

Revenue Bond Financing and Incentives for Developer-Driven Projects



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By John Mazyck

States, municipalities, and other governing bodies in the United States have traditionally focused their economic development activities and incentives on potential industrial and manufacturing projects. These projects have been the main drivers of job creation and tax revenue collections for many years. For a variety of reasons, both legal and economic, these governing bodies have expanded their slate of incentives to include a much broader use of conventional IRB financing along with a substantial enhancement to the incentives available to developers of retail, office, and other commercial development. This article addresses these developments.

Expanded Use of Industrial Revenue Bond (IRB) Financing

Traditional manufacturing projects have often been and are financed through the issuance of tax-exempt Industrial Revenue

Bonds (IRBs). Issuing IRBs allows a qualifying company to access the debt markets at substantially lower rates than conventional bank loans because the debt issued is exempt from all forms of taxation to the buyer of the debt.

For example, let's say XYZ Manufacturing issues \$8 million in tax-exempt bonds to finance a new plant in California. The debt is sold to a bond fund, and the interest income received by the bond fund is exempt from all taxation. This means that the bond fund is willing to accept a substantially lower rate (3.3 percent today) for the debt, resulting in a much lower cost of capital for XYZ Manufacturing.

While IRB financing is obviously a very meaningful incentive to a company like XYZ Manufacturing, it is increasingly difficult for manufacturing facilities to qualify for this option. Legislation passed in 1987 aimed at curbing the issuance of tax-exempt debt, stipulated that

IRBs can be issued only by those firms making a total capital investment of less than \$10 million at any particular site.

As the cost of land and construction has gone up, this \$10 million limit precludes many firms from taking advantage of IRBs. However, there is good news on the immediate horizon. Starting January 1, 2007, the \$10 million limit on the total capital investment goes up to \$20 million per project. Firms are still limited to issuing \$10 million in bonds per facility, but we expect to see a wave of new facilities that qualify under the new capital investment rules.

Financing Incentives for Developer-Driven Projects

As the tax base of governing bodies has moved away from manufacturing to retail, office, and commercial, public officials have struggled to come up with legal options to entice developers to locate tax-generating projects in their communities. Some areas of the country are in the enviable position to offer no incentives to developers, as their demographics are exactly what a developer wants. Other areas present developers with a more challenging economic demographic picture and inherently riskier situations. These areas must provide some incentive to lure the project to the area.

The range of incentives communities may legally offer developers of retail, office, and commercial projects varies widely from state to state and is always a politically-charged issue. In some areas, a city or county may inject its own cash or issue debt in direct support of a project, while in other areas, legislation and local politics preclude such subsidies. We have financed projects on both ends of this spectrum and believe that the following two financing vehicles will be of interest to you and your clients.

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1. Improvement District Financing

Many states have passed Improvement District acts to provide for the creation of a new form of public corporation (an "Improvement District") for the purpose of assisting in the development of certain commercial projects. These districts present a new opportunity for developers and landowners to finance a portion of their projects with tax-exempt bonds. These bonds are issued by an Improvement District and are secured by assessments levied on district property, revenues, letters of credit, and/or guarantees.

The following may be financed with tax-exempt bonds in an Improvement District:

- Docks, Harbors and Wharves
- Electrical Substations

- Erosion or Flood Control Facilities
- Fire Protection Facilities
- Hospitals
- Landscaping and Fountains
- Mass Transportation Facilities
Airports
- Natural Gas Distribution Systems
- Parking Facilities
- Pedestrian Malls
- Police or Sheriff Stations
- Public Libraries
- Public Parks, Lakes, and Dams
- Public Recreational Facilities
- Railroad Lines and Spurs
- Sanitary Sewer Systems
- Schools
- Solid Waste Disposal Plants
- Storm Sewer Systems
- Streets, Bridges, Sidewalks,
Curbs and Gutters
- Water Systems

*“Capital
Improvement
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for improvements within the development. While this level of government support of a project is remarkable, we have financed multiple Capital Improvement Cooperative District projects and see it more and more each day.

The world of economic development has changed, making substantial incentives available to your clients. Please don't hesitate to contact us if we can be of assistance to you and your SIOR clients in taking advantage of these opportunities.

2. Capital Improvement Cooperative Financing

While Improvement District financing represents a vehicle for developers to issue tax-exempt debt for the qualifying areas of their developments, Capital Improvement Cooperative Districts allow for direct government support for a project. A Capital Improvement Cooperative District is created by a government entity (or a group of government entities) that deems it is in its best interest to lend direct government support to a development project. This often happens when several areas are in competition for the same project.

In this type of district, a city or county can issue bonds backed by its own credit and pay