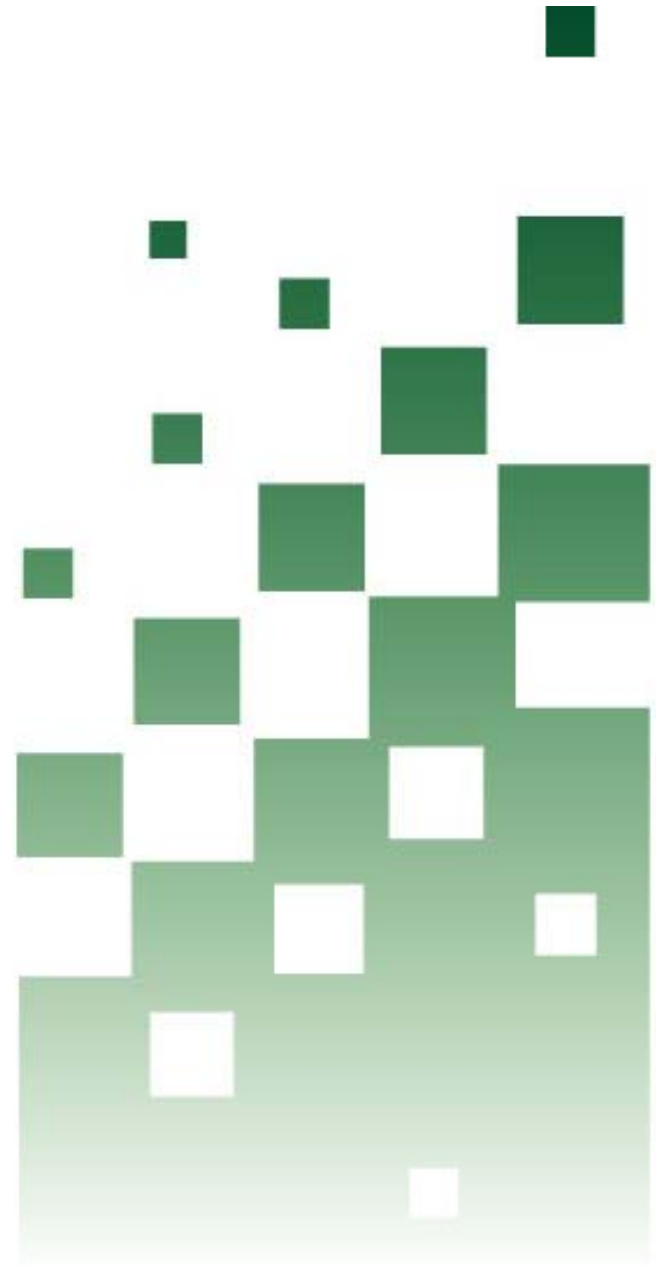
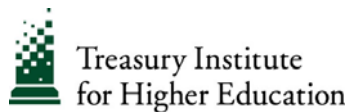


# General Session Panel Discussion – Tax Exempt Bond Compliance

Martha Bradley – Washington University in St. Louis  
Terry Burke – Pinnacle Arbitrage Compliance  
Jeff Lewis – Ice Miller LLP  
Jim Matteo (moderator) – University of Virginia

January 27, 2009 – 3:45p.m.-5:15p.m.



# Tax Exempt Bond Compliance Panel

## Agenda

- ◆ Overview of Compliance Rules
- ◆ IRS Enforcement
- ◆ Private Use Monitoring
- ◆ Arbitrage Rebate/Yield Restriction
- ◆ Bond Compliance Programs

# Continuum of Requirements

A \_\_\_\_\_ B



# Overview:

## 4 Basic Elements:

- Federal Tax Rules under IRC Sections 103 and 141-150
- Continuing Disclosure obligations under Rule 15c2-12
- Indenture/Loan/Reimbursement Agreement covenant compliance
- LOC renewals/other maintenance requirements

# Overview:

## Why Do a Compliance Program?

- **IRS ENFORCEMENT THREATS**
- Coordinate Disparate Responsibilities and Reporting Centers to Enhance Compliance
- Reduce Liabilities and Risks

# Overview:

- Reallocation of bond proceeds and equity/other sources after the fact to maximize benefits
- Manage use of facilities and related liabilities
- Recordkeeping Regimen
- **FACILITATE REFUNDINGS**

# Government Bond Financings Compliance Check Questionnaire

- Mailed Jan. 26, 2009
- 200 government entities issuing TE debt in 2005
- 90 days to respond
- Covering record retention, qualified use, arbitrage/yield restriction, policies and procedures

# IRS Compliance Checklist

IRSQuestionaire.pdf - Adobe Reader

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Form <b>13907</b> (August 2007)	Department of the Treasury — Internal Revenue Service <b>TAX-EXEMPT BOND FINANCINGS COMPLIANCE CHECK QUESTIONNAIRE</b>	OMB No. 1545-2071
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This questionnaire asks for information regarding your post-issuance bond compliance and record retention practices. Please complete the questionnaire and follow the instructions in the accompanying letter for returning it to us.

Name of Organization: \_\_\_\_\_  
Employer Identification Number: \_\_\_\_\_

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**PART I - POST-ISSUANCE COMPLIANCE - GENERAL**

1. Do you have written procedures or guidelines to ensure that qualified 501(c)(3) bond financings remain in compliance with the following federal tax requirements after the bonds are issued:

- a. Proper and timely use of bond proceeds and bond-financed property?  Yes  No
- b. Arbitrage yield restriction and rebate?  Yes  No
- c. Timely return filings and other general requirements?  Yes  No

For each yes answer, briefly describe your procedures or guidelines.



Adobe Acrobat Standard - [IRS Checklist Findings.pdf]

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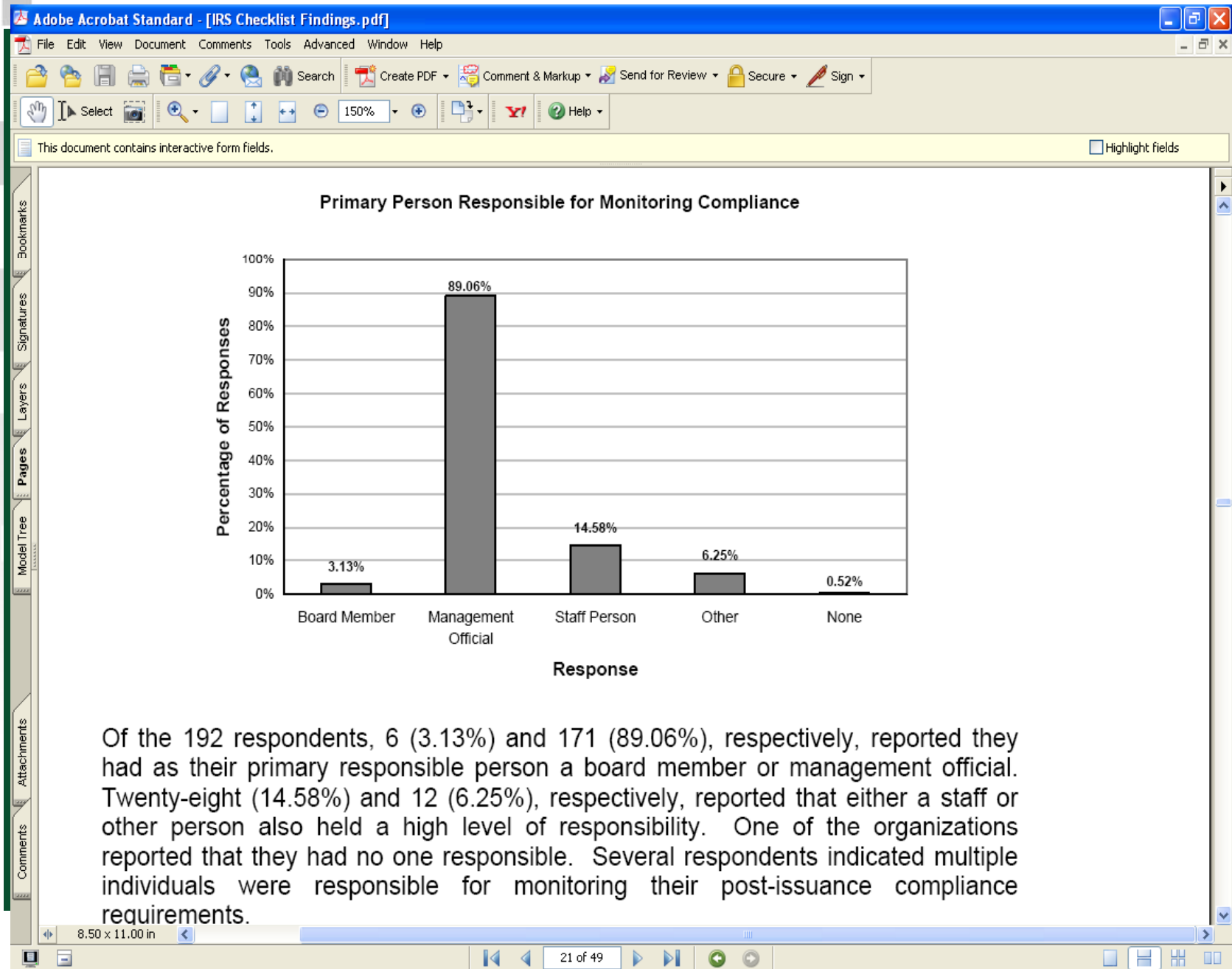
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The following charts show the analyzed responses after the narratives were reviewed:

### Written Procedures or Guidelines Number of Responses After Narrative Analysis

Response	Number of Responses
Formal Written Procedures	29
Ad Hoc Procedures	64
Written Procedures No Description	5
Contract Out	4
Rely Upon Bond Documents	54
Restate Question	8
Not Determinable	11
Blank/ No Response	17

8.50 x 11.00 in 18 of 49



# Private Use Rules

- ◆ Types of Private Use:
  - Ownership
  - Leases and similar arrangements
  - Management contracts
  - Short term facilities use
  - Research contracts
  - “Other beneficial use arrangements”

# Private Use Rules

- ◆ Exceptions:
  - General Public Use
  - Short Term Use
  - Incidental Use
  - Safe Harbors
    - Management Contracts
    - Research Contracts

# Measurement

- ◆ Per Issue, not per Project
- ◆ Period
  - Over the life of the bond
  - Annual computation
- ◆ Methods
  - Discrete space
  - Simultaneous use
  - Common areas



## 4 Steps in Calculation Process

1. Compute amount of “bad use”
2. Convert amount of BU to \$\$
3. Convert BU\$\$ to % of Bonds
4. Time conversion for life of Bonds--  
running calculation over  
Measurement Period



## Step 1

- facility based calculation
- first take equity allocations into account
- any reasonable basis consistently applied -- space, time, simultaneous/proportionate
- highly fact sensitive and dynamic over time



## Steps 2 - 4

- less commonly understood than step 1
- examples to illustrate 2 and 3

# Series 2000 Bonds

\$20M for 25 years

Project A: \$12M

Project B: \$8M

Prorated allocation over full 25 years

# Series 2005 Bonds

\$40M for 25 years

Project C: \$20M

Project D: \$15M

Ref. of 2000: \$5M

Query: What is life of refunding component?



In 2010, step 1 computation results in:

- A. 10% Bad Use
- B. 2% BU
- C. 0% BU
- D. 4% BU

# Series 2000

\$8 million outstanding in 2010

A. 60% of \$8M = \$5.4M

B. 40% of \$8M = \$3.2M

A. \$5.4 M times 10% = \$540

B. \$3.6M times 2% = \$72K

Total = \$612K

$\$612/\$8000 = 7.66\%$

# Series 2005

\$34 million outstanding in 2010

- A.  $(60\% \text{ of } 12.5\%) = 7.5\% \text{ times } \$34\text{M}$   
 $= \$2.55\text{M times } 10\% \text{ BU} = \$256\text{K allocable}$   
to bad use
- B.  $(40\% \text{ of } 12.5\%) = 5\% \text{ times } \$34\text{M} = \$1.7\text{M}$   
times 2% BU = \$34K
- C.  $50\% \text{ of } \$34\text{M} = \$17\text{M times } 0\% \text{ BU} = \$0$
- D.  $37.5\% \text{ of } \$34\text{M} = \$12.75\text{M times } 4\% \text{ BU} =$   
\$500K

Total = \$790K  
 $\$790/\$34,000 = 2.33\%$



## To be answered:

1. What is combined measurement period for each project?  
  
i.e., How long are bonds of each series allocated to a project?
2. Decisions need to be made.

# Arbitrage Rebate and Yield Restriction

Two Separate Rules to follow:

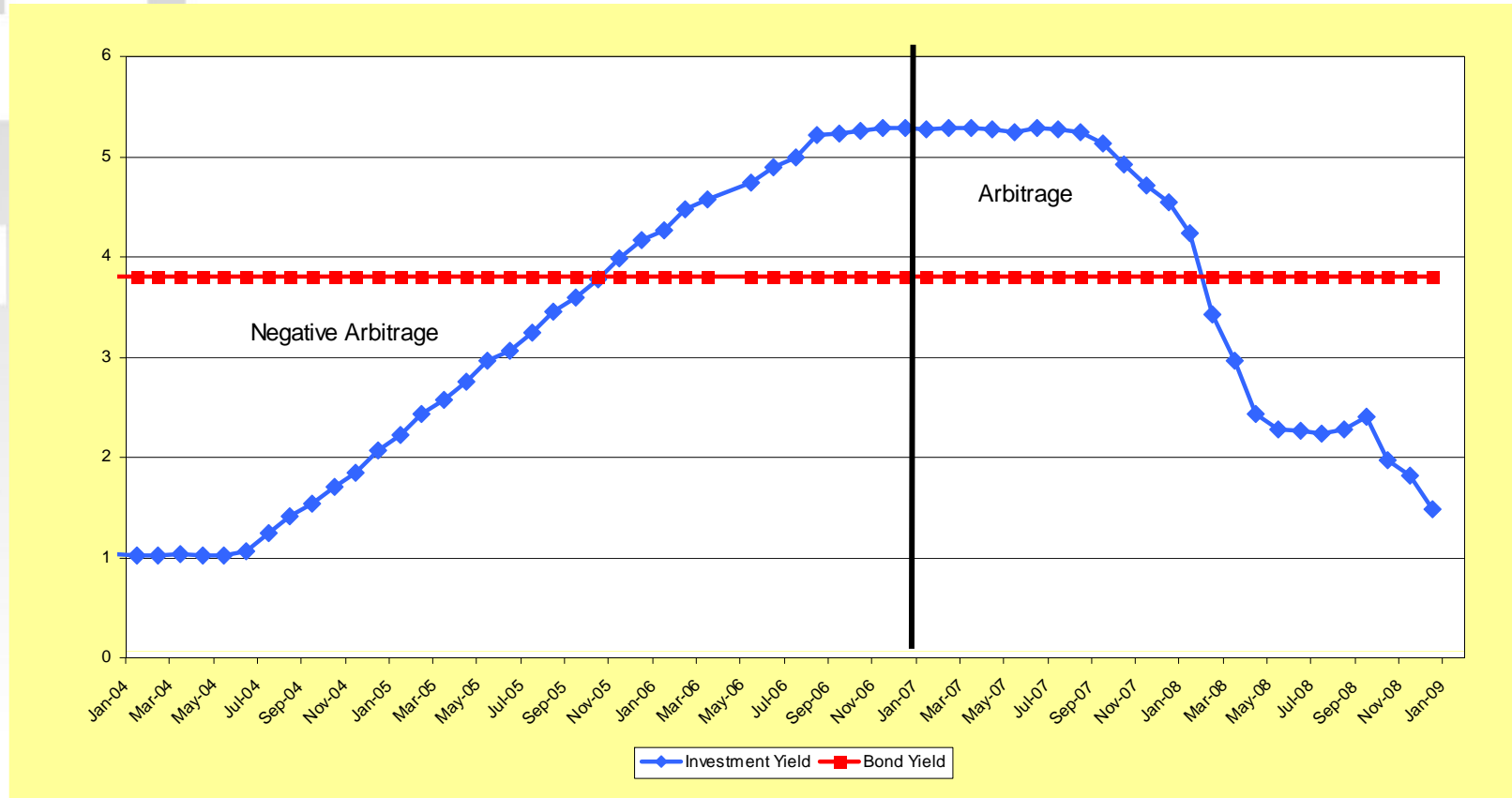
Yield Restriction – IRC Section 148(a): Governs when you may legally earn arbitrage.

Arbitrage Rebate - IRC Section 148(f): Mandates when you must rebate arbitrage to the federal government.

Prior to 1986, only yield restriction applied. After 1986, both rules apply to a bond issue.

# Rebate vs. Yield Restriction

(From 2004 – 2009)



# YRP Sample #1

		Arbitrage Earned
Years 1-3	(Unrestricted)	100,000
Years 4 & 5	(Restricted)	50,000
Arbitrage Rebate Payment		100,000
Yield Reduction Payment		50,000

# YRP Sample #2

		Arbitrage Earned
Years 1-3	(Unrestricted)	80,000
Years 4 & 5	(Restricted)	<20,000>
Arbitrage Rebate Payment		60,000
Yield Reduction Payment		-0-

# YRP Sample #3

		Arbitrage Earned
Years 1-3	<b>(Unrestricted)</b>	<900,000>
Years 4 & 5	<b>(Restricted)</b>	70,000
Arbitrage Rebate Payment		-0-
Yield Reduction Payment		70,000



# Washington University in St. Louis

- ◆ Founded in 1853, Washington University is an independent co-educational, nondenominational research University with over 11,900 degree-seeking students in a broad range of academic programs offered through the University's seven schools.
- ◆ \$1.9 billion operating revenue in FY 2008. Diverse revenue base includes federal research awards of \$440 million, or 23% of revenue.

# *Components*

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## **How a Representative Institution might structure a compliance program.**

Good pre-issuance planning makes post-issuance much easier

- ◆ Directed by the Treasurer or other senior manager
- ◆ Include active involvement of Treasury, Capital Planning/Financial Planning, Plant and Debt Accounting, Office of the General Counsel, Tax Accounting and External Reporting
  - Overlap of personnel among various committees and teams
  - Debt Strategy team (includes Treasury, CFO, OGC, Debt accounting, Plant accounting, Capital planning, Facilities, Tax) – meets monthly.
  - Projects committee – reviews all requests for capital expenditures
  - Real estate committee – reviews all real estate related transactions
- ◆ Compliance training – in-house seminar by qualified bond attorney
  - ◆ Business managers and events planners
  - ◆ Written procedures
  - ◆ Periodic update to appropriate Board of Trustees committees (audit, finance)

# *Monitoring & Tracking Private Use*

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## **How might a representative institution monitor Private Use?**

- ◆ Use the space tracking system and research database
- ◆ Manual survey of primary sources for use of space - review leases and management agreements, sponsored research agreements, clinical trial agreements, drug studies - who are the users of your space?
- ◆ Keep record of carve-outs
- ◆ Awareness of PU rules and how to interpret
- ◆ PU requests go through Dean, VC for Research, CFO
- ◆ Events on campus - short term use
- ◆ Periodic update to PU

## *Monitoring Spending*

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### **How might a representative institution monitor spending of bond proceeds?**

- ◆ Plant accountant prepares monthly schedule of drawdown on borrowed funds - allocate draws to eligible expenditures
- ◆ Treasury approves drawdown
- ◆ Work closely with Facilities and observe delays in expenditures
- ◆ Calculate percentages spent to make sure meeting spending requirements

## Record retention

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### **Maintaining adequate records to substantiate compliance**

- ◆ Written record retention policy; specify who is responsible for holding which documents
  - Plant Accounting maintains records of invoices/expenditures
  - Facilities maintains project certificates of substantial completion

## *Other Compliance Matters*

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- ◆ Maintain a bond compliance checklist
- ◆ Updates to ratings agencies and lenders
- ◆ Make sure the arbitrage rebate calculation gets done – Treasury
- ◆ Roll over standby bond purchase agreements/LOC'S – Treasury
- ◆ Review 990 tax forms – be aware of requirements/changes – Tax Accounting