NATIONAL ASSOCIATION OF BOND LAWYERS

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Conduit Issues and Issuers and Exempt Facility Bonds

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I. INTRODUCTION TO CONDUIT ISSUES AND ISSUERS

A. General Types of Municipal Bond Transactions

1. Governmental Bonds - General Obligation of the Issuer – generally a governmental entity, political subdivision or authority issuing debt for its own projects, often backed by the full faith, credit and taxing power or a revenue pledge.

2 Conduit Borrowings - Issuer and Borrower – generally, a conduit issuer is an authority that issues bonds or notes and loans the proceeds thereof to a borrower. In most conduit borrowings, the debt is secured only by the collateral and security provided by the borrower.

B. Conduit Bond Issues

1. Interest Rate Advantage – taxable rate versus tax-exempt rate.

2. Economic Advantages.

3. Ability to issue tax-exempt bonds.

II. WHAT IS A CONDUIT ISSUER

A. Types of Entities

1. "On behalf of" entities - generally, corporations or authorities authorized to issue bonds on behalf of a state or political subdivision thereof. See Rev. Proc. 02-26,1982-1 CB 476 (rules for so called "63-20" issuers)

2. In some states, a general purpose governmental issuer.

3. National Conduit Issuers.

B. Powers - State Law Driven – in all transactions, it is critical to understand the extent of the issuer's authorization as it relates to the proposed project, the proposed conduit borrower, the proposed financing structure, etc.

III. FOR WHAT AND FOR WHOM DO CONDUIT ISSUERS ISSUE BONDS

Most States have certain authorizing statutes which authorize the types of projects that can be financed with conduit bonds. Furthermore, not all conduit issuers have the same powers. For example, a health

facilities authority may not have the state law authority to issue bonds to finance an affordable housing project and *vice versa.* Additionally, certain local laws may be applicable.

A. Typical Types of Projects Financed with Conduit Bonds

1. Healthcare facilities
2. Educational facilities
3. Cultural facilities
4. Social Service agency facilities
5. Housing facilities
6. "Exempt" facilities (see further discussion below under "VI. EXEMPT FACILITY BONDS"
7. Manufacturing facilities

B. Benefitted Entities

1. Hospitals and related healthcare entities
2. Senior living organizations
3. Private colleges and universities
4. Independent schools and charter schools
5. Museums
6. Social Service Agencies
7. Municipalities
8. Political corporations
9. In some instances, religious organizations
10. In some instances, private companies

IV. FINANCING STRUCTURES FOR A CONDUIT TRANSACTION

A. Key Questions

1. What is the deal and who are the players?
2. What are some considerations for selecting an issuer?
3. What is the applicable state law and how will it affect the structure of the transaction?
4. Where will you receive TEFRA Approval?
5. How and to whom are the bonds being sold?

B Basic Fixed Rate Conduit Structures

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1. Security

    a) Promise of the conduit borrower (i.e., general obligation to repay).

    b) Revenues - pledge of revenues from the conduit borrower pursuant to a loan agreement or lease agreement.

    c) Mortgage/Deed of Trust.

    d) Credit Enhancement

2. Documents

    a) Trust Indenture

    b) Master Indenture

    c) Loan Agreement

    d) Lease Agreement

    e) Installment Sale Agreement

    f) Important Document Provisions

        (i) Indemnification – Issuer (and its members, officers, employees, etc.) should incur no costs, expenses, or liabilities of any kind as a result of issuing bonds for the benefit of the conduit borrower

        (ii) Issuer's Limited Obligation – the Issuer's obligation to pay debt service on the bonds should be limited to payment from specified sources (typically, payments made by the conduit borrower pursuant to the applicable agreement, together with any amounts received as a result of enforcement of rights in security upon the conduit borrower's default)

        (iii) Defaults

        (iv) Flow of funds

C. Alternative Structures

1. Multi-Modal

2. Project Finance

3. Structured Finance

V. SECURITIES ISSUES APPLICABLE TO CONDUIT ISSUES

Municipal bonds, including conduit obligations, are generally exempt from the registration requirements of federal and state securities laws, but are subject to securities law disclosure rules-generally referred to as antifraud rules. Also, a transaction may have more than one security. Failure to comply with all securities laws applicable to a transaction can result in liability for all of the parties to the transaction,

including the lawyers.

There are two ways to gain an exemption from the registration requirements of Section 5 of the Securities Act of 1933 (the "1933 Act") as an exempt the security, or as an exempt the transaction. Section 3(a)(2) of the 1933 Act exempts most municipal securities from the registration requirement. However, it does not exempt from the anti-fraud provisions.

A. Which Securities Laws Apply to Conduit Issues?

1. Exempt Securities

Section 5 of the 1933 Act provides that it is unlawful for any person to use the mail or other forms of interstate commerce to sell or deliver any security unless a proper "registration statement" has been filed with the Securities and Exchange Commission (the *"SEC"*) and is in effect.

Most municipal securities do not need to be registered because Section 3(a) of the 1933 Act provides that, for most purposes, certain classes of securities are not subject to the 1933 Act. These include:

a) Any security issued or guaranteed by the United States or any Territory thereof.

b) Any security issued or guaranteed by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories. Includes most municipal securities, but does not include securities issued by Indian tribes. No-action letters have extended this exemption to 63-20 corporations.

c) Any security issued or guaranteed by a national bank or a banking institution organized under the laws of any State, Territory or the District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial banking commission or similar official.

d) Any security which is an "industrial development bond" (within the meaning of Section 103(c)(2) of the 1954 Tax Code, as in effect in 1970) (each an "IDB") the interest on which is excludable from gross income under Section 103(a)(1) of the 1954 Tax Code (other than multi-family housing bonds and bonds issued to finance industrial parks). *(1933 Act, §3(a)(2)).* SEC Rule 131 (*17 CFR § 230.131)*, provides that the obligations of the ultimate obligor in a conduit bond issue are deemed to be separate securities (and thus would be subject to the 1933 Act registration requirements).

This exemption includes most "exempt facility bonds" issued under Section 142 of the 1986 Tax Code and "qualified small issue bonds" issued under Section 144(a) of the 1986 Tax Code.

e) Any security issued by an entity organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any person, private stockholder or individual (which should include most 501(c)(3) corporations and some 63-20 corporations).

f) Any insurance policy issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner or other similar officer of a State or Territory or the District of Columbia. This exemption covers bond insurance policies of major bond insurers.

g) Securities offered and sold only to persons resident within a single State or Territory by an issuer that is resident (or incorporated by) and doing business with such State or Territory This exemption can be lost if resale of the securities is out of state.

2. Separate Securities Analysis for Conduit Issues.

a) Under Rule 131(a), any part of a bond or other obligation (including those bonds or obligations otherwise exempt under Section 3(a)(2)) payable from payments to be made in respect of property or money which is or will be used under a lease, sale or loan arrangement, by or for an industrial or commercial enterprise, is considered a "separate security" issued by the lessee or obligor under such lease, sale or loan arrangement. Thus, the obligations of the ultimate obligor in a conduit bond issue are deemed to be separate securities and are subject to the 1933 Act registration requirements unless an exemption is available.

b) As noted above, the exemption under Section 3(a)(2) for tax-exempt IDBs mitigates the impact of Rule 131(a), but does not apply to separate securities related to taxable IDBs or multi-family housing conduit bonds.

c) Under Rule 131(b), the obligation(s) underlying a conduit issue will not be deemed to be a separate security if: (i) the obligation is payable from the general revenues of a governmental unit specified in Section 3(a)(2); or (ii) the obligation relates to a public project owned and operated by or on behalf of and under the control of a governmental unit; or (iii) the obligation relates to a facility that is leased to and under the control of an industrial or commercial enterprise but is part of a public project that is owned by a governmental unit.

d) In the case of multi-family housing issues, SEC no-action letters indicate that housing projects owned and operated by private developers may satisfy the requirements of Rule 131(b) if adequate governmental "control" is demonstrated. Factors showing governmental control include: (i) the right to access the project; (ii) the right to inspect books and records; (iii) the right to receive periodic reports relating to project operations; (iv) the right to obtain possession of the project in the event of a material default under the mortgage; (v) approval of the timing of construction; and (vi) approval of plans and specifications.

3. Exempt Transaction

If the securities being issued do not qualify as exempt securities under Section 3(a) of the 1933 Act, the issuer must register the securities or qualify the offering and sale of the securities as an exempt transaction under Section 4 of the 1933 Act. However, there are exemptions that apply to issuers and exemptions which apply to purchasers. Subsections a) and b) below discuss exemptions that apply to issuers.

a) Transactions involving offers or sales by an issuer solely to *"accredited investors"* if (i) the aggregate offering price is $5 million or less, (ii) there is no advertising or public solicitation in connection with the transaction, and (iii) the issuer files a Form D with the SEC. *Section 4(a)(6)*

b) Transactions by an issuer not involving any *"public offering."* To be considered within "safe harbors," the issuer must comply with SEC Rules 501 through 508, commonly known as "Regulation D" or "Reg D". *Section 4(a)(2).* Those transactions include:

(i) Exemption for offerings of $1 million or less. $1 million threshold applies to all securities sold within 12 months.

(ii) Exemption for offerings of $5 million or less sold to not more than 35 purchasers, excluding accredited investors. Also measured over 12 months. Securities may not be sold pursuant to general solicitation, and issuer must exercise *"reasonable care"* to assure purchasers are not *"underwriters."*

(iii) Exemption for offerings sold to not more than 35 purchasers, regardless of dollar amount. Among the requirements for meeting this exemption is that each purchaser (other than accredited investors) must have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." "Accredited investors" do not count toward the 35 purchaser limit.

4. If the securities being issued do not qualify as exempt securities under Section 3(a) of the 1933 Act and have not been registered, the purchaser can qualify the initial purchase and subsequent resale of the securities as exempt transactions under Section 4 of the 1933 Act. The following subsections apply to purchaser exemptions.

a) "Transactions by any person other than an issuer, underwriter, or dealer."

(i) The term *"underwriter"* is broadly defined to include any person who (X) has purchased securities from an issuer with a view to distribute such securities, or (Y) offers and sells securities for an issuer in connection with the distribution thereof. *(Rules 144 (17 CFR § 230.144) and 144A (17 CFR § 230.144A) provide safe harbors in this regard). (Section 2(a)(11)).*

(ii) *"Dealer"* means a person who works as an agent, broker or principal in the business of offering, buying, selling or otherwise dealing and trading in securities issued by another person. *(Section 2(a)(12)).*

(iii) The Section 4(a)(1) exemption should allow *"accredited investors"* other than dealers (*e.g.*, high net worth individuals) to acquire securities directly from an issuer that has qualified such sale under the Section 4(a)(2) or 4(a)(6) exemption.

b) "Transactions by a dealer (but not in the capacity of an underwriter), so long as the transactions"

(i) do not take place within 40 days after the initial public offering of the security by the issuer or an underwriter, or

(ii) do not take place within 40 days after the effective date of a registration statement, or

(iii) do not involve an unsold subscription or allotment to such dealer in connection with the distribution of the securities by the issuer or an underwriter. To qualify for this exemption, investment bankers must avoid activities that will cause them to be *"underwriters"* within the meaning of Section 2(a)(11) of the 1933 Act. *(SEC Rules 144 and 144A provide safe harbors in this regard.)*

B. Antifraud Provisions

1. Section 17(a) is a key anti-fraud provision in the Securities Act. It provides for liability for fraudulent sales of securities. Section 17(a) makes it unlawful to "employ any device, scheme, or artifice to defraud", "obtain money or property" by using material misstatements or omissions, or to "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

2. This provision closely tracks Section 10b of the Securities Exchange Act and Rule 10b-5, which is used more widely by investors suing for fraud. Section 10b of the Securities Exchange Act provides it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange.

3. The Rule 10b-5 prohibits any act or omission resulting in fraud or deceit in connection with the purchase or sale of any security. It provides as follows:

4. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

   a) To employ any device, scheme, or artifice to defraud,

   b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

   c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

C. Continuing Disclosure Requirements

1. Rule 15c2-12 requires the underwriter of an issue of governmental securities to obtain a commitment (also known as an undertaking) by the issuer of the securities to provide ongoing disclosure of certain financial information in the format presented in the Official Statement. This undertaking generally takes the form of a Continuing Disclosure Certificate or Continuing Disclosure Agreement executed by the issuer of the securities, or other obligor, at closing. Rule 15c2-12 requires ongoing disclosure in the form of an annual report, containing updated financial information, and notices of certain material events, if and when any occur.

2. In the conduit context of a conduit financing, the conduit borrower, not the issuer, is almost always the appropriate party to make a formal continuing disclosure undertaking and to provide ongoing disclosure. The conduit issuer should nonetheless ensure that the conduit borrower executes a continuing disclosure undertaking that complies with Rule 15c2-12 and provide monitoring to ensure compliance with the Rule on an ongoing basis.

VI. FEDERAL TAX ISSUES

A. Private Activity Bond Restrictions – proceeds must be used for permitted purposes.

B. Substantial User Requirement – interest is not tax-exempt if received by certain non-exempt persons who generally use or benefit from the financed project in their trade or business. (Code §149(a))

C. Volume Cap – limitation on the amount of certain private activity bonds which can be issued by a state, state agency and other issuers within the state. (Code §146)

D. Reimbursement Declarations of Official Intent – requirement for declaration of official intent to reimburse expenditures.

A conduit issuer or conduit borrower is permitted to use bond proceeds to reimburse certain expenditures paid before the date of issuance subject to certain requirements (see Treas. Reg. Section 1.150-2). One requirement is that the conduit issuer must adopt a declaration of official intent to reimburse expenditures (other than certain expenditures such as, architectural, engineering and legal fees) not later than 60 days after the reimbursed expenditure is paid. In the case of qualified 501(c)(3) bonds, a conduit borrower may adopt the declaration of official intent.

E. TEFRA Notice and Approval – requirement for public hearing and notice requirements. (Code §147(f))

Generally, prior to issuance, qualified private activity bonds (including qualified 501(c)(3) bonds) must be approved by an elected representative for the governmental entity issuing the bonds and, in some cases, for each governmental entity having jurisdiction over the area in which the bond-financed facility is to be located. The public approval must occur after the holding of a public hearing following reasonable public notice before the public hearing and must be completed within a prescribed period. Public approval by a governmental unit may also be by voter referendum. IRC Section 147(f) and Treas. Reg. Section 1.147(f)-1 define the rules for this requirement. Rev. Proc. 2022-20, 2022-14 I.R.B. 945 permits "virtual" hearings to be held by teleconference.

F. Tax Compliance Certificate – contains certificates by the issuer and borrower relating to the use of proceeds and projects financed thereby

VII. EXEMPT FACILITY BONDS

A. In General - Section 142 of the Code permits tax-exempt financing with respect to 17 categories of "exempt facilities." Exempt facility bonds are sometimes issued as conduit bonds. The types of facilities eligible are:

1. airports,
2. docks and wharves,
3. mass commuting facilities,
4. facilities for the furnishing of water,
5. sewage facilities,
6. solid waste disposal facilities,
7. qualified residential rental projects,
8. facilities for the local furnishing of electrical energy or gas,
9. local district heating or cooling facilities,
10. qualified hazardous waste facilities,

11. high-speed intercity rail facilities,

12. environmental enhancements of hydro-electric generating facilities,

13. qualified public educational facilities,

14. qualified green building and sustainable design projects,

15. qualified highway or surface freight transfer facilities,

16. qualified broadband projects, and

17. qualified carbon dioxide capture facilities

B. General Provisions Applicable to all Exempt Facility Bonds

1. Functionally Related Facilities - An exempt facility includes land, buildings or other property "functionally related and subordinate to such facility." Property is functionally related and subordinate to a facility only if it is of "a character and size commensurate with the character and size of the exempt facility." Whether the use of proceeds test is satisfied is determined by reference to the "ultimate use of proceeds," ignoring the use of proceeds by intermediate parties in the transaction (such as lenders).

2. Public Use Requirement - The regulations provide that an exempt facility must satisfy a "public use" test to "serve the public or be available on a regular basis for general public use, or be part of a facility so used." For example, a private dock owned by or leased to and serving only a single manufacturing plant would not qualify (unless it is part of a public port); however, a hanger or repair facility at a municipal airport even if owned by or leased exclusively to a nonexempt person, would qualify if such nonexempt person directly serves the general public (i.e., common passenger carrier or freight carrier). Sewage or solid waste disposal facilities are deemed to meet the public use test in all events under the regulations.

3. Special Rule Regarding Office Space - Section 142(b)(2) provides that an office will not be treated as part of an exempt facility unless it is located on the premises of such facility and the functions to be performed at such office (except for a de minimis amount) are directly related to the day-to-day operations of such facility

C. Specific Requirements for Certain Qualified Exempt Facilities

1. Airports, Docks and Wharves, Mass Commuting Facilities and High-Speed Intercity Rail Facilities

a) Governmental Ownership Requirement

(i) With respect to airports, docks and wharves, mass commuting facilities, and high-speed intercity rail facilities, section 142(b)(l) provides that such facilities will be treated as exempt facilities only if all of the property to be financed by the net proceeds of the issue are to be owned by a governmental unit.

(ii) Section 142(b)(1)(B) provides a "safe harbor" rule for ownership by a governmental unit where such facilities are leased or subject to management contracts or similar operating agreements with nongovernmental units. The safe harbor rule permits the governmental unit to lease property, enter into management contracts

or other similar types of operating agreements and still be treated as the owner of the facility if:

(a) the lessee or contractor makes an irrevocable election (binding also on successors in interest under the lease) to not claim depreciation or investment tax credit with respect to the property;

(b) the lease or contract term is not more than 80% of the reasonably expected economic life of the property; and

(c) the lessee or contractor has no option to purchase the property other than at fair market value as of the time the option is exercised.

b) Prohibition of Certain Uses - Section 142(c)(2) prohibits the use of bond proceeds to finance certain facilities to be used for a private business use in connection with the financing of airports, docks and wharves, mass commuting facilities and high-speed intercity rail facilities. Private business use is prohibited under Section 142(c)(2) with respect to the following facilities:

(i) any lodging facilities (including airport hotels);

(ii) any retail facility (including food and beverage facilities) in excess of a size necessary to serve passengers and employees at the exempt facilities;

(iii) any retail facility (other than parking) for passengers or the general public located outside the exempt facility terminal;

(iv) any office building for individuals who are not employees of a governmental unit or of the operating authority for the exempt facility; and

(v) any industrial park or manufacturing facility.

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c) Storage and Training Facility - Section 142(c)(1) permits tax-exempt financing of storage or training facilities directly related to airports, docks and wharves, mass commuting facilities and high-speed intercity rail facilities.

d) "Airports"

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1. Reg. 1.103-8(e)(2)(ii) defines the term "airport" to include facilities:

(a) which are directly related and essential to (i) servicing aircraft, enabling it to take off and land (such as a maintenance or overhaul facility), or (ii) transferring passengers or cargo to or from aircraft, and

(b) which need to be located at or in close proximity to the runway area in order to perform their function.

2. Reg. 1.103-8(a)(2) provides that a hangar or repair facility at a municipal airport will meet the public use requirement, even if leased to a nonexempt person, if the nonexempt person directly serves the general

public as a common carrier or if it is part of a facility available for public use.

2. Docks and Wharves - Reg. 1.103-8(e)(2)(iii) provides that a "dock or wharf" includes property functionally related or subordinate to exempt docks and wharves, such as the structure alongside which a vessel docks, equipment used to on and off load cargo and passengers (e.g., cranes, conveyors), and related storage, handling, office and passenger areas.

3. Mass Commuting Facilities.

   Eligible "mass commuting facilities" include real property and related improvements serving the general public commuting on a day-to-day basis by bus, subway, rail, ferry, or other conveyances that move over prescribed routes (as well as functionally related and subordinate facilities such as parking garages, car barns, and repair shops) but does NOT include "mass commuting vehicles." See Rev. Rul 88-51, 1988-1 C.B. 74.

4. Facilities for the Furnishing of Water.

   Under Section 142(e) of the Code eligible "facilities for the furnishing of water" require (i) that the water is available to members of the general public and (ii) that the facilities are either owned by a governmental unit or water rates are established or approved by a State or political subdivision, an agency or instrumentality of the federal government, or by a public service, a utility commission, or similar body of any State or political subdivision.

5. Sewage Facilities.

   "Sewage Facility" is defined in Reg. 1.142(a)(5)-1 as property used for the secondary treatment of wastewater having a biochemical oxygen demand (BOD) of 350 mg/liter and certain related facilities. The definition specifically excludes "pretreatment facilities" designed to deal with contaminants other than BOD, pH, oil and grease, fecal coliform and total suspended solids (TSS). Costs of dual function (i.e., qualifying and nonqualifying) facilities must be allocated on reasonable basis.

6. Solid Waste Disposal Facilities.

   a) On August 18, 2011, the IRS released final regulations setting forth guidance as to the definition of a solid waste disposal facility. The regulations eliminate the "no value test" from the definition of solid waste, provide that the solid waste disposal process, in effect, ends at the production of the first marketable product, eliminates the proposed rule that "residual" material is solid waste only if it is less than five percent of the material introduced into the related process, and retains the rule that an entire facility qualifies for tax-exempt financing if at least 65% of the material processed is solid waste but with a new requirement that the 65% rule is generally tested annually (subject to limited exceptions).

   b) A "solid waste disposal facility" is defined to mean any facility to the extent that the facility processes "solid waste" in a "qualified solid waste disposal process", performs a "preliminary function", or is functionally related and subordinate to a facility that performs either a qualified solid waste disposal process or a preliminary function.

   c) "Solid waste" is defined in the final regulations as garbage, refuse, and other solid materials (determined at ambient temperature and pressure) derived from any agricultural, commercial, consumer, or industrial operation or activity if the

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person generating or acquiring such waste reasonably expects the waste to be introduced into a qualified solid waste disposal process within a reasonable time. Solid waste must be either (i) "Used material", which is any material that has been previously used as a commercial, consumer, governmental, or industrial product, or a component of such product (including animal waste produced from a biological process); or (ii) "Residual material", which is any residual byproduct or excess unused raw material that remains after or results from the production of any agricultural, commercial, consumer, governmental, or industrial production process or activity or from the provision of any service. The final regulations eliminate the proposed rule that residual material does not qualify unless it constitutes less than five percent of the total material introduced into the original production but retains the requirement that such material have a fair market value that is expected to be lower than any product resulting from such production process.

d) The term "qualified solid waste disposal process" includes the following (i) a "final disposal process" which is any process that provides for the incineration or permanent containment of solid waste or the placement of solid waste in a landfill, (ii) an "energy conversion process" which is any thermal, chemical, or other process that is applied to solid waste to create and capture synthesis gas, heat, hot water, steam, or other useful energy; the energy conservation process ends at the point at which the useful energy is created, captured, or incorporated into synthesis gas, heat, hot water, or other useful energy (collectively "Useful Energy") or before any transfer of such Useful Energy and whether or not such Useful Energy is a "first useful product" (as described herein), and (iii) a "recycling process" which is any process that reconstitutes, transforms, or otherwise processes solid waste into a useful product but does not include refurbishment, repairs, or similar activities; the recycling process begins at the first application of such process to transform the solid waste into a useful product (for example, melting, re-pulping, or shredding) and the solid waste disposal process generally ends at the point the first useful product is produced from solid waste.

e) The determination of whether a useful product is produced must take into account whether a product could be sold, not whether the product is actually sold. However, operational constraints that affect the point when a useful product can be extracted or insolated and sold may be taken into account in any analysis. The cost of extracting, isolating, storing, and transporting the product to market may be taken into account only if the product is to be used at a different location from where it is produced.

f) A facility that performs a "preliminary function" also qualifies as a solid waste disposal facility. A preliminary function is a function to collect, separate, sort, store, treat, disassemble, or handle solid waste that is preliminary to and directly related to one of the qualified solid waste disposal processes described above. The final regulations eliminate the proposed rule that a function will be treated only as preliminary if more than 50% of the materials that result from the function are solid waste.

g) Regulations regarding solid waste facilities are found at Reg. §1.142(a)(6)-1.

7. Residential Rental Project (Section 142(d) of the Code)

a) A "residential rental project" is a building or structure containing one or more similarly constructed units that are not used on a transient basis.

(i) A unit must contain separate and complete facilities for living, sleeping, eating, cooking and sanitation, but may, however, be served by centrally located equipment such as air conditioning or heating

(ii) Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, nursing homes, sanitariums, and rest homes are not residential rental projects.

(iii) Revenue Ruling 98-48 distinguishes various housing components of a continuing care facility that constitute "residential rental facilities." Generally, a facility providing continuous or frequent nursing, medical or psychological services will not qualify as a residential rental facility.

(iv) Note that regulations governing residential rental facilities are generally found in Reg. §1.103-8.

b) Low Income Tenants. A "qualified residential rental project" must meet either one of the following low income tenant qualification requirements under section 142(d)(1)(A) or (B):

(i) 20% or more of the units are occupied by individuals having incomes of 50% or less of the area median gross income; or

(ii) 40% or more of the units are occupied by individuals having incomes of 60% or less of the area median gross income.

The issuer is required to elect compliance with (1) or (2) at the time the bonds are issued. This election, once made, is irrevocable.

c) Note: There are other specific requirements for bonds issued for residential rental project purposes, but above are the two main requirements.

8. Facilities for the Local Furnishing of Electrical Energy or Gas.

Section 142(f) of the Code generally limits the "local" area served by the facilities (which need not be owned by a governmental entity) to either (i) a city and 1 contiguous county or (ii) 2 contiguous counties. Certain "sunset" provisions generally limit the use of such bonds for facilities serving an area that was served by the conduit borrower (or a predecessor in interest) as of January 1, 1997.

9. Local District Heating or Cooling Facilities.

Section 142(g) of the Code permits the financing (by non-governmental conduit borrowers) of local heating or cooling facilities consisting of pipelines or networks providing hot water, chilled water, or steam to 2 or more users for residential, commercial, or industrial heating or cooling, or for process steam. A "local district" served by the facilities is defined in the same manner as "local" facilities for electric energy or gas (i.e., a city and 1 contiguous county or 2 contiguous counties).

10. Qualified Hazardous Waste Facilities.

Section 142(h) of the Code permits financing (by non-governmental conduit borrowers) of facilities for the disposal of hazardous waste by incineration or entombment if (i) the facilities are subject to certain federal permitting requirements and (ii) the financing

generally relates to the portion of the facilities disposing of waste other than that produced by the conduit borrower (and any related parties).

11. High-Speed Intercity Rail Facilities.

    a) A facility qualifies as a high-speed intercity rail facility if it is a facility (other than rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas (as such areas are defined by the Secretary of Commerce). The facilities must use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops, and the facilities must be made available to members of the general public as passengers.

    b) The facility does not have to be owned by a governmental unit; however, any non-governmental owner must elect irrevocably not to claim any deduction for depreciation under sections 167 or 168 of the Code or claim any income tax credit with respect to the property to be financed with the issue's net proceeds.

    c) Section 147(c) of the Code, which limits the use of bond proceeds to acquire land to 25%, does not apply to land acquired for noise abatement, wetland preservation or future use as a high-speed rail facility if there is no other significant use of such land. With regard to the public approval requirement, if the issuer of the bonds is also the owner or operator of the facilities, it is deemed to be the only governmental unit having jurisdiction over such facility for purposes of the requirement.

12. Environmental Enhancements of Hydroelectric Generating Facilities (Fishladders)

    Section 142(j) applies to facilities where at least 80% of the proceeds of the bonds are used to finance property for a federally licensed hydroelectric generating facility and which either protects or promotes fisheries or other wildlife resources or is a recreational facility or other improvement required by the federal licensing permit for the operation of the generating facility. The category is seldom, if ever, used.

13. Public Educational Facilities

    Section 142(k) applies to bonds at least 95% of the net proceeds of which are used to provide school facilities owned by for-profit entities pursuant to public-private partnership agreements with a State or local educational agency. The school facilities must be operated as part of a system of public schools. School facilities include school buildings and functionally related and subordinate land and can include stadiums or other athletic facilities used primarily for school events. These bonds are not subject to the general volume limitation under section 146 of the Code, but are subject to a separate volume limitation set forth in section 142(k). This category has rarely, if ever, been used.

14. Qualified Green Building and Sustainable Design Projects.

    Section 142(l) of the Code provided for financing certain "green building" and "sustainable design" projects approved by Treasury in consultation with the EPA, with no more than 1 such project per State. Qualifying bonds had to be issued by September 30, 2012 (with the exception of certain bonds issued to refund bonds issued on or before that date).

15. Highway or Surface Freight Transfer Facilities

Section 142(a)(15) was added in 2006 and currently authorizes up to $ 30 billion dollars of bonds for qualified highway or surface freight transfer facilities. It applies to bonds at least 95% of the net proceeds of which are spent to provide qualified highway or surface freight transfer facilities within five years. The Secretary of the Treasury may extend the five years upon request. Qualified highway or surface freight transfer facilities are (1) any surface transportation project that received federal highway funds, (2) any project for an international bridge or tunnel for which an international entity is responsible and received federal funds, or (3) any facility for the transfer of freight from truck to rail or rail to truck.

16. Qualified Broadband Projects.

Section 142(n) of the Code (enacted as part of the November 2021 Infrastructure Investment and Jobs Act) provides for financing projects that extend fixed, terrestrial broadband service to areas not currently receiving such service at levels that meet the detailed technical specifications set forth in that Section. Volume cap is only required for 25% of the qualified bonds (and a complete exemption from volume cap may apply to certain governmentally owned projects).

17. Qualified Carbon Dioxide Capture Facilities.

Section 142(o) of the Code (enacted as part of the November 2021 Infrastructure Investment and Jobs Act) provides for financing projects that satisfy certain detailed technical specifications in that Section (i) for capturing, treating, compressing, or storing CO_2 in conjunction with an industrial site that emits CO_2, (ii) for projects that convert solid or liquid coal, petroleum, biomass, or certain other materials into a synthetic gas (composed primarily of CO_2 and hydrogen) for direct use or subsequent chemical or physical conversion, as well as (iii) for "direct air capture facilities" that capture CO_2 directly from the ambient air. As with bonds for qualified broadband projects, volume cap is only required for 25% of the qualified CO_2 capture bonds.