



# The Stimulus Act of 2009: Structures, Strategies and Opportunities

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## Bond-Related Provisions Contained in the American Recovery and Reinvestment Act of 2009 (the "Stimulus Act")

- Marketability Enhancements for Tax-Exempt Bonds
  - Bank-Qualified Eligible Bonds ("BQ Bonds")
  - Changes to Alternative Minimum Tax ("AMT")
- New Categories of Bonds
  - Recovery Zone Bonds:
    - Recovery Zone Economic Development Bonds ("RZEDs")
    - Recovery Zone Facility Bonds ("RZFBs")
  - Build America Bonds ("BABs")
  - Qualified School Construction Bonds ("QSCBs")
  - Tribal Economic Development Bonds

- Expanded Definition of “Manufacturing” for Small Issue Industrial Development Bonds (“IDBs”)
- Modified and Allocations Increased
  - Qualified Zone Academy Bonds (“QZABs”)
  - New Clean Renewable Energy Bonds (“New CREBs”)
  - Qualified Energy Conservation Bonds (“QECBs”)
- Application of Davis-Bacon Act of 1931 (Prevailing Wage Laws) to Certain Bonds

- Enhanced Marketability Provisions
- Build America Bonds and “Direct Pay” Option
  - Recovery Zone Economic Development Bonds
- Fundamentals of Qualified Tax Credit Bonds
- Qualified School Construction Bonds
- Qualified Zone Academy Bonds
- Other Tax Credit Bonds
  - New Clean Renewable Energy Bonds
  - Qualified Energy Conservation Bonds

- Changes in Alternative Minimum Income Tax ("AMT")
- Changes in Bank Qualified Eligible Obligations ("BQ Bonds")

### Pre-Stimulus Act

- Interest on governmental bonds, 501(c)(3) bonds and tax-exempt housing and mortgage bonds was exempt from AMT
- Interest on all other private activity bonds was not exempt from AMT
- Interest on all tax-exempt obligations, whether directly subject to AMT or not, was taken into account as current earnings for purposes of corporate AMT

AMT treatment of new money bonds under the Stimulus Act

- Interest on ALL new money tax-exempt obligations (governmental and private activity bonds) issued in 2009 and 2010 is exempt from AMT
- Interest on ALL new money tax-exempt obligations (governmental and private activity bonds) issued in 2009 and 2010 is NOT taken into account in calculating current earnings for the corporate AMT

AMT treatment of refunding bonds under the Stimulus Act

- General Rule - Refunding bonds issued in 2009 and 2010 are treated as issued on the date of issue of the refunded bonds
- Exception - Interest on governmental and private activity refunding bonds issued to refund bonds issued in 2004 - 2008 (regardless of whether the refunded bonds were themselves refunding bonds) will still be exempt from AMT and not in current earnings
- Exception - Governmental refunding bonds continue to be exempt from AMT regardless of when the refunded bonds were issued

## Special rule for financial institutions

- General Rule: Financial institutions cannot deduct the interest expense to purchase or carry tax-exempt obligations
- Exception: Financial institutions can deduct 80% of the carrying cost associated with purchase of BQ Bonds
- Goal: Lower tax-exempt interest rate

### Pre-Stimulus Act

- BQ Bonds were governmental or 501(c)(3) bonds issued by or on behalf of local governments that did not expect to issue more than \$10 million of such bonds in that calendar year
- BQ Bonds could not be sold in a pooled or composite issue with an aggregate face amount in excess of the \$10 million limit

### New BQ rules under Stimulus Act

- BQ limit is increased from \$10 million to \$30 million for each of 2009 and 2010
- Each 501(c)(3) entity is now treated as an issuer with its own limit
- Issues may be pooled – for example, a single issue of \$50 million might be done benefiting two borrowers for \$25 million each

## Key Points and Predictions on AMT and BQ Provisions

- Each 501(c)(3) entity having its own BQ limit is VERY IMPORTANT and likely to promote significant volume
- Municipal issuer (e.g. EDA/IDA) should evidence in bond documents that 501(c)(3) entity is using its own BQ limit
- Outstanding Non-BQ Bonds (including some taxable issues and loans) may be able to be refunded and become BQ bonds if within the issuer's \$30 million limit

## Build America Bonds ("BABs") – Tax Credit Option

- For issuers able to issue otherwise tax-exempt governmental bonds (not private activity bonds), the issuer, during 2009 and 2010, may elect to issue such bonds as taxable interest bonds and permit bondholders to receive a tax credit equal to 35% of the total coupon interest paid on each interest payment date
  - Capital projects and working capital included
- Rules similar to tax credit bonds under IRC § 54A apply except that credit is determined based upon amount of interest paid

BABs (continued)

- No national ceiling on the amount of Tax Credit BABs
- Cannot have more than a *de minimis* amount of premium over the stated principal amount of the obligation

### BABs – Direct Pay Option

- For capital project BABs issued during 2009 or 2010 (as opposed to financing working capital), issuers may, in lieu of the tax credit to bondholders, elect to receive a direct payment from the Federal government
- The amount of the payment is 35% of the amount of interest payable on the interest payment date
- Bondholder still receives taxable interest

### BABs – Direct Pay Option (continued)

- An interest payment date is any date on which interest is payable by the issuer under the terms of the bond
- There is NO limitation on the amount of Direct Pay BABs that may be issued
- 100% of available project proceeds ("APP") (net of any amounts placed in a reasonably required reserve fund) must be used for capital expenditures; 2% costs of issuance limitation
- Unless a state's laws are changed after 02/17/09, the taxable interest or credit for any Direct Pay BAB is to be treated as federally tax-exempt for purposes of such state's income tax laws

### IRS Notice 2009-2026 (April 3, 2009)

- Make “Direct Pay” BABs tangible and user-friendly

### New Issues of BABs

- Primarily large governmental and State-university systems
- Examples

### Emerging Issues

- Redemption Provisions – Do publicly-offered BABs need to be structured similar to “corporate bonds”?

### Emerging Issues (continued)

- Short-Term and Medium-Term Maturities – Do BABs make economic sense?
- Disclosure Issues
- Opinions
- Multi-Purpose Issues

## Recovery Zone Economic Development Bonds (“RZEDs”)

- RZEDs are a subset of “Direct Pay” BABs
- The amount of the refundable credit is 45% of the amount of interest payable on the interest payment date
- Must qualify as a BAB, plus meet the following:
  - 100% of APP (net of any amounts placed in a reasonably required reserve fund) must be used for qualified economic development purposes
- The issuer must irrevocably elect the refundable credit option

RZEDs (continued)

- Qualified purposes are described as “expenditures for purposes of promoting development or other economic activity in a recovery zone” and include capital expenditures paid or incurred with respect to property in the zone, expenditures for public infrastructure and construction of public facilities and expenditures for job training and educational programs
- A recovery zone is an area (i) designated by the issuer with significant poverty, unemployment, rate of home foreclosures or general distress, or as economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990, or (ii) with an effective designation as an empowerment zone (under IRC § 1391 (b)(2)) or renewal community (under IRC § 1400E (a)(1))

### RZEDs (continued)

- There is an allocation of \$10 billion to be apportioned among the states with each state receiving an amount of allocation determined according to a ratio of that state's 2008 employment losses to such losses for all states
- Each state is guaranteed to receive at least 0.9% of the total allocation
- Each state shall apportion the allocation within the state among counties and large municipalities according to a ratio of their employment losses versus the state's losses

## (IRC § 54A) QTCBs v. Tax-Exempt Bonds

- General similarities to tax-exempt bonds
  - The issuer, with exceptions, must be a state or local governmental body or authority
  - Expenditures of proceeds are subject to arbitrage-rebate limitations
  - Must file an informational report upon closing
  - Allocation, private business use, maturity and costs of issuance limitations
  - Tax credit may be stripped

## Significant differences

- Holder or investor receives a tax credit in lieu of tax-exempt interest and tax credit is includable in gross income
- Tax credits may be carried over

### Tax credit amount

- The credit is included in gross income and treated as interest
- The credit is an annual credit measured quarterly based on a formula that accounts for the credit rate and the outstanding amount of the obligation
- Reduced amount for New CREBs & QECCBs – 70% of tax credit amount
- Full amount (100%) for QSCBs & QZABs

### Tax credit rate

- The rate is established on the sale date (*i.e.*, a date that there is a binding written contract for the sale of the bond)
- The rate changes daily and is posted at:  
[http://www.treasurydirect.gov/govt/rates/rates\\_irstcb.htm](http://www.treasurydirect.gov/govt/rates/rates_irstcb.htm)
- Per Notice 2009-15 (effective January 22, 2009), the credit rate is based off Treasury's estimate of the yields on outstanding bonds from market sectors selected by Treasury with a rating of between A & BBB for bonds of a similar maturity; previously, the benchmark was a corporate note rated AA

### Maturity of QTCBs

- Treasury publishes maximum permitted maturity monthly and is posted at the web address above
- The maturity is based on a present value calculation in which the discount rate is 110% of the long-term adjusted applicable federal rate compounded semiannually

### Recent Data

- June's permitted sinking fund yield and maximum maturity: 4.66% and 16 years
- For June 3, the tax credit rate was 7.88%

### Rules regarding proceeds for QTCBs

- Available project proceeds (“APP”) = sale proceeds less financed costs of issuance (not to exceed 2%) plus earnings thereon (also applies to direct payment bonds)
- Issuance date expectations test for expenditures
  - 100% of APP by third anniversary
  - 10% of APP by six months
- Actual test for expenditures
  - Expenditure period: three years
  - Period may be extended by Treasury
  - Test: 100% of APP spent by end of period
  - Failure to satisfy: redemption of nonqualified bonds within 90 days

## Rules regarding proceeds for QTCBs (continued)

### → Reimbursement

- Timing of allocation affects eligibility of reimbursable costs: costs must arise after allocation
- Reimbursement is no later than 18 months after original expenditure

### → Arbitrage and Rebate

- IRC § 148 restrictions apply
- Exception for investment of APP during expenditure period if spent on qualified purposes
- Exception for reserve fund

- Reserve fund exception for QTCBs
  - Not a traditional security reserve
  - Expectation of use to repay bonds
  - Funded no more than in equal annual installments
  - No more than needed to repay
  - Fund is yield restricted to semi-annual long-term adjusted AFR (*i.e.*, discount rate for maximum permitted term)
- Stripping of credits
  - Applies to all QTCBs, including BABs
  - Credit may be separated from bond
  - Tax-exempt bond stripping rules (IRC § 1286) apply
  - Regulations are to be provided

- Carryover of unused credits
  - Applies to all QTCBs, including BABs
  - No Time Limitation
- Some differences between BABs and QTCBs
  - BABs are not subject to the same tax credit rate pricing and maturity mechanics as QTCBs, and have NO allocation limitations
  - BABs are not subject to APP unless the direct pay option is elected
  - BABs must be eligible to be governmental tax-exempt bonds but for the credit

## Qualified School Construction Bonds (“QSCBs”)

- 100% of APP to be used for the construction, rehabilitation, or repair of public school facilities or for the acquisition of land on which a public school facility will be constructed with a portion of the QSCBs
- Issued by a state or local government within the jurisdiction of which the project is located
- Eligible costs must relate to issuer and allocating entity’s jurisdiction
- May allow significant non-governmental involvement

### QSCB allocation

- \$11 billion in each of 2009 and 2010
- Unused allocation may be carried over, and there is no limit on the years to which it may be carried over
- U.S. Treasury will allocate 60% to the states based upon the federal appropriations a state is eligible to receive under the Elementary and Secondary Education Act of 1965 for the fiscal year prior to the calendar year of allocation
- 40% of the total allocation for large local education agencies ("LLEA"), using the same allocation methodology for states
- Allocations to states and LLEAs made by Notice 2009-35
- 2009 Allocations to LLEAs may not be carried over unless they revert to states

### QSCB allocation (continued)

- Virginia to receive approximately \$191 million in allocation
- Governor's Office has announced that it is reviewing Literary Loan 1<sup>st</sup> Priority Waiting List projects to determine eligibility – current list includes over \$191 million of approved projects

## QZABs

- Subject to QTCB rules, including APP and reserve fund exception
- Certain old QZAB rules still apply
  - Private contribution requirement
  - Definition of “qualified zone academy”
  - Restrictions on use of funds for repairs & rehab, teacher training, course material & development of course material

## Allocation

- \$400m for 2008 and \$1.4b for each of 2009 & 2010
- Notice 2009-30 (IRB 2009-16) provides 2008 & 2009 state allocations
- Allocation administered by states
- New rules apply to all bonds issued after October 3, 2008, including bonds using 2007 allocation
- Carryover of unused allocation to two calendar years following year in which excess arose (includes carryover of eligible, old QZAB allocations)

### New CREBs Eligibility

- Qualified facilities: all IRC § 45(d) facilities without regard to placed in service dates, *e.g.*, wind, solar, geothermal, closed & open loop biomass, landfill gas, trash combustion, marine & hydrokinetic, BUT NOT Indian coal or refined coal, plus functionally related & subordinate facilities
- Qualified borrowers: governmental & tribal bodies, mutual & cooperative electric companies & public power providers (“PPPs”)
  - PPPs are state utilities providing electric services
- Qualified issuers: qualified borrowers, a “CREB lender” (*e.g.*, Co-Bank & CFC) & a not-for-profit electric utility which has received a loan or loan guarantee under the Rural Electrification Act
- Bonds must be issued within three years of allocation award date

## Allocation

- Notice 2009-33 contains the application requirements
- Deadline for application submission is August 4, 2009
- \$2.4b to be split in thirds among co-ops, governmental bodies & PPPs
- Eligible PPP projects require pro-rata awards, & allocation for co-ops & governmental bodies is subject to smallest-to-largest allocation methodology

## QECCBs Eligibility

- Projects are qualified conservation purposes (“QCPs”) & governmental issues may include working capital items
  - 100% spent on QCPs
  - QCP costs must relate to QCPs “...that are located within or attributable...” to the issuer and allocating entity’s jurisdiction
- Issuers are tax-exempt bond issuers (*e.g.*, state & local governmental entities)
- Borrowers include non-governmental entities subject to limitations
- If QECCB is a private activity bond, a QCP does not include any non-capital expenditures

## QCPs

- Capital expenditures for:
  - Reducing energy consumption in publicly-owned buildings by at least 20%
  - Implementing green community programs
  - Rural development involving production of electricity from renewable energy resources
  - New CREBs projects

## QCPs (continued)

- Expenditures for research facilities & research grants to support research in:
  - Cellulosic ethanol & non-fossil fuel development
  - Technologies for the capture & sequestration of carbon dioxide produced through the use of fossil fuels
  - Increasing in efficiency of existing technologies for producing non-fossil fuels
  - Automobile battery technologies & other technologies to reduce fossil fuel consumption in transportation
  - Technologies to reduce energy use in buildings

## QCPs (continued)

- Mass community facilities to reduce energy consumption
- Demonstration projects including commercialization of green building technology, agricultural biofuel conversion, advanced battery manufacturing technologies, technologies to reduce peak use of electricity or technologies for the capture & sequestration of carbon dioxide emitted from combusting fossil fuels to produce electricity
- Public education campaigns to provide energy efficiency

## Allocation

- \$3.2b allocated among states by population and suballocated to large local governments (“LLG”) based upon pro-rata amount of state allocation, per IRS Notice 2009-29 (IRB 2009-16, dated April 20, 2009)
  - LLG –  $\geq$  100,000 residents
  - Indian tribes are treated as LLGs
- Not more than 30% of allocation to a state or LLG can be designated for QECCBs that are private activity bonds

- Questions?
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