Finance New Mexico

Article 402 June 14, 2015

Industrial Revenue Bonds Offer Novel Approach to Economic Development

By Harold W. Lavender, Jr., Of Counsel, Montgomery & Andrews, P.A.

Industrial revenue bonds are a form of public-private partnership — a tool that governments can use to stimulate economic development, allowing them to offer tax subsidies for new or expanding businesses that create jobs and improve communities. Subsidies may include a property tax exemption; a gross receipts tax deduction and compensating tax exemption if certain equipment is purchased with bond proceeds; an exemption for bond interest from New Mexico income tax; and in some cases, an exemption of bond interest from federal income tax.

These types of bond issues have been popular as a way to help New Mexico cities and towns compete — without assuming financial liability — for capital-intensive projects by extending tax subsidies to reduce the risks and costs for a company to move here. New Mexico cities and counties are authorized to issue IRBs.

To be eligible for IRB financing in New Mexico, a project must encourage manufacturers and commercial businesses to move or expand here or to promote the state's agricultural products or natural resources. IRB candidates include factories, assembly plants, warehouse and distribution hubs, nonprofit enterprises, health-care services, research facilities, industrial parks and corporate offices.

Los Lunas village councilors persuaded an expanding Albuquerque machine and tool company to stay in New Mexico by approving an IRB that allows the company to bring 250 jobs to the village over six years. At least two of the IRBs issued by Bernalillo County in 2014 also supported job-generating initiatives — a low-income housing project in downtown Albuquerque and a manufacturing plant in the Mesa del Sol neighborhood.

How IRBs Work

In an IRB transaction, a company deeds its real estate or other property — land, buildings, furniture, fixtures and equipment — to a government body, which issues low-interest bonds. The bond issuer simultaneously leases the property back to the company (the lease payments are the source for re-payment of the bonds) until the bonds mature, when the company buys the property at a nominal prearranged price.

Since the project is legally owned by a governmental entity, the company developing the project obtains the status of a state or local government with respect to the property. The property being developed thus becomes exempt from many taxes, especially property taxes, until the bonds mature — typically in 20 years.

Approval and issuance of IRBs does not guarantee success of a project. The company is responsible for finding investors to buy the bonds, which are secured by a mortgage on the company's property. While IRBs may offer some tax incentives to bond holders, finding investors may prove no easier than finding a conventional lender.

Taxpayers are not legally responsible for repayment of the bonds and are legally prohibited from incurring any liability for re-payment of the bonds. The proceeds from the sale of the bonds are the source of a loan from the bond buyer to the company. Finding a buyer for the bonds is thus an essential early hurdle that the project developer must overcome in a successful transaction.

If the company defaults on the lease payments, the bond trustee forecloses and sells the company's assets to repay bondholders. The credit rating of the bond issuing local government is unharmed by default.

The first step in an IRB transaction is finding a governmental entity to issue the bonds. The approval process is public, which may become political, and success in finding an issuer may depend on the nature of the project or the community. Thus, developers are advised to secure the services of experienced counsel and bond counsel early in the planning process.

Commitment to Development

Loss of property revenue affects local governments — especially schools and counties, which rely on this funding source — but advocates argue that IRBs are used only when the alternative is no development at all. Companies pay gross receipts taxes on construction materials and contract labor, but these taxes are waived on purchases of depreciable assets. Those opposed to IRBs are more skeptical, arguing that the expected benefits will not justify the cost in lost tax revenues.

This raises an aspect of IRBs that is generating litigation in places: the introduction of competitors that may threaten existing businesses. The city of Anthony was sued last fall by Santa Teresa's Omega Wire Inc. over its plan to extend $100 million in IRB incentives to CNM Wire Corp, a Turkish wire maker preparing to set up shop in the area.

Omega alleges that the IRB gives its rival an unfair advantage in Omega's market. State law requires counties — but not municipalities — to evaluate potential harm to an existing local company before approving incentives for a competitor.

For more information, visit www.montand.com or call Jack Campbell at 505-766-9926, extension 17. Montgomery & Andrews provides legal solutions for local, regional and national clients. The law firm works with many of the state's municipalities, counties, water authorities and other public entities.

Finance New Mexico is a public service initiative to assist individuals and businesses with obtaining skills and funding resources for their business or idea. To learn more, go to www.FinanceNewMexico.org. Sponsored by: