

SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS (IDBs) FACT SHEET: TAXABLE BONDS

WHAT IS A TAXABLE IDB?

Taxable IDBs are debt obligations of qualified companies, which are issued and sometimes guaranteed by ADFA. The bonds are usually sold as a private placement with investors, but can also be sold in the national capital markets by investment bankers. The interest income earned by Arkansas bondholders is exempt from Arkansas State income taxes but is taxable on the Federal level.

WHAT IS THE BENEFIT OF AN ADFA GUARANTY?

Generally, the private placement of the taxable bond issue is with a pension fund which has legal obligations regarding the safety of its investment portfolio. The ADFA Bond Guaranty Program, which has been reviewed and rated A- by Standard and Poor's, gives the pension fund the level of comfort necessary to purchase the bonds.

WHAT IS THE RATE OF INTEREST ON THE ADFA GUARANTEED, TAXABLE IDB?

The rate of interest on the bonds is affected by the prevailing interest rate environment at the time the bonds are sold. Usually these taxable bonds will carry an interest rate approximately 1.5% higher than a comparable tax-exempt bond issue. Early in the application process an estimate of the net effective interest rate can be given by the ADFA staff so the borrower can estimate what effect the debt service requirements of the IDB will have on their financial performance. One major benefit to the borrower is the ability to fix the rate of interest for the entire term of the bond issue.

WHY WOULD A BORROWER CHOOSE A TAXABLE ISSUE BOND INSTEAD OF A TAX-EXEMPT BOND ISSUE?

The up-front costs of a taxable IDB are usually much less than a tax-exempt IDB. This aspect is very attractive to high growth companies which have good cash flows but may not be highly liquid. Taxable IDBs also are more easily incorporated with other financing options such as the SBA 504 loan program. Participation with other financing sources is very useful when the risk of the project is higher than usual. The requirements for qualification (based upon the nature of the business) are much less stringent with a taxable IDB because federal tax law restrictions do not apply.

WHAT ARE THE MAJOR RESTRICTIONS OF A TAXABLE IDB?

The bonds cannot be used to refinance existing debt nor can they be used to provide working capital financing. State law will not allow bonds to be issued for recreational, entertainment, liquor sales or retail purposes. Elections must be held before bonds can be issued for office buildings, hotels, motels or tourist attraction facilities.

