An Overview of Industrial Revenue Bonds in New Mexico

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The Industrial Revenue Bond

- What is it?
  a. A complex vehicle for tax abatement
  b. A very intricate set of legal and financial documents
  c. A loan from a bond purchaser to a company where the loan proceeds and repayment flow through a government issuer
  d. An incredibly valuable, if often misunderstood incentive for <u>both</u> recruitment <u>and</u> expansion of existing companies
  e. All of the above

The Industrial Revenue Bond

- What it is <u>not</u>
  a. A loan from a community to a company
  b. A way for the community to provide a loan guarantee for the company's project
  c. A way for the community to provide credit enhancement, or other financial backing
  d. A direct investment by the community in a project
  e. All of the above

Industrial Revenue Bonds

- An IRB is a loan from the bond purchaser to a company where the loan proceeds and repayment flow through a governmental issuer (via a trustee). Instead of purchasing a facility directly, companies can enter into a lease with the issuer, and, at the end of the lease, purchase the facility from the issuer for a nominal amount.

Industrial Revenue Bonds

- City council or county commission must vote to induce an IRB, and the community does not lend its credit to an IRB. The company must secure its own purchaser of IRBs or the company can purchase its own IRB
- Unlike municipal bonds, no tax revenues are pledged to pay off the bonds

Why Offer an IRB ?

- IRBs are a tool to encourage business expansions and locations, job growth and capital investment
- Most states have IRB programs, but they are not necessarily defined the same way ours are (some provide public financing)
- IRBs are an “inducement” to encourage companies to locate or expand here in New Mexico; they must be issued before a project is started (without the IRB it is unlikely that the project could happen here)
- IRBs help New Mexico be competitive for capital-intensive projects by reducing risk/cost of locating here; highly competitive market both for companies and communities

Purpose

- Only projects can be financed with IRBs
- “To promote industry and trade other than retail trade, by inducing manufacturing, industrial and commercial enterprises to locate or expand in this state, promoting the use of agricultural products and natural resources of this state, and promoting a sound and proper balance in this state between agriculture, commerce and industry. It is intended that each project be self-liquidating. It is not intended hereby to authorize any municipality itself to operate any manufacturing, industrial or commercial enterprise.” (Counties can do retail.)

Purpose-Continued

- “Projects” include land, buildings, furniture, fixtures, and equipment. Equipment only IRBs are fine. Working capital is not eligible.
- Suitable purposes include facilities for manufacturing, assembly of manufactured products, warehouse/distribution, services, 501-c-3 entities, healthcare services, research facilities, industrial parks, and office headquarters.

How do they work?

The city/county issues the bonds but is not making the loan. The investor buying the bond makes the loan. The company finds its own bond purchaser. It can also buy its own IRBs. The city technically owns title to the facility built with IRBs and leases it to the company for up to 30 years (20 years in Albuquerque). At the end of the term, title is transferred to the company.

Who Pays Off the Bond?

- The company is responsible for all loan payments, not the local government. There are no taxpayer funds involved in the bond payments. Since the city is not responsible for the loan, there is no effect on the city's credit rating.
- State law provides an IRB is not a general obligation of the City under the meaning of the Constitution. Bonds are payable solely out of revenue from the project for which the bonds were issued.

Why is an IRB useful to a company?

- IRBs help companies save money in two ways:
- Because the city technically holds the title to the project, it's exempt, for up to 30 years (20 in Albuquerque), from property taxes on land, buildings, and the useful life of equipment (usually 5-10 years) purchased with bond proceeds
- Amount/percentage of property tax exemption and length of bond term is determined by each community (statutory limit of 30 years property tax abatement)

Why is an IRB Useful?

- Also, a company usually receives gross receipts and compensating tax exemptions on initial purchases of equipment made with bond proceeds (most states do not charge a “sales tax” on manufacturing equipment)
- This is achieved through the “agency” relationship established through the IRB; company makes purchases as an agent of the city/county that issued the bonds
- NM Tax and Revenue Dept. supervises the Non-Taxable Transaction Certificates used for purchases for each IRB
- State and other gov’ts still receive GRT on construction materials and labor that they would not have realized without the IRB project

Tax-Exempt IRBs (a horse of a slightly different color)

- Almost all IRBs issued by the City are “taxable,” meaning the interest earned on the bonds is subject to Federal income taxes for the bond holder
- There are certain types of projects that fall under a different part of the IRS code, and these are called “tax-exempt”
- These projects tend to be smaller manufacturing deals (max. $10 million) or 501-c-3 entities
- 501-c-3 entities already are exempt from property and grt/comp tax; they request the City to act as a conduit issuer, as required by Federal law, to help them obtain financing

Approval Process (ABQ)

- Company meets with staff to discuss project and identify issues;
- Company secures bond counsel, identifies a purchaser for the bonds, and financial structure
- Company submits application to City staff
  - Project Description
  - Jobs (#, types,$, benefits, career opportunities)
  - Land use/zoning/development/design

Process-Continued

- Application (cont.)
  - Financing (must have financing secured)
  - Economic impact (wages, benefits, local purchases, taxes)
  - Corporate information/project management
  - General community benefits
- Staff scored evaluation, staff analysis
- Fiscal Impact Analysis prepared by UNM Bureau of Business and Economic Research

Process--Continued

- A series of at least three public hearings is held, after notification is sent to nearby property owners, neighborhood associations, potential competitors, county
- City Council votes on project after review by Council Finance Committee
- Attorneys prepare closing documents
- Mayor signs closing documents
- At closing, purchaser buys bonds

Process--Continued

- Typical fees include $2,500 application fee; fiscal impact analysis fee of $1,800-$2,500; City’s bond review counsel fees, plus company’s own counsel and transaction costs
- Total cost can range from $35,000--$75,000, depending on the complexity of the financing, and the process generally takes 3-6 months
- Accountability: Company must submit an annual report to the City regarding employment, local purchases, community involvement, etc.

Clawbacks, PILOTS and other considerations

- Local Governments adding provisions to IRB documents to protect against early closure of facilities or failure to achieve job creation or other specified goals
- Abatement reductions if job creation (or payroll or capital investment) goal not met. Can be raised again when goals met.
- PILOTs (Payment In Lieu Of Taxes) are made to cover a variety of conditions the issuing entity may wish to impose. Examples: a percentage of the abated taxes that would have been paid to the General Fund, or School District, or an “at-risk youth education initiative”

Clawbacks and PILOTs

- “Clawbacks” are financial penalties that require a repayment of abated taxes if a plant closes prior to a specified time (e.g., within five years after bond issuance)
- City of ABQ collected $13.1 million when Philips Semiconductors closed their facility, and distributed funds to all taxing entities
- State of New Mexico received $4.8 million from the City

Here's an example:

- Company X wants to build a $10 million plant and buy $15 million in equipment. The city issues a $25 million bond for 20 years. During this period the company will repay the bond. The company gets a break on property taxes for land/bldg of $2.96 million over 20 years, a break on equipment property taxes of $886,000 over 7 years, plus $769,000 compensating tax exemption on equipment purchased
- ***It is not correct to say the company is getting $25 million in tax breaks.*** <u>***The $25 million represents the amount of money the company will invest in our community.***</u>

Can a small business use an IRB?

- Any sized company can use an IRB. However, because of the financing and legal costs, IRBs are typically used for larger capital projects. They are generally not recommended for projects less than $2 million.

Do companies still have to pay taxes?

- IRBs do not affect other taxes that companies owe, such as payroll taxes or any other corporate taxes due
- Companies pay gross receipts taxes on the labor and materials used in construction of the project
- In most cases companies will pay gross receipts taxes on the services or goods they produce and sell, as well as taxes on goods and services they purchase. In addition, a company’s employees are paying income taxes and gross receipts taxes on their purchases. Additional property acquired without using bond funds is subject to property and GRT/comp taxes.

Cost or Benefit? Give-away or Investment?

- The City does a thorough analysis of the project using more than 40 criteria
- City also contracts with UNM BBER to perform a Fiscal Impact Analysis on all projects—comparing what taxes the company anticipates paying and generating to the “foregone” taxes and potential additional City costs
- Project must have a positive fiscal impact for approval

Are foregone taxes an actual loss or expenditure?

- IRBs are used when they are the critical factor for the project's viability in our community. Without the IRB the project would not have happened. The highly competitive market forces companies to reduce costs. Many states have significantly lower start-up or operating costs. Our communities look for a reasonable balance between foregone taxes and other revenues and economic/community benefits
- **You can't "lose" what you wouldn't have had in the first place.**

Are IRBs Over-Used?

- The City of Albuquerque is the largest issuer of IRBs in the state.
- Yet only ten IRBs issued in the past 10 years are still outstanding—an average of one per year
- Nine of the ten were issued to <u>existing</u> companies/facilities. Only one was a newly recruited company

Why Do Some Companies Deserve Special Treatment?

- Without “basic” industry in your economy, exporting goods/services and bringing new money in, your community cannot continue to exist, let alone thrive
- The viability of ALL other businesses in the community, small and large, depends on their success

Should the State be the Entity that makes Decisions regarding IRBs?

- Some say local governments either don’t have the sophistication to assess the true merits and costs of a proposal or they let local politics overly influence what should be a strictly fiscal decision.

Who Decides?

- Local governments are the ones that should bear the responsibility for making these decisions. They are the ones who will bear the largest share of delayed property tax revenues, and will have to answer to local residents regarding any other possible costs to the community. They are also in the best position to judge the benefits of a new or expanding company for the community. They can add additional qualifying criteria in the process to meet specific needs of the area.

Who Decides? -- Continued

- Should the state, the schools, hospitals, county, and other affected entities have the right to review and vote on proposed property tax abatements granted through each IRB?
- Should all entities which stand to have their taxes abated have a role in the approval process?

Decision Process

- The approval process currently in place in most communities already allows for a tremendous amount of public input. (City of ABQ holds a minimum of three public hearings.)
- It is not unusual for the process to take at least three months before a decision is made—three months before the company even knows if it will be possible to proceed with a project in New Mexico.

Decision Process--Continued

- Additional review and approval processes could double or triple the time frame.
- Companies cannot afford those kind of delays before knowing if the project can proceed or if they will have to start all over someplace else.
- Economic development is essentially a process of elimination; companies need predictability and need to reduce risk
- When confronted with this additional risk of delay, companies will eliminate New Mexico from consideration.

www.cabq.gov/econdev/documents/IRBapplication

- Additional information courtesy of :
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