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September 7, 2021

Sent VIA Electronic Mail

The Honorable Chuck Schumer
Majority Leader
U.S. Senate

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives

The Honorable Mitch McConnell
Minority Leader
U.S. Senate

The Honorable Kevin McCarthy
Minority Leader
U.S. House of Representatives

Re: *Statement of Support for Additional Tax Tools to Help Local Governments and Promote Infrastructure*

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

On behalf of the National Association of Bond Lawyers ("NABL"), I want to commend the Senate on passing H.R. 3684, the Infrastructure Investment and Jobs Act ("Act"), with bipartisan support. We believe the bond provisions set forth in Title IV to the Act – namely (a) private activity bonds for (i) qualified broadband projects, and (ii) qualified carbon dioxide capture facilities, and (b) an increase in the national limitation amount for qualified highway or surface freight transportation facilities – demonstrate a commitment to providing state and local governments with tools to spur economic recovery and rebuild our nation's infrastructure, and NABL applauds their inclusion.

However, three-fourths of all public infrastructure in the United States is financed by state and local governments.[1] As such, we respectfully assert that the additional tax tools identified herein, which are similar to those we previously submitted as a Statement for the Record in connection with a March 11, 2021 Ways and Means Committee hearing, are vital to spur economic recovery and rebuilding our nation's infrastructure in an efficient manner.

State and local bonds are fundamental to building and maintaining infrastructure, including roads; bridges; public buildings; governmental and nonprofit hospitals; primary and secondary schools, colleges, and universities; public power systems; water and sewer systems; ports and airports; affordable housing; and small manufacturing facilities. The cost savings realized through the issuance of tax-advantaged state and local bonds are critical to continued investment in public infrastructure while maintaining affordable taxes, fees, and other charges associated with those infrastructure projects.

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[1] Municipal Securities Rulemaking Board, 2019, Municipal Securities: Financing the Nation's Infrastructure

As Congress now turns toward work on a second reconciliation package, we urge you to use this opportunity to further strengthen the financing tools that help build strong, economically vibrant communities. Specifically, Congress should consider authorizing the tools identified in the attached summary. We stand ready to serve as a technical resource for you should there be any questions. NABL is a nonprofit corporation and specialty bar association of approximately 2,500 lawyers that promotes the integrity of the municipal bond market by advancing the understanding of and compliance with the law affecting public finance. NABL members and their firms are involved every year in a significant portion of the municipal financings by state and local governments.

We strongly encourage Congress to tap into the strength and value provided by the municipal bond market to promote economic recovery, infrastructure investment, and the overall health and safety of your constituents.

If NABL can provide further assistance, please do not hesitate to contact Brian Egan, Director of Governmental Affairs in our Washington DC office, at Began@NABL.org or at (202)-503-3290.

Sincerely,

Teri M. Guarnaccia
President
National Association of Bond Lawyers

CC: Members of the United States House of Representatives
Members of the United States Senate

Summary of Additional Tools to Facilitate Economic Development and Rebuilding Our Nation's Infrastructure

1. Restore Tax-Exempt Advance Refundings

Prior to 2018, state and local governments were able to issue tax-exempt bonds to refinance a prior issue of tax-exempt bonds that were not callable within 90 days of the issue date of the refunding issue (so-called "advance refunding" bonds). Although advance refundings were only permitted in certain circumstances (e.g., tax-exempt bonds could not be issued to advance refund an issue that was itself a tax-exempt advance refunding, advance refundings were not permitted at all for private activity bonds other than qualified 501(c)(3) bonds, and regulations provided safeguards to prevent any abuse), they were critical in helping state and local governments reduce their borrowing costs (often reducing taxes imposed upon resident taxpayers) and restructure financings to facilitate future access to capital. Unfortunately, the ability to issue tax-exempt advance refunding bonds was eliminated effective January 1, 2018.

By reinstating the ability to issue tax-exempt advance refunding bonds, subject to the same rules, restrictions, and safeguards that existed prior to the 2017 change in law, state and local governments will be able to take advantage of billions of dollars in savings and maintain flexible capital plans, allowing them to provide more comprehensive services, including infrastructure projects, at a lower cost to their citizens and greater efficiency.

2. Provide a New Direct-Pay Alternative to Tax-Exempt Financing

State and local governments commonly reduce their borrowing costs associated with infrastructure projects and other capital expenditures by issuing tax-exempt bonds (i.e., because the interest on the bond is excluded from the bondholder's gross income for purposes of federal income taxation, the bondholder is willing to accept a lower interest rate on a tax-exempt bond compared to a taxable bond). However, direct-pay bonds also have been widely accepted by financial markets as an efficient way for state and local governments to finance infrastructure projects.

Interest paid on direct-pay bonds is taxable to the bondholder, so the interest rate is higher than a tax-exempt rate, but the federal government pays an amount equal to a percentage of the interest payable on the bonds directly to the issuer of the bonds, effectively reducing the financing cost of the project funded by these bonds. The percentage paid to the issuer varies depending on the category of direct-pay bond issued.

The most utilized type of direct-pay bond has been the Build America Bond, where the direct payment is equal to 35% of the interest on such bonds. From April 2009 to December 2010 (the time period during which Build America Bonds could be issued), more than $185 billion in direct-pay Build America Bonds were issued, even though the purposes for which these bonds could be issued were narrower than for traditional tax-exempt bonds. Underlying the success of the bonds was that the investor base was expanded to include entities that would not be interested in tax-exempt bonds because they are not subject to federal income tax, such as endowment funds, pension funds, and foreign investors. The competition among the expanded investor base lowered the costs of the infrastructure financed with the bonds – both to the issuers of the bonds and to the federal government.

By creating a new version of Build America Bonds or new type of direct-pay bond as an additional alternative to tax-exempt bonds, state and local governments would have an additional tool to finance infrastructure projects on an efficient basis. Like prior types of direct-pay bonds, these new bonds would be taxable bonds issued by state and local governments, and the federal government would make payments to issuers equal to a percentage of the interest payable on the bonds or, alternatively, equal to a fixed percentage of principal amount of the bond during the period they are outstanding.

In creating the new direct-pay bonds, we suggest Congress build on the Build America Bond model, but improve it in several notable ways:

- Permit the new direct-pay bonds to be issued for any purpose for which tax-exempt bonds could be issued.
- Provide de minimis flexibility for requirements to spend proceeds on designated purposes similar to tax-exempt bond requirements (for example, a requirement to spend 95% of proceeds on a designated purpose rather than 100%).
- Make the new direct-pay bond provisions permanent.
- Consider providing an enhanced subsidy rate for specified types of facilities or governmental purposes, such as infrastructure financing.
- Protect the direct-pay subsidy of new direct-pay bonds against the effects of budgetary sequestration pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985 or the Statutory Pay-As-You-Go Act of 2010 (or future legislation having similar effect.)
- Consider providing for proportionate remedies for noncompliance similar to tax-exempt bond remediation (rather than a harsh "all or nothing" rule).

3. Promote Infrastructure Improvements with Private Sector Involvement through an Increased Private Activity Volume Cap

The Internal Revenue Code of 1986 (the "Code") limits the dollar amount of certain categories of state and local bonds that can be issued each year (referred to as a "volume cap"). Pursuant to Section 146 of the Code, volume limitations are set for each state with respect to "qualified private activity bonds" for specified facilities that are used (or even owned) by private users but in furtherance of a public purpose.

The amount of qualified private activity bonds that may be issued by a state each calendar year is generally determined to be an amount which is the greater of (a) an amount equal to $110 multiplied by the state population (for 2021), or (b) $324,995,000 (for 2021), adjusted each year for increases in the cost of living.

Certain qualified private activity bonds used for infrastructure are exempt from the volume cap requirement, including bonds for airports and docks and wharves. However, qualified private activity bonds for water and sewer facilities, privately owned solid waste disposal facilities, affordable housing, small manufacturing, and other facilities, are not currently exempt from the volume cap requirement, thus constraining the ability of state and local issuers to finance a number of otherwise qualifying infrastructure projects. In a number of communities, this constraint is significant and delays many projects. An increase in the amount of volume cap would allow a significant number of projects to proceed. An increase also would enhance the ability to issue bonds for qualified broadband projects that are not owned by a governmental unit and qualified carbon dioxide capture facilities contemplated by the Act. As currently proposed, bonds issued for these new types of facilities would further reduce the already limited availability of existing volume cap.

Accordingly, by increasing the amount of qualified private activity bonds that can be issued each year through an increase in the annual state ceiling, Congress would be encouraging further private investment

in essential facilities. Further, Congress could aid critically needed infrastructure improvements if it exempted certain qualified private activity bonds, such as bonds for water and sewer projects, from the volume cap limitation. This would put water and sewer financing on par with airport and dock and wharf financing.

4. *Expand Exempt Facility Bonds for Transportation Facilities to Include Public Roads, Tunnels, and Bridges*

Exempt facility bonds issued under Section 142(a) of the Code may be used to finance certain transportation facilities, including airports, docks and wharves, mass commuting facilities, high-speed intercity rail facilities, and qualified highway or surface freight transfer facilities (collectively "exempt facility transportation bonds.") These types of facilities provide certain types of public transportation and freight infrastructure; however, they only provide limited authority for roads, tunnels, and bridges.

Public roads, tunnels, and bridges are essential infrastructure, but many are in poor repair and are inadequate for current transportation demands. Many infrastructure improvement projects can be facilitated by public private partnerships that may not be permitted for "governmental bonds." Congress can lower costs of constructing, expanding, and rehabilitating essential infrastructure improvements by expanding exempt facility transportation bonds to include more types of transportation facilities including roads, tunnels, and bridges, with fewer restrictions than currently exist.

Specifically, by adding a new category of exempt facility bonds under Section 142(a) of the Code for transportation facilities that (i) are open to the public and (ii) have their rates or tolls subject to approval by a state or local governmental unit, tax-advantaged bonds could be used to finance the construction, expansion, or rehabilitation of any new or existing road, tunnel, or bridge that is available for public use. Further, qualified facilities also could include functionally related improvements, such as entrance and exit ramps, overpasses, turnouts, public parking areas, public restroom facilities, drainage, landscaping, lighting and signage (not including commercial advertising), and similar improvements. These bonds should not be subject to a volume cap or to a limitation on land acquisition.

5. *Modification of Small Borrower Exception to Tax-Exempt Interest Expense Allocation Rules for Financial Institutions*

Present law disallows a deduction for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from tax. In the case of a bank or other financial institution, the Code generally disallows a proportionate share of all the taxpayer's interest expense based on a ratio of its basis in tax-exempt investments to its basis in all its assets.

This general rule does not apply to "qualified tax-exempt obligations," commonly called "bank qualified bonds," held by banks or other financial institutions. Instead, only 20% of the interest expense allocable to bank qualified bonds is disallowed. As a result, bank qualified bonds typically have a lower interest rate than do non-bank qualified bonds.

A bank qualified bond generally is a tax-exempt obligation that is (i) issued by a qualified small issuer, (ii) not a private activity bond other than a qualified 501(c)(3) bond as defined in Section 145 of the Code, (iii) designated by the issuer as qualifying for the exception from the general rule of Section 265(b) of the Code, and (iv) not part of an issue larger than $10 million.

A "qualified small issuer" is an issuer that issues $10 million or less of tax-exempt obligations during a calendar year. The Code specifies the circumstances under which separate issuers are aggregated. An issuer is not allowed to designate more than $10 million of tax-exempt bonds in a calendar year. When

bank qualified bonds are issued to benefit governmental or 501(c)(3) borrowers, the bonds are tested for compliance with the bank qualification rules by reference to the conduit issuer of the bonds.

The $10 million limitation has not been increased since the provision was enacted in 1986, except temporarily in 2009 and 2010. Banks have increasingly become important lenders to state and local governments and reducing the expense of lending will encourage local government infrastructure financing. Many local governments may not have effective access to bank financing because of the $10 million limit. This limitation may be a particular problem for participation in tax-exempt financing by community banks and other small banks.

In addition, section 501(c)(3) organizations often have difficulty borrowing from banks using bank qualified bonds because the actual issuer (often a state agency) is not itself a qualified small issuer. Moreover, some otherwise qualified small issuers refrain from issuing tax-exempt bonds for 501(c)(3) organizations located in their jurisdiction because the issuance of such bonds might prevent the local government from being a qualified small issuer.

By increasing the $10 million annual limit to at least $30 million and indexing it for inflation, additional local governments or health care organizations, education institutions, or other non-profits who want to borrow for a new project will have access to cheaper capital through a bank qualified designation. In addition, by applying the $30 million annual limitation at the conduit borrower level (rather than at the level of the conduit issuer), more section 501(c)(3) organizations will be able to access bank-qualified debt.