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Muni Market Participants Applaud QPIB, Water Proposals.

WASHINGTON – Municipal market participants applauded President Obama’s proposal on Friday to create a new type of tax-exempt municipal bond that could be used to help finance public-private infrastructure projects, but one questioned whether it will pass muster with Congress.

The president also included several other proposals, such the creation of a new Water Finance Center to help state and local governments leverage federal grants to attract private investors in water and sewer projects, in a package of infrastructure initiatives announced on Friday.

The initiatives were described by the White House in a fact sheet and by Vice President Joe Biden during at the dedication of the Anacostia River Tunnel Project site here. “We want to see private capital moving off the sidelines because we want to put it to work,” Biden said. “This isn’t privatization, this is collaboration.”

Obama is expected to talk about the proposals in his State of the Union speech on Tuesday and will detail them in his budget, which is to be released on Feb. 2.

The initiatives stem from recommendations made in a 19-page report from the Build America Investment Initiative Interagency Working Group, chaired by Treasury and Transportation Secretaries Jack Lew and Anthony Foxx. That report was sent to the White House late last year.

The new Qualified Public Infrastructure Bonds are a centerpiece of the proposals. They would be a hybrid between governmental bonds and private-activity bonds with fewer restrictions than PABs. In contrast to PABs, QPIBs would not have issuance caps and would not be subject to the alternative minimum tax.

They also would not have the private business use test that is currently are used to determine if bonds are governmental bonds or PABs. Under current law, bonds are PABs and not government bonds if more than 10% of the project is used by private parties and more than 10% of the debt service is paid for, or secured by, private parties. But to be tax-exempt, a PAB has to be used to finance projects that fall within several categories, including airports and sewer facilities.

QPIBs could be used to finance airport, port, mass transit, solid waste, sewer, water and surface transportation projects, but only if they are governmentally-owned. QPIBs could not be used for privately-owned projects or privatizations of public facilities.

As a result, they would be particularly beneficial for governmentally-owned projects that have long-term leases or concessions with private parties.

The modifications to the PAB rules for QPIBs “will increase [their] impact as a permanent lower cost financing tool to increase private participation in building our nation’s public infrastructure,” the White House said in its fact sheet.

The QPIBs drew positive response.

"We think this could be a low-cost approach to stimulating much-needed infrastructure investment," said Standard & Poor's managing director and analyst Robin Prunty in New York. "But there is a cost associated with it, and as a result extensive deliberation in Congress is likely."

"Interest in the public-private 'P3' approach is growing, and many states are developing programs that combine public ownership with private sector management and operations expertise," Prunty said. "But the financing structures can be complex and generally have not benefited from tax exemption. States and other municipal market issuers have found them to be an attractive alternative to deliver large-scale infrastructure projects." "If the financing becomes more cost-effective, we expect that interest could grow. Currently, 33 states have authorized P3s and many projects have been financed or are in the planning stages," Prunty said. "The U.S. projects have primarily focused on transportation, such as roads, toll lanes, and transit projects. However, the Long Beach Courthouse in California is an example of a social infrastructure P3 project, and other states with active transportation P3 projects are also considering approving legislation allowing social infrastructure P3s. We have also started to see interest at the local level."

Susan Collet, president of H Street Capitol Strategies, said, "I think [QPIBs take] some significant steps forward in making the private-activity bond model more robust." She also said they would be "helpful to a lot of issuers."

Collet said the proposal seems to be consistent with the America Fast Forward bond proposal in that the Obama administration wants new models for bonds to enhance infrastructure. AFF bonds, proposed by Obama in 2013, would be taxable, direct-pay bonds that could be used to finance infrastructure financing.

If Congress wants to include infrastructure financing as part of tax reform, QPIBs could be something considered, Collet said, adding, "I do think it's going to be a starting point for discussion." But the tax committees may scrutinize PABs as part of tax reform to make sure their purposes are worthy of tax exemption, she said.

Michael Decker, Securities Industry and Financial Markets Association managing director and co-head of municipal securities, said, "It's a welcome proposal."

The proposal will make it easier to use tax-exempt financing when more than a de minimis amount of private involvement in projects, he said, adding, the bonds would "hopefully open the door for new financing structures" and more infrastructure.

Decker noted that tax reform is on the agenda and the Senate Finance Committee just set up working groups, including one on infrastructure. "I think this idea should be in the mix for those discussions."

If Congress wants to amend the tax code to make it more efficient and promote investment, "this certainly fits the bill," he said. The QPIBs are in contrast with proposals like the 28% cap on the valuation of tax-exemption, he added. The President has proposed the 28% cap in his last several budget proposals.

Mike Nicholas, chief executive officer of the Bond Dealers of America, said, "The BDA is favorable to this proposal under the guise it would provide municipal issuers of all shapes and sizes the ability to work together with private enterprise to expand opportunities for tax-exempt financing."

"However, the new QPIBs or any other component of the infrastructure financing proposal can't lead to changes to the tax-exemption for muni bonds or to structural change to municipal bond issuance

which has worked efficiently to the benefit of issuers and taxpayers for 100 years,” he said.

The U.S. Chamber of Commerce likes what it sees in the president’s P3 initiative at this point but the detail will be important, said Janet Kavinsky, the Chamber’s executive director for transportation and infrastructure.

“Although P3s are not a substitute for public investment, as the president’s announcement clearly states, they can bring innovation, cost discipline and time savings, and enable projects to go forward that cannot do so under conventional procurement methods,” she said. “The Chamber will take a close look as the proposals are revealed in detail in the budget and continue working with the administration on this important initiative.”

Sen. Ron Wyden, D-Ore., ranking minority member of the Senate Finance Committee, is on board with the proposal. “We were glad to see many of our Finance Committee suggestions incorporated into these proposals and support their efforts to pursue new opportunities for public-private partnerships,” said a spokesperson for him.

The new Water Finance Center would be created within the Environmental Protection Agency. “The Center will increase innovative financing support for communities to sustain their water, wastewater and stormwater infrastructure. This Center is part of the President’s Build America Investment Initiative – a government-wide effort to increase infrastructure investment and promote economic growth by creating opportunities for state and local governments and the private sector to collaborate, expand public-private partnerships, and increase the use of federal credit programs,” said Kenneth Kopocis, deputy assistant administrator in EPA’s Office of Water.

Michael Deane, executive director of the National Association of Water Companies, said the Water Finance Center and QPIBs would provide “an excellent opportunity” for the federal government to help communities that are interested in P3s.

NAWC still wants the volume caps to be lifted for regular water and sewer PABs and is also working with the Treasury to get it to clarify the remedial action rules so that governments can ensure the bonds they used to finance water facilities remain tax exempt if they enter into P3s.

The President also signed a memorandum Friday to align federal funding by several federal agencies for planning and predevelopment for the early phases of infrastructure projects.

Obama will also urge Congress to increase funding for transportation infrastructure along the lines of the four-year, \$302 billion Grow America Act the administration proposed in 2014.

“Private capital is not a substitute for public investment,” the White House statement said in its fact sheet.

THE BOND BUYER

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Kyle Glazier contributed to this story