

# Industrial Revenue Bonds in South Carolina - 2010

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## Introduction

This brochure provides an overview of financing with industrial revenue bonds (“IDBs” or “bonds”) and presents the basic facts and concepts in simple terms. Persons interested in pursuing bond financing should seek advice of bond counsel specific to the transaction under consideration.

In an IDB transaction, a state or local governmental entity issues bonds and loans the proceeds from the sale of the bonds to a private entity for an authorized project. In South Carolina, cities, counties and, at the State level, the South Carolina Jobs-Economic Development Authority (“JEDA”) may issue IDBs. Because a governmental entity issues the bonds, the bond holder may exclude the interest on the bonds from gross income for federal tax purposes as well as under South Carolina tax law. Such “tax exemption” results in a lower interest rate on the bonds, which the issuer passes along to the company on behalf of which the bonds were issued.

## Inducement

Companies considering IDB financing must obtain an inducement resolution from the issuing entity in order to preserve the option to use IDBs. The inducement resolution entails preliminary approval only and is non-binding as to all parties. Companies should *not*, except upon advice of bond counsel, acquire or enter into any contractual obligation to purchase any real or personal property before obtaining an inducement resolution from the county council or city council in whose jurisdiction the project will be located or from JEDA. To do otherwise may preclude or severely limit the use of industrial revenue bond financing. Nexsen Pruet, LLC, as bond counsel, assists with obtaining the inducement resolution.

## Manufacturing Facilities Which Qualify for IDB Financing

Many of the limitations regarding IDB financing stem from federal tax law, which limits the type of IDBs discussed herein to manufacturing projects, solid waste and hazardous waste disposal

facilities and projects in communities which receive a federal designation as an “enterprise zone” or “enterprise community”. The discussion herein centers on financing of manufacturing facilities. “Manufacturing” is defined to include those projects used in the manufacturing, processing or assembling of any agricultural or manufactured product. Other brochures are available for other facilities.<sup>1</sup>

IDBs may be used to finance the acquisition of land and buildings as well as other improvements to real property; machinery, apparatus, equipment, office facilities and furnishings; interest during construction; and costs of issuance. IDBs may also be used to expand existing projects. IDB funds cannot be used for inventory or working capital.

Federal law places certain limitations on the use of IDBs to finance land, existing facilities and used equipment. A company seeking to acquire an existing building (and the equipment therefor) using bond proceeds must, within two years following the later of the date of acquisition thereof or the issuance of the bonds, expend an amount equal to 15% of that portion of the purchase price to be financed from bond proceeds on rehabilitation of the building (and the equipment therein). For structures other than buildings, an amount equal to 100% must be spent on rehabilitation before the purchase price will qualify. The cost of expansion does not count toward the 15% rehabilitation requirement.

Office facilities, warehouses and other assets not used directly in the manufacturing process may be financed only to the extent that they are located on

the same premises as, and are functionally related to, a manufacturing plant. It should also be noted that post-issuance changes in use of the facilities and certain changes in ownership thereof could result in loss of the tax exempt status of the bonds. Moreover, if there is a prohibited change in use or ownership, an additional penalty attaches - the company may not deduct interest paid with respect to the bonds during the period when so used or owned.

### **Capital Expenditures Limit**

The Internal Revenue Code limits the amount of IDBs which may be issued for manufacturing projects as follows:

- (1) Bonds may be issued by a county, city or JEDA in an amount up to \$1,000,000 for a company and its affiliates without any restrictions on the amount of the total investment by the affiliated group within the county or city. A county and a city within that county may each issue \$1,000,000 of IDBs for separate (non-integrated and non-adjointing) projects owned collectively by the same affiliated group. The \$1,000,000 available for an affiliated group within a county or city may be split over two or more projects. For IDB purposes “affiliate” status is based upon a 50% common ownership test with very broad rules as to constructive ownership requiring aggregation of ownership interests held by family members and partners.
- (2) With a proper election, the amount of the bonds may be boosted to \$10,000,000. In order to preserve the tax exemption of interest, however, the total capital expenditures by all persons with

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<sup>1</sup> See NP Memorandum on Waste Disposal: Tax Exempt Disposal Facilities—Do You Qualify?

respect to the project may not exceed \$20,000,000. For purposes of calculating this \$20,000,000 capital expenditures limit, the borrower must include the face amount of the bonds plus a) all other capital expenditures with respect to the “project” by any person and b) all capital expenditures of members of the affiliated group which are chargeable to facilities located in the same city or county, as the case may be. The borrower must measure such capital expenditures during a six-year period running three years before and three years after the issuance of the IDB's.

Capital expenditures for these purposes include: (a) those which could be capitalized, even if they are not; (b) those made by a principal user of the project or any person related to such principal user, within the jurisdiction of the applicable city or county, regardless of whether made in connection with the project; and (c) those made in connection with the project by any person, regardless of whether such person is a principal user or person related to a principal user (for example, expenditures made by local government for site work as an incentive to lure the company to the community). Principal users include, generally, owners, tenants who occupy 10% or more of the space or who generate 10% or more of the revenue from the facility and persons who obtain the indirect use of the project through output contracts or similar arrangements.

Companies often lease machinery or tooling in order to avoid the

\$20,000,000 limit on capital expenditures. In such cases: (a) the lessor must be the manufacturer of the leased equipment or a person in the trade or business of leasing property of the same nature or similar to such properties sought to be leased; and (b) the leased property must be of a type which is ordinarily leased pursuant to general business practice. Such a lease must be a true lease, not a financing lease.

### **How IDBs Work**

With IDB financing in South Carolina, the company has the option of owning or leasing the project. In either structure, however, the company will agree to make loan repayments or lease payments in amounts sufficient to pay debt service on the IDBs. The IDBs are by law strictly a pass through or non-recourse form of financing as far as the governmental entity is concerned. The company's credit determines the marketability of the bonds.

In addition to the loan or lease agreement between the issuer and the company, which sets forth the company's responsibilities, there is usually an indenture agreement between the issuer and either a bank which purchases the bonds for its portfolio or, where the bonds are distributed through the capital markets, a corporate trustee for the benefit of the bondholders. The terms of the bonds are set pursuant to such an indenture. In both cases a bank usually holds the proceeds from the sale of the bonds in a construction fund. Such bank, upon approval by the issuer and/or the company, disburses the proceeds for the cost of construction and acquisition.

Where IDBs are publicly distributed, a commercial bank usually provides credit enhancement by issuing a letter of credit securing the bonds. In such

cases, the company would agree under a reimbursement agreement to reimburse the bank for any draws under the letter of credit. The bank, which buys the bonds or provides a letter of credit will determine whether guarantees or collateral must be provided as security for the company's repayment obligation.

There is considerable flexibility in the terms that can be worked out between the parties. The repayment schedule for the bonds can be tailored to the needs of the company. The term of the bond usually ranges from 10 to 25 years.

The use of IDB financing need not delay the project. The company may use its own funds or interim financing before the bonds are issued. However, the inducement resolution must be in place as discussed above, and the bonds must be issued within one year after completion of the project.

### **Procedure**

- (1) The company retains bond counsel.
- (2) Bond counsel and the company discuss company's plan with appropriate representatives of the public entity which will issue the bonds. If the issuer agrees to assist the company, an inducement letter between the company and the issuer can be approved. Depending upon the rules of the issuer, 7 to 30 days may be required to get to this point. This agreement does not obligate the company to undertake the project nor require it to use IDB financing.
- (3) The company arranges for the sale of IDBs via a public sale or private placement. The company may wish to utilize an underwriter to assist in

the sale of the bonds. Most local banks can also assist in this process.

- (4) The parties convene a meeting among bond counsel, counsel for the company, and counsel for the trustee or purchaser of the bonds to finalize the terms of the bonds.
- (5) The issuer adopts an ordinance or resolution approving the issuance of the bonds and authorizing the submission of a petition to the State Budget and Control Board requesting approval of IDBs to finance the project. Federal regulations require a public hearing to be held by the issuer in the city or county prior to final approval, and notice thereof must be published not less than 15 days prior to the hearing.
- (6) Generally, final approval may be followed by filings or notices which allow any interested citizen to challenge the validity of such approval in Court within 20 days. Following the 20-day period, the closing takes place at an agreed upon place. All documents are executed and the bonds are paid for and delivered to the purchaser.

Once a commitment letter issued by the purchaser is accepted by the company, the bond issue can be closed within a 60-90 day period. See the sample schedule appended hereto.

### **Additional Federal Limitations**

There are limitations on the amount of IDBs and certain other private activity bonds that can be issued by each state based on the population of the state. In South Carolina, the State Budget and Control Board allocates "volume cap"

among programs and projects, taking into account factors such as the timing of the request, the location of the project in a less developed or least developed area and the overall benefits to the State and community from the project. There have been several years in which the State's entire volume cap has been allocated, so it is best to plan carefully in scheduling the approval process.

The federal tax code provides that no group of affiliated companies may have more than \$40,000,000 of IDBs outstanding nationwide. This includes bonds to finance projects owned by the company, projects owned by any related person, and projects where the company is a principal user or lessee.

The federal tax code also limits the weighted average maturity of the bonds to 120% of the weighted average economic life of the facilities being financed and prohibits taking accelerated depreciation for property financed with IDBs. Generally, cash, certificates of deposit, taxable securities and most other investment-type property may not be pledged as security for IDBs or in connection with a letter of credit issued to secure IDBs.

In addition, bonds will not be tax exempt if more than 5% of the proceeds thereof are paid to a person or entity who was a substantial user before and after the date of the issue or a person related to such a substantial user. Substantial users consist of those who occupy more than 5% of the space of the project, generate more than 5% of the revenues from the project or for whom the project was specifically constructed. Thus, an owner of a facility who receives bond proceeds in payment of the purchase price may not remain in the facility as a long-term tenant.

## **Fees**

Certain administrative fees are payable for IDBs in South Carolina to JEDA, if JEDA issues the bonds, or to the State Budget and Control Board, if a city or county issues the bonds. Issuer fees range from \$2,000 to \$12,500 for most IDB's, depending upon the size of the transaction and the issuer.

JEDA also charges a \$500 application fee at the time of inducement with the balance payable at closing. JEDA's counsel may charge up to \$5,000. For unrated transactions, JEDA charges a separate fee for credit review. County fees, including the county attorney fees, vary widely and should be verified at the outset of the transaction.

The company is also responsible for fees of bond counsel, any lender or underwriter, any remarketing agent, any trustee, its own counsel and counsel to each of the professionals and for any and all other expenses in connection with issuing the bonds. Up to 2% of bond proceeds may be used to pay issuing expenses for tax exempt transactions.

## **Role of Bond Counsel**

Bond counsel ordinarily acts as an independent expert whose primary responsibility is to render an objective legal opinion with respect to the authorization and issuance of bonds. Unless engaged in a separate capacity in addition to its role as bond counsel, bond counsel does not advocate the interests of the company or any other party to the transaction. The issuer, the company and other parties should be represented by their respective counsel.

SAMPLE TIME SCHEDULE - INDUSTRIAL REVENUE BONDS

Preliminary            1-3 months

During this period, bond counsel will arrange for OFFICIAL ACTION by the issuer, while the company evaluates total project costs and either negotiates terms with a commercial lender or arranges the public placement of the bonds through an underwriter. Usually there will be no further action by the issuer until the company has obtained a commitment letter or term sheet.

- 0                            Date that company and underwriter/bank specify terms for first draft of documents.
- +10                        Publication of Notice of Public Hearing.
- +15                        First Reading of Bond Ordinance by Issuer (requires 3 readings); Resolution by issuer authorizing Petition to Budget and Control Board.
- +21                        Distribution of first draft of bond documents.
- +30                        Public Hearing and Second Reading of Bond Ordinance.
- +31                        Comments on first draft.
- +35                        Action by Budget and Control Board.
- +41                        Second draft of documents distributed.
- +45                        Comments on second draft.
- +50                        Final draft of documents distributed.
- +55                        Final Reading of Bond Ordinance by Issuer.
- +65                        Prepare execution pages of documents; arrange for execution.
- +70                        Assemble completed documents.
- +75                        Close.