
SIFMA: All Bonds Used for Publicly Accessible Infrastructure Should be Treated as GOs.

WASHINGTON – Preserving the tax exemption for municipal bonds, treating private activity bonds more like governmental bonds without restrictions for publicly accessible projects, and reviving direct pay bonds are some of the infrastructure funding recommendations that the Securities Industry and Financial Markets Association has made to administration officials and members of Congress.

The group also has recommended using tax credits as incentives for equity investors, promoting design-build strategies for public projects, and making infrastructure assets and liabilities more transparent in state and local government financial statements, Michael Decker, SIFMA managing director and co-head of the municipal securities division, said in a recent podcast with The Bond Buyer.

The recommendations were developed by a SIFMA task force led by Chris Hamel, head of U.S. municipal finance at RBC Capital Markets, and Suzanne Shank, CEO and chair of Siebert Cisneros Shank & Co.

"At the top of our list is preserving the tax exemption," said Decker. "Tax exemption for municipal bonds is the single most important tool that public sector infrastructure developers have. Bonds have financed 75% of the infrastructure in this country and there is a real threat, a real risk that in the context of tax reform or through some other legislative vehicle on Capitol Hill Congress could curtail or eliminate the tax exemption. [That] would drive up the cost of infrastructure finance and we'd end up with less, not more, new project investment."

A second recommendation is to expand the use of tax-exempt private activity bonds for public-private partnerships. Most P3s involve layers of capital, Decker said. One approach might be to have some equity as a base-level of investment, then some debt financing, and then perhaps some capital from the public sector partner. But under current tax law, tax-exempt PABs can only be used for certain specified categories of projects and are typically subject to volume cap limitations and private use restrictions. In addition, the interest from PABs is subject to the alternative minimum tax.

"Under our proposal, bonds issued for infrastructure, regardless of whether it is a purely public project or a P3, would be treated as governmental tax-exempt bonds without volume restrictions, no AMT, no private use restrictions, as long as the project being financed falls under the definition of publicly accessible infrastructure," Decker said.

SIFMA wants to revive direct-pay bonds structured similarly to Build America Bonds, which were issued as taxable bonds in 2009 and 2010, where issuers receive subsidy payments from the Treasury Department in lieu of investors receiving tax-free interest. These bonds broaden the universe to corporate investors for munis.

The group suggested tax credits or some other type of incentives to attract equity investors in P3s.

“If you look at the story of equity investment in other sectors like renewable energy or low-income housing, tax credit programs in those areas have been very successful in driving capital to those sectors and we think the same could be true for infrastructure,” Decker said.

SIFMA also wants to promote the use of a design-build approach for public projects, where one entity – a design-build team – works under a single contract with the project owner to provide design and construction services.

“That’s a successful procurement strategy in the public-private arena and we think that there are some efficiencies to be gained by using a design-build approach in the public sector development area,” Decker said.

SIFMA also would like some accounting issues addressed so that the full cost and value of developing infrastructure is shown on a state or local government’s annual financial statement to demonstrate the value of infrastructure to the community as well as any accumulated maintenance or expenses the government may be carrying.

“It would help identify, just from a transparency perspective, the true cost of the asset,” Decker said. “From a management perspective, it might help identify the assets or areas of investment at the state or local level that the government might not view as a priority where they might be interested in re-deploying capital that’s invested in one area into new infrastructure.”

It is somewhat ironic that infrastructure advocates are pushing for eased restrictions for the use of PABs in infrastructure or more restrictions for tax-exempt bonds. A few years ago and still today, critics decry the use of tax-exempt PABs to finance professional sports stadiums. Former House Ways and Means Committee chairman Rep. Dave Camp, R-Mich., proposed a tax plan that would have halted issuance of PABs. Former President Obama proposed capping the value of tax exemption for munis.

“Our message on this to policymakers is, ‘You’re digging a hole for yourselves. Why curtail or eliminate an existing successful tool that’s already resulted in trillions of dollars of infrastructure investment when you’re trying to promote infrastructure, not constrain it,’” Decker said.

“I think the current administration thinks infrastructure is, at least in part, part of a broader industrial or economic policy,” Decker said. ”You’re heard the president talk about reviving the manufacturing sector, returning American jobs to this country, getting companies to invest here rather than abroad. So if they’re trying to promote industrial development in a particular area, one way to do that is to ensure there’s infrastructure with sufficient capacity to support the economic development that will arise.”

Asked about critics who complain that the president only seems to be interested in big, shiny, costly P3 projects that may take years to develop, Decker said, “There are needs at so many levels.”

“We do need help with big transformational kind of cutting-edge infrastructure projects,” he said, pointing to proposals to further develop LaGuardia Airport as an example. “Then there’s street light repairs or replacing an on-ramp to a freeway, projects that are much smaller in scope that have a much more local impact,” he said, adding, “I would urge the administration to think about providing funding or enhancing funding for all levels of infrastructure development.”

Asked about projects that don’t have revenue streams, Decker said, “in terms of P3s there’s an emerging model that provides at least one approach to those kinds of projects and that is availability payments.”

“The way this works is, for a project that’s non-revenue generating, the state or local government would solicit bids from private sector developers under a standard kind of P3 arrangement – finance, build, own, operate, maintain – the full range of turnkey service that P3 infrastructure operators provide,” Decker said. “But rather than the developer being paid from revenues derived from the project, the developer is paid directly by the governmental partner-sponsor in the project through availability payments.”

The payments would depend on the project continuing to meet operational specifications that were decided at the time the P3 agreement was reached, he said.

“So that means the private developer is responsible for ensuring that the project is operating at capacity and that, in terms of maintenance and repairs, it’s in sound condition,” he continued. “The developer doesn’t get paid unless the project is performing to spec.”

“It’s an interesting approach,” Decker said. “It could potentially reduce the cost to the state or local government, but there are other elements in play too. For example … it allows that local government to lay off some risk of maintaining and operating the project at capacity. It also gives the local government leverage over the developer and avoids the risk that the government might defer operation and maintenance costs in a tight budget situation.”

Asked if he can crystal ball the timing for an infrastructure plan and the interplay between it and tax reform or even health care, Decker said: “They’re somewhat related in terms of process. Congress’ time is somewhat limited.

[Members] can only take on so many very large legislature issues in a given year because they’re so time consuming.”

“In the discussions we’ve had with key members of the administration, infrastructure continues to be at the top of their list,” he said. “I think the administration wants to be able to point to some legislative wins going into the 2018 congressional election. But I can’t tell you in terms of timing how all of this is going to play out.”

Asked about the prospects for infrastructure being wrapped into tax reform, Decker said, “It depends on what the infrastructure proposal looks like.”

He noted that virtually all of SIFMA’s recommendations deal with changes to the federal tax code and said, “I think it’s most efficient to deal with tax proposals in a single legislative vehicle, but that may not be how it ends up.”

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