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Volume cap data highlights a need for legislative reforms

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After reaching an all-time high in 2019, total issuance of private activity bonds appeared to decrease slightly in 2020, though the Council of Development Finance Agencies said the recent data shows that reforms are needed to make issuance more efficient and accessible.

Total private activity bond issuance in 2020 dipped to $27.7 billion from $30.5 billion in 2019, according to CDFA's Annual Volume Cap Report released Nov. 5. However, CDFA, which has compiled a yearly report on private activity cap trends for the last 16 years, expects bond issuance to increase steadily as it has over the last decade.

"The hard work of CDFA members and bond issuers across the country along with investments from the federal government are to be commended for leading us through an uncertain time in the bond markets," CDFA President and CEO Toby Rittner said in a statement referring to the report and the impact of the COVID-19 pandemic.

CDFA identifies private activity cap trends by using information gathered from surveys and interviews of state issuing and allocating authorities. This year's report combined data from 2019 and 2020. Iowa, North Carolina and Wyoming did not report data directly to CDFA

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“What’s interesting about this report is we have never had the benefit of having two years of data at the same time,” CDFA Vice President Katie Kramer said. “I think what surprised us more than anything is that the pandemic didn’t affect the bond market in a dramatic way.”

After soaring in 2019, total issuance of private activity bonds decreased by about $2.3 billion in 2020. But that number is “still the second highest amount CDFA has recorded since tracking this data,” according to the report. As a result, it is relatively high compared to previous years and in light of pandemic-related market uncertainty.

“We as an industry, held our own," Kramer said. "We fought through it.”

Kramer pointed to factors that contributed to high bond issuance during the pandemic, like Federal Reserve action and what Kramer described as the “hard work of agencies and governors across the country.”

Kramer also said that there was some initial uncertainty whether pandemic-related assistance like the paycheck protection program (PPP) would prompt businesses to move away from private activity bonds.

Instead, what CDFA saw was a continuation of investment in affordable housing and infrastructure, which Kramer said are great signs. Overall, the 2019 and 2020 data “point toward a consistency and reliability in the bond market throughout the COVID-19 pandemic,” Kramer said.

The 50 states and the District of Columbia received $37.6 billion in new volume cap allocation in 2020 according to the report. This represented an increase of $218.4 million from 2019.

The report states that $50.6 billion of unused cap from 2017-2019 was carried by states into 2020. Carryforward has decreased each year since 2016 as states are issuing more bonds using carried forward cap rather than allowing cap to expire.

Report data also show that total national bond capacity decreased in 2020 to $87.6 billion from $89.7 billion in 2019. CDFA expects that decline to continue and also says that “states anticipate carrying forward [into 2021] around $46.5 billion in unused cap.”

In terms of interesting trends, CDFA found that issuance of exempt facilities bonds, which for purposes of the volume cap report include multi-family housing bonds as a subset, continued to increase. For example, multi-family housing issuances were at $17.2 billion in 2020 up from $16.4 billion in 2019.

Kramer said that the necessary and important multi-family housing category is crowding out the ability of many other private activity bonds to be used with available cap state by state.

Malcolm Guy, CDFA Coordinator of Government and External Affairs and primary author of the report, echoed that notion. “We found that almost all exempt facility bonds issued were multi-family housing,” Guy says.

Because of this, Guy explains that there is not much cap left over for other equally important types of exempt bonds such as water and sewer bonds. “We only saw $2.3 billion of those types of bonds issued in 2019 and $1.4 billion of those types of bonds issued in 2020,” Guy said, adding, “Everything else was multi-family housing.”

Another issue that Guy said is “starting to become a headache for many states,” is capacity.

In 2019, 34% of states used their total private activity bond capacity, while 32% used that total capacity in 2020. According to the report, “this is a significant increase from 2018, when states only issued 26% of their total available bond capacity.”

Guy noted that as a result, oversubscription (i.e., bond issuers requesting more cap allocation than is available) is presenting challenges for many states. “We found that 20 states were oversubscribed per cap,” Guy said.

“In those 20 states, they had to institute various processes for how they were going to divide their cap...to make all these different projects financeable through tax exempt bonds,” Guy explained.

Some of the states encountering this challenge include California, Washington, Georgia and Texas. Guy noted that Texas and California have seen so many requests per cap for 2021, that they already project being oversubscribed.

According to the report, 2016 “marked the highest total capacity since CDFA tracked this figure.” Guy said that capacity has continued to decline since then, which indicates that the markets have continued to be strong.

However, both Kramer and Guy stressed that unless Congress initiates legislative reforms, capacity and other challenges will continue to plague the private activity bond market.

“Absent legislative action, the cap crunch that we’re seeing is likely to continue,” Guy says, pointing to influential underlying factors like the current economic environment of high stimulus and low interest rates.

From CDFA’s perspective, Congressional reforms are needed to modernize private activity bond language around how private activity bonds are used and who is eligible to use them. Bond categories and volume cap also need to be expanded so that states have more capacity.

“Our economy is different today and the needs of businesses are different,” Kramer says.

According to Kramer, CDFA worked in the last year on inclusion of these priorities in the bipartisan infrastructure bill already approved by the Senate and awaiting approval in the House of Representatives.

However, the bonds' title, which included specific proposals to address scarcity and capacity, was stripped out of the Democrats’ Build Back Better reconciliation bill.

“Last week, Congress had to decide what financing infrastructure looks like in their bill, and they decided that reforms to private activity bonds were not essential tools for financing infrastructure,” Kramer explained, adding, “It’s a huge failure.”

But Kramer pointed out that CDFA is “hopeful that we can see new opportunities to improve bonds in the United States. The fight continues,” she said.

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