TOPIC: **HIGHER EDUCATION CAPITAL FINANCING INSTRUMENTS IN THE AMERICAN RECOVERY AND REINVESTMENT ACT AND HB09-1346**

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I. SUMMARY

This agenda item presents three possible opportunities for institutions of higher education to realize savings through lower bond rates on self-financed capital projects: Build America Bonds, the Recovery Zone Economic Development Bond Volume Cap, and the Recovery Zone Facility Bond Volume Cap. Each of these programs is included in the Federal stimulus legislation known as the American Recovery and Reinvestment Act (ARRA) and corresponding state enabling legislation (HB09-1346). These instruments apply to cash-funded capital projects and are not allocations of Federal moneys for state capital needs.

Under HB09-1346, the Commission is tasked with approving and prioritizing higher education capital projects financed under the two volume caps. The following chart summarizes these financing instruments within the American Recovery and Reinvestment Act and HB09-1346:

Financial Instrument	Coordinating Agency	Total Cap Amount	Benefit	Higher Education Eligibility
Build America Bonds	None	No Cap	Provide bondholders a tax credit = to 35% of the interest paid for the BABs. Issuer may receive a direct payment in lieu of the tax credit to bondholders; no Davis-Bacon prevailing wage standards.	Yes
Recovery Zone Economic Development Bond Volume Cap	CCHE	$99,018,000	Provide issuer a direct payment = to 45% of the interest paid for the RZEDBs; must adhere to Davis-Bacon prevailing wage standards.	Yes, initially through local governments, then directly to institution
Recovery Zone Facility Bond Volume Cap	CCHE	$148,527,000	Allows for the issuance of tax-exempt bonds for private use projects; provides opportunity for public or privately owned/operated facilities benefiting a public institution of higher education; must adhere to Davis-Bacon prevailing wage standards	Yes, permits private companies access to tax-exempt bonds for range of projects thus may benefit campus partnerships

The benefits from these programs will expire on December 31, 2010, as provided in the ARRA legislation and HB09-1346, and ninety days before this expiration date any unused volume cap transfers to the Colorado Department of Local Affairs for allocation to local governments.

II. BACKGROUND

Much of the information presented in this item is from a presentation from Lee White of George K. Baum and Company and Stephanie Chichester from North Slope Advisors entitled "Colorado Commission on Higher Education Recovery Zone Economic Development Bonds & Private Facility Bonds." The

American Recovery and Reinvestment Act provides numerous opportunities to open up bond markets and promote capital construction as means to stimulate the economy and create jobs. Three of these opportunities may potentially reduce the interest costs for higher education capital construction financing over the term of the bond issuance.

Build America Bonds (BABs)

Financing with Build America Bonds allows units of government to receive a direct payment equal to 35 percent of the interest paid, effectively reducing the total cost of the financing. There is no cap on the amount of BABs that can be issued nation- or state-wide, nor are there additional requirements in HB09-1346 about how BABs must be issued or administered. Compared to the Recovery Zone Economic Development Bond instrument discussed below, BABs provide a lower tax credit to the issuer and are therefore a slightly less attractive opportunity on paper. However, because projects financed with BABs do not have to adhere to Davis-Bacon prevailing wage standards, which can increase costs, institutions of higher education should perform a cost-benefit analysis to determine whether BABs or the 45% subsidy from RZEDBs (which do require prevailing wages) provide a better benefit over the term of the issuance. It is also possible to finance projects through a combination of BABs and RZEDBs to realize the greatest savings over time.

Recovery Zone Economic Development Bonds (REZDBs); Recovery Zone Facility Bonds (Private Facility Bonds); Volume Caps

The state will have about $99 million in Recovery Zone Economic Development Bonds (REZDBs) and $148.5 million in Recovery Zone Facility Bonds (Private Facility Bonds) to allocate. Federal guidance on June 12, 2009, notified the state of this allocation and its initial distribution among counties and large municipalities (populations exceeding 100,000). This distribution was a proportionate allocation to counties and large municipalities based on employment decline between December 2007 and December 2008, and some areas did not receive an allocation, presumably because there was no decline in employment over the time frame measures. For example, Larimer County, Fort Collins, and Mesa County did not receive an allocation. This methodology resulted in some very small allocations (e.g., Las Animas County was allocated $68,000 in REZDB volume cap) that are uneconomic for any stand alone bonding.

Under HB09-1346, counties and large municipalities have until November 11, 2009 to use their allotted volume cap for higher education capital construction projects. On November 11, any unused cap will revert to the Commission.

Although the allocation methodology for these two financing options is similar, they differ with respect to the potential benefit to the issuer and the types of project they may fund. REZDBs are *taxable* bonds where the *issuer* receives a direct payment equal to 45 percent of the interest paid during the applicable time period. Based on current rates, for AA rated 30 year RZEDB bonds, the 45 percent interest subsidy allows projects to be financed at a net borrowing cost of 3.63

percent. These are essentially BABs with a greater subsidy to the issuer, ostensibly for the more economically distressed communities. Unlike BABs, projects funded with REZDBs must adhere to the Davis-Bacon prevailing wage standards. Further, these projects must promote development in an area designated as an economic recovery zone.

Private Facility Bonds are *tax exempt* bonds for public or privately owned projects that can include public-private partnerships. Like REZDBs, these projects must promote development in an economic recovery zone. Currently, rates in the tax exempt bond market range from high 4 percent for AAA rated bonds to mid to high 5 percent for A rated bonds. The Hotel Learning Center at Metro State College is an example of the type of project that may be eligible due to the public-private nature of the proposed facility.

III. STAFF ANALYSIS

The state enabling legislation (HB09-1346), not the Federal legislation, requires these volume caps to be used in cooperation with local governments for higher education projects. HB09-1346 requires local governments to return to the state (i.e., the Commission) on November 11, 2009 any unused share of their cap allocations. The Commission then has substantial discretion to allocate such unused bonding authority: the Commission can distribute the authority to any public entity, e.g., directly to institutions of higher education, for projects within an economic recovery zone. It is likely that the Commission will want to prioritize and approve projects under each of the volume caps. It is possible that local governments might elect to relinquish their volume caps for use by higher education institutions prior to November 11.

HB09-1346 defines an economic recovery zone as "any area . . . having significant poverty, unemployment, rate of home foreclosures, or general distress" or, "any area . . . as economically distressed by reason of the closure or realignment of a military installation" or, "an area for which a designation as an empowerment zone or renewal community is in effect." This definition is taken directly from the Federal legislation. The enabling legislation allows the Commission to determine the areas of the state that qualify as recovery zones. Current advice from bond counsel is that the entire state qualifies as an economic recovery zone under the Federal definition.

Once the unused volume cap reverts to the Commission, it will be necessary for the Commission to approve cash-funded capital requests from the institutions and, if the total dollar amount exceeds the allowable caps, to develop a priority list of projects that can use the available volume cap. A preliminary survey by staff suggests that the total dollar amount of requested projects will exceed the allowable caps. The Commission may want to consider adopting a formal policy explicitly stating the criteria that will be used to prioritize project requests under these temporary financing opportunities, in addition to the normal criteria that are used to prioritize state-funding requests each year (e.g., health and life safety concerns, state programmatic priorities, etc.). Specific criteria could include:

- The relative economic condition of the area surrounding the project compared to the rest of the state.
- The estimated added savings, after factoring Davis-Bacon prevailing wage requirements, for the specific project, compared to using BABs or another means of financing. Staff has learned that the added project cost to meet prevailing wage standards is significantly less for projects that are less labor intensive, e.g., a parking garage.
- Whether the intended use of the facility would qualify for private facility bond financing thereby maximizing the use of both volume caps

HB09-1346 also allows institutions of higher education to pool projects under the same bond issuance, thus saving on issuance costs and achieving a lower interest rate. Project financing through multiple forms of debt may also reduce costs over the term of the issuance. According to the presentation from Lee White and Stephanie Chichester, tax-exempt bonds would have a lower cost in the short term while REZDBs would be less expensive after year five.

Statutory Citation

C.R.S. 11-59.7-101