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Taxation

Bill to Raise Issuer Limit For Bank-Qualified Bonds Offered in Senate

By Evan Fallor
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WASHINGTON – Two Senators have introduced a companion bill to a measure in the House that would permanently raise the annual issuer limit for issuers of bank-qualified bonds to $30 million from $10 million.

The Municipal Bond Market Support Act of 2016 (S. 5237) was introduced by Sen. Bob Menendez, D-N.J. and referred to the Senate Finance Committee on Thursday. The bill is co-sponsored by Sen. Ben Cardin, D-Md., who is a member of the Senate Finance Committee's taxation and IRS oversight subcommittee.

It is an identical version of The Municipal Bond Market Support Act of 2015 (H.R. 2229), which was introduced in the House in May of last year by Rep. Tom Reed, R-N.Y. That bill is pending before the House Ways and Means Committee.

Menendez and Cardin could not be reached for comment Wednesday.

The companion bills would raise the annual issuer limit to $30 million permanently for the first time since bank-qualified bonds were created in 1986. The legislation would also index the annual issuer limits to inflation and apply to 501(c)(3) nonprofit borrowers rather than to the issuers they borrow from in conduit deals.

The bill pending in the Senate, if enacted, would greatly benefit many of the smaller, more rural jurisdictions that generally issue bank-qualified bonds to fund infrastructure projects, Emily Brock, director of the Government Finance Officers Association's federal liaison center here told The Bond Buyer on Wednesday.

"This would really benefit a significant number of GFOA members," Brock said, adding that roughly 70% of the organization's members are mid-to-smaller sized jurisdictions. "Smaller jurisdictions often have to pay a premium because of investor unfamiliarity with their area."

Bank-qualified bonds were created under the Internal Revenue Code of 1986 in order to allow smaller issuers to sell their tax-exempt bonds directly to local banks. These bonds give local issuers a chance to bypass the traditional underwriting process and access more cost-effective credit.

Brock said that small issuers often pay higher underwriting costs and also have a tougher time selling their bonds because investors oftentimes are not familiar with their jurisdictions. Selling bank-qualified bonds directly to banks reduces issuance costs by roughly 25-to-40 basis points, according to GFOA's bank-qualified municipals bonds resource center. As a result, GFOA said that many small issuers have been forced to pay higher interest rates.

Under the current threshold, a 25-to-40 basis points savings on a 15-year, $10 million bond would be between $232,000 and $370,000, according to GFOA. The basis points savings on a 15-year, $30 million bond would range from $696,000 to $1.1 million, the group estimates.

Banks can currently deduct 80% of the carrying cost of a qualified tax-exempt obligation under the federal tax code. The carrying cost includes the interest incurred from purchasing or carrying an inventory of securities.

However, Congress in 1986 limited bank purchases by saying banks could only buy the bonds of state and local governments that issue no more than $10 million of bonds during the calendar year.

Congress temporarily increased the issuer limit to $30 million in 2009 and 2010 under the American Recovery and Reinvestment Act, but that the increase was not renewed when it expired at the end of 2010.

Other versions of the Municipal Bond Support Act were introduced in the Senate in 2011 as well as in the House in July 2014.

Brock said the $30 million threshold was reached because the $10 million level set three decades ago was not tied to inflation. When indexed for inflation, the figure would be roughly $30 million, she said.

Brock said GFOA will continue to push through grassroots efforts to gain support for the bill, as well as urge more Senators to cosponsor the bill. A letter supporting the Municipal Bond Market Support Act of 2016 was sent to Menendez on June 24 was signed by 14 organizations, including GFOA, Bond Dealers of America and the National Association of Bond Lawyers.

She said she is confident that the bill can garner more support ahead of the next Congress because of the identical bills introduced in both the House and Senate.

"This is a stronger step than we've made in the past," she said. "It allows both houses to see that this is a priority, and it sets the stage for really good conversation. It's definitely a positive step in right direction."
