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## “BONDS FOR TITLE”

Use This Legal Product,  
Privately Placed Industrial Development Revenue Bonds,  
As A Simple Structure to Provide  
Property Tax “Abatement” for a Project

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## “BONDS FOR TITLE”

### Executive Summary

“Abatement” is an incentive increasingly demanded by companies when making project location or expansion decisions. By “abatement”, what this White Paper means is relief from *ad valorem* property taxes resulting from the bond-financed sale-leaseback structure described herein. Therefore, “savings” is used interchangeably with “abatement.”

In order to obtain *ad valorem* property tax savings for a company’s project or in order to obtain State grants or local incentives for the project, the title to the project must be vested in a development authority, with the company having the status of a lessee. There is an exception in the case of tax abatement where a local constitutional amendment provides for “direct abatement”; this exception exists in only a handful of communities. In all other cases, including projects in communities that have “constitutional” development authorities, a bond issue using a lease structure is necessary. The lease structure is commonly used where the bonds provide real financing, as well as property tax savings and, possibly, other incentives. There are other situations in which the transfer of title to the project to the development authority can represent all or part of the funding for the bonds. Bonds in that case can be referred to as “bonds for title”. In those situations, the company will pay project costs from out of its equity or funds from a commercial loan. Nevertheless, bonds for title can make the project eligible for *ad valorem* property tax savings or other incentives

In a “bonds for title” transaction, industrial development bonds (“IDBs”) are actually issued. Most often, in a typical bonds for title transaction, the Bonds are issued to the company itself. Sometimes the transaction is structured so that the bond purchaser is an affiliate of the company (in some situations, there can be Georgia income tax advantages to having the bonds purchased by an affiliate). For purposes of the following discussion, we will assume that the Bonds are sold to and held by the company itself.

The “bonds for title” structure involves the issuance of IDBs by a development authority to acquire or construct the project, and the lease of the project to the company at a rent equal to debt service on the bonds. The company, as lessee, would have an option to buy the project for \$1.00 when the bonds have been retired. The transaction results in title to the project vesting in the development authority, regardless of the extent to which there is cash funding from outside sources for the project. Thus, this transaction can be called “bonds for title”. Sometimes you will hear a transaction like this referred to in Georgia as issuing “tax abatement bonds” or “phantom bonds” instead. All of these terms refer to the same type of transaction. We use the term “bonds for title” because it best implies how the transaction works.

Bonds for title are used for projects that cannot be financed with federally tax-exempt bonds under the federal rules applicable to “private activity bonds”<sup>1</sup> and/or in situations where it

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<sup>1</sup> In such cases, the projects generally do not qualify for tax-exempt bond financing, either

is not necessary to use the bonds to provide any or all of the actual funding for the project, such as where funding is to be provided by company equity or from borrowing from a lender which does not want to invest in the bonds. Thus, the bonds will be federally taxable bonds, and the rules of the federal tax code relating to tax-exempt bonds will not be applicable to taxable bonds for title.

### **Structure**

In the typical bonds for title structure, the company is both the bondholder and the lessee. The development authority is the lessor, but its rights to receive rents and a security interest in the project would be pledged to the bondholder (i.e., the company) as security for the bonds, by a Deed to Secure Debt, Assignment of Rents and Leases and Security Agreement (or if the project is merely an equipment project, an Assignment of Rents and Leases and Security Agreement would be used). Therefore, the company has complete control over the project at all times.

Accountants should treat a bond lease as a capital lease (as contrasted with an “operating lease” or “true lease”)<sup>2</sup>. Given such treatment, the project will, for accounting and federal tax purposes, appear as an asset on the company’s balance sheet, just as though title were in the company. The asset represented by the bonds and the liability representing the company’s rent obligation to the development authority will, in effect, offset each other. At the end of the lease, which will be the end of the property tax savings period, the company will be able to obtain legal title to the project by paying \$1.00 to the development authority. If, for some reason, the company wished to obtain title earlier, it could do so by paying off (or canceling) the bonds and paying the \$1.00 option price. The lease would terminate upon reacquisition of title by the company, as would the property tax savings period.

We have developed a simplified structure bonds for title. Under this structure, the bonds are issued as a single “drawn-down bond”, which is issued under a bond resolution and a bond purchase loan agreement among the development authority, the company, as lessee, and the company as bond purchaser. No trust indenture is involved<sup>3</sup>. The development authority would appoint the company (i) as its agent for the purpose of requesting draws under the bond purchase loan agreement, (ii) as the custodian of the Project Fund and Debt Service Fund (or Sinking Fund) created by the Bond Resolution, and (iii) as Registrar and Paying Agent for the Bond. The documents would permit the company, as bond purchaser, to disburse cash (pursuant to a draw request which is made by the company as agent for the development authority) to the

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because they are not “manufacturing” projects, or because the project size exceeds the limitation on tax-exempt bonds and other capital expenditures for “manufacturing” projects. Because of a federal tax law change in 2007, the combined limit on tax-exempt manufacturing bonds and other capital expenditures is now \$20 million (of which, up to \$10 million can be represented by tax-exempt bonds). *See* our White Paper, “Bond FAQ’s.” Financing using tax-exempt bonds can also be structured to include property tax abatement as an incentive.

<sup>2</sup> How any particular bonds for title transaction (or any other transaction) is booked and reported depends on the treatment given it by the responsible accounting professional.

<sup>3</sup> It is, of course, possible to use a trust indenture and a trustee, if desired.

company, as Custodian of the Project Fund, and to use that cash to pay project costs or to reimburse the company for costs of the project that the company has paid. To the extent cash is disbursed, it will be either immediately returned to the company as a reimbursement or is used to pay current invoices for project costs. When the draw is for a reimbursement (which will generally be the case), the documents permit the foregoing to be made by book entries, so that no cash need actually be disbursed by the company for the Bond and then reimbursed to the company for project costs. Further, documents also permit property for the project, previously paid for by the company, to be transferred by the company to the development authority in exchange for increases in the principal balance of the draw-down bond. In that situation, no cash would be need to be disbursed<sup>4</sup>.

Normally, at the closing of the issuance of the bond, an initial draw would be made in an amount equal to costs theretofore incurred by the company for the project, such as costs of land and any construction to the date of closing, or , if equipment is involved, costs of equipment paid by the company prior to the issuance of the bond. The initial principal balance of the bond would be the amount funded on that date. Thereafter, additional draws would be made for additional project costs subsequently incurred by the company. In most cases the company will be transferring property in exchange for an increase in the principal balance of the bond, and no actual cash would be disbursed. Each subsequent funding would increase the principal balance until the full amount has been funded. Each draw will be reflected on a schedule of advances attached to the bonds and will increase the principal balance of the bond by the amount of the draw.

By using a draw-down bond, the company funds the bonds only when, and to the extent, required to pay or reimburse itself for costs of the project. Because the entire amount of the bonds is not funded at the closing, there is no need to have a trustee to hold and invest the bond proceeds during the construction period. The principal balance that results from draws would be reduced by any principal payments that the company may make. If the bond is structured to have a single bullet payment of principal at final maturity at the end of the property tax savings period, the company never has to disburse any cash to pay principal of the bond, because it can merely surrender the bond for cancellation at final maturity and purchase the project for \$1.00. If the bond is structured for principal to be paid periodically, the periodic rent will include the amount needed to pay principal. If the bond has a principal amortization schedule, the principal component of the basic rent can be offset against bond principal payments by book entries. Interest would accrue on the principal balance and would be payable once per year; this too can be paid by book entries. The company, as lessee, is required to pay rent to the company, as bondholder, to pay the interest and principal on the bond. The amounts are a complete “wash”. The documents permit this to be handled through book entries, and no cash actually need be disbursed. The documents can further provide that where the company is both the lessee of the project and the bondholder, the rent and matching debt service shall be deemed to be paid.

Under this simplified drawn-down bond structure, there is no need for an underwriter, no need for a letter of credit to provide credit support for the bonds and no need for a trustee or third

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<sup>4</sup> Cash funding would, of course, be possible if desired.

party paying agent for the bonds. The company would not incur any of the costs associated with those features of a traditional financing.

### **Role of the development authority**

The issuance of bonds and the use of the financing lease structure is discretionary with the development authority. If the bonds are not issued and if title is not acquired by the development authority, the project will not be exempt from property taxes, and there will be no property tax savings. Thus, the development authority is in a position to determine whether or not property tax savings will be allowed, and the amount and duration of property tax savings. By limiting the duration of the lease, the development authority can limit the period during which the project is exempt from actual property taxes, which will limit the property tax savings period. In addition, as a condition to the transaction, the development authority can require the company to make payments in lieu of taxes, in one or more years of the lease term, to the local taxing authorities, or to some other appropriate body.

The development authority can use a phase-in approach to property tax savings. For example, in the case of a 10-year lease, the transaction might be structured to require no tax payments (or payments in lieu of taxes, depending on how the savings is structured) to be made during the first five years, with payments being required in the remaining five years in an amount equivalent to an annually increasing percentage of normal taxes. Another example would be to have payments starting at ten percent (10%) and increasing by 10% in each subsequent year. Thus, the duration and amount of property tax savings is a matter of negotiation between the company and the development authority. The degree to which a project will create jobs and provide economic benefits to the community will often have an effect on the amount of property tax savings that is provided. In some cases, the documents provide for the company to provide a specified number of jobs and/or to invest a specified amount of capital in the community. If these employment and/or investment goals are not met, the property tax savings provided will be reduced (that is, additional payments will be required) by the percentage of the shortfall in meeting such goals.

More is required than just an issue of bonds to effectuate property tax savings, of course. A proper structure will have features involving the taxability or valuation of the lease. The effect of this structure, in terms of providing relief from *ad valorem* property taxation, will vary from case to case. For example, the Development Authorities Law, which governs statutory development authorities, in some cases (e.g., certain “office building facilities”) makes the Authority’s legal title taxable (a bond lease would pass the taxes through to the lessee in such a case). Different techniques exist for addressing such issues. However, specific legal advice should be obtained as to the effect of any particular savings transaction.

Local considerations are also factors that may influence the duration and amount of savings to be provided. In many communities, the Board of Commissioners and/or the City have adopted a policy defining the terms and conditions on which property tax savings will be made available. General law, and local policies consistent therewith, should always be followed.

## **Funding**

Bonds for title are most commonly used where the company is using equity as the source of funds to pay project costs and is using the bonds solely as a vehicle for placing title to the project in the development authority for property tax savings purposes. However, bonds for title can be used in situations where the company's source of funding for the project is a financing arrangement, such as a line of credit with a third party lender, e.g., a bank or insurance company. There are a number of ways that a bonds for title transaction can be combined with a true financing.

Where the initial source of funding is a loan from a financial institution, the commercial loan documents can be put in place first and the project can then be conveyed to the development authority in a bonds for title sale-leaseback transaction subject to the lender's security interest in the project. The conventional loan documents would be written to permit that subsequent sale and leaseback.

If the initial source of funding for the project is to be company equity, and if it is contemplated that, subsequent to the bonds for title closing, the company equity will be replaced by a commercial loan, the bond documents can be written to accommodate the subsequent commercial financing. For example, the documents can provide for the development authority, at the company's request, to join with the company in granting to the lender a first priority security title to the project that is superior to the security for the bond previously granted to the company.

Another approach to allow the combination of "bonds for title" with commercial financing, is to use a collateral assignment by the company of the bond (and its security interests in the project, as bondholder) to the lender to secure new borrowings by the company. Thus, the use of bonds for title does not impair the company's borrowing power. This can also be used in situations involving a parent-subsiary structure. We served as bond counsel on such a financing for a large project. The company's parent corporation obtained funding for the project and for other facilities in various parts of the country under a line of credit from an insurance company. The parent borrowed money under the line of credit and loaned it to the company to fund the bond. Those funds were used to pay and reimburse the company for project costs. The bond was issued to the parent and the collateral for the bond (the project) which was pledged by the company to its parent which pledged the bond and repledged the collateral to the insurance company. The parent borrowed additional funds under the line of credit which it loaned to other subsidiaries to pay costs of the facilities in other states. The facilities in other states were likewise pledged to the insurance company to secure amounts borrowed from the insurance company for those facilities.

## **More Information**

This paper is a quick-reference guide for company executives and managers, economic developers, participants in the real estate and financial industries, and their advisors. The information in this paper is general in nature. Various points which could be important in a

particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

Additional information concerning this topic, as well as White Papers and references on other topics, can be found at <http://danmcræ.info/>.

If you have any specific questions or comments, we would be pleased to provide more information. Please contact:

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