Council of Development Finance Agencies

April 15, 2015

United States Senate
Committee on Finance
Community Development & Infrastructure Tax Reform Working Group
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Heller and Chairman Bennet,

The Council of Development Finance Agencies (CDFA) appreciates the opportunity to comment on tax reform. CDFA is a national association dedicated to the advancement of development finance concerns and interests. CDFA is comprised of the nation's leading and most knowledgeable members of the development finance community representing thousands of public, private and non-profit development entities. Members are state, county and municipal development finance agencies and authorities that provide or otherwise support economic development financing programs.

We understand the need and support an overhaul of the nation's tax code to make it simpler, fairer, and more efficient. However, we believe the federal tax code already includes an incredibly effective tool that has served the nation for more than a century: Tax-Exempt Bonds (TEBs). We believe repealing or altering the current tax exemption for municipal and private activity bonds will not address the concerns driving tax reform and, in particular, will make infrastructure investments more difficult and more costly. Congress should instead be working to update the laws governing TEBs to make them more efficient and effective.

Background

State and local governments use TEBs to finance the construction of the majority of our nation's core infrastructure.[1] These bonds finance roads, highways, and bridges; public transportation; seaports and marine terminals; airports; water and wastewater facilities; schools; acute care hospitals; single- and multi-family housing; libraries; parks; town halls; electric power and natural gas facilities; and other public projects. In fact, TEBs financed more than $1.7 trillion in new infrastructure investments in the last decade.[2] These public investments remove barriers to commerce and make our communities livable.

Private Activity Bonds (PABs), a small but powerful segment of TEBs, are critical job-creation tools that catalyze private investment in economic development. PABs have been used to help build and improve facilities and create jobs for small manufacturers, hospitals, airports, colleges, housing, and thousands of other projects throughout the country. Many PABs are issued as Tax-Exempt Bonds, a designation that directs private investment toward carefully-defined sectors of economic development that communities need the most. This ensures that the public purpose afforded by the tax-exemption is meeting the critical job creating and quality-of-life improving demands provided by this important financing tool.

Industrial Development Bonds (IDBs), a type of PAB for qualified manufacturers, enable communities to provide up to just $10 million in tax-exempt financing for rigidly-defined manufacturing facilities. IDBs are efficient and safe investments compared to many alternatives, establishing a public-private partnership with the market determining prices. The tool enables community banks to support manufacturing clients through underwriting or privately placing the bonds. IDBs are issued on a conduit basis, meaning that there is no risk to the governmental issuer of the bonds. Thus, the nature of the tool shifts the project's risk to the private sector, providing a safe and more efficient alternative for the federal government than direct loan and grant programs provide.

In many smaller communities, IDBs are the best—and often, only—tool available to support capital access for small manufacturers and fulfill the public purpose of creating and supporting living-wage jobs. According to the ALF-CIO, nearly six million manufacturing jobs have disappeared since 2004. This has hit America's communities particularly hard, as manufacturing jobs have higher salaries and a greater economic impact than other jobs.

Congress and policy makers should be exploring ways to expand and update IDBs for use in the 21st Century economy, not potentially eliminating them. At the height of the market in 2007, nearly $3.1 billion in tax-exempt IDBs were issued nationwide. In 2013, only $355 million were issued. Manufacturers are aggressively exploring expansion projects as the economy recovers, but without access to affordable capital, the jobs that these projects could create may never materialize.

Congress should modernize IDBs to meet existing and emerging needs. The current tax code has not kept pace with inflation and does not recognize the needs of advanced manufacturing—the biggest growth opportunity for the American economy. Reforming the tax code should be about modernization and efficiency, not the elimination of an important economic development tool and job creator that is used in rural and urban areas throughout the country.

Arguments to eliminate the tax-exemption for PABs are similarly short-sighted. Repealing this exemption would raise an estimated $23.9 billion over ten years, "saving" 0.6 percent of the federal budget. These "savings" would come at the expense of leveraging $1.4 trillion in private investment for projects that have been considered to be serving the public good for decades, and these costs would actually be passed on to small manufacturers, low-income housing, and local taxpayers. The assumption that these projects would continue without low-cost tax-exempt financing is entirely inaccurate as well. A recent study by CDFA shows that 50 percent of projects would not have occurred without tax-exempt bonds and that 90 percent of projects that would have proceeded without the exemption would be scaled back or less ambitious.[3] No substantive alternative has been offered for how non-profits, manufacturers, low-income housing, infrastructure facilities, and other public-private partnerships would access affordable capital if tax-exempt PABs were eliminated.

Tax reform ideas continue to show the growing disconnect between tax-reform discussions in Washington, DC and in state and local economies throughout the country. If eliminated, thousands of projects throughout the country would lose access to the affordable and flexible capital provided by the tax-exempt PAB market, almost certainly resulting in economic development stagnation. Important infrastructure, education, health care, and community amenity projects would be delayed, scaled back, or all together eliminated. If TEBs were eliminated outright, borrowing costs would increase by 25-30 percent for state and local governments, certainly causing a decrease in employment and stalled projects throughout the country.[4]

Recommendations

CDFA has developed the following recommendations related to the federal tax code to stimulate job creation and economic development throughout the country:

1. **Preserve the Tax-Exempt Bonds**

   Tax-Exempt Bonds remain the bedrock of development finance and are critical to the ongoing growth, development, and maintenance of communities throughout the United States.

2. **Expand the use of Industrial Development Bonds**

   A. **Expanding the Definition of Manufacturing to Include both Tangible and Intangible Manufacturing Production for Industrial Development Bonds**

      CDFA proposes updating the definition of manufacturing as it relates to Industrial Development Bonds, also known as Qualified Small Issue Manufacturing Bonds, to allow for companies who produce both tangible and intangible property to access the capital markets. The measure would broaden the definition to include facilities that manufacture, create, or produce intangible property. The expanded definition would be sufficiently broad to cover software, patents, copyrights, formulas, processes, designs, patterns, know-how, format, and similar intellectual property. Under this new definition, knowledge-based businesses could access low-cost, tax-exempt IDB financing. This updated definition would align the growing high-tech manufacturing sector with the tools necessary to finance industry growth and expansion. This change will make an immediate difference throughout the country to help retain and create jobs, spur manufacturing investment, and accelerate the nation’s economy.

   B. **Eliminate the Restrictions on “Functionally Related and Subordinate Facilities” for Industrial Development Bonds**

      CDFA proposes the elimination of the restriction for “functionally related and subordinate facilities” when using Industrial Development Bonds. This change would allow manufacturers to develop projects that support modern business practices, provide for a better quality-of-life work environment, and diminish the complexity of using low-cost bond financing. This change would also expand project possibilities and give manufacturers the resources to think about long-term capital improvements, investment, workforce development, and job creation.

   C. **Increase the Maximum Bond Size Limitation from $10 million to $30 million for Industrial Development Bonds**

      CDFA recommends increasing the maximum Industrial Development Bonds size limitation from $10 million to $30 million. This relatively small change would have virtually no impact on the federal treasury as Qualified Small Issue Manufacturing Bonds remain under the national volume cap and cannot exceed total nationwide issuance beyond the total cap. In other words, this change will give manufacturers a new and improved resource for making investments and creating jobs for an investment already accounted for by the federal government.

D. Increase the Capital Expenditure Limitation from $20 million to $40 million for Industrial Development Bonds

CDFA proposes increasing the capital expenditure limitation for Industrial Development Bonds from $20 million to $40 million to reflect the 21st century manufacturing industry. This modest change will align this important limitation with the realities of the economy and cost of doing business in the United States. This change will open the door for hundreds of new manufacturing projects that have long-term expansion objectives, and will spur ongoing investment and create jobs.

3. Expand the Definition of Exempt Facilities

The current Internal Revenue Code prevents the same Private Activity Bond tools from being used to finance a now-critical element of America's infrastructure: energy independence. Exempt Facility Bonds are federally Tax-Exempt Bonds, the proceeds of which are used to finance or refinance certain qualifying facilities or projects. Under Section 142 of the Code, exempt facilities allow for a variety of important infrastructure financing options. Unfortunately, explicit provisions for renewable clean energy and energy efficiency projects are not allowed. This lack of clarity has resulted in virtually no use of Exempt Facility Bonds for the purpose of private activity bond finance in clean energy development.

In conclusion, the national Council of Development Finance Agencies (CDFA) applauds the United States Senate for taking up this important discussion. CDFA represents thousands of state and local job-generating development agencies and is available to offer insight and data supporting the critical importance of Tax-Exempt Bonds and, in particular, Private Activity Bonds. CDFA is prepared to discuss these important reforms with members of Congress as we move the tax reform discussion forward.

Thank you for your time and consideration.

Sincerely,

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[1] Congressional Budget Office, Joint Committee on Taxation (October 2009). Subsidizing Infrastructure Investment with Tax-Preferred Bonds.
[2] National Association of Counties, National League of Cities, The United States Conference of Mayors (February 2013). Protecting Bonds to Save Infrastructure and Jobs.
[3] Council of Development Finance Agencies (2011). Built by Bonds.
[4] Council of Development Finance Agencies (2011). Built by Bonds.