

# Economic Challenges and Public Finance

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special presentation for:

## FASD

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## Challenges To Borrowing

### 1. Reduced number of “players”

- Underwriters going out of business or merging with others
- Ditto for commercial banks
- Every single municipal bond insurer downgraded - most are no longer investment grade

### 2. Reduction in available financing structures

- No more auction rate security (ARS) bonds
- Commercial banks extremely reluctant to issue letters of credit to secure variable rate demand bonds (“low floater vrdb’s”)

### 3. Wild swings in interest rates

- 7 day vrdb rates went from 1.79% to 7.96% in just two week in the fall of 2008 – and back below 2% a little over a month later.
- However, for all of 2009 so far, the rate has been under 1%.

### Recent Federal Legislation – The American Recovery and Reinvestment Act of 2009 (Stimulus Bill)

#### 1. Taxable “Build America Bonds” Issued in 2009 or 2010 - Two Types of Bonds:

- **Type 1** - a tax credit to the purchaser of the bond in an amount equal to 35% of the total interest payable on the bond prior to the tax credit. These bonds can be issued for any purpose for which traditional tax exempt bonds (except private activity bonds) could be issued.
- **Type 2** - a tax credit back to the issuer of the bond in the form of a periodic refund, also in an amount equal to 35% of the total interest payable on the bond prior to the tax credit. These bonds can only be used by for capital projects and also cannot be used for private activity bonds.

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#### Interesting Market Ramifications of Build America Bonds

Issuers are asking for proposals to buy bonds in the alternative – quote both a traditional tax exempt rate and a taxable Build America Bond rate (usually Type 2), and then choosing the option that provides them the lowest interest cost, factoring in the 35% tax credit.

Expansion of market beyond potential purchasers that have an appetite for tax exempt income – local banks, for example.

**Are we looking at the “beginning of the end” of tax exempt bonds?**

### Recent Federal Legislation – The American Recovery and Reinvestment Act of 2009 (Stimulus Bill)

#### **2. Expansion of “Bank Qualified Bonds” for 2009 and 2010**

The ceiling for being able to issue “bank qualified bonds” is increased from \$10 million to \$30 million.

Not-for-profits that have bonds issued through a government conduit issuer are treated as direct issuers for purposes of the bank qualification requirements and thus have separate \$30 million limits.

Refunding of non bank qualified tax-exempt bonds issued prior to 2009 as bank qualified if the issuer or not-for-profit can meet the above test for either 2009 or 2010.

### Recent Federal Legislation – The American Recovery and Reinvestment Act of 2009 (Stimulus Bill)

#### **3. Elimination of Alternative Minimum Tax on Tax Exempt Bonds Issued in 2009 and 2010**

Interest on new money bonds will not be treated as a preference item for purposes of the alternative minimum tax and also will not be included in the current earnings adjustment under the corporate alternative minimum tax.

Tax-exempt Bonds issued on or after January 1, 2004 that are subject to the tax preference or adjusted current earnings of the alternative minimum tax may be refinanced under certain circumstances so that the refinanced debt is no longer subject to the alternative minimum tax.

### **Recent Federal Legislation – The American Recovery and Reinvestment Act of 2009 (Stimulus Bill)**

#### **4. Liberalization of Use of Private Activity Bonds for Manufacturing Facilities**

The definition of “manufacturing facilities” is expanded to include facilities used in the production of intangible property. Intangible property includes patents, copyrights, designs, know-how and other similar items. It is intended to include, among other items, the creation of computer software and intellectual property associated with bio-tech and pharmaceuticals.

The scope of a “manufacturing facility” is amended to replace the current 25% limitation for directly related and ancillary property with an unlimited use of bond proceeds for functionally related and subordinate property.

### Recent Federal Legislation – The American Recovery and Reinvestment Act of 2009 (Stimulus Bill)

#### 5. Features of the Stimulus Bill of More Limited Interest

A new category of taxable Build America Bonds, called **Recovery Zone Economic Development Bonds**, is created with authority for \$10 billion of issuance in 2009 and 2010 to finance economic-development purposes in certain designated recovery zones. These bonds provide for a payment to the issuer of 45% of the interest paid.

A new category of tax-exempt exempt facility bonds, called **Recovery Zone Facility Bonds**, is created with authority for \$15 billion of issuance to finance depreciable property to be used in a recovery zone in the active conduct of a trade or business, subject to certain exclusions.

Tax credit programs are extended or increased for Clean Energy Renewable Bonds, Energy Conservation Bonds, and Qualified Zone Academy Bonds.

### Recent State Legislation

1. Limiting each local government's revenues to population growth plus inflation fails again. (*whew!*)
2. Voters to decide on ad valorem tax "relief" for non homestead property and first time homebuyers.

## Defaults and Workouts

1. In Florida, so far, payment defaults have been primarily on bonds secured by **Special Assessments**.
2. How the **Tax Sale Certificate process** works, and what happens if there aren't any buyers.
3. What to do when your District can't meet its debt service obligations.

## Challenges To Investing

### 1. Ensuring safety of investments

- Reliance on “AAA” ratings without independent investigation
- Callable securities

### 2. Interest Rates

### 3. What about the SBA?

## Other Challenges

### 1. Selection of bond professionals

- a. The public finance “team” – why you should assemble it in this order.
  - i. **Financial Advisor**
  - ii. **Bond Counsel**
  - iii. **Separate Disclosure Counsel – when does it make sense**
  - iv. **Underwriters and or direct lender**
  - v. **Registrar and Paying Agent**
- b. The pros and cons of a formal RFP selection process.
- c. What’s the difference between a competitive bid and a negotiated sale, and when should you consider each?
- d. Why the “lowest cost provider” might not be in your best interest

### 2. Ethical considerations for public officials – Who should pay for lunch?



**Q & A**

# Thank You

For answers to all of your Public Finance law questions, please visit our website at:

**[www.ruden.com](http://www.ruden.com)**

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