

Lesson 7

IRC § 144(c)

Qualified Redevelopment Bonds

Overview

Introduction This lesson continues the text’s coverage of private activity bonds by discussing bonds issued to redevelop blighted areas. This lesson describes the elements of “qualified redevelopment bonds.”

Purpose The purpose of this lesson is to describe when redevelopment bonds qualify for tax exempt status pursuant to Code § 144(c) and Treasury Regulations § 1.144-1 and § 1.144-2.

Objectives **After completing this lesson, you will be able to:**

- Define a qualified redevelopment bond
 - List the requirements of qualified redevelopment bonds
 - **Identify a designated blighted area**
 - **Describe the “use of proceeds” requirement**
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Overview, Continued

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Use of Proceeds and Additional Requirements

Use of Proceeds Section 144(c)(1) provides that a qualified redevelopment bond means any bond if:

- 95 percent or more of the net proceeds are to be used for one or more redevelopment purposes in any designated blighted area.

Additional Requirements In addition to the above requirement, a qualified redevelopment bond must:

- Be issued pursuant to a –
 - 1) State law which authorizes the issuance of the bonds for redevelopment purposes in blighted areas, and
 - 2) A redevelopment plan approved by the governing body of a local general purpose governmental unit prior to the bond issuance. The blighted area must be within the local government's jurisdiction
- The payment of the principal and interest on the bond issue must be secured primarily by (a) general taxes imposed by a general purpose governmental unit; or (b) increases in real property tax revenues (attributable to increases in assessed value) due to the carrying out of the redevelopment if such increases are reserved solely for debt service on the issue, or similar issues, to the extent that the increases do not exceed such debt service.
- Each interest in real property in the redevelopment area that was acquired by the governmental unit with proceeds of the issue and transferred to a non-governmental person must be transferred at fair market value. While the bonds are outstanding, there may be no additional charges or fee assessments to property owners or users within the financed area that are not assessed to similarly situated owners and comparable property users outside the financed area within the local governmental jurisdiction. The financed area is the portion of the designated blighted area for which the proceeds are used. Comparable property is property of the same type within the jurisdiction of the designating local government

Use of Proceeds and Additional Requirements, Continued

Additional Requirements
(continued)

- The tax assessment methods or real property tax rates within the financed area must be the same as those used outside of the financed area for comparable property.
 - Not more than 25 percent of the net proceeds can be used for a facility whose primary purpose is: retail food and beverage services, automobile sales or services, recreation, entertainment or for facilities described in § 144(a)(8) or 147(e).
 - No portion of the proceeds can be used to provide any of the following: golf course, country club, massage parlor, tennis club, skating facility, racquet or handball facility or courts, hot tub facility, suntan facility, racetrack, gambling facility, or liquor store.
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Redevelopment Definitions and Restrictions

Introduction Section 144(c)(3) provides that redevelopment purposes refers to the following measures taken in designated blighted property within an affected area:

- The acquisition of real property in the affected area by a governmental unit possessing eminent domain
- The clearing and preparation of the acquired land for redevelopment
- The rehabilitation of real property so acquired
- The relocation of residents of the real property
- Redevelopment purposes **do not** include new construction or enlargements of existing buildings

Blighted Areas Section 144(c)(4)(A) and (B) provide that blighted areas are areas determined to be blighted by the local governmental unit due to the substantial presence of:

- Abandoned or vacant buildings
- Excessive vacant land where buildings were previously located
- Substandard structures, vacancies, and property tax delinquencies

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Redevelopment Definitions and Restrictions, Continued

The Designated 20 Percent Assessed Value Ceiling

Section 144(c)(4)(C) provides that the designated percentage, determined at the time of designation, of assessed property value of the blighted area when added to existing designated blighted areas within the governing jurisdiction must not exceed 20 percent of all assessed property value within the jurisdiction. However, any previously designated blighted area will not be included in the percentage computation unless it has or will have a qualified redevelopment bond (or similar bond) outstanding for that area.

Minimum Designated Area

Section 144(c)(4)(D) provides that any designated blighted area must be contiguous, compact and equal to or greater than 100 acres. The 100 acre minimum is lowered to 10 acres if 25 percent or less of the financed area is to be provided to one person. All related persons (as defined in § 144(a)(3)) are treated as one person under this exception. An area provided to a developer on a short-term interim basis shall not be treated as provided to such developer.

Limitations on Land Acquisitions

Pursuant to § 144(c)(8), bond proceeds cannot be used to acquire land for farming purposes. However, this restriction does not apply if the land acquisition does not exceed \$517,700 (inflation adjusted) or the land acquired is by first-time farmers.

Remedial Actions and a Field Service Advice

Remedial Action Rules

Section 1.144-2 provides that remedial action rules of Treasury Regulation § 1.142-2 apply to qualified redevelopment bonds, and for this purpose, these bonds are treated as exempt facility bonds and the qualified purposes are treated as exempt facilities.

A Field Service Advice

In FSA 200002014 the Service advised that proceeds of redevelopment bonds issued pursuant to §1317(6) of the Tax Reform Act of 1986, and held in operating reserves by an unrelated user, were not treated as expended for redevelopment purposes.

A City Authority issued bonds to redevelop urban buildings. Ninety-five percent of the net proceeds were set aside for “redevelopment activities.” The Authority borrowed additional amounts from an unrelated quasi-governmental agency that required that some of the bond proceeds be held in interest bearing reserves controlled by the agency. The Service concluded that the § 1317(6) term “redevelopment activities” has the same meaning as the § 144(c)(3) term “redevelopment purposes” and bond proceeds cannot be used for broader purposes.

The Service’s concern was that the unexpended proceeds under the agency’s control prevented the Authority’s expenditure from satisfying the 95 percent use requirement under § 1317(6). Therefore the proceeds held in reserve could not be considered as spent or held for redevelopment activities.

Summary

Review of Lesson 7

The Tax Reform Act of 1986 added qualified redevelopment bonds as a new category of qualified private activity bonds to enable qualified redevelopment financing. Qualified redevelopment bonds are issues in which 95 percent or more of the net proceeds are to be used for one or more redevelopment purposes in any designated blighted area.

Other specific requirements of qualified redevelopment bonds are:

- The bonds must be issued pursuant to a state law regarding blighted areas,
- The bonds must have a redevelopment plan approved by the local government with jurisdiction over the blighted area,
- The bonds must be secured by general obligation or real property taxes, AND
- Property acquired by the bond issue and transferred to a non-governmental person must be transferred at fair market value.

Redevelopment purposes with respect to any designated blighted area include the:

- Acquisition of real property or rehabilitation of acquired real property,
- Clearing and preparation of redeveloped land for redevelopment, OR
- Relocation of the real property occupants.

Blighted areas are defined as areas experiencing a significant degree of vacant property, abandoned buildings, substandard structures, and real property tax delinquencies.

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Summary

**Review of
Lesson 7**
(continued)

The assessed values of the designated areas, when designated, are limited to 20 percent of the total assessed real property value within the local government's jurisdiction, taking into account only areas for which there are or will be outstanding bonds.

In general, the minimum designated area must be contiguous and at least 100 acres.

Remedial action rules under Treas. Reg. § 1.142-2 apply to qualified redevelopment bonds .

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