IRBs and PVAs
Industrial Revenue Bonds

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TEAM KENTUCKY | KYDOR

How and what we will learn about IRB's

And how PVA Offices should handle them...

What are IRBs?

Industrial Revenue Bonds (IRBs) are a form of tax-exempt (sometimes taxable) bond financing used by a government entity to finance facilities for private entities.

IRBs are typically for projects that serve a broader economic or public purpose.

In Kentucky they are often used to attract and retain business, create jobs, and foster economic development.

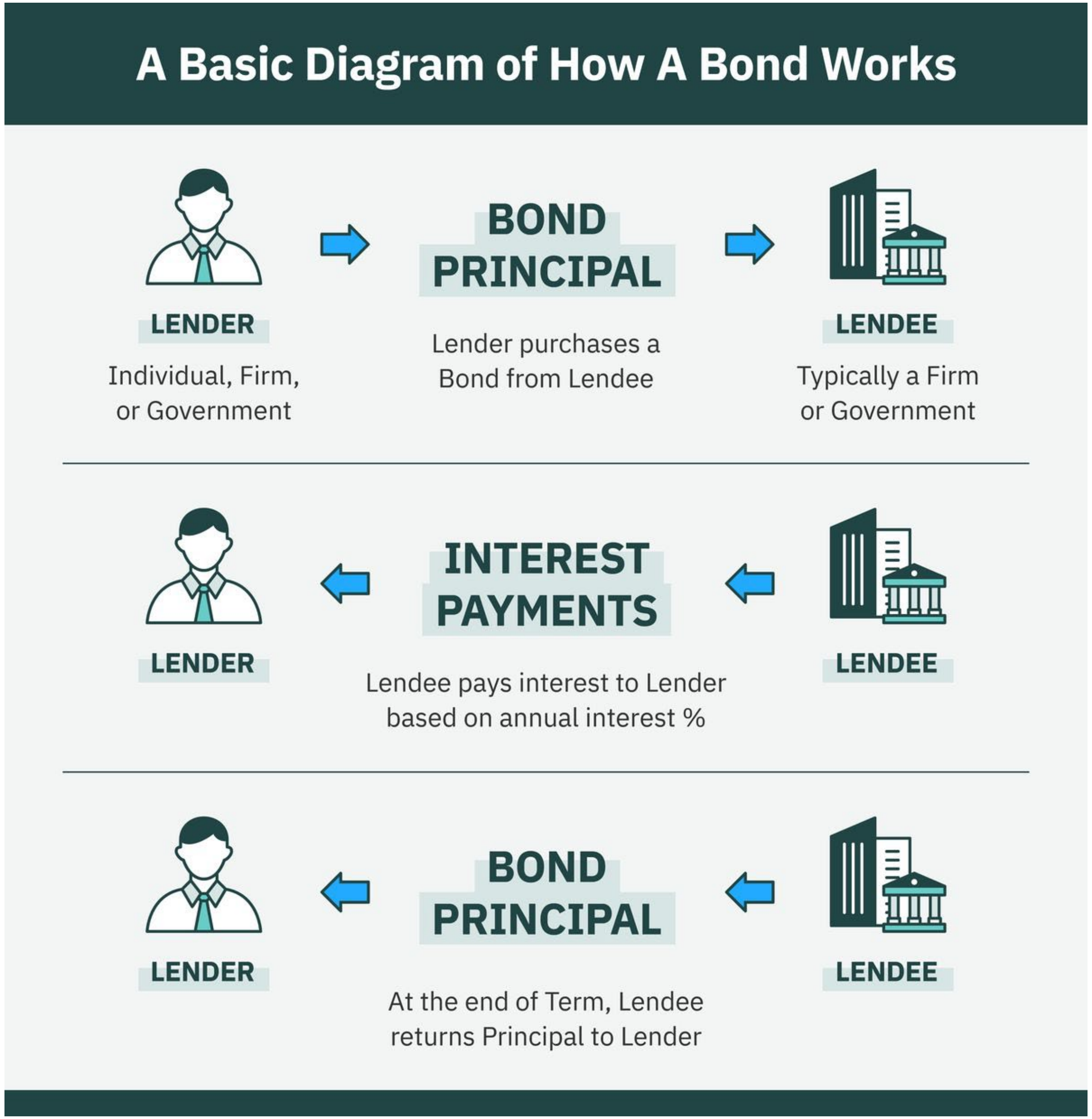
Bonds Explained

A bond is a fixed-income instrument that represents a loan made by an investor to a borrower (typically corporate or government).

Bonds Explained

All bonds: raise money now, pay interest, repay at the end.

- **Regular bonds are issued by a company to investors;**
- **Paid back from company money; and**
- **Interest is usually taxable.**


A Basic Diagram of How A Bond Works
LENDER
Individual, Firm, or Government
BOND PRINCIPAL
Lender purchases a Bond from Lendee
LENDEE
Typically a Firm or Government
LENDER
INTEREST PAYMENTS
Lendee pays interest to Lender based on annual interest %
LENDEE
LENDER
BOND PRINCIPAL
At the end of Term, Lendee returns Principal to Lender
LENDEE

Corporate Bonds vs. IRBs

Same, but different.

- **There are municipal bonds: issued by a city/county; paid from taxes or fees. (Munis for short)**
- **Conduit revenue bonds (IRBs): a kind of municipal bond — city/county issues bond; the project pays, not taxpayers.**
- **All conduit bonds are munis, but not all munis are conduit bonds.**

Bonds Explained

Unlike traditional bonds, IRBs are backed solely by the revenues generated by the project (the COMPANY using the facility).

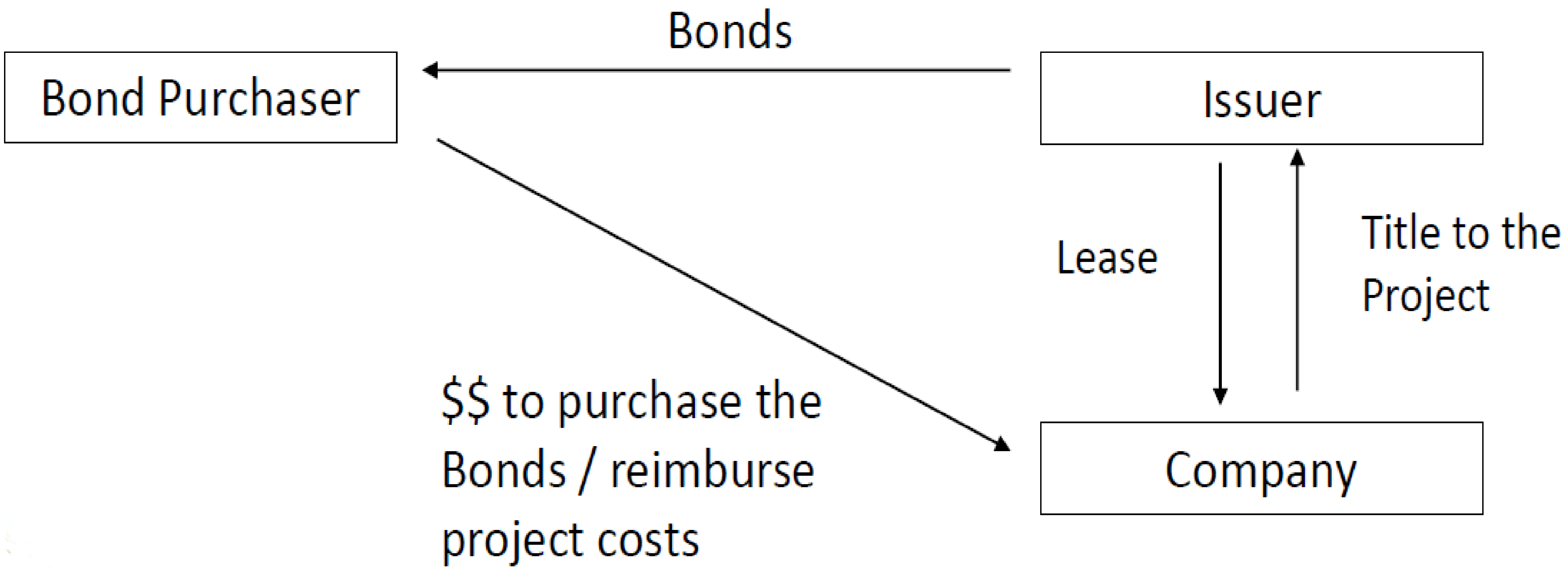
The issuing government entity (ISSUER) does not pledge its full faith and credit to repay the bonds.

How IRBs work?

Issuer (e.g. city/county) issues bonds to finance the acquisition and construction of the project; the bonds then may be bought by investors in the bond market (purchasers).

Proceeds from the sale of the bonds are paid to company to reimburse the costs of acquiring/constructing/equipping the project.

How IRBs work?



Where are IRBs used?

In Kentucky, IRBs are used by local city and county officials to attract and retain businesses, create jobs, and foster economic development:

- ***Manufacturing and processing***
- ***Transportation, utilities***
- ***Healthcare, education, recreation/cultural facilities***
- ***Hotels/motels; historic/downtown redevelopment***
- ***Bourbon warehouses/rickhouses***

Property associated with an IRB is always located within the issuing jurisdiction because the title is held by issuer during the bond term.

Why are IRBs used?

Advantages for COMPANY/Private Entity

- It provides secured financing for construction of facilities (access to capital).
- Possibly lower interest rates when compared to traditional financing.
- Property tax savings… more on this later.

Why are IRBs used?

Advantages for ISSUER (Government Entity)

- Economic Development – entices new businesses, creates jobs.
- No liability for payment – bonds are "non-recourse".
- Cities/Counties are not on "on the hook" if company defaults on bond.

(KRS 103.230 (2) - nonrecourse provision)

Why IRBs may not be used?

Considerations/Risks of IRBs

- **Complexity – numerous parties and legal rules/documents.**

- **Ongoing Compliance – ongoing relationship with government entities.**

- **Availability of Volume Cap – certain bonds for private activity are limited by state's allocation.**

Who is involved in IRB's?

Issuers & Participants

- Cities, counties, and statutory authorities (ISSUER)
- COMPANY/lessee (project)
- Bond counsel/financial advisors

Who is involved in IRB's?

State entities

- **Kentucky Economic Development Finance Authority (KEDFA) (reduced state-rate review; may require PILOT)**

- **Kentucky Private Activity Bond Allocation Committee (KPABAC) (federal volume cap allocation for tax-exempt bonds)**

- **State Local Debt Officer (certain project types)**

Who is involved in IRB's?

Local offices (implementation)

- PVA (assessment/listing, lifecycle tracking)
- County Clerk (recording title, agreements)
- Sheriff/Collector (billing/collections; PILOT receipt if applicable)

When did IRBs start?

Kentucky's General Assembly enacted the Industrial Building Revenue Bond Act in 1946 (1946 Ky. Acts ch. 58), authorizing cities and counties to issue revenue bonds to finance "industrial buildings."

Started after World War II as an employment relief measure. IRBs in Kentucky have steadily evolved—expanding eligible uses, issuers, and tax-administration mechanisms — while preserving the core principles for which they were established.

When did IRBs start?

Over time, eligible issuers have broadened beyond cities and counties — KEDFA, airport boards, and riverport authorities may now serve as issuers, reflecting decades of amendments that have expanded the program's reach.

The program has been modernized. For example:

- **In 2020, the maximum bond term was increased from 30 to 40 years.**

IRBs and the PVA Office

What is required of the PVA when it comes to IRBs?

Just Remember the Basic Duties of PVA Office

- Assess Property Values
- Maintain Property Records
- Administer Exemptions
- Support Taxing Authorities
- Serve the Public

IRBs and the PVA Office (Continued)

Recognize Government Ownership:

Under an IRB, the government issuer holds legal title to the property during the bond term.

Assess the Leasehold Interest:

The private company's leasehold interest is what the PVA values for property tax purposes.

List and Track the Property:

The PVA must list the IRB property on the tax roll, identifying both the government owner and the lessee.

IRBs and the PVA Office (Continued)

Account for Personal Property:

The company using the IRB facility must file tangible personal property returns with the PVA. Those assets are assessed like all other taxable personal property.

Maintain Accurate Records:

The PVA ensures ownership, lease, and asset records remain up-to-date throughout the IRB's duration.

IRBs and the PVA Office (Continued)

Determining the assessment to be used for IRB property…

Determining the assessment for IRBs

Under an IRB, the government issuer (city, county, or KEDFA) holds legal title to the property – *that is exempt*.

The company's right to occupy and benefit from the property is a leasehold interest — *that is taxable*.

That is what the PVA assesses (*leasehold interest*).

(KRS 132.195, 132.020(1) & 132.200)

Leasehold interest further explained

A leasehold interest is the value of a tenant's right to use property they do not own.

While similar to an apartment tenant who doesn't own the building but still receives the valuable right of use, with an IRB the company's leasehold is typically far more substantial and valuable.

The leasehold value of this beneficial use must be assessed at fair cash value, and the taxes must be billed to the COMPANY.

Foundational Case Law

The Kentucky Supreme Court in *Ky. Dept of Revenue v. Hobart Mfg. Co.*, 549 S.W.2d 297, 300 (Ky. 1977) established the standard valuation method for leasehold interests:

"[T]HE FAIR MARKET VALUE OF A LEASEHOLD (IF ANY) CAN BE ASCERTAINED BY SIMPLY SUBTRACTING THE FAIR MARKET VALUE OF THE LAND AS A WHOLE IF SOLD SUBJECT TO THE LEASE FROM THE FAIR MARKET VALUE OF THE LAND AS A WHOLE IF SOLD FREE AND CLEAR OF THE LEASE."

Foundational Case Law

The Kentucky Court of Appeals in *Pike Cnty. Bd. of Assessment Appeals & Revenue Cabinet v. Friend*, 932 S.W.2d 378 (Ky. Ct. App. 1996) reaffirmed that a lessee's beneficial use of publicly owned property is taxable, and the Court of Appeals followed the *Hobart* Court's approach regarding the valuation of the leasehold.

Together, these rulings form the legal framework guiding PVA assessments of IRB leaseholds.

How Leasehold Value Changes Over Time

A leasehold interest's value evolves as the IRB matures:

- **Early in the bond term, the lessee's equity or economic benefit is minimal due to outstanding bond debt and lease obligations.**
- **Over time, as bonds are repaid and the lessee continues to occupy the property, its economic position strengthens, increasing the leasehold's market value.**

How Leasehold Value Changes Over Time

- This rising value curve reflects the lessee's growing financial benefit from long-term, below-market control of the property.

- PVAs consider this progression when applying fair cash value to leaseholds under an IRB structure.

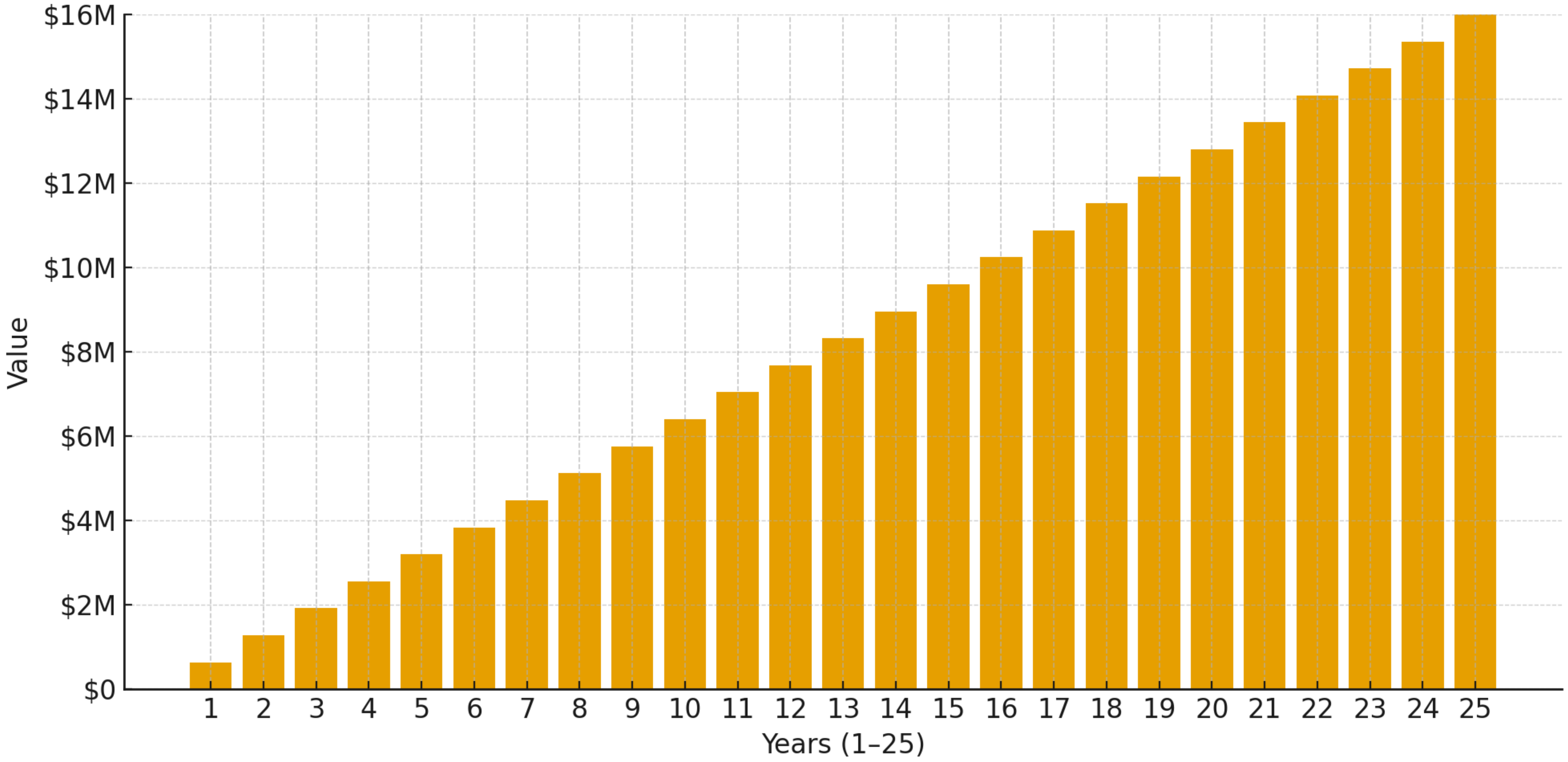
Example of IRB Valuation

Bond Issue: $16 million **Term: 25 years**

- **Year 1: Leasehold value = 1/25 of bond value**
  $16,000,000 X 0.04 (same as 1÷25) = $640,000

- **Year 2: Leasehold value = 2/25 of bond value**
  $16,000,000 X 0.08 (same as 2÷25) = $1,280,000

- **Year 3: Leasehold value = 3/25 of bond value**
  $16,000,000 X 0.12 (same as 3÷25) = $1,920,000



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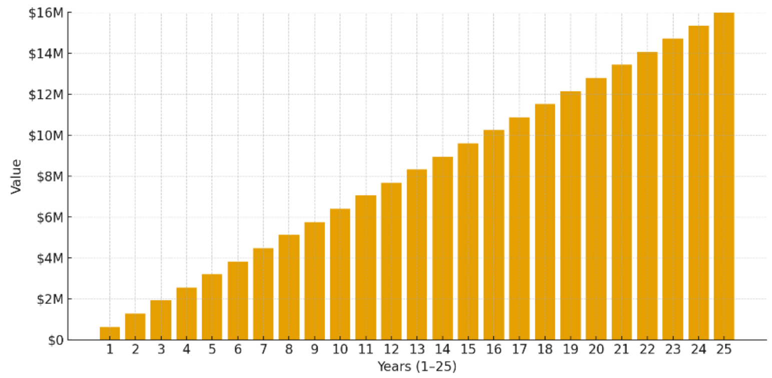
Example of IRB Valuation

Continues annually until Year 25, when the full bond value is assessed as the leasehold interest.



The valuation increases proportionally as the lessee's equity-like benefit in the property grows.

Professional & Statutory Standards

These valuation methods align with generally accepted appraisal and assessment standards, including:

- USPAP (Uniform Standards of Professional Appraisal Practice)
- IAAO (International Association of Assessing Officers) guidelines
- Kentucky Department of Revenue property valuation procedures

These authorities emphasize consistency, transparency, and recognition of economic reality—that the beneficial use of publicly held property is a taxable interest.

PVAs are legally bound to apply these principles, ensuring uniform treatment of IRB leaseholds statewide.

We have a value… now what? List it!

PVAs must list Industrial Revenue Bond (IRB) property separately from standard taxable parcels.

On the assessment roll, the real property is exempt (owned by city/county), the leasehold interest should be classified as *Leasehold (State-Rate Only)*.

The private company's leasehold interest is the only taxable component of the real estate.

Listing it (Continued)

IRB parcels are not subject to normal local or full *ad valorem* rates. They are <u>exempt</u> from <u>local</u> *ad valorem* taxation pursuant to KRS 132.200(5).

Thus, it is vitally important to classify them properly.

These parcels are taxed only at the state leasehold rate of 1.5¢ per $100 of assessed value <u>IF prior approval was received from KEDFA. If not, FULL state and local rates apply for real and personal property.</u>

As opposed to standard state real estate rate of 10.6¢ plus all local rates.

Recap Forms

62A305 (10-22)
Commonwealth of Kentucky
DEPARTMENT OF REVENUE

TEAM KENTUCKY.

PROPERTY VALUATION ADMINISTRATOR'S SUMMARY OF REAL PROPERTY TAX ROLL CHANGES (Since Recapitulation)

20 25 Taxable Assessment

County Bluegrass District All (Countywide)

Columns from Tax Rolls	PVA's Recapitulation Totals **Col. 1**	Increase by PVA **Col. 2**	Decreased by PVA **Col. 3**	Decreases from Protests **Col. 4**	Total Assessment **Col. 5**
Residential—Lots Land and Improvements	$15,010,000,000		$10,000,000		$15,000,000,000
Farm—Land and Other Improvements (Use Value)	$249,000,000	$1,000,000			$250,000,000
Commercial, Industrial, Telecommunication and Leasehold Interests (Full Local Rates)	$180,000,000		$5,000,000		$175,000,000
Value of Timber Rights					
Total Real Estate (Full Local Rates)	$15,439,000,000	$1,000,000	$15,000,000		$15,425,000,000
Total Telecommunication Assessment Included in the Above Total					
Total Real Estate (Leasehold Interests) (1 1/2¢ State Rate Only)	$7,500,000				$7,500,000

Certification Forms

Commonwealth of Kentucky
Department of Revenue
Office of Property Valuation
Frankfort, KY 40620

CERTIFICATION OF EQUALIZED ASSESSMENT

Bluegrass County

CLASS OF PROPERTY	2025 EQUALIZED ASSESSMENT		
Real Estate			
Residential-Lots	$ 15,000,000,000		
Farm	250,000,000		
Commercial and Industrial	175,000,000		
Oil & Mineral Rights	275,000		
Unmined Coal	-		
Total Equalized Assessment-Real Estate	15,425,275,000	@ 10.6	$ 16,350,791.50
Total Equalized Assessment-Leaseholds	**7,500,000**	**@ 1.5**	**1,125.00**
Tangible Personal Property			
Total Equalized Assessment (Full Rates)	200,000,000	@45.0	900,000.00
Total Equalized Assessment (state rate only)	-	@45.0	-
Total Equalized Assessment (state rate only)	100,000,000	@15.0	150,000.00

KEDFA Approval for the Reduced State Rate

The state-only leasehold tax rate can be reduced to $0.015 per $100 FCV under KRS 132.020(1)(f)1, but only with prior KEDFA approval under KRS 103.210. For bonds issued before July 15, 2002, the leasehold rate was also $0.015; however, after July 15, 2002, the rate remained the same, but it requires KEDFA approval.

Approval is by KEDFA resolution, with copies sent to the company, issuer, and DOR; KEDFA also provides quarterly reports to DOR to aid PVAs.

PVAs should look for the following:

- ◊ **A KEDFA approval resolution tied to the specific bond issue;**
- ◊ **A payment-in-lieu-of-taxes ("PILOT") agreement between the COMPANY and the school board and other local taxing districts) — may or may not exist but usually does. Ask the COMPANY.**

Do not code the parcel at the $0.015 state rate without this documentation.

Why Do IRBs get a 1.5¢ tax rate?

As we’ve learned, the private company’s leasehold interest is still taxable — but only under the state leasehold tax rate of $0.015 per $100 of assessed value.

Local, county, and school tax rates do not apply to the IRB’s leasehold.

This reduced taxation structure reflects the public ownership of the property during the bond term.

PILOT Agreements

To offset the loss of local property tax revenue, local governments often require a PILOT agreement as part of the IRB transaction.

A PILOT (Payment-in-Lieu-of-Taxes) is a contractual agreement between the company and the local government (city, county, or industrial authority).

PILOT (Payment-in-Lieu-of-Taxes)

Instead of paying regular property taxes, the company makes negotiated annual payments that are distributed to local taxing districts (e.g., schools, fire, and library districts).

These payments are not property taxes — they are contractual obligations defined in the IRB lease or bond documents.

PVAs and PILOT Agreements

PILOT agreements are independent of the PVA’s statutory assessment process.

The PILOT payment amount is negotiated separately by the local government and is not determined by the PVA taxable valuation.

However, PVA must document the existence of a PILOT for reference and must ensure correct classification of the parcel as a state-rate-only leasehold property.

Together, the assessment and PILOT ensure state compliance and local revenue stability.

What is excluded?

The leasehold valuation covers only real & tangible personal property purchased with IRB proceeds. Replacements/additions not bought with IRB funds must not be included.

Any portion created through private financing is not eligible for the state-only leasehold treatment.

Set up a separate account/parcel for non-IRB improvements and assess them at full state + local rates.

Bottom line: If it wasn't purchased with the bond, it doesn't belong in the IRB leasehold — list and tax it separately at normal rates.

When an IRB Matures — What Changes

Bonds retire (often ≤40 yrs); the lease ends and title transfers back to the COMPANY for a nominal sum.

Tax status flips: During the IRB term, ISSUER-held fee is exempt; the COMPANY'S leasehold is state-rate only. After title reverts, assess the fee-simple parcel at its FCV for both state + local rates.

Retire the leasehold account; re-establish a standard parcel in the proper class for the first tax year after maturity/recorded transfer.

Once the IRB ends, value the reunified fee like any comparable property.

Wrapping it up!

<u>IRBs — What PVAs Must Remember</u>

Scope matters: Only assets purchased with IRB proceeds belong in the IRB account; separately assess any non-IRB additions at normal state + local rates.

How to list/classify: During the IRB term, the issuer's fee is exempt; the company's leasehold is a state-rate-only account.

Rate check: The reduced $0.015 per $100 state rate applies only with KEDFA approval; if no approval, use the normal state rate. Keep the approval in parcel notes.

Personal property (PP): IRB-financed tangible PP is reported on Form 62A500 (IRB line) and taxed in the state-only leasehold; non-IRB PP is listed and taxed normally.

Wrapping it up!

IRBs — What PVAs Must Remember

PILOTs: Keep a copy of any PILOT with the parcel. PILOTs backfill local revenue during the IRB term but don't replace assessment duties.

At maturity: Lease ends, title reverts to the company, and the property returns to full state + local taxation starting with the next tax year.

Close the exempt fee/leasehold records and stand up a standard fee-simple parcel.

Paper Trail

Maintain: bond documents, KEDFA approval, PILOT, annual 62A500 filings, and clear workpapers showing what is IRB-financed vs. not.

QUESTIONS

IRBs and PVAs

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The information in this presentation is for educational and informational purposes only and does not constitute legal advice. Information is presented as an overall review that is subject to law changes and may not apply to all states. For accurate information on issues related to Industrial Revenue Bonds and how they relate to the PVA Office, please reference KRS 103.200–.285

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