



PACIFICA
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Tax-Exempt Bonds: Compliance Training

Oregon Public Universities; University Shared Services Enterprise

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Portland State University

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Agenda

Post-Issuance Tax Compliance Training

Welcome, introductions

Bond Compliance 101

- Basic federal law requirements
- Closing requirements
 - Including Shared Services role
- Post issuance and project completion
- Expenditures and allocations
- Private business use
 - Including key PBU topics
- Remedial actions



Lunch Break

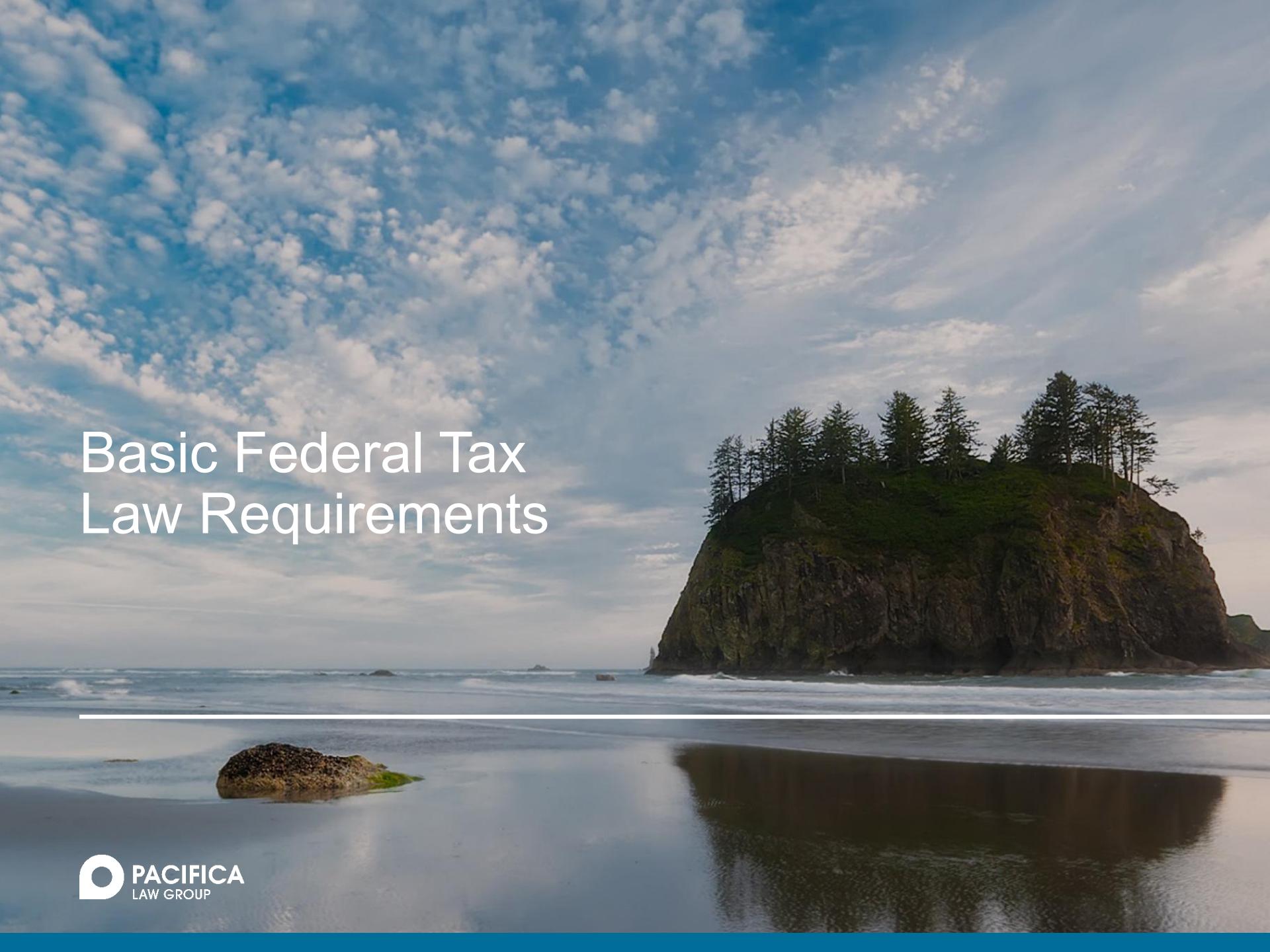
Agenda (cont.)

Post-Issuance Tax Compliance Training

Bond compliance 201

- Investments
 - Intro to arbitrage and rebate
 - Temporary periods and other exceptions
 - Rebate calculations and spending exceptions
- State grant agreements
- State tax documentation
- Private business use
 - Qualified equity and mixed use projects
 - Measurement examples, including refundings
 - Management contracts 201
 - Miscellaneous issues
- IRS audits and updates
- Continuing disclosure



A wide-angle photograph of a coastal scene. In the foreground, a dark, wet beach reflects the sky. A single, mossy rock sits in the water on the left. To the right, a large, rugged rock formation rises from the sea, its slopes covered in dense green trees. The sky above is a mix of bright blue and numerous white, fluffy clouds.

Basic Federal Tax Law Requirements

Basic Federal Tax Law Requirements

Tax-exempt bonds are subject to a number of federal tax law restrictions

Expenditures

- **What types of projects qualify for tax-exempt financing?**
 - University academic, sports and other facilities
 - Student housing
 - Other university projects



Investments

- **Monitoring the investment of bond proceeds**
 - Can you earn positive arbitrage?
 - Can you keep it?

Use

- **Who can use tax-exempt bond financed facilities?**
 - Limits on private business use

A wide-angle photograph of a sunset over a calm body of water. The sky is filled with warm, orange, and yellow hues, with some darker clouds on the right. In the distance, there are small, dark islands. The foreground is partially obscured by the branches and needles of evergreen trees.

Closing Requirements

At Closing

A number of federal tax law requirements must be met at closing

Documentation

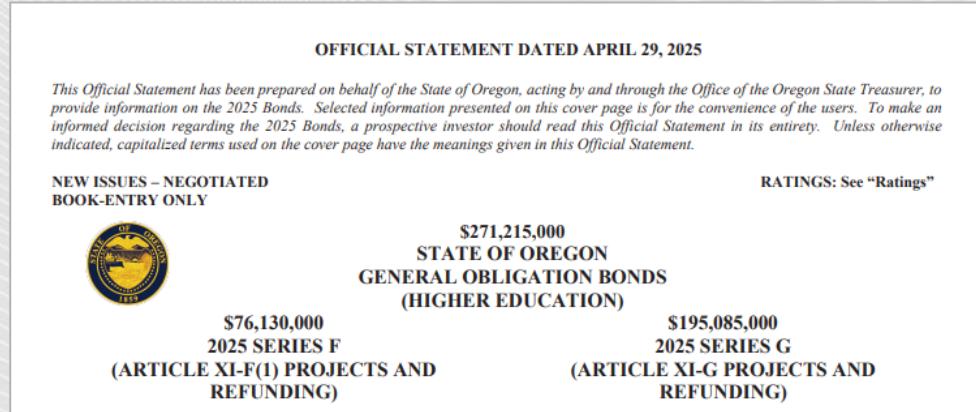
- Tax certificate(s)
- Form 8038-G (governmental bonds) and Form 8038 (qualified private activity bonds)

Based on reasonable expectations on the date of closing

8038-G Form (Rev. October 2021) Department of the Treasury Internal Revenue Service	Information Return for Tax-Exempt Governmental Bonds ► Under Internal Revenue Code section 149(e) ► See separate instructions. Caution: If the issue price is under \$100,000, use Form 8038-GC. ► Go to www.irs.gov/F8038G for instructions and the latest information.	
Part I Reporting Authority		Check box if Amended Return ► <input type="checkbox"/>
1 Issuer's name		2 Issuer's employer identification number (EIN)
3a Name of person (other than issuer) with whom the IRS may communicate about this return (see instructions)		3b Telephone number of other person shown on 3a
4 Number and street (or P.O. box if mail is not delivered to street address)	Room/suite	5 Report number (For IRS Use Only) 3
6 City, town, or post office, state, and ZIP code		7 Date of issue
8 Name of issue		9 CUSIP number
10a Name and title of officer or other employee of the issuer whom the IRS may call for more information		10b Telephone number of officer or other employee shown on 10a

At Closing: State and University Roles

State Issues Article IX-F(1), G and Q Bonds



For University Projects

Purpose and Authority

The 2025 Bonds are being issued by the Issuer, at the request of the Director of the Oregon Department of Administrative Services (“DAS”), with the concurrence of the Higher Education Coordinating Commission (“HECC”) to finance various projects for Oregon universities and community colleges, to refund certain of the State’s outstanding general obligation bonds, and to pay costs of issuing the 2025 Bonds, as described herein. The 2025 Bonds are being issued pursuant to provisions of the Oregon Constitution that specifically authorize the issuance of general obligation bonds, including refundings, for projects that benefit certain higher education institutions or activities or community colleges authorized by law to receive State aid, Oregon Revised Statutes chapters 286A, 341 and 352, as amended, and an Issuance Certificate executed by the State Treasurer. See “AUTHORITY FOR ISSUANCE” herein for a more detailed discussion.

USSE Debt Management Responsibilities

Overview of Responsibilities and
Processes

Purpose

- Legislative mandate
- Legacy Debt Services
- Non-Legacy Debt Services
 - 2015 and later

At Closing of Bond Sale

- Request Debt Sale information by Project and University from DAS:
 - Contracts Payable amount/Debt Service Schedules
 - Project Funding Amount
- Provide updated Debt Service Schedules to Universities:
 - New Money Sales
 - Refundings
 - DebtBook
- Institutional Paid Debt:
 - *Record* Contracts Payable
 - *Record* Contracts Receivable
 - If a refunding, record adjustment to Contract Liability
 - University to provide Project Fund and Liability Fund Information

At Fiscal Year End

- Institutional Paid Debt:
 - Record Short Term Liability, Adjust Long Term Liability
 - Record Interest Accrual as of June 30
 - Prepare Schedules for Financial Statement Preparation and Audit Requests

State Documentation (Summary)

Grant agreements

Based on template form

Customized schedules

Loan agreements

Based on template form

Customized schedules

PITC

Joint Post-Issuance Tax Compliance
Agreement

- Arbitrage and rebate records
- Tracking and reporting PBU

Tax certificate for each issue

Grantee/borrower exhibit to State tax
certificate

Based on template form

Reasonable expectations at closing
regarding:

- Project
- Reimbursements; spenddown
- Private use

Form 8038G

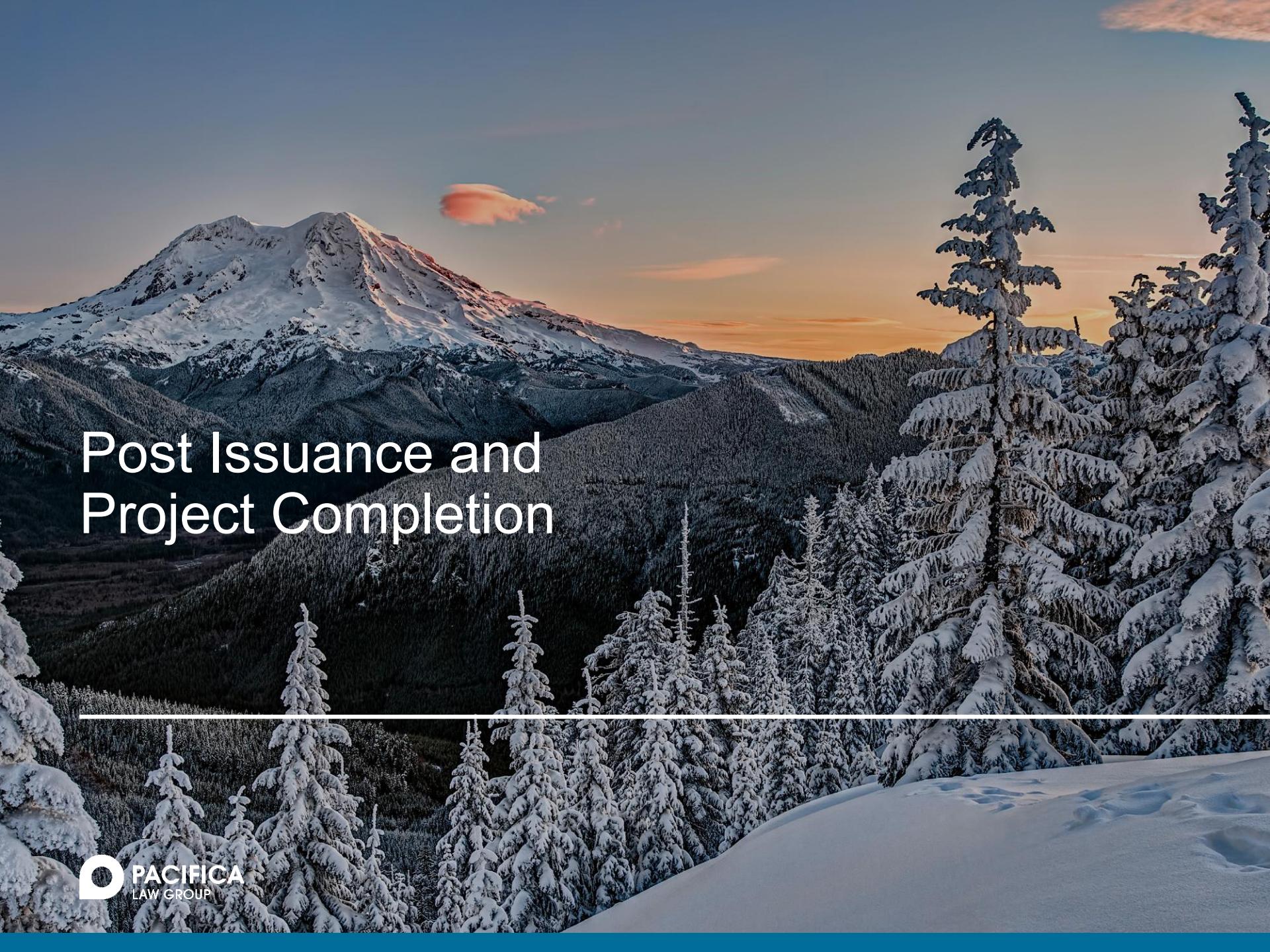
Each University's PITC policy

Polling Question

What sorts of bond grant and loan agreements does your university have with the State?

- 1. G bond**
- 2. F(1) bond**
- 3. Q bond**
- 4. All of the above**





Post Issuance and Project Completion

Importance of a Post-Issuance Compliance Program

Post-Issuance compliance

- ✓ Duration of compliance requirements
- ✓ Record keeping
- ✓ Proactively addressing potential noncompliance
- ✓ Timely corrective action

Key moments

- Refundings
- Succession
- Audits



State Compliance Reports

Ongoing reporting obligations

Grant and/or Loan Agreements

- Project completion report on the Recipient's expenditure [and the Matching Amount]
- No later than the Allocation Deadline, a final funding allocation report of all funding sources (bond and non-bond funding) allocated to the Project.
- Notice of default
- Additional reports as the State may reasonably request from time to time.

Tax Certificate

- Notice of change in use

PITC

- Notice of new Specified Arrangements
- Annual compliance report and training*



State Tax Documentation

Joint Post-issuance Tax Compliance Agreement (PITC)

Among OST, DAS and the universities

Identifies post-issuance tax compliance obligations for State bonds

- Arbitrage

- Maintain records, follow DAS/OST instructions, pay allocable rebate or yield restriction payment

- Private business use

- Provide notice of new “**Specified Arrangements**” that may give rise to PBU → consultation
 - Sales of Financed Assets
 - Leases of Financed Assets (other than residential leases),
 - management contracts not identified in Revenue Procedure 97-13, as clarified by Notice 2014-67,
 - contracts for basic research outside of the guidelines specified in Revenue Procedure 2007-47,
 - the sale or provision of electricity, water, or steam heat produced by the Financed Assets to buildings or structures that are in whole or in part used in a manner that gives rise to PBU, and
 - contracts that convey special legal entitlements for the beneficial use of Financed Assets comparable to those conveyed by the contracts identified above
 - Procedures for transferring/addressing PBU
 - Annual PBU compliance report

- Annual compliance training

- Excess PBU; remedial actions; VCAP

Key Compliance Reports

Project

- Expenditure reports
- Final allocation (including match, other Qualified Equity)

PBU

- Annual report
- Any other new Specified Arrangement

Other

- Annual training*
- Notice of default

PITC and Debt Service Payments

- State Compliance reporting:
 - Track expenditure of bond/project proceeds until all project funds are expended (Includes University issued Revenue Bonds)
 - Prepare drafts of Final Project Reports required by the State (Certificate of Completion)
 - Tax-Exempt Debt - Calculate and Track Private Business Use by Building within Series
 - Preparation of Annual Financial Status Reports
 - PBU Annual Report
- Miscellaneous tasks:
 - Initiate and Record Semi Annual Debt Service Payments

Private Business Use Tracking

- PBU Tracking by Series, University, Project, and Building
 - PBU Annual Report
 - Location Codes
 - DebtBook
- PBU Change in Use
 - Research PBU availability- current bonding associated with Building
 - Request PBU approval from the State
 - Sale of a University Building

Digitizing Debt Data

- DebtBook
 - Centralize data shared with universities
 - Reduce dependence on spreadsheets
 - Streamline reporting... *driving efficiencies*
 - PBU Beta Testing

A wide-angle photograph of a coastal scene. In the foreground, a dark, wet beach reflects the sky. A single, mossy rock sits in the water on the left. To the right, a large, dark rock formation, known as a sea stack, rises from the water. The stack is covered in a dense forest of tall, green coniferous trees. The sky above is a mix of bright blue and white, fluffy clouds.

Expenditures and Allocations

Allocating to Expenditures

General Rule: Bond proceeds cease being proceeds when properly allocated to expenditures. Once a proper allocation or expenditure occurs, the arbitrage rules no longer apply to those amounts.

The State generally requires that bond funds be distributed either for

- Reimbursement of expenditures already made or
- Amounts to be expended within 5 days.

Reimbursement or a “current outlay” of cash

- Considered expended on the date the proceeds are disbursed for the reimbursement
- Current outlay of cash means an outlay reasonably expected to occur not later than 5 banking days after the allocation date.

Reimbursement of Pre-Issuance Expenditures

General Rule: Bond proceeds can be allocated to reimbursement of expenditures made prior to closing under certain circumstances.

Nature of expenditures:

- Capital Expenditures
- Issuance costs
- “Extraordinary” working capital
- Certain grants or loans

Timing:

- Expenditure made not more than 60 days prior to “official intent” declaration
- Allocation must be made not later than 18 months after the later of—
 - The date the original expenditure is paid; or
 - The date the project is placed in service or abandoned, but in no event more than 3 years after the original expenditure is paid.

Timing Exceptions:

- Preliminary Expenditures
- Issuance costs and “de minimis” expenditures

Final Allocation

Allocation methods:

- Need to be reasonable and consistently applied
- Specific tracing (default)
- FIFO or LIFO
- Pro Rata
- Bond-proceeds-spent-first

Final allocation is an opportunity to review and change the allocation of bond proceeds.

Timing Restrictions:

- Not later than 18 months after the later of
 - The date the expenditure is paid or
 - The date the project is placed in service
- 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier

A wide-angle landscape photograph of a mountainous region at sunset. The sky is filled with large, wispy clouds colored in shades of orange, yellow, and blue. In the foreground, the tops of evergreen trees are visible. Below them, a large, calm lake stretches towards the horizon, with several small, rocky islands. In the distance, dark, silhouetted mountains rise against the sky. On the right side of the image, a rocky cliff face is visible, with a small, white, domed building perched on top. The overall atmosphere is serene and majestic.

Private Business Use

Basic Rule (Governmental)

Bonds issued as governmental bonds will become “private activity bonds” and therefore lose their tax status if:

1. More than 10% of bond proceeds are used for a “**private business use**” and
2. More than 10% of the debt service on the bonds is directly or indirectly payable from or secured by property used in a private business.

3. Or, more than 5% of the bond proceeds are loaned to a private entity



Note: Special rule for bond issues above \$150 million: The amount of private business use is effectively capped at \$15 million per issue.

Unrelated and Disproportionate Use

The PBU limit is reduced to 5% for private use that is “unrelated” or “disproportionate” to the governmental use

- Related use is within or adjacent to the bond financed, governmentally used facility for the same purpose as the governmental use. If not, may be “unrelated,” which is determined on a case by case basis.
 - Bonds finance \$18M academic building and \$2M privately operated cafeteria in an office building across campus. Cafeteria is unrelated to the academic building.
 - Bonds finance a hospital including a pharmacy within the hospital. Although the pharmacy may serve individuals not using the hospital, it is not unrelated use of the bond proceeds.

Unrelated and Disproportionate Use

Use is disproportionate to a related government use only to the extent that the amount of proceeds used for the private use exceeds the proceeds used for the governmental use.

- Bonds finance \$20M academic building and \$2M office building. Office building is 25% occupied by the University and 75% occupied by private business users.
 - Private use of the office building is unrelated to the University use of the academic building, but is related to the University use of the office building.
 - Private use is disproportionate to (i.e. greater than) the governmental use of the office building
 - Of \$22M in bond proceeds, \$1.5M is allocable to the disproportionate use of the office building. That exceeds 5% of the total bond proceeds.

Qualified 501(c)(3) Bonds

- If bonds are “qualified 501(c)(3) bonds” then most use by 501(c)(3) organizations is not considered private business use
- Need to follow special rules when issuing, such as having a public hearing and using a conduit issuer
- PBU limit is reduced to 5%
- Proceeds spent on costs of issuance count against the PBU limit
- A public university may choose to issue all or a portion of their bonds as 501(c)(3) bonds if they expect a lot of use by 501(c)(3) organizations

What is Private Business Use?

Private business use of a financed facility is any use by or for the benefit of a party other than use by a state or local governmental entity or use as a member of the general public. In short, private business use means:

- Use (directly or indirectly)
- Of a financed facility
- In a “trade or business”
- Carried on by any person other than a state or local governmental unit
 - including the federal government and nonprofit organizations

Private Business Users

- Federal government
- Foreign governments
- Corporations, partnerships or any other entity engaged in business
- Natural persons engaged in a trade or business
- Governmental Bonds: 501(c)(3) organizations
- Special rules for partnerships with private users
- Note: Students are not private users. They are natural persons, not engaged in a trade or business.

Basic Measurements

- The amount of private business use of property is determined according to the average percentage of private business use of that property during the measurement period.
- Measurement Period:
 - Starts: later of the issue date of the bonds or the date the property is placed in service
 - Ends: earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of the bonds.
- Track the private business use on an annual basis and then average the annual use over the measurement period.

Examples: Measurement Period

1. University issues tax-exempt bonds with a 22 year maturity to finance 100% of the costs of rehabilitation of a 20-story building with a 20 year expected economic life. University wants to lease 3 floors to a nongovernmental person for all 20 years.

- Measurement period?
 - 20 years
- Average percentage of PBU?
 - Years 1-20: 3 floors / 20 floors = 15% PBU
 - Average PBU = **15%**

2. University will lease the three floors to the nongovernmental person for only 10 years.

- Average percentage of PBU?
 - Years 1-10: 3 floors / 20 floors = 15% PBU
 - Years 2-20: 0 floors / 20 floors = 0% PBU
 - Average PBU: $[(15\% * 10 \text{ years}) + (0\% * 10 \text{ years})] / 20 \text{ years} = 7.5\%$

Types of Use (Overview)

- Ownership
- Leases
- Management Contracts
- Output Contracts
- Sponsored Research Agreements
- Other actual or beneficial use
 - Special Legal Entitlements
 - Priority Rights



General Public Use Exception

Use as a member of the general public is not private business use.

- Use by non-governmental (or non-exempt) persons in their trade or business is treated as general public use if
 1. The property is available for use by the general public and
 2. The use is on the same basis as the general public use.
- Use that provides priority rights or preferential benefits is not general public use.
- Use that is available for free or on the basis of generally applicable rates is not priority use
 - Discounts for volume purchases do not result in priority use if the rates are reasonable and customary
- Limitation: Can't have an arrangement for use that exceeds 200 days.

General Public Use: Examples

- Park or gardens on school grounds that are open to the public.
- Short-term rentals: Space in the University Student Center can be rented on an hourly or daily basis pursuant to a rate schedule. So, either natural persons or business entities can rent it, but it is available to either group at the same price.
 - What if student groups get a special price or are free? Generally not a problem as long as private entities don't pay a lower price.
- Parking: A parking garage on or near campus is primarily for use by students and faculty, but a nearby business leases 10 spots for its employees. The leases are for 6 month periods and renew at current prices.



Short Term Use Exceptions

50 Day Short Term Use Exception

- Use by a nongovernmental person is not PBU if
 - Term not greater than 50 days
 - Negotiated arm's length arrangement with fair market value compensation
 - The property was not financed for the principal purpose of providing that property for use by that nongovernmental person
 - Renewal options: for this purpose, it means a provision providing either party a legally enforceable right to renew the contract
 - Does not include “evergreen” provisions if either party can cancel

100 Day Short Term Use Exception

- Only applies if facilities aren't available for use by the public (i.e. prisons)

Other Exceptions

Temporary use by developers and construction companies

- Example: Infrastructure improvements such as roads and storm sewers at a new housing development for sole use by developer during construction

Agents

Incidental use exception

- Incidental uses of a financed facility are disregarded for purposes of the PBU limits to the extent that they do not exceed 2.5% of the proceeds of the bond issue used to finance the facility
- The use is non-possessory, i.e., it does not involve a transfer of space that is separated from the rest of the facility with walls or partitions
 - Examples: ATMS, pay phones, vending machines, kiosks, advertising displays, and use for television cameras



Key Private Business Use Topics

Leases and Use Agreements

- A lease or similar arrangement for a financed facility is generally considered private use.
- Relevant factors:
 - Degree of control over the property
 - Risk of loss
 - Federal tax treatment (i.e., is the lessee treating it as a lease on their taxes)
 - Example: A pizza restaurant (restaurant space leased to the business owner) on the first floor of a tax-exempt bond financed facility.
- If a lease has a sufficiently long term, it may constitute 'ownership' for federal tax purposes.

Management Contracts 101

What is a management contract?

- A management, service, or incentive payment contract between a governmental person and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility.
 - Examples: Contract for management of dining services, incentive payment contract for physician services at a hospital.
- Can result in private business use unless:
 - The Regulations specifically say it is not treated as a management contract.
 - The contract is a “qualified management contract” under Revenue Procedure 2017-13.
 - The contract under the “facts and circumstances” does not result in a net profits arrangement or otherwise constitute private business use.
- Net profit compensation is a problem 

Polling Question

Food service contracts often raise private use concerns.

Have you had a food service contract reviewed by DAS or bond counsel for compliance with the Revenue Procedure 2017-13 safe harbors?



YES

NO

Research Agreements

- What is a research agreement? An agreement by a nonqualified person to sponsor research performed by a qualified person.
 - Might also be called Collaboration Agreement, Material Transfer Agreement.
- Why would this be private use? Basically, the IRS does not want private entities using the University to do their product testing for them or to be the primary beneficiaries of University research.
- Sponsored “applied research” is generally private business use. For example, product testing supporting the trade or business of a specific nongovernmental person is applied research.
- Sponsored basic research may or may not be private business use. “Basic research” means any original investigation for the advancement of scientific knowledge not having a specific commercial objective.

Qualified Research Agreements

Safe Harbors in Revenue Procedure 2007-47:

- **Corporate Sponsorship:**
 - Single sponsor (not including federal government)
 - Can grant an exclusive license to the sponsor, but only on the same terms that would be offered to a non-sponsoring party
 - Must pay fair market value determined after the IP/technology has been created



Qualified Research Agreements

Additional Safe Harbors

- **Industry Sponsorship**

- Single or multiple sponsors (can include the federal government).
- The qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research).
- Title to any patent or other product incidentally resulting from the basic research lies exclusively with the qualified user.
- The sponsor or sponsors are entitled to no more than a nonexclusive, royalty-free (NERF) license to use the product of any of that research.

- **Federal Sponsorship**

- Subcategory under “Industry Sponsorship”—includes Federal agencies like National Institute of Health and National Science Foundation.
- The existence of march in rights under the Bayh-Dole Act will not cause the contract to be outside the safe harbor.

Qualified Research Agreements?

Sponsorship Agreement with Industry sponsor:

- University grants to sponsor a fully-paid, non-exclusive, royalty-free license for internal use only.

Sponsorship Agreement with Federal Agency:

- “Intangible property produced under the award is subject to the Federal Purpose license in accordance with the requirements of 2 CFR Part 200.315. The recipient grants to the Government all necessary and appropriate licenses as a condition of this award.”
- 2 CFR Part 200.315 says, in part, title vest with the non-Federal entity, to be used for the originally authorized purpose. Federal agency reserve a royalty-free, nonexclusive right to the property.

Sponsorship Agreement with Private Pharma:

- “Principal Investigator” is named in contract. If PI’s employment status changes, University may replace with a new PI acceptable to the sponsor.
- University has sole and exclusive authority to conduct, manage, control and direct the project and to supervise all personnel
- University will own all project intellectual property
- Sponsor has an option to purchase an exclusive license to any project intellectual property on reasonable commercial terms to be agreed upon by the parties

Not Research Agreements

License agreements are not research agreements.

- These agreements are entered into after the research has concluded and the intellectual property (IP) or technology has been developed.
- The University may sell licenses for exclusive or non-exclusive use of the IP or technology to any third parties at a negotiated price (assuming the licensee did not sponsor the research).

Clinical trials are not research agreements, so the safe harbors do not apply.

- There is little guidance from the IRS regarding whether clinical trials create private business use, so talk to your bond counsel.



Naming Rights

- Naming rights to a bond financed facility may give rise to Private Use. (Private Letter Ruling 200323006)
- Agreement may give sponsor legally enforceable rights with respect to the facility for a number of years.
- Despite the sponsor not having ownership, lease, management rights, contract provisions requiring the facility to be referred to with the name of the sponsor, the power to control how the facility is used, etc., gives rise to PBU.

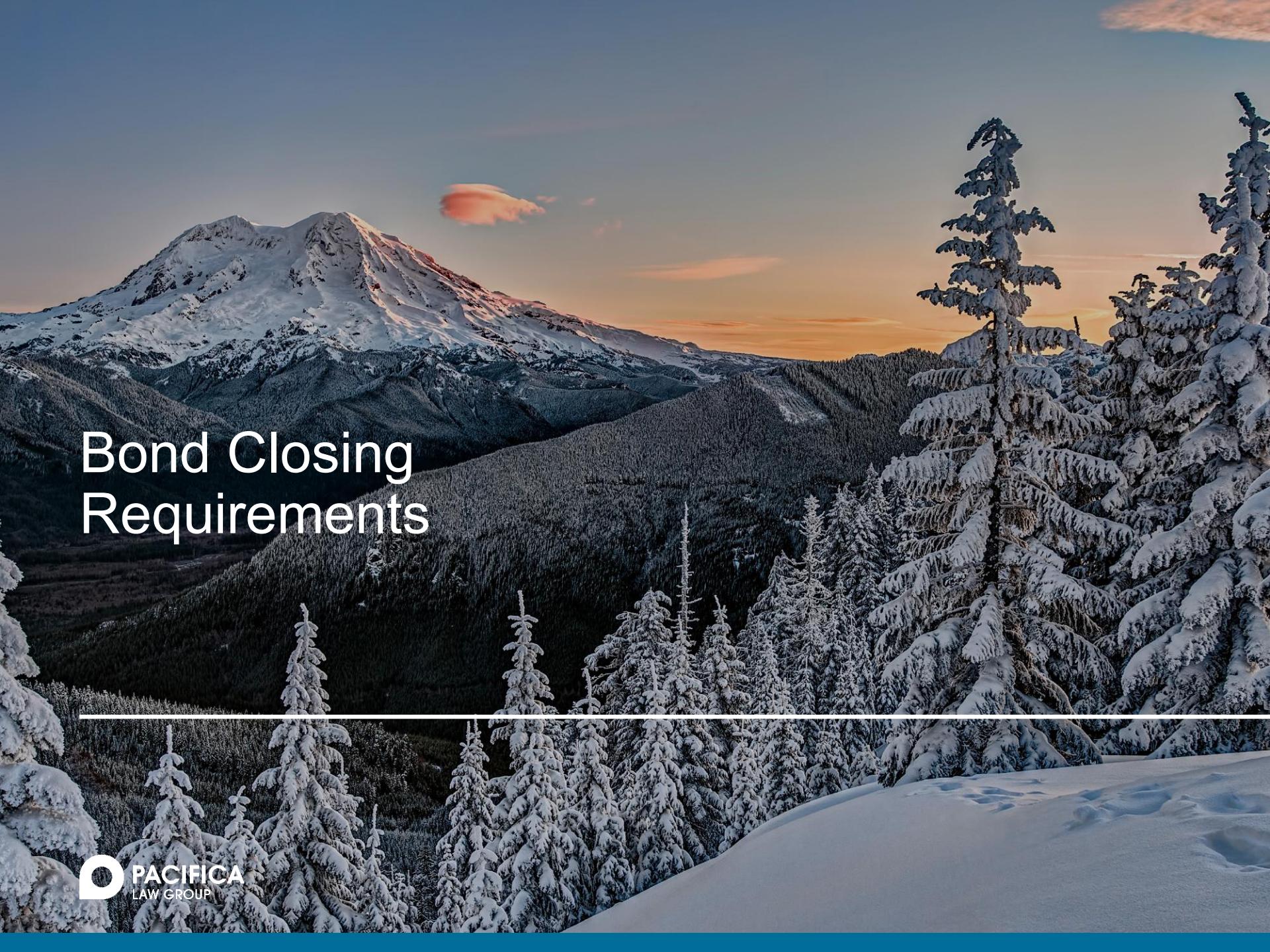
Donor Recognition

- Is the donor a natural person not acting in a trade or business?
 - If yes, no PBU.
- If the donor is a business, consider:
 - Is the gift conditioned on the use of their name?
 - Do they have any rights with respect to the facility?
- University should retain ultimate control over whether or not to recognize the donor and be able to remove the donor's name at any time for any reason.



“Other actual or beneficial use”

- City finances construction of parking lot adjacent to Corp A's factory. Corp A transfers the land to the City subject to covenant that it will always be used as a parking lot. Lot is available for use by the general public, but Corp A has the right to approve the rates.
- City builds pollution control facility on land adjacent to factory owned by Corp N. City will operate the facility, but Corp N is expected to be the only user. Facility is functionally related and physically proximate to factory; Corp N gets special economic benefit
- Also look out for any arrangements that give private users the right to revenues derived from the project or to control use of the project

A wide-angle photograph of a winter mountain range. In the background, a large, snow-capped mountain peak is visible, with a single, wispy, orange and white cloud hanging in the sky above it. The middle ground shows a dense forest of evergreen trees, their branches heavily laden with white snow. In the foreground, a large, snow-covered slope is visible, with more snow-covered trees in the immediate foreground. The lighting suggests it is either sunrise or sunset, with a warm glow on the horizon.

Bond Closing Requirements

Top 5: Examples of PBU on Campus

- 1. Campus shops**
- 2. Dining contracts**
- 3. Sponsored research**
- 4. Summer camps**
- 5. Naming rights**

A wide-angle landscape photograph of a mountainous region at sunset. The sky is filled with large, billowing clouds colored in shades of orange, yellow, and blue. In the foreground, the Columbia River Gorge is visible, with a bridge spanning the water. The surrounding mountains are dark and silhouetted against the bright sky. A small building, possibly a lookout or a house, is visible on a hill on the right side.

Remedial action

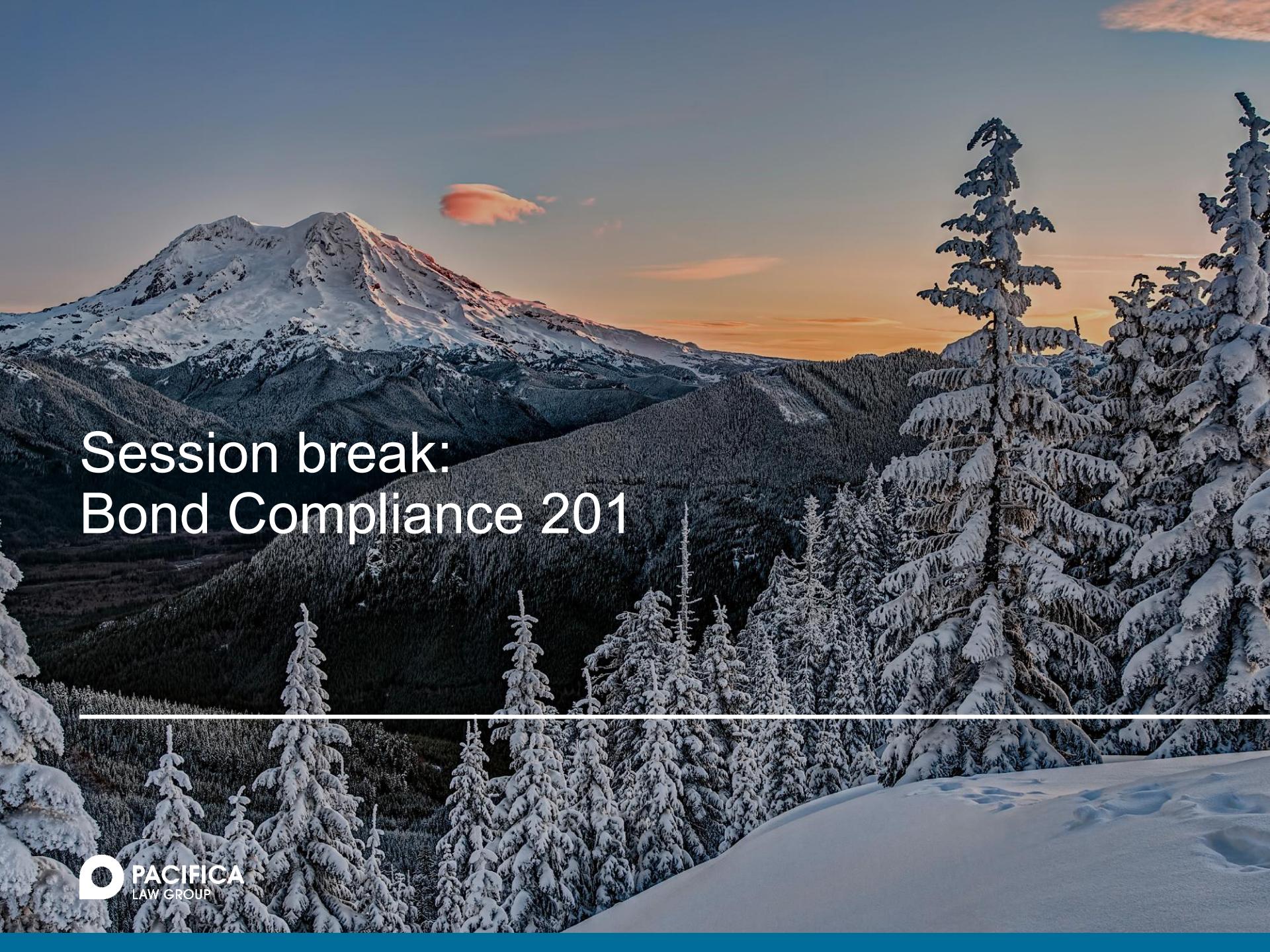
Remedial Action, VCAP, Audits

Remedial Actions

- In some cases, you can take a remedial action to 'fix' a change in use that would otherwise cause bonds to be private activity bonds
- Redeem nonqualified bonds
- Alternative use of disposition proceeds or facilities
- 90-day window

Voluntary Compliance Agreement Program (VCAP)

IRS Examinations/Audits

A wide-angle photograph of a mountain range at sunset. The peaks are covered in snow, and the sky is a gradient of orange and blue. In the foreground, several tall evergreen trees are heavily laden with snow. A thin white horizontal line is positioned across the middle of the image, partially obscuring the text.

Session break: Bond Compliance 201

Agenda

Post issuance tax compliance training

Bond compliance 201

- **Investments**

- Intro to arbitrage and rebate
- Temporary periods and other exceptions
- Rebate calculations and spending exceptions

- **State grant agreements**

- **State tax documentation**

- **Private business use**

- Qualified equity and mixed use projects
- Measurement examples, including refundings
- Management contracts 201
- Miscellaneous issues

- **IRS audits and updates**

- **Continuing disclosure**

Investments

Introduction to Arbitrage

Arbitrage

Arbitrage is the ability to earn yield by borrowing money at a lower rate (by issuing tax-exempt bonds) and investing it at a higher rate (in the taxable market)

- Positive arbitrage – earnings above the arbitrage yield
- Negative arbitrage – earnings below the arbitrage yield

Congress enacted rules to ensure tax-exempt bonds are issued for a governmental purpose and not to create arbitrage profits



Yield Restriction and Rebate

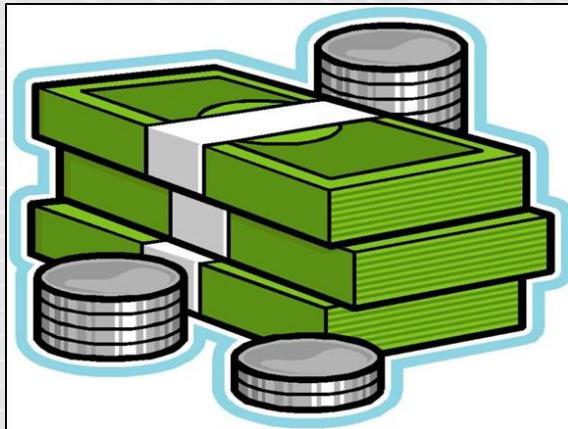
Yield Restriction and Rebate

Two sets of rules:

- Yield restriction – “Can you earn it?”
- Rebate – “Can you keep it?”

Both sets of rules must be applied to each fund containing “gross proceeds” of the bonds

For State bond issues, the State takes primary responsibility for arbitrage compliance



Gross Proceeds

Gross proceeds

Sale proceeds

- Amount received from the sale of the bonds (Issue Price)
- Includes amounts used for underwriter's discount

Investment proceeds

Transferred proceeds

- Only applies in refundings
- Tax documentation at closing will describe any expected transferred proceeds

Replacement proceeds

- Debt Service Funds
- Reserve Funds
- Other amounts that are pledged or expected to be used to pay debt service
- Can arise if bonds are outstanding longer than necessary
 - Safe harbor if term of bonds does not exceed 120% of the useful life of the project

Polling Question

Have any of you used a final allocation to change the allocation of bond proceeds to expenditures?



YES	<input checked="" type="checkbox"/>
NO	<input type="checkbox"/>

General Yield Restriction Rule

Yield restriction

Gross proceeds will be:

- Invested at unrestricted yield during an allowable temporary period;
- Invested at unrestricted yield as part of a “minor portion” not exceeding the lesser of \$100,000 or 5% of the issue;
- Invested at unrestricted yield as part of a reasonably required reserve fund; or
- Yield restricted—i.e., not invested at a yield that is materially higher than the yield on the bonds

Yield: Bond or arbitrage yield for fixed rate issues is determined at closing and will be included in the tax certificate and on the Form 8038G

Materially higher: Definition depends upon the category of funds

Exceptions to Yield Restriction

Temporary Periods

1. Construction and other capital projects – 3 years *if* test is met:
 - ✓ $\geq 85\%$ of net sale proceeds reasonably expected to be spent within 3 years;
 - ✓ Within 6 months of issue date, substantial binding obligation to spend $\geq 5\%$ of net sale proceeds; and
 - ✓ Construction or acquisition proceeds with due diligence
2. Debt service fund – 13 months
3. Replacement proceeds – 30 days
4. Miscellaneous (working capital) – 13 months
5. Current refunding escrow – 90 days

Reasonably Required Reserve Fund – sizing requirements

Investment in “Tax-Exempt Bonds” that are not considered “investment property”

Yield Restriction

At closing:

- If yield restriction is expected, the tax certificate will describe the funds to be restricted.
- Bond counsel will help structure allowable investments, such as SLGS or open market securities purchased through a bidding process

Post-closing:

- For example, if you have project funds remaining after the 3-year temporary period or if replacement proceeds arise unexpectedly, then yield restriction may be needed
- If you have questions, contact bond counsel or hire a rebate consultant

Yield Reduction Payments:

- In some cases, you can make yield reduction payments to reduce the yield on your investments. This can be easier to manage than constantly monitoring the yield.

Rebate: Exceptions

If an exception applies, rebate may not be required:

- 6 month exception
 - Refundings and new money
- 18 month exception
 - Acquisitions and construction
- 2 year exception
 - Construction only
 - Not available for some types of qualified private activity bonds
- Bona fide debt service funds
 - Full exception
- Exception \$100,000 in earnings



Reserve funds do not have an available exception. Rebate will always apply to excess earnings.

Rebate Computation and Payments

When?

- Computation Dates
 - There is some flexibility in choosing computation dates, but they cannot be later than 5 years after issue date and every 5 years thereafter
 - Date of redemption or final maturity of the bonds (“final computation date”)
- Payment
 - At least 90% must be paid \leq 60 days after each computation date
 - 100% must be paid \leq 60 days after final computation date

What?

- Difference between the amount actually earned on nonpurpose investments and the amount that would have been earned if investments had a yield equal to the yield on the bonds

How?

- Form 8038-T
- Rebate consultant can help



Arbitrage Tips

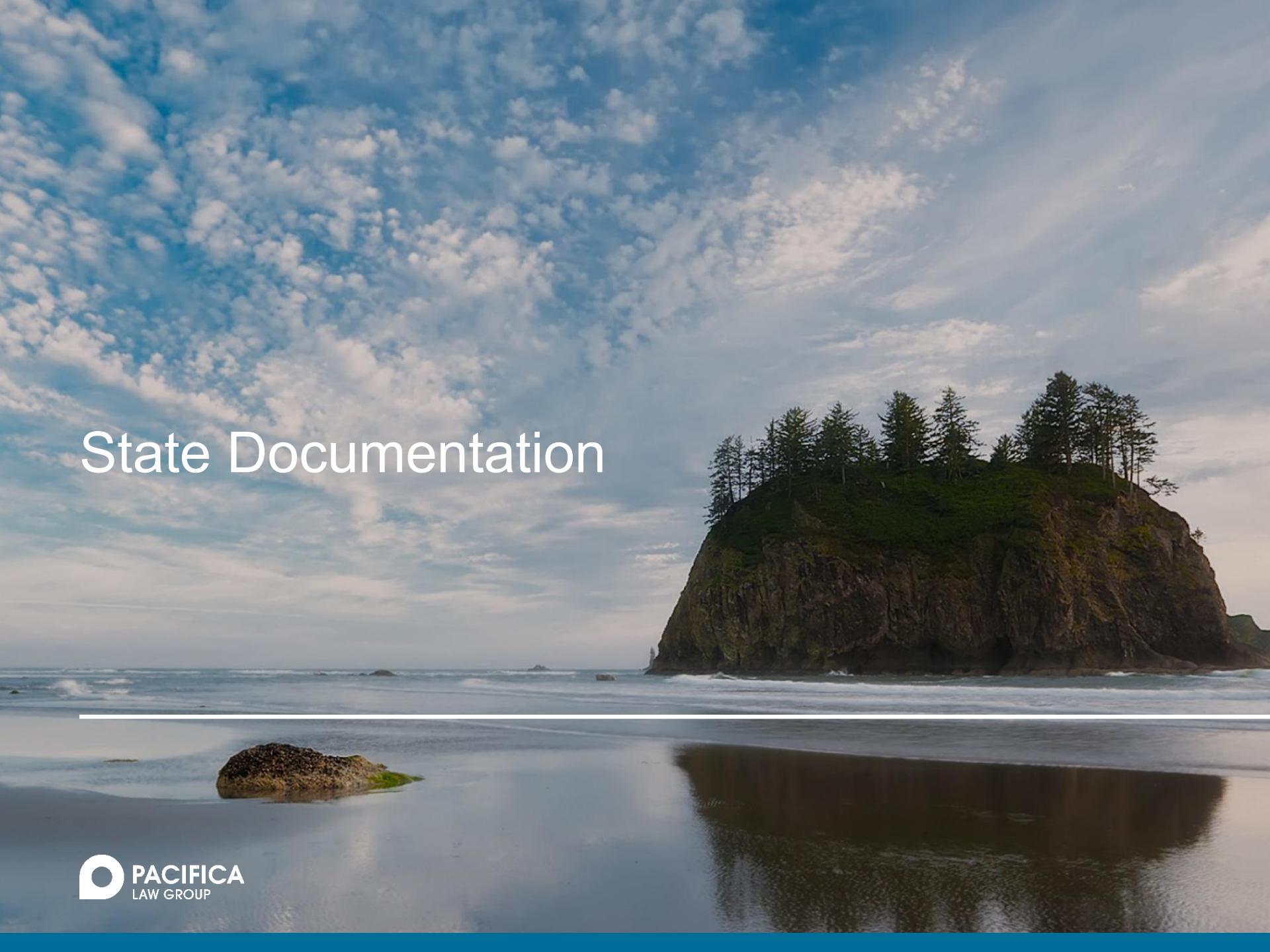
1. Look to tax certificate and 8038 or 8038G form for the arbitrage yield and expectations regarding:
 - Applicable temporary periods
 - Potential rebate exceptions
 - Funds subject to yield restriction
2. Commingled funds or investments can complicate tracking. Invest bond proceeds in separate accounts whenever possible.
3. Proceeds are tracked until expended (allocated). Know the rules for when proceeds are considered expended for tax purposes.
4. Keep detailed records of expenditures and investments.

Arbitrage Tips

5. Changing interest rate environment:
 - Possible to earn positive arbitrage
 - Investment yield is blended over time* so exceeding the bond yield temporarily may not be a problem.
6. First rebate calculation is due not later than 5 years after the issue date.
7. Get help when needed! Hire a rebate consultant or talk to bond counsel if you have questions.



**The blending rules differ for yield restriction and rebate requirements.*

A wide-angle photograph of a coastal scene. In the foreground, a dark, wet beach reflects the sky. A single, large, dark rock sits in the water on the left. In the middle ground, a massive, dark, craggy rock formation rises from the water, its top covered with a dense forest of tall, green coniferous trees. The background is a vast, light blue sky filled with wispy, white clouds.

State Documentation

State Documentation: Overarching Agreement

Debt management agreement (OST, HECC, DAS, university)

Pre-June 2015 State bonds to be paid by universities

- E.g., Article XI-f(1), Article XI-Q, certificates of participation
- Schedule of university repayment obligations

Tax compliance

- Agree to enter into an tax compliance agreement (e.g. PITC)

Refunding process

Process for future State issued bonds

Shared services

- Statement of Work (Shared Legacy Debt Services). The host university has agreed to provide certain services related to tracking, calculating and reporting interest earnings and private use of certain facilities in relation to the requirements for bonds issued with interest exempt from federal income tax.

State Documentation

Grant agreement provisions

Article XI-G:

- To provide funds with which to acquire, construct, improve, repair, equip and furnish **buildings, structures, land and other projects, or parts thereof**, that the Legislative Assembly determines will benefit higher education institutions or activities ...
- Match
 - At least equal to the amount of the indebtedness
 - Must be used for the same or similar purposes as the proceeds of the indebtedness
 - May consist of moneys appropriated from the General Fund or any other moneys available to the constructing authority for such purposes (but not State bond proceeds)
- ORS 286A.851 requires that the grant contract include:
 - A certification that the requirement for a matching amount is satisfied
 - Tax requirements
 - Terms and conditions indemnifying the State against regulatory or bondholder liability due to the action or inaction of the public university related to the Article XI-G bonds

State Documentation

Grant agreement provisions

Article XI-Q:

- **Acquiring, constructing, remodeling, repairing, equipping or furnishing real or personal property that is or will be owned or operated by the State of Oregon.**
 - Pursuant to ORS 352.113, legal title to all real property is held in the name of the State, acting by and through the Board.
 - The State, acting by and through the Board, also owns personal property financed with the proceeds of State Article XI-Q bonds during the term of the bonds.



State Documentation

Grant agreement provisions

Type of bond (XI-G or XI-Q)

Project

- Project description
- Project budget
- Qualifying costs

Any applicable match requirements

Project reporting requirements

Other

State Documentation

Loan agreement provisions

Type of bonds

- Article XI-F(1) bonds:

- Purpose: to acquire, construct, improve, repair, equip and furnish buildings, structures, land and other projects, or parts thereof, that the legislative assembly determines will benefit higher education institutions or activities.
- State repaid from University revenues including all funds available to the constructing authority except amounts appropriated by the legislative assembly from the General Fund. Article XI-Q bonds

- Article XI-Q bonds:

- Purpose: For costs of acquiring, constructing, remodeling, repairing, equipping or furnishing real or personal property that is or will be owned or operated by the State of Oregon.

State Documentation

Loan agreement provisions

1. Type of bond (XI-F(1) or XI-Q)
2. Project
 - Project description and budget
 - Qualifying costs
3. *Repayment provisions*
 - *Cash flow sufficiency affirmation*
 - *Loan repayment schedule*
4. Project reporting requirements
5. Other requirements



State Documentation

Qualifying costs definition

Qualifying costs

- Meets constitutional purpose

- Capital cost:

- Capitalized under GASB;
- Not capitalized but solely because below \$5,000; or
- Costs for abatement and pollution remediation to the extent required by law to complete the Project

- Eligible or permitted uses of the Grant under the Act and the Contract

- If tax-exempt:

- Capital expenditures for federal income tax purposes
- Not internal costs or payments to Related Parties, except to the extent that those costs represent out-of-pocket payments to or for the benefit of unrelated parties, such as employees of the Recipient or of the State, made or to be made no later than 5 days after the date on which proceeds of Bonds are allocated to such expenditure.

State Tax Documentation

Tax certificate provisions

Treatment of parties as related parties

• Expenditures

- Payment of proceeds of the Grant to the University or a Related Party of the University
 - Not an expenditure of those proceeds for federal tax purposes
- An expenditure is a current outlay of cash
 - I.e., an outlay expected to occur not later than 5 banking days after the date as of which the allocation of expenditure is made) to an unrelated third party
- Timing of expenditures

Funds and accounts

- Proceeds of the bonds
- Arbitrage
- Yield restriction and rebate

Project

- Private Business Use
- Mixed Use Projects

Other

- Document Retention

State Tax Documentation

Joint Post-Issuance Tax Compliance Agreement (PITC)

Among OST, DAS and the Universities

Identifies post-issuance tax compliance obligations for State bonds

- Arbitrage

- Maintain records, follow DAS/OST instructions, pay allocable rebate or yield restriction payment

- Private business use

- Provide notice of new “Specified Arrangements” that may give rise to PBU → consultation
 - Sales of Financed Assets
 - Leases of Financed Assets (other than residential leases),
 - Management contracts not identified in Revenue Procedure 97-13, as clarified by Notice 2014-67,
 - Contracts for basic research outside of the guidelines specified in Revenue Procedure 2007-47,
 - The sale or provision of electricity, water, or steam heat produced by the Financed Assets to buildings or structures that are in whole or in part used in a manner that gives rise to PBU, and
 - Contracts that convey special legal entitlements for the beneficial use of Financed Assets comparable to those conveyed by the contracts identified above
 - Procedures for transferring/addressing PBU
 - Annual PBU compliance report
- Annual compliance training
- Excess PBU; remedial actions; VCAP

A wide-angle photograph of a coastal scene. In the foreground, a dark, wet beach reflects the sky. A single, large, dark rock sits in the water on the left. In the middle ground, a massive, dark, craggy rock formation rises from the water, its top covered with a dense forest of tall, green coniferous trees. The background is a vast, light blue sky filled with wispy, white clouds.

Private Use 201

Qualified Equity and Mixed Use Projects

Key concepts

- Project definition
- Classifying use (good/bad)
- Measuring use (square footage, revenue etc.)
- Timeframe
- Qualified equity



Eligible Mixed-Use Projects

- 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 issue:
 - Issuers are given flexibility with how to define the Project or Projects financed.
- An Eligible Mixed-Use Project is defined as a project that is financed with:
 - Proceeds of tax-advantaged bonds and
 - Qualified equity pursuant to the same plan of financing.



The project must be wholly owned by one or more governmental persons or by a partnership in which at least one governmental person is a partner.

Divided and Undivided Portion Allocations

- Divided Portion: Equity is allocated to a specific portion of the Project expected to be used for private use (i.e. a restaurant space on the first floor) and bond proceeds are allocated to the rest of the building.
 - If the restaurant moved to a bond-financed portion of the Project, the private use would no longer be allocable to the equity.
- Undivided Portion (“floating” equity): The whole Project is treated as financed with bond proceeds and qualified equity, and qualified equity can be allocated to private business use (PBU) prior to bond proceeds (i.e., equity “floats”).
 - Under the final regulations, the undivided portion method can be used for Eligible Mixed-Use Projects.

Qualified Equity Definition

Qualified Equity (QE)

- Bonds that are not tax-advantaged bonds
 - Regular taxable bonds are not ‘tax-advantaged’
 - Build America Bonds and tax credit bonds are ‘tax-advantaged’
- Funds that are not derived from a borrowing (cash on hand; contributions).
 - State funds might be qualified equity if the funds aren’t proceeds of tax-advantaged bonds
 - Bond proceeds and equity are spent contemporaneously on the same project
- Amount of QE is included in the Fund Allocation Report provided to DAS

Not Qualified Equity

Qualified Equity (QE) does not include:

- Equity interests in real estate (FMV less debt).
- Funds used to redeem or repay governmental bonds
- QE also does not include amounts that are not part of the “same plan of financing” as the bonds



Start the Clock...

- No earlier than the date on which the expenditure would be eligible for reimbursement by proceeds of the applicable bonds
 - Qualified Equity original expenditure must be within three years of the tax-exempt bond issuance, and
 - Tax-exempt bond issuance must occur not later than 18 months after the later of:
 - The date the original expenditure was made, or
 - The date the project is placed in service or abandoned.
- Note: No reference to Official Intent

Stop the Clock...

- No later than the date on which the measurement period begins:
 - Qualified Equity must be expended prior to the placed in service date
 - Of the “Project” as a whole? Of a facility within the Project?
 - Exception for a reasonable retainage, which is an amount not to exceed 5% of ‘available construction proceeds’
 - Definition comes from rebate spending exceptions and isn’t entirely clear—should the 5% apply to the amount of QE? Of all of the Project costs?



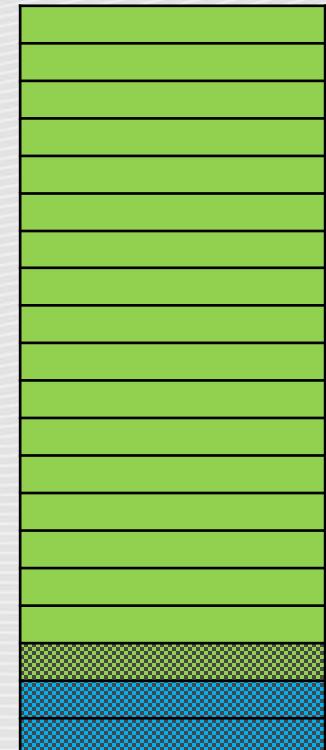
When Is Placed in Service?

- Treasury Regulation 1.150-2(c) defines “placed in service”
 - Placed in service means, with respect to a facility, the date on which, based on all the facts and circumstances—
 - The facility has reached a degree of completion which would permit its operation at substantially its design level; and
 - The facility is, in fact, in operation at such level.
- Compare to “certificate of occupancy”

Example: Qualified Equity 101

University wants to lease 3 floors of a 20 floor building for the entire life of the project. Total project cost is \$20M; University will issue \$18M bonds, and use \$2M qualified equity.

- 15% PBU of the project annually (3 / 20 floors)
- Allocate private use to QE first:
 - QE will pay for 10% of the project: $\$2M QE / \$20M \text{ total} = 10\%$
 - We can allocate 10% of the 15% PBU to qualified equity
- Then to bond proceeds:
 - Remaining PBU = 5%, or \$1M
 - Allocated to bond proceeds: $\$1M PBU / \$18M \text{ bond proceeds} = 5.6\%$



Measurement Examples (Including Refundings)

University plans to finance three buildings:

- University Offices
- Athletic Facility
- Science and Research Facility

University plans to use a mix of funding:

- Tax-exempt bonds
- State funding (not tax-exempt)
- Capital campaign contributions



“Mixed Use Project” Allocation

- The administrative building, athletic facility and research facility can be treated as a single eligible mixed use project for purposes of allocating qualified equity and private use.
- Bond proceeds and other sources can be allocated to the project as a whole (undivided portion).
 - This works even if the equity is designated for a certain portion of the project, i.e., capital contribution for the athletic facility
- Each year, private business use will be measured for the project as a whole.
- Private business use in the project is allocated first to qualified equity and then to bond proceeds.

Annual PBU Analysis

If “Project” as a whole is funded 85% with tax-exempt bond proceeds and 15% with Qualified Equity, up to 15% PBU across the projects will be allocated to the Qualified Equity.

Uses	Total Project Costs	Private Use by Facility	Private Use of “Project”
University Offices	\$20,000,000	0%	0.0%
Athletic Facility	\$30,000,000	10%	3.0%
Science Facility	\$50,000,000	25%	12.5%
Total Cost	\$100,000,000	Total PBU	15.5%
		Qualified Equity	15.0%
		Allocable to Bonds	0.5%

Other Options

- University can choose to treat each facility/building as a separate “project” for private business purposes.
- The qualified equity will be allocated to a particular facility:
 - If the equity is University cash on hand or is undesignated, then the University can choose which facility to allocate equity to.
 - If the equity has been designated by a donor or by the State for a particular facility, the equity is allocated to that facility.
 - The benefit of the qualified equity no longer “floats” between the facilities as needed.
- Why take this approach?
 - In some circumstances, it is easier to track each project separately.
 - For example, “Phased Projects.”
 - Note that internal policies can be more restrictive than the approach taken for tax-exempt purposes.

Later Improvements or Additions

Example 3 in Treas. Reg. 1.141-6(f) makes clear that subsequent improvements and replacements to a facility are not part of the same Project as the original facility.

- In the example, a hospital financed with 1998 Bonds and placed in service in 2001 has an addition constructed with proceeds of 2017 Bonds and Qualified Equity.
- The original hospital (the “1998 Project”) and the addition (the “2017 Project”) are separate Projects.
- The Qualified Equity only off-sets private business use with respect to the 2017 Project.

Management Contracts 201

Revenue Procedure 2017-13 sets forth the “safe harbor” requirements for a Qualified Management Contract:

- **Financial requirements**
 - Reasonable compensation
 - No net profits
 - No bearing of net losses
- Term no greater than the lesser of 30 years or 80% of weighted average reasonably expected economic life
- Qualified user exercises significant control
- Qualified user bears risk of loss
- No inconsistent tax position
- No circumstances substantially limiting exercise of rights

Qualified Management Contracts: No Net Profits Arrangements

Revenue Procedure 2017-13:

- Compensation must be reasonable compensation for the services rendered. Compensation includes reimbursements to provider for actual and direct expenses and related administrative overhead expenses.
- Compensation must not be a net profits arrangement:
 - Can't take into account, or be contingent upon, either the managed property's net profits or both the managed property's revenues and expenses for any fiscal period.
 - Consider: eligibility for, amount of, and timing of compensation.
 - Incentive compensation okay if it is determined by provider's performance in meeting one or more standards that measure quality of services performance or productivity and if amount and timing of compensation otherwise meet the "no net profit" requirement.

Qualified Management Contracts: No Bearing Net Losses

- Contract must not, in substance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property:
 - Amount compensation and expenses paid by provider can't take into account net losses or both the managed property's revenues and expenses for any fiscal period.
 - Timing of payment can't be contingent upon net losses.
 - However, reduction of compensation by a stated amount for failure to keep expenses below specified targets is not sharing in net losses.
- If compensation will be deferred due to insufficient net cash flows:
 - Must be payable at least annually.
 - University is subject to reasonable consequences for late payment (interest or late payment fees).
 - University will pay such deferred compensation no later than the end of five years after the original due date.

Qualified Management Contracts: Safe Harbor Compensation

- Revenue Procedure says these fees are not net profit or net loss arrangements:
 - Capitation fee
 - Periodic fixed fee
 - Per-unit fee
 - Certain incentive compensation
 - Or a combination of the above
- What about gross revenue or profit arrangements?
 - Prior Revenue Procedure had a specific safe harbor for gross revenue arrangements
 - Rev Proc 2017-13 is silent regarding gross revenue compensation. Need to evaluate for possible net profit or loss arrangement. Who pays the expenses?

Qualified Management Contracts: Other Requirements

- Term no greater than the lesser of 30 years or 80% of weighted average reasonably expected economic life:
 - Retest on the date of any material modification to the contract
- Qualified user exercises significant control:
 - Annual budget
 - Capital expenditures
 - Disposition of any property
 - Rates charged
 - General nature and type of use/services offered
- Qualified user bears risk of loss upon damage or destruction of property.
- Provider must agree to take no inconsistent tax positions.
- No circumstances substantially limiting exercise of rights:
 - Look at control of University (i.e., voting power, involvement of service provider on governing board, shared CEO)

Miscellaneous Issues

Discussion



A wide-angle photograph of a coastal scene. In the foreground, a dark, wet beach reflects the sky. A single, mossy rock sits in the water on the left. To the right, a large, dark rock formation rises from the water, its slopes covered with a dense forest of tall evergreen trees. The ocean waves are visible at the base of the rock. The sky above is a vibrant blue, filled with wispy, white clouds.

IRS Audits and Updates

IRS Enforcement Updates

Trends in enforcement

- Volume trends
- Staffing trends
- Resolution timing

IRS

IRS explains longer audits, uptick in exams to bond lawyers

By [Jennifer Shea](#)

September 19, 2024, 12:34 p.m. EDT

3 Min Read

ELECTION 2024

Cut in IRS funding may limit bond audits

By [Scott Sowers](#)

November 11, 2024, 12:56 p.m. EST

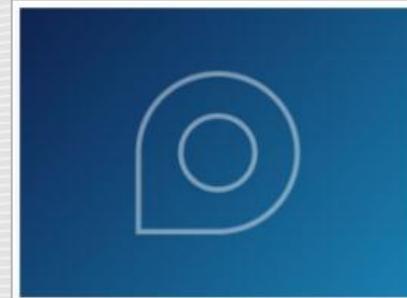
3 Min Read

A wide-angle landscape photograph of a mountainous region at sunset. The sky is filled with large, billowing clouds colored in shades of orange, yellow, and blue. In the foreground, the tops of evergreen trees are visible. Below them, a large, calm lake stretches towards the horizon, with several small, rocky islands. On the right side of the image, a steep mountain slope is covered in dense forest. A small, white, classical-style building with a prominent dome sits atop a rocky outcrop on the mountain. The overall atmosphere is serene and majestic.

Continuing Disclosure

Post-Issuance Compliance: Securities Law

- University issuers
- Required under SEC Rule 15c2-12
 - Applies to all public bond sales
 - Duration = the life of the bonds
- Elements of an undertaking:
 - Annual financial and operating information
 - Notice of “listed” events
- Published on “EMMA”



JULY 21, 2016

On the To Do List for
Municipal Bond Issuers:
Disclosure Policies and
Procedures

[Read more](#)

Post-Issuance Compliance: Securities Law

- Sixteen notice events identified in Rule 15c2-12
 - Some must always be disclosed
 - E.g., rating change
 - E.g., defeasances and redemptions
 - Others must be disclosed only if *material*
 - E.g., defaults
 - E.g., incurrence of a new financial obligation
- Must disclose within **10 business days** 

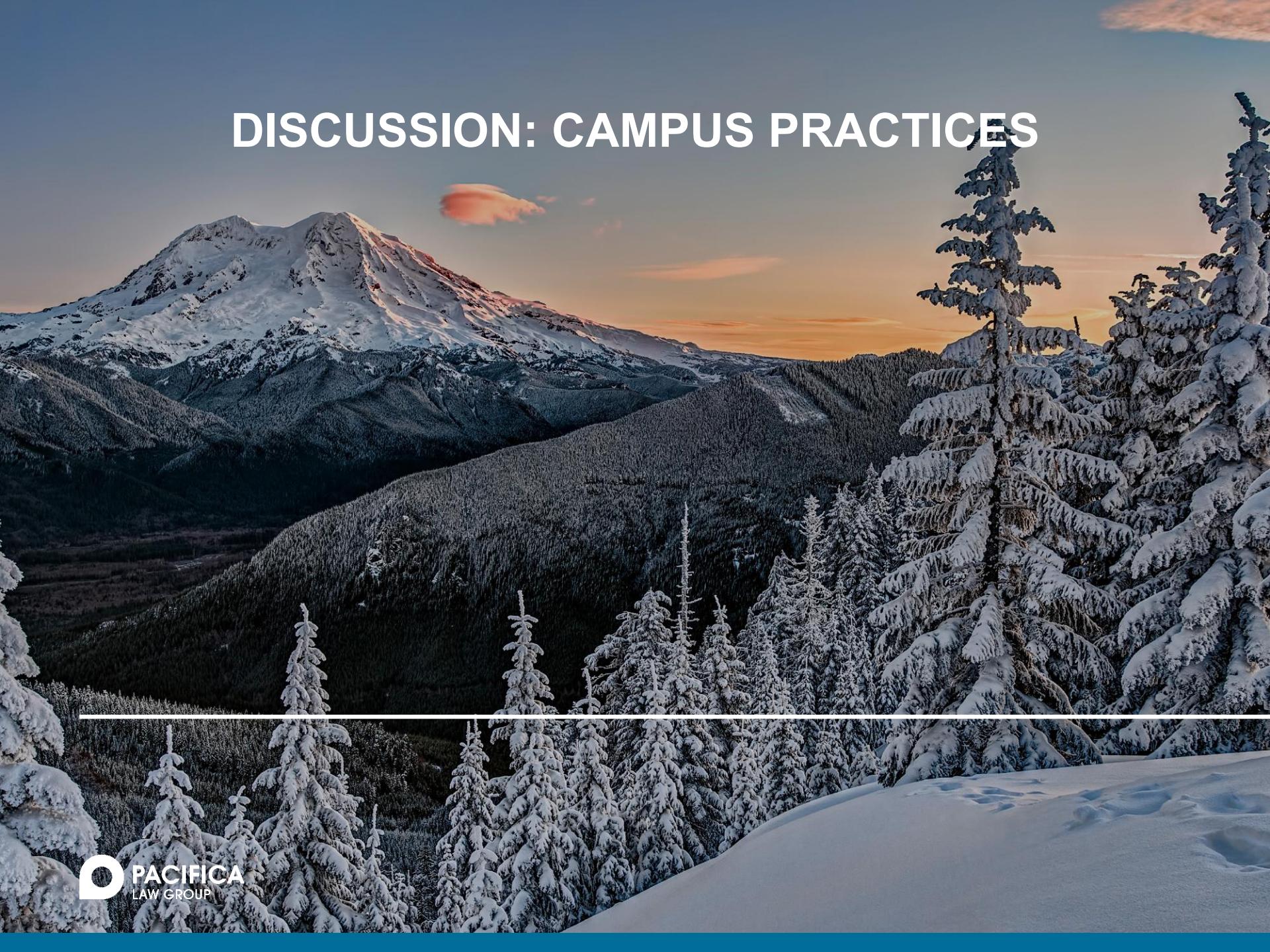


← News & Resources AUGUST 21, 2018

Muni News: SEC Adopts Rule 15c2-12 Amendments, Adding Two New Notice Events

On August 20, 2018, the Securities and Exchange Commission (the "SEC" or "Commission") adopted a final rule amending Rule 15c2-12 under the Exchange Act of 1934 (the municipal securities disclosure rule that requires an underwriter to determine, prior to purchasing bonds, that an issuer and/or other obligated person has undertaken to provide continuing disclosure to bondholders in the form of annual financial information and notice of certain listed events via emma.msrb.org).

DISCUSSION: CAMPUS PRACTICES

A wide-angle photograph of a mountain range at sunset. The peaks are covered in snow, and the sky is a gradient of orange and blue. In the foreground, several snow-laden evergreen trees are visible. A thin white horizontal bar is positioned near the bottom of the image.

QUESTIONS?

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A Note: This presentation is for informational purposes and does not provide legal advice. It is not intended to be used or relied upon as legal advice in connection with any particular situation or facts.