IFA
ILLINOIS FINANCE AUTHORITY

180 North Stetson Ave.
Suite 2555
Chicago, IL 60601
312-651-1300
312-651-1350 fax
www.il-fa.com

March 11, 2014

TO: William A. Brandt, Jr., Chairman
Gila J. Bronner
James J. Fuentes
Norman M. Gold
Lerry Knox
Edward H. Leonard, Sr.
Carmen Lonstein
Terrence M. O'Brien
Michael W. Goetz, Vice-Chairman
Heather D. Parish
Mayor Barrett F. Pedersen
Roger Poole
Mordecai Tessler
David Vaught
Bradley A. Zeller

RE: Message from the Executive Director

Dear Members of the Authority:

House Ways and Means Chairman Camp's Tax Reform Plan Threatens Conduit Bonds

On February 26, 2014, United States House of Representatives Ways and Means Committee Chairman Dave Camp (R – MI) released a draft tax reform plan that would end the federal tax exemption for conduit bonds as a whole and for advanced refunding conduit bonds issued after 2014. The Camp Plan is an existential threat to federal tax exemption of conduit bonds (and to conduit borrowers that rely on the lower interest rate provided). The Camp Plan comes at a time when the Illinois Finance Authority (the "Authority") faces macroeconomic challenges of declining refundings in the municipal marketplace, a notable increase in taxable issuance of health care and education bonds, and having the economic value of tax-exemption to borrowers at historic lows. See., e.g., Chin, Tonya. *"With Sharp Decline in Refundings, New-Issue Supply Slid 12.5% in '13"*. The Bond Buyer. 23 Feb. 2014.

Fortunately, the Authority has long been active with two national organizations of issuers with a strong Capitol Hill presence: the Council of Development Finance Agencies ("CDFA"; focused on private "for profit" sector conduit bonds) and the National Association of Health and Educational Facilities Finance Authorities ("NAHEFFA"; focused on 501(c)(3) not-for-profit conduit bonds). Both CDFA and NAHEFFA provide an excellent return on the Authority's membership investment. Both organizations watch the wide variety of federal proposals that could negatively impact (or more rarely help) the Authority in fulfilling its job creation and retention mission through the issuance of federally tax-exempt conduit bonds. Going back to their public service with the Authority's predecessor agencies, ***Pam Lenane*** (*healthcare finance*) and ***Rich Frampton*** (*business, industry, non-profit, education finance*) have served in leadership roles in both CDFA and NAHEFFA. Rich is a long-time board member of CDFA and as a nationally recognized subject matter expert in private activity conduit finance teaches courses to public finance professionals through CDFA. Pam is completing her term as President of NAHEFFA and has long served in board and other leadership roles in that organization.

Through both NAHEFFA and CDFA, Authority staff understands that the informed view from Capitol Hill among members of both parties and in both the House and the Senate is that the Camp Tax Reform Plan is a non-starter. This is important to know because federally tax-exempt conduit finance is the Authority's primary job creation and retention tool – and consistently provides the Authority's largest single source of revenue to support our public mission.

Some years ago, we saw that the Bowles-Simpson Deficit Reduction plan suggested the elimination of tax-exempt conduit bonds. Now the Chairman of the House Ways and Means Committee has proposed the same thing in a lengthy and comprehensive tax reform proposal. The Authority, its Board and its staff need to continue to educate federal policy makers on the job creation and job retention value of federally tax-exempt conduit bonds. As the Board Members know, the Authority's work financing billions of dollars in the construction of hospitals, factories, universities, water infrastructure is dependent on the continued existence and economic viability of this important tool.

American Manufacturing Bond Finance Act

Sometimes the best defense is a good offense. The Authority's primary tool to help small and mid-sized manufacturing is the federally tax-exempt conduit industrial revenue bond. In decades past, industrial revenue bonds have been an excellent incentive for industrial capital investment keeping the Illinois manufacturing ecosystem competitive in the global economy. However, Congress has not updated industrial revenue bonds since the late 1970's – and a lot has changed in the American economy since that time.

Here at the Authority, we have seen first-hand the negative impact of an excellent job retention and creation tool that has become slowly outdated. In calendar year 2007, the Authority issued 27 conduit industrial revenue bonds with a total par value of just under $220 million. Between 2008 and 2013 (six calendar years), the Authority successfully closed a total of 21 conduit industrial revenue bonds equating to a total par value of just under $120 million. This decline in activity tracks national trends, but the decline cannot simply be attributed to the Great Recession and historically tight spreads between tax-exempt and taxable interest rates. We believe that it is the case of a tool that has failed to stay relevant to the needs of manufacturing borrowers and the capital markets.

Despite Washington gridlock, the Authority and CDFA have been steadily making the policy and fiscal case to Congress to update industrial revenue bonds. This is not only to preserve our remaining manufacturing infrastructure. Modernizing industrial revenue bonds will take advantage of the trend towards returning manufacturing assets to American shores ("reshoring") and encourage research and innovation among manufacturers here.

The result of this effort is the proposed American Manufacturing Bond Finance Act. A brief but detailed summary is attached to this letter and more information is available at www.cdfa.net.

We expect that Ohio U.S. Senator Sherrod Brown (D-OH) will soon introduce the American Manufacturing Bond Finance Act. Authority staff has also made the case, on a bipartisan basis, for the proposal among members of the Illinois federal delegation. The American Manufacturing Bond Finance Act also allows an opportunity to educate Congress about the benefits of conduit bond finance and the hospitals, universities, museums, water infrastructure and factories that it supports.

To date, this effort has been favorably received – and we hope to have favorable news to share shortly with you.

The Business of the Authority – and New Potential Opportunities

At our February 2014 meeting, there was a robust discussion regarding Authority revenues which, of course, through our enterprise model are tied to the dollar volume and number of conduit bond issued. In short, Authority income exceeded budget for the first half of Fiscal Year 2014 (July 2013 through December 2013). The third quarter of Fiscal Year 2014 (January 2014 through March 2014) is proving to be more challenging. Spreads between tax-exempt interest and taxable interest are not as wide as they were several years ago. A slow economic recovery, we believe, has also hurt volume. Most importantly, we recognize that conduit bond issuance is cyclical and it may well prove that we are currently experiencing a down-cycle. It is for this reason that we have been laying the foundation for a diverse set of initiatives.

A major contribution to the Authority's policy and financial success during the first half of Fiscal Year 2014 was closing the financing of Governor Quinn's "AAA-rated" Clean Water Initiative Bonds in December 2013. It should be noted that this success was the capstone of nearly eighteen months of Authority staff work in close partnership with the Illinois Environmental Protection Agency. We hope, in perhaps a more modest manner, to duplicate the success of the Clean Water Initiative through one or more of the following initiatives:

- Working with Governor Quinn and State sister agencies to provide below-market local government capital financing to storm and tornado-ravaged communities. Vice-Chairman Mike Goetz attended this announcement in Washington, Illinois on March 5, 2014;

- Next steps in a pilot energy efficiency project for State facilities;

- Next steps in partnership with the Office of the State Fire Marshal (OSFM) in updating the local government fire truck, ambulance and other capital investment loan program. The Authority and OSFM partnership on this effort resulted in Public Act 97-901;

- First steps in working with the Illinois Department of Transportation (IDOT) on innovative public-private partnerships;

- Expanding the jurisdiction of the Healthcare Committee to include Education; and

- Proactively confronting our revenue and program challenges by taking the next step in the Authority's strategic and enterprise planning process.

News from Springfield

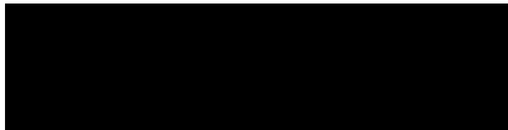
On February 25, 2014, the Authority appeared before the Senate Appropriations I Committee led by Chair Heather Steans, Vice-Chair Dan Kotowski, and Minority Spokesperson Matt Murphy. Thanks in large part to the Board's leadership, the Authority was favorably received. However, the fact that the Authority receives no State taxpayer appropriation to support its operations in what is

predicted to be a very difficult budget year probably didn't hurt either. Working with Howard Kenner, the Authority's Springfield representative, we are working on a variety of initiatives to improve our ability to help agriculture, education and infrastructure through financing. We will keep you advised as to how these efforts develop.

As of this date, the House Appropriations Hearing for the Authority has not yet been scheduled nor have we been informed of a release date for the Fiscal Year 2013 Auditor General Compliance Audit for the Authority. As you know, the Fiscal Year 2013 Auditor General Financial Audit was released on January 29, 2014.

As always, the Authority staff looks forward to working with all of you to fulfil our job creation and retention mission.

Respectfully,



Christopher B. Meister
Executive Director

Attachments:

Attachment 1 – Overview of American Manufacturing Bond Finance Act
Attachment 2 – Bonds Activity Reports; Schedule of Debt

MEMORANDUM

To: United States Congress

From: Toby Rittner, President & CEO
Council of Development Finance Agencies

Date: March 5, 2014

Re: The American Manufacturing Bond Finance Act

Perhaps nothing is more pressing than the plight of American manufacturers over the past decade. Since 2001, nearly 5.7 million[1] manufacturing jobs have disappeared due to a variety of reasons. Low-cost, affordable, flexible, and efficient capital access, however, remains the number one concern for manufacturers. For small- to mid-sized manufacturers, access to capital remains elusive and problematic.

The **American Manufacturing Bond Finance Act** is a comprehensive reform package that will modernize and revolutionize **Qualified Small Issue Manufacturing Bonds**, more commonly known as Industrial Development Bonds (IDBs) or simply manufacturing bonds. Manufacturing bonds are a type of Private Activity Bond (PAB) that allow the public sector to pass considerable interest rate reductions on to private companies through the issuance of tax-exempt bonds.

This bedrock tool is the single most actively used bond tool for financing the small- to mid-sized manufacturing sector and are a key economic development tool for state and local economic development agencies. The eight reforms will expand the capacity and usability of manufacturing bonds to help create American jobs immediately.

The eight reforms are as follows:

1. **Expand the Definition of Manufacturing to Include both Tangible and Intangible Manufacturing Production for Manufacturing Bonds**

2. **Eliminate the Restrictions on "Functionally Related and Subordinate Facilities" for Manufacturing Bonds**

3. **Increase the Maximum Bond Size Limitation from $10M to $30M for Manufacturing Bonds**

4. **Increase the Capital Expenditure Limitation from $20M to $40M for Manufacturing Bonds**

5. **Expand and Raise the Limits for Bank Deductibility to $30M for Manufacturing Bonds and 501(c)(3) Bonds**

6. **Eliminate the Restriction on the Use of Accelerated Depreciation by Manufacturers Using Manufacturing Bonds**

7. **Expand the 2% De Minimis Rule to Financial Institutions for Manufacturing Bonds and 501(c)(3) Bonds**

8. **Allow Qualified Small Issue Manufacturing Bond volume cap allocation to be carried forward in accordance with other bonds subject to volume cap**

Manufacturing bonds have not been reformed in nearly thirty years, and this lack of reform has caused stagnation and decline in issuance. Over $3.1 billion in manufacturing bonds were issued nationwide in 2007. In 2010, just $666 million in manufacturing bonds were issued. The drop in manufacturing bond issuance is directly related to the outdated rules and regulations that govern these bonds. Improved tax policy will enable manufacturers to access bond financing again.

These eight recommended reforms would expand access to capital for manufacturers, support America's most productive industry, and create jobs now.

The **Council of Development Finance Agencies** is a national association dedicated to the advancement of development finance concerns and interests. CDFA is comprised of the nation's leading and most knowledgeable members of the development finance community representing public, private and non-profit entities. For more information concerning the American Manufacturing Bond Finance Act, contact Toby Rittner (trittner@cdfa.net) or go to www.cdfa.net.

[1] AFL-CIO

The American Manufacturing Bond Finance Act
At A Glance

Reform 1: Expand the Definition of Manufacturing to Include both Tangible and Intangible Manufacturing Production for Manufacturing Bonds
The measure would broaden the definition to include facilities that manufacture, create, or produce intangible property. The expanded definition would be sufficiently broad to cover software, patents, copyrights, formulas, processes, designs, patterns, know-how, format, and similar intellectual property. Under this new definition, knowledge-based businesses could access low-cost, tax-exempt IDB financing. This updated definition would align the growing high-tech manufacturing sector with the tools necessary to finance industry growth and expansion.

Reform 2: Eliminate the Restrictions on "Functionally Related and Subordinate Facilities" for Manufacturing Bonds
This change would allow manufacturers to develop projects that support modern business practices, provide for a better quality-of-life work environment, and diminish the complexity of using low-cost bond financing. This change would also expand project possibilities and give manufacturers the resources to think about long-term capital improvements, investment, workforce development, and job creation.

Reform 3: Increase the Maximum Bond Size Limitation from $10M to $30M for Manufacturing Bonds
This relatively small change would have virtually no impact on the federal treasury as Qualified Small Issue Manufacturing Bonds remain under the national volume cap and cannot exceed total nationwide issuance beyond the total cap. In other words, this change will give manufacturers a new and improved resource for making investments and creating jobs for an investment already accounted for by the federal government.

Reform 4: Increase the Capital Expenditure Limitation from $20M to $40M for Manufacturing Bonds
This modest change will align this important limitation with the realities of the economy and cost of doing business in the United States. This change will open the door for hundreds of new manufacturing projects that have long-term expansion objectives, and will spur ongoing investment and create jobs.

Reform 5: Expand and Raise the Limits for Bank Deductibility to $30M for Manufacturing Bonds and 501(c)(3) Bonds
CDFA also proposes that Congress allow "bank qualified" debt to be applied on a borrower-by-borrower basis, rather than aggregating all "bank qualified" bonds issued by an issuer. This targeted change will open the financial markets for manufacturing deals by giving borrowers and issuers the ability to place their bonds with their local community banks. This change will significantly ease the complexity and cost of smaller manufacturing bond transactions. These changes will level the playing field and allow small and mid-sized manufacturers access to an economic development tool that most have not been able to access cost effectively since 1986.

Reform 6: Eliminate the Restriction on the Use of Accelerated Depreciation by Manufacturers Using Manufacturing Bonds
This very small, but significant, change would allow small- to medium-sized manufacturers to access the bond markets for more affordable rates while also benefiting from depreciation tax-savings in the early years of the investment. This change would encourage manufacturers to explore bond financing as an affordable and cost-effective way to make investments and ultimately create jobs.

Reform 7: Expand the 2% De Minimis Rule to Financial Institutions for Manufacturing Bonds and 501(c)(3) Bonds
This reform would permit financial institutions to purchase new money tax-exempt bonds issued in an aggregate amount not to exceed 2% of their adjusted bases of assets. This change would allow small, local lenders to purchase Qualified Small Issue Manufacturing Bonds that directly support manufacturing investment and job creation in their communities.

Reform 8: Allow Qualified Small Issue Manufacturing Bond volume cap allocation to be carried forward in accordance with other bonds subject to volume cap
CDFA proposes a simple legislative fix to allow volume cap to be carried forward for IDBs and allow the IRS to revise their interpretation. Alternatively, one could simply have the statute indicate that bonds which close and spend funds in a given year can be issued using volume cap from that year for the entire issue. This approach is consistent with the way counsel had treated bonds prior to the IRS issuing a contrary interpretation.