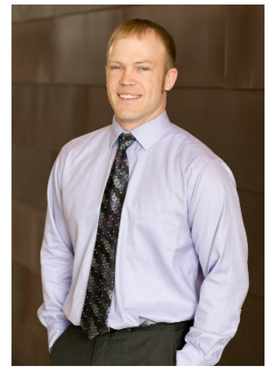
MANUFACTURING
in Lehman's Terms

Incentives 101: PACE Loan Overview



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As the seasons change, so has my focus. For much of this year I have covered COVID-19 related content, and I think it's time for a bit of a change. Instead, I would like to once again, concentrate on the incentives available in North Dakota to help manufacturers advance and grow. For this month's article, I will cover one of the most highly utilized programs the state has to offer for manufacturing expansion projects, the Partnership in Assisting Community Expansion (PACE) Program.

North Dakota, being the only state in the nation with a state-run bank has a unique opportunity to provide programs that other states can't. The PACE Program is one such example. This is an interest buydown program primary sector certified manufacturers can tap into to grow their operations by purchasing equipment, and/or real estate or to provide working capital. What makes this program special is that it can buy down the interest rate to 1% in many cases. So, how does it work? Let's look at a typical scenario. As we go through this scenario, please keep in mind that it all depends on the nature of the project (scope, risk, etc.). The Bank of North Dakota (BND) uses traditional underwriting practices and the program does not require any specific parameters. Although there is a lot of flexibility in how the purchase can be structured, the following is common.

Let's Assume Bob owns a manufacturing facility in West Fargo. He wants to borrow funds to finance a $1 million building expansion which will allow him to gain new contracts and create 11 additional jobs. Given this information we will break down how the program can work.

Bob spoke with his local economic development professional about the project who helped pull everyone together. Let's look at who would be involved and their participation.

- **Economic Developer:** Bob's economic developer listened to Bob's plan and helped him identify various incentives that could help Bob out. One of the incentives identified was the PACE Program so the economic developer decided to host a call with Bob, BND, Flickertail Lending (Bobs local bank), and the Department of Commerce's manufacturing developer.

- **Bob:** During this conference call, Bob gave an update regarding his plan. Upon further review, Flickertail lending and BND decided that 75% Loan to Value (LTV) would be required based on the project type. Bob would need to provide equity of 25% or $250K. Please keep in mind this may not need to be all cash if Bob has other assets available that can be pledged as collateral.

- **BND & Lead Lender:** BND requires a lead lender for the PACE Program, so Bob's loan would be originated by the lead lender and a portion would be participated to BND. They would assess Bob's request and evaluate the collateral to determine the amount they can finance. In this scenario they determine Bob's loan amount would be $750,000. BND must participate in at least 50% of the loan (but not more than 80%) with the lead lender retaining the remaining portion. It was decided the interest rate would be 5% with an amortization period of 15 years. Traditional amortization periods for various asset classes are as follows but each situation may vary:

    Working Capital 1-5 years
    Equipment: 5-7 years
    Real Estate: Up to 20 years.

The Buydown: Great, Bob has all the funds pulled together for his expansion. Unfortunately, the 5% interest rate on his loan is too high for Bob to pull the trigger on the project. His breakeven cost would require a monthly payment of less than $5000. Here's where the interest buydown comes in. Given the following chart, we see that based on Bob's $1 million investment he is eligible for a $100,000 interest buydown (tier one). Since he plans to add 11 new jobs over the next three years, however, we see that he is eligible for $300,000 (tier three).

	BND Buydown	Minimum investment or	Jobs created
Tier One	$100,000	$750,000-$1,200,000	2-5
Tier Two	$200,000	$1,200,001-$2,200,000	6-10
Tier Three	$300,000	$2,200,001-$3,500,000	11-15
Tier Four	$400,000	$3,500,001-$4,500,000	16-20
Tier Five	$500,000	$4,500,001 +	20+

To be eligible for the PACE program, Bob must secure a community match. This is where the local economic developer comes in. Depending on the community, they must provide a match of 15-35% of the total buydown amount. Based on the Community percentage factors chart on the BND website, we find that West Fargo must provide a 35% match. The maximum amount of $300,000 BND will provide represents 65% of the total buydown and the community must provide the other 35%, or a maximum amount of $161,538. With BND's $300,000 and the communities $161,538 there is now a total of approximately $462,000 available to buy down the interest rate on his loan. Keep in mind the loan can only be bought down to 1%, so depending on the loan terms, the total buydown amount exhausted may be less than the maximums referenced above.

Let's assume Bob had not gone with the PACE funding. He may have had to put down 25%, borrowing $750,000 over 15 years at 5%. This would result in a monthly payment of around $5,959.21 and a total interest paid of $322,613.84 over the 15-year period.

In contrast, by using the PACE loan, Bob again put down $250,000, and had a $750,000, 15-year note. The $462,000, however, was put toward buying the 5% interest rate down to 1%. At this rate, instead of paying $322,613.84 in interest over 15 years at the 5% rate, Bob is now only responsible for $64,522.70 after the interest buydown is applied. This will save Bob $258,091.14 in interest costs over the 15-year amortization period. This also drops Bob's monthly payment. Instead of paying $5959.21 per month, Bob's payment would be $3,375.87 for the first month escalating to $5,918.57 at the end of the 15-year note. Bob doesn't go beyond his breakeven point of $5,000 until he is into his 11th year. By that time, he feels his breakeven point will be much higher. Keeping his monthly payments below the breakeven point allows the project to be profitable resulting in growth for Bobs operation, more work being brought to North Dakota, and more job opportunities for his region.

If you are considering an expansion project, whether it be for operating capital, equipment, or real estate, I would encourage you to look into the PACE Program. A link to the program can be found on the BND website at: https://bnd.nd.gov/business/pace-program.

For additional information regarding this or other incentives applicable to your manufacturing operation, please feel free to reach out and I will point you in the right direction. Also, if you are considering an expansion or relocating to North Dakota, I would be happy to work with you to make that a reality!

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