<u>Availability and Usage of Qualified Energy Conservation Bonds (“QECBs”) in Illinois</u>

This overview is intended to provide general background information regarding eligibility parameters and legal requirements for QECBs pursuant to Section 54D of the Internal Revenue Code of 1986, as amended, subsequent notices posted by the IRS, and pertinent sections of the Illinois Finance Authority Act (20 ILCS 3501/201-1 et seq.) (the “Act”). Prospective borrowers and issuers should engage and rely on bond counsel to provide definitive guidance in order to evaluate and determine project eligibility.

<u>Section 1: Overview of QECBs – Background</u>

Qualified Energy Conservation Bonds (QECBs) are taxable tax credit bonds authorized under Section 54D the Internal Revenue Code. QECBs are designed to provide an interest rate subsidy on capital improvement projects undertaken primarily by governmental entities and designed to result in documented minimum energy savings of 20% or more. A portion of the State’s QECB allocation may also be issued for government-purpose projects that also include private use components (attributable to management contracts or facility usage, for example).

<u>*In addition to government-purpose QECBs, governmental issuers also have the option to establish a “Green Community Program” – pursuant to Section 54D of the Internal Revenue Code of 1986, as amended. Please see Section 5 below for additional information regarding “Green Community Programs”.*</u>

State or Local Government Issuers of QECBs may choose between two forms of tax-credit subsidy for a project. **The underlying issuer may select one of the following two QECB subsidy options:**

1. **<u>The Direct [Interest Rate] Subsidy Method:</u>** under which the QECB Borrower receives a direct interest rate rebate from the U.S. Treasury based on a percentage of the taxable interest paid on the Bonds. The QECB Borrower pays a taxable interest rate to the bond investor (e.g., bank or external bondholder).
2. **<u>The Tax Credit Method:</u>** under which the QECB investor(s) (e.g., bank or other bond investor) receives a federal tax credit instead of traditional bond interest payments. Accordingly, under this Tax Credit Method, the QECB Borrower would pay 0% interest to the QECB investor(s), while the QECB investors receive a credit against their federal income tax liability.

Of the two authorized subsidy methods, the Direct Interest Rate Subsidy Method (i.e., Method #1 above), which results in a direct interest rate rebate to the Borrower, has been, essentially the only QECB structure used in transactions that have closed nationally (including Illinois) since the Direct Pay Subsidy Method was authorized in March 2010..

<u>*Please refer to Section 4 – Quantifying Prospective Savings from QECBs under the Direct Project Subsidy Method for additional information on how the US Department of the Treasury establishes the subsidy for QECBs financings and how that cash subsidy effectively reduces the net interest cost to the QECB Borrower under the Direct Subsidy Method discussed above (i.e., Method #1).*</u>

<u>Section 2: Overview of Eligible QECB Projects by Issuer or User</u>

General Project Eligibility and Benchmark Energy Conservation Requirements: Ultimately, the issuance of QECBs to finance a qualified project will require the local government issuer to engage bond counsel to undertake a project eligibility review, draft legal documents, and deliver a legal opinion relating to the QECB issuance. Bond counsel responsibilities on a QECB financing are comprised of substantively the same scope of due diligence legal review that would be undertaken in connection with a tax-exempt municipal bond issue.

1. **<u>Governmental Projects: Governmental projects that qualify for QECB financing</u> <u>involve capital project in publicly-owned buildings and facilities that reduce base energy consumption by a minimum of 20%.</u>** Improvements can include projects that involve, for example, heating, ventilation, and air conditioning (i.e., HVAC systems); hot water systems; lighting systems; key items in the "building envelope" or "shell" (e.g., windows, doors, roof, walls, insulation); or electricity usage (i.e., equipment and fixtures plugged into electrical outlets for use such computers, kitchen appliances, and walk-in coolers and freezers).
2. **<u>Non-Governmental Projects financed under an authorized "*Green Community Program*" established pursuant to requirements posted pursuant to Section 54D of the Internal Revenue Code and subsequent revisions to Code Section 54D and related IRS Notices:</u>** <u>Please see Section 5 below for additional information on Green Community Programs which may enable proceeds to be used to fund loan or grant programs various non-governmental users.</u>
3. **<u>Mass commuting facilities and related facilities or initiatives</u>** that reduce pollution from vehicles used for mass commuting or for purposes that reduce pollution by encouraging alternate transportation methods (e.g., bicycling).
4. **<u>Rural development projects</u>** <u>that involve production of electricity from renewable energy resources.</u>
5. **<u>Any facility eligible for the Production Tax Credit</u>** <u>under U.S. Code, Title 26, Section 45.</u>
6. <u>Subject to bond counsel guidance, QECBs may also be used in limited circumstances to finance other specific initiatives that support energy conservation, including:</u>
    a. Expenditures to facilities or to finance grants that support research in alternate energy or energy conservation technologies (as identified in the U.S. Code).
    b. Demonstration projects designed to promote the commercialization of specified energy technologies (as identified in the U.S. Code), and for public education campaigns that promote energy efficiency.

<u>Section 3: Periodic Report on Qualified Energy Conservation Bond ("QECB") Allocations in Illinois – Status of Statewide QECB Allocation Use as of December 31, 2016</u>

US TREASURY DEPARTMENT QECB ALLOCATION TO STATE OF ILLINOIS

The State of Illinois was allocated a total of $133,846,000 of Qualified Energy Conservation Bond ("QECB") issuance allocation (the "QECB Volume Cap Allocation") pursuant to the American Recovery & Reinvestment Act of 2009 ("ARRA").

SUB-ALLOCATIONS TO 8 SPECIFIED CITIES AND 19 SPECIFIED COUNTIES IN ILLINOIS

This approximately $133.85 million of QECB Volume Cap Allocation was further sub-allocated to units of local government.

This section details how the 2009 allocation to Illinois was sub-allocated for use by eight (8) cities with populations over 100,000 and 19 specified counties (also with populations over 100,000).

This section of the QECB Summary discusses how units of local government that either lack a QECB Allocation or have insufficient QECB allocation to undertake a proposed financing may go about obtaining additional QECB allocation from a City or County that possesses its own allocation. **The Illinois Finance Authority has prepared this summary information as a resource to prospective issuers or users of QECB Allocation**.

Overview of the 2009 Illinois QECB Sub-Allocations to Municipalities and Counties:

1. Approximately $39.56 million was allocated among "large municipalities" (i.e., eight cities, each with a population over 100,000);

2. Approximately $71.66 million was allocated among nineteen Illinois counties (these sub-allocations to municipalities and counties were assigned based on population); and,
3. Approximately $22.62 million was allocated to the Illinois Finance Authority for use statewide.
    - *Additionally, pursuant to 20 ILCS 3501/825-110, the Authority is authorized to manage the State of Illinois' portion of the national QECB allocation under the Code and to allocate and reallocate QECB allocations within the State as requested by any of the 27 local government allocatees.*

The 27 units of Illinois local government that possess an QECB Allocation may reallocate to other local government units located within their corporate boundaries by an official resolution or ordinance. Additionally, local government allocatees may transfer their allocation to other specified government units outside of their corporate boundaries by adopting a duly approved resolution or ordinance transferring the specified QECB Allocation to the Illinois Finance Authority. The local government unit may specify one or more end users/issuers or projects that should ultimately receive any QECB allocation that is transferred to the Illinois Finance Authority. The Illinois Finance Authority will undertake actions as authorized in the local government resolution transferring any allocation to the Authority.

QECB ALLOCATION AND ISSUANCE REPORT – UPDATED AS OF DECEMBER 31, 2016

The QECB Allocation and Issuance report below includes all local issuance activity reported to date by all 27 local government QECB Allocatees and the Illinois Finance Authority.

The report includes (i) public domain information reported on (a) the Municipal Securities Rulemaking Board's "EMMA" website and (b) other public domain websites, and (ii) to the Illinois Finance Authority directly.

Please note that some QECB issuance structures (e.g., bank direct purchase transactions) may be exempt from EMMA reporting requirements. Given that all local government QECB reallocation activity is undertaken at the discretion of the City or County that possesses a QECB allocation, the report presented below represents a "best efforts" report prepared by IFA regarding QECB issuance activity to date as of December 31, 2016.

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Illinois Qualified Energy Conservation Bond Allocation and Issuance Report as of December 31, 2016			
Counties with QECB Allocations	**Initial 2009 Allocation (under ARRA)**	***Amount Issued or Transferred / Waived**	**Net Allocation Available (for use or transfer):**
Champaign	$2,021,135	$705,000	$1,316,135
Cook	$24,948,146	$24,945,000	$3,146
DeKalb	$1,103,086	$0	$1,103,086
DuPage	$8,173,550	$6,815,000	$1,358,550
Kane	$3,089,684	$3,086,799	$2,885
Kankakee	$1,170,159	$0	$1,170,159
Lake	$7,357,456	$0	$7,357,456
LaSalle	$1,178,255	$0	$1,178,255
Macon	$1,138,706	$0	$1,138,706
Madison	$2,797,540	$0	$2,797,540
McHenry	$3,295,988	$1,500,000	$1,795,988
McLean	$1,717,486	$0	$1,717,486
Peoria	$726,949	$0	$726,949
Rock Island	$1,540,357	$0	$1,540,357
Sangamon	$804,820	$0	$804,820
St. Clair	$2,736,092	$0	$2,736,092
Tazewell	$1,371,743	$1,300,000	$71,743
Will	$5,008,254	$0	$5,008,254
Winnebago	$1,480,857	$0	$1,480,857
SUBTOTAL - Counties	**$71,660,263**	**$38,351,799**	**$33,308,464**
Cities with QECB Allocations	**Initial 2009 Allocation (under ARRA)**	***Amount Issued or Transferred / Waived**	**Net Allocation Available (for use or transfer):**
Aurora	$1,778,201	$1,778,201	$0
Chicago	$29,666,445	$29,665,000	$1,445
Elgin	$1,085,427	$0	$1,085,427
Joliet	$1,497,510	$0	$1,497,510
Naperville	$1,485,203	$0	$1,485,203
Peoria	$1,190,634	$0	$1,190,634
Rockford	$1,636,106	$0	$1,636,106
Springfield	$1,225,428	$0	$1,225,428
SUBTOTAL - Cities	**$39,564,954**	**$31,443,201**	**$8,121,753**
QECB Allocation - IFA	**Initial 2009 Allocation (under ARRA)**	***Amount Issued or Transferred / Waived**	**Net Allocation Availabile (Encumbered for Use by State Universities)**
Illinois Finance Authority	$22,620,783	$21,865,000	$755,783
TOTALS	**Initial Statewide QECB Allocation $133,846,000**	***Amount Issued or Transferred / Waived $91,660,000**	**Net Allocation Available (for use or transfer): $42,186,000**

* **NOTE:** **"Amount Issued"** is as reported by the Issuers in the public domain, including on the Muncipal Securities Rulemaking Board's "EMMA" website (see www.emma.msrb.org and type "Illinois Qualified Energy Conservation Bonds" in the search box).

Disclaimer - Limitations on accuracy of QECB Allocation Report as presented above: The Illinois Finance Authority is presenting the information in this article as a service to prospective issuers and members of the general public. Please note that sub-allocatees (i.e., any of the eight municipalities or 19 Illinois counties on the preceding list) are under no legal obligation to report local QECB issuance or QECB Allocation transfers to any third party entity other than the Internal Revenue Service.

Accordingly, the Illinois Finance Authority is providing the issuance information in the preceding table on an informational and "best efforts" basis.

The Illinois Finance Authority does not warrant the accuracy of QECB Issuance or QECB Allocation transfers (or encumbrances) reported above from any allocatee listed above except the $22,620,783 under the Authority's direct management control. *Accordingly, the Illinois Finance Authority suggests that inquiries regarding availability of any local QECB Allocation be directed to the Local Government Unit directly (and, specifically to the Finance Director, Administrator (e.g., City/County/Village Manager or Administrator), or the Legal Department or Corporation Counsel's office).*

<u>Section 4: Quantifying Prospective Savings resulting from QECBs using the Direct Subsidy Method:</u>

QECBs were originally structured as tax credit bonds under federal law.

However, the March 2010 ***HIRE Act** (H.R. 2847 (Sec. 301)) added a second QECB subsidy method by authorizing and providing Issuers/QECB Borrowers with <u>a direct subsidy bond rebate option</u> that was analogous to the subsidy method created for Build America Bonds (BABs).

As a result of under the Direct Subsidy Method created pursuant to the HIRE Act, the QECB Issuer/Borrower could choose to pay the QECB investor a taxable coupon (i.e., taxable interest rate), while receiving a direct cash rebate from the U.S. Treasury to partially offset the taxable interest rate paid to the QECB Investor/Lender.

***The Hiring Incentives to Restore Employment Act (the "HIRE" Act) was (Pub.L. 111–147, 124 Stat. 71), enacted March 18, 2010.**

Prior to the March 2010 HIRE Act, there was very little QECB issuance activity under the "Tax Credit Method".

Subsequent to enacting the HIRE Act, the Direct Subsidy Method has been the QECB subsidy structure of choice and has been used to finance essentially all QECBs in Illinois (and nationally) since that time.

<u>How Does the QECB Direct Pay Subsidy Benefit the QECB Borrower?</u>

<u>Under the Direct Subsidy Method, the QECB Borrower pays a taxable rate of interest to the QECB project lender/investor. The QECB Borrower receives a cash rebate from the U.S Treasury that offsets a portion of the taxable interest paid by the Borrower.</u>

The QECB subsidy is set at 70% of the "Qualified Tax Credit Bond Rate" and is correlated with U.S. Treasury yields. The U.S. Treasury's "Treasury Direct" website may be found at the following location (as of 4/10/2017): www.treasurydirect.gov/GA-SL/SLGS/selectQTCDate.htm . *This Qualified Tax Credit Bond Rate quoted on this site is reset each business day.*

<u>Maximum QECB Maturity – Set by the Department of the Treasury – 31 years as of 4/10/2017</u>: The maximum maturity for QECBs are also set by the Treasury Department and are reported at the "Treasury Direct" website and was 31 years (maximum) as of 4/10/2017). Prospective issuers and investors may structure a QECB for any maturity up to the maximum maturity specified at the time of the QECB issuance (subject to a bond counsel tax due diligence review of the useful life of the proposed QECB-financed assets).

<u>Example:</u> of mechanics of savings resulting from a QECB through the Direct Pay Subsidy (i.e., cash rebate from the U.S. Treasury to the QECB borrower to partially offset the taxable bond rate paid to the investor):

- **The QECB Issuer sells taxable bonds and pays a taxable coupon to the QECB Investor/Lender as established pursuant to mutually agreeable terms (and subject to the maximum maturity and interest rate parameters established by the IRS and a bond counsel opinion).**
- **The QECB Issuer (Borrower) receives from U.S. Treasury <u>the lesser of</u>:**
  - **i. the taxable rate borne on the QECB (i.e., rate paid to the QECB investor on the Bonds); or**
  - **ii. 70% of the "Qualified Tax Credit Rate" posted on the "Treasury Direct" website and updated every business day.**

Sample Computation based on 4/10/2017 Treasury Direct – Qualified Tax Credit Rate – Value of QECB Direct Subsidy to QECB Issuer/Borrower:

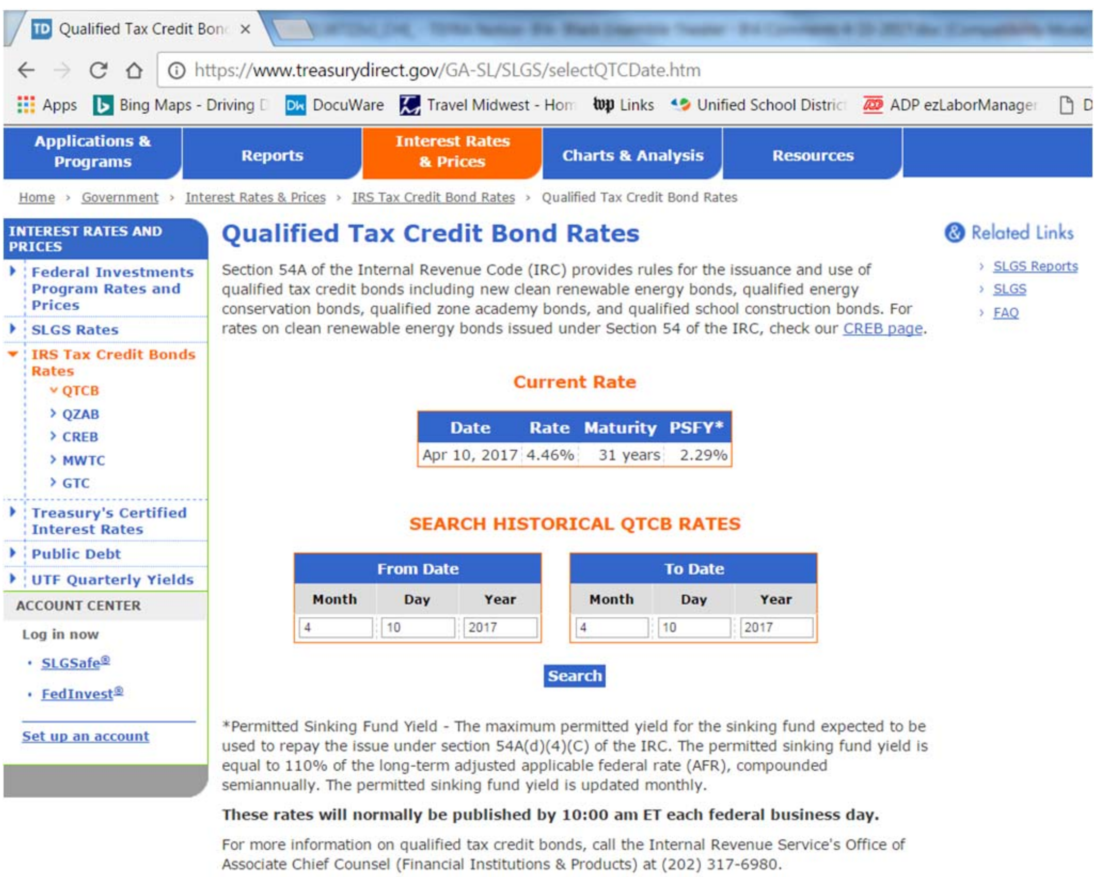
- **Qualified Tax Credit Rate (as of 4/10/2017) as posted on "Treasury Direct" website: 4.46%**
- **Note: Maximum Maturity (as of 4/10/2017) as posted on "Treasury Direct" website: 31 years**

- ***Assumed Taxable QECB Bond Rate to Investor*** (Set by market sale or negotiation with Lender/QECB Investor): **5.00%**
- ***Less: Direct Subsidy Computation:*** *(4.46% Rate x 70% QECB subsidy = 3.12%)* **(3.12%)**
- ***Equals: Net Interest Cost from QECB Subsidy*** *(Taxable QECB Bond Rate less QECB Subsidy):* **1.88%**

For a financing with, potentially, up to a 31-year maturity, the prospective net 30-year interest rate in the above example would result in a net interest cost of 1.88% that would be substantially less than a taxable conventional loan or (under current market conditions) than a tax-exempt bond issue or conventional financing (at the assumed 5.00% taxable rate).

As noted previously, the U.S. Treasury cash rebate on QECB Direct Subsidy Bonds may be subject to reduction through sequestration. Readers are urged to discuss the issue of federal sequestration resulting from federal budget considerations further with bond counsel in order to quantify the reduced savings.

Here is a screenshot from the Treasury Direct website that reports the QECB Qualified Tax Credit Rate and the Direct Subsidy (as of 4/10/2017):


Qualified Tax Credit Bon

https://www.treasurydirect.gov/GA-SL/SLGS/selectQTCDate.htm

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Qualified Tax Credit Bond Rates

Section 54A of the Internal Revenue Code (IRC) provides rules for the issuance and use of qualified tax credit bonds including new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds. For rates on clean renewable energy bonds issued under Section 54 of the IRC, check our CREB page.

Current Rate

Date	Rate	Maturity	PSFY*
Apr 10, 2017	4.46%	31 years	2.29%

SEARCH HISTORICAL QTCB RATES

From Date			To Date		
Month	Day	Year	Month	Day	Year
4	10	2017	4	10	2017

Search

*Permitted Sinking Fund Yield - The maximum permitted yield for the sinking fund expected to be used to repay the issue under section 54A(d)(4)(C) of the IRC. The permitted sinking fund yield is equal to 110% of the long-term adjusted applicable federal rate (AFR), compounded semiannually. The permitted sinking fund yield is updated monthly.

These rates will normally be published by 10:00 am ET each federal business day.

For more information on qualified tax credit bonds, call the Internal Revenue Service's Office of Associate Chief Counsel (Financial Institutions & Products) at (202) 317-6980.

Related Links
- SLGS Reports
- SLGS
- FAQ

<u>Note:</u> Because very few QECBs nationally have selected the Tax Credit Method, this report does not describe the mechanics of the Tax Credit Method (which simply provides the Borrower with a zero-interest rate while the QECB Investor/Lender receives a federal tax credit benefit over the life of the QECB). IFA suggests that readers interested in learning more about the Tax Credit Method refer to IRS guidance and discuss further with bond counsel

Section 5: Requirements for a QECB Issuer to establish a "Green Community Program":

QECBs may be issued to finance certain "Green Community Programs", which based on guidance provided pursuant to:

a) Section 54D of the Internal Revenue Code of 1986, as amended;
b) Section 1112 of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. (2009), which amended Code Section 54D in several respects, including amendments to the provision on "Green Community Programs"; and
c) IRS Notices including the following:

- IRS Notice 2009-29, 2009-1 C.B. 849 (as of April 6, 2009), under which the U.S. Treasury Department and the Internal Revenue Service allocated the national bond volume cap for Qualified Energy Conservation Bonds to States, the District of Columbia, and possessions of the United States in proportion to population.
- IRS Notice 2012-44, 2012-28 IRB 45 (as of June 25, 2012), under which the purposed of a Green Community Program was established to promote on e or more of the purposes of energy conservation, energy efficiency, or environmental conservation initiatives relating to energy consumption, broadly construed, and eligible program purposes (as summarized immediately below) and must be broadly available to members of the general public (as detailed immediately below).

1. ***Purpose.*** The purpose of a Green Community Program is to promote the financing of capital expenditures for one or more of the purposes of energy conservation, energy efficiency, or environmental conservation initiatives relating to energy consumption. Sample qualified energy efficiency or environmental conservation capital expenditures could include building retrofitting initiatives (e.g., HVAC system improvements; interior lighting system improvements; building envelope improvements (insulation; window and door replacement; roof replacement); water-usage/water conservation programs; and storm water reduction. Additionally, various transportation initiatives that conserve energy and/or support alternative fuel or public or private commuting and transportation energy saving infrastructure could also qualify (e.g., public mass commuting facilities or improvements to public bicycle paths, or bicycle parking at mass commuting facilities).

2. ***General Public Use or Broad Public Availability.*** A Green Community Program must: (1) involve property that is available for general "public use" (as defined consistently with various tests that establish, identify and distinguish public use from private business use by the IRS); or (2) involve a loan or grant program that is broadly available to the general public, <u>including</u> individuals or businesses. Sample projects undertaken by other units of state and local government nationally have included residential housing or private building energy efficiency initiatives that provides grants or loans that are broadly available for homeowners or businesses (including both for-profit businesses and Code 501(c)(3) not-for-profit corporations).

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Section 6: Additional QECB Resources and Background from the IRS

This section is provided to readers with supplemental information to help facilitate basic understanding of QECBs and to expedite discussion and identification of considerations that merit further review and discussion with bond counsel.

Readers should be able to find these IRS Notices through a basic internet search. Additionally, these IRS Notices are also posted on the IFA's website for Energy Programs (please see www.il-fa.com/programs/energy ; these IRS Notices are posted under the heading "Qualified Energy Conservation Bond Program"):

- IRS Notice 2009-29
- IRS Notice 2010-35
- IRS Notice 2012-44

Please note that the IRS may release updated notices on Qualified Energy Conservation Bonds at any time.

ILLINOIS FINANCE AUTHORITY WEBSITE DISCLAIMER:

The explanations and examples regarding QECBs presented on this website and related documents posted on IFA's website (collectively, "IFA website information") is intended to provide the reader with basic, introductory-level information on Qualified Energy Conservation Bonds and is intended for preliminary discussion purposes only.

Accordingly, IFA's information and commentary on QECBs is not intended to be comprehensive and should not be construed as providing the reader with definitive tax guidance.

The Illinois Finance Authority advises all readers with an interest in using or issuing QECBs to contact a qualified municipal bond attorney (i.e., bond or tax counsel) to initiate and complete a definitive due diligence review of the underlying facts in order to maximize compliance with all pertinent QECB legal requirements specified pursuant to the Internal Revenue Code, all IRS Notices on QECBs, as released, and pertinent sections of the Illinois Finance Authority Act, as necessary.