

# “What keeps you up at night?”

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## Internal Revenue Service issues guidance for new Recovery Zone Bonds

By George T. Magnatta and Joshua S. Pasker

In Notice 2009-50 (the “Notice”), issued on June 12, 2009, the Internal Revenue Service (the “IRS”) provided important guidance regarding Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds (collectively, the “Recovery Zone Bonds”). Recovery Zone Bonds are included as part of the American Recovery and Reinvestment Act (the “Act”) signed into law by President Obama on February 17, 2009.

The Notice provides that “eligible issuers” of Recovery Zone Bonds include states, political subdivisions, and entities empowered to issue bonds on behalf of any such entity. Under the Act, Recovery Zone Bonds may be issued in 2009 and 2010.

The Act includes a total of \$25 billion (the “Allocation”) for Recovery Zone Bonds. Ten billion dollars has been designated for Recovery Zone Economic Development Bonds (“Direct Payment RZBs”) and \$15 billion has been designated for Recovery Zone Facility Bonds (“Facility RZBs”). The volume cap for Recovery Zone Bonds is allocated among the states, counties and large municipalities (with populations over 100,000) within states based on relative declines in employment in 2008.

Direct Payment RZBs are a form of Build America Bond (“BAB”) under the Act which bonds must benefit a “recovery zone” (discussed below). BABs are governmental bonds (not including private activity bonds) that an issuer elects to issue as taxable bonds with a federal tax credit. An issuer may elect to receive either a direct federal cash subsidy with respect to certain BABs (“Direct Payment BABs”) or the issuer may elect to provide non-refundable tax credits to the bondholders (“Credit BABs”). The credit for either Direct Payment BABs or Credit BABs is 35 percent of the coupon interest payable to bondholders. Direct Payment RZBs are comparable to Direct Payment BABs, except that the Direct Payment RZBs provide a refundable tax credit paid to state or local governmental issuers in an amount equal to 45 percent of the total coupon interest payable to investors.

Direct Payment RZBs may be used to finance certain “qualified economic development purposes” for use within certain “recovery zones.” The Act defines a “qualified economic

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development purpose” as any expenditure for purposes of promoting development or other economic activity in a recovery zone. Thus, Direct Payment RZBs may be issued for projects located within a recovery zone, including public infrastructure, public facilities and educational facilities.

A “recovery zone” is defined to include any area designated by the issuer as having significant poverty, unemployment, rate of home foreclosures or general distress. The Notice provides that any state, county or large municipality that receives an Allocation for Recovery Zone Bonds may make designations of recovery zones in any reasonable manner as it shall determine in good faith in its discretion.

Facility RZBs are a type of traditional tax-exempt private activity bond that may be used in designated recovery zones to finance certain recovery zone property. Facility RZBs may be issued for any depreciable property that (a) was acquired after the date of designation of a “recovery zone,” (b) the original use of which occurs in the recovery zone and (c) substantially all of the use of the property is in the active conduct of a “qualified business.” A “qualified business” is any trade or business except residential rental property, private or commercial golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other gambling facilities, or stores the principal business of which is the sale of alcoholic beverages for consumption offsite the premises.

The Notice provides that entities authorized to allocate the Allocation to ultimate beneficiaries consist of states (with respect to allocation waived or deemed waived by any county or large municipality), counties and large municipalities that receive an Allocation under the Act. Such states, counties and large municipalities may use such Allocation themselves for eligible costs or may allocate such Allocation they receive to ultimate beneficiaries in any reasonable manner as they shall determine in good faith in their discretion for eligible costs for qualified

economic development purposes, in the case of Direct Payment RZBs, or recovery zone property, in the case of Facility RZBs.

The Act provides that a county or large municipality may waive any portion of its Allocation received for Recovery Zone Bonds. The Notice states that upon any such waiver, the state in which such county or large municipality is located is authorized to reallocate the waived Allocation in any reasonable manner as the state shall determine in its discretion and in good faith.

On June 12, 2009, the IRS released the Allocations for counties and large municipalities throughout the United States. The list of Allocations can be found at [http://www.treas.gov/press/releases/docs/rzballocation-local\\_AR-ZS.pdf](http://www.treas.gov/press/releases/docs/rzballocation-local_AR-ZS.pdf). Feel free to contact the authors for assistance in receiving benefits that can be provided by Recovery Zone Bonds.

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