

Alert: IRS Issue Price Regulations Effective June 7, 2017

For bonds sold on or after June 7, 2017, the manner in which the issue price of a bond issue is determined will change. The issue price for each maturity will now be based on 10% of actual sales. Previously, it was based on the price at which bonds were reasonably expected to be sold. Competitive sales which meet certain conditions will be exempt from the 10% threshold.

The initial compliance on these new rules on or shortly after June 7, 2017 should be a consideration as issuers schedule competitive sales of new bond issues.

This GFOA Alert provides an explanation of how the rules are likely to impact issuers. State and local governments are encouraged to consult bond counsel and their municipal advisor as to how these changes may impact upcoming bonds sales.

I. Importance of the New Issue Price Regulations

Establishing the issue price of a tax-exempt bond is important to issuers of tax-exempt debt as it:

- determines the arbitrage yield restriction for rebate compliance purposes; and
- determines the maximum allowable escrow yield for advance refunding bonds.

Issuers should consult counsel on the application of the issue price when determining other financing conditions, such as whether an issuer has exceeded threshold limits where there are volume caps required for certain private activity bonds, or for determining the cost of issuance limit on bank-qualified debt or voter-authorized debt.

The new [IRS Issue Price regulations](#) are significantly different than prior regulations, which determined issue price by a reasonable expectation standard – established as the “first price at which a substantial amount of the bonds is *reasonably expected to be sold* to the public.” This new definition applicable to all bonds sold on or after June 7, 2017 is the price at which bonds are *actually sold* to the public.

Ultimately the documentation to accompany the debt issue, including underwriter certifications, Notice of Sale and pricing wires, will be required to establish issue price and should be discussed between the issuer, the issuer’s municipal advisor, bond counsel, and the underwriter in advance of the sale. Various trade groups, such as SIFMA and NABL have offered model documentation for consideration and use by their members. Some of these documents may not be favorable to issuers or certain types of bonds.

Issuers should be aware of the following information when speaking with their financing team.

II. New Issue Price Regulations

General Rule. The issue price is the first price at which a substantial amount (at least 10%) of each maturity is sold to the public. For private placements, the issue price is the price paid by the buyer.

Exception: Competitive Sales. The issue price for qualifying competitive sales can be based on the reasonably expected initial offering price in the winning bid. To meet the requirements of a competitive sale, issuers must make the notice of sale widely available to underwriters, give all bidders an equal opportunity to bid and award the sale to the bidder with the highest price (lowest cost of funds). In addition, and very importantly, issuers must receive bids from at least three underwriters for the exception to apply.

Exception: Hold the Price. The bond's issue price may be determined based on the initial offering price to the public on the sale date if each underwriter agrees in writing to hold the price of the bonds of a maturity at a price no higher than the initial offering price for up to five business days after the sale date.

III. Implementation of the New Issue Price Regulations

Negotiated Sales. The Bond Purchase Agreement for a negotiated sale should reflect actual sales on the sale date (typically, the date on which the bond purchase agreement is signed). Provisions of the Bond Purchase Agreement may include reporting requirements should substantial sales not occur on the sale date, or the requirement that the underwriter will hold the price for up to five days after the sale. Expectations of the entire underwriting syndicate should be reflected in the sale and bond purchase documents.

Competitive Sales. The general rule standard can be avoided in competitive sales when the issuer receives at least three bids for their bonds. However, in the event that the three-bid minimum is not met, the issuer's Notice of Sale will need to clearly describe how the issue price will be established. At least four options may apply, depending on the types of bonds sold and other factors:

1. General Rule. Issuer states in the Notice of Sale that if 10% of each maturity is not sold on the sale date (generally, the date of the verbal or written award), the winning bidder will provide the issuer with ongoing pricing information until 10% of each maturity is sold and the issue price can be established.
2. Hold the Price. Issuer states in the Notice of Sale that underwriters will be required to "hold the price" for up to five business days after the sale. This requires underwriters to limit the price of a given maturity to a price no higher than the initial offering price for the lesser of (i) five business days after the sale date, or (ii) date on which at least 10% of that maturity is sold. This option is likely to negatively impact the pricing of the bonds.

3. Hold the Price/Underwriter Cancel the Bid. Issuer states in the Notice of Sale that underwriters will be required to “hold the price” for up to five business days after the sale; however, the winning bidder may elect to withdraw the bid.
4. Issuer Cancel the Bid. Issuers may state in the Notice of Sale that the issuer will cancel the sale if three bids are not received, and either reschedule the sale date or consider selling the bonds through a different process.

Issuers should analyze the relative risks and merits of these options with their municipal advisor and bond counsel and ensure that the preferred option is clearly communicated in the Notice of Sale. Factors that may affect this analysis include the type of sale, use of proceeds (new money or refunding), issuer’s history of receiving three or more bids, interest rate sensitivity and the timing of when proceeds are needed. Small or infrequent issuers who may be less likely to receive three bids, and issuers of advance refunding bonds may weigh the costs and benefits of each approach differently than larger issuers of new money bonds. Issuers may choose to distribute information about each competitive issue widely and build more time in the pre-sale schedule in order to enhance likelihood of receiving at least three bids.

Documentation Considerations: Issuers should be aware that various industry groups have created model documents to implement the regulations, some more favorable to issuers than others. The terms in the Notice of Sale, the Bond Purchase Agreement and other documents should be discussed with the finance team, including bond counsel.

IV. Conclusion

Issuers, especially those who plan to issue after June 7, should consult with their finance team to best understand how these rules will apply to their specific situation. Additional guidance related to the SIFMA and NABL documents is forthcoming.

This document was developed to educate members about the Final Issue Price Regulations and should not be construed as legal advice.