The American Recovery and Reinvestment Act of 2009

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Build America Bonds

Presented by
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What are Build America Bonds (BABs)?

- A new category of governmental bonds; cannot be used for 501c3 entities or other private activities
- Any State or local government may issue BABs simply by making an irrevocable election at the time of issuance
- The interest on BABs is “taxable” – included in federal gross income; interest can be exempt from State taxation
- The bonds must otherwise comply with all rules for a tax-exempt “governmental bond” under existing law
- BABs must be issued with no more than a *de minimis* amount of original issue premium

Two Types of BABs

- ARRA creates two categories of BABs, each designed to provide an additional federal subsidy

  -- Direct Subsidy BABs (also called "Direct Payment BABs")

  -- Tax Credit BABs

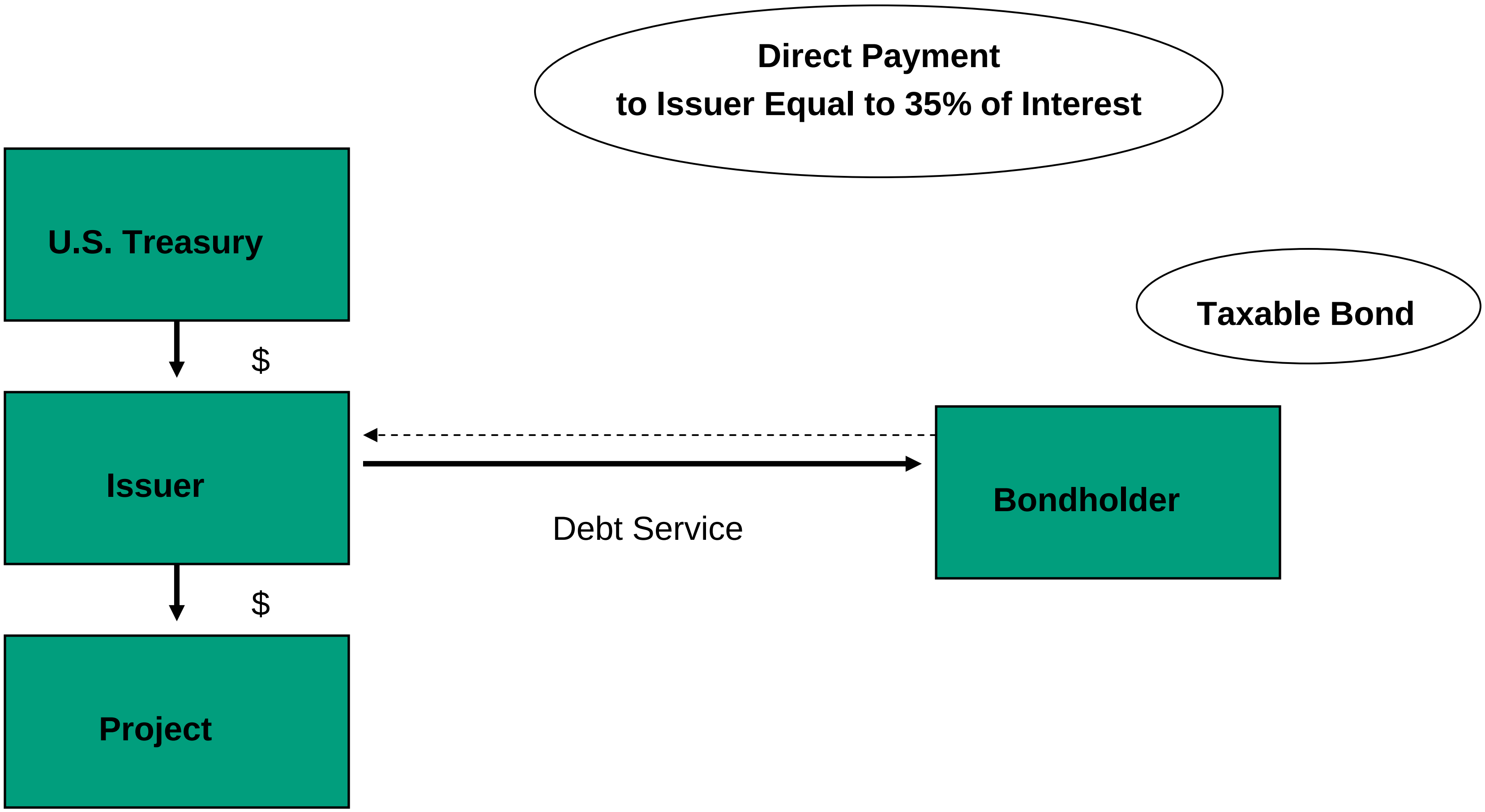
  (Recovery Zone Economic Development Bonds are in effect a third category of BABs; not discussed in this presentation)

- By having taxable bonds, BABs provide access to a new and larger investor community than traditional tax exempt bonds
- BABs may be issued throughout 2009 and 2010
- No volume limit on BABs (unlike other programs under ARRA)

How Do Direct Subsidy BABs Work?

- A Federal subsidy equal to 35% of the interest cost of the bonds will be paid to the issuer by the Treasury
- Issuer will file a form with the Treasury prior to each interest payment date for fixed rate bonds; Treasury will try to pay at or very close to the payment date
- For variable rate bonds, file quarterly in arrears
- It appears there will be a check put in the mail; make sure correct name and address is on the form!
- IRS is hiring new staff to review filings to assure that issuers are entitled to the subsidy payments
- IRS hoping to move to electronic payment system in future

Direct Subsidy – Build America Bonds



Rules For Direct Subsidy BABs

- Direct Subsidy BABs may be issued for new money capital expenditures only
  - 100% of bond proceeds in excess of costs of issuance (up to 2%) and a reasonably required reserve must be used for capital expenditures
  - No working capital use or refunding
  - With no “bad money” category very important to ensure all proceeds used for capital expenditures
  - Note that capitalized interest ceases to be a capital cost once the project is completed; issuers may have to use equity or non-BAB source to fund later stages of cap. interest. Not clear if overfunded cap. interest can be “cured” by a special excess proceeds call of the bonds

Rules for Direct Subsidy BABs (cont.)

(capital expenditures, cont.)

– Also watch for internal administrative costs which are not directly related to the project

- Regular Reimbursement Rules Apply

- In addition, special rule permits BABs to refund any temporary short-term **instruments issued after February 17, 2009 (e.g. commercial paper)**

- Tax-exempt bond rules apply to BABs (e.g., arbitrage rebate, too much private use will jeopardize the subsidy); arbitrage yield is calculated net of the BAB subsidy

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Risks for Direct Subsidy BABs?

Loss of Federal Subsidy?

-- The way the subsidy is written into the law, it is equivalent to a tax refund, for which there is a continuing federal appropriation

-- IRS spokesmen insist there is no risk of retroactive loss of subsidy as this would take an affirmative act of Congress

-- Some state/local government representatives still fear addition of conditions, reporting requirements, certifications in the future

Offset

-- Apparently the BAB subsidy is subject to being offset against any other amounts owed by the issuer to the federal government

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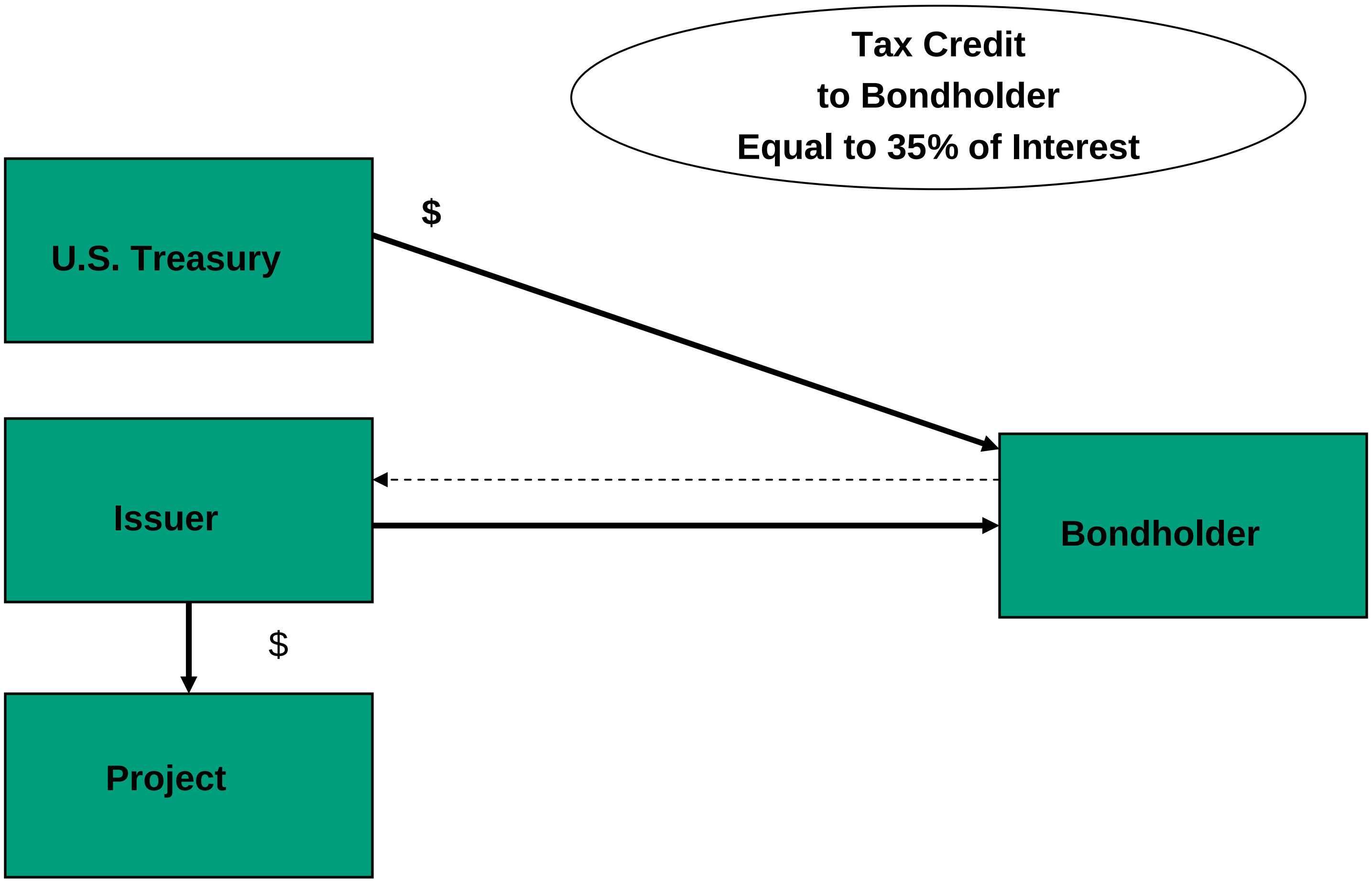
How Do Credit BABs Work?

- In lieu of cash subsidy paid to the issuer, a tax credit equal to 35% of the interest is provided to the bondholder
- Unlike Direct Subsidy BABs, Credit BABs may be issued for both refunding purposes and working capital purposes; not subject to 2% costs of issuance limit
- If credits cannot be used in a tax year, they may be carried forward
- The tax credits may be stripped from the bond and sold separately
- Unlike QZAB and other tax credit programs, not designed to provide a 0% interest cost to issuer
- No established market yet, and credit less valuable than subsidy
- Credit BABs would be attractive mostly in situations where Direct Subsidy BABs are not permitted

Tax Credit – Build America Bonds



Other Considerations for BABs

Legal Opinions

-- Since Subsidy BABs are taxable, investor doesn't require a federal tax exemption opinion, but issuer will want bond counsel to affirm the issuer is entitled to claim the direct subsidy. This is likely to be a different kind of opinion as it is subject to IRS Circular 230. More normal opinions for Credit BABs

Post-Issuance Risks

-- If issuer fails to comply with applicable tax rules for Direct Subsidy BABs, IRS can seek repayment directly; will not involve the bondholder

-- Greater risks for stripped tax credits for Credit BABs; issuer cannot retire the underlying bond early

-- IRS "change of use" rules may require redeeming bonds early; will need to have some kind of call feature in the issue

Other Considerations for BABs (cont.)

Combined Issues

- If all of a proposed issuance doesn't meet BAB rules, issue can be split between a BAB portion and either tax-exempt or "true" taxable portion

Refundings

- Rules on refunding of BABs after January 1, 2011 still uncertain; unless Treasury rules otherwise, assume that subsidy or tax credit will cease upon refunding
- After January 1, 2011, can refund a BAB with a normal tax-exempt bond
- One major open issue: Treasury has not indicated if it will continue to pay subsidy on defeased bonds. If it does not, value of keeping a call option on a BAB is greatly reduced.

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