

Government Obligations

- I. Issued by a state or local government entity
- II. Tax-exempt unless you do something to cause them to be taxable
- III. Used for public purpose projects without significant private business involvement
- IV. How a governmental obligation becomes a private activity bond
 - A. By meeting both the private business use test and the private security or payment test
 - i. Private business use test is met if more than 10% of proceeds will be used in a trade or business of a nongovernmental person
 - a. The IRS looks at indirect use as well as direct use
 - b. Must take into account management contracts unless they comply with IRS limitations
 - 1. A management contract generally results in private business use if compensation is based, in whole or in part, on a share of net profits from the operation of the facility
 - 2. Detailed rules set forth in Code and Regulations
 - ii. Private security or payment test is met if more than 10% of issue is either secured or paid by private business
 - iii. The limits in i and ii above are generally lower for electric generation, transmission, and distribution facilities (5% instead of 10%)
 - B. By meeting the private loan financing test
 - i. If loans to persons other than governmental units exceed the lesser of (a) 5% of the proceeds of the bonds or (b) \$5,000,000
 - C. By acquiring nongovernmental output property
 - i. If the amount used to acquire a nongovernmental output property

exceeds the lesser of (a) 5% of the proceeds of the bonds or (b) \$5,000,000

- ii. However, “nongovernmental output property” does not include any property which will be used in connection with an output facility 95% or more of the output of which will be consumed in (a) a qualified service area of the governmental unit acquiring the property, or (b) a qualified annexed area of such unit
 - a. A “qualified service area” the area where the acquiring governmental unit has provided electric service for the 10-year period ending on the date of acquisition
 - b. A “qualified annexed service area” means the area contiguous to the governmental units service area if electric service is made available to all members of the general public in the annexed area and if the annexed area is not greater than 10% of the governmental unit’s original service area

Private Activity Bonds

- I. Issued by a state or local government entity
- II. Taxable unless you satisfy the requirements of the Tax Code for a specific tax-exemption
 - A. Local furnishing of gas or electricity
 - i. Provider of electric service must have provided that service in that area at least since January 1, 1997, or be a successor to such an entity
 - ii. Cannot provide electricity to more than two contiguous counties
 - B. Subject to alternative minimum tax
 - C. Subject to volume cap
 - i. Approximately \$235,000,000 per year in Alaska
 - ii. Allocated by State Bond Committee among various users
 - D. Maturity of bonds may not exceed 120% of reasonably expected economic

life of project to be financed

- E. No more than 25% of bond issue can be used to acquire land
- F. Cannot be used to acquire existing property unless rehabilitation expenditures are made
 - i. Must be capital expenditures
 - ii. Must be made within 2 years after acquisition or bond issuance, whichever is later
 - iii. Must at least equal 15% of the acquisition cost paid with bond proceeds (100% if acquisition is not a building)
- G. Public approval required
 - i. Public hearing following at least 14 days public notice
 - ii. Approval by chief elected officer of issuing entity and also chief elected officer of each jurisdiction in which the project is located
- H. No more than 2% of bond issue can be used to pay issuance costs

All Tax-Exempt Bonds

- I. No Federal guarantees
- II. Reimbursement limitations
 - A. You can use bond proceeds to reimburse for an original expenditure only if the original expenditure occurred not more than 60 days before adoption of an official intent
 - i. An official intent is the bond issuer's declaration that they intend to incur debt (issue bonds) to pay for the costs of the project
 - ii. Can be in any reasonable form – generally a resolution
 - iii. Must include a description of the project and state the maximum principal amount of the bonds
 - B. There are some exceptions for preliminary expenditures (engineering, architecture, surveying, soil testing, etc.) but the exceptions cannot exceed 20% of the bond issue

- C. The reimbursement must occur (i.e., the bonds must be issued) no later than 18 months after the later of (i) the date of the original expenditure or (ii) the date the project is placed in service or abandoned, but, in any event, no more than 3 years after original expenditure

III. Arbitrage