



**MICHAEL J. MURPHY**  
*State Treasurer*

Spring 2008

# The LOCAL View

## Local Option Capital Asset Lending

### MASON COUNTY PUBLIC WORKS FACILITY

by **Mike Murphy**  
State Treasurer

The Mason County Public Works Department is one of the County's largest departments. They are accountable for the management of the engineering, construction, maintenance and administration of the County Road System in Mason County – a tremendous responsibility.

Mason County is in the process of constructing a new public works facility consisting of a 26,500-square-foot county road facility and office building, a 25,000-square-foot vehicle maintenance shop, and a 5,000-square-foot equipment storage shop. This new facility will allow Mason County Public Works, which has employees located in various sites throughout the county, to consolidate their Department at a single location ensuring better efficiency, communication and service to the citizens of Mason County. It is estimated that the new complex will be complete and ready for occupancy by this time next year.



local administrators should be recognized, and commended, for their prudent use of tax payer money. These stewards of the public trust have exercised admirable judgment and responsibility in their management of public funds by utilizing the LOCAL Program. They have fulfilled their mission and provided efficient, effective, and equitable management of available public resources by borrowing at low cost.

With their \$15 million project, Mason County has the distinct privilege of becoming the largest Local governmental borrowing to participate in the LOCAL program. By utilizing the LOCAL Program to finance their project, Mason County was able to borrow at an excellent rate (4.5% all in rate) and they have shown themselves to be excellent stewards of public funds. They have demonstrated their ability to make good business decisions in the public's best interest.

Congratulations to Mason County on a great financing! We are excited to be a part of your agency's project. ■



The Mason County Commissioners, County Treasurer, Public Works Director and

#### Office of the State Treasurer

**Mailing address**  
P.O. Box 40200  
Olympia, WA 98504-0200  
(360) 902-9000 (main)

**Street address**  
416 Sid Snyder Ave. SW  
Legislative Building  
2nd Floor, Room 230  
Olympia, WA 98504-0200

#### LOCAL Program Staff

**Richard Patrick**  
Deputy Treasurer  
(360) 902-9007  
Rick@tre.wa.gov

**Wendy Kancianich**  
LOCAL equipment specialist  
(360) 902-9022  
wendyk@tre.wa.gov

**Noah Crocker**  
LOCAL real estate specialist  
(360) 902-9020  
noah@tre.wa.gov

**Pam Johnson**  
LOCAL specialist  
(360) 902-9021  
pam@tre.wa.gov

**Nancy Notter**  
LOCAL accounting  
(360) 902-9026  
nancyn@tre.wa.gov

[www.tre.wa.gov](http://www.tre.wa.gov)

## POST-ISSUANCE TAX COMPLIANCE POLICIES FOR TAX-EXEMPT BONDS

by William G. Tonkin, Foster Pepper PLLC



In 2007, the Internal Revenue Service (“IRS”) sent a “Compliance Check Questionnaire” to nonprofit 501(c)(3) organizations to determine whether those organizations have in place written policies and procedures for ensuring that federal tax requirements applicable to their tax-exempt bonds are met. Later this year, the IRS is expected to issue a similar questionnaire to governmental entities that have issued tax-exempt bonds.

The form of an IRS Compliance Check Questionnaire issued to governmental entities can be expected to inquire about many of the same items that were addressed in the inquiry of 501(c)(3) organizations. With regard to general post-issuance compliance, the IRS questionnaire likely will ask whether you have written policies and procedures to ensure proper and timely use of bond proceeds and compliance with arbitrage yield restriction and rebate requirements, including the identification of which official or officials of the issuer is primarily responsible for monitoring post-issuance compliance.

With respect to investments and arbitrage compliance, the IRS questionnaire will ask whether the governmental entity maintains documentation showing how bond proceeds were invested, when the bond proceeds were actually expended for the governmental purpose of the bonds, calculations showing that an available arbitrage rebate exception was satisfied, computation and payment of an arbitrage rebate amount that was found to be due, and filing of IRS Form 8038-T with any required rebate payment. For example, the questionnaire likely will ask whether you have specific procedures or guidelines for monitoring bond issues that you expect will satisfy a spending exception to the rebate requirement.

More specifically with respect to the use of bond proceeds, the IRS questionnaire will ask whether you maintain records showing how the bond proceeds were used to pay costs of acquiring, constructing and/or renovating property, including property purchase and construction contracts, progress payment requests, invoices, cancelled checks, payment of bond issuance costs, and records of “allocations” of bond proceeds to make reimbursement for project expenditures made before the bonds were actually issued.

In relation to the federal tax limitations on private business use of bond-financed property, the IRS questionnaire will ask whether you maintain records of the use, if any, of your bond-financed property by private businesses or other nongovernmental persons, such as nonprofit corporations, partnerships and any federal agency, under leases, man-

agement or service contracts, privately sponsored research contracts, “naming rights” contracts, or other “public-private partnership” arrangements.

Obviously, all of these inquiries relate to the governmental entity’s written policies and procedures on record-keeping, and the IRS questionnaire will ask what your record-keeping policies are with respect to compliance with federal tax rules for your outstanding tax-exempt bonds. Be aware that existing IRS guidance requires maintaining all such bond-related records for the life of the bond issue (including any refunding issue) plus three years.

In view of this compliance check initiative by the IRS, it will behoove each governmental issuer of tax-exempt bonds to adopt and put in place written policies and procedures that not only would ensure that it complies with federal tax requirements in fact but also would enable it to readily demonstrate those facts to the IRS upon any audit of the bond issue. The written policies and procedures should address the general subjects summarized above, but the specific policies and procedures will vary from issuer to issuer: one size does not necessarily fit all.

The IRS also has stated that an important factor in its evaluation of tax compliance is whether the issuer has a written policy on providing education to the appropriate officials and personnel on the federal tax requirements for tax-exempt bonds. In this respect, the Washington Municipal Treasurers Association and the Washington Finance Officers Association can play an invaluable role in both providing education and assisting in the development federal tax compliance policies and procedures, which should be made an integral part of recommended debt management policies. ■

### Come see us

LOCAL representatives will be available at these upcoming meetings:

**School Business Officials Annual Conference**  
May 7-9  
Tacoma Convention Center

**Association of Washington Cities Annual Conference**  
Jun 17-20  
Yakima

**Washington State Association of Fire Chiefs**  
Jul 8-11  
Wenatchee

## Is your document archival? Essential? How safe is it? – SoS – Help is available

Julie Woods, the Local Records Grant Administrator with the Washington State Archives, a division of the Office of the Secretary of State, spoke last spring to the Local Advisory Group. A summary of her presentation follows:



The office of the Secretary of State (SoS) welcomes questions on protecting and preserving records. In fact, SoS offers a number of guides, training sessions and grant programs to help local governments manage their documents.

Documents are considered ‘archival’ if they have permanent or historical value – examples include deeds, land surveys, and resolutions. Records considered ‘essential’ are those needed for continuity of government and required for operations in an emergency or in the reestablishment of normal operations. *Essential* records are identified in the General Records Retention Schedule for your specific type of agency; e.g., hospital district, school district.

Questions of safe storage and reliable retrieval are also important issues to address. Unfortunately insects and mildew secretly destroy records even though it may take longer than the more dramatic fire or flood.

Many times, funding can help bring good intentions into reality. That’s where the SoS Local Records Grant Program can help. Our grant program is funded by monies collected by county auditors and clerks and then allocated by the Legislature. Grants can be used for such things as the scanning and microfilming of *archival* and *essential* records, metal shelving, archival boxes and microfilm readers. We also offer workshops across the state to help prepare grant applications.

Last summer we completed the 5th cycle of the grants, accepting 169 grant applications requesting over \$3.4 million – a dramatic increase from our first cycle when 45 applications were received requesting \$757,000. Working within the Legislature’s authorization, awards totaling \$898,438 were granted to 93 local government agencies.

A good introduction to some of the resources available is offered on the SoS web site: [http://www.secstate.wa.gov/archives/records\\_local.aspx](http://www.secstate.wa.gov/archives/records_local.aspx). You’ll also find the email address for your regional archive contact person. ■

### LOCAL Advisory Group

**The Hon. Judy Ainslie**  
Washington State Assn. of  
County Treasurers  
(360) 577-3059

**The Hon. Dani Burton**  
Washington State Assn. of  
County Treasurers  
(509) 776-4664

**The Hon. Thad Duvall**  
Washington State Assn. of  
County Auditors  
(509) 745-8527

**Roger Ferris**  
Fire Commissioners Assn.  
(360) 943-3880

**Stan Finkelstein**  
Assn. of Washington Cities  
(360) 753-4137

**Donna Gregg**  
Educational Service Dist. 112  
(360) 750-7511

**The Hon. David Griffiths**  
Washington State Assn. of  
County Treasurers  
(509) 667-6405

**James Hendrickson**  
Washington Municipal  
Treasurers Assn.  
(360) 754-5855

**Alexandra Johnson**  
State Auditor’s Office  
(360) 725-5596

**The Hon. Robert Lothspeich**  
Washington Association of  
County Officials  
(509) 397-6230

**Larry Mayfield**  
Washington Association of  
School Business Officials  
(509) 786-3323

**Debbie Tarry**  
Washington Finance Officers  
Association  
(206) 546-1700

**The Hon. Ilene Thomson**  
Washington State Assn. of  
County Treasurers  
(509) 574-2800

## Is my AIC better than your NIC?

by Susan Musselman, DashenMusselman, Inc.

Many local participants are familiar with the terms “interest rate,” “average interest rate,” “net interest cost,” or “true interest cost,” but seldom focus on the overall cost of borrowing, the “all in cost” or “AIC.” The net interest cost is often referred to as “NIC” and is a calculation that reflects the weighted average interest rate on your borrowing, plus any underwriting or loan fees and cost of bond insurance, if any. The true interest cost, known as “TIC”, is the same as the NIC, but takes into account the time value of money. No other costs, such as bond counsel, financial advisor, rating, and official statements, are included in calculation of NIC or TIC.

This is where the AIC comes in. The AIC is a calculation that reflects the weighted average interest rate, including all related borrowing costs. It is important to understand the concept of AIC when comparing financing alternatives, and in particular when viewing the LOCAL borrowing rates.

When you contact a bank for a rate quote, you are often told the interest rate and fee only. When you contact an underwriter for an estimate of bond rates, you often receive an average interest rate. Unless you were to specifically ask, you are not generally quoted an NIC, TIC, or an AIC. In order to compare the alternatives on an equal basis, you need to know the amount of all other related costs, and be able to translate those costs into a representative cost or AIC.

Let’s start with a couple of examples: Take a \$500,000 borrowing need, with 10 year term. Assume the following bank loan: 3.5% interest rate; 1% loan fee; \$3,500 bond counsel fee, \$1,500 financial advisor fee. No disclosure or rating required, and no other costs. The average interest rate in this example is 3.5%; the NIC is 3.6733%; the TIC is 3.6988%; and the AIC is 3.900%

*Continued on page 4*

**AIC, NIC continued from page 3**

Take a \$9,000,000 borrowing need, with a 10 year term. Assuming the following bond scenario: 3.2% average interest rate; \$4/\$1,000 underwriting spread; \$14,000 bond counsel fee; \$9,000 financial advisor fee; \$7,500 rating fee; \$5,000 official statements. The average interest rate in this example is 3.2%; the NIC is 3.2704%; the TIC is 3.2685% and the AIC is 3.3461%.

How can you calculate the AIC? Well, unfortunately it isn't as easy as it may sound. Without the right computer program or formula, you will need to request that information from the lender, financial advisor or underwriter. In the case of the LOCAL Program, the AIC is always the rate that is provided.

**Calculating Interest Rates**

NIC or Net Interest Cost is a simple calculation that takes into account the total interest to be paid on the bonds, plus underwriting compensation, divided by the weighted average life of the bond issue. The formula for NIC does not include time value of money, but does consider weighted life of the bonds. TIC or True Interest Cost is the rate that will discount underwriting compensation, bond insurance (if any), and future debt service payments so the sum of the present value of all these cashflows will equal the bond proceeds. The calculation of TIC takes into account the time value of money, and the inter-

est and underwriting costs (including bond insurance, if any) only. The concept is similar to an IRR or Internal Rate of Return calculation, which you may be familiar with.

AIC or All In Cost is based on the same formula as TIC, but factors in all issuance costs as cash flows. The calculation of AIC takes into account the time value of money, and all related borrowing costs. Because the formula is the same, the AIC is sometimes referred to as the "All in TIC."

With about 15 minutes of time, the NIC can be calculated by hand, but the TIC and AIC calculations are much more complicated and require the use of a computer to run the formula.

When you call the State Treasurer's office, the estimated interest rate you are provided will always be an AIC, or all in cost, and will include market rate cushion to cover normal fluctuations in the market. You may also be advised to view recent interest rates shown on the Treasurer's website as a guide for planning purposes. In cases where you wish to drill down for comparison purposes, you should be sure you are comparing market rates vs. market rates and that you are taking into account the full cost of borrowing as reflected in the AIC. Even then, if the rates you are comparing are based on future sale of bonds or COPs, keep in mind that they are estimates only. ■

Page 3 LOCAL Records Grants  
 Page 2 Is my AIC better than your NIC?  
 Page 2 Post Issuance Tax Compliance Policies  
 Page 1 Mason County Public Works

Annual LOCAL financing schedules		
Real estate	Equipment	
Cutoff	Cutoff	
Jan. 1	Jan. 1	
April 1	April 1	
July 1	July 1	
Oct. 1	Oct. 1	
Fund date	Fund date	
March	March	
June	June	
September	September	
December	December	
	Nov. 1	



**Office of the State Treasurer**  
 P.O. Box 40200  
 Olympia, WA 98504-0200

PRSRT STD  
 U.S. Postage Paid  
 Olympia WA  
 Permit No. 179