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

Senate Finance Committee

"Funding and Financing Options to Bolster American Infrastructure"

May 18, 2021

Chairman Wyden, Ranking Member Crapo:

We applaud your leadership of the Senate Finance Committee. Your direction in making infrastructure investment, including municipal bond financing, a priority for the committee is timely and prudent during these challenging times. We thank you for convening this important hearing and our members stand ready to continue their supporting role as the economy recovers.

Introduction

The Securities Industry and Financial Markets Association ("SIFMA")[1] and its member firms[2] strongly support increased investment in this country's infrastructure, which will help spur job creation and economic growth. To that end, we believe it is critical to support 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. We believe that this partnership is especially important during this difficult fiscal environment as states and local governments seek to lower their costs and also finance much-needed infrastructure such as schools, roads, and hospitals.

At SIFMA, we believe it is critical to close the infrastructure financing gap by restoring and creating additional vehicles to assist in resolving these needs. We hope that you agree that increased investment in our infrastructure has a critical role to play as our nation will continue to grapple with the economic impact of the COVID-19 pandemic for years to come. Further, the provisions outlined in this testimony will facilitate the more efficient leveraging of our capital markets for the benefit all Americans.

After decades of underinvestment, the U.S. faces an extraordinary infrastructure deficit. In their most recent report card, The American Society of Civil Engineers (ASCE) estimates a $2.59 trillion investment gap over 10 years between what we are currently projected to spend on infrastructure and what must be spent to fully address the deficiencies in our aging infrastructure. They also estimate that by 2039, a continued underinvestment in our nation's infrastructure at current rates will cost $10 trillion in GDP, more than 3 million in American jobs, and $2.4 trillion in exports over the next 30 years. With existing federal infrastructure programs failing to meet current demand, the U.S. is continuing the troubling trend of underinvestment 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.

Specifically, SIFMA strongly supports providing incentives to rebuild our nation's infrastructure including: 1) preserving the tax exemption for interest earned by investors on state and local bonds; 2) reinstating the tax exemption on the advance refunding of municipal bonds; 3) expanding private activity bonds (PABs); 4) reinstating a direct pay bond program; and 5) expanding the small issuer exception so that states and municipalities have a variety of additional tools to finance their local projects. It is important to note that all of these priorities were included in some form in H.R. 2, the Moving Forward Act, which SIFMA publicly supports.

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, transportation facilities

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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). For more information, visit http://www.sifma.org.

[2] In 2020, SIFMA members underwrote over 90% of the volume of new issues of municipal securities.

and other public projects. 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 dollars of financing for public works over decades.

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.

Reinstate the Tax Exemption on Advance Refunding Municipal Bonds

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 tool operates 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 tax exempt advance refundings of outstanding municipal bonds by making the 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 and hold the proceeds in escrow until the call date of the original bonds, then pay off the original 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 tax exempt refunding bonds, which potentially reduces their 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 being 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. Sens. Roger Wicker (R-MS) and Debbie Stabenow (D-MI) introduced S. 479, the LOCAL Infrastructure Act and Reps. C.A. Dutch Ruppersberger (D-MD) and Steve Stivers (R-OH) introduced identical legislation in the form of H.R. 2288, the Investing in Our Communities Act. If enacted, these bipartisan pieces of legislation would restore the tax exemption for interest on advance refunding bonds. Further, this reinstatement is also provided for in Section 90102 of the Moving Forward Act.

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 in the form of a refundable tax credit, 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 this tool. Reinstating a direct pay program could be designed to be revenue neutral, with a lower subsidy to the issuer than the 35 percent reimbursement for Build America Bonds.

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 so long as the program ensures reimbursements to borrowers will not be affected by budget sequesters. In addition to S. 1308, the American Infrastructure Bonds Act, legislation introduced by Sens. Roger Wicker (R-MS) and Michael Bennet (D-CO) which authorizes a new direct pay bond program, Section 90101 of the Moving Forward Act would also permanently implement a direct pay bond program. In sum, any comprehensive expansion of federal investment in infrastructure should include the authorization of a new direct payment bond program.

The Small Issuer Exception
Our national infrastructure challenges are so complex and large that a single solution is not enough. An expansion of the "small issuer exception" for 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) introduced H.R. 2634, the Local Infrastructure Financing Tools (LIFT) Act, which includes several modifications to the small issuer exception as well as reinstates the tax exemption for interest on advance refunding bonds and establishes a permanent direct pay bond program. This legislation would increase the annual limit for the small issuer exception from $10 million to $30 million and this limit would be adjusted by inflation in future years. This legislation would also apply the small issuer exception debt limit on a borrower by borrower basis, rather than aggregating all qualified loans of an issuer. SIFMA strongly urges the Congress to include this legislation in any comprehensive infrastructure legislation. Section 90103 of the Moving Forward Act would also permanently increase the limit for the small issuer exception.

Private Activity Bonds
State and local governments are permitted under the tax code to issue bonds on behalf of private borrowers for a limited list of public purposes, including infrastructure. However, these bonds come with significant restrictions such as volume limitations and, for some purposes, the 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 markets where the interest earned by investors is exempt from federal income tax, which can significantly reduce the interest cost for the borrower compared to 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 deemed by the IRS to be 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;
- efforts to create a National Reallocation Pool so that unused volume cap can be redistributed among states; and
- expanding the permissible uses for PABs to activities such as rural broadband, amongst others.

Importantly, Section 90104 of the Moving Forward Act would expand the volume cap for private activity bonds.

Conclusion

In conclusion, we applaud the Committee for holding this critical hearing on infrastructure financing, and we encourage lawmakers to use this opportunity to consider the proposals suggested in this submission that will help expand the ability of municipalities to finance their infrastructure needs.