

# PUBLIC FINANCE LAW UPDATE

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

## **Moving the Goalposts: Tennessee Changes the Recovery Zone Allocation Process**

**February 18, 2010**

In an executive order signed on February 5, 2010, Governor Bredesen directed the Department of Economic and Community Development (ECD) to move the date on which counties and large municipalities (defined as cities with populations greater than 100,000) will be deemed to have waived direct allocations of Recovery Zone volume cap from May 1, 2010 to March 10, 2010, and clarified that all counties and large municipalities must file an application with ECD in order to use their direct allocations.

*Background.* The American Recovery and Reinvestment Act of 2009 (aka, the Stimulus Act) created two new types of municipal bonds—recovery zone economic development bonds (RZEDBs) and recovery zone facility bonds (RZFBs)—designed to spur spending in economically-burdened areas. The requirements relating to RZEDBs and RZFBs are complex, but the basics are as follows:

-- The proceeds of both RZEDBs and RZFBs may only be spent in “recovery zones” designated by the county or large municipality as areas “having significant poverty, unemployment, rate of home foreclosures or general distress.” The IRS announced that a county or large municipality may make the determination of a recovery zone” in any reasonable manner as it shall determine in good faith in its discretion,” thereby signaling that it will give great deference to the county or large municipality’s designation.

-- RZEDBs are taxable governmental bonds that are potentially attractive to issuers because the U.S. Treasury makes subsidy payments to the issuer in amounts equal to 45 percent of the interest due on each interest payment date. (RZEDBs are very similar to “build America bonds,” which were also created by the Stimulus Act and carry subsidy payments equal to 35 percent of the interest due on each interest payment date.) RZEDBs may only be issued to finance new money capital expenditures in a designated recovery zone and must meet all of the requirements that apply to traditional tax-exempt bonds, such as restrictions on private use and payment,

arbitrage yield restriction and rebate. The federal Davis-Bacon “prevailing wage” requirements apply to RZEDBs, potentially increasing the project costs.

-- RZFBs are a new type of tax-exempt, exempt facility bonds, similar to other exempt facility bonds such as qualified small issue bonds (formerly referred to as “industrial development bonds” or “IDBs”) and low-or-moderate income multifamily housing bonds. The proceeds of RZFBs must be used to finance capital improvements for a business located in a designated recovery zone. RZEDBs will generally be issued by an industrial development board, which will loan the proceeds of the RZFBs to a for-profit business.

Nationwide, issuance of RZEDBs is capped at \$10 billion, and RZFBs at \$15 billion. The Stimulus Act provided for mandatory direct allocations of this cap to all counties and large municipalities in the U.S., based on 2008 employment declines. The direct allocation amounts made to Tennessee counties and large municipalities [are listed here](#) (click on “TN”).

Under the Stimulus Act, a Tennessee county or large municipality may:

- use its direct allocation to issue RZEDBs and RZFBs,
- sub-allocate its direct allocation to other issuers to finance projects located within the county or large municipality, or
- waive its allocation, in which case ECD will re-allocate such amount to other issuers to finance projects located in the state of Tennessee.

*Original ECD Plan.* On September 25, 2009, ECD announced its plan for re-allocating recovery zone bond allocations that are waived by counties and large municipalities. In addition to setting out the procedure for obtaining such reallocations, the ECD Plan provided that any direct allocation made to a county or large municipality that is not used by May 1, 2010, will be deemed to have been waived and will be re-allocated by ECD in accordance with the allocation plan. ([Click here for a link to the ECD allocation plan.](#))

*ECD Plan as Modified by Executive Order.* The February 5, 2010 executive order directed ECD to conduct a survey of counties and large municipalities on their plans to use direct allocations and provided that the failure of a county or large municipality to respond to the survey would be deemed a waiver of its Recovery Zone bond allocations, thereby permitting ECD to re-allocate it to other counties or municipalities. Also, under the February 5, 2010 executive order, a county or large municipality that receives a direct allocation of Recovery Zone volume cap must nevertheless file an application with the ECD by March 10, 2010 or it will be deemed to have waived the allocation. Although the application attached to the ECD allocation plan generally works for RZFBs,

several provisions are problematical for RZEDBs, including the official intent date, which is not required for RZEDBs, and the financial commitment letter, which is not feasible for most RZEDBs because they must be competitively bid. Issuers of RZEDBs might consider adding a note to their applications explaining the absence of any required items.

To summarize, any county or large municipality that desires to utilize its direct allocation of RZEDB or RZFB volume cap should respond to ECD's survey and file an allocation with ECD by March 10, 2010.

Please call any of the Bass, Berry & Sims PLC bond lawyers listed below to discuss your questions about RZEDBs and RZFBs.

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