



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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MEMORANDUM 2010-34

TO: Local Government Officials and Public Finance Counsel

FROM: Tim Romocki, Director
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SUBJECT: Credit Requirement Changes for Recovery Zone Facility Bonds

DATE: May 17, 2010

The American Recovery and Reinvestment Act of 2009 (ARRA) created five public finance tools “to jumpstart our economy, create or save millions of jobs, and put a down payment on addressing long-neglected challenges so our country can thrive in the 21st century.” This memo presents a policy adjustment of the North Carolina Local Government Commission (LGC) to maximize the use of available State resources.

I. Qualified Institutional Buyers will be considered in private placement and negotiated sales for Recovery Zone Facility Bonds.

As part of the ARRA, Congress authorized \$25 billion to be allocated through the Recovery Zone Bonds program in two parcels. \$10 billion of the authorized funds were devoted to Recovery Zone Economic Development Bonds, a taxable bond that allows local and state governments to obtain lower borrowing costs through a direct federal payment of 45% of the interest. North Carolina counties and a few large cities received \$418 million in direct allocations from the U. S. Treasury of the economic development bonds. Local units declared their intent to use about \$133 million of this amount, and the North Carolina Tax Reform Allocation Committee (TRAC), which is responsible for administering reallocations, has reallocated about \$284 million through April 19.

The remaining \$15 billion of the congressional authorization was in the form of Recovery Zone Facility Bonds. Facility bonds are a type of traditional tax-exempt private activity bond that may be used by private businesses to finance a broad range of capital projects in designated recovery zones. North Carolina counties and large cities received \$627 million in direct allocations of the facility bond allocation from the U.S. Treasury. The local units were required to declare their intent to use the initial allocation, and the

unused allocation reverts to the State to be administered by the State's Tax Reform Allocation Committee (TRAC). Local units initially declared their intent to use approximately \$212 million of the total allocation, and the TRAC has reallocated approximately \$202 million of these bonds as of April 19.

As required by general statutes, the LGC's approval of facility bond financings includes evaluation of each project's and/or borrower's financial feasibility. The standard for financial feasibility in this case is the same standard applied to other types of private activity bonds (such as industrial development bonds, solid waste disposal bonds, and 501(c)(3) bonds issued by local Authorities). That is, the LGC must determine:

“Whether the proposed operator and obligor have demonstrated or can demonstrate the financial responsibility and capability to fulfill their obligations with respect to the financing agreement. In making such determination, the Commission may consider the operator's experience and the obligor's ratio of current assets to current liabilities, net worth, earnings trends and coverage of fixed charges, the nature of the industry or business involved and its stability and any additional security such as credit enhancement, insurance, guaranties or property to be pledged to secure such bonds.” 159C-8(b)(1) and 159D-8(b)(1)

Historically, the LGC has found projects to meet this feasibility standard in one of the following ways:

- 1) The bonds have an investment grade rating (*i.e.*, BBB or better) from at least one national rating agency;
- 2) The bonds are supported by a letter of credit from a bank or other financial institution that has an investment grade rating;
- 3) A bank, insurance company or “similar financial institution” commits to purchase and hold the bonds in a private placement transaction.

These feasibility standards have allowed the staff to utilize the credit evaluation of banks and other similar entities when conducting our own feasibility analysis. National default rates for tax-exempt private activity bonds are generally estimated at one to two percent which is similar to commercial loan default rates.

In order for entities to take full advantage of financing available through ARRA, the LGC will expand the definition of institutions that can purchase facility bonds to include Qualified Institutional Buyers (“QIBs”) as defined by Rule 144A of the Securities Act of 1933. This temporary change in standard will apply only to the authorization of Recovery

Zone Facility Bonds. In addition, the change only applies where the QIB agrees to limit the secondary market sale of the facility bonds to banks, insurance companies, other QIBs and similar financial institutions.

II. ARRA Bond Utilization in North Carolina as of 5/4/2010.

<u>Bond Type</u>	<u>Amount Approved</u>	<u>Amount Available in N.C.</u>
Build America Bonds (BABs) ¹	\$ 687,651,734	no federal limit
Clean Renewable Energy Bonds (CREBs) ²	\$ -	no specific allocation
Qualified Energy Conservation Bonds (QECBs) ³	\$ -	\$ 95,677,000
Qualified School Construction Bonds (QSCBs) ⁴	\$ 103,788,764	\$ 552,830,000
Qualified Zone Academy Bonds (QZABs) ⁵	\$ 5,807,500	\$ 56,699,000
Recovery Zone Econ. Dev. Bonds (RZEDBs) ⁶	\$ 144,340,000	\$ 418,154,000
Recovery Zone Facility Bonds (RZFBs) ⁶	\$ 76,310,000	\$ 627,231,000
Clean Water Revolving Loans	\$ 166,790,749	\$ 136,300,000

¹ Currently, there is no limit on the maximum bond volume allocation for BABs, nor is there any specific amount allocated to particular states. State and local governments issue BABs in the same way that they go about issuing other bonds.

² Congress authorized \$2.4 billion to be available for CREBs, \$800 million in 2008 and \$1.6 billion in 2009. The U.S. Department of Treasury administers CREB authorization. Entities interested in issuing CREBs apply directly to the Department. Though there is approximately \$200 million authorized but unallocated in the program, all application deadlines have expired.

³ Congress authorized \$3.2 billion to be available for QECBs, \$800 million in 2008 and \$2.4 billion in 2009. Each state received its allocation based on population. ARRA required that local government units with more than 100,000 residents receive a portion of the State's allocation. These large local governments may reallocate their designated portion back to the state if they choose to do so.

⁴ Congress authorized QSCBs in 2009 and 2010. N.C. received \$276 million in 2009, of which \$89 million went directly to the five districts with the largest population of low-income students. N.C. received \$277 million in 2010, of which \$88 million went to the five largest districts. For additional information, visit www.schoolclearinghouse.org.

⁵ Congress authorized QZABs in 2008 and 2009. N.C. received \$12.6 million in 2008 and \$44.1 million in 2009. For additional information, visit www.schoolclearinghouse.org.

⁶ The N.C. Department of Commerce Finance Center oversees the distribution of the State's allocation of Recovery Zone bonds. For more information, visit: www.nccommerce.com/en/BusinessServices/LocateYourBusiness/WhyNC/Incentives/RecoveryZoneBonds.htm