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2-8-1973

# Rural Development and Industrial Revenue Bonds

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## Recommended Citation

Rudel, Richard, "Rural Development and Industrial Revenue Bonds" (1973). *Economics Commentator*. Paper 13.  
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# Economics Newsletter

Economics Department

• South Dakota State University

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No. 14

February 8, 1973

## RURAL DEVELOPMENT AND INDUSTRIAL REVENUE BONDS

With the growing emphasis on rural development, many communities are intensifying their search for ways and means to create new employment opportunities. One tool used in a number of states over the last 20 years has recently become legally available for use by South Dakota communities. This tool is the industrial revenue bond to secure funds to finance industrial development.

Industrial revenue bonds are bonds issued by governmental units to finance the purchase or improvement of land, buildings and equipment.

The site or facility is then rented to a private firm under a lease contract. The lease payments are designed to be sufficient to pay the interest and amortize the principal of the bonds. At the end of the lease contract period and the complete redemption of the bonds, the ownership of the property is transferred to the private firm.

The retirement of the bonds and interest is paid solely from the rentals and revenues of the site or facility and is not the obligation of the taxing power of the governmental unit.

It is well to remember at this point that most development methods have both advantages and disadvantages. Some of these are pointed out below.

Financing by means of industrial revenue bonds holds several advantages for firms. Under federal income tax laws, the interest income received from industrial revenue bonds is tax-exempt. The tax-exempt feature means that these bonds can be issued at lower rates of interest and thereby indirectly reduce the cost of capital to the firm.

Because the title or ownership of the real estate and/or facilities remains in public hands, the property is often exempt from state and local property taxes. This results in further cost savings to the firm. It should be noted, however, that the issuing authority can negotiate for a payment in lieu of property taxes.

Finally, the firm may have a cost savings due to the nature of the federal corporate income tax structure. Ordinarily, expenditures on plant and equipment are not immediately deductible but must be depreciated over some period of time. With rental payments, the entire sum is fully deductible as current expense.

Municipalities should be aware of all the benefits and costs involved with industrial revenue bonds before issuing them for a specific project. South Dakota communities are in their infancy with respect to the use of these types of bonds and should carefully plan and carefully research the firms which might locate there.

From the standpoint of the community, the advantages and disadvantages of using industrial revenue bonds are not so clear cut. Based on experiences in other states, and on economic theory, the benefits and costs of industrial revenue bonds can be categorized into several areas.

Benefits to the community can come from (1) increased employment and income, (2) multiplier effects which increase returns to the community, (3) the attraction of additional firms to the community and (4) often a broadened tax base for the community.

However, the community, or some parts of the community, also may incur costs in the form of: (1) increased wage rates, (2) additional public facilities, (3) environmental effects, (4) changes in the rural atmosphere and (5) risk of firm failure or of leaving the commun-

ity when the lease expires and costs rise, (6) possible higher interest costs on general obligation bonds of the community.

Industrial revenue bonds will likely not prove to be the answer for every community, but there appears to be opportunity for several communities to make use of this tool. Wisely used, this tool can be of great importance and one of the keys to rural development of South Dakota, although experience indicates it is likely to be more widely used by larger cities to attract larger industries.

A more detailed discussion of the costs and benefits potentially associated with the use of industrial revenue bonds is available in Circular EC 689 published by South Dakota State University, Brookings, South Dakota 57006.

Richard Rudel, Assistant Professor - Economics

**IMPORTANT NOTICE:**

The 1973 AGRI-BUSINESS DAY has been changed to Wednesday April 4, to take advantage of an unexpected opportunity of having several nationally-known Economists on our program.

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