Industrial Development Revenue Bond (IDRB) Financing

For New and Existing Manufacturing Facilities

By

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INTRODUCTION

For the past 39 years, members of Dean & Fulkerson's Economic Development Group have assisted business clients in obtaining the most advantageous financing available for their manufacturing projects.

Our goal is to assist clients in minimizing the cost of acquiring and developing new manufacturing sites and expanding or rehabilitating their existing manufacturing facilities.

This booklet deals with tax-exempt bond financing. This is a special form of financing available for construction of new manufacturing facilities, for expansion of existing manufacturing facilities and for rehabilitation of existing manufacturing facilities. Tax-exempt bond financing is a national program administered through state and county agencies. This method of financing is a cost-effective alternative to conventional financing.

This booklet will help you understand the tax-exempt bond financing program and help you determine whether you can use tax-exempt bond financing for your new project.

WHAT IS TAX-EXEMPT BOND FINANCING?

There are two kinds of bond financing available for new manufacturing facilities: "taxable" bond financing and "tax-exempt" bond financing. The adjectives "taxable" or "tax-exempt" indicate whether or not the income derived by the bond holder (or purchaser) is taxable under federal law (i.e., the Internal Revenue Code of 1986, as amended). The interest received by the bond holder of a "taxable" bond is taxable as income under the Internal Revenue Code. The interest received by the bond holder of a "tax-exempt" bond is not taxable as income under the Internal Revenue Code.

The interest rate on the "tax-exempt" bond is significantly lower than the interest rate for either conventional financing or "taxable" bonds. The lower interest rate of the tax-exempt bond results in significant savings to the borrower on its debt service.

Tax-exempt revenue bonds for manufacturing projects are also known as "Industrial Development Revenue Bonds" or IDRBs.

WHY IDRB FINANCING EXISTS

IDRB financing exists to encourage development of manufacturing facilities, to create new jobs within the jurisdiction of the governmental agency issuing the bonds or to maintain existing jobs within that agency's jurisdiction.

Although the number of new jobs created in the agency's jurisdiction is important, it is not always determinative of whether or not IDRB financing will be available for a project. In some cases, expansion of existing facilities or rehabilitation of existing facilities can receive IDRB financing without the creation of new jobs, particularly when necessary to retain existing jobs.

ELIGIBILITY FOR TAX-EXEMPT IDRB FINANCING

● Manufacturing Facilities

For purposes of the Internal Revenue Code and for IDRB financing, a manufacturing facility is defined as one which is used in the manufacture or production of tangible personal property or the processing of such property by physical or chemical change. This definition embraces the full range of operations which create goods. In short, a wide variety of operations are included – from a bakery to a stamping plant.

● New Manufacturing Facilities

New manufacturing projects are eligible for IDRB financing. IDRB financing can be used to acquire land, buildings and equipment directly related to the manufacturing process. At least 75% of the bond proceeds must be used for project costs expended for "core" manufacturing (e.g., manufacturing equipment and building area devoted to manufacturing). Up to 25% of the bond proceeds can be expended for project costs which are "directly related and ancillary" to the manufacturing process (e.g., office space, short term warehousing of raw materials and/or finished goods, sales areas, loading docks, research and development areas).

● Existing Manufacturing Facilities

IDRB financing is available for the acquisition and rehabilitation of existing manufacturing facilities. For the acquisition of existing facilities (including land, building and equipment), an amount equal to 15% of the bond proceeds must be spent on "qualified rehabilitation expenditures" to renovate the facilities within 2 years from the date of bond issuance. Note: For the acquisition of existing machinery and equipment only (not associated with the purchase of land and building), the 15% number becomes 100%, thus making IDRB financing generally impractical for equipment only acquisitions. IDRB financing for working capital and inventory purposes is not available.

REQUIREMENTS TO QUALIFY AS A
TAX-EXEMPT IDRB UNDER THE INTERNAL REVENUE CODE

The following is a general summary of the Internal Revenue Code requirements or limitations to qualify for IDRB financing:

1. Manufacturing Facilities Only. The proceeds can be used only for manufacturing facilities.

2. Term. The maturity of a bond issue cannot exceed 120% of the average, reasonably expected economic life of the assets being financed with the bond proceeds. Generally, land is not taken into account when determining the average economic life.

3. Inducement. Bond proceeds cannot be used to finance the acquisition of assets which occurred more than 60 days prior to the adoption by the governmental entity of its resolution of intent to issue revenue bonds.

4. Depreciation. Assets financed with IDRBs must be depreciated on a straight-line level yearly basis using the class life set forth in the Alternative Depreciation System rather than the more favorable Accelerated Cost Recovery System ("ACRS").

5. Use of Bond Proceeds. At least 95% of the net proceeds of the bonds must be spent for land or depreciable property (e.g., buildings, machinery, equipment). In addition, at least 75% of the net bond proceeds must be spent for "core" manufacturing facilities, i.e., property used in the production of the product. No more than 25% of the net bond proceeds may be used for purposes directly related or ancillary to "core manufacturing," e.g., warehousing, test labs, office space, plant employee areas, loading docks, etc. No more than 25% of the bond proceeds may be used for the acquisition of land. No bond proceeds may be used to purchase existing facilities without qualified rehabilitation expenditures equaling at least 15% of the bond proceeds being made within two years from the date of issuance of the bonds.

6. $20 Million Capital Expenditure Limit. If the bond issue is over $1 million, the capital expenditures of the borrower including any principal users, e.g., lessees of the bond-financed facility and of any related parties thereto, which are made in the jurisdiction in which the bond proceeds are spent, may not exceed $20 million during the 6 year period beginning 3 years before the date of issuance and ending 3 years thereafter.

7. Customer Tooling. Tooling purchased and owned by the borrower's customers but retained and used by the borrower in the production of parts may be deemed capital expenditures which count toward the borrower's $20 million limit.

8. $40 Million Company Limit. The Internal Revenue Code imposes a $40 million national limit on the aggregate principal amount of outstanding IDRBs for a borrower, its affiliates, substantial users of the facility or any related parties thereto.

9. Cost of Issuance Limitation. The issuance costs financed by the bond issue may not exceed 2% of the proceeds of the issue. Costs of issuance subject to the 2% limitation include, but are not limited to, underwriter's discount, financial advisor fees, trustee fees, state sponsoring agency fees, legal advertisement charges, bond counsel fees, rating agency fees, printing fees, paying agent fees, accountant fees, and feasibility and engineering studies related to the issuance of bonds.

10. Unified Volume Cap. Small issue IDRBs are subject to an annual volume cap in each state. The volume cap is based on a state's population. Once the volume cap is reached, the issuer may be unable to issue any bonds until the next calendar year.

11. Arbitrage Restrictions. If all of the bond proceeds are not expended in accordance with IRS regulations (primarily within 18 months after the issuance of the bonds), any arbitrage yield in excess of that permitted by law must be rebated to the federal government.

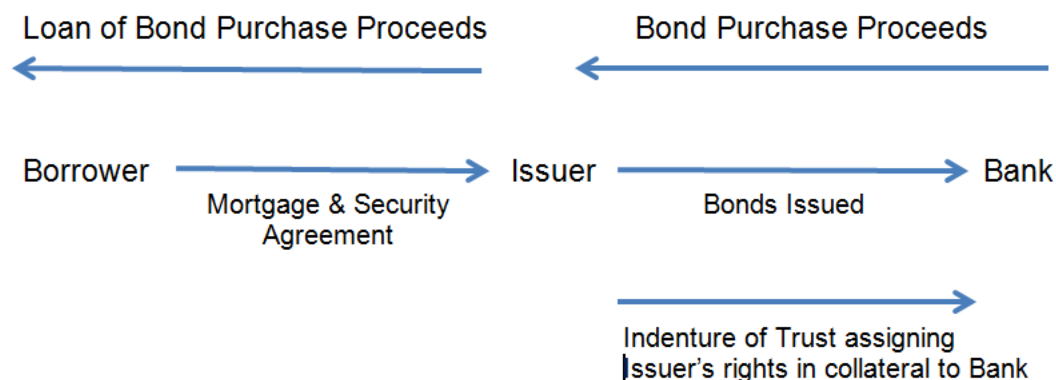
12. Refunding. Refunding (i.e., revenue bond refinancing of projects previously financed with revenue bonds) of outstanding bond issues will be permitted if the new issue does not extend maturity and the new amount does not exceed the outstanding amount of the refunded bonds.

13. Change in Use of Bond-Financed Property. Change in the use of the property financed with an IDRB to a non-qualified use may result in the loss, under present law, of tax exemption on bond interest to the bond holder.

THE BOND TRANSACTION

The parties in a direct bank purchase IDRB transaction are: (1) the Borrower, (2) the Governmental Agency issuing the Bonds (the "Issuer"), and (3) the Bank.

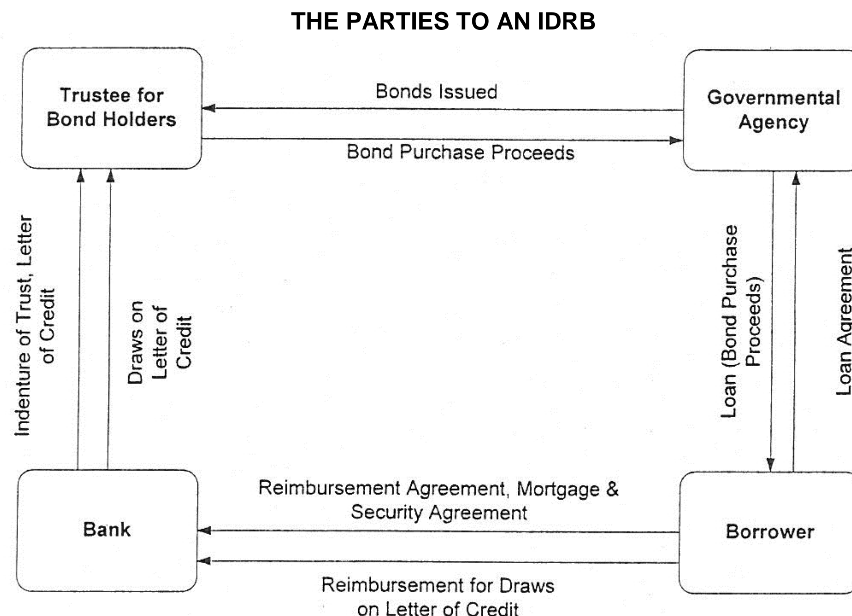
The transaction utilizes the format illustrated below:



The parties in a privately-placed or publicly-marketed IDRB bond issue sold to multiple purchasers are:

(1) the Borrower,
(2) the Governmental Agency issuing the bonds,
(3) the Bank which provides a letter of credit to the trustee for the benefit of the bond holders,
(4) the Placement Agent or Underwriter who markets the bonds to the bond holders, and
(5) the Trustee who administers the various bond funds and who services the bond holders' accounts.

Essentially, in a privately-placed or publicly marketed bond issue sold to multiple purchasers, the IDRB transaction utilizes the format illustrated below:



The Borrower executes a loan agreement with the Governmental Agency issuing the bonds. The Bank issues a letter of credit to the Trustee for the principal amount of the bonds to be issued plus 45 days' interest. The Placement Agent markets the bonds to bond holders through a private placement or public offering. The bonds are typically 25-30 year bonds with interest-only payments until redemption. The Governmental Agency issues the bonds to the bond holders in care of the Trustee. The Trustee pays the Governmental Agency for the bonds. The Governmental Agency uses these proceeds to fund the loan to the Borrower. The Trustee makes draws against the letter of credit (typically, monthly for interest and annually for principal). The Bank collects payments from the Borrower (at the same times as the Trustee makes draws on the letter of credit) as a reimbursement for the draws under the letter of credit.

In a direct purchase transaction with a bank as the sole purchaser, the bank purchases the bonds from the Governmental Agency in accordance with the terms of a Bond Purchase Agreement. The Governmental Agency loans the bond proceeds to the borrower and the borrower provides collateral to the Governmental Agency and to the bank to secure its obligation to repay.

Usually, the initial interest rate mode on the bonds is a variable or “floating” rate. The bonds can be redeemed (or prepaid) at any time without premium or penalty as long as the bonds are in a floating rate mode. The interest rate floats at approximately 40% to 65% of prime. The bonds (or portions of the bonds) may be assumable by a successor entity qualified to participate in the IDRB program. The interest rate on the bonds can, at the option of the Borrower, be converted from a floating rate to a fixed rate.

The Borrower can be either a user of a manufacturing facility or the owner (landlord) of the manufacturing facility when the facility is being leased to a qualified tenant engaged in manufacturing and otherwise meeting the IRC requirements for an IDRB. Thus, an owner/landlord of a manufacturing facility can qualify for IDRB financing as well as an owner/user.

Typically, the IDRB transaction is closed within 90 to 120 days from the date the governmental agency issues its “Resolution of Inducement,” approving the borrower as an entity qualified to receive IDRB financing.

PLANNING FOR YOUR TAX-EXEMPT IDRB FINANCING

To obtain tax-exempt IDRB financing for your manufacturing project, you will need to plan ahead. Before entering into a binding purchase agreement for the purchase of land or construction of a facility for manufacturing purposes, consult with an attorney who specializes in tax-exempt IDRB transactions. This is a specialty practice in the law. Your attorney can help you determine whether your manufacturing project will qualify for tax-exempt IDRB financing.

Your attorney also will assist you in preparing and presenting your application to the Governmental Agency with the required disclosure information and help you identify those financial institutions that are willing to issue a letter of credit to support the marketing of the IDRBs to the ultimate bond holders.

Remember that IDRB financing can be used in conjunction with conventional financing or taxable bond financing on the same project. IDRB financing can be used to finance the “qualified” portion of the project. Conventional or taxable bond financing can be used to finance the remainder or “non-qualified” portion of the project.