BONDS 101

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WHY ARE BONDS SO IMPORTANT?

- A GEORGIA REQUIREMENT FOR-
  - “ABATEMENT”
  - ANY SUBSTANTIAL CASH OR IN-KIND INCENTIVES
- BEST WAY TO BORROW MONEY

3 URBAN MYTHS (RURAL, TOO)

1. "My development authority can do abatement without bonds."
2. "I can save money by using a promissory note instead of bonds."
3. "Some development authorities can levy taxes.

MYTH NO. 1

- "My development authority can do abatement without bonds." NO, IT CAN'T.
- Approximately 6 Georgia communities have Local Constitutional Amendments (LCA's) that provide property tax abatement, automatically, without bonds or a development authority being involved.
  - Examples: Jefferson County, Screven County, Early County.
- These LCAs are decades old and contain parameters that don't fit today's projects.
  - Even in those communities, bonds are used.
- So, a bond-financed sale-leaseback structure is needed.

A BOND-FINANCED SALE-LEASEBACK STRUCTURE IS NEEDED

- WHAT ARE THE POWERS OF YOUR DEVELOPMENT AUTHORITY?
  - ►A DEVELOPMENT AUTHORITY HAS THE POWER TO FINANCE THE ACQUISITION OR FINANCING OF A PROJECT, THE POWER TO LEASE THE PROJECT, AND THE POWER TO GRANT AN OPTION TO PURCHASE THE PROJECT.
  - ►PUT IT ALL TOGETHER, AND YOU GET…. A BOND-FINANCED SALE-LEASEBACK STRUCTURE.
  - ►PROPERTY TAX ABATEMENT "ON DEMAND" IS <u>NOT</u> A POWER THAT <u>EITHER</u> A DEVELOPMENT AUTHORITY <u>OR</u> A LOCAL GOVERNMENT HAS.
    - PROPERTY TAX SAVINGS RESULTS FROM THE BOND-FINANCED SALE-LEASEBACK STRUCTURE.

A BOND-FINANCED SALE-LEASEBACK STRUCTURE IS NEEDED

- "HOW CAN YOU JUSTIFY GIVING THE COMPANY AN OPTION TO BUY THE PROJECT FOR $1 WITHOUT VIOLATING THE CONSTITUTION'S PROHIBITION OF "GIFTS AND GRATUITIES"?
  - ►CONNECTING THE PURCHASE OPTION WITH THE BONDS PERMITS THIS.
- "BONDS FOR TITLE" HAS LEGAL PRECEDENTS; "NAKED LEASES" DON'T. DON'T YOU NEED THEM?
  - ►See O.C.G.A. SEC. 36-80-16.1(e); *W.C. Harris, et al. vs. DeKalb County Board of Tax Assessors,* 248 Ga. 277, 282 S.E.2d 880 (1981)
- FINALLY, HOW MUCH BUDGET DO YOU HAVE FOR LEGAL FEES TO DEFEND AGAINST TAXPAYER SUITS?

MYTH NO. 2

- "I can save money by using a promissory note instead of bonds."
  - FALSE- 95% OF THE TIME.
  - BAD IDEA- 100% OF THE TIME.
- "Statutory" Development Authorities
  - activated under Development Authorities Law
  - don't have the power to issue promissory notes
    - exception- temporary bond anticipation notes when bonds have been validated and will actually be used for financing
  - "Constitutional" Development Authorities
  - created by Local Constitutional Amendment (LCA)
  - each LCA is different
  - most authorize promissory notes
  - But- promissory notes aren't validated, and validation is a Best Practice for economic development projects

VALIDATION IS A BEST PRACTICE FOR ECONOMIC DEVELOPMENT PROJECTS

- Bonds are validated in Court
  - ▶ development authority promissory notes are not validated
- Judge's final validation order is "forever incontestable and conclusive." Ga. Const. Art. IX, Sec. VI, Para. IV
- Traditional- Use validation orders to cover-
  - ▶ Incentives don't violate Constitutional prohibition of "Gifts and Gratuities"
  - ▶ Validity of "abatement" structure
    - leasehold valuation
    - usufruct
      - nontaxable lease
      - PILOT (payment in lieu of taxes) bonds

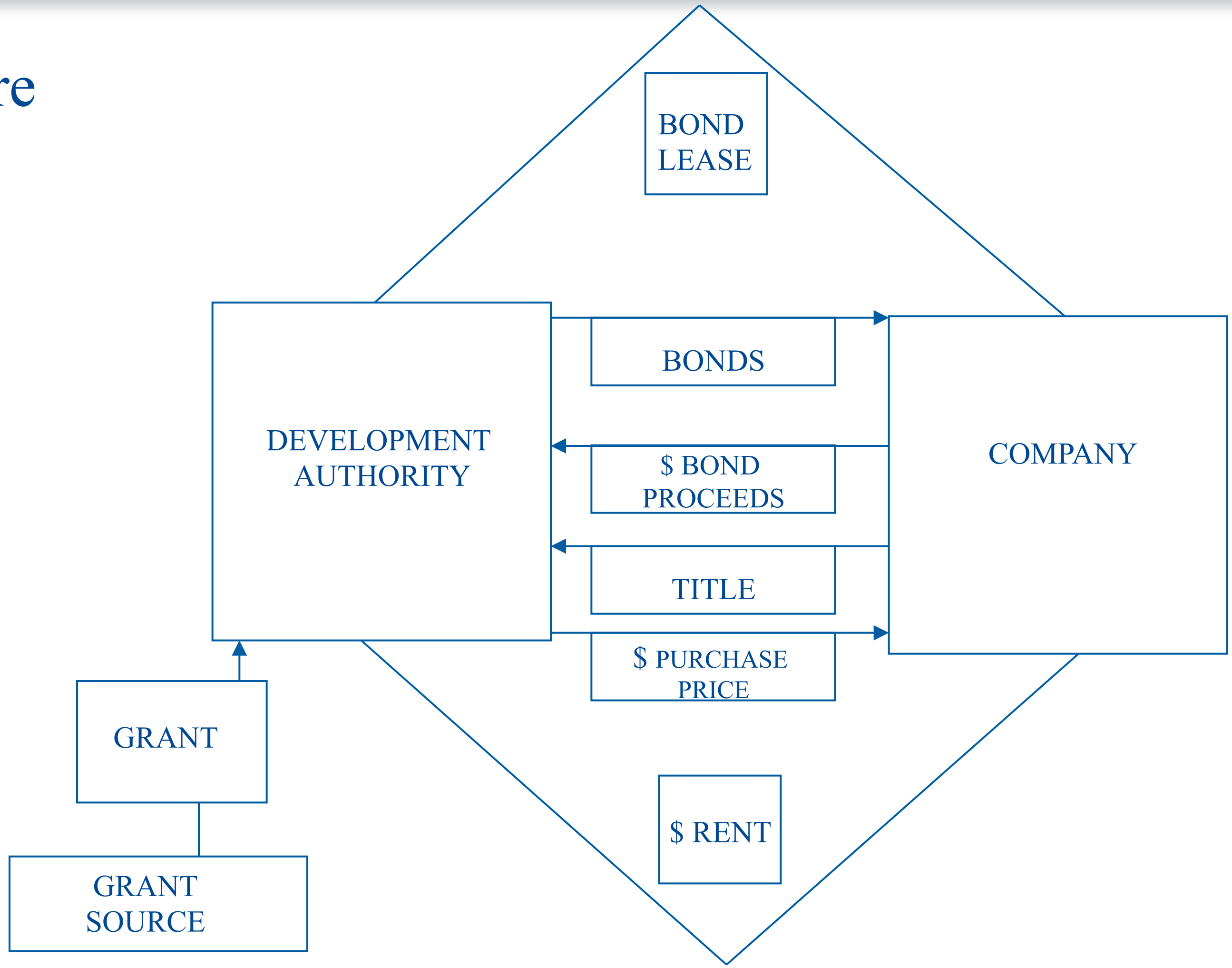
VALIDATION IS A BEST PRACTICE FOR ECONOMIC DEVELOPMENT PROJECTS

Now- Also use validation orders to cover-

- if the project is a public/private project (P3), it is Constitutional because properly integrated
- the project is not subject to the Georgia Local Government Public Works Construction Law (O.C.G.A. Sec. 36-91-1 *et seq.*)
- the bonds do not constitute a "business loan" or confer any other "public benefit" within the meaning of O.C.G.A. Sec. 50-36-1 (HB 87)
- neither the Company nor any other participant constitutes an "applicant for public benefits" regarding the bonds within the meaning of O.C.G.A. Sec. 50-36-1
  - therefore, such persons are not subject to Systematic Alien Verification of Entitlement (SAVE)
- the bonds are not subject to the PILOT Restriction Act (O.C.G.A. Sec. 36-80-16.1)
- the bond issue and the expenditure of the proceeds thereof are exempt from the performance audit and performance review provisions of O.C.G.A. Sec. 36-82-100

"BONDS FOR TITLE"

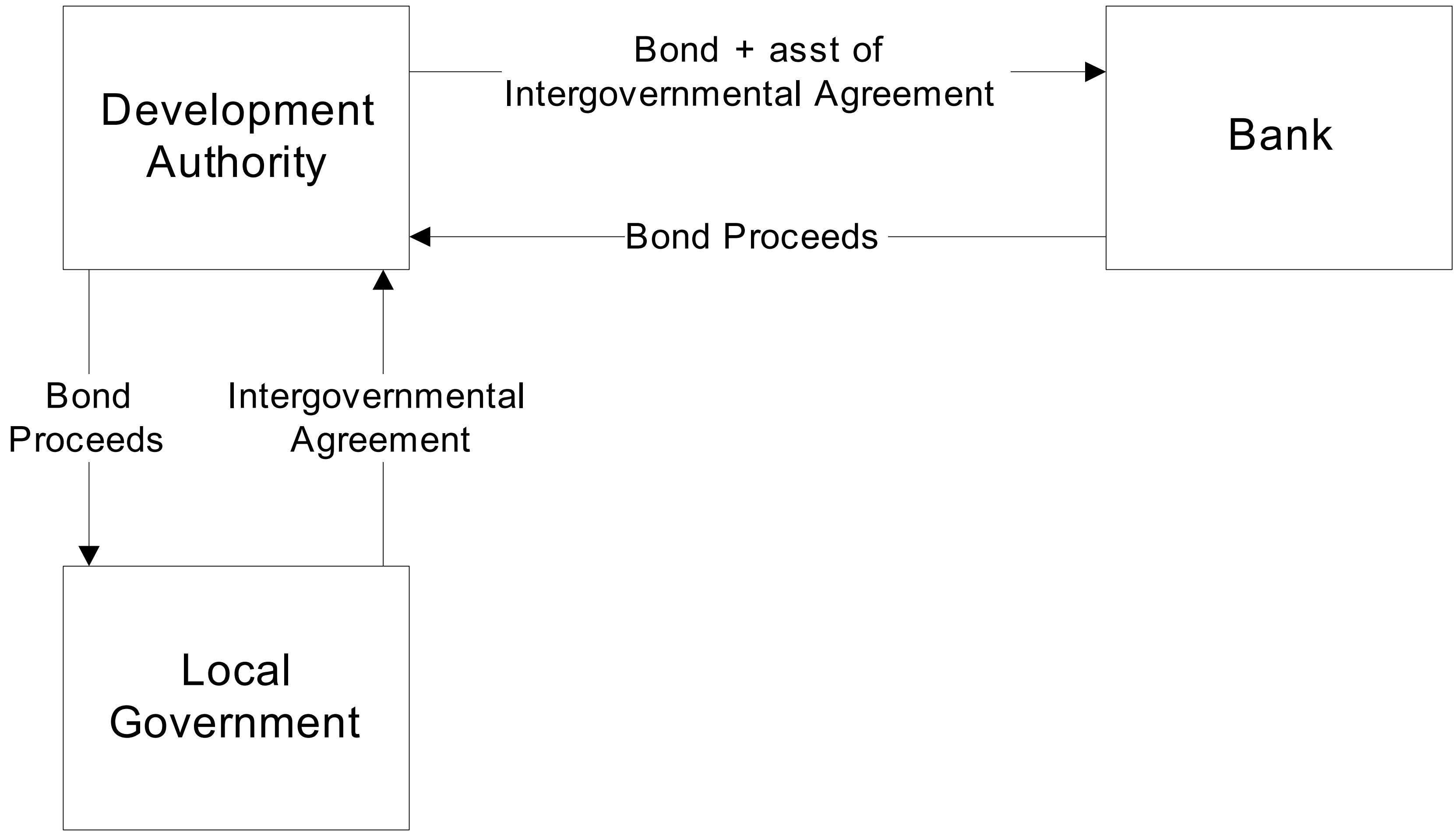
Basic Structure to Use for Grants and Property Tax Savings



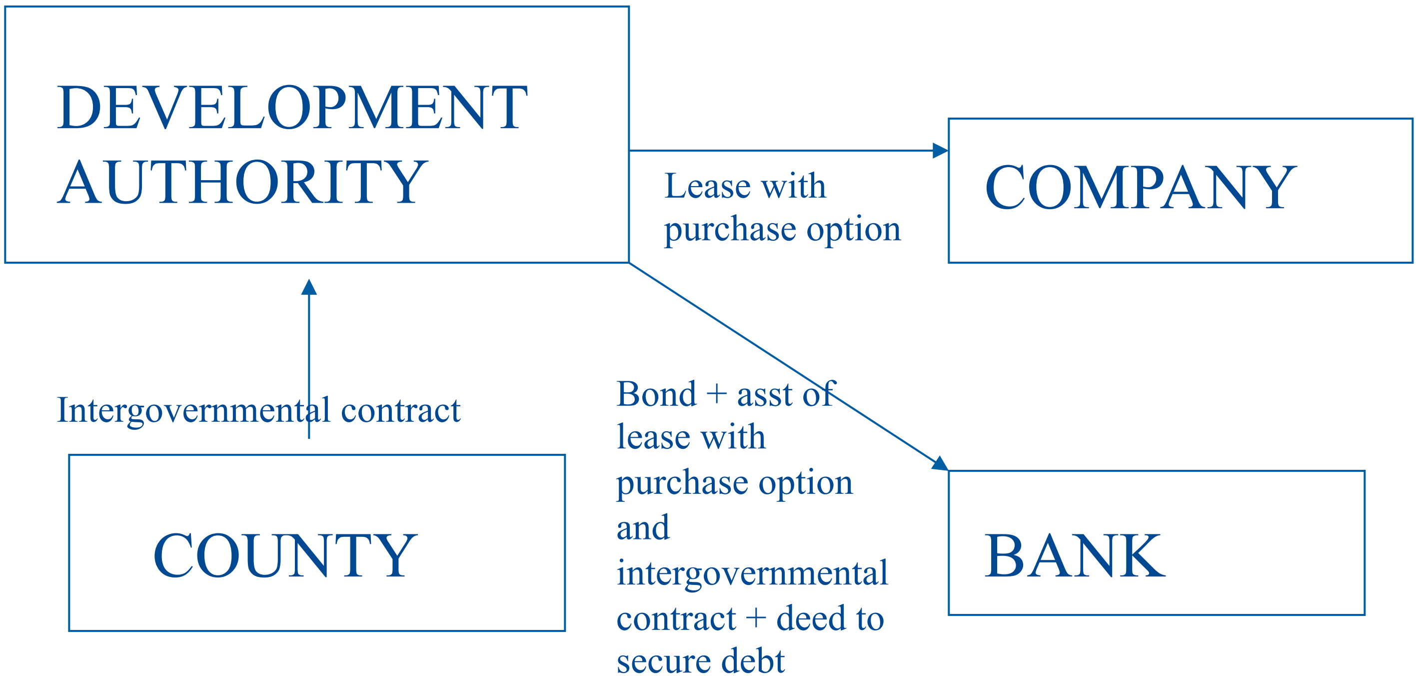
MYTH NO. 3

- "Some development authorities can levy taxes." NO, THEY CAN'T.
- Local governments have the <u>option</u> to financially support their development authorities.
  - County: 1 mill to a county development authority or a joint city/county development authority (O.C.G.A. Sec. 48-5-220 (20))
  - City: 3 mills to a city development authority or a joint city/county development authority (O.C.G.A. Sec. 48-5-350)
  - More: if governmental purpose or if provided in Local Constitutional Amendment
- Some Local Constitutional Amendments (LCAs) <u>authorize</u> additional millage.
- A few LCAs <u>mandate</u> additional millage.
  - To support the development authority.
  - To pay off bonds that have gone into default.
- But no city or county development authority has the power to levy taxes.
  - Taxes are levied by the local government.
  - Bonds issued by local governments repaid by taxes are called "general obligation bonds."
  - Bonds issued by local authorities repaid by pledged revenues are called "revenue bonds."
- An intergovernmental agreement (IGA) between the local government and the development authority can be used to "monetize" this millage.
  - Monetization is through "contract revenue bonds."
  - IGA can be multiyear.

"CONTRACT REVENUE BOND"- GRANT STRUCTURE



“CONTRACT REVENUE BOND”- “GUARANTY” STRUCTURE



BEST WAY TO BORROW MONEY

- The interest on bonds issued by a development authority (industrial development revenue bonds, or IDBs) is either federally taxable or federally tax-exempt.
- Federally tax-exempt bonds are more desirable.
  - Advantages of tax-exempt financing
    - Lower interest rate
    - Longer term
    - Greater marketability
    - More availability of interest-only/ capitalized interest
    - Smaller bond issues more do-able

DO YOU SPEAK "BOND"? AND CAN YOUR DEVELOPMENT AUTHORITY ISSUE BONDS LIKE THESE?

THIS …	IS THE OPPOSITE OF…THIS
REVENUE BOND Yes. Only revenue and other collateral from the private company is at risk. No repayment obligation on the part of the development authority, the city, the county or the State. Caveat: Some Constitutional development authorities.	GENERAL OBLIGATION BOND No (with contract revenue bonds, the IGA is pledged)
TAX-EXEMPT BOND Yes- mainly "small issue" manufacturing bonds, qualified 501(c)(3) bonds, and exempt facility bonds (if state law authorizes for development authority). Federal tax laws make inducement resolution mandatory.	"TAXABLE" BOND Yes. Some taxable "green" bonds are actually "tax credit" bonds with economics like tax-exempt bonds. Examples: CREBs; QECBs. Inducement resolution is traditional but optional.

DO YOU SPEAK "BOND"? AND CAN YOUR DEVELOPMENT AUTHORITY ISSUE BONDS LIKE THESE?

THIS …	IS THE OPPOSITE OF…THIS
PRIVATELY PLACED Yes. Example- bond sold to local bank. No underwriter necessary. Fewer private placements, because fewer profitable banks that can use tax-exempt bonds.	PUBLICLY SOLD Yes. An underwriter is needed for public offerings. A bank letter of credit is needed to secure the bonds. Fewer public offerings because fewer banks provide LOCs.
INVESTMENT GRADE Yes- depending on quality of pledged revenue and/or credit enhancement	"JUNK"/HIGH YIELD/ UNRATED Yes (but be cautious)

DO YOU SPEAK "BOND"? AND CAN YOUR DEVELOPMENT AUTHORITY ISSUE BONDS LIKE THESE?

THIS …	IS THE OPPOSITE OF…THIS
PRIVATE ACTIVITY Yes- if project is authorized by governing law (Development Authorities Law or LCA and local acts; Constitution)	GOVERNMENTAL PURPOSE Only for qualified public/private partnership projects (P3) or if LCA permits
FLOATING RATE Yes (letter of credit normally required)	FIXED RATE Yes
NON-AMT Except for qualified 501(c)(3) bonds, most development authority bonds are subject to the Alternative Minimum Tax.	AMT Yes

DO YOU SPEAK "BOND"?
AND CAN YOUR DEVELOPMENT AUTHORITY ISSUE BONDS LIKE THESE?

THIS …	IS THE OPPOSITE OF…THIS
"BANK QUALIFIED" Except for some situations involving qualified 501(c)(3) bonds, most development authority bonds are not "bank qualified", or "BQ" (doesn't mean banks can't buy them; means banks don't get a carrying charge deduction)	NOT "BANK QUALIFIED" Yes
AUTHORITY-ISSUED Yes. Bonds that are tax-exempt have to be issued though a public body.	COMPANY-ISSUED No- Taxable bonds can be issued directly by the company. But no incentives authorized!

DO YOU SPEAK "BOND"? AND CAN YOUR DEVELOPMENT AUTHORITY ISSUE BONDS LIKE THESE?

THIS …	IS THE OPPOSITE OF…THIS
CAPITAL MARKETS Yes. "Capital markets" refers to the various types of bond purchasers.	"BONDS FOR TITLE" Yes. Company buys its own bonds.
LOCAL GOVERNMENT APPROVED Yes. In order for private activity bonds to be tax-exempt, they have to be approved by the local government (TEFRA approval).	NOT APPROVED BY LOCAL GOVERMENT Yes- Taxable bonds can always be issued by a development authority. (Some LCAs require local government approval.)

WHAT DOES "INVESTMENT GRADE" MEAN?

- HINT- IT'S GOT NOTHING TO DO WITH DUN & BRADSTREET.
- YOUR PROSPECT IS ALMOST CERTAINLY NOT "AAA". THERE ARE ONLY A FEW "AAA" CREDITS LEFT IN THE WORLD. BUT IT MIGHT BE INVESTMENT GRADE.
- IN THE TERMINOLOGY USED BY S&P AND FITCH, FOR EXAMPLE, INVESTMENT GRADE IS A RATING OF BBB- THROUGH AAA
  - (MOODY'S IS THE OTHER MAJOR RATING AGENCY, AND HAS ITS OWN TERMINOLOGY)
- IF THE BONDS ARE SECURED BY A BANK LETTER OF CREDIT, THE BANK'S LETTERS OF CREDIT MUST BE RATED INVESTMENT GRADE
- ON THE STRENGTH OF THE LETTER OF CREDIT, THE RATING AGENCY WILL ASSIGN A RATING TO THE BONDS
  - (THE SAME RATING AS THE LETTER OF CREDIT)

RATINGS SYMBOLS

SUMMARY OF RATING SYMBOLS AND DEFINITIONS			
MOODY'S	**S&P**	**FITCH**	**BRIEF DEFINITION**
INVESTMENT GRADE—HIGH CREDITWORTHINESS			
AAA	AAA	AAA	GILT EDGE, PRIME, MAXIMUM SAFETY
AA1	AA+	AA+	VERY HIGH GRADE, HIGH QUALITY
AA2	AA	AA	VERY HIGH GRADE, HIGH QUALITY
AA3	AA-	AA-	VERY HIGH GRADE, HIGH QUALITY
A1	A+	A+	VERY HIGH GRADE, HIGH QUALITY
A2	A	A	UPPER MEDIUM GRADE
A3	A-	A-	UPPER MED. GRADE
BAA1	BBB+	BBB+	UPPER MED. GRADE
BAA2	BBB	BBB	LOWER MED. GRADE
BAA3	BBB-	BBB-	LOWER MED. GRADE

RATINGS SYMBOLS

SUMMARY OF RATING SYMBOLS AND DEFINITIONS			
MOODY'S	S&P	FITCH	BRIEF DEFINITION
DISTINCTLY SPECULATIVE—LOW CREDITWORTHINESS			
BA1	BB+	BB+	LOW GRADE, SPECULATIVE
BA2	BB	BB	LOW GRADE, SPEC.
BA3	BB-	BB-	LOW GRADE, SPEC.
B1	B+	B+	LOW GRADE, SPEC.
B2	B	B	HIGHLY SPECULATIVE
B3	B-	B-	HIGHLY SPECULATIVE

RATINGS SYMBOLS

SUMMARY OF RATING SYMBOLS AND DEFINITIONS			
MOODY' S	**S&P**	**FITCH**	**BRIEF DEFINITION**
PREDOMINANTLY SPECULATIVE—SUBSTANTIAL RISK OR IN DEFAULT			
	CCC+		SUBSTANTIAL RISK, IN POOR STANDING
CAA	CCC	CCC	SAME AS ABOVE
	CCC-		SAME AS ABOVE
CA	CC	CC	MAY BE IN DEFAULT, EXTREMELY SPECULATIVE
C	C	C	EVEN MORE SPECULATIVE THAN THOSE ABOVE
	CL		CL=INCOME BONDS-NO INTEREST IS BEING PAID
		DDD	DEFAULT
		DD	DEFAULT
	D	D	DEFAULT

MANUFACTURING BONDS

- A "small issue" manufacturing bond is a type of federally tax-exempt revenue bond that development authorities can issue.
- According to the IRS, the common characteristics of a manufacturing facility are:
  - Facilities may be land/or property of a character subject to allowance for depreciation.
  - The property produced at the facilities must be tangible personal property.
  - To be "manufacturing" (including processing) there must be a "change" or "transformation" of the original materials and such "transformation" should be substantial.
  - Manual or machine labor must be expended in the process (as opposed to natural growth). "Manufacturing" does not include agriculture, mining, or fishing.
  - As a result of the process, a new and different article must be created.

MANUFACTURING HURDLES

- Capital expenditure limit ($10 million tax-exempt bond proceeds + $10 million other) /$40 million national limit on tax-exempt bonds for the "Company"
- Spending requirements –
  - 95% or more of the proceeds must be used for a "manufacturing" facility (only 5% may be "bad money")
  - no more than 25% on land costs
  - at least 15% on rehabilitation expenditures, if acquiring an existing building (and the equipment therein)
  - at least 70% on "core manufacturing" facilities (e.g., manufacturing part of the building and new manufacturing equipment)
  - no more than 25% on "directly related and ancillary" facilities
  - up to 2% can be spent for issuance costs (this 2% is a part of the 5% allowable "bad money")

“QUALIFIED 501(C)(3) BONDS”

- BONDS FOR ORGANIZATIONS THAT ARE TAX-EXEMPT 501(C)(3) ORGANIZATIONS UNDER THE INTERNAL REVENUE CODE WHICH ARE ISSUED FOR FACILITIES SUCH AS PRIVATE HIGH SCHOOLS AND COLLEGES AND MEDICAL FACILITIES.
- THESE ORGANIZATIONS ARE GENERALLY FAMILIAR WITH TAX-EXEMPT FINANCING (BECAUSE THEY TEND TO USE BOND FINANCING REPETITIVELY)
- NO “VOLUME CAP” FROM DCA NEEDED.
- CAN “SELF-INDUCE”. (BUT DEVELOPMENT AUTHORITY HAS TO ISSUE THE BONDS.)
- TEFRA APPROVAL FROM LOCAL GOVERNMENT REQUIRED.

EXEMPT FACILITIES

- Exempt facilities bonds are tax-exempt under federal law.
- Development authority can issue if its state law powers permit.
- Not subject to capital expenditure limitation. Federal "volume cap" usually required.
  - Among the exemptions from the volume cap requirement: any qualified veterans' mortgage bond; bonds used for airports, docks and wharves, environmental enhancements of hydroelectric generation facilities, and qualified public educational facilities; to specified percentages, bonds for any high-speed intercity rail facility; and certain qualified private activity bonds used for solid waste disposal facilities.
- Exempt facilities bonds are for-
  - solid waste disposal facilities
  - airports
  - docks and wharves
  - mass commuting facilities
  - facilities for furnishing of water
  - sewage facilities
  - qualified residential rental projects
  - facilities for the local furnishing of electric energy or gas
  - local district heating and cooling facilities
  - qualified hazardous waste facilities
  - high-speed intercity rail facilities
  - environmental enhancements of hydroelectric generating facilities
  - qualified public educational facilities
  - qualified green building and sustainable design projects
  - qualified highway or surface freight transfer facilities

WHO DOES WHAT, WHEN?
THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
5/24	Inducement Resolution adopted Tax Questionnaire received, reviewed and discussed with Company	Issuer Bond Counsel	Issuer's Counsel is Authority Counsel. Bond Counsel prepares inducement resolution; Issuer Counsel handles adoption. MOU has usually been negotiated by this point and is usually approved by the development authority at the same time. This is one of the two times that the whole board of the development authority meets and votes.

WHO DOES WHAT, WHEN?

THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
5/31	Bond Counsel distributes schedule and distribution list Bond Counsel distributes TEFRA Documents, first drafts of Bond and validation documents	Bond Counsel Bond Counsel	
6/3	**BY 6/3 (noon)** – TEFRA notice provided to paper by noon (TEFRA hearing date to be 6/27)	Bond Counsel; Issuer's Counsel	Bond counsel coordinates running of ad (at least 14 days notice required) with Issuer's Counsel, taking into account local government meeting dates.

WHO DOES WHAT, WHEN?
THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
6/8	**ON 6/8 –** Newspaper publishes TEFRA notice **BY 6/10 –** Comments provided to Bond Counsel on first drafts of Bond and validation documents	Newspaper All	
Week of 6/12	Revised bond and validation documents distributed to parties and counsel	Bond Counsel	

WHO DOES WHAT, WHEN?
THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
Week of 6/19	Closing documents and opinions distributed Volume Cap Application documents distributed: to Issuer – Volume Cap Application to Company – Volume Cap Application and jobs letter to bond purchaser – commitment letter to DCA BY 6/23 – Final comments provided to Bond Counsel on second drafts of Bond and validation documents	Bond Counsel All	An allocation of volume cap is needed from DCA for these tax-exempt "small issue" manufacturing bonds. The financing commitment letter comes from the bond purchaser, either a bank or an underwriter. If the bonds will be publicly sold, the underwriter will normally distribute the Preliminary Official Statement to the finance team at this point. The Official Statement is a disclosure document, like a prospectus. It has to be approved by the development authority

WHO DOES WHAT, WHEN?

THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
Week of 6/26	ON 6/27 – TEFRA hearing ON 6/27 – Bond Resolution adopted BY 6/30 – Comments provided to Bond Counsel on closing documents and opinions BY 7/1 (morning) – Petition and Complaint filed; Order to Show Cause signed and hearing date and time set BY 7/1 (noon) – validation notice delivered to newspaper for publication on 7/6 and 7/13	Hearing Officer Issuer All Issuer's Counsel Issuer's Counsel	The TEFRA hearing officer is usually Issuer's Counsel or the development authority's executive director. Adoption of the Bond Resolution is the second and final time that the whole board of the development authority meets and votes. The bonds have to be judicially validated. The hearing has to be advertised two weeks in advance. It has to be coordinated with the judge's schedule.

WHO DOES WHAT, WHEN?

THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
Week of 7/3	ON 7/5 – Local Government meets and adopts TEFRA approval BY 7/5 – Signed Volume Cap Application Documents returned to Bond Counsel ON 7/6 – First validation notice published Application for Volume Cap allocation filed with DCA	City/County Attorney; Local Government Issuer, Company & bond purchaser Newspaper Bond Counsel	Private activity bonds have to be approved by the local government in order to be tax-exempt.

WHO DOES WHAT, WHEN?

THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
Week of 7/10	ON 7/13 – Second validation notice published Answers of Company and Issuer distributed for signing and return to Bond Counsel Bond documents and closing documents sent out for execution	Newspaper Bond Counsel Bond Counsel	

WHO DOES WHAT, WHEN?
THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
Week of 7/17	ON 7/20 @ 9:00 a.m. – Validation hearing Executed Bond documents, closing documents and opinions sent to Bond Counsel to hold in escrow pending closing	Issuer's Counsel All	Bond counsel gives an opinion that covers tax status and all other matters. Issuer's counsel's opinion covers Authority matters. If the bonds will be publicly sold, the underwriter will be offering the bonds by this point.

WHO DOES WHAT, WHEN?

THE SCHEDULE FROM AN ACTUAL BOND FINANCING

Date	Event	Responsible Parties	Sidebar Comments
Week of 7/24	Volume cap received PRECLOSING (by mail) CLOSING (by telephone)	DCA All All	In-person closings are very rare

CONCLUSION- BONDS ARE NOT ENOUGH

•Changes in the national economy over the years, plus tougher rules for tax-exempt bonds, have caused a decline in bond deals.

►Exception- 2009 and 2010, when rules were relaxed under the American Recovery and Reinvestment Act of 2009

Year	No. of Muni. Bond Issues
2002	14,401
2003	15,053
2004	13,614
2005	13,959
2006	12,766
2007	12,659
2008	10,830
2009	11,721
2010	13,828
2011	10,589

Source: Bond Buyer

CONCLUSION- YOU CAN STILL GET YOUR PROJECTS FINANCED

- BEST BETS FOR BONDS
  - “taxable floaters” secured by a bank’s letter of credit confirmed (or wrapped) by a FHLB in order to get an investment grade rating. Of course, if you can get an investment grade letter of credit from a stronger bank, that means that the FHLB is not needed. It also means that the bonds can be tax-exempt, if otherwise qualified.
  - private placements of tax-exempt bonds with banks and financial institutions. Even though most of these bonds won’t get BQ treatment or an AMT exemption, they could still be attractive to a profitable bond purchaser.
  - “project finance”
    - non-recourse, off-balance sheet bonds issued for “de-risked” projects
  - P3 projects
    - public-private partnerships, like TADs (same as TIFs)
      - local government, not development authority, issues TAD bonds
- BETTER BET
  - make bonds part of a capital stack, along with such capital sources as New Markets Tax Credits (NMTC), EB-5 immigrant investor funding, etc.

REFERENCES

THIS PRESENTATION AND OTHER REFERENCES CAN BE DOWNLOADED AS FOLLOWS:

- March 2012- "In-Sourcing Capital: EB-5 Loans and Equity; NMTC Tax Credit Equity; and Non-Recourse Project Finance Bonds“
- October 2011 - “Project Finance - No Banks, No Recourse, No Problem!”
- June 2011- "TIFs and TADs in Tough Times“; TIFs and TADs Questions and Answers
- January 2011 - “Introduction to Tax-Exempt Bonds”
- January 2011 - “Introduction to 'Taxable Floaters' ”
- August 2010 – "Bonds For Title"

at http://danmcrae.info/whitepapers

QUESTIONS?

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MORE INFORMATION

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