

COMMISSION ADOPTED POLICY
Post-Issuance Tax Compliance



Adopted: March 27, 2012

Revised: March 28, 2023

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1.0 Purpose and Need

Hampton Roads Sanitation District ("HRSD") from time-to-time issues tax-exempt bonds and other "tax-advantaged" obligations (collectively "Tax-Advantaged Bonds"¹) to raise funds to finance and refinance various capital improvements of HRSD. These procedures (the "Post-Issuance Compliance Procedures") have been adopted by HRSD to assist it in monitoring compliance with certain rules applicable to Tax-Advantaged Bonds in order to preserve their tax-advantaged status. These Post-Issuance Compliance Procedures specifically cover:

- (1) record retention;
- (2) limitations on "private loans" and "private business use," including in particular the rules relating to the taking of "remedial action" to preserve the status of an issue of Tax-Advantaged Bonds; and
- (3) limitations on earning arbitrage, including the payment of arbitrage rebate to the federal government at various intervals (the "Rebate Requirement").

HRSD recognizes that the various tax-related limitations, including the above-mentioned limitations, are based on the provisions of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"), and the regulations of the U.S. Treasury promulgated thereunder (the "Treasury Regulations").

These Post-Issuance Compliance Procedures are intended to document and supplement existing practices and describe various procedures and systems implemented and to be implemented to demonstrate compliance with the requirements that must be satisfied before and after the issuance of Tax-Advantaged Bonds. Compliance with applicable provisions of the Internal Revenue Code and the Treasury Regulations is an ongoing requirement and an integral component of HRSD's debt management program. Accordingly, implementation of these Post-Issuance Compliance Procedures will require ongoing surveillance through, and sometimes beyond, the final maturity of Tax-Advantaged Bonds and may require on-going consultation with bond counsel after the issuance of particular obligations.

¹ Reference to Tax-Advantaged Bonds herein includes tax-exempt bonds and other tax-advantaged obligations issued by other governmental entities, e.g., Virginia Resources Authority, the proceeds of which are loaned to HRSD to finance or refinance various capital improvements of HRSD, and other forms of borrowing, e.g., leases entered into to purchase equipment, revolving credit arrangements, and private loans advanced by a local bank.

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These Post-Issuance Compliance Procedures are intended to reflect best practices, to be revised periodically as circumstances warrant, including changes in federal tax law, and as the municipal bond market and Internal Revenue Service ("IRS") enforcement each evolve. Given the scope and complexity of HRSD's financings, compliance with these Post-Issuance Compliance Procedures will require ongoing review and refinement. Failure to conform to any element of these Post-Issuance Compliance Procedures, however, should in no way imply that HRSD is not in compliance with the provisions of the Internal Revenue Code applicable to its Tax-Advantaged Bonds. In addition, the Tax Compliance Designee (defined below) is authorized to deviate from strict compliance with these Post-Issuance Compliance Procedures to the extent necessary to carry out the intent and purpose of the Post-Issuance Compliance Procedures and provided such deviations do not jeopardize the tax-advantaged status of any Tax-Advantaged Bonds.

2.0 Definitions

Construction Contracts and Other Purchases of Capital Assets: A contract with a Nongovernmental Person to construct capital assets or to sell capital assets to HRSD does not generally result in Private Use unless the Nongovernmental Person is providing additional services in connection with such contract, *e.g.*, construction management or consulting services, or has some other special legal entitlement or special economic benefit with respect to such capital assets. Such services, special legal entitlement or special economic benefit with respect to bond financed property must be analyzed for Private Use.

Leases of bond financed property: All leases of bond financed property to a Nongovernmental Person constitute Private Use of such property unless an exception for short term use is satisfied.

Management and Service Contracts: With respect to management and service contracts, the determination of whether a particular contract results in Private Use shall be based on the application of the Code and Treasury Regulations, including particularly Revenue Procedure 2017-13, 2017-6 I.R.B. 787 ("Revenue Procedure 2017-13"), and, for any management and service contract entered into before August 18, 2017 and not materially modified or extended on or after such date, such determination may be made on the basis of applying Revenue Procedure 97-13, 1997-1 C.B. 632, as amended by Revenue Procedure 2001-39, 2001-2 C.B. 38, and as amplified by Notice 2014-67, 2014-46 I.R.B. 822 (collectively, "Revenue Procedure 97 13" and referred to collectively with Revenue Procedure 2017-13 as the "Management Contract Safe

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Harbors”). Such management and service contracts include, but are not limited to, operating agreements, construction management agreements, business services agreements, technical consulting services agreements and other similar agreements. Further, for purposes of determining the nature of a Private Use, any management or service contract that is properly characterized as a lease for federal income tax purposes is treated as a lease. Consequently, any such agreements, even though referred to as a management or service contract may nevertheless be treated as a lease. In determining whether a management or service contract is properly characterized as a lease, it is necessary to consider all of the facts and circumstances, including, but not limited to, the following factors:

- the degree of control over the property that is exercised by a Nongovernmental Person; and
- whether a Nongovernmental Person bears risk of loss of the financed or refinanced property.

Materials and Commodity Supply Contracts: A contract or purchase order for materials, commodities, inventory or other supplies from a Nongovernmental Person does not generally result in Private Use unless there are additional services being provided by the Nongovernmental Person in connection with the contracts, *e.g.*, consulting services. Such service arrangements with respect to bond financed property must be analyzed for Private Use under the Management Contract Safe Harbors.

Nongovernmental Person: Any person or entity other than a state or local government entity. State and local governments used herein are governmental entities. The United States of America (including any federal agencies) and non-profit corporations, including charitable organizations exempt from tax under Section 501(c)(3) of the Code, are Nongovernmental Persons.

Nonpossessory Incidental Use: Any nonpossessory incidental use such as vending machines, bank machines and similar uses may be excluded from the Private Use rules if the nonpossessory use is not functionally related to any other use of the bond financed facility by the same person and all such nonpossessory uses of the financed facility do not in the aggregate involve the use of more than 2.5% of facility. Such use of bond financed property shall be tracked by Tax Compliance Designee.

Ownership of bond financed property: If bond financed property is owned by a Nongovernmental Person, either in name or in substance pursuant to the

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federal income tax rules, such ownership will be considered Private Use of the asset for purposes of the Private Use rules.

Private Payments: For purposes of these Post-Issuance Compliance Procedures, "Private Payments" means payments derived, directly or indirectly, in respect of property used or to be used for Private Use. As an example, if there is Private Use with regard to a facility of HRSD as a result of a non-complying management contract and HRSD customers make payments with respect to such facility, such payments may be treated as Private Payments.

Private Use: For purposes of these Post-Issuance Compliance Procedures, the term "Private Use" means any activity that constitutes a trade or business that is carried on by Nongovernmental Persons. Any activity carried on by a person other than a natural person is treated as a trade or business. Any asset financed with Tax-Advantaged Bonds not owned by a Governmental Entity will be considered to be used in a Private Use.

In most cases, Private Use will occur only if a Nongovernmental Person has a special legal entitlement to use the bond financed property. Such a special legal entitlement includes ownership or actual or beneficial use pursuant to a lease, management, service or incentive payment contract, output contract, research agreement or similar arrangement. Private Use may also be established solely on the basis of a special economic benefit to one or more Nongovernmental Person.

Short-Term Use Exception: Arrangements fitting within either of the following two exceptions will not result in Private Use unless the property is financed for the principal purpose of providing that property for use by that Nongovernmental Person.

(1) ***100 Day Exception - Use Pursuant to Generally Applicable and Uniformly Applied Rates:*** An arrangement will not result in Private Use if:

- (a) the arrangement does not transfer ownership for federal income tax purposes of the property to a Nongovernmental Person,
- (b) the term of the use under the arrangement, including all renewal options, is not longer than 100 days, and

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(c) the arrangement would be treated as general public use, except that it is not available for use on the same basis by natural persons not engaged in a trade or business because generally applicable and uniformly applied rates are not reasonably available to natural persons not engaged in a trade or business.

(2) ***50 Day Exception - Use Pursuant to Negotiated Arm's Length Arrangements:*** An arrangement will not result in Private Use if:

- (a) the arrangement does not transfer ownership for federal income tax purposes of the property to a Nongovernmental Person,
- (b) the term of the use under the arrangement, including all renewal options, is not longer than 50 days, and
- (c) the arrangement is a negotiated arm's-length arrangement and compensation under the arrangement is at fair market value.

Special Priority Rights or Special Economic Benefits: A contract that conveys special priority rights or special economic benefits in bond financed property to a Nongovernmental Person may create Private Use. In determining whether special economic benefit gives rise to Private Use of bond financed property, it is necessary to consider all of the facts and circumstances, including, but not limited to, one or more of the following factors:

- whether the bond financed property is functionally related or physically proximate to property used in the trade or business of a Nongovernmental Person;
- whether only a small number of Nongovernmental Persons receive the economic benefit; and
- whether the cost of the bond financed property is treated as depreciable by the Nongovernmental Person.

Such arrangements with respect to bond financed property must be reviewed by bond counsel.

3.0 Procedures

3.1 Guiding Principles

Policies and Post-Issuance Compliance Procedures Generally: HRSD's Director of Finance shall be responsible for monitoring tax compliance with regard to HRSD's debt offerings (the "Tax Compliance Designee"). The Tax Compliance Designee shall also be responsible for ensuring an adequate succession plan for transferring tax compliance responsibilities when changes in staff occur.

The Tax Compliance Designee needs to review the tax compliance procedures and systems on a periodic basis (e.g., annually), and consult with the General Manager and bond counsel as appropriate and as needed.

3.2 Private Use, Change in Use and Remedial Action

1. Private Use Generally

Tax-Advantaged Bonds may lose their tax status if they meet either:

- the private business use test in Section 141(b)(1) of the Internal Revenue Code, and
- the private security or payment test in Section 141(b)(2) of the Internal Revenue Code, or
- the private loan financing test in Section 141(c) of the Internal Revenue Code.

The private business use test relates to the use of the proceeds of an issue and the test is met if more than the lesser of (1) \$15,000,000 and (2) 10%² of the proceeds of an issue meet the private business use test. Generally, private business use arises if proceeds of an issue are used by Nongovernmental Persons in a trade or business ("Private Use"). It is necessary to look to direct and indirect uses as well as actual and beneficial uses. In most cases, Private Use arises if a Nongovernmental Person has special legal entitlements with respect to financed property.

² Such ten percent limitation is reduced to five percent with respect to Private Use that is either unrelated to governmental uses of proceeds of the same issue, or disproportionate to related governmental uses of proceeds of such issue.

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Private payments include revenues derived, directly or indirectly, with respect to property used or to be used for a Private Use ("Private Payments"). Private security takes into account the payment of debt service on an issue that is directly or indirectly secured by any interest in property used or to be used for a Private Use.

The private loan financing test is met if more than the lesser of:

- (1) \$5,000,000, and
- (2) 5% of the proceeds of an issue is or are to be used, directly or indirectly, to make or finance loans to Nongovernmental Persons ("Private Loan")³.

In addition to these procedures, the Tax Compliance Designee shall refer to the Tax Certificate executed for a particular issue of Tax-Advantaged Bonds for purposes of ascertaining the application of the private business tests and the private loan financing test to such issue of Tax-Advantaged Bonds. The Tax Compliance Designee shall also consult with bond counsel as appropriate for clarification and guidance with respect to the application of such tests.

The following are specific HRSD policies with respect to addressing Private Use.

- a. *Structuring of Arrangements to Avoid Private Use or Private Payments.* It is the policy of HRSD that, to the extent consistent with the business objectives of HRSD, any potential arrangement that might result in Private Use of bond financed property shall be structured so as to avoid or minimize Private Use or Private Payments.
- b. *Structuring of Arrangements to Avoid Private Loans.* It is the policy of HRSD that, to the extent consistent with the business objectives of HRSD, any potential arrangement with respect to bond financed property that might result in a direct or indirect loan of bond

³ Such arrangements may include arrangements in which the Nongovernmental Person leases the bond financed property and is the owner for federal income tax purposes, or installment sales of bond financed property to Nongovernmental Persons.

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proceeds to a Nongovernmental Person shall be structured so as to avoid or minimize the amount of such loan.

- c. *Allocating Equity or Taxable Debt to Capital Improvement Program Components with Private Use or Private Payments.* If an arrangement cannot be structured so as to avoid Private Use, Private Payments or Private Loan, it is the general policy of HRSD to use its equity or proceeds of debt that is not tax-advantaged, to finance the subject property.
- d. *Allocation of Bond Proceeds to Assets Financed.* For each issue of Tax-Advantaged Bonds, HRSD shall maintain records establishing costs financed. In addition, to the extent any improvements are financed with taxable debt that HRSD anticipates to be refinanced with the proceeds of Tax-Advantaged Bonds, HRSD shall maintain records establishing the costs of the capital improvements financed by such taxable debt. Guidelines for allocating proceeds to expenditures/costs are set forth in Treasury Regulations Sections 1.141-6 and 1.148-6.

Generally, HRSD must account for the allocation of proceeds to expenditures (final allocations) not later than 18 months after the later of:

- the date the expenditure is paid, and
 - the date the project that is financed by the issue is placed in service but in no event later than the date 60 days after the fifth anniversary of the respective issue date or the date 60 days after the retirement of the issue, if earlier.
- e. *Contract Log.* A listing of the ownership arrangements, leases, management contracts, output contracts, research agreements, other arrangements that convey special legal entitlements, arrangements with special economic benefits, and other contractual arrangements with respect to the Tax-Advantaged Bonds shall be developed and maintained substantially in the form attached hereto as Schedule 1 (referred to as the "Contract Log").

Each item listed in the Contract Log shall set forth the issue or issues of Tax-Advantaged Bonds that financed property used in connection with such arrangement, the amount of proceeds of such

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issue allocable to such property, and the amount of payments, if any, expected with respect to such arrangement, net of the incremental costs incurred by HRSD to operate and maintain the facility as a result of such arrangement.

- f. *Quantifying Private Use and Periodic Review.* HRSD will monitor compliance with the private business tests and the private loan financing tests and develop and maintain a log with respect to each issue of Tax-Advantaged Bonds, either separate and apart from or part of the Contract Log and Disposition Log, and periodically (e.g., annually), set forth the amount of proceeds of such issue allocable to each separate facility financed by HRSD, and the amount of proceeds of such issue attributable to Private Use and Private Loan.
- g. *Dispositions.* HRSD policies with respect to dispositions of HRSD property are addressed in the HRSD Procurement Manual and appendices thereto (the "Surplus Property Procedures"). It is the policy of HRSD that all dispositions of bond-financed property are to be addressed in a manner that does not jeopardize the tax-advantaged status of obligations issued by or for the benefit of HRSD. In furtherance of this policy, HRSD personnel responsible for implementing the Surplus Policy Procedures are required to be familiar with the requirements of these Post Issuance Compliance Procedures and are to receive training as necessary. If capital assets financed or refinanced with Tax-Advantaged Bonds are to be transferred to another state or local governmental entity (a "Governmental Transferee"), such Governmental Transferee shall also be required to comply with the private business use and private loan limits.

2. Remedial Action and Voluntary Compliance Agreement Program

Even though HRSD reasonably expects on the issue date of each issue of Tax-Advantaged Bonds to satisfy all applicable federal tax requirements relating to such bonds for so long as the bonds remain outstanding, post-issuance events can occur that jeopardize compliance with these requirements. As a private business use example, property financed with Tax-Advantaged Bonds that is leased to a private party may be contrary to the private business tests. Such lease may be entered into out of necessity or without an understanding that it may be contrary to the

private business tests. As an arbitrage example, HRSD may inadvertently violate an applicable yield restriction.

In the event HRSD does not stay within the limitations of the private business tests, the private loan financing tests, or the arbitrage requirements described herein, the Tax Compliance Designee shall work with bond counsel to take appropriate steps to preserve the tax-advantaged status of the respective bond issue, including taking appropriate "remedial action" pursuant to Section 1.141-12 of the Treasury Regulations. Remedial action for this purpose may consist of the redemption or defeasance of bonds and/or the investment/expenditure of amounts received as a result of the sale of bond financed property in other qualified capital improvements of HRSD. HRSD may also be able to take corrective action under the Voluntary Compliance Agreement Program of the IRS (commonly referred to as VCAP). The Tax Compliance Designee shall maintain copies of the documentation with respect to the remedial action.

3.3 Arbitrage and Rebate

Section 148 of the Internal Revenue Code, the regulations promulgated thereunder and pronouncements relating thereto (the "Arbitrage Rules") are intended to ensure that issuers of Tax-Advantaged Bonds, such as HRSD, issue Tax-Advantaged Bonds for the primary purpose of financing property needed to carry out its governmental purposes, and not for the purpose of exploiting the difference between the tax exempt and taxable interest rates. Compliance with the Arbitrage Rules requires that:

- (a) proceeds of Tax-Advantaged Bonds are not invested at a yield in excess of the yield of the Tax-Advantaged Bonds unless an exception applies, and
- (b) even if an issuer is permitted to invest the proceeds at a higher yield pursuant to an exception, the excess of the aggregate amount earned on all investments over the amount that would have been earned if such investments had a yield equal to the yield of the Tax-Advantaged Bonds, plus any income attributable to such excess must be rebated to the United States Treasury unless an exception applies.

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The Tax Compliance Designee shall undertake the following actions in furtherance of complying with the Arbitrage Rules:

1. Refer to the Tax Certificate executed for a particular issue of Tax-Advantaged Bonds for purposes of ascertaining the application of the Arbitrage Rules to such issue of Tax-Advantaged Bonds.
2. Consult with bond counsel as appropriate for clarification and guidance with respect to application of the Arbitrage Rules.
3. Review these Post-Issuance Compliance Procedures with bond counsel periodically (e.g., annually) and refine and update the procedures as needed.
4. Ensure that adequate records are established and maintained to set forth the date, amount and nature of each expenditure of the Bond Proceeds of each issue of Tax-Advantaged Bonds and investment earnings thereon. Specifically, a record of the following is to be established and maintained for each investment of Bond Proceeds:
 - the purchase date,
 - the purchase price,
 - information establishing that the purchase price is the fair market value as of such date (e.g., the published quoted bid by a dealer in such an investment on the date of purchase),
 - any accrued interest paid,
 - the face amount,
 - the coupon rate,
 - periodicity of interest payments,
 - disposition price,
 - any accrued interest received, and
 - disposition date.
5. Monitor the expenditure of Bond Proceeds of each issue of Tax-Advantaged Bonds and any investment earnings thereon.
6. Maintain a procedure for the allocation of proceeds of each issue of Tax-Advantaged Bonds and investment earnings to expenditures, including the reimbursement of pre-issuance expenditures.

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7. Consult with and seek the assistance of HRSD's financial advisor as needed to comply with and memorialize compliance with the requirements set forth in these Post-Issuance Compliance Procedures.
8. Engage a firm with expertise in the area of arbitrage rebate compliance (the "Rebate Consultant") with respect Tax-Advantaged Bonds to arrange, as necessary, for the monitoring of Bond Proceeds expenditure for compliance with various expenditure exceptions and timely computation of arbitrage rebate or arbitrage yield reduction liability.
9. If rebate or a yield reduction payment is due to the IRS, arrange for the timely filing of Form 8038-T and the payment of such rebate liability.
10. Prior to engaging in any post-issuance credit enhancement transactions (e.g., bond insurance, letter of credit) or hedging transactions (e.g., interest rate swaps, caps), the Tax Compliance Designee is to consult with bond counsel.
11. In the case of refunding bonds, the Tax Compliance Designee should consult with bond counsel and coordinate with HRSD's financial advisor, the bond trustee or escrow agent to arrange for the purchase of the refunding escrow securities and should obtain a computation of the yield on such escrow securities from HRSD's outside arbitrage rebate specialist.

3.4 Reissuance

Generally, a reissuance occurs when there are significant changes to the terms of a bond so that the bond ceases to be the same bond for federal tax purposes. A reissuance is a *deemed exchange* of the modified bond for the original bond and is treated as a new debt issuance for federal income tax purposes.

The Tax Compliance Designee is to:

- (a) identify and consult with bond counsel regarding any post-issuance change to any terms of an issue of Tax-Advantaged Bonds,

- (b) request bond counsel to determine whether such potential change would cause the bond issue to be treated as “reissued” for federal income tax purposes, and
- (c) take such action as may be required to the preserve the tax-advantaged status of the subject obligations.

3.5 Records Retention

The Tax Compliance Designee is to coordinate procedures for record retention and review of such records as more fully described herein and shall be familiar with IRS Forms 8038-G, 8038-B, 8038-TC, 8038-CP, and relevant provisions of the Internal Revenue Code and the Treasury Regulations, including but not limited to Treasury Regulations Sections 1.141-2, 1.141-3, 1.141-12, and 1.148-1 through 1.150-2.

Commonwealth of Virginia statutes also address record retention requirements (the “Virginia Record Retention Requirements”). These Post-Issuance Compliance Procedures are independent of the Virginia Record Retention Requirements. It is HRSD’s policy and intention to fully comply with both the federal requirements applicable to Tax Advantaged Bonds and the Virginia Record Retention Requirements.

Retention of Record: In addition to the preparation and maintenance of the Contract Log described above, HRSD is to retain the following documentation (the “Records”):

- a. All legal and accounting documents relating to proceeds of the Tax-Advantaged Bonds, including opinions of counsel and the tax certificate with respect to each issue of Tax-Advantaged Bonds.
- b. Expenditure of proceeds of Tax-Advantaged Bonds as described below:
 - Documents evidencing the expenditure of the proceeds of the Tax-Advantaged Bonds and investment earnings thereon and the specific assets financed with such proceeds, including projected draw schedules and invoices (e.g., records with respect to the bond accounts and funds);
 - Documents setting forth all funds and accounts relating to the Tax-Advantaged Bonds;

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- Documents pertaining to the investment of the proceeds of the Tax-Advantaged Bonds (e.g., records with respect to the bond accounts and funds), including the purchase and sale of securities, guaranteed investment contracts, and swap/hedge transactions; and
 - With respect to all investments acquired in any fund or account in connection with the Tax-Advantaged Bonds, the specific information set forth under the heading "Arbitrage and Rebate" herein.
- c. Documents evidencing any allocations with respect to the proceeds of the Tax-Advantaged Bonds.
- d. Documents evidencing the use and ownership of the bond financed property, including contracts for the use of such property (e.g., the Contract Log described herein, and documents evidencing the sale or other disposition of the bond financed property.
- e. Copies of the documentation with respect to any remedial actions.

Required Retention Period: HRSD will retain the Records until the date that is six years after the complete retirement of the related Tax-Advantaged Bonds.

Form of Records: HRSD will keep all records in a manner that ensures complete access thereto for the applicable above-described period either in hard copy or electronic format. Records kept in electronic format, shall comply with Revenue Procedure 97-22, 1997-1 C.B. 652 (or subsequent guidance provided by the Internal Revenue Service), which provides guidance for maintaining books and records by using an electronic storage system that either images their hardcopy books and records or transfers their computerized books and records to an electronic storage media (e.g., an electronic data compression system).

3.6 Training and Periodic Review of Post-Issuance Compliance Procedures

HRSD personnel are to periodically obtain training with regard to the record retention, private business use, arbitrage and rebate issues addressed by these Post-Issuance Tax Compliance Procedures. The training shall include a review of HRSD's recent compliance initiatives, discussions relating to restrictions on the use of proceeds of Tax-Advantaged Bonds, arbitrage requirements and recent developments with respect to Tax-Advantaged Bonds. Training is especially warranted in the event of changes in law or changes in HRSD staff.

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HRSD shall periodically (e.g., annually) review its post-issuance compliance efforts and these Post-Issuance Compliance Procedures and consult with bond counsel with regard to updates or changes that may be warranted.

Approved:



Stephen C. Rodriguez
Commission Chair

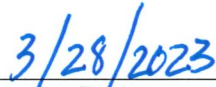


Date

Attest:



Jennifer L. Cascio
Commission Secretary



Date

