

# Stimulating Municipal Bonds in Tennessee—

## *Recent Federal Tax Law Developments Affecting Municipal Bonds*

July 16, 2009

# American Recovery and Reinvestment Tax Act of 2009

- creates a new type of taxable, municipal bonds – Build America Bonds
- dramatically expands tax credit bonds, including qualified school construction bonds
- provides financing incentives for economically distressed recovery zones
- enhances the marketability of all types of tax-exempt bonds

# Build America Bonds

Two types of BAB's:

➤ Tax Credit BABs

- Bondholder receives taxable interest and a tax credit equal to 35% of each interest payment

➤ Direct Payment BABs

- Bondholder does not receive tax credits
- U.S. Treasury makes a direct payment to the issuer on each interest payment date equal to 35% of interest on bonds

# Build America Bonds

Common features of both types of BABs:

- Interest is taxable
- Must meet all requirements that apply to tax-exempt bonds
- Must be issued before 2011
- May not be sold with more than *de minimis* original issue premium

# Build America Bonds

## Additional Restrictions Applicable to Direct Payment BABs:

- May be used only to finance new money capital expenditures (i.e., no refunding or working capital)
- Subject to 2% cost of issuance limitation

# Build America Bonds

## Considerations in Issuing Direct Payment BABs:

- Determination of savings over traditional tax-exempt bonds
- Acceptable call provisions
- Risk of change of law
- Risk of IRS compliance procedures
- Administrative burden associated with obtaining direct payment of subsidy

# Tax Credit Bonds

An alternative financing method designed to provide issuers with zero or extremely low cost financing for certain targeted assets or programs

# Tax Credit Bonds

## Basics:

- Zero coupon
- Instead of interest, bondholder receives a stream of tax credits equal to a percentage specified by the IRS on the original sale date, multiplied by principal amount of bond
- Maximum maturity is also specified by IRS when bonds on the original sale date
- Issuer may invest proceeds for three years without regard to yield restriction or rebate but must spend earnings on project
- Issuer allowed to create a sinking fund and invest at a yield specified by IRS on the original sale date
- Subject to 2% cost of issuance limitation
- Federal Davis-Bacon prevailing wage regulations apply

# Tax Credit Bonds

## IRS terms for tax credit bonds sold on July 14, 2009

- Credit rate – 6.96%
- Maximum term – 15 years
- Sinking fund investment limitation – 4.71%

see <https://www.treasurydirect.gov/sz/SPESRates?type=QTCB> for daily information

# Tax Credit Bonds

## Types:

- New Clean Renewable Energy Bonds (New CREBs)
  - broad range of “green” generation facilities
- Qualified Energy Conservation Bonds (QECCBs)
  - broad range of “green” expenditures, including conservation facilities
- Qualified Zone Academy Bonds (QZABs)
  - renovation, equipping and training teachers at qualified schools
- Qualified School Construction Bonds (QSCBs)

# Tax Credit Bonds

## QSCBs

- May finance construction, rehabilitation or repairing public schools and acquisition of land for public schools
- Federal Davis-Bacon prevailing wage regulations apply
- Must have an allocation of QSCB volume cap:
  - \$11.0 billion nationwide in each of 2009 and 2010
  - \$184,606,000 allocated to Tennessee in 2009 (including direct allocations to Memphis and Metro Nashville)
  - Tennessee State School Bond Authority will be the sole issuer of QSCBs in Tennessee and will determine the local governments that will participate in state pool issue and the level of participation

# Recovery Zone Bonds

Two types of bonds, both of which are intended to spur development in “recovery zones”

“Recovery Zone” =

- Area designated by the issuer as having significant poverty, unemployment, rate of home foreclosures or general distress, or
- Area designated by issuer as distressed by reason of a military base closure, or
- Area for which a designation as an empowerment zone or renewal community is in effect

# Recovery Zone Bonds

## Recovery Zone economic development bonds

- Type of direct payment BABs that may only be issued in 2009 and 2010
- Issuer receives a subsidy payment of 45% of interest instead of 35%
- Proceeds must be used for a “qualified economic purpose” in a recovery zone, including:
  - Capital expenditures with respect to property in the zone or
  - Expenditures for public infrastructures and construction of public facilities or
  - Expenditures for job training and educational programs
- Federal Davis-Bacon prevailing wage regulations apply

# Recovery Zone Bonds

## Recovery Zone economic development bonds (continued):

- Must have a volume cap allocation
  - \$10.0 billion nationwide
  - \$231,417,000 allocated to Tennessee based on employment decline 2007-2008
  - IRS reallocated Tennessee allocation among large municipalities (i.e. >100,000) and all counties
  - See <http://www.irs.gov/taxexemptbond/index.html> for the specific allocation to each Tennessee large municipality and county
  - Counties may reallocate to other issuers within county

# Recovery Zone Economic Development Bonds

## Sample allocations

City of Knoxville	\$ 6,693,000
Metro/Davidson County	\$21,090,000
Anderson County	\$ 2,545,000
Blount County	\$ 4,476,000
Coffee County	\$ 1,579,000
Hamblen County	\$ 1,874,000
Hawkins County	\$ 266,000
Jefferson County	\$ 1,505,000
Knox County	\$ 9,747,000
Lincoln County	\$ 1,313,000
Madison County	\$ 4,091,000
Rutherford County	\$ 8,479,000
Sevier County	\$ 1,549,000
Williamson County	\$ 5,729,000

# Recovery Zone Bonds

## Recovery Zone Facility Bonds

- New type of tax-exempt private activity bond to support businesses in areas suffering from economic distress
- May be issued only in 2009 and 2010
- 95% of proceeds must be spent on depreciable assets located in an issuer-designated recovery and used by any business other than rental of residential property
- May not finance a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other gambling facility or store for sale of off-premises alcohol

# Recovery Zone Bonds

## Recovery Zone Facility Bonds (continued)

- Must have a volume cap allocation
  - \$15.0 billion nationwide
  - \$347,126,000 allocated to Tennessee based on employment decline 2007-2008
  - IRS reallocated Tennessee allocation among large municipalities (i.e. > 100,000) and all counties
  - See <http://www.irs.gov/taxexemptbond/index.html> for the specific allocation to each Tennessee large municipality and county
  - Counties may reallocate to beneficiaries

# Recovery Zone Facility Bonds

## Sample allocations

City of Knoxville	\$10,039,000
Metro/Davidson County	\$31,634,000
Anderson County	\$ 3,818,000
Blount County	\$ 6,714,000
Coffee County	\$ 2,368,000
Hamblen County	\$ 2,811,000
Hawkins County	\$ 399,000
Jefferson County	\$ 2,257,000
Knox County	\$14,620,000
Lincoln County	\$ 1,969,000
Madison County	\$ 6,137,000
Rutherford County	\$12,718,000
Sevier County	\$ 2,324,000
Williamson County	\$ 8,594,000

# Changes Affecting the Marketability of Tax-Exempt Bonds

## Bank Qualified Bonds

- Increase in qualified small issuer limit from \$10.0 million to \$30.0 million
- 501(c)(3) organizations treated as “issuers”
- Relaxation of pool and composite issue limits
- 2% *de minimis* exception

# Changes Affecting the Marketability of Tax-Exempt Bonds

## Alternative Minimum Tax Changes

- Suspends applicability of both individual and corporate AMT to:
  - all new money bonds issued in 2009 and 2010
  - bonds issued in 2009 and 2010 to refund bonds issued between 2004 and 2008
- Primarily benefits exempt facility bonds (i.e., airport bonds) and qualified small issue bonds because governmental bonds and 501(c)(3) bonds are not subject to individual A.M.T.

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