



**TRIBAL ECONOMIC  
DEVELOPMENT BONDS**

*In Plain English*





By now, you've probably seen dozens of articles about Tribal Economic Development Bonds ("TED Bonds"). Most of the commentary seems to focus on dry technical and legal requirements, in particular IRS administrative procedures for TED Bonds. That information is useful. However, it doesn't quite put things in a perspective that's accessible to most tribal leaders trying to answer a bigger question—that is, what are TED Bonds and how can they help *my* tribal project?

With the bigger question in mind, this bulletin takes a slightly different approach. First of all, we don't assume TED Bonds are right for everybody. They may be perfect for some tribes but less so for others. Second, we've tried to do more than just deconstruct regulatory guidance put forward by the IRS. IRS guidance is important for complying with tax laws, but it doesn't help much with the business aspects of project finance. Our goal is to provide a simple, easy to understand discussion of what TED Bonds are (and what they are not) and why you might want to consider them. To that end, we've tried to offer some practical examples to illustrate our points and assist tribal leaders in evaluating TED Bonds as a financing tool.

Please note, this bulletin isn't meant to be a comprehensive dissertation on TED Bonds. That's beyond our scope. Besides, information overload can be counterproductive. Our hope is that we give you enough information to continue a thoughtful discussion of TED Bonds with your own bond counsel.

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#### **A WORD ABOUT TAX EXEMPTION**

To understand TED Bonds, you first need to know a little something about tax exempt borrowing. Indian tribes don't pay federal income tax, but banks and financial institutions who lend money to tribes generally are subject to tax. This tax liability drives up their cost of making a loan to you. But if they can avoid paying the tax through a special exemption, that reduces their cost. They, in turn, can pass the savings along to you in the form of a lower interest rate. And that's where TED Bonds come into play.

### WHAT ARE TED BONDS?

TED Bonds are a new type of tax exempt borrowing created under the Stimulus Act passed by Congress in February 2009. Up to \$2 billion in the aggregate may be issued by tribes nationwide (this \$2 billion limit is called “volume cap”). TED Bonds break important new ground by allowing tribes to use tax exempt financing for a much wider variety of projects than before. Previously, only a limited range of so-called “essential governmental functions” were permitted. But by using TED Bonds, tribes can finance almost anything that state governments finance through tax exempt bonds. TED Bonds are in addition to (and not a replacement of) traditional essential governmental function bonds. Tribes may still incur an unlimited amount of tax exempt debt for essential governmental functions. That allowance becomes more meaningful when you take into account the dollar limitations on TED Bonds discussed below.

### IS IT FREE MONEY?

No. The most important thing for tribal leaders to understand about TED Bonds is that they are not grants. There is no \$2 billion pot of federal money waiting to be claimed and spent. Instead, TED Bonds are a new way for tribal governments to borrow money. Like any other type of borrowing, TED Bonds must be paid back. That means principal plus interest, and this repayment obligation will affect your tribal budget for years to come. Therefore, among the first questions you should ask yourself is: How are we going to repay TED Bonds? Your project may not be economically self-sufficient. That's okay, but you do need to show investors some stable source or sources of repayment.

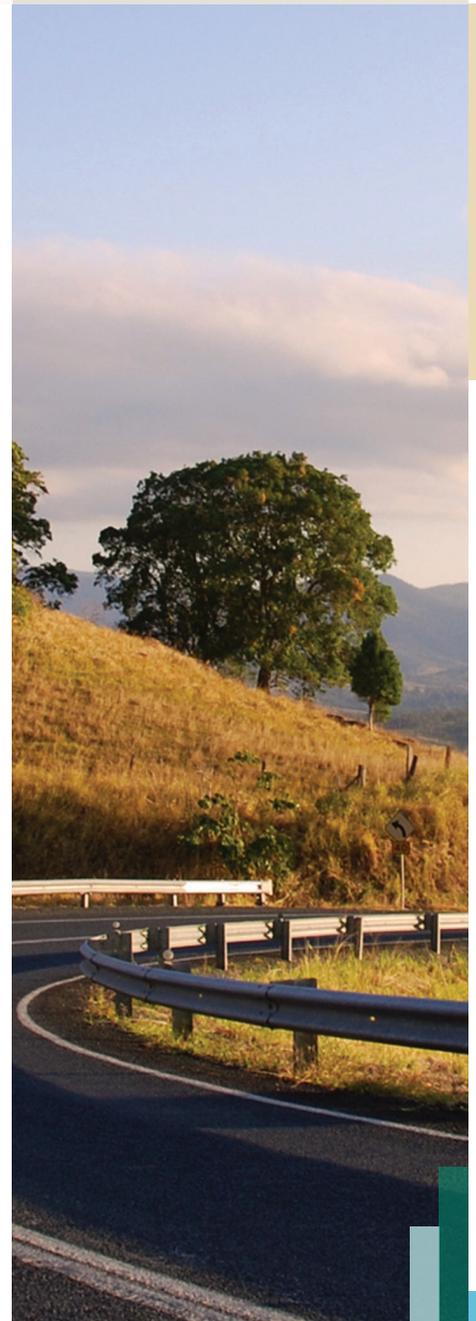
### WHO PROVIDES THE FUNDING?

You can't borrow money unless someone is willing to lend it. The federal government doesn't provide any funding under the TED Bond program. It simply offers a tax incentive to those who do provide money to tribes. That means you have to find funding for your tribal project. It may come from private investors who have an appetite for tax exempt bonds, or it may come from a bank or group of banks in the form of a tax exempt loan. The choice is up to you, but you need to start identifying candidates early on since there are deadlines fast approaching. As described more below, each tribe may initially receive up to \$30 million in TED Bond allocation. That amount may not cover the full cost of your project, but it can be combined with other funding sources, and some savings is better than none.

### WHAT ARE THE BASIC QUALIFICATIONS?

Tribes can finance *anything* with TED Bonds that state governments can do using tax exempt bonds, subject to three specific qualifications:

1. Your project must be located on the reservation (which is broadly defined to include most of Indian country with special rules applying in Oklahoma),
2. You cannot finance property actually used in gaming or any portion of a building in which gaming occurs, and
3. Prior to issuing TED Bonds, you must apply to the IRS and receive an allocation of part of the \$2 billion “volume cap.”





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In addition to the qualifications above which are unique to Indian tribes, other rules and restrictions that apply to tax exempt bonds generally will also apply to a tribe issuing TED Bonds. These include limitations on how and when borrowed proceeds are spent, how they may be invested prior to expenditure, the amount of private (*i.e.*, nongovernmental) involvement that can be associated with a project, and more. Unfortunately, the tax rules are complex and defy a simple explanation in a bulletin of this sort. You'll need to talk with your bond counsel. However, the importance of exploring the tax issues early in the planning stages cannot be over-emphasized. They can make or break the eligibility of your project.

#### WHAT KINDS OF PROJECTS NOW QUALIFY?

All sorts of things which were previously ineligible now qualify for tax exempt financing through TED Bonds. The list includes commercial enterprises—hotels, golf courses, convention centers, entertainment venues, commercial energy plants and more. If it's a business enterprise owned and operated exclusively by the tribe, you simply need to meet the basic qualifications and limitations described above. If it's a project where private parties own, lease, manage, use or pay for the project, then you may have what's called a "private activity bond."

For the first time ever, tribes can finance private activity projects to the same extent as state or local governments can. This presents some exciting possibilities. For instance, tribal governments may issue tax exempt single-family housing bonds to promote home ownership on reservation. Or, tribes may issue student loan bonds to promote higher education of individual tribal members. Certain larger projects that involve a combination of public and private use may also qualify—

*e.g.*, airports, docks and wharves, and solid waste disposal facilities.

The main limitation to keep in mind for private activity bond projects is that tribes can do what states can do—no more, no less. That means tribes cannot use TED Bonds to pay for projects that a state would be prohibited from financing with tax exempt bonds—for example, retail shopping centers or industrial parks leased to private businesses. To be eligible, private activity bonds must fall within a tax exempt project category recognized by the federal tax code. A list of these categories is contained on pages 2 and 3 of IRS Notice 2009-51 ([www.irs.gov/pub/irs-drop/n-09-51.doc](http://www.irs.gov/pub/irs-drop/n-09-51.doc)).

#### HOW ABOUT GAMING?

As previously noted, Congress excluded gaming as a permitted use of TED Bonds. However, that prohibition doesn't necessarily extend to ancillary facilities, such as a hotel. The test is whether the asset you intend to finance is either (A) property actually used in the conduct of gaming, or (B) any portion of a building in which gaming is conducted or housed. In either of these cases, the assets are ineligible. With respect to buildings, though, the IRS has clarified that a structure will be treated as a separate building and not part of the casino if it is "structurally independent," meaning its foundation, outer walls and roof are independent of the casino's. Additionally, connections such as doorways, covered walkways or enclosed common areas that may lie between the casino and any separate buildings will be disregarded so long as they don't affect structural independence. So, a hotel built on top of the casino would be ineligible, but a hotel built next to the casino would qualify—even though they serve exactly the same function. If that distinction seems strange to you, you're not alone.



#### WHEN ARE TED BOND ALLOCATIONS DETERMINED?

The IRS has announced there will be two rounds (or “tranches”) of allocations from the \$2 billion cap. Each round will allocate up to \$1 billion. Initially, each tribe may receive \$30 million of allocation, but these numbers are subject to modification by the IRS depending upon whether demand for allocation exceeds supply. For your planning purposes, there are several calendar deadlines to be aware of:

- Applications for Round One must be filed by August 15, 2009
- TED Bonds authorized in Round One must be issued by December 31, 2010
- Applications for Round Two must be filed by January 1, 2010
- TED Bonds authorized in Round Two must be issued by December 31, 2011

#### HOW DO WE GET OUR ALLOCATION?

There is an official form of application contained as Appendix A to IRS Notice 2009-51 ([www.irs.gov/pub/irs-tege/tribal\\_development\\_bonds\\_-\\_application.rtf](http://www.irs.gov/pub/irs-tege/tribal_development_bonds_-_application.rtf)).

The application is pretty straightforward and solicits the following items of information:

- *Basic Information.* Name, address, designated tribal contact person(s), federal tax ID number, and authorized signature.
- *Evidence of Tribal Status.* Proof that you are a federally recognized Indian tribe, such as being listed in the Federal Register.
- *Amount of Volume Cap Requested.* Dollar amount of allocation being requested for your project.

- *Project Description.* Including location, expected start dates for construction and completion, a statement that the project won't be used for gaming, and a description of regulatory approvals needed.
- *Plan of Financing.* Including a description of who is providing the financing, what the sources of repayment are, your ETA for issuing bonds, and a schedule for spending proceeds.
- *Statement of Readiness.* A statement that you expect to issue your TED Bonds within the applicable deadline.
- *Consent to Disclosure.* Appendix B to Notice 2009-51 is a form by which the IRS seeks your consent to disclosure of certain details of your project and the amount of allocation you receive. This form is optional and is not a condition for receiving allocation.
- *Attestation.* You must attest that the information contained in your application is true, correct and complete. As with most tax filings, this attestation is made under penalty of perjury.

Of these informational requirements, the *Plan of Financing* is perhaps the most challenging because (arguably) it assumes that you've shopped your project to financial institutions and have received preliminary indications about terms on which the project is bankable.

#### DOES TED BOND ALLOCATION EXPIRE?

Yes. It's important to note that under the deadlines described above, you have a relatively short amount of time to apply for TED Bond allocation. However, once you've received allocation, you have a fairly long time to complete your financing. In fact, some tribes might argue that too much time is permitted between allocation and funding. Why? Because the generous timetable for completion presents a risk that allocation may be handed out but then languish unconsummated on projects that can't get funded. After all, the application process itself does little to weed out projects that aren't viable. Some observers have suggested that it's better for stronger tribal projects to receive more than \$30 million rather than have allocation assigned but unused on projects that never move past conception.

#### DO WE HAVE TO ISSUE BONDS?

No. You don't have to borrow through a bond issue. “Bonds” may include almost any type of debt. In fact, it's very likely many TED Bonds will be structured as tax exempt bank loans. That's partly because the market for tribal bonds has been stagnant for some time. Most of the capital that has been flowing to Indian country since the recession started has been coming from banks. Congress seems to have recognized the role banks can play in re-energizing the tax exempt market. As part of the Stimulus Act, Congress raised the limit on so-called “bank qualified obligations” from \$10 million to \$30 million. This increase provides an additional incentive to banks to make tax exempt loans.



#### **CAN I PAY OFF EXISTING DEBT WITH TED BONDS?**

Yes. Refinancing current taxable debt with a cheaper tax exempt borrowing may be one of the best strategic uses of TED Bonds. But, you need to be careful here in two respects. First, your existing debt might not be prepayable, or it may be prepayable only at a premium. This can be especially true for outstanding bonds, but it can also apply to loans which have been “swapped” to a fixed rate. Second, is a more subtle consideration. Credit has tightened, and many lenders would welcome an opportunity to re-price existing loans upwards not downwards. If you have an outstanding loan and need your lender’s consent to incur more debt (such as TED Bonds), then your lender may use the occasion to try to re-negotiate price. This risk more likely affects tribes who have multiple borrowing arrangements in place. Certainly, no borrower wants to convert to a higher interest rate—that defeats the whole point of refinancing. Just be mindful that any concessions your lender may make for extending or allowing TED Bond financing may carry a price elsewhere in the borrowing relationship.

#### **WHAT IF OUR PROJECT CHANGES?**

Projects can evolve. It’s possible that differences may arise between the project as it was described in the TED application and the project as it ultimately unfolds. The IRS has said that “insubstantial deviations” are generally okay. However, the IRS will determine what constitutes an insubstantial deviation based on the facts and circumstances using criteria applied in other tax exempt borrowing contexts. There is also a process for seeking IRS approval of specific insubstantial deviations.

#### **WHAT IF WE’VE ALREADY BEGUN SPENDING MONEY ON OUR PROJECT?**

That’s fine, but make sure you have a reimbursement resolution in place. In fact, do it before you submit your TED Bond application. What’s a reimbursement resolution? It’s a formal declaration that allows you to spend money today and then reimburse yourself with proceeds of a future tax exempt borrowing. Typically, the declaration is made by a Tribal Council resolution, and it covers all capital expenditures made after the date that is 60 days prior to the resolution date. Certain preliminary expenditures, meaning architectural, engineering, surveying, soil testing and similar pre-construction expenses, are also fully recoverable in most cases.

#### **WHAT ARE “BUILD AMERICA” BONDS?**

If you speak with finance professionals, you may hear them mention *Build America Bonds* as they talk about TED Bonds. What’s the difference? Build America Bonds are a new type of *taxable* bond that tribes may use instead of issuing tax exempt bonds. Why would you consider issuing taxable bonds if tax exempt interest rates are cheaper? The answer is because with Build America Bonds the federal government will cover 35% of the interest costs that you pay. Essentially, it’s a 35% federal subsidy in cash, which is something you can’t get with TED Bonds.

Depending on the spread (*i.e.*, difference) between tax exempt versus taxable rates, it may be more cost-effective to use Build America Bonds instead of TED Bonds because the 35% federal subsidy gives more bang-for-buck than a lower tax exempt interest rate does. It’s worth noting there is no restriction on what you do with the 35% subsidy payments. The cash subsidy can be used to collateralize the borrowing, or it can be freely spent. Build America Bonds are subject to three conditions: (1) they may be issued only during 2009 and 2010 (though they may mature later), (2) they cannot be private activity bonds, and (3) they can be used only for new money projects and not for refinancings.

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#### **WHERE CAN WE GET MORE INFORMATION?**

If you find this bulletin useful, you might be interested in some of our related materials, which are available on our website at [www.orrick.com/publications/publicfinance](http://www.orrick.com/publications/publicfinance).

- *New Economic Stimulus Bonds for Indian Tribes*
- *Ten Questions Tribal Council Should Ask Before Borrowing Money*
- *Treasury Guidance on Build America Bonds*
- *Financing Renewable Energy Development on Native American Lands*
- *An Introduction to Indian Tribal Finance*

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## 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 1-503-943-4820 or [thyatt@orrick.com](mailto:thyatt@orrick.com).

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