Putting Projects in Motion

State bond banks and conduits are the wheel that needs no reinvention

BY MATT POSNER

Two pieces of historic legislation passed in the last three years has the White House and Congress committing more money to public projects and infrastructure than any presidential administration going back to the New Deal—nearly a century. Virtually all industries, from transportation to healthcare to housing to broadband, are being transformed as a result. And as state and local governments find ways to participate, state-sponsored financing vehicles such as bond banks, green banks, and/or financing authorities can help them fill an important financing void.

These financing mechanisms are at the ready, and they include market participants that have been capitalizing infrastructure ideas into reality for decades. There is no need to reinvent the wheel in many circumstances. Government officials and their partners use tried-and-true programs, but much more could be done as these bills turn to shovels in the ground.

When it comes to navigating this brave new world of financing, "a lack of a federal concierge service" has become a theme. State and local governments come in many shapes and sizes, and there is an information gap when it comes to the new grants and programs. A slightly more organized approach would be to aggregate the flow of information and the financing mechanisms through state-level government apparatus to the local level applicants—which brings us to the importance of state bond banks and other financing authorities. (See the "What is a state bond bank?" sidebar for more information about what they are and how they work.)

COMMUNITY INFRASTRUCTURE FINANCE

American communities can raise capital to fund state and local government's essential services through the municipal bond marketplace, a $4 trillion dollar collection of governments, bankers, financial advisors, professional investors, and everyday citizens that

Public funding for infrastructure projects through new federal grant programs put an unprecedented focus on climate resilience, requiring that projects address current and potential climate risk.

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collectively raise money for public schools, sewer systems, roads, bridges, and hospitals, among other things. This marketplace is unique to the United States as it allows virtually any local government entity to access capital on its own behalf—a tip of the hat to the federalist tendencies of the nation's founders to see that a centralized federal government did not impede state rights. As a result, the marketplace is made up of tens of thousands of state and local governments, counties, public utility providers, public school systems, healthcare systems, and others that borrow through the marketplace at any given time.

While the marketplace allows any local government to raise capital for public purposes, it does not guarantee the best cost of borrowing. And while regulations are in place to safeguard investors, they don't provide assistance for local government decision-makers. As such, several states recognized that not only could they help lower the cost of capital through pooling multiple governments together, but they could also support communities around their state by providing technical assistance when navigating the marketplace.

THE CURRENT INFRASTRUCTURE LANDSCAPE

With no shortage of criticism about the state of American infrastructure, challenging economic conditions, and a renewed interest in climate-oriented resiliency, the federal legislation has dramatically changed the landscape through two major pieces of legislation in the last three years. While the Inflation Reduction Act (IRA) was partisan in nature, the Infrastructure Investment and Jobs Act (IIJA) was not, which is indicative of the underlying fact that investing in U.S. infrastructure, schools, healthcare systems, and utilities' providers is not a political issue.

Billions of dollars have been spent on programs already, and billions more are expected in the next few years as a result of these bills. This provides an opportunity to focus on building infrastructure to help make our communities more resilient and to address environmental risks. The reality is that the way the United States invests in public projects is unlike any other developed country in the world, and a lot of that has to do with the origins of the country itself. Our prioritization of states' rights plays out in the way in which capital gets allocated to public projects.

It is largely up to state and local governments to make sense of the ways in which funding of infrastructure has changed and identify strategies to capture the newly available federal dollars.

State bond banks and other financing authorities can be efficient distributor of capital through a variety of financial mechanisms; but they are most effective in the way they use the municipal bond market to raise capital for local governments.

FINANCIAL TRANSPARENCY AND BOND BANKS

In 2022, Congress passed the Financial Data and Transparency Act (FDTA) to improve the accessibility and transparency of information published by U.S. financial regulatory agencies. It was created largely in response to concerns that current financial data was difficult to find and understand.

When it comes to ease of access to information, state and local government financial documents can be challenging. This problem is twofold. First, it is rooted in the structure of the marketplace itself as having tens of thousands of obligors that can raise capital through the municipal bond market.[2] The second is that regulators have little purview

While the broad directives are coming from the federal level, it is up to states and local governments to make decisions about what is best for their communities.

over state and local governments per Congressional action in the 1970s that only holds them accountable in cases of fraud.[3] There is a logical reason behind this, as small governments that access the marketplace don't have the same financial resources as a major corporation, and logically, as these governments rarely default on their obligations, the lack of financial transparency has not been a problem.

FDTA caused chagrin among many groups that represent small governments, and currently, we are in the phase of discovery on how exactly these new rules will come to fruition. Still, the concern of these groups is well founded. It looks as though FDTA will require the tens of thousands of local governments that borrow in the municipal bond market to invest in new software and adhere to a new set of protocols that will require more time and resources, and the federal government, to date, has not offered any financial support in adhering to pending requirements.

State bond banks could be leveraged to solve these issues. These entities already uniformly disclose information about the local governments that choose to use their services. Bond banks tend to have a variety of programs that local governments can apply to, depending on the nature of the project that needs funding. It may be a clean water project that matches Environmental Protection Agency (EPA) revolving fund guidelines or a state-specified program that, in turn, has access to a credit enhancement if the loan is qualified. To qualify, the local government must apply and offer information that is then used in some form or another in the eventual disclosure of the bond issue. As such, these bond banks can ease some of the financial reporting burden. They are a natural aggregator of financial data that is more likely to meet the FDTA requirements than what local governments would produce if they go it alone.

With these systems already in place, where available, state bond banks may be a natural fit for some governments being tasked with supporting FDTA-oriented upgrades as the act gets sorted out. To date, we are unaware of any specific efforts to rely on state bond banks to engage in FDTA practices, but bond banks may be in a better position than the broader community to deal with requirements because they are better able to support new disclosure functions.

CLIMATE VOLATILITY AND BOND BANKS

New grant programs have a climate focus that the federal government has never had before. The 2023 White House *National Climate Resilience Framework* says:

"Ensure that public funding requires climate-resilient infrastructure investments. Government at all levels can drive climate resilience of the built environment by adopting the latest consensus engineering standards or encouraging their adoption through funding opportunity requirements for all publicly funded or financed infrastructure projects. Federal agencies should include requirements that all federally funded and financed infrastructure projects address vulnerabilities posed by future climate impacts over the full-service life of the proposed project, and encourage the use of nature-based features to reduce impacts from climate hazards like stormwater flooding. Agencies should also identify ways to further mitigation opportunities after disasters strike, better connecting resilience funding with disaster recovery efforts. When community infrastructure is being rebuilt, there is an opportunity to ensure the increasing risk is considered."

It is hard to marginalize the climate focus in the way infrastructure will be financed in the future. This shift requires consistency among market participants at all levels of government, and the role of state-level actors becomes increasingly important. Intergovernmental coordination is essential when considering the national framework, and financing is going to be needed, given the scope of capital that is needed. The federal grants are a starting point, but tools like securitization from private capital will be needed. And matching securitization through the complex process of quantifying climate issues and infrastructure make it more difficult. State bond banks will be key to this process going forward.

Take the State of Vermont's 2015 economic resilience plan, for example. At 738 pages, it's a lot of information to parse, but this is an effort led by various state agencies to identify climate-related risks and quantify them. These efforts have been used in applying for federal support through existing programs and a template for future efforts. Local governments can use Vermont's quantitative and scientific process to local government loan applications for, say, pre-disaster risk mitigation, that the Vermont Bond Bank is committed to engaging in. The local focus shown here is the type of work that can be used to procure federal funding and securitization, with a state-level concierge to oversee the process.

Another area to consider when reviewing the IIJA and IRA is the considerable research on the distribution of formulaic federal grants. Recently, the Urban Institute issued a report looking at racial equity components of these calculations.[4] Nationwide calculations are bound to miss important parts of our communities. Broadly, this emphasizes the need for more state- and local-level

In areas of the country that are impacted by climate-related natural disasters, state-run banks can help fund recovery efforts and investments to prevent future damage.

involvement in deciding where federal funding is spent. It is through these state-level banks, where local partnerships already exist, that equitable policy goals are more likely to come to fruition.

To take the climate issues beyond the current administration's push: changes in the property and casualty insurance industry will put an economic strain on state and local governments that are more prone to natural disasters. Less affordable insurance has and will continue to put strain on state and local budgets and increases the need to finance resilience infrastructure and pre-disaster risk mitigation.[6]

The role of state bond banks or other financing authorities in this process, regardless of federal funding, is already a reality. We see state green banks evolving across the country, focusing on disaster work. In areas that are seeing an increase in climate-related natural disasters, like the wildfires in the State of California, state-level budgets use state-run banks to move quickly to address infrastructure issues.

In states that have long had to contend with natural disasters, such as the State of Florida, we see an increase in state-level engagement to address the hole left by the decline in affordable insurance.[7] In the southeastern part of the country, where flooding and hurricanes are costing more each year, addressing these costs still requires a more holistic solution. It will likely require a more significant federal government role in national flood insurance and through other remedies, but more state-oriented funding mechanisms would support pre-disaster risk investments that would lower the cost of disasters longer-term.

The next phases in understanding and predicting climate-related infrastructure needs will be larger investments in data-driven modeling, monitoring, and evaluations. Already we see certain bond banks investing in their own processes, outsourcing to private companies, or supporting low-cost financing options, like the State of Illinois did in recent legislation.[8]

CONCLUSION

There is no shortage of great ideas about how to better prepare and finance shared infrastructure and public resources. A new lens on how policy can promote equality in our communities and better prepare safe and sustainable infrastructure, for now and the future, is best implemented with local stakeholder input. But at the same time, a broader vision (and more dollars) comes from the federal government. Matching these concepts to local governments can be difficult through America's decentralized financing system.

State-sponsored financing vehicles such as bond banks, green banks, and/or financing authorities can fill an important void. They are known financing vehicles that balance local agency with an ability to tap into the efficiencies of scale. The beauty of the American system is that our process is democratic, and each community can decide for itself how to best prepare for the future. These state-level financing vehicles are optional, not mandatory. But writing them off may be a mistake, given the benefits.

State bond banks act in accordance with their state's interests and are non-political. They offer a full-time staff that focuses on federal programs, an understanding of market conditions, and legal support that local governments may not have the capacity to employ. These mechanisms thread an important needle in balancing local interests while taking full advantage of open markets.

1 Alec Tyson, Cary Funk, and Brian Kennedy, "What the data says about Americans' views of climate change," Pew Research Center, August 9, 2023.

2 Matthew Posner, "Community Finance Brief: Impact Obstacles, Disclosure," Court Street Group, November 6, 2023.

3 Matthew Posner, "Community Finance Brief: Overcoming Obstacles to Impact: Disclosure, Part 2," Court Street Group, November 13, 2023.

4 Yonah Freemark, Mel Langness, Amanda Hermans, et al, *Examining How the Distribution of New Infrastructure Funding May Address Historic Racial and Economic Inequities*, Urban Institute, October 25, 2023.

5 Jacob Bogage, "Home insurers cut natural disasters from policies as climate risks grow," The Washington Post, September 3, 2023.

6 Matthew Posner, "Community Finance Brief: Less Affordable Insurance Likely to Burden State, Local Budgets," Court Street Group, October 10, 2023.

7 Hurricane Loss Mitigation webpage, FloridaDisaster.org.

8 "Illinois Climate Bank Announces over $250 Million in Climate Finance Achieved in First Year," press release, March 17, 2023, Illinois.gov.

What is a state bond bank?

In June 2023, Rhode Island Infrastructure Bank closed on a $77 million Green Bond to support clean water projects for the Narragansett Bay Commission and the communities of East Greenwich, East Providence, Middletown, Woonsocket, and Warwick, and for drinking water projects in the City of Providence.

A state bond bank is a state-sponsored entity that makes local infrastructure projects feasible by providing access to the municipal bond market and by providing direct and indirect financial subsidies to localities, primarily through debt issuance. State bond banks take many forms throughout the United States, but they all share a few common attributes:

- They sell their own securities in the public bond market and re-lend the proceeds to local governments.
- They intend to lower the cost of capital by allowing access to economies of scale and support them with financial and technical expertise.
- They are backed by some sort of credit enhancement that the community wouldn't have if it were to sell bonds on its own.
- They provide knowledge about federal programs that local governments can benefit from, which in some cases means taking advantage of state-revolving loan funds.

There are certain entities that share the attributes of a state-sponsored bond bank but aren't officially labeled banks, even though they in effect meet the criteria just mentioned. In these instances, they are entities that focus on a particular type of essential services (for example, the Virginia Public School Authority), are focused on economic development of local governments (such as, the California Infrastructure and Economic Development Bank) or, of late, on sustainable infrastructure (as in, green banks).

Bond banks issue municipal bonds into the public market to raise capital for any number of local projects within the bank's jurisdiction. In the municipal bond market, a state or local government normally raises funds by issuing bonds for projects it's pursuing. With a bond bank, the bank is the issuer of bonds and the proceeds go toward a variety of community projects and local governments can apply for loans. When local governments apply for the loan, the bank goes through a due diligence process before issuing the bond and then lending the money for the project. Local governments within the state can apply for a loan from the bank; the bank goes through a due diligence process on the project, and the bank then uses the bond market to raise the money, which it uses to lend money to the local government for its project.

The lower cost of capital, as it pertains to economies of scale, is that the bond bank essentially bundles local government debt into a single bond issuance. By issuing larger volumes, all else being equal, the interest rate on the bond will be lowered. Further, a bond bank is made up of a team of professional staff who provide financial and technical support that a local government may not have on its own. From a financial standpoint, the bank's staff advises on the structure of the loan and decides on whether or not the repayment method is suitable. From a technical perspective, a bond bank will review the merits of the project and advise on a variety of fronts, depending on the type of project being considered. In many of these instances, if the local government were to go ahead and issue the bonds on its own, it would likely have to pay a fee for independent advice. With the bond bank this assistance is included as part of the service.

Munising Marketplace, an $18 million mixed-used development project in the City of Munising, Michigan, will address local housing shortages and provide job training through a workforce development center. Alger County Land Bank contributed to the project through a loan approved by the State Land Bank Authority. *Photo courtesy of Renovare Development.*

A credit enhancement also lowers the cost of capital for local governments that opt to borrow from a state bond bank. Most states provide additional interest rate savings to local borrowers by providing some form of state credit enhancement to bond bank issues. State credit ratings can also be higher than local government ratings, but bond banks can offer other enhancements as well. These can be in the form of a moral obligation, appropriation support, or a state aid intercept provision, to name a few. In all these instances, the local government lowers its cost of capital by borrowing from the bond bank because the bond bank has a better credit rating.

Finally, assistance in regard to federal programs is another area where these organizations support local governments. While not the first, perhaps the most widely known program is the EPA's Clean Water State Revolving Fund (SRFs), which became popular in the early 1990s with the Safe Drinking Water Act. SRFs are loan programs capitalized by federal grants, state appropriation, and dedicated revenues. In many cases, it is a state bond bank that handles the low-interest loan that ends up being used by the local government for the project, spending on which program is being leveraged. SRFs are used in water projects through the EPA but are also used in infrastructure projects with guidelines from the U.S. Economic Development Administration, Department of Housing and Urban Development, and Department of Agriculture.

STATE BOND BANKS AND FEDERAL DOLLARS

With state bond banks already well practiced in the process of administering federal programs through revolving fund facilities, it is natural to extend this expertise to new programs. Policymakers in Congress and the White House did not explicitly guide new programs through the state bond bank networks, and as a result, the process to-date has been somewhat haphazard. Understandably, policy did not choose specific avenues within which projects should be capitalized, but these state-level apparatuses are beginning to be apparent.

To better explain what this means in practice, consider bond banks to be a public-facing, transparent broker, or concierge, between local governments and the federal government. This work, at times, is getting into the details of what can be a cumbersome and complicated process for lesser-staffed local governments. Here are some specific examples of ways local governments across the country have been helped:

- Identifying and prioritizing projects that are eligible for funding under these acts (il-fa.com/programs/cb).
- Developing and submitting grant applications (ctgreenbank.com/engagement-on-iija-ira/).
- Providing technical assistance on grant management (sib.nv.gov).
- Accessing other sources of funding to match grant funding (hcd.ca.gov/docs/grants-and-funding/2022-LGMG-Final-Guidelines.pdf).
- Financing for early project costs such as planning and design (vtbondbank.org/resource/financing-v-funding-there-difference).

Matt Posner *is founder and principal of Court Street Group, a research and consulting firm.*

[1] Jean Chemnick, "Here's who wants to run the country's $14B 'green bank,'" Politico ClimateWire, November 6, 2023.

[2] "Our Partners" webpage, Coalition for Green Capital (coalitionforgreencapital.com/about-us/our-partners/).