

Lesson 7

Section 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. During this lesson, criteria to satisfy the term “qualified redevelopment bonds” will be explained.

Purpose The purpose of this lesson is to assist in the training of IRS agents to determine when bonds qualify for tax exempt status pursuant to Code §§ 141(e)(1)(F) and 144(c) and Treasury Regulations §1.144-1 and §1.144-2 as qualified redevelopment bonds.

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
 - Determine 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 of which 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 –
 - State law which authorizes the issuance of the bonds for redevelopment purposes in blighted areas, and
 - A redevelopment plan adopted 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 primarily secured by general taxes imposed by a general purpose governmental unit, or 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 the increases do not exceed the 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 person other than a governmental unit 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 users of comparable property (*i.e.*, property of the same type) outside the financed area but within the governmental jurisdiction. The *financed area* is the portion of the blighted area for which the proceeds are to be used.

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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 for comparable property located within the jurisdiction of the local governmental unit.
 - Not more than 25% 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 as otherwise provided 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 (including land for these facilities).
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Redevelopment Definitions and Restrictions

Redevelopment Purposes Section 144(c)(3) provides that redevelopment purposes refers to the following measures taken with respect to any designated blighted area:
The acquisition of real property in the designated blighted area by a governmental unit having the power to exercise eminent domain.
The clearing and preparation of the acquired land for redevelopment.
The rehabilitation of real property so acquired.
The relocation of the occupants 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 by the the governing body of the local general purpose governmental unit with jurisdiction over the area as having the substantial presence of factors such as:
Abandoned or vacant buildings;
Excessive vacant land where buildings were previously located; and
Substandard structures, vacancies, and property tax delinquencies.

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Redevelopment Definitions and Restrictions, Continued

The Designated 20% Assessed Value Ceiling Section 144(c)(4)(C) provides that, at the time of designation, the designated percentage of the assessed property value of the blighted area, when added to the designated percentages of all other designated blighted areas within the jurisdiction, must not exceed 20% of all assessed property value within the jurisdiction. However, the designation percentage of any previously designated blighted area will not be included in the designated percentage computation unless it has or will have a qualified redevelopment 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% or less of the **financed area** is to be provided to one person. All related persons 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), § 147(c) – limitation on land acquisition with private activity bonds - (other than § 147(c)(1)(B) and § 147(c)(2) relating to the limitation on the acquisition of land for farming purposes) does not apply to qualified redevelopment bonds. Thus, generally, qualified redevelopment bond proceeds can be used to acquire land (except for farming purposes, unless the land acquisition does not exceed \$450,000 or the land is acquired by first-time farmers).

Remedial Actions and a Field Service Advice

Remedial Action Rules

Pursuant to Treasury Regulation § 144-2, 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 qualified redevelopment 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 under the control of an unrelated entity, 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 amount held in the operating reserve were not spent and were subject to arbitrage. However, the Service recognized the concern that the agency’s control over the unexpended proceeds prevented the Authority from satisfying the 95% use of proceeds requirement under § 1317(6). Nevertheless, the Service indicated that under the terms of the reserve, the Authority had the ability to spend the reserve.

As part of the FSA, the Service also concluded that the term “redevelopment activities” under § 1317(6) has the same meaning as the term “redevelopment purposes” under § 144(c)(3) and that under § 1317(6) bond proceeds cannot be used for broader purposes.

Summary

Review of Lesson 7

The Tax Reform Act of 1986 added qualified redevelopment bonds as a new category of qualified bonds. This addition was to prevent qualified redevelopment financing from being considered private activity bonds. 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 be issued after a redevelopment plan has been adopted by the local government in the jurisdiction of which the blighted area is located.
- The bonds must be secured by general taxes or increases in property taxes.
- The transfer of property acquired by the bond issue to a nongovernmental person must be at fair market value.

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

- Acquisition of real property.
- Clearing and preparation of land for redevelopment and rehabilitation of real property.
- Relocation of the real property occupants.

Blighted areas are areas determined to have a substantial presence of factors such as vacant real property, abandoned buildings, substandard structures, and property tax delinquencies.

In general, the assessed values of the designated areas, when designated, are limited to 20% of the total assessed real property value within the government's jurisdiction.

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

Exempt facility bond remedial action rules under Treasury Regulation §1.142-2 apply to qualified redevelopment bonds.
