



GILMORE & BELL, PC

**Bond Provisions in the  
American Recovery and Reinvestment  
Act of 2009**

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# Overview:

## American Recovery and Reinvestment Act

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- Creates new financing tools for traditional tax-exempt bond issuers
- Most bond provisions effective only during 2009 and 2010
- Issuer-friendly legislation

# Overview:

## American Recovery and Reinvestment Act

- New provisions to enhance marketability:
  - Increase in bank qualified bonds cap
    - Increases cap from \$10M to \$30M for Purposes of Testing the Small Issuer Exemption and the Amount that an Issuer can Designate Bank Qualified
    - "Qualified 501(c)(3) Bonds" – \$30M limit Tested for Each 501(c)(3) Organization Borrower, not the Issuer
    - Applies Only to Governmental Bonds and 501(c)(3) Bonds
  - AMT Relief for Private Activity Bonds

# Overview:

## American Recovery and Reinvestment Act

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- New types of bonds authorized by ARRA:
  - Build America Bonds
  - Recovery Zone Economic Development Bonds
  - Tax-Exempt Recovery Zone Facilities Bonds
  - Expansion of tax-credit bond programs

# What is a Build America Bond?

- **Issuer benefits:**
  - Indirectly -- Federal tax credit for investors; OR
  - Directly -- interest subsidy payments to Issuer
- **Must be a “Governmental Bond”**
  - All tax-exempt bond compliance rules apply!
  - No Private Activity Bonds (IRBs)
  - No 501(c)(3) Bonds
  - TIF, TDD and CID Bonds can be governmental bonds
- **Interest paid on Build America Bonds is:**
  - Subject to Federal income tax
    - Fundamental difference from traditional borrowing
    - All state law and Federal tax law restrictions apply
  - Exempt from Kansas state income tax

# What is a Build America Bond?

- Must be issued by December 31, 2010
- No limit on amount of debt that may be issued
- All tax-exempt bond compliance rules apply
  - No Private Activity Bonds
    - Restrictions on private use/private security or payments
    - No Industrial Development Bonds or 501(c)(3) Bonds
  - Arbitrage rules apply
- Failure to comply with all tax-exempt bond rules may result in loss of federal income tax credit (if Tax Credit BAB) or interest subsidy payment (if Interest Subsidy BAB)

# What is a Build America Bond?

## ➤ Two types of Build America Bonds:

### ➤ Interest Subsidy BAB

- IRS pays Issuer 35% of interest paid on each payment date
- Issuer must apply for each subsidy payment

### ➤ Tax Credit BAB

- Bondholder claims tax credit on federal income tax return
- Tax credit = 35% of total coupon interest

# Interest Subsidy BAB vs. Tax Credit BAB

## Interest Subsidy BAB

- Eligible financings:
  - Only new money
  - No refunding
- Issuer applies for interest subsidy payments from IRS; due prior to each interest payment date

## Tax Credit BAB

- Eligible financings:
  - New money; or
  - Refunding
- No ongoing filings required
- Marketability questions

# Tax-Exempt Bond vs. Interest Subsidy BAB

## – Illustration Only

### Tax-Exempt Bond

- Principal Amount = \$1,000,000
- Interest Rate = 5%
- Term: 20 Year
  - Annual Interest Payments
  - Balloon Principal Payment

### BAB (Interest Subsidy)

- Principal Amount = \$1,000,000
- Interest Rate = 7%
- Term: 20 Year
  - Annual Interest Payments
  - Balloon Principal Payment

# Tax-Exempt Bond vs. Interest Subsidy BAB

## - Illustration Only

**Tax-Exempt Bond (5% Rate)**

<u>Date</u>	<u>Interest</u>	<u>Interest Subsidy</u>	<u>Net Interest Payments</u>
Year 1	\$50,000	-	\$50,000
Year 2	\$50,000	-	\$50,000
Year 3	\$50,000	-	\$50,000
Year 4	\$50,000	-	\$50,000
Years 5-20	\$800,000	-	\$800,000
Total	\$1,000,000	-	\$1,000,000

**Interest Subsidy BAB (7% Rate)**

<u>Date</u>	<u>Interest</u>	<u>Interest Subsidy</u>	<u>Net Interest Payments</u>
Year 1	\$70,000	\$24,500	\$45,500
Year 2	\$70,000	\$24,500	\$45,500
Year 3	\$70,000	\$24,500	\$45,500
Year 4	\$70,000	\$24,500	\$45,500
Years 5-20	\$1,120,000	\$24,500	\$728,000
Total	\$1,400,000	\$24,500	\$910,000

# Tax-Exempt Bond vs. Interest Subsidy BAB

- BAB is not always the lowest cost option
  - Usually works best for long-term maturities
  - May have to modify call rights to maximize savings
  - Consider cost of staff time to administer
    - Failure to apply for BAB interest subsidy may result in inability to obtain interest subsidy
- Non-compliance with tax-exempt bond rules may be costly
  - No future interest subsidy
  - Government claim for refund of prior payments

# Recovery Zone Bonds Overview

- Two types of Recovery Zone bonds:
  - Recovery Zone Economic Development Bonds (RZEDBs)
    - Like interest subsidy BABs, except with 45% subsidy
  - Recovery Zone Facilities Bonds (RZFBs)
- All Recovery Zone bonds must be issued by December 31, 2010

# RZEDBs vs. RZFBs

## RZEDBs

- Governmental purpose bonds
- Davis-Bacon applies
- Taxable, with 45% federal subsidy payment to issuer
- Improvements must be located in or constructed for the benefit of a Recovery Zone
- Must have RZEDB allocation

## RZFBs

- Private activity bonds
- Davis-Bacon does not apply
- Tax-exempt
- Improvements must be located in a Recovery Zone
- Must have RZFB allocation
- May only finance costs incurred after Recovery Zone designation made

# Recovery Zone Economic Development Bonds

- Governmental purpose bonds
  - Permissible uses of RZEDB proceeds:
    - Capital expenditures
    - Public infrastructure or construction of public facilities
    - Job training and educational programs
  - Traditional state law rules regarding project authorization apply
  - New money expenditures only; generally, no refundings
- Taxable bond
  - Direct subsidy payment from federal government to issuer on each interest payment date equal to 45% of interest due on RZEDBs
  - All tax-exempt bond compliance rules apply, with additional rules for the receipt of subsidy payments
    - Restrictions on private use/private payments
    - Arbitrage rules apply

# Recovery Zone Facilities Bonds

- Private activity bonds
  - Transaction structured like an IRB where beneficiary of bond proceeds is responsible for repayment
  - Permissible uses of RZFB proceeds:
    - May fund any business facility other than residential rental housing and certain other prohibited facilities (golf course, hot tub facility, gambling, retail liquor store, etc.)
    - May build new buildings and purchase new equipment
    - Special rules for acquiring existing buildings and equipment
- Tax exempt bond
  - May help beneficiary obtain lower cost of financing

# What is a Recovery Zone?

- Geographic area designated by the Issuer using good faith discretion, as:
  - Having significant poverty, unemployment, rate of home foreclosures or general distress;
  - Economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act; or
  - Designated as an empowerment zone or renewal community as of February 17, 2009
- Designation may be made by ordinance or resolution
- Issuer may designate entire geographic area in the Issuer's jurisdiction as a Recovery Zone

# Recovery Zone Bond Allocations

- Many Kansas counties and large municipalities (over 100,000 population) received an allocation based on increase in unemployment in 2008
- Each county or large municipality may either:
  - Use their allocation;
  - Grant their allocation to another municipal entity within the county/large municipality (i.e., a county may grant allocation to one or more cities within the county); or
  - Waive their allocation
    - If the allocation is waived, it is redirected to the State to reallocate.

# Tax-Credit Bond Programs

- Bondholder claims a tax credit on federal income tax return
  - Equal to a percentage of outstanding bond principal (not interest paid)
  - Rate designed to significantly reduce or eliminate Issuer interest expense and bond discount
    - Credit rate & maximum bond term reset daily by U.S. Treasury
    - See [treasurydirect.gov](http://treasurydirect.gov)
- Davis–Bacon Act applies to projects
- Tax credits may be separated from the Principal Portion and sold separately

# Tax-Credit Bond Programs

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- Types of Tax-Credit Bonds:
  - New Clean Renewable Energy Bonds
  - Qualified Forestry Conservation Bonds
  - Qualified Energy Conservation Bonds
  - Qualified Zone Academy Bonds
  - Qualified School Construction Bonds

**SUMMARY OF BOND OPTIONS CREATED BY  
THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009, P.L. 111-5**

	<b>Build America Bonds (Tax Credit)</b>	<b>Build America Bonds (Direct Pay)</b>	<b>Recovery Zone Economic Development Bonds (Direct Pay)</b>	<b>Recovery Zone Facility Bonds</b>	<b>Qualified School Construction Bonds</b>
<b>Bond Interest Tax Status</b>	Taxable	Taxable	Taxable	Tax-Exempt	Taxable
<b>Federal Subsidy</b>	Federal tax credit to bondholders equal to 35% of total coupon interest	Federal payments to issuer equal to 35% of total coupon interest	Federal payments to issuer equal to 45% of total coupon interest	No tax credit or interest subsidy	Quarterly Federal tax credits to bondholders at rates determined by the Treasury on the issue date (similar to QZABs)
<b>Type</b>	Governmental <sup>1</sup>	Governmental <sup>1</sup>	Governmental <sup>1</sup>	Private Activity Bond	Governmental <sup>1</sup>
<b>Use of Proceeds</b>	Any expenditures qualifying for a governmental tax-exempt bond issue	New Money Capital Expenditures <sup>2</sup> for governmental purposes	New money Qualified Economic Development Purposes <sup>3</sup> in or related to a Recovery Zone <sup>4</sup>	95% of net proceeds must be used for new money Recovery Zone Property <sup>5</sup>	Qualified School Construction Purposes <sup>6</sup>
<b>National Volume Cap</b>	None	None	\$10 Billion total for calendar years 2009 and 2010	\$15 Billion total for calendar years 2009 and 2010	\$11 Billion for each of calendar years 2009 and 2010
<b>IRS Reporting</b>	Form 8038-G with special annotations and attachments	(1) Form 8038-G with special annotations and attachments (2) Form 8038-CP for each interest payment	(1) Form 8038-G with special annotations and attachments (2) Form 8038-CP for each interest payment	Form 8038	Form 8038 with special annotations
<b>Special Requirements</b>			Davis-Bacon	100% Rehabilitation	Davis-Bacon

<sup>1</sup> Build America Bonds, Recovery Zone Economic Development Bonds and Qualified School Construction Bonds are subject to normal tax rules regarding use of proceeds, use of financed property, and arbitrage; failure to comply could lead to loss of tax credit or federal subsidy.

<sup>2</sup> New Money Capital Expenditures means 100% of the excess of (1) "available project proceeds" (sale proceeds less not more than 2% of sale proceeds used to pay costs of issuance, plus investment earnings on those proceeds), over (2) the amounts in a reasonably required reserve fund. In addition to new expenditures, Direct Payment BABs may be used to (a) reimburse prior capital expenditures under the normal reimbursement rules and (b) refinance temporary short-term obligations issued *after* February 17, 2009 to finance capital expenditures paid or incurred *after* that date.

<sup>3</sup> Qualified Economic Development Purposes means expenditures for purposes of promoting development or other economic activity within a Recovery Zone, including (1) capital expenditures for property located in a Recovery Zone, (2) expenditures for public infrastructure and construction of public facilities and (3) expenditures for job training and educational programs. 100% of the excess of (1) the "available project proceeds" (as defined above) must be used to finance Qualified Economic Development Purposes.

<sup>4</sup> Recovery Zone means (1) any area designated by the issuer as having significant poverty, unemployment, home foreclosures or significant distress, (2) any area distressed by reason of the closure or realignment of a military installation pursuant to Defense Base Closure and Realignment Act of 1990 and (3) any area for which a designation as an empowerment zone or renewal community is in effect.

<sup>5</sup> Recovery Zone Property means any depreciable property constructed, reconstructed, renovated or acquired by purchase the original use of which in the Recovery Zone begins with the taxpayer and substantially all of the use is in the Recovery Zone in the active conduct of a trade or business other than residential rental housing in the Recovery Zone.

<sup>6</sup> Qualified School Construction Purposes means 100% of available project proceeds (sale proceeds less not more than 2% of sale proceeds used to pay costs of issuance, plus investment earnings on those proceeds) must be used for the construction, rehabilitation or repair of a public school facility or the acquisition of land on which a public school is to be constructed. Eligible expenditures include expenditures for the cost of acquisition of equipment to be used in the portion(s) of the public school facility that is being constructed, rehabilitated, or repaired.

# Questions?

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