

Tax-exempt Bonds

These Are Commercial Loans at Below-market Interest Rates

By GARY S. FENTIN

For business owners and nonprofit managers, there is a way to finance your next capital project from your own bank, on the same terms you would obtain conventionally — but at a reduced interest rate.

The vehicle is a tax-exempt bond issued by the Mass. Development Finance Agency (“MassDevelopment”), a product that comes in several forms, including industrial revenue bonds (IRBs), bonds for nonprofit organizations (501c3 bonds), and bonds for other eligible entities.

But what is a tax-exempt bond? What do they cost? How do you get one? Who is eligible? Are they more trouble than they’re worth? These are all commonly asked questions.

This article is geared primarily to tax-exempt bonds that are purchased by a bank or single lending institution. Bonds that are publicly issued or credit-enhanced involve additional parties and additional cost. Here are the answers to those questions and several others.

What is a Tax-exempt Bond? It is a financing vehicle that works basically like a loan from a bank that satisfies certain federal tax and MassDevelopment requirements. From the borrower’s and the bank’s perspective, it looks and feels like a regular bank loan, typically with the same payment terms and collateral as the borrower would obtain generally, but with a lower interest rate.

What are the federal tax requirements? The primary federal tax requirement is that the project finance capital costs incurred for qualified initiatives. Although there are other federal tax requirements, if your project qualifies and you feel that a bond is cost effective, you should contact MassDevelopment or the author of this article to inquire regarding qualification.

What are the MassDevelopment requirements? MassDevelopment must approve the project and the applicant. This is a fairly straightforward process that includes speaking to the local MassDevelopment representative for Western Mass., Frank Canning, and completing and submitting an applica-

tion. Canning will coordinate with one of the agency’s bond counsels to review the application and to prepare the forms of votes for the agency approval and notices of public hearing. Shatz, Schwartz and Fentin, P.C. is

million bond, the interest savings could be \$40,000 in the first year, which would pay all of the extra issuance costs in one year. The savings on a \$1 million bond (\$20,000) would pay the extra issuance costs in about one year for a 501(c)(3) project, and in about 1.5 years for a manufacturing project.



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What does bond counsel do?

Bond counsel is responsible for filing the necessary federal and state approval and filing documents, drafting the basic bond documents, and issuing an opinion that interest payments received on the bond are exempt from federal taxation. The exemption from federal taxation of interest on the bond is the reason that the bank can charge a lower interest rate and still earn a similar after-tax yield as it would have received on a conventional loan.

Bond counsel is also allowed to represent the borrower or the bank, in addition to acting as bond counsel.

Who should you contact to see if you are eligible? Frank Canning at MassDevelopment, 1350 Main St. 11th Floor, Springfield, MA 01103; (413) 731-8848; fcanning@massdevelopment.com

How long do they take to get? A bond can usually close on the same closing schedule the bank and the borrower would use for a conventional loan. Generally it takes about 4-6 weeks to close a bond from the issuance of a bank’s commitment letter, which is the time that the borrower and the bank generally need to prepare and submit their respective due diligence items. ■

Attorney Gary S. Fentin is a shareholder of Shatz, Schwartz and Fentin, P.C., and concentrates his practice in the areas of commercial and real estate finance and development, industrial revenue bonds, affordable housing, estate planning, business law, and business foreclosures and workouts. He is the only approved bond counsel for Massachusetts Development Finance Agency with offices located west of Worcester; (413) 737-1131.

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What is a qualified project? Tax-exempt bonds are available to finance eligible capital costs incurred in Massachusetts by manufacturing companies, 501(c)(3) entities, and certain assisted-living and long-term-care facility developers, affordable rental housing developers, and solid waste and recycling facilities.

What do they cost? The cost of an IRB includes the following: (1) the cost the borrower would otherwise incur to close a conventional loan for the same project with a bank (2) plus MassDevelopment’s issuance fee and the cost of bond counsel, which is generally \$12,000 to \$13,000. For a bond amount of \$2 million, MassDevelopment’s fee would be \$20,000 (1%) for a manufacturing project, or \$10,000 (.5%) for a 501(c)(3) project, plus \$13,000 bond-counsel fee, for a total of about \$33,000 for a manufacturing project and \$23,000 for a 501(c)(3) project.

Are they worth the money? Typically the interest rate on a bond is up to 2% or more less than conventional financing. For a \$2