



HUSCH BLACKWELL

Taking the Mystery Out of Conduit Bond Financing – “Defying Gravity”

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CREATING A WIN WIN WIN

WHAT IS A BOND?



What is a Municipal Bond?

- A debt instrument issued by a governmental or quasi-governmental issuer.
- To issue a bond is to borrow money. A bond is the evidence of the debt.
- Structure and security for the bond may vary. Municipal bonds must be issued by a governmental or quasi-governmental issuer.
- There are two primary types of bonds issued:
 - **General Obligation Bonds** – issued to provide funding for governmental projects (water, sewer, etc.); and
 - **Private Activity Bonds (Conduit Bonds)** – issued in order to loan the bond proceeds to an eligible third party authorized by law to use municipal bond proceeds (e.g. bonds issued to provide funds for a manufacturer).
- Today we will be talking exclusively about **Conduit Private Activity Bonds**

CONDUIT BONDS



Hypothetical #1 – Willie Widget

Manufacturer Willie Widget owns a large manufacturing company. Ironically, they make widgets at the facility. Their existing manufacturing facility is in Cheesetown, Wisconsin. They want to expand in either Wisconsin or another State and are exploring various incentives available through the State, the County or the municipality where they ultimately expand.

Willie Widget plans to build an approximately 150,000 square foot manufacturing facility. About 10,000 square feet will be office space and 30,000 square feet will be used for warehouse and shipping space. The budget for the building is \$11.6 million. Willie Widget will also purchase and install approximately \$2.7 million of manufacturing equipment.

Obviously, you want them to expand in your Wisconsin community. Willie Widget's lender has suggested they might consider tax-exempt bond financing. They have asked you whether they could utilize tax-exempt bonds if they locate in your municipality.

Quiz the Audience

The project would likely qualify for tax-exempt financing.

Please indicate if you believe the statement above is “True” by ringing your bell now. If you believe the statement is “False” shake the hand clapper now.

ASK THE EXPERT

Potential Borrower

MANUFACTURING COMPANY

- Manufacture or production of tangible personal property
- Includes the processing resulting in a change in the condition of the property

IRB Limit, Capital Expenditures and Volume Cap

- ✓ Maximum small issue manufacturing bond amount – \$10 million
- ✓ Capital expenditures test – \$20 million
- ✓ Bond amount plus capital expenditures during six-year period
- ✓ Both size limitations include principal user of facility and related persons (more than 50% owner of stock or partnership interests)
- ✓ \$40 million limitation aggregate IRB nationwide of a borrower and its affiliates nationwide
- ✓ Volume cap allocation
 - Application for volume cap must be made to appropriate state agency for small issue manufacturing bonds and exempt facility bonds

Prohibited Projects

“The 12 Deadly Sins”

- 
- Airplane
 - Skybox
 - Private Luxury Boxes
 - Health Club Facility
 - Golf Course
 - Country Club
 - Massage Parlor
 - Hot Tub Facility
 - Suntan Facility
 - Racetrack
 - Gambling Facility
 - Liquor Store

Hypothetical #2

Instead of Willie Widget, your community is approached by Reggie Recycling. His company recycles antiquated, broken or otherwise discarded electronics. The building and equipment budget for Reggie's project is \$26 million. Could this company use tax-exempt bonds?

Quiz the Audience

The project is (a) not a manufacturer and (b) too big to utilize tax-exempt bond financing.

Please indicate if you believe the statement above is “True” by ringing your bell now. If you believe the statement is “False” shake the hand clapper now.

ASK THE EXPERT

Potential Borrower

EXEMPT FACILITY



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graph TD; A[EXEMPT FACILITY] --> B["- Solid waste<br/>- Recycling"]
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- Solid waste
- Recycling

Exempt Facility Bonds

Exempt Facility Bonds are issued for private entities engaged in various quasi-governmental purposes, including:

- Airports, docks and other transportation related facilities
- Water, sewer and certain other local utilities
- Solid waste and hazardous waste disposal facilities
- Residential rental projects (multi-family housing)
- Enterprise zone facilities

Hypothetical #3

The Humane Society, a not-for-profit, 501(c)(3) organization, wants to build a new facility to be utilized in pursuit of the Humane Society's exempt purpose. The project has a budgeted cost of \$8.4 million. They have embarked on a fundraising campaign and, to date, have raised \$2.4 million. They have approached the municipality and their lender to ask if financing for the project could be structured as a \$6 million tax-exempt bond.

Quiz the Audience

The project could be financed using a tax-exempt bond.

Please indicate if you believe the statement above is “True” by ringing your bell now. If you believe the statement is “False” shake the hand clapper now.

ASK THE EXPERT

Potential Borrower

501(c)(3) ORGANIZATION



- 100% of property must be owned and 95% used by a 501(c)(3) organization
- No volume cap, manufacturing, size limits, capital expenditures limits, low income housing requirements

What are Private Activity Bonds?

Private activity bonds (conduit bonds) are a type of municipal bond where the proceeds are used by a private entity rather than a governmental entity.

- **Industrial Revenue Bonds (IRBs)** are issued for the benefit of manufacturing companies.
- **Qualified 501(c)(3) Bonds** are used by not-for-profit corporations.
- **Exempt Facility Bonds** are issued for private entities engaged in various quasi-governmental purposes, including:
 - Airports, docks and other transportation related facilities
 - Water, sewer and certain other local utilities
 - Solid waste and hazardous waste disposal facilities
 - Residential rental projects (multi-family housing)
 - Enterprise zone facilities
- **Other**
 - Qualified redevelopment bonds
 - Qualified mortgage bonds (single family, veterans)
 - Student loan bonds

The Whys?

Why would a municipality serve as conduit issuer of the bonds?

Why would a lender structure a loan as a tax-exempt bond?

Why would a borrower want to use a conduit tax-exempt bond?



ISSUER WIN

Issuer – confers a monetary contribution – at NO cost to municipality

- Increases economic development
- Increases tax base
- New/additional job creation

BANK WIN

Bank – confers a monetary benefit to its customer

- At no cost to the bank
- Interest on bank held tax-exempt bonds is exempt from federal corporate income tax
- Pass benefit on to customer – discount of interest rate approximately 17%

BORROWER WIN

Borrower – manufacturer, exempt facility,
501(c)(3)

- Cost of loan discounted approximately 17%
- Discount will grow as conventional interest rates rise
- Recover transaction costs in approximately 18 months

Assumptions

- Par Amount of Tax-Exempt Bond = \$4 Million
- Maturity Date = 20 Years
- Payments = Quarterly payments of interest and annual principal payments of \$200,000
- Interest Rate = Variable interest rate (based on 5-year LIBOR) as illustrated below:

YEAR	TAX-EXEMPT RATE (83% of Conventional Rate)	CONVENTIONAL RATE	IMPROVEMENT IN RATE
Years 1 through 5	4.56%	5.50%	.94%
Years 6 through 10	6.47%	7.80%	1.33%
Years 11 through 15	7.55%	9.10%	1.55%
Years 16 through 20	8.46%	10.20%	1.74%

Savings Comparison

INTEREST PAID	TAX-EXEMPT BONDS	CONVENTIONAL LOAN
Years 1 through 5	\$ 820,300	\$ 989,397
Years 6 through 10	\$ 841,596	\$1,014,598
Years 11 through 15	\$ 604,662	\$ 728,798
Years 16 through 20	\$ 253,893	\$ 306,112
Total Interest	\$2,520,451	\$3,038,905

Interest Savings on \$4 million Tax-Exempt Bond = \$518,454

If you agree that

**EVERYONE IS A
WINNER!**

**Ring bells and clap
clappers in unison!**

QUESTIONS