Bond Case Briefs

Municipal Finance Law Since 1971

Congress Considers Additional Support for Tax-Exempt Issuers and State and Local Infrastructure Projects during COVID-19 Recovery.

Two bills from the House of Representatives (H.R.2, the Moving Forward Act, and H.R.3967, the Municipal Bond Market Support Act) and two from the Senate (S.4203, the American Infrastructure Bonds Act, and S.4129, the Lifting Our Communities through Advance Liquidity ("LOCAL") for Infrastructure Act) could have significant effects on state and local government bond issuers and developers of infrastructure, if enacted, as lawmakers continue to address financial hurdles facing issuers related to the COVID-19 pandemic. This alert will discuss some of the significant provisions of each bill and how each could affect state and local government issuers, as well as certain 501(c)(3) conduit borrowers.

H.R.2, the Moving Forward Act
On June 30, 2020 the House of Representatives voted to pass H.R.2 the Moving Forward Act. The 2,300 page bill dedicates $1.5 trillion over the next five years to dramatically improve and develop American infrastructure.

The Moving Forward Act introduces taxable "qualified infrastructure bonds," under which the Treasury Department would make direct payments to issuers to offset a portion of the interest paid by issuers on such bonds. Under the Moving Forward Act, a qualified infrastructure bond is a bond (1) that would otherwise be exempt from taxation under existing IRS rules and (2) which 100% of the net proceeds are to be used for capital expenditures or operations and maintenance expenditures in connection with capital expenditures. This program is similar to the Build America Bonds program that expired in 2010. The direct payments would begin at 42% of the interest on the bonds, decreasing over seven years to 30%.

The Moving Forward Act proposes the reinstatement of tax-exempt advance refundings, which were eliminated after the passage of the Tax Cuts and Jobs Act of 2017. In addition, the Moving Forward Act would also nearly double the annual volume cap on Private Activity Bonds allotted to the states. Finally, the legislation would greatly expand the New Markets Tax Credit and the Historic Tax Credit programs.

S.4129, the LOCAL Infrastructure Act
On July 1, 2020, Mississippi Senator Roger Wicker introduced S. 4129, the LOCAL Infrastructure Act. The LOCAL Infrastructure Act, like the Moving Forward Act, proposes the elimination of the Tax Cuts and Jobs Act 2017's repeal of tax-exempt advance refundings. It would permit issuers to refinance certain outstanding obligations while maintaining their tax-exempt status. These actions could, potentially provide significant cost savings that issuers could use to fund additional infrastructure, education, healthcare, or other capital improvements.

S.4203, the American Infrastructure Bonds Act
On July 8, 2020, Senator Wicker and Colorado Senator Michael Bennet introduced S.4203, the American Infrastructure Bonds ("AIB") Act, a bipartisan bill which substantially expands upon the

“qualified infrastructure bonds” provision of Moving Forward Act.

Under the AIB Act, state and local governments would be permitted to issue taxable American Infrastructure Bonds (“AIBs”) for any public expenditure that is eligible to be financed with tax-exempt bonds. This program is also modeled after the Build America Bonds program. However, unlike the Moving Forward Act, proceeds of AIBs are not limited to expenses related to capital expenditures, permitting issuers to use bond proceeds on a wide array of public projects. However, the direct payments under the AIB Act are slightly less than under the Moving Forward Act, beginning at 35% of the interest on the bonds, decreasing over six years to a revenue neutral 28%.

H.R.3967, the Municipal Bond Market Support Act

A fourth bill introduced in the House last year also could provide additional support for certain non-profit and small issuers in their COVID-19 recovery. H.R.3967, the Municipal Bond Market Support Act, introduced by Alabama Representative Terri Sewell and New York Representative Tom Reed in July 2019, would increase the annual limit for certain bank qualified borrowing for small issuers and increase the availability of tax-exempt debt for 501(c)(3) organizations.

Section 265 of the Internal Revenue Code currently permits issuers that issue less than $10 million in tax-exempt obligations annually to designate certain bonds as “qualified tax-exempt obligations.” This designation provides an incentive for banks to purchase debt of these “qualified small issuers” by permitting the banks to deduct 80% of the carrying costs of these obligations. These bonds typically bear interest at lower rates due to their attractive tax-exempt status.

Two large hurdles make taking advantage of qualified tax-exempt obligations particularly difficult for many small issuers. First, the $10 million dollar limit has not been indexed for inflation since its enactment in 1986, meaning that over time, many issuers have become too large to qualify as a qualified small issuer. The bipartisan Municipal Bond Market Support Act proposes to adjust the limit up to $30 million in annual tax-exempt debt and index the limit to inflation to prevent small issuers from losing their qualified status over time.

Second, 501(c)(3) borrowers of tax-exempt conduit issues are pooled together in determining if the conduit issuer may designate the issue as a qualified small issue. The act proposes to count each 501(c)(3) conduit borrower as a separate issuer for purposes of determining whether conduit debt may be designated as qualified tax-exempt obligations. This change would substantially increase the number of nonprofit organizations able to take advantage of the program.

Conclusion

Each of these legislative items could prove helpful for issuers that have been forced to put critical infrastructure projects on hold due to capital markets drying up in the wake of COVID-19 by increasing the number of prospective investors in their obligations. Ultimately, these bills reflect Congress’s continued efforts to stimulate state and local economies throughout the country. The bipartisan support of these bills strongly suggests that some form of additional support is likely forthcoming, and issuers should maintain contact with their bond counsel and advisors in order to stay prepared for any enacted legislation.

Frost Brown Todd LLC

Authors: Denise Y. Barkdull David A. Rogers Michael D. Elliott Michael A. Brockman Emmett M. Kelly

Jul 16, 2020

For updates on the status of the proposed legislation or other information on tools available to government issuers to address financing and cash flow issues related to COVID-19, contact Denise Barkdull, David Rogers, Emmett Kelly, Michael Elliott, Michael Brockman, or any attorney in Frost Brown Todd's Public Finance industry team, Government Services practice group or the Public-Private Partnerships (P3) industry team.