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Taxation

PAB Issuance Up in 2014, Reversing Three-Year Trend

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WASHINGTON — Issuance of private-activity bonds subject to state volume caps rose in 2014 following three years of declining issuance, according to an **annual survey** conducted by the Council of Development Finance Agencies.

The increase in PAB issuance is in line with issuance in the municipal bond market as a whole, which "bounced back" in the second half of 2014, CDFA said. States reported cap-subject PAB issuance of $11.61 billion in 2014 — $2.79 billion or 31.57% more than the $8.82 billion issued in 2013.

"Hopefully, this is the start of a trend that will continue, reversing the shrinking private-activity bond market that has occurred recently," CDFA officials wrote in their report on the survey. "Increased tax-exempt bond issuance may be a sign that businesses are investing in more projects, or at least larger projects, than have been initiated in recent years. Certainly a variety of indicators suggest that the economy has been improving, and private-activity bond issuance may be another sign of recovery."

Tax-exempt PABs face competition from bank loans and taxable bonds, particularly when interest rates are low. Rates are expected to increase in the near future, and "this change, coming on the back of a private-activity bond market that is already growing, could result in ample opportunity for bond issuance," the group said.

Private-activity bonds are issued by public entities to provide low-cost financing for the projects of nonprofit organizations or companies that serve a public purpose.

Issuance of most types of PABs are subject to state volume caps based on a formula published by the Internal Revenue Service. In 2014, state volume caps for PAB issuance were the greater of $100 per capita or $296.83 million. Unused cap can be carried forward for up to three years but must be abandoned after that.

The types of bonds subject to the volume caps include certain types of exempt-facility bonds (such as multifamily housing bonds, water and sewer bonds and bonds for hazardous waste facilities), as well as mortgage-revenue bonds, industrial development bonds, student-loan bonds and agricultural bonds.

PABs that are not subject to the state volume caps include 501(c)(3) bonds, veterans' mortgage revenue bonds and certain types of exempt-facility bonds, such as those for airports, docks and wharves. Data on the issuance of these types of bonds was not included in CDFA's report.

CDFA's survey is based on data voluntarily reported each year by officials of the state and District of Columbia authorities that allocate PABs based on the state caps. The Internal Revenue Service, which oversees the program, only releases this data on a delayed basis.

Not every state provides data in every year, so some variation in the data can be attributed to their differing participation. Additionally, some of the numbers states report may not be accurate.

CDFA found that issuance of exempt-facility bonds, mortgage revenue bonds and student loan bonds increased in 2014, while issuance of IDBs declined.

The states that reported the most cap-subject PAB issuance in 2014 were New York, California, Massachusetts, Pennsylvania and Washington. All of those states except for Pennsylvania were also in the top five states for PAB issuance the previous year.

In 2014, the 50 states and D.C. received $34.53 billion of new volume cap allocation and carried forward $59.12 billion from 2011 to 2013. In total, states could issue about $92.08 billion of cap-subject PABs, according to CDFA.

Issuance in 2014 was about 12.61% of the total volume cap, a slightly greater percentage than the percent of total capacity that was used in 2013. With a greater percentage of total capacity being used in 2014, states reported that they expected to carry forward less cap into 2015 than they carried into 2014, CDFA said.

Housing Bonds

Issuance of multifamily housing bonds increased 37.13% in 2014 and issuance of tax-exempt, single-family mortgage-revenue bonds increased 55.39%.

Barbara Thompson, executive director of the National Council of State Housing Agencies, said that the numbers confirm what the group has heard anecdotally from its members, which is that "the bond market is truly coming back."

Multifamily housing bonds are used to finance multifamily rental real estate with units set aside for lower income households. The rental market as a whole has been "booming" since the financial crisis, said Richard Froehlich, chief operating officer and general counsel of the New York City Housing Development Corp.

Also, the U.S Department of Housing and Urban Development's Rental Assistance Demonstration (RAD) program has encouraged issuance, Froehlich said. The RAD program allows public housing agencies and owners of other HUD-assisted properties to convert their assistance for units to project-based Section 8 contracts. Public housing agencies that make RAD conversions can finance repairs for properties with private money.

Thompson said that the RAD program has created more demand for low income housing tax credits. If a project is financed with tax-exempt PABs, developers can get 4% LIHTCs.

Froehlich and Thompson said MRBs, which allow housing finance agencies to provide mortgages to first-time home buyers who meet certain income restrictions, are becoming more attractive compared to other financing tools. Housing finance agencies are again able to use MRBs to finance mortgages with rates lower than the conventional rates, Thompson said.

Student Loan Bonds/IDBs

Student-loan bond issuance rose in 2014. States reported issuing $754.3 million of student-loan bonds, compared to $480.2 million the previous year.

New Jersey did not provide 2013 data to CDFA but reported $226.1 million of student-loan bond issuance in 2014. States reporting increased issuance of these types of bonds in 2014 included Michigan and Vermont.

Debra Chromy, president of the Education Finance Council, said that student-loan bond issuers in some states can offer loans with more competitive interest rates than Federal Direct PLUS loans, which are made to graduate students and the parents of undergraduate students. People are becoming more aware of this, she said.

Also, for Direct PLUS loans, there's a loan origination fee, but issuers in some states don't have upfront fees for their loans, Chromy said.

Issuance of IDBs, which provide financing for small manufacturers, fell to $269.5 million in 2014 from $355.8 million the previous year.

IDB issuance in recent years has been far less than the nearly $1 billion of IDBs states issued in 2009, according to CDFA.

Twenty-two states reported at least one IDB issuance in 2014. The Midwest region was the most active for IDB issuance, CDFA said.

Bolstering Issuance

Actions could be taken at the local, state and federal levels to increase PAB issuance, CDFA said.

At the state and local levels, bond programs could be branded better and marketed more. Also, issuers could standardize issuing documents or create private-activity bond banks to help borrowers save costs. And issuers could create their own credit-enhancement programs, CDFA said.

At the federal level, Congress could pass legislation to increase issuance of certain types of PABs, CDFA said. One such bill, backed by CDFA, is the Modernizing American Manufacturing Bonds Act. The bill, which was introduced in June by Reps. Randy Hultgren, R-Ill. and Richard Neal, D-Mass., would increase the types of projects that could be financed with IDBs and the maximum size of an IDB issue.

President Obama's fiscal 2016 budget included a 28% cap on the value of the tax-exemption for municipal bonds, but it also proposed some changes to ease restrictions on PABs. The president proposed creating a new type of PAB called qualified public infrastructure bonds, which could finance certain types of governmentally owned infrastructure projects and would not be subject to state volume caps or the alternative minimum tax. Sens. Ron Wyden, D-Ore., and John Hoeven, R-N.D., have also proposed creating a new type of PAB to finance infrastructure projects. Those bonds, called Move America Bonds, could finance projects that are privately owned and would not be subject to the AMT but would be subject to new volume caps that could be converted to tax-credit allocations. -30--