Project Finance: Leveraging the Capital Stack

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In an ideal world, economic development finance is easy. A small manufacturer needs a factory expansion and equipment purchase to keep up with rising demand. A standard bank loan might be too expensive, and mean delaying the project. However, a local conduit issuer can provide tax-exempt industrial development bonds (IDBs), enabling the manufacturer's expansion to go forward.

There are many cases where this relatively straightforward scenario proceeds as described. Oakland County, Michigan issued a $3.3M IDB on behalf of Total Door & Openings, which was subsequently able to support 80 jobs. Producers Feed Co. of Humphreys, Mississippi used an IDB from the Mississippi Business Finance Corp. to create 60 jobs. The Industrial Development Corp. of the City of Blackfoot, Idaho issued $4.5M in IDBs to enable an equipment manufacturer to construct a new facility and support 30 jobs. There are hundreds of these examples throughout the country.

> Find 150 examples of projects financed with tax-exempt bonds in CDFA's *Built by Bonds*.

Much of the time, of course, economic development finance is a more complex proposition.

Anyone in the development finance industry is familiar with the problems. Tax credit-eligible projects are challenged by current uncertainty over the longevity of the programs. Tax increment finance is repeatedly challenged by poor public understanding. Bond finance has been challenged in recent years by the shriveling of the market for credit enhancement products.

Fortunately, despite these challenges, the industry has been very successful at finding innovative and creative ways to combine programs in order to complete a project's capital stack.

From the comparatively modest bonds and tax credits combination to the borderline mind-boggling bonds, tax increment finance (TIF), EB-5 visa program investments (see page 14 of this issue), and state grants and incentives, developers, financial advisors, and economic development agencies are using every financing tool in the toolbox to leverage public dollars and catalyze investment.

Bond Finance

Tax-exempt bonds are the bedrock of development finance in the U.S. The National League of Cities reported last year that 4M miles of roadway, 900K miles of water pipes, and 16K airports—to name just a few components of infrastructure—were at least partially financed with tax-exempt bonds. CDFA's survey of volume cap allocation found that $14.6B of Private Activity Bonds was issued in 2010 alone. Clearly, tax-exempt bonds deserve their status as the underlying financing tool for economic development.

Bond finance has been a critical component of infrastructure and private development because bonds are essentially loans, and tax-exempt bonds are therefore akin to low-interest loans. In the case of a loan, the lender will hold the debt, whereas in a bond financing, "bondholders," who may include traditional lenders, hold the debt. The low-interest benefit is gained when the bond is tax-exempt because the bondholders do not pay taxes on the interest payments they receive—and are therefore willing to accept a lower interest rate in return. The end result to the borrower is low-cost capital.

In the case of most project financings covered by CDFA, the types of bonds in question are Private Activity Bonds (PABs), which are tax-exempt bonds issued for the benefit of a non-government entity. Congress has defined a number of acceptable private uses of tax-exempt bonds, including small manufacturing, multi-family housing, solid waste disposal facilities, and non-profits, to name a few.

In order to qualify for the tax-exemption, the borrower must have a project that fits the usually narrow definitions of the particular category of PAB in question. For example, IDBs cannot be used for working capital and have a $10M issuance limit. Failure to adhere to the requirements of the PAB category may mean losing the tax-exempt status of the bonds—and may subject the bonds to additional tax-related penalties.

Combining Bonds and Other Financing Tools

Of course, other public development incentives have their own sets of requirements, which is why combining multiple incentives successfully often requires some creativity. In some cases, multiple programs may not be compatible, as is the case with a number of federal programs and tax-exempt bonds. In other cases, receiving assistance from one program may limit the level of assistance another governmental unit is willing to provide. Identifying program requirements and investigating the plausibility of balancing multiple incentives are steps that must be undertaken early on for a potential project.

> See CDFA's *Tax Credit Finance Reference Guide*, Chapter 3, for more information on combining tax-exempt bonds and federal tax credits.

In order to avoid unnecessary challenges, developers and development agencies may find it preferable to combine financing tools that have a record of being used together successfully. New Markets Tax Credits (NMTCs), for example, have been used with tax-exempt bonds numerous times. NMTCs provide a 39% credit over seven years for projects that are developed in low-income census tracts and can pair well with tax-exempt projects that fall within one of these tracts.

Wofford College in South Carolina was able to combine 501(c)(3) bonds and NMTCs for portions of a project that renovated four residence halls and built two more, including an apartment-style housing complex for senior students. Harry Huntley of the South Carolina Jobs-Economic Development presented this project, which also created 32 jobs and retained 414 jobs.

Laura Radcliff of Stifel Nicolaus presented the financing for the Grant Center Arts Academy, which combined a number of tools. In addition to non-public sources, the project received $14M in NMTCs and $600K in TIF bond proceeds, as well as $3.5M in federal historic tax credits and $2.7M in state historic tax credits. Although this was a complex financing structure, the project greatly benefited the 900-student performing arts charter school.

> CDFA members can access dozens of presentations related to combining financing programs in the CDFA Online Resource Database.

When a one-two punch of public incentive programs is still insufficient for a project, then everyone involved must become even more creative to complete the deal. In addition to federal tax credit programs, state tax credits, TIF, tax abatements, governmental grants or loans, and a variety of other programs may be available to combine with bonds.

A recently-closed housing complex project, Walden Park, in Buffalo, New York used $4.9M in tax-exempt bonds, $3.4M in U.S. Dept. of Housing and Urban Development replacement housing funds, $3M in Low Income Housing Tax Credits equity, $650K from a city housing program, and $150K from a state energy project. This project, which was reported by WKBW news, combined five programs from local, state, and federal governments to leverage $12.1M into over 100 affordable housing units and a catalyst for redeveloping an entire neighborhood.

Of course, tax-exempt bonds—or any form of bond finance—are not always the answer to a project's needs. The East Bank Flats Project in Cleveland, Ohio combined multiple programs with taxable bonds. Brian Cooper of Robert W. Baird & Co. and Steve Strnisha of Project Management Consultants presented this $139.7M project. Of the financing sources, $21M came from state incentives, $20M came from EB-5 visa program investments, $18.9 from state loans, and $13.5M came from TIF bonds, to name a few. Once again, local, state, and federal programs were combined to enable a transformational development project.

> To learn more about these projects, or to send CDFA information and photos for your own projects, contact Jason Rittenberg at jrittenberg@cdfa.net.

Many of the projects featured on the cover of this issue, or on the pages of this article, required creative financing solutions to complete. Some included bond financing, although some were successful with other tools alone. The Connecticut Brownfields Redevelopment Authority used TIF, bonds, federal assessments, and more to cleanup and redevelop a former tank farm. Walnut Street Capital and the Urban Redevelopment Authority of Pittsburgh used NMTCs, historic tax credits, TIF, grants, EB-5 investments, and more to complete the Bakery Square district. These are just two of the featured projects—as well as the Wofford Project above–provided by CDFA members.

As the examples in this article make clear, whatever the challenges posed to finance tools individually, creative approaches to economic development finance can still be successful, if not always easy.

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Thank you to the CDFA members whose project photos appear in this issue:

- City of Chicago
- City of Cleveland
- City of Conroe
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- Colorado Housing and Finance Authority
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- MB Financial Bank
- Midcoast Regional Redevelopment Authority
- National Development Council
- South Carolina Jobs-Economic Development Authority
- Summit County Port Authority
- U.S. Bank
- Urban Redevelopment Authority of Pittsburgh