Bond Dealers of America

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May 7, 2020

Via Electronic Mail

The Honorable Nancy Pelosi
Speaker, U.S. House of Representatives
235 Cannon House Office Building
Washington, D.C. 20515

The Honorable Kevin McCarthy
Minority Leader,
U.S. House of Representatives
326 Cannon House Office Building
Washington, D.C. 20515

The Honorable Mitch McConnell
Majority Leader, U.S. Senate
317 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Charles Schumer
Minority Leader, U.S. Senate
322 Hart Senate Office Building
Washington, D.C. 20510

Dear Speaker Pelosi, Majority Leader McConnell, Minority Leader McCarthy and Minority Leader Schumer,

We commend and thank you all and your congressional colleagues for your quick action to address the economic fallout from the coronavirus pandemic. The CARES Act will provide much needed help to individuals, businesses, and governments around the country as we work together to restore the economy. We especially support those provisions of the CARES Act that are providing vital help to states and localities for expenses associated with fighting the pandemic as well as the funds allocated to support Federal Reserve programs to maintain the liquidity of the capital markets. The BDA is the only DC-based organization exclusively representing the interests of securities dealers and banks focused on the US bond markets.

States and local governments have been on the front lines of the virus response. The crisis has put enormous strains on state and local budgets. As constructive as the CARES Act is in helping state and local government stay afloat during the crisis, it will not be enough to fully restore state and local finances. The nation needs fiscally healthy state and local governments to continue to fight the pandemic and lead the economic recovery. Beyond the virus, states are responsible for a large portion of public services that we all depend on every day like education, healthcare, infrastructure, public safety, sanitation, transportation, and many others. Citizens depend on these services, and extreme fiscal stress could threaten states' and localities' abilities to provide these services efficiently. For that reason, it is essential that Congress act once again in response to the virus and enact legislation to provide additional financial assistance to states and localities.

Only federal fiscal help can ensure that states and localities are strong enough to drive economic growth and expansion. We urge Congress to act quickly to provide meaningful financial aid to state and local governments. In addition to cash assistance, incentives and help in planning and financing infrastructure would contribute significantly to the recovery of the economy. Infrastructure projects create high-paying engineering and construction jobs while the projects are under development, and most infrastructure projects have useful lives measured in decades, ensuring that an investment today will contribute to economic growth and productivity for many years.

The most important tool available to state and local governments for infrastructure finance is the municipal bond market. The federal tax-exemption on interest paid to most municipal bond investors reduces the interest rate states and localities pay when they borrow to finance infrastructure investment, saving many billions of dollars every year. The federal tax expenditure provided to state and local governments through the ability to issue tax -free bonds is the most important form of federal aid for infrastructure investment. In order to promote economic recovery and infrastructure investment, there are several steps Congress could take that would provide meaningful assistance to states and localities and encourage new investment in infrastructure.

Advance refundings. Market interest rates for state and local governments are near historic lows. Now is the perfect time for governments to lock in low interest rates on their borrowing, potentially generating substantial savings. Unfortunately, one of the most important tools for refinancing government bonds—advance refundings, the ability to issue new bonds to replace old, high-interest debt before the old bonds become "callable"—was taken away in the Tax Cuts and Jobs Act of 2017. We urge Congress to reinstate this authority.

Bank qualified bonds. The vast majority of municipal bond issuers are small governments, school districts, finance authorities and similar public entities. Smaller issuers tend to face more friction when accessing the capital markets. They are not as well known as bigger issuers, and not as many institutional investors "follow" small borrowers. That is why in 1986 Congress created a provision in the Tax Code that makes it easier for small communities who sell less than $10 million bonds per year to place their bonds with commercial banks. The problem is that the $10 million figure has not been updated in 34 years, and in real terms is worth less than half what it was in 1986. In 2009 Congress raised the $10 million limit temporarily to $30 million as an economic stimulus, and that change was successful in motivating new investment. Banks have been stable funding source for all sectors of the municipal market during this unprecedented time. By increasing the bank qualified limit, we would only encourage more of this valuable, local, and stable funding into the municipal market. We urge Congress to permanently raise the $10 million bank qualified limit to $30 million, automatically index that amount for inflation each year, and apply the volume test at the level of the borrower, not the issuer.

Direct pay bonds. One of the most successful provisions of the 2009 American Recovery and Reinvestment Act was the Build America Bonds (BABs) program. BABs provided an alternative for state and local governments to issuing tax-exempt bonds. Governments could issue taxable bonds instead of tax-exempt. To make up for the higher interest cost, the federal government reimburses states and localities 35 percent of their interest expense on BABs. More than $180 billion of BABs were issued during the two years the authority was available. The problem with the program is that the interest reimbursement payments are subject to budget sequestration, which goes against the promise the federal government made when the bonds were issued. We urge Congress to reinstate a direct pay bond program for state and local governments and ensure the interest reimbursement payments are exempt from sequestration.

State and local governments have led much of the nation’s response to the coronavirus. As a result of the extreme stress on state and local finances brought about by the pandemic and economic shutdown, however, state and local fiscal positions are severely hampered. On May 1 the rating agency Moody’s Investors Service placed the entire state sector on “negative watch,” saying “the historic crisis will substantially test the options” of states to manage through difficult economic conditions. Many local governments and government authorities have also been downgraded.

Quarantine is beginning to wind down in many places. Businesses are starting to reopen, and economic activity is beginning to resume. It is vital at this stage of the recovery that state and local governments remain financially strong and able to continue to lead the fight against the virus. Moreover, infrastructure investment can be the kernel of a robust recovery plan, and state and local government are in the perfect position to lead on that action. As you contemplate additional steps in response to the crisis, we urge you to focus hard on state and local fiscal conditions and provide meaningful assistance as we have described.

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Thank you for the opportunity to provide these comments. We look forward to the opportunity discuss our concerns with you.

Sincerely,

Mike Nicholas
Chief Executive Officer

CC: The Honorable Richard Neal, Chairman House Committee on Ways and Means
The Honorable Kevin Brady, Ranking Member House Committee on Ways and Means
The Honorable Maxine Waters, Chairwoman House Financial Services Committee
The Honorable Patrick McHenry, Ranking Member House Committee on Financial Services
The Honorable Chuck Grassley, Chairman Senate Committee on Finance
The Honorable Ron Wyden, Ranking Member Senate Committee on Finance
The Honorable Michael Crapo, Chairman Senate Committee on Banking, Housing and Urban Development
The Honorable Sherrod Brown, Ranking Member Senate Committee on Banking, Housing and Urban Development