

Summary of Bond Financing Options Including Tax-exempt, Taxable, Exempt-facility and Sales Tax Bonds

The authority to issue tax-exempt Industrial Revenue Bonds was reinstated when "Title XIII, the Revenue Reconciliation Act of 1993," was signed into law on August 10, 1993. The previous guidelines and requirements remain in effect.

Bonds may be issued by non-profit development corporations or authorities ("IDCs or issuers"), pursuant to the Development Corporation Act of 1979 (the "Act"). The Act allows non-profit corporations to issue bonds on behalf of cities, counties, conservation or reclamation districts ("governmental units") for eligible projects. The purpose of bond financing is to promote new and existing businesses, encourage employment in the state, and increase the tax base of the community where the project is located.

IMPORTANT NOTE: These guidelines are general and specific questions should be referred to the local IDC or an attorney who specializes in bond issues ("bond counsel"). The use and issuance of bond financing is governed by both state and federal laws. The Act requires that certain bonds be approved by the Texas Department of Economic Development ("the Department") and also by the Attorney General's Office. The bonds are repaid from revenues of the business and do not constitute obligations of the IDC (except for Sales Tax Bonds, which are described below), the governmental unit, the Department or the State of Texas.

All projects must be located within the boundaries of the sponsoring issuer and governmental unit unless the IDC is requested to issue bonds by another governmental unit. Generally, the terms may be fixed or variable, less than prime, and amortized over the useful life of the assets being financed.

Types of Bonds Available:

Tax-Exempt Industrial Revenue Bonds for Manufacturing Projects: Bonds issued to finance land and depreciable property for manufacturing facilities. Manufacturing is generally defined as companies that manufacture or produce tangible personal property, including processing resulting in a change of such property. Since the interest earned by the bond purchaser is exempt from federal income taxes, the bonds are sold at a lower rate of interest than conventional financing, thus lowering the cost of capital for a project.

The advantages of IRBs include:

- * Access to long-term financing.
- * Lower interest rates.
- * No income tax on interest earned by bond purchasers.
- * Increase in community's tax and employment base.

The maximum bond amount is \$10,000,000. However, the actual amount may be lower since the bond amount AND certain capital expenditures made by the business within the issuer's jurisdiction for 3 years back and 3 years forward cannot exceed \$10,000,000. Capital expenditures made for facilities located outside of the issuing corporation's jurisdiction would not be included in calculating the \$10,000,000 limitation of the new issue. IRBs may not be used to finance a portion of an overall project within one political jurisdiction, unless the total project size is less than \$10 million. The bonds will become taxable at the point capital

expenditures on the project exceed \$10 million. The maximum any company can have in IRBs outstanding nationwide is \$40 million.

In general, only costs that have been incurred after the execution of an inducement resolution (declaration of intent) can be recovered through bond issuance. The applicant may incur certain expenses such as surveys, soil testing and preliminary architectural and engineering fees prior to inducement.

Up to 2% of bond proceeds may be used to cover issuance expenses. All other financing costs are paid by the user. Non-capitalized costs, which include issuance costs, cannot exceed 5% of the bond proceeds.

Eligible project costs include the acquisition by a business of an existing facility, acquisition of land, construction of new facilities, machinery, tools, equipment, limited costs of issuing the bonds, such as legal fees, and administrative costs. Only office space that is directly related to the day-to-day operations of a project may be financed. Commercial projects are not eligible.

These issues must receive a reservation under the State's volume limitation ("volume cap") managed by the Bond Review Board. The Tax Reform Act of 1986 imposes a volume ceiling on the aggregate principal amount of "private activity bonds" that may be issued within the state during any calendar year. Currently, the Bond Review Board holds its annual lottery for volume cap allocation in October of every year.

Exempt-Facility Bonds: Bonds issued to finance certain facilities such as airports, dock and wharf facilities, mass commuting facilities, high-speed inter-city rail facilities, or certain qualified hazardous waste facilities (including certain training and storage facilities). There is not a limit on the amount of the issue and these issues do not require a reservation under the volume cap. Although the facility must be governmentally owned, it may be leased or subject to management contracts with the business. These issues must be approved by the Department and the Attorney General's Office.

Other types of exempt facility bonds include projects for water, sewage and solid waste facilities, qualified residential rental projects, facilities for the local furnishing of electricity or gas, local district heating or cooling facilities. These types of exempt-facility issues must reserve a portion of the volume cap, receive AG approval and if the issuer was formed under the Development Corporation Act of 1979, the Department's approval is generally required.

Exempt-facility bonds that are not governmentally owned may reserve up to \$25 million in tax-exempt volume cap allocation each year, however there is no restriction to project size.

Taxable Industrial Revenue Bonds: Although these bonds typically have higher interest rates than tax-exempt issues, these issues do not have restrictions on the use or amount of the issue. In addition, they are not required to reserve a portion of the volume cap. The process and fees are the same as the tax-exempt issues.

Sales Tax Bonds (Bonds Issued pursuant to Sections 4A and 4B of the Development Corporation Act): Available only for those cities that have passed the local Sales and Use Tax for Economic Development. These can be taxable or tax-exempt bonds, depending on the

type of project and business. Issues are primarily for manufacturing or industrial projects, but can also be issued for commercial, recreational, infrastructure, and other types of projects. Bonds that utilize economic development sales tax as collateral may not be issued for projects that fall outside the guidelines as set forth in Section 4A and/or 4B of the Development Corporation Act of 1979. This type of bond does not have a limitation as to the amount and may not require a portion of the volume cap. These bonds do not require approval by the Department. Bonds are secured and repaid by proceeds from the Economic Development Sales and Use Tax collected by the city. Ineligible projects include for-profit hospitals, multi-family projects and municipal services. These issues must be approved by the Attorney General's Office.

Empowerment Zone Bonds: Empowerment Zone Bonds (EZ Bonds) are allowable for projects located in federally designated empowerment zones or enterprise communities. The bond financed amount for any business user may not exceed \$3 million in any one zone and cannot exceed \$20 million for that user nationwide. Projects can be either manufacturing or commercial in nature. Eligible costs include: new construction, purchase of existing property that will have its first in-zone use pursuant to the financing, and renovation of in-zone property. The user must be an in-zone, local hire business (i.e. 35% zone resident employees). EZ bonds do not have the same capital expenditure limits imposed on small issue IDBs. In addition, EZ bonds have a special exemption from the 25% limitation of bond proceeds for the acquisition of land. These bonds require the approval of the Attorney General's Office, Texas Bond Review Board and generally the Texas Department of Economic Development.

Procedures for issuing IRBs:

At the beginning of the process, it is important for businesses to contact the local IDC. The local city officials may be able to assist in contacting the IDC. A bond counsel will be contacted to determine eligibility and feasibility of the project, to prepare and review documents, package the applications, and to verify availability of authority if the project requires a portion of the volume cap through the Bond Review Board.

It is important to note that only after a "Declaration of Official Intent" (formerly called an "Inducement Resolution") is adopted by the IDC can certain costs associated with the project be reimbursed from the bond proceeds.

- * Applications for projects are made directly to the local IDC. The Board of Directors will consider the project.
- * Once the project is determined to be eligible, a Declaration of Official Intent is passed by the Issuer's Board of Directors with the assistance of Bond Counsel.
- * A Public Hearing must be held.
- * Through the counsels, the documents are then negotiated between the business, issuer, and bond purchasers.

- * The issuer will pass a bond resolution which authorizes the project, principal amount of the bonds and makes findings regarding the project as required under state and federal law.
- * After the passage of the bond resolution, the governmental unit will review the issuer's resolution and issue a Unit resolution.
- * If a bond is required to reserve a portion of the volume cap, bond counsel will prepare the application to the Bond Review Board.
- * After receiving a Reservation of the state ceiling, if required, bond counsel will prepare and submit the IRB application to the Department and the Attorney General's Office.
- * After approval the bonds are closed, issued and delivered.

Fees: Fees are required by the Department and the Attorney General's Office. The fees are due at the time of filing the application. If a project is subject to the volume cap, additional fees are required by the Bond Review Board.

For more information, please contact:

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For Information Regarding:
State Volume Cap and Private Activity Bonds

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