



**STATE OF NEW MEXICO
DEPARTMENT OF FINANCE AND ADMINISTRATION
STATE BOARD OF FINANCE**

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**POST-ISSUANCE COMPLIANCE
PROCEDURES FOR TAX-EXEMPT BONDS**

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I. INTRODUCTION

The Internal Revenue Code of 1986, as amended (the "Code") and the regulations promulgated thereunder (the "Regulations") impose certain requirements on tax-exempt obligations, including but not limited to, restrictions on the use of bond proceeds and bond-financed property, arbitrage yield restrictions, and the arbitrage rebate requirement. These requirements are generally applicable throughout the period that the bonds remain outstanding.

The September 2011 revision to the Form 8038-G, Information Return for Tax Exempt Governmental Obligations ("Form 8038-G") requires the issuer to represent whether it has established written procedures to (a) monitor the requirements of Section 148 of the Code, including, but not limited to, the arbitrage rebate and arbitrage yield restriction requirements; and (b) ensure that any nonqualified bonds (within the meaning of Section 1.148-12(j) of the Regulations) are remediated in accordance with the Code and the Regulations.

In light of these requirements, the State Board of Finance ("SBOF") has developed these written procedures to monitor compliance with Section 148 of the Code and to ensure that any nonqualified bonds are remediated in accordance with the Code and the Regulations. Actions pursuant to these procedures (collectively referred to as post-issuance tax compliance) are intended to assist the SBOF in documenting compliance with the applicable federal tax requirements. Post-issuance tax compliance begins with the debt issuance process itself and includes a continuing focus on the investment of bond proceeds and use of bond-financed property. Post issuance tax compliance requires identifying the responsible parties and the applicable procedures.

References herein to a "bond" or to "bonds" shall apply to all forms of tax-exempt obligations issued by the SBOF.

II. GOVERNING LAWS AND PRINCIPLES

The SBOF's Bond Project Disbursements Rule, NMAC 2.61.6, provides guidance for the appropriate use of bond proceeds to ensure compliance with state laws and, where applicable, the Internal Revenue Code. Board staff, in consultation with the SBOF's bond counsel and arbitrage/rebate consultant, is responsible for monitoring and enforcing the Bond Project Disbursements Rule.

Treasury Regulation 1.148-2(e)(2) sets forth spend-down tests to establish that tax-exempt bonds are not arbitrage bonds. The "Expenditure Test" is met if at the time of issuance there is a reasonable belief that at least 85 percent of the net sale proceeds of the bond issue will be expended on capital projects within three years. The "Time Test" is met if at the time of issuance the issuer reasonably expects to incur a substantial binding obligation to a third party to expend at least 5 percent of the net sale proceeds of the bond issue on the capital projects within six months.

III. PARTIES INVOLVED

- a. State Board of Finance ("SBOF");

- b. State Treasurer's Office ("STO") acting as paying agent and investing authority for the bonds;
- c. the Board's Financial Advisor;
- d. the Board's Bond Counsel;
- e. the Board's Board Counsel; and
- f. the Board's Arbitrage Consulting and Compliance Services Provider.

IV. PROCEDURES

The Director of the SBOF (hereinafter referred to as the "Director") is designated as being responsible for post-issuance tax compliance. The Director may delegate to his or her staff or contract advisors (such as an arbitrage/rebate consultant) responsibility for different aspects of post-issuance tax compliance. However, the Director will be ultimately responsible for implementing the procedures described herein.

The SBOF recognizes that it has issued a substantial amount of tax-exempt debt prior to the adoption of these procedures. With respect to this prior issued debt, the Director will take reasonable steps to collect and maintain appropriate documentation of compliance with these procedures. However, the SBOF recognizes that such documentation may not exist with respect to some of the items enumerated in these procedures.

Activities Following Bond Issuance

Upon issuance, the Director will:

- a. Confirm the filing of the Form 8038 or Form 8038-G (or applicable successor form) with the Internal Revenue Service ("IRS"). Filing of the applicable Form 8038 is usually overseen by bond counsel at or soon after the closing of a bond issue.
- b. Obtain and store the Transcript of Proceedings prepared by bond counsel (which typically includes the applicable Form 8038 and the Federal Tax Certificate containing the SBOF expectations as of the date of issuance of the bonds).

Recordkeeping

STO acts as the paying agent and investing authority for the SBOF's bonds. Bond proceeds are invested by STO in the Tax-Exempt and Taxable Bond Proceeds Investment Pools (collectively "BPIP") as set forth in STO's Investment Policy. The investment objectives of the BPIP are to preserve capital, provide liquidity and generate the highest return possible. All investments are in accordance with STO's Investment Policy, which is approved by the SBOF.

The BPIP investment strategy is a two-tiered money market and enhanced cash strategy which aims to (i) preserve capital and provide liquidity by investing in short-term (0 to 3 year) fixed income securities with high investment grade ratings per STO's Investment Policy, and (ii) earn excess returns relative to traditional money market strategies by slightly increasing duration consistent with the timing of the need for funds. Monthly position reports and quarterly performance reports can be found on STO's website at www.nmsto.gov.

When a request for bond proceed reimbursement is processed by the SBOF, the SBOF delivers to STO a record of the reimbursement having been entered into the state's general ledger. Within five business days of STO's receipt of the evidence that the reimbursement has been recorded in the state's general ledger, STO records the expenditure of bond proceeds in its investment accounting system. With relation to expenditures, arbitrage calculations are currently based on STO's recording of expenditures. It is anticipated that STO's investment activity will be integrated into the state's general ledger in coming years, and once that occurs it is understood that at that time arbitrage calculations will be based on the recording of expenditures in the state's general ledger.

The SBOF maintains a Capital Projects Database, which tracks the allocation of bond proceeds to each appropriated project and the drawdown history and balances for each project. The type of information maintained includes, but is not limited to, appropriation identification number and description, authorizing law, amount appropriated, bond series, amount sold for the project, expenditure amounts, project balances, and expiration dates. This database is reconciled monthly to the state's general ledger. The SBOF generates quarterly reports for each bond issue outstanding showing the amount expended within six months and three years following bond issuance as this relates to meeting the 5 percent "Time Test" and the 85 percent "Expenditure Test" established in Treasury Regulation 1.148-2(E)(2).

Following issuance, the Director will:

- a. Coordinate with the State Treasurer's Office ("STO") to establish a plan for keeping relevant books and records as to the investment and the expenditure of bond proceeds.
- b. Assure that accurate records are kept, including:
 - Basic records relating to the bond transactions (including the bond regulations and related documents, and bond counsel opinion; see Transcript of Proceeding, above);
 - Documentation evidencing the expenditure of bond proceeds;
 - Documentation evidencing use of bond-financed property by public and private sources (e.g., copies of leases and management contracts);
 - Documentation evidencing all sources of payment or security for the bonds; and
 - Documentation pertaining to any investment by STO of bond proceeds (including the purchase and sale of securities, SLGS subscriptions, yield calculations for each class of investments, actual investment income received from the investment of proceeds, guaranteed investment contracts and rebate calculations).
- c. Assure that accurate records are kept in a manner that ensures their complete access to the IRS so long as they are material. While this is typically accomplished through the maintenance of hard copies, records may be kept in an electronic format if certain requirements are satisfied, in accordance with the guidelines in Revenue Procedure 97-22, 1997-1 C.B. 652.
- d. Assure that relevant records are kept for each bond issue for as long as such bond issue is outstanding (including any bonds issued to refund such issue of bonds) plus three (3) years after the final redemption date of the bonds.

Arbitrage Rebate and Arbitrage Yield Restriction

The Director will:

- a. Engage the services of an arbitrage/rebate consultant for assistance in compliance with arbitrage related issues.
- b. Work with the SBOF's bond counsel, financial advisor and/or arbitrage/rebate consultant to monitor compliance with "temporary period exceptions" for expenditure of bond proceeds—typically three years for new money bonds—and provide for yield restriction of investments or "yield reduction payments" if exceptions are not satisfied.
- c. Work with STO to ensure investments acquired with bond proceeds are purchased at fair market value. This may include use of bidding procedures under the regulatory safe harbor (Section 1.148-5(d) of the Regulations) and complying with procedures set forth in investment instructions furnished by the SBOF's bond counsel.
- d. Consult with the SBOF's bond counsel or arbitrage rebate consultant prior to the creation of funds which would reasonably be expected to be used to pay debt service on tax-exempt bonds to determine in advance whether such funds must be invested at a restricted yield.
- e. Consult with the SBOF's bond counsel and financial advisor before engaging in post issuance credit enhancement transactions (e.g., bond insurance, letter of credit) or hedging transactions (e.g., interest rate swap, cap).
- f. Consult with the SBOF's bond counsel, financial advisor, and/or arbitrage rebate consultant to identify situations in which compliance with applicable yield restrictions depends upon subsequent investments (e.g., purchase of 0% SLGS from U.S. Treasury) and monitor implementation.
- g. Work with the SBOF's arbitrage rebate consultant to arrange for timely computation of rebate/yield reduction payment liability and, if an amount is payable, for timely filing of Form 8038-T, Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate (or applicable successor form), and payment of such liability. Rebate/Yield Reduction payments are ordinarily due at 5-year intervals.

Private Use of Bond-Financed Facilities

The SBOF's bonds are repaid with dedicated severance taxes and dedicated property taxes. As such, the SBOF's bonds generally should not in any circumstance constitute private activity bonds, as they fail the private payment test. Nevertheless, the SBOF monitors private use of property financed through tax exempt bonds.

Prior to issuance, due diligence is performed on each project. The recipient of bond proceeds is required to certify the proposed ownership, operation and use of the capital assets to be financed. If there is a lease or operating agreement, the recipient of bond proceeds must provide a copy of that agreement for legal review. SBOF board counsel

makes a determination that the arrangement does not violate the anti-donation clause of the New Mexico constitution (Article IX, Section 8) or the terms of the appropriation and bond counsel determines that any private use is consistent with IRS rules.

Following issuance, the Director will:

- a. Create and maintain records of which bond proceeds were used to finance which facilities. These records shall incorporate the refunding or partial refunding of any bond issues.
- b. Record the allocation of bond proceeds to expenditures, including reimbursements. These records will be consistent with the expenditures used for arbitrage purposes.
- c. Record the allocation of bond proceeds in connection with any bond funded project. Review expenditure of bond proceeds with the SBOF's bond counsel to ensure bond proceeds are used for qualifying costs.
- d. Consult with SBOF's bond and board counsel and reach a conclusion regarding the allowance of any proposed arrangement involving the sale or lease of a bond-financed facility, or the granting of a license or management contract, or any other arrangement allowing private use of a bond financed facility.
- e. Keep records of private use, if any, of bond financed facilities to monitor the amount of private use of bond financed facilities. Private use of bond-financed facilities shall be monitored periodically. If a change in private use is identified, bond counsel will be consulted to determine if remedial action is necessary.

Reissuance

The Director will:

- a. Consult with SBOF's bond counsel to identify any post-issuance modification to the terms of bonds which could be treated as a current refunding.
- b. Consult with SBOF's bond counsel to determine whether any "remedial action" (see item (e) under "Private Use of Bond-Financed Facilities" above) in connection with private use must be treated as a "reissuance."

Other Post-Issuance Compliance Responsibilities:

The SBOF has various other post issuance compliance activities that do not relate directly to the IRS bond rules that are not included in this document. Some of these activities include the SBOF's continuing disclosure responsibilities pursuant to the Securities and Exchange Commission Disclosure Rule 15c2-12; the Antifraud Provision Rule 10b5; and the Municipal Securities Rulemaking Board Rule G-36. The SBOF also monitors compliance with state laws, including ensuring that reversion dates are met and that proceeds are used in accordance with state appropriation language.

Approved by the State Board of Finance this 26th day of November, 2012.

A handwritten signature in black ink, appearing to read 'Stephanie Schardin Clarke', written over a horizontal line.

Stephanie Schardin Clarke, Director

