MEMORANDUM

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FROM: Peter Franklin, Modrall Sperling

RE: Workshop with County Commission on Industrial Revenue Bonds

DATE: May 7, 2019

INDUSTRIAL REVENUE BOND TRANSACTION MECHANICS

This purpose of this Memorandum is (1) to describe the basic mechanics of an industrial revenue bond transaction under the New Mexico County Industrial Revenue Bond statutes, 4-59-1 through 4-59-16 NMSA 1978, as amended, and to summarize the provisions of the basic transaction documents (the Inducement Resolution, Bond Ordinance, Lease Agreement, Indenture and Bond Purchase Agreement, referred to below as the "Bond Documents"), and (2) to address frequently asked questions about IRBs, which appears in the "FAQ" beginning on p. 8 of this Memorandum.

This Memorandum is not intended to be an exhaustive description of all documents and provisions thereof which would be included in the final transcript of a completed transaction, but instead as a general description and guide to understanding how an IRB transaction is structured and intended to operate.

1. <u>Summary of an IRB Transaction (after the County has authorized issuance of the IRB and the necessary transaction documents, i.e. at closing and beyond)</u>.

A. At the closing of the IRB transaction:

- The Project Company transfers "bare legal title" to the Project Property to the County.
- The County leases the Project Property back to the Project Company pursuant to the Lease Agreement. (This is the mechanism by which the Project Property receives a property tax abatement-- improved real property that is governmentally owned does not appear on the property tax rolls.)
- The County issues the IRB pursuant to an Indenture (an agreement between the County and a Depositary Bank in which the County collaterally pledges (conveys a security interest in) the rents paid by the Company under the Lease Agreement for the benefit of the bond purchaser), and delivers the IRB to the Bond Purchaser pursuant to a Bond Purchase Agreement.
- The County's pledge of its right to receive rent and other rights under the Lease Agreement does not include its rights to indemnity, PILOT payments and certain other notice rights, which are retained by the County.

B. After the IRB transaction closes:

- The Project Company requests an advance of principal amount (possibly 100%, but usually in installments) from the Bond Purchaser to construct and equip the project.
    - The Indenture and the Bond Purchase Agreement may provide that the Project Company can make the request directly to the Bond Purchaser, and that the Bond Purchaser transfer the amount requested directly to the Project Company
    - Alternatively, the Bond Documents may require that the Project Company make a request for proceeds to the Depositary, that the Bond Purchaser deposit the amount requested with the Depositary, and that the Depositary disburse that amount to the Project Company.
    - The first alternative is often used when the Project Company and Bond Purchaser are wholly-owned affiliates of the same parent company, whereas the second is used when the Bond Purchaser is an independent lender or investor.
- The Project Company will make PILOT payments to the County, School District and other taxing jurisdictions (as negotiated by the County and the Project Company), usually after Project construction has been completed.
- Under the Lease Agreement, the Indenture and the Bond Purchase Agreement, the Project Company's payment of debt service on the IRBs (which equal the rent payments under the Lease) are structured as follows:
    - If the Project Company and Bond Purchaser are wholly-owned affiliates of the same parent company, the Bond Documents leave it up to the Company and the Purchaser to decide on whatever repayment schedule is suitable to them; or
    - If the Bond Purchaser is an independent lender or investor, the Bond Documents will include a specific repayment schedule.
- After the IRB is fully repaid, the Project Property is deeded back by the County to the Project Company, and the Property becomes subject to property taxes.

C. Defaults and Remedies.

- Failure of the Project Company to pay Basic Rent (i.e. debt service on the IRB):
    - IRBs are payable solely from the payments the Project Company must make under the Lease.
    - If the Project Company does not make the payments necessary to pay debt service on the IRBs, the Bond Purchaser, not the County, must seek to enforce the Project Company's obligation.
- The County can enforce remedies under the Lease for failure of the Project Company to make PILOT payments or default in its indemnity obligations to the County.
- Use of the Project Site for purposes other than a qualifying project under the IRB statute:
    - County can terminate the Lease and deed the Project Property back to the Company, which ends the property tax abatement.

2. Summary of the Bond Documents.

A. Inducement Resolution. ***Please note: an inducement resolution is not legally required to be adopted by Los Alamos County)*** An IRB transaction typically begins with the adoption of an inducement resolution by the Board of County Commissioners (the "Board"). The inducement resolution expressly does not bind the Board to adopt an ordinance authorizing issuance of the IRB or to issue the bonds, but does do the following:

- It announces the Board's interest in the project proposed to be financed with the IRB, and intent to consider for adoption an ordinance authorizing issuance of the IRB, at a public hearing to be held at least 2 weeks after notice of that hearing is published in a newspaper of general circulation within the county.
- It may authorize the form of notice of the public hearing to be published in the newspaper.
- It may set the date of the public hearing.
- It may authorize notice of the public hearing to be given to the other taxing jurisdictions in which the proposed project will be located (such notice must be given at least 30 days prior to the date of the public hearing, pursuant to Section 4-59-4.1 NMSA 1978).
- It permits the Project Company (the conduit borrower and beneficiary of the IRB) to make eligible equipment purchases with nontaxable transaction certificates ("NTTCs") prior to the time that the IRB is actually issued (Note: equipment will probably not be purchased before the IRBs are issued).

B. Bond Ordinance. Following the adoption of an inducement resolution, the delivery of notification letters to taxing jurisdictions pursuant to §4-59-4.1, and publication of the notice of hearing, the Board holds a public hearing to consider adoption of the Ordinance authorizing issuance of the IRB. ***(Please note that prior authorization by the Los Alamos County Council to send the notification letters and publish the notice of hearing on the IRB Ordinance is not required by statute)*** The Ordinance does the following: ***(The section references in the Bond Ordinance, Lease Agreement, Indenture and Bond Purchase Agreement that appear below refer to a set of bond documents that were used in another IRB transaction; those documents are not provided with this memorandum, but we'd be happy to provide them at the County's request.)***

- Authorizes the IRB to be issued in a maximum principal amount. (Ordinance, Section 3)
- Authorizes officers of the County to execute and deliver the Bond Documents in a form consistent with the forms of the Bond Documents presented in connection with the Ordinance and to take such other actions as are necessary to effectuate the IRB transaction. (Ordinance, Section 4)
- Authorizes delivery of the IRBs to the Purchaser under the terms and conditions in the Bond Documents. (Ordinance, Section 5)
- Authorizes establishment of funds and accounts for the IRBs as described in the Indenture. (Ordinance, Section 6)

- As required by §4-59-7(A), includes the Board's determination of the amount required each year to pay the principal of and interest on the IRB. (Ordinance, Section 7.

  This is often shown as a 30 year maturity schedule assuming interest-only payments at a specified rate for the first 29 years, and then redemption of the maximum principal amount of the IRB in year 30 plus that year of interest, e.g.:

  The maximum amount necessary in each year to pay the principal of and interest on the Bonds, assuming issuance of the Bonds as of ___________, in the maximum aggregate principal amount of $____________ and bearing a maximum interest rate of ______%, is as follows:

Year	**Total Debt Service**	**Principal**	**Interest**

- Provides that the Lease will include PILOT provisions (Note: if the PILOT has already been agreed to by County and other taxing jurisdictions before the Ordinance is adopted, it can be specifically described in both the Ordinance and the Lease Agreement) (Ordinance, Section 7(G))
- ***Provides that the Bonds are a limited obligation of the County, payable solely from Basic Rent (as defined in the Lease Agreement), and that no other revenues of the County are pledged or available to pay debt service on the Bonds.*** (Ordinance, Section 8; See Also §4-59-6(C) NMSA 1978)
- Approves indemnification of the County by the Project Company and requires that the Lease Agreement include such provisions. (Ordinance, Section 9)

C. Lease and Purchase Agreement (the "Lease"). After the Project Company transfers "bare legal title" to the County, the County enters into the Lease. The Lease provisions include the following:

- The Company will construct and acquire the Project as agent for the County (Section 4.1)
- The Company is authorized to construct the Project in the manner it determines is best, without approval of the County or the Bond Purchaser (Section 4.2)
- ***The County makes no warranty of condition or suitability for use by the Company.*** (Section 4.3)
- The Company will construct the project in compliance with applicable laws, will pay applicable taxes and charges, and will keep maintain the Project at its own expense (Sections 4.4-4.8)

- The Company will arrange to have the Project Property assessed in its name when the Lease term expires or 30 days before the 30th anniversary date of the Lease, and will pay taxes thereafter. (Section 4.12)
- Lease Term is 30 years or on such earlier date that the IRB is fully repaid. (Section 5.1)
- Company is to pay Basic Rent (i.e. debt service on the IRBs) directly to the Purchaser (Section 5.3)
- Company releases from, and indemnifies the County and its officials, agents and employees against, any claims against the County in connection with the construction, operation and use of the Project by the Company or issuance of the IRB by the County (Section 6.2)
- PILOT provisions (Section 6.3)
- Company has the right to assign its rights in the Lease to a company whose financial standing is equal to or better than the Company's financial standing (Section 7.3)
- Company has the right to mortgage its interest in the Project to finance or refinance the Project (Section 7.4)
- Under Section 8.1, Events of Default include the following:
    - Failure of the Company to make any Rent Payment, Additional Payments or PILOT payments
    - Material misrepresentation by the Company in any Bond Document
    - Insolvency of the Company
- Under Section 8.2, the Purchaser (but not the County) may exercise remedies which include:
    - Acceleration of all amounts of Basic Rent payable for the remainder of the Lease Term
    - ***Terminate the Lease, which requires immediate reconveyance of the Project Property by the County to Company per Article X of the Lease, and ends the property tax abatement.***
- Under Section 8.3, Events of Default with remedies available to the County include failure by the Company to do any of the following:
    - pay Additional Payments (to reimburse costs incurred by the County) due under Section 5.3(b)
    - indemnify the County under Section 6.2
    - make PILOT payments to the County and the School District under Section 6.3
    - in the context of assigning its rights to a 3rd party, failure to assign to a party of equal or greater financial standing than that of the Company.

D. <u>Indenture (alternatively, Trust Indenture and Mortgage)</u>

- Agreement by which County pledges rights in the Lease for the payment of debt service on the IRB
    - Indenture/depositary agreement is used when the Project Company and Bond Purchaser are wholly-owned affiliates of the same parent company

    - Trust Indenture + mortgage is used when the Bond Purchaser is an independent lender or investor and requires a mortgage of the Project Property.
- Section 301 provides for assignment and pledge of the Lease to secure payment of the principal and interest on the IRB
    - Reserved from the pledge are the County's right to receive Additional Payments (to reimburse costs incurred by the County) due under Lease Section 5.3(b), payment of indemnity obligations under Lease Section 6.2, and PILOT payments under Lease Section 6.3.
- Section 302 provides for release of the Indenture when all principal and interest on the IRB is paid in full.
- Sections 401 and 402 authorize issuance of the IRB as an obligation secured by the Indenture, and provide for the form of the IRB (which appears in Exhibit A to the Indenture.
- Sections 403 and 404 provide for execution, delivery, registration and transfer of the Bond.
    - The IRB cannot be transferred by the Purchaser to a 3rd party without an opinion of counsel satisfactory to the County that the transfer complies with the Securities Act of 1933 (basically the federal securities anti-fraud laws).
- Section 501 allows the Company to redeem the IRB at any time that all unpaid principal and interest is repaid.
- Section 601 provides that the IRB and all payments by the Issuer under the Indenture are not general obligations of the Issuer, but are limited obligations payable solely from revenues and receipts derived from the leasing of the Project Property.
    - ***The reference to "payments by the Issuer" is a "legal fiction"—other provisions of the Lease, the Bond Purchase Agreement and the Indenture provide for all payments to be between the Purchaser and the Company, including disbursement of bond proceeds by the Purchaser directly to the Company, and payment of debt service by the Company directly to the Purchaser.***
    - See Lease, Section 5.3 (Company is to pay Basic Rent (i.e. debt service on the IRBs) directly to the Purchaser).
    - See Indenture Section 602 (Bond Fund established for deposit of Basic Rent by Company to pay debt service on IRB) and Section 603 (Bond Fund is in custody of Company, which will withdraw amounts needed to pay debt service when the payments are due).
- Section 701 creates Acquisition Fund, which is held by the Depositary.
- Section 702: Company may request an Advance of IRB proceeds directly from Purchaser; Purchaser delivers the Advance to the Depositary for deposit to the Acquisition Fund.
- Section 801 states that the IRB is not secured by the faith or credit of the Issuer or its general taxing power (i.e. not a general obligation).

- Sections 902-903: Purchaser's remedies for default by Company
- Section 904: Neither Issuer nor Depositary is responsible for acting on behalf of the Purchaser to exercise remedies in the event of Company default.
- Section 911: Lender with mortgage lien on Project Property (i.e. provider of secured 3rd party financing to Company) may exercise its own remedies in the event of Company default.
- Section 1207: Limitation of Issuer's liability (reasserts that Issuer has no pecuniary liability under the Bond Documents or any of the transactions to be undertaken pursuant to the Bond Documents).

E. Bond Purchase Agreement

- Styled as agreement between Bond Purchaser, County and Company
  - While County is a party, most of the material provisions concern the Purchaser and the Company.
- Section 6: Purchaser and Company indemnify the County (including the County Commissioners, County officials, agents, etc., and the and the Depositary) for any claims relating to the offering, sale or resale of the IRB
- Section 7: Closing conditions for sale and delivery of the IRB (bond lawyer stuff)
- Section 13: Limitation on Issuer's Liability (similar to the limitation of liability in other Bond Documents).

Industrial Revenue Bond FAQ

Q: Is the County responsible for repaying the IRB indebtedness or for how Bond proceeds are distributed or spent?

- No. In fact, the IRB statute prohibits the County from using any of its own resources to either pay debt service on the IRBs or to operate the project being financed with the IRB.

- After the County issues the IRB, for all practical purposes (other than receiving the PILOT), the transaction is entirely between the Project Company, the Bond Purchaser and a Depositary Bank:

    - The Project Company requests advances of bond proceeds to the Bond Purchaser, which transfers the proceeds either directly to the Project Company or deposits them with the Depositary

    - The Project Company pays principal and interest on the amounts advanced by the Purchaser either directly back to the Purchaser or through the Depositary

    - ***The County is not involved in disbursing bond proceeds or collecting debt service on the IRBs.***

Q: What is the process for issuing IRBs?

- The County Commission adopts an Inducement Resolution indicating its intent to issue IRBs for a project. ***(Note: Los Alamos County is not required by statute to adopt an inducement resolution prior to publishing a notice of hearing to consider the adoption of an IRB ordinance.)***

    - The Inducement Resolution may also authorize publication of a notice of intent to consider an ordinance authorizing issuance of the IRBs.
    - The notice must be published at least two weeks before action on the IRB ordinance. ***(Under Los Alamos County's Charter, the notice must be published as least one week prior to the hearing on the ordinance.)***

- Notice is given to taxing entities within the county at least 30 days before the County Commission considers the IRB ordinance.

- The County Commission adopts the IRB ordinance authorizing issuance of the IRBs and approving the primary bond documents and terms.

- The County may negotiate a payment in lieu of taxes to hold itself and/or other taxing jurisdictions (most commonly, the school district in which the project will be located) harmless from the abatement of property taxes, but this isn't required by statute (except for electric generation projects).

Q: What is the legal structure of IRBs?

- The project company conveys bare legal title to the real property and equipment to be used in the project to the County.

- The County leases the project back to the project company. The project company has complete responsibility for operation and maintenance of the project under the lease agreement. The lease agreement has a maximum term of 30 years.

- The County issues IRBs, which are purchased by a bond purchaser.

  - The bond purchaser may be an affiliate of the project company, or may be a 3rd party lender or investor in the Project.

- When the IRBs are purchased by the bond purchaser, the proceeds are transferred in installments by the purchaser directly to the project company (rather than through the County) to construct the project, usually over the period of constructing and equipping the Project.

- The principal and interest on the IRBs are repaid by the project company directly to the purchaser, not through the County.

  - The only revenue pledged to payment of the IRBs are the rent payments under the lease agreement between the County and the project company, which match the debt service requirements of the IRB.

  - ***The project company is solely responsible for paying debt service on the bonds, and pays the debt service to the project company directly or to the depositary (depending on the arrangement required by those parties), rather than to the County, which has no responsibility for receiving or disbursing debt service payments.***

- When the bonds are fully repaid, the lease agreement is terminated and the project property is conveyed by the County back to the project company, and is returned to the property tax rolls.

Q: How do the tax abatements resulting from IRBs work?

- Because the County owns bare legal title to the real property on which the project is located, no property tax is paid for the project property between the time the IRBs are issued and the date of full repayment or final maturity (maximum of 30 years)..

- The project company acquires qualifying equipment for the project as agent for the County. As a result, no gross receipts tax or compensating tax is paid on eligible equipment

    - "Ingredients of construction" are not eligible and remain subject to gross receipts tax.

    - Gross receipts taxes are required in connection with gross receipts from construction materials and labor.

- The State Department of Taxation and Revenue oversees the Non-Taxable Transactions Certificates used to purchase the project equipment and materials.

<u>Q: How do IRBs affect a County's credit and revenues?</u>

- IRBs are payable strictly from the payments the project company must make under the lease agreement. If the project company does not make the payments necessary to pay debt service on the IRBs, the bond purchaser, not the County, must seek to enforce the project company's obligation.

    - If the project company became insolvent or bankrupt, this would constitute a default under the lease agreement and the County would deed the project property back to the project company, making it subject to property taxes.

    - Although it is possible that the property taxes could be delayed, reduced or set aside by a bankruptcy court, the County could object as one of the project company's creditors

- ***Issuance of IRBs does not impact a County's credit rating or ability to issue bonds or borrow money.***

- The project company must pay for any outside professional fees the County incurs in connection with the IRB issuance (outside attorneys and financial advisors).

- Issuance of IRBs does not affect property tax rates or gross receipts tax rates for County residents.

- The county receives PILOTs at a negotiated amount from the project company. PILOTs can be used by the County for any legal purpose.