



MEMORANDUM

Recovery Zone Facility Bonds (RZFBs)

The American Recovery and Reinvestment Act of 2009, signed into law on February 17, 2009 (“ARRA”) created a new type of tax-exempt facility bond, termed “recovery zone facility bonds” (“RZFBs”). In order to qualify as a RZFB, (i) at least 95 percent of the net proceeds of the bond must be used for “*recovery zone property*”, (ii) the bond has to be issued in 2009 or 2010, and (iii) the bond has to be designated as such by the issuer.

“*Recovery zone property*” is defined as property subject to depreciation, which was constructed, reconstructed, renovated or purchased from an unrelated party after the date on which the “recovery zone” designation took effect. Additionally, the original use of such property in the recovery zone must commence with the taxpayer, and substantially all of the use of such property must be in the recovery zone and must be in the active conduct of a “*qualified business*” within the recovery zone.

A *qualified business* is one which (i) does not involve the rental of residential real property (defined for this purpose as real property at least 80 percent of the rental income of which is from dwelling units), and (ii) does not include the operation of a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store of which the principal purpose is the sale of alcoholic beverages for off-site consumption.

The national limitation (referred to as the “*volume cap*”) on the amount of RZFBs that can be issued is \$15 billion. This limitation is allocated among the states based upon the reduction in employment in each state between December 31, 2007 and December 31, 2008 (referred to as the “2008 employment decline”), with each state being allocated a minimum of 0.9% of the national limitation (\$135 million). Each state’s entire allocation of RZFBs is then reallocated among its counties and “large municipalities” (defined as municipalities with populations of more than 100,000) in proportion to the 2008 employment declines in such counties and municipalities. On June 12, 2009, the IRS released Notice 2008-50, which sets forth the state-wide allocations of RZFB volume cap, and also announced the reallocations of RZFB volume cap to counties and large municipalities. New York State received a total RZFB volume cap allocation of \$555,147,000, which amount was then reallocated among the counties and the large municipalities in the State as set forth in the table attached to this memo.

“*Recovery zones*” are defined as including: (i) any area designated by an issuer as having significant poverty, unemployment, rate of home foreclosures or general distress, (ii) any area designated by the issuer as economically distressed due to the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990, or (iii) any area which has been designated as an empowerment zone (e.g., Syracuse, Yonkers and New York City) or a renewal community (e.g., Buffalo-Lackawanna, Jamestown, Niagara Falls, Rochester, and Schenectady). Since the designation of recovery zones is largely to be made by each individual issuer, there is a fair amount of flexibility as to where and what types of projects can be financed with these bonds.

Under the guidance provided by the IRS in Notice 2008-50, a county IDA generally has the authority to issue RZFBs to finance qualifying projects that are located within the county served by that IDA or in any large municipality located in that county. Further, an IDA serving a specific large municipality generally has the authority to issue RZFBs to finance qualifying projects located within that large municipality. In either case, however, the IDA must first receive an allocation of volume cap allocation from the county or large municipality, as applicable, for the specific project being financed.

Questions and Answers Regarding RZFBs

1. Who are eligible issuers of RZFBs?

Under IRS Notice 2009-50, eligible issuers of RZFBs include a state, any “political subdivision” within the meaning of Section 103 of the Code, and any entity that can issue bonds on behalf of a state or political subdivision under rules similar to those that apply with respect to qualified issuers of tax-exempt bonds generally. In addition an issuer includes otherwise eligible issuers of conduit financing issues. However, in all cases, the *recovery zone property* being financed must be located within the jurisdiction of both the issuer of the bonds and the county or large municipality that allocated the volume cap to the bond issue to finance such property.

In New York, an IDA serving a county generally would be an eligible issuer of RZFBs for recovery zone properties located in such county, or within a large municipality located in such county, provided the IDA or the conduit borrower for the bond issue has received a volume cap allocation for such issue from the county or large municipality, as applicable. Similarly an IDA whose jurisdiction is limited to a specific large municipality would be an eligible issuer of RZFBs for recovery zone properties located in that large municipality, provided the IDA or the conduit borrower has received a volume cap allocation for the bond issue from the large municipality.

2. Who may designate a “recovery zone”?

Under IRC Section 1400U-1(b), added by ARRA, “recovery zone” means:

- (i) any area designated by *the issuer* as having significant poverty, unemployment, rate of home foreclosures or general distress,
- (ii) any area designated by *the issuer* as economically distressed due to the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990, or
- (iii) any area which has been designated as an empowerment zone (e.g., Syracuse, Yonkers and New York City) or a renewal community (e.g., Buffalo-Lackawanna, Jamestown, Niagara Falls, Rochester, and Schenectady).

Notice 2009-50 provides that for this purpose, *any State, county or large municipality* that receives a volume cap allocation for RZFBs may make designations of recovery zones in accordance with paragraphs (i) or (ii) above “*in any reasonable manner as it shall determine in good faith in its discretion*”. Thus, even though the statute provides that designation is to be made by the issuer of the bonds, the Notice appears to limit this to the State, county or the large municipality that received a volume cap allocation for RZFBs.

3. *Must the county or large municipality select or approve the “ultimate beneficiaries” for whom the RZFBs are to be issued, or can the IDA do this, following an assignment of the county’s or large municipality’s volume cap allocation to the IDA?*

IRS Notice 2009-50 provides that only the State (in the case of volume cap allocations that have been waived; see Q&A 4 below), counties and large municipalities are authorized to make volume cap allocations to ultimate beneficiaries. Thus, if the bonds are to be issued by another entity, such as an IDA, the allocation of volume cap to the specific conduit borrowers and/or projects for whose benefit the RZFBs are to be issued must be made by the county or large municipality.

4. *May a county or large municipality waive or assign its volume cap allocation to another municipality?*

A county or large municipality may “waive” all or any portion of its RZFB volume cap allocation. Notice 2009-50 provides that upon making such waiver, the waived volume cap effectively gets re-assigned to the State, and the State “*shall be authorized reallocate the waived allocation in any reasonable manner as it shall determine in good faith in its discretion*”. Further, the State may then assign the waived allocation to specific conduit borrowers and/or projects for which RZFBs are to be issued.

While the State does not have the explicit authority under the statute to recapture unused volume cap, it may be possible for the State to adopt legislation to require counties or large municipalities to waive their unused volume cap or, as a matter of law, to be deemed to have waived their unused volume cap allocations.