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March 5, 2010

The Honorable Sander M. Levin
Committee on Ways and Means
1102 Longworth House Office Building,
Washington, DC 20515

Re: Need to Extend ARRA Relief for Small Local Governments and Nonprofit Organizations

Dear Chairman Levin,

During this recent period of market disruption, small local governmental units, including cities, counties, townships, and school districts and certain nonprofit entities that provide critical health, education and other services, faced considerable challenges in borrowing. Two provisions of the American Recovery and Reinvestment Act ("ARRA") that are currently scheduled to expire on December 31, 2010 brought considerable relief to these borrowers. Each of these provisions temporarily amended Section 265 of the Internal Revenue Code of 1986 in ways that expanded the ability of banks to "buy" bonds issued by these borrowers or to make loans at a tax-exempt rate and hold them in their own portfolio, thereby providing a critical source of financing and refinancing for local governmental and 501(c) (3) organizations. These provisions of ARRA have saved smaller local governmental units as well as nonprofits such as colleges, schools, hospices, nursing homes, YMCA's and cultural arts facilities substantial interest expense and other costs associated with issuance.

The organizations below, which represent government finance officials, management, financial officers of schools, universities and hospitals, and bond lawyers representing issuers, banks and other market participants, believe that the case for extending these provisions permanently is strong. It is generally expected that the fiscal conditions will remain unstable for state and local governments in the next fiscal years and the need for this provision to remain in effect will only intensify. We urge you to ensure that these provisions are extended prior to their expiration on December 31, 2010.

Attached is a memorandum prepared by the National Association of Bond Lawyers, which sets forth further explanation of the provisions.

Respectfully Submitted,

American Council on Education
American Hospital Association
Council of Development Finance Agencies
Government Finance Officers Association
National Association of Bond Lawyers
National Association of College and University Business Officers
National Association of Counties
National Association of Health and Educational Facilities Finance Authorities
National Association of Independent Colleges and Universities
National Association of State Auditors, Comptrollers and Treasurers
National League of Cities
U.S. Conference of Mayors

EXTENDING ARRA RELIEF FOR DEBT ISSUANCE OF SMALL GOVERNMENTAL ENTITIES AND 501(C)(3) ORGANIZATIONS

Relief Provided By ARRA-Bank Qualified Bonds. The 1986 Tax Act amended Section 265 of the Internal Revenue Code in a manner that made it less financially attractive for a bank to be a direct purchaser of tax-exempt bonds for its own loan portfolio, by denying interest expense deduction for debt incurred to purchase or carry tax-exempt obligations, subject to a very limited exception intended to help small issuers. Under this limited exception, an issuer (but not the 501(c)(3) beneficiary) could issue and designate up to $10 million aggregate principal amount of its governmental obligations, or bonds it issues for 501(c)(3) organizations, as Bank Qualified ("BQ") bonds each year to be excepted from this disallowance rule..

This $10 million amount had not been changed for 23 years and had never been indexed for inflation, so with each passing year it was harder for governmental issuers to finance their own governmental projects in a cost-effective manner through local banks. Moreover, in most states, few 501(c)(3) organizations could achieve BQ status on bonds issued for them (and attract bank purchasers) because most statewide issuers of bonds and many local issuers always issued in the aggregate more than $10,000,000 of bonds in a calendar year.

Upon passage on February 17, 2009, the ARRA increased the BQ limit from $10 million $30 million. It also permitted each 501(c) (3) organization "for whose benefit the bonds are issued" its own $30 million of BQ bonds that it can designate. With this change, states and local governments, and tax-exempt entities such as hospitals, schools, nursing homes and hospices had a viable economic alternative to issue debt through most of 2009. Scores and scores of these entities made use of this provision.

Relief Provided by De Miminis Holding Exception for Banks. The second ARRA provision designed to encourage banks to provide a market for tax-exempt bonds gives banks the ability to hold a 2% de minimis amount of tax-exempt bonds issued in 2009 and 2010 outside of the general proportionate interest expense disallowance rule (the "2% rule"). Thus, banks are given the same ability to hold up to 2% of their total assets in tax-exempt bonds that corporations have had for decades under IRS administrative practice. The 2% rule is in addition to the traditional BQ bonds, now with the $30 million limit. That means a bank can use the 2% rule to purchase bonds that cannot be designated by the issuer as a BQ bond. For example, a bank could enter into a 3-way financing agreement with a local Industrial Development Agency and a company to do a small issue manufacturing bond or one of the new Recovery Zone Facility Bonds included in the ARRA under the 2% rule. In addition, the bank could directly purchase within its 2% rule a $10 million bond for fire trucks or for energy conservation improvements for a 501(c)(3) organization that is not BQ eligible because the issuer or 501(c)(3) organization has already issued bonds in excess of $30 million in that same year.

The benefits conferred by both of these temporary amendments to Section 265 of the Code is currently limited to bonds issued in 2009 and 2010, including refunding bonds issued during this time period. Once issued, these bonds will be able to keep that BQ status throughout the life of the bonds.[1] We believe that extending these benefits to bonds issued beyond 2010 will ensure that small governmental issuers and certain 501(c) (3) organizations delivering health care, education and other vital services retain access to critical capital.

Bank-Held Debt is the Only Viable Means for Many Small Governmental and Nonprofit Issuers to Finance Operations in Uncertain Times. In the last year, these two provisions of the ARRA have in many cases provided the only

[1] Moreover, under prior law, Section 265 treated pooled bond or composite issues rather harshly. Both the pool issue and the individual loans were subject to the $10 million size limit. ARRA provides relief for pooled bond issuances by eliminating the limitation on the total size of the pooled issue, applying the new $30 million limit only to the governmental or 501 (c) (3) conduit borrowers. We also urge that this change be extended.

viable opportunities to many 501(c)(3) organizations and smaller governmental issuers that otherwise would find going to the public market uneconomical if not impossible. Without the ARRA provisions, these entities often had to draw upon taxable bank loans to purchase the bonds that were tendered, often increasing the overall borrowing by 3.00-4.00%--or more. Upon expiration of the ARRA provisions, the pre-ARRA regime comes back into play with smaller issuers losing the banks as purchasers and the advantages to small borrowers of having a much less expensive, complex and risky financing.