

## Qualified Energy Conservation Bonds (QECBs)

April 2009

Qualified Energy Conservation Bonds (QECBs) are codified in Section 54D of the Internal Revenue Code of 1986. QECBs were initially authorized under the Energy Improvement and Extension Act of 2008 and the provisions were amended by the American Recovery and Reinvestment Tax Act of 2009. A total of \$3.2 billion is available for qualified energy conservation bonds, which are a new category of tax credit bonds that can be used to finance government initiatives designed to reduce greenhouse gas emissions. The \$3.2 billion will be allocated to states, municipalities and tribal governments, and a portion of the allocation may be issued as private activity bonds.

Type of Debt. A QECB is a tax credit bond. Issuers repay principal on a regular schedule, but generally do not pay interest. Instead, the holder of a QECB receives a federal tax credit in lieu of interest. The tax credit may be applied against the bond holder's regular and alternative minimum tax liability. The tax credit amount is treated as taxable interest income to the holder of the bonds. For example, if the tax credit amount is \$100 and the holder is in the 35% tax bracket, the credit provides a \$65 benefit to the holder.

Amount of Tax Credit. The tax credit amount is set by the Treasury on a daily basis and can be found on-line at [https://www.treasurydirect.gov/govt/rates/irs/rates\\_qtcb.htm](https://www.treasurydirect.gov/govt/rates/irs/rates_qtcb.htm). The credit rate is 70% of the rate set by the Treasury for qualified tax credit bonds. In theory, QECBs could provide a borrower with a 0% interest rate, but it is likely that purchasers will require a discount on the QECB or a supplemental interest payment. Any supplemental interest earned on a QECB is federally taxable.

Here are the qualified tax credit rates set by Treasury for bonds priced between March 30, 2009 and April 14, 2009. The fourth column is the credit rate for QECBs (70% of the published rate).

<u>Date</u>	<u>Rate</u>	<u>Maturity</u>	<u>QECBs Rate</u>
4/14/09	7.89%	14 yrs	5.52%
4/13/09	7.95%	14 yrs	5.57%
4/10/09	7.75%	14 yrs	5.43%
4/9/09	7.75%	14 yrs	5.43%
4/8/09	7.82%	14 yrs	5.47%
4/7/09	7.83%	14 yrs	5.48%
4/6/09	7.75%	14 yrs	5.43%
4/3/09	7.66%	14 yrs	5.36%
4/2/09	7.57%	14 yrs	5.30%
4/1/09	7.64%	14 yrs	5.35%
3/31/09	7.70%	15 yrs	5.39%
3/30/09	7.74%	15 yrs	5.42%

Maturity and Payments. Each month the Treasury sets the maximum maturity for QECBs priced during that month. There are no legal requirements relating to amortization of the QECBs. Payments can be structured by the parties.

Sinking Fund. A reserve/sinking fund expected to be used to repay QECBs is not subject to arbitrage limitations if (i) it is funded no faster than equal annual installments, (ii) it is funded such that it is not expected to exceed the amount necessary to repay the bonds, and (iii) it is invested at a yield no greater than the permitted sinking fund yield. The permitted sinking fund yield is set daily by Treasury and can be found on-line at [https://www.treasurydirect.gov/govt/rates/irs/rates\\_qtcb.htm](https://www.treasurydirect.gov/govt/rates/irs/rates_qtcb.htm).) A reserve/sinking fund may not be financed with proceeds of the QECBs.

Qualified Issuers. States and local governments are authorized to issue QECBs.

Qualified Borrowers. There is no concept of “qualified borrower” in the QECB legislation (as opposed to the Clean Renewable Energy Bond legislation). QECBs may be private activity bonds and finance certain projects owned or used by private entities, with certain restrictions described below.

Qualified projects. 100% of the available project proceeds of QECBs must be used for one of the following qualified conservation purposes:

- (A) capital expenditures incurred for purposes of:
  - (i) reducing energy consumption in publicly owned buildings by at least 20%;
  - (ii) implementing green community programs (including the use of loans, grants, or other repayment mechanisms to implement such programs);
  - (iii) rural development involving the production of electricity from renewable energy sources; or
  - (iv) any facility eligible for the production tax credit under Section 45 (other than Indian coal and refined coal production facilities); or
- (B) expenditures with respect to facilities or grants that support research in the development of cellulosic ethanol or other nonfossil fuels, technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels, increasing the efficiency of existing technologies for producing nonfossil fuels, automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation, and technologies to reduce energy use in buildings; or
- (C) mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting; or
- (D) demonstration projects designed to promote the commercialization of green building technology, conversion of agricultural waste for use in the production of fuel or

otherwise, advanced battery manufacturing technologies, technologies to reduce peak use of electricity, and technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity; or

(E) public education campaigns to promote energy efficiency.

Costs of Issuance. Costs of issuance to be paid from QECCB proceeds are limited to 2% of the QECCB proceeds. For small transactions, issuers or end borrowers may need to fund the costs of issuance from other sources.

Allocations. Allocations of QECCBs have been made to the states based on each state's proportional population as compared to the population of the United States. The State of California was allocated \$381,329,000 of QECCB volume cap. Within each state, each large local government, which is defined as any municipality or county that has a population of 100,000 or more, will receive a portion of its state's allocation. Each state must allocate volume cap to large local governments in amounts determined by their proportional population to the state. Large Indian tribal governments also receive allocations based on population.

Private Activity Bonds. Up to 29.9% of each state or large local government allocation may be issued as private activity bonds, where the proceeds of the QECCBs are loaned to non-governmental entities and used for energy conservation improvements on privately owned property. Private activity bonds may only be issued to finance capital expenditures. However, the statute states that bonds issued to provide loans, grants or other repayment mechanisms for capital expenditures to implement green community programs will not be treated as private activity bonds for purposes of the allocation provisions.

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