



Municipal Finance – Post-Issuance Legal Compliance

**Erin McCrady, Partner
Dorsey & Whitney LLP**

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Post-Issuance Legal Compliance

- The municipal securities market is a significant part of the United States credit markets, with over \$3.83 trillion in principal amount outstanding as of December 2016.
- At the end of the third quarter 2016, individuals or retail investors held, either directly or indirectly through mutual funds, money market mutual funds, closed-end funds, and exchange-traded funds, approximately \$2.545 trillion of outstanding municipal securities.
- According to the Municipal Securities Rulemaking Board, approximately \$2.42 trillion of municipal securities were traded in 2015 in approximately 9.26 million trades.
- There are approximately 44,000 state and local issuers of municipal securities, ranging from villages, towns, townships, cities, counties, territories, and states, as well as special districts, such as school districts and water and sewer authorities.

Post-Issuance Legal Compliance

The issuance of tax-exempt bonds is regulated by the Internal Revenue Service (IRS) and the Securities and Exchange Commission (SEC).

Post-issuance, there are ongoing legal compliance obligations:

- Tax Matters (IRS)
- Securities Laws (SEC)
- Covenants and Other Obligations (Contractual)

Tax Matters

Governmental units are allowed to borrow money on a tax-exempt basis, subject to compliance with IRS rules and regulations.

Tax-exempt financing is generally not available for private businesses.

Tax-exempt financing can result in interest rate savings to borrowers (sometimes substantial).

Tax Matters

After tax-exempt bonds are issued, it is important that interest on the bonds remains tax-exempt (excludable from gross income under Section 103 of the Internal Revenue Code).

Tax-exempt status can be lost (retroactive to the date of issue of the bonds) if the borrower does not comply with legal requirements with respect to:

- Spending of tax-exempt bond proceeds
- Use of tax-exempt bond financed property
- Investment of tax-exempt bond proceeds

Tax Matters

After tax-exempt bond financing closes, bond counsel generally has no information about changes to:

- Spending of tax-exempt bond proceeds (timing and scope of project)
- Use of tax-exempt bond financed property
- Investing of tax-exempt bond proceeds

versus what was disclosed to bond counsel at the time of the tax-exempt bond financing (which is memorialized in the tax certificate for the financing).

Tax Matters

Spending of Tax-Exempt Bond Proceeds

Generally, spend tax-exempt bond proceeds within three years (I.R.C. 149(g))

Consult with bond counsel prior to changing intended use of tax-exempt bond proceeds from that which was discussed/disclosed to bond counsel at outset of financing:

- Tax-exempt bond proceeds may generally be spent on capital expenditures (any cost that is properly chargeable to a capital account or would be so chargeable with a proper election under general federal income tax principles)
- Limitations on using tax-exempt bond proceeds for working capital expenses (day-to-day operations), although Montana law imposes additional material limitations
- Limitations on using tax-exempt bond proceeds to reimburse internally borrowed funds (Regulations § 1-150-2)

Tax Matters

Use of Tax-Exempt Bond Financed Property

The use of property financed with tax-exempt bond proceeds must be monitored to ensure that:

- Not more than 10% of the proceeds of a tax-exempt bond issue are to be used in the trade or business of a person other than a governmental unit.
- Not more than 5% of the proceeds of a tax-exempt bond issue are to be used for private business use that is not functionally related to the governmental use being financed by the tax-exempt bond issue (for example a privately operated cafeteria in a school cafeteria is a functionally related use).

(I.R.C. § 141)

Tax Matters

Use of Tax-Exempt Bond Financed Property

“Use” is defined very broadly:

- includes actual or beneficial use of tax-exempt bond proceeds or tax-exempt bond financed property by any person other than a governmental unit

Use can occur in connection with the ownership of, the lease of, or the management of tax-exempt bond financed property, an incentive payment contract, or in connection with any arrangement that results in any non-governmental person being the ultimate beneficiary of the tax-exempt bond financing.

Discussion of real life examples

Tax Matters

Use of Tax-Exempt Bond Financed Property

- IRS Regulations permit management contracts and other agreements with service providers with respect to tax-exempt bond financed property if the contract contains specific provisions and limitations with respect to:
 - Term of contract
 - Retention of “control” over managed property by governmental unit
 - Service provider must bear risk of loss
 - Service provider must not have any role or relationship with the governmental unit that substantially limits the governmental unit’s ability to exercise its rights under the contract
 - Compensation and expenses paid must be reasonable
 - No sharing of net profits or net losses

See attached Summary of Revenue Procedure 2017-13.

Tax Matters

Use of Tax-Exempt Bond Financed Property

- If a post-issuance act results in bonds failing the private business use tests, the issuer can take certain qualifying remedial actions to prevent the bonds from becoming taxable.
 - Often requires redemption of the bonds

Tax Matters

Investing Tax-Exempt Bond Proceeds

Because of the potential disparity between taxable and tax-exempt interest rates, governmental units that invest the proceeds of lower-cost tax-exempt bonds in higher yielding taxable obligations have the opportunity to profit from the differential.

Some investment earnings are inevitable because money borrowed is not spent immediately. The IRS Regulations control:

- permissible investments and method of acquisition
- earnings on tax-exempt bond proceeds (referred to as the “yield limitation”)

Tax Matters

Investing Tax-Exempt Bond Proceeds

Bond proceeds cannot be invested at above the yield on the bonds, except (a) during IRS defined temporary periods, or (b) as part of a reasonably required reserve, or (c) as part of a minor portion (lesser of 5% or \$100,000 of bond proceeds).

- Bond proceeds qualify for temporary period exception if:
 - Within 6 months, there is a binding contract to spend 5% of bond proceeds
 - 85% of bond proceeds expected to be spent within three years
 - Bond proceeds are “diligently” spent

Tax Matters

Investing Bonds Proceeds

Unless the bond issue qualifies for an exception to rebate, any positive spread during the aforementioned temporary period must be rebated to the United States every five years (I.R.C. § 148(f)).

- This is referred to as the “rebate requirement”

Tax Matters

Maintaining Adequate Records

Essential to keep the following records:

- Records concerning investment of bond proceeds
- Records concerning use of bond proceeds, identifying assets or portions of assets financed
- Records of rebate calculations and payments
- Records concerning use of bond-financed property

IRS requires maintenance of records for at least 3 years after the later of retirement of (1) the original bonds or (2) any bonds issued to refinance the original bonds

Tax Matters

Best Practices for Municipalities

Know what the bond and tax documents say

Designate responsible personnel to manage compliance process (typically City Finance Director and finance personnel)

Implement policies and procedures to ensure and prove compliance

Tax Matters

Post-Issuance Tax Compliance Policy

IRS will ask about tax compliance policies in an audit

IRS requires disclosure about existence of written tax policies in forms filed after each tax-exempt bond issuance.

- “Do you have post-issuance tax compliance policies?”
- “Do you have remedial action procedures?”

| Part VI Miscellaneous | | | |
|-----------------------|---|-----|-------------------------------------|
| 35 | Enter the amount of the state volume cap allocated to the issue under section 141(b)(5) | 35 | \$0 00 |
| 36a | Enter the amount of gross proceeds invested or to be invested in a guaranteed investment contract (GIC) (see instructions) | 36a | \$0 00 |
| b | Enter the final maturity date of the GIC ▶ | | |
| c | Enter the name of the GIC provider ▶ | | |
| 37 | Pooled financings: Enter the amount of the proceeds of this issue that are to be used to make loans to other governmental units | 37 | \$0 00 |
| 38a | If this issue is a loan made from the proceeds of another tax-exempt issue, check box <input type="checkbox"/> and enter the following information: | | |
| b | Enter the date of the master pool obligation ▶ | | |
| c | Enter the EIN of the issuer of the master pool obligation ▶ | | |
| d | Enter the name of the issuer of the master pool obligation ▶ | | |
| 39 | If the issuer has designated the issue under section 265(b)(3)(B)(i)(II) (small issuer exception), check box <input type="checkbox"/> | | <input checked="" type="checkbox"/> |
| 40 | If the issuer has elected to pay a penalty in lieu of arbitrage rebate, check box <input type="checkbox"/> | | <input type="checkbox"/> |
| 41a | If the issuer has identified a hedge, check here <input type="checkbox"/> and enter the following information: | | |
| b | Name of hedge provider ▶ | | |
| c | Type of hedge ▶ | | |
| d | Term of hedge ▶ | | |
| 42 | If the issuer has superintegrated the hedge, check box <input type="checkbox"/> | | <input type="checkbox"/> |
| 43 | If the issuer has established written procedures to ensure that all nonqualified bonds on this issue are remediated according to the requirements under the Code and Regulations (see instructions), check box <input type="checkbox"/> | | <input checked="" type="checkbox"/> |
| 44 | If the issuer has established written procedures to monitor the requirements of section 148, check box <input type="checkbox"/> | | <input checked="" type="checkbox"/> |
| 45a | If some portion of the proceeds was used to reimburse expenditures, check here <input type="checkbox"/> and enter the amount of reimbursement | | |
| b | Enter the date the official intent was adopted | | |

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. I further declare that I consent to the IRS's disclosure of the issuer's return information, as necessary to process this return, to the person that I have authorized above.

Signature

Tax Matters

Post-Issuance Tax Compliance Policy

Written policies should cover:

- Use of bond proceeds
 - Establish system to monitor expenditure of proceeds
- Use of bond-financed property
 - Establish system to monitor use of financed projects
 - Conduct periodic review of private business use
 - Ensure management contracts are reviewed by bond counsel prior to executing
- Investment of bond proceeds
 - Establish system to monitor investment of proceeds and schedule periodic review and rebate calculations
 - Involve bond counsel before bidding investment contracts or executing swaps
- Rebate & yield restriction compliance
- Record retention

Tax Matters

See attached sample Post-Issuance Tax Compliance Policy.

Call your bond counsel and tell us how we can help!

Covenants and Contractual Obligations

Understand bond resolutions, loan documents and other financing documents. Many contain covenants and contractual obligations regarding:

- Delivery of audited annual financial reports
- Evidence of budget appropriations
- Annual certificate regarding reserves and maintenance of minimum balances
- Annual certificates regarding insurance coverage
- Annual certificates regarding no defaults and compliance with all covenants
- Restrictions regarding issuance new debt and granting of liens/security interests on assets

Securities Laws

Rule 15c2-12

Securities and Exchange Commission Rule 15c2-12 requires that the underwriter of a municipal public bond offering (taxable or tax-exempt) cause the issuer and any other obligor with respect to the bonds to undertake in writing to provide post-issuance disclosures to holders of securities (subject to certain exceptions).

Two types of continuing disclosure required:

- Annual reports: including annual financial information and operating data and audited financial statements (all similar to that contained in the official statement for the public bond offering)

Securities Laws

Rule 15c2-12

- Material event notices
 - Principal and interest payment delinquencies
 - Non-payment related defaults, if material
 - Unscheduled draws on debt service reserves reflecting financial difficulties
 - Unscheduled draws on credit enhancements reflecting financial difficulties
 - Substitution of credit or liquidity providers, or their failure to perform
 - Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security

Securities Laws

Rule 15c2-12

- Material event notices
 - Modifications to rights of security holders, if material
 - Bond calls, if material, and tender offers
 - Defeasances
 - Release, substitution, or sale of property securing repayment of the securities, if material
 - Rating changes
 - Bankruptcy, insolvency, receivership or similar event of the obligated person
 - Merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business
 - Appointment of a successor or additional trustee or the change of name of a trustee, if material

Securities Laws

Rule 15c2-12

Some issuers will also agree to provide quarterly unaudited financial information.

Regulation of underwriters in this manner results in the indirect regulation of issuers - by conditioning an issuer's access to the public markets on its agreement to provide continuing disclosure.

Obligation to provide continuing disclosure is typically included in the bond resolution or a stand-alone continuing disclosure agreement.

Continuing disclosure filings are to be made via EMMA.

Securities Laws

Rule 15c2-12

Failure to comply does not constitute an event of default with respect to the bonds; only remedy is action for specific performance.

Failure to comply could potentially affect the transferability and liquidity and market price of the existing bonds, and could also impact the sale of new bonds.

Securities Laws

Rule 15c2-12 – Impact on New Bond Issues

When issuing new public bonds, an underwriter must have reasonable basis for recommending the bonds to potential investors, including a reasonable basis for believing that the issuer of the bonds will comply with continuing disclosure undertaking.

In this regard:

- Underwriter has a duty to investigate an issuer's past compliance
- Underwriter has a duty to disclose any instance of an issuer's failure to comply during previous five years

Securities Laws

Rule 15c2-12 – Impact on New Bond Issues

Compliance disclosure often looks like this:

The City has complied in all material respects with its previous undertakings under Rule 15c2-12 to provide annual reports or notices of material events. A failure by the City to comply with the undertakings will not constitute an event of default on the Bonds (although holders or other beneficial owners of the Bonds will have the sole remedy of bringing an action for specific performance). Nevertheless, such a failure must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the Bonds in the secondary market. Consequently, such a failure may adversely affect the transferability and liquidity of the Bonds and their market price.

Securities Laws

Rule 15c2-12 – Impact on New Bond Issues

Materially misleading statements about prior compliance has given rise to fines and sanctions by the SEC, including with respect to the underwriter, the issuer and employees of the underwriter and issuer.

Securities Laws

Rule 15c2-12 – Proposed Amendments

SEC has proposed amendments to Rule 15c2-12 requiring additional disclosures regarding:

- incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material; and
- default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties.

Questions or Comments

SUMMARY OF REVENUE PROCEDURE 2017-13

Management contracts and other agreements with service providers with respect to property financed with proceeds of tax-exempt bonds may result in private business use of that property for purposes of § 141 of the Internal Revenue Code of 1986. Whether such an agreement results in private business use is generally based on all of the facts and circumstances but generally results in private business use if the contract provides for compensation based, in whole or in part, on a share of net profits from the operation of the facility. An agreement that results in a lease or ownership of the property by the service provider for federal income tax purposes generally is not considered a management contract for this purpose and generally results in private business use.

Revenue Procedure 2017-13 provides conditions under which a management contract does not result in private business use of the financed property.¹ The following is a summary of the Rev. Proc. 2017-13 requirements and safe harbors and should be used with care. Rev. Proc. 2017-13 and other relevant authority should be reviewed in connection with each proposed management or other service-provider agreement.

I. General Definitions

“*Managed property*” means the portion of a project with respect to which a service provider provides services.

“*Management contract*” means a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services for a managed property. A management contract does not include a contract or portion of a contract for the provision of services before a managed property is placed in service (for example, pre-operating services for construction design or construction management).

“*Project*” means one or more facilities or capital projects, including land, buildings, equipment, or other property, financed in whole or in part with proceeds of the bond issue.

“*Qualified user*” means for projects financed with governmental bonds, any governmental person (as defined in § 1.141-1(b)).

¹ An issuer may continue to rely on Rev. Proc. 97-13, as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67, with respect to a management contract that is entered into before August 18, 2017 and that is not materially modified or extended on or after that date (except pursuant to certain renewal options).

“*Related party*” means, in reference to a governmental unit, any member of the same controlled group, and in reference to any person that is not a governmental unit, a related person (as defined in § 144(a)(3) of the Code).

“*Renewal option*” means a provision under which either party has a legally enforceable right to renew the contract. Thus, for example, a provision under which a contract is automatically renewed for one-year periods absent cancellation by either party is not a renewal option (even if it is expected to be renewed).

“*Service provider*” means any person other than a qualified user that provides services to, or for the benefit of, a qualified user under a management contract.

“*Unrelated parties*” means persons other than either: (1) a related party to the service provider or (2) a service provider’s employee.

II. Eligible Expense Reimbursement Arrangements

A management contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider does not result in private business use.

III. Qualified Management Contracts

Management contracts that are not eligible expense reimbursement arrangements (as described above) do not result in private business use if the below requirements are met. Moreover, a service provider’s use that is functionally related and subordinate to its services provided under such a qualifying management contract (*e.g.*, use of storage areas to store equipment used to perform the services) does not result in private business use.

A. *Term of the Contract*

The term of the contract, including all renewal options, must not be greater than the lesser of 30 years or 80% of the weighted average reasonably expected economic life of the managed property, determined as of the beginning of the term of the contract.

B. *Control of Managed Property*

The qualified user must exercise a significant degree of control over the use of the managed property. This requirement is met if the contract requires the qualified user to approve:

- the annual budget;
- capital expenditures (*e.g.*, by approving an annual budget for capital expenditures described by functional purpose and specific maximum amounts);

- each disposition of property (as with capital expenditures);
- rates charged for use (*e.g.*, by expressly approving the rates or a general description of the rate-setting methodology (such as a method that establishes hotel room rates using specified revenue goals based on comparable properties), or by requiring that the rates be reasonable and customary as specifically determined by, or negotiated with, an independent third party (such as a medical insurance company)); and
- the general nature and type of use of the managed property.

C. *Risk of Loss of the Managed Property*

The qualified user must bear the risk of loss upon damage or destruction of the managed property (*e.g.*, due to *force majeure*). A qualified user may, however, insure against risk of loss and impose a penalty on the service provider for failure to operate the property in accordance with certain standards.

D. *No Inconsistent Tax Position*

The service provider must agree that it is not entitled to and will not take any tax position that is inconsistent with being a service provider with respect to the managed property. For example, the service provider must agree not to claim any depreciation or amortization, investment tax credit, or deduction for any payment as rent with respect to the managed property.

E. *No Substantial Limitation of Rights*

The service provider must not have any role or relationship with the qualified user that, in effect, substantially limits the qualified user's ability to exercise its rights under the contract, based on all the facts and circumstances. A service provider will not be treated as having such a prohibited role or relationship if:

- no more than 20% of the voting power of the governing body of the qualified user is vested in the directors, officers, shareholders, partners, members, and employees of the service provider (or its related parties) in the aggregate;
- the governing body of the qualified user does not include the CEO or other person with equivalent management responsibilities of the service provider (or any of its related parties) or other chairperson or equivalent executive of the service provider's governing body (or that of any of its related parties); and
- the CEO or equivalent of the service provider (or any of its related parties) is not the CEO or equivalent of the qualified user or any of the qualified user's related parties.

F. ***Compensation and Expenses***

Reasonable Compensation

Payments to the service provider under the contract must be reasonable compensation for services rendered during the term of the contract. Compensation includes payments to reimburse actual and direct expenses and related administrative overhead expenses.

No Net Profits or Net Losses

The contract must not (i) provide to the service provider a share of net profits from the operation of the managed property or (ii) in substance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property.

Compensation will not be treated as a share of net profits if *no element of the compensation*² takes into account, or is contingent upon, either net profits or both revenues and expenses (other than any reimbursements of actual and direct expenses paid to unrelated parties). Incentive compensation will not be treated as providing a share of net profits if the eligibility for the incentive compensation is determined by the service provider's performance in meeting standards for quality of service, performance, or productivity and the amount and timing of payment otherwise meet this requirement.

An arrangement will not be treated as requiring the service provider to bear a share of net losses if:

- the amount of the service provider's compensation and the amount of expenses to be paid by the service provider (and not reimbursed), separately and collectively, do not take into account either net losses or both revenues and expenses, and
- the timing of the payment is not contingent upon net losses.

A service provider whose compensation is reduced by a stated dollar amount (or one of multiple stated dollar amounts) for failure to keep expenses below a specified target (or one of multiple specified targets) will not be treated as bearing a share of net losses as a result of this reduction.

Payment Deferral

Deferral due to insufficient net cash flows from the operation of the managed property of the payment of compensation that does not otherwise provide a share of net profits or require the service provider to bear a share of net losses will not cause the deferred compensation to be treated as contingent upon net profits or net losses if the contract includes requirements that:

² For this purpose, the elements of compensation are: the *eligibility* for payment, the *amount* of payment, and the *timing* of payment.

- the compensation is payable at least annually;
- the qualified user is subject to reasonable consequences for late payment, such as reasonable interest charges or late payment fees; and
- the qualified user will pay such deferred compensation (with interest or late payment fees) no later than the end of five years after the original due date of the payment.

Certain Compensation Arrangements

Without regard to whether the service provider pays expenses with respect to the operation of the managed property without reimbursement by the qualified user, compensation for services will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses if the compensation for services is: (a) based solely on a capitation fee, a periodic fixed fee, or a per-unit fee; (b) incentive compensation as described above; or (c) a combination of these types of compensation.

“*Capitation fee*” means a fixed periodic amount for each person for whom the service provider or the qualified user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to such persons varies substantially.³ A fixed periodic amount may include an automatic increase according to a specified, objective, external standard that is not linked to the output or efficiency of the managed property. A capitation fee may include a variable component of up to 20% of the total capitation fee designed to protect the service provider against risk such as risk of catastrophic loss.

“*Periodic fixed fee*” means a stated dollar amount for services rendered for a specified period of time.⁴ The stated dollar amount may automatically increase according to a specified, objective external standard that is not linked to the output or efficiency of the managed property. Capitation fees and per-unit fees are not periodic fixed fees.

“*Per-unit fee*” means a fee based on a unit of service provided specified in the contract or otherwise specifically determined by an independent third party, such as the administrator of the Medicare program, or the qualified user.⁵ Separate billing arrangements between physicians and

³ For example, a capitation fee includes a fixed dollar amount payable per month to a medical service provider for each member of a health maintenance organization plan for whom the provider agrees to provide all needed medical services for a specified period.

⁴ For example, a stated dollar amount per month is a periodic fixed fee.

⁵ For example, a stated dollar amount for each specified medical procedure performed, car parked, or passenger mile is a per-unit fee.

hospitals are treated as per-unit fee arrangements. A fee that is a stated dollar amount specified in the contract does not fail to be a per-unit fee as a result of a provision under which the fee may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of the managed property.

The Consumer Price Index and similar external indices that track increases in prices in an area or increases in revenues or costs in an industry are examples of objective, external standards.

IV. Contract Revisions

A contract that is materially modified with respect to any matter relevant to these requirements must be retested under these requirements as a new contract as of the date of the material modification.

_____, Montana
Tax Compliance Policy
For
Tax-Exempt Bonds

Adopted: _____

I. Purpose

This policy is approved by _____, Montana (the “City”), to ensure that interest on tax-exempt bonds, notes or other obligations (“Bonds”) of the City remains excludable from gross income under Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”).

This policy is intended to formally memorialize certain practices and policies of the City previously followed in connection with its issuance of Bonds. The City reserves the right to make exceptions to this policy as necessary or appropriate.

The City’s policy for post-issuance tax compliance is as follows:

II. Expenditure/Use of Bond Proceeds

- A. Expenditures of Bond proceeds will be reviewed by the City Finance Director¹. Such review will include comparison of actual expenditures to statements made in Bond documents, including any Bond Resolution or Trust Indenture and the Tax Certificate (collectively, the “Bond Documents”).
- B. The City has separately established procedures for the preparation and review of requisitions of Bond proceeds as part of its accounting system. The City’s accounting system will identify, for each Bond-financed project, the capital expenditures, the costs of issuance, the reserve fund deposit, if any, and any other categories of expenditures identified in the related Tax Certificate.
- C. None of the Bond proceeds will be used to reimburse the City for costs paid prior to the date of issuance of the Bonds unless the City shall have complied with Section 1.150-2 of the Treasury Regulations with respect to such reimbursed

¹ Consider other City executives/employees, as appropriate.

amounts. Attached hereto as Exhibit A is a summary of the reimbursement regulations for tax-exempt bonds.

- D. Costs of staff may be financed with Bond proceeds only to the extent that they are properly capitalized as a cost of a capital project under generally accepted accounting principles and federal tax law.
- E. Requisitions of Bond proceeds will be summarized in a “final allocation” of Bond proceeds to uses not later than 18 months after the in-service date of the Bond-financed property or the date of completion of the project (and in any event not later than 5 years and 60 days after the issuance of the Bonds and not later than 60 days after earlier retirement of the Bond issue).
- F. Expenditure of Bond proceeds will be measured against the City’s expectation, as set forth in the Tax Certificate delivered at the closing of Bonds, to (i) incur a substantial binding obligation to a third party to spend at least 5% of the net sales proceeds of the Bonds on the capital project within 6 months after the issue date, and (ii) proceed with due diligence to complete the capital project and spend at least 85% of the net sale proceeds within three years from the issue date.
- G. If there are any Bond proceeds remaining other than in a reserve or debt service fund established pursuant to the Bond Documents after completion of a project, unless the proceeds can be properly allocated to other uses, such proceeds shall be applied to make debt service payments on the Bonds or otherwise defease the Bonds.
- H. In the event that Bond proceeds are to be used to make a grant to an unrelated party, a grant agreement will be reviewed prior to execution for compliance with the Code. Such agreement will be approved by the City Finance Director upon consultation with Bond Counsel. The repayment of any portion of a grant by the grantee shall be treated as unspent Bond proceeds.
- I. In the event that Bond proceeds are to be loaned to a conduit borrower, such conduit borrower will be required to agree to all terms of the Tax Certificate prepared by Bond Counsel and provide evidence of tax compliance policies and procedures deemed adequate and consistent with those set forth herein; and all such obligations for tax compliance shall be assumed by such conduit borrower. The City Finance Director shall be the primary contact for all conduit borrowers and related compliance matters.

III. Use of Bond-Financed Property

- A. Use of Bond-financed facilities when completed and placed in service will be reviewed by the City Finance Director. The City Finance Director will consult with Bond Counsel regarding any third-party use of Bond-financed facilities, including, without limitation, leases, use, management or service contracts, and research contracts.

- B. Appropriate department/facility managers shall be instructed to consult with the City Finance Director regarding any third-party use of the Bond-financed facilities, including without limitation leases, use, management or service contracts, and research contracts.
- C. Agreements with third-parties for the use of Bond-financed facilities, including without limitation leases, use, management or services contracts, and research contracts, or non-governmental use of Bond-financed facilities will be reviewed prior to execution for compliance with the Code. Such agreements will be approved by the City Finance Director upon consultation with Bond Counsel, who will be responsible for determining whether the proposed agreement (i) results in private business use of the facilities, (ii) meets the compensation, term and other requirements under Revenue Procedures 97-13 or Revenue Procedure 2017-13, as applicable and (iii) meets the compensation, terms and other requirements under Revenue Procedure 2007-47; all upon advice of Bond Counsel, as necessary.
- D. Upon issuance of Bonds, there shall be no expectation that the Bond-financed property will be sold or otherwise disposed of by the City during the term of the Bonds, except for replacement due to normal wear and tear or obsolescence; and no item of Bond-financed property will be sold or transferred by the City while the Bonds are outstanding without approval of the City Finance Director upon consultation with Bond Counsel or advance arrangement of a “remedial action” under the applicable Treasury Regulations. Attached hereto as Exhibit B is a summary of certain remedial actions.
- E. The City acknowledges that any sale, transfer, change in use, or change in the users of the Bond-financed property may require remedial action or resolution pursuant to the IRS Voluntary Closing Agreement Program (“VCAP”) to assist in resolving violations of federal tax laws applicable to the Bonds.

IV. Investments

- A. Investment of Bond proceeds in compliance with Montana law (Title 7, Chapter 6, Part 2, Montana Code Annotated), the City’s investment policy, and the arbitrage and rebate requirements of the Code and applicable Treasury Regulations will be supervised by the City Finance Director.
- B. All investments will be purchased only at fair market value, as determined under applicable Treasury Regulations.
- C. Guaranteed investment contracts (“GICs”) and other open-market securities will be purchased only according to applicable Treasury Regulations, including bid requirements and fee limitations.
- D. Calculation of rebate liability will be performed by outside consultants and reviewed by the City Finance Director. Such calculations shall be made annually and within the period prescribed following full retirement of the Bonds.

- E. Upon final expenditure of the gross proceeds of Bonds, and in any event promptly following the fifth anniversary of the date of issuance of the Bonds or earlier retirement of the Bonds, the City Finance Director will consult a qualified professional to prepare a spending exception report or an arbitrage rebate computation (as applicable) for the issue of Bonds.
- F. Rebate payments, as required based upon the advice of a qualified professional, will be made with Form 8038-T no later than 60 days after (i) each fifth anniversary of the date of issuance of the Bonds and (ii) the final retirement of the Bond issue.

V. Record Management and Retention

- A. Management and retention of records related to Bond issues will be supervised by the City Finance Director.
- B. Records for Bonds will be retained for the life of the Bonds, plus any refunding Bonds, plus three years (or such longer term as may be required under State law). Such records may be in the form of documents or electronic copies of documents, appropriately indexed to specific Bond issues and compliance functions.
- C. Retainable records pertaining to Bond issuance shall include a transcript of documents executed in connection with the issuance of the Bonds and any amendments thereto, copies of rebate calculations, records of payments, including Forms 8038-T, escrow agreements, verification reports, records of investment earnings on any relevant funds/accounts, IRS filings and audit reports/investigations.
- D. Retainable records pertaining to expenditures of Bond proceeds include requisitions, reimbursement allocations, paying agent statements, if applicable, trustee statements, if applicable, and final allocation of proceeds.
- E. Retainable records pertaining to use of Bond-financed property include all third-party contracts concerning use of the facilities, including, without limitation, leases, use, management or service contracts and research contracts.
- F. Retainable records pertaining to investments include GIC documents under the Treasury Regulations, records of purchase and sale of other investments, and records of investment activity sufficient to permit calculation of arbitrage rebate or demonstration that no rebate is due.

VI. Overall Responsibility

- A. Overall administration and coordination of this policy is the responsibility of the City Finance Director.
- B. Review of compliance with this policy shall be undertaken not less than annually.

- C. The City understands that failure to comply with this policy could result in the retroactive loss of the exclusion of interest on Bonds from federal gross and Montana taxable income and, thus, it would be advisable to consult with Bond Counsel and other professionals in advance regarding deviations from the facts and expectations as set forth in any Bond Documents.

- D. Any violations or potential violations of federal tax requirements shall promptly be reported to the City Finance Director, and the City Finance Director will engage qualified consultants and Bond Counsel to further investigate potential violations or recommend appropriate remedial actions, which actions shall be approved by the governing body of the City.

EXHIBIT A

REIMBURSEMENT BOND SUMMARY

Following is a general summary of the requirements relating to bonds that are issued in whole or in part to reimburse expenditures that were paid prior to the date of issuance of bonds (“Reimbursement Bonds”).

Reimbursement Bond proceeds cannot be used to reimburse expenditures paid more than 60 days prior to the adoption of the declaration of official intent/reimbursement resolution, which must contain:

- a general functional description of the property to which the reimbursement relates or an identification of the fund or account from which the expenditure is to be paid and a general functional description of the purposes of such fund or account; and
- the maximum principal amount of debt proposed to be issued.

The Treasury Regulations generally require that Reimbursement Bonds must be issued not later than 18 months after the later of (i) the date on which the original expenditure is paid, or (ii) the date on which the property is placed in service or abandoned, but in any case not more than three years after the date on which the original expenditure is paid. If possible, actual reimbursement should be made within 30 days of the date of issuance of the Reimbursement Bonds. Treasury Regulations generally permit reimbursement of capital expenditures and costs of issuance of the Reimbursement Bonds.

Note that there are exceptions for “de minimis” amounts (not in excess of the lesser of \$100,000 or 5% of proceeds of the issue) and for “preliminary expenditures” (such as architectural, engineering, surveying, soil testing and similar costs and costs of issuance), so long as such preliminary expenditures do not exceed 20% of the aggregate issue price.

EXHIBIT B

CERTAIN REMEDIAL PROVISIONS APPLICABLE TO BONDS

The City acknowledges that any deliberate action by the City after Bond issuance that results in a satisfaction of the private business tests or the private loan test will result in private activity bond status unless one or more qualifying remedial actions are taken by the City. Specifically, Treasury Regulations provide that actions are not treated as deliberate actions if (A) five conditional requirements are met, and (B) one of three remedial actions is taken, with respect to the disposition proceeds and nonqualified bonds*:

CONDITIONAL REQUIREMENTS

1. Reasonable Expectations – The City reasonably expected on the issue date that it would not meet the private business tests or the private loan test for the whole term of the bonds; and
2. Reasonable Bond Maturity – The term of the issue must not be unreasonably long; this requirement is met if the weighted average maturity of the bond issue is not greater than 120% of the expected economic life of the property financed; and
3. Fair Market Value Consideration – The terms of any agreement (relating to satisfaction of a private activity bond test) must be bona fide and at arm's-length, and the new user must pay a fair market value consideration for the use of the bond-financed property; and
4. Disposition Proceeds Are Gross Proceeds – The City must treat any disposition proceeds as gross proceeds subject to arbitrage/rebate restrictions; and
5. Proceeds Spent for Authorized Purpose – Except as described with respect to redemption and defeasance options below, prior to deliberate actions, the affected proceeds must have been spent for the authorized purposes under the applicable bond documents.

REMEDIAL ACTIONS – Under Treasury Regulations, Sections 1.141-12(d), (e) and (f):

1. Redemption of Non-Qualified Bonds – Under the general rule, all nonqualified bonds of the issue must be redeemed. Tax-exempt bond proceeds (i.e., refunding bond proceeds) cannot be used unless the tax-exempt bonds are qualified bonds, taking into account the purchaser's use of the facility. The bonds must be redeemed within 90 days of the date of the deliberate action or a defeasance escrow for the bonds must be established within such 90-day period. Special rules apply to transfers exclusively for cash and to defeasance escrows.

* The portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the deliberate action occurs, the remaining bonds would not satisfy the private business use test or the private loan financing test, as applicable. The amount of private business use is the highest percentage of business use in any one-year period, commencing with the deliberate action.

2. Alternative Use of Disposition Proceeds – To meet this requirement, all disposition proceeds must be in cash, the City must reasonably expect to expend the proceeds within 2 years, the new use must not meet the private business tests or the private loan test (and the City cannot take any action subsequent to the date of the deliberate action to cause the tests to be met), and any unused proceeds must satisfy the redemption requirement in the preceding paragraph.
3. Alternative Use of Facility – This remedial action is satisfied if the bond-financed property itself (as distinguished from the proceeds of the issue) is used in an alternative manner (e.g., for a different purpose or by a different person); the nonqualified bonds are treated as reissued on the date of the deliberate action and independently meet all of the requirements for tax exemption under Sections 141 through 150 of the Code, except the arbitrage and rebate rules of Section 148, for the remaining term of the nonqualified bonds; the deliberate action does not involve a transfer of the property to a purchaser that finances the acquisition with the proceeds of another issue of tax-exempt bonds; and any disposition proceeds, other than those arising from an agreement to provide services, resulting from the deliberate action are used to pay debt service on the bonds on the next available payment date or escrowed within 90 days of receipt and yield restricted to pay debt service on the next available payment date.

The above is only a brief summary of certain remedial actions, and additional special rules may be applicable. As provided in the City’s Compliance Policy for Tax-Exempt Bonds, the City Finance Director shall seek advice of Bond Counsel as necessary to provide guidance as to “remedial action” that may be required under the applicable Treasury Regulations.

The Commissioner of the IRS may, by publication, provide for additional remedial actions. In addition, the IRS provides a program in which issuers/borrowers which cannot meet a listed remedial action can enter into a closing agreement with the IRS to avoid private activity bond status. The closing agreement program includes several conditions, including providing for the redemption of the bonds and paying the IRS an amount based on an assumption that the non-qualified bonds are taxable from the date of the subsequent act until they are redeemed.