PHONE 202-503-3300 601 Thirteenth Street, NW
FAX 202-637-0217 Suite 800 South
www.nabl.org Washington, D.C. 20005

National Association of Bond Lawyers

President
KRISTIN H.R. FRANCESCHI
Baltimore, MD

President-Elect
SCOTT R. LILIENTHAL
Washington, DC

Treasurer
ANTONIO D. MARTINI
Boston, MA

Secretary
KENNETH R. ARTIN
Orlando, FL

Directors:

KIMBERLY C. BETTERTON
Baltimore, MD

KIMBERLY A. CASEY
Denver, CO

CLIFFORD M. GERBER
San Francisco, CA

ALEXANDRA M. MACLENNAN
Tampa, FL

RICHARD J. MOORE
San Francisco, CA

ALLEN K. ROBERTSON
Charlotte, NC

DEE P. WISOR
Denver, CO

Immediate Past President
JOHN M. MCNALLY
Washington, DC

Director of Governmental Affairs
WILLIAM J. DALY
Washington, DC

Chief Operating Officer
LINDA H. WYMAN
Washington, DC

July 25, 2012

John J. Cross, III
Associate Tax Legislative Counsel
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Reissuance Concerns Related to Certain Private Purchases of Multimodal Tax-Exempt Obligations

Dear Mr. Cross:

The National Association of Bond Lawyers ("NABL") respectfully submits the attached memorandum discussing how reissuance principles, including those of Notice 2008-41, might be applied in the context of multimodal, or other interest rate reset, tax-exempt municipal obligations that are privately purchased rather than publicly offered. In view of the increasing participation of banks as purchasers in the municipal finance market, NABL believes that reissuance guidance to address the instruments used in these financings would be very helpful to market participants. In that light, after your consideration of the attached paper, members of the NABL Board and the NABL Tax Committee would like to engage you, and officials in the IRS Office of Chief Counsel, in a dialogue on these issues.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission. A list of the NABL members who participated in this project is attached as Appendix B.

If NABL can provide further assistance, please do not hesitate to contact Bill Daly in our Washington, D.C., office at (202) 503-3300.

Sincerely,

Kristin H. R. Franceschi

Enclosure

cc: James Polfer, Internal Revenue Service

Application of Reissuance Principles, Including the Principles of Notice 2008-41, in the Context of Private Placements of Multimodal Tax-Exempt Obligations

The National Association of Bond Lawyers ("NABL") sets forth herein a brief discussion of the treatment under the principles set forth in Internal Revenue Service Notice 2008-41, 2008-1 C.B. 742, as modified by Internal Revenue Service Notice 2008-88, 2008-42 I.R.B. 933, and Internal Revenue Service Notice 2010-7, 2010-3 I.R.B. 296 ("Notice 2008-41"), of certain tax-exempt obligations that are privately purchased by banks or other purchasers.[1] NABL requests, after due consideration of the analysis herein, that officials at Treasury and the IRS Office of Chief Counsel participate in a discussion of these issues with certain NABL Board members and Tax Committee members.

For various reasons, in the last few years there has been an increase in the number of tax-exempt financings effected through the direct issuance of bonds or other obligations to a bank or other financial institution[2] rather than through a traditional public offering.[3] In 2009 and 2010, many of these bank-based financings were encouraged by more liberal "bank-qualified" provisions of the Internal Revenue Code of 1986, as amended (the "Code"), created by the American Recovery and Reinvestment Act of 2009 ("ARRA").[4]

In a typical scenario, a bank makes a direct tax-exempt loan to, or purchases a tax-exempt obligation from, an issuer.[5] Often, bonds are initially held by a bank in what is typically referred

---

[1]This paper does not address any other tax issues relating to such transactions, nor does it address the application of other areas of law, such as securities law, to private purchases of tax-exempt obligations.

[2]Often, the purchasing bank may include its affiliated entities in the purchase of the obligations. For purposes of this paper, and to promote simplicity, references will be to the "bank."

[3]There are likely several factors at play. As part of the credit crisis fallout, a number of small- to medium-sized bond issues that were secured by letters of credit from downgraded banks began to reprice in the market at significantly higher interest rates. That created a movement on the part of some issuers and conduit borrowers to refinance or otherwise restructure such debt. Some banks that came through the credit crisis relatively unscathed were ready and able investors in tax-exempt obligations. Also, some larger banks during this time seemed to develop more of an appetite to take on the credit of governmental entities and medium to larger 501(c)(3) organizations. *See generally* Banks Bulked Up Their Muni Bond Portfolios in 2011, *The Bond Buyer* (March 27, 2012).

[4]Pub. L. No. 111-5, 123 Stat. 115 (2009). To encourage banks to invest in tax-exempt obligations during 2009 and 2010, ARRA amended Section 265 of the Code to expand the scope of "qualified tax-exempt obligations" (otherwise known as "bank-qualified" obligations). For governmental and qualified 501(c)(3) bonds issued during 2009 and 2010, the $10 million limit for qualified small issuers was increased to $30 million. In addition, 501(c)(3) organizations borrowing through a conduit issuer were treated as qualified small issuers entitled to their own $30 million limit. The ARRA bank-qualification provisions enabled many governmental issuers and 501(c)(3) organizations to access the bank-qualified market during 2009 and 2010.

[5]The terms "loan," "bond" and "obligation" are interchanged freely within this paper, with no intended distinction. *See* Treas. Reg. § 1.150-1(b). NABL acknowledges that there may be distinctions for state law, securities law, accounting or other purposes between a "loan," a "bond" and other types of municipal "obligations." Such considerations are beyond the scope of this paper. In the case of a conduit financing, as is customary, the underlying loan agreement between the conduit issuer and the conduit borrower would, insofar as the payment of debt service is concerned, mirror the debt service on the loan, bond or other obligation.

to as a "term mode" or "bank rate mode."[6] At the end of the term mode, the bonds are subject to a mandatory tender by the holder.[7] The terms of the bond documents provide that, in connection with the end of such mode and the mandatory tender, the borrower[8] may redeem the bonds or it may continue to have the bonds outstanding. If the latter option is selected, the borrower must select a new mode provided under the bond documents. Such new mode may have the same terms and conditions, including the duration of the mode, as the mode that just ended,[9] or it may have different terms and conditions from those that applied during the mode that just ended, as long as the terms and conditions of the new mode are provided in the bond documents. In any case, it is necessary at that point to determine the interest rate for the bonds in the new mode. The determination of such interest rate could, depending on the new mode, involve (i) determining a new fixed rate for the term of the mode (which could be to the bonds' final maturity or for a shorter term), (ii) determining a new fixed spread above a specified index (*e.g.,* a fixed spread above SIFMA or a fixed spread above a percentage of LIBOR), or (iii) determining the initial daily, weekly or other rate in a mode where the rate is regularly reset by a remarketing agent throughout the mode.

Bonds issued with optional and mandatory tender rights have long raised issues concerning the circumstances under which such bonds will be considered reissued for purposes of Sections 103, 141 through 150, and 265 of the Code. Reissuance of a tax-exempt bond generally triggers retesting of all the various federal tax requirements that apply to a new tax-exempt bond issue. Potential consequences of a reissuance include, among other things, a change in yield affecting arbitrage investment restrictions, acceleration of rebate payments, potentially new public approval requirements for qualified private activity bonds, deemed terminations for arbitrage purposes of integrated interest rate swaps under the qualified hedge rules and the required filing of a new information return. Moreover, reissuance can present a problem for certain types of bonds initially issued within a statutory deadline.[10]

---

[6]If the bond documents provide more than one such mode, the bonds are considered to be "multimodal." Further, bonds are considered multimodal for purposes of this analysis even if the bond documents only provide a single bank rate mode such that, following the end of the initial bank rate mode, a new interest rate must be determined to start the succeeding bank rate mode.

[7]The bond documents may not explicitly provide for a mandatory tender, but instead provide that, if the parties cannot agree on an interest rate for the new term within a specified time period, the borrower must select a different mode, if the bonds are multi-modal, or find another purchaser. Such provisions, it would seem, are tantamount to a mandatory tender.

[8]The use of the terms "issuer" and "borrower" throughout this paper is not meant to imply any substantive difference. These references simply recognize that the same rights or obligations an issuer has in a nonconduit financing usually rest with the ultimate borrower in a conduit financing.

[9]For example, in the simplest case, if the bonds during the original mode bore a fixed rate of interest for a specified term, the borrower could decide to repeat such specified term for another fixed rate of interest, recognizing that such fixed rate in all likelihood will have changed from the original fixed rate. Similarly, if the bond during the original mode floated at SIFMA plus a fixed spread for an agreed-upon term, the borrower could decide to repeat such specified term using SIFMA as the "base" once again, recognizing that, based on any number of factors, the appropriate spread over SIFMA may have changed.

[10]For example, as noted above, in 2009 and 2010 banks purchased a significant amount of bonds under the more liberal "bank-qualified" provisions in ARRA, many utilizing a multimodal structure of the type described

Notice 2008-41 provides the most recent guidance from the IRS for determining the circumstances under which certain bonds with optional and mandatory tender rights are treated as reissued for purposes of Sections 103 and 141 through 150. Notice 2008-41 generally provides that, in the case of a "qualified tender bond," any "qualified interest rate mode change" and any "qualified tender right" will not be treated as a modification under Treas. Reg. § 1.1001-3, and therefore will not result in a reissuance.

Section 3.2(3)(a) of Notice 2008-41 provides that, in order for a tender right to constitute a qualified tender right, "the terms of the tender right must require the issuer or its remarketing agent to use at least best efforts to remarket a bond upon a purchase pursuant to the tender right."[11] Although issuers of qualified tender bonds in the past have typically utilized a remarketing agent to determine the new interest rate on the bonds and to remarket the bonds following a tender, that is generally not the case in private bond purchase transactions of the type described herein. In these transactions, the issuer is likely dealing directly with a single lender – often the same lender that held the bond during the immediately preceding mode.

Importantly, the language in Section 3.2(3)(a) of Notice 2008-41 specifically contemplates that the issuer, rather than a remarketing agent, may be the party that remarkets the bonds. That language may be instructive in formulating an approach to address the transition from one mode to another in the context of privately purchased bonds.

NABL recognizes that Notice 2008-41 was drafted with public offerings in mind and understands that the term "remarketing" is typically a term used in that context. NABL suggests, however, that the language of Notice 2008-41 supports the notion that the use of a remarketing agent should not be the sole permitted means of avoiding a reissuance upon the ending of one mode and the start of another. Arguably, the determination of the rate for a new mode with a single lender bank is of little substantive difference from the determination of a rate with a bank that acts as the borrower's remarketing agent in a public reoffering. If an objective is to provide a "check" on the setting of the interest rate, it may be that having an issuer or borrower (a) engage a financial advisor for an independent assessment of the appropriate interest rate (and/or spread, and/or applicable percentage of the specified index) for the new mode, (b) solicit quotations from several competing banks for the new mode, or (c) even solicit and collect formal bids (akin to the process for bidding GICs under existing regulations) is sufficient for such purpose.[12] NABL thus believes that the reissuance analysis should primarily be based on

---

herein. Under current law, many of these bonds would no longer be bank-qualified were they to be reissued after 2010.

[11]The purpose of the "best efforts to remarket" requirement is not entirely clear. It appears that the" best efforts to remarket" requirement may have originally been intended to address the ability of issuers to hold their own bonds for up to 90 days without causing an extinguishment under general federal tax principles where the issuer (or its agent) continuously uses its best efforts to remarket the bonds.

[12]In practice, each of the above alternatives is likely to have various pitfalls. For example, a bidding process that is based on current bidding procedures for guaranteed investment contracts and advance refunding escrows may be the most difficult to employ and, thus, the least workable given such procedures' rules relating to "last looks" and the avoidance of courtesy bids. Independent financial advisors, for larger borrowers, may be affordable, but they may be less affordable for smaller borrowers with limited budgets. In NABL's view, the delivery of certifications by both the borrower and the lending bank reflecting the bona fide, arm's-length nature of their relationship in such case ought to be sufficient in most, if not all, cases.

whether the terms of the new mode (aside from terms that, if changed, would not result in a reissuance under the general principles of Treas. Reg. § 1.1001-3) are provided for in the original bond documents.

As we have indicated, after your consideration of the discussion herein, members of the NABL Board and the NABL Tax Committee would like to engage officials at Treasury and in the IRS Office of Chief Counsel in a dialogue to see whether a non-reissuance solution may be formulated to accommodate what has become an increasingly prevalent form of financing in the municipal marketplace.

An appendix setting forth some interest rate mechanisms NABL members have observed to be commonly used in the context of privately purchased bonds is attached.

APPENDIX A

COMMONLY-USED INTEREST RATES FOR PRIVATELY PURCHASED BONDS[13]

1. Fixed rate for a designated term that is shorter than the nominal maturity

2. Percentage of one-month LIBOR plus a fixed spread for a term that is shorter than the nominal maturity

3. SIFMA plus a fixed spread for a term that is shorter than the nominal maturity

4. Determination of a daily, weekly, etc. rate in a mode where the rate is regularly reset by a remarketing agent throughout the mode, where such mode is shorter than the nominal maturity

[13]This list of interest rates and interest rate mechanisms is not meant to be exhaustive.

APPENDIX B

LIST OF PARTICIPANTS

Clifford M. Gerber
Sidley Austin LLP
San Francisco, CA
cgerber@sidley.com

Michael L. Larsen
Parker Poe Adams & Bernstein LLP
Charleston, SC
mikelarsen@parkerpoe.com

Vanessa Albert Lowry
Greenberg Traurig, LLP
Philadelphia, PA
lowryv@gtlaw.com

Kristin H.R. Franceschi
DLA Piper LLP (US)
Baltimore, MD
kristin.francheschi@dlapiper.com

Scott R. Lilienthal
Hogan Lovells US LLP
Washington, DC
scott.lilienthal@hoganlovells.com

Antonio D. Martini
Edwards Wildman Palmer LLP
Boston, MA
amartini@edwardswildman.com

Richard J. Moore
Orrick, Herrington & Sutcliffe LLP
San Francisco, CA
rmoore@orrick.com

Kimberly C. Betterton
Ballard Spahr LLP
Baltimore, MD
bettertonk@ballardspahr.com

Allen K. Robertson
Robinson, Bradshaw & Hinson, P.A.
Charlotte, NC
arobertson@rbh.com

Jeffery D. Berry
Chapman and Cutler LLP
Chicago, IL
berry@chapman.com

Mitchell J. Bragin
Kutak Rock LLP
Washington, DC
mitch.bragin@kutakrock.com