

Grant Anticipation Notes



Heidi Garner Studio

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THE ISSUE

Your agency has been awarded a grant or low-interest loan for a project, and the project is ready to begin construction, but:

- (1) Grant or loan proceeds are delivered on a reimbursement basis, and your agency doesn't wish to draw down its own cash; or
- (2) The timing of the receipt of grant or loan proceeds is uncertain; or
- (3) Both (1) and (2) are true.

THE SOLUTION: GRANT ANTICIPATION NOTES

- A Grant Anticipation Note financing is a short-term borrowing.
- Grant Anticipation Notes allow your agency to receive funds when needed to pay project costs.
- The funds are repaid (at a tax-exempt interest rate, where applicable) from grant or loan proceeds when those proceeds come in.

WHAT ARE GRANT ANTICIPATION NOTES?

- They are promissory notes issued by a city, county, school district or special district pursuant to Government Code Section 53859 *et seq.*
- They are purchased by one or more buyers and evidence the obligation to repay the buyer(s).
- They can be publicly sold to multiple investors or privately placed with a single bank or other lender.
- They have a maximum maturity of 36 months.

WHAT ARE GRANT ANTICIPATION NOTES? (continued)

- They are issued in a principal amount not exceeding 95% of the grant or loan award, provided that the principal payable in any single year does not exceed your agency's annual revenues.
- They can be prepaid on your agency's desired terms (for a public sale) or negotiated with the lender (i.e., at any time with no prepayment penalty if the lender agrees).
 - This allows your agency to pay them off immediately when grant or loan funds come in.
- They are secured by a pledge of *committed and appropriated* grant or loan funds. Bond Counsel will want to see correspondence from the state or federal entity that is making the grant or loan in order to confirm this.
- To the extent not paid from grant or loan funds, they are payable from your agency's other legally available funds (although it is *not* necessary to pledge such other funds).

HOW ARE GRANT ANTICIPATION NOTES ISSUED?

- The governing board adopts a resolution as a business item.
- The form of Grant Anticipation Note is attached as an exhibit to the resolution.
- The resolution approves a Note Purchase Agreement with the lender(s). The Note Purchase Agreement contains representations and warranties by your agency and lays out the documents that are required to be signed at closing.
- No other documents are required under the Government Code. Unless the lender requests other documents, there *are* no other documents.

HOW ARE GRANT ANTICIPATION NOTES ISSUED? (continued)

- Bond Counsel will prepare closing documents, including a closing certificate, an incumbency certificate and an opinion for your agency's General Counsel to sign.
- Your General Counsel's opinion will cover matters such as:
 - the authorizing resolution was duly adopted;
 - no litigation affects your agency's ability to issue and repay the Grant Anticipation Note;
 - issuing the Grant Anticipation Note will not breach existing obligations; and
 - no consents of other parties are required to issue the Grant Anticipation Note.
- Bond Counsel will deliver an opinion to your agency and the lender covering: (i) the validity of the Grant Anticipation Note; and (ii) the exemption of interest on the Grant Anticipation Note from federal and State of California income taxes.

REQUIREMENTS TO SELL *TAX-EXEMPT* GRANT ANTICIPATION NOTES

- Grant Anticipation Note proceeds (and the grant or loan funds not used to repay the Grant Anticipation Notes) must be used to pay for capital expenditures on publicly owned and operated projects.
- Your agency covenants to comply with federal tax law and signs a tax compliance certificate at closing.
- Bond Counsel provides a tax exemption opinion letter at closing.
- Grant Anticipation Note proceeds can be invested until needed to pay contractors, provided that: (i) the investment rate does not exceed the interest rate payable on the Grant Anticipation Notes; and (ii) the investment term does not go beyond the final maturity of the Grant Anticipation Notes.

REQUIREMENTS TO SELL *TAX-EXEMPT* GRANT ANTICIPATION NOTES (continued)

- In addition to interest on the Grant Anticipation Notes being exempt from federal and State of California income taxation, if the agency is not issuing more than \$10 million (principal amount) of debt in the calendar year, Grant Anticipation Notes can be “bank-qualified” under Internal Revenue Code Section 265(b)(3).
- Banks are more willing to purchase “bank-qualified” debt because they can deduct 80% of carrying costs.

COSTS ASSOCIATED WITH GRANT ANTICIPATION NOTES

- Interest is payable on the Grant Anticipation Notes. If the interest is tax-exempt, the rate will be lower. If the maturity is earlier, total interest paid will be less. If you can prepay at any time with no penalty, you can avoid paying additional interest once the grant or loan proceeds come in.
- Bond and tax counsel fees (~\$30,000 for private sale). Bond counsel drafts all documents and provides an opinion that: (i) interest on the Grant Anticipation Notes is exempt from federal and state income taxation; and (ii) the Grant Anticipation Notes are valid and binding obligations of your agency under California law.
- Lender and lender's counsel fees (~\$30,000 for private sale).

COSTS ASSOCIATED WITH GRANT ANTICIPATION NOTES (continued)

- Your agency's general counsel may wish to be paid at issuance. General counsel provides an opinion as discussed on slide 7.
- Costs will be ~\$30,000 higher for a public sale because a securities disclosure (known as an official statement) is required.
- Consultant costs must be paid upon issuance, which (because it is before grant or loan proceeds are available) means that they are paid from agency revenues unless the grant or loan award contemplated using the grant or loan proceeds to pay costs of issuance.

CONCLUSION: WHY ISSUE GRANT ANTICIPATION NOTES?

- Project funding can be available on your agency's timeline, not when the State or federal government granting agency dictates.
- Cost/benefit analysis: is it better to wait until grant or loan proceeds come in to begin construction of your agency's project, or is better to pay costs of issuance and interest costs and begin your agency's project on the desired timeline?
 - The answer may depend on whether project costs will rise if there is a delay in commencement. For example, will you lose a Guaranteed Maximum Price?

CONCLUSION: WHY ISSUE GRANT ANTICIPATION NOTES? (continued)

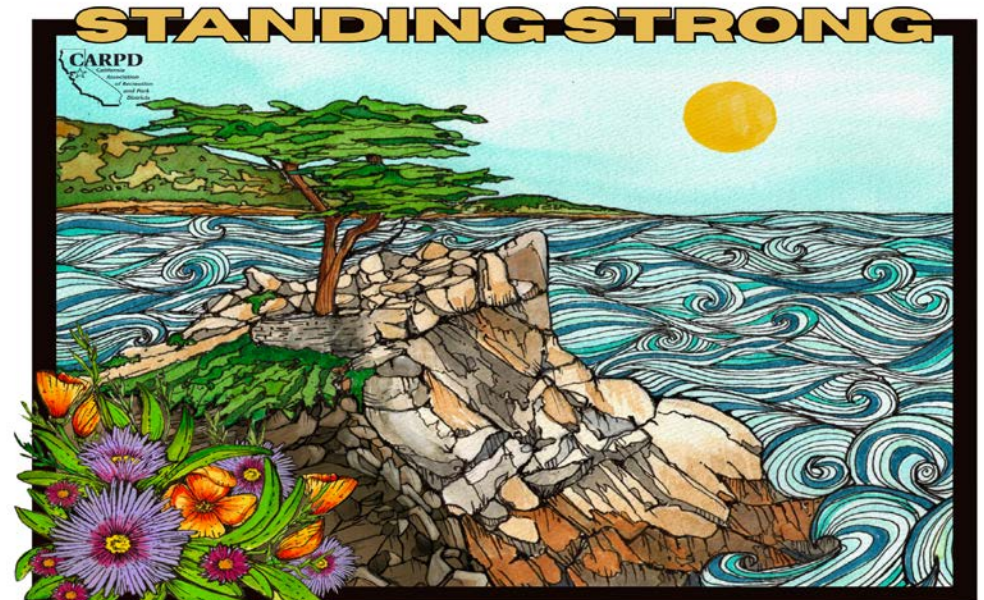
- The principal of the Grant Anticipation Notes is repayable from grant or loan proceeds, not from operating revenues.
- Grant Anticipation Notes are short-term obligations (maximum 36-month maturity), so interest costs are limited.
- Ideally, Grant Anticipation Notes will be prepayable immediately upon receipt of grant or loan proceeds, so interest would only need to be paid through the prepayment date.
- Given costs of issuance of up to ~\$90,000 which must be paid at issuance, Grant Anticipation Notes may not be appropriate for very small grants.

QUESTIONS?

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