



# 501(c)(3) Tax-Exempt Financings

Presented by:

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Gilmore Bell was established in 1979 and is one of the leading public finance law firms in the United States with 56 attorneys nationwide. The firm primarily represents governmental entities and 501c3 organizations to negotiate financing alternatives including bond and lease transactions, economic development incentives and public-private partnerships. Complementing its core practice, Gilmore Bell also acts as underwriter's counsel and bank counsel in public finance transactions.

The firm has an extensive tax and arbitrage rebate compliance practice – with four full-time tax attorneys and a staff of tax analysts – that has grown in response to increased complexity of Federal tax laws, regulations and IRS audit examinations. In addition, the firm provides continuing disclosure compliance services to issuers of municipal securities.

For more than 20 years, Gilmore Bell has consistently ranked in the top 10 nationally in number of bond counsel opinions rendered on municipal bond issues, and the firm consistently ranks 1st in the Midwest region, both in number and dollar volume of long-term state and local government bond issues. We strive to provide timely, effective and efficient service to assist our public finance clients in meeting their goals. This work ethic and practice integrity are at the core of our firm's culture.

# Overview – Tax-Exempt Financing

- Who: 501(c)(3) organizations
- What: qualified projects
- When: raise money for projects or refinance high interest debt
- Why: lower borrowing costs compared to taxable financings
- How: financing process

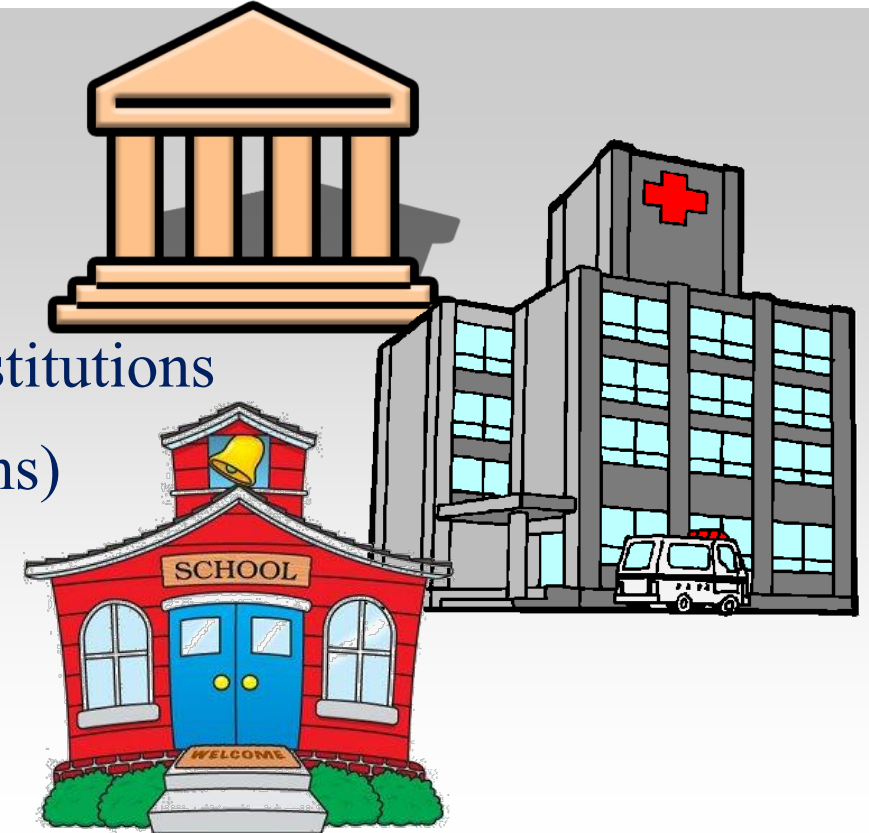
# Who? 501(c)(3) Organizations

- Tax-exempt bonds may be issued for the benefit of a 501(c)(3)
- Interest paid on “Qualified 501(c)(3) Bonds is exempt from gross income for Federal income tax purposes



# Who? 501(c)(3) Organizations

- Hospitals/health systems
- Nursing homes/senior living institutions
- Private colleges and universities
- Charter schools, private schools and child care institutions
- YMCAs (and other similar charitable organizations)
- Charitable Foundations
- Museums
- Research institutions



# What? Types of Financings

- New money financings (capital expenditures)
- Working capital expenditures (special rules)
- Refunding outstanding bonds and refinancing other indebtedness

# Why? Tax-Exempt Rate Savings

## Example: \$10,000,000 Financing

	<u>Taxable Bonds</u>	<u>Tax-Exempt Bonds</u> (37% / 21% Federal Tax Rate)
Interest Rate	7.00%	4.41% / 5.53%
Annual Interest	\$700,000	\$441,000 / \$553,000
Annual Savings	-	\$259,000 / \$147,000

# How? Financing Process

- What are the capital projects?
- What are the options for financing?
- What can be financed tax-exempt?



# Financing Process



# Financing Process

- Capital project may be financed from:
  1. Excess operating revenues
  2. Donations
  3. Debt
  4. Grants

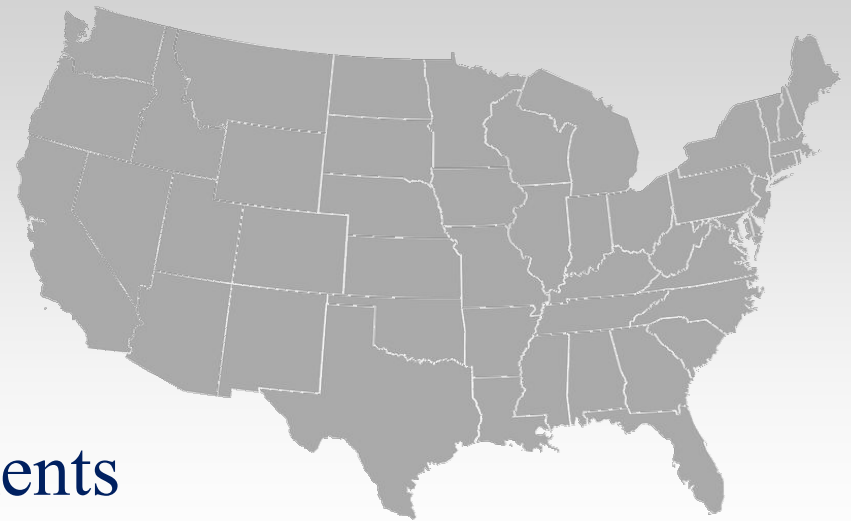


# Financing Team

- **Conduit Issuer**
    - Conduit Issuer Counsel
    - Conduit Issuer Financial Advisor
  - **501(c)(3) Borrower**
    - 501(c)(3) Borrower Counsel
    - 501(c)(3) Borrower Financial Advisor
  - **Purchaser/Underwriter**
    - Purchaser/Underwriter Counsel
- Bond Counsel
  - Bond Trustee
  - Accountant
  - Master Trustee
  - Rating Agencies
  - Placement Agent
  - Liquidity / Credit Provider

# Conduit Issuer

- Tax-Exempt Financings by 501(c)(3) Borrowers require a state or political subdivision to issue bonds = “Conduit Issuer”
  - Statewide issuers
  - Local issuers
  - Cities, counties
- Conduit Issuer is not liable for bond payments to be made by the 501(c)(3) borrower



# Financing Process

- Due Diligence Request (securities law)
  - Underwriter and counsel
- Basic Documents
  - Bond Trust Indenture
  - Loan Agreement / Lease Agreement
  - Tax Agreement
  - Purchase Contract
  - Public Offering Disclosure Document or Bank Agreement



# Financing Process

- Tax Due Diligence
  - New Money
    - Identify capital projects and budget
    - Identify location of each project
    - Determine which projects (or portion) of the projects can be financed tax-exempt based on expectations of use
  - Refinancing Prior Debt
    - Identify capital projects previously financed – Final Written Allocation
    - Confirm expectations of use

# Financing Process

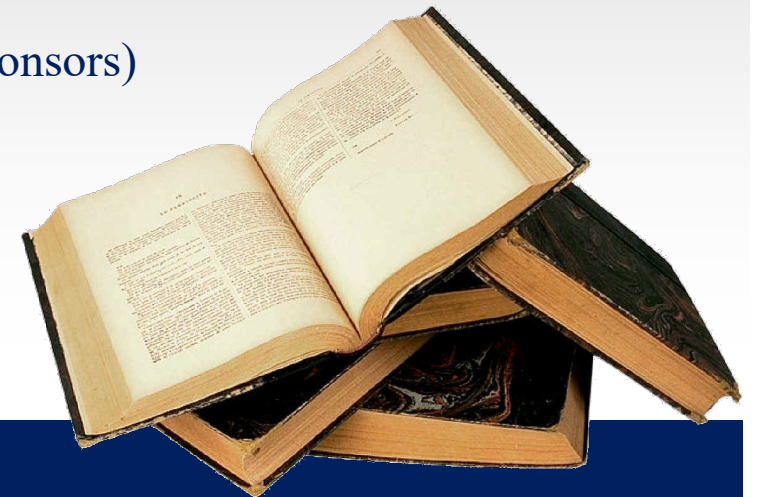
*Follow the Rules*



# Getting Started – Legal Considerations

## Consider:

- State and Federal law
  - Constitutions, statutes, regulations, case law, etc.
- Borrower’s corporate organization
  - Organizational documents (articles, bylaws)
  - Corporate structure (parents, subsidiaries, members, affiliates, sponsors)
- Financing documents for other debt



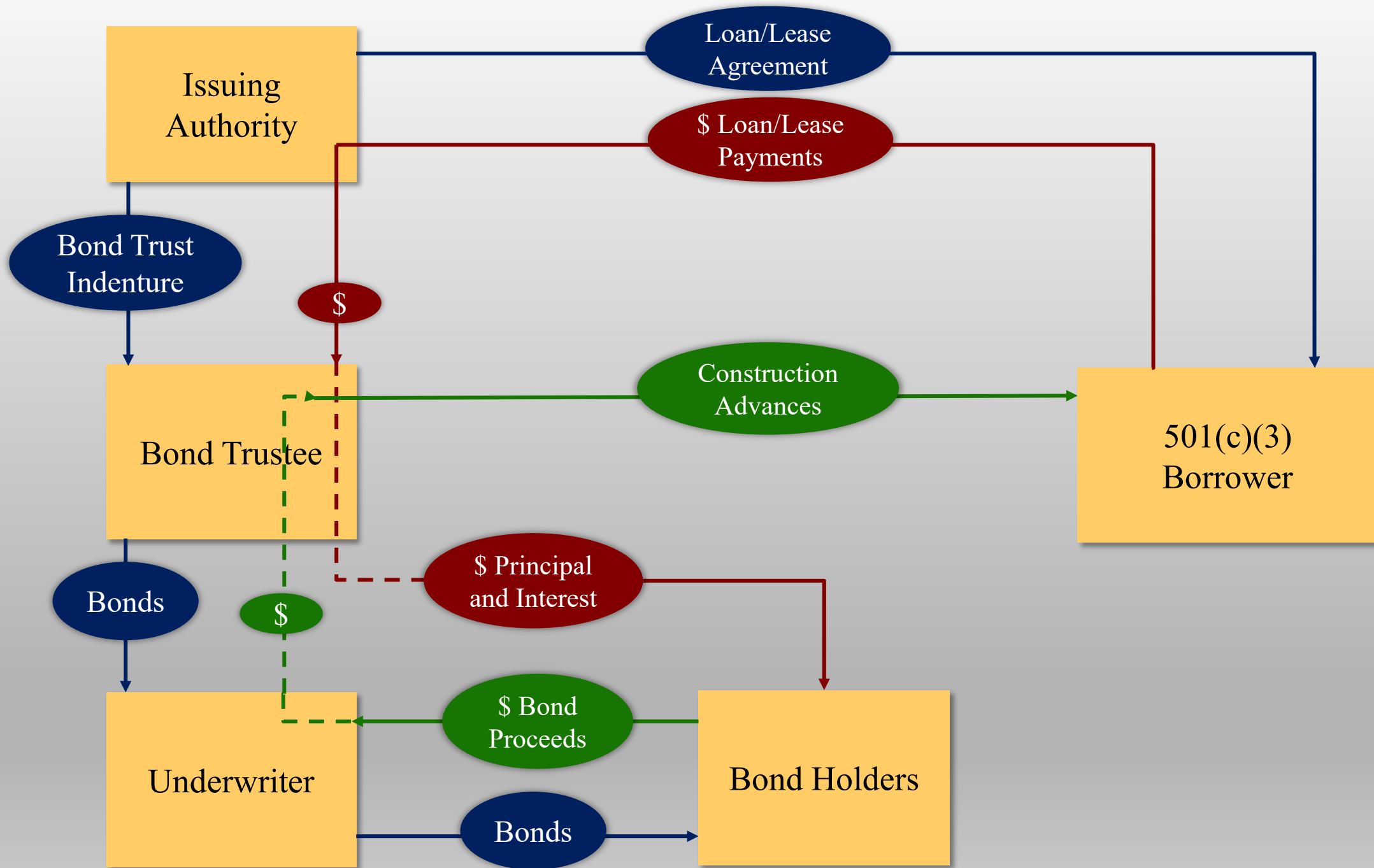


# Financing Document Considerations

- Limits on additional debt issuance
- Financial covenants
  - rate covenants
  - debt service coverage ratio
  - liquidity covenants
  - days cash on hand
- Consent rights
- Priority of indebtedness
- Limits on liens, encumbrances and transfers of property
- Existing liens and indebtedness



# Revenue Bond Structure

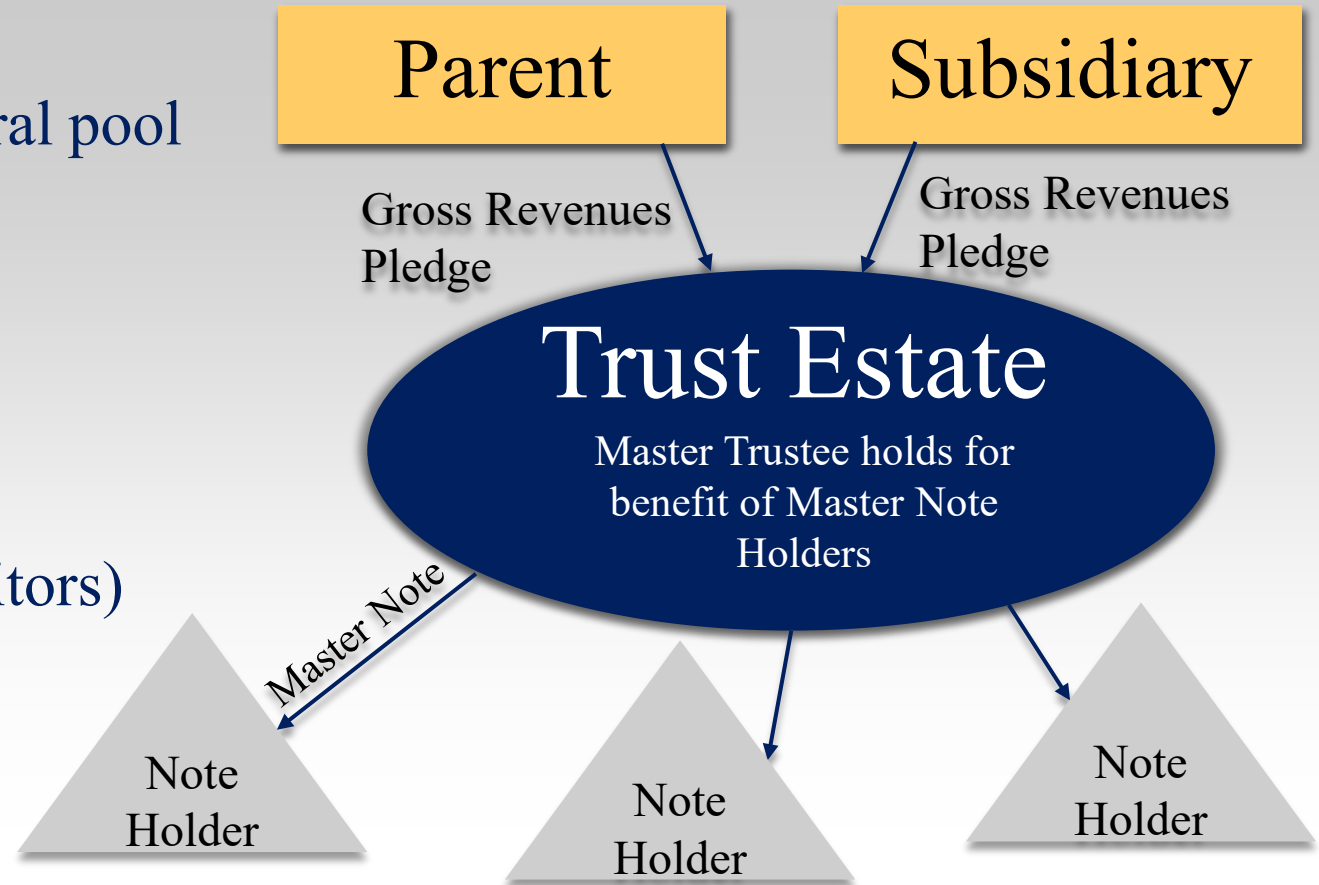


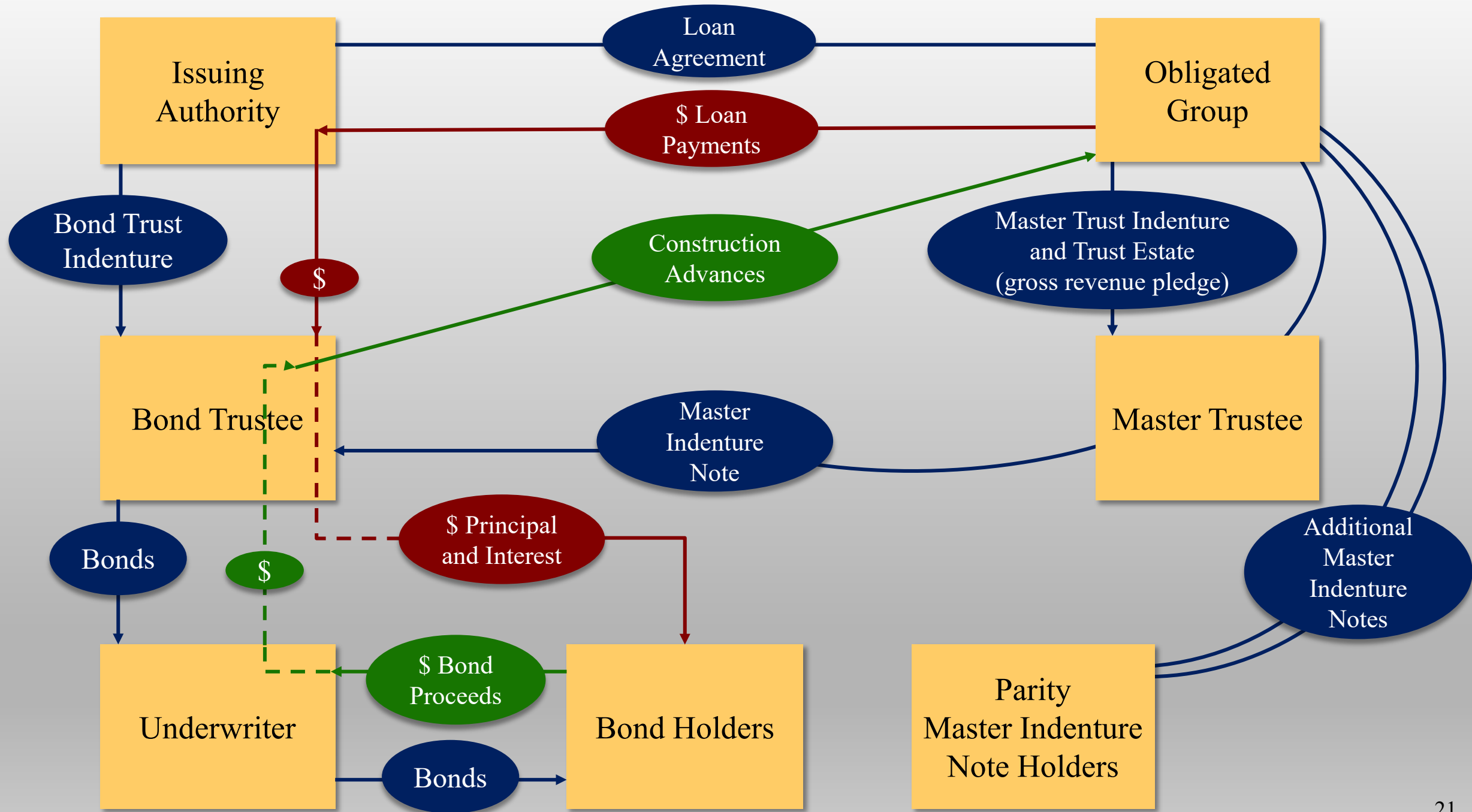
# Master Trust Indenture Structure

# Master Trust Indenture

(cont'd)

- Purpose:
  - consolidate credit and collateral pool
  - standardize covenants
  - streamline borrowing process
  - all Master Note holders (creditors) secured on parity basis





# Public Offerings

- Underwriter
- Official Statement
- Public Investors
- Interest Modes:
  - Fixed rate to maturity
  - Variable rate modes (daily, weekly, short-term/CP, indexed/floating rate, long-term, etc.)

# Direct Purchases / Private Placements

- Direct Purchase Bank (or other financial institution as purchaser)
- Placement Agent
- Bank Agreements
- Interest Modes:
  - Fixed rate to maturity
  - Fixed or floating/variable rate for term (*e.g.*, bank hold period 5/7/10 years)



# Continuing Disclosure

# Continuing Disclosure for Publicly Offered Bonds – SEC Rule 15c2-12

- Securities Exchange Commission (SEC) *Rule 15c2-12* requires underwriters of publicly sold bonds (with certain exceptions) to obtain from borrowers a **continuing disclosure undertaking/agreement** to provide:
  - annual public disclosure of **certain financial information and operating data**
  - disclosure of the occurrence of any of **16 listed material/notice events**
- Required information posted on the Municipal Securities Rulemaking Board (MSRB) **Electronic Municipal Market Access (EMMA)** service website.  
<https://emma.msrb.org/>

# Continuing Disclosure for Publicly Offered Bonds – SEC Rule 15c2-12

- Borrowers may undertake to provide additional financial and operational information on a more frequent basis (e.g., quarterly reports)
- Voluntary notices also permitted to be posted
- *Rule 15cs-12 overview available on the MSRB's website at:*
  - <http://www.msrb.org/msrb1/pdfs/SECRule15c2-12.pdf>



# Continuing Disclosure for Publicly Offered Bonds – SEC Rule 15c2-12

## 16 Events to be reported within 10 business days of occurrence include:

1. Principal and interest payment delinquencies;
2. Non-payment related defaults, if material;
3. Unscheduled draws on debt service reserves reflecting financial difficulties;
4. Unscheduled draws on credit enhancements reflecting financial difficulties;
5. Substitution of credit or liquidity providers, or their failure to perform;
6. Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;
7. Modifications to rights of bondholders, if material;
8. Bond calls, if material, and tender offers;

# Continuing Disclosure for Publicly Offered Bonds – SEC Rule 15c2-12

## 16 Events to be reported within 10 business days of occurrence include (cont'd):

9. Defeasances;
10. Release, substitution or sale of property securing repayment of the Bonds, if material;
11. Rating changes;
12. Bankruptcy, insolvency, receivership or similar event of the obligated person;
13. The consummation of a merger, consolidation, or acquisition involving the obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;
14. Appointment of a successor or additional trustee or the change of name of the trustee, if material;
15. Incurrence of a Financial Obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a Financial Obligation of the obligated person, any of which affect security holders, if material; and
16. 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.

# Tax Law Considerations

# 501(c)(3) Tax Law Considerations

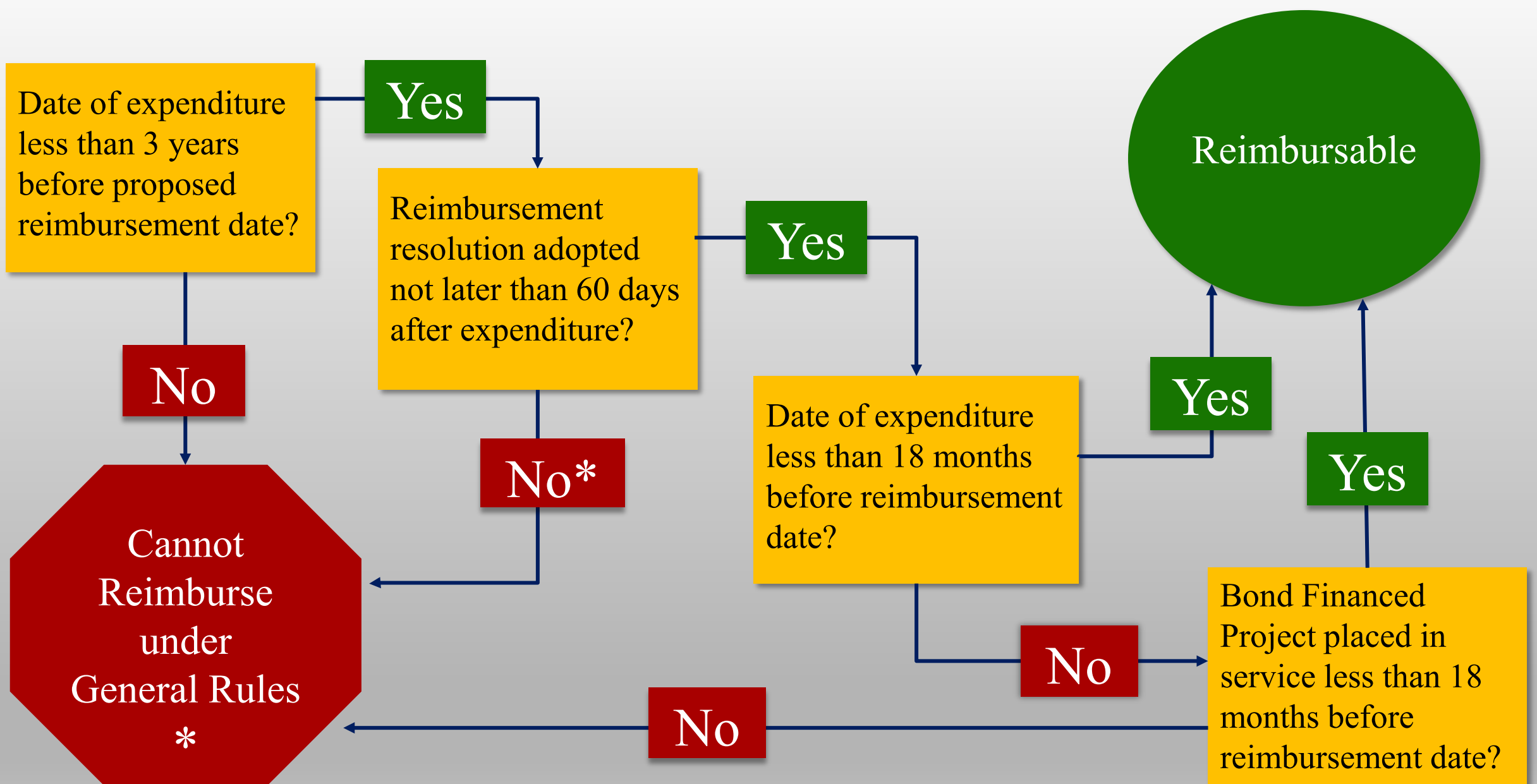
- Expenditure Reimbursement Rules
- TEFRA – Public Hearing and Approval
- Ownership Requirement
- Private Business Use – 5% Limit
- Unrelated Trade or Business Use
- 2% Costs of Issuance Limit
- Economic Life vs. Average Maturity



# Tax Law Considerations – Reimbursement Rules

- May reimburse expenses paid prior to the issue date if:
  - Board adopts an “official intent” resolution early
  - Resolution includes brief description of project, not to exceed dollar amount and intent to be reimbursed from proceeds of tax-exempt obligation
  - Exceptions
    - Preliminary Expenditures
      - » Architect, Engineering
    - De Minimis Amounts





\* Special exceptions to reimbursement rules are available for certain small-issuers, long-term construction projects, de minimis expenditures, and preliminary expenditures (e.g., architectural, engineering, surveying, soil-testing). Additionally, certain expenditures may be reimbursed/refinanced if previously financed directly with a taxable 3<sup>rd</sup> party loan that is to be refinanced with proceeds of the tax-exempt bond issue.

# What is “Private Use”?

The sale of a financed project results in private use



**Ownership Requirement!**



# What is “Private Use”?

- How long do we have to track this stuff?
  - IRS restricts the use of financed projects during the entire term of the bond issue (including refunding bond issues)
- *Are you saying we have to track FOREVER???*

# What is “Private Use”?

- Example: Bond issue financed MRI machine
  - Five years later: Hospital decides to replace MRI machine and sells at a substantial discount
  - Fifteen years later: Hospital disposes of the MRI machine
- Exception: No need to continue tracking if project has no remaining useful life



# What is “Private Use”?

A lease of all or a portion of a financed project  
**may** result in private use



# What is “Private Use”?

- Example: Hospital leases space within MOB to physician practice group



- Short Term Exceptions:
  - Leases under 50 days
  - Leases under 100 days pursuant to rate scale

# What is “Private Use”?

Arrangements for a third party to operate or manage financed projects may result in private use



# What is “Private Use”?

- Example: Hospital enters into a contract with physician practice group to operate bond financed emergency department?
- Radiology department?
- Provide anesthesiology services?





# What is “Private Use”?

- Safe Harbor Requirements
  - Revenue Procedures 2017-13
  - Proprietary interest vs. service providers
  - No sharing of “net profits”
  - Limit on term of contract
  - Discuss with legal counsel in advance

# What is “Private Use”?

Use by a 501(c)(3) organization of a bond financed project in an unrelated trade or business results in private use (regardless of profit)



# What is “Private Use”?

- Example: Hospital uses bond financed lab to perform tests for other hospitals and clinics in the area



*If we have “private use”... what happens?*

# What is “Private Use”?

- Can we fix it?
  - Cash in the project
  - 5% limit on private use
  - Modify contract
  - Remedial Action
  - IRS Voluntary Closing Agreement Program



# What is “Private Use”?

- How can you help?
  - Track the use of financed projects
    - Annual Compliance Checklist
  - Ask questions early and often!
  - Identify issues early...
    - More options available
    - Avoid jeopardizing tax advantaged status of bonds



Joint Ventures<sup>(c)(3)</sup>P3s  
Mergers & Acquisitions  
Sales and Dispositions

# Joint Ventures and Public Private Partnerships

- Joint Ventures between nonprofit/governmental and for-profit entities
  - Partnership accounting tax-exempt bond rules
  - Tax-exempt eligible portions up to the nonprofit/governmental user's partnership %s
  - Tax-exempt and taxable debt combination financing structures
  - Floating qualified equity, qualified management agreements and optimizing 5% private use
- Joint Ventures among multiple qualified 501(c)(3)/governmental entities

# Mergers & Acquisitions

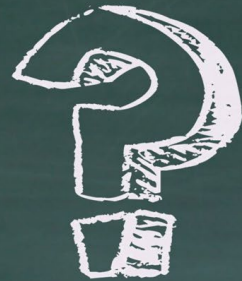
- Bond document related differences - mergers vs acquisitions
- Acquisition financing tax treatment
  - Survives tax reform's elimination of tax-exempt advance refundings
  - Preserving ability to finance or refinance on a tax-exempt basis after original acquisition or initial taxable acquisition financing
    - Cash acquisition → tax-exempt financing
    - Taxable acquisition financing → tax-exempt financing



# Sales, Non-Qualified Leases and other Dispositions

- Remedial Actions
  - Redemption or defeasance of non-qualified bonds
  - Alternative use of financed asset disposition proceeds (substituting new facilities)
  - Alternative use of financed assets (tax use agreements between seller and qualified user buyer)
  - Timing considerations

QUESTIONS





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