

Banks, Troubled Borrowers and Tax Exempt Bonds

While a full understanding of the economic effects of the COVID-19 virus is likely many years in the future, one existing consequence of the widespread economic downturn is that many borrowers are facing serious liquidity problems because of a sudden reduction in revenues. While federal assistance may provide relief to some borrowers, others will turn to their banks to request relief from scheduled debt service payments. Deferring interest and principal payments or restructuring scheduled principal payments pose challenges in any lending relationship, and an additional set of challenges arise if the debt being restructured is a tax exempt bond owned by the bank.

If not done properly, changes to the terms of tax exempt bonds will result in the interest on those bonds no longer being exempt from federal income tax. A material modification to the terms of the bonds will constitute a “reissuance” of the bonds, and the tax exempt status of interest on the bonds will be lost unless certain actions necessary under the Internal Revenue Code are taken by the parties in a timely manner. While not every modification to the terms of the bonds is “material” (for example, an interest rate reduction or change in yield of less than 25 basis points is generally not material), the more significant the changes are to the interest rate, payment structure or principal amortization, the more likely those changes will be material and the bonds will be deemed to be reissued. Providing additional collateral to secure the bonds or adding a new guarantor may also result in the bonds being reissued.

The negative consequences from a reissuance can be avoided. If a borrower has both conventional loans and tax exempt debt with the same bank, the restructuring could be limited to the conventional loan. If the tax exempt bonds must be restructured to achieve the financial relief needed by the borrower, the bank should involve its counsel as soon as possible to determine if the changes can be structured in such a way that no reissuance occurs. If that is not possible, counsel will be able to guide the parties through the reissuance process and take the actions necessary to preserve the tax exempt status of interest on the bonds.

Other ancillary documents relating to the tax exempt bonds need to be reviewed as well. If the bank sold participation interest to other financial institutions, the participation agreement will need to be carefully reviewed as many participation agreements prohibit changes to interest rate or payment terms without the consent of the participant bank. If the borrower issued the debt under a master

POSTED:

Apr 10, 2020

RELATED PRACTICES:

[Banking and Finance](#)

<https://www.reinhartlaw.com/practices/banking-and-finance>

[Tax](#)

<https://www.reinhartlaw.com/practices/tax>

RELATED PEOPLE:

[William F. Flynn](#)

<https://www.reinhartlaw.com/people/william-flynn>



trust indenture, that indenture and its supplements will need to be reviewed to ensure that the consent of the holders of other debt is not required.

Changing the terms of tax exempt debt has traps for the unwary. Involve experienced counsel early in the process so that issues can be identified and resolved.

If you would like to discuss this further, contact [Bill Flynn](#), [David Schulz](#) or [John Wink](#).

These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.