State of Connecticut

American Recovery and Reinvestment Act of 2009

Overview of Financing Opportunities

June 12, 2009

The Treasurer’s Working Group

The Treasurer’s Office is working in conjunction with its Strategic Advisors and Legal Counsel to evaluate the funding and legal aspects of the programs established under the Recovery Act

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General Overview

- The American Recovery and Reinvestment Act (“Recovery Act”) was signed into law on February 17, 2009
- The Recovery Act provides State and local municipalities with significant opportunities to obtain low- or zero-cost financing for various public and private activity projects throughout the State
  - The State and its advisors are currently evaluating the policy, legal and financial impact of implementing the Recovery Act programs
  - The Governor’s and Treasurer’s offices will work with the CT Recovery Group to identify the appropriate projects to be funded either in full or in part by Recovery Act programs, if such programs are deemed to be cost-effective and consistent with the State’s objectives

Achieving the State's Objectives

Establish Recovery Act bonding objectives, a Project Management Team, and a Project Selection Process

Bond Program Policy and Financing Objectives

- Preliminary goals the State may consider:
  - Efficiently use programs under the Recovery Act
    - Maximize funding for strategic projects with limited funding alternatives (i.e. projects that may not otherwise be completed)
    - Identify projects that can utilize funding from multiple programs
  - Minimize cost of capital and annual debt service requirements
  - Integrate bond issuance with existing debt or project management systems
  - Meet program deadlines (i.e. application deadlines, issuance timeframes)

Program Management Team and Project Selection Process

- Preliminary guiding questions:
  - How can the roles of the Governor's office, the Treasurer's office and the CT Recovery Group be coordinated?
  - What mechanism will be utilized to prioritize and select projects?
    - Should the State draw from an existing list or solicit new proposals?

Recovery Act Programs

Three Categories of Programs

Direct Subsidy Taxable Bond Programs

- Issuer pays interest that is taxable at the federal and state levels
- Issuer receives a direct subsidy (35% or 45%) from the federal government toward the interest cost incurred
- Includes, among others, the "Direct Subsidy Build America Bonds" program
  - Issuance began in April 2009, and the market has developed quickly
  - Issuers include State of California, MTA and University of Texas

Tax Credit Bond Programs

- Investors receive a federal income tax credit based on a rate set by the U.S. Treasury, allowing for a reduction in investors' tax liability
- The market for municipal tax credit bonds is relatively untested
  - Two transactions to date: $38.8MM San Diego USD (April 21) and $49.9MM School Board of Broward County (June 5)
  - U.S. Treasury guidelines on credit stripping are expected by year-end

Tax-Exempt Private Activity Bond Program

- A new tax-exempt-qualified private activity bond designed to support trades or businesses in areas suffering from economic distress

Recovery Act Programs

Overview of Programs, Program Objectives and Target Costs

- Estimated size of markets (annual new issuance)
  - Taxable Bond Market: ~ Over $ 1 trillion
  - Tax-Exempt Bond Market: ~ Over $400 billion
  - Tax-Credits Market ~ $10 billion (mostly privately negotiated)

Program	General Purpose	Target Cost to Issuer
Direct Subsidy Taxable Bond Programs		
Build America Bonds	***Fund general governmental projects*** through the taxable market, ***while receiving a 35% subsidy on interest costs*** from the federal government	4.0%-4.5% *(20-30 Year)*
Recovery Zone Economic Development Bonds(1)	***Generate economic growth*** in areas particularly affected by the recession, ***while receiving a 45% interest subsidy*** as the issuer of taxable bonds	3.5-4.0% *(20-30 Year)*
Tax Credit Bond Programs		
Qualified School Construction Bonds	***Construct and rehabilitate public school facilities or acquire land for public school facilities***	0%-Low
Qualified Zone Academy Bonds	Promote ***educational development in economically disadvantaged*** below-college-level public schools	0%-Low
Qualified Energy Conservation Bonds	***Fund a broad array of "green" projects***, such as research, education programs, mass commuting, energy conservation, and renewable energy generation	2.0-2.5%
New Clean Renewable Energy Bonds	***Support development of a broad array renewable energy facilities***	2.0-2.5%
Tax-Exempt Private Activity Bond Program		
Recovery Zone Facility Bonds(1)	***Generate economic growth*** in areas particularly affected by the recession by providing for ***tax-exempt private activity bonds*** used for this purpose	4.5-6.0%

(1) Allocations and qualified issuers for these programs are to be determined

Direct Subsidy Taxable Bond Programs

Build America Bonds (BABs)

General Governmental Purposes

Key Elements of the Program

- **Total Volume Cap:** Unlimited
- **Benefits:** BABs will pay investors taxable interest, and the federal government will provide issuers a 35% subsidy on the interest cost
- **Use of Proceeds:** ***New money governmental capital expenditures***
  - ***BABs can be viewed as an alternative to traditional tax-exempt funding***
    - Subsidy savings are greatest in longer-dated maturities
  - BABs can also be issued as tax credit bonds, where investors receive a 35% federal income tax credit. The Tax Credit BABs, unlike Direct Subsidy BABs, can also be used for working capital financings and refundings (no issues to date)
- **Qualified Issuers:** State and local governments
- **Time Frame For Funding:** Funding can be obtained now, subject to market conditions. ***Bonds must be issued before January 1, 2011***

Select Build America Bond Transactions To Date

$5.0 Billion	$1.375 Billion	$500 Million	$375 Million
State of California	New Jersey Turnpike Auth	Metropolitan Transportation Authority	San Antonio Electric & Gas
April 22, 2009	April 20, 2009	April 23, 2009	June 2, 2009

Implementation Considerations

- The market has developed quickly, and would respond well to a State issue
- Appropriate entry point depends on funding needs and relative cost of tax-exempt and taxable funding at time of issue

Potential Projects in Connecticut

- Same as typical tax-exempt-funded new money projects

Proposed Action Plan

- Treasurer's Office will identify appropriate market entry points, and continue, as is typical, to secure funding for general governmental expenditure
- As refunding or working capital needs arise, the Treasurer will consider issuing Tax Credit BABs

Recovery Zone Economic Development Bonds (RZEDBs)

Promote Public Sector Activity within Recovery Zones

Key Elements of Program

- **Volume Cap:** $10 billion for entire program. Connecticut has an allocation of $90 million for 2009, and expects a similar allocation in 2010
  - Allocated to States in proportion to relative 2008 job losses, with subsequent sub-allocations to counties and large municipalities
- **Benefit:** RZEDBs will pay investors taxable interest, and the federal government will provide issuers a 45% subsidy on the interest cost
- **Use of Proceeds:** ***New money governmental purpose projects or programs*** for use in designated Recovery Zones
  - ***Recovery Zones are areas designated by state and local governments as those with significant poverty, unemployment, or home foreclosure rates, as well as empowerment zones, renewal communities and area negatively impacted by military base closures***
  - ***Permitted expenditures include capital expenditures and can include job training and educational program expenditures***
  - 501(c)(3) nonprofit and private activity purposes do not qualify
- **Qualified Issuers:** Cities with a population over 100,000 and all counties
  - Subject to Treasury guidance, individual volume cap may be surrendered to the State for reallocation
- **Time Frame For Funding:** To be determined. ***Allocation must be utilized by January 1, 2011***

Implementation Considerations

- Possible integration with the State's Urban Action Grants
- Methodology for identifying RZs
- Treasury has indicated that providing allocations and further guidance is a high priority item

Potential Projects in Connecticut

- CDA/Tax Increment Financings

Proposed Action Plan

- Designate Recovery Zones
- Monitor Treasury allocation
- Identify potential projects
- Determine appropriate bond issuer and State's ability to issue through the GO credit

Tax Credit Bond Programs

Qualified School Construction Bonds (QSCBs)

Expand Funding for the Construction and Improvement of Public Schools

Key Elements of Program

- **Volume Cap:** $11 billion annually for 2009 and 2010. Connecticut allocation is $105.1 million for 2009 and a similar allocation is expected for 2010
  - Unused allocations may be carried into the following year
- **Benefits:** ***Aims to provide issuers with a 0% cost of funds,*** by providing bondholders a federal tax credit against income
  - With assumed earnings of 2%, sinking fund installments could reduce effective cost of funds from 0% (if bonds sold at par) to -1.74%
- **Use of Proceeds:** ***Must be used to construct, rehabilitate or repair a public school facility or to acquire land on which such a facility will be built***
  - Bond proceeds must be spent on qualified purposes within three years of issuance
- **Qualified Issuers:** States and school districts. For Connecticut, the State makes the allocation decision
- **Time Frame For Funding:** Once State approval is received, funding may be available, subject to market conditions

Implementation Considerations

- Potential benefits of State-level issuance
  - More efficient tracking of use of funds (3-year time limit)
  - GO credit should generate greater visibility and demand
  - Larger transactions provide greater pricing efficiency
  - Issue bullet maturities to maximize benefit of subsidy

Potential Projects in Connecticut

- Vocational/Technical Schools
- Local Schools

Proposed Action Plan

- Identify projects
- Obtain approvals needed for bond issuance

Qualified Zone Academy Bonds (QZABs)

Increase Funding Available for Educational Development in Economically Disadvantaged Areas

Key Elements of Program

- **Volume Cap:** $1.4 billion annually for 2009 and 2010. Connecticut allocation is $9.4 million for 2009
  - Unused allocations may be carried forward into the following two years
  - Allocations to States were made in proportion to the number of individuals living below the poverty line in a state, and subsequently to specific zones
  - Expansion of an existing program; previously had a $400 million annual cap
- **Benefits:** A traditional tax-credit bond that ***aims to provide issuers with a 0% cost of funds***, by providing bondholders a federal tax credit against income
- **Use of Proceeds:** ***Bond proceeds must be used to renovate, equip or train teachers and personnel, or develop course materials for "qualified zone academies"***
  - ***Qualified Zone Academies are public schools that serve economically disadvantaged areas or student populations, and also sponsor academic programs in conjunction with private businesses***
- **Qualified Issuers:** School districts—probably not applicable to State-level issuers
- **Time Frame For Funding:** Funding can be obtained now, subject to market conditions and school districts' decision to issue bonds

Implementation Considerations

- Expansion of an existing program
- Given small allocation (below $10 million), issue as part of a larger transaction
  - Otherwise, ability to issue will depend on demand from traditional investors in Connecticut (community banks, State-based corporations, etc.)

Potential Projects in Connecticut

- Schools designated as Qualified Zone Academies

Proposed Action Plan

- Continue to use the program as opportunities arise

Qualified Energy Conservation Bonds (QECBs)

Promote "Green" Energy Development

Key Elements of the Program

- **Volume Cap:** $3.2 billion total. Connecticut allocation is $36.3 million
- **Benefits:** A traditional tax-credit bond that aims to provide issuers with a 70% interest subsidy by providing bondholders with a federal tax credit
  - Net cost to issuer is expected to be 2.0%-2.5%
- **Use of Proceeds:** Fund a broad range of "green" projects:
  - ***Capital Expenditures***, for example, related to reduced energy consumption in publicly owned buildings by at least 20%, green community programs, renewable energy-based electricity generation in rural areas, or any NCREB-eligible facility
  - ***Research Expenditures***, to develop/improve non-fossil fuels or reduce dependence on fossil fuels (e.g. capture/sequester carbon dioxide, improve automobile battery technologies, increase efficiency of other existing alternative energy technologies)
  - ***Mass Transit Projects*** to reduce energy consumption or pollution
  - ***Demonstration Projects*** to promote commercialization of, for example, green building technology, improved battery manufacturing, reduced electricity use
  - ***Public Education Campaigns*** (excluding events held primarily for entertainment)
  - No more than 30% of a state's allocation may be used for private activity purposes, and all proceeds must be used for capital expenditures
- **Qualified Issuers:** State and local governments
- **Time Frame For Funding:** Funding can be obtained now subject to market conditions

Implementation Considerations

- Can fund portions of other, larger projects, which include some green energy components

Potential Projects in Connecticut

- Mass Transit Purchases
- Waste removal and management
- Resources Recovery Facilities
- Alternative Fuels and Solar Projects in Public Facilities

Proposed Action Plan

- Identify projects

Tax-Exempt Private Activity Bond Program

Recovery Zone Facility Bonds (RZFBs)

Promote Private-Sector Businesses in Economically Distressed Areas

Key Elements of Program

- **Volume Cap:** $15 billion for entire program. Connecticut has an allocation of $135 million for 2009, and expects a similar allocation in 2010
  - Allocated to States in proportion to relative 2008 job losses, with subsequent sub-allocations to counties and large municipalities. Minimum of 0.9% of total volume cap allocated to each state
- **Benefit:** Additional tax-exempt capacity for State private activity
- **Use of Proceeds:** A new ***tax-exempt-qualified private activity bond to support trades or businesses in areas suffering from economic distress***
  - ***95% of proceeds must be used for Recovery Zone depreciable property, such as equipment or buildings***
    - Exclusions: land (not depreciable), residential rental property, golf courses, country clubs, racetracks or other gambling and certain recreational facilities
  - Proceeds are expected to be loaned (or the project is to be leased or sold) to a for-profit company as the true borrower and real party in interest
  - Property use must occur in the Recovery Zone, and the property must be constructed, reconstructed, renovated or acquired *after* the area is so designated
- **Qualified Issuers:** Cities with a population over 100,000 and all counties
  - Subject to Treasury guidance, individual volume cap may be surrendered to the State for reallocation
- **Time Frame For Funding:** To be determined. ***Allocation must be utilized by January 1, 2011***

Implementation Considerations

- Could be used in concert with funding for broader projects, which include investments in depreciable property in Recovery Zones

Potential Projects in Connecticut

- Connecticut Development Authority and other projects

Proposed Action Plan

- Designate Recovery Zones
- Monitor Treasury allocation
- Identify potential projects

Proposed Action Plan

Proposed Action Plan

Achieving the State's Objectives

- Many Recovery Act programs expire on December 31, 2010
  - The State has only 18 months left to capitalize on these significant opportunities

As the State seeks further federal guidance on certain issues, there are a number of concrete steps that can be taken to prepare the State to take advantage of current and forthcoming opportunities.

Direct Subsidy Taxable Bond Programs (Recovery Zones)

- State and Qualified Issuers* to identify and designate Recovery Zones
- Given 45% subsidy, identify and prioritize projects that should be funded as soon as State allocation and City/County sub-allocations are finalized

Tax Credit Bond Programs

- Identify projects for the Qualified School Construction Bonds, and enter the market as soon as appropriate
- Given the breadth of "green" projects in the State, work with various State agencies to identify strategic funding opportunities
- Consider applying funding to eligible expenditures of ongoing projects
- Identify projects that can utilize funding from multiple programs

Tax-Exempt Private Activity Bond Program

- As with the tax credit bond programs, consider using funding for smaller components of larger projects, where applicable

* Qualified Issuers for Recovery Zones include the State's five largest cities and all eight counties:
  - Cities: Bridgeport, Hartford, New Haven, Stamford, Waterbury
  - Counties: Fairfield, Hartford, Litchfield, Middlesex, New Haven, New London, Tolland, Windham (It is assumed that the State controls use of proceeds for county sub-allocations, pending Treasury guidance)

Project Compliance Considerations

Davis-Bacon Wage Rules

- Federal Davis-Bacon wage rules will apply to projects financed with the proceeds from the following programs:
  - Recovery Zone Economic Development Bonds
  - Qualified School Construction Bonds
  - Qualified Zone Academy Bonds
  - Qualified Energy Conservation Bonds

"Buy America" Provisions

- Legal Counsel is evaluating the applicability of Buy America regulations to projects funded by the proceeds of the Recovery Act programs
  - Provisions may apply only to programs that would directly receive federal monies