



Private Activity Bonds Public Hearing

December 14, 2011

Private Activity Bond Advisory Committee



Act 52: Review of Private Activity Bonds

H. 287 (ACT 0052)

An Act Relating to Job Creation, Economic Development, and Buy Local Agriculture

Sec. 64. STUDY; PRIVATE ACTIVITY BONDS

(a) Findings.

(1) Due to changes in federal law governing underwriting and servicing student loans, the Vermont student assistance corporation (VSAC) has experienced a substantial decrease in its ability to generate revenue and is currently downsizing its operation.

(2) As a result, the general assembly finds that VSAC's private activity bond allocation, which in recent years has exceeded \$100 million, may be available for use as an economic development tool, and that the secretary of administration should review the process of allocation and the potential uses to which the state's allocation should be dedicated.

(b) On or before November 1, 2011, the secretary of administration, in collaboration with the office of the treasurer, shall review and report his or her findings to the house committee on commerce and economic development and to the senate committee on economic development, housing and general affairs concerning:

(1) the state's current process for allocation of private activity bond capacity, including whether the process should be modified to increase participation by the public and interested parties; and

(2) a cost-benefit analysis of one or more projects that may be suitable for private activity bond funding.

Executive Order No. 14-11: Private Activity Bond Advisory Committee

Governor seeks to:

- (1) Develop an advisory process relating to such allocation that increases awareness of the availability of private activity bonding capacity to prospective issuers,*
- (2) Encourages new and creative uses of this financing mechanism,*
- (3) Promotes job creation in Vermont, and*
- (4) Otherwise maximizes the economic benefits of private activity bonding.*

The Committee shall:

- (1) Survey the expected need for private activity bond allocations among the constituted and eligible issuing authorities empowered to issue such bonds on an annual basis,*
- (2) Develop recommended guidelines for the allocation of PAB capacity...,*
- (3) Make annual recommendations to the Emergency Board on the allocation...,*
- (4) Meet at least annually...,*
- (5) Hold at least one public hearing prior to submitting its recommendation, and*
- (6) File an annual report with the Governor and Legislature.*

What Are Private Activity Bonds?

Private Activity Bonds (PABs)

- Private activity bonds are bonds that are issued to finance purposes of, or facilities owned and/or used by, private entities in a private trade or business. Unless a private activity bond qualifies under one of the IRS Code exceptions, interest on such bonds is not tax-exempt.
- A number of qualified private activities are granted special status and are entitled to the beneficial “tax-exempt” treatment. These activities are called “qualified private activities”
- The federal government has limited the amount of private activity bonds that states can issue to a subset of the 21 activities. Some of these are subject to a the state’s bond volume cap., while others are not.
- The state or local government does not generally pledge its credit for payment of the bonded debt.
- Private activity bonds are normally payable solely from payments made by the private user of the property financed.
- They bear numerous restrictions imposed by federal and state regulations.

Not Subject to Bond Cap

- Exempt facility bonds:
 - airports,
 - docks and wharves,
 - environmental enhancements of hydro-electric generating facilities,
 - qualified public educational facilities,
 - governmentally owned solid waste disposal facilities,
 - governmentally owned high-speed intercity rail facilities,
 - privately owned high-speed intercity rail facilities (only 75% of the bond proceeds)
- Qualified veterans' mortgage revenue bonds
- Qualified 501(c)(3) bonds

Subject to Volume Cap

- Qualified mortgage revenue bonds (e.g., VHFA)
- Qualified small issue bonds (e.g., VMBB)
- Qualified student loan bonds (e.g., VSAC)
- Qualified redevelopment bonds (e.g., VEDA)
- Exempt facility bonds:
 - mass commuting facilities,
 - facilities for the furnishing of water,
 - sewage facilities,
 - solid waste disposal facilities,
 - qualified residential rental projects,
 - facilities for the local furnishing of electric energy or gas,
 - local district heating or cooling facilities,
 - qualified hazardous waste facilities,
 - privately owned high-speed intercity rail facilities (only 25% of the bond proceeds),
 - qualified enterprise zone and empowerment zone facilities

Qualified Private Activities

Internal Revenue Code Section	Type of Private Activity (Italicized activities must be owned by the issuing government to qualify)	Subject to Volume Cap	Year Established
Sec. 142	Exempt facility bonds		
Sec. 142(c)	<i>Airports</i>	No	1968
Sec. 142(c)	<i>Docks and wharves</i>	No	1968
Sec. 142(c)	<i>Mass commuting facilities</i>	Yes	1981
Sec. 142(e)	Water furnishing facilities	Yes	1968
Sec. 142(a)(5)	Sewage facilities	Yes	1968
Sec. 142(a)(6)	Solid waste disposal facilities	Yes/No ^a	1968
Sec. 142(d)	Qualified residential rental projects	Yes	1968
Sec. 142(f)	Local electric energy or gas furnishing facility	Yes	1968
Sec. 142(g)	Local district heating and cooling facilities	Yes	1982
Sec. 142(h)	Qualified hazardous waste facilities	Yes	1986
Sec. 142(I)	High-speed intercity rail facilities	Yes ^b	1988
Sec. 142(j)	<i>Environmental enhancements of hydroelectric generating facilities</i>	No	1992
Sec. 142(k)	Qualified public educational facilities	No ^c	2001
Sec. 142(l)	Qualified green building and sustainable design projects	No ^c	2005
Sec. 142(m)	Qualified highway and surface freight transfer facilities	No ^c	2005
Sec. 143	Mortgage revenue bonds		
Sec. 143(a)	Qualified mortgage bond	Yes	1968
Sec. 143(b)	Qualified veterans' mortgage bond	No	1968
Sec. 144(a)	Qualified small issue bond	Yes	1968
Sec. 144(b)	Qualified student loan bond	Yes	1976
Sec. 144(c)	Qualified redevelopment bond	Yes	1968
Sec. 145	Qualified 501(c)(3) bond	No	1968

Notes:

a. Exempt from the cap if governmentally owned. Subject to the cap if privately owned.

b. 25% of the bond issue is included in the cap. If the facility is owned by a governmental unit, no cap allocation is required. In addition, if the facility is not governmentally owned, to qualify for tax-exempt status, the owner must elect not to claim any depreciation deductions or investment tax credits with respect to the property financed with the bonds.

c. Educational facility bonds are subject to a separate cap: the greater of \$10 per capita or \$5 million. Green building bonds are subject to a national aggregate amount of \$2 billion through the expiration of the program, scheduled for October 1, 2009. Highway bonds are subject to the following annual issuance limits: \$130 million in 2005; \$750 million each year for 2006 through 2009; \$1.87 billion in 2010; and \$2 billion each year for 2011 through 2015, zero thereafter.

Vermont's 2011 PAB Allocation

January 14, 2011 Emergency Board meeting initial 2011 allocation

Vermont Housing Finance Agency:	\$ 90,000,000
Vermont Student Assistance Corporation:	\$ 50,000,000
Vermont Economic Development Authority:	\$ 20,000,000
Vermont Municipal Bond Bank:	\$ 10,000,000
Contingency:	<u>\$107,820,000</u>
	\$277,820,000

July 21, 2011 Emergency Board meeting reallocation

Vermont Housing Finance Agency:	\$ 90,000,000
Vermont Student Assistance Corporation:	\$ 50,000,000
Vermont Economic Development Authority:	\$ 40,000,000
Vermont Municipal Bond Bank:	\$ 10,000,000
Contingency:	<u>\$ 87,820,000</u>
	\$277,820,000

Final 2011 PAB reallocation to be determined...

Private Activity Bonds - Process

- Each state independently determines the allocation of its volume capacity.
- Unused volume capacity can be carried forward for up to three years, as long as the state identifies the project for which the cap space is dedicated and files notice with the IRS
- Bond capacity that has not been used after three years is then abandoned.
- The tax code steers almost all the cap authority to five uses: industrial development, utilities, mortgage revenue bonds, multifamily housing bonds, and student loan bonds (IRS Code Section 146)
 - (95% of allocation; see Whitaker, 2011)
- The proceeds of mortgage revenue bonds must be directed to households with below-median incomes
 - for the bonds to maintain their tax exempt status. Likewise, low-income renters must occupy at least 20 percent of the units in a multifamily building if it is funded with private activity bonds.

Advantages and Disadvantages

Advantages:

- A frequent advantage of PABs is the private-use of a municipality's tax-exempt name as a means to tax-exempt interest rates.
- This type of a bond results in reduced financing costs because of the exception of federal tax.
- The local government issuer incurs no legal responsibility to repay private activity bonds; rather, the private business's credit quality provides the security for the debt financing and ultimately all repayment responsibilities.

Disadvantages:

- Application process can be expensive and time consuming
- Reporting requirements needed to maintain the bonds' tax-exempt status
- Limited by volume cap causing historical competition for resources
- Many IRS requirements
 - Significant compliance review needed (pre and post issuance)
 - Restrictions is use

PAB Requirement/Restrictions

- Specific requirements are applicable to the particular bond issued. In addition :
- The maturity of the bonds cannot be greater than 120% of the economic life of the asset purchased with the bonds
- less than 25% of the bond proceeds can be used to acquire land (except for qualified first-time farmers)*
- proceeds of the bond issue cannot be used to purchase existing property unless a requirement for “substantial rehabilitation” is satisfied; greater than 15% of the cost of acquiring the property is spent on rehabilitating the property*
- The interest on private activity bonds is not excluded from gross income during any time in which such bonds are held by someone who is a substantial user of the property financed with proceeds of the bonds, or a related person to such substantial user.*
- public approval of bonds, either through public hearing and notice or voter referendum, is required for private activity bonds (26 U.S.C. 147(f)**); and
- no more than 5 percent may be used for other purposes (e.g., working capital, soft costs), but this 5 percent figure is further limited
 - issuance costs cannot be any greater than 2% of the bond proceeds (3.5% for mortgage bond issues of less than \$20 million) (26 U.S.C. 147(g)).
 - The 2% limitation is particularly important for smaller issues because the actual costs of issuance could exceed the threshold.
- private activity bonds cannot be advance refunded

Source: Maguire, Steven, Congressional research Service, Private Activity Bonds: An Introduction, June 2006

* Does not apply to Qualified 501(c)(3) Bonds

**Per IRS: Public approval can be accomplished by either voter referendum or by an applicable elected representative of the governmental entity after a public hearing following reasonable notice to the public.

PABs: Yield Restriction Requirements

- IRS: “ direct or indirect investment of the gross proceeds of an issue in investments earning a yield materially higher than the yield of the bond issue causes the bonds of that issue to be arbitrage bonds. While certain exceptions to these rules may be available, the term “materially higher” is generally applied to certain types of investments as follows:”

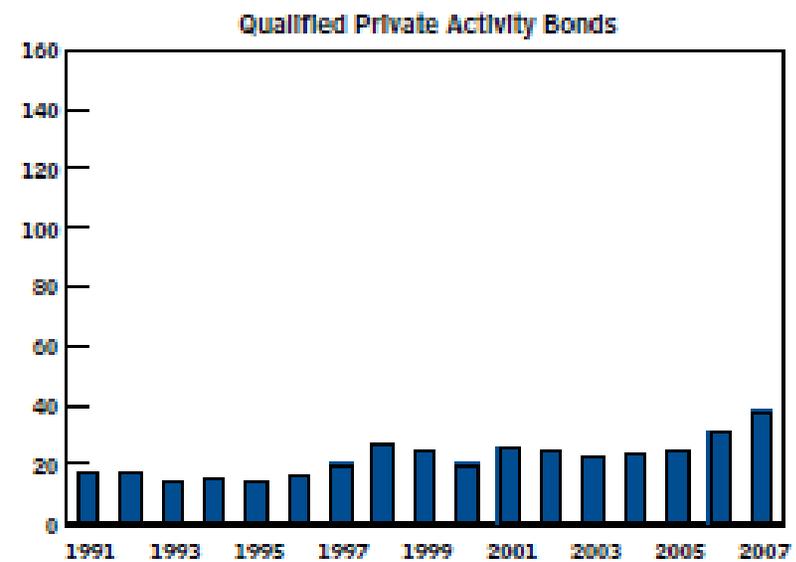
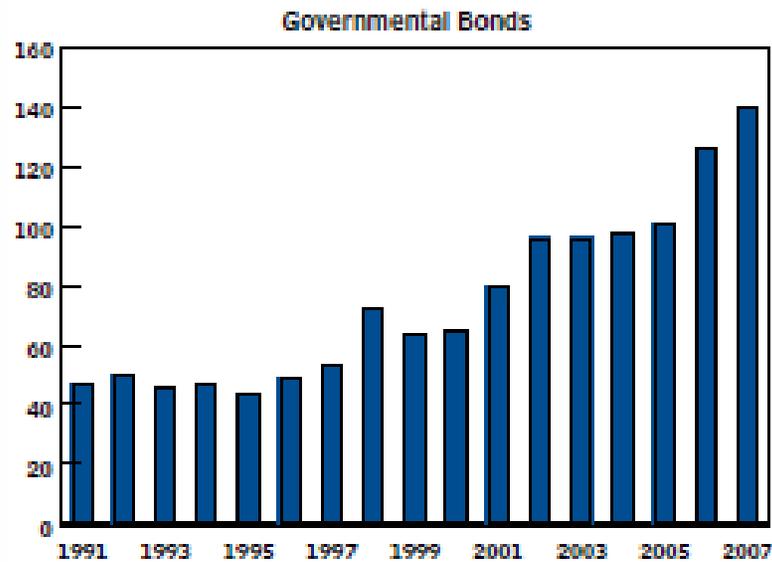
Types of Investments	Materially Higher
general rule for purpose and nonpurpose investments	1/8 of one percentage point
investments in a refunding escrow	1/1000 of one percentage point
investments allocable to replacement proceeds	1/1000 of one percentage point
program investments	one and one-half percentage points
student loans	two percentage points
general rule for investments in tax-exempt bonds	no yield limitation
mortgage loans	must meet the requirements of section 143(g) of the Code

“However, the investment of proceeds in materially higher yielding investments does not cause the bonds of an issue to be arbitrage bonds in the following three instances: 1) during a temporary period (i.e., generally, 3-year temporary period for capital projects and 13 months for restricted working capital expenditures); 2) as part of a reasonably required reserve or replacement fund; and 3) as part of a minor portion (an amount not exceeding the lesser of 5% of the sale proceeds of the issue or \$100,000”

PAB Volume Cap: National Trends

Issuance of Tax-Exempt Bonds for New Investment in Infrastructure, Calendar Years 1991 to 2007

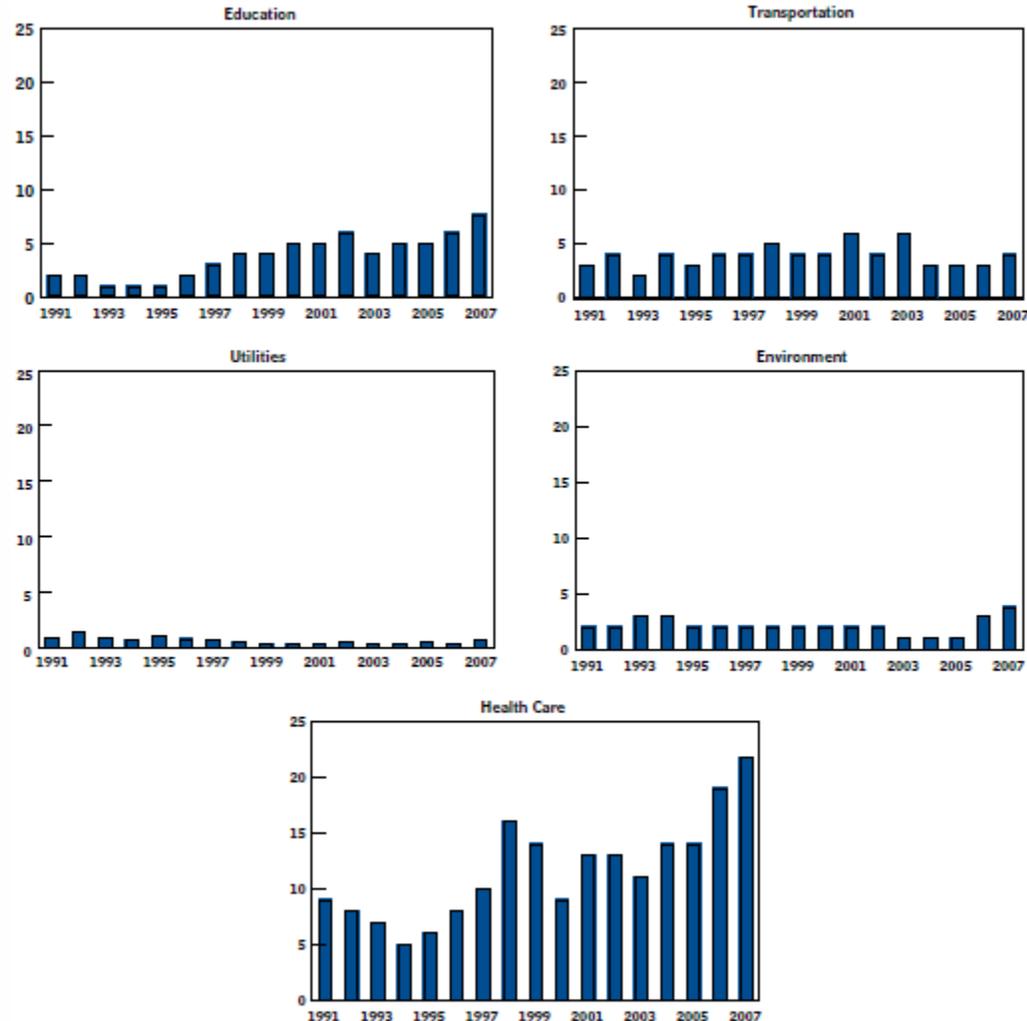
(Billions of dollars)



Source: Congressional Budget Office based on data from the Internal Revenue Service.

Issuance of Qualified Private Activity Bonds for New Investment, by Type of Infrastructure, Calendar Years 1991 to 2007

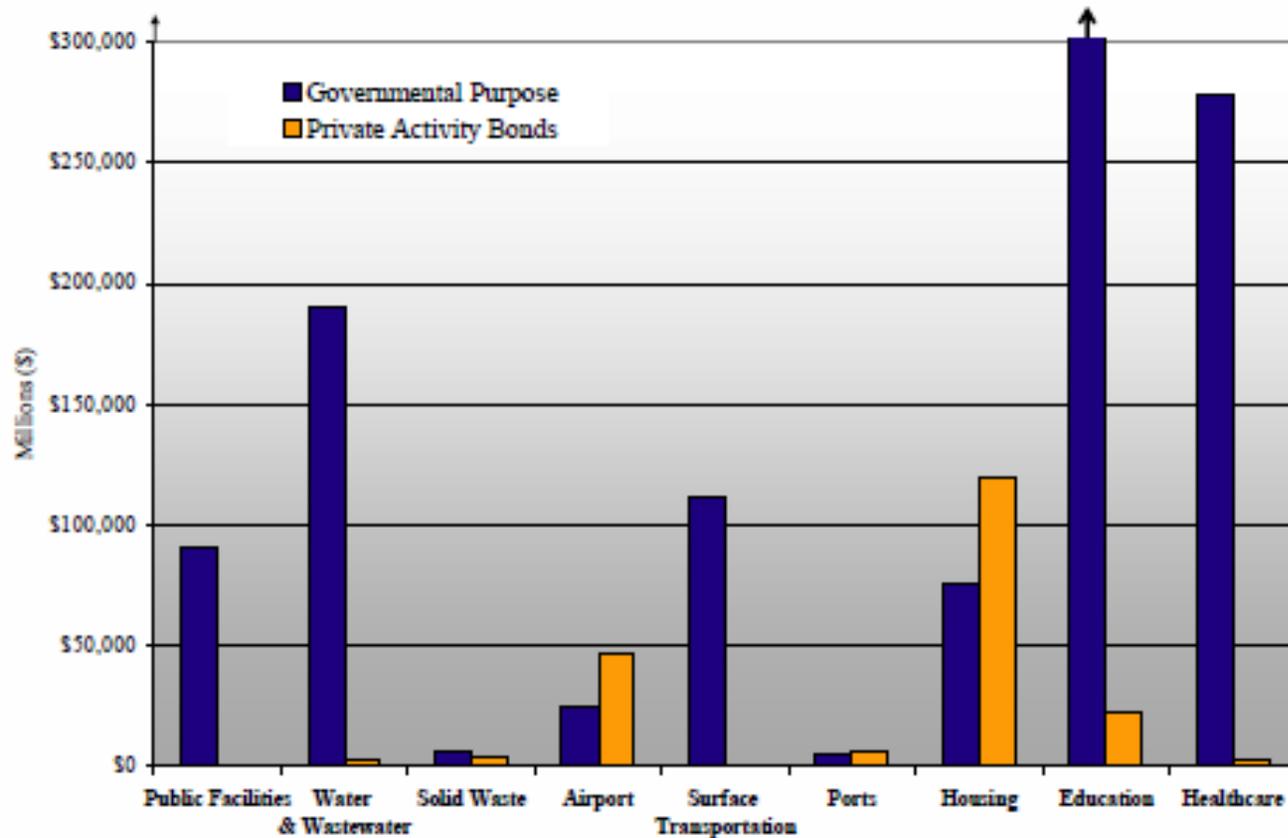
(Billions of dollars)



Source: Congressional Budget Office based on data from the Internal Revenue Service.

Note: Infrastructure categories reflect the grouping of qualified private activity bonds as identified on Internal Revenue Service Form 8038 (Information Return for Tax-Exempt Private Activity Bond Issues). See Box 3-2 for a description of those categories.

Issuance of Governmental Purpose and Private Activity Bonds by Sector from 1995 through 2005



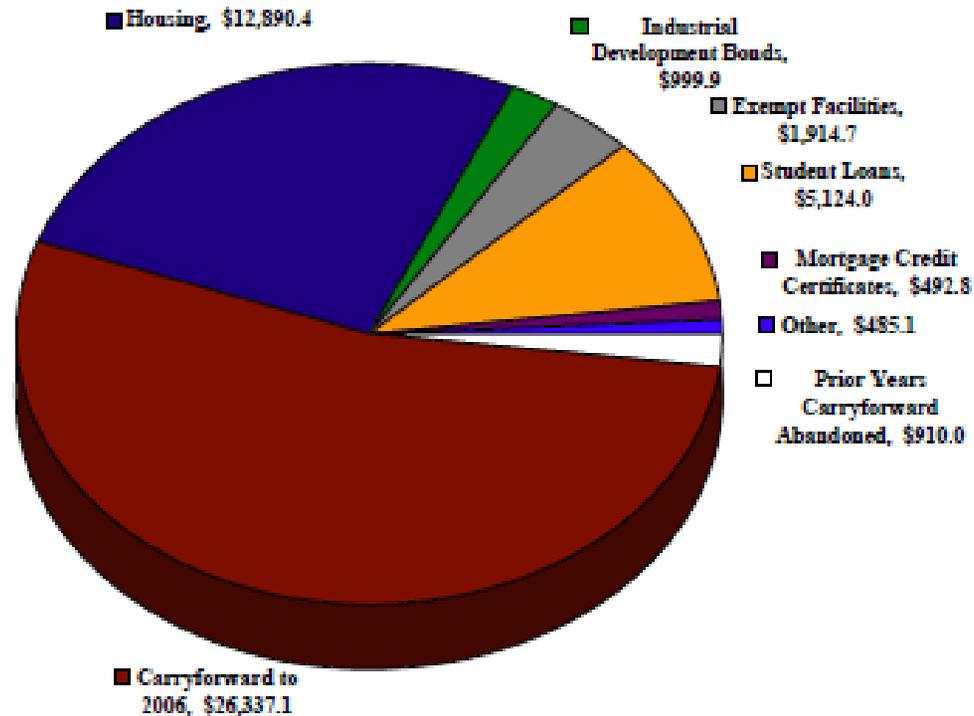
Source: SDC - Thomson Financial

Cited in Lehman Brothers, Paying for Sustainable Water Infrastructure, Use of Tax-Exempt Private Activity Bonds, March 2007

2005 Tax-Exempt Private Activity Bond Volume Cap

Total National Volume Cap Available: \$49 billion

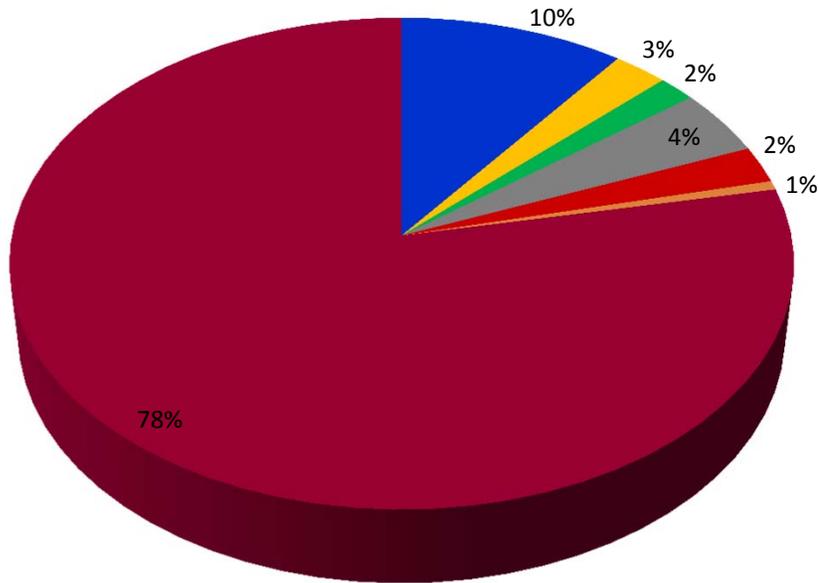
Individual State Volume Cap: The greater of \$80.00 per capita or \$239 million



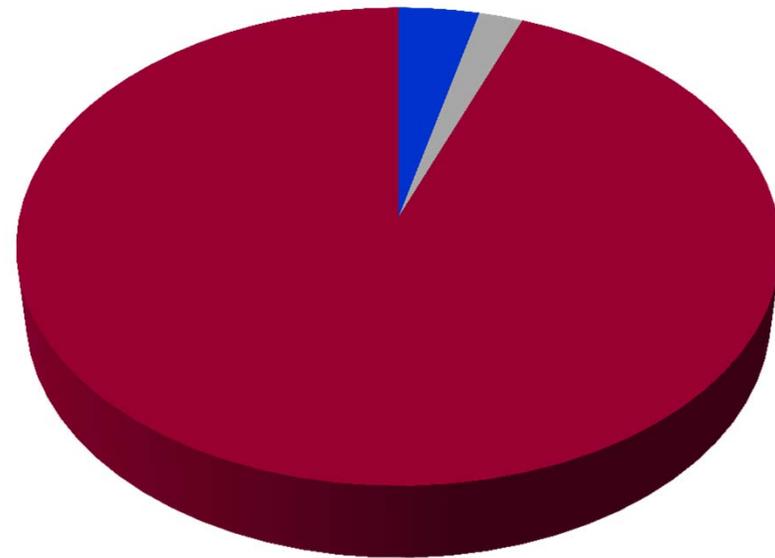
Source: *The Bond Buyer*, pie chart in millions

2009 Activity

2009 U. S. Private Activity Bond Activity Issuance



2009 Vermont Private Activity Issuance



- Housing
- Industrial Development Bonds
- Mortgage Credit Certificates
- Prior Year Carryforward, Abandoned
- Student Loans
- Exempt Facilities
- Other

- Housing
- Industrial Development Bonds
- Prior Year Carryforward, Abandoned

National Trends:

- PAB issuance down in 2008 and 2009
- Bond Buyer: PAB issuance fell in 2008 more than 51% from 2007 levels

Source: Adapted from CDFA, 2009 National Volume Cap Report, July 2010.

Vermont Specific Data

Volume Cap Data from CDFA

Vermont	Amount in \$ Millions		
	2007	2008	2009
Allocating Agency	Emergency Board	Emergency Board	Emergency Board
New Cap	\$256	\$262	\$273
Carryover from Previous Years	\$28	\$1	\$83
Extra Housing Cap		\$97	\$97
Total Capacity	\$284	\$360	\$453
Mortgage Revenue Bonds	\$113	\$50	\$0
Multifamily Housing	\$11	\$7	\$17
Housing Not Broken Out	\$0	\$0	\$0
IDBs	\$15	\$11	\$10
Exempt Facilities	\$5	\$0	\$0
Student Loans	\$139	\$113	\$0
Mortgage Credit Certificates	\$0	\$0	\$0
Other Bond Issuance	\$0	\$0	\$0
Total PAB Issuance	\$283	\$181	\$27
Prior Years Carryforward Abandoned	\$0	\$0	\$0
Carryforward to Next Year	\$1	\$83	\$346
Extra Housing Cap Carryforward to Next Year		\$97	\$79
Total Carryforward to Next Year		\$179	\$426

Private Activity Bond Cap Allocations 2001 to 2011

Summary 2001 to 2011				
Agency	Original Emergency Board Allocation	Amounts Reallocated	Amount of Reallocation Received	Total After Reallocation
Municipal Bond Bank	\$55,000,000	(\$45,000,000)	\$0	\$10,000,000
Jay/Troy Project	\$6,000,000	\$0	\$0	\$6,000,000
Town of Brattleboro	\$3,500,000	\$0	\$0	\$3,500,000
Greater Upper Valley Solid Waste	\$11,500,000	\$0	\$0	\$11,500,000
VEDA	\$185,000,000	(\$104,985,197)	\$5,500,000	\$85,514,803
VHFA	\$976,685,000	(\$57,000,000)	\$39,764,000	\$959,449,000
VSAC	\$1,233,355,000	\$0	\$286,721,197	\$1,520,076,197
Contingency	\$232,820,000	(\$125,000,000)	\$0	\$107,820,000
Totals	\$2,703,860,000	(\$331,985,197)	\$331,985,197	\$2,703,860,000

Data compiled from VSAC spreadsheet

Private Activity Bond Cap Allocations

2001-2003

2001					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0
VEDA	\$20,000,000	(\$14,500,000)	VSAC		\$5,500,000
VHFA	\$77,750,000				\$77,750,000
VSAC	\$84,750,000			\$19,500,000	\$104,250,000
Contingency	\$0				\$0
Totals	\$187,500,000	(\$19,500,000)		\$19,500,000	\$187,500,000

2002					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0
VEDA	\$20,000,000	(\$11,500,000)	VSAC		\$8,500,000
VHFA	\$82,000,000			\$25,000,000	\$107,000,000
VSAC	\$93,000,000			\$16,500,000	\$109,500,000
Contingency	\$25,000,000	(\$25,000,000)	VHFA		\$0
Totals	\$225,000,000	(\$41,500,000)		\$41,500,000	\$225,000,000

2003					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0
VEDA	\$20,000,000	(\$17,349,362)	VSAC		\$2,650,638
VHFA	\$44,000,000				\$44,000,000
VSAC	\$134,580,000			\$47,349,362	\$181,929,362
Contingency	\$25,000,000	(\$25,000,000)	VSAC		\$0
Totals	\$228,580,000	(\$47,349,362)		\$47,349,362	\$228,580,000

Private Activity Bond Cap Allocations

2004-2006

2004					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0
VEDA	\$10,000,000	(\$8,161,142)	VSAC		\$1,838,858
VHFA	\$33,000,000				\$33,000,000
VSAC	\$160,795,000			\$38,161,142	\$198,956,142
Contingency	\$25,000,000	(\$25,000,000)	VSAC		\$0
Totals	\$233,795,000	(\$38,161,142)		\$38,161,142	\$233,795,000

2005					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0
VEDA	\$10,000,000	(\$6,667,250)	VSAC		\$3,332,750
VHFA	\$122,000,000	(\$32,000,000)	VSAC		\$90,000,000
VSAC	\$82,180,000			\$63,667,250	\$145,847,250
Contingency	\$20,000,000	(\$20,000,000)	VSAC		\$0
Totals	\$239,180,000	(\$63,667,250)		\$63,667,250	\$239,180,000

2006					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0
VEDA	\$10,000,000	(\$5,659,786)	VSAC		\$4,340,214
VHFA	\$110,000,000				\$110,000,000
VSAC	\$111,610,000			\$20,659,786	\$132,269,786
Contingency	\$10,000,000	(\$10,000,000)	VSAC		\$0
Totals	\$246,610,000	(\$20,659,786)		\$20,659,786	\$246,610,000

Private Activity Bond Cap Allocations

2007-2009

2007					
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation
Municipal Bond Bank	\$0				\$0
Town of Brattleboro	\$3,500,000				\$3,500,000
Upper Valley Solid Waste	\$1,500,000				\$1,500,000
VEDA	\$10,000,000			\$5,500,000	\$15,500,000
VHFA	\$113,000,000			\$4,500,000	\$117,500,000
VSAC	\$118,235,000				\$118,235,000
Contingency	\$10,000,000	(\$10,000,000)	VHFA/VEDA		\$0
Totals	\$256,235,000	(\$10,000,000)		\$10,000,000	\$256,235,000

2008							
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation	Carry Forward	Unused & Abandoned
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0		
Jay/Troy Project	\$6,000,000				\$6,000,000		
VEDA	\$25,000,000	(\$14,486,459)	VSAC		\$10,513,541		
VHFA	\$113,047,500	(\$25,000,000)	VSAC		\$88,047,500		
VSAC	\$113,047,500			\$44,486,459	\$157,533,959	\$44,486,499	\$0
Contingency	\$0				\$0		
Totals	\$262,095,000	(\$44,486,459)		\$44,486,459	\$262,095,000		

2009							
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation	Carry Forward	Unused & Abandoned
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VHFA/VSAC		\$0		
VEDA	\$25,000,000	(\$15,528,000)	VHFA/VSAC		\$9,472,000		
VHFA	\$75,000,000			\$10,264,000	\$85,264,000		
VSAC	\$168,270,000			\$10,264,000	\$178,534,000	\$178,534,000	\$0
Contingency	\$0				\$0		
Totals	\$273,270,000	(\$20,528,000)		\$20,528,000	\$273,270,000		

Private Activity Bond Cap Allocations

2010-2011

2010							
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation	Carry Forward	Unused & Abandoned
Municipal Bond Bank	\$5,000,000	(\$5,000,000)	VSAC		\$0		
Greater Upper Valley Solid Waste	\$10,000,000				\$10,000,000		
VEDA	\$15,000,000	(\$11,133,198)	VSAC		\$3,866,802		
VHFA	\$116,887,500				\$116,887,500		
VSAC	\$116,887,500			\$26,133,198	\$143,020,698	\$169,153,896	
Contingency	\$10,000,000	(\$10,000,000)	VSAC		\$0		
Totals	\$273,775,000	(\$26,133,198)		\$26,133,198	\$273,775,000		

2011						
Agency	Original Emergency Board Allocation	Amounts Reallocated	Agency Receiving Reallocation	Amount of Reallocation Received	Calendar Year Total After Reallocation	Unused & Abandoned
Municipal Bond Bank	\$10,000,000				\$10,000,000	
Greater Upper Valley Solid Waste	\$0				\$0	
VEDA	\$20,000,000			\$20,000,000	\$40,000,000	
VHFA	\$90,000,000				\$90,000,000	
VSAC	\$50,000,000				\$50,000,000	
Contingency	\$107,820,000	(\$20,000,000)	VEDA		\$87,820,000	
Totals	\$277,820,000				\$277,820,000	

2011 Final Proposed Reallocation

- The following 2011 allocations would be released for reallocation:

\$26,942,520	VEDA
\$10,000,000	VMBB
\$87,820,000	Contingency
\$124,762,520	Total

- Proposal: re-allocate $\frac{1}{2}$ of this to VSAC (\$62,381,260) and the other $\frac{1}{2}$ to VHFA (\$62,381,260). The \$124,762,520 cannot be re-allocated to any other issuer, and if not re-allocated, will be forfeited. VSAC and VHFA will roll forward their unused 2011 allocations.

2012 Proposed Initial Allocation

\$25.00 million VEDA

\$25.00 million VMBB

\$0.30 million Hinesburg sewer project

\$0.00 million VHFA

\$0.00 million VSAC

\$234.26 million Contingency

\$284.56 million Total

- Rationale – VEDA and VMBB requested \$25 million each, and Paul Giuliani requested \$300,000 for a Hinesburg sewer project. The large Contingency for 2012 can be allocated later in the year by the Emergency Board, or the Governor by delegation from the Emergency Board, if projects present themselves from any of these issuers, or from other eligible issuers.
- This will be an ongoing review process to identify the appropriate allocation of contingency to the Emergency Board and the Governor incorporating recommendations received by the Advisory Committee.