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PUBLIC FINANCE LAW ALERT

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Municipalities Should Not Miss the Deadline for Submitting Applications for Clean Renewable Energy Bonds

August 4, 2009, the deadline for submitting applications for Clean Renewable Energy Bonds (CREBs), is fast approaching. CREBs were created to offer another means for financing solar energy, wind energy, geothermal, qualified hydro, trash combustion, landfill gas, marine/tidal energy and biomass projects. CREBs can be issued by state and local governments, tribal governments, electric cooperatives and regulated utility companies.

Under the recently enacted American Recovery and Reinvestment Act (better known as the Stimulus Bill), the volume cap for qualified projects to be funded with CREBs was increased by $1.6 billion up to an aggregate total of $2.4 billion. Once volume cap is allocated, CREBs are required to be issued within three years. Once issued, the issuer has three years to complete the project spending, 10 percent within six months and 100 percent within three years.

In 2008, certain aspects of the CREB program were changed. Importantly, 100 percent of the "available project proceeds" (as defined in §54A(e)(4)) are to be used for capital expenditures for qualified renewable projects. Additionally, the CREB credit is reduced to 70 percent of the allowable tax credit rate under the statute (§54A(b) of the Internal Revenue Code). Finally, there are restrictions on the allocation of the $2.4 billion of volume cap among qualified projects, arbitrage and the structure of the bonds.

Why are CREBs Beneficial to the Issuers?

With a conventional bond, the issuer pays interest to the bondholder. With a tax credit bond, like the CREB, the issuer does not make interest payments directly to the bondholder, rather the federal government provides a tax credit to the bondholder for holding such a bond. The tax credit rate is set by reviewing numerous factors, including the average interest rate for bonds with similar underlying credit ratings generally ranging from A to BBB. The tax credit rate is locked in on the day the CREBs are sold.

In an ideal world, the tax credit rate would be a significant enough investment return for the bondholders. However, because (1) the tax credit is taxable, (2) CREBs are a relatively new type of bond with smaller transactions and significant transaction costs and (3) the tax credit has some liquidity concerns, the issuer usually has to sweeten the deal by adding additional taxable interest investment return on the deal.

At the 35 percent federal tax rate, the benefit to the purchaser of the CREB would look like this:

Par Amount :	$100,000
Tax Credit Rate (70%)	5.12%
Interest Rate	2.00%
Tax Credit	$5,124
Interest Payment	$2,000
Tax on Credit	$1,793
Tax on Interest	$700
Net Benefit	$4,631*
[(Credit + Interest) - Taxes]	

The issuer benefits from a low interest rate, and, even with transaction costs, the benefits of CREBs begin to mirror the benefits of government issued tax-exempt bonds. For this reason, CREBs are a viable investment vehicle to be used by issuers for eligible projects.

For more information, see all the federal guidance documents at http://www.irs.gov/pub/irs-drop/n-09-33.pdf.

**National Renewable Energy Laboratory, Claire Kreycik, TAP Finance Webinar, June 24, 2009.*

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