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## Changes to “Bank Qualified” Industrial Development and 501 (c) (3) Bonds

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### **Background:**

Tax-exempt bonds may be issued to finance projects for both small manufacturers and 501(c)(3) non-profit organizations under the federal tax code. Banks may purchase these bonds to hold in their bond portfolios, or there are a number of options to place the bonds into the public marketplace, particularly for transactions in excess of \$3 million.

If the issuer of the bonds issues less than \$10 million in bonds in a calendar year, the bonds purchased by a bank are “bank-qualified.” “Bank-qualified” means that the bank is allowed to deduct 80 percent of the interest on monies that the bank borrows to purchase the bond for the eligible non-profit project (or governmental project). If the issuer of the bonds issues more than \$10 million of bonds in a calendar year, the bonds are then “non-bank-qualified,” and the bank is not allowed to deduct any of the interest on monies that the bank borrows to fund the bond. The interest rate pricing difference between a “bank-qualified” bond and a “non-bank-qualified” bond is approximately 1 percent higher for a “non-bank-qualified” bond.

The real world effect of the above treatment of industrial development and 501(c)(3) bonds is that similar projects in urban and many somewhat larger rural areas are treated differently. Many larger rural communities and counties and most urban areas issue more than \$10 million in bonds in a calendar year, making the bonds “non-bank-qualified.” This is because they must keep pace with substantial infrastructure needs. Moreover, construction costs have risen substantially since 1986 when the \$10 million cap was put in place. A road that cost \$10 million in 1986 would cost \$18.75 million today. As a result, many even very small communities are no longer able to issue “bank-qualified” bonds.

### **CDFA Proposal:**

CDFA is proposing that small issue IDBs and 501(c)(3) bonds be eligible as “bank qualified” bonds. This focused change will open the financial markets for industrial development and smaller non-profit transactions by giving them the ability to place their bonds with their local community banks. This change will significantly ease the complexity and cost of smaller non-profit bond transactions.

### **Summary:**

CDFA recommends that eligible small issue manufacturing and 501(c)(3) non-profit bonds issued under Section 103 of the Internal Revenue Code of \$3 million or less be allowed to be “bank-qualified.” This modest change will open the market for small manufacturers and non-profits across the country to once again work with their local bank to place an industrial development bond or 501(c)(3) non-profit bond. This change will “level the playing field” and allow small companies and non-profits access to an economic development tool that most have not been able to access cost effectively since 1986. This can be done at minimum cost to the federal treasury, while providing a significant benefit to small manufacturers and communities across the country. Maintaining and growing manufacturing jobs through capital investments ultimately increases tax revenues at all levels of government.