TAX-EXEMPT BONDS FOR
PRIVATE BUSINESSES IN NEW ORLEANS:
QUESTIONS & ANSWERS*

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How can a private business use tax-exempt bonds?

Nationwide, a common form of corporate finance involves the issuance of tax-exempt bonds (which were once known as "industrial revenue bonds" or "IRBs") for private businesses. Since IRBs are not limited to industrial projects, they are now referred to as "private activity bonds," or "PABs." A PAB is issued by a local government, an industrial development board or an economic development authority, under state law, to finance capital improvements for private businesses. The business for which the PAB is issued is solely responsible for repaying the principal and interest on the bond. NO PUBLIC FUNDS OR CREDIT MAY BE USED TO REPAY THIS TYPE OF BOND.

Who issues Private Activity Bonds for private businesses?

In Louisiana, statewide issuers of PABs include the Louisiana Public Facilities Authority (LPFA) and the Louisiana Community Development Authority (LCDA). In some cases, municipalities and parishes can issue GO Zone Bonds for industrial facilities within their boundaries. Also, local industrial development boards and economic development districts can issue PABs for most other purposes within their jurisdiction. These kinds of issuers are referred to as "conduit issuers" since they function solely as a "conduit" to assist businesses in financing capital improvements through the issuance of private activity bonds.

The business for which the PAB is issued is sometimes referred to as the "conduit borrower."

In New Orleans, the Industrial Development Board of the City of New Orleans, Louisiana, Inc. ("NOIDB") is a conduit issuer that has been issuing these bonds since about 1980.

Although PABs are issued by conduit issuers, the conduit issuer itself has no responsibility for the repayment of the bonds. In fact, many conduit issuers have no assets whatsoever. It is conduit borrower, i.e. the company that is building the new facility, that is solely responsible for the repayment of the bonds.

Even when PABs are issued by a city or parish government, the assets (taxes, property, revenues, etc.) of the public body can not be used to repay the bond. The bond is payable SOLELY from money that is repaid by the conduit borrower.

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Do Private Activity Bonds feature any kind of government funding, or any public guarantee or grant?

PABs DO NOT include any governmental guarantee or grant. The bonds are payable strictly from moneys provided by the company for which the bonds are issued, and backed by collateral that is put up by the company.

Furthermore, conduit issuers of PABs do not act as lenders and do not purchase their own bonds. The conduit borrower, i.e., the private beneficiary of the financing, must arrange for a bank or other investor to purchase the bonds for their project, and must negotiate the terms of the financing.

If there is no government guarantee or grant, then why would a business be interested in financing a project using Private Activity Bonds?

If all of the other requirements can be met, interest on some kinds of Private Activity Bonds is exempt from federal income taxes. Also, under the 2008 "Stimulus" legislation, the interest on most PABs issued in 2009 and 2010 IS NOT subject to the federal alternative minimum tax. Like other kinds of tax-exempt bonds, PABs will have a lower rate of interest than a conventional (i.e. taxable) loan. So, instead of borrowing money for your business at a conventional (i.e. taxable) rate of interest, the interest rates on tax-exempt PABs could be two to five percent lower, depending on the creditworthiness of the borrower and the structure of the bond.

Who would invest in or purchase a Private Activity Bond?

A PAB is not like a "traditional" municipal bond, which is payable from governmental revenues like property taxes, sales taxes or utility revenues. Generally, PABs are unsuitable for investment by individuals, and are sold strictly to banks and other institutional investors.

To put it more plainly, PAB financing is essentially corporate financing rather than municipal financing. The conduit borrower and the bond purchaser negotiate the terms of the bond, and the borrower furnishes whatever collateral (mortgages, assignments of rents or revenues, personal guaranties, etc.) that they would normally furnish to their lender. Instead of receiving a promissory note from the borrower, the lender purchases a PAB from the conduit issuer, which then loans the bond proceeds to the conduit borrower to finance the improvements. The borrower enters into an agreement whereby it is obligated to make payments to the conduit issuer that match the principal and interest payments due on the bonds. Those payments flow through a bond trustee directly to the bondholder.

Purchasers of PABs are looking for the same benefits as any lender. By virtue of the interest on the PAB being exempt from federal income tax and the federal alternative minimum tax, the lender/purchaser usually benefits by getting a better "after-tax" return than they would with a normal conventional loan.
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This is the sole reason that a business would consider using tax-exempt PABs instead of conventional financing: the lower interest rate.

What kinds of property can be financed with tax-exempt Private Activity Bonds?

Through the end of 2010, the NOIDB can also issue a special kind of PAB known as a "Gulf Opportunity Zone Revenue Bond" (GOZone Bond). GOZone Bonds are just a special kind of tax-exempt PAB, and can be issued for the following purposes:

(i) The cost of acquisition, construction, reconstruction and renovation of nonresidential real property (including fixed improvements for such property).

Translation: land, buildings and fixtures to be used by just about any kind of business in the GO Zone. Examples include manufacturing and industrial facilities, retail, warehouse and distribution, hotels, hospitals, office buildings, etc.

Exceptions: The IRS Code prohibits the use of GO Zone Bonds, for the following: any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises

Further Exceptions: GO Zone Bonds cannot be used for vehicles, equipment or other movable property. As stated by Congress: "The purpose of this limitation is to ensure that property financed with the bonds will remain in the Gulf Opportunity Zone."

(ii) The cost of qualified residential rental projects.

Translation: Multi-family residential rental projects, i.e. apartment buildings or complexes. A portion of the units must be set aside for low/moderate income tenants, EITHER 20% or more of the units for individuals whose income is less than 60% of area median gross income OR 40% or more of the units for individuals whose income is less than 70% of area median gross income. These requirements are relaxed slightly as compared to the normal requirements.

(iii) The cost of acquisition, construction, reconstruction and renovation of public utility property.

In addition to GOZone bonds, the NOIDB can issue tax-exempt bonds under more restrictive guidelines for manufacturing facilities, multi-family residential rental projects and dock & wharf facilities.

Can existing property be financed or refinanced with Private Activity Bonds?

An existing building (and its fixtures) can be purchased with the proceeds of tax-exempt bonds as long as the property is being purchased from an unrelated party and the borrower makes "rehabilitation expenditures" equal to at least 15% of the acquisition cost of the building and its fixtures (50% in the case of a GOZone Bond). For structures (or
equipment) other than a building, the rehabilitation expenditures must equal at least 100% of the acquisition cost.

**Do Private Activity Bonds have to be secured by a mortgage or other collateral?**

The security for PABs depends on who is purchasing the bonds. There is no federal or state law that requires PABs to be secured by a mortgage, guaranties, assignments or other security or collateral. It is possible, but would be unusual, for PABs to be a non-recourse issue unless the company is a very large organization with its own investment-grade credit rating.

Generally, however, there is at least a mortgage on the property that is being financed, guaranties of the owners or principals of the company, and sometimes an assignment of revenues or leases.

If the PABs are backed by a letter of credit, the collateral may be pledged to the letter of credit provider rather than to the bondholders.

**Are there any size limitations on the amount of a Private Activity Bonds?**

There is no maximum size for GO Zone Bonds, other than the limitation imposed on the aggregate amount of such bonds that can be issued in each state (about $7.9 billion in Louisiana; about $4.8 billion in Mississippi and about $2.1 billion in Alabama).

Bonds for multi-family residential rental projects and dock & wharf facilities, which are usually NOT issued as GOZone Bonds, also may be issued in any amount.

Under current law only non-GOZone PABs for manufacturing facilities are limited in size - to no more than $10 million. Until the GOZone bond authority has been exhausted, bonds in excess of $10 million for manufacturing facilities may be issued as GOZone Bonds instead.

However, the complexity inherent in issuing tax-exempt bonds will make tax-exempt PABs inefficient, generally speaking, for projects that are significantly less than $1 million. For projects between $1 million and $5 million, PABs Bonds will work best if the company can arrange private financing through a bank or other kind of private placement. For projects in excess of $5 million, PABs are almost always more efficient than conventional financing, since the issue is large enough to support the costs of a more complex structure and limited offering.

**What steps are involved in obtaining Private Activity Bond financing?**

The steps involved in obtaining tax-exempt PAB financing depend to some extent on which kind of conduit issuer is being used. While the steps may vary, there are some elements in common. Assuming a private bank placement, some or all of the following steps would need to be taken (the exact order may vary) for financings done through the New Orleans Industrial Development Board:
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• Application submitted to the NOIDB;
• Preliminary approval of the NOIDB;
• Application for private activity bond or GOZone allocation/designation from State is filed;
• Preliminary approval of the State Bond Commission;
• Publication of a Notice of Public Hearing;
• Public hearing is held by the NOIDB;
• Approval of local official (usually the Mayor);
• Preparation of Financing Documents based on term sheet furnished by lender;
• Final approval of the NOIDB;
• Publication of final approval of the NOIDB (starting a 30-day protest period);
• Final approval of the State Bond Commission;
• Approval of the Secretary of the Louisiana Dept. of Economic Development; and
• Bond are delivered to the purchaser.

These steps would take anywhere from 3 to 6 months if the Company has lined up financing (i.e. a purchaser for the bonds). Depending on the complexity of the issue, there may be more steps, and the process can take longer.

Construction is already underway; is it too late to use bond-financing?

In order to use tax-exempt bonds (including GOZone Bonds), it is necessary for the conduit issuer to adopt a preliminary approval of the issue no more than 60 days after project expenditures begin. Most expenditures made prior to the 60-day cutoff cannot be financed or refinanced with proceeds of tax-exempt bonds. Therefore, it is important, if bond financing is being considered, to secure a preliminary approval from the conduit issuer at the earliest possible date.

What are the costs of Private Activity Bonds?

As you might expect, there are significant additional costs to issue a PAB as compared to conventional financing. A relatively simple private bank placement might involve "costs of issuance" of up to 2% of the principal amount of the loan. For larger issues ($5 million or more), the costs are in the range of 1% to 1.5% of the principal amount of the loan. These additional costs can include:

• State Bond Commission fees;
• NOIDB application & closing fees;
• Costs of publication of notices and resolutions;
• Bond Counsel fees and expenses;
• Bond Trustee fees and expenses;
• Underwriter/Placement Agent fees;
• Letter of Credit or other credit enhancement fees; and
• Rating Agency fees (for larger issues)

Generally speaking, the conduit borrower will recoup the higher costs of issuance from the interest savings that result from the lower tax-exempt interest rate on the bond.
Some bond issues have a "PILOT" feature; what is that?

The term "PILOT" stands for "payment in lieu of taxes." For conduit issuers that are political subdivisions or industrial development boards (such as the New Orleans IDB), it is possible to use a "sale-leaseback" arrangement whereby the conduit issuer actually has title to the financed project during the term of the bonds. The conduit borrower is still treated as the owner for purposes of depreciation, insurance, maintenance and operation, however since the conduit issuer is a governmental unit, its property is exempt from property taxes. So, while this kind of bond issue is outstanding, the bond-financed project is not subject to property taxes.

So, how does a PILOT benefit the Conduit Borrower?

When a PILOT structure is utilized, the conduit borrower negotiates a "payment in lieu of taxes" to the conduit issuer, which is less than the amount of property taxes that they would pay if the property was on the tax rolls. This reduced tax payment, a form of abatement, is the economic incentive. Although PILOTs are generally used in conjunction with taxable bonds, they can sometimes be used as an additional incentive for tax-exempt bonds or GOZone Bonds.

In most cases, a PILOT will only be offered upon a showing that the benefits to the community in the form of additional employment, sales tax revenues, etc., will offset the fact that the full amount of property taxes are not being paid on the new property.

I may be interested in Private Activity Bond financing for my New Orleans business; whom should I contact to get more information?

The New Orleans Industrial Development Board's website is at www.idbreno.com, and an application may be downloaded there. Further information may also be obtained from the IDB's administrator, Sharon Martin, at 504-658-4242, or from the authors of this handout.

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