



# Public Finance Alert

## Developments in public finance law

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### Treasury and IRS issue Recovery Zone Bond guidance

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#### **Summary**

On June 12, 2009, the Internal Revenue Service (IRS) issued Notice 2009-50 (the Notice), which provides guidance regarding the allocation of the \$10 billion national volume limitation for Recovery Zone Economic Development Bonds and the \$15 billion national volume limitation for Recovery Zone Facility Bonds authorized by the American Recovery and Reinvestment Act of 2009 (ARRA). The Notice provides both the allocations of volume limitation to the states and suballocations to counties and large municipalities within the states.

#### **Recovery Zone Bonds**

The ARRA authorized the issuance of two new types of tax-preferred bonds that can be issued by state and local governments for areas designated as Recovery Zones: Recovery Zone Economic Development Bonds (RZEDBs) and Recovery Zone Facility Bonds (RZFBs and, collectively with RZEDBs, Recovery Zone Bonds). In general, Recovery Zones are areas designated by state and local issuers as having significant poverty, unemployment, rate of home foreclosures, or general distress. Areas currently designated as enterprise zone or renewal community areas, or areas experiencing economic distress by reason of military base closure pursuant to the Defense Base Closure and Realignment Act of 1990, also may be designated as Recovery Zones.

- **RZEDBs** operate in a manner similar to Build America Bonds (Direct Payment) (see our April 7, 2009, *Alert* at [www.nixonpeabody.com/services\\_pubdetail.asp?ID=2684&SID=43](http://www.nixonpeabody.com/services_pubdetail.asp?ID=2684&SID=43)). That is, RZEDBs are taxable bonds that provide state and local government issuers with a direct federal subsidy payment equal to a percentage of the interest paid to investors on such bonds. RZEDBs provide a direct payment equal to 45 percent of the interest payable on the bonds and, thus, provide a deeper subsidy than Build America Bonds (Direct Payment), which provide a 35-percent direct payment.
- **RZEDBs** generally can be used to finance capital and working capital expenditures that promote development or other economic activity in a Recovery Zone, including (1) capital expenditures paid or incurred with respect to property in the Recovery Zone, (2) expenditures for public infrastructure and construction of public facilities, and (3) expenditures for job training and educational programs. Like Build America Bonds, RZEDBs generally are subject to the tax requirements that apply to governmental tax-

exempt bonds and may not be issued as private activity bonds. RZEDBs may not be issued to refund other bonds, other than certain interim financings issued after the effective date of the ARRA.

- **RZFBs** are a new category of tax-exempt private activity bonds. Generally, property eligible for depreciation that is actively used in a business in a Recovery Zone (other than residential rental property and certain prohibited facilities, such as golf courses) may be financed with the proceeds of RZFBs, provided the property is acquired after the date on which a Recovery Zone designation took effect.
- Both RZEDBs and RZFBs must be issued before January 1, 2011.
- Davis-Bacon Act federal prevailing wage requirements apply to RZEDBs, but not to RZFBs.

### ***Allocations of volume cap***

The ARRA provides that the \$10 billion and \$15 billion volume limitations for RZEDBs and RZFBs, respectively, are to be allocated to the states in proportion to their respective 2008 job losses, but with each state receiving a minimum allocation of \$90 million in RZEDBs and \$135 million in RZFBs. The ARRA further provides that the allocation to a state is suballocated to counties and large municipalities within the state (i.e., those with a population of over 100,000), also on the basis of relative job losses.

The Notice provides for the allocation of Recovery Zone Bond authority to the states, as well as for the suballocations to the counties and large municipalities within the states. These allocations and the Notice can be viewed by accessing the following links:

Recovery Zone allocation-

[http://www.nixonpeabody.com/linked\\_media/publications/recovery\\_zone\\_allocations.pdf](http://www.nixonpeabody.com/linked_media/publications/recovery_zone_allocations.pdf)

IRS Notice-

[http://www.nixonpeabody.com/linked\\_media/publications/IRS\\_Notice.pdf](http://www.nixonpeabody.com/linked_media/publications/IRS_Notice.pdf)

The allocation methodology has led to some interesting results. For example, Texas received the minimum allocations of RZEDBs and RZFBs, and Michigan received nearly as much as California. In addition, many of the allocations to counties are very small, due to the mandatory suballocation to all the counties within a state.

Recovery Zone Bonds may be issued by a state, an issuer that receives a direct allocation of authority, or an entity issuing on behalf of such an issuer. For example, if a county that receives an allocation of authority cannot issue bonds directly, another entity with jurisdiction that includes that county may issue Recovery Zone Bonds on behalf of the county.

The Notice also provides that a county or large municipality may waive any portion of a Recovery Zone Bond allocation to the state. The state in which the county or large municipality making a waiver is located is authorized to reallocate waived volume cap in any reasonable manner.

If you have any questions or require further information regarding these or other matters, please call your regular Nixon Peabody contact or feel free to contact one of the attorneys listed below:

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