



**STATEMENT FOR THE RECORD**

**United States House of Representatives  
Committee on Ways and Means**

**Hearing on Paving the Way for Funding and Financing  
Infrastructure Investments**

**January 29, 2020**

**Bond Dealers of America  
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**Introduction**

The Bond Dealers of America (BDA) appreciates this opportunity to offer its views regarding the critical issue infrastructure investment and financing. BDA commends the Committee on working to address the massive and growing infrastructure deficit our country is currently facing, a deficit that continues to metastasize into a national crisis which strains on our national economy and has the potential to grow unchecked without federal action.

As the only Washington, DC-based trade association representing the interests of “main-street” investment firms and banks active predominately in the U.S. fixed income markets, BDA has a unique perspective on how best to ensure that the capital required to put our small businesses to work is readily available. In particular, our members provide essential assistance to state and local governments and private entities to raise the capital used to finance a large majority of new infrastructure investment.

The BDA applauds the Committee for recognizing the breadth and robust strength of the municipal bond market and understanding that tax-exempt municipal bonds have been a cornerstone of all infrastructure investment for over a century, and remain a steadfast way for state and local governments to improve the daily lives of their constituents at a low cost.

In our comments, BDA would like to focus on four tax policy goals that Congress must pursue if it is to ensure capital is readily available for priority projects as efficiently and cost-effectively as possible:

- Continue the tax-exemption for interest paid on bonds issued by state and local governmental entities;
- Restore the ability of state and local governments to save taxpayer dollars and generate additional funds for infrastructure and other key initiatives by restoring tax-exempt Advanced Refundings (ARs);
- Expand the use of tax-exempt Private Activity Bonds (PABs);
- Raise the Bank Qualified Debt limit; and
- Ensure that any direct-pay bond program is untethered to federal budget sequestration as called for in *the Budget Control Act of 2011*

### **Preserve Tax Exemption for Interest Paid on State and Local Government Bonds**

Since the enactment of the federal income tax in 1913, interest paid on most bonds issued by state and local governments has been excluded from federal taxation. Over the century since, the wisdom of that approach has been repeatedly affirmed.

In principle, the federal government has no business taxing the legitimate governmental functions of state and local government, including the servicing of debt incurred for vital government projects and services.

In practice, the tax exemption for interest paid by state and local governments has reduced their borrowing costs by hundreds of billions of dollars. Further, the proceeds of the tax-exempt bonds, together with concomitant interest savings, have been used to create much of the existing stock of roads, bridges, schools, hospitals, and other key physical and institutional assets that are essential to the operation of our economy and society—assets that largely were built, supplied, or served by small businesses. Had the interest on state and local government bonds been taxable, the cost of those assets would have been vastly higher. In turn, those higher capital costs necessarily would have resulted in higher state and local tax burdens and dramatically fewer infrastructure projects. Seventy-five percent of the nation's infrastructure is built and paid for by state and local governments, and 90 percent of that if financed with municipal bonds.

The BDA commends the Committee and Congress for recognizing the strength of tax-exempt municipal bonds and for committing to ensure the financing tool will continue to be protected. However, BDA also is mindful that such exemption is a regular target of proposals to raise federal tax revenue. BDA urges the Committee and Congress to be wary of such proposals, and continue to reject any initiatives, which ignore the lessons of the past century and tax interest paid on state and local debt.

## **Restore Advance Refundings**

State and local governments routinely refinance their outstanding debt obligations, just as corporations and homeowners do. The advance refunding (AR) technique allows state and local government issuers to refinance, and thus benefit from lower interest rates, when the outstanding bonds are not currently callable. It is important to note that, under pre-2018 law, tax-exempt bonds could be issued to advance refund an outstanding issuance only once, a significant restriction on these transactions.

According to recent Government Finance Officers Association data, between 2012 and 2017, there were over 9,000 advance refunding issuances nationwide, saving taxpayers over \$14 billion based on bonds issued in the five-year period. This represents the “present value” measurement of the savings—nominal savings were substantially greater.

Though the negative consequences of the repeal of advance refundings already are clear, the extent of that impact will not be fully evident for some time. Also, given that overall market interest rates are currently so extraordinarily low, some states and localities have been able to partially mitigate the loss of tax-exempt advance refunding authority by using low-rate taxable bonds to refund outstanding tax-exempt debt. But these unusually low rates will not last forever. As interest rates rise, the effects of the loss of advance refunding will be acutely felt by state and local governments.

The inability to lock in lower interest rates when they are available will result in increased costs to these governmental entities and increased tax burdens on their residents. Moreover, at a time of relatively low, but steadily increasing, interest rates, state and local governments have lost an important means of restructuring their outstanding debt to respond to short or long-term fiscal issues (which can include both paying off their debt more quickly or restructuring debt to deal with short term financial difficulties).

There are no alternatives to advance refundings that are as effective in terms of cost or risk. State and local governments are, wisely, hesitant to use interest rate swaps or other derivatives to “simulate” the benefits of advance refundings. Similarly, other alternatives are more costly than ARs and will not be able to provide an effective replacement for advance refunding bonds.

Currently, there is legislation in the House that would remedy this shortfall. H.R. 2772 *the Investing in Our Communities Act*, bipartisan legislation introduced by Congressmen Dutch Ruppersberger (D-MD) and Steve Stivers (R-OH), would fully reinstate the ability of state and local governments to tax-exempt advance refund outstanding debt, in turn directly saving taxpayers money. The bill has received

strong support from Members of the House Municipal Finance Caucus, as well state and local advocacy groups. We request that the Committee include H.R. 2772 in any infrastructure initiative.

### **Expand the Use of Private Activity Bonds**

Bonds issued by state and local governments may be classified as either governmental bonds or Private Activity Bonds (PABs). Governmental bonds are bonds where there is no significant involvement of private entities in a project. PABs are bonds more than ten percent of the proceeds of an issue are used by a private entity and more than ten percent of the debt service on the bonds is paid or secured by a private entity. The Internal Revenue Code significantly restricts the use of PABs, since the subsidy provided by the tax-exemption is intended to be directed to projects which have a discernable public benefit.

There are two general restrictions on PAB issuance. The first imposes overall limits on the volume of PABs that can be issued in each state. States must treat their annual volume allocation of PABs as a scarce resource and allocate it to only the most worthy projects. The second restriction is on which types of projects are eligible for PAB financing. In general PABs are limited to infrastructure projects such as water and sewer systems, airports, transit system, solid waste disposal facilities and others. There is a separate, nationwide volume cap on PABs issued for highway projects which is administered by the Department of Transportation. Other uses of PABs include single- and multi-family housing for targeted populations and financing for small manufacturing companies.

PABs are an important tool for public-private partnerships in infrastructure finance and development. Sometimes it is more efficient for a state or local government to partner with a private developer on an infrastructure projects than to develop the project on a purely public basis. Public-private infrastructure partnerships can often deliver projects faster, more efficiently and at a lower cost than purely public projects.

Towards that end, BDA strongly supports expanding PABs. For projects defined as publicly accessible infrastructure, the Tax Code should be indifferent as to whether the project is public, private, or some mix. If a state or local government determines that the best approach to building a new airport terminal, sewage treatment plant, or other infrastructure project is to work with a private developer, they should not lose access to tax-exempt financing. The benefits to taxpayers are the same whether the project is public or private.

### **Raise the Bank Qualified Debt Limit**

The BDA calls on the Committee to enact legislation that will increase the limit on BQ debt that was recently introduced in the House of Representatives. As a long standing priority for the BDA, *the Municipal Bond Market Support Act*, co-sponsored

by Rep Terri Sewell (D-AL) and Rep. Tom Reed (R-NY), will raise the BQ limit to 30 million, while tying increases to inflation, something that the 1986 tax law failed to implement. The legislation also applies the bank qualified debt limit on a borrower-by-borrower basis, rather than aggregating all bank qualified bonds issued by a conduit issuer, so that schools, hospitals and other community organizations can more easily access capital. This sensible legislation, while not addressed in the recent *Moving America and the Environment Forward* draft, is an effective solution to make rural municipal debt a more attractive investment, in turn, lowering the cost to issuers. We call on the Committee to include the language provided in H.R.3967 in any infrastructure draft.

### **Ensure Direct-Pay Bonds are not Affected by Sequestration**

The Committee has proposed to institute a new, direct-pay bond program such as Build American Bonds (BABs), which were enacted in *the American Recovery and Reinvestment Act of 2009* and expired in 2011. Accord to the House Transportation and Infrastructure Committee report titled, *Moving America and the Environment Forward: Funding Our Roads, Transit, Rail, Aviation, Broadband, Wastewater and Drinking Water Infrastructure*, more than \$181 billion in Build America Bonds were issued in the two years they were available, supporting nearly 2,300 projects around the country. This influx of taxable bonds helped ensure a prosperous recovery from the devastation of the Great recession, however, due to the uncertainties provided by sequestration, inserted unforeseen issues into the municipal marketplace.

Direct pay bonds are a tool where instead of issuing bonds where the interest is tax-exempt to the investor, the state or local government issues higher rate taxable bonds and receives a direct cash subsidy from the federal government for a portion of the interest expense. The experience with BABs demonstrates that direct pay bonds open new avenues for states and localities. Investors who traditionally do not buy tax-exempt bonds because they do not pay US income tax and have no need for tax-exempt income, like pension funds and foreign investors, have an appetite for taxable direct-pay bonds. By drawing issuance volume away from the tax-exempt market, direct-pay bonds can lower tax-exempt yields and provide benefits to state and local issuers who do not even use them.

The main impediment associated with legacy BABs is that the interest subsidy payments due to issuers are reduced below that initially promised by the federal government under budget sequestration. Instead of receiving the 35-percent subsidy promised when the program was enacted and when the bonds were issued, state and local government with outstanding BABs have been receiving reduced payments. If Congress revives direct-pay bonds, continuing to apply sequestration to interest subsidy payments will be a major discouragement for issuers to adopt the product. It is essential if Congress revives direct-pay bonds that interest subsidy payments no longer be subject to sequestration.

## **Conclusion**

For over 100 years, municipal bonds have served as the primary financing mechanism for public infrastructure. Three-quarters of the nation's core infrastructure is built and financed by state and local governments. Restrictions such as prohibiting advance refundings and limiting the use of PABs for infrastructure ties the hands of local governments and discourages capital investment in new infrastructure projects. The BDA appreciates the Committees work on addressing the infrastructure needs of the country, and reaffirming support for the cornerstone of infrastructure financing, tax-exempt municipal bonds.