Washington's Public Ports:
Financing Airport and Seaport Infrastructure

Washington's public ports support trade, commerce and economic development and are responsible for the development and operation of seaport, airport, marina, recreational, and industrial development facilities throughout the state. Port districts have a variety of options for financing these facilities, including issuing bonds secured by operating revenues, lease revenues, facility charges, taxes, assessments, or user fees. Ports often issue bonds on a tax-exempt basis to reduce financing costs.

The following provides an overview of port general obligation, revenue, special facility, local improvement district and industrial development bonds, summarizing basic characteristics of each financing type, highlighting certain limitations that apply to facilities financed on a tax-exempt basis, and introducing securities law considerations applicable to port bond issues, noting in particular the recent Securities and Exchange Commission ("SEC") settlement with the Port Authority of New York and New Jersey.

General Obligation Bonds

Overview. Washington ports issue general obligation bonds paid from property taxes and backed by the full faith and credit of the port, subject to constitutional and statutory limitations on indebtedness.[1] General obligation bonds are issued in one of two forms: "councilmanic" limited tax general obligation bonds ("LTGO" bonds) and voter-approved unlimited tax general obligation bonds ("UTGO" bonds).

LTGO bonds. A Washington port does not need voter approval to issue LTGO bonds within the port's nonvoted debt capacity.

- *Payment and Security*. LTGO bonds are paid from nonvoted regular property taxes and other legally available funds. Ports may impose a levy of up to \$0.45 per \$1,000 of assessed valuation for general port purposes and, in addition, may levy in excess of the \$0.45 per \$1,000 limit to pay principal of and interest on general obligation bonds. Although the bond portion of the tax levy is not limited by rate, the total dollar amount of the tax levy (including the bond portion) is subject to the "101%" limitation under chapter 84.55 RCW, which limits annual increases in the total dollar amount of the levy to one percent with an additional adjustment for new construction. Ports may levy in excess of this 101% limitation by drawing on banked capacity or by asking voters to approve a levy lid lift (which requires simple majority voter approval).[2]

[1] RCW 53.36.030 and chapter 39.46 RCW.

[2] In addition to regular and excess property taxes, Washington port districts also may impose industrial development district ("IDD") and dredging levies. Pursuant to RCW 53.36.160, ports may impose an IDD levy to pay costs of improvements within IDDs created by the port. In 2015, the Washington legislature amended the IDD levy

- *Limitations.* A port district generally may incur LTGO debt in amounts equal to up to one-fourth of one percent of the value of the taxable property in the district.[3]

UTGO bonds. With super majority voter approval, Washington ports also may issue UTGO bonds within the port's voted debt capacity for capital purposes other than the replacement of equipment.

- *Payment and Security.* UTGO bonds are paid from an excess property tax levy approved at the time the voters approve the UTGO bonds.
- *Election.* Ports may seek voter approval to issue UTGO bonds at any of the four election dates per year. To qualify a bond measure for the ballot, a port must meet several deadlines well in advance of the election. State and local election laws and regulations govern the specific steps involved in placing a ballot measure before the voters and the restrictions on a port district's communications with voters.[4]
- *Limitations.* A port district generally may incur UTGO debt up to three-fourths of one percent of the value of the taxable property in the district.[5] A UTGO bond measure must be approved by at least 60 percent of the voters in the port district, in an election where voter turnout is at least 40 percent of the turnout in the most recent November election.

Port Revenue Bonds

Overview. Washington ports may issue revenue bonds for the purpose of carrying out all port district powers including acquiring, constructing, maintaining, repairing and operating port properties and facilities.[6]

Payment and Security. Revenue bonds are "special fund obligations" payable solely out of operating revenues of the port district.[7] A port may obligate its general revenues or a specific portion of its revenues to pay port revenue bonds. Tax revenue may not be used to pay, secure, or guarantee the payment of port revenue bonds, but tax revenue may be applied to pay operating expenses, thereby increasing net operating revenues available for revenue bond debt service.

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statute to provide an additional multi-year levy option for port districts' IDD levies meeting certain criteria. With voter approval, a port also may impose a dredging levy for dredging, canal construction, leveling, or filling.

[3] RCW 53.36.030(1). Port districts that had less than $800,000,000 in assessed value during 1991 may incur LTGO debt up to three eighths of one percent of the value of taxable property in the district, subject to additional requirements.

[4] For 2017, the election dates are February 14, April 25, August 1 and November 7. The filing deadlines for the elections are December 16 (of the prior year), February 24, May 12 and August 1, respectively. The filing deadline for the February 2018 special election is December 15, 2017.

[5] RCW 53.36.030(2).

[6] See RCW 53.40.010 and .020. See also RCW 39.46.150, 39.46.160 (alternative municipal revenue bond authority) and RCW 14.08.112, 14.08.114 (alternative airport revenue bond authority).

[7] See RCW 53.40.040.

Limitations. Although port revenue bonds are not subject to any constitutional or statutory debt limitation, as a practical matter, the issuance of revenue bonds is limited by covenants (including debt service coverage requirements) and ratings criteria. For example:

- Covenants with outstanding revenue bondowners:
  - Rate covenant: Ports covenant to impose rates and charges sufficient to produce net operating revenue equal to debt service plus some coverage factor.
  - Additional bonds covenant: Ports covenant not to issue additional revenue bonds with a parity lien on gross revenues unless the port demonstrates (generally based on historic performance) sufficient net operating revenue to pay debt service on the outstanding bonds and the additional revenue bonds, plus some coverage factor.
  - Reserve fund covenant: Ports may covenant to establish a reserve fund and to maintain such fund at a certain threshold for the life of the bonds.
- Ratings criteria: Rating agencies consider factors that affect net operating revenue of public ports, including factors subject to the control of the port (such as the strength of planning, budgeting and management, legal covenants, and terms of tenant leases for landlord ports, and shipping and other agreements in the case of operator ports). Some factors are outside the control of the port such as broader economic and trade trends that affect enplanements, container or other cargo volumes.

Port Special Facility Bonds

Overview. Washington public ports have issued special facility bonds to finance facilities leased to airport or seaport tenants (or to a consortium of tenants) for airport, dock and wharf facilities. As noted above, a port may obligate a specific portion of its revenues (such as airport passenger facility charges, customer facilities charges or lease revenues from a specific facility, rather than all of its operating revenues) to pay port revenue bonds.[8] Port revenue bonds generally carve "special facility revenues" out of the gross revenues pledged to the port's general revenue bond owners, providing flexibility to subsequently pledge these special facility revenues to support a stand-alone special facility financing.

Special facility bonds are paid solely from lease payments received from the tenant or consortium of tenants, with no recourse to other port revenues. Lease terms must be reviewed carefully to ensure the lease fits within the governmental ownership safe harbor (as described under the heading "Tax Exemption" below), and provides sufficient security for bond owners, who will rely on the lease revenues for payment, including in the event of a tenant bankruptcy.

[8] RCW 53.40.040.

Local Improvement District Bonds

Washington public ports may issue local improvement district ("LID") bonds, to be paid from assessments on property that will specially benefit from the financed improvements.[9] A port may establish one or more LIDs within the port district, levy special assessments on all property specially benefited by the local improvement to pay costs of the local improvement, and issue LID bonds to be paid from these assessments. The assessments may be paid by property owners in annual installments over 10 years.

Ports are subject to the same procedures as cities for establishing the local improvement district and levying and collecting assessments.[10] Although many Washington cities have used LID bonds to finance sidewalk, street and other improvements that specially benefit certain property owners, Washington public ports generally have not used this financing tool.

Tax Exemption

Overview. Certain port facilities may be financed on a tax-exempt basis under Section 103 of the Internal Revenue Code (the "Code"), which can provide significant interest savings to the port over the life of the bonds. Port bonds may be issued on a tax-exempt basis either as (a) "governmental" bonds or (b) "exempt facility" bonds, as described below.[11] Governmental bonds may provide interest savings compared to exempt facility bonds. In addition, governmental bonds require fewer procedural steps, and offer more flexibility than exempt facility bonds.

Governmental Bonds. Ports often finance marina, parking and other governmentally owned public infrastructure with tax-exempt governmental bonds. Governmental bonds generally may be used to finance any governmentally owned port facilities, so long as no more than 10 percent of the facility is used in a private trade or business (for example, under a lease or management contract).[12] Certain short-term arrangements can be disregarded for the purposes of this 10 percent limit. In addition to reviewing whether the facility is leased to or otherwise used by a private trade or business, bond and tax counsel also review whether a private trade or business has a special economic entitlement to the financed facility.[13] Facilities with private users may need to be financed with exempt facility– rather than governmental – bonds, depending on this analysis.

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[9] See RCW 53.08.050.
[10] Chapter 35.43 RCW.
[11] Governmental tax-exempt bonds are sometimes referred to as "non-AMT" bonds and exempt facility bonds as "AMT" bonds, in reference to the applicability of the alternative minimum tax to the latter. Interest on exempt facility bonds is subject to alternative minimum tax (AMT) while interest on governmental bonds generally is not.
[12] The private payment and private loan tests of Section 141 of the Code also apply.
[13] For example, through an airline use agreement.

Exempt Facility Bonds. Airports, docks and wharves and other specified "exempt facilities" receive special treatment under the Code. Exempt facility bonds may be used to finance governmentally-owned exempt facilities, even when more than 10 percent of the facility is leased to or used by a private business. Ports often finance airport terminal or dock and wharf improvements with exempt facility bonds to accommodate leases to airline and shipping tenants. In doing so, a port must make sure any lease of the financed facility does not transfer ownership of the facility to the private trade or business.[14]

Exempt facility bonds are subject to a variety of requirements and restrictions that do not apply to governmental bonds. At least 95% of the net proceeds of exempt facility bonds must be used for capital costs of the exempt facility, and there are restrictions on the use of proceeds for land acquisition, existing property and certain prohibited facilities. There is also a 2% limitation on costs of issuance to be financed with bond proceeds. Exempt facility bonds also are subject to public hearing requirements and maturity limitations and have less access to refunding opportunities and to remedial actions than governmental bonds.

Industrial Development Revenue Bonds

Ports also issue "industrial development revenue bonds" on a conduit basis through industrial or development corporations ("IDCs") formed under chapter 39.84 RCW. A number of Washington ports have formed IDCs, and IDC bonds have been issued to finance industrial development facilities including "small issue manufacturing," "solid waste disposal" and certain other industrial development facilities that qualify for tax-exempt financing.[15]

Bonds issued by an IDC are paid from and secured by payments from the private business owner or lessee of the financed facility, with no recourse to the port or its IDC. Many IDC bonds traditionally were issued on a variable rate basis, backed by a letter of credit between a bank and the borrower or lessee. In the current regulatory environment, banks are more inclined to purchase a bond directly (i.e. make a loan) rather than issue a letter of credit. Compared to a commercial loan, an IDC bond structure may be beneficial to a port customer if the bond meets the requirements for the loan to bear interest at a tax-exempt rate.

[14] A lease that meets the safe harbor provisions under Section 142(b)(1) of the Code will not be deemed to have transferred ownership to the private business. This safe harbor requires the lessee to make an irrevocable election not to claim depreciation or an investment credit with respect to the facility, requires the lease term to be no more than 80 percent of the reasonably expected economic life of the property, and requires the lessee not have an option to purchase the property other than at fair market value at the time such option is exercised, all as further provided in the Code. Similar requirements apply to management contracts.

[15] Although chapter 39.110 RCW was enacted in 2012 to authorize taxable industrial development financings, as a practical matter, taxable IDB bonds may not provide a benefit compared to a commercial loan unless Congress revives certain authority to issue taxable debt with federal interest subsidies, which have expired.

- Manufacturing facilities may be financed with IDC bonds on a tax-exempt basis under Section 144(a) of the Code. The term "manufacturing facility" means any facility that is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). The term includes facilities that are directly related and ancillary to a manufacturing facility, if certain other requirements are met.
- IDC bonds to finance a manufacturing facility also must be a "small issue" in order to be issued on a tax-exempt basis (currently not more than $10 million in bonds and not more than $20 million in capital expenditures for the facility).
- Solid waste disposal and other exempt facilities also may be financed on a tax-exempt basis through an IDC.

Securities Law Considerations

The federal securities laws prohibit fraud in connection with the sale of securities including port and IDC bonds. Specifically, it is unlawful to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, in connection with the sale of bonds.[16] A port or other state or municipal issuer may be liable to investors in connection with an intentional or even reckless material misstatement or omission in bond offering documents and other communications to the bond market. The SEC also has pursued enforcement actions based on negligence (that is, based on an issuer's failure to take reasonable care in reviewing its disclosure documents for accuracy and completeness).

The SEC continues to focus on the municipal bond market, through both voluntary initiatives and through enforcement actions against state and municipal issuers including ports. On January 10, 2017, the Port Authority of New York and New Jersey entered into a settlement with the SEC under Section 17(a) of the Securities Act, paying a $400,000 penalty and admitting negligence in not disclosing to bondowners the legal uncertainty of the Port's authority to finance certain roadway projects. As part of the settlement, the Port undertook remedial and corrective actions, including eliminating its consent agenda approach for certain expenditure decisions, hiring outside bond counsel (the Port's general counsel had previously delivered the bond opinions), hiring new general counsel, hiring an independent consultant to review its disclosure procedures, adopting written policies and procedures and periodic trainings relating to bond offering disclosures, and adopting a policy requiring certifications and opinions of the Port's law department for future expenditures.

This settlement underscores that ports and other state and municipal issuers must take care in preparing and approving bond disclosure documents. Also among the consistent take-aways from these enforcement actions – as well as other SEC initiatives - are: (1) an emphasis on adopting written

[16] Section 17(a) of the Securities Act of 1933 and Rule 10(b)(5) under the Securities and Exchange Act of 1934.

disclosure policies and procedures and (2) the importance of periodic training regarding issuer responsibilities under the federal securities laws.

Conclusion

Washington public ports finance a broad range of airport, seaport and other marine, recreational, and industrial development facilities. Many of these facilities are financed with tax-exempt bonds, and the reduced financing costs are passed on to port tenants, customers and taxpayers. As ports look to finance projects, a review of the available financing tools, and the tax and securities law considerations, may be helpful. The legal requirements with respect to bond issuance can be complex, particularly the requirements relating to tax exemption. Significant attention should also be paid to the securities antifraud laws. If you have any questions regarding finance tools available to Washington public ports, please contact any of our public finance attorneys.

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