UNIVERSITY OF HOUSTON SYSTEM
ADMINISTRATIVE MEMORANDUM

SECTION: Fiscal Affairs **NUMBER: 03.A.28**

AREA: General

SUBJECT: Tax-Exempt Bond Post-Issuance Compliance

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1. PURPOSE

This policy establishes the requirements and procedures for ensuring compliance with federal laws relating to the issuance and post-issuance monitoring of tax-exempt bonds.

The Board is authorized to issue tax-exempt bonds pursuant to Chapter 55, Texas Education Code, as amended, and Chapters 1207 and 1371, Texas Government Code, as amended. With respect to tax-exempt bonds, the Board covenants to bondholders that it will monitor and control the receipt, investment, expenditure and use of all bond proceeds and take or omit to take such other and further actions as may be required by Sections 103 and 141 through 150 of the United States Internal Revenue Code of 1986, as amended, to cause interest on such tax-exempt bonds to remain excludable from the gross income of bondholders.

2. POLICY

2.1 The System shall comply with all federal tax laws related to tax-exempt bonds and bond financed facilities prior to and after issuance. The System shall have procedures in place to ensure compliance with this policy including the retention of relevant documents. This policy supersedes any other general document retention policy with respect to the retention of documents related to tax-exempt bonds and bond financed facilities.

2.2 All management contracts, naming rights agreements, lease agreements, or any other agreement for the use of space by a non-governmental entity (i.e., space used by an entity other than a System component university), in which tax-exempt bonds were issued and remain outstanding for a building, require prior approval from the component university's Chief Financial Officer with notice to the Treasurer.

2.3 All non-standard research agreements will be monitored by the Division of Research and approved by the Associate Vice President for Technology Transfer with notice to the Treasurer prior to their execution for any such agreements that may give rise to public business use.

3. PRIVATE ACTIVITY LIMITATIONS

3.1. Section 141 of the United States Internal Revenue Code (“Code”) sets forth private activity tests for the purpose of limiting the volume of tax-exempt bonds that finance activities of persons other than state and local governmental entities. These tests serve to identify arrangements that actually or reasonably expect to transfer the benefits of tax-exempt financing to non-governmental persons, including the federal government.

3.2. The determination of whether state or local governmental bonds are private activity bonds (or are not qualified 501(c)(3) bonds) takes into consideration two primary factors:

3.2.1. The level of private uses of the financed facility in a trade or business, and

3.2.2. The amount of payments to be received from a private source with respect to such uses.

3.3. The statutory language is contained in IRS Code §141. A bond issue constitutes a private activity bond if:

3.3.1. More than 10% of the proceeds of the issue or the bond-financed property are to be used by any person other than a state or local governmental unit (the “private business use” test), and

3.3.2. More than 10% of the present value of the debt service on the bond is secured by privately used property or private payments (the “private payment” test), or

3.3.3. The amount of proceeds of the issue which is to be used (directly or indirectly) to make or finance loans to persons other than governmental entities exceeds the lesser of 5% of such proceeds or $5 million.

4. BUSINESS USE TEST PROCEDURES – POST ISSUANCE

4.1. By October 1st of each year, the Treasurer will provide each component university associate vice president for finance a private business use test worksheet. This worksheet will include all projects financed with System tax-exempt bonds issued through the most recent fiscal year end.

4.2. By January 1st, the component university associate vice president for finance will return to the Treasurer the completed private business use test worksheet.

4.3. If there are any instances where the private business use test suggests the System may exceed a private activity limitation, the Treasurer will consult with System staff and bond counsel to determine the appropriate corrective action.

5. INFORMATION FILING AND MONITORING REQUIREMENTS AND PROCEDURES

At the time of issuance, issuers of governmental bonds must comply with certain information filing requirements under Section 149(e) of the Code.

5.1. IRS Form 8038-G (Information Return for Tax-Exempt Governmental Obligations)

5.1.1. Must be filed by the 15th day of the second calendar month following the quarter in which the bonds were issued. For example, the due date of Form 8038-G for bonds issued on February 15th is May 15th.

This form must be delivered to:
Internal Revenue Service,
Ogden Submission Processing Center
Ogden, UT 84201-0027

5.1.2. The Treasurer works with the System's bond counsel to complete and file Form 8038-G by the required due date for each bond issue.

5.2. Arbitrage Rebate

5.2.1. Rebate – The arbitrage that must be rebated to the U.S. Department of the Treasury is based on the excess (if any) of the amount actually earned on non-purpose investments over the amount that would have been earned if those investments had a yield equal to the yield on the issue, plus any income attributable to such excess. Under Section 1.148-3(b) of the Treasury regulations, the future values of all earnings received and payments made with respect to non-purpose investments are included in determining the amount of rebate due.

5.2.2. Timeline – An arbitrage rebate installment payment is required to be paid no later than 60 days after the end of every 5th bond year throughout the term of a bond issue.

5.2.3. Payment – The payment must equal at least 90% of the amount due as of the end of that 5th bond year. Upon redemption of a bond issue, a payment of 100% of the amount due must be paid no later than 60 days after the discharge date.

5.2.4. Exceptions – There are two exceptions to the general rebate requirements applicable to government bonds: the small issuer exception and spending exceptions. The small issuer exception does not apply to the System due to the size of its bond issues. However, the spending exceptions can apply to the System. The spending exceptions are provided in Exhibit A.

5.2.5. Monitoring – The Treasurer will monitor ongoing compliance with regards to arbitrage.

- Schedule – The Treasurer maintains a schedule of each bond issue and the 5th bond year. The Treasurer regularly reviews the schedule to determine when a 5th bond year is approaching. For new construction projects, interim arbitrage rebate calculations may be performed to determine if any positive arbitrage exists even though it may not yet be payable to the IRS. In the event of positive arbitrage during the construction period, the Treasurer will notify the Executive Director of Financial Reporting who will record a contingent liability equal to the positive arbitrage. Additional arbitrage rebate calculations may be performed at the Treasurer's discretion.

- Calculations – The System contracts with a 3rd party provider for the arbitrage rebate calculations and preparation of IRS Form 8038-T (Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate). The 3rd party provider also maintains a list of our bond issues and scheduled 5th anniversary bond years.

- Procedures – Treasury provides the 3rd party provider with copies of all applicable bank statements (e.g. debt service, escrow, project fund, and cost of issuance) at least 45 days prior to the 5th anniversary year for a bond issue. The 3rd party provider prepares the arbitrage calculation and submits a report and IRS Form 8038-T, if applicable, to Treasury. If positive arbitrage exists and is payable to the IRS, Treasury submits a voucher to Accounts Payable for a check payable to the IRS. Treasury mails the check, certified mail return receipt requested, and signed IRS Form 8038-T to: Internal Revenue Service Center, Ogden, UT 84201-0002.

5.3. Yield Restriction

The Treasurer will monitor ongoing compliance with regards to yield restriction. State and Local Government Securities (SLGS) are commonly used for refunding escrows to yield restrict the investments. The System works with its financial advisor to purchase SLGS for a refunding escrow account to meet the yield restriction requirement.

6. RECORDS RETENTION

6.1. Each component university shall maintain all material records and information necessary to support a municipal bond issue's compliance with Section 103 of the Code. All records should be kept in a manner that ensures their complete access for so long as they are material. While this is typically accomplished through the maintenance of hard copies, records may be retained in an electronic format if certain requirements are satisfied. Material records should generally be kept for as long as the bonds are outstanding, plus 6 years after the final redemption date of the bonds. For certain federal tax purposes, a refunding bond issue is treated as replacing the original new money issue. To this end, the tax-exempt status of a refunding issue is dependent upon the tax-exempt status of the refunded bonds. Thus, certain material records relating to the original new money issue and all material records relating to the refunding issue should be maintained until 6 years after the final redemption of both bond issues. State record retention policies should also be considered, but in the event of a discrepancy, the guidelines established by the IRS shall prevail.

6.2. Although the required records to be retained depend on the transaction and the requirements imposed by the Code and the regulations, records common to most tax-exempt bond transactions include:

6.2.1. Basic records relating to the bond transaction (including the trust indenture, loan agreements, and bond counsel opinion);

6.2.2. Documentation directing, authorizing and showing expenditure of bond proceeds;

6.2.3. Documentation evidencing use of bond-financed property by public and private sources (i.e., copies of management contracts and research agreements);

6.2.4. Documentation evidencing all sources of payment or security for the bonds;

6.2.5. Documentation pertaining to any investment of bond proceeds (including the purchase and sale of securities, SLGS subscriptions, yield calculations for each class of investments, actual investment income received, the investment of proceeds, guaranteed investment contracts, and rebate calculations).

6.2.6. All tax returns related to the bonds such as IRS Forms 8038-G, 8038-T and 8038-R; and

6.2.7. Any other documentation that is material to the bonds or the bond financed facilities based on particular facts.

6.2.8. The list above is very general and only highlights the basic records that are typically material to many types of tax-exempt bond financings. Each transaction is unique and may, accordingly, have other records that are material to the requirements applicable to that financing. The decision as to whether any particular record is material must be made on a case-by-case basis and could take into account a number of factors, including, for instance, the various expenditure exceptions.

7. MANAGEMENT AND SERVICE CONTRACTS

Management contracts between government entities and certain private parties under which private parties receive compensation for services provided with respect to a tax-exempt, bond-financed facility may result in a loss of the tax-exempt status of the bonds as a result of a violation of the private business tests. However, the IRS has provided safe harbors regarding such contracts, and the Treasurer and legal counsel must be consulted before entering into any such contract for facilities currently financed with tax-exempt debt.

8. RESEARCH AGREEMENTS

Generally, certain agreements, where private entities, including the federal government, sponsor research through government entities that benefit from tax-exempt bond financing, may result in a violation of the private business tests. However, the IRS has provided safe harbors regarding such agreements, and the System Office of General Counsel has established standardized agreements to maintain these safe harbors. The Treasurer and legal counsel must be consulted before entering into any non-standard agreements.

9. NAMING RIGHTS AGREEMENTS

It generally is considered that the naming of a tax-exempt, bond-financed facility in honor of a donor is not, in and of itself, viewed as private use. However, the grant of intangible rights in connection with a tax-exempt, bond-financed facility, such as the right to the use of the name, can be treated as private business use. The sale of naming rights is characterized by a payment made in consideration for the receipt of an enforceable contractual right. If the payment constitutes consideration for the sale of a naming right, then use will result, and if the payer is engaged in a trade or business, then the use is private business use. The Treasurer and the System Office of Legal Counsel must be consulted before entering into a naming rights agreement.

10. REIMBURSEMENT RESOLUTIONS

The Treasurer is responsible for ensuring that Reimbursement Declarations are prepared in accordance with Section 1.150-2 of the Treasury regulations for projects the Board intends to finance with bonds.

11. BOND PROCEED EXPENDITURES

Projects are assigned a specific cost center and the associated expenditures are recorded in the general ledger to the specific project cost center. The Executive Director for

Financial Reporting and/or the Executive Director of Accounting Services is responsible for requesting from the Treasurer reimbursement from bond proceeds.

12. BOND PROCEED INVESTMENTS

The Treasurer invests bond proceeds in accordance with the System's Investment Policy for Non-Endowed Funds.

13. TRAINING

The Treasurer is responsible for staying current with any changes in the rules for tax-exempt bonds and communicating these rules to the appropriate System staff. The Treasurer may rely upon outside advisors for assistance and guidance with these matters.

14. REVIEW AND RESPONSIBILITY

Responsible Party: Associate Vice Chancellor for Finance

Review: Every three years on or before December 1

15. APPROVAL

Approved: Jim McShan
Interim Vice Chancellor for Administration and Finance

Renu Khator
Chancellor

Date: July 29, 2015

REVISION LOG

Revision Number	Approval Date	Description of Changes
1	12/01/2010	Initial version
2	12/21/2011	Added new Revision Log. In Section 6.1, changed the record retention period from 3 years to 6 years to comply with current standards and recommendations

Revision Number	Approval Date	Description of Changes
3	07/29/2015	Added Section 2.1 on the policy for standard contracts and agreements and Section 2.3 on the policy for non-standard research agreements. Removed Section 4.1. Made minor changes to Sections 7 and 8 regarding Treasurer and System Office of Legal Counsel consultation for contracts and research agreements. Added Section 9 on Naming Rights Agreements. Added the Executive Director of Accounting Services to the ability to request Treasurer reimbursement from bond proceeds. Added communication of rules to appropriate System staff for tax-exempt bond training in Section 13

Exhibit A

SPENDING EXCEPTIONS

Spending Period	Spending Exceptions
6-month spending exception	Section 1.148-7(c) of the Treasury regulations provides an exception to rebate if the gross proceeds of the bond issue are allocated to expenditures for governmental or qualified purposes that are incurred within 6 months after the date of issuance.
18-month spending exception	Section 1.148-7(d) of the Treasury regulations provides an exception to rebate if the gross proceeds of the bond issue are allocated to expenditures for governmental or qualified purposes which are incurred within the following schedule: 1. 15% within 6 months after the date of issuance 2. 60% within 12 months after the date of issuance 3. 100% within 18 months after the date of issuance
2-year spending exception	Section 1.148-7(e) of the Treasury regulations provides that an exception to rebate is available with respect to construction issues financing property to be owned by a governmental entity or 501(c)(3) organization when certain available construction proceeds are allocated to construction expenditures within the following schedule: 1. 10% within 6 months after the date of issuance 2. 45% within 12 months after the date of issuance 3. 75% within 18 months after the date of issuance 4. 100% within 24 months after the date of issuance