The Basics of Tax-Exempt Bond Financing

Presented by:
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1. Types of Bonds
2. Structural Options
3. Approval Process
4. Federal Tax Law Considerations
5. Securities Law Considerations
Tax-Exempt Bonds

- Obligations of state and political subdivisions the interest on which is exempt from federal income taxation
- Exemption from state income tax usually exempted on bonds issued in state of the issuer
Types of Bonds

• Governmental Bonds

• Private Activity Bonds

• Tax Increment/Special Assessment Bonds
Governmental Bonds

- Schools, courthouses, government office buildings, libraries, water and sewer systems, etc.
- Use and Payment Restrictions
The 10 Percent Test

- 90% ≥ of proceeds used for gov’tal purposes or
- 90% ≥ of debt service is from general tax revenues
- If > 10% of the proceeds are used for private business purposes and > 10% of the debt service comes from private sources, the bonds are private activity bonds
Private Activity Bonds

- Exempt Facility Bonds
- Qualified Small Issue Bonds
- Qualified 501(c)(3) Bonds
Exempt Facility Bonds

- Airports
- Docks and Wharves
- Sewage Facilities
- Solid Waste Disposal Facilities
- Facilities for the Furnishing of Water
Qualified Small Issue Bonds

- Manufacturing Facility Bonds
  - Definition of “Manufacturing Facility”
- Size Limitations
  - $1 million
  - $10 million election
  - $40 million limit
Qualified 501(c)(3) Bonds

• Hospitals
• Health Care Facilities
  – Retirement Facilities/Assisted Living Facilities
• Educational Institutions
  – Primary, Secondary, Higher Education
Structural Options

- Fixed Rate Bonds
- Variable Rate Bonds
- Credit and Liquidity Enhancement
- Collateral Options
- Derivatives
Fixed Rate Bonds

- Term Bonds (bullet maturity)
- Serial Bonds
- Redemption Features
  - Optional and Mandatory Redemptions
Variable Rate Bonds

- Daily
- Weekly
- Monthly
- Semi-Annual
Credit and Liquidity Enhancement

• Credit Enhancement
  – Letter of Credit
  – Bond Insurance

• Liquidity Enhancement
  – Standby Bond Purchase Agreement
Other Collateral Options

• Real Estate Mortgage/Deed of Trust
• Covenants – Tax and Credit Driven
• Revenue Pledges
• Debt Service Coverage Requirements
• Debt Service Reserve Fund
Approval Process

- Application
- Inducement Resolution
- Notice of Public Hearing
- Public Hearing
- Bond Resolution
- Approval of Applicable Elected Representative
- Other Approvals (e.g., volume cap allocation)
Inducement Resolution

- Reimbursement Resolution
- Issuer or 501(c)(3) Borrower
- 60 day window
Public Hearing

• TEFRA Hearing
• 14 day notice requirement
• Description of project, location, amount of bonds, borrower, etc.
Bond Resolution

• Approves terms of the transaction
• Authorizes execution of bond documents
Approval of Elected Representative

- TEFRA Approval
- Valid for one year
Other Approvals

• Volume Cap
• State Environmental Requirements
Federal Tax Law Considerations

- Reimbursement Regulations
- Arbitrage
- Restrictions on Use of Proceeds
- Maturity Limitations
- Depreciation
Reimbursement Regulations

- 60 Day “Look Back”
- Preliminary Expenditure Exception
Arbitrage

- Limits the yield earned on bond proceeds
  - Not greater than yield on bonds
- Rebate requirement
  - Excess earnings paid to Government
- Exceptions
Use of Proceeds

- 5% “Bad Money”
- 2% Issuance Costs
- 15% Rehabilitation Expenditures Requirement
- 25% Limitation on the Acquisition of Land
Maturity Limitations

Average Maturity of Bonds

≤

120% of Average Reasonable Expected Life of Financed Facilities
Depreciation

- Straight line depreciation
Securities Law Considerations

- Exemption from Registration
- Anti-Fraud Rules
- Continuing Disclosure
Exemption from Registration

• Securities Act of 1933
  – Exempts “any security issued or guaranteed by the United States, or by any political subdivision of a state”

• Blue Sky Laws
  – No registration required
  – Notice filing and fee
Anti-Fraud Rules

- Rule 10b-5
- Offering Document
Continuing Disclosure

- Rule 15c2-12
- Annual Financial Information
- Material Event Reporting
Follow-Up Questions

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