NEW ECONOMIC STIMULUS BONDS FOR INDIAN TRIBES

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How would you like to pay for your next tribal economic development project using cheaper tax exempt bonds? Or what if the federal government offered to pay 35% of your borrowing costs, would that make your project more affordable? How about funding new improvements for your tribal school at zero percent interest? Sound too good to be true? Keep reading.

On February 17, 2009, President Obama signed into law the $787 billion American Recovery and Reinvestment Act of 2009. It is the single largest piece of economic stimulus legislation in U.S. history, and it contains a number of groundbreaking provisions that benefit Indian country. In addition to earmarking funds for various tribal programs, the Stimulus Act creates new bonding authority for tribal governments. For the first time, Indian tribes will finally have all the tools that state and local governments have in financing public works, home ownership and private economic development. To summarize, the Stimulus Act (1) dramatically expands the ability of tribes to borrow on a lower-cost tax exempt basis, (2) permits tribes to issue a new type of tax credit bond, (3) provides tax credit subsidies of up to $400 million for tribal school construction, and (4) adds further tax incentives to make tribal bonds more appealing to investors and lenders.

The new bonding provisions represent a huge leap forward in borrowing options for Indian tribal governments. There is good reason to celebrate. However, tribal leaders should be aware that there is a limited window of opportunity to take advantage of these benefits.

HOW IT WORKS—TAX EXEMPT BONDS AND TAX CREDIT BONDS

The Stimulus Act helps tribal borrowers by creating two new categories of bonds. One is a tax exempt bond, and the other is a tax credit bond. Both enjoy favorable tax treatment and reduce a tribe's borrowing costs, but they function in different ways. A *tax exempt bond* is one where the interest payments a tribe makes in repaying the debt are not treated as taxable income to the person who provided the money. Since the lender does not pay taxes on the interest payments received, the lender is willing to offer funding to you at a lower rate of interest. Tax exempt bonding is how state and municipal governments pay for the vast majority of their public improvements. A *tax credit bond* involves a different form of tax incentive. Instead of excluding the interest payments from tax, the lender receives a tax credit from the federal government in lieu of receiving interest payments. The lender then uses this tax credit to reduce its overall tax liability. Because the lender's economic motivation is to receive a tax credit, they will often loan you the money at a zero percent interest rate—meaning, you repay only the principal amount you have borrowed.

TRIBAL ECONOMIC DEVELOPMENT BONDS

Tribal Economic Development Bonds are an important new type of tax exempt bonds. Prior to passage of the Stimulus Act, Indian tribes could issue tax exempt bonds only for certain "essential governmental functions," as defined by the federal tax code. The problem with the essential governmental function standard has been that the IRS reads it very narrowly. So narrowly, that any project alleged to be remotely commercial has been subject to challenge.

The Stimulus Act addresses this problem. Tribes may still borrow for essential governmental functions. However, with the new Tribal Economic Development Bonds, tribes may finance a much wider variety of projects. To put it briefly, tribes can use Tribal Economic Development Bonds to finance anything that state governments can finance, subject to three qualifications. First, the project has to be located on an Indian reservation (as broadly defined). Second, the bonds cannot finance any property used in gaming or any portion of a building in which gaming occurs. Third, a tribe must receive volume cap allocation, as explained below.

The following types of tribal projects that were previously ineligible for tax exempt financing are now eligible through issuance of Tribal Economic Development Bonds:

- Hotels and convention centers
- Golf courses and other resort enhancements
- HUD-insured loans to first-time tribal homebuyers
- Energy development and transmission facilities
- Solid waste systems, such as landfills
- A wide variety of public-private enterprise bonds
- Privately owned manufacturing facilities

These are just a few examples. If states can do it, tribes can do it—subject to the same tax limitations. Furthermore, tribes may use Tribal Economic Development Bonds to refinance more expensive taxable debt that may still be outstanding.

VOLUME CAP FOR TRIBAL ECONOMIC DEVELOPMENT BONDS

Congress has placed a national ceiling on the amount of Tribal Economic Development Bonds that Indian tribes may issue. That limit, also known as volume cap, is $2 billion. It is to be shared among all Indian tribal governments. Does that mean first come, first served? Not exactly. The Stimulus Act provides that the U.S. Treasury Department, in consultation with the Department of the Interior, will decide how the $2 billion is to be apportioned among the tribes. So far, the allocation process has not been determined. It might be based on project feasibility, tribal membership, reservation population, economic need, job creation, or any number of other factors. Treasury and Interior will need to move quickly for the stimulus to have its desired effect. In the meantime, tribal leaders would be well-advised to get their project financing plans ready for consideration. As soon as the allocation process is determined, a line will surely form.

BUILD AMERICA BONDS

If Tribal Economic Development Bonds sound good, it gets even better with Build America Bonds. This is a new type of tax credit bond that tribes may elect to use instead of issuing *tax exempt* bonds. These bonds are radically different from anything seen before in Indian country.

Under this program, any project that is eligible for tax exempt bonding (either as an essential governmental function or as a Tribal Economic Development Bond) may instead be financed using Build America tax credit bonds. The tribe may elect to give the tax credit to the lender, presumably in exchange for zero percent interest. Or, what is most significant, the tribe can elect to keep the tax credit and have the federal government cover 35% of the interest cost that the tribe pays. Essentially, it's a 35% federal subsidy. Most often, it will probably be more cost-effective for a tribe to use Build America Bonds instead of Tribal Economic Development Bonds because the 35% federal subsidy gives more bang-for-buck than a lower tax exempt interest rate does. Furthermore, there is no restriction on what the tribal borrower does with the 35% subsidy payments. They can be used to collateralize the borrowing, or they can be freely spent.

Build America Bonds are subject to three important conditions: (1) they may be issued only during 2009 and 2010, (2) they cannot be private activity bonds (meaning bond proceeds may not be used by or loaned to private parties), and (3) the 35% federal subsidy may be used only for new money projects and not for refinancings.

TRIBAL SCHOOL CONSTRUCTION BONDS

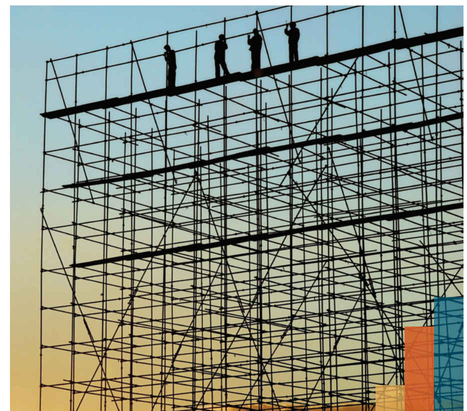
Tribal educators should be pleased to learn there has never been a better time to consider making capital improvements for tribal schools. The Stimulus Act creates a new category of tax credit bonds known as Qualified School Construction Bonds. Up to $400 million of these bonds may be issued nationwide by tribes in 2009 and 2010. You might ask what's so special about these bonds since tribes have always been able to finance schools on a tax exempt basis. What's special is that the new bonds may be issued at a zero percent interest rate. That's because they are *tax credit* bonds. Remember, the investor's motivation for buying these bonds is the tax credit and not the tax-free interest earnings. Zero percent interest is always better than low interest. Any tribal school eligible for BIA funding may use these bonds to finance new construction and improvements.

TRIBAL HOUSING PROGRAMS

The Stimulus Act allows tribes for the first time to issue tax exempt, HUD-insured bonds to finance loans to first time homebuyers. It also allows tribes to issue bonds to finance rental housing that is jointly owned by the tribe and private investors and which qualifies for low-income tax credits. Because the majority of rental housing over the last 20 years has been financed using tax credits, this new opportunity will put tribal housing authorities in charge of a program that previously required assistance from state and local housing agencies.

ADDITIONAL TAX INCENTIVES

The Stimulus Act provides two more tax incentives that will make tribal bonds issued during 2009 and 2010 more attractive to investors. First, the $10 million annual limit on so-called "bank qualified obligations" has now been raised to $30 million. What does this mean? It means your bonds are now a lot more attractive to banks. That's because, in addition to the benefits of tax exemption or tax credit, banks also get to deduct up to 80% of their carrying costs associated with making a bank qualified loan. By increasing the annual limit to $30 million, more tribal projects will be eligible for bank financing. Second, the Stimulus Act provides that bonds issued during 2009 and 2010 will not be subject to the alternative minimum tax—a complicated formula for adjusting the calculation of gross income. AMT can undo many of the benefits of tax exemption for bonds that benefit privately owned businesses. Therefore, removing the threat of AMT makes certain types of tribal bonds much more appealing to investors.



STAY INFORMED

For Indian country, the Stimulus Act is a ray of light in otherwise dark economic times. It is not free money, and tribal projects still have to make economic sense in order to get financing.
But the potential is enormous. As noted, there are still questions about implementation, in particular how the $2 billion allocation for Tribal Economic Development Bonds will be handed out. But these are details that will be sorted out in time. By the time you have read this and contacted your bond counsel, the details may already be known. Good luck.

ABOUT ORRICK

Orrick has been the nation's top-ranked bond counsel firm for more than a decade and is listed in Band 1 (highest category) in the field of Native American Law by *Chambers USA—America's Leading Lawyers for Business*.

We have been privileged to represent tribal governments in more than a dozen states on a variety of projects, including land acquisitions, health clinics, tribal housing, schools, government administration buildings, cultural centers, tribal utilities, parks and recreation facilities, and so on. In addition, we have represented tribal business enterprises in gaming, hotel and entertainment facilities, manufacturing plants and other commercial activities. Our Indian Tribal Finance Group is nationwide and comprises lawyers from our Public Finance, Corporate, Banking, Tax and Securities practices.

For more information or assistance, please contact Townsend Hyatt, Chair of Orrick's Tribal Finance Practice, at (503) 943-4820 or thyatt@orrick.com.

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