SEYFARTH SHAW ATTORNEYS LLP

Quick Takes

February 2005

After the Inducement Resolution: "Now, How Do I Get These Bonds Sold?"

In this issue of *Quick Takes*, let's assume that a company has a project that qualifies for industrial development revenue bond financing. Let's also assume that the local development authority has adopted an inducement resolution, committing to issue the bonds.

Question: "Are we pretty much done with this financing?"

Answer: "No. We're just getting started. In fact, a better question would be – Now, how do I get these bonds sold?"

Answering the question about selling the bonds is what this issue of *Quick Takes* is about. In fact, this issue premieres a new White Paper: "Bond FAQ's-Questions and Answers About Industrial Development Revenue Bonds." That White Paper covers the whole bond process in an informal, question-and-answer format. If you'd like to have a copy, just send me an email.

Now, let's turn to today's question.

In order to be marketable, the bonds must be backed by a good enough credit. The company will sign a lease or a note, promising to pay basic rent or note payments to the development authority. The basic rent or note payments match the debt service on the bonds. However, public investors usually aren't willing to just look to the basic rent or note payments for repayment of the bonds; they want to be able to look up a credit rating for the bonds, find that it is investment grade, and know that they will be paid through a bank letter of credit (that has been issued to secure the bonds), without having to worry about defaults by the company.

The letter of credit for a bond deal is issued by a commercial bank. A letter of credit is a separate document, in which the bank itself undertakes to make stipulated payments on the conditions specified in the letter of credit itself. This means that the bank's own credit is passed through to the bonds. In bond financings, the type of letter of credit that is involved is called a "direct pay" letter of credit (as opposed to a "stand-by" letter of credit). Instead of the company making basic rent or note payments directly, the bank, under the letter of credit, pays the amount thereof to the trustee for the bondholders (and is reimbursed by the company), rather than "standing by" in case the company defaults on its basic rent payments or note payments. This is done to avoid problems under the Bankruptcy Code if the company goes bankrupt.

In some cases, a company with good, but unrated, credit may be able to privately place the bonds with a bank or financial institution with which it regularly deals, without a letter of credit. Sometimes community banks will buy the bonds on the same basis. The process can be simplified in either case if the bonds are drawdown bonds (funds are drawn down as needed and there is no trustee for the bondholders). Privately placed bonds can be sold through a placement agent or underwriter to investors that do not have a pre-existing relationship with the company (often a letter of credit is required, even if the bonds are being privately placed). If the bonds are publicly sold, they are sold to (or through) an underwriter, who sells or resells them publicly to such investors as tax-exempt money market funds, bank trust departments, and profitable corporations.

Regardless of whether a bank issues a letter of credit to support the bonds, or buys the bonds directly into its portfolio, the transaction is an extension of credit by the bank to its customer. The bank will underwrite the extension of credit in accordance with its normal policies. If the company has strong credit of its own, perhaps the extension of credit will not be collateralized. Otherwise, the bank would require collateral, perhaps including personal guaranties from the company's principals, and could be expected to impose such requirements as a debt-to-equity ratio for the project being financed. More stringent underwriting requirements can be expected for start-up projects. The "Bond FAQ's" White Paper has more information about collateral requirements, including some rules that apply to tax-exempt financings and limit the types of collateral that can be used.

Remember, the big advantage of bond financing (in addition to any incentives that it may enable) is the low interest rates it offers (today's rates are at the foot of this issue of *Quick Takes*). But, also remember the old saying- "You've got to work hard, if you want cheap money!"

I hope this information helps you get those bonds sold. (If you are a bank, I hope this helps you with your credit decision). If you have any questions or comments, please let me know.

Daniel M. McRae

February 7, 2005 interest rates on IDBs (variable rate demand bonds; AMT 7 day general markets; rates are market extracted and approximations):

Interest Rates:
tax-exempt 1.97%
taxable 2.64%

Seyfarth Shaw LLP

This email was sent by:
Seyfarth Shaw LLP
1545 Peachtree Street, N.E.
Suite 700
Atlanta, GA 30309
Attention: Daniel M. McRae
dmcrae@seyfarth.com

Atlanta Boston Chicago Houston Los Angeles New York Sacramento San Francisco Washington, D.C. Brussels

SEYFARTH ATTORNEYS SHAW LLP

General note: This issue of *Quick Takes* is a quick-reference guide for economic developers, participants in the real estate and financial industries, and company executives and managers and their advisors. The information in this issue is general in nature. Various points that could be important in a particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case.