Infrastructure Priorities

May 29, 2020

The Bond Dealers of America (BDA)[1] appreciates this opportunity to offer its views regarding the critical issue of infrastructure finance. We commend the Committee for working to address the growing infrastructure deficit our country is currently facing and for recognizing the breadth and robust strength of the municipal bond market. The tax-exempt municipal bond market has been the cornerstone of infrastructure investment and capital improvement for over a century and remains a steadfast way for state and local governments to improve the daily lives of their constituents through efficient and low-cost financing for public works.

Below are top priorities for the BDA as Congress begins to address infrastructure financing:

Restore Advance Refundings

State and local governments routinely refinance their outstanding debt obligations, just as 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 effect 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.

[1] BDA is the only DC-based group exclusively representing the interests of securities dealers and banks focused on the US fixed income markets.

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 often hesitant to use interest rate swaps or other derivates 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 only a *de minimis* level of private involvement in a project. PABs are bonds where 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. To that end, we urge Congress to exempt PABs issued for bona fide infrastructure projects from the volume and use restrictions under current law.

Raise the Bank Qualified Debt Limit

Small municipalities have a more difficult time accessing the capital markets. They do not attract the same attention from investors and intermediaries. To address this situation, Congress created bank qualified (BQ) bonds. Normally, when banks buy tax-exempt bonds, they face a tax penalty. But if a bank buys a BQ bond, defined as issued by a community that sells less than $10 million per year, the bank faces no penalty. Congress enacted this provision to provide a means for small communities to more easily access the capital markets. In many cases, BQ bonds are bought and held by local banks familiar with local issuers. The program has been an unqualified success. However, the $10 million annual limit for BQ issuers has not been raised since 1986, and inflation has eroded its value by more than half.

The BDA calls on the Committee to enact legislation that will increase the limit on bank qualified (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 and increase the limit annually for 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 at the end of 2010. 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 under budget sequestration, the interest subsidy payments due to issuers are reduced below that initially promised by the federal government. 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 me 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.