



Debt Management Guidelines

University of Arizona

Prepared by Financial Services Office

Debt Management Guidelines

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I. Introduction

In order for the University of Arizona to maintain its mission of providing excellent education and research programs, the University must continue to strategically invest in its capital program. Management recognizes that capital investment requires substantial financial commitment. It is therefore prudent for the University to consider a diverse source of funding mechanisms, including debt financing. Debt financing provides a low cost source of capital for the University to fund capital investments through tax-exempt debt instruments. Financial leverage, when strategically applied, serves a beneficial role and should be considered as a long-term component of the University's balance sheet. Similar to investments, debt is viewed to be a continuing component, that when managed appropriately, could provide significant benefits to the University. The following Debt management guidelines seek to provide management a background into debt related matters, establish criteria to monitor debt capacity and delineate principles for structuring debt and debt financings. The Sr. Vice President of Business Affairs is responsible for the Debt Management Guidelines and shall delegate responsibilities for implementation and oversight. Currently these functions are jointly delegated to the Financial Services Office and the Budget Office.

Approach

The following objectives coupled with management judgment provide the framework by which decisions will be made regarding the use and management of debt. The guidelines and objectives are subject to ongoing changes based on the goals and priorities of the University.

Objectives

1. Use debt to fund mission critical projects to ensure that debt capacity is optimally utilized to fulfill the University's mission.
2. Consider all financing options and select the method that is most advantageous to the University.
3. Limit the risk of the University's debt portfolio by applying risk mitigating procedures or mechanisms.
4. Strive to maintain the University's credit ratings at the highest grade level as possible.
5. Comply with all policies, laws and regulations.
6. Perform post issuance functions on tax-exempt financed projects until maturity to maintain tax-exempt status.

II. Debt Issuance Strategies

The University follows debt strategies and procedures relating to both the external and internal management of debt and interest. It is intended for these strategies to be reviewed and reassessed periodically by management.

A. Mission Based Capital Planning

1. Only projects that relate to the mission of the University, directly or indirectly, will be considered for debt financing.
2. A project that has a related revenue stream or can create budgetary savings will receive priority consideration. Every project considered for financing must have a defined, supportable plan of costs approved by management.
3. State funding and philanthropy are expected to remain major sources of financing for the University's plant investments. In assessing the possible use of debt, all other financing and revenue sources will be considered. State appropriations, philanthropy, project-generating revenues, research facilities and administration cost reimbursement, expendable reserves, and other sources are expected to finance a portion of the cost of a project. Debt is to be used conservatively and strategically.
4. Federal research projects will receive priority consideration for external debt financing due to partial reimbursement of operating expenses (including the interest component of applicable debt service) of research facilities.

B. Core Ratios

Debt Ratio

The University of Arizona debt ratio is governed by Arizona Board of Regents and State Statutes.

ABOR and State statutes provide that as of the date of issuance of system revenue bonds or certificates of participation for any institution, the projected debt service on bonds and certificates of participation then outstanding and proposed to be issued for such institution, as shown in the most recent capital improvement plan, may not exceed, in any fiscal year shown in such capital improvement plan, more than eight (8%) of such institution's total projected expenses and mandatory transfers. This limit is currently established by ABOR policy 7-101(K) and ARS 15-1683. The ratio is calculated as follows:

$$\frac{\text{PRINCIPAL AND INTEREST ON BONDS AND COPS}}{\text{TOTAL EXPENSES \& MANDATORY TRANSFERS (PRINCIPAL AND INTEREST PMT)}}$$

Bond Coverage Ratio

Annually, the University calculates and evaluates its Revenue Bond Coverage ratio.

C. Financial Instruments

1. Tax-Exempt Debt

The University recognizes the benefits from lower interest costs associated with tax-exempt debt, and therefore will manage the debt portfolio to maximize the portion of tax-exempt debt outstanding under the debt management guidelines.

2. Taxable Debt

The University will manage its debt portfolio to minimize its taxable component. Unlike tax-exempt debt, taxable debt will not be considered a perpetual component of the University's liabilities. Taxable debt will be utilized to fund project(s) ineligible for tax-exempt financing or for those projects for which the University wants to preserve maximum operating flexibility. The University will manage its overall debt portfolio and total financing sources in order to minimize (or eliminate) the need for taxable debt. Periodically when any new debt is issued, the University will determine its aggregate taxable needs and manage the taxable debt portfolio -based on the aggregate need and desired flexibility.

3. Commercial paper

The University recognizes that a commercial paper (CP) program can provide low-cost bridge financing for projects, however, as with other debt structures, the level of CP outstanding impacts the overall debt capacity.

4. Interest Rate Swaps

The University evaluates potential derivative instruments by: comparing a desirable allocation of fixed rate to variable rate debt to the actual current allocation, analyzing the current market and interest rate conditions, and determining the benefit to the University in undertaking counterparty exposure. The University will analyze the cost/benefit of any derivative instrument. Under no circumstances will a derivative transaction be utilized that is not fully understood by the University or that imposes inappropriate risk on the University.

5. Fixed Versus Variable Allocation

Due to the financing flexibility and typically low interest cost associated with variable rate debt, it is desirable to maintain a portion of the University's aggregate debt on a floating rate basis. However, variable rate debt also introduces volatility to the University's debt service obligations. Volatility is reflected in interest rate changes and can be caused by a number of factors including rating changes, seasonal factors, general market conditions, and tight credit markets. The University will balance the mix of variable and fixed rate debt with careful consideration of these attributes.

D. Third Party Financing

The University may use third-party arrangements to support capital development needs. Among other approaches, these arrangements can involve leasing University land to a third party that builds a facility on the land and then leases the facility to the University. Third party financing arrangements may also involve issuing tax-exempt bonds through nonprofit corporations affiliated with the University or private development companies.

The University will consider third party financing which results in favorable interest rates, lower project costs due to specialized tax incentives, or expedited project completion schedules. The University will consider the following best practices when engaging in a third party transaction:

1. Complex transactions can benefit from using experienced and knowledgeable legal experts and financial advisors.
2. Verify the qualifications of all third party participants such as financiers, developers and operators.
3. Include a buyout purchase option if possible.
4. Ensure maintenance requirements.
5. Conduct project feasibility studies.

E. External and Internal Debt Repayment

University debt is managed by the Financial Services Office and the Budget Office under the direction of the Senior Vice President of Business Affairs and consultation of the University's financial advisors. The Financial Services Office and the Budget Office will employ the debt strategy that is best for the University as a whole. When at all possible, in order to maintain consistency and assist with budgeting of debt service for the departments and colleges, a fixed amortization schedule will be provided to the units on their financed project through maturity. Subsequent actions related to the outstanding debt shall be administered by the Financial Services Office and the Budget Office under the direction of the Sr. Vice President of Business Affairs. In this regard, the Financial Services Office and the Budget Office is viewed as a central bank for financing of capital acquisitions for and across departments and colleges.

III. Debt Issuance Authority

Scope and Authority

The Debt Management Guidelines shall govern the issuance and management of all debt and lease financings funded from the capital markets, and shall include all obligations and ancillary facilities, e.g. credit support, derivative agreements, etc., related to those debt and lease financings, including investment of bond proceeds not otherwise covered by other investment policies of the University or the Arizona Board of Regents (“ABOR” or “Board”).

While adherence to these Guidelines is required in applicable circumstances, UA recognizes that changes in the capital markets, University programs and other unforeseen circumstances may produce situations that are not covered by these Guidelines or require modifications or exceptions to achieve the Guideline goals. In these cases, management flexibility is appropriate provided that any required specific authorization is obtained from the Board and, if necessary pursuant to statute, from the Arizona State Legislature.

The University’s Debt Management Guidelines will be periodically reviewed and updated as required. The University’s Financial Services Office and the Budget Office under direction of the Senior Vice President for Business Affairs administer the UA’s Debt Guidelines and shall have the day-to-day responsibility and authority for structuring, implementing, and managing the University’s debt and finance program in accordance with programs authorized by the Board and/or the University. The University’s Debt Management Guidelines shall comply with ABOR policies, Arizona State Law, I.R.S. regulations, and Security Exchange Commission regulation. Each debt financing shall be specifically authorized by the Board and, if required by law, review by the Legislature’s Joint Committee on Capital Review.

IV. Capital Development Overview and Debt Issuance

Summary of ABOR Policy 7-102

All capital projects greater than \$2.0 million (New Construction, Major Maintenance, Infrastructure, etc.) anticipated to be financed by debt shall be brought to the Board for approval regardless of funding source or financing structure.

A. Capital Development Process

The capital development process related to debt is divided into five phases of which both the Capital Committee and the Board of Regents must review and approve:

1. Master Plan – The Capital Committee and the Board focus on the relationship between the University’s mission statement, strategic plan and campus physical development plans.
2. Capital Improvement Plan (CIP) - Every year the Universities are required to prepare a Capital Improvement Plan that contains proposals for spending on land acquisition, capital projects, energy systems, energy management systems and building renewal. This CIP is to include a one-year plan and at least a two-year forecast of proposed capital activity.
3. Capital Development Plan (CDP) – This plan identifies capital building projects that each university intends to initiate for the upcoming fiscal year, including a fiscal management plan. The CDP is only submitted for new construction and renovation projects.
4. Project Implementation Approval (PIA) – The University defines elements of the project scope, schedule and budget, and proceeds with completion of schematic design.
5. Project Approval (PA) – The University completes the design and prepares construction documents. This document serves as notification that the project is ready to advertise for bids, or that acceptance of the final guaranteed maximum price has been approved.

B. Debt Issuance request to ABOR (Executive Summary)

Debt issuance request may be submitted to ABOR after the project has received project implementation approval (PIA).

1. Universities must designate funding sources, including annual debt service if required to construct each project proposed in the CIP. Notwithstanding this designation by the Universities, the Capital Committee must review, and the Board must approve the specific issuance of bonds, certificates of participation, or any debt instrument regardless of total project cost.

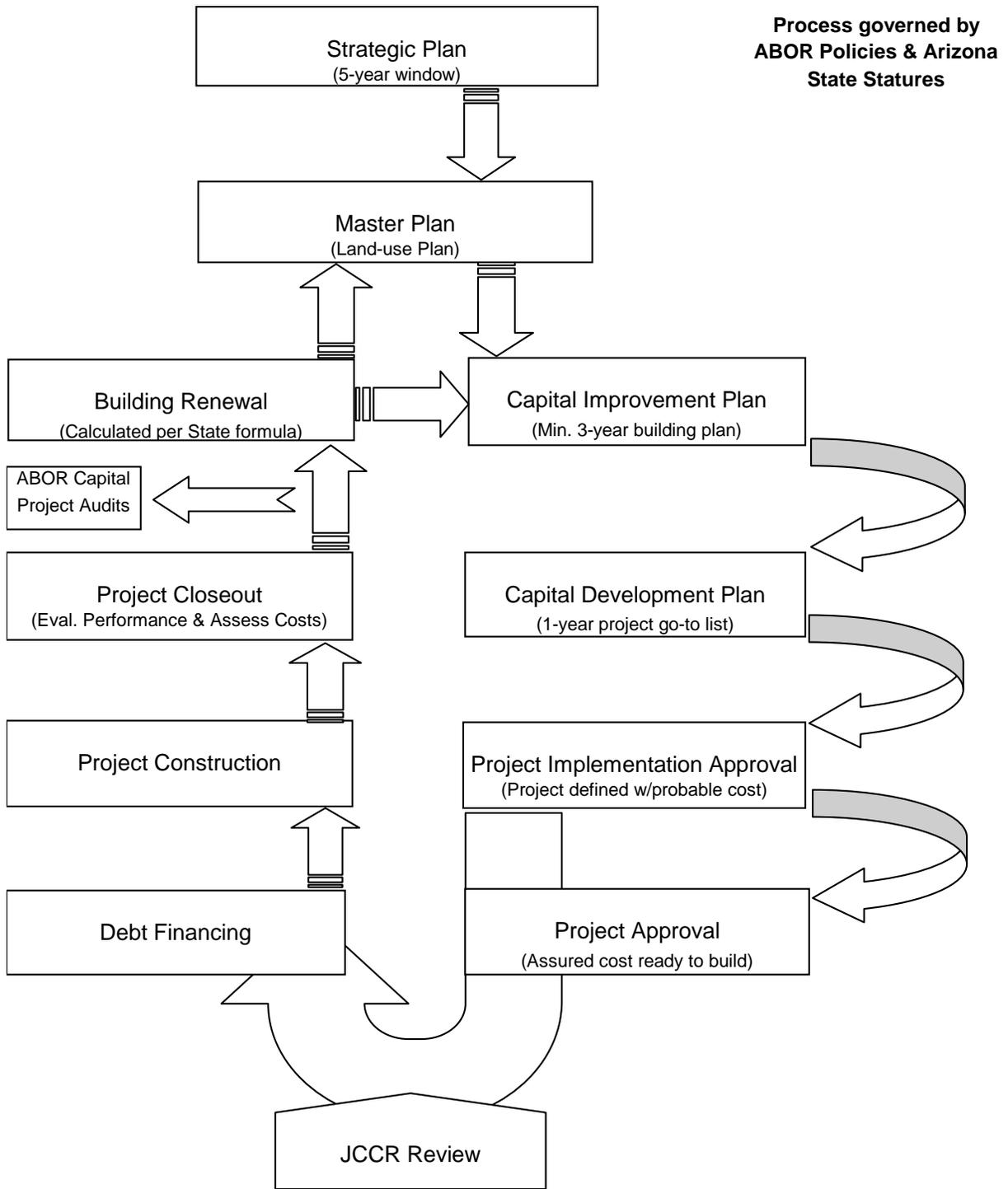
2. Request for debt issuance approval may not occur prior to Project Implementation Approval. The Universities must disclose fully the estimated costs of the project and the debt issuance, information on debt capacity, outstanding debt levels, and debt service payments.
3. For gift funded projects, the Senior Vice President for Business Affairs will determine the percentage of funds to be received before allowing the project to progress through the development process.
4. Any capital project funded with debt may not increase the University's debt ratio to more than eight percent (8%) as defined in ABOR policy and State Statute.
5. The final maturity of any capital financing undertaken by a university will not exceed the estimated useful life of the capital asset being acquired or constructed.
6. In requesting authorization for capital debt, the University shall provide written justification for the debt instrument requested. This will include the assumptions made for the source of resources for the repayment of the debt and the fiscal impact.

C. Debt Issuance Review by Joint Committee on Capital Review (JCCR)

Arizona statutes define the projects that must be reviewed by the JCCR prior to the University undertaking a debt financing. For projects requiring JCCR review, the following generally applies:

1. The projects shall be presented to the JCCR for review after receiving Project Approval from the Capital Committee or the Board.
2. The projects shall have a JCCR review prior to issuance of debt.
3. Both the request for JCCR review and the request to the Board for debt issuance shall display full disclosure of the project description, estimated costs of the project, estimated bond issuance costs, and debt service funding sources.
4. Use of project budget in excess of the amount initially approved by the Board and reviewed by the JCCR will require Board approval prior to seeking any additional review, if any, from the JCCR.

Debt Service Flow Chart



V. Affordability

It is the University's fiduciary responsibility to make sure that the amount of debt that may be authorized and issued in a given period of time shall be funded by identifiable funding sources and commit those sources through the budget process. A financing and funding plan (Debt Capacity Review) must be submitted for review and approval to the Arizona Board of Regents (ABOR) and must adhere to the debt ratio limit. A debt capacity analysis is done annually by the Financial Services Office.

VI. Purpose of Financing

The University generally finances capital improvements and acquisition through the issuance of debt with System Revenue Bonds (SRBs) and Certificates of Participation (COPs). Another purpose of financing is to achieve debt service savings on outstanding debt by refinancing with refunding SRBs and COPs.

A. New Money Financing

New money to the University means financing of new capital projects; unlike refunding which means refunding of existing debt. Some examples of New money finance for capital projects are: construction of a new dormitory, athletic facility, parking lots, academic buildings, acquisitions and renovation of aging buildings.

B. Refunding Bonds

A refunding bond is a type of bond whose proceeds are used to retire all or part of an outstanding prior bond issue. Refunding bonds may be issued to:

1. Take advantage of lower interest rates; the conversion from a high interest rate bond to a lower interest rate bond.
2. Restructure debt service - to defer or stretch out debt service obligations.
3. Remove old bond covenants that are too restrictive.

UA, in conjunction with its financial advisor, regularly monitors its existing debt for refinancing opportunities. As federal law places a number of complicated restrictions and requirements on the ability to issue tax-exempt debt to refinance existing tax-exempt debt (including that tax-exempt debt issued from 1986 or later may only be refinanced on an advanced basis one time under the Internal Revenue Service code), the UA uses a case-by-case analysis to determine when to refinance debt. Factors that are considered in this process include:

- the call date or dates of the existing debt
- the length of time until the call date or dates
- any call premiums associated with the existing debt
- the maturity date or dates of the existing debt
- the length of time between the call date or dates and the maturity date(s) of the existing debt
- current interest rate levels
- projected interest rate levels
- historical interest rate levels
- interest rate trends and interest rate cycles

- investor demand in general and for various premium, par and discount bonds across the maturity date(s) of the existing debt
- current, historical and projected investment yields for escrowed funds to pay off existing debt that is refinanced
- costs of issuance, both in absolute and in relation to the amount of existing debt to be refinanced
- other factors which may include credit and credit enhancement issues, cash flow and budgetary issues, etc.

While all these factors are considered on a case-by-case basis in evaluating debt of the University that may be refinanced, it is generally unlikely that a refinancing that saves less than 3% of the par amount of debt being refinanced, on a present value basis net of all issuance costs, would be undertaken. Generally, savings below this level are not economically sufficient to justify refinancing existing debt given federal tax law restrictions. One exception is the case of debt for which the call date is relatively soon, in which case any savings net of issuance costs may be advisable as such savings would otherwise be lost.

VII. Types of Financing Products

A. Current Coupon Bonds

Current coupon bonds are bonds that pay interest periodically (generally every six months) and principal at maturity. They may be used for both new money and refunding transactions. Current coupon bonds may be structured to meet the demands of the investor and thereby can sometimes reduce the cost of borrowing. Features such as annual principal maturities, the use of premiums and discounts, maturity of the debt, and the parameters of the call provisions can be adjusted to the market conditions at the time of sale.

B. Zero Coupon or Capital Appreciation Bonds

Zero coupon bonds or capital appreciation bonds are a type of debt security that doesn't pay interest periodically, but is instead priced at a deep discount, rendering payment at maturity when the bond is redeemed for its full face value. These bonds have principal amortization that is much slower than level debt service resulting in increased interest expenditure over the life of the bonds. The University will only use Zero Coupon or Capital Appreciation Bonds in limited circumstances where the need to defer principal and interest payments is critical for cash flow reasons.

C. Lease Purchase Financing

Lease purchase financing represents a long-term financing lease which is suitable for financing the acquisition and construction of real property. The University's policy is that the final maturity shall not exceed the estimated useful life of the facility. In general, the University's policy is for the final maturity to not exceed 30 years. Principal payments related to real property acquisition or construction will generally be amortized such that it results in approximately level debt service payments. The University may consider alternative amortization structures to meet its repayment objectives.

D. Derivative Products

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.

The University will comply with the following guidelines when using derivative products:

1. Derivative agreement may only be entered into with financial counterparties that are signatories to the derivative agreement having current long-term credit ratings of at least “AA-/Aa3” by Standard & Poor’s Rating Group and Moody’s Investors Service, respectively.
2. The notional amount of any derivative agreement (when taken together with any other derivative agreement related to an issue of debt) does not exceed the outstanding principal amount of such debt (except for derivative agreements that have the effect of reversing an existing derivative agreement and are netted out for purposes of determining their effect).
3. The University will require collateral posting by the financial counterparty entering into the derivative agreement in the event such counterparty’s long-term ratings are downgraded below levels determined by the University and a potential termination payment is owing from such counterparty.
4. The University will contract with an independent swap advisor with demonstrated expertise to advise the University on the appropriateness of any proposed derivative agreement and the pricing of the trade pursuant to the agreement.

The University may enter into derivative agreements on not more than 40% of its debt outstanding at any time.

VIII. Financing Structural Features

A. Maturity of Debt and Debt Service Structure

The University will employ maturity structures that correspond with the useful life of the financial asset(s) being financed and the expected availability of cash flows to meet debt service requirements. The overall maturity should not exceed the useful life of the financial asset(s).

Debt issued for Auxiliary enterprise projects will include soliciting input regarding revenue projections to meet debt service and other feedback pertinent to the process.

B. Capitalized Interest

Capitalized interest is where a portion of the proceeds of an issue are set aside to pay interest on the securities for a specified period of time. Certain types of financings may require that interest be paid from capitalized interest until the project is operational and producing revenues.

C. Discount Bonds

A discount bond is when a bond is purchased at a price less than its face value.

D. Debt Service Reserve Fund and Credit Enhancement

When issuing debt, The University will assess the economic benefit of possibly utilizing a debt service reserve fund or bond insurance in order to receive the lowest market rate or borrowing cost possible.

E. Call Provisions

The University may use call provisions when issuing debt. Callable bonds enable the University to redeem or pay off the debt prior to the maturity date. In general, the University will utilize call dates of up to 10 years.

IX. Method of Bond Sale

The University shall generally utilize a sale process that seeks to obtain the lowest interest cost for the debt, using three possible methods of sale: competitive sale, negotiated sale, and private placement. As each type of sale has the potential to provide the lowest cost given the right conditions, decisions as to the type of sale will be determined based on market conditions at the time of sale. The factors that will be considered by the University relative to each type of sale are outlined below:

A. Competitive Sale

1. Bond prices are stable and/or demand is strong
2. Market timing and interest rate sensitivity are not critical to the pricing
3. The debt issue has a strong credit rating
4. There are no complex explanations required during marketing regarding the University's projects, media coverage, political structure, political support, funding, or credit quality
5. The bond type and structural features are conventional
6. Market acceptable bond insurance is included or the debt issue is pre-qualified for being insured
7. Transaction size is manageable for a competitive sale

B. Negotiated Sale

1. Bond prices are volatile and/or demand is weak or supply of competing bonds is high
2. Market timing is important, such as for refundings
3. Coordination of multiple components of the financing are required
4. The credit rating for the issue is lower or weakening
5. The University is not well known to investors
6. Sale and marketing of the bonds will require complex explanations about the University's projects, media coverage, political structure, political support, funding, or credit quality
7. Off-balance sheet financings
8. Variable rate financings

9. The bond type and/or structural features are non-standard, such as for a forward bond sale, issuance of variable rate bonds or where there is use of derivative products
10. Bond insurance is not available or not offered
11. Early structuring and market participation by underwriters is desired
12. Pre-qualified underwriters pool
13. Large transaction size
14. Expected high retail demand or a desire by the University to make bonds available to retail investors, including various constituencies of the University (e.g. alumni, community members, etc.)

C. Private Placement

Private Placement is a sale that is structured specifically for one purchaser, such as a bank. The University reserves the right to privately place its securities with one or more investors if the need arises. As this is generally a more costly approach, the University is generally unlikely to use this approach.

X. Investment of Bond Proceeds

A. Purchase and Sale of Investment

The University shall adhere to the University investment policy when investing or utilizing an asset management company to invest bond-funded construction proceeds, capitalized interest funds and costs of issuance funds to achieve the highest return available at the same time complying with arbitrage regulations. The University's investment policy (ABOR Policy 3-301 University Investments) states that funds may be invested only in the purchase of collateralized time certificates of deposit with commercial banks and savings and loans, collateralized repurchase agreements with commercial banks, savings and loans, and other financial institutions, the purchase of United States obligations and obligations of agencies sponsored by the United States Government such as treasury bills, notes, bonds and asset-backed securities or in the local government investment pool administered by the State Treasurer's office. When economically beneficial, the University may enter into Guarantee Investment Contracts (GICs) for investment of bond proceeds.

B. Diversification and Risk Assessment

The University will diversify invested proceeds in order to reduce risk exposure to providers, types of investment products, and types of securities held. Additionally, the University shall consult with external financial professionals and assess market sector risk in order to avoid investments in high risk sectors.

C. Disclosure

The University requires that fees for investment services or any associated compensation must be fully disclosed in the contract in order to ensure that there are no conflicts of interest.

XI. Market Relationships

A. Rating Agencies and Investors

Maintaining an ongoing relationship with rating agencies is essential to the University credit rating. This allows the rating agencies to have comprehensive knowledge of the University mission, operation, new challenges and initiatives. When necessary, University Financial Services staff will work with external financial advisors to prepare rating presentations for the rating agencies in order to provide updates of the University's initiatives and operations.

The Financial Services Office is primarily responsible for maintaining relationships with the three nationally recognized rating agencies (Moody's Investors Service, Standard & Poor's, and Fitch.). Central Administration will participate with credit presentations, when necessary.

B. Rating of Financings

Whenever possible, the University will be rated by at least two of the rating agencies (Moody's Investors Service, Standard & Poor's, and/or Fitch) to substantiate the University's financial position for ABOR, State JCCR and investor's considerations.

C. Official Statement

This document is prepared before the financing of debt in order to describe the type of debt, issuer, project and sources of payment for the potential investors. Additionally, the University's statistical data related to the audited financial statements, bond counsel opinion, and credit enhancements are included.

XII. Consultants

Every two to five years, the University Financial Services Office will issue a Request for Proposals (RFPs) for Financial Advisor, Bond Counsel, and Trustee to help execute documents related to the issuance of debt and for underwriters to market the university's debt instruments. When it is necessary, the University may utilize state consultant contracts or consultant contracts from the other two State Universities in obtaining services.

Per ABOR Policy 3-803 A, "Request for proposals" means all documents, whether attached or incorporated by reference, which are used in soliciting proposals in accordance with procedures prescribed in ABOR Policy 3-803 C (Bidding and Source Selection Procedures, Competitive Sealed Proposals) or ABOR Policy 3-804B.6 (Professional Services and Construction Services Procurement, Procurement of Professional Services and Construction Services; Definition).

Per ABOR Policy 3-501, matters relating to revenue bonds, including issuance, sale, appointment of bond counsel, appointment of financial consultant, appointment of trustee, and all other incidents connected with revenue bonds shall be presented for Board action.

A. Financial Advisor

The Financial Advisor assists with capital planning, determines possible funding sources, assists with the selection of other team members, reviews documents, coordinates the rating agency review, prepares post-sale market memorandum, prepares financing schedules and distribution lists. The University's Financial Advisor(s) are responsible for:

1. Attending State Legislative hearings and ABOR meetings on behalf of the University to present and answer questions about debt related issues
2. Reviewing and providing recommendations on debt financing/refinancing opportunities presented by other financial institutions
3. Preparing drafts of the "Official Statement", structuring of the debt service schedules, soliciting bids for investment contract of debt proceeds, and coordinating with the bond rating services.
4. Disclosing to the University all fees, compensation, commission, or other remuneration received or to be received by the financial advisor in connection with a UA financing irrespective of the source of such compensation.

B. Bond Counsel

Bond Counsel provides an opinion that the University has the legal authority to issue bonds and designate the tax status of such bands. Bond Counsel ensures compliance with federal, state and local laws. Bond Counsel drafts bond documents. Bond Counsel is responsible for ensuring that the official statement complies with all applicable rules, regulations and guidelines.

Bond Counsel may also occasionally appear before and assist the University in presentations to ABOR and any relevant legislative committees including the Joint Committee on Capital Review (JCCR).

C. Underwriters

The University, with the assistance of financial advisors, works closely with the Underwriters to determine the offering price of the securities to be sold to investors through the underwriter's distribution networks.

The University reserves the right to utilize the services of one or more Firms from the awarded pool for each financing undertaken during the term of the agreement. Additionally, firms chosen to be part of the Underwriter pool have no guarantee the University will use their services for any or all of the debt financings undertaken.

D. Bond Trustee

The Trustee is an authenticating agent, bond registrar, transfer agent and paying agent for the University's SRBs and COPs. These services consist of performing all duties outlined within the Bond Resolution or COPs Indenture in conjunction with the state and federal laws and regulations. The University's Bond Trustee will be responsible for, but not limited to:

1. Investing bond proceeds as directed by the University and in accordance with the University's Investment Policy.
2. Disbursing bond proceeds during construction periods
3. Collecting debt service payments and paying principal and interest to bondholders.
4. Authenticating the SRBs and COPs and maintaining a bond register.
5. Setting up accounts, records, files, preparing letters and reports along with providing bank statements of transactions.

E. Award of Contracts

The University will carefully evaluate all proposals received from prospective Financial Advisors, Bond Counsel, Underwriters, and Bond Trustees. The award shall be made to the responsible vendor whose proposal is determined to provide the most advantageous to the University, taking into consideration the evaluation factors (criteria) set forth in the RFP. The University will award contracts pursuant to the applicable terms of the University procurement code.

The University expects that all of its financial team will at all times provide the University with objective advice and analysis, maintain the confidentiality of the University's financial plans, and be free from any conflicts of interest. All financing team members will be required to provide full and complete disclosure relative to any and all agreements with other financing team members and outside parties that could compromise any firm's ability to provide independent advice that is solely in the best interests of the University, or that could be perceived as a conflict of interest. The extent of disclosure may vary depending on the nature of the transaction.

XIII. Post-Issuance Compliance

POST-ISSUANCE COMPLIANCE PROCEDURES: Tax Exempt Bonds and Direct Payment Build America Bonds

The federal tax laws impose a number of requirements for bonds to constitute “Build America Bonds” that are “qualified bonds” within the meaning of Section 54AA of the Internal Revenue Code of 1986, as amended (the “Code”). Such bonds entitle the University of Arizona to interest-subsidy payments from the federal government and are referred to herein as “Direct Pay BABs.” Many of these requirements address circumstances at the time the bonds are issued. However, others require the University to monitor various attributes of the bonds, the Proceeds¹ of the bonds, and the bond-financed facilities throughout the term of the bonds. All of these requirements are set forth in the Tax Compliance Certificate or Tax Certificate and Agreement (“Tax Certificate”) executed upon the issuance of the bonds, which should be consulted in addition to the procedures set forth herein.

The procedures that follow are designed to ensure consistent compliance with the tax laws over the term of each issue of Direct Pay BABs issued by the issuer that are outstanding at the time of adoption of these procedures and those that are issued after the adoption of these procedures (the bonds of each respective issue being referred to generically below as the “Bonds”). These procedures are to be applied on an issue-by-issue basis to each issue of Bonds.

Throughout the term of each issue of Bonds, the federal tax law requirements on which the following procedures are based may change. The University should regularly consult bond counsel, who can assist with amending these procedures where necessary, and tailor them to the changing laws and University’s changing needs.

Overall administration and coordination of these procedures is the responsibility of the Financial Services Office

¹ All capitalized terms used but not defined herein have the meanings provided in the Treasury Regulations issued under Code sections 54AA, 103, 141 through 150, and 6431, and as generally provided in the Tax Compliance Certificate or Tax Certificate and Agreement for the bond issue.

A. General Matters

- a. Identify the officer who will be responsible for each of the procedures listed below, notify the current holder of that office of the responsibilities, and provide that person a copy of these procedures. (For each procedure, this may be the same person identified above as having overall responsibility or another person who is assigned the particular responsibility.)
 - i. Upon employee or officer transitions, advise new personnel of responsibilities under these procedures and ensure they understand the importance of these procedures.
 - ii. If employee or officer positions are restructured or eliminated, reassign responsibilities as necessary to ensure that all procedures have been appropriately assigned.
- b. Conduct periodic reviews of compliance with these procedures and with the terms of the Tax Certificate to determine whether any violations have occurred so that such violations can be remedied through the “remedial action” regulations (Treas. Reg. 1.141-12) or the Voluntary Closing Agreement Program described in IRS Notice 2008-31 (or successor guidance).
- c. If any changes to the terms of the Bonds are contemplated, consult bond counsel. Such modifications could result in a reissuance, i.e., a deemed refunding, of the Bonds and thereby jeopardize the status of the Bonds as Direct Pay BABs.

B. Issue Price and Premium Limit

(The procedures in this Section B relate largely to pre-issuance events. These procedures are included as requirements to be confirmed and to be satisfied for future Bond issues.)

- a. Consult with bond counsel to ensure that:
 - i. Premium on *each maturity* of the Bonds (stated as a percentage of principal amount) does not exceed one-quarter of one-percent (0.25%) multiplied by the number of complete years to the earlier of final maturity of the Bond or, generally, the earliest call date of the Bond.
 - ii. The excess of the Issue Price of the Bond issue over the price at which the Bond issue is sold to the underwriter or placement agent, when combined with other Issuance Costs paid from Proceeds of the Bond issue, does not exceed 2% of the Sale Proceeds of the Bond issue.
- b. Ensure that a party other than the underwriter or placement agent (referred to herein as “underwriter”), such as a financial advisor, reviews the market trading activity of the Bonds after their Sale Date but before their Issuance Date to determine whether the market pricing of the Bonds appears consistent with the Issue Price reported by the Underwriter of the Bonds as of their Sale Date. (Market trading information is generally available through the

Municipal Securities Rulemaking Board's Electronic Municipal Market Access System (EMMA) (<http://www.emma.msrb.org>).

- iii. A record of such determination, including copies of the market trading information, should be maintained.

C. IRS Information Return Filing

- a. Ensure that Internal Revenue Service (IRS) Form 8038-B is timely filed with respect to each Bond issue, including the required debt service schedule and other required schedules and attachments. Request a date-stamped copy of the filed form from the IRS and maintain it as part of the transcript for the Bond issue.
- b. Timely file IRS Form 8038-CP with respect to each interest payment date or each quarter (in the case of certain variable rate Bond issues).
 - iv. Monitor the amount of interest payable on each interest payment date to ensure that the proper amount of direct payment is requested on each Form 8038-CP.
 - v. If the payments to be made by the federal government with respect to the Bonds will be paid to a person other than the Issuer (*e.g.*, the Bond trustee or the state or local government on whose behalf an authority issued the Bonds), obtain and record the contact information of that person, and ensure that it is properly shown on Form 8038-CP so that the direct payment will be made to the proper person.

D. Use of Proceeds

- a. Ensure there exists a clearly established accounting procedure for tracking investment and expenditures of Bond Proceeds, including Investment Proceeds.
- b. At or shortly after issuance of a Bond issue, allocate Proceeds of the Bond issue to reimbursement of prior expenditures, as appropriate.
- c. Ensure that a final allocation of Bond Proceeds (including Investment Proceeds) to qualifying expenditures is made if Bond Proceeds are to be allocated to project expenditures on a basis other than "direct tracing" (direct tracing means treating the Bond Proceeds as spent as shown in the accounting records for bond draws and project expenditures). *An allocation other than on the basis of "direct tracing" is often made to reduce the Private Business Use (see Section E, below) of Bond Proceeds that would otherwise result from "direct tracing" of Bond Proceeds to project expenditures. This allocation must be made within 18 months after the later of the date the expenditure was made or the date the project was placed in service, but not later than five years and 60 days after the Issuance Date of the Bonds or 60 days after the Bond issue is retired. Bond counsel can assist with the final allocation of Bond Proceeds to project costs.*
- d. Maintain careful records of all facilities and other costs (*e.g.*, Issuance Costs, credit enhancement and capitalized interest) and uses (*e.g.*, deposit to reserve

fund) for which Bond Proceeds were spent or used. These records should be maintained separately for each issue of Bonds.

- e. Ensure that no more than 2% of the Sale Proceeds of a Bond issue are used to pay Issuance Costs.
- f. Ensure that 100% of all Sale Proceeds and Investment Proceeds, other than Sale Proceeds used to pay Issuance Costs (up to the 2% limit described above) or deposited in a reasonably required reserve fund, are allocated to Capital Expenditures.

E. Monitoring Private Business Use

- a. Before entering into any new management, service, or research agreements described in E.viii and E.ix, engage bond counsel to review such agreements to determine whether they result in private business use.
- b. Analyze any private business use of Bond-financed facilities and, for each issue of Bonds, determine whether the 10% limit on private business use (5% in the case of “unrelated or disproportionate” private business use) is exceeded. Contact Tax Advisors if either of these limits is exceeded.
- c. Maintain copies of all of the following contracts or arrangements (or, if no written contract exists, maintain detailed records of the following contracts of arrangements) with non-governmental persons or organizations or the federal government (collectively referred to as “Private Persons”):
 - vi. Sales of Bond-financed facilities.
 - vii. Leases of Bond-financed facilities.
 - viii. Management or service contracts relating to Bond-financed facilities.
 - ix. Research contracts under which a Private Person sponsors research in Bond-financed facilities.
 - x. Any other contracts involving “special legal entitlements” (such as naming rights or exclusive provider arrangements) granted to a Private Person with respect to Bond-financed facilities.
- d. Each of the foregoing contracts or arrangements may result in Private Business Use of the Bond-financed facilities.

F. Arbitrage

- a. Note the “Yield” of the Bond issue, as shown on the Form 8038-B.
- b. Review the Tax Certificate to determine the “Temporary Periods” for the Bond issue, during which periods various categories of Gross Proceeds of the Bond issue may be invested without Yield restriction.
- c. Do not invest Proceeds of the Bond issue in investments with a Yield above the Bond Yield following the end of the applicable Temporary Period identified in F.b. unless Yield reduction payments may be made (see Tax Certificate).
- d. Monitor expenditures of Bond Proceeds, including Investment Proceeds, against Issuance Date expectations for satisfaction of three-year or five-year

Temporary Period from Yield restriction on investment of Bond Proceeds and to avoid “hedge bond” status.

- e. Ensure that investments acquired with Bond Proceeds satisfy IRS regulatory safe harbors for establishing fair market value (e.g., through the use of bidding procedures), and maintain records to demonstrate satisfaction of such safe harbors.
- f. Consult with bond counsel before engaging in credit enhancement or hedging transactions in respect of a Bond issue, and before creating separate funds that are reasonably expected to be used to pay Debt Service on the Bonds.
- g. Maintain copies of all contracts and certificates relating to credit enhancement and hedging transactions.
- h. Before beginning a capital campaign that may result in gifts that are restricted to Bond-financed projects (or, in the absence of such a campaign, upon the receipt of such restricted gifts), consult bond counsel to determine whether Replacement Proceeds may result.
- i. *Even after all Proceeds of a given Bond issue have been spent, ensure that the debt service fund meets the requirements of a “Bona Fide Debt Service Fund,” i.e., one used primarily to achieve a proper matching of revenues with Debt Service that is depleted at least once each Bond Year, except for a reasonable carryover amount not to exceed the greater of (i) the earnings on the fund for the immediately preceding Bond Year; or (ii) one-twelfth of the Debt Service on the issue for the immediately preceding Bond Year. To the extent that a debt service fund qualifies as a Bona Fide Debt Service Fund for a given Bond Year, the investment of amounts held in that fund is not subject to Yield restriction for that year.*
- j. Ensure that amounts invested in any reasonably required debt service reserve fund do not exceed the least of: (i) 10% of the stated principal amount of the Bonds (or the Sale Proceeds of the Bond issue if the Bond issue has original issue discount or original issue premium that exceeds 2% of the stated principal of the Bond issue plus, in the case of premium, reasonable underwriter’s compensation); (ii) maximum annual Debt Service on the Bond issue; or (iii) 125% of average annual Debt Service on the Bond issue.
- k. *Satisfaction of rebate requirement -- see Rebate Instructions attached to Tax Certificate. Subject to the exceptions described below, investment earnings on Bond Proceeds at a Yield in excess of the Bond Yield (i.e., positive arbitrage) generally must be rebated to the U.S. Treasury, even if a Temporary Period exception from Yield restriction allowed the earning of positive arbitrage.*
 - xi. Ensure that rebate calculations will be timely performed and payment of Rebate Amounts, if any, will be timely made; such payments are generally due 60 days after the fifth anniversary of the Issuance Date of the Bond issue, then in succeeding installments every five years; the final rebate payment for a Bond issue is due 60 days after retirement of the last Bond of the issue. Hire a rebate consultant if necessary.
 - xii. Review the rebate section of the Tax Certificate to determine whether the “small issuer” rebate exception applies to the Bond issue.

- xiii. If the 6-month, 18-month, or 24-month spending exceptions from the rebate requirement (as described in the Rebate Instructions attached to the Tax Certificate) may apply to the Bonds, ensure that the spending of Proceeds is monitored prior to semi-annual spending dates for the applicable exception.
 - xiv. *Timely make rebate and Yield reduction payments and file Form 8038-T.*
 - xv. Even after all other Proceeds of a given Bond issue have been spent, ensure compliance with rebate requirements for any debt service reserve fund and any debt service fund that is not exempt from the rebate requirement (see the rebate instructions attached to the Tax Certificate).
1. Maintain records of investments and expenditures of Proceeds, rebate exception analyses, rebate calculations, Forms 8038-T, and rebate and Yield reduction payments, and any other records relevant to compliance with the arbitrage restrictions.

G. Record Retention

For each Bond issue, maintain *all* records and documents described in these procedures while any of the Bonds of the issue are outstanding and during the three-year period following the final maturity or redemption of the Bond issue or, if later, while any bonds that refund (or re-refund) Bonds of that original issue are outstanding and for the three year period following the final maturity or redemption date of the latest refunding Bond issue.

H. Special Rules for Pool Bonds

Redeem Bonds at one-year and three-year expenditure target dates. Ensure that 95% of costs of issuance are paid within 180 days.

XIV. Other Considerations

A. Arbitrage Calculations

Arbitrage is interest earned on bond proceeds in excess of the bond yield. The University complies with the IRS arbitrage regulation, Section 148(f), on invested tax-exempt bond proceeds. Arbitrage calculations are performed monthly or annually either internally or by an outside consultants.

C. Internal Controls

The University will adhere to the following internal controls relating to debt:

1. All transactions must be initiated by authorized individuals and approved by ABOR (and reviewed by JCCR if required by statute).
2. All documents related to debt are subject to custodial controls and physical safeguards by the Financial Services Office.
3. Adequate detailed accounting records are maintained and appropriate reports are issued by the Financial Services Office.
4. All transactions are properly classified and summarized in the accounts.

C. Disclosure

Continuing Disclosure

The University will continue to meet its ongoing disclosure requirements in accordance with SEC rule 15c2-12. The University will submit financial reports, statistical data, and any notice of material events as required under outstanding bond indentures.

Material Event Disclosure

The University will collaborate with its bond counsel and financial advisor to monitor bond insurance companies who insured UA SRBs and COPs for possible downgrade of the insurer's credit ratings by the rating agencies in order to prepare and file material events disclosure with NRMSIR's.

D. Tax-Exempt Status

The University generally issues tax-exempt debt to finance the institution's capital program. Tax-exempt debt allows the University to finance capital projects at a lower cost of borrowing, however, the tax-exempt status of the debt must be maintained throughout the term of the debt. If not, the I.R.S will impose financial penalties and fines

on the University. In order to maintain the tax-exempt status, the University must monitor and comply with the following requirements:

Government Bonds

Ownership- Section 145(a)(i) of the I.R.S Code provides that all property financed by the net proceeds of tax-exempt bonds must be owned by a government entity.

Private Activity Bonds

Private Business Use Test - Not more than 10 percent of the net proceeds of the debt issue is used for any private business use.

Private Payment or Security Test - Not more than 10 percent of the payment of principal or interest on the debt issue is either made or secured directly or indirectly by payments on property used or to be used for a private business use. Private use is use (directly or indirectly) in a trade or business carried on by any person other than a government entity. The federal government is considered a private entity for this analysis. Certain private (including the federal government) research agreement activities performed in a tax-exempt financed building may qualify for exemptions under IRS safe harbors revenue procedure 97-14, 1997-1 and 2007-45.