

Industrial Development Authority Bonds 101 – An Introduction to Public Finance in Arizona

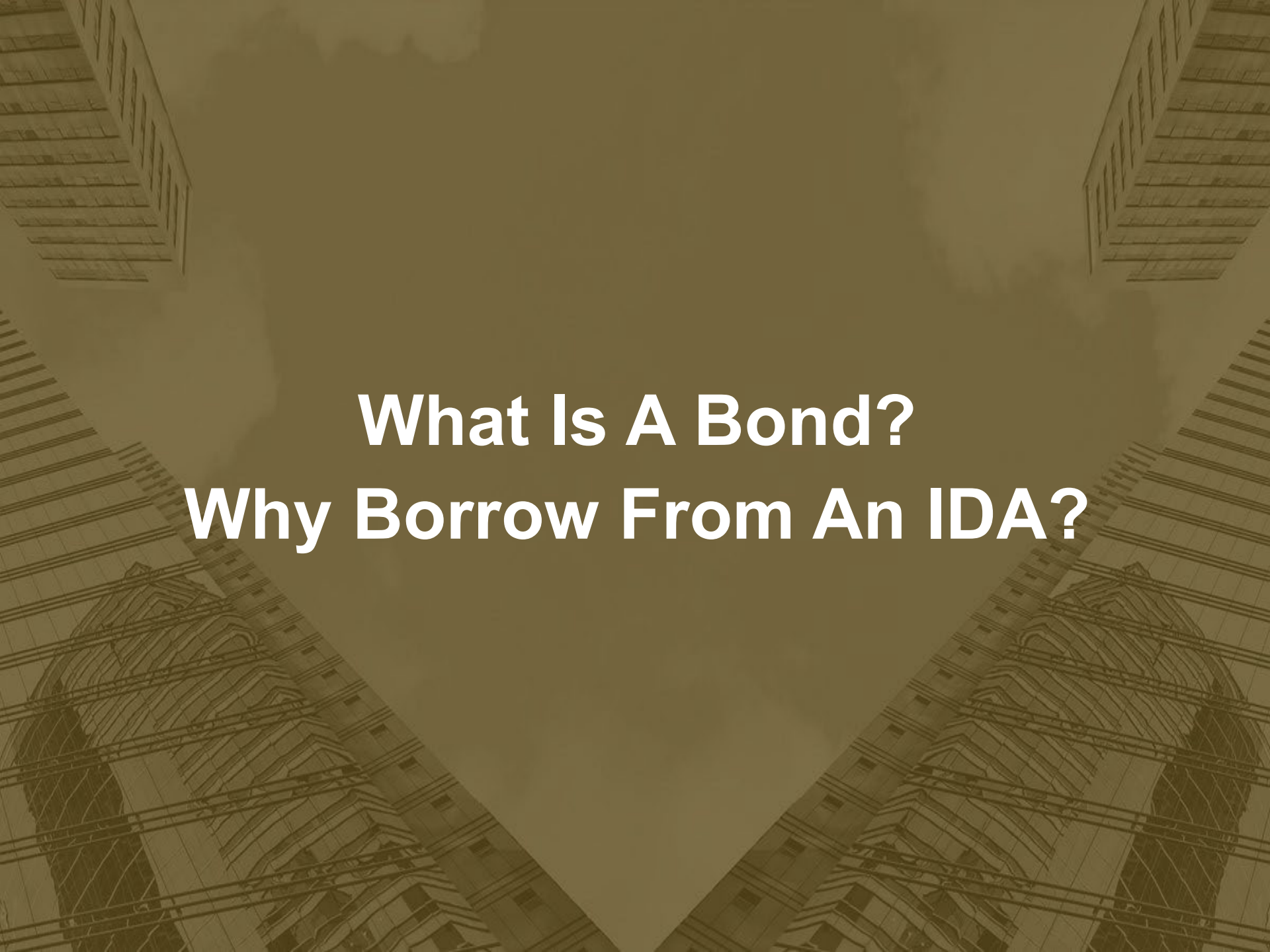
The Industrial Development Authority of the City of
Chandler, Arizona

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AGENDA

- What is a Bond? Why borrow from an IDA?
- Transaction Participants & Timing
- Applicable Law
 - Arizona Law
 - Securities Law
 - Federal Tax Law
- Chandler IDA Board's Role In a Bond Transaction

A low-angle, upward-looking photograph of several tall skyscrapers reaching towards a cloudy sky. The image is overlaid with a semi-transparent brown filter. The perspective creates a sense of height and scale, with the buildings converging towards the top of the frame.

What Is A Bond?

Why Borrow From An IDA?

What Is A Bond?

- “A bond is a fixed-income investment that represents a loan made by an investor to a borrower. A bond could be thought of as an ‘I.O.U.’ between the lender and the borrower that includes the details of the loan and its payments. Bonds are used by companies, municipalities, states, and sovereign governments to finance projects and operations. Owners of bonds are debtholders, or creditors, of the issuer.” – Investopedia.com
- Issuers pay principal and interest to investors
- After the initial sale of a bond issue to investors, those investors may sell bonds to other investors
- Per the Municipal Securities Rulemaking Board, municipal bonds are an approximately \$4 trillion capital market (2021)

Why Borrow From An IDA?

- Generally, Arizona industrial development authorities issue bonds to finance capital facilities for use by certain categories of private business and industry
 - Eligibility for projects/borrowers generally comes from federal tax law
 - 501(c)(3) organizations including educational institutions (charter schools and private religious schools), hospitals, senior living facilities, etc.
 - Manufacturing facilities (but generally limited to \$10 million)
 - Certain exempt facilities (airports, dock and wharf facilities, mass commuting facilities, etc.)

Why Borrow From An IDA? (cont'd)

- Borrowing at “tax-exempt” interest rates enables qualified borrowers to pay less interest
- Borrowers usually may not issue tax-exempt debt directly, and need a governmental entity to function as a “conduit” to access the tax-exempt market
- Generally, the interest income on Arizona industrial development authority bonds is exempt from federal income taxation, and exempt from Arizona income taxation
- Issuers may also refinance or “refund” prior bond issues to achieve debt service savings or restructure debt service payments

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Transaction Participants & Timing

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- Issuer
- Bond Underwriter
- Issuer's Counsel
- Bond Counsel
- Underwriter's Counsel
- Borrower's Counsel
- Trustee/ Bond Registrar & Paying Agent
- Depending on the specific transaction, may also have Financial Advisor, Disclosure Counsel, Rating Agencies, Bond Insurer, Verification Agent and Escrow Bidding Agent

Transaction Participants & Timing (cont'd)

- Timing is typically between 60-90 days from “kick-off” call to bond transaction closing and funds received by the borrower

Transaction Participants & Timing (cont'd)

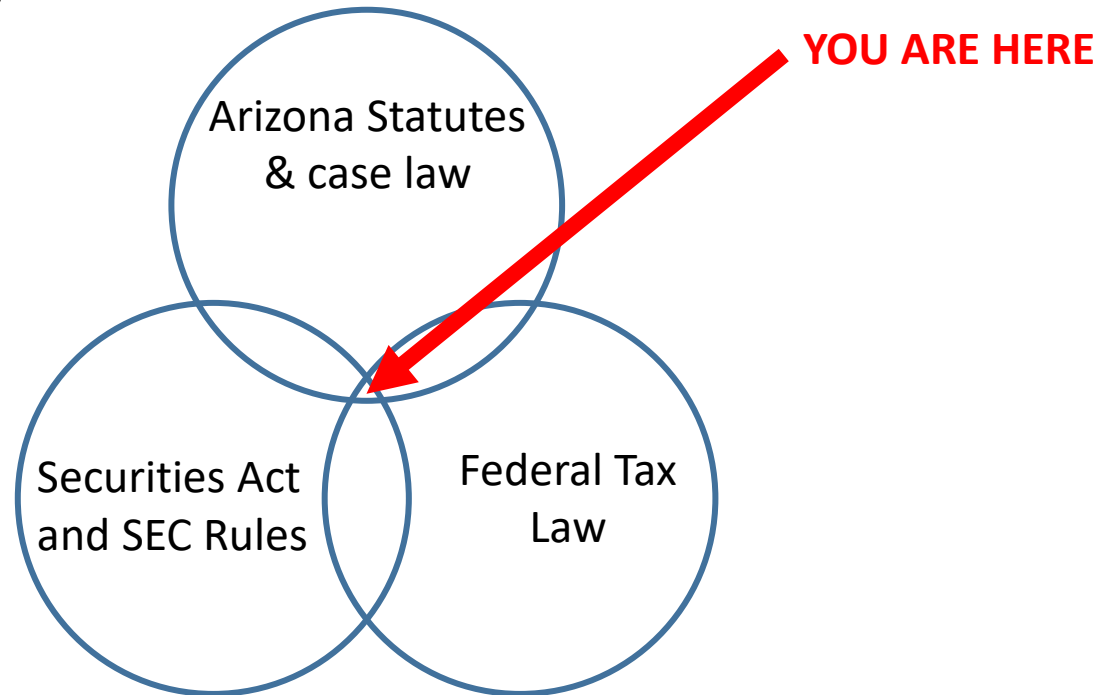
- Preparation of POS and bond documents/ due diligence
- Public hearings
- IDA Board consideration and adoption of authorizing resolution
- City Council resolution
- Pricing/ post final OS
- Closing document preparation and execution
- Closing - funds received by borrower (or trustee)
 - IRS reporting
- Post-issuance compliance

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Applicable Law

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- Intersection of state & local law, federal tax law, and securities law



A low-angle, upward-looking photograph of several tall skyscrapers reaching towards a bright blue sky filled with scattered white clouds. The perspective creates a sense of height and grandeur. The buildings are modern, with glass and steel facades. The text is centered in the middle of the frame.

Applicable Law - Arizona Law

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- Arizona Law
 - Arizona Revised Statutes Title 35, Chapter 5 – Industrial Development Financing
- IDA is a political subdivision
 - A.R.S. 35-702 – IDA is nonprofit corporation designated by statute as a political subdivision
 - An IDA is a political subdivision of the State of Arizona, with limited governmental powers (no taxing authority)
 - Only one IDA may be formed by a municipality for operation at any time

Applicable Law – AZ Law (cont'd)

- IDA Board Composition
 - Not less than 3 nor more than 9 directors
 - All directors must be duly qualified electors of the municipality that formed the IDA
 - No compensation
 - Directors may not be officers or employees of the municipality that formed the IDA
 - Subject to conflict of interest laws in Title 38, Chapter 3, Article 8, Arizona Revised Statutes
 - Elected by the governing body (city council) of the municipality, and overlapping terms

Applicable Law – AZ Law (cont'd)

- IDA Bonds
 - Repaid from revenues pledged by borrowers
 - Proceedings to issue bonds require approval of the governing body (city council) for each issuance of bonds
 - Also required with respect to federal tax law (Tax Equity and Fiscal Responsibility Act (aka “TEFRA”) hearing)
 - May be paid in installments and at such time approved by the Board, but the final maturity may not exceed 40 years from the issuance date of the bonds
 - IDA required to notify the Arizona Attorney General of its intention to issue bonds, and Attorney General responds within 10 days if the Attorney General’s opinion is the project is not permitted by Arizona law
 - IDA bonds are not a debt of the State of Arizona or the City of Chandler
 - Interest income from bonds issued by an Arizona IDA are exempt from State of Arizona income taxes (A.R.S. 35-741)

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Applicable Law – Securities Law

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- An “official statement” is prepared in connection with a public sale of IDA bonds to investors
- Bonds of a political subdivision are exempt from registration under the Arizona Securities Act – A.R.S. 44-1843
- Bonds of a political subdivision are exempt from registration under the Securities Act of 1933 – Section 3(a)(2)
- Federal laws prohibit the SEC from requiring a political subdivision to file any application, document or report with the SEC before the sale of the political subdivision’s bonds
- BUT municipalities and other governmental issuers are still subject to the disclosure-based portions of federal securities laws

Applicable Law – Securities Law (cont'd)

- Securities Act of 1933 (1933 Act)
 - Requires broad, accurate and complete disclosure in connection with the primary offer and sale of securities
 - Section 17(a): unlawful to employ any device, scheme or artifice to defraud, or to engage in any transaction which operates as a fraud or deceit upon a purchaser of securities
- Securities Exchange Act of 1934 (1934 Act)
 - Requires disclosure of information to investors in secondary markets
 - Section 10(b): unlawful to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance

Applicable Law – Securities Law (cont'd)

- SEC Rule 10b-5
 - Adopted in 1942 to implement Section 10(b) of the 1934 Act
 - Prohibits misstatements of material fact or misleading omissions of material fact in offer, purchase, or sale of securities
- SEC Rule 15c2-12
 - Adopted in 1990
 - Most recent amendments effective February 2019
 - Regulates municipal securities brokers and dealers and requires issuers and/or “obligated persons” to provide continuing disclosure

Applicable Law – Securities Law (cont'd)

- More about SEC Rule 10b-5
- “It shall be unlawful for any person . . . to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”
- Materiality covers both: (i) materially incorrect information as well as (ii) the omission of material information.
- Information is “material” if there is a substantial likelihood that a reasonable investor would consider it important to an investment decision.

Applicable Law – Securities Law (cont'd)

- Preliminary Official Statement and Official Statement
 - The Official Statement is the municipal analog to the Prospectus in corporate finance — it is the disclosure document that the issuer provides to prospective investors in a public offering of securities
 - Preliminary Official Statement or “POS” refers to the disclosure document before pricing details are included
 - Final Official Statement or “OS” refers to the disclosure document containing all final pricing terms
- POS and OS contain financial and operating data, description of security for the bonds, and risks to repayment of the bonds

Applicable Law – Securities Law (cont'd)

- In connection the POS and OS, there is due diligence
 - Document review
 - Due diligence meetings or conference calls
 - Potential visits to see the project
- With respect to IDA, only certify to limited portions of the OS
 - Litigation, General Description of IDA, etc.
 - Otherwise the OS is the responsibility of the Borrower, and IDA wants full indemnification from Borrower if the IDA was ever sued for material misstatements or omissions in an OS

Applicable Law – Securities Law (cont'd)

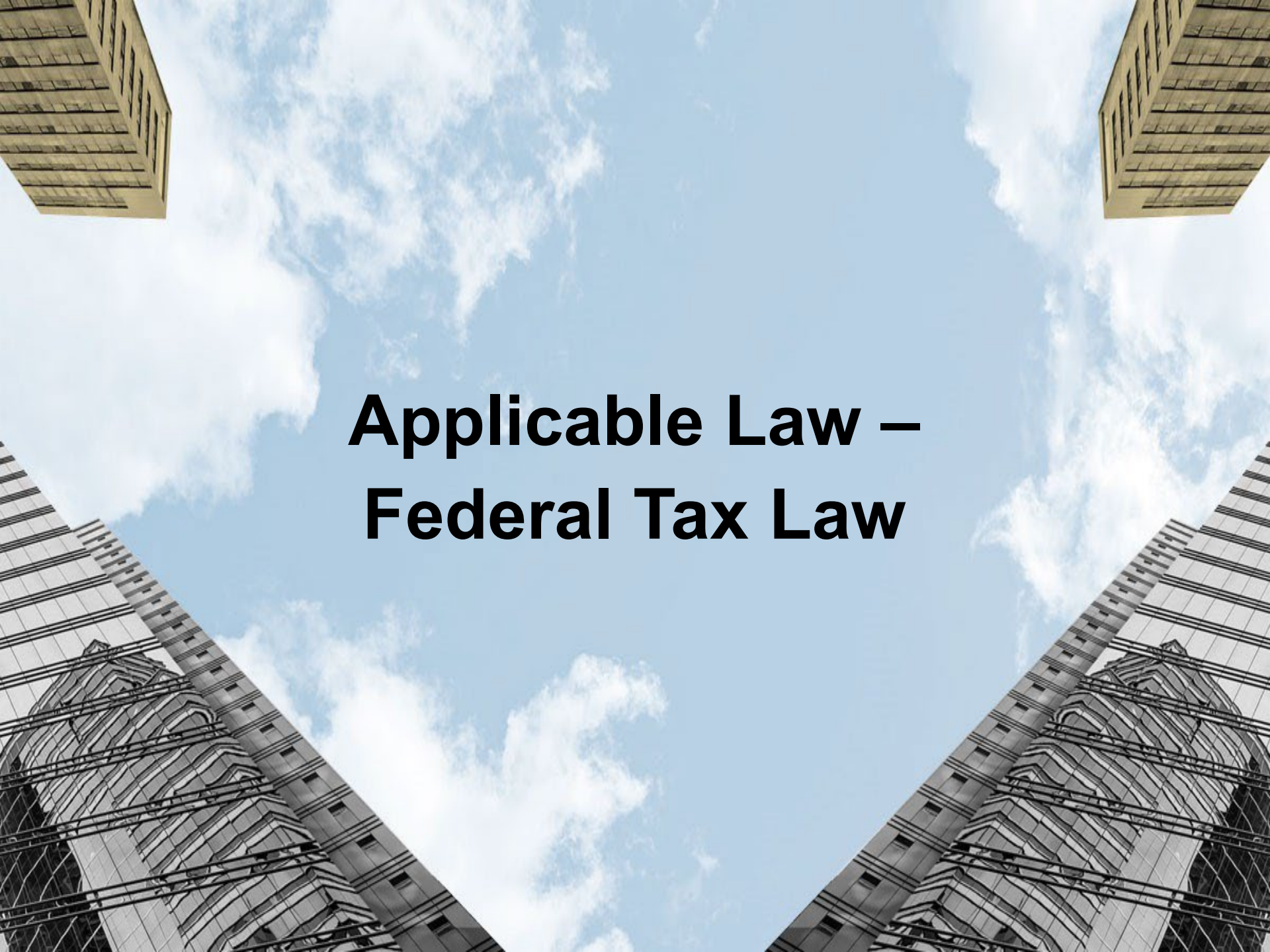
- Continuing Disclosure Obligations After the Bonds Have Been Sold
 - Rule 15c2-12 governs underwriters' conduct and requires underwriters in primary offerings to:
 - obtain, review and distribute a “deemed final” Official Statement (which contains a description of any instances in the previous five years in which the obligated persons failed to comply with Rule 15c2-12); and
 - obtain a written **undertaking** of the issuer or obligated person that it will (a) provide “annual financial information” as required by Rule 15c2-12 and (b) file timely notices of certain enumerated events

Applicable Law – Securities Law (cont'd)

- Continuing Disclosure Undertaking is less onerous as compared to more stringent SEC disclosure regime of Form 10-K Annual Reports and Form 10-Q Quarterly Reports
- Although the direct impact of Rule 15c2-12 is on underwriters, the indirect impact (and direct purpose) is to impose continuing disclosure obligations on issuers or obligated persons
- Certain exemptions to Rule 152-12 exist for certain private placements, issues less than \$1 million, and certain issues sold in \$100,000 minimum denominations to 35 investors or less that mature in 9 months or less

Applicable Law – Securities Law (cont'd)

- Rule 15c2-12 requires obligated persons to enter into a continuing disclosure undertaking pursuant to which the municipality will:
 - Provide financial and operating data reflected in the OS,
 - Provide audited financial statements from the most recently completed fiscal year, and
 - Provide timely disclosure (10 business days) of 16 listed events
- Disclosures are posted to the Electronic Municipal Market Access system of the Municipal Securities Rulemaking Board (EMMA) – emma.msrb.org
- For industrial development authority bonds, the borrower is the obligated person and enters into the continuing disclosure undertaking

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Applicable Law – Federal Tax Law

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- Internal Revenue Code of 1986, as amended, Section 103
 - (a) Exclusion. Except as provided in subsection (b), gross income does not include interest on any state or local bond.
 - (b) Exceptions:
 - Any private activity bond which is not a qualified bond (Section 141)
 - Any arbitrage bond (Section 148)
 - Any bond unless such bond meets the applicable requirements of Section 149 (i.e. bond is not in registered form)

Applicable Law – Federal Tax Law (cont'd)

- A variety of federal tax laws, rules and regulations regulate the tax-exempt nature of interest income on municipal bonds, the application of bond proceeds and the use of bond-financed facilities
- In addition to Section 103 of the Code, see Sections 141-150 and 265, as well as pertinent Treasury Regulations

Applicable Law – Federal Tax Law (cont'd)

- Very generally, private activity bonds are bonds that benefit nongovernmental persons, such as private businesses
- Bonds are private activity bonds if the issuer reasonably expects, as of the date of issuance that the bonds will meet either of:
 - The private business tests (private business use test AND private security or payment test), OR
 - The loan financing test
- The issuer's reasonable expectations must take into account events and actions over the entire stated term of an issue

Applicable Law – Federal Tax Law (cont'd)

- Private Business Use Test – in general, if more than 10% of the proceeds of a bond issue are to be used in the trade or business of a nongovernmental person, the issue meets the private business use test
- Some of examples of use include:
 - Ownership
 - Actual or beneficial use of property pursuant to a lease
 - Management or incentive contracts
 - Certain contractual arrangements (i.e. utility output contracts)
 - Research contracts
- Use by all nongovernmental persons is aggregated to determine whether the private business use test is met

Applicable Law – Federal Tax Law (cont'd)

- Private Security or Payment Test – a bond issued meets this test if the payment of principal of, or interest on, more than 10% of the proceeds of the issue is directly or indirectly
 - Secured by an interest in (1) property used or to be used for private business use, or (2) payments in respect of such property, OR
 - To be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use

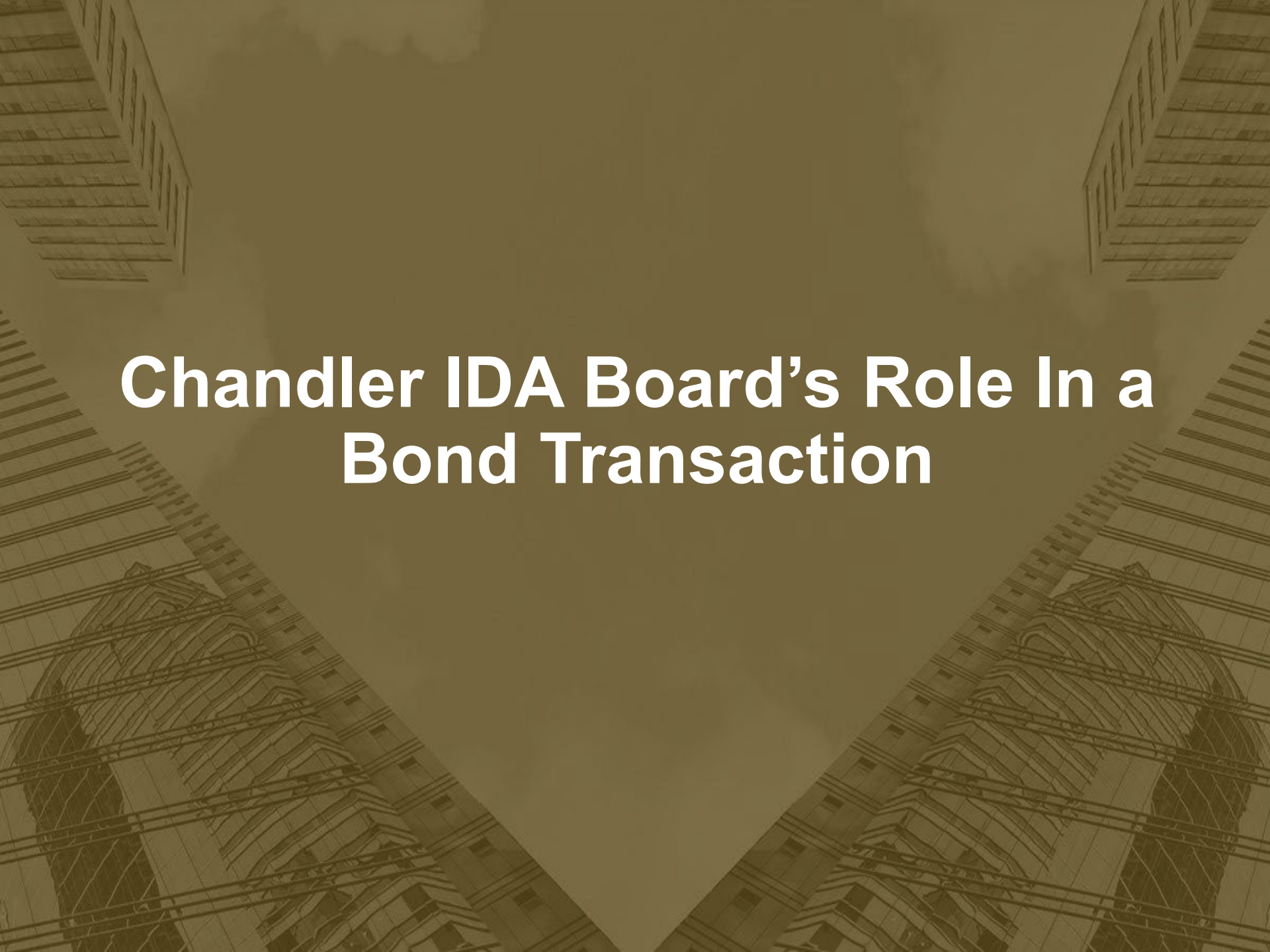
Applicable Law – Federal Tax Law (cont'd)

- Generally, industrial development authority bonds are expected to be private activity bonds
- Meet certain requirements under the Internal Revenue Code
 - For example, Section 147(a) of the Code has specific guidance regarding wastewater facilities owned and operated by a private business, i.e. Intel

Applicable Law – Federal Tax Law (cont'd)

Reimbursement Bonds:

- Sometimes borrowers will spend money on a project before the bonds are issued
 - E.g. paid from the general operating revenues, and the operating account will be replenished with a portion of the bond proceeds
- General rule is before making such expenditures (or within 60 days after the expenditure), the issuer or borrower must “declare” the “official intent” to reimburse the expenditure with tax-exempt bond proceeds
- The effect of a reimbursement that complies with these regulations is to treat the reimbursement as an expenditure of proceeds
- May incorporate reimbursement declarations into the IDA’s authorizing resolution

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Chandler IDA Board's Role In a Bond Transaction

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- Review proposed projects for Chandler IDA financing
 - Staff reviews potential applications with outside consultants to ensure compliance with statutory requirements prior to presenting for Board review
 - Board members should diligently review all bond materials provided and be prepared to interview the bond applicant to ensure the applicant and the application are appropriate for financing and in furtherance of the Chandler IDA's purpose
 - Board members should disclose any conflict of interest
 - As necessary, the Board should consult with City staff and outside consultants regarding applications
- If the Board deems the project appropriate, approve a resolution authorizing the issuance of Chandler IDA bonds and recommend City Council approval
- After City Council approval, officers of the Board will review and execute bond transaction closing documents

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Q&A

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THANK YOU!