Qualified Small Issue Manufacturing Rules

Industry Primer: Development Bond Finance Course

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Manufacturing Facility Defined

- The IRS says it’s a “ facility used in the manufacture or production of tangible personal property (must create depreciable property)—including a change in condition of such property”
- If the business is classified as manufacturing under the North American Industrial Classification Codes it will likely qualify as manufacturing

Manufacturing Facility Defined

- Manufacturing includes nearly every type of processing that results in a change in the condition of tangible property; e.g. company purchases unfinished fishing lures, paints them, adds feathers, and sells them. However, if the same company just purchased lures and added their name and then sold the lures, it would not be manufacturing—no value added.

Which are Manufacturing?

- Assembling a toy with just a few parts
- Transforming rolls of paper into bags
- Crushing and flattening aluminum, glass or plastic
- Meatpacking
- McDonald’s
- Growing, feeding and harvesting live animals
- Processing, cleaning and canning food
- Snow making at a ski resort
- Cement trucks

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Core vs. Directly Related and Ancillary Facilities

At least 70% of the net proceeds of the bonds (bond amount minus any debt service reserve fund) must be used to provide **core** manufacturing facilities; and (2) not more than 25% of Net Proceeds can be used to provide facilities that are directly related and ancillary to the manufacturing process on the same site—any portion of the remaining 5% (bad money) may be used for either but is generally reserved for cost of issuance and other costs.

Core vs. Directly Related and Ancillary Facilities

Core manufacturing facilities includes space that is reasonably necessary to house machinery, equipment, and fixtures used directly in the production process, including open space immediately adjacent to production or processing that is necessary for its safe operation. “Core Manufacturing Facilities includes equipment used in the manufacturing process but does not include used equipment, unless it is a fixture (equipment that can not be moved that is part of an existing manufacturing facility).

Core vs. Directly Related and Ancillary Facilities

The Core and Ancillary space limitations require calculations that compare the amount of Core space to the total Bond Financed portion of the building and similarly with directly related and ancillary space that cannot exceed 25%.

Directly Related and Ancillary Facilities

- Only a small amount of office space may be financed such as administrative offices for employees at the facility (supervisor of manufacturing process).
- Short term warehousing of raw materials necessary for production or temporary warehousing of finished product is functionally related and subordinate and must be on the same site.
- Are sales, payroll and marketing office space OK? (no) For example, a sales office that markets product for multiple plants.

Which are Related and Subordinate to Manufacturing?

- An on-site lab for quality control or testing of raw materials used in the manufacturing process
- A lab for new R & D
- Equipment used to load and unload raw material like forklifts
- Vehicles used to deliver raw material or finished product

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95% of Bond Proceeds Must be Spent on Capital Costs

- Of the remaining 5% (bad money), 2% maybe spent for cost of issuance like underwriter's discount, bond counsel and trustee fees, etc.
- Bond insurance premiums or letter of credit fees maybe be financed in addition to the 2% COI limit up to the 5% maximum limit.

Land Cost Limitation

- Not more than 25% of net bond proceeds may be spent on land.

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Acquisition of Existing Buildings and Integrated Equipment

- Existing or used buildings along with used equipment in the building may be acquired with bond proceeds, provided at least 15% of the acquisition cost minus the land cost is spent on rehabilitation or new equipment that replaces used equipment performing the same function in the acquired building.

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Acquisition of Existing Buildings and Integrated Equipment

- Rehabilitation must occur within the footprint of the acquired building. Expansions outside of the footprint do not count towards the 15% test but may still qualify under other rules.

- **Used equipment may not be purchased with bond proceeds unless part of an acquired building.**

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Dollar Limitations on the Amount of Bonds Issued

- The $1 million and $20 million tests take into account bonds issued or capital expenditures by all “ Principal Users” and “ Related Persons.”
- A **Principal User** is any person who holds a 10% interest in the project, or a lessee who occupies more than 10% of the space.

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Dollar Limitations on the Amount of Bonds Issued

- A **"Related Person"** is someone related to a principal user. Related persons include: family members, and a corporation that owns 50% of the stock of the principal user.

- **$1 million or less**. Very seldom used, if at all. The bond issue plus the principal amount of any outstanding bonds in the same jurisdiction must be less than $1 million. There is no capital expenditure test.

$20 Million Limitation on Capital Expenditures and $10 Million on Bonds

- All capital expenditures of principal users and related persons, in the same political jurisdiction may not exceed $20 million over a six-year window beginning three years before bonds are issued and ending three years after bonds are issued.

- Although there is a $20 million capital expenditure limit, the maximum amount of Small Issue bonds that can be issued or outstanding is $10 million.

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$20 Million Limitation on Capital Expenditures and $10 Million on Bonds

- Capital costs include: All costs that maybe capitalized; capitalized soft costs like capitalized interest, some R&D costs maybe capital expenditures, etc.

$40 Million Nationwide Limitation on Outstanding Tax Exempt Bonds

- All bonds including exempt facility and IDBs

Reimbursement Rules and Official Action

- Bonds can be used to reimburse eligible project costs prior to the issuance of bonds, if the issuer takes “official action” typically in the form of adopting an Inducement Resolution or “declaration of Intent.” However, you can only reimburse costs paid within 60 days of the Inducement.
- Important for clients not to incur costs like land prior to getting an Inducement which is only a finding that there is a reasonable expectation that bonds will be issued.

Prohibition on Advance Refunding

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Depreciation of Financed Property

- Bond financed property must be depreciated on a straight-line basis—no accelerated depreciation.