THE BOND BUYER

Volume caps for private activity bonds may hinder 3 states

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Three states with high housing costs are expected to have difficulty coping with the new volume caps for tax exempt private activity bond issuance announced by the Internal Revenue Service on Wednesday.

The limits set annually by the IRS may constrain California, Massachusetts, and New York as they seek to finance multifamily housing bonds, single-family mortgage revenue bonds and qualified student loan bonds.

The three came closest to utilizing their volume caps for PABs in 2018, according to a recent survey by the Council of Development Finance Agencies. Multifamily housing PABs represent a large majority of the PABs that are subject to volume caps.

California and New York have both been using much of their multifamily housing PAB volume cap for mixed income multifamily apartment towers where at least 20% are for households with 50% or less of area median income.Multifamily housing bonds have traditionally been used by smaller nonprofit developers as part of their financing packages.

The recent CDFA survey found Massachusetts had no unused volume cap at the start of 2018 after having used its entire $681.2 million volume cap for 2017 and its $14 million in unused cap carried forward from 2014-2016. The CDFA survey found California also began 2018 with no unused volume cap and New York only had $3.3 million.

“I’d say there’s a lot of increased attention on what is being called the affordable housing crisis here,” said Justin Cooper, a partner at Orrick in San Francisco who chairs his firm's housing finance group and serves as a member of the board of directors of the California Housing Consortium.

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Cooper said gap financing is flowing into affordable housing projects from corporations such as Google and Wells Fargo to help make them feasible to build.

“But they still need volume cap for the senior debt and also for the tax credits that generate the equity,” Cooper said, referring to the federal Low Income Housing Tax Credit. “So basically you’ve got additional sources coming in, making projects feasible, which creates more demand for the cap.”

California has an additional complexity because of its new commitment to allocate part of its volume cap toward PABs that will help finance Virgin Train USA’s Victorville, California to Las Vegas high speed passenger rail line.

Last month the California Debt Limit Allocation Committee chaired by state Treasurer Fiona Ma approved a $300 million allocation of PABs for the Virgin

Train USA rail project with another $300 million to be considered in 2020. Other parts of the financing will come from the U. S. Department of Transportation and the state of Nevada’s volume cap allocation.

The Nov. 6 IRS announcement in Revenue Procedure 2019-44 states in section 21 that the 2020 volume cap will remain at $105 multiplied by the state population or $321.775 million, whichever is greater.

The minimum guarantee for small states is only $5 million more than the $316.745 million minimum for 2019.

State with small populations, however, don’t generally have problems with the volume cap.

The exact amount of the 2020 volume caps for large population states won’t be known until next month when the Census Bureau announces its official estimates for state populations as of July 1, 2019.

While California and Arizona can expect an increased volume cap in 2020 because they have been growing in population, New York is one of nine states that lost population in the 12 months ending July 1, 2018.

New York’s population fell by 48,510 during that period.

California and Arizona, on the other hand, ranked No. 3 and 4, respectively, among the top states for population growth.

The framework for issuing tax exempt PABs was established in the Revenue and Expenditure Control Act of 1968. Over time the number of eligible purposes or projects for which they can be used has gradually increased from 12 to 22, according to the nonpartisan Congressional Research Service.

Thirteen of those 22 activities are subject to annual state volume caps. Among them are multifamily housing bonds, single-family mortgage revenue bonds and qualified student loan bonds.

Others include small issue bonds, redevelopment bonds, exempt facility bonds such as water and sewage facilities, hazardous waste facilities and other utility facilities.

Among the PABs not subject to volume caps are those financing airports, docks, wharves and projects for nonprofit 501(c)(3) organizations such as hospitals and universities.

A bond is a private activity bond if more than 10% of the proceeds are used for private business and more than 10% of the proceeds are secured by or derived from a private business. A PAB is only tax-exempt if it would finance a project that falls into certain categories specified by the tax code.

The tax code also contains a private loan financing test. Under this test, a bond is not tax-exempt if more than the lesser of 5% or $5 million of the proceeds of the issue are to be used directly or indirectly to make or finance loans to persons other than governmental persons.