Department of Administrative Services, Capital Investment Section
Arbitrage Compliance Procedures: Timing and Use of Proceeds
Updated: January 17, 2012

This document establishes the general operating procedures for the timing and use of proceeds for bonds issued by the Capital Investment Section (CIS) on behalf of the State and its agencies. This guidance helps assure continuing compliance with Internal Revenue Code and GASB Statements as well as conformity with generally accepted accounting principles.

Responsible Party	Action	Time Frame
CIS Staff	Monitor General Fund (a/c 0401) and reconciliations to determine that proceeds from working capital borrowing through Tax Anticipation Notes are fully expended within six months from date of issue.	Ongoing on a quarterly basis subsequent to TANs issuance
CIS Staff	Provide instruction to State Agencies on Internal Revenue Code (IRC) requirements regarding the timing and use of bond proceeds. Generally, bond proceeds are for capital expenditures and not working capital expenditures which are current operating expenses.	During budget preparation, Pre-bond sale and Ongoing
CIS Staff	Provide guidance to State Agencies that sets forth current IRC spending requirements to qualify for the “temporary period exception” pursuant to section 1.148-2(e)(2).	Pre-bond sale and Ongoing
CIS Staff	Provide guidance to State Agencies on rebate spending exceptions under the IRC which allow the State to retain earnings on invested proceeds above calculated arbitrage yields for “Project/Construction” funds and for the Cost of Issuance. Calculations are made by individual bond series.	Pre-bond sale and Ongoing
State Agencies / Grantees	State Agencies/Grantees will affirm to CIS that the “Temporary Period” exception timeline is met. State Agencies/Grantees will certify via their Spend Plan in the Interagency Agreement that the “Temporary Period” is satisfied in order for the State to issue the bonds tax-exempt, and the State Agency/Grantee reasonably expects at the time the bonds are issued: ➢ to spend, or have a binding commitment to an unrelated third party to spend, at least 5% of the net sale proceeds of the issue within 6 months after the	Pre-bond sale and Ongoing

Responsible Party	Action	Time Frame
	issue date; ➢ to spend at least 85% of the net sale proceeds of the issue within three (3) years after the issue date; and ➢ to proceed with spending the proceeds of the issue on eligible expenditures with "due diligence".	
State Agencies / Grantees	Provide spend plan that shows the spending exception to arbitrage rebate for construction issues of at least 75% of available proceeds spent on "construction expenditures" as defined in the Tax Certificate for the issue is as follows: <u>Elapsed Time After Issuance</u> — <u>Required Spending</u> Six (6) months — 10% 12 months — 45% 18 months — 75% 24 months — 100%	Pre-bond sale and Ongoing
State Agencies / Grantees	Provide spend plan that shows the spending exception to arbitrage rebate for non-construction issues as follows: <u>Elapsed Time After Issuance</u> — <u>Required Spending</u> Six (6) months — 15% 12 months — 60% 18 months — 100% Example: When more than 25% of the proceeds of a new borrowing issue are spent on a combination of land and equipment (other than specially made equipment) that issue would be only be eligible for the 18 month exception in this section.	Pre-bond sale and Ongoing
State Agencies / Grantees	Prepare formal Agency Request to Reimburse letter. Identify any expenditures to be reimbursed from bond proceeds between 18 months and 60 days prior to bond sale. Submit to CIS for review and approval. See the following: Attachment A: Instructions to Agencies/Agency Request to Reimburse sample letter	Pre-bond sale and Prior to incurring expenditures

Responsible Party	Action	Time Frame
CIS Staff	Review State Agency requests to borrow debt service costs (capitalized interest) to ensure period for which debt is borrowed precedes the date assets are placed in service as provided by State Agencies in the Completion Certificate.	During budget preparation and pre-bond sale
CIS Staff	Provide guidance and requirements on operational readiness to State Agencies/Grantees new to bond issues.	During budget preparation and pre-bond sale
CIS Staff	Include requirement in all inter-agency agreements and grant agreements that bond proceeds be spent within three years of issuance to ensure compliance with rules on excessive borrowing.	During pre-bond sale communication
CIS Staff / State Agency / Bond Counsel	Evaluate potential “private use” of financed assets, including use by such entities as the federal government, private research at universities or local governments. Determine appropriate action for proposed private use including removing the item from the financing or selling taxable bonds to finance the asset.	Prior to bond sale
CIS Staff	Review and approve State Agency requests to incur costs prior to date of bond sale to ensure compliance with all necessary components of Agency Request to Reimburse letter. Prepare formal DAS Declaration of Official Intent to Reimburse Capital Costs and assign control number. Record control number and date in Intent Resolution Register, a CIS internal permanent file and control document. See the following: Attachment B: DAS Declaration of Official Intent to Reimburse Capital Costs Attachment C: Intent Resolution Register	Intent to Reimburse Declaration completed before expenditure is incurred
State Agencies including DAS	For bond proceeds that will be granted to unrelated parties, enter into written contractual agreement with the unrelated party. Include in contractual agreement that obligations of grant are **limited solely** to	Agreement is completed before expenditure is incurred

Responsible Party	Action	Time Frame
	conditions required to ensure and confirm that expenditures are made in accordance with the purpose of the grant and that granted funds will only be used for capital expenditures unless the use of granted funds for working capital is discussed with bond counsel prior to the bond sale in accordance with tax code. Provide a copy of agreement to CIS.	
CIS Staff	For COP, Lottery Bonds, and Article XI-Q Bonds, record list of assets acquired by agency and series in the Issuance Register, a CIS internal permanent file and control document. See the following: Attachment D: Issuance Register	Time of bond sale
CIS Staff	Compare actual cash draws and expenditures to spend plans through review of Trustee/Disbursing Agent bank statements and Treasury statements. If necessary, evaluate alternative uses of funds (e.g. permit use by other qualifying projects) to maintain compliance with IRC spending requirements.	Semi-annually
CIS Staff	At the time that annual arbitrage rebate liability communications and surveys are conducted with State Agencies, request affirmative confirmation that assets acquired with bond proceeds continue to be used for eligible purposes.	Annually in July / August
State Agencies	Report on status of assets acquired with tax-exempt bond proceeds. If necessary, work with CIS on remedial action up to and including defeasance of outstanding bonds.	Annually in July / August
State Agencies	Send “Completion Certificate” when project financed has been completed as required in Exhibit F in the Interagency Agreement.	At time asset is ready for its intended use
CIS Staff	After receipt of Completion Certificate, analyze balance in project/construction fund. In consultation with counsel, determine appropriate course of action regarding investment/use of remaining proceeds,	At receipt of construction certificate

Responsible Party	Action	Time Frame
	including potential requirement to yield-restrict investments. State policy is to use excess to pay debt service for borrowing agency; however, use for another qualifying asset is permitted. Debt service payments will be spent for arbitrage purposes when the proceeds are paid to bondholders not when the money is transferred to the debt service account.	
State Agencies / Grantees CIS Staff / Bond Counsel	In the rare event a State Agency/Grantee abandons a project that it originally expected to undertake as a capital project: ➢ Pre-Issuance Abandonment: If the State Agency/Grantee has made expenditures for a capital project that it intended to reimburse with tax-exempt bond proceeds of a future issue, and the project is abandoned prior to the issue, the State Agency/Grantee will not seek to reimburse such expenditures with tax-exempt bonds. ➢ Post-Issuance Abandonment: If the State Agency/Grantee abandons a capital project after expenditures on such project have been repaid with tax-exempt bond proceeds, the State Agency/Grantee will notify CIS staff. CIS will consult with Bond Counsel to determine if the State Agency/Grantee may reallocate the tax-exempt bonds originally allocated to the project to another capital project or other applicable remedies provided under tax code.	At project abandonment
State Agencies / Grantees	To the extent that all proceeds from a bond issue have not been spent within three (3) years, State Agencies/Grantees will provide a written explanation from Project Management to CIS describing what circumstances changed after the bonds were issued such that all of the proceeds could not be spent within 3 years. State Agencies/Grantees shall provide an amended Spend Plan with a revised “date certain” completion date.	Third anniversary of bond issue
CIS Staff	If bond proceeds remain unexpended after three (3)	Three (3) years after

Responsible Party	Action	Time Frame
	years, work with counsel to determine if such proceeds should be placed in “yield-restricted” investments only, pursuant to the following: ➢ The project proceeds of tax-exempt borrowings for capital projects can be invested at an unrestricted yield for a temporary period of 3 years (Treasury Reg. Sec. 1.148-2(e)(2)). ➢ After the third anniversary date, any unspent project proceeds are yield restricted to the bond yield plus 1/8% (Treasury Reg. Sec. 1.148-2(d)(2)(i)). ➢ However, the regulations permit issuers to make yield reduction payments to satisfy the yield restriction rule (Treasury Reg. Sec. 1.148-5(c)(3)(i)(A)). ➢ The yield reduction payments need to be calculated at the same time and in the same manner as rebate payments (Treasury Reg. Sec. 1.148-5(c)(2)(i)). ➢ Although the calculation of yield reduction payments and rebate payments are made at the same time and in the same manner, the calculation of yield reduction payments is a separate calculation and so the amount of rebate owed would not generally equal the amount of yield reduction payments owed at a computation date. Example: It took 5 years to spend all project proceeds of an issue. For the first 2.5 years, there was negative arbitrage, but for the second 2.5 years there was positive arbitrage. It is possible that over the 5 year rebate computation period, the State did not earn net positive arbitrage on the project fund and would not owe rebate. However, if the State did earn positive arbitrage after the temporary period ended at year three (between year 3 and year 5), the State would owe yield reduction payments in an amount necessary to bring the post year-3 yield down to the bond yield plus 1/8%. The State could owe yield reduction payments but not rebate.	bond sale date
CIS Staff	CIS will invest the proceeds of an advance refunding that are being held in escrow pending the time when the bonds to be refunded become callable, as well as	At time of request for bond refunding

Responsible Party | Action | Time Frame

any transferred, unspent proceeds from the refunded bonds, in a yield-restricted manner.

In the event of a refunding request, CIS will comply with the following refunding rules:

- New money tax-exempt bonds issued on or after January 1, 1986 can be advance refunded only once.
- Tax-exempt bonds refunded by an advance refunding with resultant present value debt service savings must be redeemed on their first call date.
- Current refundings may be done without limitation as to number.
- A bond issued after August 5, 1997 to finance or advance refund capital expenditures (other than hospital expenditures) incurred prior to August 5, 1997 will not be treated as a tax-exempt bond if the face amount of the issue exceeds $150 million. Expressly excluded from this restriction are the following permissible actions:
    - Issuing tax-exempt bonds after August 5, 1997 for the purpose of financing costs incurred after that date in connection with capital projects
    - Engaging in current refundings regardless of when the refunded bonds were issues:
        - if the amount of the refunding bonds does not exceed the outstanding amount of the refunded bonds, and
        - if either (1) the weighted average maturity of the refunding bonds does not exceed 120% of the weighted average reasonable expected economic life of the facilities financed with the refunded bonds, or (2) the last-maturing bond in the refunding issue matures no later than 17 years after the issue date of the refunded bonds; and
    - Engaging in single advance refunding after March 1986 of any bond issued before January 1, 1986; provided, however, that any

Responsible Party	Action	Time Frame
	such advance refunding is counted as outstanding for purposes of determining whether subsequent new money or advance refunding bonds may be issued. ➢ Review final maturity of the refunded bonds for changes in arbitrage calculation date to determine if there is any potential rebate.	

ATTACHMENT A

Agency Request to Reimburse Capital Costs with Oregon Bonds, Certificates of Participation, or Other Financing Agreements

Generally: Agencies which will be making project expenditures prior to the issuance of "Bonds, Certificates of Participation or Other Financing Agreements (Bonds)" need to take the following steps if they want the expenditures reimbursed after the Bonds are issued.

They must send a letter to the Capital Investment Section (CIS) of Budget and Management Division (BAM) with enough information so that CIS can prepare and file a Declaration of Intent to Reimburse. CIS must receive the request prior to the expenditure of the money. The CIS Finance Manager will execute a ***Declaration of Official Intent to Reimburse Capital Costs*** once the request has been approved. Failure to follow this procedure will mean the State will be unable to issue Bonds for the purpose of reimbursing the agency's costs paid prior to the time of financing.

Steps/Rules Necessary to Comply with the Federal Requirements:

1. Before making any project expenditures (or within sixty days afterwards), the agency must obtain an approved DAS Declaration of Official Intent to Reimburse Capital Costs. To achieve this, the agency must provide the CIS with a description of the project for which the expenditures are being paid and state the maximum principal amount of bonds to be issued for the purpose of reimbursement. The description must include the amount of expenditures summarized by type. Project substitution will not be made without the prior written approval of the DAS Director/Deputy Director.
2. The agency must expect that the reimbursement will be required to successfully implement the project.
3. The expenditure must be a Capital Expenditure, not working capital or operating costs.
4. The State must issue the Bonds to make the reimbursement for prior expenditures within eighteen months after the date the expenditure was paid or, if later, eighteen months after the property resulting from the expenditure was placed into service. In any event, the Bonds must be sold to make the reimbursement within three years after the date the expenditure was paid.
5. The financing must not be motivated by arbitrage considerations, that is attempting to profit by the purchase and sale of investments in different markets to take advantage of the difference between the market prices.
6. The agency must identify the Account(s) from which the expenditures will be made and reimbursed.
7. Requests for reimbursement must be made with the full intent of issuing Bonds and not as a matter of course.
8. The request must not be in amounts substantially in excess of expected amounts to be reimbursed.

ATTACHMENT A, CONTINUED
Instructions for Sample State Agency Request Letter

AGENCY LETTERHEAD

Date

Department of Administrative Services
Capital Investment Section
155 Cottage St., NE
Salem, OR 97301

DECLARATION OF INTENT TO INCUR COSTS AND EXPEND FUNDS

The letter should cover the following items:

1. Describe generally the authorization under which the expenditure authority is granted. This should also include a brief description of the project and the total amount authorized for the project.
2. A general description of project expenditures and amounts expected to be paid prior to the issuance of the Bonds. If a sale date is delayed for any reason, an amendment to the declaration maybe necessary to maintain compliance with the Federal rules. If you're not sure of the scheduled sale date, contact CIS.
3. Identify by name and purpose the fund or account from which the expenditure is to be paid.
4. Note, in brief, the extent the project has been approved as part of the agency's budget.

Finally, have the letter signed by an authorized agency official and send to CIS.

SIGNATURE

NOTE: This sample is available in electronic format if you desire. Please contact CIS and ask to have it e-mailed to you.

ATTACHMENT B

DAS Declaration of Official Intent to Reimburse Capital Costs

Declaration ___
20xx-xx Biennium

Section 1. The Oregon Department of Administrative Services, Capital Investment Section (the "issuer") reasonably expects to issue Bonds authorized by ORS 283 and 286A on behalf of ______________________________________ (the "Agency") to reimburse the Agency for the expenditures described herein. That portion of the bond proceeds used for reimbursement will be considered Reimbursement Bonds.

Section 2. This Declaration of Official Intent to Reimburse is made pursuant to the Income Tax Regulations promulgated by the United States Department of the Treasury.

Section 3. The maximum principal amount of Reimbursement Bonds expected to be issued is $xxx.

Section 4. The expenditures with respect to which the Issuer reasonably expects to be reimbursed from the proceeds of Reimbursement Bonds are for the capital costs incurred in the following:

xxx	$ xxx
xxx	xx
TOTAL	$ xxx

Section 5. The expenditures with respect to which the Issuer reasonably expects to be reimbursed from the proceeds of Reimbursement Bonds will be made from the _________________________.

Adopted this ____ day of __________, 20xx

Issuer: Department of Administrative Services, Capital Investment Section (CIS)

____
CIS Finance Manager

ATTACHMENT C
Intent Resolution Register

Date	Biennium	Intent Number	Debt Type	Series	Agency Number	Agency	Description	Amount
May-26-11	09-11	5	COP	2011 J	1xx00	XYZ Agency	XYZ Building	$75,000,000

ATTACHMENT D

Issuance Register

#		Biennium	Series	Issue Date	Agency Number	Agency Name	Project or Purpose	PAR refunding amount of bonds	Amount	Interest Rate	Term	Final Maturity	Reserves	Financing Type	Amount of other Financing	Description	Rebate Estimate Required	Next Arbitrage Rebate Payment Date	Arbitrage Yield Limit (from Tax Certificate)
1		09-11	2011 J	May-26-11	1xx00	XYZ Agency	XYZ Building		$75,000,000	4.00%	25 yrs	5/1/2036						5/1/2012	3.000000