PILOT Agreements and Act 9 Bonds

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Economic Incentives

- Ad Valorem/Property Tax Abatement
  - Government's investment or cost
- Commonly Known as:
  - Payment in Lieu of Taxes
  - PILOT or PILT Agreements
- Quid Pro Quo
  - <u>Company</u> agrees to invest money in plant, property and/or equipment
    - Possible commitment for job creation
  - <u>Government</u> agrees to accept tax payments that are less than what it would otherwise be entitled to receive

Purpose of PILOTs

- Economic Development
    - New Industry
    - Expansion of Existing Industry
- Why are governments willing to enter into PILOTs?
    - The ripple effects of expanded or new industry will compensate for cost to government on front end

PILOT Payment Calculation

- Estimated Appraised Value* = $300,000,000
  - *Actual Value will be determined by county assessor on an annual basis
- Taxable Value (20% of AV) - $60,000,000
- Millage* = 64.3 mills
  - *Actual millage to be determined
- 64.3 mills = 0.0643%
- $60,000,000 X 0.0643 = $3,858,000 (no PILOT)
- $3,858,000 X 0.35 = $1,350,300 (with PILOT)

Process

- Legal Authority: Article 16, Section 5 of the Arkansas Constitution and Arkansas Code Annotated § § 14-164-201 and § 14-164-701 *et seq.*

- Key Requirement/Glitch: Property for which an abatement is granted must be owned by governmental entity granting abatement

  - City or County must be the owner of the real and personal property

  - Example: If Company purchases real estate, then Company will execute a deed transferring the real estate to the City or County

  - Example: If Company purchases equipment, then the Company will execute a bill of sale transferring the equipment to the City or County

Compliance with Law

- Goals:
  - Transfer ownership of property to City or County
    - Terminable – Typically, Company may reacquire property at its option for nominal consideration
    - Escrow of Transfer Documents – Deeds and Bills of Sale returning property to Company upon termination will be held in escrow by Trustee; Company assured that property will be returned to it
  - Possession and use of property and investment of moneys controlled by Company during term of PILOT

- Mechanism for achieving Goals:

  - Issuance of Act 9 or Industrial Development Revenue Bonds

Act 9 or IDR Bonds

- Legal Authority: Arkansas Code Annotated § § 14-164-201 *et seq*. and Amendment 65 to Arkansas Constitution
- Eligible Projects: “Industry” means, but is not limited to, manufacturing facilities, warehouses, distribution facilities, repair and maintenance facilities, agricultural facilities, corporate and management offices for industry, tourism attractions and facilities, and technology-based enterprises (ACA § 14-164-203(6))
- Typical Bond Transaction: The City or County would issue its bonds to raise money to fund the economic development project
- Act 9 Bond Transaction:
  - Bond Transaction can be simplified with minimal on-going compliance and involvement with the City or County

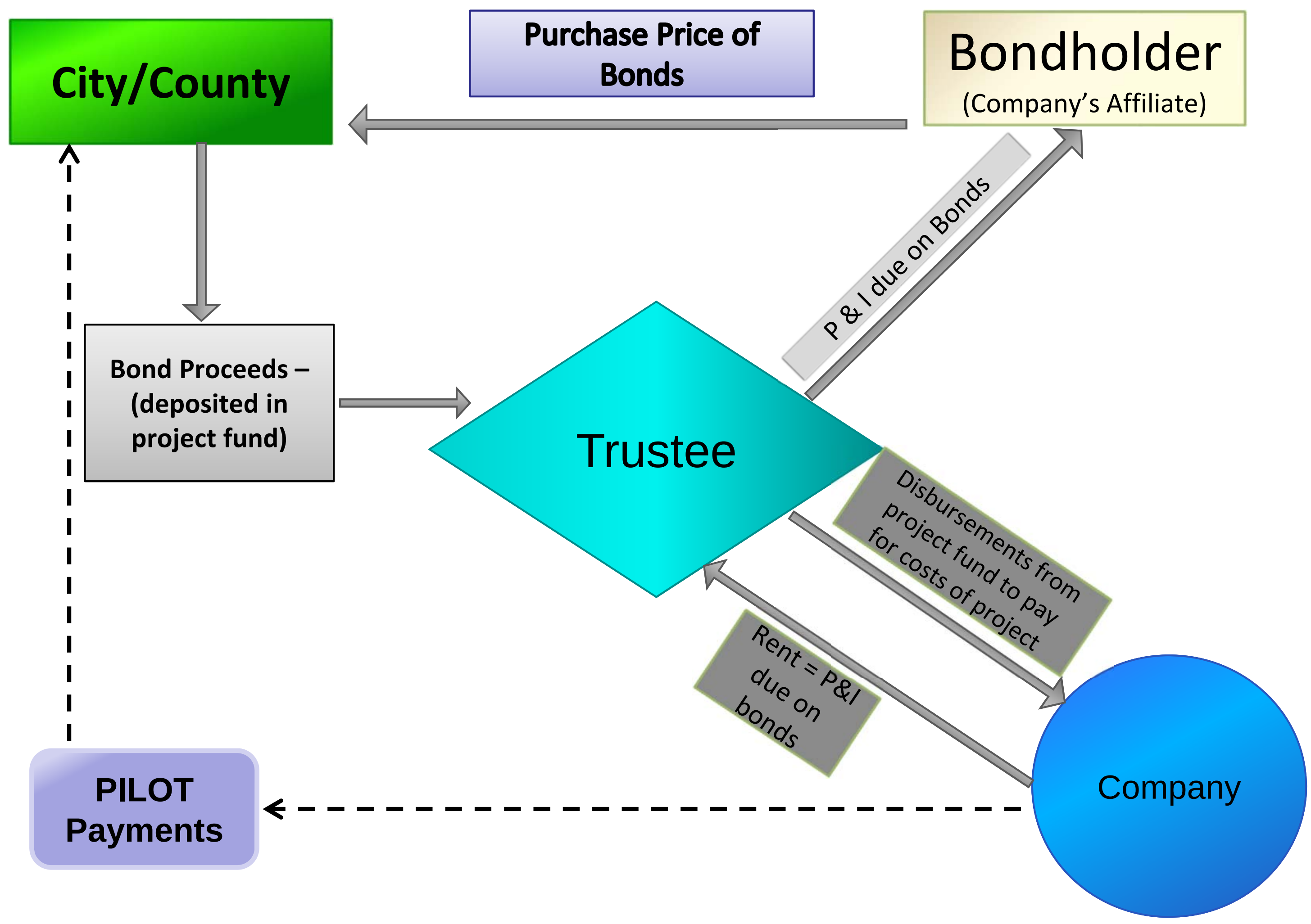
IDRBs with PILOT

- City or County complies with Arkansas law with regard to bond issuance
  - Project must have significant economic benefit for the local community to evidence the “public purpose” for issuing the Bonds and entering into the PILOT Agreement
  - Standard notices, public hearing, and public approval process
- Bonds are taxable; therefore, do not have to comply with federal tax law provisions relating to tax exemption
- Bonds are typically “purchased” by an entity related to the Company, so market financial disclosure is not required
  - Not required to provide audits or financial statements
  - Limited disclosure may be required to evidence compliance with the terms of the incentive package, if applicable
- Transaction documents are simplified to reduce the compliance burden for the Company and the Issuer

Necessary Parties

- Issuer/Governmental Entity/Landlord – City or County
- Borrower/Tenant – Company
- Bondholders/Lenders – Investors that purchase Bonds
    - If sole purpose is to achieve tax abatement, investor will be affiliate of Company; Company and Bondholder financial statements should consolidate
- Trustee – Financial institution with corporate trust powers
    - Commonly, the financial institution with which the Company has an existing relationship

PILOT Requires Industrial Revenue Bond



Flow of Funds

- Home Office Payment Agreement documents “net settlement” process consistent with Accounting Standards Codification 210-20 (Offsetting) (formerly Interpretation 39 of the Financial Accounting Standards Board)
  - Permits accounting entries to evidence transfers of funds without money moving among accounts or companies

- At Closing:
  - Bondholder (Affiliated Company) delivers money to Trustee in exchange for Bond
  - Issuer through Trustee delivers money to Company pursuant to lease/loan agreement

- On-going:
  - Company delivers money to Trustee/Issuer as lease/loan payments
  - Trustee/Issuer pays principal and interest to Bondholder

What the Company and Issuer Negotiate:

- % of Tax Abatement
  - maximum = 65%
  - Company must pay a minimum of 35% of what would otherwise be due
- Period of Abatement
  - maximum 30 years
  - typical term = 15-20 years

(City/County will be responsible for distributing payment amount among taxing authorities on a pro rata basis)

A.C.A. § 14-164-701 et seq.

Pros and Cons

- Pros
  - Decreased property tax payments
  - Company remains owner for income tax purposes
  - Accounting entries net out; therefore, only impact on books is an additional asset
  - Goodwill associated with being a good corporate citizen
- Cons
  - Additional accounting entries
  - Procedural process with governmental entity; coordination of “public” disclosure of project
  - Up front legal fees; Nominal on-going trustee fees and very limited on-going legal fees

Expense considerations

- Bond Counsel Fees and Expenses – amount varies, but is negotiable; primary factors are goal and structure of financing
- Issuer Counsel Fees – it is not uncommon for the local governmental entity to want its attorney to be involved; negotiable
- Company Counsel Fees – within discretion of Company; most frequently in-house counsel is involved rather than outside counsel
- Trustee Fees – authentication fee and on-going annual fees; some trustees will hire trustee's counsel
- Publication costs – notice of public hearing; authorizing ordinance must be published in a local newspaper
- Issuer Fee – varies by Issuer; could be $0 or may be a formulaic calculation based on principal amount of bonds (typically only charged if a state agency is the issuer)
- Financial Advisor Fee – uncommon in connection with Act 9 Transaction
- Underwriter's Discount or Placement Agent Fee – only applicable if the bonds are sold to an entity that is not affiliated with Company

Questions?

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