



New Bond Opportunities Under the Stimulus Bill

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This is the third and final installment in a series of articles regarding local government initiatives under the \$787 billion piece of legislation signed into law on February 17, 2009 known as The American Recovery and Reinvestment Act of 2009 (Stimulus Bill). The first two articles in the series outlined opportunities under the appropriations provisions of the Stimulus Bill.

This article discusses new opportunities available to local government and private businesses under the tax/bond provisions of the Stimulus Bill. Bear in mind, however, that although the Stimulus Bill created new bonding opportunities for local governments, the local governmental entity issuing the bonds must still have the statutory authority to issue bonds for that particular type of project and then to repay the bonds from the identified repayment source under Indiana law. These programs created by the Stimulus Bill do not expand the authority to issue bonds or provide a new revenue source to fund projects. The local governmental entity, as the issuer of the bonds, must still pledge a traditional repayment source such as property taxes, tax increment, local option income taxes, motor vehicle excise taxes, etc., to the payment of the bonds. However, these bond programs do provide new options for structuring the financial aspect of the bonds.

BUILD AMERICA BONDS

One of the goals of the Stimulus Bill is to provide a larger market for municipal bonds, thus expanding the pool of potential purchasers in order to provide more competitive interest rates. Build America Bonds (BABs) are a new category of bonds for governmental entities authorized under the Stimulus Bill. State and local governmental entities have three (3) new options for funding traditional governmental projects, including those governmental projects that promote economic development. Under current provisions of the Stimulus Bill, all three options of BABs discussed below must be issued by December 31, 2010.

Direct-Pay BABs

The most talked about type of BAB that may be issued by local governmental entities is the "Direct-Pay BAB". Counties are familiar with issuing traditional tax-exempt bonds for governmental projects in which the county pledges to pay the principal of and interest due on the bonds (Debt Service) either annually or semiannually. Whether the repayment source is a property tax levy or county revenue, the tax is levied or the revenue source is set aside to match the Debt Service payments. The costs of issuance (e.g. underwriter's discount, bond counsel fees, financial advisor fees, trustee fees, etc.) are traditionally paid from the bond proceeds and funds on hand of the county may or may not be used.

Instead, a county could issue a Direct-Pay BAB for a traditional governmental project for which the county pledges to pay the Debt Service annually or semiannually from a traditional governmental source of funds. That is where the similarities end. Direct-Pay BABs are issued at a higher taxable interest rate and the county then receives a refund payment from the federal government equal to thirty-five (35%) percent of the interest paid on the Direct-Pay BABs on each interest payment date (assuming certain filings are made in a timely manner). Only capital expenditures may be financed and costs of issuance are limited to two (2%) percent of the issuance amount, with any excess costs required to be paid from county funds on hand.

There are also legal and financial considerations related to any outstanding bonds that are payable from the same repayment source expected to be pledged to the BABs (other than a property

tax levy). There may be issues with existing covenants regarding debt service reserves and coverage required to issue additional parity bonds because it is unclear how the refund payments are taken into account for such tests.

Furthermore, the financial advisor needs to analyze expected tax-exempt interest rates against expected taxable interest rates, taking into account the thirty-five (35%) percent refund in order to determine if there is a financial benefit to issuing Direct-Pay BABs. All of these considerations must be evaluated on a case-by-case basis.

Tax Credit BABs

While a local governmental issuer may elect to issue BABs as Direct-Pay BABs, the issuer may also issue taxable, Tax Credit BABs ("Tax Credit BABs") for traditional governmental purposes. Tax Credit BABs provide the bond purchaser with a tax credit equal to thirty-five (35%) percent of the taxable interest earned, as opposed to the federal government making a refund payment to the issuer of the bonds. Presumably, if the bond purchaser receives a tax credit against the taxable interest they earn, the bond purchaser will bid a lower interest rate on the bonds.

While Tax Credit BABs do not cause the same issues with respect to outstanding bond covenants, the economics of Tax Credit BABs have traditionally been less favorable than Direct-Pay BABs. However, a county should still have their financial advisor compare the total cost (i.e. total interest costs, costs of issuance, etc.) of issuing a traditional tax-exempt bond issue, Direct-Pay BAB and Tax Credit BAB before making a decision regarding the type of bond to issue.

Recovery Zone Economic Development Bonds

The third type of BABs is a Recovery Zone Economic Development Bond (Recovery Zone Bond). Recovery Zone Bonds are bonds that may be issued for governmental purposes that promote development or other economic activity in a Recovery Zone (as hereinafter defined). As with Direct-Pay BABs and Tax Credit BABs, the local governmental issuer must pledge a traditional repayment source and follow existing statutory procedures for the issuance of Recovery Zone Bonds.

Like Direct-Pay BABs, Recovery Zone Bonds are "direct-pay" bonds in which the local governmental issuer receives a refund from the federal government. However, while Direct-Pay BABs refund 35% of the taxable interest paid, Recovery Zone Bonds refund forty-five (45%) percent of the interest paid on each interest payment date. There is no option for issuing Recovery Zone Bonds as tax credit bonds. Because Recovery Zone Bonds provide a larger refund

than Direct-Pay BABs, they are limited in amount. \$10 billion of Recovery Zone Bonds have been authorized nationwide, with such amount allocated to each state and then to each county and any large municipality (i.e. population \geq 100,000) based on job losses from 2007 to 2008. A county or large municipality may delegate the volume to another issuer in its jurisdiction or may waive its allocation to the State of Indiana, who may then reallocate the volume, at its discretion.

In order to take advantage of the Recovery Zone Bond volume allocated to it, a county or large municipality must designate a Recovery Zone. A Recovery Zone is defined as one or more areas in the county/large municipality that has significant poverty, unemployment, home-foreclosure rates or general distress; or any area for which a designation as an empowerment zone or renewal community is in effect.

OTHER BONDS UNDER THE STIMULUS ACT

While most counties are probably familiar with tax-exempt bonds issued to finance governmental purposes such as a courthouse, sewer system, jails or parks, they are likely less familiar with tax-exempt bonds issued for private business. Traditionally, tax-exempt bonds could only finance capital projects for private businesses if they fell into certain categories such as manufacturing facilities, solid waste disposal facilities or low income residential rental housing. Many counties have issued bonds for these types of projects over the years. The Stimulus Bill, however, lifted many of the restrictions on the types of private businesses that can benefit from tax-exempt bonds, essentially creating a new tool for local governments to use to spur economic development and job creation.

How Do Bonds for Private Companies Work?

Like traditional governmental tax-exempt bonds, bonds for private companies must be issued by the county or another governmental entity. The county then loans the proceeds of the bonds to the private company to fund the capital costs of the project. Only the company is obligated to repay the bonds, and the county's only obligation is to pass on payments made by the company. Essentially, the county gives a benefit to the company by "lending" the company its tax-exempt borrowing status. Importantly, issuing these bonds does not affect the county's capacity to borrow for its own needs.

Recovery Zone Facility Bonds

As discussed above, the Stimulus Act allows counties and large municipalities to create Recovery Zones and issue Recovery Zone Bonds to finance governmental projects in those areas. The Stimulus Bill also created a new category of bonds for financing

projects for private business located in Recovery Zones called Recovery Zone Facility Bonds ("RZ Facility Bonds"). Unlike traditional tax-exempt bonds for private entities, however, RZ Facility Bonds can be issued for most any private business. RZ Facility Bonds can be issued to construct, renovate or expand office buildings, retail facilities, parking garages, grocery stores, car dealerships, etc. in the Recovery Zone. While there are a few prohibited businesses (tanning bed facilities, health clubs, golf courses, liquor stores, residential rental property, etc.), most businesses will qualify for RZ Facility Bonds.

Only \$15 billion of RZ Facility Bonds were authorized nationwide, with that amount divided among the states and then suballocated to counties and large municipalities in the same manner as the Recovery Bond volume discussed above. This means that most every county (three Indiana counties had no 2007-2008 job loss and thus received no allocation) has some capacity to assist local businesses by providing them with tax-exempt financing. If a county or large municipality does not intend to use its allocation (or its allocation is too small for practical use), the county or municipality may waive its volume to the State of Indiana, who may then reallocate the volume to other projects in the state. If a business in a particular county is interested in financing a larger project than that county's allocation of RZ Facility Bonds, the company and the county may work together to request that the state reallocate a portion of the waived volume to the project. Like the other bonds created by the Stimulus Act, RZ Facility Bonds must be issued prior to December 31, 2010.

Qualified Energy Conservation Bonds

The final new category of bond created by the Stimulus Act is Energy Conservation Bonds ("Conservation Bonds"). Conservation Bonds are tax-credit bonds (much like the Tax-Credit BABs discussed above) and \$3.2 billion of Conservation Bonds are authorized nationwide. The Conservation Bond volume is allocated to states and suballocated to each county and municipality with more than 100,000 people. 70% of the allocation to any county or municipality must be used for governmental purpose bonds, and not more than 30% of the allocation may be used for private businesses. While the individual allocations are relatively small, these bonds offer another financing tool to combine with other available bonds.

Conservation Bonds may finance "qualified conservation purposes" which includes many conservation and renewable energy projects, such as capital expenditures for (a) reducing energy consumption in publicly owned buildings by at least 20%; (b) implementing green community programs; (c) production of electricity from renewable energy resources; (d) research facilities and research grants to

support certain research related reducing energy consumption or creating or improving certain fossil fuels; (e) mass commuting facilities and related facilities that reduce the consumption of energy; (f) demonstration projects designed to promote the commercialization of certain conservation technology; and (g) public education campaigns to promote energy efficiency. The projects that qualify for Conservation Bonds are varied and the details relating to qualification for financing are too extensive for a detailed discussion here. However, Conservation Bonds are an alternative to consider for any kind of energy conservation project (window or HVAC replacement, for example) that the county may be considering.

CONCLUSION

As described above, the Stimulus Act created several new tools for counties to utilize to finance their own governmental projects, as well as to encourage private investment, economic development and job creation. Many of these new programs are placed directly in the hands of the county to utilize and administer as it wishes. Consider how you might utilize these new tools to "STIMULATE" your county. •

Ice Miller LLP serves as general counsel to the Association of Indiana Counties. For more information on bond opportunities under the Stimulus Bill, please call Lisa at (317) 236-2268 or Denise at (317) 236-5803.

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