

1.0 Purpose and Need

Hampton Roads Sanitation District (the “HRSD”) from time to time issues tax-exempt bonds and other “tax-advantaged” bonds (collectively “Tax-Advantaged Bonds”) to raise funds to finance 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 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 consultation with legal counsel beyond the initial engagement for the issuance of particular obligations.

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 additional services are being provided by the Nongovernmental Person in connection with such contract, *e.g.*, construction management or consulting services. Such services with respect to bond financed property must be analyzed for Private Use under Revenue Procedure 97-13.

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 97-13, 1997-1 C.B. 632, as amended by Revenue Procedure 2001-39, 2001-2 C.B. 39 ("Revenue Procedure 97-13"). 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 the following factors: (i) the degree of control over the property that is exercised by a Nongovernmental Person; and (ii) 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 Revenue Procedure 97-13.

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 is not treated as a governmental entity.

Nonpossessory Incidental Use: Any nonpossessory incidental use such as vending machines, bank machines and similar uses may be excluded from the Private Use rules

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to the extent of 2.5% of an issue of Tax-Advantaged Bonds. 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, 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.

1. Use Pursuant to Generally Applicable and Uniformly Applied Rates: Use pursuant to an arrangement will not result in Private Use if (A) the arrangement does not transfer ownership 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 (C) compensation under the arrangement is based on generally applicable and uniformly applied rates.

2. Use Pursuant to Negotiated Arm's Length Arrangements: Use pursuant to an arrangement will not result in Private Use if (A) the arrangement does not transfer ownership 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 which 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 one or more of the following factors: (a) whether the bond financed property is functionally related or physically proximate to property used in the trade or business of a Nongovernmental Person; (b) whether only a small number of Nongovernmental Persons receive the economic benefit; and (c) 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

1. 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 (1) (a) the private business use test in Section 141(b)(1) of the Internal Revenue Code, and (b) the private security or payment test in Section 141(b)(2) of the Internal Revenue Code, or (2) 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%¹ 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 persons or

¹ 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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entities other than state or local governmental entities (“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. 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.

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 which might result in Private Use of bond financed property shall be structured so as to avoid or minimize Private Use or Private Payments.
- b. *Allocating Equity to Capital Improvement Program Components with Private Use or Private Payments.* It is the general policy of HRSD that to the extent an arrangement that might result in Private Use cannot be structured so as to avoid Private Use or Private Payments, HRSD will use its equity, or proceeds of debt that is not tax-advantaged, to finance the subject property.
- c. *Allocation of Bond Proceeds to Assets Financed.* For each issue of Tax-Advantaged Bonds, HRSD shall maintain records establishing costs financed. Guidelines for allocating proceeds to expenditures/costs are set forth in Treasury Regulations Sections 1.141-6 and 1.148-6.
 - i. *Final Allocations.* Generally, HRSD must account for the allocation of proceeds to expenditures not later than 18 months after the later of (i) the date the expenditure is paid or (ii) 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.

- d. *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 issued by HRSD 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 (i) the issue or issues of Tax-Advantaged Bonds that financed property used in connection with such arrangement, (ii) the amount of proceeds of such issue allocable to such property, and (iii) 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.

- e. *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.
- f. *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.

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, HRSD may lease property financed with governmental bonds to a private party in a manner 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 the 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 by HRSD to carry out its governmental purposes, and not for the purpose of exploiting the difference between the interest cost to HRSD on the Tax-Advantaged Bonds and the yield on higher yielding taxable obligations. Section 148(f) of the Internal Revenue Code, which sets forth the “Rebate Requirement,” requires that an amount equal to the sum of (i) 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 with respect to the respective Tax-Advantaged Bonds, plus (ii) any income attributable to the excess described in (i), be paid to the United States Treasury.

Compliance with the Arbitrage Rules is required on a continuing basis and primarily involves ensuring that proceeds of Tax-Advantaged Bonds (“Bond Proceeds”) are invested in accordance with the applicable yield limitations, and rebating certain investment earnings to the United States Treasury, unless an exception to the Rebate Requirement can be satisfied.

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.

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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 are to be established and maintain for each investment of Bond Proceeds: (i) the purchase date, (ii) the purchase price, (iii) 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), (iv) any accrued interest paid, (v) the face amount, (vi) the coupon rate, (vii) periodicity of interest payments, (viii) disposition price, (ix) any accrued interest received, and (x) disposition date.
5. For each issue of fixed rate Tax-Advantaged Bonds, obtain a computation of the yield on such issue from HRSD's financial advisor, and obtain from bond counsel the Tax Certificate and a listing of all arbitrage yield restrictions attributable to Bond Proceeds or amounts treated as Bond Proceeds of each such issue. The tax certificate will typically contain the information described in the preceding sentence.
6. For each issue of variable rate Tax-Advantaged Bonds, obtain from bond counsel the Tax Certificate and a listing of all arbitrage yield restrictions attributable to Bond Proceeds or amounts treated as Bond Proceeds of each such issue.
7. Maintain with respect to each issue of Tax-Advantaged Bonds a schedule setting forth:
 - a. The latest date the Bond Proceeds of each issue may be invested at an unrestricted yield;
 - b. The benchmarks that must be satisfied in order to meet exceptions to the arbitrage rebate requirements (a general description of the rebate exceptions is set forth in Appendix C attached hereto); and
 - c. The dates on which any arbitrage rebate computations are required to be completed and arbitrage rebate is required to be paid to the United States Treasury.

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8. Monitoring the expenditure of Bond Proceeds and any investment earnings, which monitoring shall include obtaining and reviewing monthly reports of the expenditure and investment of proceeds of each issue of Tax-Advantaged Bonds.
9. 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.
10. 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.
11. 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 (described in Appendix A) and timely computation of arbitrage rebate or arbitrage yield reduction liability.
12. 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.
13. 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.
14. In the case of refunding bonds, the Tax Compliance Designee should 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 for federal income tax purposes. The reissuance rules apply to all Tax-Advantaged Bonds, from a large bond issue, a loan from Virginia Resources Authority, a small lease entered into to purchase equipment and to a note held by a local bank.

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 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 not intended to conflict with 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.

1. Retention of records

Retention of Record: As described above, HRSD is to prepare and maintain the Contract Log, which summarizes potential Private Uses to HRSDs Tax-Advantaged Bonds. In addition, 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.
 - i. 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);
 - ii. Documents setting forth all funds and accounts relating to the Tax-Advantaged Bonds;

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- iii. 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;
- iv. 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; and
- 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. If the records are kept in electronic format, compliance is necessary with the requirements of 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.

3.7 Additional Resources

Additional resources available to HRSD include the following, accessible on the internet.

<u>Item</u>	<u>Description</u>
IRS Publication 3755	Addresses filing requirements applicable to tax-exempt bonds (e.g., 8038-G and 8038-T)
IRS Publication 4079	IRS Tax-Exempt Governmental Bonds Compliance Guide
http://www.irs.gov/taxexemptbond/	IRS website providing Information for the Tax Exempt Bond Community

Approved:

Vishnu K. Lakdawala, Ph.D.
Commission Chairman

3-27-2012

Date

Attest:

Jennifer L. Heilman
Commission Secretary

3-27-2012

Date

APPENDIX A

1. BONA FIDE DEBT SERVICE FUND EXCEPTION

Amounts earned on money in a bona fide debt service fund shall not be taken into account for a bond year for purposes of complying with the Rebate Requirement. For purposes of complying with the Rebate Requirement with respect to issues other than as described in the preceding sentence, amounts earned on money in a bona fide debt service fund shall not be taken into account for a Bond Year if the gross earnings thereon are less than \$100,000; an issue with an average annual debt service not in excess of \$2,500,000 may be treated as satisfying this \$100,000 limitation. A bona fide debt service fund is defined as a fund that (a) is used primarily to achieve a proper matching of revenues with principal and interest payments within each bond year, and (b) is depleted at least once each bond year, except for a reasonable carryover amount not to exceed the greater of the earnings on the fund for the immediately preceding bond year or one-twelfth of the principal and interest payments on the issue for the immediately preceding bond year.

2. EXPENDITURE EXCEPTIONS

The "Six-Month Exception" to rebate is set forth in subsection (a) below and the "Eighteen-Month Exception" to rebate is set forth in subsection (b) below. The "Two-Year Exception" to rebate, available only with respect to "available construction proceeds," is set forth in subsections (c) and (d) below.

a. Six-Month Exception

- i. In General. The Six-Month Exception will be treated as having been satisfied if (A) all "Gross Proceeds"² of the Tax-Advantaged Bonds are allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds no later than the date that is six months after the date of issuance of the Tax-Advantaged Bonds, and (B) the Rebate Requirement is satisfied with respect to [1] other Gross Proceeds that arise after six months from the

² Gross Proceeds means proceeds and replacement proceeds, within the meaning of Treasury Regulation Section 1.148-1. Under Section 1.148-1 of the Treasury Regulations, proceeds are amounts derived from the sale of the Tax-Advantaged Bonds, investment earnings thereon and transferred proceeds of an issue. Under Section 1.148-1 of the Treasury Regulations, amounts are replacement proceeds of an issue if the amounts have a sufficiently direct nexus to the issue or to the governmental purpose of the issue to conclude that the amounts would have been used for that governmental purpose if the proceeds of the issue were not used or to be used for that governmental purpose. Replacement proceeds are more fully described in Section 1.148-1(c) and include, but are not limited to, sinking funds, pledged funds, and "other replacement proceeds."

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date of issue but that are not reasonably anticipated to arise as of the date of issue, [2] repayment of any grants made with proceeds of the Tax-Advantaged Bonds, [3] sale or investment proceeds on payments under a purpose investment, and [4] amounts on deposit in a reasonably required reserve or replacement fund, if any.

- ii. Gross Proceeds. For purposes of meeting clause (i) above, the term Gross Proceeds excludes (A) amounts on deposit in the Bond Fund, (B) other Gross Proceeds that arise after six months from the date of issue but that are not reasonably anticipated to arise as of the date of issue, (C) repayment of any grants made with proceeds of the Tax-Advantaged Bonds, (D) sale or investment proceeds on payments under any purpose investment, and (E) amounts on deposit (if any) in a reasonably required reserve or replacement fund, as defined in Treasury Regulation Section 1.148-7(b)(5).
- iii. Additional Six Months for Non-Private Activity Bonds. The Six-Month Exception will be treated as satisfied if, in addition to satisfying subparagraph (ii) of this subsection (a), all Gross Proceeds of the Tax-Advantaged Bonds are expended as provided in paragraph (i) of this subsection (a) except for an amount of Gross Proceeds that does not exceed the lesser of five percent (5%) of the proceeds of the Tax-Advantaged Bonds and \$100,000 and such unexpended amount of Gross Proceeds is expended within one year from the date of issuance of the Tax-Advantaged Bonds.

b. Eighteen-Month Exception

- i. In General. The Eighteen-Month Exception will be treated as having been satisfied if (A) all Eighteen-Month Moneys (as defined in paragraph (ii) below) meet the Eighteen-Month Test, (B) the Rebate Requirement is satisfied with respect to all Gross Proceeds of the Tax-Advantaged Bonds other than Eighteen-Month Moneys and amounts on deposit in a bona fide debt service fund for the Tax-Advantaged Bonds, and (C) all Eighteen-Month Moneys qualify for the three (3) year temporary period set forth in Section 1.148-2(e)(2) of the Treasury Regulations.
- ii. Eighteen-Month Moneys. For purposes of meeting paragraph (b)(iii) below, the term "Eighteen-Month Moneys" means all Gross Proceeds of the Tax-Advantaged Bonds other than (A) amounts on deposit in a bona fide debt service fund, (B) Gross Proceeds of

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the Tax-Advantaged Bonds that arise after eighteen (18) months from the date of issue but are not reasonably anticipated to arise as of the date of issue, (C) repayment of grants financed with proceeds of the Tax-Advantaged Bonds, (D) sale or investment proceeds derived from payments under any purpose investment of the Tax-Advantaged Bonds, and (E) any amounts on deposit in a reasonably required reserve or replacement fund, as defined in Treasury Regulation Section 1.148-7(b)(5). For purposes of complying with the first two spending periods set forth in paragraph (b) (iii) below, above, the estimated amount of investment earnings as of the issue date (based on reasonable expectations) are to be included in the gross proceeds of the issue.

- iii. Eighteen-Month Test. To meet the Eighteen-Month Test, (A) at least fifteen percent (15%) of the Eighteen-Month Moneys have been allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within the six (6) month period beginning on the date of issuance of the Tax-Advantaged Bonds, (B) at least sixty percent (60%) of the Eighteen-Month Moneys have been allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within the one (1) year period beginning on the date of issuance of the Tax-Advantaged Bonds and (C) all of the Eighteen-Month Moneys have been expended for the governmental purposes of the Tax-Advantaged Bonds within the eighteen (18) month period beginning on the date of issuance of the Tax-Advantaged Bonds.
- iv. Reasonable Retainage. For purposes of paragraph (iii) of this subsection (b), an issue will not fail to satisfy the spending requirement for the third spending period as a result of a reasonable retainage if such amount is allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within thirty (30) months from the date of issuance of the Tax-Advantaged Bonds. For purposes of this paragraph (iv), a reasonable retainage is an amount retained for reasonable business purposes relating to the property financed with the proceeds of the Tax-Advantaged Bonds, *e.g.*, a retention to ensure compliance with a construction contract in circumstances in which the amount retained is not yet payable or in which the Issuer reasonably determines that a dispute exists regarding completion of payment, and shall not exceed five percent (5%) of the net sale proceeds of the Tax-Advantaged Bonds minus \$100,000.

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v. De Minimis Exception. Any failure to satisfy the final spending requirement of the Eighteen-Month Exception is disregarded if the Issuer exercises due diligence to complete the project and the amount of the failure does not exceed the lesser of three percent (3%) of the issue price of the Tax-Advantaged Bonds and \$250,000.

c. Two-Year Exception

i. 75 Percent Test. The Issuer reasonably expects as of the issue date of the Tax-Advantaged Bonds that at least seventy-five percent (75%) of the “available construction proceeds” (defined below) of the Tax-Advantaged Bonds will be allocated to construction expenditures (including reconstruction and rehabilitation) with respect to property that is owned by a governmental unit or an organization described in Section 501(c)(3) of the Code and exempt from federal income tax under Section 501(a) of the Code.

ii. Two Year Test. To meet the Two-Year Exception, (A) at least ten percent (10%) of the available construction proceeds of the Tax-Advantaged Bonds have been allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within the six (6) month period beginning on the date of issuance of the Tax-Advantaged Bonds, (B) at least forty-five percent (45%) of the available construction proceeds have been allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within the one (1) year period beginning on the date of issuance of the Tax-Advantaged Bonds, (C) at least seventy-five percent (75%) of the available construction proceeds of the Tax-Advantaged Bonds have been allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within the eighteen (18) month period beginning on the date of issuance of the Tax-Advantaged Bonds, and (D) all of the available construction proceeds of the Tax-Advantaged Bonds have been allocated to expenditures for the governmental purposes of the Tax-Advantaged Bonds within the two (2) year period beginning on the date of issuance of the Tax-Advantaged Bonds. For purposes of determining compliance with the first three spending periods described above, the estimated amount of investment earnings as of the issue date (based on reasonable expectations) are to be included in the gross proceeds of the issue.

d. Available Construction Proceeds

- i. In General. For purposes of subsection (c), the term “available construction proceeds” means an amount equal to the issue price of the Tax-Advantaged Bonds (or the portion thereof at least seventy-five percent (75%) of the available construction proceeds of which are to be used for the purposes described in paragraph (i) of subsection (c) above), plus investment earnings on the Tax-Advantaged Bonds or, where applicable, such portion thereof, plus investment earnings on any reasonably required reserve or replacement fund not funded from proceeds of the Tax-Advantaged Bonds, plus investment earnings on all of the above described investment earnings, minus the amount of the issue price of the Tax-Advantaged Bonds (or, where applicable, such portion thereof) deposited in the debt service reserve fund (if any) or to be applied to pay costs of issuance of the Tax-Advantaged Bonds (if any), minus pre-issuance accrued interest. The term “available construction proceeds,” however, shall not include payments on any obligation acquired to carry out the governmental purpose of the issue or the investment earnings thereon, and shall not include investment earnings on amounts on deposit in a debt service reserve fund, if any, after the earlier of two years from the date of issue or the date on which construction of the project is substantially completed.
- ii. Reasonable Retainage. For purposes of paragraph (ii) of subsection (c), all of the available construction proceeds of the Tax-Advantaged Bonds shall be treated as expended for the governmental purposes of the Tax-Advantaged Bonds within two (2) years from the date of issuance of the Tax-Advantaged Bonds if all of such proceeds are expended for the governmental purposes of the Tax-Advantaged Bonds within three (3) years from the date of issuance of the Tax-Advantaged Bonds and such amounts would have been expended for such purposes within two (2) years from the date of issuance of the Tax-Advantaged Bonds but for an amount that is retained for reasonable business purposes relating to property financed with the proceeds of the Tax-Advantaged Bonds and that amount retained does not exceed five percent (5%) of the available construction proceeds of the Tax-Advantaged Bonds as of the end of the fourth (4th) spending period referred to in paragraph (ii) of subsection (c) above. Reasonable retainage may include, for example, an amount retained to ensure compliance with the terms of a construction contract in circumstances in which the amount retained is not yet payable, or in which the Issuer reasonably

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determines that a dispute exists regarding either completion of construction or payment.

De Minimis Exception. Any failure to satisfy the final spending requirement of the Two-Year Exception is disregarded if the Issuer exercises due diligence to complete the project and the amount of the failure does not exceed the lesser of three percent (3%) of the issue price of the Tax-Advantaged Bonds and \$250,000.