

## Frequently Asked Questions

This document provides general information about financing solid waste disposal facilities with exempt facility bonds under Section 142(a)(6) of the Internal Revenue Code (the Code). Each financing is unique, and the applicable federal and state laws are complex and varied. Accordingly, the answers below are not intended to provide an exhaustive discussion of the topic and do not constitute legal advice.

### **Q** What are exempt facility bonds?

Exempt facility bonds (EFBs) are tax-exempt obligations issued by a governmental entity to finance certain authorized facilities, including airports, docks and wharves, sewage facilities, and solid waste disposal facilities, among others. Often, the governmental entity (the Issuer) sells the EFBs and loans the sale proceeds to a private corporation (the Borrower) to acquire or construct the facilities. The Borrower's loan payments are structured to cover the payment of principal and interest to the bondholders, for whom the interest payments are exempt from federal income tax. Because the EFBs are paid solely from the revenues that the financed facilities generate and any other security that the Borrower provides, the EFBs are not direct obligations of the Issuer.<sup>1</sup>

### **Q** How does EFB financing compare to other options?

Because the interest that bondholders earn on EFBs is tax exempt, the interest rate the Borrower pays on the EFBs is generally lower than the rate the Borrower would pay on a conventional loan. The resulting debt service savings over the life of the loan is often significant.

The procedural requirements associated with EFB financing are generally more intensive than those associated with conventional loans. Accordingly, costs of issuance, which include legal fees paid to bond counsel for preparing documents and rendering a legal opinion on the tax-exempt status of the EFBs, are generally higher. Further,

<sup>1</sup> EFB financings may be structured so that the issuer is the owner of the financed facility and the EFBs are direct obligations of the issuer. This document addresses only "conduit" financings in which private corporations are the borrowers and ultimate owners of solid waste disposal facilities. For more information about non-conduit EFB financings, please contact any of the Dorsey attorneys listed on page 3.

Borrowers who obtain EFB financing must comply with certain tax covenants and restrictions on the use of the financed facilities. These covenants and restrictions are incorporated into the legal documents prepared by bond counsel.

Another difference between EFB and conventional loan financing concerns the depreciation of the financed assets. Property financed with EFBs must be depreciated for tax purposes using the straight-line method rather than an accelerated method. The impact of this requirement may be negligible if the financed property has a 40-year applicable recovery period. For certain kinds of equipment, however, the prohibition against accelerated depreciation may be more significant.

### **Q** What kinds of costs can a Borrower finance with EFBs?

The Borrower must use at least 95 percent of the net proceeds of the EFB issue to acquire and construct the solid waste disposal facility. Net proceeds are the proceeds of the issue less amounts used to fund a reasonably required reserve or replacement fund. Treasury Regulations define "solid waste disposal facility" to mean "any property or portion thereof used to collect, store, treat, utilize, process or finally dispose of solid waste."<sup>2</sup> A facility for collecting and storing solid waste may qualify as a "solid waste disposal facility" depending on particular facts and circumstances,

<sup>2</sup> For the purposes of EFB financing, Treasury Regulations require that the material to be disposed of or otherwise processed be, on the date the EFBs are issued, "useless, unused, unwanted, or discarded solid material, which has no market or other value at the place where it is located." In addition, the material must meet the definition of "solid waste" under the Solid Waste Disposal Act, which includes "garbage, refuse, and other discarded solid materials, including solid-waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but . . . not solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in return flows or other common water pollutants."

one of which is that the collection and storage must be a preliminary step to recycling or finally disposing of the solid waste within a reasonable period of time. A facility that reconstitutes, converts or recycles solid waste into material which is not waste will qualify if at least 65 percent (in weight or volume) of the total materials introduced into the process meet the definition of “solid waste” provided in footnote 2.

Subject to the limitations below, a solid waste disposal facility includes “any land, building, or other property functionally related and subordinate to such facility”—that is, “of a character and size commensurate with the character and size of such facility.” Whether all elements of a proposed project qualify as “functionally related and subordinate” to the facility such that the Borrower can finance them with EFB proceeds must be determined on a case-by-case basis.

Aside from the foregoing requirements, the Code contains certain limitations applicable to all tax-exempt private activity bonds. For example:

- Proceeds used to acquire land (directly or indirectly) must comprise less than 25% of the total proceeds.
- Proceeds use to finance costs of issuance must comprise no more than 2% of the total proceeds.
- Subject to certain exceptions unlikely to apply in an EFB financing for solid waste disposal facilities, no proceeds may be used to acquire land for farming purposes.
- Subject to an exception for circumstances in which existing facilities will undergo substantial rehabilitation, no proceeds may be used to acquire existing structures (or used equipment).

## **Q What is the maximum term of an EFB financing?**

The weighted average maturity of the EFBs cannot exceed 120% of the average reasonably expected economic life of the facilities they finance.

## **Q What is the maximum principal amount that may be financed through EFBs?**

EFBs are not subject to any maximum principal amount.

## **Q What are the procedural steps involved in an EFB financing?**

The first step is to identify which governmental entities are authorized under state law to issue EFBs and to initiate communication with the most appropriate Issuer, which the Borrower will generally identify based on the project's location. Once the Issuer has agreed to work with the Borrower, it must take preliminary official action (e.g., adopt a resolution) on the proposed issuance.

The Borrower must then apply to the appropriate governmental entity, which is often different from the Issuer, for an allocation of the applicable “volume cap.” The volume cap is the maximum amount of tax-exempt bonds that may be issued to finance a particular qualified purpose during a calendar year. State law designates the entity to which the Borrower must submit the volume cap application. In many instances, the Borrower must pay an application fee equivalent to a certain percent of the principal amount of EFBs to be issued.

The Issuer must then hold a public hearing on the issuance of the EFBs, having provided published notice in advance of the hearing in accordance with applicable state and federal law. Only after the hearing has occurred may the Issuer take final official action (usually by adopting a resolution) authorizing the issuance of the EFBs. The financing may then proceed to closing.

Depending on the structure of the financing, the Borrower will either make its loan payments to the Issuer directly or on behalf of the issuer to a trustee or bondholder(s). The Borrower must comply with the applicable tax covenants and restrictions on the use of the financed facilities as long as any of the bonds are outstanding. A violation of such covenants and restrictions may cause the EFBs to lose their tax-exempt status, at which point the Borrower may be liable for increased costs calculated retroactively to the date of issuance.

**For more information about financing solid waste disposal facilities with tax-exempt bonds, please contact any of the following Dorsey attorneys:**

**DENVER**

**Douglas W. Fix**  
303-629-3449  
fix.doug@dorsey.com

**Jane Roberts**  
303-628-1501  
roberts.jane@dorsey.com

**DES MOINES**

**Amy Bjork**  
515-699-3285  
bjork.amy@dorsey.com

**David L. Claypool**  
515-699-3275  
claypool.david@dorsey.com

**John Danos**  
515-699-3275  
danos.john@dorsey.com

**Darla M. Giese**  
515-699-3293  
giese.darla@dorsey.com

**David G. Grossklaus**  
515-699-3287  
grossklaus.david@dorsey.com

**Robert E. Josten**  
515-283-1000  
josten.robert@dorsey.com

**Cristina Kuhn**  
515-699-3273  
kuhn.cristina@dorsey.com

**James Smith**  
515-699-3276  
smith.james@dorsey.com

**MINNEAPOLIS**

**Lynnette Slater Crandall**  
612-343-8288  
crandall.lynnette@dorsey.com

**Lynn Endorf**  
612-340-2651  
endorf.lynn@dorsey.com

**Jerome P. Gilligan**  
612-340-2962  
gilligan.jerome@dorsey.com

**Jennifer L. Hanson**  
612-492-6959  
hanson.jennifer@dorsey.com

**Andrea B. Hedtke**  
612-492-6912  
hedtke.andrea@dorsey.com

**Richard A. Helde**  
612-343-7912  
helde.richard@dorsey.com

**Jay R. Lindgren**  
612-492-6875  
lindgren.jay@dorsey.com

**Michael E. Reeslund**  
612-340-2960  
reeslund.mike@dorsey.com

**Leonard S. Rice**  
612-343-7971  
rice.len@dorsey.com

**Paula S. Rindels**  
612-343-7983  
rindels.paula@dorsey.com

**Andrea Specht**  
612-492-6917  
specht.andrea@dorsey.com

**Suzanne B. Van Dyk**  
612-340-5631  
van.dyk.suzanne@dorsey.com

**Thomas D. Vander Molen**  
612-340-2934  
vander.molen.tom@dorsey.com

**MISSOULA**

**Jeremy Brown**  
406-721-6025  
brown.jeremy@dorsey.com

**Mae Nan Ellingson**  
406-721-6025  
ellingson.mae.nan@dorsey.com

**Dan Semmens**  
406-721-6025  
semmens.dan@dorsey.com

**NEW YORK**

**David Fernandez**  
212-415-9362  
fernandez.david@dorsey.com

**Melissa Paparone**  
212-415-9304  
paparone.melissa@dorsey.com