NACUA

TAX-EXEMPT BONDS

Considerations for College and University In-House Counsel

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PUBLICATION SERIES

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This is one of a series of publications from NACUA, an organization whose mission is to advance the effective practice of higher education attorneys for the benefit of the colleges and universities they serve.

Printed in the United States of America

All URLs are current as of June 2006

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Many, if not most, public and private non-profit colleges and universities have issued, or at some point will issue, tax-exempt bonds to fund capital expenditures. Major capital projects, such as construction of new facilities, renovation of existing facilities, acquisition of real property, and the purchase of equipment are the usual focus of these financings.[1]

As may be expected when numerous provisions of the Internal Revenue Code of 1986, as amended (Code) are involved, the tax-exempt debt issuance process is complex and fraught with a series of potential problems for those who are not familiar with such financings. The issues with which counsel must deal range from the process and the players involved in the financing to tax issues that bedevil lawyers who otherwise understand a major taxable financing.

This monograph highlights some of the critical procedural and substantive issues that arise in tax-exempt financings. Its intended audience is in-house counsel of non-profit colleges and universities, and its purpose is to provide a level of comfort to those who either serve as the institution's primary counsel in such financings or who are the institution's liaison to outside counsel.

THE BASICS

Under federal law, virtually all non-profit institutions of higher education holding 501(c)(3) status under the Code are eligible to benefit from the issuance of tax-exempt debt,[2] as are those public institutions that do not hold such status, but are tax-exempt because they are a political subdivision or other instrumentality of the state. This does not mean, however, that tax-exempt financing will in fact be available, as the Code leaves to each state the determination of which institutions may issue tax-exempt debt.[3] Because

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1. In some states, these educational institutions also may issue tax-exempt debt to fund their lines of credit. While certain of the principles set forth herein apply to such financings, the use of tax-exempt debt for such a purpose is beyond the scope of this monograph.

2. It is unclear to what extent those colleges and universities that are "pervasively sectarian" qualify under the Code for tax-exempt financings. Although United States Supreme Court decisions gradually have moved closer to endorsing such financings if the bond proceeds are used to provide facilities for secular activities (e.g., residence and dining facilities and academic buildings where core curriculum courses such as English, Mathematics, and History are taught), the vast majority of bond counsel are not yet comfortable giving the required opinion in financings involving pervasively sectarian educational institutions. To the extent that the courts view the use of tax-exempt financing as an indirect form of aid, similar to a local real estate tax exemption, the likelihood of being able to use tax-exempt bonds is greater. The lower courts currently have taken a variety of different positions on such use by pervasively sectarian institutions of higher education.

3. Certain public institutions have the legal authority under state law to issue bonds directly, but private institutions cannot. Such institutions – and some public institutions – are required to issue bonds through some form of governmental

higher education has long been viewed as an appropriate beneficiary of the provisions of both the Code and state law permitting the issuance of tax-exempt debt, non-profit colleges and universities generally can benefit from tax-exempt debt.[4]

Since tax-exempt debt results in a significant economic benefit (in the form of lower interest rates) to the institution issuing bonds, there are numerous restrictions on the uses of bond proceeds, how earnings on the proceeds may be invested, what may be financed by the bonds (including the periods during which bond proceeds may be used), and what may secure the institution's obligation to repay the bonds. The issuance process is considerably more expensive than the costs associated with a taxable loan, and it generally makes sense to issue bonds only when a certain level of indebtedness is involved.[5]

Because of the complexity of the tax-exempt debt issuance process, many college and university in-house counsel retain outside counsel to represent the institution in its bond issue. While there is no doubt that certain expertise is required in such a representation, there always is a significant role for in-house counsel, and there are numerous circumstances in which in-house counsel can successfully carry out the entire representation.

THE PROCESS

As noted above, the process involved in issuing tax-exempt debt is considerably more complex than obtaining a commercial loan at taxable rates of interest. Furthermore, it also is state-specific, meaning that conduit issuers – and the processes they use and require – vary from jurisdiction to jurisdiction. The range of independent powers of public institutions, and their processes for borrowing, also vary from state to state. In some cases, more than one potential issuer may be available to a borrowing institution, and whichever one it chooses can have a major impact on the ease, efficiency, cost, and ultimate success of the process.

As a general matter, the following steps are involved in issuing tax-exempt bonds. Each is discussed in more detail in the sections below.

1. Determining the project(s) to be financed with tax-exempt bonds;
2. Obtaining the necessary institutional Board approvals for the project(s) and the financing;
3. Obtaining approvals relating to the project(s) from state and local boards and agencies (e.g., land use, zoning, environmental, etc.);
4. Choosing the issuer of the bonds;
5. Selecting the professionals who will work on the bond issue (the working group);
6. Creating a timetable for issuance of the bonds;

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agency, which usually is a state or local agency. These issuers – which provide the governmental nexus required under the Code to issue "municipal" bonds – are referred to as "conduit" issuers, meaning that they issue the bonds based on the underlying credit of the actual borrowing institution. Use of a conduit issuer does not implicate the faith and credit of that entity or the state or other political subdivision of which it is a part.

4. Rather than use the more precise concept of "benefiting" from tax-exempt debt, this monograph will use the term "issuance" regardless of whether it refers to bonds issued directly by the institution or bonds issued through a conduit issuer.

5. One common threshold is $5 million of indebtedness, although this can vary in either direction depending on the actual costs associated with a particular bond issue. Some issuers have crafted programs designed to aid institutions wishing to borrow smaller amounts under simpler documents and with lower closing costs.

7. Structuring a plan of finance;
8. If appropriate, soliciting responses to requests for proposals (RFPs) for bond insurance or other credit enhancement, such as a letter of credit;
9. If appropriate, obtaining a credit rating for the bonds;
10. Generating, reviewing, and finalizing documents, including bond documents, offering documents, credit enhancement documents, and bond proceeds investment documents;
11. Conducting tax and due diligence with respect to the institution and the proposed bond issue, including a review of tax issues by bond counsel and disclosure/securities law review by the underwriter and its counsel;
12. Analyzing and resolving specific tax issues, such as related capital campaigns or issues associated with private use of the bond-financed facilities;
13. Conducting a public hearing describing the project;
14. Obtaining governmental approvals relating to the bond issue;
15. Marketing and pricing the bonds;
16. Closing the bond issue;
17. Disbursing and requisitioning bond proceeds and entering into investment agreements;
18. Addressing post-closing matters.

It should be noted that the process of issuing tax-exempt bonds for a public institution often is simpler than for a private institution. As a general matter, public colleges and universities – or their centralized governing boards – have more authority to administer their own financings, including picking the members of their working group, although in some cases either the state attorney general's office or the state treasurer may be involved in selecting outside counsel and investment bankers. Bond counsel generally represent the borrowing institution and work closely with in-house counsel on various institution-specific issues. Certain of the federal tax requirements for private borrowers, including in most cases the Tax Equity and Fiscal Responsibility Act (TEFRA) notice, do not apply to or are more lenient for public institutions. In addition, because there is no conduit issuer, the documentation tends to be simpler. Among the specific issues that in-house counsel for public institutions should consider are: state statutory limitations on the incurrence of debt (whether tax-exempt or taxable) by the institution; state law provisions that enable state officers such as the attorney general or treasurer to become involved; other restrictions, including those in the institution's bylaws or any prohibitions against pledging certain forms of security under state law; and limitations on the delegation of authority to committees or officers of the institution.

1. Determining the Project

Tax-exempt bonds most often are used to finance capital projects that otherwise might have been paid for with current revenues allocated to capital expenditures, the proceeds of a fundraising campaign, a taxable loan, or a combination thereof. While one or more projects must be financed with the bond issue, the specific project does not need to be determined when beginning the bond issuance process.

Bond issues on average take anywhere from two to six months to complete; therefore, an institution may find it advantageous to finalize certain project details concurrently with the bond issuance process. In addition, because bond proceeds can be spent during the three-year period following their issuance, it often is possible to earmark a number of potential projects that could be financed over that period.[6] However, where a range of projects is involved, bond counsel will need to be sure that all such projects meet federal tax requirements, including economic life standards and prohibitions against private use of bond-financed facilities.

In addition to new projects, bond issues can be used to refinance most existing taxable (or, subject to certain limitations, tax-exempt) debt that was used, without interruption, to pay for capital expenditures.[7] Finally, an institution may reimburse itself for monies it has advanced toward a qualifying project, subject to adopting what is known as an "intent" resolution or taking some other "official action" that makes clear the borrower's intention to reimburse itself from bond proceeds. The borrower may recover its expenditures for hard costs made up to 60 days before passage of the intent resolution[8] and for soft costs (such as architectural, engineering, surveying, soil testing and similar costs) – in an amount up to 20% of the associated debt – without any time limit.

2. Obtaining Institution Board Approvals

Before bonds may be issued, an institution's Board of Trustees must give its initial approval. This often will be in the form of an "intent" resolution, signaling the institution's intention to reimburse itself from bond proceeds for its out-of-pocket expenditures for the project.

At some point in the process, and usually when the general finance plan for the proposed bond issue has been defined, the Board will need to grant its broad approval of the financing. Since it usually is impractical for the Board to convene when the bonds are being sold, to the extent permitted by governing law and the institution's bylaws, most Boards adopt what is known as a "delegation" resolution,[9] charging a specific Board

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6. As more fully described in "Public Hearing Requirements" *infra*, except with respect to certain public institutions, projects that may be financed from bond proceeds must be described with particularity in what is known as a "TEFRA Notice," which is required under Section 147(f) of the Code. Because bond counsel must pass on the sufficiency of the TEFRA Notice, it should be prepared in consultation with bond counsel.

7. As a general matter, tax-exempt debt that previously has been "advanced refunded," i.e., refunded prior to the first date at which it can be called, may not be advance refunded a second time. One technique used with increasing frequency to resolve this issue involves the issuance of taxable debt that converts to tax-exempt debt at the first call date.

8. Intent resolutions are very simple and straightforward. A sample set of intent resolutions can be found on page 26. These are not intended to constitute legal advice, but rather are an example of the types of intent resolutions an institution might pass. Institutional counsel will need to tailor all such resolutions to effect compliance with the institution's charter, bylaws, etc., as well as ensure that bond counsel is satisfied that the resolutions are effective. Other actions that will grandfather prior expenditures include official action taken by the issuer, filing an application with the issuer, or taking similar measures demonstrating the borrower's intention to reimburse itself from the proceeds of the bonds. An intent resolution is the preferred method of evidencing intent, since it is so easy to adopt and in no way binds the institution, thereby giving the borrower control over the time frame applicable to reimbursable costs. Nevertheless, institutions should use reimbursement resolutions only when they expect to issue tax-exempt debt for a project, since adopting such resolutions frequently and as a matter of course where debt is not ultimately issued may result in the institution losing its ability to rely on reimbursement resolutions.

9. A sample set of delegation resolutions can be found on page 27. These are not intended to constitute legal advice, but rather are an example of the types of delegation resolutions an institution might pass. Counsel for the institution will need to tailor all such resolutions to effect compliance with the institution's charter, bylaws, etc.

committee or subcommittee, or one or more officers of the institution, with determining the final details of the bond issue within a series of preset parameters closely approximating the expected amounts (e.g., not-to-exceed principal amount, maximum interest rate, maximum maturity, etc.). Either the Board, in its resolutions, or the delegated body must designate one or more signing officers, whose signatures on the documents will constitute evidence of their acceptance, on behalf of the institution, of the final terms of the documents.

Some institutions are comfortable delegating signing authority to one person; others prefer two. Regardless of the number of required signers, it is important to have at least one additional person authorized to sign documents as one (or more) of the designated signers may not be available at the time documents must be executed.

3. General Project Approvals and Requirements

The extent to which certain state and local governmental bodies must authorize a project to be financed with the proceeds of the bonds varies from issuer to issuer and from bond issue to bond issue. Some issuers require that all material approvals that can be obtained be in place prior to closing; others are more flexible. Likewise, if there is credit enhancement in the form of bond insurance or a bank letter of credit, many issuers will defer to the credit enhancer. As a general matter, bonds may not be issued for a project that cannot be completed, which is the reason for requiring all material approvals prior to sale of the bonds.[10]

If there is a mortgage on the institution's project or its real estate, issuers and credit enhancers also will have different opinions as to whether, and to what extent, there must be title insurance, environmental surveys, property surveys, etc. Some issuers will require a mortgage even if the credit enhancer does not. Since mortgage-related expenses can be a significant part of the institution's costs of issuance, it is important when choosing both an issuer and a credit enhancer to explore these requirements (and their related costs), as well as the general project approval requirements. More recently, many issuers and credit support providers have not required mortgages, relying instead on so-called "negative pledges" that prohibit the institution from creating or granting future liens on core properties.[11] Many lenders recognize that foreclosing on a college's or university's property may cause more expense (and public relations issues) than the value that could be realized from the sale of the property. Mortgages of a public institution's property are quite rare.

4. Choosing the Bond Issuer

Unless an institution can issue its bonds directly, it will need to identify the conduit issuer(s) through which it can issue tax-exempt bonds, as well as the types of projects

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10. There are circumstances in which an institution may issue bonds before all material project approvals have been obtained. Typically, this occurs when the institution has other projects that qualify for tax-exempt financing and that do not require similar approvals. This avoids the problem that arises where bonds are considered to be an "over-issuance," i.e., bonds have been issued for more than the expenses of qualifying projects.

11. Some credit enhancers require a "double negative pledge," which includes an agreement not to create future liens and a further agreement not to agree with other lenders to grant a negative pledge in their favor. Other lenders will take a mortgage on an "abundance of caution" basis, which ensures that third party creditors cannot gain priority over the lender, but does not include such expense items as title insurance, surveys, and environmental reports. The most conservative lenders view bond issues in the same way as commercial real estate loans, requiring loan-to-value ratios, appraisals, title insurance, etc.

that the issuer(s) can finance under governing law. Through contact with the issuer(s), the borrower's financial and legal staff should be able to determine the following matters:

- The issuer's process and timeframe for issuing bonds;
- The costs associated with using the issuer and any of its designated professionals (such as bond counsel, financial advisors, investment bankers, etc.);
- Any specific requirements of the issuer, e.g., what law firms may serve as bond counsel, whether there are restrictions on the use of other professionals such as investment bankers, whether the bonds must carry an investment grade rating, to whom the bonds may be marketed, etc.

It is not unusual for more than one issuer to have concurrent jurisdiction over the issuance of bonds for institutions of higher education. While "issuer shopping" may sound unattractive, the fact is that issuers often vary significantly in their requirements, costs, and willingness to assist the borrower. In choosing an issuer, therefore, the more flexibility the borrower has in selecting professionals, the easier and more cost-effective the process likely will be. Furthermore, if any of the borrower's existing professionals – attorneys, accountants, commercial and/or investment bankers – have experience with the potential issuer(s), their participation can make the process more expeditious and efficient.

5. Choosing the Professional Working Group

Once the issuer has been determined, the next critical step is assembling the professionals who will be involved in bringing the bond issue to fruition. While some issuers have rigid requirements for the professional team, many others will allow a certain level of flexibility, and permit the institution to choose such key players as bond counsel and the investment banker and its counsel. Although choosing professionals who have substantial issuer experience may seem the best way to proceed, most issuers welcome and will cooperate with professionals who have not worked with them on prior financings, but who have prior experience and relationships with the borrower. Since the makeup of the working group has a significant impact on how the deal proceeds, there are many circumstances in which professionals who perhaps are new to the issuer, but known to the borrower, will enhance the process.

The following professionals generally comprise the working group involved in tax-exempt bond issues. Those designated with an asterisk may not always be part of such a group, depending on the structure of the bond issue.

- Issuer
- Issuer's General Counsel*
- Bond Counsel
- Borrower
- Borrower's Counsel
- Investment Banker
- Investment Banker's Counsel
- Bond Trustee
- Bond Trustee's Counsel*
- Financial Advisor(s) (to the Issuer, the Borrower, or both)*

- Credit Enhancer (Bond Insurer or Letter of Credit Bank)*
- Credit Enhancer's Counsel*
- Rating Agency(ies)*

To the extent the borrowing institution has input, choosing the members of the working group can have a major impact on how the financing proceeds and its eventual cost. The following factors should be taken into account in identifying specific working group members:

- ***Borrower's In-House Counsel*** – At the very least, in-house counsel should serve as a liaison to the borrower's chief financial officer and the other borrower administrators involved in the financing. Under certain circumstances, in-house counsel may be able to provide primary, if not exclusive, representation for the borrower, including rendering the required opinion on behalf of the borrower (a form of which can be found in *Appendix A*).
- ***Borrower's Outside Counsel*** – In many financings, the borrower retains outside counsel as primary representation. This especially makes sense if the in-house counsel is not in a position – either because of time constraints or lack of familiarity with the bond issuance process – to take a primary role. If the borrower's regular outside counsel is not experienced in bond financings, it is best to identify and use an outside firm that has this type of expertise. In certain cases, it may make sense to use regular outside counsel for matters such as planning, zoning, and title matters and then to retain special outside counsel to represent the borrower on bond authorization, securities law, and tax issues.
- ***Bond Counsel*** – Some issuers use one firm as bond counsel for all of their issues; some use firms that are qualified to appear before them, and others allow the borrower to choose any nationally recognized bond counsel.[12] In some cases, the borrower's outside counsel may have the ability to serve as bond, as well as borrower's counsel.[13] To the extent that a borrower can participate in selecting the firm that will serve as bond counsel, it should take into account the firm's bond counsel experience, the fees it will charge for the engagement, its errors and omissions coverage, and which lawyers it will assign as primary and backup for the transaction. Because bond counsel plays a significant role in how smoothly and efficiently the transaction moves forward to closing, selecting such counsel based solely on the lowest fee quote may in the end be less productive and create greater expense from other members of the working group. The best source of referral will be other non-profit institutions that have used the particular firm, as they can judge the extent to which the firm facilitated the process, responded in a proactive manner, and met the terms of their agreements on fees and deal personnel.

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12. The conduit issuer generally requires, as a policy rather than legal matter, that any firm that serves as bond counsel be a "Red Book" firm, meaning that it is listed in *The Bond Buyer's Municipal Marketplace* (The Red Book), a directory of bond counsel firms in the United States. In order to become listed in the Red Book, a law firm must have given at least one opinion as bond counsel in a tax-exempt transaction (which typically is done either on a small local bond issue or as co-counsel with an established Red Book firm). This is a very low threshold and, thus, not all Red Book firms have comparable or directly relevant experience or qualifications.

13. Some issuers permit this practice, while others are concerned that it may raise a potential conflict of interest, since bond counsel has what amounts to a general oversight of the transaction.

Although bond counsel approach transactions in different ways, their responsibilities typically involve drafting authorizing resolutions, the TEFRA notice, bond indentures, and loan agreements, as well as tax and closing documents. In addition, bond counsel will review the other transaction documents, including disclosure documents and tax diligence materials. They also will analyze tax issues and render the opinion required by investors that the bonds are valid, binding, and enforceable obligations of the issuer, and that interest on the bonds is excluded from gross income. Most bond counsel work closely with the issuer and the underwriter in setting and maintaining the schedule for the transaction, and may assist in evaluating alternate financing structures.

- *Investment Banker* – Most issuers allow the borrower to have some say in who serves as the investment banker for the transaction. Some require that a borrower undertaking a bond issue for the first time engage in an RFP process involving a selection of bankers. Others designate a set of qualified bankers from which the borrower can choose, and a few go so far as to assign a specific banker to a particular financing. To the extent that a borrower can assist in selecting an investment banker, the factors listed above for choosing bond counsel will apply to this process. However, when the bond issue requires full disclosure on the borrower, there is a critical distinction among investment bankers regarding their role in preparing the disclosure. Some investment bankers take an active role in the process by providing the borrower with examples of disclosures used in similar transactions for similar institutions, and assisting in finalizing the disclosure; others view the disclosure obligation as falling exclusively on the borrower and its counsel. Since the latter approach places additional stress on the borrower's administrative resources (including its in-house counsel) and is more expensive in terms of outside counsel fees, most borrowers prefer an investment banker that takes an active role in assisting them in the disclosure process. Furthermore, since the investment banker drives the process in most financings, both proactivity and experience are critical factors in making a choice. In addition, because there will be substantial interaction between the firm and the borrower, it is imperative that they have a good working relationship.

  If the borrowing institution does not have or use a financial advisor, the investment banker may take the lead in negotiating with credit enhancers and ensuring that parties to the transaction adhere to their fee estimates/fee caps. In variable rate financings, the investment banker also usually serves as the remarketing agent, charged with remarketing any bonds that are tendered by the bondholders.[14] Finally, he or she is responsible for the securities law due diligence, although a significant portion of that work often is performed by the investment banker's counsel.

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14. Although this usually is the case, some investment bankers do not perform remarketing duties because their firms are not equipped to do so. It is important to understand not only the fee for remarketing services, but also the variance between the standard variable rate – based on the BMA (The Bond Market Association) rate – and the remarketer's rate for its clients using similar letters of credit. Although there often is a "spread" from the BMA rate, i.e., some level of basis points above or below BMA, remarketing agents vary in the spread that applies to similar letters of credit. In evaluating remarketing agents, the borrower should review historic spreads based on transactions involving the same credit enhancer to determine the "all in" remarketing rate. There are other factors that may influence the spread, such as the institution's own credit strength and the extent to which the jurisdiction imposes state or local income taxes. Very active borrowers may use more than one remarketing agent and thereby get actual comparative results.

- *Investment Banker Counsel* – The primary role of investment banker counsel is preparing the offering documents for the financing. In most cases, he or she also drafts the bond purchase agreement and takes an active, if not a lead, role in securities diligence matters. In variable rate transactions, investment banker counsel drafts the remarketing agreement. In addition to rendering an opinion on the disclosure document, he or she generally reviews and comments on all other documents. Many investment bankers have more than one choice of counsel available for the financing, in which case, the borrower should attempt to determine which firm(s) will help move the transaction along and still charge a reasonable fee. Some issuers appoint disclosure counsel to the issuer, limiting the investment banker's counsel to preparing the bond purchase agreement and underwriting agreements (if there is more than one underwriter), and to advising the investment banker on securities law matters.
- *Bond Trustee* – The issuer may either designate the specific trustee for the issue or select the trustee based on a bidding process. In some cases, the borrower may determine the bond trustee. Although cost is an important factor in choosing such a trustee, service ultimately is the most important factor. A trustee that is inexpensive, but also not responsive or detail-oriented, may cause more problems for the borrower than paying higher initial and annual fees. The trustee's role includes paying the bondholders, receiving and investing funds from the borrower, drawing on a letter of credit to make payments in a letter of credit-backed financing, sending notices, and maintaining records of investments and earnings that are critical for tax calculations relating to the bond issue.
- *Bond Trustee Counsel* – The role of bond trustee counsel is restricted, and usually confined to reviewing the documents and occasionally providing an opinion as to the trustee's ability to undertake its duties. Most trustees use a limited number of firms that are familiar with the trustee and knowledgeable about tax-exempt bonds, and that tend to be cost-effective.
- *Financial Advisor* – Some issuers have a financial advisor whose role may be to help structure the transaction or assist the borrower and issuer in the pricing process. In some situations, the issuer determines the financial advisor; in others, borrowers engage their own financial advisors. This may make sense when the borrower does not have experience in a bond issue or does not have the staffing required to perform the work associated with a bond issue. The best financial advisors are those who criticize constructively and when appropriate, and do not feel that they have failed to carry out their role if they concur with the suggestions of the investment banker, the issuer, and others involved in the deal. Many borrowers have found that choosing an excellent investment banker makes the need for a financial advisor for the borrower unnecessary, or allows the borrower to limit the financial advisor's role to specific issues such as pricing. However, there are certain circumstances in which it makes sense to have such an adviser; for example, it is critical for a borrower that is entering into an interest rate swap or other derivative transaction with an affiliate of the underwriter to have independent review and advice.
- *Credit Enhancer* – The choice of a credit enhancer, whether a bond insurer or a letter of credit issuer, should be based on three factors: pricing, terms of the credit enhancement (e.g., with respect to a letter of credit, length of commitment, renewal options, etc.), and covenants. There are some, but very few, situations in which a

borrower should not engage in a competitive RFP process for a credit enhancer. An example might be the existence of a strong relationship with a local bank combined with some credit issues that the local bank understands. Even when a borrower has used a particular credit enhancer in the past, it usually makes sense to re-bid credit enhancement. As critical as pricing is, the credit enhancer's ratings, as well as its flexibility with respect to covenants, future financings, and understanding the borrower's needs, are factors that may outweigh a somewhat lower price.

- *Credit Enhancer Counsel* – Particularly where the credit enhancer is a bank providing a letter of credit, the price of, and the ability to work with, the credit enhancer's counsel should be factors in choosing the credit enhancer. Reasonably priced counsel who allow their client to make the business decisions facilitate the credit enhancement process.
- *Rating Agency(ies)* – Depending on the type of financing involved, there may be a need or desire for a rating. The two primary agencies are Moody's Investors Service, Inc. (Moody's) and Standard and Poor's Ratings Services (S&P). Whether one agency should be preferred depends on two factors. First, one agency may charge a more favorable fee for rating the bonds. Second, these agencies frequently rate the same credit (whether the borrower or a bank issuing a letter of credit) in somewhat different categories. In most cases where a letter of credit is involved and the credit enhancer has existing ratings that differ, the agency that provides the higher rating is the one to use if only one is to be used. The investment banker can assist in determining with which agency(ies) to proceed when the borrower is obtaining its own credit rating(s). Some transactions that carry two ratings select one of the primary agencies and then Fitch Ratings as the second agency.

6. Creating a Timetable

The period between filing an application with the issuer and the actual issuance of the bonds may be governed by the issuer or the working group, with the investment banker or the financial advisor generally taking the lead in scheduling calls, document sessions (usually conducted by conference call), due diligence sessions, and so forth.

Although bonds can be issued in less time, the normal timeframe where the project has been defined and is in the process of receiving all material approvals is between three and four months, unless the borrower has not previously issued bonds or the financing has unusual complexity. During this time, the bond and offering (and, if applicable, credit enhancement) documents must be negotiated, the terms of the financing must be determined, the issuer must grant its approval, and, in the case of conduit financings for private, non-profit institutions, there must be at least one public hearing (the "TEFRA" hearing), and receipt of at least one further governmental approval.

In fixed rate bond issues, there typically is a two- to three-week period between the sale and closing of the bonds (i.e., execution of the bond purchase agreement among the investment banker, the issuer, and the institution). In variable rate issues, the bond purchase agreement typically is signed one day before closing, at which time the initial rate (usually, but not always, a weekly rate) is set. Most bond issues are "pre-closed," that is, the parties assemble one or two days prior to the actual closing to execute and review the documents and to make arrangements to release opinions and other documents following the bond trustee's receipt of bond proceeds. Some issuers preclose by mail whereby the parties forward their documents and signatures to bond counsel for assembly and review; he or she then holds the documents in escrow until the trustee receives the bond proceeds. In virtually all cases, the "closing" is a telephone call among the issuer, investment banker, institution, bond trustee, and the securities depository[15] releasing the bonds after the funds have been wired to the bond trustee.

7. Structuring the Bond Issue

There are two fundamental types of bond issues: fixed rate and variable rate. A bond may bear interest at either a variable or fixed rate, or it may bear an initial variable rate with an option to convert to a fixed rate.

A fixed rate bond issue usually has more than one maturity with interest rates that are set based on market rates immediately prior to the sale date for the maturities of the bonds that are issued. As an example, the issue may include either or any combination of "serial" bonds, which mature on an annual basis usually for the first five to 10 years of the issue, and "term" bonds, which have maturities in excess of one year (e.g., 10, 20, 30 years). Term bonds normally are subject to annual mandatory redemption or "sinking fund" requirements. Each serial bond carries its own interest rate, as does each term bond. Serial bonds typically are sold to retail (i.e., individual) investors, and, under certain circumstances, banks; term bonds usually are sold to bond funds and institutional investors such as insurance companies. In some cases, there may be no serial bonds and as few as one term bond; in others, there may be only serial bonds.

As a general matter, fixed rate bond issues that have an "investment grade" rating (BBB- or Baa3 or above) may be sold at retail, or in a combination of retail and institutional sales, in denominations of $5000 or multiples thereof.[16] Non-investment grade bond issues may have larger minimum denominations, often $100,000 or any multiple of $5,000 in excess of $100,000. Fixed rate bonds usually have a "no call" period, typically 10 years from the date of issuance, during which the bonds may not be "called" by the issuer for redemption. The purpose of this is to afford the original investors "call protection," i.e., their bond return is guaranteed for that initial period. Frequently, there will be a call premium in the first two years that bonds may be called (i.e., at 102% of par, dropping to 101% of par, and then to par in the third year).

Some fixed rate bond issues (those sold to the general public, as well as to institutional investors) are considered full "public" offerings, with full disclosure on the borrower. There also are limited public offerings, where the bonds are sold to a limited number of institutional investors, with accompanying full disclosure. Finally, there are occasional tax-exempt bank loans and private placements, sometimes not requiring a formal written disclosure document, with one or a few institutional buyers. The full public offerings tend to have the most favorable interest rates, followed by limited public offerings, and then bank loans or private placements. The fundamental principle is that the wider the range of potential buyers, the more price competition, with resulting lower rates.

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15. Most bond issues are done in "book entry" form, meaning that one physical bond for each maturity is delivered to the Depository Trust Company (DTC). Purchasers of the bonds hold their interests in book-entry form upon the books of their broker or other financial institution. In rare cases, physical bonds may be delivered to the bondholder(s).

16. Some issuers have specific rules about what minimum denominations can be sold, and these usually depend on whether the bonds are investment grade or above. Such requirements may reflect state "Blue Sky" law requirements. Other issuers leave determination of the minimum denomination – regardless of rating – to the borrower and the investment banker. A policy rationale behind limiting smaller denominations to investment grade bond issues is that retail buyers should not be exposed to the risk of lesser credits. As a practical matter, smaller denominations create greater retail marketability as many retail investors either don't want, or can't afford, to purchase bonds in larger denominations.

One of the most significant differences between a fixed rate and a variable rate bond issue is that most fixed rate issues (whether or not insured) include full disclosure about the aspects of an institution that impact its system revenues or general funds (whichever secures the bonds), as well as the institution's general financial strength, i.e., its economics, management, governance, charges, enrollment (including applications, acceptance rates, matriculation, and retention rates), curriculum, and so forth. Economic and operational statistics will be required for three to five years, and any unusual trends –positive or negative – will need to be explained in the disclosure. Such disclosure needs to meet securities law standards, most notably Rule 10b-5 promulgated under Section 10(b) of the Securities Exchange Act of 1934,[17] prohibiting "any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading." Counsel to the borrower will need to opine that the disclosure on the borrower meets that standard. The collection of this information requires myriad hours of work from the institution's liaisons, usually staff in the chief financial officer's group.

In addition, the offering document – known as an Official Statement (OS) –contains information about the issuer, the bonds, any credit enhancement, risk factors, and related matters. Its appendices normally include two to three (but in some cases up to five) years of a private borrower's audited financials, or one year of audited financials for a public college or university, as well as the form of bond counsel opinion that will be given upon issuance of the bonds. Virtually all fixed rate bond issues, and some variable rate issues, have a Preliminary Official Statement (POS), which the investment banker will use with potential buyers to determine pricing on the bonds. Generally the only changes between the POS and OS will relate to pricing and sizing of the bonds, although buyers occasionally will request that certain additional protective covenants be added to the documents, and these would be reflected in the OS. The Official Statement is not required to be filed with the Securities and Exchange Commission under the Securities Act of 1933.

Unlike a fixed rate bond issue, most issuers, investment bankers, and counsel are comfortable with limited disclosure in a variable rate financing backed by a letter of credit where the rate is reset on a daily or weekly basis. This sense of comfort is based on the bonds being secured by a letter of credit payable by a bank, rather than payments from the borrowing institution. Disclosure about the borrowing institution and its financial statements are omitted because they do not enlighten potential investors with respect to the security for the bonds, with the emphasis being on the letter of credit provider and the terms of the bond issue.[18] Variable rate bonds may be issued in any set of variable periods, but the most usual period is weekly, meaning that each week the rate on the bonds is reset.[19] Certain variable rate bonds require the liquidity most often provided by a letter of credit.[20] In this structure, the letter of credit provides credit enhancement and liquidity for the principal of the bonds and interest up to a maximum rate, generally 10% or 12% (or, if required by state law, a lesser percentage).

17. 17 CFR § 240.10b-5.

18. In longer rate periods, disclosure may be required. Furthermore, there may be circumstances where the underlying credit can result in a lower variable rate, which may make disclosure desirable even though it is not required.

19. Some investment bankers market (and remarket) daily variable bonds, in which the interest rate is reset each day.

20. Some borrowers combine bond insurance with a liquidity facility in lieu of a letter of credit, while a few very strong credits can market variable rate debt on a combination of their own rating (usually AAA/Aaa or AA+/Aa1) and a liquidity facility.

Variable rate bonds further differ from fixed rate bonds in that they may be tendered by the bondholders for purchase at any time with seven days of notice and may be called for redemption by the borrower at any time with 30 days of notice. As long as the variable rate is below the maximum rate, the bonds should not experience any problems being remarketed if they are tendered by the bondholders.

Variable rate bonds, by their nature, carry more risk than fixed rate bonds. In times of rising interest rates, their cost increases. Beyond that, significant changes in federal tax rates – or the adoption of a flat tax – could have an adverse effect on the interest rate. However, their historical interest rates have made them less expensive than fixed rate bonds because, at issuance, a variable rate generally is lower than a fixed rate. In addition, the ability to call them for redemption (i.e., the absence of a "no call" period) allows the borrower flexibility that it otherwise would not have. Variable rate bonds are useful in certain specific situations, such as where the borrower wants to issue bonds for a project for which it is conducting a capital campaign. Issuing the bonds allows construction to go forward before all of the pledges and contributions have been collected; as the funds are received, they can be used to retire a portion of the variable rate bonds without penalty.

In recent years, many borrowers have combined variable rate bonds with interest rate swaps to produce what is referred to as a "synthetic fixed rate" bond issue. If the swap is structured properly, the synthetic fixed rate generally is 50-100 basis points less expensive than a traditional fixed rate bond issue. Although this is a very appealing structure economically, swaps carry a number of risks that must be understood and evaluated if they are to be used as part of a finance plan.[21]

Finally, there are combined issues, known as "multi-mode" issues in which the borrower has the ability to move from mode to mode – weekly variable rate, semi-annual, multi-annual, and fixed rates.[22] While this structure has great flexibility, most borrowers use only the weekly variable and fixed rate options.

8. Soliciting Security for the Bond Issue

Most bond issues are so-called "revenue bonds," where the borrower repays from its general revenues or a dedicated set of revenues. Many bond issues include some form of security for this repayment obligation. Some bond issues provide credit enhancement as a further assurance of repayment of the institution's obligations.

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21. Interest rate swaps are very complex in terms of documentation and risks. While this monograph does not discuss these risks in any detail, it is critical for a borrower to understand them before committing to a swap, and it is highly recommended that a borrower retain an experienced swap adviser to assist in structuring and evaluating a swap. It is misleading to suggest that a synthetic fixed rate assures the same protections as a traditional fixed rate bond issue; rather, it is more a question of the borrower's comfort with the various risks associated with a swap. Briefly stated, the risks are: (1) counterparty risk – its strength and longevity; will it be around for the length of the swap and what happens if the counterparty is downgraded?; (2) pricing risk – because there may not be any "market transparency," how can a borrower achieve a fair price from the counterparty?; (3) basis risk – most swaps are London InterBank Offered Rate (LIBOR)-based while bonds carry BMA-based interest rates; (4) tax reform risk – the effect of changing tax brackets or fundamental reform (e.g., a flat tax); and (5) termination risk – will the borrower have to pay when the swap is terminated, which may occur prior to its stated maturity and as the result of events beyond the borrower's control? In addition to these financial risks, because a swap bears on the true interest rate paid on a bond, there are federal income tax issues and implications associated with a swap. And finally, the borrower's financial statements will reflect the market value of the swap (which will reflect the relationship between the swap rate and then-current interest rates) in a manner similar to unrealized gains and losses from investments.

22. Some variable rate bonds are "auction rate" bonds, with interest reset periods varying from seven to 35 days. Auction rate bonds typically require bond insurance (or a very high credit rating), but do not require either a letter of credit or liquidity facility.

General Forms of Security. Except in the rare instance where bonds are issued on a non-recourse basis, most bond issues include the institution's general obligation to repay the bonds and one or more forms of negative or affirmative security. The type and amount of security for a bond issue can include the institution's general obligation to repay the bonds; a source of dedicated revenues from which bonds will be repaid; one or more negative pledges on the institution's assets; a pledge of its gross revenues, equipment, and other personal property; a mortgage lien on all or certain of its facilities; or any combination of these. The type and amount of security are affected by such factors as the borrower's credit strength, any requirements under state law or as a result of using a specific conduit issuer, and general market factors.

Credit Enhancement. Credit enhancement may be used in combination with, or in lieu of, certain or all of the security that can be provided by the borrower. Credit enhancement generally comes in two forms: bond insurance and letters of credit.[23] Bond insurance is a commitment, for the life of the bond issue, to pay the principal and interest on the bonds when due. In exchange for the rating of the bond insurer – which may be AAA, AA, or A – the borrower pays an upfront non-refundable premium. Bond insurance almost always is used when fixed rate bonds are issued. The fundamental questions a borrower must ask when considering bond insurance are: (1) the cost benefit, i.e., how great are the savings achieved by using the bond insurer's rating; and (2) what restrictions, in the form of covenants, come with the bond insurance? Institutions that require flexibility in future debt issuances may find the covenants with respect to future debt and related liens so burdensome that they outweigh the savings achieved by purchasing bond insurance. In addition, the availability and cost of bond insurance depend on the borrower's own creditworthiness.

Letters of credit are a very common mechanism for enhancing a bond issue, and almost always the only way for sub-investment grade credits to issue bonds with an investment grade rating.[24] They typically are provided by commercial banks rated at least in the "A" category, which is a level of rating that can be achieved either because a commercial bank itself holds the rating or it provides a confirming letter of credit from a bank with an "A" or higher rating.[25]

Under the letter of credit, issued in favor of the bond trustee, the issuing bank agrees to pay principal and interest on the bonds from its own funds as they become due, as well as for any bonds that are tendered by a bondholder and not remarketed.[26] Critical

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23. In certain circumstances, a standby bond purchase agreement (SBPA) may be used in addition to bond insurance or in place of a letter of credit. The SBPA is similar to a letter of credit in one respect as it provides liquidity in a variable rate bond financing by supporting remarketing of the bonds. Unlike a letter of credit, an SBPA does not provide regular payments of principal and interest on the bonds. In a bond issue with bond insurance, the SBPA allows variable rate debt to be used. It also can be used with a credit that is rated in the AAA or AA category that wants to issue variable rate debt on the combination of its own credit rating and the SBPA. Some highly rated institutions can issue variable rate debt based on their rating and an agreement to keep an appropriate level of their investments liquid (to pay for tendered bonds). Even where that is possible, such institutions may find that paying for an SBPA is less expensive than keeping the necessary amount of assets liquid (which usually will result in lower returns on those assets than otherwise would be the case).

24. Letters of credit frequently are used by "BBB"- or "A"-rated institutions that otherwise could not issue variable rate debt without this form of credit enhancement (or bond insurance paired with a standby bond purchase agreement, as more fully describe in note 23, *supra*.)

25. Generally speaking, a confirming letter of credit is no more than an agreement by the confirming bank to honor a draw on its letter of credit if the underlying bank does not. Most confirming letters of credit are based on agreements between the underlying and confirming banks, and the latter's credit review is related to the former rather than the borrower.

26. Although all letters of credit provide for draws for failed remarketings, investment bankers are quick to point out that there has never been a failed remarketing, even during the week of September 11, 2001. Because of the possibility of a

issues to be determined when negotiating a Reimbursement Agreement with the bank issuing a letter of credit include: (1) pricing; (2) the economic and operational covenants the bank will require the borrower to meet; (3) length of the letter of credit; (4) renewal options and timing; (5) whether the letter of credit bank will obligate itself to provide a confirming letter of credit if the bank is downgraded below the "A" category;[27] (6) term out provisions; and (7) the borrower's ability to terminate the letter of credit without a penalty.[28]

With respect to these factors, the following are important points to keep in mind. First, although pricing is a seemingly obvious factor, it is only one of four parts that will make up the true cost of credit to the institution. The other three are the manner in which the bank's paper trades in the market,[29] the remarketing fee charged by the remarketing agent, and the spread between the BMA index and the actual interest rate following remarketing of the bonds.[30]

With respect to the second factor, the longer the term of the letter of credit, the less risk the borrower has of a non-renewal or a renewal at a higher cost. Banks often will provide a prospective borrower with a grid, showing pricing options for differing terms of the letter of credit. Depending on the borrower's confidence in its continued results and its relationship with the letter of credit bank, it may opt for a shorter or longer term. Similarly, the timing of a renewal is important; the earlier in the term, the greater the borrower's opportunity to replace its letter of credit provider with another bank in the event that the current bank either raises its rate if it renews its letter of credit, or it simply declines to renew the letter of credit.

The fourth factor speaks to the credit risk that comes either with an "A"-rated bank or with an unrated (or "A"-rated) bank that uses a confirming letter of credit. The higher the initial rating of the bank, the less likely it is that the borrower will need a confirmation either initially or during the term of the letter of credit. However, if a confirmation is necessary, assurance by the primary bank that it will provide a confirming letter of credit at all times, and that it will do so within its quoted price, is a significant factor that, if not agreed to, may make a somewhat higher priced letter of credit more desirable over the long run. In addition, a confirmation will be required if a bank is downgraded below the "A" category.

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sustained failed remarketing and the further possibility that the letter of credit may expire and the borrower may not be able to replace it with another letter of credit, it is important for the borrower to negotiate "term out" provisions with the letter of credit bank, allowing the institution to convert its debt to a taxable line of credit to be paid out over a period of years. The most conceivable scenario in which a remarketing might fail would be if the market were such that the maximum interest rate on the bonds were exceeded. Under those circumstances, a borrower could seek to amend the bond documents and letter of credit to provide for a higher maximum interest rate.

27. While some banks are willing to agree to this, many will not, thereby simply allowing the borrower to terminate the letter of credit and requiring it to find another letter of credit to support the bond issue in the event of a credit rating decline below the "A" category.

28. One other issue that borrowers may consider when using letter-of-credit-backed debt is placing the amortization schedule for the bonds in the Reimbursement Agreement rather than in the bond documents. The purpose of doing this is to allow the bank and the borrower to be the only parties affected by it, thereby affording both parties flexibility if the borrower should experience unanticipated liquidity issues.

29. By way of illustration, if an "A"-rated bank offers a letter of credit at 65 basis points, but it trades 8 basis points above an "AA"-rated bank that offers the letter of credit at 70 basis points, the AA bank will offer a better economic deal. A borrower's investment banker should be able to assist the borrower in determining how a specific bank's paper trades and thus the true cost of using a particular bank's letter of credit.

30. As set forth in note 14, *supra*, the true cost of remarketing involves considerably more than the rate charged by the Remarketing Agent.

Finally, the covenants that the letter of credit bank requires can have a substantial effect on the borrower's economic and operational flexibility. The bond documents may defer to the reimbursement agreement on such issues as further debt, liens, and acquisitions, or they may have more generous covenants than the reimbursement agreement, in which case the latter's covenants will govern while the letter of credit is outstanding. Although the reimbursement agreement covenants can be changed by agreement between the borrower and the bank, and thus do not carry the same permanence factor as covenants in the bond documents, the covenants negotiated by the bank constitute the bank's base line for the borrower, and should not be considered freely changeable.

9. Obtaining a Credit Rating

As noted above, credit ratings generally determine both the extent to which a borrower's bonds will be marketable and the pricing that will apply to the bonds. Credit ratings may be obtained based on the borrower's own credit or by purchasing credit enhancement. A borrower's investment banker should run economic scenarios that evaluate the value of credit enhancement against the cost of marketing the bonds based on the borrower's own credit. If there is a savings, as usually is the case, it needs to be weighed against the economic and operating covenants that the credit enhancer requires.

If a borrower is issuing bonds on its own credit, it needs to go through the ratings process with at least one of the rating agencies. Although many investment bankers do not believe in obtaining ratings if the borrower will be below investment grade (or in the lowest investment grade category, i.e., BBB- or Baa3), others believe that a defined rating in the BB/Ba category can be an aid in marketing the bonds to particular institutional buyers.

In order to obtain a credit rating, the borrower will need to submit economic and other materials to the rating agency(ies) it plans to use. If the borrower is seeking a first-time rating, in addition to telephone conversations, it often makes sense to have the rating agency representatives visit the borrower's facility. The rating agency will look carefully at such factors as the borrower's economics, its management, and its demographics. A good investment banker is invaluable in choosing the proper agency(ies) and shepherding the borrower through the process.

Recently, some investment bankers have recommended acquiring and disclosing an "underlying rating" (i.e., the rating that reflects the borrower's own credit) even where the issue is credit enhanced when it is expected that doing so will result in a rating higher than the credit enhancer's rating.

10. Generating and Reviewing Documents

Bond transactions generate an enormous amount of paper. The tax-exempt nature of the transaction – including the general use of a conduit structure – requires considerably more documentation than a taxable loan. Because bond counsel produce these documents, and their views of what the documents should include vary widely, there is no standard set of documents. Nor are the documents referred to in the same way; thus, a bond indenture in one jurisdiction may be a trust agreement in another. One issuer may prefer to use a separate loan agreement between the borrower and the issuer and pair it with a bond indenture between the issuer and the bond trustee. Other issuers may use an integrated loan and trust agreement. Regardless, all issuers have some form of documentation containing the tax covenants to which the issuer and borrower must adhere in order to preserve the tax-exempt nature of the bonds.

As is the case with any major loan closing, there will be certificates from various parties, requirements of certified documents, security documents, and counsel opinions. If the transaction includes a letter of credit, bond insurance, and/or a standby bond purchase agreement, additional documents will be required to set out the terms of the credit enhancement. Some of these will stipulate that certain actions be taken annually, or more frequently, during the time the bonds are outstanding.

Proper documentation is necessary to ensure that numerous obligations of the parties under state law and federal securities and tax laws are met. In-house counsel who have not grappled with these documents before would be well advised to seek the assistance of outside counsel experienced in representing borrowers in tax-exempt bond issues.

The primary documents for a bond issue include an agreement (which may be an integrated loan and trust agreement or a combination of a loan agreement and a trust or bond indenture) that sets forth the borrower's obligations to the conduit issuer and the bond trustee.[31] In addition to provisions that set forth the terms of the borrowing – principal amount, interest rate(s), form of debt, rights to redeem bonds, events of default and remedies, etc. – the agreement usually contains a series of operational and financial covenants, such as those designed to maintain the tax-exempt status of the bonds (including the use(s) of the bond-financed facilities), maintenance of certain levels of financial performance (e.g., debt service coverage), and restrictions on incurrence of further indebtedness, granting of liens, and similar matters.

The second part of the agreement focuses more on the bond rather than the borrower side of the transaction. Thus, provisions governing conversion of the bonds from one interest rate mode to another, the duties of the bond trustee, the types and uses of funds relating to the bonds (including the types of investments of bond proceeds), the conditions under which the documents may be amended, and the conduit issuer's obligations are typical bond-related provisions.

Many bond counsel produce an additional document that relates solely to tax matters, such as a tax regulatory agreement or tax certificate. This document often uses a number of technical terms and definitions, and may make reference to applicable Code sections. It also includes matters such as the borrower's expectations for using the bond proceeds, the economic life associated with the bond-financed facilities, provisions relating to arbitrage rebate to the federal government, etc. Completing it requires considerable input from the borrower with respect to the project facilities.

In financings involving a letter of credit, one of the most critical documents is the letter of credit reimbursement agreement, which represents the borrower's contract with the letter of credit bank. In addition to containing information pertaining to the terms of the letter of credit, e.g., length of the initial letter of credit, renewal options and fees, the reimbursement agreement generally also includes certain financial and operating covenants that may be stricter or more complete than those included in the loan agreement or loan and trust agreement.[32] In some circumstances, an optional redemption

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31. A public institution issuing bonds generally will not need a conduit issuer and, thus, the agreement will be directly between the borrower and the bond trustee.

32. In letter of credit financings, one strategy that borrowers should consider is moving as many of the financial and operational covenants out of the bond documents and into the reimbursement agreement. Because the letter of credit bank and the borrower are the only parties to the reimbursement agreement, the borrower's failure to meet a certain covenant can be resolved between them without involving the conduit issuer, the bond trustee, and/or the bondholders.

schedule in the reimbursement agreement may take the place of a sinking fund schedule in the bond documents.[33]

Financings that involve other forms of credit enhancement (such as bond insurance) also contain specific covenant requirements, which may be set forth in the bond documents or in a separate agreement such as an insurance agreement.

As discussed more fully elsewhere in this monograph, there are a number of other documents – including disclosure and remarketing documents – that are part of the record of proceedings. In-house counsel, even if they have employed outside counsel to assist them, should scrutinize the various covenants to which the borrower is subject, as well as the economic and operational provisions of the bond documents to ensure that the borrower officials charged with ensuring compliance with the covenants and carrying out those obligations understand their responsibilities.

11. Conducting Tax and Due Diligence

There are two areas of due diligence with which counsel should be familiar.

Tax Diligence. Bond counsel vary widely in how they pursue tax issues and the investigative process referred to as diligence, or "due diligence" (a term borrowed from securities law), ranging from those who conduct very substantial written diligence (including document review) to those who rely primarily on answers to questionnaires. In order to give its opinion that interest on the bonds is not includable in gross income for income tax purposes, bond counsel will need to assure itself that none of the institution's activities or agreements, or its planned use of the bond proceeds, interfere with the tax-exempt nature of the bonds. Among the issues that bond counsel probe are: (1) whether there are any "private use" issues, such as using the facilities to be financed with the proceeds of the bonds for non-exempt purposes or by non-exempt persons (whose contracts will be subject to review); (2) whether the institution can be reimbursed from the bond proceeds if it has used its own funds prior to the bond issue; (3) whether the security supporting the bond issue is permitted under the Code; and (4) whether using the bond proceeds creates potential First Amendment issues for the institution or any of its affiliations.[34]

In addition to the tax issues and diligence that occur prior to issuing the bonds, there are certain post-closing requirements with which borrowers must comply, some of which also relate to tax issues. As a very general matter, a borrower may not earn a return on the investment of the funds held by the bond trustee (which may be undisbursed construction or project monies or reserve funds) that is higher than the yield on the bonds. In other words, an institution may not use the direct or indirect proceeds of the bonds, including funds held by the trustee, as a positive arbitrage mechanism.[35]

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33. The concept here is similar to that outlined in footnote 32, *supra*. However, since there are limits on the length and amortization of a bond issue related to the economic life of the assets being financed, this strategy works from a federal tax perspective only if the project could have a "bullet" maturity, with all principal payments on the bonds being paid at the end of the bond issue.

34. In the context of tax-exempt financing, the first amendment issues relate to the separation of church and state. For example, a sectarian chapel may not be financed with the proceeds of tax-exempt bonds; nor may facilities devoted to teaching a particular religious faith.

35. However, the borrower may earn a return that is in excess of the bond yield on its investments that are not actually or constructively held by the bond trustee, so-called "legal arbitrage." For example, if the bonds cost the borrower five percent (in terms of interest to be paid on the bonds, costs of issuance, and administrative expenses) and the investment of the borrower's funds unrelated to the bond financing return more than that amount, borrowing, rather than using those

Securities Diligence. In addition to the tax diligence conducted by bond counsel, the investment banker – and the investment banker's counsel – conduct securities diligence to ensure that: (1) all disclosure meets the 10b-5 standard; and (2) diligence was conducted in a manner that establishes defenses to a securities action.

Where the Official Statement includes full disclosure on the borrower, usually there are one or more calls or sessions during which the members of the working group discuss this disclosure in detail. The investment banker and its counsel supplement these sessions by conducting further due diligence with certain key personnel from the institution, such as the President, Chief Financial Officer, Director of Admissions, Director of Development, and one or more members of the Board of Trustees, as well as the borrower's certified public accountants. In addition to testing the contents of the institution's disclosure, these sessions – which may be conducted in person, by conference call, or by a combination of these methods – often delve into such issues as changes in management, relationships between management and the Board, employee relations, strategic planning, challenges and successes on both a financial and operational nature, any existing litigation that may be material, etc. Generally speaking, these interviews take 20-30 minutes each, and are conducted individually.

Investment bankers and their counsel differ on the extent to which (if at all) there needs to be similar diligence when there is a letter of credit supporting the financing, and virtually no disclosure about the borrower. The better practice appears to be conducting diligence, although in a somewhat more abbreviated form, as the bond offering is not based on the institution's disclosure document.

12. Resolving and Analyzing Specific Tax Issues

Capital Campaign Issues. Many institutions conduct capital campaigns for a variety of purposes, one of which often is to support the construction of one or more new facilities. However, before an institution undertakes a capital campaign it needs to understand the relationship, under federal tax law, between such campaigns and the issuance of tax-exempt bonds.

Essentially, if an institution seeks and receives funds dedicated for the same project that is to be financed by tax-exempt bonds, the bonds may not be issued. The underlying rationale is that, if an institution is able to raise funds on its own for the same purpose, then the bonds are not necessary. In order to issue bonds for one or more specific projects, the funds received from a capital campaign must either be earmarked for the institution's general purposes or dedicated to other specific projects or uses. Unfortunately, many institutions are well along in a capital campaign when they decide to issue bonds, not realizing that the receipt of monies for a specific purpose precludes them from issuing bonds for that same purpose. Consulting with bond counsel – or borrower's counsel experienced in these issues – early in the process may help in formulating language for the solicitation materials and gift instrument that in turn directs the donated funds to more general uses.

Bond counsel disagree whether the same restriction applies to monies that have been pledged, but not yet received, by the institution. Some bond counsel are of the

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unrelated funds for the bond-financed project, is an appropriate way to preserve and enhance the borrower's investments. This explains why such well-endowed institutions as Harvard University have substantial amounts of tax-exempt bonds outstanding. Although the concept seems simple, there are circumstances in which endowment funds or other investments may become subject to restrictions on their yield, a topic that is outside the scope of this monograph.

opinion that bonds can be issued for the same project initially, but must be retired as pledges are converted to cash. Other bond counsel take the view that pledges made, but not converted to cash, can be recast if the donor agrees.[36] While there are myriad views between these extremes, all agree that the outcome depends on the facts and circumstances of a particular case. The ability to recast pledges can be particularly helpful for certain smaller institutions that may not realize both the need to retain a certain amount of cash on its balance sheet and the ability to leverage the tax-exempt bond issue against those investments.

Private Use Issues. Private institutions of higher education that hold Section 501(c)(3) status must be "organized and operated exclusively for charitable purposes" to qualify for tax-exempt status. As the term suggests, the "organized exclusively" test focuses on organizational documents and structure. The entity's governing documents and its plan of operation must demonstrate that the entity has been formed, and is intended to operate, for charitable purposes, and provide that, upon dissolution, its assets will be distributed exclusively for such purposes.

The "operated exclusively" test is both more complex and forgiving than its words perhaps suggest. Treasury Regulation 1.501(c)(3)-1(c) provides:

> [A]n organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

The key phrases are "engages primarily" and "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."[37] Rather than connoting exclusivity, these phrases make it clear that the operational focus of a tax-exempt entity and the substance of its activities must be devoted to its exempt purpose. However, a tax-exempt entity under Section 501(c)(3) may still engage in non-exempt activities to a limited extent. Although this perspective is realistic, it has resulted in the promulgation of numerous regulations, revenue rulings, revenue procedures, information letters, and private letter rulings, as well as occasional litigation.

Maintaining an institution's 501(c)(3) status may be related to, but is not the same as, "private use" issues under Section 141 of the Code. If a private institution loses its tax-exempt status, any bonds it has issued generally will become taxable. But the converse is not necessarily true, as there are circumstances under which an institution may retain its exempt status at the same time that some, or all, of its bonds become taxable due to the specific use of the facilities that were bond financed.[38]

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36. Under governing IRS regulations, the relationship between capital campaign monies and bond issues is determined by the "nexus" between the object(s) of the campaign and the project(s) to be financed by the tax-exempt bond issue. Nexus is determined on a facts and circumstances basis. State law issues also must be considered to the extent that an institution seeks to have previously made pledges recast or donations unrestricted.

37. Leaving aside the obvious gap between the concepts of "exclusively" and "primarily," the "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose" language has been the source of considerable comment and interpretation. In *St. David's Health Care System, Inc. v. United States of America*, 2002-1 U.S.T.C. ¶ 50,452 (W.D. Tex .) 2002, Judge Nowlin could not resist taking the drafters to task: "Sadly, the last sentence of that section is a horrible amalgamation of negatives arranged like an inside joke prompting laughter only from seasoned and sadistic bureaucrats. In plain English, it means that an organization cannot be exempt while devoting a substantial portion of its activities to non-exempt purposes." *Id*.

38. Another related, but separate, tax issue is Unrelated Business Income Tax (UBIT). For private non-profit institutions, unrelated trade or business activities (as defined in Section 513 of the Code) that can give rise to UBIT are treated as

There may never be a set of bright line rules that clearly defines the extent to which an exempt organization may pursue activities in its bond-financed facilities with non-exempt parties. Nevertheless, it is important to recognize that the types of relationships that give rise to private use include interests in real property by private parties (whether by ownership or leasing interests), so-called "management" contracts[39] with private parties, and the use of bond proceeds by private parties. Thus, the contracts between an institution of higher education and private parties are subject to scrutiny as part of the tax diligence process.

There are, however, certain safe harbors for contracts with private parties that provide services to the exempt institution or that provide services on the bond-financed portions of the exempt institution's facilities.[40] In addition, there are two fundamental principles that must be kept in mind to avoid private use of the bond-financed facilities.[41] Any contracts with private parties "must provide for reasonable compensation for services rendered;"[42] and, no compensation may be "based, in whole or in part, on a share of net profits from the operation of the facility."[43] The Revenue Procedures set forth what is effectively a "grid" that allows certain types of compensation in contracts of certain lengths. As a general rule, contracts that provide for all or most compensation to be paid on a fixed, pre-determined basis may have a longer term than those that are slanted more toward compensation that is variable in nature.

Regardless of whether the educational institution has bonds outstanding, or plans a bond issue, in-house counsel negotiating agreements with private parties will want to keep these fundamental principles in mind.

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private use of a bond-financed facility. But an activity that does not constitute an unrelated trade or business (whether for public or private institutions) may nonetheless constitute private use. These are the types of issues with which bond counsel must grapple in its tax diligence.

39. Although there are many agreements that are considered "management" contracts, a typical example for many educational institutions would be a contract to provide food services in a dining hall.

40. Rev. Proc. 97-13, as supplemented by Rev. Proc. 2001-39 sets forth these safe harbors and the general rules relating to these types of contracts. However, in certain specialized areas, such as research agreements, there are a series of further requirements, the scope of which are beyond this monograph. These requirements must be taken into account where and whenever a college or university is a party to research agreements that make use of its facilities. As a result of recent comments by IRS staff, Rev. Proc. 97-14 and private use issues relating to research agreements have become issues of major concern for public research institutions. As a general matter, a research agreement results in private use if the entity sponsoring the research is: (a) neither a state or local governmental entity nor a 501(c)(3) organization (i.e., is part of the federal government or a private entity); and (b) is considered the owner or lessee of the bond-financed property under federal tax law. And, even if the non-ownership/lessee test is met, special entitlements (including certain licensing agreements) in favor of the sponsor can result in private use. Any public institution with significant research agreements should review these requirements with care – and should consider reviewing them with bond counsel – before undertaking a tax-exempt financing involving facilities in which the activities relating to research agreements are conducted. Rev. Proc. 97-14 contains certain safe harbors with respect to research agreements. These include: (a) providing licenses of the results of the research to the sponsor on the same terms as would be provided to an independent, non-sponsoring third party; and (b) in certain cases, the use of cooperative research agreements involving multiple, unrelated sponsors who are limited to obtaining a non-exclusive, royalty-free license to the results of the research.

41. Although the principles in Rev. Proc. 97-13 apply only where bond-financed facilities are involved, the general principles are consistent with the prohibition against private inurement. If bond counsel discovers that certain pre-existing agreements result in private use, the educational institution will have to either modify those agreements before the bonds are issued or exclude the facilities in question from the bond financing.

42. Rev. Proc. 97-13.

43. *Id.*

13. Conducting a Public Hearing

Under the Tax Equity and Fiscal Responsibility Act, issuers of tax-exempt bonds – except for most public institutions – must publish a "TEFRA Notice" and conduct a "TEFRA Hearing" prior to actually issuing the bonds. After the TEFRA hearing has occurred, the issuer also must obtain written approval for the bond issue from the highest elected official or body of elected officials for the jurisdiction issuing the bonds.[44]

The purpose of the TEFRA notice, which must be published in a newspaper of general circulation in the community in which the bonds will be issued (but which also may have statewide circulation), is to allow the public to understand the proposed project, its costs, and components, and to have an opportunity to appear and speak for or against it. As a general matter, the TEFRA Notice will be published at least 14 days prior to the TEFRA Hearing. Typically, the entity conducting the hearing prepares minutes of the hearing, noting when it commenced and concluded, and who was in attendance, and summarizing any testimony or other comments.

Bond counsel often differ on the degree of detail that must be contained in a TEFRA Notice, with views ranging from descriptions that specifically identify the components of the project as to use, square footage, and price (including any components that are being refinanced or reimbursed with bond proceeds) to more generic descriptions. The TEFRA Notice must identify the project with sufficient specificity so that anyone reading the notice can understand what the institution proposes to finance, how much it is expected to cost, and where it will be located (using street addresses if possible). Most TEFRA Hearings do not involve any substantial public participation. Usually the issuer is responsible for not only conducting the hearing, but also securing the appropriate elected official's or elected official body's approval.

14. Obtaining Bond Issue Approvals

In addition to any local or state approvals for a project, as well as approval by the issuer and elected official(s), some states have further processes that must be followed before bonds can be issued. Some may apply to all institutions that use a particular issuer, while others may apply to specific types of institutions seeking to issue bonds. The issuer, its counsel, and bond counsel usually will identify these early in the process and provide an explanation of when and how such approvals may be obtained.

15. Marketing and Pricing Bonds

After the documents have been negotiated and the Preliminary Official Statement (or Official Statement in the case of most variable rate bonds, as described below) has been printed, the investment banker will market and price the bonds. In a fixed rate issue, the process will conclude with the parties (issuer, borrower, investment banker, and any financial advisor(s)) agreeing on a price scale for the serial and term bonds. Once that scale is determined, the parties will sign a bond purchase agreement reflecting that pricing and specifying the conditions of the issuance and delivery of the bonds. When those conditions have been satisfied, the investment banker is obligated to purchase and the issuer is obligated to sell the bonds at the agreed-upon prices, on the date specified in

44. For example, in most states the Governor's approval would be required for any bonds issued by a state agency.

the bond purchase agreement regardless of any movement of bond interest rates and prices in the market at large between pricing and closing.[45]

In most variable rate issues, because the rates are reset on a weekly basis,[46] pricing usually occurs the day before or the day of closing. The bond purchase agreement is signed at that time, and the parties commit to the initial weekly rate. Because weekly variable rate bonds are considered to be a commodity, generally sold in a minimum of $100,000 denominations to institutional investors, their marketing is simple and no Preliminary Official Statement is required as the terms of the bonds described in the Official Statement do not change after the pricing. An OS, however, is required, and usually is circulated about one week prior to the pricing and closing of the bond issue. The pricing changes as supply and demand dictate not only at the time of closing, but throughout the life of the variable rate issue.

Although many bond issues are sold through underwritings, certain bond issues may be sold through a competitive bid process. This is done more frequently when a public institution is issuing debt than when a private borrower is using a conduit issuer, and it typically is used for new money fixed rate issues rather than variable rate issues or advance refundings. In most instances, competitive bidding works best with a strong credit that is well established in the marketplace. The primary differences between a sale through competitive bidding and an underwriting are: (a) there is no need for an investment banker, although most institutions often retain a financial adviser to help structure the bond issue and assist with disclosure issues; and (b) rates are established by a true market process rather than through negotiation.[47]

16. Closing the Bond Issue

The official closing on a bond issue occurs after bond counsel confirms that all documents have been properly executed, all opinions have been delivered, and the net bond proceeds (usually the aggregate principal amount of bonds minus the underwriter's "discount" or compensation) are transferred from the purchaser (the investment banker or group of investment bankers put together to effect the sale in certain larger bond issues) to the bond trustee, invariably by wire transfer. The bond trustee then rewires funds to certain closing participants as payment of their fees and to any entities whose debt will be refinanced with the proceeds of the bonds.

Some bond counsel conduct preclosings (which typically occur one or two days prior to the actual closing) in person, while other bond issues preclose by mailing the documents to bond counsel. The former allows the participants to ensure that all documents meet their requirements, make any last minute changes, and address any final unresolved issues.

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45. In a fixed rate issue, this period typically is 10-14 days, although there are circumstances in which the parties might enter into a forward purchase agreement, pursuant to which the prices are set months in advance. This can be helpful in certain refundings or where a borrower has a sequence of projects and does not want to take the risk of interest rates rising between the time of the agreement and issuance of the bonds. The premium – i.e., additional interest cost – is determined at the time of pricing by the additional interest that buyers will require for their commitment to purchase the bonds at the future date.

46. Although there are other types of variable rate issues, this discussion is limited to weekly rate bonds since they are the most prevalent in the market place.

47. Although fixed rate bond issues that are underwritten are the result of negotiations, generally the underwriter (and, if one is in place, the financial adviser) will provide the borrower and the conduit issuer with a series of comparable transactions in order to establish a pricing schedule. This usually is done one day before the bonds are actually priced. While it might appear that a competitive bidding process will result in lower rates than an underwriting, there is no firm evidence one way or the other. In an underwriting, although the investment banker will try to take orders before the sale for the

17. Disbursing the Bond Proceeds

The bond proceeds usually are disbursed over a period of up to three years. It often makes sense to invest the proceeds pursuant to what is known as a "full flex" guaranteed investment contract (GIC). The borrower estimates its draw schedule for capital expenditures at closing and can draw amounts invested under the GIC as disbursements are needed until the termination of the GIC. While the "full flex" concept does not hold the borrower rigidly to the schedule, the borrower may not accelerate the draws for the purpose of reinvesting the bond proceeds in another, higher yielding instrument. GICs must be acquired through a bidding process with at least three independent (i.e., some party other than the underwriter) bidders. Another approach is to use a laddered maturity of investment securities permitted under the indenture.

Proceeds will be disbursed in accordance with the issuer's requisition process. Typically, the borrower initiates the process and the issuer approves each requisition. To the extent proceeds are being drawn for a construction or major renovation project, an architect's signature likely will be required. If a letter of credit secures the bond issue, the letter of credit bank often will require the borrower to obtain its signature on each requisition. For tax reasons, the letter of credit bank should not have complete discretion with respect to requisitions. If the certificate and supporting documents meet the requirements of the bond documents, including the reimbursement agreement, the disbursements should be made.

To the extent the bond issue has a trustee-held debt service reserve fund, those funds similarly may be invested in a GIC with a maturity not exceeding the maturity of the bonds. A portfolio of investment securities, with mark-to-market requirements, may provide a better return than a GIC for the reserve fund. And, to the extent the interest paid on any GIC – whether for bond proceeds for the project or in a debt service reserve fund – exceeds the bond yield, the excess monies generally must be rebated to the federal government. However, if the construction fund meets certain spend-down requirements, including spending all monies within two years (except for punch list holdback items), the borrower may keep any positive arbitrage it makes on that fund and will not have to calculate rebate with respect to that fund.

18. Addressing Post-Closing Matters

As significant as the closing is, it is not the end of the process for the borrower. In addition to requisitioning the monies for the project, the borrower has several other obligations that will continue on a periodic basis.

Rebate Calculations/Payments. All borrowers must calculate the extent to which their earnings on trustee-held funds exceed the yield on the bonds.[48] If the calculation shows an excess, this amount must be rebated to the federal government at least every five years. Most borrowers hire an outside firm to perform these calculations, which are based in large part on the records maintained by the bond trustee.

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various maturities, once the bond purchase agreement is signed the underwriter bears the risk with respect to any bonds that have not been committed to by third parties, which can result in an advantage to the borrower.

48. The interest rate is not necessarily the only factor taken into account in determining bond yield. On a variable rate issue, the interest rate will be added to the letter of credit fee to calculate "yield." If the borrower has entered into an interest rate swap and has "integrated" that swap (a subject outside the scope of this publication), then the swap payments can be factored into the determination of yield.

Compliance Matters. Although issuers and credit enhancers vary, most will have some economic and operational reporting requirements, e.g., furnishing annual audited financial statements, providing continuing evidence of insurance, producing budgets, etc. These will be bond issue specific and should be part of a tickler system maintained by both the borrower and the trustee.

Continuing Disclosure. In certain bond issues, primarily "retail" issues with small minimum denomination bonds (i.e., less than $100,000), there is a continuing disclosure requirement. In certain fixed rate issues where continuing disclosure is not mandated under governing law, some investment bankers and issuers nevertheless require the borrower to provide continuing disclosure. Either the borrowing institution or the trustee is designated as the "dissemination agent," which is the party responsible for filing annual disclosure reports with certain securities information repositories at the national (and, if they exist, state) level. The continuing disclosure typically includes the audited financial statements, certain information about enrollment and admissions, and other institution-specific data which, in each case, was included in the Official Statement and would be relevant to a decision to purchase bonds in the secondary market (i.e., after their original issuance). If certain significant events occur, as specified in Rule 15c2-12(b)(5) promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, such as a payment or other default, or changes in credit enhancement providers, a report must be made to any federal or state municipal securities information repositories[49] as soon as possible following the event.

CONCLUSION

Serving as legal counsel to a college or university that is issuing bonds requires a certain degree of specialized knowledge. Institutions that are issuing bonds for the first time, or whose in-house counsel does not have previous bond issue experience, would be well served to employ outside counsel skilled in this area of the law. Notwithstanding, in-house counsel will be the critical link between outside counsel and the members of the institution's administration who will be involved in the structuring, disclosure, and negotiations relating to the bond issue. Although the steps associated with tax-exempt financing can be complex and intricate, in-house counsel who familiarize themselves with the myriad procedural and substantive issues that are outlined in this monograph can work in conjunction with the members of the professional working group and the institution's bond issuer to undertake a successful bond financing process.

49. These repositories typically will be identified in the Continuing Disclosure Agreement. It is possible that the repositories may change during the course of the bond issue, and counsel should be alert to that.

Exhibit 1

Sample Intent Resolutions

WHEREAS: [NAME OF INSTITUTION] (the "Institution") wishes to finance or refinance costs of one or more of the following (collectively, the "Projects"), consisting generally of (i) acquisition of real estate; (ii) construction of new buildings and/or facilities; (iii) renovations of, and improvements or additions to, existing buildings and/or facilities; and (iv) acquisition of furniture, furnishings, and equipment for one or more of the foregoing buildings and/or facilities, all for use by the Institution in furtherance of its educational purposes [AS A GENERAL MATTER, MORE SPECIFIC DESCRIPTIONS OF THE ABOVE SHOULD BE INCLUDED]; and

WHEREAS: The Institution intends to finance or refinance costs of all or a portion of one or more of the Projects, costs of issuance, and other related costs and fees (including, if necessary or desirable, capitalized interest to the extent permitted by federal and state law), through the issuance of tax-exempt revenue bonds in an amount not to exceed $[MAXIMUM PRINCIPAL AMOUNT OF BONDS] (the "Bonds"); and

WHEREAS: In order to temporarily finance costs of all or a portion of one or more of the Projects in anticipation of such borrowing, the Institution wishes to make expenditures for any of the Projects from funds of the Institution available therefor; and

WHEREAS: the Institution is an educational institution providing post-secondary education;

NOW, THEREFORE, BE IT RESOLVED:

(1) That this Board hereby authorizes each of the [OFFICER TITLE] or [OFFICER TITLE], acting singly, to borrow money temporarily from funds of the Institution available therefor in order to finance costs of the Project, including costs of issuance and related costs and fees.

(2) That, to the extent necessary, this resolution shall constitute a declaration of intent under Treas. Reg. §1.150-2 (the "Reimbursement Regulations") promulgated under the Internal Revenue Code of 1986, as amended, for the Projects, and each of the [OFFICER TITLE] or [OFFICER TITLE], acting singly, is hereby authorized to take any additional action with respect to this declaration of official intent to assure compliance with the Reimbursement Regulations.

Exhibit 2

Sample Delegation Resolutions

VOTED, that the Board of Trustees (the "Board") of [NAME OF INSTITUTION] (the "Institution") hereby authorizes and approves the incurrence of indebtedness and the participation in all transactions on behalf of the Institution relating to: (1) the issuance, sale, and delivery by the [NAME OF ISSUER] (the "Issuer") of a series of its bonds (the "Bonds") on behalf of the Institution; and (2) the entry by the Institution into an interest rate swap agreement with respect to all, or a portion of the Bonds.

VOTED, that the aggregate principal amount of the Bonds shall not exceed [MAXIMUM PRINCIPAL AMOUNT OF BONDS] Dollars ($______________) (the "Maximum Principal Amount") and the [initial variable rate of interest] [average interest rate] on the Bonds shall in no event exceed [MAXIMUM INTEREST RATE] percent (___%) per annum (the "Maximum Rate").

VOTED, that the proceeds of the Bonds shall be used to [refund the Institution's existing bond issue and certain other indebtedness as well as] fund improvements relating to the Institution's campus and educational facilities.

VOTED, that in connection with the Bonds, the Board further authorizes and approves the entry by the Institution into a letter of credit reimbursement agreement (the "Reimbursement Agreement") with [NAME OF LOC BANK] [a bank to be designated by the Finance Committee] (the "Bank") to provide credit support for the Bonds through the issuance of an irrevocable direct pay letter of credit (the "Letter of Credit").

VOTED, that in connection with the Bonds, the Board approves the Institution's entry into an interest rate swap agreement with a counterparty to be designated by the Finance Committee of the Board (the "Swap Agreement").

VOTED, that the plan of financing presented to the Board be accepted, subject to the limits on the Maximum Principal Amount and the Maximum Rate set forth herein and, subject to such limits, further subject to modification by the Finance Committee of the Board.

VOTED, that the Finance Committee of the Board is duly authorized and is hereby delegated the power to adopt any further resolutions on behalf of the Institution necessary or desirable in connection with the issuance, sale, and delivery of the Bonds, entry into the Reimbursement Agreement, issuance of the Letter of Credit, and entry into the Swap Agreement.

VOTED, that any one of the Officers listed below, acting singly, shall have the power and authority on behalf of the Institution to execute and enter into any and all agreements, instruments, or any other documents such Officer shall, in his or her discretion, determine to be necessary to effect the issuance, sale, and delivery of the Bonds, entry into the Reimbursement Agreement, and issuance of the Letter of Credit, and that such Officer's execution of such agreements, instruments, or other documents shall constitute conclusive evidence of his or her determination to such effect.

VOTED, that without limiting the generality of the foregoing vote, the signing Officer(s) shall have authority to enter into, or otherwise accept the form of, a(n) [NAMES OF DOCUMENTS SUCH AS: Trust Indenture, Bond Indenture, Loan Agreement, Loan and Trust Agreement, Promissory Note(s), Tax Regulatory Agreement, Tax Certificate, Bond Purchase Agreement, Remarketing Agreement, Institution Certificate, Letter of Credit Reimbursement Agreement, Official Statement, Interest Rate Swap Agreement] on behalf of the Institution.

VOTED, that the Officers designated herein shall have such other power and authority with respect to issuance of the Bonds, entry into the Reimbursement Agreement, issuance of the Letter of Credit, and entry into the Swap Agreement as is reasonably necessary to effect the transactions contemplated by the preceding votes.

VOTED, that the Officers referred to in the preceding votes are the [OFFICER TITLE] and the [OFFICER TITLE].

Appendix A

Sample Form of Borrower's Counsel Opinion

[Date]

[Name and Address of Issuer]

[Name and Address of Bond Trustee]

[Name and Address of Underwriter]

[Name and Address of Issuer]

Ladies and Gentlemen:

This opinion is provided to you pursuant to the requirements of the Contract of Purchase, dated [Date], between [Name of Underwriter], (the "Underwriter") and [Name of Issuer] (the "Issuer"), and accepted by the [Name of Borrower] (the "Borrower") relating to the purchase of the [$ Value and Name of Bond Issue] of the Issuer (the "Bonds").

I am [Title of Borrower's Counsel] to the Borrower.

All references in this opinion to instruments and other defined terms shall mean the instruments and other terms as defined in the Contract of Purchase. The opinions expressed below are qualified to the extent that the enforceability of any provisions in the Agreement, the Tax Regulatory Agreement, the Disclosure Agreement, the Note, or the Letter of Representation attached to the Contract of Purchase, or of any rights granted to the Issuer pursuant to such instruments, may be subject to and affected by applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws affecting the rights of creditors generally.

Furthermore, I call to your attention the fact that I am only licensed to practice law in [Jurisdiction(s)] and express no opinion whatsoever as to the laws of any other state or political subdivision thereof.

I have reviewed the instruments referred to in this opinion and the proceedings of the Borrower in connection with this transaction. I also have examined such public records and other documents and materials as I have deemed necessary under the circumstances in connection with this opinion. On the basis of such examination, I am of the opinion that:

(1) The Borrower has been duly created and validly exists as a [Type of Entity] under the laws of [Jurisdiction].

(2) The Agreement, the Tax Regulatory Agreement, the Letter of Representation, the Disclosure Agreement, and the Note have been duly authorized, executed, and delivered by the Borrower, and constitute binding and enforceable agreements of the Borrower in accordance with their terms.

(3) To the best of my knowledge, there is no action, suit, proceeding, or investigation at law or in equity before or by any court, public board, or body, pending or threatened, against or affecting the Borrower of the Project, wherein an unfavorable decision, ruling, or finding would materially adversely affect the Borrower, the Project, or transactions contemplated by the Official Statement, the Bond Resolution, the Bond Indenture, the Agreement, the Tax Regulatory Agreement, the Note, the Letter of Representation, the Disclosure Agreement, or the Contract of Purchase.

(4) To the best of my knowledge, the execution and delivery of the Letter of Representation, the Note, the Agreement, the Disclosure Agreement, and the Tax Regulatory Agreement, and the approval of the Official Statement and the Contract of Purchase, and compliance with the provisions thereof by the Borrower, under the circumstances contemplated thereby, do not and will not in any material respect conflict with or constitute on the part of the Borrower a breach of or default under any other material agreement or instrument to which the Borrower is a party or any existing law, regulation, court order, or consent decree to which the Borrower is subject.

(5) To the best of my knowledge, there are no legal or governmental proceedings, pending or threatened, against or affecting in any material way the Borrower or the Project.

(6) The Borrower has duly approved the Contract of Purchase and the Standby Bond Purchase Agreement and has approved the inclusion in the Official Statement of the information relating to the Borrower.

(7) On the basis of the information that was developed in the course of performance of my services in connection with the preparation of the Official Statement, nothing has come to my attention that would lead me to believe that the Official Statement (except for the financial statements and other financial and statistical data included therein, as to which I express no opinion), as of its date and as of the date hereof, contains any untrue statement of a material fact as it relates to the Borrower or the Project, or omits to state a material fact, as it relates to the Borrower or the Project required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

(8) The Borrower has full corporate power and authority to enter into the Letter of Representation, the Tax Regulatory Agreement, the Note, the Disclosure Agreement, and the Agreement, and to pledge the System Receipts under the Agreement, and has full corporate power and authority, and all necessary licenses, approvals, and permits, to own and operate the Project; except that there may be permits, approvals, or licenses that have not been obtained that will either (a) be received in the ordinary course of business; or (b) the absence of which would not materially impair the Borrower's ability to develop, construct, own, use, or operate the Project.

(9) The Borrower has fee title to the land upon which the Project will be constructed, sufficient for the purposes contemplated by the Agreement, subject to no encumbrances that would have a material adverse effect on the ability of the Borrower to discharge their obligations under the Agreement.

(10) Based solely on the UCC Searches (the contents of which are incorporated herein by reference), the records of the Filing Offices indicate no filings of record under the names of the Borrower regarding the Project.

(11) The Financing Statements conform to the requirements of the [Jurisdiction] Uniform Commercial Code (the "Code").

(12) The Financing Statements have been filed in the Filing Offices. I know of no security interests, liens, pledges, or assignments that may have priority over the Issuer's interest in the Collateral, except as set forth in the Agreement.

Counsel to all of the parties to the above-referenced financing, including Bond Counsel, may rely on this opinion as if it were specifically addressed to them.

Sincerely yours,

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