

Understanding Financing Options Used for Public Infrastructure

➔ A PRIMER

**PUBLIC
FINANCE
NETWORK**



About the **Public Finance Network**

Formed in 1988, the Public Finance Network is a coalition of organizations united to preserve state and local government use of tax-exempt bonds. The Network represents the wide array of local and state government financing and infrastructure activities. The Public Finance Network is administered by the GFOA and its Director of the Federal Liaison Center, Emily Brock.

For information about the Network and financing issues, contact any of its members, listed in Appendix C, call 202-393-8467 or write to 660 North Capitol St., NW, Suite 410 Washington, D.C. 20001.



TABLE OF CONTENTS

- 2** Fundamentals of the Tax-Exempt Market and Other Financing Structures Utilized by the Public Sector
- 4** Projects Funded by Tax-Exempt Bonds
- 8** Recent Federal Infrastructure Legislation
- 9** Tax-Exempt Bonds Serve Another Purpose—Safe Investments for Citizens
- 13** Appendices
 - Appendix A:** Various Types of Bonds and Financings Used by State and Local Governments to Provide for the Nation's Infrastructure
 - Appendix B:** Chronology of Federal Laws Affecting Tax-Exempt Bonds and Financings
 - Appendix C:** Who's Who in the Public Finance Network

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INTRODUCTION

Understanding Financing Options Used For Public Infrastructure (the “Primer”) provides an overview of tax-exempt bonds and other financings used by state and local governments and public entities.

The Primer covers numerous issue areas related to tax-exempt financings. These sections include:

- » **The fundamentals of tax-exempt bonds** and other financing tools that are available to state and local governments and related entities;
- » **The role tax-exempt bonds play** in infrastructure financings and as an investment product;
- » **Congressional actions** over the past fifty years related to this market

This Primer was prepared in coordination with several members of the Public Finance Network (PFN). The PFN is a coalition of organizations interested in preserving the tax-exempt status of state and local government bonds. A list of some PFN members and contact information appears in Appendix C.

FUNDAMENTALS OF THE TAX-EXEMPT MARKET AND OTHER FINANCING STRUCTURES UTILIZED BY THE PUBLIC SECTOR

For over a century, state and local governments and public entities have depended on access to the capital market and issuance of tax-exempt bonds to provide for the nation’s infrastructure. Unlike the Federal Government that issues bonds (Treasuries) to pay for operating expenses, state and local governments primarily issue bonds to pay for long term capital projects and longstanding infrastructure.

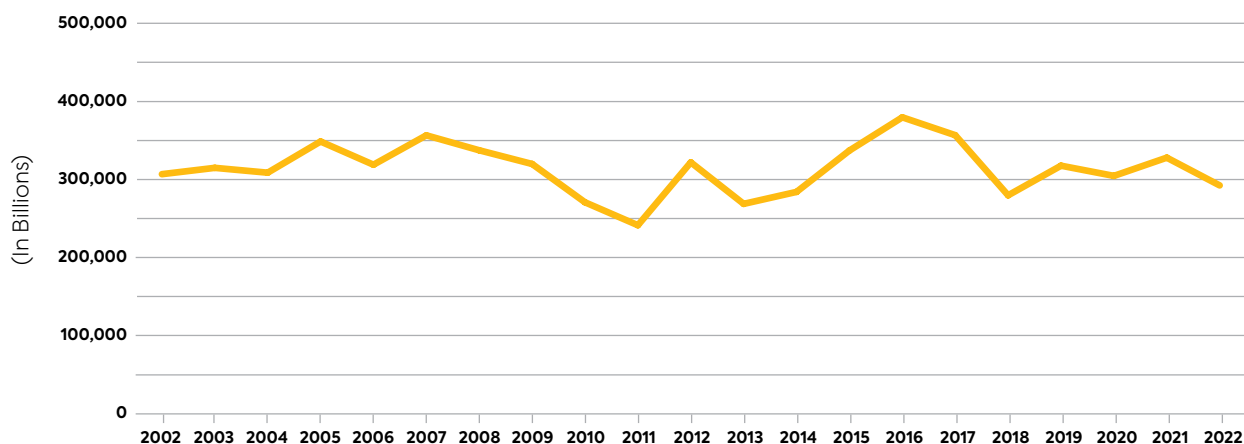
All citizens benefit from the issuance of tax-exempt bonds. Although the primary beneficiaries of a particular bond issuance are the citizens of the issuing community for a specific project, the nation as a whole has a vital interest in maintaining adequate public facilities to support a dynamic economy. The national interest is well served by keeping state and local government borrowing costs at the lowest cost to taxpayers, thereby providing an incentive for public investment in infrastructure and other facilities.

Over 50,000 state and local governments and public entities are able to issue tax-exempt bonds for key infrastructure in their communities at a lower cost, as the interest of the bonds is exempt from federal taxation to investors. **Tax-exempt bonds are a fundamental and important intergovernmental partnership between the Federal Government and communities.**

Bond Issuance

There are three main ways for state and local governments to finance capital projects: 1. pay-as-you-go financing, 2. using intergovernmental revenues such as federal and state grants, and 3. issuing bonds or securing other financing. Borrowing, or debt financing, is accomplished by issuing bonds or other debt to pay for specific projects or services. A bond is a debt instrument bearing a stated rate of interest that matures on a certain date, at which time a fixed sum of money plus interest is payable to the bondholder. Bonds are most often structured with a 20-30 year term to coincide with the useful life of the project. Governments establish payment structures and use platforms (typically through the use of trustee services) to ensure payments are made to investors in a manner that is timely and easy to manage.

Pursuant to federal and state laws, tax-exempt bonds may be issued by a state or local government. Tax-exempt bonds may also be issued by special units of government such as authorities, commissions, or districts to benefit other entities such as non-profit hospitals and colleges who cannot issue bonds themselves, a relationship called “conduit financing.”

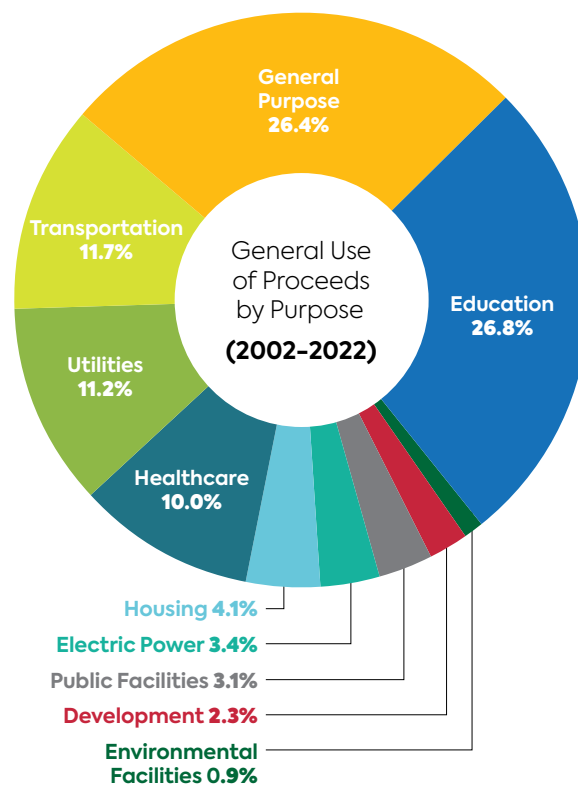
Exhibit 1. 20-Year History of Tax-Exempt Bond Issuance

SOURCE: THOMSON REUTERS, 1/10/2023

Entities issuing debt typically need the support of their communities when pursuing a bond measure. This allows the decisions on public infrastructure and capital improvement needs to be made at the level where the project impacts citizens directly (e.g., libraries, schools, roads and road improvements, water systems, mass transit, affordable housing, public and non-profit hospitals, and other government owned facilities). The entity must also abide by various federal laws and regulations at the time of and following the issuance of the bonds as well as numerous zoning, environmental, licensure and other regulatory requirements. They are the best way to implement the infrastructure needs of each community effectively, as the decision to issue bonds for various projects is determined and approved of by either the citizens themselves through bond referenda or by their elected legislative bodies directly or through appointed boards.

Snapshot of Tax-Exempt Bond Issuance and Projects Funded by Bonds

Long-term bonds to finance infrastructure are those that are issued with call or maturity dates of more than one year. The projects financed through tax-exempt bonds cover a multitude of public purposes that help communities across the country. Exhibit 2 provides an overview of the categories financed by long-term bonds from 2002-2022.

Exhibit 2. Projects funded by bonds by type and five year average

SOURCE: THOMSON REUTERS, 1/10/2023

PROJECTS FUNDED BY TAX-EXEMPT BONDS

The Tax-Exemption of Bond Interest

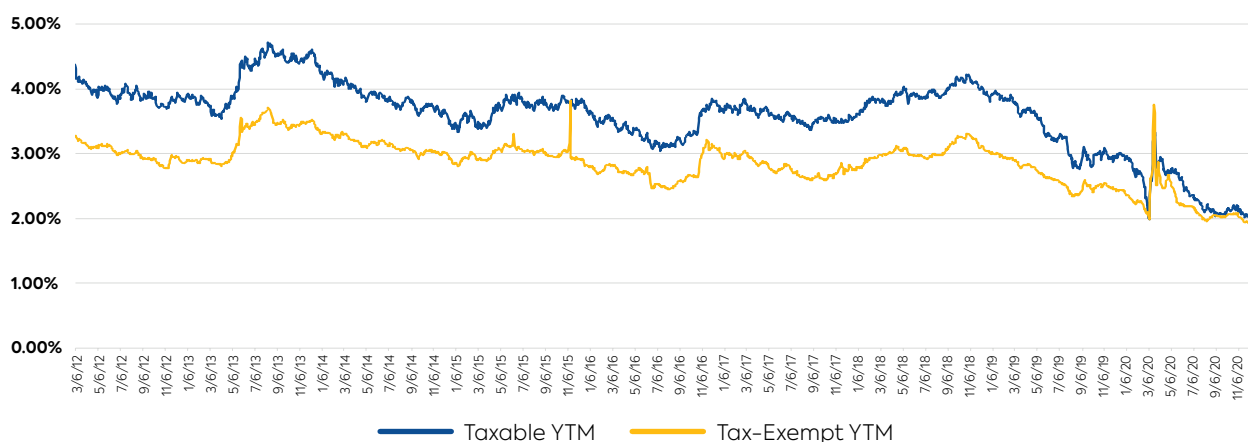
The exemption from income tax of tax-exempt bond interest existed prior to and was included in the country's first income Tax Code over a century ago. Today, the Internal Revenue Code in §103 and §141 through §150 specifies the rules for determining if a bond may be issued on a tax-exempt basis and severely restricts the issuance procedures and purposes—and in some cases the volume—of debt sold annually in each state.

Unlike corporate debt issues, the interest received by holders of tax-exempt bonds is exempt from federal income taxes and may also be exempt from state and local income taxes. Consequently, investors accept a lower interest rate on these investments. For over 100 years, this lower rate meant reduced borrowing costs for state and local governments, which directly benefits tax and rate payers. Even from a small snapshot comparing yield data as illustrated in Exhibit 3, it is clear that tax-exempt bonds are advantageous for state and local governments from a cost savings perspective.

The difference in savings between taxable and tax-exempt municipal bonds to the issuer is about 210 basis points, according to a 2025 data brief supported by municipal market participants.¹ In other words, if a community were offered a taxable borrowing rate of 5.5 percent, the decision to issue on a tax-exempt basis would be expected to drive the borrowing rate down by 2.10 percentage points to a new rate of 3.4 percent. Further, the data brief estimates the tax-exemption will save issuers and borrowers about \$823.92 billion between 2026 and 2035. Elimination of the tax-exemption would correspondingly raise borrowing costs \$823.92 billion, a cost that would be passed onto American residents and amount to a \$6,554.67 tax and rate increase for each American household over the next decade.

Tax-exempt bonds are generally categorized as one of two types—general obligation bonds or revenue bonds.² General obligation bonds are backed by the “full faith and credit” of the state or local government that issues the bonds. These typically would be

Exhibit 3. Comparison of Taxable and Tax-Exempt Yield to Maturity (2012–2020)



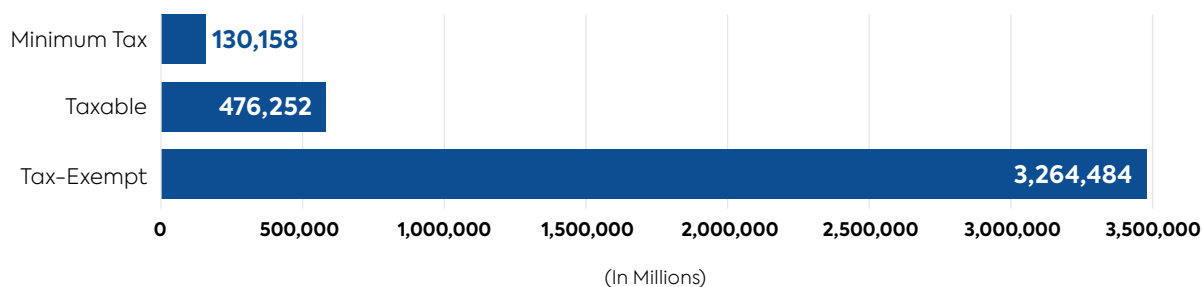
SOURCE: S&P DOW JONES INDICES, S&P MUNICIPAL BOND INDEX AND S&P TAXABLE MUNICIPAL BOND INDEX, 1/1/2021

¹ <https://www.gfoa.org/protecting-bonds>

² A complete discussion of types of bonds issued by state and local governments and entities can be found in Appendix A.



Exhibit 4. Bond Issuance Volume by Type, 2012 to 2022



SOURCE: THOMSON REUTERS, 1/10/2023

financings for fire stations, police stations, K-12 schools, and city halls. The general taxing authority of the jurisdiction is pledged to guarantee repayment of the debt on these different public facilities.

Revenue bonds are issued for a specific project or system, such as power, water and sewer, and are paid for from the revenues received from the project or system. One category of revenue bonds are qualified private activity bonds. These bonds finance a specified list of public purpose projects where use of the project and repayment of the bonds comes from a non-public source, such as airports, low income housing, and colleges and hospitals. For a time, issuers of tax-exempt debt were also able to issue two types of taxable bonds—tax credit bonds and direct subsidy bonds. The former were issued for specific types of projects prior to 2018. By investing in tax credit bonds, the investor received a federal tax credit and the issuer paid a lower interest rate. The

latter (including former Build America Bonds) were issued mostly from 2010-2012. With direct subsidy bonds, the issuing entity receives a payment from the Federal Government for part of the interest costs. Exhibit 4 illustrates the amount of bonds issued in each of these categories over the past 10 years.

What is a basis point?

A basis point is a way to talk about very small changes in percentages. If you split 1% into 100 pieces, each piece would be 1 basis point. So, if you have a savings account with an interest rate that goes from 2.00% to 2.50%, that's a change of 50 basis points.

The Nation's Infrastructure Needs Remain Critical

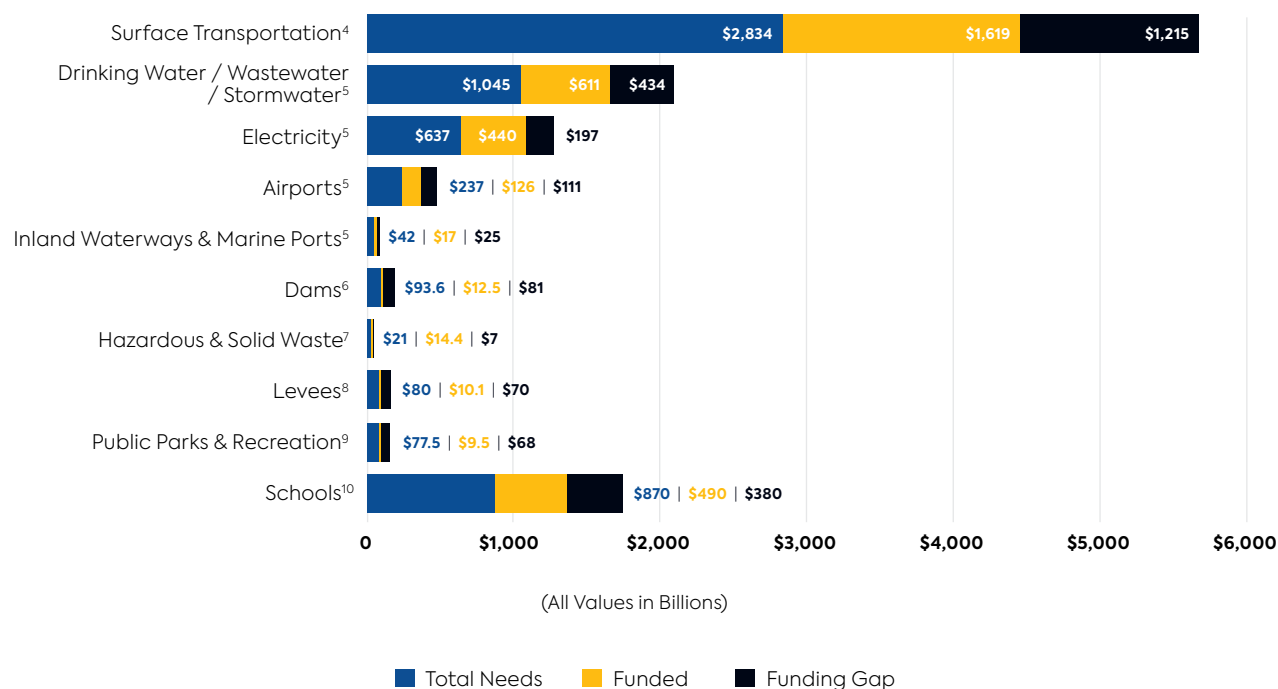
According to the 2021 Infrastructure Report Card by the American Society of Civil Engineers (ASCE), our nation's infrastructure earned a cumulative grade of C-.³ For the years 2020-2029, infrastructure spending needs are estimated to be \$5.9 trillion. However, the likely funding available for this infrastructure is \$3.4 trillion, leaving unmet infrastructure spending needs at \$2.6 trillion through 2025 (see Exhibit 5).

With the country's infrastructure needs being so great, it is important to note that the majority of these infrastructure costs have traditionally been borne by state and local governments and public entities.

Exhibit 6 illustrates the amount of public spending by level of government from 2002-2022.

Also as noted in Exhibit 6, the Federal Government's contributions to public construction spending has remained relatively constant especially over the past 20 years. This has increased pressure on state and local governments to provide for the initial infrastructure (mainly through the issuance of tax-exempt bonds as demonstrated in Exhibit 1), and to maintain the infrastructure throughout its lifecycle in order to best serve their communities.

Exhibit 5. ASCE Cumulative Infrastructure Needs by System Based on Current Trends, 2016–2025 (10 Years)



³ ASCE, 2021 Infrastructure Report Card at 4

Data taken from ASCE Failure to Act 2021 study + rail funding gap from ASLRRA

⁵ Data taken from ASCE Failure to Act 2021 study. www.asce.org/failuretoact

⁶ Includes estimates from ASDSO, USACE, U.S. Bureau of Reclamation, and FEMA

⁷ Data based on conversations with ASTSWAMO: RCRA Part C; Brownfield analysis; the Superfund funding information does not include DOE's Environmental Management program

⁸ Total needs numbers is based on discussions with the National Committee on Levee Safety

⁹ Estimates from National Parks Service; National Association of State Park Directors; City Parks, and National Association of State Park Directors

¹⁰ Data from State of our Schools: America's K-12 Facilities (2016). 21st Century School Fund, Inc., U.S. Green Building Council, Inc.

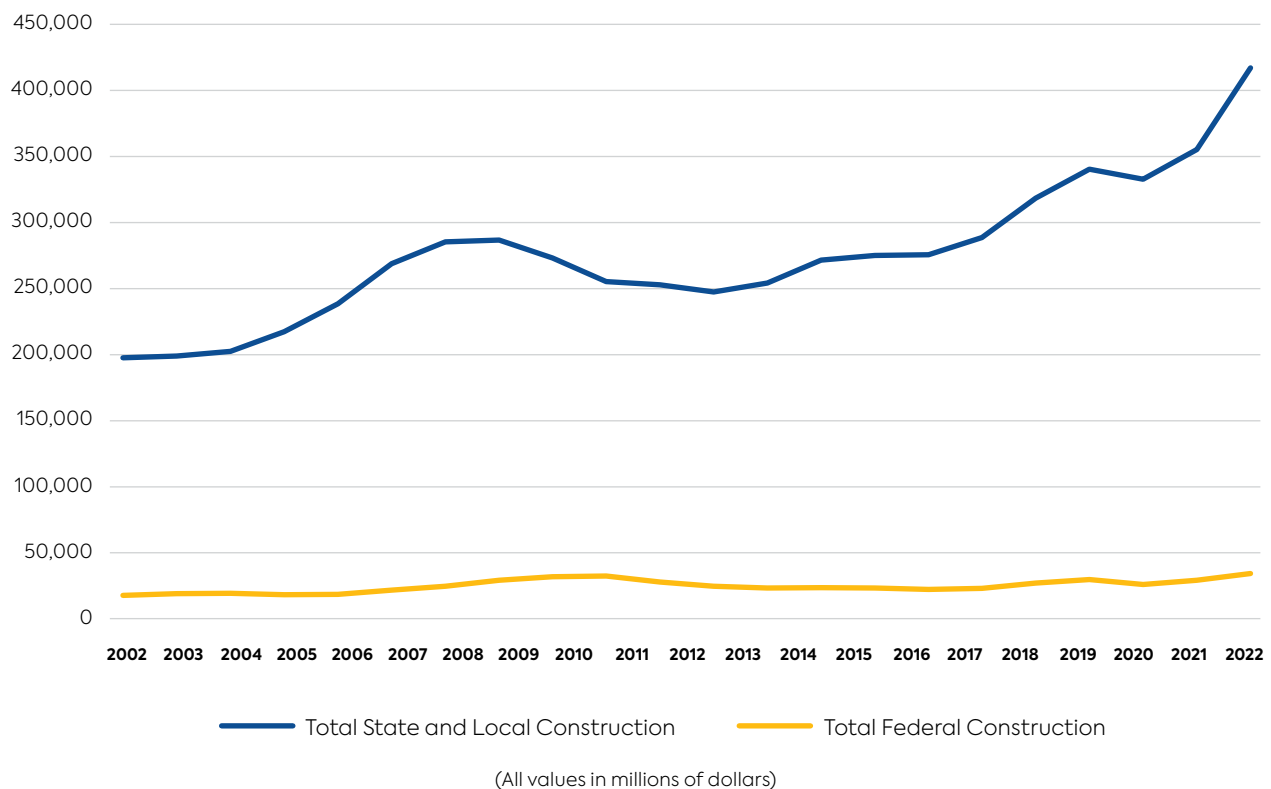
Public Construction: the State and Local Share

The construction projects that are paid for by tax-exempt bonds and other funding mechanisms is borne primarily by state and local governments. These projects not only serve to provide the capital improvements of specific communities, but also positively impact the national economy.¹¹

“Sustained infrastructure spending creates a progressively more productive economy. Because of cumulative effects through time, by 2030 infrastructure investments would produce economy-wide returns of close to \$3 per every \$1 invested.”

– **National Association of Manufacturers, 2014**

Exhibit 6. Annual Value of Public Construction Put in Place 2002–2023



SOURCE: GFOA ANALYSIS OF U.S. CENSUS BUREAU DATA ON PUBLIC CONSTRUCTION

¹¹ [Census Data on Public Construction](#)

RECENT FEDERAL INFRASTRUCTURE LEGISLATION

Infrastructure Investment and Jobs Act of 2021

One positive development regarding federal infrastructure spending, is that after a one-year extension, the 117th Congress managed to enact the next five-year surface transportation program – the Infrastructure Investment and Jobs Act (IIJA) of 2021 (aka the Bipartisan Infrastructure Law). However, the IIJA not only provided funding for the nation's surface transportation programs, it also provided over \$500 billion in new spending focused on upgrading roads and bridges, repairing and

improving water systems, and increasing access to broadband, plus many other areas of investment.

The IIJA provided a much needed boost in funding that complements the financing tools available to state and local governments and public entities. Further, the IIJA also included private activity bond enhancements by creating new categories as well as increasing the nationwide volume cap for qualified highway or surface freight transportation bonds (*see Appendix B for further details*).

Inflation Reduction Act of 2022

A year after passing the IIJA, the 117th Congress passed another historic infrastructure related bill, the Inflation Reduction Act of 2022 (IRA), which will invest \$370 billion over ten years to help lower energy costs, strengthen supply chains, and incentivize more investment in clean energy solutions across all sectors. It is important to note that there will be additional tax incentives offered for projects that will benefit low-income and disadvantaged communities.

There are over a dozen programs that will receive funding thanks to the IRA, and a few of them deserve to be highlighted, as they finally allow tax-exempt entities (e.g., cities, towns, etc.) to take advantage of renewable energy tax incentives. The Production Tax Credit (PTC) for energy property provides tax credits for projects that produce electricity from renewable sources and the Investment Tax Credit (ITC) provides a tax credit for investment in renewable projects more broadly.

Both the PTC and ITC offer credits through 2033 and will help localities finance clean energy projects more efficiently by complementing the municipal bonds typically used to start those projects. It should be noted, both PTC and ITC incorporate a reduction of up to 15% of the total credit amount if tax-exempt bonds are used to finance the acquisition or construction of eligible energy property or facilities.

Some of the other programs worth mentioning include the following:

- **Clean Commercial Vehicles Tax Credit:** a new direct pay provision that gives tax exempt entities a tax credit when they purchase a qualified commercial clean vehicle.
- **Greenhouse Gas Reduction Fund:** new competitive grants program administered by the Environmental Protection Agency intended to mobilize financing for clean energy and climate projects that reduce greenhouse gas emissions. There is \$27 billion available, of which \$15 billion must benefit low-income and disadvantaged communities.
- **Funding for Local Climate Resiliency Projects:** over \$4 billion in funding is available to help municipalities combat climate change by focusing on flooding, drought mitigation, and other climate resiliency related projects.

TAX-EXEMPT BONDS SERVE ANOTHER PURPOSE – SAFE INVESTMENTS FOR CITIZENS

Most tax-exempt bonds are purchased and held by individuals. At the end of 2016, of the more than \$3.8 trillion of tax-exempt bonds outstanding, 74% were held by individuals through direct investments and indirectly through mutual funds, money market funds, state and local government retirement plans, and related holdings.

As portrayed in Exhibit 8, more than half of all individuals claiming tax-exempt interest are over the age of 65. The fixed income needs and investment strategies of retirees underpins the fact that there remains strong constant demand for tax-exempt bonds. While there are many investment reasons and strategies for individuals to hold tax-exempt bonds, one of the key reasons is that they are historically very safe investments.

The tax-exempt bond sector has proven over and over again to be safe for investors. Since 2007, tax-exempt bonds have a five-year average default rate of 0.15%, while corporate bonds using the same criteria show 6.92%.¹² Exhibit 9 shows that municipal defaults since 1937, when the U.S. Bankruptcy Code was amended to include municipalities, pale in comparison to corporate defaults in 2020 alone.

General Federal Regulations and Municipal Obligations

The IRS has numerous sections of the Internal Revenue Code related to tax-exempt obligations. It specifies the determination of the tax-exempt status of bonds, when bonds can be refunded, and numerous other rules that issuers of tax-exempt bonds must adhere to under §103 of the Code in order to qualify as tax-exempt. Taxable bonds, tax credit bonds and direct subsidy bonds are also addressed in the Internal Revenue Code.

Tax-exempt bonds must also adhere to arbitrage regulations. This means that any amount of arbitrage (earnings on the investment of tax-exempt bond proceeds at a rate that exceeds the municipal bond yield) must be (painstakingly) calculated, and any earnings gained (with certain exceptions) rebated to the Federal Government.

Exhibit 7. 20 Year Average History of Holders of Municipal Securities

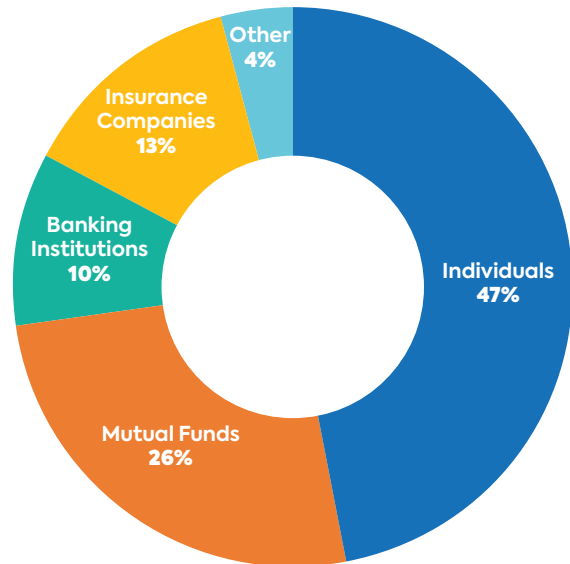
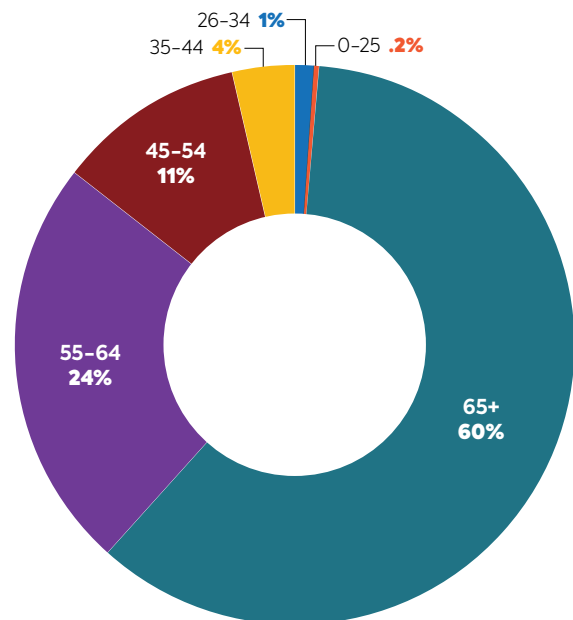
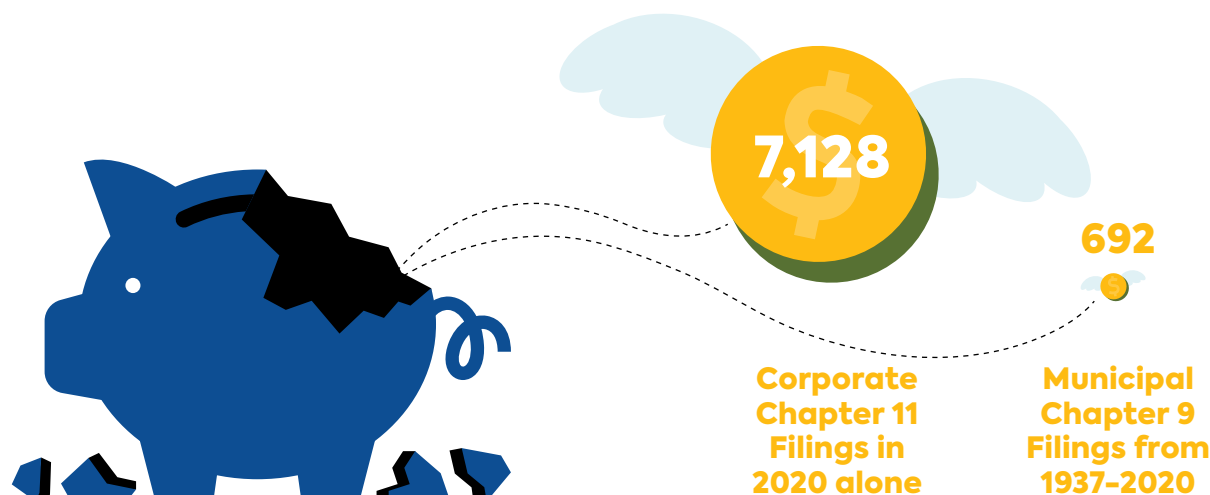


Exhibit 8. Retirees as Bond Holders



Number of Returns with Tax-Exempt Interest Deduction by Age Group, Tax Year 2018

¹² Moody's Investor Service, US Municipal Bond Defaults and Recoveries, 2017

Exhibit 9. Comparison of Defaults between Corporations and Municipalities

SOURCE: GFOA ANALYSIS OF AACER DATA, 1/1/2021

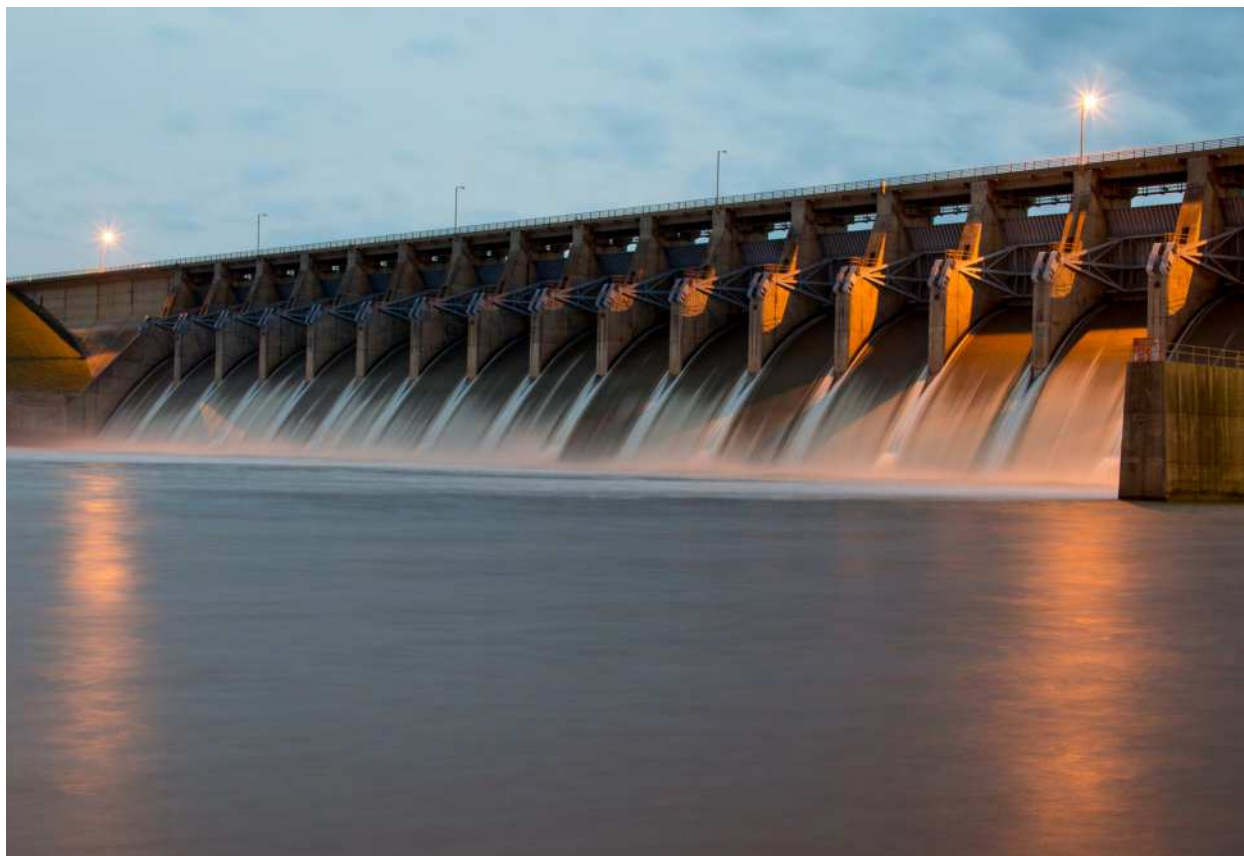
In keeping with principles of federalism that preserve state and local financial authority, municipal obligations issued by state and local governments are exempt from the Securities and Exchange Commission's (SEC) registration and reporting requirements that apply to corporations. However, the anti-fraud provisions of the Securities Exchange Act of 1934 (SEC Rule 10b-5) apply. Any person, including a municipal issuer, who makes false or misleading statements of material fact or omits any material fact that causes such statements to be misleading violates federal law.

To ensure that existing and potential bondholders have relevant financial and operating information about state and local governments that are issuing municipal bonds, state and local government issuers provide or disclose information about their bonds and/or about their governmental functions before, during, and after

issuing municipal obligations. Since certain municipal bonds are exchanged between buyers and sellers in the secondary market after a primary issuance (bond sale) has been completed, continuing disclosure information remains necessary for decisions being considered by investors in the municipal market. The securities laws related to these disclosures can be found in Rule 15c2-12 of the Securities Exchange Act of 1934.

Issuer disclosure practices continue to evolve and be enhanced. GFOA leads the Disclosure Industry Group that is a consortium of industry associations committed to developing market-based, not regulatory-based, solutions to meet issuer and investor needs. For example, in 2020, this group developed the General Continuing Disclosure Considerations for Municipal Securities that focuses on considerations related to COVID-19 pandemic disclosures.¹³

¹³ Available at <https://www.gfoa.org/gfoa-led-disclosure-industry-working-group-publishes>



CONCLUSION

Financing our country's infrastructure depends on a robust and reliable tax-exempt bond market. Allowing state and local governments to issue bonds in this affordable manner provides the capital for projects that are important to their communities—as well as for projects that benefit the country as a whole. Governments have issued bonds to pay for capital projects since the 1800s, and the interest on those bonds has been exempt since the country's first tax code was enacted.

In addition to being the financing source for which a majority of infrastructure projects are funded, tax-exempt bonds provide safe investment vehicles, with a

majority of owners being individuals, and many of those being retirees.

Utilizing tax-exempt bond financings is a win-win-win for the country, communities, and investors. Our country benefits by allowing for a robust capital market to flourish, our communities are able to build affordable infrastructure specifically related to their needs, and investors have a safe haven for their investment portfolios.

As our country's infrastructure needs continue to grow, maintaining tax-exempt bonds is essential to making that happen.



APPENDIX A: TYPES OF BOND ISSUANCES AND FINANCINGS

As noted previously, the two most common types of bonds issued are: **General Obligation** – bonds backed by the full faith and credit of the state or local government that issues the bonds. This means the general taxing power of the jurisdiction is pledged to guarantee repayment of the debt. The second type is **Revenue Bonds** – bonds issued for a specific project or system and paid for from the revenues received from the project or system.

There are other types of bonds and financings utilized by state and local governments and entities which are noted below. Most of the descriptions come from the Glossary developed by the Municipal Securities Rulemaking Board¹² and discuss the types of bonds as identified under the federal tax rules.

Bank Qualified Debt

This is the designation given to a public purpose bond offering by the issuer if it reasonably expects to issue in the calendar year of such offering no more than \$10 million (\$30 million for bonds issued in 2009-2010) of bonds of the type required to be included in making such calculation under the Internal Revenue Code. When purchased by a commercial bank for its portfolio, the bank may deduct a portion of the interest expense incurred to carry the position.

Private Activity Bonds (PAB)¹³

The proceeds of a PAB are used by one or more private entities. A municipal security is considered a private activity bond if it meets two sets of conditions set out in Section 141 of the Internal Revenue Code. A municipal security is a private activity bond if, with certain exceptions, more than 10 percent of the proceeds of the issue are used for any private business use (the “private business use test”) and the payment of the principal of or interest on more than 10 percent of the proceeds of such issue is secured by or payable from property used for a private business use (the “private security or payment test”). A municipal security is also a private activity bond if, with certain exceptions, the amount of proceeds of the issue used to make loans to non-governmental borrowers exceeds the lesser of 5 percent of the proceeds or \$5 million (the “private loan financing test”). Interest on private activity bonds is generally not excluded from gross income for federal income tax purposes unless the bonds fall within certain defined categories (“qualified bonds” or “qualified private activity bonds”), as described below. For some private activity bonds, the Federal Government sets an annual volume cap of how much each state can issue.

The following categories of private activity bonds are qualified bonds under current federal tax laws and can be issued on a tax-exempt basis if a variety of requirements are met:

Exempt facility bonds – Private activity bonds issued to finance various types of facilities owned or used by private entities, including airports, docks and certain other transportation-related facilities; water, sewer and certain other local utility facilities; solid and hazardous waste disposal facilities; certain residential rental projects (including multi-family housing revenue bonds); and certain other types of facilities. Enterprise zone and recovery zone facility bonds are also considered exempt facility bonds.

Qualified 501(c)(3) bonds – Private activity bonds issued to finance a facility owned and utilized by a 501(c)(3) organization, such as a college or hospital.

Qualified mortgage bonds – Private activity bonds issued to fund mortgage loans to finance owner-occupied residential property. Qualified mortgage bonds are often referred to as single family mortgage revenue bonds.

Qualified small issue bonds – Private activity bonds issued to finance manufacturing facilities. Qualified small issue bonds may be issued on a tax-exempt basis in an amount up to \$1 million, taking into account certain prior issues, or an amount up to \$10 million, taking into account certain capital expenditures incurred during the three years prior and the three years following the issuance of such bonds.

Qualified student loan bonds – Private activity bonds issued to finance student loans for attendance at higher education institutions.

Qualified veterans’ mortgage bonds – Private activity bonds that are general obligations of a state issued to fund mortgage loans to finance owner-occupied residential property for veterans. The ability of states to issue new and refunding qualified veterans’ mortgage bonds on a tax-exempt basis is limited.

Tax Credit Bonds

Tax Credit Bonds are taxable bonds issued by governmental entities that provide the investor with a credit on their taxes instead of interest payments. Prior to 2018, Congress authorized the credit amounts available to be issued for the following programs – *Qualified Zone Academy Bonds* (QZABs); *Qualified School Construction Bonds* (QSCBs); *Clean Renewable Energy Bonds* (CREBs) and *New Clean Renewable Energy Bonds* (NCREBs); and *Qualified Energy Conservation Bonds* (QECBs). However, all tax credit bond programs were eliminated as of 12/31/2017.

Direct Subsidy Bonds

While not currently permitted to be issued, in the past, Congress authorized governments to issue taxable direct subsidy bonds. These bonds allowed the government/issuing entity to receive a payment from the Federal Government for the life of the bond, covering a percentage of the interest costs. The largest direct subsidy bond program was Build America Bonds (BABs), which could be issued for most governmental purposes, and state and local governments received a subsidy equal to thirty-five percent (35%) of the interest paid on the bonds for the life of the bond. In many cases, BABs provided the issuer with a lower net interest cost on the financing compared with conventional tax-exempt bonds. The authority to issue new BABs expired at the end of 2010.

Other direct subsidy bond programs that are no longer available include Recovery Zone Economic Development Bonds (RZEDBs), which provided a 45% subsidy rate for qualifying governmental purpose projects.

Additionally, beginning in 2010 and continuing until applicable volume caps were used up, traditional tax credit bond programs—QZABs: Qualified Zone Academy Bonds, QSCBs: Qualified School Construction Bonds, NCREBs: New Clean Renewable Energy Bonds, and QECBs: Qualified

Energy Construction Bonds were permitted to be issued as direct subsidy bonds with various subsidy rates.

Subsequently, Congress has effectively reduced the subsidy amounts that were promised to issuers within the sequestration process.

Other Types of Financings

Direct Loans – A loan to a state or local government or entity from a banking institution or another lender. The obligations may constitute municipal securities.¹⁴

Public-Private Partnerships (P3) – A generic term for a wide variety of financial arrangements whereby governmental and private entities agree to transfer an ownership interest of, or substantial management control over, a governmental asset to the private entity in exchange for upfront or ongoing payments and/or services.¹⁵

Green Bonds – Bonds that are issued and whose proceeds are used for environmental benefits, and appeal to some investors. Of note, there is nothing in the tax code nor are there any federal laws related to green bonds.

Environment, Social and Governance (ESG) Bonds – Bonds that are issued and whose proceeds are used for various environmental, social and governance criteria, and appeal to some investors. Of note, there is nothing in the tax code nor are there any federal laws related to ESG bonds.

¹⁴ MSRB, Glossary of Municipal Securities Terms, 2013, www.msrb.org/glossary.aspx {with minor non-material edits}.

¹⁵ Ibid.

APPENDIX B: FEDERAL LAWS AFFECTING BOND FINANCINGS

Over the years, Congress has changed, added to, eliminated and even restricted the various types of bond financing options available to state and local governments and entities. The following summary outlines some of the major provisions of federal tax law since 1968 as they relate to tax-exempt bond financing.

Infrastructure Investment and Jobs Act of 2021 (Public Law 117-58)

This Act provided another five-year authorization of the nation's surface transportation programs, as well as a \$550 billion infusion of new spending focused on various infrastructure related sectors. The Act also introduced new private activity bond categories by allowing the issuance of tax-exempt PABs for qualified broadband projects and carbon dioxide capture facilities. Further, the Act increased the separate nationwide volume cap for qualified highway or surface freight transportation bonds from \$15 billion to \$30 billion.

Tax Cuts and Jobs Act of 2017 (Public Law 115-97)

The tax bill established into law on January 3, 2018 contains several provisions which directly impact state and local government bond issuance.

Advance Refunding of Municipal Bonds: To the surprise of many within the public issuer community, both House and Senate versions included a repeal of advance refunding bonds. Public issuers sought to fully preserve advance refunding, given the significant savings public issuers have historically experienced as a result. Unfortunately, the conference bill repealed advance refunding bonds after December 31, 2017 and provided no transition relief.

Tax Credit Bonds: Tax credit bonds are another important finance mechanism used by various public issuers that were also impacted by the conference bill. Initially, only the House version repealed the ability to issue tax-credit and direct-pay bonds, while the Senate retained current law. The conference bill prospectively repealed the authority to issue all tax credit and direct pay bonds, such as clean renewable energy bonds and qualified school new construction bonds, after December 31, 2017.

Revenue Provisions Contained in the American Taxpayer Relief Act of 2012 (Public Law 112-240)

The Act extended the ability to issue tax-exempt enterprise zone facility bonds and New York Liberty Zone bonds for two years, through December 31, 2013.

The Airport and Airway Trust Fund Provisions and Related Taxes in the FAA Modernization and Reform Act of 2012 (Public Law 112-95)

The Act amended the prohibition on the use of qualified

tax-exempt private activity bond proceeds for airplanes to exclude fixed-wing emergency medical aircraft.

Revenue Provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312)

The Act extended for two years through December 31, 2011, the special \$15 million per-user bond limitation and the relief from resident and employee requirements for certain tax-exempt bonds issued in the District of Columbia Enterprise Zone.

The Act extended authority to issue New York Liberty Zone bonds for two years and Gulf Opportunity Zone Bonds for one year (both through December 31, 2011).

Revenue Provisions of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5)

This law provided a de minimis safe harbor to allow financial institutions to hold up to 2 percent of their assets in tax-exempt obligations issued in 2009 and 2010 without full reduction of their attributable interest expense deductions. For bonds issued in 2009 and 2010, the law increased the annual volume limit from \$10 million to \$30 million for qualified small issuers and applies that limitation at the borrower level (rather than at the level of the conduit issuer).

Private activity bonds – and current refundings of private activity bonds – issued in 2009 and 2010 are exempt from the Alternative Minimum Tax.

The Act expanded the availability (through January 1, 2011) of PABs to facilities creating intangible property.

The Act creates a new category of exempt facility bonds, “Recovery Zone Facility Bonds”, to finance acquisition, construction, or reconstruction of depreciable property in a “recovery zone.” The Act provides several criteria of economic distress for qualifying as a “recovery zone.”

The Act allows Indian tribal governments to issue up to \$2 billion of “tribal economic development bonds” if such a bond would qualify as a tax-exempt bond if issued by a state or local government. Additionally, tribal economic bonds cannot finance gaming facilities, buildings containing gaming facilities, or any facility outside the Indian reservation.

The Act provides that for purposes of qualifying as an exempt facility PAB, a high-speed intercity rail transportation facility must use vehicles that are capable of attaining speeds in excess of 150 miles per hour, rather than using vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour.

Emergency Economic Stabilization Act of 2008, Energy Improvement and Extension Act of 2008, and Tax Extenders and the Alternative Minimum Tax Relief Act of 2008 (110-343)

The law extended the authority to issue qualified green bonds

through September 30, 2012, and the authority to issue qualified enterprise zone facility bonds through December 31, 2009.

It provided tax-exempt bond financing like Gulf Opportunity Zone Bonds with certain modifications to the Midwestern disaster area. Specifically, it allows the issuance of a certain type of qualified private activity bonds (called, “qualified Midwestern disaster area bonds”) to finance the construction and rehabilitation of certain residential and nonresidential property located in the Midwestern disaster area. Qualified Midwestern disaster area bonds must be issued before January 1, 2013. Depending on the purpose for which such bonds are issued, qualified Midwestern disaster area bonds are treated as either exempt facility bonds or qualified mortgage bonds. Bond issuance within a state is limited to \$1,000 multiplied by that state’s population. It eased first-time homebuyer rules for mortgage revenue bonds for residences in the Midwestern disaster area.

It provided tax-exempt bond financing like Gulf Opportunity Zone Bonds with certain modifications to Louisiana and Texas. Specifically, it allows the issuance of a certain type of qualified private activity bonds (called, “Hurricane Ike disaster area bonds”) to finance the construction and rehabilitation of certain residential and nonresidential property located in the Hurricane Ike disaster area. Hurricane Ike disaster area bonds must be issued before January 1, 2013. Depending on the purpose for which such bonds are issued, Hurricane Ike disaster area bonds are treated as either exempt facility bonds or qualified mortgage bonds. Bond issuance within each state is limited to \$2,000 multiplied by that state’s population.

The law waived certain mortgage revenue bond requirements for affected taxpayers and allows the bond proceeds to be used for rebuilding.

Housing and Economic Recovery Act of 2008 (Public Law 110-289)

The law provided that a multi-family refinancing bond is treated as a refunding notwithstanding a change in obligors under the first and second conduit loans. It conformed “next available unit,” full-time student, and single occupancy requirements for the low-income housing tax credit and tax-exempt bond qualified residential rental project rules. It waived annual recertification requirements under the low-income credit and tax-exempt bonds for any project as long as no residential unit in the project is occupied by tenants who fail to satisfy the otherwise applicable income limits.

It authorized an additional \$11 billion of volume cap for 2008 for the purpose of issuing qualified mortgage bonds or private activity bonds for qualified residential rental projects.

It created an exception to the new mortgage requirement for qualified mortgage bonds by authorizing the use of such bonds to refinance certain qualified subprime loans.

It exempted from the Alternative Minimum Tax interest paid on qualified residential rental program bonds, qualified mortgage revenue bonds, and qualified veterans’ mortgage bonds issued after July 30, 2008.

It waived the federal guarantee proscription for Federal Home Loan Bank guaranteed bonds issued after July 30, 2008, and before January 1, 2011, (i.e., these bonds are not proscribed from qualifying as tax-exempt.)

It waived mortgage revenue bond first-time homebuyer requirements for residences located in Presidentially declared disaster areas. In addition, residences located in such areas were treated as targeted area residences for purposes of the income and purchase price limitations. The provision applies to bonds issued after May 1, 2008 and before January 1, 2010.

It expanded the Gulf Opportunity Zone (for purposes of qualifying to issue Gulf Opportunity Zone Bonds) to include Colbert County, Alabama, and Dallas County, Alabama.

Heroes Earnings Assistance and Relief Tax Act of 2008 (Public Law 110-245)

The Act permanently extended the limited exception from the first-time homebuyer rule for veterans under the qualified mortgage bond program. The Act increases the annual limit on qualified veterans’ mortgage bonds that can be issued in Alaska, Oregon, and Wisconsin in years after 2009 to \$100 million. For 2008 and 2009, the \$100 million limit is phased in by applying the present-law applicable percentages for those years (i.e., 60 percent in 2008 and 80 percent in 2009).

With respect to qualified veterans’ mortgage bonds issued in California or Texas, the provision repeals the requirement that veterans receiving loans financed with qualified veterans’ mortgage bonds must have served before 1977 and reduces the eligibility period to 25 years (rather than 30 years) following release from military service.

Food, Conservation, and Energy Act of 2008 (Public Laws 110-234 and 110-246)

The law increased the maximum amount of qualified small issue bond proceeds available to first-time farmers from \$250,000 to \$450,000 and indexed this amount for inflation. The provision also eliminates the fair market value test when determining whether a farmer has previously owned “substantial farmland” and, so, does not qualify.

U.S. Troop Readiness Veterans’ Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 (Public Law 110-28)

The Act provided that qualified Gulf Opportunity Zone repair or reconstruction loans (financed with qualified mortgage revenue bonds and Gulf Opportunity Zone Bonds) are treated as qualified rehabilitation loans for purposes of

qualified mortgage bond rules and, as a result, may be used to acquire or replace existing mortgages, without regard to the “existing walls” or 20-year rule under present law.

Tax Relief and Health Care Act of 2006 (Public Law 109-432)

The law extended by two years (through 2007) the authority to issue qualified enterprise zone facility bonds by the District of Columbia.

It modified qualified mortgage bond requirements to allow financing of mortgages without regard to the first-time homebuyer requirement for certain veterans. It also made permanent Tax Increase Prevention and Reconciliation Act of 2005 changes to the definition of an eligible veteran and State volume limits for qualified veterans’ mortgage bonds issued by the States of Alaska, Oregon, and Wisconsin. The total volume of veterans’ bonds that can be issued in each of these three States is \$25 million for 2010 and each calendar year thereafter.

It made permanent the Tax Increase Prevention and Reconciliation Act of 2005 codification of the arbitrage exceptions for the Texas Permanent University Fund.

Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109-222)

The Act reversed the exclusion from taxpayer information reporting requirements for municipal bond interest payors. Instead, payors must file an information return with the Internal Revenue Service including the amount of interest paid and the name, address, and taxpayer identification number of every person to whom interest is paid in a calendar year.

The law also expanded the Qualified Veterans’ Mortgage Bond program to allow financing for more recent veterans – including active duty personnel – to qualify and increased the volume limit for such bonds in certain states, with all volume for new issuances for those states expiring after 2010.

It codified and extended through August 31, 2009, an IRS exception granted to certain arbitrage rules for the Texas Permanent University Fund.

It accelerated the application of the \$20 million capital expenditure limitation for qualified small issue bonds (from bonds issued after September 30, 2009, to bonds issued after December 31, 2006).

It imposed new requirements on pooled financing bonds. First, the provision imposes a written loan commitment requirement to restrict the issuance of pooled bonds where potential borrowers have not been identified (“blind pools”). Second, in addition to the current three-year expectations requirement, the issuer must reasonably expect that at least 30 percent of the net proceeds of the pooled bond will be loaned to ultimate borrowers one year after the date of issue. Third, the provision requires the redemption of outstanding bonds with proceeds that are not loaned to ultimate borrowers

within the required loan origination periods. Finally, the provision eliminates the rule allowing an issuer of pooled financing bonds to disregard the pooled bonds for purposes of determining whether the issuer qualifies for the small issuer exception to rebate.

It provided exceptions to service area limitation and local furnishing restrictions for bonds issued to finance the Lake Dorothy (Alaska) hydroelectric project or the acquisition of the Snettisham (Alaska) hydroelectric project.

Gulf Opportunity Zone Act of 2005 (Public Law 109-135)

The Act authorized the issuance of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone (“Gulf Opportunity Zone Bonds”). Issuance of such bonds is limited in each affected state to \$2,500 times the population of that state. Depending on the purpose for which such bonds are issued, Gulf Opportunity Zone Bonds are treated as either exempt facility bonds or qualified mortgage bonds.

The law permitted an additional advance refunding of certain governmental and qualified 501(c)(3) bonds issued by the State of Alabama, Louisiana, or Mississippi, or their political subdivisions. It also permitted one advance refunding of certain exempt facility bonds for airports, docks, or wharves. Such refundings are subject to a state-by-state cap.

It created Gulf Tax Credit Bonds, proceeds from which were to repay bond debt outstanding prior to Hurricane Katrina. The maximum amount of Gulf Tax Credit Bonds that may be issued is \$200 million in the case of Louisiana, \$100 million in the case of Mississippi, and \$50 million in the case of Alabama.

It eased first-time homebuyer rules for mortgage revenue bonds for residences in the Gulf Opportunity Zone and extended the waiver of the first-time homebuyer requirement provided by the Katrina Emergency Tax Relief Act of 2005 to financing provided through December 31, 2010.

Katrina Emergency Tax Relief Act of 2005 (Public Law 109-73)

The law waives the mortgage revenue bond first-time homebuyer requirement for qualified Hurricane Katrina recovery residences. The provision also increased from \$15,000 to \$150,000, the permitted amount of a qualified home-improvement loan with respect to residences located in the Hurricane Katrina disaster area to the extent such a loan is for the repair of damage caused by Hurricane Katrina.

Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (Public Law 109-59)

The Act established a new category of exempt facility PABs to finance surface transportation projects receiving federal assistance, surface freight transfer facilities, and international bridge or tunnel projects. The Department of Transportation is authorized to allocate up to \$15 billion in such bonds. The

Act also provides that bonds issued by a state-acquired railroad real-estate investment trust (REIT) should be considered exempt from tax.

The Energy Policy Act of 2005 (Public Law 109-58)

This law created an exception from arbitrage restrictions for tax-exempt bond-financed prepayments by a governmental utility for supplies of natural gas to be sold to its retail customers. The exception also applies to prepayments by a governmental utility for natural gas to be used to generate electricity to be sold to its retail customers.

American Jobs Creation Act of 2004 (Public Law 108-357)

The Act increased the \$10 million capital expenditures limit for small-issue bonds to \$20 million.

It also created a new category of exempt-facility bond, the qualified green building and sustainable design project bond (“qualified green bond”). The bonds are exempt from state volume limitations. Rather, there is a national limitation of \$2 billion of qualified green bonds that the Secretary may allocate to qualified green buildings and sustainable design projects.

To Clarify the Tax Treatment of Bonds and Other Obligations Issued by the Government of American Samoa (Public Law 108-326)

The Act provided that in addition to the prior exemption from federal income tax, the interest on any obligation issued by the Government of American Samoa is exempt from State, local, and territorial taxes.

Working Families Tax Relief Act of 2004 (Public Law 108-311)

The Act extended authority to issue Liberty Zone bonds through December 31, 2009, extended additional advance refunding authority through December 31, 2005, and provided that bonds of the Municipal Assistance Corporation are eligible for advance refunding.

Job Creation and Worker Assistance Act of 2002 (Public Law 107-147)

The Act allowed the issuance in 2002 through 2004 of up to \$8 billion in tax-exempt private activity bonds called Liberty Zone Bonds to finance rebuilding of portions of New York City damaged in the September 11, 2001, terrorist attacks. To further ease reconstruction, the law allowed additional exceptions to private activity bond rules, including volume limits, certain restrictions on acquisition of existing property, arbitrage restrictions, and the alternative minimum tax. The law also allowed certain bonds (including governmental bonds and 501(c)(3) bonds) financing facilities located in New York City to be advance refunded one additional time.

Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16)

This law increased the additional amount of governmental bonds

for public schools that small governmental units may issue without being subject to the arbitrage rebate requirements from \$5 million to \$10 million. Thus, these governmental units may issue up to \$15 million of governmental bonds in a calendar year provided that at least \$10 million of the bonds are used to finance public school construction expenditures. The law also expanded the definition of a qualified facility eligible for private activity bond financing to include elementary and secondary public school facilities owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency. These bonds were subject to a separate volume limit equal to the greater of \$10 per resident or \$5 million.

Community Renewal Tax Relief Act of 2000 (Public Law 106-554)

This law accelerated scheduled increases in state volume limits on tax-exempt private activity bonds. Specifically, it increased State volume limits from the greater of \$50 per resident or \$150 million to the greater of \$62.50 per resident or \$187.5 million in calendar year 2001; and then to the greater of \$75 per resident or \$225 million in calendar year 2002. Beginning in calendar year 2003, the volume limits were adjusted annually for inflation.

Omnibus Appropriations Act of 1998 (Public Law 105-277)

This law included the first increase in private-activity bond volume caps since the 1986 Tax Reform Act. The current (1999) volume cap of \$50 per capita or \$150 million, whichever is greater, will be increased to the greater of \$55 per capita or \$165 million beginning in fiscal year 2003. The volume cap will then increase each fiscal year by \$5 per capita or \$15 million until fiscal year 2007, when it will reach the maximum level of \$75 per capita or \$225 million, whichever is greater. The volume cap will not be indexed for inflation thereafter.

The Taxpayer Relief Act of 1997 (Public Law 105-34)

This law included several provisions in the area of tax-exempt bonds.

It increases the small issuer arbitrage rebate exception from \$5 to \$10 million for qualified education facilities allowing up to \$5 million of additional bonds used to finance public school capital expenditures to be issued on a tax-exempt basis, after December 1, 1997. It waives certain mortgage revenue bond requirements and limitations in certain Presidentially declared disaster areas for bonds issued after December 31, 1996, and before January 1, 1999. It repeals the \$150 million cap on nonhospital 501(c)(3) bonds for new money issues.

It includes a package of simplification changes related to the \$100,000 arbitrage rebate limitation, debate on debt service funds, limitations on certain non-purpose investments, and repeal of expired provisions, effective after August 5, 1997.

Small Business Jobs Protection Act of 1996 (Public Law 104-188)

This legislation included three tax-exempt bond provisions. It made modifications to rules governing the issuance of tax-exempt bonds for first-time farmers; it modified the “two-county” bond rule for local furnishers of electricity and gas; and it authorized tax-exempt bonds for the purchase of the Alaska Power Authority.

Unfunded Mandates Reform Act of 1995 (Public Law 104-4)

The Act affects Congressional Budget Office cost estimates on bills impacting state and local government expenditures and revenue authority. Establishes a point of order against any reported bill estimated to cost state and local governments more than \$50 million (adjusted for inflation) per year for new mandate proposals that are not fully funded. Mandates are defined as enforceable duties imposing direct costs on state and local governments. Direct costs also include amounts state and local governments would be prohibited from raising in revenues.

Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66)

This law contained several provisions that affect tax-exempt financing and the market for tax-exempt bonds.

It extended the mortgage revenue and small-issue industrial development bond programs permanently, retroactive to June 30, 1992, when they expired.

It authorized the designation of nine empowerment zones and 95 enterprise communities in economically distressed urban and rural areas. A new category of exempt-facility bonds could be used in the zones and enterprise communities to buy land, buildings, and equipment.

It extended the exemption from volume cap allocation to 100 percent of bonds for governmentally owned high speed intercity rail facilities (not including rolling stock).

This law also changed market discount rules so that market discount earned on tax-exempt bonds purchased after April 30, 1993, would be treated as ordinary income rather than capital gain as under previous law. Since ordinary income tax rates for many investors are higher than the capital gains rate, this change could have a negative impact on the demand for state and local government bonds.

Energy Policy Act of 1992 (Public Law 102-486)

This Act contained three provisions that affect tax-exempt financing.

The Act removed restrictions on investments of nuclear decommissioning funds (previously restricted to U.S. Treasury securities, bank deposits, and tax-exempt state and local government securities) and lowered the funds’ 34 percent tax rate to 22 percent in 1994 and 20 percent in 1996. The removal of restrictions on investments also removed an incentive for

the funds to purchase state and local government bonds.

Tax-exempt financing is permitted for local furnishing of electricity, previously limited to certain contiguous areas, to facilities that have been ordered by the Federal Energy Regulatory Commission to provide transmission (“wheeling”) services to other parties that generate electricity without violating the Internal Revenue Code’s local furnishing exception if no tax-exempt bond financing is provided for the non-local furnishing activities.

The Act also authorized a new type of exempt-facility bond for environmental enhancement of hydroelectric generation facilities that is not subject to the statewide volume cap, provided 80 percent of the net proceeds of each bond is used to finance property for the promotion of fisheries or other wildlife resources.

Tax Extension Act of 1991 (Public Law 102-227)

This Act extended the mortgage revenue bond and small-issue IDB programs for six months, through June 30, 1992.

Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508)

This Act extended the mortgage revenue bond and small-issue MB programs through December 31, 1991.

Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239)

This Act contained changes to the arbitrage rebate requirement, use of hedge bonds, and the alternative minimum tax (AMT).

Specifically, relief from the arbitrage rebate requirement was provided for issuers of governmental bonds, qualified §501(c)(3) bonds, and private-activity bonds for governmentally owned facilities if at least 75 percent of net proceeds are to be used for construction and 95 percent of the funds are spent according to a spending schedule over a 24-month period. Issuers using this rebate relief provision may elect a financial penalty in lieu of rebate if the spending schedule is not met.

In addition, new requirements were imposed on the ability of state and local governments to sell bonds as a hedge against future increases in interest rates (so-called “hedge bonds”). The Act also provided that 75 percent of bonds issued to finance high speed intercity rail facilities (but not rolling stock) would not be subject to the statewide volume cap. Finally, the mortgage revenue bond and small-issue IDB programs were extended for nine months.

Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647)

This Act made a number of technical changes to the arbitrage rebate requirement and other tax-exempt bond provisions of the tax law, and extended the mortgage revenue bond program one year, through December 31, 1989, with tighter targeting provisions. It also authorized the use of tax-exempt,

private-activity bonds for certain high speed rail facilities and required that only 25 percent of the financing would be subject to the statewide volume cap. A new savings program was instituted under this Act that permitted taxpayers below a certain income level to exclude from taxable income the interest income on U.S. savings bonds (Series EE Bonds) if the bonds are used to help pay education expenses of the taxpayers, their spouses, or their children. These bonds carry a superior yield and compete with the market for state and local government bonds.

Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203)

This legislation defined bonds used by cities to acquire nongovernmental gas and electric utility output property as “private activity” bonds if the city does not already operate a municipal utility. Exceptions were allowed for qualified annexations no greater than 10 percent (per annexation) of the geographic service area or output capacity of the public power system.

Superfund Amendments and Reauthorization Act of 1986 (Public Law 99-571)

This Act increased the corporate alternative minimum tax (AMT) on all tax-exempt interest income.

Tax Reform Act of 1986 (Public Law 99-514)

The Tax Reform Act of 1986 rewrote the Internal Revenue Code of 1954, resulting in the following changes to tax-exempt bond law:

- » Defined and restated “private-activity bonds” to include IDBs as well as student loan bonds, mortgage revenue bonds, and §501(c)(3) organization bonds;
- » It also subjected all tax-exempt income of individuals and corporations that is preferentially treated under the tax code, including income from private-activity bonds issued after August 7, 1986 (excluding §501(c)(3) organization bonds), to an alternative minimum tax (AMT), resulting in a new class of bonds that may be only partially tax-exempt. Also subjected all tax-exempt interest earned by corporations to the AMT under the adjusted net book income calculation (changed in 1989 to the adjusted current earnings (ACE) calculation);
- » Required rebate of “excess” arbitrage earnings to the Federal Government, with exemption for small issuers (governmental units with taxing authority that issue less than \$5 million of bonds annually) or if proceeds are spent within six months of issuance;
- » Added hazardous waste disposal facilities as a new category of exempt-facility bonds;
- » Denied tax-exempt status to private-activity bonds for sports facilities, convention or trade show facilities, parking facilities (unless functionally related to other exempt

facilities), air or water pollution control facilities, alcohol and steam generation facilities, qualified hydroelectric generating facilities, and privately owned airports, docks, wharves, and mass-commuting facilities;

- » Prohibited advance refunding for private-activity bonds (§501(c)(3) organization bonds excepted), and limited governmental obligations issued after 1985 to one advance refunding;
- » Lowered the private use and security interest tests from 25 percent to 10 percent, and added a special private use restriction on “output facilities” (for generation, transmission, and distribution of electricity or gas) of the lesser of 10 percent or \$15 million;
- » Imposed a limit of the lesser of 5 percent or \$5 million on loans to nongovernmental persons or for private business purposes unrelated to the governmental use of the financing;
- » Limited bond issuance costs for private-activity bonds to 2 percent of proceeds;
- » Reduced the statewide volume cap on private-activity bonds to the greater of \$50 per capita or \$150 million effective in 1988, and subjected the excess over \$15 million of private use portion of governmental bonds to the volume cap;
- » Required all individual income tax returns filed after December 31, 1987, to report tax-exempt interest income;
- » Repealed the bank interest deduction for costs of purchasing and carrying tax-exempt bonds except for issuances of governmental units and §501(c)(3) organizations that issue less than \$10 million of bonds annually;
- » Required property and casualty insurance companies to reduce deductions for loss reserves by 15 percent of the company’s tax-exempt interest income from bonds acquired after August 7, 1986.

Deficit Reduction Act of 1984 (Public Law 98-369)

This Act imposed a statewide volume cap on private-activity bonds of the greater of \$150 per capita (reduced to \$100 after 1986) or \$200 million. There were exceptions for certain “qualified public facilities,” including multifamily housing and publicly owned airports, docks, wharves, mass-commuting facilities, and convention or trade show facilities, but the Act repealed authority for advance refunding for qualified public facilities. The Act also eliminated the tax-exemption of interest on bonds in cases where more than five percent of the proceeds of such bonds were to benefit a non-exempt purpose. Tax-exemption was also denied for bonds issued to finance “sky boxes” in sports arenas, airplanes, health club facilities, gambling facilities, or liquor stores. Additional restrictions were placed on veterans’ mortgage bonds, and the bank deduction of the costs of purchasing and carrying tax-exempt bonds was lowered from 85 to 80 percent. The Act also restricted tax-exempt entity leasing and arbitrage earnings for student loan bonds, made changes to the small-

issue IDB program, and extended the sunset date of the program through 1988 for manufacturing facilities.

Social Security Amendments of 1983 (Public Law 98-21)

This Act required Social Security recipients to include interest earned on tax-exempt bonds in gross income for purposes of determining the taxation of Social Security benefits.

Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248)

This Act required that bonds be issued in registered form in order to remain tax-exempt. The Act also imposed an information reporting requirement on certain types of bonds called “private-activity bonds,” including IDBs, student loan bonds, and §501(c)(3) bonds. The law also added local district heating and cooling facilities to the list of eligible purposes, and set a sunset date of December 31, 1987, for the small-issue IDB program. In addition, the legislation reduced the interest deduction for financial institutions from 100 percent to 85 percent of the costs to purchase and carry tax-exempt obligations.

Economic Recovery Tax Act of 1981 (Public Law 97-34)

This law added certain mass-commuting vehicles and certain volunteer fire departments to the list of eligible facilities, and provided a safe harbor for the leasing of mass-commuting vehicles.

Mortgage Subsidy Bond Tax Act of 1980 (Public Law 96-499)

This legislation eliminated tax-exempt mortgage bonds as of January 1, 1984 (later extended), and also made such bonds subject to an annual state volume cap (the first time such a limitation was imposed) and to arbitrage and advance refunding restrictions.

Crude Oil Windfall Profits Tax of 1980 (Public Law 96-223)

Electricity-generating or alcohol-producing solid waste disposal facilities were made eligible for tax-exempt financing by this Act, and hydroelectric and other renewable energy generating facilities were also added to the list of eligible facilities.

Revenue Act of 1978 (Public Law 95-600)

This Act further liberalized eligibility for tax-exemption by allowing more private projects to qualify under “local furnishing” of electricity. It also increased the limits on small-issue IDBs from \$5 million to \$10 million.

Tax Reform Act of 1976 (Public Law 94-455)

This law added a new tax-exempt purpose: qualified scholarship funding bonds.

Revenue Adjustment Act of 1975 (Public Law 94-164)

A new exception was added by this law to the list of exempt-purpose IDBs, allowing tax-exempt financing for dams

furnishing water for irrigation with a subordinate use for generating electricity. The exception was allowed only if substantially all stored water was available for release for irrigation purposes.

Tax Reform Act of 1969 (Public Law 91-172)

This legislation denied the tax-exemption for any municipal bond issuance defined as an “arbitrage bond.” An arbitrage bond is an issuance in which all or a major portion (subsequently defined as more than 15 percent) of the proceeds are used directly or indirectly to purchase securities producing a materially higher yield. Exceptions were provided for temporarily investing the proceeds (with “temporary period” later defined as three years) and for a reasonably required reserve or replacement fund.

Revenue and Expenditure Control Act of 1968 (Public Law 90-364)

This legislation established that the interest income from IDBs is taxable, and defined IDBs according to a two-part test. Any bond that met a private use test and a security interest test was defined as taxable.

The private use test was satisfied if all or a major portion of the bond proceeds were to be used in a trade or business of a non-exempt person (that is, neither a government unit nor a charitable §501(c)(3) organization). The security interest test was satisfied if all or a major portion of the debt service was to be secured by property used in or payments derived from a trade or business of a non-exempt person. The threshold level for both tests was set at 25 percent. (Later, as part of the 1986 Tax Reform Act, the allowable private use and payments were reduced to 10 percent or, for public power, the lesser of 10 percent or \$15 million.)

The 1968 legislation also provided a long list of exceptions, termed “exempt purpose IDBs,” for projects that were deemed to serve a worthwhile public purpose and thus should be eligible for tax-exemption. Such exceptions included:

- » air and water pollution control facilities;
- » sewage or solid waste disposal facilities;
- » facilities for local furnishing of electric energy, gas or water; and
- » airports, docks, and wharves.

This legislation also restricted the use of IDBs to small issues of not more than \$1 million, which was raised to \$5 million in subsequent legislation.

Chronology of Federal Laws Creating and Altering Tax Credit and Direct Payment Bonds

Consolidated Appropriations Act of 2016 (Public Law 114-113)

The Act authorizes issuance of up to \$400 million of qualified zone academy bonds for 2015 and 2016, respectively. The option to issue direct-pay bonds is not available.

Tax Increase Prevention Act of 2014 (Public Law 113-295)

The Act authorizes issuance of up to \$400 million of qualified zone academy bonds per year for 2014. The option to issue direct-pay bonds is not available.

Revenue Provisions Contained in the American Taxpayer Relief Act of 2012 (Public Law 112-240)

The Act authorizes issuance of up to \$400 million of qualified zone academy bonds per year for 2012 and 2013. The option to issue direct-pay bonds is not available.

Revenue Provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312)

The Act authorizes issuance of up to \$400 million of qualified zone academy bonds for 2011. The option to issue direct-pay bonds is not available.

Hiring Incentives to Restore Employment Act of 2010 (Public Law 111-147)

The Act allows issuers to elect to issue new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds issued, and qualified school construction bonds as direct payment bonds, rather than as tax credit bonds.

Revenue Provisions of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5)

The Act created a new type of bond, the Build America Bond (“BAB”). A BAB is a bond which would otherwise qualify as a tax-exempt bond, but which is issued either:

- » As a tax credit bond, i.e., the interest paid is taxable, but the bondholder receives a tax credit, in this case equal to 35 percent of the interest paid; or
- » As a direct payment bond, i.e., the interest paid is taxable, but the issuer receives a credit payment equal to 35 percent of interest paid.

Issuance of Build America Bonds was limited to the period after the date of enactment (Feb. 17, 2009) but before 2011, i.e., through Dec. 31, 2010.

The Act created a new category of tax-credit bonds: qualified school construction bonds, for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a bond-financed facility is to be constructed. The annual limit for such bonds is \$11 billion for 2009 and 2010, allocated to states along similar proportions to other federal elementary and secondary school funding. The credit rate for the bond is equal to the rate that would permit issuance of the bond without discount and interest cost to the issuer.

The Act also authorized the issuance of up to \$1.4 billion of qualified zone academy bonds annually for 2009 and 2010, respectively.

The Act created a new type of tax credit bond, the Recovery Zone Economic Development Bond, for capital expenditures paid or incurred with respect to property located in such zone and expenditures for public infrastructure and construction of public facilities located in a “recovery zone.” The Act provides several criteria of economic distress for qualifying as a “recovery zone.”

The Act provides procedures for passing through credits on “tax credit bonds” to the shareholders of an electing regulated investment company.

The Act authorized issuance of up to an additional \$1.6 billion of new CREBs.

The Act authorized issuance of an additional \$2.4 billion of qualified energy conservation bonds and clarified that capital expenditures to implement green community programs include grants, loans and other repayment mechanisms to implement such programs. For example, this expansion enables States to issue these tax credit bonds to finance retrofits of existing private buildings through loans and/or grants to individual homeowners or businesses, or through other repayment mechanisms.

The Act prospectively applies federal prevailing wages requirements to any project financed with New CREBs; qualified energy conservation bonds; qualified zone academy bond; school construction bond; or recovery zone economic development bond.

Emergency Economic Stabilization Act of 2008, Energy Improvement and Extension Act of 2008, and Tax Extenders and the Alternative Minimum Tax Relief Act of 2008 (110-343)

The law created a new category of Clean Renewable Energy Bond (New CREB) with a national issuance limit of \$800 million to be allocated equally to public power providers, other governmental bodies, and rural electric cooperatives. Unlike the credit rate for CREBs, the credit rate for New CREBs is equal to 70 percent of the rate that would permit the issuance of such bonds without discount and interest cost to the issuer. Additionally, tax credits may be stripped from the underlying bond, similar to how interest coupons are stripped for interest-bearing bonds.

It created a new category of tax credit bond, the Qualified Energy Conservation Bond (QECB), for financing a variety of energy conservation and renewable energy projects and investments. There is an \$800 million volume limit, with allocations made to States, and sub-allocations to large local governments. In contrast to generally applicable rules, 100 percent of bond proceeds must be used on capital expenditures. The credit rate for QECBs is equal to 70 percent of the rate that would permit the issuance of such bonds without discount and interest cost to the issuer. Additionally, tax credits may be stripped from the underlying bond, similar to how interest coupons are stripped for interest-bearing bonds.

It authorized the issuance of up to \$400 million of qualified zone academy bonds annually through 2009. For bonds issued after Oct. 3, 2008, 100 percent of available project proceeds must be spent on qualified zone academy property (up from a prior-law requirement of 95 percent). In addition, the provision modifies the arbitrage rules by providing that available project proceeds invested during the three-year period beginning on the date of issue are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements).

The Act allows tax credit bonds (“Midwestern Tax Credit Bonds”) to be issued in 2009 by a Midwestern disaster area state (or instrumentality of the State). As with Gulf Tax Credit Bonds, proceeds from Midwestern Tax Credit Bonds are used to pay principal, interest, or premium on outstanding state and local debt. The maximum amount of Midwestern Tax Credit Bonds that may be issued is: (1) \$100 million Midwestern disaster area states with a population of 2 million or more and (2) \$50 million for Midwestern disaster area states with a population of less than 2 million.

Food, Conservation, and Energy Act of 2008 (Public Laws 110-234 and 110-246)

The Act created a new category of tax-credit bonds, qualified forestry conservation bonds, to be issued by state and local governments or 501(c)(3) organizations for the purpose of acquiring forest land adjacent to U.S. Forest Service land. At least half of the land acquired must be transferred to the U.S. Forest Service and the land must be subject to a habitat conservation plan. There is a national volume limit of \$500 million and the credit rate is set to allow the issuer to issue the bond without discount and interest cost.

Tax Relief and Health Care Act of 2006 (Public Law 109-432)

The law extended authorization of qualified zone academy bonds for two years (through 2007). It also imposed arbitrage requirements, new spending requirements, and information reporting requirements.

It also increased the volume of CREBs that could be issued by \$400 million (for a total of \$1.2 million).

Gulf Opportunity Zone Act of 2005 (Public Law 109-135)

The Act created Gulf Tax Credit Bonds proceeds from which were to repay bond debt outstanding prior to Hurricane Katrina. The maximum amount of Gulf Tax Credit Bonds that may be issued pursuant to this provision is \$200 million in the case of Louisiana, \$100 million in the case of Mississippi, and \$50 million in the case of Alabama.

The Energy Policy Act of 2005 (Public Law 109-58)

The Act created a new category of tax credit bond, the Clean

Renewable Energy Bond (CREB), to finance expenses related to facilities that would otherwise qualify for the Internal Revenue Code Section 45 renewable energy production tax credit. Like qualified zone academy bonds, CREBs are not interest-bearing, but the taxpayer holding a CREB is allowed a tax credit equal to the bond’s credit rate times the face amount on the bond. The credit rate is set by Treasury at a rate estimate to allow the bond to be issued without discount and interest to the qualified issuer. Qualified issuers include governmental bodies and rural electric cooperatives. Issuers must be allocated CREB bond volume – which is capped at \$800 million – by Treasury.

Working Families Tax Relief Act of 2004 (Public Law 108-311)

The Act extended the authority to issue qualified zone academy bonds through 2005.

Job Creation and Worker Assistance Act of 2002 (Public Law 107-147)

The law authorized issuance of up to \$400 million of qualified zone academy bonds annually in calendar years 2002 and 2003.

Tax Relief Extension Act of 1999 (Public Law 106-170)

The law authorized up to \$400 million of QZABs to be issued in each of calendar years 2000 and 2001 and unused QZAB authority may be carried forward two years. Unused QZAB authority arising in 1998 and 1999 may be carried forward by the State or local government entity to which it was allocated for up to three years after the year in which the authority originally arose.

Taxpayer Relief Act of 1997 (Public Law 105-34)

The Act created the first tax credit bond, a Qualified Zone Academy Bond (QZAB), to be issued by state and local governments to finance expenses related to primary and secondary schools operated cooperatively with private entities in an Empowerment Zones or Enterprise Community (or meeting other criteria for qualifying as serving lower-income students). Under the provision, certain financial businesses actively engaged in the business of lending money that hold “qualified zone academy bonds” are entitled to a nonrefundable tax credit equal to a credit rate multiplied by the face amount of the bond. The credit is includible in gross income (as if it were an interest payment on the bond), but may be claimed against regular income tax and AMT liability. Treasury sets the credit rate at the date of issuance at a level estimated to allow issuance of QZABs without discount and without interest cost to the issuer. The maximum term of QZABs are limited and the volume of QZABs is limited to \$400 million annually in 1998 and 1999.

APPENDIX C

Some of the Public Finance Network members include:

Government Finance Officers Association, Emily Swenson Brock, 202-393-8467
Airports Council International – North America, Annie Russo, 202-293-4544
American Hospital Association, Jocelyn Francis, 202-638-1100
American Planning Association, Jason Jordan, 202-349-1005
American Public Gas Association, Joshua St. Pierre, 202-407-0015
American Public Power Association, John Godfrey, 202-467-2929
American Public Transportation Association, Ward McCarragher, 202-819-4895
American Public Works Association, Andrea Eales, 202-218-6730
American Securities Association, Jessica Giroux, 518-469-1565
American Society of Civil Engineers, Eleanor Lamb, 202-789-7847
Association of Metropolitan Water Agencies, Dan Hartnett, 202-331-2820
Association of Public and Land Grant Universities, MacGregor Obergfell, 202-478-6052
Association of School Business Officials International (ASBO), Elleka Yost, 866-682-2729
Bond Dealers of America, Brett Bolton, 850-393-3728
Council of Development Finance Agencies, Toby Rittner, 614-705-1300
International City/County Management Association, Amber Snowden, 202-460-2280
Large Public Power Council, Tom Falcone, 202-417-8836
National Association of Bond Lawyers, Brian Egan, 202-503-3290
National Association of Clean Water Agencies, Kristina Surfus, 202-833-4655
National Association of College and University Business Officers, Ashley Jackson, 202-861-2552
National Association of Counties, Paige Mellerio, 202-942-4272
National Assoc. of Health and Educational Facilities Finance Authorities, Chuck Samuels, 202-434-7311
National Association of Municipal Advisors, Susan Gaffney, 703-395-4896
National Association of Regional Councils, Erich Zimmerman, 202-618-5697
National Association of State Auditors, Comptrollers and Treasurers, Cornelia Chebinou, 202-989-6801
National Association of State Treasurers, Dillon Gibbons, 916-290-3741
National Association of Towns and Townships, Jennifer Imo, 202-331-8500
National Community Development Association, Vicki Watson, 540-656-9552
National Conference of State Legislatures, Brian Wanko, 202-624-8197
National Council of State Housing Agencies, Garth Rieman, 202-624-7710
National Governors Association, Richard Lukas, 202-624-3623
National League of Cities, Dante Moreno, 202-626-3058
National Special Districts Association, David Ulbricht, 503-472-9965
Securities Industry and Financial Markets Association, Nick Key, 202-962-7330
The Council of State Governments, Jamal Nelson, 202-624-5460
The United States Conference of Mayors, Dave Gatton, 202-957-6530





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