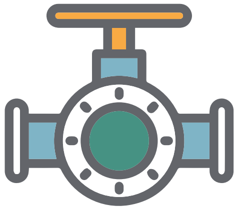
Private Activity Bonds (PABs)

MASSIVE FUNDING GAP FOR WATER PROJECT NEEDS

There is an investment-funding gap of more than **$500 billion** over the next 20 years for upgrades and repairs to public water and wastewater systems.



Source: U.S. EPA, Gov't Accountability Office

EXISTING VOLUME CAPS ARE TOO SMALL

The total 2022 private activity bond volume cap for all states and the District of Columbia is about **$39.8 billion.**

Source: Congressional Research Service, Publication RL31457

BILLIONS ARE AVAILABLE TODAY IF CAPS ARE LIFTED

Regulatory changes could unlock **$43 billion** in incremental water infrastructure investments, and **$25 billion** in wastewater investments.

Source: National Association of Water Companies

Issue background:

Today, the federal tax code allows state and local governments to use tax-exempt bonds to finance certain projects that would be considered private activities. These bonds are known as Private Activity Bonds (or Exempt Facility Bonds). The private activities that can be financed with tax-exempt bonds are called "qualified private activities."

Congress uses an annual state volume cap to limit the amount of tax-exempt bond financing generally and restricts the types of qualified private activities that would qualify for tax-exempt financing to selected projects defined in the tax code.

Drinking water and sewer projects are eligible for these bonds, but there is currently a limit on how much can be financed annually using these bonds. These caps and restrictions artificially reduce the amount of resources available to states and municipalities for their local infrastructure needs. Lifting the cap on PABs will infuse hundreds of millions in private capital into water and wastewater projects.

What is NUCA's position?

PABs are an approach of tax-exempt financing to encourage state and municipal governments to work with sources of private capital to meet a public need. A partnership makes infrastructure repair and construction more affordable for governments and ultimately for customers. Using private capital instead of public debt help shift the risk and long-term debt from taxpayers to the private financing entity. Tax-exempt bonds also provide lower-cost financing to municipalities.

Congress uses two primary means to restrain the use of state and local debt for private activities: an annual state volume limit (or separate national aggregate limit) and restrictions on the type of qualified private activities. The private activity bond volume limit, which originated in the Deficit Reduction Act of 1984, was implemented because "Congress was extremely concerned with the volume of tax-exempt bonds used to finance private activities." Given the urgent need for our nation's infrastructure financing, this limit no longer makes sense.

The annual volume cap hinders the use of PABs for water and wastewater infrastructure, which are generally multi-year projects. Over the years, annually only about 1.3% of all exempt facility bonds were issued to water and wastewater projects.

To give lawmakers a sense of private resources available, in 2019 the $30 trillion taxable bond market and the $4 trillion tax-exempt bond market was being used by private and public entities for capital investments. Removing the EFB state volume cap increases private investment and capital investment, and enables more public-private partnerships which decrease the risk placed on local governments.

The annual cap is adjusted each year for inflation, and is the greater of $110 per capita or $335 million in 2022. Because of the $335 million floor, many smaller states are allowed to issue relatively more private activity bonds (based on the level of state personal income) than larger states.

Examples of private activities subject to the volume cap include water furnishing facilities, sewage facilities, broadband projects, small issue bonds, and redevelopment bonds. Other private activities are not subject to the volume cap, such as government-owned airports, municipal-owned solid waste disposal facilities, recovery zone facility bonds, and other green building and educational facilities.

Providing private developers and operators with access to tax-exempt interest rates lowers the cost of capital significantly, enhancing investment prospects. Increasing the involvement of private investors in highway and freight projects generates new sources of money, ideas, and efficiency.

Most significantly, the cap increase will allow state and local governments to pursue additional, mutually beneficial public-private partnerships to supplement future infrastructure projects.

What can Congress do to help?

Exceptions from the volume cap are currently provided for other governmentally owned facilities such as airports, ports, housing, high-speed intercity rail, and solid waste disposal sites.

The Infrastructure Investment and Jobs Act of 2021 (IIJA) made a number of changes to federal incentives for infrastructure development, and included an expansion of the list of activities eligible for exempt facility bonds to include qualified broadband projects, carbon capture facilities, and highway and surface freight transfer facilities.

Congress needs to either increase the volume cap, or legislate that the volume cap also does not apply to water and sewage facilities.

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