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October 15, 2008

Internal Revenue Service
CC:PA:LPD:PR (REG-128841-07) Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: REG-128841-07: Public Approval Guidance for Tax-Exempt Bonds

Ladies and Gentlemen:

The National Association of Bond Lawyers (NABL) respectfully submits the enclosed comments on the proposed regulations on public approval guidance for tax-exempt bonds published September 9, 2008, and corrected October 8, 2008.

NABL appreciates the significant effort of the Department of the Treasury and the Internal Revenue service in the preparation of the proposed regulations.

Primary drafting responsibilities for these comments were assumed by Frederic L. Ballard, Jr., Scott R. Lilienthal, and Perry E. Israel.

NABL believes that participating in the guidance process supports clarification of and facilitates compliance with the tax law and regulations. Accordingly, NABL members would welcome the opportunity to discuss these recommendations to achieve clarity, certainty and administrability in this area of the law.

If you have any questions, please contact Frederic L. Ballard, Jr., at 202-661-2210 or through email at flb@ballardspahr.com.

National Association of Bond Lawyers

Thank you again for the opportunity to submit NABL's comments.

Sincerely,

William A. Holby

Enclosure

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National Association *of* Bond Lawyers

RECOMMENDATIONS BY THE
NATIONAL ASSOCIATION OF BOND LAWYERS
TO THE
DEPARTMENT OF THE TREASURY
OFFICE OF TAX POLICY
AND THE
INTERNAL REVENUE SERVICE
REGARDING
PROPOSED REGULATIONS ON PUBLIC APPROVAL GUIDANCE
FOR TAX-EXEMPT BONDS

OCTOBER 15, 2008

The National Association of Bond Lawyers ("NABL") submits the following comments on the proposed regulations concerning the public approval requirement under section 147(f) of the Internal Revenue Code (the "Code") published in the Federal Register on September 9, 2008, and corrected on October 8, 2008 (the "Proposed Regulations"). The comments were prepared by members of a NABL task force who are identified on an attachment.

General Comments

NABL thanks the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") for the flexibility and practicality of the Proposed Regulations in dealing with many specific problems that arise for bond issuers and bond counsel in complying with the public approval requirement. Given that the public approval requirements apply generally to all forms of private activity bonds issued under sections 142, 143, 144, or 145 of the Code, the Proposed Regulations are clearly of great importance to NABL's members and their clients. While NABL does have comments, NABL hopes that the comments will not obscure the basic appreciation of NABL for the various policy decisions reflected in the Proposed Regulations. NABL applauds particularly the addition of the post-issuance remedial action procedure for correction of deviations between a granted approval and subsequent events. And more broadly, NABL congratulates the Treasury and the IRS on the "principle-based" approach of the Proposed Regulations, which are a model for other future rule-making concerning tax-exempt bonds.

The Explanation of Provisions (the "Explanation") that accompanied the Proposed Regulations recognizes that several categories of bonds became subject to the public approval requirement for the first time as a result of the Tax Reform Act of 1986, such as qualified mortgage bonds ("QMBs") or qualified student loan bonds ("QSLBs"), and that the pre-1986 public approval regulations in Treas. Reg. §5f.103-2, being appropriately "facility-focused" as required by the pre-1986 application of the public approval

requirement to various forms of exempt facility bonds or small issue manufacturing bonds, provided no specific guidance for "portfolio loan" financing using QMBs or QSLBs or in certain other situations that became subject to the public approval requirement in 1986. The Explanation states that an issuer of these post-1986 bonds that made a "good faith effort" to comply with section 147(f) of the Code and Treas. Reg. §5f.103-2(f)(2) will not be subject to audit by the Service "merely because the issuer did not include all of the information required to be included in the public notice and public approval" under §5f.103-2(f)(2). This principle of giving effect to good faith efforts at compliance is of course welcome. NABL suggests that the principle is so important that it ought to be included in the text of the final regulations in a number of specific contexts as well as in the transitional rule in the manner suggested in the Explanation.[1] While a general statement of a good faith rule would be helpful, there are specific contexts in which it may be particularly relevant, as indicated by the presence of a reference to good faith in certain of the comments below.

Specific Comments

Preservation of pre-1986 regulations (Prop. Treas. Reg. §1.147(f)-1(a)). The Proposed Regulations state that to the extent not inconsistent with the Proposed Regulations, the pre-1986 regulations (Treas. Reg. §5f.103-2) continue to apply. NABL recommends that with exceptions noted at the end of these comments, the substance of the pre-1986 regulations in matters not addressed by the Proposed Regulations be brought forward into the final regulations so that bond issuers and bond counsel are not faced with the need to review two sets of regulations on the same subject and decide to what extent they are consistent with each other. Provisions in Treas. Reg. §5f.103-2 that NABL believes should be modified in addition to the changes made by the Proposed Regulations are indicated at the end of these comments.

Information required in public notice relating to the facility (Prop. Treas. Reg. §1.147(f)-1(b)(2)(i)). The Proposed Regulations (similar to the existing regulations) require a "general functional description" of the use of the facility financed with the issue, but also add new language making it easier to satisfy this standard. NABL appreciates the flexibility provided in the Proposed Regulations, including the ability to satisfy the requirement by making reference to a specific category of exempt facility bond.

Maximum stated principal amount of bonds (Prop. Treas. Reg. §1.147(f)-1(b)(6)(ii)). NABL recommends the addition of a statement that in the case of a multipurpose issue, the notice and approval do not need to allocate the amount of the issue between the various facilities or purposes of the issue. The statutory requirement of approval of the issue is satisfied by a notice and approval of the estimated amount of the issue as a whole and does not require a breakdown or itemization of different portions of the issue, other than in the case of post-issuance pooled financing approvals as discussed below.

There is precedent for the use of a "good faith" standard in the context of tax-exempt bonds. See, e.g., Temp. Reg. §6a.103A-2(c), relating to single family housing bonds.

Initial owner or principal user (Prop. Treas. Reg. §1.147(f)-1(b)(2)(iii)). The Proposed Regulations require the notice and approval to state the "expected initial owner or principal user" of the facility or the name of the "true beneficial party of interest for such legal owner or user," such as a 501(c)(3) organization that is the sole member of a limited liability company that owns the facility. "Principal user" is defined in turn by reference to the rules for aggregation of capital expenditures and prior bond issues in measuring the compliance of a "small issue" with the dollar limits of section 144(b) of the Code. Those rules provide generally that a user of 10% or more of a facility may be treated as a principal user, so that there could be up to 10 principal users (generally, tenants) in addition to the owner of a facility. In situations where there are multiple parties who could be listed, NABL recommends that language be added stating that the requirement as to names of parties may be met by naming one or more of the parties in a manner intended in good faith to carry out the purposes of section 147(f) of the Code.

Location of the facility (Prop. Treas. Reg. §1.147(f)-1(b)(2)(iv)). NABL supports the provision in the Proposed Regulations stating that issuers may identify multiple capital projects located on the same, adjacent, or proximate sites, and notes that this is consistent with what has long been the practice with respect to hospital and university campuses. NABL notes that, in addition to identification of the various boundary streets, it is often just as informative to identify a campus solely by its main address, and recommends that the final regulations include such an option as an alternative to identifying what may be numerous boundary streets. In addition, NABL also recommends that the final regulations provide additional flexibility in identifying the general location of a facility where the project is located over a widespread area, such as a privately operated water supply system or properties purchased with the proceeds of qualified redevelopment bonds.

In one or more recent audits of 501(c)(3) Bonds involving improvements at multiple locations, an issue was raised as to whether the public notice had to set forth the maximum amount of proceeds to be used with respect to each location. NABL does not believe that the maximum amount of proceeds to be used with respect to each location needs to be specified. Either the preamble to the final regulations or the text of the final regulations should state that for a bond issue financing improvements for multiple locations, it is not necessary to specify the dollar amount at each location in the public notice and public approval.

Special rules for mortgage revenue bonds and qualified student loan bonds (Prop. Treas. Reg. §1.147(f)-1(b)(3) and (4)). NABL is concerned that the Proposed Regulations appear to require that the notice and approval for QMBs or QSLBs specifically cite section 143 or section 144. NABL recommends that the language be revised to eliminate any inference to this effect. A required citation of Code sections would not further the purposes of section 147. For example, in a public notice of QMBs, NABL believes that it would be more meaningful to say that the bonds are being issued to finance residential mortgages than to say that the bonds are to be issued under section 143. Also, in the case of qualified student loan bonds, it seems unnecessary to require that the notice and approval indicate whether the issue will be for Federally guaranteed loans or unguaranteed "state supplemental" programs: both types of financing are portfolio loan

financings for student loans and NABL believes that they should not have to be further categorized in this technical manner. Further, § 1.147(f)-1(b)(3) should also apply to refinancings of obligations issued to finance single family mortgages to which section 143 of the Code or section 103Aof the Internal Revenue Code of 1954 do not apply. This could be accomplished by an amendment to the definition of "mortgage revenue bond" in § 1.147(f)-1(c)(F).

Post-issuance public approvals (Prop. Treas. Reg. §1.147(f)-1(b)(5)(ii)). NABL applauds the two-part approval process provided in the Proposed Regulation for certain qualified 501(c)(3) bonds issued to finance pools described in section 147(b)(4)(B). NABL believes the approach taken is an intelligent and effective way to deal with the problem of identifying projects in pools. Moreover, in response to the request in the preamble to the Proposed Regulations, NABL recommends that the two-step process be adopted in other situations involving pools, such as pools for multi-family rental housing projects or enterprise zone facility bonds (without regard to the implication in § 1.1394-1(p) example 6 that some of the facilities must be described in the initial approval). NABL also recommends that the final regulations make it clear that a second, post-issuance approval is not required for the initial use of the proceeds to the extent that the projects are identified in the pre-issuance public notice and approval. Finally, NABL notes that, in describing the characteristics of the post-issuance approval before each loan from a pooled issue of 501(c)(3) bonds, the Proposed Regulations require the issuer to treat the bonds that finance each loan as if they were reissued for purposes of the public approval requirement. NABL recommends that the regulations indicate specifically whether for this purpose the bonds to finance any particular loan include a share of the portion of the issue used to finance a common reserve fund or common costs of issuance.

Deviations in public approval information (Prop. Treas. Reg. §1.147(f)-1(b)(6)). NABL applauds the attempt in the Proposed Regulations to provide guidance on what constitutes an "insubstantial deviation" for purposes of the approval requirements. However, NABL suggests that the proposed standard of 5% of "net proceeds" be modified in certain respects. On a technical level, NABL believes this standard should refer to the principal amount of the issue rather than net proceeds, in order to conform with the underlying requirement for the notice and approval. And more broadly, the standard for deviations should be measured against the purpose of the approval process, which we believe is to state and approve potential uses and maximum amount of the issue, rather than to create an affirmative commitment as to particular uses or sizing. In this light, NABL recommends that the final regulations state as a general matter that it is not a substantial deviation (i) to issue fewer bonds than stated in the approval (even if the reduction is more than 5%), (ii) to delete from a multipurpose issue one or more projects identified in the approval, (iii) to redirect proceeds between the different purposes covered by a multipurpose issue (since only the total amount of the issue should be required in the approval in any event), or (iv) to redirect proceeds from approved facilities to working capital for an activity conducted in whole or in part at the approved facilities, or (v) to redirect the "insubstantial deviation" amount from approved facilities to some other facility not covered by the approval. NABL believes that these rules would provide issuers with needed flexibility without materially affecting the reasonableness of the notice and approval. In addition, NABL recommends that the final regulations clarify

that the facts and circumstances that are relevant in determining whether a deviation is substantial should include whether the issuer has made a good faith effort to carry out the purposes of section 147(f). Finally, with respect to deviations from the project as described in the notice, NABL believes that it is probably more accurate to refer to deviations between the notice and the actual *use* of the proceeds rather than to deviations between the notice and the actual *information*.

Working capital (Prop. Treas. Reg. § 1.147(f)-1(b)(6)). NABL has recommended, in the prior paragraph, that reprogramming funds from approved facilities to working capital be treated as an insubstantial deviation. The use of unspent proceeds from a construction or acquisition fund or, with bondholder permission, from a reserve fund to pay working capital costs may be essential to avoidance of default in many distress situations. The initial public hearing and approval as to the bond-financed facility is sufficient to satisfy the legislative purpose of section 147(f). The Service recognized this in Private Letter Ruling 9452021.

Substantial deviations (Prop. Treas. Reg. §1.147(f)-1(b)(6)(iii)). NABL cannot express strongly enough our support of the ability to correct unexpected problems that arise after the issue date. The ability in those cases to do a supplementary public notice and approval will allow issuers to redirect the use of those funds without incurring the additional costs of redeeming the bonds and issuing new bonds to finance the alternative projects. NABL views this as being the most important and most helpful proposal in the package. With that in mind, NABL does have relatively minor recommendations for improvement. First, NABL believes that the unexpected events or changes in circumstances that can be cured by a remedial public approval should also include changes in the initial owner or user of a facility. This recommendation would only be necessary in the case in which proceeds have not been expended on the facility so that there is in fact no initial owner or user. Once there has been an expenditure of proceeds, there is an initial owner/user who has benefited from the expenditure. At that point a change in the owner/user would not invalidate the existing approval, since the new owner/user will not be the initial owner/user. In order to create a workable and simple rule, NABL recommends that the final regulations clarify that the status of an initial owner/user as such comes into effect as soon as a specific, bright-line percentage of the proceeds have been expended: NABL recommends 5% of proceeds (net of proceeds deposited in reserve funds or spent on costs of issuance).

Second, the Proposed Regulations state that the standard for use of the remedial approval is that either the originally approved use is no longer feasible or viable, or that the cost of the facility was less than expected. NABL suggests that this standard be liberalized to give issuers and borrowers more flexibility. An issuer or borrower should be permitted to use the proceeds for projects with more pressing needs (e.g., where exigent circumstances warrant a re-prioritization of a capital improvement program or a need for an unforeseen capital improvement arises). For example, assume that a borrower plans to build a new hospital and bonds are issued but a exigent need for an unforeseen clinic arise at a different location arises). The borrower should be allowed to use the proceeds for the clinic provided a remedial public approval is obtained.

Timing requirements (Prop. Treas. Reg. § 1.147(f)-1(b)(7)). The timing requirements section is incorrectly cited as (8) rather than (7) in § 1.147(f)-1(b)(1) and § 1.147(f)-1(b)(5)(i).

Definition of facility (Prop. Treas. Reg. §1.147(f)-1(c)(1)). In general, NABL supports the newly revised definition of facility and the manner in which it includes working capital and portfolio financings, such as QMBs and QLSBs. In addition, NABL recommends that the final regulations include the concept stated § 5f.103-2(f)(4) of the existing regulations to the effect that separate tracts of land (including improvements and personal property) may be treated as a single facility if they are used in an "integrated operation").

Definition of public hearing (Prop. Treas. Reg. §1.147(f)-1(c)(2)). NABL supports the ability to cancel a public hearing if there are no timely requests to participate in the hearing. However, NABL requests clarification as to whether the notice of public hearing must indicate that the hearing may be cancelled without notice if no timely request to participate are received. NABL also requests clarification on how to address situations where timely requests to participate are not received by the issuer (e.g., a failed email or a late receipt of a regular mailing) in the context of a cancelled hearing due to no timely requests to participate Once option is to allow the public hearing requirement to be satisfied by providing notice for the cancellation of a public hearing in the same manner as the initial hearing notice was given (but with a limited time requirement (e.g., cancellation notice provided at least 48 hours prior to the hearing).

NABL appreciates the regulatory language allowing the hearing to be conducted by an appointed or employed individual or by the issuer. NABL recommends the addition of language clarifying that if the hearing is conducted by the issuer, the applicable procedural rules would be those that apply to the issuer (as distinguished, for example, from the rules that would apply to a county on behalf of which the bonds will be issued).

Definition of reasonable public notice (Prop. Treas. Reg. §1.147(f)(-1(c)(3)). NABL applauds the extension of reasonable methods of providing notice to include notice provided electronically and on websites. NABL recommends that the language of 1.147(f)-1(c)(3)(iii) be modified to clarify that, while it is necessary that "the governmental unit regularly uses that web site to inform its residents about events affecting the residents (including notice of public meetings of the governmental unit)," it is not necessary that state law allows such notice alone to be sufficient. Use of active web sites for public notice should be allowed under section 147(f) even in states which may still require paper publication. NABL believes this is an appropriate recognition of the way governments generally operate today. NABL also supports the reduction of the required notice time. However, we note that "business days" is not a concept that is uniform across different jurisdictions. NABL recommends that the notice time be reduced to 7 days (or, in the alternative, to 10 days) rather than 7 business days. Also, with respect to publication on a website, NABL notes that questions may arise as to the appropriate website on which to post the notice. For example, should the publication be on the issuer's website or on the website of the governmental entity on behalf of which

the issuer is issuing? NABL recommends clarification in the final regulations that the notice must be posted on the issuer's website. NABL would also recommend that the public posting of notices at one or more designated locations be recognized as an acceptable alternative to phone recordings. Many smaller issuers will not want to incur the expense of establishing a phone recording system when the issuer may hold very few public hearings each year.

Special rule on governmental approvals (Prop. Treas. Reg. §1.147(f)-1(d)). NABL applauds the proposed rule limiting the required governmental unit approving the issue to the issuer in the case of mortgage revenue bonds, qualified student loan bonds, and working capital financings for qualified 501(c)(3) bonds.

Effective date (Prop. Treas. Reg. §1.147(f)-1(e)). The effective date provision of the Proposed Regulations states that the final regulations will apply to bonds sold on or after the date of publication of the final regulations. NABL hopes that final regulations, modified to reflect the NABL comments, will be adopted promptly. At the same time, to protect the status of public approval proceedings prior to the date of publication of final regulations, we recommend that the final regulations be made effective for bonds issued on or after the date of publication of the final regulations pursuant to public approvals granted on or after the date falling 30 days after the date of publication. To illustrate the problem, assume that a "plan of finance" notice and approval were carried out in 2007 to cover three years of issuance of qualified mortgage bonds by a state housing finance agency. Assume also that the Proposed Regulations are adopted as final regulations in their current form in 2008. The effectiveness of the notice and approval for bonds sold subsequently to the date of the final regulations should not be affected by whether the notice and approval contain a reference to section 143, as may be required by the Proposed Regulations. NABL also recommends that the final regulations be effective on an elective basis to bonds issued prior to their publication. This would make the ability to do a post-issuance correction in the event of unexpected circumstances available to previously issued bonds.

The rule in existing Treas. Reg. § 5f.103-2(b)(1) dealing with refunding issues, which generally imposes a bond-by-bond approach in determining whether the refunding results in an extension of maturity necessitating a new TEFRA approval, was made obsolete by statutory changes enacted by the 1986Act as provided in section 147(f)(2)(D) of the Code, which instead compares the average maturity of the issue of which the refunding bond is a part to the average maturity of the bonds to be refunded. NABL recommends that the final regulations clarify that for this purpose the average maturity of a refunding issue will be considered not later than the average maturity of the bonds being refunded if the amount and date of the maturities or mandatory sinking fund installments of the refunding issue are not larger or later than those of the refunded bonds, provided that the bonds have no more than a de minimis original issue discount or premium. The recommended rule will avoid the difficulties that arise if the maturities of the refunding issue match exactly the maturities of the refunded bonds but the longer maturities of the refunding issue are sold at a premium, thus creating an extension of average maturity under a literal application of the requirement that average maturity be determined by reference to issue price in accord with section 147(b). Limiting the

recommended rule to cases where the premium is de minimis will protect against abuse of the rule in extreme cases.

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