How PE Firms' Portfolio Companies Can Use Economic Development Incentives to Help Grow the Bottom Line

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Private equity firms acquire portfolio companies to increase the acquired company's value and earn a return on the investment through a sale. Private equity firms' portfolio companies are often engaged in activity that qualifies the operating business for economic development incentives, and using economic development incentives advances those goals. Opportunities to utilize incentives arise in both the acquisition and disposition of businesses, as well as during efforts to optimize operations.

Why Use Economic Development Incentives?

Whether the portfolio company is pursuing growth or consolidating, economic development incentives provide an opportunity to either reduce operating costs or create additional revenue that drops to the bottom line performance of the company. That benefit may even be accelerated in the event of a sale of the company, where the overall profitability may directly factor into the sales price. Increasing net income due to cash grants, utility savings, reduced rent and other benefits could add 1+% to a company's income. That benefit may be multiplied at a sale and can account for driving multi-million dollar sale price increases.

Does the Portfolio Company Qualify?

Economic development organizations generally incentivize projects rather than organic growth. The most common projects include: (i) expansion, such as adding a production line or line of business; (ii) consolidation of facilities from other states; and (iii) relocation to a new jurisdiction. It is important not to let the incentives tail wag the dog, but private equity portfolio companies are often focused on these three types of projects. The primary driver for firms may be the opportunity

for add-ons, being able to make appropriate and effective investment to grow the business, or addition by subtraction through consolidating facilities. Prior to undertaking any of these strategies, considering economic development incentives may provide an opportunity to boost net income.

Where to Find the Incentives?

There are specialized federal incentives including the federal historic tax credit, opportunity zone benefits, or industry based credits, but a majority of incentives are at the state and local levels. Some states use an affiliated non-governmental organization to provide in-take, while others use a cabinet agency like a department of development. Still others use a hybrid – quasi-independent economic development agency. State-offered incentives (from whatever economic development body) often include income and sales tax abatements or refunds, forgivable or below market rate loans, and grants.

Local incentives often focus on smaller grants but larger abatements for property taxes. Local income tax or cash grants can still add meaningful value (tens of thousands to hundreds of thousands of dollars annually, often for three to five years), and real and personal property tax abatements can be substantial (in the millions of dollars over terms that can run as long as thirty years).

There are also various types of financing incentives that may be available. For instance, tax increment financing (TIF), property assessed clean energy (PACE), and other opportunities to pay for capital investment and other cost-saving investment without incurring the debt at the company level can build the company's bottom line.

How Does it Really Work?

There are examples from each stage of portfolio companies. For instance, in a consolidation or relocation, the private equity firm may have acquired a new company that it now must integrate with a current portfolio business. In addition to removing redundancy, the new company may be growing in one jurisdiction thanks to the consolidation. When considering how and where to consolidate the business, seeking incentives may help the bottom line financials. For instance, the local community could provide a long-term real property tax abatement for the new consolidated facility and an income tax grant for the additional employees (from the consolidation). The state may also provide training and income tax grants as well. Similarly, for a growth project, state and local incentives may include income tax grants and grants to offset the costs of new equipment and training. There are a wide range of potential incentives, and certain life-cycle stages of private equity portfolio companies may qualify as economic development projects.

The Bottom Line

Private equity owned portfolio companies often pursue strategies that match up with economic development incentives opportunities. Acquisitions, consolidations and growth all provide the potential for a new project with jobs being created and capital investment. Economic development incentives can support such projects, fill capital investment gaps, and provide either lower expenses (such as property tax) or offsetting revenue (such as an income tax grant) and other benefits. By utilizing these resources, portfolio companies can improve their financial results, creating added value.

Vorys encourages you to contact your Vorys attorney or advisor with questions economic development incentives for private equity firms' portfolio companies and how incentives for your project may improve your bottom line results. Please feel free to contact the following Vorys attorneys: Sean Byrne, 614.464.8247, spbyrne@vorys.com; Scott J. Ziance, 614.464.8287, sjziance@vorys.com; Christopher J. Knezevic, 614.464.5627, cjknezevic@vorys.com; or Jonathan K. Stock, 614.464.5647, jkstock@vorys.com.