



Public Finance Alert

Developments in public finance law

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IRS Issues Proposed TEFRA Public Approval Regulations

On September 9, 2008, the Internal Revenue Service (the IRS) issued proposed regulations (the “Proposed Regulations”) that provide guidance regarding the public approval requirements applicable to tax-exempt private activity bonds issued by state and local governments. In general, the Proposed Regulations provide additional flexibility for obtaining public approval as compared to the existing regulations, and provide special rules for mortgage revenue bonds and student loan bonds. The Proposed Regulations are, however, applicable only after publication of final regulations and may not be applied until such time.

In general. One requirement for the issuance of tax-exempt private activity bonds is that the bonds meet the public approval requirement before issuance. Specifically, the Internal Revenue Code requires approval by the governmental unit issuing the bonds and each governmental unit having jurisdiction over the area in which the bond-financed facility is located. Public approval by a governmental unit can be either by (1) an applicable elected representative of the governmental unit after a public hearing that followed reasonable public notice about the bonds, or (2) voter referendum of the governmental unit.

Existing Treasury regulations provide that reasonable public notice means published notice that is reasonably designed to inform residents of the affected governmental units. The existing regulations require the public notice to contain certain information with respect to the facility to be bond-financed, including: (1) a functional description of the type and use of the facility; (2) the name of the expected owner, operator, or manager; and (3) a general description of the prospective location of the facility by street address or, if no address, by a general description designed to inform readers of the facility’s specific location. Certain insubstantial deviations are permitted, but the IRS has interpreted this provision somewhat narrowly.

Public notice and approval content. The Proposed Regulations would make several changes to the content required in the public notice. First, the Proposed Regulations permit a general reference to the type of facility financed or the type of qualified bond and a general description of the use the facility. Thus, for example, a public notice stating that bonds will be issued to finance a hospital for a 501(c)(3) organization is reasonable, even if such notice does not specify the total number of beds expected at the hospital.

Second, the Proposed Regulations modify the rule relating to the identification of the owners or operators that must be provided in the public notice. Under the Proposed Regulations, the name provided in the notice may be either the name of the legal owner or principal user or the name of the beneficial party of interest (e.g., the name of a 501(c)(3) organization that is the sole member of the LLC that will own the project).

Third, the Proposed Regulations clarify the requirements for bond issues financing multiple capital projects. The Proposed Regulations provide that a consolidated description of the geographic boundaries of a facility that involves multiple capital projects may be sufficient if such capital projects are located on the same site, or on adjacent or reasonably proximate sites used for similar purposes. For example, a 501(c)(3) university with multiple buildings on its campus may describe the location of the facilities to be financed by reference to the outside street boundaries of the campus, with a reference to any noncontiguous features of the campus.

Special rules for certain financings. The Proposed Regulations provide special rules for mortgage revenue bonds, student loan bonds, and qualified 501(c)(3) bonds financing multiple loans. For mortgage revenue bonds, the Proposed Regulations generally provide that public notice and approval are reasonable if they provide the maximum stated principal amount of the bonds that will be issued and a general description of the geographic jurisdiction in which the residences to be financed will be located. Similarly, for qualified student loans, the Proposed Regulations generally require that public notice state the maximum stated principal amount of the bonds that will be issued to finance student loans and a general description of the student loan program under which the loans will be made (e.g., a federally guaranteed student loan program under the Higher Education Act of 1965). The Proposed Regulations provide a similar rule for qualified 501(c)(3) bonds financing multiple loans if the ultimate borrower and facility information is unknown at the time of issuance (i.e., a “blind” pool), but also require a second “supplemental” public approval process to occur after the bonds are issued and as loans are made.

The Proposed Regulations indicate that outstanding mortgage revenue bonds, student loan bonds, and qualified 501(c)(3) bonds financing multiple loans will not be subject to audit for failing to include all information required under the existing regulations if a good faith effort was made to comply with the public notice and approval requirements of the existing regulations.

Deviations from public approval requirements. The Proposed Regulations provide guidance for situations where the actual projects financed deviate from the projects described in the public notice. The Proposed Regulations provide that the following deviations may be disregarded as “insubstantial”: (1) a difference between the actual amount of bond proceeds used for a facility and the amount stated in the public approval that is not more than 5 percent of net proceeds of the issue; and (2) a change in initial owner or principal user of a project, when the new owner or principal user is a related party to the person named in the public approval.

The Proposed Regulations also permit an issuer to cure or “remediate” a substantial deviation in certain situations by holding a supplemental public hearing after the bonds are issued. To qualify for this option, the issuer must have complied with the general public approval requirement and must have reasonably expected to use the bond proceeds in accordance with that public approval. In addition, unexpected events or unforeseen changes in circumstances must occur after the issue date, causing the issuer to determine either that it is no longer feasible or viable to use the proceeds as set forth in the original public approval, or that it did not need to use the full amount of the proceeds for the facilities stated in the public approval. To complete the remediation, the issuer must obtain a supplemental public approval that meets the public approval requirement.

Public notice and hearings. The Proposed Regulations simplify the rules for providing public notice by allowing a governmental unit to provide public notice of a public hearing by posting notice on its website, but only if (1) such governmental unit regularly uses that website to inform its residents about events affecting the residents, and (2) it offers a reasonable alternative method for obtaining this information for residents without access to computers (e.g., by phone recordings). This method is in addition to existing permitted methods for providing public notice such as newspaper publication or television or radio broadcast. The Proposed Regulations also reduce the minimum required time between the public notice and public hearing from 14 days to 7 business days.

Effective date. The Proposed Regulations apply to bonds that are sold on or after the date of publication of final regulations. They may not be applied before that date.

If you have any questions or require further information regarding these or other matters, please call your regular Nixon Peabody contact or feel free to contact one of the attorneys listed below:

Gary Bornholdt	202-585-8154	gbornholdt@nixonpeabody.com
Travis Gibbs	213-629-6029	tgibbs@nixonpeabody.com
John McQueen	585-263-1345	jmcqueen@nixonpeabody.com
Jeffrey Piemont	212-940-3059	jpiemont@nixonpeabody.com
Mitch Rapaport	202-585-8305	mrapaport@nixonpeabody.com
Bruce Serchuk	202-585-8267	bserchuk@nixonpeabody.com

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