Private Activity Bond Tests

Fundamental Principles
Basic Issue Spotting

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Agenda

- The Basics
- Qualified Management Contracts
- Allocation and Accounting Rules
- Tax Increment Financings

The Panel will be hypo-based with the black letter and/or guiding principles layered throughout the discussion of the hypotheticals

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The Basics

General Two-Prong Test

Private Use-More than 10% of proceeds of an issue used in a private trade or business by a person other than a state or local governmental unit; AND

Private Security/Payments-Payment of the principal of, or the interest on, more than 10% of the proceeds of a bond issue is:

- Secured by an interest in property used or to be used for a private business use or payments in respect of such property; or
- To be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use

The Basics (Continued)

For Private Use that is Unrelated to Governmental Use or Disproportionate to the Governmental Use to which such Private Use Relates-10% limits are reduced to 5%

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The Basics (Continued)

$15 Million Limitation

- Even if the two-prong test is not met, bonds may be private activity bonds if the "nonqualified amount" exceeds $15 million
  - Nonqualified amount is the lesser of:
    i. The portion of the bond proceeds to be used for a private use; or
    ii. The portion of the bonds that are secured by, or the payments of which are derived from property used in a private business use

  - Issuer may allocate portion of its state's annual volume cap for qualified private activity bonds in excess of $15 million

  - Application of multipurpose allocation rules under Treasury Regulation Section 1.141-13(d) to treat each refunding purpose as a separate issue for purposes of the $15 million limitation

The Basics (Continued)

Private Loan Financing Test

Not more than the lesser of 5% or $5 million of proceeds may be used (directly or indirectly) to make or finance loans to persons other than state or local governmental units

- Loans to individuals not engaged in a trade or business are subject to the test

The private loan financing test is based on general federal tax principles. For example, a long-term lease to a non-governmental person may be treated as a loan if the arrangement transfers tax ownership to a non-governmental person

The Basics (Continued)

The private activity bond tests are based on

DELIBERATE ACTION after the issue date that cause the private activity limitations to be exceeded

AND

REASONABLE EXPECTATIONS of the issuer as of the issue date that the private activity bond tests will not be satisfied during the term of the issue

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The Basics (Continued)

Types of Private Business Use

- Private tax-ownership
- Certain leases, licenses and permits
- Certain management agreements or service agreements that do not satisfy the qualified management contract rules
- Certain research arrangements
- Certain output contracts
- Arrangements that convey similar legal entitlements, e.g., naming rights and special pricing arrangements
- For facilities not available for use by the general public, private use may arise as a result of a special economic benefit to a non-governmental person

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The Basics (Continued)

Exceptions to Private Business Use	Private Uses with No Private Payment or Security
• General public use • Agents • Incidental Use • Qualified Improvements • Temporary Use Exceptions	• Grants • $1/Year Leases • Operational and Administrative Expenses

Private Trade or Business Use Hypothetical

- City receives a federal grant to install 50 electronic vehicle charging stations in a City-owned 200 space garage (the charging stations would use 50 of the parking spaces).
- City issued $20 million of its bonds in 2019 to construct the garage, which was placed in service in 2022
- City enters into a 10-year agreement with ElectriCo. to service the charging stations and supply electricity to the charging stations. ElectriCo bills and charges customers directly for charging services at rates approved by the City
- Does the use by ElectriCo satisfy the incidental use exception?
- Would the answer differ if the EV chargers are used both for City vehicles and members of the general public, and public users are charged by the City at rates determined solely by the City?

Qualified Management Agreements

Revenue Procedure 2017-13 sets forth the following factors to determine whether an arrangement is a qualified management contract

- Control over the managed property
- Compensation
  - Reasonableness
  - No net profits arrangements
  - Treatment and timing
- Service provider does not bear burden of net losses or losses of the property
  - Contract term
  - Circumstances substantially limiting exercise of rights
  - No inconsistent tax position

Management Agreement Hypothetical

- In 2022 City issues $50,000,000 of bonds to finance the construction of a state of the art multi-sport and training facility (the “Facility”) and adjacent parking garage for City University (“CU”). The term of the Bonds is 30 years. The Facility will be used by CU’s men’s and women’s basketball teams, men’s and women’s volleyball teams for games and training. The Facility will also house a training gym and equipment that will be open to CU students.

- CU has entered into an agreement with “Service Provider” to maintain daily operations, book events, market CU’s men’s basketball and manage the parking facility. Facility and parking will open to CU teams and students in 2025; Construction of the training areas will be completed in 2024 and the basketball and volleyball arena space in 2025

Management Agreement Hypothetical (Continued)

- Term of Agreement is for 32 years beginning in 2023
- Service provider enters into agreement with region's professional basketball team to use the Facility's training gym and equipment in 2024 for one year while the team's training facility is being renovated; team will pay City $350,000 for such use
- Service provider will perform pre-opening services in 2023 to accommodate professional team use
- Service provider to receive a periodic fixed annual fee beginning in 2025, and a separate fixed fee for preopening services
- CU to determine student rates
- Parking to be managed by independent vendor selected by service provider; vendor shall retain charges for parking and receive from service provider reimbursement for costs in excess of receipts
- Service provider to receive incentive equal to 10% of men's basketball ticket sales in excess of $1,000,000 in any year

Management Contract Hypothetical Analysis

- Is the arrangement a management contract?
- When is the Project placed in service?
- Does the term of the management contract conform to the management contract rules?
- Does City have sufficient control of the Facility to comply with the management contract rules?
- What questions should be asked regarding control?
- Does the compensation arrangement satisfy the qualified management contract rules?
- Does the parking arrangement give rise to private activity, and if so, does it taint the remainder of the contract?

Allocation and Accounting Rules

Allocation Rule with respect to an "Eligible Mixed Use Project"

"Qualified Equity" is allocated first to private trade or business use of bond-financed property and then to governmental use; Bond proceeds are allocated first to governmental use of bond-financed property and then to private trade or business use

Eligible Mixed Use Project

- An "Eligible Mixed Use Project" is a project financed with governmental bond proceeds and "qualified equity" pursuant to the same "plan of financing"

Qualified Equity

- Qualified Equity are proceeds of bonds that are not tax-advantaged bonds or funds that are not derived from the proceeds of a borrowing that are spent on the same eligible mixed used project as tax-exempt proceeds. Qualified Equity does not include equity interests in real property or tangible personal property, or moneys used to redeem governmental bonds

Allocation and Accounting Rules

Project

The term "project" for this means one or more facilities or capital projects, including land, buildings, equipment or other property, financed in whole or in part, with proceeds of an issue.

Same Plan of Financing

Bond proceeds and qualified equity finances a project under the same "plan of financing" if the qualified equity pays for an expenditure no earlier than the date such expenditure would have been eligible to be reimbursed under the arbitrage rules, and no later than the date the project is placed in service

Allocation and Accounting Rules Hypothetical

City issues $100 million of taxable bonds in 2013 to construct a new 15-story tower for City University. City applies $50 million of the proceeds of the taxable proceeds to acquire the land, $40 million to build the core and shell of the tower and $10 million of taxable proceeds and $30 million of City general fund revenues to fit-out floors 1-5 for use as its main library. The library was placed in service in 2015. Beginning in 2016, City used $40 million of capital campaign moneys and $10 million of proceeds of tax-exempt bonds issued in 2016 to fit-out floors 6-15 for use as a student dormitory. The dormitory was placed in service in 2019. In 2021, City refunded the 2013 taxable bonds with $90 million of proceeds of its 2021 tax-exempt general obligation bonds and $10 million of equity-funded debt service reserve fund moneys released as a result of the defeasance of the 2013 taxable bonds.

Allocation and Accounting Rules Hypothetical Timeline

2013	• Taxable Bond Issue Date (Proceeds funded land acquisition, core and shell and part of library fit-out)
2013-14	• $30 million of equity to used for library fit-out
2015	• Library placed in service
2016	• Issue Date of tax-exempt new money bonds
2016-18	• $40 million of equity for dormitory fit-out
2019	• Dormitory placed in service
2021	• Issue Date of tax-exempt bonds to refund taxable bonds

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Allocation and Accounting Rules Analysis

What is the project? For example, is the library space and the dormitory space part of the same project?

May the City general fund revenues used to fit-out the library space treated as qualified equity with respect to the 2016 bonds?—the 2021 bonds?

Could the released reserve fund moneys be treated as qualified equity with respect to the 2016 bonds or the 2021 bonds?

Tax Increment Financing-Payments in Lieu of Taxes ("PILOT")

PILOT Payments

Commensurate and not greater than generally applicable tax

- Fixed percentage or fixed adjustment
- Must take into account annual assessed value of property determined in the same manner as generally applicable tax
- Cannot be a fixed dollar amount

Designated for use for a public purpose

Tax Increment Financing Bonds Backed by Special Assessments

Essential Government Function

- Utilities or systems available for use by the general public
- Customarily performed by governmental units with general taxing powers
- Eligible to make deferred payments on an equal basis

Enforced Contributions for a specific purpose

- State law of general application
- Applicable equally to natural persons and entities engaged in a trade or business

Tax Increment Financing Hypothetical

City P, pursuant to state legislation, creates a tax increment financing district within its boundaries (the "TIF District").

The TIF District will consist of a single parcel of land owned by Corporation T. Corporation T plans to build a $400 million 20,000 seat basketball arena and sufficient parking on the parcel.

Instead of paying property taxes on the parcel, Corporation T agrees to make annual PILOT payments to City P equal to the mill rate times 60% of the market value of the arena and property. Other taxpayers within City P, pay property taxes semi-annually equal to the mill rate times 70% of the market value of their property.

Tax Increment Financing Hypothetical

The arena will be financed by a $300 million equity contribution by Corporation T and by a grant of $100 million from City P. City P will fund the grant with the proceeds of City P's issuance of TIF revenue bonds that are solely repayable from the incremental real property taxes generated from the parcel (the "TIF Bonds").

Corporation T intends to lease the basketball arena to Professional Team K, an affiliated entity of Corporation T, for its home basketball games and to State University U, at a below market rate, for its men's and women's home basketball games.

Tax Increment Financing Analysis

Are the TIF Bonds generally applicable taxes?

Are the TIF revenues generally applicable taxes?

What if the PILOT payment is an amount equal to 70% of the annual debt service on the TIF Bonds?

What if the PILOT payment is equal to the mill rate times 75% of the market value of the arena and property, but are paid quarterly?

How would the tax analysis analysis be affected if the District includes other parcels that generate incremental property taxes pledged to the repayment of the TIF Bonds?

Tax Incremental Financing Analysis

In addition to the incremental property taxes, the TIF Bonds are secured by a ticket tax collected by City P for all events at any facility that has a seating capacity of at least 1,000 people.

- Is the ticket tax a generally applicable tax?
- What if the basketball arena is currently the only private facility with a seating capacity of at least 1,000 people. Is the ticket tax a generally applicable tax?

Tax Increment Financing -Hypothetical

Would City's P's bonds be private activity bonds if the grant from City P is used only for infrastructure and parking for the arena and City P's bonds were also backed by a benefit assessment imposed on all property owners within the TIF District that is collected only if the incremental property taxes are not sufficient to pay debt service on the revenue bonds?

Would it make a difference if the arena is located downtown and the parking is available to the general public and not limited to arena events?

Questions

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