



501(c)(3) Tax-Exempt Financings

Presented by:

GILMORE & BELL, P.C.

**2405 Grand, Suite 1100
Kansas City, Missouri 64108
Phone: 816-221-1000**

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

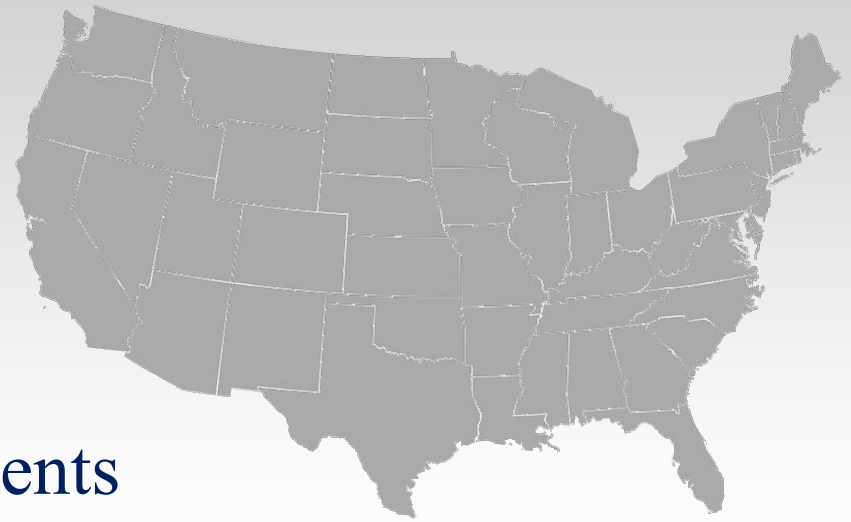


Financing Team

- Conduit Issuer
 - Conduit Issuer Counsel
 - Conduit Issuer Financial Advisor
 - Bond Counsel
 - Bond Trustee
 - Accountant
- 501(c)(3) Borrower
 - 501(c)(3) Borrower Counsel
 - 501(c)(3) Borrower Financial Advisor
 - Master Trustee
 - Rating Agencies
- Purchaser/Underwriter
 - Purchaser/Underwriter Counsel
 - 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

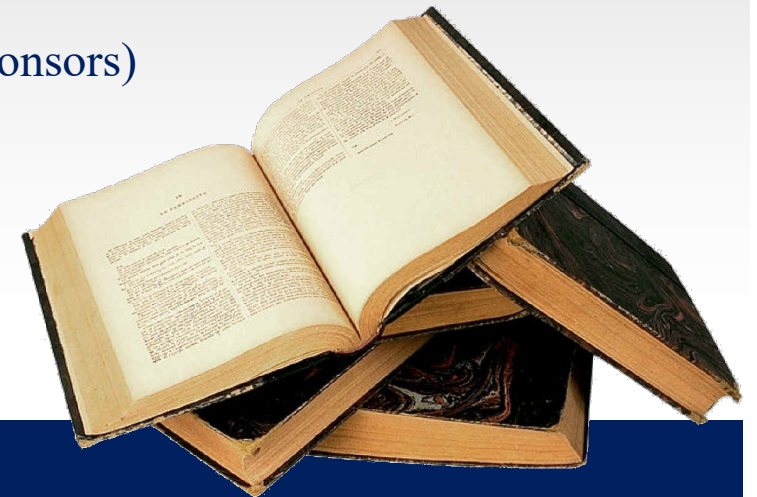
Follow the Rules



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

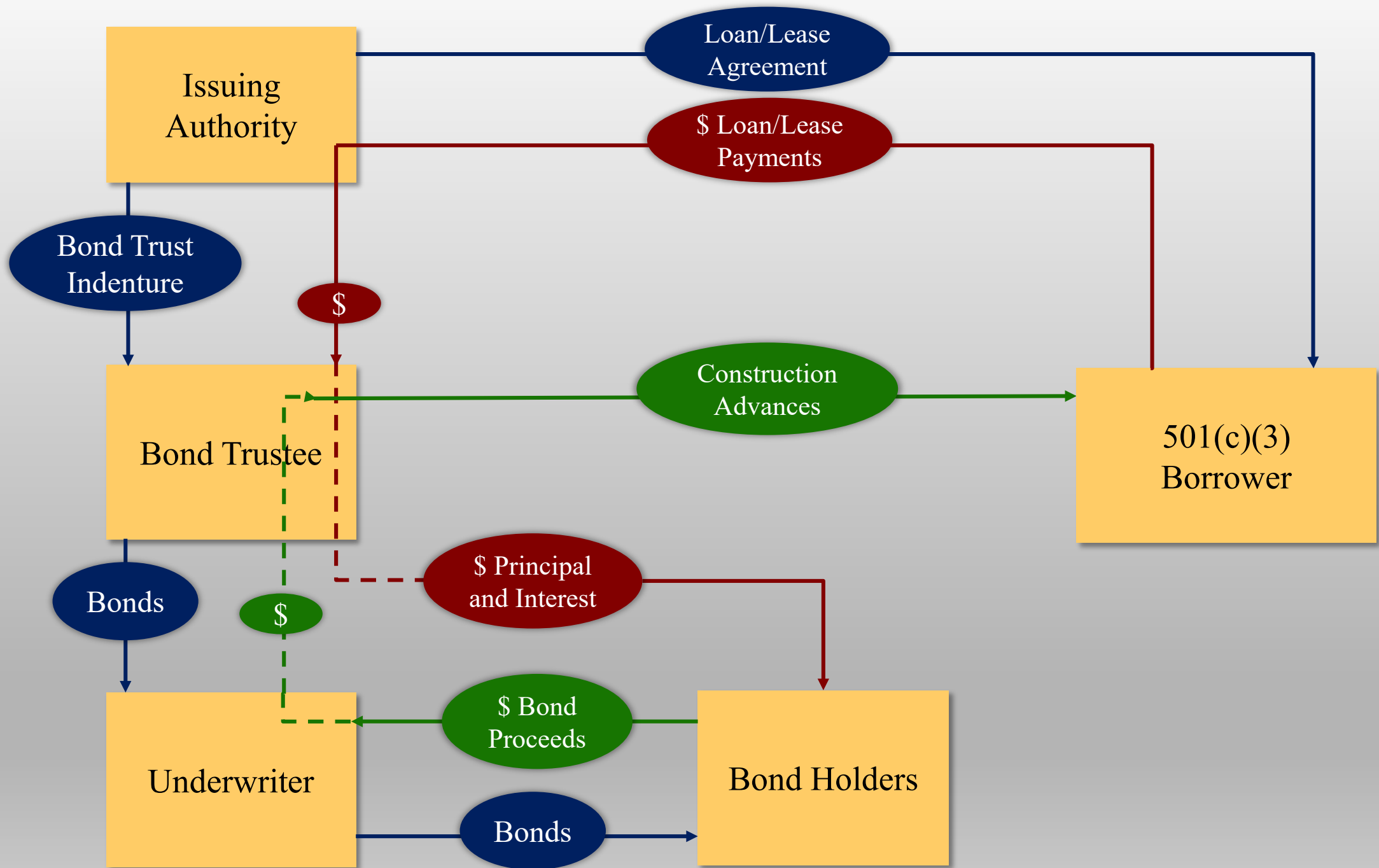


Financing Document Considerations

- 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

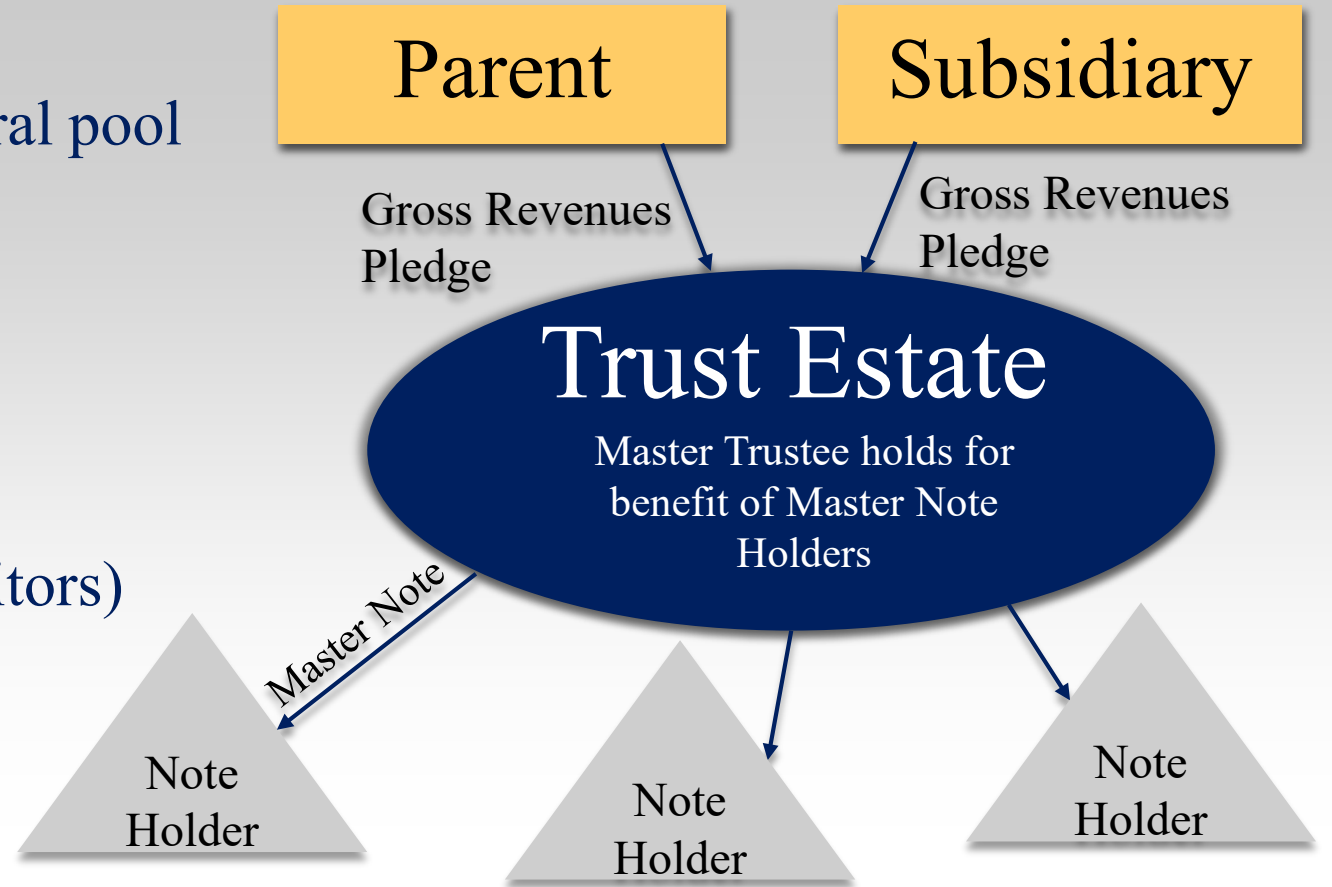


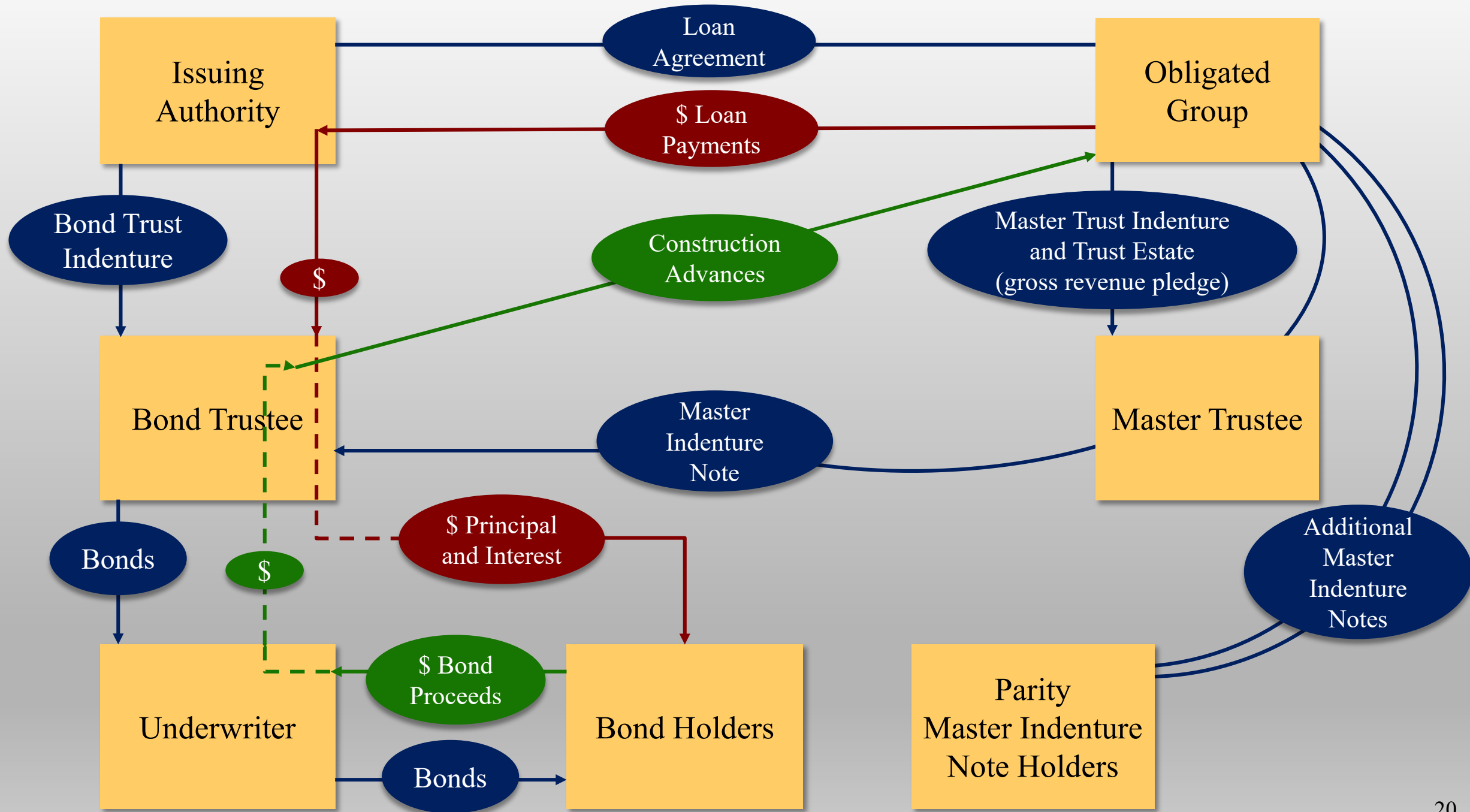
Master Trust Indenture Structure

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)

Common Types of Bonds and Other Obligations

Public Offering Interest Rate Modes/Mechanics (tax-exempt)	Rated (if Borrower Rated)	Offering Document and Continuing Public Disclosure	Liquidity/ Credit Facility (bank or self- liquidity)	Bank Covenants & Agreement (CCA, SBPA, RA)	Governmental Conduit Issuer	Optional Redemption Provisions
Fixed to maturity (single interest rate through maturity)	yes	yes	no	no	yes	callable after X-years no-call period, and/or tiered premium schedule
Daily Mode (interest rate reset daily)	yes	yes	yes	yes - SPBA/RA	yes	always callable
Weekly Mode (interest rate reset weekly)	yes	yes	yes	yes - SPBA/RA	yes	always callable
Short-Term / Commercial Paper Mode (period up to 270 days)	yes	yes	no	no	yes	always callable
Long-Term Mode (fixed for term before maturity - e.g., 3/5/7/10 years)	yes	yes	no	no	yes	callable at L-T Period end
Indexed Mode / Floating Rate Notes (reset monthly based on index (e.g., SIFMA, LIBOR -> SOFR/EFFR, Swap, Treasury)	yes	yes	no	no	yes	always callable
Direct Purchase Interest Rate Modes/Mechanics (tax-exempt)						
Fixed to maturity (single interest rate through maturity)	no	no	no	yes - CCA	yes	make-whole premium (precludes interest savings refundings)
Fixed for term (fixed for term before maturity - e.g., 5/7/10 years)	no	no	no	yes - CCA	yes	make-whole to term
Floating/Variable based on Index/Formula (index reset monthly)	no	no	no	yes - CCA	yes	always callable
Taxable						
Fixed to maturity bonds (single interest rate through maturity)	yes	yes	no	no	optional	make-whole premium (precludes interest savings refundings)
Commercial Paper (period up to 270 days)	yes	yes	no	no	optional	always callable
Revolver - fixed rate	no	no	no	yes	no	always prepayable
Revolver - variable rate	no	no	no	yes	no	always prepayable
Bank Direct Term Loan	no	no	no	yes	no	make-whole premium

Common Types of Bonds and Other Obligations

Public Offering Interest Rate Modes/Mechanics (tax-exempt)	Put/ Remarketing Risk	Interest Rate Risk	Bank Renewal Risk	Borrower Assumes Bank's Regulatory, Tax and Increased Costs Risks	Federal Tax Compliance
Fixed to maturity (single interest rate through maturity)	no	no	no	no	yes
Daily Mode (interest rate reset daily)	yes	yes	yes	yes - regulatory and increased costs	yes
Weekly Mode (interest rate reset weekly)	yes	yes	yes	yes - regulatory and increased costs	yes
Short-Term / Commercial Paper Mode (period up to 270 days)	yes	yes	no	no	yes
Long-Term Mode (fixed for term before maturity - e.g., 3/5/7/10 years)	yes (period end)	yes (period end)	no	no	yes
Indexed Mode / Floating Rate Notes (reset monthly based on index (e.g., SIFMA, LIBOR -> SOFR/EFFR, Swap, Treasury)	yes	yes	no	no	Yes
Direct Purchase Interest Rate Modes/Mechanics (tax-exempt)					
Fixed to maturity (single interest rate through maturity)	no	no	no	yes - all	yes
Fixed for term (fixed for term before maturity - e.g., 5/7/10 years)	yes (term end)	yes (term end)	yes	yes - all	yes
Floating/Variable based on Index/Formula (index reset monthly)	yes (term end)	yes	yes	yes - all	yes
Taxable					
Fixed to maturity bonds (single interest rate through maturity)	no	no	no	no	no
Commercial Paper (period up to 270 days)	yes	yes	no	no	no
Revolver - fixed rate	no	no	yes	yes/no	no
Revolver - variable rate	yes	yes	yes	yes/no	no
Bank Direct Term Loan	yes (term end)	yes (term end)	yes	yes/no	no

Tax Law Considerations

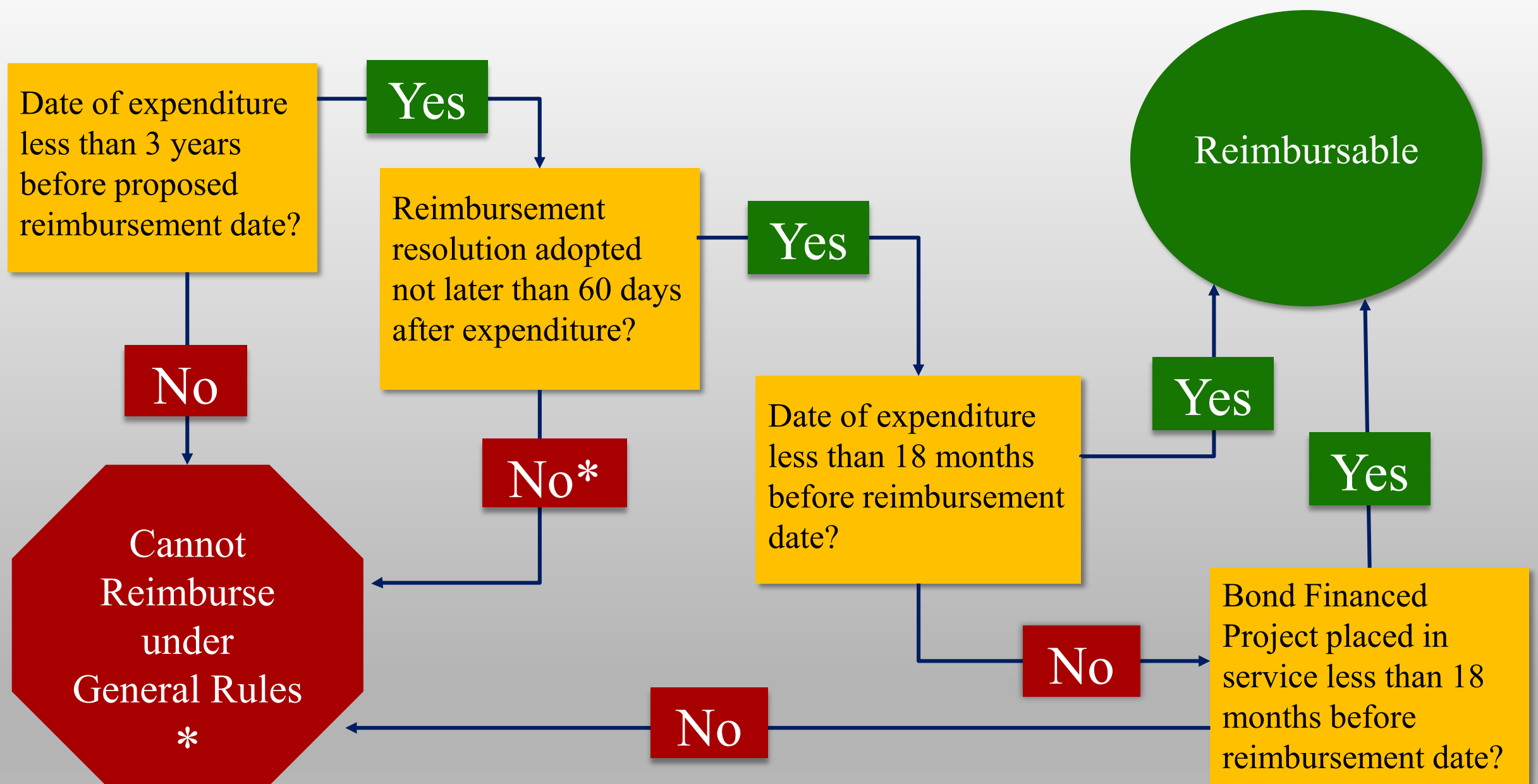
501(c)(3) Tax Law Considerations

- 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 3rd 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^{(c)(3)}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





<https://www.gilmorebell.com/>

e-mail: nonprofitfinance@gilmorebell.com