

Quick Takes

August 2011

Quick Takes: New Regs, New Rush- Finance Your Renewable Energy and Solid Waste Disposal Projects Now!

There is very good news in the renewable energy and solid waste disposal space! After almost 10 years, the IRS has finalized its regulations on solid waste disposal bonds. This is hugely significant if you have a renewable energy project, like biomass to electricity, or a solid waste disposal project, like tire recycling.

It's almost unheard of for new IRS regulations to be helpful, but this time they are. These regulations can even be called- "pro-recycling."

Here are some of the significant changes-

1. The contentious "No Value Rule," which constrained financing recycling plants that used materials that had any value, is gone.
2. "Dual use" projects, like those that use solid waste to produce electricity, have a "ramp up" period before they are tested for meeting the requisite level of solid waste use, and a "cure period" to remediate shortfalls caused by events beyond the operator's control.
3. The focus on whether or not a feedstock is "solid waste" now is directed at whether it is used material or residual material.
4. The final regulations eliminate an unwieldy requirement in the proposed regulations that provided that material qualified as residual material only to the extent that it constituted less than 5% of the total material introduced into the production process.

The new regulations also contain many other helpful provisions, such as those dealing with logs and bark (and are helpful regarding slash), manufacturing (including wood pellets), MSW (municipal solid waste) and landfills, tires, paper recycling, mixed-input facilities, and many others.

For a more detailed analysis of the regulations, *see* "Final Regulations," below.

This is really a window of opportunity for financing these facilities, for a couple of reasons.

First, if part of your project's capital stack is a "Section 1603 grant" in lieu of an investment tax credit under the American Reinvestment and Recovery Act, you should be fixated on a deadline. This year you have to begin construction of your project, which occurs when "physical work of a significant nature begins." There is a safe harbor involving incurring or paying more than 5% of certain costs. There is still time this year to finance your project on a non-recourse, "project finance" basis, but the time to start that process is now.

Second, if part of your project's capital stack is tax-exempt solid waste disposal bonds, remember that these bonds require an allocation of the host state's share of the federal "volume cap". Today, most states have plenty of volume cap. Tomorrow? Well, these new regulations are going to spur a lot of financings. Don't be left out!

If you have questions regarding any of this, please do not hesitate to let me know.

Dan

FINAL REGULATIONS

On August 18, 2011, Treasury issued final regulations on the definition of solid waste disposal facilities for purposes of the rules applicable to tax-exempt bonds issued by State and local governments (the "**Final Regulations**"). The Final Regulations apply to bonds sold on or after October 18, 2011. However, bond issuers may elect to apply the Final Regulations, in whole, but not in part, to bonds sold before October 18, 2011.

Solid Waste Disposal Facility. The Final Regulations provide that a facility qualifies as a solid waste disposal facility if it processes solid waste in a qualified solid waste disposal process, performs a preliminary function, or is a functionally related or subordinate facility.

Solid Waste. Prior regulations required that solid-waste must be property that is useless, unused, unwanted, or discarded solid material "that has no market or other value at the place where the property is located" (the "**No-Value Test**"). The Final Regulations eliminate the **No-Value Test**, and instead define solid waste to mean, with certain specific exclusions, garbage, refuse, and other solid material derived from any agricultural, commercial, consumer, governmental, or industrial operation or activity if the material is either a "used material" or a "residual material". "Used material" means any material that has been used previously as an agricultural, commercial, consumer, governmental or industrial product or as a component of any such product. Previously proposed regulations defined "residual material" as any residual byproduct or excess unused raw material that remains from the production of any agricultural, commercial, consumer, or industrial product, provided that material qualified as residual material only to the extent that it constituted less than 5% of the total material introduced into the production process and it had a fair market value that is reasonably expected to be lower than that of any product made in that production process. The Final Regulations eliminate the five percent (5%) limitation on residual material, but otherwise generally retain the analytic standard for residual materials. The following items are excluded from the definition of solid waste: (1) virgin material; (2) solids within liquids and liquid waste; (3) precious metals; (4) most hazardous material; and (5) most radioactive material. The Final Regulations also clarify that material is "solid" only if it is solid at ambient temperature and pressure.

Qualified Solid Waste Disposal Process. The Final Regulations provide for three eligible types of solid waste disposal processes: a final disposal process, an energy conversion process, and a recycling process. To provide flexibility for future innovation, the Final Regulations provide that a solid waste disposal process may employ any biological, engineering, industrial, or technological method. The Final Regulations clarify that a final disposal process includes the spreading of solid waste in an environmentally compliant and safe manner.

First Useful Product Principle. The Final Regulations provide guidance on the standard for determining the first useful product for purposes of establishing the end point of a solid waste disposal process. Under the Final Regulations, a useful product is a product useful for consumption, either as an ultimate end-use product or as an input to some stage of a manufacturing or production process, and that could be sold for such use (taking into account operational constraints on such sales for certain integrated processes), whether or not actually sold. The Final Regulations also clarify that an energy conversion process ends at the point at which useful energy is first created or incorporated into the form of synthesis gas, heat, hot water, or other useful energy.

Mixed-Use/Mixed Input Facilities. The Final Regulations also contain various allocation and accounting rules based on existing principles for mixed-input facilities and mixed-use facilities. In the case of a mixed-use facility, the costs of the facility allocable to the qualified solid waste disposal function are determined using any reasonable method, based on all the facts and circumstances. In the case of mixed-input facilities, costs can be allocated based on the percentage of solid waste processed, by weight or volume, to the total materials processed. The amount of costs allocated to processing solid waste can be financed tax-exempt as a solid waste disposal facility. For example, if each year while an issue of tax-exempt bonds used to finance an energy conversion facility is outstanding, 40% by volume and 45% by weight of the solid material that the borrower processes in the conversion process is not solid waste, but the remainder of the solid material is either used material or residual material, then 60% of the costs of the property used to perform the energy conversion process are allocable to a solid waste disposal function. However, if solid waste constitutes 65% or more of the total inputs, then 100% of the facility qualifies as a qualified solid waste disposal facility. Under previously proposed regulations a practical problem existed in the allocation of mixed-input facilities, since the regulation required that the comparison of solid waste inputs to total inputs be measured annually, but the allocation of qualified project costs associated with the expected solid waste inputs would have to be made at the time the bonds are issued based on the expected amount of solid waste inputs relative to all other inputs. The Final Regulations provide special rules that: (1) annual testing does not begin until the facility is placed in service within the meaning of a special placed-in-service definition, which focuses on the point at which a facility is operational at substantially its design level, and (2) allows a three-year curative period to address the impact of extraordinary events outside the control of the operator of the solid waste disposal facility (such as natural disasters, strikes, major utility disruptions, or governmental interventions).

This analysis is qualified in its entirety by reference to the Final Regulations, which are incorporated herein by reference, and which are available at-

<http://danmcrae.info/whitepapers>

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.)

CURRENT BOND RATES	
EFFECTIVE AUGUST 18, 2011	
Interest Rates:	
tax-exempt -	floating: 0.25% fixed: 2.25% <small>(eff. 08/12/11)</small>
Taxable -	floating: 0.45% - 0.50% fixed: 2.51%
General notes:	

1. Rates are posted weekly. These rates are for the effective date indicated above, or as otherwise indicated. For intra-week rates, Contact Dan.
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.

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