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Whiplashed Planners Fear GOP Swerve on Infrastructure.

After close call on public-private financing tool, all eyes on 2018

Los Angeles has gained national notice for a series of ambitious projects affecting all facets of southern California's transportation network, from the city's light rail system to Los Angeles International Airport.

Many of the projects — a multibillion dollar expansion of the airport, work on roads leading to and from the busy ports of Los Angeles and Long Beach and a new light rail line, among others — were or will be financed with a tool called private activity bonds.

Known as PABs by those who use them, the bonds are issued by public-sector authorities to raise tax-exempt financing for private entities doing a project with a public benefit. Buyers of the bonds don't have to pay tax on the interest income, allowing the issuer to borrow at a lower rate than would otherwise be available.

But Republican lawmakers sent a shudder through the groups that rely on the financing tool by proposing to eliminate the tax exemption in versions of the tax overhaul bill cleared by Congress just before Christmas.

"I think surprised is an understatement," said Annie Russo, vice president of government affairs at Airports Council International-North America, a Washington group that describes itself as "the voice of airports."

Congress eventually decided to keep the exemption, but the proposal to do otherwise put a spotlight on the importance that stakeholders give to private activity bonds. The proposal, which originated in the House tax bill and wasn't matched in the Senate version, also raised questions about what could be included in Republican plans for infrastructure legislation in 2018.

President Donald Trump campaigned on a pledge to spend $1 trillion on infrastructure over 10 years. He had said most of that would come from the private sector, but has more recently been quoted saying he doubts the value of public-private partnerships. The administration is expected to deliver a plan early this year.

In and out of Washington, some who work in the transportation sector had hoped the tax bill would include provisions to help pay for infrastructure projects, or at least provide incentives for the private sector to do more. At one time in the run-up to the tax bill, Republicans even talked about encouraging corporations to repatriate profit held abroad and steering that money into infrastructure projects.

So the House Republicans' proposed treatment of private activity bonds caught the industry off guard. Some saw the potential for hundreds of millions of dollars in additional interest costs on projects already underway. The House summary of its tax proposal — referring to the exemption as a giveaway — rang alarm bells on Republican thinking about the future.

According to Adam S. Wallwork, a public finance lawyer at Ballard Spahr, private activity bonds are a $102-billion-a-year business, representing 20 percent of the tax-exempt bond market.

Flying high on PABs

Airports in particular rely on private activity bonds for work on terminals.

Under the last major tax code rewrite in 1986, commercial U.S. airports — despite being almost universally owned and operated by public entities with bond-issuing authority — cannot issue standard municipal bonds for improvements to terminals because they benefit private companies like airlines and shops and restaurants.

But airport terminals have a clear public benefit, and therefore qualify for tax-exempt private activity bonds.

"Almost any" expansion or renovation of an airport terminal is financed through private activity bonds, Russo said.

Several parts of the Los Angeles airport's multibillion-dollar overhaul — including a $5.5 billion "automated people mover" to connect the airport terminals to the city's transit system, a new 18-gate international terminal and major renovations to other terminals — were financed through private activity bonds.

Mark Waier, director of communications for the Los Angeles airport, said PABs would finance about $5.1 billion of the roughly $8 billion of spending remaining to complete the project. Losing the tool could add $500 million just to interest payments on that total, he said.

Waier won't speculate on how the loss of that financing would affect the project, but said it would require either a new source of revenue or a smaller scope of one or more components of the program.

"If this was eliminated, we would need to either identify new sources of revenue or make a reduction to scope that would equate to $500 to $550 million out of our capital investment plan," he said.

A tool for transit

Unlike airport terminals, public transit systems haven't traditionally relied on private financing for expansions, but major projects in recent years included private partners, making private activity bonds an option for funding. Transit agencies that now have access to federal Transportation Infrastructure Finance and Innovation Act, or TIFIA, loans and local payments would be better positioned to work with a private partner.

"It's one more tool in the toolbox," said Rob Healy, vice president of government affairs for the American Public Transportation Association.

Denver's $2.2 billion Eagle public-private partnership project combined a number of development options. The project, which added two new light rail lines and the starting component of a third, got the bulk of its funding through a 2011 $1.03 billion grant from the Federal Transit Administration.

But its second-biggest source was private activity bonds, which provided $398 million for the project, according to the Department of Transportation. Other funding and financing sources for the Eagle project include new sales tax revenues, a TIFIA loan, other federal grants and private equity contributions.

A furious response

The House proposal to drop the tax exemption engendered a backlash in part because it contradicted one of Trump's early ideas for an infrastructure package — incentives for private sector involvement.

Private activity bonds have been used for "pretty much every project" that's part of a public-private partnership, said Robert Puentes, president and CEO of the think tank Eno Center for Transportation. So far, PABs have worked well and without much controversy. Taking them away wouldn't serve anyone's interest, he said.

"It doesn't seem to serve any public interest to get rid of it at this point, unless there are some kind of egregious problems," Puentes said. "But it's the opposite that we're seeing."

The near-universal outcry from infrastructure stakeholders that greeted the House proposal on PABs produced some echoes on Capitol Hill.

Senate Commerce, Science and Transportation Chairman John Thune, a South Dakota Republican who served on the conference committee that negotiated the final tax bill, told reporters during negotiations that PABs had fierce support in both chambers, leading to the removal of the House provision.

That account was backed up by a Dec. 13 letter from 39 House Republicans calling for members of the conference committee to protect private activity bonds. The letter nodded at Trump's onetime proclamation that private sector money would be a key part of his infrastructure plan.

"Given the administration's stated priority for increasing investment in infrastructure, we believe the elimination of tax exempt private activity bonds would be a step in the wrong direction toward fulfilling the president's goal," they wrote. "In fact, it will make infrastructure projects more expensive."

But the criticism of private activity bonds in some ways aligns with the critique of public-private partnerships generally. The difference is that Republicans were the critics of the interest exemption on PABs, while Democrats are more likely to criticize proposals that turn public infrastructure assets over to private operators in exchange for investment.

A summary of the original House proposal said PABs were essentially a giveaway to private interests that created an uneven playing field.

"The federal government should not subsidize the borrowing costs of private businesses, allowing them to pay lower interest rates while competitors with similar creditworthiness but that are unable to avail themselves of PABs must pay a higher interest rate on the debt they issue," the summary said.

The House proposal may also have failed to split some hairs among Republicans who like the bonds for transportation projects, but dislike their use for things such as sports stadiums and housing.

A 2016 Brookings Institution paper said private activity bonds are sometimes used to finance professional sports stadiums, a popular punching bag for those deriding "corporate welfare."

Small-government conservatives have issues with the use of private activity bonds for housing, which accounts for about 80 percent of the private activity bonds issued, said Marc Scribner, a senior fellow at the libertarian Competitive Enterprise Institute. When used for housing, the bonds can turn into tax breaks for well-connected developers without fixing the fundamental problems driving housing shortages, he said.

But in terms of transportation infrastructure, the bonds encourage private sector involvement, and CEI has supported them for transportation projects, especially highways, he said.

The House bill's solution to scrap the entire private activity bond function would hurt the ability of the private sector to spend on transportation infrastructure, he said. The system could be improved, but eliminating private activity bonds completely would be a mistake, tantamount to "throwing the baby out with the bath water," Scribner said.

"If you want to increase the private sector in the provision of public-sector infrastructure, eliminating private activity bonds is a really bad way to do that," he said.

The measure was "not very well thought out and certainly not thought out in terms of broader goals outside of tax issues," he said.

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by Jacob Fischler

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