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MEMORANDUM

TO: Rena Weber, City of Rockville
FROM: Mary L. Ippel
DATE: March 7, 2014
RE: Post-Issuance Compliance Policies and Procedures

Following issuance by the City of Rockville of tax-exempt governmental bonds, the City of Rockville must continue to take certain actions with respect to the bonds in order that they retain their tax-exempt status. In particular, the City of Rockville must be sure that the project financed with the bonds continues to be used for public purposes and that the proceeds of the bonds are applied in a manner that complies with the arbitrage rules on the Internal Revenue Code of 1986, as amended (the "Code"), and its related regulations.

Over the last couple of years, the IRS has increased its scrutiny of tax-exempt bonds and has strongly expressed an expectation that issuers of tax-exempt bonds have written procedures in place to ensure compliance with these rules. Most recently, in September, 2011, the IRS released a new Form 8038-G, which is the form that issuers file upon the issuance of each tax-exempt bond issue. The new version of the form specifically asks the issuer to check a box that it has established written procedures "to ensure that all nonqualified bonds of this issue are remediated according to the requirements under the Code and Regulations." There is a second box asking if the issuer has written procedures "to monitor the requirements of Section 148," which is the Code section governing arbitrage.

There is no statutory or rule requirement that the City of Rockville have such written procedures. By including these questions on Form 8038-G (the same questions also appear on Form 8038), however, the IRS is strongly emphasizing its view of the importance of having such procedures in place. Informally, the IRS has also indicated that having such procedures in place may result in a lower penalty in the event of any audit or voluntary compliance agreement related to an issuer's bonds. Therefore, we strongly recommend that the City of Rockville adopt the proposed Post-Issuance Compliance Policies and Procedures.

The proposed Policies and Procedures have been drafted to cover the concerns and expectations that have been expressed by the IRS. Yet, at the same time, we recognize that the

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City of Rockville, along with its bond counsel and financial advisor, are already doing many of the tasks set forth in the document. It simply demonstrates that the City of Rockville is, in fact, taking the appropriate actions to ensure that its bonds remain tax-exempt.

CITY OF ROCKVILLE, MINNESOTA

**GOVERNMENTAL BONDS
POST-ISSUANCE COMPLIANCE
POLICIES AND PROCEDURES**

The following policies and procedures were adopted by the City Council of the City of Rockville, Minnesota (the "City") as of the date indicated below with respect to the governmental bonds of the City, to require, and further ensure, the ongoing compliance of governmental bonds issued by the City with the Internal Revenue Code of 1986, as amended (the "Code"), and the Treasury Regulations promulgated thereunder (the "Regulations"), including the record retention requirements of Code Section 6001 and Section 1.6001(a) of the Treasury Regulations. Such policy and procedures were adopted after consultation with Briggs and Morgan, P.A., the bond counsel ("Bond Counsel"), and David Drown Associates, Inc., the financial advisors, to the City and are internal operating procedures to be used by the City's management in connection with the issuance and sale of all issues of governmental bonds.

The City Council of the City has the overall, final responsibility for monitoring whether the City is in compliance with post-issuance federal tax requirements for the City's governmental bonds. However, the City Council assigns to the Administrator of the City the primary operating responsibility to monitor the City's compliance with post-issuance federal tax requirements for the City's governmental bonds. The Administrator may further assign post-issuance compliance responsibilities to other staff of the City, Bond Counsel, the paying agent for the bonds, and a rebate analyst. The Administrator shall provide training and educational resources to City staff who are responsible for ensuring compliance with any portion of these policies and procedures.

1. Appropriate Application of Proceeds.

- (a) The Administrator shall ensure the timely expenditure of the proceeds of governmental bonds by monitoring the application of all bond proceeds in accordance with the source of funds used and in accordance with the documents related to the issuance of the governmental bonds, including the reimbursement of pre-issuance expenses.
- (b) The Administrator shall ensure the correct calculation and application of bond proceeds pursuant to the Code by:
 - (i) confirming that any closing and/or allocation memorandum for the issuance of the bonds is accurate in the deposits directed thereunder, including ensuring that bond proceeds are used only for public purposes; and
 - (ii) through the draw request process, identifying requested expenditures that are not eligible expenditures.
- (c) The Administrator shall monitor the use of all bond-financed facilities in order to:
 - (i) determine whether private business uses of bond-financed facilities have exceeded de minimus limits set forth in Section 141(b) of the Code, and

- (ii) determine whether private security or payments have exceeded the de minimus limits set forth in Section 141(b) of the Code.

2. Arbitrage Yield Restriction and Rebate Requirements.

The Administrator shall monitor and calculate arbitrage, and shall coordinate and maintain, or cause to be maintained, records of:

- (a) Computations of the yield on the bonds by the City's financial advisor, and purchases and sales of investments made with bond proceeds (including amounts treated as "gross proceeds" of bonds under section 148 of the Code) and receipts of earnings in those investments;
- (b) Expenditures made with bond proceeds (including investment earnings on bond proceeds) for the governmental purposes of the bonds;
- (c) Calculations that will be sufficient to demonstrate to the Internal Revenue Service ("IRS") upon an audit of a bond issue that, where applicable, the City has complied with any available exception to the arbitrage rebate requirement in respect of that bond issue;
- (d) Calculations that will be sufficient to demonstrate to the IRS upon an audit of a bond issue for which no exception to the arbitrage rebate requirement was applicable, that the rebate amount, if any, was payable to the United States of America in respect of investments made with gross proceeds of that bond issue, was calculated and timely paid with Form 8038-T timely filed with the IRS; and

- (e) Information and records showing that investments held in yield-restricted advance refunding or defeasance escrows for bonds, and investments made with unspent bond proceeds after the expiration of the applicable temporary period, were not invested in higher yielding investments.

The Administrator shall also:

- (a) Ensure that any third-party entity tasked with investment responsibility for governmental bonds is provided with a copy of the tax compliance or arbitrage certificate for each bond issue and is advised as to all investment restrictions with respect to the proceeds of and funds related to any governmental bonds issued by the City;
- (b) Cause any funds subject to yield restriction to be segregated;
- (c) If necessary, hire an independent contractor annually or every five years, as the case may be and as required by any arbitrage certificate, to perform all arbitrage and rebate calculations and to review the City's investment process to ensure that it is in compliance; and
- (d) If necessary, consult with Bond Counsel prior to engaging in post-issuance credit enhancement transactions.

3. Record Retention Requirements.

It is the policy of the City that, unless otherwise permitted by future IRS regulations or other guidance, written records (which may be in electronic form) will be maintained with respect to each bond issue for as long as those bonds remain outstanding, plus three years. For

this purpose, the bonds include refunding bonds that refund the original bonds and thereby refinance the property that was financed by the original bonds.

In maintaining electronic storage, the Administrator will comply with applicable IRS requirements, such as those contained in Revenue Procedure 97-22.

The records to be obtained and maintained are to include:

- (a) The official transcript of proceedings for the original issuance of the bonds (including ensuring that all applicable documents are included in such transcript);
- (b) Records showing how the bond proceeds were invested, as described in 2 above;
- (c) Records showing how the bond proceeds were spent, as described in 1 above, including, but not limited to, loan documents, construction contracts, draw requests, invoices, payment of bond issuance costs, and records of "allocations" of bond proceeds to make reimbursement for project expenditures made before the bonds were actually issued;
- (d) Information, records, and calculations showing that, with respect to each bond issue, the City was eligible for an exception to the arbitrage rebate requirement or, if not, that the rebate amount, if any, that was payable to the United States of America in respect of investments made with gross proceeds of that bond issue, was calculated and timely paid with Form 8038-T timely filed with the IRS, as described in 2 above;

- (e) Schedules of all bond-financed facilities, including whether such facilities are land, buildings, or equipment, economic life calculations, and information regarding depreciation;
- (f) Records and agreements related to any trade or business activities by or with non-governmental entities or persons with respect to any facilities financed with the proceeds of governmental bonds, including, but not limited to, management agreements and leases; and
- (g) Documentations of all sources of payment or security for the issue.

The basic purpose of the foregoing record retention procedure for the City's governmental bonds is to enable the City to readily demonstrate to the IRS upon a questionnaire or an audit of any bond issue that the City has fully complied with all federal tax requirements that must be satisfied after the issue date of the bonds.

4. Reissuance.

The following policies relate to compliance with rules and regulations regarding the reissuance of bonds for federal law purposes.

The Administrator will:

- (a) Identify and consult with Bond Counsel regarding any post-issuance change to any terms of an issue of bonds which could potentially be treated as a reissuance for federal tax purposes; and
- (b) Confirm with Bond Counsel whether any "remedial action" in connection with a "change in use" (as such terms are defined in the Code and

Treasury Regulations) would be treated as a reissuance for tax purposes and, if so, confirm the filing of any new Form 8038-G.

5. Direct Pay Bonds.

(a) In addition to the other requirements herein, should the City issue direct pay bonds pursuant to Sections 54A through 54F of the Code, the Administrator shall also be responsible for:

(i) determining the amount of interest payable on each interest payment date and the proper amount of refundable credit reported on Form 8038-CP;

(A) as appropriate, the Administrator shall compare the interest payment calculations to any independently-verified report prepared at closing for the bond issue; and

(B) the Administrator shall approve all disbursements.

(ii) preparing and timely filing all Forms 8038-CP;

(A) timely filing of Form 8038-CP shall be made to insure that payments are timely made on the interest payment date and such timely filing is ensured by the use of a third-party filing agent; and

(B) in the case of bond issues with multiple maturities, a separate Form 8038-CP shall be filed for each maturity;

- (iii) ensuring all credit payments shall be requested to be made by wire. The Administrator is familiar with the wire payment procedures for the City and will ensure that the Form 8038-CP includes the proper information for payment of the credit to the proper person; and
 - (iv) alternatively, hiring a third party (the "Filing Agent") who shall be responsible for the matters in this Section 5 and any other responsibilities set forth in a filing agent agreement between the City and the Filing Agent.
- (b) In addition to the records retained pursuant to Section 3, the records to be obtained and maintained with respect to direct pay bonds are to include:
- (i) information, records, and calculations showing that Forms 8038-CP were properly prepared and timely filed, as described in (a) above;
 - (ii) all contracts that are subject to the federal Davis-Bacon prevailing wage rules; and
 - (iii) with respect to Qualified Energy Conservation Bonds, such documents, test results, audits, and reports obtained by the City that demonstrate that the final project has achieved a reduction in energy consumption in publicly-owned buildings by at least 20%.

- (c) The Administrator shall ensure that all contracts let for projects financed with direct pay bonds shall comply with the federal Davis-Bacon prevailing wage rules.

6. Taxable Governmental Bonds.

Most of the provisions of these policies and procedures are not applicable to governmental bonds the interest on which is includable in gross income for federal income tax purposes. However, if an issue of taxable governmental bonds is later refunded with the proceeds of an issue of tax-exempt governmental refunding bonds, then the uses of the proceeds of the taxable governmental bonds and the uses of the facilities financed with the proceeds of the taxable governmental bonds will be relevant to the tax-exempt status of the governmental refunding bonds. Therefore, if there is any reasonable possibility that an issue of taxable governmental bonds may be refunded, in whole or in part, with the proceeds of an issue of tax-exempt governmental bonds then, for purposes of these policies and procedures, the Administrator shall treat the issue of taxable governmental bonds as if such issue were an issue of tax-exempt governmental bonds and shall carry out and comply with the requirements of these policies and procedures with respect to such taxable governmental bonds. The Administrator shall seek the advice of Bond Counsel as to whether there is any reasonable possibility of issuing tax-exempt governmental bonds to refund an issue of taxable governmental bonds.

7. Qualified 501(c)(3) Bonds.

If the City issues bonds to finance a facility to be owned by the City but which may be used, in whole or in substantial part, by a nongovernmental organization that is exempt from federal income taxation under Section 501(a) of the Code as a result of the application of Section 501(c)(3) of the Code (a "501(c)(3) Organization"), the City may elect to issue the bonds as

"qualified 501(c)(3) bonds" the interest on which is exempt from federal income taxation under Sections 103 and 145 of the Code and applicable Treasury Regulations. Although such qualified 501(c)(3) bonds are not governmental bonds, at the election of the Administrator, for purposes of these policies and procedures, the Administrator may treat such issue of qualified 501(c)(3) bonds as if such issue were an issue of tax-exempt governmental bonds and shall carry out and comply with the requirements of these policies and procedures with respect to such qualified 501(c)(3) bonds. Alternatively, in cases where compliance activities are reasonably within the control of the relevant 501(c)(3) Organization, the Administrator may determine that all or some portion of the compliance responsibilities described herein shall be assigned to organization.

8. Conduit Bonds.

The provisions of these policies and procedures are primarily intended to be applicable to governmental bonds. However, the City may from time to time issue qualified 501(c)(3) bonds or other qualified private activity bonds that are not governmental bonds and loan the proceeds thereof to a nongovernmental organization that is the obligor on such conduit bonds. Although such conduit bonds are not governmental bonds, at the election of the Administrator, for purposes of these policies and procedures, the Administrator may treat such issue of conduit bonds as if such issue were an issue of tax-exempt governmental bonds and shall carry out and comply with the requirements of these policies and procedures with respect to such conduit bonds. Alternatively, in cases where compliance activities are reasonably within the control of the relevant obligor, the Administrator may determine that all or some portion of the compliance responsibilities described herein shall be assigned to or required of such obligor.

9. General Requirements.

- (a) Periodically, the Administrator shall consult with Bond Counsel, general counsel, and financial advisors to the City to determine if any changes to these procedures are advisable and shall amend these procedures accordingly.

- (b) These procedures may be amended or withdrawn from time to time and constitute internal management procedures for compliance with certain provisions of the Code and do not constitute and are not intended to be, rules of the City.

Adopted this ____ day of _____, 2014 on behalf of the City.

CITY OF ROCKVILLE, MINNESOTA

By _____
Its Administrator

