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Industrial Development Bonds: An Often Overlooked Opportunity for Expansion

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Industrial Development Bonds: An Often Overlooked Opportunity for Expansion

By Eric Dusch, Chief Commercial Officer, Equipment Finance at GE Capital, Corporate Finance

Industrial development bonds (IDBs) are a relatively unpublicized and often misunderstood source of tax-advantaged financing for business that declined in usage during the recession. Now, however, as the economy strengthens and companies begin to consider new equipment and new projects to expand operations, IDBs are worth a closer look.

But first, what exactly are IDBs? How do they work, and who should use them? In brief, they are tax-exempt bonds—up to $10 million per deal—issued by a state or local government entity to finance qualified manufacturing and processing companies looking to expand, improve, replace or relocate facilities. IDBs can be used for the purchase of new equipment, the construction or acquisition of facilities and other projects intended to help drive local economic growth.

For example, a manufacturer of steel structures and related products for the utility and telecom industries in Texas and surrounding states decided to increase production capacity. After a search for suitable property, the company found an existing facility in Ohio where it could make the necessary renovations to set up new design and fabrication operations. The company financed the project through an IDB, which was issued through the county of Defiance, Ohio, which acts as a conduit for the IDB financing. In this case, the financier purchased the entire $7 million bond issue for its own portfolio from the government entity which, in turn, lent the money to the manufacturer.

While the ability to finance an expansion and acquire facilities are relevant financing applications for borrowers, IDBs also offer three unique advantages—and a few common misconceptions.

Three Advantages

Tax-Exempt Financing: For borrowers, the most obvious advantage of IDBs is the ability to access tax-exempt financing normally reserved for governments and non-profit organizations. In a normal interest-rate environment, IDB's tax-exempt nature is a strong advantage over conventional financing. However, the very low interest rate environment for conventional financing has lessened IDB's comparable advantage over the last few years. That's starting to change now that interest rates are starting to rise.

Turn-Key Solution: Another advantage of IDBs is they can fund equipment and real estate. For example, a borrower can purchase new equipment, renovate and expand a facility or buy a new one. This makes IDBs an ideal turn-key financing solution that allows a company to lock-in a low, long-term rate under one bond issue. The fact that this bond can include real estate is also attractive.

Property-Tax Abatements: In conjunction with the tax-exempt bonds, some government entities will grant other tax incentives such as property-tax abatements to encourage companies to expand or establish facilities that create jobs in their jurisdictions. For instance, in a payment-in-lieu-of-taxes loan or lease, the deal is structured with the government entity holding title to the financed asset in order to eliminate the property tax typically assessed to the customer.

Three Misconceptions

The Governmental Entity Makes Payments: One common misperception with IDBs is that the governmental entity is responsible for bond payments, since technically it is the issuer of the bonds. In fact, these deals are structured as pass-through facilities. The governmental entity is merely a "conduit" and not responsible for the bond payments. It does, however, allow for companies to benefit from the tax-exempt status of the IDBs. These entities are typically motivated to help a company expand their operations by acting as issuer.

IDB Structures are Complicated: IDBs can be structured in a variety of ways, some more complicated and expensive than others. For instance, the bank might arrange additional credit enhancement for the IDB in the form of a letter of credit and then sell the bonds to investors who are looking solely to the letter of credit for repayment. This is a relatively complicated process and adds additional cost, structure and risk to the beneficiary of the bond issue. But IDBs can be done more simply. For instance, the bank or financing company can buy the entire issue for its own portfolio without seeking credit enhancement by focusing on the credit worthiness of the beneficiary of the bonds and the project being financed by the IDB.

My Company Isn't Eligible: IDBs are traditionally used by small manufacturers or processors of tangible "widgets." However, the definition of "manufacturing" is expanding to include intangible manufacturing (such as software, patents, copyrights, research, etc.), which is increasing the scope of potential issuers. What's more, "ancillary" or non-process manufacturing facilities are increasingly being allowed under federal rules. And it's important to keep in mind that IDBs are not just appropriate for small companies (given the $10 million limit), but also for large companies with smaller, disbursed plants in multiple jurisdictions. Additionally, if a project exceeds $10 million, more proceeds can be generated through a conventional financing or lease to pay for the project.

Worth a Closer Look

For all these reasons, issuers should take a closer look at IDBs as they consider long-delayed capital projects in a rising rate environment. Their advantages are clear: tax-free financing and other possible tax abatements, as well as the ability to package real estate and equipment financing into one bond issuance. But it's equally important to debunk the misconceptions that can deter companies from considering IDBs. Many companies might not even realize that IDBs are an option for them. But new views of intellectual property are expanding the bounds of these tax-exempt bonds. As the economy is evolving, so too are IDBs.

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INDUSTRIAL DEVELOPMENT BONDS

Why are more mid-size companies taking a closer look at this tax-exempt financing solution?

IT ALL STARTS WITH A DESIRE TO EXPAND.

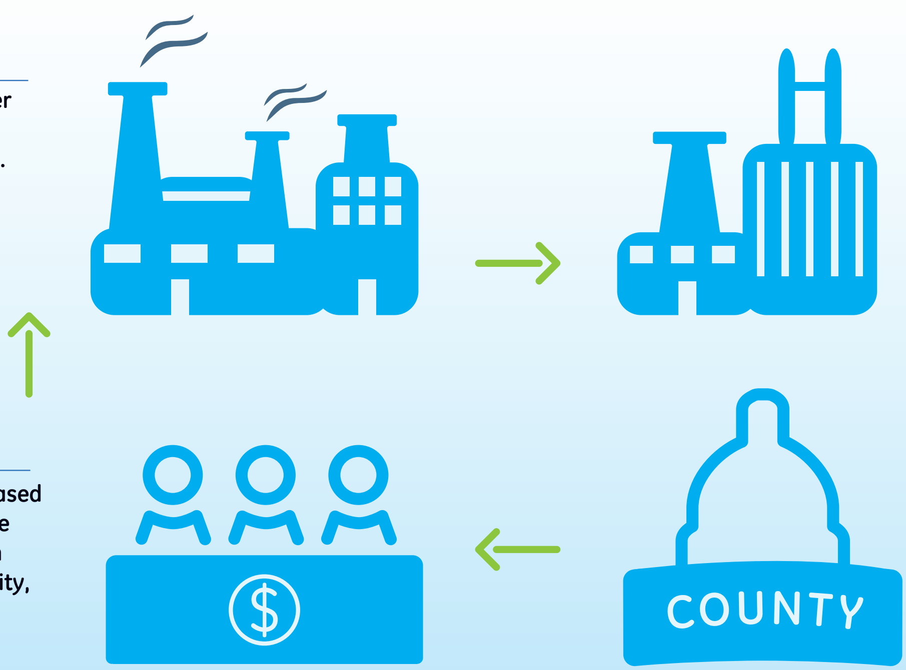
What they are:
Tax-exempt bonds—up to $10 million/deal—issued by a government entity to finance qualified growth and expansion projects.

Who may qualify:
Manufacturing and processing companies looking to expand, improve, replace or relocate facilities that will drive local economic growth.

IDBs can be used to fund:
- Purchase of new equipment.
- Renovation, construction or acquisition of facilities.
- Projects intended to drive local economic growth.

FORGING GROWTH WITH AN IDB

A steel manufacturer wanted to increase production capacity.



An existing facility in a qualifying geographic region was the perfect place to set up new operations.

The project was financed with an IDB issued by the county.

The financier purchased the entire bond issue for its portfolio from the government entity, and in turn lent the money to the manufacturer.