

Federal Regulatory Compliance of Outstanding Bond Debt – Be in Compliance



Cities and water districts with outstanding bonds need to ensure that they are in compliance with agreements executed in conjunction with the financing at the time of original bond issuance. Required compliance measures are in effect as long as the bonds are outstanding. An entity's ignorance of its obligations and/or lack of action in respect to compliance measures can have extensive ramifications to an entity's ability to obtain and/or maintain tax-exempt financing. In the wake of the corporate scandal and corruption associated with the fall of

Enron in the early 80's, ever-increasing scrutiny has resulted in federal laws being enacted which are intended to protect both bondholders and stakeholders of tax-exempt bond offerings. Bond issuers should be knowledgeable of the on-going compliance requirements.

The first area of compliance is directed toward entities having bonds outstanding with an original issue amount in excess of \$1 million and, accordingly, are subject to laws enacted by the Securities and Exchange Commission (the "SEC") regarding continuing disclosure. Rule 15c2-12 of

the SEC (the "Rule") requires cities and rural water districts that have issued bonds in excess of \$1 million to make continuing disclosure for the benefit and protection of the holders of the bonds. Although the Rule was first adopted in the mid-1980's, as technology has evolved, so has the Rule, demanding disclosure of timely and current financial and operating data in a readily accessible venue.

An advertisement for Caldwell Tanks. At the top, two water towers are shown side-by-side. The one on the left is rusted and labeled "Neglected", while the one on the right is clean and labeled "Preserved". Below the towers, the text reads: "Don't Neglect Your Tank - Preserve It!". Underneath, it lists services: "Caldwell's professional tank services include: TAP-ONE - Extended warranty program, TAP-ON - Full-service on-going maintenance". At the bottom left is the Caldwell logo with "Since 1887" and "Water - Energy - Industrial". At the bottom right is contact information for Rick A. Smith: "Phone 605.270.1675, Fax 502.810.0989, rsmith.sd@caldwelltanks.com, www.caldwelltanks.com".

Neglected Preserved

Don't Neglect Your Tank - Preserve It!

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Since 1887
Water - Energy - Industrial

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Rule 15c2-12 of the SEC (the "Rule") requires cities and rural water districts that have issued bonds in excess of \$1 million to make continuing disclosure for the benefit and protection of the holders of the bonds.

The Rule now requires annual filing of audits and general operating information to a national electronic repository hosted by the Municipal Securities Rulemaking Board (MSRB) and known as EMMA (Electronic Municipal Market Access). If annual information is not filed on time, a

Notice of Failure to file by the designated date must be filed. Additional filing requirements include notices of material events including: 1) Principal and interest payment delinquencies; 2) Nonpayment-related defaults; 3) Unscheduled draws on debt services 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 or events affecting the tax-exempt status of the Bonds; 7) Modifications to rights of bondholders; 8) Bond calls; 9) Defeasances; 10) Release, substitution or sale of property securing repayment of the Bonds; and, 11) Rating changes.

Consequences for issuers that fail to make required disclosures are varied. In addition to the Agreement requiring issuers to file a Notice of Failure to comply when filing deadlines regarding annual financial and operating information are not met, failure to comply with the requirements can also impact the entity's future ability to secure bond financing. Underwriters are obligated by the Rule to disclose in future bond offerings if the issuer has upheld its continuing disclosure obligations in the past. Accordingly, if it is disclosed an issuer was not compliant, such failure may "chill the market" since potential bond purchasers may believe the issuer cannot be relied upon to comply in the future. At the extreme, if an aggrieved bondholder could prove a loss arising out of failure to disclose, an action for damages for breach of contract or securities fraud is a possibility. For example, an investor could assert he would have sold his bonds before a decline in their price if missing information had been filed on time.

There are some very limited exemptions to the Rule. To become knowledgeable of your entity's continuing disclosure obligations to bondholders, refer to the Continuing Disclosure Agreement (the "Agreement") found within the Official Statement associated with each

outstanding bond issue. The Agreement will detail the issuer's specific obligations as issuer of the bonds.

The Rule does however, provide for the use of a Dissemination Agent to assist an entity with maintaining compliance with Continuing Disclosure obligations. A Dissemination Agent will monitor deadlines associated with filing of required information, coordinate with the entity to secure the documents in a timely manner, post the required documents, reports and notices in the prescribed format to EMMA, the national electronic repository, and provide proof of such filing to the entity.

The second area of compliance targets the tax-exempt status of the bonds. Tax-exempt bonds are bonds issued by or on behalf of state and local governments that receive preferential tax treatment. Such bonds are subject to applicable federal tax requirements both at the time of issuance and for so long as the bonds remain outstanding. An issuer's failure to comply with any applicable federal tax requirement with respect to tax-exempt bonds

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Although some aspects of compliance occur at the closing of the bond transaction and are typically included in the services either performed or monitored by bond counsel, other federal tax requirements require on-going monitoring after the issuance of the bonds. Post-issuance compliance requirements in regard to the tax-exempt status of the bonds generally fall into two categories: (1) qualified use of proceeds and financed property; and (2) arbitrage yield restriction and rebate. Qualified use requirements require monitoring of the



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various direct and indirect uses of the bond-financed property over the life of the bonds and calculations of the percentage of nonqualified uses. Arbitrage requirements also require monitoring over the life of the bonds to determine whether both the yield on investments acquired with bond proceeds are properly restricted and whether the issuer must file Form 8038-T to pay a yield reduction payment and/or rebate payment.

The Internal Revenue Service strongly encourages issuers to adopt written procedures, applicable to all tax-exempt bonds, which address on-going post-issuance compliance obligations. Written procedures should include: 1) due diligence review at regular intervals; 2) identifying the official or employee responsible for review; 3) training of the responsible official/employee; 4) retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds); 5) procedures reasonably expected to timely identify noncompliance; and, 6) procedures ensuring that the issuer will take steps to promptly correct

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noncompliance. Adopting and following such written procedures will help assist in identification and resolution of non-compliance, thereby preserving the preferential status of tax-exempt bonds. Generally, an issuer that has established and followed comprehensive written procedures to promote post-issuance compliance is less likely than an issuer that does not have such procedures to violate the federal tax requirements related to the bonds.

In like fashion the designation of a Dissemination Agent to assist with maintaining compliance with Continuing Disclosure obligations, an entity may also outsource assistance

with implementation of written policies and procedures to address compliance associated with the tax-exempt status of outstanding bonds, including reviewing and monitoring adherence to such procedures on a periodic basis. Local government environments composed of elected or appointed policy makers and administrators, especially in small jurisdictions with limited staffing, should make a purposeful plan for addressing post-issuance compliance in the areas of Continuing Disclosure and the tax-exempt status of the bonds.

If you would like to learn more about your post-issuance obligations on outstanding debt, or discuss assistance with such, please contact John Haas at 866-436-1100 or Linda Bell at 785-370-4206.

The Kansas Public Water Loan Fund

If a city or RWD is seeking the financing of a water system project, the Kansas Public Water Supply Loan Fund is a good option. Also known as the “SRF” (for State Revolving Fund), this program is administered by the

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Historical Interest Rates, Kansas Public Water Supply Loan Fund 1997 - 2012

As of December 31, 2011, small systems have received 162 of the 226 loans (72%) for a total of \$185,779,529.74 of the total \$463,506,137.03 (40%) committed in loans. Systems serving a population of 5,000 or fewer are classified as small systems under the Kansas Public Water Supply Loan Fund.

Kansas Public Water Supply Loan Fund Historical Interest Rates																
Month	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
January		4.25	3.98	4.73	4.37	4.08	3.91	3.80	3.60	3.60	3.35	3.54	4.34	3.40	3.55	2.42
February		4.15	4.00	4.77	4.25	4.11	3.92	3.73	3.58	3.57	3.33	3.51	4.21	3.44	3.90	
March		4.09	4.00	4.80	4.13	4.14	3.89	3.68	3.53	3.53	3.35	3.54	4.13	3.44	4.08	
April		4.09	4.04	4.77	4.11	4.15	3.86	3.62	3.56	3.53	3.36	3.67	3.98	3.48	4.08	
May		4.15	4.05	4.69	4.15	4.16	3.81	3.69	3.58	3.58	3.37	3.81	3.91	3.50	4.01	
June		4.17	4.09	4.69	4.18	4.18	3.69	3.82	3.56	3.62	3.39	3.78	3.82	3.49	3.87	
July		4.15	4.16	4.68	4.21	4.13	3.59	3.97	3.46	3.67	3.51	3.73	3.77	3.48	2.81	
August		4.12	4.25	4.65	4.19	4.08	3.60	3.99	3.42	3.68	3.58	3.72	3.75	3.46	2.72	
September		4.10	4.35	4.52	4.11	4.01	3.78	3.90	3.43	3.63	3.69	3.75	3.77	3.39	2.62	
October		4.07	4.44	4.45	4.08	3.92	3.92	3.78	3.44	3.54	3.67	3.79	3.63	3.26	2.50	
November	4.31	4.00	4.58	4.44	4.04	3.89	3.97	3.66	3.49	3.46	3.63	4.04	3.47	3.13	2.43	
December	4.29	3.98	4.65	4.45	4.04	3.88	3.88	3.62	3.55	3.49	3.57	4.17	3.41	3.22	2.50	
Average	4.30	4.11	4.22	4.64	4.16	4.06	3.82	3.77	3.52	3.58	3.48	3.75	3.85	3.39	3.26	2.42

Kansas Department of Health and Environment (“KDHE”). The interest rate as of December 2011 is 2.50%. For comparison, the average interest rate for a twenty general obligation bond issue for a small borrower is about 3.50%. The total interest cost savings utilizing the SRF versus general obligation bond issues for small borrowers is approximately \$125,000 per \$1 million borrowed.

During calendar year 2011, ten cities and two rural water districts received loan commitments from KDHE for more than \$11 million. The cities included: Manhattan, Beloit, Lyons, Delphos, Medicine Lodge, Kinsley, Marion, Ogden, Chanute and Copeland. The rural water districts

receiving loans were RWD 7, Johnson County and RWD 2, Dickinson County. The largest loan for 2011 was approximately \$4,500,000 (via two loans) to the City of Manhattan and the smallest loan was about \$55,000 to the City of Copeland. This demonstrates the SRF can assist a wide range of water projects.

The Kansas Rural Water Finance Authority, which contracts with Ranson Financial Consultants, LLC for financial advisory service, provides ‘no-cost’ assistance to cities and RWDs with loan applications. Ranson may be contacted by calling 316-264-3400 if your city or rural water district is interested in discussing funding options or desire assistance with the

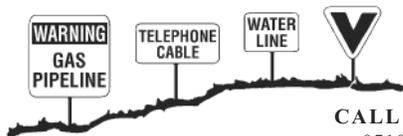
loan application process to the SRF. Ranson will also be available at the KRWA Annual Conference, March 27 – 29 at Century II Convention Center in Wichita. Look for us in the Finance Authority’s booth #151.

John J. Haas is President of Ranson Financial Consultants, L.L.C. John has been a financial advisor to Kansas local units of government since 1978. He received a Master's Degree from the Hugo Wall Center for Urban Studies at Wichita State University and has a Certificate of Public Management and graduate hours in finance from Wichita State. John specializes in general public finance and analytical services.



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