

## **Industrial Development Bonds**

### **PURPOSE**

Industrial development bonds ("IDBs") were developed by the US Congress and the Missouri General Assembly to facilitate the financing of business projects. In 1986, a significant change in the federal tax laws severely limited the use of tax-exempt IDBs. The various types of IDBs are discussed below.

### **METHODS OF ISSUANCE**

#### **"CHAPTER 100" CITY OR COUNTY INDUSTRIAL DEVELOPMENT BONDS**

Sec. 100.010 to 100.200, RSMo allows cities or counties to purchase or construct certain types of projects with bond proceeds and to lease or sell the project to a company. These "industrial development" bonds may be issued either as a "revenue" bond or a **general obligation** bond.

### **ELIGIBLE PROJECTS**

The purchase, construction, extension and improvement of warehouses, distribution facilities, and industrial plants, including the real estate either within or without the limits of such municipalities, buildings, fixtures, and machinery; except that any project of a municipality having fewer than eight hundred inhabitants shall be located wholly within the limits of the municipality. (HB 1656 of the 1998 legislative session will go into effect 1/1/99 which adds "office" projects.)

### **REVENUE BOND**

An industrial development "revenue " bond does not require a public vote and does not have the general credit of the city as a guarantee. Since revenue bonds are merely a "pass through" (as the bonds are sold on the basis of the company's credit), there are four reasons that Chapter 100 Revenue Bonds may be a benefit:

The interest received by the bondholders may be exempt from federal and state income taxes, if the project is eligible. (See Tax-Exempt Bond Requirements)

Real estate or other assets may be exempt from some or all property taxes if structured as a lease to the company. (See Property Tax Exemption/Abatement)

The company may desire an "off-balance sheet" lease structure, with the city/county owning the facility. The lease could be structured as an "operating" lease under generally accepted accounting standards; and

If the city/county owns the facility and purchases the building materials, the building materials would likely be exempt from state and local sales taxes. (See Sales Tax Exemption)

### **GENERAL OBLIGATION BOND**

A "general obligation" Chapter 100 Industrial Development Bond requires a 2/3 public voter approval since it will have the credit of the city or county issuer as a guarantee on the bonds. The 4/7 vote on municipal general obligation bonds does not apply to "industrial development" general obligation revenue bonds. The benefit of General Obligation bonds is that the bonds are highly marketable, whether or not the company's credit is good. Even if the company's credit is good, General Obligation bonds typically will have a somewhat lower interest rate.

It is rare in Missouri for a city or county to issue general obligation, industrial development bonds. The downside to this approach is that if the company (who is the underlying borrower or lessee) defaults, the city or county must make up any deficiency to the bondholders either by their budget reserves or an increase in property taxes. The limited number of general obligation bonds that have been issued were for industrial buildings that were highly marketable to other companies.

## **TAX-EXEMPT INTEREST**

The interest paid to bondholders may be exempt from federal income taxes if the project meets eligibility requirements that would allow a lower interest rate. (See Tax-Exempt Bond Requirements for eligibility.) Most industrial revenue bonds would be exempt from state income taxes whether or not they would be exempt from federal income taxes, however, since state income taxes are low, this is a negligible benefit. Taxable bonds may be issued if the project does not meet the federal eligibility requirements, but there is no significant benefit compared to conventional financing by a bank or other lenders.

## **PROPERTY TAX EXEMPTION/ABATEMENT**

Upon the approval of the city/county issuer, it may be possible to exempt/abate most of the real and/or personal property tax of new real estate improvements and new machinery financed by a Chapter 100 bond. To enact this procedure, the city/county must own the assets financed by the bonds and an eligible company would lease the assets from the city/county for the term of the bonds. The amount and term of abatement/exemption depends on a negotiation with the city/county issuer, as they have the discretion to abate any portion of the property taxes. In effect, the property tax is exempt by virtue of public ownership, however, the city/county may require that a portion of the payments otherwise due will be paid in the form of a payment in lieu of tax.

The possible exemption of personal and/or real property as described in this section should be fully discussed with the city/county attorney, as the Department of Economic Development (DED) does not necessarily represent the validity of this procedure. Various reputable attorneys have represented that this procedure is valid, however, state statutes do not specify this procedure. Some of the cities and counties that have issued Chapter 100 bonds for the purposes of tax abatement/exemption in the recent past are Kansas City (several companies), Cape Girardeau County (Procter and Gamble), O'Fallon (MEMC), Farmington (Huffy Bicycle), and Buckner (Bean Lumber). Before indicating how much a company may save in property taxes, it is important that the county tax assessor rule on how he/she will value the lease. Some assessors required a property tax based on the "bonus" value of the lease (the value remaining when the bonds are retired).

There are other possible ways to abate/exempt real and personal property taxes including bonds issued by a Land Clearance for Redevelopment Authority (limited to only certain types of cities), Planned Industrial Expansion Authority bonds (also limited to certain types of cities), or the Missouri Development Finance Board. In addition, real property abatement is also possible through Enterprise Zones, Tax Increment Financing, Brownfield Redevelopment Program, and Chapter 353 Urban Redevelopment Corporations, but these programs do not affect personal property. Port Authorities may issue IDBs, but do not have many of the other powers of Chapter 100 bonds.

DED strongly recommends that a city or county obtain the endorsement of all taxing authorities **before** they offer any type of tax abatement to a company. It is not a legally required procedure, but history has demonstrated it is a very good practice to prevent poor public relations and possible lawsuits.

## **PLAN**

Any municipality proposing a Chapter 100 project for industrial development shall first, by majority vote of the governing body of the city/county, approve the plan for the project. The plan shall include the following information pertaining to the proposed project:

A description of the project;

An estimate of the cost of the project;

A statement of the source of funds to be expended for the project;

A statement of the terms upon which the facilities to be provided by the project are to be leased or otherwise disposed of by the municipality; and

Such other information necessary to meet the requirements of sections 100.010 to 100.200.

### **BIDDING, WAGE RATES**

Since a private company will provide the funding for payments on Chapter 100 Revenue Bonds, there appears to be adequate precedence that bids are not required and wage rates are not in effect. A city/county should be aware of Section 100.170, RSMo, which says: "Whenever the approved plan for the project calls for the construction, improvement or extension of facilities, the municipality shall enter into a contract for the purpose. All contracts shall be let on competitive bidding to the lowest and best bidder. Notice of the letting of the contracts shall be given in the manner provided by section 8.250, RSMo." However, *Wring v. City of Jefferson (Mo.)*, 413 S.W.2d 292, indicates that: "This section is ordinarily applicable only to contracts whereby city itself assumes obligation or indebtedness, and a third class city is not required to let construction contracts for projects financed by industrial revenue bonds by competitive bidding to lowest and best bidder." Given this information, the city/county should ask the advice of their attorney.

### **"CHAPTER 349" INDUSTRIAL DEVELOPMENT CORPORATIONS**

Sec. 349.010 to 349.100 establishes industrial development corporations (IDCs) for the purpose of issuing taxable bonds or tax-exempt bonds for eligible projects (see definition below). There is no voter approval required and the general credit of a city or county does not guarantee the bonds. An IDC does not have taxing authority. Many IDCs own property or buildings and lease them to companies. Since 1986 (due to the federal tax changes reducing the eligibility of tax-exempt bonds), the number of IDC issued bonds has dropped significantly.

### **LOCAL FUNDING**

It is a fairly common practice for a city or county to provide funds to an IDC for various economic development purposes, such as marketing or incentives. However, such transactions are done as a contract for services as a grant may not be legal.

### **TAX-EXEMPTION**

IDC bond requirements for federal tax-exemption of the interest to the bondholders is the same as Chapter 100 bonds.

### **PROPERTY TAX ABATEMENT**

Property taxes cannot be exempted by the use of IDC bonds, and an IDC has no authority for general obligation bonds to be issued.

### **MISCELLANEOUS PROVISIONS**

Property may be owned by an IDC and leased to a company. IDCs have no power to enact eminent domain. Wage rates and bidding are not required for Chapter 349 bonds.

"Project" means the purchase, construction, extension and improvement of plants, buildings, structures, or

facilities, whether or not now in existence, including the real estate, used or to be used as a factory, assembly plant, manufacturing plant, processing plant, fabricating plant, distribution center, warehouse building, public facility, waterborne vessels excepting commercial passenger vessels for hire in a city not within a county built prior to 1950, office building, for profit or not for profit hospital, not for profit nursing or retirement facility or combination thereof, physical fitness, recreational, indoor and resident outdoor facilities operated by not for profit organizations, commercial or agricultural facility, or facilities for the prevention, reduction or control of pollution. Included in all of the above shall be any required fixtures, equipment and machinery. Excluded are facilities designed for the sale or distribution to the public of electricity, gas, water or telephone, together with any other facilities for cable television and those commonly classified as public utilities. Projects of a municipal authority must be located wholly within the incorporated limits of the municipality except that such projects may be located outside the corporate limits of such municipality and within the county in which the municipality is located with permission of the governing body of the county. Projects of a county authority must be located within an unincorporated area of such county except that such projects may be located within the incorporated limits of a municipality within such county, when approved by the governing body of the municipality.

### **MEMBERSHIP**

All IDC directors (not less than 5) shall be appointed by the chief executive officer of the county or municipality with the advice and consent of a majority of the governing body of the county or municipality. All directors must be residents of that city or county.

### **MISSOURI DEVELOPMENT FINANCE BOARD (MDFB)**

Sec 100.250 establishes the Missouri Development Finance Board (MDFB), an independent agency affiliated with DED. The MDFB has the ability to issue tax-exempt bonds (for eligible projects) or taxable bonds. The MDFB cannot issue general obligation bonds.

MDFB revenue bonds may exempt property taxes (similar to the ownership/lease provisions of a Chapter 100 bond), however, MDFB's policy is to do so only if the affected local governments request the exemption.

The MDFB has the power to issue all types of IRBs for nearly any type of project anywhere in the state. They cannot enact eminent domain, and cannot pledge the credit of the state to guarantee a bond issue that benefits a private company. The MDFB can guarantee a bond (using state tax credits) if the proceeds are used only for a public infrastructure facility owned by a public entity.

The MDFB occasionally issue bonds for public infrastructure or buildings where the MDFB would own the facilities and lease them to a public entity. The public entity would make an annual appropriation from their budget for lease payments; therefore, it is not considered a long-term debt that requires a public vote. This transaction is similar to a "6320" non-profit corporation, many of which are called "public facility authorities", as created by local governments.

### **INFORMATION ON INDUSTRIAL DEVELOPMENT BONDS TAX-EXEMPT BOND REQUIREMENTS**

Requirements for the interest on industrial development bonds to be tax-exempt to the bondholders;

The benefiting company must be a manufacturer (SIC 20-39 generally);

Capital expenditures of the company (within that city, or county if not in a city) must be less than \$10 million for the past 3 years and the next 3 years combined. (This includes all sources of funds for any capital expenditure except operating leases for real estate, or machinery/equipment.)

Bond proceeds may finance only fixed assets (real estate, machinery/equipment, etc.).

Total outstanding tax-exempt bonds for all related companies of the borrower cannot exceed \$40 million. ("Related" includes companies that are owned by a majority interest.)

Must obtain a "tax-exempt allocation" by the Missouri Department of Economic Development. The federal tax laws allows DED to issue up to about \$270 million each year in tax-exempt bonds for industrial development, first-time farmers, student loans, multi-family housing, low-income housing, and "exempt" facility bonds. The demand for the allocation greatly exceeds the limit.

Other requirements, which depend on the specific case.

### **SALES TAX EXEMPTION**

Building materials and other real property improvements financed with Chapter 100 revenue bonds may be exempt from state and local sales taxes. To qualify for this exemption, the city/county must use their exemption certificate and comply with other procedures as established by the Missouri Department of Revenue.

### **MARKETING OF THE BONDS**

For any of the methods cited above except general obligation bonds, industrial revenue bonds are sold to investors solely on the credit of the company; therefore, it makes little difference that the issuer is. Bond investors are very conservative, therefore, the company must be very creditworthy (preferably with a rating from S&P or Moodys), or, be able to obtain a letter of credit from a regional or national bank to guarantee the bonds. Unfortunately, the IRB route is not practical for expansions of small companies or start-ups who need the interest rate break the most.

Prior to 1986, banks were the largest purchasers of tax-exempt IRBs; however, the tax reform act of 1986 eliminated the tax benefits of IRBs from banks. Since then, institutional buyers, such as insurance companies, mutual funds, and wealthy individuals who can benefit from the tax advantages of tax-exempt investments have purchased most IRBs. Some companies have bought their own tax-exempt bonds, but there are restrictions that make this somewhat problematic.

### **INTEREST RATE, TERM**

The interest rate of IRBs depends upon several factors - term, fixed or floating rate, credit rating, and current market conditions. Tax Exempt rates for a one-year floating rate based on a AAA letter of credit generally will be about 50 basis points (1/2%) below the one year US Treasury bills. Historically, this has been about 57% of the prime rate. For lesser credit ratings, generally add 25 basis points for an AA rated and 25 more for A rated. For a fixed rate AAA rated 20-year bond, the rate would be about the same as a 20-year Treasury bill.

Generally, purchasers prefer shorter terms, floating rates, and an investment grade credit rating by Standard and Poors or Moodys by the company, or a letter of credit from a highly rated bank. The issuance fees (attorney, underwriter, trustee, printing, etc.) can range from 2.5% - 4% (generally about 3%), depending upon the amount of the bond issue (the smaller the issue, the higher the fees), and the difficulty in selling the bonds. In addition, annual letter of credit fees (if applicable) can range from .5% to 1.5%. Generally, an issue less than \$500,000-\$1,000,000 may not be cost effective due to the fees and marketing difficulty.

The term of bonds is generally negotiated between the company and a bank that may issue a letter of credit or the purchaser (if the bonds are sold as a private placement to primarily one buyer). Federal tax law limits the term of tax-exempt bonds to 125% of the useful life of the asset.

If a company is interested in pursuing a tax-exempt bond, it should:

Discuss the possibility of a letter of credit with a regional bank; or

Engage the services of a reputable investment-banking firm to analyze the company's options of selling the bonds without a bank letter of credit.

### **INDUCEMENT RESOLUTION**

Prior to the commencement of the project, the issuer must authorize an "inducement resolution", which basically indicates the issuer agrees to issue the bonds if a buyer can be found. Since the issuer is not providing a guarantee for the borrower, the only reason an inducement resolution would be denied is if the project would in some way be an embarrassment to the issuer. (Such a situation may be an environmental problem, competition with an existing industry, past financial problems, or obvious inability to service the debt.) In reality, if the project is not creditworthy, the company will not be able to attract a buyer for the bonds. Therefore, the issuer doesn't have to worry about a thorough credit analysis of the company.

The bonds should generally be issued within a year from the date of the inducement resolution. The issuer may provide an extension. Generally, the federal tax laws provide that any costs incurred within 60 days prior to the date of the inducement resolution may be financed with bond proceeds.

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