**Tax-Exempt Debt Compliance Policy**

**Policy Type:** Board of Visitors  
**Responsible Office:** Treasury Services  
**Initial Policy Approved:** 02/09/2012  
**Current Revision Approved:** 10/21/2014

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**Policy Statement and Purpose**

This policy provides a framework for complying with federal laws relating to the issuance and post-issuance monitoring of tax-exempt bonds. The purpose of this policy is to identify the compliance areas of tax-exempt bond financing and define the University’s policy for fulfilling all requirements in these areas during both pre- and post-issuance processes. This policy provides guidance to University units involved in tax-exempt financings so that they understand and are able to carry out their roles in these processes.

The University relies heavily on the tax-exempt bond market to finance a significant portion of the University’s capital projects. The consequences of violating federal laws can be severe and can include the retroactive loss of tax-exempt status, significant liability to the IRS or bondholders, reputational damage, and the inability to access the tax-exempt bond market in the future.

Accordingly, the policy provides guidance in the following areas:

- Identification of applicable Internal Revenue Code provisions and Treasury rules and regulations relating to tax-exempt debt compliance (collectively, the “Tax Rules”);
- Definition of the University’s policy for complying with applicable rules and regulations to safeguard against violations that may result in penalty or the loss of the tax-exempt status of its bonds;
- Assignment of responsibility for tax-exempt bond compliance to specific departments to maintain continuity and ensure that sufficient information is routinely identified, maintained and shared as appropriate between departments; and,
- Identification of the University’s continuing disclosure requirements and establish procedures for providing annual disclosure, "event disclosure" and voluntary disclosure through the EMMA system.

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1 These requirements relate, not to federal tax exemption, but to the federal securities law, as discussed below.
The principal purpose of the policy is to ensure that (1) the proceeds of tax exempt bonds are spent as required by both the bond documents and the Tax Rules and (2) the buildings and equipment financed by tax-exempt bonds do not have impermissible amounts of "bad use." In simplest terms "good use" is use exclusively by the University or other governmental entity (like the VCU Health System) or, in the case of 501(c)(3) bonds, by a private charitable organization in connection with its charitable activities, while "bad use" is use by or for benefit of private, for-profit entities or the Federal Government. There are special rules relating to sponsored research. Management and development contracts with private parties also can create bad use. There are also requirements requiring the timely expenditure of bond proceeds (usually within three years) and on the payment of investment "arbitrage" arising from the investment of bond proceeds prior to their expenditure.

The University recognizes compliance with IRS and Treasury Regulations is fluid. Accordingly, the Policy requires on-going monitoring and will be reviewed periodically and modified as necessary.

**Oversight:**

The Director of Treasury Services is responsible for administering and overseeing the day-to-day aspects of the program as well as supporting the Bond Compliance Committee. At a minimum, the committee shall consist of the individuals from the following departments: Treasury Services, Facilities Management Division, the Controller’s Office, the Office of the General Counsel, and the Office of Research. The Bond Compliance Committee reviews compliance procedures and systems on a periodic basis, not less than annually.

Each individual department is responsible for maintaining a written set of procedures to ensure compliance with this policy.

Noncompliance with this policy may result in disciplinary action up to and including termination. VCU supports an environment free from retaliation. Retaliation against any employee who brings forth a good faith concern, asks a clarifying question, or participates in an investigation is prohibited.

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Who Should Know This Policy

- Vice Presidents and other Senior Executives
- Vice Provosts, Deans, Directors, and Department Heads

Definitions

There are no definitions associated with this policy and procedures.

Contacts

The Department of Treasury Services within the Office of the Assistant Vice President for Finance and Administration officially interprets this policy. The Department of Treasury and Foundation Services is responsible for obtaining approval for any revisions as required by the policy Creating and Maintaining Policies and Procedures through the appropriate governance structures. Please direct policy questions to the Department of Treasury Services. The Office of the Vice President for Finance and Administration is responsible for responding to inquiries by investors, rating agencies and other outside parties relating to the status of projects, the financial condition of the University and any other events that may affect investors. All such inquiries should be referred to the Office of the Vice President for Finance and Administration.

Procedures

Pre-Issuance:

Tax-exempt debt compliance begins with the proper planning for debt issuances. While capital projects can be proposed and approved at any time, it is expected that the majority will be identified during the biennial updates to the University’s six-year capital plan which is approved by the Board of Visitor’s.

For projects that require debt as part of the financing, Treasury Services will complete a project initiation form which can be accessed at http://www.vcu.edu/treasury/.

Upon receipt of a project initiation form or in coordination with biennial updates to the six-year capital plan, Treasury Services will assemble a group of key stakeholders and coordinate the completion of a financial feasibility study. Such a study is required for “double barrel” bonds under section 9(c) of Article X of the Virginia Constitution.

Final approval of the financial feasibility study will be given by Senior Management, and at a minimum, will include approval by the University’s Vice President for Finance and Administration and the Dean/Vice President of the sponsoring department.
Once a financial feasibility study is complete and the project is approved by senior management, the following authorizations are generally required to be in place prior to any debt issuance:

**Authorization of Debt** — All indebtedness incurred by the University, whether tax-exempt or taxable, must be authorized by the Board of Visitors.

**Declaration of Intent to Borrow and Reimbursement Resolution** — While the Tax Rules restrict the ability of the University to use bond proceeds to reimburse itself for costs incurred prior to the issuance of the Bonds, the University can in many circumstances preserve the right to reimburse itself for current expenditures with the proceeds of future bonds by passing a qualifying "reimbursement resolution" or adopting a qualifying expression of intent to reimburse. The Board of Visitors has authorized the Vice President for Finance and Administration to take such action. Reimbursement resolutions and expressions of intent should be regularly reviewed to see if they need to be updated to cover project changes. In general bond proceeds can be used for reimbursement for prior costs within 18 months after the project is "placed in service" but in no event later than three years after the date of the expenditures. There are exceptions for certain preliminary costs, such as architects' and engineering fees.

**State Authorization** — Legislative approval is required as well as approval by the Treasury Board in accordance with § 2.2-2416 of the Code of Virginia for any debt issued through a State authority.

**Legal Opinions** — Legal counsel is required to opine on debt authorizations and the effect on the tax-exempt status of the debt being issued. For new bond issues, bond counsel opines on the validity and tax-exempt status of the bonds, while University counsel opines on due authorization of the bonds and compliance with existing bond documents and similar restrictions.

**Tax Certificate** — also known as an Arbitrage Certificate is required to properly document the validity (and tax-exempt status) of the financing and to evidence compliance with applicable laws and regulatory requirements during the time of issuance. The Arbitrage Certificate sets forth the University's expectations as to the use of bond proceeds and should be reviewed by an official familiar with the project being financed, the cost components and the schedule. For bonds issued by another entity for the benefit of the University (such as The Treasury Board for 9(c) Bonds or the Virginia College Building Authority), similar certificates are required.

Treasury Services will manage the pre-issuance process including the drafting, review, and development of any needed resolutions, write-ups, Financial Feasibility Studies or other materials.

**Post Issuance:**

For bonds to continue to qualify for tax-exempt status, the applicable detailed provisions in the Tax Rules must be satisfied. Accordingly, post issuance debt compliance generally falls into the following categories:

- Expenditure and allocation of bond proceeds
- Investment of bond proceeds and payment of rebates to the U.S. Government
- Use of bond financed project (private use) and compliance with remedial action in case of a "change in use"
- Disclosure and other filing requirements
Record retention
Training

If the potential to fail to comply with post issuance compliance activities is identified, the Director of Treasury Services will notify the Controller and the Vice President for Finance and Administration and seek the advice of qualified bond counsel in order to assess the need to take remedial actions described under section 1.141-12 of the Income Tax Regulations or enter into a closing agreement under the Tax-Exempt Bonds Voluntary Closing Agreement Program described in Notice 2008-31

Expenditure and Allocation of Bond Proceeds
Bond proceeds can only be used for eligible project costs in accordance with applicable federal law and the restrictions of the bond documents. The spending of bond proceeds and related investment earnings toward eligible project costs must be tracked to ensure they are used for qualified purposes. Bond proceeds shall only be disbursed for the following expenditures:

- Project Costs
- Capitalized Interest
- Bond Issuance Costs

The Director of Facilities Management Division Financial Services is responsible for verifying that bond proceeds are spent on qualified purposes and maintaining related payment records. At the conclusion of a project, a final accounting should be compiled, documenting the use of all bond proceeds and related investment earnings and arrangements made to having the accounting documentation made part of the permanent records for the particular bond transaction. There are rules that permit a reallocation of use of bond proceeds if action is taken not later than 18 months after the later of the date of the expenditure or the date the project is placed in service. Bond counsel should be consulted regarding any planned reallocations.

Spending Requirements and Arbitrage Rebate
There also are restrictions on the timing of the expenditure of bond proceeds. Generally proceeds must be spent within three years of bond issuance. If it appears that all proceeds will not be spent within the three year period, bond counsel should be consulted.

The Tax Rules also generally require borrowers to calculate and pay or "rebate" to the U.S. Government any "arbitrage profit" earned on the investment of bond proceeds prior to their expenditure. Arbitrage is the investment gain made by investing the proceeds of tax exempt bonds in taxable investments. Arbitrage compliance is governed by arcane provisions of the Tax Rules. There are several "rebate exceptions" if bond proceeds are spent promptly.

As a general rule, the University will seek to finance projects when proceeds will be spent within two years, and thus, attempt to meet the two year spending rebate exception. The two year spending exception requires that proceeds be spent as follows:

- 10% within 6 months of issue date
- 45% within 12 months of issue date
- 75% within 18 months of issue date
- 100% (less "reasonable retainage") within 24 months of issue date
Expenditures should be reviewed 30 days prior to the end of each six month period to minimize the chance of forfeiting the rebate exception. The two year exception applies only to transactions primarily for construction. In addition, there is an 18 month exception available for bonds with the following spending thresholds:

- 15% within 6 months of issue
- 60% within 12 months of issue
- 100% within 18 months of issue

**Investment Proceeds**

All bond proceeds will be invested in the Virginia State Non-Arbitrage Program ("SNAP"), unless approved in writing by the University’s Vice President for Finance and Administration. The Virginia Treasury Board sponsors the SNAP to provide comprehensive investment management, accounting and arbitrage calculation services for the proceeds of tax-exempt financings of Virginia governments.

The Director of Treasury Services will monitor compliance with periodic spending exceptions and the investment of bond proceeds. In cases when a rebate is owed (as calculated by the Arbitrage Rebate Consultant), any resulting liability will be paid and properly reported on the applicable IRS form(s).

**Private Business Use**

The Tax Rules generally limit the amount of Private Business Use or the amount of private payment or "security." The University generally complies with these provisions by limiting Private Business Use rather than private payment or security.

Private Business Use is use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Pursuant to the Private Business Use test, the tax-exempt status of a bond issuance is jeopardized if more than 10% of the proceeds are used for Private Business Use. Improper use of the bond financed facility is considered bad use of the proceeds of the bonds that financed the facility. Generally, most Private Business Use in a tax-exempt financed facility arises from the following types of arrangements:

- **Ownership:** A sale or transfer of ownership to a Non-Governmental Person (as defined by applicable tax law) of tax-exempt financed property. For 501(c) (3) bonds, no portion of the bond financed property can be owned by a private, for-profit entity.

- **Leases:** Any arrangement where the University leases a tax-exempt financed property to a Non-Governmental Person. Transactions that are not called lease transactions may be treated as a lease based on the level of control given to the Non-Governmental Person and whether the Non-Governmental Person bears the risk of loss.

- **Management Contracts:** A management contract is any arrangement whereby a Non-Governmental Person actively manages the operations of a facility. Management contracts include, for example, contracts for dining services (food courts), retail services, and facility

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2 In the case of bonds that are "501(c)(3) bonds" rather than "governmental bonds," the maximum amount is 5% rather than 10%. While most bonds issued by the University are governmental bonds, bonds involving related foundations may be 501(c)(3) bonds.
management, or vivarium services (management of an animal facility). The basic rules for permitted management contracts are set forth in IRS Revenue Procedure 97-13. As a general principle, the contract should not give the private party any kind of profit sharing or “investment” in the undertaking, and the term of the contract is limited based on the type of compensation to the Non-Governmental Entity. All management contracts for bond-financed space should be reviewed.

- **Sponsored Research Agreements:** Any research that is sponsored by a Non-Governmental Person (including the federal government and its agencies). The basic rules for determining when sponsored research is not considered “bad use” are set forth in IRS Revenue Procedure 2007-47. Generally, qualifying research agreements must be for “basic research” and the rights of the sponsor to the results of the research must comply with the stated rules.

- **Other Actual or Beneficial Use:** Any other arrangement that conveys special legal entitlements to a Non-Governmental Person for beneficial use of tax-exempt financed property, such as an arrangement that conveys priority rights to use a tax-exempt financed facility, will result in Private Business Use. Examples of such “special legal entitlements” include summer camps having the exclusive right to use an athletic facility, specially designed courses open only to one company, or use of a parking garage for a private event.

The Controller will be responsible for monitoring private use and will maintain and distribute a Private Use Questionnaire to responsible Department Managers prior to debt issuance and annually thereafter. The Controller with the assistance of Treasury Services will analyze questionnaire responses to: (i) determine whether taxable financing is appropriate for a particular capital project; (ii) identify impermissible Private Business Use in existing facilities so that corrective action can be taken; and (iii) collect information necessary for reporting purposes. If potentially impermissible Private Business Use is identified, the Controller will notify the Vice President of Finance and Administration and seek the advice of qualified bond counsel.

In addition, any change in a project’s use or contemplated change in a project’s use that includes Private Business Use must be reported to the Controller’s Office and Treasury Services prior to the implementation of the proposed change in use to ensure compliance with applicable regulations.

**Tax and State Filings**
The University is required to provide the following filings:

- **Tax Forms** – Tax-exempt debt obligation issuers are required to file the 8038 series of IRS forms (8038, 8038-G, 8038-T, and 8038-R) in accordance with applicable federal law.
- **Statistics and filings** required to be sent to the State for any debt issued through a State authority for the benefit of the University.
- **Arbitrage Certificates** – Within five years of the anniversary of the debt issue to close out the issue, the University, must calculate any arbitrage on the debt in a final accounting, and make any required rebate payment.

The Director of Treasury Services is responsible for ensuring that such filings are made.
Continuing Disclosure
In connection with the issuance of the Bonds the University has signed several, substantially identical continuing disclosure agreements ("CDAs"). These are required, not by the Tax Rules, but by a rule of the United States Securities and Exchange Commission that requires the University's bond underwriters to require the execution of a CDA in connection with sale of bonds to the public. The CDAs require the University to file certain annual financial and operating information with the Electronic Municipal Market Access System ("EMMA") maintained by the Municipal Securities Rulemaking Board. EMMA permits investors to access the information to assess the University's financial position. The CDAs also require the University to disclose through EMMA certain specified events ("event disclosure") such as bond defaults. Future bond issues for special university credits may require CDAs that require the filing of additional different information.

The Director of Treasury Services is responsible for making all filings required by CDAs, and any events affecting such filings should be reported to Treasury Services. The Office of the Vice President for Finance and Administration is responsible for responding to inquiries by investors, rating agencies and other outside parties relating to the status of projects, the financial condition of the University and any other events that may affect investors. All such inquiries should be referred to the Office of the Vice President for Finance and Administration.

Record Retention
It is the University's policy to retain all records relating to tax-exempt bond financings for the entire term of the bond issue plus three years. This policy supersedes any other documented retention policies at the University or the Commonwealth.

Generally, records refer to all documents, reports, accounts and certifications relating to the:

- Issuance of tax-exempt bonds
- Investment of bond proceeds
- Expenditure and allocation of bond proceeds
- Use of debt-financed property
- Disclosure and other filing requirements

Due to the decentralized nature of the University, specific departments are responsible for the following:

**Treasury Services** – is responsible for maintaining records relating to the issuance of the University’s tax-exempt bonds, the investment of bond proceeds and the University’s annual continuing disclosure.

**The Facilities Management Division** – is responsible for maintaining records on the expenditure and allocation of bond proceeds including construction contracts, vendor invoices, payments and requisitions.

**The Office of the Controller** – is responsible for maintaining records on private use including responses to the annual private use questionnaire, service contracts, leases, and other pertinent contracts. The Controller’s Office will also retain the audited financial statements and reports of any prior IRS examinations of VCU or bond financings.
The Office of Research – is responsible for maintaining records relating to research contracts.

Training
The Controller’s Office will develop training materials, hold classes for employees in departments that are impacted by this policy, and post the training to the web site for reference.

Forms
There are no forms associated with this policy and procedures.

Related Documents

1. Debt Management Policy
2. Treasury Board of the Commonwealth of Virginia: Post Issuance Compliance Policy for Tax-Exempt Qualified Obligations
3. US Code: Title 26, Section 141
4. IRS Revenue Procedure 97-13 (management contracts)
5. IRS Revenue Procedure 2007-47 (research agreements)
6. Tax-Exempt Governmental Bonds Compliance Guide
7. VCU Private Use Questionnaire

Revision History
This policy supersedes the following archived policies:

February 9, 2012, New Policy VCU Tax-Exempt Debt Compliance Policy
October 21, 2014 Tax-Exempt Debt Compliance Policy

FAQs
There are no FAQs associated with this policy and procedures.