# Bond Case Briefs

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## SIFMA Muni Month: Advocating for Change to Fund Our Nation’s Infrastructure

Municipal bonds are a critical funding source of infrastructure in America. Munis finance the bridges, roads, schools, health care facilities, water and sewer facilities, airports and seaports our communities rely on. Building, maintaining and improving our infrastructure creates jobs and facilitates economic growth.

For example, in 2020, the Colorado Housing & Finance Authority issued $878 million of municipal bonds, and the Las Vegas Valley Water District $344 million.

The total amount of municipal bonds outstanding stood at $3.9 trillion at the end of the third quarter of 2020, which represents 7.8% of the total U.S. fixed income markets. Total issuance of municipal bonds in 2020 was $475.5 billion, an increase of 10.9% over 2019, and our members forecast 2021 issuance to be $502 billion. The three-year annual issuance average is $416.2 billion, which demonstrates the current strength of the market. 45.2 % of municipal bond investors are individuals, while 26.5% are held by mutual funds, which are held by individuals or asset managers on behalf of their investors. Municipal bonds are a popular investment option for those looking to preserve capital while earning interest, and most municipal bonds are tax-free at the federal if not the state and local levels. There are many benefits to this market not the least of which is the role it plays in infrastructure investment.

After decades of underinvestment, the U.S. faces an extraordinary infrastructure deficit. State and local capital investment has fallen from three percent of GDP in the late 1960s to less than two percent in 2014. The American Society of Civil Engineers (ASCE) estimates that the U.S. needs to invest $4.6 trillion in infrastructure by 2025 to replace failing facilities and maintain the capacity needed for a growing economy and population.

The impact of aging infrastructure on the U.S. economy is significant. The ASCE also estimates that the U.S. economy is expected to lose just under $4 trillion in GDP between 2016 and 2025 if the government does not invest in our infrastructure, 2.5 million American jobs will be lost.

SIFMA has designated this February “SIFMA Muni Month” during which we plan to meet with members of Congress and work with our state and local government and industry partners to advocate for ways to address the spending shortfall and the critical need to fund the restoration and improvement of our nation’s crumbling infrastructure. While we consistently engage on these issues, bringing a viewpoint which encompasses the breadth of the market with our broker-dealer, investment bank and asset manager members, the focus on infrastructure by the new Administration makes this a particularly timely topic for a concerted outreach to both newly elected and existing members of Congress.

We firmly believe that it is important to share our ideas and legislative initiatives with policy makers so that they are aware of programs which would benefit their constituents and local areas. Legislation which includes necessary financing tools is particularly needed now, when state and local governments are facing unprecedented expenses due to the COVID-19 pandemic.

Many of the legislative issues we are advocating for will reduce the cost of funding for state and local bond issuers and can result in additional bonding capacity to fund critical infrastructure, benefiting taxpayers and the local economy. Additionally, infrastructure investment and in particular tax-exempt bonds can be a key component to green finance. State and local governments are increasingly turning to municipal green bonds to finance projects which align with environmental, social and governance (ESG) goals. For example, the South Davis Sewer District in Utah issued bonds in 2017 for a project to convert organic waste into renewable natural gas for sale to power plants. The $43 million project is expected to generate enough electricity to power 25,526 average U.S. homes and reduce carbon dioxide emissions equivalent to taking 36,515 cars off the road.

President Biden has made infrastructure investment a key component of his agenda. We support these efforts and the related economic growth and job creation.

As part of SIFMA Muni Month we will advocate for changes which would allow for increased infrastructure spending:

1. Secure the passage of legislation to permit issuers to advance refund their municipal debt on a tax-exempt basis;
2. Authorize a new direct payment bond program on a permanent basis;
3. Expand the volume cap and uses for Private Activity Bonds (PABs); and
4. Increase the annual limit on the amount of tax-exempt obligations that may be issued to qualify for the small issuer exception to the tax-exempt interest expense allocation rules.

In addition, we continue to believe 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.

*Advance refunding* is an important financial management tool which, prior to its elimination in the Tax Cuts and Jobs Act, allowed state and local governments to save billions in interest costs by using proceeds from one bond issuance to pay off another outstanding bond. The new bond was then be issued at a lower interest rate than the older unpaid obligation.

By reducing their debt service expenses through tax-exempt 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—much like homeowners refinance their mortgages to lower costs. We strongly support restoring tax-exempt advance refundings to help state and local governments efficiently manage their financial obligations.

*Taxable direct pay bonds* may attract a significant pool of capital from long-term investors, such as pension funds and insurers who have a substantial appetite for long duration assets to match their liabilities. While traditional municipal bonds are tax-exempt, the interest on direct pay bonds is taxable, with the issuer receiving a refundable tax credit for a portion of the interest costs. For example, in 2009 and 2010, the federal government authorized the “Build America Bond” program whereby states and localities issued bonds with taxable interest instead of tax-exempt interest and received a partial reimbursement for their interest expense.

We believe that Congress should authorize a new direct pay program on a permanent basis as a supplement to, not a replacement for, tax-exempt bonds. This program should be structured such that reimbursements to borrowers are not affected by budget sequesters.

*Private activity bonds* are issued by state and local governments on behalf of private borrowers for a limited list of uses. We support expanding the use of private activity bonds for infrastructure. However, because this issuance comes with significant restrictions like volume limitations and application of the alternative minimum tax, which raises the cost of financing for each project, we believe that state and local governments should be able to issue tax-exempt bonds for infrastructure projects with private participation in the same manner as they issue bonds for purely public projects.

*The small issuer exception program* offers a proven incentive for local banks to purchase the tax-exempt debt of small local governments and borrowers, such as small colleges, health care facilities, and charities. The current limit, set at $10 million, has not been increased since 2010 and should be increased and adjusted for inflation in future years.

Our national infrastructure challenges are so complex and large that a single solution is not enough. With existing federal infrastructure programs failing to meet current demand, the U.S. is continuing the troubling trend of under-investment 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. SIFMA strongly supports providing incentives to rebuild our nation's infrastructure and we encourage policymakers to explore funding options to address this crisis.

February 1, 2021

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