AC28 File: ACCOUNTING AND FINANCE

FINANCING WITH INDUSTRIAL DEVELOPMENT BONDS

SUMMARY

Members should find this introduction to tax-exempt financing useful when planning for future capital expenditures. This BMA is intended to provide only a brief summary of the bond financing process. Members are encouraged to seek a thorough understanding of the industrial revenue bond program before initiating a new project.

INDUSTRIAL DEVELOPMENT FINANCING

Sometimes referred to as the "financing vehicle of choice," tax-exempt Industrial Development Bonds (IDBs) offer the business owner a low cost alternative when purchasing land, buildings and equipment. Industrial development financing is a technique for using tax-exempt bonds issued by a state or local government entity to borrow capital funds at interest costs found in the "municipal" tax-exempt financial market. From the standpoint of the borrower, these "IDBs" are very similar to a commercial bank loan without the high interest costs and rapid repayment schedules. Interest rates are generally in the low 3% range and have averaged 4.40% for the past 15 years. Amortization payments are negotiable and can be reset from time-to-time. The maturity of the bonds can extend out to 30 years and are also set at the option of the borrower.

CAPITAL EXPENDITURES

Industrial Development Bonds, or IDBs, are available for manufacturing companies that will use the proceeds for capital expenditures. The Internal Revenue Code of 1986 (the "Code") defines capital expenditures as those funds used for the acquisition of land, the construction of a new building or the purchase of an existing facility, and the purchase of new equipment. In keeping with the intent of the enabling legislation to have IDB's benefit small and midsize businesses, the capital expenditures of a particular project must not exceed $10 million within the political jurisdiction where the project is located. Also included are the capital expenditures in that jurisdiction within the past three years and those that will be made in the succeeding three years. Beyond the nature and the amount of capital expenditures, the rules vary widely and are outside the scope of this article. It is significant to remember that if you are a manufacturer and can meet the expenditure tests, your project will qualify for IDB financing.

THE IDB PROCESS

The IDB "process" involves a number of participants and a number of steps. It is important to keep in mind that unlike most government related programs IDBs are relatively logical and simple to utilize. The principal participants are the municipal issuer (city or county), the borrower (either the manufacturing entity itself or the individual owner or family partnership when state planning is a consideration), a commercial bank to act as guarantor via a letter of credit, a bond counsel firm, a trustee, a rating agency and the financial advisor/underwriter. These participants constitute the "financing team," usually led by the financial advisor, who takes you through the issuance process. A typical time frame is 60 to 90 days and is not all that different from a commercial bank financing. Of all the participants the single most important is the bank providing the guarantee or letter of credit. Usually the borrower or company already has a strong banking relationship with a commercial bank and the latter would be the logical choice to provide the letter of credit. The role of the financial advisor is to bring together the financing team, keep the financing project on budget and represent the interests of the borrower in dealing with the bank and the various counsels.

QUALIFIED COMPANIES

Once a determination is made that a company qualifies for IDB financing, the major steps include an initial application to a municipal entity (the "inducement resolution"), a commitment letter from the bank for the letter of credit, an approval from a state agency, the drafting of documents, and the sale of the bonds. The entire process is user friendly with the goal being to help growing manufacturing companies obtain financing at rates competitive with those available to larger corporations. The date of the inducement resolution is noteworthy in that it establishes a legal benchmark after which any expenditures that the borrowing company incurs can be recovered from bond proceeds. The costs of obtaining industrial revenue bonds are generally a percentage of the bond amount, are quoted on a fixed price basis and are contingent upon a successful bond closing. In most cases these issuance costs range between 2% and 4% of the bond amount. The Code allows up to 2% of issuance costs to be financed from bond proceeds.

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