

Policies and Procedures Relating to Tax-Exempt Bond Compliance
November 2010

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. Because bondholders do not pay federal income tax on the interest received on such bonds, they are generally willing to accept a lower interest rate than if the bonds were issued on a taxable basis. Tax-exempt bonds thus provide the University with the ability to finance many of its capital projects at a greatly reduced cost.

For bonds to qualify for tax-exempt status, many detailed rules set forth in the Internal Revenue Code and Treasury Regulations must be satisfied, which in particular place restrictions on "arbitrage" and "private business use." 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.

Set forth below is a general summary of the policies and procedures that the University is following, and will continue to follow, to maintain compliance with the federal tax rules relating to tax-exempt bonds following their issuance.

I. Responsibility for Maintaining Compliance

The University's compliance efforts are led by the Director of Capital Financing or his or her designee. (Such person is hereafter referred to as the "Bond Compliance Coordinator.") The Bond Compliance Coordinator consults periodically with the Bond Compliance Committee, consisting of the representatives from Capital Financing, Tax, Legal Counsel, Capital Programs, Accounting & Financial Reporting, Investments, Facilities & Services, and Grants & Contracts. Discrete compliance tasks are assigned to specific individuals across the University, as determined through consultation between the Bond Compliance Coordinator, the Bond Compliance Committee, and the identified individuals. The Bond Compliance Coordinator maintains a list of these discrete compliance tasks and the individuals to whom the tasks are assigned. The individuals are identified by position rather than name, to ensure continuity even as the people occupying the positions change.

The Bond Compliance Coordinator provides these responsible individuals with sufficient training and background resources to perform their tasks. One such resource is *Post-Issuance Bond Compliance: A Guide to Practical Strategies and Procedures for 501(c)(3) Borrowers* (the "Guide") written by Ropes & Gray LLP. The Bond Compliance Coordinator provides relevant excerpts from the Guide to the responsible persons, including the "task summaries" attached as an exhibit to the Guide.

The Bond Compliance Coordinator and other members of the Bond Compliance Committee are informed of relevant legal requirements and stay abreast of developments in the law through the Guide, consultation with counsel, attendance at conferences, and other means.

II. Annual Private Business Use Compliance Surveys

Following the close of each fiscal year, representatives from Capital Financing and the Tax Department (the Survey Team) conduct a survey of the uses of bond-financed property to determine the amount of private business use of each outstanding bond issue for that year. The Survey Team prepares a "Building Questionnaire" for each building that was financed in whole or in part with tax-exempt bonds. The Building Questionnaire is given to the Director of Facilities, who confirms whether the space usage information (including information concerning management and service contracts, leases, and space rentals) provided in response to the prior year's questionnaire is still accurate, and if not, provides any necessary updates. For any facilities that were not addressed by a prior-year questionnaire, the Director of Facilities provides a description of the use of space in the facilities. The Survey Team reviews this information to identify private business uses of bond-financed space and, as necessary to make this determination, obtains copies of relevant contracts. The Survey Team refers to the description of the relevant legal standards in the Guide in making this determination, although any management or service contracts that do not qualify as "incidental services" as described in the Guide should generally be reviewed by counsel.

In addition, the Survey Team asks the Director of Sponsored Research to identify any sponsored research contracts for the fiscal year in question that may give rise to private business use. The Director of Sponsored Research refers to the flow chart and the relevant discussion in the Guide in making this determination.

The Survey Team also asks the Tax Director to identify any arrangements that may be regarded as an "unrelated trade or business" for the fiscal year in question (regardless of whether or not the arrangement in fact gives rise to unrelated business taxable income).

To the extent private business use arose from any arrangement, the Survey Team gathers any information necessary to identify and/or allocate the bond-financed space to private business use. For example, if a noncompliant sponsored research contract is performed in the same space as other compliant research contracts, the Survey Team obtains from the Director of Sponsored Research data as to the revenues derived from the noncompliant contract, and data as to the revenues derived from all research contracts performed in that space, from which the Bond Compliance Coordinator makes a proportional allocation.

If any arrangements are not clearly categorized as private business use or compliant, or if it is unclear how mixed-use property should be allocated to private business use, the Survey Team discusses the issue with counsel.

The Survey Team then calculates the amount of private business use of each of the University's outstanding bond issues for the fiscal year, following the examples of private business use

calculations attached to the Guide. The purpose of these calculations is to confirm the University's continued compliance with the limitations on private business use.

As part of the annual update process, the Bond Compliance Coordinator also "checks in" with each person responsible for a bond compliance task, to confirm that the person understands and is continuing to perform his or her responsibilities. Attached to the Guide is a form that may be used for this purpose.

III. Screening Proposed Arrangements for Private Business Use

Before the University enters into an arrangement that may give rise to private business use, the arrangement is reviewed to make sure that entering into the arrangement would not cause a violation of the private business use rules. The types of proposed arrangements that are reviewed include leases, management and service contracts, sponsored research agreements, potential unrelated trades or business, partnerships, joint ventures and naming rights agreements. Responsibility for screening these proposed arrangements is assigned to particular individuals around the University, who are designated through consultation between the Bond Compliance Coordinator, the Bond Compliance Committee and the identified individuals. As a resource, the Bond Compliance Coordinator provides these individuals with the applicable "task summaries" which are attached as an exhibit to the Guide. The "task summaries" describe the general legal standard against which the screeners should review the proposed arrangements.

If the screener believes that a proposed arrangement will, or possibly could, give rise to private business use, the screener refers the proposal to the Bond Compliance Coordinator. If the Bond Compliance Coordinator (in consultation with counsel as necessary) determines that no private business use would arise, the arrangement may proceed. If the Bond Compliance Coordinator determines that private business use would arise under the arrangement as then proposed, he or she will recommend appropriate steps to promote the best interests of the University. Such steps ("corrective steps") may include: requiring that the arrangement be modified to eliminate the private business use (for example, by fitting the arrangement within IRS "safe harbor" guidance); taking "remedial action" as permitted under the Treasury Regulations to cure any private business use resulting from the arrangement; re-allocating the sources of funding of the facility at issue to the extent permitted by the Treasury Regulations; or determining that the amount of private business use generated by the arrangement is immaterial and will not cause the applicable limitation on private business use to be exceeded. In no event may the Bond Compliance Coordinator approve, or the University enter into, a proposed arrangement that would cause the limitation on private business use for a given bond issue to be exceeded.

Even if a given arrangement would not cause the applicable limitation on private business use to be exceeded, if the amount of private business use generated by the arrangement would be material, the Bond Compliance Coordinator will ordinarily recommend that one of the corrective steps described above be undertaken. Only in rare and unusual cases will the Bond Compliance Coordinator authorize such an arrangement to be entered into without a corrective step, and shall consult with counsel before providing any such authorization.

IV. Rebate

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. The University retains an outside rebate computation firm to calculate its liability, if any, for rebate for each of its bond issues. The Bond Compliance Coordinator is 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, and retaining appropriate records. The Bond Compliance Coordinator is 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.

V. Source of Debt Service Payments; Gifts

To avoid creating a "sinking fund" that is subject to restriction on the yield at which it may be invested, payments of principal and interest on the University's tax-exempt bonds are derived from current revenues (including current gifts), not directly or indirectly from the University's endowment or other set-aside funds. The chief financial officer is responsible for maintaining accounting and cash flow practices that will satisfy this requirement.

Whenever a gift is received that bears a close relationship to bond-financed capital costs (e.g., because it is designated for a bond-financed project, is received through a fundraising campaign that focuses on the project, or otherwise), the gift generally should be (i) used to pay capital costs of the project not financed with bond proceeds, (ii) deposited into the debt service fund for the issue within 30 days of being received and entirely used for the next payment of debt service on the bonds, or (iii) used to pay other capital costs of the University (if permitted under the terms of the gift) within 30 days of being received. If these approaches are not feasible (for example, because the amount of the gift exceeds the amount of the next debt service payment, or there are insufficient other capital costs to which the gift may be applied), counsel should be consulted, who can advise whether in this situation the gift will need to be yield-restricted. The director of development is responsible for alerting the Bond Compliance Coordinator whenever a gift is received that may bear a close relationship to a facility (other than gifts received pursuant to a pre-approved fundraising campaign), and the Bond Compliance Coordinator will ensure that the gift is applied in a manner consistent with these procedures.

VI. Other Rules Regarding Investment and Expenditure of Bond Proceeds

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. The rules for establishing fair market value are summarized in the tax certificates executed by the University at the time of issuance of each bond issue; certain investments, for example, must be acquired through the detailed "three-bid" procedure set forth in the Treasury Regulations. Typically, bond counsel would review the initial investments of bond proceeds acquired on the issue date for compliance with these rules, but would not necessarily do so for any subsequent investments or reinvestments of such proceeds. The Bond Compliance Coordinator will take appropriate steps, in consultation with counsel, to assure that

subsequent investments or reinvestments of bond proceeds are made in compliance with these rules. For example, investments of proceeds in any guaranteed investment contract, and investments of funds in an escrow to defease a bond issue, will be acquired through the "three-bid" procedure noted above.

Federal tax law places many restrictions on the types of expenditures that may be financed with tax-exempt bond proceeds, including, among other things, that the expenditures fall within the scope of the "TEFRA" public notice and approval, meet certain useful life requirements, not be used for more than a minimal amount of issuance costs, be made within certain deadlines, and not be used to reimburse expenditures made before the issuance date unless certain requirements are satisfied. 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. The Bond Compliance Coordinator will make sure that the University's actual expenditure of proceeds of each bond issue will not deviate materially from the expectations and limitations stated in the tax certificate for the issue without consulting beforehand with counsel.

The Bond Compliance Coordinator is responsible for making sure that, for each bond-financed project, bond proceeds are allocated to expenditures for the project within the period ending on 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. This means that, before the end of the Permitted Allocation Period for a given project, the Bond Compliance Coordinator should take two steps: (i) make sure the University actually spends bond proceeds (and equity or taxable debt proceeds, if applicable) on project expenses in a manner that can be documented (e.g., through requisitions, invoices and canceled checks), and (ii) prepare an allocation certificate (such as that attached to the Guide) that summarizes the total expenditures of bond proceeds and equity or taxable debt proceeds on the project, and that allocates the equity or taxable debt to any private business uses of the project.

VII. Record Retention

Governmental and Section 501(c)(3) borrowers are required to maintain sufficient records to demonstrate that their bonds have satisfied the requirements for tax-exempt status. Under current IRS policy, these records generally should be maintained for the entire term of the bond issue (and the term of any refunding issue), plus three years.

Borrowers typically find compliance with these rules to be very challenging. A broad range of matters can in principle bear on the tax-exempt status of an issue, and the amount of records required to fully document all such matters may be vast. Certain matters may not readily lend themselves to documentation in the first place – for example, establishing that a given facility was not subject to private business use for a particular period. Bond issues often are outstanding for many decades, and it can be difficult over such a long period to assure that records will remain pristine. There is little IRS guidance addressing the scope of the record retention requirement, and no IRS guidance at all on whether more streamlined retention strategies may be employed to make the task manageable for section governmental borrowers.

Nevertheless, as stated before, the University is committed to preserving the tax-exempt status of its outstanding governmental bond issues. The University will strive to maintain records of the type, in the manner, and for the length of time required under federal tax law to establish the tax-exempt status of its bond issues.

To this end, the Bond Compliance Coordinator maintains a list of key records that generally should be retained. For each category of records, the list identifies the individuals responsible for maintaining the records. These individuals are designated through consultation between the Bond Compliance Coordinator, the Bond Compliance Committee and the identified individuals. Certain records (such as the bond transcript) are maintained centrally by the Bond Compliance Coordinator in the Capital Financing Office, while other records are maintained by the departments in which the responsible individuals work. Regardless of where held, the records should be maintained for the entire period required by federal tax law. Records may be stored in either hard copy or electronic format

The Bond Compliance Coordinator monitors IRS guidance and other developments in the law relating to record retention (based on contacts with counsel, attendance at conferences or other means) and, in consultation with the Bond Compliance Committee, shall modify these procedures in accordance with any such guidance and developments.

With respect to records relating to tax-exempt bonds, these procedures supersede any of the University's general record retention procedures that may be less stringent.

Published by Capital Financing, November 2010

Reviewed by Capital Financing Committee, March 2011

Reviewed by Post Issuance Bond Compliance Committee, March 2011

Formalized by Post Issuance Bond Compliance Committee, September 2011

This policy was written from a template provided by *Post-Issuance Bond Compliance: A Guide to Practical Strategies and Procedures for 501(c)(3) Borrowers* (the "Guide") written by Ropes & Gray LLP. Copyright material purchased in June 2010.