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Commentary

Final Issue Price Regulations Significantly Change Current Rules

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On Dec. 9, the IRS released final Treasury Regulations (the "[Final Regulations](#)") relating to the "issue price" of tax-exempt bonds for purposes of arbitrage investment restrictions. Although on balance an improvement to the proposed Treasury Regulations released in 2015, the Final Regulations represent a departure from the current Treasury Regulations (the "Current Regulations") and will affect long-held practices regarding the documentation of issue price. As such, issuers, underwriters, financial advisors and others involved in the municipal bond market will need to determine how they will comply with the Final Regulations, which are effective for bonds sold on or after June 7, 2017.

Set forth below is a general summary of pertinent provisions of the Final Regulations.

Actual Sales Test Adopted for Publicly Offered Bonds

Unless the issuer elects to use one of the two "special rules" for determining issue price, the issue price of bonds that are publicly offered is the first price at which a substantial amount (i.e., 10%) of the bonds is sold to the public. However, unlike the Current Regulations, which allow the issue price to be determined as of the sale date based on *reasonable expectations* regarding the initial public offering price, the Final Regulations provide that the "issue price of bonds issued for money is the first price at which a substantial amount [defined as 10%] of the bonds is sold to the public." Thus, the Final Regulations adopt an *actual sales* test to determine issue price for publicly offered bonds, a significant change from the Current Regulations.

Special Rule for Use of Initial Offering Price to the Public

As an alternative to the "actual sales" test, the Final Regulations include a "special rule" for determining the issue price of publicly offered bonds, pursuant to which an issuer may treat the initial offering price to the public as of the sale date as the issue price of the bonds if the following requirements are met:

- The underwriters offered the bonds to the public for purchase at a specified initial offering price on or before the sale date, and the lead underwriter in the underwriting syndicate or selling group (of, if applicable, the sole underwriter) provides, on or before the issue date, a certificate to that effect to the issuer, together with reasonable supporting documentation for that certification, such as a copy of the pricing wire or equivalent communication; and
- Each member of the underwriting syndicate agrees in writing that it will neither offer nor sell the bonds to any person at a price that is higher than the initial offering price to the public during the period starting on the sale date and ending on the earlier of (i) the close of the 5th business day after the sale date or (ii) the date on which the underwriters have

sold a substantial amount (i.e., 10%) of the bonds to the public at a price that is no higher than the initial offering price to the public.

Special Rule for Competitive Sales

Recognizing that competitive sales inherently "favor competition and price transparency that may result in better pricing for issuers," the Final Regulations include a special rule for competitive sales. Specifically, the Final Regulations provide that, for bonds issued in an eligible competitive sale, the issue price is the price produced based on the winning bid and requires the winning bidder to provide an appropriate certification regarding the reasonably expected initial offering prices of the bonds.

An eligible "competitive sale" is a sale of bonds by an issuer to an underwriter that is the winning bidder in a bidding process in which the issuer offers the bonds for sale to the underwriters pursuant to specified written terms and that meets the following requirements:

- The issuer disseminates the notice of sale to potential underwriters in a manner reasonably designed to reach potential underwriters;
 - All bidders have an equal opportunity to bid;
 - The issuer receives bids from at least three underwriters of municipal bonds who have established industry reputations for underwriting new issuances of municipal bonds; and
 - The issuer awards the sale to the bidder who offers the highest price (or lowest interest cost).
- Issue Price in Private Placements

The Final Regulations expressly provide that, for a bond issued for money in a private placement to a single buyer that is not an underwriter or a related party to an underwriter, the issue price of the bond is the price paid by the buyer.

Determining Issue Price when More than One Rule is Available

The Final Regulations include more than one way to determine issue price (i.e., the general rule, the special rule, and the competitive bid rule). Accordingly, the Final Regulations provide that for bonds for which more than one rule for determining issue price is available, an issuer may select the rule it will use to determine the issue price at any time on or before the issue date of the bonds by identifying the selected rule in the books and records maintained for the bonds.

Definition of Underwriter

The Final Regulations define "underwriter" to mean (i) any person that agrees pursuant to a written contract with the issuer (or with the lead underwriter to form an underwriting syndicate) to participate in the initial sale of the bonds to the public and (ii) any person that agrees pursuant to a written contract directly or indirectly with a person described in (i) to participate in the initial sale of the bonds to the public (for example, a retail distribution agreement between a national lead underwriter and a regional firm under which the regional firm participates in the initial sale of the bonds to the public).

Conclusion

Although it is too soon to tell exactly how the Final Regulations will affect the way in which issuers, underwriters, financial advisors and others approach issuances of tax-exempt bonds, the Final Regulations will affect the way that issue price is established and documented and may have other ancillary effects on the municipal bond market. Market participants should review the Final Regulations carefully and consult their advisors, as appropriate.

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