Qualified Energy Conservation Bonds

In General

A Qualified Energy Conservation Bond or "QECB" is a taxable bond issued by a State or local government to finance one or more "qualified conservation purposes." Although QECBs are taxable bonds, QECBs provide a Federal income tax credit to bond holders on quarterly credit allowance dates. From the issuer's perspective, the Federal income tax credit results in the Federal government paying a significant portion of the interest on the QECB. This means that theoretically issuers will pay a lower net interest rate on the principal amount borrowed than on a comparable tax-exempt bond. Accordingly, QECBs are subject to certain Federal tax requirements typically associated with traditional tax-exempt bonds, as well as additional more stringent guidelines.

Federal Income Tax Credit

QECB Tax Credit. A taxpayer holding a QECB on one of the quarterly credit allowance dates (defined below) may claim a Federal income tax credit equal to 70% of one-quarter of the product of the applicable credit rate (stated as a percentage) multiplied by the outstanding face amount of the QECBs held by the QECB holder on a credit allowance date. Because the QECB tax credit rate is limited to 70% of the tax credit rate determined by the U.S. Treasury Department (the "Treasury"), successful marketing of QECBs may require the imposition of Federally taxable supplemental stated interest rates.

Credit Allowance Date. A Federal income tax credit is allowed to holders of a QECB on each of four credit allowance dates during each calendar year: March 15, June 15, September 15, and December 15 and the last day on which a QECB is outstanding. The tax credit may only be claimed against Federal income taxes due in the year in which the credit allowance date falls.

Maximum Maturity and Applicable Credit Rate. The maximum maturity and applicable credit rate are determined as of the date that there is a binding, written contract for the sale or exchange of the QECB. The maximum maturity and applicable credit rate for QECBs are published daily by the Bureau of Public Debt at: http://www.treasurydirect.gov.

Determination of the Tax Credit Rate. The Treasury and the Internal Revenue Service ("IRS") determine credit rates for tax credit bonds daily with the goal of estimating a rate that will permit the issuance of tax credit bonds with a specified maturity without discount and without interest cost to the issuer. The Treasury's estimate is based on yields on outstanding bonds from market sectors selected by the Treasury in its discretion that have an investment grade rating of between A and BBB for bonds of a similar maturity for the business day immediately preceding the sale date of the QECB.

<u>Qualified Conservation Purpose</u>

Permitted Projects. QECBs may be issued to finance one or more "qualified conservation purposes." A "qualified conservation purpose" means any of the following:

(a) Capital expenditures incurred for purposes of:

(1) reducing energy consumption in publicly-owned buildings by at least 20%;

(2) implementing green community programs (including the use of loans, grants, or other repayment mechanisms to implement such programs);

(3) the production of electricity from renewable energy resources in rural areas; or

(4) any of the following qualified facilities if meeting specific criteria set forth under the Internal Revenue Code (the "Code") for electricity produced from certain renewable resources:

(A) Wind Facility;

(B) Closed-Loop Biomass Facility;

(C) Open-Loop Biomass Facility;

(D) Geothermal or Solar Energy Facility;

(E) Small Irrigation Power Facility;

(F) Landfill Gas Facility;

(G) Trash Facilities;

(H) Qualified Hydropower Facility;

(I) Marine and Hydrokinetic Renewable Energy Facility.

(b) Expenditures for research facilities and research grants to support research in the following areas:

(1) development of cellulosic ethanol or nonfossil fuels;

(2) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels;

(3) increasing the efficiency of existing technologies for producing nonfossil fuels;

(4) automobile battery technologies and other technologies to reduce fossil fuels consumption in transportation; or

(5) technologies to reduce energy use in buildings.

(c) Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting.

(d) Demonstration projects designed to promote the commercialization of:

(1) green building technology;

(2) conversion of agricultural waste for use in the production of fuel or otherwise;

(3) advanced battery manufacturing technologies;

(4) technologies to reduce peak use of electricity; or

(5) technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity.

(e) Public education campaigns to promote energy efficiency.

Limitation for Private Activity Bonds. For a private activity bond (defined below), a qualified conservation purpose is limited to expenditures that are considered a capital expenditure for Federal tax purposes. For example, QECBs may be issued to finance public education campaigns to promote energy efficiency but, to the extent expenditures for this purpose are not capital expenditures, proceeds of a private activity QECB may not be used to finance costs of these public education campaigns.

Private Activity Bond. Private Activity Bond means any QECB that meets either (1) the private business tests of Code § 141(b), or (2) the private loan financing test of Code § 141(c). In general, the private business tests are met if more than 10% of the proceeds of the issue are (1) used for any private business use, and (2) directly or indirectly (A) secured by any interest in property used for a private business use, or payments in respect of property used in a private business use, or (B) derived from payments in respect of property, or borrowed money used for a private business use. The private loan financing test is met if the proceeds of a QECB are used to make or finance loans to a private business in excess of the lesser of 5% of QECB proceeds or $5,000.

<u>Use of Proceeds</u>

100% Requirement; 3 Year Expenditure Period. 100% of Available Project Proceeds (defined below) must be used for one or more qualified conservation purposes (as defined above) within 3 years of the issue date of the QECBs. Further, a binding commitment with a third party to spend at least 10% of the Available Project Proceeds must be incurred within 6 months of the issue date.

Failure to Spend 100% of Available Project Proceeds within 3 Years. To the extent that less than 100% of Available Project Proceeds are expended for qualified conservation purposes by the end of the 3 year expenditure period, the issuer must use the remaining Available Project Proceeds to redeem bonds within 90 days after the end of the 3 year expenditure period.

2% Cost of Issuance Limitation. Not more than 2% of sale proceeds may be used to finance costs of issuing the QECBs. For this purpose, bond insurance and credit enhancement are not considered costs of issuing QECBs. However, bond insurance is considered a capital cost that counts toward the requirement of spending 100% of Available Project Proceeds within 3 years (as discussed above).

Available Project Proceeds. Available Project Proceeds means sale proceeds, plus investment earnings on those proceeds, less issuance costs financed by QECB proceeds.

Allocation of National Bond Volume Cap

Allocation of National Bond Volume Cap. There is a national QECB volume cap of $3,200,000,000. This national volume cap was allocated by the Treasury and the IRS among the states in IRS Notice 2009-29, 2009-16 I.R.B. 849 (Apr. 20, 2009). The allocations are as follows:

State	QECB Allocation (in dollars)
Illinois	$133,846,000
Kansas	$29,070,000
Missouri	$61,329,000
Nebraska	$18,502,000

State Reallocation of National Bond Volume Cap Allocation. Each State must allocate a portion of its allocation of the national volume cap to each large local government (any municipality or county that has a population of 100,000 or more) in the State in an amount that bears the same ratio to the State's allocation as the population of the large local government bears to the population of the State.

In making reallocations, a State must use population figures for large local governments within the State based on data available from the U.S. Census Bureau for the period that is closest in time to that used for the State and released by the Census before 2009 which consists of information as of July 1, 2007. City and county population figures are located generally at http://www.census.gov/popest/. In making reallocations to large local governments, the population of any municipality which is a large local government may not be taken into account in determining the population of the county. Also, an Indian tribal government is treated in the same manner as a large local government, except only to the extent of the population of the Indian tribal government that resides within the State.

Large Local Government Reallocation. Any amount allocated by the State to a large local government may be reallocated by the large local government back to the State where the large local government is located. In addition, large local governments may reallocate any amount allocated to the large local government to an eligible issuer (defined below) of QECBs.

Restriction on Private Activity Bonds. Any allocation to a State or large local government must be reallocated in a manner that results in the use of not less than 70% of the allocation to the State or large local government to designate bonds that are not private activity bonds. Without any Treasury Regulations or other guidance from the IRS on this limitation, it appears as though this limitation applies to both the allocation to the State and any reallocation to a large local government. Solely for purposes of this limitation, a special rule for bonds to finance green community programs provides that bonds issued for the purpose of providing loans, grants or other repayment mechanisms for capital expenditures to implement green community programs are not treated as private activity bonds.

Additional Provisions

Eligible Issuers. Eligible issuers include States, political subdivisions, and entities empowered to issue bonds on behalf of any such entity. Further, eligible issuers include otherwise eligible issuers in conduit financing issues. In all events, the eligible costs for qualified conservation purposes (as defined above) financed with proceeds of a QECB must relate to qualified conservation purposes that are located within or attributable to both the jurisdiction of the issuer of the QECBs and the jurisdiction of the entity authorized to allocate volume cap to an issue of QECBs for the financing of those qualified conservation purposes.

Form 8038. Issuers of QECBs must file a Form 8038 with the IRS upon issuance of the QECBs. When completing Form 8038, issuers must check Line 20c “Other” and insert “QECBs” in the space provided for the bond description.

Prevailing Wages. Any project financed with proceeds of a QECB is subject to the Federal Davis-Bacon Act prevailing wage laws, including any project financed with proceeds of a QECB which is a private activity bond.

Prohibition of Financial Conflict of Interest. An issuer of QECBs must certify that applicable State and local law requirements governing conflicts of interest are satisfied with regard to the QECBs.