HUNTON & WILLIAMS

MEMORANDUM

TO:	State and Local Government Clients	**DATE:**	June 18, 2009
FROM:	Douglass P. Selby, Esq. Caryl Greenberg Smith, Esq.	**FILE:**	99999.000502

IRS Guidance on Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds

On Friday June 12, 2009, the Internal Revenue Service (the "IRS") released guidance on "Recovery Zone Economic Development Bonds" and "Recovery Zone Facility Bonds" (together, **"Recovery Zone Bonds"**), two new financing options created by the American Recovery and Reinvestment Act of 2009 (the **"Recovery Act"**). IRS Notice 2009-50 (http://www.irs.gov/pub/irs-drop/n-09-50.pdf), (the **"June 12 Notice"**), provides allocations to the states of the national bond volume caps for each type of bond, and provides interim guidance to enable states and local governments to begin issuing these bonds notwithstanding that regulations have yet to be published. Recovery Zone Bonds are expected to enlarge the portion of the capital markets into which obligations of state and local governments are sold and, in the case of Recovery Zone Facility Bonds, significantly expands the types of projects which can be financed with tax-exempt bonds. This memorandum provides guidance for Georgia issuers considering financing eligible projects.

Allocation of Recovery Zone Bonds

<u>In General</u>

The Recovery Act authorized a total amount of $10 billion in Recovery Zone Economic Development Bonds and $15 billion in Recovery Zone Facility Bonds for the years 2009 and 2010 ("volume caps"). As required by the Recovery Act, the IRS allocated these national volume caps among the states in proportion to their relative declines in employment during 2008 (although each state received at least 0.9% of the national allocation for each type of bond). The state allocations are provided in the June 12 Notice and reflect the total amount of Recovery Zone Bonds that may be issued within each state through December 31, 2010.

The state allocations provided in the June 12 Notice were further sub-allocated by the IRS among counties and large municipalities (municipalities with a population of at least 100,000) within each state in proportion to the relative declines in employment for all counties and municipalities within the state for 2008. A comprehensive listing of these sub-allocations was released by the IRS on June 12, 2009, and can be found at http://www.irs.gov/pub/irs-tege/rzblocalreallocations.pdf. The sub-allocations provided in the listing represent the total amount of Recovery Zone Bonds that may be issued by a county or large municipality through December 31, 2010.

Georgia

As provided in the June 12 Notice, Georgia received an allocation equal to approximately 3.55% of the national volume cap for each type of bond: $355,785,000 in Recovery Zone Economic Development Bonds and $533,677,000 in Recovery Zone Facility Bonds. Set forth below are the ten largest allocations made to counties and large municipalities in Georgia. A complete listing of sub-allocations within Georgia is attached to this memorandum.

County or Large Municipality	Recovery Zone Economic Development Bond Allocation	Recovery Zone Facility Bond Allocation
Gwinnett County	$41,186,000	$61,778,000
Cobb County	$37,197,000	$55,796,000
DeKalb County - Residual[1]	$36,349,000	$54,524,000
Fulton County - Residual	$26,441,000	$39,662,000
City of Atlanta	$22,776,000	$34,163,000
Clayton County	$13,078,000	$19,617,000
Cherokee County	$10,767,000	$16,150,000
Henry County	$9,440,000	$14,160,000
Forsyth County	$8,302,000	$12,453,000
Floyd County	$8,269,000	$12,404,000

As a result of the IRS' direct "sub-allocations" to local governments within Georgia, allocation amounts are immediately available to localities, thereby avoiding the typical administrative process required to obtain other allocations through application to the Georgia Department of Community Affairs.

Eligible Issuers and Allocation Uses

The June 12 Notice provides guidance on the permitted uses of an allocation including re-allocation of any unused amounts. This guidance is particularly important in Georgia where a number of counties have received relatively small allocations. According to the June 12 Notice, a county or large municipality in receipt of a volume cap allocation, may:

1) use any portion of such volume cap itself,

2) allocate any portion of such volume cap to "ultimate beneficiaries" in any reasonable manner as it shall determine in good faith, or

[1] Residual indicates that the allocation is for the residual part of the county after excluding allocation for large municipalities with populations of at least 100,000.

3) may waive any portion of such volume cap.

With respect to any portion of a volume allocation that is waived, the state in which such county or large municipality is located is authorized to either use the waived allocation itself for eligible costs or may allocate the waived volume cap in "any reasonable manner as it shall determine in its good faith and discretion". Importantly, this provides for a state in receipt of a waived volume cap to reallocate without regard to relative unemployment decline.

Regarding the ability of counties, large municipalities, (or states in receipt of waived allocation amounts), to allocate any portion of a volume cap to "ultimate beneficiaries" it is important to consider who may issue a Recovery Zone Bond. According to the June 12 Notice, **eligible issuers** of Recovery Zone Bonds include: (i) states, (ii) political subdivisions (as defined for purposes of Section 103 of the Code), (iii) entities empowered to issue bonds on behalf of a State or political subdivision for purposes of Section 103 of the Code (e.g. statutory, local act or constitutional development authorities and other such entities) and (iv) otherwise-eligible issuers in conduit financing issues (as defined in §1.150-1(b) of the Treasury Regulations). A state, county, or municipality wishing to allocate a portion of its volume cap to an "ultimate beneficiary" must allocate to an eligible issuer. Beyond this restriction, counties and large municipalities have broad authority to transfer their allocations and need not seek approval of the transfer at the State level.

Eligible Financings

Recovery Zone Economic Development Bonds

Recovery Zone Economic Development Bonds are a special type of bond referred to as "Build America Bonds" under the Recovery Act. Recovery Zone Economic Development Bonds provide a payment in an amount equal to 45% of the interest paid in respect of such bonds directly to the issuer as a subsidy for financing qualified economic development projects.. Interest on Recovery Zone Economic Development Bonds is taxable to investors. For additional information on Build America Bonds please see our April 7, 2009 client alert: (http://www.hunton.com/emailblast/pdfs/irs_guidance_on_build_america_bonds.pdf).

Recovery Zone Economic Development Bonds are codified in Section 1400U-2 of the Internal Revenue Code of 1986, as amended (the "Code"). Section 1400U-2 of the Code requires that a Recovery Zone Economic Development Bond qualify as a "Build America Bond" under Section 54AA(d) of the Code. Consequently, Recovery Zone Economic Development Bonds must meet the requirements of traditional tax-exempt governmental bonds under Section 103 and must not be issued with more than *de minimis* amounts of premium over the stated principal amount of the bonds. In addition, to qualify as a Recovery Zone Economic Development Bond:

1) 100% of available proceeds (net of debt service reserve and 2% cost of issuance) must be used to finance qualified economic development purposes,

2) the bond must be issued before January 1, 2011, and

3) the issuer must designate the bond as a Recovery Zone Economic Development Bond.

As noted above, 100% of the available project proceeds of Recovery Zone Economic Development Bonds must be used for one or more "**qualified economic development purposes"**. Such purposes are defined in Section 1400U-2 of the Code as "expenditures for purposes of promoting development or other economic activity within a 'recovery zone' (defined below) including:

1) capital expenditures paid or incurred with respect to property located in a recovery zone,

2) expenditures for public infrastructure and construction of other public facilities, wherever located, that promote development or other economic activity in a recovery zone, and

3) expenditures for job training and educational programs; Recovery Zone Economic Development Bonds can be issued to reimburse any such expenditures incurred since the enactment of the Recovery Act.

As provided in the IRS notice, this broad definition allows issuers to finance capital expenditures and <u>working capital expenditures</u> that promote development or other economic activity within a recovery zone.

A "recovery zone" is defined as any area <u>designated by the issuer</u> as (i) having significant poverty, unemployment, home foreclosures, or general distress, or (ii) as distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990. In addition, the term recovery zone includes any area currently designated as a an empowerment zone or as a renewal community area.

Pursuant to the June 12 Notice <u>issuers have significant flexibility in designating recovery zones</u> within the subjective criteria provided in 1400U-1(b) of the Code (poverty, unemployment, home foreclosures, general distress) . The June 12 Notice provides that any State, county, or large municipality that receives an allocation for Recovery Zone Bonds may designate a recovery zone in any reasonable manner as it shall determine in its good faith and discretion." Presumably, the adoption of a resolution acknowledging the existence of one or more of the criteria provided within an area should suffice as a designation of a recovery zone.

Recovery Zone Economic Development Bonds cannot be issued to refund debt except temporary short term financings that were issued for qualified economic development purposes after the enactment of the Recovery Act. Additionally, Federal Davis-Bacon wage rules (relating to prevailing wages) apply to projects financed with proceeds of Recovery Zone Economic Development Bonds.

<u>Recovery Zone Facility Bonds</u>

Recovery Zone Facility Bonds are a new category of tax-exempt private activity bonds that can be used to finance an <u>extremely broad range</u> of depreciable capital projects in recovery zones (as defined above.) To qualify as an Recovery Zone Facility Bond:

1) At least 95% of the "net proceeds" (as defined in Section 150 of the Code) of the bond must be used for "recovery zone property" (as defined below),

2) the bond must be issued before January 1, 2011, and

3) the issuer must designate the bond as a Recovery Zone Facility Bond.

Recovery zone property is defined as depreciable property within a recovery zone that is: (i) used in a qualified trade or business (excludes non-transient rental housing and facilities described in Section144(c)(6)(B) of the Code) (ii) constructed, renovated or acquired by purchase after the date in which the recovery zone designation took effect, and (iii) first used within the recovery zone by the taxpayer. Accordingly, any capital asset used in any trade or business will qualify for financing except residential rental property, golf courses, country clubs, massage parlors, hot tub facilities, sauna facilities, racetracks or other gambling facilities, or stores that principally sell alcoholic beverages for consumption off site. As an example, an issuer could finance shopping centers or other retail, manufacturing facilities otherwise in excess of capital limitations under Section 144, hotels, restaurants, or office buildings. Another noteworthy example of allowable projects are facilities leased to private users for athletic and entertainment purposes. Land and non-depreciable land improvements do not qualify as recovery zone property and may not be included for purposes of the 95% requirement.

For your reference, attached to this memorandum is a listing of the sub-allocations for Recovery Zone Bonds to all counties and large municipalities in Georgia. Please contact me or my partners, Caryl Greenberg Smith and Wally McBride, if you have any questions. Thanks.

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Recovery Zone Bonds: Sub-Allocations to Georgia Counties and Large Municipalities[2]

	Recovery Zone Economic Development Bonds	Recovery Zone Facility Bonds
Large Municipalities		
Athens-Clarke	1,086,000	1,629,000
City of Atlanta	22,776,000	34,163,000
Augusta-Richmond	2,418,000	3,627,000
Columbus-Muscogee	2,090,000	3,135,000
City of Savannah	2,205,000	3,307,000
Counties		
Baker County	63,000	94,000
Baldwin County	402,000	603,000
Barrow County	3,304,000	4,957,000
Bartow County	4,440,000	6,660,000
Ben Hill County	536,000	804,000
Berrien County	823,000	1,235,000
Bleckley County	358,000	538,000
Brantley County	271,000	406,000
Bryan County	572,000	858,000
Burke County	260,000	390,000
Butts County	982,000	1,473,000
Camden County	905,000	1,358,000
Carroll County	5,162,000	7,743,000
Catoosa County	1,915,000	2,872,000
Charlton County	309,000	464,000
Chatham County	2,374,000	3,562,000
Chattahoochee County	41,000	62,000
Chattooga County	670,000	1,005,000
Cherokee County	10,767,000	16,150,000
Clay County	183,000	275,000
Clayton County	13,078,000	19,617,000
Cobb County	37,197,000	55,796,000
Columbia County	1,633,000	2,450,000
Coweta County	5,838,000	8,756,000
Crisp County	1,105,000	1,658,000
Dade County	451,000	677,000
Dawson County	1,089,000	1,633,000
DeKalb County	36,349,000	54,524,000
Dodge County	1,198,000	1,797,000
Dooly County	372,000	558,000
Dougherty County	1,567,000	2,351,000
Douglas County	6,292,000	9,437,000
Effingham County	982,000	1,473,000
Elbert County	1,100,000	1,649,000
Emanuel County	1,349,000	2,023,000
Fannin County	399,000	599,000
Fayette County	5,244,000	7,866,000
Floyd County	8,269,000	12,404,000

[2] Numbers as released by the Department of Treasury Internal Revenue Service on June 12, 2009

Forsyth County	8,302,000	12,453,000
Franklin County	684,000	1,026,000
Fulton County	26,441,000	39,662,000
Gilmer County	840,000	1,260,000
Glascock County	19,000	29,000
Glynn County	1,472,000	2,208,000
Gordon County	1,814,000	2,720,000
Grady County	708,000	1,063,000
Gwinnett County	41,186,000	61,778,000
Hall County	6,842,000	10,262,000
Hancock County	63,000	94,000
Haralson County	1,250,000	1,875,000
Harris County	399,000	599,000
Hart County	1,329,000	1,994,000
Heard County	473,000	710,000
Henry County	9,440,000	14,160,000
Houston County	1,384,000	2,076,000
Irwin County	293,000	439,000
Jasper County	624,000	936,000
Jeff Davis County	224,000	336,000
Jefferson County	233,000	349,000
Jenkins County	1,513,000	2,269,000
Johnson County	238,000	357,000
Lamar County	766,000	1,149,000
Laurens County	1,461,000	2,191,000
Lee County	673,000	1,009,000
Lumpkin County	832,000	1,247,000
McDuffie County	282,000	423,000
McIntosh County	191,000	287,000
Madison County	268,000	402,000
Marion County	82,000	123,000
Meriwether County	919,000	1,379,000
Murray County	3,835,000	5,753,000
Newton County	4,478,000	6,717,000
Oconee County	309,000	464,000
Oglethorpe County	129,000	193,000
Paulding County	6,448,000	9,671,000
Pickens County	1,485,000	2,228,000
Pierce County	290,000	435,000
Pike County	788,000	1,182,000
Polk County	1,302,000	1,953,000
Putnam County	922,000	1,383,000
Quitman County	71,000	107,000
Rabun County	391,000	587,000
Rockdale County	3,906,000	5,859,000
Screven County	159,000	238,000
Spalding County	2,716,000	4,074,000
Stephens County	178,000	267,000
Talbot County	27,000	41,000
Telfair County	2,418,000	3,627,000
Terrell County	167,000	250,000
Thomas County	2,883,000	4,325,000

Tift County	755,000	1,132,000
Towns County	397,000	595,000
Troup County	2,298,000	3,447,000
Turner County	211,000	316,000
Union County	1,234,000	1,851,000
Upson County	290,000	435,000
Walker County	1,773,000	2,659,000
Walton County	3,994,000	5,991,000
Ware County	506,000	759,000
Warren County	57,000	86,000
Washington County	678,000	1,018,000
Wayne County	665,000	997,000
Wheeler County	290,000	435,000
White County	1,124,000	1,686,000
Whitfield County	8,562,000	12,843,000
Worth County	380,000	570,000