

Client Advisory | August 2012

Taxable Financing an Attractive Option for 501(c)(3) Borrowers

With the spread between taxable and tax-exempt yields closer than it has been in years, borrowers that normally would issue tax-exempt debt are looking more and more to the taxable market. In lieu of issuing tax-exempt bonds in a conduit transaction through a governmental issuer, borrowers are issuing bonds in their own names. In some cases, depending on the credit of the borrower, these bonds are issued as “century bonds” where the final maturity date is 100 years away. Members of the Edwards Wildman Public Finance Department have worked on many of these transactions.

Why issue taxable debt? There are several benefits. Borrowers can finance projects that otherwise would have been restricted by tax law surrounding tax-exempt debt. For example, borrowers can

finance research facilities, parking garages, ice hockey rinks or other facilities without regard to private business use analysis. Hospitals can collaborate with other healthcare providers to finance jointly-used facilities, without being concerned about the congruency of their 501(c)(3) missions. Borrowers can refinance non-callable debt or debt that is or may become taxable. Generally, taxable financing provides flexibility with fewer rules governing how the proceeds or the facilities that are financed with the proceeds are used. In addition, costs of issuance of a taxable transaction may be lower than in tax-exempt financings and the schedule may be faster, as there is no need in a taxable financing for conduit issuer board approval or a TEFRA hearing and Governor’s approval.

Century bond and other taxable debt financings may give rise to unrelated business income tax (“UBIT”) issues. The Edwards Wildman team has advised borrowers with respect to potential UBIT.

Taxable bonds, as well as traditional tax-exempt bonds, issued directly by a 501(c)(3) organization are exempt from registration under the federal securities laws. Both types of bonds are subject to the federal anti-fraud provisions, commonly known as Rule 10b-5. The Edwards Wildman team has advised clients with respect to these issues, as well as with respect to state securities laws (so-called “blue sky laws”), which may require special analysis depending on the financing structure.

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