Preserving Tax-Exempt Bonds

Toby Rittner,
President & CEO
trittner@cdfa.net

For over 30 years, state and local governments have used tax-exempt bonds to catalyze and spur investment in business, industry, real estate, amenities, infrastructure, and community assets. In 1986, Congress heavily regulated bonds to establish a system of checks and balances while also instituting limitations on the types of projects that are eligible for this type of financing. CDFA was part of the 1986 discussion, and today we find ourselves facing a very similar review of tax-exempt bonds.

Over the past three years, tax-exempt bonds have ridden a wave of popularity, speculation, examination, interference, and now an analysis of the tool's relative efficiency. It is no secret that bonds are having difficulty reaching the market this year. Bond volume in 2011 is at a decade low and market participants do not see a return to high volume bond issuances for several more years. This concerning trend comes after a productive 2010, when Build America Bonds (BABs) and Recovery Zone Bonds helped to open markets for municipal bonds during the economic downturn. Federal intervention through the American Recovery & Reinvestment Act (ARRA) helped to further ease the tight credit market for bond transactions, resulting in projects and investments throughout the country.

At the end of 2010, Congress failed to renew these provisions, effectively closing access to capital for the bond markets. To make matters worse, irresponsible market pundits have fueled speculation that the municipal bond markets are faltering. The most infamous of these is Meredith Whitney, who last December predicted 50 to 100 municipal bond defaults in 2011. However, muni defaults have been below normal, with just a handful of defaults nationwide. Ms. Whitney's actions directly caused a muni bond selloff at the end of last year and the early part of 2011, needlessly adding further stress to an already constrained market.

To further confuse the situation, Capitol Hill has begun an examination concerning the efficiency of tax-exempt bonds. One recently introduced piece of legislation would eliminate tax-exempt bonds in favor of tax-credit bonds, despite the fact that no market or demand exists for this type of bond structure. The Obama Administration continues to favor a return of the popular BABs, which utilized a direct subsidy bond structure. These policies seek—in the midst of a weak economic recovery—to replace successful, long-standing financing tools with unproven or lightly tested programs.

Today, tax-exempt bonds, such as Industrial Development and 501(c)(3) Bonds, provide a valuable, affordable, and accessible source of capital for many borrowers. Issuers throughout the country have spent decades working to build bond programs and products while establishing strong relationships with manufacturers, developers, hospitals, universities, and the economic engines of our communities to advance economic development and job creation.

At CDFA's 25th Annual Development Finance Summit this past May, hundreds of development finance agencies and private sector participants gathered to discuss the ongoing challenges to municipal bonds. While we find our industry battered and bruised, we are set to continue to fight for preserving these important financing tools.

At the end of the day, we all want an efficient and effective means for financing development. Tax-exempt bonds have been through both the booms and the busts and remain the primary tool for economic development for state and local governments. At a time when our country desperately needs economic opportunity, we would be penny wise and pound foolish to eliminate tax-exempt bonds in favor of structures that may not work or establish barriers to capital.

As in 1986, CDFA will be ready and on call to address any and all challenges to tax-exempt bonds. The Council is prepared to recommend reforms and program improvements to both Congress and the Obama Administration concerning these critical provisions. CDFA is actively working to combat the negative stereotypes and inaccurate characterizations of the municipal bond industry. We call on issuers and private sector stakeholders to stand behind our efforts to preserve tax-exempt bonds in the months and years to follow.