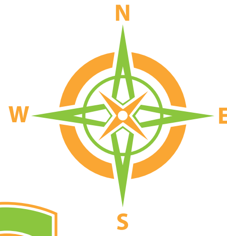
FIELD NOTES



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A QUICK-READ STRATEGIC RESOURCE OF DONOR BY DESIGN GROUP

MY TAX-EXEMPT BOND IS FIXED — ISN'T IT?

Many not for profits (NFPs) benefitted from the lower cost of borrowing after Congress allowed them to utilize the same tax-exempt financing that municipalities used for many years. This generally was 35% less than conventional market-priced financing, allowing NFPs to expand their facilities, grow revenues and serve more communities. YMCAs alone have approximately $3 billion of long-term financing with over 90% of the financing done on a tax-exempt basis.

BENEFITS OF TAX-EXEMPT FINANCING

One of the most attractive features of tax-exempt financing was the fact that a NFP could finance major capital projects over 20, 25, or even 30 years with financing at rates in the low 2-3%.

Long-term tax-exempt financing generally was in the form of either bank-owned debt, privately-placed debt, or publically-owned debt. If the debt was a "fixed rate," NFPs believed they were being good, long-time stewards of their organization's finances, assuming the rates would not change. Most would not have predicted that federal tax structure, embedded for so many decades, would change.

THE COMPLEX LANGUAGE OF A LOAN

Not for profit tax-exempt loans are complex and have an abundance of conditions and restrictions. Many fixed-rate debt documents have language that protected the yield and/or the interest income return to the holder. This language is referred to as "rate yield maintenance" or "rate yield protection," meaning that the interest rate could be adjusted, even though it was "fixed" on the surface of the loan or the bond.

Cities, counties, and states that regularly issue large tax-exempt bonds routinely negotiate out this type of language. Typically, NFPs simply don't have that type of "clout" with the banks and underwriters; therefore this issue of possible adjustment to a "fixed" rate tax-exempt bond is not common for NFP organizations.

SO, WHAT DOES YOUR ORGANIZATION NEED TO DO?

1. First, **be proactive, be positive, and be informed.** Check your loan documents. Discuss the issue with your bond attorney or closing attorney. Discuss it with your bank or lender.
2. Next, if after you check with your lender and learn you DO have that "rate yield maintenance" language, what can you expect? Banks and lenders don't want to force you, or themselves, into re-issuing the tax-exempt bond; it's expensive and takes time. **If the debt is bank-owned, then you are in a better situation. Both of you may agree to NOT to enforce the lender's "rights."** This is particularly true if the balance amount is small, say under $3 million, and there are not many years left on the loan.

   If the bond or loan is relatively new, it might contain specific language that allows a rate adjustment without re-issuing the debt. **Many bonds and loans done in the last three to four years have contemplated this decrease in the corporate tax rate from 35%, and have built in language and formulas.**
3. Lastly, many lenders (not wanting to cancel and reissue the bond or loan, or incur time, expense, and potentially bad publicity) will with work with your organization to **reach a reasonable compromise where both parties can agree upon a smaller interest rate adjustment.**

In short, work with your lender. After all, you agreed to this condition and it is "their" money. Be positive, get educated, and always work to a reasonable solution that continues to show that your organization is a good steward of your finances.

For more information on how DBD can help you manage this conversation, contact Jim Mellor at jim@donorbydesign.com