Municipal Bonds: Reimbursement Rules

Issuers of governmental bonds, qualified 501(c)(3) bonds, and private activity bonds issued for the purpose of financing governmentally owned facilities, may allocate all or a portion of the proceeds of such bonds to the reimbursement of expenditures made prior to the date of issuance if certain rules are followed. These bonds are referred to as "reimbursement bonds." If the rules are followed, the portion of the proceeds allocated to the reimbursement will be considered "spent" when the allocation is made, and will not be subject to the general arbitrage and rebate rules imposed under the Internal Revenue Code of 1986, as amended (the "Code") and the federal tax regulations (the "Regulations"). The following is a summary of the general requirements for qualifying reimbursements.

Official Intent Declaration Requirement. The issuer, or in limited circumstances the ultimate borrower, must declare its "official intent" to reimburse itself not later than 60 days after payment of the original expenditure. The declaration of official intent may be made before any expenditures are made, and will essentially "start the clock" for purposes of reimbursement. The official intent declaration must include the following requirements:

- The declaration may be made in any reasonable form, including a resolution or other legislative authorization. The legislative action may specifically declare the intent to reimburse or may delegate to an individual the authority to make the declaration.
- The declaration of official intent must:
  - contain a general functional description of the project, property or program to be financed by the reimbursement bonds (for instance, highway capital improvement program or school building renovation). The project description is sufficient if it identifies, by name and functional purpose, the fund or account from which the original expenditure is paid (for instance, parks and recreation fund-recreational facility capital improvement program); and
  - state the maximum principal amount of the obligations expected to be issued for the project.

  The Regulations allow for reasonable deviations in the project description, so long as the actual project is reasonably related in function to the described project.
- The declaration of intent must be "reasonable." A declaration of intent will be considered reasonable if, on the date of the declaration, the issuer or ultimate borrower had a reasonable expectation that it would reimburse the original expenditure with proceeds of reimbursement bonds. Reasonableness is based on the relevant facts and circumstances, including the issuer's history of making declarations and actually reimbursing expenditures. For instance, declarations of intent made as a matter of course or in amounts substantially in excess of the amounts expected to be necessary for the project are not reasonable. Similarly, a pattern of failing to reimburse original

expenditures covered by declarations of official intent (other than due to extraordinary circumstances) is evidence of unreasonableness.

Eligible Expenditures. Generally, the expenditures to be reimbursed must be "capital expenditures." A capital expenditure is any cost of a type that is properly chargeable to a capital account (or would be so chargeable with a proper election) under general federal income tax principles. The Regulations also include extraordinary working capital expenditures, bond costs of issuance, grants, qualified student loans, and qualified mortgage loans as expenditures eligible for reimbursement. Non-extraordinary working capital expenditures are typically not eligible. The determination of whether an expenditure is a capital expenditure is made at the time the expenditure is made, not at the time of issuance of the reimbursement bonds.

Reimbursement Period. The reimbursement bonds must be issued and proceeds must be allocated to reimburse the issuer or conduit borrower not later than 18 months after the *later* of:

- The date on which the original expenditure is paid, or
- The date that the project to be financed was placed in service, but in no event more than three years after the original expenditure is paid.

Special rules apply for governmental issuers that expect to issue no more than $5 million of governmental bonds in any calendar year, and for long term construction projects.

Proceeds of reimbursement bonds will be "allocated" to reimbursement once there is written evidence of an issuer's (or conduit borrower's) use of the proceeds to reimburse a prior expenditure. An allocation made within 30 days of issuance of the reimbursement bonds may be treated as made on the date of issuance of the reimbursement bonds.

Special Exceptions. The official intent declaration requirement and the timing of issuance of reimbursement bonds do not apply to:

- costs of issuance for a bond issue;
- an amount not in excess of the lesser of $100,000 or 5% of the bond proceeds; or
- preliminary expenditures not in excess of 20% of the aggregate issue price of the related reimbursement bond issue. Preliminary expenditures include architectural, engineering, surveying, soil testing, reimbursement bond issuance, and similar costs that are incurred before commencement of acquisition, construction or rehabilitation of the financed property. Land acquisition, site preparation and other costs incident to commencement of construction do not constitute preliminary expenditures.

Original expenditures in these categories may be reimbursed with bond proceeds without following the reimbursement bond rules.