Policy Proposal: Create a Permanent Category of Disaster Recovery Bonds

OVERVIEW

In the aftermath of severe weather events and natural disasters, communities often find themselves in dire need of federal assistance to enable recovery and rebuild essential infrastructure. While the federal aid offered through the Stafford Act offers a much-needed source of funds for communities affected by disasters, those funds are rarely available in the immediate onset of a disaster, and are often insufficient for comprehensive recovery efforts. American communities are in need of a permanent financing tool that they can access immediately after disaster strikes, and that can leverage private investment for longer-term redevelopment of essential infrastructure.

CONGRESSIONAL ACTION

After the devastation of Hurricane Katrina in 2005, Congress responded with the Gulf Opportunity Zone Act of 2005 (the "GO Zone Act") in order to provide Alabama, Louisiana, and Mississippi federal assistance to aid such states in recovery and promote economic development. Given the massive destruction caused by recent hurricanes, wildfires, tornadoes, and other extreme weather phenomena, legislation is needed from Congress for the benefit of the states and territories to support economic recovery and redevelopment. Using the GO Zone Act as a guide, legislation should be enacted as soon as possible and provide the following reforms.

PROPOSED REFORMS

Natural disasters cause both physical damage and economic losses, which in total can easily top hundreds of millions of dollars. Existing financing tools are not always immediately available in the wake of a disaster. To mitigate the financial impacts of disasters on communities, a permanent category of Disaster Recovery Bonds should be created so that Congress does not need to create a special allocation after each disaster.

Reform 1 – Create a Permanent Category of Disaster Recovery Bonds

We propose the creation of a permanent category of tax-exempt private activity bonds to be known as Disaster Recovery Bonds. These bonds could be issued by the affected states and territories in the event of a disaster and would be separate from federal volume cap restrictions. The bonds would become available to the affected areas upon the declaration of a state of emergency by a state's Governor. We recommend a maximum federal allocation of $20 billion.

Disaster Recovery Bonds would be authorized to be used in a disaster Reconstruction Zone to finance (i) the acquisition, construction, reconstruction or renovation of non-residential real property (land, buildings, and fixtures – no equipment); (ii) the construction and rehabilitation of multi-family rental property for low- and moderate-income individuals, and (iii) the repair or reconstruction of damaged public utilities facilities and transportation infrastructure.

Disaster Recovery Bonds would only be issued for the aforementioned purposes in the affected states if approved by the respective governors of such states or any duly designated officer. In order to increase the

demand for Disaster Recovery Bonds, allow financial institution purchasers of such bonds to deduct the interest cost of carrying an amount of such bonds not exceeding 2% of the purchaser's assets.

Reform 2 – Provide Flexibility for Tax-Exempt Financing for Working Capital
Permit the state and local governments within the Reconstruction Zone to issue tax-exempt obligations on a short-term or long-term basis (e.g., up to 30 years) for governmental working capital requirements, without regard to the deficit sizing limits imposed under current law, in order to provide access to funds for crucial operating cash flow and to replenish "rainy day" reserves.

Permit the eligible costs of nonresidential projects to include working capital in an amount up to 5% of the cost of the project, to assist businesses in replacing lost inventory and other working capital items.

Permit the eligible costs of nonresidential projects to include the cost of acquiring or rehabilitating moveable equipment and fixtures in an amount up to 25% of the cost of the project, provided the equipment was used in the Reconstruction Zone by the beneficiary of the financing prior to the disaster or replaces such equipment.

Reform 3 – Ease the Burden of Servicing Debt on Disaster Recovery Bonds
Permit the state and local governments within the Reconstruction Zone to extend repayment schedules for tax-exempt debt, without regard to the safe harbor provisions of current law that generally require the weighted average maturity of governmental tax-exempt bond borrowing to not exceed 120% of the useful lives of the financed facilities. As with bonds issued under the GO Zone Act, provide that interest on Disaster Recovery Bonds is not an item of tax preference for purposes of the federal alternative minimum tax.

Given the devastation caused by recent natural disasters, as well as the likelihood that similarly destructive events occur in the future, affected states and communities need all available resources at their disposal to foster recovery and redevelopment. Federal legislation can play a vital role in that rebuilding effort, just as it has done in the past for Alabama, Louisiana, and Mississippi after Hurricane Katrina. Measures in addition to those in the GO Zone Act or otherwise identified above should be considered to assure that future disasters, both natural and man-made, do not undermine the advance of improving state and local government budgets.

CONTACT

Toby Rittner, President & CEO, Council of Development Finance Agencies
Katie Kramer, Vice President, Council of Development Finance Agencies
Malcolm Guy, Government & Legislative Affairs Coordinator, Council of Development Finance Agencies

ADDITIONAL RESOURCES

Disaster Recovery Bond Financing: Considerations for Congress
National Association of Bond Lawyers

Gulf Opportunity Zone Financing Report
U.S. Government Accountability Office

CDFA COVID-19: Comprehensive Recovery Strategy
Council of Development Finance Agencies