Clean Energy Bond Finance Model

Industrial Development Bonds (IDBs)

Full Description

Qualified Small Issue Bonds for Manufacturing, more commonly known as Industrial Development Bonds (IDBs), are a type of tax-exempt Private Activity Bond (PAB). PABs exist to enable state and local governments to encourage economic development in their communities by facilitating access to the capital markets for private borrowers. Qualified PABs grant certain types of borrowers that Congress deems important the ability to borrow at rates that are exempt from federal income taxes. Tax-exempt rates are lower than traditional interest rates.

PABs provide a public benefit to a private borrower, but the success or failure of IDB projects does not directly reflect on the participating governmental entity. Any state or municipality can issue IDBs on behalf of qualifying manufacturers. The authority serves as the conduit through which the private borrower accesses the public benefit of the tax exemption. IDBs are backed by project revenues, rather than by the general obligation or tax pledge of the issuing authority. This conduit revenue bond structure means that the private borrower, and not the public entity, is solely responsible for the performance of the bonds.

Example of solar panels on a manufacturer.

In exchange for providing the tax exemption benefit to the manufacturer, the tax code places several restrictions on the use of IDBs. The most significant of these is that the maximum size of IDBs is capped at $10 million. Additionally, use of bond proceeds is largely restricted to core manufacturing facilities and equipment only. Additional requirements can be found in the tax code, but these three clearly frame IDBs as being for smaller projects and borrowers and focused exclusively on the manufacturing process for tangible goods.

In order to achieve lower interest rates or issuance costs, the financing structure for IDBs can be made more complex. The most common addition to an IDB issuance is the support of a letter of credit. Additional forms of credit enhancement can be provided by complementary public programs. Several economic development organizations have created systems to effectively lower the costs of issuing bonds. Any of these additions to the model ultimately lowers the cost of capital for the private borrower.

IDBs are relevant to clean energy development in two major ways. First, manufacturers in the supply chain of clean energy (e.g., solar panel, wind turbine and biomass equipment manufacturers) can receive tax-exempt financing. States or regions looking to cultivate a clean energy manufacturing cluster can look at (a) targeting IDB marketing to such companies and (b) creating an enhancement or similar program to facilitate the use of IDBs by clean energy manufacturers. Second, changes to the federal tax code for IDBs could allow any manufacturer to place clean energy generation equipment on their facilities. Whole-facility clean energy generation is not a currently permitted use of IDB proceeds, but was temporarily allowed from 2009-2010. Congress could act to authorize a permanent rule change, making tax-exempt bonds an option for all small- to mid-sized American manufacturers seeking lower-cost, clean energy.

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Summary Description

Industrial Development Bonds (IDBs) are a type of Qualified Small Issue Private Activity Bond that provides tax-exempt financing for small- to mid-sized manufacturers. These bonds are backed by project revenues, and can be issued as a conduit bond by any state or municipal authority. IDBs are relevant to clean energy development in two ways. First, manufacturers in the supply chain (e.g., solar panel manufacturers) can receive tax-exempt financing. Second, changes to the tax code for IDBs could allow any manufacturer to place clean energy generation equipment on their facilities.

Model Profile

Model Type:	Project	**Energy Type:**	Renewables
Bond Type:	Tax-Exempt; Private Activity Bond; Revenue	**Applying Entity:**	State or local

Model Benefits

- **Low interest rates** – Tax-exempt bonds provide interest rates that are typically 25-30% less than traditional bank financing.
- **Long term financing** – Bond financing provides long terms, lowering individual payments.
- **Potential for savings through standardization** – IDB programs can employ a standardization process to make bond financing accessible and affordable for smaller projects.

Model Shortcomings

- **Generally not cost effective for projects <$3 million** – Most bond financings require the assistance of multiple financial professionals, rendering the projects prohibitively expensive for small deals. However, several agencies have created standardized systems to enable smaller projects.
- **Cap on bond size and capital expenditures** – The tax code places a cap on IDBs of $10 million per project; the borrower is also limited to $20 million in capital expenditures during a window beginning three years before the project and three years after issuance of the bonds.
- **Core manufacturing requirement** – IDB proceeds can only be used for project costs directly involving the manufacturing or production of a physical product.

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Model Applications

- **Oregon Express Bond Program** – Business Oregon uses this streamlined IDB program to standardize documents, limiting paperwork, costs, and time, and enabling tax-exempt bond finance for small projects.
- **Minneapolis Common Bond Fund Revenue Bond** – The City of Minneapolis uses this streamlined IDB program through its Common Bond Fund to standardize documents, limiting paperwork, costs, and time, and enabling tax-exempt bond finance for small projects.
- **CPCFA Small Business Assistance Fund** – The California Pollution Control Finance Authority, part of the State Treasurer's Office, subsidizes the borrowing cost of tax-exempt bonds up to $13.75 million, at a rate according to bond size, in order to offset high costs of issuance.
- **Solar panel installation on a CA manufacturer** – The California Industrial & Economic Development Bank (I-Bank) issued an IDB to finance the majority of costs related to solar panel installation on a manufacturing facility; this issuance was conducted under a short-term expansion in the tax code for Qualified Small Issue Bonds.

Locations / Projects that Could Apply the Model

IDBs can be issued by any state, county, or local government or authority on behalf of any eligible borrower in the issuer's jurisdiction. Tens of thousands of authorities throughout the country can issue IDBs.

Potential Modifications to the Model

- Expand the use of the standardization program to facilitate tax-exempt finance access for small projects.
- Pool several smaller IDB projects into one, near-cap issuance to limit issuance costs for all borrowers.
- Provide credit enhancement through public- or energy-funds to further lower borrowing costs.
- Pair IDB issuance with eligible tax credits to expand projects.
- Work with Congress to permanently expand the tax code for Qualified Small Issue Bonds.

Items for Further Research / Development

- To what extent can IDB proceeds be used by manufacturers for renewable energy or energy efficiency under current tax code?
- What is the appetite for manufacturers in the clean energy supply chain for tax-exempt bond financing?

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Additional Resources

Industrial Revenue Bonds – Playing to our Strengths Presentation:
http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=pfr12-rogers.html

Using Bond Financing Mechanisms for Your Energy Project Presentation:
http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=iefc12-neal.html

Private Activity Bond Factsheet:
http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=oakland-pab-factsheet10.html

I-Bank Industrial Development Revenue Bond Application:
http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=Ibankrbfpa.html

California Pollution Control Financing Authority SBAF Policy:
http://www.treasurer.ca.gov/cpcfa/sbaf.pdf

Oregon Express Bond Program:
http://www.oregon4biz.com/Business-financing-resources/Oregon-Finance-Programs/Oregon-Industrial-Development-Bonds/

Minneapolis Common Bond Fund Revenue Bond Program:
http://www.minneapolismn.gov/cped/ba/cped_common_bond

CDFA Online Resource Database for Industrial Development Bonds:
http://www.cdfa.net/cdfa/cdfaweb.nsf/ord.html?open&tag=Industrial%20Development%20Bonds%20(IDBs)

For More Information

Clean Energy + Bond Finance Initiative (CE+BFI), created by CEG and CDFA, is working with finance and energy professionals across the country to find ways to increase clean energy investment. For more information, visit: www.cleanenergybondfinance.org.

Clean Energy Group (CEG) is a leading national, non-profit advocacy organization working in the U.S. and internationally on innovative technology, finance, and policy programs in the areas of clean energy and climate change. For more information, see www.cleanegroup.org.

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