Recommended Practices: Effective Industrial Development Bond Program Management

EXECUTIVE SUMMARY

The Council of Development Finance Agencies (CDFA) has developed this publication as a set of guiding principles when developing or implementing an Industrial Development Bond (IDB) program. This publication has been researched, reviewed and approved by a committee of development finance professionals and other industry experts, as well as the CDFA Board of Directors. This piece is the first in a series of documents that CDFA will produce. Future documents on IDBs will go into more detail about specific aspects of this important financing tool.

Tax-exempt bond financing, as we know it today, has become the cornerstone of economic development financing. While there are a myriad of tax-exempt bond financing options available, one of the most popular is qualified small issue Industrial Development Bonds (IDBs) for manufacturers. IDBs are used to finance the expansion and investment of small to medium sized manufacturers. The IDB issuance process is complex and requires considerable understanding and dedication. Issuers routinely encounter pitfalls that hinder or halt the success of their IDB programs. This document is intended to highlight these pitfalls and provide guidance on strategies and best practices for avoiding challenges.

INTRODUCTION

The Tax Reform Act of 1986 sculpted much of today's development finance landscape. The massive tax reforms changed the way municipalities use development finance bond tools. Included in the changes were provisions impacting both businesses and individuals. The 1986 tax bill distinguished between two types of municipal bonds: Governmental Bonds and Private Activity Bonds (PABs), of which IDBs are considered part of the PAB family. Furthermore, the changes included allowing the interest on some bonds to be exempt from federal taxes while also introducing the Alternative Minimum Tax (AMT) for PABs.

Industrial Development Bonds (IDBs) are a very popular financing tool, but the question remains, "What are IDBs?" IDBs are designated as municipal bonds, whereby a private company, such as a manufacturer, is able to take advantage of the government's tax-exempt status to receive financing at a lower cost through the government's ability to issue debt obligations at tax-exempt rates. In many instances, these rates are lower and provide better terms than conventional loan methods and taxable bonds. While IDBs have been around for more than 70 years, they have grown in popularity over the last 25 years.

IDBs are issued through state and local governments, or by entities that have been granted authority by state & local governments to issue bonds within a jurisdiction. Issuers can be cities, counties, port authorities, states, community improvement corporations, industrial development agencies and many other types of authorized agencies.

Typically, IDB's are issued as conduit debt on behalf of an eligible borrower. That is to say, the proceeds of the bonds are "passed through" and loaned to the borrower for their project. As a result, the bonds become limited obligations of the issuing entity, and payable solely from loan repayments or similar payment obligations by the borrower. The ultimate obligation to repay the bonds is by the borrower, not the issuing entity.

Issuers, as they are commonly called, are able to issue bonds, for the benefit of the communities they serve, by allowing private firms to access capital at a lower cost and finance development that might not otherwise have been economically feasible. IDBs can provide an alternate debt option for private companies to finance the acquisition, construction, rehabilitation and equipping of manufacturing or processing facilities. Bond proceeds can be used to finance the expansion, purchase or construction of manufacturing or industrial plants. This includes real estate, buildings, fixtures and equipment.

IDBs play an important role in the economic development arena by supporting financing for the manufacturing sector across the country. Continually challenged, communities must find creative ways to stimulate their economies and provide employment opportunities for their residents. IDBs provide an essential financing tool to aid in job creation in the manufacturing sector. The impact of IDBs can be felt across the nation through the vast number of small- and medium-sized manufacturers that have benefited from IDB financing, building a stronger economy across many industry sectors.

Furthermore, IDBs provide a source for project funding that improves what is available through traditional commercial

lending programs. Traditionally, IDBs offer financing at a lower interest rate than what is commercially available. IDBs also offer flexible terms, which often are better suited to meet the needs of the manufacturing sector. IDBs offer a financing tool for small manufactures that are often overlooked through more traditional lending mechanisms. Furthermore, IDBs may provide a tax-exempt source of investment for those who purchase the bonds.

IDBs are issued by following a predetermined process through the issuing governmental agency that works in conjunction with several players including the borrower, bond counsels, underwriters, financial institutions, consultants and the community.

IDENTIFICATION OF COMMON CHALLENGES

Issuers face a variety of common challenges when employing IDBs. Issuing IDBs can be a complex, and at times, a lengthy process. The most common challenge facing issuers is providing sufficient and necessary oversight. These shared challenges generally fall into three areas: program management, marketing and oversight. These are some areas that need particular attention to maximize investment in the IDB program.

Program Management

In certain instances, issuers who operate IDB programs may not have sufficient staffing levels to provide the appropriate level of due diligence. In addition, the goals and objectives of some IDB programs may not have been fully articulated in advance, which is a critical first step necessary to allow for performance measurements and benchmarks.

Some IDB issuers may not provide enough information about their programs to their potential clients, or information may be difficult to obtain.

Issuers may not be well versed in the tax implications of issuing IDBs. This is not only a problem for the issuer, but also the private party for whose benefit the bonds have been issued. The manufacturer needs to be aware of the tax implications and tax benefits.

Marketing

Some IDB issuers may miss opportunities to maximize their program by overlooking the importance and benefits of marketing and promotion. Other issuers may lack sufficient resources to invest in marketing and promotion of their IDB program.

These drawbacks are a concern when trying to develop and administer a successful IDB program.

While IDBs continue to be a popular economic development tool, they don't sell themselves; many manufacturers do not know the program is available. Businesses are being pulled in various directions when it comes to receiving the best deal to meet their financing needs. There is stiff competition for their business. However, many issuers do not take the time to properly market their services to the communities they serve. In many cases, bond financing, which can save a business a significant amount of financial resources for use elsewhere, is not actively explored.

Furthermore, many IDB issuers fail to promote the flexibility of IDBs as but one element in larger scale projects. IDBs do not need to be issued as the sole component in a financing package, but can serve as a one of multiple facets in a financing deal.

Program Oversight

Some IDB issuers may lack the proper follow-up and documentation for IDB programs. This includes monitoring outstanding bonds, proper reporting and maintaining general accounting practices. This oversight can lead to serious problems with the IRS, rating agencies, the lending community and potential users. Proper oversight is critical in the IDB process. It is important for issuers to adopt and follow post-issuance compliance procedures.

RECOMMENDATIONS

Several general principles should be considered when managing and implementing an IDB program to avoid the challenges discussed above. These recommendations, while broad based, focus on the three main areas of challenges: program management, marketing and oversight.

Program Management

- Proper oversight is necessary for an IDB program to meet the needs of the community it serves. Issuers should dedicate adequate staff and resources to serving the program needs.

- Staff should be adequately trained. This includes detailed knowledge of IDBs, what they can be used for, the process for issuing an IDB, as well as proper reporting. It is essential for staff to fully understand

the bond program and all of its benefits and responsibilities to fully inform clients.

- Issuers should possess a clear understanding of the tax codes in their respective states and jurisdictions to provide appropriate information to existing and potential users.

- Public access to important program materials such as Fact Sheets, applications, etc. should be made readily available and easily accessible. Informational materials should be updated as needed to provide accurate information about the program. In addition, information required from program participants should be collected in a succinct manner.

- Issuers should develop a mission statement for the bond program.

- Issues should old regular public meetings and invite the media to participate in issuance announcements.

- An IDB issuer should adhere to any and all government regulations. This includes those required under the Internal Revenue Code such as assuring that the public approval requirement of the Internal Revenue Code is met. Adherence to the laws and regulations of the Internal Revenue Code will ensure the maximum efficiency of an issuer's program.

- IDB issuers must also make certain that the appropriate players are involved in the issuance process. This includes competent and qualified bond counsel. Bond counsel plays an important role in the bond issuing process. The role of the bond counsel includes, but is not limited to:
    - Preparation of public notices and hearing documents required to obtain the public approval requirement under the Internal Revenue Code
    - Preparation of appropriate resolutions approving the project and the bonds for adoption by the issuer
    - Preparation of bond documents including a loan agreement, trust indenture, and arbitrage certificate
    - Providing legal opinions as to the validity of the bonds and the bond documents, as well as to the exemption of interest on the bonds on federal, state and local levels.
    - Assist with legislative matters

Marketing

- To receive maximum return on investment, an IDB program should be marketed to the community. It is important to make sure that potential users and their representatives have sufficient understanding of the offerings and how they may benefit companies. Not only should the program be marketed as a stand-alone financing option, but also as an element of a larger more comprehensive financing package, such as in conjunction with local real property or sales tax exemption programs.

- Issuers should think creatively in marketing the IDB program to the right target audience. Often small to medium size manufacturers are unaware of the financing options available to them through these types of programs. Outreach to the local manufacturing community and the promotion of success stories in the media and online will cultivate new projects and drive demand. Additionally, banks and other financial institutions should be provided the necessary materials for marketing the program and should be an active partner in engaging potential clients in the promoting the program.

- Many communities have also found success in the bond financing programs by having representatives located throughout their jurisdiction. This helps to build connections and product awareness with potential clients. In addition, placing a staff member on local boards and/or commissions that promote economic development will provide a greater focus on the available bond financing options.

- It may also be helpful to hold presentations with local chamber of commerce organizations, banks and business groups.

- Partnership is key to building a successful bond program. Issuers should work to build relationships with local realtors, banks and other financial institutions. Equally important, issuers should build strong relationships with various economic development and like-minded organizations. These networks can help to build a referral network and enhance issuers programs.

- Good communication is recommended throughout the bond issuance process. An open channel of communication should be maintained among all involved parties. It is important to keep all parties informed as the bond issuance progresses.

Oversight

- Most issuing activities should be centered on the organization's mission statement with detailed oversight and reporting. The mission statement should be accompanied with clearly defined goals and objectives with measurable results.

- Document a detailed oversight process that will ensure manufacturing companies comply with the requirements of the bond financing documents and that bond proceeds are spent properly to adhere to applicable laws and regulations.

- It is also important for issuers to produce an annual report to detail the bond program, including updates on bonds issued during the immediate past year and information on issuance performance compared to expectations. This is typically done in conjunction with the participating borrowers to ensure they are reporting on the project on an annual basis.

- Perform regular independent audits as necessary. Audits provide a third party, objective review of programs and allow an issuing authority a foundation with which to build a strong program.

CONCLUSION

Industrial Development Bonds have seen a major resurgence over the past three years. As resources at both the state and federal level continue to diminish, local economic development finance agencies will continue to search for sources of capital and affordable financing for small/medium sized manufacturers. The IDB program is the cornerstone for assisting this valuable contributor to the local economy. Proper oversight and the adherence to the aforementioned recommended practices will solidify the local IDB program as a strong tool for financing economic development projects.

For more information about the topic discussed above, please use the following resources:

CDFA Bond Finance Training Courses

The Industry Primer: Development Bond Finance Course

Course Home Page
Course Manual

Advanced Bond Finance Course

Course Home Page
Course Manual

Program Descriptions & Sound Marketing Examples

Local Program Guide – St. Louis IDA

Program Web page – City of Minneapolis Community Planning & Economic Development Department

County Application – Chester County IDA

State Conduit Bond Application – Alaska IDA

State Marketing Web page – Missouri Department of Economic Development

Virginia Small Business Financing Authority - Fact Sheet

IDB Application – MassDevelopment

State IDB Page – California iBank

General Resources

Breaking Down the New $20 million IDB Capital Expenditure Limitation

Building and Marketing an IDB Program

Examining the Best Method of Sale for IDBs

How Bonds are Structured and Sold