



Contractors Can Assist Municipalities to Build Infrastructure through IPA'S

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Municipalities have been permitted by statute for many years to purchase real and personal property through installment purchase agreements ("IPAs"). IPAs have traditionally been used to finance fire trucks, police cars, and other personal property. A less-known use of IPAs is for the financing of water and sewer infrastructure projects, or for public buildings, such as fire stations and township halls. An IPA for these kinds of projects can have unique attributes and advantages over traditional bond financing, including greater flexibility and lower cost.

Contractors can assist a municipality that desires to obtain a project that has been stalled for one reason or another. In one scenario where a municipality does not have the up front cash to obtain a design or pay for bond financing, a contractor can provide a design build-construction-financing approach to build the project. The contractor's overall design construction financing and construction costs will be built into the ultimate price that would be submitted through an RFP proposal or in some instances, sole sourced. At the completion of the project, the contractor would issue a bill of sale of the finished project to the municipality in exchange for the municipality's unconditional obligation to pay. The terms of the unconditional obligation to pay as to amount, interest and term of repayment would be negotiated with a financial institution and the municipality prior to commencement of the project. Upon completion receipt of the unconditional obligation to pay, the contractor would assign it to the financial institution in exchange for full payment for the project. Once the contractor is paid, the municipality would begin its installment payments of principal and interest to the financial institution.

The above-described financing and construction model has been used successfully many times throughout the state. The details of the financial arrangement are described below.

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The bank or broker will generally accept the assignment of the IPA obligation without security if it is backed by a municipality's limited-tax full faith and credit. However, the obligation is generally viewed as secure even though no security attaches to it specifically, because the unconditional obligation of a municipality is a debt of a municipality that would ultimately be funded by tax dollars.

The interest rate of the unconditional obligation to pay by the township can be negotiated or could be a rate set by a brokerage firm that would market the payment obligation to ultimate purchasers of the unconditional obligation to pay. The installment interest rate could contain a cap tied to the revenue bond index.

Certain projects financed under the installment purchase method have the ability to result in an interest rate lower than the revenue bond index. When the obligation is less than \$10 million, it qualifies under a small issuance provision of the IRS Code, which permits any financial institution that purchases the obligation to receive an 80% deduction for its carrying charges. This Internal Revenue Code provision enhances the obligation in the bank's portfolio and usually mitigates the interest rate that a municipality would be required to pay.

It is also attractive to local banks who have an obligation to invest in the community in which they do business and in some instances fulfills their regulatory requirements relating to community reinvestment.

Financing through the installment purchase method reduces administrative fees and underwriting costs that are typically associated with traditional bond financing methods. The method also permits capping the cost of the purchase, capping the interest rate, and can be utilized without regard to a bond rating.

Typical installment purchase contracts are able to be commenced and completed in a shorter period of time than occurs utilizing the traditional bond method. Installment financing would not require a vote of the citizens of the municipality and is exempt from the provisions of the Municipal Finance Act, and does not require review by the Michigan Finance Commission.

However, in order to qualify for the installment purchase contract method (i) the contract payback shall not exceed 15 years, or the useful life of the property, and (ii) the total of all indebtedness contracts of the municipality shall not exceed one and one-quarter percent of the equalized assessed value of all real and personal property within the municipality.

The above method is an excellent way for contractors to assist municipalities to develop infrastructure projects. If there is an interest in pursuing the development of an infrastructure project through this method, the experienced construction attorneys at Foster, Swift, Collins & Smith, P.C. would be happy to assist you.