



Chapman, Spira & Carson, LLC

## Corporate Finance

Chapman Spira & Carson draws upon a depth of experience and established relationships to assist U.S and foreign corporations with acquisitions, divestitures and joint ventures.

Our finance staff guides client companies through changing economic environments while providing them the necessary financial and management tools to assure their success in these globally dynamic times. Municipal financing for your Place of Business or Your Investments.

A Primer When the American Constitution was original written, an extraordinary effort was made to separate states right's from those of the Union as a whole. Although the colonies were involved in a common argument with England, they were composed of people with dissimilar backgrounds who had immigrated to the United States for much contrasted reasons.

At that time, homogeneous groups tended to settle within borders containing similar ethnicity's. These people brought to this country different understandings of the way laws worked and what they ought to look like.

As time has gone on the ghetto mentality as for the most part disappeared and this particular issue has lost its relevancy. Although most were in favor of a union, the great majority wanted to preserve certain rights that they felt important, and the founding fathers did a superlative job to deliver on that premise.

These rights gave the original participants in the Continental Congress sovereignty over a number of important spheres. Among these are the ability to set their own local regulations as long as they don't conflict with the constitution. They were also allowed to levy taxes on people living within their defined area while maintaining some veto power over new constitutional actions. Therefore, a scenario begins to unfold in which the states compete among themselves for revenue. Considering the fact literally all of the revenue accruing to the states is tax based, they are all anxious to increase their indigenous community of taxpayers, both individual and corporate. States mold their laws to attract businesses in particular industries in which they feel they have an edge.

Delaware has become synonymous as the most congenial state in which to incorporate, Michigan has very favorable legislation on their books that are directed toward resident automobile manufactures and Nevada is a breeze for anyone desiring helpful legislation in the gambling field. Localities that have taxing powers within states also have joined this regional economic chauvinism. These can be cities, counties, townships, school districts, sanitary districts or just about anything else that the elected officials determine qualify for such status. Fortunes in certain regions wax and wane creating pressures on the tax receipts from residents. When this situation becomes to severe, social services are usually the first to suffer and the result is that the government that cut them usually loses the next election. It is far easier to anticipate the occurrence in the first place by insuring that the tax base remains intact no matter what the short-term regional economics may be. A combination of taxing authorities within the individual state often work in harmony to create a package of incentives that will be attractive to industry.

These benefits many include but are not limited to reduction of the company's taxation for a period of time, credits for hiring workers and donations of plant, equipment and land. They also set up regional authorities to help the new business get off to a flying start while making sure that the local banker is an integral part of the local welcome wagon. Early on, it dawned on the powers that be that by financing revenue producing civic products with project specific municipal revenue bonds two things could be accomplished simultaneously; the first is the fact that a much needed civic facility such as a hospital, dormitory or toll road would be actualized without creating a credit risk to the issuing authority if the projected revenues did not cover the debt serviced. This probably represented one of the earliest attempts at off balance sheet financing ever undertaken by state government. Once the project had paid for itself through internally generated revenues the tax authority could reduce its fee income or use the proceeds to erect other projects from existing cash flow without having to go back to the voters for approval. Many of civic projects exist only because someone thought up this ingenious format without which we doubt that new football stadiums or civic centers could be built. The toll roads of America constructed shortly after World War II ended stand as another monument to this type of debt structure.

An interesting example of the scope of this concept would be the regional toll roads built surrounding the city of Chicago. Tolls collected from this confined system ultimately were responsible for the creation of most of the state highway network in

Illinois. The downstate region's tax base could not support the mammoth construction necessary to create the highway grid. Revenues would from the sparse traffic using the highways would never support another revenue bond; thus, money was simply siphoned from the successful toll operations in the Chicago area. Grave questions arose as to why the citizens of Chicago should be subsidizing roads over 250 miles away. A legal case brought by residents and bond holders eventually went to the courts which said some very strange things which no one seemed to understand and the export of funds continued unabated. Therefore, we can see that profit-making enterprises have been allowed to use the vehicle of municipal financing to create needed infrastructure.

A whiz kid of another age probably got up in a state legislature and stated to one and all; "if we can build stadiums and dormitories and airports and tunnels and bridges and roads and buildings by forming a new taxing body, why can't we create an aberration, authorized to operate in the private sector under our municipal aegis if it ultimately benefits the community." We can visualize the hush that must have gone up in the chamber; a startling idea everyone agreed. The environment was now ripe for another phase in America's glorious economic history. Everybody joined this new game allowing one and all to use municipal financing authorities to act as stalking horses for attracting industry into their locale. As can be expected, the early birds were opportunists that were more interested in lining their own pockets than helping either the investors or the municipalities. Scattered all over the United States are plants that never opened, built with money, which came from hybrid types of municipal financing. The casualty rate among investors was legion and the big economic losers were concentrated among the poor and the returning Vietnam War Veterans. Regulations were tightened up because of this and it became more difficult to obtain this type of financing.

Today, there is substantial less fanfare and few less promoters floating around attempting to pick peoples pockets as regulations have been tightened. There is probably no state in the country that is not anxious to bring in industry in one form or another to their region. One of the prizes that has been offered to companies over the years has been Industrial Development Bond status. (IDB) At the bargaining table, the public sector officials ultimately put on the table the fact that; "maybe you could use some cheap money". Who could say no to a request like that? What is occurring is an offer of municipal bond status to company, thus because states and their affiliates are exempt from federal taxation, so are the purchasers of the their debt.

Municipal securities (muni's) sell a price that represents the tax differential between debt's coupon and the purchasers federal tax rate. As an example, assuming an equal rating, a person in a 30% federal tax bracket being offered a 5% muni or a 5% treasury bond would not have much of a choice. The effective rate on the treasury would only be 3.5%, to equal the muni; the treasury would have to yield almost 7%. There is also a bit of cache attached to the state giving the company this status which for no apparent reason makes the instrument appear more attractive for cosmetic reasons as well. The yields can be adjust up or down considering what the markets perception of the industry is.

These bonds are revenue securities and not guaranteed either by any authority or by the company. They are only geared to pay interest if the entity that is issuing them is successful in their business. Thus the company receives money and other benefits that may not have been available under other circumstances, they receive terms and conditions that are extremely favorable and their credit is not effected by the infusion because it is not an obligation of the company if not earned. Sounds like a good idea. Well it is, but it was so good, some very smart people started to take special advantage of it. So some states got together, raised a lot of money in municipal financing, and then invested the receipts in government bonds. Whatever project the municipal funding was supposed to cover become mired in one delay after another while the taxing authority kept collecting the difference between what they were paying out and what they were receiving. Uncle Sam scratched hard at his beard and said; "Hey guys, state's rights don't mean you can steal from your uncle, that's enough already." Indigenous taxing bodies are not the only parties interested in providing incentives to attract new industry into a region?

Any local purveyor may have a personal stake in joining the party. An obvious example would be the local trucking company or railroad. The fact that you may be shipping substantial product from your plant and bringing in raw materials is of great appeal to these people. We are aware of railroads that will organize the overall negotiation strategy with taxing authorities in an effort to attract a potential user. They will donate land and property on their right-of-way and walk to prospect through the regional authority. This type of financing is extremely economic for the user, it is an excellent bargaining tool for the authority and it is more often than not considered choice paper by brokers. Could any of this apply to your situation? Let us know.