



DEBT 101: Issuing Bonds and Your Continuing Obligations



Issuing debt results in major responsibilities that many public finance professionals undertake with limited experience and typically as a secondary or tertiary responsibility to their main duties of preparing the budget, meeting payroll deadlines, issuing the CAFR, or addressing the hundreds of other assignments that come up from time-to-time. But issuing debt and the responsibilities that follow once the bond sale is complete cannot be taken lightly and possibly could create an unanticipated burden not foreseen at the beginning of the process.

This document provides the reader with a basic understanding of what a bond is, who the typical players are, what you need to be thinking about from a legal standpoint, what are the structuring considerations, how bonds get sold, your responsibilities during and, as important, following the bond sale so long as the bonds remain outstanding, and will also provide a brief overview of alternative financing products. This document is not going to make you an expert; however, will provide you with a framework from which to understand the mechanics and responsibilities that come with going to the public markets. In addition, references are provided to more detailed Best Practices, Advisories and other resources. The GFOA strongly advises that issuers wishing to proceed with a debt financing review these resources as well.

Getting Ready to Issue a Bond

Governmental entities have been using debt (most often in the form of “municipal bonds”) for over 200 years to fund public infrastructure such as government buildings, water distribution systems, schools, police stations and many other projects that require significant capital investment. When a government issues debt (Issuers), it receives an infusion of cash to build a project; in return the government repays the bond purchasers (Investors) over time, plus interest. By using debt, the government can complete a capital project today with a repayment schedule that spreads the cost of that project over its useful life.

Before issuing debt, there are many factors that a government official should consider. Appropriate planning and understanding helps to provide the most favorable results and also helps avoid unnecessary risks and negative consequences. Debt issuance requires working with a number of partners, each of whom has a specific role. The debt issuance will result in a financing agreement that is legally binding, and it is critically important that government officials understand the basic terms of the agreement and what the agreement commits them to do.

Successful financing requires **assembling a team of capable professionals** to assist the Issuer.



The Financing Team

A successful financing requires assembling a team of capable professionals to assist the Issuer, each with a different specialization and focus on the financing. It is important to understand the different roles of each team member.

Bond Counsel

Bond Counsel works directly for the Issuer. Bond Counsel is an attorney (or team of attorneys), typically with specialized experience in municipal financings, that generally issues two legal opinions in conjunction with the offering:

1. An opinion as to whether the financing is a valid legal, binding obligation of the Issuer, and,
2. An opinion of the nature of the taxability of the interest the investor earns on the financing.

These two opinions are relied upon by Investors when considering whether to purchase the bonds. In order to provide these opinions, Bond Counsel must work closely with the Issuer to understand the nature and structure of the issue.

Bond Counsel should also be knowledgeable in local, State and federal laws and regulations related to municipal financings and any special requirements for public agencies.

The Bond Counsel will often also serve as a disclosure counselor for the issue. This attorney assists with the preparation of the official statement and the continuing disclosure agreement, and will help facilitate preparation of the final (closing) documentation.

Municipal Advisor/Financial Advisor

A financial advisor (or “Municipal Advisor” or “MA”) is a professional consultant that works directly for the Issuer. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, a Municipal Advisor working for a municipality must be registered with the Securities and Exchange Commission Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB) and must give fiduciary care in advising the Issuer by putting the Issuer’s interests above their own financial interests in a transaction.



The role of the MA varies upon the level of sophistication of the Issuer, but often the MA works as an extension of the Issuer's staff with a specialty focus on the proposed financing. The MA has an independent view of the financing market, and works closely with Bond Counsel and the Issuer to assist in structuring and marketing the financing in the most economical way. The MA will also assist in determining if the bonds should be through a competitive or negotiated sale. They will further assist by participating in the credit rating process, managing the sale, and assisting the Issuer through the closing process.

Underwriter/Investment Banker

An Underwriter or Investment Banker is the key conduit between the Issuer and Investor. In a financing, they are ultimately working for the Investors. The Underwriter, via the bond sale, agrees to buy the bonds and resell them to investors. Their role varies by the type of sale the Issuer chooses ("competitive" versus "negotiated") as described under "Issuance Process" below. Unlike the MA, the Underwriter is not a fiduciary and has a naturally built in

conflict of interest between trying to obtain the lowest borrowing costs for the Issuer, while providing the Investor with the highest yield. This is neither good nor bad, but a fact the Issuer needs to be aware of.

Other Participants

Paying Agent/Trustee. A paying agent or trustee may be used to take debt service payments from the Issuer and distribute to the investors that actually own the bonds. A paying agent may also be used to hold a reserve or other funds as determined in the issuing documents.

Rating Agency. A credit rating may be requested in order to help the investor determine the level of repayment risk before purchasing a bond. The higher the rating, in the opinion of the rating agency, the less risk of delinquency or default, and ultimately the lower the interest rate.

Bond Insurance Provider or Other Credit Enhancer. The financing may also include a credit enhancer to entice the investor to offer a lower rate. The enhancer can be an insurance company, bank or other government authority.

➔ Further information regarding the financing team is available in the following resources:

[GFOA Best Practice: Selecting Bond Counsel](#)

[GFOA Best Practice: Selecting and Managing Municipal Advisors](#)

[GFOA Best Practice: Using Credit Rating Agencies](#)

[GFOA Best Practice: Debt Issuance Transaction Costs](#)

Legal Considerations

In order to issue debt, Issuers must comply with local, State and federal laws, and enter into a number of legal agreements with various parties. Local and State laws will vary, and it is critical that Issuers consult with specialized legal counsel (Bond Counsel) to determine if they are authorized to issue debt, what actions are required to authorize issuance, and any constraints placed on debt issuance. For example, State law may place legal limits on the amount of debt to be secured by a government's general revenues.

The use of the capital project(s) financed by debt will impact the project's eligibility for federal tax exemption, and the associated reduced borrowing cost to the Issuer. Legal counsel should advise the Issuer on tax implications related to private use and tax exempt status affecting the debt obligation. These requirements could have significant impact on interest rates, repayment and continuing disclosure for the debt instrument selected.

Additionally, an Issuer's legal counsel (and/or MA) should consider outstanding debt agreements or other legal agreements that may include financial covenants or restrictions. An Issuer's debt management policy may also provide guidance or limits related to legal considerations.

Structuring Considerations

Issuers looking to utilize debt financing should review and update annual capital improvement plans to identify projects that can be funded with annual operating funds, in addition to those that might be candidates for debt financing. Projects should be thoroughly reviewed as to scope, feasibility, cost, useful life of the financed asset, and capacity to repay debt. All of these factors will help determine whether long-term financing is an appropriate tool – and if so, what revenues are appropriate to pledge for repayment and what the term of repayment should be.

Sufficient revenues should be available to meet ongoing debt payments and jurisdiction needs to understand what type of revenues are pledged to support (or “secure”) the debt. Potential revenues may include a full or limited taxing power of the jurisdiction, utility revenues, other specific revenue streams, or collateral such as the asset that is being acquired with the debt proceeds.

Various types of debt are typically available to Issuers. Financing tools may include municipal bonds (both taxable and tax-exempt), direct loans from financial institutions, and other less common alternatives. Each option has its own benefits and risks, and the Issuer should utilize a MA to assist with determining which type of obligation best suits a specific circumstance.



Further information is available in the following resources:

[Debt Issuance Checklist: Considerations When Issuing Bonds](#)

[GFOA Best Practice: Selecting and Managing the Method of Sale of Bonds](#)

[GFOA Best Practice: Issuing Taxable Debt](#)

[GFOA Best Practice: Bank Loans and Direct Placements](#)

[GFOA Best Practice: Debt Management Policy](#)

How do Bonds Get Sold?

Most local governments do not have the in-house expertise or resources to find Investors for their proposed bond offerings, and will require the services of a specialized municipal securities broker/dealer, bank or a syndicate of firms to underwrite the bonds for them (Underwriter).

The decision of how to market municipal bonds should be based on the characteristics of the Issuer, the bond issue, and the financial market. Governmental entities usually issue bonds through competitive bid or a negotiated sale. The primary goal of an Issuer undertaking a bond issue should be the proper administration of the bond issue at the least possible issuance cost and lowest interest rate. Both methods are used frequently in bringing municipal bonds to market.

The overriding concern of many Issuers is the minimization of interest rates and issuance costs; however, there currently are varying opinions regarding which type of sale results in the best outcome. Competitive bidding is most appropriate when the Issuer is well known and/or highly rated, high demand for the bonds is predicted, and the market is stable. A negotiated sale can be more appropriate when the Issuer is less known, the financing instrument is complex and less well understood by investors, and/or the market is less stable.

Competitive Bid Process

In a competitive bid sale, the Issuer conducts all of the tasks necessary to offer bonds for sale including structuring the maturity schedule, preparing the official statement, verifying legal documents, obtaining a bond rating, securing credit enhancement, if advantageous, and considering the timing of the sale. These tasks are normally done with the assistance of outside consultants, including a Municipal Advisor and Bond Counsel. Once the issue is structured, the public sale begins with the publication of an official notice of sale that describes the size, maturities, purpose, and structure of the proposed issue, along with instructions for submitting bids. Underwriters submit closed bids to the Issuer on the day and

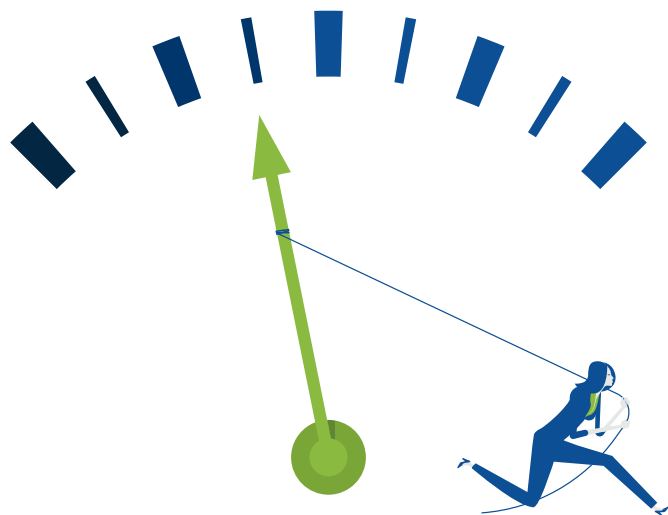
time designated in the official notice of sale. The bonds are awarded to the Underwriter that has submitted the best price (i.e., the lowest true interest cost bid). Once the bid is awarded, pricing and major structural aspects of the bonds are locked in regardless of the success or failure of the Underwriter to sell the bonds to Investors.

Negotiated Sale Process

In a negotiated sale, the bond issue is not structured before an Underwriter is chosen. If the Issuer has not retained a Municipal Advisor, the Underwriter may assist the Issuer in determining what is to be financed, the method of financing and the financing structure. The Underwriter is chosen based on expertise, financial resources, compatibility, and experience. After the Underwriter is selected, the Issuer and the Underwriter will begin the process of structuring the bond issue and completing the other origination tasks. The Underwriter starts the marketing process and develops an interest rate to be negotiated with the Issuer. It is highly recommended that Issuers using a negotiated sale employ a Municipal Advisor not associated with the underwriting firm to assist in representing the Issuer's interests in the process.

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Investors use the bond ratings to determine the level of repayment risk associated with the specific issue and determine a **minimum rate of return for the risk involved.**

Credit Rating Agencies

Municipal bond credit ratings measure the Issuer's risk of paying all interest and principal back to investors. A bond rating system helps Investors assess credit risk. Municipal Issuers rely on specialized rating agencies to determine the overall risk of the issue and assign a "grade" to the bond. The four major rating agencies are Fitch Ratings, Kroll Bond Rating Agency, Moody's Investors Services, and Standard and Poor's Global Ratings. Ratings have a significant effect on both the ability of the Issuer to raise funds and the price the Issuer will be required to pay.

Bond Ratings

Debt issued by governmental entities is rated to reflect the degree of risk and probability of repayment of all interest and principal to the investor. Investors use the bond ratings to determine the level of repayment risk associated with the specific issue and determine a minimum rate of return for the risk involved. If the bonds have high ratings, they are assumed to have low risk and the investor will therefore require a lower yield. Just the opposite will occur for a lower rated (riskier) bond. There are four major investment grade ratings assigned to bonds by the rating agencies—

Highest (AAA/Aaa), High (AA/Aa), Above Average (A), and Medium (BBB/ Baa). All long-term bonds rated below the fourth category are judged to be below investment grade (speculative grade) and are often referred to as "junk" bonds.



Below are the Best Practices related to the sale of bonds. These resources should be read and considered in conjunction with each other because of the interaction of the processes to which they apply.

[GFOA Best Practice: Selecting and Managing the Method of Sale of Bonds](#)

[GFOA Best Practice: Selecting and Managing Underwriters for Negotiated Bond Sales](#)

[GFOA Best Practice: Pricing Bonds in a Negotiated Sale](#)

Issuer Responsibilities During and Following the Bond Sale

The Issuer is more than just a participant in the sale of the bonds. The governmental entity is the owner of the transaction and the obligor of the debt until “maturity” when the debt is fully repaid - perhaps a period of 20 to 30 years. This means staff must take more than a casual interest in the transaction. While the Issuer will hire various finance professionals to assist in the structuring of the transaction and the preparation of various legal documents and financial analysis, staff must also have a firm understanding of the commitments being made on behalf of their organization. When the transaction closes, the financing team will move on and the public entity will be left with a number of ongoing obligations. If staff cannot explain the structure and obligations of the transaction to their governing board, the deal most likely should not be done.

The Issuer’s typical duties at and after the time of sale include the approval of a pricing scale (if the bonds are to be sold on a negotiated basis). While it may only be a few basis points, the decision to accept or reject a proposed pricing scale could mean the difference of hundreds of thousands of dollars in interest expense over the life of the bonds. Once the sale is completed and bids accepted, the designated staff will sign a bond purchase agreement. Following this, the lawyers will finalize the remaining legal documents which will likely be signed a day or two before the actual closing of the transaction.

Once the deal closes, staff will need to book the transaction in the general ledger/balance sheet. Depending upon the structure, consulting with external auditors may be advised. In addition, setting up a tickler file with key dates of when bond payments are due and when continuing disclosure information needs to be filed is extremely useful. During the period when there are unspent bond proceeds or reserve funds, staff will want to determine how these funds should be invested. This may be with the help of a third party, the purchase of a guaranteed investment contract, providing specific investment instructions to the Trustee, or in some instances, managing the funds directly in-house. Federal tax laws, in some instances, will require Issuers to rebate any net positive arbitrage earned on the investments of the bond proceeds. As such, staff will need to track interest earnings, offset by the true interest costs, in order to do the calculations. Finally, the organization needs to keep detailed records as to how the bond proceeds were spent. First of all, when the original bond documents were signed, staff acknowledged that there was a reasonable expectation that the bond proceeds will be spent within a three year period. If this does not happen, the issuing agency will be required to yield restrict the investments of any remaining unspent bond proceeds. In addition, it is important to be able to report the use of bond proceeds to the governing board and the general public, should the transaction ever be audited by the IRS.



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Alternative Financing Products

In addition to traditional municipal bonds, a number of alternative financing products are available to Issuers. These financing tools carry special considerations, as described briefly below. These financing tools may be more or less appropriate for less frequent Issuers and – as with municipal bonds – a Municipal Advisor and Bond Counsel should be consulted before proceeding.

Commercial Paper is a fixed-income instrument that matures in 270 days or less. This short-term instrument can be a viable alternative to the more traditional long term debt and may be an appropriate source of funding for the design and construction phase of a project or projects with the long term debt being issued once there is more certainty as to the completion of the project. While often supported by one or more dedicated revenue streams or an Issuer’s general obligation pledge, commercial paper sometimes in an unsecured form of a promissory note that pays a fixed rate of interest. The commercial paper may be rolled into a new commercial paper issue at maturity and is typically backed by a letter of credit issued by a bank. As with any other type of bond or debt instrument, the issuing entity offers the paper assuming that it will be in a position to pay both interest and principal by maturity. One significant aspect of commercial paper is that it is negotiable, which means that it can be freely transferred (traded) from one Investor to another.

Bank Loans and Direct Placements can take on many forms and can typically be structured to provide the Issuer with flexibility regarding duration and repayment. A bank loan may carry a fixed or variable interest rate, in which interest may be repaid in equal payments over a fixed period of time, or there may be interest only with a balloon payment at maturity. In addition, bank loans can be structured as a revolving line of credit.

This means the borrower can draw on the funds up to the loan amount, pay some or all of the loan back, and then redraw funds all during the term of the loan.



Bank loans can take on many forms and can typically be structured to provide the Issuer with **flexibility regarding duration and repayment.**

Typically bank loans are for a shorter duration than traditional bonds and are usually in the five to ten year duration, though some banks may be willing to go as long as 20 years. The legal work involved in preparing loan documents is more straightforward and thus less expensive than a traditional bond deal. Bank loans and direct replacements are required to be disclosed as part of the debt portfolio.

Inter-fund Borrowing can be complex, and the ability to do so may be restricted by an Issuer’s local charter, governing board policies, and State laws. The duration of inter-fund borrowing may also be limited in duration. If permitted, this may be a quick, flexible and inexpensive way to do some short-term borrowing for necessary projects or equipment. Typically, the internal borrowing rate would be tied to the investment rate of return on the Issuer’s pooled portfolio in order to ensure that one fund is not subsidizing another fund.

Your Continuing Disclosure Obligations After a Bond Has Been Issued

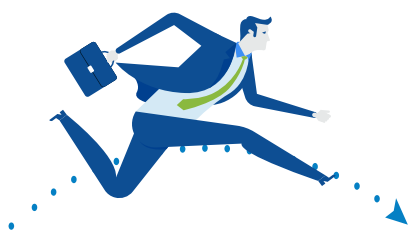
Governments that issue bonds have an obligation to meet specific continuing disclosure requirements that are identified specifically in a continuing disclosure agreement (CDA's, also called continuing disclosure certificates or undertakings). These are entered into at the time of bond issuance pursuant to SEC Rule 15c2-12 (Rule). Obligations that have a maturity of 270 days or less are exempt from these requirements, while other short-term issues with a maturity of 18 months or less are subject to lesser requirements.

When bonds are issued, the Issuer covenants via the CDA to provide certain annual and possibly more frequent financial information as identified in the CDA, and to notify the public within 10 business days of occurrence of certain material events as described in the Rule. Such information is required to be submitted electronically either by the Issuer or by their agent via the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market

Access (EMMA) portal (www.emma.msrb.org). In addition to filing through EMMA, an Issuer may also choose to post its annual financial information or other reports on its own web site.

Typically, a series of bonds will require its own CDA. While a separate CDA will generally be required with the issuance of each series of bonds, the information that is required to be disclosed is generally quite similar for each issue. In the offering document for those bonds, Issuers will be required to state whether or not they are in compliance with all previous continuing disclosure obligations for the prior five years.

Issuers may choose to provide information beyond that required by the Rule and identified in its CDA on a voluntary basis. Such information may also be posted on EMMA. Issuers should be aware that they should disseminate such information to the market as a whole and not provide any one individual or group with any information that is not readily available to the public as a whole. Issuers should also develop a continuing disclosure policy or procedure as further described below.



- ➔ Issuers should review the following GFOA best practices for further information on meeting their disclosure responsibilities:

[GFOA Best Practice: Primary Market Disclosure](#)

[GFOA Best Practice: Understanding Your Continuing Disclosure Responsibilities](#)

[GFOA Best Practice: Using Technology for Disclosure](#)

Tax Compliance

When tax-advantaged bonds are issued, an Issuer needs to ensure they have the appropriate procedures in place to comply with all the federal tax rules applicable to those bonds from the date of issuance through their final maturity.

Federal tax rules applicable to tax-advantaged bonds generally include the following major areas:

Expenditure of Proceeds:

At the time of sale, the Issuer must expect to expend bond proceeds promptly, and, in some cases, by time-specific deadlines set forth in the Internal Revenue Code and Treasury Regulations. Furthermore, bond proceeds may only be spent for purposes permitted based upon the type of bonds issued.

Use of Financed Assets:

Internal Revenue Code and Treasury Regulations limit how an Issuer may use assets financed with the proceeds of tax-advantaged bonds. For example, for governmental purpose bonds, there are detailed rules that limit both direct and indirect use of bond-financed assets by private entities.

Issuers need to ensure they have the **appropriate procedures in place** to comply with all federal tax rules applicable to tax-advantaged bonds.



Investment of Proceeds:

Tax rules generally require that, except during certain temporary periods, the proceeds of tax-advantaged bonds may not be invested at a yield materially higher than the yield on the bonds. Any permitted investment income above the yield on the bonds is rebated to the federal government.

Recordkeeping:

The Issuer needs to retain sufficient records to support the continuing tax-advantaged status of its bonds, and to prove compliance with the rules for expenditure of proceeds, use of the financed assets, and investment of proceeds.



The National Association of Bond Lawyers and GFOA have collaborated on a useful and detailed document “Considerations for Developing Post-Issuance Compliance Policies,” that Issuers are encouraged to consult for much more detail on tax compliance requirements. That document may be found at:

[Developing and Implementing Procedures for Post-Issuance Compliance for Issuers of Governmental Bonds](#)

[GFOA/NABL Post Issuance Compliance Checklist](#)



Developing a Policy and Establishing a Compliance Program

It is recommended that Issuers establish written policies and procedures to comply with post-issuance and ongoing requirements. The policy should identify a single individual with primary responsibility for monitoring and complying with the program and be approved by the governing body. While multiple individuals (or external service providers) may help with performing compliance tasks, assigning a single point of responsibility can help prevent inconsistency and unintentional omissions. It is also helpful to create a checklist or inventory of requirements, including when the tasks are performed and by whom.

It is critical that once a policy and/or program are defined, Issuers closely follow the requirements and document their compliance. Documented proof of intentional compliance can be a very effective defense against any potential regulatory investigation. It is also important that a compliance program consider the process for dealing with non-compliance in the event this is discovered. Generally, Issuers should take actions to get back into compliance as soon as possible.



Further detail on post-issuance compliance is available at the following resources:

[GFOA Best Practice: Debt Management Policy](#)

[GFOA/NABL Post Issuance Compliance Checklist](#)

[Debt Issuance Checklist: Considerations When Issuing Bonds](#)

Investment of Bond Proceeds

Upon the issuance of bonds by a State or local government, the bond proceeds are usually deposited in various funds. These funds may be construction funds, debt service funds, debt service reserve funds, an escrow fund, etc. The deposited proceeds are usually invested until they are needed.

There are a number of items governments should consider when making decisions to invest such proceeds. Examples of these considerations include the anticipated drawdown schedule of the proceeds, federal and State regulations governing the types of investments permitted for the investments, the arbitrage yield, the State or local government's investment policy, and requirements from rating agencies.

The anticipated use and drawdown of the invested proceeds, such as projected expenditures for capital projects or use for coverage of debt service, will be a major consideration in the investment of the proceeds. Those responsible for making investment decisions should coordinate closely with departments and staff that will be drawing down proceeds, depending upon the purpose of the bonds issued. This may involve coordinating with the staff responsible for engineering and construction of the bonds issued for capital projects, or with cash management and treasury staff responsible for making debt service payments for bonds issued for refunding purposes.

A written investment policy is the single most important element in a public funds investment program. The investment policy should describe the most prudent objectives for a sound policy, including safety, liquidity, and yield. It should indicate the type of instruments eligible for purchase by a government entity, the investment process, and the management of a portfolio, and conform to applicable State laws. Adherence to the investment policy signals to rating agencies, the capital markets and the public that a government

agency is well managed and is earning interest income suitable to its situation and economic and regulatory environment. The GFOA has developed a Best Practice titled *Creating an Investment Policy* available for reference.

In 2014, the SEC Municipal Advisors (MA) Rule took effect. The MA Rule has implications that may impact the investment of bond proceeds, as it limits the kinds of communications brokers may have with Issuers. Specifically, brokers may be considered Municipal Advisors if they provide advice on investments of bond proceeds to governments. Brokers are prohibited from providing advice to governments unless the brokers become Municipal Advisors in accordance with the MA Rule, including following requirements to register with the SEC and the MSRB, or meet one of the exemptions to the MA Rule.

One result of the MA Rule is that certain brokers are sending letters to State and local governments asking them to indicate that none of the funds they are investing on behalf of the government are bond proceeds. They do this because bond proceeds now have certain requirements under the MA Rule within which the brokers may be out of compliance. The investment of bond proceeds is now treated differently in some respects, and is subject to different requirements, than investment of other funds, in accordance with the MA Rule.

The GFOA has issued an *Alert on the MA Rule and Issuers*, and this Alert details the multiple exemptions permitted. It is recommended that Issuers become familiar with the MA Rule and its definitions, requirements and exemptions. A link to the Alert is provided below.

As with the investment of other governmental funds, there are risks inherent in investing bond proceeds. These include credit risk (safety), the risk of investing in instruments that may degrade in credit quality or default; market risk (liquidity), the risk of selling an investment prior to maturity at less than book value; and opportunity risk (yield/return),

the risk of investing long term and having interest rates rise, or investing short term and having interest rates fall while needing to reinvest the bond proceeds. Issuers should develop and adhere to investment policies and activities that minimize these risks. The GFOA has a Best Practice on the *Investment of Bond Proceeds*.

Issuer should become acquainted with federal tax law as it applies to arbitrage restrictions, and maintain adequate records to comply with arbitrage reporting and rebate requirements. Arbitrage is the ability to obtain tax-exempt bond proceeds and invest the funds in higher yielding taxable securities, resulting in a profit. In short, arbitrage occurs when interest earned on invested proceeds exceeds the interest rate of the interest repayment, or debt service, of the proceeds. Investments should be considered in light of the yields permitted to comply with federal arbitrage requirements. Procedures should be established to monitor any arbitrage rebate liabilities and reserve liabilities for future remittance to the IRS.



Further detail is available at the following resources:

[Alert on the MA Rule and Issuers](#)

[GFOA Best Practice: Creating an Investment Policy](#)

[GFOA Best Practice: Investment of Bond Proceeds](#)

Payment of Debt Service

Issuers of government debt have a fiduciary responsibility to manage their funds in a manner that assures timely and accurate payment of debt service principal and interest. Failure to make a debt service payment generally results in a default, a requirement to post a Material Events Notice pursuant to Rule 15c2-12 on the MSRB EMMA system, and can have major negative consequences. If a debt service payment is missed, Issuers should take immediate action to remedy the situation.

It is recommended that Issuers review GFOA's Best Practice *Settlement Procedures for Debt Service Payments*. Major recommendations of this Best Practice include:

- » Establishing procedures and appropriate contractual terms for making debt service payments
- » Use of electronic funds transfers to ensure timely payments and to ensure full utilization of funds until the due date.

In addition to the recommendations from the Best Practice, Issuers should consider the following items when designing procedures and policies for making debt service payments:

- » Issuers should have a debt service schedule for each bond issue containing all principal and interest payment dates and amounts
- » Issuers should be aware of any “flow of funds” requirements contained in a bond indenture. Some bond issues may require monthly or other periodic transfers of funds before actual payment dates (i.e. 1/12th of principal payment each month)
- » Issuers with variable rate debt should understand and monitor changing debt service requirements

Refunding Analysis

It is common that – prior to the final maturity of the debt – an Issuer will have the opportunity to refinance the remaining debt at lower interest rates (called a “refunding”). Municipal debt is typically issued with an optional call or redemption feature. The call feature must be specific and include what bonds can be called,

at what time, and for what price, giving flexibility to the Issuer. The date is usually approximately 10 years after the original issue date, but can vary based upon the specific terms agreed to at the time of issuance and the term of the bonds. Refunding debt at or after the call date is called a “current refunding.” Debt can also be refunded prior to the call date via an “advance refunding”, though there are typically additional cost requirements and tax compliance issues associated with an advance refunding prior to the call date. The Tax Cuts and Jobs Act enacted in December 2017 removed the tax exemption from advance refunding of municipal bonds.

Refunding of debt requires essentially the same process and effort as a “new money” issue, and often there is only one opportunity to refund debt for significant interest savings. Therefore, an Issuer should have a policy or guidelines that set a minimum savings baseline under which a refunding would be pursued. For example, many Issuers require a minimum of 3% or 5% savings (and/or a minimum dollar amount of savings) in order for a refunding to proceed. Setting an appropriate savings minimum avoids inefficient use of time exploring inefficient refundings, and can prevent refunding too early and missing greater savings by waiting until a later date.

Typically, the final maturity in a refunding remains unchanged, and the other terms of the refunding often closely match the original debt issue. The proceeds of the refunding are generally placed into an escrow until the call date (or next payment date) occurs, at which point the original bonds are paid off from money in the escrow. It is important that an Issuer work with service providers to create an escrow that earns as much as possible (i.e. an efficient escrow) without exceeding maximums allowed under federal regulations.



Further detail is available at the following resource:

[GFOA Best Practice: Refunding Municipal Bonds](#)



Other Requirements

Issuers should be aware that in addition to continuing disclosure and tax compliance requirements, there are often other legal documents, laws and regulations, policies, contractual requirements, and/or relationships that must be monitored. Some of the most common of these are included in this section.

Bond Indentures/Bond Ordinance/ Bond Resolution

Many bond issues have an ordinance and/or resolution that authorize and set many of the terms of the bond issue. Also, some bonds may have a bond indenture, which is a legal contract between the Issuer and bond holders. These documents can contain a variety of requirements that may include:

- i. Notice requirements
- ii. Reporting requirements
- iii. Coverage ratio or revenue covenants
- iv. Additional bonds tests
- v. Permitted investments
- vi. Debt service payment requirements
- vii. Debt service reserve fund requirements
- viii. Bond insurance or surety bond requirements
- ix. Required accounts/segregation of funds
- x. Requirements related to a trustee or paying agent
- xi. Restrictions on the use of bond proceeds
- xii. Redemption provisions

State/Local Law Requirements

Issuers should work with Bond Counsel and/or legal counsel to determine if there are any ongoing requirements related to State or local law that must be monitored. These may include items such as notice requirements, public protest procedures, legal debt limits, or limitations on revenue used to pay debt service.

Policy Requirements

Issuers may have debt or other financial policies that must be monitored to ensure compliance. Common

policy items that relate to debt issuance are debt limits, use of debt, debt ratios, and investment policies.

Rating Agencies

Issuers should be familiar with the GFOA best practice Using Credit Rating Agencies. Issuers (often with assistance from their Municipal Advisor) are responsible for managing the relationship with rating agencies after issuance. This can involve keeping the rating agencies informed of material events and responding to ongoing requests for information.

Investor Relations

Issuers should be familiar with the GFOA best practice Maintaining an Investor Relations Program. An effective investor relations program that responds to the informational needs of investors may lead to lower future borrowing costs for Issuers.

Financing Team Relationships

Issuers should manage the ongoing relationships with the various members of the financing team, which may include a Municipal Advisor, Bond Counsel, disclosure counsel, trustee banks, and/or paying agents. Issuers should continuously evaluate services provided, ensure compliance with contracts, and periodically conduct selection processes as needed.



Further detail is available at the following resources:

[GFOA Best Practice: Refunding Municipal Bonds](#)

[GFOA Best Practice: Using Credit Rating Agencies](#)

[GFOA Best Practice: Maintaining an Investor Relations Program](#)



Glossary / Other References

For additional information on post-issuance compliance you can refer to the following references:

<http://www.msrb.org/msrb1/pdfs/MSRB-Glossary-of-Municipal-Securities-Terms-Third%20Edition-August-2013.pdf>

<http://www.investinginbonds.com/story.asp?id=52>

About GFOA

Founded in 1906, the Government Finance Officers Association represents public finance officials throughout the United States. The association's nearly 20,000 members are federal, state and local finance officials who are deeply involved in planning, financing and implementing thousands of governmental operations in each of their jurisdictions. GFOA's mission is to promote excellence in state and local government financial management. For information about GFOA or to discuss any state or local finance matters, please contact our Federal Liaison Center, 202-393-8467. 660 North Capitol Street, NW, Suite 410, Washington DC 20001



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