NATIONAL ASSOCIATION OF STATE TREASURERS

STATEMENT OF

THE HON. RACHAEL EUBANKS
TREASURER
STATE OF MICHIGAN

DELIVERED BEFORE:

THE HOUSE COMMITTEE ON WAYS AND MEANS

"LEVERAGING THE TAX CODE FOR INFRASTRUCTURE INVESTMENT"

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The Hon. Rachael Eubanks
Treasurer
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Good morning, Chairman Neal, Ranking Member Brady and members of the Committee. My name is Rachael Eubanks and I am the 47th Treasurer for the great State of Michigan. My remarks today are delivered as a member of the National Association of State Treasurers (or "NAST"), which represents the nation's state and territorial treasurers as well as other statewide finance officers with comparable duties and responsibilities. I want to thank you all for holding today's hearing on such an important topic and for inviting me to speak on behalf of my colleagues across the nation.

NAST serves as an authority on state finance issues and related state treasury programs, practices and policies. We serve our members through educational conferences and virtual learning experiences, a variety of working groups, policy advocacy and publications that provide information about developments in public finance. We enable state finance officials to pursue and administer sound financial practices and programs benefiting our shared constituencies. NAST also hosts the State Debt Management Network, which is a group of about 150 managers of statewide debt issuances. I am honored to serve as the Network's vice chair this year alongside my friend and colleague, Treasurer Zach Conine of Nevada.

As the stewards of our states' finances, treasurers know that if America is truly committed to addressing our infrastructure needs, it will take both funding and financing tools. We also know that state and local governments already fund and finance the lion's share of our national infrastructure network. Specifically, state and local governments contributed more than 75 percent of public capital and operations spending on transportation and water infrastructure in recent years.[1] We have long leveraged the municipal bond market to finance those capital contributions. I am honored to be here today to share a bit more about how various bond proposals before this Committee could be transformative in helping state and local governments play a role in our infrastructure solutions. I plan to elaborate on specific policies and tools, but I would first like to make a few general points:

- One: The tax-exempt treatment of municipal bonds is a critical keystone of our federal-state system that enables state and local governments to finance our infrastructure network at reduced cost. As such, the tax-exemption should be maintained and protected at all costs, and we welcome the chance to discuss ways in which we can expand and improve how we

[1] Congressional Budget Office (CBO). "Public Spending on Transportation and Water Infrastructure, 1956 to 2017." October 2020. Web Access: https://www.cbo.gov/publication/54539

finance infrastructure in the United States. We appreciate that Congress has recognized that importance and maintained that tax-exempt treatment through the more than one hundred years of the tax code.

- Two: I am here today to discuss and focus on potential finance tools that would act as a multiplier for the federal government's investment in infrastructure. While these tools are essential, it is also worth noting that our infrastructure needs as a nation are great. If we are to truly close our infrastructure deficit, we will need both funding AND finance solutions.

- Three: While states and local governments are grateful for the much-needed fiscal aid included in various coronavirus response packages, such aid represents one time, "shot in the arm" rescue policy and does not negate the need for long-term stable financing tools.

About Municipal Bonds

Municipal bonds make up a nearly $4 trillion market that has long served to meet the capital finance needs of states, local governments and nonprofits— as well as a stable investment for American investors.[2] The vast majority of the infrastructure we use and take for granted each day has been financed through municipal bonds. Everything from the roads and bridges we drive on; the mass transit we ride on; the waterlines we drink from; the powerlines we plug into. Municipal bonds also finance other public services from airport expansions, universities and research labs, affordable housing projects and much more.

In Michigan— the State issues bonds under various financing authorities for a variety of purposes. General obligation full faith and credit bonds and notes are issued for environmental and natural resource protection, recreation and school loan purposes. The State Building Authority (SBA) issues revenue bonds to finance the construction of facilities used by the State and universities. As of September 30, 2020, the SBA had $2.9 billion in outstanding debt. The Michigan Department of Transportation issues revenue bonds for various transportation related purposes. As of September 30, 2020, MDOT had approximately $1.75 billion in outstanding debt. The Michigan Finance Authority (MFA) issues limited obligation bonds to finance loans to private or nonpublic, nonprofit institutions of higher education, qualified public or private educational facilities and healthcare providers for capital improvements. As of September 30, 2020, MFA had $10.8 billion in outstanding debt.

Even in current markets where spreads are tight, the tax-exemption on municipal bonds continues to lower the borrowing cost of infrastructure for our states and local governments. This core principle is built into the financial models and assumptions of virtually every state and local government. Without the exemption, our shared constituencies, the American taxpayer, would ultimately bear the added borrowing costs.

[2] https://www.sifma.org/resources/research/us-municipal-bonds-statistics/

Bond Financing Proposals

Members of Congress, including members of this Committee, have put forth several proposals on how municipal bonds could be further strengthened as a financing tool to spur additional infrastructure investment.

> Tax-Exempt Advance Refunding Bonds: Prior to 2018, state and local governments could refinance outstanding municipal bond debt prior to the call date on a tax-exempt basis by issuing an "advance refunding bond." The tool allowed issuers to take advantage of lower interest rate environments or more favorable covenants to lower borrowing costs, achieve savings, and ultimately free up public capital for additional infrastructure investment. In a consumer context, it is much like refinancing your home when rates drop – in our case we save our taxpayers money and have more to invest in infrastructure when we complete advance refundings.
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> From 2007 to 2017, the State of Michigan, our local governments and school districts within Michigan issued more than 586 advance refunding bond issues, amounting to a total par amount of over $15.4 billion. Of this total, local governments and school districts issued 551 advance refunding bonds totaling over $8.3 billion in par amount and the State issued over 35 advance refunding bonds totaling over $7 billion in par amount. Assuming the refundings achieved an average of 5% net present value savings to refunding bonds, these advance refundings state-wide would be estimated to have saved Michigan taxpayers over $771 million in borrowing costs. Under these assumptions, of the total, local governments and school districts would have saved over $418 million in borrowing costs and the State would have saved over $353 million in borrowing costs.
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> In that same time, nationally, state and local governments issued more than 12,000 advance refunding bonds to save a minimum of $18 billion in borrowing costs.[3] Those lower bond estimates represent real savings that freed up capital for greater infrastructure investment. Absent the ability to advance refund on a tax-exempt basis, issuers have turned to taxable or forward alternatives that may still generate some degree of savings, but still deny issuers the full benefit previously allowed by the tax code. Furthermore, as rates normalize in the future, issuers will be left with less options to refund prior to call dates.
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> Restoring the ability for state governments to advance refund tax-exempt municipal bonds would better allow state governments to adjust to market changes and free up billions of dollars in borrowing costs that could otherwise be spent on infrastructure projects. Above all else, municipal issuers believe the restoration of tax-exempt advance refunding bonds would be the most effective financing tool for spurring additional, sustainable and continued infrastructure investment.

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[3] Government Finance Officers Association (GFOA). "Frequently Asked Questions: Advance Refunding of Municipal Bonds." Web access: https://gfoaorg.cdn.prismic.io/gfoaorg/eda63e83-f12f-4a6b-806e-2061309f8a2d_2020+AdvRef+MythBuster.pdf

NAST supports several bills that would restore tax exempt advance refunding bonds, including:

- The *Investing in Our Communities Act* (H.R. 2288) introduced by Representative Dutch Ruppersberger (D-MD) and Steve Stivers (R-OH).

- The *LOCAL Infrastructure Act* (S. 479) introduced by Senators Roger Wicker (R-MS) and Debbie Stabenow (D-MI).

- The *Local Infrastructure Financing Tool (LIFT) Act* (H.R. 2634) introduced by Representative Terri Sewell (D-AL), which would also expand bank qualified debt and create a direct subsidy bond program.

<u>Bank Qualified Debt / Small Issuers Exemption</u>: The federal tax code generally disincentivizes banks from investing in municipal securities by severely limiting their abilities to deduct the carrying cost from their taxable income. An exception exists for banks holding bonds from small issuers, which are defined as those issuing under $10 million per calendar year. Issuers of bank qualified debt are small communities that may traditionally struggle to access the larger market. Furthermore, issuers of bank qualified debt tend to save between 25–40 basis points on transactions.[4] This tool has tremendously helped smaller communities access credit directly from community and regional banks, but the $10 million threshold has not been adjusted since 1986.

Various policies have proposed modernizing this provision by 1) raising the threshold for small issuers to $30 million per calendar year; 2) indexing the threshold to the rate of inflation for future years; and 3) applying the threshold to borrowers and not issuers to help smaller conduit borrowers, such as small hospitals and educational institutions, access this helpful tool. Taken together, these changes would greatly expand the number of small issuers who could access this cost saving financing tool. While NAST does not have an official policy on this proposal, State Treasurers and state debt managers generally find it to be good policy that would particularly support smaller and rural communities in our states.

- The *Local Infrastructure Financing Tool (LIFT) Act* (H.R. 2634), introduced by Representative Terri Sewell (D-AL), would expand bank qualified debt as described above.

<u>Direct Subsidy Bonds</u>: Unlike traditional municipal bonds, direct subsidy bonds are taxable, but include a federal subsidy to the issuer worth a portion of the interest costs. In theory, the taxable nature of these bonds come with higher interest rates that are attractive to a larger

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[4] https://www.gfoa.org/bank-qualified-debt

buyer class similar to that in the corporate market. The federal subsidy compensates the issuer for the added interest costs. It is important to note there are other differences in the way the market structures taxable bonds, such as they are often shorter in duration and are often bullet maturities – meaning the principal is paid at the end of the duration of the bond, and have less favorable call features, making it more difficult for issuers to take advantage of favorable future interest rates. These distinctions mean that direct subsidy bonds can supplement but not replace tax-exempt bonds, and that often a combination may be appropriate depending on the timeline and characteristics of the project being financed.

The American Recovery and Reinvestment Act (ARRA) of 2009 created a temporary bond financing program for issuers known as Build America Bonds (BABs). The program sunset in 2010. These bonds came with a 35 percent subsidy to issuers that helped spur infrastructure investment during the height of the recession. The Budget Control Act of 2011 (BCA) enacted mandatory spending cuts (sequestration) in 2013 that included a drastic reduction to BAB subsidies that continues to challenge certain issuers.

Currently, there are a few proposals that would create a new iteration of direct subsidy bonds, including:

- *The Local Infrastructure Financing Tool (LIFT) Act* (H.R. 2634), which was introduced by Representative Terri Sewell (D-AL), would create an American Infrastructure Bond (AIB) program that would come with an initial subsidy of 42 percent for bonds issued through 2024 and would ramp down to 30 percent for bonds issued in 2027 or thereafter.

- The *American Infrastructure Bond Act* (S. 1308), which was introduced by Senators Wicker (R-MS) and Bennet (D-CO), would create a slightly different version of a direct subsidy bond program that comes with a static 28 percent subsidy and an exemption from future sequestration.

While direct subsidy bonds would be a welcomed back added tool for state and local finance, municipal issuers remain concerned of the ongoing threat of sequestration. In order to ensure that a new iteration of a direct subsidy bond program is actually utilized, it must include an added level of legislative assurance that future subsidies will not be altered. NAST supports efforts to bring back direct subsidy bonds, but urges Congress to address the inevitable uncertainty caused by future sequestration threats and to understand that such a program would complement, rather than replace, the traditional tax-exempt municipal bond.

Private Activity Bonds: Qualified private activity bonds (PABs) provide tax-exempt financing to certain infrastructure projects that serve a public purpose but may be held by a private user or backed by private proceeds. These bonds are critical in funding public good projects such as airports, hospitals, affordable housing, economic development projects, private universities and research facilities, and more. Issuers are limited, however, in their capacity to issue PABs for certain projects by volume caps allocated across the states each year. Many states exhaust their allowed volume of PAB issues and would benefit from an expanded cap or the exemption of certain qualifying projects from the volume limit.

There have been a number of proposals to expand PABs, including exempting certain qualifying projects from volume caps, such as those for green energy purposes, or altering the formulas used to calculate caps. While NAST does not have official policy beyond protecting the current tax treatment of PABs, efforts to expand PABs would spur greater infrastructure investment in regions where volume caps are a limiting factor.

Conclusion

We appreciate the opportunity to weigh in with some of our collective thoughts on various infrastructure tax and bond policy proposals. Please continue to turn to NAST and our members as a resource. We look forward to continuing to work with Committee members and staff on these critical issues to state and local finance. I now look forward to answering your questions. Thank you.