



# Development Finance: Tax-Exempt Debt Terms

*Conduit Issuer* - A private corporation (the "Borrower") is required to have a conduit governmental issuer to issue the bonds.

*Inducement Resolution* – An inducement resolution must be passed by the conduit issuer for the tax-exempt bonds. This resolution is the first "official action" and indicates an Issuer's intent to issue the bonds. The inducement resolution determines the point after which the project being financed can be reimbursed for capital costs paid or incurred in connection with the acquisition or construction of the project.

*Volume Cap Allocation* – Each state is allocated an amount for a tax-exempt bond cap each year. The Company must obtain volume cap approval from the state before proceeding with the financing. (Not applicable to non-profits).

*TEFRA Hearing* - Issuer must hold a public Tax Equity and Fiscal Responsibility Act Hearing ("TEFRA Hearing") on the issuance of the bonds, having provided the published notice in advance of the hearing in accordance with applicable state and Federal law.

*Use Covenants* - The Borrower must comply with all the applicable tax covenants and restrictions on the use of the financed facilities as long as any of the bonds are outstanding. A violation may cause the bonds to lose their tax-exempt status.

## Tax-Exempt Debt Example

Borrower borrows \$100,000 of taxable debt at a 6% interest rate.

Borrower pays \$6,000 in taxable interest, but bondholder has to pay \$2,000 of that to the IRS. This leaves the bondholder with \$4,000.

Alternatively, the borrower can borrow tax-exempt debt at a 4% interest rate. The bondholder receives \$4,000 in tax-exempt interest and pays nothing to the IRS.

The bondholder is indifferent, because it received \$4,000 in both scenarios, but the borrower paid \$2,000 less in interest. This \$2,000 is, in effect, a subsidy from the federal government (and maybe the state government) to the borrower. Since the federal government is providing the subsidy, it sets the rules that entities must meet to borrow tax-exempt debt.