Policy for Post Issuance Tax-Exempt Bond Compliance

Unit: Financial Accounting and Reporting
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Contact: Meredith Boteler
Title: Director, Financial Accounting and Reporting

Purpose

The purpose of these post-issuance compliance policies for tax-exempt bonds and federal tax credit bonds issued by The Board of Trustees of The University of Alabama ("University") is to ensure that the University will be in compliance with requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied with respect to tax-exempt bonds and federal tax credit bonds and other obligations ("bonds") after the bonds are issued so that interest on the bonds will be and remain tax-exempt or eligible for the federal tax credit, as applicable.

The University has financed the acquisition and construction of, and improvements to, many of its facilities and other capital projects with the proceeds of tax-exempt bonds, Direct Pay Build America Bonds, and Recovery Zone Economic Development Bonds. Because bondholders do not pay federal income tax on the interest received on tax-exempt bonds, they are generally willing to accept a lower interest rate than if the bonds were issued on a taxable basis. Build America Bonds (BABs) and Recovery Zone Economic Development Bonds (RZED) are taxable governmental bonds eligible for certain tax credits under the Internal Revenue Code. Those tax credits have been furnished in the form of direct payment subsidies made by the U.S. government. Tax-exempt bonds and federal tax credit bonds provide the University with the ability to finance many of its capital projects at a greatly reduced cost. University bonds are considered governmental bonds and not 501(c)(3) bonds.

For bonds to qualify for tax-exempt status, many detailed rules set forth in the Code and Treasury Regulations must be satisfied. When bonds are issued, outside bond counsel is engaged to review and confirm compliance with these rules as of the issue date. Many rules, however, continue to apply throughout the entire term of the bond issue. The University has accepted the responsibility of maintaining compliance with these rules following the issue date, in order to meet its obligations under federal tax law and to preserve the important benefits associated with tax-exempt financing. The University has assigned to the Vice President for Financial Affairs and Treasurer of the University the primary responsibility of monitoring the University's compliance with federal tax requirements for the University's tax-exempt bonds and federal tax credit bonds for the benefit of the University (but not with respect to the University's other divisions – University of Alabama at Birmingham and University of Alabama in Huntsville).

Policy

I. Investment of Bond Proceeds

A. Investments must be purchased at Fair Market Value

Prior to being spent, bond proceeds must be invested in a manner that will establish fair market value for federal tax purposes, in order to maintain compliance with the rebate and arbitrage yield restriction rules per Code Section 148. The rebate regulations require that investments made with Bond proceeds be purchased at fair market value. The purpose of this requirement is to prevent the avoidance of rebate that would otherwise be payable to the US Treasury by purchasing investments at an artificially low price. Unless an investment fits one of the established safe harbors in the regulations, it is rebuttably presumed that an investment is not purchased at fair market value. The following safe harbors are provided under the fair market value rule (Reg. 1.148-5):

1. Securities traded on an established market.
2. SLGs (State and Local Government Series) – A Treasury obligation purchased directly from the US Treasury Department under its program for SLGs.
3. Certificates of Deposit – Issued by a bank if the CD has a fixed interest rate, fixed payment schedule, substantial penalty for early withdrawal, a yield not less than the yield on a reasonably comparable direct obligation of the US, or a yield that is published or posted by the bank to be currently available from the bank on reasonably comparable CDs offered to the public.
4. Guaranteed Investment Contracts – an investment contract with negotiated withdrawal and reinvestment provisions and a specifically negotiated interest rate. Must meet bidding requirements of the regulations.
5. Securities purchased on the open market for a yield restricted defeasance escrow.

The Associate Vice President (AVP) for Finance provides direction for investing the proceeds in accordance with the University investment guidelines. Unless safe harbor provisions are met, all investments of bond proceeds are purchased at fair market value.

B. Arbitrage Yield Restriction and Rebate Requirements

Tax-exempt bonds lose their tax-exempt status if they are arbitrage bonds under section 148 of the Code. In general, arbitrage is earned when the gross proceeds of an issue are used to acquire investments that earn a yield materially higher than the yield on the bonds of the issue. The earning of arbitrage does not, however, necessarily mean that the bonds are arbitrage bonds.

Federal tax law requires the University to "rebate" to the federal government any amounts earned from the investment of bond proceeds at a yield in excess of the bond yield, unless an exception applies. Arbitrage rebate is due on the fifth anniversary of bond issuance plus 60 days and succeeding installments every five years. The final installment is due 60 days after retirement of last bonds of issue. The University retains an outside rebate computation firm to calculate its liability, if any, for rebate for each of its bond issues. The AVP for Finance, along with Financial Accounting & Reporting, are responsible for maintaining the engagement with the firm, providing the firm with the documentation it requires, making sure the firm prepares calculations at the required intervals (including upon the retirement of a given bond issue), reviewing the firm's calculations for obvious errors, coordinating with the issuer to remit any required rebate to the federal government (Form 8038-T), and retaining appropriate records. The AVP for Finance and Financial Accounting & Reporting are also responsible for monitoring the spending of bond proceeds and taking appropriate steps to qualify for a "spending exception" to rebate, to the extent practicable.

II. Expenditure of Bond Proceeds

Federal tax law places restrictions on the types of expenditures that may be financed with tax-exempt or federal tax credit bond proceeds.

A. The University's expectations as to the expenditure of bond proceeds are set forth in the tax certificate executed on the date of issuance of each bond issue, which bond counsel uses to evaluate compliance with these rules as of such date. Expenditures should not deviate materially from the expectations and limitations stated in the tax certificate for the issue without consulting beforehand with bond counsel.
B. Costs of issuance financed by the issue are treated as common costs and generally have a private business use percentage equal to the weighted average private business use percentage of the projects financed by the issue. This includes issuance costs withheld from proceeds and any costs incurred separately by the University.
C. With respect to the proceeds of Build America Bonds (Direct Pay), 100 percent of the excess of "available proceeds" must be used only for capital expenditures. Available proceeds are the sale proceeds the issuer receives from the bonds minus proceeds it is allowed to spend on costs of issuance (up to 2%) plus proceeds from investment earnings. Thus, investment earnings on BABs (Direct Pay) must also be spent on capital expenditures. The authorizing legislation for BABs expired on December 31, 2010, so no new BABs can be issued.
D. Issuers of RZED Bonds must spend 100% of the "available proceeds" for one or more qualified economic development purposes. A qualified economic development purpose means expenditures for promoting

development or other economic activity in a recovery zone, including capital expenditures and working capital expenditures paid or incurred in such zone, expenditures for public infrastructure and construction of public facilities, and expenditures for job training and education programs. Available proceeds are the sale proceeds the issuer receives from the bonds minus proceeds it is allowed to spend on costs of issuance (up to 2%) plus proceeds from investment earnings. Thus, investment earnings on RZED bonds must also be spent on a qualified economic development purpose. The authorizing legislation for RZED Bonds expired on December 31, 2010, so no new RZED Bonds can now be issued.

E. Projects financed with RZED bond proceeds are subject to Davis-Bacon labor standards. The Davis-Bacon contract clauses stated in 29 CFR 5.5(a)(1) through (10) must be incorporated into covered contracts for construction, alteration, or repair work.

F. For each bond financed project, bond proceeds are allocated to expenditures for the project within the period ending on the earliest of the following (the “Permitted Allocation Period”): (i) 18 months after the placed-in-service date of the project (or the payment of the expenditure in question, if later), (ii) five years (plus 60 days) after the issue date of the bonds, or (iii) 60 days after the retirement of the bonds.

G. Projects may be approved by the Board of Trustees with a funding source of future bonds and projects may be started prior to the issuance of bonds. In those instances, the board resolution must declare the University’s official intent to use bond proceeds to reimburse the University for expenditures made with University funds and the resolution must be adopted not longer than 60 days after the first expenditure expected to be reimbursed. The following language must be included in the resolution for the project:

   WHEREAS, officials at The University of Alabama have determined that the Board will incur certain costs in connection with the acquisition, construction, and installation of the Project prior to the issuance of the Bonds, and the Board intends to allocate a portion of the proceeds of the Bonds to reimburse the Board for certain costs incurred in connection with the acquisition, construction and installation of the Project paid prior to the issuance of the Bonds; and

   The University of Alabama does hereby declare that it intends to allocate a portion of the proceeds of the Bonds to reimburse the Board for expenses incurred after the date that is no more than sixty days prior to the date of the adoption of this resolution, but prior to the issuance of the Bonds in connection with the acquisition, construction, and installment of the Project. This portion of this resolution is being adopted pursuant to the requirements of Treasury Regulations Section 1.150- 2(e).

H. Preliminary expenditures (often referred to as soft costs) can be reimbursed even if incurred more than 60 days before the adoption of an official intent resolution. Preliminary expenditures include architectural costs, engineering costs, surveying costs, testing costs, advertising, and other similar costs before commencement of construction. Expenditures may not be reimbursed once a construction contract is let and “dirt is turned.”

III. Restrictions on Private Business Use and Private Loans

Restrictions on private business use exist for property financed with proceeds of tax-exempt bonds or federal tax credit bonds and apply to that property after the bonds have been issued. There is also a restriction on the use of the proceeds of tax-exempt bonds or federal tax credit bonds to make or finance any loan to any person other than a state or local government unit. Bonds classified as Private Activity Bonds (IRC sec 141) can lose tax-exempt status. A private activity bond is one that meets the private business use test and the private security/payment test or the private loan financing test.

- Private Business Use means use directly or indirectly in a trade or business carried on by any person other than a governmental unit (use as a member of the general public shall not be taken into account). A bond is a private activity bond when more than the lesser of $15 million or 10% of the proceeds of a tax exempt issue are used for any private business use. The pro-rata private use portion of costs of issuance is considered private business use and must be deducted in this determination. (5% limit applies to use that is considered unrelated to any government use of bond proceeds, as described more specifically in IRC section 141(b)(3)).

- Private Security or Payment test is met when more than 10% of the proceeds of a tax exempt issue are directly or indirectly (a) secured by any interest in property used or to be used for private business use or payments in respect of such property or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for private business use.
- Private Loan Financing test is met if the amount of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than governmental units exceeds the lesser of 5% of the proceeds of the issue or $5,000,000.

When a portion of a building is expected to be used by a private business or as a private loan, UA generally funds the private business use portion with taxable bonds or University funds and the remainder with tax-exempt bonds in order to remain in compliance. Private Business Use can arise from the following:

A. **Management Contracts** – A management contract is defined by the IRS as a management, service or incentive payment contract with a service provider under which the service provider provides services involving all or a portion of any function of a facility. Examples would include food service and bookstore, where the outside company has an ongoing presence in or control of the facility. IRS Revenue Procedure 97-13 provides safe harbors for management or service contract arrangements to avoid private business use.
B. **Sponsored Research Agreements** – Research performed in bond-financed facilities may constitute private business use if a commercial business funds the research and receives particular benefits from the results of the research. IRS Revenue Procedure 2007-47 provides three safe harbors for research agreements.
C. **Unrelated Trade or Business** –The general unrelated business use principles under Section 513 of the Internal Revenue Code are applied to analyze the use of tax-exempt bond financed facilities for this purpose.
D. **Naming Rights of Facilities** – Private use is generally not created when a building, or a room or an area within a building, is named for an individual or individuals when the name is not that of a company or a commercial name, e.g., the John and Mary Doe Building. Private use could result when a naming situation involves a company or commercial name such as the XYZ Bank Building. A naming rights situation involving a company or a commercial name may require outside bond tax counsel review and/or a ruling request from the Internal Revenue Service.

IV. Record Retention Requirements

The basic purpose of record retention for the University's tax-exempt bonds and federal tax credit bonds is to enable the University to readily demonstrate to the IRS upon an audit of any tax-exempt or federal tax credit bond issue that the University has fully complied with all federal tax requirements that must be satisfied after the issue date of the bonds so that interest on those bonds continues to be tax-exempt under section 103 of the Code or qualifies for the applicable tax credit. Documentation should be maintained for the entire term of the bond issue plus three years after the bonds have matured. If the bonds are refunded in later issues, the combined term of the issues plus three years will be the required retention period. The records may be in paper or electronic form. However, most of the documentation should be saved on the Sharepoint Bond Compliance website https://finance-estus.fa.ua.edu/bondcomp/default.aspx. The records to be maintained include:

A. The official Transcript of Proceedings for the original issuance of the bonds;
B. Records showing how the bond proceeds were invested, as described in I above;
C. Arbitrage calculations and if applicable, information, records and calculations showing that, with respect to each bond issue, the University was eligible for the "small issuer" exception or one of the spending exceptions to the arbitrage rebate requirement or if not, that the rebate amount, if any, that was payable to the United States of America in respect of investments made with gross proceeds of that bond issue was calculated and timely paid with Form 8038-T and then timely filed with the IRS, and;
D. Records showing how the bond proceeds were spent, as described in II above;
E. Records showing that special use arrangements, if any, affecting bond-financed property made by the University with nongovernmental persons, if any are consistent with applicable restrictions on private business use of property financed with proceeds of tax-exempt bonds and restrictions on the use of proceeds of tax-exempt

bonds or federal tax credit bonds to make or finance loans to any other person other than a state or local government unit.

V. Other General Requirements

For federal tax credit bonds, Form 8038-CP must be filed from 45-90 days in advance of the bond interest payment. The Form 8038-CP requests a refundable credit for interest on BABS and RZED bonds.

Annually, the Director of Budget provides an email and a hard copy of the Board of Trustees approved budget for the University to the Bond Trustee per the Master Trust Indenture. The Master Trust Indenture states that the annual budget should be filed with the Bond Trustee not less than five days prior to the beginning of each Fiscal Year. If for any reason the Board shall not have adopted the annual budget for a Fiscal Year before the first day of such Fiscal Year, the annual budget for the preceding year shall be deemed to have been adopted and be in effect for such Fiscal Year until the annual budget for such Fiscal Year is adopted and a copy thereof filed with the Bond Trustee.

VI. Remediation and the Voluntary Closing Agreement Program

If the potential to fail to comply with post issuance compliance activities is identified, the Bond Compliance Accountant will notify the Director of Financial Accounting and Reporting and seek the advice of qualified bond counsel in order to assess the need to take remedial actions described under section 1.141-12 of the Income Tax Regulations or enter into a closing agreement under the Tax-Exempt Bonds Voluntary Closing Agreement Program described in Notice 2008-31.

Scope

This policy applies to employees who work with the tax-exempt bonds and federal tax credit bonds issued by The Board of Trustees of The University of Alabama including AVP for Finance, Financial Accounting and Reporting, Tax Office and Budget Office.

Office of the Vice President of Financial Affairs

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Signed: Cheryl Mowdy 2/12/2018

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Cheryl Mowdy
Assistant Vice President for Financial Affairs