

Strategies & Models for Capital Project Financing: American Recovery and Reinvestment Act Bond Financing Options

Linda Schakel

schakel@ballardspahr.com

www.ballardspahr.com



Ballard Spahr LLP

Build America Bonds

- New taxable tax credit bond for bonds that otherwise would qualify as tax-exempt governmental bonds
- Taxable interest + 35% tax credit to bondholder

OR

- Taxable interest to bondholder, 35% cash payment to issuer
- Rates and maturity determined by market
- No limit on amount of bonds that can be issued

- Must be issued in 2009 or 2010
- Qualified purposes = anything that could be financed with a governmental tax-exempt bond, including TIFs, PILOTs, refundings, working capital
- Limited to capital expenditures (no refunding of existing outstanding tax-exempt bond) if elect direct payment from federal government

Recovery Zone Economic Development Bonds

- Form of Build America Bond, direct payment to issuer of 45% for projects in “Recovery Zone”
- Must otherwise qualify as tax-exempt governmental bond
- Capital expenditures, infrastructure, job training
- TIF, PILOT bonds would qualify
- Subject to nationwide limit of \$10 billion
- Must be issued in 2009 or 2010

- Financing for projects located in “Recovery Zone”
 - Issuer of bonds makes designation of “Recovery Zone”
 - Area of economic distress by reason of military base closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990 or
 - Area with significant unemployment, poverty, home foreclosures, or general distress or
 - Federally designated empowerment zone

Recovery Zone Facility Bonds

- New category of exempt facility bond
 - Available to finance projects that have private business involvement
 - Tax-exempt bonds, with rate set by market and maturity subject to 120% limit
 - Subject to separate volume cap (\$135 million minimum per state)

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- Qualifying costs
 - New construction
 - Renovation of building
 - New or used equipment
 - Acquisition of existing building with substantial rehabilitation
 - Must be issued in 2009 or 2010

General Provisions for Tax Credit Bonds

- Tax Credit Bonds Are Taxable Bonds
 - Different market than tax-exempt bonds
- Issuer Pays Principal Only to Bondholder
- Bondholder receives return as credit against its federal tax liability – no cash in typical tax credit bond
- Credit rate established by US Treasury daily

- Maturity of Tax Credit Bonds
 - Set by US Treasury for month, published daily
 - Current maturity limit is 14 years
 - Bondholder can maximize credit by keeping entire principal amount outstanding to maximum maturity date
 - For credit purposes, bondholder may require that issuer establish sinking fund or some state laws may require amortization



- Spending Bond Proceeds

- 100% of proceeds, including investment earnings, must be spent on qualified purposes within 3 years of issuing bonds
- Unspent bond proceeds at end of 3 years must be used to redeem bonds, unless IRS extends spending period
- Up to 2% of proceeds can be used to pay costs of issuance
- None of proceeds can be used for a reserve fund

- Qualified Purposes - Qualified School Construction Bonds
 - New construction, renovation, land for new schools (not clear: equipment, acquisition of existing building)
 - Facility must be public elementary or secondary school
 - Permits public/private partnerships – co-locate 501(c)(3) services, private management of buildings
 - Charter schools qualified even if 501(c)(3) organization

- Qualified Purposes - Qualified Zone Academy Bonds
 - Renovation, equipment, curriculum development, teacher training for “qualified zone academy”
 - Must have written commitment for 10% match from private business
 - Permits public/private partnerships
 - Charter schools qualified even if 501(c)(3) organization



- Qualified Purposes - Qualified Energy Conservation Bonds

- Capital expenditures that reduce energy consumption in public buildings by 20%
- Grants or loans to private entities to implement “Green Community Programs”
- Demonstration projects designed to promote commercialization of technologies to reduce peak use of electricity, green building technology
- Up to 30% of volume cap for private party involvement (privately owned solar panels)

Allocations for 2009 and 2010

- Qualified School Construction Bonds
 - \$11 billion allocation for 2009 and 2010
 - 40% direct allocation to 100 large school districts plus 25 determined by Secretary of Education as in need
 - 60% allocation to States based on proportion of prior year's Title I funding
 - Separate allocation to possessions
 - Special allocation for Bureau of Indian Affairs schools

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- Qualified Zone Academy Bonds
 - \$1.4 billion for 2009 and 2010
 - Allocated in same manner as before to States with no statutory suballocation process
 - Qualified Energy Conservation Bonds
 - \$3.2 billion
 - Allocated to States by population, suballocation to large municipality or county by population

Incentives for Banks to Purchase and Hold Bonds

- ARRA provides relief from 100% interest expense disallowance, though still subject to 20% interest expense disallowance
- Increase limit for 2009 and 2010 to permit \$30 million per year by issuer that are not subject to interest expense disallowance
- Each 501(c)(3) organization will have its own \$30 million limit per year for 2009 and 2010

2% De Minimis Holdings

- Banks will be permitted to have up to 2% of total assets in bonds issued in 2009 and 2010 that are not subject to interest expense disallowance
- 2% de minimis limit is in addition to \$30 million BQ bonds
- Could include 501(c)(3) issues larger than \$30 million, new Recovery Zone Facility Bonds and traditional Industrial Development Bonds

Additional Market Access Provisions

- Alternative Minimum Tax Relief
 - Generally for bonds issued in 2009 and 2010 interest on 501(c)(3) bonds not indirectly subject to AMT
 - Adjustment not likely to provide much of a rate differential for governmental bonds
 - Other private activity bonds issued in 2009 and 2010 and refundings of bonds issued 2004-2008 not item of tax preference