

Private Activity Bond Guide

January 2023



What are Private Activity Bonds?

Private Activity Bonds (PABs) are taxed exempt fixed income instruments. Simply put, it is another way for a business or developer to finance certain types of projects or what the Internal Revenue Service (IRS) calls “Qualified Activities”. Essentially the PAB is a financial contract between an investor and borrower. (IOU is too casual of a term to use in my opinion.)

Benefits of Private Activity Bond Financing

For the investor, a PAB is like a municipal bond. In most cases, interest earned on a PAB is exempt from Federal and Idaho income taxesⁱ.

For the borrower the benefits may include the following:

- Lower borrowing costs.
- Flexible and longer repayment periods.
- Financing for projects too large for a single lender or investor to take on.
- Financing for projects perceived as too risky that banks may be reluctant to fund.
- A way to leverage other incentives like the Federal 4% Low Income Housing Tax Credit.

Often, but not in all cases, PABs may be used alongside other tax and business incentives. It should be noted that PAB funded projects are not necessarily exempt from other local, state, and federal taxes. Cities and Counties with entities eligible to issue PABs have an additional tool for shaping the impact of a project beyond traditional planning and zoning provisions.

Drawbacks of Private Activity Bond Financing

Borrowers utilizing PABs give up the right to use accelerated depreciation on their tax returns. There are certain restrictions on the advance refunding of PABs. Setting up a PAB is more expensive than the closing costs associated with a traditional bank loan. As such, PABs may not be suited for projects whose financing need is below \$5 million.

Time may be another drawback to PAB financing. A business or developer must go through a public process to receive PAB approval. If insufficient volume cap is available to cover the project, a business or developer may need to wait till such a time that new volume cap becomes available. It can take between six to twelve weeks for a PAB application to work its way through the process.

ⁱ. There maybe some circumstances where PAB interest income maybe taxed. Please consult a tax expert before investing.

Qualified Activities

Qualified Activities (QAs) fall into one of two categories: small issue and exempt. Not all QAs count against a state’s volume cap, while others partially count against a state’s cap or fall into a special category that is managed at the federal level.

Qualified Activities Subject to Volume Cap

- Mass Commuting Facilities
- Water Facilities
- Private Solid Waste Facilities
- **Low Income Rental Housing**
- Power Generating Facilities
- Redevelopment Bonds
- Hazardous Waste Facilities
- High Speed Rail
- **Single Family Mortgage**
- **Small Issue (Industrial Revenue Bonds)**
- Agricultural (First Time Farmer Loans)

Note: items highlighted in **red** are those that have a recent history of accessing Idaho’s PAB volume cap.

Qualified Activities Exempt from Volume Cap

- Airports
- Docks & Wharves
- Government Solid Waste Facilities
- Government Owned Highspeed Railⁱⁱⁱ
- Educational Facilities
- Green Building Projects
- Veterans Mortgage Bonds
- Hydro Electric Facilitiesⁱⁱ
- 501(c) 3 Bonds

The Infrastructure and Jobs Act of 2021 created a new category of Qualified Activities whereby 75% of the PAB is exempt from volume cap with the remaining 25% counting towards a state’s allocation. QAs in this new category include broadband projects serving areas defined as underserved by the Federal Communications Commission and carbon capture projects.

Along with the QAs listed above, there is a special category for highways and surface freight transfer facilities. These projects are subject to a national volume cap that is administered by the Federal Department of Transportation.

ⁱⁱ Only bonds financing environmental retrofits to hydroelectric facilities are excused from volume cap. All other hydro projects are treated as power generating facilities subject to cap.

ⁱⁱⁱ Government ownership presumes the facility will be operated by a private entity. Government owned and operated facilities are covered by traditional municipal bonding.

Public vs Private Activities

The types of QAs funded with PABs can sometimes blur the border between public and private sectors. To distinguish these boundaries, the IRS uses a four-pronged test to determine whether a project is eligible for PAB consideration. These questions ensure that a project complies with both state and federal laws.

- 1) Is the project an IRS “Qualified Activity”?
- 2) Will the project be operated by a private (for-profit or non-profit) business?
- 3) Will the assets securing the debt be privately owned by a for-profit or non-profit entity?
- 4) Will the debt be repaid with private funds?

Dollars that may be paid by a local government in the form of fees and rents are private funds for the purpose of the private vs public funding test.

Small Issue Private Activity (Industrial Revenue) Bonds

Small Issue PABs, also called Industrial Revenue Bonds, are for the exclusive purpose of building, equipping, and retrofitting manufacturing facilities. The IRS uses the term “Small Issue” to distinguish that these bonds are limited in size not to exceed a tax-exempt bond issue of \$10 million for a total bond issue not to exceed \$20 million. The IRS defines manufacturing facility through the following tests^{iv}:

- The facility must be of a character subject to depreciation.
- The facility must produce tangible personal property.
- There must be a substantial transformation of inputs or raw materials.
- Manual or machine labor must be expended. Natural or accelerated growth, such as what one may see in factory farm, does not meet this test.
- Something new must be created that has a distinctive name, character, or use.

The IRS also places limits on how the funds generated by Small Issue PABs are spent^v:

- 70% must be spent on core manufacturing assets. This will typically be for equipment and floor space containing the production line.
- 20% of the proceeds may be spent on ancillary assets (storage areas, offices, shipping and receiving areas, etc.)
- 5% may be spent on the administrative, legal and placement costs associated with setting up the bond.

^{iv} See [IRC § 144\(a\) – Qualified Small Issue Bonds](#)

^v [IRC § 144\(a\) – Qualified Small Issue Bonds](#)

Financing from other sources like equity investors or other types of loans are not subject to the above limitations. Commercial buildings, mixed-use developments, and facilities dedicated to the development of intellectual property do not meet the IRS definition of manufacturing, and thus are not eligible for Small Issue PAB funding.

Exempt Facilities

All QAs other than Small Issue are referred to by the IRS as “Exempt” facilities. These projects are called “Exempt” because there are no limits on the size of the bond or project subject to the availability of volume cap, if applicable.

Volume Cap

Each calendar year the IRS establishes a volume cap that limits the amount of PAB activity that can take place in a given calendar year. For calendar year 2022, the volume cap for small population states like Idaho is \$358,845,000. Any leftover cap each year may be carried forward for up to three years. States are allowed to prioritize certain type of QAs over others. In Idaho the volume cap is dictated by executive order and may be changed at any time through new orders. Under the most recent executive order governing PABs ([Executive Order 2018-05](#)), the set asides for 2022 are as follows.

Private Activity Bond Set Asides 2023		
Qualified Activity	Percentage	Volume Cap
Small Issue (IRB)	13%	\$46,649,850
Single Family Mortgages	55%	\$197,364,750
Low Income Multi Family Housing	18%	\$64,592,100
All Other Exempt Facilities ^{vi}	14%	\$50,238,300

Idaho’s 2022 Allocations

In 2022 Idaho issued the entirety of its volume cap. Three certificates for the combined sum of \$62,000,000 were issued for multi-family, low income, Federal 4% tax credit housing projects. Upon completion, these projects will result in the creation of 217 units of income qualified housing. The remaining volume cap (\$273,115,000) was allocated to the Idaho Housing and Finance Association for their Single-Family Mortgage program. Idaho Commerce received inquires for Small Issue and Exempt Facility projects, but those inquires did not result in any volume cap request.

Public Corporations

Private Activity Bonds are issued by public corporations also known as local industrial development corporations. In accordance with [Title 50, Chapter 27](#) of Idaho Code,

^{vi} Broadband and carbon capture projects will be treated as “exempt facilities”.

cities and counties are empowered to create and dissolve public corporations. Public corporations may also be created by the Idaho Legislature. State public corporations capable of issuing PABs include the [Idaho Housing and Finance Association](#) and the [Idaho Health Facilities Authority](#).

While issued by public corporations, PABs are not guaranteed debt. It is the investors and not the public corporation nor the government entity that created them, that assume all default risk. Since PABs are not backed by tax revenues, they do not require a bond election. Public corporations are not required to approve qualified projects and may negotiate with developers to ensure that a project conforms with community values and regulations. Business and developers are responsible for all the legal and other costs associated with issuing the bond. A list of the public corporations known to Idaho Commerce may be found on page 9 of this guide.

Creating a Private Activity Bond Team

The first step in pursuing PAB funding is to assemble a team of experts to help prepare the paperwork and ensure that the project conforms with state and federal requirements. Members of the team should include...

1. **Bond Counsel**— A business or developer should seek legal representation experienced in the areas of business finance and municipal bonding. A bond counsel will typically draft the requisite documents, certify that a PAB issue complies with all state and federal legal requirements, and deliver an opinion regarding the tax-exempt status of the bonds. A bond counsel can aid in the formation of a public corporation and connect the borrower with local officials and lenders. See the list of Experienced Idaho Bond Counsels on page 7.
2. **Underwriter/Purchaser/Lender**—This will be a bank, investment banking firm, financial advisor, or other financial institution. The underwriter is involved only if the bonds are to be marketed to the public rather than privately placed by the company. The underwriter helps structure the financing and ultimately purchases the bonds for resale to the public. A lender is usually found through bond counsel, or a bond placement service. See page 8 of this guide for a list of banks and other financial institutions with a history of working with PAB and municipal bond projects in Idaho.
3. **Governmental Issuer/Public Corporation**—This will be governmental industrial development corporation (public corporation) created by a city or county authorized by law to issue PABs. The local governmental body must formally approve each PAB by issuing an “Inducement Resolution”. The public corporation also coordinates the activities of all the participants in the process. The responsibility for repayment of the bond lies with the borrower. Neither the public corporation nor the government entity responsible for its creation incurs liability for repayment or any other acts of malfeasance caused by the borrower. A list of public corporations known to Idaho Commerce may be found on page 9 of this guide.

4. **The Borrowing Business / Developer** – This will be the business or developer utilizing the proceeds from the PAB. There may be more than one eligible participant, and the eligible participant does not need to be directly or indirectly the user of the project. In most cases the eligible participant will be the principal user of the QA to be financed.

Application Process

1. **Preliminary Discussions** - A borrower discusses the preliminary project proposal with bond counsel and the public corporation (where in existence) or with city or county officials where a public corporation does not exist
2. **Application Submittal** - If the project is feasible and deemed eligible by bond counsel, an application is submitted to the public corporation.
3. **Preliminary Project Evaluation** - The public corporation reviews the application with assistance from staff, financial institutions, and bond counsel. Project evaluation often will include a credit review conducted by an investment banker or lender.
4. **Substantive Negotiations Begin** - If the project is eligible, negotiations begin between the company/developer, public corporation, bond counsel and the bond purchaser. Once all parties agree to the project scope, size of the bond, and terms for repayment, then the issue will be ready for formal review and approval.
5. **“Inducement Resolution”** – Once agreement is reached on basic terms and conditions, the bond counsel assists the public corporation in preparing an “inducement resolution”. This resolution will stipulate the public corporation’s conditional intent to issue revenue bonds in a certain amount for a specified company and use. The date that this inducement resolution is approved by the public corporation is important to the borrowing company because only the project expenditures made within 60 days of that date are recoverable from the bond proceeds. As such, it is best to work toward an inducement resolution early in the process so that costs of initiating and planning the project can be financed by bond proceeds.
6. **Planning Jurisdiction Approval** - Project approval of the planning jurisdiction, if different from the creating municipality, must be secured.
7. **Final “Bond Issuing Resolution”** - Negotiations may continue until the final bond issuing resolution is approved. This final resolution approves the documents setting forth the terms and conditions of the bond sale, and it is approved by the creating municipality using a resolution or ordinance.
8. **Request IRB Allocation from the Department of Commerce** - Federal law restricts the amount of private activity bonds that can be issued in Idaho each year. The Idaho Department of Commerce allocates the amount of each bond issued to ensure the ceiling is not exceeded. The public corporation submits its

requests to the Idaho Department of Commerce when a buyer for the bond has committed to the purchase. A request for allocation is made with the form on page 9, and an attached inducement resolution.

9. **Bond Counsel Opinion and Issuance of Bonds** -Once the opinion of the bond counsel regarding tax-exempt status of the project is rendered, the sale is closed, and the bonds are purchased. Post-closing reports are made to the Internal Revenue Service and Idaho Department of Finance. The process for bond payment may then vary depending upon whether it is to be a public or private bond placement.
10. **Other Documentation and Procedures Involved** – The bond counsel may be called upon to file additional documentation with local, state, and federal authorities and other financial entities.

**STATE OF IDAHO
EXPERIENCED BOND COUNSEL^{vii}**

MSBT Law
Ms. Stephanie J. Bonney
7699 W. Riverside Drive
Boise, Idaho 83702
208-331-1800

Skinner, Fawcett
Mr. Richard A. Skinner
250 Bobwhite Ct #240,
Boise, ID 83706
208-345-2663

Hawley Troxell
Mr. Nicholas G. Miller
Wells Fargo Center, Suite 1000
877 West Main Street
Post Office Box 1617
Boise, Idaho 83701
208-344-6000

^{vii} These are Idaho based legal firms with experience in private activity and/or municipal bonding known at the time of publication. This list shall not be considered as an endorsement of any firms over those not appearing in this publication. The contact information is subject to change.

BOND PLACEMENT SERVICES^{viii}

Mr. Eric Heringer
Investment Banker
Piper Sandler
101 South Capitol Boulevard
Boise, Idaho 83702
208-344-8577

US Bank
Government Banking Center
Post Office Box 8247
Boise, Idaho 83733
503-275-5506

Caitlin Meussner
Vice President
Public Finance Investment Banking
KeyBank Capital Markets
Seattle, WA 98101
Office: 303-518-5782

GE Capital
6510 Millrock Drive, Ste. 200
Holladay, UT 84121
801-733-3058
Fax: 888-867-0031

Shaun Kelley, V.P.
Zion's Bank
800 West Main Street
Boise, ID 83702
208-501-7533
Office: 208-501-7575

For questions or to submit a Private Activity Bond request, please contact:

[Jerry Miller](#)
Idaho Department of Commerce
700 West State Street
Post Office Box 83720
Boise, Idaho 83720-0093
(208) 287-0780

^{viii} These are bond placement entities with experience in private activity and/or municipal bonding in Idaho, known at the time of publication. This list shall not be considered as an endorsement of any firms over those not appearing in this publication. Contact information is subject to change.

STATE OF IDAHO CHARTERED PUBLIC CORPORATIONS

The cities and counties listed below have formed chartered public corporations for the purpose of issuing private activity bonds. Projects financed by PABs can be completed more quickly in these cities and counties because they have completed the necessary groundwork of forming a public corporation. Each of these corporations may issue any number of bonds as long as they do not exceed \$20 million (\$10 million tax-exempt/\$10 million taxable) per project each and \$40 million per beneficiary per year.

Legislation passed in 2007 permits the financing of economic development projects through the issuance of revenue bonds by the Idaho Housing and Finance Association.

Potential PAB users can still pursue PAB projects in places without public corporations. In those cases, the Idaho Department of Commerce will be glad to assist city or county officials in forming a public corporation to expedite the PAB financing process. Businesses attempting to use PAB financing in cities or counties without public corporations should contact local elected officials and inform them of the Idaho Department of Commerce's offer to help them charter a public corporation.

Because public corporations are not centrally registered, the list below may be incomplete. Check with the city and/or county government office to confirm the existence or absence of a public corporation. Also note that many of these entities were created during the 1980s and may be dormant.

CITIES

Boise
Caldwell
Eagle
Fruitland
Garden City
Idaho Falls
Lewiston (Port of Lewiston)
Meridian
Nampa
Shelley
Twin Falls
Mountain Home

COUNTIES

Ada
Bannock
Benewah
Bingham
Bonneville
Bonner
Camas
Canyon
Cassia
Custer
Gooding
Jerome
Kootenai
Lincoln
Madison
Minidoka
Nez Perce
Oneida
Payette
Power
Shoshone
Twin Falls
Washington

Date:

To: Idaho Department of Commerce
700 West State Street
Post Office Box 83720
Boise, Idaho 83720-0093

In accordance with Executive Order No. 2018-05 of the Governor of the State of Idaho, dated May 23, 2018, the Issuing Authority indicated below hereby requests an allocation from the state ceiling of Private Activity Bonds and as evidence of compliance with said Executive Order, hereby files with the Idaho Department of Commerce the attached Bond Inducement Resolution (or similar binding commitment), and the following information:

Issuing Authority Name: _____
Identification number _____ Phone: _____
Executive Officer Title: _____
Address: _____
City, State, Zip: _____
Bond Counsel Name: _____
Name of firm: _____
Address: _____
City, State, Zip: _____
Phone number: _____
Name of project: _____
Location: _____
Description of use: _____
Name of project owner/user: _____
Par amount of obligations (allocation requested): _____
Date of purchase agreement: _____
Purchaser(s): _____
Name of bond issue: _____
Anticipated closing date: _____
Anticipated date for issuing certificates: _____
Applicable Provision of Internal Revenue Code: _____
Request allocation be carried forward to: _____
Evidence of need, economic impact and distribution
of resources throughout the State: _____

(please attach a separate sheet of paper if needed)

Signed: _____

Name: _____

Title: _____

NOTES

Addendum A – Broadband Projects

I on behalf of (Insert Public Corporation Name Here) certify the following.

- 1) This project solely serves census block groups in which more than 50% of residential households lack fixed, terrestrial broadband service delivering 25 megabits per second downstream and at least 3 megabits per second of upstream speeds.
- 2) This project will result in internet access to residential and commercial locations at speeds not less than 100 megabits per second of downstream and 20 megabits per second of upstream speeds.
- 3) 90% of the locations served by this project are locations where before the project a broadband service provider either did not offer service or failed to offer service at the minimum speeds described in item 1.
- 4) All broadband providers serving the census blocks included in the project have been notified of the project scope. (Attach a list of census blocks to be served, the notified service providers, and a copy of the notice).

Signed: _____

Name: _____

Title: _____

Addendum B –Carbon Capture Projects

I on behalf of (Insert Public Corporation Name Here) certify the following.

- 1) This project utilizes direct air capture or other equipment that results in the capture, treatment, purification, transportation or on-site storage of carbon dioxide produced by an industrial or energy generating facility Or..

Utilizes equipment that is functionally related or subordinate to a process that converts a solid or liquid product from coal, petroleum residue, biomass or other materials that are recovered for their energy or feedstock value into synthesis gas composed primarily of carbon dioxide and hydrogen for direct use of subsequent chemical or physical conversion.

- 2) This project is not an industrial carbon dioxide or geological gasification facility, or any separation unit does not qualify as gasification equipment or is not a necessary component of an oxy-fuel combustion process.
- 3) The facility resulting from this project will have a capture and storage efficiency equal to or greater than 65% or that the percentage of costs of the eligible components identified in item #1 is equal to or less than capture and storage efficiency percentage.

Signed: _____

Name: _____

Title: _____