Tax-Exempt Private Activity Bonds

What is a Private Activity Bond?

- A private activity bond (PAB) is a municipal bond issued to finance a facility that includes some private use, which can occur, for example, through ownership, facility management, a lease, or another economic interest in the bond-financed facility.
- Use of more than 10% of a facility, coupled with payments for that use in excess of 10% of the principal and interest on the bond issue, by a private entity is sufficient to categorize a bond issue as a PAB.

When is a Private Activity Bond Tax-Exempt?

- Unless a PAB is a “Qualified PAB,” the interest on the PAB will be taxable and so will have a higher interest rate.
- Qualified PABs include only those bonds that finance limited types of facilities that Congress expressly determined over the years to have a significant public purpose (even with private involvement).

How are Qualified PABs Used?

- Subject to state law requirements, Qualified PABs are used to benefit local communities by financing infrastructure projects such as nonprofit hospitals, nonprofit educational facilities (colleges, universities, charter schools), airports and seaports, affordable housing, and local water systems.
- The lower cost of tax-exempt financing for Qualified PABs allows for the more efficient deployment of capital.

Types of PABs

- Many seemingly public facilities fall into the PAB category because of private involvement.
  - Airports typically lease their gates to private airlines.
  - Seaports typically lease their terminals to private commercial entities.
  - Solid and hazardous waste disposal facilities are often-times owned by private entities but provide a needed public service.
- Affordable housing facilities provide much needed housing options, and the use of PABs provides private developers the incentive to set aside a portion of their developments as affordable housing. Also, PABs for low-income housing are a requirement for eligibility for certain tax credits. Elimination of PABs for low-income housing would eliminate approximately 40% of low income housing tax credits.
- Prior to the 1986 Tax Reform Act, bonds issued to finance facilities owned and operated by a 501(c)(3) organization were treated the same as traditional municipal bonds. Now, subject to state law requirements, these bonds are subject to some restriction. These facilities include, among other things, local YMCA recreational facilities, charter schools, colleges and universities, hospitals and other healthcare facilities, and some church facilities (although not generally houses of worship).
- Small-issuer manufacturing facility bonds are limited to financing facilities that do not exceed $10 million within a jurisdiction. Although not currently widely utilized, this remains an important tool for locally controlled economic development programs.