

GUIDANCE AND ALLOCATIONS RELEASED FOR ARRA RECOVERY BONDS

Introduction

As you know, the American Recovery and Reinvestment Act of 2009 ("ARRA") enacted February 17, 2009, included several provisions related to public finance. Previous updates regarding these provisions can be found on our [website](#) and an updated matrix which compares all of these provisions can be found [here](#).

On June 12, 2009, the Internal Revenue Service (IRS) issued guidance and allocated volume cap to counties and large municipalities (population over 100,000) in connection with two new types of bonds authorized and created by ARRA:

- Recovery Zone Economic Development Bonds ("RZEDBs"); and
- Recovery Zone Facility Bonds ("RZFBs").

In general, RZEDBs and RZFBs (collectively, the "Recovery Bonds") provide lower borrowing costs for municipalities to promote job creation and economic recovery that is targeted to areas particularly affected by employment declines.

Provisions Applicable To All Recovery Bonds

Allocation

Attached is a [list of Wisconsin counties and large municipalities](#) showing the amount of volume cap of RZEDBs and RZFBs the IRS allocated to each entity. The volume cap represents the maximum amount of each type of Recovery Bond that can be issued or reallocated by each county or large municipality on the list.¹ Both types of Recovery Bonds must be issued before January 1, 2011.

¹ The IRS made allocations based on the proportion that each county's or large municipality's 2008 employment decline bears to the aggregate of the 2008 employment decline for all counties and large municipalities in Wisconsin. Therefore, counties with proportionately lower employment declines received no allocation or smaller allocation than counties with proportionately higher employment declines.

CHICAGO
300 N. LaSalle Street
Suite 4000
Chicago, IL 60654
phone: (312) 715-5000
fax: (312) 715-5155

MADISON
33 East Main Street
Suite 900
Madison, WI 53703-3095
phone: (608) 251-5000
fax: (608) 251-9166

MILWAUKEE
411 East Wisconsin Avenue
Suite 2040
Milwaukee, WI 53202-4497
phone: (414) 277-5000
fax: (414) 271-3552

NAPLES
1395 Panther Lane
Suite 300
Naples, FL 34109-7874
phone: (239) 262-5959
fax: (239) 434-4999

PHOENIX
One Renaissance Square
Two North Central Avenue
Phoenix, AZ 85004-2391
phone: (602) 229-5200
fax: (602) 229-5690

TUCSON
One South Church Avenue
Suite 1700
Tucson, AZ 85701-1621
phone: (520) 770-8700
fax: (520) 623-2418

www.quarles.com

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Counties and large municipalities that received an allocation may use such volume cap themselves by issuing Recovery Bonds for eligible projects or may allocate such volume cap received to other eligible issuers (states and political subdivisions empowered to issue bonds) in any reasonable manner at their discretion in good faith for eligible projects. For example, a county that received a volume cap allocation may issue Recovery Bonds and designate them as either RZEDBs or RZFBs or a county may reallocate its volume cap to another eligible issuer who may issue RZEDBs or RZFBs. In either case, the proceeds of the issue must be used to finance eligible projects that are located within or attributable to both the jurisdiction of the issuer of the Recovery Bonds and the jurisdiction of the county or large municipality authorized to allocate volume cap.

Any county or large municipality that receives an allocation of volume cap can waive its allocation. All waived allocations will revert to the State to be reallocated in any reasonable manner at the State's discretion in good faith.

Recovery Zones

One provision common to each type of Recovery Bonds is that the projects financed must be within "recovery zones." The term "recovery zone" means:

- any area having significant poverty, unemployment, rate of home foreclosures or general distress;
- any area that is economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990; and
- any area for which a designation as an empowerment zone or renewal community is in effect as of February 17, 2009.

Eligible issuers can designate recovery zones based on the above specified criteria in any reasonable manner as they shall determine in good faith in their discretion.

State Law

Any and all State laws that apply to borrowing for counties or other municipalities must be followed, in addition to the federal rules established for Recovery Bonds.

Recovery Zone Economic Development Bonds (RZEDBs)

Build America Bond (Direct Payment) Status

RZEDBs are taxable bonds that are a form of Build America Bonds (Direct Payment). However, the subsidy from the federal government is greater with RZEDBs than other Build America Bonds (Direct Payment). With RZEDBs, the eligible issuer will qualify for a refundable credit in an amount equal to 45% of the total interest payable to bondholders. To qualify for the 45% refundable credit, the RZEDBs must satisfy the following conditions of Build America Bonds:

- RZEDBs cannot be "private activity bonds;"
- interest on the RZEDBs would (but for Build America Bond status) be excludable from the gross income of bondholders;
- the issue price of the RZEDBs cannot have more than a *de minimis* amount of premium over the stated principal amount of the bond;
- eligible issuers make an irrevocable election to designate the RZEDBs as Build America Bonds (Direct Payment); and
- issuance costs payable from proceeds of the RZEDBs are limited to 2% of the proceeds of the RZEDBs.

Permitted Purposes

Proceeds of RZEDBs must be used for one or more "qualified economic development purposes." Qualified economic development purpose means any expenditures for purposes of promoting development or other economic development in a recovery zone including:

- capital expenditures paid or incurred to property located in the recovery zone;
- expenditures for public infrastructure and construction of public facilities; and
- expenditures for job training and education programs.

This broad definition of qualified economic development purpose includes capital expenditures and working capital expenditures to promote development or other economic activity in a recovery zone.

The traditional tax-exempt reimbursement rules apply to RZEDBs and only "temporary short-term financings" issued after February 17, 2009 to finance otherwise qualified expenditures can be refunded.

Recovery Zone Facility Bonds (RZFBs)

Exempt Facility Bonds — Qualified Private Activity Bonds

RZFBs are a type of tax-exempt "exempt facility bond." They are qualified private activity bonds, and so can be issued to finance projects that are owned or used by private businesses.

Permitted Purposes

Proceeds of RZFBs must be used for "recovery zone property." Recovery zone property means any property to which Section 168 of the Internal Revenue Code, as amended (the "Code") applies (relating to the accelerated cost recovery system) or would apply but for Section 179 of the Code (relating to electing to expense certain depreciable business assets) if:

- such property was constructed, reconstructed, renovated, or acquired by purchase by the taxpayer after the effective date on which the county or large municipality designated the recovery zone;
- the original use of which in the recovery zone commences with the taxpayer; and
- substantially all of the use of the property is in the recovery zone and is in the active conduct of a "qualified business" (defined below) by the taxpayer in the recovery zone.

Property owned by any state or local government that is not subject to federal income taxation can be recovery zone property, provided that such property otherwise meets the above requirements.

Qualified business is defined as any trade or business that is not in the business of renting residential property and is not a trade or business consisting of the operation of a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

While most of the rules regarding exempt facility bonds will apply to RZFBs (e.g. public hearing must be held), the private activity volume cap rules and limitations on acquisition of existing property do not.

Next Steps

Counties and large municipalities which receive an allocation may want to consider which areas to designate as recovery zones. ARRA and the IRS have given broad discretion to the governing bodies to make these determinations based on the criteria cited above.

A review of plans for capital projects in the next few years may be in order to determine if any projects will qualify to be financed with Recovery Bonds.

Finally, counties and large municipalities may want to consider or adopt procedures (informal or formal) for sharing allocations received with other municipalities within their jurisdiction or other non-governmental entities. In the case of RZFBs, non-governmental entities may approach those receiving an allocation with requests to issue bonds for qualified projects.

Please contact any of the Quarles & Brady LLP Public Finance lawyers if you have questions about Recovery Bonds.