June 19, 2009

American Recovery and Reinvestment Act of 2009:

Recovery Zone Facility Bonds and Improvements/Expansions of Existing Tools

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Executive Summary

- *On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act ("ARRA"). Certain stimulus provisions in the bill favorably impact issuers of tax-exempt private activity bonds. Relevant highlights pertaining to such issues include:*
    - Creation of a new class of tax-exempt private activity bonds known as Recovery Zone Facility Bonds ("RZFB"s) issued in either 2009 and 2010
        - Dramatically broadens tax-exempt financing opportunities for corporate, for-profit borrowers with capital infrastructure projects that traditionally have not qualified for tax-exempt financing consideration under the Federal Tax Code
    - Expanded definition of regulations governing small-issue Industrial Development Bonds ("IDB"s) issued in either of 2009 and 2010
        - Borrowers that manufacture, create or produce *tangible property* may more readily qualify certain project expenditures that are "non-core" (but are still subordinate and functionally related) to the central production process
        - Eligible borrowers now also include those companies that create or produce *intangible property*, which includes (but is not limited to) the creation of computer software and intellectual property more commonly associated with biotech, pharmaceutical and technology firms
    - Relief from AMT for new-money, tax-exempt private activity bonds issued in either of 2009 or 2010
    - Relief from AMT for current refundings or re-issuances of tax-exempt private activity bonds issued at any time between January 1, 2004 and December 31, 2008

- *Today's panel will seek to highlight those structural, legislative and market dynamics that frame the creation of RZFBs and the expanded IDB regulations so that eligible Borrowers may realize the maximum benefits available under ARRA*

Recovery Zone Facility Bonds

Overview of Recovery Zone Facility Bonds

- Recovery Zone Facility Bonds are a new type of *tax-exempt* private activity bond, newly created under ARRA
  - A "Recovery Zone" is defined as any area designated as (1) having significant poverty, unemployment, rate of home foreclosures, or general distress, (2) economically distressed due to closure or realignment of a military installation due to the Defense Base Closure and Realignment Act of 1990, or (3) an empowerment zone or renewal community
- Recovery zone property is any property where
  - The Company constructed, reconstructed, renovated, or purchased property after the passage of the ARRA
  - The original use of such property in the recovery zone commences with the taxpayer (subject to certain exceptions for renovations)
  - Substantially all the use is in the recovery zone for the active conduct of a qualified business by the taxpayer
    - A qualified business is any trade or business except for:
      - *Residential rental property*
      - *Any 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*
  - The Recovery Zone Facility Bond proceeds can be used to acquire existing property located outside of a Recovery Zone and place such assets "in service" within a designated Recovery Zone

Recovery Zone Facility Bonds

Overview of Recovery Zone Facility Bonds

- Recovery Zone Facility Bonds are subject to an allocation of $15 billion nationally. Such allocation is to be determined by the Secretary of the Treasury
  - Each State will receive at least 0.90% of the bond allocation
  - Allocation will be based upon each State's employment decline in 2008
    - Each State must then "re-allocate" its allocation among large cities (population of greater than 100,000) and counties based upon the pro rata unemployment losses suffered in such jurisdiction relative to the State in calendar year 2008. The Federal Government has predetermined the allocation to States, Counties and qualified Cities based upon Bureau of Labor Statistics unemployment data
    - Cities and counties may elect to forego a portion or all of their respective allocations, which can be reallocated by the State
- Recovery Zone Facility Bonds must be issued by January 1, 2011
- Existing regulations that govern Exempt Facility Bonds will substantially hold as the basis for RZFBs:
  - 95% of proceeds must be used for recovery zone property and must be depreciable property
  - TEFRA Hearing requirements are applicable
  - Bond maturity date limited to 120% of weighted average life of assets financed
  - Not more than 2.00% of par amount of Bonds may be allocated to Costs of Issuance

Recovery Zone Facility Bonds

RZFB Issuance Update

- Initial Internal Revenue Service guidance on RZFB issuance considerations have been national in scope
- On June 12, 2009, the Internal Revenue Service released interim guidance as it relates to RZFBs
  - The Federal RZFB Allocation to the State of California amounts to $1,209,338,000
    - Sub-allocation recipients include 48 cities and 29 counties across the State
      - *Please see Appendix A for a comprehensive schedule of the Statewide sub-allocations*
  - Traditional conduit financing issuers are permitted to act as the Issuer for RZFBs
  - Sub-allocation that is not utilized at the City / County level may be re-allocated by the State
- In lieu of RZFB allocation guidance having just been released, prospective Borrowers may consider certain procedural steps for Projects in anticipation of competition for limited allocation:
  - Contact relevant Public Finance professionals (e.g. – CDIAC, Bond Attorney, Underwriter, Financial Advisor) to consider Project feasibility for RZFBs
  - Seek formal designation that the Project resides within a Recovery Zone
    - As feasible, file an Inducement Resolution prior to the expenditure of Project costs

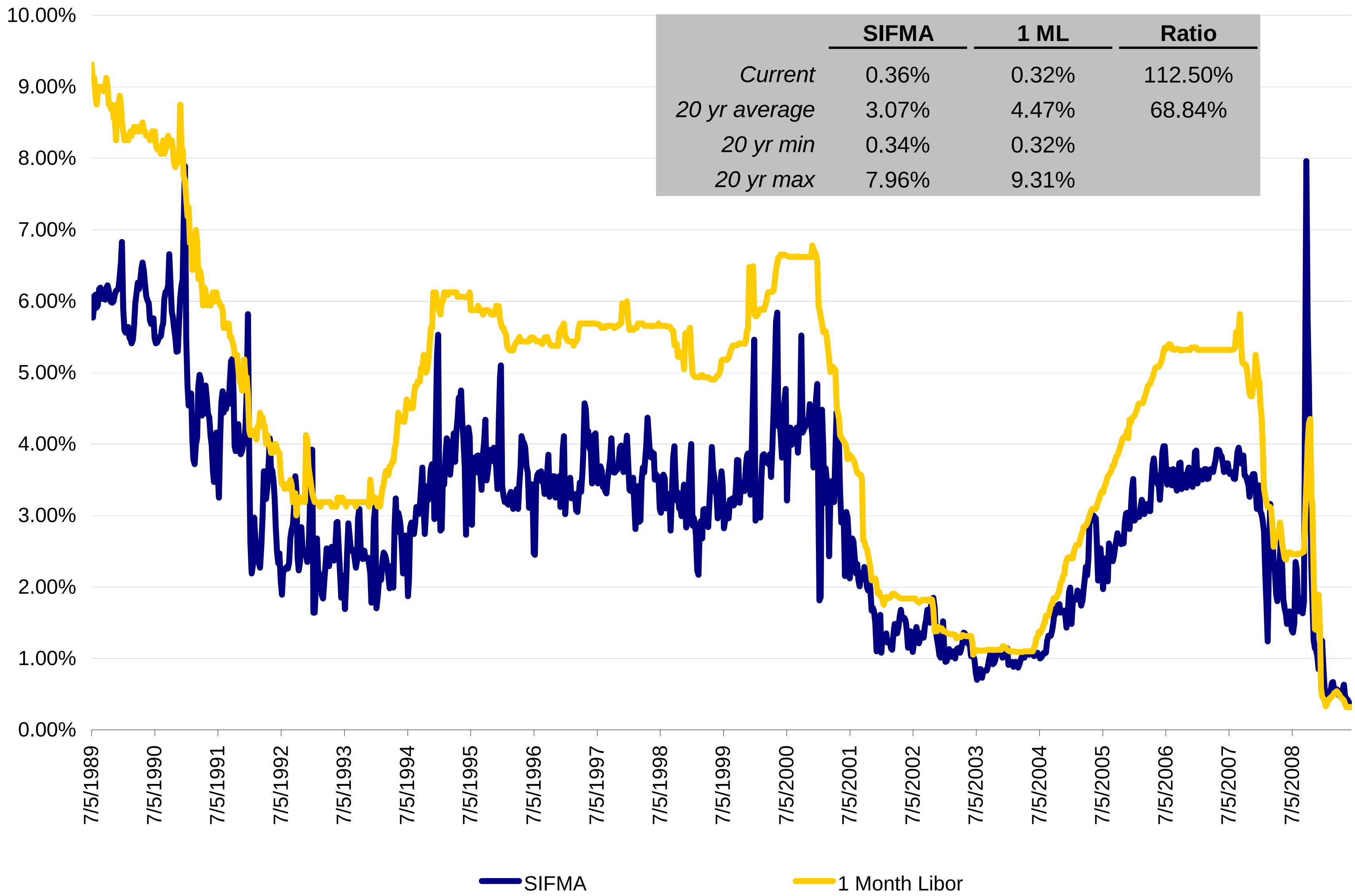
Recovery Zone Facility Bonds

Market Considerations for RZFB Borrowers

- The RZFB Program substantially increases the breadth and depth of Borrowers that may access tax-exempt debt to finance capital projects
  - RZFBs are available to any Borrower with capital expenditures within a Recovery Zone
  - Traditional Private Activity Bond offerings for corporate borrowers have historically been limited to small-issue Industrial Development ("IDB"), Solid Waste Disposal, Airport/Port Facilities and certain Power Generation providers

- Borrower considerations for RZFB issuance
  - **Over the last 20 years, the average variable rate tax-exempt index ("SIFMA") has reliably priced at approximately 70% of the equivalent variable rate taxable index ("1M LIBOR")**
    - The Fed's ongoing policy of quantitative easing has helped reduce taxable rates in the current market such that the prevalent SIFMA / 1M LIBOR ratio for most of 2009 has been closer to 1:1.
  - Bondholders that purchase RZFBs will <u>NOT</u> be subject to the Alternative Minimum Tax ("AMT")
    - Owing to the increasing number of taxpayers ensnared in the "AMT trap", Bonds issued in the Non-AMT market enjoy a persistent discount to a parallel bond structure in the AMT market
      - In the current variable rate market, coupons for Non-AMT bonds are consistently 0.25% (or 25 basis points) lower than for AMT
      - For investment-grade borrowers able to access the fixed rate market, N-AMT coupons are approximately 1.00% (100 basis points) below the corresponding AMT coupon across the yield curve
  - Ongoing Federal dialogue relating to future increases in the marginal income tax rate suggest that the demand for N-AMT paper will remain robust for the indeterminate future.

Historical Comparison: Variable Rate Tax-Exempt vs. Variable Rate Taxable



	SIFMA	1 ML	Ratio
Current	0.36%	0.32%	112.50%
20 yr average	3.07%	4.47%	68.84%
20 yr min	0.34%	0.32%	
20 yr max	7.96%	9.31%	

Source: Thomson Reuters; Bloomberg

Adjustments to Small-Issuer Industrial Development Bonds

Overview of Industrial Development Bonds ("IDB"s)

- Borrowers can take advantage of low cost, long term tax-exempt bonds to finance capital expenditures for the acquisition, construction, development, rehabilitation and/or equipping of facilities for the production of tangible or intangible manufactured goods.
  - These expenditures may qualify under Federal tax law as a small issue manufacturing facility, thus enabling a Company to finance a significant portion of a Project with tax-exempt bonds.
    - Letter of credit backed or privately placed variable rate demand bonds ("VRDBs") afford the Borrower the opportunity to achieve significant savings as compared to other financing alternatives

- Federal tax laws govern Project eligibility for IDB financings:
  - Maximum par amount of $10.0 million to finance a "small issue" manufacturing facility on a tax-exempt basis
  - "Core manufacturing" must be conducted
    - "Small Issue Manufacturing Facilities" are any facility used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property); facilities which are directly related and ancillary to a manufacturing facility (such as warehousing) may be financed through bond proceeds
  - $20.0 million capital expenditure test (over a six year test period)
    - Aggregate **capital expenditures** by the Borrower, including expenditures of a "related" party, **cannot exceed $20 million** within the jurisdiction in which the Project is located over a six-year test period **3 years prior to and 3 years after** the closing date of the financing (including any outstanding tax-exempt bonds issued for such Project in the applicable jurisdiction)

Adjustments to Small-Issuer Industrial Development Bonds

Overview of Industrial Development Bonds ("IDB"s)

- Additional Federal tax laws governing traditional Project eligibility for IDB financings:
  - Not more than 25% of Bond proceeds may be used for the acquisition of Land
  - Tax Equity & Fiscal Reform Act ("TEFRA") public hearing must be held by the Governmental issuer in the jurisdiction where the Project is located prior to issuance of the Bonds
  - Existing buildings may be financed provided that at least 15% of the purchase price financed with tax-exempt debt is spent on rehabilitation
    - Used equipment does NOT generally qualify to be financed with tax-exempt debt unless substantially refurbished
  - "Insubstantial Portion" of project cannot exceed 5% of qualifying costs
    - Up to 2% of bond proceeds may be used to finance costs of issuance
    - Leaving 3% for "non-qualifying" costs
  - Capitalized interest may be financed
  - Total outstanding IDBs by any one Borrower may not exceed $40.0 million on a nationwide basis

Adjustments to Small-Issuer Industrial Development Bonds

Overview of Industrial Development Bonds ("IDB"s)

- **What are Variable Rate Demand Bonds?**
  - VRDBs, also called low floaters, are long-term, variable rate securities

- **What are some characteristics of VRDBs?**
  - They typically require credit support in the form of a Letter of Credit
  - Seven-day interest rate resets allow the borrower to benefit from the short end of the yield curve
  - VRDBs are issued at par and contain a "put option" that gives the investor the option to give back their bonds, at par, upon seven days' notice
  - Bonds that are tendered are then resold to other third-party investors by the Remarketing Agent
  - Investors typically include corporations, tax-exempt money market funds and high net worth individuals

- **What level of flexibility does financing through VRDBs provide?**
  - Prepayment Flexibility - VRDBs have no prepayment penalty and can be prepaid in whole or in part within 30 days notice on any date
  - Structuring Flexibility - Principal amortization can be structured to provide the Borrower with greater flexibility
  - Interest Rate Mode Flexibility - VRDBs are issued as variable rate bonds, however, all or a portion of the issue can be swapped to a fixed rate or capped at the discretion of the Borrower

Adjustments to Small-Issuer Industrial Development Bonds

Impact of ARRA upon Qualified IDB Projects

- Passage of ARRA has boosted issuance opportunities for Borrowers with qualified Industrial Development Bond Projects in three distinct ways
  - IDBs issued for the remainder of 2009 and all of 2010 will be N-AMT
    - Historically, bondholders that purchase IDBs are subject to AMT
  - Increased flexibility surrounding the "Core Manufacturing" definition for Manufacturing Facilities
    - Prior to passage of ARRA, at least 75% of bond proceeds had to be directed toward the core manufacturing component of a Project
      - Those Projects where the majority of expenditures were deemed not to be "core manufacturing" (i.e. – office space, cold storage, warehousing, etc.) struggled to qualify for tax-exempt IDB financing
    - With the passage of ARRA, the 75% "core manufacturing" threshold was struck from the governing regulations for 2009 and 2010
      - Federal tax law continues to require a "core manufacturing" activity for eligible IDB financings but it removes entirely any percentage threshold for that activity as a % of Bond proceeds
      - Policy target of this revision is to incrementally open the IDB financing tool for those Manufacturers/Processors with a differentiated financing need relative to prior tax law
  - Increased accessibility to IDB financing for producers of intangible property
    - Prior to passage of ARRA, the definition of a "Manufacturing Facility" was explicitly limited to manufacturers/processors of tangible goods
    - With the passage of ARRA, the definition was expanded to also include producers of intangible goods
      - Policy target of this revision is to better allow the start-up, "knowledge" economy (e.g. – biotech and pharmaceutical firms) to access tax-exempt IDB financing in its embryonic stages

Adjustments to Small-Issuer Industrial Development Bonds

Market Considerations for IDB Borrowers

- With the broader accessibility of the IDB Program to producers of tangible and intangible goods alike through the end of 2010, the State of California anticipates that applications to secure tax-exempt status for eligible IDB projects will grow
  - Given the limited pool of tax-exempt allocation directed to IDBs in the State of California, Borrowers that contemplate prospective IDB financings in the upcoming 18 months will serve their interests well to begin relevant financing conversations and inquiries as early as reasonably possible
    - In the event that IDB demand outstrips the available pool of tax-exempt allocation, the State of California does reserve the right to re-direct additional allocation to the IDB pool within a given year

- Like the RZFB Program, Borrowers that utilize the IDB for their financing requirements in 2009 and 2010 will realize an incrementally lower cost of capital inherent to a N-AMT bond issuance
  - While it remains likely that tax-exempt IDB financing will remain an available tool for Borrowers beyond 2010, it is by no means certain that such transactions will enjoy N-AMT status after 12/31/10.
    - Recall that IDBs historically have been subject to AMT
  - Borrowers contemplating IDB issuance in the coming years may wish to consider accelerating such financings into calendar year 2010
    - In the current market, a pre-2011 issuance may reliably reduce annual debt service by 0.25% (25 basis points) for the life of the Bonds

Appendix A

State of California Allocation Schedule for Recovery Zone Facility Bonds (by City)

City	Bond	City	Bond	City	Bond
Anaheim	9,859,000	Inglewood	7,488,000	Richmond	1,973,000
Berkeley	2,337,000	Irvine	4,902,000	Riverside	20,662,000
Burbank	8,748,000	Lancaster	7,614,000	Roseville	3,136,000
Concord	2,746,000	Long Beach	33,353,000	Sacramento	12,063,000
Corona	11,223,000	Los Angeles	269,191,000	San Bernardino	10,602,000
Costa Mesa	3,857,000	Modesto	1,356,000	San Buenaventura	2,887,000
Downey	7,815,000	Moreno Valley	11,041,000	Santa Ana	8,807,000
Elk Grove	2,059,000	Norwalk	6,945,000	Santa Clarita	13,270,000
El Monte	7,187,000	Oakland	7,581,000	Santa Rosa	4,448,000
Fairfield	1,401,000	Ontario	10,669,000	Simi Valley	3,311,000
Fontana	8,131,000	Orange	4,225,000	Stockton	5,262,000
Fremont	4,456,000	Oxnard	4,069,000	Thousand Oaks	3,397,000
Fullerton	4,058,000	Palmdale	7,704,000	Torrance	11,970,000
Garden Grove	4,794,000	Pasadena	11,115,000	Vallejo	1,832,000
Glendale	15,065,000	Pomona	9,350,000	Victorville	3,828,000
Hayward	2,750,000	Rancho Cucamonga	10,572,000	West Covina	7,964,000
Huntington Beach	7,128,000				

Source: Internal Revenue Service Notice 2009-50 (Recovery Zone Bond Volume Cap Allocations)

Appendix A

State of California Allocation Schedule for Recovery Zone Facility Bonds (by County)*

County	Bond
Alameda County	*12,966,000*
Amador County	1,531,000
Butte County	2,527,000
Calaveras County	1,524,000
Contra Costa County	*16,050,000*
El Dorado County	5,206,000
Glenn County	427,000
Humboldt County	123,000
Kings County	4,426,000
Lake County	97,000
Los Angeles County	*271,484,000*
Mendocino County	665,000
Mono County	494,000
Nevada County	5,035,000
Orange County	*44,598,000*
Placer County	*6,841,000*
Plumas County	505,000
Riverside County	*74,702,000*
Sacramento County	*24,701,000*
San Bernardino County	*69,139,000*
San Joaquin County	*7,681,000*
Shasta County	5,834,000
Siskiyou County	208,000
Solano County	*2,925,000*
Sonoma County	*9,554,000*
Stanislaus County	*1,732,000*
Trinity County	89,000
Ventura County	*6,488,000*
Yolo County	5,585,000

* *Italicized counties represents an allocation for the residual part of the County after excluding allocation for large municipalities with populations of at least 100,000.*

Source: Internal Revenue Service Notice 2009-50 (Recovery Zone Bond Volume Cap Allocations)