REGENTS OF THE UNIVERSITY OF MINNESOTA

DEBT MANAGEMENT GUIDELINES FOR UNIVERSITY-ISSUED DEBT

June 30, 2016

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INTRODUCTION

These Debt Management Guidelines (the "Guidelines") are intended to present overall direction for the management of University-issued debt at the University of Minnesota (the "University"). They are not meant to be a constraint to the University taking the best course of action when beneficial, but instead should be used as an aid in making the appropriate decisions depending upon circumstances at that time. Management flexibility is necessary provided that any required specific authorization is obtained from the Board of Regents (the "BOR").

The Guidelines confirm the commitment of the University's management, staff, advisors and other decision makers to:

- adhere to sound financial management practices, including full and timely repayment of all loans or borrowed funds,
- achieve the lowest possible cost of capital within prudent risk parameters, and
- conform with all the laws and regulations relating to post-issuance compliance.

The Guidelines shall be periodically reviewed and updated as needed. The Treasurer is the administrator of the Guidelines and has the responsibility and authority for structuring, implementing, and managing the University's debt and finance program in accordance with Board Policy.

Definitions of the terms used in the Guidelines can be found in Appendix A. Reference to additional related policies can be found in Appendix B.

Statement of Guideline Objectives

The Guidelines are established to ensure that each debt transaction of the University is completed in the most effective and professional manner, in accordance with the highest standards of the industry, laws and governmental practices, and to meet the following objectives:

- Preserve the University core debt ratings at the target levels established by Board Policy
- Maintain financing flexibility on all debt issued by the University through the use of broad guidelines for identifying and managing debt capacity, choosing fixed and floating rate mix, using various financing instruments, and engaging in refunding opportunities
- Minimize borrowing costs and manage market risk
- Follow all related laws and regulations

Use of Debt Financing

Debt financing allows the University to pay for an asset over a period of time, rather than pay for it at the time of purchase. This is a financially responsible practice for acquiring certain types of capital investments within appropriate limitations. Debt financing may be financially beneficial if borrowing rates are below investment returns or if the University invests in capital assets that provide investment returns or cost savings which are greater than the cost of borrowing.

The scope, requirements, and demands of the Capital Budget, and the ability or need to expedite or maintain the programmed schedule of approved capital projects, should be factors in the decision to issue long-term debt.

The University shall also assess the viability of funding capital projects, or portions of capital projects, on a pay-as-you-go basis using University cash reserves in Central or departmental accounts, as an alternative to debt financing.

Principles of Debt Issuance

The University has access to a variety of forms of public debt. Financings vary in terms of maturity, tax status and interest rate mode. The University should evaluate all types of financing structures when considering raising capital. The following principles should be followed when issuing debt:

- Long-term debt will be issued only to finance capital expenditures, including property acquisitions and certain equipment.
- Long-term debt will not be used to fund University operating costs.
- When issuing debt, the University will seek the lowest-cost source of financing available at acceptable levels of risk over the life of the issue.
- External borrowings will be coordinated to the extent practical so that multiple project needs can be accommodated in a single borrowing.
- External borrowings will not fund debt service reserve requirements unless it is more cost-effective, or there is a compelling market reason, to do so.
- The amount and timing of borrowings will take into account arbitrage restrictions and opportunities.
- External borrowings will generally be on a tax-exempt interest rate basis, unless there is private use within the project that approaches the University's threshold, or when certain financial considerations indicate the use of taxable debt is in the best interest of the University.
- The average maturity of tax-exempt debt should be as short as economically feasible for the project, generally not to exceed the useful life of the financed asset, and will not exceed the federal limit of 120% of the useful life of the financed asset.

Roles and Responsibilities

Debt Management Oversight

The University's debt management responsibilities are outlined in these guidelines into the categories of pre-issuance, issuance, and post-issuance, with oversight responsibility of all three areas assigned to the Director of Debt Management, as the designee of the Treasurer. This person, in turn, relies on various individuals in certain University departments for the expertise needed to ensure compliance with policy, laws and regulations, and to handle specific tasks.

The roles and responsibilities of each of the following are outlined in Appendix C:

- Board of Regents (BOR)
- Treasurer
- Director of Debt Management
- Capital Planning and Project Management ("CPPM")
- University Services – Finance
- Treasury Operations (within the Office of Investments and Banking ("OIB")
- Accounting Services (within the Controller's Office)
- University Tax Management Office ("TMO")
- Office of General Counsel ("OGC")

The University also utilizes a structure of three committees in its debt management oversight. Each of the committees and their respective responsibilities are defined in Appendix D and summarized below:

Debt Process Team (DPT)
DPT acts in the capacity of the University's trustee to approve the draws on unspent bond proceeds to reimburse expenditures incurred on eligible projects. In addition, the group establishes and insures that appropriate accounting and compliance procedures are in place and working properly.

Debt Oversight Group (DOG)
DOG supports and advises the Treasurer and Director of Debt Management in decisions regarding policy, capital financing strategies, and debt capacity analysis. In addition, the committee periodically reviews the debt management processes to insure compliance with University and tax requirements.

Debt Management Advisory Committee (DMAC)
DMAC advises the Finance Committee of the BOR and the University's Treasurer on the issuance and ongoing management of debt. In doing so, the group evaluates, recommends, and monitors debt management policies, strategies, and guidelines and provides advice on their implementation so as to best serve the financial objectives of the University.

In addition, the University has retained an independent registered municipal advisor (IRMA). The University is represented by and will rely on its municipal advisor, Public Financial Management, Inc. (PFM) to provide advice on proposals from financial services firms concerning the issuance of municipal securities and transactions involving municipal financial products. PFM has represented to the University that is it an “independent registered municipal advisor” within the meaning of Section 15Ba1-1(d)(3)(vi) of the Securities Exchange Act of 1934. The IRMA Exemption Notice is posted as a “Quick Link” on the University’s Debt Management website at finance.umn.edu/debt_ratings.html

Compliance Oversight

The University has a responsibility to its bondholders to ensure that the bonds retain any tax advantages afforded under current tax law. Appendix C identifies those University individuals responsible for this oversight. Each responsible individual takes steps to timely document compliance and correct instances of noncompliance as required under the rules and regulations relating to the issuance of tax-exempt debt.

PRE-ISSUANCE PLANNING

The University maintains a structured program for making capital investments and managing its capital resources. Capital Planning and Project Management (CPPM) manages all capital projects, system-wide and regardless of funding source, to ensure compliance with local, state and federal laws, guidelines and regulations.

The full capital budget process is outlined in the University Administrative Policy: *Funding and Approvals of Capital Projects*.

Capital Projects generally fall into one of three broad categories:

- Demolition of existing buildings and infrastructure
- New construction (whole building, building additions, and infrastructure)
- Renovation or renewal of existing facilities and infrastructure

Identification of the Need for External Debt Financing

The University maintains a list of potential future capital projects where external debt is expected to be part or all of the funding for the projects. The list encompasses land and building purchases, projects in the approved fiscal year capital budget, projects in the current six-year capital plan, and other potential opportunities. This running list provides a two to three year total of future debt issuances.

Once the projects have been approved by the BOR, estimated cash flows for each project are prepared by CPPM and shared with the Treasurer and Director of Debt Management. The size and timing of each issuance is dependent on the estimated cash flows with the goal that the bond proceeds will be spent within two years of issuance. The University generally issues debt once or twice a year, depending on the list of projects and the rate of spending on each.

Financial Market Considerations

Since debt financing availability by its nature is limited and our demand for debt may exceed our willingness to pay the interest and other carrying costs related to it, it is imperative that borrowings are structured to effectively utilize the financial capital market.

Bridge Financing Program

Certain approved projects include the “local units” share as a piece of the total funding. This local unit funding may be made up of “cash-in-hand”, fundraising, and/or bridge financing. Many gifts come in over time, and the total pledged amount may not be received until long after the construction is completed.

The University can choose to issue short- to intermediate-term debt to finance the construction of the capital asset with the understanding that this funding “bridges” the local units’ share of the total resources until the gift is received. The terms of the gift/pledge should allow for portions of the gift received after construction is completed and all costs are paid to be applied to the principal and/or interest of the bridge financing if necessary. Commercial paper is one of the easiest forms of debt to use as bridge financing to facilitate the reduction in principal as the gifts are received by the University.

Depending upon the commitments made at the time the gift was pledged, gifts and their respective earnings from investments may become replacement proceeds for arbitrage rebate purposes. When gifts are treated as replacement proceeds, both interest earnings and gift/pledge principal will need to be used to pay down the bridge loan within legally permissible timeframes. The University will be provided the most flexibility if the terms of the gifts or pledges received are not specifically tied to any one facility or any one purpose. If worded correctly, pledges made using this approach will not create replacement proceeds when they are eventually received by the University. Units should consult with the Tax Management Office when gifts and/or pledges are being received for capital projects to ensure that the wording provides the University with the most flexibility as to use of the gift.

Capital Lease Financing

Capital leasing is a frequent practice in the business world of finance. The use of capital leases at the University can be an additional source of funding for the needs of the University. Consideration of this alternative funding source must be undertaken with a basic understanding of factors unique to the University as a whole in order to effectively utilize this funding source alternative.

A capital lease is a transaction whereby the goods or property leased have the economic characteristics of asset ownership. A capital lease would be considered a purchased asset for accounting purposes and the leased property becomes property of the University at the end of the lease period. In these leases, a portion of the periodic payment will be treated as interest and a portion will be treated as principal payment on the acquisition of the equipment financed by the lease.

Debt Capacity

Debt capacity is the level of debt an institution can prudently bear. The notion of managing and monitoring debt capacity is important for several reasons. It acknowledges the relationship between outstanding debt, the University's ability to pay debt service, the current credit rating, and the importance of maintaining a high rating. A high rating helps to preserve the University's continuous access to low-cost capital financing, and investor demand.

The University periodically assesses its debt capacity for new external debt financing, using the considerations outlined by the rating agencies. The long-term financial planning model is updated with assumptions of growth in revenues and expenses over a 5-6 year horizon. In addition, the balance of debt outstanding and annual interest expense, including debt issued for projects in the six-year capital plan, is projected for that same time period. Appropriate ratios are computed and compared to our peers.

The rating agencies do not consider the rating process and debt capacity to be a formulaic concept derived from income statement or balance sheet ratios alone. Rather, they assign ratings by weighing core credit variables over time and in relation to broad competitive trends in higher education. These variables include an institution's evolving overall financial strength, market position and strategy, governance and management, as well as legal security and debt structure. Although the debt capacity of any institution is a function of numerous specific factors, such as the strength of state support, student demand, and unrestricted assets, many colleges and universities may have some degree of unused debt capacity. Management's risk tolerance will often be the final arbiter of debt capacity for a particular institution.

Target Ratios used by the University when contemplating new debt issuances and debt capacity are indicated in Appendix E.

Determination of Type of Debt to Issue

Core Debt vs. Special Purpose Debt

Core Debt

Core debt is regarded by the University as any general obligation bond or other University debt backed by the full faith and credit of the University. The structure of such debt is based on the general financial strength of the University.

Core debt will be issued with a goal of preserving the University's core debt ratings at the target levels established by Board Policy.

General Obligation Bonds and Commercial Paper issued by the University plus the obligations to the State of Minnesota pursuant to Infrastructure Development Bonds generally make up the Core Debt of the University.

General Obligation (GO) Bonds

GO bonds are long-term obligations that are backed by the full faith and credit of the issuer, a state or local government. The credit structure of these bonds is based on the general financial strength and taxing authority of the issuer, without limitation. GO bonds are the original and most basic form of municipal debt.

Commercial Paper (CP) Notes

CP notes are short-term obligations that are backed by the full faith and credit of the University. With maturities of 1 to 270 days, the CP notes are short-term in nature and classified as current liabilities in the financial statements. However, the University currently treats the CP as a long-term financing vehicle, thus renewing the notes for extended periods as they come due, with annual required "pay-downs" established in the original offering memorandums.

Infrastructure Development Bonds (IDBs) – State of Minnesota

The State of Minnesota (the "State") issues bonds for the University and other state agencies for certain capital projects. Between July 1990 and October 2005, the State issued 100% of the funding for certain University capital projects with the understanding that pursuant to Minnesota law, the University is obligated to pay the state one third of the debt service of the IDBs issued on its behalf. The IDBs are generally issued once or twice a year, with a fixed rate, 20-year amortization. Payment to the state is made once a year upon receipt of their billing, due every November. Since October 2005, the University has chosen to issue its own debt for its 1/3 share of projects, rather than having the state issue IDBs on its behalf.

Special Purpose Debt

Special purpose debt refers to University debt issued to support specific projects where the revenues from specified sources are pledged to repay the indebtedness. Special purpose debt is not supported by the full faith and credit of the University.

State Supported Debt

The state supported bonds are special limited obligations of the University. Specified transfers expected to be made by the State of Minnesota pursuant to legislation providing for the appropriation of such transfers from the general fund of the state are pledged for the payment of the debt service on the bonds. No other revenues or assets of the University, nor the full faith and credit of the University, is pledged for the payment of the principal or interest on these bonds. Currently the University has four series of bonds that are considered "state supported":

- Series 2010A – State Supported Biomedical Science Research Facilities Funding Program – issued September 2010
- Series 2011B – State Supported Biomedical Science Research Facilities Funding Program – issued October 2011
- Series 2013C – State Supported Biomedical Science Research Facilities Funding Program – issued November 2013
- Series 2015A – State Supported Stadium Debt – issued August 2015 for the purpose of refunding Series 2006 (the original State Supported Stadium Debt issued December 2006)

Revenue Bonds

Revenue bonds will usually fall into the category of Special Purpose Debt unless they are also backed by the full faith and credit of the University, in which case they will fall under the core debt category. The issuance of revenue bonds may be limited due to the uncertainty of internal revenue streams and higher debt service costs. However, based on the concept of user fees, revenue bonds allow the University to expand its debt capacity without creating greater burdens on general tax revenues.

Certificates of Participation

Certificates of Participation (COPs) is a structure where investors buy certificates that entitle them to receive a participation, or share, in the lease payments from a particular project. The lease payments are passed through the lessor to the certificate holders with the tax advantages intact. The lessor typically assigns the lease and lease payments to a trustee, which then distributes the lease payments to the certificate holders. COPs themselves are not municipal obligations but are instead an interest in an underlying municipal obligation. Due to the underlying security of the municipal obligation the interest rate charged on COPs is generally higher than Revenue bonds. The University has never issued COPs but may choose to do so if circumstances warrant.

Short-Term Debt

Short-term debt and a line of credit may be employed to finance short-term liquidity needs. A bank line of credit may be a valuable source of liquidity when the use of internal sources would cause unfavorable investment results. The University could maintain a line of credit with a reputable institution for an appropriate amount of liquidity. The line of credit may be drawn upon to fund short-term cash needs.

Bank Financing can be an inexpensive, flexible source of financing when interest rates are lower than tax-exempt options. Funds can be drawn, repaid and redrawn continuously and without penalty. Transaction costs can be less. A line of credit can be maintained at minimal cost. Size and flexibility will determine whether bank financing is less costly. The University may consider the use of bank and/or capital markets financing to bridge funding needs from expenditures on capital projects to the receipt of gift funds. Lending facilities and tax-exempt variable rate bonds both provide prepayment flexibility to allow principal to be reduced as gift funds are received.

Commercial paper can be tax-exempt or taxable. Commercial paper is a flexible source of financing which is useful as bridge financing of capital projects with long-term construction periods and/or during periods of high long-term interest rates.

Taxable vs. Tax-Exempt

Financings generally will be on a tax-exempt interest rate basis, unless there is private use that approaches the University's threshold within the project, or when other financial considerations indicate the use of taxable debt is in the best interest of the University.

Situations that call for taxable debt to be issued rather that tax-exempt debt include:

- Private Business Use limitations are expected to be exceeded;
- Unknown future use of the property;
- Longer or unknown construction time;
- Market rates for both tax-exempt and taxable debt are similar or taxable debt has a lower interest rate;
- The rate difference between taxable debt and tax-exempt debt is so small as to make the costs of post-issuance compliance on tax-exempt debt an overly burdensome requirement.

Taxable debt may take the form of commercial paper, variable rate debt or fixed rate debt.

A summary of considerations for tax-exempt vs taxable financings follows:

TAX-EXEMPT	**TAXABLE**
<u>Cost & Call Flexibility</u> • Generally, less expensive than comparable taxable debt • 10-year par call is standard	**<u>Cost & Call Flexibility</u>** • Generally, more expensive than comparable tax-exempt debt • Make-whole call is standard

Investor Base • Focused on coupon payment/tax-exempt income • Accustomed to amortizing debt	**Investor Base** • Focused on total return • Accustomed to bullet maturities • May require minimum size
Administrative Burden/Tax Risk • Certain administrative and tracking requirements (arbitrage compliance; private use compliance; data retention)	**Administrative Burden/Tax Risk** • No on-going bond-related tax-code compliance • Eliminates risk IRS will deem bonds taxable
Use of Proceeds/Average Life Considerations • Use of proceeds restrictions • Spend-down schedule restrictions • Matching of useful life of bonds and projects	**Use of Proceeds/Average Life Considerations** • Unrestricted use of proceeds • No spend-down requirements • No structuring or useful life restrictions

Qualified 501(c)(3) Bonds

For a bond to be a qualified 501(c)(3) bond, two basic requirements must be met. First, property that is to be provided by the net proceeds of the issue must be owned by a 501(c)(3) organization or by a governmental unit. Second, the private business test for Section 141(b) must not be satisfied. At least 95% of the net proceeds of the bonds and 95% of the facilities financed with the bonds must be used exclusively by governmental units or by one or more 501(c)(3) organizations in a trade or business related to the 501(c)(3) organizations' exempt purpose.

The University may choose to issue 501(c)(3) debt in the case where primary users are 501(c)(3) organizations. This was done with the GO Bonds, Series 2014B, issued August 2014, where the net proceeds were used for the University of Minnesota Health Clinics and Surgery Center (CSC) that opened February 2016. CSC, referred to as the Ambulatory Care Center (ACC) prior to construction, is owned by the University and occupied by Fairview Health Services ("Fairview") and a Minnesota nonprofit corporation, the members of which are Fairview and University of Minnesota Physicians.

Fixed Rate vs. Variable Rate

Long-term fixed-rate tax-exempt debt is the most common form of debt issued by institutions of higher education, in which interest rates are fixed for a single or multiple maturities. This type of debt allows institutions to lock into certain debt service obligations at tax-advantaged interest rates over a long period of time. Long-term fixed rate debt generally includes a call option by the University within 0-10 years after the issuance date to allow for refinancing opportunities – i.e., either reduce interest rates (subject to market conditions) or restructure principal payments.

Variable rate financings can lower overall cost of capital. Financings of all maturities can carry a variable rate. Tax-exempt variable rate financings retain the tax risk that fixed rate tax-exempt financing lays off to investors. Bonds are callable at any interest payment date (daily, weekly, monthly, etc.) with no premium. Risks include interest rate risk, credit risk, tax law risk and remarketing risk.

VARIABLE RATE PRODUCTS	FIXED RATE BONDS
• Historically lowest cost of funding	• Generally higher cost of debt
• Uncommitted funding source	• Committed funding source

• Exposed to interest rate, tax, counterparty, put/remarketing risks	• Not subject to interest rate, tax, renewal, or counterparty risk
• Administrative oversight and more involved debt management required	• Less active debt management required
• Can help reduce negative arbitrage in project fund depending on draw schedule of bond proceeds	• Preserves variable rate debt capacity for potentially higher interest rate environments
• May require bank credit – cost and availability considerations	• No bank credit required
• Can be redeemed as new gifts are received	• Can only advance refund debt once throughout the bond's life

The University will review its fixed/variable rate mix on a periodic basis and during periods of significant shifts in the interest rate environment. Adjustments to the fixed/variable rate mix can be accomplished through the use of hedging (internal or external) vehicles and/or through the issuance of new debt. Issuing and or retiring debt can also change the fixed/variable rate profile of the University.

Considerations for the Fixed/Variable Rate Mix of Outstanding Debt
When evaluating the appropriateness of issuers' variable rate debt exposure, the **rating agencies** examine such factors as financial flexibility, liquidity sources, asset-liability management, and other risk management tools. The University will consider rating agency views when evaluating its fixed/variable rate mix.

Moody's Investor Services has no specific quantitative benchmarks or rules in this area, other than the basic observation that the appropriate mix of debt will depend on an organization's ability to handle potential swings in the interest rate on variable rate debt.

The University will consider the impact of the cost and availability of bank standby bond purchase agreements or credit lines that provide liquidity support on variable rate debt. The **use of liquidity facilities** requires on-going discussions with the support bank as to their renewals and continuance of the facility, the facility fee amount that is charged, and the reporting covenants required of the University.

The University will consider the **impact of rising rates** on the operating budget when considering the appropriate fixed/variable rate mix.

The University generally will issue debt that provides flexibility to reduce financing costs. The current **interest rate environment** and interest rate expectations will be among the considerations.

Derivative Products - Use of Hedging Instruments
Hedging instruments are derivatives used to change the risk profile of a financing and/or entire balance sheet. Derivatives are broadly defined as securities whose value is derived from the value of other securities and indices. Hedging instruments can be used to change the fixed/floating rate profile of the capital structure. In addition, hedging instruments can be appropriate to lock in low

rates on future debt issuances. Hedging products that may have appropriate uses include forward rate agreements, caps and swaps.

Derivative products will be considered where appropriate in the issuance or management of debt only in instances where it has been demonstrated through analyses that the derivative product will either provide a hedge which reduces risk of fluctuations in expense or revenue, or alternatively, where it will reduce total project cost. An analysis of early termination costs and other conditional terms will also be performed given certain financing and marketing assumptions. Such analyses will document the risks and benefits associated with the use of the particular derivative product.

Short-term financial assets can act as a natural or "internal" hedge for variable rate debt. Both rates tend to float in the same direction. Issues can use variable rate debt without external hedges when (or if) their internal liquidity or external liquidity support is an adequate buffer.

The University adopted GASB 53, *Accounting and Financial Reporting for Derivative Instruments,* effective for the fiscal year ended June 30, 2010.

Use of Credit Enhancement/Liquidity Facilities

Third party guarantees of debt may be used to improve the marketability of a particular issue or when the cost of the credit enhancement – as in the form of additional collateral or insurance - is less than the financial benefit which results from use of the enhancement. Absent special circumstances, credit enhancement providers, if considered necessary, will be selected by competitive proposal. Normally, due to the high ratings on University GO bonds, credit enhancement is not cost effective. Credit enhancement may be beneficial on revenue bonds or specially secured debt of the University.

The issuance of variable rate debt, including variable rate bonds and commercial paper, may require the use of an external liquidity facility. The President or his delegate is authorized to appoint a bank(s) to ensure the availability of liquidity support, should the bonds or commercial paper be tendered for payment and not remarketed. The University recognizes that it may not be cost-effective to issue variable rate debt when a bank facility must be added to provide liquidity support. In addition, the University recognizes that it may not be advantageous to solicit banks with credit ratings less than the University's. Consideration should be given to these criteria when soliciting banks for responses to RFPs issued.

Preliminary Analysis - Private Business Use ("PBU")

A tax-exempt financing will have general and specific covenants in the bond documents for purposes of maintaining the tax-exempt status of the bonds. These covenants generally require the University to not do anything that would result in the bonds being classified as "private activity bonds" under Internal Revenue Code Section 141. Failure to comply with these covenants would result in possible taxability of the bonds or at least require a payment to the IRS to maintain the tax-exempt status of the bonds. The Treasury Regulations may also provide for some remedial action rules to specifically assist in managing private use for actions entered into after the issuance of the bonds which were not contemplated by the University at the time the bonds were issued.

Under IRC Section 141, a governmental bond issue constitutes a private activity bond if a) more than 10% of the proceeds of the issue or the bond financed property are to be used by any person other than a state or local governmental unit, and b)(i) more than 10% of the present value of the debt service on the bond is secured by privately used property or private payments or b)(ii) more than 10% of the issue are loaned to any person other than a state or local government unit.

See **Tax Management Office Guideline (TMOG) #14, Private Business Use**, for more information and examples.

Roles and Responsibilities

The compliance responsibility for PBU of the contemplated bonds is delegated to the University Tax Director. As part of that responsibility, the University Tax Management Office is tasked with monitoring and analyzing the use of property financed by bond proceeds to ensure that the University is in compliance with PBU limitations. This may require units of the University with business arrangements to remain flexible on the ultimate location of the activities depending upon the recommendation of the Treasurer as a result of the PBU analysis completed by the Tax Management Office.

Before each issuance of tax-exempt debt, the University will analyze the planned use of bond proceeds and the planned use of property financed by bond proceeds to ensure that the above mentioned 10% limit will not be exceeded.

A copy of the preliminary private business analysis will be kept with the bond records.

Private Business Use Threshold

For purposes of managing PBU on its bonds, the University has established a maximum PBU threshold of 5% when issuing tax-exempt debt. This threshold should be used unless there are extenuating circumstances relating to the projects funded by the debt. The use of the 5% threshold will create a cushion for PBU that might occur over the lifetime of the bonds outstanding on the financed facilities.

Generally, the University should also strive to keep PBU to less than 15% per building. Using the 15% threshold will enable the University to use the Qualified Improvement Exception [See Treasury Regulation 1.141-3(d)(6)] for the financing of subsequent qualified building improvements (e.g., windows and roofs).

In no event should PBU exceed 50% per building. The 50% limit is established to enable the University to prevent a disproportionate amount of PBU. If a facility has a disproportionate amount of PBU then the overall limit of allowable PBU drops from 10% to 5% - a reduction in allowable PBU that needs to be avoided.

See **TMOG #1, University Tax-Exempt Bonds and Private Use Guidelines**, for more information.

Preliminary Analysis - Arbitrage Rebate

During the planning phase of issuing debt, the University should analyze the individual project cash flow expectations as they relate to the facts and circumstances of the timing of the debt issuance in an effort for the University to meet the spending exceptions to arbitrage rebate. Such an analysis should include a review of the University's obligation to enter into a binding contract for spending 5% of the bond proceeds within 6 months of the issuance date and whether the University will spend the proceeds within the other allowable benchmarks for exceptions to rebate allowed by the code and regulations.

Declaration of Official Intent to Reimburse from Bond Proceeds

Generally, the net proceeds to be received by the University from the sale of general obligation bonds will be used for certain capital projects of the University which may also include the reimbursement of the University for certain amounts previously expended in connection with capital projects. When the debt issue encompasses reimbursement of amounts expended for capital projects prior to the issuance date for expenditures, other than preliminary construction and design costs, the bonds are referred to as "reimbursement bonds".

If project construction costs, other than preliminary or design costs, are anticipated to begin prior to debt issuance, a "Declaration of Official Intent" document within the meaning of Treasury Regulations Section 1.250-2 will be prepared and approved by the University Treasurer within 60 days of the date of the expenditure for which reimbursement from bond proceeds will be sought. The purpose of the official intent requirement is to provide evidence that a future debt issue is intended to reimburse a construction expenditure at the time the University made such expenditure, thus insuring that the subsequent reimbursement is not a device to avoid tax-exempt bond requirements.

See Appendix F for a template "Declaration of Official Intent to Reimburse from Bond Proceeds".

Board of Regents (BOR) Approval

Approval by the BOR for new borrowings and refinancings will be secured as required by policies and procedures in place at the time of the borrowing.

THE DEBT ISSUANCE PROCESS

Initial Designation of Proceeds

Prior to issuance, the University prepares a list of projects that are to be funded by the bond proceeds, which in turn determines the amount to issue. This list of projects constitutes the "initial designation" of projects to a specific bond issue. This is used for the preliminary private use analysis and the calculation of estimated useful lives of the projects financed by bond proceeds. Both the calculation of potential private use and the calculation of the estimated useful lives of the projects are used by bond counsel in drafting the Tax and Rebate Certificate that is signed by the Treasurer of the University and delivered as part of the Bond Transcripts at the time the bond closing occurs.

Debt Service Structure

The debt service structure for each bond issue will be determined on a case-by-case basis. The University has typically structured its debt so that the annual debt service payments on each bond issue are somewhat equal.

The University may amortize its debt over the most advantageous term available, with the understanding that principal payment schedules will not exceed the average economic useful life of the asset being financed and the limits of state or federal law, or related prior bond covenants. Principal and interest will be scheduled to be within the resources available for debt service.

Method of Sale

Debt issues of the University may be sold by competitive, negotiated, or private placement sale methods unless otherwise limited by State law. The selected method of sale will be the option that is expected to result in the lowest cost and most favored terms given the financial structure used, market conditions, and prior experience.

Negotiated sale - The University has historically sold its bonds through a negotiated sale. A negotiated sale is the sale of a new issue of municipal securities by an issuer directly to an underwriter or underwriting syndicate selected by the issuer. Among the primary points of negotiation for an issuer are the interest rate, call features and purchase price of the issue. The University selects the underwriter for a negotiated sale through a competitive process by issuing a Request for Proposal (RFP). Per current BOR policy, *Debt Transactions*, "the Board shall have the exclusive authority and power to engage underwriters and debt advisers."

Competitive sale - A competitive sale is a method of sale where underwriters submit proposals for the purchase of a new issue of municipal securities on the specified sale date and the securities are awarded to the underwriter or underwriting syndicate presenting the best bid according to stipulated criteria set forth in the notice of sale. The underwriting of securities in this manner is also referred to as a "public sale" or "competitive bid." Per current BOR policy, *Debt Transactions*, "If the Board approves the issuance of debt in a competitive sale, the president or delegate shall report the identity of the selected underwriter(s) at the regularly scheduled Board meeting immediately following the sale."

Private placement (or direct purchase) - Since the meltdown of the secondary bond markets in 2008, banks have played a more direct role in providing services and products to tax-exempt entities. The increased use of a bank's products frequently involves contractual provisions typically present in the taxable market and not seen in transactions that are publically sold.

As a result, the consideration of the use of banks for certain debt instruments can be particularly troublesome when such tax exempt offerings contain contractual terms that call for negative pledges or have contingent payments. The University should seek competent advice from bond counsel when considering products offered by banks that relate to tax exempt financing.

Use of External Professionals

The University maintains ongoing agreements with certain professionals related to the issuance and management of debt including:

Underwriter – purchases the bond issue from the University to resell it to investors as part of a negotiated sale. The University coordinates with the underwriter on the development of the Official Statement and on decisions relating to type of debt to issue.

Bond Counsel – represents the interest of the bondholders. Bond counsel renders opinions on the validity, enforceability and tax exempt status of the debt and related legal matters, and prepares necessary agreements and other documents. The bond closing documents include a written opinion by bond counsel affirming that (a) the University is authorized to issue the proposed debt and has met all constitutional and statutory requirements necessary for issuance, and (b) a determination of the proposed debt's federal and state income tax status has been made. This approving opinion and other bond documents will be prepared by a nationally recognized bond counsel firm with extensive experience in public finance and tax issues.

Issuer's Counsel – represents the interest of the University. The Office of General Counsel (OGC) at the University prepares the 'Board Resolution Related to Issuance of Debt' and reviews the bond documentation prepared by bond counsel and/or underwriter counsel. The University may choose to engage external issuer's counsel, when appropriate. OGC renders an opinion on the planned transaction as required by applicable section(s) of the Contract of Purchase.

Paying Agent – acts solely as the agent of the University and will not assume any relationship of trust with the holders of the bonds except with respect to funds held by it for the payment of principal and interest on the bonds. The University transfers sufficient funds to the paying agent prior to each payment date to cover principal and/or interest payments due to the bondholders. The paying agent, in turn, pays the bondholders the appropriate payment(s) due.

Financial Adviser (FA) – advises and assists on all elements of planning, structuring, and pricing of debt transactions. The use of a financial advisor for a debt issuance is not required, though is recommended. The University retained its FA in April 2014 due to the release of the SEC Municipal Advisor Rule (the "Rule") effective July 2014. The University's FA has represented to the University that it is an "independent registered municipal advisor" (IRMA) within the meaning of Section 15Ba1-1(d)(3)(vi) of the Rule. As an IRMA, the FA has a fiduciary duty to the University which precludes the FA from serving in any role that could be adverse to the University.

Independent Auditors – provide consent on the use of their opinion on the University's audited financial statements contained in the Official Statement.

The President or delegate will periodically issue Requests for Proposals (RFPs) for professional services for the University for a specific debt issuance or for periods of up to five years, unless he/she determines in writing that a contract extension beyond five years would be advantageous to the University. Under BOR delegation policy: *Attorneys and Related Services*, the University's OGC may retain attorneys on a case-by-case basis without competitive bidding.

The University will periodically review fees, quality of service, and performance of professional service firms. All contracts for professional services will be in accordance with University contracting policy and procedures including affirmative action goals.

Other professional services will be retained when required and when in the best interest of the University.

Bond Documentation and Disclosure Review

Official statements and other financial disclosure materials will be prepared based upon industry practices and regulatory requirements. University disclosure, typically Appendix A to the Official Statement, "The University", is prepared and/or updated by the Director of Debt Management and reviewed by OGC prior to a draft being submitted to the issuance working group. In addition, Accounting Services typically reviews the financial disclosure in Appendix A. The information categories contained in Appendix A form the basis of the annual continuing disclosure reporting.

All bond documents are reviewed by the Director of Debt Management and a Senior Associate General Counsel from OGC. In addition, the Director of Tax Management reviews the University Tax and Rebate Certificate and the IRS Form 8038-G – Information Return for Tax-Exempt Governmental Obligations, and confirm the timely filing of the 8038-G.

Depending on the specific bond document, required signatures include the President's, the Treasurer's, and the Secretary's. Certain documents, including the applicable 'Resolutions Related to the Issuance of Debt' and the University Bylaws, are certified by the Secretary and stamped with the

University seal. It is the responsibility of the Director of Debt Management to obtain all required signatures needed for closing and deliver the executed documents to bond counsel.

Reimbursement Bonds

Language in the “use of bond proceeds” section of the official statement will reference the use of proceeds for various or specific projects, plus “including the reimbursement of the University for certain amounts previously expended by it for the costs of such projects”, if the bonds are considered “reimbursement bonds.”

Use of Bond Proceeds for Capitalized Interest

The University’s practice is to use University equity to pay the interest due on the bonds and could classify this payment as a period expense. However, during the construction period of the asset, the University capitalizes the interest paid on the bonds, i.e., for accounting purposes, the interest paid becomes part of the total cost of the asset, rather than being charged as a period expense.

The University reserves the right to apply a portion of net proceeds of a specific bond issue to pay for the portion of the interest payments that represent capitalized interest on the Bonds. This statement will be included in the Official Statement under “use of bond proceeds” to provide the greatest flexibility to the University so that it may elect to use bond proceeds for capitalized interest should the need ever arise in the course of appropriately spending bond proceeds.

Optional Redemption

Tax-exempt debt issues will customarily include an optional redemption (referred to as the ‘call feature’) by the University to redeem the outstanding principal after a specific date at a price equal to or greater than the par amount of the principal then outstanding plus accrued interest. Ten-year call options are typical for the University and the industry as a whole. Exceptions may exist for shorter-term debt (less than 10 years) for which optional redemption may have an adverse effect on the interest rate or marketability of debt. The optional redemption terms will be determined based upon the following factors:

- Special requirements of the University due to program or business considerations
- The earliest date at which bonds may be redeemed at the lowest price which does not have a material adverse effect on the price or marketability of the debt issue

Taxable debt issues customarily include an optional make-whole redemption feature**.** This call provision allows the University to redeem the bonds prior to maturity, in whole or in part, at the “Make-Whole Redemption Price”, which is derived from a formula based on the net present value (NPV) of future coupon payments that will not be paid because of the call. The University doesn’t expect to have to use this provision, but if so, investors will be compensated, or “made whole.” Because the cost can be significant, such provision is rarely invoked.

The ten-year optional call feature can also be included in taxable debt issues for the same reasons the feature is included in tax-exempt issues, as stated above.

Debt Service Reserve Funds

Debt service reserve funds are cash assets that are designated by the borrower to ensure full and timely payments to bondholders. They will be created only when required to market a specific type of debt, achieve a desired credit rating or provide a needed liquidity source for a debt issue. The University does not typically establish a debt service reserve requirement when issuing bonds.

Credit Ratings

The University's bonds and commercial paper will be rated by one or more bond rating firms - Standard and Poor's Ratings Services (S&P), Moody's Investors Service (Moody's), or Fitch Ratings. Generally, the University obtains ratings from S&P and Moody's. Core debt will be issued with the goal of maintaining the University's core debt ratings at the target levels established in the BOR Policy: *Debt Transactions.* Special purpose debt issued may be issued only if it will receive an investment grade credit rating, if rated.

The rating review with each agency may be by phone or in person, depending on how recent the University met with each respective analyst, or the nature of the issuance. Information for the ratings review is gathered by the Director of Debt Management, and formatted into a presentation with the assistance of the FA. Ideally the phone calls (or meetings) are scheduled with each analyst at a point in the issuance process that will allow the ratings to be received prior to posting of the Preliminary Official Statement (POS). University participants in these reviews should be the individuals who are responsible for each major agenda item that is likely to be discussed. Typically, this includes the Treasurer and/or Budget Director, Chief Investment Officer, Controller, Director of Debt Management, and the Director of Institutional Analysis.

Closing

Closing of the issuance transaction is typically scheduled within 1-2 weeks of the pricing of bonds and as quickly as the day after the sale and pricing of commercial paper. All bond documentation is signed and delivered to bond counsel no later than the day before closing to insure the transaction will close smoothly. A representative from the Office of Investments and Banking should be part of the closing process to confirm that the funds have been wired to a University bank account on the closing date.

THE POST-ISSUANCE PROCESS

Investment of Bond Proceeds

The University will comply with all applicable Federal, State, and contractual restrictions regarding the use and investment of bond proceeds. This includes compliance with restrictions on the types of investment securities allowed, restrictions on the allowable yield of some invested funds, as well as restrictions on the time period over which some bond proceeds may be invested.

Bond proceeds for each series will be invested in separate Custodial accounts as outlined in the "University Order Authorizing the Issuance and Sale of the Bonds" and in the "University Tax & Rebate Certificate" related to each specific bond issue.

Investment earnings on the bond proceeds will be reinvested in the Custodial account(s) and become additional bond proceeds to be spent on appropriately approved costs of capital projects authorized for use of bond proceeds.

In general, bond proceeds must be Yield-Restricted after 3 years (36 months) from the issuance date of the bonds. Any investment of proceeds after this period must be restricted to lesser than the yield on the bonds, or alternatively, the University is required to make "yield reduction payments" as provided in Treasury Regulations section 1.148-5(c).

Allocation of Bond Proceeds

Allocation to Expenditures
"Allocation" is the formal action of the issuer by which it declares which expenditures incurred on the projects are to be deemed made with bond proceeds. The 'draw process' is the University's formal allocation process where bond proceeds are allocated to expenditures. Generally, the University uses the specific tracing method whereby bond proceeds are specifically traced to expenditures for meeting the spending exceptions to arbitrage and for meeting the 3 year spending requirement on the bonds. Other acceptable methods of allocating proceeds include first-in, first-out (FIFO), last-in, first-out (LIFO), or a ratable allocation. See **TMOG #12, Tax-Exempt Bond Expenditure Allocation Rules**, for more information.

Allocation for Private Use
The University also allocates private use to the various funding sources used to build a facility, based upon the permissible accounting and allocating methods permitted under tax law. The Tax and Rebate Certificate relating to each specific debt issuance may contain more specific allocations.

Change in Initial Allocation
The allocation memorialized in the Tax and Rebate Certificate finalized at the time the bonds are issued may need to be revised within approved time periods for changing such an allocation. Such may be the case, for example, if the University wishes to incorporate qualifying equity incurred prior to the issuance of the bonds into the definition of the projects funded by the bonds. This also might be the case with respect to making a multi-purpose allocation, which can be made any time after the

bonds are issued but once made, cannot be made again. For purposes of documenting the allocation in these situations a memorandum spelling out the parameters upon which the University is making the allocation will be prepared and incorporated into the bond documents relating to the issuance.

Timing

Regulation 1.148-6(d)(1)(iii) provides that an issuer must account for the allocation of proceeds to expenditures not more than 18 months after the later of the date the expenditure is paid or the date the financed project is placed in service. In any event, the allocation must be made by the date 60 days after the 5th anniversary of the issue date (or if earlier, 60 days after the issue retirement date).

These time limits apply to the spending of proceeds relating to the specific tracing, FIFO, LIFO, and ratable allocation methods in addition to the allocation for private use. The external issuers counsel used by the University had advised the University that when it takes more than 5 years to incur bond expenditures, the University's only allocation method is that of specific tracing.

Additional allocations may be necessary outside of these timeframes when funds become replacement proceeds or when remedial actions are required as a result of the disposition of bond financed facilities at a future date. Because of the complexity of the varying types of allocations, the University Tax Director will be consulted for compliance with all allocation rules.

See Appendix G for information on key deadlines and timeframes connected to tax-exempt debt.

Project Spending

Allowable Uses of University and State Bond Proceeds

The University may only use bond proceeds for qualified or eligible capital expenditures. Bond proceeds may only be used for direct capital costs and not for noncash provisions for or charges for depreciation, amortization, or cash outlays for overhead, general administration or similar costs not associated with the construction project.

Qualified capital expenditures (or eligible costs) include land acquisition, predesign, design, construction, major remodeling (if it adds to the value or life of a building and is not of a recurring nature), and other improvements or acquisitions of tangible fixed assets of a capital nature. Equipment may be eligible if purchased and installed upon initial acquisition and construction of a building, expansion or major remodeling.

There is a provision within the tax code that allows for a small portion of operating expenses to be paid from bond proceeds as long as those costs are related to the projects funded by the bonds. This provision only applies when such costs do not exceed 5% of the issuance proceeds of the bonds. In addition, for state bond proceeds, there may be state specific limitations narrower than this 5% threshold and may restrict such proceeds even further than what the University may allow on its debt.

Charges for University Personnel and Expenses (including Project Management)

The University allows internal personnel and project-related expenses to be billed to capital projects under very limited conditions when the University self-constructs capital projects. All charges must be made in compliance with relevant Internal Revenue Code, Treasury Regulations, University policies, and Generally Accepted Accounting Principles related to capital expenditures. Costs charged to state capital appropriation funding must be in compliance with Minnesota Management and Budget (MMB) policies as outlined in the memo dated October 20, 2009 entitled: Policy Regarding Use of General Obligation Bond Proceeds to Fund Staff Costs. In addition:

- personnel charges must be done on an individual basis and must be based on actual hours worked on the project by an individual;
- the hourly rate shall not include depreciation or amortization costs, overhead or other general administration expenses not directly related to, or incurred as a result of, the construction activity. The hourly rate must comply with University Administrative Policy: *Selling Goods and Services to University Departments* and OMB Uniform Guidance dated 12/19/2013 (formerly OMB Circular A-21);
- for Internal Service Organizations (ISOs), staffing rates require annual review and approval as defined in Administrative Procedure: *Establishing Internal Sales Rates*; or
- For non-ISOs, staffing rates are limited to actual cost of salary and fringe unless otherwise approved by the Internal/External Sales department.

Draws of Bond Proceeds

The University may either act as its own trustee or appoint an outside trustee for investing bond proceeds and/or managing the draws on those unspent bond proceeds. Draws of bond proceeds occur upon written requests with supporting documentation provided of expenses incurred on applicable projects. It is intended that all draws will adhere to spending exceptions to arbitrage schedules and guidelines.

The University's Debt Process Team (DPT) acts in the capacity of the University trustee for purposes of determining the timing and appropriateness of bond draws. University Services-Finance tracks spending on projects and presents the draw request, along with supporting documentation, to the DPT on a monthly basis (generally the last week of a month) for review and approval. Effective July 1, 2015, draws made near the end of a month are for project expenses incurred as of the end of the previous month-end with checks issued prior to the draw date*. Generally, draw requests are made only when they exceed $100,000 for an individual bond series. Exceptions can be made when the draw represents the final amount for a specific project, or for the balance of the remaining series' proceeds.

After review of the submitted documentation by the DPT, the "Draw Request Approval Checklist" is completed and signed by the Director of Debt Management and the University Services' accountant that prepared the request. The completion of this form represents the approval of the draw. Subsequently the approved draw request is emailed to the Director of Treasury Operations in the Office of Investments and Banking (OIB), with copies to all members of the DPT. Upon receipt, OIB draws the appropriate amount of bond proceeds from the applicable bond account at the third party custodial institution and wires it to the University's general account. Accounting Services processes the general ledger entries that record the draw from the custodial account and reimburses the applicable projects for expenses paid.

*Prior to July 1, 2015, the expense incurred by previous month-end was included in the draw only if the check had cleared the bank prior to the draw date.

See Appendix D for more information on the DPT.

See Appendix H for a copy of the University "Draw Request Approval Checklist".

Subsequent Designation of Proceeds

Subsequent to the issuance of the bonds, but before all proceeds of a bond series are spent, the University may decide to change its designation of bond proceeds to other projects. This decision to assign proceeds to another project not contemplated when the bonds were issued requires authorizing language to do so in the bond transcripts. When authorizing language permits, the "Certificate as to Designation of Bond Proceeds to Specific Projects" will be prepared and signed by the Treasurer of the University prior to drawing any proceeds to pay for these projects.

See Appendix I for the template "Certificate as to Designation of Bond Proceeds to Specific Projects".

Arbitrage Rebate Compliance

Arbitrage is defined as the investment earnings representing the difference between what could be earned on bond proceeds if they were invested at the yield on the bonds and the amount actually earned on the investment of the proceeds. The Internal Revenue Code regulates the amount and conditions under which arbitrage on the investment of bond proceeds is permissible. Any arbitrage profits earned must be rebated to the federal government unless the exceptions to arbitrage rebate apply. The 1986 Tax Reform Act requires, with limited exceptions, that arbitrage must be rebated to the federal government.

Negative arbitrage, the condition of earning less than the yield on the bonds, is not the University's preference. Unless the allowable 36-month "temporary investment period" has expired, it is the University's goal to invest bond proceeds to the bond yield or higher – and then meet the exceptions to arbitrage rebate. This practice maximizes the amount of available bond funds to spend on the projects. Absent meeting the spending exceptions, arbitrage up to the yield on the bonds can be kept by the University and only the amount of arbitrage in excess of the yield on the bonds will be rebated to the federal government.

The Director of Debt Management prepares and maintains the spending exception to arbitrage schedule for each bond issue for purposes of tracking the spending against the spending exception requirements. The schedule is shared and discussed with the DPT on a regular basis to insure that all appropriate offices are aware of any potential consequences and/or limitations related to the unspent bond proceeds.

To the extent required by applicable laws, regulations, and bond covenants, the University and component units will comply with all arbitrage rebate requirements. The University may use outside experts, including bond counsel, financial advisers or public accountants, to assist in preparing required filings and making payments. The University will annually determine any accrued rebate liability, record the liability in the financial statements, and make provisions for reserving funds for rebate purposes.

When it deems the action is necessary, the University may elect to pay a Penalty in-lieu of Rebate. This can be a useful tool when the University knows up-front that meeting the exceptions to arbitrage rebate cannot be met for spending on the projects relating to the debt issuance. This is a very technical and complicated process and the election should only be made when the University earns arbitrage on the investment of bond proceeds and can otherwise ensure compliance with all the rules and regulations relating to this process. Practically speaking, bond advisers do NOT generally recommend using this alternative due to the risks associated with not making arbitrage on the investment of funds and meeting the sending exceptions on a project. Due to the complex and technical nature of this process, OIB and the University Tax Management Office will need to work together and consult with outside bond counsel before making this election.

Investment earnings on bond proceeds are retained in the same investment account as the original proceeds and thus become additional bond proceeds that generally must be spent on appropriate capital costs. A permitted use of these proceeds is the rebating of arbitrage to the federal government. As a result, investment earnings on tax-exempt debt can be used as a primary funding source for arbitrage rebate. To the extent the funds have otherwise been spent on appropriate capital costs and funds are not otherwise available for arbitrage rebate, the internal loan pool contains funds that can be used, as needed and authorized by the Treasurer, for any future required arbitrage rebate. The DPT will annually monitor the availability of University equity for arbitrage rebate should the need arise.

Some circumstances regarding bond proceeds may require that such proceeds are yield restricted for arbitrage purposes. The University will adhere to the appropriate yield restrictions whenever such action is determined to be necessary by the University Tax Management Office, outside bond tax counsel, or by other third party consultants engaged by the University.

The Director of Debt Management and the Director of the Tax Management Office will arrange for the timely computation of the rebate liability and, if rebate is payable, the timely filing of Form 8038-T and payment of the rebate. Rebate is ordinarily due at 5-year intervals.

See **TMOG #13, Arbitrage Rebate Compliance**, for more information. Also see Appendix J for an example of a Spending Exception Worksheet.

PeopleSoft Treasury System

The Deal Management module within PeopleSoft contains the information supporting all outstanding long-term debt and swap agreements. This system was implemented on July 1, 2008 with conversion of existing outstanding debt as individual "debt deals". When long-term debt is issued, new debt deals are added to the system. The debt deals in Deal Management include:

- CUSIP #
- Par amount
- Settlement amount
- Premiums/discounts
- Interest rate
- Due dates of principal and interest payments
- Cash flows of principal and interest payments
- Interest accruals
- Amortization of premiums and/or discounts

Within Deal Management, one bond series may have one or more deals; there is one deal for each of the individual bond maturities. The individual debt deals are assigned to a "portfolio" representing the total bond series. Deals are coded as open or matured. The portfolio totals represent only the open deals.

Proceeds of each debt issuance are invested in a separate bank or investment account at the custodial bank. These are entered in PeopleSoft as an investment deal. As the proceeds are drawn to fund capital projects, a portion of the investment is redeemed.

As deals are entered into the system, cash flows for the life of the deal are available. The payment for debt service is scheduled through Deal Management for payment on an Electronic Funds Transfer (EFT) through the settlement process within the Cash Module.

Accounting entries for the events surrounding monthly interest accruals, amortization of premiums and discounts, and payments of principal and interest are created within Deal Management on templates and automatically fed from Deal Management to the PeopleSoft General Ledger through a nightly process. Manual accounting entries for any correcting entries related to the initial debt setup, interest or principal payments, or premium/discount amortization are created within the Cash Module and fed from Cash Management to PeopleSoft General Ledger through a nightly process.

See Appendix K for the Accounting Model.

Payment of External Bond Debt Service & Related Expenses

The University uses two external paying agents for its debt – one for its variable rate bonds and commercial paper, and one for its fixed rate debt. Until 2013, the Treasurer of the University acted as the Paying Agent for the fixed rate bonds with the responsibility delegated to the Office of Investments & Banking (OIB). The University reserves the right at any time to vary or terminate the appointment of the Paying Agents upon written notice.

OIB receives billings for principal and interest payments on external debt from the external paying agents. The swap counterparties provide the billing for the net swap payments due under existing swap agreements. When the debt deal is entered into Deal Management, these payments are scheduled within the system for the entire length of time the related debt is outstanding. When the billings are received, it is the responsibility of OIB to compare the amount and due date to what is scheduled within Deal Management, and ensure that payments are made accurately and timely.

The Director of Debt Management receives the invoices for costs of issuance, annual ratings maintenance, annual administration fees, remarketing, and any other debt-related billings. After review and approval, the invoice is scanned and an electronic copy is maintained by the Director of Debt Management. The original paper copy of the approved invoice is forwarded to Accounting Services for payment by check or via ACH.

Once paid, the invoices are copied into the imaging system by Disbursement Services. Preparation of and/or review of all accounting transactions related to debt transactions is the responsibility of Accounting Services. This review verifies that the applicable general ledger accounts are appropriately debited and credited.

Annual Monitoring of Bond Covenants

The University will monitor its debt for compliance with bond covenants, third party agreements, and state and federal laws and regulations. A compliance worksheet is maintained by the Director of Debt Management, detailing out the specific covenants and regulations, and timing required.

Build America Bonds (BAB) Compliance

To ensure receipt of the federal subsidy due the University on the 2009 and 2010 BABs issued with a Direct Pay Election, the 8038-CP will be prepared in accordance with Steps 4a, 4b and 4c of the BAB Compliance Checklist as follows:

- Report the proper amount of refundable credit.
- Record all amounts in pennies.
- File the 8038-CP timely (at least 45 days before but no earlier than 90 days before the interest payment date).
- Insure the 8038-CP has “Regents of the University of the Minnesota” as the entity to which the payment is to be made.

The Director of Debt Management is responsible for the accurate completion of the 8038-CP and timely filing. The form is submitted to the IRS with a delivery service that requires written signature for receipt (e.g., Fed Ex), thus providing the documentation of proof-of-delivery. Copies of all filed forms are maintained by the Director of Debt Management.

The Tax Management Office typically receives an official acknowledgement of receipt by the IRS of the University’s 8038-CP. This, however, is often received less than 45 days prior to the interest due date, thus the written proof-of-delivery insures that the IRS received the form in a timely manner.

Accounting Services notifies the Director of Debt Management when the subsidy is received. This notification provides the confirmation of receipt, the amount of the subsidy, and confirmation of the general ledger chartstring for recording of the receipt.

Congressionally-mandated sequestrations consisting of across-the-board federal budget cuts were implemented beginning in March 2013 and are to be phased in through 2021. It was triggered by Congress' failure to reach agreement over how to significantly cut the deficit. An analysis from the Center on Budget and Policy Priorities in March 2013 estimated that the reduction rate for direct-pay bond subsidies and some other mandatory programs will decrease in each subsequent fiscal year of sequestration, in part because the amount of money cut from Medicare will increase annually. However, the actual reduction rate is not known until prior to each fiscal year. The table below reflects the reduction rate for the federal fiscal years to date:

Time Period	Reduction Rate
March 1, 2013 through September 30, 2013	8.7%
October 1, 2013 through September 30, 2014 (federal fiscal year 2014)	7.2%
October 1, 2014 through September 30, 2015 (federal fiscal year 2015)	7.3%
October 1, 2015 through September 30, 2016 (federal fiscal year 2016)	6.8%

See Appendix L for more information regarding the BAB program.

Private Business Use (PBU) Analysis

A tax-exempt financing will have general and specific covenants in the bond documents for purposes of maintaining the tax-exempt status of the bonds. These covenants generally require the University to not do anything that would result in the bonds being classified as "private activity bonds" under Internal Revenue Code Section 141. Failure to comply with these covenants would result in possible taxability of the bonds or at least require a payment to the IRS to maintain the tax-exempt status of the bonds as determined by the Voluntary Closing Agreement Program (VCAP). The Treasury Regulations may also provide for some remedial action rules to specifically assist in managing private use for actions entered into after the issuance of the bonds which were not contemplated by the University at the time the bonds were issued.

The University Tax Management Office annually analyzes the status of the tax-exempt financing with regards to the private use limitation with the intent that the University can appropriately manage the use of facilities financed by tax-exempt bond proceeds so that it can remain in compliance with the private use limitations. Private business use measurement will be calculated for all university-debt financed buildings on campus and updated annually based on the Tax Management Office review. Risks associated with private business use for each building connected to each debt issuance will be identified. The University may need to take corrective action on how its bond financed facilities are utilized to keep the PBU within acceptable limits. When necessary, the Tax Management Office will explore and advise of ways to reduce private business use.

Continuing Disclosure Practices

The University will remain in compliance with the Security and Exchange Commission Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders within 180 days of the close of the fiscal year.

The University will provide financial statements, official statements and periodic financial information under the Electronic Municipal Market Access System ("EMMA") created by the Municipal Securities Rulemaking Board. Any notice of material events will also be filed under EMMA.

The Director of Debt Management is responsible for the required filings.

Annual Reporting

Report to the BOR

As required under the BOR policy: *Debt Transactions*, the Treasurer and Director of Debt Management will provide a "Capital Financing and Debt Management Report" annually to the BOR. The report will include a review of the current and projected interest rate environment, current and anticipated debt plans, appropriate financial benchmarks and ratios, and other factors deemed appropriate or requested by the Board in order that it may exercise its oversight function. The report shall rely on selected financial ratios, consistent with major credit rating agency criteria, to ensure that the University is operating within appropriate financial parameters to maintain the core debt ratings.

The Treasurer will be kept informed of all unanticipated financial obligations related to each bond issue. Significant financial obligations will be reported by the Treasurer to the President and BOR. In the case of arbitrage rebate, a guideline of 1% or more of rebate due as a percentage of the amount of the initial bond issue shall be deemed as 'significant'. [i.e., amount of arbitrage rebate divided by amount of initial bond issue]

Additional Reporting

Ratio Analysis

The University annually calculates certain ratios as outlined by the ratings agencies as described in Appendix E, based on the financial information contained in the audited year-end financial statements and the long-term planning/projection process that has been developed. These ratios will be periodically updated when a new debt issuance is contemplated and as a part of the debt capacity analysis.

Peer Analysis

The University compares the capital structures, including the relative level of debt and types of debt, adopted by its peer group when evaluating its own capital structure. In addition, other selected financial ratios, consistent with major credit rating agency criteria, will be compared to peers, and to other public institutions with the same rating. The peer group will consist of highly rated preeminent public research universities.

Record Retention

Various sections of the Code and Regulations including, but not limited to, sections 103, 141-150, and 6001 require the retention of the records necessary to substantiate compliance with federal tax requirements applicable to tax-exempt bonds.

For each financing, documentation surrounding pre-issuance planning will be prepared and retained, including:

- vendor selections
- decision process for sizing and structure
- the method of bond sale
- investment decisions
- project descriptions
- Declaration(s) of Intent

Subsequent to the completion of each bond issuance, bond counsel provides a "bond issuance book" that contains closing documents related to the transaction. Two paper copies are received – one is retained by the Director of Debt Management and the other by the Senior Associate General Counsel who worked on the transaction. In addition, 5 CD copies of the transmittal are also received. These are distributed to Debt Management, OGC, Accounting Services, Treasury Operations, and Tax Management.

Although the required records to be retained depend on the transaction and the requirements imposed by the Internal Revenue Code and the Treasury Regulations, records common to most tax-exempt bond transactions include:

<u>Basic records relating to the bond transaction – i.e, the "Bond Issuance Book"</u>

- University Bylaws (Certified) and University Charter
- BOR resolutions authorizing the debt issuance (Certified)
- Contract of Purchase between the University and Underwriter
- University Order Authorizing the Issuance and Sale of the Bonds
- Preliminary and Final Official Statements
- Closing documents, including the University Tax and Rebate Certificate and copy of the filed IRS Form 8038, 8038-G, or 8038-GC (whichever applicable)
- The Certificate of Registrar
- Letters from Accountants and Opinions of Counsel
- Ratings letters
- Blue Sky Memorandum
- Specimen Bond

<u>Additional Issuance Records</u>

- Initial private use calculations
- Interest projection on unspent proceeds
- Estimated useful life analysis
- Final pricing
- Costs of issuance
- Project descriptions (initial designation of proceeds)
- Declaration of Intent to Reimburse Bonds (for specific projects)

<u>Post-Issuance Compliance</u>

- Documentation evidencing expenditure of bond proceeds
- Draw Requests, Draw Request Approval Checklists, Draw Summary
- Spending Exception Worksheets
- Documentation evidencing use of bond-financed property by public and private sources (i.e., copies of management contracts and research agreements)
- Documentation evidencing all sources of payment or security for the bonds
- Designation Certificates for specific projects
- Documentation pertaining to any investment of bond proceeds, including:
    - the purchase and sale of securities,
    - SLGS (State and Local Government Securities) subscription,
    - yield calculations for each class of investments, actual investment income received
- Final Use of Total Proceeds
- Arbitrage rebate calculations
- Annual private use calculations

Section 1.6001-1(e) of the Regulations provides that records should be retained for so long as the contents thereof are material in the administration of any internal revenue law. To support these tax positions, material records should generally be kept for as long as the bonds are outstanding, plus 3 years after the final redemption date of the bonds. The records are retained in a combination of both paper and electronic form.

For certain federal tax purposes, a refunding bond issue is treated as replacing the original new money issue. To this end, the tax-exempt status of a refunding issue is dependent upon the tax-exempt status of the refunded bonds. Thus, all material records relating to both the original new money issue and the refunding issue should be maintained until 3 years after the final redemption of both bond issues.

Disposition of Bond-Financed Facilities

Sale or disposition of facilities financed by bond proceeds cause a requirement that the underlying debt be retired or that the University otherwise follow the remedial actions as contained in Treasury Regulation 1.141-2, when sold or disposed prior to the retirement of the underlying debt. Care needs to be exercised because this provision also applies when the underlying debt is defeased but not entirely retired.

Use of VCAP Program offered by the Internal Revenue Service

There may be times when the University may need to consider using the Voluntary Closing Agreement Program (VCAP) when issues arise with regards to post-issuance compliance on tax-exempt bonds that are beyond the gambit of the remedial actions contained in the Treasury Regulations. This process will require that the University work with bond tax counsel or issuer's tax counsel to ensure the University is legally represented by appropriate competent tax advisors.

MAINTENANCE OF EXTERNAL RELATIONSHIPS

Rating Agencies

The University continues to maintain high credit ratings for its general obligation bonds from Moody's (Aa1) and S&P (AA). These credit ratings permit the University to borrow at a low interest cost and are a reflection of the University's excellent management, financial controls, economic conditions and moderate debt levels.

The Treasurer and the Director of Debt Management have primary responsibility for maintaining the University's relationships with Moody's and S & P. They periodically meet with representatives from each rating agency and communicate with each of the assigned analysts prior to each competitive or negotiated sale.

The University provides information to the rating agencies to ensure that they are regularly updated as to the University's student demand, financial position, investment performance, level of state appropriations and the University's relationship with the State of Minnesota, capital plans, major initiatives, and other information as requested. The Treasurer will inform the credit rating service(s) regarding material changes in financial condition and developing events that may influence outstanding or future ratings.

The University will actively seek to preserve the credit ratings of its outstanding bonds at the target levels established by Board policy.

See Appendix M for the table of Investment Grade Long-Term Bond Ratings.

Investment Banks/Underwriters/Market and Investor Relationships

The University maintains favorable relations with the investing public and the underwriters that buy and sell its debt. The following actions may be taken to achieve this purpose:

- Maintain a mailing list of underwriter and institutional investors to which financial statements and information concerning any upcoming issues may be distributed.

- Develop contacts with the portfolio managers for the major tax-exempt mutual funds that purchase the University's debt. Mutual funds are among the most important forces in pricing large issues.

- Maintain informal contacts with the underwriting desks of the dealers that routinely buy and sell the University's debt.

- Meet regularly with current and/or prospective underwriters for an exchange of ideas and plans regarding the University's debt profile.

CHANGING THE DEBT STRUCTURE

Refunding Procedures and Practices

Refunding of a bond is the issuance of a new bond for the purpose of retiring an already outstanding bond issue. Refunding of outstanding debt will be considered in order to:

- Achieve interest rate savings
- Restructure principal
- Eliminate burdensome covenants with bondholders

The proceeds of the new bonds are either deposited in escrow to pay the debt service on the outstanding bonds when due in an ‘advance refunding" or used to promptly (typically within 90 days) retire the outstanding bonds in a "current refunding." The new bonds are referred to as the "refunding bonds," and the outstanding bonds being refinanced are referred to as the "refunded bonds" or the "prior issue."

Advance Refunding

Advance refunding is a financing technique that allows an issuer to obtain the benefit of lower interest rates when the outstanding bonds are not currently callable. The proceeds from the sale of the refunding bonds are generally used to purchase taxable government securities, which are deposited in an escrow account. The escrow account is structured so that the principal and interest earned on the securities are sufficient to pay all principal, interest, and call premium, if any, on the outstanding bonds up to and including the call date. The refunding bonds are secured by the same sources of taxes or revenue previously pledged to the payment of the outstanding bonds.

The outstanding debt is generally considered "defeased" either legally or in substance. A legal defeasance occurs when the covenants relating to the outstanding bonds are satisfied with respect to the retirement of the debt. For accounting and financial reporting purposes the issue is treated as defeased when the escrow account is irrevocably pledged to the retirement of such debt.

Savings are affected by many factors including the spread between current rates and rates of the outstanding bonds, the amount of bonds outstanding, and the time remaining before the bonds are callable. There are numerous statutory and regulatory rules that affect advance refundings. **One important rule is that a tax-exempt bond issue may be advance refunded only once.** For this reason, an advance refunding should be implemented only when there are significant savings.

Since the number of refundings of tax-exempt bonds which may be undertaken to achieve interest rate savings are limited by federal regulations, savings should be sufficient to offset reduced future refunding flexibility. Savings can be evaluated on a maturity-by-maturity basis; however, the University will only advance refund the entire series, not select maturities, due to the administrative task that that would entail. The targeted level of interest rate savings will be consistent with industry practices in evaluating refunding criteria:

- The net present value savings threshold minimum should be equal to or exceeding 3% of the par amount of the bonds being refunded, net of all transaction costs.
- Utilize breakeven analysis to determine the point at which there is little difference between refunding now or waiting until the call date of the bonds.
- Utilize sensitivity analysis to evaluate current NPV savings relative to NPV savings in a different market to identify how sensitive a refunding candidate's savings are to interest rate improvements.
- The actual dollar savings are large enough to impact the University's current or future borrowing capabilities or finances.

In addition, the net present value savings should generally be larger than the negative arbitrage that exists. Exceptions to this savings target may be made in special circumstances where savings above this level may not be achievable due to call dates, interest rate levels, and market conditions.

The manner in which savings are realized (up front, deferred or on a level annual basis) should be determined based upon the overall needs and objectives of the University. In most instances, up front savings may be used to fund capital projects, while annual savings likely will be used to reduce internal charges for the units who are paying for the debt.

Refundings undertaken to respond to a change of legal covenants or to make pledged reserves available for other purposes should be analyzed to determine any economic effect on the University as measured by present value savings or losses, inclusive of cash contributions and any debt service reserve fund earnings. Such economic effects include:

- Limitations imposed by the Internal Revenue Code
- Use of reserves
- Future financing capacity
- Future marketability of the University's debt
- Credit ratings which may be related to the specific circumstances of the refunding

Any debt service reserve funds that are released after a refunding will not be used for operating expenses.

In the event of a proposed refunding transaction, the Treasurer is responsible for the review of the refunding analysis and to determine that interest rate projections will produce the expected savings sufficient to cover the costs of the refinancing and provide a satisfactory level of net present value savings to the University. The Treasurer will monitor the timing of the transaction to assure that sufficient savings are realized. Notwithstanding these procedures, it is impossible to predict the exact savings from a refinancing transaction since the savings are dependent upon market conditions at the time of the borrowing, and interest rates are not known until the issuance is completed.

Current Refunding

A current refunding transaction is where the municipal securities being refunded will all mature or be redeemed within 90 days or less from the date of issuance of the refunding issue. Certain federal income tax rules relating to permitted yields of invested proceeds of the refunding issue, rebate of arbitrage earnings and the ability to refund certain types of municipal securities may be less restrictive in the case of current refundings as contrasted with advance refundings.

Reissuances for Tax Purposes

Treasury Regulations specifically provide that when the terms of a bond issue are significantly modified then a *reissuance* of the bonds (for tax purposes) results. In these instances, the originally issued bonds are considered retired and a new issuance of the bonds takes place. For tax purposes, this type of reissuance is considered a current refunding. Typically, no changes are recorded for financial reporting purposes when there is a reissuance for tax purposes, although new CUSIPs may be used for such reissuances.

The determination of whether the terms of a bond issue will be significantly modified to meet the threshold of a reissuance is one that requires the assistance of expert legal opinion on the proposed transaction. Different criteria of what constitutes a significant modification exist for qualified tender bonds versus other types of bonds.

In instances of reissuance, care must be exercised to make sure that all arbitrage rebate payments have been made appertaining to the bond issue.

The University experienced the reissuance of bonds for tax purposes when it entered into substitute liquidity facilities that were not originally required when the bonds were issued. [*Example: Series 1999A was issued as variable rate demand bonds in February 1999 with self-liquidity. The addition of a Standby Bond Purchase Agreement on June 1, 2004 was considered a reissuance for tax purposes.]*

Crossover Refunding

Because the University issued two series of its Build America Bonds (BABs) with a 10-year call provision, we may want to consider an advance refunding of these two series depending on the interest rate markets. An advance refunding typically results in a loss of the federal subsidy payments as soon as the BABs are defeased as the advance refunding constitutes a reissuance for tax purposes. Legislative authority for BABs has statutorily expired so any resulting reissuance cannot be a BAB. A better economic result, however, may be achieved by using a crossover refunding, which allows an issuer to remain eligible for the subsidy payments until the BABs are actually discharged.

In a crossover refunding, the escrow secures the refunding bonds, and the issuer remains liable for the prior bonds. There is no legal defeasance and therefore no resulting reissuance of the refunded bonds. Because the original BABs remaining outstanding for tax purposes, the issuer is still eligible for the federal subsidy payments until the BABs are redeemed at a later time.

Both the refunding and refunded bonds would be considered outstanding until the call date for purposes of the University's financial statements and indenture. For this reason, the University would need to determine if the present value savings through a crossover advance refunding outweighs the doubling up of outstanding debt for a period of time just to maintain the federal subsidy of the BABs.

Defeasance of Debt

Bonds are legally defeased when the payment of principal and interest has been assured through the structuring of a portfolio of government securities within an irrevocable trust to provide for all future debt service payments on the old bonds. This method of advance refunding, referred to as “Standard Defeasance”, is the most common. When high interest rate bonds are advance refunded with low interest rate bonds, the amount of securities required for the escrow account will be greater than the amount of outstanding bonds being refunded. This is because the portfolio of government securities may have a yield no higher than the rate on the refunding bonds. As a result, the refunding bond issue must be in a larger principal amount than the outstanding bonds unless a high premium is received on the bonds.

When a bond issue is legally defeased, the claim on the revenues of the issuer is usually eliminated. Neither the outstanding indebtedness nor the related trust account assets for the defeased bonds are included in the University’s financial statements. However, disclosure will be made in the footnotes to the annual financial statements including the bond series defeased, refunding date, the amount defeased, the refunded amount, the bond call date, and the amount outstanding at year-end.

OFF-BALANCE SHEET FINANCINGS

In recent years, there has been a significant increase in off-balance sheet financing, primarily for student housing at public universities that are constrained by state regulations on bidding and capital construction. While these transactions generally are structured so that the university has no legal obligation for debt repayment, rating agencies typically include them as part of an institution’s overall leverage profile due to the strategic and economic linkages to the university. They characterize these transactions as “indirect debt” of the institution, recognizing that the lack of a legal obligation to make debt service payments makes these types of transactions fundamentally different from debt issued directly by the institution. The extent to which the project affects debt capacity depends on their assessment of the project’s independent financial strength and ability to support debt service, as well as the structure of the transaction and involvement of the university.

The University will seek to identify and discourage any potential future financing deals that indirectly obligate the University and affect its overall leverage profile.

Appendix A

DEFINITIONS

For purposes of these Guidelines, the terms below shall have the following meanings:

Advanced refunded bonds – A bond issue sold by a municipality to be used to repay an earlier bond issue more than 90 days after the refunding issue closes. The proceeds of the refunding issue are usually put into an escrow account from which the first issue's principal and interest will be repaid when due. If all principal and interest requirements of the first issue are to be paid from the escrow, it is considered "defeased" upon advance refunding.

Arbitrage – Investment earnings representing the difference between what could be earned on bond proceeds if they were invested at the yield on the bonds and the amount actually earned on the investment of the proceeds. The Internal Revenue Code regulates the amount and conditions under which arbitrage on the investment of bond proceeds is permissible and the 1986 Tax Reform Act requires, with limited exceptions, that arbitrage from nonpurpose investments must be rebated to the federal government.

Base point (or basis point) – One one-hundredth of one percentage point (1/100 % or 0.01 percent). Thus 25 basis points equal one-quarter of one percentage point (0.25%), 100 basis points equal one percentage point (1.0%).

Bond – An interest-bearing promise to pay with a specific maturity.

Bond counsel – A lawyer who writes an opinion on the bond or note as to its tax-exempt status and the authenticity of its issuance.

Callable bond – A bond that is subject to redemption prior to maturity at the option of the issuer. tax-exempt issuances are typically issued with a 10-year call feature.

Commercial paper – Variable rate, short-term debt instruments (i.e., notes) that are issued with a maximum length of 270 days, but which can be remarketed for additional terms. Though classified as a current liability in the financial statements, the University intends to hold its commercial paper as a long-term financing vehicle.

Competitive sale – A method of sale where underwriters submit proposals for the purchase of a new issue of municipal securities and the securities are awarded to the underwriter or underwriting syndicate presenting the best bid according to stipulated criteria set forth in the notice of sale. The underwriting of securities in this manner is also referred to as a "public sale" or "competitive bid."

Core Debt – General obligation debt issued by Regents of the University of Minnesota that is backed by the full faith and credit of the University. The structure of such debt is based on the general financial strength of the University.

Costs of issuance – The expenses associated with the sale of a new issue of municipal securities including fees charged by rating agencies, bond counsel, underwriter counsel, auditors (to obtain consent to use auditor's opinion on financial statements) and printing fees. In addition, the underwriter's discount is considered one of the costs of issuance – this fee is deducted from the amount of proceeds received at closing. The Internal Revenue Code restricts the use of bond proceeds to pay costs of issuance for certain types of tax-exempt bonds, such as private activity bonds. Effective with GASB 65 in FY14, these costs are expensed during the year of the bond issuance. Previous GASB guidance allowed for bond issuance costs to be recorded as a prepaid expense on the balance sheet and amortized over the life of the bond.

Debt adviser – a person or entity engaged to advise the University with respect to the planning and structuring of debt transactions.

Debt transactions – as defined by the University's Board of Regents policy include:

(1) issuing bonds or commercial paper, whether in underwritten offerings, competitive sales, or direct (private) placements;
(2) refunding debt;
(3) entering into capital leases;
(4) entering into liquidity facilities or lines of credit;
(5) engaging in hedging transactions related to University debt.

Defeased bonds – Refunded bonds for which the payment of principal and interest has been assured through the structuring of a portfolio of government securities placed into an irrevocable trust to provide for all future debt service payments on the old bonds. Neither the outstanding indebtedness nor the related trust account assets for the defeased bonds are included in the University's financial statements. When a bond issue is defeased, the claim on the revenues of the issuer is usually eliminated.

Discount – The amount, if any, by which the principal amount of a bond exceeds the cost price.

Hedging transactions – The use of instruments (such as interest rate caps or swaps) to manage interest rate risk in connection with debt transactions.

Negotiated sale – The sale of a new issue of municipal securities new issue of municipal securities by an issuer directly to an underwriter or underwriting syndicate selected by the issuer. A negotiated sale is distinguished from a sale by competitive bid, which requires public bidding by the underwriters. Among the primary points of negotiation for an issuer are the interest rate, call features, and purchase price of the issue. The sale of a new issue of securities in this manner is also known as a negotiated underwriting.

Official Statement (OS) or Offering Circular (OC) – An official document (or prospectus) circulated for an issuer prior to a bond sale that gives in detail the security and financial information relating to the issue. There can be two OSs, the first identified as the preliminary official statement (POS), available to the investor before the sale. The final OS must be sent to the purchaser after pricing and before delivery of the bonds.

Paying agent – An entity, generally a bank, that performs the function of paying interest and principal for the issuing body. The University currently uses two separate external paying agents but has acted as its own paying agent for certain issuances with the role assigned to the Office of Investments and Banking. Also referred to as fiscal agent.

Preliminary Costs – Costs incurred prior to commencement of construction, rehabilitation or acquisition of a project. The official intent requirement and the reimbursement period requirement do not apply to these costs. Preliminary expenditures cannot exceed 20% of the issue of the related reimbursement bond issue. Preliminary expenditures include architectural, engineering, design, surveying, and soil testing. Preliminary costs do not include land acquisition, site preparation, hazardous abatement, and similar costs incident to the commencement of construction.

Premium – The amount, if any, by which the price exceeds the principal amount of a bond. The premium received is additional proceeds that can be used by the University for funding the costs of projects.

Private Business Use (PBU) – Use of bond proceeds in a manner that would cause the bonds to be classified as private activity bonds, as defined under Internal Revenue Code Section 141.

Private Placement Memorandum – A document functionally similar to an official statement used in connection with an offering of municipal securities in a private placement. Circulation of a private placement memorandum often is strictly controlled to avoid distribution to investors who may not be qualified to purchase the securities.

Ratings – Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness. Each of the services use + or - or +1 to indicate half steps in between. The top four grades are considered Investment Grade Ratings. See Appendix I for the rating scales used.

Real property – Includes land, building and infrastructure.

Refunding bond – The issuance of a new bond for the purpose of paying principal of and/or interest on an already outstanding bond issue.

Reimbursement bond – A reference to bonds for which some of the proceeds will be used to reimburse amounts expended prior to the issuance date for capital expenditures other than preliminary construction and design costs.

Remarketing – A formal reoffering of a bond for which the form or structure is being changed.

Select Auction Variable Rate Securities (SAVRs) – SAVRs were long-term variable rate bonds whose interest rates were typically reset approximately every 7 to 35 days through a Dutch auction, rather than through a traditional remarketing conducted by an underwriter. The major advantage of SAVRs to issuers of variable rate debt was that buyers did not have a put option. By eliminating the put option, the SAVRs program eliminated the need for a standby liquidity facility. (*The University issued SAVRS in May 2003 - $71,000,000 in Series 2003A General Obligation Refunding Bonds; the outstanding balance* *of $64,100,000 was converted to VRDBs in October 2008; the Series 2003A VRDBs were refunded by Series 2011A fixed rate bonds in February 2011).*

Serial bond – A bond that has a single maturity and with no interim principal payments, as opposed to a Term Bond, which is a bond that has "sinking fund payments" prior to its stated maturity date.

Sinking fund – Money set aside on a periodic basis and accumulated to retire term bonds at or prior to maturity.

Sinking fund schedule – A schedule of payments required under the original revenue bond resolutions to be placed each year into a special fund, called the sinking fund, and to be used for retiring a specified portion of a term bond issue prior to maturity.

Special purpose debt – Debt issued by Regents of the University of Minnesota that is supported exclusively by specified revenues, appropriations, or other funds and not supported by the full faith and credit of the University.

Term bond – A bond of an issue that has a single maturity but with requirements that sinking fund payments be paid prior to its maturity.

Tranche – One of a related series of security issues – each with different cash flows, strike prices, expiration dates, and/or return patterns-created to meet differing investor or issuer requirements or to carve up the returns from a set of underlying cash flows in a marketable way. *(The University's debt issued under the Biomedical Science Research Facilities Funding Program totaling$292,000,000 was issued in 3 tranches – Series 2010A&B, Series 2011B&C, and Series 2013C&D.)*

Trustee – Acts as the custodian of funds and official representative of bondholders. Trustees are appointed to insure compliance with the contract and represent bondholders to enforce their contract with the issuers. The use of a trustee for a particular bond issue is not required but is a decision to be made each time during the issuance process. The University currently acts as its own trustee.

Underwriter – A person or firm engaged by the University to underwrite debt transactions through a negotiated sales process.

Variable rate demand bonds (VRDB) – A bond which bears interest at a variable or floating rate established at specified intervals (e.g. daily, weekly, or monthly) and which contains a put option permitting the bondholder to tender the bond for purchase on the date a new interest rate is established.

RELATED POLICIES/PROCEDURES/OVERSIGHT

Board of Regents Policy: ***Debt Transactions***

Last amended: December 2012

regents.umn.edu/policies/index

Click on "Financial"
Click on "Debt Transactions"

Board of Regents Policy: ***Attorneys and Related Services***

Last amended: July 2009

regents.umn.edu/policies/index

Click on "Delegation of Authority"
Click on "Attorneys and Related Services"

Administrative Policy: ***Funding and Approvals of Capital Projects***

Last amended: July 2016

http://www.policy.umn.edu/Policies/Finance/Budget/FUNDINGPROJECTS.html

Appendix C

ROLES & RESPONSIBILITIES

Pre-Issuance	Board of Regents (BOR)	Treasurer	Director of Debt Management (DDM)	Capital Planning and Project Management (CPPM)	Treasury Operations	Accounting Services	Tax Mngt Office	Office of General Counsel (OGC)
Project Analysis		X	X	X				
Capital Planning	Approve	X		X				
Type of debt to issue		X	X				X	X
Private Use/Private Placement Analysis		X					X	
Debt Capacity Analysis		X	X					
Declaration of Official Intent		X	X					
RFP Issuance/Evaluation	Approve	X	X					
Issuance	**BOR**	**Treasurer**	**DDM**	**CPPM**	**Treasury Operations**	**Accounting Services**	**Tax Mngt Office**	**OGC**
Debt Resolution	Approve	X	X					X
Method of Sale		X	X					X
Working Group		X	X				X	X
Debt Service Structure		X	X					X
Credit Ratings		X	X					
Pricing & Closing		X	X		X			

Post-Issuance	BOR	Treasurer	DDM	University Services - Finance	Treasury Operations	Accounting Services	Tax Mngt Office	OGC
Investment of Bond Proceeds					X		X	
Allocation of Bond Proceeds		X	X				X	
Draws of Bond Proceeds			X	X	X *(in DPT)*	X *(in DPT)*	X *(in DPT)*	
Arbitrage Rebate Compliance			X				X	
Accounting Entries						X		
Debt Service & Other Debt Related Expense Payments			X		X	X		
Monitoring of Bond Covenants			X					
BAB Compliance			X				X	
Private Placement/Private Use Continuing Analysis			X				X	X
Continuing Disclosure			X					
Annual Reporting			X					
Record Retention			X				X	
Maintenance of Relationships		X	X					
Disposal of Bond-Financed Facilities			X				X	

COMMITTEE OVERSIGHT RESPONSIBILITIES

The University of Minnesota utilizes a structure of three (3) committees in its Debt Management Oversight. The Director of Debt Management oversees the committees and sets the agendas for each. Each of the committees and their respective responsibilities are defined below:

Debt Process Team (DPT)
The Debt Process Team meets monthly, at a minimum, regarding current and future debt issuances. The DPT acts as the University's trustee to approve the draws on unspent bond proceeds to reimburse expenditures incurred on eligible projects. In addition, the group establishes and insures that appropriate accounting and compliance procedures are in place and working properly.

The team consists of representatives from applicable departments within the University that have a direct involvement in various aspects of debt management compliance. These departments include:

- University Services-Finance
- Treasury Accounting *(within Accounting Services in the Controller's Office)*
- Treasury Operations *(within the Office of Investments and Banking)*
- University Tax Management

Debt Oversight Group (DOG)
The Debt Oversight Group supports and advises the Treasurer and Director of Debt Management in decisions regarding policy, capital financing strategies, and debt capacity analysis. In addition, the committee periodically reviews the debt management processes to insure compliance with University and tax requirements. Meetings are scheduled monthly.

Members in addition to the Treasurer and Director of Debt Management include the following individuals:

- Controller
- Tax Director
- Chief Investment Officer (CIO)
- Chief Financial Officer of the Academic Health Center
- Senior Associate General Counsel

Debt Management Advisory Committee (DMAC)
The Debt Management Advisory Committee advises the Finance Committee of the Board of Regents and the University's Treasurer on debt management issues. In doing so, the Committee evaluates, recommends, and monitors debt management policies, strategies, and guidelines and provides advice on their implementation so as to best serve the financial objectives of the University of Minnesota. The committee typically meets two to four times per year.

The Chair or Vice Chair of the Finance Committee of the BOR, or a designee who is a member of the Finance Committee, chairs the Committee. The President appoints the remaining members who consist of the following:

a) The Treasurer of the University

COMMITTEE OVERSIGHT RESPONSIBILITIES

b) A faculty member of the Carlson School of Management whose area of expertise is relevant to the work of the committee; and
c) Up to six members of the local business community with relevant professional training and experience.

COMMITTEE OVERSIGHT RESPONSIBILITIES (BROADLY DEFINED)

Responsibilities	Debt Management Advisory Committee (DMAC)	Debt Oversight Group (DOG)	Debt Process Team (DPT)
Debt Policies & Objectives	Review, advise, and make recommendations	Develop	Implement
Debt Capacity	Review calculation & advise	Develop models for Board consideration; review calculations	
Debt Issuance	Review, advise on recommended transaction structure, method of sale; underwriter selected	Select underwriter; structure transaction	Support transaction planning and execution
Expenditure of Proceeds		Review efforts of debt process team periodically to ensure compliance with debt policy	Timely draws; cash flow updates and projections; accurate accounting; proper allocation of proceeds; monitoring of unspent proceeds; review private use limitations, etc.
Ongoing Compliance through Life of Debt		Periodic review to ensure compliance	Debt service payments; accurate accounting, arbitrage and yield restriction payments; monitor use of facilities over life of debt, etc.
Debt Management Simulation Tool		Define desired outcomes, reports, data, simulations for management purposes	Research products possibly available on market and/or design tool internally; provide information necessary to run simulation
Tracking and Accounting Practices		Review and approve, if appropriate, modifications proposed by DPT	Analyze current accounting practices for opportunities to simplify; recommend appropriate changes to existing practices.

TARGET RATIOS

The University will calculate certain ratios on a proforma basis when contemplating the issuance of new debt and calculating debt capacity, and include the ratios for the current and previous years in the Annual Capital Financing and Debt Management Report. The following ratios have been used as relevant measures of financial health up to this time. However, due to the revision in Rating Methodologies by both Moody's and S&P in the last year, the University is currently re-evaluating the ratios to track going forward. We anticipate a change to this Appendix by fall 2016.

a) **Debt Service Ratio** - This ratio measures the University's ability to service debt and the impact of debt financing on the University's operations. The ratio is defined as:
   Actual Annual Debt Service divided by Total Operating Expenses

   The University shall broadly target its capital structure to result in a maximum Debt Service Ratio between the Moody's Aa1 and Aa2 medians.

b) Leverage Ratios - These ratios measure the ability to retire debt with assets.

   Total Financial Resources to Direct Debt is calculated by taking the:
   The sum of:
   University unrestricted net assets,
   plus University restricted expendable net assets,
   plus University restricted nonexpendable net assets,
   plus University of Minnesota Foundation (UMF) total net assets,
   less UMF net investment in plant, and
   Dividing the result by:
   Total direct long-term debt.

   The ratio is a broad measure of overall wealth. The University shall broadly target its capital structure to result in a Total Financial Resources to Direct Debt ratio that is no less than Moody's Aa2 median.

   Expendable Financial Resources to Direct Debt is calculated by taking:
   The sum of:
   University unrestricted Net Assets,
   University restricted expendable net assets,
   UMF unrestricted net assets,
   UMF temporarily restricted net assets,
   less UMF net investment in plant, and
   Dividing the result by:
   Total direct long-term debt.

This ratio is narrower than the Total Financial Resources to Debt ratio and measures the degree of flexibility in the balance sheet. The University shall broadly target its capital structure to result in a minimum Expendable Financial Resources to Debt Ratio in the range of Moody's Aa1 and Aa2 Medians.

Note that Moody's calculations include all of the debt of the University. The University also calculates the ratios by excluding the outstanding balance of the special purpose revenue bonds and related interest expense for a fiscal year from direct long-term debt and annual debt service/operating expenses, respectively. The special purpose revenue bonds, while issued by the University, are based on the State of Minnesota's appropriation credit and therefore should not be included when determining debt capacity for the University of Minnesota.

<u>DECLARATION OF OFFICIAL INTENT TO REIMBURSE</u>
<u>[TEMPLATE]</u>

<u>Declaration of Official Intent</u>

The undersigned, being the duly appointed and acting Treasurer of the Regents of the University of Minnesota (the "University") pursuant to and for purposes of compliance with Treasury Regulations, Section 1.150-2 (the "Regulations"), promulgated under the Internal Revenue Code of 1986, as amended, hereby states and certifies as follows:

1. The undersigned has been and is on the date hereof duly authorized by the Board of Regents of the University of Minnesota to make and execute this Declaration of Official Intent (the "Declaration") for and on behalf of the University.

2. The University proposes to undertake certain projects (the "Projects"), which projects and the estimated costs thereof are generally described on <u>Schedule I</u> hereto, which is hereby incorporated herein and made a part hereof.

3. The University reasonably expects to incur the expenditures made for costs of the Projects in the estimated amounts shown on <u>Schedule I</u> hereto and use the proceeds of debt in an estimated maximum aggregate principal amount of $xxx,xxx,xxx (the "Bonds") after the date of payment of all or a portion of the costs of the Projects and after the issuance of the Bonds. All expenditures shall be capital expenditures, a cost of issuance of the Bonds or other expenditures eligible for reimbursement under Section 1.150-2(d)(3) of the Regulations.

4. As of the date hereof, there are not University funds reserved, allocated on a long-term basis or otherwise set aside (or reasonably expected to be reserved, allocated on a long-term basis or otherwise set aside) to provide permanent financing for the expenditures related to the Projects to be financed on a permanent basis out of the proceeds of the Bonds. The statement of intent contained in this Declaration, therefore, is determined to be consistent with the University's budgetary and financial circumstances as they exist or are reasonably foreseeable on the date hereof.

Dated: ____________________, __________

REGENTS OF THE UNIVERSITY OF MINNESOTA

By ______________________________________
Name
Treasurer

Subscribed and sworn to before me

this ______ day of ________________, 20XX

____
Notary Public

[TEMPLATE]

SCHEDULE I

Description of Projects (1)	Total Estimated Costs (2)	Portion of Total Estimated Costs To be Financed With Proceeds Of Bonds
NAME PROJECT #	$ xxx,xxx,xxx	$ xxx,xxx,xxx
[DETAILED DESCRIPTION OF PROJECT/PROPERTY]		
Totals	$ xxx,xxx,xxx	$ xxx,xxx,xxx

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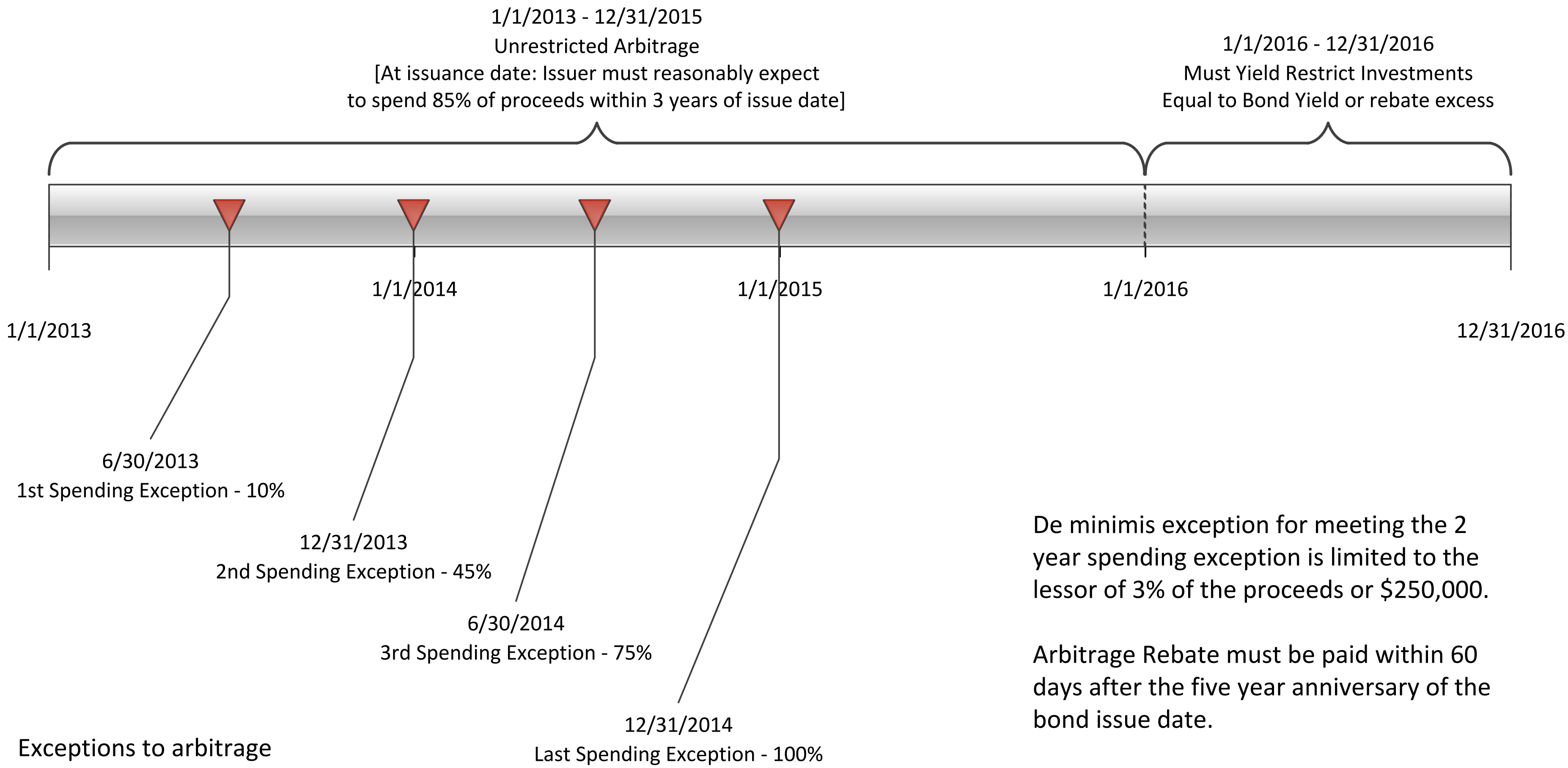
(1) Include general functional description of character or type of Project, which may include any property, project or program. Examples contained in the Regulations are "highway capital improvement program", "hospital equipment acquisition", and "school building renovation." Alternatively, the University may designate particular funds or accounts as the project description if the functional purpose to be reimbursed is set forth. Example contained in the Regulations is, "parks and recreation fund -- recreational facility capital improvement program."

(2) Include construction or acquisition costs and engineering, architectural, legal, fiscal and other costs.

Tax-Exempt Debt Post-Issuance Timeline

(Illustrative example below assumes issue date of 1/1/2013)



De minimis exception for meeting the 2 year spending exception is limited to the lessor of 3% of the proceeds or $250,000.

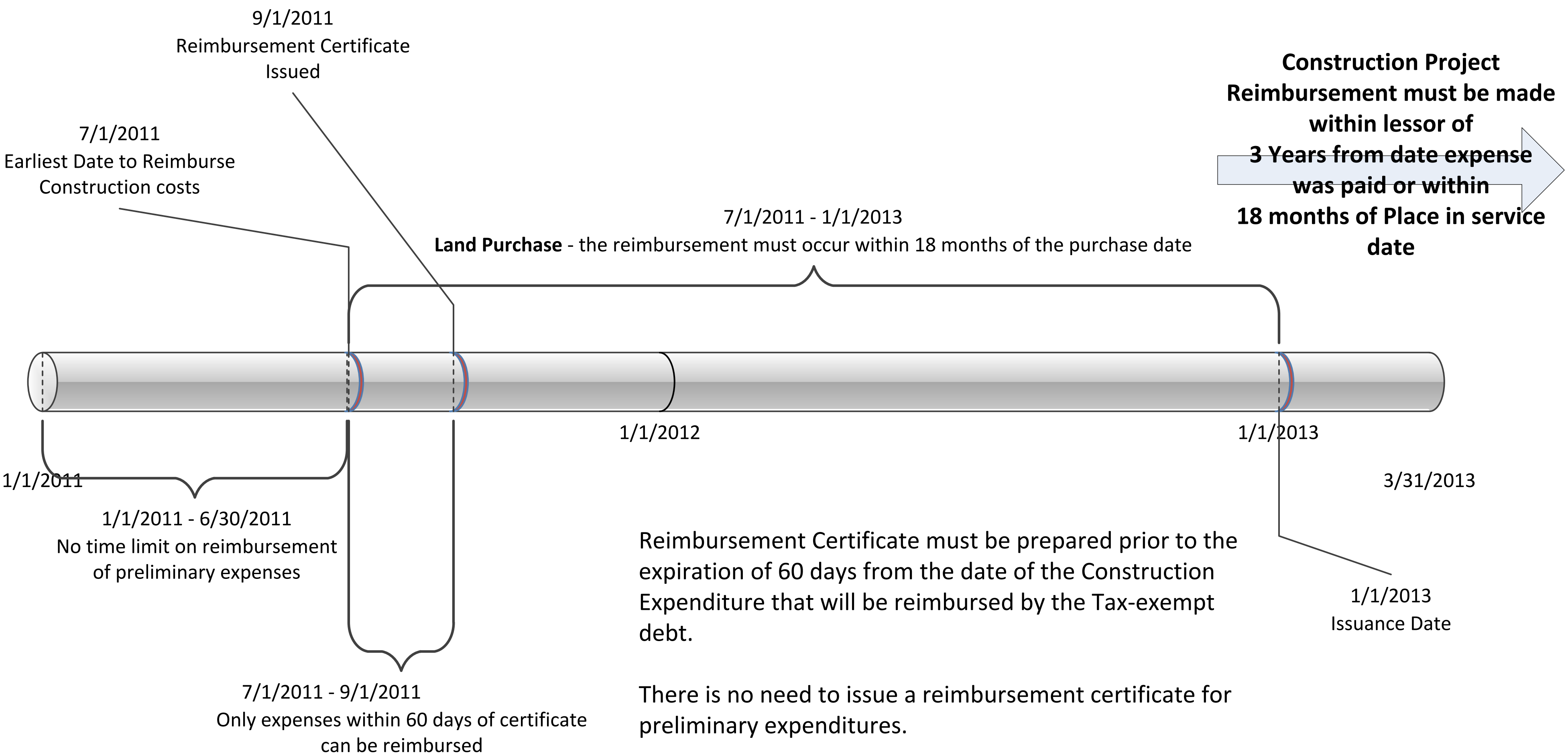
Arbitrage Rebate must be paid within 60 days after the five year anniversary of the bond issue date.

Exceptions to arbitrage rebate other than the 2 year exception above are available. The TMO needs to be consulted regarding the use of these exceptions.

TMO 4/28/2015

Tax-Exempt Debt Reimbursement Timeline

(Illustrative example below assumes issue date of 1/1/2013)



Reimbursement Certificate must be prepared prior to the expiration of 60 days from the date of the Construction Expenditure that will be reimbursed by the Tax-exempt debt.

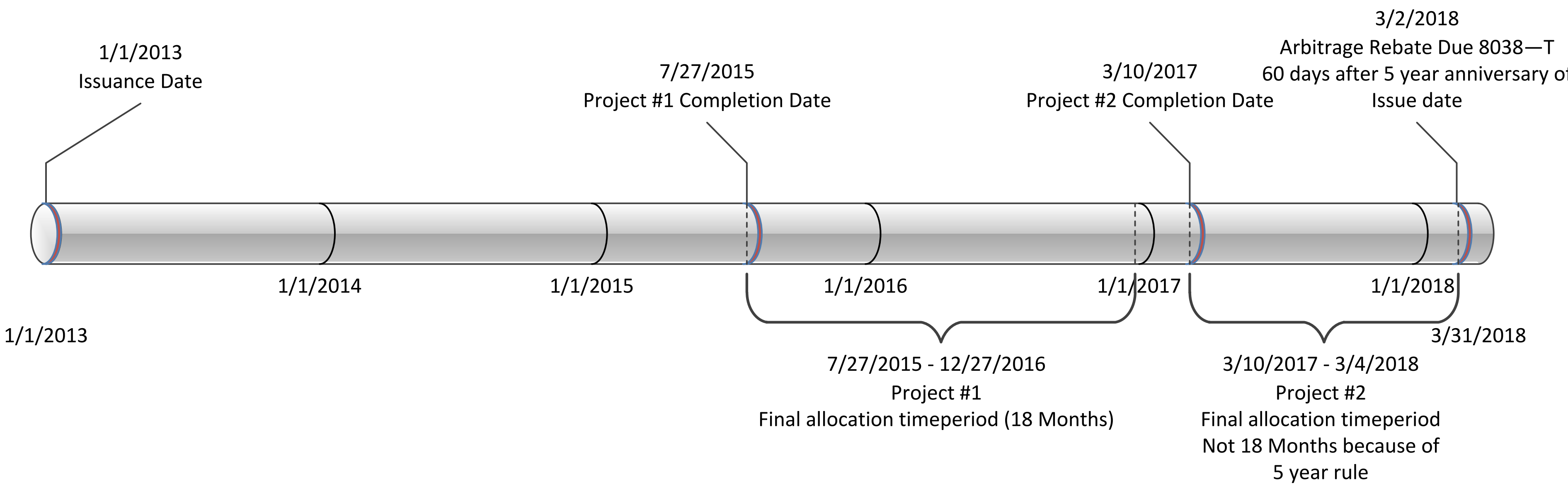
There is no need to issue a reimbursement certificate for preliminary expenditures.

TMO 4/28/2015

Tax-Exempt Debt Allocation Timeline

(Illustrative example below assumes issue date of 1/1/2013
Debt issuance consists of 2 separate projects)

Allocations must be made within the applicable time period allowed for each project. Allocations consist of:
1) identification of costs using specific tracing method
2) allocating private business use between equity and proceeds



TMO 4/28/2015

University of Minnesota

Draw Request Approval Checklist*

Bond Draw Description	
Description of Bonds:________________	Total Draw Amount: $__________
Expected Draw Date: ________________	DPT Meeting Date: __________

Allocation of Bonds to Projects	Yes	No	N/A
1. Have the projects relating to the bond draw request been authorized for use of bond proceeds in the University Order appertaining to the bonds? (If yes, then question 2 is not applicable)			
2. If the question above is answered No, then have the projects relating to the bond draw request been authorized for use of tax-exempt bond proceeds by the Treasurer of the University in accordance with procedures outlined in the University Order? (If No, then tax-exempt debt cannot be used for reimbursement of project expenses.)			

Allocation of Project Expenditures to Bond Proceeds	Yes	No	N/A
1. Have copies of the invoices been reviewed and matched to the draw request?			
2. Are the invoices for work performed on the above listed authorized bond projects and not for other projects? (See section above.)			
3. Are the expenditures for a capital asset (as defined by tax law) and not for other non-capital costs?			
4. Are internal University departmental costs for projects **excluded** in the bond draw request? (If Yes then question 5 is not applicable.)			
5. If the answer to the above question is No then are the departmental charges for the projects determined in accordance with Internal Revenue Code Section 263A and the U.S. Treasury regulations promulgated thereunder? These requirements have been outlined in the May 17, 2010 memorandum to the Assistant Commissioner, Treasury Division of the Minnesota Management and Budget Office.			

Timing of Expenditures	Yes	No	N/A
1. Are the dates of the original expenditures for the capital projects after the issuance date of the tax-exempt debt? (If yes then 2 & 3 are not applicable.)			
2. If the question above is answered No, has the University properly executed a reimbursement certificate for these expenditures? (If yes, then question 3 is not applicable.)			
3. If the question above has been answered No, have 60 days expired since the date of the expenditure and the current date? (if Yes, then tax-exempt debt cannot be used to reimburse the university for the expenditures – If No, then time may exist for a reimbursement certificate to be completed and authorized.)			
4. For reimbursement draws upon which the University has executed a reimbursement certificate, are the dates of the original expenditure for the capital projects (that are to be reimbursed by bond proceeds) less than 60 days prior to the date of the reimbursement certificate? (If no, then such expenditures need to be removed from the draw request.)			

Debt Process Team Approval

We affirm to the best of our knowledge and belief that the above information is accurate and that the attached draw request meets the standards for appropriate use of tax-exempt bond proceeds.

Department	Signed	Date	Print Name	Print Title
Debt Management				
University Services - Finance				

Distribution

Office of Investments & Banking
University Services – Finance
Accounting Services
Debt Management Office

[*] A review of the draw request is necessary to ensure that the University is fulfilling its fiduciary responsibility with respect to tax-exempt bond draws. The use of tax-exempt debt for construction projects is permissible only when the expenditures of the debt are for permissible projects and expenses. The purpose of this form is to document the University's review process for authorization of draws of bond proceeds.

<u>Certificate as to Designation of Bond Proceeds</u>
<u>To Specific Projects</u>

The undersigned, being the duly appointed and acting Treasurer of the Regents of the University of Minnesota (the "University") pursuant to and for purposes of compliance with Treasury Regulations (the "Regulations"), promulgated under the Internal Revenue Code of 1986, as amended, hereby states and certifies as follows:

1. The undersigned has been and is on the date hereof duly authorized by the Board of Regents of the University of Minnesota to make and execute this Certificate as to Designation of Bond Proceeds (the "Allocation") for and on behalf of the University.

2. The University has undertaken certain projects (the "Projects"), which projects and the costs thereof are generally described on <u>Schedule I</u> hereto, which is hereby incorporated herein and made a part hereof.

3. The University has paid or will pay for costs of the Projects in the amounts shown on <u>Schedule I</u> hereto. Such costs to which bond proceeds are to be allocated must either 1) be paid after the issuance date of the below referenced bonds or 2) be covered under a Reimbursement Certificate executed consistent with the rules contained in Treasury Regulation 1.150-2.

4. The University hereby designates University of Minnesota General Obligation Bonds Series _________ proceeds to such costs in the aggregate amount of $____________ [plus any adjustments due to changes in estimated costs attributable to the purchase and/or subsequent demolition of building]. Such amount includes unspent proceeds in addition to accumulated interest on such proceeds through the date of this allocation certificate [plus an estimate of additional estimate to be earned].

5. As of the date hereof, there are not University funds reserved, allocated on a long-term basis or otherwise set aside (or reasonably expected to be reserved, allocated on a long-term basis or otherwise set aside) to provide permanent financing for the expenditures related to the costs allocated to bond proceeds identified in Item 4 above. This Designation, therefore, is determined to be consistent with the University's budgetary and financial circumstances as they exist or are reasonably foreseeable on the date hereof.

6. This Certificate as to Designation will be entered on the official books and records of the University with respect to the Series _________ of the University.

Dated: ________________

REGENTS OF THE UNIVERSITY OF MINNESOTA

By ____________________________________

Name

Treasurer

Subscribed and sworn to before me

this _____day of _______________, 201x

____

Notary Public

SCHEDULE I

Description of Projects (1)	Total Estimated Costs (2)	Portion of Total Estimated Costs To be Financed With Proceeds Of Bonds (CP) (3)
Total		

[* plus any adjustments due to changes in estimated costs attributable to the purchase and subsequent demolition of building]

[Represents unspent proceeds, plus accumulated interest through month day, year, plus an estimate of additional interest to be earned until funds are drawn – actual amount used on this project may be slightly more or slightly less than this total.]

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(1) Include general functional description of character or type of Project, which may include any property, project or program. Examples contained in the Regulations are “highway capital improvement program”, “hospital equipment acquisition”, and “school building renovation.” Alternatively, the University may designate particular funds or accounts as the project description if the functional purpose to be reimbursed is set forth. Example contained in the Regulations is, “parks and recreation fund -- recreational facility capital improvement program.”

(2) Include construction or acquisition costs and engineering, architectural, legal, fiscal and other costs.

(3) The University will ensure that the allocation of the above referenced bond proceeds to costs of the project will occur within 18 months of the date the expenditures are paid or, if later, the date the financed project is placed in service, subject to an outside limit of sixty days after the fifth anniversary of the issuance date, or sixty days after the retirement of the issue date of the bonds [see Treasury Regulation 1.148-6(d)(i)(iii)].

SPENDING EXCEPTION WORKSHEET - Example

Appendix J

University of Minnesota

Summary of Draw Requests & Spending Exception Analysis

Series 2010C GO Bonds

Fund 7120

	A		B	C		D	E	F	G
	Date	#	Draws Against Proceeds	Projected Investment Earnings (Tax & Rebate Certificate)	Actual Interest Earned on Unspent Proceeds	Net Proceeds Remaining [D – B + C]	Cumulative Draws [E + B]	For Spending Exception Purposes [D + E]	% of Total Drawn [E/F]
Par	2/10/2010					8,480,000.00			
Bond Premium						507,833.70			
Less: Underwriter's discount						(22,092.80)			
Original deposit 2/10/2010						**8,965,740.90**			
Less: Estimate for COI						(27,858.99)			
Balance						8,937,881.91		8,937,881.91	100.00%
Draw against proceeds	3/25/2010	1	3,519,034.87			5,418,847.04	3,519,034.87	8,937,881.91	39.37%
Interest earnings	3/31/2010				113.70	5,418,847.04	3,519,034.87	8,937,881.91	39.37%
Interest earnings	4/30/2010				0.00	5,418,847.04	3,519,034.87	8,937,881.91	39.37%
Draw against proceeds	5/06/2010	2	2,115,078.83			3,303,768.21	5,634,113.70	8,937,881.91	63.04%
Interest earnings	5/31/2010				22.45	3,303768.21,	5,634,113.70	8,937,881.91	63.04%
Draw against proceeds	6/24/2010	3	0.00			3,303,768.21	5,634,113.70	8,937,881.91	63.04%
COI estimate			(27,858.99)			3,331,627.20			
Draw against proceeds (COI)	6/24/2010	3	25,259.27			3,306,367.93	5,659,372.97	8,965,740.90	63.12%
Interest earnings	6/30/2010				29.37	3,306,367.93	5,659,372.97	8,965,740.90	63.12%
Interest earnings	7/31/2010				(13.71)	3,306,367.93	5,659,372.97	8,965,740.90	63.12%
Projected interest earnings	1st 6 months			3,057.14		3,309,425.07	5,659,372.97	8,968,798.04	63.10%
Requirement (6 months)	**8/10/2010**			**3,057.14**	151.81				**10.00%**
Draw against proceeds	8/26/2010	4	1,390,771.26			1,918,653.81	7,050,144.23	8,968,798.04	78.61%
Interest earnings	8/31/2010				52.99	1,918,653.81	7,050,144.23	8,968,798.04	78.61%
Draw against proceeds	9/23/2010	5	1,912,997.04			5,656.77	8,963,141.27	8,968,798.04	99.94%
Interest earnings	9/30/2010				55.18	5,656.77	8,963,141.27	8,968,798.04	99.94%

SPENDING EXCEPTION WORKSHEET - Example

Appendix J

	Date	#	Draws Against Proceeds	Projected Investment Earnings Tax & Rebate Certificate	Actual Interest Earned on Unspent Proceeds	Net Proceeds Remaining [D – B + C]	Cumulative Draws [E + B]	For Spending Exception Purposes [D + E]	% of Total Drawn [E/F]
Interest earnings	10/31/2010				0.00				
Draw against proceeds	12/23/2010	6	2,859.61			2,797.16	8,966,000.88	8,968,798.04	99.97%
Interest earnings	12/31/2010				0.00	2,797.16	8,966,000.88	8,968,798.04	99.97%
Interest earnings	1/31/2011				0.00	2,797.16	8,966,000.88	8,968,798.04	99.97%
Projected interest earnings	2nd 6 months			76.67		2,873,83	8,966,000.88	8,968,874.71	99.97%
Estimated interest earnings				**3,133.81**					
Adjust to actual earnings				(2,873.83)		(0.00)	8,966,000.88	8,966,000.88	100.00%
							Proceeds are	**fully spent**	
Requirement (12 months)	**2/10/2011**			259.98	259.98				**45.00%**
Requirement (18 months)	**8/10/2011**								**75.00%**
Requirement (24 months)	**2/10/2012**								**100.00%**
	Total Draws		8,966,000.88		259.98	Total interest	Earnings		
	Less COI draw		25,259.27		8,965,740.90	Original	Deposit		
	Project draws		8,940,741.61		8,966,000.88	Total Available	to draw		

ACCOUNTING MODEL

Note: The 'Fund' listed is a fund specific to a bond issuance; e.g., the Series 2010C Bond activity is recorded in Fund 7120. Therefore, where the word "Fund" is shown below, the number 7120 would be part of the accounting entry.

		G/L Fund-DeptID-Account	Debit	Credit
1	Cash	1000-12000-100101	$	
	Expense – Bond Issuance Costs	Fund-10011-21377-890104	$	
	Bonds Payable	Fund-10011-21377-230100		$
	Bonds Payable Premium *(or discount)*	Fund-10011-21377-230105	*Or $*	$

<u>Description:</u> To record sale of bonds at a premium or discount, amount of underwriter's discount, and receipt of cash by the University. (Effective FY14, underwriter's discount, i.e., COI, is expensed in the year incurred.)
<u>Action:</u> Cash is wire-transferred into the University's general account; Debt Deal is set up in Deal Module.

		G/L Fund-DeptID-Account	Debit	Credit
2	Unspent Bond Proceeds	Fund-10011-108700	$	
	Cash	1000-10011-100101		$

<u>Description:</u> To record the investment of the bond proceeds.
<u>Action:</u> Cash is moved from the general account to a separate investment.

		G/L Fund-DeptID-Account	Debit	Credit
3	Unspent Bond Proceeds	Fund-10011-108700	$	
	Bond Activity/Investment Income	Fund-10011-21377-580102		$

<u>Description:</u> To record investment earnings on the unspent bond proceeds.
<u>Action:</u> Investment income is reinvested, not drawn, and the income becomes additional bond proceeds.

		G/L Fund-DeptID-Account	Debit	Credit
4	Expense- Bond Issuance Costs	Fund-10011-21377-890104	$	
	Cash	1000-12000-100101		$

<u>Description:</u> To record the payment of invoices related to the Costs of Issuance (COI). Effective FY14, COI is expensed in the year incurred. Prior to that, COI was set up as an asset and amortized over the life of the bonds.
<u>Action:</u> Invoices are approved for payment and paid either via wire transfer by OIB or via check by Accounting Services through the Accounts Payable system.

		G/L Fund-DeptID-Account	Debit	Credit
5	Bond Activity/Interest on Indebtedness	Fund-10011-21377-890102	$	
	Bond Interest Payable	Fund-10011-21377-210140		$

<u>Description:</u> To record monthly accrual of interest due on bonds.
<u>Action:</u> Once Accounting Template is set up, Deal Module interfaces to G/L.

		G/L Fund-DeptID-Account	Debit	Credit
6	Bonds Payable Premium	Fund-10011-21377-230105	$	
	Bond Activity/Interest on Indebtedness	Fund-10011-21377-890102		$

<u>Description:</u> To record amortization of Bond Premium on monthly basis.
<u>Action:</u> Once Accounting Template is set up, Deal Module entry interfaces to G/L.

		G/L Fund-DeptID-Account	Debit	Credit
8	Bond Interest Payable	Fund-10011-21377-210140	$	
	Bonds Payable	Fund-10011-21377-230100	$	
	Cash	1000-12000-100101		$

<u>Description:</u> To record debt service payment.
<u>Action:</u> Funds are wire-transferred to pay principal and/or interest; Cash Management entry is interfaced to G/L.

Note: Interest payments under the terms of swap agreements were accounted for in the same manner as interest payments on the original debt. Interest payments received under the terms of swap agreements are credits to interest expense rather than debits. (Termination date of debt 08/27/2017)

		G/L Fund-DeptID-Account	Debit	Credit
9	Bond Activity/Licenses & Fees	Fund-10011-21377-720312	$	
	Cash	1000-12000-100101		$

<u>Description:</u> To record fees associated with bonds, e.g. annual ratings agency fees, paying agent administration fee.
<u>Action:</u> Payments made via check by Accounting Services through payables; in some cases, by wire transfer by OIB.

		G/L Fund-DeptID-Account	Debit	Credit
10	Cash	1000-12000-100101	$	
	Unspent Bond Proceeds	Fund-10011-108700		$

<u>Description:</u> To record draw down of bond proceeds.
<u>Action:</u> Draw request is submitted to OIB; Investment Deal is partially liquidated in Deal Module.

		G/L Fund-DeptID-Account	Debit	Credit
11	Bond Activity/Transfer Out	Fund-10011-21377-610202	$	
	Departmental A/c-project/Transfer In	Fund-12007-program or PCBU/Project/1/GLR/600202		$

Description: *To allocate bond proceeds to specific projects.*
Action: *Manual entry in G/L by Accounting Services.*

BUILD AMERICA BONDS (BABs)

Section 1531 of Title I of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) (enacted February 17, 2009) ("ARRA"), added § 54AA to the Code, authorizing state and local governments, at their option, to issue two general types of Build America Bonds as taxable governmental bonds with Federal subsidies for a portion of their borrowing costs. The subsidies take the form of either tax credits provided to holders of the bonds or refundable tax credits paid to state and local governmental issuers of the bonds. Build America Bonds have different levels of Federal subsidies and program requirements depending on the particular type of bond.

The first type of Build America Bond provided a Federal subsidy through Federal tax credits to investors in the bonds in an amount equal to 35 percent of the total coupon interest payable by the issuer on taxable governmental bonds (net of the tax credit), which represents a Federal subsidy to the state or local governmental issuer equal to approximately 25 percent of the total return to the investor (including the coupon interest paid by the issuer and the tax credit). This type of Build America Bond was referred to as "Build America Bonds (Tax Credit)."

The second type of Build America Bond provided a Federal subsidy through a refundable tax credit paid to state or local governmental issuers by the Treasury Department and the Internal Revenue Service ("IRS") in an amount equal to 35 percent of the total coupon interest payable to investors in these taxable bonds. This type of Build America Bond was referred to as "Build America Bonds (Direct Payment)."

The University issued Direct Payment BABs during their availability in 2009 and 2010 when it was determined that it resulted in a lower cost of capital, and there was investor demand for these bonds. The program was not extended by Congress beyond December 31, 2010. The University issued three series of BABs – Series 2009D (issued May 5, 2009), Series 2010D (issued February 5, 2010), and Series 2010D (issued September 30, 2010).

To ensure than any BABs with a Direct Pay Election were issued within the parameters allowed by code section 54AA, the University completed Steps 1, 2 and 3 of the BAB Compliance Checklist as part of the issuance of Series 2009B, Series 2009D, and Series 2010D as follows:

1. Verify that none of the maturities of the direct pay bonds are issued with a more than de minimis amount of premium (defined as less than 2% of the bond issue price)

2. Determine that costs of issuance do not exceed 2% of the proceeds of the sale

3. Verify that the amount of interest payable on each interest payment date has properly been determined.

INVESTMENT GRADE LONG-TERM BOND RATINGS

Moody's Investors Service Rating	Financial Security Evaluation	Standard and Poor's Rating *
Aaa	Exceptional	AAA
Aa1, Aa2, Aa3	Excellent	AA+, AA, AA-
A1, A2, A3	Good	A+, A, A-
Baa1, Baa2, Baa3	Adequate	BBB+, BBB, BBB-
Ba1, Ba2, Ba3	Moderate	BB+, BB, BB-
B1, B2, B3	Weak	B+, B, B-
Caa to C	Default	CCC to D

The University of Minnesota is currently rated Aa1 by Moody's, and AA by Standard and Poor's.

*Rating scale also used by Fitch Ratings