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TO:	City of Ann Arbor, Mayor and Council c/o Stephen K. Postema, City Attorney
FROM:	Dykema Gossett PLLC
RE:	Public Advice Memorandum on Use of Bond Proceeds and Allocation of Bond Proceeds and Non-Bond Proceeds to a Parking Structure Financed with Build America Bonds
DATE:	October 11, 2017

The City Council of the City of Ann Arbor, Michigan (the "City"), by resolution approved on April 17, 2017 (R-17-121) (the "Resolution"), requested that we, as the City's outside bond counsel, provide a public advice memorandum regarding the question of whether the sale of above ground development rights related to the Airspace Development (defined below) will affect the tax advantaged status of the City's $49,420,000 Capital Improvement Bonds (LTGO) Series 2009-A (Taxable Build America Bonds - Direct Payment) (the "Bonds"). The Bonds were issued to finance a portion of the costs of construction of an underground public parking facility, known as the Library Lane deck (the "Project"), together with other public infrastructure improvements. We issued our approving bond opinion as to the validity and tax advantaged status of the Bonds when they were issued on August 19, 2009 (the "Bond Opinion").

We have reviewed information provided by the City and the City's structural engineers for the Project relating to the various Project elements and their respective costs, including costs for structural and utility improvements necessary to support future development, and the allocation of those costs as between (1) costs targeted to support the future needs of the general public in the Project neighborhood, and (2) costs to support a multi-story building in the airspace above the Project ("Airspace Development"). At the time we delivered the Bond Opinion, and in connection with our tax analysis necessary to support that opinion, we were advised by the City that there was uncertainty as to whether the Airspace Development would be developed and, if so, whether it would be used for governmental, private for profit, or private non-profit purposes, or a combination thereof. We therefore applied the conservative approach of treating the costs supportive of the Airspace Development as "private business use."

Bonds will not be tax advantaged if both of two tests are met: (1) more than 10% of the proceeds of the bonds are used for private business use (the "private business use test"), and (2) more than 10% of the bonds are secured by private payments. If either test is not met, the tax advantaged status of the Bonds is not adversely affected. The funding sources for construction of the Project were proceeds of the Bonds and other funds available to the City and the City's Downtown Development Authority ("City Equity"). We advised the City as to the applicable method for allocating the funding sources for the Project between public and private uses under the Internal Revenue Code ("Code") and relevant Treasury Regulations.

Where a state or local project is being financed with both tax advantaged bond proceeds and other sources, such as other funds on hand or non-tax advantaged bond proceeds ("qualified equity," as defined in the Treasury Regulations)[1], Treasury Regulations and other IRS guidance require an allocation of the tax advantaged bond proceeds and the "qualified equity." The method used by the City to allocate the proceeds of the Bonds and City Equity to public and private uses follows the requirements of the Code, Treasury Regulations and other guidance.

Under the "undivided allocation method" (Treasury Reg. 1.141-6(b)(1)):

> (1) "qualified equity" is allocated first to costs related to any anticipated private business uses, and second to governmental uses; and,
>
> (2) proceeds of the tax advantaged bonds are allocated first to governmental uses, and second to any private business uses.

Based on the information provided by the City, the City has used the "undivided allocation method" to allocate the City Equity (which meets the regulatory definition of "qualified equity") and the proceeds of the Bonds to the costs of the Project. As stated above, the costs of the additional structural and utility support within the Project for the Airspace Development were treated as private business use, to which "qualified equity" was first allocated. Based on the methodology described above, no proceeds of the Bonds were allocated to costs for the Airspace Development since City Equity was sufficient to cover those costs. Accordingly, the "private business use test" described above has not been met (i.e., less than 10% of the proceeds of the Bonds were used for private business use).

As the City Council has been advised by the City Attorney, the Bonds were the subject of an audit by the Internal Revenue Service, which was commenced on February 3, 2017 (either under the IRS random audit program, in reaction to a third party referral, or pursuant to an IRS audit initiative for a selected category of bonds). The audit was closed by the IRS on September 22, 2017, with its decision that the tax-advantaged status of the Bonds remains unchanged. In the course of that audit, the foregoing analytical approach was shared with the IRS.

[1] See Treas. Reg. §1.141-6(b)(3).

This advice is limited to the effect of the proposed Airspace Development upon the tax advantaged status of the Bonds, as set forth in the Bond Opinion. We have not considered any other facts or events subsequent to the original issuance of the Bonds other than the City's proposed sale of the above ground development rights as set forth in the Resolution.

This advice is provided exclusively for the benefit of the City, and may not be relied upon by any other person without our prior written consent.