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INDUSTRIAL DEVELOPMENT AND POLLUTION CONTROL FINANCING IN NORTH CAROLINA

WILLIAM H. MCBRIDE† and DAVID DREIFUS‡

In 1976 the people of the State of North Carolina voted to amend the State constitution to allow the issuance of tax-exempt industrial development and pollution control bonds. This amendment, coupled with the Industrial and Pollution Control Facilities Financing Act passed by the North Carolina General Assembly in anticipation of adoption of the amendment, gives North Carolina the ability to attract potential employers by allowing tax-exempt financing. Messrs. McBride and Dreifus describe the interaction of the North Carolina Act with federal law, the mechanics of tax-exempt financings, and particular points of interest to companies contemplating the use of tax-exempt industrial development financing.

On March 23, 1976, the people of the State of North Carolina voted to amend the State constitution to allow industrial development and pollution control financings. In such transactions a local political subdivision issues bonds, the proceeds of which are used to finance the acquisition and construction of industrial, pollution control, or other capital facilities to be used by a private company. The bonds are secured by and are sold exclusively on the basis of the company's obligation to make payments under a financing agreement entered into between the company and the political subdivision. The bonds therefore are not an unlimited obligation of the issuing political subdivision. Because the interest on such bonds is exempt from North Carolina

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1. N.C. CONST. art. V, § 9 now states:
   
   Capital projects for industry.

   Notwithstanding any other provision of this Constitution, the General Assembly may enact general laws to authorize counties to create authorities to issue revenue bonds to finance, but not to refinance, the cost of capital projects consisting of industrial, manufacturing and pollution control facilities for industry and pollution control facilities for public utilities, and to refund such bonds.

   In no event shall such revenue bonds be secured by or payable from any public moneys whatsoever, but such revenue bonds shall be secured by and payable only from revenues or property derived from private parties. All such capital projects and all transactions therefor shall be subject to taxation to the extent such projects and transactions would be subject to taxation if no public body were involved therewith; provided, however, that the General Assembly may provide that the interest on such revenue bonds shall be exempt from income taxes within the State.

   The power of eminent domain shall not be exercised to provide any property for any such capital project.

2. N.C. GEN. STAT. § 159C-14 (1982). Since the transaction is for financing purposes no
and federal income taxes, the interest payments (made indirectly by the private company) are considerably lower than would be required in an ordinary taxable financing. Traditionally, the "spread" or difference between taxable and tax-exempt rates for the same company was thought to be two and one-half percent. Beginning in 1978, however, this percentage appears to have dramatically increased, even as compared with higher interest rates in general, to five or six percent. Consequently, private industry views such transactions quite favorably. In turn, the communities offering tax-exempt financing are aided in attracting new industry or encouraging the expansion of existing facilities, thereby increasing their tax base and creating new jobs.

Tax-exempt financing for industrial development and pollution control facilities was not readily accepted in North Carolina. Two legislative attempts to institute tax-exempt financing were struck down by the North Carolina Supreme Court. In 1968, in *Mitchell v. North Carolina Industrial Development Financing Authority*, the court struck down the North Carolina Industrial Development Financing Act for violating article V, section 3 of the North Carolina Constitution. In 1973, in *Stanley v. Department of Conservation and Development*, the court held that the North Carolina Pollution Abatement and Industrial Facilities Financing Act was unconstitutional for violating the same provision. Both cases were decided on the ground that the financing schemes were not within the constitutional definition of "public purpose" because the benefits of the financing went directly to private industry and only indirectly to the public. In 1974, an attempted constitutional amendment to

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4. Interest on the bonds is not exempt from taxation by other states and the bonds themselves are subject to federal capital gains taxation. Wilcuts v. Bunn, 282 U.S. 216 (1931). Any discount from the original sales price of the bonds given to the original purchasers is tax-exempt as "interest," but this is to be apportioned over the life of the bonds. Rev. Rul. 73-112, 1973-1 C.B. 47. See Treas. Reg. § 1.103-6(a)(6), T.D. 7868 (1982). A premium on redemption is "principal" and therefore is taxable. District Bond Co. v. Commissioner, 1 T.C. 837 (1943); accord Rev. Rul. 73-587, 1972-2 C.B. 74. The exemption from federal taxes is given on an individual basis to the bondholder and is predicated on the assumption that such bondholder is not a "substantial user" of the facility financed. I.R.C. § 103(b)(10) (Supp. V 1981) ( redesignated as I.R.C. § 103(b)(13) in TEFRA, infra note 15). A substantial user is a person (1) for whom the facility was built, (2) who has a right to more than 5% of the revenues of the facility, or (3) who occupies more than 5% of the area of the facility. Treas. Reg. § 1.103-11(b) (1972). See also Rev. Rul. 76-406, 1976-2 C.B. 30.
5. The most common rate in North Carolina appears to be a floating rate in the range of 62% to 75% of the "prime" rate. With a rate of 70% and prime at 13%, the spread is 3.9% for a very strong credit and more for a less creditworthy company.
10. N.C. CONST. art. V, § 2(1), the successor to N.C. Const. art. V, § 3.
11. The court's general hostility to public financing is evident from the following language in *Mitchell v. North Carolina Indus. Dev. Fin. Auth.*:
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allow such financings was defeated at the polls.12

Since the 1976 approval of the constitutional amendment, there have been, through December 31, 1982, 381 industrial development or pollution control bond issues in North Carolina, aggregating over $1,225,287,000 in principal amount.13 The statute under which such bonds are issued is the North Carolina Industrial and Pollution Control Facilities Financing Act (the Act).14 This article describes the interaction of the Act with federal law, the mechanics of tax-exempt financings, and particular points of interest to companies contemplating the use of tax-exempt industrial development financing.

The Tax Equity and Fiscal Responsibility Act of 1982,15 which was passed by Congress on August 19, 1982, contains the primary federal provisions affecting industrial development bonds. Most notably, there is now a "sunset date" on these bonds barring their issuance after December 31, 1986.16 Additionally, the maturity of industrial development bonds issued after December 31, 1982, is limited to 120% of the economic life of the property financed,17 and all such bonds issued after June 30, 1983 will have to be issued

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subsidy, the people themselves must so declare. Such fundamental departures from well established constitutional principles can be accomplished in this State only by a constitutional amendment.


12. The proposed amendment would have added the following provision as N.C. Const. art. V, § 8:

Sec. 8. Capital projects for industry. To create jobs and employment opportunities, to improve the economic welfare of the State, and to provide for the protection of the environment and the health and well-being of the people of the State that notwithstanding any other provision of this Constitution, the General Assembly may enact laws to authorize the State or any county or any authority created by the State or county to issue revenue bonds to finance the cost of acquiring and constructing capital projects consisting of industrial facilities, including any pollution control facilities, land or equipment related thereto. Such bonds shall be payable from revenues derived from the ownership, leasing, sale or other disposition of any capital projects or part thereof and shall be deemed to have been issued for a public purpose, but such bonds shall not be secured by moneys derived from the exercise of the taxing power of any such issuer and no such issuer shall have the right to acquire property for such purposes through the exercise of the power of eminent domain. Every such capital project in which any nongovernmental entity has an interest derived from the ownership, leasing, sale or other disposition of such capital project shall be subject to property taxation. Every such project shall be taxed to such nongovernmental entity as if such nongovernmental entity was seized of such project in fee simple.


13. Office of the State Treasurer, State & Local Government Finance Division, Industrial and Pollution Control Facilities—Summary (Dec. 31, 1982) [hereinafter cited as Summary] and Office of the State Treasurer, State & Local Government Finance Division, Industrial and Pollution Control Facilities—Summary (June 30, 1982). The principal amount for the 115 issues of 1982 was $350,218,000.


16. TEFRA, supra note 15, § 214(e) (to be codified at I.R.C. § 103(b)(6)(N)). Pollution control and other "exempt" facility bonds, see infra text accompanying notes 37-45, will still be issuable after December 31, 1986.

17. TEFRA, supra note 15, § 219 (to be codified at I.R.C. § 103(b)(14)(A)(ii)). Statutory his-
in registered form. These changes do not vitiate the benefits of financings under the Act, however, and it seems likely that the volume of such bonds will continue to increase during the period of their availability.

I. PROJECTS THAT MAY BE FINANCED

The type and size of facilities that may be financed by industrial development and pollution control bonds are limited by both federal and state law.

A. Federal Law

Section 103 of the Internal Revenue Code, which deals generally with tax-exempt bonds issued by a local government or political subdivision, places certain limitations on tax-exempt bonds issued for the benefit of any particular company. As a general rule, a company may have up to $1,000,000 in tax exempt bonds issued on its behalf in each political subdivision in which it operates, provided that substantially all of the proceeds raised by the issuance and sale of the bonds are used for the “acquisition, construction, reconstruction, or improvement” of land or depreciable property.

Tory indicates that the asset depreciation range (ADR) guidelines will be used in determining “economic” life. See 1982 U.S. CODE & CONG. AD. NEWS No. 7, at [517-18].

18. TEFRA, supra note 15, § 310 (to be codified at I.R.C. § 103(j)), amended by Technical Corrections Act of 1982, Pub. L. No. 97-448, § 306(b)(2) (passed Jan. 12, 1983) (adds TEFRA § 310(d)(4), which provides that registration requirements need not be met until July 1, 1983). Prior to January 1, 1983, many “coupon” bonds were issued. Such bonds have detachable coupons evidencing future interest payment obligations and are usually in “bearer” form.


20. The applicable federal law is a tax statute and does not give power to issue bonds. It only provides guidelines for determining the tax treatment of the interest on the bonds. Thus, two requirements exist—tax exempt bonds must be validly issued under state statutes (and constitutions) and must be of a type approved by federal law.

21. Prior to 1968 there was no federal statutory language dealing specifically with industrial development and pollution control bonds, and they were treated for federal tax purposes as the functional equivalent of municipal debt. In that year, in response to the growing volume of bonds being issued, Congress adopted the basic provisions now in force. Revenue and Expenditure Control Act of 1968, Pub. L. No. 90-364, § 107, 82 Stat. 251, 266-68 (codified at I.R.C. § 103(b) (1976 & Supp. V 1981)).

22. This article uses “company” generally, but any type of entity (partnership, individual, trust, etc.) could be the obligor on such a bond issue.


24. I.R.C. § 103(b)(6)(B)(i) (1976) states that the limitation applies to all bonds issued “primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality).” In North Carolina, this limitation means $1,000,000 per county unless there is an incorporated municipality within the county. In the latter case, there could be up to $1,000,000 issued in the municipality as well as in the county. See Rev. Rul. 75-333, 1975-2 C.B. 40. See also Rev. Rul. 74-381, 1974-2 C.B. 34. As the result of a rule holding true for $10 million issues as well, see infra note 27 and accompanying text, this separation and multiplication of issues is not possible if either: (a) the facilities in the different municipalities are “integrated,” which depends on whether they are coordinated in their use, Rev. Rul. 76-427, 1976-2 C.B. 29, 30 (“involvement . . . in various stages of the same overall continuing manufacturing process”), and are in close proximity, id. (one-half mile is close proximity); or (b) the facilities, even though not integrated, are contiguous, albeit separated by a boundary line, Rev. Rul. 75-193, 1975-1 C.B. 44. See Treas. Reg. § 1.103-10(b)(2)(ii)(e) (1973) ($10 million); Treas. Reg. § 1-103-10(d)(2)(i) (1975) ($1 million).

25. I.R.C. § 103(b)(6)(A) (1976). The test is whether the proceeds are used for or on property “of a character subject to the allowance for depreciation under section 167.” Working capital and
The $1,000,000 limitation may be exceeded in only two instances. These instances are issues that meet the criteria for a $10,000,000 limitation and issues for "exempt activities." A company may have issued for its benefit bonds in a principal amount of up to $10,000,000 if it meets certain criteria. The most important of these criteria is that the total capital expenditures of the company in the area for a period of three years before and three years after issuance of the bonds, plus the face amount of the proposed


29. See Rev. Rul. 77-262, 1977-2 C.B. 41. Treas. Reg. § 1.103-10(b)(2)(ii)(a) (1973) defines total capital expenditures generally as capital expenditures financed other than out of the proceeds of the issue. The only specific exceptions are statutorily prescribed in I.R.C. § 103(b)(6)(F) (1976) and, in any event, capital expenditures required as a result of a change in law or regulations, and (2) expenditures otherwise required by unforeseen circumstances or a mistake of law or fact, if not over $1 million. These exceptions are rarely used and cannot be anticipated because they are designed to deal with unforeseen events. See Rev. Rul. 75-147, 1975-1 C.B. 41 (unforeseen circumstances—change in design and increased engineering fees). True leases of tangible personal property do not count against the limit. See Rev. Rul. 77-353, 1977-2 C.B. 44; cf. Rev. Proc. 79-48, 1979-2 C.B. 529 (modifying § 4(4) of Rev. Proc. 75-21, 1975-1 C.B. 715); Rev. Proc. 75-21, 1975-1 C.B. 715 (guidelines for determining what constitutes a lease).

30. Included are not only expenditures of the company, but also those of "related persons" and all other entities, whether or not related, made with respect to facilities where the company or a related person is the principal user. Therefore, if another facility in the county is used by the company or a related person, all expenditures made there, no matter by whom, must be counted. Treas. Reg. § 1.103-10(c)(2)(ii)(c) (1972) (citing I.R.C. § 103(b)(6)(C) (1976)), which defines the term "related person" to mean (1) the relationship between the parties is such that I.R.C. § 267 applies, (2) expenditures "with respect" to a facility may occur in another municipality, or indeed in another state, and still be qualifying expenditures. See, e.g., Rev. Rul. 77-27, 1977-1 C.B. 23 (research and development expenses incurred in another county must be counted); Rev. Rul. 77-255, 1977-2 C.B. 40. But see TEFRA, supra note 15, § 214(d) (to be codified at I.R.C. § 103(b)(6)(F)(ii) to (iv)).

31. Beyond the instances noted above concerning integrated or contiguous facilities, see supra note 24, there is usually no problem specifying the facilities for which capital expenditures must be counted, because they are all in the particular incorporated municipality. In addition, expenditures "with respect" to a facility may occur in another municipality, or indeed in another state, and still be qualifying expenditures. See, e.g., Rev. Rul. 77-27, 1977-1 C.B. 23 (research and development expenses incurred in another county must be counted); Rev. Rul. 77-255, 1977-2 C.B. 40. But see TEFRA, supra note 15, § 214(d) (to be codified at I.R.C. § 103(b)(6)(F)(ii) to (iv)).

32. The regulations state that capital expenditure must either be "paid or incurred" in this period. Treas. Reg. § 1.103-10(b)(2)(ii)(b) (1972). Thus, when a contract provided that the contractor for a new facility in the locality would retain title until the facility was finished and that no payments would be made until completion, the Internal Revenue Service stated that expenditures by the contractor which would later be a part of the sale price, if made in the six-year period
bond issue, must not exceed $10,000,000. Ascertaining whether a particular item is a capital expenditure that must be counted against the $10,000,000 limit can pose a significant difficulty. Frequently, there is a problem in determining whether to "count" other bond issues toward the limit. If the limit is exceeded, the interest on the bonds is subject to federal taxation from the date the limit is violated.

The basic $1,000,000 limit also does not apply to certain "exempt" facilities. These include air and water pollution control facilities under section 103(b)(4)(F) and solid waste and sewage disposal facilities under section 103(b)(4)(E) of the Internal Revenue Code. There is no limit on the principal amount of bonds that can be issued for such exempt facilities, but substantially all the proceeds must be used on the exempt facilities. Nevertheless, other restrictions usually preclude the financing of the entire cost of such exempt facilities. For example, the proposed pollution control regulations is-

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33. The total capital expenditures may be $20,000,000 if an urban development action grant under § 119 of the Housing and Community Development Act of 1974 is obtained, I.R.C. § 103(b)(6)(I) (Supp. V 1981), but the maximum bond amount is still $10,000,000.

34. Examples of some hard questions are: Treas. Reg. § 1.103-10(f)(11) (1972) (trucks "based" at a facility are to be counted); Rev. Rul. 75-208, 1975-1 C.B. 46 (mobile buildings used during construction are qualifying expenditures); Rev. Rul. 76-132, 1976-1 C.B. 32 (timber contracts—payment of lump sum for right to cut is a capital expenditure when made but entry into a "pay as cut" contract is not); Rev. Rul. 77-224, 1977-1 C.B. 25 (payments for molds used in a plastics manufacturing plant are capital expenditures even though unique and only used once per customer); Rev. Rul. 77-234, 1977-2 C.B. 39 (bond issuance expenses are capital expenditures even when not paid from proceeds). For purposes of the $10 million limit, it does not matter if the expenditure is actually capitalized, only that it be capitalizable. Hence, interest costs on construction money must be counted towards the limit regardless of whether they are actually capitalized.

35. The regulations state that for the purposes of calculating the $1 million and $10 million limits the outstanding face amount of any prior exempt issue for facilities of the same company or related persons in the locality must be included, but issues exempt under I.R.C. § 103(b)(4) (1976 & Supp. V 1981) (pollution control, etc.) are not counted. Treas. Reg. § 1.103-10(d) (1972). Because proceeds of an I.R.C. § 103(b)(4) issue are "capital expenditures," if they are spent in the relevant period, the face amount of such issues is effectively weighed against the $10 million limit. Therefore, a $1 million industrial issue and an $11 million pollution issue for facilities in the same county could be issued, but a $2 million industrial issue and a $9 million pollution issue could not be issued. See Rev. Rul. 76-98, 1976-1 C.B. 31; Rev. Rul. 74-380, 1974-2 C.B. 32.


38. I.R.C. § 103(b)(4) (1976 & Supp. V 1981) also lists other exempt facilities, including residential real property for family units, sports facilities, convention or trade show facilities, airports, docks, wharves, mass commuting facilities, parking facilities, facilities for the local furnishing of electric energy or gas, and facilities for the furnishing of water.

39. Treas. Reg. § 1.103-8(a)(1)(i) (1977). "Substantially all" means 90% of the proceeds must qualify or be so-called "good costs." The remaining 10% or "less than substantially all" may be otherwise nonqualifying "bad costs."

40. Proposed Treas. Reg. § 1.103-8(g), 40 Fed. Reg. 36,370-75 (1975) (to be codified at 26 C.F.R. pt. 1) (proposed Aug. 20, 1975) [hereinafter cited as P.C. Regs.]. Although only "proposed," if adopted these regulations would apply to all issues sold after August 20, 1975. Therefore, to violate them now is to run the unacceptable risk that the tax exemption for an issue will be eliminated upon adoption of the regulations. Not all proposed regulations have such an effective
sued by the Internal Revenue Service clearly state that tax-exempt bonds may not be issued to finance facilities that only "avoid the creation of pollutants."\(^{41}\)

Moreover, under these proposed regulations a political subdivision may not issue bonds to finance the portions of pollution control facilities to be installed for reasons other than to comply with environmental regulations. Thus, reasons such as the following are unacceptable: prevention of a nuisance; traditional practice of the company; health or safety reasons; need for emergency facilities; prevention of the release of a material that would cause a substantial risk of injury or harm to persons or property.\(^{42}\)

Furthermore, if part of the pollution control facilities creates an economic benefit\(^{43}\) to the company, that part of the facilities may not be financed with the bonds.\(^{44}\)

Whether or not the proposed regulations correctly interpret the statutory description of "air or water pollution control facilities" is beyond the scope of this article,\(^{45}\) but the date provision. Proposed regulations dealing with the qualification of certain issuers were drafted to become effective only 180 days after adoption. Proposed Treas. Reg. § 1.103-1, 41 Fed. Reg. 4,829 (1976) (to be codified at 26 C.F.R. pt. I) (proposed Feb. 2, 1976).

41. P.C. Regs., supra note 40, §§ 1.103-8(g)(2)(i) & (ii). See also Rev. Rul. 75-404, 1975-2 C.B. 39 (an acid plant designed so no pollutant is created does not qualify); Rev. Rul. 75-167, 1975-1 C.B. 40 (a smokestack only diffuses rather than abates air pollution and does not qualify).

42. P.C. Regs., supra note 40, § 1.103-8(g)(2)(iii).

43. An "economic benefit" is defined to be any:

- gross income or cost savings resulting from any increase in production or capacity, production efficiencies, the production of a byproduct, the extension of the useful life of other property . . . and any other identifiable cost savings, such as savings resulting from the use, reuse, or recycling of items recovered . . . [W]here that part of property which controls pollution makes unnecessary the use of any property which otherwise would be necessary but for the use of the property which controls pollution, the term "cost savings" includes capital expenditures and operating and maintenance expenses which need not be incurred as a result of the use of the pollution control property.

P.C. Regs., supra note 40, § 1.103-8(g)(3)(i). See also Rev. Rul. 75-334, 1975-2 C.B. 37 (new recovery boiler, installed to compensate for the loss of operating capacity of existing boilers resulting from compliance with air pollution control requirements, does not qualify as an air pollution control facility).

44. The costs that may not be financed are taken into account by either (a) eliminating the financing of the facility that would have been put in anyway or that causes the benefit, or (b) using a very complicated allocation formula based on present values of estimated future costs and benefits to strike a fraction of the total cost. See P.C. Regs., supra note 40, § 1.103-8(g)(3)(ii). In any particular case it may turn out that all the amounts lost by allocation may be financed as part of the 10% "bad" cost. Their relegation to that position decreases the amount of 90% "good" cost and hence decreases the total possible issue size. An allocation example appears in I.R.S. Letter Ruling 7745047, 31 IRS LETTER RUL. REPS. (CCH) pt. II (Aug. 12, 1977). It should be noted that Letter Rulings have no precedential value because they are not binding on the Service. I.R.C. § 6110(j)(3) (1976).

practical effect of the proposed regulations is to limit the types of facilities that may be financed.

B. State Law

The federal laws and regulations governing the type and size of facilities that may be financed with tax-exempt bonds are only half the picture. Restrictions under state law are just as important because a project must satisfy both federal and state requirements before it is eligible for tax-exempt financing.46

The North Carolina Constitution states that bonds may be issued “to finance, but not to refinance, the cost of capital projects consisting of industrial, manufacturing and pollution control facilities for industry and pollution control facilities for public utilities.”47 The Act states that the purposes of the issuing political subdivisions must be “(i) to aid in the financing of industrial and manufacturing facilities . . . and (ii) to aid in financing pollution control facilities for industry in connection with manufacturing and industrial facilities and for public utilities.”48

More specific requirements are set forth in the definitional provisions of the Act. For example, a “project” for which bonds may be issued is defined as:

any land, equipment or any [one] or more buildings or other structures, whether or not on the same site or sites, and any rehabilitation, improvement, renovation or enlargement of, or any addition to, any building or structure for use as or in connection with (i) any industrial project for industry which project may be any industrial or manufacturing factory, mill, assembly plant or fabricating plant, or freight terminal, or industrial research, development or laboratory facility, or industrial processing facility or distribution facility for industrial or manufactured products, or (ii) any pollution control project for industry or for public utilities which project may be any air pollution control facility, water pollution control facility, or solid waste disposal facility in connection with any factory, mill or plant described in clause (i) of this subdivision or in connection with a public utility plant, or (iii) any combination of projects mentioned in clauses (i) and (ii) . . . . 49

1. Industrial Facilities

It can be seen that industrial projects within the $1,000,000 or $10,000,000 federal limitations are restricted by the Act to projects that are, or are associated with, manufacturing facilities, industrial processing facilities, industrial research facilities, or distribution facilities. This definition of projects that

46. Interest on an issue could be exempt from state taxation under the Act but not exempt from federal taxation under I.R.C. § 103, but this is rare. The financing benefits in North Carolina would almost certainly not be worth the issuance expenses (this is not true in certain other states where ad valorem and sales and use tax exemptions are given to bond financed property.). The reverse situation is not possible. See supra note 20.
49. Id. § 159C-3(11) (1982).
may be financed with industrial development bonds in North Carolina is narrower than the definition used in other states, but there is no conflict between the Act and federal law, because any project within the terms "industrial or manufacturing facility" of necessity must contain depreciable property.

Nevertheless, because these terms are not further defined, questions have often arisen about the qualification of certain projects. The Department of Commerce, the state agency called upon to approve projects, views the scope of allowable industrial projects very narrowly. For example, distribution and warehouse facilities have not been approved, except in a few specific instances, unless they are adjacent to a manufacturing facility and used in conjunction with it. In addition, the Department of Commerce has determined that "industrial" does not include "mining."

In some states bond issue validation proceedings are possible and are a valuable aid in determining the status of projects considered questionable under a statute. North Carolina does not have a comparable procedure, and absent such a proceeding, a conservative interpretation of qualifying facilities is the only viable approach. Clearly, traditional industrial or manufacturing facilities qualify, but other types of projects should and will be closely scrutinized.

2. Pollution Control Facilities

There are specific definitions in the Act for air, water, and solid waste disposal facilities. An air pollution control facility is defined as:

any structure, equipment or other facility for, including any increment in the cost of any structure, equipment or facility attributable to, the purpose of treating, neutralizing or reducing gaseous industrial waste and other air pollutants... which shall have been certified by the agency having jurisdiction to be in furtherance of the purpose of abating or controlling atmospheric pollutants or pollutants.


51. If the main goal of industrial development financing is to create jobs by aiding in the financing of capital projects out of which will flow easily observable products for sale, then a food processing plant should qualify. Nevertheless, since the essence of what is done is processing, rather than creation of products, it could well be argued that the facility is not "industrial or manufacturing." Other states run the gamut from restrictive to fairly broad interpretations. See Opinion of the Justices to the House of Reps., 373 Mass. 873, 366 N.E.2d 1230 (1977) (expansive); State v. McDonnell, 426 S.W.2d 11 (Mo. 1968) (restrictive).


53. It appears that such questions could be answered in North Carolina only if the Department of Commerce refuses to approve a project and the company contests this decision under the Administrative Procedures Act. N.C. Gen. Stat. §§ 150A-1 to -64 (1978 & Cum. Supp. 1981). In such a proceeding, however, the contestant must show abuse of discretion, which seems per se impossible with statutorily questionable projects.
Similarly, a water pollution control facility is defined as:

any structure, equipment or other facility for, including any increment in the cost of any structure, equipment or facility attributable to, the purpose of treating, neutralizing or reducing liquid industrial waste and other water pollution, . . . which shall have been certified by the agency exercising jurisdiction to be in furtherance of the purpose of abating or controlling water pollution.\(^5\)

Solid waste disposal facilities are defined as facilities "for the purpose of treating, burning, compacting, composting, storing or disposing of solid waste."\(^6\)

Finally there are specific definitions of pollutants\(^7\) and solid wastes.\(^8\) Sewage disposal facilities, while being specifically mentioned in the federal law,\(^9\) are covered under the Act as water pollution control facilities.\(^10\)

These definitions, and the Act as a whole, do not substantially limit pollution control facilities financeable under federal law.\(^11\) Thus, unlike the situation with industrial projects, it is virtually certain that any facility, or part thereof, which qualifies under the proposed federal regulations as a pollution control project will also satisfy the definitions in the Act.\(^12\) Indeed, it is the converse that will sometimes not be true. To the extent that the Act allows the financing of facilities which only "reduce" pollution, there may be some items that qualify under the Act but fail to meet federal requirements since they only "prevent the creation" of pollution.\(^13\) One requirement, however, is the same for both the Act and federal law. Anything called a pollution control facility must be certified by a local agency as being a furtherance of pollution control purposes.\(^14\) The financing of solid waste disposal facilities under the Act is unaffected by the proposed federal regulations, since they do not deal with solid waste facilities.\(^15\)

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54. N.C. GEN. STAT. § 159C-3(2) (1982).
55. Id. § 159C-3(16).
56. Id. § 159C-3(15).
57. Id. § 159C-3(10).
58. Id. § 159C-3(14).
60. Such wastes are clearly "other water pollution" on which water pollution control facilities operate. N.C. GEN. STAT. § 159C-3(16) (1982). If allocation is required under the Proposed Regulations against the water pollution control facility as a whole, the sewage disposal part should be segregated for that purpose, because I.R.C. § 103(b)(4)(E) (1976) and the applicable regulations do not contemplate allocation for such facilities.
61. The definition of "pollutants" in N.C. GEN. STAT. § 159C-3(10) (1982) does not include "heat," which is accepted as a pollutant even under the Proposed Regulations. P.C. Regs., supra note 40, § 1.103-8(g)(2)(ii). This problem is essentially eliminated because a "water pollution control facility" includes items which cool, N.C. GEN. STAT. § 159C-3(16) (1976), but care should be taken on the point.
63. See supra notes 40-45 and accompanying text.
64. P.C. Regs., supra note 40, § 1.103-8(g)(2); N.C. GEN. STAT. § 159C-7 (1982); 4 N.C. ADMIN. CODE 1E.0103(b) (1980).
Federal law allows tax-exempt financing of certain other "exempt" facilities that are not within the ambit of the Act. To finance such items, including sports arenas and convention or trade show facilities, the operators must find some other financing vehicle under state law. Given the strict construction and constitutional limitations imposed on statutes authorizing tax-exempt financings in previous court decisions, it is unlikely that many such facilities may be financed through tax-exempt bonds in North Carolina.

The federal law requirements and the restrictions under the Act thus combine to allow the financing of industrial or manufacturing projects with a bond issue principal limit of $1,000,000 and, in certain circumstances, $10,000,000, and pollution control projects for which the bond issue size is limited only by the qualifying capital cost of the facility. Prior to 1981 a company was permitted to combine in a single public offering a pollution control issue and a $1,000,000 industrial issue for the same political subdivision. A company could also offer a number of industrial issues in different political subdivisions or even different states, thus saving transaction expenses for the company. This practice is no longer possible due to Revenue Ruling 81-216, which put an end to the grouping of industrial development issues.

II. SPECIFIC PROJECT QUALIFICATIONS

A. Statutory Tests

Wages, employment, and environmental impact are probably the three most crucial factors to the success of a company seeking tax-exempt financing for a new or expanded facility in North Carolina. Strict rules cover each of these areas and every project must comply with these requirements.

66. See supra note 38.
67. The Act does mention docks and wharves in the definition of "Project," but this apparently contemplates financing such items only when they are a part of an industrial facility rather than on their own as an entire project. N.C. GEN. STAT. § 159C-3(11) (1982).
70. Certain facilities complying with constitutional limitations but not covered in statutes, such as proprietary nursing homes, can be financed through nonprofit corporations working with a municipality. Rev. Rul. 63-20, 1963-1 C.B. 24.
1. Wages

The Act requires that the average weekly manufacturing wage\textsuperscript{72} paid at any facility financed with tax-exempt bonds must be either above the average weekly manufacturing wage paid in the county in which the facility is located or at least ten percent higher than the average weekly manufacturing wage paid in the State.\textsuperscript{73} There is a provision in the Act which permits financing for a company that does not meet the wage requirements if the county has extraordinarily high unemployment,\textsuperscript{74} but comparatively few counties meet this test.

2. Employment

As a general rule, for every $100,000 of bond financing, one job must be saved or created. This rule is set out in the Department of Commerce regulations\textsuperscript{75} and is designed to ensure that the benefits of tax-exempt financing will be enjoyed, directly or indirectly, by as many people as possible. The direct consequence of this requirement is that a company cannot finance a million dollar piece of equipment that only requires two people to operate.

The one job per $100,000 ratio is not absolute and is used only as a guideline by the Department of Commerce. Additional considerations are listed in the regulations, including the economic situation in the county, the wage scale to be paid, and the increase to the tax base in the county resulting from the project.\textsuperscript{76}

3. Environmental Impact

The Department of Natural Resources and Community Development (NRCD) must make a finding in every industrial development issue that the facility will not have a materially adverse impact on the environment.\textsuperscript{77} If the company has obtained all necessary pollution control permits from the State, there should be little problem in obtaining approval from the NRCD. If the required permits have not been obtained, the company will have to submit detailed information about the raw materials used and the waste products that will be created at the plant.\textsuperscript{78}

\textsuperscript{72}This average includes the wages of all employees in the company, including those on salary, but generally does not include overtime payments.

\textsuperscript{73}N.C. GEN. STAT. § 159C-7(1) (1982); 4 N.C. ADMIN. CODE 1E.0303 (1980), as amended effective Mar. 1, 1983. The county and state figures are determined from the most recent Employment Security Commission statistics.

\textsuperscript{74}N.C. GEN. STAT. § 159C-7 (1982); 4 N.C. ADMIN. CODE 1E.0303 (1980), as amended effective Mar. 1, 1983. If a company does not meet the average wage test, the board of county commissioners must adopt a resolution stating that the project should be financed in spite of the wages paid.

\textsuperscript{75}4 N.C. ADMIN. CODE 1E.0306 (1980), as amended effective Mar. 1, 1983. Prior to the 1983 amendment, the general rule was that one job had to be saved or created for every $75,000 of bond financing.

\textsuperscript{76}Id.

\textsuperscript{77}N.C. GEN. STAT. § 159C-7 (1982).

\textsuperscript{78}4 N.C. ADMIN. CODE 1E.0305 (1980).
The NRCD is required to find in a pollution control issue that the facility will have a materially favorable impact on the environment. All permits and engineering reports must be forwarded to the NRCD to enable it to make the required findings.

If a project is deficient in any of these three areas (wages, employment or environmental impact), the facility will not qualify for tax-exempt financing. Therefore, it is crucial that any operator interested in tax-exempt financing keep these three tests in mind when planning a project.

B. Financeable Costs

The operator of a facility seeking tax-exempt financing under the Act must not only consider whether the facility is a qualified project in general, but also what specific cost items involved in the facility are financeable. In the Act, “cost” is defined as:

all capital costs thereof, including the cost of construction, the cost of acquisition of all property, including rights in land and other property, both real and personal and improved and unimproved, the cost of demolishing, removing or relocating any buildings or structures on lands so acquired, including the cost of acquiring any lands to which such buildings or structures may be moved or relocated, the cost of all machinery and equipment; installation, start-up expenses, financing charges, interest prior to, during and for a period not exceeding one year after completion of construction, the cost of engineering and architectural surveys, plans and specifications, the cost of consultants’ and legal services, other expenses necessary or incident to determining the feasibility or practicability of such project, administrative and other expenses necessary or incident to the acquisition of construction of such project and the financing of the acquisition and construction thereof.

The relevant definition of costs for federal purposes states that substantially all of the proceeds, other than proceeds devoted to payment of issuance expenses and the creation of allowable reserve funds, must be spent for “the acquisition, construction, reconstruction or improvement of land or property of a character subject to the allowance for depreciation.” Thus, the state law definition of costs on its face is more inclusive than the federal definition.

80. 4 N.C. Admin. Code 1E.0305 (1980).
84. It used to be true that financeable costs had to be actually capitalized to qualify. Treas. Reg. § 1.103-10(b)(1)(ii) (1972). The situation has changed in the past several years, and now any costs that are capitalizable can be financed, even if they are not actually capitalized. Treas. Reg. § 1.103-8(a)(1)(i), T.D. 7362, 1975-2 C.B. 42. In practice, this change means that interest during the construction period, which is usually not capitalized, can be financed in the bond issue, as long
To ensure that the relevant federal and state restrictions on types of expenditures are complied with, the security agreement under which bonds are issued usually incorporates certifications and strictures with which the company must comply before requisitioning proceeds to pay for expenditures. Normally, certificates must be signed by the company and submitted to an escrow agent who holds the bond proceeds. Such requisitions can be countersigned by the issuing political subdivision or by an independent third party, such as an architect or contractor, or both.85

A company has some flexibility in determining what costs it will finance because only "substantially all" of the proceeds must qualify, and hence some amounts can be spent on nonqualifying costs. In practice, however, the Act limits the available options, and the amount of the issue usually is determined by taking all "hard" costs (machinery, land, and equipment) plus five percent86 and adding issuance expenses and reserve funds, if any, for the grand total.

III. MECHANICS OF BOND ISSUANCE

A. Preliminary Steps

1. Authority Creation

The first step for the issuance of any bonds under the Act may be the creation of an Authority in the county in which the facility to be financed is located.87 The mechanism of creation is complex,88 but to date 93 of the 100 North Carolina counties have Authorities in existence.89

Section 159C-4 sets out certain qualifications for commissioners and requirements for the meetings of an Authority.90 The Act provides for seven

as it is identifiable and traceable to the funds borrowed to finance the construction of the project. For interest costs during construction that occur after issuance, tracing is no problem; the bond rate is the cost of money. But cf. STATEMENT OF FINANCIAL ACCOUNTING STANDARDS No. 62 (Financial Accounting Standards Board 1982) (Capitalization of Interest Cost in Situations Involving Certain Tax Exempt Borrowings and Certain Gifts and Grants).

85. Provision for this requirement will be contained in the bond financing documents.

86. Five percent rather than ten percent (the balance of the ninety percent "substantially all" requirement) is added. If ten percent were added, only one minor nonqualifying cost item would destroy the tax exempt status of the entire issue. See Rev. Proc. 79-5, 1979-1 C.B. 485, and Rev. Proc. 81-22, 1981 C.B. 692, for what happens if there are "excess" proceeds (i.e. 90% cannot be spent as "good" costs).

87. N.C. GEN. STAT. § 159C-10 (1982). In other states, an authority may finance projects beyond the boundaries of the city or county creating it, as its jurisdiction covers the entire state. See, e.g., VA. CODE § 15.1-1388 (1981). But cf. Rev. Rul. 77-281, 1977-2 C.B. 31 (such issue of industrial development bonds does not qualify as exempt small issue and interest is not excludable from income).

88. The county commissioners must give the Department of Commerce and Local Government Commission at least 30 days notice of their intention to adopt a resolution creating an Authority. After it is adopted, the Authority must notify the same agencies within 30 days. N.C. GEN. STAT. § 159C-4 (1982).

89. The seven counties without authorities are Camden, Chowan, Currituck, Gates, Madison, Tyrell, and Yancey. Summary, supra note 13, at 1-9.

90. Actions may be taken at regular or special meetings by resolution for which no specific notice, posting, or second reading is necessary (unless specified in bylaws adopted by the Authority). A majority of all commissioners in office, not just those commissioners present at a meeting,
commissioners, each of whom serves a term of six years. Each commissioner must take an oath before entering office, must be a qualified elector and resident of the county, and must not be an elected official of the county. Commissioners serve entirely at the discretion of the governing body of the county and can be removed with or without cause. From among the commissioners, the Authority annually elects a chairman and vice-chairman. Additional officers, including the secretary, may be selected, and they need not be commissioners.

The constitution and organization of an Authority are direct products of federal considerations. For interest on bonds to be tax-exempt under federal law, they must be issued "by or on behalf of" a state or a political subdivision. Since counties in North Carolina are not directly involved as issuers in industrial development financing, an Authority must either be a local governmental unit itself or qualify as an issuer of bonds "on behalf of" the county. An Authority does not qualify as a local governmental unit, because it does not have substantial sovereign powers of taxation, eminent domain, or the police power. Nevertheless, the Act is drawn in such a manner that, when properly constituted, an Authority is within the traditionally accepted notion of an entity that may issue bonds "on behalf of" a local governmental unit.

2. Bond Counsel

Assuming the county has created a duly constituted Authority, either


91. To stagger the reappointment times, the Act provides that the initial appointment will list two commissioners with two year terms, two with four year terms, and three with six year terms. N.C. Gen. Stat. § 159C-4(a) (1982).

92. Id. But see N.C. Gen. Stat. § 128-1.1(a) (1981) (any person holding an appointed office in state or local government can hold one other appointed or elected office in either state or local government).

93. Treas. Reg. § 1.103-1(b) (1956).


95. Rev. Rul. 57-187, 1957-1 C.B. 65, sets out an eight part test to determine whether an entity is one that may issue bonds "on behalf" of a local governmental unit: (1) the municipality approves the creation of the authority (see N.C. Gen. Stat. § 159C-4(a) (1982)); (2) the municipality selects the commissioners who serve without pay (see id. §§ 159C-4(a) & -4(e) (1982)); (3) the authority has certain powers including the power to acquire projects, to lease projects and collect rent, to sell and convey property, and to issue bonds (see id. §§ 159C-5(6) to (8) & -6 (1982)); (4) the bonds are payable solely from revenues and receipts from such leasing or sale (see id. § 159C-6 (1982)); (5) the authority is not liable for the payment of principal or interest on the bonds (see id. § 159C-17 (1982)); (6) the interest on the bonds is exempt from state taxation (see id. § 159C-14 (1982)); (7) no part of the authority's earnings inures to the benefit of a private person (see id. § 159C-6 (1982)); and (8) upon dissolution of the authority, its property goes to the municipality (see id. § 159C-21 (1982)). Proposed Treas. Reg. § 1.103-1, 41 Fed. Reg. 4,829 (1976) (to be codified at 26 C.F.R. pt. 1) (proposed Feb. 2, 1976), which would supersede the present "on behalf of" decisions, is pending. An Authority would not qualify under these regulations, but if adopted, such provisions will not become effective until 180 days after the date of adoption.
before or very soon after contact is made with the Authority the company will encounter bond counsel. Bond counsel are attorneys, who, as in general obligation or revenue local government issues, guide the transaction through the legal intricacies involved and opine that the bonds are validly issued and that the interest thereon is tax-exempt. They must be satisfied with all documentation and, in fact, usually draft all papers in the transaction.

Since the bonds issued are those of the Authority, the Authority selects its own bond counsel. Until 1979, it was recommended that an Authority use the county's bond counsel, and therefore almost all transactions were handled by the two New York firms that represent the great majority of counties. Only occasionally were issues done by any of the other nationally recognized bond firms. Since 1980, when the Local Government Commission, at the urging of the North Carolina Bar, issued guidelines for Authorities desiring to use the other bond counsel, several firms have begun serving as bond counsel in industrial development and pollution control financings.

3. Inducement

Once an Authority is in operation, the next step in an industrial development or pollution control financing is the initial action by the Authority. Federal tax law requires that an Authority take some "official action" to induce a company to locate the financed facilities in a particular location. The policy behind this requirement is that the advantage of tax-exempt financing should be given only to organizations that otherwise would not settle in the area. In theory the company's ability to finance some costs under the Act should be a crucial factor in its decision to locate or expand in a particular area. The "official action" is intended to document this inducement, and the requirement effectively prevents the use of tax-exempt financing by companies that have already made a commitment to spend money before approaching the Authority. The official action of the Authority is often called the Inducement Resolution.

At the time the resolution is passed, it is customary for the company seeking tax-exempt financing and the Authority to enter into an Inducement Agreement or Memorandum. This agreement sets out the parties' understandings about the construction of the project and payment of issuance expenses.

96. This is true even though the company pays the fees of bond counsel, and the bondholders (including institutional investors) rely on the opinion.


98. Treas. Reg. § 1.103-8(a)(5) (1972) applies only to exempt facilities (including air or water pollution control and solid waste and sewage facilities) and requires that there be a "bond resolution . . . or some other similar official action" taken by the issuer prior to the commencement of the construction, reconstruction, or acquisition of the facility. This regulation is applied, by analogy, to industrial projects as well. I.R.S. Letter Rul. 8047067, 1980 I.R.S. LETTER RUL. REPS. (CCH) pt. II (Aug. 28, 1980).

99. It is customary to secure such a resolution prior to signing any binding contracts. Post-inducement costs, however, may be financed even if other items were acquired prior to the official action. Rev. Rul. 77-292, 1977-2 C.B. 35.
The purposes of the Inducement Agreement could be served by particular provisions in the Inducement Resolution or by other collateral agreements, but a separate Inducement Agreement simplifies matters and, in any event, is required by the Department of Commerce.\textsuperscript{100}

After this step the parties may encounter a long period in which nothing is done. This period may last for several months or years if construction is delayed. There is no limitation on the length of this period under the Act, although the Authority may impose a limit in the Inducement Agreement. There is a federal time limit that prevents issuance of bonds more than one year after the facility has been placed in service at substantially the level for which it was designed,\textsuperscript{101} but the chances of a financing actually having problems with this restriction are very slight.

Soon after the adoption of the Inducement Agreement, the company will have definite plans for the project and will be in a position to consummate the financing. The next step is approval of the project by the Department of Commerce. This approval should not be sought too swiftly for two reasons. First, the application required by the Department of Commerce requires a fair amount of detail; therefore, the company needs to have clear ideas about project composition. Second, the approval of the Department of Commerce is only effective for one year without a formal reapplication.\textsuperscript{102} Thus, closing of the financing has to occur within that year, and it cannot be rushed without risking a violation of one of the federal spending standards by having inaccurately figured costs.\textsuperscript{103}

\section*{B. Department of Commerce Application}

One major feature of the Act is its requirement that each project be approved by the Secretary of the Department of Commerce.\textsuperscript{104} As discussed above, specific tests for approvals of applications are set forth in the Act, and the Secretary is given the power to request information from the applicant and to prescribe forms, rules, and regulations as he deems necessary for his proper consideration of applications. When the Act was first codified, the power to

\textsuperscript{100} North Carolina Dept'\textquoteleft t of Commerce, \textit{Application for Approval of [Pollution Control] [Industrial] Project} 2 (Jan. 1, 1980) [hereinafter cited as Forms]. Deciding who should sign the Inducement Agreement may be a problem. If there is only one company involved, the answer is easy—that company signs it. If a subsidiary will operate the facility and a parent will guarantee payment of the bonds or otherwise lend financial support, there is a difficulty. The Act distinguishes between the “operator,” who runs the project, and the “obligor” (which may include the operator, among others), who must provide payments sufficient to meet the debt service requirements of the bonds. N.C. GEN. STAr. § 159C-3 (1982). The Forms state that the operator signs the Inducement Agreement. Forms, supra. Query whether it is correct to have only the operator and not the fiscally responsible obligor sign the Inducement Agreement, especially when the operator may be a shell corporation. The Authority will want to sue on the contract for expenses if bonds are not issued. An easy solution is to have both sign.

\textsuperscript{101} Treas. Reg. § 1.103-8(a)(5)(v) (1972). If the facility was acquired by the company after it was already in service, the later of the date of acquisition or the date placed in service is used for the one year test.

\textsuperscript{102} N.C. GEN. STAr. § 159C-7 (1982).

\textsuperscript{103} \textit{See supra} text accompanying notes 82-86.

\textsuperscript{104} N.C. GEN. STAr. § 159C-7 (1982).
approve applications was given to the Department of Natural and Economic Resources (DNER), which was the predecessor of the NRCD. DNER developed regulations for project approvals, and when the powers of that department and the task of considering applications were transferred to the Department of Commerce, the regulations concerning applications and approvals were adopted by the Department of Commerce with only slight modifications.\textsuperscript{105} It is pursuant to these regulations that an Authority and company desiring to finance a project must make application. The application and the associated procedure also serve the purpose of collecting information relevant for Local Government Commission consideration.

1. Preapplication Conference

The first step in making application is the preapplication conference. The regulations require that the conference be held at least one week prior to submission of the formal written application,\textsuperscript{106} but in practice it is permissible to have the preapplication conference immediately prior to submission of the formal application. The application will not be treated as submitted, however, until the end of the one-week period. The preapplication conference will include representatives from the Authority, the Department of Commerce, the Local Government Commission, the NRCD, and the private companies involved.\textsuperscript{107} This meeting is designed to facilitate the application's path through the Department of Commerce by identifying potential problems in advance. The Authority may obtain a letter outlining various areas of concern, if any, seen by the Department of Commerce, although such determinations are not binding on the Department.\textsuperscript{108}

Two additional steps must be taken before, or contemporaneously with, submission of the written application to the Department of Commerce. The first is that the project must be "approved in principle"\textsuperscript{109} by the governing body of the county in which the project is located. This requirement ensures that the Department of Commerce does not approve projects that are not acceptable to the county.\textsuperscript{110} The second action to be taken at this time is publication of a notice of the application in a newspaper of general circulation in the county and the holding of a public hearing.\textsuperscript{111} This requirement is designed to give interested parties an opportunity to comment on the project. The Authority must include a summary of the oral comment made at the pub-

\textsuperscript{106} 4 N.C. ADMIN. CODE 1E.0202(b) (1980), as amended effective Mar. 1, 1983.
\textsuperscript{107} The Local Government Commission is involved because it must pass on the bonds before issuance pursuant to N.C. GEN. STAT. §§ 159C-8, -9 (1982). See infra text accompanying notes 142-48.
\textsuperscript{108} 4 N.C. ADMIN. CODE 1E.0202(e) (1980), as amended effective Mar. 1, 1983.
\textsuperscript{109} Id. 1E.0203 (1976), as amended effective Mar. 1, 1983.
\textsuperscript{110} Because of this provision, the new federal requirement of "public" approval will not force a change in the practice in North Carolina, as it will in other states. See TEFRA, supra note 15, § 215 (to be codified at I.R.C. § 103(K) (former subsection (K) to be redesignated (L))).
\textsuperscript{111} 4 N.C. ADMIN. CODE 1E.0204 (1977), as amended effective Mar. 1, 1983; TEFRA, supra note 15, § 215 (to be codified at I.R.C. § 103(K) (former subsection (K) to be redesignated (L))).
POLLUTION CONTROL FINANCING

lic hearing.  

2. Written Application

The actual formal application consists of a very short paragraph by the Authority requesting that the Department of Commerce approve the project. Extensive exhibits are required in industrial development applications, however, which are intended to describe fully the proposed project, including its location and the experience of the company involved. The exhibits required in a pollution control application are only slightly different and place more emphasis on environmental concerns. Information about the actual exhibits is provided in the application forms distributed to interested companies and Authorities by the Department of Commerce. There is a separate form for each type of application (industrial and pollution control) but they include many of the same requirements and will be discussed together, noting any differences that do exist.

The written application must contain the following items:

1. Narrative Description. The first requirement in each application is a narrative description of the project. For an industrial project the narrative should describe the plant, all or a part of which includes the actual project. For a pollution control project, the narrative must describe not only the pollution control equipment and facilities, but also the industrial facility to which they will be attached. Ordinarily, the narrative description will be one of the easiest requirements to satisfy, since any company considering a project should already have a good description on hand. In addition, a narrative description will probably have been required by the Authority at the Inducement Resolution or Agreement stage. The Department also requires various maps to accompany the description.

2. Inducement Agreement. This document must be submitted to the Department as part of the application.

3. Employment Profile. Each applicant must submit detailed information about prospective employment at the project. For a pollution control project, the report must deal with employment at the industrial facility at which the pollution control facility is to be operated. The Department has promulgated a specific form for this submission, which requires the listing of specific numbers of different types of jobs either to be saved or created at the facility, along with a breakdown of projected wage figures for the end of the year in which the project is financed and three years thereafter. If the company cannot predict wages with the required specificity, it should provide the best possible approximations. In addition, the Department will inspect prior Employment Security Commission filings by the company.

112. Id.
113. Forms, supra note 100.
114. Id. at 4.
The Department has correctly perceived one potential problem with the employment profile in that, without some qualification, a company could view the profile as a guarantee of particular wages to its employees. Thus, the regulations of the Department allow for a specific disclaimer of any guarantee of the projections made in the employment profile section of the application.116

4. Secondary Economic Impact. Both types of projects require a narrative on the secondary economic impact of the facilities. This submission aids the Department in determining whether the project will have a measurable, favorable, economic impact on the area that is commensurate with the size and cost of the proposed project.117 The regulations of the Department do not define “measurable impact,” but there are guidelines that serve as a rough approximation.118 The narrative should include a discussion of raw materials and services used, other industries affected, movement of employees into the area, competitive effects within the industry, effect on the tax base, and revenues for local governments.119 All this information should be available to a company considering movement into the area but may take some amount of time to ferret out. The local Chamber of Commerce is often a good source for this material.

5. Water, Sewer, Electric, and Gas Services. The next item to be discussed in an application is utilization of present sources and location of alternate sources for the various utility services required on site. If extensions of various utilities are necessary to serve the site, the Department requires that “written commitments” for those extensions be included with the application.120

6. Reasons for Pollution Control Project. The Department also requires inclusion of a section in the application discussing the reasons for the construction of a pollution control facility. There is no analogous section in the industrial application, probably because a profit motive is presumed. Giving any reason for the construction of a pollution control facility other than that the project is being built pursuant to local, state, or federal pollution control requirements is a declaration against the interest of the company. This follows because the proposed regulations dealing with pollution control facilities bar financing of facilities installed for any other reason.121 It is likely, therefore, that the Department will always see the same language in this part of the application.

7. Environmental Consideration Checklist. One provision that applies only to industrial project applications is the required completion of an environmental consideration checklist.122 This is a long and detailed question-

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116. Forms, supra note 100, at 4.
117. N.C. GEN. STAT. § 159C-7(3)(a) (1982).
119. Forms, supra note 100, at 2.
120. Id.
121. P.C. Regs., supra note 40.
122. See supra note 44.
123. Forms, supra note 100, at 5-8.
naire developed by the NRCD that is designed to solicit information from the company about all of the raw materials and waste products that will be used and created at the plant. If the applicant has already obtained a pollution control permit from the State, then this provision should not present any difficulty. The operators of some manufacturing facilities, however, will have to gather this information. The requirements and questions are detailed, but reasonable, considering that the NRCD is charged with finding that the facility will have no materially adverse effect on the environment.  

The required finding for a pollution control project is somewhat more stringent. The NRCD must find that the facility will have a materially favorable impact on the environment. For this reason all permits or engineering reports on a pollution control project must be forwarded to the NRCD.

8. Economic and Environmental Characteristics of the Affected Community. An applicant must supply information about the economic and environmental aspects of the surrounding community. This information should include population and demographic statistics and analysis to aid the Department in reaching the necessary conclusion that the project will have a beneficial, material economic or environmental impact on the surrounding area.

9. Capability of the Operator. The Department also desires an analysis of the capability, previous experience with similar facilities, and financial resources of the company that will be involved in the operation of the facility. Financial reports, preferably audited, for the past three years should be included and are considered heavily by the Local Government Commission.

10. Abandonment Statement. The application requires a statement by the operator of the proposed facility that the financing and location of the project will not result in the abandonment of other facilities in North Carolina owned or operated by the company or an affiliate. The forms provided by the Department state that if such a facility is being abandoned, then additional certifications have to be provided stating that the abandonment is the result of obsolescence, lack of available labor, or site limitations rather than a consequence of the location and financing of the new facility.

124. 4 N.C. ADMIN. CODE IE.0207(a) (1980).
125. Id.
126. Forms, supra note 100, at 3.
127. Id.
128. This material is ultimately used by the Local Government Commission. See infra notes 142-48 and accompanying text.
129. Forms, supra note 100 at 3; 4 N.C. ADMIN. CODE IE.0308 (1976). The purpose behind the requirement of such information is the test of N.C. GEN. STAT. § 159C-7(3)(c) (1982), which mandates a finding that no other plant is being abandoned. This is in line with the “inducement” theory of the Act—why aid a company in moving from place to place within the State?
130. Forms, supra note 100, at 3.
3. Project Approval

With these exhibits forwarded, the application to the Department of Commerce is complete. The next step is the Department's consideration of the project. This may involve a public hearing held by the Secretary of the Department of Commerce. If a hearing does occur, a complete transcript of the hearing will be forwarded to the NRCD.

At some point the Department of Commerce, having received the appropriate approvals from the NRCD, tentatively approves the project. A certificate of approval by the Department of Commerce is then published in a newspaper of general circulation in the county in which the facility will be located. The notice will state that court action to prevent the approval's becoming effective must be filed in the Wake County Superior Court within thirty days after publication of the notice. At the end of this period, the approval of the Department of Commerce becomes effective, proof of which may be obtained by securing a certificate of no filing from the Clerk of the Wake County Superior Court.

C. Financing the Issue

The financing, much like a taxable, corporate issue or an industrial development issue in other states, may occur in one of two ways. First, the issue may be privately placed. In a private placement the buyers are privately located, either by the company itself or by an agent on behalf of the company. This type of sale is usually formalized by a bond purchase agreement, either in contract or letter form, memorializing the terms and conditions of the purchase. Second, there may be a public offering of the bonds. In this type of sale, there will usually be a group of underwriters who purchase the bonds for immediate resale to the public. An official statement, analogous to a corporate prospectus, will be used as a selling document, and there may be tombstone ads or other items similar to those used in taxable corporate financings.

131. N.C. Gen. Stat. § 159C-7 (1982); 4 N.C. Admin. Code 1E.0206 (1980), as amended effective Mar. 1, 1983, provides that the Secretary may hold a public hearing upon seven days notice if there is "significant adverse public reaction as determined from the responses to the public notice or the public hearing . . ., or where the facts are unclear and do not support clear findings." This hearing is distinct from that required by TEFRA, supra note 15, § 215 (to be codified at I.R.C. § 103(K)); see supra note 111 and accompanying text. Prior to the 1983 amendment, this public hearing was held by the Authority.

132. 4 N.C. Admin. Code 1E.0206(c) (1980), as amended effective Mar. 1, 1983. Prior to the 1983 amendment, the transcript was forwarded to the Department of Commerce.


134. This certificate is only obtainable after the 30 day period. Since the period cannot end on a Saturday, Sunday, or holiday, N.C. Gen. Stat. § 1-594 (Cum. Supp. 1981) and N.C.R. Civ. P. 6(a), the certificate cannot be obtained on a Monday.

135. Because the Authority actually issues the bonds, it hires the underwriter. The company is technically not involved since it never owns the bonds. As a practical matter, the company will usually specify in the Inducement Resolution or Agreement that the Authority will select the agent or underwriter recommended by the company.
The Securities and Exchange Commission does not usually oversee or require registration of anything involved in these financings, even if public offerings are made.\(^\text{136}\) Moreover, state law does not require blue sky registration of such securities.\(^\text{137}\) Both the federal and state exemptions, however, depend on the bonds being "exempted securities," and this designation does not remove their sale from the various antifraud provisions of the respective securities laws.\(^\text{138}\) Thus, the offering document is usually drafted to include all the information that would be in a registered prospectus. The various problems of securities law involved in industrial development and pollution control bonds are beyond the scope of this article, but it is a large and growing area and financiers contemplating use of the Act should be aware of the potential problems.\(^\text{139}\) Whatever method of financing is used, the Authority has to obtain the approval of the county and the Local Government Commission before it may issue the bonds.\(^\text{140}\)

D. Approval of County and Local Government Commissions

The Act requires that prior to the issuance of any bonds, the approval of the county must be obtained.\(^\text{141}\) This is consistent with the idea that the Authority acts "on behalf of" the county, but it seems unlikely that the county would deny approval at this stage when both the Authority and Department of Commerce have given their approval.

Pursuant to the Act, the bonds, the price, and the manner of sale must be approved by the Local Government Commission. In determining whether to give this approval, the Local Government Commission may consider the financial responsibility and capability of the companies involved, the ability of the surrounding local political subdivisions to cope with the economic impact of the project, and the effect of the proposed sale of the bonds on the sale of other obligations by the State or any political subdivision or agency.\(^\text{142}\) Although it has not exercised such power, the Local Government Commission may prescribe certain forms, rules, and regulations to implement its review of the necessary information for the required decision.\(^\text{143}\)


\(^{137}\) N.C. Gen. Stat. § 78A-16 (1978); id. § 159C-6 (1982). This exemption does not mean North Carolina industrial development and pollution control bonds may be sold in other states with impunity. Other states may have registration requirements or limitations on who may invest in such instruments, unlike the situation in North Carolina. N.C. Gen. Stat. § 159C-18 (1982).


\(^{140}\) N.C. Gen. Stat. § 159C-8 (1982). Of course, the Authority itself will have formally adopted and approved the bonds by this time.

\(^{141}\) Id. § 159C-4(d) (1976). This approval must be distinguished from the "approval in principle" required by the North Carolina Dep't of Commerce regulations. See supra note 62 and accompanying text.


\(^{143}\) The Commission charges a $1,000 fee for each issue considered.
In the absence of formal regulations, it is now common practice to apply to the Commission by a letter from the Authority enclosing copies of the financing documents substantially in final form. Because the Commission receives a copy of the application that was made to the Department of Commerce, other material is unnecessary.

The Local Government Commission requires two additional features in the bond offering. First, although Commission approval is not a rating, validation, or other credit affirmation of the bonds, there still must be some assessment of ability to pay. Therefore, the Commission requires that floating interest rate provisions have ceilings,\textsuperscript{144} and it is preferred that principal repayments be spread over a number of years rather than having “bullet” maturities.\textsuperscript{145}

Second, as a part of the entirely proper watchfulness and concern over the general credit of North Carolina and its political subdivisions, the Local Government Commission and most Authorities have decided that bonds which become taxable, or finance projects which become no longer operative, should be redeemed.\textsuperscript{146} Thus, the benefits of the Act may only be enjoyed while its purposes are being fulfilled. The bond documents must contain mandatory redemption provisions triggered by such events.\textsuperscript{147} Once the approval of the county has been obtained and the Commission’s approval received (usually in the form of a resolution approving the issuance of the bonds) the sale may be consummated.\textsuperscript{148}

IV. FINANCING DOCUMENTS AND SECURITY

One of the most important aspects of any transaction involving tax-exempt financing is the documentation. Every step of the transaction should be documented, starting with the formation of the Authority, in order for bond counsel to give the opinion that the bonds are validly issued and the interest thereon is tax-exempt. In addition to ensuring that all the procedural documentation is in proper form, bond counsel must also make certain that the financing and security documents accurately represent the deal struck by the parties. At the same time, the financing and security documents must comply with all state and federal requirements so that there will be no question about the tax-exempt status of the bonds.

\textsuperscript{144} The Commission’s concern is financial capacity to meet debt service obligations. Consequently, this requirement may be waived if the company is of such a size and credit that it could pay off the bonds at any time out of current assets (a relatively rare situation).

\textsuperscript{145} This requirement also may be waived for companies with strong financial positions.

\textsuperscript{146} As noted, the Local Government Commission has no formal regulations for these financings, but their position on this point has been consistent since the Act was passed.

\textsuperscript{147} Document provisions are required because after bond issuance the state and local governments are not involved with the bonds. Therefore, only a binding agreement with bondholders ensures maintenance of such policies.

\textsuperscript{148} This statement assumes the Department of Commerce approval is effective (i.e., the 30 day waiting period is over). Note also that if Local Government Commission approval is by Executive Committee another five-day wait is necessary. N.C. GEN. STAT. § 159-4(b) (1982).
A. Financing Agreements

The financing agreement is one of the major documents in any bond transaction. It is the only document executed solely between the Authority and the company. It sets out their relationship and usually forms the basic security for the bonds. It is the document in which the Authority agrees to use the bond proceeds to finance the project and the company agrees to repay the Authority. The financing agreement may take the form of a lease, an installment sale, or a loan. All things being equal, the loan is the simplest of the three forms and is therefore the most commonly used. The only reason for using a lease or installment sale in North Carolina would be a restrictive covenant in some other agreement the company has with a lender that prohibits the company from entering into a loan. The reasons for preferring a loan will become obvious from a brief look at the differing structures of the three available financing devices.

1. Lease

In a lease agreement title to the project is in the Authority, and the Authority leases the project for a number of years to the company. At the end of the lease the company usually has the option to purchase the project for a nominal sum. To lease the project to the company the Authority must first acquire title to it. Thus, the company must transfer the personalty by bill of sale and the realty by deed to the Authority. The deed must then be recorded. The lease itself should also be recorded, and if it is for a term of three years or more, it must be recorded. At the termination of the lease, there must be a bill of sale or deed from the Authority, or both, to transfer title back to the company, which again may necessitate recordation.

2. Installment Sale

In an installment sale agreement the Authority sells the project, which the Authority theoretically has constructed with the bond proceeds, to the company, which agrees to pay the purchase price in installments over a term of years. As with a lease, the Authority cannot sell what it does not own, so the personalty and realty must be transferred by the company to the Authority and then transferred back to the company. This procedure involves two bills of sale and, if there is realty, two deeds. Recordation is not considered necessary in this structure because the transfers are simultaneous, and although title passes to the Authority and back to the company, there is no change in the company's title that would affect third parties. Thus, an installment sale agreement is simpler than a lease but requires more documentation than a loan.

150. Id. § 47-18(a) (1976).
3. Loan

A loan most accurately reflects the reality of the actual transaction between the parties. The Authority simply agrees to loan the proceeds of the bonds to the company for the company to use to acquire and equip the project, and the company agrees to repay the loan. Less documentation is required with a loan because title to the project never leaves the company. This procedure results in at least some saving to the company because it reduces the time spent in document preparation.

There is no reason not to use a loan unless the company is prohibited from doing so. The tax consequences to the company will be the same whether a sale, lease, or loan is used. In each case the company will be treated as the owner of the project, will be able to take any tax credit and depreciation on the project, and will be required to pay property taxes on the project.151


The Act provides that every financing agreement, whether a sale document, lease, or loan agreement, must contain certain provisions, including: the amounts payable under the financing agreement shall be sufficient to pay the principal of, premium, if any, and interest on the bonds as they become due; the company shall pay all costs incurred by the Authority in connection with the financing; the company shall pay all costs of the project; and the company’s obligations to pay all costs will not be terminated before payment of the bonds.152 Other terms may be included in the financing agreement. The Act specifically allows provisions concerning rights on default, including acceleration, reentry, termination of the financing agreement, and leasing, sale, or foreclosure of the facility to other parties.153 Companies will usually have other terms in the financing agreement, either at their own request or at the insistence of underwriters or lenders. These terms generally include a variety of representations by the Authority and the company about the correctness of proceedings, their respective power to enter into the document and undertake their obligations thereunder, and provisions on how the project will be constructed or installed. Other possible provisions include: terms dealing with problems such as contractors’ liens; provisions for prepayment of the obligation; financial covenants affecting the company, such as maintenance of corporate existence or limitations on distribution of capital; and any other clause that the parties might want to include. In general, the permissible terms that may be included are limited only by the same considerations involved in taxable transactions.

If the bondholders are to have a security interest in the project, the financing agreement itself may act as the Uniform Commercial Code “security

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152. N.C. GEN. STAT. § 159C-11 (1982).
153. Id.
agreement." If a deed of trust is desired, it will, of course, have to be a separate document. In either case, the company gives the security to the Authority to secure its obligations under the lease, sale, or loan document. In turn, the Authority assigns this security to the bondholders in the security document described in section 159C-12.

C. Security Documents

There are two basic types of security documents that may be used in a bond issue: a bond purchase agreement and an indenture of trust. If the issue is placed privately and there are a small number of bondholders, a bond purchase agreement will normally be used. If the issue is sold to the public, or if there is a private placement with a large number of investors, the appropriate document is an indenture of trust with a corporate trustee.

Although differing in form, both documents serve essentially the same functions—to give a security interest to the bondholders and to establish how the bonds will be serviced. The Authority assigns all of the rights granted to it by the company in the financing agreement, including security interests and liens, with the exception of certain provisions relating to indemnity and reimbursement, to the bondholder or trustee. A separate assignment agreement may be necessary in some cases. Payments under the security document will equal the debt service due on the bonds plus other expenses of the Authority involved in the transaction. This payment provision is the essential feature of a limited revenue obligation because no general obligation credit, or other imposition on credit, of the local political subdivision is pledged to pay the bonds. The security document usually creates a construction fund or acquisition fund, held by the trustee or an escrow agent, which is used to pay for the costs of the project.

The security document also sets up the method in which the bonds will be serviced. With a bond purchase agreement this is very simple; the company makes payments directly to the bondholders. With an indenture the process is more complex; the company makes payments to the trustee who is then responsible for paying the bondholders. To make sure the bondholders' interests are protected the trustee is also given a wide range of duties under the indenture.

It is common to include provisions for the issuance terms and the pledging and assigning of revenues, as well as provisions covering rights and remedies of the trustee or bondholders on default, and a provision for sinking funds or other methods of prepayment or redemption of the bonds. The parties

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155. Unlike some states, in North Carolina the trustee may be a bank or trust company from within or without the State. N.C. GEN. STAT. § 159C-12 (1982). This flexibility is a great benefit. In large public financings the bondholders may frequently desire a New York trustee or paying agent, but when a local bank purchases the issue it would be extremely cumbersome not to have a local trustee.
156. Ordinarily these duties correspond to those of a trustee for taxable corporate debentures.
will often desire additional terms, which may include provisions for dealing with transfer, registration, or replacement of bonds; the holding, investment, and withdrawal of construction money;\textsuperscript{158} payment of extra interest in the event the bonds become taxable; use of excess money in, and interest from, the various funds;\textsuperscript{159} defeasance of the bonds;\textsuperscript{160} successor trustees; and amendments to the major documents.\textsuperscript{161}

In both the financing agreement and the security document, there should be some mention of additional bonds—a second or other issuance of bonds to pay additional costs of the project.\textsuperscript{162} If the additional bonds are to be issued on a parity with the first issue, this must be provided for in the original indenture. Moreover, there will have to be an amendment to the financing agreement if the project is expanded.\textsuperscript{163} Even if the project is not expanded, an amendment may be required unless the original financing agreement was artfully drafted. In either event, a supplemental security document stating the terms of the additional bonds will be required.

Both the financing agreement and the security document are binding contracts and must be executed with appropriate formality. The security interest given by the financing agreement may be perfected by the filing of financing statements. Filing in both the local and the state offices may be necessary in certain situations.\textsuperscript{164}

Frequently, in a desire to achieve the lowest interest rate possible a parent company of the operator will guaranty the bonds.\textsuperscript{165} There may be financial restrictions on the parent, but the parent generally will make a guaranty of all

\begin{footnotes}
\item[158] Drawdowns on the construction fund should be allowed only on proper certification of permissible use. Provisions for this procedure should be in the indenture since it is binding on the trustee. This will assure the Authority and bondholders that proper steps will be taken.

\item[159] Interest on the funds is not a minor concern. According to Rev. Rul. 68-590, 1968-2 C.B. 66, it is taxable income to the corporate obligor. Moreover, it is also probably subject to the “substantially all” test. \textit{See supra} text accompanying notes 81-86.

\item[160] To defease an issue is to put up enough in cash or other securities to provide for payment at maturity or on a specified prepayment date. Thus, it is part of refinancing or refunding an issue.

\item[161] Obviously, other terms must be included, but the variation involved is so great that specific discussion with bond counsel will be required in every case.

\item[162] Additional bonds may be desired for many reasons: the company may be unsure of final costs and will wait to put out a second issue that will make the total exact; the prevailing interest rates may indicate a better rate in the future, so a large part of the borrowing will be delayed until then; internal corporate considerations or debt restrictions may require spreading the borrowing over a period of time.

\item[163] The project could be expanded in both size and scope. If expansion occurs, however, another application to the Department of Commerce is required because new land and equipment would be used, as defined in N.C. GEN. STAT. § 159C-3(11) (1982). If there is no expansion in size or scope of the project, then the original application and approval should suffice. In either situation, the issuance of the bonds must receive the blessing of the Local Government Commission, the Authority, the county, and the company. N.C. GEN. STAT. §§ 159C-7 to -9 (1982).


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payments due on the bonds. If care is taken, this document can cover additional bonds for the same project.

V. MISCELLANEOUS CONCERNS

A. Perfection and Recordation

A transaction as described above includes many transfers, some for purposes of security and some not. Prudent participants must be sure that proper steps are taken to perfect and, if necessary, to record the various security interests and documents created and used. If a security interest is granted to the Authority in the financing agreement, the interest attaches at the time the agreement goes into effect and the project is acquired, but it is not perfected until a financing statement is filed.\(^{166}\)

Filing is a simple matter. If the project includes fixtures, a financing statement must be filed in the county in which the project is located.\(^{167}\) If there are no fixtures, a financing statement must be filed in the office of the Secretary of State and, if the company has only one place of business, in that county.\(^{168}\) If there is any question about the classification of the property, or if the project includes both personalty and fixtures, then there should be a filing in all relevant places. As a practical matter, multiple filings are made as a matter of course to avoid any possible problems.

The security document assigns to the trustee, or the bondholders, the Authority's rights under the financing agreement. It is necessary to file financing statements for the security interest assigned to the trustee by the Authority. This filing must be done even if the company has not granted a security interest in the project to the Authority, because the trustee has at least a security interest in the financing agreement. Although the Uniform Commercial Code states that the secured transactions recordation provisions of the Code do not apply to transfers by a governmental subdivision or agency such as an Authority,\(^{169}\) the Act specifically makes this provision inapplicable.\(^{170}\) In addition, because the North Carolina General Assembly never abolished the chattel mortgage system of recording security interests, it may be desirable to file the financing agreement and the security document in the chattel mortgage books of the county in which the project is located.

B. Refinancing

Refinancings, also called refundings, are bond issues used to "pay off" an

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167. Id. § 25-9-401(1)(b).
168. Id. § 25-9-401(1)(c). The statute also states that if there is no place of business the filing should also be made at the debtor’s residence in North Carolina. This possibility cannot occur in industrial development or pollution control financings because a project must either be, or be associated with, an industrial plant that will count as a place of business.
170. Id. § 159C-28 (1982).
earlier issue.\textsuperscript{171} Such issues are desired usually for either of two purposes. First, the company may desire to avoid restrictive or negative covenants associated with the earlier issue.\textsuperscript{172} Second, and more commonly, the company may wish to reduce the amount of its debt service obligations. This can occur if the interest rate is lower on the new issue than on the prior issue. The standard method of refunding is to use the proceeds to purchase federal government obligations that pay or will pay off the prior issue.

Federal law prior to November 1977 allowed considerable latitude and flexibility in the issuance of bonds to refund prior industrial development or pollution control issues.\textsuperscript{173} Now, because of proposed regulations, which, if adopted, become effective as of November 4, 1977, refundings of prior industrial development and pollution control issues are limited to those issued less than 180 days before the prior issue is discharged.\textsuperscript{174} While this is a severe cutback that has significantly reduced the volume of refundings, there still can be instances when a refunding is clearly indicated. The rationale of removing inordinately restrictive covenants still applies, and refinancings may simply be used to extend the amortization period of a project.\textsuperscript{175}

The Act provides that any issue used to refund a prior issue under the Act will also be tax-exempt.\textsuperscript{176} The issue may also finance, in part, new projects for the company, but in such a case, the Department of Commerce must approve the new projects. Such approval is not necessary if the aim is only a refunding. In every case, approval of the Local Government Commission is necessary.\textsuperscript{177}

\textbf{C. Arbitrage}

All tax-exempt bond issues are subject to the arbitrage restrictions of section 103(c) of the Internal Revenue Code. This section generally prevents ex-

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\item \textsuperscript{171} This must be distinguished from using tax-exempt bonds to refinance the cost of a project already permanently financed from some source other than industrial development bonds, which is specifically barred by the North Carolina Constitution. N.C. Const. art. V, § 9.
\item \textsuperscript{172} Although not an industrial development financing, this situation arose before the New York Port Authority. After its legislatively mandated attempts to ignore covenants in certain prior issues were declared unconstitutional, United States Trust Co. v. New Jersey, 431 U.S. 1 (1977), the Authority decided to refund the prior issues to remove the covenant from consideration. N.Y. Times, Sept. 29, 1977, § 1, at 1, col. 1.
\item \textsuperscript{173} The old rule was that the proceeds of a refunding issue were to be considered as spent for the same purposes as the proceeds of the prior issue. Treas. Reg. § 1.103-7(d)(1) (1972). Therefore, the "substantially all" tests were passed. It should be realized, however, that refunding bonds under the old rule were subject to "arbitrage" regulations of extreme complexity. The type of bonds, terms of maturity, interest rates earned by investment of proceeds, and use of proceeds all were extensively restricted.
\item \textsuperscript{174} If the prior issue is callable on July 1, 1983, an issue to refund it may not be issued until January 1, 1983. Proposed Treas. Reg. § 1.103-7(e), 42 Fed. Reg. 61,614 (1977) (to be codified at 26 C.F.R. pt. 1) (proposed Dec. 6, 1977). This restriction eliminates refundings based solely on a presently low interest rate. Formerly, issues were refunded years in advance, and, generally speaking, the savings gained were in proportion to the timing of the refunding.
\item \textsuperscript{175} Once the prior issue is callable at the option of the company, the company is relatively free to refund. This argues for increased use of option call provisions in drafting original issues.
\item \textsuperscript{176} N.C. Gen. Stat. § 159C-19 (1982).
\item \textsuperscript{177} \textit{Id.}
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tended investment of bond proceeds at yields in excess of the bond rate.\(^{178}\)
The ramifications of this prohibition are extensive and can affect many facets of a transaction.

VI. CONCLUSION

The North Carolina Industrial and Pollution Control Facilities Financing Act has given North Carolina an ability to attract potential employers by allowing tax-exempt financing. While almost all other states have comparable laws, restrictions and requirements mandated by prior North Carolina case law and the state constitution are numerous and complicated in comparison with those of other states: for example, the wage test mandates that wages paid at the financed project must exceed the average in the county or be ten percent above the state average; there must be jobs created or saved by the financing; and only industrial, as opposed to commercial, facilities are financeable.

Moreover, the Act and the administration built up surrounding it require six different approvals of four governmental bodies—the Authority, the county of issuance, the Department of Commerce, and the Local Government Commission. These approvals necessarily require a longer period of time for consummation of any financing done in North Carolina in comparison to what could be done in other states.\(^{2}\)

Notwithstanding its complexity, North Carolina’s financing vehicle for industrial development and pollution control financings does have a singular benefit. Because of the approvals required, lenders and bondholders tradition-ally consider North Carolina issuers to be a slightly stronger credit than otherwise comparable issuers in other states. Even though most industrial development bond financings are sold to private lenders, this imprimatur is still a benefit to companies using the Act in North Carolina.

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178. For example, absent I.R.C. § 103(c) (1976 & Supp. V 1981), a city could issue $100,000,000 in bonds due in 20 years, build a $10,000,000 facility, invest $90,000,000 in federal government securities and, because it pays no taxes, use the principal and earnings on the $90,000,000 to pay off the entire $100,000,000 issue, thus getting a virtually free facility at the expense of the United States Treasury.