

# Public Finance Tax Advisory: \$25 Billion Recovery Zone Bond Program Implemented

6/15/2009

## Allocations Of Volume Cap Published

On June 12th, 2009, the U.S. Treasury and the IRS released Notice 2009-50, which contains interim guidance on taxable recovery zone economic development bonds (RZEDBs) (\$10 billion national limit) and tax-exempt recovery zone facility bonds (RZFBs) (\$15 billion national limit). RZEDBs are supercharged Build America Bonds (because the direct pay subsidy from the Treasury to the issuer is 45% of interest payable) issued to finance certain eligible costs, and RZFBs are exempt facility bonds which may be issued to finance certain eligible costs of active private businesses (excluding residential rental properties and certain banned facilities). Projects financed with RZEDBs or RZFBs must generally be located within a designated Zone. We expect this program to be highly successful, due to the deep subsidy for RZEDBs and the availability of RZFBs to private business for economic development, once Zones are designated and projects are selected for financing.

Notice 2009-50 provides volume cap allocations for each type of bond by county (and its equivalent) and large city (population more than 100,000), based on relative employment declines in 2008. Recipient counties and cities within each state received volume cap allocations of no less than \$90 million for RZEDBs and \$135 million for RZFBs (with possessions being treated as states for purposes of the allocations), with flexibility to reallocate in a reasonable manner, as discussed below. The 94 pages of allocations by recipient counties (or equivalent) and cities by state are posted at <http://www.irs.gov/pub/irs-tege/rzbllocalreallocations.pdf>. The allocations for possessions can be found in the Notice at <http://www.irs.gov/pub/irs-drop/n-09-50.pdf>.

## Zone Designations To Be Made by Original Volume Cap Recipients

The Notice further provides that Zones can be designated by the recipient receiving the allocation in its good faith discretion, so long as they meet the criteria of having significant poverty, unemployment, rate of home foreclosures, general distress or economic distress by reason of military base closure pursuant to the Defense Base Closure and Realignment Act of 1990, or are currently designated enterprise zone or renewal community areas. It is important to stress that recipients with an allocated volume cap are in full control of Zone designations. Based on the broad discretion given recipients, a good faith adoption of a resolution designating the boundaries of the Zone by reason of one or more of the necessary factors should suffice to create a Zone.

## Eligible Bond Issuers

The Notice generally provides volume cap recipients, including those receiving reallocations (discussed below), the choice of either (i) issuing bonds themselves, if they have the ability, or (ii) the alternative of utilizing other eligible issuers with jurisdiction over the designated Zone(s) to issue bonds on their behalf.

## Reallocations of Volume Cap by Original Recipients

Volume cap recipients are further permitted to reallocate their volume cap to conduit borrowers, or other ultimate beneficiaries within their jurisdiction, in any reasonable manner as determined in their good faith discretion for eligible costs. For those recipients intending to reallocate their volume cap, allocations may be made either (i) on a completely discretionary basis or (ii) on the basis of their published guidelines, which could specify selected criteria such as the amount of expected job creation or type of industry. To prevent wasted, and promote timely, use of volume cap, volume cap recipients can voluntarily waive or be “deemed” to waive their allocations. Waived allocations can be reallocated by the state. Under the Notice, states may also make Zone designations and allocate waived or deemed waived volume cap that they may receive from the waiving recipients within their jurisdiction. The Notice does not provide any guidance regarding how a “deemed” waiver can put into effect. Presumably, a state may establish guidelines for all volume cap recipients within its jurisdiction to ensure that allocated volume cap is used or reallocated on a timely basis within a reasonable period prior to the expiration of the program for the benefit of all citizens of the state.

## Eligible Costs

RZEDBs generally can be used for any governmental expenditures “for purposes of promoting development or other economic activity in a recovery zone, including (1) capital expenditures paid or incurred with respect to property in the recovery zone, (2) expenditures for public infrastructure and construction of public facilities, and (3) expenditures for job training and educational programs.” 100% of bond proceeds, inclusive of investment earnings but excluding proceeds funding a reasonably required reserve fund and costs of issuance of the bonds (capped at 2% of proceeds), must be used for these eligible expenditures. Federal Davis Bacon prevailing wage rules apply and private activity bonds cannot be RZEDBs.

RZFBs generally can be used to benefit active private businesses (excluding residential rental properties and certain banned facilities, such as race tracks) in the Zone, so long as 95% of the net proceeds are used for depreciable property acquired, constructed or substantially rehabilitated, with an original use commencing in the Zone with the borrower on a date after Zone designation, meaning that almost any capital asset, except for land, should qualify as an eligible cost. No more than 2% of proceeds may be used for costs of issuance. There are no limitations on the amount of capital expenditures a beneficiary can have, and the used property limitations applicable to exempt facility bonds generally do not apply. RZFBs are more desirable

than tax-exempt small issue bonds, except for the requirement of a Zone location, and there is no Federal Davis Bacon requirement.

RZEDBs and RZFBs must be issued before January 1, 2011, and are not subject to AMT.

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