

TO: Jo Bradley
Beth Pearce

FROM: Tony Martini

DATE: February 3, 2012

RE: A Brief Overview of Tax-Exempt Financing for
“Exempt Facilities” and Manufacturing Facilities

As you know, last week we discussed the types of privately-owned or -operated facilities that can be financed on a tax-exempt basis when an allocation of private active bond volume cap has been made under the provisions of Section 146 of the Internal Revenue Code of 1986 (the “Code”).

At your request, I have prepared the following summary of the types of facilities that can be financed through the Vermont Economic Development Authority (“VEDA”) with volume cap under current law.¹

Exempt Facilities

Section 142(a) of the Code describes 15 categories of “exempt facilities” that can be financed on a tax-exempt basis, most of which require an allocation of volume cap. Section 142(a) generally requires at least 95% of the “net proceeds” of the issue to be used to finance costs chargeable to the capital account of these exempt facilities. These facilities are as follows:

1. Airports. Governmentally-owned airport facilities that are used to serve the general public (*i.e.*, as general aviation or common carrier facilities), including certain storage and training facilities. Facilities for lodging and for certain types of on- and off-airport retail establishments do not qualify as airport facilities for these purposes.²
2. Docks and Wharves. Governmentally-owned docks and wharves that are located in a public port or serve the general public.

¹ Please note that the principal aim of this memorandum is to catalog the types of facilities that can be financed with tax-exempt bonds following an allocation of volume cap under Code Section 146. The other requirements of federal tax law that apply to these so-called “qualified private activity bond” financings, including the public hearing and approval requirement of Code Section 147(f), the limitation on financing for costs of issuance under Code Section 147(g), the reimbursement rules of Treasury Regulations Section 1.150-2 and many others, are beyond the scope of this piece.

² Note that airport facilities, as well as docks and wharves facilities, which are described in the immediately following text, may be tax-exempt financed without an allocation of volume cap.

3. Mass Commuting Facilities. Governmentally-owned mass-commuting facilities, such as commuter rail or bus terminal facilities. Mass commuting vehicles do not qualify as “mass commuting facilities”.
4. Water Furnishing Facilities. Facilities for the furnishing of water, such as artesian wells, reservoirs, dams and pipelines, that are available to the general public (including electric utility, industrial, agricultural or commercial users). These facilities must be (i) operated by a governmental unit or (ii) the rates for furnishing or selling the water must be set or approved by a governmental unit or by a public service or public utility commission or other similar body.
5. Sewage Facilities. Facilities for the transportation and treatment of what is traditionally characterized as “municipal sewage” (based on an expected wasteload concentration of biochemical oxygen demand), principally in facilities that are so-called “secondary treatment” facilities. Certain primary and tertiary sewage treatment facilities, together with related assets such as sewer mains and pumps, also qualify as sewage facilities.
6. Solid Waste Disposal Facilities. Facilities for the processing or disposal of solid waste material. These facilities can range from relatively conventional landfills and transfer stations to recycling facilities to complex waste-to-energy or gasification facilities.³
7. Qualified Residential Rental Projects. Projects containing multiple residential units (*i.e.*, apartment units) that are available for rental by the general public, provided that a specified percentage of the units must be set aside for low- and moderate-income renters.
8. Local Electric Energy or Gas Furnishing Facilities. Facilities for the furnishing of electric energy or gas solely within a service area consisting of (a) a city and 1 contiguous county or (b) 2 contiguous counties. Although this category of exempt facility remains on the books under current law, it was substantially repealed in the late 1990s in connection with the imposition by the Federal Energy Regulatory Commission of an “open access” regime for the transmission of electric energy across most service areas in the country.⁴
9. Local District Heating and Cooling Facilities. Facilities that are part of a local district heating or cooling system consisting of a pipeline or network providing hot or chilled water or steam to two or more users for residential, commercial or industrial heating or cooling or process steam. To constitute a “local system,” the facilities must serve an area consisting of no more than a city and one contiguous county.

³ Note that an allocation of volume cap is not required for an issue of bonds that finances governmentally-owned solid waste disposal facilities.

⁴ Under the repealer, “local furnishing” bonds generally cannot be issued today, unless the financed facilities will be used by a person who was engaged in the local furnishing of the same energy source on January 1, 1997, to provide service within a service area no greater than that served by the same person on January 1, 1997.

10. Qualified Hazardous Waste Facilities. Facilities for the disposal of hazardous solid waste (not including radioactive waste) by incineration or permanent entombment which are subject to the final permit requirements under subtitle C of Title 11 of the Solid Waste Disposal Act as in effect on October 22, 1986. Such a facility qualifies only if the facility (or the portion of facility that is being financed) is used to dispose of hazardous waste generated by the public, as opposed to hazardous waste generated by the owner or operator of the facility or a person related to the owner or operator.
11. High Speed Intercity Rail Facilities. Facilities (not including rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas using vehicles that are reasonably expected to be capable of attaining a maximum speed in excess of 150 miles per hour between scheduled stops, but only if such facilities will be available to members of the general public as passengers.
12. Environmental Enhancements of Hydroelectric Generating Facilities. Facilities whose use is related to a federally licensed hydroelectric generating facility owned and operated by a governmental unit and which either (i) protects or promotes fisheries or other wildlife resources (such as a fish ladder or fish hatchery) or (ii) is a recreational facility or other improvement required by the terms or conditions of the federal licensing permit for the operation of the hydroelectric facility.⁵
13. Qualified Public Educational Facilities. Facilities to provide school facilities owned by for-profit entities pursuant to public-private partnership agreements with a State or local educational agency. The school facilities must be operated as part of a system of public schools. Qualifying facilities include school buildings and functionally related and subordinate land and can include stadiums or other athletic facilities used primarily for school events.⁶
14. Qualified Green Building and Sustainable Design Facilities. A category for a limited number of projects designated by the Secretary of the Treasury meeting certain specified conservation and technology innovation objectives, including electric consumption and sulfur dioxide emission reductions.⁷
15. Qualified Highway or Surface Freight Transfer Facilities. Generally, any facility for the transfer of freight from truck to rail or from rail to truck, including temporary storage

⁵ Generally, no volume cap allocation is required for 75% of a “fish ladder” issue, but volume cap is required for the remaining 25%. This 25% requirement does not apply if the financed facilities are governmentally owned.

⁶ Bonds for qualified public school facilities are not subject to the general volume limitation under Code Section 146 but are subject to a separate volume limitation set forth in Code Section 142(k).

⁷ Bonds for qualified green building and sustainable design facilities are not subject to the general volume limitation under Code Section 146 but are subject to a separate volume limitation set forth in Code Section 142(l).



facilities relating to such transfers, which receives assistance under Title 23 or Title 49 of the United States Code.⁸

Manufacturing Facilities

Code Section 144(a) permits “qualified small issue” bonds to be issued on a tax-exempt basis pursuant to an allocation of volume cap to finance manufacturing facilities. Generally, these bonds are limited to an amount not exceeding \$10,000,000, and at least 95% of the “net proceeds” of the issue must be used to finance costs chargeable to the capital account of assets used for the manufacturing (*i.e.*, a process resulting in a substantial transformation) of tangible personal property. Moreover, at least 75% of such proceeds must be used on costs directly related to actual manufacturing activities, as opposed to costs of activities that are “ancillary” to manufacturing, such as raw materials storage or post-manufacturing shipping. Substantial limitations are imposed under the Code on the total amount of capital expenditures made from bond proceeds or other sources by the borrower of the bonds and others during a six-year period beginning three years prior to the issue date, such that the benefits of this type of financing are generally reserved for small-scale manufacturers.

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The foregoing is a summary of the principal types of facilities that can be financed with tax-exempt VEDA bonds pursuant to a volume cap allocation under Section 146 of the Code. There are other types of private activity bonds that can be issued on a tax-exempt basis with volume cap, including qualified mortgage bonds (also known as “single family” bonds), qualified veterans’ mortgage bonds, qualified student loan bonds and qualified redevelopment bonds. Section 146 volume cap also may be used by governmental bond issuers for certain issues in which the applicable private activity bond limitations of Code Section 141 otherwise would be exceeded, in cases in which the issuer is financing electric or gas output facilities.

If you would like information about these other types of bonds, or have questions about any of the categories of exempt facility or manufacturing facility bonds described above, please do not hesitate to contact me.

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⁸ Bonds for qualified highway or surface freight transfer facilities are not subject to the general volume limitation under Code Section 146 but are subject to a separate volume limitation set forth in Code Section 142(m).