

OVERVIEW OF INDUSTRIAL DEVELOPMENT FINANCING UNDER CHAPTER 100 MISSOURI REVISED STATUTE IN CONNECTION WITH OFFICE PROJECTS

Applicability of Chapter 100. Sections 100.010 to 100.200 of the Missouri Revised Statutes (referred to herein as the “Act”) provides a method of financing industrial and commercial development projects for private companies through the issuance of industrial development bonds (“IDBs”). The Act permits any city, county, town or village (referred to herein as a “Municipality”) to issue IDBs to finance the costs of warehouses, distribution facilities, industrial plants and “office industries,” which include national and regional headquarters. In connection with such projects, the bond proceeds may be used to finance land, buildings, fixtures and machinery. IDBs issued under Act could be used to finance the acquisition of land and construction and equipping of a new facility for major commercial enterprises.

Benefits of IDBs. There are two primary reasons to issue IDBs under the Act. First, if the bonds are tax-exempt, it may be possible to issue the bonds at lower interest rates than those obtained through conventional financing. Unfortunately, the financing of office projects would not qualify for federal income tax exemption. The second reason, however, is applicable; even if the bonds are not tax-exempt, ad valorem taxes on bond-financed property may be exempt so long as the bonds are outstanding because legal title to the property and improvements financed with Chapter 100 obligations is held by the City during the financing period.

Here is how it works: Under Article X, Section 6 of the Missouri Constitution and Section 137.100 of the Missouri Revised Statutes, all property of any political subdivision is exempt from taxation. In a typical IDB transaction, the Municipality holds fee title to the project and leases the project to the company. Although the Missouri Supreme Court has held that the leasehold interest is taxable, it is taxable only to the extent that the economic value of the lease is less than the actual market value of the lease. See *Iron County v. State Tax Commission*, 437 S.W.2d 665 (Mo. 1968) (*en banc*) and *St. Louis County v. State Tax Commission*, 406 S.W.2d 644 (Mo. 1966) (*en banc*). Accordingly, if the rental payments under the Chapter 100 lease agreement equal the actual debt service payments on the bonds, the leasehold interest has no “bonus value” and the bond-financed property should be exempt from ad valorem taxation and personal property taxation so long as the bonds are outstanding. This structure effectively provides an abatement of the ad valorem taxes the company would ordinarily have to pay for that portion of the project financed with Chapter 100 obligations.

Revenue Bonds. IDBs can be issued as either general obligation bonds or revenue bonds. Unlike general obligation or “G.O.” bonds, revenue bonds issued pursuant to the Act do not require voter approval and are payable solely from revenues received from the project. The Municipality applies the proceeds derived from the sale of the bonds to purchase, construct, improve or equip the facility. In exchange, the company promises to make payments that are sufficient to pay the principal and interest on the bonds as they become due. Thus, the Municipality merely acts as a conduit for the financing. Revenue bonds would be the appropriate financing vehicle where the property is to be transferred to a private party at the termination of the Chapter 100 financing for a nominal amount.

STRUCTURE OF THE TRANSACTION

As noted above, IDBs issued to acquire a national or regional headquarters facility would not qualify for federal or state tax exemption. Instead, the benefit of issuing IDBs would be to provide ad valorem tax abatement while the bonds are outstanding. Accordingly, the transaction would be structured so that the City would purchase and own the facility and lease it to a private entity for purposes of housing an “office industry” while the bonds were outstanding. Lease payments would cover debt service on the bonds. Upon final maturity of the bonds, the lessee would have an option to purchase the facility for a nominal price. This Section describes this structure in more detail.

General Structure. The City issues its bonds pursuant to a trust indenture entered into between the City and a bank or trust company acting as trustee. The bond proceeds are deposited with the trustee bank in a separate trust account to be used to purchase and construct the project. The City and the development entity and/or the company enter into lease/sublease agreements that will set forth specific requirements regarding the application of the bond proceeds.

The agreements will require the City, or the development entity acting on behalf of the City, to use the proceeds of the bonds to purchase and construct the project. The development entity and company will be entitled to possession and use of the project after it is acquired or completed and will be unconditionally obligated to make payments to the trustee sufficient to pay principal and interest on the bonds as they become due. In order to secure payment of the bonds, the City pledges and assigns to the trustee bank under the trust indenture the payments to be received from the development entity/company pursuant to the agreements. A deed of trust and a security agreement mortgaging and granting a security interest in the project may also be given to further secure payment of the bonds.

Security and Liability Issues. Under this structure the company typically: (a) unconditionally agrees to make payments sufficient to pay the principal of and interest on the bonds as they become due; (b) agrees, at its own expense, to maintain the project, pay all taxes and assessments with respect to the project and maintain adequate insurance; (c) has the right, at its own expense, to make certain additions, modifications or improvements to the project; (d) may assign its interests under the agreement or sublease the project while remaining responsible for payments under the agreement; (e) covenants to maintain its corporate existence during the term of the bond issue; and (f) agrees to indemnify the City for any liability the City might incur as a result of its participation in the transaction.

If the lessee breaches any material provisions of the lease agreement (such as, for example, by failing to pay rent or by declaring bankruptcy), the trustee may declare a default. The City may have the right (but not the obligation) to cure any such default, or it may choose to allow the trustee to pursue the remedies provided under the trust indenture. These remedies include reletting the facility or foreclosing on the deed of trust and selling the facility. In either event, the rent or sale proceeds received by the trustee are used to pay bond holders. In no event would the City have any obligation to pay the bondholders.

Offering or Placement of Bonds. IDBs, like issues of conventional corporate securities, are sold by two basic methods--public offerings or private placements.

If the development entity/company has access to the regional or national securities markets, it may retain an investment banker as underwriter and sell the bonds publicly. The size and financial condition of the company are the primary factors that determine the company's ability to utilize a public offering. Certain credit enhancement devices, such as a bank letter of credit or bond insurance, may be used to make an issue more marketable. If the bonds are to be marketed in a public offering, a disclosure document in the form of an official statement or offering circular will be necessary to inform prospective bond purchasers of all material information regarding the investment they are considering. The preparation of the official statement or offering circular is primarily the responsibility of the company and the investment banker and their counsel.

As an alternative to a public offering, the company may wish to place the bonds with a sophisticated purchaser. A private placement is very similar to a long-term bank loan. The purchaser will conduct its own investigation of the creditworthiness of the company and will meet directly with the development entity and company or investment banker acting as financial advisor to negotiate the terms of the bond issue. It is generally not necessary to prepare a disclosure document such as an official statement or offering circular where the purchaser is willing to execute an investment representation letter.

If bonds are being issued at a taxable interest rate for the sole purpose of receiving tax exemption, it is common for the development entity, company or their commercial lender to purchase the bonds.

CONCLUSION

From the City's standpoint, IDB financing is a useful tool for encouraging certain high profile companies to locate or remain in the City by assisting them in improving their present facilities or in acquiring new ones. The end result is increased job opportunities for the inhabitants of the City and an improved economic climate.

From the company's standpoint, the principal advantage of IDB financing depends on the purpose for which the bonds are being issued. If the bonds are tax-exempt, the cost of funds provided by IDBs generally is significantly below that of other alternatives because the interest paid to holders of such bonds is exempt from federal and state income taxation. If the bonds are taxable, as would be the case with office industries, the company can receive significant financial incentives in the form of reduced rent via the tax-exempt nature of the bond-financed property.

Prepared By:

James E. Mello, Esq.
Armstrong Teasdale LLP
One Metropolitan Square
Suite 2600
St. Louis, Missouri 63102-2740
(314) 621-5070

Date: March 21, 2002