Oregon Department of Transportation

Debt and Investments Policy and Guidelines

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Revision 3.0

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Revision History

Revision No.	Date	Revision Summary
Rev. 1.0	01/01/2017	Original Debt and Investments Policy and Guidelines
Rev. 2.0	12/27/2023	Substantial revisions to language concerning short-term debt, debt affordability model, and bond proceeds expenditure documentation. Other non-substantial revisions made.
Rev. 3.0	1/2/2026	Revisions to GARVEE bonds and other non-substantial revisions made

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Chapter 1 Purpose, Scope and Objectives

1.1 Purpose of Financing

The Debt and Investments Policy and Guidelines (the "Debt Policy" or "Guidelines") sets forth comprehensive procedures and guidelines under which the State of Oregon (the "State") Department of Transportation (the "Department" or "ODOT") plans for and manages the use of debt financing and its investments necessary to meet the Department's long-term transportation infrastructure requirements and obligations. In addition, the purpose of this Debt and Investment Policy is to assist administrators, managers and staff to identify clear debt and investment policy objectives, improve the quality of decision-making processes, provide a basis for the determination of appropriate debt capacity and structures, and to demonstrate a commitment to best debt and investment management planning, practices and execution.

This Policy shall govern the issuance and management of all bonds and other forms of indebtedness of the Department, together with any credit, liquidity or other security instruments and agreements that may be executed in connection with the issuance of bonds and other forms of indebtedness (i.e. "Bonds") including lease-purchase financings or other capital financings and availability payments associated with public-private partnership ("P3") contractual agreements.

An additional purpose of this Policy is to set forth criteria for the operation of the Department's investment activities including bond related investments. This Policy governs the investment of all funds on deposit at Oregon State Treasury, as well as all trust funds for which the Department has investment responsibility.

1.2 Goals and Objectives

This Policy is intended to guide the Department in the issuance and management of bonds and other debt obligations. The intent and goal of this Policy is to foster a prudent and pragmatic approach to indebtedness and to investments whereby:

1) Debt financings are entered into only when practical and fiscally advisable.
2) The process for identifying the timing and amount of debt or other financing is pragmatic and efficient.
3) Competitive interest and other costs can be obtained.
4) Conflicts of interest are avoided.
5) Costs and risks are appropriately disclosed.
6) Debt transactions and ongoing compliance and administration conform to applicable state and Federal law and other regulatory requirements.
7) Investment activities will be undertaken with the objective of attaining a market return but not at the expense of safety and adequate liquidity.

Some additional objectives of this Policy are to:

- Establish clear criteria and guidelines that promotes prudent financing of capital transportation infrastructure projects using debt obligations.
- Maintain appropriate resources and debt financing capacity for present and future capital needs.
- Promote cooperation and coordination with Department management and staff and other stakeholders involved in the financing, construction and ongoing maintenance and administration of capital transportation infrastructure projects.
- Define the criteria for the issuance of debt and evaluate debt issuance options.
- Identify the types of debt approved for use by the State Constitution, the Legislative Assembly and the Oregon Transportation Commission.
- Identify and comply with legal and administrative limitations related to debt issuance and management.
- Manage interest rate exposure and other risks.
- Define the appropriate uses of debt and minimize the cost of debt.
- Define the criteria for evaluating refunding candidates or alternative debt structures.
- Protect and enhance the Department's and the State's credit rating.
- Document responsibility for the oversight and management of debt related transactions.
- Comply with Federal Regulations and Generally Accepted Accounting Principles ("GAAP").
- Document all outstanding debt and associated costs proposed and actual.
- Establish criteria to determine use of general obligation bonds, revenue bonds, short-term debt, and capital leases.
- Establish criteria for the use of pay-as-you go financing versus debt financing.
- Establish the maximum life, or the criteria for establishing the maximum life of a debt transaction.
- Assess and mitigate debt portfolio risks to short and long-term operations.
- Address bond arbitrage related risks particularly those related to bond proceeds account balances.
- Provide for sound financial guidance to management and staff.

1.3 Planning and Administration

The Debt Manager shall be responsible for administering the Department's debt and investment programs, including monitoring ongoing compliance with this Policy by Department divisions that oversee and manage programs and projects financed with the proceeds of Bonds or and other debt obligations. It shall be the responsibility of the Debt Manager, at the direction of the Finance and Budget Division Administrator, to coordinate the timing, process, and sale of the Department's debt obligations. The Debt Manager shall make recommendations to the Oregon

Transportation Commission and Department divisions responsible for the management of the Department’s debt-financed capital programs and projects as necessary in order to accomplish Department’s capital financing objectives.

Responsible Divisions (defined for purposes of this Policy as any division, program or project that utilizes debt financing) are responsible for coordinating with the Debt Manager in connection with any planned or active debt financing to ensure compliance with this Policy

1.4 Periodic Review of Policy and Guidelines

At least annually, the Debt Manager shall perform a thorough review of the Debt and Investments Policy and Guidelines and its provisions. Minor changes of a housekeeping nature may be made as required. Any significant changes to the Policy and Guidelines will be reviewed by the Department’s Financing Team, the responsible Department administrators, managers and staff as appropriate, and approved by the Finance and Budget Division Administrator.

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Chapter 2 Conditions for Debt issuance

2.1 Purpose of Debt Financing

The Department issues debt primarily to finance long-term capital transportation infrastructure projects, equipment and related capital expenditures and to refinance existing debt. Debt will be issued pursuant to the authority of and in full compliance with the provisions, restrictions and limitations of the Oregon Constitution and laws of the State of Oregon ('State") including Article XI, Section 7 and various debt authorizations enacted by the Oregon Legislative Assembly and the approving resolutions of the Oregon Transportation Commission.

As provided in Article XI, Section 7 of the State Constitution and Oregon Revised Statute ("ORS") Chapter 367, authorized purposes for which the Department may issue debt include:

- Building and maintaining permanent roads, including the costs of location, relocation, improvement, construction and reconstruction of state highways and bridges.
- Financing the cost of state highways, county road and city street projects throughout the state.
- Financing the costs of transportation infrastructure preservation and modernization projects.
- Financing infrastructure grants and loans to state agencies, cities, counties, metropolitan governments, incorporated towns, cities, special districts of the state, or government agencies or instrumentalities of any of them.
- Financing transportation projects or undertakings that facilitate any mode of transportation within the state, including but not limited to, projects for highway, transit, rail and aviation capital infrastructure, bicycle and pedestrian paths, bridges, ways and thoroughfares, and other projects that facilitate the transportation of materials, animals or people.
- Providing financial assistance to cities, counties, and various other public and private entities for transportation projects, including but not limited to, use of moneys to finance loans, leases, fund reserves, make grants, pay issuance costs or provide credit enhancement, loan guarantees, extensions of credit or other security for bonds issued by a public or private entity to finance transportation projects.
- Issuance of bond anticipation notes for the payment of costs of projects in anticipation of the issuance of a future, authorized debt offering.
- Issuance of bonds to refinance outstanding debt.

In general, long-term debt may not be used to pay for working capital or other short-term, non-capital operational costs. Short-term debt may only be issued to finance working capital if it is determined to be in the best interests of the Department to meet unanticipated expenses or fluctuations in revenues.

2.2 Financing Priorities and Responsibilities

The Debt Manager, working with responsible Department divisions ("Responsible Divisions"), including Highway Division, Transportation Development Division, Facilities Services, the Office of Innovative Partnerships and Alternative Funding, Budget Services, and Government Relations, oversees and coordinates the timing, processing, and marketing of the Department's borrowing and capital funding activities. Close coordination of capital planning and debt planning will ensure that the maximum benefit is achieved with the limited capital funds available. The debt management process will determine the availability of funds that can be raised through debt financing based upon available debt capacity and affordability analysis.

All borrowing requests or debt refunding proposals shall be reviewed by the Finance and Budget Division Administrator and the Debt Manager. The Debt Manager shall be responsible for analyzing debt financing proposals to determine if it is beneficial to the Department and complies with legal authorizations and the Department's long-term financial planning objectives. Borrowing requests include any debt or refunding proposals involving a pledge or other extension of the Department's credit through the sale of securities, execution of loans or leases, or making of guarantees, P3 availability payments, or other instruments involving the direct or indirect lending or pledging of the Department's credit.

2.2.1 Nature of Project and Identification of Funding Sources

Debt-financed program and project sponsors (i.e. "Responsible Divisions) will work with the Finance and Budget Division Administrator and the Debt Manager to assess the feasibility and the impact for all debt financing proposals related to capital improvement projects, facilities construction, renovation, capital leasing, and equipment and vehicle purchase or leasing.

Responsible Divisions that sponsor or manage debt-financed programs or projects will provide to the Finance and Budget Division Administrator and the Debt Manager detailed descriptions of all projects to be financed using bond proceeds or other debt obligations. The description should specify how the project furthers the Department's transportation policy objectives as laid out in the Department's budget, the Statewide Transportation Improvement Program ("STIP") or other applicable policies and plans.

The costs and benefits of proposed projects must be defined and where appropriate quantified in monetary terms. Project funding sources, both bond proceeds and other available funds, are to be identified and estimated.

2.2.2 Expenditure Plan

The Responsible Division will provide to the Finance and Budget Division Administrator and the Debt Manager a detailed plan for the expenditure of funds for each debt-financed program and project. The expenditure plan will specifically address the estimated draw down of bond proceeds used to finance the programs and projects.

2.2.3 Revenue for Debt Service Payment

A detailed plan for the debt repayment will be developed for each program or project funded with bond proceeds. The underlying assumptions of revenue cash flow estimates will be documented, and any risks associated with these revenue streams will be analyzed.

2.2.4 Refinancing/Refunding Existing Debt

The Debt Manager will periodically evaluate the Department's existing debt portfolio and coordinate the planning and execution of a refinancing with the State Treasurer when deemed economically beneficial. A refinancing may include the issuance of new bonds to refund existing bonds or other obligations. See Chapter 9 – *Debt Refinancing or Refunding* for additional debt refunding information and considerations.

2.3 Long-Term Debt

Long-term debt is variously defined as any loan or debt obligation with a maturity of five to ten years or more. Long-term debt obligations may be issued by the Department to finance the acquisition or construction of long-lived capital projects and improvements, land acquisition, facilities, essential equipment and vehicles.

The proceeds of long-term debt obligations will not be used to pay for working capital costs, normal maintenance or routine day-to-day operating purposes. In no case may the maturity of long-term debt obligations exceed the average useful life of the project, facilities or assets being financed. Long-term debt is generally issued with a term of not more than 20-30 years and an overall structure that approximates level debt service. Bond call provisions for long-term debt obligations should be as short as reasonably possible, consistent with obtaining the lowest interest cost to the Department. When feasible, all bonds should be callable at par.

The cost for taxable long-term debt is usually higher than for tax-exempt governmental purpose obligations. Consequently, taxable bonds should be issued only when they will economically benefit the Department. In certain circumstances the issuance of taxable debt is required if there is an expectation that the proceeds will be used for private, non-governmental purposes (i.e. "Private Business Use"). In other situations, the use of taxable debt may allow advantageous flexibility in subsequent contracts with users or managers of the improvements constructed with the bond proceeds. Therefore, the Department will in most situations issue tax-exempt obligations, but occasionally may issue taxable debt if the situation warrants.

The principal types of debt instruments that may be used by the Department to finance long-term capital projects are general obligation ("GO") bonds, revenue bonds, appropriation credits or certificates of participation ("COPs") and capital leases. Such instruments may be refunded by the issuance of refunding obligations for economic savings or restructuring considerations.

2.4 Short-Term and Medium-Term Debt

By convention, short-term debt is commonly defined as a debt obligation with a stated maturity of thirteen (13) months or less. Medium-term debt falls between the two boundaries of short-term debt and long-term debt. Whereas, GO bonds and revenue bonds are usually classified as long-term debt, short-term and medium-term debt instruments are as a rule referred to as notes or warrants. The Department may use short-term and medium-term debt obligations to provide interim financing for capital projects or portions of capital projects that will ultimately be refunded with the proceeds of long-term obligations. Both short-term and medium-term obligations may be backed with a GO or revenue pledge, or a pledge of other available resources as applicable.

The principal types of short-term and medium-term debt instruments that may be employed by the Department include, among others, bond anticipation notes ("BANs"), commercial paper ("CP"), lines and letters of credit, and direct bank loans. Such instruments may be refinanced by the issuance of refunding obligations for economic savings and/or restructuring considerations.

2.5 Tax-Exempt Versus Taxable Debt

Best efforts will be made to maximize the use of tax-exempt financing based on the assumptions that tax-exempt interest rates are generally lower than taxable rates and that the interest savings outweigh the administrative costs and restrictions on the allowable use of projects that are financed with tax-exempt debt.

Taxable debt will be used when necessary to finance projects that are not eligible to be financed with tax-exempt debt. However, the Department will finance taxable projects within the permitted limits and constraints of tax-exempt financings whenever possible.

2.6 Asset Life and Bond Structure Limits

The useful life of an asset financed with debt will be determined to ensure that the life of the asset is equal or greater than the last maturity of a proposed debt issue. For short-term and medium-term financing, the physical asset should have a useful life of at least three or more years. For long-term financing, the physical asset should have a useful life of five to ten years or longer. Generally, the final maturity of debt obligation will not exceed the useful life or average useful lives of the financed projects or assets.

2.7 Maintenance, Replacement and Renewal

Consistent with the philosophy of maintaining capital facilities and infrastructure in good repair and to maximize the useful life of capital facilities and assets, the Department will strive to set aside sufficient current revenues to finance ongoing maintenance needs and to provide reserves for periodic renewal and replacement.

2.8 Investments

The Debt Manager, in consultation with the Finance and Budget Division Administrator, shall be responsible for managing the Department's investments including the investment of unspent tax-exempt and taxable bond proceeds in accordance with state and Federal legal requirements and regulations, this Debt and Investments Policy including the requirements and provisions set forth in Chapter 11 – *Investment Policy*.

2.9 Investor Relations and Communications

The Debt Manager shall be the Department's designated point of contact for questions from current or prospective bondholders, bond rating agencies and credit analysts regarding Department's bond programs, bond disclosure and this Policy.

2.10 Approval Process and Issuer Responsibilities

Debt obligations whether issued publicly or privately must comply with both Oregon law and Federal securities law. The Oregon Constitution and applicable State law provide the authority and govern the types and purposes for which debt may be issued by State agencies.

2.10.1 Legislative Bonding Authorizations and Limitations

Oregon has historically operated under a biennial debt review and authorization process. Under this model, in addition to specific constitutional and statutory debt authorizations and limitations, each individual bonding program receives specific biennial legislative bonding authorization. The biennial bonding authorization is commonly referred to as the "Bond Bill." The State Constitution was amended in 2010 changing the schedule of regular legislative sessions from bi-annual to annual. This change provides flexibility, in certain circumstances, for the Legislative Assembly to enact amendments to the Bond Bill mid-biennium.

Prior to each biennium, agencies submit bonding requirements to the Department of Administrative Services ("DAS") for inclusion in the Governor's budget. The Governor's budget, in conjunction with advice from the Office of the State Treasurer, detail program amounts recommended for bonding authority during the upcoming biennium. The budget recommendation takes into account agency requests for capital project requirements and grant and loan needs. The Legislative Assembly conducts a program-by-program review process and approves what it determines to be an appropriate level of issuance with subsequent enactment of the biennial Bond Bill.

2.10.2 Oregon State Treasury

The Oregon State Treasurer ("OST"), as issuer of all State of Oregon bonds, is charged with the responsibility to centrally oversee the issuance and management of all agency long-term debt programs. The State Treasurer's Debt Management Division ("OST-DMD") is assigned day-to-day responsibility for the coordinated issuance of all State debt obligations including those of the Department. OST-DMD is responsible for, among other things, reviewing bond structure and security features, coordinating the timing and administration of agency bond sales, securing credit ratings, engaging investment banking and bond underwriting services, preparing or causing to be prepared bond documents and transcripts and other documents and coordinating Security and Exchange Commission ("SEC") and Municipal Securities Regulatory Board ("MSRB") disclosure issues.

2.10.3 Oregon Transportation Commission

The Oregon Transportation Commission (the "OTC" or "Commission") is a five-member, voluntary citizen's board appointed by the Governor, with the consent of the Oregon State Senate. The Commission is empowered to develop and maintain State transportation policy and coordinate and administer transportation related programs. This includes the responsibility to approve all major policy decisions related to ODOT financings. The key components of the Commission's financing decisions and debt authorizations are incorporated in its approving resolutions.

2.10.4 Department Director

To assist in carrying out the Department's administrative and operational functions and to support actions taken by the Commission, the Commission delegates to the Director certain of its responsibilities including those related to program administration, finance and debt issuance. The Director further delegates administrative and operational authorities to appropriate administrators and managers within the Department.

2.10.5 Financial Services Branch

The Finance and Budget Division Administrator under the supervision of the Department's Deputy Director, manages the Department's Financial Services Branch ("FSB") and is tasked with the responsibility to oversee and coordinate the broad financial activities of the Department, including, among others, accounting, financial reporting and compliance, investments and debt issuance and ongoing debt management and administration. FSB is responsible for maintaining the Department's books and accounts which are subject to audit or review by the Secretary of State's Audits Division.

2.10.5.1 Financial Reporting

FSB prepares and publishes the Department's Annual Financial Report ("AFR"), in compliance with various continuing disclosure covenants and agreements. The AFR is a non-audited annual financial report based on generally accepted accounting principles prescribed by the Governmental Accounting Standards Board ("GASB"). The financial data summarized in the AFR comes from the Department's detailed financial data and is submitted to DAS's Statewide Accounting and Reporting Services section for incorporation into the State's Annual Comprehensive Financial Report ("ACFR").

2.10.5.2 Debt and Investment Management

The primary responsibility for developing financing, debt issuance and investment recommendations and ongoing debt management and administration rests with the Department's Finance and Budget Division Administrator, or their designee. In developing debt financing and investment recommendations, the staff will consider, among other things:

- State and Federal law and authorizations.
- Risk, liquidity and cash flow requirements.
- Debt affordability, costs and benefits.
- Available options including long-term, interim and short-term financings and interfund borrowing.
- Bond sale timing, expected proceeds spenddown and the related carrying costs.
- Federal and state bond proceeds expenditure reimbursement regulations.
- Marketplace and interest rate trends.
- Developments relating to public finance instruments and products, and
- Other factors as appropriate and relevant.

In advance of any legislatively authorized bond sale, staff will prepare a resolution of intent to issue bonds for consideration by the Commission authorizing Department staff to proceed with bond sale preparations. Additionally, staff will work with the State Treasurer to negotiate, execute and deliver any and all documents or agreements required in connection with the Department's debt financings. Resolutions may be prepared individually for each bond sale, or aggregate (for each credit structure) at the beginning of each biennium, following legislatively authorized bond authority.

2.10.6 Debt Manager

The Debt Manager, is responsible for the day-to-day management of the Department's debt, investment and capital finance activities. This, among other things, includes:

- Ensuring that the Department's financing needs are met through cost-effective borrowing (short and long-term).
- Working with Department divisions and State Treasurer's Office to maximize investment earnings on all departmental funds.
- Complying with the various laws and regulations governing issuers of municipal debt.
- Identifying and developing new financing methods that can be effectively employed by the Department.
- Maintaining contacts with the various participants in the public finance marketplace.
- Working cooperatively with other state and local agencies to enhance the financing of transportation infrastructure in the state.
- Periodically evaluating the Department's existing debt portfolio and coordinating the execution of refinancings when deemed economically beneficial.

2.10.7 Budget Office.

The Budget Office is responsible for coordinating the Department's legislative budget development process including all requests related to capital budgeting, bonding authorizations and debt service requirements. The Budget Office staff prepare the Department's budget request and bonding requirements for submission to DAS and inclusion in the Governor's budget request to the Legislative Assembly.

2.10.8 Government Relations

The Government Relations unit is responsible for coordinating the Department's participation in the legislative process. In consultation with appropriate Departmental staff, Government Relations works directly with the Governor's Office, DAS, the Oregon Department of Justice, and Legislative Assembly staff in the review, analysis and drafting of legislative bills and amendments, including those relating to the Department's capital finance and debt issuance programs.

2.10.9 Policy, Data, & Analysis Division

The Policy, Data, & Analysis Division ("PDAD") provides policy analysis, strategic planning, research and program development services for the Department, including implementation of the

Oregon Transportation Plan and the Oregon Highway Plan, the Oregon Freight Plan and planning support for other modal plans. The Active Transportation section, which resides within PDAD, is responsible for strategically integrating the Department's overall program funding sources to promote multimodal and sustainable transportation solutions.

2.10.9.1 Economic and Financial Analysis Unit

The Economic and Financial Analysis Unit provides Highway Fund revenue forecasts, feasibility studies, cash flow forecasting, revenue impact analysis, and DMV transaction forecasting. In addition, the unit provides economic, financial and policy studies. These include Highway cost allocation studies, comparisons of state automobile taxes, motor carrier fee and tax comparisons, transportation finance studies, benefit-cost analysis, estimates of value of travel time and cost of delay, and estimates of job and income generation from construction projects.

The Economic and Financial Analysis Unit prepares and publishes the Department's semiannual *Revenue Forecasts*, dated June and December, to assist budget and financial planners and policy-makers in formulating budgets and other decision-making activities. The *Revenue Forecast* is comprised of three independent modules – motor fuels, motor carrier, and drivers/vehicles – which roughly correspond to each of the three revenue categories that make up the revenues pledged to the repayment of the Department's Highway User Tax Revenue Bonds.

2.10.10 Oregon Department of Justice

Attorney's assigned to the Oregon Department of Justice ("DOJ") General Counsel Division's Tax and Finance unit serve as the State's legal or issuer's counsel ("Issuer's Counsel") regarding all matters related to debt borrowing and investment activities. DOJ finance attorneys assist the Department in negotiating loans, grants or other financial transactions and drafting the documents for those transactions. As Issuer's Counsel, DOJ attorneys are an integral member of the bond financing team and are involved in the entire bond issuance process including the review and approval of legal and disclosure documents.

2.10.11 Department of Administrative Services

The Department of Administrative Services is the administrative arm of the Governor's Office. DAS prepares and coordinates State agency budget requests, including those of the Department, for incorporation into the biennial budget submitted by the Governor to the Legislative Assembly. DAS also provides administrative support services to State agencies and prepares the State's Annual Comprehensive Financial Report (i.e. "ACFR") each fiscal year. The Capital Finance and Planning section has direct responsibility for managing several independent financing programs, coordinating statewide budgeting for bonds and capital construction, and coordinating statewide facilities planning.

DAS is additionally delegated the responsibility and authority to issue Article XI-Q GO bonds, COPs and other financing agreements and forms of indebtedness, as authorized by the Legislative Assembly, on behalf of State agencies and with the approval of the State Treasurer. Article XI-Q bonds have in the most part replaced COPs as the primary source for financing state facilities and capital equipment. DAS is also responsible for the issuance and administration of the State's Lottery Revenue Bond program including the distribution of funds to State agencies for grants and loans and for the payment of outstanding Lottery Revenue Bond debt service from available unobligated net Lottery proceeds.

2.10.12 Secretary of State

The Secretary of State ("SOS") Audits Division, the constitutional auditor of public accounts in Oregon, audits the State's financial statements, as part of a broader, federally mandated "Single Audit" designed to meet the needs of Federal agencies that provide aid to the State. The goal of the independent audit by Audits Division is to provide reasonable assurance that the financial statements provided in the State ACFR are free of material misstatement. The financial data in the Department's Annual Financial Report (i.e. "AFR") is provided to DAS for incorporation in the State ACFR.

In connection with and prior to each bond sale the SOS's Audits Division is requested by the State Treasurer to provide an "accountant's letter" or "agreed-upon-procedures letter" in accordance with the requirements specified in the bond purchase agreement ("BPA"). The general purpose of the accountant's letter is to, among other things: (i) make inquiries regarding the Department's financial affairs, (ii) provide assurance that there is no pending litigation against the Department that might negatively impact the ability of the Department to meet its debt service obligations, and (iii) that there are no material changes that negatively affect the financial condition and affairs of the Department.

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Chapter 3 Financing Team and Consultants

Debt financings are complex undertakings requiring the services of qualified financial and legal professionals. A key part of issuing and administering debt obligations involves assembling an experienced financing team. The finance professionals that assist the Department and the State to develop its financing plans and offering documents typically include bond counsel, financial advisors, underwriters and other consultants and advisors. The finance team also assists the Department to prepare rating agency and investor presentations, market the bond offering to investors, price the bonds, close the transaction and assist with required ongoing bond compliance and administration.

3.1 Selection Process

The Debt Manager, working with the State Treasurer's staff and DOJ, shall be responsible for establishing a solicitation and selection process for securing professional services that are required to develop and implement the Department's debt financing and administration programs.

Goals of the solicitation and selection process shall include encouraging participation from qualified service providers, both local and national, including the participation of Disadvantaged Business Enterprises ("DBEs") and Minority, Women, and Other Emerging Small Business Enterprises ("MWESBs"), and securing such services at competitive prices. The solicitation and selection process for such bond related services will comply with State law, the provisions of ORS 286A.130 and ORS 279A.025 and the Department's procurement policies.

The selection of financial advisors, bond counsel and underwriters will generally be through a Request for Proposals ("RFP") or Request for Qualifications ("RFQ") process, whichever is most appropriate given the circumstances. In special instances, contracts for some bond related services may be awarded on a sole source basis if it is clear that an RFP/RFQ process would not be feasible or in the State's best interest. In all cases, as provided in ORS 286A.130 and 279A.025, bond-related services contracts will not be entered into unless the State Treasurer and DOJ have reviewed and approved the terms and conditions of the agreement.

3.2 Compensation

Compensation for bond counsel, disclosure counsel, financial advisors, and other consultants should be fair, reasonable and justifiable, given desired qualification levels, and consistent with industry standards.

The Department may encumber and advance the fees associated with legal and financial advisory services for later reimbursement from bond proceeds, or may enter into contracts on a contingent basis. Compensation for the other service providers involved in a bond transaction is typically included in the cost of issuance ("COI"), and paid from the bond proceeds. Ongoing bond related fees for fiscal agents, paying agents, arbitrage consultants, and other legal and financial advisory costs directly related to the Department's bond programs are generally included in the Financial Services Branch's budget under bond administration costs.

Eligible Department and other State agency staff costs related to the issuance and administration of the Department's bonds may be reimbursed from bond proceeds or by the Department as bond administration or other expenses as appropriate. Ongoing State Agency bond administration costs may include debt administration fees, bond account maintenance fees and investment management fees charged by the State Treasurer, DAS debt administration fees, DOJ legal services fees, and Secretary of State Audits Division fees.

3.3 Financing Team and Outside Consultants

Contracts for financial advisors, bond and disclosure counsel, and most other consultants and advisors will be awarded on a competitive basis and in compliance with State law, the provisions of ORS 286A.130 and ORS 279A.025, and the Department's procurement policies. The underwriting syndicate on negotiated transactions is managed by the State Treasurer's office in collaboration with the Department. Other professionals may be selected, on an as needed basis. These may include, among others, the services of credit rating agencies, escrow agents, bond insurance providers, credit and liquidity banks, verification agents and arbitrage rebate and compliance consultants. See Appendix C – *Debt Compliance Responsibilities*.

3.3.1 Issuer's Counsel

Assistant Attorneys General ("AAG") assigned to the Oregon Department of Justice General Counsel Division's Tax and Finance section represent the State as its legal or "Issuer's Counsel" for all bond transactions. DOJ attorneys are especially knowledgeable of matters about the State and the Department that are of specific concern to investors and to regulators. DOJ attorneys have a very important role with respect to the conformance of procedures and documents to the needs and requirements of the State. They possess an in-depth understanding of state law and the governmental powers of the State including the legality and validity to enter into financings, and the enforceability or legal sufficiency of financing documents to which the State and the Department are parties. The DOJ finance attorneys assist the Department in the preparation of contracts, development of RFPs/RFQs, negotiating loans, grants or other financial transactions and drafting the documents for those transactions. They also have an in-depth understanding of matters related to pension liabilities, other post-employment benefits ("OPEB") liabilities, and any pending litigation that could have an adverse material effect on the financial condition of the Department.

Issuer's Counsel will be involved in the entire bond issuance process including the review of bond documents and the selection of bond counsel and will be engaged by the Department in the legal sufficiency review and approval of all bond related contracts and agreements. In addition, DOJ attorneys will be engaged to review and comment on all legislation that affects the Department's bond programs and the revenues pledged or otherwise available to the repayment of the Department's debt obligations.

3.3.2 Bond Counsel

The Department's bond counsel is an essential member of the financing team. One of the primary functions of the attorney or principal partner serving as bond counsel to the Department concerns the rendering of a legal or bond opinion as to the validity of the bonds under applicable laws, the Federal and state tax treatment of the interest on the bonds, and other matters. Bond counsel is involved and responsible for other bond issuance related functions including the drafting of bond documents and structuring and closing the financing. Bond counsel may help draft state legislation or state constitutional amendments authorizing the issuance of the bonds or participated in judicial bond validation proceedings with respect to the bonds. Some of the responsibilities and actions required of bond counsel include:

- Supervision of the bond proceedings.
- Drafting resolutions authorizing the issuance of the debt obligations.
- Preparation of bond documents.
- Assistance structuring or evaluating the structure of a bond issuance to ensure compliance with applicable law.
- Closing of the transaction.
- Preparation of the bond sale transcripts.
- Performance of other services as defined by contract and approved by the Department.

Except in special circumstances, the Department's bond counsel will be selected based on merit using a competitive RFP or RFQ process. The Debt Manager is responsible for coordinating the selection process in consultation with the Finance and Budget Division Administrator, the State Treasurer's office and DOJ. The Debt Manager in most cases will be the designated contract administer of any subsequent bond counsel contract. As provided in ORS 286A.130 and 279A.025, review and approval by both the State Treasurer and DOJ of the terms and conditions of the bond counsel contract is required.

3.3.2.1 Bond Counsel Review of Legislation

An additional and important function of the Department's bond counsel is their role in the review of any proposed or enacted legislation that may affect the Department's existing debt obligations or issuance of additional debt obligations. This includes the review of legislation that in any way may affect the revenues directly pledged to the repayment of the Department's debt obligations or are otherwise legally available to the Department. Enacted legislation that adversely affects the Department's ability to repay its debt obligations or is in violation of existing bond covenants can have significant and serious implications and a detrimental impact on the Department's ability to access the public finance markets. The Government Relations unit will ensure that the Debt Manager is included in the review of all proposed legislation that may affect the Department's existing debt obligations, additional debt obligations or bond programs and the revenues that are pledged or available to the Department for debt repayment. The Debt Manager will in turn consult with bond counsel and DOJ regarding any proposed or newly enacted legislation that may affect the Department's existing or future debt financing programs.

3.3.3 Disclosure Counsel

Disclosure counsel is the attorney or law firm retained to provide advice on an issuer's bond disclosure obligations. Some of the duties of disclosure counsel may include the preparation of the disclosure document (i.e. the official statement), conducting due diligence investigations associated with the disclosure document and the preparation and delivery of a due diligence or "10b-5 Opinion" which addresses the accuracy and truthfulness of the issuer's official statement. Other responsibilities may involve the preparation of the continuing disclosure undertaking and advising the issuer regarding its post-issuance disclosure responsibilities.

The same firm hired as bond counsel in many cases additionally functions as disclosure counsel, however, separate public finance law firms providing such services is also common. The Debt Manager, in consultation with the Finance and Budget Division Administrator, the State Treasurer's office and DOJ, is responsible for coordinating the hiring of disclosure counsel, whether separate or combined with bond counsel, using an RFP/RFQ selection process and in accordance with ORS 286A.130 and 279A.025.

3.3.4 Underwriter's Counsel

Underwriter's counsel is the attorney or law firm retained to represent the interests of the underwriter in connection with the purchase of new issue municipal securities. Typical duties of underwriter's counsel may include:

- Review of the issuer's bond resolution and documentation.
- Preparation of the agreement among underwriters ("AAU").
- Drafting the bond purchase contract and in some cases the official statement or other disclosure documents.
- Preparation of the blue-sky memorandum or "legal investment survey."
- Providing general assistance to the underwriter in meeting their due diligence obligations
- Rendering legal opinions addressing certain transaction matters upon which the underwriters may rely.

The selection of underwriter's counsel is the responsibility of the underwriter. Nonetheless, the Department and the State Treasurer (i.e. the "State") do have a legitimate role to ensure that the underwriter's counsel is competent, has no conflicts of interest, and the costs of their services are reasonable. Designation or undue influence by the State regarding the selection of underwriter's counsel could call into question their qualifications or independence and create a risk to the State and to the underwriter because of the increased potential of inadequate disclosure related to the issuance of the Department's bonds. Selection of the underwriter's counsel based on the recommendation of the Department or its agent (e.g. the Department's financial advisor) or from a limited pool of underwriter counsel firms may require disclosure of those facts in the preliminary and final official statement for the transaction. Except in its legitimate role as issuer, the Department's policy is to not recommend, select, designate or unduly influence the underwriter's choice of counsel.

3.3.5 Financial or Municipal Advisor

The financial or municipal advisor is the person or firm that provides "municipal advisory activities." The Securities and Exchange Commission ("SEC") defines "Municipal Advisory Activities" as advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues." The person or firm that provides Municipal Advisory Activities must be registered as a "Municipal Advisor" and is subject to rules promulgated by the Municipal Securities Rulemaking Board ("MSRB"). The Municipal Advisor for a particular transaction has a fiduciary duty to their municipal entity client (e.g. the Department) and may not underwrite securities for that transaction.

The role of a financial advisor to the Department may vary depending on the circumstances and the type of transaction. For a competitive sale, the financial advisor will have a more active role throughout the debt issuance process. The financial advisor will assist the Department to determine the structure and timing of the issue, prepare certain bond documents and the rating agency presentation, evaluate and select best offers, and facilitate the transaction in close coordination with bond counsel and other financing participants. For negotiated sales, the financial advisor's role is to ensure that the Department's goals and interests are represented and protected especially regarding the structuring of the transaction and determining the borrowing rates and yields.

The Department will select and retain a financial advisor for its various bond programs based on merit using a competitive RFP or RFQ process. The Debt Manager is responsible for coordinating the selection process in consultation with the Finance and Budget Division Administrator, the State Treasurer's office and DOJ. In most cases, the Debt Manager will be the designated contract administrator of any subsequent financial advisor contract. As provided in ORS 286A.130 and 279A.025, both State Treasurer and DOJ review and approval of the terms and conditions of the financial advisor contract is required.

3.3.5.1 Municipal Advisor Annual Compliance Certification

On an annual basis, the chief executive officer or equivalent officer at each municipal advisor firm must certify that it has in place processes to establish, maintain, review, test and modify written compliance policies and supervisory procedures reasonably designed to achieve compliance with applicable rules.[1]

Each January, all municipal advisor firms registered with the MSRB are required to affirm or correct their registration information on MSRB Form A-12. The registration status and professional qualifications of municipal advisory firms and a list of associated qualified municipal advisors is available on the MSRB's website at "www.msrb.org/MARegistrants.aspx."

3.3.6 Underwriter, Private Placement Agent and Purchaser

Underwriters or investment bankers are securities firms and commercial banks that purchase a new issue of municipal securities from an issuer with the intention to resell the securities to investors at a profit. The underwriter is awarded the securities through a competitive bidding process or through negotiation directly with the issuer. The underwriter's functions and responsibilities will vary significantly depending on whether the securities are competitively sold or sold through a negotiated process. In a competitive sale, the issuer is responsible, with the assistance of its financial advisor, for the planning and design of the bond offering. Competitively sold bonds use an auction-like process whereby competing underwriters make bids for the issuer's bonds. In a negotiated sale, the underwriter or the underwriting syndicate is selected by the issuer and the municipal securities are sold directly to the underwriters.

Private placement agents are municipal securities dealers, generally banks or securities firms, that act for the issuer in the arrangement or placing a new issue security directly to a private

[1] MSRB Rule G-44 Supervisory and Compliance Obligations of Municipal Advisors.

placement purchaser. They differ from underwriters in that a private placement agent does not actually purchase the bonds from the issuer; rather they arrange the bond sale to a third party for a fee.

The Oregon State Treasurer as issuer of all State of Oregon bonds, including those of the Department, is responsible for determining the method of sale (i.e. competitive, negotiated, private placement). For negotiated sales, the State Treasurer will, in most circumstances, select the senior managing underwriters and co-managers using a competitive RFP/RFQ process. Private placement agents may be selected through a competitive RFP/RFG process or by direct negotiation with a single bank or commercial lender as the situation warrants.

3.3.7 Commercial Banks

The Department may engage commercial banks to provide credit enhancements, lines of credit, letters of credit, direct loans and direct placements as needed. Selection of such providers will be based on the proposed financial terms deemed most advantageous to the Department, including, but not limited to, lowest cost. As with all debt related financings, the participation of and the approval by the State Treasurer is required for the selection and awarding of all contracts and engagements with commercial banks.

3.3.8 Bank Counsel

Investment and commercial banks often have an important role in the successful structuring of public finance transactions. They serve as direct purchasers of municipal bonds and as providers of credit enhancement facilities such as letters of credit or liquidity facilities that secure bond issues. The role of a bank counsel is to assist and advise banks and other credit providers in all aspects of a transaction, from negotiating the underlying credit terms and coordinating the operation of the credit facility to preparing and reviewing financing documents, security instruments, certificates and opinions necessary to close a transaction.

The selection of bank counsel rests with the bank involved in the transaction. Similar to underwriter's counsel, the Department does not recommend or unduly influence the selection of a bank's counsel except in its legitimate role as issuer to ensure that the individual or firm selected by the bank is competent, has no conflicts of interest, and the costs of their services are reasonable.

3.3.9 Credit Rating Agencies

Credit rating agencies such as Moody's Investors Service, Inc., Standard & Poor's Corporation and Fitch Ratings Inc. appraise, analyze, and monitor the credit quality of a bond issuer. These firms provide credit ratings for use by retail and intuitional investors to gauge the credit risks inherent in the bond issue. The fee for the rating service is paid by the issuer and is based on the issue size, type, and complexity. Credit rating agency fees are most commonly associated with bond issuance transactions with the fees included as a bond cost of issuance. Credit rating agencies may also charge ongoing or "*surveillance*" fees particularly for variable rate bonds.

The importance of a bond or credit rating is dependent on a variety of conditions and may not always be a necessity for specific types of debt obligations; for example, directly or privately placed debt transactions.

The State Treasurer as issuer of all State agency debt obligations is generally the principal point of contact with credit rating agencies. However, the Department and its financial advisor also have important roles and responsibilities to communicate with rating agency analysts and to disclose operating and financial information necessary to the analysis and determination of proper and appropriate credit ratings for the Department's debt obligations.

3.3.10 Fiscal Agent, Paying Agent, Registrar and Trustee

The fiscal agent, paying agent, registrar and trustee facilitate transactions with investors (i.e. bondholders). The fiscal agent or paying agent is usually a commercial bank or trust company appointed to act as the issuer's agent to pay to bondholders the periodic principal and interest payments when due throughout the life of the bonds. The registrar is the entity responsible for registering the bonds upon sale, re-registering the securities as they are traded on the secondary market and to otherwise maintain records on behalf of the issuer that identify the owners of the registered bond issue.

A trustee is a financial institution with trust powers, designated by the issuer that acts, pursuant to a bond contract, in a fiduciary capacity "*for the benefit of the bondholders*" in enforcing the terms of the bond contract. In many cases, the bank or trust company appointed by the issuer will fulfill a number of functions including responsibilities as trustee, fiscal agent, paying agent, registrar, bond transfer agent and other associated bond administrative duties as assigned.

The Oregon State Treasurer's Finance Division provides cash management and banking services for state agencies. The Treasurer's office currently contracts with The Bank of New York Mellon ("BNYM") to provide fiscal agent services associated with State of Oregon general obligation bonds, revenue bonds, certificates of participation or other borrowing programs of State agencies, including those of the Department. Under the contract, BNYM, as the State's fiscal agent, provides the following services in connection with the Department's bond programs: (i) fiscal agent, (ii) paying agent, (iii) registrar, (iv) transfer agent, (v) exchange agent and (vi) tender agent. The State's fiscal agent additionally provides other services including those associated with the mandatory and optional bond calls or redemptions and Federal subsidy calculation agent services for eligible Build America Bonds.

While the State Treasurer has the responsibility to manage the fiscal agent contract for all State of Oregon general obligation bonds, state agencies do have the discretion to contract fiscal agent, paying agent and trustee services separately for agency revenue bond programs. The Department currently utilizes the State Treasurer's contract with BNYM for both its GO and revenue bond programs but may in the future choose to contract with an alternative provider for its revenue bond programs.

3.3.11 Credit Enhancement Provider

In the context of public finance, credit enhancement providers are banks, firms or government agencies that provide various credit enhancement services such as letters of credit, lines of credit, liquidity facilities and standby purchase agreements, bond insurance and guarantees.

3.3.12 Broker-Dealers, Remarketing Agents and Tender Agents

Broker-dealers or remarketing agents are responsible for reselling to investors securities such as variable rate demand ("VRD") obligations and other tender option bonds that are tendered for purchase by their owner. The remarketing agent typically is responsible for resetting the interest rate for a variable rate issue and may act as tender agent. The tender agent is the entity to whom bondholders "tender" or surrender their bonds upon a mandatory or optional tender option.

For VRD obligations, broker/dealers or remarketing agents may be selected through an RFP/RFQ process or by direct appointment with the approval of the State Treasurer. For each transaction, the Debt Manager will monitor and evaluate broker-dealer/remarketing agent performance and may replace any broker-dealer or remarketing agent at any time.

3.3.13 Investors and Bondholders

Investors or bondholders are the owners or holders of an issuer's debt obligations to whom the issuer is obliged to pay the principal and interest at maturity, in accordance with the terms of the bond. In general, holders of the Department's bonds include individual retail investors, high net worth investors, and institutional investors such as insurance companies, bond funds, trust accounts, money managers and investment advisors.

There are times, especially when the Department is in the process of issuing bonds, that investors, both retail and institutional, will contact the Department requesting information about the Department, its operations, financial condition and debt programs. In these situations, the Debt Manager shall be the Department's principal point of contact for questions from current or prospective bondholders or other parties such as credit rating agencies or institutional investors.

3.3.14 Arbitrage and Post-Issuance Compliance Consultant

Internal Revenue Service ("IRS") regulations stipulate how tax-exempt bond proceeds can be invested prior to being expended and restrict how facilities and assets funded with tax-exempt bond proceeds can be used. The ultimate aim of the IRS is that issuers of tax-exempt bonds comply with the applicable tax laws under which the bond proceeds are borrowed.

Arbitrage refers to the taxable interest income that issuers of tax-exempt bonds may earn through investing the proceeds from the sale of tax-exempt bonds in higher yielding taxable securities. Arbitrage regulations permit an issuer to earn arbitrage in specified circumstances but in most cases, requires any arbitrage profits be paid back or rebated to the Federal government. Federal arbitrage restrictions are among the most complex aspects of the Federal tax code. Failure to adhere to the many restrictions and requirements can result in significant monetary penalties to the Department.

In addition to bond proceed investment and arbitrage constraints, there are also complex IRS rules, restrictions and calculations relating to the spend down of bond proceeds, the private-business use of facilities and assets financed with tax-exempt bonds, document retention requirements and other post-issuance compliance responsibilities.

To better comply with the various Federal arbitrage rebate rules, tests and calculations, the Department will generally select and retain a qualified arbitrage compliance firm based on merit using a competitive RFP or RFQ process. The Department may also consider engaging the services of a qualified firm to assist with other post-issuance compliance requirements. The Debt Manager is responsible for coordinating the selection process in consultation with the Finance and Budget Division Administrator , the State Treasurer's office and DOJ. In most cases, the

Debt Manager is the designated contract administrator of any subsequent arbitrage rebate or post-issuance compliance consultant contract. As provided in ORS 286A.130 and 279A.025, both State Treasurer and DOJ review and approval of the terms and conditions of the contract is required.

3.3.15 Yield Verification Agent

In an advance refunding or debt defeasance bond proceeds and other available funds are placed in an escrow account and invested in non-callable securities, generally either State and Local Government Securities ("SLGS") or open market securities ("OMS"). In this type of financing a yield verification agent specializing in independent yield verification is engaged to verify that the yield on investments acquired with the refunding bond proceeds is sufficient to pay off the refunded bonds when due and that the investments do not exceed the amount permitted under the Federal arbitrage rules.

The Department will generally engage a yield verification agent, either a certified public accounting firm or other qualified third party, prior to the marketing phase of a bond refunding. Selection of the yield verification agent in most situations is based on the recommendations of the Department's financial advisor in consultation with other members of the financing team and the approval of the State Treasurer.

3.3.16 Escrow Agent

In an advance refunding or other debt defeasance, the escrow agent, typically a commercial bank or trust company, is retained to serve as the custodian of funds and securities needed to pay debt service on the refunded bonds. The escrow agent for the Department's advance refunding is usually the State's fiscal agent under contract with the State Treasurer. Alternatively, the escrow agent may be engaged separately based on an RFP or RFQ process administered by the Department or direct appointed based on the recommendation and approval of the State Treasurer.

3.3.17 Escrow Bidding Agent

In an advance refunding, an issuer will generally consider either SLGS or OMS investments to fund the defeased escrow account. The escrow bidding agent assists the issuer to confirm the list of OMS available for purchase, determine whether the costs of OMS are lower than SLGS, bid the portfolio to competitive sellers and provide a bidding agent certificate that can be relied on by tax counsel.

The escrow bidding agent may be selected through an RFP/RFQ process coordinated by the Department's financial advisor and approved by the State Treasurer. Alternatively, the services of the escrow bidding agent may be included in a separate contract with a firm retained by the Department that specializes in municipal finance and investment advisory and compliance services or may be direct appointed in consultation with and the approval of the State Treasurer.

3.3.18 Federal Subsidy Calculation Agent

Build America Bonds ("BABs") are taxable direct pay subsidy bonds or tax credit bonds issued under the American Recovery and Reinvestment Act of 2009 ("ARRA"). The BABs Federal subsidy calculation agent assists the issuer to manage Internal Revenue Service compliance and filing requirements in order to receive Federal subsidy payments from the U.S. Treasury. The

Department may engage the services of a BABs subsidy calculation agent either through the State Treasurer's fiscal agent contract or through a separate RFP/RFQ process.[2]

3.3.19 Swap Advisor or Consultant

An interest rate exchange agreement or "Swap" is a contractual agreement between two parties, often referred to as counterparties, where one stream of future interest payments is exchanged for another based on a specified principal amount. Interest rate Swaps often exchange a fixed payment for a floating payment that is linked to an interest rate (most often the LIBOR[3]). Swaps are typically used to limit or manage exposure to fluctuations in interest rates, or to obtain a marginally lower interest rate than it would have been able to get without the Swap

A Swap Advisor or consultant provides portfolio monitoring and consulting services concerning Swaps that have been entered into in connection with the issuance of bonds, notes or other obligations. The Swap Advisor is generally required to provide valuations, reporting and monitoring services relating to the issuer's Swap portfolio and act as the issuer's advisor on any transactional matters relating to its existing Swap portfolio and any additional Swaps that may be considered or entered into by the issuer.

The engagement of a Swap Advisor is required prior to the Department entering into any Swap or other derivative product. The selection of a Swap Advisor will be by competitive RFP/RFQ process. Alternatively, with the State Treasurer's approval, the Department may use the State's Swap Advisor[4] to act on its behalf. The Debt Manager is responsible for coordinating the selection process in consultation with the Finance and Budget Division Administrator, the State Treasurer's office and DOJ. The Debt Manager will be the designated contract administrator of any subsequent Swap Advisor contract. As provided in ORS 286A.130 and 279A.025, both State Treasurer and DOJ review and approval of the terms and conditions of the contract is required.

[2] The Department currently does not have BABs in its debt portfolio
[3] London Interbank Offered Rate.
[4] See State of Oregon Swap Policy or the Oregon State Treasury and State Agencies dated as of June 10, 2013.

Chapter 4 Debt Instruments and Authorizations

Municipal bonds are debt securities issued by states, cities, counties and other local government entities to fund day-to-day operations, short-term cash flow requirements and to finance capital projects such as highways, bridges, transit systems and various other types of infrastructure. Municipal bonds are purchased by lenders (i.e. “bondholders”) in exchange for a promise of regular interest payments, usually semi-annually, and the return of the original investment – or principal.

There are a number of different types of bonding instruments and authorizations available to the Department. These include, for example, long term financing debt obligations like general obligation bonds, revenue bonds and certificates of participation and short-term debt programs such as bond anticipation notes and tax-exempt commercial paper programs.

The following are brief summaries of different types of debt instruments and authorizations that the Department may consider.

4.1 General Obligation Bonds

General Obligation bonds are issued by governmental entities and are not primarily backed by revenues from a specific project or source. Some GO bonds are secured by dedicated taxes on real property and, on occasion, other taxes. Other GO bonds are secured by the full faith and credit of the participating issuer, for our purposes, the State of Oregon. Typically, municipal GO debt requires constituency approval. In the State’s case, each GO bond program was created by a constitutional amendment passed by state voters. Therefore, the People of the State have unconditionally pledged to pay debt service (i.e. principal and interest) payments, over the life of each GO issue. This means that, barring the existence of other adequate repayment sources, all unrestricted public revenues must be used as needed to support debt service payments. This may include the levy of a statewide property tax if necessary and allowed by law.

Article XI, Section 7 of the Constitution provides the State with the general authority to issue GO debt. Currently there are eighteen constitutionally authorized GO bond programs. While each of these programs has the potential for drawing on the State’s General Fund or other taxing authority, many of the programs are fully self-supporting and are repaid from program revenues, gifts, grants, or other revenue streams.

The constitutionally authorized State of Oregon GO bond programs that are available to ODOT include the following:

- Transportation General Obligation Bonds – Article XI, Section 7
- City and County Roads and Recreation Facilities Bonds – ORS 367.700
- State Facilities Bonds[1] – Article XI-Q

[1] Also referred to as Article XI-Q “State General Purpose Bonds.”

4.1.1 Transportation General Obligation Bonds – Article XI, Section 7

Article XI, section 7 of the Oregon Constitution provides the authority to issue debt obligations in an amount up to one percent (1%) of the true cash value of property in the State[2] for the purpose of building and maintaining permanent roads within the State. These bonds have the State's general obligation backing as security.

4.1.2 City and County Roads and Recreation Facilities Bonds

Oregon Revised Statutes 367.700 to 367.750 provides authority for the State Department of Transportation to issue general obligation State Highway Bonds in an aggregate principal amount of $50 million. This provision was enacted into law in 1975 for the purpose of providing funds to cities and counties to defray the costs of city and county street construction and the acquisition, development, maintenance and care of public park and recreation facilities. The specified source of repayment of bonded debt service for those cities and counties receiving funds from the issuance of bonds under this program are from payments due to a city receiving funds under ORS 366.785 to 366.820 or to county under ORS 366.762 to 366.768.

4.1.3 Article XI-Q

Article XI-Q of the Oregon Constitution authorizes the State to incur indebtedness in an amount not to exceed one percent (1%) of the real market value of the real property in the state to provide funds to acquire, construct, remodel, repair, equip or furnish real or personal property that is or will be owned and/or operated by the State of Oregon. Passed by voters in November 2010, and enacted into statute in the following year by the 2011 Legislative Assembly, the Article XI-Q bonding program replaced, for most purposes, the Certificate of Participation bonding program as a means of financing state owned property due to superior credit ratings and lower cost of funds.

The Department of Administrative Services is responsible for administering the Article XI-Q bond program and issuing Article XI-Q GO Bonds on behalf of State and local government agencies including ODOT.

4.2 Revenue Bonds

Unlike GO bonds, direct revenue program debt is not secured by the State's unlimited pledge to fund debt service with unrestricted public revenues or, where permitted, a statewide ad valorem property tax. Rather, funds to pay debt service are provided by a specific and dedicated revenue stream, and normally program revenues are directly associated with the funded project(s). State revenue bond programs do not require a vote of the People however they must be authorized by the Legislative Assembly.

Oregon Revised Statutes provide for a variety of revenue bond programs. These programs are each considered fully self-supporting, and have no general obligation backing from the State. However, if program revenues were to become insufficient to support debt service payments, this does not preclude the State from providing a funding stream.

[2] Debt limitation in dollars is approximately $5.06 billion based on the January 1, 2015 Real Market Value (RMV) of $506,175,463,644 as determined by the Oregon Department of Revenue.

Statutorily authorized direct revenue bond programs that are applicable to ODOT include:

- State Highway User Tax Bonds – ORS 367.620
- Oregon Transportation Infrastructure Fund Bonds – ORS 367.630
- State Transportation Enterprise Fund Revenue Bonds – ORS 367.812
- Toll Revenue Bonds – ORS 283.023
- Lottery Revenue Bonds – ORS 286A.560 to 286A.585
- Grant Anticipated Revenue Bonds – ORS 367.161 to 367.181

4.2.1 State Highway User Tax Bonds

The Oregon Constitution Article IX, Section 3a provides that revenues received from taxes levied on the ownership, operation or use of motor vehicles and on motor vehicle fuel may be used only for the construction, reconstruction, improvement, repair, maintenance, operation and use of public highways, roads, streets and roadside rest areas in the State, the cost of administration, payment of refunds or credits and for the retirement of bonds for which such revenues have been pledged.

The State Highway User Tax Revenue Bond program is set out under ORS 367.605 to 367.665. Pursuant to ORS 367.615, the Department of Transportation may request the State Treasurer to issue highway user tax bonds to provide proceeds for the purpose of building and maintaining permanent public roads and may be used, among other things, to finance the cost of state highway, county road and city street projects in the State, to pay the costs of issuing the bonds, for loans to cities and counties as provided by Oregon law, to pay debt service on the bonds, and to pay the costs of the State Treasurer and the Department to administer and maintain the bonds and the Highway User Tax Bond program. Highway User Tax Revenue ("HUTR") bonds differ from other State revenue bond programs in that they are secured by constitutionally dedicated tax proceeds from fuel sales and other taxes or fees charged for vehicle use and licensing pursuant to Oregon Constitution Article IX, Section 3a as noted above.

4.2.2 Oregon Transportation Infrastructure Fund Revenue Bonds

ORS 367.015 to 367.030 authorize the Department of Transportation to issue revenue bonds for the Oregon Transportation Infrastructure Fund. The fund is to provide infrastructure loans and assistance for transportation projects. The total principal amount of revenue bonds that may be issued and outstanding at any one time under this authorization cannot exceed $200 million.

4.2.3 State Transportation Enterprise Fund Revenue Bonds

ORS 367.812 provides the authority for the State Treasurer to issue and sell bonds or other similar obligations, at the request of the Department of Transportation to finance transportation projects secured by a pledge of, and a lien on, and payable from moneys in the State Transportation Enterprise Fund established by ORS 367.810 and any other revenues specifically pledged to the repayment of the bonds. Revenues received from the issuance of revenue bonds or other debt obligations may be used for the purpose of financing the costs of transportation projects established under the Oregon Innovative Partnerships Program pursuant to ORS 367.804.

4.2.4 Toll-Backed Revenue Bonds

The Department is authorized to finance transportation facilities using a variety of funding mechanisms including funding through the imposition of tolls on those who use such facilities. As provided in ORS chapter 383, the Department is also authorized to enter into various contracts, agreements and other arrangements with private entities and other units of government for purposes of the acquisition, design, construction, reconstruction, operation or maintenance and repair of tollway projects. These financial arrangements may include, among other things, design-build contracts, lease agreements, lease-purchase agreements, and financing agreements. Furthermore, ORS chapter 383 and applicable provisions of ORS chapter 286A authorize the Department to issue revenue bonds to finance tollway projects.

4.2.5 Lottery Revenue Bond Program

The Oregon State Lottery was created by an amendment to the Oregon Constitution in 1984. That amendment revised Article XV, Section 4 of the Oregon Constitution to require the establishment and operation of the Oregon State Lottery. Article XV, Section 4 requires that all proceeds from the Lottery, including interest earnings but excluding expenses and payment of prizes, be used for creating jobs, furthering economic development, financing public education in Oregon, restoring and protecting Oregon's parks, beaches, watersheds, critical fish and wildlife habitats, and providing for veterans' services.

The Article also requires the Legislative Assembly to appropriate Lottery net proceeds in amounts sufficient to pay lottery bonds before appropriating the Lottery's net proceeds for any other purpose. Once debt service on Lottery-backed bonds are paid each year, the remaining State Lottery revenues are distributed to the Education Stability Fund, the Parks and Natural Resources Fund, the Veterans Services Fund, and the Outdoor School Education Fund, as required by the Constitution. Revenues are then allocated and applied to certain economic development and educational purposes. The Education Stability Fund and the Parks and Natural Resources Fund are allocated 18% and 15% respectively of unobligated net proceeds; the Veteran Services Fund receives 1.5%, and the Outdoor Education Fund receives the lesser of four percent (4%) or $22 million per year. Also, an amount of not less than one percent (1%) of net Lottery proceeds is allocated to the Problem Gambling Treatment Fund, which is separate and distinct from the General Fund. Article XV, Section 4 of the Oregon Constitution and applicable Oregon law allocate any remaining amounts to various economic development and public education projects as authorized.

The Department of Administration is responsible for administering the Lottery Revenue Bond Program and issuing Lottery Revenue Bonds on behalf of State and local government agencies including ODOT.

4.3 Appropriation Credits

Similar to revenue program debt, appropriation credits are not secured by the State's unlimited pledge to fund debt service with unrestricted public revenues or, where permitted, a statewide ad valorem property tax. These credits are special limited obligations of the State payable solely from funds appropriated or otherwise made available by the State Legislative Assembly. The obligation of the State to provide appropriated moneys and to pay the bonds is subject to future appropriation by the Legislature for the fiscal period in which payments are due. As with State direct revenue bond programs, appropriation credits do not require a vote of the People, but must be authorized by the Legislative Assembly.

The State currently uses two types of appropriation credits, Appropriation Bonds and Certificates of Participation. The Department of Administration is responsible for administering the State's appropriation credit program and issuing Appropriation Bonds and Certificates of Participation on behalf of State agencies including ODOT. Of the two, only Certificates of Participation are applicable to ODOT.

4.3.1 Certificates of Participation

ORS 283.085 to 283.092 permits the State to enter into financing agreements, including lease purchase agreements, installment sales agreements and loan agreements to finance essential real or personal property and issue certificates of participation evidencing these financing agreements.

Certificates of Participation are considered tax-exempt government securities and special obligations of the State payable solely from available funds. They are not general obligations secured by the full faith and credit of the State. Rather, the Oregon Legislative Assembly must appropriate COP repayment amounts each biennium for which repayments are scheduled. If the Legislature were to deny a budget request to make the COP payments for a future biennium, the COP trustee would exercise available legal remedies against the State. These remedies could include the denial of the use of the building(s) or the equipment financed by the COPs for which payment had been denied.

Since the passage of Article XI-Q general obligation bonds for state owned and/or operated facilities by voters in 2011, the State has not issued new money appropriation credits, as general obligation Article XI-Q State Facilities Bonds provide a higher rating and lower cost of funds compared to COPs.

DAS is responsible for administering COP program and issuing COPs on behalf of State agencies including ODOT.

4.4 Pension Obligation Bonds

Pension Obligation Bonds ("POB") are financing instruments used to pay some or all of the unfunded pension liability of a pension plan. POBs are taxable instruments generally issued over a 30 to 40-year term or by matching the term with the amortization period of the outstanding unfunded actuarial accrued liability. The purpose of pension obligation bonds, its structure, and the use of the proceeds will go through an active validation process prior to the sale of the bonds.

POBs allow municipal governments, which includes the State, to borrow at a rate that is lower than the assumed actuarial rate that is built into the Unfunded Actuarial Liability" ("UAL"). Such assumed actuarial rate is used to project the investment rate to be earned on the proceeds of the POBs and the investment rate payable on the UAL. The State may consider the issuance of POBs if they are cost effective and in the State's overall best financial interest.

4.4.1 State of Oregon Pension Obligation Bonds

The 72nd Oregon Legislative Assembly convened in January 2003 for its regular session and passed significant reforms to the Public Employees Retirement System ("PERS") that were approved by the Governor. Oregon voters also approved a Legislative referral to establish an authority in Article XI-O[3] to the Oregon Constitution to issue general obligation bonds to fund the State's share of the UAL. The 2003 Legislature passed HB 3659 that implemented the administrative authority and procedures for issuing the POBs. As of October 1, 2003, the PERS Consulting Actuary estimated the state share of the UAL at $2.196 billion.

On October 31, 2003, the Oregon General Obligation Pension Bonds were issued and $2.0 billion was delivered directly to PERS. On November 1, 2003, PERS rates were reduced by 6.6% in recognition of this contribution to the PERS fund. However, the State is obligated to make the principal and interest payments on these pension obligation bonds through fiscal year 2027. All benefiting agencies, including ODOT, are charged the same rate to pay this debt service. Two factors go into the rate formula. 1) Pension bond debt service (net of interest earned on the money in the debt service account) scheduled to be paid by the State in a biennium and 2) the estimated agency payroll for the biennium. For agencies participating in the Oregon State Payroll System ("OSPS"), the collection of the debt service payment is automatic. Those beneficiaries not on OSPS provide to DAS, as the executive agency responsible for the administration of the POBs, a PERS monthly payroll report to determine their payroll covered by PERS.

The POB rate is set each biennium to afford agencies some certainty over what their expenses will be over a two-year period. The state agency assessed rate to pay the POB debt service effective November 1, 2015 is 6.0% of the PERS subject payroll according to the schedule published by DAS at https://services.oregon.gov/das/Financial/Pages/pob.aspx.

The issuance of POBs by the State does not directly affect the debt service coverage requirements for ODOT's highway user tax revenue bond program and may offer financial benefits in lowering the State's overall PERS UAL. However, general obligation POBs do come with a tradeoff of higher State debt ratios and a reduction in the State's overall borrowing capacity to meet other needs.

4.5 Line of Credit and Letter of Credit

4.5.1 Line of Credit

A Line of Credit is a credit source often extended by banks and other financial institutions to provide liquidity and cash flow to a borrower. The advantage of a Line of Credit is that typically interest is not charged until the borrower draws on the line or on any unused balance. A Line of Credit can be either revolving or non-revolving and may be useful as an interim source of capital construction funding prior to the issuance of long-term debt. Additionally, a Line of Credit may be established to fulfill bond covenant requirements for a reserve fund when permitted and when determined to be cost effective.

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[3] Article XI-O pension obligation bonds are constitutionally limited to 1% of Real Market Value (RMV) or approximately $5.06 billion as of January 1, 2015.

4.5.2 Letter of Credit

A Letter of Credit is frequently used to provide credit and liquidity support for variable rate demand ("VRD") obligations and other types of securities. Bank Letters of Credit are sometimes used as additional sources of security for issues of municipal notes, commercial paper or bonds, with the bank issuing the Letter of Credit committing to pay principal of and interest on the securities in the event that the issuer is unable to do so.

The Department may enter into agreements with commercial banks or other financial entities for purposes of acquiring a Line of Credit or Letter of Credit where their use is determined to be prudent and advantageous.

4.6 Short-Term Debt

4.6.1 Bond Anticipation Notes

Bond Anticipation Notes ("BANs") may be used by the Department to provide more immediate funds to begin a project prior to issuing approved long-term obligations. BANs are issued under the authority of ORS 287A.180 to provide interim financing for capital assets and must mature not later than one year after the estimated completion date or acquisition of the capital asset being financed. In periods of market instability and volatile interest rates, BANs can be used to delay the sale of a long-term debt issue until the market climate becomes more favorable to the issuer. BANs may be sold in a fashion similar to bonds or more commonly they are sold as direct bank placements or as lines of credit. Other considerations related to the issuance of BANs include:

- Difference between long term rates or cost of capitalizing interest versus short term rates.
- Timing of ratings on long term debt.
- Coverage requirements related to revenue bonds.
- Actual cost of the project.

It is important to note, however, that deferring long-term debt involves the risk that interest rates may rise from the time of the planning phase of the project to the actual issuance of the permanent financing. Care must be taken in financial projections to allow sufficient room in projections to allow for some upward movement in interest rates.

4.6.2 Grant Anticipation Notes

Grant Anticipation Notes ("GANs") are notes issued on the expectation of receiving grant funds, usually from the Federal government. The notes are payable from the grant funds, when received and may be used to finance a project for which a Federal or state grant has been committed. See discussion below in Section 4.10 – *Grant Anticipation Revenue Vehicle (GARVEE)*.

4.6.3 Commercial Paper

Commercial Paper is a series of short-term notes with maturities from 1 to 270 days issued in minimum denominations of $100,000 at a fixed rate set at the time of issuance. CP notes, though a short-term obligation, are issued as part of a longer open-ended rolling program. Maturities are often staggered, resulting in a blended interest rate on the total notes outstanding.

Tax-exempt CP notes can be issued in smaller denominations and shorter maturities that closely match a construction project's immediate requirements. In comparison to the traditional fixed-rate bond program a CP program can realize significant interest cost savings especially in the early years of project construction. CP programs can also eliminate the need for capitalized interest and the potential for negative "costs of carry" in a construction fund. A CP program is also a method to diversify interest rate risk.

4.7 Interest Rate Exchange Agreement and Swaps

An interest rate exchange agreement or swap is a specific derivative contract entered into by an issuer or obligor with a swap provider to exchange periodic interest payments. Typically, one party agrees to make payments to the other based upon a fixed rate of interest in exchange for payments based upon a variable rate. The swap contract may provide that the issuer will pay to the swap counter-party a fixed rate of interest in exchange for the counter-party making variable payments equal to the amount payable on the variable rate debt. See Chapter 12 – *Interest Rate Swap Policy* for additional information regarding swaps and derivatives.

Swaps and related financial instruments and derivatives are appropriate interest rate management tools (if properly used) and can increase financial flexibility and provide opportunities for interest rate savings.

4.8 Capital Leasing and Lease-Purchase Financings

The Department may enter into capital leases and financing agreements to fund the acquisition of facilities, equipment, furnishings and vehicles. A capital lease may consist of both real and personal property acquired by the Department on lease terms that transfer substantially all of the benefits and risks of ownership to the Department. In contrast, an operating lease does not transfer the risk of ownership to the Department. In general, a capital lease constitutes a debt obligation of the Department whereas an operating lease does not.

Financing agreements are often in the form of capital leases and typically involve agreeing to make payments over time for the acquisition of an asset (or use of such an asset for much of the period of its useful life). Because financing agreements involve committing state resources over a period of over one year, it is a form of borrowing. Most borrowing by state governments is prohibited under the State Constitution, however, because financing agreements must be structured in such a way that biennial payments can be made only "subject to appropriation" they are technically not borrowings for Constitutional purposes as confirmed in the 1989 Oregon Supreme Court ruling *Kane v Goldschmidt*.

ORS 283.085(4) defines financing agreements as a lease purchase agreement, an installment sale agreement, a loan agreement or any other agreement entered into to finance, among other things, real or personal property that is or will be owned and operated by the state or any of its agencies. ORS 283.087(5) prohibits state agencies from entering into financing agreements over $100,000 under any provision of law except ORS 283.085 to 283.092. Among other provisions, ORS chapter 283 requires approval by the DAS Director and the State Treasurer or his/her designee for any financing agreement over $100,000. Oregon Administrative Rules ("OAR") 122-070-0100 to 122-to 122-070-0160 provides additional legal guidelines for administration of the financing agreement program consistent with ORS chapter 283.

ORS 283.087(3) subjects financing agreements to authorization requirements of ORS 286A.085. Therefore, financing agreements may not be entered into unless authorized by the Legislative Assembly (typically through the Bond Bill). Furthermore, ORS 283.091 requires that amounts necessary to repay financing agreements be included in the Governor's Budget submitted to the Legislative Assembly.

An additional Federal Internal Revenue Service disclosure is required when property is acquired through a "tax-exempt" lease. These leases may be referred to as conditional sales contracts or loans where the interest component is tax-exempt to the vendor-lessor. See IRS Form 8038-GC *Information Return for Small Tax-Exempt Government Bond Issues, Leases, and Installment Sales* for additional information.

Department division, branch and unit managers evaluating transactions that contemplate entering into a capital financing agreement should contact DAS's Capital Finance and Planning Office in advance and are additionally responsible for coordinating with Financial Services and its Debt Manager prior to the execution of any capital lease obligation.

For additional information refer to "*Other Financing Agreements Policies and Procedures*" on the DAS Capital Finance and Planning website at http://www.oregon.gov/DAS/CFO/Pages/CapInvestment.aspx.

4.9 Interfund/Interagency Loans and Borrowings

Oregon law provides authority for state agency interfund borrowing under the terms of ORS 293.210 to 293.225. Interfund borrowing is a financing tool the Department can employ to provide for short-term, transitory cash imbalances. For example, the Department may experience a temporary need to cover capital construction expenditures prior to the issuance of its authorized bonds and receipt of bond proceeds.

Interfund borrowings are not to be used to fund activities not already contemplated in the Department's approved budget. Further, the eventual source of repayment for the borrowing must be clearly demonstrated at the time of the borrowing (e.g. future bond sale proceeds).

Oregon State Treasury is the state agency responsible for coordinating interfund loans and borrowings; the Oregon Short-Term Fund ("OSTF") is typically the source of funds. Such borrowings will incur interest costs set at a rate determined by OST and will be evidenced by a formal borrowing agreement (e.g. an "Interagency Loan Agreement"). Additional information regarding interfund loans and the documentation required is provided in OST Policy 02.18.09 available on OST Finance Division's website at http://www.oregon.gov/treasury/Divisions/Finance/StateAgencies/Pages/Interfund-Loans.aspx.

4.10 Federal Financing Tools

The Federal Highway Administration's ("FHWA") Center for Innovative Finance Support (formerly Office of Innovative Program Delivery) provides expertise and a number of transportation infrastructure financing tools that are available to the Department for consideration. Some of the transportation infrastructure financing instruments and programs sponsored by FHWA include:

- Grant Anticipation Revenue Vehicles (GARVEE)

- Transit Grant Anticipation Notes (GAN)
- Transportation Infrastructure Finance and Innovation Act (TIFIA) Credit Assistance
- Build America Bonds (BAB)
- State Infrastructure Banks (SIBs)
- Section 129 Loans
- Toll Credits
- Private Activity Bonds (PAB)
- Public-Private Partnerships

4.10.1 Grant Anticipation Revenue Vehicle (GARVEE)

A Grant Anticipation Revenue Vehicle ("GARVEE") is a type of tax-exempt security or debt instrument that is backed by annual Federal-aid grants for transportation projects. Specific to highways, a GARVEE is a term for a debt instrument that can be used for the costs of right of way and/or construction of highway or other transportation projects that are eligible under Title 23 of the United States Code and that meet all Federal requirements. A GARVEE bond has a pledge of future Title 23 Federal-aid funding and is authorized for Federal reimbursement of debt service and related financing costs.

The Department issued GARVEE bonds in 2024 with an issuance of $230,510,000.00, with net proceeds of 257,483,174.58, to fund the American with Disabilities Act curve ramp program. Future issuances of GARVEE bonds are planned in future biennium. Current debt service is paid with 10% State Highway Funds and 90% Federal Grant Revenue.

4.10.2 Transit Grant Anticipation Notes (GANs)

Transit agencies can use mechanisms similar to FHWA's GARVEE program to borrow against future Federal-aid funding. While transit financings are quite similar to the GARVEE type instruments, the transit debt mechanisms are administered by the Federal Transit Administration ("FTA") and are known as Grant Anticipation Notes ("GANs"). However, the idea is the same; the agency (i.e. the borrower) issues bonds secured with a pledge of Federal-aid assistance, thus amassing up-front capital, and pays down the bonds over a period of time as the Federal funds are received.

4.10.3 Transportation Infrastructure Finance and Innovation Act (TIFIA)

The Transportation Infrastructure Finance and Innovation Act ("TIFIA") of 1998 established a Federal credit program that provides Federal credit assistance in the form of direct loans, loan guarantees, and standby lines of credit to finance surface transportation projects of national and regional significance. TIFIA credit assistance can provide improved access to capital markets, flexible repayment terms, and potentially more favorable interest rates than can be found in private capital markets for similar instruments. Many surface transportation projects including highway, transit, railroad, intermodal freight, and port access projects are eligible for TIFIA credit assistance.

4.10.4 Build America Bonds (BABs)

Build America Bonds are taxable municipal bonds introduced as part of the February 2009 American Recovery and Reinvestment Act ("ARRA") and are administered by the U.S. Treasury Department. A Build America Bond is a bond issued prior to January 1, 2011 by a state or local entity for governmental purposes (non-private activity purposes) and for which the issuer elects to have the interest on the bond be taxable in return for a Federal interest subsidy. Governmental purposes include financing surface transportation projects. The program expired on December 31, 2010.

There are two types of BABs: "Tax Credit BABs" and "Direct Payment BABs." The Direct Payment BAB program provides a subsidy of 35% of the interest, paid to the issuer. The Tax Credit BAB program provides a refundable tax credit directly to the bondholders.

Due to the requirements of the U.S. Congressional Balanced Budget and Emergency Deficit Control Act of 1985, as amended, certain automatic subsidy reductions were instituted to the BABs program commencing as of March 1, 2013. Absent further Congressional budget action that changes the sequester, the reduction in the payment of BABs federal subsidy is expected to continue.

The Department issued Direct Payment BABs in 2010 with the issuance of its $544,675,000 Highway User Tax Revenue Subordinate Lien Bonds, Series 2010A (Federally Taxable Build America Bonds). This BAB issue was refunded in 2024 with the Series 2024A Highway User Tax Bonds.

4.10.5 State Infrastructure Bank (SIB)

State Infrastructure Banks ("SIBs") are revolving infrastructure investment funds for surface transportation that are established and administered by states. A SIB, much like a private bank, can offer a range of loans and credit assistance and enhancement products to public and private sponsors of Title 23 highway construction projects or Title 49 transit capital projects.

The Department entered a Cooperative Agreement between FHWA and FTA in 1996 that established the Oregon Transportation Infrastructure Bank ("OTIB"). This action was followed in 1997 with the creation of the Oregon Transportation Infrastructure Fund ("OTIF") by the 69th Oregon Legislative Assembly's passage of House Bill 2097.

The OTIB is authorized to provide loans and credit enhancement to transportation projects to include projects for highway, transit, rail, and aeronautics capital infrastructure, bicycle and pedestrian paths, bridges and ways, and other projects that facilitate transportation. In addition to OTIB's revolving loan and credit enhancement programs, the Department is authorized pursuant to ORS 367.015 to 367.030 to issue bonds for the OTIF to fund transportation infrastructure assistance and loans.

4.10.6 Section 129 Loans

Section 129 of Title 23 allows Federal participation in a state loan to support projects with dedicated revenue streams including tolls, excise taxes, sales taxes, real property taxes, motor vehicle taxes, incremental property taxes, or other beneficiary fees.

Similar to State Infrastructure Bank loan programs, Section 129 loans allow states to leverage additional transportation resources and recycle assistance to other eligible projects. States have the flexibility to negotiate interest rates and other terms of Section 129 loans. When a loan is repaid, the state is required to use the funds for a Title 23 eligible project or credit enhancement activities, such as the purchase of insurance or a capital reserve to improve credit market access or lower interest rate costs for a Title 23 eligible project. One important distinction between SIB and Section 129 loans is that projects that receive assistance from repaid Section 129 loans are not required to meet the same number of Federal requirements as those using SIB loans.

Section 129 of Title 23 was originally amended by the Intermodal Surface Transportation Efficiency Act of 1991 ("ISTEA") to allow Federal participation in a state loan to a toll project. In response to experience under FHWA's Innovative Finance Test and Evaluation ("TE-045") program, the National Highway System ("NHS") Designation Act of 1995 further expanded Federal-aid eligibility to include state loans to non-toll projects with a dedicated revenue stream.

4.10.7 Toll Credits

Section 120(j) of Title 23 permits states to substitute certain previous toll-financed investments for state matching funds on current Federal-aid projects. This provision dates back to ISTEA and has since been modified by the Transportation Equity Act for the 21st Century ("TEA-21") and Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users ("SAFETEA-LU"). It permits the non-Federal share of a project's cost to be met through a "soft match" of toll credits. The flexibility of state transportation finance programs is increased by allowing states to use toll revenues when other state highway funds are not available to meet non-Federal share matching requirements. Toll credits encourage states to increase capital investment in infrastructure and enable them to more effectively utilize existing resources. By using toll credits to substitute for the required non-Federal share on a new Federal-aid project, the Federal share can effectively be increased to 100 percent (100%).

Toll credits are earned when the state, a toll authority, or a private entity funds a capital transportation investment with toll revenues earned on existing toll facilities (excluding revenues needed for debt service, returns to investors, or the operation and maintenance of toll facilities). The amount of credit earned equals the amount of excess toll revenues spent on Title 23 highway capital improvement projects (except emergency relief program projects) and Title 49, Chapter 53 transit projects. If Federal funds were used for the project, the credit is reduced by the percentage of the total project cost derived from Federal funds.

4.10.8 Private Activity Bonds (PABs)

Private Activity Bonds ("PABs") are government debt instruments issued for the direct benefit of private businesses. These bonds bear numerous restrictions imposed by Federal and state regulations. Specifically, they are subject to the limitations and provisions of the Federal Tax Reform Act of 1986, section 141 of the Internal Revenue Code ("IRC"), and ORS 286A.605 to 286A.625.

A frequent advantage of PABs is the private-use of a municipality's tax-exempt name as a conduit to tax-exempt interest rates. Another advantage is that the government issuer incurs no legal responsibility to repay private activity conduit bonds; rather, the private business' credit quality provides the security for the debt financing and ultimately all repayment responsibilities.

Section 11143 of Title XI of SAFETEA-LU amended Section 142 of the Internal Revenue Code to add highway and freight transfer facilities to the types of privately developed and operated projects for which PABs may be issued. This change allows private activity on these types of projects, while maintaining the tax-exempt status of the bonds.

Federal law limits the total amount of such transportation related bonds to $15 billion and directs the Secretary of Transportation to allocate this amount among qualified facilities. The $15 billion in exempt transportation facility bonds is not subject to the state volume caps.

Passage of the private activity bond legislation reflects the Federal Government's desire to increase private sector investment in U.S. transportation infrastructure. Providing private developers and operators with access to tax-exempt interest rates lowers the cost of capital significantly, enhancing investment prospects. Increasing the involvement of private investors in highway and freight projects generates new sources of money, ideas, and efficiency.

4.10.8.1 Expending Private Activity Bond Proceeds

The Federal legislation requires that at least 95 percent (95%) of the net proceeds of bond issues be expended for qualified highways or surface freight transfer facilities within a five-year period from the date of issue. If this does not occur, the issuer must use all unspent proceeds to redeem bonds of the issue within 90 days after the conclusion of the five-year period. Alternatively, the issuer may request an extension of the five-year period if it can establish that the failure to expend the funds was due to circumstances beyond its control.

4.10.8.2 Private Activity Bonds and TIFIA

Any surface transportation project which receives Title 23 assistance is qualified to benefit from private activity bonds. Because projects that receive TIFIA credit assistance are Title 23 projects, this means that TIFIA projects are also eligible to receive this tax-exempt bonding authority. This provision therefore extends eligibility to TIFIA-assisted public transportation, intercity bus or rail facilities and vehicles, including vehicles and facilities owned by Amtrak, public freight rail facilities or private facilities providing public benefit for highway users, and intermodal freight transfer facilities. Together TIFIA and private activity bonds provide substantial incentives for private equity investment in highway and freight projects.

4.10.9 Public-Private Partnerships (P3)

The Department encourages private sector firms and units of government to conceive, develop, construct and operate Oregon transportation projects in partnership with ODOT. The consideration of public-private partnerships (i.e. "P3") in the development of transportation improvements and early involvement of the private sector can bring creativity, efficiency, and capital to address complex transportation problems facing State and local governments. FHWA's Center for Innovative Finance Support (formerly Innovative Program Delivery or "IPD") provides information and expertise in the use of different P3 approaches, and assistance in using tools including the Special Experimental Project Number 15 ("SEP-15") program, PABs, and the TIFIA Federal credit program to facilitate P3 projects.

4.11 Refunding Transactions

Refunding bonds are bonds issued to replace or refinance previously issued debt with new debt. Refunding is typically used to restructure debt, to save borrowing costs through lower interest rates and revise legal restrictions or covenants. For Federal tax purposes, there are two principal categories of refunding bonds; (i) current refunding bonds and (ii) advance refunding bonds. Current and advance refunding bonds are authorized under the provisions of ORS 286A.025.

4.11.1 Current Refunding

Current refunding usually involves selling new bonds to refinance outstanding bonds prior to their maturity date but slightly before or after their "call date." The current refunding may take place no earlier than three (3) months before the call date and any time after the call date. Under Federal law, the payment of bonds must occur within ninety (90) days of selling the new bonds, otherwise the refunding will be considered an "advanced refunding." Under Oregon Law, the redemption of the bonds must occur within one year to be considered a current refunding and not fall under the State's advance refunding rules. Refundings are normally executed to generate interest cost savings or remove covenants the issuer considers onerous. The new bond is sold for the remaining principal of the old bond plus any interest accrued until the date the bonds are called.

4.11.2 Advance Refunding

An advance refunding occurs when outstanding bonds are refinanced with the sale of new bonds (i.e. the "refunding bonds") but before the first call date of the old bonds (i.e. the "refunded bonds"). Under Federal tax and securities law and regulations, an advance refunding occurs when the refunded bonds remain outstanding for more than ninety (90) days after the issuance of the refunding bonds. An advance refunding under Oregon law occurs in situations where the refunded bonds remain outstanding for one year or more. The refunding bond proceeds are used to fund an escrow defeasance portfolio or irrevocable refunding escrow account consisting of cash, taxable government securities and/or open market securities. The escrow account is structured so that the combination of cash and securities is sufficient to pay the escrow requirements; that is, the maturing principal and interest and call premium, if any, on the outstanding refunded bonds due on the optional call date. The outstanding debt held in the refunding escrow account is considered to be void and defeased, either legally or in substance and does not count as part of the issuer's debt limitations.

4.11.3 Refunding Considerations

The Federal government restricts the yield on the investment of the proceeds of an advance refunding bond. State regulations also limit the size of the refunding bond and the manner in which the proceeds can be invested. State regulations require that advance refunding bonds be sold only to achieve a net dollar benefit to the issuer or for debt reorganization purposes.

4.11.4 Refunding Escrow Account and Defeasance Securities

In an advance refunding an escrow account is funded with proceeds from the refunding bonds, available cash and escrow defeasance securities. The types of defeasance escrow securities generally used are taxable U.S. Treasury securities, other open market securities or other permitted investments.

Special State and Local Government Series Securities

State and Local Government Series ("SLGS") securities are taxable U.S. Treasury securities offered to state and local government entities as an investment alternative which assists issuers of tax-exempt obligations in complying with yield restrictions and arbitrage rebate provisions of the Internal Revenue Code. SLGS securities are issued in book-entry form and are non-marketable. The SLGS demand deposit security is a one-day certificate of indebtedness. The principal and daily-accrued interest is automatically rolled over each day until redemption is requested. The interest rate on SLGS demand deposit securities is based on an adjustment of the average yield in the most recent auction of the 13-week U.S. Treasury bills. SLGS securities are purchased through the U.S. Treasury and additional information can be obtained at http://www.treasurydirect.gov.

Open Market Securities and Other Permitted Investments

An alternative to SLGS involves the purchase of escrow securities in the open market, other permitted investments or the use of a hybrid structure.

Open market securities ("OMS") may have a higher return than SLGS securities depending on market conditions but they also may not mature or pay interest on the date when debt payments are due. Use of OMS must be purchased at market price and not at some artificial price designed to comply with Federal yield restrictions. To avoid violation of Federal requirements a safe harbor practice is to engage an escrow bidding agent to coordinate bidding from qualified securities firms. A minimum of at least three (3) bids is required to establish a clear market price necessary to satisfy the Federal tax law requirements.

Other permitted investments generally include U.S. Treasury securities, Federal agency securities or other qualified instruments. They may provide even higher yields, resulting in greater savings, but often do not allow issuers to meet the requirements for a legal defeasance. Other investments permitted by law or under a bond contract to be held in an escrow account for the purpose of defeasing bonds generally include:

1) Obligations of the U.S. Government (e.g. U.S. Treasury Bills and U.S. Treasury Notes).
2) Non-callable U.S. Government sponsored agencies that are fully guaranteed by the U.S. Government (GSA STRIPS are not permitted).
3) Certificates of Deposit that are FDIC insured or collateralized by U.S. Government securities.
4) Repurchase agreements collateralized by permitted investments (#1 and #2 above).
5) Money-market funds investing in permitted investments (#1, #2 and #4 above).

Chapter 5 Credit Ratings

Credit ratings play an integral role in the municipal bond market and are a major factor in determining borrowing costs. An issuer's credit rating represents a rating agency's assessment of the willingness and ability of an issuer to repay its debt obligations. Rating agencies consider various factors on a quantitative and qualitative basis in issuing a credit rating; these typically include:

- Governance
- Budget and financial management
- Debt history and current debt structure
- Economic conditions that may impact the stability and reliability of debt repayment sources
- Capital improvement project being funded
- Covenants and conditions in the governing legal documents

The Department's publicly offered bonds will generally receive ratings from at least two of the three principal credit rating agencies, which include Moody's Investors Service, Standard & Poor's Rating Services and Fitch Ratings. An exception to this general requirement may apply to a private or direct placement of the Department's bonds with banks or other financial institutions.

The Department will make every effort to maintain the highest possible credit ratings for its debt obligations consistent with the Department's policy objectives. The Debt Manager will evaluate the potential impact of all additional debt proposals on the Department's credit ratings. The structure of the Department's debt will be in a manner consistent with the best practice standards established by the rating agencies including, among other things:

- Rapid debt amortization
- Stringent additional bonds test (revenue-backed debt)
- Flow of funds (debt service paid first)

By maintaining the highest possible credit ratings, the Department can issue its debt at a lower interest cost. To enhance creditworthiness, the Department is committed to prudent financial management, systematic capital planning, interdepartmental cooperation and coordination, and long-term financial planning.

5.1 Rating Agency Relationship

The State Treasurer, as issuer of all State of Oregon debt obligations, is responsible for requesting ratings and maintaining relationships with the rating agencies that assign ratings to the Department's various debt obligations. Likewise, the Debt Manager is the Department's principal representative responsible for maintaining relationships with the rating agencies in consultation with the State Treasurer. This effort includes distribution of the Department's Annual Financial Report after its official release to the public and providing periodic updates on the Department's general financial condition along with coordinating meetings and presentations in conjunction with a new debt issuance.

5.2 Bond Ratings

Credit ratings are generally assigned to most bonds or debt obligations issued by or on behalf of the Department including general obligation bonds, appropriation credits, which certificates of participation are a type of, and revenue bonds.

- **General Obligation Bonds:** General Obligation bonds are direct, general obligations of the State of Oregon, and the full faith and credit and taxing power of the State is irrevocably pledged to make payment on the bonds when due. Credit rating agencies generally consider that a GO bond pledge offers significant security to bond holders and will frequently be assigned superior investment grade ratings. General Obligation bond programs currently issued by or on behalf of the Department include Article XI, section 7 – State Highway Bonds, Article XI-Q – State Facilities Bonds and Article XI-O – Pension Obligation Bonds.
- **Appropriation Credits:** Certificates of Participation are an appropriation credit that is not secured by the State's unlimited pledge to pay debt service. Rather, they are special limited obligations of the State payable solely from funds appropriated or otherwise made available by the Legislative Assembly. COPs generally receive lower ratings than GO bonds because they lack the unlimited general obligation pledge and are additionally subject to appropriation risk.
- **Revenue Bonds:** Revenue bonds are secured by a specified income source but not by the State's general obligation pledge. In many cases, because revenue bonds are not backed by the full faith and credit of the issuing municipality as are general obligation bonds, they may carry a somewhat higher default risk for which they offer higher interest rates. Highway User Tax Revenue Bonds and Lottery Revenue Bonds are currently the only revenue bond programs being used by the Department.

As noted above, credit ratings may or may not be required or needed for a private or direct placement of the Department's bonds with banks or other financial institutions.[1]

5.3 Change in Ratings

Appendix B – *State and Agency Credit Ratings* provides current State of Oregon and relevant State Agency credit ratings. Any change in the State's or the Department's bond credit ratings is a significant event and requires filing of a material event notice on the Municipal Securities Regulatory Board's ("MSRB") Electronic Municipal Market Access ("EMMA") website at http://emma.msrb.org/ and additionally to any other parties as required by existing bond disclosure agreements and bond covenants. In the event of a change in credit rating or outlook, whether upward or downward, the Debt Manager will consult with the State Treasurer and the Department's Bond Counsel to ensure that the proper notices and disclosures are filed.

[1] The Department's directly placed Highway User Tax Revenue Bonds Subordinate Lien Refunding Bonds, 2013 Series B (SIFMA Index Rate) were not assigned a credit rating.

Chapter 6 Debt Limits and Affordability

Given the limitations of the Department's revenue sources, the Department needs to be mindful of the effect of ongoing debt service on its budget and fiscal priorities over time. To provide a debt affordability plan and keep debt levels within acceptable ranges, the Department will consider generally accepted debt affordability standards in evaluating when, why, and how much additional debt should be issued. For each new debt proposal, an analysis of these debt affordability standards will be included in the financing plan. Guided by rating agency recommendations, long-term debt obligations incorporated in debt ratios include all debt obligations directly supported by the State Highway Fund ("SHF") and other funds legally available to the Department. SHF-supported debt obligations may include GO bonds, revenue bonds, Certificates of Participation, bank loans, capital leases, availability payments related to public-private-partnerships (i.e. "P3") and Federal financing programs such as the Federal Highway Administration's credit assistance programs. While other long-term liabilities such as unfunded pension liabilities are accounted for in determining the overall credit rating of an issuer, they are not included in these ratios. An exception to this could include pension obligation bonds or POBs if the Department is required to pay any portion of the POB debt service issued by the State on behalf of the Department.[1] For additional information regarding State of Oregon Pension Obligation Bonds, see Chapter 4.4 – *Pension Obligation Bonds*.

Coverage ratios in Section 6.1 – *Coverage for State Highway User Tax Revenue Bonds* below pertain specifically to the Department's SHF-supported Highway User Tax Revenue Bond program. Debt affordability ratios discussed in Section 6.2 – *Overall Debt Affordability* are inclusive to all of the Department's SHF-supported long-term GO Bonds, revenue bonds and COPs. These coverage and affordability ratios pertain only to debt instruments issued by or on behalf of the Department in the public or private financial marketplace.

As discussed more fully in Chapter 2 – *Conditions for Debt Issuance* and Chapter 4 – *Debt Instruments and Authorizations*, all debt obligations issued by or on behalf of the Department must comply with both Oregon law and Federal securities law. Each individual bonding program must be included in the legislatively approved biennial Bond Bill. The Bond Bill requirement is in addition to specific Constitutional and statutory debt authorizations and limitations.

The Debt Manager will determine if a proposed debt transaction complies with Constitutional and statutory debt limitations and authorizations and additionally adheres to the Department's debt management policies and affordability limitations. Proposed debt transactions that satisfy these requirements will be subject to approval of the Oregon Transportation Commission by resolution.

6.1 Coverage for State Highway User Tax Revenue Bonds

The Department's State Highway User Tax Revenue Bonds are special revenue obligations of the Department that do not constitute a debt or general obligation of the State or its political subdivisions. While the full faith and credit of the State is not pledged to the repayment of the

[1] The Department's proportionate share of the debt service for the State Pension Bonds issued in October 2013 constitute "Administrative Expenses" that are paid from revenues before they become "Pledged Revenues" under the Highway User Tax Revenue Bond Program.

Department's HUTR Bonds, under Oregon law and the Department's Master Declaration[2], the Department is required to deposit into the State Highway Fund "Pledged Revenues" sufficient to pay, when due, annual debt service on all of its outstanding HUTR Bonds.

The State Highway Fund is established under ORS 366.505 as a trust fund, separate and distinct from the State's General Fund. Pursuant to ORS 366.505, certain moneys deposited to the State Highway Fund are pledged to the payment of Highway User Tax Revenue Bonds. HUTR Bond Pledged Revenues are held in the State Highway Fund, but not all moneys and revenues held in the State Highway Fund constitute Pledged Revenues.

In determining the affordability of proposed HUTR bonds, the Debt Manager will perform an analysis comparing projected Pledged Revenues to estimated annual debt service. In general, minimum coverage ratios are determined based on the level of security provided to the bondholders of the Department's senior or subordinate debt obligations. Under the Master Declaration, the Department may issue additional HUTR Bonds subject to certain conditions including satisfying an additional bonds test ("ABT") and meeting minimum coverage ratios of not less than three (3) times maximum annual debt service ("MADS") on all senior-lien HUTR Bonds and two (2) times coverage on combined senior- and subordinate-lien HUTR Bonds.

Analysis of debt service coverage requirements will be performed in connection with the issuance of all new money and refunding HUTR bonds and subsequent to the release of the Department's semi-annual June and December "*Revenue Forecasts*."

6.2 Overall Debt Affordability

6.2.1 Debt Capacity Model Inputs and Assumptions

The Department will model its debt capacity forecast for years in which revenue forecast data is available. The model will include appropriate debt obligations paid by the Department from State Highway Fund revenues, and that are required under the Department's Master Bond Declaration. Not included in the model are those debt obligations with other dedicated revenue streams such as those debt obligations supported directly by State General Fund revenues, Lottery bonds, and certain obligations issued by or on behalf of the Department paid by other agencies or entities.

The model will solve for senior and aggregate debt service coverage ratios, which is solved by dividing net pledged revenues by total outstanding senior/aggregate debt service.

[2] The Department's Highway User Tax Revenue Bonds are issued pursuant to the Conformed, Amended and Restated Master Highway User Tax Revenue Bond Declaration, dated as of June 1, 2006, and conformed as of November 1, 2010.

Chapter 7 Debt Issuance Procedures

The Debt Manager is responsible for coordination and issuance of all Departmental debt. The responsibilities include issuance sizing, debt structure, cash flow analysis, and method of sale. The Debt Manager will also coordinate the issuance of debt obligations issued on behalf of the Department by another agency. These would include; Lottery Revenue Bonds, Certificates of Participation, and Article XI-Q bonds issued and administered by the Department of Administrative Services. In this capacity, the Debt Manager will consult with the State Treasurer, DAS, the Department's Bond Counsel and Financial Advisor and other members of the Department's financing team and consultants as more fully discussed in Chapter 3 – *Financing Team and Consultants*.

7.1 Conditions and Method of Sale

The three main bond sale methods are competitive, negotiated and private placement. The sale of debt obligations may be to a single underwriter or bank or to an underwriting syndicate through a public or private offering. The selected method of sale will be that which is the most advantageous to the State and the Department in terms of lowest true interest cost and the most advantageous in terms and structure given the prevailing market conditions.

7.1.1 Public Offerings

Public bond offerings may be either through a competitive or negotiated sale. The Debt Manager will confer with the State Treasurer and the Department's Financial Advisor and Bond Counsel to determine the appropriate method of sale depending on size, structure, timing and other financing factors.

7.1.1.1 Competitive Sale

In a competitive bond sale, the award of the winning bid should be on a true interest cost ("TIC") basis provided other bid requirements are satisfied. In instances where an insufficient number of bids are submitted, or the bids received are determined to be unsatisfactory, the Department may enter into a negotiated sale with an underwriter or underwriting syndicate or reject all bids. A competitive sale is often useful and recommended for uncomplicated financings with a strong underlying credit rating and if the bonds will not be considered "story bonds" by the investors. In a competitive sale, the bidder's role is limited to its review of the offering circular or official statement released by the State and the Department, making a credit assessment based on the facts presented in the offering circular, and offering its bid per the offering circular bidding parameters.

7.1.1.2 Negotiated Sale

In certain situations, a competitive sale may not be in the Department's best interest or be considered the most suitable or viable option. Examples of such circumstances include complex financing terms and security (i.e. "story bonds"), market volatility, and weaker credit quality. Whether to use the negotiated method of sale should be decided on an issue-by-issue basis or for part or all of a specific financing program. An advantage of the negotiated sale process is that it will generally provide the State Treasurer and the Department with more control over the financing structure, the issuance timing, and provide bond distribution flexibility and targeting (e.g. retail and institutional).

In a negotiated sale, the method of selection of the underwriter or the underwriting syndicate is, in most situations, through a competitive RFP/RFQ process. The underwriter will actively assist the Department in structuring the financing and marketing the bonds including providing assistance in preparing the bond official statement.

The Debt Manager, in consultation with the State Treasurer and the Department's Financial Advisor, will be responsible for monitoring pricing results to confirm that bond price behavior after the pricing is consistent with reasonable market expectations.

The sale of variable rate bonds, which may include direct purchase variable rate bonds, variable rate demand bonds ("VRDB"), commercial paper, etc., will normally be through a negotiated offering. For VRDBs, the Department will typically retain at least two broker/dealers or remarketing agents for each bond series. The broker/dealers or remarketing agents would be retained for a period co-terminus with the final maturity of the variable rate bonds provided that the Department may replace a broker/dealer or remarketing agent with notice at any time for any reason at its sole discretion.

7.1.2 Private or Direct Placements

When determined appropriate, the Department, in consultation with the State Treasurer, may enter into negotiations with banks and financial institutions for specific borrowings on a private offering basis. Private or direct placements of municipal securities are an alternative to traditional public municipal bond sales. They can provide funding through direct negotiation with one or more private financial institutions and used when circumstances preclude public offerings. Direct placements are often useful to consider with an interim financing or to avoid the costs of a public offering for smaller issuances. In general, private placements do not require registration with the Securities and Exchange Commission and may not demand many of the disclosure requirements found in public offerings. As such, private placements are not publicly issued or traded and typically do not require a rating from a credit rating agency.

7.2 Competitive Bond Sale Bidding Considerations

With a competitively issued bond, an internet-based electronic bidding platform will generally be used with the bond "Notice of Sale," preliminary official statement and other bond sale details posted to the bidding service provider's website. Underwriters and financial institutions will sign up for the bond sale offering with the bidding service provider and submit bids using a standardized format. The issuer is then able to view the sale results, confirm the bid calculations, and award the bid electronically.

The Notice of Sale will be prepared in consultation with the Department's Financing Team, to include the State Treasurer, the Department of Justice, and the Department's Financial Advisor and Bond Counsel. The Notice of Sale should be carefully constructed and reviewed to ensure that it satisfies relevant legal requirements and ensures the most favorable bids for the Department's bonds. Some competitive bond sale processes to consider include:

a) *Bidding Parameters:*

- Limits between lowest and highest coupons
- Coupon requirements relative to the yield curve
- Method of underwriter compensation – discount or premium coupons
- Use of true interest cost (TIC)
- Use of bond insurance
- Deep discount bonds
- Variable rate bonds
- Call provisions

b) *Marketing*: Advertisement of a bond sale will be as broad as possible, including consideration of local and industry-wide advertising if deemed advantageous. The Department's Financial Advisor will undertake to market the bonds to prospective bidders and investors as appropriate and in accordance with state and Federal law.

c) *Amendments*: Terms of the bonds shall be amendable as late as possible and generally, until at least 1:00 p.m. Pacific Time the day prior to bid closing.

d) *Cancellation*: Cancelation of the bond sale may be at any time prior to bid closing.

e) *Award*: Acceptable bids must strictly adhere to the terms and conditions of the Notice of Sale, some of which would include:

- Conditional and qualified bids should be rejected.
- The Department reserves the right to reject all bids or waive bid irregularities.
- Winning and cover bids will be identified and the Department's Financial Advisor and/or Bond Counsel will verify the computations provided by the electronic bidding platform.
- The winning bid will be awarded to the bidder whose conforming bid offers the lowest True Interest Cost (TIC) by the State Treasurer or his/her designee and with the concurrence of the Department's Chief Financial Advisor.
- Restructuring of the bonds may be permitted in accordance with the official Notice of Sale and if deemed in the best interest of the Department.

7.3 Primary Market Disclosure

The Debt Manager, together with the State Treasurer, DOJ, and the Department's Financial Advisor and Bond/Disclosure Counsel, is responsible for establishing a process for the review, approval and coordination of all the necessary documents for publication of official primary market disclosure information. Responsible Division administrators, managers and subject matter experts (as applicable for a particular bond issuance) will cooperate with the Debt Manager to review and validate the disclosure information contained in the preliminary official statement (i.e. the bond offering disclosure document). Periodic review of the primary market disclosure process is necessary to ensure that the Department is complying with legal and regulatory requirements, departmental policies and adherence to accepted best practices with respect to primary market disclosure.

Each publicly offered debt issuance will meet the disclosure requirements of the SEC and other government agencies before and after the bond sale takes place. The disclosure documents, particularly the official statement, will provide the potential investor with relevant and accurate information necessary to make prudent investment decisions.

Bond sale information generally includes a description of the bonds, issuance authority, bond proceed sources and uses, security and sources of repayment, recent developments of interest to investors, relevant tax, legal, litigation and disclosure matters, and credit rating information. Various appendices will include summary information relating to the Department, pension and other post-retirement benefit programs, financial reports, economic and revenue forecasts, selected summaries of bond document provisions, opinions of bond and underwriters' counsel and a description or form of the continuing disclosure undertaking.

All primary disclosure documents which are a part of the bond offering documents (e.g. official statement) will be reviewed and approved by the Financing Team and other responsible Department personnel as applicable. The State Treasurer and the Department will provide ongoing disclosure, in accordance with the Department's continuing disclosure undertakings executed when the financing is authorized, as required by SEC Rule 15c2-12 (see Chapter 14 – *Continuing Disclosure Compliance*.

7.4 Approval Process

In coordinating the bond issuance process, the Debt Manager will work with the Financing Team, other responsible Department divisions and units, and outside consultants to compile all bond related documents (see Chapter 3 – *Financing Team and Consultants*). The Department's Bond and Disclosure Counsel and DOJ will assess any legal issues that may arise with respect to the issuance of the bonds.

All Department debt financings must first be authorized by the Legislative Assembly in the biennial Bond Bill and require separate approval by resolution of the Oregon Transportation Commission. To ensure accuracy, thorough review of all disclosure and bond related documents by the Financing Team prior is necessary prior to submission to the OTC for approval. For additional information relating to the Department's debt approval procedures, see Chapter 2.10 – *Approval Process and Issuer Responsibilities*.

7.5 Post-Sale Evaluation and Documentation

7.5.1 Post-Sale Evaluation

Following the bond pricing the Financing Team will evaluate the bond sale process and outcome. The review and evaluation will include, among other things:

a) The market conditions at the time of sale or pricing.

b) All borrowing costs including underwriting spread and a comparison of rates on the debt with similar issues.

c) For negotiated bond sales, analysis of the performance of the syndicate members/firm(s).

d) Review of the bond investors.

e) Review of the secondary market activity on the debt for two weeks following the sale or pricing of the debt.

7.5.2 Post-Sale Documentation

Post-sale documentation includes, among other things, the following:

a) Senior book-running manager detailed post-pricing report.

b) Financial Advisor detailed post-pricing analysis and opinion as to the fairness of the bond pricing.

c) Debt Manager's summary post-sale report describing the transaction and setting forth all the costs associated with the transaction.

The Department will retain the bond pricing documentation, including pre-sale and post-sale data, for the life of the bonds plus three (3) years.

In addition, the Debt Manager will establish guidelines and procedures for tracking the flow of all bond proceeds over the life of bonds, all arbitrage earnings associated with the financing and any tax liability owed to the Internal Revenue Service. For additional information, see Chapter 13 – *Federal Tax Compliance*.

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Chapter 8 Debt Structuring Practices

8.1 Term of Debt

The structure of the Department's debt obligations and the overall debt portfolio will reflect the shortest period possible, consistent with a fair allocation of costs to current and future beneficiaries and users. Borrowings by the Department should be of a duration that does not exceed the useful life of the improvement that it finances and where feasible, should be shorter than the projected economic life. The standard term of long-term borrowing is typically 20-30 years.

8.2 Rapidity of Debt Repayment

The Debt Manager will endeavor to structure the debt amortization to match the available cash flow to projected debt service payments. The Department's debt obligations are typically structured to approximate an aggregate level debt service for the overall debt portfolio. Back loading debt service is a consideration when one or more of the following occurs:

- Natural disasters or extraordinary or unanticipated external factors make payments on the debt in early years prohibitive.
- Benefits derived from the debt issuance are demonstrably greater in the future than in the present.
- Structuring is beneficial to the Department's aggregate overall debt payment schedule.
- Structuring will allow debt service to match more closely project revenues during the early years of the project's operation (e.g. a new tolling project).

8.3 Serial Bonds, Term Bonds, and Capital Appreciation Bonds

"Serial Bonds" are bonds that mature in consecutive years or other intervals and are not subject to mandatory sinking fund provisions. "Term Bonds" are bonds that incorporate a sinking fund mechanism whereby bond repayment is on a single or limited number of maturity dates. Bonds with sinking funds are often preferred by investors since these funds provide the security of knowing that the issuer has appropriately budgeted and funded sinking fund accounts for expected future payments. The sinking fund also ensures that the payment of funds at maturity does not overtax the issuer's resources at that time.

Capital Appreciation Bonds ("CABs") are deeply discounted bonds that pay investors the face value of the bond upon maturing. In some financings, CABs may be a consideration to match a project's cash flow to the bond's debt service.

For each issuance, the Department will select serial bonds or term bonds, or both. On the occasions where circumstances warrant, CABs may be used. Current market conditions and investor preferences are factors in the decision to use term, serial, or CAB bonds.

8.4 Interest Rate Structure

The Department may issue its bonds in both fixed and variable interest rate modes. Fixed rate securities ensure budget certainty through the life of the securities and can be advantageous in a low interest rate environment. A variable interest rate bond, sometimes referred to as a "floating rate bond," is a security whose interest rate resets at specified intervals according to market conditions or a predetermined index or formula. Variable rate bonds generally have a nominal long-term maturity similar to fixed rate bonds but with a coupon rate that resets typically on a daily, weekly or monthly basis.

8.5 Debt Instrument Rating

The State Treasurer, in consultation with the Department's Debt Manager and the Financing Team, will assess whether to obtain a credit rating for a debt obligation. If it is determined that a credit rating is desirable, the probable rating of the proposed bond issuance is assessed before it is marketed and sold, and necessary steps are taken in structuring the debt obligation to ensure that the best possible rating is achieved.

8.6 Credit Enhancement

Credit enhancement is a financial product used by issuers to reduce the credit/default risk of its debt obligation, improve the bond credit rating and thereby lower interest costs. Credit enhancement generally allows the issuer to obtain better or less restrictive terms or covenants for its bond offering and provides reassurance to investors that the issuer will honor its obligation to pay through additional collateral, insurance, or a third-party guarantee.

The Debt Manager, in consultation with the State Treasurer and the Financing Team, may choose to use a credit enhancement product to improve or enhance the credit rating of its bond offerings. Types of credit enhancement include letters of credit and bond insurance or surety policies. The Debt Manager may consider the use of credit enhancement if it reduces the overall cost of the proposed financing or if the use of such credit enhancement furthers the Department's overall financial objectives.

8.6.1 Letter of Credit

A letter of credit, usually from a major bank, is an irrevocable commitment and unconditional pledge of the bank's credit to make principal and interest payments on the debt in the event insufficient funds are available to meet a debt service obligation. A letter of credit is frequently used to provide credit and liquidity support for variable rate demand obligations and other types of securities. Bank letters of credit are sometimes used as additional sources of security for issues of municipal notes, commercial paper or bonds, with the bank issuing the letter of credit committing to pay principal of and interest on the securities in the event that the issuer is unable to do so.

8.6.2 Bond Insurance

Bond insurance is an unconditional pledge by an insurance company to make principal and interest payments on a debt obligation. It is a guarantee by the bond insurer of payment of the principal and interest on the bonds as they become due should the issuer or obligated person fail to make required payments. In the case of bond insurance obtained at the time of issuance, the issuer of the policy typically has extensive rights under the bond contract to control remedies in the event of a default.

8.7 Debt Service Reserve Fund

A debt service reserve fund ("DSRF") is a fund maintained by a trustee as a supplemental source of money for the payment of debt service on the obligations. The DSRF may be funded:

- Entirely with bond proceeds at the time of issuance.
- Over time through the accumulation of pledged revenues.
- With a surety or other type of guaranty policy (described below).
- Only on the occurrence of a specified event such as the failure to comply with a covenant in the bond contract (i.e. a "springing reserve").

Issuers may sometimes authorize the provision of a surety bond or letter of credit to satisfy the DSRF requirement in lieu of cash. If the DSRF is used, in whole or part, to pay debt service, the issuer usually is required to replenish the fund from the first available revenues or in periodic repayments over a specified period.

Bond covenants and provisions of the U.S. Treasury's Internal Revenue Code[1] largely govern the amount of funds required in a DSRF. A typical DSRF requirement (sometimes referred to as the "reserve fund requirement" or "reserve requirement") might be a fixed percent of the outstanding par value or the maximum annual debt service of the issue. The size and investment of the DSRF is subject to Federal arbitrage regulations[2] and is limited to the lesser of:

- Maximum annual debt service
- 125% of average annual debt service
- 10% of par amount

DSRF's are common to many types of bonds with the exception of general obligation bonds. The Department has not typically used a debt service reserve fund for its Highway User Tax Revenue Bond program. Future use of a DSRF will be determined on a case-by-case basis and based on the recommendations of the Debt Manager in consultation with the State Treasurer and the Department's Financing Team. If a DSRF is determined to have an economic or credit advantage the Department will size the bond issuance to fund the DSRF at the time of issuance of the bonds. The Department will not rely on any uncollateralized credit instruments for any reserve requirement unless justified by significant financial advantage. If a surety policy is used in lieu of a debt service reserve fund, a provider distinct from any bond insurer, if applicable, will be used.

[1] Federal tax law begins with the Internal Revenue Code (IRC), enacted by Congress in Title 26 of the United States Code (26 U.S.C.).
[2] 26 CFR §1.148-2(f).

8.8 Capitalized Interest

Capitalized or funded interest is a portion of bond proceeds that are set aside to pay interest on the bonds for a specified period. The interest is "capitalized" for the construction period, and sometimes for a period thereafter, so that debt service expense does not begin until the project is expected to be operational.

Use of capitalized interest in bond financings can be a useful strategy. A tolling project is an example where the revenues to pay debt service might not be available until sometime after project completion. In such a case, estimated bond interest payments while the project is under construction and up to one year after its completion would be included in the bond issue and capitalized. A portion of the bond proceeds would be deposited in an account established under the bond documents and held by a trustee to pay capitalized interest on the bonds.

8.9 Callable or Redeemable Bond Options

A callable or redeemable bond is a type of bond that can be redeemed or paid off prior to the bond maturity date. When an issuer calls its bonds, it repays investors the call price (usually the price of the bonds) together with any accrued interest to date and at that point stops making debt service payments. In most cases, bonds will be called at par, however, a penalty or "call premium" may be incurred whereby the issuer is required to pay the bondholder a specified amount over the par value of the callable bond. Call provisions are a common feature of tax-exempt municipal bonds but are a less common feature with taxable bonds.

A callable bond option allows the issuer to call a bond when current interest rates drop below the interest rate on the bond. That way the issuer can save money by paying off the higher interest bond and issuing new bonds at a lower interest rate. This is similar to refinancing a home mortgage to realize lower interest cost savings. Investors generally view callable bonds as riskier than a non-callable bond because when the bond is "called" the investor generally needs to reinvest the money and often at a lower interest rate. As a result, callable bonds frequently have a higher annual return (i.e. "call premium") to compensate for the risk that the bonds could be called prior to the stated maturity.

There are three primary types of call features, including:

- *Optional Redemption*: Allows the issuer, at its option, to redeem the bonds after a certain number of years, often ten years.
- *Sinking Fund Redemption*: Requires the issuer to regularly redeem a fixed portion or all of the bonds in accordance with a fixed schedule.
- *Extraordinary Redemption*: Allows the issuer to call its bonds before maturity if certain specified events occur, such as the project for which the bonds have been issued has been damaged or destroyed.

Costs of a call option can vary widely, depending largely on market conditions. The Debt Manager, in consultation with the Financing Team, needs to evaluate bond call options and associated costs in connection with each issuance including:

- The call premium
- Level of rates relative to historical standards
- The time until the bonds may be called at a premium or at par, and
- Interest rate volatility

While it is common for the Department's bonds to feature 10-year call options, the callable bond generally comes with a higher interest cost than non-callable alternatives. For each bond issuance, a determination needs to be made whether the flexibility to redeem the bonds prior to maturity versus the cost of the call privilege provides sufficient risk-reward optionality and is in the best interest of the Department.

8.10 Issue Price

8.10.1 Summary of Current Law

Issue price is an important component of a tax-exempt bond financing especially as it relates to Federal arbitrage regulations and must be precisely identified at the time bonds are sold.[3] Existing Federal tax regulations[4] (i.e. "Existing Regulations") allow the "issue price" of publicly offered bonds to be determined based on the first price at which at least ten percent (10%) of all substantially identical publicly offered bonds are sold to purchasers other than underwriters and wholesalers. By a special alternative rule, Existing Regulations allow the issue price to be determined based on the issuer's reasonable expectations as of the sale date about the price at which substantially identical publicly offered bonds will be sold to the public. Most bond counsel interpret the rule to permit issuers to determine the issue price of any maturity of bonds for which at least ten percent (10%) was not sold to the public based on a certificate of the underwriters regarding their reasonable expectations at the time of the sale.

8.10.2 2016 Final Regulations

Internal Revenue Service released new final rules on December 8, 2016 that revised the definition of issue price for tax-exempt bonds and other tax-advantaged bonds contained in IRS Regulation Section 1.148-1(b) under the Internal Revenue Code of 1986, as amended (the "2016 Final Regulations").[5]

The 2016 Final Regulations apply to bonds sold on or after June 7, 2017, and provide three options for determining issue price: (i) the general actual facts rule, (ii) a special reasonable expectations rule, and (iii) a special rule for competitive sales. Underwriters are required to provide certain certifications in order to fall under the special expectations rule and the special rule for competitive sales. Issuers have the discretion to select among the rules to determine the issue price for the bonds at any time on or before the sale date and may select a different rule for

[3] See 26 CFR 1.148-1(b) for "Issue Price" definition.
[4] Treasury Regulations (26 C.F.R.), commonly referred to as Federal tax regulations, pick up where the Internal Revenue Code (IRC) leaves off by providing the official interpretation of the IRC by the U.S. Treasury.
[5] Source information for issue price discussion: Orrick, Herrington & Sutcliffe LLP Public Finance Alert "*Final Treasury Regulations Defining Issue* Price" dated December 12, 2016 and Hawkins Delafield & Wood LLP Advisory "*Final Issue Price* Regulations" dated December 27, 2016.

different maturities of the same issue. No later than the issue date, the issuer must identify on its books and records maintained for the bonds which of the above rules for determining “issue price” it has selected for the bonds.

8.10.2.1 General Rule – Actual Sales of a Substantial Amount

1) Public Offerings

The 2016 Final Regulations continue to allow the “issue price” of bonds to be determined based on the first price at which a substantial amount of at least ten percent (10%) of all bonds with the same credit and payment terms in fact are sold to purchasers other than underwriters or related parties. In general, this rule will apply to determine a separate “issue price” for each CUSIP of bonds.

Bonds sold to a broker, dealer or bond house which is not part of the underwriting syndicate (and which does not have a contractual relationship with the issuer or any member of the underwriting syndicate to participate in the initial sale of the bonds) would qualify as sales to the public and count toward the ten percent (10%) threshold.

2) Private Placements

In the case of private placement to a single buyer that is not an underwriter or a related party to an underwriter, the “issue price” is the actual price paid by the buyer.

8.10.2.2 Optional Alternative Special Rule for Publicly Offered “Hold-the-Price” Bonds

The 2016 Final Regulations generally revoke the special rule based on the issuer’s reasonable expectations in connection with publicly offered bonds, but substitute a new alternative special rule that the “issue price” may be the initial public offering price if each underwriter agrees in writing not to offer or sell any bonds to any person (including to another underwriter) at a higher price than the initial offering price until the earlier of (a) the close of the fifth (5th) business day after the sale date, or (b) at least 10% of the bonds in fact have been sold to the public at a price not higher than the initial offering price.

8.10.2.3 Optional Alternative Special Rule for Competitive Sales

As an additional alternative, the 2016 Final Regulations allow the “issue price” of bonds sold in a qualified competitive sale to equal the reasonably expected initial reoffering price of the bonds to the public based on the winning bidder’s certification of that price. A competitive sale qualifies for this alternative rule only if the issuer follows a prescribed competitive process which includes receiving bids from at least three (3) qualified firms and awards the sale to the bidder who submits a firm offer to purchase the bonds at the highest price (or lowest interest cost).

8.10.2.4 Record Keeping Requirements

The issuer must maintain reasonable documentation in its books and records to support its issue price determinations. In addition, the 2016 Final Regulations require that the issuer obtain from the underwriter certain certifications and other reasonable supporting documentation such as a pricing wire to establish its issue price determination under a specific rule. A certification from the underwriter of the first ten percent (10%) of the bonds of each maturity were sold to the public is an example of reasonable supporting documentation to establish the issue price of the bonds under the general rule in the 2016 Final Regulations.

8.10.2.5 Definitions – 2016 Final Regulations

"Public" means, for the purposes of determining issue price of tax-exempt bonds, any person other than an underwriter or a related party to an underwriter.

"Reasonable Expectations" means, as under the Existing Regulations, an issuer's expectations or actions as treated as "reasonable" only if a prudent person in the same circumstances as the issuer would have those same expectations or take those same actions, based on the overall objective facts.

"Substantial Amount" means, as under the Existing Regulations, at least ten percent (10%) of the bonds.

"Underwriter" is defined to mean (1) any person who agrees to participate in the initial sale of the bonds to the public pursuant to a written contract with the issuer or the lead underwriter in an underwriting syndicate, or (2) any person who has a written contract directly or indirectly with a person described in the foregoing clause (for example, a retail distribution agreement with the lead underwriter).

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Chapter 9 Debt Refinancing or Refunding

9.1 Background

Debt refinancing (“refunding”) is an important debt management tool that allows the Department to consider refinancing its existing tax-exempt debt obligations if it is determined that the benefits outweigh the risks. Refundings are commonly executed to achieve interest cost savings, remove or change burdensome bond covenants, or restructure the stream of debt service payments to avoid a default, or in extreme circumstances, an unacceptable tax or rate increase.

A debt refunding involves issuing “new” debt whose proceeds are used to repay previously issued “old” debt. The new debt proceeds may be used to repay the old debt immediately (a “current refunding”) or the new debt proceeds may be placed with an escrow agent and invested until they are used to pay principal and interest on the old debt at a future time (an “advance refunding”). Most advance refundings result in defeasance of debt. Both tax-exempt bonds and Certificates of Participation are eligible candidates for refundings.

9.2 Optional Call Date

Most municipal bond issues are structured with an optional call provision that allows the issuer to refund/refinance the existing bonds by purchasing the outstanding bonds at a pre-determined price and replacing them with new refunding bonds. Optional call dates are typically ten years from the date of issuance of the bonds.

9.3 Types of Refundings

There are two principal types of refundings, current and advance, as defined by Federal Treasury Regulations.[1] Other methods of advance refunding or achieving the same practical effect as an advance refunding include “crossover refunding,” “forward refunding,” and “synthetic refunding.”

9.3.1 Current Refunding

A current refunding is one in which the refunding bonds are issued less than ninety (90) days before the date upon which the refunded bonds will be redeemed (i.e. the optional call date). Refundings in which the refunded bonds are outstanding for less than ninety (90) days are not advance refundings for Federal tax purposes, but they may be advance refundings under state law or the provisions of bond contracts requiring specified comfort that the escrow securing payment of the refunded bonds is adequate.

9.3.2 Advance Refunding

For purposes of Treasury Regulations, an advance refunding is one in which the refunding bonds are issued more than ninety (90) days prior to the date upon which the refunded bonds will be redeemed. Advance refundings are used to refinance outstanding debt before the date the outstanding debt becomes due or callable. Proceeds of the advance refunding bonds are placed into an escrow account with a fiduciary, typically a trustee acting as the issuer’s escrow agent. The escrowed funds serve to pay interest and principal on the refunded bonds and to redeem the

[1] 26 U.S. Code §149(d).

refunded bonds at their maturity or call date. Treasury Regulations provide that tax-exempt governmental bonds issued after 1985 may only be advanced refunded once over the life of a bond issuance.[2] However, the issuer does retain the option to refund the tax-exempt advance refunded bonds with taxable refunding bonds.

9.3.3 Crossover Refunding

A method of advance refunding in which the revenue stream originally pledged to secure the refunded bonds continues to be used to pay debt service on the refunded bonds until they mature or are called. At that time the pledged revenues "crossover" to pay debt service on the refunding bonds and escrowed securities are used to pay the refunded bonds. During the period when both the refunded and the refunding bonds are outstanding, debt service on the refunding bonds is paid from interest earnings on the invested proceeds of the refunding bonds.

9.3.4 Forward Refunding

An agreement, usually between an issuer and the underwriter, whereby the issuer agrees to issue bonds on a specified future date and an underwriter agrees to purchase such bonds on such date. The proceeds of such bonds, when issued, will be used to refund the issuer's outstanding bonds. Typically, a forward refunding is used where the bonds to be refunded are not permitted to be advance refunded on a tax-exempt basis under the Internal Revenue Code. In such a case, the issuer agrees to issue, and the underwriter agrees to purchase, the new issue of bonds on a future date that would affect a current refunding.

9.3.5 Synthetic Refunding

An arrangement that allows an issuer to generate debt service savings that it would realize if it were permitted to advance refund the outstanding bonds. This agreement is generally used by issuers that either choose not to or are not permitted under the Internal Revenue Code to advance refund outstanding bonds on a tax-exempt basis. Such arrangements generally require an issuer to enter into an agreement with a counter-party and receive an upfront payment from the counter-party in return for a specified action of the issuer or a right to take a specified action by the counter-party at a future date, typically a date on which the issuer can call the outstanding bonds and effect a current refunding. For example, on the future call date, the counter-party may have the right to require the issuer to issue refunding bonds with certain specified terms for purchase by the counter-party. Alternatively, the issuer may issue variable rate refunding bonds and have the right to require the counter-party to enter into an interest rate swap on specified terms.

9.4 Escrow Defeasance Portfolio

The mechanics of a refunding are the same in both a current and an advance refunding. That is, refunding bonds are issued in an amount sufficient to generate proceeds to fund an escrow defeasance portfolio. The escrow defeasance portfolio or refunding escrow consists of a combination of cash and securities that are sufficient to pay the escrow requirement: the debt service, call premium, and outstanding principal of refunded bonds due on the optional call date.

The proceeds of the refunding issue are generally invested in U.S. Treasury securities or Federal Agency securities (although other instruments are sometimes used), with principal and interest

[2] 26 U.S. Code §149(d)(3).

from these investments being used (with limited exceptions) to pay principal and interest on the refunded issue.

Bonds are "escrowed to maturity" when the proceeds of the refunding issue are deposited in an escrow account for investment in an amount sufficient to pay the principal of and interest on the issue being refunded on the original interest payment and maturity dates, although in some cases an issuer may expressly reserve its right, pursuant to certain procedures delineated by the Security and Exchange Commission, to exercise an early call of bonds that have been escrowed to maturity. Bonds are considered "pre-refunded" when the refunding issue's proceeds are escrowed only until a call date or dates on the refunded issue, with the refunded issue redeemed at that time. The Internal Revenue Code and regulations thereunder restrict the yield that may be earned on investment of the proceeds of an advance refunding issue.

The Department will generally seek to purchase State and Local Government Securities (i.e. "SLGS") to fund its refunding escrows. However, the Department, in consultation with the State Treasurer and the Financing Team, may choose to fund an escrow through purchase of permissible securities on the open market (i.e. "OMS") when market conditions make such an option financially preferred.

9.5 Legal versus Economic Defeasance

9.5.1 Legal Defeasance

A legal defeasance will occur when debt is legally satisfied based on certain provisions in the debt instrument even though the debt is not actually paid. In a legal defeasance, certain of the rights and interests of the bondholders and their lien on the pledged revenues or other security may be terminated in accordance with the terms of the bond contract. A legal defeasance typically occurs when an escrow defeasance portfolio is funded with either SLGS or securities that are direct obligations of the U.S. Government. In a legal defeasance, the refunded bonds are legally removed from the issuer's balance sheet.

9.5.2 Economic Defeasance

An economic defeasance typically occurs when the refunding escrow is funded with permitted investments that do not meet the defined criteria of a legal defeasance, such as Federal Agency securities ("Agency Securities") or other usually higher-yielding securities.

In some cases, particularly where the bond contract does not provide a procedure for termination of these rights, interests, and lien other than through payment of all outstanding debt in full, funds deposited for future payment of the debt may make the pledged revenues available for other purposes without effecting a legal defeasance. If for some reason the funds deposited in an economic defeasance prove insufficient to make future payment of the outstanding debt, the issuer would continue to be legally obligated to make payment on such debt from the pledged revenues.

9.5.3 In-substance Defeasance

An in-substance defeasance occurs when debt is considered defeased for accounting and financial reporting purposes even though a legal defeasance has not occurred. When debt is defeased, it is no longer reported as a liability on the face of the government-wide statement of net assets; only the new debt is reported as a liability.

Debt is considered defeased in-substance for accounting and financial reporting purposes when:

a) Assets are placed in irrevocable escrow to be used solely for the purpose of making payments of interest and principal on the old debt.
b) The possibility that the debtor will be required to make future payments on that debt is remote.
c) The assets in the escrow account are essentially risk-free as to amount, timing, and collection of interest and principal.
d) The timing of collections approximately coincides with the timing and amount of scheduled interest and principal payments.

9.6 Refunding Considerations

Refundings may be undertaken to:

- Take advantage of lower interest rates and achieve debt service cost savings.
- Eliminate restrictive or burdensome bond covenants.
- Restructure debt to either lengthen the duration of debt or free up reserve funds.
- Refund outstanding indebtedness when existing bond covenants or other financial structures impinge on prudent and sound financial management.

Generally, the Department will consider a refunding only when there is a net economic benefit; i.e., when there is an aggregate net present value savings, expressed as a percentage of the par amount of the refunded bonds, at three percent (3%) and above for a current refunding, and four percent (4%) and above for an advance refunding. This savings requirement for a refunding may be waived in consultation with the State Treasurer if upon finding that such a restructuring is in the Department's overall best financial interest.

Chapter 10 Basic Legal Documents

This section describes some of the basic legal documents that that may be required in connection with a debt financing, together with a brief explanation of their purpose, alternative or related documents, the key document drafter and principal parties involved. There are many types of debt financing transactions available to the Department with each requiring their own particular and sometimes unique legal documentation provisions and requirements. The particular legal document required is dependent on the type of financing transaction, whether the debt obligations are tax-exempt or taxable and whether the financing is a publicly offered transaction or is privately placed directly with a bank or other lender.

10.1 Bond Transcript

Purpose: The bond transcript consolidates documents considered necessary by the parties to the debt financing transaction. It is prepared in hardcopy or electronic versions and delivered to the issuer and other participating parties. The bond transcript includes only certain documents that were available at the time of the issuance and sale of the debt obligations. Additional documents reflecting events occurring after the issuance of the bonds but not included in the bond transcript will need to be reviewed and retained by the issuer including, among other things, financial statements, bond proceed expenditure data, continuing disclosure undertakings, arbitrage rebate records, and other documents, records and reports.

Principal Drafter: Bond counsel

Parties: All parties to the transaction

Key Documents:

Initial Offering Documents
- Bond Purchase Agreement
- Preliminary Official Statement
- Official Statement
- Copies of Official Notices of Sale, as applicable
- Blue Sky Survey/Memorandum
- Continuing Disclosure Undertaking
- Blanket Letter of Representations to Depository Trust Company
- Rating Agency Letters

Redemption and Refunding Documents
- Escrow Deposit Agreement
- Escrow defeasance certificates and receipt of escrow securities
- Notices of defeasance and bond call

Basic Legal Documents
- Copies of relevant state law
- Copies of organizational documents of the issuer
- General incumbency certificate of the issuer or borrower
- Resolutions, ordinances, or other documents of the issuer authorizing the financing
- Reimbursement resolution or declaration of “official intent” to reimburse prior expenditures

Trust Indenture/Declaration/Resolution
Loan/Lease/Continuing Covenant Agreement
Remarketing Agreements
Standby Purchase Agreement
Tax Certificate
IRS Form 8038/8038-G
Credit enhancement documents
Certificate of bond execution, specimen bond and bond preparation data
Request to authenticate and deliver bonds

Resolutions and Certificates of the Parties

Certificates of the issuer
Certificate of the credit enhancer
Certificate of the trustee/fiscal agent/paying agent
Certificate of the financial advisor

Legal Opinions

Opinions of bond and disclosure counsel
Opinion of underwriter's counsel
Opinion of the bank's counsel
Opinion of issuer's counsel
Opinion of credit enhancer's counsel

Miscellaneous

Receipts for the bonds and proceeds
Cash flow and flow of fund reports
Bond sale and pricing analysis
Additional or supporting documents required by bond counsel

10.2 Constitutional and Statutory Authorization

Purpose: The Oregon Constitution and laws of the State of Oregon including Article XI, Section 7 and various debt authorizations enacted by the Oregon Legislative Assembly provide the authority and govern the types and purposes for which debt may be issued by State agencies. All general obligation debt requires specific constitutional authority approved by a vote of the people of the State. In addition, all State agency debt obligations require specific statutory authorization by the Legislative Assembly including authorization in the biennial "Bond Bill." State agencies also require specific Legislative authority to spend the proceeds of the debt issuance (i.e. "expenditure limitation") as defined in the agency's legislatively approved budget.

Alternative Documents: None

Principal Drafter: Legislative Assembly or Oregon electorate through the initiative and referendum process

Parties: Legislative Assembly, Oregon electorate and State and local government agencies

10.3 Authorizing Resolution

Purpose: The authorizing resolution is the issuer's document or documents that authorize the issuance and sale of debt obligations, authorize the execution and delivery of documents, and direct staff to take other actions necessary to complete the financing. The authorizing resolution constitutes the bond resolution, which describes the nature of the obligation, the issuer's duties to the bondholders and the issuer's rights with respect to the obligations and the security for the debt obligations.

Alternative Documents: Bond resolution, ordinance, or declaration

Principal Drafter: Bond counsel or issuer's counsel

Party: Issuer

10.4 Reimbursement Resolution

Purpose: The reimbursement resolution declares the issuer's official intent to be reimbursed from bond proceeds incurred prior to the date of the issuance of the tax-exempt debt obligations in compliance with Federal tax law promulgated under the Internal Revenue Code ("IRC") and U.S. Treasury Regulations and guidance. Under Treasury Regulations, the proceeds of bonds may be allocated to a prior capital expenditure for a period of time after the expenditure is made, but only if a formal declaration of reasonable intention to reimburse the expenditure with the proceeds of a borrowing (a "declaration of official intent") had been properly made within sixty (60) days after the date the expenditure was paid and certain other requirements.[1]

Alternative Documents: Reimbursement Declaration, Declaration of Official Intent

Principal Drafter: Bond Counsel, Issuer, Legislative Assembly

Party: Issuer

10.5 Official Statement or Disclosure Document

Purpose: The Official Statement ("OS") is the disclosure document prepared by or on behalf of the issuer of municipal securities in connection with a primary or initial public offering ("IPO"), which discloses material information on the offering of such securities. The Official Statement is the counterpart to the prospectus in the corporate finance industry. The Securities and Exchange Commission promulgates rules that govern the information to be included in the Official Statement. Information in an Official Statement includes, but is not limited to, the terms under which bonds may be redeemed prior to maturity, the sources of money pledged to repay the bonds, and the issuer's covenants for the benefit of investors. The following information is typically included in an Official Statement:

- The interest rate or, if the interest rate is variable, the manner in which such rate is determined.
- The timing and manner of payment of the interest on and the principal of the bonds
- The minimum denomination in which the bonds may be sold.

[1] 26 CFR §1.150-2.

- Whether the bonds can be redeemed by the issuer prior to maturity and, if so, on what terms.
- Whether the investor has the right to require the issuer to repurchase the bonds at their face value.
- The sources from which the issuer has promised to make payment on the bonds.
- Whether any bond insurance, letter of credit or other guarantees have been provided for repayment.
- The consequences of a default by the issuer.
- A description of outstanding debt, the authority to incur debt, limitations on debt and the future debt burden of the issuer.
- A description of basic legal documents such as authorizing resolution, indenture and trust agreement.
- Legal matters such as pending proceedings that may affect the securities offered, legal opinions and tax considerations.

Investors and market intermediaries may use the information in the OS to evaluate the credit quality of the securities and potential risks of the primary offering. Under Federal securities laws, the issuer is obligated to disclose in the OS all information that a "reasonable investor" would consider important in deciding whether to purchase a bond. This would include terms of bonds, security, risk factors, financial and operating information concerning issuer, and background information. Most publicly offered financings are required to have an Official Statement under SEC Rule 15c2-12[2] (the "Rule") and must additionally comply with the SEC Rule 10b-5[3] securities fraud standard. The Official Statement is dated as of the date the bonds are sold (i.e. the "Date of Delivery") and contains the final terms of the bonds.

Alternative Documents: Disclosure Document, Offering Memorandum, Offering Circular, Private Placement Memorandum

Related Document: Publicly offered bonds are sold through the distribution of the preliminary Official Statement ("POS") to the general public and potential investors. This is not a draft version of the Official Statement but is prepared by or for the issuer for potential purchasers of the bonds prior to the availability of the final Official Statement ("FOS"). Under the securities laws, offers for the sale of or acceptance of securities are not made on the basis of the preliminary Official Statement and a statement to that effect appears on the face of the document generally in red print, which gives the document its nickname, "red herring." Under SEC Rule 15c2-12, the preliminary Official Statement must be "deemed final" and complete in all respects except for certain information specified in the Rule that may be excluded. The information permitted to be excluded under the Rule includes the interest rate(s), the offering price, the redemption provisions, delivery dates, ratings and certain other terms of the bonds that are dependent upon the market. In most instances, the aggregate principal amount of the bonds will be different in the preliminary Official Statement from that stated in the final Official Statement.

Principal Drafter: Varies. The issuer may prepare the Official Statement but more commonly, the document will be prepared by the issuer's bond counsel or separately engaged issuer's disclosure counsel. Also common is for the underwriter's counsel to serve as disclosure counsel

[2] 17 CFR 240.15c2-12.
[3] 17 CFR 240.10b-5.

for the offering. In some transactions, the financial advisor or other party may be the principal drafter.

Party: Issuer

10.6 Official Notice of Sale

Purpose: In a competitive bond sale, the issuer conducts all of the tasks necessary to offer the sale of the bonds to the public through an open, competitive bidding process. Underwriters or an underwriting syndicate submit bids for purchase of the new bond offering on the day and time designated in the official Notice of Sale ("NOS"). The NOS, prepared by on or behalf of the issuer, includes, among other things:

- Date, time and place of sale
- Size, maturity dates, redemption provisions and structure of the bonds
- Type of security
- Terms, process and bidding limitations
- Amount and procedure for handling the good faith deposit that each bidder must submit with its bids
- Basis and standards that the issuer will use in evaluating the bids
- Method, time and place of delivery of the bond proceeds
- Bid form

Generally, the issuer's financial advisor is responsible for announcing the date and time of sale, distributing the near-final preliminary Official Statement and Notice of Sale to prospective bidders, and submitting financial information to the rating agencies and municipal bond insurance companies if applicable.

The bonds are awarded to the underwriter or the underwriting syndicate that have submitted the best bid (lowest true interest cost). No structural aspects of the bonds are changed regardless of the success or failure of the winning underwriter or syndicate to sell the bonds. Any unsold bonds remain the responsibility of the purchasing underwriter or syndicate.

Alternative Documents: Placement Agreement used in connection with a private placement of the debt with a bank.

Principal Drafter: Financial Advisor, Bond Counsel

Parties: Underwriter or Bank, Issuer, Conduit Borrower

10.7 Bond Purchase Agreement

Purpose: The Bond Purchase Agreement ("BPA") is an agreement between the issuer and the underwriter or bank in connection with a negotiated sale or a private placement of governmental tax- or revenue-supported securities, including fixed, variable-rate, credit-enhanced and taxable securities. In the case of a conduit financing, the conduit borrower may also be a party to the BPA. The Bond Purchase Agreement will include an offer to purchase the bonds by the underwriter or bank and the acceptance of the issuer to sell the bonds to the underwriter or bank. The BPA will generally provide:

- A description of the bonds and the terms of the purchase

- The authorizations of the issuer to sell the bonds
- The pledged of revenues providing security for the bonds
- Representations and warranties of the issuer and the underwriter or bank
- The conditions which must be met before the purchase of the bonds
- The delivery date and placement of the bonds
- The conditions under which the underwriter or bank may withdraw from the contract
- The underwriter's or bank's fees and a breakdown of costs of issuance and expenses to be paid by various parties
- Indemnification provisions of the issuer and the underwriter or bank
- Governing law provisions
- Certain SEC requirements to be followed by all parties

In the case of a public offering, the underwriters will be required to make representations that they have made a "Good Faith Offering to the Public" of all the bonds at the "Initial Public Offering Price." The BPA will also include a description of the end of the "Underwriting Period" which occurs the earlier of (i) the Delivery Date (unless on or prior to the Delivery Date the issuer has been notified by one or more of the underwriters that an unsold balance of the bonds remains), or (ii) the date on which the underwriter has sold all off the bonds. The end of the Underwriting Period starts the 25-day clock under Rule 15c2-12 whereby the issuer must update the Official Statement if a material event occurs.[4]

This BPA is executed after the bonds have been priced. The Official Statement is dated the same date as the Bond Purchase Agreement.

Alternative Documents: Official Notice of Sale and Bid Form (competitive sales), Placement Agreement (private placements)

Principal Drafter: Underwriter's Counsel, Disclosure Counsel

Parties: Underwriter, Bank, Issuer, Conduit Borrower

10.8 Continuing Disclosure Undertaking

Purpose: The Continuing Disclosure Undertaking, Agreement or Certificate contains the undertakings of the issuer to provide ongoing disclosure in the form of annual reports and event notices pursuant to SEC Rule 15c2-12. The undertakings must remain in place for the life of the issuance, with certain exceptions for pool bonds. Under SEC Rule 15c2-12 an underwriter cannot sell securities in an offering unless it has reasonable certainty that the issuer as the obligated person has undertaken to provide ongoing information. As required by the Rule, the issuer is obliged to execute a Continuing Disclosure Undertaking under which it agrees to provide annual financial information, similar to the financial disclosure in the Official Statement, and information about specific material events for the benefit of the bondholders. See Chapter 14 – *Continuing Disclosure Compliance* for more detailed discussion of SEC Rule 15c2-12 and the disclosure requirements generally.

Alternative Documents: Continuing Disclosure Certificate or Agreement

[4] 17 CFR 240.15c2-12(b)(4).

Principal Drafter: Bond Counsel, Disclosure Counsel or Underwriter's Counsel

Parties: Issuer, Obligated Person, Trustee

10.9 Indenture

Purpose: The Indenture is the legal contract between the issuer of municipal securities and a trustee for the benefit of the bondholders. The trustee administers the funds or property specified in the indenture in a fiduciary capacity on behalf of the bondholders. The Indenture, which is generally part of the bond contract, establishes the rights, duties, responsibilities and remedies of the issuer and trustee and determines the exact nature of the security for the bonds. The trustee is generally empowered to enforce the terms of the indenture on behalf of the bondholders.

In many governmental issues (particularly for general obligation bonds and some types of limited tax bonds and revenue bonds), the issuer may forego using an indenture and set forth the duties of the issuer and the rights of bondholders in a bond resolution or declaration[5]. In certain transactions, the indenture may be called a "trust agreement."

The Indenture creates the legal structure for the security for the bonds, including:

- Creation and granting of the Trust Estate
- Authorization, execution, authentication, registration and delivery of the bonds
- Refunding and defeasance provisions
- Funds, accounts, and investment or deposit of funds
- Pledge of revenues and other collateral to secure the payment of the debt obligations
- Flow of funds from bond proceeds and debt service payments
- Establishment of the priority and uses of revenues pledged to repayment of the bonds
- Additional bonds tests or parity debt provisions for issuance of additional bonds
- Representations and covenants of the issuer
- Event of default and remedy provisions
- Trustee-related provisions including indemnification, rights, removal and new appointment

Alternative Documents: Bond Resolution, Ordinance or Declaration, Trust Agreement, Fiscal Agent Agreement

Principal Drafter: Bond Counsel

Parties: Issuer, Trustee, Bond Registrar, Fiscal Agent and Paying Agent

10.10 Loan Agreement

Purpose: The Loan Agreement is a document common to direct or privately placed loans and government agency conduit revenue bond financings. The Loan Agreement establishes the terms under which the bond proceeds are lent or otherwise provided for the project being financed and the user of the proceeds agrees to pay the amount of the bonds, plus interest. The Loan Agreement establishes the terms, conditions, and repayment provisions of the loan or lease payments sufficient in time and amount to pay debt service on the bonds. In a conduit

[5] This is the case with Department's Highway User Tax Revenue Bonds where a "Master Bond Declaration" rather than a trust indenture is used.

transaction, the government agency issues the bonds and then loans the proceeds to the conduit borrower to finance the project.

Alternative Documents: Continuing Covenant Agreement, Installment Sale Agreements, Facilities or Project Lease, Lease Agreement

Principal Drafter: Bond Counsel, Bank Counsel

Parties: Issuer, Conduit Borrower/Obligor, Lender, Bank

10.11 Insurance and Credit Enhancement Agreements

Purpose: Issuers oftentimes will choose to use some form of insurance or credit enhancement to secure or guarantee the payment of bond debt service. This may involve a bond insurance policy, a letter of credit, a reimbursement agreement, a standby purchase agreement, a surety policy, a collateral agreement, a financial guarantee, or other form of insurance guaranteeing payment on the bonds or draws against the reserve fund. Credit enhancement agreements also will generally contain provisions regarding the obligation of the issuer to repay the credit enhancement provider amounts drawn on the credit facility. The term and conditions of a credit enhancement agreement will vary depending upon the type of transaction involved.

Alternative Documents: Bond Insurance Policy, Financial Guaranty Agreement, Surety Bond Policy, Letter of Credit Agreement, Reimbursement Agreement, Standby Purchase Agreement

Principal Drafter: Insurance Company, Bank Counsel, Surety Provider Counsel

Parties: Issuer, Bank, Credit Provider and Trustee (in some cases)

10.12 Tax Compliance Certificate

Purpose: The tax compliance certificate ("Tax Certificate") is a document executed by the issuer, and in the case of a conduit issue, the borrower, of tax-exempt or other Federally tax-advantaged bonds at the time of initial issuance certifying as to various matters relating to compliance with Federal tax laws and regulations, including arbitrage rules. The Tax Certificate also describes the rules applicable to the investment of bond proceeds under the Internal Revenue Code.

The Tax Certificate certifies the issuer's reasonable expectations[6] as of the issuance date and states certain representations and warranties of the issuer including:

- The purpose of the financing
- The amounts and uses of the bond proceeds
- The issue price and the stated redemption price at maturity of the final maturity of the bonds
- The issue price and the stated redemption price at maturity of the entire issue
- The yield and the net interest cost of the entire issue
- The interest rate of the final maturity

[6] 26 CFR 1.148-2(b)(2).

- Information regarding the refunded bonds, if applicable

Also included are representations and warranties of the issuer or parties regarding future acts and use of the project in accordance with the purposes for which it was financed and matters regarding any change in use of the project and the conditions under which a change will be permitted in order to maintain the tax-exempt status of the bonds.

Alternative Documents: Tax Agreement, Tax Compliance Certificate, Tax Regulatory Agreement, Arbitrage or Non-Arbitrage Certificate

Principal Drafter: Bond Counsel, Tax Counsel

Parties: Issuer, Borrower

10.13 Escrow Deposit Agreement

Purpose: In an advance refunding a new bond issue is sold to refund an outstanding (old) issue. Typically, such refunded bonds are secured solely by an escrow funded with the proceeds of the refunding bonds. Although a defeasance is generally the outcome of a refunding transaction, a defeasance can also be accomplished with cash rather than the issuance of any bonds. In a defeasance, the issuer purchases government securities for deposit in an escrow account. The escrow account is held by a bank or trust company that serves as escrow agent. Under the terms of an escrow agreement, the government securities are irrevocably pledged to the payment of the outstanding bonds. The government securities are in a principal amount such that the principal and interest earned are sufficient to retire the principal of and interest on the outstanding bonds as they come due. The government securities and all costs related to the defeasance are paid with funds accumulated in the various accounts established for the outstanding bonds or with other available funds.

The Escrow Deposit Agreement defines the duties and responsibilities of the escrow agent relating to the defeasance of the refunded bonds that would include:

- To serve as the issuer’s agent and custodian of the refunding bond proceeds
- To hold the securities to pay debt service on refunded bonds
- Invest or reinvest any money or escrowed securities
- To send out call notices of the refunded bonds to the registered owners
- File material event notices of the redemption of the refunded bonds, and
- Other duties as assigned

Alternative Documents: Advance Refunding Documents, Refunding Agreement

Principal Drafter: Bond Counsel

Parties: Issuer, Bond Counsel, Bank or Trust Company serving as Escrow Agent, Financial Advisor, Certified Public Accountant serving as Verification Agent

10.14 Bond Counsel and Other Legal Opinions

Purpose: In order for municipal bonds to be valid and enforceable, they must comply with applicable law. The attorney serving as bond counsel to the issuer delivers the legal opinion attesting to the validity of the bonds under applicable laws, and typically a tax opinion that interest on the bonds is exempt from Federal and state income tax. In situations where the bonds being issued do not qualify for tax-exemption from Federal or state income taxes (i.e. a taxable bond), the bond counsel opinion will be limited to the validity of the bonds or, sometimes exemption from state income taxes but not Federal income taxes.

Bond counsel's opinion usually addresses the following subjects:

- That the bonds have been duly authorized and executed by and are valid and binding obligations of the issuer.
- The source of payment or security for the bonds.
- Whether and to what extent interest on the bonds is exempt from Federal income taxes and from other taxes, if any, imposed by the state of issue.

The bond opinion is based upon an examination of material legal and factual sources (including certifications regarding relevant facts provided by persons in a position to have knowledge) regarding the subjects addressed therein.

Supplemental Opinion or 10b-5 Opinion

Bond counsel does not customarily assume responsibility for the preparation of the disclosure document (i.e. the "Official Statement") or the delivery of any opinion regarding its accuracy and completeness. However, the issuer may engage its bond counsel or separately engage a "Disclosure Counsel" to deliver a separate or "Supplemental Opinion." The Supplemental Opinion will generally include an opinion that the bonds and indenture are:

- Exempt from registration or qualification under certain securities laws.
- That the bond purchase agreement was duly executed and delivered.
- That the Official Statement does not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein not misleading.

The Supplemental Opinion will be addressed to the underwriter and may also be referred to as a due diligence opinion, "10b-5 Opinion," or a related reliance letter.

Related Documents: Legal Opinion, Unqualified Legal Opinion, Qualified Legal Opinion, Supplemental Opinion, 10b-5 Opinion, Due Diligence Opinion, Reliance Letter

Principal Drafter: Bond Counsel, Tax Counsel, Disclosure Counsel,

Parties: Issuer, Underwriter, Bank, Trustee, Fiscal Agent, Paying Agent

10.15 Closing Documents

Purpose: Bond Counsel will coordinate assembling the bond "Closing Documents" which include the certificates, receipts, written directions and requests, requisitions and similar documents that are delivered at the closing of the issuance. The Closing Documents generally serve to:

- Document the factual representations required by the purchase contract and accuracy and completeness of expertise portions of the disclosure.
- Document compliance with the requirements of state and Federal law including Federal securities law and U.S. Treasury Regulations, contract for the issuance of the bonds and the disclosure, including the effectiveness of resolutions, due execution of documents, conduct of meetings and compliance with applicable law, etc.

- Document the flow of funds at closing including the deposit and receipt of bond proceeds, investment of funds, payment of costs, and in the case of refundings the defeasance of prior bonds.
- Instruct parties to take certain actions upon closing including the deposit funds in accounts, record documents, file reports, release security in the case of refundings, etc.

Alternative Documents: None

Principal Drafter: Bond Counsel

Parties: All parties to transaction

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Chapter 11 Investment Policy

11.1 Scope and Purpose

This chapter sets forth criteria for the operation of the Department's investment activities including bond related investments (the "Investment Policy"). The investment of the Department's funds, both State Highway Funds and bond funds, will be in compliance with Oregon law, Federal regulations, existing bond indentures, declarations and resolutions, and this Investment Policy.

This Investment Policy applies to the investment of all funds on deposit at Oregon State Treasury, as well as all trust funds for which the Department has investment responsibility. All trust or custodial funds shall be invested and administered at the direction of the Chief Financial Officer. Funds held by a Trustee or Fiscal Agent are excluded, if the Department does not have investment control.

Bond proceeds are included in the Department's overall "Investment Portfolio", factored into its structure and managed to meet cash-flow requirements. Specific investments may, on occasion be established to recognize the long-term nature of some funds (e.g. capital projects) and conform to legal restrictions (e.g. bond covenants). The Department may sell securities subject to arbitrage restrictions prior to their maturity and reinvested in instruments with a lower yield to minimize arbitrage.

11.2 Role of Oregon State Treasury

Oregon Revised Statute 293.875 designates the State Treasurer as the sole banking and cash management officer for the State of Oregon and its agencies. Given that designation, Oregon State Treasury has broad authority to review, establish, and modify policies and procedures for the efficient handling of cash and cash equivalents under the control of all state agencies. Treasury acts as the bank for all state agencies, contracting with private banks and financial services providers to deliver a variety of cash management and investment services to those agencies.

The State Treasury Investment Division, among other duties, invests cash via the programs outlined below while the Finance Division provides all related administrative and operational support activities.

11.2.1 Oregon Short-Term Fund

The Oregon Short-Term Fund ("OSTF") is a short-term cash investment vehicle for state agencies' idle cash. The primary objectives of the OSTF, in priority order, are preservation of principal (safety), liquidity, and return on investment (yield). The Investment Division invests the cash while the Finance Division provides all administrative and operational support activities.

11.2.2 Oregon Intermediate Term Pool

The Oregon Intermediate Term Pool ("OITP") is an intermediate term fixed income investment program that provides Oregon state-owned and sponsored entities with a vehicle to invest dollars not needed to cover short-term needs and able to withstand greater price volatility to achieve returns often associated with longer-term investments. The OITP is a voluntary investment program that invests in securities with a longer than average maturity than a short-term portfolio such as the OSTF. Since proportionate ownership in the OITP is based on market value, participants can expect the value of their investment in the OITP to fluctuate over time. Participating agencies should therefore only invest monies that they consider longer-term in nature (such as 3.5 years or longer).

11.2.3 Other State Fixed Income Portfolios

State agencies may enter into separate interagency agreements with Treasury to discretely invest funds in individual or pooled "Fixed Income Portfolios." The interagency agreement memorializes the understanding and intentions of each party with respect to the agency's investment objectives, constraints and guidelines for the moneys deposited in the Fixed Income Portfolio. As per ORS 293.723, "discretely invested" means investments in something other than the OSTF.

11.3 Investment Objectives

The primary objectives, in priority order, of the Department's investment activities shall be:

1) **Preservation of Invested Capital**
Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The goal is to mitigate credit risk and interest rate risk. The Department, in general, has a low tolerance for interest rate and credit risk.

2) **Liquidity**
The Investment Portfolio shall remain sufficiently liquid to meet all reasonably anticipated operating needs and daily cash requirements. The Portfolio should consist of securities with active secondary or resale markets. Minimum cash needs are to be reviewed and adjusted by the Department on at least an annual basis.

3) **Return**
The Investment Portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the safety and liquidity needs of the portfolio. Although return consists of both principal return (gains and losses due to market value fluctuations) and income return (yield), the Department's investment philosophy and policy discourages active trading and turnover of investments. Investments should generally be held to maturity.

To mitigate credit risk, the Department's funds shall be invested in, or collateralized by, U.S. Treasury securities and "highly liquid" U.S. agencies or other identified investments in the "Permitted Investments" section of this Investment Policy. To mitigate interest rate risk, the Investment Portfolio shall be structured so that securities mature to meet cash requirements, limiting the need to sell securities on the open market before maturity. Consistent with these objectives, and subject to arbitrage regulations and any bond indenture requirements, and the "Prudent Person Standard" (see section 11.5 – *Standard of Judgement and Care*), available funds shall be managed and invested to achieve the maximum allowable yield.

11.4 Responsibilities and Authority

The authority to manage the Department's investment program is granted to the Chief Financial Officer and shall be conducted in conformance with applicable Oregon and Federal law. Specifically, this Investment Policy is written in conformance with ORS chapters 293, 295, 286A and 367. All funds within the scope of this Investment Policy are subject to regulations established by the State of Oregon and specifically the Office of the Oregon State Treasurer. Any revisions or extensions of these ORS chapters shall be assumed to be part of this Investment Policy.

Responsibility for the operation of the Department's investment program is hereby delegated to the Debt and Quantitative Analysis Manager, who shall carry out established written procedures and internal controls for the operation of the investment program consistent with this Investment Policy and the Department's "Cash Management Policy."

The Revenue and Expenditure Accounting Manager shall manage the day to day activities of the Department's Investment Portfolio such as recording investment sales and purchases and tracking activity on investments to maturity. The Debt Manager coordinates monitoring bond yield restrictions to insure compliance with arbitrage regulations and coordinates the Department's Fixed Income Portfolio and Oregon Intermediate Term Pool (OITP) investments. The Financial Policy and Compliance Manager is responsible for investment reporting and disclosure in the Department's financial statements in accordance with generally accepted accounting principles ("GAAP").

11.5 Standard of Judgement and Care

All persons performing investment duties ("investment officers") shall do so applying the "prudent person standard" in managing all funds for which the Department has investment responsibility. The prudent person standard, as set forth in ORS 293.721 and 293.726, states that investments shall be made with judgement and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Investment officers acting in accordance with written procedures and this Investment Policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported timely and the liquidity and the sales of securities are carried out in accordance with the terms of this policy.

11.6 Permitted Investments

All investment activities shall be conducted in conformance with State and Federal law and adhere to the requirements of this Investment Policy, the Department's bond indentures and other investment agreements entered into by the Department. Permitted investments may include:

1) Securities eligible for the Oregon Short-Term Investment Fund (OSTF)
2) Securities eligible for the Oregon Intermediate-Term Pool (OITP)

3) Obligations issued or guaranteed by the U.S. Federal Government, U.S. Federal agencies or U.S. government-sponsored corporations and agencies
4) Obligations of U.S. and non-U.S. corporations, commercial paper, certificates of deposit and banker's acceptances issued by industrial, utility, finance, commercial banking or bank holding company organizations
5) Municipal debt with long-term investment grade ratings of A3 or A-, or better, or are rated in the two highest Rating Categories for short-term debt by Standard & Poor's, Moody's Investors Services, or Fitch Ratings, respectively, at the time of purchase
6) Corporate debt with long-term ratings at or above Baa3 or BBB- or are rated in the two highest Rating Categories for short-term debt by Standard & Poor's, Moody's Investors Services, or Fitch Ratings, respectively, at the time of purchase
7) U.S. Agency Mortgage-backed Securities (MBS) which include both pass-through securities and Collateralized Mortgage Obligations (CMO)
8) Commercial Mortgage-backed Securities (CMBS) rated AAA
9) Asset-backed securities (ABS) rated AAA
10) Repurchase agreements or other investment agreements collateralized by securities issued or guaranteed by the U.S. Federal Government, U.S. Federal agencies or U.S. government-sponsored corporations and agencies
11) Investment agreements or guaranteed investment contracts ("GIC") which are, at the time of the investment, rated in one of the three highest Rating Categories for comparable types of obligations by any Rating Agency
12) Money market funds rated in one of the three highest Rating Categories for comparable types of obligations by any Rating Agency
13) Interest-Bearing Deposits (Time Deposits, Interest-Bearing Deposits, or Certificates of Deposit) in Banks and Credit Unions in Compliance with the Provisions of ORS Chapter 295
14) Securities defined under Rule 144A and Commercial Paper defined under Section 4(2) of the Securities Act of 1933
15) Yankee Bonds (dollar denominated sovereign and corporate debt)
16) Obligations of any person or entity which are, at the time of the investment, rated in one of the three highest Rating Categories by any Rating Agency
17) Any other investment in which the State is permitted to invest under applicable law

11.7 Investment Constraints

11.7.1 Sales of Securities

Securities held in the Investment Portfolio are generally purchased and held to maturity. However, in certain circumstances selling investment securities before maturity may be of benefit to meet changing cash management needs, objectives and requirements of the

Department. Sales of investment securities will be made after consideration of, among other things, the following:

- Liquidity needs
- U.S. Treasury arbitrage regulations
- Capital preservation or restructuring
- Potential risk to capital arising from declining investment prices
- Decline in the rating of an investment below the Department's acceptable rating
- Bond indenture requirements
- Under limited circumstances, a security swap at fair market value that would improve the quality, yield, or target duration in the portfolio

11.7.2 Downgraded Securities

Securities that are downgraded below the minimum credit rating do not have to be liquidated unless warranted by the State Treasurer's Investment Division staff credit research and compliance analysis, required by existing bond indentures or other legal prohibitions, or as determined by the Department's Chief Financial Officer.

11.7.3 Excluded Investments

The following types of investments are to be excluded from the Department's Investment Portfolio:

- Zero coupons
- Interest only securities
- Principal only securities
- Structured notes such as index-amortizing notes, dual-index notes, deleveraged bonds, range bonds and inverse floaters
- Securities tied to foreign currencies or indices based on foreign currencies
- Alt-A; non-agency; sub-prime; limited documentation; or other "sub-prime" residential mortgage pools or related securities
- Collateralized debt obligations (CDO), collateralized loan obligations (CLO), and Z-tranche ABS investments

11.7.4 Currency Considerations

Investments should generally be restricted to U.S. dollar denominated securities only.

11.8 Investment Considerations

State Highway Fund moneys, as defined in ORS 366.505, are deposited with the State Treasurer and primarily invested in the Oregon Short-Term Fund. By keeping a large balance of cash on deposit in the OSTF, the Department's rate of return is limited to the OSTF's short-term investment rate. The Department may, in accordance with its Cash Management Policy invest State Highway Fund moneys in the OSTF, the Oregon Intermediate Term Pool (OITP), Other State Fixed Income Portfolios, investment agreements, GICs, or other financial vehicles authorized by State law, existing bond indentures and this Investment Policy.

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Chapter 12 Interest Rate Swap Policy

12.1 Introduction

Interest rate exchange agreements ("Swaps") and related financial instruments and derivatives can be appropriate interest rate management tools. Properly used, Swaps can increase the Department's financial flexibility and provide opportunities for interest rate savings.

Swaps are appropriate to use when they achieve a specific financial objective consistent with the Department's overall Swap and debt management policies. Swaps can be useful financial tools to, for example, lock-in a current market fixed rate or create additional variable rate exposure. A Swap can produce interest rate savings, alter the pattern of debt service payments or cap, limit or hedge variable rate payments.

Swaps contemplated in this policy are intended to reduce the amount or duration of interest rate risk, or produce a lower cost of borrowing when used in combination with the issuance of bonds.

12.2 Scope and Purpose

The purpose of this Interest Rate Swap Policy (the "Swap Policy") is to establish guidelines for the execution and management of the Department's use of interest rate and other swaps, caps, options, basis swaps, rate locks, total return swaps and other similar products (collectively, "Swap Products"). This Policy confirms the commitment of the Oregon Transportation Commission and the Department's management, staff, advisors, and other decision makers to adhere to sound financial and risk management practices. As noted below, the use of Swap Products will be considered only in so much as they are the most effective instrument for implementing the goals and policies of the OTC and the Department and to minimize exposure to risk.

12.3 Utilizing Interest Rate Swaps

The Department recognizes that Swap Products can be effective financial management tools. This Policy sets forth the manner in which the Department may enter into a transaction involving Swap Products ("Swap Transaction"). The Department shall integrate Swap Transactions into its overall debt management programs in a prudent manner in accordance with the parameters set forth in this Policy.

Swap Products may be used by the Department to achieve a specific objective consistent with its overall long-term financial objectives. However, the Department shall not assume risks through the use of Swap Products that would not be considered prudent in light of the below-stated rationales. Rationales for the use of Swap Products and the execution of Swap Transactions include, but are not limited to:

- Hedge or actively manage interest rate, tax, basis, and other risks.
- Enhance the relationship between risk and return with respect to debt or investments.
- Achieve an appropriate match of assets and liabilities.
- Reduce the cost of fixed or variable rate debt, through swaps and related products by synthetically creating fixed or variable rate exposure.

- Lock in current fixed rates for future use, including synthetically advance refunding debt that cannot be refunded with a conventional cash-market issuance.
- Access the capital markets more rapidly than may be possible with conventional debt instruments.
- Provide a higher level of savings, lower level of risk, greater flexibility, or other direct benefits not available in the conventional debt market.
- Manage the Department's exposure to the risk of changes in the legal and regulatory tax treatment of tax-exempt bonds (e.g., income tax rate changes).
- Manage the Department's credit exposure to financial institutions and other entities.
- Achieve more flexibility in meeting overall financial objectives than can be achieved in conventional markets.

The Department shall not enter into Swap Transactions under any of the following circumstances:

- The Swap Transaction will expose the Department to extraordinary leverage or risk.
- The Swap Transaction serves a purely speculative purpose, such as entering into a Swap Transaction for the sole purpose of trading gains.
- The Department is unable to reasonably anticipate that it will have sufficient liquidity or financing capacity to terminate the Swap Transaction at market rates, if it should need to.
- There is insufficient pricing data available to allow the Department and its advisors to adequately value the Swap Transaction or Product.

When a Swap Product or Transaction is being used in connection with a refunding rather than a new-money bond issue in order to produce savings, as a general rule the level of savings should exceed the Department's fixed rate refunding savings target for conventional debt. The analysis of savings should take into account the presence or absence of call options and advance refunding restrictions on both the bonds and the Swap Transaction (See Chapter 9 – *Debt Refinancing or Refunding* for additional criteria). When a Swap Transaction is used in connection with a new-money financing, a similar analysis may be used, comparing the savings produced through use of a Swap Transaction or Product with a hypothetical conventional fixed rate or variable rate financing.

12.4 Authority for Entering Into Swap Transactions

The purpose of this Swap Policy is to integrate the use of Swaps into the Department's overall debt management practices. The use of Swaps will be limited to the Department's outstanding debt, or executed in conjunction a new debt offering. Swaps will not be used for speculation and are not authorized for use in conjunction with the Department's investment portfolio.

The authority for state agencies, including the Department, to enter into Swap Transactions is governed by ORS 190.110 and ORS 286A.110. The Department, as of the date of this Swap Policy, has not previously entered into any Swap Transaction. The Department may consider future use of Swaps or related financial instruments covered by this Policy but only in consultation with and the approval of the Oregon State Treasury, Director of Debt Management. In connection with the use of any Swap, the Department shall comply with all applicable State and Federal laws and agreements entered into by and between the Department and the State Treasurer and shall adopt and adhere to the State of Oregon Swap Policy for the Oregon State

Treasury and State Agencies ("State Swap Policy") dated as of June 10, 2013 and included as Appendix E – *State of Oregon Swap Policy*.

Prior to the use or execution of any Swap Transaction, the Department will first request the approval of the State Treasurer and enter into certain amendments to the State Swap Policy and certain agreements including those listed below and which shall be incorporated as appendices to the Department's Debt Policy.

- State of Oregon Swap Policy Amendments and Policy Clarifications Relating to the Oregon Department of Transportation
- Interagency Agreement Regarding the Use of Interest Rate Exchange Agreements

In addition, for any Swap Transaction entered into, the Department must receive an opinion acceptable to the market from a nationally recognized firm that the swap contract is a legal, valid, and binding obligation of the Department and that entering into such a contract complies with applicable State and Department policies and State and Federal laws and regulations.

12.5 Dodd-Frank Swap Advisor Requirements

The Department will employ a "Swap Advisor" in all communications with swap dealers that are intended to lead to recommendations or advice from swap dealers, and in all transactions with swap dealers (including executions, novations, amendments, and negotiated terminations of swaps). The Swap Advisor must meet the standards of a qualified independent representative (a "QIR") under the Dodd-Frank Act[1], and all regulations promulgated thereunder. The Department may use the State's Swap Advisor or, with the State Treasurer's approval, engage its own QIR Swap Advisor.

12.6 Swap Transaction Considerations

The Department shall consider entering into Swap Transactions based on the following analysis:

- The appropriateness of the transaction for the Department based on the balance of risks and rewards presented by the proposed transaction, including a detailed description of the transactional structure, a description of the risks it presents, and risk mitigation measures, where applicable.

- The legal framework for the transaction within the context of Oregon statutes, OTC authorization, and relevant indenture and contractual requirements (including those contained in credit agreements), as well as any implications of the transaction under Federal tax regulations.

- The reporting impact of the execution, performance and value of a Swap Transaction for accounting purposes. A comprehensive discussion of any Swap transaction should be included in the Department's Annual Financial Report.

[1] The Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111–203, H.R. 4173; commonly referred to as Dodd-Frank) was signed into federal law on July 21, 2010.

- The potential effects that the transaction may have on the credit ratings of the Department assigned by the rating agencies.
- The potential impact of the transaction on any areas where the Department's capacity may be constrained, now or in the future, including the availability of credit facilities such as bank liquidity facilities, letters of credit, and bond insurance.
- The impact on the Department's policy limitation on variable rate exposure, taking into account the degree of variability in the Department's net debt service payments that may be caused by basis risk, and specifically, by the form of basis risk known as tax risk (i.e., when a taxable index such as LIBOR or the SIFMA Municipal Swap Index[2] is used to hedge underlying tax-exempt floating rate debt).
- The ability of the Department and its professional staff to handle any administrative burden that may be imposed by the transaction, including accounting and financial reporting requirements.
- Other implications of the proposed transaction as warranted.

12.7 Permitted Instruments

The Department may consider the following, or similar, Swap Products, each of which is a two-party agreement between the Department and a counterparty:

- Interest Rate Swaps
- Options on Swaps or Swaptions
- Basis Swaps
- Rate Locks
- Interest Rate Caps, Collars, Floors
- Total Return Swaps
- Embedded Options
- Constant Maturity Swaps
- Other Swap Products shall be permitted at the discretion of the State Treasurer and the Department.

12.8 Swap Risk Analysis

Among the risks that the Department will monitor, evaluate, and seek to mitigate are the following, listed in order of greatest potential impact:

[2] The Securities Industry and Financial Markets Association Municipal Swap Index is a 7-day high-grade market index comprised of tax-exempt Variable Rate Demand Obligations (VRDOs) with certain characteristics. The Index is calculated and published by Bloomberg. The Index is overseen by SIFMA's Municipal Swap Index Committee.

Type of Risk	Description	Evaluation Methodology	Mitigation
Counterparty Risk	The risk that the counterparty will not fulfill its obligations as specified by the terms of the Swap Transaction, typically due to default by the counterparty or other severe credit event.	The Department will evaluate the Swap providers' credit ratings and existing exposure on other transactions.	The Department will diversify its counterparty exposure, impose minimum credit rating standards and require protective documentation provisions. ("Counterparty Credit Standards")
Termination Risk	The risk that a Swap Transaction could be terminated prior to its scheduled termination date pursuant to its terms as a result of any of several events relating to either the Department or its counterparty. Upon an early termination, the Department could owe a termination payment to the counterparty or receive a termination payment from the counterparty. Such payment would typically reflect the then-current market value of all Swap Transactions executed between the Department and its counterparty under a single master agreement.	The Department will review potential causes of early termination, including those resulting from documentation provisions and the likelihood of credit downgrade that could precipitate an early termination.	The Department will use protective documentation provisions and will evaluate sources of internal liquidity and market access that could be used in the event a termination payment were required to be made. For example, the risk of termination due to the Department's downgrade to a rating below BBB may be mitigated with bond insurance when the associated bond issue is insured.
Interest Rate Risk	The risk that the Department's costs associated with variable-rate exposure increase and negatively affects budgets, coverage ratios and cash flow margins. Variable-rate exposure may be created by a Swap from fixed to floating, or a Swap that otherwise creates some type of variable liability, such as basis risk, tax risk or yield curve risk (described below). The interest rate risk presented by such a Swap may be increased as interest rates increase generally, as intra-market relationships change, or because of credit concerns relating to the Department or a credit enhancer.	Prior to taking on interest rate risk, the Department will measure its capacity for floating rate exposure, based on policy targets for its mix of fixed and floating rate debt and investments, taking into consideration future variable rate needs.	The Department will maintain floating rate exposure within the 15% limitation specified in its Long-term Financial Obligation Management Policy (B-65), and will make selected use of interest rate hedges, like caps and collars, to reduce that risk. In evaluating its variable rate exposure, the Department will consider the residual risks of variable rate debt that is not fully hedged by swaps, such as basis and tax risk.

Type of Risk	Description	Evaluation Methodology	Mitigation
Basis Risk	The mismatch between the rate received by the Department under a Swap Transaction and the rate payable by the Department on any related obligation. For example, the risk in a floating-to-fixed swap that the floating rate received by the Department under the Swap Transaction may not at all times equal the floating rate paid by the Department on the variable rate bonds that it is hedging.	The Department will measure and review the historic variation between the floating rate index used in the Swap and the underlying floating rate instrument it is hedging. In the absence of a sufficient history of underlying instrument, it will use relevant comparable floating rate instruments. The degree of risks should be evaluated in comparison with degree of benefit provided.	The Department will analyze historic relationships and consider mitigation techniques as warranted, When used in connection with an advanced refunding, mitigation techniques could include maintaining a cushion between the floating rate index and the expected trading level of the floating rate instrument, creating a reserve to cover potential basis risk mismatches, and including provisions for optional termination.
Tax Risk	A common type of basis risk on Swaps used in conjunction with floating-rate tax-exempt debt is often referred to as “tax risk”, or the risk of a mismatch between the floating rate on the tax-exempt debt and a Swap index based on a taxable index like LIBOR. The correlation between the LIBOR-based rate and the floating rate on the debt may change based on changes in tax law, for example, changes in marginal tax rates, or other market events that change the trading pattern between tax-exempt and taxable securities. This risk can also be created by “basis swaps,” where-in both parties pay a variable rate, but only one is based on a tax-exempt index	The Department will assess the risk of a significant tax law change that could reduce the benefits of a Swap or generate unanticipated losses. Because this assessment requires judgment about future actions by the Federal government, the rewards for taking this risk should be deemed to be significantly greater than the risks, based on a careful assessment.	The Department should monitor its tax risk position, including taking steps to reduce tax risk when favorable market opportunities present themselves, limiting tax risk to within acceptable bounds, and considering the use of financial mechanisms to cap tax risk exposure.
Yield Curve	Yield curve risk may be present in swaps where a longer-term floating rate is used to hedge a shorter-term floating rate, creating different potential gain and loss depending on the steepness of the yield curve. This form of swap, often called a “constant maturity swap” to reflect the fact that one party continues to receive payment based on a rolling long-term rate, is popular when there is a flat yield curve, in anticipation of a steepening in the future.	In addition to an examination of historic yield curves and the probability of net positive receipts, the Department will also evaluate how the use of this swap fits into its overall risk management goals. For example, yield-curve swaps can help mitigate the underperformance of other structures in certain markets.	The Department will identify offsetting transactions that mitigate the effect of continued or renewed flattening of yield curves. Also, the Department will consider forward-starting instruments in flat- yield curve environments.

Type of Risk	Description	Evaluation Methodology	Mitigation
Rollover Risk	When a Swap is used in conjunction with underlying puttable floating-rate debt, bank facility rollover risk exists if the term of a needed liquidity or credit facility on the debt is shorter than the term of the Swap. The Department is at risk as to both the availability and the price of successive bank facilities.	The Department will evaluate the likelihood of unavailability of bank facilities based on the underlying credit of the debt as well as the general market for liquidity facilities.	This is a risk shared generally by variable-rate debt structures. The Department may use any of the following mitigation techniques: purchasing longer term facilities for credits where rollover risk is greatest; including alternative floating rate mechanisms like auction rate securities; and staggering the maturity dates of different liquidity facility programs to diversify points of market re-entry.
Pricing Risk	The risk that the Swap may not be priced fairly in comparison to the market for comparable Swap transactions.	Prior to entering into a Swap, the Department will make a determination that the transaction can be priced with reasonable transparency and confidence.	The Department will not enter into overly complex or illiquid transactions where fair pricing cannot be ascertained. For negotiated transactions, the Department will seek independent price verification through appropriate professional advice. The Department will also consider pursing a competitive process for swap transactions, based on the complexity of the structure.

12.9 Swap Procurement

The Department, acting in consultation with and the approval of the State Treasurer, may choose counterparties for entering into swap contracts on either a negotiated or competitive basis. However, the Department will have a bias toward competitively bidding financial products of a general nature that are widely available in the marketplace. On a product-by-product basis, the Department may negotiate the procurement of financial instruments that have a customized or specific attributes designed on its behalf.

The Debt Manager, in consultation with the Finance and Budget Division Administrator and the State Treasurer, will be responsible for determining the method of procurement for Swap Products. To provide safeguards on negotiated transactions, The Department will secure outside professional advice including that of the Department's Financial Advisor and the State's Swap Advisor to assist in the process of structuring, documenting and pricing the transaction, and to render an opinion that a fair price was obtained.

To uphold the highest standards and integrity of the municipal securities industry, the Department requires that counterparties comply with the Municipal Securities Rulemaking Board (i.e. "MSRB") rules regulating political contributions. In addition, the counterparty must disclose to the Department any gifts or payments made to State Treasury or Department officials, State elected officials and State Treasury or Department finance professionals. The counterparty must also disclose any payment made to State Treasury or Department consultants, including financial consultants and attorneys, who assisted the counterparty in securing business with the

Department and all payments made to third parties for the benefit of the Department in connection with the Swap Transaction (such as fees to a broker or other intermediary.) In addition, upon request of the Department, the counterparty shall disclose the terms of any "mirror" or "back-up" Swap Transaction or other hedging relationship entered into the counterparty in connection with the Department's Swap Transaction.

12.10 Counterparty Credit Standards

Unlike conventional debt instruments, Swap Products can create for the Department a continuing exposure to the creditworthiness of financial institutions that serve as the Department's counterparties on Swap Transactions. To protect the Department's interests in the event of a counterparty credit problem, Swap Transactions entered into by the Department will adhere to the following standards:

- *Use of highly rated counterparties*: Standards of creditworthiness, as measured by credit ratings, will determine eligible counterparties. Differing standards may be employed depending on the term, size, and interest-rate sensitivity of a transaction, types of counterparty, and potential for impact on the Department's credit ratings. As a general rule, the Department will enter into transactions only with counterparties whose obligations are rated in the double-A category or better from at least one nationally recognized rating agency.

- *Collateralization on downgrade*: If a counterparty's credit rating is downgraded below the double-A rating category, the Department shall generally require that its exposure to the counterparty be collateralized.

- *Termination*: If counterparty's credit is downgraded below a second (lower) threshold, that is, below an A-level rating, the Department may exercise a right to terminate the transaction prior to its scheduled termination date notwithstanding the counterparty's posting of collateral. The Department will seek to require, whenever possible, that terminations triggered by a counterparty credit downgrade will occur on the side of the bid-offer spread which is most beneficial to the Department, and which would allow the Department to go back into the market to replace the downgraded party with another suitable counterparty at no out-of-pocket cost to the Department.

- *Notice*: The Department's Swap counterparties will be required to notify the Department in the event a credit agency takes negative action with regard to the counterparty's credit rating, including both an actual downgrading of the credit rating as well as the publication of a notice by a rating agency that the counterparty's rating is in jeopardy of a downgrading (i.e., being placed on Standard & Poor's Credit Watch or being assigned a negative outlook by Moody's).

- *Exposure limits*: In order to limit the Department's counterparty risk, the Department will seek to avoid excessive concentration of exposure to a single counterparty or guarantor by diversifying its counterparty exposure over time. Exposure to any counterparty will be measured based on the termination value of any Swap Transactions entered into with the Counterparty, as well as such other measurements as the Department may deem suitable to measure potential changes in exposure, such as peak exposure. Peak exposure will be determined by a standard quantitative measurement that reflects the size, term, and projected volatility of the Swap Transactions. Exposure measurement will take into account offsetting swaps. The maximum potential exposure of all Department Swap Transactions should be no more than 10% of outstanding debt.

- *Termination Value*: Termination value will be determined at least annually, based on a mark-to-market calculation of the cost of terminating the Swap Transaction given the market conditions on the valuation date. Aggregate Swap termination value for each counterparty should take into account netting of offsetting transactions (i.e., fixed-to-floating vs. floating-to-fixed). The Department may require counterparties to provide regular mark-to-market valuations of Swap Transactions they have entered into with the Department, and may also seek independent valuations from third-party professionals.

12.11 Swap Documentation

The Department will use one of the forms of the International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreement as a framework for Swap documentation. The Swap agreement between the Department and each counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions, provisions and safeguards as the Department, in consultation with its advisors and legal counsel, deems necessary or desirable.

Subject to the provisions contained herein, the terms of any new Department Swap agreement shall adhere to the following guidelines:

- Downgrade provisions triggering termination shall be reflective of the relative credit strength of the Department in comparison with the Swap provider. This comparison should give weight to the prevailing greater credit strength of public sector entities as compared with the credit strength and higher corporate-equivalent ratings assigned to private sector financial institutions. For example, downgrade provisions affecting the Department would be triggered at a BBB- level, while downgrade provisions affecting the Swap provider would be triggered at an A- level.

- The Department will strive to minimize or avoid cross default provisions. The specific indebtedness related to credit events in any Swap agreement should be narrowly defined and refer only to indebtedness of the Department that could have a materially adverse effect on the Department's ability to perform its obligations under the Swap Transaction. Debt should only include obligations within the same or superior lien as the Swap obligation.

- Collateral thresholds[3] for the Swap provider should be set on a sliding scale reflective of credit ratings. Collateral requirements should be established and based upon the credit

[3] Collateral thresholds are used to determine the amount of securities that a swap counterparty must post as collateral to secure their potential payment if there were an early termination. The threshold is generally expressed as a specified dollar amount. If the mark-to-market value of the swap exceeds the dollar amount, the counterparty is required to post collateral equal to the amount of the excess. As counterparty's credit ratings decline, the threshold

ratings of the Swap provider or its guarantor. Department collateral thresholds, if any, will be negotiated on a transaction-by-transaction basis.

- Eligible collateral should generally be limited to cash, Treasuries and direct obligations of Federal Agencies, excluding interest-only, principal-only, and other complex securities.
- The Department shall have the right to optionally terminate a Swap agreement “at market” at any time over the term of the agreement. The Swap provider should have no similar right.
- The Department understands that its procurement and negotiation of the optimum portfolio of Swap Transactions in accordance with the terms of this Policy may be dependent, in part, on its ability to secure its payments to its counterparties. The Department shall consider, in light of its overall debt and investment management policy, and consistent with any limitations imposed by its other credit agreements, the benefits of providing its counterparties with a favorable credit position vis-à-vis its other creditors (e.g., parity with bondholders, etc.). Additionally, the Department may provide additional credit enhancement to its counterparties in the form of collateral, financial guaranty insurance or other credit support.

12.12 Execution and Ongoing Management

The Department shall seek to maximize the benefits it accrues and manage the risks it bears by actively managing its use of Swap Products. This shall entail continuous monitoring of market conditions, in conjunction with the counterparty and the State’s and Department’s advisors, for emergent opportunities and risks. The Department is authorized to manage any existing Swap Transactions without additional OTC approval, but consistent with any applicable resolution of the Commission. This discretion shall extend to future termination or modifications of the initial Swap Transactions provided the resulting structure does not exceed the parameters set forth in this Policy. Ongoing management may entail modifications of existing positions including:

- Early termination of a Swap Transaction
- Modification of the duration of a Swap Transaction
- A sale or purchase of options
- Application of basis swaps

The Department recognizes that changes in the capital markets or, the Department’s programs, and other unforeseen circumstances may from time to time produce circumstances that are not contemplated by this Policy and shall require modifications or exceptions to achieve the Department’s goals. In these cases, management flexibility is appropriate, provided that specific authorizations from the OTC and the State Treasurer are obtained on a financing basis.

amount should shrink, requiring collateral posting even for smaller mark-to-market values. If ratings drop far enough, the threshold will fall to zero, meaning the counterparty must post collateral equal to the full amount of the market-to-market value.

12.13 Reporting and Compliance

12.13.1 Annual Reporting

The Debt Manager shall prepare an annual report as of June 30 of each fiscal year that describes the status of its Swap Transactions to be provided to the State Treasurer. Each report shall include an evaluation of the performance of each Swap Transaction in relation to the goals and risks identified when the Swap Transaction was entered into. Each report shall include a summary of the terms of each Swap Transaction, including the credit rating and outlook of the counterparty, the market value of any collateral that has been posted, the market value of the Swap Transaction, as well as cumulative and periodic cash flows. Each report shall note all material changes to existing Swap Transactions and any new Swap Transactions entered into by the Department since the previous report.

12.13.2 GASB Reporting Requirements

Upon request at the end of each fiscal year, the Department will provide to the Oregon Department of Administrative Services – State Controller's Division with information required for financial reporting under the Governmental Accounting Standards Board and any other reporting requirements.

The Department complies with GASB 53 Accounting and Financial Reporting for Derivative Instruments and GASB 63 Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position. The mark-to-market valuation (i.e. "fair value"_ is recorded as an Asset – Deferred Outflow of Resources and as a Noncurrent Liability – Derivative Instrument – Interest Rate Swap on the Statement of Net Assets. The Department's Swap Advisor, as assigned, will provide the fair value using the zero-coupon method as of June 30 of each fiscal year. Additional information regarding existing swaps is provided in the Notes to the Financial Statements contained in the Department's Annual Financial Report.

12.13.3 MDAC Required Reporting

The Department will comply with Oregon Administrative Rule 170-060-101(5) – MDAC Notice by providing the following to the State Treasurer within thirty (30) days of execution or modification of a swap agreement:

- MDAC Form 3 (prepared by the Department's Financial Advisor)
- Executed copy of OTC resolution authorizing the Swap Transaction
- Swap Policy
- Legal opinion

12.13.4 Compliance with Dodd-Frank Act Regulations

For all Swap Transactions entered into, the Department will complete the following in compliance with the Dodd-Frank Act regulations and ISDA Protocols:

- Registered entity record
- ISDA Adherence Letter for Protocol I
- ISDA Protocol I Questionnaire
- ISDA Adherence Letter for Protocol II
- ISDA Protocol II Questionnaire

- Mapped ISDA Protocol I & II Questionnaires to the applicable counterparties

12.14 Conclusion

As noted in Section 12.4 – *Authority for Entering Into Swap Agreements*, the Department has not entered into any Swap Transactions as to the date of this Swap Policy. If the Department contemplates incorporation of Swap Transactions or Products into its overall debt management strategies, the Department will first request the approval of the State Treasurer, as required by the State Swap Policy, and enter into the below listed State Swap Policy amendment and interagency agreement which shall be incorporated as appendices to this Policy.

- State of Oregon Swap Policy Amendments and Policy Clarifications Relating to the Oregon Department of Transportation
- Interagency Agreement Regarding the Use of Interest Rate Exchange Agreements

The Debt Manager shall ensure compliance with the Department's Swap Policy as well as prevailing accounting practices and Federal, state, and local regulations and requirements including adherence to the Dodd-Frank Act. In any situation where this policy is in conflict with the State Swap Policy or related amendments and agreements, the State Swap Policy or related amendments and agreements will take precedence

12.15 Related Definitions

"Basis Risk" means the risk of a mismatch between the rate received by the Department under a Swap Transaction and the rate payable by the Department on any related obligation. For example, the risk in a floating-to-fixed swap that the floating rate received by the Department under the Swap Transaction may not at all times equal the floating rate paid by the Department on the variable rate bonds that it is hedging. Basis risk commonly occurs if variable rate swap payments are based on a percentage of LIBOR.

"Basis Swap" means a floating-to-floating rate swap in which one variable rate index is swapped for another. Basis swaps are commonly used to modify basis risk.

"Bid/Ask Spread" means the difference between the (i) bid price at which a market maker is willing to buy and (ii) the ask price at which a market maker is willing to sell. Also referred to as a bid/offer spread.

"Collar" means a combination of an interest rate cap and an interest rate floor.

"Collateral Thresholds" are used to determine the amount of securities that a swap counterparty must post as collateral to secure their potential payment if there were an early termination. The threshold is generally expressed as a specified dollar amount. If the mark-to-market value of the swap exceeds the dollar amount, the counterparty is required to post collateral equal to the amount of the excess. As counterparty's credit ratings decline, the threshold amount should shrink, requiring collateral posting even for smaller mark-to-market values. If ratings drop far enough, the threshold will fall to zero, meaning the counterparty must post collateral equal to the full amount of the market-to-market value.

"Collateralization Risk" means the risk that circumstances will arise in the future that will require an agency to post collateral pursuant to a swap agreement.

"Constant Maturity Swaps" means a Swap in which a longer-term floating rate is used to hedge a shorter-term floating rate, creating different potential gain and loss depending on the steepness of the yield curve.

"Counterparty" means a party in a swap transaction.

"Counterparty Credit Risk" means the risk that the counterparty will not fulfill its obligations as specified by the terms of the Swap Transaction, typically due to default by the counterparty.

"Credit Support" means collateral in the form of cash and/or marketable securities posted by one party to a swap agreement to reduce the credit exposure of the counterparty.

"Credit Support Annex" means a document governed by the ISDA Master Agreement which states the provisions and circumstances under which collateral posting is required.

"Derivative Subsidiary" an entity typically created by a financial institution for entering into swap transactions. Such subsidiaries are usually guaranteed by the financial institution creating them, or are terminated if such financial institution falls into bankruptcy.

"Fixed Rate Swap" means an interest rate swap in which an agency pays a counterparty a fixed interest rate in exchange for receiving a variable interest rate – commonly used to create synthetic fixed rate obligations.

"Floor" means a financial contract under which an issuer will make a payment to the swap provider when the underlying debt falls below the predetermined strike rate, or floor rate.

"Forward Starting Swap" means an interest rate swap under which the exchange of cash flows commences at later date - commonly used to lock in current interest rates for future transactions.

"Interest Rate Cap" means a financial contract in which the provider, in exchange for a fee, will make payments to an issuer of variable rate debt to the extent that the interest rate on that debt exceeds a specific rate (known as the "cap rate").

"Interest Rate Risk" means the risk that the Department's costs associated with variable-rate exposure increase and negatively affect budgets, coverage ratios and cash flow margins. Variable-rate exposure may be created by a Swap Transaction or Product from fixed to floating, or a Swap Transaction or Product that otherwise creates some type of variable liability, such as basis risk, tax risk or yield curve risk. The interest rate risk presented by such a Swap Transaction or Product may be increased as interest rates increase generally, as intra- market relationships change, or because of credit concerns relating to the Department or a credit enhancer.

"Interest Rate Swaps" means a contractual agreement to exchange periodic payments based upon changes in rates over a period of time. Cash flows are calculated based on a fixed or floating rate against a set "notional" amount (amount used only for calculation of payments) and may begin on a current or forward basis. Principal is not exchanged.

"ISDA Master Agreement" means the standardized master legal agreement for all derivative transactions between an agency and counterparty.

"London Inter-Bank Offered Rate (LIBOR)" means the interest rate banks charge each other for short-term money, up to a 12-month term. LIBOR is typically used as the index for the variable rate component of interest rate swaps.

"Mark-to-Market" means the calculation of the value of a financial instrument (e.g., an interest rate swap) based on current market rates.

"Notional Amount" is similar to bond principal amount; used as the basis to determine the amount of swap interest payments. The notional amount will often amortize over time to match the amortization of the bonds to which the swap is related.

"Optional Termination" means the right of a party to terminate a swap at any time at prevailing market prices - in swap agreements, typically the agency is the only party to have such rights.

"Options on Swaps" means an agreement in which one party has the right, but not the obligation, to enter into, cancel or modify a predetermined swap with the other party on a future date or dates or during a specific period.

"Peak Exposure (also "Value at Risk")" provides a quantification of the Department's reasonable "worst case" swap exposure, i.e. the risk to the Department in the event of a swap termination. It is calculated by applying stress tests to the Department's swaps to show how large the potential termination cost of the swaps could be if markets moved in an extremely adverse manner. Market movements are typically calculated assuming two standard deviations in interest rates, based on historic and/or implied volatilities, to provide a better than 95% degree of confidence.

"Pricing Risk" means the risk that the Swap Transaction or Product may not be priced fairly in comparison to the market for comparable Swap Transactions.

"Rate Locks" means an agreement with a single cash flow, which is most often used to hedge, though not necessarily reduce, the interest cost of an anticipated future fixed rate issue.

"Rollover Risk" means the risk when a Swap Product is used in conjunction with underlying puttable floating-rate debt, bank facility rollover risk exists if the term of a needed liquidity or credit facility on the debt is shorter than the term of the Swap Transaction or Product. The Department is at risk as to both the availability and the price of successive bank facilities.

"Settlement Amount" means the amount the Department or the counterparty would need to pay to the other upon early termination of the swap to make up for a loss in value due to a change in interest rates.

"SIFMA Municipal Swap Index" means the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index is a 7-day high-grade market index comprised of tax-exempt variable rate demand obligations from the Municipal Market Data's database.

"Swap Curve" means the swap's equivalent of a yield curve for fixed rate securities. The swap curve identifies the relationship between rates at varying maturities.

"Strike Rate" means the rate at which the cash flows will be exchanged between the purchaser and the seller.

"Swaption" means an option on an interest swap that gives the purchaser the right, but not the obligation to begin, terminate or extend a swap based on certain agreed upon parameters.

"Synthetic Fixed Rate" means a synthetic fixed rate is created when issuing variable rate bonds together with entering into a variable to fixed interest rate swap agreement. 15

"Tax Risk" means the risk of a mismatch between the floating rate on the tax-exempt debt and a Swap index based on a taxable index like LIBOR. The correlation between the LIBOR-based rate and the floating rate on the debt may change based on changes in tax law, for example, changes in marginal tax rates, or other market events that change the trading pattern between tax-exempt and taxable securities. This risk can also be created by "basis swaps," where-in both parties pay a variable rate, but only one is based on a tax-exempt index.

"Termination Event" means events that allow for the termination of a swap, e.g., a credit downgrade of the counterparty.

"Termination Payment" means the payment made by one counterparty to the other if the swap is terminated before its scheduled termination date. The payment is commonly based on the market value of the swap.

"Termination Risk" means the risk that a Swap Transaction could be terminated prior to its scheduled termination date pursuant to its terms as a result of any of several events relating to either the Department or its counterparty. Upon an early termination, the Department could owe a termination payment to the counterparty or receive a termination payment from the counterparty. Such payment would typically reflect the then-current market value of all Swap Transactions executed between the Department and its counterparty under a single master agreement.

"Threshold" means the point at which the counterparty or the Department will need to post collateral under the swap agreement. Threshold will vary with rating levels.

"Total Return Swap" means a swap pursuant to which one party receives synthetic exposure to a debt or equity instrument in return for a fixed or floating payment.

"Variable Rate Swap" means an interest rate swap in which an agency pays counterparty a variable interest rate in exchange for receiving a fixed interest rate - commonly used to create synthetic variable rate obligations.

"Yield Curve Risk" means the risk that may be present in swaps where a longer-term floating rate is used to hedge a shorter-term floating rate, creating different potential gain and loss depending on the steepness of the yield curve. This form of swap, often called a "constant maturity swap" to reflect the fact that one party continues to receive payment based on a rolling long-term rate, is popular when there is a flat yield curve, in anticipation of a steepening in the future.

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Chapter 13 Federal Tax Compliance

13.1 Purpose and Scope

The purpose of this Federal Tax Compliance Policy and Guidelines (the "Tax Compliance Policy" or "Guidelines") is to ensure that the Department complies with applicable requirements of Federal tax and securities laws that apply to any tax-exempt obligation or other debt issued by or on behalf of the Department. This Tax Compliance Policy is intended to formally memorialize certain policies previously adopted or followed by the Department in connection with its issuance of tax-exempt bonds or other debt obligations. The Policy is designed to set forth compliance procedures and processes so that interest on tax-exempt governmental bonds of the Department ("TEBs") remains excludable from gross income under Section 103 of the Internal Revenue Code of 1986, as amended (i.e. the "U.S. Code" or the "Code") and regulations promulgated thereunder (i.e. "Treasury Regulations").

The Department understands that failure to comply with the policies and procedures set forth in these Guidelines may result in the retroactive loss of the exclusion of interest on TEBs from Federal gross income. Therefore, the Department will consult with counsel nationally recognized in the area of municipal finance (i.e. "Bond Counsel"), in advance, regarding deviations from the facts and expectations as set forth in the closing certifications relating to any issue of Bonds.

To comply with applicable Federal tax requirements, the Department must confirm that the requirements are met at the time each series of Bonds are issued and throughout the term of the Bonds (until maturity or redemption). Generally, compliance includes, among other things:

- Retention of records relating to the expenditure of the proceeds of each Bond issue;
- The investment of the proceeds of each Bond issue; and
- Any allocations made with respect to the use of the Bond proceeds, sufficient to establish compliance with applicable Federal tax requirements, including records related to periods before the Bonds are issued (e.g., in the case of reimbursement of prior expenditures) until three (3) years after the final maturity or redemption date of any issue of Bonds.

An additional purpose of these Tax Compliance Guidelines is to advise the Department's management and staff that are responsible for the administration of the Department's debt-financed programs and the expenditure of Bond proceeds of their obligation to comply with State and Federal law, the Code and Treasury Regulations regarding tax-exempt and tax-advantaged debt.

These Tax Compliance Guidelines describe Federal tax laws and Treasury Regulations and for the most part only apply to Bonds to the extent that they are Federally tax-exempt obligations. Such procedures do not apply to Bonds issued as Federally taxable obligations. However, these procedures suggest supplementary actions that while not required for Federal tax compliance are nonetheless recommended in order to encourage the Department's ability to track continuing tax compliance in the event that uses of a financed project changes unexpectedly during the term of a financing.

13.2 Source of Tax Exemption

Section 103(a) of the Code[1], as amended, provides that interest on any "State or local bond" (an obligation of a state or political subdivision of a state) is excluded from Federal gross income. This is the basis for Federal tax exemption of municipal bonds. The Federal tax exemption does not apply[2]:

1) To a private activity bond, unless it is a "qualified bond" under Code section 141;
2) To an "arbitrage bond," defined in Code section 148; or
3) To any bond unless it meets certain requirements of Code section 149.

The above requirements also include:

- The bond must be registered.
- The issuer must file a form 8038 with the Internal Revenue Service after the governmental bonds are issued, as more fully described in Section 13.4.4 – *Information Reporting*.
- Limits on advance refunding.
- Rules relating to hedge bonds.

13.3 Ongoing Relationship with Outside Advisors

The Department maintains an ongoing relationship with Bond Counsel, arbitrage and Federal tax compliance consultant (the "Arbitrage Consultant") and other advisors to serve as a resource for advice regarding the Bonds' Federal tax compliance and adherence to state and Federal laws, the Code and Treasury Regulations. Chapter 3 – *Financing Team and Consultants* and Appendix C – *Debt Compliance Responsibilities* identifies additional outside organizations and advisors that will be engaged to assist the Department in carrying out tax and post-issuance compliance requirements.

13.4 Issuance of Bonds

13.4.1 Bond Authorization

Legislative Assembly authorization, including enactment in the biennial legislative bond authorization (i.e. the "Bond Bill"), is required for issuance of all State of Oregon bonds; this includes all debt obligations issued by or on behalf of the Department.

For Bonds issued by the Department, additional authorization by resolution (i.e. "Bond Resolution") of the Oregon Transportation Commission is also required. The Debt Manager will coordinate the preparation of the required Bond Resolution for OTC approval in consultation with Bond Counsel, the State Treasurer, the Department of Justice and the Department management and staff responsible for the administration of debt-financed programs and projects.

For Bonds issued on behalf of the Department by another agency, such as Certificates of Participation, Facilities Bonds, and Lottery Revenue Bonds issued by the Department of Administrative Services, the Debt Manager will coordinate the Department's bond issuance

[1] 26 U.S. Code §103(a).
[2] 26 U.S. Code §103(b).

request with Department management, the State Treasurer, and the responsible issuing agency and, if applicable, a resolution for reimbursement of prior incurred expenditures.

13.4.2 Consultation with Bond Counsel and Other Advisors

In connection with any tax-exempt Bond issue, Bond Counsel will deliver a legal opinion which will be based in part on covenants and representations set forth in the Bond's Tax Certificate (or other closing documents containing the tax representation). Bond Counsel will also deliver other certificates and documents relating to the Bonds, including covenants and representations concerning compliance with post-issuance Federal tax law requirements that must be satisfied to preserve the tax-exempt status of TEBs.

As described more fully below, the Debt Manager or other designated personnel will consult with Bond Counsel and other legal counsel and advisors, as needed, following Bond issuance to identify requirements and to establish procedures necessary or appropriate to ensure that the tax-exempt status of interest is maintained for Federal income tax purposes so long as any Bonds remain outstanding. Those requirements and procedures will be documented in a Tax Certificate and other certificates and/or other documents finalized at or before issuance of the Bonds. The requirements and procedures in the Tax Certificate shall include future compliance with applicable arbitrage rebate requirements and all other applicable post-issuance requirements of Federal tax law throughout (and in some cases beyond) the term of the Bonds.

13.4.3 Tax Requirements and Documentation

Federal tax requirements relating to each Bond issue will be set forth in the Tax Certificate executed in connection with the Bond issue, which will be included in the closing transcript. The certifications, representations, expectations, covenants and factual statements in the Tax Certificate relate mainly to the following:

- Restrictions on use of the Bond-financed facilities by persons or entities other than the issuer.
- Changes in use of assets financed or refinanced with bond proceeds.
- Restrictions applicable to the investment of bond proceeds and other moneys relating to the Bonds.
- Arbitrage rebate requirements, and
- The economic life of the Bond-financed assets.

13.4.4 Information Reporting

The Debt Manager or other designated personnel will assure filing of information returns on IRS Form 8038-G, Form 8038-B or other form required by the IRS no later than the 15th day of the second calendar month in the calendar quarter following the calendar quarter in which an issue of Bonds is issued[3].

For all bond issues, the Debt Manager will confirm that information returns required by the IRS are accurate and filed in a timely manner, including any required schedules and attachments. The applicable information return form filed with the IRS, together with an acknowledgement

[3] 26 CFR §1.149(e)-1 – *Information Reporting Requirements for Tax-Exempt Bonds*

copy (if available) or IRS Notice CP152, will be included as part of the closing Bond Transcript for each Bond issue, or kept in the records related to the appropriate issue of Bonds.

Note that in practice, Bond Counsel is generally tasked with the responsibility to prepare and file the IRS Form 8038-G or other form as applicable in connection with the issuance of the Department's Bonds with copies included in the Bond Transcript.

13.5 Persons Responsible for Bond and Tax Compliance

Treasury Regulations require that governmental issuers of tax-exempt obligations monitor the spending and investment of the TEB proceeds and the use of the facilities financed with the tax-exempt obligations.

13.5.1 Chief Financial Officer

The Chief Financial Officer shall be primarily responsible for ensuring that the Department successfully carries out its tax and post-issuance compliance requirements under applicable provisions of the Code and Treasury Regulations. Financial Services Branch staff and other responsible Department staff, as appropriate, will assist the Chief Financial Officer to carry out the Department's tax and post-issuance compliance responsibilities.

The Chief Financial Officer shall be responsible for assigning tax and post-issuance compliance responsibilities to members of the Financial Services Branch, other staff of the Department, Bond Counsel, and other members of the Department's Financing Team. The Chief Financial Officer shall utilize such other professional service organizations as are necessary to ensure compliance with the post-issuance compliance requirements of the Department. Importantly, the Chief Financial Officer shall provide training and educational resources to Department staff responsible for ensuring compliance with any portion of the post-issuance compliance requirements of this Tax Compliance Policy.

13.5.2 Tax Compliance Officer Responsibilities

The Debt Manager is the Department's "Tax Compliance Officer" and, at the direction of the Chief Financial Officer, is the primary person to consult with Bond Counsel and other advisors on a continual basis with respect to the Bonds. In general, the Debt Manager as the designated Tax Compliance Officer has the primary responsibility to ensure compliance with the tax requirements relating to all Bonds issued by or on behalf of the Department.

As described in these Guidelines, tax requirements vary with respect to the different types of Bonds of the Department but include one or more of the following:

- The expenditure and investment of "Bond Proceeds."[4]
- The use or sale of the assets or facilities financed or refinanced with Bond Proceeds (the "Bond-Financed Assets or Facilities").
- Limitations on the amount of direct or indirect payments from persons other than another state or local governmental unit (a "Non-Governmental Person")[5] with respect to Bond-Financed Assets ("Private Payments") as described further in Section 13.7 – *Use of Bond-Financed Assets* of this Tax Compliance Policy.

[4] The money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities.
[5] Non-Governmental Person includes the Federal government.

- Record-keeping and filing requirements.

The Tax Compliance Officer shall review the Tax Certificate and any other relevant documents executed by the Department that outline the Federal tax law requirements affecting the TEBs with respect to any particular issue. The Tax Certificate is included as part of the respective Bond Transcript.

The Debt Manager, as the designated Tax Compliance Officer, shall develop and institute such procedures necessary and appropriate to monitor the use of the proceeds of TEBs issued by or on behalf of the Department, to verify that certain post-issuance tax and disclosure compliance actions have been taken by the Department, and to provide for the inspection of the projects and facilities financed with the proceeds of such bonds.

In particular, the Tax Compliance Officer is responsible for ensuring compliance with tax requirements during the life of the Bonds or the Bond-Financed Assets including:

- Monitoring the use of the Bond Proceeds and the requisitions for payment of costs.
- Monitoring the use, sale or other disposition of Bond-Financed Assets (e.g., facilities, furnishings or equipment) throughout the term of the Bonds (or the expected useful life of the Bond-Financed Assets, if shorter) to identify whether any use of such Bond-Financed Assets is classified as a "Private Business Use" as defined in Section 13.7 – *Use of Bond-Financed Assets*.
- Monitoring the amount and allocation of Private Payments throughout the term of the Bonds to identify whether such Private Payments exceed the limitations set forth in the Code.
- Determining whether Private Business Uses of Bond-Financed Assets have exceeded the de minimus limits set forth in Section 141(b) of the Code[6] as a result of leases and subleases, management contracts, or other arrangements that provide special legal entitlements to nongovernmental persons.
- Determining whether private security or payments that exceed the de minimus limits set forth in Section 141(b) of the Code have been provided by nongovernmental persons with respect to such bond-financed facilities.
- Ensuring compliance with the expenditure and investment requirements under the temporary period provisions set forth in Treasury Regulations, Section 1.148-2(e).[7]
- Ensuring compliance with the safe harbor restrictions on the acquisition of investments set forth in Treasury Regulations, Section 1.148-5(d).[8]
- Ensuring that Bond Proceeds are invested at fair market value at or below the applicable yield restrictions and that any rebate payments are timely calculated and remitted to the Internal Revenue Service.
- Determining whether there has been compliance with the spend-down requirements under the spending exceptions to the rebate requirements set forth in Treasury Regulations, Section 1.148-7.[9]

[6] 26 U.S. Code §141(b).
[7] 26 CFR 1.148-2(e).
[8] 26 CFR 1.148-5(d).
[9] 26 CFR 1.148-7.

In addition, the Tax Compliance Officer will:

- Provide advice to Department management and staff responsible for the expenditure of Bond Proceeds of their obligations to comply with applicable state and Federal law and Treasury Regulations and the ongoing requirements of this Tax Compliance Policy.
- Communicate as necessary and appropriate with personnel responsible for the Bond-Financed Assets to identify and discuss any existing or planned use of the Bond-Financed Assets, to ensure that those uses are consistent with all covenants and restrictions set forth in the applicable Tax Certificate.
- Provide training and educational resources to any Department staff that have the primary responsibility for the operation, maintenance, or inspection of Bond-Financed Assets with regard to the limitations on the private business use of Bond-Financed Assets and as to the limitations on the private security or payments with respect to Bond-Financed Assets.
- Consult with Bond Counsel and other legal counsel as needed in the review of any contracts or arrangements involving the use of Bond-Financed Facilities to ensure compliance with all covenants and restrictions set forth in the applicable Tax Certificate.
- Ensure training opportunities are available to Debt Management staff and other Department staff responsible for the management and expenditure of Bond Proceeds to support understanding of the tax requirements applicable to the Department's debt obligations.

13.5.3 Responsible Division Responsibilities

In carrying out the Department's tax and post-issuance compliance requirements, the Debt Manager, as the Department's Tax Compliance Officer, will be assisted by Financial Services Branch staff and other Department program and project administrators, managers and staff that are responsible for the administration and management of debt-financed projects and programs and the expenditure of Bond Proceeds (i.e. the "Responsible Division").

Appendix C – *Debt Compliance Responsibilities*, identifies Department division, program and project management administrators, managers and staff who by their position are required to assist the Debt Manager for compliance with bond and tax requirements during the life of the Bonds or the Bond-Financed Assets. The Debt Manager will provide the person or the current holder of the position identified in Appendix C – *Debt Compliance Responsibilities* a copy of these procedures and other information relevant to their bond and tax compliance responsibilities.

Responsible Division administrators, managers and staff that oversee and administer programs or projects that use the proceeds of Department debt obligations have the responsibility to:

- Develop and provide to the Tax Compliance Officer bond proceed expenditure plans that reflect reasonable spend down expectations prior to the issuance of any bond series.
- Ensure Bond Proceeds are spent for the purpose(s) designated in the authorizing legislation, resolution, declaration, official statement or other authorizing documents.
- Ensure Bond Proceeds are spent timely and with due diligence.
- Monitor spend-down of proceeds and notify the Tax Compliance Officer of status related to the requirements set forth in relevant bond documents, interagency or inter-department agreements and the 3-year "Temporary Period," (as more fully described below and in

Treasury Regulations, Section 1.148-2(e))[10] and, if spending exceptions to rebate are not met or are not anticipated to be met.

- Ensure all expenditure documentation, including contracts, invoices, draw requests and payment documentation are retained and disposed of in accordance with the Code, the Department's Retention Policy, and Section 13.12 – *Documentation and Record Keeping Requirements* of this Tax Compliance Policy.
- Ensure financed capital improvements are used for eligible or qualified purposes in compliance with all relevant laws, statutes and regulations.
- Maintain records of debt financed projects that identify and track, among other things:
    - the issuance date and the final redemption date of the specific debt issue (i.e. Bond Series) that provided funding for the project, facility, program or asset.
    - the allocation of project expenditures to the specific debt issue.
    - the useful or economic life of the debt financed facility or asset.
    - the sale, lease or transfer of debt financed facility or asset.
    - any private-use of debt financed facilities or assets.
    - project completion information.
- Notify the Tax Compliance Officer before any planned change in use or sale of an asset or facility financed with tax-exempt and tax-advantaged debt that is still outstanding. Examples include leases to private entities of a floor or building, private management contracts to operate a facility, sale of an asset prior to its useful life expiration, etc.
- Upon issuance of debt, provide certification to the Tax Compliance Officer that Departmental staff responsible for the financed project will conform to all applicable processes and procedures contained as provided in this Tax Compliance Policy.
- Notify the Tax Compliance Officer of any concerns that these responsibilities are not being met.

Note that the above requirements are applicable to all programs financed with bond proceeds including grant programs such as the Lottery Bond funded *Connect*Oregon multimodal transportation program.

13.6 Expenditure of Bond Proceeds

Bond Proceed expenditure requirements are established in accordance with Oregon and Federal law and U.S. Treasury Regulations. Oregon and Federal law and Treasury Regulations define the purposes for which Bond Proceeds may be used, set requirements for the issuance of tax-exempt Bonds and for the expenditure of Bond Proceeds. The primary Federal requirement is to exercise due diligence at all times in spending Bond Proceeds within reasonable timeframes and for the intended purposes. If Federal expenditure *timing* requirements cannot be met, consequences to the Department may include higher costs in a negative arbitrage environment, the significantly higher costs of a taxable borrowing, or reduced flexibility in future tax-exempt bond issuance. If Federal expenditure *purpose* requirements are not met, the IRS may declare the Department's TEBs taxable and demand monetary penalties, **even if the violation is**

[10] 26 CFR 1.148-2(e).

unintentional. The Department benefits from lower borrowing costs of tax-exempt Bonds by complying with Federal expenditure requirements.

The Debt Manager is responsible for the development of the Department's bond issuance strategy in collaboration with Responsible Division administrators and staff and the Department's debt Financing Team that includes, among others, the State Treasurer, ODOT's Financial Advisor and Bond Counsel, and the Department of Justice. The individual project delivery schedule and actual project delivery execution will determine bond issuance timing, structure and size. Bonds will be issued to assure that Bond Proceeds are available to meet project needs. Funds will be borrowed based on program cash flow requirements and market conditions and will be managed through the selection of appropriate financing tools.

It is critical for project expenditure plans to be as accurate as possible in order to properly time the sale of bonds and to determine appropriate investment horizons for Bond Proceeds.

13.6.1 Cost of Issuance Limitation

Not more than two percent (2%) of the sale of proceeds of a Bond issue may be used to pay for costs of issuing the Bonds.[11] Bond closing documents prepared by Bond Counsel, requisitions for costs of issuance, and final pricing numbers provided by the underwriter or bond purchaser, should appropriately demonstrate that costs of issuance financed by the Bond issue do not exceed two percent (2%) of the sale proceeds.

Note that the 2% limitation works in tandem with the associated calculations commonly referred to as the "95 percent" test. The 95 percent test refers to the calculation of qualified and unqualified costs as percentages of tax-exempt bond proceeds; that is, at least 95% of the net proceeds of the bonds must be used for qualified exempt purposes; e.g. construction costs, etc. The 2% cost of issuance limitation must be financed only from the allowable five percent (5%) "bad money" portion of the issue. The 2% cost of issuance limitation is counted as part of the 5% "bad money" limit.

The 5% "bad money" limit and 2% cost of issuance limitations are calculated differently. The 5% "bad money" limit is applied to net bond proceeds (sale proceeds minus deposit to a reserve fund), while the 2% limit is applied to sale proceeds.

The Debt Manager will monitor the Bond Proceeds to ensure that no more than 2% of the sale of proceeds of a Bond issue will be used for costs of issuance.

13.6.2 Timely Expenditure of Bond Proceeds

In accordance with Treasury Regulations, the Department must at the time of bond issuance reasonably expect to spend at least eighty-five percent (85%) of all proceeds anticipated to be used to finance improvements (which proceeds would exclude proceeds in a reserve fund or for any non-project purpose) within three (3) years of issuance.[12] Other limitations or adjustments may be set out in the Tax Certificate. The Department must also have incurred or have reasonably expected to incur, within six (6) months after issuance of the Bonds, binding obligations to unrelated parties involving an expenditure of not less than five percent (5%) of

[11] 26 U.S. Code §147(g)(1).
[12] 26 U.S. Code §149(g)(3)(A)(i).

such amount of Bond Proceeds, and that completion of the project and allocations of Bond Proceeds to costs would proceed with due diligence. Meeting all these requirements will generally allow the Department to invest these project-related Bond Proceeds at an unrestricted yield for three years (i.e. 3-Year "Temporary Period"). See Section 13.9.12 – *Exceptions to Rebate Requirements* regarding rebate exceptions.

Note that if the 3-year spending expectation is not met, then at least 85% of the TEB proceeds must be spent within five (5) years of issuance.[13]

It is important that Responsible Divisions understand that failure to spend down Bond Proceeds in a timely fashion as required by Federal tax law may result in the designation of the Department's TEBs as taxable "Hedge Bonds" by the IRS.

Bonds issued to refinance outstanding obligations are subject to separate expenditure requirements as outlined in the Tax Certificate relating to such Bonds. The Tax Compliance Officer will monitor the appropriate capital project accounts (and, to the extent applicable, working capital expenditures and/or refunding escrow accounts) and ensure that Bond proceeds are spent within the applicable time-period required under Federal tax law.

13.6.3 Bond Proceed Expenditure Documentation

The Department's Debt Manager is responsible for ensuring compliance with all IRS regulations concerning the appropriateness and timeliness of bond proceed expenditures. The Debt Manager shall utilize available accounting information to document the receipt and expenditure of bond proceeds, and the proper retention of expenditure records. Current practice utilizes Power BI reports to document this information.

13.6.4 Capital Expenditures or Capital Costs

In general, proceeds (including earnings on original sale proceeds) of Bonds issued to fund original expenditures, other than proceeds deposited in a reasonably required reserve fund or used to pay costs of issuance, should be spent on capital expenditures. For this purpose, "Capital Expenditures" or "Capital Costs" generally mean costs to acquire, construct, or improve property (land, buildings and equipment), or to adapt the property to a new or different use. The property financed or refinanced must have a useful life longer than one (1) year.

Capital Expenditures include design and planning costs related to the project, and architectural, engineering, surveying, soil testing, environmental, and other similar costs incurred in the process of acquiring, constructing, improving or adapting the property. Other project costs that may be allowable Capital Costs include, for example, personnel salary and benefits, contracting and legal expenses, accounting costs, etc., **but only** if those costs are directly related to the capital project.

Critical to the analysis as to whether a cost is allowable is its connection to the capital project. For example, with personnel costs it is the actual work done on or in support of the authorized project. To the extent that Department staff record their time appropriately and that the recorded time allows for identification that the time spent is directly involved with the capital project,

[13] 26 U.S. Code §149(g)(2)(D).

rather than other non-related Departmental programs and functions, then those allocable personnel costs should be eligible Capital Costs of the project.

Generally, planning and program coordination costs would not be capitalizable. Four exceptions may include:

1) Negotiations to secure financing could qualify as an allowable cost of issuance
2) Site ownership and availability of property may be capitalizable as soft costs of the physical project
3) Oversight of procurement, acquisition and the work specifically related to project construction
4) Legal costs relating exclusively to contract work with architects, designers and contractors

Capital Costs or Expenditures do not include operating expenses of the project or incidental or routine repair or maintenance of the project, even if the repair or maintenance will have a useful life longer than one (1) year.

13.6.5 Working Capital or Operating Costs

"Working Capital" or "Operating Costs" are the expenses required to maintain an organization's existence. These are not capital outlays but expenses associated with the administration, operations and maintenance of the organization. Working Capital or Operating Costs may include:

- Accounting expenses
- Association and professional memberships
- Conferences and associated travel
- Education and training
- General development of operational programs
- Facility expenses such as rent, utilities, snow removal, janitorial services, etc.
- Maintenance and repair costs
- Office expenses and supplies
- Personnel costs
- Strategic planning
- Travel expenses

Working Capital and Operating Costs of the Department are **NOT** to be funded with long-term tax-exempt debt obligations except out of the five percent (5%) capital allowance permitted by the Internal Revenue Code.

Responsible Division management should be especially careful when authorizing expenditures using TEB proceeds for maintenance and repair, training, conferences and other administrative costs that may be deemed Working Capital or Operating Costs. The rules for Working Capital are complex and restrictive and as a practical matter may result in the TEBs being deemed Federally taxable "arbitrage bonds" by the IRS and/or result in significant payments and penalties for which the Department would be responsible.

13.6.6 Assignment of Responsibility and Establishment of Bond Calendar

On the date of issuance of any Bond, the Debt Manager will identify for that Bond issue:

- The funds and/or accounts into which Bond Proceeds are deposited.
- The types of expenditures expected to be made with the Bond Proceeds deposited into those funds and/or accounts and any expenditures prohibited from being made from such funds or accounts.
- The dates by which all Bond Proceeds, as described in Section 13.6.2 – *Timely Expenditure of Bond Proceeds* of this Tax Compliance Policy, must be spent or become subject to arbitrage yield limitations ("Expenditure Deadlines") and all interim dates by which funds and/or accounts must be checked to ensure compliance with the applicable Expenditure Deadlines.

13.6.7 Expenditure Failures

If any person discovers that an Expenditure Deadline or a restriction on expenditures as described herein has not or will not be met, such person will promptly notify the Debt Manager who will consult with Bond Counsel to determine the appropriate course of action with respect to such unspent Bond Proceeds or prohibited use of Bond Proceeds. Special action may need to be taken with such unspent or misspent Bond Proceeds, including yield restriction, or redemption of Bonds.

13.6.8 Final Allocation of Bond Proceeds to Expenditures

As required by Treasury Regulations,[14] Bond Proceeds for each issue of TEBs will be allocated (i.e. used to reimburse) to expenditures for assets, and the Department shall trace and keep track of the use of Bond Proceeds and property financed or refinanced therewith. As a practical matter, the Department should use Bond Proceeds to reimburse itself for all outstanding "eligible" expenditures on or shortly after the closing date of the Bonds and then allocate Bond Proceeds to new expenditures as they occur.

Requests for expenditures will be summarized in a final allocation of Bond Proceeds ("Final Allocation") in a manner consistent with allocations made to determine compliance with arbitrage yield restriction and rebate requirements (See Section 13.8 – *Investment Restrictions, Arbitrage Yield and Rebate Compliance*). The Final Allocation will memorialize the assets or portion thereof financed with Bond Proceeds and the assets or portion thereof financed with other funds. The Final Allocation must occur:

(i) not later than 18 months after the later of (a) the date the expenditure is paid, or (b) the date the project or facility to which the expenditure relates is completed and actually operating at substantially the level for which it was designed;

(ii) but in all events, not later than 60 days after the end of the fifth (5th) year after issuance of the Bonds or 60 days after none of the Bonds are outstanding, if earlier.

[14] 26 CFR §1.148-6(d)(1).

The Debt Manager will be responsible for ensuring that such Final Allocation is made for the Bonds. The Debt Manager and the Responsible Division will maintain records that show, among other things:

- The first and last dates for which an expenditure can be reimbursed.
- Project expenditure amounts and dates.
- Placed in service dates for each expenditure.

Note that for purposes of these guidelines, "placed in service" date is considered the same as "project completion" date.

13.7 Use of Bond-Financed Assets

13.7.1 Statutory Requirement

As required by U.S. Code, not more than five percent (5%) of the net proceeds of the TEBs may be used in a "Private Use." Net proceeds exclude bond proceeds used to fund a reasonably required reserve fund. However, costs of issuance funded with bond proceeds count towards this five percent (5%) limitation. As a result, if two percent (2%) of the net proceeds (the maximum amount permitted under the Code) of a bond issue are applied to pay costs of issuance, only three percent (3%) of the remaining net proceeds may be used in a "Private Use." See generally 26 U.S. Code §§141(b) and 145(a)(2)(B) and Treasury Regulations 26 CFR §1.141-3.

If such costs are above this 2% limitation, an equity contribution must be paid by the borrower or from other sources.

13.7.2 Ownership and Use of Bond-Financed Asset.

For the life of a TEB issue, the project or Bond-Financed Asset must be owned and operated by the Department (or another state or local governmental entity). At all times while the TEB issue is outstanding, no more than ten percent (10%) (or $15 million, if less) of the Bond Proceeds for the project may be used, directly or indirectly, in a trade or business carried on by a person other than a state or local governmental unit ("Private Use" or "Private Business Use"). In addition, not more than five percent (5%), or $5 million, if less, of the proceeds of any TEB issue may be used, directly or indirectly, to make a loan to any person other than governmental persons. Generally, Private Business Use consists of any contract or other arrangement, including leases, management contracts, service contracts, operating agreements, guarantee contracts, take or pay contracts, output contracts or research contracts, which provides for use by a person who is not a state or local government on a basis different than the general public. The project may be used by any person or entity, including any person or entity carrying on any trade or business, if such use constitutes "General Public Use."[15] Use of the asset or facility by a member of the public or an employee of the organization is not Private Business Use. General Public Use is any arrangement providing for use that is available to the general public at either no charge or on the basis of rates that are generally applicable and uniformly applied.

[15] 26 CFR §1.141-3(c).

13.7.3 Sale or Other Transfer of Ownership of Bond-Financed Property

The transfer of ownership of any portion of the property, facility or asset financed with TEBs to any non-exempt person is a Private-Business Use. Such a transfer of ownership is directly prohibited by the Internal Revenue Code if it occurs prior to the earlier of the end of the expected economic life of the property or asset, or the latest maturity date of any TEBs financing (or refinancing) the property (the "measurement period").

No Bond-Financed Facility or Asset will be sold or transferred by the Responsible Division managing the bond-financed program or project without prior approval by the Chief Financial Officer.

13.7.4 Lease of Bond-Financed Property

Contracts for use of the Department's bond financed facilities or assets by parties other than the Department are to be reviewed by DOJ and the Financial Services Branch. The Debt Manager will provide Bond Counsel copies of all such contracts prior to the issuance of any TEBs to finance facilities used by outside parties. The Department will consult with the DOJ and Bond Counsel prior to any new, or expanded, use of such facilities by outside parties.

The Responsible Division is responsible for maintaining a list of the Bond-Financed Facilities leased to third parties. The Debt Manager will review such records with the appropriate parties, and if a use is determined to constitute Private Business Use, the Department will consult with DOJ and Bond Counsel.

No Bond-Financed Facility or Asset will be leased by the Responsible Division managing the bond-financed program or project without prior approval by the Chief Financial Officer.

13.7.5 Monitoring of Private Business Use

For each new Bond-Financed Asset or Facility, the Debt Manager, as advised by the Responsible Division, will determine the expected use of such Bond-Financed Asset and whether such Bond-Financed Asset is or will be subject to any contracts or other arrangements that may give rise to Private Business Use.

The Debt Manager will inform the persons responsible for the management and operation of the Bond-Financed Asset ("Asset Managers") of the Private Business Use restrictions relating to the Bond-Financed Asset.

The Debt Manager will require Asset Managers to submit any "Management Contract" with respect to Bond-Financed Assets to the Chief Financial Officer for review prior to entering such Management Contract. The Debt Manager will forward such Management Contract to Bond Counsel or to other capable advisors to determine whether such Management Contract complies with the IRS rules under Revenue Procedure 97-13 ("Rev. Proc. 97-13") Safe Harbors as updated by Rev. Proc. 2016-44.

The Debt Manager will meet regularly with Responsible Division Asset Managers to identify and discuss any existing or planned Private Business Use of Bond-Financed Assets or Facilities.

13.7.6 Monitoring of Private Payments

For each issue of tax-exempt Bonds, the Debt Manager will review the Tax Certificate and consult with outside advisors, as described below, to determine if the expected use of any Bond-Financed Asset may result in excess Private Business Use. If excess Private Business Use is expected, the Debt Manager shall consult with Bond Counsel and follow instructions regarding monitoring of Private Payments to ensure that excess Private Payments do not occur.

13.7.7 Management, Operating or Service Contracts and Agreements

Management, operating or service contracts or agreements whereby a non-exempt entity is using assets financed or refinanced with TEB proceeds (such as externally managed cafeteria or dining facility, parking facilities, communications facilities, etc.) must relate to portions of the project that fit within the allowable private use limitations or the contracts must meet the IRS safe harbor for management contracts. Any replacements of or changes to such contracts relating to Bond-Financed Assets or Facilities, or leases of such assets or facilities, should be reviewed by Bond Counsel. The Debt Manager shall contact Bond Counsel if there may be a lease, sale, disposition or other change in use of assets or facilities financed or refinanced with TEB proceeds.

The IRS has identified certain contractual relationships that are generally not considered to create private business use issues. Those include:

(i) contracts for services that are solely incidental to the primary function of the Bond-Financed Facility (such as contracts for janitorial, office equipment repair, vending or similar services), and

(ii) contracts to provide for services if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties.

Also, contracts that relate to a use that is functionally related and subordinate to a qualified management contract and the use is not, in substance, a separate contractual agreement will not create private business use. For example, the use of a storage area by a manager for equipment that is necessary for the manager to perform its services under a qualified management contract. In addition, management contracts that comply with certain term, termination and compensation provisions are excluded from the five percent (5%) limitation. See generally Rev. Proc. 93-19, 1993-1 C.B. 526 or Rev. Proc. 97-13, 1997-1 C.B. 632 (as modified by Rev. Proc. 2001-39, 2001-2 C.B. 38).

13.7.8 Measurement of Private Business Use

13.7.8.1 Measurement Period

Private Business Use, once identified, needs to be measured to determine if the amount of Private Business Use fits within the 5% limitation or if it needs to be excluded from the Bond-Financed Facility. The amount of Private Business Use is determined according to the average percentage of Private Business Use of the Bond-Financed Facility during the measurement period. As a general rule, except in the case of certain refundings, the measurement period begins on the later of the issue date of the bonds or the date the Bond-Financed Facility is placed in service. The measurement period ends on the earlier of the last date of the reasonably expected useful or economic life of the Bond-Financed Facility or the last maturity date of any of such bonds (determined without regard to any optional redemption dates). See Treasury Regulations 26 CFR §1.141-3(g)(2).

The measurement period for bonds being refunded begins on the later of the issue date of the refunded bonds or each component of the property financed with the refunded bonds was placed in service and ends on the maturity date of the refunding bonds.

Private Use typically commences on the first date on which there is a substantial right to actual use by the Private User. However, if an arrangement is entered into prior to the date actual use commences and the arrangement transfers ownership or right to long term use (such as a lease arrangement), the Private Use is considered to commence on the date the arrangement is entered into. See Treasury Regulations 26 CFR §1.141-3(g)(7).

13.7.8.2 Method of Allocation

Private Business Use may be allocated on a square footage or time allocation. Square footage allocation identifies by square footage the areas of a facility that will be used in a Private Use and compares that space to the total square footage of the facility, taking into account common space areas that benefit both Private Use space and non-Private Use space. A time allocation may also be used in cases where the same space is used in a Private Use and a governmental or "good use" but at different times. The average amount of Private Use is generally based upon the amount of time such space is used in a Private Use as a percentage of the total time for all actual use. Periods during which the space is not in use is disregarded.[16]

IRS regulations also provide rules for the measurement of Private Use of a project financed in part with proceeds of TEBs and in part with other funds of an issuer or borrower. The regulations provide rules for "mixed use" facilities or facilities that are simultaneously used in a Private Use and a good or qualified use. The multipurpose allocation rules permit an issuer to break a bond issue into different portions, and to apply Private Activity Bond rules separately into each portion.

Under the multipurpose allocation rules, bond proceeds and other sources of funds can be allocated to Private Use and non-Private Use under one of three methods: (1) a pro rata method; (2) a discrete physical method; or (3) an undivided portion method. The details of the special rules for eligible mix-use or multipurpose projects are complex. Any application of such multipurpose allocations of bond proceeds to eligible mixed-use projects by the Department will require the assistance of Bond and Tax Counsel.[17]

13.7.9 Consultation with Outside Advisors

The Department acknowledges that certain refinements, interpretations and exceptions apply to the analysis of Private Business Use and Private Payments and that Bond Counsel and other qualified advisers should be engaged and consulted to review contracts or other information relating to such use of Bond-Financed Assets. In addition, the Final Allocation of Bond Proceeds (see Section 13.6.7 – *Final Allocation of Bond Proceeds to Expenditures* above) may affect the Private Business Use and Private Payment determinations. The Debt Manager will consult at

[16] 26 CFR §1.141-3(g)(4).
[17] 26 CFR §1.141-6 – *Allocation and Accounting Rules*.

least annually with Bond Counsel to review any changes in the law with respect to Private Business Use of Bond-Financed Assets and to identify and discuss any existing or planned Private Business Use of Bond-Financed Assets or sources of revenue that may be considered Private Payments.

13.7.10 Ongoing Compliance

The bond and tax documents executed in connection with a bond issue provide for a borrower's reasonable expectations as of the time of issuance of the bonds. *However, Private Use limitation compliance will be based on facts and not intentions.* The Tax Compliance Officer and Responsible Divisions need to monitor actual usage of the Bond Financed Facility. Such monitoring includes reviewing compliance of management contracts entered into post bond issuance (or amendments to existing management contracts) with IRS Rev. Proc. 97-13, ensuring that bond proceeds are properly allocated to "good use" space and being aware of how new arrangements and unanticipated use of Bond Financed Facility may affect the Private Use allocations. Some examples of such change would be the unanticipated leasing, use or management, subsequent to the issuance of the TEBs, of a communications tower to a private entity or entering into an arrangement such as a private-public partnership whereby a private entity operates and/or manages the tolling of a bridge, a portion of a highway or managed lane operations.

13.7.11 *Identification and Correction of Violations*

In the event the use of Bond Proceeds or Bond-Financed Assets or the nature or amount of Private Payments is different from the covenants and representations set forth in the Tax Certificate, the Department will contact Bond Counsel in a timely manner to ensure that there is no adverse effect on the tax status of the Bonds. Various remedies are available to the Department in the event of certain violations on the limits of use of Bond Proceeds, amounts of Private Payments, the investment of Bond Proceeds, and the use of the Bond-Financed Assets. For example, a change in the use of the Bond-Financed Assets after the issuance of the Bonds that result in excessive Private Business Use or Private Payments may be corrected through a "remedial action" that is described in the Treasury Regulations. Such remedial actions include a defeasance of the portion of the Bonds affected by the excessive Private Business Use or Private Payments.

Other actions (or inaction) that potentially adversely affect the status of the Bonds may be corrected through the Internal Revenue Service's Office of Tax Exempt Bonds Voluntary Closing Agreement Program ("VCAP") for tax-exempt bonds and tax credit bonds described in IRS Notice 2008-3, 2008-11 I.R.B. 592 or successor guidance.

13.7.12 Record Keeping and Document Retention Requirements

The Debt Manager will coordinate with Responsible Division managers and key personnel (see Appendix C – *Debt Compliance Responsibilities*) to ensure that copies of all contracts and arrangements involving the lease, management, sale, operation, service or other use of all Bond-Financed Assets are maintained on file. The Debt Manager will also maintain and update a ledger or spreadsheet with respect to each issue of Bonds regarding the cumulative amount of Private Business Use with respect to such issue. Retention of such records will be for the life of the Bonds, plus any refunding bonds, plus three (3) years and may be in the form of documents or electronic copies of documents, appropriately indexed to specific Bond issues and compliance functions. See also Section 3.12 – *Documentation and Record Keeping Requirements* of this Tax Compliance Policy.

13.7.13 Useful Life Limitation

The weighted average maturity of the Bond issue cannot exceed 120% of the weighted average economic life of the Bond-financed assets. In other words, the weighted average economic life of the project financed with TEBs must be at least 80% of the weighted average maturity of the Bond issue.[18] Additional state law limitations may apply as well.

13.8 Reimbursement Rules and Declarations

The Department may spend money on a project and then pay itself back with Bond Proceeds. This requires, among other things, that a formal declaration of reasonable intent to reimburse the expenditure with the Bond Proceeds has been properly made.

13.8.1 Responsible Authority

For debt obligations issued by the Department, the OTC or authorized representative designated by the OTC ("Authorized Representative") is the proper authority to adopt resolutions to declare the intent of the Department to use Bonds, if applicable, to reimburse for expenditures incurred prior to the borrowing.

For debt obligations issued by another agency on behalf of the Department, the issuing agency is the responsible authority to establish procedures regarding the adoption of a reimbursement resolution to allow the Department to be reimbursed for expenditures incurred prior to the issuance of the bonds. Debt obligations issued on behalf of ODOT typically include COPs, Facilities Bonds, and Lottery Revenue Bonds issued by the Department of Administrative Services.

13.8.2 Reimbursement Declaration

Under Treasury Regulations[19], the proceeds of TEBs may be allocated to a prior capital expenditure for a period of time after the expenditure is made, but only if a formal declaration of reasonable intention to reimburse the expenditure with the proceeds of a borrowing (a "declaration of official intent" or "Reimbursement Declaration") had been properly made within sixty (60) days after the date the expenditure was paid and certain other requirements, described below, are satisfied. These rules significantly affect common practices and must be taken into account in planning for all future tax-exempt financings. Responsible Division managers and staff must be aware of the steps necessary to permit a later financing when incurring expenditures that they may intend to finance with a future issuance of TEBs. The regulations, as summarized below, should be consulted to assure compliance.

[18] 26 U.S. Code §147(b).
[19] 26 CFR §1.150-2.

13.8.3 Reimbursement Period and Nature of Expenditure

Except as otherwise described in this section, Capital Expenditures made more than sixty (60) days prior to the date of the Reimbursement Declaration are not eligible for reimbursement.[20] Capital Expenditures made more than sixty (60) days prior to the date of the Reimbursement Declaration can be reimbursed only if such expenditures are "Preliminary Expenditures." No declaration of official intent is required for Preliminary Expenditures such as design, architectural, engineering, surveying, soil testing, bond issuance and similar costs that do not exceed twenty percent (20%) of the Bond Proceeds issued for the Project. The costs of land acquisition, site preparation and similar costs incident to commencement of construction are not considered Preliminary Expenditures. No declaration of intent is required for bond costs of issuance or for other amounts not exceeding the lesser of $100,000 or five percent (5%) of the bond issuance amount.

Additionally, except for Preliminary Expenditures such as design or engineering expenditures for a project, for which no time limits generally apply, you cannot reimburse an expenditure on a project later than the EARLIER of:

1) Eighteen (18) months after the project is placed in service, or
2) Three (3) years after the individual expenditure is made.

For this purpose, a "project" should be thought of as all assets that will be placed in service simultaneously.

13.8.4 Required Content of Reimbursement Declaration

The form of official intent can be made in any reasonable form, including issuer resolution, action by an appropriate representative of the issuer (e.g., a person authorized or designated to declare official intent on behalf of the issuer), or specific legislative authorization for the issuance of obligations for a particular project.[21]

A declaration of official intent must indicate that the issuer reasonably expects to reimburse the planned expenditures with the proceeds of a debt to be incurred. The Reimbursement Declaration must generally describe the project for which the expenditure to be reimbursed is paid, such as highway and bridge capital construction, facility construction or renovation, or vehicle or other equipment acquisition, and a statement regarding the maximum principal amount of debt expected to the issued for such purposes.

Instead of describing a project, a declaration of official intent may identify a fund or account from which the expenditure to be reimbursed is paid and describe the general functional purpose of the fund or account, such as "State Highway Fund – highway capital improvement program." Reasonable deviations from the description in the declaration of official intent are permitted. A reasonable deviation might include a bridge construction program instead of highway capital improvement program, but would not include significant deviations such as non-project related vehicle or equipment acquisition when the declaration described highway improvements.

[20] 26 CFR §1.150-2(d).
[21] 26 CFR §1.150-2(e).

13.8.5 Reasonableness of Reimbursement Declaration

Reimbursement Declarations must be "reasonable." An issuer of bonds cannot make blanket or routine declarations without a real intent to finance the specific expenditures, but for the purpose of building up reimbursable expenditures to which the proceeds of Bonds for later projects would be artificially allocated.[22]

Additionally, Federal tax regulations do not specify how long a reimbursement resolution is effective, however, Bond Counsel will generally encourage that expenditure reimbursement resolutions be renewed after three (3) years. The reason is that a resolution is only good if the issuer reasonably expects to reimburse expenditures with bond proceeds. The longer you wait, the greater the chance that the IRS would question whether the expectation was reasonable.

13.8.6 Reimbursement Declaration Preparation Responsibilities

For Bonds issued by the Department, the Debt Manager will coordinate the preparation of the Reimbursement Declaration for OTC or Authorized Representative approval at the request of the Responsible Division and in consultation with Bond Counsel, the State Treasurer, and DOJ.

For Bonds issued on behalf of the Department by another issuing agency, the Debt Manager will coordinate any such reimbursement requirements, at the request of the Responsible Division, in accordance with the issuing agency's policies and procedures.

The Responsible Division is required to provide the Debt Manager with a description of the project and the estimated amount of reimbursement for capital project expenses that are eligible to be paid with TEBs.

The Debt Manager will distribute a copy of the approved Reimbursement Declaration to the Responsible Division accompanied with descriptive guidelines for the reimbursement of expenditures incurred prior to the issuance of the applicable Bonds.

13.8.7 Consequences of Violation

Failure to comply with the Federal reimbursement regulations may result in the TEB proceeds treated as not expended and as remaining subject to arbitrage, rebate and other restrictions. Such a failure and noncompliance with such restrictions may result in the loss of tax exemption of the bonds. Remedies may include making penalty payments, taking a remedial action described in the Treasury Regulations, initiating a settlement with the IRS through its VCAP program described in IRS Notice 2008-31, or taking some other action as prescribed by Bond Counsel in consultation with the State Treasurer and DOJ.

13.9 Investment Restrictions, Arbitrage Yield and Rebate Compliance

The Chief Financial Officer directs all of the Department's cash management and investment portfolio activity. All monies and cash assets coming into the Department including tax-exempt and tax-advantaged debt proceeds, debt reserves, taxes, fees, charges and other miscellaneous revenues, are invested in accordance with the Department's Investment Policy[23] and applicable state and Federal laws and regulations. Interest earned on the Department's investment portfolio

[22] 26 CFR §1.150-2(e).
[23] See Chapter 11 – Investment Policy.

is accrued daily and distributed to each Department fund based on each fund's average daily balance. The daily investment portfolio yield represents the annualized yield paid to each fund on each day's average daily balance.

The Bond Proceeds will be invested until used for the intended project in order to maximize utilization of the public funds. The investments will be made to obtain the highest level of safety.

The Department's Investment Policy, applicable laws and regulations and the bond indentures govern objectives and criteria for investment of Bond Proceeds. The Debt Manager, under the direction of the Chief Financial Officer, or assigned bond trustees under the direction of the Debt Manager, will invest the Bond Proceeds in a manner to avoid, if possible, and minimize any potential negative arbitrage over the life of the bond issuance, while complying with arbitrage and tax provisions.

Accounting for the investment and spend-down of tax-exempt or tax-advantaged debt proceeds is provided through the Department's Transportation Environment Accounting and Management System ("TEAMS") accounting system. TEAMS is designed to provide specific accounting for proceeds of tax-exempt or tax-advantaged bonds subject to arbitrage rebate. This accounting system segregates cash balances and interest earnings thereon, preventing bond proceeds from being commingled with other Department resources. The information extracted from TEAMS is provided to the Department's arbitrage rebate consultant to compute the arbitrage rebate liability as required by the IRS.

On the "Date of Issue" of any Bond, the Debt Manager will identify for that Bond:

- All of the funds and accounts into which Bond Proceeds are deposited and the applicable yields at or below which such funds must be invested.
- Any funds or accounts not directly funded with Bond Proceeds that must be invested at or below the yield on the Bonds.

The Debt Manager will:

- Ensure that the investment of Bond Proceeds complies with the applicable yield restrictions contained in the Treasury Regulations.
- Ensure that all investments, including guaranteed investment contracts ("GICs") and certificates of deposit purchased with Bond Proceeds, are purchased in compliance with the applicable fair market value requirements of the Treasury Regulations.
- Obtain regular, periodic (monthly) statements regarding the investments and transactions involving Bond Proceeds.

The Debt Manager will keep all records with respect to investments, including:

- The solicitation and all responses received from the bidding of any GICs.
- Information with respect to any investment agreements, including certificates of deposit and GICs.
- United States Treasury Securities-State and Local Government Series (i.e. "SLGS") subscription information.
- Records of investment activity sufficient to permit calculation of arbitrage rebate or demonstration that no rebate is due.

13.9.1 Use and Control of Bond Proceeds

Unexpended Bond proceeds (including reserves) are deposited in various funds and accounts which may include a project construction fund, debt service fund, capitalized interest fund, debt service reserve, or in the case of a refunding, an escrow fund. The deposited funds may be held directly by the Department in Oregon State Treasury accounts, other investment accounts or by the trustee for the Bond issue under an indenture, trust or escrow agreement. The investment of Bond Proceeds shall be managed by the Debt Manager as directed by the Chief Financial Officer. The Debt Manager shall maintain appropriate records regarding investments and transactions involving Bond Proceeds. The trustee or escrow agent, if appropriate, shall provide regular statements to the Department regarding investments and transactions involving Bond Proceeds.

13.9.2 Investment Restrictions

Investment restrictions relating to Bond Proceeds and other moneys relating to the Bonds are set forth in the Tax Certificate. The Debt Manager and responsible Financial Services Revenue and Expenditure Accounting staff will monitor the investment of Bond Proceeds to ensure compliance with applicable arbitrage yield and rebate restrictions and rules.

To ensure the Department's ability to monitor arbitrage related exceptions, if TEB proceeds are to be deposited in any account other than the Oregon Short-Term Fund, the Debt Manager will consult with the Department's Bond Counsel to establish an appropriate investment plan for the proceeds prior to issuance.

13.9.3 Purpose of Code and Treasury Regulations Regarding Arbitrage

The Internal Revenue Code and Treasury Regulations relating to tax-exempt and tax-advantaged bonds were established to minimize the economic benefits of investing tax-exempt debt proceeds, thus encouraging the timely expenditure of debt proceeds for the governmental purpose identified in the "Offering Statement" or "Official Statement" and to remove the incentive to, among other things:

- Issue tax-exempt debt earlier than the proceeds are needed
- Leave unspent tax-exempt bond or line of credit proceeds outstanding for a longer period than the project requires
- Issue more tax-exempt debt than necessary for a governmental purpose

13.9.4 Arbitrage Bonds

Under the Internal Revenue Code,[24] an arbitrage bond ("Arbitrage Bond") means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly:

1) To acquire higher yielding investments, or
2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

[24] 26 U.S. Code §148(a).

As bond is treated as an Arbitrage Bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraphs (1) or (2) above.

13.9.5 Type of Funds Subject to Arbitrage Compliance

The Internal Revenue Code and Treasury Regulations apply to all tax-exempt and tax-advantaged offerings including long-term bonds, bank loans, lines of credit, notes and other applicable borrowing facilities. The obligations under these procedures pertain to the uses of all financed assets and to amounts in the following funds, all of which are subject to arbitrage rebate:

- Project Funds (including interest earnings thereon)
- Debt Service Funds
- Costs of Issuance Funds
- Refunding Escrow Funds
- Reserve Funds
- Transferred Proceeds (Unspent Proceeds from refunded bonds)
- Tax-advantaged debt (i.e. Build America Bonds) and related subsidies

13.9.6 Arbitrage Yield and Rebate Compliance

Investment earnings on Bond Proceeds should be tracked and monitored to comply with applicable yield restrictions and/or rebate requirements. Any funds of the Department set aside or otherwise pledged or earmarked to pay debt service on Bonds should be analyzed to assure compliance with the tax law rules on arbitrage, invested sinking funds, and pledged funds (including gifts or donations linked or earmarked to the Bond-Financed Assets.

The Federal Tax Code[25] sets forth general arbitrage and rebate requirements for issuers of tax-exempt debt obligations and tax credit obligations. The general rule is that any arbitrage earned must be determined and reported to the Federal government every fifth-year anniversary date after the Date of Issue and as of the final maturity, or as elected. Arbitrage rebate is essentially 100% of investment earnings in excess of the debt issue's Arbitrage Yield.

The Code establishes various investment yield limitations for different categories of proceeds from a debt issue. Generally, if there are unspent Bond Proceeds at the end of the initial 3-year Temporary Period, the Department may no longer invest the remaining proceeds above the Arbitrage Yield without taking corrective action to remedy interest earnings above the materially higher yield. The investments must be either yield restricted below the materially higher yield, or a yield reduction payment report is required. Yield reduction payments must be made according to the same schedule as the arbitrage rebate requirements, i.e., as of the fifth anniversary from the Date of Issue (or any earlier date selected in the Tax Certificate) and every five years thereafter until the debt issue matures.

During the construction period of a capital project, the investment and expenditure of Bond Proceeds are to be monitored and the Arbitrage Consultant consulted to determine whether the

[25] 26 U.S. Code §148.

Department is meeting any spending exception. Available spending exceptions are in periods of 6 months, 18 months and two years (for construction only), with the 18-month and 2-year exception subject to six-month internal benchmarks. See Section 13.9.12 – *Exceptions to the Rebate Requirements* below and the applicable Tax Certificate or consult Bond Counsel or the Arbitrage Consultant for more details regarding the spending exceptions.

13.9.7 IRS Filing Dates for Arbitrage Rebate Calculations and Payments

Arbitrage rebate calculations and any installment payments to the U.S. Treasury for a bond treated as an Arbitrage Bond are required to be made at least once every five (5) years as detailed in the Federal Code[26] and the schedule below.

1) Within 60 days after the fifth-year anniversary of the Date of Issue unless stated otherwise in the Tax Certificate or tax covenants in other documents.
2) Subsequent Rebate installment calculations(s) occur every five years after the end of the fifth bond year or earlier if all the bonds are redeemed.
3) Final Rebate Calculation is due 60 days after all the bonds have matured, retired or been redeemed.

A rebate installment payment is considered paid on the date that the IRS Form 8038-T – *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*, and accompanying check is postmarked to IRS.

Copies of all rebate payments made to the U.S. Treasury will be maintained, at a minimum, for the life of the Bonds, plus any refunding bonds, plus three (3) years.

13.9.8 Arbitrage Rebate Compliance Consultant

The Debt Manager is responsible for calculating (or causing the calculation of) rebate liability for each Bond issue, and for the coordination of any required rebate payments in accordance with Section 148(f) of the Code. Unless Bond Counsel has advised that the Bonds are exempt from the rebate requirements, due to the complexity of Federal tax law and Treasury Regulations, it is recommended that the Department engage an Arbitrage Rebate Compliance Consultant, as necessary, to assist in the calculation of arbitrage rebate attributable to the investment of Bond Proceeds and the preparation of arbitrage related reports. See Appendix C – *Debt Compliance Responsibilities* for a listing of outside consultants engaged to assist the Department in arbitrage calculations and other compliance matters.

The Debt Manager is responsible for providing the Arbitrage Consultant with requested documents and information on a prompt basis, reviewing applicable rebate reports and other calculations and generally interacting with the Arbitrage Consultant to ensure the timely preparation of rebate reports and payment of any rebate.

The Debt Manager will monitor the work and actions of the Arbitrage Consultant to assure compliance with required rebate calculations and payments, if any, as provided in Section 13.9.7 – *IRS Filing Dates for Arbitrage Rebate Calculations and Payments* above.

[26] 26 U.S. Code §148(f).

13.9.9 Payment to the IRS

If a rebate payment is required to be paid by the Department, the Debt Manager shall prepare or cause to be prepared the IRS Form 8038-T – *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*, and submit such Form 8038-T to the IRS with the required rebate payment. The Responsible Division is responsible for any rebate payments made to the IRS, fees of the rebate consultant or tax counsel and any other costs incurred.

If the Department is authorized to recover a rebate payment previously paid, the Debt Manager shall prepare or cause to be prepared the IRS Form 8038-R – *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*, with respect to such rebate recovery, and submit such Form 8038-R to the IRS.

The Debt Manager will retain copies of all arbitrage reports, related return filings with the IRS, **<u>and copies of cancelled checks</u>** with respect to any rebate payments and information statements. The Debt Manager will also retain copies of any hedge agreements such as swaps or interest-rate caps entered into with respect to the Bonds. Such records will be retained for the life of the Bonds, plus any refunding bonds, plus three (3) years and may be in the form of documents or electronic copies of documents, appropriately indexed to specific Bond issues and compliance functions.

13.9.10 Annual Rebate Report

The Debt Manager will prepare an Annual Rebate Report as of June 30 of each fiscal year. The report will include at a minimum the following information with additional information provided at the discretion of the Debt Manager:

- Master list of all debt issued by the Department where an IRS 8038-G form (or other applicable IRS 8038 form) has been filed
- Listing of all active rebate files and control numbers
- Required calculations due in the next 12 months
- Any exceptions where rebate calculations were not performed e. Listing of any defeased bonds held in escrow
- Listing of bond issues held in the Department accounts along with any potential rebate liability (whether negative or positive).
- Issues that have reached the final computation

13.9.11 Tax-Advantaged Debt

Certain types of tax-advantaged debt, such as taxable Build America Bonds, are different from tax-exempt debt and have unique tax requirements. As a result, these tax compliance procedures shall be deemed to include any of the requirements as described in the Tax Certificate executed in connection with that tax-advantaged debt and where these procedures and the Tax Certificate for such tax-advantaged debt conflict, the Department shall comply with the requirements and procedures as described in the Tax Certificate.

13.9.12 Exceptions to the Rebate Requirements

Exceptions to the rebate requirements for tax-exempt debt are defined in the Federal tax law and described below.[27] There are additional rebate exceptions that apply to certain types of tax-advantaged debt. The Debt Manager will review the Tax Certificate for any tax-advantaged debt to determine the availability of such additional rebate exceptions. Depending on which exception applies to the particular issue, and if the exceptions are met, all or a portion of the debt issue's proceeds may not be subject to rebate.

The Responsible Division is responsible for knowing which expenditure exception applies to the debt being issued and must monitor the expenditure exceptions as the TEB proceeds are spent down. The Debt Manager will provide advice and assistance in performing the calculation, but **it is ultimately the Responsible Division that is responsible for ensuring the expenditure exceptions are met.**

The Debt Manager in consultation with the Arbitrage Consultant will prepare the final assessment to determine whether any exception requirements were met. The following are descriptions of the various exceptions available for tax-exempt debt and will be established prior to issuance and stated in the Tax Certificate:

- **6-Month Spending Exception:**

If all gross Bond Proceeds (including interest earnings, but excluding any debt-funded reserve) of the debt issue are expended within six (6) months after the Date of Issue of the debt, the interest earned (but excluding interest on the debt reserve) during that period is not subject to rebate. The debt reserve is subject to the Rebate Requirements and does not qualify for the 6-Month Spending Exception.

- **18-Month Spending Exception:**

If a debt issue does *not* qualify as a "construction" issue (75% of gross Bond Proceeds are spent on actual construction), then the debt issue is eligible for the 18-Month Spending Exception, but *not* the 2-Year Spending Exception. If all gross Bond Proceeds (including interest earnings, but excluding any debt-funded reserve) and actual and expected earnings are spent within 18 months, according to a strict timetable, the interest earned during that period is not subject to the Rebate Requirements. Intermediate expenditure requirements must be met: 15% spent within six (6) months; 60% spent within 12 months; and 100% spent within 18 months, with a 5% *de minimis* carryover amount permitted for one additional year for punch list items only. Reserve funds are subject to the Rebate Requirements and do not qualify for exemption under the 18-Month Spending Exception.

- **2-Year Spending Exception:**

If a debt issue does qualify as a "construction issue" (75% of gross Bond Proceeds are spent on actual construction) and all Gross Proceeds (excluding any debt funded reserve) and actual and expected earnings are spent within two (2) years according to a strict timetable, then interest earned during that period is not subject to the Rebate Requirements. Intermediate expenditure

[27] 26 U.S. Code §148(c).

requirements must be met: 10% spent within 6 months; 45% spent within 12 months; 75% spent within 18 months; and 100% spent within two (2) years, with a 5% *de minimis* carryover amount permitted for one additional year for punch list items.[28]

- **Small Issuer Exception:**

The Department does not qualify for the Small Issuer Exception since the Department issues more than $5 million in a calendar year.[29]

13.9.13 Consequences of Violation

Failure to comply with the Federal arbitrage regulations may result in an adverse effect on the tax-exempt or tax-advantaged status of the Department's Bonds. Such a failure and noncompliance with arbitrage restrictions may result in the loss of tax exemption of the Bonds. Remedies may include making penalty payments, taking a remedial action described in the Treasury Regulations, initiating a settlement with the IRS through its VCAP program described in IRS Notice 2008-31, or taking some other action as prescribed by Bond Counsel in consultation with the State Treasurer and DOJ.

13.10 Grant Programs

While most of the bond programs managed by the Department finance direct expenditures for State government transportation projects, tax-exempt and taxable bonds are also issued by or on behalf of the Department to finance grant programs to accomplish a governmental purpose for unrelated persons, including other governmental agencies, non-profit and for-profit entities, and individuals.

Grants are often financed as part of a broad governmental program administering grants to multiple recipients or on an individual basis. For example, the "OTIA 3 Local Bridge Program" established pursuant to Section 10(1)(b) of 2003 Oregon Laws Chapter 618 to provide funding for local city and county bridge replacement and repair projects was financed with tax-exempt Highway User Tax Revenue Bonds. *Connect*Oregon is a Lottery Revenue Bond funded program administered by the Department to provide grants and loans to public and private entities to invest in non-highway multimodal transportation infrastructure projects. The Department also administers other essentially "pass-through" Lottery Revenue Bond funded grants authorized by the Legislative Assembly for specific local government transportation projects.

There are many types or applications of bond-financed grants, for example:

- Grant to a local government to pay a portion of the costs of a specific type of facility (*e.g.* airport, port or transit system). The grant is based on an application process and a grant agreement that specifically describes the project.
- Grant to a local government to pay a portion of the costs of capital projects for specified purposes, without specifying the nature of the assets to be acquired (*e.g.* buildings or computers).

[28] 26 U.S. Code §148(f)(4)(C).
[29] 26 U.S. Code §148(f)(4)(D).

- Grant to a local government entity for a capital project. The grantee may have initially paid all or a portion of the costs of such project with proceeds of its own bonds and pays such bonds with the grant proceeds.
- Grant for capital projects to a non-profit organization, such as an environmental organization. The grant may or may not specifically describe the assets to be acquired with the grant proceeds.
- Grant for capital projects to a for-profit company under an economic development program. The grant may or may not specifically describe the assets to be acquired with the grant proceeds.
- Bond proceeds used to make a grant to a governmental entity, which may use some or all of the proceeds for operating expenses or programs or, in the case of a distressed governmental entity, to cover an operating deficit.

13.10.1 Grants Generally

All grants and loans financed through the issuance of Bonds and administered by the Department must comply with the requirements of Oregon law, the Code and Treasury Regulations regarding eligible capital projects and the proper use of tax-exempt and taxable bond proceeds.

A grant by definition means a transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the transferor.[30] The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor. Obligations or conditions intended solely to assure expenditure of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.

Under Federal arbitrage regulations, whether a transaction is a grant or a loan is principally determined as to whether there is an expectation of repayment. So long as it is truly a grant with no expectation of repayment then the bond proceeds are treated as spent once the issuer makes a grant of the bond proceeds to the unrelated party. This means that the issuer, for purposes of arbitrage yield restriction and rebate, can stop monitoring the investment yield that it receives from those bond proceeds once it makes the grant.

In general, the gross proceeds of a bond issue that are used to make a grant are allocated to an expenditure on the date on which the grant is made.[31] If any amount of a grant financed by gross proceeds of an issue is repaid to the grantor, the repaid amount is treated as unspent proceeds of the bond issue as of the repayment date unless expended within sixty (60) days of repayment.

13.10.2 Related Parties

In the administration of a tax-exempt financed grant program it must be determined whether the grantee is a related party to the issuer or grantor. A "<u>Related Party</u>," in reference to a governmental unit, is any member of the same controlled group.[32] A "controlled group" is

[30] 26 CFR §1.150-1(f).
[31] 26 CFR §1.148-6(d)(4).
[32] 26 CFR §1.150-1(b).

defined as a group of entities controlled directly or indirectly by the same entity or group of entities.[33]

Whether direct control exists is a facts and circumstances analysis but Treasury Regulations state that an entity generally controls another entity if "the controlling entity possesses either of the following rights and powers and the rights and powers are discretionary and non-ministerial –(i) [t]he right or power to both approve and to remove without cause a controlling portion of the governing body of the controlled entity; or (ii) [t]he right or power to require the use of funds or assets of the controlled entity for any purpose of the controlled entity or entities."

Even in cases where the grantee is a controlled entity under the definition above, 26 CFR §1.150-1(e)(3) tells us that an entity is not a controlled entity if it possesses "substantial taxing, eminent domain, and police powers."

The Department administers grant programs that are funded with tax-exempt Bond Proceeds. These programs may provide grants for governmental purposes to grantees that are not a Related Party or an agent of the Department or the State. A tax-exempt financed grant by the Department to one of its Divisions or units or to another agency of the State would **not** be an allowable use of tax-exempt Bond Proceeds. Grants provided to local governments and private entities that are not directly related to the Department or the State would be considered an allowable use of tax-exempt Bond Proceeds.

In certain situations, such as in the case of the Port of Portland or Tri-Met[34], questions may arise as to whether the entity is an agent of the State and thus a Related Party and not an eligible grantee. Further analysis of the facts and circumstances must be undertaken to determine whether the Department or the State directly controls the party, agency or organization under Treasury Regulations, and if so, whether the controlled entity has substantial taxing, eminent domain, and police powers" that would prevent it from being treated as a related party.

As noted above, even though an entity would be considered controlled by another agency, under 26 CFR §1.150-1(e), that entity would not be considered controlled if it has substantial taxing, eminent domain, and police powers as stipulated in 26 CFR §1.150-1(e)(3). Based on this analysis, agencies that have substantial taxing, eminent domain, and police powers, such as for example the Port of Portland and Tri-Met, would not be considered to be controlled by the State and as such would be eligible to receive grants from the Department.

13.10.3 Term of the Issue – Useful Life

The general rule provided in the Federal arbitrage regulations provides that the term of a bond issue should not be longer than is reasonably necessary for the governmental purposes of the issue.[35] This standard is also applied, under the arbitrage regulations in determining whether an issue has the effect of overburdening the tax-exempt bond market.[36] It is in this context that the question arises as to how long bonds issued to finance grants may be outstanding.

[33] 26 CFR §1.150-1(e).
[34] Tri-County Metropolitan Transportation District of Oregon ("Tri-Met").
[35] 26 CFR §1.148-1(c)(4)(A)(1).
[36] 26 CFR §1.148-10(a)(4).

Applicable limitations on the term of a bond issue, require that the grantor of bond proceeds for a grant must "*look through*" to the grantee's use of the proceeds for all purposes other than determining when the bond proceeds are spent for arbitrage purposes and any other purposes (26 CFR §1.150-1(f)(2)). For example, a grantee's use of proceeds generally determines whether the proceeds are used for capital projects or working capital expenditures under Federal regulations (26 CFR §1.148) and whether the qualified purposes for the specific type of bond issue are met.

For a series of bonds as a whole, the weighted average maturity of the bonds cannot exceed 120% of the reasonably expected weighted average economic life of the assets or facilities financed by the grants (26 U.S. Code §147(b)). The useful life of the assets and facilities funded using bond proceeds will be documented by the Responsible Division administering the grant or grant program and monitored by the Debt Manager for compliance.

13.10.4 Private Business Use Restrictions

Private Business Use restrictions are different when the State (or the Department) is financing its own projects versus when it is financing grants through, for example, the *Connect*Oregon program or other grant programs (which may involve grantees that are private entities). The difference is due to the operation of the private use restrictions.

The use of Bond Proceeds to fund grants generally does not create problems under the Code's private activity provisions but it does require an analysis of the Private Business Use of Bond Proceeds. The Treasury Code provides that "[i]n determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds" (26 CFR §1.141-3(a)(2)).

The general rule as provided in 26 U.S. Code §141 is that you run into tax-exemption issues if both

(iii) more than ten percent (10%) of the proceeds of a bond issue is used in respect of a private business use (the "Use Limitation") and

(iv) more than ten percent (10%) of the payments of principal and interest on such issue is directly or indirectly secured by any interest in property used or to be used for a private business use or payments in respect of such property (the "Payment or Security Limitation").

Because both the Use Limitation and the Payment or Security Limitation must be met in order to jeopardize the tax-exemption on an issue of bonds, it is possible that an arrangement that exceeds the Use Limitation may still be acceptable because it does not exceed the Payment or Security Limitation. Note that the 10% Use Limitation and Payment or Security Limitation are reduced to five percent (5%) in certain situations.[37]

A grant is a situation in which there may be more than 10% private use but less than 10% private payments since in a grant situation, there are no repayments to the grantor (the State or ODOT). So, when tax-exempt bond proceeds are used for grants, we are essentially conceding that we

[37] 26 U.S. Code §141(b)(3).

may meet the Use Limitation, but since we will not exceed the Payment or Security Limitation, the bonds can still be issued tax-exempt.

13.10.5 Arbitrage

Arbitrage rules were established to stop an abuse of tax-exempt bonds. Without these rules, governments could issue tax-exempt debt and invest the proceeds in higher yielding taxable instruments thereby making a profit on the "spread." Arbitrage rule specifics are more fully discussed in this Policy section 13.9 – *Investment Restrictions, Arbitrage Yield and Rebate Compliance.*

As previously noted, Treasury Regulations 26 CFR §1.148-6(d)(4)(i) provide that the "gross proceeds of an issue that are used to make a grant are allocated to an expenditure on the date on which the grant is made." This rule enables issuers to avoid the administrative burden of tracking the investment of bond proceeds by grantees. A "grant" for this purpose is "a transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the transferor." Thus, an issuer may only benefit from this rule if the grantee is neither a related party nor its agent. In the case of grants to other governmental entities, status as a "related party" usually turns on the existence of discretionary approval and removal rights as to the governing body of a controlled entity or discretionary rights to use funds or assets of the controlled entity.

To ensure that its bonds are not vulnerable to challenge, an issuer must determine that grantees reasonably expect to expend grant proceeds in a timely and orderly manner in accordance with the purpose of the grant even though the grant proceeds are no longer bond proceeds otherwise subject to arbitrage limitations.

13.10.6 Use of Proceeds

Federal tax law imposes numerous requirements as to the use of proceeds of private activity bonds, however, tax-exempt bonds issued to fund grants ordinarily are not private activity bonds for the reasons stated above.[38] Therefore, such "governmental bonds" ordinarily remain subject only to State law limitations on allowable use of bond proceeds and as otherwise permitted and defined in the Code.

A "grant," as defined for arbitrage purposes, applies to all purposes relating to tax-exempt bonds and tax-advantaged bonds (e.g. Build America Bonds). Importantly, the character and use of the grant monies generally is taken into account in determining whether arbitrage and other applicable requirements of the bond issue are met. **This means that the grantee's uses of the grant funds may impact the tax-exemption of the bonds.**

Under the Treasury Regulations, for certain tax purposes, the use of grant monies by the grantee is traced to determine whether those monies are applied to a proper purpose that is consistent with the requirements for tax-exemption of the bonds that funded the grant monies. For example, a grantee's uses of the grant monies will be traced to determine whether bond proceeds are used for a private business use, capital expenditures or working capital expenditures and whether other applicable non-arbitrage purposes of the bond issue are met. Further, the use of grant

[38] 26 U.S. Code §§142-145).

proceeds by the grantee to make loans could cause the bonds to be considered private loan bonds and thus taxable.[39]

Under current tax law, and as a general rule, Bond Proceeds issued for the purpose of funding grants are to be used for **capital expenditures –NOT working capital** (i.e. operating expenditures). The rules for working capital are different – much more restrictive, and as a practical matter will likely result in arbitrage bonds.

It is important to make sure that the grants are "grants" as defined in the tax rules. A grant for this purpose is a transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the transferor. The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor, however, obligations or conditions intended solely to assure expenditures of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.[40]

Making sure that tax-exempt funded grants are true grants is particularly important because in the event the grant does not qualify under this rule the IRS would likely view the arrangement as a loan. There is a limitation on using more than the lesser of five percent (5%) or $5 million of a tax-exempt bond issue to finance loans to private parties. This limitation (the "Private Loan Financing Limitation") is a separate and different matter from the Use and Payment or Security Limitations.

As with all tax-exempt financings of State-owned projects, there is the expectation that the State reasonably expects to disburse at least 85% of the grant funds within three (3) years after issuance of the tax-exempt bonds that fund the grant.

13.10.7 Expenditure Reimbursement – Intent Resolutions

The IRS requires the filing of an intent resolution prior to any expenditure made before the bond sale for which an issuer plans to reimburse itself with bond proceeds. This applies to grantees and loan recipients as well. Therefore, The Department must obtain satisfactory evidence of the date expenditures occurred to construct (or renovate) capital assets under the program.

The OTC or an Authorized Representative approves intent resolutions (i.e. "Reimbursement Declarations") for bonds issued by the Department or by the issuing agency for bonds issued by another agency on behalf of the Department (e.g. DAS).[41] For grant and loan programs, intent resolutions that pre-date the award of the grant or approval of the loan are not acceptable.

13.10.8 Cost of Administration

No more than five percent (5%) of the bond proceeds can be used for administration of the grant program – assuming such administrative costs are necessary to execute the grant program and construct or complete the grant-financed capital projects.

[39] 26 CFR §1.150-1(f).
[40] 26 CFR §1.150-1(f)).
[41] Refer to Section 13.8 – *Reimbursement Rules and Declarations* for additional information.

Failure to expend bond proceeds longer than the 3-year Temporary Period as permitted by Federal arbitrage rules may result in additional costs to the Department related to ongoing arbitrage rebate computations and potential arbitrage rebate liabilities.[42]

There are also ongoing bond administration costs that will be incurred every year the bonds are outstanding. These ongoing costs may include, for example, State Treasury Debt Management charges, trustee and paying agent costs, possibly special project or program costs and other legal costs necessary to maintain the tax-exempt status of the bonds. Some ongoing bond administrative costs can be paid directly out of bond proceeds. However, it is generally recommended that these costs be paid with non-bond proceeds such as State Highway Funds or other legally available monies. In any case, it is important to confer with Bond Counsel to determine whether costs related to the administration of the bonds are in fact an eligible use of tax-exempt bond proceeds.

13.10.9 Returned Grant Funds

Grant funds financed from tax-exempt bond proceeds that are returned to the grantor (i.e. ODOT) are considered to be unspent bond proceeds of the original issuance as of the date that the grant funds were returned unless the returned funds are redistributed to another qualified grantee within 60 days of the repayment date.[43] The effect of this requirement is that if the returned grant amounts are not redistributed to another qualified grantee within 60 days, then the investment earnings of the returned funds will have to be tracked for arbitrage rebate and other Federal tax regulatory purposes.

The Responsible Division shall provide oversight and administration for the distribution and expenditure of grant monies originating from bond proceeds. Upon completion of an authorized project the grantee is required to return to the grantor (i.e. ODOT) any unexpended grant proceeds and investment earnings and to document compliance with all terms of the grant. In addition, each grant agreement administered by the Responsible Division shall provide that failure of the grant recipient to comply with terms of its grant agreement will trigger remedies under the terms of the grant agreement including potential recapture of the full amount of the grant.

The Responsible Division will notify and coordinate with the Debt Manager and the Financial Services Branch Revenue and Expenditure Accounting unit the return of any grant funds in accordance with the procedures outlined in the applicable Financial Administration and Standards Manual ("FASM").

13.10.10 Grant Agreements

All recipients of a grant funded with bond proceeds must enter into a grant agreement with the Department before receiving any grant money. The Department will not advance bond proceeds to grantees prior to the signing of a grant agreement by the grantee.

Note that if a grant is financed with bond proceeds, then the facility, asset or property will then become bond-financed property subject to all the requirements of State and Federal law and Treasury Regulations. Once a facility or property becomes bond-financed property, it will remain

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[42] 26 CFR §1.148-2(e).
[43] 26 CFR §1.148-6(d)(4)(ii).

so for 125% of its useful life or until such property is disposed or sold in accordance with applicable state law, the grant agreement and any bond covenants or other restrictions and requirements. In addition, the Department and the grant recipient are required to maintain records for a minimum of the life of the bonds that financed the grant plus three (3) years. See also Section 13.12 – *Documentation and Record Keeping Retention* of this Tax Compliance Policy.

The Responsible Division has the responsibility to prepare the grant agreement for all bond-financed projects. The Debt Manager shall review the grant agreement, or the form of grant agreement, and coordinate further review by Bond Counsel prior to the issuance of the associated bonds to ensure that the grant agreement complies with applicable state and Federal law and Treasury Regulations.

13.10.11 Grant Administration and Oversight

Grants come with requirements that apply to operations, compliance, sub-recipient monitoring and reporting. Typically, there are negative consequences for failing to meet these requirements, such as the need to return funds to the grantor. Likewise, a grant may result in a program that continues, or an asset that must be maintained, well beyond the expiration of the grant.

As discussed above, individual grants and grant programs funded with bond proceeds come with numerous state and Federal requirements and restrictions. They also come with significant and long-term costs associated with debt service payments. To help avoid potential negative consequences or unanticipated burdens associated with the grant award process and administration the Responsible Division shall ensure that there are established and appropriate grant administration policies and procedures and that a grant administrative oversight working group or committee ("Grant Oversight Committee") is in place to ensure adherence to that policy. The Grant Oversight Committee should be both interdisciplinary and permanent and meet regularly.

Given the complexity of grant programs funded with bond proceeds, the composition of the Grant Oversight Committee should include the Chief Financial Officer, the Debt Manager or other designated Financial Services staff with appropriate expertise and understanding of the bond issuance process and ongoing bond compliance administration.

13.11 Loans

The issuance of tax-exempt or taxable bonds can be a source of funding for a leveraged loan program used to finance all or a portion of a transportation infrastructure project or program. Many leveraged loan programs administered by governmental entities have the authority to issue Federally tax-exempt bonds that yield a lower interest rate compared to taxable bonds. Some programs may use higher cost taxable bonds, the main benefit of which is that they are not subject to many of the restrictions and requirements associated with Federally tax-exempt bonds.

13.11.1 Leveraged Loans Versus Grants

Leveraged loan programs, where the issuer transfers tax-exempt bond proceeds to a loan recipient are more complicated than grant programs financed with bond proceeds. For grant programs, under Federal Treasury Regulations 26 CFR §1.148-6(d)(4), the bond proceeds are treated as spent once an issuer (i.e. the grantor) makes a grant of the bond proceeds to an unrelated party. In contrast, in a tax-exempt leveraged loan program, when the issuer transfers the bond proceeds to a borrower the loan is treated as an investment of bond proceeds. This means that the issuer must continue to monitor the investment yield that it receives on the loan, in the form of loan payments from the recipient. In addition, in the case of a loan, under other provisions that apply to tax-exempt bonds the issuer must "*look through*" to examine what the loan recipient does with the proceeds and whether the loan recipient is a governmental person or a private person for purposes of the Private Business Use rules.

13.11.2 Authorized Leveraged Loan Programs

Leveraged loan programs vary significantly based on their target borrowers whether governmental entities, non-profit organizations or private-sector for-profit businesses. The most active State of Oregon leveraged loan programs are administered by Business Oregon, the Department of Housing and Community Services and the Department of Veterans' Affairs.

The Department has the statutory authority to issue tax-exempt or taxable bonds to leverage transportation infrastructure loan programs. Such leveraged programs could be financed by the Department with, for example, Highway User Tax Revenue Bonds, State Highway GO Bonds, or revenue bonds issued and administered by the Oregon Transportation Infrastructure Bank. In addition, a leveraged bond program administered by the Department could be financed with Lottery Revenue Bonds issued on behalf of the Department by DAS.

Currently the only leveraged loan programs managed by the Department include the OTIB which leverages Federal and state transportation funds to provide loans and other financial assistance for transportation infrastructure projects and the Lottery Revenue Bond funded *Connect*Oregon program which finances non-highway multimodal transportation infrastructure projects.

In the case of the OTIB the source of funding has been limited to direct funding from Federal funds and State Highway Funds. The *Connect*Oregon leveraged loan program was financed with taxable bonds so is subject only to the requirements of state law as opposed to the more restrictive Federal Treasury Regulations.

Given the extensive and complex requirements associated with tax-exempt bonds, which must be complied with to maintain tax exemption, the origination and administration of any loan program using tax-exempt bond proceeds by the Department needs to involve the engagement of Bond Counsel and participation of the State Treasurer, DOJ, and the Department's Financial Advisor. In addition, any loan program using Lottery Revenue Bond proceeds will involve DAS and the engagement of its Bond Counsel.

13.11.3 Forgivable Loans

Bond-financed loans can be structured to be forgiven over time based on certain circumstances and in compliance with the terms of a loan agreement. If the forgivable loan is treated as a "loan" for tax purposes, the Department could not finance the loan to a private entity with tax-exempt bond proceeds (so any bond-funded loans to private entities would need to be financed on a Federally taxable basis). The Department could finance such loans to local governments, but there are a number of compliance issues that would need to be worked through that apply when tax-exempt bonds proceeds are loaned to two or more governments.

However, it may be possible to structure a forgivable loan so that it is treated as a “grant” for Federal income tax purposes. Whether a forgivable loan could be treated as a grant would require a fact intensive analysis by Bond Counsel. Factors that may be important to the determination that a forgivable loan may be treated as grant include, but are not limited to, the extent to which the “grantee/borrower” controls the conditions under which the “loan” would be forgiven, how the transaction is treated on the “grantor/lender’s” books for accounting and budget purposes, the parties’ intent upon entering into the arrangement, and the existence of any unconditional obligation to repay.

Ultimately, because of the fact-intensive nature of the analysis, for the Department to enter into a forgivable loan would require DOJ and Bond Counsel review of authorizing legislation and the draft forgivable loan agreement in order to determine whether the forgivable loan arrangement could be treated as a grant for tax purposes and therefore be financeable with tax-exempt bond proceeds.

13.12 Documentation and Record Keeping Requirements

The Debt Manager and Responsible Division management, as applicable, will ensure that copies of relevant records and documentation sufficient to support an assertion that the tax requirements relating to a Bond issue have been satisfied will be maintained by the Department for the term of a Bond issue (including refunding Bonds, if any) plus three (3) years.

13.12.1 Bond Documents and Official Transcript

Bond Counsel shall provide an official bond transcript to the Debt Manager in a reasonable time after the bond closing. The transcript documents are required for Arbitrage Rebate computations and to comply with Department and IRS archive requirements. Transcript documents should include, among other things, the following:

- Copies of legislative authorizations
- Copies of resolutions authorizing debt issuance
- Bond, Disclosure and Underwriter’s Counsel opinions
- Trust Indenture (i.e. declaration, ordinance, credit agreement, etc.)
- Tax Certificate
- IRS Form 8038-G, IRS Form 8038-B or other applicable IRS Form 8038
- Preliminary and Final Official Statement or Private Placement Memorandum
- Bond Purchase Agreement
- Rating Agency Letters
- Refunding documents (e.g. Escrow Deposit Agreement, Notices of Defeasance, etc.)
- CPA Verification Report (for applicable refundings only)
- Continuing Disclosure Undertaking
- Debt insurance documents
- Letter of Credit Agreement (generally for variable rate debt issues only)
- Winning Bid Form (for competitively sold debt issues)
- Closing Certificates
- Closing Memorandum

13.12.2 Debt Manager Document Retention Responsibilities

In accordance with IRS record retention requirements and in addition to the transcript and above listed documents, the following information (as applicable) will be retained in either a hardcopy folder or electronically by the Debt Manager for the term of a Bond issue (including refunding Bonds, if any) plus three (3) years:

- Bond proceed spend down documentation
- Debt service balances
- Reserve balances
- All prior rebate calculation reports and yield restriction reports
- Copy of accounting journal entries posting the debt issue sale and receipt of debt issue proceeds and the related supporting documentation
- Any relevant correspondence with the Arbitrage Consultant, Bond Counsel or others;
- Any notes describing relevant post-issuance facts
- Copies of records of investments, investment agreements, credit enhancement transactions, financial derivatives (e.g., an interest rate swap), arbitrage reports and underlying documents, including trustee statements.

13.12.3 Responsible Division Document Retention Responsibilities

Responsible Division tax compliance duties and responsibilities are detailed above and specifically in Section 13.5.3 – *Responsible Division Responsibilities.* In accordance with IRS record retention requirements, Responsible Divisions are tasked to retain debt related documentation in either a hardcopy folder or electronically for the term of a Bond issue (including refunding Bonds, if any) plus three (3) years which includes, among other things, the following:

- Copies of material documents relating to capital expenditures financed or refinanced by Bond proceeds, including (without limitation) construction contracts, purchase orders, invoices, requisitions and payment records, as well as documents relating to costs reimbursed with Bond proceeds and records identifying the assets or portion of assets that are financed or refinanced with Bond proceeds.
- Copies of all contracts and arrangements involving the lease, management, sale, operation, service or other use of Bond-Financed Facilities or Assets.
- Other pertinent documentation related to the uses of the financed assets for the same period. Such documentation would include, but may not be limited to, any leases with third parties, management contracts with third parties and any sales agreements related to the sale of financed assets.
- All contracts and arrangements involving private use, or changes in use, of the Bond-financed property.
- All grant and loan agreements and relevant documentation involving the use of Bonds including invoices and expenditure documentation.
- All reports and documents relating to the allocation of Bond proceeds and private use of Bond-financed property.
- Identification and itemization of the assets or portion of assets financed with Bond proceeds, including placed in service dates.
- Records relating to costs reimbursed with Bond Proceeds.

- Records relating to any action taken as a result of a failure to meet the Expenditure Deadlines.
- Records relating to the Final Allocation of Bond Proceeds and all supporting documentation.

Bond compliance and document retention requirements are applicable to the recipients of tax-exempt financed grant programs such as the Lottery Revenue Bond financed *Connect*Oregon program. The grantees documentation responsibilities should be clearly set out in the grant agreement and fully understood by both the Department grant manager and the grantee.

13.13 Post-Issuance Compliance

13.13.1 In General

The Debt Manager will conduct periodic reviews of compliance with these procedures to determine whether any violations have occurred so that such violations can be remedied through the “remedial action” regulations as provided in 26 CFR §1.141-12 or the Internal Revenue Service’s VCAP program described in IRS Notice 2008-31 (or successor guidance). If any changes or modifications to the terms or provisions of a Bond issue are contemplated, the Debt Manager will consult with Bond Counsel. The Department recognizes and acknowledges that such modifications could result in a “reissuance” of the Bonds for Federal tax purposes (i.e., a deemed refunding) and thereby jeopardize the tax-exempt status of the Bonds after the modifications.

The Debt Manager and/or other designated Department personnel will consult with Bond Counsel and other legal counsel and advisors, as needed, following issuance of each issue of the Bonds to ensure that all applicable post-issuance requirements in fact are met, so that interest on the Bonds will be excluded from gross income for Federal income tax purposes so long as any Bonds remain outstanding. This will include, without limitation, consultation in connection with future contracts with respect to the use of Bond-financed assets and future contracts with respect to the use of output or throughput of Bond-financed assets.

Whenever necessary or appropriate, the Department will engage an expert advisor as arbitrage rebate consultant to assist in the calculation of arbitrage rebate payable in respect of the investment of Bond proceeds.

13.13.2 Monitoring Private or Other Use of Financed Assets

The Responsible Division will maintain records identifying the assets or portion of assets that are financed or refinanced with proceeds of a Bond issue, including the uses and the users thereof (including terms of use and type of use). Such records may be kept in any combination of paper or electronic form. In the event the use of Bond Proceeds or the assets financed or refinanced with Bond Proceeds is different from the covenants, representations or factual statements in the Tax Certificate or other bond-related documents (e.g. Interagency Agreements, Memoranda of Understanding, etc.), the Responsible Division will notify the Debt Manager who will then promptly contact and consult with Bond Counsel to ensure that there is no adverse effect on the tax-exempt status of the Bond issue and, where appropriate, will remedy any violations through the "remedial action" regulations[44], the VCAP program, or as otherwise prescribed by Bond Counsel.

13.13.3 Ongoing Training

Training shall be made available to the Debt Manager, as the Department's designated Tax Compliance Officer and Disclosure Compliance Officer, to support his or her understanding of the tax requirements applicable to the Bonds. Such training may include, but would not be limited to, attending training sessions at local conferences such as Oregon Government Finance Officers Association ("OGFOA"), national conferences sponsored by the Government Finance Officers Association ("GFOA"), the National Association of Bond Lawyers ("NABL"), participation in conferences or teleconferences sponsored by the IRS, Securities and Exchange Commission, Municipal Securities Regulatory Board, Bond Buyer, etc., reading technical guidance materials provided by educational organizations, the IRS, and/or Bond Counsel, and discussing questions and issues with the Department's Bond Counsel and/or Arbitrage Consultant.

13.13.4 Annual Checklist of Tax-Exempt Bond Compliance

The Debt Manager will complete an "Annual Tax-Exempt Bond Compliance Guidelines/Checklist" with respect to all outstanding Bonds on or before the end of each Fiscal Year. The Debt Manager will retain a copy of each completed and signed checklist in a file that is retained in accordance with the document retention requirements described in Section 13.12 – *Documentation and Record Keeping Requirements* of this Tax Compliance Policy.

13.14 IRS Audit

In the event a Department debt issue is audited by the IRS the Debt Manager will be the Department's lead contact. The Responsible Division will be required to gather any necessary information requested by the IRS at the direction of the Debt Manager. The Responsible Division will be required to cooperate in a timely manner with the audit and may be required to pay penalties (if any), legal fees and any other audit costs.

13.15 Procedures For Taxable Debt

Most of the provisions of this Tax Compliance Policy are not specifically applicable to Federally taxable debt. However, while specific compliance may not be a requirement of Federal tax law, if a taxable bond issued by or on behalf of the Department is later refunded with the proceeds of tax-exempt refunding bonds, then the uses of the proceeds of the taxable bonds and the uses of the facilities financed with the proceeds of the taxable bonds will be relevant to the tax-exempt status of the refunding bonds. Therefore, if there is any reasonable possibility that an issue of taxable bonds may be refunded, in whole or in part, with the proceeds of an issue of tax-exempt bonds then, for purposes of this Policy, the Debt Manager and the Responsible Division shall treat the issue of taxable bonds as if such issue were an issue of tax-exempt bonds and shall carry out and comply with the requirements of this Policy with respect to such taxable bonds.

[44] 26 CFR §1.141-12.

It is also advisable to maintain comparable documentation for taxable debt financings and the expenditure of Federally taxable bond proceeds as it would assist future information gathering efforts in the event of changes of use of a financed asset, or during an audit of tax exempt or tax-advantaged debt issue that also includes a taxable debt component or a potential "private use" component.

The Debt Manager shall seek the advice of Bond Counsel in the event situations arise whereby there is a reasonable possibility of issuing tax-exempt bonds to refund an issue of taxable bonds, there are changes in the use of a debt financed asset, or there is potentially a private use component in the financing of a project that includes tax-exempt financing.

Chapter 14 Continuing Disclosure Compliance

14.1 Purpose and Scope

This Continuing Disclosure Compliance Policy and Guidelines (the "Disclosure Policy" or "Guidelines") is adopted by the Department to ensure that interest on tax-exempt governmental bonds of the Department remain excludable from gross income under Section 103 of the Internal Revenue Code of 1986, as amended and Treasury Regulations promulgated thereunder. This Disclosure Policy also serves to enhance compliance with the continuing disclosure undertaking(s) the Department has entered or will enter into pursuant to Securities and Exchange Commission Regulation, C.F.R. Section 240.15c2-12[1] (Municipal Securities Disclosure), as in effect (i.e. "Rule 15c2-12" or the "Rule") in connection with publicly-offered municipal securities issued by the Department.

These Disclosure Guidelines document existing practices and describes various procedures and systems designed to identify on a timely basis facts relevant to demonstrating compliance with the requirements of Federal law, Treasury Regulations and Rule 15c2-12. Such requirements must be satisfied subsequent to the issuance by the Department of tax-exempt Bonds or other debt obligations in order that the interest on such TEBs be, or continue to be, or would be but for certain provisions of the Code, excludable from gross income for Federal income tax purposes.

The Department understands that failure to comply with the policies and procedures set forth in this Disclosure Policy may result in the retroactive loss of the exclusion of interest on TEBs from Federal gross income. Accordingly, the Department will consult with counsel nationally recognized in the area of municipal finance (i.e. "Bond Counsel"), in advance, regarding deviations from the facts and expectations as set forth in the closing documents and certifications relating to any Debt Obligation issuance.

14.2 Background Information/Federal Securities Law Procedures

14.2.1 Anti-Fraud Provisions

Pursuant to the antifraud provisions of the Securities Act of 1933 and the Securities and Exchange Act of 1934, and accompanying regulations, applicable to securities such as the Bonds, if publicly offered, any material provided by the Department in connection with the offer or sale of the Bonds may not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

This material may be in the form of an offering circular or offering memorandum for a private placement and, although it is unclear whether such rules apply to these materials, the Disclosure Compliance Officer, as defined below, should review them with the same standard in mind. For a publicly offered transaction, the disclosure document may be a preliminary official statement or a final official statement and any materials provided to the rating agencies or credit enhancement provider. Such material may also include information provided to a bank or institutional investor

[1] 17 CFR §240.15c2-12 (Rule 15c2-12).

about the Issuer or the Bonds in connection with a bank loan or private placement. The antifraud provisions also apply to continuing disclosure discussed below.

The Disclosure Compliance Officer will actively participate in the Bond issuance process to ensure that all information regarding the Department described in the official statement or other materials prepared in connection with the initial sale of publicly offered Bonds or bank placements do not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

14.2.2 Continuing Disclosure Undertaking

In connection with an offering of the Bonds, and not a bank or private placement, the Department will execute a Continuing Disclosure Undertaking, Continuing Disclosure Agreement, Continuing Disclosure Certificate or such similarly titled document (herein referred to as the "Undertaking").

14.3 Persons Responsible for Compliance with Undertakings

If the Department has not appointed a Dissemination Agent (as described below), then the Debt Manager as the designated "Disclosure Compliance Officer," as of the date of adoption of these Disclosure Guidelines, has the primary responsibility to take action or direct others to take action to make required filings in compliance with the Undertakings relating to all Bonds. If the Department has appointed a Dissemination Agent to assist the Department in carrying out its obligations under the Undertakings, the Disclosure Compliance Officer will work with the Dissemination Agent to confirm that required filings are made by the Dissemination Agent in compliance with the Undertakings relating to all Bonds.

14.4 Dissemination Agent; External Advisors

To satisfy its obligations under these Disclosure Guidelines, the Department may appoint or engage a third-party dissemination agent with expertise in compliance with the Rule (the "Dissemination Agent") to assist the Department in carrying out its obligations under the Undertakings. The Department may discharge any such Dissemination Agent with or without appointing a successor Dissemination Agent.

14.5 Interagency Agreement to Comply with SEC Rule 15c2-12

The Department has entered into an "*Interagency Agreement to Comply with SEC Rule 15c2-12*" with the Office of the State Treasurer and the Department of Administrative Services, dated January 1, 2011, as amended (the "Disclosure Agreement"). In accordance with the Disclosure Agreement, the Disclosure Compliance Officer shall consult with and provide to the Debt Management Division of OST notice of the occurrence of any material event as described in the Disclosure Agreement and any Undertaking entered into by the Department. A copy of the Disclosure Agreement is provided in Appendix F –*Rule 15c2-12 Compliance Agreement*.

Further and as necessary and appropriate, the Disclosure Compliance Officer will consult with the Department's Bond Counsel and Financial Advisor, OST, DAS, the Department of Justice, and other legal counsel and advisors, as needed, to ensure compliance with applicable post-issuance disclosure requirements set forth in the Undertakings related to all Bonds.

14.6 Provision of Annual Reports to MSRB

Pursuant to Rule 15c2-12[2], and the Undertakings, the Department must file an annual report with the Municipal Securities Rulemaking Board on the MSRB's Electronic Municipal Market Access ("EMMA") system (accessible as of the date of adoption of these Disclosure Guidelines at "*emma.msrb.org*") within 270 days[3] after the Department's fiscal year end (June 30) (the "Annual Report Filing Deadline"). The annual report must include the financial statements of the Department and, if specified in the Undertakings, additional information related to the finances and operations of the Department (collectively, the "Annual Report"). The Undertakings for each series of Bonds may require different types of additional financial information and operating data to be included in the Annual Report for each series of Bonds.

On or before the Annual Report Filing Deadline, the Disclosure Compliance Officer will review the Undertaking for each series of Bonds then outstanding, will assemble the required contents of the Annual Report for such Bonds and will file on EMMA the Annual Report for such Bonds.

14.7 Provision of Material Event Filings to MSRB

The Rule and the Undertakings require notice of the occurrence of certain material events ("Material Events") to be provided to the MSRB within ten (10) business days after the occurrence of the Event if such an Event is determined to be material (a "Material Event Filing").

The occurrence of certain Material Events, including payment defaults, requires a Material Event Filing without the need for a materiality determination (i.e. deemed material under the Rule). Analysis of Other Material Events, such as non-payment related defaults, is required to determine if the Event is material and if so, a Material Event Filing is required. Questions as to whether a Material Event has occurred and what filings are required will be referred by the Debt Manager, as the designated Disclosure Compliance Officer, to Bond Counsel, OST and DOJ for discussion and resolution.

The Debt Manager is to be immediately notified by all responsible Department administrators, managers and staff (i.e. the "Responsible Division"), the Tax Compliance Officer, and other agents and officials of the Department of the occurrence of any listed Material Event so that he or she may determine whether a Material Event Filing is required pursuant to the Rule and the Undertakings. As soon as the Disclosure Compliance Officer has knowledge of the occurrence of an Event that is deemed material, the Disclosure Compliance Officer will coordinate with the State Treasurer, Bond Counsel and DOJ the preparation and filing, within ten (10) business days of the occurrence of the Material Event, a Material Event Filing on EMMA.

14.7.1 Material Events Requiring Disclosure

In a timely manner and pursuant to the Rule 15c2-12 notice of the occurrence of any of the following Material Events for which a Material Event Filing may be required with respect to the securities in the offering, if material, include:

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[2] 17 CFR §240.15c2-12 (Rule 15c2-12).
[3] Beginning with the Series 2010AB Bonds the filing date of the annual report was changed to 9 months.

1) Principal and interest payment delinquencies
2) Non-payment related defaults, if material
3) Unscheduled draws on debt service reserves reflecting financial difficulties
4) Unscheduled draws on credit enhancements reflecting financial difficulties
5) Substitution of credit or liquidity providers, or their failure to perform
6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701 TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax-exempt status of the security
7) Modifications to rights of security holders, if material
8) Bond calls, if material, and tender offers
9) Defeasances
10) Release, substitution, or sale of property securing repayment of the securities, if material
11) Rating changes
12) Bankruptcy, insolvency, receivership or similar event of the obligated person
13) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material, and
14) Appointment of a successor or additional trustee or the change of name of a trustee, if material

The Disclosure Compliance Officer will review the above list of Material Events, the Undertakings entered into by the Department, and the Disclosure Agreement at least annually, and consult with Bond Counsel or other advisors, as necessary, to update the list of Material Events under the Rule.

14.7.2 Inclusion of CUSIP Numbers with MSRB Filings

The Annual Report and any Material Event Filings must be filed on the MSRB's EMMA system to the CUSIP numbers for the maturities of each series of Bonds outstanding. If a Material Event Filing only applies to a certain series of Bonds (such as a notice of optional redemption), the filing is only required on the CUSIP numbers for the affected series of Bonds.

14.8 Rating Agency and Other Disclosures

The Department will provide full and complete financial disclosure to rating agencies, institutional and individual investors, other levels of government, and the general public to share clear, comprehensible, and accurate financial information using the appropriate channels, policies and procedures.

14.9 Disclosure Compliance Officer Responsibilities

In order to maintain compliance with the Department's obligations in the Undertakings, the Disclosure Compliance Officer will, if and as required by such Undertakings:

- Assist in the preparation or review of the Department's Annual Reports in the form required by the related Undertaking.
- Maintain a ledger or calendar, with appropriate reminder notifications, listing the Annual Report Filing Deadlines as provided in the related Undertaking.
- Ensure timely dissemination of the Annual Report by the Annual Report Filing Deadline, in the format and manner provided in the related Undertaking, which may include transmitting such filing to the MSRB through the EMMA system in the format prescribed by the MSRB.
- Monitor the occurrence of any material Event (as defined in the Undertaking) and coordinate with OST and Bond Counsel the timely filing of the notice of the occurrence of any such material Event in the manner provided under the Undertaking. To be timely filed, such notice must be transmitted within ten (10) days (or such other time-period as set forth in the Undertaking) of the occurrence of such material Event.
- Ensure timely dissemination of notice of any failure to perform under an Undertaking, if and as required by the Undertaking.
- Respond to requests, or ensure that the Department contact responds to requests, for information under SEC Rule 15c2-12, as provided in the Undertaking.
- Monitor the performance of any dissemination agent(s) engaged by the Department to assist in the performance of any obligation under the Undertaking.

14.10 Recordkeeping; Future Bond Issuance

The Debt Manager, as the designated Disclosure Compliance Officer, will maintain copies of and evidence of filing of the Department's Annual Reports and Material Event in the Department's records. In accordance with IRS record retention requirements, copies of the Department's Annual Reports and Material Event filings will be retained in either a hardcopy folder or electronically by the Debt Manager for the term of a Bond issue (including refunding Bonds, if any) plus three (3) years.

In connection with any subsequent issuance of Bonds by the Department, the Debt Manager shall review and verify any statements concerning the Department's compliance with its Undertakings in any offering documents (such as an Official Statement) for such Bonds. After the issuance of such Bonds, the Disclosure Compliance officer will file a copy of the Undertaking entered into in connection with such Bonds with the copies of Department's currently outstanding Undertakings.

14.11 Identification and Correction of Violations

In the event that the Department does not timely file complete information required in any Annual Report or does not timely make a Material Event Filing on EMMA, the Department will contact OST and Bond Counsel in a timely manner and undertake any appropriate corrective action that may be necessary to bring the Department into compliance with the Rule.

14.12 Compliance with Other Bond Covenants

In addition to financial disclosure and arbitrage compliance, once Bonds are issued the Disclosure Compliance Officer is responsible for verifying compliance with all Undertakings, covenants, and agreements of each Bond issuance on an ongoing basis. This typically includes ensuring:

- Annual appropriation of revenues to meet debt service payments
- Taxes/fees are levied and collected where applicable
- Timely transfer of debt service/rental payments to the trustee or paying agent
- Compliance with insurance requirements
- Compliance with rate covenants where applicable
- Compliance with all other bond covenants

The Disclosure Compliance Officer will coordinate verification of covenant compliance and will work with its Bond Counsel and all responsible Department divisions and units to monitor compliance with the aforementioned compliance requirements.

Chapter 15 Reserved

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Appendices

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Appendix A Debt Financing Terms and Concepts

"10b-5 Opinion" means a letter of counsel, sometimes referred to as a due diligence opinion, generally based upon an investigation of specified facts and addressing the accuracy and completeness of the official statement. A due diligence opinion addressed to an underwriter by underwriter's counsel customarily states that, based on certain specified inquiries, nothing has come to such counsel's attention indicating that the official statement contains any misstatements of material facts or any material omissions. An opinion by counsel to an issuer or conduit borrower may use similar or different language to address the adequacy and accuracy of the disclosure made.

"Accountant's Letter" or "Agreed-Upon-Procedures Letter" means a letter from an auditor to the underwriters of a new issue of municipal securities setting forth the procedures undertaken with respect to the review of specified financial information (e.g., interim period financial statements or other information not covered by audited statements) appearing in the official statement and providing certain conclusions regarding the information with respect to which such review procedures were applied. Compare to "Comfort Letter.

"Advance Refunding" means, for purposes of certain tax and securities laws and regulations, a refunding in which the refunded issue remains outstanding for a period of more than 90 days after the issuance of the refunding issue.

"Agency Securities" means a term for securities issued by a federal agency or certain federally chartered entities (often referred to as government-sponsored enterprises or GSEs). Agency securities typically are not guaranteed by the federal government, particularly those of GSEs. Agency securities also are generally exempt from the registration and prospectus requirements of the Securities Act of 1933. Securities of the following entities are generally considered agency securities although the terms of a bond contract or escrow deposit agreement may further limit what are considered to be agency securities for purposes of that contract or agreement: Federal Agricultural Mortgage Corporation (Farmer Mac); Federal Farm Credit Banks Funding Corporation (FFCB or Farm Credit); Federal Home Loan Bank System (FHLB or Home Loan); Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac); Federal Housing Administration (FHA); Federal National Mortgage Association (FNMA or Fannie Mae); Government National Mortgage Association (GNMA or Ginnie Mae); and Tennessee Valley Authority (TVA).

"Agreement Among Underwriters (AAU)" means the contract among the members of an underwriting syndicate establishing the syndicate rules, including the rights, duties and commitments of the senior manager and the other syndicate members with respect to the new issue of municipal securities being underwritten. In a competitive bid underwriting, the AAU is sometimes referred to as a syndicate account letter. The agreement among underwriters is also sometimes referred to as the underwriting agreement.

"Arbitrage" is the price differential, or profit made, from investing inherently lower yielding tax exempt debt proceeds in higher yielding taxable investments. Arbitrage is the difference between the yield on an issuer's tax-exempt or tax-advantaged debt issue and the investment income earned by investing the proceeds in taxable instruments.

Example:

Debt Issue's Arbitrage Yield	Overall Investment Yield for Gross Proceeds	Arbitrage Result
4.0%	5.0%	Positive Arbitrage
5.0%	5.0%	No Arbitrage
6.0%	5.0%	Negative Arbitrage

"Arbitrage Bond" means a bond initially issued on a tax-exempt or other federally tax-advantaged basis that are formally deemed by the Internal Revenue Service to violate federal arbitrage regulations. If the Internal Revenue Service finds that tax-exempt bonds are "arbitrage bonds," the interest becomes retroactively taxable and therefore is included in each bondholder's gross income for federal income tax purposes. However, the issuer and/or related parties may make payments to the IRS in return for the IRS not declaring the bonds taxable. Similarly, certain federal tax benefits are lost if other types of federally tax-advantaged bonds are found by the Internal Revenue Service to be "arbitrage bonds."

"Arbitrage Rebate" is the dollar profit earned from positive arbitrage, which must be paid back (rebated) to the federal government.

"Arbitrage Rebate Consultant" is a consultant, experienced in making arbitrage and rebate calculations required pursuant to Section 148 of the Internal Revenue Code of 1986, retained by the Department to make the computations for tax-exempt debt issued by or on behalf of the Department.

"Arbitrage Yield" is a calculation of yield on a debt issue, excluding cost of issuance and underwriter's discount, for purposes of determining compliance with applicable arbitrage regulations.

"Bid Form" means a document, often included with the notice of sale for a competitive bid underwriting, to be completed by underwriters submitting a bid on a new issue of municipal securities to be sold at a competitive sale. A bidding underwriter will state on the bid form its proposed interest rate(s) on the issue and the price it would be willing to pay for the new issue (subject to any conditions stated by the issuer in the notice of sale).

"Bidding Limitations" means the restrictions established by the issuer in the notice of sale for a competitive bid underwriting on the terms of bids submitted by prospective underwriters. Such restrictions might include: maximum range of permissible interest rates; the number of different interest rates permitted; a particular interest rate structure (such as ascending coupons only, no zero-coupon bonds, etc.); and the amount of any permitted discount or premium.

"Blind Pool" refers to any program under which bonds are issued to finance projects not yet identified at the date of issue

"Blue-Sky Laws" is a colloquial term for state securities laws derived from a statement that such laws were directed at unethical promoters who "would sell building lots in the blue sky."

Although these laws vary from state to state, most contain provisions concerning (a) prohibitions against fraud, (b) regulation of broker-dealers and investment advisors doing business in the state, and (c) registration of securities. Municipal securities are generally exempt from state securities registration requirements, although municipal securities dealers selling them are subject to many states' registration and regulatory requirements.

"Blue-Sky Memorandum" means a memorandum typically prepared by underwriter's counsel describing the treatment of a particular new issue of municipal securities under the blue-sky laws of the various states. Compare with "Legal Investment Survey."

"Bond Counsel" means an attorney or law firm retained, typically by the issuer, to give the traditional bond counsel opinion. Such opinion customarily opines that the bonds have been validly issued and, if tax exemption is intended, that the bonds are tax-exempt bonds. The opinion also may address related matters, such as state or local tax exemption and the enforceability of certain security provisions. Typically, bond counsel may prepare, or review and advise the issuer regarding, authorizing resolutions, bond contracts, official statements, validation proceedings and litigation.

"Bond Pool" means a municipal bond offering in which a sponsor sells an issue of bonds with proceeds used by a number of government entities or other tax-exempt organizations. The pool permits small issuers with low borrowing requirements to reduce the underwriting and interest costs inherent in a small issue.

"Bond Proceeds" means the money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities. These funds are used to finance the project or other purpose for which the securities were issued and to pay certain costs of issuance as may be provided in the bond contract or bond purchase agreement. See also "Net Proceeds."

"Bond Purchase Agreement" or "BPA" means the contract between the underwriter and the issuer setting forth the final terms, prices and conditions upon which the underwriter purchases a new issue of municipal securities. A conduit borrower also is frequently a party to the bond purchase agreement in a conduit financing. The bond purchase agreement is sometimes referred to as the "purchase contract."

"Call Premium" means a dollar amount, usually stated as a percentage of the principal amount called, paid as a "penalty" or a "premium" for the exercise of a call provision.

"Callable Bond" means a bond that the issuer is permitted to redeem before the stated maturity at a specified price, usually at or above par, by giving notice of redemption in a manner specified in the bond contract. In the case of zero coupon bonds, the call will be effected at equal to or greater than the compounded accreted value.

"Comfort Letter" means an independent accountant's letter delivered to the underwriter at the sale and closing of the issue that provides information concerning certain financial matters that may have occurred since the last audited financial statements of the issuer or other borrower. Compare to "Accountant's Letter" or "Agreed Upon Procedures Letter."

"Comprehensive Annual Financial Report" or "CAFR" is a set of U.S. government financial statements comprising the financial report of a state, municipal or other governmental entity that complies with the accounting requirements promulgated by the Governmental Accounting Standards Board (GASB).

"Capital Cost or Expenditure" means an expense where the benefit continues over a long period, rather than being exhausted in a short period. Such expenditure is of a non-recurring nature and results in acquisition of permanent assets. It is thus distinct from a recurring operation and maintenance expense.

"Code of Federal Regulations (CFR)" is a codification (arrangement of) the general and permanent rules and regulations (sometimes called administrative law) published in the Federal Register by the executive departments and agencies of the Federal Government.

"Competitive Sale" means a method of sale chosen by an issuer, requesting underwriters to submit a firm offer to purchase a new issue of municipal securities. The issuer awards the municipal securities to the "winning" underwriter or syndicate presenting a bid complying with the terms of a Notice of Sale that provides the lowest interest rate cost 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."

"Computation Date" is the date defined in the Tax Certificate and identifies the dates by which the rebate computations must be completed.

"Conduit Revenue Bonds" is type of revenue bond issued by a governmental issuer acting as conduit for the benefit of a private sector entity or a 501(c)(3) organization. In these cases, the governmental issuer is seeking to advance specific public purposes within its mission, with such conduit bonds commonly issued for not-for-profit hospitals, single and multi-family housing, industrial or economic development, student loan programs or waste disposal facilities. Principal and interest on such bonds normally are paid exclusively from revenues pledged by the entity receiving financing (the "obligor"). Unless otherwise specified under the terms of the bonds, the issuer is not required to make payments of principal or interest if the obligor defaults.

"Conflicts of Interest" occur in situations where parties in a transaction have multiple interests or relationships that could possible corrupt the motivation to act. The presence of a conflict of interest indicates the potential for divided loyalties but does not necessarily indicate wrong doing.

"Controlled Group" means a group of entities controlled directly or indirectly by the same entity or group of entities within the meaning of 26 CFR §1.150-1(e).

"Costs of Administration" no more than 5 percent of bond proceeds can be used for administration of the program – assuming such administrative costs are necessary to execute the program and get the capital projects completed.

"Costs of Issuance" or "COI" means the expenses associated with the sale of a new issue of municipal securities, including such items as underwriter's discount and financial advisory, bond counsel, other counsel and rating agency fees and other expenses.

"Credit Enhancements" refers to municipal securities that are backed by a third-party credit enhancement, which backstops the primary pledge to pay principal and interest. Forms of credit enhancement include bond insurance, bank letters of credit, state school guarantees and credit programs of federal or state governments or federal agencies. Credit enhancement serves as a secondary source of payment if the primary source of payment is insufficient. Investors should take care to note the current credit quality of the guaranty or letter of credit bank but should also consider carefully the credit of the issuer or the obligor since the financial strength of credit enhancers can change over time and, in some situations, could decline.

Insured bonds and bonds backed by letters of credit often carry two separate ratings, one of which is based on the financial strength of the insurer or bank and the other underlying rating is based on the financial strength of the issuer or obligor making the primary pledge for payment of principal and interest. However, in other cases, a guarantee may be provided by a different type of related third party, such as another unit of government, or in the case of conduit revenue bonds, a parent corporation or other entity related to the private beneficiary of the bonds.

"Date of Issue" also referred to as the Closing Date, is the date on which the Gross Proceeds are received by the Department from the purchaser of the bonds. For lines of credit, it is the date the agreement with the credit provider is signed and the date the first substantial draw (greater than the lesser of 5% of the Gross Proceeds or $50,000) is taken.

"Debt" means indebtedness lawfully issued, executed or assumed by a public entity. Debt is created when a public entity agrees to pay overtime to someone else, in exchange for receiving an upfront payment or loan or for acquiring an asset. "Security" refers both to debt that can be transferred or delivered to another party, as well to property or assets pledged as collateral for a debt. Common instruments or evidence of debt are:

- **Bonds** are debt instruments issued for a period of one year or longer, usually for permanent financing.
- **Notes** are debt instruments issued for a short period of time, often for interim financing. Notes may be rolled to bonds. Examples are Capital Outlay Notes, Tax and Revenue Anticipation Notes, Bond Anticipation Notes, and Grant Anticipation Notes.
- **Capital leases or a lease purchase** are written agreements allowing the use of property in exchange for payment of funds.
- **Loans** are debt agreements usually with a financial institution such as a local bank or an organized loan program such as the Oregon Transportation Infrastructure Fund or the Oregon Business Development Fund (OBDF).

"Debt Manager" means the staff of the Debt Management unit or authorized designee.

"Debt Service" means the amount of money necessary to pay interest on outstanding bonds, the principal of maturing or redeemed bonds and any required contributions to a sinking fund for term bonds. This amount is also known as the "debt service requirement." "Annual debt service" refers to the total principal and interest required to be paid in a calendar year, fiscal year, or bond fiscal year. "Total debt service" refers to the total principal and interest paid throughout the life of a bond issue. "Average annual debt service" refers to the average debt service payable each year on an issue. "Maximum annual debt service" refers to the amount of debt service for the year in which the greatest amount of debt service payments are required and is often used in calculating required reserves and in additional debt tests

- **Backloading** refers to delaying repayment of principal until the end of the financing term. Backloading should be considered only when beneficial to the overall amortization of debt, upon the occurrence of natural disasters, or when project revenues are not available during the early years of a project.
- **Level debt service** refers to a debt service schedule in which the combined annual amount of principal and interest payments remains relatively constant over the life of the issue of bonds. Level debt service is generally the standard or default structure for debt service similar to a standard home mortgage
- **Level principal** refers to a debt service schedule in which the annual amount of principal payments remains relatively constant over the life of the issue of bonds, resulting in declining annual debt service as the annual amount of interest payments declines. This is sometimes referred to as "declining debt service."

"<u>Debt Service Fund</u>" means a fund into which the issuer makes periodic deposits to assure the timely availability of sufficient funds for the payment of debt service requirements. Typically, the amounts of the revenues to be deposited into the debt service fund and the timing of such deposits are structured to ensure a proper matching between debt service fund deposits and debt service payments becoming due. For many issues, the debt service fund may contain a separate "principal account" and "interest account" in which funds for such respective purposes are held. In addition, the debt service fund for many variable rate securities may contain a "letter of credit account," a "swap payments account" or "reimbursement account" in which funds are held to reimburse the issuer of a liquidity facility for draws made to pay amounts owing on the securities, or payments due under a swap agreement.

"<u>Debt Service Reserve Fund</u>" means a fund in which funds are placed to be applied to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements. The debt service reserve fund may be entirely funded with bond proceeds at the time of issuance, may be funded over time through the accumulation of pledged revenues, may be funded with a surety or other type of guaranty policy (described below), or may be funded only upon the occurrence of a specified event (e.g., upon failure to comply with a covenant in the bond contract) (a "springing reserve"). Issuers may sometimes authorize the provision of a surety bond or letter of credit to satisfy the debt service reserve fund requirement in lieu of cash. If the debt service reserve fund is used in whole or part to pay debt service, the issuer usually is required to replenish the fund from the first available revenues or in periodic repayments over a specified period of time.

"<u>Disclosure Counsel</u>" means an attorney or law firm retained by the issuer to provide advice on issuer disclosure obligations and to prepare the official statement and/or continuing disclosure agreement.

"<u>Double-Barreled Bonds</u>" is the term used to describe bonds secured by a defined revenue source as well as the full faith and credit of an issuer that has taxing power. It has both general obligation and revenue pledges.

"<u>Expenditure Deadlines</u>" means the dates by which bond proceeds must be spent or become subject to arbitrage yield limitations.

"Expenditure Limitation" means the maximum amount of Lottery Funds, Other Funds, or Federal Funds an agency may spend as defined in an agency's legislatively approved budget.

"Extraordinary Call or Redemption" means mandatory or optional redemption triggered by the occurrence of certain one-time or extraordinary events specified in the bond contract. An extraordinary redemption may be triggered by, among other things, bond proceeds remaining unexpended by a specified date or the loss of the facility financed with the proceeds of the bonds by fire or damage or by eminent domain taking.

"GASB" means the Governmental Accounting Standards Board which is the source of generally accepted accounting principles used by state and local governments in the United States.

"General Obligation Bonds" are issued by a state or local government that pledges its full faith, credit and taxing power to pay principal and interest. General obligation bonds may be payable from general funds including income taxes or property taxes of the issuer, although the precise source and priority of payment for general obligation bonds may vary considerably from issuer to issuer depending on applicable state or local law. General obligation bonds issued by local units of government often are payable from (and in some cases solely from) the issuer's ad valorem taxes, while general obligation bonds issued by states often are payable from appropriations made by the state legislature. General obligation bonds may require approval by voters prior to issuance. In the event of default in required payments of interest or principal, general obligation bondholders typically have certain rights to compel a tax levy or a legislative appropriation.

"General Public Use" means any arrangement providing for use that is available to the general public at either no charge or on the basis of rates that are generally applicable and uniformly applied. Use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business.

"Good Faith Offering" means a bona fide offering that is actively made to as many members of the Public as is reasonably practical, as part of a good faith effort by the Underwriters to sell as many Bonds as practicable to the Public at the Initial Public Offering Prices.

"Gross Proceeds" is the amount received from the purchaser of the bonds on the Date of Issue or the amount drawn on a line of credit.

"Indirect & Administrative Costs" means costs that cannot be directly attributable to the Project as they benefit multiple projects.

"Initial Public Offering Prices" means the initial public offering prices (or yields corresponding to such prices) that are as set forth in the Official Statement.

"Internal Revenue Code" or "IRC" means the Internal Revenue Code of 1986, the domestic portion of federal statutory tax law in the United States, published in various volumes of the United States Statutes at Large, and separately as Title 26 of the United States Code (USC). It is organized topically, into subtitles and sections, covering income tax, payroll taxes, estate taxes, gift taxes, and excise taxes; as well as procedure and administration. Its implementing agency is the Internal Revenue Service.

"Legal Investment Survey" means a memorandum typically prepared by underwriter's counsel that surveys the laws of the states with respect to whether the securities being offered by an underwriting syndicate are legal investments for specified types of entities. Compare with "Blue-Sky Memorandum."

"Legal Opinion" means the written conclusions of bond counsel that the issuance of municipal securities and the proceedings comply with applicable laws, that the municipal securities are legal, valid and enforceable obligations of the issuer and that, in the case of tax-exempt bonds, interest on the bonds is excluded from gross income of the bondholders for federal income tax purposes and, where applicable, from state and local taxation. Bond counsel's legal opinion is often referred to as the "approving opinion" or "bond counsel opinion."

"LIBOR" means the "London Interbank Offered Rate," which represents the average rate at which a leading bank can obtain unsecured funding in the London interbank market. LIBOR serves as a benchmark for various interest rates. Obligations of parties to such transactions are typically expressed as a spread to LIBOR.

"Mandatory Redemption" requires the issuer to redeem or call (a "mandatory redemption"), all (an "in-whole redemption") or a portion (a "partial redemption") of an outstanding issue of bonds prior to its stated date of maturity.

"Mandatory Redemption Fund" means a fund into which the issuer is required to make periodic deposits of funds to be used to pay the costs of calling bonds in accordance with the mandatory redemption schedule in the bond contract or to purchase bonds in the open market in satisfaction of such mandatory redemption requirement. This term is sometimes used interchangeably with the term "sinking fund."

"Minor Portion" means the lesser of $100,000 or 5% of Gross Proceeds (minus any bond reserve funded with Gross Proceeds).

"Moral Obligation Bonds" refers to a bond, usually issued by a state or agency, that is secured by a non-binding covenant that any amount necessary to make up any deficiency in pledged revenues available for debt service will be included in the budget recommendation made to the state legislature or other legislative body, which may appropriate funds to make up the shortfall. The legislature or other legislative body, however, is not legally obligated to make such an appropriation. Unlike a general obligation pledge, the moral obligation bond does not require voter approval and does not have the state's official pledge of its full faith and credit.

"Negative Arbitrage" means earnings lower than the Arbitrage Yield. Negative arbitrage can be used to offset positive arbitrage during the five-year cumulative calculation period.

"Negotiated Sale" means the sale of a 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.

"Net Proceeds" means, generally, the proceeds from the sale of a new issue of municipal securities less costs of issuance.

"Notice of Sale" means a document describing the terms established by an issuer for a competitive sale of an anticipated new issue of municipal securities. It generally contains the date, time and place of sale, amount of issue, type of security, amount of any good faith deposit, basis of award, name of bond counsel, maturity schedule, method of delivery, time and place of delivery, and bid form.

"Offering Circular" means a document about an issue of municipal securities expected to be offered in the primary market. The document discloses to investors information regarding the securities to be offered. See also "Official Statement."

"Official Statement" means a document prepared by or on behalf of the issuer of municipal securities in connection with a primary offering that discloses material information on the offering of such securities. Official statements typically include information regarding the purposes of the issue, how the securities will be repaid, and the financial and economic characteristics of the issuer, conduit borrower or other obligated person with respect to the offered securities. Investors and market intermediaries may use this information to evaluate the credit quality of the securities and potential risks of the primary offering.

"Operating Costs" or "Working Capital" mean expenditures for current operating expenses and other expenditures which would not be treated as capital expenditures for federal income tax purposes within the meaning of Section 1.150-1(b) of the Code, but do not include the costs of issuance of the bonds.

"Optional Redemption" allows the issuer, at its option, to redeem the bonds. Optional redemptions often can be exercised only on or after a specified date, typically for a municipal security beginning approximately ten years after the issue date.

"Original Expenditure" means qualified Project expenditures originally paid from a source other than tax-exempt bond proceeds before the Date of Issuance yet not earlier than 60-days prior to the date of issuance or the date of the Reimbursement. An original expenditure is a capital expenditure, a cost of issuance for a bond, an expenditure described in Treas. Reg. § 1.148-6(d)(3)(ii)(B) (relating to certain extraordinary working capital items), a grant (as defined in Treas. Reg. § 1.150-1(f)), a qualified student loan, a qualified mortgage loan, or a qualified veterans' mortgage loan (Treas. Reg. § 1.150-2).

"Par" means 100 percent of the face value of a security.

"Par Value" means the amount of principal of a security that must be paid at maturity. The par value may also be referred to as the "face amount" of a security.

"Preliminary Expenditure" means qualified architectural, engineering, surveying, soil testing, and similar costs that, in the aggregate, are not in excess of 20% of the project issuance amount.

- Preliminary Costs are not otherwise subject to reimbursement restrictions.
- Costs of land acquisition, site preparation and similar costs incident to commencement of construction are not Preliminary Expenditures.

"Private Person" means any person or entity other than a state or local governmental unit or an individual not acting in a trade or business. Accordingly, a Private Person would include the federal government, for-profit organizations, non-profit organizations, and individuals who are acting in a trade or business capacity.

"Private Use" or "Private Business Use" means any Use or ownership of the property by a person that is neither a state or local governmental unit nor a 501(c)(3) Organization (i.e. a Private Person) as well as other arrangements that transfer to the Private Person the actual or beneficial use of the property (such as a lease, management contract, service or incentive payment contract, output contract, naming rights contract or other special arrangement) in such a manner as to set the Private Person apart from the general public. If property is used simultaneously in a Private Use and in a Use that is not a Private Use, such property is used in a Private Use.

"Prudent Person Standard or Rule" generally refers to a legal maxim that symbolizes a standard that requires that a fiduciary entrusted with funds shall invest such funds in securities that any reasonable individual interested in receiving a good return of income while preserving his or her capital would purchase.

"Rebate Calendar" is a database managed by the Debt Manager that tracks Computation Dates for all tax-exempt and tax-advantaged debt issued by the Department since 1986.

"Reimbursement Bond" means the portion of an issue allocated to reimburse an original expenditure that was paid before the issue date.

"Reimbursement Declaration" is a declaration of official intent to issue future debt, the proceeds from which will, in whole or in part, reimburse for eligible capital expenditures (i.e. "Original Expenditure"). A project description and not-to-exceed amount is required. The not-to-exceed amount should include all project costs expected to be financed, which costs can include expenditures incurred no more than 60 days prior to the date it is executed.

"Related Party" means, in reference to a governmental unit or a 501(c)(3) organization, any member of the same controlled group, and, in reference to any person that is not a governmental unit or 501(c)(3) organization, a related person (as defined in 26 USC §144(a)(3)).

"Responsible Division" is the division, branch or unit that is responsible for the administration and management of programs or projects financed with bond proceeds.

"Revenue Bonds" is the term used generally to describe a bond that is payable from a specific source of revenue and to which the full faith and credit of an issuer with taxing power is not pledged. The issuer of a revenue bond is not obligated to pay principal and interest on its bonds using any source other than the source(s) specifically pledged to the bond. Revenue bonds are payable from identified sources of revenue and do not permit the bondholders to compel taxation or legislative appropriation of funds not pledged for payment of debt service. Pledged revenues may be derived from operation of the financed project, grants or excise or other specified non-ad-valorem taxes. Generally, no voter approval is required prior to issuance of such obligations. If the specified source(s) of revenue become inadequate, a default in payment of principal or interest may occur. Various types of pledges of revenue may be used to secure interest and principal payments on revenue bonds. The nature of these pledges may differ widely based on the type of issuer, type of revenue stream and other factors.

Some revenue bonds are issued by governmental agencies to fund facilities for essential public services. A bond issued by a municipal water and sewer authority, for example, typically would involve revenues obtained through local water and sewer assessments. The pledge of revenue would identify specific assessments that can be used to pay principal and interest on the bonds, the authority's responsibility and ability (if any) to raise water and sewer assessments, and any superior claim on the assessments, for example.

"Revenue Procedures" means an official statement of a procedure published in the Internal Revenue Service Bulletin that either affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code and related statutes, treaties, and regulations or, although not necessarily affecting the rights and duties of the public, should be a matter of public knowledge.

"Rule 10b-5" codified at 17 C.F.R. 240.10b-5 means a rule promulgated under the Securities Exchange Act of 1934 that makes it unlawful for any person, in connection with the purchase or sale of any security, (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

"Rule 15c2-12" means an SEC rule governing the obligations of dealers regarding municipal securities disclosure under the Securities Exchange Act of 1934.

"Sinking Fund" means a fund into which funds are placed to be used to redeem securities in accordance with a redemption schedule in the bond contract. This term is sometimes used interchangeably with the term "mandatory redemption fund."

"Sinking Fund Redemption" requires the issuer to regularly redeem a fixed portion or all of the bonds in accordance with a fixed schedule.

"Special Tax Counsel" means a lawyer or law firm employed to give an opinion that the interest on tax-exempt bonds qualifies for exclusion from gross income of the bondholders thereof for federal income tax purposes.

"Story Bond" refers to a bond with highly unusual characteristics that may be complex or difficult to understand. Investors are usually hesitant to invest in stocks or bonds (or other securities) that they do not understand; thus, representatives of the issuer or the underwriters must explain the stock's or bond's features in such a way as to convince the investor to buy it. The term comes from the fact that having the bond explained can feel like having a story told to the investor.

"SWAP" is a generic term used to describe a broad range of derivative products, including but not limited to interest rate swap contracts.

"Tax-advantaged Bonds" means a tax-exempt bond, a taxable bond that provides a federal tax credit to the investor, a taxable bond that provides a refundable tax credit payable directly to the issuer of the bond or any future similar bond that provides a federal tax benefit that reduces the issuer's borrowing costs.

"Tax Certificate" is a certification prepared on the date of issuance listing the principal facts and expectations allowing the conclusion that interest on the debt is excludable from gross income under the Treasury Regulations.

"Tax Compliance Officer" means the designated person responsible for the compliance with federal tax requirements.

"Temporary Period" is the period from the Date of Issue to the third bond anniversary date.

"Tenor" commonly refers to the length of time a bond, note, loan, interest rate swap or other debt obligation reaches maturity or until a financial contract expires. Tenor can also refer to the coupon payment frequency on an interest rate swap or for a bond, the remaining time to maturity.

"Treasury Regulations" means the tax regulations (26 C.F.R.) issued by the United States Internal Revenue Service (IRS), a bureau of the United States Department of the Treasury. These regulations are the Treasury Department's official interpretations of the Internal Revenue Code and are one source of U.S. federal income tax law.

"Underwriting Period" means for purposes of SEC Rule 15c2-12, the period in connection with a primary offering of municipal securities ending on the later of the closing of the underwriting or the sale of the last of the securities by the syndicate. Rule 15c2-12 obligates an underwriter to send the final official statement for a primary offering to any potential customer, upon request, from the time the final official statement becomes available until the earlier of 90 days from the end of the underwriting period or the time when the official statement is available to any person from the Municipal Securities Rulemaking Board through the Electronic Municipal Market Access ("EMMA") system, but in no case less than 25 days following the end of the underwriting period

"Unqualified Legal Opinion" means a legal opinion of bond counsel that does not contain any qualifications. An unqualified legal opinion is frequently distinguished from a qualified or "reasoned" opinion expressing a lesser degree of confidence by the counsel delivering the opinion. A legal opinion generally is not considered to be qualified if it is subject to customary assumptions, limitations and qualifications or if the opinion is otherwise explained. In the municipal securities market, legal opinions generally are unqualified.

"Unrelated Trade or Business" means an activity that constitutes an "unrelated trade or business" within the meaning of Section 513(a) of the Code, without regard to whether such activity results in unrelated trade or business income subject to taxation under Section 511 of the Code.

"Unspent Proceeds" means, at any point in time, the proceeds of a bond issue or amounts drawn on a line of credit, plus investment earnings, less all cash payments made for eligible expenditures.

"U.S. Code" or "Code" is the codification by subject matter of the general and permanent laws of the United States. It is divided by broad subjects into 53 titles and published by the Office of the Law Revision Counsel of the U.S. House of Representatives. The U.S. Code was first published in 1926. The next main edition was published in 1934, and subsequent main editions have been published every six years since 1934. In between editions, annual cumulative supplements are published in order to present the most current information.

"Use" includes any use as a result of (i) ownership, (ii) actual or beneficial use pursuant to a lease or a management, service, incentive payment, research or output contract, (iii) any other similar arrangement, agreement or understanding, whether written or oral, (iv) with respect to any portion of the Bond Financed Property available for use by the general public, any arrangement that conveys special legal entitlements to any person with respect to such portion of the Bond Financed Property or (v) with respect to any portion of the Bond Financed Property not available for use by the general public, any arrangement that conveys special economic benefits to any Person with respect to such portion of the Bond Financed Property.

"Voluntary Closing Agreement Program (VCAP)" means the program for tax-exempt bonds and tax credit bonds administered by the IRS Office of Tax Exempt Bonds and described in IRS Notice 2008-31(or successor guidance). VCAP functions to assist governmental issuers in resolving violations of the federal tax laws applicable to their tax-exempt bonds, tax credit bonds, or direct pay bonds (tax-advantaged bonds). Under VCAP, issuers can conclusively resolve violations through the execution of closing agreements with the Service.

"Working Capital" or "Operating Costs" mean expenditures for current operating expenses and other expenditures which would not be treated as capital expenditures for federal income tax purposes within the meaning of Section 1.150-1(b) of the Code, but do not include the costs of issuance of the bonds.

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Appendix B State and Agency Credit Ratings

As of January 1, 2026

Agency	Type	Lien	Fitch	Moody's	S&P
State of Oregon	General Obligation	First Lien	AA+	Aa1	AA+
Department of Transportation	Highway User Tax Revenue	Senior Lien Subordinate Lien	AA+ AA+	Aa1 Aa2	AAA AA+
Department of Transportation	Grant Anticipation Revenue Bonds	First Lien			AA
Department of Administrative Services	COP Lottery Revenue	First Lien First Lien	- –	Aa2 Aa2	 AAA

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Appendix C Debt Compliance Responsibilities

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Appendix D Annual Bond Compliance Review

Form of Annual Bond Compliance Review

(to be completed by the designated "Tax and Disclosure Compliance Officer" as described in the Department's Debt and Investments Policy and Guidelines)

Bond Series: ________________________

Date Completed:____________________

Description	Yes	No
Information Return Filing An IRS Form 8038 must be filed with the IRS to report the issuance of a bond issue not later than the 15th day of the second month following the end of the calendar quarter in which the bonds were issued. The Form 8038 filed with the IRS will be included as part of the closing bond transcript for each Bond issue. Required Action: was the Form 8038 filed with required schedules and attachments?		
Tax Certificate Representations Is the Department in compliance with all covenants and representations made in the bond Tax Regulatory Agreement (i.e. the Tax Certificate)? *If no, consult with Bond Counsel.*		
Bond Proceed Expenditure Compliance Have Bond Proceeds been allocated to expenditures for non-qualified purposes or for purposes not described in the authorizing legislation, the bond official statement or other relevant documents (e.g. Interagency Agreement or Memorandum of Understanding) by the Responsible Division? *If yes, consult with Bond Counsel.*		
Project Change in Use Has the Responsible Division reported any change in the use or sale of all or any portion of the project or facility financed with tax-exempt bonds as described in the bond Tax Regulatory Agreement? *If yes, consult with Bond Counsel.*		
Lease of Facilities Has there been a lease of all or any portion of a Project by the Responsible Division to any party other than a state or local government? *If yes, consult with Bond Counsel.*		
Management Contracts If applicable, has the Department's Responsible Division entered into a new, or amended an already existing, management or service contract related to a project or facility financed with tax-exempt bonds?		

Description	Yes	No
Private Use of Bond Proceeds or Bond-Financed Facility or Property Has the Responsible Division reported any Private-Use of all or any portion of a project or facility by any party other than a state or local government? *If yes, consult with Bond Counsel.*		
Document Retention Requirements Is the Department and/or the Responsible Division out of compliance with the record retention requirements as described in Chapter 13 and Chapter 14 of the Debt and Investments Compliance Policy and Guidelines? *If yes, consult with Bond Counsel.*		
Bond Cost of Issuance Limitation Have more than 2% of the sale proceeds of the bonds been used to pay cost of issuance of the bonds? *If yes, consult with Bond Counsel.*		
Arbitrage Rebate/Yield Restriction Compliance Will there be a rebate/yield restriction arbitrage computation date during the upcoming annual period? *If yes, consult and engage with Department's Arbitrage Consultant.*		
Final Allocation of Expenditures If the bond proceeds have been fully spent, has the Department made a final allocation of the bond proceeds within the time periods described in Chapter 13 of the Department's Debt and Investments Compliance Policy and Guidelines? *If no, consult with Bond Counsel.*		
Material Event and Financial Information Reporting Has the State Treasurer and/or the Department filed all required annual financial information and notices of material events with EMMA as required by the bond Continuing Disclosure Agreement? *If yes, consult with Bond Counsel.*		

If an answer to any question above is unclear, the Tax and Disclosure Compliance Officer shall consult with the Department's Bond Counsel, the State Treasurer and the Department of Justice to determine (i) if the event could adversely impact the tax-exemption of the Department's outstanding tax-exempt bonds and/or (ii) whether any action needs to be taken during the upcoming annual period to ensure compliance with the tax-exempt bond or securities law restrictions.

The undersigned is the "Tax and Disclosure Compliance Officer" as described in the Debt and Investments Policy and Guidelines and has completed the above checklist to the best of the knowledge of the undersigned.

____

Signature of ______________________ - Tax and Disclosure Compliance Officer

(print name)

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Appendix E State of Oregon Swap Policy

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Appendix F Rule 15c2-12 Compliance Agreement

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