Submission for the Record by the Securities Industry and Financial Markets Association

House Committee on Ways and Means

Hearing entitled "Paving the Way for Funding and Financing Infrastructure Investments"

January 29, 2020

Introduction

The Securities Industry and Financial Markets Association ("SIFMA")[1] and its member firms strongly support your commitment to infrastructure investment, which will help spur job creation and economic growth. We also support leveraging the great work states and localities do in building and maintaining our infrastructure. A partnership among federal, state and local governments and private investors will ease the burden on the cash-strapped federal government by leveraging our capital markets to create expanded financing options

After decades of underinvestment, the U.S. faces an extraordinary "infrastructure deficit." State and local capital investment in the U.S. has fallen from three percent of GDP in the late 1960s to less than two percent in 2014. The American Society of Civil Engineers (ASCE) estimates that the U.S. needs to invest $4.6 trillion in infrastructure by 2025 to replace failing facilities and maintain the capacity needed by a growing economy and population. The impact of aging infrastructure on the U.S economy is significant. The ASCE also estimates that the U.S. economy is expected to lose just under $4 trillion in GDP between 2016 and 2025 if the government does not invest in our infrastructure, and 2.5 million American jobs will be lost. With existing federal infrastructure programs failing to meet current demand, the U.S. is continuing the troubling trend of under-investment in this area and risks substantially, adding to the financial burdens of state and local governments. This will only lead to further delays of investment in and maintenance of critical public projects, including highways, bridges, hospitals, airports, schools, water and sewer systems.

SIFMA strongly supports providing incentives to rebuild our nation's infrastructure. These incentives should include 1) preserving the tax exemption for interest earned by investors on state and local bonds, 2) reinstating advance refunding of municipal bonds, 3) expanding private activity bonds (PABs), 4) authorizing direct pay bonds, and 5) expanding bank qualified bonds so that states and municipalities have significant additional tools to finance their local projects.

Preserve Tax Exemption for Interest Earned by Investors on State and Local Bonds

State and local governments bear responsibility for financing and building a significant portion of the nation's public infrastructure, including schools, roads, water and sewer systems, airports and other facilities. The bulk of these projects have been financed using tax-exempt bonds, wherein the interest earned by investors is generally exempt from federal income tax. As a result, the state or local government pays a significantly lower interest rate to investors than other borrowers in the capital markets. The tax-exemption on state and local bond interest is one of the most important forms of federal assistance for infrastructure investment, and the tax-exempt bond market has successfully provided trillions of financing for public works over decades.

At SIFMA, we believe it is critical to close the infrastructure financing gap and it is imperative to restore and create additional vehicles to assist in resolving these needs.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

Recommendations
Preserving the tax-exemption for interest earned by investors on state and local bonds, which is the financing mechanism for the clear majority of infrastructure projects that state and local governments undertake, is crucial.

<u>Reinstate Advanced Refunding of Tax-Exempt Bonds</u>
Advance refundings provided states and localities with an important tool for refinancing outstanding debt at lower rates and have generated many billions of dollars of interest savings over decades. By reducing their debt service expenses through advance refundings, states and localities were able to free up their borrowing capacity for new investments in infrastructure and other important public projects, in turn boosting their local economies with the creation of new jobs and making public services more affordable. This is much like homeowners refinancing mortgages to a lower interest rate.

State and local governments can no longer access cost savings through this valuable financial tool. The Tax Cuts and Jobs Act of 2017 eliminated the ability of state and local governments to execute "advance refundings" of outstanding tax-exempt bonds after 2017 by making interest on advance refunding bonds taxable.

Tax-exempt bonds were first written into the tax code in 1913 and have since then remained an important financing tool. Eliminating advance refundings removed an important financial management tool that allowed state and local governments to save billions on interest costs. When interest rates fall, states and localities seek to take advantage of lower rates. However, bonds can only be paid off early on or after certain specified times known as "call dates." Before 2018, if an issuer wanted to refund their bonds before 90 days prior to the call date, they needed to issue new advance refunding bonds hold the proceeds in escrow until the call date, then pay off the old bonds on the call date. Now, issuers must wait until the bonds can be refunded on a current basis, 90 days prior to the call date, to issue the refunding bonds, potentially reducing the savings.

Advance refundings were already restricted and regulated. The limitation of one advance refunding per bond issue was put in place in 1986 to correct the perception of too many bonds outstanding at the same time for a single project. Limiting governments to a single advance refunding was a compromise that recognized how important advance refundings are for states and localities while respecting the interest of the federal government to limit the number of tax-exempt bonds outstanding.

Recommendations
SIFMA supports reinstating the tax exemption for interest on advance refunding bonds, which would allow local governments to invest in additional infrastructure projects by saving local taxpayer dollars. Rep. C.A. Dutch Ruppersberger (D-MD) introduced H.R. 2772, the Investing in Our Communities Act, in May 2019. If enacted, the bipartisan legislation would restore the tax exemption for interest on advance refunding bonds. The bill currently awaits action by the House Ways & Means Committee.

<u>Private Activity Bonds</u>
State and local governments are permitted under the tax code to issue bonds on behalf of private borrowers for a limited list of uses, including infrastructure. However, this issuance comes with significant restrictions like volume limitations and application of the individual Alternative Minimum Tax, which raises the cost of financing.

State and local governments are eligible to issue bonds in the capital market where the interest earned by investors is exempt from federal income tax, which reduces the interest cost for the borrower by as much as two percentage points below other forms of debt. However, if more than 10 percent of the proceeds of a state or local bond issue are used by a private business and more than 10 percent of the debt service on a bond is paid or secured by a private business, the bond is a Private Activity Bond (PAB) and cannot be tax-exempt unless it meets one of the exceptions specified in law.

These exceptions were included in the tax code to promote the use of bonds to finance targeted categories of facilities and include, among others:

- Bonds where the project being financed is "exempt facility" infrastructure such as airports, docks and wharves, mass commuting facilities, water and sewer facilities, solid waste disposal facilities, and others;
- Bonds where the borrower is a 501(c)3 organization;
- Bonds used to finance qualified home mortgages for low- and middle-income families that meet certain criteria; and
- Bonds issued for the benefit of very small manufacturing companies.

Recommendations

State and local governments should be able to issue tax-exempt bonds for infrastructure projects with private participation in the same manner that they issue bonds for purely public projects. In addition, Congress should permit the sale or lease of infrastructure assets financed with governmental tax-exempt bonds to private parties without threatening the tax status of the interest on the bonds. A comprehensive expansion of federal investment in infrastructure should also include an increase in the volume cap for private activity bonds.

SIFMA supports increasing the volume cap for private activity bonds, particularly by:

- increasing the volume cap for PABs for affordable and public housing projects;
- efforts to create a National Reallocation Pool so that unused volume cap can be redistributed among states; and
- exempting rental assistance demonstrations from the volume cap would result in additional housing in local areas.

Bank Qualified Bonds

Our national infrastructure challenges are so complex and large that a single solution is not enough. An expansion of "bank qualified" tax-exempt bonds would support infrastructure investment in small and rural communities that may have difficulty accessing the capital markets.

Under current law, small issuers can issue up to $10 million or less in bonds per calendar year to be sold directly to local banks at a cost savings for local taxpayers. This $10 million limit was set in 1986 under the Tax Reform Act of 1986. This limit was briefly raised in 2009 as part of the American Recovery and Reinvestment Act of 2009.

Recommendations

Congresswoman Terri Sewell (D-AL) has introduced H.R. 3967, the Municipal Bond Market Act of 2019, which includes several modifications to the bank-qualified bond program. This legislation would increase the annual limit for bank-qualified bonds from $10 million to $30 million and this limit would be adjusted by inflation in future years. This legislation would also apply the bank-qualified debt limit on a

borrower by borrower basis, rather than aggregating all qualified loans of an issuer. SIFMA strongly supports the Municipal Bond Market Act of 2019 and would urge the House to include this legislation in comprehensive infrastructure legislation.

Direct Pay Bonds

In 2009 and 2010, the federal government authorized a direct payment "Build America Bond" program whereby states and localities could choose to issue bonds with taxable interest instead of tax-exempt interest and receive a partial reimbursement for their interest expense, which generated new investment in public infrastructure in all 50 states. During the time in 2009 and 2010 that direct pay bonds were authorized, state and local governments financed more than $150 billion of infrastructure investments using the product. Reinstating a direct pay program could be designed to be revenue neutral, with a subsidy to the issuer of 28 percent instead of 35 percent.

Recommendations

SIFMA supports the authorization of a new direct payment bond program by Congress on a permanent basis as a supplement to, not a replacement for, tax-exempt bonds which ensures reimbursements to borrowers will not be affected by budget sequesters. A comprehensive expansion of federal investment in infrastructure should include the authorization of a new direct payment bond program.

Conclusion

In conclusion, we applaud the House Committee on Ways and Means for holding this critical hearing on improving our nation's infrastructure and appreciate your review of our suggested proposals which would expand the ability of municipalities to finance their infrastructure needs.