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MEMORANDUM

To: Amberley Village Finance Committee

From: Peck, Shaffer & Williams

Re: Financial Options and Considerations for Amberley Green Debt

Date: June 6, 2012

The current short term note of $6,220,000 for Amberley Green is due on October 4, 2012. If the Village is considering other options for the future of the debt, analysis must be done now in order to make decisions in time to implement such plan prior to the maturity of the outstanding note. This Memorandum will discuss the various financing options available to the Village as well as some legal issues regarding those options.

Renew the Short Term Note Without Paying Principal:

Pursuant to current statutes, the note can be renewed/refinanced through December 31, 2013 without paying any amount towards the principal reduction of the Note. Current interest due on the note ($85,049.86) must be paid in October. Previous interest on the note has been paid from the Village's general fund in the amount of $178,328.26 ($85,287.43 in 2011; $93,040.83 in 2010). In 2009, interest of $216,895.83 was capitalized and added to the original amount of the Note ($6,000,000).

An advantage of rolling over the note and making interest only payments allows for a decision to be made regarding the permanent use of the property. The disadvantage is that the Village is not making any payments towards principal meaning the amount to be rolled over remains the same instead of financing less. A principal reduction payment can be made in 2012 but is optional.

Annually rolling over the note without paying principal can occur for 1 additional year. This process requires council to pass an authorizing ordinance each year. Principal can be paid towards the note at each renewal but does not have to be paid during the first five years. Current interest payments must be made annually. After 2013, the $6.2 million note must be treated as if

it was bonded debt, meaning annual payments of both principal and interest will have to be made, likely around $350,000 per year assuming short term interest rates remain low. After 2013, the Village can no longer renew the note without paying principal at the time of each renewal.

Renew the Short Term Note and Make a Principal Payment:

After 2013, the note can still be renewed as short term debt but principal reduction payments must be made in addition to paying current interest. This stipulation is non-negotiable and has its advantages, including that the note gets paid off over time and the Village can take advantage of current low short term interest rates. It also provides flexibility if the Village sells part of the property for development; therefore this type of financing doesn't create obstacles to certain options for long term use of the property like long term financing might.

The most significant negative that accompanies this option is the inability to lock in a low long term interest rate. If interest rates rise, borrowing costs increase and the Village will be paying more towards interest. However, it is important to recognize that short term interest rates have historically been significantly less than long term rates. Short term rates would have to rise significantly and stay there in order for the net effect to be negative for the Village.

Long Term Bond Issuance with Tax-Exempt Debt

If the Village wanted to secure the financing of the property as a governmental asset, long term tax-exempt financing would require that the property be used for governmental purposes. If the property is used for private use, the tax exemption on the bonds may be void back to the original purchase date or from the time of the decision to use the property for a private use (IRS determination).

If bonds were issued, an interest rate would be locked in for the duration of the bond, payable over approximately 20 years. The benefit would be to take advantage of current low long term rates. However, the annual payment would be nearly $420,000. The Village would need to have an income stream identified to pay debt service in order to enter into long term financing. Also, if there are plans to sell the property for private development, there are some possible consequences and potential additional costs if the Village has benefited from long term tax-exempt financing.

General obligation tax-exempt debt generally provides the lowest interest cost compared to other financing options, but it is not always a viable option.

Long Term Bond Issuance with Taxable Debt

If the Village has plans to sell or privately develop the property, taxable debt can be issued. This avoids any question about the Village's intent to initially utilize tax exempt debt until it

determines the future use of the property. However, taxable debt carries with it a higher interest rate. The difference in interest for tax-exempt debt versus taxable debt is currently about $50,000 annually for a $6.2 Million issue.

To determine if the property will be eligible for tax-exempt financing several criteria must be evaluated. The IRS Code provides the terms and conditions for the private activity test, which determines eligibility to issue tax-exempt vs. taxable debt. The most simplistic test to determine tax-exempt versus taxable status is determined by who is using the property, for what purpose is the property being used, and who benefits from such use. If the Village owns the property and uses it for a governmental purpose, then tax-exempt debt can usually be issued. If the benefit of the property goes to another entity, which is not a governmental entity, then taxable debt will probably have to be issued. The IRS places significant emphasis on the expectations of the issuer regarding the use of the property at the time of the issuance of the debt obligation. Bond Counsel should be included in any discussions, especially if there is discussion about selling part of the property for less than fair market value or if any tax-exempt debt is outstanding at the time of sale.

General Obligation vs. Revenue Debt

If the property is used by the Village for a governmental purpose then general obligation debt, pledging the full faith and credit of the Village can be issued. However, if the property is sold to, leased to, or used by a non-governmental entity then the Ohio Constitution prohibits the lending of municipal credit (there are certain economic development exceptions) and revenue or special obligation debt rather than general obligation debt would have to be issued. Revenue debt is typically sold at a higher interest rate than general obligation debt.

If general obligation debt cannot be issued, then a non-tax revenue source must be identified and pledged to secure the debt obligations.

General State Law and Federal Tax Law Considerations

If the Village determines to pursue long term financing options at this time, while expecting to later sell the property, special obligation taxable debt may have to be issued.

There are federal tax law and state law issues associated with selling property financed with general obligation tax-exempt bond proceeds. Consequences for both federal tax matters and state law issues depend partly on whether the property is sold or transferred at, above, or below fair market value ("FMV"). It is relevant that the Village purchased the property pursuant to a court approved settlement and in an increasing real estate value market and in the current real estate market the property is valued lower than when the Village purchased it. For purposes of determining whether the Village sells the property at FMV, FMV in 2012 is equal to the actual current FMV of the property and does not have to equal the purchase price paid by the Village when they acquired the property in 2008.

In order to preserve the tax-exempt status of Bonds issued to purchase property that is later sold to a non-governmental entity, the Bonds must not become a private activity bond as a result of the sale. The Bonds will constitute an issue of private activity bonds if the Village takes a deliberate action, after the issue date of the Bonds, that causes the two private business tests to be met.

Even if both of the private business tests are met due to an action taken by the Village, that action is not treated as a deliberate action if the Village takes a remedial action described in the Treasury Regulations. The requirements will be satisfied, if the property is sold in a bona-fide arm's length transaction for fair market value and the Village reasonably expected on the issue date that the Bonds would not meet the private business tests for the entire term of the Bonds. **Specifically, the Village must not have anticipated that the property would be sold during the term of the Bonds.**

The two remedial actions available are a defeasance of Bonds due to the sale of the property or an alternative use of the sale proceeds. Under the first option, a defeasance escrow is established for a portion of the Bonds equal to the percentage of private use within 90 days of the sale of the tax-exempt bond-financed property. The Bonds will be defeased either on a pro rata basis among all of the outstanding maturities of the Bonds or the longest maturities will be defeased first. If sale proceeds are less than the outstanding Bonds, all sale proceeds must be used to defease Bonds. The cost of a defeasance escrow will depend on when a sale of the property occurs and when the first call date for the Bonds is and what the interest rate on the Bonds is compared to the interest rate earned on the escrow.

Sale proceeds may also be used for an alternative use. The proceeds may only be used to make capital expenditures for property with a useful economic life meeting or exceeding the remaining useful economic life of the originally purchased property and all proceeds must be spent on such alternative use within two years.

While defeasance of less than all of the Bonds or designation of an alternative use of less than the full amount of outstanding Bonds may preserve the federal tax-exempt status of any outstanding Bonds, the Village may still be in violation of the Ohio Constitutional provision prohibiting lending of credit if the Village issued general obligation bonds and later sells all or a portion of the property for less than they paid and is unable to defease bonds or provide an alternative use in an amount proportionate to the amount of property sold.