

AMERICAN RECOVERY & REINVESTMENT ACT OF 2009 (RECOVERY ACT) RECOVERY ZONE BONDS

The *Recovery Act* creates two new categories of bonds to provide reduced rate financing and stimulate economic growth in Recovery Zones:

- Recovery Economic Development Bonds (for governmental borrowers)
- Recovery Zone Facility Bonds (for private borrowers)

BOND ALLOCATION TO COUNTIES AND LARGE MUNICIPALITIES

Recovery Zone Bond authority was allocated to local governmental units by the federal government based on the decrease in an area's employment compared to the national decrease in employment. Michigan counties and seven major cities have been allocated \$2 billion of the nation's \$25 billion in Recovery Zone Bonds. For the list of allocations by location, see www.treas.gov/press/releases/docs/rzballocation-local_AR-ZS.pdf.

The county board of commissioners or city council of an eligible municipality will exercise their discretion when deciding on the designation of Recovery Zones and the awarding of volume cap allocation to specific projects, and will be responsible for the public actions necessary to formalize their decisions.

Counties and eligible municipalities may use volume cap themselves or allocate their volume cap to ultimate beneficiaries for use for qualified economic development purposes or Recovery Zone property. Some bonds may be issued by other bodies, such as county economic development corporations. Before bonds can be issued by other bodies, the appropriate County or City commission must allocate volume cap to the authorized issuer through a board resolution.

In some cases, counties or large municipalities may want to delegate their volume cap for use outside of their jurisdiction. This may occur if they will not be using all

or a portion of their volume cap, their allocation is too small to be economically useful, or they would like to participate in a regional project. These bonds may only be issued until December 31, 2010, so some areas may not find a use for the allocation before the allocation expires. Local jurisdictions with an allocation may assign any portion of their Recovery Zone Bonds allocation to the state, but not to another jurisdiction. Upon such assignment, the State is authorized to reallocate the volume cap to other projects in the state.

RECOVERY ZONE DESIGNATION

A "Recovery Zone" is any area that has been designated by a county or municipality as having "significant poverty, unemployment, rate of home foreclosures or general distress" or satisfies the other criteria for designation of a Recovery Zone. Recovery Zones are flexible, permitting counties and eligible municipalities that receive a volume cap allocation for Recovery Zone Bonds to make designations of Recovery Zones in any reasonable manner.

There is no fixed benchmark that must be satisfied to meet this requirement and no limitation on the number of Recovery Zones that can be created within a county or eligible municipality, except as limited by the amount of volume cap allocation available to the county or eligible municipality.

In order to be eligible for either type of Recovery Zone Bond, the project area must first be officially designated as a Recovery Zone. This requirement has led some counties to declare their entire jurisdiction a Recovery Zone. Designation of a Recovery Zone does not commit bond allocation to a project, so officials retain the right to review and approve the allocation of bond volume cap for specific projects.



TYPES OF RECOVERY ZONE BONDS

Recovery Zone Economic Development Bonds (Government Borrowers)

Recovery Zone Economic Development Bonds (RZEDBs) allow governmental units to borrow at a lower cost than traditional tax-exempt financing. RZEDBs are a class of taxable bonds called tax credit bonds. The issuer can elect that the bondholder receive a federal tax credit of 45% of the total coupon interest payable on the bonds, or the federal government can make a direct payment to the issuer to reimburse them for 45% of the interest paid. This federal subsidy makes the true cost of the interest paid lower than that paid on tax-exempt bonds. Issuers should consult with their financial advisors and bond counsel to determine which alternative best meets their financing goals.

In designated Recovery Zones, RZEDBs may be issued for purposes of promoting development or other economic activity, including capital expenditures, public infrastructure and construction of public facilities including convention centers, and job training and educational programs. These bonds may not be used for the direct benefit of private businesses; however they may be used for the construction or improvement of infrastructure that supports private business. RZEDBs cannot be used to refinance current debt. Federal Davis-Bacon Act prevailing wage rules apply to projects financed with RZEDB. As a result, persons performing work in connection with the construction of facilities financed with RZEDB must be paid in accordance with federal prevailing wage laws.

Communities may benefit from working with the Michigan Municipal Bond Authority (MMBA), housed at the Michigan Department of Treasury. The MMBA can pool similar borrowings from multiple communities into one large bond offering that may be more attractive to the taxable bond market.

Recovery Zone Facility Bonds (Private Borrowers)

Recovery Zone Facility Bonds (RZFBS) are a type of private activity bond (PAB) which allows governmental units to provide tax-exempt financing to private borrowers. These bonds can be used for commercial and industrial projects which historically would not qualify for tax-exempt financing, such as large manufacturing plants, distribution centers, hotels, and research parks. RZFBS can be used for all qualified businesses, which include any trade or business except for residential rental facilities or other specifically listed "exemptions," such as golf courses, massage parlors, gambling facilities, etc. RZFBS can be used to finance projects greater than \$10 million. The \$20 million total capital financing cap applicable to other types of private activity bonds does not apply, unless the taxpayer already has a bond issued under another private activity bond program.

These bonds may be used to finance plant and equipment purchases for both commercial and industrial businesses. Proceeds can be used to finance depreciable property located in a Recovery Zone provided that: (1) the property was constructed, reconstructed, renovated, or acquired by purchase after the date on which the "Recovery Zone" is designated, (2) the original use of the property commences with the taxpayer, and (3) substantially all of the property is in the active conduct of a "qualified business." Existing property may be purchased with RZFBS, provided that the property is renovated by the taxpayer over a two year period at a cost at least equal to the taxpayer's tax basis in the property at the beginning of the two year period. Land and rental property is excluded.

To justify issuance costs, generally bond issues need to be at least \$1.5 million for new buildings, or \$3 million for machinery and equipment financing. Depreciable equipment acquired using tax exempt financing must



be depreciated using straight line depreciation, so equipment financed using RZFBS cannot take advantage of the bonus depreciation benefits offered under the Recovery Act. Loss of depreciation benefits may outweigh the financing benefits offered by RZFBS.

These bonds are issued on the basis of the credit of the benefitted business and will be sold only if the credit of the recipient is strong enough to draw a market for the bonds. County economic development corporations (EDCs) and the Michigan Strategic Fund (MSF), administered by the Michigan Economic Development Corporation, are primary issuers of these bonds. They have the statutory authority to issue RZFBS for the purpose of making conduit loans to borrowers, but are not a guaranteeing body.

Davis-Bacon requirements do not apply to RZFBS. However, if a local economic development corporation issues the bonds, the project financed is subject to the Michigan prevailing wage law. Projects also may be subject to Davis-Bacon or prevailing wage if bonds are issued by a county or city that has an ordinance or policy with this requirement. Bonds issued by the MSF are not subject to Michigan prevailing wage law, nor to Davis-Bacon requirements.

NEXT STEPS

If you anticipate having a project eligible for a Recovery Zone Bond, contact the county or eligible municipality where the proposed project will be located to begin the discussion of Recovery Zone designation and the bond allocation process.

For additional information concerning Recovery Zone Bonds, contact:

- Recovery Zone Economic Development Bonds—Michigan Municipal Bond Authority, 517.335.0994
- Recovery Zone Facility Bonds—Michigan Economic Development Corporation, 517.373.2778

For more information on this program, see www.irs.gov/irb/2009-26_IRB/ar06.html.

