SEYFARTH ATTORNEYS SHAW LLP

Quick Takes

JANUARY 2011

Quick Takes: After ARRA- What Bonds Can We Use Now to Finance Projects?

Financing projects is hard in difficult times. It helped that the bond provisions in the federal Recovery Act (ARRA) created some incentives for lenders to loan. But, those provisions are gone now. So where do we turn for bond financing?

What happened is that The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 is now law. This law did <u>not</u> contain an extender for the following programs, so they expired at the end of 2010-

- Build America Bonds (BABs) and Recovery Zone Economic Development (ED) bonds, for public projects
- Recovery Zone Facility Bonds, for private projects
- the larger ($30 million) small-issuer limit for bank-qualified (BQ) bonds (in addition to which, the test again is applied at the issuer level, not the borrower level). Also gone is the *de minimis* rule, which allowed many types of bonds that are ineligible for BQ status to provide the same benefits (an 80% deduction for their carrying costs) to banks and other financial institutions that bought them, provided their tax-exempt holdings did not exceed 2% of their assets
- the alternative minimum tax (AMT) exemption for private-activity bonds (other than housing bonds), like the industrial development revenue bonds issued by development authorities
- the exemption of water and sewer bonds from the federal "volume cap" allocated to each state to limit the amount of private activity bonds that are issued within each state
- the provision allowing tax-exempt "small issue" manufacturing bonds to finance projects that produce intangible property
- the provision allowing tax-exempt "small issue" manufacturing bonds to finance, not just "core manufacturing" facilities, but also "functionally related and subordinate" parts of such a facility

(after 2010, “small issue” manufacturing bonds can still be issued under the old rules)

- authorization for Federal Home Loan Banks (FHLBs) to issue letters of credit to credit enhance tax-exempt bonds without affecting the tax status of the bonds

So, projects lost a lot of access to the capital markets as a result of the new law. Then what <u>did</u> that law accomplish?

The law-

- extends QZABs (qualified zone academy bonds) through 2011 and authorizes $400 million more (as tax-credit bonds only) in QZABs

- ignores QSCBs (qualified school construction bonds), QECBs (qualified energy conservation bonds), and CREBs (clean renewable energy bonds), so these bonds can still be issued after 2010, subject to the limits on allocation, even as direct-pay bonds

- extends through 2012 the increase (from $5 million to $10 million) in the amount of governmental bonds that small governmental units (who issue $15 million or less of bonds in a year) may issue without being subject to the arbitrage rebate requirements if they issue at least $10 million of such bonds to finance construction of public school facilities

- retains through the end of 2012 a type of tax-exempt bonds that private, for-profit corporations can use to finance public school facilities if they are operated by public educational agencies under certain public-private partnership (P3) agreements

- extends through 2011 certain disaster relief provisions, such as Gulf Opportunity Zone bonds, or GO Zone bonds

Some other types of bonds, such as qualified 501(c)(3) bonds, can still be used after 2010.

In this new world, we will have to mainly look to these techniques for successful bond financings for projects-

- ✓ “taxable floaters” secured by a bank’s letter of credit confirmed (or wrapped) by a FHLB in order to get an investment grade rating. Of course, if you can get an investment grade letter of credit from a stronger bank, that means that the FHLB is not needed. It also means that the bonds can be tax-exempt, if otherwise qualified.

- ✓ private placements of tax-exempt bonds with banks and financial institutions. Even though most of these bonds won’t get BQ treatment or an AMT exemption, they could still be attractive to a profitable bond purchaser.

- ✓ “project finance”, where the finance team works to “build a bond” that can be marketed to finance a stand-alone (or mostly stand-alone) project by putting together a sound “capital stack.” These bonds won’t be fully secured by a letter of credit and in fact there may be no letter of credit all. Some of these bonds can get an investment grade rating. For those that can’t, issuer discretion is advisable. Of course, some companies can get an investment grade rating for financings based on their own general credit, and these companies will in many cases be looking to the tax-exempt bond markets.

- ✓ "contract revenue bonds", wholly or partially secured by an intergovernmental agreement between a local authority and a local government (both of whom, if they proceed, should do so prudently)

- ✓ "special district bonds", like TIF bonds or Georgia's tax allocation (TAD) bonds. The source for repayment of these bonds is taxes and/or assessments within the district. A "back-up assessment" within the district is often needed to make them marketable if the positive tax increment is the intended source of repayment. Regardless, we are already seeing communities use special district bonds as a way to "catch the wave" as the economy continues to improve.

The details of these techniques are beyond the scope of this issue of *Quick Takes*, but stay tuned! Meanwhile, I have posted lots of new White Papers on these and other topics, which you can download at-

http://danmcrae.info/whitepapers.asp

The "Current Bond Rates" page at danmcrae.info is updated weekly. This week's version is what you see below.

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General note: This issue of *Quick Takes* is a quick-reference guide for elected and appointed officials, economic developers, community developers, participants in the real estate and financial industries, company executives and managers, and their advisors. The information in this issue is general in nature. Various points that could be important in a particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

<table>
<tr><td colspan="2" align="center">CURRENT BOND RATES</td></tr>
<tr><td colspan="2" align="center">EFFECTIVE JANUARY 20, 2011

Interest Rates:</td></tr>
<tr><td colspan="2">tax-exempt-</td></tr>
<tr><td align="right">floating:</td><td>0.37%</td></tr>
<tr><td align="right">fixed:</td><td>3.04%
(eff. 01/14/11)</td></tr>
<tr><td colspan="2">taxable-</td></tr>
<tr><td align="right">floating:</td><td>0.50% - 0.80%</td></tr>
<tr><td align="right">fixed:</td><td>3.50%</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td colspan="2">General notes:
1. Rates are posted weekly. These rates are for the effective date indicated above, or as otherwise indicated. For intra-week rates, <u>Contact Dan.</u>
2. These are interest rates on revenue bonds that are variable rate demand bonds; i.e., floating. These can be synthetically fixed via interest rate swaps, as noted below.
3. Tax-exempt rates are for industrial development revenue bonds (IDB's") that are subject to the AMT and are 7 day general market quotes.
4. Taxable rates are for taxable IDB's or for taxable "corporate bonds".
5. Fixed rates are for 10 year terms via swaps.
6. All rates are market extracted and approximations, and are not guaranteed.
7. These rates do not reflect all-in costs; e.g., annual letter of credit fees are not included.</td></tr>
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