

SALT LAKE CITY COUNCIL STAFF REPORT

DATE: February 7, 2003

SUBJECT: **INDUSTRIAL REVENUE BOND APPLICATION FROM
SPRING AIR MOUNTAIN-WEST, INC.**

AFFECTED COUNCIL DISTRICTS: District 3

STAFF REPORT BY: Gary Mumford

**ADMINISTRATIVE DEPT.
AND CONTACT PERSON:** Community and Economic Development
Luann Clark

CC: Rocky Fluhart, David Nimkin, Alison Weyher, David Dobbins, LuAnn Clark,
Bob Gore, Dan Mulé, DJ Baxter

KEY ELEMENTS:

Spring Air Mountain-West, Inc., located in Salt Lake City at 402 West 300 North, is requesting that the City issue industrial revenue bonds in the amount of \$4,455,000 to help the company finance expansion and modernization of its manufacturing facility. The Administration requests that the Council consider adopting an inducement resolution indicating that the City is willing to consider issuing industrial revenue bonds. Some of the key elements of the proposal are:

- Spring Air Mountain-West, a Utah corporation, has operated in Salt Lake City for about 75 years, formally as Stover Bedding. Spring Air Mountain-West manufactures mattresses and sleep sets under a franchise from the Spring Air Company. Thomas C. LeDuc is President of Spring Air Mountain-West. Mr. LeDuc took over the business in the early 1970's from his father-in-law, Walter Stover. The company services over 200 dealers in the western United States.
- Industrial revenue bonds (also referred to as private activity bonds) are bonds issued by government and backed solely by the private entity for which the bonds are issued. No real or implied guarantee or obligation is assumed by the City for payment of the bonds.
- The repayment of industrial revenue bonds relies upon revenue generated by the private entity and is not considered an obligation of the issuing local governmental entity. However, based on experience of other jurisdictions, Salt Lake City may need to defend itself in case of default.
- In 2001, the City Council adopted a resolution establishing review criteria for private activity bonds. The one absolute criterion is the guarantee of the bond repayment by a direct-pay letter-of-credit issued by a financial institution with at least an AA rating. Spring Air Mountain-West is in the process of obtaining a direct pay letter of credit.

- Spring Air Mountain-West plans to increase production volume from 83,500 to 232,061 pieces per year to meet sales growth projections of its current customer base, which includes major expansion plans of RC Willey. Approximately 15% of Spring Air Mountain-West's business relates to the RC Willey account.
- Spring Air Mountain-West currently employs 60 people and plans to add 85 new permanent jobs over the next ten years.
- Spring Air Mountain-West plans to expand the existing building on the north side of the current property increasing the square footage from 62,220 to 94,200 square feet. Bond proceeds will also be used to update the manufacturing equipment. Construction is planned to occur in phases so that the manufacturing operations will continue with current employees remaining on the job.
- The project includes new curb, gutter, and landscaping on the north, south and west blocks on 400 West, 200 North and 300 North. The current building will be restored to its early 1900's exterior. The company's paperwork states that the appearance of the completed project may encourage development of surrounding properties, and the project will most likely enhance the appearance of the north entrance to the City on 400 West.
- Industrial revenue bond financing will save the company about \$132,000 in interest per year over SBA and conventional financing alternatives.

MATTERS AT ISSUE/POTENTIAL QUESTIONS FOR ADMINISTRATION:

Salt Lake City requires applicants to secure a direct pay letter-of-credit from a financial institution with at least an AA rating. Under a direct pay letter-of-credit, a financial institution guarantees payments to the bondholders regardless of whether the conduit borrower makes payments to the bank. Spring Air Mountain-West is still in the process of obtaining a direct pay letter-of-credit for the bond issue. *At the briefing, the Council may wish to ask about the status of the company's efforts to obtain a direct pay letter-of-credit.*

Nonprofit organizations are allowed by IRS regulations to apply directly to a local government, to act as a conduit issuer, for bonding relating to health care or educational purposes. The IRS has set a "volume cap" for each state (\$150 million per year for Utah) for entities other than health care or education that are seeking to finance facilities or equipment through industrial revenue bonds. The Utah Legislature has established priorities for allocating the volume cap with most going to the Utah Housing Finance Agency for first-time single-family homeowners or to college student loan programs. On January 8, 2003, the Utah Private Activity Bond Authority authorized up to \$4,455,000 for industrial revenue bonds subject to City Council approval and issuance. This authorization is valid for 90 days.

Resolution 91 of 2001 establishes review criteria for private activity bonds. Spring Air Mountain-West addressed the review criteria in its application material. Council staff has summarized the company's responses:

- Will the project have a positive economic impact on the community? *Spring Air Mountain-West will add 85 permanent employees or approximately \$2 million in annual wages by 2012. Over 100 construction jobs totaling approximately \$1 million will occur during construction in 2003. Annual purchases from local suppliers will rise from \$12.6 million to \$17.3 million by 2012.*
- What social and physical benefits will be realized by the City? *The property tax base will increase as a result of the facility expansive and updated equipment. The project includes curb, gutter, and landscaping on the north, south and west blocks on 400 West, 200 North and 300 North. The current building will be restored to its early 1900's exterior.*
- How many new jobs to be created, at what levels, and at what percentage of the applicant's total payroll will they comprise? *Eighty-five additional permanent jobs will be created expanding the annual payroll by about \$2,000,000 in 10 years.*

Additional Permanent Jobs	
Job Type	Number of Jobs
Production	66
Distribution	12
Sales/Administration	7

- Does the project contribute to the development of underutilized property in the City? *The building expansion will be placed on property previously left vacant or utilized as storage for vehicles and buses. The project will enhance the appearance of the north entrance to the City on 400 West.*
- Does the project serve unmet needs of City residents? *Spring Air Mountain-West offers executive, management, clerical skilled and unskilled jobs to the local community. The work force consists of over 40% local minority residents.*
- Does the project generate synergies for the development of surrounding properties? *The appearance of the completed project will encourage development of surrounding properties. The property is bordered on the north and south by underutilized parking lot properties.*
- What is the current vitality of the proposed applicant and what impact will the proposed expansion have in the applicant? *Expanding and modernizing the plant layout and equipment will increase production capacity by 375%.*
- Does the direct pay letter-of-credit ensure terms and conditions that are acceptable to the City? *A direct pay letter-of-credit has not been finalized. The company will need to be meet this requirement before the Council will be asked to consider issuing the bonds.*

- Has the applicant's financial performance remained relatively stable for the past three years? *The audited financial statement of Spring Air Mountain-West report net income in 1999 of \$25,357; net loss in 2000 of \$307,373; and net income of \$363,775 in 2001. Unaudited net income of \$775,000 is shown for 2002. The letter-of-credit financial institution assumes the risk for bond repayment with the land, building and equipment as collateral.*
- Has the applicant clearly identified the sources and uses of funds? *The company proposes that the expansion will be financed entirely from the bond proceeds. The company owns the land where the expansion will occur. The proposed use of funds are: \$1,562,394 renovation costs; \$1,197,008 new construction costs; \$1,148,744 equipment costs; \$129,790 architect and engineer costs; \$50,565 permits; \$10,000 utilities connection costs; \$177,632 bond expenses; \$71,280 letter-of-credit and bond insurance fee; and \$107,587 interest during construction.*
- Does the applicant's finance plan identify how the bonds will be repaid? *The bonds will be paid through the positive cash flow generated by the increased capacity and efficiencies generated by the expansion and plant modernization. Sales are projected to increase from \$12,625,000 to \$23,817,000 in five years. Cash flow projections show sufficient net income to meet bond debt service requirements. Again, the letter-of-credit financial institution assumes the risk for bond payment repayment.*

The City's administration fee for issuing the bonds will be \$15,000 to be paid by Spring Air Mountain-West at the time of closing the sale of the bonds.

Salt Lake City has not issued any industrial revenue bonds for manufacturing expansion for at least the past 10 years. An application was received from Basic Research this past summer, and the City Council adopted a resolution to begin the process. However, Basic Research was not able to obtain a direct-pay letter of credit from an AA or higher rated financial institution. Basic Research's Authorization from the Utah Private Activity Bond Authority expired on October 10, 2002 (90 days from date of authorization).

Options: The Council may wish to consider adopting the inducement resolution indicating that the Council is willing to consider issuing industrial revenue bonds providing that Spring Air Mountain-West obtain a direct-pay letter of credit. Additional Council actions that will be requested after the company obtains a direct-pay letter-of-credit will be to conduct a hearing under the Tax Equality and Fiscal Responsibility Act (TEFRA) and adopt a resolution authorizing issuance of the bonds.

CHRONOLOGY:

January 3, 2003 - Spring Air Mountain-West submitted an application requesting Salt Lake City to act as a conduit issuer of industrial revenue bonds.

January 8, 2003 - The Utah Private Activity Bond Authority authorized up to \$4,455,000 for industrial revenue bonds subject to approval and issuance by a local government.

January 24, 2003 - The City's Small Business Revolving Loan Fund Committee reviewed the application and approved it to be forwarded to the Mayor and City Council.