

STATE WATER RESOURCES CONTROL BOARD
POST-ISSUANCE TAX COMPLIANCE POLICY FOR TAX-EXEMPT BOND ISSUES
JULY 2013

I. PURPOSE

The purpose of this policy is to ensure that the State Water Resources Control Board (State Water Board) complies with applicable requirements of federal tax law necessary to preserve the tax-exempt status of interest on tax-exempt obligations issued by or on behalf of the State Water Board. This policy is designed to set forth compliance procedures so that the State Water Board utilizes the proceeds of all issues of bonds or other obligations (collectively, the Bonds) in accordance with applicable federal tax requirements and complies with all other applicable federal requirements with respect to Bond issues.

To comply with applicable federal tax requirements, the State Water Board must confirm that the requirements are met at the time Bonds are issued and throughout the term thereof. Generally, compliance should include retention of records sufficient to establish compliance with applicable federal tax requirements, including records related to periods before the Bonds are issued (e.g., in the case of reimbursement of prior expenditures) until three (3) years (or, if longer, such other time period provided in the tax certificate related to an issue of Bonds) after the final maturity or redemption date of any issue of Bonds (including any refinancing thereof).

The State Water Board reserves the right to use its discretion as necessary and appropriate to make exceptions or request additional provisions as circumstances warrant. The State Water Board also reserves the right to change this Policy from time to time.

II. PROCEDURES

Responsible Official

The Section Chief of the State Revolving Fund and Special Programs Section of the Division of Financial Assistance (DFA CWSRF Section Chief) shall be responsible for overseeing compliance with the provisions of this Policy, and will identify the employee(s) who will be responsible for each of the procedures listed below, notify the appropriate current employee of the responsibilities, and provide that person a copy of these procedures.

Upon employee transitions, the DFA CWSRF Section Chief will advise the new personnel and their supervisors of their responsibilities under these procedures and will ensure that they understand these procedures. If employee positions are restructured or eliminated, the DFA CWSRF Section Chief will reassign or seek to reassign responsibilities as necessary.

Issuance of Bonds

Bond Counsel. The State Water Board will retain a nationally recognized bond counsel firm (Bond Counsel) to deliver a legal opinion upon issuance of Bonds. State Water Board staff will consult with Bond Counsel and other legal counsel and advisors, as needed, following issuance of Bonds to ensure that applicable post-issuance requirements in fact are met, so that interest on all Bond issues will be excluded from gross income for federal income tax purposes so long as any Bonds remain outstanding. This shall include, without limitation, consultation in connection with any potential changes in the use of Bond-financed or refinanced Projects (as defined herein). The Division of Financial Assistance will coordinate with the Division of

Administrative Services and the Office of Chief Counsel to maintain a contract with Bond Counsel.

Documentation of Tax Requirements. The federal tax requirements relating to each issue of Bonds will be set forth in the Tax Certificate executed in connection with each issue, which will be included in the closing transcript for each issue. The certifications, representations, expectations, covenants and factual statements set forth in the Tax Certificate relate primarily to the restriction on use of Bond-financed facilities by persons or entities other than local government recipients, changes in use of assets financed or refinanced with Bond proceeds, restrictions applicable to the investment of Bond proceeds and other moneys relating to the Bonds, arbitrage rebate requirements, and economic life of the Bond-financed assets. In addition, the federal tax requirements relating to each loan made with the Bond proceeds is set forth in the financing agreement executed by each local government recipient in connection with each loan.¹

Information Reporting. The DFA CWSRF Section Chief will coordinate with the SRF and Systems Accounting Unit Supervisor of the Division of Administrative Services (DAS SRF Accounting Supervisor) and the Office of Chief Counsel to confirm that the IRS Form 8038-G is timely filed with respect to all Bond issues, including any required schedules and attachments. The Form 8038-G filed with the IRS, together with an acknowledgement copy (if available) or IRS Notice CP152, will be included as part of the closing transcript for each Bond issue, or kept in the records related to the appropriate issue of Bonds.

Application of Bond Proceeds

Timely Expenditure of Bond Proceeds. The State Water Board will ensure the timely expenditure of Bond proceeds. The DFA CWSRF Section Chief will coordinate with the Section Chief of the Administrative Section of the Division of Financial Assistance (DFA Administrative Section Chief) to effectuate this requirement. At the time of issuance of any Bonds (or any portion thereof) issued to fund original expenditures, as to each loan of Bond proceeds to local government recipients, the State Water Board must reasonably expect that there will be a substantial binding obligation to spend at least 5% of the loaned Bond proceeds on capital project costs, that the Bond-financed project (the "Project") and the expenditure of Bond proceeds to costs will proceed with due diligence, and that at least 85% of the loaned Bond proceeds (excluding Bond proceeds held in a reasonably required reserve fund) will be spent by the local government recipients on capital project costs within three (3) years of the issue date of the Bonds.² Satisfaction of these requirements allows project-related Bond proceeds to be invested at an unrestricted yield by the State Water Board for six (6) months from the issue date of the Bonds and by the local government recipients for the balance of the three (3) year period from the issue date of the Bonds. Bonds issued to refinance outstanding obligations are subject to separate expenditure requirements, which shall be outlined in the Tax Certificate relating to such Bonds. The DFA Administrative Section Chief will coordinate with the DAS SRF Accounting Supervisor to monitor the appropriate capital project accounts (and, to the extent applicable, working capital expenditures and/or refunding escrow accounts) and ensure that Bond proceeds are spent within the time period(s) required under federal tax law.

Loan Origination Expectations. The State Water Board must reasonably expect the following on the date of issue of the Bonds: (i) that at least 30% of the net proceeds of the Bonds will have been used directly or indirectly to make or finance loans to local government recipients by the end of the one-year period beginning on the date of issuance of the Bonds (the "one-year/30%

¹ The term "loan" is used generally herein and includes Installment Sale Agreements and other forms of repayable financing.

² These requirements do not apply to refinancings.

test”), and (ii) that at least 95% of the net proceeds of the Bonds will be lent to local government recipients by the end of the third year after the date of issuance (the “three-year/95% test”). The DFA CWSRF Section Chief will coordinate with the DFA Administrative Section Chief to effectuate this requirement.

Redemption Requirement. To the extent that less than the applicable percentage of the proceeds of any Bond issue that is required to comply with the one-year/30% test or the three-year/95% test, above, is used by the close of the one-year or three-year period, respectively, beginning on the date of issuance of such Bond issue, the State Water Board shall redeem the appropriate amount of outstanding Bonds within 90 days after the end of the applicable period. The DFA CWSRF Section Chief will coordinate with the DAS SRF Accounting Supervisor and the Office of Chief Counsel to monitor and implement the foregoing.

Capital Expenditures. In general, proceeds (including earnings on original sale proceeds) of Bonds issued to fund original expenditures, other than proceeds deposited in a reasonably required reserve fund or used to pay costs of issuance, should be spent by the local government recipients on capital expenditures. For this purpose, capital expenditures generally mean costs to acquire, construct, or improve property (land, buildings and equipment), or to adapt the property to a new or different use. The property financed or refinanced must have a useful life longer than one (1) year. Capital expenditures include design and planning costs related to the Project, and include architectural, engineering, surveying, soil testing, environmental, other similar costs incurred in the process of acquiring, constructing, improving or adapting the property. Capital expenditures do not include operating expenses of the Project or incidental or routine repair or maintenance of the Project, even if the repair or maintenance will have a useful life longer than one (1) year.

Use of Bond-Financed Assets

Ownership and Use of Project. For the life of the Bond issue (including any refinancing thereof), the Project must be owned and operated by a state or local governmental entity. At all times while the Bond issue is outstanding, no more than 10% (or \$15,000,000, if less) of the Bond proceeds or the Project may be used, directly or indirectly, in a trade or business carried on by a person other than a state or local governmental unit (“Private Use”). Generally, Private Use consists of any contract or other arrangement, including leases, management contracts, operating agreements, guarantee contracts, take or pay contracts, output contracts or research contracts, which provides for use by a person who is not a state or local government on a basis different than the general public. The Project may be used by any person or entity, including any person or entity carrying on any trade or business, if such use constitutes “general public use.” General Public Use is any arrangement providing for use that is available to the general public at either no charge or on the basis of rates that are generally applicable and uniformly applied. The DFA CWSRF Section Chief will coordinate with the DFA Administrative Section Chief and the Office of Chief Counsel to monitor at least annually the foregoing throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in the Tax Certificate relating to the Bonds.

Management or Operating Agreements. Any management, operating or service contracts whereby a non-governmental entity (including the federal government) is using the Project must fit within the above-mentioned 10% allowable Private Use limit or the contracts must meet the IRS safe harbor for management contracts. Any such management, operating or service contracts, including any replacements of or changes to such contracts, must be reviewed by Bond Counsel. State Water Board staff will contact Bond Counsel if there may be a lease, sale, disposition, or other change in use of assets financed or refinanced with Bond proceeds. The DFA CWSRF Section Chief will coordinate with the DFA Administrative Section Chief and the

Office of Chief Counsel to monitor and consult at least annually regarding the foregoing throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in the Tax Certificate relating to the Bonds.

Useful Life Limitation. The weighted average maturity of the Bond issue cannot exceed 120% of the weighted average economic life of the assets financed or refinanced with Bond proceeds. In other words the weighted average economic life of the Project must be at least 80% of the weighted average maturity of the Bond issue (including any refinancing thereof). The DFA CWSRF Section Chief will coordinate at least annually with the DFA Administrative Section Chief to monitor the foregoing throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in the Tax Certificate relating to the Bonds.

Investment Restrictions; Arbitrage Yield Calculation; Rebate

The State Water Board will retain an arbitrage/rebate consultant to ensure that applicable arbitrage/rebate requirements are met, as discussed below. The DAS SRF Accounting Supervisor will coordinate with the Division of Financial Assistance and the Office of Chief Counsel to maintain a contract with such a consultant.

Investment Restrictions. Investment restrictions relating to Bond proceeds and other moneys relating to the Bonds are set forth in the Tax Certificate. The DAS SRF Accounting Supervisor will monitor at least annually the investment of Bond proceeds to ensure compliance with yield restriction rules.

Arbitrage Yield Calculation. Investment earnings on Bond proceeds will be tracked and monitored to comply with applicable yield restrictions and/or rebate requirements. The State Water Board is responsible for calculating (or causing the calculation of) rebate liability for each Bond issue, and for making any required rebate payments. Any funds of the State Water Board set aside or otherwise pledged or earmarked to pay debt service on Bonds must be analyzed to assure compliance with the tax law rules on arbitrage, invested sinking funds, and pledged funds (including gifts or donations linked to the Bond-financed assets). The DAS SRF Accounting Supervisor will oversee this activity.

Rebate. The State Water Board will retain an arbitrage rebate consultant to perform rebate calculations that may be required to be made from time to time with respect to any Bond issue. The State Water Board is responsible for providing the arbitrage rebate consultant with requested documents and information on a prompt basis, reviewing applicable rebate reports and other calculations and generally interacting with the arbitrage rebate consultant to ensure the timely preparation of rebate reports and payment of any rebate. The DAS SRF Accounting Supervisor will oversee this activity.

The reports and calculations provided by the arbitrage rebate consultant will ensure compliance with rebate requirements, which require the State Water Board to make rebate payments, if any, no later than the fifth (5th) anniversary date and each fifth (5th) anniversary date thereafter through the final maturity or redemption date of a Bond issue. A final rebate payment must be made within sixty (60) days of the final maturity or redemption date of a Bond issue. The DAS SRF Accounting Supervisor will oversee this activity.

The DAS SRF Accounting Supervisor will confer and consult with the arbitrage rebate consultant to determine whether any rebate spending exception may be met. The DAS SRF Accounting Supervisor and the Office of Chief Counsel will review the Tax Certificate and/or consult with the arbitrage rebate consultant or Bond Counsel for more details regarding the rebate spending exceptions.

Copies of all arbitrage rebate reports, related return filings with the IRS (i.e., IRS Form 8038-T), copies of cancelled checks with respect to any rebate payments, and information statements must be retained as described below. The DAS SRF Accounting Supervisor will follow the procedures set forth in the Tax Certificate entered into with respect to any Bond issues that relate to compliance with the rebate requirements.

Record Retention

Allocation of Bond Proceeds to Expenditures. The State Water Board shall allocate (spend) Bond proceeds to loans made to local government recipients, and shall trace and keep track of the use of Bond proceeds and assets financed or refinanced therewith. The DAS SRF Accounting Supervisor will ensure compliance with this requirement. Copies of all relevant documents and records sufficient to support that the tax requirements relating to a Bond issue have been satisfied will be maintained by the DFA Administrative Section Chief for the term of a Bond issue plus three (3) years (or, if longer, such other time period provided in the tax certificate related to an issue of Bonds), including any refinancing thereof, including the following documents and records:

- Bond closing transcript;
- All records of investments, arbitrage reports, returns filed with the IRS and underlying documents;
- Construction contracts, purchase orders, invoices and payment records;
- Documents relating to costs reimbursed with Bond proceeds;
- All contracts and arrangements involving Private Use of the Bond-financed property;
- All reports relating to the allocation of Bond proceeds and Private Use of Bond-financed property; and
- Itemization of property financed with Bond proceeds.

III. EDUCATION AND TRAINING

The DFA CWSRF Section Chief, the DAS SRF Accounting Supervisor, relevant counsel in the Office of Chief Counsel, and other appropriate staff of the State Water Board shall periodically obtain education and training on federal tax requirements for post-issuance compliance applicable to the Bonds. The State Water Board will enable relevant personnel to attend and participate in educational and training programs regarding compliance with federal tax requirements for the Bonds.

IV. CORRECTING NON-COMPLIANCE

If any non-compliance of applicable federal tax requirements is identified or otherwise brought to the State Water Board's attention, the DFA CWSRF Section Chief shall, in consultation with legal counsel and the appropriate tax compliance personnel of the State Water Board, cause the State Water Board and any other parties involved with the issuance of the Bonds or the use of the proceeds of the Bonds, as required, to take all steps necessary or advisable in order to timely correct or remediate such non-compliance.

POST-ISSUANCE COMPLIANCE

A) In General.

The DFA CWSRF Section Chief will conduct periodic reviews of compliance with these procedures to determine whether any violations have occurred so that such violations

can be remedied through the “remedial action” regulations (Treas. Reg. Section 1.141-12) or the Voluntary Closing Agreement Program (VCAP) described in IRS Notice 2008-31 (or successor guidance). If any changes to the terms or provisions of a Bond issue are contemplated, State Water Board staff will consult Bond Counsel.

B) Private Use.

The DFA CWSRF Section Chief will maintain records identifying the proceeds of a Bond issue (including earnings thereon or the repayment of loans made therewith) used to make loans to local government recipients, including the uses and the users (including terms of use and type of use) thereof. Such records may be kept in any combination of paper or electronic form. In the event the use of Bond proceeds or assets financed or refinanced with Bond proceeds is different from the covenants, representations or factual statements in the Tax Certificate (or the tax certifications and representations made by any local government recipient), the DFA CWSRF Section Chief will promptly contact the Office of Chief Counsel, which will promptly contact and consult with Bond Counsel to ensure that there is no adverse effect on the tax-exempt status of the Bond issue and, where appropriate, will remedy any violations through the “remedial action” regulations (Treas. Reg. § 1.141-12), the Voluntary Closing Agreement Program (VCAP) described in IRS Notice 2008-31 (or successor guidance), or as otherwise prescribed by Bond Counsel.