

Fee In Lieu of Taxes and Special Source Revenue Bonds/Credits in South Carolina _ 2000

Prepared by Nexsen Pruet Jacobs & Pollard, LLP
 April C. Lucas, Esquire
 ALucas@NPJP.com

1441 Main Street, Ste. 1500	Other offices:
P.O. Drawer 2426	Greenville, SC Charleston, SC
Columbia, SC 29202	Myrtle Beach, SC Charlotte, NC
Telephone (803) 540-2035	

© All rights reserved.

Introduction

This brochure outlines the basic parameters of the Fee in Lieu of Taxes ("FILOT") and Special Source Revenue Bond programs in South Carolina, each of which has the net effect of reducing the burden of property taxes for qualifying businesses. This document should not be considered as legal advice and companies seeking to undertake such transactions should seek the advice of counsel before commencing negotiations with a county.

FILOT Benefits

Companies with qualifying projects may negotiate with the county to reduce the rate at which real and personal property will be assessed over a twenty-year period for *ad valorem* taxation purposes. South Carolina assesses most industrial property at 10.5% of fair market value. Under the FILOT, a county may reduce the assessment ratio to as low as 6% for most projects. Certain projects entailing unusually large investments, as discussed below, may qualify for a 4% assessment ratio for up to thirty years. In opting for a FILOT arrangement, companies forego a five-year moratorium on the non-school portion of *ad*

valorem taxes otherwise available for manufacturing facilities.

For example, a project with \$25,000,000 in personal property in an area with 200 mils in *ad valorem* taxes, of which 50 mils is subject to abatement, would pay \$393,750 in the first year under the 10.5% assessment ($\$25,000,000 \times .105 \times .150$). A 6% assessment ratio under a FILOT reduces the payment to \$300,000 ($\$25,000,000 \times .06 \times .200$). Taking into account depreciation on personal property, the above calculation (the "Standard Calculation") produces a payment schedule which declines over time until the assets are fully depreciated. The parties may opt to fix the millage rate for the entire term of the FILOT or adjust the millage rate at five-year intervals based upon the average millage during the preceding five years. Set forth in **Attachment A** hereto is a more detailed sample calculation.

Qualifying Projects

The "Original FILOT Act", Title 4, Chapter 29 of the Code of Laws of South Carolina, 1976, as amended, authorizes counties to negotiate FILOT agreements with companies which undertake to establish

or expand manufacturing facilities, centers, tourism facilities, and certain other commercial and industrial projects. To qualify under the Original FILOT Act, **companies must commit to invest at least \$45,000,000 in land, buildings and other improvements and machinery and equipment and must convey title to the property to the county in exchange for a lease-purchase agreement.**

Projects entailing investment levels between \$5,000,000 and \$45,000,000 may utilize the provisions of Title 4, Chapter 12, Code of Laws of South Carolina, 1976, as amended (the "Streamlined FILOT Act"), or Title 12, Chapter 44, Code of Laws of South Carolina, as amended (the "Simplified FILOT Act"). Although the Streamlined FILOT Act and the Simplified FILOT Act provide for less complicated procedures in arranging a FILOT, they also eliminate certain benefits available under the Original FILOT Act, as discussed below. Projects aggregating in excess of \$45,000,000 may choose between the Original FILOT Act, the Streamlined FILOT Act or the Simplified FILOT Act.

In 1999, the minimum investment level to qualify for a FILOT arrangement under the Streamlined and Simplified FILOT Act **was lowered from \$5,000,000 to \$1,000,000** for counties that have an average annual unemployment rate of at least twice the state average during each of the last two completed calendar years. Currently, the counties that qualify for the \$1,000,000 investment level are: **Marlboro, Williamsburg; Georgetown; Chester; Lee; and Allendale.**

Under each of the acts, a company must comply with the minimum investment criteria within five years from the end of the property tax year in which the company places the project or the first phase of the project in service (the "Threshold Period").

distribution

The county may, in its discretion, allow either five or seven years for completion of the project (the "Investment Period") as long as the company meets the minimum, threshold investment within the five-year Threshold Period. The parties may also agree to allow replacement property to be included in the negotiated fee after the five to seven year Investment Period up to the basis of the original property and for the remaining term applicable to the original property. In addition, the parties may provide for reductions in the FILOT when the company disposes of project assets. Each increment of the project placed in service during the five to seven year Investment Period benefits from the reduced assessment ratio for a period of 20 years calculated separately for each increment. Thus, the FILOT agreement may extend to a maximum term of 27 years.

Mega Projects

As noted above, certain very large projects ("Mega Projects") qualify for a 4% assessment ratio for a period of thirty years. In addition, the county may extend the five-year minimum investment Threshold Period to eight years with the possibility of a ten-year Investment Period for project completion as long as the investor meets the minimum investment within eight years. Generally, Mega Projects must reflect investment of at least \$400,000,000 (of which at least \$200,000,000 must post-date approval by the county of the FILOT arrangement) and at least 200 new, full-time jobs at the project site. The FILOT statutes reduce or dispense with the minimum job requirement in certain isolated instances.

Original FILOT Act, Streamlined FILOT Act and Simplified FILOT Act

Under the Original FILOT Act, the parties can opt to adjust the Standard Calculation (see "FILOT Benefits" above) to suit the cash flow requirements of the company. Under this option, most companies opt for equal annual payments with respect to each project increment, an arrangement often referred to as the "Flat Fee" arrangement. Such a Flat Fee calculation, or any other deviation from the Standard Calculation, must produce the same net present value as the Standard Calculation over the twenty-year term. The Original FILOT Act also permits facilities previously subject to property taxes in South Carolina ("Previously Existing Property") to benefit from the negotiated FILOT if acquired in an arms-length transaction and if the company invests an **additional** \$45 million in the project.

The Streamlined FILOT Act allows for none of these options. Moreover, it purports to give the county the right to terminate the lease and sell the property free and clear of any claim by the company upon ninety-days notice if the company fails to make any payments under the lease. The Streamlined FILOT Act does, however, eliminate the need for the county to issue industrial development bonds in conjunction with the FILOT arrangement as will be discussed below, a circumstance which simplifies the documentation and the procedures.

Although the Simplified FILOT Act does not allow for a Flat Fee calculation or other deviation from the Standard Calculation, it does significantly simplify the FILOT arrangement. As with the Streamlined FILOT Act, the Simplified

The South Carolina General Assembly utilized South Carolina's Industrial Revenue Bond Act as the vehicle for the Original FILOT Act, and many of the transactions closed to date have been structured accordingly. Under the Original FILOT Act, the county utilizes the proceeds

FILOT Act eliminates the need to issue industrial revenue bonds. Moreover, the Simplified FILOT Act retains the provisions allowing companies to include Previously Existing Property in the FILOT arrangement where there is \$45 million in additional investment. Most importantly, however, the Simplified FILOT Act eliminates the requirement that **the county hold title to the FILOT assets and requires use of a simple "fee agreement" instead of a lease-purchase structure.**

Relatively, few companies have taken advantage of the Simplified FILOT Act to date because there exists no judicial precedent approving the constitutionality of this statute. In 1990 the South Carolina Supreme Court upheld the constitutionality of the Original FILOT Act as then constituted in *Quirk v. Campbell, et al.* Most attorneys familiar with these transactions believe that, under our State Constitution, retention of title by the county was a fact considered by the Supreme Court to be important to its decision in that case. Accordingly, many companies have decided to follow the tried and true lease-purchase structure until there is more judicial gloss on the Simplified FILOT Act.

Typical Structure

To avoid the 10.5% assessment ratio specified in South Carolina's Constitution for most industrial property, the industry, as noted above, typically transfers title to the project to the county. Property owned by a county is exempt from *ad valorem* taxation under the State Constitution.

of the industrial development bonds to pay the cost of acquisition and construction of the project, leases the project to the industry and grants the industry an option to purchase all or part of the project for a nominal amount upon retirement of the bonds associated with that portion of the project so

purchased. Most companies have opted to purchase the bonds themselves or through an affiliated company. As noted above, the Streamlined FILOT Act and the Simplified FILOT Act dispense with the requirement to issue bonds, but the company could still utilize industrial bonds at its option. Note: The bonds issued pursuant to a FILOT are not necessarily tax exempt for purposes of federal income tax.

The industry obligates itself under the lease to pay base rent in an amount sufficient to pay the bonds, if any, and to pay fees in lieu of taxes plus any incidental costs to the county, including the county's legal fees. The transactions to date have involved large projects by many well-known companies, as well as a number of projects in the \$5 to \$10 million range.

Investment Shortfall and Early Termination

If the company fails to reach the minimum level of investment within the applicable Threshold Period (five years, or for Mega Projects, eight years), the FILOT rate reverts retroactively to a payment equal to the taxes which would otherwise have been due had the industry owned the property. The Company must then pay any differential to the county together with interest thereon at the statutory rate. Note, however, that the industry would have been eligible for a five-year moratorium on the county portion of the *ad valorem* taxes (school taxes are not abated), and the retroactive application of this exemption considerably diminishes the impact of the loss of the fee at the five/eight-year mark.

Similarly, purchases of property by the company during the term of the lease and certain transfers of project property or interests under the lease may subject the

company to an obligation to pay such a differential.

Special Source Revenue Bonds/Credits and Other Incentives

As noted above, property which is a part of a FILOT project is not eligible for the five_year property tax exemption for manufacturing facilities nor is such property eligible for the five_year corporate office and headquarters property tax exemption. However, the county may offer a FILOT in conjunction with the enhanced jobs tax credit of a multi-county park or with a Special Source Revenue Bond or Credit.

Special Source Revenue Bonds or Credits are payable solely from FILOT payments received by the county for projects located in multi-county parks, and the proceeds of such bonds may be used by the county to pay the costs of infrastructure serving the county or for improved or unimproved real property used by manufacturing or commercial enterprises ("Special Source Improvements"). The county may also pay certain costs of issuance and capitalized interest with bond proceeds. The county also has the right to use FILOT revenues for the same purposes for which Special Source Revenue Bond proceeds could have been used, a right which has led counties to offer credits to the prospect which is willing to front the cost of the Special Source Improvements. Thus, instead of issuing a bond to pay for land to be given to a prospect, the company could pay for the land and receive a credit against a certain percentage of future FILOT payments until it had recouped the cost of the land.

As with the industrial revenue bonds associated with some FILOTs, the company can purchase the Special Source Revenue Bonds or the county may agree to place the debt with a third party such as a local bank. Companies should anticipate that the county will ask for covenants and security arrangements which will ensure that sufficient revenues will be payable under the FILOT to pay debt service on the Special Source Revenue Bonds. Such arrangements may include a mortgage and covenants to maintain a certain level of investment while the Special Source Bonds are outstanding.

Because of the delicacy of negotiating such covenants during the recruiting process, many counties prefer to offer the Special Source Credits rather than bring in a bank to buy the bonds. The Credits have the added advantage of being self-adjusting. If the company fails to invest as much as it anticipates and within the time anticipated, they simply do not earn the full Credit.

Some counties have looked to Special Source Revenue Bonds as a means of financing economic development infrastructure, such as new industrial parks, spec buildings, roads and water and sewer. By combining FILOT revenues from a large number of projects, the county can achieve a blended credit which can be funded by the banks. For counties which have a lower volume of projects, planning should start several years in advance to allow a critical mass of revenues to aggregate. Because Special Source Revenue Bonds/Credits have not been tested in court, most bond counsel will give only a reasoned opinion, at best as to their enforceability.

All Special Source Revenue Bond transactions are particularly sensitive for the school districts and other taxing entities. Accordingly, care should be taken to put in

place policies regarding the use of these incentives, as to which all governmental entities can concur. **Attachment A** illustrates the manner in which Special Source Revenue Bonds and multi-county park arrangements dovetail with a FILOT arrangement.

Procedures

1. Since these transactions may entail industrial revenue bonds or Special Source Revenue Bonds, the company should retain corporate counsel and local bond counsel at the outset.
2. Since any FILOT and Special Source Revenue Bond arrangements are discretionary with the county, the company should negotiate the basic parameters of the transaction with the county governing body prior to announcement of its intent to locate in the county. Once the company has committed, the county has no incentive to forego revenue. The counties will weigh the potential benefits and costs associated with the project in determining the appropriate level of commitment.
3. Once the parties set the basic terms, the county should formally approve an inducement agreement.
4. Prior to the end of the property tax year in which the company places any portion of the project in service, the county should adopt an ordinance approving the issuance of any necessary bonds, accepting the transfer of the title to the project if applicable, authorizing the execution of the lease-purchase agreement or fee agreement, preauthorizing the

retransfer of the project at the expiration of the term of any lease and Special Source Revenue Bonds or Credits are involved, designate the project as part of a multi-county park.

5. Closing should take place at an agreed upon place at which time all documents will be executed and any bonds may be funded.