



## New Tax Credit Financing Opportunities

The American Recovery and Reinvestment Act of 2009 ([Pub. L. 111-5](#)) (the “Recovery Act”), signed into law on February 17, 2009 by President Obama, and the Economic Stabilization Act of 2008 ([Pub. L. 110-343](#)) (the “Economic Stabilization Act”), signed into law on October 3, 2008 by President Bush, provide for a number of new tax credit financing options for states, local governments and conduit borrowers. This Peck Shaffer news alert discusses the key features of Qualified School Construction Bonds (QSCBs), one of the tax credit bond programs created by the Recovery Act and further explained by Internal Revenue Service [Notice 2009-35](#). This alert also provides information on both the Qualified Energy Conservation Bonds (QECBs) program and the New Clean Renewable Energy Bonds (NCREBs) program addressed by the Recovery Act and subsequent guidance by the Internal Revenue Service in [Notice 2009-29](#) and [Notice 2009-33](#), respectively.

### A. Common Characteristics of QSCBs, QECBs and NCREBs

QSCBs, QECBs and NCREBs share many common characteristics, including the following:

- **Tax Credit Bonds:** QSCBs, QECBs and NCREBs are three types of “qualified tax credit bonds.” Tax credit bonds allow the holders of the bonds to claim a federal tax credit equal to a specified credit rate as determined by the Secretary of the Treasury. This credit rate is a rate that the Secretary of the Treasury estimates will permit the issuance of the qualified tax credit bond with a specified maturity or redemption date without discount and without interest cost to the qualified issuer.<sup>1</sup>
- **Designation by Issuer:** A qualified issuer must designate bonds as QSCBs, QECBs or NCREBs prior to the issue date of such bonds using appropriate findings or statements in bond documents or in the bond resolution relating to the bonds.
- **Available Project Proceeds:** The issuer of QSCBs, QECBs or NCREBs must reasonably expect that (a) 100 percent of “available project proceeds” will be spent for one or more qualified purposes within the three year period beginning on the issuance date of the bonds and (b) a binding commitment with a third party will be incurred to spend at least 10 percent of such available project proceeds within the 6-month period beginning on the issuance date of the bonds. “Available project proceeds” means (i) the excess of (A) the proceeds from the sale of the bonds over (B) the costs of issuance financed by the bonds (up to a maximum of two percent of such proceeds), plus (ii) the proceeds from any investment of such excess. Available project proceeds do not include reserve funds, which means proceeds from QSCBs, QECBs and NCREBs may not be used for reserve fund purposes. “Qualified purposes” are explained in the following sections for each type of tax credit bond.

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<sup>1</sup> See [IRS Notice 2009-15](#). The credit rate applicable to certain qualified tax credit bonds is published on the Internet by the Treasury Department’s Bureau of the Public Debt at [http://treasurydirect.gov/govt/rates/irs/rates\\_qtcb.htm](http://treasurydirect.gov/govt/rates/irs/rates_qtcb.htm). The credit rate applicable to QSCBs is equal to the credit rate listed on this Web site, and the credit rates applicable to QECBs and NCREBs is equal to 70% of the QSCB credit rate. For example, if the annual tax credit rate shown on the Web site for QSCBs on May 15, 2009 (with a term of 15 years) is 7.68%, the tax credit rate for QECBs or NCREBs sold on this date is 5.376% (7.68% × 70%). The annual tax credit amount is calculated by multiplying this credit rate by the outstanding face amount of the bond. A \$100,000 QECBs or NCREBs series issued on May 15, 2009 will therefore yield an annual tax credit of \$5,376 (7.68% × 70% × \$100,000), or \$1,344 quarterly, for the term of the bonds. The Web site of the Bureau of the Public Debt also sets forth the maximum maturity for the QSCBs, QECBs and NCREBs issued during the given month. Shorter maturities are permitted.

- **Costs of Issuance Limitation:** Costs of issuance paid from QSCBs, QECCB or NCREB proceeds may not exceed two percent of the sale proceeds of the bonds.
- **Arbitrage Rules:** QSCBs, QECCBs and NCREBs are subject to the yield restriction and arbitrage rebate rules of section 148 of the Internal Revenue Code of 1986, as amended (the “Code”), just like tax-exempt bonds. However, available project proceeds (described above) that are invested during the three year spending period are not subject to yield restriction and arbitrage rebate requirements. In addition, amounts invested in certain properly sized sinking funds are not subject to arbitrage restrictions.<sup>2</sup> Peck Shaffer recommends that yield restriction and arbitrage rebate liability be analyzed on a yearly basis by attorneys specializing in providing such services.
- **Prevailing Wages:** Projects financed with proceeds of QSCBs, QECCBs or NCREBs must comply with the Davis-Bacon Act which requires that workers be paid wages at rates not less than those prevailing on similar work in the locality.<sup>3</sup>
- **Information Reporting:** Upon issuing QSCBs, QECCBs or NCREBs, issuers must submit information reporting returns to the Internal Revenue Service akin to the reporting returns required to be submitted for tax-exempt state or local government bonds. Pending further guidance from the Internal Revenue Service, the applicable reporting form for QSCBs, QECCBs and NCREBs is Form 8038.<sup>4</sup>
- **Credit Stripping:** Tax credits provided under the QSCB, QECCB and NCREB programs may be stripped pending guidance from the Treasury Department. Stripping tax credits refers to the separation of the ownership of a qualified tax credit bond and the entitlement to the credit with respect to such bond. The ability to strip credits from these bonds may have a positive effect on the marketability of the bonds.

## B. Qualified School Construction Bonds

Congress established the QSCB program in the Recovery Act in order to facilitate the construction, rehabilitation and repair of public K-12 schools and the acquisition of land on which public schools will be constructed. QSCBs have the following characteristics:

- **Authorization:** QSCBs may be issued pursuant to section 54F of the Code.
- **Qualified Issuers:** Qualified issuers of QSCBs include states, political subdivisions, large local educational agencies that are state or local governmental entities, and entities empowered to issue bonds on behalf of any such entity. Qualified issuers of QSCBs also include otherwise eligible issuers in conduit financing issues. The public school benefitting from the proceeds of the QSCBs must be located within the jurisdiction of the

<sup>2</sup> The sinking fund exception applies only to the extent (a) such fund is funded at a rate not more rapid than equal annual installments, (b) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue, and (c) the yield on such fund is not greater than the “permitted sinking fund yield,” which is equal to 110% of the long-term adjusted applicable federal rate (AFR), compounded semiannually and published on the Internet by the Treasury Department’s Bureau of the Public Debt at [http://treasurydirect.gov/govt/rates/irs/rates\\_qtdb.htm](http://treasurydirect.gov/govt/rates/irs/rates_qtdb.htm).

<sup>3</sup> In contrast, the prevailing wage requirements of the Davis-Bacon Act do not apply to Build America Bonds other than Recovery Zone Economic Development Bonds.

<sup>4</sup> [IRS Notices 2009-29](#) and [2009-33](#) have special instructions for completing the 8038 Form for QECCBs and NCREBs, respectively.

issuer. “Large local educational agencies” include any local educational agency if the agency is (a) among the 100 local educational agencies with the largest number of children aged 5 through 17 from families living below the poverty level (as determined by the Secretary of the Treasury) or (b) one of not more than 25 local educational agencies that are in particular need of assistance (as determined by the Secretary of the Treasury).

- **Qualified Purposes:** Proceeds from the issuance of QSCBs must be used for the construction, rehabilitation or repair of public school facilities or for the acquisition of land on which such facilities are to be constructed with part of such proceeds. “Public school facilities” include public K-12 schools only and do not include facilities for institutions of higher education. QSCB proceeds may also be spent on equipment as long as such equipment will be used in such portion or portions of the public school facility that is also being constructed, rehabilitated or repaired with the proceeds of the QSCBs.<sup>5</sup>
- **Volume Allocation:** In the Recovery Act, Congress established an \$11 billion volume cap limit for each of 2009 and 2010 for QSCB issuances. In Internal Revenue Service [Notice 2009-35](#), the Secretary of the Treasury allocated the 2009 volume cap to states,<sup>6</sup> large local educational agencies<sup>7</sup> and certain possessions of the United States based on Title I grant funding levels for disadvantaged children. These entities may allocate their portions of the volume cap to issuers within their jurisdictions.

### C. Qualified Energy Conservation Bonds

Congress established the QECB program and set applicable initial volume cap allocations in the Economic Stabilization Act of 2008. The Recovery Act increased the applicable volume cap allocation and provided guidance on certain matters relating to the issuance of QECBs. QECBs have the following characteristics:

- **Authorization:** QECBs may be issued pursuant to section 54D of the Code.
- **Qualified Issuers:** Qualified issuers of QECBs include states, political subdivisions and entities empowered to issue bonds on behalf of any such entity. Qualified issuers of QECBs also include otherwise eligible issuers in conduit financing issues.
- **Qualified Purposes:** QECBs must be issued for one or more “qualified conservation purposes.” Qualified conservation purposes include the following:
  - (a) *Capital expenditures* incurred for (i) reducing energy consumption in publicly owned buildings by at least 20 percent, (ii) implementing green community programs, (iii) rural development involving the production of electricity from

<sup>5</sup> See [IRS Notice 2009-35](#).

<sup>6</sup> The volume capacity in 2009 is \$87,147,000 for Colorado, \$201,062,000 for Georgia, \$244,435,000 for Illinois, \$135,132,000 for Kentucky and \$267,112,000 for Ohio.

<sup>7</sup> Large local educational agencies that have received volume allocation in Colorado, Georgia, Illinois, Kentucky and Ohio include Denver County 1 in Colorado, Atlanta City, Clayton County, Cobb County, De Kalb County, Fulton County, Gwinnett County and Richmond County School Districts in Georgia, City of Chicago School District 299 in Illinois, Jefferson County School District in Kentucky and Akron City, Cincinnati City, Cleveland Municipal, Columbus City and Toledo City School Districts in Ohio.

renewable energy resources, or (iv) any facilities eligible to be funded by NCREBs (except for Indian coal and refined coal production facilities);

- (b) *Expenditures* (not limited to capital expenditures) with respect to research facilities, and research grants, to support research in (i) development of cellulosic ethanol or other nonfossil fuels, (ii) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels, (iii) increasing the efficiency of existing technologies for producing nonfossil fuels, (iv) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation, or (v) technologies to reduce energy use in buildings;<sup>8</sup> and
  - (c) Certain mass commuting facilities, demonstration projects and public education campaigns to promote energy efficiency.<sup>8</sup>
- ***Volume Allocation:*** When created by the Economic Stabilization Act of 2008, QECBs were initially limited by a volume cap of \$800 million. The Recovery Act increased this volume cap by \$2.4 billion for a total available cap of \$3.2 billion. Volume cap is allocated to states based on each state's share of the total U.S. population.<sup>9</sup> Large local governments, defined as any municipality or county with a population greater than 100,000, are eligible for a direct allocation. Unlike NCREBs (discussed below), QECBs are not subject to a Department of Treasury application and approval process. Instead, each state or large local government must allocate volume cap to qualified issuers within such state in a manner that results in the use of not less than 70% of the allocation to such state or large local government to designate bonds that are not private activity bonds. A state's authority to allocate QECBs, so long as volume cap remains, does not expire.

#### **D. New Clean Renewable Energy Bonds**

Congress established the NCREBs program in the Economic Stabilization Act of 2008. NCREBs are based on the Clean Renewable Energy Bonds program (CREBs) initially created in 2005 and extended in 2006. The Recovery Act increased the applicable volume cap allocation for NCREBs. Internal Revenue Service [Notice 2009-33](#) provides guidance on certain matters relating to the eligibility for receiving an allocation of volume cap. NCREBs have the following characteristics:

- ***Authorization:*** NCREBs may be issued pursuant to section 54C of the Code.
- ***Qualified Issuers:*** Qualified issuers of NCREBs include: (a) public power providers; (b) cooperative electric companies; (c) governmental bodies (including political subdivisions thereof and entities empowered to issue bonds on behalf of governmental bodies<sup>10</sup>); (d) clean renewable energy bond lenders; and (e) not-for-profit electric utilities that have received loans or loan guarantees under the Rural Electrification Act.
- ***Qualified Purposes:*** NCREBs may be issued to finance capital expenditures incurred by governmental bodies, public power providers or cooperative electric companies for one

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<sup>8</sup> Qualified conservation purposes that relate to non-capital expenditures apply to state and local government bonds only. Private activity bonds that are QECBs may only finance capital expenditures.

<sup>9</sup> See [IRS Notices 2009-29](#) for QECB allocations for 2009.

<sup>10</sup> See [IRS Notice 2006-7](#).

or more “qualified renewable energy facilities.” Qualified renewable energy facilities must be owned by a governmental body, a public power provider or a cooperative electric company, and generally include the following types of facilities operated to produce electricity: (a) Wind facilities; (b) Closed-loop and open-loop biomass facilities; (c) Geothermal and solar energy facilities; (d) Small irrigation power facilities; (e) Landfill gas facilities and trash combustion facilities; (f) Qualified hydroelectric facilities; and (g) Marine and hydrokinetic renewable energy facilities.

- **Volume Allocation:** The Recovery Act assigned a \$2.4 billion national volume cap limitation to NCREBs that does not expire. Unlike the volume cap for QSCBs, which is allocated by states, large local educational agencies and certain other entities, and QECBs, which is allocated by states or large local governments, the volume cap for NCREBs is allocated by the Secretary of the Treasury upon receipt and approval of applications from qualified issuers. Not more than 1/3 of the volume cap limitation may be allocated to qualified projects owned by governmental bodies, public power providers and cooperative electric companies, respectively.
- **Application:** A form of application for an allocation of volume cap is attached to Internal Revenue Service [Notice 2009-33](#) and must be submitted to the Internal Revenue Service. As part of the application process, an issuer must provide a certification of an independent licensed engineer stating (a) that the project will meet the requirements for a qualified renewable energy facility under section 54C of the Code (*i.e.*, a “qualified facility” under section 45(d) of the Code except for Indian coal and refined coal production facilities and without regard to placed in service requirements) and (b) that the project will be technically viable and will produce electricity (a form of the certificate is attached as an exhibit to the application). The deadline for applying for an allocation of volume cap is August 4, 2009. An allocation of NCREBs volume cap is valid for three years, which means the issuer, if it receives an allocation of volume cap, may issue NCREBs pursuant to the allocation anytime within three years after receiving the allocation. The project must comply with the project described in the application, and only “insubstantial” deviations<sup>11</sup> from the project described in the application are permitted.
- **Methodology for Allocating Volume Cap:** For qualified projects owned by governmental bodies or cooperative electric companies, the Secretary of the Treasury will allocate volume cap beginning with the projects for which the smallest dollar amount of volume cap has been requested and continuing with the projects for which the next-smallest dollar amount of volume cap has been requested until the earlier of (a) the total amount of volume cap set aside has been exhausted for each category of qualified owners or (b) all applications from each category of qualified owners have been granted. For qualified projects owned by public power providers, the Secretary of the Treasury will allocate volume cap on a pro rata basis. The amount of volume cap allocated to a project for a public power provider will bear the same proportion to the national volume cap allocated to public power providers as the amount of volume cap requested for that project bears to the total amount of volume cap requested for all projects by public power providers.

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<sup>11</sup> See [IRS Notice 2009-33](#).

If you have questions about Qualified School Construction Bonds, Qualified Energy Conservation Bonds or New Clean Renewable Energy Bonds, or if you have questions about other tax credit bonds or tax-exempt bonds, please contact the Peck Shaffer Tax and Financial Analysis group:

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