MAKING PROJECTS POSSIBLE: TAX-EXEMPT QUALIFIED 501(c)(3) BONDS

Daniel M. McRae, Partner

Seyfarth Shaw LLP
1075 Peachtree St., N.E., Ste. 2500
Atlanta, GA 30309
404.888.1883
404.892.7056 fax
dmcrae@seyfarth.com
dan@danmcrae.info
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FINANCING FOR NON-PROFITS

- Qualified 501(c)(3) bonds are the best way for non-profits to borrow money. If done right, they are federally “tax-exempt”.
- Federally tax-exempt bonds are more desirable.
  - Lower interest rate
  - Longer term
  - Greater marketability
  - More availability of interest-only/capitalized interest
  - Smaller bond issues more do-able
- Rates from banks and financial institutions even lower if bonds are “bank qualified” (BQ)
  - public purpose, “qualified small issuer” ($10 million/year), issuer BQ designation

WHAT'S A NON-PROFIT?

- organizations that are tax-exempt 501(c)(3) organizations under the federal tax-law
  - "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment) or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual."
  - no prohibited activities; e.g., lobbying
- IRS determination letter a necessity
  - exception- churches
    - but determination letter needed for bonds to be marketable
  - "Establishment Clause" under U.S. and state Constitutions can be an issue
    - trend in judicial sentiment towards allowing tax-exempt financing for non-profits with religious affiliations

WHAT'S SPECIAL ABOUT 501(c)(3) BONDS?

- non-profits deemed to "relieve the burdens on government"
  - bonds for them are "private activity bonds"
  - non-profits can "self-induce" (adopt reimbursement resolution complying with Treasury Regulations)
    - but tax-exempt bonds must be issued by public body
- only governmental units and 501(c)(3) organizations may receive any material benefit from an issue of qualified 501(c)(3) bonds
  - can allocate tax-exempt and taxable bonds between facility's qualifying portion (e.g., charitable hospital assets) and non-qualifying portion (e.g., offices for doctors in private practice within hospital)

WHAT RULES APPLY?

- Generally, the normal requirements for tax-exempt private activity bonds apply to qualified 501(c)(3) bonds. Examples-
  - TEFRA notice, hearing and approval
  - average maturity may not exceed 120% of the average reasonably expected economic life of the facilities being financed with bond proceeds.
  - limit of 2% on costs of issuance paid out of bond proceeds.
  - can't finance airplane, skybox, gambling facility or liquor store.
  - prohibition of "federal guaranty" applies
    - alternative to tax-exempt bonds: "taxable floaters" secured by community bank LOC "wrapped" by FHLB

WHAT EXCEPTIONS APPLY?

- not subject to the state volume cap relating to private activity bonds
- bondholder may be “substantial user” of the bond financed facility
- limitation on expenditures for land to 25% of bond proceeds does not apply
- limitation on the use of bond proceeds to acquire existing property does not apply
  - exception- certain types of existing housing facilities
- 5% “bad money” limit
  - includes use in an unrelated trade or business

CONCLUSION

- Recent examples-
  - $11.6 million refinancing for a Georgia private K-12 Christian school facility- unrated, privately placed, stand-alone credit
  - $225 million new money financing of facilities for a New Jersey acute care hospital (pending)- rated, publicly sold, stand-alone credit (expected terms)
  - $5.9 million refunding of financing of family and children's services and health and recreation facilities for a Georgia YMCA (pending)- unrated, privately placed (replaces publicly-sold, LOC secured bonds), stand-alone credit
- Non-profits that want to finance social assets, and catalyze social impacts, should put qualified 501(c)(3) bonds on their shopping list!

REFERENCES

THIS PRESENTATION AND OTHER REFERENCES CAN BE DOWNLOADED AS FOLLOWS:

- January 2011 - “Bonds 101”
- January 2011 - “Introduction to Tax-Exempt Bonds”
- January 2011 - “Introduction to 'Taxable Floaters' ”

at http://danmcrae.info/whitepapers

- May 2013 – Quick Takes: “Financing Updates and Save the Dates”
- January 2011 - Quick Takes: “After ARRA - What Bonds Can We Use Now to Finance Projects?”

at http://danmcrae.info/quicktakes

QUESTIONS?

Daniel M. McRae, Partner

Seyfarth Shaw LLP

1075 Peachtree Street, N.E., Suite 2500
Atlanta, Georgia 30309
Telephone: 404.888.1883
dmcrae@seyfarth.com

http://danmcrae.info

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