

TAX-ADVANTAGED BONDS POST-ISSUANCE COMPLIANCE PROCEDURES

1. BACKGROUND AND TRAINING

Bonds that receive preferential treatment under federal law are commonly referred to by the Internal Revenue Service as "tax-advantaged bonds". These bonds are issued by or on behalf of state and local governments, such as the City of Hawthorne and its related public entities such as the Hawthorne Public Financing Authority and the Successor Agency to the Community Redevelopment Agency of the City of Hawthorne. These bonds are subject to federal tax requirements both at the time the bonds are issued and for as long as they remain outstanding. An issuer's (or other party's) failure to comply with any applicable federal tax requirement with respect to these bonds jeopardizes their preferential treatment.

While compliance with many federal tax requirements occurs at closing, other federal tax requirements require on-going monitoring after the issuance of the bonds. These requirements include filing a Form 8038 information return (8038-G for fully tax-exempt bonds, 8038-GC for fully tax-exempt bonds with an issue price of less than \$100,000, 8038 for tax-exempt private activity bonds, 8038-B for Build America Bonds, or 8038-TC for tax credit bonds, such as qualified school construction bonds) and the issuer having reasonable expectations of on-going, post-issuance compliance.

Post-issuance federal tax requirements generally fall into two categories: (1) the use of proceeds and the use of bond-financed property; and (2) arbitrage yield restriction on investments and rebate. Use requirements require monitoring of the various direct and indirect uses of bond-financed property over the life of the bonds and calculations of the percentage of nonqualified uses. Arbitrage requirements also require monitoring over the life of the bonds to determine whether both the yield on investments acquired with bond proceeds are properly restricted and whether the City must file a Form 8038-T to pay a rebate or a yield reduction payment.

Post-issuance compliance procedures will help the City monitor compliance as long as the bonds remain outstanding and improve the City's ability to identify noncompliance and prevent violations from occurring, or timely correct identified violations, to ensure the continued tax-advantaged status of the bonds.

The designated officer or employee (described in Section 2.A, below) and anyone assigned particular responsibilities in connection with the procedures described below must read the certificate regarding compliance with certain tax matters (commonly referred to as the "tax certificate") that is executed by the City in connection with each bond issue for a more complete explanation of the matters described in these Procedures. In addition, the designated officer or employee and anyone assigned particular responsibilities should discuss these matters with bond counsel.

2. GENERAL ADMINISTRATION

A. Responsible Officers or Employees. The City Manager and Finance Manager will be responsible for compliance with each of the procedures set forth below. The City Manager may

designate other employees who will also be responsible for such compliance. The City Manager will notify the current holder of that office, or the employee, of the responsibilities and provide that person a copy of these Procedures. The holder of the office, or the employee, may in turn designate other officers or employees and assign to them particular responsibilities for certain of these Procedures. The City Manager will be notified in writing of all such designations and assignments. Training will be provided for each person assigned responsibility for compliance with any federal tax requirements under this Section or under the following Section 2.B.

B. Reassignment of Responsibilities. Upon the transition of a designated officer or employee, the City Manager will advise the new officer or employee of the responsibilities under these procedures. If officer or employee positions are restructured or eliminated, the City Manager, or his or her designee will reassign responsibilities as necessary to ensure that all of the procedures listed below have been appropriately assigned.

C. Periodic Reviews. The designated officer or employee will conduct periodic reviews of compliance with these procedures and with the terms of any existing tax certificate relating to outstanding tax-advantaged bonds, such as fully tax-exempt bonds or Build America Bonds, to determine whether any violations have occurred. Such periodic reviews will occur at least once every six months. In the event that violations have occurred, bond counsel will be contacted immediately so that violations can be remedied through the remedial actions set forth in Section 1.141-12 of the Treasury Regulations, the Voluntary Closing Agreement Program described in IRS Notice 2008-31, or further guidance as may be provided by the IRS. Where necessary, violations will be reported to the IRS by submitting a VCAP request within 90 days after identification of the violation.

D. Changes or Modifications to Bond Terms. If any change or modification to the terms of tax-advantaged bonds is contemplated, the designated officer or employee will immediately contact bond counsel (a change or modification could result in a reissuance, which in the case of BABs, for example, would constitute a refunding of the BABs and thereby jeopardize their status).

E. Recordkeeping. For each issue of tax-advantaged bonds, the designated officer or employee will:

- (1) maintain a copy of the transcript of the documents relating to the bonds.
- (2) maintain records of all facilities and other costs (e.g., issuance costs, credit enhancement fees and capitalized interest) and uses (e.g., deposits to project funds and reserve funds) for which bond proceeds were spent or used;
- (3) maintain records of investments and expenditures of bond proceeds, rebate exception analyses, rebate calculations, Forms 8038-T, and rebate and yield reduction payments, and any other records relevant to compliance with arbitrage restrictions;
- (4) maintain all records described in these Procedures while any bonds of the issue are outstanding and during the three-year period following the final maturity or redemption of the bond issue or, if later, while any bonds that refund bonds of that original issue are

outstanding and for the three year period following the final maturity or redemption date of the latest refunding bond issue; and

(5) maintain copies of all of the following contracts or arrangements with non-governmental persons or organizations or with the federal government: (a) the sale of any bond-financed facility; (b) the lease of any bond-financed facility; (c) management or service contracts relating to a bond-financed facility; (d) research contracts involving research undertaken in a bond-financed facility; and (e) any other contracts involving "special legal entitlements" (such as naming rights or exclusive provider arrangements) with respect to a bond-financed facility.

3. IRS INFORMATION RETURN FILING

In cooperation with bond counsel, the designated officer or employee will ensure that the Form 8038-G (or other applicable Form 8038) is timely filed (on or before the 15th day of the second calendar month after the end of the calendar quarter in which the bonds were issued) with respect to each tax-advantaged bond issue, including any required schedules and attachments.

4. INVESTMENT AND EXPENDITURE OF BOND PROCEEDS AND REBATE

A. Track Investments and Expenditures. The designated officer or employee will ensure the existence of an established accounting procedure for tracking the investment and the timely expenditures of bond proceeds, including investment earnings.

B. Reimbursement. Upon issuance of the bonds, the designated officer or employee will allocate bond proceeds to reimbursement of prior expenditures (assuming, if required, an appropriate declaration of intent to reimburse has been adopted).

C. Final Allocations. The designated officer or employee will ensure that a final allocation of bond proceeds (including investment earnings) to qualifying expenditures is made if bond proceeds are to be allocated to project expenditures on a basis other than "direct tracing" (direct tracing means treating the bond proceeds as spent as shown in the accounting records for bond draws and project expenditures). This allocation must be made within 18 months after the later of the date the expenditure was made or the date the project was placed in service, but not later than the earlier of five years and 60 days after the issuance date of the bonds or 60 days after the bond issue is retired.

D. Timely Expenditure of Bond Proceeds. Mindful of the expectations regarding the timing of the expenditures of bond proceeds set forth in the tax certificate, the designated officer or employee will monitor expenditures of bond proceeds, including investment earnings, against issuance date expectations for satisfaction of three-year (or five-year) temporary period from yield restriction on investment of bond proceeds.

E. Yield. The designated officer or employee will make note of the "yield" of the bond issue, as shown on the applicable Form 8038.

F. Temporary Periods and Yield Restriction. The designated officer or employee will review the tax certificate to determine the "temporary periods" for the bond issue, during which

periods various categories of gross proceeds of the bond issue may be invested without restriction as to yield.

G. Investment of Proceeds and Yield Restriction. The designated officer or employee will ensure that bond proceeds are not invested in investments with a yield above the bond yield following the end of the applicable temporary period unless yield reduction payments are permitted to be made.

H. Bidding Requirements. If purchasing investments other than publicly traded securities for immediate delivery (for example, a guaranteed investment contract or certificates of deposit), the designated officer or employee will consult with bond counsel as to whether the investments of bond proceeds satisfy IRS regulatory safe harbors for establishing fair market value (e.g., through the use of bidding procedures), and maintain records to demonstrate satisfaction of such safe harbors.

I. Credit Enhancement and Hedging Transactions. The designated officer or employee will consult with bond counsel before engaging in credit enhancement or hedging transactions with respect to a bond issue. The designated officer or employee will maintain copies of all contracts and certificates relating to credit enhancement and hedging transactions.

J. Debt Service Fund. After all proceeds of a bond issue have been spent, the designated officer or employee will ensure that the debt service fund meets the requirements of a "bona fide debt service fund," i.e., one used primarily to achieve a proper matching of revenues with debt service that is depleted at least once each bond year, except for a reasonable carryover amount not to exceed the greater of (i) the investment earnings on the fund for the immediately preceding bond year; or (ii) one-twelfth of the debt service on the bond issue for the immediately preceding bond year. To the extent that a debt service fund qualifies as a bona fide debt service fund for a given bond year, the investment of amounts held in that fund is not subject to yield restriction for that year. The designated officer or employee will consult with bond counsel before creating separate additional funds that are expected to be used to pay debt service on the bonds.

K. Reserve Fund. The designated officer or employee will ensure that amounts invested in any reasonably required reserve fund do not exceed the least of (each determined at the time of issuance of the bonds): (i) ten percent of the stated principal amount of the bonds (or the sale proceeds of the bond issue if the bond issue has original issue discount or original issue premium that exceeds two percent of the stated principal of the bond issue plus, in the case of premium, reasonable underwriter's compensation); (ii) maximum annual debt service on the bond issue; or (iii) 125 percent of average annual debt service on the bond issue. The designated officer or employee will consult with bond counsel before creating any separate additional funds or accounts that will secure or provide payments of debt service on the bonds.

L. Escrow Fund. For an advance refunding escrow (where the escrow is established 90 or more days before the refunded bonds are to be redeemed) funded with taxable open market securities earning yields higher than the yield of the advance refunding bonds, assure that all or part of the escrow is invested in zero interest rate SLGS issued by the U.S. Treasury Department if needed to blend down the yield.

M. Gifts for Bond-Financed Projects. Before beginning a campaign that may result in gifts that will be restricted for use relating to a bond-financed facility (or, in the absence of such a campaign, upon the receipt of such restricted gifts), the designated officer or employee will consult with bond counsel to determine whether replacement proceeds may result.

N. Performance of Rebate Calculations. Subject to the small issuer exception and the exceptions described in the tax certificate, investment earnings on bond proceeds at a yield in excess of the bond yield generally must be rebated to the United States. The designated officer or employee will ensure that rebate calculations will be timely performed and payment of rebate amounts, if any, will be timely made. Rebate payments are generally due 60 days after the fifth anniversary of the issuance date of the bond issue, then in succeeding installments every five years. The final rebate payment is due 60 days after retirement (or early redemption) of the last bond of the issue.

O. Rebate Consultant. The designated officer or employee will engage the services of an experienced rebate consultant to undertake rebate calculations described above for each bond issue.

P. Spending Exceptions. If the six-month, 18-month, or 24-month spending exceptions from the rebate requirement (as described in the tax certificate) apply to the bond issue, the designated officer or employee will ensure that the spending of bond proceeds is monitored prior to semi-annual spending dates for the applicable exception.

Q. Follow-up on Rebate. After all bond proceeds have been spent, the designated officer or employee will ensure compliance with rebate requirements for any reserve fund and any debt service fund that is not exempt from the rebate requirement.

R. Filing of 8038-T. The designated officer or employee will make rebate and yield reduction payments timely and file Form 8038-T.

5. PRIVATE BUSINESS USE

A. Private Business Use. Use of bond proceeds or bond-financed property by a nongovernmental person (including the federal government) in furtherance of a trade or business activity is considered private business use. Any activity carried on by other than a natural person (individual acting as a member of the general public) is treated as a trade or business. Indirect uses of bond proceeds may also be considered private business use. For example, a facility is treated as being used for a private business use if it is sold or leased to a nongovernmental person and the nongovernmental person's use is in a trade or business. The designated officer or employee will analyze any private business use of bond-financed facilities and, for each issue of bonds, determine whether there is or may in the future be more than five percent private business use. If so, the designated officer or employee will immediately contact bond counsel to discuss the private business use limit, including whether the alternative ten percent limit is applicable.

B. Management and Service Contracts. Management or service contracts between governmental entities and nongovernmental persons (private parties) under which the

nongovernmental person receives compensation for services provided with respect to a bond-financed facility may result in private business use. Before entering into any new management agreement or service agreement relating to bond-financed facilities, the designated officer or employee will immediately contact bond counsel to review any such agreement to determine whether it may result in private business use.

C. Special Legal Entitlements. Before entering into any agreement providing special legal entitlements relating to a bond-financing facility, such as naming rights or an exclusive provider agreement, the designated officer or employee will immediately contact bond counsel to review such agreement to determine whether it may result in private business use.

6. PROCEDURES RELATING ONLY TO BUILD AMERICA BONDS AND TAX CREDIT BONDS

A. Monitor Interest For Refundable Credit. In the case of BABs or tax credit bonds, the designated officer or employee will monitor the amount of interest payable on each interest payment date to ensure that the proper amount of direct payment (refundable credit) is requested on each Form 8038-CP.

B. Filing of 8038-CP. In the case of BABs or tax credit bonds, the designated officer or employee will ensure that IRS Form 8038-CP is timely filed with respect to each interest payment date (or each quarter in the case of certain variable rate bond issues).

C. Refundable Credit Payments to Proper Person. In the case of BABs or tax credit bonds, if the direct payments (refundable credits) to be made by the federal government with respect to the bonds will be paid to a person other than the issuer (e.g., the bond trustee or the state or local government entity on whose behalf an authority issued the bonds, such as the California Statewide Communities Development Authority), the designated officer or employee will obtain and record the contact information of that person, and ensure that it is properly shown on Form 8038-CP so that the direct payment (refundable credit) will be made to the proper person.

D. Available Project Proceeds. In the case of BABs or tax credit bonds, the designated officer or employee will ensure that all of the sale proceeds and investment earnings, other than (i) sale proceeds used to pay issuance costs (up to the two percent limit described above) or (ii) deposited in a reasonably required reserve fund, are allocated to capital expenditures.