

Southern Methodist University



**Tax-Exempt Debt
Post-Issuance Compliance Policies and Procedures**

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Part I. Purpose.

It is the policy of the Southern Methodist University (the “University”) to comply with all applicable federal tax rules related to its tax-exempt debt issuances. This includes compliance with all applicable federal tax documentation and filing requirements, yield restriction limitations, arbitrage rebate requirements, use of proceeds and financed projects limitations and recordkeeping requirements. In recognition of the importance of compliance with Federal Tax Regulations with respect to tax-exempt debt, the University adopted “SMU Procedures for Post Issuance Compliance of Tax-Exempt Bond Issues.” (See Exhibit A)

These Policies and Procedures (the “Policies and Procedures”) are intended to provide further detail regarding the procedures previously adopted and to serve as a guide for the University to facilitate compliance with the federal tax law applicable to the University’s outstanding tax-exempt debt issuances. In the event these Policies and Procedures conflict, in whole or in part, with the Arbitrage and Tax Regulatory Certificate (or other similar certificate) (the “Tax Certificate”) prepared on behalf of the University in connection with a tax-exempt debt issuance, the terms of the Tax Certificate shall control.

Part II. Responsibility of University Officials.

Except as otherwise described herein, the Vice President for Business and Finance has primary responsibility for ensuring that the University’s outstanding tax-exempt debt issuances are, and will remain, in compliance with federal tax law. The Vice President for Business and Finance will consult with other departments within the University, including the Office of the Controller (the “Controller’s Office”), as well as third-party professionals (e.g., the University’s bond counsel, Digital Assurance Certification, L.L.C. (DAC), and arbitrage rebate provider), as needed, to ensure compliance with such rules, including these Policies and Procedures. The Controller’s Office will ensure that these policies and procedures are reviewed on an annual basis.

Part III. Closing of Debt Issuances.

A. Tax Certificates. University bond counsel, with assistance from the University and other professionals associated with the financing, shall prepare a Tax Certificate in connection with each tax-exempt debt issuance issued by the University, to be executed by the University’s Vice President for Business and Finance, or other authorized official, at closing. The Tax Certificate shall serve as the operative document for purposes of establishing the University’s reasonable expectations as of the date of issue of a tax-exempt debt issuance, as well as, providing a summary of the federal tax rules applicable to such issuance. The Controller’s Office, in consultation with the University’s bond counsel, will review the Tax Certificate prepared for each of the University’s tax-exempt debt issues prior to the closing of the issue.

The Tax Certificate will be included as part of the transcript for each University tax-exempt debt issuance. A copy of the Tax Certificate may be retained through the DAC system, and in all events the University will keep a copy of the final executed version of the Tax Certificate in accordance with the provisions of Part VII, “Recordkeeping,” of these Policies and Procedures.

B. Internal Revenue Service Form 8038 – Tax-Exempt Bonds. University bond counsel, with assistance from the University and other professionals associated with the financing, shall prepare an Internal Revenue Service Form 8038, Information Return for Tax-Exempt Governmental Obligations, in connection with each tax-exempt debt issuance issued by/to benefit the University, which the Controller’s Office will review prior to closing. Each Internal Revenue Service Form 8038 prepared for a tax-exempt debt issuance will be filed with the Internal Revenue Service no later than the 15th day after the 2nd calendar month after the close of the calendar quarter in which the tax-exempt obligation to which such Form 8038 relates is issued. All Form 8038s shall be filed by the University’s bond counsel with the Internal Revenue Service.

The Internal Revenue Service Form 8038 will be included as part of the transcript for each University tax-exempt governmental debt issuance. A copy of Internal Revenue Service Form 8038 may be retained through the DAC system, and in all events the University will keep a copy of the final executed version of the Internal Revenue Service Form 8038 in accordance with the provisions of Part VII, “Recordkeeping,” of these Policies and Procedures.

Part IV. Use of Debt Proceeds – Tax-Exempt Bonds.

A. Private Use Generally. The University will not knowingly take or permit to be taken any action which would cause any of its outstanding tax-exempt debt issuances to become “private activity bonds,” as described below. Generally, an issue of tax-exempt debt will be considered “private activity bonds” if:

- (1) more than 5% of the net proceeds of the debt are used directly or indirectly
 - (a) in any unrelated trade or business or
 - (b) in any trade or business carried on by a private business user; and,
- (2) more than 5% of the debt service on the debt is directly or indirectly
 - (a) secured by any interest in property used or to be used in any trade or business carried on by a private business user or payments in respect of property used or to be used in any trade or business carried on by a private business user, or
 - (b) derived from payments made in respect of property used or to be used in any trade or business carried on by a private business user.

When calculating the percentage of private business use the University will also include the cost of issuance, which will not exceed 2%.

B. Overview. The University routinely reviews, and will continue to review, third-party uses of its tax-exempt debt financed facilities for “private business use.” The Controller’s Office and the University’s Legal Counsel are responsible for monitoring all private business use arrangements. In addition, the University will continue to consult regularly with its bond counsel regarding the applicable federal tax limitations imposed on the University’s outstanding tax-exempt debt issuances and whether arrangements with third parties give rise to private business use of the financed projects. For these purposes, the Controller’s Office will monitor all uses of the University’s tax-exempt debt financed facilities, including but not limited to uses pursuant to management contracts, operating agreements, licenses, leases, subleases, naming rights agreements, research agreements, clinical trial agreements, and joint venture or partnership arrangements. In the event the University enters into an arrangement involving a facility for which tax-exempt debt is outstanding, and which

gives rise to private business use, the University may consult its bond counsel regarding the arrangement and whether such arrangement impacts the tax-exempt status of the University's outstanding debt.

C. Management or Other Service Contracts. In the event the University enters into management contracts, service agreements, operating agreements or licenses with individuals or entities whose use of the University's tax-exempt debt financed projects could potentially result in private business use, the University's Legal Counsel will review such arrangements and evaluate whether such arrangements result in private business use. For these purposes, management contracts, service agreements, operating agreements and licenses include any contracts between the University and service providers under which the service providers provide services involving all, or a portion of, or any function of, projects financed with tax-exempt debt proceeds ("Service Contracts").

It is the University's intent to structure all Service Contracts impacting tax-exempt debt financed property so as to satisfy one of the private business use safeharbors set forth in Revenue Procedure 97-13 described below. The University's Legal Counsel will review every service contract entered into involving the use of tax-exempt bond financed property and will cause to be maintained a copy of each such Service Contract in accordance with the provisions of Part VII, "Recordkeeping," of these Policies and Procedures.

Pursuant to Revenue Procedure 97-13, a Service Contract between the University and a private party will not result in the proceeds of University debt being used in the trade or business of the private party if the following guidelines are satisfied:

The Service Contract must be described in section 5.03(1), (2), (3), (4), (5), or (6) of Revenue Procedure 97-13 as follows:

- (1) *95 percent periodic fixed fee arrangements*. At least 95 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 15 years. For purposes of this section 5.03(1), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.
- (2) *80 percent periodic fixed fee arrangements*. At least 80 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 10 years. For purposes of this section 5.03(2), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

- (3) *Special rule for public utility property.* If all of the financed property subject to the contract is a facility or system of facilities consisting of predominantly public utility property (as defined in § 168(i)(10) of the 1986 Code), then “20 years” is substituted-
- (a) For “15 years” in applying section 5.03(1) of this revenue procedure; and
 - (b) For “10 years” in applying section 5.03(2) of this revenue procedure.
- (4) *50 percent periodic fixed fee arrangements.* Either at least 50 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee or all of the compensation for services is based on a capitation fee or a combination of a capitation fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 5 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the third year of the contract term.
- (5) *Per-unit fee arrangements in certain 3-year contracts.* All of the compensation for services is based on a per-unit fee or a combination of a per-unit fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 3 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the second year of the contract term.
- (6) *Percentage of revenue or expense fee arrangements in certain 2-year contracts.* All the compensation for services is based on a percentage of fees charged or a combination of a per-unit fee and a percentage of revenue or expense fee. During the start-up period, however, compensation may be based on a percentage of either gross revenues, adjusted gross revenues, or expenses of a facility. The term of the contract, including renewal options, must not exceed 2 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the first year of the contract term. This section 5.03(6) applies only to-
- (a) Contracts under which the service provider primarily provides services to third parties (for example, radiology services to patients); and
 - (b) Management contracts involving a facility during an initial start-up period for which there have been insufficient operations to establish a reasonable estimate of the amount of the annual gross revenues and expenses (for example, a contract for general management services for the first year of operations).

In addition, the service provider must not have any role or relationship with the University that, in effect, substantially limits the University’s ability to exercise its rights, including cancellation rights, under the Service Contract, based on all the facts and circumstances.

If the University enters into a Service Contract that does not satisfy the safe harbors set forth in Revenue Procedure 97-13, the University may consult with its bond counsel to assess the impact, if any, that the noncompliant Service Contract has on the tax status of the University’s outstanding tax-exempt debt, if any.

D. Leases and Subleases. The Controller's Office will track all leases and subleases that involve the use of tax-exempt debt financed projects, including the name of the lessee (or sublessee), the term of the lease (or sublease), the amount of the rent paid by the lessee (or sublessee) and the square footage of space used by the lessee (or sublessee) relative to the square footage of the debt-financed facility. If the University desires to enter into a lease or sublease related to the use of tax-exempt debt financed property, the University's Legal Counsel shall review such arrangement and may consult with the University's bond counsel to determine what impact, if any, such lease or sublease would have on the tax status of the University's outstanding tax-exempt debt.

E. Naming Rights Agreements. The Controller's Office will monitor all naming rights agreements that involve tax-exempt debt financed projects, including the term of the arrangement and the amount paid by the naming party. Prior to entering into a naming rights agreement involving its tax-exempt debt financed property, the University's Legal Counsel shall review such arrangement and may consult with the University's bond counsel to determine what impact, if any, such agreement would have on the tax status of the University's outstanding tax-exempt debt.

F. Sponsored Research. The University will apply Revenue Procedure 2007-47, 2007-29 I.R.B. 108, to any research sponsorship agreement existing now or in the future with respect to the property financed using the proceeds of tax-exempt debt. Prior to entering into a sponsored research agreement involving its tax-exempt debt financed property, the University's Research Administration shall review such arrangement and may consult with the University's Legal Counsel, who in its discretion, may consult with the University's bond counsel to determine what impact, if any, such agreement would have on the tax status of the University's outstanding tax-exempt debt.

G. Clinical Trials. The Controller's Office will monitor all clinical trial agreements that involve tax-exempt debt financed projects, including the term of the arrangement, the sponsoring entity, the trial to be conducted and the amount paid by the sponsoring party. Prior to entering into a clinical trial arrangement involving its tax-exempt debt financed property, the University's Legal Counsel shall review such arrangement and may consult with the University's bond counsel to determine what impact, if any, such agreement would have on the tax status of the University's outstanding tax-exempt debt.

H. Joint Ventures and Partnership Arrangements. The Controller's Office will monitor all uses by third parties of University property financed using the proceeds of tax-exempt debt to a joint venture, partnership or other cooperative agreement between the University and the third party. Prior to entering into such an agreement or agreeing to permit the use of financed property in such a manner, the University's Legal Counsel shall review such arrangement and may consult with the University's bond counsel to determine what impact, if any, such use would have on the tax status of the University's outstanding tax-exempt debt.

I. Sales of Debt-Financed Property. It is the University's policy to finance projects using tax-exempt debt that the University intends to own for the entire term of the debt issue financing the projects. Prior to selling or otherwise disposing of any tax-exempt debt financed project for which debt remains outstanding, the University's Legal Counsel shall review such arrangement and may consult with the University's bond counsel to determine the impact, if any, such sale or disposition would have on the tax status of the University's outstanding tax-exempt debt.

J. Remedial Actions. The University is aware of the remedial action rules contained in Treasury Regulations Section 1.141-12, providing the University with the ability, in certain circumstances, to voluntarily remediate violations of the private business tests or private loan financing test. Although the University intends that none of its tax-exempt debt issuances will require the application of the remedial action rules, prior to taking any action that would cause one or more of its outstanding tax-exempt debt issuances to, absent a remedial action, violate the private business tests or private loan financing test, the University will consult with its bond counsel regarding the applicability of the remedial action rules to such action and the ability to remediate the impacted tax-exempt debt issuance.

K. Private Loans. The University will not take or permit to be taken any action which would cause any of its tax-exempt debt issuances to be considered “private loan bonds.” University debt will be considered “private loan bonds” if more than 5% of the proceeds of the issue are used directly or indirectly to make or finance loans to private persons. The University will not loan the proceeds of any University debt issuance to a third party.

Part V. Arbitrage Limitations Imposed on Debt Issuances.

A. Arbitrage Rebate Monitor. The University will continue to retain an arbitrage rebate monitor to review its outstanding tax-exempt debt issuances, unless, in the judgment of the University, and in compliance with these Policies and Procedures and the Tax Certificate entered into in connection with a tax-exempt debt issuance, there is no reasonable prospect of an arbitrage rebate or yield reduction payment liability. If an arbitrage rebate monitor is retained, the arbitrage rebate monitor will perform calculations to ascertain whether the University owes an arbitrage rebate payment or yield reduction payment to the Internal Revenue Service, including whether the tax-exempt debt issuance in question qualifies for an exception to the arbitrage rebate rules. The Controller shall be responsible for determining whether an arbitrage rebate monitor is engaged.

B. Yield Restriction Limitations. Each Tax Certificate prepared for the University’s tax-exempt debt issuances shall contain the applicable yield restriction investment limitations, including the applicable investment limitations imposed on proceeds of the debt issuance and any temporary periods during which the University may invest proceeds of the debt issuance at an unrestricted yield.

C. Monitoring Yield Restriction Limitations. The University’s Controller’s Office will ensure that the University complies with the yield restriction limitations outlined in the Tax Certificate entered into by the University in connection with a tax-exempt debt issuance, including any exceptions to yield restriction described therein.

D. Payment of Arbitrage Rebate and Yield Reduction Liability. In the event the University owes arbitrage rebate or has accrued a yield reduction payment liability to the Internal Revenue Service, the University will timely submit Internal Revenue Service Form 8038-T, Arbitrage Rebate Yield Reduction and Penalty in Lieu of Arbitrage Rebate, to be prepared by the arbitrage rebate monitor, together with payment in the amount equal to the arbitrage rebate or yield reduction payment liability calculated by the arbitrage rebate monitor in accordance with the Tax Certificate related to such debt issue. For these purposes, within 60 days after each installment computation date, the University will cause to be paid to the Internal Revenue Service at least 90% of the amount

of arbitrage rebate and yield reduction payment liability owed, determined in accordance with the provisions of the Tax Certificate related to such tax-exempt debt issuance and the applicable federal tax rules, and based on calculations performed by the arbitrage rebate monitor.

In addition, within 60 days after the final installment computation date, the University will cause to be paid to the Internal Revenue Service 100% of the amount of arbitrage rebate and yield reduction payment liability owed, determined in accordance with the provisions of the Tax Certificate related to such tax-exempt debt issuance and the applicable federal tax rules, and based on calculations performed by the arbitrage rebate monitor.

Each completed Internal Revenue Service Form 8038-T, Arbitrage Rebate Yield Reduction and Penalty in Lieu of Arbitrage Rebate, together with full payment in the amount equal to the arbitrage rebate or yield reduction payment liability calculated by the Arbitrage rebate monitor in accordance with the Tax Certificate related to such debt issue, shall be filed with the Internal Revenue Service.

E. Expenditure of Tax-Exempt Debt Proceeds. It is the policy of the University to expend tax-exempt debt proceeds as promptly and appropriately as possible within the confines of these Policies and Procedures and the Tax Certificate entered into by the University in connection with a particular debt issuance. For these purposes, it is the University's policy not to finance projects using the proceeds of tax-exempt debt for which the University expects that the tax-exempt debt proceeds will not be fully spent within 3 years of the date of issue of the debt.

F. Arbitrage Rebate Exceptions. Each Tax Certificate prepared for the University's tax-exempt debt issuances shall contain the arbitrage rebate exception(s) applicable to the debt issuance, which arbitrage rebate exceptions will be applied by the rebate monitor in assessing whether the University owes arbitrage rebate.

G. Verification Agent. The University will continue to retain a third-party verification agent for each of its advance refunding bond issues. The verification agent will verify the arbitrage yield on the tax-exempt debt issuance, the arbitrage yield on the investments acquired as part of the refunding escrow established using gross proceeds of the tax-exempt debt issuance, and the sufficiency of the refunding escrow.

H. Establishment of Advance Refunding Escrows and Trustee Responsibilities. The University will deposit tax-exempt debt proceeds (and any other amounts) to be used to advance refund prior University debt into one or more separate escrow trust accounts established with the trustee selected for the transaction. Working with University bond counsel, and in accordance with the documentation prepared for the refunding transaction, the University will impose primary responsibility for initiating actions required to be taken with respect to the refunding escrow (including the reinvestment of amounts within the escrow and disbursing funds from the escrow) on the trustee¹. In the event of an omission on the part of the trustee, an error in the documentation or procedures establishing the escrow, or an investment to be acquired as part of the refunding escrow is not available for purchase, the University will timely consult with University bond counsel, as

¹ Trustee: A financial institution with trust powers that acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the trust indenture

applicable, to determine the impact, if any, on the tax-exempt status of the bond issue and actions to be undertaken by the University to ensure the continuing tax-exempt status of the obligations.

I. Acquiring Investments for Advance Refunding Escrows. It is the policy of the University to maximize the investment return on all investments acquired with tax-exempt bond proceeds and to acquire such investments at fair market value. When funding deposits to advance refunding escrows using tax-exempt debt proceeds, it is the University's policy to acquire United States Treasury Securities – State and Local Government Series (SLGS) or securities purchased on the open market in accordance with the terms of the University's bond documents.

In the event the University chooses to fund an advance refunding escrow using securities purchased on the open market, the University will solicit bids from providers of qualifying securities in accordance with the limitations described in the "3-bid" safeharbors set forth in Treasury Regulations Section 1.148-5(d)(6).

J. Interest Rate Hedges. The University will engage a third party financial advisor for all interest rate hedges entered into by the University, irrespective of whether any such hedge is acquired through a direct negotiation with the provider or procured through a bidding process. In all cases, the University will obtain appropriate certifications from its financial advisor and/or the provider to establish the fair market value of the product. The University will consult with its bond counsel with respect to all interest rate hedging transactions related to an outstanding or prospective debt issuance prior to the date on which the interest rate hedging transaction is entered into.

The University currently maintains a debt policy that elaborates on the University's policy in regard to interest rate hedges. (See Exhibit B)

Part VI. Accounting for Debt Proceeds.

A. General. Except as otherwise described below and in the Tax Certificate entered into by the University in connection with a tax-exempt debt issuance, it is the policy of the University to consistently apply a generally accepted method of accounting for and allocating its tax-exempt debt proceeds.

B. Investment of Proceeds. Proceeds of the University's capital borrowings shall be accounted for in a separate fund or account. All proceeds shall be invested at the direction of the Controller's Office.

C. Expenditure of Debt Proceeds on Capital Projects. The Vice President for Business and Finance shall be responsible for ensuring that bond proceeds are properly allocated. All invoices and records of payment (either in the form of paper checks or electronic funds transfer confirmations) are retained by, or caused to be retained by, the Controller's Office in accordance with Part VII, "Recordkeeping," below.

The University shall maintain an active ledger, updated with each payment of an expenditure from tax-exempt debt Proceeds, that for each outstanding debt issuance shows:

- (1) The name and date of issue of the tax-exempt debt issue to which the proceeds relate;
- (2) The projects financed with the proceeds of the issue;
- (3) The authorized amount of proceeds to be used to finance each project;
- (4) The amount of proceeds of the debt issuance used to date to finance each project;
- (5) The amount of unspent proceeds of the debt issuance to be used to finance each project; and
- (6) The date on which the debt proceeds related to each project were fully expended.

Part VII. Recordkeeping.

A. General. The University is aware of its ongoing recordkeeping responsibilities associated with its debt issuances. The University's relationship with DAC is intended to assist the University in maintaining compliance with its recordkeeping responsibilities. Each Tax Certificate prepared on behalf of the University for a debt issuance shall provide for a description of the records to be maintained by or on behalf of the University and period of time such records must be maintained. In addition, the University is familiar with the IRS's Frequently Asked Questions related to the recordkeeping requirements for debt.

B. Means of Maintaining Records. The University may maintain all records required to be held as described in this Part VII in paper and/or electronic (e.g., CD, disks, tapes) form either internally or through the DAC system. It is the policy of the University to maintain as much of its records electronically as feasible.

C. Transcript and Use of Debt Proceeds. The University shall maintain, or cause to be maintained, all records relating to the tax-exempt status of its debt issuances and the representations, certifications and covenants set forth in its respective Tax Certificates until the date 3 years after the last outstanding obligation of the issue to which such records and Tax Certificate relate has been retired. These include, but are not limited to, the following:

- (1) basic records and documents relating to the obligations (including the transcript, which shall include, among other records, the Tax Certificate, IRS Form 8038, verification report, authorizing resolution(s), trust indenture, loan agreement, record of public approval, and the opinion of bond counsel),
- (2) documentation evidencing the expenditure of debt proceeds, copies of all requisitions, draw schedules, draw requests, invoices, bills and cancelled checks, if available, related to bond proceeds spent during the construction period, copies of all contracts entered into for the constructions, renovation, or purchase of bond-financed facilities, records of expenditure reimbursements incurred prior to issuing bonds for facilities financed with bond proceeds,
- (3) documentation evidencing bond issuance costs,
- (4) documentation evidencing depreciation of bond-financed depreciable property,
- (5) documentation of any purchase or sale of bond-financed assets,
- (6) documentation evidencing the use of debt financed projects by public and private sources, including copies of all arrangements described in Part VI of these Policies and Procedures,
- (7) documentation evidencing all sources of payment or security for the debt issuance; and
- (8) documentation pertaining to any investment of debt proceeds (including the purchase and sale of securities, SLGS subscriptions, yield calculations for each class of investments, actual

investment income received from the investment of proceeds, guaranteed investment contracts, and rebate calculations), and

- (9) documentation evidencing the University's status as a 501(c)(3), including determination letter, Form 1023, form 990 and 990T, Organizational Documents, any relevant IRS correspondence.

D. Investment Records. The University shall maintain detailed records with respect to every investment acquired with proceeds of its debt issuances until the date three years after the last outstanding obligation of the issue to which such records and non-purpose² investments relate has been retired. These records may reflect, but are not limited to, the following:

- (1) purchase date, (2) purchase price, (3) information establishing fair market value on the date such investment became allocated to gross proceeds of the debt, (4) any accrued interest paid, (5) face amount, (6) coupon rate, (7) periodicity of interest payments, (8) disposition price, (9) any accrued interest received, (10) disposition date, and (11) broker's fees paid (if at all) or other administrative costs with respect to each such nonpurpose investment.

E. Arbitrage Rebate and Yield Reduction Payment Records. The Finance and Business Department shall maintain all records of arbitrage rebate payment and yield reduction payment calculations performed by the arbitrage rebate monitor (irrespective of whether the University owed any amount to the IRS), and records related to any arbitrage rebate payments or yield reduction payments made to the IRS, including the calculations performed by the arbitrage rebate monitor substantiating such payments, together with the IRS Form 8038-T, Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate, that accompanied all such payments, until the date 3 years after the last outstanding obligation of the issue to which such records and rebate payments relate has been retired.

F. Overpayment of Arbitrage Rebate Records. In the event the University has overpaid to the United States an arbitrage rebate or yield reduction payment liability, the University shall maintain all records of such arbitrage rebate payments or yield reduction payments, including calculations performed by the arbitrage rebate monitor, together with the IRS Form 8038-R, Request for Recovery of Overpayments Under Arbitrage Rebate Provisions, that accompanied the request for a recovery of such overpayment until the date 3 years after the last outstanding obligation of the issue to which such records and rebate overpayments relate has been retired.

G. Other Records. In addition to the records described above, the University will maintain the following records, to the extent applicable to a particular debt offering, until the date 3 years after the last outstanding obligation of the issue to which such relate has been retired:

- (1) minutes and resolutions authorizing the issuance of, or the reimbursement of expenditures using proceeds of, the financing,
- (2) appraisals, demand surveys and feasibility studies related to debt financed or refinanced property,

² Nonpurpose investment means any investment property, as defined in section 148(b) of the Federal Tax Regulations, that is not a purpose investment. A purpose investment is an investment that is acquired to carry out the exempt purpose of an issue.

- (3) documentation relating to any third-party funding for a project to which debt proceeds will be applied (including government grants),
- (4) audited financial statements, issue price certifications, trustee statements, bond election records,
- (5) publications, brochures, and newspaper articles for the bond financings,
- (6) records of any IRS audit(s) or compliance check(s), or any other IRS inquiry related to the debt.

H. Applicability of Recordkeeping Requirement in the Event of a Refunding. In the event the University issues debt to retire prior University debt, the University shall maintain all of the records described in this Part VII with respect to the refunded debt until the date that is three years after the last outstanding tax-exempt obligation of the issue the proceeds of which were used to retire the refunded debt has been retired.

Part VIII. Voluntary Closing Agreement Program.

The University is aware of its ability, pursuant to Internal Revenue Service Notice 2008-31, to request a voluntary closing agreement with the Internal Revenue Service to correct failures on the part of the University to comply with the federal tax rules related to tax-exempt debt issuances.

Part IX. Continuing Education.

The University will continue to consult regularly with its bond counsel regarding the federal tax rules applicable to its outstanding tax-exempt debt and changes to the federal tax law, and the University will regularly update these Policies and Procedures to reflect any such changes.

The University shall ensure that those who are tasked with bond compliance responsibilities shall undertake a reasonable amount of continuing education on an annual basis, which may include but is not limited to, consulting with outside professionals, participation in conferences, reading informational updates from governmental resources and professional organizations, and participation in webinars.

Exhibit A

SMU Procedures for Post Issuance Compliance of Tax-Exempt Bond Issues

SMU Procedures for Post Issuance Compliance of Tax-Exempt Bond Issues

The Vice President for Business and Finance is ultimately responsible for the post-issuance compliance of bond financings. The Controller's Office and the Bond Manager perform the compliance monitoring. As part of the compliance process, SMU will provide training and/or make available educational materials to the Bond Manager and other appropriate personnel.

I. General Recordkeeping:

Documents that are to be retained are as follows:

- a) Form 1023
- b) Determination letter for Section 501(c)(3) status
- c) All IRS correspondence related to bond issues and exempt status
- d) Organizational documents (articles of incorporation, bylaws and amendments)
- e) Forms 990 and 990T
- f) Audited Financial Statements
- g) Bond transcripts and all offering documents
- h) Minutes and resolutions authorizing tax-exempt bond issues
- i) Issue price certifications
- j) Bond election records
- k) Appraisals, land surveys, and /or feasibility studies for bond-financed property
- l) Government grant documentation related to construction, renovation, or purchase of bond-financed facilities and any government or private research grants that are being hosted in bond-financed facilities
- m) Publications, brochures, and newspaper articles for the bond financings
- n) Bond Trustee statements
- o) All correspondence regarding tax-exempt bond issues
- p) Reports of any prior IRS examinations of SMU or its bond financings

All documents pertaining to tax-exempt bond issues should be retained for the life of the bond plus three years.

- A) The transcripts of the bond issues should be reviewed every five years to verify that all compliance items are being addressed. If there is not a checklist of compliance items for a tax-exempt bond issue, the transcripts should be reviewed annually and addressed for compliance. Each bond has a set of covenants that are part of a quarterly checklist that tests the financial covenants and continuing disclosures. The Bond Manager will keep the checklist up-to-date and monitor the checklist for compliance. If the Bond Manager identifies a compliance issue, the Bond Manager will consult with Bond Counsel to determine if a remedial action or other corrective action (e.g., voluntary closing agreement program) should be taken.

SMU Procedures for Post Issuance Compliance of Tax-Exempt Bond Issues

- B) The University does have a debt policy and such policy is reviewed by management for compliance.

II. Investments and Arbitrage Compliance:

- A) Maintain documentation of allocations of investments and calculations of investment earnings on all bond financings.
- B) Maintain documentation for investments of the bond proceeds related to:
 - a) Investment contracts (*e.g.*, guaranteed investment contracts)
 - b) Credit enhancement transactions (*e.g.*, bond insurance contracts)
 - c) Financial derivatives (*e.g.*, swaps, caps, etc.)
 - d) Bidding of financial products
- C) Maintain the following arbitrage-related documents on the bond financings:
 - a) Computation of bond yield
 - b) Computation of rebate and yield reduction payments
 - c) Form 8038-T, *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*
 - d) Form 8038-R, *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*
- D) SMU has hired Arbitrage Compliance Specialists, Inc. who works in conjunction with SMU's Bond Manager and the Director of Capital Planning to monitor compliance with rebate and yield restriction rules on a yearly basis. The Director of Capital Planning and the Bond Manager will monitor how SMU spends the bond proceeds for compliance with rebate exceptions and yield restriction rules on a monthly basis and ensure that the Form 8038-T (if applicable) is filed timely.

III. Expenditures and Assets:

Maintain the following documentation for:

- a) Documentation of bond-financed proceeds of expenditures (*e.g.*, allocation of bond proceeds for expenditures for the construction, renovation or purchase of facilities we own and use in the performance of our tax-exempt purpose.)
- b) Documentation of all bond issuance costs
- c) Copies of all requisitions, draw schedules, draw requests, invoices, bills, and cancelled checks, if available, related to bond proceeds spent during the construction period
- d) Copies of all contracts entered into for the construction, renovation or purchase of bond-financed facilities
- e) Records of expenditure reimbursements incurred prior to issuing bonds for facilities financed with bond proceeds

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- f) List or schedule of all bond-financed facilities or equipment
- g) Copies of depreciation schedules for bond-financed depreciable property
- h) Documentation of any purchase or sale of bond-financed assets

The Bond Manager and Director of Capital Planning will monitor the expenditure of bond proceeds to ensure the timely use of bond proceeds.

IV. Private Business Use:

The University uses a service called DAC to do the private business use calculations. Each time a bond is issued the following documents must be sent to DAC:

- 1. Forms 990 and 990T
- 2. Form 8038
- 3. No Arbitrage Use of Proceeds Agreements
- 4. Any agreement with outside parties that are using bond financed property

DAC will work with SMU to get the private business use calculations done annually. DAC also reminds the university if any of the contracts they have on file will be expiring soon.

The Bond Manager will walk the campus and the bond-financed facilities annually to verify that all bond-financed facilities are in compliance with private business use rules. Each year, the Bond Manager will complete and send to DAC for retention a checklist reflecting the use of all bond-financed facilities. Bond-financed facilities will comply with federal guidelines and will generally maintain less than 5% of unrelated trade or business or other private use activities each year in any bond financed portion. For this purpose, the Bond Manager will work with DAC to ensure that the 5% test is appropriately computed for each bond issue and reflects the amount of costs of issuance financed by bond issues as private use or other “bad” or neutral costs. Any business activities by third parties that are allocated to the bond-financed facilities will be tracked and verified. All third party contracts will be reviewed by the Legal Department and checked to determine their impact on the private use calculations of bond-financed facilities. The Associate Vice President of Campus Planning and Plant Operations, who also knows which facilities are bond-financed, will also review any changes to the use of such facilities.

A) Prior to the University entering into any of the following types of agreements or contracts, the legal department, Controller’s Office and the Bond Manager must determine if the contract relates to any tax-exempt financed facility and if so, the contract will be analyzed for compliance with the private use (e.g. management contract) guidelines:

- a) Management and other service contracts
- b) Research contracts

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- c) Special legal entitlement contracts (e.g., naming rights and/or sponsorship contracts)
- d) Ownership
- e) Leases
- f) Subleases
- g) Leasehold improvement contracts
- h) Joint venture arrangements
- i) Limited liability corporation arrangements
- j) Partnership agreements

V. Material Event Requirements

Material event notices must be filed within 10 business days of the occurrence of the event,

The following events are considered material events for disclosure agreements entered into on or after December 1, 2010:

1. Principal and interest payments 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 or event affecting the tax-exempt status of the security
7. Modifications to rights of security holders, if material
8. Bond call, if material
9. Defeasances
10. Release, substitution, or sale of property securing repayment of the securities, if material
11. Ratings changes
12. The issuance by the IRS of proposed or final determinations of taxability, Notice of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the securities
13. Tender offers
14. Bankruptcy, insolvency, receivership or similar proceeding
15. Mergers, consolidations, acquisitions, the sale of all or substantially all of the assets of the obligated person or their termination, if material
16. Appointment of a successor or additional trustee or the change of the name of a trustee, if material
17. Noncompliance with the rule

SMU Procedures for Post Issuance Compliance of Tax-Exempt Bond Issues

Bond Counsel and the University's Financial Advisor are always available to help with the material event notices that must be filed.

Exhibit B

Southern Methodist University Debt Policy

Southern Methodist University

Debt Policy

The purpose of this Debt Policy is to guide the issuance and prudent use of debt in financing capital projects to achieve the University's mission and strategic objectives. Financial leverage, and particularly tax-exempt debt, provides a low-cost source of capital to meet the University's strategic objectives. Debt is both an important ongoing component of the University's capital structure and a finite resource. Decisions regarding the use of financial leverage should balance the University's current and future financial health, taking into consideration the cost of capital, budget impact, strategic priorities and other relevant factors.

The external environment and the University's circumstances are constantly subject to change. Accordingly, this policy should be reviewed and revised periodically, as necessary to respond to these changes.

Scope

Debt includes all short and long-term obligations, guarantees, and other instruments that commit the University to future payments. The assumption of debt, both direct and indirect, is subject to approval by the Board of Trustees. Leases payable, lines of credit, and other accounts payable assumed during the normal course of business are excluded from the definition of debt for the purposes of this policy. Further, debt incurred incidental to the receipt of gifts and bequests, while includable in debt ratio calculations, also is excluded from this policy. The Administration is authorized to accept debt acquired in conjunction with gifts and pledges, based on analysis of the transaction and its effect on the University's financial ratios. The Administration will report annually to the Board on total debt, including leases, lines of credit, accounts payable and debt acquired in the course of accepting pledges and gifts.

Objectives

The objectives of this policy are to 1) maintain and continue to improve the University's debt rating with a goal of gradual improvement toward the average rating of its aspirant institutions, 2) to provide financing flexibility by allowing continued capital markets access at a low cost, and 3) to set broad guidelines for debt capacity, fixed and floating rate mix, and use of various financing instruments to reduce risk and ensure budget feasibility.

Authority

Given that the University has limited debt resources, the Administration will use debt financing for high-priority projects with the approval of the Board of Trustees. This authorization process will include the prioritization of alternative uses of capital, including construction projects, equipment purchases, real estate acquisitions, and other

capital projects. Generally, the considerations identified in this policy will guide the authorization process, although they are not intended to be all-inclusive. Judgment by the Administration and the Board of Trustees, upon the recommendation of the Finance Committee, ultimately will determine the appropriate uses and structure of the University's debt financing.

Financial Feasibility

Each project proposed for debt financing must be supported by an achievable financial plan that includes servicing the debt and meeting any new or increased operating costs. A debt-financed project must have an established funding source prior to the issuance of the debt. The useful life of a project should be considered when evaluating the use of long-term debt to finance a capital investment. Normally, the term of the debt should not exceed the estimated useful life of the capital asset being acquired.

Financial Comparisons and Ratios

In evaluating debt capacity and considering alternative debt structures, the Administration will take into consideration available data from peer institutions in the aspirant and cohort groups. These data should include relative debt levels, endowment asset and spending levels, financial ratios and type of debt.

The University will limit its overall debt to a level that will maintain an acceptable credit rating with the bond rating agencies. These agencies help maintain the confidence of the public and purchasers of debt regarding the ability of a borrower to service and repay bonds. In order to meet this objective, this policy establishes targets based on financial ratios routinely used by rating agencies. The Administration will review annually all key rating agency ratios to monitor compliance with rating agency guidelines.

The following three ratios are debt ratios specific to this policy:

Ratio 1

$$\text{Leverage Ratio} = \frac{\text{Outstanding Debt}}{\text{Available Net Assets}}$$

The leverage ratio measures the availability of net assets (unrestricted net assets plus temporarily restricted net assets) to cover debt should the University be required to repay its outstanding obligations in total.

The University shall not permit the leverage ratio to exceed 2.0, consistent with the requirement in the Master Trust Indenture.

Ratio 2

$$\text{Debt Service Ratio} = \frac{\text{Current Debt Service}}{\text{Total Expense}}$$

The debt service ratio (or debt service as a percentage of operations) measures the relative cost of debt to overall University expenses (total expenses). By maintaining an appropriate proportion of debt service to total expenses, funding for other critical and strategic investments necessary to academic quality can be incorporated in the University's expense base.

This ratio normally should not exceed 7% percent. Bullet maturities and bridge financing that are fully funded by reserves or documented pledges will be excluded from the debt service ratio calculation.

A level or decreasing trend indicates that there is sufficient coverage for debt service without diverting financial resources needed to support institutional operating requirements. A steadily rising trend over several years suggests a demand on financial resources to cover the debt service that may result in budgetary reductions or constraints in other areas.

Ratio 3

$$\text{Variable Rate Allocation} = \frac{\text{Variable Rate Debt}}{\text{Total Debt}}$$

The variable rate allocation ratio measures total exposure to variable rate debt (including "synthetic" variable rate debt achieved through use of a derivative product) as a proportion of total debt. Variable rate debt typically lowers overall borrowing costs but exposes the University to budgetary uncertainty and the potential for a rapidly rising cost of capital. The target for this ratio is to be no greater than 40.0 percent.

Interest Rate Swap Policy

The use of derivative products and the inclusion of synthetic variable or fixed rate debt in the University's debt structure may be pursued when it is deemed advantageous and beneficial. In May 2003, the Board of Trustees passed a resolution establishing an Interest Rate Swap Policy (see Exhibit A).

Southern Methodist University

Interest Rate Swap Policy

Exhibit A

This policy will govern the use by the University of interest rate swap transactions for the purpose of hedging existing and planned debt obligations.

I. Authority

The Board of Trustees has granted authority for the University to enter into swap transactions and related agreements.

II. Purpose

Interest rate swap transactions should be an integral part of the University's liability management program. By utilizing swaps in a prudent manner, the University can react quickly and take advantage of market opportunities to reduce costs and/or reduce interest rate risk. The notional size of the swaps cannot exceed that of the associated University debt instruments that they affect. The University shall not enter into swap transactions for speculative purposes.

III. Review and Approval

In order to enter into a specific swap transaction, the University must receive: 1) approval from an ad hoc Board of Trustees Committee having familiarity with such instruments, to the extent possible, appointed by the Finance Committee Chair, and 2) an opinion from counsel (a) that the agreement relating to the swap transaction is a legal, valid and binding obligation of the University and the counterparty, (b) that entering into the transaction complies with applicable state and Federal laws, and (c) that it will not adversely impact the tax-exempt status of any of the University's outstanding debt.

IV. Form of Swap Agreements

Each new master swap agreement shall contain terms and conditions consistent with those set forth in the International Swap and Derivatives Association, Inc. (ISDA) Master Agreement as well as such other terms and conditions, including schedules and confirmations, as deemed necessary by the Vice President for Business and Finance.

V. Methods of Soliciting and Procuring Swaps

In general, swaps will be contracted with firms possessing minimum provider credit ratings of "A" from at least two nationally recognized credit rating agencies. The University may procure swaps by negotiated method provided that, in light of the facts and circumstances, doing so will promote the University's interests by encouraging and rewarding ongoing service and counsel to the University.

VI. Management of Swap Transaction Risk

Certain risks are created when the University enters into any swap transaction. In order to manage the associated risks, guidelines and parameters are as follows:

Counterparty risk Swaps are to be contracted with firms possessing at least "A" category credit ratings, as specified above. The University also may arrange to have the swaps collateralized. However, it is not required. Collateral will consist of cash, U.S. Treasury securities and/or agency securities. Collateral, when arranged, shall be deposited with a third party trustee, or as mutually agreed upon between the University and the counterparty. Under no conditions will a swap be entered into with a firm with less than an "A" category rating.

Termination risk The termination provisions of any swap agreement shall be bilateral. However, the University shall unilaterally have the option to terminate a swap agreement at any time over the term of the agreement (elective termination right). In general, exercising this right to terminate a swap agreement should produce a benefit to the University, either through receipt of a payment as a result of the termination, or if a termination payment is made by the University, by allowing conversion to a more beneficial debt instrument or credit relationship. The basis for calculating termination payments will be established at the time the swap is entered.

In some circumstances, a termination payment by or to the University may be required in the event of termination of a swap agreement due to a swap provider default or following a decrease in the swap provider's credit rating. The University will review swap providers' credit-worthiness no less frequently than annually so it can be proactive in addressing this possibility.

Amortization risk Mismatched amortization schedules can result in a less than perfect hedge and create unnecessary risk. The amortization schedules of the University debt and the associated swap transaction will be as closely matched as possible for the duration of the swap to minimize amortization risk.

Term risk In no circumstance may the term of a swap agreement entered into for liability management purposes between the University and a qualified swap provider extend beyond the final maturity date of the associated debt instrument.

Basis (index) risk Any index chosen as part of an interest rate swap agreement shall be an industry-recognized market index, including but not limited to the Bond Market Association (BMA) or London Interbank Offering Rate (LIBOR). The potential risk to the University of making or receiving payments based upon these indexes which may differ from the basis on which the University pays its associated debt will be quantitatively measured and evaluated prior to entering the swap.

Tax risk The tax risk, if any, shall be understood and detailed as part of the approval process. The potential risk to the University of changes in tax law or other similar events that cause the rate paid to the University to be different from the rate it pays on the associated debt will be measured and evaluated.

VII. Reporting Requirements

The Annual Financial Report prepared by the University Administration and presented to the Board of Trustees shall reflect all interest rate swaps as required by generally accepted accounting principles and disclose the status of each interest swap in the Notes to the Financial Statements. The notes shall include a list of all swaps with notional value and interest rates, a list of providers and their respective credit ratings, and other key terms.