Municipal Finance & Economic Development

- State & local government taxing powers, debt tools and credit quality can serve economic development purposes:
  - Raise capital for development finance programs
  - Finance infrastructure, public improvements or services needed to attract private development and investment
  - Expand capital availability for manufacturers and development projects in targeted areas
  - Finance non-profit facilities
- Primary municipal finance tools are:
  - Tax-exempt debt
  - Tax-increment financing
  - Assessment districts

Municipal and Tax-exempt Debt

- Major Types of Municipal Debt
  - General Obligation Bonds
  - Revenue Bonds
  - Tax Increment Financing
- Allowable Uses of Tax Exempt Bonds Under IRS code.
  - General state and local government facilities/uses
  - 501(c)(3) use, i.e., non-profit organizations
  - Industrial development bonds for small manufacturers
  - Waste-water and solid waste treatment facilities; pollution control facilities
  - Multi-family and single family housing bonds for low-income households
  - Redevelopment bonds to eliminate slums and blight
  - Empowerment Zone Facility Bonds

Industrial Development Bonds

- Tax-exempt financing for manufacturing plants
- A source of long-term fixed rate debt
- Firms limited to $10 million within 3 years (+ or -) of the date of issue and $40 million over their lifetime
- Primarily a capital subsidy for firms that are bankable as bonds require a letter or credit or willing buyer
- Can expand access to capital markets for small firms:
  - Pooling several small loans into one bond (PA, AR)
  - Provide credit enhancement through reserve or insurance fund (MA)
  - Lower transaction costs with private placement, standard legal documents and financing team=> makes small transactions feasible. St. Louis mini-bond program with deals of $500,000 to $2 million

Structuring Municipal Debt

- Interest paid semi-annual
- Typical structure is serial bonds
  - Principal divided into series of bonds with sequential annual maturities
  - Lowers interest cost
  - Match annual maturities to available cash flow
  - Debt service = interest on all bonds & principal of maturing bond

How much debt can be supported?

Year	Available Cash Flow	Interest Rate	Principal Amount
2007	2,000,000	4.80%	
2008	2,250,000	4.85%	
2009	2,500,000	4.90%	
2010	3,000,000	5.00%	
2011	3,000,000	5.00%	
Total	12,750,000		

Calculating Principal Amount

- Start at last year=>interest paid only on maturing bond
  - Cash flow (CF)=Principal (P)+ Interest (I)
  - Interest = Interest rate (i)*Principal
  - Cash flow = P + P*I; CF=(1+i)*P
  - P=Cash flow/(1+i)
  - P_{2011}= 3,000,000/(1.05) = 2,857,000
- 2^{nd} to last year, interest on P_{2011} & P_{2010}
  - I = .05(P_{2011} & P_{2010})
  - CF = P_{2010} + .05(P_{2011} & P_{2010}) = 1.05* P_{2010}+ .05*P_{2011}
  - P_{2010} = (CF -.05* P_{2011})/1.05
  - P_{2010} =(3,000,000-.05*2,857,000)/1.05 = 2,721,000

P_n = (CF_n – Interest on future principal)/(1+ i_n)

How much debt can be supported?

Year	Available Cash Flow	Principal	Interest
2007	2,000,000	1,460,000	539,043
2008	2,250,000	1,780,000	468,963
2009	2,500,000	2,117,000	382,633
2010	3,000,000	2,721,000	278,907
2011	3,000,000	2,857,000	142,850
Total	12,750,000	10,935,000	1,812,396

Tax Increment Financing

- Set aside new "incremental" tax revenues to raise financing for a project or public improvements. Financing can be on “pay as you go” basis, debt, or developer financing
- “Base year” tax assessments & revenue frozen at year TIF district is established and continue to flow to taxing jurisdictions
- New or incremental taxes after base year are diverted to TIF district and its governing authority. Increment comes from assessment growth, improvement to existing properties and new development

TIF Uses to Support Economic Development

- Address site and infrastructure obstacles for a project
  - Site assembly and preparation
  - Environmental contamination
  - Public infrastructure
- Address blight and infrastructure needs that impair development & investment in a large area or district
- Target investment of tax revenues to an area suffering from neglect and disinvestments
- Can be a tax base sharing mechanism (e.g., Montgomery County EDGE Program)
- Spread and abuse of TIF whereby it is used to bypass voter referendum requirements and/or subsidize development that would otherwise occur, diverting revenue from local governments
- Uncertainty in level and timing of incremental tax revenues is a obstacle to selling bonds and using TIF
  - Orlando TIF Case