 days of certification of value pursuant to subsection (1), but not earlier than 65 days after certification. The hearing shall be held in accordance with the applicable provisions of paragraph (d), except that a newspaper advertisement need not precede the hearing.

(g) Notwithstanding other provisions of law to the contrary, a taxing authority may:

1. Expend moneys based on its tentative budget after adoption pursuant to paragraph (c) and until such time as its final budget is adopted pursuant to paragraph (d), only if the fiscal year of the taxing authority begins prior to adoption of the final budget or, in the case of a school district, if the fall term begins prior to adoption of the final budget; or

2. Readopt its prior year's adopted final budget, as amended, and expend moneys based on that budget until such time as its tentative budget is adopted pursuant to paragraph (c), only if the fiscal year of the taxing authority begins prior to adoption of the tentative budget. The readopted budget shall be adopted by resolution without notice pursuant to this section at a duly constituted meeting of the governing body.

(3) The advertisement shall be no less than one-quarter page in size of a standard size or a tabloid size newspaper, and the headline in the advertisement shall be in a type no smaller than 18 point. The advertisement shall not be placed in that portion of the newspaper where legal notices and classified advertisements appear. The advertisement shall be published in a newspaper of general paid circulation in the county or in a geographically limited insert of such newspaper. The geographic boundaries in which such insert is circulated shall include the geographic boundaries of the taxing authority. It is the legislative intent that, whenever possible, the advertisement appear in a newspaper that is published at least 5 days a week unless the only newspaper in the

county is published less than 5 days a week, or that the advertisement appear in a geographically limited insert of such newspaper which insert is published throughout the taxing authority's jurisdiction at least twice each week. It is further the legislative intent that the newspaper selected be one of general interest and readership in the community and not one of limited subject matter, pursuant to chapter 50.

(a) For taxing authorities other than school districts which have tentatively adopted a millage rate in excess of 100 percent of the rolled-back rate computed pursuant to subsection (1), the advertisement shall be in the following form:

#### NOTICE OF PROPOSED TAX INCREASE

The (name of the taxing authority) has tentatively adopted a measure to increase its property tax levy.

Last year's property tax levy:

A. Initially proposed tax levy.....\$XX,XXX,XXX

B. Less tax reductions due to Value Adjustment Board and other assessment changes.....(\$XX,XXX,XXX)

C. Actual property tax levy.....\$XX,XXX,XXX

This year's proposed tax levy.....\$XX,XXX,XXX

All concerned citizens are invited to attend a public hearing on the tax increase to be held on (date and time) at (meeting place) .

A FINAL DECISION on the proposed tax increase and the budget will be made at this hearing.

(b) In all instances in which the provisions of paragraph (a) are inapplicable for taxing authorities other than school districts, the advertisement shall be in the following form:

#### NOTICE OF BUDGET HEARING

The (name of taxing authority) has tentatively adopted a budget for (fiscal year) . A public hearing to make a FINAL DECISION on the budget AND TAXES will be held on (date and time) at (meeting place) .

(c) For school districts which have proposed a millage rate in excess of 100 percent of the rolled-back rate computed pursuant to subsection (1) and which propose to levy nonvoted millage in excess of the minimum amount required pursuant to s. [1011.60](#)(6), the advertisement shall be in the following form:

#### NOTICE OF PROPOSED TAX INCREASE

The (name of school district) will soon consider a measure to increase its property tax levy.

Last year's property tax levy:

A. Initially proposed tax levy.....\$XX,XXX,XXX

B. Less tax reductions due to Value Adjustment Board and other assessment changes.....(\$XX,XXX,XXX)

C. Actual property tax levy.....\$XX,XXX,XXX

This year's proposed tax levy.....\$XX,XXX,XXX

A portion of the tax levy is required under state law in order for the school board to receive \$ (amount A) in state education grants. The required portion has (increased or decreased) by (amount B) percent and represents approximately (amount C) of the total proposed taxes.

The remainder of the taxes is proposed solely at the discretion of the school board.

All concerned citizens are invited to a public hearing on the tax increase to be held on (date and time) at (meeting place) .

A DECISION on the proposed tax increase and the budget will be made at this hearing.

1. AMOUNT A shall be an estimate, provided by the Department of Education, of the amount to be received in the current fiscal year by the district from state appropriations for the Florida Education Finance Program.

2. AMOUNT B shall be the percent increase over the rolled-back rate necessary to levy only the required local effort in the current fiscal year, computed as though in the preceding fiscal year only the required local effort was levied.

3. AMOUNT C shall be the quotient of required local-effort millage divided by the total proposed nonvoted millage, rounded to the nearest tenth and stated in words; however, the stated amount shall not exceed nine-tenths.

(d) For school districts which have proposed a millage rate in excess of 100 percent of the rolled-back rate computed pursuant to subsection (1) and which propose to levy as nonvoted millage only the minimum amount required pursuant to s. [1011.60](#)(6), the advertisement shall be the same as provided in paragraph (c), except that the second and third paragraphs shall be replaced with the following paragraph:

This increase is required under state law in order for the school board to receive \$ (amount A) in state education grants.

(e) In all instances in which the provisions of paragraphs (c) and (d) are inapplicable for school districts, the advertisement shall be in the following form:

#### NOTICE OF BUDGET HEARING

The (name of school district) will soon consider a budget for (fiscal year) . A public hearing to make a DECISION on the budget AND TAXES will be held on (date and time) at (meeting place) .



(f) In lieu of publishing the notice set out in this subsection, the taxing authority may mail a copy of the notice to each elector residing within the jurisdiction of the taxing authority.

(g) In the event that the mailing of the notice of proposed property taxes is delayed beyond September 3 in a county, any multicounty taxing authority which levies ad valorem taxes within that county shall advertise its intention to adopt a tentative budget and millage rate in a newspaper of paid general circulation within that county, as provided in this subsection, and shall hold the hearing required pursuant to paragraph (2)(c) not less than 2 days or more than 5 days thereafter, and not later than September 18. The advertisement shall be in the following form, unless the proposed millage rate is less than or equal to the rolled-back rate, computed pursuant to subsection (1), in which case the advertisement shall be as provided in paragraph (e):

#### NOTICE OF TAX INCREASE

The (name of the taxing authority) proposes to increase its property tax levy by (percentage of increase over rolled-back rate) percent.

All concerned citizens are invited to attend a public hearing on the proposed tax increase to be held on (date and time) at (meeting place) .

(h) In no event shall any taxing authority add to or delete from the language of the advertisements as specified herein unless expressly authorized by law, except that, if an increase in ad valorem tax rates will affect only a portion of the jurisdiction of a taxing authority, advertisements may include a map or geographical description of the area to be affected and the proposed use of the tax revenues under consideration. In addition, if published in the newspaper, the map must be part of the online advertisement required by s. [50.0211](#). The advertisements required herein shall not be accompanied, preceded, or followed by other advertising or notices which conflict with or modify the substantive content prescribed herein.

(i) The advertisements required pursuant to paragraphs (b) and (e) need not be one-quarter page in size or have a headline in type no smaller than 18 point.

(j) The amounts to be published as percentages of increase over the rolled-back rate pursuant to this subsection shall be based on aggregate millage rates and shall exclude voted millage levies unless expressly provided otherwise in this subsection.

(k) Any taxing authority which will levy an ad valorem tax for an upcoming budget year but does not levy an ad valorem tax currently shall, in the advertisement specified in paragraph (a), paragraph (c), paragraph (d), or paragraph (g), replace the phrase "increase its property tax levy by (percentage of increase over rolled-back rate) percent" with the phrase "impose a new property tax levy of \$ (amount) per \$1,000 value."

(l) Any advertisement required pursuant to this section shall be accompanied by an adjacent notice meeting the budget summary requirements of s. [129.03](#)(3)(b). Except for those taxing authorities proposing to levy ad valorem taxes for the first time, the following statement shall appear in the budget summary in boldfaced type immediately following the heading, if the applicable percentage is greater than zero:

THE PROPOSED OPERATING BUDGET EXPENDITURES OF (name of taxing authority) ARE (percent rounded to one decimal place) MORE THAN LAST YEAR'S TOTAL OPERATING EXPENDITURES.

For purposes of this paragraph, "proposed operating budget expenditures" or "operating expenditures" means all moneys of the local government, including dependent special districts, that:

1. Were or could be expended during the applicable fiscal year, or
2. Were or could be retained as a balance for future spending in the fiscal year.

Provided, however, those moneys held in or used in trust, agency, or internal service funds, and expenditures of bond proceeds for capital outlay or for advanced refunded debt principal, shall be excluded.

(4) The resolution or ordinance approved in the manner provided for in this section shall be forwarded to the property appraiser and the tax collector within 3 days after the adoption of such resolution or ordinance. No millage other than that approved by referendum may be levied until the resolution or ordinance to levy required in subsection (2) is approved by the governing board of the taxing authority and submitted to the property appraiser and the tax collector. The receipt of the resolution or ordinance by the property appraiser shall be considered official notice of the millage rate approved by the taxing authority, and that millage rate shall be the rate applied by the property appraiser in extending the rolls pursuant to s. [193.122](#), subject to the provisions of subsection (6). These submissions shall be made within 101 days of certification of value pursuant to subsection (1).

(5) In each fiscal year:

(a) The maximum millage rate that a county, municipality, special district dependent to a county or municipality, municipal service taxing unit, or independent special district may levy is a rolled-back rate based on the amount of taxes which would have been levied in the prior year if the maximum millage rate had been applied, adjusted for change in per capita Florida personal income, unless a higher rate was adopted, in which case the maximum is the adopted rate. The maximum millage rate applicable to a county authorized to levy a county public hospital surtax under s. [212.055](#) and which did so in fiscal year 2007 shall exclude the revenues required to be contributed to the county public general hospital in the current fiscal year for the purposes of making the maximum millage rate calculation, but shall be added back to the maximum millage rate allowed after the roll back has been applied, the total of which shall be considered the maximum millage rate for such a county for purposes of this subsection. The revenue required to be contributed to the county public general hospital for the upcoming fiscal year shall be calculated as 11.873 percent times the millage rate levied for countywide purposes in fiscal year 2007 times 95 percent of the preliminary tax roll for the upcoming fiscal year. A higher rate may be adopted only under the following conditions:

1. A rate of not more than 110 percent of the rolled-back rate based on the previous year's maximum millage rate, adjusted for change in per capita Florida personal income, may be adopted if approved by a two-thirds vote of the membership of the governing body of the county, municipality, or independent district; or
2. A rate in excess of 110 percent may be adopted if approved by a unanimous vote of the membership of the governing body of the county, municipality, or independent district or by a three-fourths vote of the membership of the governing body if the governing body has nine or more members, or if the rate is approved by a referendum.

(b) The millage rate of a county or municipality, municipal service taxing unit of that county, and any special district dependent to that county or municipality may exceed the maximum millage rate calculated pursuant to this subsection if the total county ad valorem taxes levied or total municipal ad valorem taxes levied do not exceed the maximum total county ad valorem taxes levied or maximum total municipal ad valorem

taxes levied respectively. Voted millage and taxes levied by a municipality or independent special district that has levied ad valorem taxes for less than 5 years are not subject to this limitation. The millage rate of a county authorized to levy a county public hospital surtax under s. [212.055](#) may exceed the maximum millage rate calculated pursuant to this subsection to the extent necessary to account for the revenues required to be contributed to the county public hospital. Total taxes levied may exceed the maximum calculated pursuant to subsection (6) as a result of an increase in taxable value above that certified in subsection (1) if such increase is less than the percentage amounts contained in subsection (6) or if the administrative adjustment cannot be made because the value adjustment board is still in session at the time the tax roll is extended; otherwise, millage rates subject to this subsection may be reduced so that total taxes levied do not exceed the maximum.

Any unit of government operating under a home rule charter adopted pursuant to ss. 10, 11, and 24, Art. VIII of the State Constitution of 1885, as preserved by s. 6(e), Art. VIII of the State Constitution of 1968, which is granted the authority in the State Constitution to exercise all the powers conferred now or hereafter by general law upon municipalities and which exercises such powers in the unincorporated area shall be recognized as a municipality under this subsection. For a downtown development authority established before the effective date of the 1968 State Constitution which has a millage that must be approved by a municipality, the governing body of that municipality shall be considered the governing body of the downtown development authority for purposes of this subsection.

(6) Prior to extension of the rolls pursuant to s. [193.122](#), the property appraiser shall notify each taxing authority of the aggregate change in the assessment roll, if any, from that certified pursuant to subsection (1), including, but not limited to, those changes which result from actions by the value adjustment board or from corrections of errors in the assessment roll. Municipalities, counties, school boards, and water management districts may adjust administratively their adopted millage rate without a public hearing if the taxable value within the jurisdiction of the taxing authority as certified pursuant to subsection (1) is at variance by more than 1 percent with the taxable value shown on the roll to be extended. Any other taxing authority may adjust administratively its adopted millage rate without a public hearing if the taxable value within the jurisdiction of the taxing authority as certified pursuant to subsection (1) is at variance by more than 3 percent with the taxable value shown on the roll to be extended. The adjustment shall be such that the taxes computed by applying the adopted rate against the certified taxable value are equal to the taxes computed by applying the adjusted adopted rate to the taxable value on the roll to be extended. However, no adjustment shall be made to levies required by law to be a specific millage amount. Not later than 3 days after receipt of notification pursuant to this subsection, each affected taxing authority shall certify to the property appraiser its adjusted adopted rate. Failure to so certify shall constitute waiver of the adjustment privilege.

(7) Nothing contained in this section shall serve to extend or authorize any millage in excess of the maximum millage permitted by law or prevent the reduction of millage.

(8) The property appraiser shall deliver to the presiding officer of each taxing authority within the county, on June 1, an estimate of the total assessed value of nonexempt property for the current year for budget planning purposes.

(9) Multicounty taxing authorities are subject to the provisions of this section. The term "taxable value" means the taxable value of all property subject to taxation by the authority. If a multicounty taxing authority has not received a certification pursuant to subsection (1) from a county by July 15, it shall compute its proposed millage rate and rolled-back rate based upon estimates of taxable value supplied by the Department of

Revenue. All dates for public hearings and advertisements specified in this section shall, with respect to multicounty taxing authorities, be computed as though certification of value pursuant to subsection (1) were made July 1. The multicounty district shall add the following sentence to the advertisement set forth in paragraphs (3)(a) and (g): This tax increase is applicable to (name of county or counties) .

(10)(a) In addition to the notice required in subsection (3), a district school board shall publish a second notice of intent to levy additional taxes under s. [1011.71](#)(2) or (3). The notice shall specify the projects or number of school buses anticipated to be funded by the additional taxes and shall be published in the size, within the time periods, adjacent to, and in substantial conformity with the advertisement required under subsection (3). The projects shall be listed in priority within each category as follows: construction and remodeling; maintenance, renovation, and repair; motor vehicle purchases; new and replacement equipment; payments for educational facilities and sites due under a lease-purchase agreement; payments for renting and leasing educational facilities and sites; payments of loans approved pursuant to ss. [1011.14](#) and [1011.15](#); payment of costs of compliance with environmental statutes and regulations; payment of premiums for property and casualty insurance necessary to insure the educational and ancillary plants of the school district; payment of costs of leasing relocatable educational facilities; and payments to private entities to offset the cost of school buses pursuant to s. [1011.71](#)(2)(i). The additional notice shall be in the following form, except that if the district school board is proposing to levy the same millage under s. [1011.71](#)(2) or (3) which it levied in the prior year, the words "continue to" shall be inserted before the word "impose" in the first sentence, and except that the second sentence of the second paragraph shall be deleted if the district is advertising pursuant to paragraph (3)(e):

#### NOTICE OF TAX FOR SCHOOL CAPITAL OUTLAY

The (name of school district) will soon consider a measure to impose  
a (number) mill property tax for the capital outlay projects listed herein.

This tax is in addition to the school board's proposed tax of (number) mills for operating expenses and is proposed solely at the discretion of the school board. THE PROPOSED COMBINED SCHOOL BOARD TAX INCREASE FOR BOTH OPERATING EXPENSES AND CAPITAL OUTLAY IS SHOWN IN THE ADJACENT NOTICE.

The capital outlay tax will generate approximately \$ (amount) , to be used for the following projects:

(list of capital outlay projects)

All concerned citizens are invited to a public hearing to be held on (date and time) at (meeting place) .

A DECISION on the proposed CAPITAL OUTLAY TAXES will be made at this hearing.

(b) In the event a school district needs to amend the list of capital outlay projects previously advertised and adopted, a notice of intent to amend the notice of tax for school capital outlay shall be published in conformity with the advertisement required in subsection (3). A public hearing to adopt the amended project list shall be held not less than 2 days nor more than 5 days after the day the advertisement is first published. The projects should be listed under each category of new, amended, or deleted projects in

the same order as required in paragraph (a). The notice shall appear in the following form, except that any of the categories of new, amended, or deleted projects may be omitted if not appropriate for the changes proposed:

#### AMENDED NOTICE OF TAX FOR

#### SCHOOL CAPITAL OUTLAY

The School Board of (name) County will soon consider a measure to amend the use of property tax for the capital outlay projects previously advertised for the (year) to (year) school year.

New projects to be funded:

(list of capital outlay projects)

Amended projects to be funded:

(list of capital outlay projects)

Projects to be deleted:

(list of capital outlay projects)

All concerned citizens are invited to a public hearing to be held on (date and time) at (meeting place) .

A DECISION on the proposed amendment to the projects funded from CAPITAL OUTLAY TAXES will be made at this meeting.

(11) Notwithstanding the provisions of paragraph (2)(b) and s. [200.069](#)(4)(f) to the contrary, the proposed millage rates provided to the property appraiser by the taxing authority, except for millage rates adopted by referendum, for rates authorized by s. [1011.71](#), and for rates required by law to be in a specified millage amount, shall be adjusted in the event that a review notice is issued pursuant to s. [193.1142](#)(4) and the taxable value on the approved roll is at variance with the taxable value certified pursuant to subsection (1). The adjustment shall be made by the property appraiser, who shall notify the taxing authorities affected by the adjustment within 5 days of the date the roll is approved pursuant to s. [193.1142](#)(4). The adjustment shall be such as to provide for no change in the dollar amount of taxes levied from that initially proposed by the taxing authority.

(12) The time periods specified in this section shall be determined by using the date of certification of value pursuant to subsection (1) or July 1, whichever date is later, as day 1. The time periods shall be considered directory and may be shortened, provided:

(a) No public hearing which is preceded by a mailed notice occurs earlier than 10 days following the mailing of such notice;

(b) Any public hearing preceded by a newspaper advertisement is held not less than 2 days or more than 5 days following publication of such advertisement; and

(c) The property appraiser coordinates such shortening of time periods and gives written notice to all affected taxing authorities; however, no taxing authority shall be denied its right to the full time periods allowed in this section.

(13)(a) Any taxing authority in violation of this section, other than subsection (5), shall be subject to forfeiture of state funds otherwise available to it for the 12 months following a determination of noncompliance by the Department of Revenue.

(b) Within 30 days of the deadline for certification of compliance required by s. [200.068](#), the department shall notify any taxing authority in violation of this section, other than subsection (5), that it is subject to paragraph (c). Except for revenues from voted levies or levies imposed pursuant to s. [1011.60](#)(6), the revenues of any taxing authority in violation of this section, other than subsection (5), collected in excess of the rolled-back rate shall be held in escrow until the process required by paragraph (c) is completed and approved by the department. The department shall direct the tax collector to so hold such funds.

(c) Any taxing authority so noticed by the department shall repeat the hearing and notice process required by paragraph (2)(d), except that:

1. The advertisement shall appear within 15 days of notice from the department.
2. The advertisement, in addition to meeting the requirements of subsection (3), shall contain the following statement in boldfaced type immediately after the heading:

THE PREVIOUS NOTICE PLACED BY THE (name of taxing authority) HAS BEEN DETERMINED BY THE DEPARTMENT OF REVENUE TO BE IN VIOLATION OF THE LAW, NECESSITATING THIS SECOND NOTICE.

3. The millage newly adopted at this hearing shall not be forwarded to the tax collector or property appraiser and may not exceed the rate previously adopted.

4. If the newly adopted millage is less than the amount previously forwarded pursuant to subsection (4), any moneys collected in excess of the new levy shall be held in reserve until the subsequent fiscal year and shall then be utilized to reduce ad valorem taxes otherwise necessary.

(d) If any county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county is in violation of subsection (5) because total county or municipal ad valorem taxes exceeded the maximum total county or municipal ad valorem taxes, respectively, that county or municipality shall forfeit the distribution of local government half-cent sales tax revenues during the 12 months following a determination of noncompliance by the Department of Revenue as described in s. [218.63](#)(3) and this subsection. If the executive director of the Department of Revenue determines that any county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county is in violation of subsection (5), the Department of Revenue and the county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county shall follow the procedures set forth in this paragraph or paragraph (e). During the pendency of any procedure under paragraph (e) or any administrative or judicial action to challenge any action taken under this subsection, the tax collector shall hold in escrow any revenues collected by the noncomplying county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county in excess of the amount allowed by subsection (5), as determined by the executive director. Such revenues shall be held in escrow until the process required by paragraph (e) is completed and approved by the department. The department shall direct the tax collector to so hold such funds. If the county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county remedies the noncompliance, any moneys collected in excess of the new levy or in excess of the amount allowed by subsection (5) shall be held in reserve until the subsequent fiscal year and shall then be used to reduce ad valorem taxes otherwise necessary. If the county or municipality, dependent special



district of such county or municipality, or municipal service taxing unit of such county does not remedy the noncompliance, the provisions of s. [218.63](#) shall apply.

(e) The following procedures shall be followed when the executive director notifies any county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county that he or she has determined that such taxing authority is in violation of subsection (5):

1. Within 30 days after the deadline for certification of compliance required by s. [200.068](#), the executive director shall notify any such county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county of his or her determination regarding subsection (5) and that such taxing authority is subject to subparagraph 2.

2. Any taxing authority so noticed by the executive director shall repeat the hearing and notice process required by paragraph (2)(d), except that:

a. The advertisement shall appear within 15 days after notice from the executive director.

b. The advertisement, in addition to meeting the requirements of subsection (3), must contain the following statement in boldfaced type immediately after the heading:

THE PREVIOUS NOTICE PLACED BY THE (name of taxing authority) HAS BEEN DETERMINED BY THE DEPARTMENT OF REVENUE TO BE IN VIOLATION OF THE LAW, NECESSITATING THIS SECOND NOTICE.

c. The millage newly adopted at such hearing shall not be forwarded to the tax collector or property appraiser and may not exceed the rate previously adopted or the amount allowed by subsection (5). Each taxing authority provided notice pursuant to this paragraph shall recertify compliance with this chapter as provided in this section within 15 days after the adoption of a millage at such hearing.

d. The determination of the executive director shall be superseded if the executive director determines that the county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county has remedied the noncompliance. Such noncompliance shall be determined to be remedied if any such taxing authority provided notice by the executive director pursuant to this paragraph adopts a new millage that does not exceed the maximum millage allowed for such taxing authority under paragraph (5)(a), or if any such county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county adopts a lower millage sufficient to reduce the total taxes levied such that total taxes levied do not exceed the maximum as provided in paragraph (5)(b).

e. If any such county or municipality, dependent special district of such county or municipality, or municipal service taxing unit of such county has not remedied the noncompliance or recertified compliance with this chapter as provided in this paragraph, and the executive director determines that the noncompliance has not been remedied or compliance has not been recertified, the county or municipality shall forfeit the distribution of local government half-cent sales tax revenues during the 12 months following a determination of noncompliance by the Department of Revenue as described in s. [218.63](#)(2) and (3) and this subsection.

f. The determination of the executive director is not subject to chapter 120.

(14)(a) If the notice of proposed property taxes mailed to taxpayers under this section contains an error, the property appraiser, in lieu of mailing a corrected notice to all taxpayers, may correct the error by mailing a short form of the notice to those taxpayers affected by the error and its correction. The notice shall be prepared by the property appraiser at the expense of the taxing authority which caused the error or at the property appraiser's expense if he or she caused the error. The form of the notice must be approved by the executive director of the Department of Revenue or the

executive director's designee. If the error involves only the date and time of the public hearings required by this section, the property appraiser, with the permission of the taxing authority affected by the error, may correct the error by advertising the corrected information in a newspaper of general circulation in the county as provided in subsection (3).

(b) Errors that may be corrected in this manner are:

1. Incorrect location, time, or date of a public hearing.
2. Incorrect assessed, exempt, or taxable value.
3. Incorrect amount of taxes as reflected in column one, column two, or column three of the notice; and
4. Any other error as approved by the executive director of the Department of Revenue or the executive director's designee.

(15) The provisions of this section shall apply to all taxing authorities in this state which levy ad valorem taxes, and shall control over any special law which is inconsistent or in conflict with this section, except to the extent the special law expressly exempts a taxing authority from the provisions of this section. This subsection is a clarification of existing law, and in the absence of such express exemption, no past or future budget or levy of taxes shall be set aside upon the ground that the taxing authority failed to comply with any special law prescribing a schedule or procedure for such adoption which is inconsistent or in conflict with the provisions of this section.

History.—s. 13, ch. 73-172; s. 16, ch. 74-234; ss. 1, 2, ch. 75-68; s. 19, ch. 76-133; s. 1, ch. 77-102; s. 1, ch. 77-174; s. 1, ch. 78-228; ss. 2, 9, ch. 80-261; s. 25, ch. 80-274; s. 14, ch. 82-154; s. 12, ch. 82-208; ss. 4, 11, 25, 72, 80, ch. 82-226; s. 5, ch. 82-388; s. 2, ch. 82-399; s. 28, ch. 83-204; s. 61, ch. 83-217; s. 2, ch. 84-164; s. 20, ch. 84-356; s. 1, ch. 86-190; s. 12, ch. 86-300; s. 5, ch. 87-284; s. 13, ch. 88-216; s. 2, ch. 88-223; s. 14, ch. 90-241; ss. 136, 165, ch. 91-112; s. 8, ch. 91-295; s. 1, ch. 92-163; ss. 5, 15, ch. 93-132; s. 25, ch. 93-233; s. 1, ch. 93-241; s. 52, ch. 94-232; s. 4, ch. 94-344; s. 41, ch. 94-353; s. 1481, ch. 95-147; s. 2, ch. 95-359; ss. 1, 2, 3, ch. 96-211; s. 1, ch. 98-32; s. 1, ch. 98-53; s. 18, ch. 99-6; s. 11, ch. 2002-18; s. 911, ch. 2002-387; s. 2, ch. 2004-346; s. 3, ch. 2007-194; ss. 2, 33, ch. 2007-321; s. 11, ch. 2008-173; s. 3, ch. 2009-165; s. 29, ch. 2012-193; s. 7, ch. 2012-212; s. 13, ch. 2015-2; s. 17, ch. 2016-10; s. 2, ch. 2017-35.

<sup>1</sup>Note.—Section 4, ch. 2017-35, provides that “[t]his act shall take effect on the effective date of the amendment to the State Constitution proposed by HJR 7105 or a similar joint resolution having substantially the same specific intent and purpose, if such amendment to the State Constitution is approved at the general election held in November 2018 and shall apply to the 2019 tax roll.” If such an amendment is approved, current subsection (15) is renumbered as subsection (16), and a new subsection (15) is added, by s. 2, ch. 2017-35, to read:

(15)(a) Notwithstanding the method of computing the rolled-back rate in subsection (1), the taxable value that is used in computing the rolled-back rate in subsection (1) and the maximum millage rate under subsection (5) shall be increased by an amount equal to the reduction in taxable value occurring as a result of the revision to s. 6(a) of Art. VII of the State Constitution approved in November 2018 which authorizes an additional exemption of up to \$25,000 for all levies other than school district levies. For purposes of this paragraph, the taxable value shall be based on value as of January 1, 2019, within each taxing authority.

(b) This subsection is repealed on December 31, 2019.

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**218.25 Limitation of shared funds; holders of bonds protected; limitation on use of second guaranteed entitlement for counties.—**

(1) Except as provided in subsection (2) with respect to the second guaranteed entitlement for counties, local governments shall not use any portion of the moneys received in excess of the guaranteed entitlement from the revenue sharing trust funds created by this part to assign, pledge, or set aside as a trust for the payment of principal or interest on bonds, tax anticipation certificates, or any other form of indebtedness, and there shall be no other use restriction on revenues shared pursuant to this part. The state does hereby covenant with holders of bonds or other instruments of indebtedness issued by local governments prior to July 1, 1972, that it is not the intent of this part to affect adversely the rights of said holders or to relieve local governments of the duty to meet their obligations as a result of previous pledges or assignments or trusts entered into which obligated funds received from revenue sources which by terms of this part shall henceforth be distributed out of the revenue sharing trust funds.

(2) The second guaranteed entitlement for counties may be assigned, pledged, or set aside as a trust for the payment of principal or interest on bonds, tax anticipation certificates, or any other form of indebtedness, including obligations issued to acquire an insurance contract or contracts from a local government liability pool and including payments required pursuant to any loan agreement entered into to provide funds to acquire an insurance contract or contracts from a local government liability pool.

(3) As an additional assurance to holders of bonds issued before April 18, 2000, which are secured by the guaranteed entitlement or second guaranteed entitlement for counties, or bonds issued to refund such bonds which mature no later than the bonds that they refunded and which result in a reduction of debt service payable in each fiscal year, it is the intent of the Legislature that, to the extent the elimination of tax sources dedicated to funding the guaranteed entitlement or the second guaranteed entitlement for counties or a reduction in the rate of assessment of such taxes results in an inability of a county to pay debt service on such bonds, the Legislature will provide alternative funding sources in an amount sufficient to pay any deficit in the amount required for such debt service. This commitment of the Legislature is contingent on the county first using any funds available under this part for the payment of such debt service.

(4) Notwithstanding subsections (1) and (2), a local government may assign, pledge, or set aside as a trust for the payment of principal or interest on bonds, tax anticipation certificates, or any other form of indebtedness an amount up to 50 percent of the funds received in the prior year.

History.—s. 1, ch. 72-360; s. 1, ch. 73-349; s. 1, ch. 74-194; s. 9, ch. 87-237; s. 11, ch. 2000-173; s. 96, ch. 2003-402.

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**Internal Revenue Service  
Publication 4079  
Tax-Exempt  
Governmental Bonds**



Tax Exempt & Government Entities

**OFFICE OF  
TAX EXEMPT BONDS**



# **Publication 4079**

## **Tax-Exempt Governmental Bonds**



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## INTRODUCTION

The Office of Tax Exempt Bonds (“TEB”), of the Internal Revenue Service (“IRS”), Tax Exempt and Government Entities division, offers specialized information and services, including educational materials, to the municipal finance community.

This IRS Publication 4079, *Tax-Exempt Governmental Bonds* (the “Publication”), provides to state and local governments that issue tax-exempt bonds an overview of the federal tax law rules that apply to municipal financing arrangements commonly known as “governmental bonds.” Certain exceptions or additional requirements to these rules, which are beyond the scope of this Publication, may apply to particular financing arrangements. This Publication is intended to help issuers meet applicable federal tax law requirements to ensure that interest earned by bondholders is exempt from taxation under Section 103 of the Internal Revenue Code (the “Code”).

This Publication is an overview of the rules; it is not official guidance that taxpayers may rely upon for planning purposes. This Publication refers to various Code sections, income tax regulations (the “Regulations”), revenue procedures and other official guidance relating to the topics discussed. Please refer to the official guidance for the rules that apply to governmental bonds. Unless otherwise indicated, references in this Publication to section numbers are references to sections of the Code.

This Publication is only one of TEB’s many outreach efforts. For publications regarding the general rules applicable to qualified 501(c)(3) bonds or other qualified private activity bonds, see IRS [Publication 4077, \*Tax-Exempt Bonds for 501\(c\)\(3\) Charitable Organizations\*](#) and IRS [Publication 4078, \*Tax-Exempt Private Activity Bonds\*](#), respectively. For an overview of an issuer’s responsibilities in a conduit financing arrangement, see IRS [Publication 5005, \*Your Responsibilities as a Conduit Issuer of Tax-Exempt Bonds\*](#). TEB also provides detailed information on specific provisions of the tax law through other IRS publications and through outreach efforts as noted on the TEB website at [www.irs.gov/Tax-Exempt-Bonds](http://www.irs.gov/Tax-Exempt-Bonds). See also [TEB INFORMATION AND SERVICES](#), at the end of this Publication.

## BACKGROUND

State and local governments receive direct and indirect tax benefits under the Code that lower borrowing costs on their valid debt obligations. Because interest paid to bondholders on these obligations is not includable in their gross income for federal income tax purposes, bondholders are willing to accept a lower interest rate than they would accept if the interest was taxable. These benefits apply to many different types of municipal debt financing arrangements including bonds, notes, loans, lease purchase contracts, lines of credit and commercial paper (collectively referred to as “bonds” in this Publication).

To receive these benefits, issuers must ensure that the requirements under the Code are met, generally for as long as the bonds remain outstanding. These requirements include, but are not limited to, information filing and other requirements related to issuance, the proper and timely use of bond-financed property, and limitations on how bond proceeds (funds derived from the sale of bonds) may be invested. This Publication describes these rules as they relate to governmental bonds.

This Publication also addresses practices and steps the issuer can take to protect the tax-exempt status of the bonds. For example, because the requirements and limitations generally apply at the time the bonds are issued and throughout the term of the bonds, this Publication encourages issuers and beneficiaries of tax-exempt bonds to create procedures for monitoring compliance throughout the life of the bonds. For more information, see the discussion below in the section titled POST-ISSUANCE COMPLIANCE MONITORING.

## TAX-EXEMPT GOVERNMENTAL BONDS

Governmental bonds are bonds that **do not** meet the private activity bond tests described in this section. Proceeds of these bonds may be used to finance activities of, or facilities owned, operated or used by, the issuer for its purpose or another state or local government for its own purposes. This can include financing the construction, maintenance or repair of various types of public infrastructure such as highways, schools, fire stations, libraries or other types of municipal facilities. To be tax-exempt, governmental bonds must comply with the requirements that define governmental bonds and requirements that apply to tax-exempt bonds generally.

In this section, we discuss the tests for determining whether a bond is a governmental bond or a private activity bond. These tests apply at issuance and after the bonds are issued. This discussion includes remedial action provisions that apply when a deliberate action causes governmental bonds to become private activity bonds. If a deliberate action that results in a violation of any of the federal tax requirements cannot be corrected under the remedial action provisions, issuers may be able to enter into a closing agreement under the TEB Voluntary Closing Agreement Program (“TEB VCAP”) described in [Notice 2008-31, 2008-11 I.R.B. 592](#) (see WHAT TO DO UPON DISCOVERING A VIOLATION – TEB VOLUNTARY CLOSING AGREEMENT PROGRAM at the end of this Publication).

## Testing for Governmental Bonds: The Private Activity Bond Tests

Section 141 of the Code sets forth tests to determine if a bond is private activity bond. These tests identify arrangements that actually, or are reasonably expected to, transfer benefits of tax-exempt financing to a nongovernmental person. A “nongovernmental person” is a person other than a governmental person. A governmental person means a state or local government as defined in section 1.103-1 of the Regulations or any instrumentality of such entity. Governmental persons do not include the United States or any agency or instrumentality of the United States.

A state or local bond will be a private activity bond if, as of the issue date of the bonds or at any time while the bonds are outstanding, the bond issue exceeds the limits set forth in either:

- the private business tests of Section 141(b), which consist of the private use test and the private security and payment test, and certain special private business rules (see [Special Private Business Test Rules](#) and [Special Rules for Certain Utility Financings](#), below), or
- the private loan financing test of Section 141(c).

The bond issue exceeds the limits set forth in the private activity bond tests as of the issue date if the issuer or a conduit borrower of the bond proceeds reasonably expects that the issue will exceed the limits while the bonds are outstanding. A bond issue also exceeds the limits set forth in the private activity bond tests after the issue date if a deliberate action is taken that causes those limits to be exceeded.

If a bond is a private activity bond, interest on the bond may still be excludable from federal income tax if the bond issue meets the additional requirements that apply to qualified private activity bonds. For a discussion of these additional requirements, see IRS [Publication 4078, Tax-Exempt Private Activity Bonds](#).

### Private Business Tests

Under Section 141(b) of the Code, a bond issue exceeds the limits of the private business tests, and therefore does not qualify as a governmental bond issue, if the issue exceeds the limit of the private business use test **and** also exceeds the limit of the private security or payment test.

**Private Business Use Test.** A state or local bond issue exceeds the limit of the private business use test if more than 10 percent of the proceeds of an issue are to be used for any private business use. Use of bond proceeds or bond-financed property by a nongovernmental person (individual or entity) in furtherance of a trade or business activity is considered private business use for tax-exempt bond purposes. For this purpose, any trade or business activity of a natural person is treated as a trade or business, and any activity carried on by a person (including a governmental entity or corporation) other than a natural person is treated as a trade or business.

Indirect uses of proceeds must also be considered in determining whether more than 10 percent of the proceeds of an issue will be used in a private business use. For example, property is treated as being used for a private business use if it is leased to a nongovernmental person and then sub-leased to a governmental person if the nongovernmental person’s use is in a trade or business.

Many types of arrangements can result in private business use under Section 141 of the Code at issuance or later, including management and service contracts and research agreements.

Management and Service Contracts. Contracts for a private entity to manage a bond-financed facility may cause the private business use test to be met. For example, a management contract



between a governmental entity and a nongovernmental person under which the nongovernmental person receives compensation for services provided with respect to bond-financed property may result in the bonds meeting the private business use test.

The IRS has provided safe harbors protecting against private business use for management and service contracts between a private entity and a governmental entity when such service is provided in connection with bond-financed property. For more information, see [Revenue Procedure 97-13, 1997-5 I.R.B. 18](#), as modified by [Revenue Procedure 2001-39, 2001-28 I.R.B. 38](#), and as amplified by [Notice 2014-67, 2014-46 I.R.B. 822](#). Contracts that fail the safe harbor do not automatically meet the private business use test; all facts and circumstances are considered to determine whether the contract meets the test.

Research Agreements. Research agreements may also cause the private business use test to be met. For example, when private entities or the federal government sponsor research at a facility financed with tax-exempt bonds, such research agreements may result in the bonds meeting the private business use test. However, the IRS has provided safe harbors for research agreements. For more information, see [Revenue Procedure 2007-47, 2007-29 I.R.B. 108](#). As with management contracts, failure to meet the safe harbors does not automatically cause the private business use test to be met.

*NOTE: If an issuer determines that its bonds meet the private business use test, the bonds have not met the private business tests unless the bonds also meet the private payment or security test.*

**Private Security or Payment Test.** A state or local bond exceeds the limit of the private security or payment test if more than 10 percent of the proceeds of the bond issue is (under the terms of the issue or any underlying arrangement) directly or indirectly (1) secured by any interest in property used or to be used for a private business use or payments in respect of such property, or (2) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use. For example, lease payments made by private businesses to a city for the lease of property in a blighted area that was rehabilitated with proceeds of the city's bonds would be treated as private payments.

*NOTE: If an issuer determines that its bonds meet the private security or payment test, the bonds have not met the private business tests unless the bonds also meet the private business use test.*

**Special Private Business Test Rules.** Additional limits on private business activity apply when private business use is unrelated to the governmental use, when private business use is disproportionate to the governmental use, and when the "nonqualified amount" exceeds \$15 million.

Unrelated and Disproportionate Use. Section 141(b)(3) of the Code provides an additional limit for unrelated and disproportionate business use, which is lower than the limits in Sections 141(b)(1) and 141(b)(2). In particular, it limits unrelated or disproportionate private use of assets financed with governmental bonds to 5 percent of the proceeds of the bonds. The rule also reduces the private security or payment test limit to 5 percent. For this purpose, only payments, property and borrowed money with respect to the unrelated or disproportionate use are taken into account.

Unrelated use is private use that is not related to the governmental use of the issue. Whether a private business use is related to a government use financed with the proceeds of an issue



is determined on a case-by-case basis, emphasizing the operational relationship between the government use and the private business use. In general, a facility that is used for a related private business use must be located within, or adjacent to, the governmentally-used facility.

Example: A county issues bonds with proceeds of \$20 million and uses \$18.1 million of the proceeds for construction of a new school building and \$1.9 million of the proceeds for construction of a privately operated cafeteria in its administrative office building, which is located at a remote site. The bonds are secured, in part, by the cafeteria. The \$1.9 million of proceeds is unrelated to the governmental use (that is, school construction) financed with the bonds and exceeds 5 percent of \$20 million. Thus, the issue exceeds the limit under the private business tests.

A private business use is disproportionate to a related government use only to the extent that the amount of proceeds used for that private business exceeds the amount of proceeds of the issue used for the related government use. For example, a private use of \$100 million of proceeds that is related to a government use of \$70 million of proceeds results in \$30 million of disproportionate use.

When unrelated use and disproportionate use occur in the same bond issue, the two uses are aggregated to test against the 5 percent limit. Additional examples of application of the unrelated or disproportionate private use limits may be found in section 1.141-9(e) of the Regulations.

Remedial Actions for Unrelated or Disproportionate Use. A deliberate action that occurs after the issue date does not result in unrelated or disproportionate use if the issue meets the remedial action provisions in Regulation section 1.141-12(a), discussed below in Remedial Actions for Nonqualified Use.

The \$15 Million Limit on the Nonqualified Amount. An additional limit may apply even though the “nonqualified amount” of proceeds does not exceed 10 percent of the proceeds of the bonds (or a lesser amount of unrelated or disproportionate use of proceeds), and therefore the private activity limits discussed above have not been exceeded. The nonqualified amount is the lesser of the amount of proceeds used in private business use or the amount of proceeds with respect to which there are private payments or security. Section 141(b)(5) provides that an issue of bonds will be private activity bonds if the nonqualified amount exceeds \$15 million, unless the issuer applies state volume cap under Section 146 to the excess of the nonqualified amount over \$15 million. For additional information on the state volume cap limit under Section 146, see IRS [Publication 4078, Tax-Exempt Private Activity Bonds](#).

**Special Rules for Certain Utility Financings.** There are two additional limits that issuers of bonds for utility projects should consider. The first limit, under Section 141(b)(4), applies if 5 percent or more of the proceeds of the issue are to be used to finance any “output facility,” as defined in the Regulations (other than a facility for the furnishing of water). Section 141(b)(4) limits the nonqualified amount of proceeds of a governmental bond issued to finance such output facilities to \$15 million. This rule applies in addition to the tests under Section 141(b)(1) and (2). In applying this limit, issuers must include the nonqualified amounts with respect to any prior outstanding tax-exempt bond issues for which 5 percent or more of the proceeds of the prior issue are or will be used with respect to either the same output facility or another output facility that is part of the same project. If the nonqualified amount exceeds \$15 million, the bonds are private activity bonds.

Under the second limit, bonds will be private activity bonds if the amount of the proceeds of the issue that are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of 5 percent of such proceeds or \$5

million. “Nongovernmental output property” means any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (other than a facility for the furnishing of water). The rule has several exceptions, which are beyond the scope of this Publication.

### **Private Loan Financing Test**

A state or local bond exceeds the limit of the private loan financing test if the amount of proceeds of the issue which is to be used (directly or indirectly) to make or finance loans to persons other than governmental entities exceeds the lesser of 5 percent of such proceeds or \$5 million. A bond that exceeds the private loan financing test limit is a private activity bond, even if it does not also meet the private business tests.

### **Exceeding the Private Activity Bond Tests Limits after Issuance**

Even if the bonds comply with the limits of the private activity bond tests at issuance, a governmental bond issue can lose its tax-exempt status (from the time of issuance) if the issuer or a conduit borrower of the bond proceeds takes a “deliberate action” subsequent to the issue date that causes the issue to exceed those limits. A deliberate action is any action taken by the issuer or conduit borrower that is within its control; intent to exceed the limits is not necessary for an action to be deliberate. A deliberate action occurs on the date the issuer or conduit borrower enters into a binding contract (that is not subject to any material contingencies) with a nongovernmental person for use of the bond-financed property in a manner that causes the limits of the private activity tests to be exceeded.

**Remedial Actions for Nonqualified Use.** The Regulations provide that an issuer and, in conduit financings, a conduit borrower that engages in a deliberate action causing the limits of the private activity bond tests to be exceeded may, in certain cases, cure that deliberate action. Section 1.141-12 of the Regulations provides that an issuer may take remedial actions to cure a deliberate action that would otherwise cause the bonds to lose their tax-exempt status. Such remedial actions include redemption or defeasance of nonqualified bonds, alternative use of disposition proceeds and alternative use of bond-financed property.

Example: A city enters into an agreement through which it sells a building financed with governmental bond proceeds to a corporation and leases the same building back from that corporation, with the result that the corporation owns the building for federal income tax purposes. This change in ownership of the property results in private business use and is a deliberate action. However, the city may remediate the deliberate action by redeeming the nonqualified bonds within 90 days of the action.

## **OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS**

This section describes other rules an issuer must also meet for a governmental bond to be tax-exempt. These include:

- rules a governmental bond must meet for interest to be excluded from federal income tax, including rules that relate to issuance of the bonds (including elections that need to be made when the bonds are issued) and rules that apply at issuance and throughout the life of the bonds;
- rules that apply when modifications are made to bond terms; and
- recordkeeping requirements.

## Requirements Related to Issuance

The following is an overview of several general rules related to the issuance of governmental bonds.

**Issuers Must File an Information Return.** Issuers of governmental bonds must comply with certain information filing requirements under Section 149(e) of the Code. The size of the issuance dictates which information return an issuer is required to file. The chart below describes what form is required and when it must be filed. The [IRS Forms](#) listed below are available on the TEB website.

Information Reporting Under Section 149(e)		
Information Return	Due Dates	Where to File
Form 8038-G, <i>Information Return for Tax-Exempt Governmental Obligations</i> , for a governmental bond issue with an issue price of \$100,000 or greater.	Generally, both returns are due on or before the 15 <sup>th</sup> day of the 2 <sup>nd</sup> calendar month after the close of the calendar quarter in which the bonds were issued.  Example: The due date of the return for bonds issued on February 1 is May 15.	File Form 8038-G and Form 8038-GC information returns with the IRS at the following address:  <b>Department of the Treasury Internal Revenue Service Center Ogden, UT 84201</b>
Form 8038-GC, <i>Information Return for Small Tax-Exempt Governmental Bond Issues, Leases, and Installment Sales</i> , for a governmental bond issue with an issue price of less than \$100,000. May be filed for a single issue or on a consolidated basis for all “small” issues in a calendar year.	Alternatively, Form 8038-GC may be filed annually on a consolidated basis for all bond issues of less than \$100,000 that are not reported on a separate Form 8038-GC and that are not construction issues electing to pay a penalty in lieu of rebate. Consolidated returns are due on or before February 15 following the calendar year in which the bonds were issued.  Example: An issuer issues three governmental bond issues with issue prices and dates as follows: \$50,000 Issue A - March 1, 2012; \$75,000 Issue B - June 15, 2012; and \$30,000 Issue C - October 5, 2012. This issuer can file one consolidated Form 8038-GC by February 15, 2013 for all three bond issues.	

An issuer may request an extension of time to file Forms 8038-G or 8038-GC if the failure to file the return on time was not due to willful neglect. To request an extension, the issuer must follow the procedures outlined in [Revenue Procedure 2002-48, 2002-37 I.R.B. 531](#). These procedures generally require that the issuer: (1) attach a letter to the Form 8038-G or Form 8038-GC briefly explaining when the return was required to be filed, why the return was not timely submitted, and whether or not the bond issue is under examination; (2) enter on top of the letter “Request for Relief under section 3 of Rev. Proc. 2002-48;” and (3) file this letter and the return at the Internal Revenue Service Center, Ogden, UT 84201.

**Bonds Must Be in Registered Form.** Section 149(a) of the Code generally provides that any tax-exempt bond, including governmental bonds, must be issued “in registered form” unless the bond (1) is not of a type offered to the public or (2) has, at the date of issue, a maturity of not more than one year. The Regulations describe what it means to be “in registered form.” Section 5f.103-1(c)(1) of the Regulations provides that an obligation issued after January 20, 1987, pursuant to a binding contract entered into after January 20, 1987, is in registered form if:

- the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and that the transfer of the obligation to a new holder may be effected only by surrender of the old instrument and either the reissuance by the issuer of the old instrument to the new holder or the issuance by the issuer of a new instrument to the new holder; or
- the right to the principal of, and stated interest on, the obligation may be transferred only through a book-entry system maintained by the issuer (or its agent); or
- the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and may be transferred through both of the methods described above.

**Issuers Must Make Certain Elections at Issuance.** When an issuer considers actions it must take when it issues bonds, it should consider whether it wants to make any elections. Various provisions of the Code and Regulations require that the issuer make certain elections in writing and retain elections as part of the bond documents. Many elections have to be made on or before the issue date of the bonds. Some elections may be made by either the issuer or a conduit borrower. Others must be made by the actual issuer of the bonds. The IRS frequently observes that issuers make the written elections in the arbitrage certificate prepared pursuant to section 1.148-2 of the Regulations. Once made, elections cannot be revoked without the IRS’s permission.

Examples of elections include:

- waiving the right to treat a purpose investment as a program investment
- waiving the right to invest in higher yielding investments during any temporary period
- the issuer of a pooled financing issue electing to apply rebate spending exceptions separately to each conduit loan
- applying actual facts rather than reasonable expectations for certain provisions under the two-year spending exception from rebate
- excluding the earnings on a reasonably required reserve fund from available construction proceeds under the two-year spending exception from rebate
- treating a portion of an issue as a separate construction issue under the two-year spending exception from rebate
- electing to pay one and one-half percent penalty in lieu of arbitrage rebate
- electing to treat portions of a bond issue as separate issues

## Requirements that Apply at Issuance and Throughout the Life of the Bonds

**Proceeds Must Be Timely Allocated to Expenditures.** Issuers and conduit borrowers are required to follow the rules for allocating bond proceeds. The issuer or other entity controlling expenditure of the proceeds of a governmental bond issue must allocate those proceeds among the various expenditures or other purposes of the issue in a manner demonstrating that the private activity bond tests are not met. These allocations must generally be consistent with the allocations made for determining compliance with the arbitrage yield restriction and rebate requirements, as well as other federal tax filings. See Proceeds are Subject to Investment Restrictions: the Arbitrage Yield Restriction and Arbitrage Rebate Requirements, below, for an overview of those rules.

An issuer must allocate proceeds to expenditures not later than 18 months after the later of the date each expenditure is paid or the date the project, if any, that is financed by the issue is placed in service. This allocation must be made in any event by the date 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier.

**Proceeds Are Subject to Investment Restrictions: the Arbitrage Yield Restriction and Arbitrage Rebate Requirements.** Issuers of tax-exempt bonds, including governmental bonds, are generally subject to investment or arbitrage limitations under Section 148 of the Code. Failure to comply with those arbitrage limitations will result in the bonds being arbitrage bonds and interest on the bonds being taxable.

In general, arbitrage is earned when the gross proceeds of an issue are used to acquire investments that earn a yield that is materially higher than the yield on the bonds of the issue. Earning arbitrage is permitted in certain circumstances. In some circumstances arbitrage may be earned but must be paid, or rebated to the U.S. Department of the Treasury. In some cases, an issuer may be able to reduce the yield on an investment for arbitrage purposes and thereby avoid an arbitrage violation by making a yield reduction payment to the U.S. Department of the Treasury. See Where and When To File Arbitrage Rebate and Yield Reduction Payments, below, for information on how to make yield reduction payments.

An issuer must comply with two general sets of arbitrage rules: (1) the yield restriction requirements of Section 148(a) and (2) the rebate requirements of Section 148(f). An issuer may meet the rules of one of these regimes but still have arbitrage bonds because it failed to meet the other. Even though interconnected, both sets of rules have their own distinct requirements. The following is an overview of the basic requirements of these two general rules. Additional requirements or exceptions, beyond the scope of this Publication, may apply in certain instances.

An issuer's reasonable expectations on the issue date regarding the amount and use of gross proceeds of the issue are used to determine whether an issue consists of arbitrage bonds. In addition, if an issuer or any person acting on behalf of the issuer takes a deliberate, intentional action to earn arbitrage after the issue date, that action will cause the bonds of an issue to be arbitrage bonds if that action, had it been reasonably expected on the issue date, would have caused the bonds to be arbitrage bonds. Intent to violate the requirements of Section 148 is not necessary for an action to be intentional.

Yield Restriction Requirements. The yield restriction rules of Section 148(a) of the Code generally provide that the direct or indirect investment of the gross proceeds of bonds in investments earning a yield materially higher than the yield of the bond issue causes the bonds to be arbitrage bonds. The chart below describes when the yield on particular investments will be "materially

higher” (the chart shows the permitted yield spread between the yield on the bond issue and the yield on the particular investment; any spread beyond that stated is materially higher):

Applicable "Materially Higher" Limits	
Type of Investments	Materially Higher
general rule (when other rules below don't apply)	1/8 of one percentage point
investments in a refunding escrow	1/1000 of one percentage point
investments allocable to replacement proceeds	1/1000 of one percentage point
program investments	1.5 percentage points
investments in tax-exempt bonds that are not subject to the alternative minimum income tax	no yield limitation

Certain exceptions are available under the yield restriction rules. The investment of proceeds in materially higher yielding investments does not cause the bonds of an issue to be arbitrage bonds in the following three instances: (1) during a temporary period (e.g., three-year temporary period for capital projects and 13 months for restricted working capital expenditures); (2) as part of a reasonably required reserve or replacement fund; and (3) as part of a minor portion (an amount not exceeding the lesser of 5 percent of the sale proceeds of the issue or \$100,000). Whether or not the arbitrage yield restrictions rules apply, issuers should consider whether the rebate requirements apply.

**Rebate Requirements.** The rebate requirements of Section 148(f) of the Code generally provide that, unless certain earnings on “nonpurpose investments” allocable to the gross proceeds of an issue are rebated to the U.S. Department of the Treasury, the bonds in the issue will be arbitrage bonds. Generally, nonpurpose investments are investment securities such as Treasury bonds, bank deposits or guaranteed investment contracts, etc., and do not include “purpose investments.” A purpose investment is an investment that the issuer acquires to carry out the governmental purpose of an issue. An example of a purpose investment is the loan obligation created when an issuer loans bond proceeds to another governmental unit, such as in a pooled or “bond bank” financing.

The arbitrage that must be rebated is based on the excess (if any) of the amount actually earned on nonpurpose investments over the amount that would have been earned if those investments had a yield equal to the yield on the issue, plus any income attributable to such excess. Under section 1.148-3(b) of the Regulations, the future values (as of the computation date) of all earnings received and payments actually or constructively made with respect to nonpurpose investments are included in determining the amount of rebate due.

See Where and When To File Arbitrage Rebate and Yield Reduction Payments, below, for information on how to make rebate payments.

There are, however, two types of exceptions to the general rebate requirements applicable to governmental bonds: the small issuer exception and the spending exceptions.

**Small Issuer Exception** — This exception provides that governmental bonds issued by small governmental issuers with general taxing powers are treated as meeting the arbitrage rebate requirement. A governmental entity has general taxing powers if it has the power to impose taxes of general applicability which, when collected, may be used for its general purposes.



An issue (other than a refunding issue, for which other rules apply) qualifies for the small issuer exception only if the issuer reasonably expects as of the issue date to issue, or in fact issues, \$5 million or less in tax-exempt governmental bonds during the calendar year. The aggregation rules of Section 148(f)(4)(D) should be considered when determining whether this exception applies. The \$5 million limit is increased by the aggregate face amount of bonds attributable to financing the construction of public school facilities, up to an additional \$10 million. For example, the small issuer exception could apply if the qualifying issuer issued \$5 million in tax-exempt governmental bonds for street improvements and \$5 million in tax-exempt bonds to finance construction of public school facilities in the same calendar year.

An issue meeting the small issuer requirements is exempt from rebate for all gross proceeds. However, the small issuer exception is an exception from rebate and not from the arbitrage rules altogether. The yield restriction rules still apply. Therefore, an issuer qualifying for this exception needs to establish a temporary period for project fund investments and needs to establish that any reserve fund is reasonably required.

**Spending Exceptions** — There are three spending exceptions to the rebate requirements. Whether these exceptions apply depends on the timing of expenditures of required amounts of proceeds, as follows:

Spending Exceptions	
Spending Period	Spending Exception
Six months	Section 1.148-7(c) of the Regulations provides an exception to rebate if the gross proceeds of the bond issue are allocated to expenditures for governmental or qualified purposes that are incurred within six months after the date of issuance.
18 months	Section 1.148-7(d) of the Regulations provides an exception to rebate if the gross proceeds of the bond issue are allocated to expenditures for governmental or qualified purposes which are incurred within the following schedule: (1) at least 15 percent within six months after the date of issuance; (2) at least 60 percent within 12 months after the date of issuance; and (3) 100 percent within 18 months after the date of issuance.
Two years	Section 1.148-7(e) of the Regulations provides an exception to rebate for construction issues financing property to be owned by a governmental entity or 501(c)(3) organization when certain available construction proceeds are allocated to expenditures within the following schedule: (1) at least 10 percent within six months after the date of issuance; (2) at least 45 percent within 12 months after the date of issuance; (3) at least 75 percent within 18 months after the date of issuance; and (4) 100 percent within 24 months after the date of issuance.
<i>Note: Issuers may still owe rebate on amounts earned on nonpurpose investments allocable to proceeds not covered by one of the spending exceptions, which may include earnings in a reasonably required reserve or replacement fund.</i>	

Where and When To File Arbitrage Rebate and Yield Reduction Payments. Issuers of tax-exempt bonds file IRS [Form 8038-T, Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate](#), to make the following types of payments:

- yield reduction payments
- arbitrage rebate payments
- payments of a penalty in lieu of rebate
- payment in connection with the termination of the election to pay a penalty in lieu of arbitrage rebate
- payment of the penalty for failure to pay arbitrage rebate on time

A yield reduction payment and/or arbitrage rebate installment payment is required to be paid no later than 60 days after the “computation date” to which the payment relates. An issuer of a fixed yield issue may treat any date as a computation date. An issuer of a variable yield issue may treat the last day of any bond year ending on or before the latest date for making the first rebate payment (generally not later than five years after the issue date) as a computation date. Thereafter, the issuer must consistently treat either the end of each bond year or the end of each fifth bond year as a computation date. Generally, a “bond year” is a one-year period that ends on the date that the issuer selects. If the issuer does not make a timely selection, the bond years for the issue end on each anniversary of the issue date and on the final maturity date.

Recovering an Overpayment of Rebate. If an issuer pays more than the required rebate, it may ask to recover the overpayment. In general, an issuer may request an overpayment of arbitrage rebate when it can establish that an overpayment occurred. An overpayment is the excess of the amount paid to the U.S. Department of the Treasury for an issue under Section 148 of the Code over the sum of the rebate amount for the issue as of the most recent computation date and all amounts that are otherwise required to be paid under Section 148 as of the date the recovery is requested. The request can be made with the IRS by completing and filing IRS [Form 8038-R, Request for Recovery of Overpayments Under Arbitrage Rebate Provisions](#). An issuer must file a Form 8038-R no later than the date that is two years after the final computation date for the issue. For more information, see [Revenue Procedure 2008-37, 2008-29 I.R.B. 137](#).

Special Remedial Action for Failure To Timely Pay Arbitrage Rebate. An issuer that fails to timely pay arbitrage rebate will be excused from having its bonds be arbitrage bonds if the failure is not due to willful neglect and the issuer submits a Form 8038-T with a payment of the rebate amount owed, plus penalty and interest. The penalty may be waived under certain circumstances. For more information, see section 1.148-3(i)(3) of the Regulations and [Revenue Procedure 2005-40, 2005-28 I.R.B. 83](#).

**Bonds May Not Be Federally Guaranteed.** Section 149(b) of the Code provides that any tax-exempt bond, including a governmental bond, will not be treated as tax-exempt if the payment of principal or interest is directly or indirectly guaranteed by the federal government or any agency or instrumentality of the federal government. Exceptions to this general rule include guarantees by certain quasi-governmental entities administering federal insurance programs, and federal guarantees for qualified residential rental projects, home mortgages and student loans. Additional exceptions apply for the investment of bond proceeds that are invested in U.S. Treasury securities or held in a bona fide debt service fund, a reasonably required reserve or replacement fund or a refunding escrow, and investments during a permitted initial temporary period.



**A Bond May Not Be a Hedge Bond.** Section 149(g) of the Code states that hedge bonds will not be tax-exempt unless certain requirements, described below, are satisfied. A “hedge bond” is any bond that is part of a bond issue that fails **either** of the following requirements:

- The issuer must reasonably expect that 85 percent of the spendable proceeds of the issue will be used to carry out the qualified purpose within the three-year period beginning on the date the bonds are issued (“spendable proceeds” means proceeds from the sale of the issue, less the portion invested in a reasonably required reserve or replacement fund or as part of a permitted “minor portion”).
- Not more than 50 percent of the proceeds of the issue are invested in nonpurpose investments having a substantially guaranteed yield for four or more years.

Section 149(g)(3)(B) provides an exception to the general definition of a hedge bond if at least 95 percent of the net proceeds of the issue are invested in tax-exempt bonds that are not subject to the alternative minimum tax. For this purpose, amounts held either: (1) in a bona fide debt service fund, or (2) for 30 days or less pending either reinvestment of the proceeds or bond redemption, are treated as invested in tax-exempt bonds not subject to the alternative minimum tax. Additionally, a refunding bond issue does not generally consist of hedge bonds if the prior issue met the requirements for tax-exempt status and issuance of the refunding bonds furthers a significant governmental purpose (*e.g.*, realize debt service savings, but not to otherwise hedge against future increases in interest rates).

Even if an issue otherwise meets the definition of a hedge bond, it will generally still be tax-exempt if two requirements are satisfied. First, at least 95 percent of the reasonably expected legal and underwriting costs associated with issuing the bonds must be paid within 180 days after the issue date *and* the payment of such costs must not be contingent upon the disbursement of the bond proceeds. Second, on the date of issuance the issuer must reasonably expect that the spendable proceeds of the issue will be allocated to expenditures for governmental or qualified purposes within the following schedule:

- 10 percent within one year after the date of issuance;
- 30 percent within two years after the date of issuance;
- 60 percent within three years after the date of issuance; and
- 85 percent within five years after the date of issuance.

**Limitations on Refunding Governmental Bonds.** Governmental bonds may be currently refunded and advance refunded. However, governmental bonds issued after 1985 can be advance refunded only one time. Under section 1.150-1(d)(1) of the Regulations, a refunding bond issue is an issue the proceeds of which are used to pay principal, interest, or redemption price on another issue (a prior issue), as well as the issuance cost, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or any similar cost properly allocable to that refunding issue. Current and advance refunding issues are distinguished as follows:

Types of Refundings	
Current Refunding Issue	A refunding issue that is issued not more than 90 days before the final payment of principal (e.g., the redemption date) or interest on the prior issue.
Advance Refunding Issue	A refunding issue that is issued more than 90 days before the final payment of principal (e.g., the redemption date) or interest on the prior issue.

Refunding issues generally derive their tax-exempt status from the prior issue they refund; if the prior issue was not tax-exempt, the refunding bonds generally cannot be tax exempt.

### **Bonds May Not Be Used for Abusive Tax Transactions**

The IRS, including TEB, is engaged in extensive efforts to curb abusive tax shelter schemes and transactions. Information about [abusive tax-exempt bond transactions](#) is available on the TEB website.

### **What Happens When the Terms of a Bond Are Modified?**

If the terms of a governmental bond are sufficiently modified, the bond will be treated as reissued. When bonds are reissued, either actually or in a deemed reissuance, the new bonds must be re-tested as of the date of the reissuance to determine if all the various federal tax requirements are met for the “new” issue. These include the requirements that apply when bonds are issued, such as timely filing Form of the 8038-G or 8038-GC, as applicable. See [Requirements Related to Issuance – Issuers Must File an Information Return](#), above.

A deemed reissuance may arise if sufficient changes are made to the terms of the bond, such as when a bondholder and issuer agree, directly or indirectly, to a significant modification of the terms of any bonds. See [Reissuance of Tax-Exempt Obligations: Some Basic Concepts](#) for examples of significant modifications. If deemed reissued, the modified bonds are deemed exchanged for the original bonds. In general, the date the issuer and bondholder enter into the agreement to modify the terms of the bonds is treated as the date of issuance of the new bonds, even if the modification is not immediately effective. At reissuance, the modified bond must meet any tax law requirements that apply upon its early retirement in connection with the reissuance, including the acceleration of any arbitrage rebate or yield reduction payment that is due. See [Proceeds Are Subject to Investment Restrictions: the Arbitrage Yield Restriction and Arbitrage Rebate Requirements – Where and When To Make Arbitrage Rebate and Yield Reduction Payments](#), above. For more information on the reissuance rules, see [Reissuance of Tax-Exempt Obligations: Some Basic Concepts](#).

## Issuers Must Retain Records to Show That Requirements Are Satisfied

Section 6001 of the Code and section 1.6001-1(a) of the Regulations generally provide that any person subject to income tax, or any person required to file a return of information with respect to income (e.g., the issuer filing information returns relating to its bond issues), must keep such books and records as are sufficient to establish the amount of gross income, deductions, credits or other matters required to be shown by that person in any return. Answers to [Frequently Asked Questions](#) regarding record retention requirements applicable to tax-exempt bonds are available on the TEB website.

## POST-ISSUANCE COMPLIANCE MONITORING

In this section, we discuss the importance of issuers monitoring compliance with the Code requirements and suggest steps an issuer may take to monitor its bond issues.

### Protecting Against Post-Issuance Violations

Issuers may be concerned with how they can further protect the tax-exempt status of their bonds. Reliance solely on bond documents and tax certificates provided when the bonds are issued will not likely provide the assurance an issuer desires. To gain greater confidence that bonds are in compliance with federal tax laws, an issuer may adopt post-issuance monitoring procedures. TEB believes that issuers that establish and follow comprehensive written monitoring procedures to promote post-issuance compliance generally are less likely to violate the federal tax requirements related to its bonds, and are more likely to find any violations earlier, than those without procedures. Early discovery of a violation is a factor TEB considers in determining the appropriate resolution under its Voluntary Closing Agreement Program.

### Steps to Better Monitoring

In formulating its procedures, an issuer may consider:

- Designating one or more officials to assist in post-issuance compliance;
- Designating one or more officials to assist with and respond to examinations of the bond issue;
- Providing training or other technical support to designated official(s);
- Designating time intervals within which compliance monitoring activities will be completed; and
- Timely completing remedial actions (including requests under TEB VCAP) to correct or otherwise resolve identified noncompliance.

The chart below identifies particular areas for compliance monitoring procedures.

Compliance Procedures		
Type of Procedures	Description of Procedures for Post-Closing Matters	Where Responsibility Is Discussed in this Publication
Information Return Filing	Procedures to ensure timely filing of information returns, including procedures concerning amended and late filed returns	OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS – Requirements Related to Issuance – Issuers Must File an Information Return
Private Use of Proceeds or Bond-Financed Property	Procedures to timely identify and remediate deliberate actions	TAX-EXEMPT GOVERNMENTAL BONDS – Meeting the Private Activity Bond Tests after Issuance
Reissuance	Procedures to satisfy applicable tax requirements when a significant modification in terms results in a reissuance for federal income tax purposes	OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS – What Happens When the Terms of a Bond Are Modified?
Elections	Procedures for timely federal income tax elections	OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS – Requirements Related to Issuance – Issuers Must Make Certain Elections at Issuance
Allocation of Proceeds	Procedures for the timely expenditure and accounting for use and investment of bond proceeds	OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS – Requirements That Apply at Issuance and Throughout the Life of the Bonds – Proceeds Must be Timely Allocated to Expenditures
Arbitrage Compliance	Procedures for the timely computation and payment of arbitrage rebate and yield reduction payments	OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS – Requirements That Apply at Issuance and Throughout the Life of the Bonds – Proceeds are Subject to Investment Restrictions: the Arbitrage Yield Restriction and Arbitrage Rebate Requirements
Record Retention	Procedures for the maintenance of records	OTHER REQUIREMENTS APPLICABLE TO GOVERNMENTAL BONDS – Issuers Must Retain Records To Show That Requirements Are Satisfied
IRS Contacts	Procedures concerning contacts from the IRS	POST-ISSUANCE COMPLIANCE MONITORING – Steps to Better Monitoring

Additional information on [Post-Issuance Compliance](#) is available on the TEB website.

## WHAT TO DO UPON DISCOVERING A VIOLATION — TEB VOLUNTARY CLOSING AGREEMENT PROGRAM

TEB is committed to resolving federal tax violations with the issuer. To that end, TEB created the TEB Voluntary Closing Agreement Program. This program, which the Compliance and Program Management (“CPM”) function of TEB administers, provides remedies for issuers of tax-exempt bonds, tax credit bonds, and direct pay bonds that voluntarily come forward to resolve a violation of the Code that cannot be corrected under self-correction programs described in the Regulations or other published guidance. [Notice 2008-31, 2008-11 I.R.B 592](#), provides information and general guidance about TEB VCAP. [IRM section 4.81.6](#) provides general procedures under which TEB will enter into closing agreements. Closing agreement terms and amounts may vary according to the degree of the violation as well as the facts and circumstances surrounding it.

Issuers must use IRS [Form 14429, Tax Exempt Bonds Voluntary Closing Agreement Program Request](#), to submit a request and provide the required information. See [I.R.M. section 7.2.3.2.1](#) with respect to completing the March 2013 version of the form. To encourage issuers and other parties to voluntarily come forward to resolve problems, TEB VCAP also permits an issuer or its representative to initiate preliminary discussions of a closing agreement anonymously.

For more information about this program, including request submission requirements, case processing procedures, and resolutions standards, see [IRM section 7.2.3](#). Additional educational resources on [Voluntary Compliance](#) (including TEB VCAP administrative procedures and resolution standards) are available on the TEB website.

## TEB INFORMATION AND SERVICES

TEB offers information and services through its education and outreach programs. You can learn about these programs through the [TEB website](#).

TEB has reading materials about the tax laws applicable to municipal financing arrangements, including revenue rulings, revenue procedures, notices and announcements, available on the TEB website under [Published Guidance](#).

Tax forms, instructions, and publications are also available at the TEB website under [Tax-Exempt Bonds Forms and Publications](#).

For personal assistance, you can call our Customer Account Services toll-free at (877) 829-5500, Monday through Friday, 8:00 a.m. – 5:00 p.m. your local time.





# **MSRB**

## **SEC Rule 15c2-12**

### **Continuing Disclosure**





## SEC Rule 15c2-12: Continuing Disclosure

### What is Continuing Disclosure?

Continuing disclosure consists of important information about a municipal bond that arises after the initial issuance of the bonds. This information generally reflects the financial health or operating condition of the state or local government as it changes over time, or the occurrence of specific events that can have an impact on key features of the bonds.

### SEC Rule 15c2-12

Securities and Exchange Commission (SEC) Rule 15c2-12 requires dealers, when underwriting certain types of municipal securities, to ensure that the state or local government issuing the bonds enters into an agreement to provide certain information to the Municipal Securities Rulemaking Board (MSRB) about the securities on an ongoing basis. Such continuing disclosure agreements on or after February 27, 2019, for new issues generally require the following:

- Unscheduled draws on credit enhancements reflecting financial difficulties
- Substitution of credit or liquidity providers, or their failure to perform
- Adverse tax opinions or events affecting the tax-exempt status of the security
- Modifications to rights of security holders
- Bond calls and tender offers
- Defeasances
- Release, substitution or sale of property securing repayment of the securities
- Rating changes
- Bankruptcy, insolvency or receivership
- Merger, acquisition or sale of all issuer assets
- Appointment of successor trustee
- Financial obligation incurrence or agreement, if material\*
- Default, event of acceleration, termination event, modification of terms or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties\*

*SEC Rule 15c2-12 ensures municipal securities issuers enter into agreements to provide certain information to the MSRB about their securities on an ongoing basis.*

### Annual Financial Information

- Financial information and operating data provided by state or local government or other obligated persons
- Audited financial statements for state or local government or other obligated persons, if available

### Event Notices

- Principal and interest payment delinquencies
- Non-payment related defaults
- Unscheduled draws on debt service reserves reflecting financial difficulties

\*Effective February 27, 2019



Subscribe to issuer education and EMMA email updates from the MSRB.



## MSRB Support

**Phone:**  
202-838-1330

**Hours:**  
7:30 a.m. – 6:30 p.m. ET

**Email:**  
MSRBsupport@msrb.org  
**Hours:**  
7:00 a.m. – 7:00 p.m. ET

## Definitions of Financial Obligation

- (i) Debt obligation, derivative instrument entered into in connection with, or
- (ii) Pledged as security or a source of payment for, an existing or planned debt obligation; or
- (iii) Guarantee of (i) or (ii)

The term financial obligation shall not include municipal securities as to which a final official statement has been provided to the MSRB.

## Timeframes for Submitting Disclosures

State or local governments or obligated persons must submit annual disclosures on or before the date specified in the continuing disclosure agreement or provide notice of failure to do so to the MSRB through the [Electronic Municipal Market Access \(EMMA®\) website](#). Disclosure of events must be submitted to EMMA within 10 business days of the event.

## Exemptions from Rule 15c2-12

Continuing disclosure generally is not required for an issue if:

- The entire issue is for less than \$1 million
- The bonds are sold to investors in authorized denominations of \$100,000 or more to no more than 35 sophisticated investors
- The bonds are sold in authorized denominations of \$100,000 or more and mature in nine months or less from initial issuance
- The bonds were issued prior to July 1995 (or prior to December 1, 2010 for certain "puttable" securities.)

## Locating Continuing Disclosure Information

The MSRB's EMMA website publicly displays continuing disclosure information submitted since July 1, 2009, as part of the MSRB's mission to provide access to key municipal market information. The EMMA website also displays market transparency data and educational materials about the municipal securities market.



Subscribe to issuer education and EMMA email updates from the MSRB.