

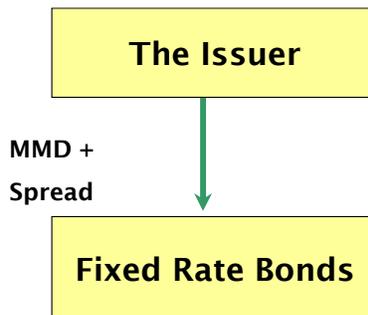
Finance 302

The "Post Crisis" Municipal Market



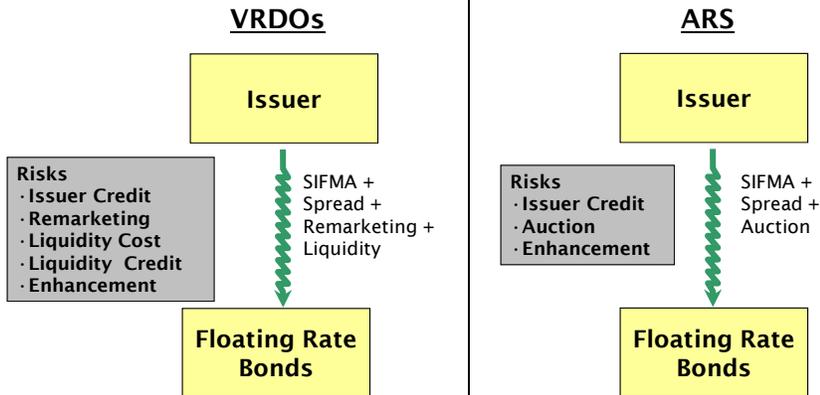
Center for Public Investment Management

Fixed Rate Bond Structure



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Variable Rate Bond Structures



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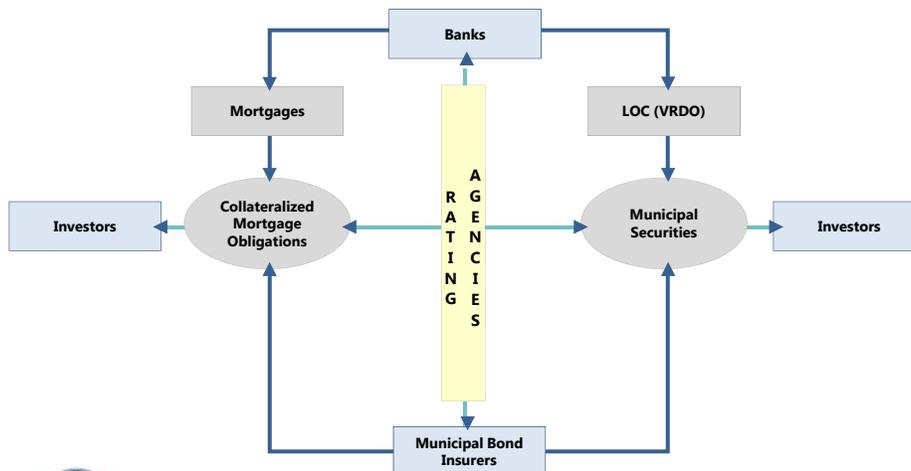
Risk Comparison of Debt Products

	Fixed Rate Bonds	VRDOs	ARS
Tax Risk	No	Yes	Yes
Liquidity Risk	No	Yes	No
Remarketing/Auction Risk	No	Yes	Yes
Credit Exposure	No	Yes	Yes



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Players in the Financial Market Crisis



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The Sub-Prime Mortgage Market

- Low interest mortgage products were created (ARMs, Interest Only, etc.).
- Documentation and credit standards were relaxed.
- Mortgages were securitized into collateralized debt obligations (CDOs).



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The Sub-Prime Mortgage Market

- CDOs were insured by AAA rated monoline insurance companies (bond insurers) in order to obtain higher ratings and attract a wider investor base.
- Interest rates increased.
- Other costs were incurred.



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The Sub-Prime Mortgage Market

- Defaults and foreclosures increased.
- Property values declined.
- CDO payments in jeopardy.
- CDOs downgraded.
- Bond insurers were downgraded.
- Banks and investors stuck with "toxic assets" that must be written down.



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The Credit Crisis

- Banks and other financial institutions had to write-down “toxic assets.”
- Reduced asset base restricted lending and the availability of credit.
- Credit became extremely expensive when/where available.
- Unused credit facilities closed.



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Impact on the Municipal Market

- Bond Insurers downgraded.
- Lack of liquidity.
- Auction Rate Securities.
 - Failed auctions
 - Increased interest costs
- Issuers unable to refund ARS.



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Impact on the Municipal Market

- VRDOs
 - Failed remarketings
 - Increased interest costs
 - Increased liquidity costs
- Dislocation between tax-exempt and taxable interest rates (even high grade municipals).
- Investor base shift from institutional to retail.
- Major market “sell off.”



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Bond Insurers Continue to Face Major Challenges

- The sub-prime debt crisis has had its greatest impact on the monoline bond insurers—nearly all have been downgraded or are at risk of a downgrade.
- Most companies have effectively ceased to offer new insurance policies.
- The ability to solicit cost effective bids from the insurers, while monitoring trading spreads for both insured and uninsured bonds has become increasingly important.
- This credit market dislocation has also placed greater focus on the underlying credit quality of municipal issuers.
- Insurance is much less prevalent in the municipal market. Where available, it is much more expensive with more restrictive covenants.



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Bond Insurers Continue to Face Major Challenges

Summary of Bond Insurer Ratings

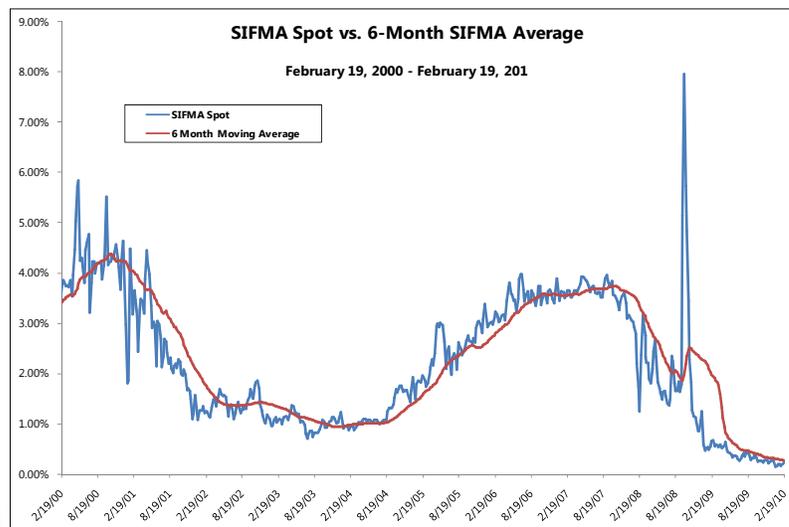
Insurer	Moody's		Standard & Poor's		Fitch	
	Rating	Status	Rating	Status	Rating	Status
Berkshire Hathaway	Aaa	Stable outlook	AAA	Stable outlook	NR	-
Assured Guaranty	Aa2	Stable outlook	AAA	Stable outlook	AAA	Stable outlook
FSA	Aa3	Outlook developing	AAA	Negative watch	AAA	Negative watch
Radian	A3	Under review for downgrade	BBB+	Negative outlook	NR	-
Ambac	Baa1	Outlook developing	A	Negative watch	NR	-
MBIA	Baa1	Under review for downgrade	AA	Negative outlook	NR	-
FGIC	Caa1	Negative outlook	CCC	Negative outlook	CCC	On "evolving" watch
CIFG	B3	Under review, direction uncertain	B	Developing watch	NR	-
ACA	NR	-	NR	-	NR	-
Syncora Guarantee Inc. (formerly XL Capital Assurance)	Caa1	Under review, direction uncertain	B	Developing watch	NR	-

As of December 22, 2008



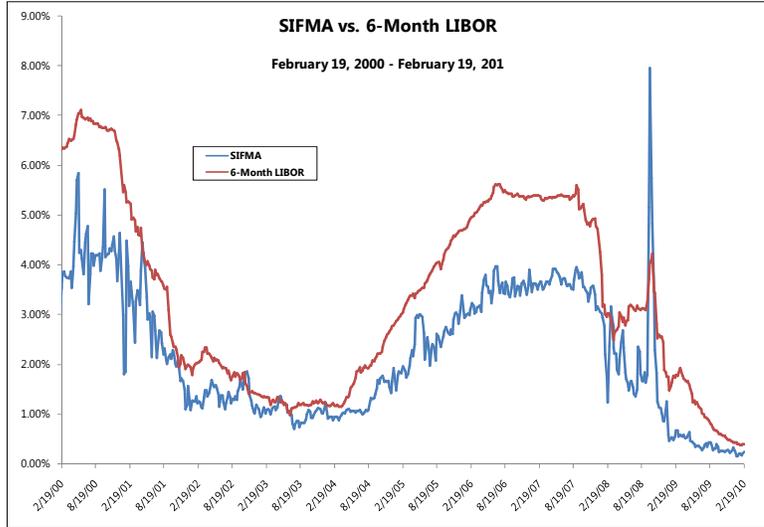
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SIFMA Spot vs. 6-Month SIFMA Average



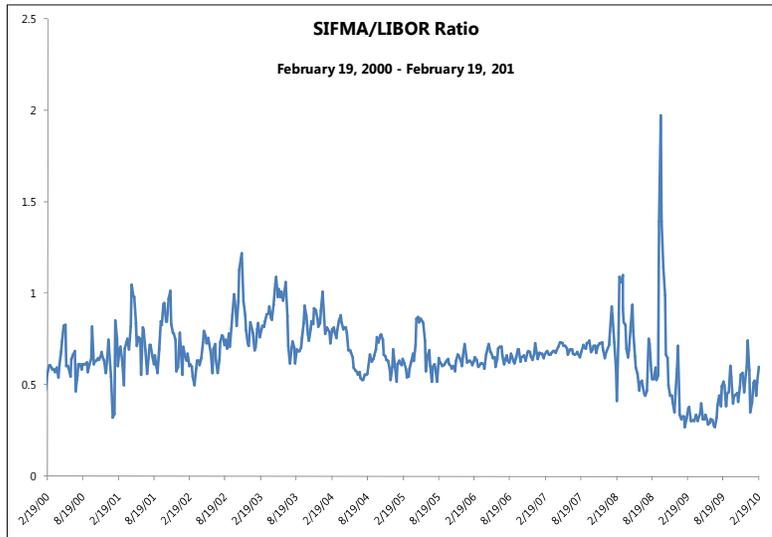
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SIFMA Spot vs. 6-Month LIBOR



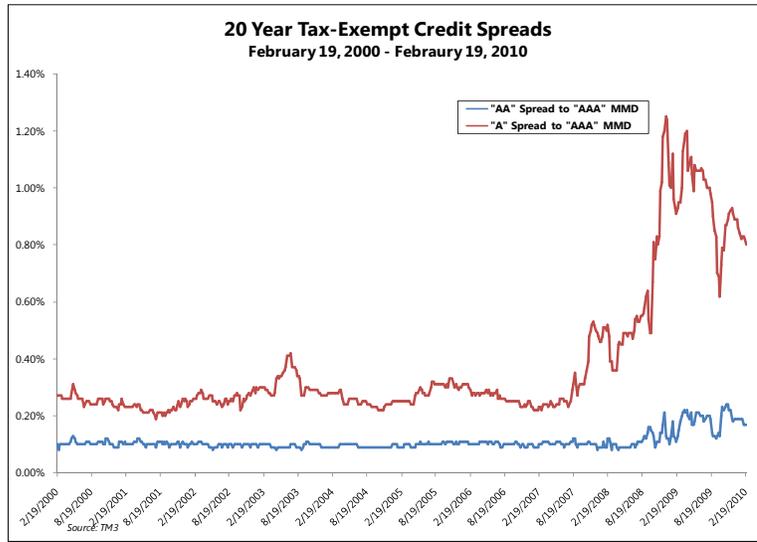
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SIFMA/LIBOR Ratio



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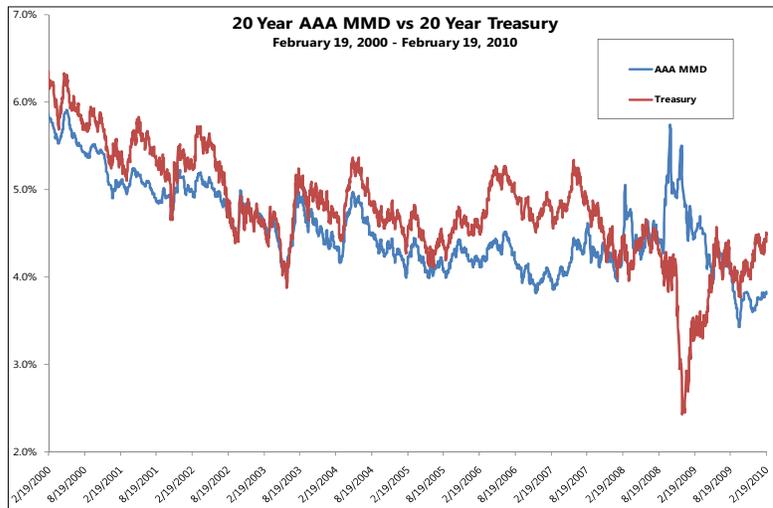
20 Year Tax Exempt Credit Spreads



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20 Year AAA MMD vs. 20 Year Treasury



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Impact on the Stock Market

- Financial institutions' stock values declined precipitously.
- Some financial institutions face the possibility of bankruptcy.
- Consolidation of financial institutions.



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Impact on the Stock Market

- Money market fund "breaks the buck."
- Major market "sell off" (flight to quality?). Investors lose trillions of dollars of value on their investments (retirement accounts, college tuition accounts, etc.).



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Impact on the Economy

- Consumer confidence decreased.
- Consumer spending decreased.
- Unemployment increased.
- Tax base eroded.
- Municipalities face severe budget deficits.
- Economy in a recession.



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Federal Government Actions

- Fed stepped in to guarantee MMFs.
- FDIC insurance limits increased.
- FMOC lowered interest rates.
- Federal Government bailed out banks (with TARP money) to provide liquidity and "unfreeze" credit.



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Federal Government Actions: What's Next?

- Federal Government _____ to address the banking crisis.
- Federal Government _____ to address the auto industry crisis.
- Federal Government _____ to address the mortgage crisis.



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Federal Government Actions: What's Next?

- Federal Government _____ to address the local government crisis.
- Federal Government _____ to address the unemployment crisis.
- Federal Government _____ to address the credit card crisis.



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Build America Bonds

The American Recovery and Reinvestment Act of 2009 (April 2009)

- Created BABs as a new financing tool for state and local governments
- BABs are an alternative to traditional tax-exempt debt.
- BABs attract a different buyer (i.e. global taxable investors).



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

- BABs provide more borrowing capacity and lower borrowing costs.
- BABs are currently authorized through December 31, 2010.
- The authority to issue BABs may be extended.



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

The ARRA authorized 2 types of BABs, which are taxable bonds with Federal subsidies:

1. Tax credits given to holders
2. Interest subsidies paid directly to the issuer

Note: Securities involving tax credits have not been as widely used.



FIN 302: The "Post Crisis" Municipal Market

American Recovery & Reinvestment Act of 2009

- On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was signed into law by President Barack Obama.
- The Act contains modifications to certain existing rules governing municipal bonds and creates several new financing vehicles for municipal issuers.

Modifications in General Tax-Exempt Bond Restrictions

	Interest Expense Safe Harbor	Bank Qualified Bonds	Alternative Minimum Tax	Qualified Zone Academy Bonds (QZABs)
General Rule	Individuals and corporations, but not financial institutions, can invest 2% of assets in tax-exempt bonds and deduct allowable interest	Issuers must not issue more than \$10 million in bonds in calendar year in order for bonds to be Bank Qualified	All tax-exempt private activity bonds except housing bonds and 501(c)(3) bonds are subject to Alternative Minimum Tax	Limited to \$400 million total issuance nationwide in 2009 and \$0 thereafter
Stimulus Plan Modification	Rule expanded to include financial institutions for municipal bonds issued in 2009 and 2010	Bank Qualified amounts increased to \$30 million for 2009 and 2010; allows pooled loans to treat each borrower as a separate issue in order to meet requirements	Alternative Minimum Tax suspended through Dec. 31, 2010 (except for refundings of AMT bonds issued before 2004)	National limit increased to \$1.4 billion for each of 2009 and 2010



FIN 302: The "Post Crisis" Municipal Market

New Authorizations for Tax-Exempt Bonds (see next 3 pgs)

Name/Description/ Type of Bond	Build America Bonds (BABs)		Qualified School Construction Bonds (Taxable w/ Tax Credit)	Recovery Zone Economic Development Bonds (Taxable)	Recovery Zone Facility Bonds (Tax-Exempt)
	Tax Credit Bonds (Taxable)	Interest Subsidy Bonds (Taxable)			
Tax Benefit/Credit	Tax Credit equal to 35% of the interest payable on bonds paid to the purchaser of the taxable bonds	Interest Subsidy equal to 35% of each interest payment of the taxable bonds payable to the issuer	Tax Credit bonds which are to be issued at a credit that permits the bonds to be issued without interest or discount – goal is to provide issuers with 0% cost of funds	Tax Credit equal to 45% of the interest payable on bonds paid to the purchaser or Interest Subsidy equal to 45% of each interest payment payable to the issuer	Tax-exempt private activity bonds
Tax Benefit/Credit Provided to	Investor	Issuer	Investor	Issuer or Investor (Similar to BABs)	Issuer
Issuer of Bonds	Any State or local government issuer of tax-exempt bonds		State or local government with jurisdiction over the relevant school	Municipalities with a population in excess of 100,000 and Counties	
Allowable Use of Proceeds	Any qualified governmental purpose, must be non-private activity May be issued for both refunding purposes and capital expenditure purposes	Only for new capital expenditures, bond issuance, DSRF deposit	To finance the construction, rehabilitation and repair of public school facilities, or the acquisition of land on which a public school facility will be constructed	To promote development and other economic activity in a "recovery zone", including capital expenditures for property located in the zone, expenditures for public infrastructure and construction of public facilities, and job training and educational programs.	Ninety-five percent (95%) of the proceeds of such bonds, net of the deposit, if any, to a DSRF-eligible expenditure To construct, reconstruct, renovate or acquire property in a Recovery Zone
Restrictions	Bonds cannot be issued with more than a <i>de minimis</i> amount of premium that applies to private activity bonds, including 501(c)(3) bonds Tax-exempt rules apply (arbitrage rebate, private use)		100% of the available project proceeds must be used for at least one of the purposes above Issuer must designate the bonds as Qualified School Construction Bonds Face amount of the bonds does not cause the issuer's allocated limit for each type of bonds for that year to be exceeded National limit is \$1.3 billion/year Allocated 50% to States in proportion to the respective amount of government bonds each State is eligible to receive, 40% to 100 largest school districts and 10 to school districts chosen by Secretary of Education	One-time nationwide volume cap of \$10 billion with respect to such bonds Authority of use will be allocated to States in proportion to decline in employment for 2008 Bonds must be governmental bonds	Subject to a one-time nationwide volume cap of \$1.3 billion Authority of use will be allocated to States in proportion to decline in employment for 2008 Bonds must be governmental bonds
Advantages	Potential to access new investor base Credits can be carried forward if not used in the tax year May be stripped by the issuer from the bond and separately sold	Potential to significantly expand investor base Requires no investor involvement in Tax Credit process No volume allocation	Tax Credit is set at a rate that will permit the bonds to be sold at par Tax Credit may be stripped off and sold separately Unused credits can be carried forward	Greatest Tax Credit: 45% of the bond interest rate	Wide range of facilities eligible to be financed Tax-exempt funding provided to private business
Issues to Consider	Uncertain investor appetite; previous Tax Credit bonds had limited investor base Reduced income levels may decrease appetite for Tax Credit bonds	Use of proceeds only new money Taxable bonds generally issued as non-callable Increased ongoing disclosure	Private use limitations Unclear details about location of schools that are eligible	Uncertain allocation – subject to volume cap	Uncertain allocation – subject to volume cap



FIN 302: The "Post Crisis" Municipal Market

New Authorizations for Tax-Exempt Bonds, p. 1 of 3

Name/Description/ Type of Bond	Build America Bonds (BABs)	
	Tax Credit Bonds (Taxable)	Interest Subsidy Bonds (Taxable)
Tax Benefit/Credit	Tax Credit equal to 35% of the interest payable on bonds paid to the purchaser of the taxable bonds	Interest Subsidy equal to 35% of each interest payment of the taxable bonds payable to the issuer
Tax Benefit/Credit Provided to	Investor	Issuer
Issuer of Bonds	Any State or local government issuer of tax-exempt bonds	
Allowable Use of Proceeds	- Any qualified governmental purpose, must be non-private activity - May be issued for both refunding purposes and capital expenditure purposes	- Only for new capital expenditures, bond issuance, DSRF deposit
Restrictions	- Bonds cannot be issued with more than a <i>de minimis</i> amount of premium - Not applicable to private activity bonds, including 501(c)(3) bonds - Tax-exempt rules apply (arbitrage rebate, private use)	
Advantages	- Potential to access new investor base - Credits can be carried forward if not used in the tax year - May be stripped by the issuer from the bond and separately sold	- Potential to significantly expand investor base - Requires no investor involvement in Tax Credit process - No volume allocation
Issues to Consider	- Uncertain investor appetite; previous Tax Credit bonds had limited investor base - Reduced income levels may decrease appetite for Tax Credit bonds	- Use of proceeds only new money - Taxable bonds generally issued as non-callable - Increased ongoing disclosure



FIN 302: The "Post Crisis" Municipal Market

New Authorizations for Tax-Exempt Bonds, p. 2 of 3

Qualified School Construction Bonds (Taxable w/ Tax Credit)
Tax Credit bonds which are to be issued at a credit that permits the bonds to be issued without interest or discount – goal is to provide issuers with a 0% cost of funds
Investor
State or local government with jurisdiction over the relevant school
- To finance the construction, rehabilitation and repair of public school facilities or the acquisition of land on which a public school facility will be constructed
- 100% of the available project proceeds must be used for at least one of the purposes above - Issuer must designate the bonds as Qualified School Construction Bonds - Face amount of the bonds does not cause the issuer's allocated limit for such types of bonds for that year to be exceeded - National limit is \$11 billion/year - Allocated 60% to States in proportion to the respective amounts of government funds each State is eligible to receive, 40% to 100 largest school districts and 25 to school districts chosen by Secretary of Education
- Tax Credit is set at a rate that will permit the bonds to be issued at par - Tax Credit may be stripped off and sold separately - Unused credits can be carried forward
- Private use limitations - Unclear details about location of schools that are eligible



FIN 302: The "Post Crisis" Municipal Market

New Authorizations for Tax-Exempt Bonds, p. 3 of 3

Recovery Zone Economic Development Bonds (Taxable)	Recovery Zone Facility Bonds (Tax-Exempt)
Tax Credit equal to 45% of the interest payable on bonds paid to the purchaser or Interest Subsidy equal to 45% of each interest payment payable to the issuer	Tax-exempt private activity bonds
Issuer or Investor (Similar to BABs)	Issuer
Municipalities with a population in excess of 100,000 and Counties	
- To promote development and other economic activity in a "recovery zone," including capital expenditures for property located in the zone, expenditures for public infrastructure and construction of public facilities, and job training and educational programs	- Ninety-five percent (95%) of the proceeds of such bonds, net of the deposit, if any, to a DSRF eligible expenditure - To construct, reconstruct, renovate or acquire property in a Recovery Zone
- One-time nationwide volume cap of \$10 billion with respect to such bonds - Authority of use will be allocated to States in proportion to declines in employment for 2008 - Bonds must be governmental bonds	- Subject to a one-time nationwide volume cap of \$15 billion - Authority of use will be allocated to States in proportion to declines in employment for 2008 - Bonds must be governmental bonds
- Greatest Tax Credit: 45% of the bond interest rate	- Wide range of facilities eligible to be financed - Tax-exempt funding provided to private business
- Uncertain allocation – subject to volume cap	- Uncertain allocation – subject to volume cap



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

- Generally, the same tax restrictions apply to BABs which apply to traditional tax-exempt bonds (i.e. they cannot be issued to finance private activity).
- Direct Subsidy BABs can be issued in combination with traditional tax-exempt bonds.



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

- The Federal subsidy is paid to the issuer by the IRS.
- The subsidy is equal to 35% of the total coupon interest on the Direct Subsidy BAB.



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

'Aa3/NR/A' - Rates as of 2/18/10

Term	Tax-Exempt			US Treasury Benchmark	Yield	Spread	Make-Whole BABs			Spread	Callable BABs		
	MMD	Spread	Yield				BAB Yield	After-Subsidy Yield	Yield Savings		BAB Yield	After-Subsidy Yield	Yield Savings
5	1.51%	100	2.51%	2.25 due 01/31/15	2.47%	302	5.49%	3.57%	-1.06%	302	5.49%	3.57%	-1.06%
10	2.89%	100	3.89%	3.625 due 02/15/20	3.79%	237	6.16%	4.00%	-0.11%	237	6.16%	4.00%	-0.11%
15	3.37%	100	4.37%	3.625 due 02/15/20	3.79%	283	6.62%	4.30%	0.07%	313	6.92%	4.50%	-0.13%
20	3.83%	100	4.83%	4.625 due 02/15/40	4.72%	230	7.02%	4.56%	0.27%	260	7.32%	4.76%	0.07%
25	4.10%	98	5.08%	4.625 due 02/15/40	4.72%	240	7.12%	4.63%	0.45%	275	7.47%	4.86%	0.22%
30	4.19%	98	5.17%	4.625 due 02/15/40	4.72%	250	7.22%	4.69%	0.48%	290	7.62%	4.95%	0.22%



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

- Most BAB issues have optional call provisions, as well as, extraordinary call provisions.
- Call provisions vary (par call vs. make whole call).
- Most BABs have been issued as par bonds (vs. premium or discount bonds).



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Build America Bonds

BAB Pricing and Credit Considerations

- **Extraordinary Events** – An “extraordinary event” will have occurred if Section 54AA or 6431 of the Internal Revenue Code of 1986, as amended (as such Sections were added by Section 1531 of the Recovery Act, pertaining to Build America Bonds), is modified, amended or interpreted in a manner pursuant to which an issuer’s cash subsidy payment from the United States Treasury is eliminated or reduced.
- **Interest Subsidy Payment Offsets** – Some issuers’ interest subsidy payments are subject to offsets against certain amounts that may, for unrelated reasons, be owed by their respective states, counties or authorities to an agency of the United States.



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Build America Bonds

- **Not Receiving Subsidy in Time for Payment of Interest** – In some instances, in the event that the issuer does not receive the cash subsidy payment from the US Treasury in a timely fashion to pay the 35% interest of the stated interest on each payment date subsidy, the issuer is obligated to pay such amounts from other available funds
- **Receipt of the Subsidy Payments** – Issuers are subject to certain requirements imposed by the IRS Code of 1986 which must be met in order to receive the 35% subsidy interest payment, including:
 - The use of the proceeds of the BABs;
 - Yield and other restrictions on investments of available project proceeds, including redemptions of unspent proceeds at a specified anniversary date; and
 - The filing of a form with the Internal Revenue Service prior to each interest payment date.

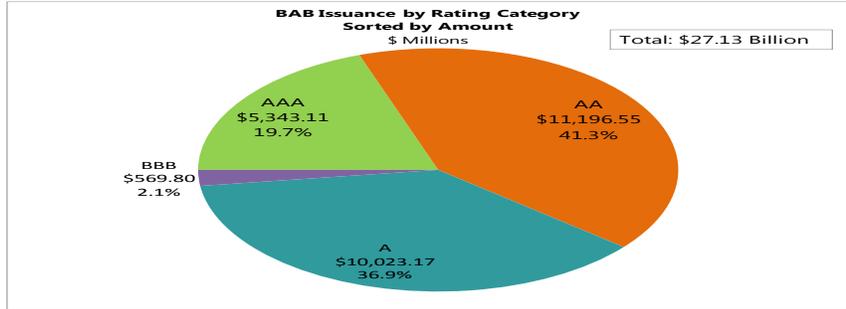


FIN 302: The "Post Crisis" Municipal Market

BAB Deals by Rating Category & Type of Issuer, p. 1 of 3

- Through November 2009, AA rated issuers have raised the most capital (\$11.2 billion) while accessing the BAB market most frequently, with 43 issues, or 54%, of the total.
- Over that same time period, transportation issuers seized the opportunity of a new funding source by issuing \$8.9 billion, or 33%, of the market for deals with a maturity greater than \$50 million.

Transactions Greater than \$50 Million in Par: \$27.13 Billion Total



* Issues with split ratings were grouped according to highest rating.

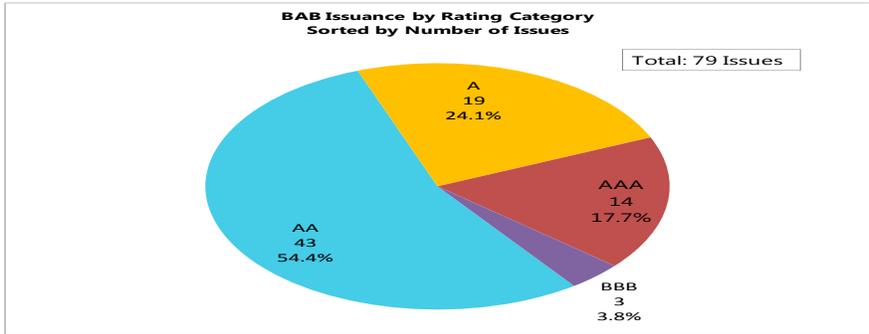


FIN 302: The "Post Crisis" Municipal Market

BAB Deals by Rating Category & Type of Issuer , p. 2 of 3

- Through November 2009, AA rated issuers have raised the most capital (\$11.2 billion) while accessing the BAB market most frequently, with 43 issues, or 54%, of the total.
- Over that same time period, transportation issuers seized the opportunity of a new funding source by issuing \$8.9 billion, or 33%, of the market for deals with a maturity greater than \$50 million.

Transactions Greater than \$50 Million in Par: \$27.13 Billion Total



* Issues with split ratings were grouped according to highest rating.

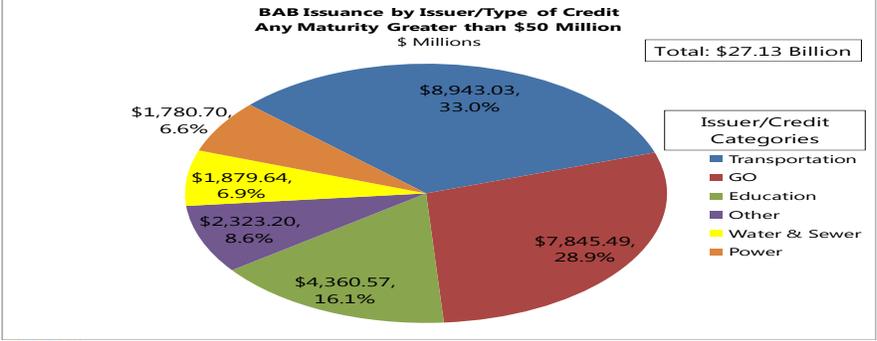


FIN 302: The "Post Crisis" Municipal Market

BAB Deals by Rating Category & Type of Issuer , p. 3 of 3

- Through November 2009, AA rated issuers have raised the most capital (\$11.2 billion) while accessing the BAB market most frequently, with 43 issues, or 54%, of the total.
- Over that same time period, transportation issuers seized the opportunity of a new funding source by issuing \$8.9 billion, or 33%, of the market for deals with a maturity greater than \$50 million.

Transactions Greater than \$50 Million in Par: \$27.13 Billion Total



* Issues with split ratings were grouped according to highest rating.

Major Taxable Investor Participants

- Insurance Companies**
 - Prudential
 - Loews
 - State Farm
 - MetLife
 - Aegon
 - AIG
 - GE Re
- Money Managers**
 - Deutsche AM
 - Blackrock
 - PIMCO
 - Loomis Sayles
 - Fidelity
- State / Corporate Pension Funds**
 - CalPERS
 - State of Washington
 - Ohio Teachers
 - Texas PERS
 - State of New Jersey

- Key Categories of Fixed Income Investors**
- Strong force in the corporate market
 - Consistent flow from traditional insurance products such as GICS, variable life, life insurance, and annuity
 - Credit oriented investors, focused on relative value
 - Now becoming a money manager in addition to traditional insurance products
 - Highly sophisticated total-rate-of-return investors
 - Actively trading nature gives preference for large allocations in large liquid transactions
 - Momentum players that can add volatility to the market
 - Consolidation among money managers is dramatically increasing influence of dominant players
 - Long-term investment horizons, but will participate across the curve
 - Often yield bogey driven
 - Credit quality is important with some investors limited by credit ratings
 - Participation in new offerings can be inconsistent



Build America Bonds

- Generally, BABs may not be used to refund outstanding bonds.
- Up to 2% of the proceeds may be used to finance transaction costs.
- BAB subsidy payments are not Federally guaranteed.



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Build America Bonds

- BABs may only be used to finance capital expenditures.
- BABs may not be used to finance working capital expenditures.
- Federal tax law does not require the subsidy payments be used to pay debt service.



FIN 302: The "Post Crisis" Municipal Market

Credit Considerations: Issuer's Use & Pledge of Subsidy Payments

- Issuers are eligible to receive a cash subsidy payment from the United States equal to 35% of the interest payable.
- **Application of Federal Subsidy** – It has been noted that issuers are applying the 35% interest subsidy in a variety of ways, including the following:

Treatment of Interest Subsidy	Description	Applicability to Coverage and ABT	Example(s)
Net to Debt Service	Subsidy is netted against annual debt service.	For purposes of coverage and ABT calculations, the subsidy reduces annual debt service.	MWAA Dulles Tollway, State of Iowa, North Texas Tollway Authority
Pledged Revenue	Subsidy is pledged as revenue to pay annual debt service.	For purposes of coverage and ABT calculations, the subsidy is treated as revenues.	Public Power Generation
Additional Revenues	Subsidy is not pledged as revenue to pay annual debt service, and it is not considered operating revenue, however constitute additional revenues which <i>can</i> be taken into consideration when establishing rates and charges.	For purposes of coverage and ABT calculations, the subsidy is considered additional revenue.	Southern California Metropolitan Water District
Payment of Expenses	Subsidy is deposited into general fund and applied towards payment of operating expenses.	For purposes of coverage and ABT calculations, the subsidy is excluded.	Pennsylvania Turnpike



FIN 302: The "Post Crisis" Municipal Market

Build America Bonds

- For arbitrage yield purposes, the yield on Direct Subsidy BABs is calculated by reducing the amount of interest paid by the amount of the subsidy payments received.



FIN 302: The "Post Crisis" Municipal Market

Recovery Zone Economic Development Bonds

Recovery Zone Economic Development
Bonds

RZEDBs

Or

“Super BABs”



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Super BABs

- The Federal government has authorized up to \$10 billion national volume cap in Recovery Zone Economic Development Bonds (RZEDBs).
- The Treasury has provided guidance regarding allocations received by each state, including distributions to counties and large municipalities.



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Super BABs

- Super BABs are like Direct Subsidy BABs with more limitations but a higher subsidy payment.
- Super BABs receive an enhanced subsidy rate of 45%.
- The prevailing wage requirement of the Davis-Bacon Act applies to projects financed with Super BABs.



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Super BABs

“Qualified Economic Development Purpose” means expenditures promoting development or other economic activity in a recovery zone including:

- Capital expenditures paid/incurred with respect to property located in such zone



FIN 302: The "Post Crisis" Municipal Market

Super BABs

- Expenditures for public infrastructure and facilities
- Expenditures for job training and educational programs



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Super BABs

The project must be in a Recovery Zone which is any area designated by an issuer as having significant poverty, unemployment, home foreclosure, or general distress or an area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation. It also includes Empowerment Zones and Renewal Community Areas.



FIN 302: The "Post Crisis" Municipal Market

Super BABs

- A county or large municipality may waive some or all of its allocation.



FIN 302: The "Post Crisis" Municipal Market

Qualified School Construction Bonds

Qualified School Construction Bonds

"QSCBs"



FIN 302: The "Post Crisis" Municipal Market

QSCBs

- A new category of tax-credit bonds created by the ARRA to finance the construction, rehabilitation or repair of public school facilities.
- \$11 billion of annual authority for 2009 and 2010, allocated to states
- Structure is similar to existing tax-credit bonds and adds the ability to “strip” the tax credits.



FIN 302: The "Post Crisis" Municipal Market

QSCBs

- The credit rate for QSCBs is required to be set by the Secretary of the Treasury at a rate that permits issuance of such bonds without interest cost to the qualified issuer.
- The Act increases the annual volume limitations for Qualified Zone Academy Bonds (QZABs) in 2009 and 2010 to \$1.4 billion.



FIN 302: The "Post Crisis" Municipal Market

QSCBs

Guidelines for QSCBs Pursuant to IRS Notice 2009-35 and 2009-30

- Notice 2009-35 provides interim guidance and sets forth the allocations of the special volume cap for QSCBs.
- **Use of Proceeds**
 - proceeds of QSCBs must be spent on constructing, rehabilitating or repairing a public school facility or for acquiring land on which such a facility is to be constructed with the proceeds the QSCBs.
 - proceeds of QSCBs may also be spent on costs of acquisition of equipment to be used in portions of public school facilities constructed, rehabilitated or repaired with the proceeds of the QSCBs.
 - No guidance has been provided regarding the use of proceeds of QSCBs to reimburse expenditures paid prior to the issuance of QSCBs.



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QSCBs

• Eligible Issuers

- entities eligible to issue QSCBs include states, political subdivisions, local educational agencies that are state or local governmental entities and entities empowered to issue bonds on behalf of the aforementioned entities.
- an issuer may issue QSCBs as a conduit financing based on a volume cap allocation received by the issuer itself or by a conduit borrower or other ultimate beneficiary of the issue of QSCBs.



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QSCBs

- **Eligible Issuers, cont'd**

- the costs of school facilities financed with the proceeds of an issue of QSCBs must relate to school facilities located within both the jurisdiction of the actual issuer of QSCBs and the jurisdiction of the entity that allocates volume cap to that issue of QSCBs.
- a school district that has received volume cap for QSCBs may either issue QSCBs itself or it may be a beneficiary of QSCBs issued by another eligible issuer provided that the school facilities to be financed with the proceeds of the issue of QSCBs are located within the jurisdiction of both the actual issuer of the QSCBs and the jurisdiction of the school district that allocated volume cap to the issue of QSCBs.



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QSCBs

- Allocations are published at <http://www.irs.gov/pub/irs-drop/n-09-35.pdf>.
- Information Reporting
 - Section 54A(d)(3) requires issuers of QSCBs to submit information reporting returns to the IRS similar to those required to be submitted under § 149(e) for tax-exempt State or local governmental bonds, and are required to be submitted at the same time and in the same manner as those under § 149(e).
 - A timely Form 8038 (as opposed to 8038-G) must be completed and filed for the issue of QSCBs with a notation on Line 20c that the bonds are "QSCBs"



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QSCB Structuring Considerations

QSCBs differ significantly from traditional tax-exempt bonds and have implications for the way they are structured and sold.

	Coupon-Bearing Tax-Exempt Bond	QSCBs
Maturity	Issuer discretion; generally 30 years, consisting of serial and term bonds.	"Bullet" maturity bonds, with the Treasury Department establishing the maximum maturity, typically between 14 and 15 years.
Interest	Payable semi-annually by issuer, in cash.	Federal tax credit in lieu of interest. The amount of the tax credit is determined by multiplying the bond's "credit rate" by the face amount of the holder's bond. Tax credit is payable quarterly, on March 15, June 15, September 15, December 15.
Interest/Credit Rate	Market rate of interest determined at time of issuance.	Tax credit rate determined by the Treasury Secretary on the date the bonds are sold. The applicable maximum maturity date and credit rate are published daily by the Bureau of Public Debt on https://www.treasurydirect.gov .
Amortization	Principal amortizes on basis set by issuer to fully amortize the bonds over their life.	Although QSCBs are issued with a bullet maturity, regulations permit the use of a "sinking fund" to aggregate periodic principal payments.
Sinking Fund	Used to amortize term bonds. Annual principal payments applied to retire bonds.	Sinking fund may be funded annually, with payments aggregated to retire bonds at maturity. Sinking fund may be invested at a yield not greater than the "Permitted Sinking Fund Yield". Permitted sinking fund yield is determined by using a rate equal to 110 percent of the long-term adjusted federal rate, compounded semi-annually, for the month in which the issue of QSCBs was sold. Permitted sinking fund yield for each month will be published on https://www.treasurydirect.gov .
DTC Eligible?	Yes	Yes
CUSIPs	One per principal maturity.	One for principal maturity, separate CUSIP for each quarterly tax credit payment date (e.g. up to 61 for a 15 year maturity).



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QSCBs

Marketing Considerations

- Due to the complexities surrounding the purchase of tax credit bonds, the investor market to date has been dominated by taxable institutional investors, including banks, insurance companies and corporations, which are best able to evaluate the benefits and risks associated with these instruments and have predictable tax liabilities against which the tax credit may be applied.
- Most issues have been registered as "combination bonds" to permit the separation of the bonds into separate principal certificates ("Principal Certificates") and tax credit certificates ("Tax Credit Certificates").



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QSCBs

Marketing Considerations, cont'd

- The novelty and complexity associated with tax credit bonds will likely demand a longer marketing period to tap the widest possible investor base.
- Taxable buyers that are new to the municipal market will need to familiarize themselves with the specifics of the credit being offered and will also need to be educated about the nuances of tax credit bonds, registration requirements, and payment and transfer mechanisms.



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Top 5 Takeaways

1. Always understand what you are doing and why you are doing it.
2. Understand the risks and rewards.
3. Understand and independently test the assumptions used in financial models.
4. The new municipal market is more focused on an issuer's underlying credit.
5. Through BABs, the investor market has been expended for municipal issuers.



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