

FINANCING CONSIDERATIONS FOR P3 PROJECTS

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FINANCING CONSIDERATIONS FOR P3 PROJECTS

PUBLIC vs. PRIVATE FUNDS – ADVANTAGES AND DISADVANTAGES

Advantages to Public Funds

- Government ability to access capital markets through tax-exempt financing – lower coupon
- Availability of credit rating from national rating agencies – attract a wider number of investors
- Regular calendar of bond issuances – more established debt markets
- Taxing authority (subject to limits in state law or municipal charter)
- Financial credit not tied directly to a single developer or project

FINANCING CONSIDERATIONS FOR P3 PROJECTS

PUBLIC vs. PRIVATE FUNDS – ADVANTAGES AND DISADVANTAGES

Disadvantages to Public Funds

- Timeliness of process – requirement for multiple steps to achieve closing
- Public nature of process – ancillary considerations may come into play
- Structure of financing may be costly and inefficient
- Competition from other public financing needs
- Political vagaries
- Strict limits on uses of funds

FINANCING CONSIDERATIONS FOR P3 PROJECTS PUBLIC vs. PRIVATE FUNDS – ADVANTAGES AND DISADVANTAGES

Advantages to Private Funds

- Flexibility on types of financing depending upon source
- Multiple sources depending upon risk profile of investor
- Speed of execution
- Confidentiality of financing terms
- Less restrictions on use of funds

FINANCING CONSIDERATIONS FOR P3 PROJECTS PUBLIC vs. PRIVATE FUNDS – ADVANTAGES AND DISADVANTAGES

Disadvantages to Private Funds

- Impact on balance sheet / return to investor may be adversely impacted
- Difficulty in financing assets which may be owned by public entity – inability to pledge as collateral and lack of control
- Financing may be tied to progress of project and other conditions which may be outside of control of developer
- Need for “deep pocket” to secure financing
- Higher coupon for private debt due to lack of tax exemption

FINANCING CONSIDERATIONS FOR P3 PROJECTS LAND ASSEMBLY AND CONVEYANCE

- Government-owned ground may be sold or leased for private development or held by the government agency throughout the construction period and leased or sold back
- Ability to structure land swaps from public sector ownership
- Eminent domain power of governmental agencies

FINANCING CONSIDERATIONS FOR P3 PROJECTS TIERED FINANCING THROUGH FEDERAL, STATE AND LOCAL PROGRAM

- Participation by federal, state and local governmental agencies and sources of funding
- Overlapping jurisdiction
- In Maryland, each local government must contact the State on an annual basis with respect to its priority programs for transportation projects

FINANCING CONSIDERATIONS FOR P3 PROJECTS

TAX CREDITS AND OTHER SUBSIDIES

Federal Income Tax Credit Programs

- Low-income housing tax credit (Sec. 42 of Internal Revenue Code)
 - Awarded to for-profit and non-profit sponsors of eligible housing projects on a competitive basis subject to meeting state allocation plans.
 - Credits (9% or 4%) of income on annual basis are allowed for up to 70% of qualified basis for new construction.
 - Owner of qualified low-income building must rent either 20% of units to households with incomes of 50% or less of area median income or 40% of units to households with incomes of 60% or less of area median income.
 - Administered by Dept. of Housing and Community Development in Maryland which allocates credits and approves development proposals.

FINANCING CONSIDERATIONS FOR P3 PROJECTS

TAX CREDITS AND OTHER SUBSIDIES

Federal Income Tax Credit Programs

- New markets tax credit program (Sec. 45D of the Internal Revenue Code)
 - Goal of program is to spur revitalization efforts in low-income and impoverished communities.
 - Tax credit incentives for equity investment in certified “Community Development Entities”.
 - Credit is for 39% of the investment over a seven year period (5% in first 3 years, 6% in remaining 4 years).
 - Credits are awarded by US Treasury Department.

FINANCING CONSIDERATIONS FOR P3 PROJECTS

TAX CREDITS AND OTHER SUBSIDIES

Federal Income Tax Credit Programs

- Historic preservation tax credit program (Section 47 of Internal Revenue Code)
 - Provides a federal income tax credit equal to 20% of the investment for the rehabilitation of income producing “certified historic structures.”
 - Program administered through the National Park Service within the U.S. Department of the Interior.
 - Maryland’s State Sustainable Rehabilitation Communities tax credits available through the Maryland Historical trust (MHT) for certified historic structures.

FINANCING CONSIDERATIONS FOR P3 PROJECTS

TAX CREDITS AND OTHER SUBSIDIES

State Tax Credit Programs

- Enterprise Zones are zones intended to promote economic development in economically distressed communities
 - Ten-year credit against property tax and 1- or 3-year income tax credit for wages paid to new employees
 - Administered by the MD Dept. of Business and Economic Development and by the local economic development agencies of counties and other local jurisdictions.
- Other programs include One Maryland Economic Development Program, Jobs Creation Tax Credit, Brownfields Tax Credits and Film Production Activity Tax Exemption

FINANCING CONSIDERATIONS FOR P3 PROJECTS

TAX CREDITS AND OTHER SUBSIDIES

State and Local Authority for Certain Other Subsidy Programs

- Business Improvement Districts -- *Annotated Code of Maryland, Economic Development Article, Section 12-401 – 12 -411.*
- Arts and Entertainment Districts - *Maryland Annotated Code, Economic Development Article, Section 4-701 – 4-707*
- PILOTS (Payment in Lieu of Taxes) - *Maryland Annotated Code, Tax-Property Article, Section 7-501 – 7- 517*

**MUNICIPAL BOND REQUIREMENTS
CONSTITUTIONAL AND STATUTORY AUTHORITY FOR BORROWINGS
BY LOCAL JURISDICTIONS**

Federal Constitution – Tenth Amendment

- Powers not delegated to the United States by the Constitution nor prohibited by it to the States are reserved to the States respectively, or to the People

MUNICIPAL BOND REQUIREMENTS CONSTITUTIONAL AND STATUTORY AUTHORITY FOR BORROWINGS BY LOCAL JURISDICTIONS

State Constitutions

- Provide further delegation of authority to counties, municipalities and other jurisdictions or authority is provided expressly under State-enabling legislation
 - Maryland Express Powers for Charter Counties – Article 25A, Section 5 Annotated Code of Maryland

MUNICIPAL BOND REQUIREMENTS CONSTITUTIONAL AND STATUTORY AUTHORITY FOR BORROWINGS BY LOCAL JURISDICTIONS

Three Different Categories of Maryland Counties

- Commissioner Counties – power to pass local laws vested in Maryland General Assembly with no or very limited authority to adopt legislation by the County Commissioners
- Charter Counties – broad authority for counties to legislate on almost all local matters – generally more populated counties are charter counties, including Montgomery, Prince George’s, Howard, Anne Arundel and Baltimore Counties; Frederick County adopted charter last year which will take effect in 2014

MUNICIPAL BOND REQUIREMENTS CONSTITUTIONAL AND STATUTORY AUTHORITY FOR BORROWINGS BY LOCAL JURISDICTIONS

Three Different Categories of Maryland Counties

- Home Rule Code Counties – authority for County to enact legislation in the areas granted under the express powers provision of the Maryland Constitution to charter counties with authority over certain matters reserved to the State includes Charles County

MUNICIPAL BOND REQUIREMENTS CONSTITUTIONAL AND STATUTORY AUTHORITY FOR BORROWINGS BY LOCAL JURISDICTIONS

Varying Authority for Municipalities Home Rule

- Baltimore City effectively operates as a charter county, but authority of other municipalities may differ widely

MUNICIPAL BOND REQUIREMENTS

- General rule for local governmental political subdivisions is that indebtedness may only be contracted for a “Public Purpose” must be an expenditure that furthers the purpose of the local government

MUNICIPAL BOND REQUIREMENTS

State Constitution Debt Limits

- Often limit the amount of public debt to a specific percentage of assessed valuation of property, which may vary depending on level of government, types of indebtedness, etc.
 - Charter Counties in MD limit is 6% of real property assessed base
 - County charters may also limit ability to increase tax rates to a specified percentage of existing tax obligations in any given year

MUNICIPAL BOND REQUIREMENTS

State Constitution Debt Limits

- Debt ceilings apply to general obligation debt, as opposed to revenue bonds, but there are other limitations from a credit rating perspective on issuance of bonds which are not considered to be “self-supporting.”

MUNICIPAL BOND REQUIREMENTS

General Obligation Bonds vs. Special Revenue Bond Authority

- General Obligation Bonds – full faith and credit of the local governmental issuer is pledged to support the obligation – bonds are repaid from general taxing authority of the local governmental issuer
- Revenue Bonds – bonds repaid from a dedicated source of revenues (*i.e.*, tolls, fees, dedicated taxes or assessments) but for which local jurisdiction has not pledged its full faith and credit; generally, there is increased risk for revenue bonds and, accordingly, the interest coupon is generally higher than general obligation bonds

MUNICIPAL BOND REQUIREMENTS

Examples of Maryland State Revenue Bond Authorities

- Maryland Transportation Authority (MdTA)
- Maryland Community Development Administration (CDA)
- Maryland Industrial Development Financing Authority (MIDFA)
- Maryland Economic Development Corporation (MEDCO)
- Maryland Health and Higher Education Facility Authority
- Maryland Stadium Authority

MUNICIPAL BOND REQUIREMENTS

Local Government Issuers of Municipal Debt

- Subject to authorization, counties and municipalities may issue revenue bonds directly.
- In addition, State law may provide for authority to governmental agencies or districts to issue debt – i.e., several counties have established housing authorities that may issue debt and inter-county agencies such as in the Washington, D.C. area, the Washington Suburban Sanitary Commission

MUNICIPAL BOND REQUIREMENTS

Bonding Authority for Local Jurisdictions

- Economic Development Revenue Bonds - *Annotated Code of Maryland, Economic Development Article, Sec. 12-101-118*
- Redevelopment Bonds - *Annotated Code of Maryland, Economic Development Article, Sec. 12-301 – 312.*

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

- Interest on municipal bonds is only exempt if it satisfies the requirements of Section 103 of the Internal Revenue Code
 - Three exceptions include (i) private activity bond which is not a qualified bond; (ii) arbitrage bonds; and (iii) bonds not in registered form (*i.e.*, bearer bonds)
 - Some taxable bonds allow for tax credits on holders' tax returns – *i.e.*, under American Recovery and Reinvestment Act adopted in 2009, Congress authorized "Build America Bonds" to finance many types of public projects which, while interest paid was considered taxable, provided for a tax credit to the holder on their federal income tax return

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

Private Activity Bonds

- Section 141 of Internal Revenue Code defines the term “private activity bonds” to be any bond issued as part of an issue which meets (A) the private business use test and the private security payment test or (B) which meets the private loan financing test
 - Private business test is satisfied if more than 10 percent of the proceeds of an issue are to be used for any private business use and private security test is met if payment of principal or interest on more than 10 percent of the proceeds of the issue are directly or indirectly secured by or payable from property or payments used for a private business use

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

Private Activity Bonds

- Term “private business use” means use by a trade or business carried on by any person other than a governmental unit
- Private loan financing test is satisfied if more than the greater of 5 percent of the proceeds or \$5 million is used directly or indirectly to make or finance loans (other than certain defined exceptions such as tax assessment loans) to private business

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

Qualified Bonds

- Category of private activity bonds that are nonetheless tax exempt (subject to meeting volume cap and other limitations) – narrowed the categories of what used to be called “industrial revenue bonds”:
 - *Exempt Facility Bonds*
 - *Qualified Mortgage Bonds*
 - *Qualified Veterans’ Mortgage Bonds*
 - *Qualified Small Issue Bonds*
 - *Qualified Student Loan Bonds*
 - *Qualified Redevelopment Bonds*
 - *Qualified 501(c)(3) Bonds*

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

Arbitrage Bonds

- Section 148 of Internal Revenue Code defines as an arbitrage bond as any bond having a yield materially higher than the yield on previously issued tax exempt bond – permits temporary investment of bond proceeds or investment of up to 10% in a required reserve fund at higher rate. Issuer must rebate any excess earnings to federal government.

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

Reimbursement Limitations for Tax-Exempt Bonds

- Subject to certain exceptions, no later than 60 days after expending bond proceeds for project costs, issuer must adopt an “official intent” resolution.
- Further limit of reimbursing costs made pursuant to an official intent resolution to occur not more than 18 months following later of (i) date of original expenditure or (ii) date project placed in service or abandoned, and in any event not longer than 3 years after date of original expenditure

MUNICIPAL BOND REQUIREMENTS FEDERAL INCOME TAX CONSIDERATIONS FOR MUNICIPAL BONDS

Operational Limits on Bond-Financed Facilities

- To avoid private use of a bond-financed facility, IRS has promulgated guidelines for management agreements with private parties to operate such facilities (such as parking lots)
- Must pay reasonable compensation and not based upon net profits of operation of the facility and
- Method or formula for compensation falls within a number of safe harbor tests depending on the length of the contract which require primarily a fixed fee, a capitation fee or per unit fee;
- Ability of the government unit that owns the facility to cancel the agreement.

TIFS AND SPECIAL TAXING DISTRICTS

LEGISLATIVE AUTHORITY FOR SPECIAL TAXING DISTRICTS

State Enabling Authority for Special Taxing Districts

- *Annotated Code of Maryland, Article 23A, Section 44A – Financing New Infrastructure Improvements – Authority for Municipalities and Article 24, Section 9-1301. Special Districts – Authority for Selected Counties (Anne Arundel, Baltimore, Calvert, Cecil, Charles, Garrett, Harford, Howard, Prince George’s, St. Mary’s, Washington and Wicomico)*
 - Authorizes issuance of bonds secured by pledge of special real property taxes to construct infrastructure improvements including storm drainage systems, sewers, water systems, roads, bridges, culverts, tunnels, streets, sidewalks, lighting, parking, parks and recreational facilities, libraries, schools, transit facilities, solid waste facilities, and other infrastructure improvements

TIFS AND SPECIAL TAXING DISTRICTS

LEGISLATIVE AUTHORITY FOR SPECIAL TAXING DISTRICTS

State Enabling Authority

- In addition to foregoing, district may support payment of costs of construction, as well as operation and maintenance, of infrastructure improvements located in or supporting a transit-oriented development
- Certain counties have adopted local variations to State enabling legislation (*i.e.*, Prince George's, Charles Counties) or separate enabling legislation for special taxing districts (*i.e.*, Frederick, Montgomery Counties)

TIFS AND SPECIAL TAXING DISTRICTS

LEGISLATIVE AUTHORITY FOR SPECIAL TAXING DISTRICTS

State Enabling Authority

Requirements to create special taxing district includes the following;

- Petition signed by two-thirds of owners of real property by number and by assessed value (80% in Montgomery County)
- Adoption of resolution or ordinance by municipality or county
- Adoption of bond resolution to authorize issuance of bonds by local jurisdiction
- Filing of declaration within land records to subject property to special tax

TIFS AND SPECIAL TAXING DISTRICTS

LEGISLATIVE AUTHORITY FOR SPECIAL TAXING DISTRICTS

State Enabling Authority

- Special tax methodology must be approved as part of the creation resolution to specify type of tax, rate of tax, provision for increase or prepayment of taxes and finding of public benefit; and
- Authorization for MEDCO (Maryland Economic Development Corporation) to issue bonds on behalf of infrastructure improvements located in or supporting a transit-oriented development or a State hospital redevelopment

TIFS AND SPECIAL TAXING DISTRICTS

LEGISLATIVE AUTHORITY FOR SPECIAL TAXING DISTRICTS

Baltimore City Authority

- ***Section 62A of Baltimore City Charter***
 - In addition to authorizing costs of transportation, water and sewer, and recreation-based infrastructure improvements, special tax districts can be used to fund costs of providing units of affordable housing

TIFS AND SPECIAL TAXING DISTRICTS

LEGISLATIVE AUTHORITY FOR SPECIAL TAXING DISTRICTS

Other Authority

- *Montgomery County Taxing District for White Flint – Section 68C of the Montgomery County Code*
 - District imposed under authority of Maryland Annotated Code express powers provision giving County authority to levy special taxes for governmental purposes
 - Infrastructure improvements limited to transportation infrastructure, including roads, bridges, streetscape, etc. and transit facilities
 - State law adopted to exempt special taxes imposed from Montgomery County Charter requirements on yearly tax caps

**TIFS AND SPECIAL TAXING DISTRICTS
LEGISLATIVE AUTHORITY FOR TAX INCREMENT
FINANCING DISTRICTS**

State Enabling Authority for TIF District

*Annotated Code of Maryland, Economic Development Article,
Sec. 12-201-213*

- Authorizes all political subdivisions (counties and municipalities) in State, except Baltimore City, to form “development districts” whereby a portion of the tax increment of real property taxes above a base year normally paid into the General Fund of the political subdivision is instead paid into a special fund to be used to support bonds issued by the political subdivision

TIFS AND SPECIAL TAXING DISTRICTS
LEGISLATIVE AUTHORITY FOR TAX INCREMENT
FINANCING DISTRICTS

State Enabling Authority

- Proceeds of bonds may be used:
- buy, lease or acquire property,
 - conduct site removal,
 - relocation of businesses or residents;
 - installation of roads, installation of utilities,
 - construction of parks and playgrounds,
 - construction or rehabilitation of buildings for governmental purposes and related costs of issuance

TIFS AND SPECIAL TAXING DISTRICTS LEGISLATIVE AUTHORITY FOR TAX INCREMENT FINANCING DISTRICTS

State Enabling Authority

- Special authority to pledge other local taxes that are attributable to or generated within a “Transportation-Oriented Development.”
- In addition to bonds issued by local jurisdictions, MEDCO authorized to issue bonds to support TOD, “sustainable community” and state hospital redevelopments

TIFS AND SPECIAL TAXING DISTRICTS LEGISLATIVE AUTHORITY FOR TAX INCREMENT FINANCING DISTRICTS

State Enabling Authority

Process to create tax increment financing district includes the following:

- Adoption of resolution or ordinance by municipality or county
- Certification of the amount of the original assessable base of the real properties
- Adoption of bond resolution to authorize issuance of bonds
- May need to adopt special tax district as back-up to support bond debt service

TIFS AND SPECIAL TAXING DISTRICTS LEGISLATIVE AUTHORITY FOR TAX INCREMENT FINANCING DISTRICTS

Baltimore City Authority

- *Sec. 62 of Baltimore City Charter*
 - In addition to authorizing cost of transportation, water and sewer, recreational and governmental purpose based infrastructure improvements, TIF districts can be used to fund costs of providing units of affordable housing and construction or rehabilitation of buildings that are abandoned property or distressed property; may also be utilized for construction of structured and surface parking facilities that are publicly owned or privately owned but serve a public purpose

TIFS AND SPECIAL TAXING DISTRICTS MUNICIPAL BOND UNDERWRITING CRITERIA FOR SPECIAL TAXING DISTRICTS

Underwriting Criteria for Infrastructure Related Municipal Bonds

- Debt Service Fund to cover unexpected shortfalls in collection of tax
- Value-to-Debt Criteria
- Debt Service Coverage
- Additional Credit Support

**TIFS AND SPECIAL TAXING DISTRICTS
TIMELINE – BOND FINANCING PROCEDURES FOR
TAXING DISTRICTS**

Timeline for Bond Financing of Infrastructure

- Developer initiates process through filing petition or lobbying local government to issue bonds
- Adoption of Resolutions and Ordinances
- Local government hires bond counsel
- Preparation of tax methodology and financial projections
- Negotiation of acquisition or funding agreement

TIFS AND SPECIAL TAXING DISTRICTS TIMELINE – BOND FINANCING PROCEDURES FOR TAXING DISTRICTS

Timeline for Bond Financing of Infrastructure

- Preparation of bond indenture
- Negotiation of bond purchase agreement
- Preparation of bond disclosure document for investors
- Continuing disclosure agreement for local government and for developer
- Bond rating submission
- Marketing of bonds, road shows, bond closing