

California Educational Facilities Authority (“CEFA”)

Agenda Item 6 – Resolution No. 2011-02

Staff Report: Post-Issuance Tax Compliance Procedures

Executive Summary

Some time ago, Authority staff established a working group composed of staff, counsel from the State Treasurer’s Office, counsel from the Attorney General’s office and the Authority’s financial advisor to examine the post-issuance compliance duties and responsibilities of the Authority as a conduit issuer. Once the work of this group concludes, staff intends to inform the board of its findings and to make recommendations concerning a comprehensive and official policy (and related procedures) for post-issuance compliance activities.

In the meantime however, the Internal Revenue Service (IRS) recently revised a key form (known as Form 8038) the Authority executes whenever a new issue of tax-exempt bonds or commercial paper notes occurs. The IRS revisions to Form 8038 impose new post-issuance reporting and responsibilities on issuers, examined in more detail below, and to this end, staff now recommends the Authority adopt the post-issuance compliance procedures attached hereto as an Appendix. As mentioned above, staff anticipates presenting additional information regarding post-issuance compliance matters to the Authority at a later date once the efforts of the working group conclude and staff is ready to present recommendations generated from those efforts.

Background:

The IRS requires Form 8038 (Information Return for Tax-Exempt Private Activity Bond Issues) to be completed and executed by any bond issuer in connection with a new issue of tax-exempt bonds. The IRS revised the form in April 2011 which added five additional lines. The only changes directly affecting the Authority are lines 43 and 44. Line 43 states “Check the box if the issuer has established written procedures to ensure that all nonqualified bonds of this issue are remediated in accordance with the requirements of the Code and Regulations.” Line 44 states “Check the box if the issuer has established written procedures to monitor the requirements of section 148.”¹

¹ Section 148 of the IRS code is the statute defining arbitrage and how borrowers must handle investments of bond proceeds. By definition, an arbitrage bond means “any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly to acquire higher yielding investments or to replace funds which were used directly or indirectly to acquire higher yielding investments.”

The Authority does have internal procedures for monitoring arbitrage compliance and for responding to changes in use of bond proceeds and bond-financed assets, but a formal policy has not yet been considered or adopted by the board.

In consultation with Orrick, Herrington & Sutcliffe LLP, Authority staff submits the attached written procedures to comply with the new requirements prompted by the IRS revisions to Form 8038. The procedures address three major issues, which are:

1. Arbitrage rebate and yield;
2. Use of bond proceeds and bond-financed or refinanced assets (including remedial action, if necessary);
3. Record keeping requirement;

If adopted by the board, these new procedures and the responsibility for complying with each aspect of the procedures will be memorialized in a signed writing between the Authority and the Borrower. Specifically, the procedures will be documented in the Tax Certificate and Agreement (the "TCA"); a document which both the Authority and the Borrower currently sign in connection with a new issue of tax-exempt bonds and which historically memorializes these types of activities and responsibilities for both the Authority and the Borrower. The TCA is one of many documents that need to be executed for a bond sale to close.

The Authority currently anticipates filing IRS Form 8038s in connection with two existing commercial paper note programs in July of this year. Since the newly revised Form 8038 is a required element of the ongoing maintenance of these programs, and most bond closings, staff submits the procedures attached herein must be adopted as soon as practicable. Bond counsel for the commercial paper note transactions scheduled to close in July has already expressed counsel's preference for the new Form 8038 procedures concerning post-issuance tax compliance to be in place prior to those closings.

Recommendation:

Staff recommends the Authority approve Resolution No. 2011-02 authorizing the adoption of the written procedures for post bond issuance tax compliance.

Attachments:

- CEFA's proposed written procedures
- IRS form 8038

Appendix A

California Educational Facilities Authority Post-Issuance Tax Compliance Procedures For Tax-Exempt Bonds

June 30, 2011

The purpose of these Post-Issuance Tax Compliance Procedures is to establish policies and procedures in connection with tax-exempt bonds, commercial paper notes or other obligations (collectively, the “Bonds”) issued by the California Educational Facilities Authority (the “Authority”) so as to maximize the likelihood that certain applicable post-issuance requirements of federal income tax law needed to preserve the tax-exempt status of the Bonds are met. The Authority reserves the right to use its discretion as necessary and appropriate to make exceptions or request additional provisions as circumstances warrant. The Authority also reserves the right to change these policies and procedures from time to time.

General

Inasmuch as the Authority is a responsible conduit issuer authorizing the issuance of Bonds for private college and university borrowers, the Authority now identifies post-issuance tax compliance procedures for all Bonds issued by the Authority, as well as the Authority’s expectations of all Bond borrowers concerning these procedures.

Post-Issuance Compliance Requirements

External Advisors / Documentation

The Authority and the Borrower shall consult with bond counsel and other legal counsel and advisors, as needed, throughout the Bond issuance process to identify requirements and to establish procedures necessary or appropriate so that the Bonds will continue to qualify for tax-exempt status. Those requirements and procedures shall be documented in the tax certificate and agreement (the “Tax Certificate”) and/or other documents finalized at or before issuance of the Bonds. Those requirements and procedures shall include future compliance with applicable arbitrage rebate requirements and all other applicable post-issuance requirements of federal tax law throughout (and in some cases beyond) the term of the Bonds.

The Borrower also shall consult with bond counsel and other legal counsel and advisors, as needed, following issuance of the Bonds to ensure that all applicable post-issuance requirements in fact are met. This shall include, without limitation, consultation in connection with future contracts with respect to the use of Bond-financed or refinanced assets.

The Authority shall encourage or require the Borrower to engage expert advisors (each a “Rebate Service Provider”) to assist in the calculation of arbitrage rebate payable in respect of the investment of Bond proceeds, unless the Tax Certificate documents that arbitrage rebate will not be applicable to an issue of Bonds.

Unless otherwise provided by the indenture relating to the Bonds, unexpended Bond proceeds shall be held by a trustee, and the investment of Bond proceeds shall be managed by the Borrower. The Borrower shall prepare (or cause the trustee to prepare) regular, periodic statements regarding the investments and transactions involving Bond proceeds and such statements shall be delivered to the Authority if it so requests.

Arbitrage Rebate and Yield

Unless the Tax Certificate documents that arbitrage rebate will not be applicable to an issue of Bonds, it is the Authority’s policy that the Borrower shall be responsible for:

- engaging the services of a Rebate Service Provider and, prior to each rebate calculation date, causing the trustee to deliver periodic statements concerning the investment of Bond proceeds to the Rebate Service Provider;
- providing to the Rebate Service Provider additional documents and information reasonably requested by the Rebate Service Provider;
- monitoring efforts of the Rebate Service Provider;
- assuring payment of required rebate amounts, if any, no later than 60 days after each 5-year anniversary of the issue date of the Bonds, and no later than 60 days after the last Bond of each issue is redeemed;
- during the construction period of each capital project financed in whole or in part by Bonds, monitoring the investment and expenditure of Bond proceeds and consult with the Rebate Service Provider to determine compliance with any applicable exceptions from the arbitrage rebate requirements during each 6-month spending period up to 6 months, 18 months or 24 months, as applicable, following the issue date of the Bonds; and
- retaining copies of all arbitrage reports and trustee statements as described below under “Record Keeping Requirements” and, upon request, providing such copies to the Authority.

The Borrower, in the Tax Certificate relating to the Bonds and/or other documents finalized at or before the issuance of the Bonds, shall agree to undertake the tasks listed above (unless the Tax Certificate documents that arbitrage rebate will not be applicable to an issue of Bonds).

Use of Bond Proceeds and Bond-Financed or Refinanced Assets:

It is the Authority's policy that the Borrower shall be responsible for:

- monitoring the use of Bond proceeds and the use of Bond-financed or refinanced assets (e.g., facilities, furnishings or equipment) throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in the Tax Certificate relating to the Bonds;
- maintaining records identifying the assets or portion of assets that are financed or refinanced with proceeds of each issue of Bonds, including a final allocation of Bond proceeds as described below under "Record Keeping Requirements";
- consulting with bond counsel and other legal counsel and advisers in the review of any contracts or arrangements involving use of Bond-financed or refinanced assets to ensure compliance with all covenants and restrictions set forth in the Tax Certificate relating to the Bonds;
- maintaining records for any contracts or arrangements involving the use of Bond-financed or refinanced assets as described below under "Record Keeping Requirements";
- conferring at least annually with personnel responsible for Bond-financed or refinanced assets to identify, and discussing, any existing or planned use of Bond-financed or refinanced assets, to ensure that those uses are consistent with all covenants and restrictions set forth in the Tax Certificate relating to the Bonds; and
- to the extent that the Borrower discovers that any applicable tax restrictions regarding use of Bond proceeds and Bond-financed or refinanced assets will or may be violated, consulting promptly with bond counsel and other legal counsel and advisers to determine a course of action to remediate all nonqualified bonds, if such counsel advises that a remedial action is necessary.

The Borrower, in the Tax Certificate relating to the Bonds and/or other documents finalized at or before the issuance of the Bonds, shall agree to undertake the tasks listed above.

All relevant records and contracts shall be maintained as described below.

Record Keeping Requirement

It is the Authority's policy that the Borrower shall be responsible for maintaining the following documents for the term of each issue of Bonds (including refunding Bonds, if any) plus at least three years:

- a copy of the Bond closing transcript(s) and other relevant documentation delivered to the Borrower at or in connection with closing of the issue of Bonds;
- a copy of all material documents relating to capital expenditures financed or refinanced by Bond proceeds, including (without limitation) construction contracts, purchase orders, invoices, trustee requisitions and payment records, as well as documents relating to costs reimbursed with Bond proceeds and records identifying the assets or portion of assets that are financed or refinanced with Bond proceeds, including a final allocation of Bond proceeds;
- a copy of all contracts and arrangements involving the use of Bond-financed or refinanced assets; and
- a copy of all records of investments, investment agreements, arbitrage reports and underlying documents, including trustee statements, in connection with any investment agreements, and copies of all bidding documents, if any.

The Borrower, in the Tax Certificate relating to the Bonds and/or other documents finalized at or before the issuance of the Bonds, shall agree to retain the records listed above.

**Information Return for Tax-Exempt
 Private Activity Bond Issues**
 (Under Internal Revenue Code section 149(e))
 ▶ See separate instructions.

Part I Reporting Authority		Check if Amended Return <input type="checkbox"/>
1 Issuer's name		2 Issuer's employer identification number
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) <input type="checkbox"/> 1 <input type="checkbox"/> <input type="checkbox"/>
6 City, town, or post office, state, and ZIP code		7 Date of issue (MM/DD/YYYY)
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

Part II Type of Issue (Enter the issue price.)	Issue Price
11 Exempt facility bond:	
a Airport (sections 142(a)(1) and 142(c))	11a
b Docks and wharves (sections 142(a)(2) and 142(c))	11b
c Water furnishing facilities (sections 142(a)(4) and 142(e))	11c
d Sewage facilities (section 142(a)(5))	11d
e Solid waste disposal facilities (section 142(a)(6))	11e
f Qualified residential rental projects (sections 142(a)(7) and 142(d)) (see instructions)	11f
Meeting 20–50 test (section 142(d)(1)(A)) <input type="checkbox"/>	
Meeting 40–60 test (section 142(d)(1)(B)) <input type="checkbox"/>	
Meeting 25–60 test (NYC only) (section 142(d)(6)) <input type="checkbox"/>	
Has an election been made for deep rent skewing (section 142(d)(4)(B))? . . . <input type="checkbox"/> Yes <input type="checkbox"/> No	
g Facilities for the local furnishing of electric energy or gas (sections 142(a)(8) and 142(f))	11g
h Facilities allowed under a transitional rule of the Tax Reform Act of 1986 (see instructions)	11h
Facility type _____	
1986 Act section _____	
i Qualified enterprise zone facility bonds (section 1394) (see instructions)	11i
j Qualified empowerment zone facility bonds (section 1394(f)) (see instructions)	11j
k District of Columbia Enterprise Zone facility bonds (section 1400A)	11k
l Qualified public educational facility bonds (sections 142(a)(13) and 142(k))	11l
m Qualified green building and sustainable design projects (sections 142(a)(14) and 142(l))	11m
n Qualified highway or surface freight transfer facilities (sections 142(a)(15) and 142(m))	11n
o Other (see instructions) _____	
p Qualified New York Liberty Zone bonds (section 1400L(d)) _____	11p
q Other (see instructions) _____	11q
12a Qualified mortgage bond (section 143(a))	12a
b Other (see instructions) _____	12b
13 Qualified veterans' mortgage bond (section 143(b)) (see instructions) ▶	13
Check the box if you elect to rebate arbitrage profits to the United States <input type="checkbox"/>	
14 Qualified small issue bond (section 144(a)) (see instructions) ▶	14
Check the box for \$10 million small issue exemption <input type="checkbox"/>	
15 Qualified student loan bond (section 144(b))	15
16 Qualified redevelopment bond (section 144(c))	16
17 Qualified hospital bond (section 145(c)) (attach schedule—see instructions)	17
18 Qualified 501(c)(3) nonhospital bond (section 145(b)) (attach schedule—see instructions)	18
Check box if 95% or more of net proceeds will be used only for capital expenditures ▶ <input type="checkbox"/>	
19 Nongovernmental output property bond (treated as private activity bond) (section 141(d))	19
20a Other (see instructions) _____	
b New York Liberty Zone advance refunding bond (section 1400L(e)) (see instructions) _____	20b
c Other. Describe (see instructions) ▶ _____	20c

Part III Description of Bonds (Complete for the entire issue for which this form is being filed.)

Table with 5 columns: (a) Final maturity date, (b) Issue price, (c) Stated redemption price at maturity, (d) Weighted average maturity, (e) Yield. Row 21 contains input fields for these values.

Part IV Uses of Proceeds of Issue (including underwriters' discount)

Table with 2 columns: Description of use of proceeds, Amount. Rows 22-30 list various categories like accrued interest, bond issuance costs, and nonrefunding proceeds.

Part V Description of Property Financed by Nonrefunding Proceeds

Caution: The total of lines 31a through e below must equal line 30 above. Do not complete for qualified student loan bonds, qualified mortgage bonds, or qualified veterans' mortgage bonds.

Table with 2 columns: Type of Property Financed by Nonrefunding Proceeds, Amount. Rows 31a-31e list property types like Land, Buildings, and Equipment.

32 North American Industry Classification System (NAICS) of the projects financed by nonrefunding proceeds.

Table with 4 columns: NAICS Code, Amount of nonrefunding proceeds, NAICS Code, Amount of nonrefunding proceeds. Rows a and b provide input fields.

Part VI Description of Refunded Bonds (Complete this part only for refunding bonds.)

Form with rows 33-36 for entering maturity dates and issue dates for refunded bonds.

Part VII Miscellaneous

Form with rows 37-46 for miscellaneous information including governmental unit name, hedge details, GIC information, and remediation procedures.

EIN

Part VIII	Volume Caps	Amount
47	Amount of state volume cap allocated to the issuer. Attach copy of state certification	47
48	Amount of issue subject to the unified state volume cap	48
49	Amount of issue not subject to the unified state volume cap or other volume limitations:	49
a	Of bonds for governmentally owned solid waste facilities, airports, docks, wharves, environmental enhancements of hydroelectric generating facilities, or high-speed intercity rail facilities	49a
b	Under a carryforward election. Attach a copy of Form 8328 to this return	49b
c	Under transitional rules of the Tax Reform Act of 1986. Enter Act section ▶	49c
d	Under the exception for current refunding (section 146(i) and section 1313(a) of the Tax Reform Act of 1986)	49d
50a	Amount of issue of qualified veterans' mortgage bonds	50a
b	Enter the state limit on qualified veterans' mortgage bonds	50b
51a	Amount of section 1394(f) volume cap allocated to issuer. Attach copy of local government certification	51a
b	Name of empowerment zone ▶	
52	Amount of section 142(k)(5) volume cap allocated to issuer. Attach copy of state certification	52

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

▶ _____ Date _____ ▶ _____
 Signature of issuer's authorized representative Type or print name and title

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	Preparer's PTIN
	Firm's name ▶			Firm's EIN ▶	
	Firm's address ▶			Phone no.	